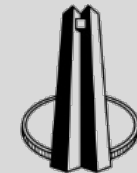


National Monetary Policy Forum

Chris Loewald, Head: Policy Development and Research

10 April 2016 · Pretoria



South African Reserve Bank

In the April 2017 *MPR*

- Executive summary & overview of the policy stance
- Overview of the world economy
- Financial market developments (new chapter)
- Overview of the domestic economy
- Overview of inflation developments and the forecast

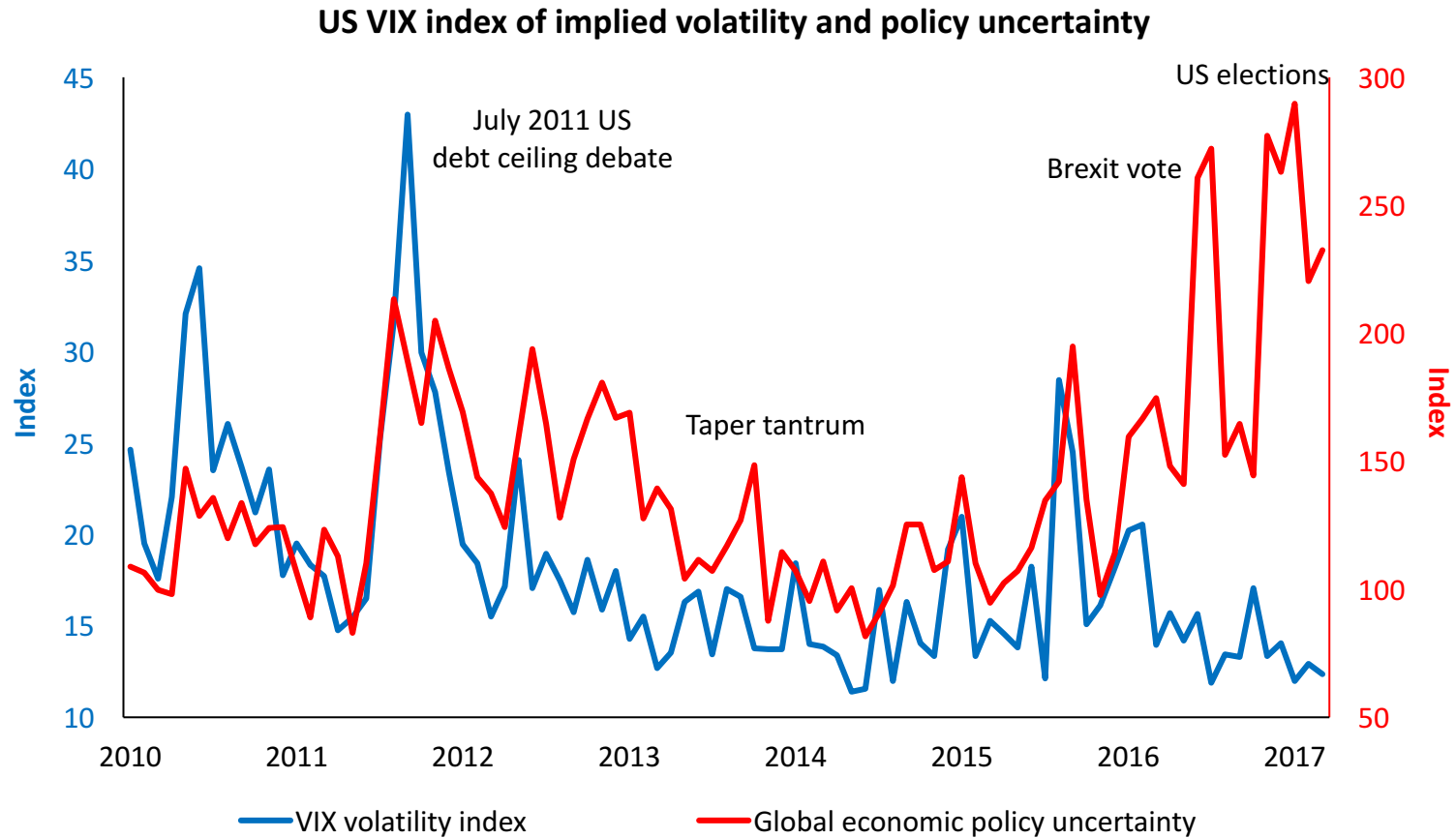
- Boxes:
 - Reweighting and rebalancing of CPI
 - Forecast accuracy compared with other forecasters
 - Asymmetric Phillips Curve

- Next MPR release: 3 October

Overview

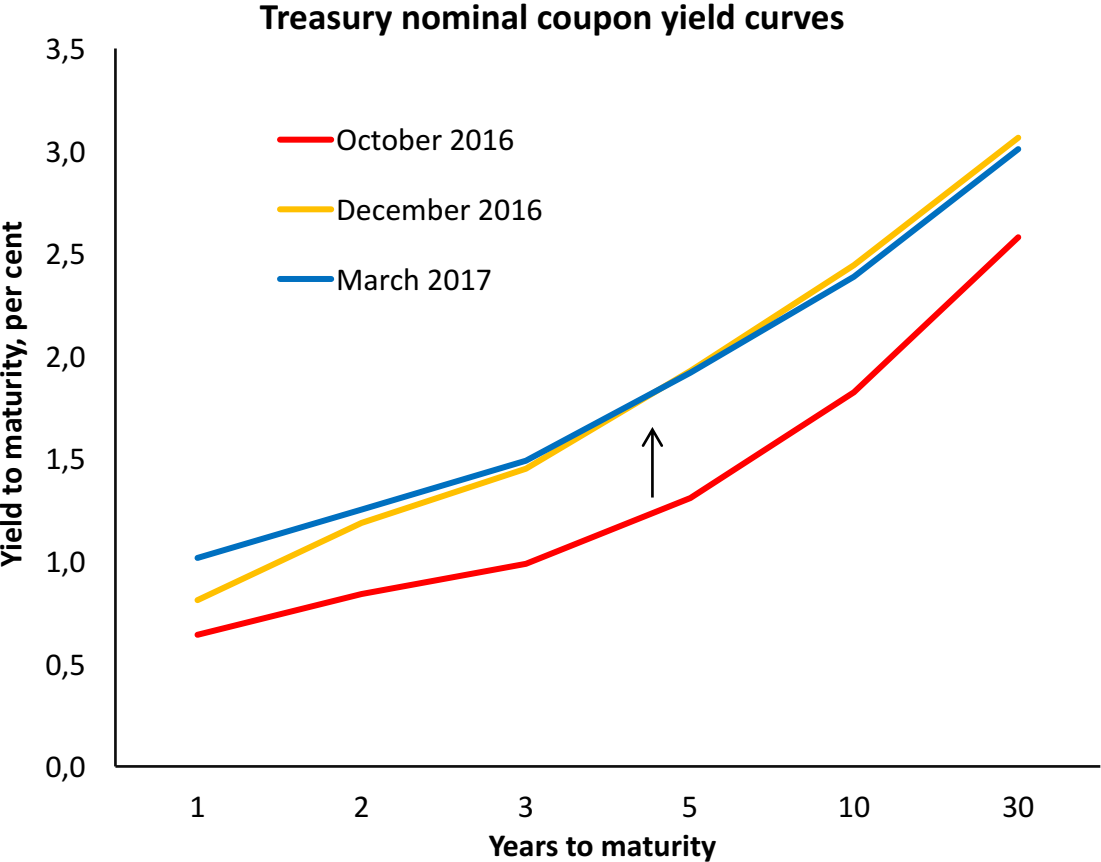
- **International economy**
 - High policy uncertainty, but very low volatility
 - World growth above trend, and inflation generally returning to targets
- **Domestic economy**
 - Growth has probably bottomed, but the forecast recovery is not robust
 - Macroeconomic imbalances have moderated
- **Prices**
 - Short term inflation volatile (oil, food)
 - Medium-term inflation forecast has been stable and benign...
 - ... but underlying inflation and inflation expectations remain elevated
- **Policy**
 - Repo stable at 7.0% since March 2016

Global policy uncertainty is high – but volatility is simultaneously unusually low

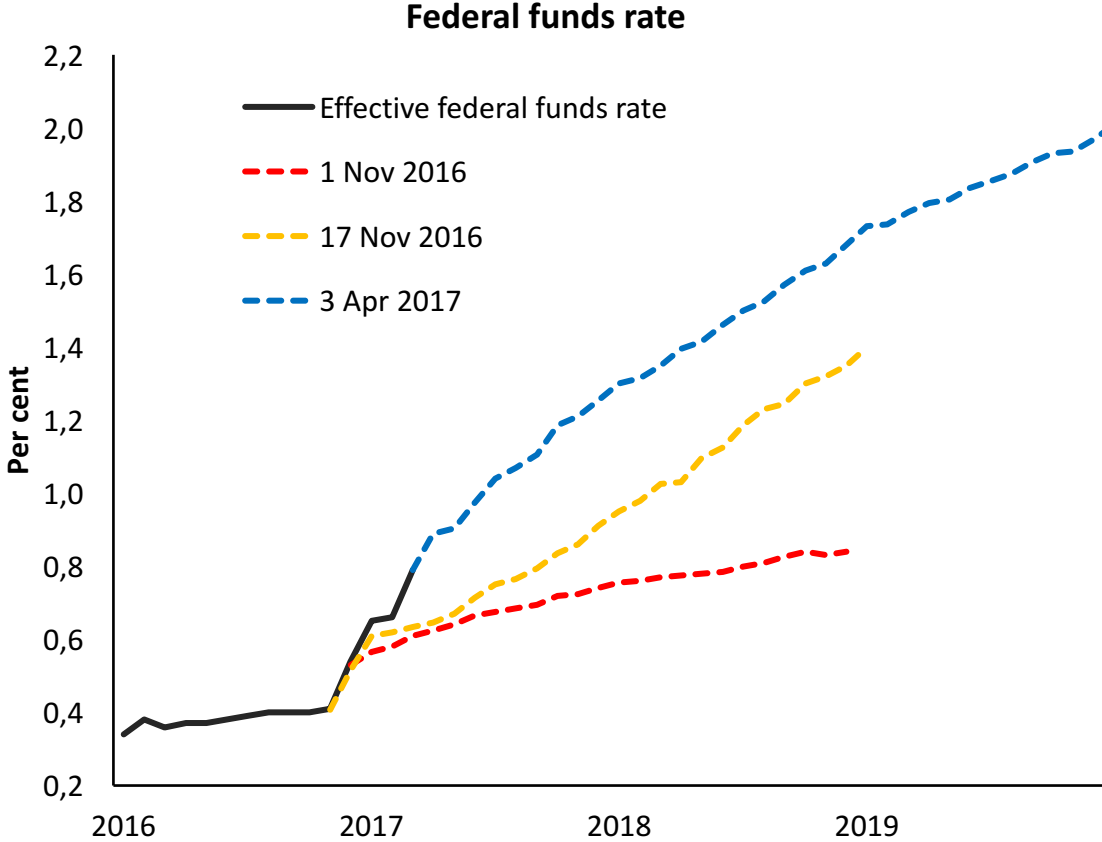


Sources: Baker, Bloom, and Davis (2016), and Bloomberg

Although the world risk-free interest rate is rising...

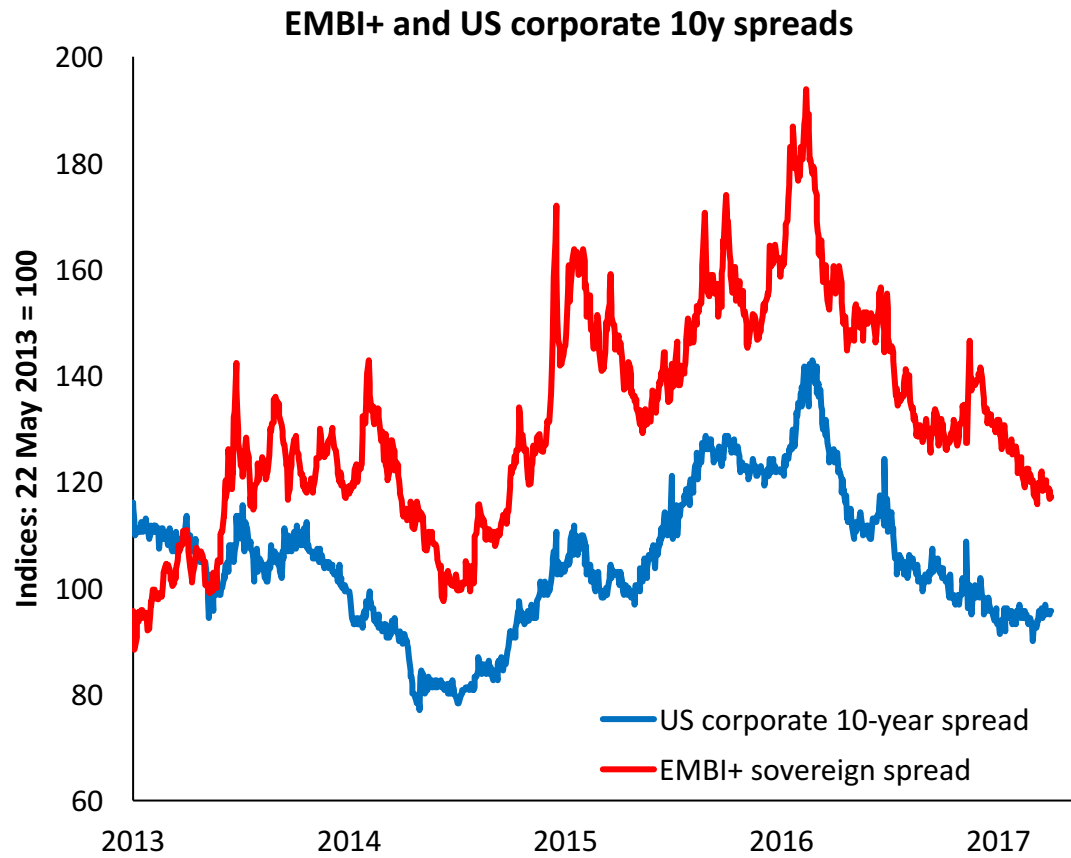


Source: Bloomberg

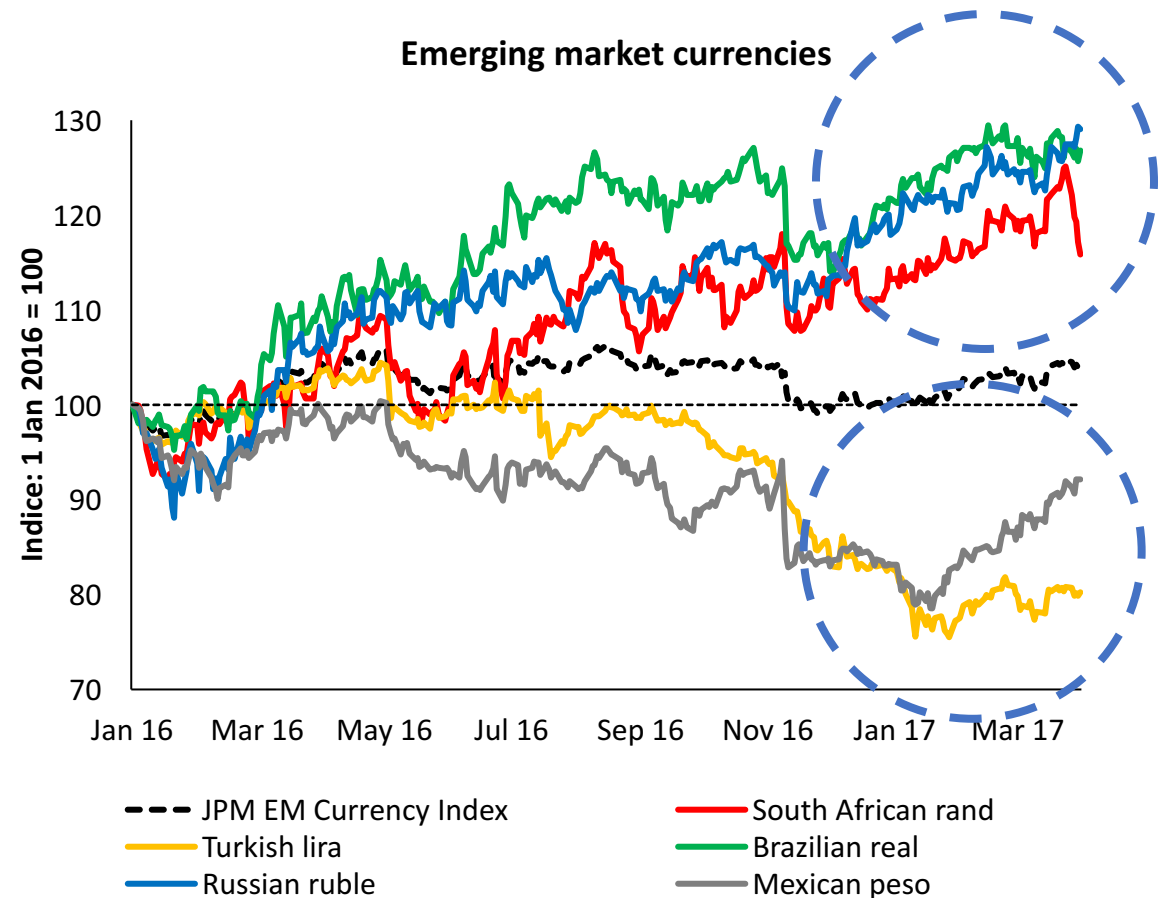


Sources: CME group, Federal Reserve and South African Reserve Bank

Riskier assets are doing well (with some exceptions)

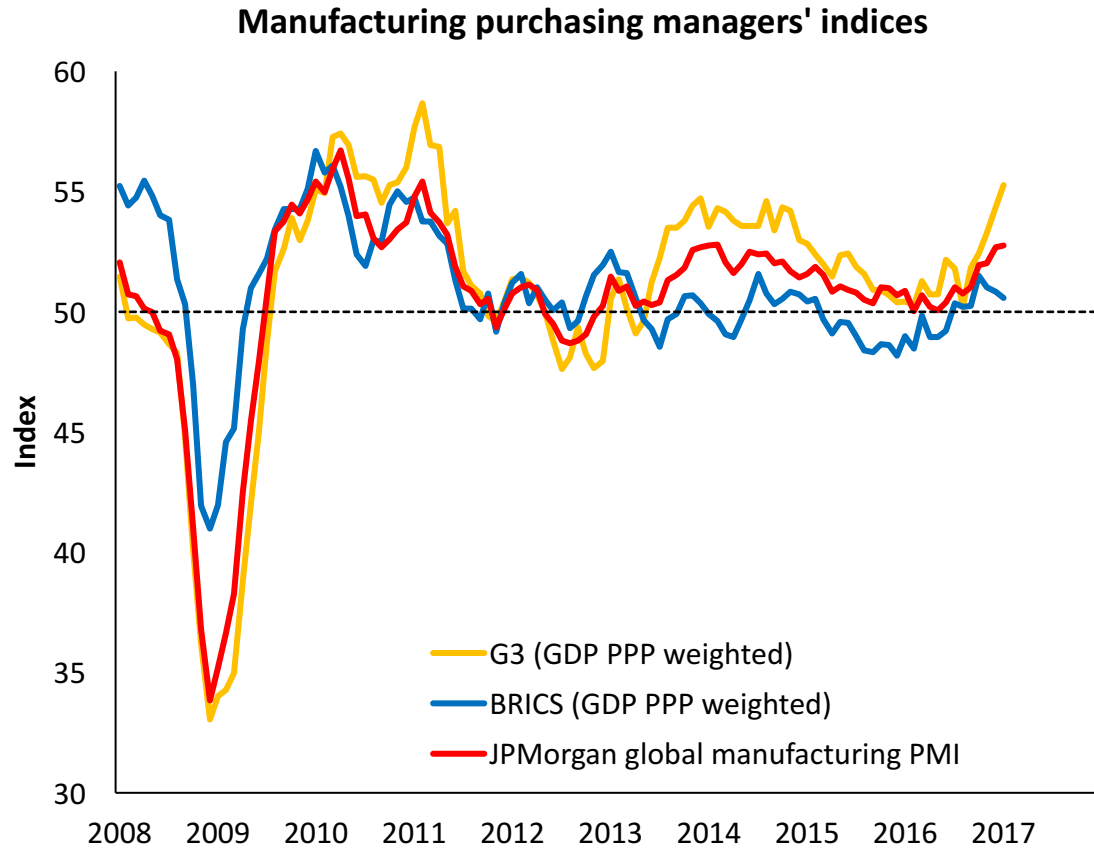


Source: Bloomberg

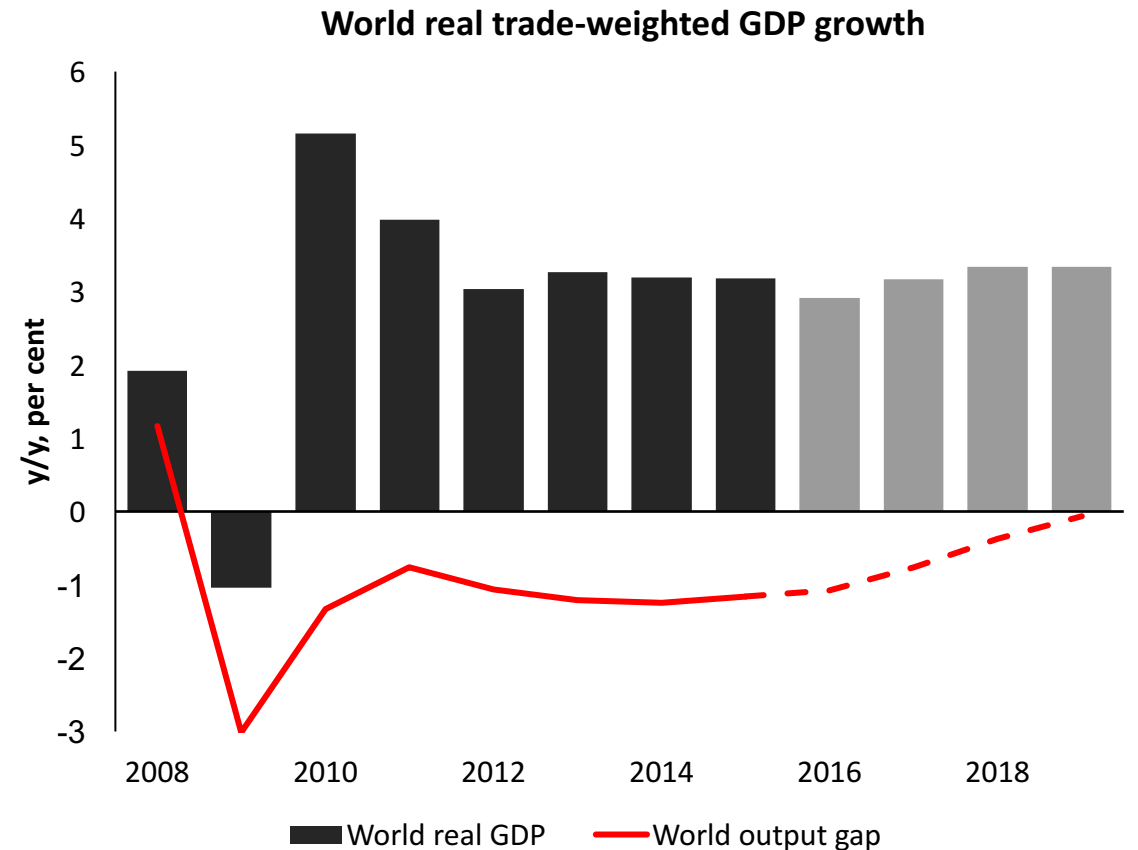


Sources: Bloomberg and South African Reserve Bank

This is probably explained by better fundamentals, with global growth improving and output gaps narrowing



