

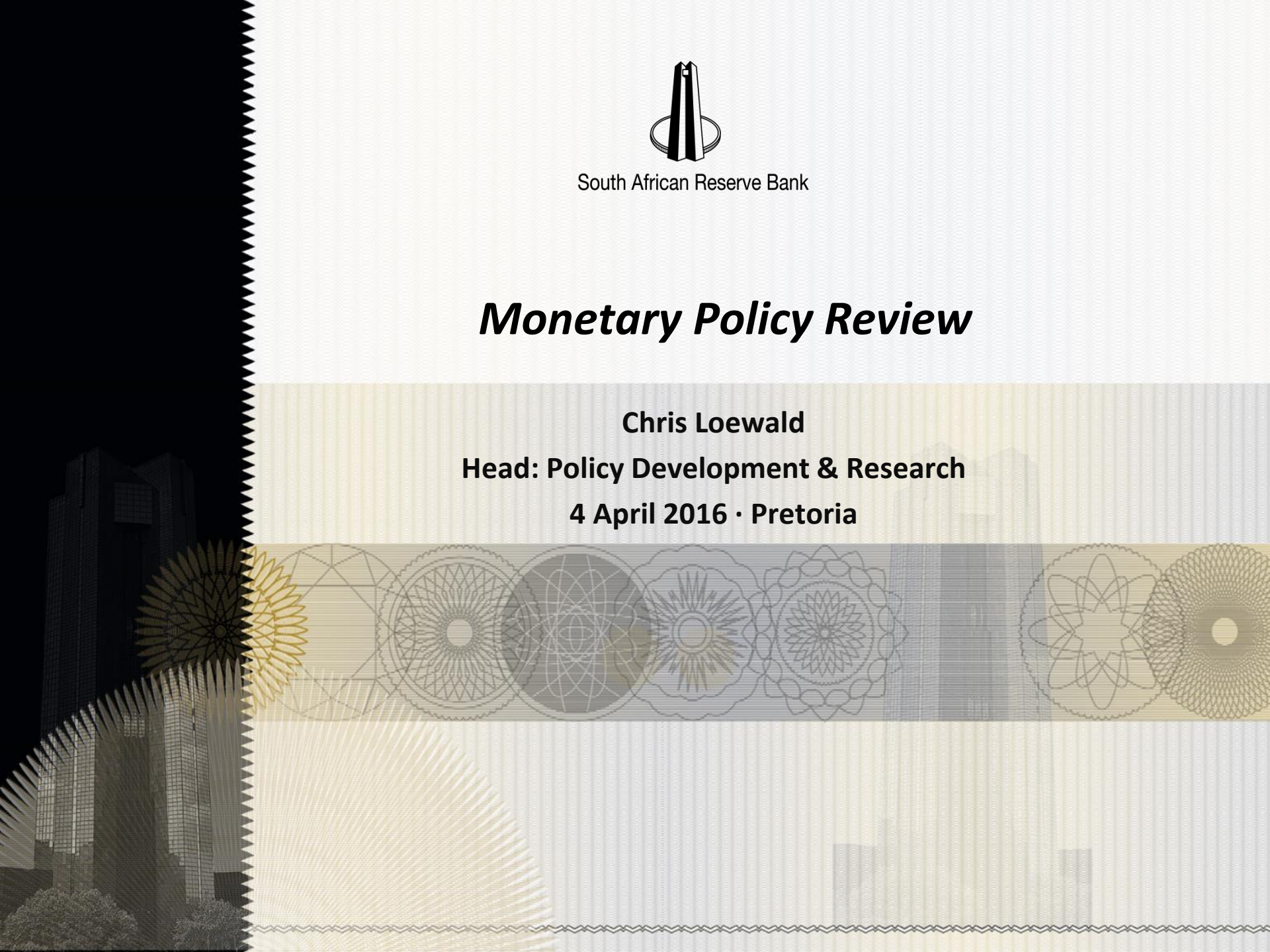
South African Reserve Bank

# ***Monetary Policy Review***

**Chris Loewald**

**Head: Policy Development & Research**

**4 April 2016 • Pretoria**



# Overview of MPR

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- **Chapters:**
  - Executive summary and overview of the policy stance
  - Overview of the world economy
  - Overview of the domestic economy
  - Inflation developments and outlook
  - Conclusion
- **Boxes:**
  - Sovereign credit ratings and downgrade implications
  - Output gap uncertainty
  - Forecast accuracy (November 2013 growth and inflation forecasts and outcomes)
  - The Bank's January 2016 inflation forecast versus private sector forecasts
- **Next MPR: Tuesday, 4 October 2016**

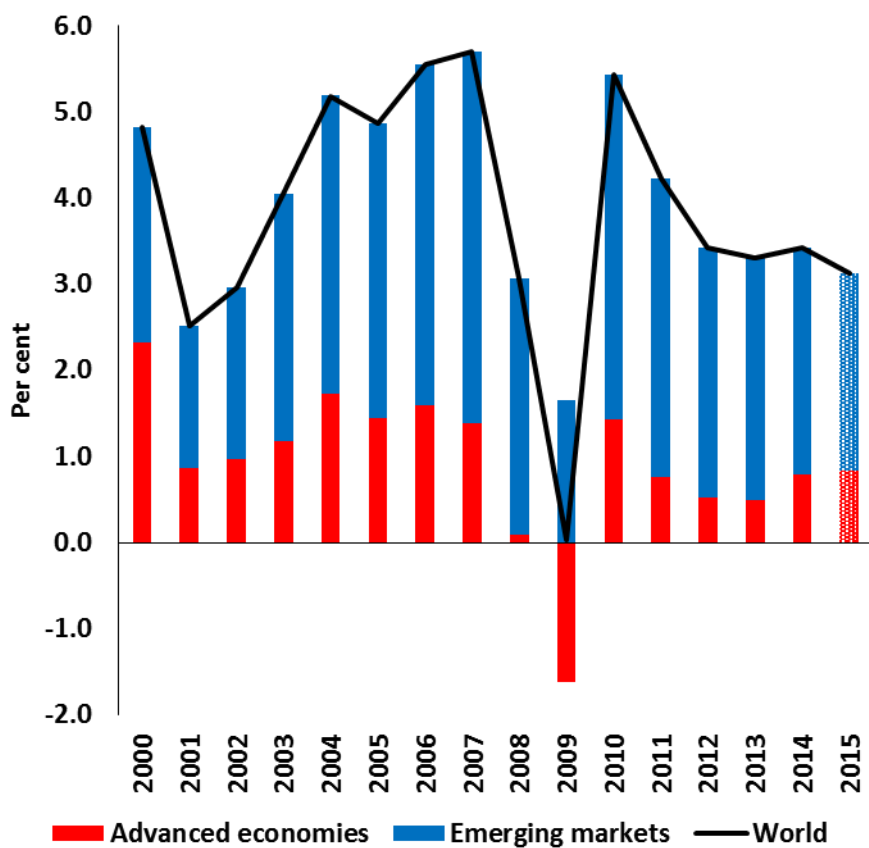
# Overview

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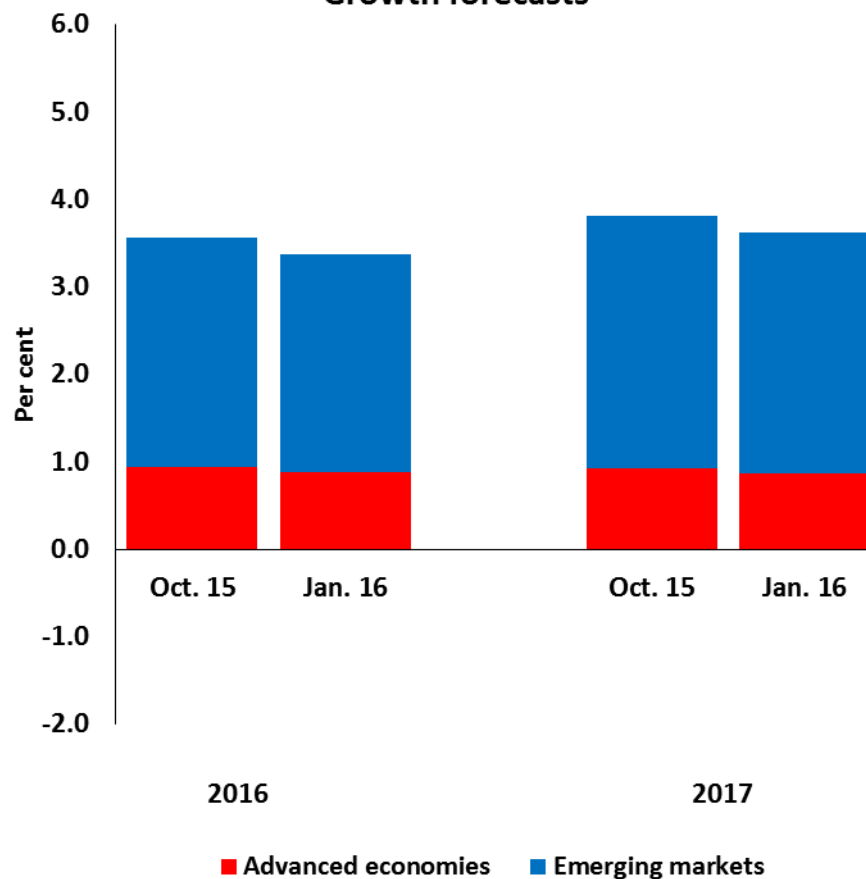
- Global economy
  - Both global growth and inflation at post-crisis lows
  - Higher inflation in commodity-exporting EMs
- SA's growth low & debt-constrained, expected to improve marginally
- Domestic inflation
  - Worse outlook driven by food and the exchange rate
  - Risks of second-round effects, on top of already-elevated core inflation, expectations and wage growth
- Gradual adjustment, avoiding accelerating inflation, while retaining a supportive environment

## Global growth at post-crisis low, with tepid forecasts

Contributions and overall global growth

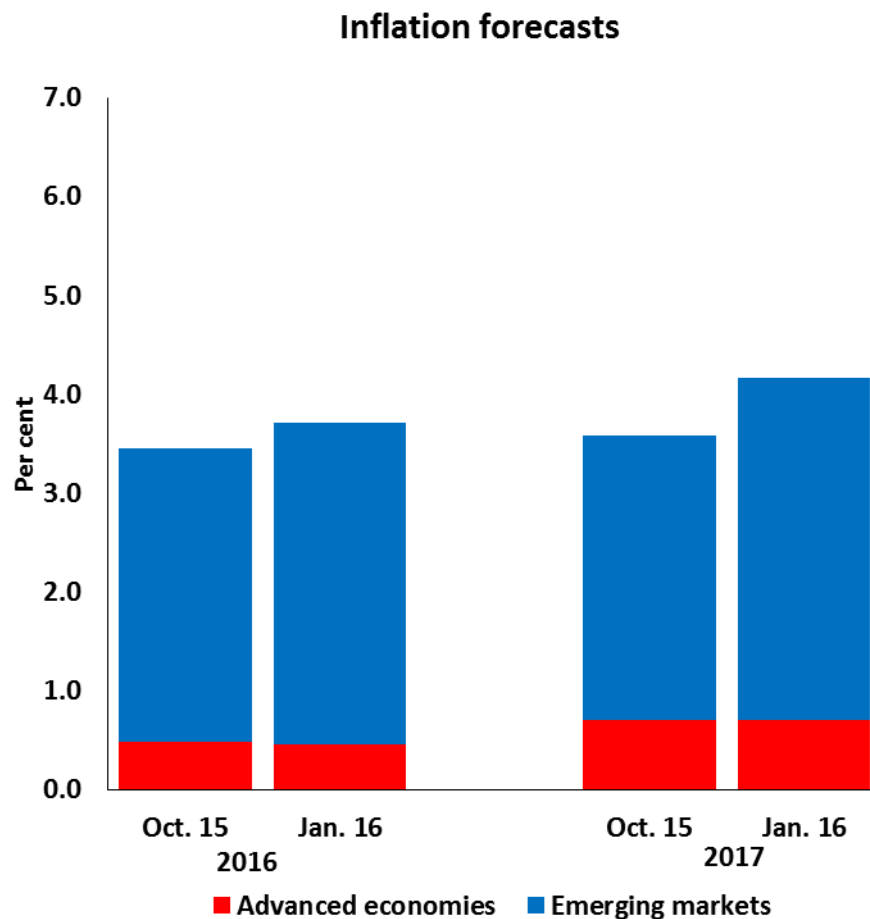
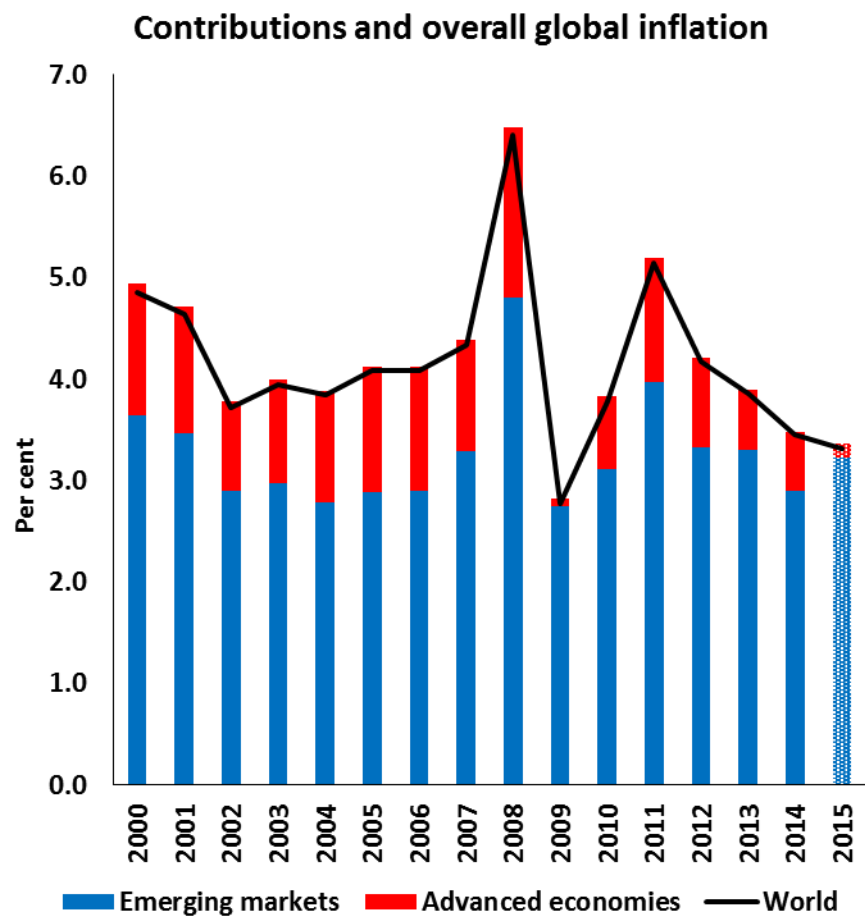


Growth forecasts



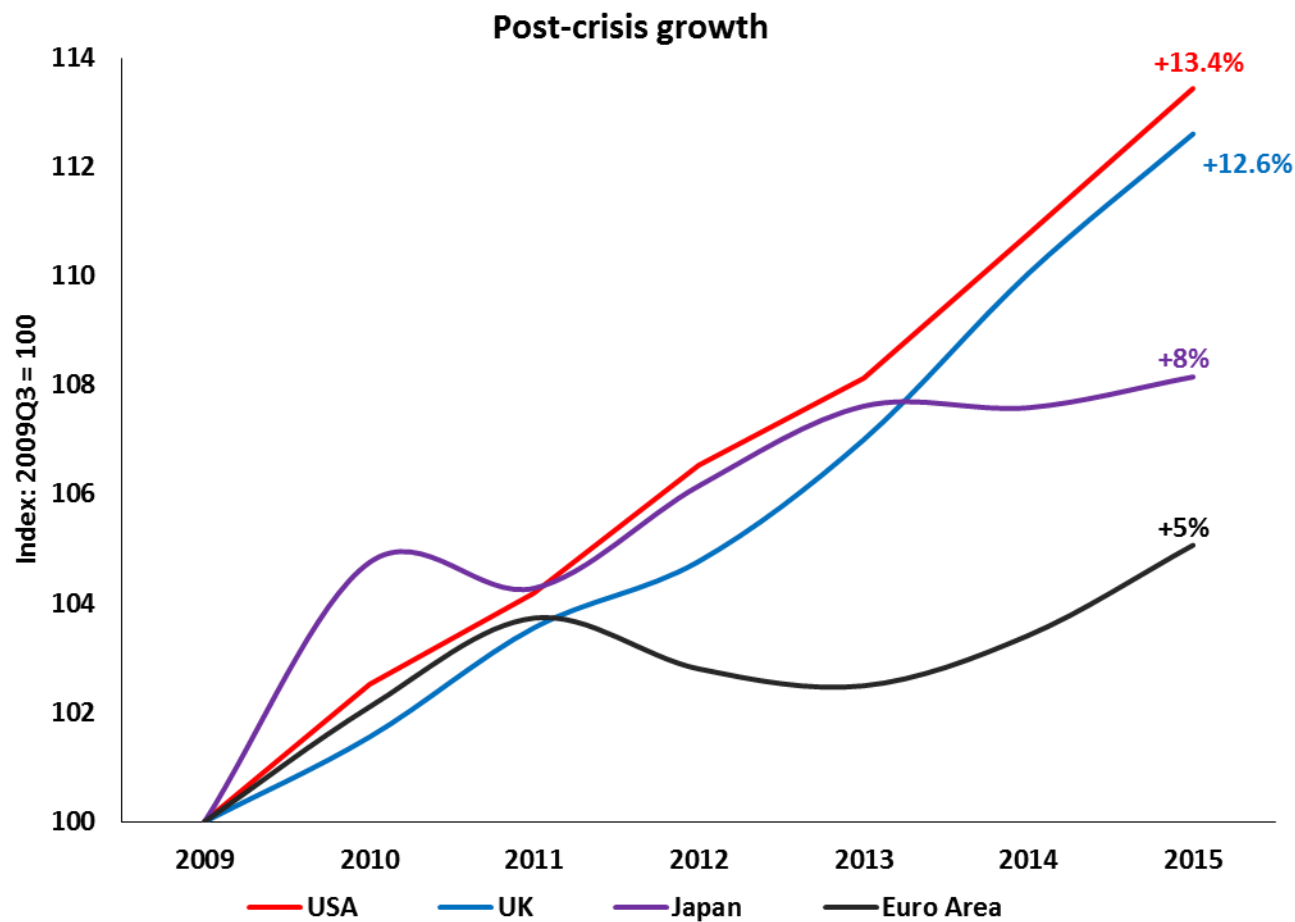
Source: International Monetary Fund and own calculations

