

Nedbank

Economic commentary

22 September 2009

MONETARY POLICY COMMITTEE MEETING

Rates left unchanged on balanced inflation risks

- Although domestic economic activity remains subdued, signs of improvement are emerging.
- Inflation risks are evenly balanced, although the outlook has improved moderately due to the stronger rand.
- Inflation expectations have improved somewhat, but remain high.
- We still expect a further cut in this cycle.

Latest

Repo rate: 7,0% (previously 7,0%, effective 14 August 2009)

Prime rate: 10,5% (previously 10,5%, effective 14 August 2009)

Comment

The Monetary Policy Committee (MPC) left its repo rate unchanged at today's meeting. Although the domestic economy remains weak, signs of improvement are emerging, with some indicators already having turned while others are deteriorating more slowly.

The Reserve Bank's short-term outlook for inflation has remained largely unchanged. The positive impact of the stronger rand was offset by higher oil price assumptions and rising unit labour costs over the forecast period. CPI is expected to continue moderating steadily and to fall within the target range in the second quarter of 2010 and stay within the 3% to 6% range for the period to end 2011. The inflation outlook for 2011, however, has improved slightly.

The Bureau for Economic Research's third quarter *Inflation Expectations Survey* points to inflation expectations improving only moderately. Inflation is still expected to remain outside the target range for the forecast period. CPI is now expected to average 8,2% in 2009 (from 8,7% in the second quarter), 7,5% in 2010 (from 8,1%) and 7,5% in 2011 (from 7,9%). Only financial analysts expect CPI to be within the target range in the next two years.

Other key developments highlighted by the MPC were:

- ❑ There are signs of recovery in the global economy, with growth forecasts for the second quarter of this year revised upwards. The underlying trend, however, remains weak, pointing to a sluggish recovery.
- ❑ Domestic economic activity has remained under pressure, but the rate of contraction is falling, with signs that the trough may have been reached.
- ❑ Demand for credit remained depressed by weak economic activity and tighter lending criteria, but lower interest rates have eased debt servicing obligations.

Research

Group Economic Unit

Isaac Matshego
011 295 6451
Isaacmat@nedbank.co.za

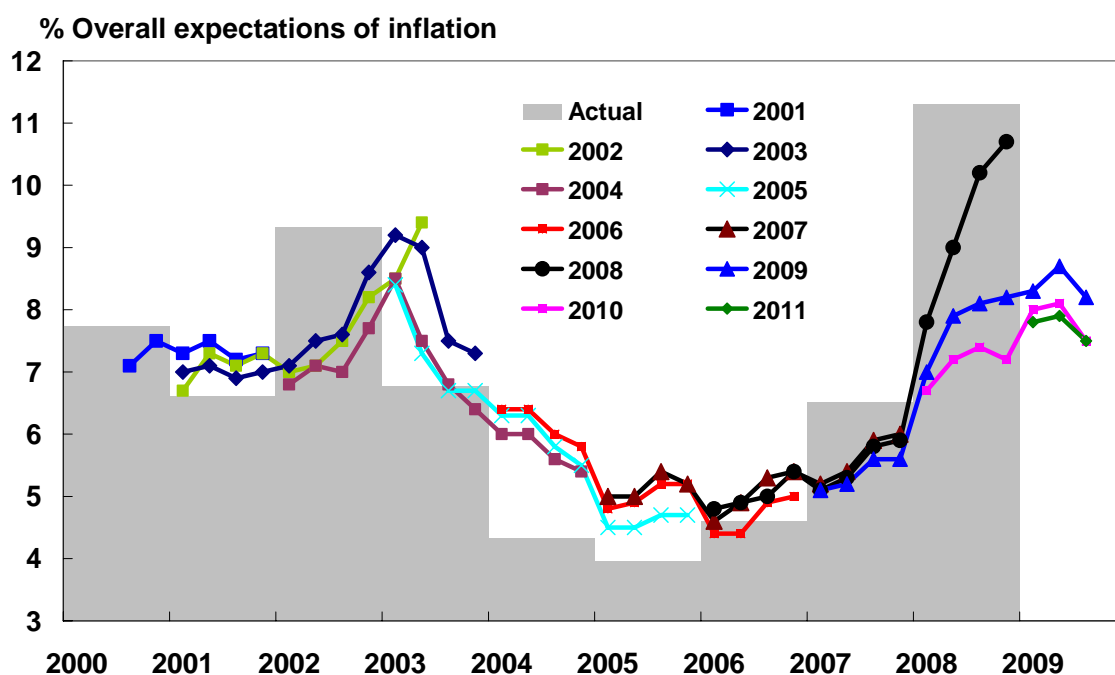
Dennis Dykes
011 295 6435
Dennisd@nedbank.co.za

- ❑ Consumption expenditure is likely to remain depressed on the back of negative wealth effects, but the improvement in equity values is likely to soften this effect somewhat.
- ❑ The Bank's composite leading indicator continues to point to a recovery towards the end of this year.
- ❑ The break-even inflation rate, as indicated by the differential between conventional and inflation-linked bonds, has dropped to within the inflation target band across all maturities.
- ❑ The rand has appreciated by about 20% on a trade-weighted basis and 26% against the US dollar since the beginning of the year and this has contributed to the positive outlook for inflation.

Implications

The MPC's decision to go with the consensus view of no change was not too surprising. Although recent rand strength could have tipped the balance in favour of another cut, the committee instead chose to wait and see whether recent indications that the global and domestic economies are starting to recover will be confirmed.

Despite the pause, it is not clear whether this signals the end of the cutting cycle. Given the unusual nature of the economic downswing any recovery is likely to be patchy, with setbacks over the coming months possibly prompting further easing. Our central forecast is still for one last cut in the repo rate to 6,5% from the current 7,0%, taking prime to 10% by year end. However, the timing of any moves at this stage of the cycle is always uncertain as the MPC will have to deal with conflicting evidence on growth and inflation prospects from meeting to meeting.



Nedbank Head office
 NEDBANK GROUP ECONOMIC UNIT
 135 Rivonia Road Sandown 2196
 PO Box 1144 Johannesburg 2000
 Tel +27 (0)11 295 6363
 Fax +27 (0)11 294 6363
 Email EstelleO@nedbank.co.za

Regular economic analysis is available on the Nedbank Group's internet site, <http://www.nedbankgroup.co.za>.

Copyright Nedbank Limited 1997, updated 2008. Nedbank Limited, 135 Rivonia Road, Sandown, 2196. The information furnished in this report (the 'report'), which information may include opinions, estimates, indicative rates, terms, price quotations and projections, reflects the existing judgement of the author(s) and current market conditions, which judgement and conditions are subject to change without notice, modification or amendment. This report does not necessarily reflect the opinion of Nedbank Limited ('Nedbank'). The information herein has been obtained from various sources, the accuracy and/or completeness of which Nedbank does not guarantee. Nedbank recommends that independent tax, accounting, legal and financial advice be sought should any party seek to place any reliance on the information contained herein. This report has been prepared for general dissemination and information purposes only and may not be construed as an offer to buy or sell or a solicitation of an offer to buy or sell any financial instruments or to participate in any particular trading strategy in any jurisdiction. Any additional information relative to any financial instruments and/or financial products reviewed in this report is available on request. All rights reserved. Any unauthorised use or disclosure of this report is prohibited.