MONETARY POLICY REVIEW

OCTOBER 2021

SOUTH AFRICAN RESERVE BANK

SARB 100 YEARS 1921–2021

A purposeful journey

Enquiries relating to this *Monetary Policy Review* should be addressed to:

Head: Economic Research Department
South African Reserve Bank
P O Box 427
Pretoria 0001

Tel. +27 12 313 4416

www.resbank.co.za

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Preface

The primary mandate of the South African Reserve Bank (SARB) is to achieve and maintain price stability in the interest of balanced and sustainable economic growth. In addition, the SARB has a complementary mandate to oversee and maintain financial stability.

Price stability helps to protect the purchasing power and living standards of all South Africans. It provides a favourable environment for investment and job creation, and supports international competitiveness. The goal of price stability is quantified through an inflation target, which is set in consultation with government. The target is a range of 3–6%, which has been in place since 2000.

The SARB has full operational independence. Monetary policy decisions are made by the SARB's Monetary Policy Committee (MPC), which is chaired by the Governor and includes the Deputy Governors and other senior officials of the SARB.

The inflation-targeting framework is flexible, meaning that policymakers will seek to look through temporary shocks, thereby avoiding excessive volatility in interest rates and economic output. The MPC takes a forward-looking approach to account for the time lags between policy adjustments and economic effects. MPC decisions are communicated at a press conference at the end of each meeting, accompanied by a comprehensive statement.

The *Monetary Policy Review (MPR)* is published twice a year and is aimed at broadening the public's understanding of the objectives and conduct of monetary policy. The *MPR* covers domestic and international developments that affect the monetary policy stance.

In normal circumstances, the *MPR* is presented by senior officials of the SARB in major centres across South Africa. However, due to COVID-19, this *MPR* will be launched virtually.

Questions about the publication may be directed to Marlene Hugo at Marlene.Hugo@resbank.co.za.

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Beyond the recovery: rebuilding policy space

Executive summary and overview of the policy stance

The Monetary Policy Committee (MPC) has left the repurchase (repo) rate unchanged at 3.5% for over a year, since July 2020, extending meaningful support to the economy as it recovers from the pandemic and lockdown. Low interest rates, financial regulatory easing, fiscal support measures and less stringent COVID-19 restrictions have supported economic activity. The domestic economic recovery has additionally benefitted from stronger global growth, spurred by expansionary policy settings and wide-spread vaccination in advanced economies. The terms of trade reached record highs, sharply raising national income. However, stronger growth momentum has been held back, in large part by uncertainty and electricity shortages. In the absence of broad improvements to the investment climate, growth momentum will slow into 2022 even as risks to the inflation outlook rise. While headline consumer price inflation remains generally well-contained, the medium-term forecast implies the need for gradual normalisation to keep inflation around the midpoint of the target and longer-term interest rates low.

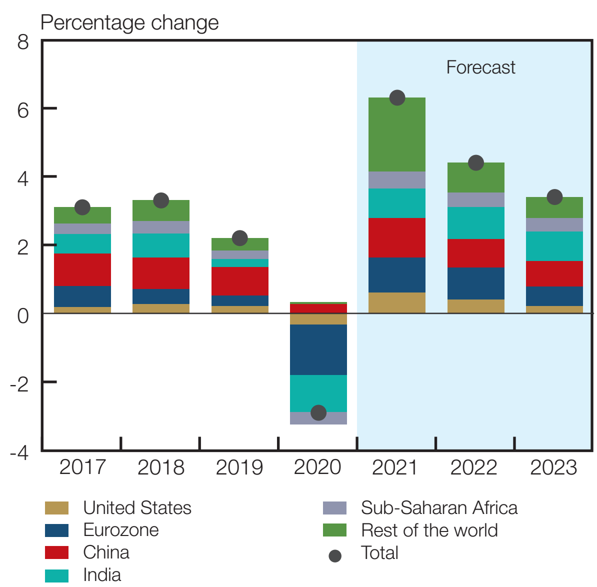
The global economy continues to exhibit a robust recovery from the COVID-19-induced recession of 2020, strengthened by widespread vaccination roll-outs and accommodative fiscal and monetary policy settings in advanced economies. Indicators of economic activity in some major global economies are now above their pre-COVID trend. As of September, the SARB estimates trade-weighted global growth of 6.2% in 2021, in part due to stronger outcomes in Europe and the United States (US), with medium term growth forecasts of 4.4% and 3.4% in 2022 and 2023 respectively.[1, 2]

