Daniel Mminele: Recent economic and monetary policy developments in South Africa

Address by Mr Daniel Mminele, Deputy Governor of the South African Reserve Bank, at the European Economics & Financial Centre (EEFC), London, 12 January 2016.

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Your Excellencies, distinguished guests, ladies and gentlemen.

Thank you to Professor Scobie and the Board of the EEFC, and I am truly humbled by the invitation to participate in the Distinguished Speakers Seminar Programme.

Let me start by thanking the European Economics and Financial Centre for the good work they are doing in seeking to forge closer links between theorists and practitioners in economics and finance. I guess when it comes to monetary policy, that's where the art and the science meet. Your work reminds me of the quote that is attributed to Yogi Berra that "In theory there is no difference between theory and practice, in practice there is." The practice of monetary policy has been undergoing significant changes, and it will be interesting to see how much of all that ends up being embodied in the theory.

The New Year is typically a time for reflection and as such I thought it appropriate to start by reflecting on some of the recent international economic developments. I will then focus on South African economic developments and end with a consideration of some of the issues that will warrant attention in the monetary policy sphere in the year ahead.

International economic developments and outlook

Over the past year, the global economy has struggled to gain traction. Unfortunately this has been an all too familiar theme in the aftermath of the global financial crisis. According to the IMF, world growth for 2015 is expected to have slowed to 3.1 per cent, from 3.4 per cent in 2014, reflecting a weaker than anticipated recovery in advanced economies and, more significantly, broad-based weakness in emerging market economies. The IMF expects growth to pick up in the coming year, to 3.6 per cent with downside risks continuing to dominate.[1] A further slowdown in China and other emerging markets (EMs), tightening financial conditions and lower commodity prices could provide significant headwinds to growth going forward. The volatility in financial markets in the first week of 2016, influenced to a large extent by ongoing concerns about Chinese growth and uncertainties about the policy response of authorities, served as a reminder that many investors remain very nervous about the road ahead. Then there is the issue of geopolitical risks, which unfortunately have also shown signs of escalating of late.

Global growth in 2015 was driven by the advanced economies and in particular by the sustained recoveries in the United States and United Kingdom. The US experienced higher-than-expected growth in the third quarter, which, together with robust domestic private demand and job creation, allowed the Fed last month to finally embark on its much anticipated lift-off as part of policy normalisation. Market participants viewed the Fed's statement following the December FOMC meeting as somewhat dovish, reinforcing the gradual prospective path of normalisation. Furthermore, as demonstrated by the FOMC's "dot plots" over the last few FOMC meetings, the range of the projected target federal funds rate has narrowed, signifying a more clearer and coherent path of normalisation. Such perceived moderation of the Fed's expectations, together with ample advance notice through its communication strategy, no

1 World Economic Outlook, IMF, October 2015.

doubt helped markets digest the dreaded "first hike in the cycle" (the first increase in the Fed funds target in almost ten years) without major price swings.

In Japan and the euro area, however, growth remains weak and fragile. The euro area expanded by an annualised 1.2 per cent in the third quarter, and indicators ranging from business confidence to credit growth are showing increasing signs of upward normalization. However, concerns over a lack of pricing pressures[2] prompted the ECB to lower its deposit rate and extend its QE programme last month. On the other hand, even as Japan avoided a technical recession in the third quarter, inflation remains well below its 2 per cent target level. Going forward, it is anticipated that growth in advanced economies will strengthen on the back of supportive fiscal and accommodative monetary policies and lower commodity prices. However, weaker growth in emerging markets and resultant feedback loops, harbour downside risks.

Emerging market growth continued to disappoint in 2015, with the slowdown in China, recessions in Brazil and Russia and weak commodity prices dominating the outlook going forward. China continues to rebalance its economy, and according to the IMF is expected to have grown by 6.8 per cent in 2015, and achieve growth of 6.3 per cent in 2016.[3] Monetary policy continues to support the economy, with the People's Bank of China reducing the policy rate by 165 basis points in 2015, and new fiscal measures announced in 2015 should help shore up demand and avoid a hard landing. Meanwhile the Chinese financial markets have gained in prominence in the past few years, which is why the turbulence over last week warrants particular attention. The Chinese authorities' decision to implement and then remove the 7 per cent "circuit breaker", which was triggered twice in the week, was a significant development and may suggest that financial market volatility may well be something that we have to live with for the time being.