## Global inflation unusually low, forecasts edging up for emerging markets



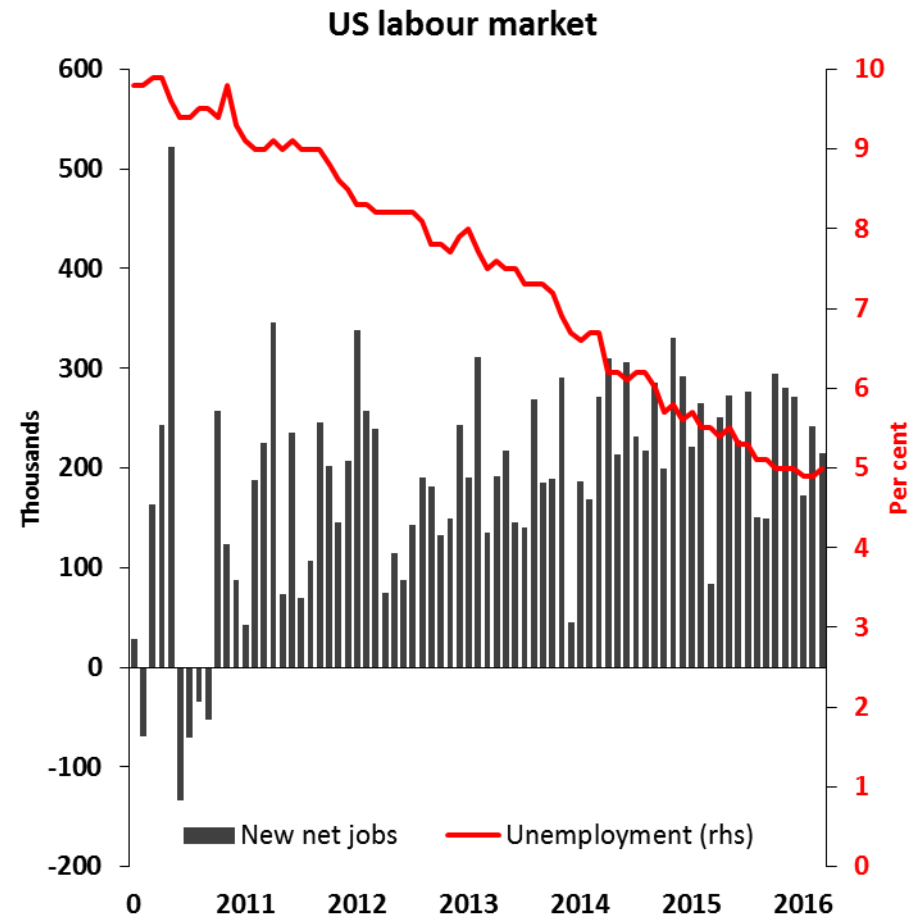
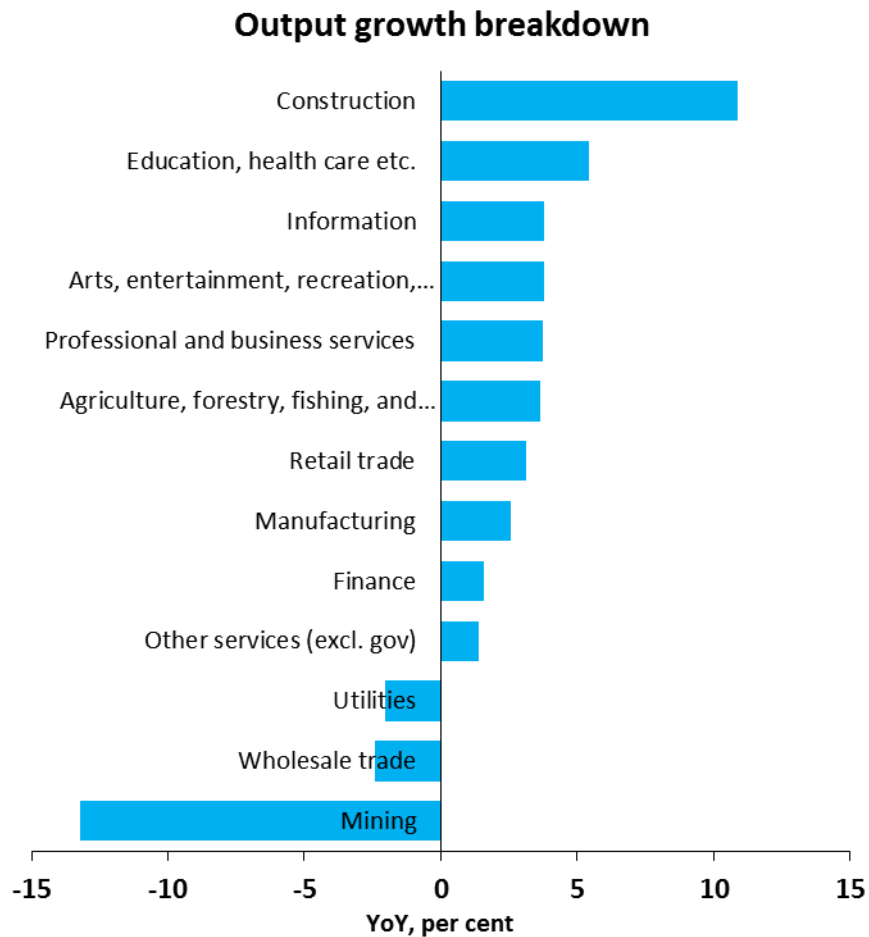
Source: International Monetary Fund and own calculations

## US and UK growth continues to outpace euro area and Japan



Source: International Monetary Fund, Bloomberg and own calculations

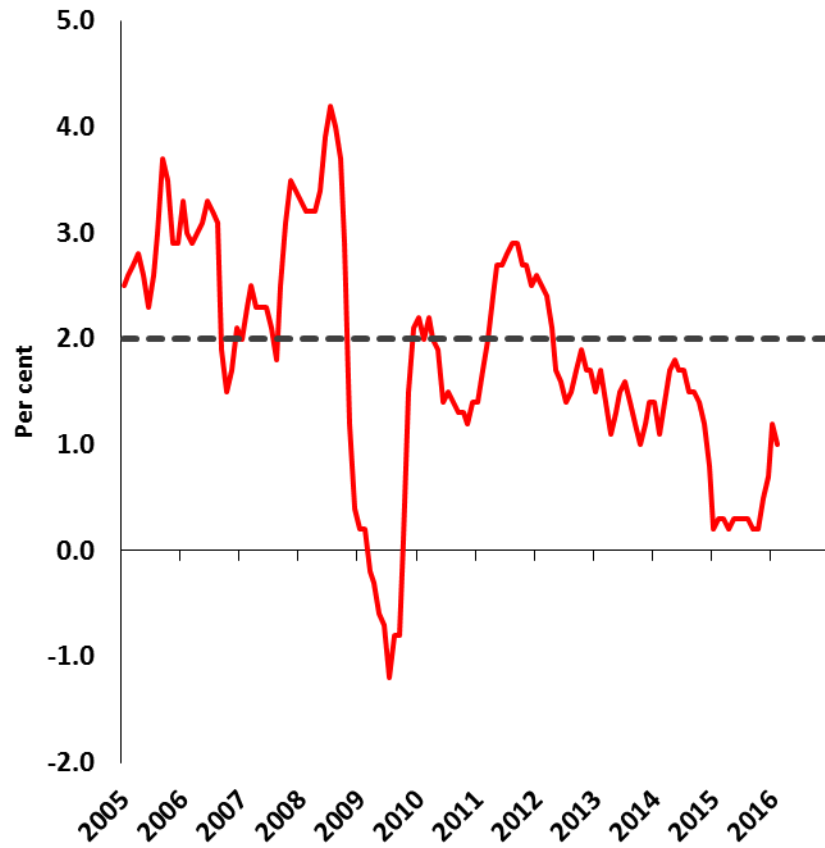
## US indicators positive



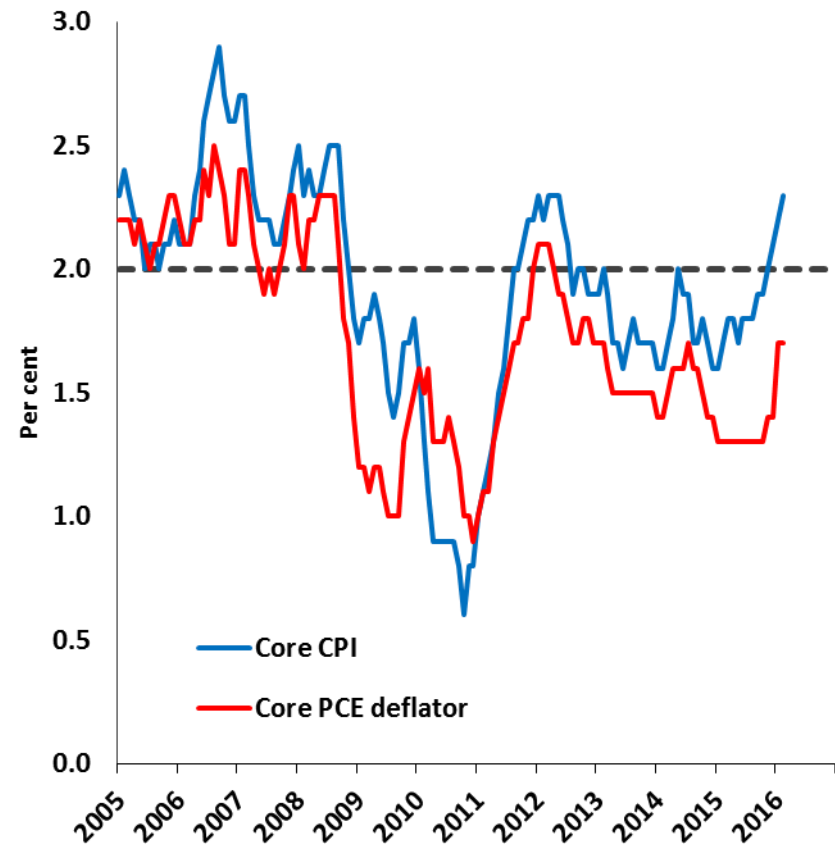
Sources: US Bureau of Labor Statistics, Bank for International Settlements and own calculations

## US inflation increasing towards 2% goal

PCE deflator, change



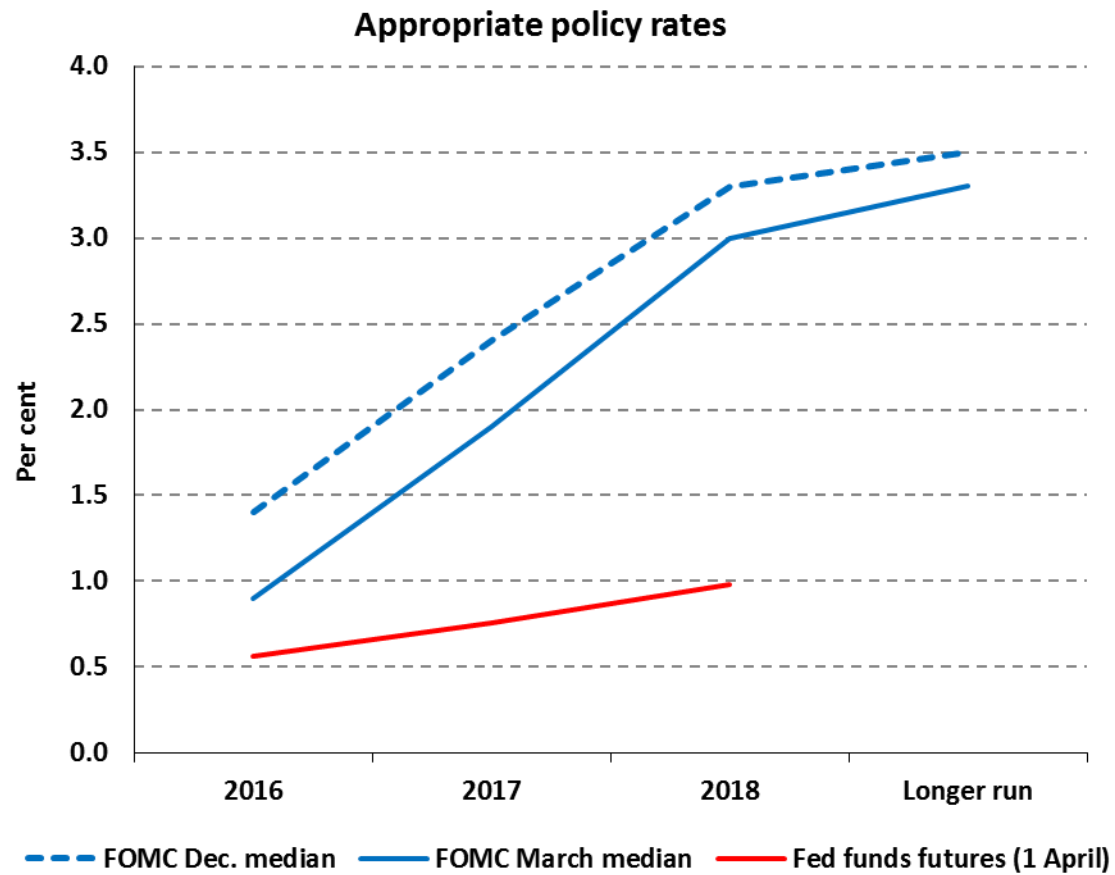
Core PCE and core CPI



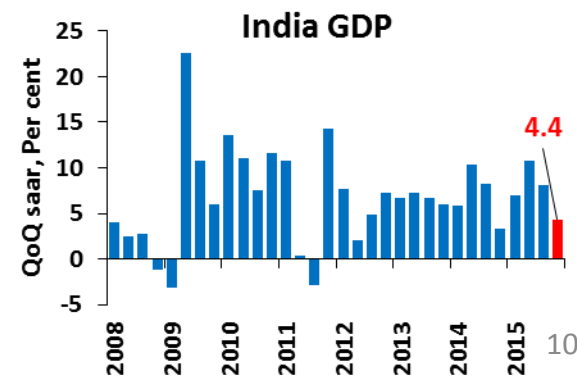
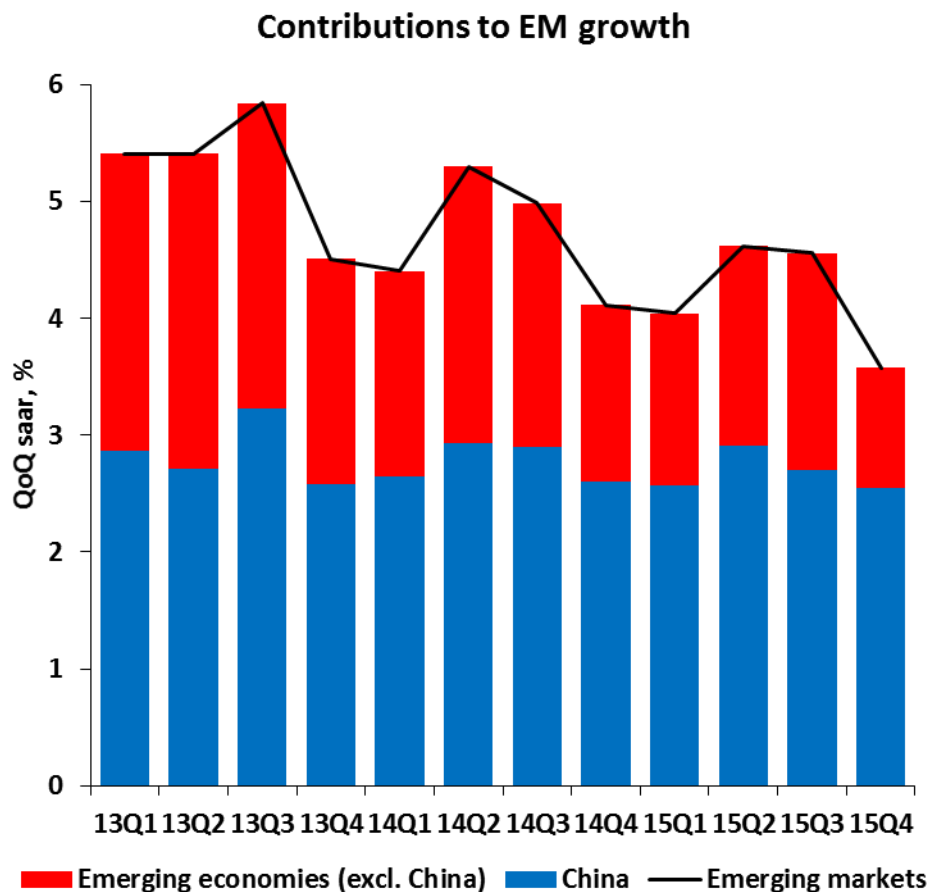


## At the moment, Fed sees lower interest rate path than previously

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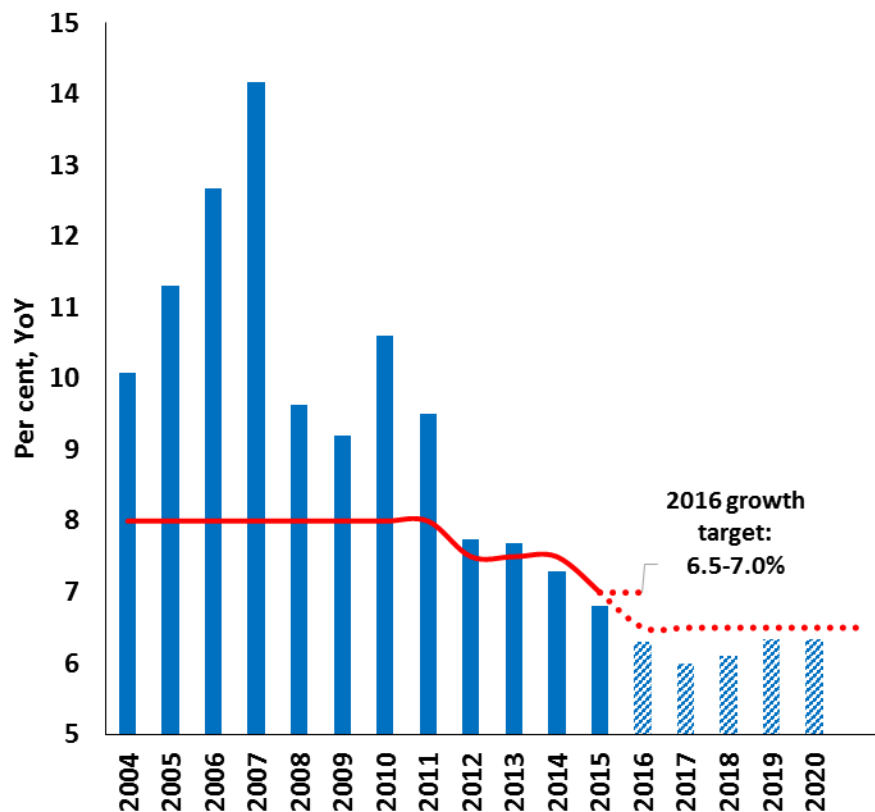