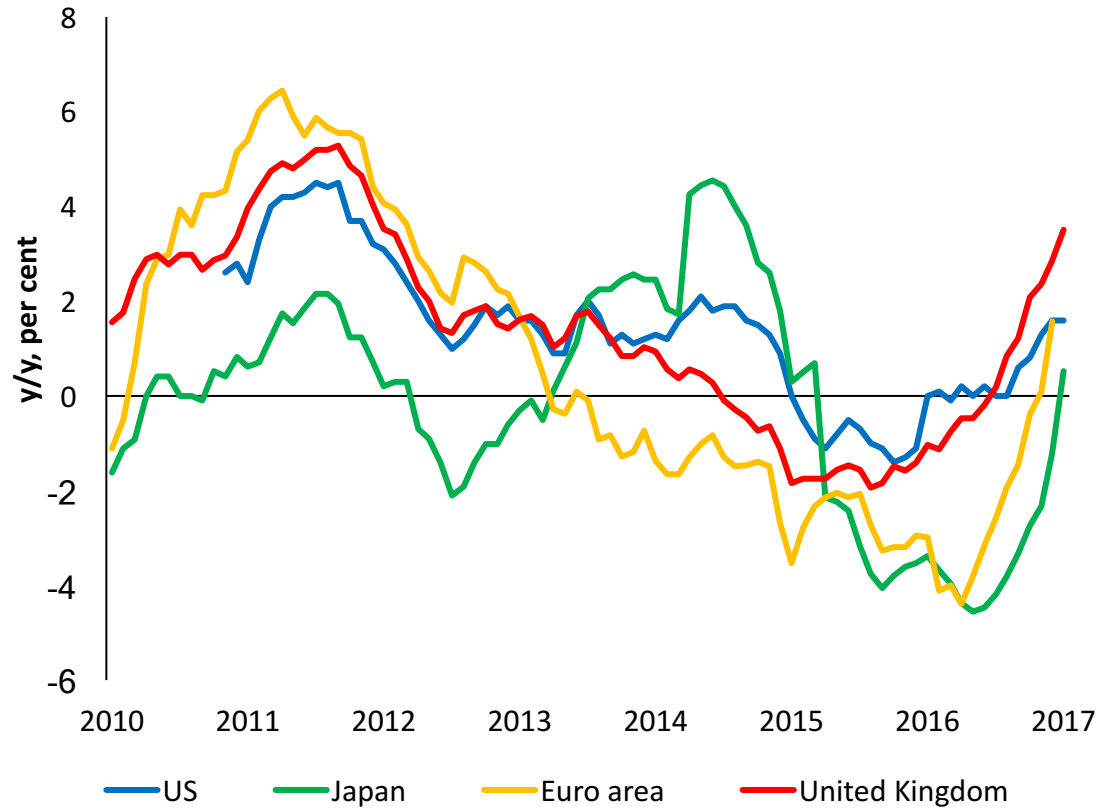
Source: International Monetary Fund, JPMorgan and own calculations



Source: International Monetary Fund and South African Reserve Bank

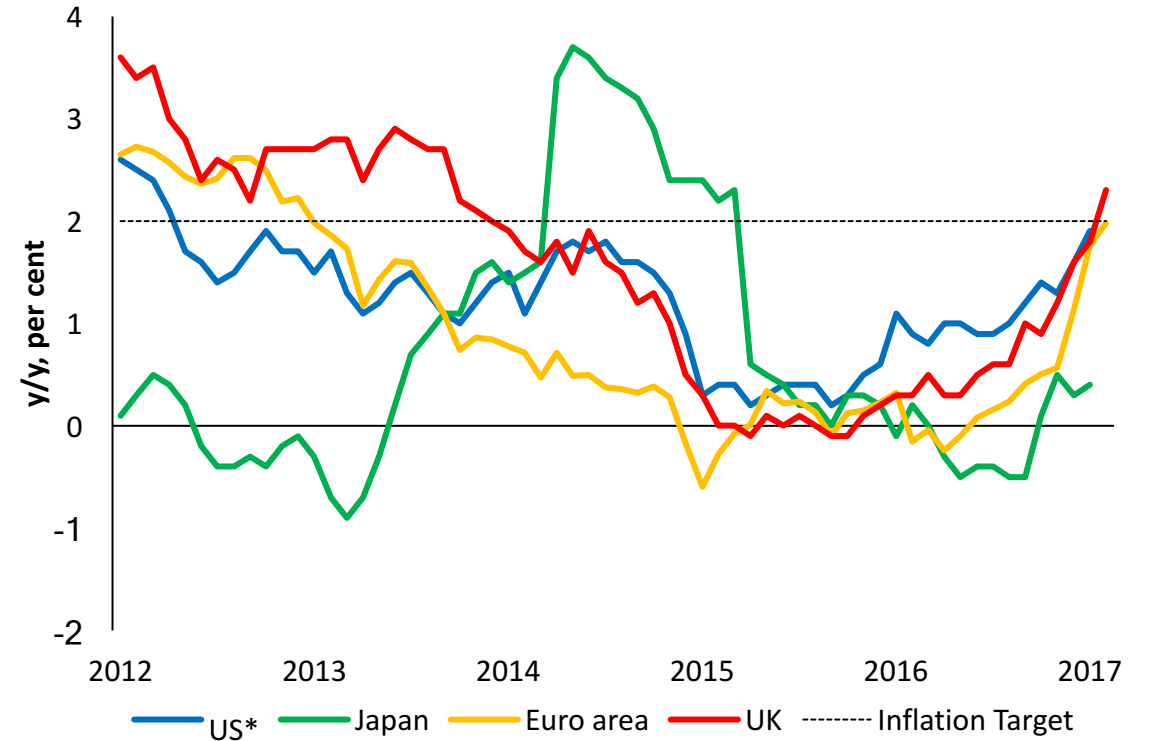
Inflation is moving back towards targets – from below in advanced economies...

Producer price inflation



Source: Haver Analytics

Headline consumer price inflation

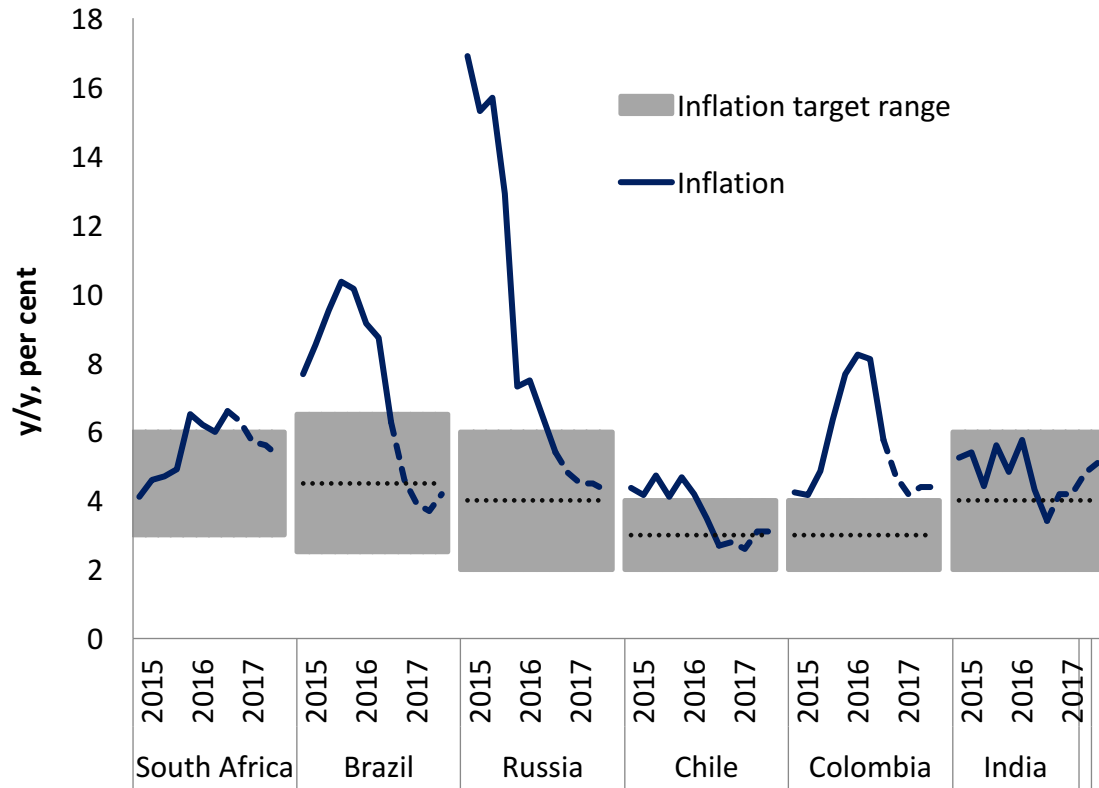


*Personal Consumption Expenditure deflator

Source: Bloomberg

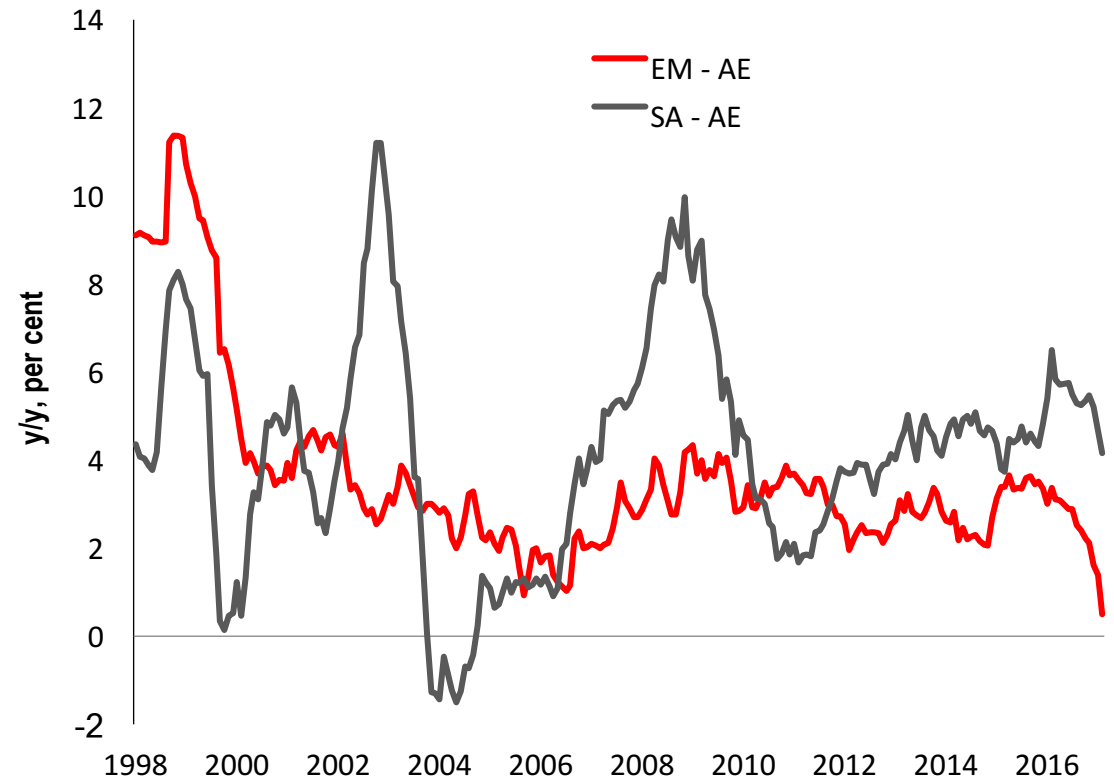
... and from above for many emerging markets

Actual and forecasted inflation and Central Bank rates



Source: Bloomberg and various central banks

Inflation spreads

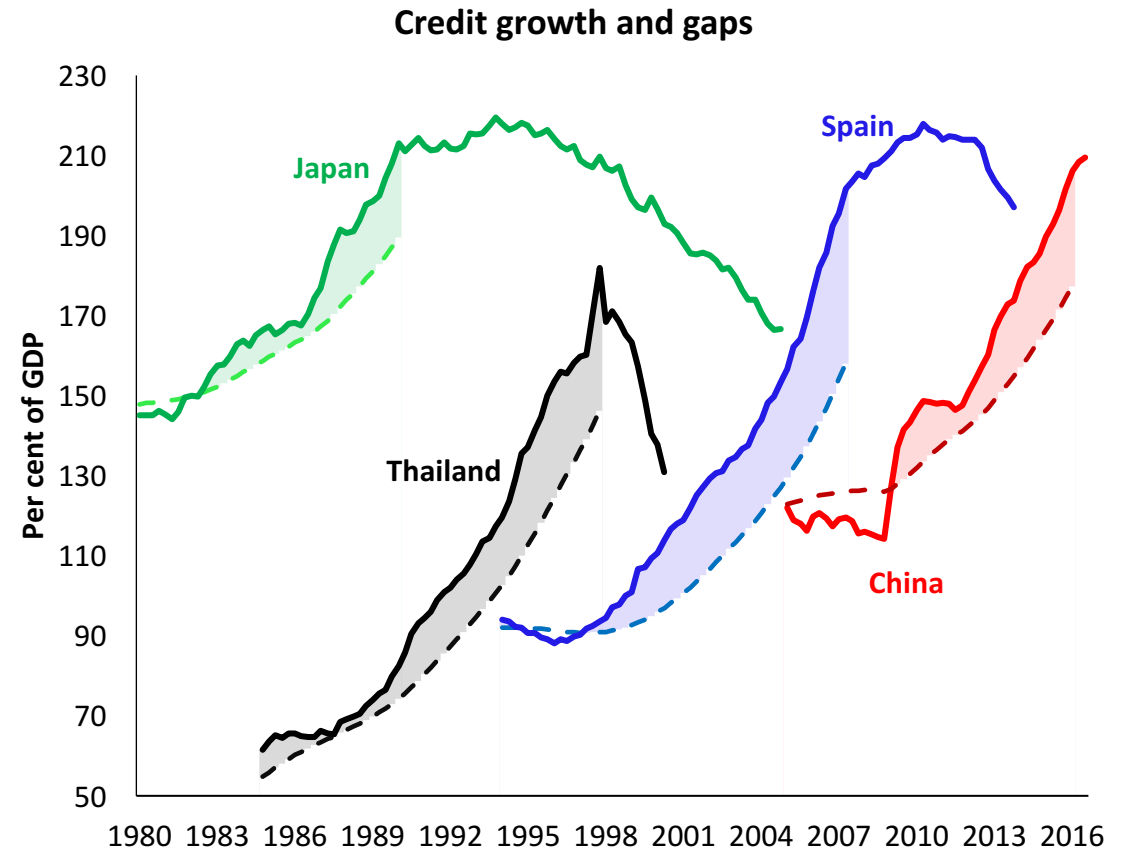


Source: JP Morgan, Statistics South Africa and South African Reserve Bank

Potential for upset? China's stimulus benefits short term growth but exacerbates imbalances

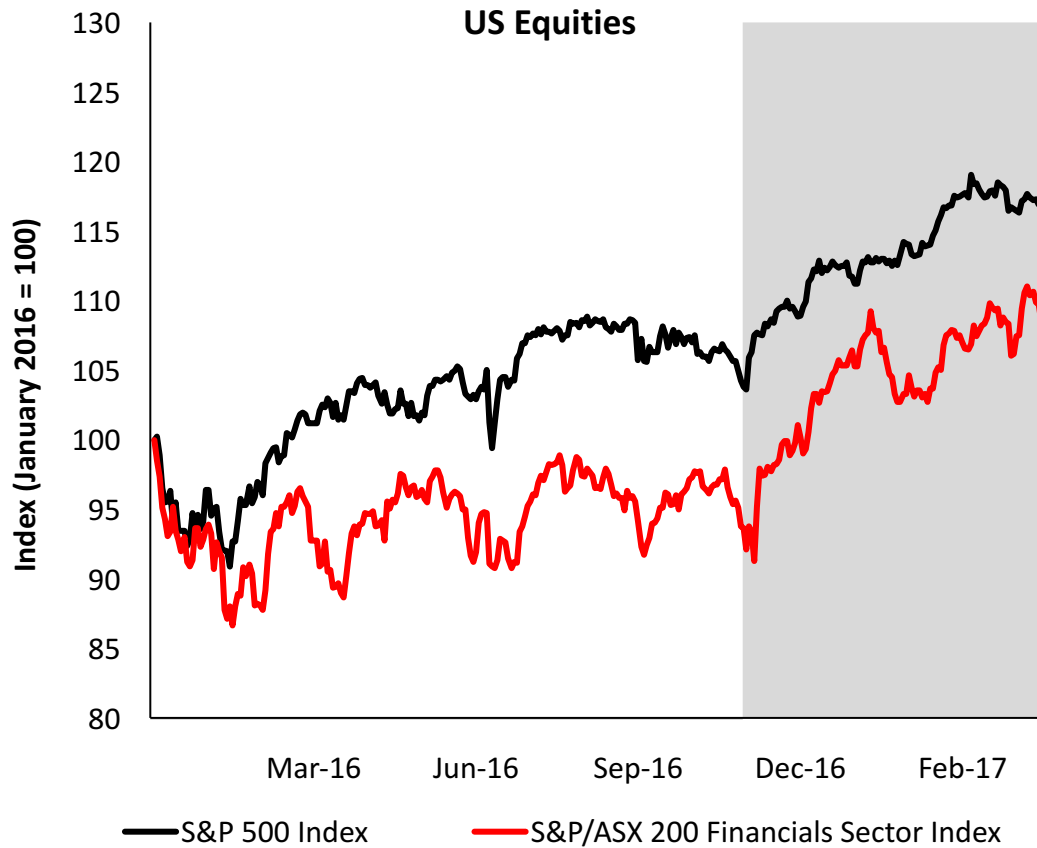


Sources: Bloomberg and South African Reserve Bank

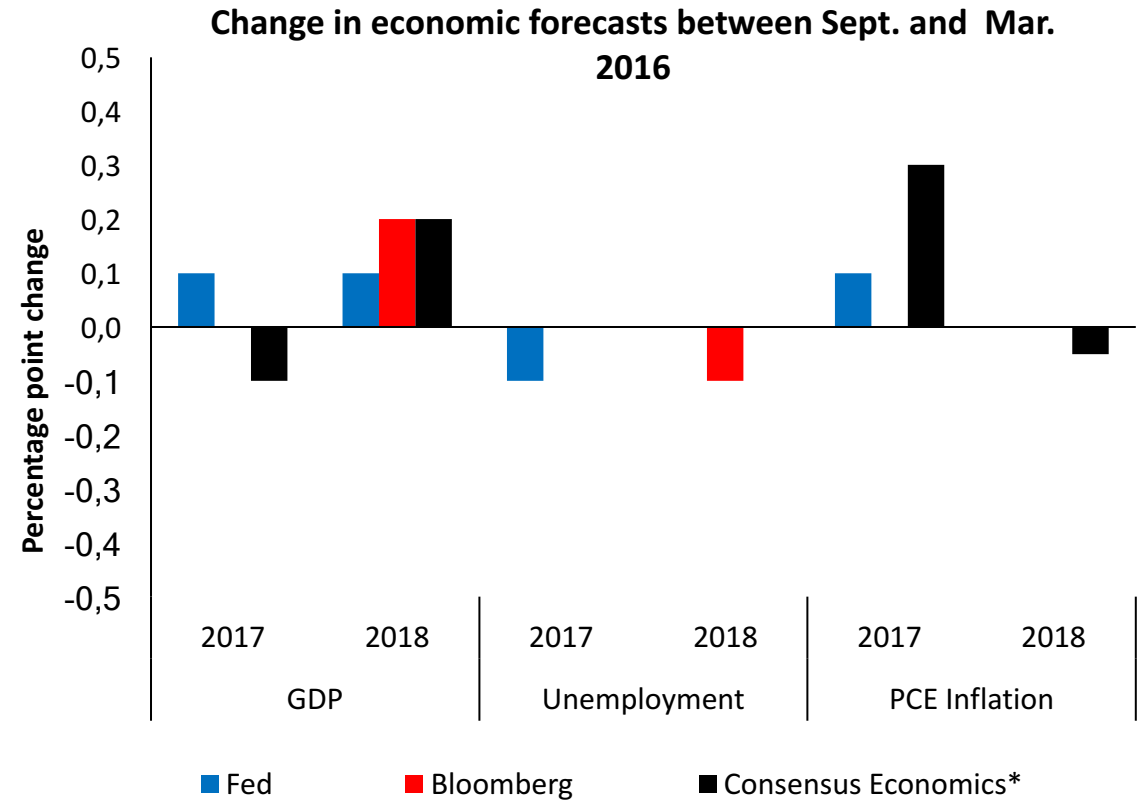


Sources: Bank for International Settlements and International Monetary Fund

In the United States, the new administration may do less for growth than markets now expect



