

# Nedbank

## Economic commentary

13 May 2010

### MONETARY POLICY COMMITTEE MEETING

#### ***No surprises as the MPC leaves the repo rate unchanged***

- The MPC presented a dovish statement, leaving interest rates unchanged
- The inflation outlook remains benign and CPI is projected to fall further
- The domestic economic recovery remains moderate but has become sustainable
- The rand remains supportive of the benign inflation environment
- We expect interest rates to be left unchanged well into 2011, but a faster drop in inflation and inflation expectations, coupled with data pointing to the fragility of the recovery could open the door for another cut

#### **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 following March's surprise 50 basis points cut. The MPC's statement was relatively dovish, with the SARB's inflation forecasts revised slightly downwards and no inflationary pressures anticipated from either domestic demand or global factors.

The MPC's inflation outlook has improved, although marginally. CPI is projected to remain within the target band during the forecast period, bottoming at 4,7% (4,9% at the time of the March 2010 meeting) in the third quarter of this year, before rising gradually to 5,3% at the end of 2012. Risks to this inflation trajectory would arise from administered prices and global developments.

Other key developments highlighted by the MPC were:

- The global environment is more favourable, with world gdp forecasts revised upwards
- However, difficulties relating to government finances in some European countries pose a risk to the global economy, particularly financial markets
- South Africa's large budget deficit does not pose a significant threat to macroeconomic stability, but current global developments highlight the threat of fiscal imbalances
- The domestic economy is recovering moderately and there are no threats to the inflation outlook from this front
- The SARB projects gdp growth of 2,7% and 3,6% in 2010 and 2011, respectively

#### **Research**

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- ❑ Risks to the growth outlook emanate mainly from adverse global developments
- ❑ Market inflation expectations, as indicated by both the Reuters survey and the break-even inflation rate, remain within the inflation target band
- ❑ Wage settlements remained above the inflation target band in the first quarter of 2010, and this could pose an upside risk to the inflation outlook if not coupled with productivity gains
- ❑ The rand exchange rate remains supportive of the benign inflation outlook despite the local unit's recent turbulence

### **Implications**

There was little doubt that the SARB would keep rates unchanged at today's meeting. Data released since the March meeting has not indicated any deterioration in the domestic economy. The recovery continued, although the upward trend is still in its early stages and it is driven mainly by the supply side of the economy. Inflation has continued to moderate in line with expectations. In addition, Governor Marcus's hawkish comments at the Bureau for Economic Research conference on 22 April also made any short-term change in stance unlikely.

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 edges 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, raising rates in the third quarter.

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