Although global growth remains strong overall, that of emerging market and developing economies has decelerated (IMF *WEO Update*, July 2021). This slowing in growth and increasing divergence with advanced economies reflects differences in available fiscal and monetary policy space early in the timeline of the pandemic, and importantly, differences in vaccination rates. Economies that have achieved widespread vaccination have reopened and eased restrictions more quickly than

1 The €800 billion NextGenerationEU stimulus package, to be implemented from the summer of 2021, should further support eurozone growth into 2022.

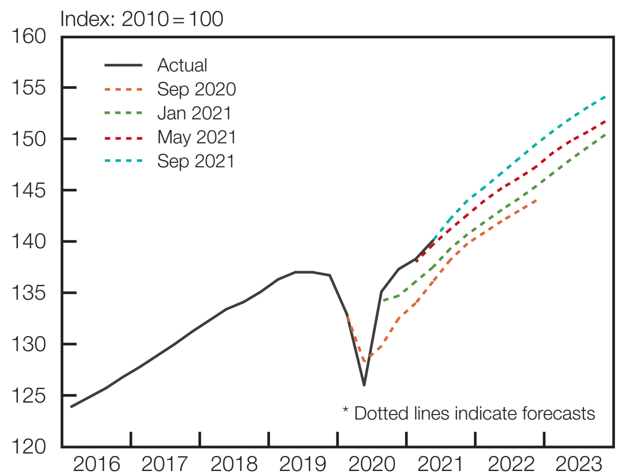
2 In its July 2021 *World Economic Outlook (WEO) Update*, the International Monetary Fund (IMF) projects global growth to reach 6% in 2021, unchanged from the April 2021 *WEO*, and a stronger 4.9% in 2022 (4.4% previously).