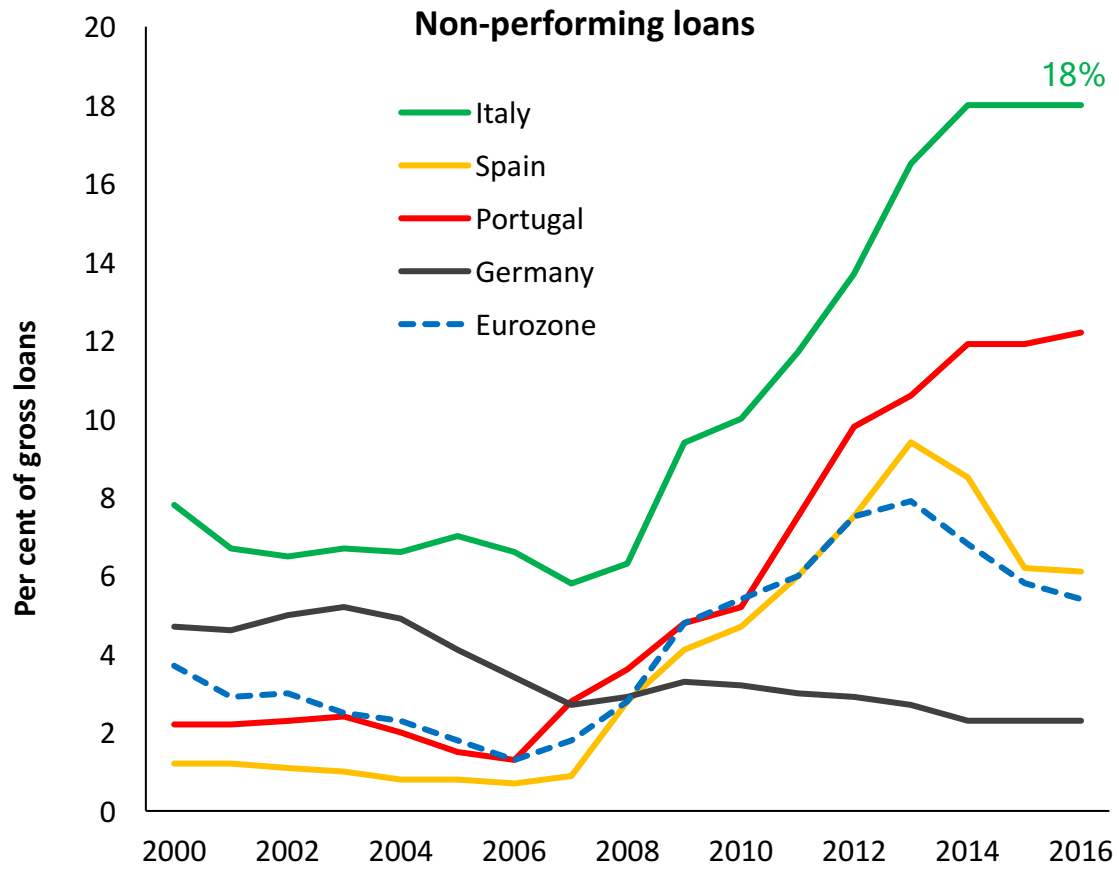
Source: Bloomberg



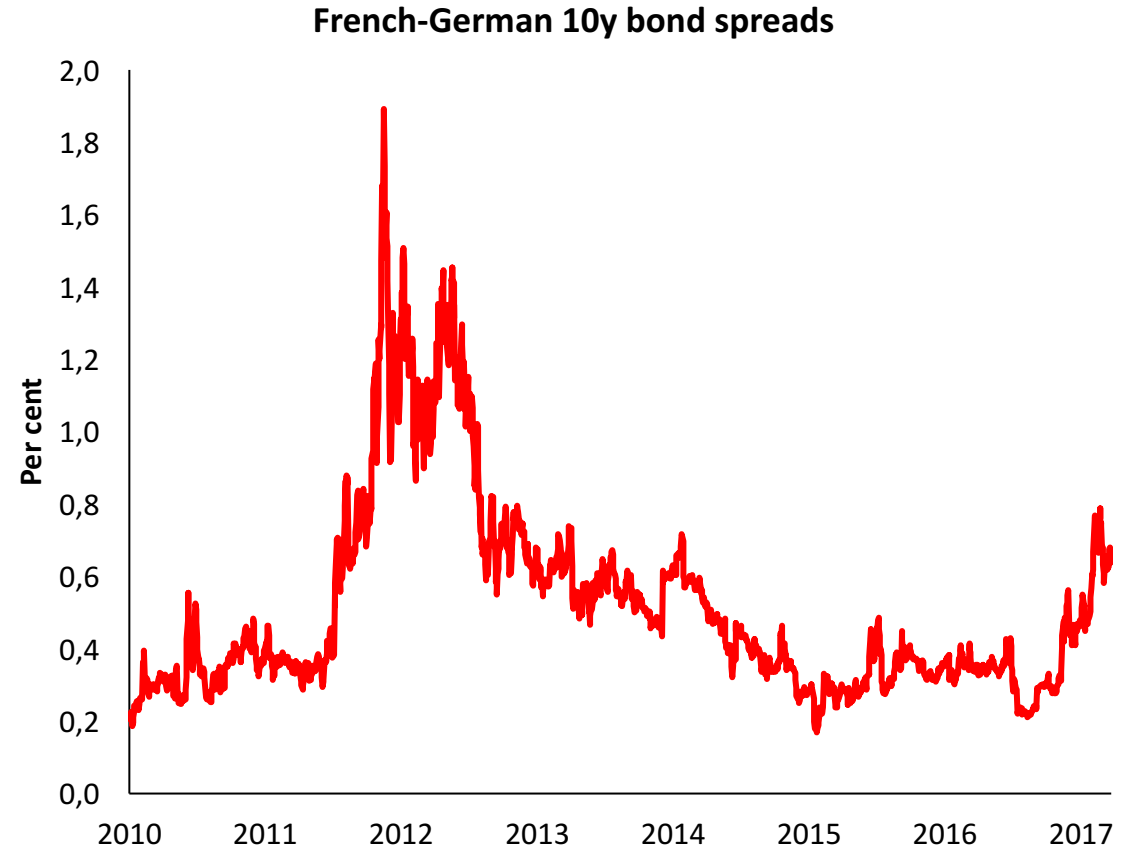
*No unemployment forecast is available.

Source: US Federal Reserve, Bloomberg, Consensus Economics, and South African Reserve Bank

European crisis is also far from resolved... Brexit, French polls, Italian banks and Greek debt

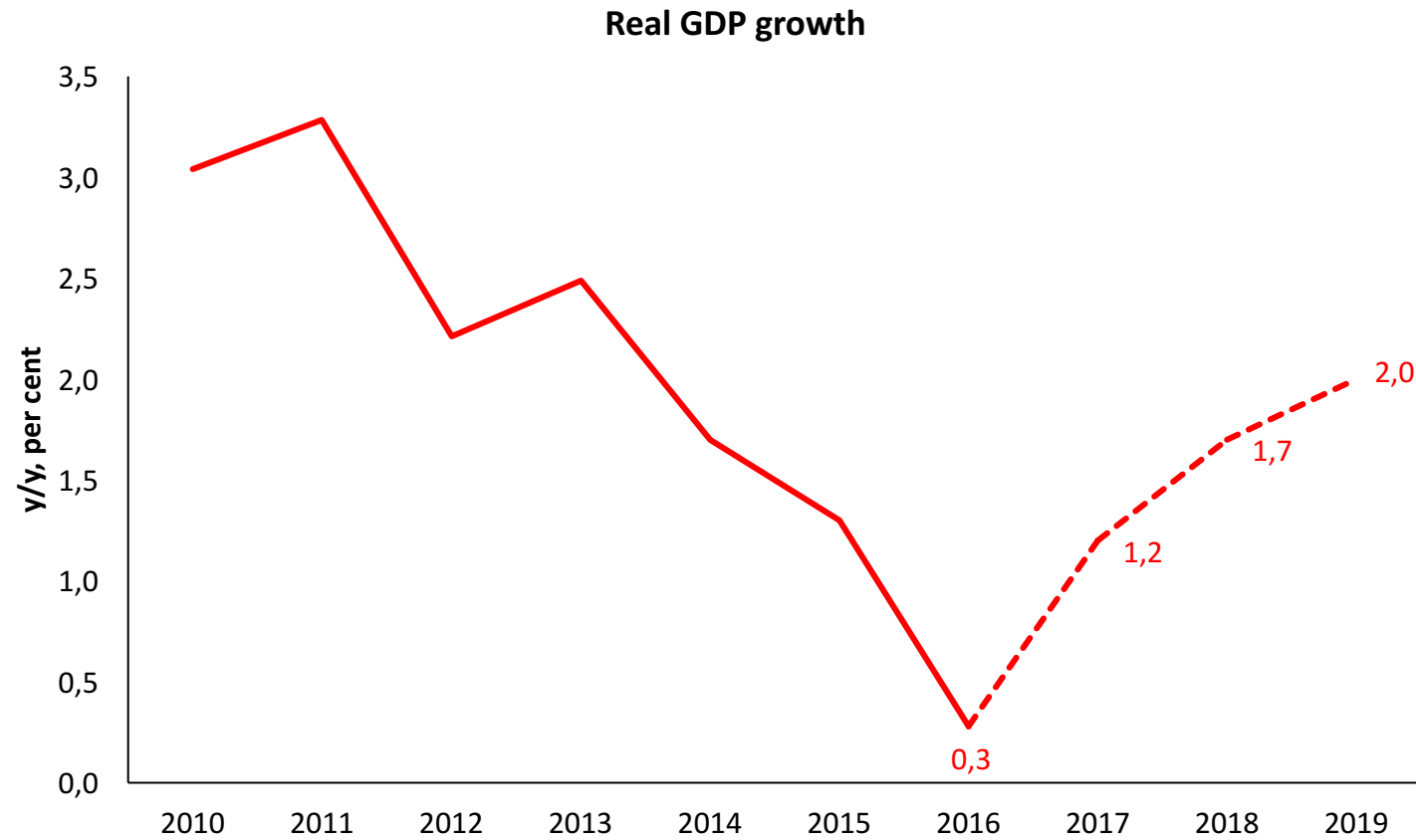


Source: Bloomberg



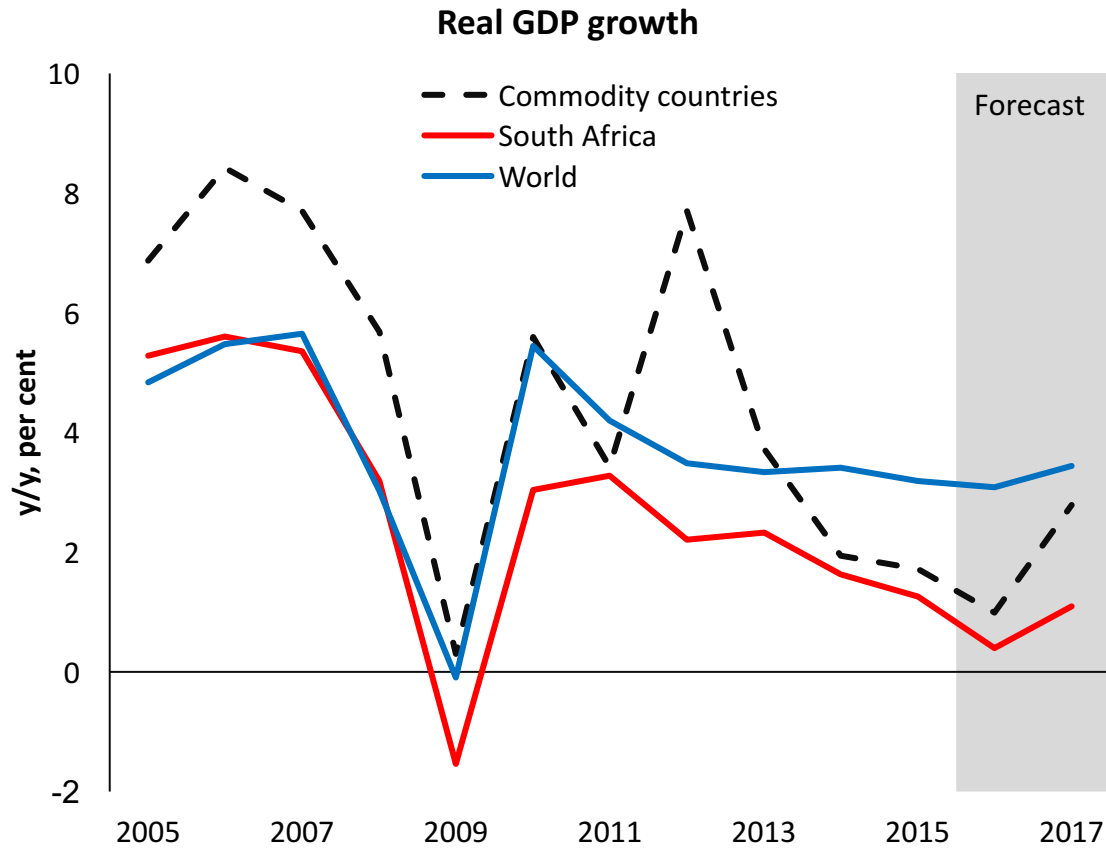
Source: Bloomberg and South African Reserve Bank

Growth in South Africa had been expected to pick up from just 0.3% in 2016

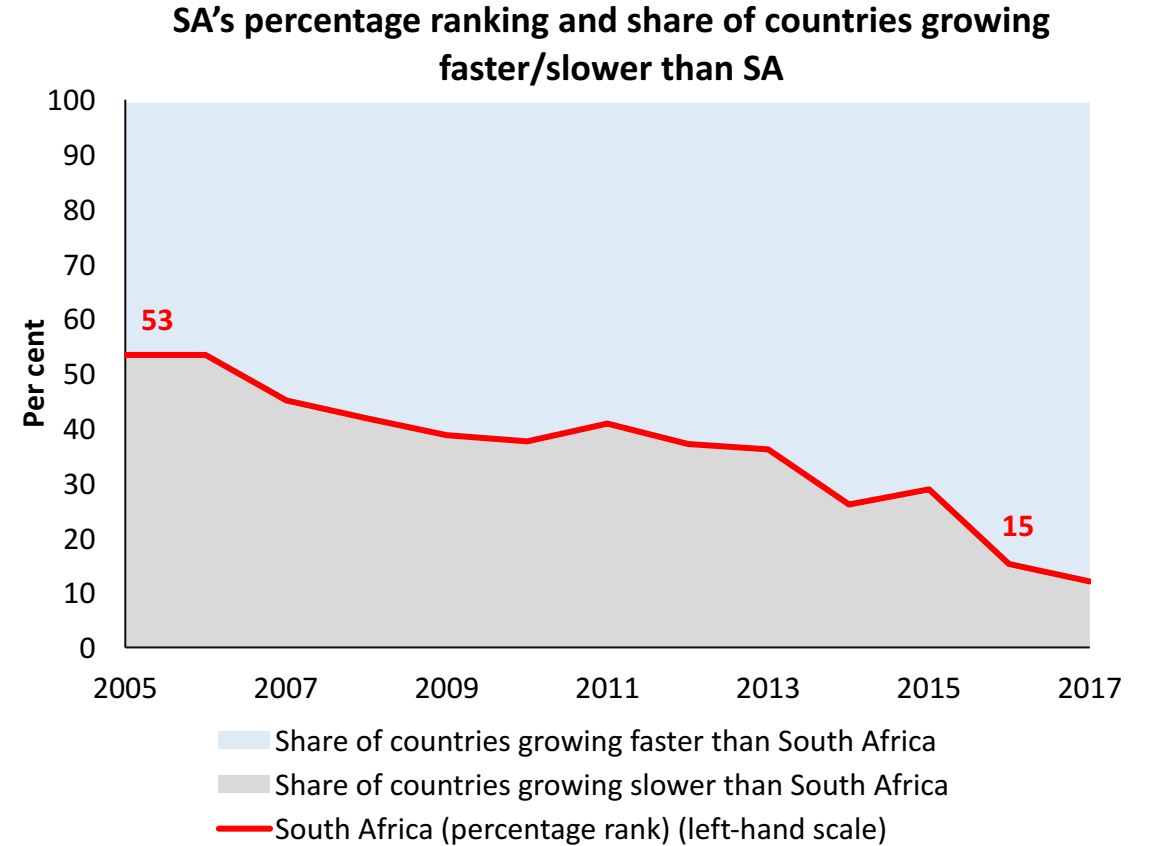


Source: Statistics South Africa and South African Reserve Bank

Recovery lags accelerations in other economies, and SA remains a global under-performer

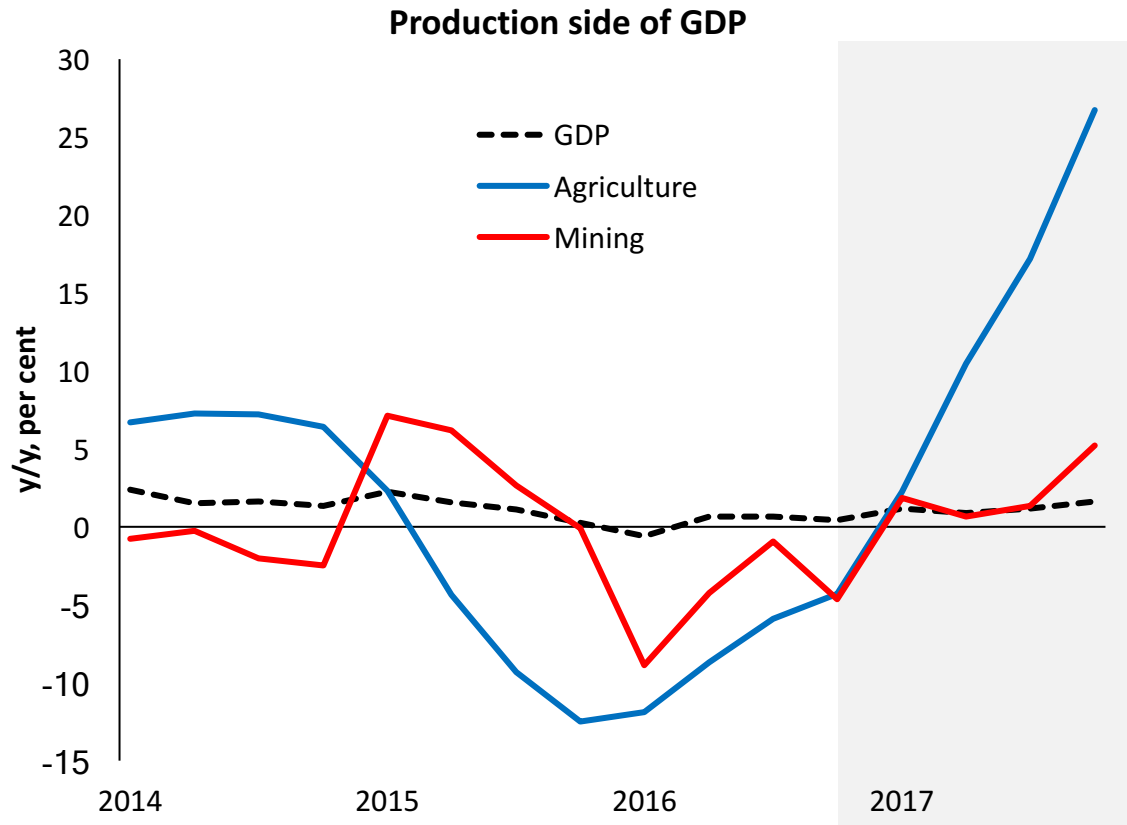


Sources: International Monetary Fund, Statistics South Africa and South African Reserve Bank

