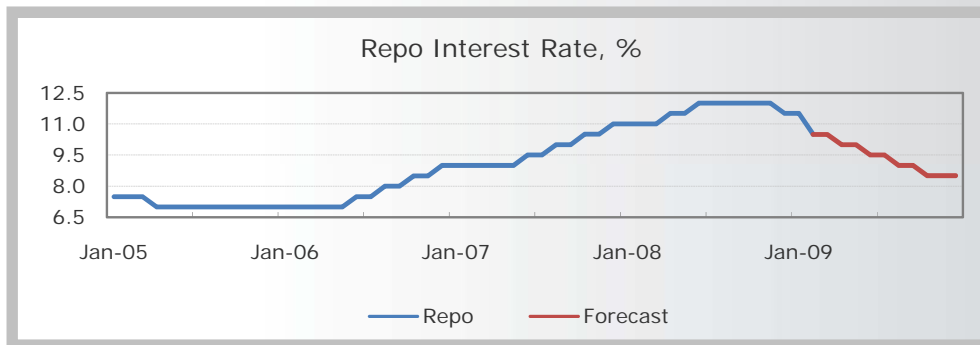


MPC Interest Rate Decision – Be Careful for that Heartburn, Tito...

Report by Doret Els (Economist)

- ♦ The SARB **lowered** its main repo interest rate by **100 basis points** (1%-point) to 10.5%, as effective from 6 February 2009.

	Feb '08	Dec '08	Feb '09	M/M% Change	Y/Y% Change
REPO	11.0%	11.5%	10.5%	-8.7%	-4.5%



Highlights of MPC Statement

- It is expected that the **reweighting and rebasing of the CPI** basket implemented by StatsSA will lead to a further decline in domestic inflation, following the already downwards trend.
- In **December**, **CPIX** inflation measured **10.1% y/y** from a high of 13.6% y/y in August. If food and petrol were to be excluded, CPIX inflation would have measured 8.7% y/y in December.
- **Producer prices** reflect a significant slowdown in food price inflation at the agricultural level (Dec: 0.0% y/y) but not as aggressive at the manufacturing level (Dec: 12.8% y/y).
- The **outlook for inflation** remains unchanged from December 2008. CPI is expected to average 7.5% y/y in Q109, return to below 6.0% in Q309

5 Feb 2009

(average 5.2% in Q3) .

- Inflation is expected to again **breach the upper target in 2010Q1** due to technical base effects, but to average 5.5% till the end of the forecast period.
- **Inflation expectations** improved; Reuters consensus survey indicates that analysts expect inflation to average 6.4% in 2009 and 5.8% in 2010.
- The **volatility of the rand** poses the main risk to inflation. The rand has remained relatively stable against the US dollar since the last MPC meeting whilst it appreciated only marginally on a trade weighted basis.
- The average price of **brent crude oil** in January was higher at \$45 per barrel than in December (\$41 per barrel). The price of Brent crude oil is expected to remain subdued as the global economy weakens.
- The **domestic economy** continues to show signs of slowing; GDP growth (2008Q3) 0.2% q/q, manufacturing production (Nov) -4.4% y/y, mining output (Nov) -6.1% y/y, real value of total building plans approved (Nov) -25.3% y/y.
- **Household consumption expenditure** under pressure; real retail trade sales (Nov) – 4.0% y/y, commercial vehicle sales (Jan) -35.4% y/y.
- **Exports** expected to remain under pressure due to slower world demand, however, trade gap could shrink slightly during fourth quarter.
- **Wage inflation:** Andrew Levy Employment Publication indicates rise of 9.8% in average 2008 wage settlements, compared to average inflation of 11.3%.
- The rise in **credit extension** to the domestic private sector continues to decelerate and total loans and advances by banks to private sector measured 14.4% y/y in December.
- The international Monetary Fund significantly downgraded its **global growth** forecast for 2009, to 0.5%.



Efficient Group (Pty)Ltd • FSP No: 859
Authorised Financial Services Provider

5 Feb 2009

The fact that the Governor mentioned his proposal of a 200 basis point cut creates serious concern. Although Inflation is expected to drop below the target in the third quarter 09, it is by a small margin (according to the SARB's own forecast). Further, the outlook for inflation again indicates a breach of the 6.0% upper target band in the first quarter of 2010 – a major risk to large interest rate cuts this soon in the cycle. It is also creating a grey area – is the SARB targeting *growth or inflation*? The Bank has been very conservative in the tightening phase. To suddenly switch to an aggressive loosening cycle might lead to serious adverse consequences. The rand remains volatile; the current account deficit remains high; credit extension are still expanding at double digit rates – all factors that can cause serious heartburn for the economy after a (too) generous helping of interest rate cuts.