Trading-partner GDP growth



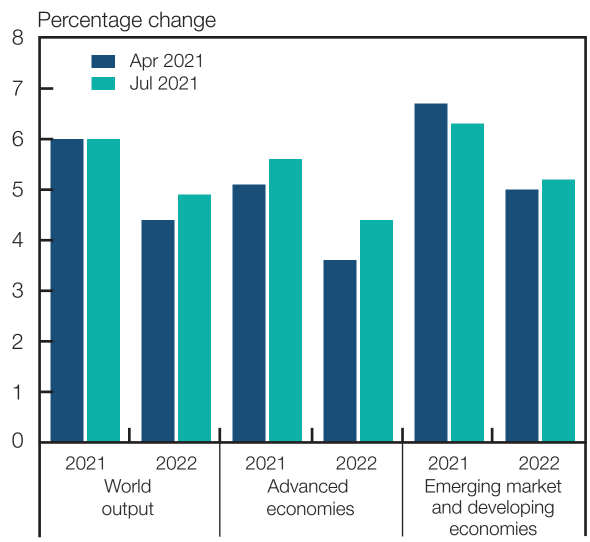
Source: SARB

Evolution of trading-partner GDP forecasts*



Source: SARB

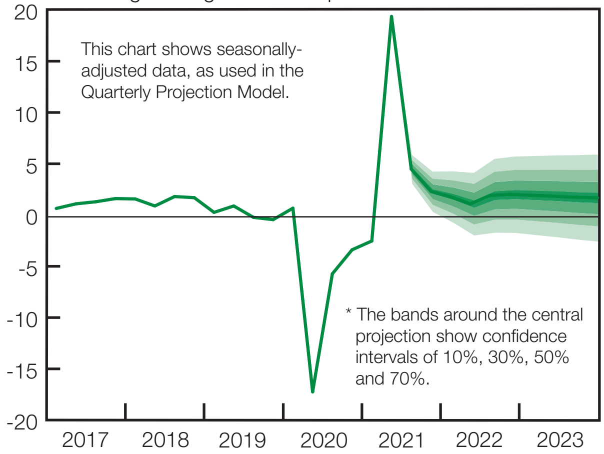
IMF growth projections



Source: IMF

Real GDP growth*

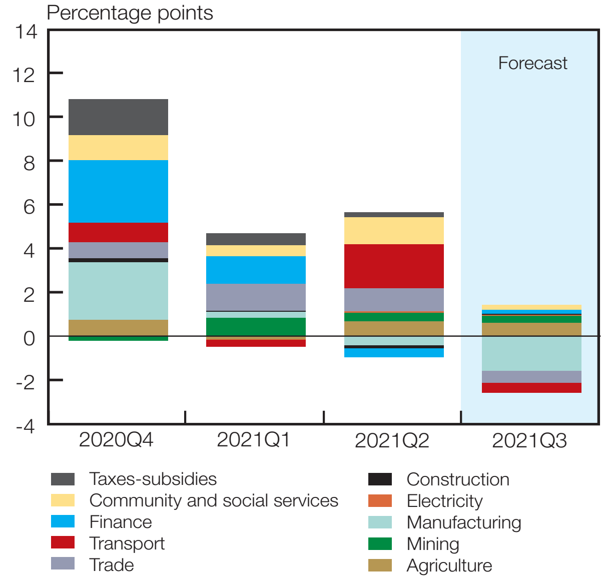
Percentage change over four quarters



Sources: Stats SA and SARB

Contributions to GDP growth*

Percentage points

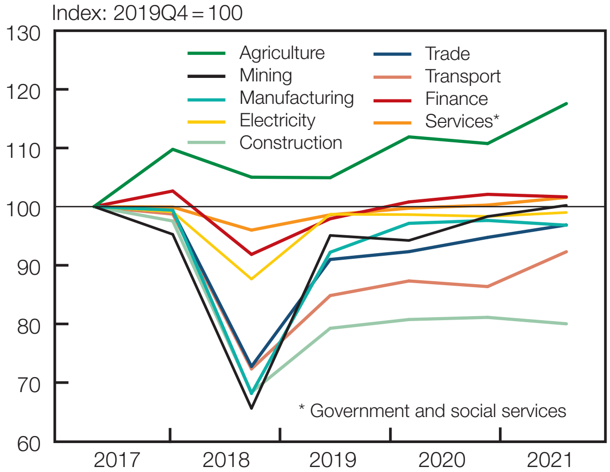


* Quarter-to-quarter percentage change at seasonally adjusted annualised rates.

Sources: Stats SA and SARB

Gross value added

Index: 2019Q4 = 100



Sources: Stats SA and SARB

others, supporting progressive normalisation of economic activity. Those with lower vaccination rates (mostly developing economies) continue to exhibit sluggish economic activity levels, including in relation to medium-term projections.

One consequence of the sharper global recovery is rising global price pressures, created by strong demand for goods, higher food and oil prices, and supply bottlenecks associated with slow reopening of services and logistics sectors.[3] Major global central banks currently perceive these price pressures to be transitory, suggesting that gradual policy normalisation would proceed as expected, beginning in 2023. Despite this relatively benign analysis, rising global inflation and greater uncertainty about the path of interest rates has contributed to financial market and capital flow volatility over the past six months. This reflects in part risks of overheating as policy accommodation remains extensive, as well as risk aversion toward emerging markets with weaker growth and higher inflation. Most emerging market economies face the prospect of sustaining recoveries and rebuilding fiscal and monetary policy space even as global conditions become less supportive.

South Africa's own recovery from the sharp contraction in the second quarter of 2020 has been unusually strong, especially by the growth standards of the post global financial crisis (GFC) period. Domestic growth benefitted from favourable global and domestic conditions and the momentum of the second half of 2020 carried through to this year. Gross domestic product (GDP) rose by 4.2% in the first quarter of 2021 on an annual basis and by 4.7% in the second quarter, taking GDP to within 1.1 percentage points of the pre-pandemic output level.[4] Until the growth momentum was interrupted by the July riots, looting and disruption of supply chains that rocked the KwaZulu-Natal (KZN), Gauteng and Mpumalanga provinces, the economy was on track to recoup most of the GDP losses by the end of 2021. The latest projections suggest the economy will contract by 1.2% in the third quarter, with growth averaging 5.3% in 2021. Medium-term growth is forecast somewhat lower at 1.7% and 1.8% in 2022 and 2023 respectively, on substantially lower investment.

