South African Reserve Bank

Overview of monetary policy

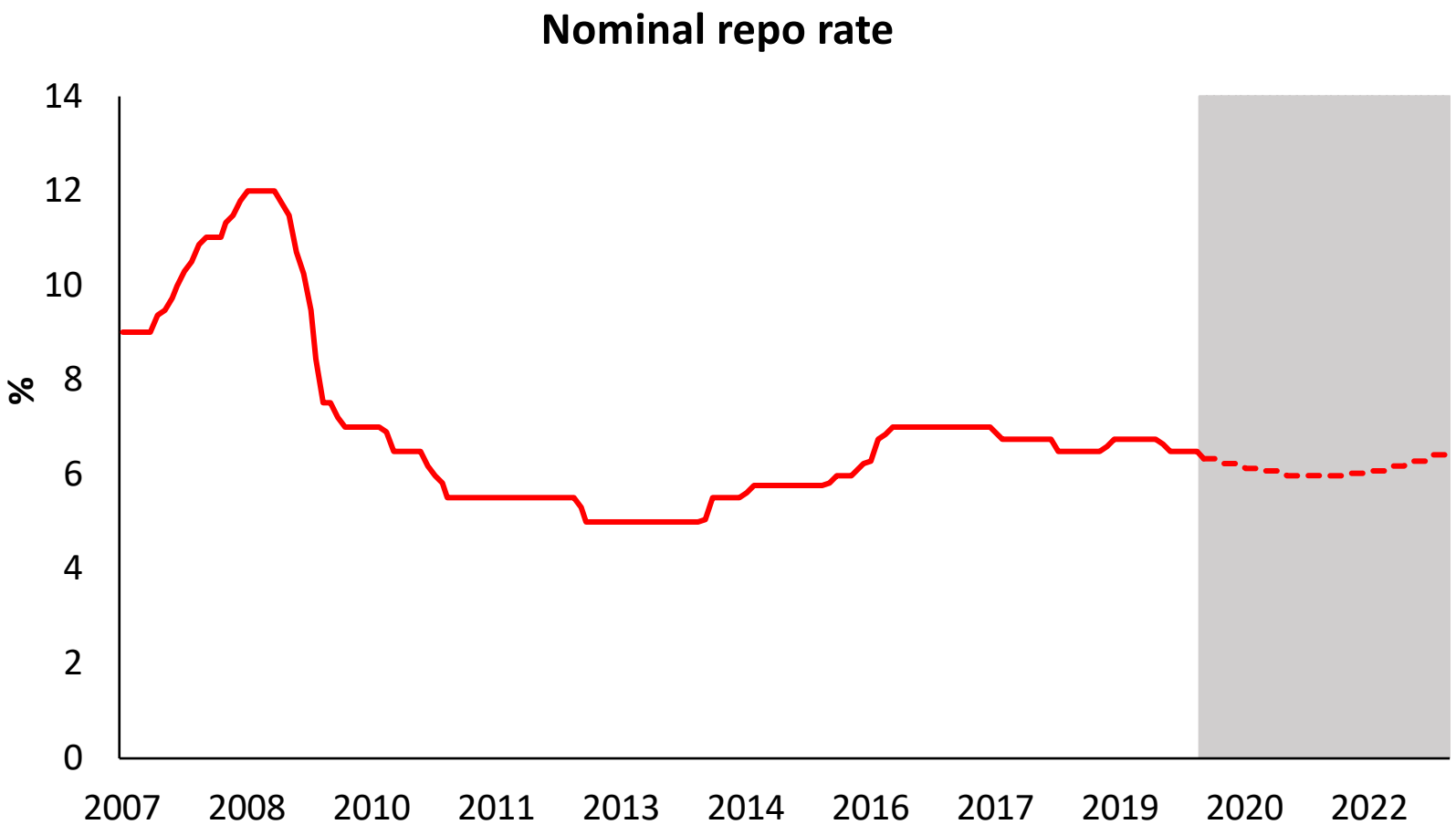
Presentation to the Standing Committee on Finance

18 February 2020

Overview

- Lower inflation has created space for rate cuts (July ’19; Jan. ’20)
- Growth weak, mostly for structural reasons, but lower rates may help on the margin
- Monetary policy credibility helps mitigate SA’s longstanding stagflation problem
- But elevated country risk still generating some upward pressure on rates
- Lower inflation + lower risk = lower rates

Repo down to 6.25%; model currently sees a second cut in late-2020



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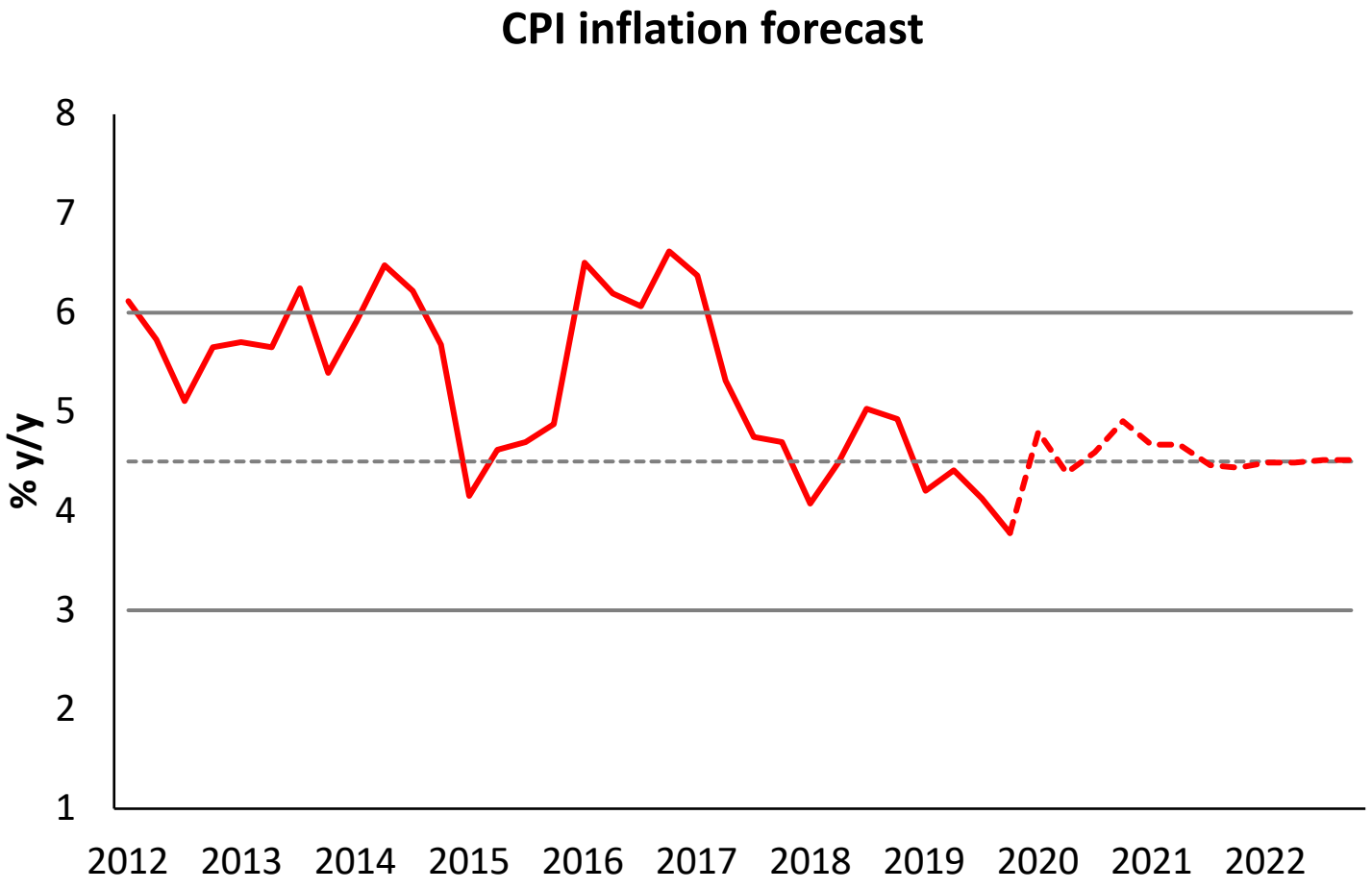
Inflation forecast near the 4.5% target midpoint for 2020, 2021 and 2022



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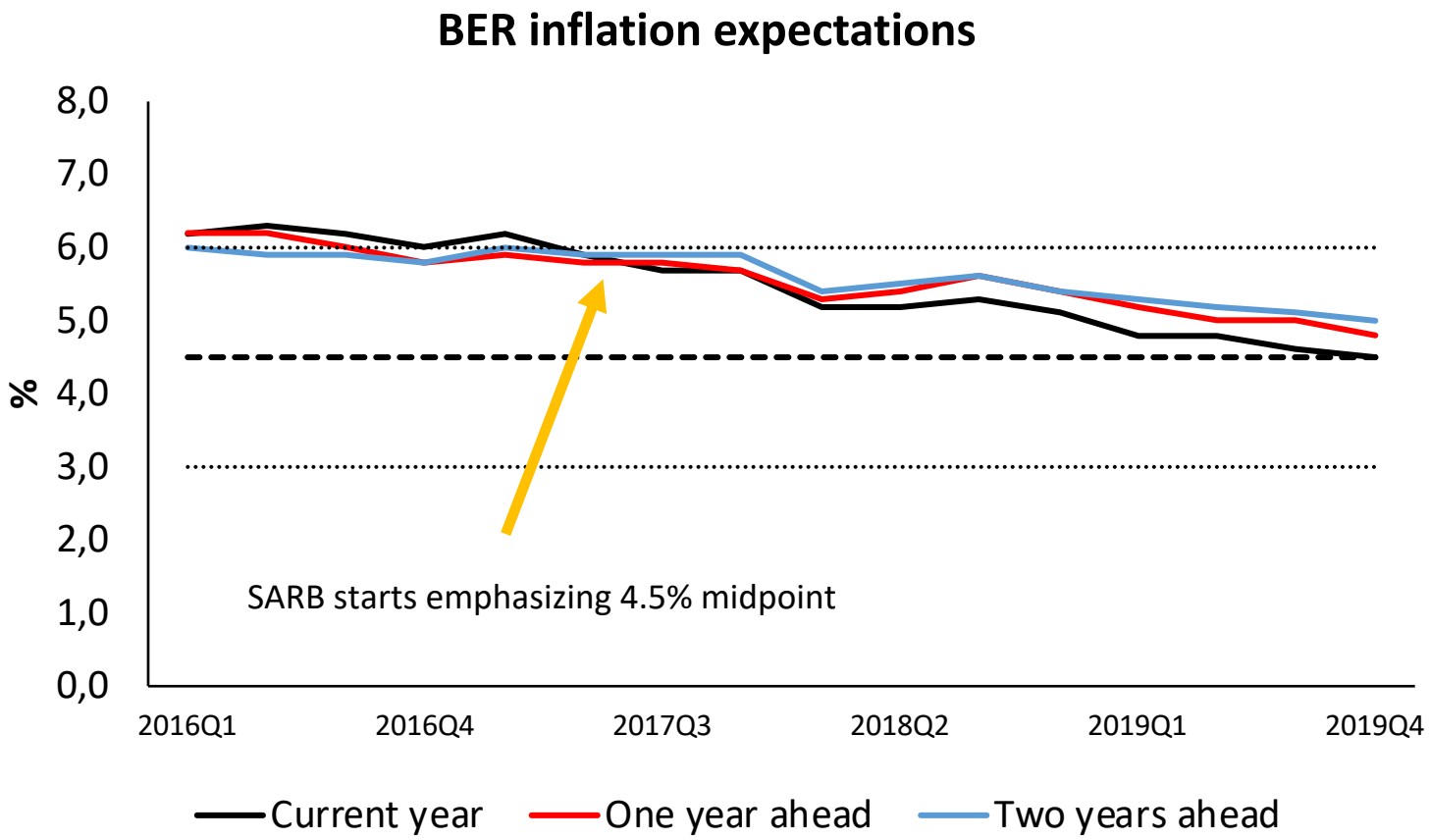
Inflation expectations coming down – South Africans getting used to lower inflation



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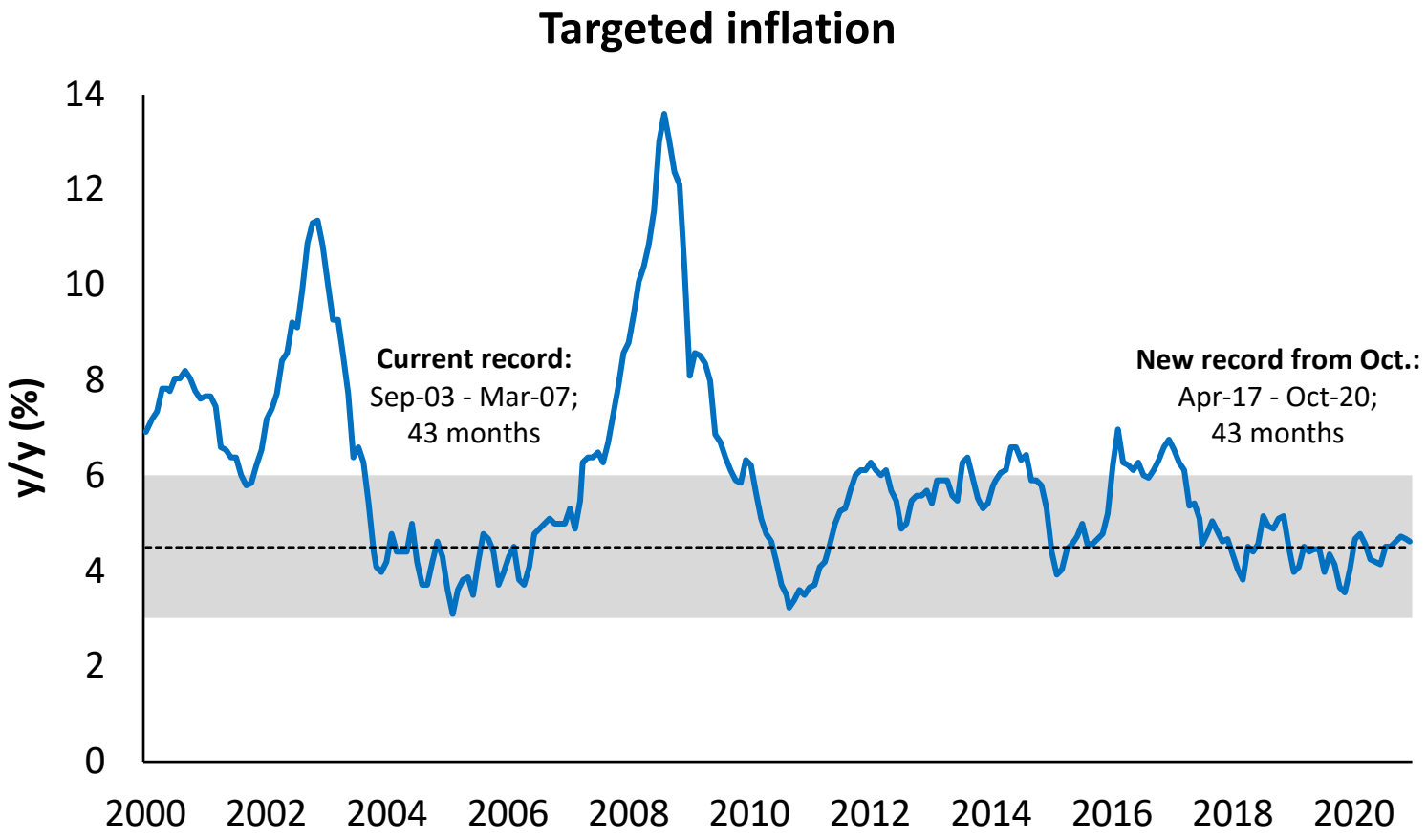
Inflation on track for longest-ever period inside the target range



