

# Nedbank

## Economic commentary

22 July 2010

### MONETARY POLICY COMMITTEE MEETING

#### ***Rates left unchanged against the backdrop of a more dovish tone***

- The MPC presented a dovish statement, paving the way for another cut later in this cycle.
- The global economic outlook is more uncertain, with a high degree of downside risk.
- The SARB now expects gdp growth of 2,9% in 2010 and CPI is still projected to remain within the target band until 2012.
- Inflation expectations eased slightly during the second quarter, but inflation is still expected to remain outside the target band over the forecast period.
- We still expect interest rates to remain unchanged until well into 2011, but today's dovish statement suggests that the chances of another cut in this cycle have increased.

#### **Latest**

Repo rate: 6,5% effective 26 March (previously 7%, effective 14 August 2009)

Prime rate: 10% effective 26 March (previously 10,5%, effective 14 August 2009)

#### **Comment**

The Monetary Policy Committee (MPC) kept the repo unchanged at today's meeting. The MPC's statement was very dovish taking into account the Governor's recent public statements. We believe it paves the way for another interest rate cut later in this cycle, particularly if growth disappoints.

The SARB's growth and inflation forecasts have remained largely stable. CPI is projected to remain within the target band during the forecast period, bottoming at 4,5% (4,7% at the time of the May meeting) in the third quarter of this year, before rising gradually to 5,3% in the fourth quarter of 2012. Risks to this inflation trajectory emanate from administered prices as well as high wage settlements.

The Bureau for Economic Research's second quarter *Inflation Expectations Survey* indicates that overall inflation expectations eased during the quarter, albeit slightly. However, inflation is still expected to remain outside the target band over the forecast period. CPI is expected to average 6,3% in 2010, 6,5% in 2011 and 6,8% in 2012 compared with 6,5%, 6,7% and 6,8% in the previous survey, respectively. Analysts remained the most optimistic about the inflation trajectory, expecting CPI to average 5,0%, 5,7% and 6,0%, while business people still expected CPI to remain firmly above the target band at 6,9%, 7,2% and 7,4% in 2010, 2011 and 2012, respectively.

Other key developments highlighted by the MPC were:

- The global economy seems to have lost some momentum and the global environment remains uncertain, with austerity measures in the

#### Research

##### Group Economic Unit

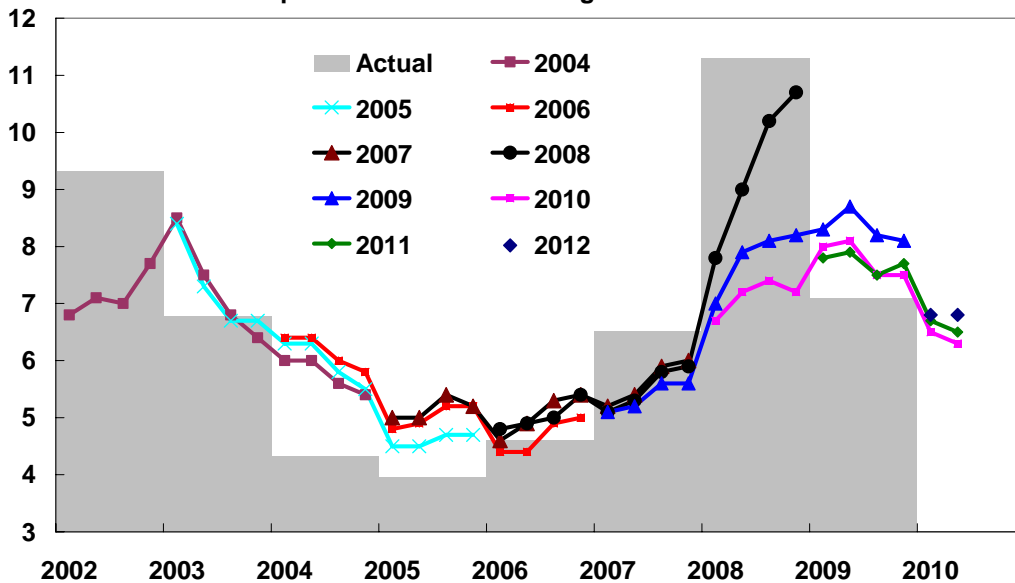
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key industrialised economies likely to result in persistently low growth for sometime

- Global inflationary pressures are expected to remain subdued and pose no risk to domestic inflation
- The SARB projects gdp growth of 2,9% (slightly up from 2,7%) in 2010
- Domestic demand growth remains moderate and does not pose a threat to inflation
- Wage settlements and wage expectations have remained elevated and are still a threat to the benign inflation outlook
- The rand exchange rate, which has risen by 1,6% on a trade-weighted basis since the beginning of this year, remains supportive of the benign inflation outlook
- The rand has, in line with other emerging-market currencies, benefitted from the global search for yield

Overall inflation expectations: annual average %



### Implications

Although we expected the MPC to leave interest rates unchanged, the more dovish statement suggests there is still a chance of another cut in this cycle, particularly if the economy stalls in the coming months. Data released since the May meeting has been mixed. Retail sales growth has improved further, but manufacturing activity dipped recently, suggesting that the recovery remains fragile.

We do not expect interest rates to be reduced again in this cycle. Although the inflation outlook remains favourable, the MPC will be forward looking and focus on 2011 and 2012, when growth is expected to gain momentum and inflation is likely to edge upwards. However, a further drop in inflation and inflation expectations, coupled with more data pointing to the fragility of the recovery would strengthen the case for another rate cut. On balance, we think that the Reserve Bank will keep interest rates unchanged until well into 2011.

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