# Global slowdown mostly due to middle-income emerging markets, slowing since 2010

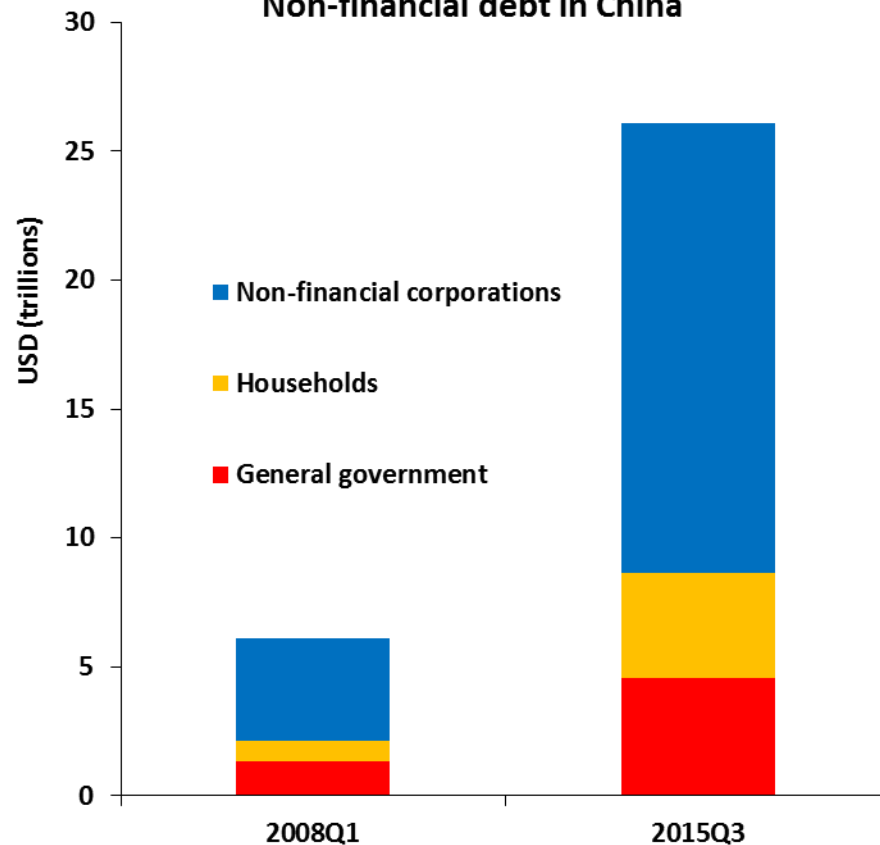


# China remains biggest risk to global growth

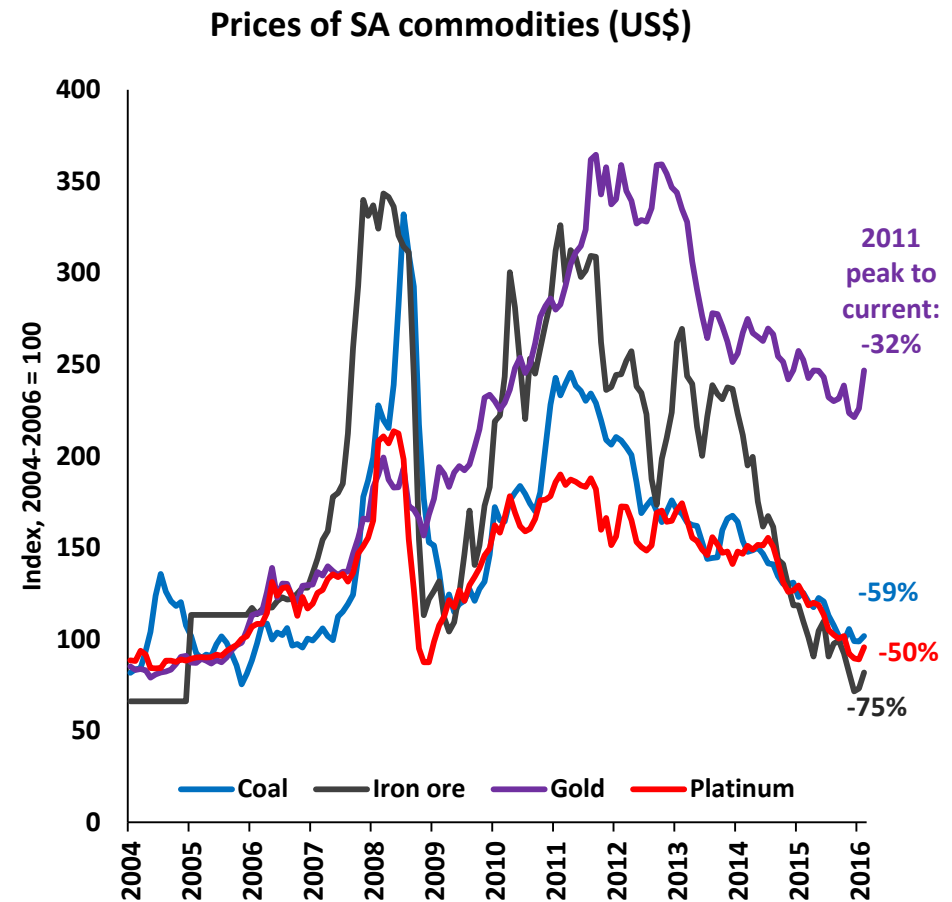
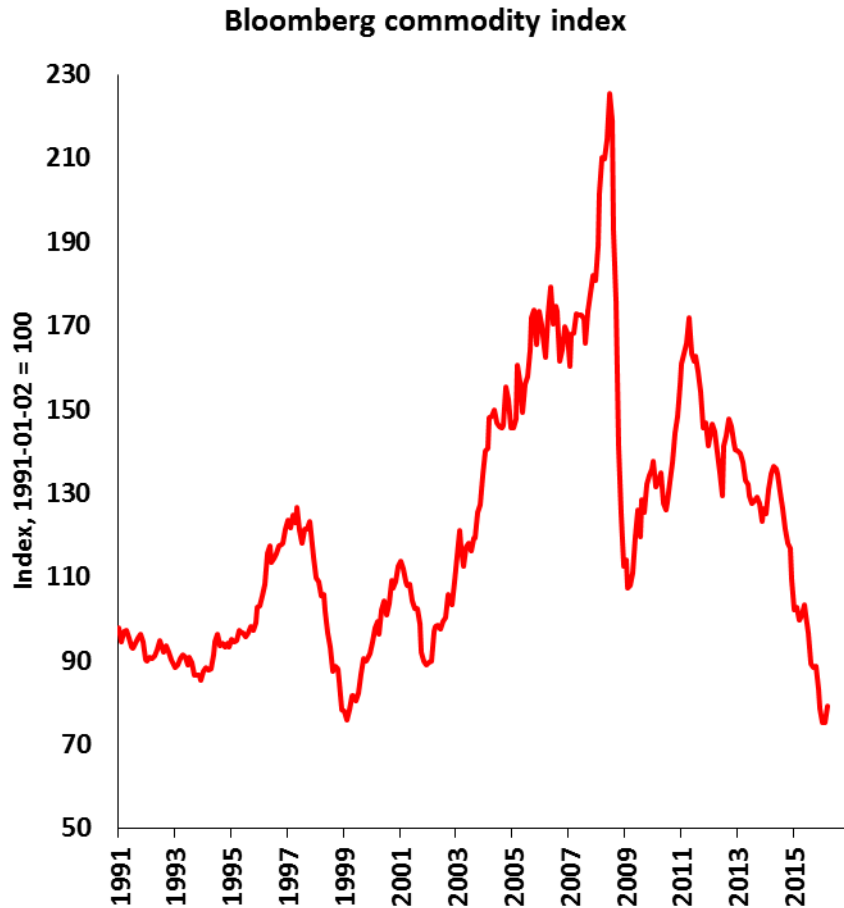
## Chinese GDP growth and targets



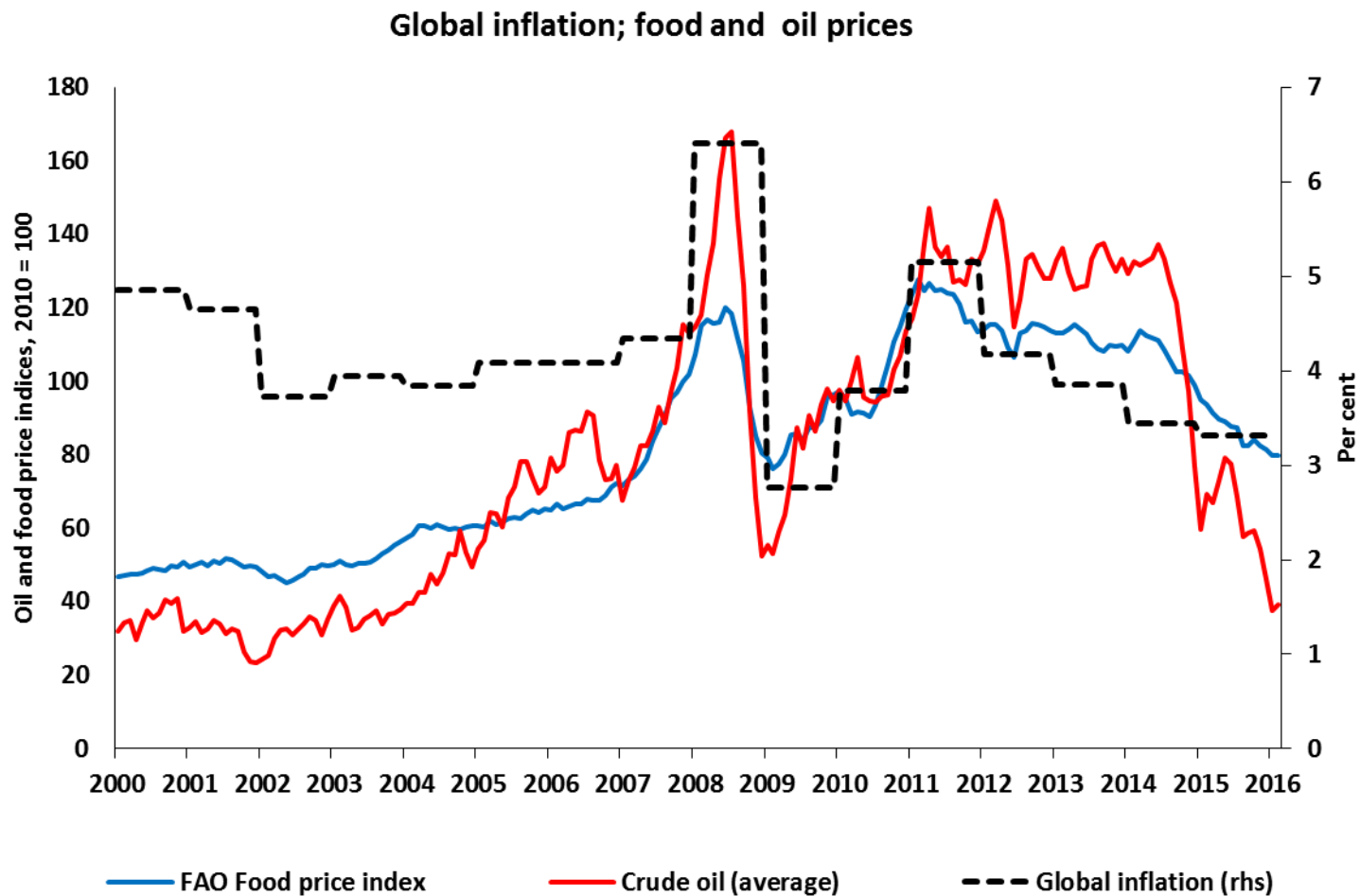
## Non-financial debt in China



# Unexpectedly low growth is contributing to lower commodity prices

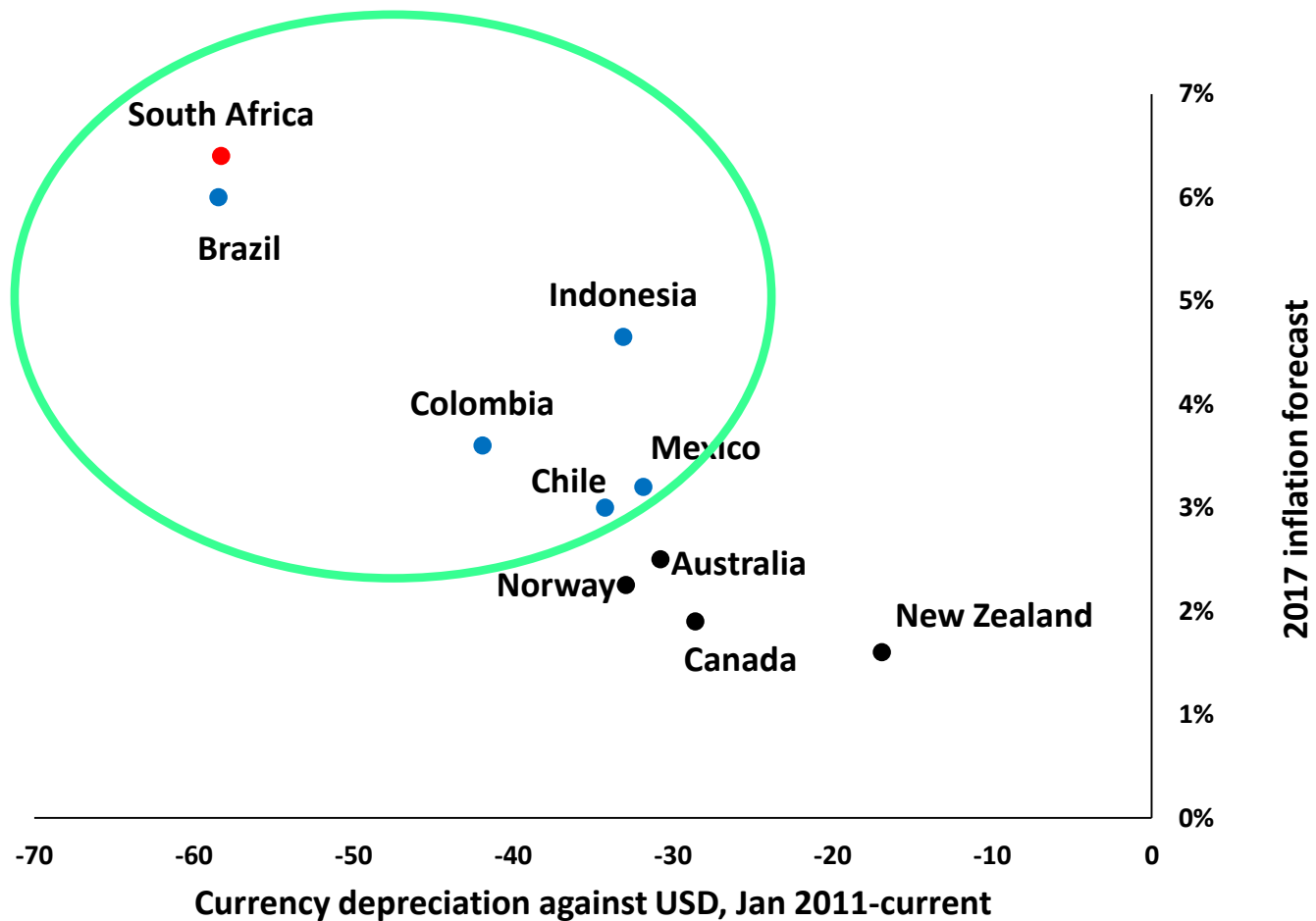


## ... and unusually low global inflation



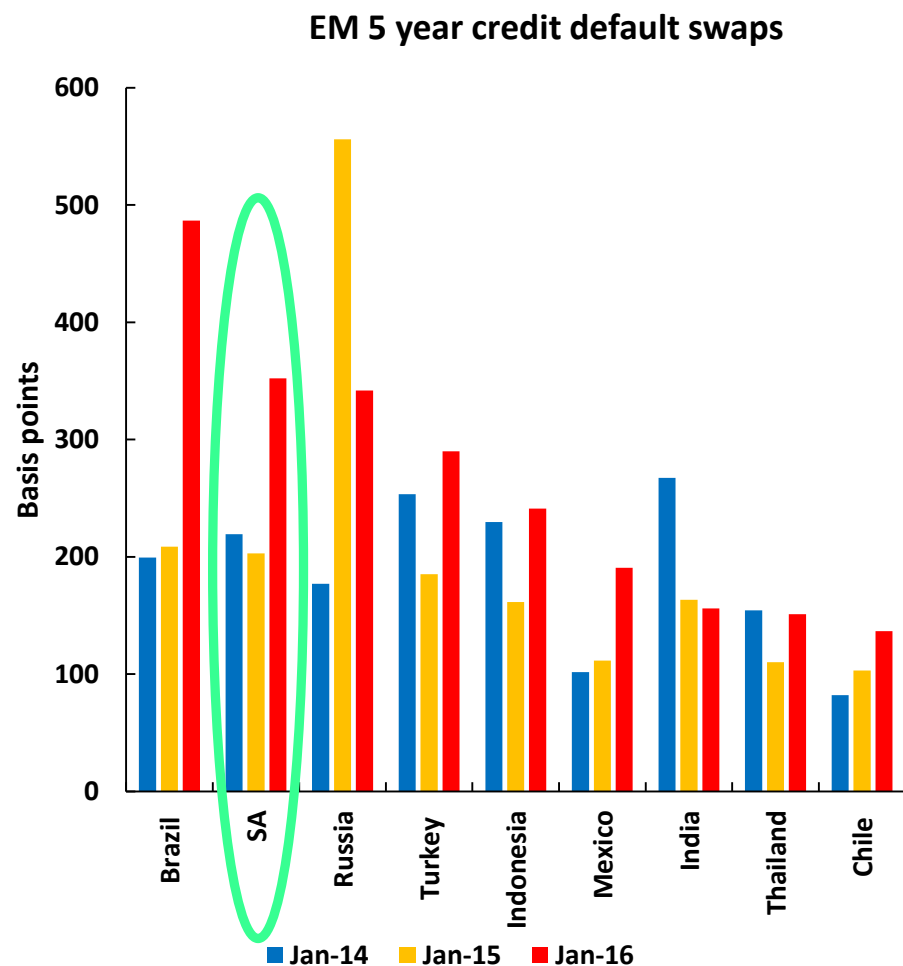
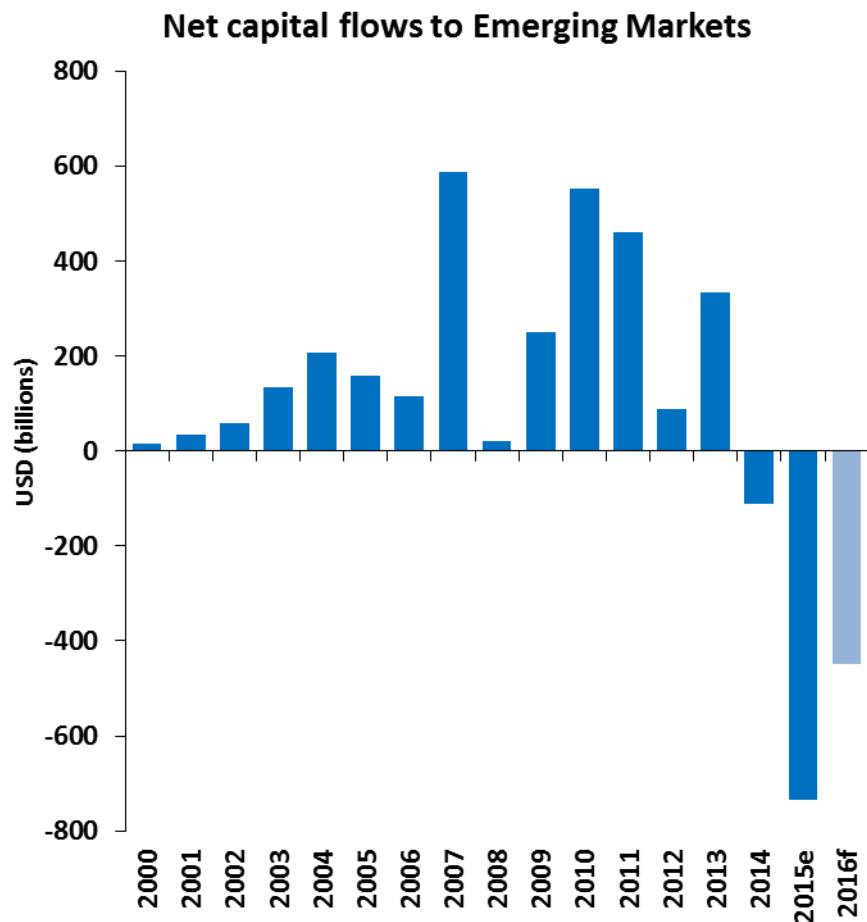
## Exceptions to low-inflation pattern are emerging-market commodity exporters