On a sectoral basis, the recovery remains uneven. Scarring from the pandemic and associated lockdowns is visible in some parts of the secondary and tertiary sectors, while others have recovered or moved beyond pre-pandemic levels of output. Agriculture remained largely unscathed and continues to expand. The sector grew at 13.4% in 2020 and is expected to grow by 11.8% in 2021, benefitting from favourable weather

3 Bottlenecks include shortages of semi-conductors, shipping containers and vessels.

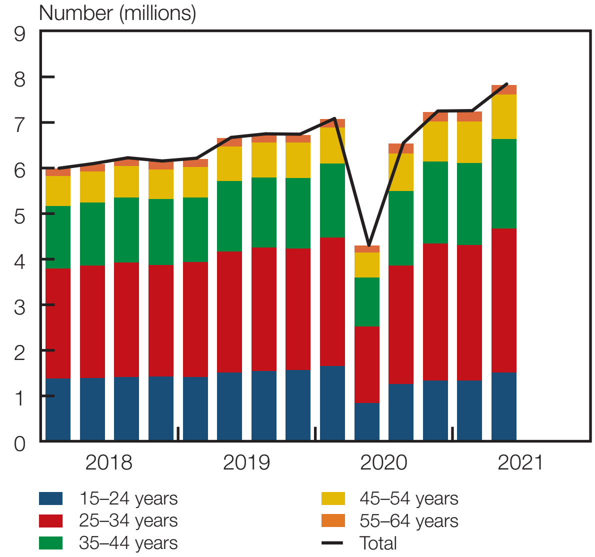
4 Throughout this report we use quarter-on-quarter seasonally adjusted and annualised growth rates, unless stated otherwise.

and demand conditions. Mining production has recovered to the pre-pandemic level, supported in part by sharply higher commodity prices. The secondary sector has moved sideways since the third quarter of 2020, weighed down in particular by the low level of construction activity. Construction is the least recovered of all sectors (operating at 79% of its pre-pandemic level). Idiosyncratic factors have weighed on growth in manufacturing, which has remained around 95% of its pre-pandemic level since the fourth quarter of 2020. The tertiary sector is back to its 2019 level, lifted by finance and community and social services, despite transport and trade remaining depressed, reflecting the lingering effects of the COVID-19 waves and the associated lockdowns, particularly for the tourism subsector.

Despite the exceptionally strong recovery in GDP, job creation has been weak, reflecting the poor growth performance of the more labour-intensive sectors such as construction, transport and trade. Firms have intensified the use of overtime work to meet growing demand, delaying hiring of workers. At the same time, labour force participation has improved, rising to 57.5% in the second quarter of 2021, as job seekers previously discouraged from seeking jobs return to active search. Consequently, unemployment reached a new record high of 34.4% in the second quarter. Despite weak employment growth and rising unemployment, average earnings have largely recovered to their pre-pandemic levels.

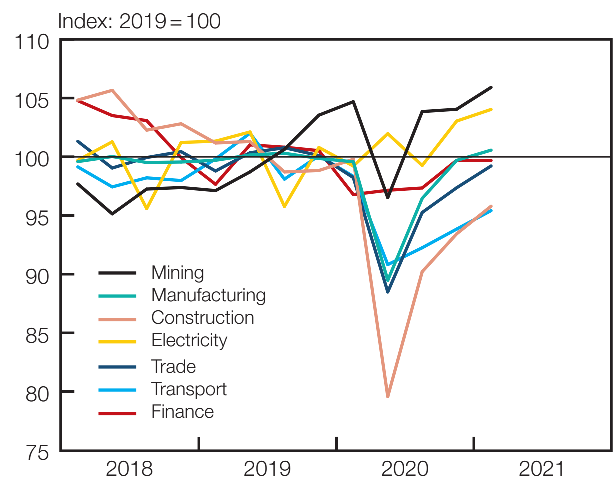
Turning to the demand side, real household spending has been resilient and has, in part, underpinned the recovery in GDP. Consumption benefitted from a faster recovery in worker earnings, growth in net wealth, record low borrowing costs and increased social transfers. The extension of the COVID-19 social relief of distress (SRD) grant should further support household consumption.