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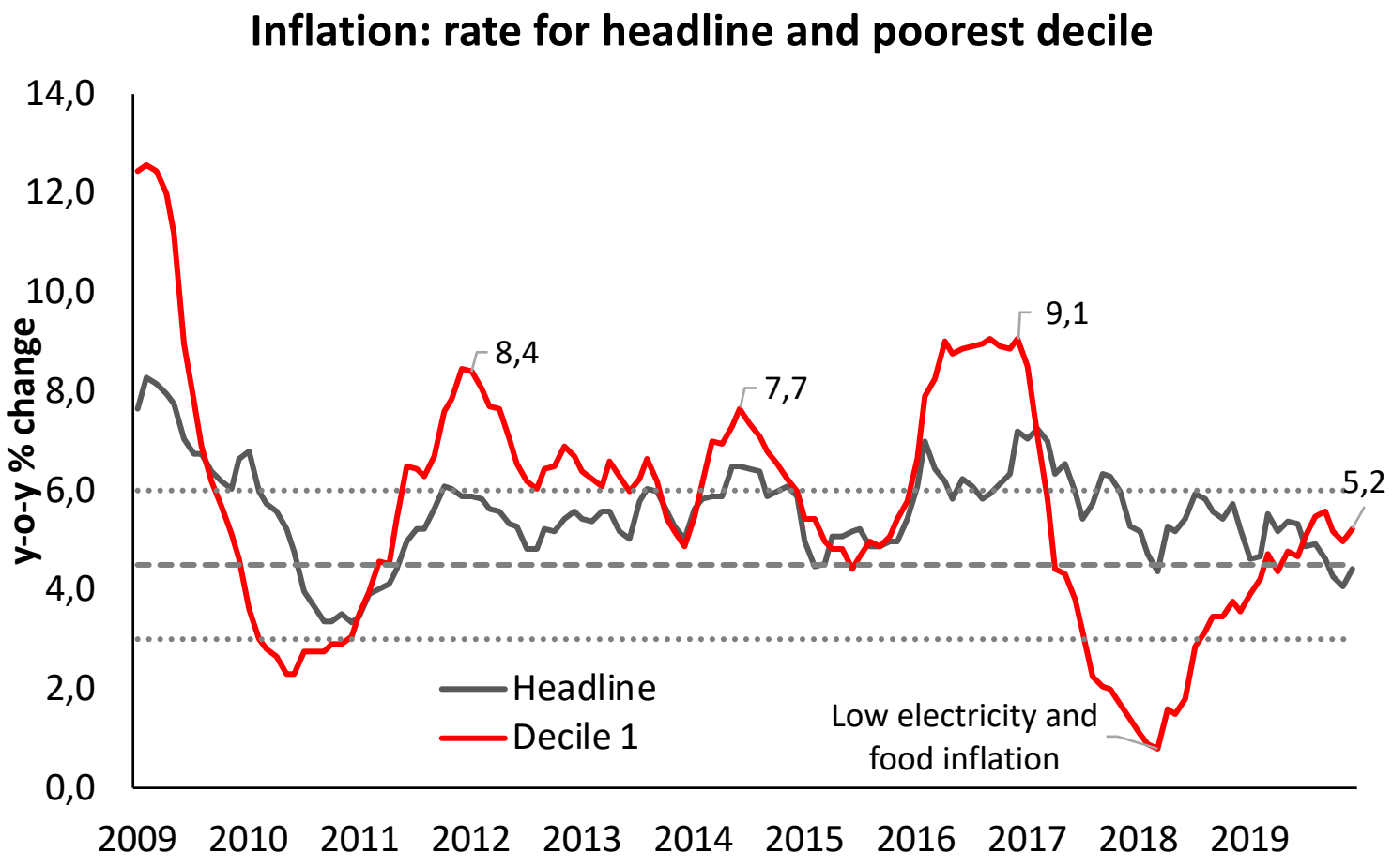
Inflation for poorer South Africans also lower; inside the target range



Source: StatsSA

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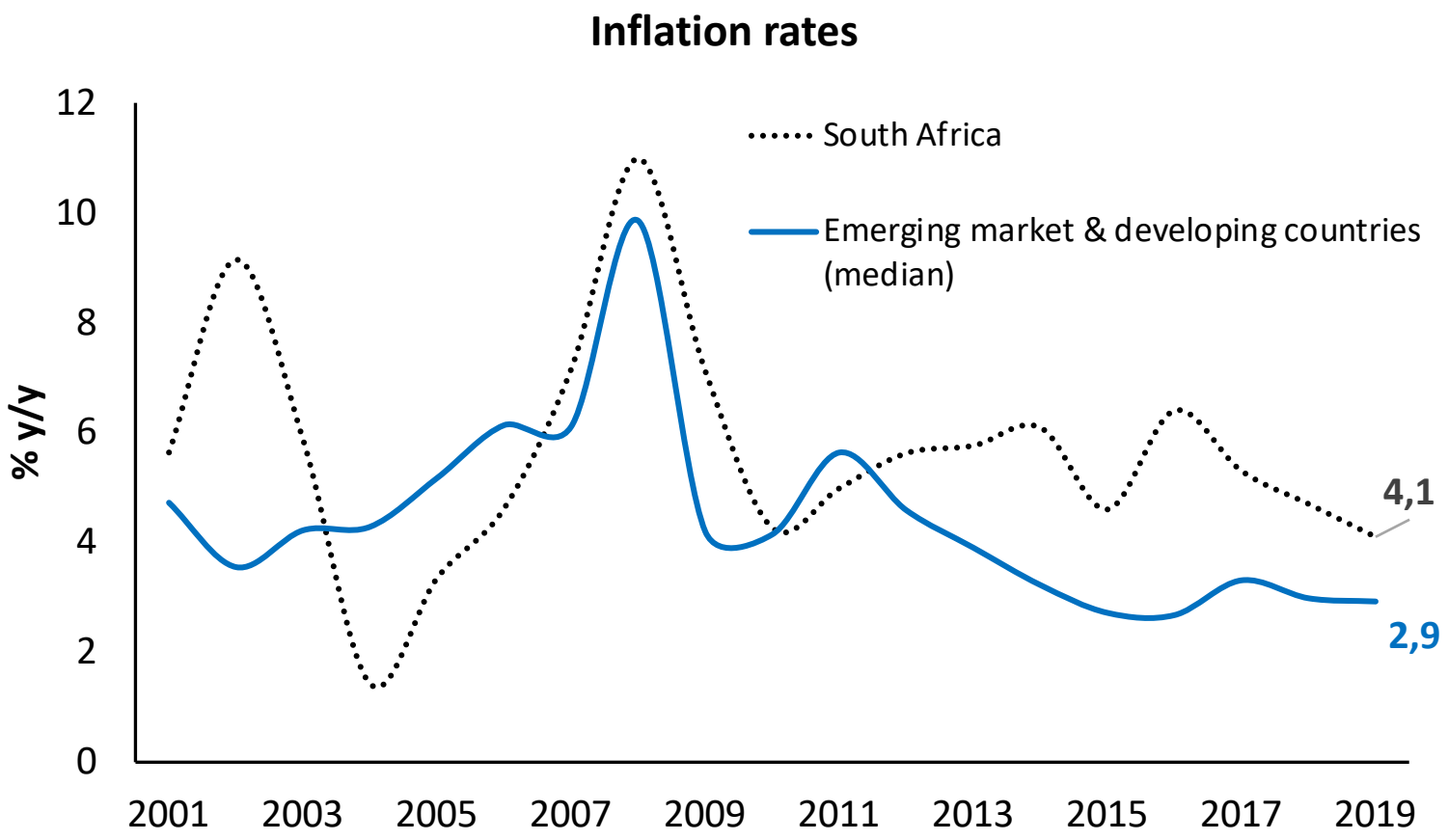
SA inflation nonetheless quite high, compared with peers



Source: IMF

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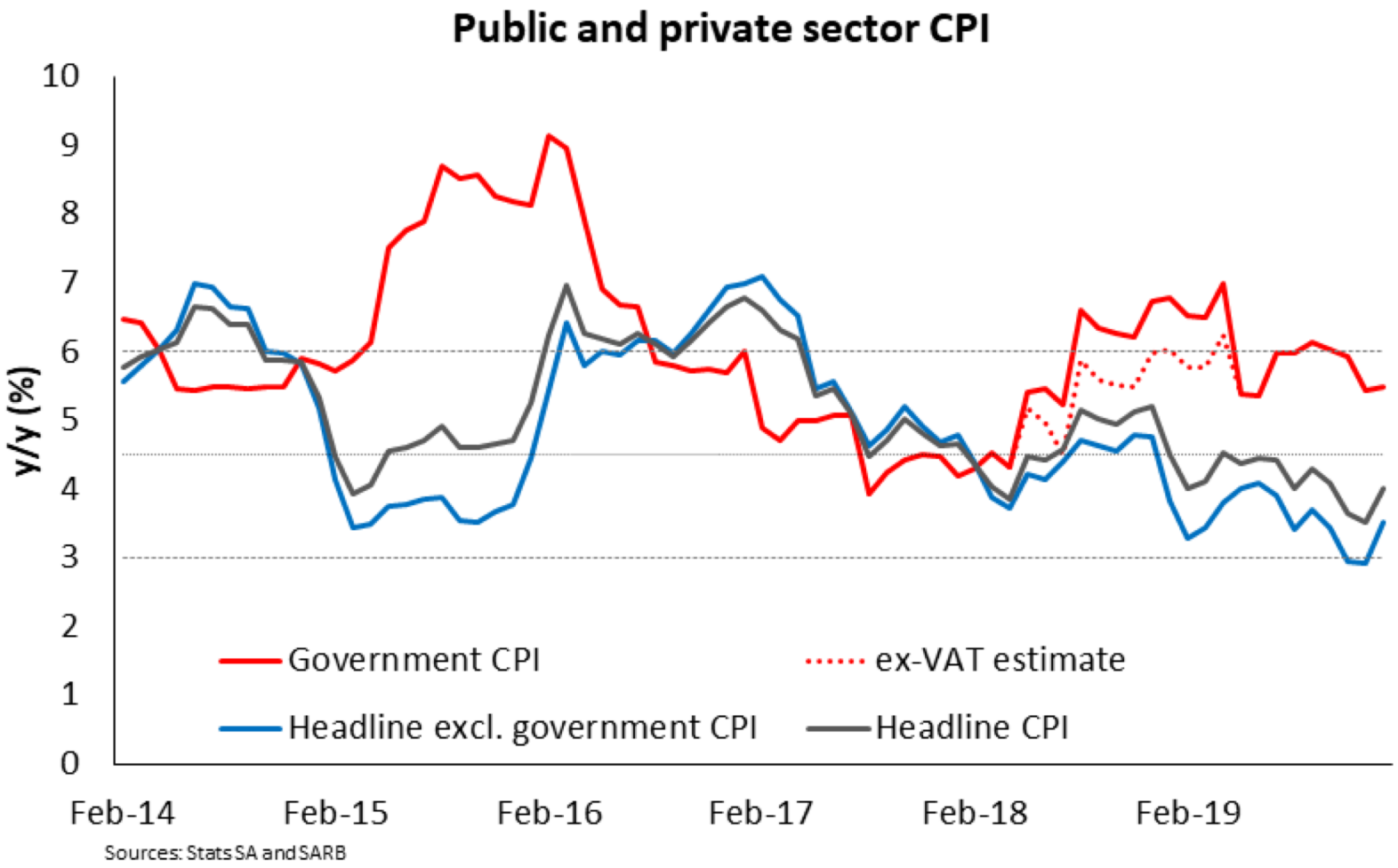
Government-affected prices rising relatively fast (water, electricity, sin taxes)



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SA growth weak, below long-run averages…

Source: StatsSA

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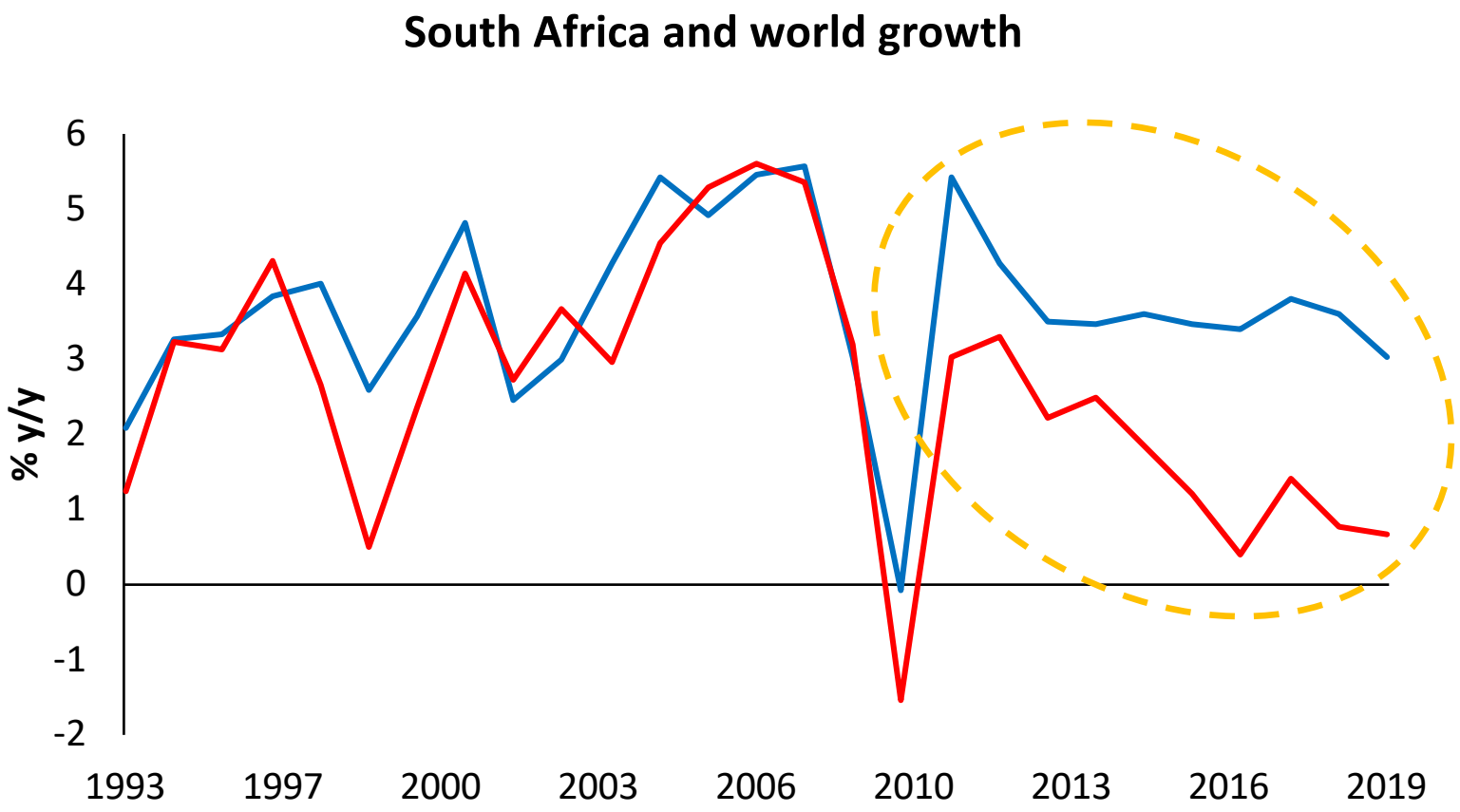
And disconnected from world growth, which is unusual