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Sources: IMF and Bloomberg

## Emerging markets vulnerable, but some more than others

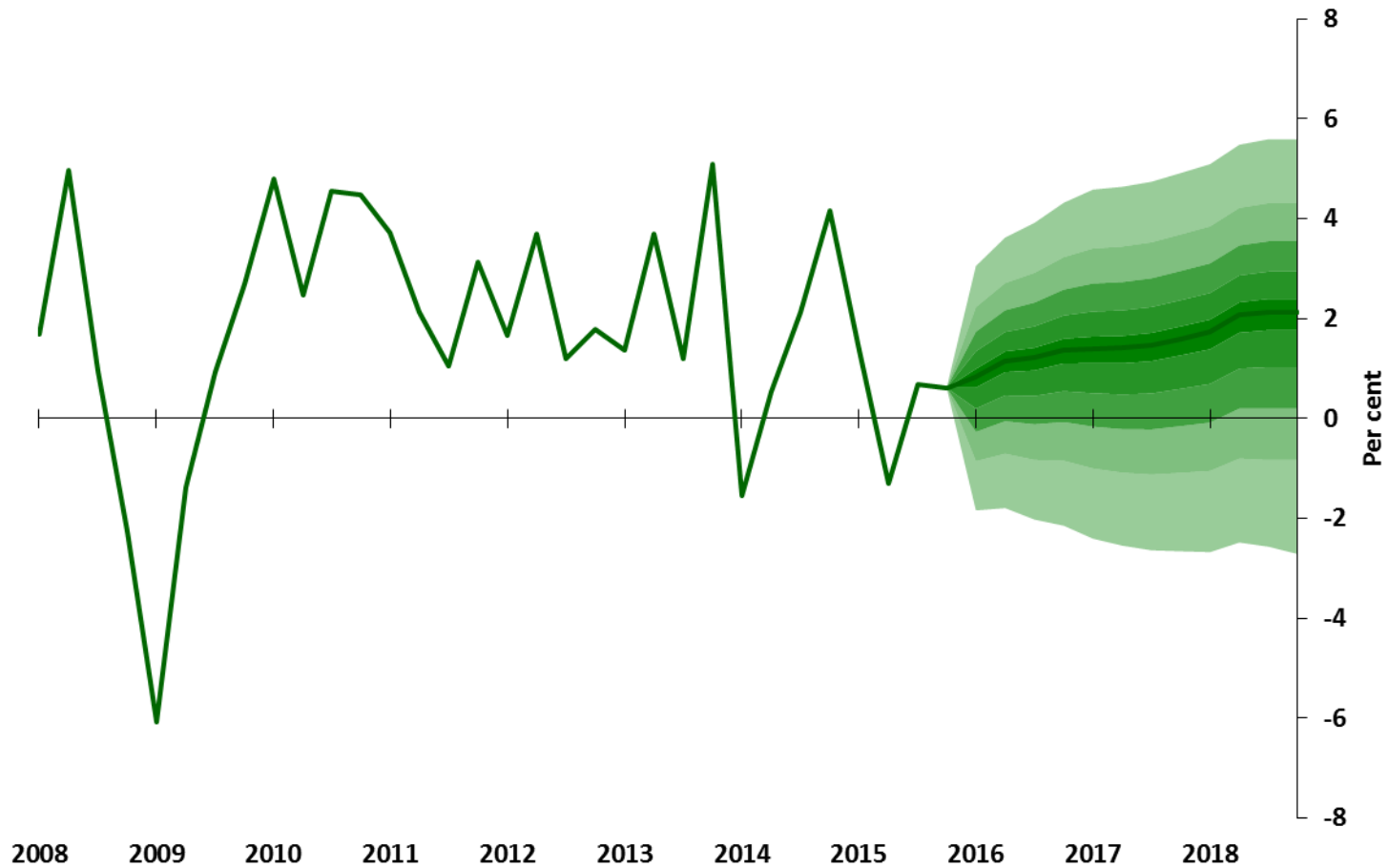


## Domestic growth outlook

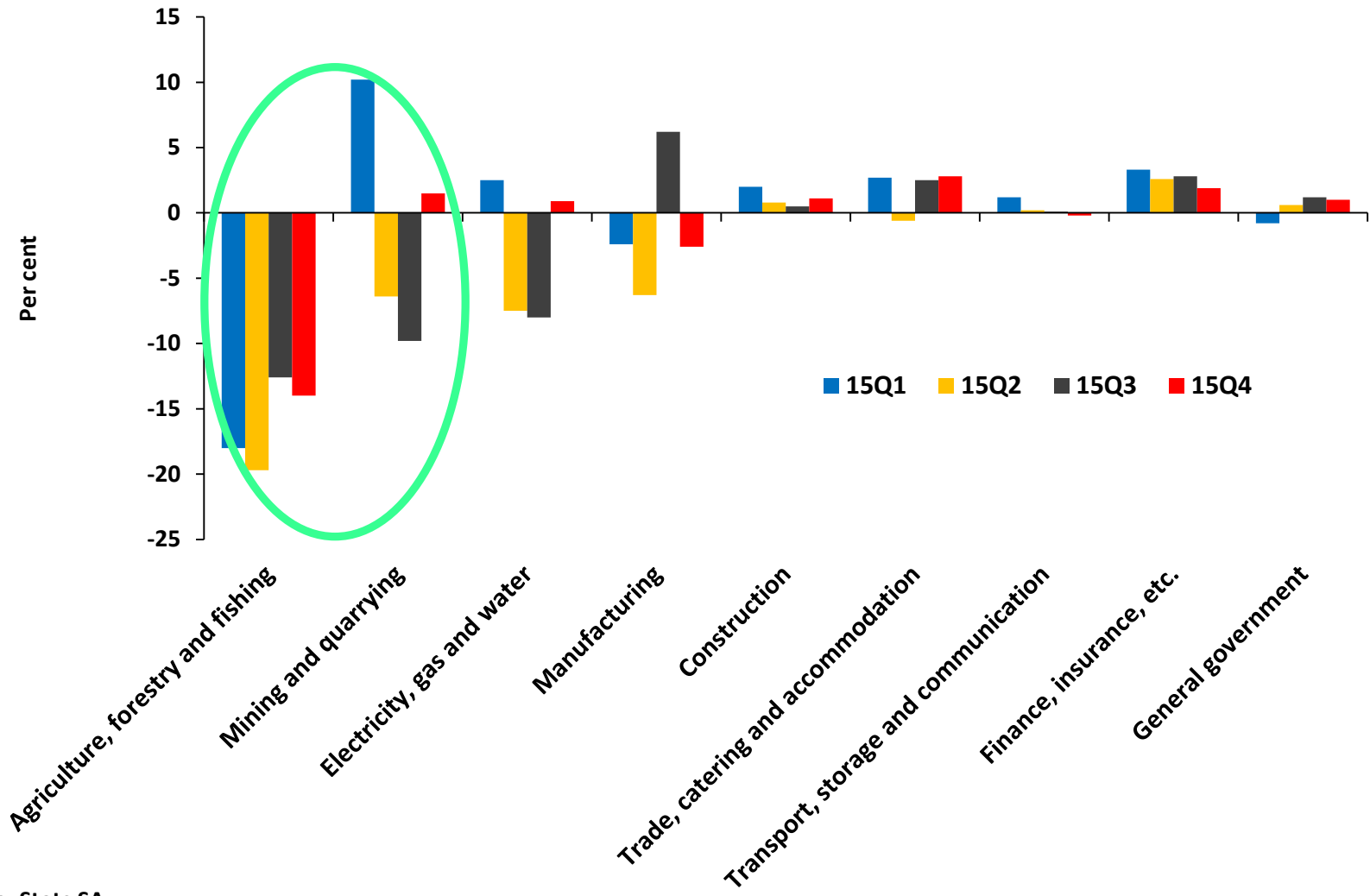
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## Growth outcomes disappointing and expected to improve marginally

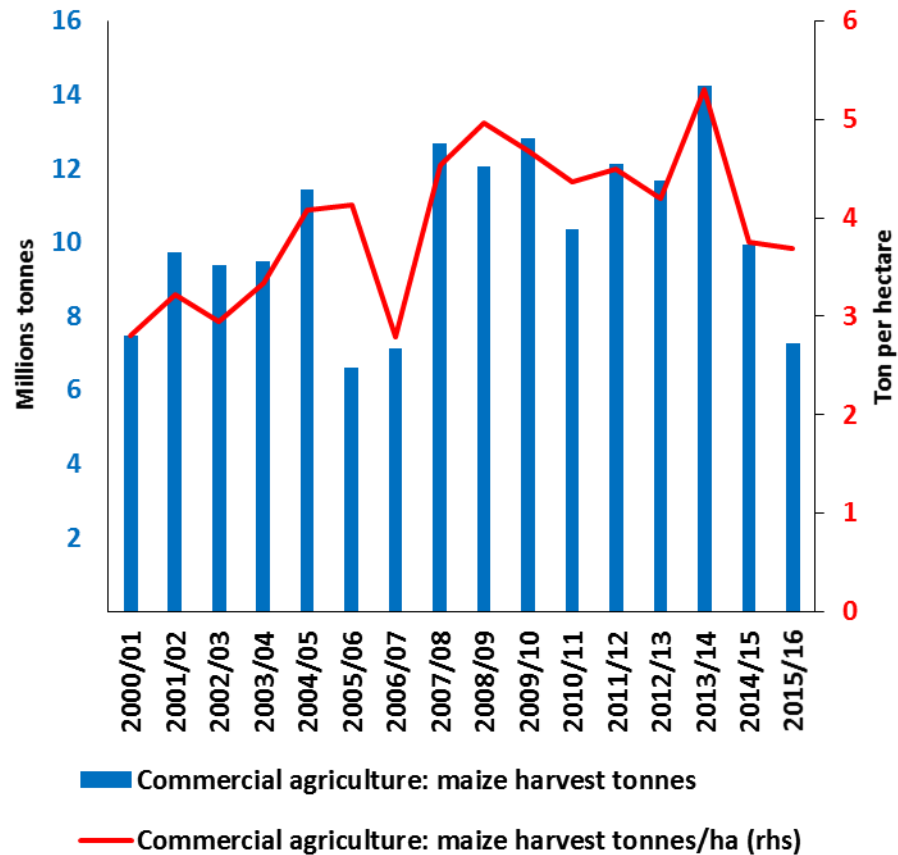


## Shocks are hitting primary sector particularly hard

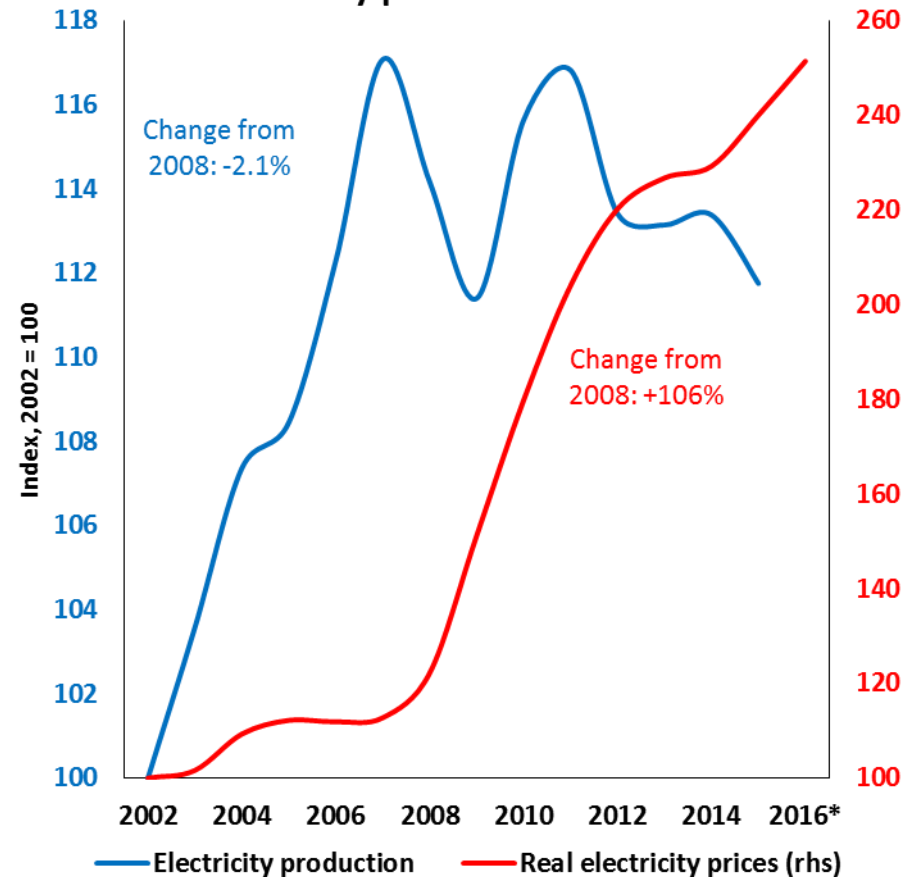


# Drought effects and electricity shortages have weakened growth

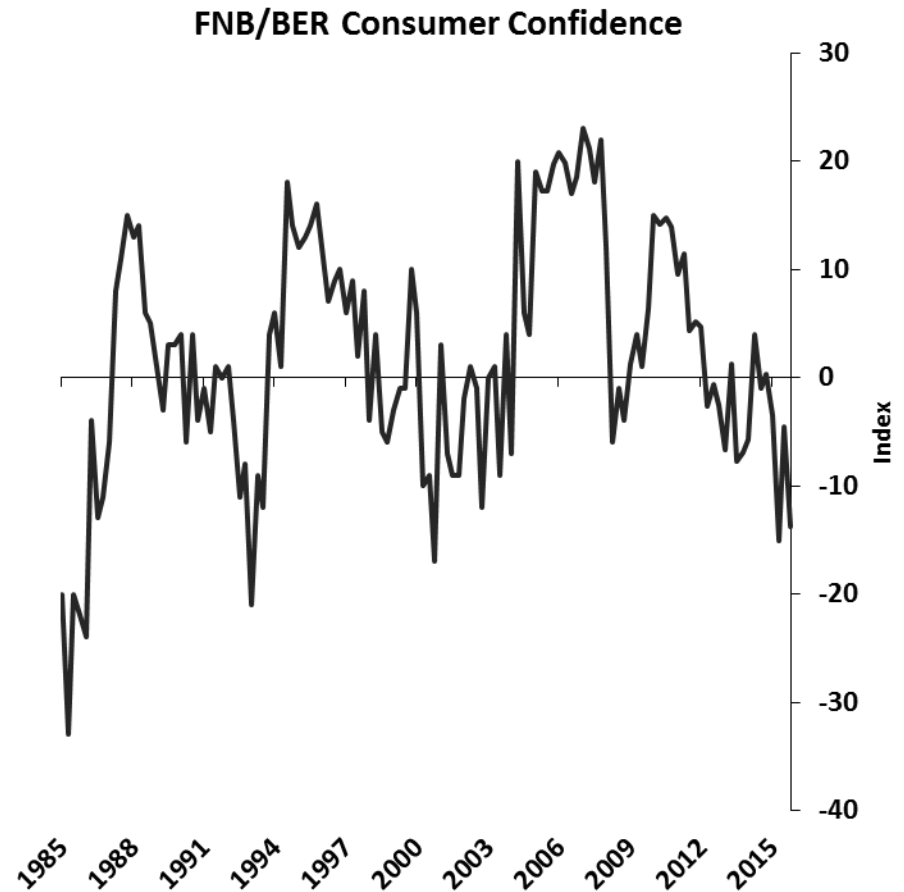
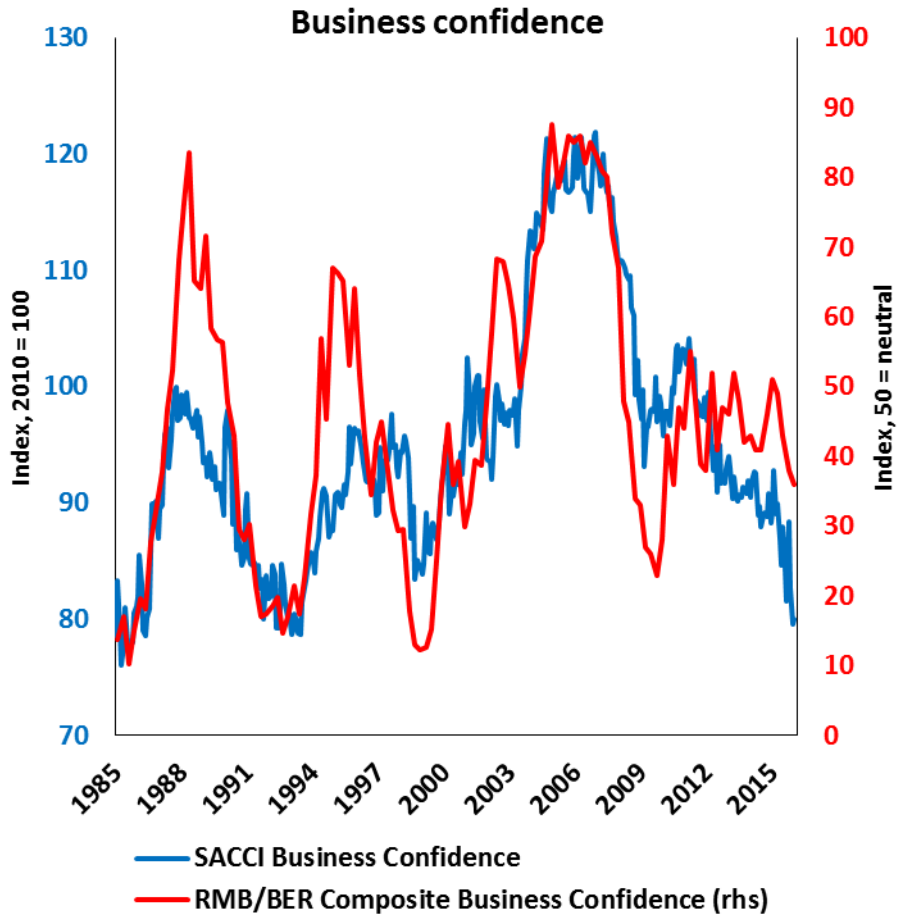
## Commercial maize harvests