On a more positive note, India's strong growth momentum continues. The IMF expects India to grow faster than China for the first time since 1999, forecasting GDP growth of 7.3 per cent in 2015 and 7.5 per cent in 2016. Indeed, India's economy grew by 7.4 per cent, year on year, in the third quarter, making it the world's fastest growing major economy for that quarter. In Russia, third quarter data suggests that the pace of contraction, and the impact of declining oil prices and political sanctions may be slowing. Prospects for Brazil, however, remain challenging, with the economy contracting by 4.5 per cent, year on year, in the third quarter. Meanwhile the 10.7 per cent year on year increase in consumer prices recorded in December confirmed that Brazil missed their inflation target for the first time in more than a decade. Political challenges have weighed heavily on consumer and business confidence, while cutbacks in public investment and government spending will impinge on the growth prospects in the near-term.

Closer to home, the growth momentum is slowing in sub-Saharan Africa (SSA). Since achieving growth of 5.0 per cent in 2014, the region is forecast to grow by 3.8 per cent in 2015, and 4.3 per cent over the coming year.[4] As you are aware, the region is dependent on commodity exports and as such has been hard-hit by the decline in commodity prices and the slowdown in global trade. Oil exporters, such as Nigeria and Angola, have been severely affected, with growth for this group of countries expected to drop from 5.9 per cent in 2014, to 3.6 and 4.2 per cent for 2015 and 2016 respectively. The further unexpected decline in oil prices that we have witnessed since the beginning of the year does not bode well for growth prospects and may result in actual outcomes being worse than current forecasts. Yet even for oil-importers, reduced demand for raw materials has meant that the benefits of cheaper energy imports have been offset by the general decline in commodity prices, which have decreased

[2] Inflation in the euro area stands at only 0.2% y/y in both November and December 2015.

[3] World Economic Outlook, IMF, October 2015.

[4] All data on sub-Saharan Africa from the Regional Economic Outlook for sub-Saharan Africa, IMF, October 2015.

by approximately 40 to 60 per cent between January 2013 and August 2015. In several African countries, the decline in prices of commodity exports has also led to a deterioration in both external and government balances, which had already been stretched by ambitious public infrastructure programmes and some relaxation of government spending discipline. In an environment of higher US interest rates, international diversification of investments is less forthcoming with a result that many countries in the region have found that external financing has become more difficult, or at least more costly.

This has been the case of middle-income countries on the African continent, such as Ghana and Zambia, where tighter financing conditions as well as supply constraints are expected to weigh down on growth. Other countries, however, face fewer of the aforementioned constraints, such as Kenya and Senegal, and are expected to see an acceleration in economic activity, supported by public investment and private sector activity, respectively. For low-income countries in the region, the outlook is more favourable, mainly as a result of robust infrastructure investment and private consumption driving growth. On average, this group of countries is expected to grow by 6.0 per cent in 2015, which while impressive, is still roughly three quarters of a percent lower than was forecast by the IMF in October 2014. This downward revision highlights the challenging headwinds facing the region. In the context of persistently low commodity prices, less favourable financial conditions, currency pressures, and external and fiscal vulnerabilities, risks to the outlook for sub-Saharan Africa remain on the downside.

On the inflation front, global inflationary pressures are subdued. In advanced economies, lower commodity prices and weak growth have led to lower inflation, and even deflation in some cases. Core inflation is expected to remain soft in advanced economies over the next two years,[5] reflecting persistent slack and lower import, particularly energy prices. In emerging markets the picture is more mixed. In Latin America, countries such as Chile, Colombia, Peru and Brazil have raised interest rates, as currency depreciation has led to a rise in inflation, and inflation expectations in some cases. However, in other emerging markets, particularly in Asia, policy rates have been eased in order to support growth. Overall, despite significant currency depreciations faced by emerging markets, inflation pressures in general remain fairly contained mainly as a result of weak demand.

Moving to the economic outlook for 2016, one issue that is likely to dominate the policy landscape is the tightening of international financial conditions and the impact that this may have on emerging markets. In the aftermath of the financial crisis, extraordinarily accommodative monetary policies in the advanced economies and the search for yield, combined with the relative strong growth performance of many emerging markets, drove strong capital inflows into emerging markets.