Source: IMF & StatsSA

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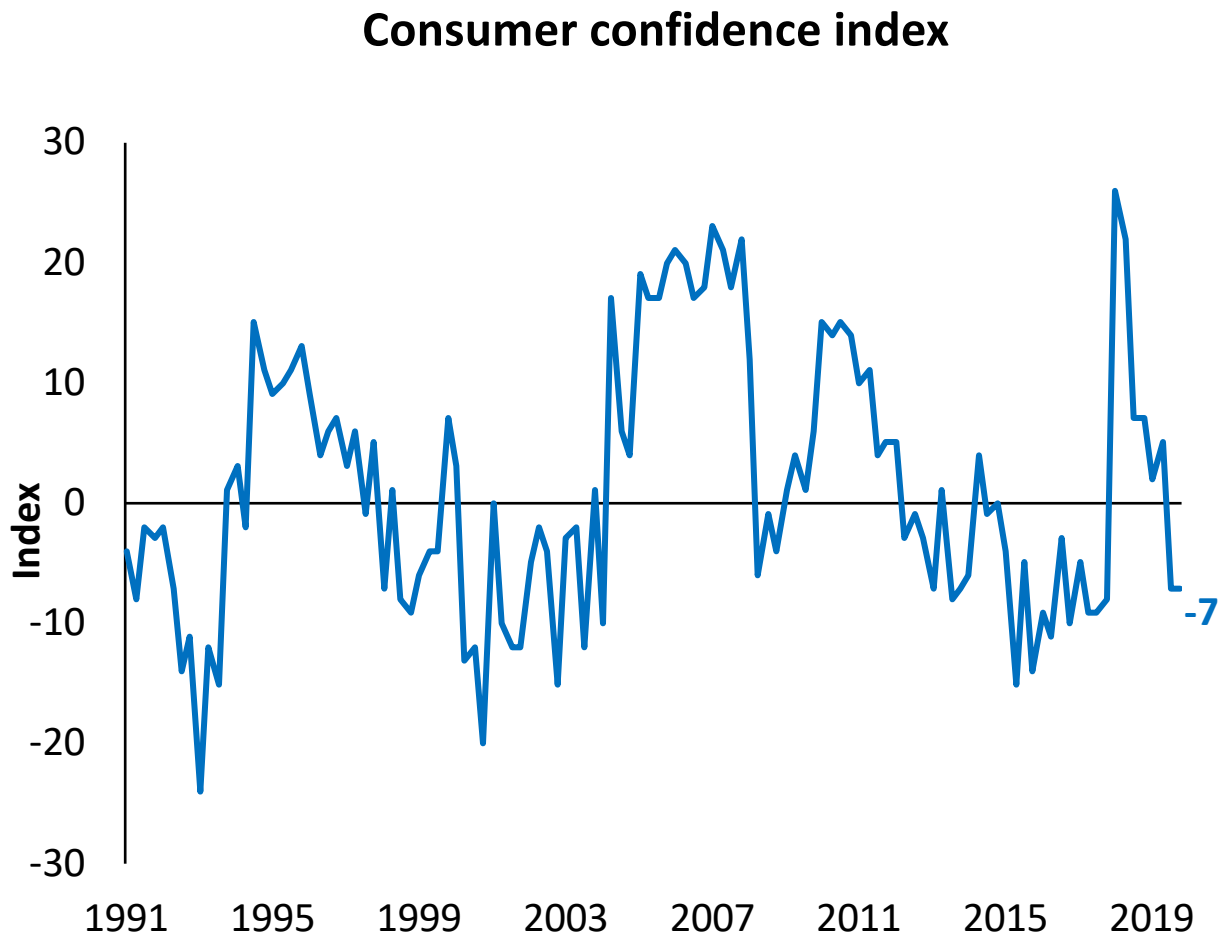
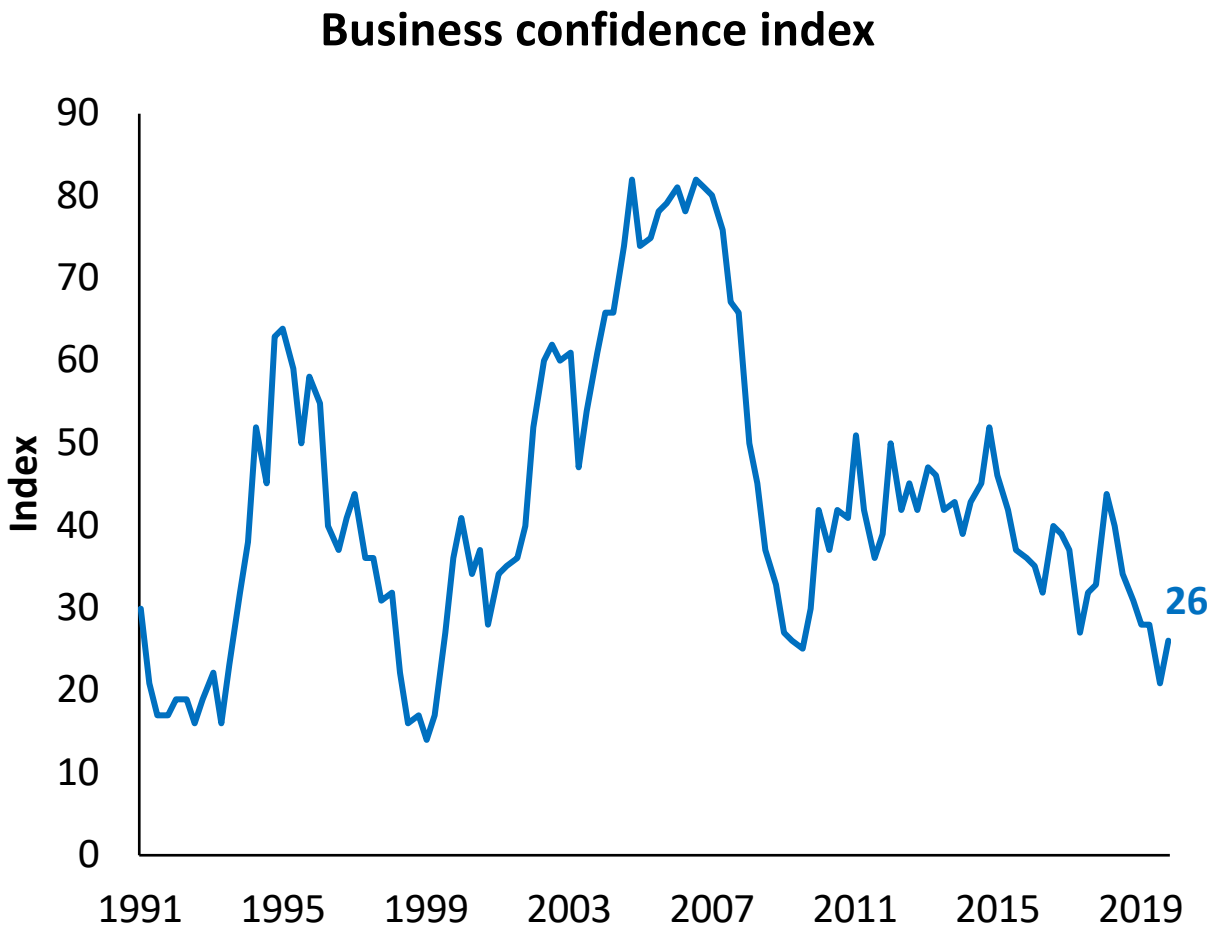
Confidence is very subdued



Source: BER



Source: BER

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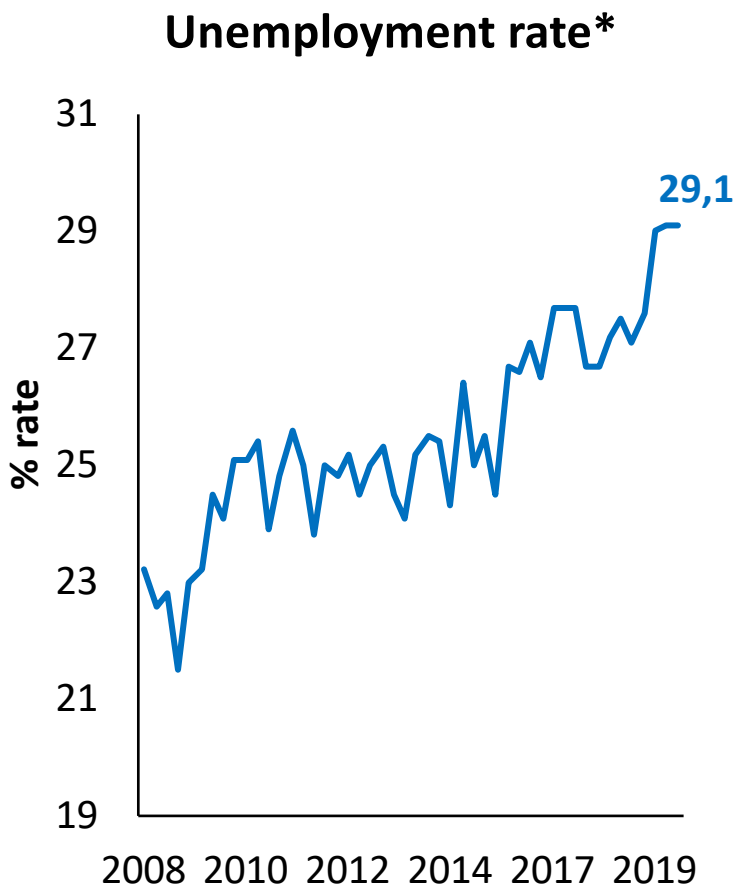
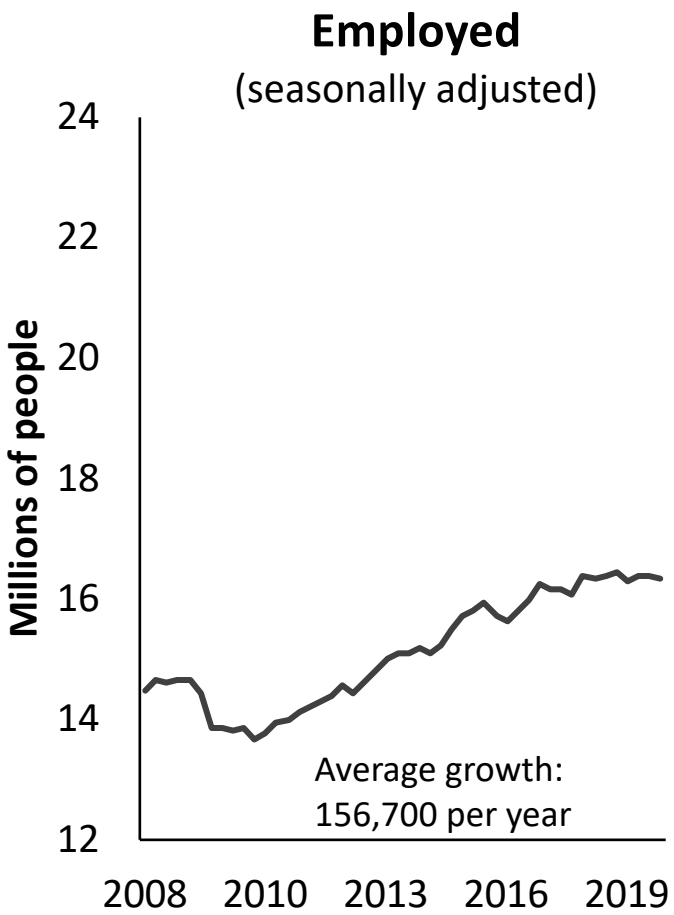
Unemployment rising, jobs growing slower than workforce

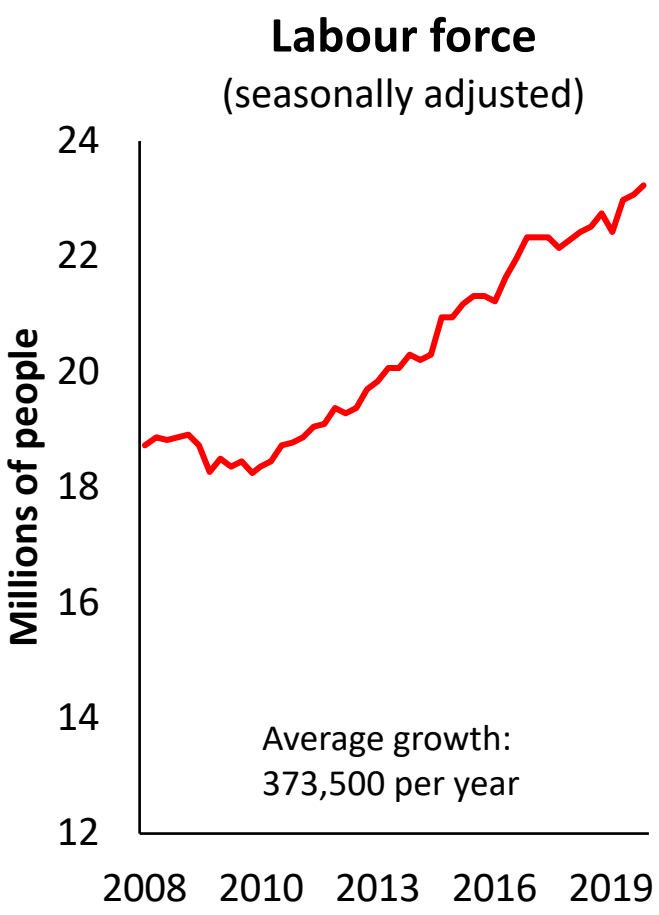


Source: StatsSA

*Headline rate, not seasonally adjusted
(seasonally adjusted rate is 29.6% for 2019Q4)