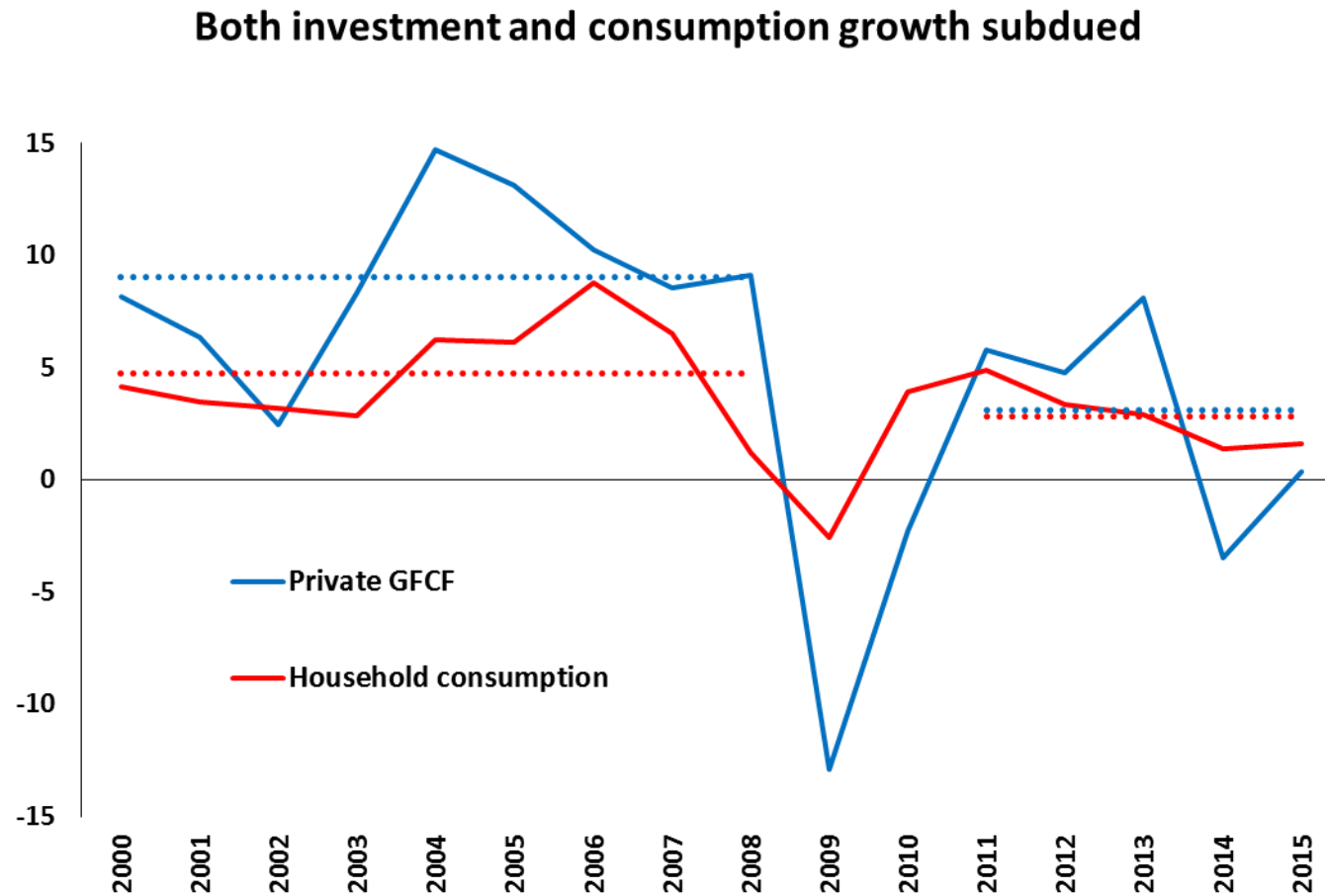
## Electricity production and costs



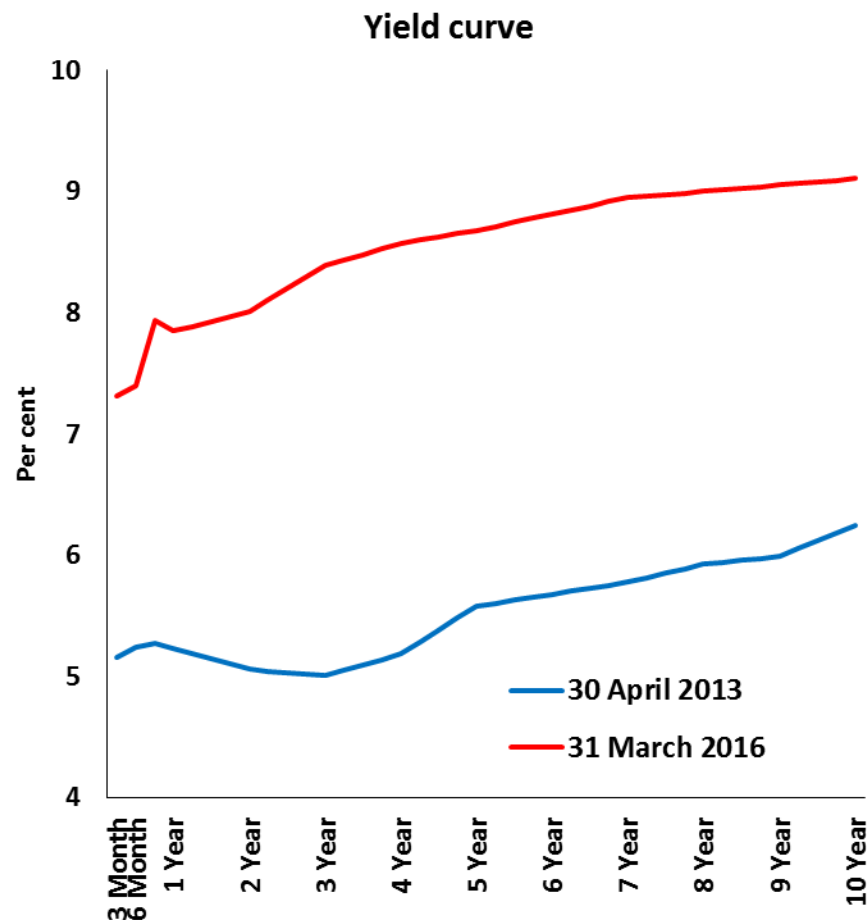
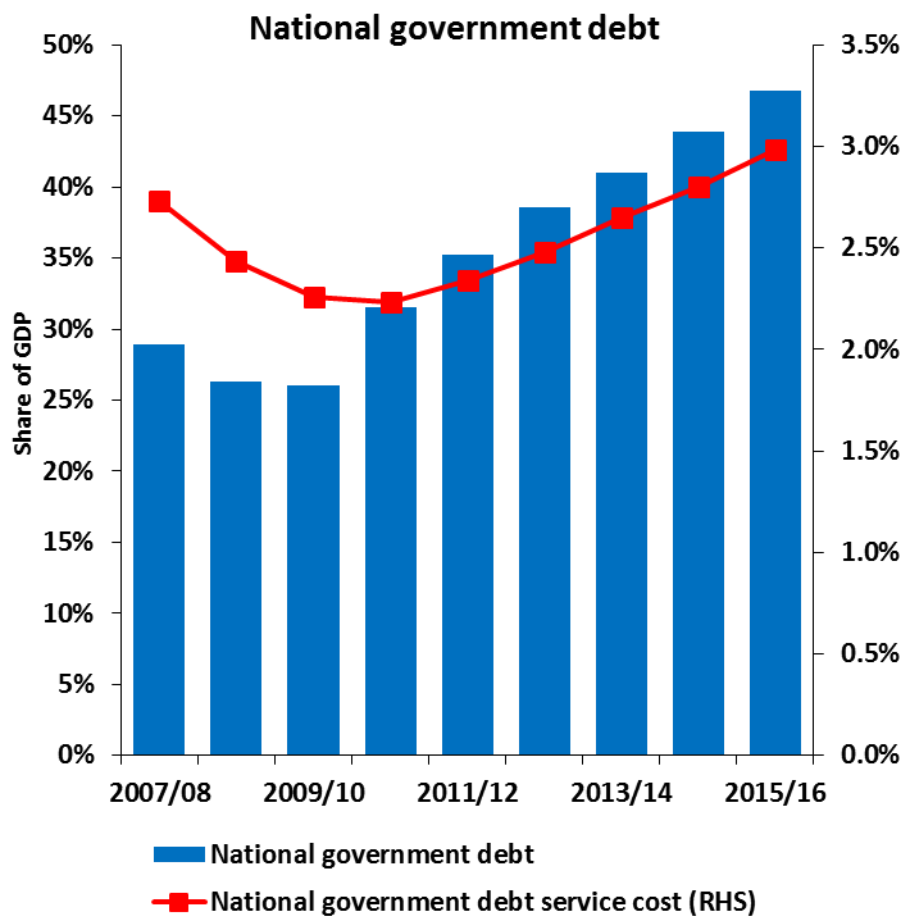
## Business and consumer confidence is very low



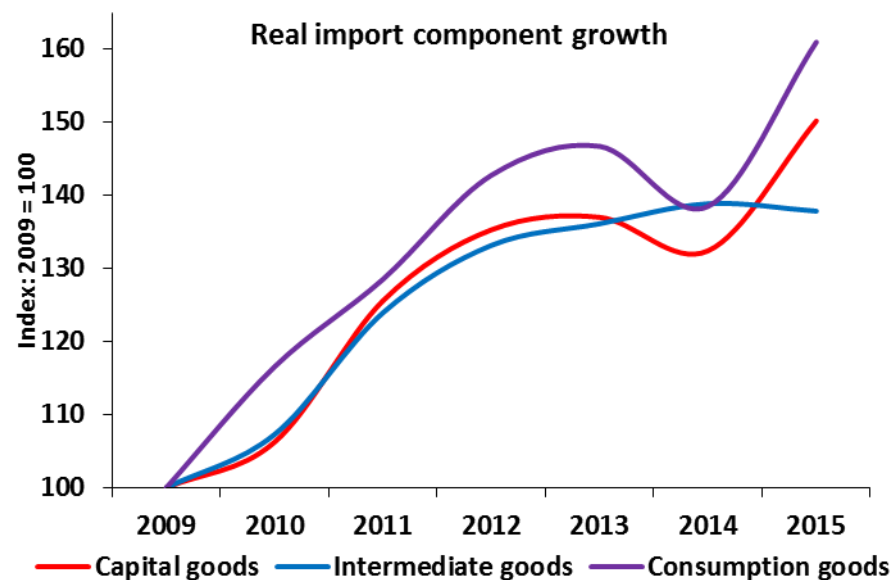
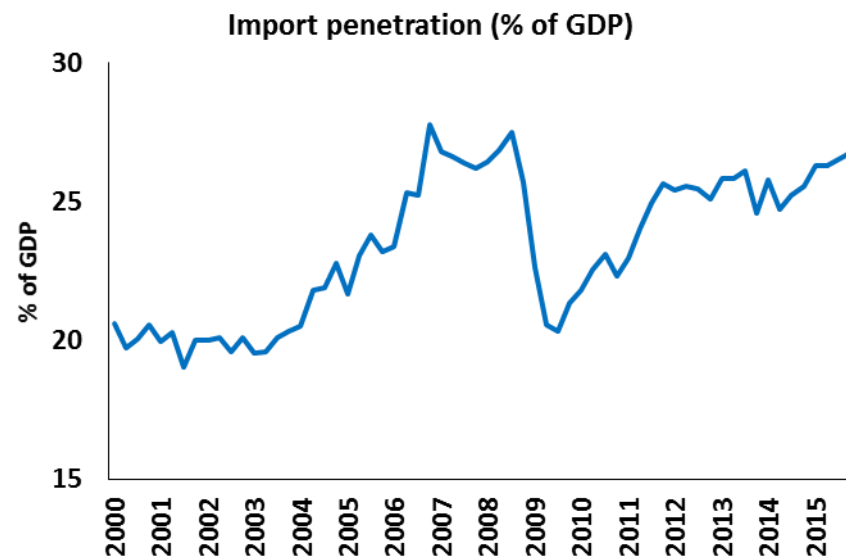
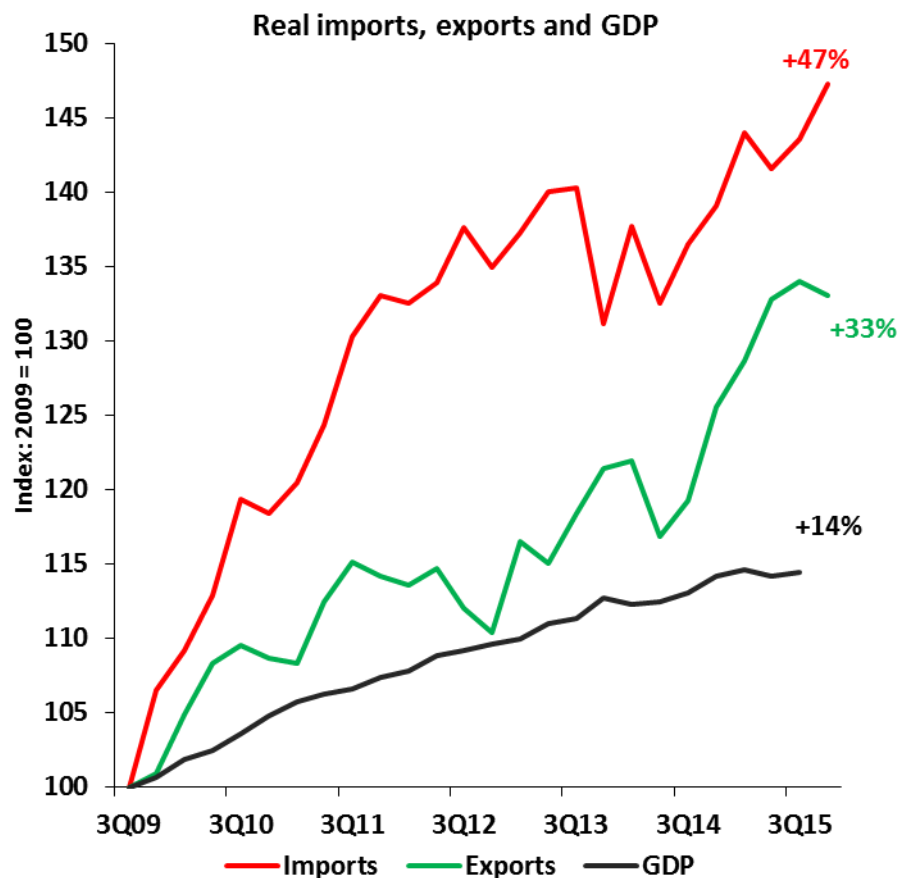
## Implying that private sector will not add much to growth



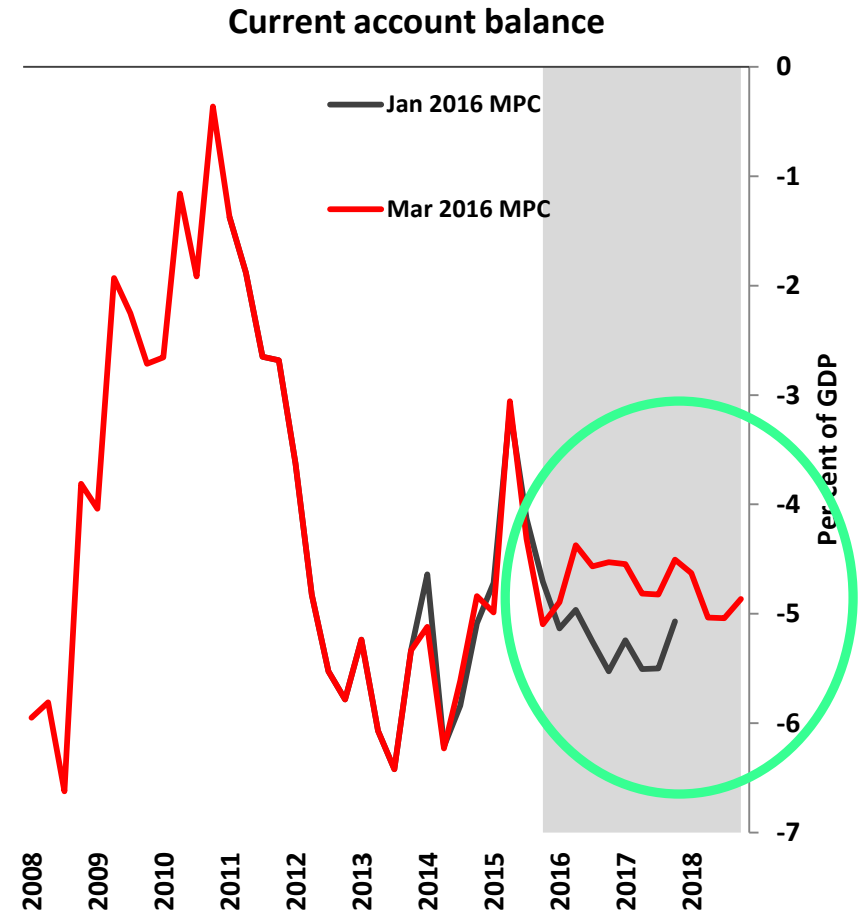
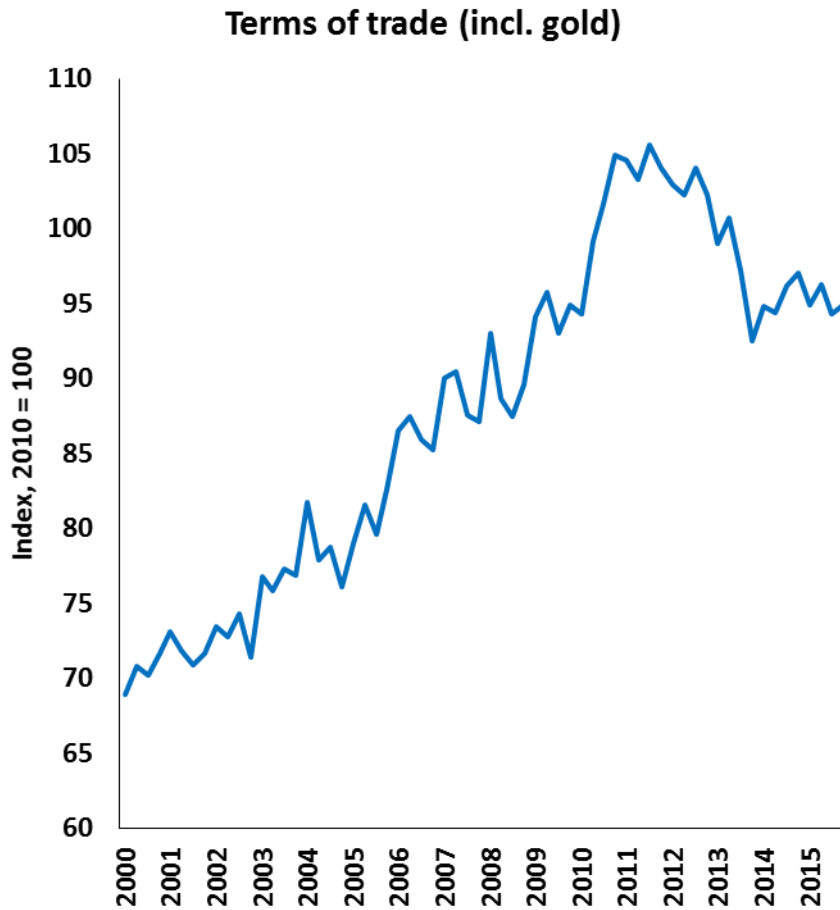
## Fiscal policy has supported the economy, but policy space has narrowed