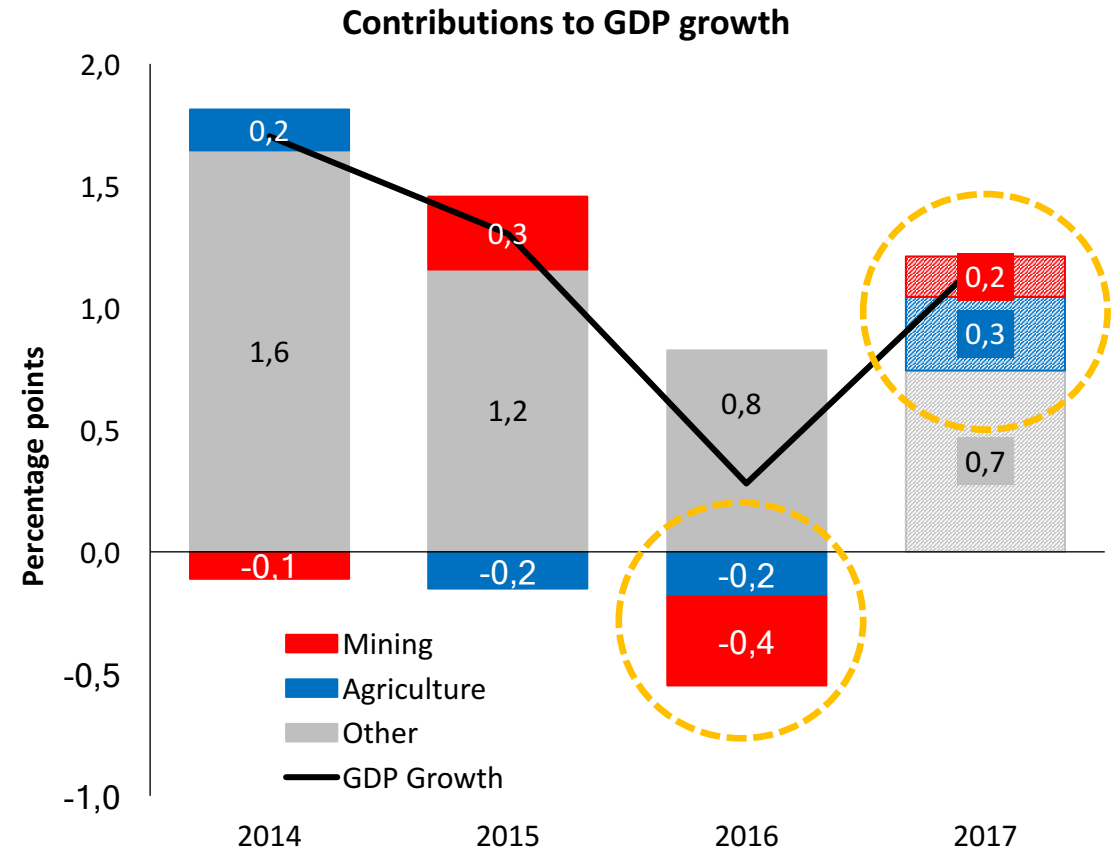


Sources: International Monetary Fund, Statistics South Africa and South African Reserve Bank

Better growth in 2017 partly reflects a primary sector recovery

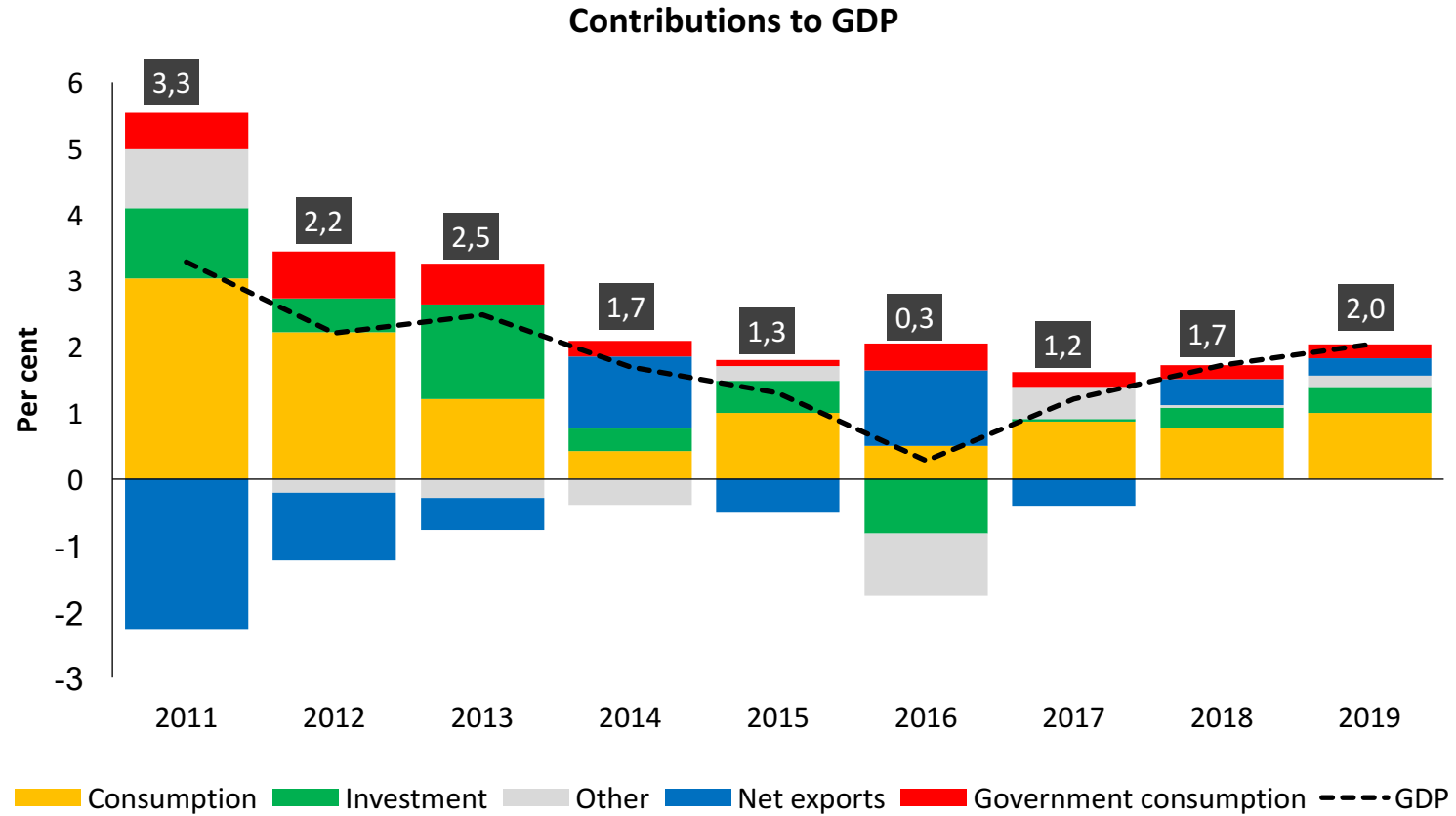


Source: Statistics South Africa and South African Reserve Bank



Source: Statistics South Africa and South African Reserve Bank

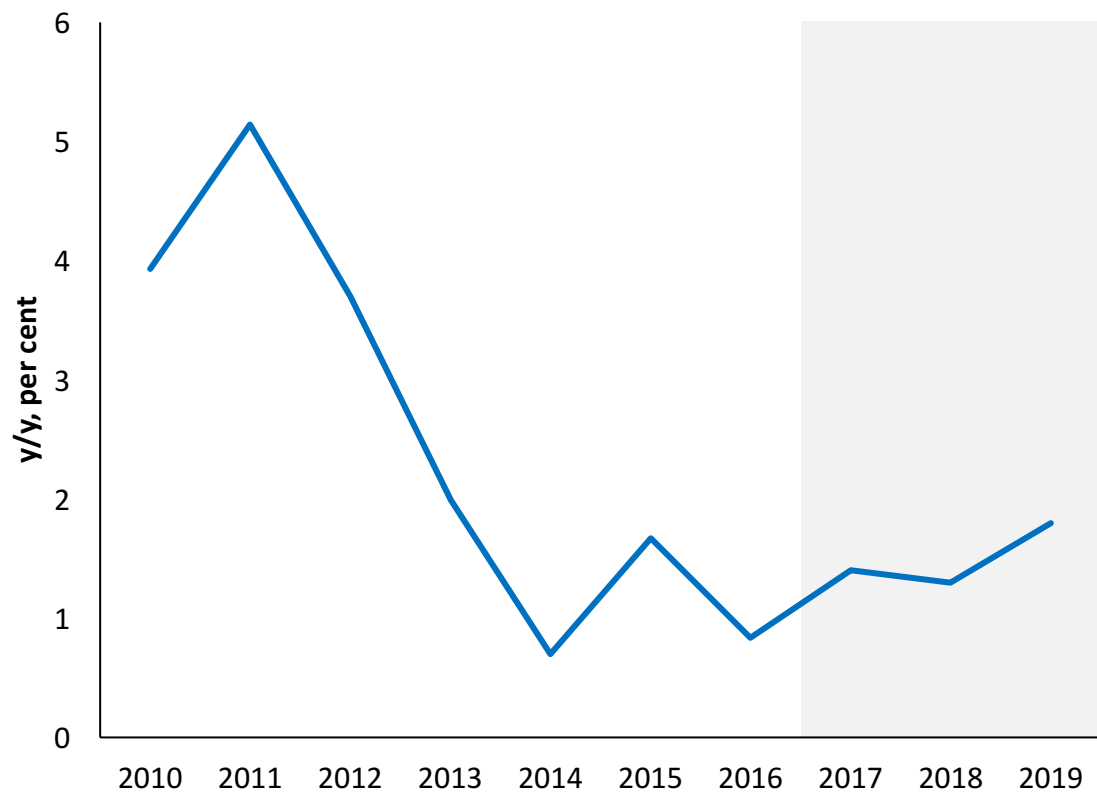
Over 2018 and 2019, growth benefits from stronger investment and household consumption



Sources: Statistics South Africa and South African Reserve Bank

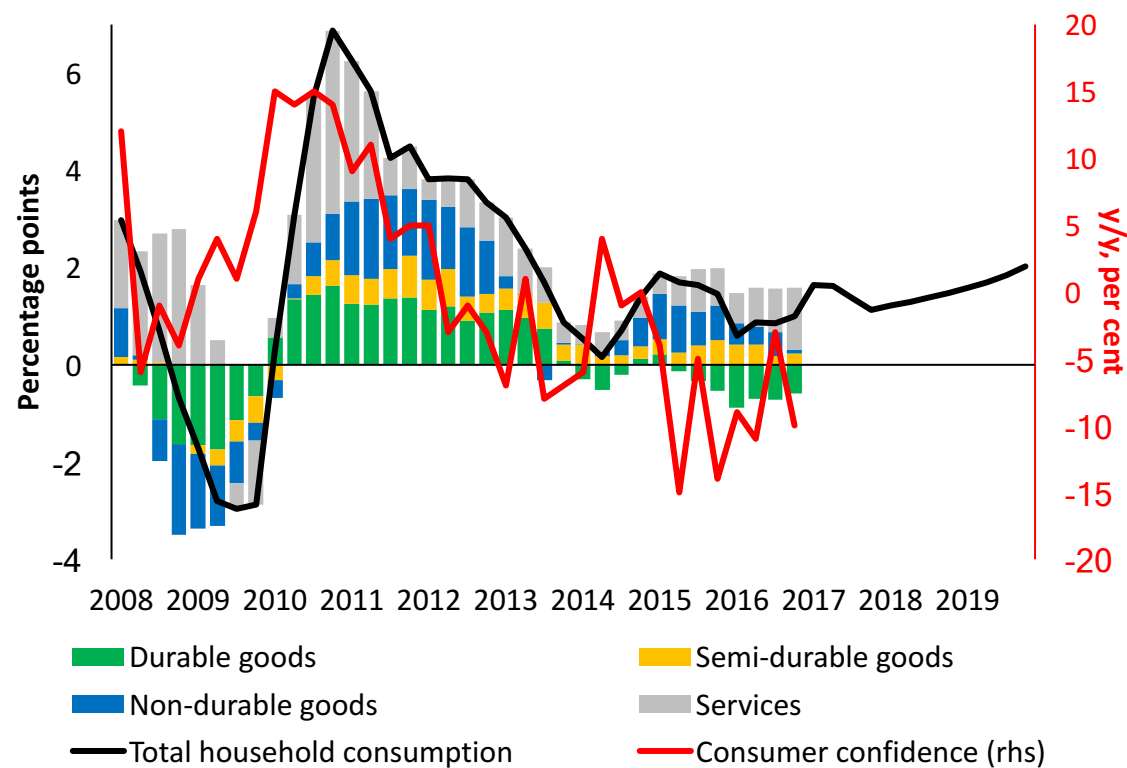
Household consumption up on income and lower inflation, but confidence needs to recover

Real Final Household Consumption



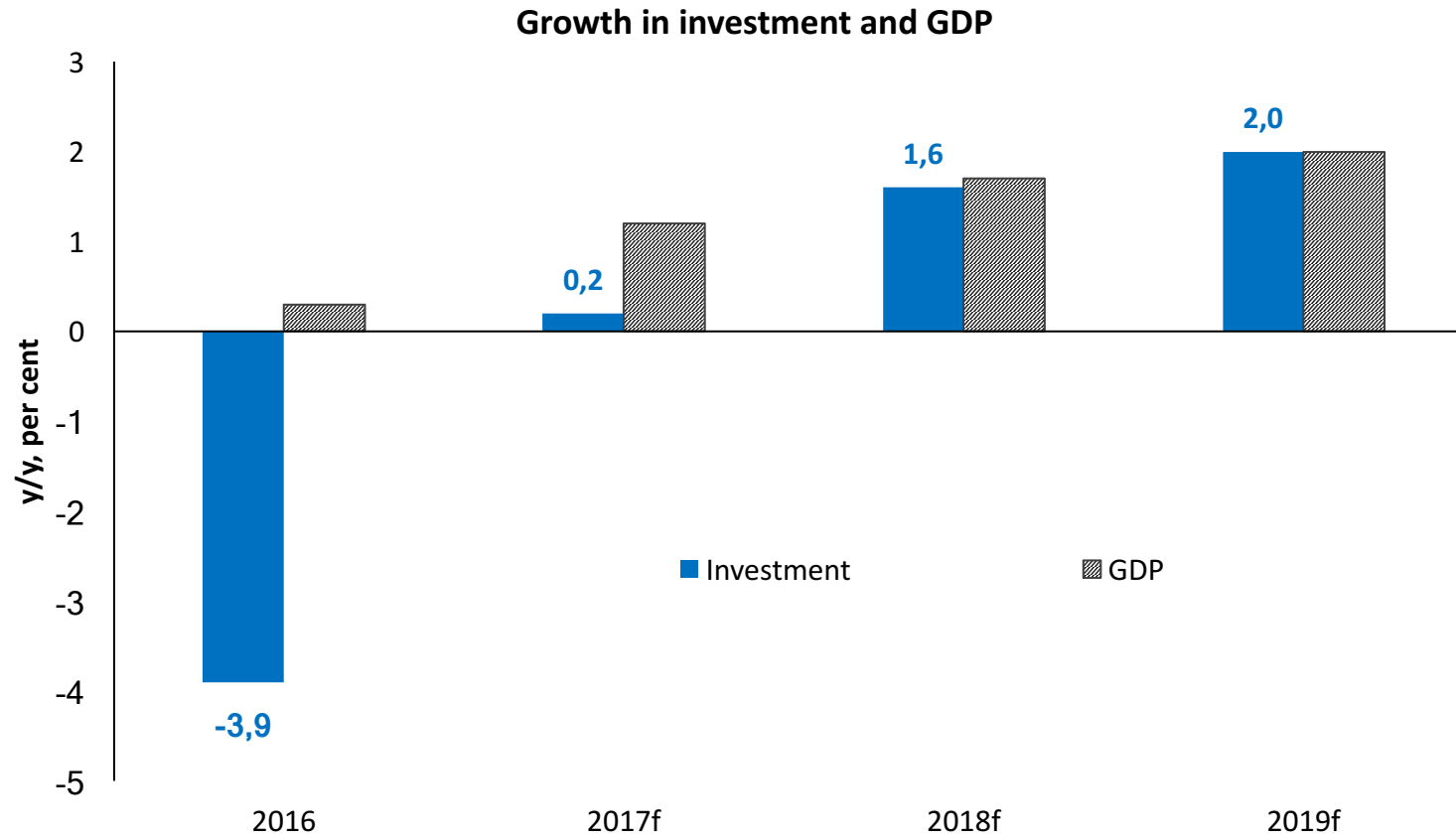
Sources: Statistics South Africa and South African Reserve Bank

Consumer expenditure



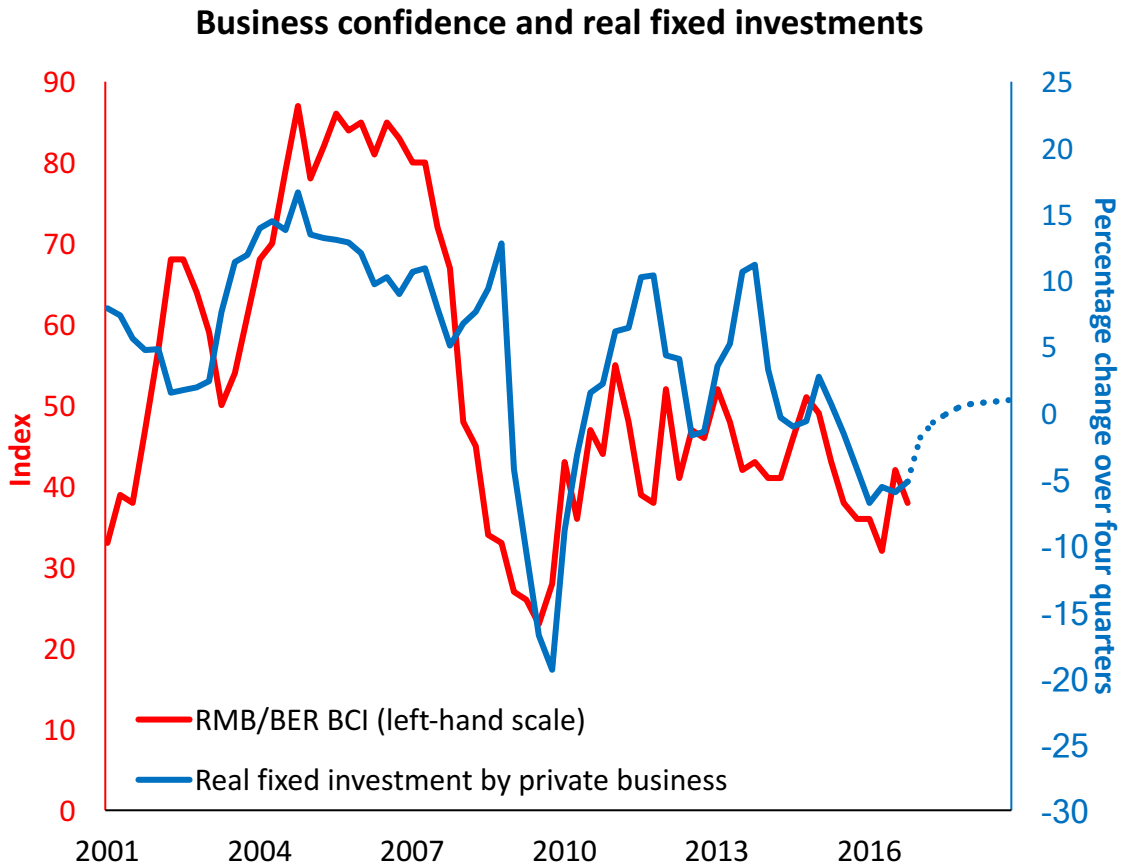
Sources: Statistics South Africa and South African Reserve Bank

Investment slumped to a post-crisis low in 2016, but expected to improve

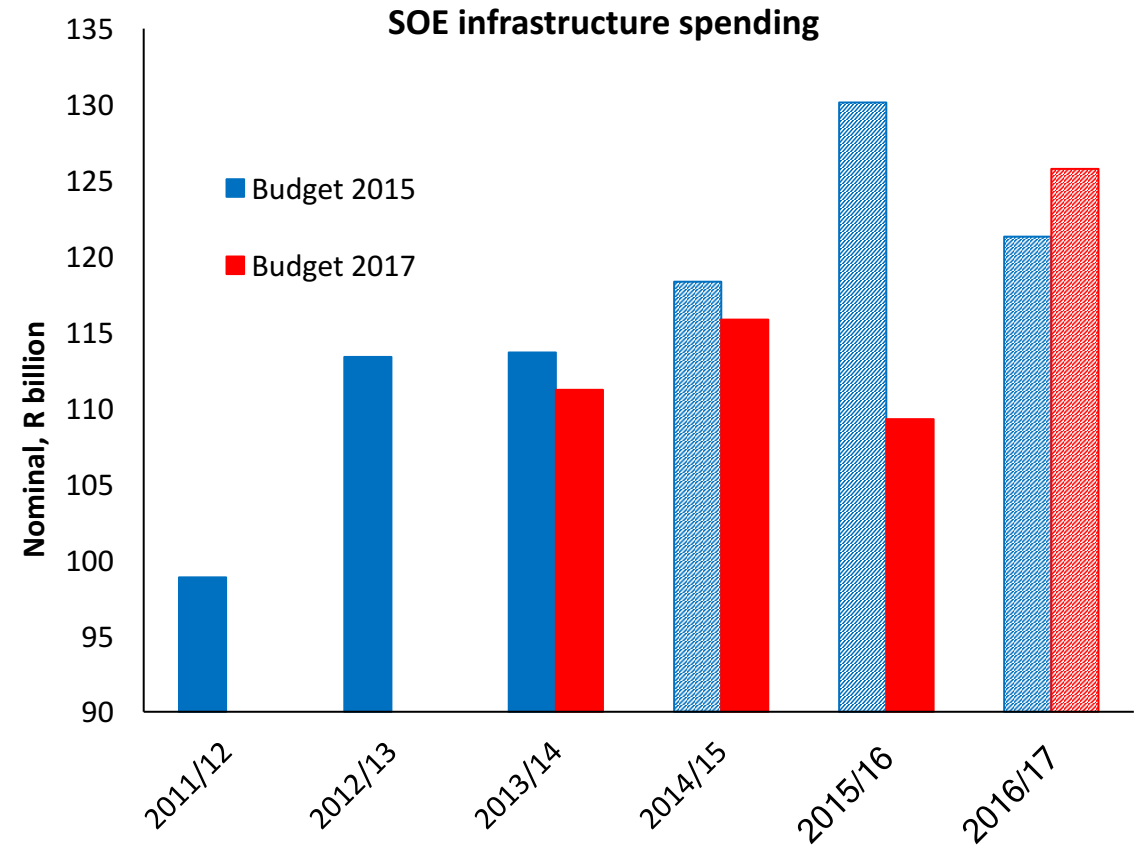


Source: Statistics South Africa and South African Reserve Bank

An investment recovery relies on private sector confidence and the public sector implementing spending plans