Source: StatsSA



Source: StatsSA

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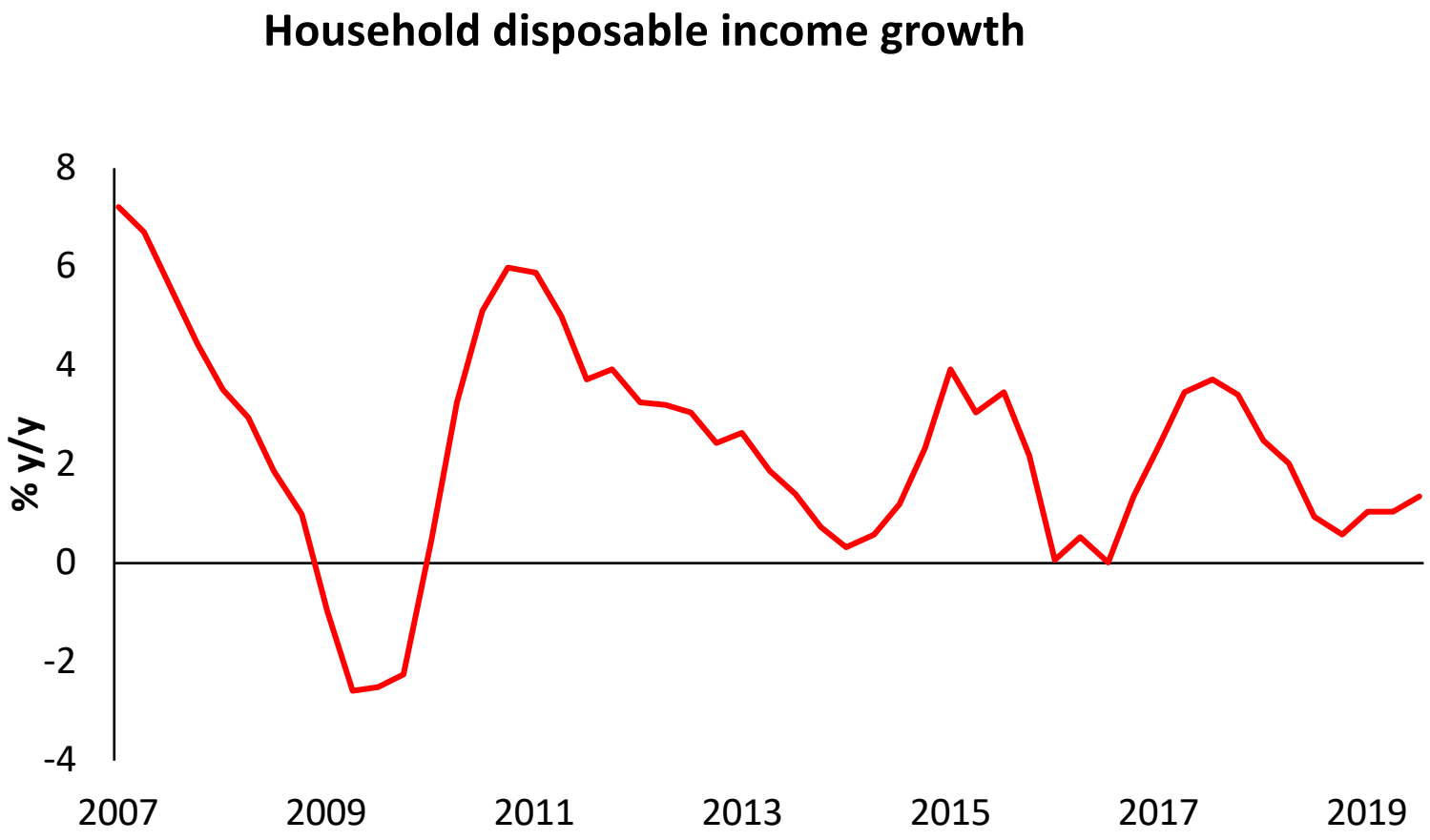
Household incomes growing, but sluggishly



Source: StatsSA

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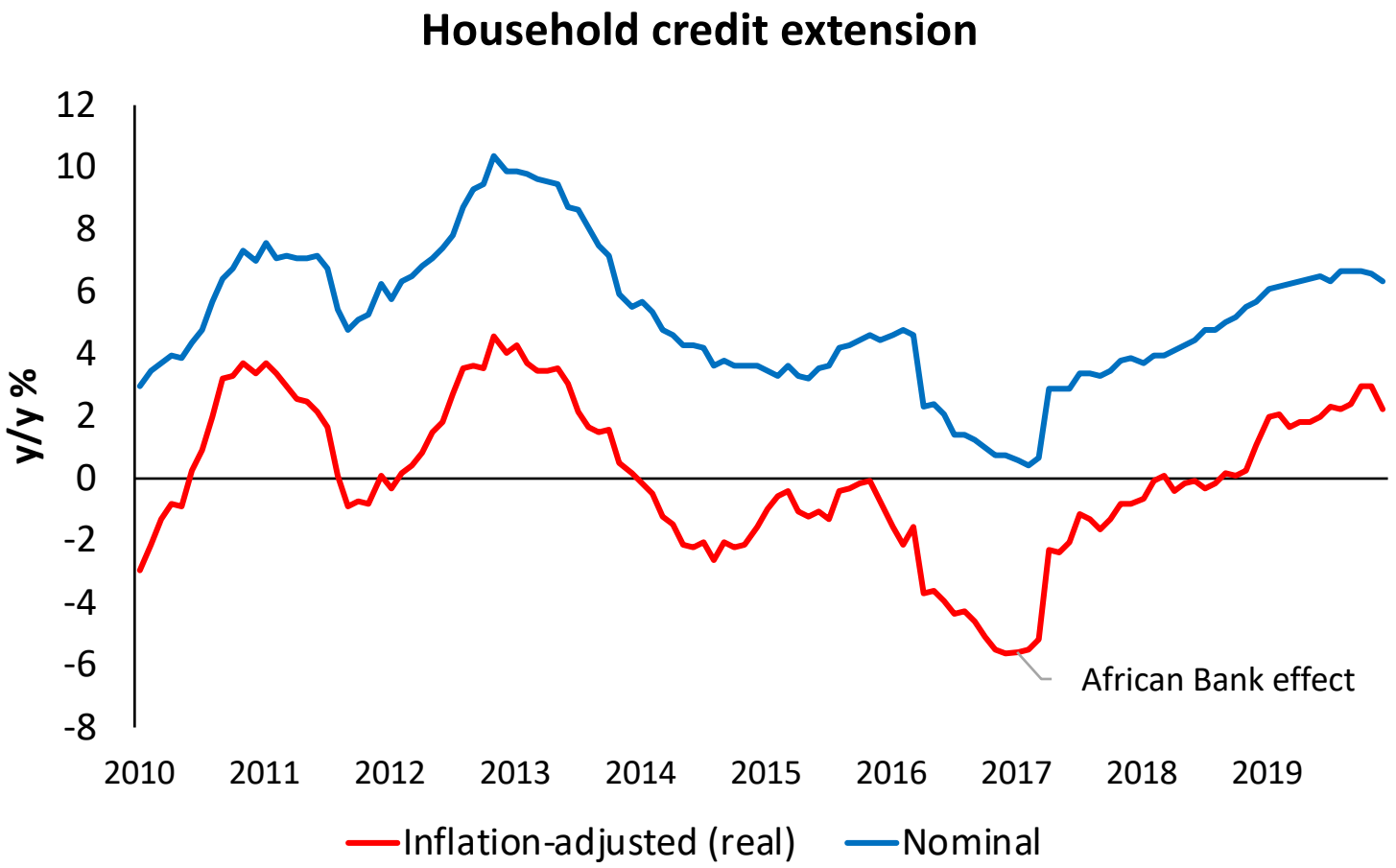
Some signs of life in household credit growth



Source: SARB

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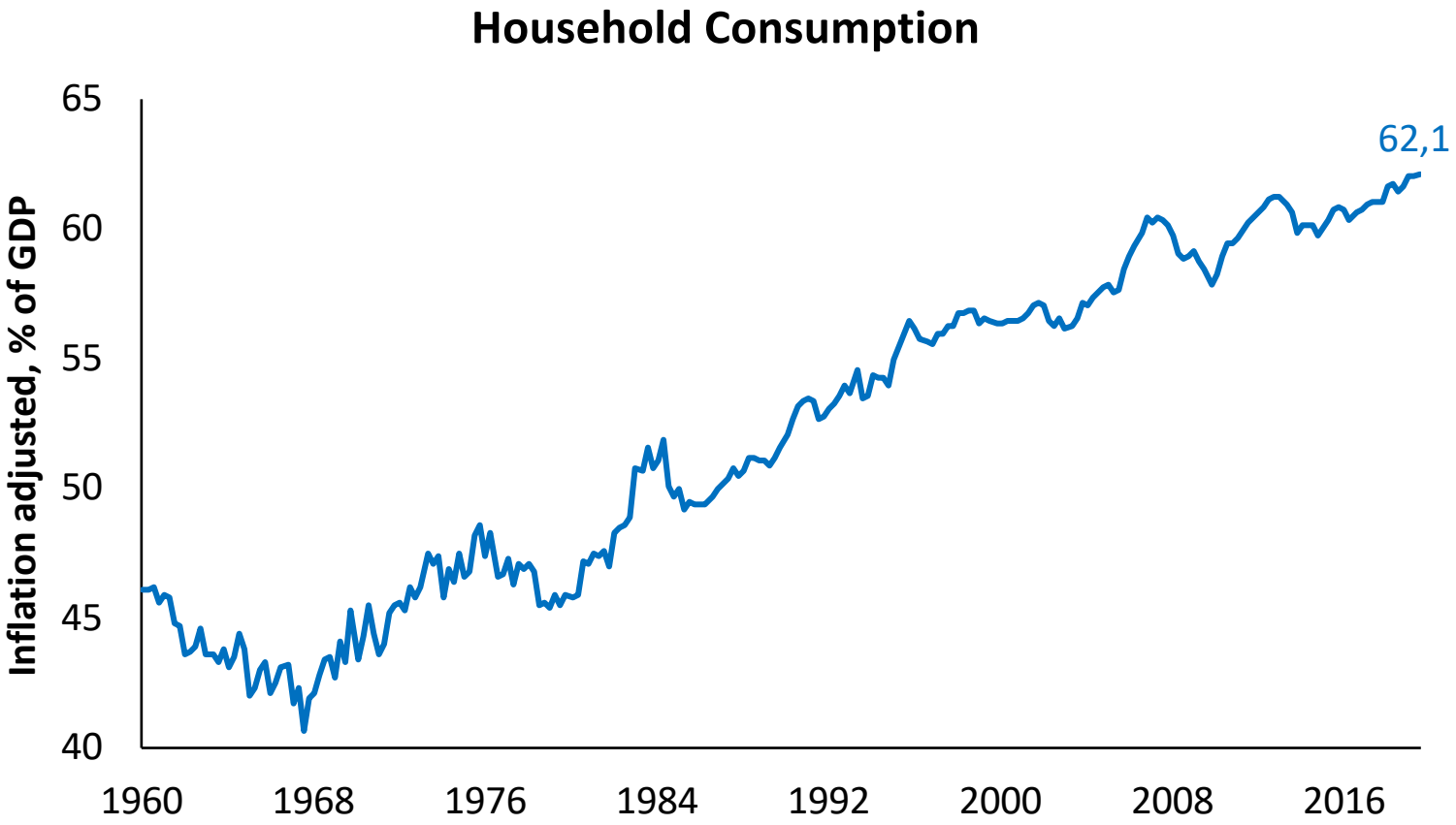
Household consumption remains high relative to GDP



Source: Stats SA and SARB

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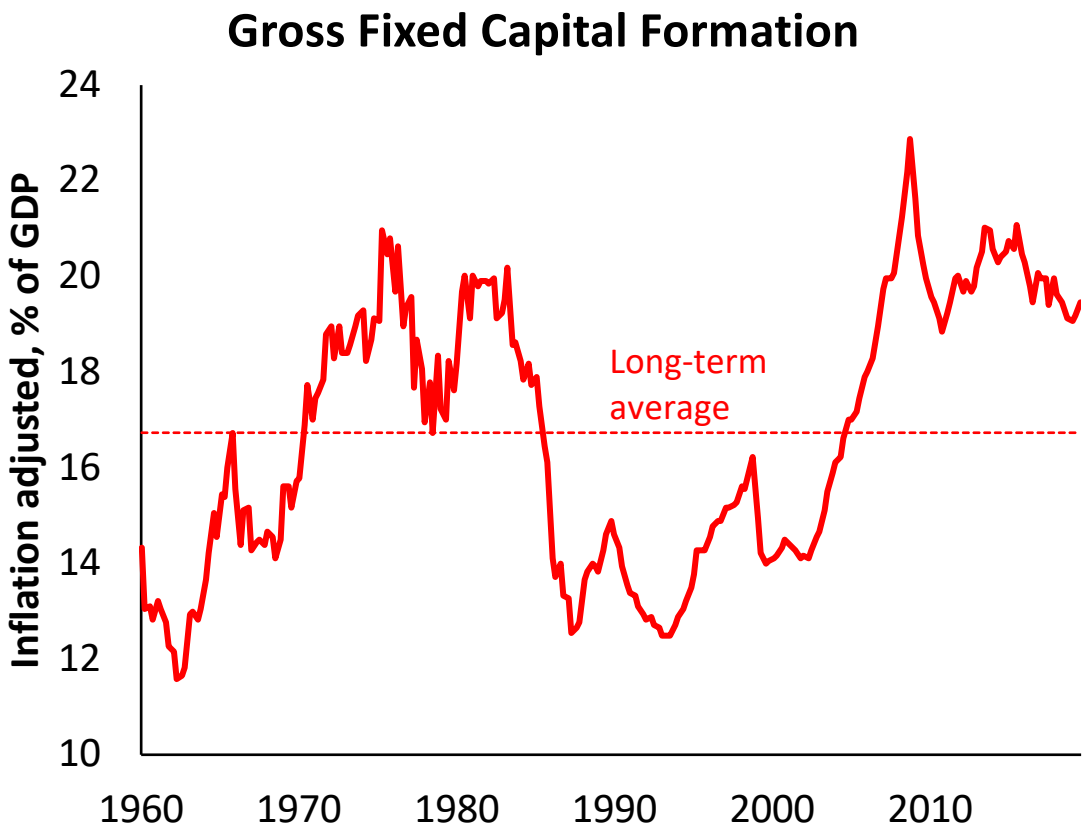
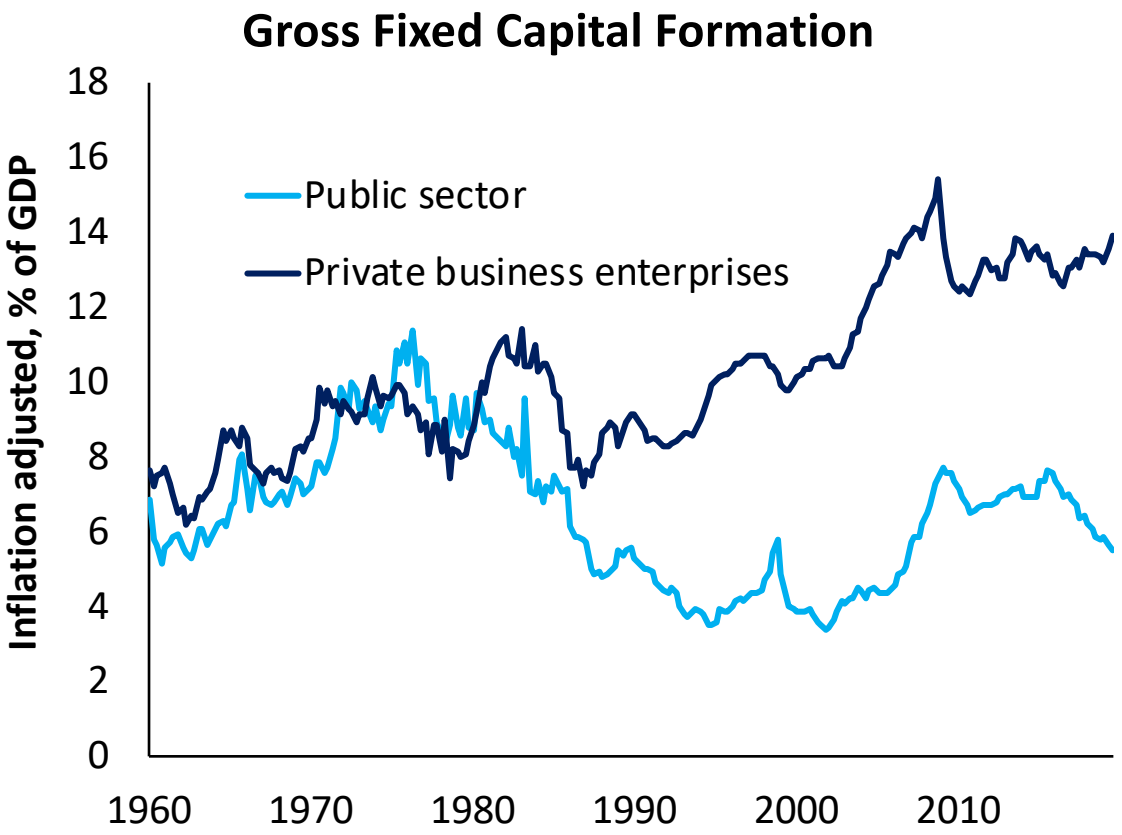
Investment more resilient than advertised – especially private investment