## Low net export stimulus to growth, given demand leakage...



## ... and less favourable terms of trade, maintaining a large current account deficit



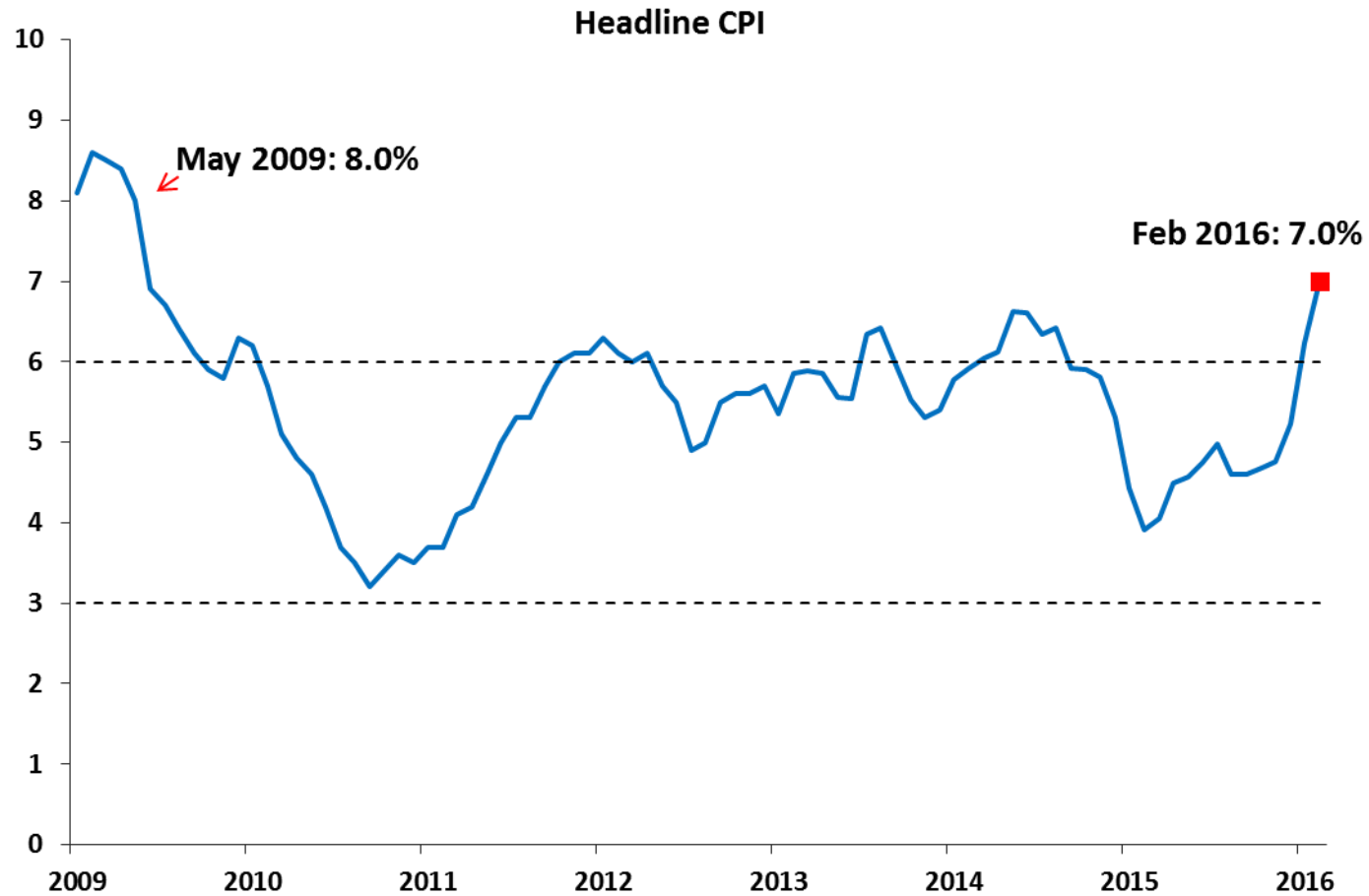


## Inflation outlook

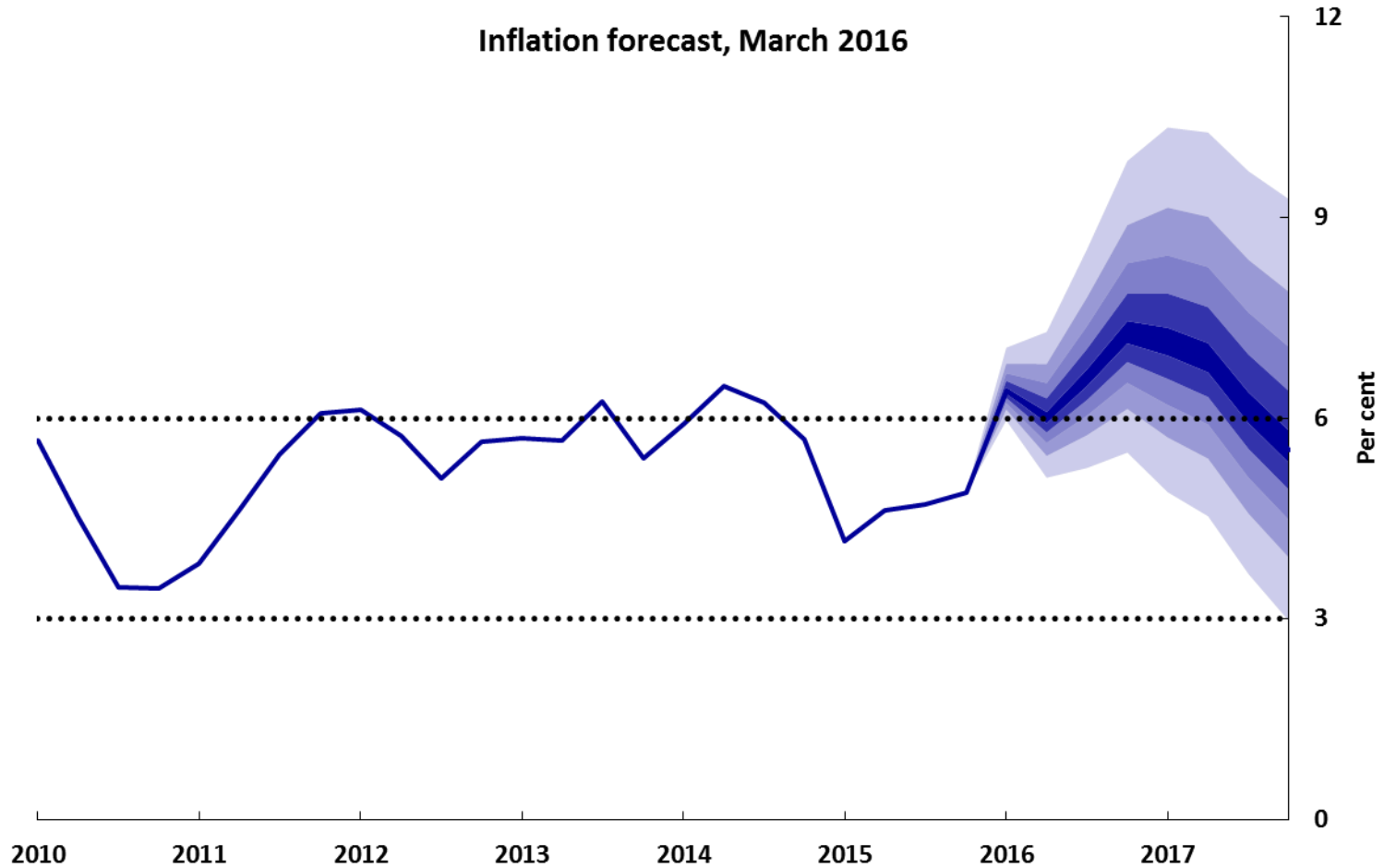
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## Inflation is at its highest level in nearly seven years...

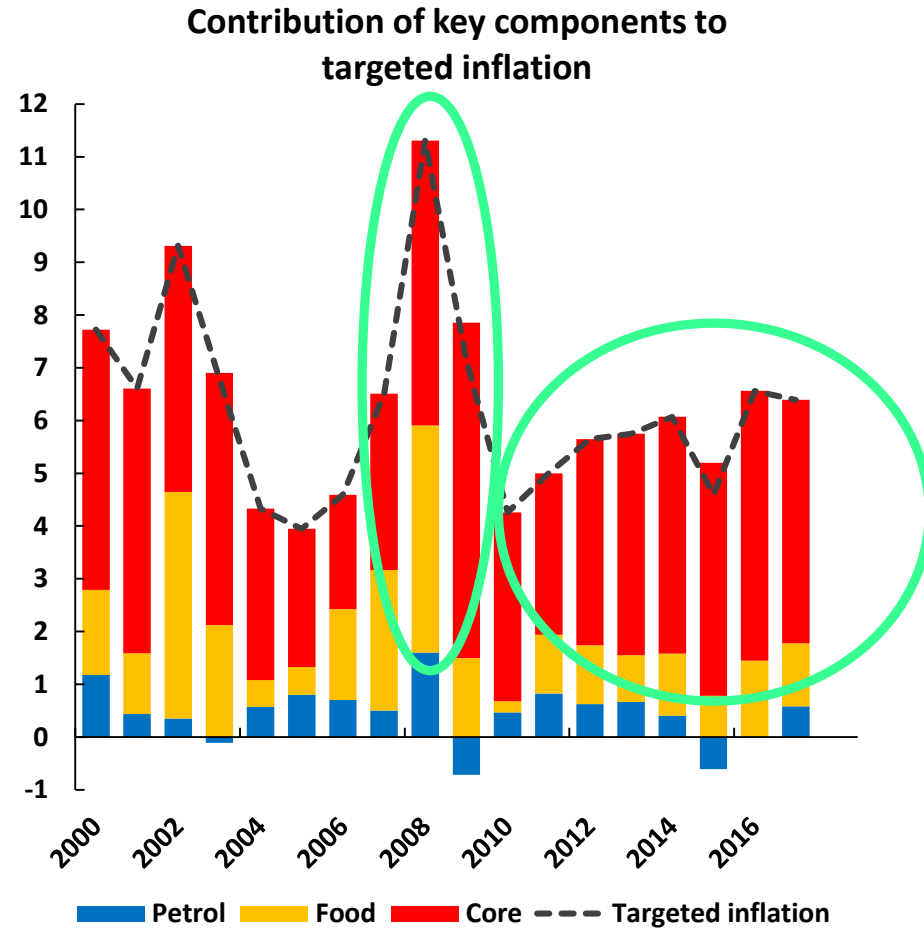
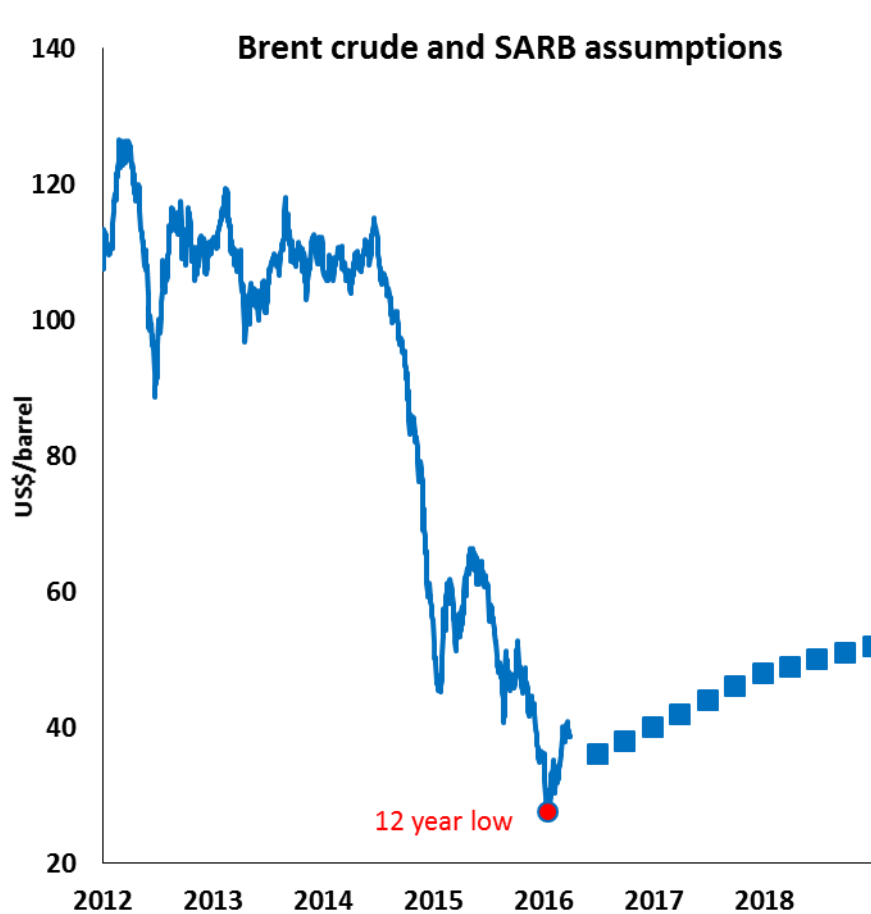
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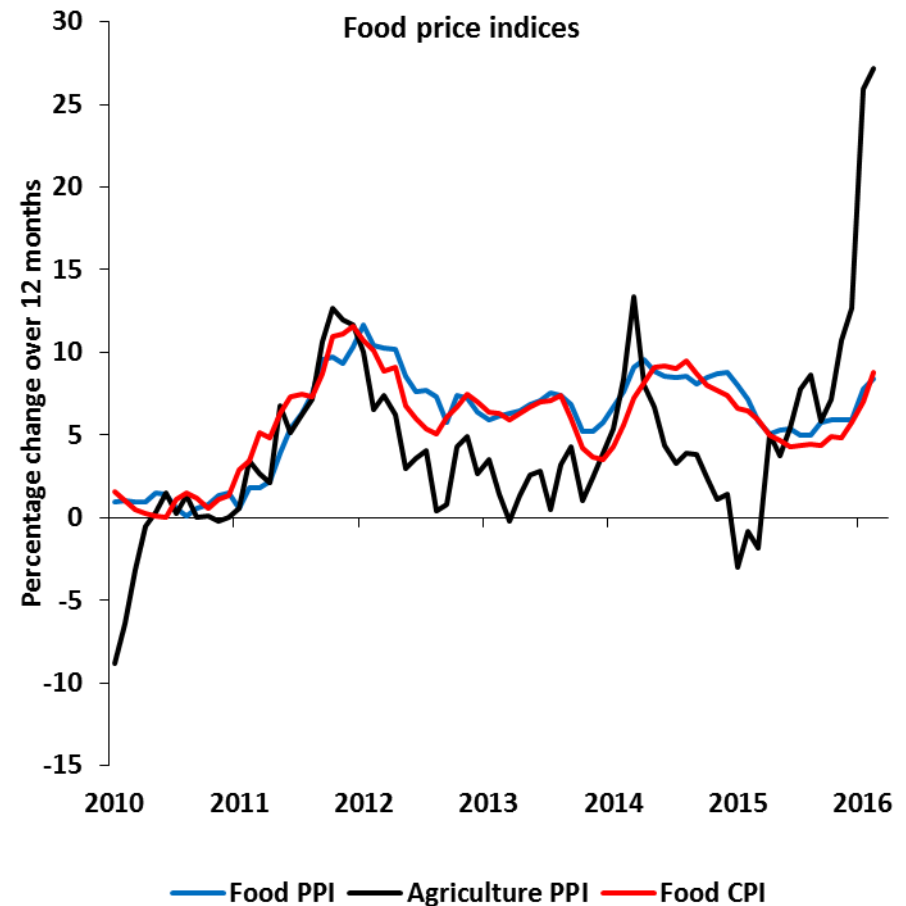
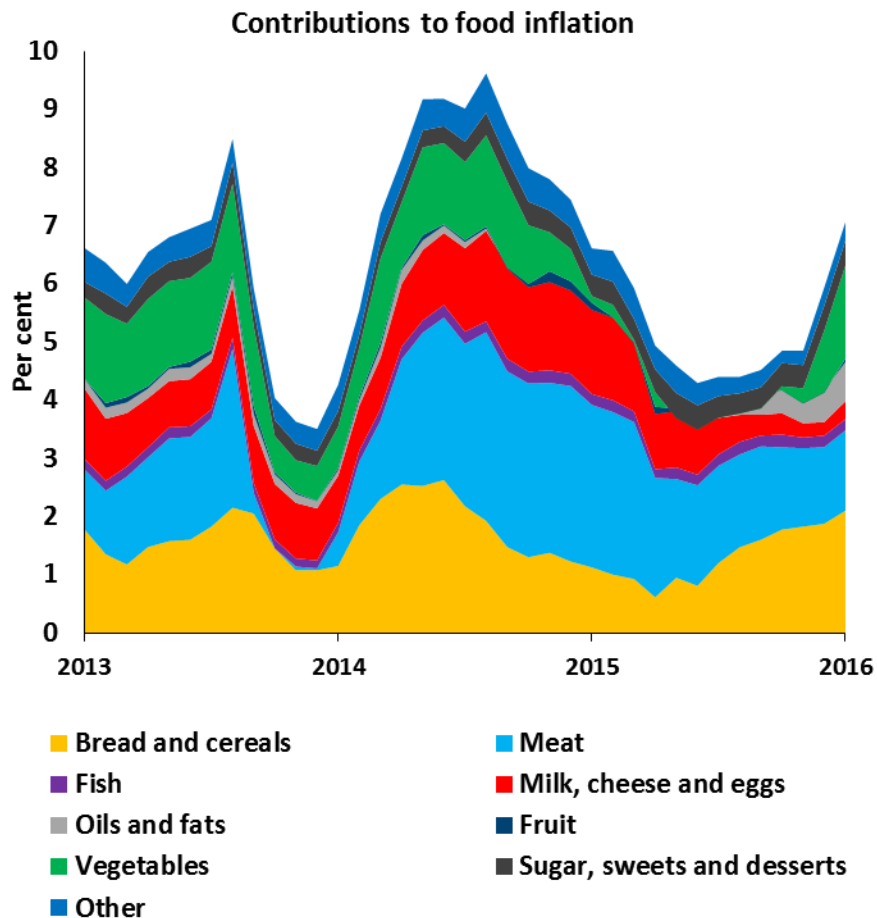
## ... with the breach expected to last until late 2017