However, as you are aware, there has been a turning of the tide. This is in response to both the beginning of monetary policy normalisation in the US, as well as the weakening fundamentals in many EMs. For example, the IIF expects non-resident inflows to emerging markets to have reached US$ 548 billion in 2015, below the levels recorded in 2008/2009, and for net capital flows to EMs in 2015 to have been negative. As a share of emerging market GDP, capital inflows are estimated to have fallen from a high of 8 per cent in 2007 to 2 per cent for 2015.[6] China accounts for a large proportion of these outflows, with the IIF estimating capital outflows of over $500 billion from the country in 2015. The market turbulence experienced in September and October 2015, as well as in the past week, also highlight the manner in which developments in China, and fears of a crisis in emerging markets, will influence financial market conditions. Whilst the announcement of the initial Fed rate hike removed one source of uncertainty, other potentially more disruptive risks persist.

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5 Economic Outlook, OECD, November 2015.

6 Capital Flows to Emerging Markets, IIF, October 2015.

Despite the weakness and uncertainties that exist in the outlook for advanced economies, developments in emerging markets are likely to prove crucial for the global economy in 2016. Between the 1980s and present, emerging markets and developing countries' share of global GDP growth (in PPP terms) has doubled to over 70 per cent.[7] The growing importance of emerging markets to the global economy implies that a faster slowdown in China, or a protracted slowdown in EMs in general, could threaten the fragile global recovery. Recent research by the World Bank indicated that on average, a one percentage point decline in growth in BRICS countries could lead to a reduction of global growth of 0.4 per cent over the next two years.[8] At the same time, EMs face significant headwinds in the form of monetary policy divergence in the advanced economies, weaker commodity prices, dwindling policy buffers and a weak global growth and trade outlook. Further dollar appreciation and an increased sensitivity of EM yields to US rates not only pose risks to growth and inflation in many emerging markets, but also to financial stability, through balance sheet exposures.

Policy makers globally need to commit to policies aimed at boosting both actual and potential output, in order to support a strong, sustainable and balanced global recovery. Looking to the near-term, demand management measures also have a role to play in supporting growth outcomes globally. In many advanced economies, negative output gaps and low inflation trends allow for a continuation of accommodative monetary policies, and in some instances for more expansionary fiscal policies. In many emerging markets, however, the scope for both monetary and fiscal easing has narrowed, as policy makers look to manage rising vulnerabilities. In many cases cyclical policies need to move in sync with structural reform measures aimed at boosting potential growth in the medium-to-long term.

Globalisation and interconnectedness are key features of the world economy. Thus, exogenous influences are an integral part of policymaking today. This includes, inter alia, the spillover risks generated by policy decisions in large key economies such as the US or China. To further support global growth, there is therefore a need for continued global cooperation, and well calibrated communication, in order to mitigate the negative spillovers national policies may generate.

South African economic developments and outlook

2015 was a challenging year for the South African economy. Despite consecutive contractions in the primary sector in the second and third quarters, we avoided a technical recession in the third quarter. The economy registered annualised growth of 0.7 per cent in the third quarter, driven by a rebound in the manufacturing sector. Growth continues to be constrained by certain cyclical elements, such as weaker global trade and commodity price declines, as well as more idiosyncratic factors. Electricity shortages, although easing somewhat as more generating capacity has come online, continue to constrain production in some of the energy intensive sectors of the economy. In addition, the recent drought, said to be the worst in decades, has had a severe negative impact on the agricultural sector, which may worsen in coming quarters. Indeed initial crop estimates indicate that South Africa will likely need to import a significant amount of grain this year.

Looking to the year ahead, as at November last year the Bank's projections for growth was 1.5 per cent for this year and 2.1 per cent in 2017 as electricity constraints ease, but the risks remain skewed to the downside. The slowdown in China and persistently low commodity prices are expected to have a negative impact on the mining sector, which, while contributing only 5 per cent to GDP has accounted for more than 60 per cent of South Africa's export revenues over the past decade. Internal estimates by the Reserve Bank indicate that the drop in commodity prices between June and November 2015 could take a quarter of a percent off real

7 IMF WEO database.

8 Global Economic Prospects, World Bank, January 2016.

GDP growth in 2016.[9] With regard to manufacturing, the Barclays Purchasing Managers' Index fell sharply in November from 48.1 to 43.3 index points – the lowest level since August 2009, suggesting a constrained outlook for the sector. Furthermore, business confidence remains low, with the SACCI Business Confidence Index for December 2015 declining by 3.1 index points to 79.6, when compared to the month prior. The 2015 annual average of the Business Confidence Index is at the lowest level since 1993.