Source: Stats SA and SARB



Public sector = general government + public corprorations.
Source: Stats SA and SARB

Latest observation is higher than 75.7% of the sample

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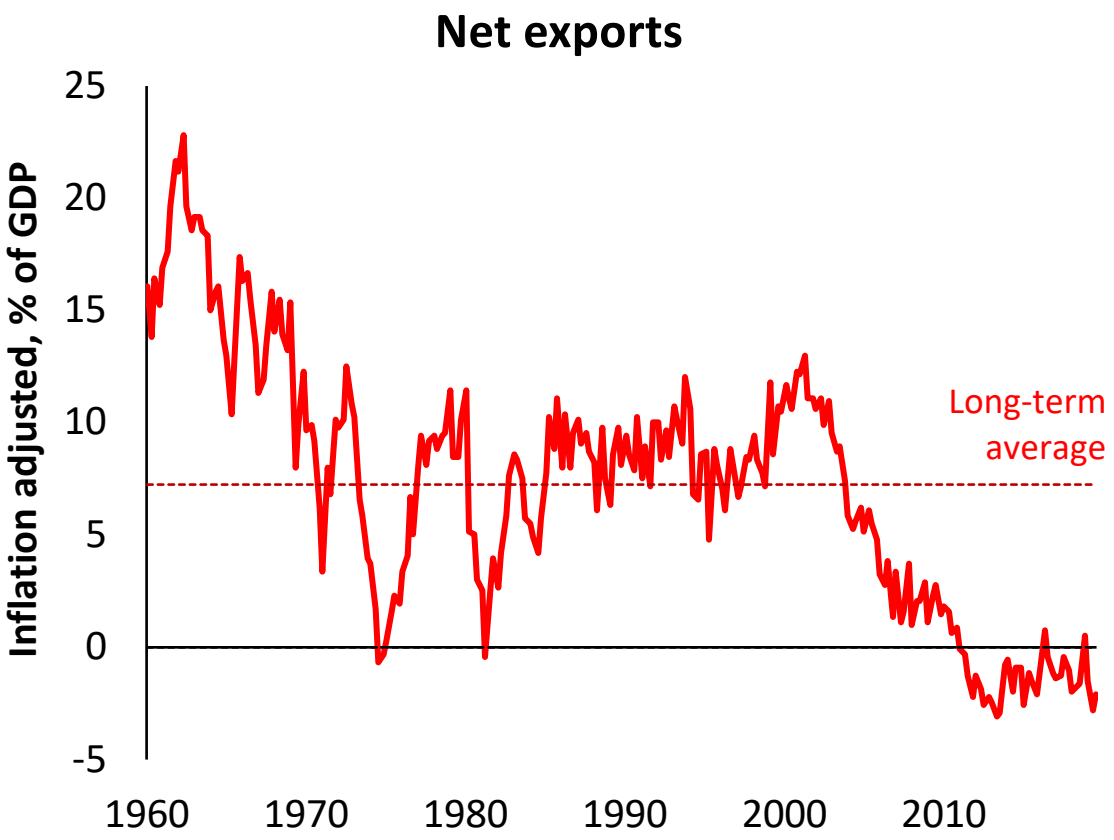
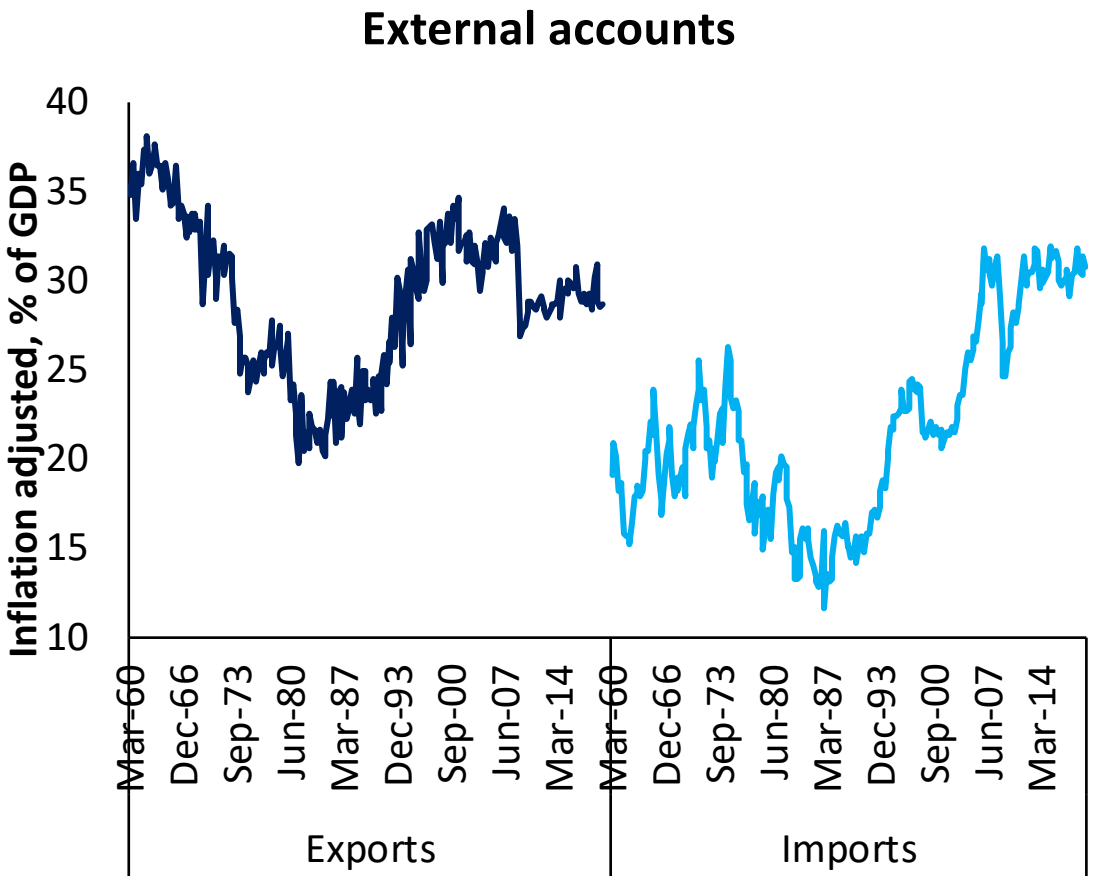
While imports are high and exports under-performing



Source: Stats SA and SARB



Source: Stats SA and SARB

Latest observation is lower than 95.8% of the sample

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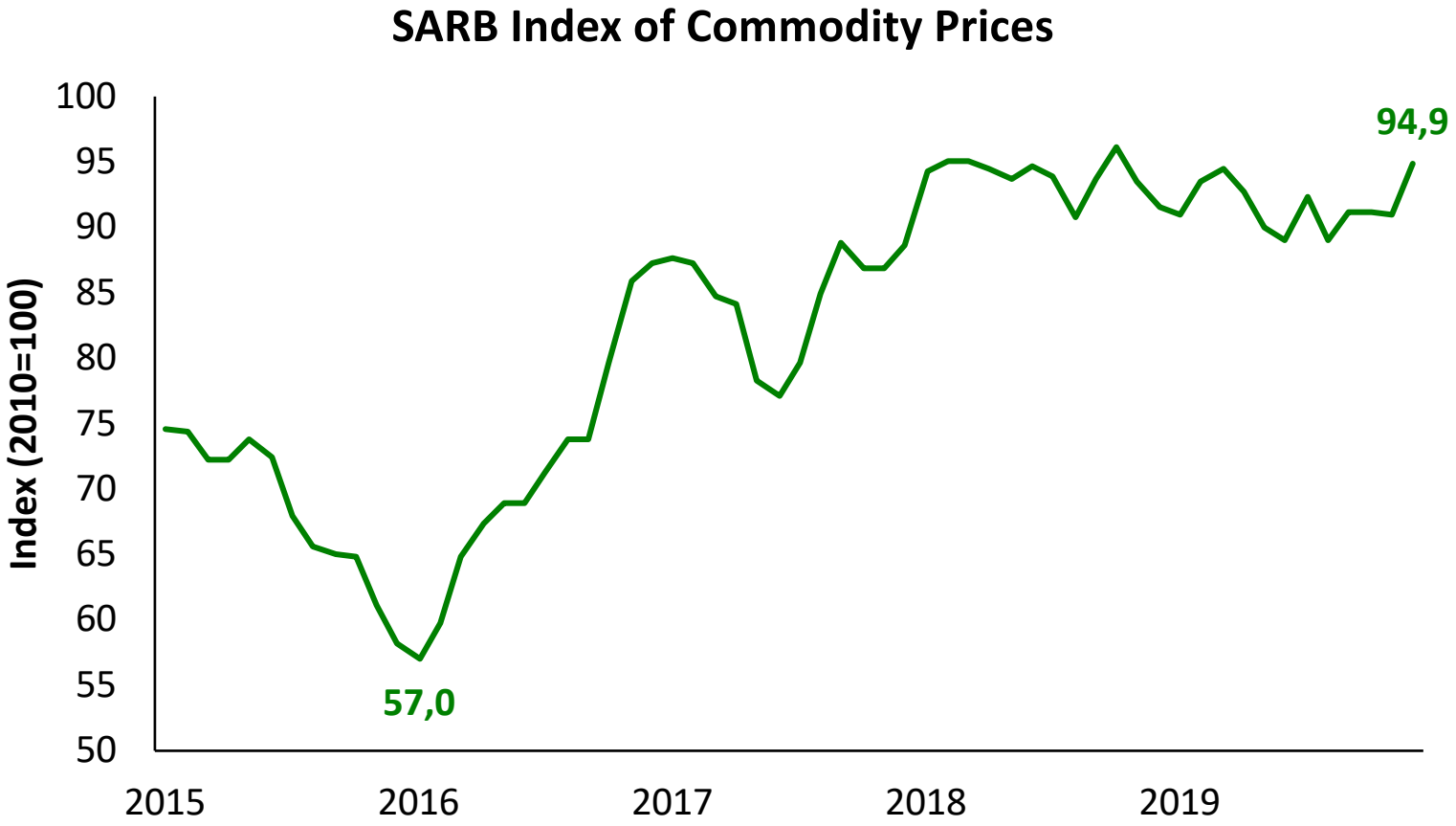
Even though SA commodity price index remains high



Source: SARB

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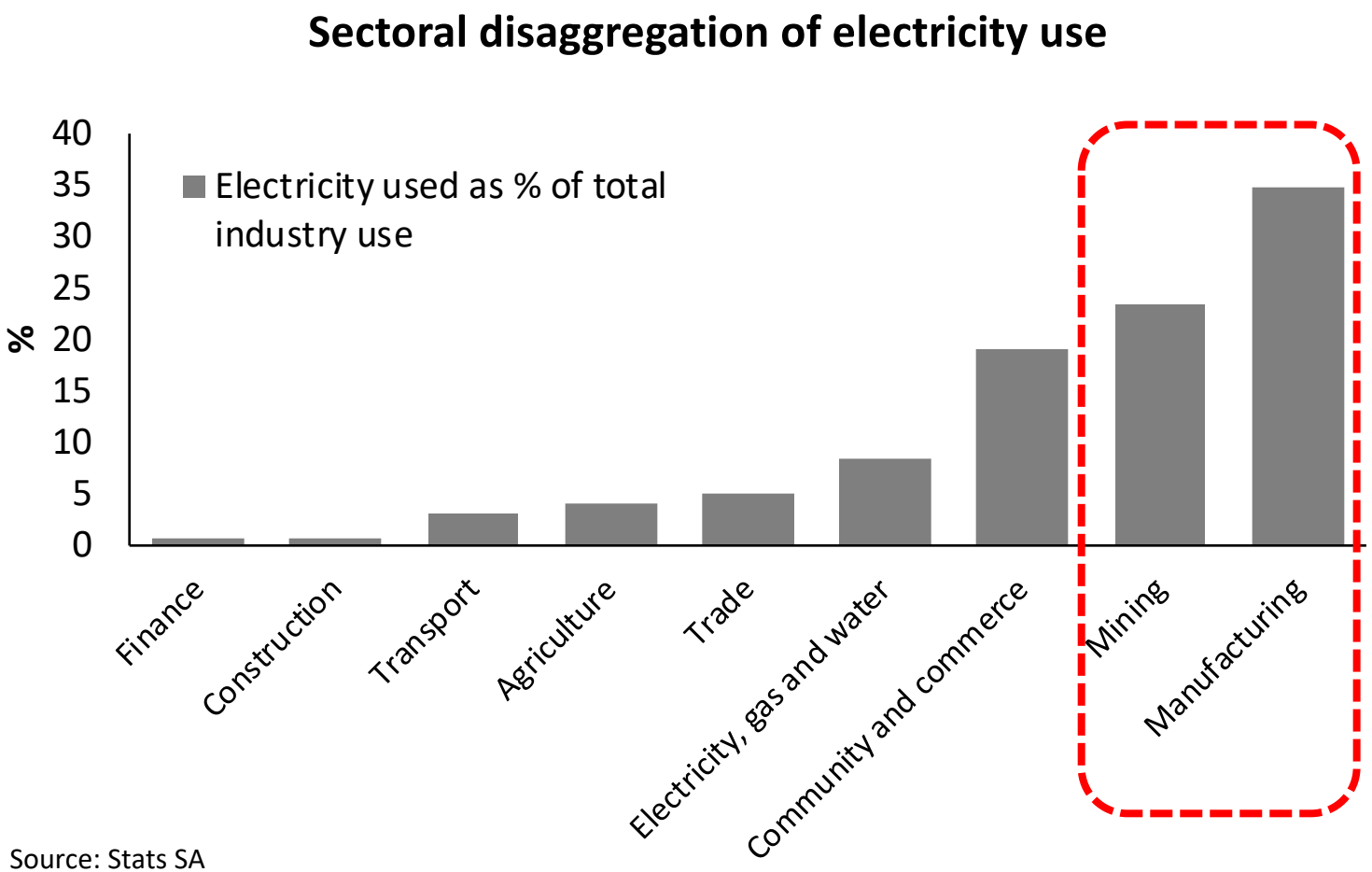
Weakness in export sectors related to problems like electricity shortages