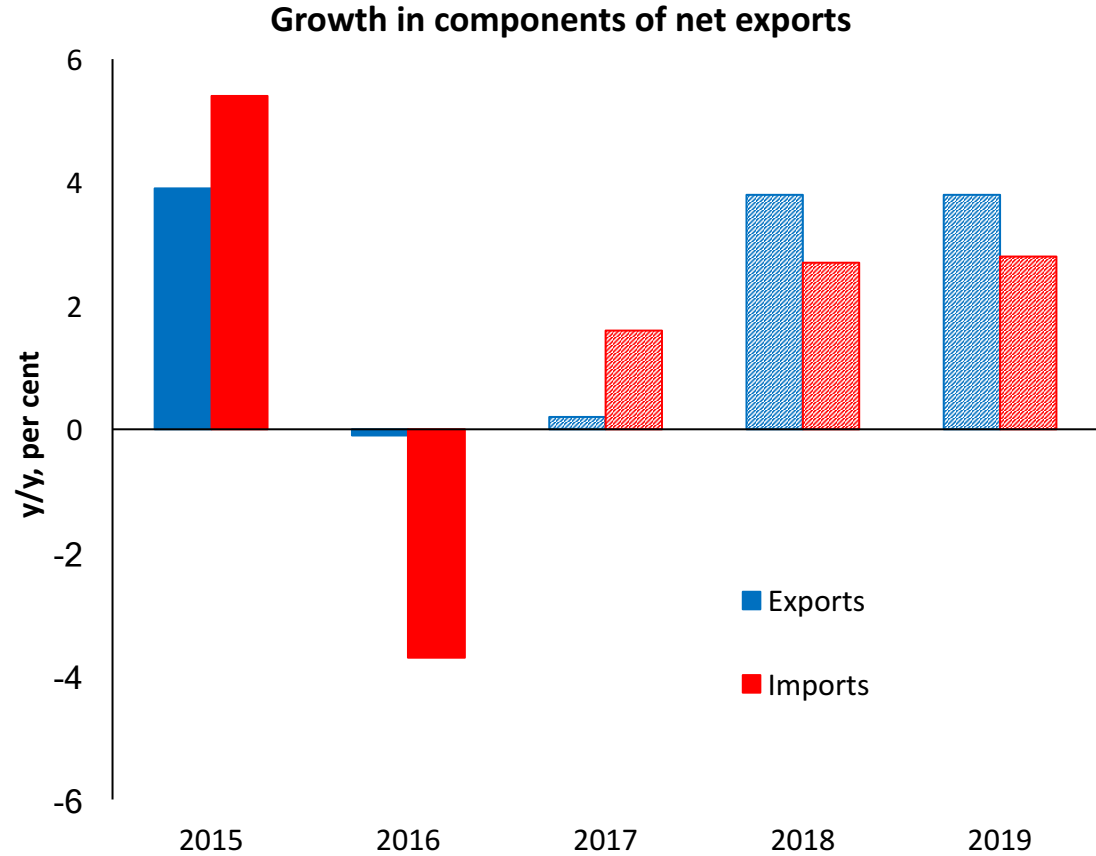


Sources: South African Reserve Bank and Rand Merchant Bank/Bureau for Economic Research

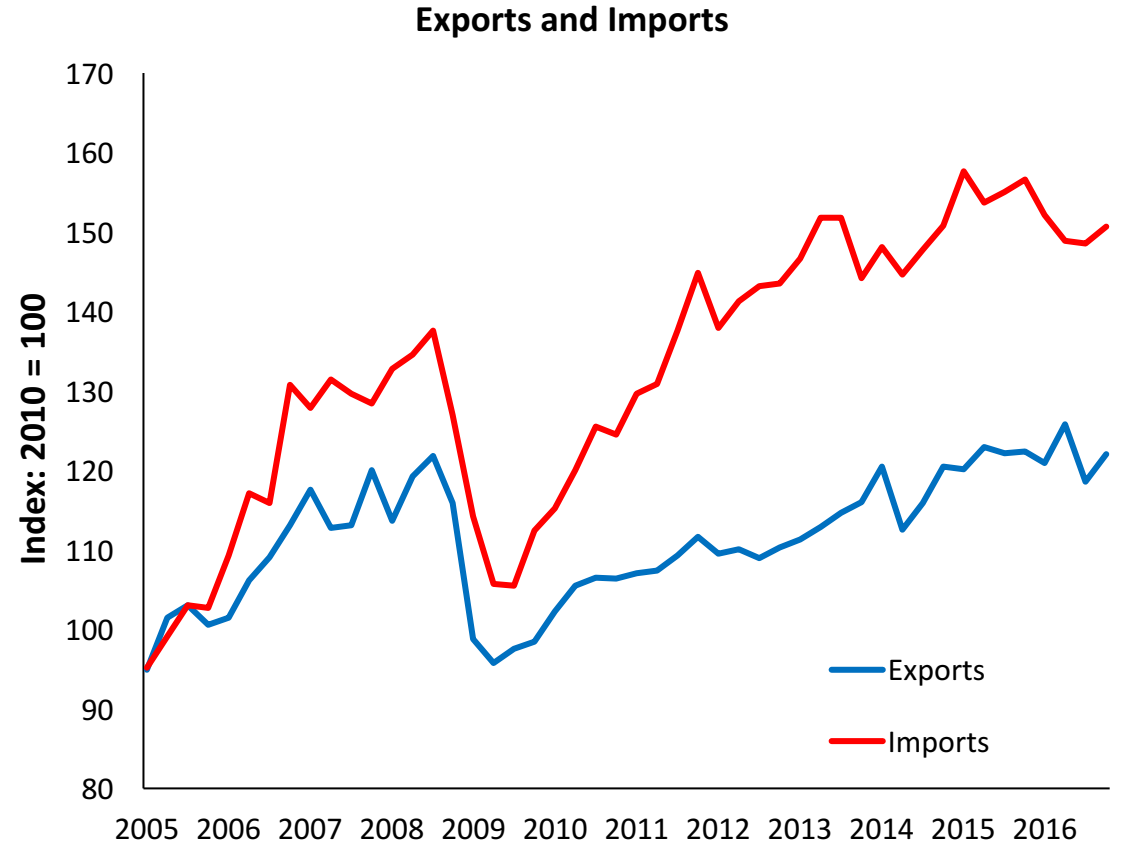


Sources: National Treasury

Net exports contributing to growth, but modest, as imports expected to rise

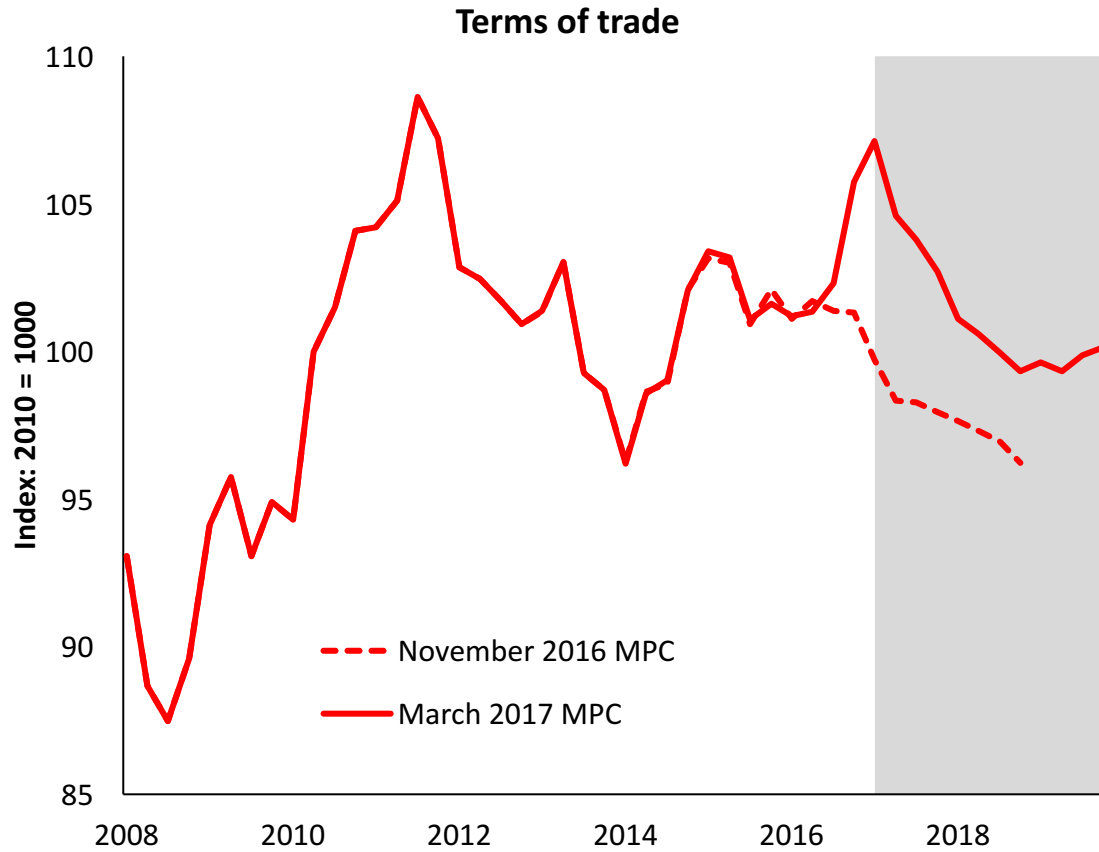


Source: Statistics South Africa and South African Reserve Bank

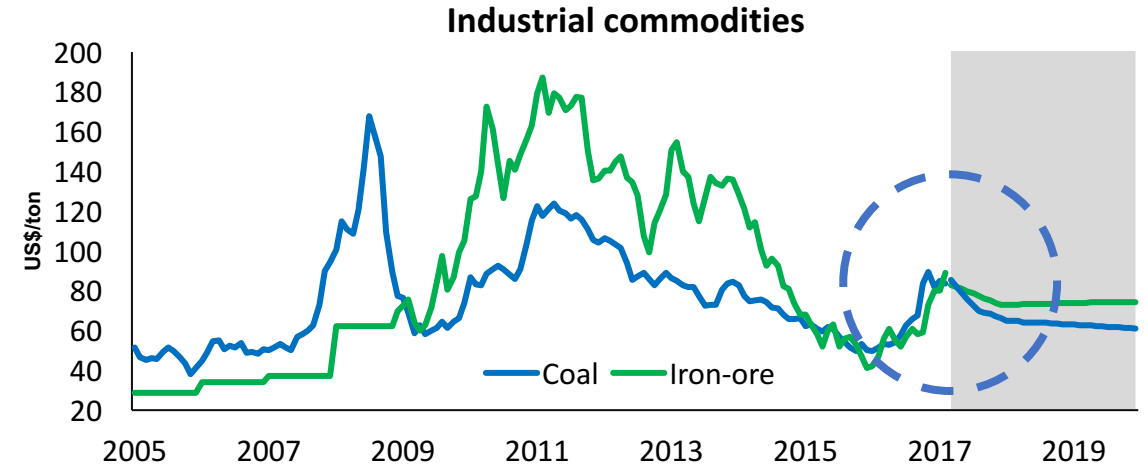


Source: Statistics South Africa and South African Reserve Bank

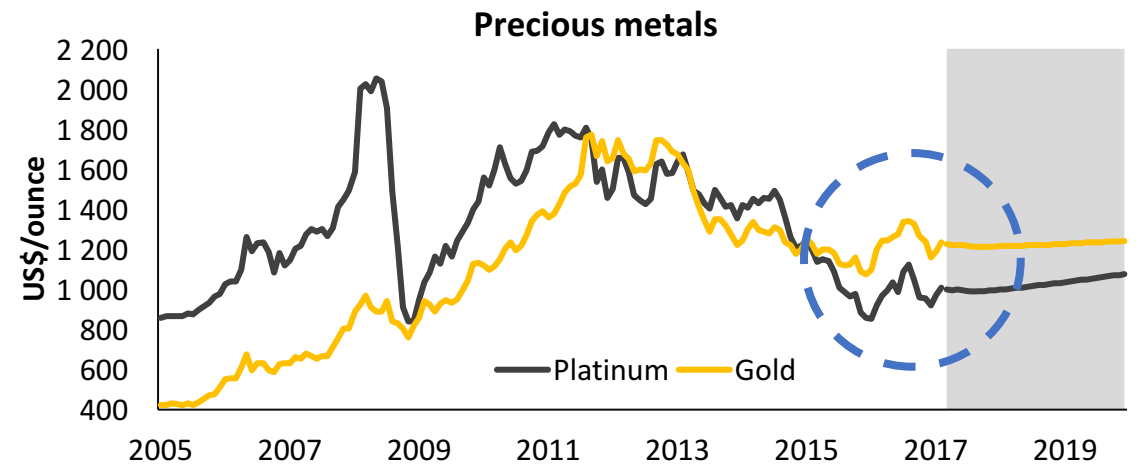
SA's terms of trade hit a post-2011 high in the first quarter of 2017, mostly due to higher prices for industrial commodities...