Unemployment



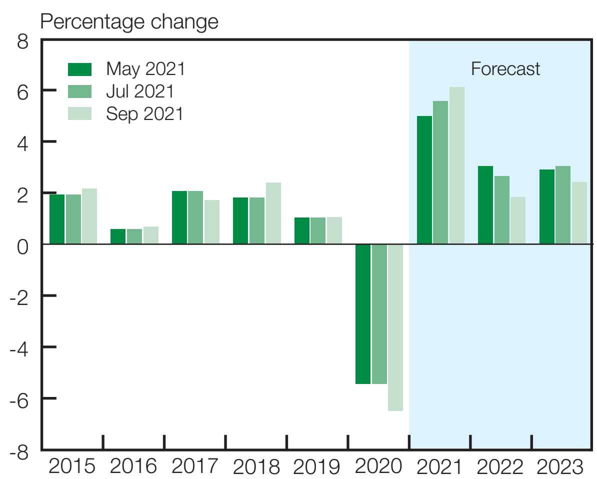
Sources: Stats SA and SARB

Real average earnings by industry



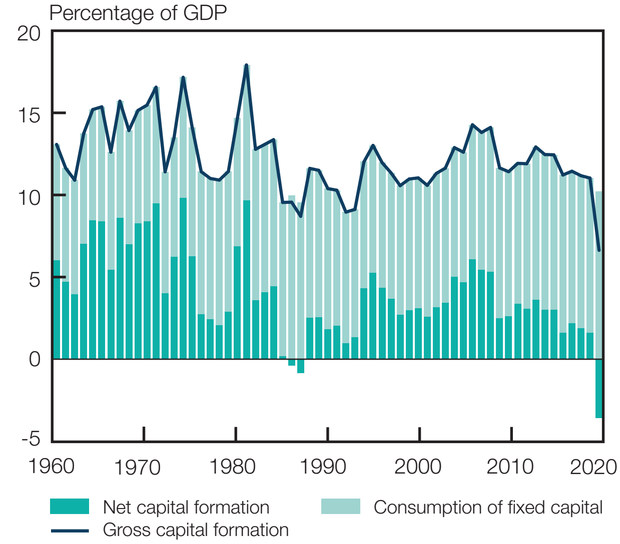
Source: SARB

Final consumption expenditure of households



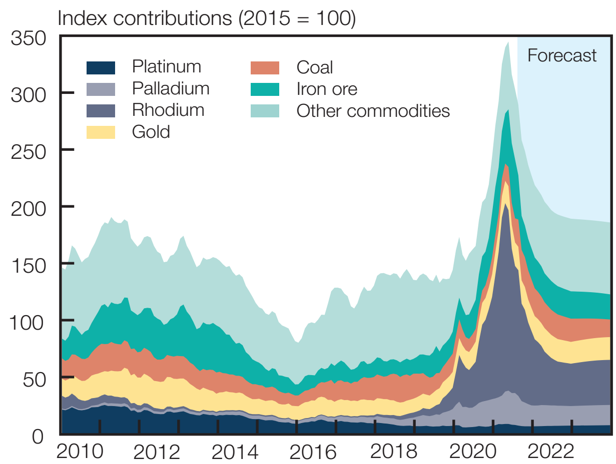
Source: SARB

Gross capital formation: private business enterprises



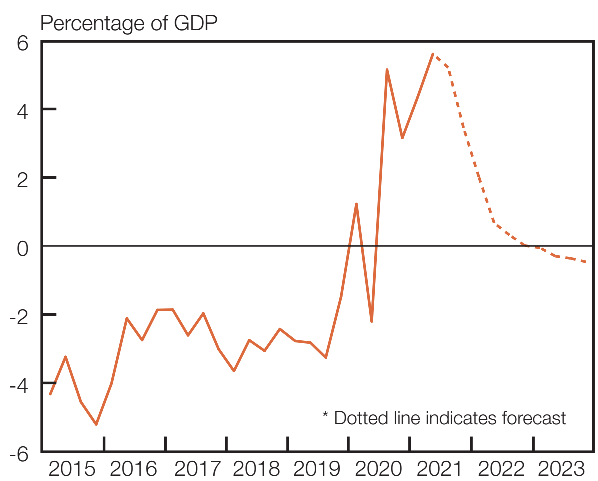
Sources: Stats SA and SARB

Contributions of different commodities to SA's export-weighted commodity prices



Source: SARB

Balance on current account



Source: SARB

Despite the strong recovery in household consumption and also production levels, gross fixed capital formation remains weak. Over the period under review, forecasts for investment have shifted to being less negative, but investment growth is still projected at -0.3% in 2021, before improving to 0% in 2022 and 1.8% in 2023. Weak investment appetite also marked the pre-pandemic economy, as electricity supply was constrained, and with the extraordinary uncertainty associated with the pandemic helps explain the slow recovery in investment spending expected over the medium term. The July unrest further dented investor confidence.

The drag on growth from weaker investment has been partially offset by commodity exports, which have played a central role in South Africa's macro adjustment over the past year. Sharply higher export commodity prices have aided the economic recovery, improved the fiscal position and helped turn a current account deficit into surplus. The export price trajectory has facilitated the financing of the extraordinary fiscal deficits of the pandemic period, in part by raising income and in part by keeping the currency appreciated and the cost of borrowing lower than it might have been. The current account swung into surplus in the third quarter of 2020 and is projected to remain in surplus for this year, at 4.6% of GDP. As economic activity levels, imports and export prices normalise in 2022 and beyond, a deficit is expected to re-emerge.