Source: Stats SA

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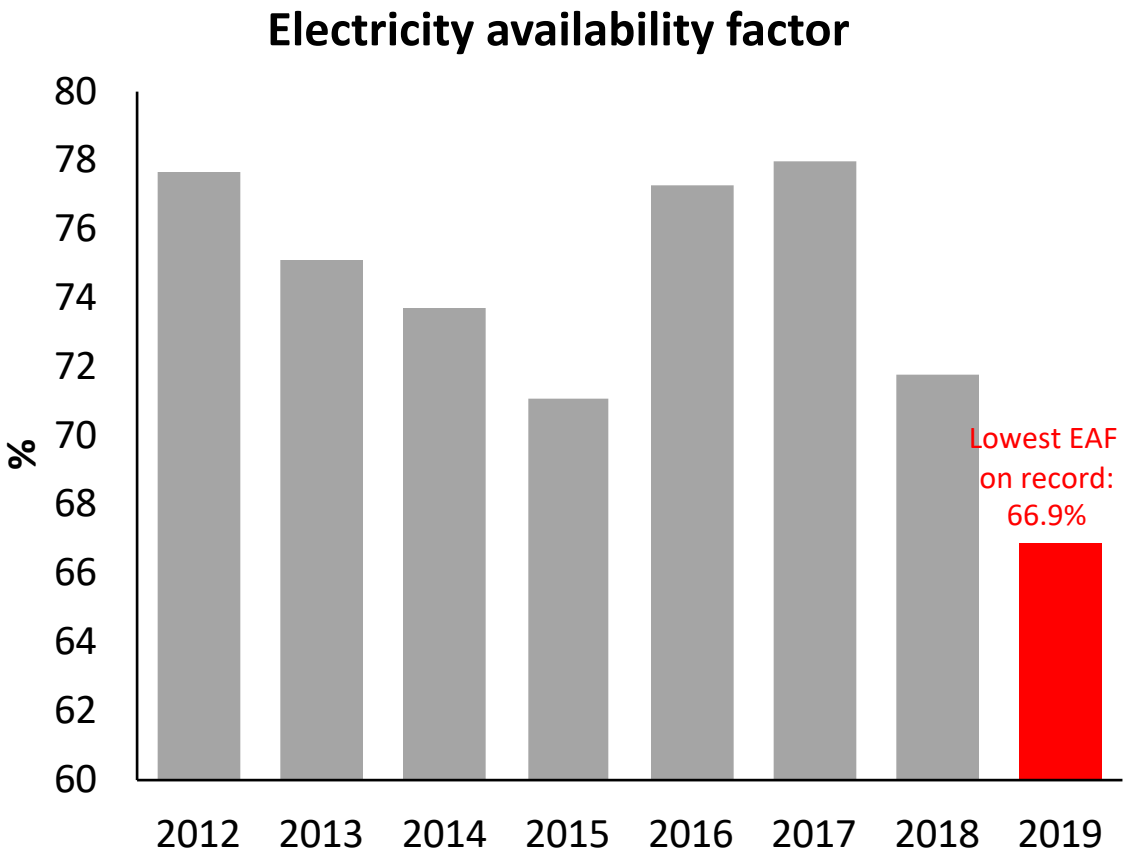
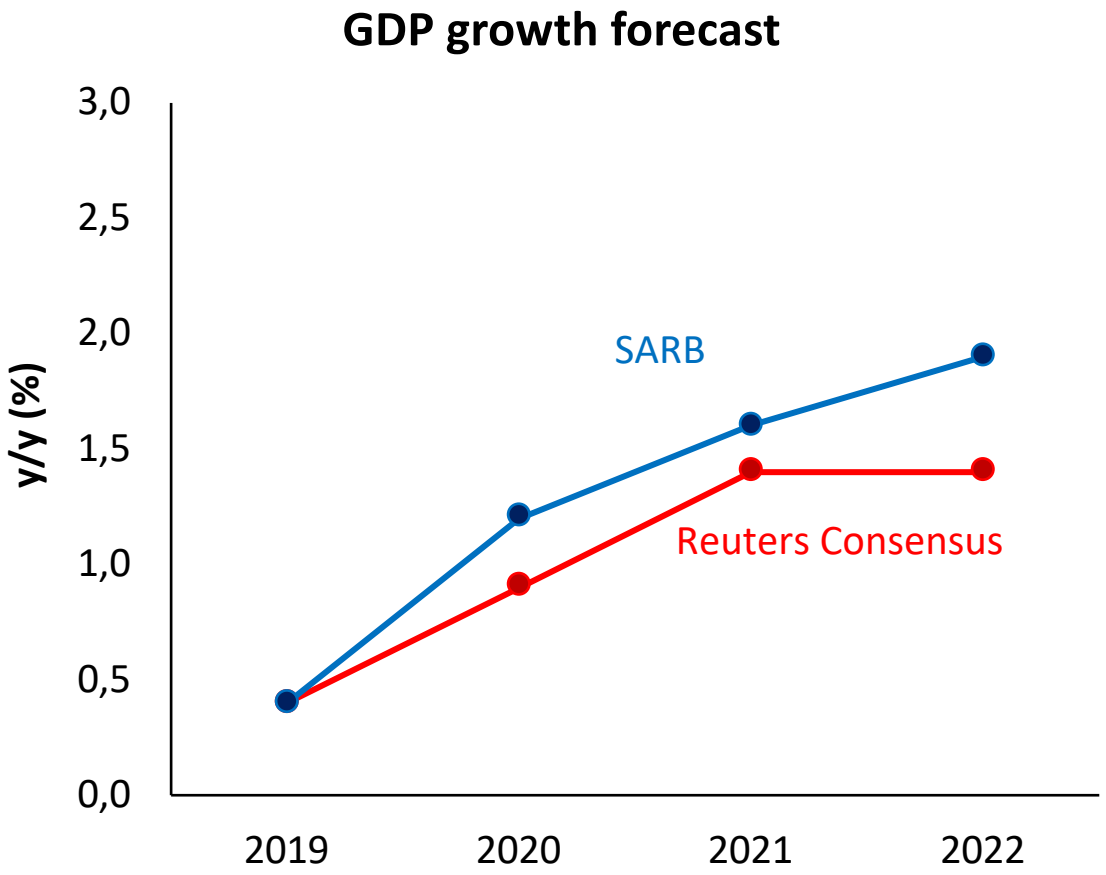
Constraints likely to keep growth low





Source: Eskom

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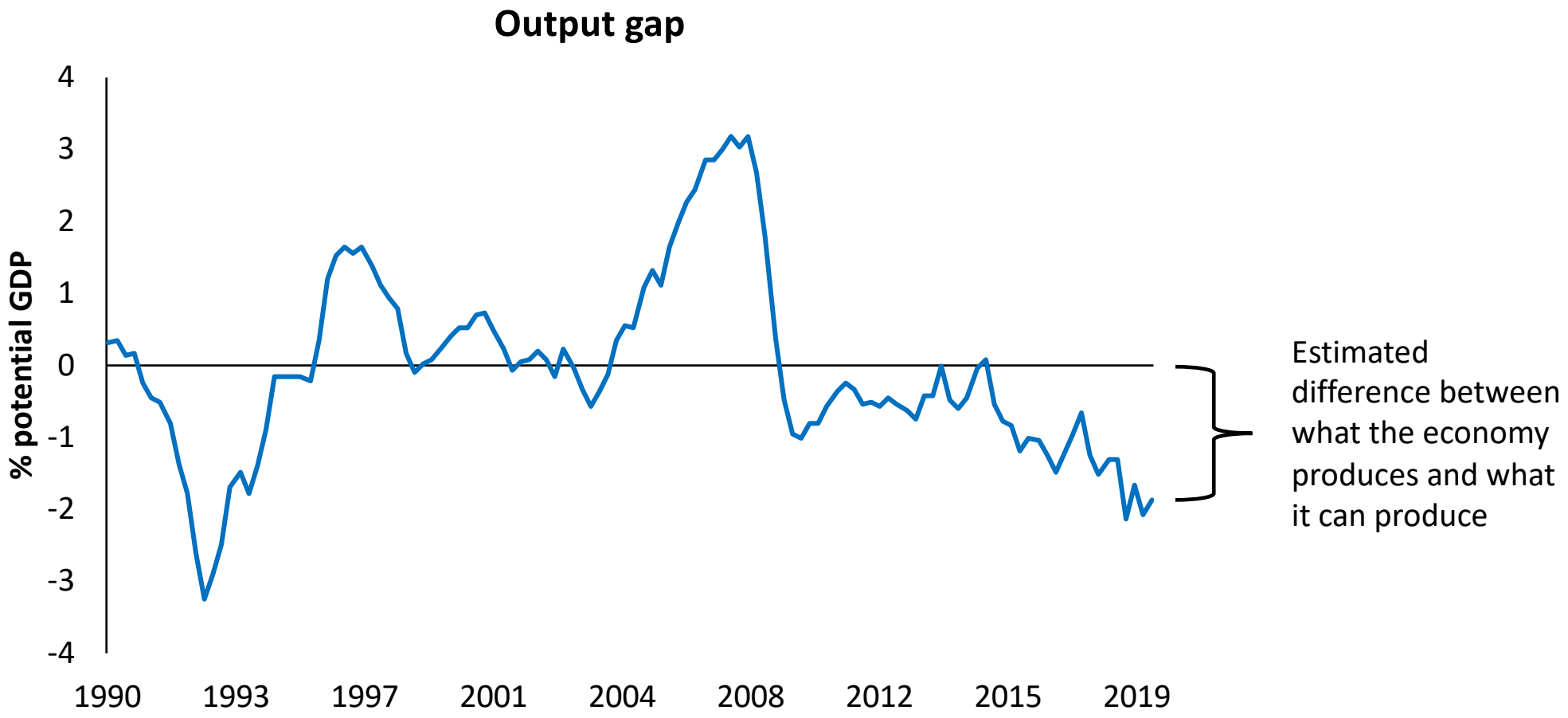
Potential growth is low (around 1%), but realised growth is even lower



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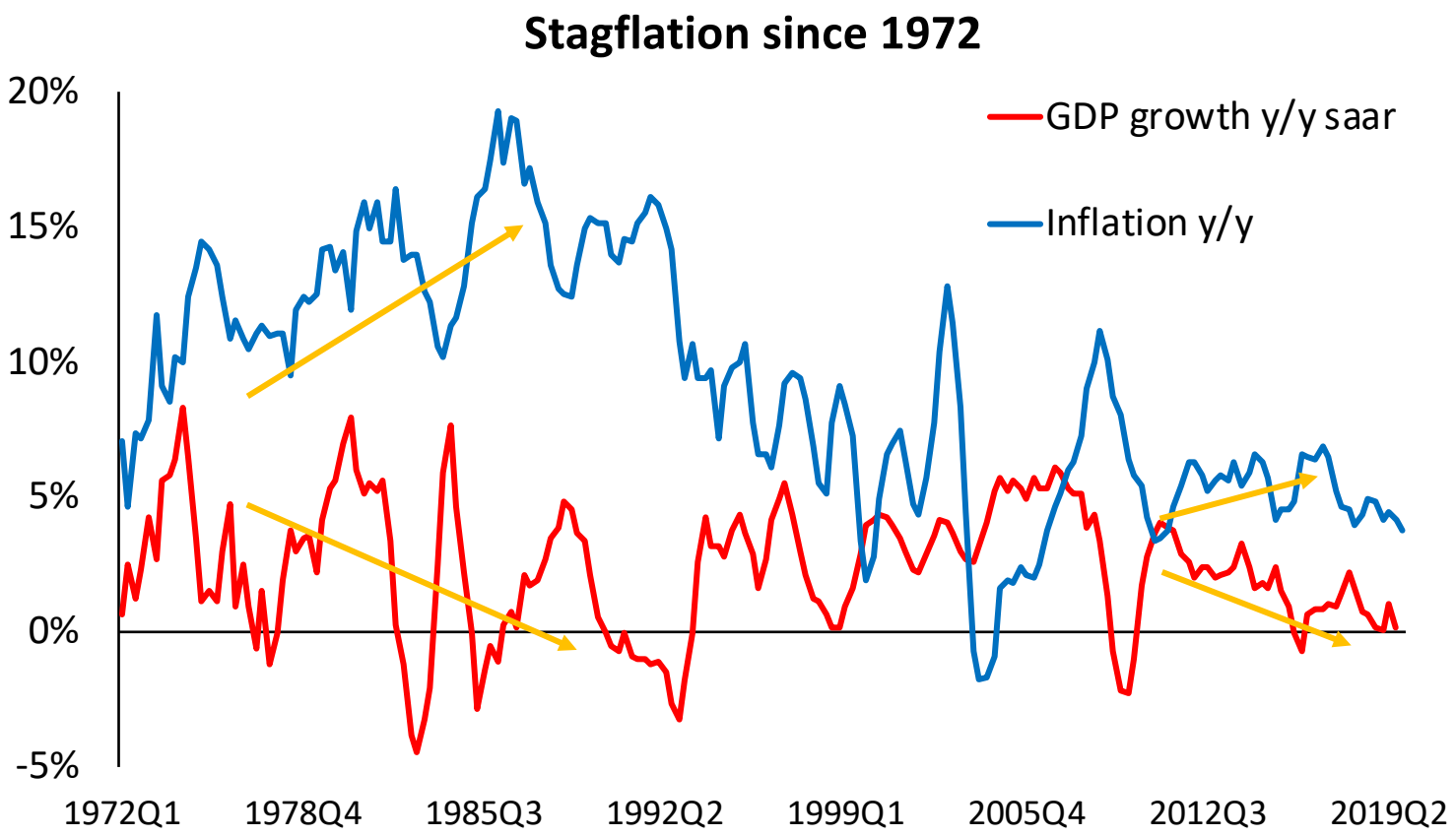
Historically, South Africa has suffered from stagflation



Source: StatsSA

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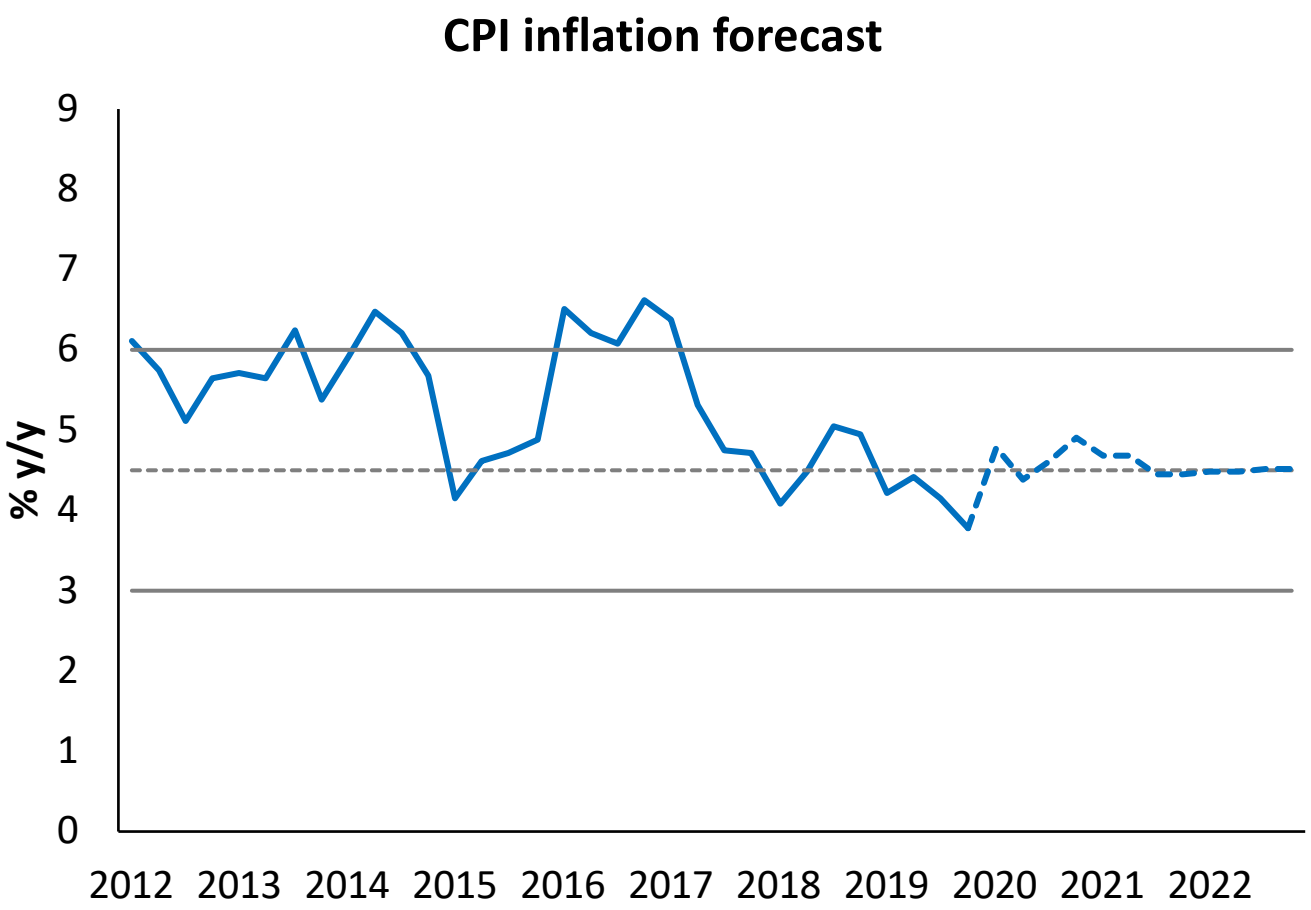
Trade-offs better now… should get lower inflation and lower rates