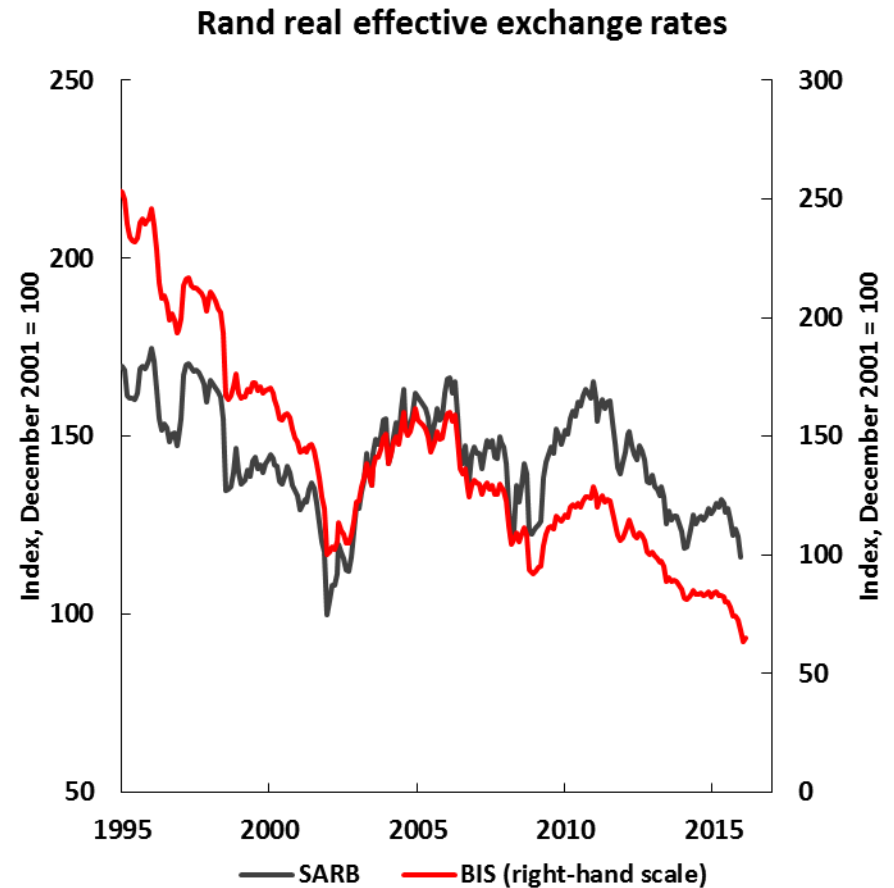
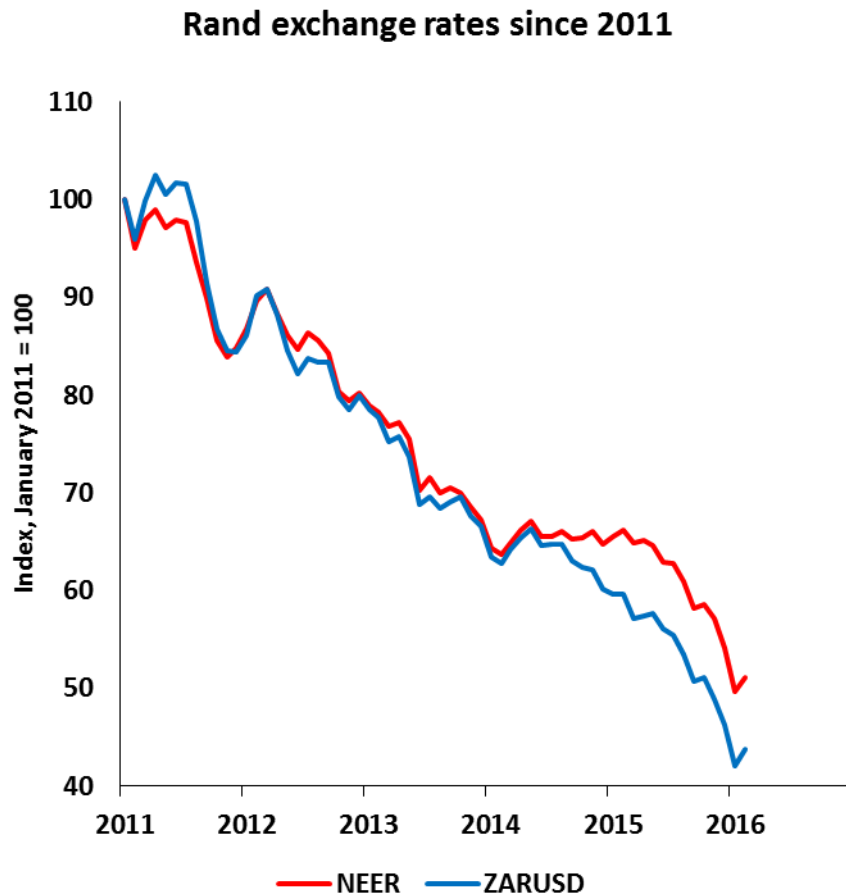
## Falling oil prices lowered inflation in 2015, but core only moderately affected



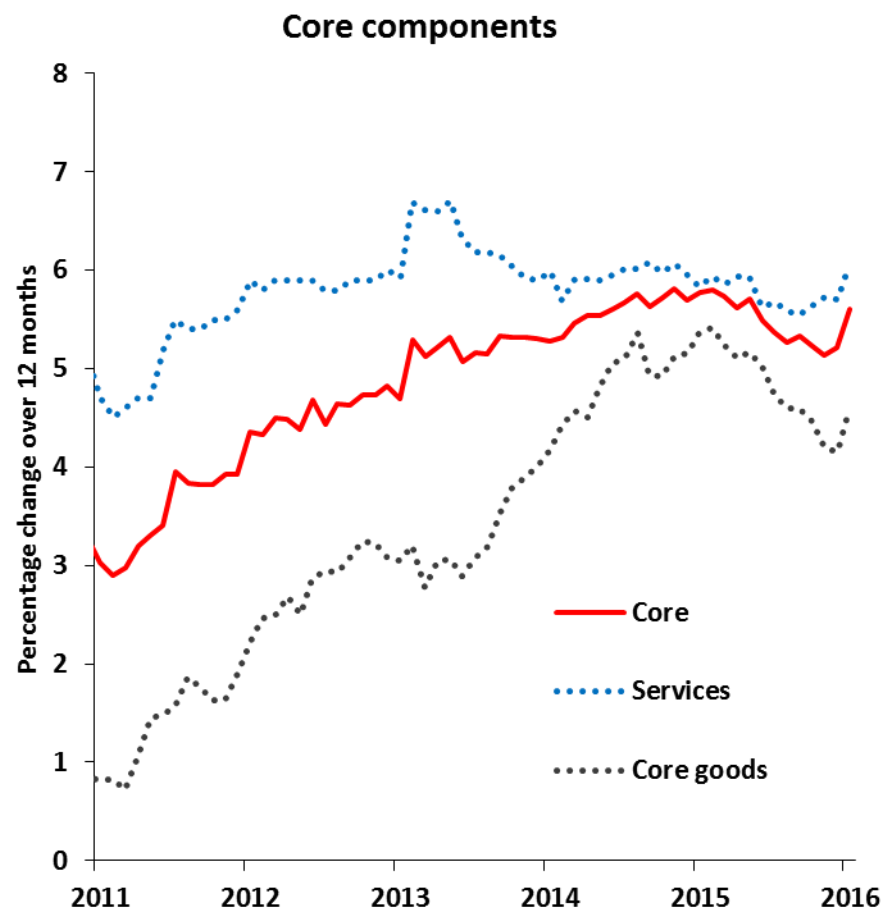
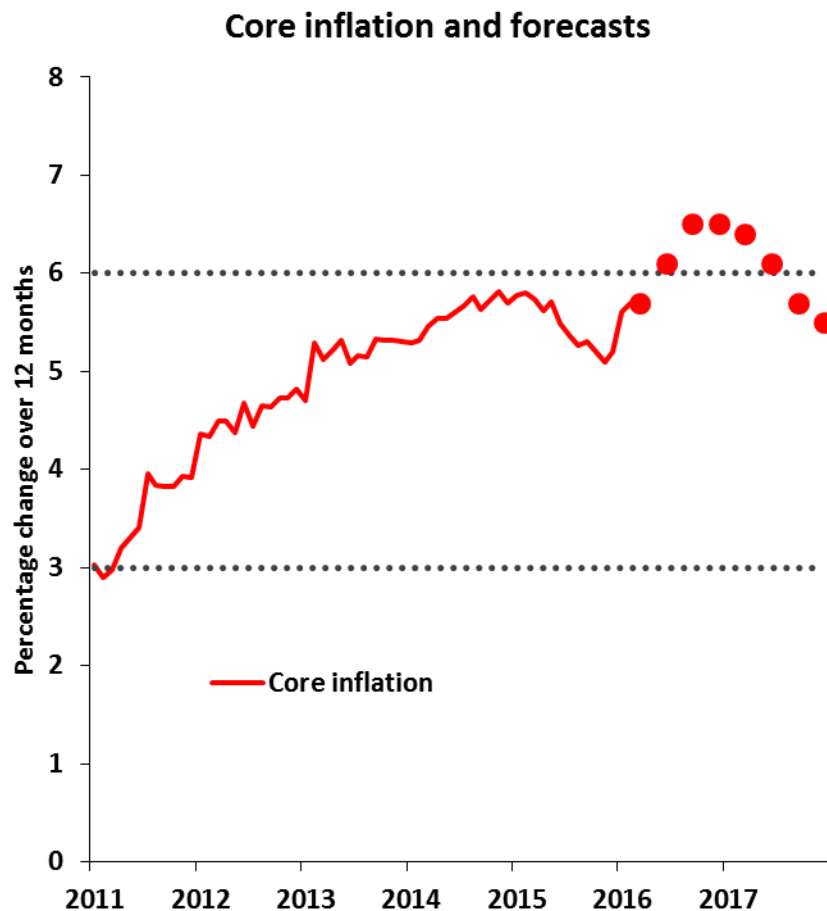
## Food prices are increasing rapidly, due to exchange rate and drought



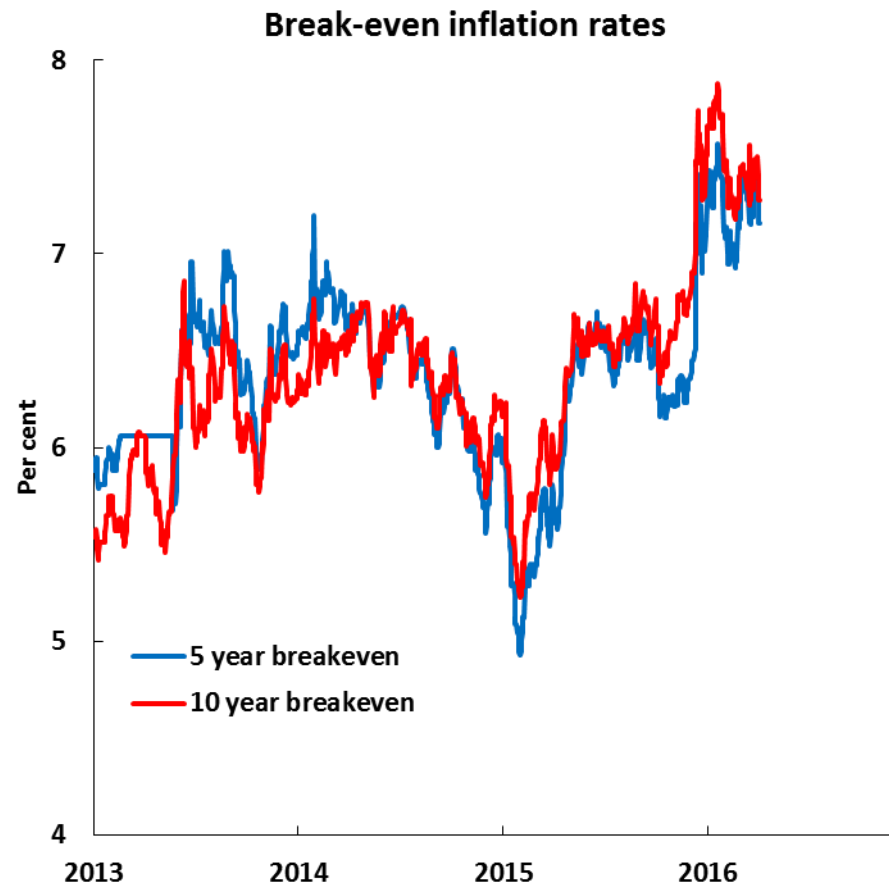
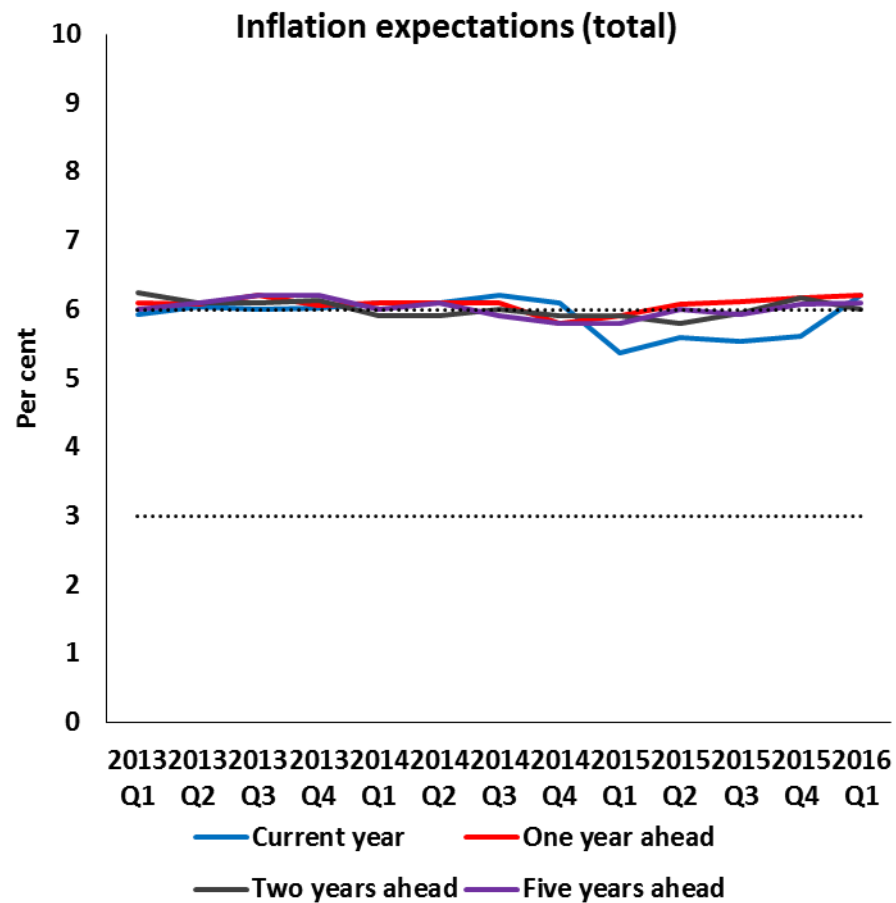
## The exchange rate has weakened sharply since the last *MPR*



## Following a slight dip in 2015, core is increasing again

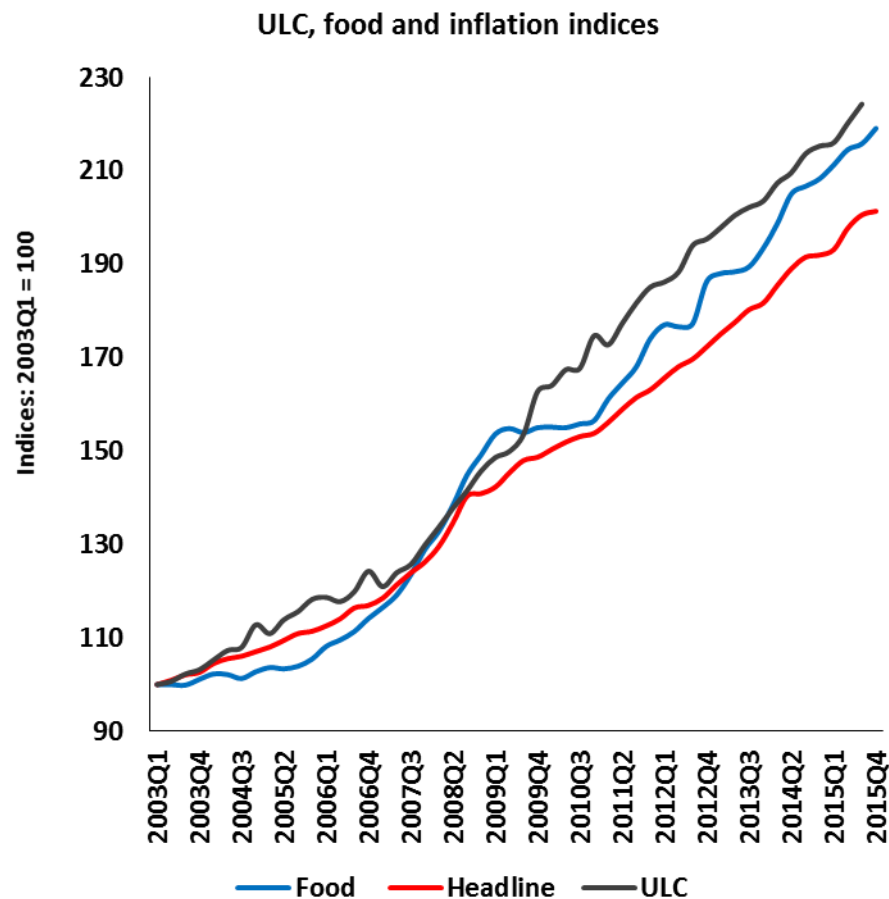
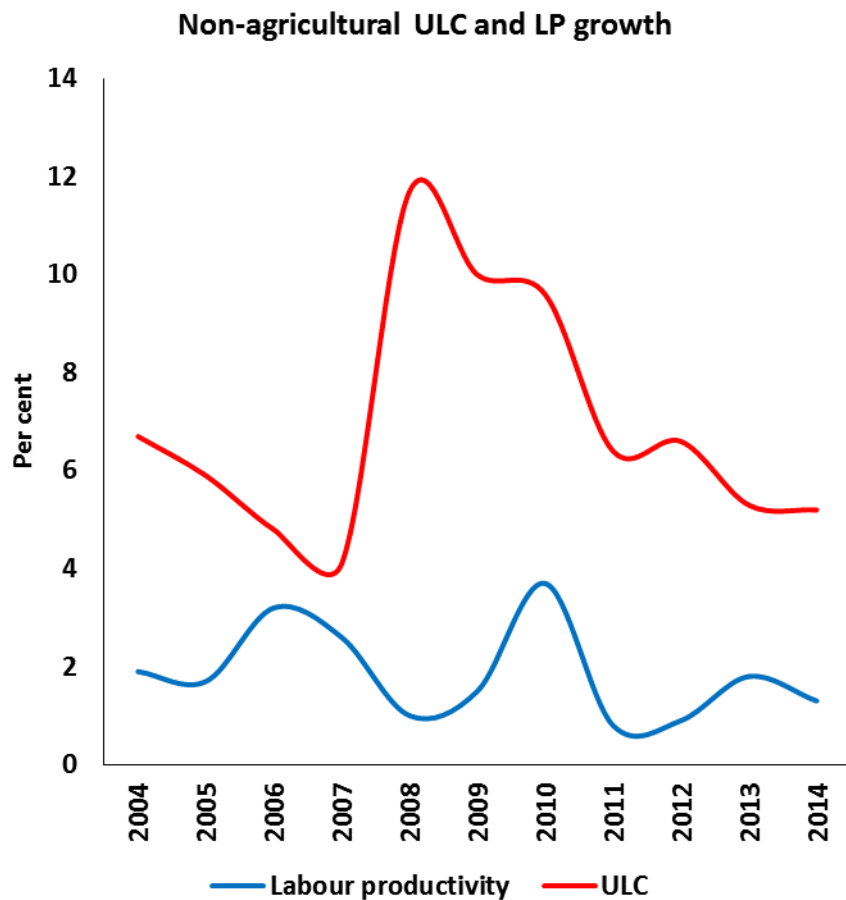


