

# Economic Commentary

## Monetary Policy Statement

### An improved inflation outlook and disappointing growth prompt another cut

- The MPC has reduced the repo rate by another 50 basis points to 6,0%, with the committee taking a unanimous decision.
- The MPC presented another dovish statement, which suggested that there was still room for another cut even after today's move.
- The main factors which prompted the cut were the better than expected inflation outcome and a benign inflation outlook, below potential gdp growth, persistent rand strength and the fragile global economy.
- Today's action was in line with our expectations following recent data, which pointed towards the domestic recovery losing some momentum and inflation falling further than was initially expected. We believe there is still downside risk to interest rates, although a further cut would require negative growth surprises both globally and locally.

### Comment

As expected, the SARB's MPC reduced the repo rate by another 50 basis points to 6,0%. The prime rate therefore falls to 9,5%, its lowest level since 1980. The Governor stressed that the decision was unanimous. The statement indicated that the improved inflation outlook on the back of the persistently strong rand and low capacity utilisation, the slower domestic recovery and the fragile global economy provided room for further monetary policy stimulus.

The SARB's inflation projections have been revised downwards, with CPI now expected to bottom at 3,7% (previously 4,5% at the time of the 22 July meeting) in the third quarter of this year, to average 4,8% in 2011 and reach 5,1% (previously 5,3%) in the fourth quarter of 2012.

Other key points highlighted by the MPC were:

- Economic growth is expected to moderate further in the second half of 2010 following slower growth in the second quarter, as indicated by the SARB's leading indicator.
- The SARB now projects gdp growth of 2,8% (previously 2,9%) in 2010 and 3,2% in 2011.
- Household consumption growth moderated to a seasonally adjusted and annualised 4,8% in the second quarter from 5,7% in the first quarter. High household indebtedness, high unemployment, further job losses and the low level of credit extension will continue to impact negatively on demand growth.
- The rand has strengthened despite the SARB accumulating foreign exchange reserves. This is partly due to strong foreign capital inflows as global investors seek higher returns.
- Inflation expectations have eased on the back of favourable inflation outcomes, with the break-even inflation rate (as implied by the difference between yields on conventional government bonds and inflation-linked bonds) remaining below the 6% level, while the Reuters survey shows that inflation is projected to average 4,6% in 2010 and 5,2% in 2011.
- Key risks to the inflation outlook are above-inflation wage settlements and cost-push pressures exerted by high increases in administered prices.

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## Implications

Today's action was in line with our expectations following recent data releases. Inflation has come out lower than expected, reaching a low point below the SARB's, and our, initial projections. Gdp growth has lost momentum, with demand growth easing in the second quarter, the labour market remains weak and household indebtedness remains elevated.

Following the MPC's dovish statement we believe there is still downside risk to interest rates, although a further cut would require negative growth surprises both globally and locally, given that inflation is now close to its lows in this cycle.

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