Inflation above target:
3% probability

Inflation within target:
94% probability

Of which, 55% chance in top half of range; 39% bottom half

Inflation below target:
3% probability

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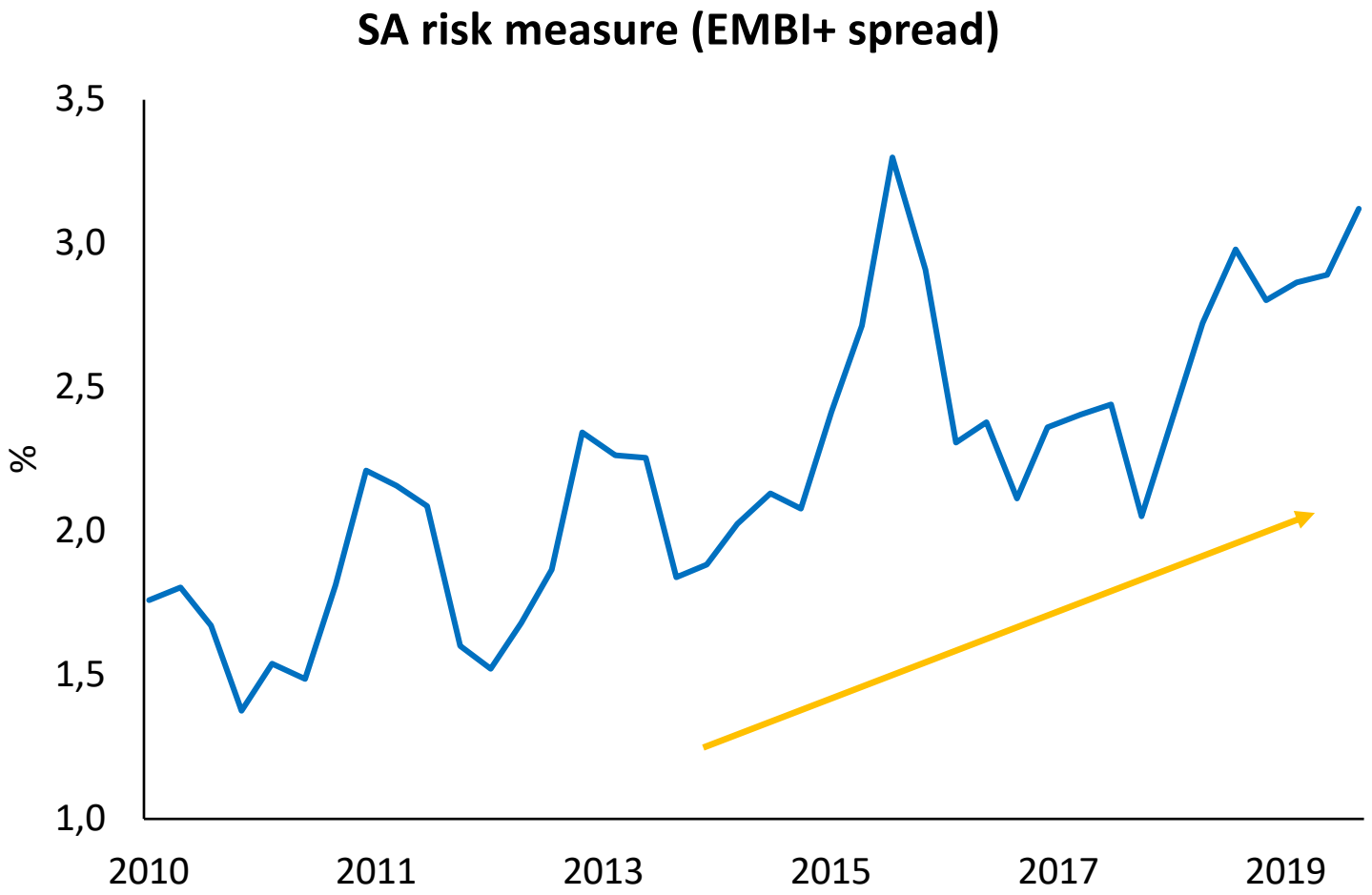
Lingering problem is upward pressure on rates from rising country risk



Source: JP Morgan

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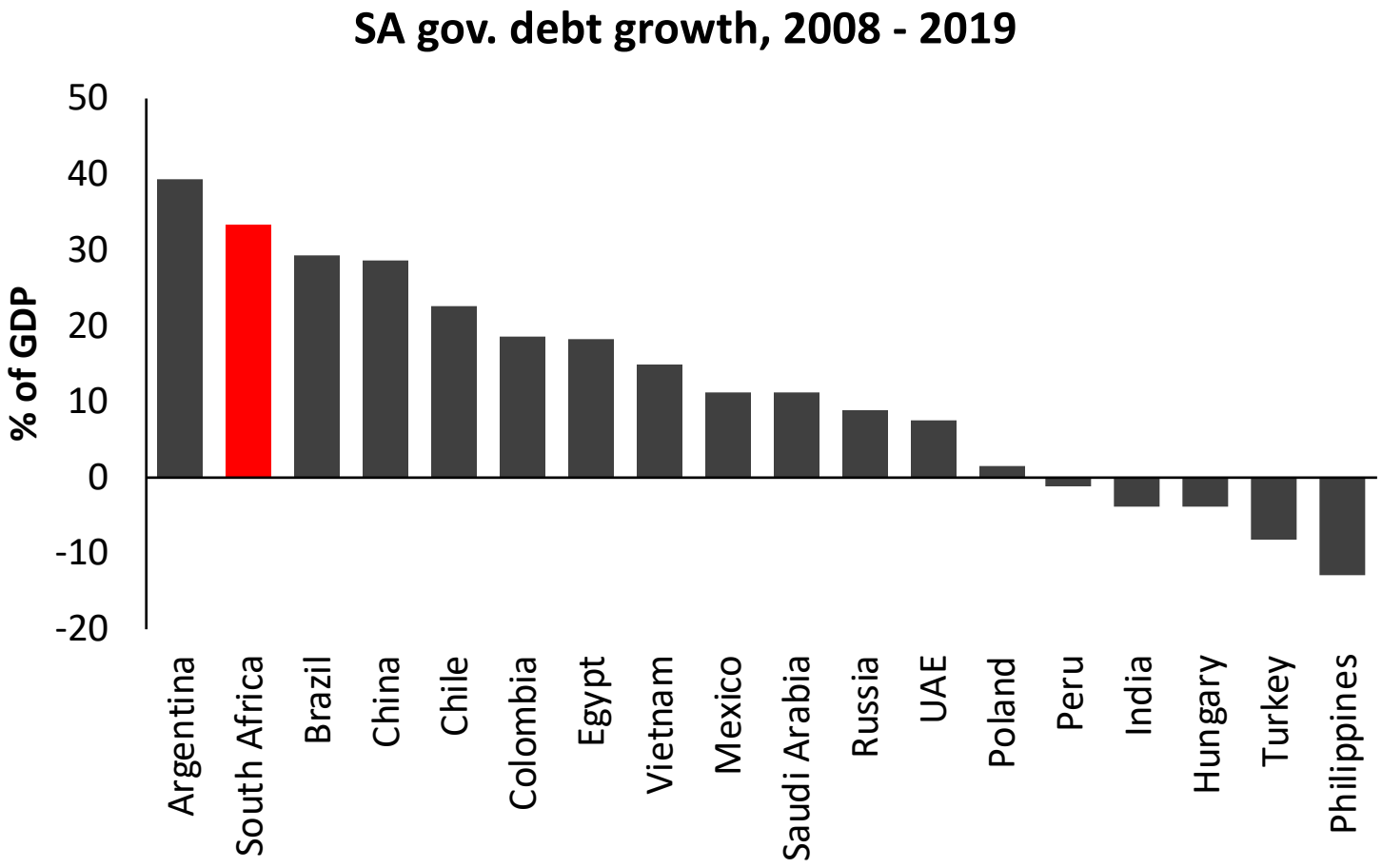
Increase in public debt very high relative to peers



Source: IMF

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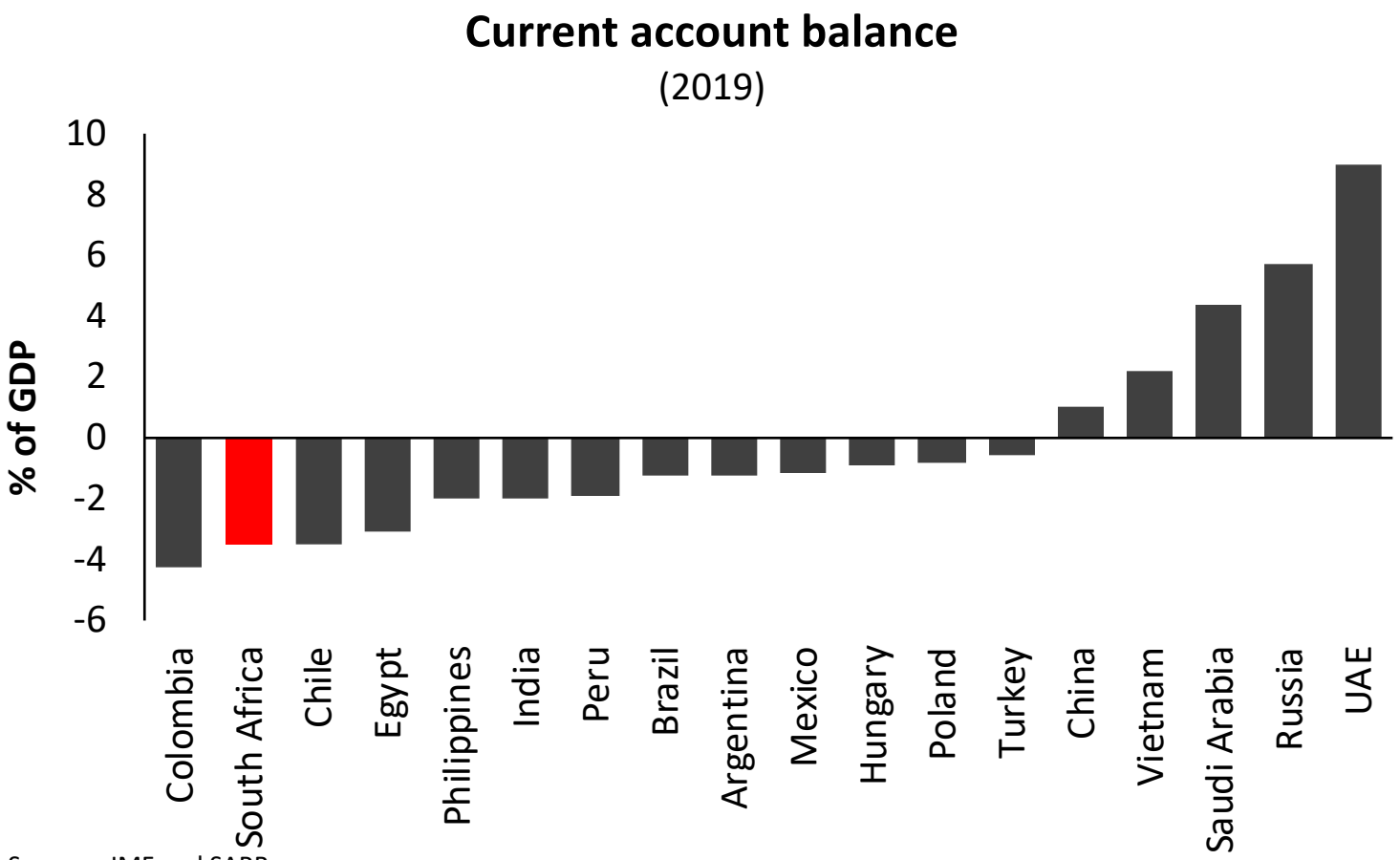
SA also runs a large current account deficit – major borrower from the world