Source: South African Reserve Bank

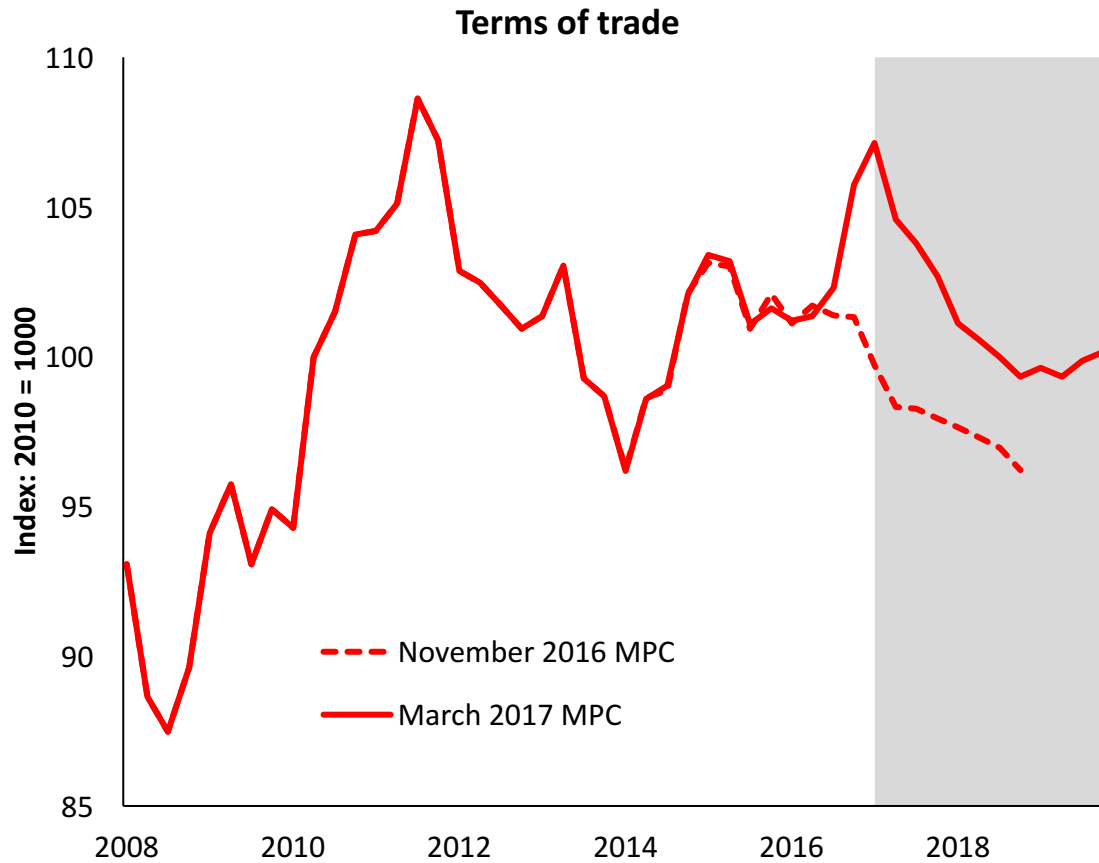


Source: Bloomberg and South African Reserve Bank

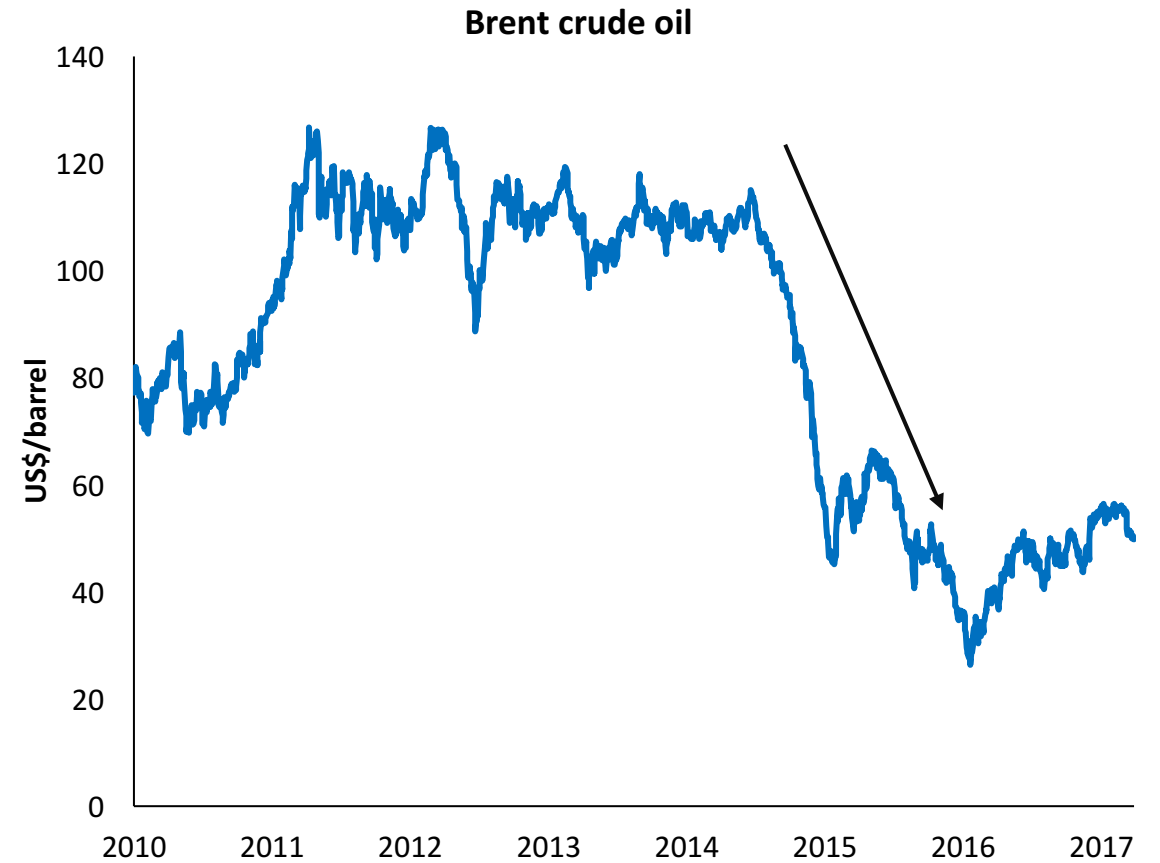


Source: Bloomberg and South African Reserve Bank

... and declining oil prices

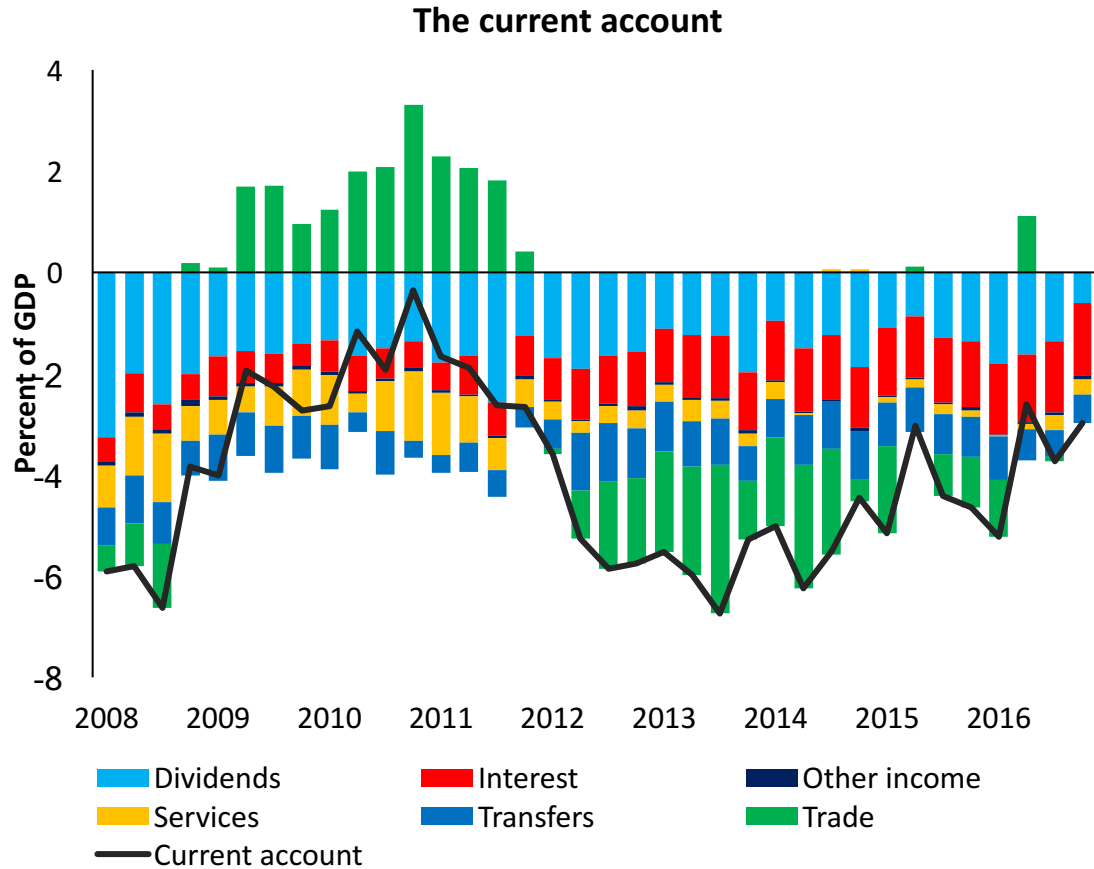


Source: South African Reserve Bank

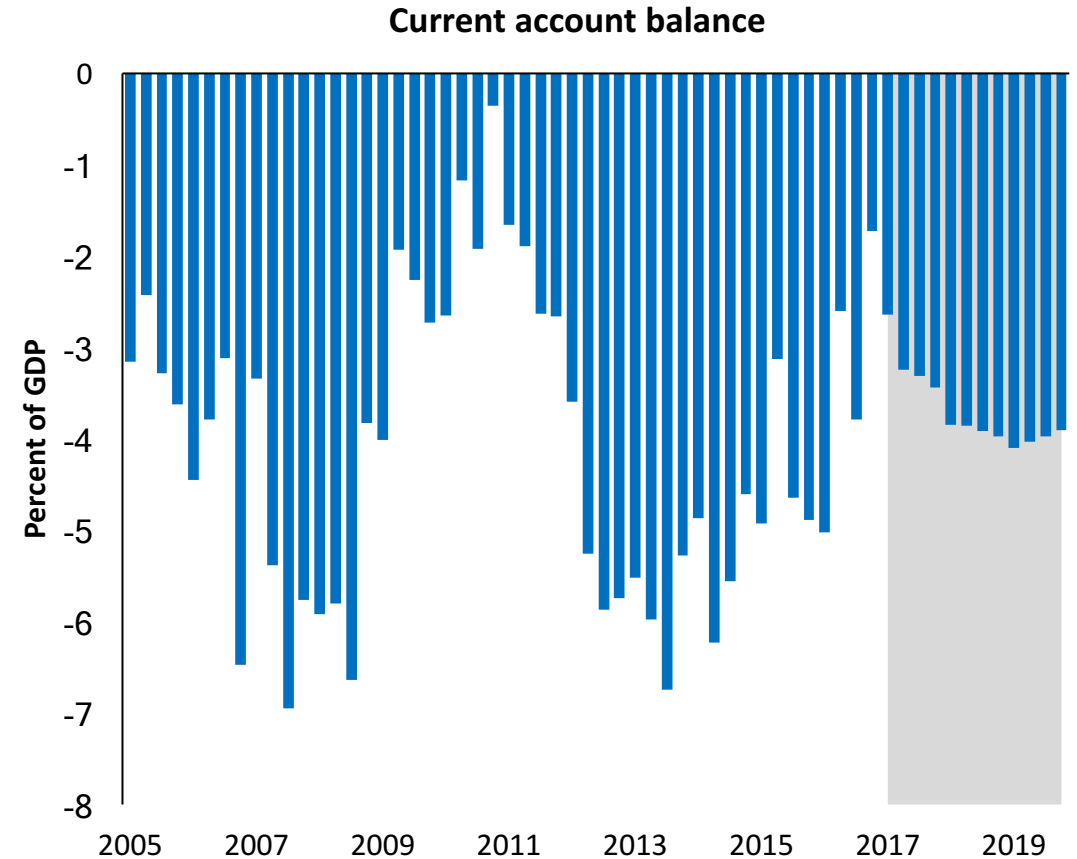


Sources: Bloomberg

The forecast anticipates moderating terms of trade, stronger imports, widening the current account deficit somewhat

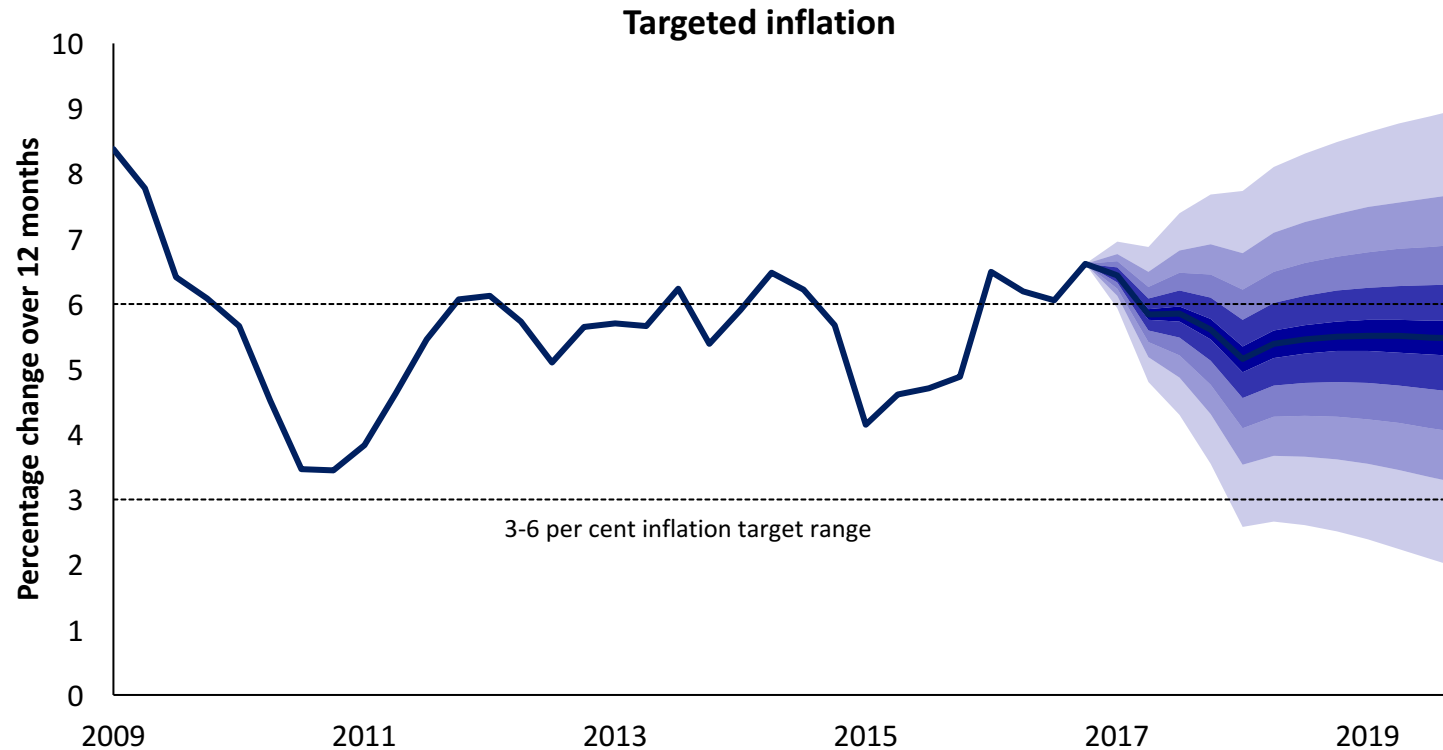


Source: South African Reserve Bank



Source: South African Reserve Bank

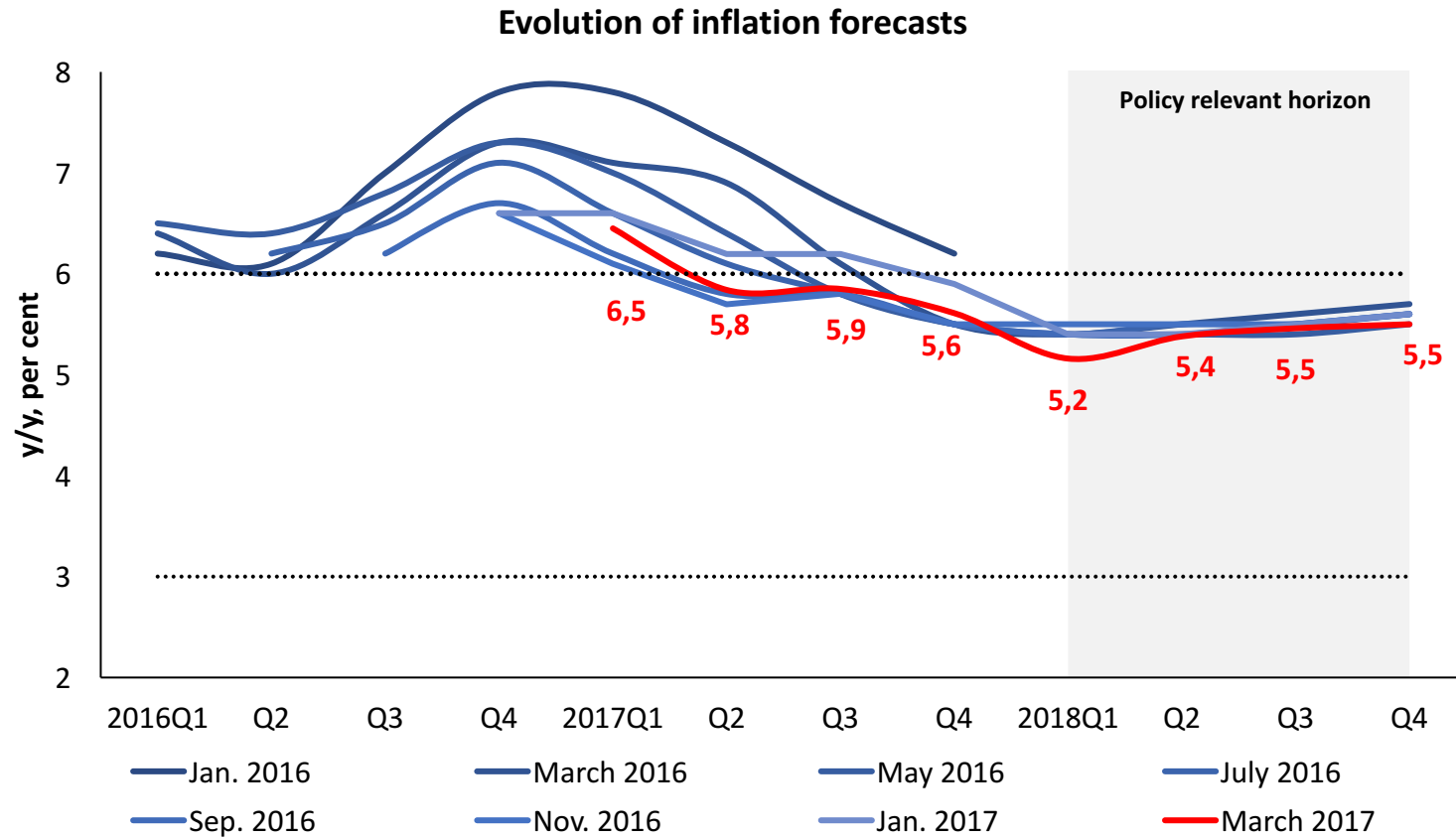
Inflation back within the 3-6% range around mid-2017, following a period of target breaches



Source: Statistics South Africa and South African Reserve Bank

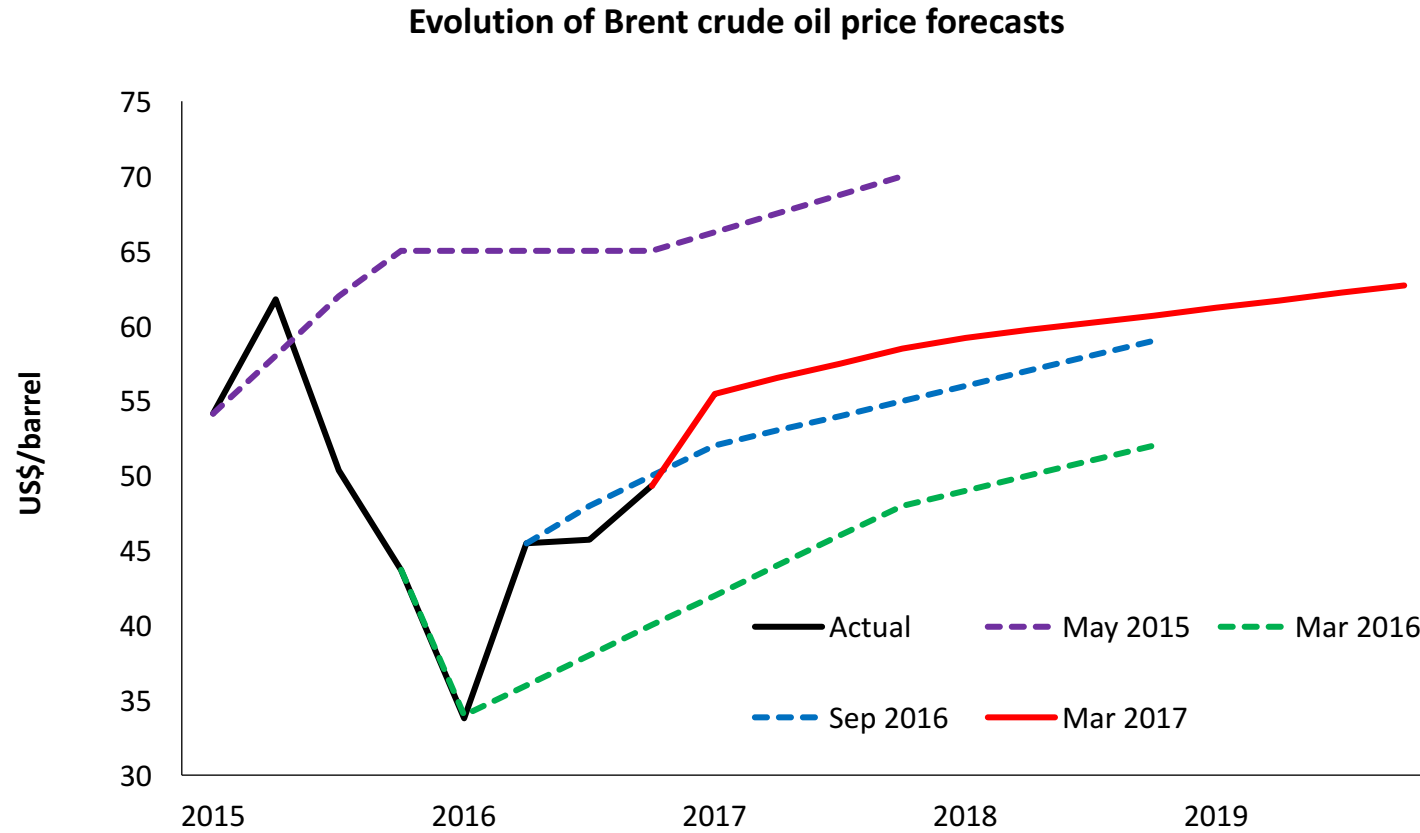
	2014	2015	2016	2017	2018	2019
Annual inflation (%)	6.1	4.6	6.3	5.9	5.4	5.5

The near-term forecast has fluctuated much more than the medium term...



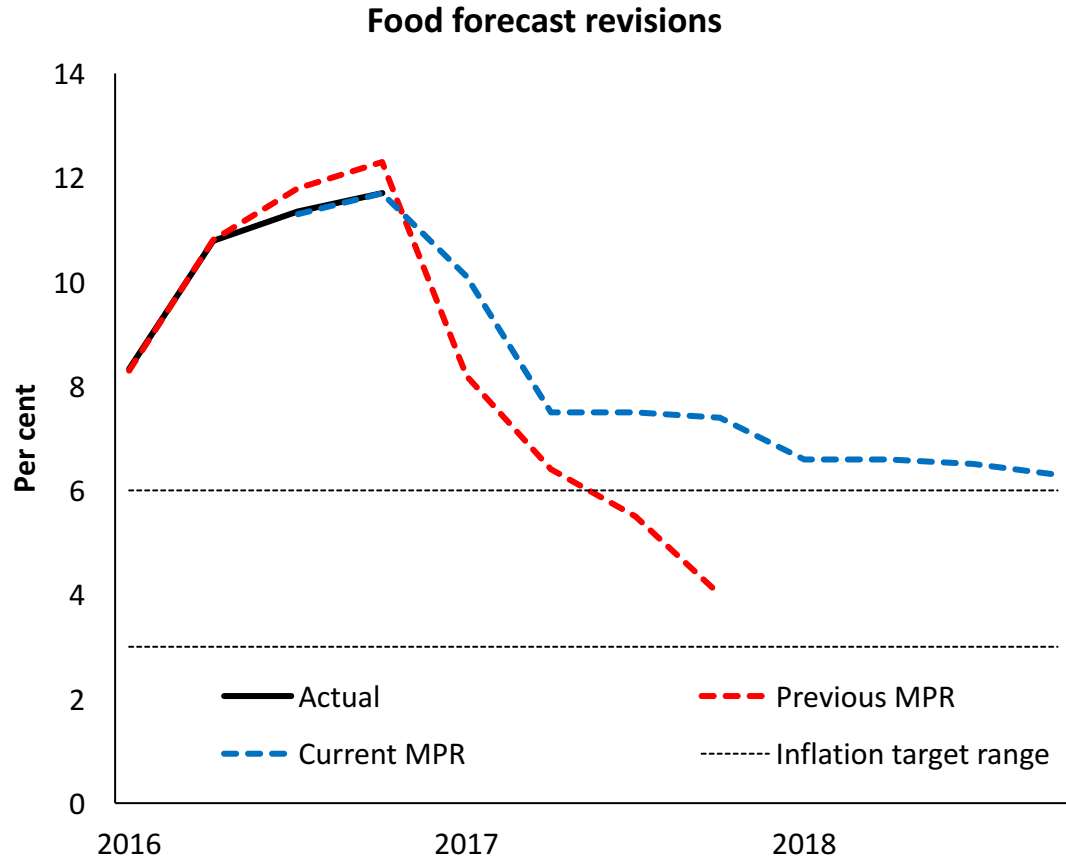
Source: Statistics South Africa and South African Reserve Bank

...reflecting petrol price developments...

