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 November meeting of the Monetary Policy Committee (MPC), global economic indicators improved somewhat and global inflation remained low. Central banks in advanced economies provided more monetary accommodation, helping to ease global financing conditions, but further easing appears less likely. While downside risks from trade tensions and geo-political developments remain, the global slowdown appears to be bottoming out.

The domestic economic outlook remains fragile. Despite a rebound in local GDP in the second quarter of 2019, GDP contracted in the third quarter. The fourth quarter is expected to show some positive growth.

Recent monthly inflation has been lower than the mid-point of the inflation target range. The year-on-year inflation rate, as measured by the headline consumer price index

(CPI) was 3.6% in November (down from 3.7% in October). Goods price inflation in November was 2.8% (down from 3.1% in October), while services price inflation remained at 4.2%. Food and non-alcoholic beverage price inflation was stable at 3.5% (down from 3.6%). The Bank's measure of core inflation, which excludes food, fuel and electricity decreased slightly to 3.9% (from 4.0% in October). Producer price inflation for final manufactured goods decreased to 2.3% in November (from 3.0% in October).

The medium-term inflation outlook has been revised significantly lower compared to the November forecast. The inflation forecast generated by the SARB's Quarterly Projection Model (QPM) averages 4.1% in 2019 (down from 4.2%), 4.7% for 2020 (down from 5.1%) and 4.6% for 2021 (down from 4.7%). The Bank's forecast for headline CPI inflation for 2022 is 4.5%. Headline CPI inflation is now expected to peak at 4.9% in the final quarter of 2020 and settle at 4.5% in the third quarter of 2021 (one quarter earlier). The forecast for core inflation for 2019 is unchanged at 4.2%, is 4.3% in 2020 (down from 4.5%) and 4.4% in 2021 (down from 4.6%). The Bank's forecast for core inflation for 2022 is 4.5%. Food price inflation continues to surprise to the downside on a monthly basis, and is revised from 5.8% to 4.7% for 2020.

Inflation expectations have continued to moderate gradually. According to the Bureau for Economic Research (BER) fourth quarter survey, expectations for headline inflation are down slightly for 2019 to 4.5% (from 4.6%). Expectations for 2020 declined to 4.8% (from 5.0%) and to 5.0% (from 5.1%) for 2021. Five-year-ahead inflation expectations also eased to 4.9% (from 5.0%).

The inflation expectations of market analysts in the December 2019 Reuters Econometer survey are generally lower, at 4.2% (from 4.3%) for 2019, 4.6% (from 4.7%) for 2020 and 4.7% (from 4.8%) in 2021.

Market based expectations implicit in the break-even inflation rate (the yield differential between conventional and inflation-linked bonds) have moderated somewhat since the previous MPC. Five-year break-even rates are currently about 4.1% and ten-year break-even rates are 5.3%.

Global GDP is expected to average 3.0% in 2019, rising to about 3.4% in 2020. In recent months, global trade and manufacturing indicators have exhibited signs of stabilisation, and, alongside resilient services, suggest that global growth rates will hold up. However, a range of downside risks to growth remain. These include geo-political developments, trade tensions, further oil price shocks, and high levels of corporate and sovereign debt.

Inflation outcomes and inflation expectations in most advanced economies remain below target levels. Barring significant shocks, monetary policy in major advanced economies will remain accommodative over the medium term.

Since the November MPC, the rand has appreciated by 2.6% against the US dollar, and by 1.8% against the euro. The implied starting point for the rand is R14.60 against the US dollar, compared with R14.94 at the time of the previous meeting. While the rand has benefited from improvements in global sentiment, high long-term bond yields reflect concerns about domestic growth prospects and fiscal risks.

The GDP growth outcome for the third quarter confirmed that the economy remains weak and vulnerable to idiosyncratic shocks and poor sectoral performances. While growth in the fourth quarter is expected to have picked up, electricity supply constraints will likely keep economic activity muted in the near term. Public sector investment continues to be weak and export growth remains lacklustre, despite strong terms of trade. Government and household consumption, and private investment, continue to grow, albeit modestly.

Business confidence remains weak. The RMB/BER Business Confidence Index improved to 26 points (from 21), while the Absa Purchasing Managers' Index fell to 47.1 points in December (from 47.7). The SARB's composite leading business cycle indicator also continued to trend lower, while the coincident indicator increased marginally month-on-month.

The forecast of GDP growth for 2019 is revised lower to 0.4% (from 0.5%). The forecasts for 2020 and 2021 have also decreased to 1.2% (from 1.4%) and 1.6% (from 1.7%), respectively, due to lower growth than previously expected in the third and fourth quarters. The GDP forecast for 2022 is 1.9%.

The MPC assesses the risks to the growth forecast to be to the downside. Escalation in global trade tensions, geo-political risks, further domestic supply constraints and/or sustained higher oil prices could generate headwinds to growth. Public sector financing needs have risen, increasing risk premiums and pushing borrowing costs for the broader economy higher. Implementation of prudent macroeconomic policies and structural reforms that lower costs and increase investment, potential growth and job creation, remains urgent.

The overall risks to the inflation outlook are assessed to be balanced. Demand side pressures remain subdued and house rental prices are expected to increase at only moderate rates. Global inflation should also remain low. Food price inflation has continued to surprise to the downside, although rising imported food prices create some caution about the future price trajectory. While the currency has strengthened relative to the November meeting, the risk remains that domestic shocks generate more capital flow volatility and put pressure on the exchange rate and inflation. Other upside risks to the inflation outlook remain, including from fuel, electricity and water prices, and from nominal wage growth.

The MPC welcomes the lower inflation outcomes and continued moderation in inflation expectations. While the Committee would like to see inflation expectations anchored closer to the mid-point of the inflation target range on a sustained basis, the lower inflation forecast and improved risk profile opens some space to provide further policy accommodation to the economy.

Against this backdrop, the MPC decided to reduce the repurchase rate by 25 basis points. The decision was unanimous.

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 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 two repo rate cuts of 25 basis points each in the first and fourth quarters of 2020. 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 19th March 2020.

Contact person:

Ziyanda Mtshali

012 399 7966

media@resbank.co.za