An important macroeconomic feature of the commodity price surge has been its fiscal effects, with the strong terms of trade pushing nominal GDP higher, buoying government tax revenues, reducing fiscal deficits, and slowing the projected rise in public debt.[5] This has made it possible for government to implement COVID-19-related social transfers, adjust the public sector wage offer and provide relief to businesses impacted by the July riots, while preserving the integrity of the fiscal framework. The better-than-expected fiscal outcomes, together with more buoyant projections for global growth, have eased South Africa's fiscal risk, benefitting the risk premium, which has declined back towards its long-run equilibrium. Nonetheless, the yield curve for rand-denominated bonds remains steep, reflecting concerns around fiscal credibility.

5 The fiscal deficit and debt-to-GDP ratio have also benefitted from the recent benchmarking and rebasing of GDP. These benefits, however, are temporary.

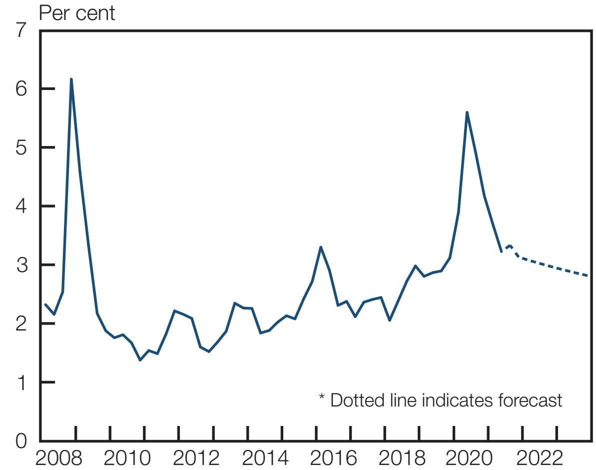
Despite these clear benefits, the dependence of the economy on sharply higher commodity prices presents risks. While commodity prices have increased across the board, the terms of trade rise was sourced primarily from a narrow range of commodities, particularly rhodium, palladium and iron ore (see Box 1). A sudden and sharp correction in commodity prices could undermine the broader economic recovery, unwind the current account surplus and put the fiscal trajectory in jeopardy, while the rand would depreciate, with adverse effects for inflation. This fragility to the recovery implies that steps to broaden the sources of the recovery and strengthen its momentum should be prioritised. Large economic gains could be achieved by removing barriers to increasing the supply of network services, especially electricity, easing constraints to small business growth, increasing the supply of skills in the economy and further de-risking the economy by stabilising public debt.