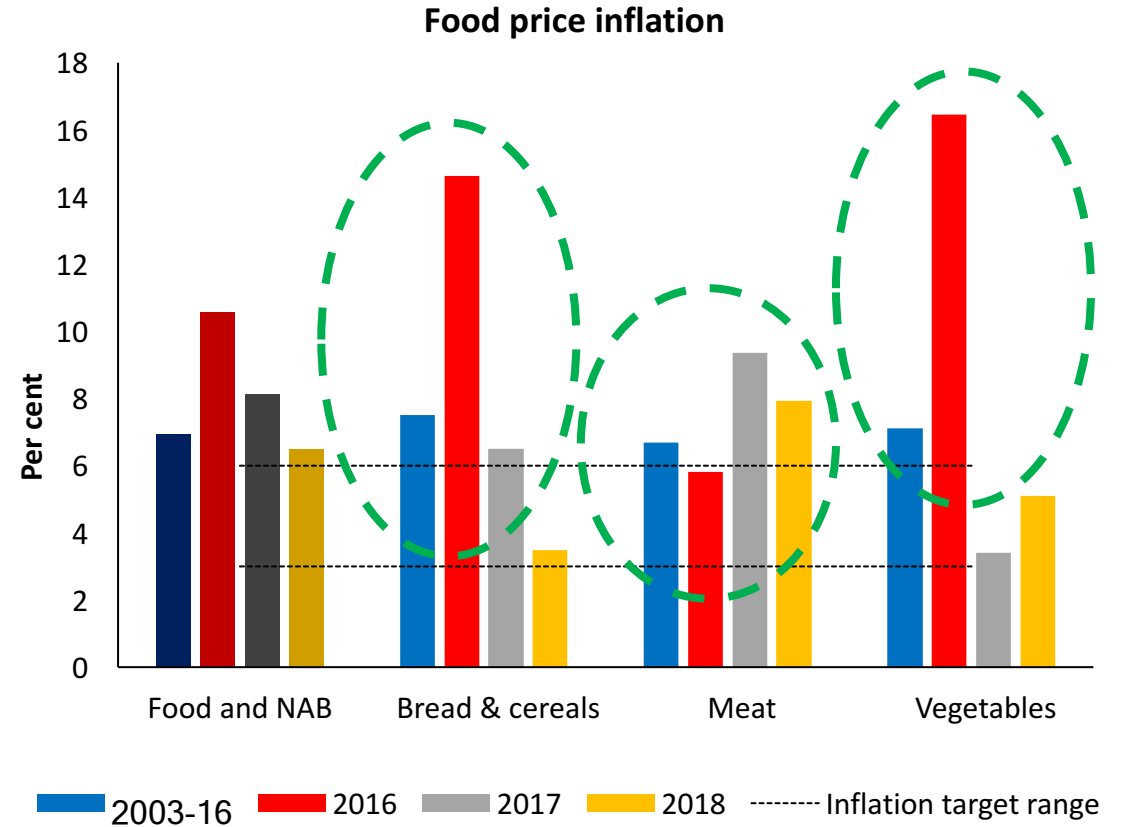


Sources: Bloomberg and South African Reserve Bank

...as well as food price fluctuations

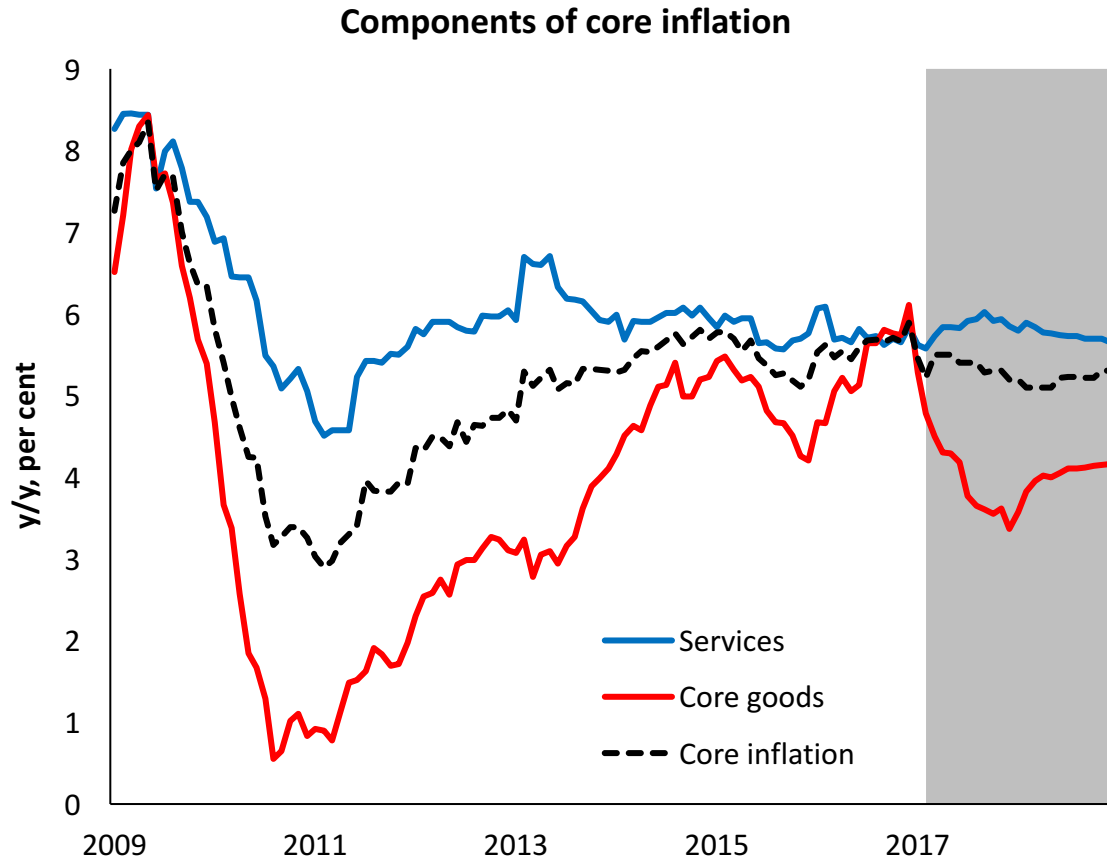


Source: South African Reserve Bank

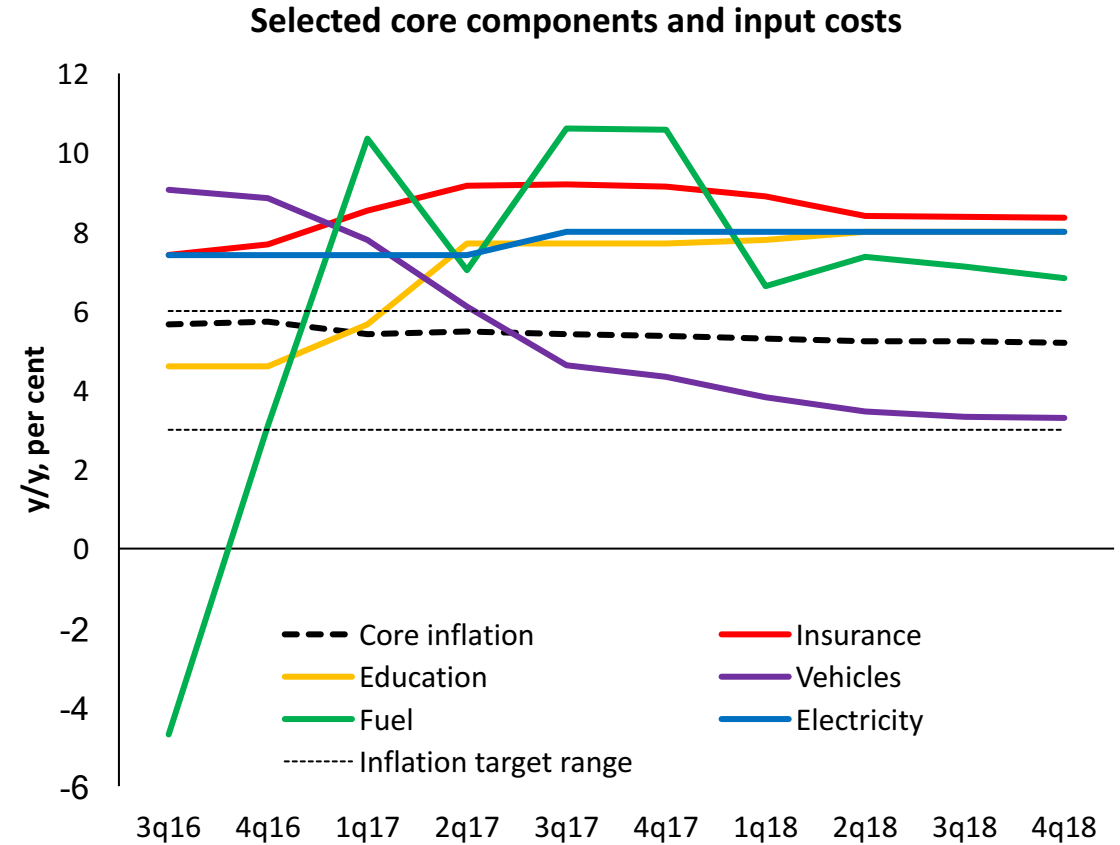


Sources: Statistics South Africa and South African Reserve Bank

Despite medium term forecast stability, a key question is why inflation remains relatively high despite fading shocks (food, fuel, exchange rate) and persistently weak demand

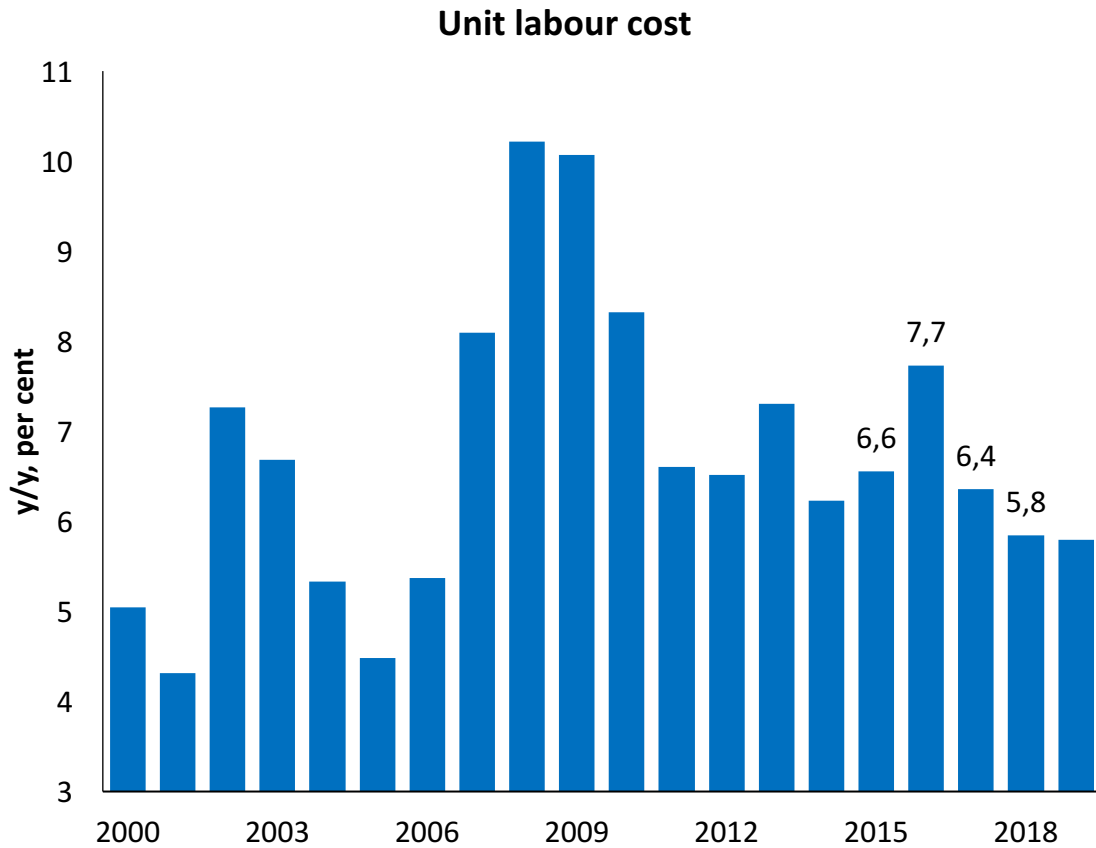


Sources: Statistics South Africa and South African Reserve Bank

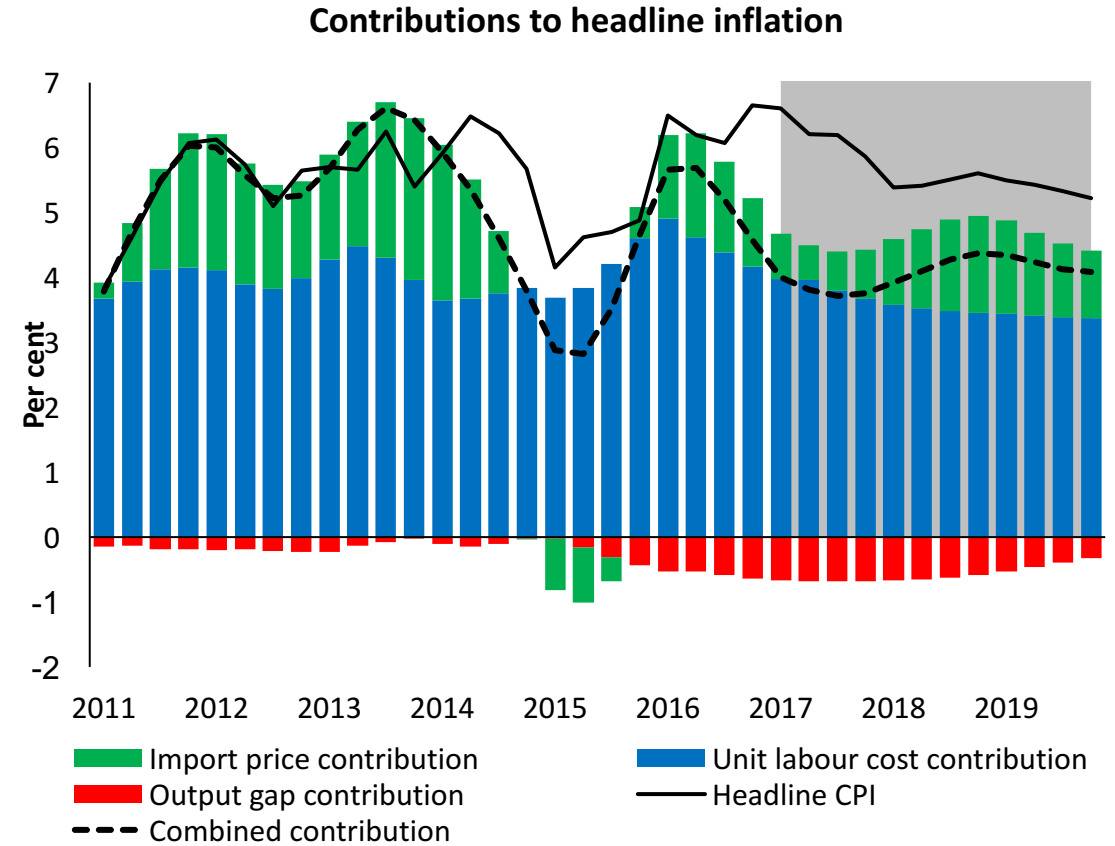


Sources: Statistics South Africa and South African Reserve Bank

Wage and salary pressure is an important part of the puzzle...

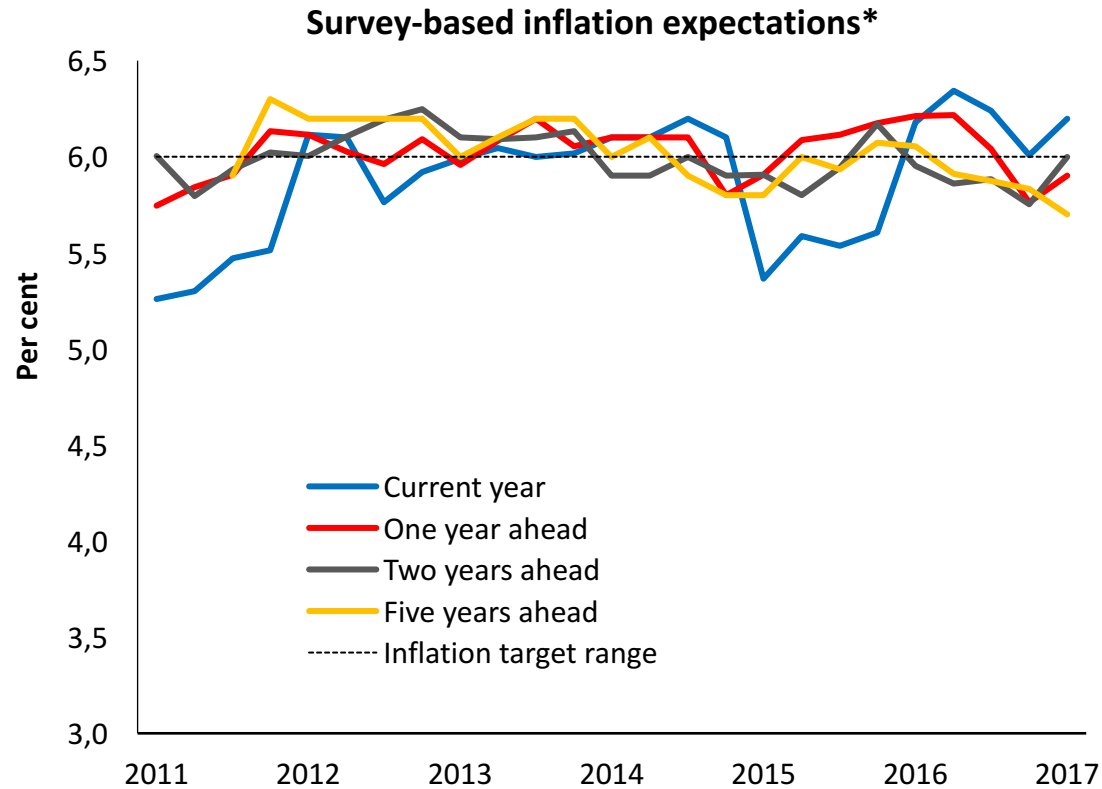


Source: South African Reserve Bank



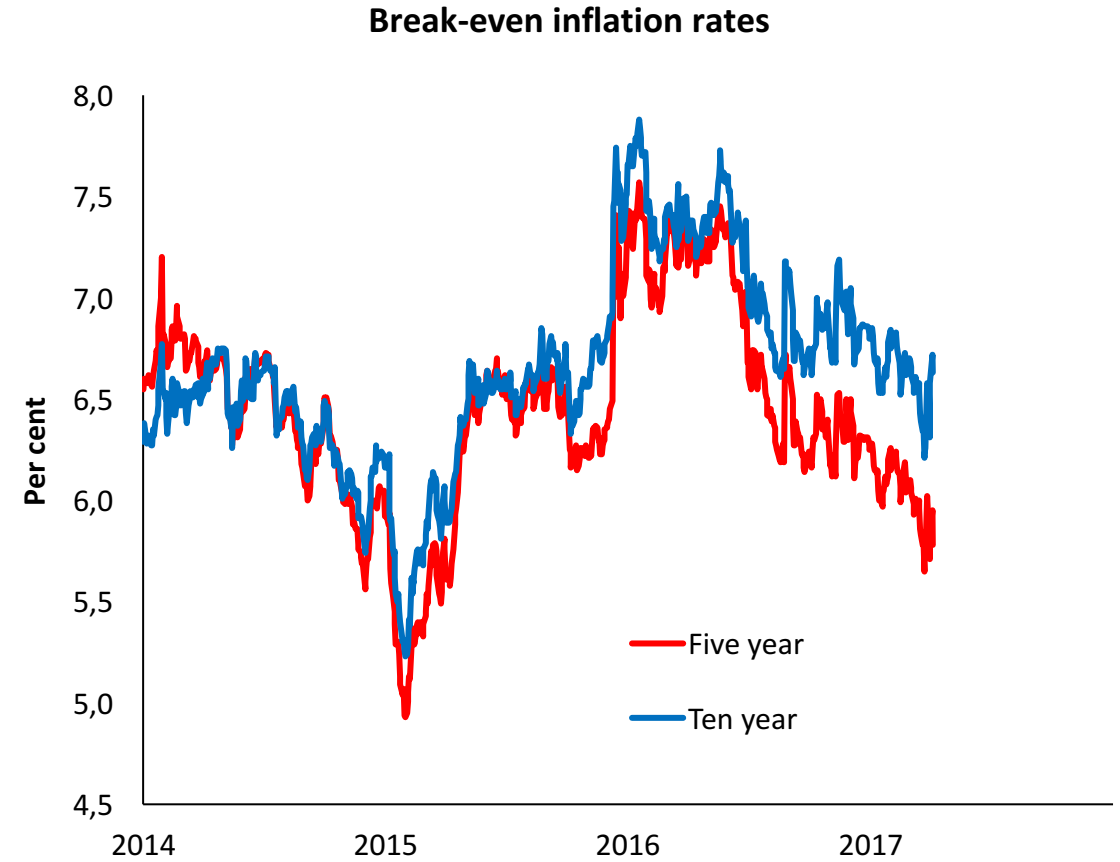
Sources: Statistics South Africa and South African Reserve Bank

... which is related to uncomfortably high inflation expectations



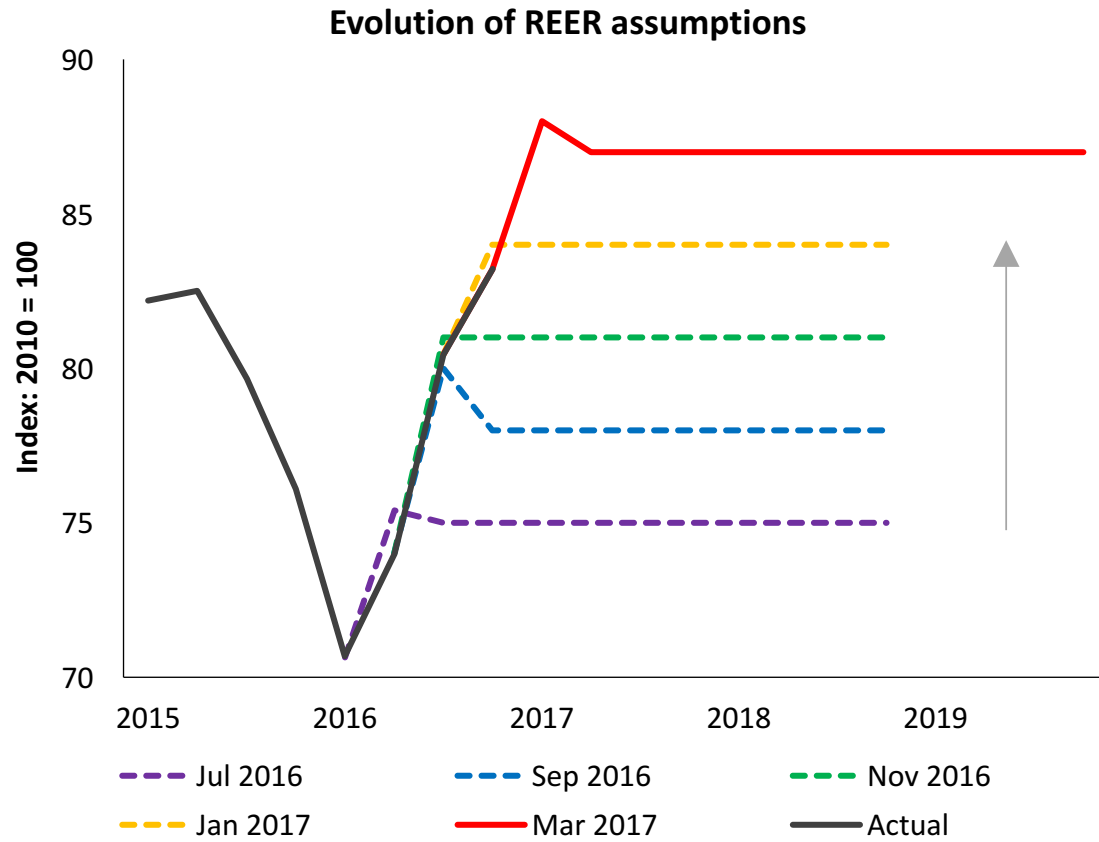
* Total, combining expectations of labour, business and analysts