Unsurprisingly, in light of the weak growth prospects for the South African economy, and low levels of business confidence, growth in gross fixed capital formation has remained subdued. After reaching a five-year low in 2015, private sector fixed investment growth has since picked up slightly. The SARB expects private sector fixed investment growth to reach 1.6 per cent in 2016, from 0.4 per cent in 2015, with electricity shortages and weak demand for commodities being among the main factors responsible for this subdued outlook.[10]

On the demand side, the financial position of households remains under pressure, despite some gradual deleveraging since the global financial crisis. Consumer expenditure growth remains weak as a result of a moderation in real income growth and low levels of consumer confidence. Real spending on durable goods contracted in the third quarter of 2015 – the first contraction since the second quarter of 2009. Credit extension to the household sector has been weak over the last few years, and is likely to remain so in the future, given the subdued growth and employment prospects South Africa faces over the short- to medium-term. Unemployment remains high, at 25.5 per cent. With electricity price increases and last year's personal tax increase further constraining consumer income growth, the Bank projects household consumption growth to be below 2 per cent for 2015 and 2016.

According to the World Bank, structural impediments have been putting a brake on emerging market growth, with declining potential growth, on average, accounting for a third of the slowdown in EMs since 2010, South Africa being no exception.[11] Our estimates suggest that potential output growth for 2015 in South Africa was around 1.8 per cent, the lowest since the transition to democracy, and a significant decline from the 4.0 per cent level in the pre-crisis period.[12] However, monetary policy has a limited role to play in boosting potential growth. Structural policies are needed to boost the productive capacity of South Africa and promote the steady growth that is needed to make a meaningful dent in our unemployment figures. The Infrastructure Development Act and Employment Tax Incentive introduced by government are meant to address some of the structural impediments in the economy.

Like other emerging markets, South Africa has felt the impact of tighter international financial conditions. Data shows that portfolio flows into South Africa and into emerging markets as a whole have followed the same trend since 2010. Consequently, South Africa's recent experience of capital outflows and currency pressures has displayed similarities with the rest of the emerging world. Between September and November, non-resident sales of equities amounted to R25.9 billion, while net bond sales amounted to R5.9 billion. We have also observed that, in recent years, capital inflows have been increasingly sensitive to shifts in the US yield curve; while the rand, since May 2013, has been negatively correlated to US Treasury yields.

Given these experiences, the lift-off in the US suggests that were higher Fed funds rates to push longer-term US yields higher, South Africa could anticipate tighter financial conditions and further pressure on the rand. Indeed, immediately following the announcement, the rand

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9 Monetary Policy Review, SARB, November 2015.

10 Monetary Policy Review, SARB, November 2015.

11 "Slowdown in Emerging Markets: Rough Patch or Prolonged Weakness?" by T. Didier, M. Kose, F. Ohnsorge and L. Ye, World Bank Policy Research Note PRN/15/04, December 2015

12 Monetary Policy Review, SARB, November 2015.

fell against the dollar, although it subsequently rallied somewhat, and government bond yields rose. While some volatility was expected, the relatively muted market response in South Africa and elsewhere is encouraging, and suggests that the rate hike was mostly priced in by the market. Continued clear communication by the Fed will be instrumental in containing the potential negative spillovers of US monetary policy to emerging markets going forward.

Rand depreciation remains a significant source of risk for the South African economy. While many peer emerging market currencies have also faced currency depreciation and volatility, the rand has, on average, underperformed. Since the beginning of last year, the rand has depreciated by 44 per cent against the US dollar, 48 per cent against the Yen, and 31 per cent against the euro. Furthermore, since the end of 2015, the rand has also lost ground against other emerging market currencies. It is clear that both external and internal developments have been driving the rand weaker. Tighter global financial conditions as the beginning of Fed normalization approached, uncertainties regarding the rebalancing in China and the consequent decline in commodity prices, have played a part – unfortunately, these factors may well persist into the coming year.

Domestically, weaker growth prospects and perceptions around political events such as the cabinet reshuffle resulted in volatility in the local financial markets increasing sharply just before year-end. Markets initially reacted extremely negatively to the developments, with local assets experiencing severe selling pressure. The exchange rate of the rand touched what was then a historic low of R16.05 against the US dollar, the benchmark R186 government bond yield reached its highest level in seven years of 10.62 per cent on 11 December, while the country's 5-year CDS spreads also widened substantially by 72 basis points relative to emerging market peers. Part of this selloff was later reversed, but the impact of this on investor sentiment, as well as local business and consumer confidence may linger. This is particularly true in the context of recent sovereign credit downgrades.

