South African Reserve Bank

PRESS STATEMENT

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STATEMENT OF THE MONETARY POLICY COMMITTEE

Issued by Lesetja Kganyago, Governor of the South African Reserve Bank

Since the July meeting of the Monetary Policy Committee (MPC), economic indicators confirm weaker global economic conditions and low inflation. Central banks in advanced economies have provided more monetary accommodation, helping to ease global financial conditions. Downside risks from escalating trade and geo-political tensions remain pronounced.

In the second quarter of this year, South Africa's GDP rebounded from the contraction experienced in the first quarter, but economic activity levels still remain weak. Monthly inflation has been around the mid-point of the inflation target range, as food and services inflation remains subdued.

The year-on-year inflation rate, as measured by the consumer price index (CPI) for all urban areas, was 4.3% in August (up from 4.0% in July). Goods price inflation in August was 3.9% (up from 3.4% in July), while services price inflation remained at 4.7%. Food price inflation rose to 3.9% (up from 3.4%), due to rising cereal and bread prices. The Bank's measure of core inflation, which excludes food, fuel and electricity, rose slightly to 4.3%. Producer price inflation for final manufactured goods decreased to 4.9% in July (compared to 5.8% in June).

The medium-term inflation outlook is largely unchanged. The inflation forecast generated by the SARB's Quarterly Projection Model (QPM) is for headline inflation to average 4.2% in 2019 (down from 4.4%). The projection for 2020 is unchanged at 5.1%, and for 2021 slightly up to 4.7% (from 4.6%). Headline CPI inflation is expected to peak at 5.3% in the first quarter of 2020 and settle at 4.5% in the last quarter of 2021. The forecast for core inflation is lower at 4.3% in 2019 (down from 4.4%), is unchanged at 4.7% in 2020 and is slightly higher at 4.6% in 2021 (up from 4.5%).

Electricity, food and fuel price inflation continue to shape the near and medium-term trajectory of headline inflation. Fuel price inflation is expected to average 2.4% in 2019 and to peak at 11.8% in the first quarter of 2020. While food price inflation has generally surprised on the downside, it is expected to peak at about 6.0% in the third quarter of 2020. Electricity prices came out higher than expected in August, at 11.8%, but remain in line with the forecast.

Inflation expectations have continued to moderate gradually. According to the Bureau for Economic Research (BER) third quarter survey, expectations for headline inflation are down slightly for 2019 to 4.6% (from 4.8%). Expectations for 2020 remain unchanged at 5.0% and eased from 5.2% to 5.1% for 2021, reaching the lowest levels since 2007. Five-year-ahead inflation expectations also declined to 5.0% (from 5.1%).

The inflation expectations of market analysts in the September 2019 Reuters Econometer survey have been revised lower to 4.3% (from 4.4%) for 2019 and remain unchanged at 4.9% and 4.8% in 2020 and 2021, respectively.

Market based expectations implicit in the break-even inflation rate (the yield differential between conventional and inflation-linked bonds) have remained stable since the previous MPC. Five-year break-even rates are currently about 4.6% and ten-year break-even rates at 5.4%.

Global GDP is expected to slow to 3.2% in 2019 and rise to around 3.5% in 2020. While global growth remains resilient, recent indicators on trade and manufacturing have deteriorated and a range of downside risks to growth remain. Growth in world trade volumes has continued to decline, with trade tensions weighing on market confidence and lowering investment. Other downside risks include geo-political developments, further oil price shocks, and high levels of corporate and sovereign debt. Across most countries, there is limited policy space to respond to shocks.

Inflation outcomes and inflation expectations in most advanced economies remain below targeted levels. Barring significant shocks, monetary policy in major advanced economies will remain accommodative over the medium term. However, market expectations of further accommodation appear high, creating ongoing risk of market volatility should these not materialise.

Since the July MPC, the rand has depreciated by 4.6% against the US dollar, and by 3.0% against the euro. The implied starting point for the rand is R14.88 against the US dollar, compared with R14.40 at the time of the previous meeting. At these levels, the QPM assesses the rand to remain slightly undervalued. While the rand has benefited from improvements in global sentiment, investors remain concerned about domestic growth prospects and fiscal risks.

GDP rebounded to 3.1% in the second quarter, following a decline of 3.1% in the first quarter. The sharp quarterly rebound was caused by stronger output in nearly all sectors, including investment and government consumption spending. However, longer term weakness in most sectors remains a serious concern. Based on recent short term economic indicators for the mining and manufacturing sectors, the third quarter GDP outcome is expected to be muted.

Business confidence has declined further. The Absa Purchasing Managers' Index came out at 45.7 points in August (from 46.3), and the RMB/BER Business Confidence Index fell to 21 points (from 28). The SARB's composite leading business cycle indicator also continued to trend lower, although the coincident indicator remains positive.

The forecast of GDP growth for 2019 remains unchanged at 0.6%. The forecasts for 2020 and 2021 have decreased to 1.5% (from 1.8%) and 1.8% (from 2.0%), respectively, due to revisions to global growth and domestic potential growth.

The MPC assesses the risks to the growth forecast to be balanced in the near term, but remains concerned about medium term growth and weak employment prospects. Escalation in global trade tensions, further domestic supply constraints and/or sustained higher oil prices could generate headwinds to growth. Public sector financing needs remain high, exerting pressure on the currency and pushing local bond yields higher relative to country peers. Implementation of prudent macroeconomic policies and structural reforms that lower costs, and raise investment and potential growth, remains urgent.

The overall risks to the inflation outlook are assessed to be largely balanced. Demand side pressures remain subdued and food, wages and rental prices are expected to increase at moderate rates. Global inflation should remain low. In the absence of shocks, relative exchange rate stability is expected to continue. Some upside risks to the inflation outlook remain, in particular from fuel, electricity and water prices.

The MPC welcomes the sustained moderation in inflation outcomes and the fall in inflation expectations of about one percent since 2016. The Committee would like to see inflation expectations also anchored closer to the mid-point of the inflation target range on a sustained basis.

Against this backdrop, the MPC unanimously decided to keep the repurchase rate unchanged at 6.5% per annum.

Monetary policy actions will continue to focus on anchoring inflation expectations near the mid-point of the inflation target range in the interest of balanced and sustainable growth. In this persistently uncertain environment, future policy decisions will continue to be highly data-dependent, sensitive to the assessment of the balance of risks to the outlook, and will seek to look-through temporary price shocks.

The implied path of policy rates over the forecast period generated by the Quarterly Projection Model indicated no changes to the repo rate. This remains a broad policy guide which could change in either direction from meeting to meeting in response to new developments and changing data and risks.

Lesetja Kganyago

GOVERNOR

The next statement of the Monetary Policy Committee will be released on 21 November 2019.

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