# Inflation expectations are elevated





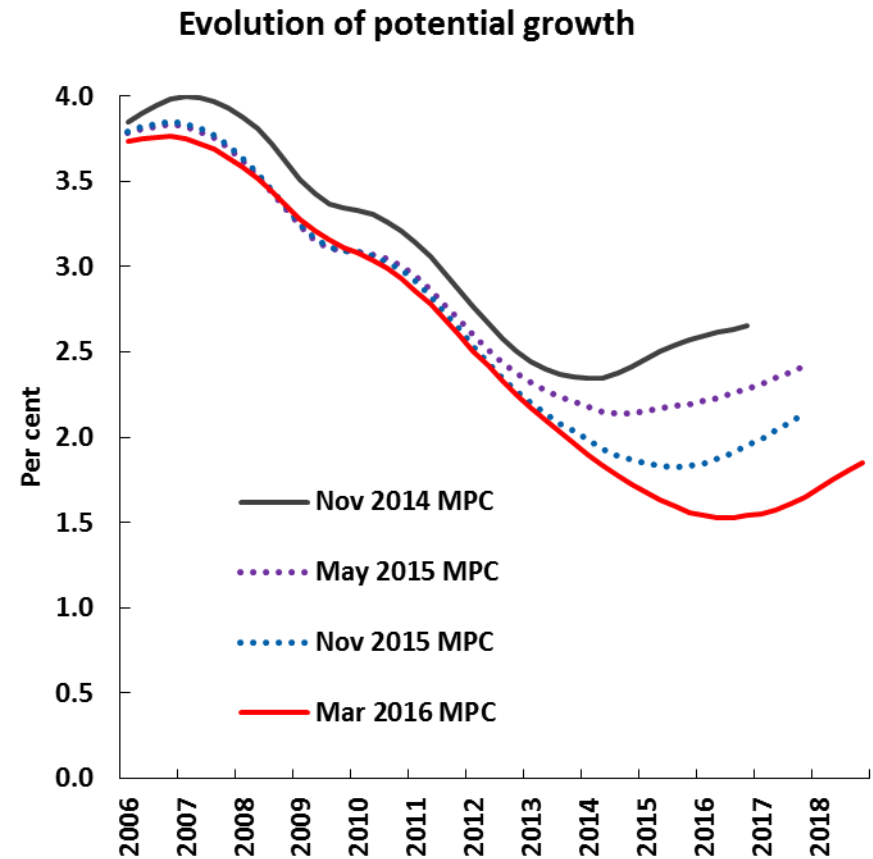
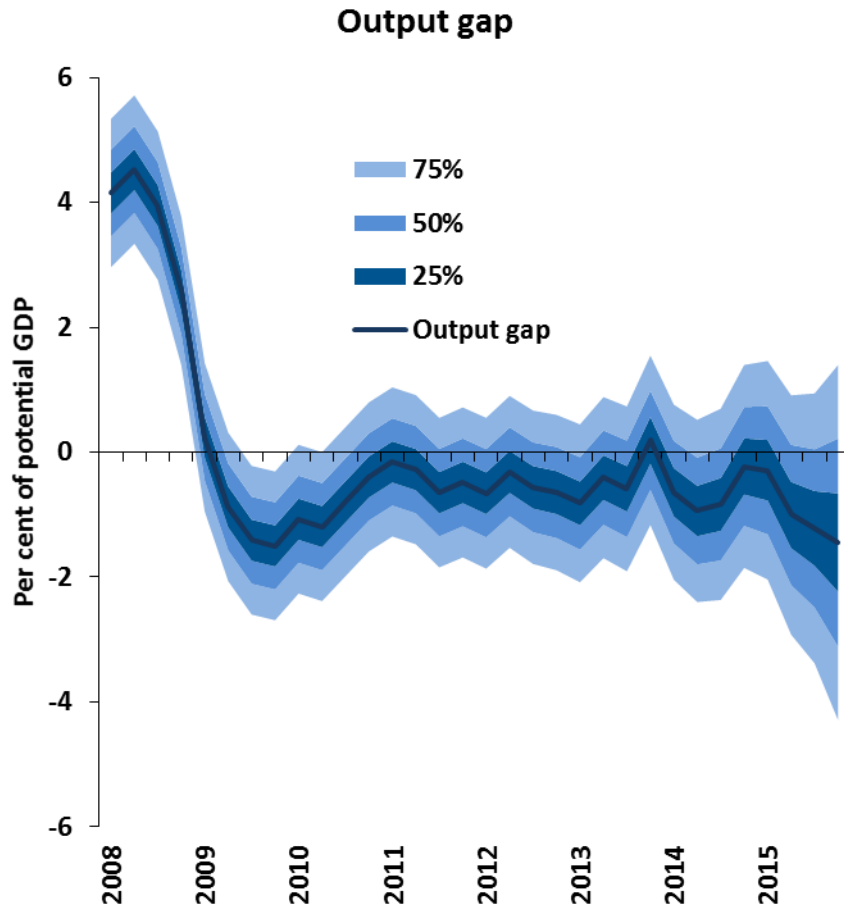
# Unit labour costs remain a persistent source of underlying inflationary pressure



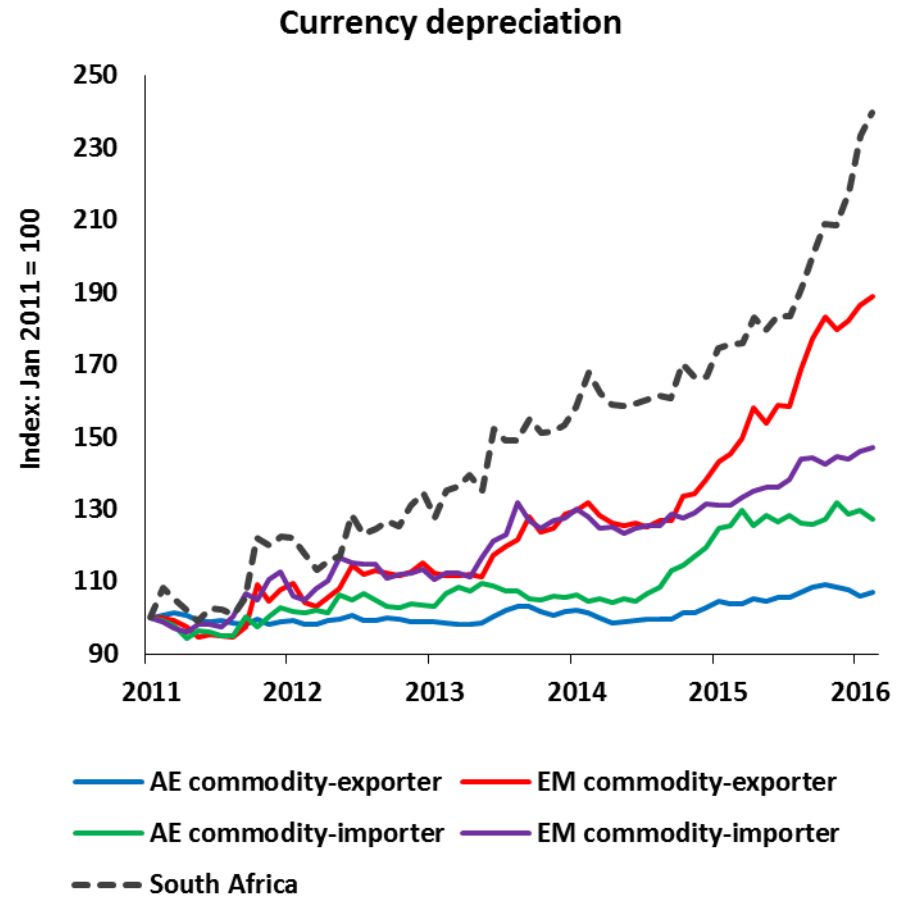
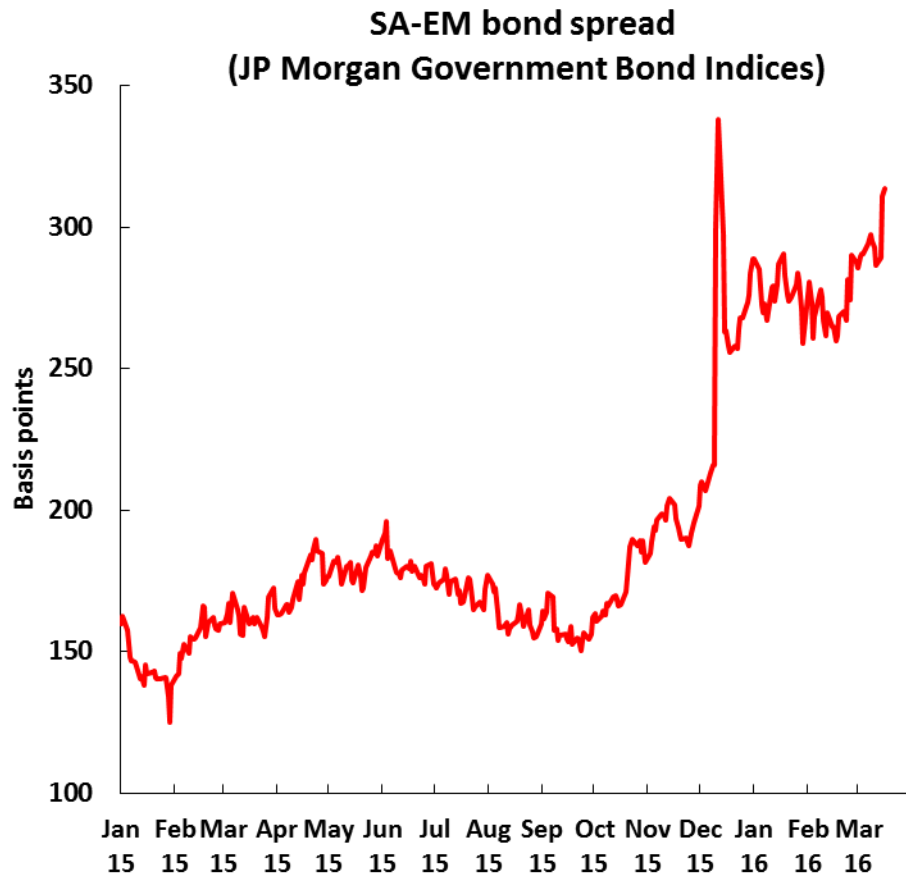
## Policy stance

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## Slower growth widens the output gap, but size is uncertain & potential growth falling



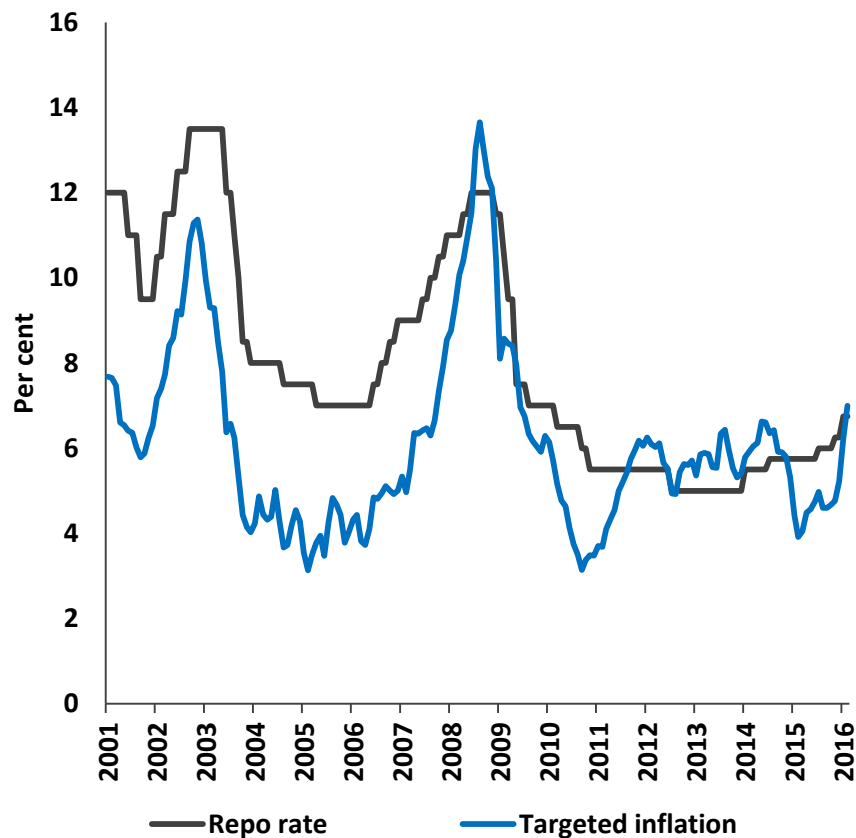
## Imbalances and financing costs contribute to inflation risk



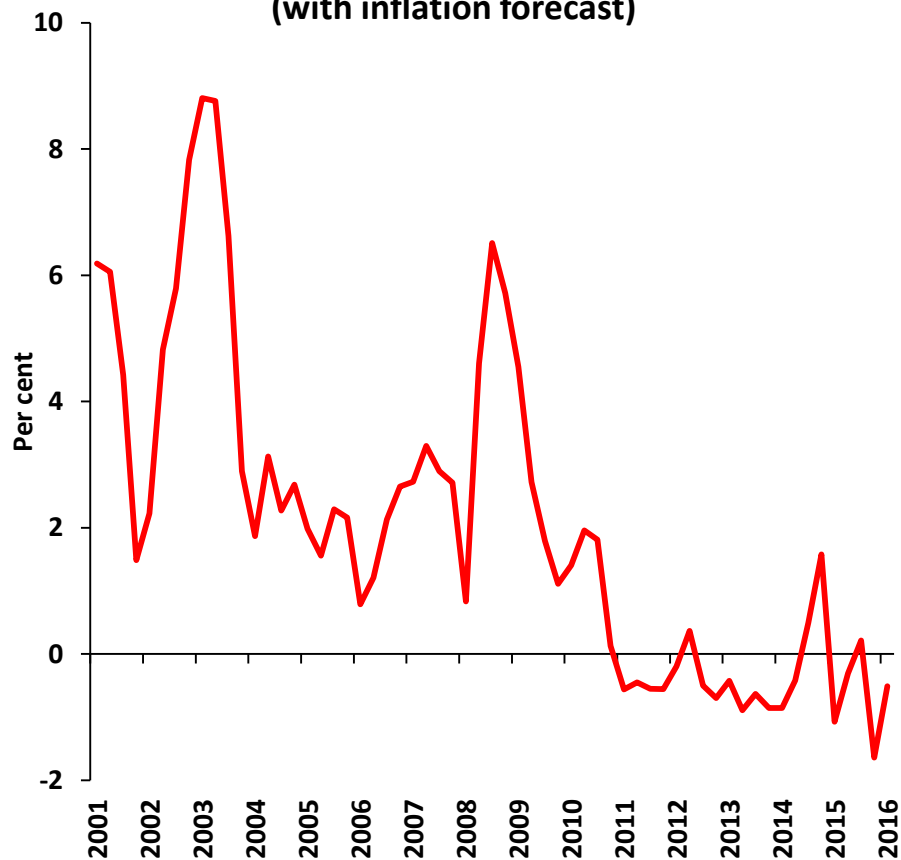
Source: JP Morgan, Bloomberg, SARB and own calculations

## Repo still low in historical perspective and in real terms

Repo rate and targeted inflation

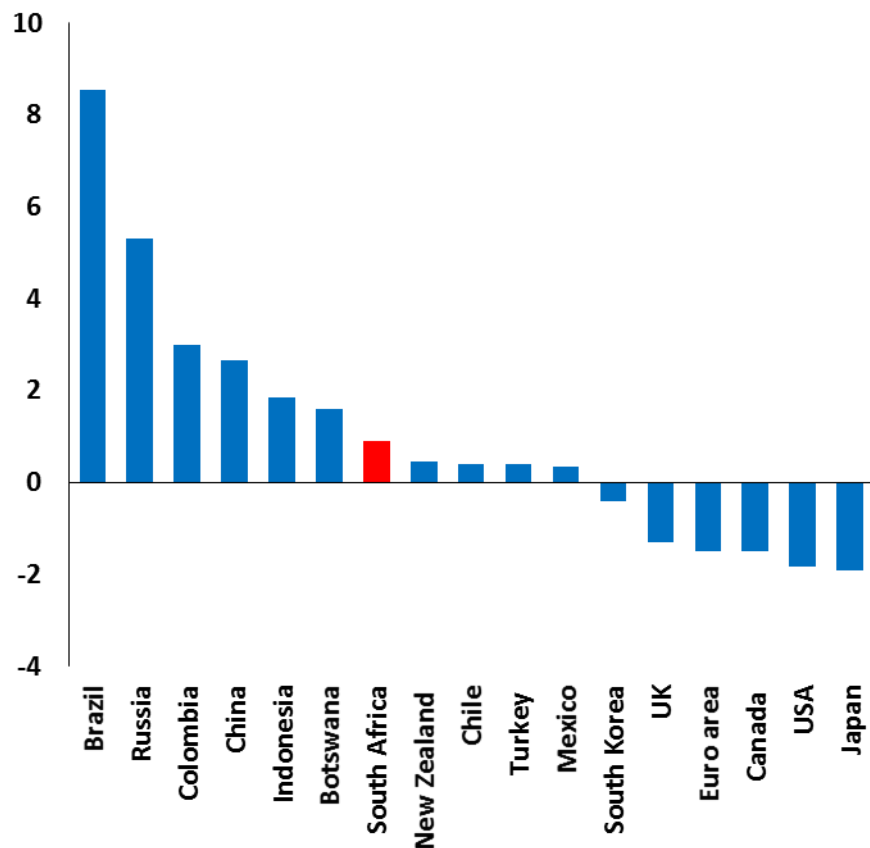


Real repurchase rate  
(with inflation forecast)

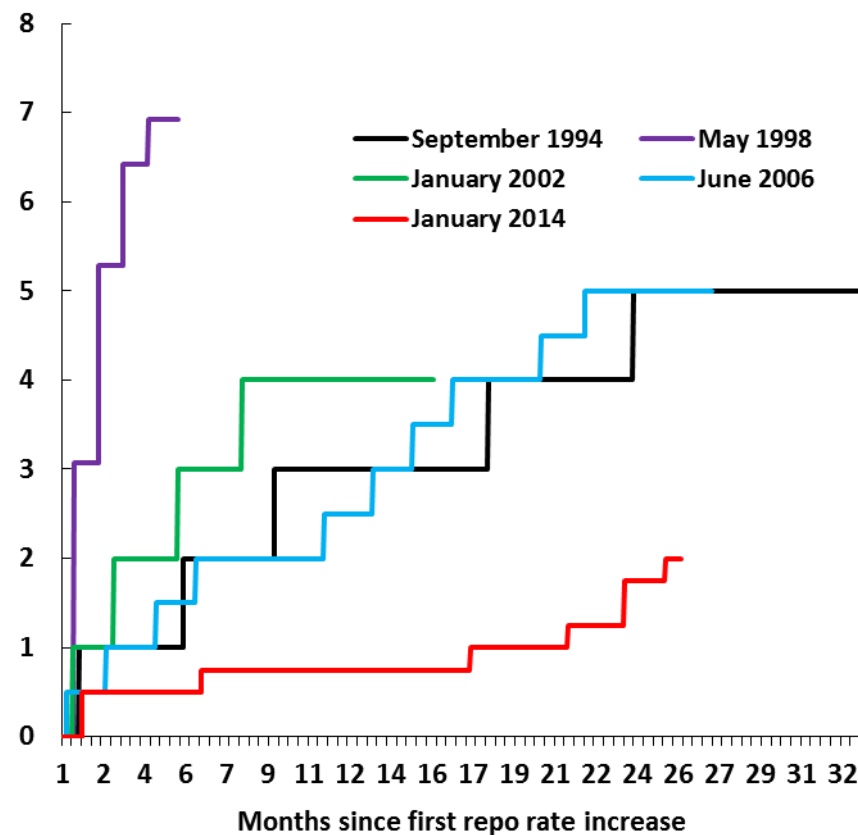


## Policy adjustment remains gradual

Real policy rate (2017 CPI forecasts)



Cumulative change (Percentage points)



## Conclusion

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- Economy weak, with incremental recovery expected
- Policy settings generally supportive for short-run growth
- Inflationary pressures rising; target breaches expected through 2016 and 2017, creating risks to long term economic growth
- Inflation risks lie in global volatility, normalisation, pass-through, oil, food and ULCs
- Policy change to better guide expectations & to minimise second-round effects