Sources: IMF and SARB

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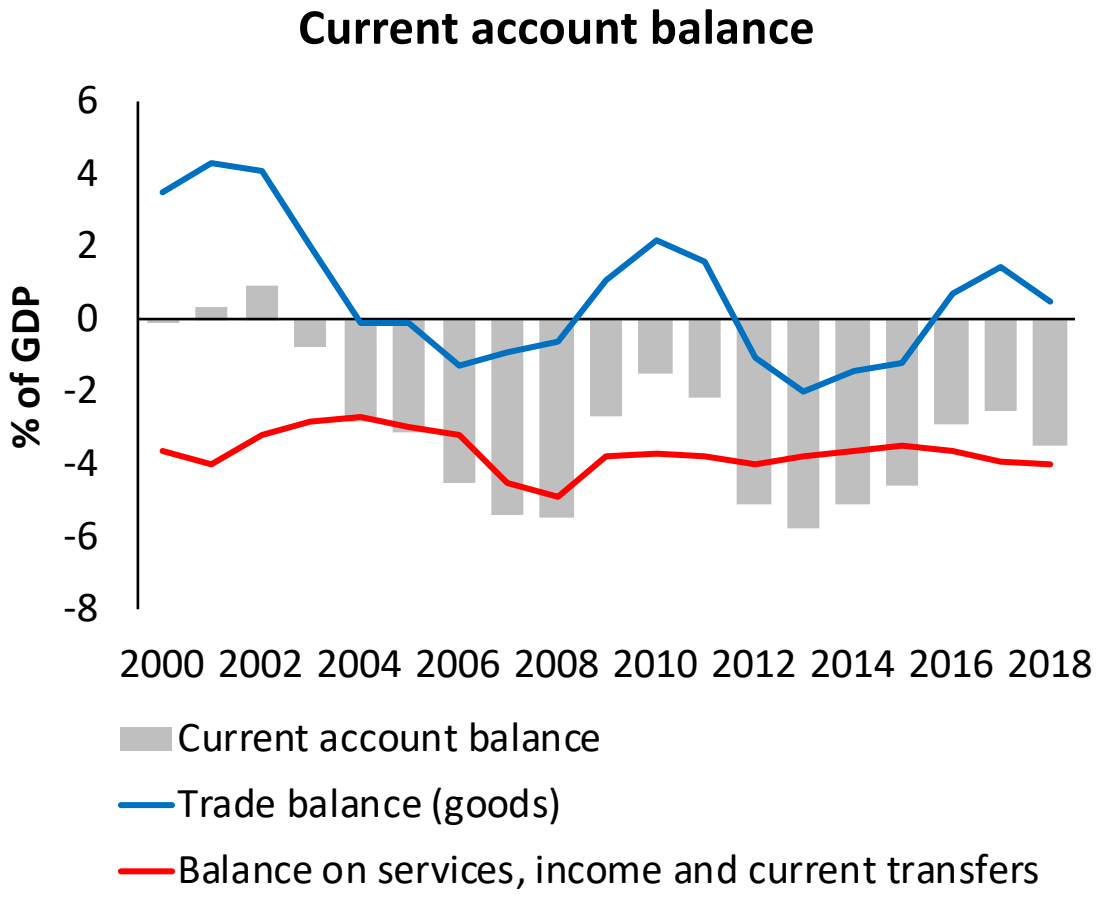
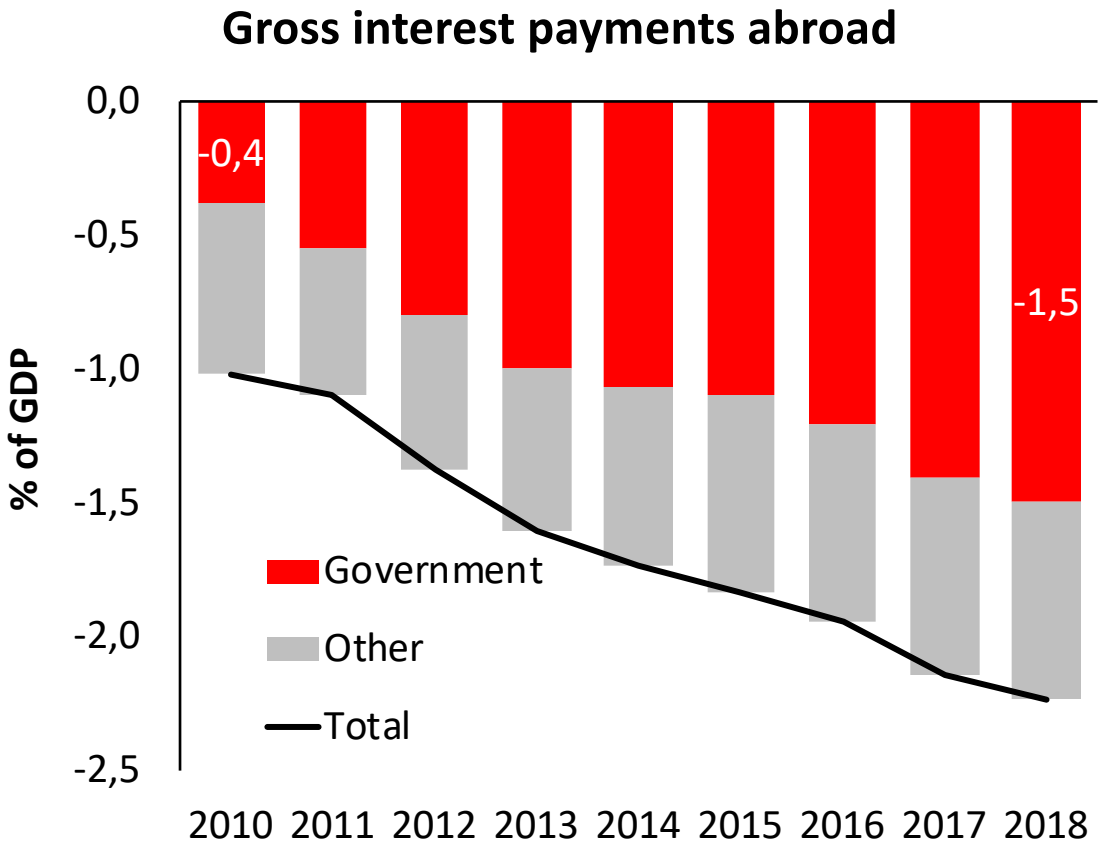
Despite trade surplus, interest payments keep current account deficit large





Source: SARB

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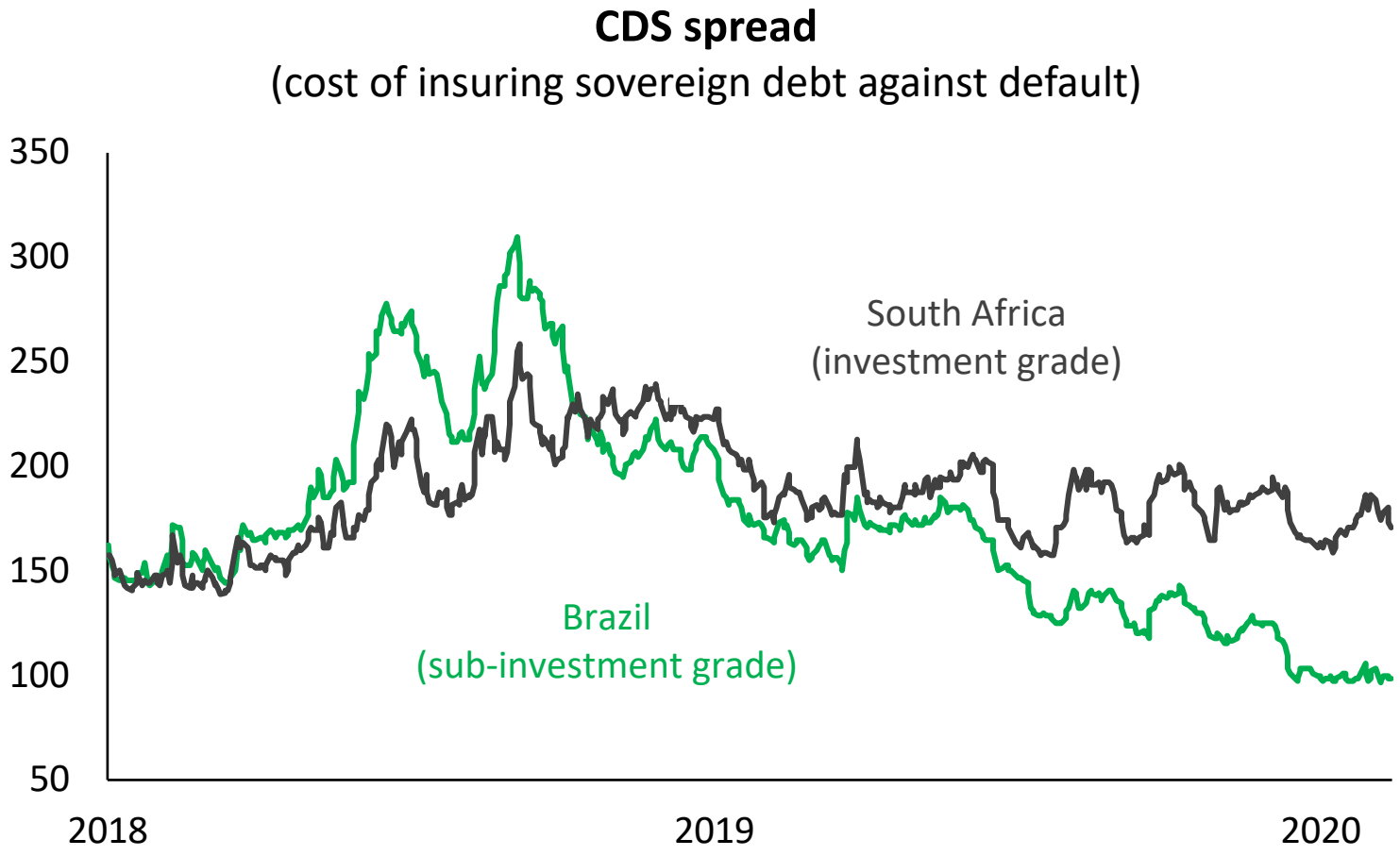
Markets already pricing SA as below investment grade



Source: Bloomberg

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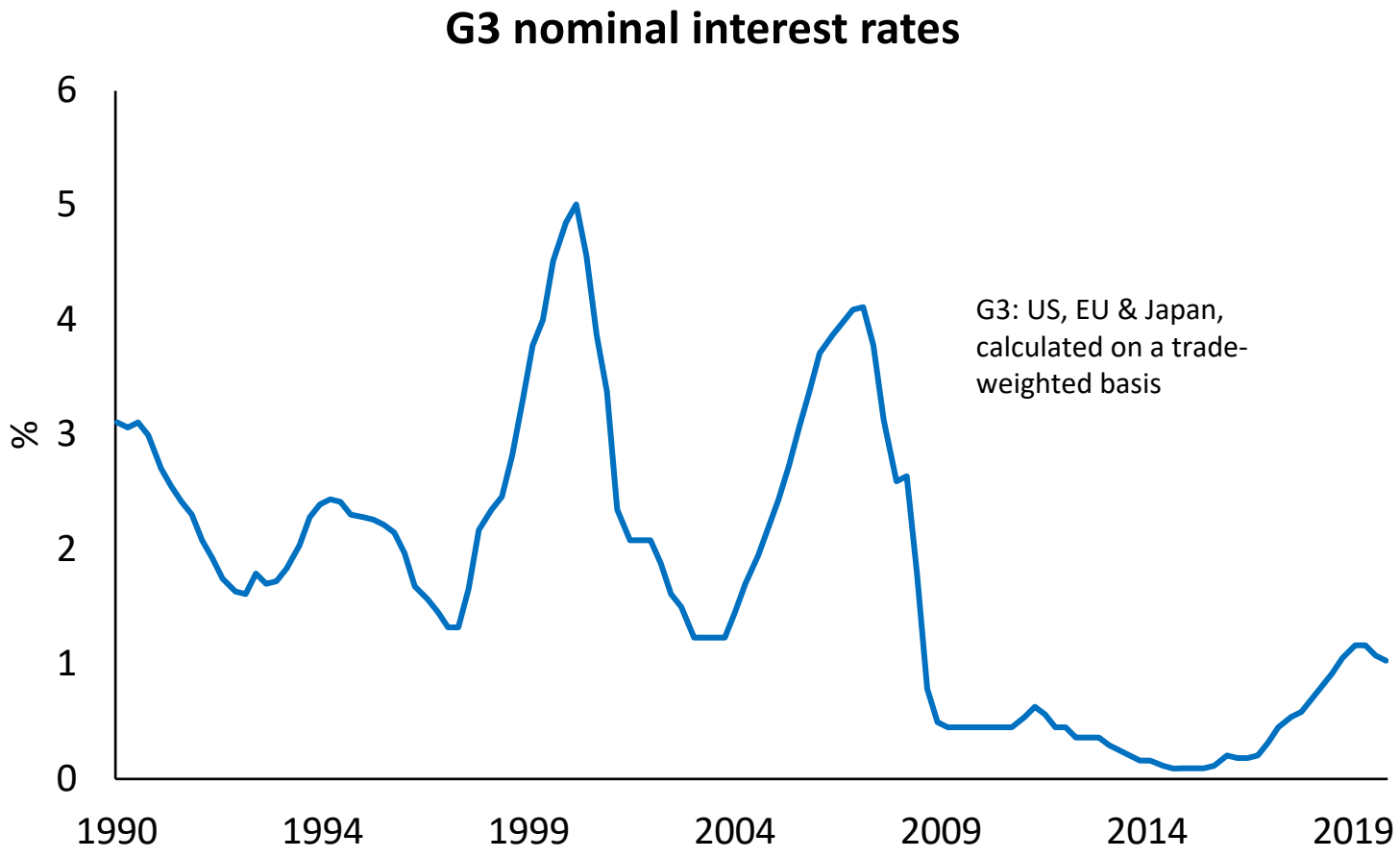
Global conditions generally helping SA (world interest rates unusually low)



Source: SARB

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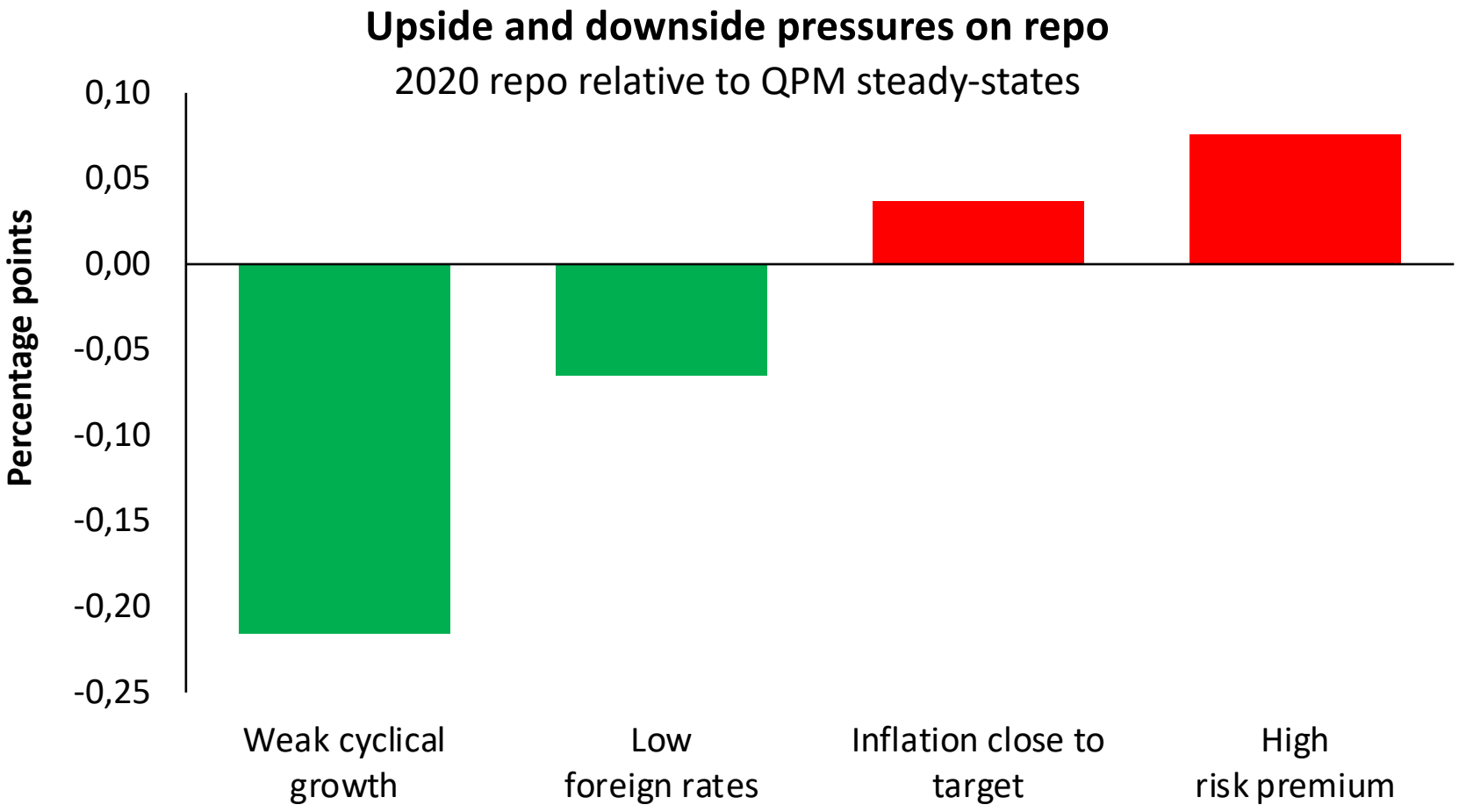
Putting it all together to set the repo rate:



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Conclusions

- SA has serious growth challenges - bigger than monetary policy…
- But lower inflation & improved credibility of policy limits stagflation risk, so monetary policy can provide more support
- Higher SA risk premium creates upside pressure on rates
- **Lower inflation + lower risk = lower rates**