

## **Statement of the Monetary Policy Committee: February 23, 2010.**

### **1. Introduction**

- 1.1 At the meeting of February 23, 2010, the Bank's Monetary Policy Committee observed that the medium-term outlook for price developments was positive. The Committee anticipated that, following a short-term spike resulting from the impact of the increase in value added tax (VAT), inflation will fall within the 3 – 6 percent objective range only in 2011. Indications are that the decline in overall output will continue in the short-term and remain below trend while recovering in the medium-term.
- 1.2 The world economy is now projected to grow at a faster pace in 2010, hence a consideration of withdrawal of stimulus packages in a timely and coordinated manner would contribute to sustaining the normal functioning of the global financial system. It will also minimise the risk of unsustainable public debt, achieve improved balance among countries with substantial deficits and those with large surpluses, and forestall inflationary pressures.

### **2. Recent Economic Developments**

- 2.1 Inflation rose to 6.1 percent in January 2010 and was, therefore, above the Bank's medium term objective range of 3 – 6 percent. The rise in inflation mainly reflects the continuing impact of base effects arising from fuel price reductions in the second half of 2008 and early 2009. Underlying inflation is restrained in the context of benign external price pressures and subdued domestic demand.
- 2.2 It is estimated that in the third quarter of 2009, output was 3.2 percent lower than for the same period in the previous year. This followed an annual increase of 1.3 percent in the second quarter of 2009. The decrease in GDP in the third quarter is

due to the 28.1 percent decline in mining output, while growth for the non-mining sectors was strong at 12.8 percent.

- 2.3 Overall, the fall in output and moderate inflationary pressures occurred against the background of considerable decline in monetary expansion, that resulted from the reduction in foreign exchange reserves and lower rate of increase in both government expenditure and commercial bank credit to the private sector.

### **3. Economic Outlook and Assessment of Risks**

- 3.1 As far as the global economy is concerned, economic recovery appears to be on track. South Africa is expected to register higher rates of GDP growth in the second half of 2009. Growth is expected to be sustained into 2010 and buoyed by improvement in global demand for base metals and manufacturing output. However, output is projected to remain below potential, hence exerting low pressure on inflation. However, there are upside risks to inflation in South Africa including the possible large upward adjustment in electricity prices. The forecast is, nevertheless, for inflation to fall within target in the first quarter of 2010.
- 3.2 The projected faster rate of global economic recovery will, however, be uneven across countries and regions and is mostly due to higher levels of output expansion in Asia, notably China. Although recovering at a slower pace, the improvement in performance in the major economies and the normalisation of financial intermediation, within an improved global supervisory framework, are pivotal to sustained growth of the world economy. Overall, the world economy is anticipated to grow by 3.9 percent in 2010, reversing the 0.8 percent decline of 2009. However, this is in the context of low levels of capacity utilisation and high rates of unemployment. Therefore, it is expected that world inflation will be restrained.

- 3.3 On the domestic front, the decline in output is projected to continue into the first quarter of 2010 and GDP will remain below trend in the medium-term. In addition to the slow recovery of world demand for major exports, domestic economic activity will be lower due to reduced government spending. Furthermore, demand and its impact on economic activity will be low owing to the effect on real incomes of the wage freeze and the increase in VAT and other levies. Nevertheless, the loosening of monetary policy in 2009 will contribute to a narrowing of the output gap in the medium-term.
- 3.4 Overall, the low domestic demand pressures, together with the projected benign external inflationary pressures, contribute to the positive inflation outlook. In the short-term, inflation is projected to rise as influenced by, among others, the faster quarterly price increases due to South African price developments, base effects related to fuel price changes, as well as the increase in VAT. In the medium-term, inflation is expected to be within the objective range on a sustained basis by the first quarter of 2011. The risks to this outlook include any substantial upward adjustment in administered prices and government levies as anticipated in the revenue projections announced in the 2010 Budget Speech. Moreover, there is a risk that any accelerated world economic recovery may lead to a rise in oil prices. It is anticipated that the Pula exchange rate will be largely stable with minimal effect on domestic price developments.

#### **4. Monetary Policy Stance**

- 4.1 The current state of the economy and the assumptions on both the domestic and external economic outlook, as well as the inflation forecast, suggest that maintaining the prevailing interest rates is consistent with the achievement of the Bank's 3 – 6 percent inflation objective in the medium term. Accordingly, the Monetary Policy Committee decided to maintain the Bank Rate at 10 percent.