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MPC might anchor interest rate, economists predict

By Michael Appel

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Many economists are predicting the interest rate will remain unchanged when the Monetary Policy Committee (MPC) meet on Wednesday and Thursday to review current monetary policy, but it will be a close call.

The meeting is expected to be closely watched this week with economists saying that after 10 interest rate hikes or a cumulative 5% increase in the repo rate since the inflationary cycle began in June 2006, tightening monetary policy is finally beginning to pay off.

“The economy has responded overwhelmingly to the interest rate hikes so far as there has been a significant slowdown in consumer demand, such that households are under stress and the effects are evident.

“We believe the interest rate will remain unchanged because food prices are past their peak, the Rand, shaky at times, is steady, and oil prices have also peaked,” said Nedbank senior economist, Nicky Weimar, speaking to *BuaNews*.

Interest rates will most likely be revised downwards in the beginning of 2009 allowing the Reserve Bank to get the inflation rate back within the 3 - 6% target band, sooner than expected said Weimar.

According to Nedbank's predictions, inflation will fall back within the target band by about the second quarter of 2010.

Economist at Econometrix Treasury Management (ETM) George Glynos told *BuaNews* a likely scenario would see the repo rate remaining stable at 12% after a 50 basis point increase in June 2008.

“We believe it will remain unchanged, but it's going to be a close call. It actually wouldn't surprise us if the Reserve Bank gives the interest rate one last hike,” said Glynos.

There has been a significant reversal in oil prices in the past two months and South African motorists can look forward to an 80 - 90 cents decrease in fuel prices by September 2008,” Glynos said.

“The Rand has remained reasonably resilient ... and South Africa's trade deficit margin has narrowed. Whether this means South Africa is exporting more or importing less, we are not sure, but the trade deficit margin has decreased.

“The inflation trajectory at the moment remains on the upside, and the Reserve Bank could hike one more time to drive home the point that the revision of the CPIX basket does not have such a great effect as inflationary pressures are still evident,” Glynos explained to BuaNews.

An unchanged interest rate in August is also a likely outcome of the MPC's two-day meeting believes Sanlam Chief Economist Jac Laubscher.

Laubscher told *BuaNews* South Africa's inflation rate has reached its peak it seems, and that leaving interest rates unchanged would be wise.

“We predict an unchanged repo rate because we have almost reached a peak in inflation ... the Reserve Bank has also achieved what it set out to do, which was to cool consumer demand.

“Although the Reserve Bank does not directly take the oil price into consideration, the knock on it has on prices will definitely have an effect and the decline in oil prices will improve the economic environment,” said Laubscher.

With the changes in the Consumer Price Index excluding interest on mortgage bonds (CPIX) basket coming into effect in January 2009, as announced by Statistics South Africa (Stats SA), inflation is likely to be revised downwards.

Head of Investec Asset Management André Roux recently told *BuaNews* that South Africa's official inflation rate was about 1 - 2% above the reported figure.

Roux said the sluggishness by Stats SA in implementing a reweighted and rebased CPIX basket will have an effect on processes such as wage negotiations and price hikes across the board.

The 2005/06 income expenditure survey conducted by Stats SA was to be used for the reweighting of the consumer basket in 2007 but was delayed for reasons of analysis and verification said Stats SA in reply to Investec's findings.

According to a document released by ETM in July, whether a lower inflation trajectory would have resulted in looser monetary policy is not a given.

“It brings into question whether the Reserve Bank would focus on the absolute inflation number or whether they would focus on the underlying inflation trend.

“A lower inflation number does not necessarily mean a less threatening upward inflation trend,” read the ETM report.

ETM economist Russell Lamberti told *BuaNews* that South Africa is still suffering under high inflationary pressures and the MPC - whether inflation is within or outside the inflation target band - bases its decisions on the inflation outlook.

The Reserve Bank's sole mandate of inflation targeting has come under the spotlight in recent times as country-wide strikes against rising food and fuel prices have prompted many to question why the Bank is not dually concerned with economic growth.

Remaining tight-lipped on a possible MPC decision, Reserve Bank Governor Tito Mboweni, speaking at Wits University last week told reporters and students he was concerned inflation was outside the target band.

"We are better off with inflation targeting for the moment so let us stick with it ... even if the government had not specified a mandate for the central bank, the Bank would still pursue low inflation,” said Mboweni.

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