During the period under review, South Africa's inflation trajectory has remained relatively contained and supportive of the economy's recovery. South African food price inflation has ticked up, more closely in line with rapid global food price inflation, and oil prices have also turned sharply higher, pulling headline consumer price inflation to 5.2% in May. The more appreciated level of the rand, underpinned by a more supportive global environment, has however lessened the impacts of imported inflation in the domestic economy. Headline inflation is expected to average 4.4% in 2021, compared to 3.3% in 2020, and remain close to the target midpoint over the forecast period. Administered price inflation, particularly electricity prices (13.8% in July), will exert upward pressure on headline inflation into 2022.

While exogenous price pressures explain the higher headline inflation outcomes, core inflation remains subdued, reflecting currency strength, moderate demand, temporarily very low medical insurance prices, alongside still relatively low housing price inflation and subdued labour market pressures. These factors continue to keep inflation expectations well-anchored between 4 and 4.5%. After averaging 3.3% in 2020, core inflation is projected at 3.0% in 2021, rising to 3.8% in 2022 and 4.3% in 2023.

Risk premium

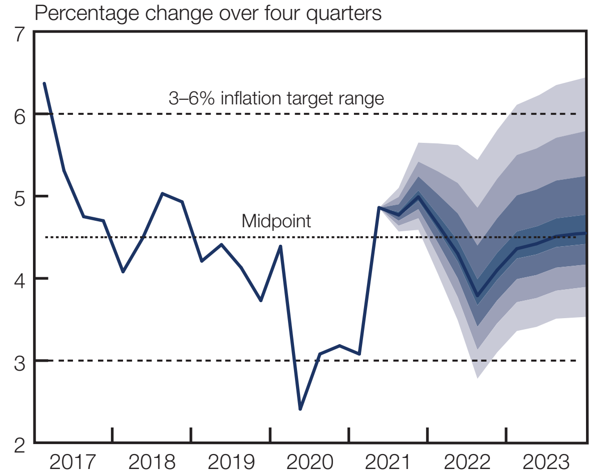
Per cent



Sources: JPMorgan and SARB

Targeted inflation forecast*

Percentage change over four quarters

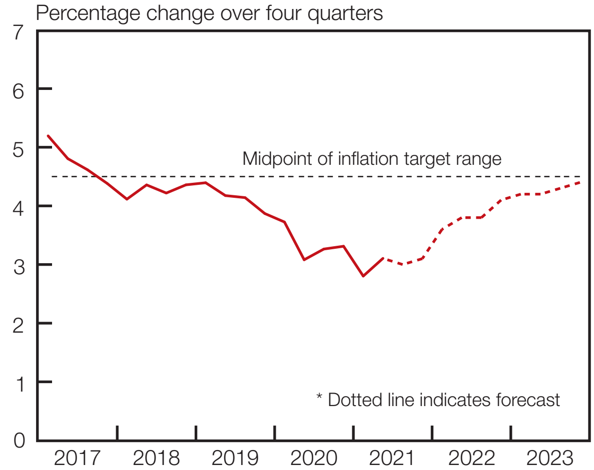


* The bands around the central projection show confidence intervals of 10%, 30%, 50% and 70%.