The seemingly persistent current account deficit, which currently stands at 4.1 per cent of GDP, remains another source of vulnerability. Despite a drop in the price of oil and the depreciation of the rand, the current account deficit widened in the third quarter of last year, after benefiting from a temporary positive trade balance in the previous quarter. Despite recording a small net inflow of foreign direct investment in our financial account in the third quarter of 2015, portfolio flows dominate, and this makes us vulnerable to changing risk sentiments in the markets.

In terms of the trade account, despite the depreciation in the currency, slower growth in export volumes and the decline in commodity prices have meant that South Africa only experienced marginal growth in the nominal value of merchandise exports. At the same time, the value of merchandise imports rose by 3.6 per cent in the third quarter of 2015, driven by a boost in the quantity and price of imports, as a result of the weaker rand. Intermediate and capital goods account for approximately three quarters of South Africa's imports, and as such our demand for imports remains relatively price-inelastic. Furthermore, key export sectors, such as mining and manufacturing, have been unable to fully exploit the benefit of a weaker rand due to electricity constraints and labour disputes, not to mention the impact of lower international commodity prices and demand.

Our external vulnerability is however mitigated somewhat by our level of reserves, measured in terms of import cover, which increased from 4.8 months in June to 5.2 months in September. Relatively low levels of foreign-denominated debt also limit the financial stability risks that can arise as a result of currency depreciation. Foreign debt of government remains low, at 9.8 per cent of total gross loan debt of national government, and 4.8 per cent relative to GDP as of the end of the third quarter. Furthermore, South Africa's proportion of total foreign debt as a percentage of GDP is also relatively low, at 41.6 per cent. Unlike in some other EMs, the issuance of international debt by non-financial corporates, while having picked up over the last couple of years, does not present a significant financial stability risk, as many of these corporates are commodity exporters or other multinationals likely to have hedged their foreign currency assets and liabilities.

As outlined in the most recent Medium Term Budget Policy Statement (MTBPS), and echoed by Finance Minister Gordhan, South Africa remains committed to a path of fiscal consolidation. The budget deficit for 2014/2015 was 3.6 per cent of GDP, and is expected to reach 3.8 per cent in 2015/2016, before narrowing to 3.0 per cent in 2018/2019. Implementing the fiscal sustainability measures as detailed in the most recent Policy Statement, in conjunction with the structural reforms needed to address impediments to growth, are all crucial in these times and this is something that the authorities are cognisant of and remain committed to achieving.

While South Africa is currently facing some headwinds, the fundamentals underpinning the South African economy, such as the strong macroeconomic policy framework and the strength of institutions, provide the platform from which to successfully implement structural reforms that will lift both potential and actual growth and enhance resilience to external shocks.

The South African monetary policy outlook

Over the past year, the South African Reserve Bank has faced the policy challenge of rising inflationary pressures amid weak domestic growth and significant external headwinds. The deterioration in the inflation outlook over the past year prompted the SARB to raise the repo rate by 25 basis points in July and again in November 2015. Looking ahead, domestic constraints, exchange rate developments, the domestic drought and tighter financial conditions pose significant risks to the inflation outlook, and will continue to inform the monetary policy stance of the Bank in 2016.

Headline inflation for 2015 is expected to have averaged 4.6 per cent, on the back of low oil prices, well within the target band of 3 to 6 per cent. However, the SARB forecasts show that inflation will pick-up over the next two years, averaging 6.0 per cent for 2016, with two breaches of the target, in the first and last quarter of the year. This anticipated rapid acceleration in headline inflation is as a result of base effects from the fall in fuel prices in 2014, coupled with rising food price inflation, which is forecast at 6.0 per cent for 2016, and fairly sticky core inflation, which I'll return to in a moment. I should add that these forecasts were presented to the MPC in November of last year, and that following the recent developments, they are currently being revised in preparation for our next MPC meeting later this month.

According to the latest inflation expectations survey in the fourth quarter of 2015, average headline CPI inflation expectations of analysts, business people and trade unions for 2016 increased marginally by 0.1 percentage points to 6.2 per cent, respectively. Average expectations for 2017 increased by a more substantial 0.3 percentage points to 6.2 per cent, driven largely by trade unions who raised their forecast by a noticeable 0.4 percentage points to 6.3 per cent. This uptick, while marginally above the upper target limit, nonetheless suggests that the risk of a "de-anchoring" of inflation expectations, from the upper end of the 3,0–6,0 per cent target range, where they had stabilized in recent years, cannot be overlooked. Furthermore, break-even inflation rates reflect elevated longer-run inflation expectations, with implied inflation rates from five- and ten-year bonds averaging 6.5 per cent over the past year.

