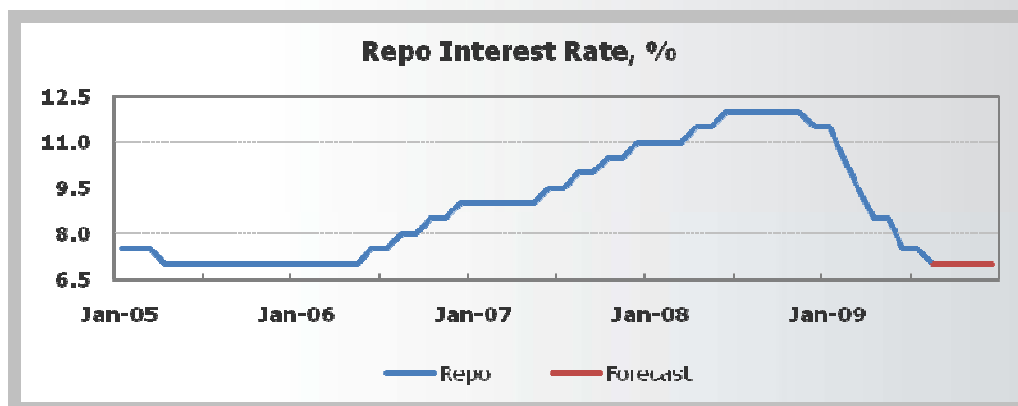


## MPC Interest Rate Decision – ‘A Huge surprise’

Report by Freddie Mitchell (Economist)

- ♦ The SARB **lowered** its main repo interest rate by **50 basis points** to 7%, as effective from 14 August 2009.

	Aug '08	Jul '08	Aug '09	M/M% Change	Y/Y% Change
REPO	12%	12%	7.0%	-6.7%	-41.7%



### Highlights of MPC Statement

- There are encouraging signs that that the **global slowdown may have reached its lower turning point**. The speed and extent of the recovery are still subject to a high degree of uncertainty. The IMF expects a contraction of 1.4% in 2009 in the global economy followed by a recovery of 2.5% in 2010.
- The South African Reserve Bank composite leading indicator increased for a second consecutive month in May 2009, indicating the possibility of a recovery later in the year.
- **Domestic demand** remains subdued as real retail sales (June: -6.7% y/y), real wholesale sales (June: -9.9% y/y) and manufacturing production (June: -17.1% y/y) all recorded contractions.

14 Aug 2009

- Negative wealth effects on domestic consumption expenditure may have dissipated somewhat with partial recovery of equity prices on the local and international markets. The all-share index on the JSE experienced a 14% increase year to date while various house price indices all indicate a continued decline in house prices during July. Growth in **Household consumption expenditure** decelerated further during the past few months due to tighter credit conditions imposed on the private sector by banks.
- The **inflation outlook of the SARB** has not changed significantly since the May meeting. The Bank's estimated are in line with the Reuters consensus forecast of inflation to average 5.8% in 2010 and 5.6% in 2011.
- **The main upside risks** to inflation emanate from cost-push pressures within the economy and an increase in international oil prices. Fuel prices are likely to increase in August as a result of an under-recovery due to an increase in international oil prices. Other costs that need to be taken into account are the increase in electricity prices and wage increases negotiated by unions.
- The exchange rate remained volatile and traded between R7.68 and R8.32 against the US dollar since the last MPC meeting. Despite its volatility, the nominal effective exchange rate appreciated by 13% this year. The appreciation in the **rand** exchange rate since the beginning of the year has, despite its tendency to be volatile, **reduced the upside risk** to inflation. The increase in the **output gap** (i.e. the difference between the potential and actual economic output) is expected to contribute to an improved inflation outlook.

During the previous tightening phase, the MPC lifted rates by 500 basis points over a period of 24 months. The 50 basis point cut announced today brings the cumulative lowering in interest rates to 500 since June 2008, 14 months, highlighting the aggressive extent to which monetary policy has been loosened. At a barely positive real repo in the region of 0.1% and a relatively high inflation, 'another rate cut' by the MPC will not be wise and an increase in the repo rate may be the next move; albeit sometime in the future.