Source: Bureau for Economic Research

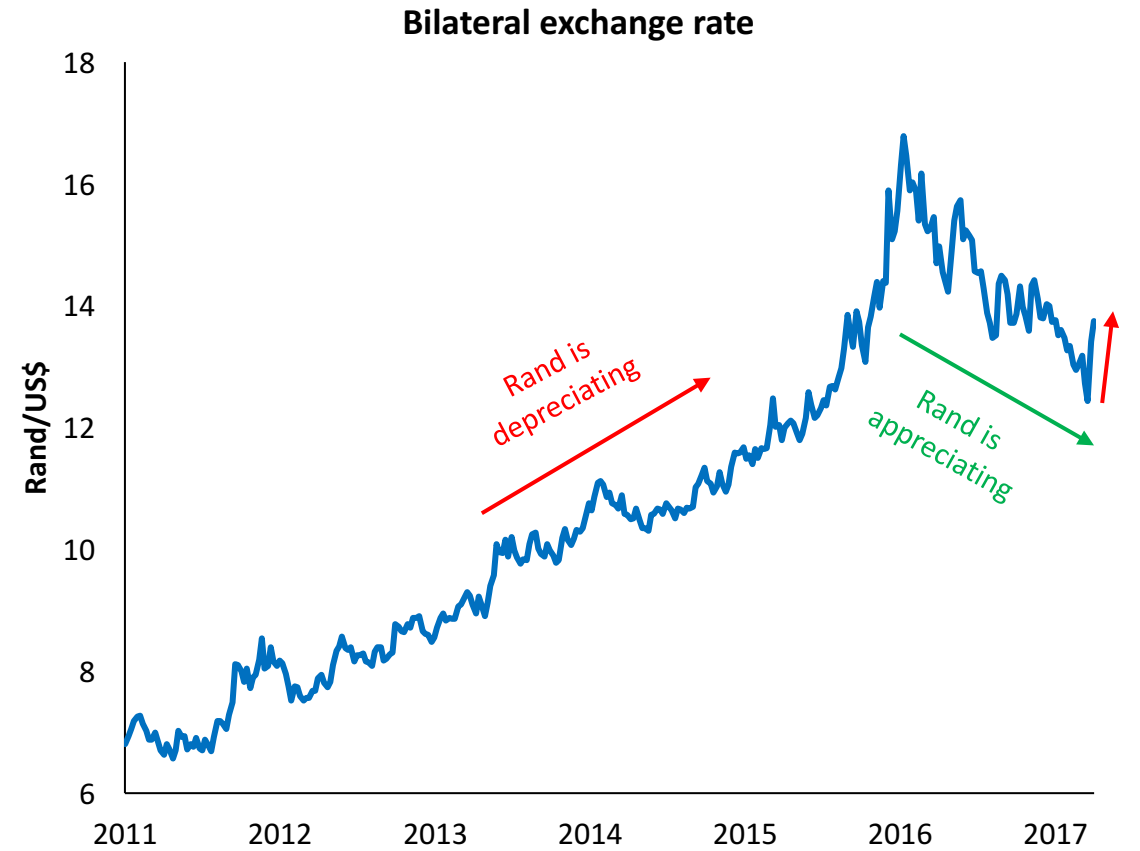


Source: Bloomberg

The inflation forecast also faces risks, of which the biggest is the exchange rate



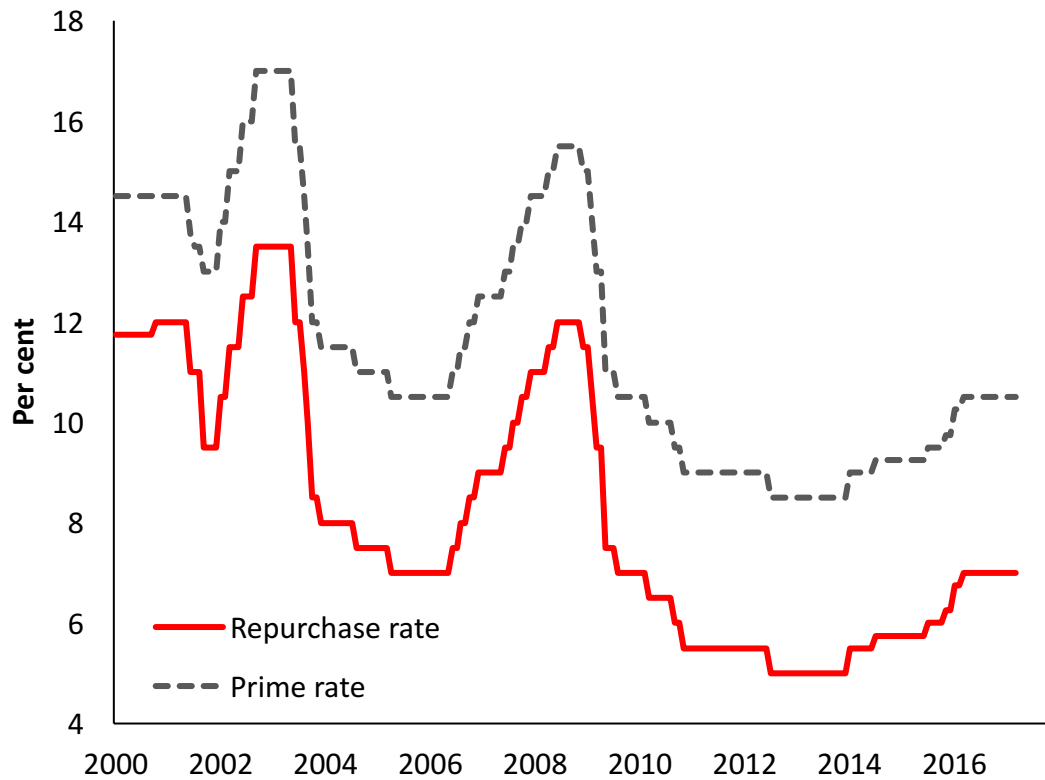
Source: South African Reserve Bank



Source: Bloomberg

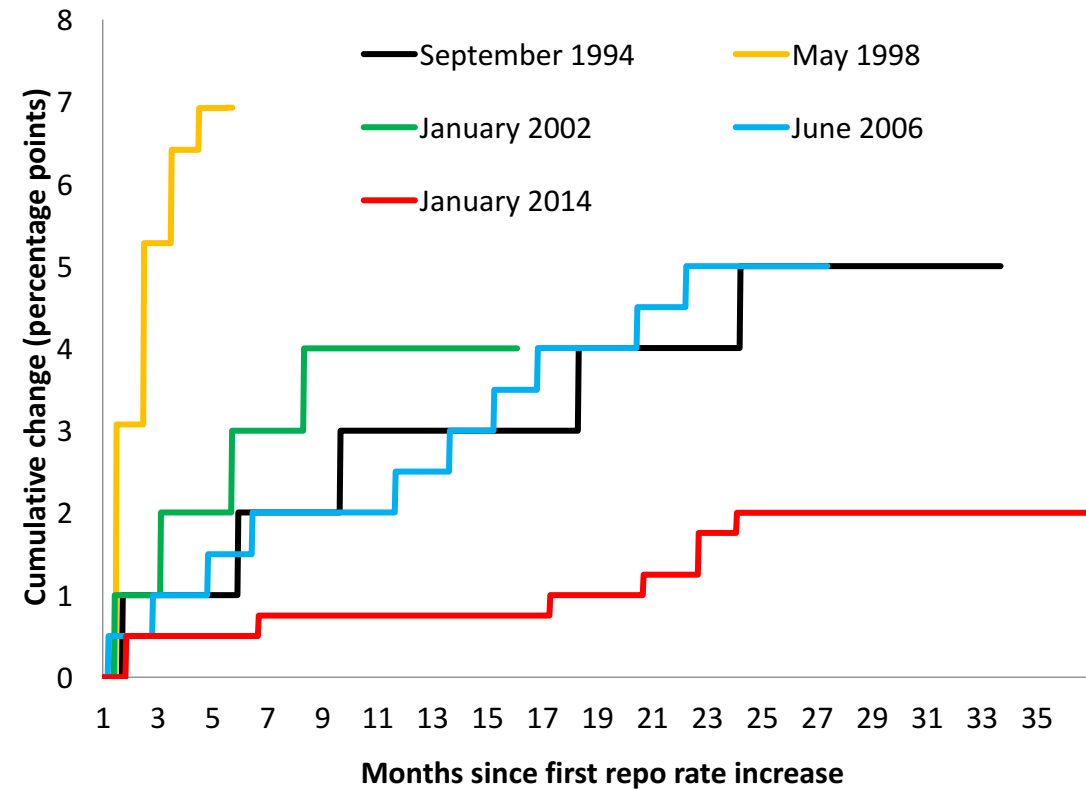
The repo rate has now been stable at 7% for a year

Key policy rates are still relatively low



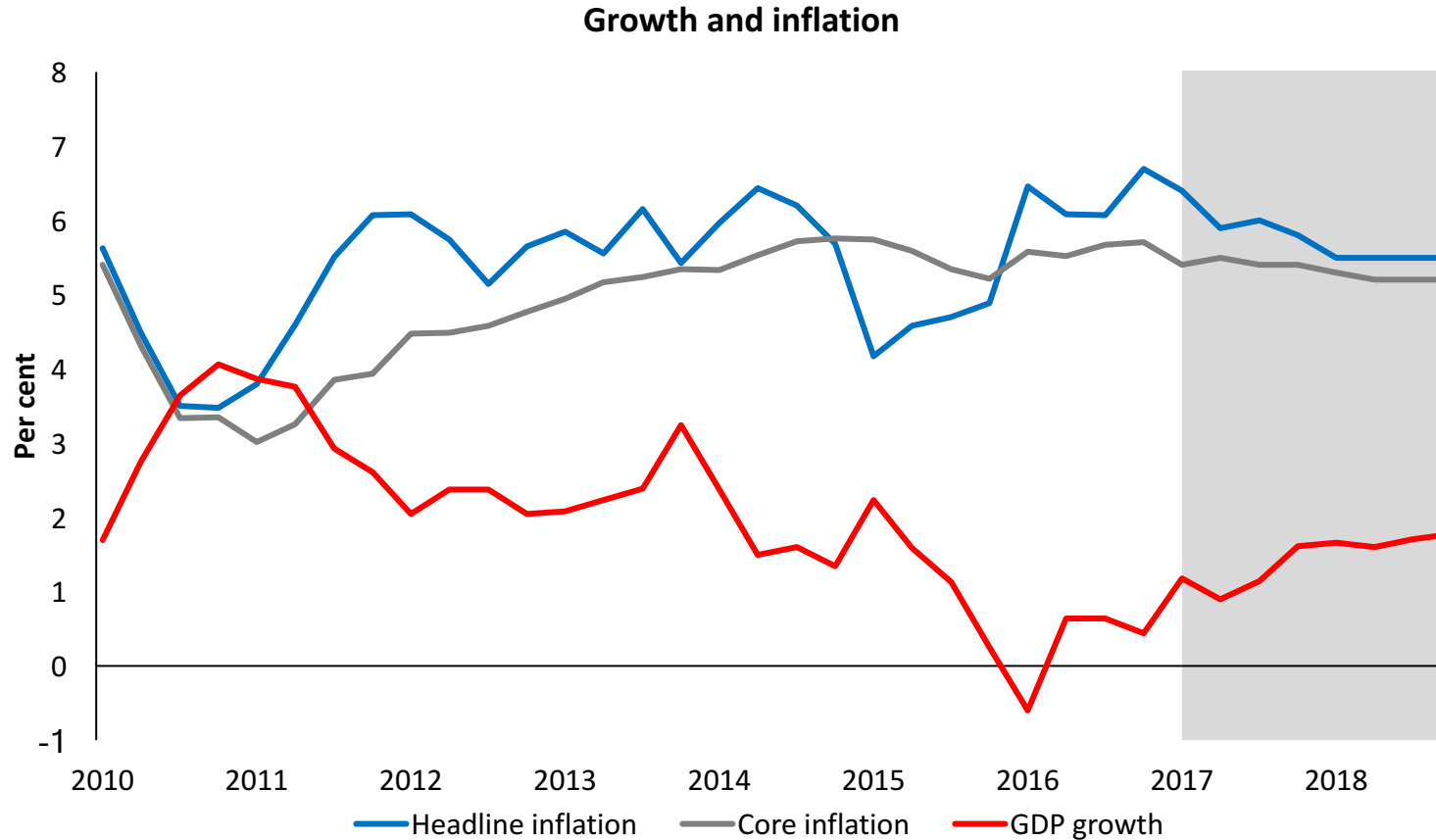
Source: South African Reserve Bank

The hiking cycle has been gentle



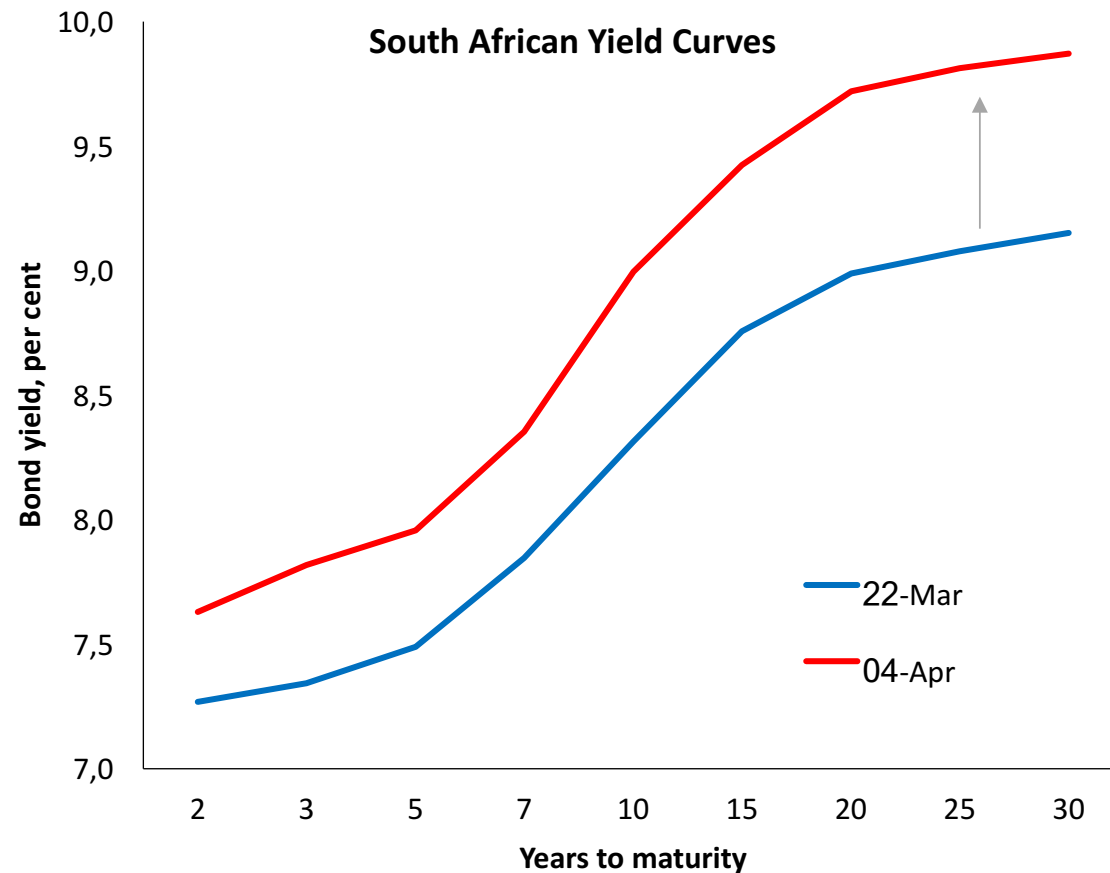
Source: South African Reserve Bank

The forecast showed an easing in the inflation and growth trajectories



Source: Statistics South Africa and South African Reserve Bank

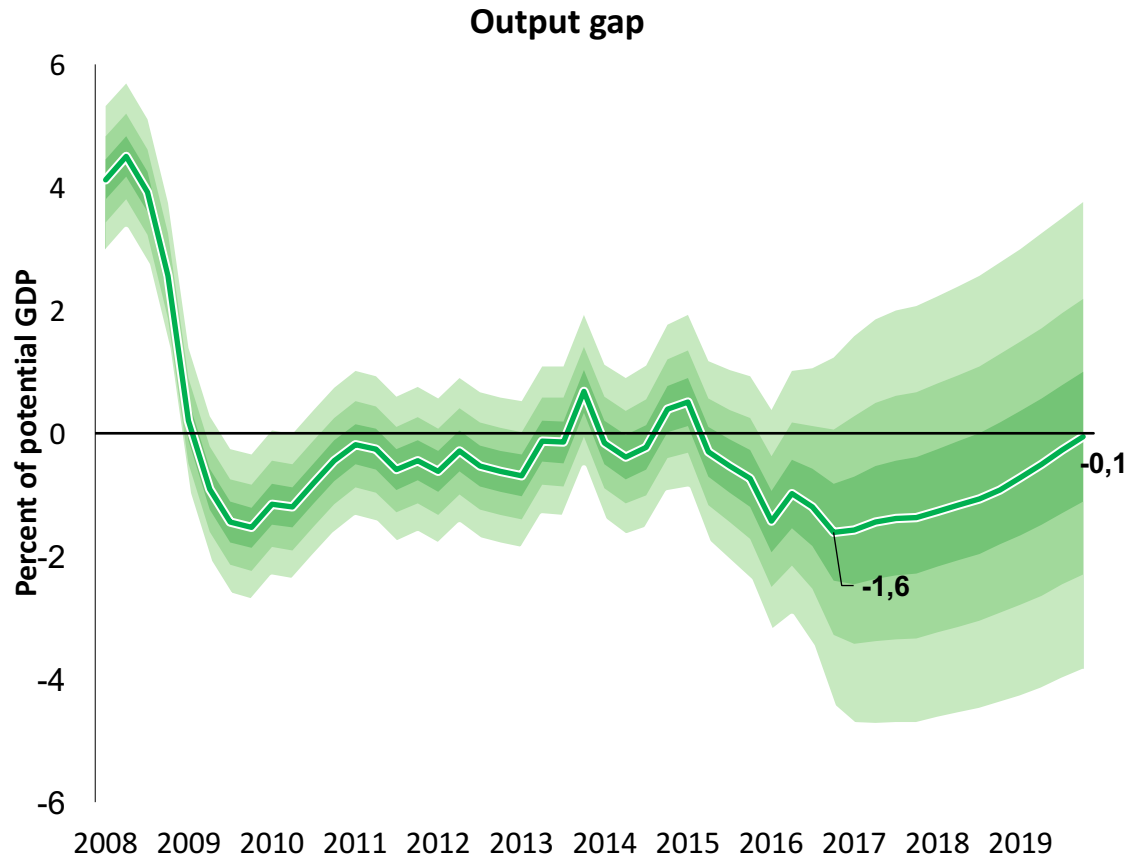
...while downgrades jeopardise the expected improvement in the inflation and growth trend



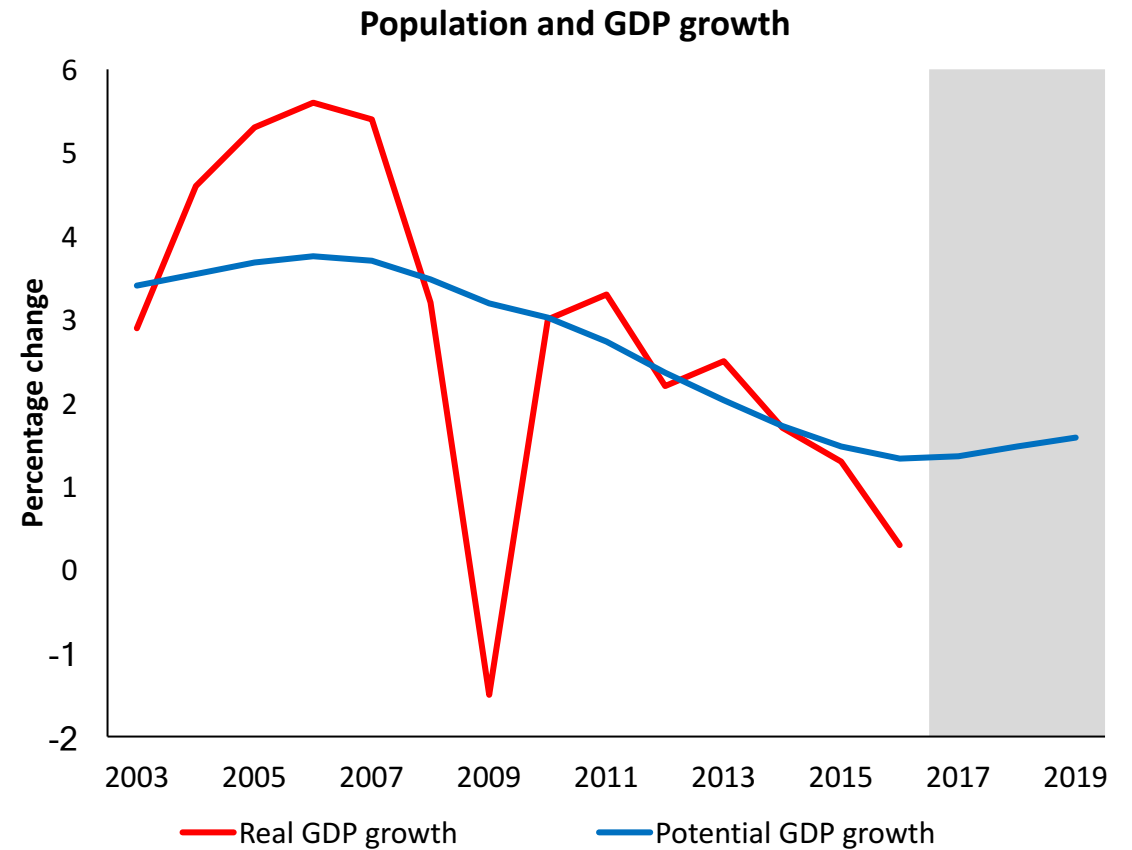
Source: Bloomberg

- Impact on yield curve largely depends on how markets have priced in the downgrades
- Estimates range from 80 to 164 basis points shift in the short-end of the yield curve*
- Higher costs per increment of debt-financed real output
- Inflation outcomes net effect of fx depreciation, larger output gap

Relatively accommodative policy settings use up existing slack in the economy – but cannot push up potential



Source: South African Reserve Bank



Sources: Statistics South Africa and South African Reserve Bank

Conclusion

- World economic conditions have improved; this could be a blip or a trend
- SA growth looks better, mainly because recent outcomes were so disappointing
- However, macroeconomic imbalances have improved, supporting the rand
- Inflation expected to return to within the target range following an extended breach
- While inflation and inflation expectations remain high over the medium term
- Downgrade may delay improvement