Despite weak growth and the lack of demand pressures, inflation in South Africa remains elevated partly because of structural rigidities in product and labour markets.[13] Product markets in South Africa are highly concentrated and are characterised by high and inflexible prices, which reduces the sensitivity of corporate pricing power to the business cycle and thus adversely impacts on inflationary pressures. Wage growth in many industries is not strongly correlated to productivity growth, and the shortage of skilled workers in the tertiary sector means that average salary expectations – at 7.1 per cent for 2016 – remain above current and expected inflation. This of course has implications for core inflation and is part of the reason that it hasn't slowed as much in 2015 as we would have hoped. After averaging 5.6 per cent

[13] Monetary Policy Review, SARB, November 2015.

in 2014, core inflation is expected to have only moderated to 5.5 per cent in 2015, which coincides with the Bank's forecast for this year.

As the MPC has clearly noted in its statements, the currency remains a key source of risk for inflation in South Africa, despite some recent evidence of weaker pass-through. Rand depreciation is a major factor underpinning inflationary pressures in so far as they increase the domestic prices of imported goods. Commodity price movements also lead to a negative demand shock, which serves to offset inflationary pressures somewhat. Recent indications suggest, however, that the transmission of import prices to domestic prices has been more muted in South Africa and other emerging markets. In our case, this could be explained by a lack of demand pressures, represented by a negative output gap, which is forecast at –1.8 per cent of GDP for 2015.[14] However, it is unclear as to whether this trend will continue, or if the full impact of the pass-through is merely delayed, and policy makers must thus remain vigilant.

Earlier in 2015, there were signs of a relatively benign path for the exchange rate, as it held up well against the yen and euro. However, as the year progressed and the rand weakened across the board, inflation risks heightened and prompted the decision to resume the hiking cycle in July 2015. In general, the MPC aims to see through the first round effects of exogenous shocks. However, in the context of prolonged currency depreciation, the first and second round effects are harder to disentangle. As such, the Bank decided to increase the policy rate to minimise the risk of second-round effects and the need for a stronger reaction in the future.

But the impact of a weaker currency is not limited to its effect on inflation. The currency impacts on real output through two channels, namely, trade and income. With regard to the former, theory states that currency depreciation will boost net exports, as exports become relatively cheaper in the world market. However, as a result of the prevailing structural constraints, the potential benefits from depreciation to exporters and import-competing firms have not fully materialised. As far as the income effect on growth is concerned, currency depreciation, and the ensuing rise in inflation, will lead to a decline in real wages and real disposable income, all else being equal. This in turn would negatively impact on real household expenditure and real GDP growth. While some may question our decision to further raise rates in November given the weak growth outlook, the income channel highlights the growth enhancing effect of keeping inflation under control.

The SARB decided to raise rates in July and November 2015 in order to prevent potential second-round inflationary effects from occurring and to anchor long-term inflation expectations, which remain uncomfortably close to or above the upper band of the inflation target. In general, risks to the inflation outlook for 2016 remain tilted to the upside and have recently deteriorated further. Rand depreciation, electricity tariff increases, and the impact of the drought on food prices are expected to outweigh the impact of lower oil prices. Nevertheless, the Bank has made it clear that any future decisions will be data dependent and driven by the developments in the inflation outlook.

It may be useful to comment on this concept of data dependency, which some have argued was violated in the wake of our most recent policy adjustment in November 2015. We think of "data" in the broader sense of all pieces of information on a collective basis that in our judgement may have a bearing on the inflation trajectory in the medium term, rather than only in a narrower sense of looking at individual economic indicators as they are released. The latter would invariably embed a "behind-the-curve bias", which, given the lags with which monetary policy works, would be contrary to the principle of needing to adopt a forward looking approach to monetary policy formulation, and also reduce policy flexibility.

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[14] Monetary Policy Review, SARB, November 2015.

Conclusion

In conclusion, there is no doubt that South Africa, as an emerging market economy, remains vulnerable to global economic and financial markets developments and currency pressures these uncertainties generate, as well as a number of domestic challenges to both growth and inflation outcomes. The opening weeks of 2016 suggest that the conduct of monetary policy in South Africa will be further complicated. Therefore utmost vigilance remains the order of the day, and risks will require close monitoring as we move deeper into 2016, and preparedness to take decisive action within our flexible inflation targeting framework if the key mandate of price and financial stability comes under threat. Given the recent escalation of risks to the inflation outlook, including since the last meeting of the MPC, the MPC will need to assess very carefully whether the current monetary policy stance remains appropriate.

Thank you.