Sources: Stats SA and SARB

Core inflation

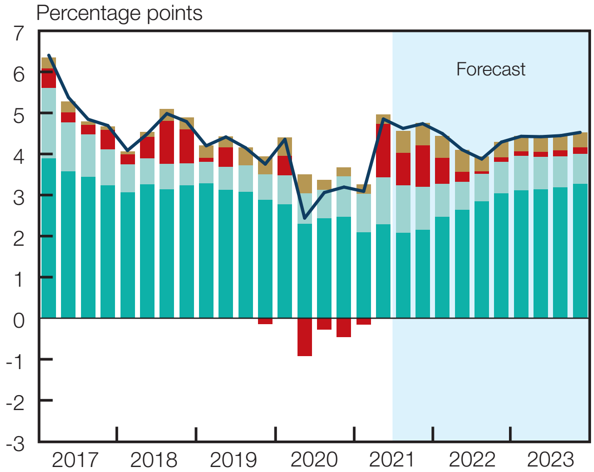
Percentage change over four quarters



Sources: Stats SA and SARB

Contributions to headline inflation

Percentage points

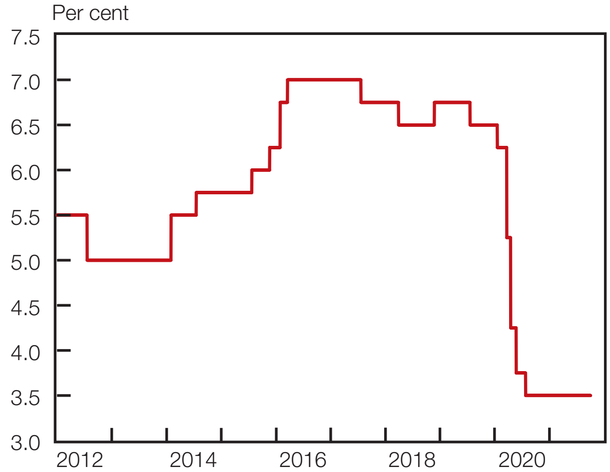


* Percentage change over four quarters

Sources: Stats SA and SARB

Repo rate

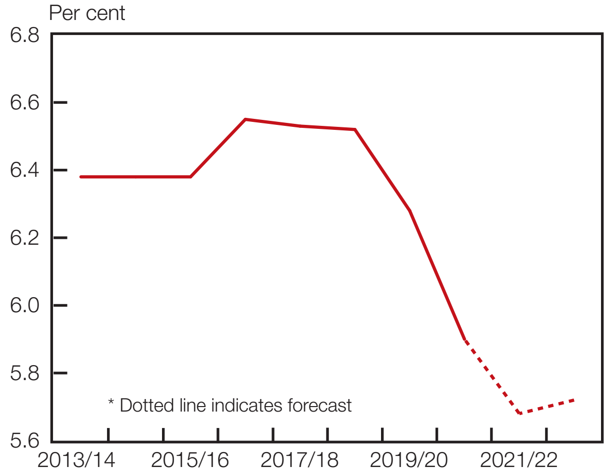
Per cent



Source: SARB

Implied government interest rate

Per cent



Sources: National Treasury and SARB

While headline inflation remains contained and core inflation modest, there are several material upside risks. Global food prices look set to remain elevated, posing a risk to domestic inflation despite the expected bumper harvest in 2021. Similarly, administered prices, particularly for water, electricity and petrol, have exceeded recent estimates and present further upside risks to the forecast. Skills shortages could cause premature tightening of the labour market, and with increased pressures in collective bargaining forums, push unit labour costs (ULCs) higher. Lastly, rising global inflation and supply constraints could drive up imported inflation, with the impacts exacerbated potentially by rand depreciation.

Overview of the policy stance

With moderate headline consumer price outcomes, forecast trajectories indicating well-contained inflation, and inflation expectations moderating generally, the MPC left the repo rate unchanged at 3.5% over the last seven meetings (since July 2020). Together with higher global growth, low borrowing costs spurred on the recovery of the domestic economy, propping up consumption, refinancing of existing credit, and better activity levels in housing markets. The low repo rate helped to reduce the prime lending rate to its lowest level in 56 years and sharply reduced the real cost of servicing debt. For cash-constrained households, this helped boost real consumption.

Low short-term interest rates also presented an opportunity for the public sector to reduce its borrowing costs, with the effective interest rate on government debt driven to below 6%, compared to borrowing costs of around 9% at longer maturities. However, the need for funding from short-dated Treasury bills has reduced, following unexpectedly strong revenue flows and good uptake for non-competitive bond auctions.

With economic recoveries expected to continue at moderate rates of inflation, global and domestic policy settings are likely to remain accommodative even as major advanced economies begin to taper asset purchases and real interest rates start to normalise.

A key feature of the domestic economic recovery has been the divergence in monetary policy transmission to households and that to firms, even as market rates show strong co-movement with the repo rate indicative of strong pass-through.[6] The incomplete transmission of policy to investment is reflected in weak corporate borrowing and higher saving despite record

6 See also Greenwood-Nimmo, Steenkamp and Van Jaarsveld (2021). 'A bank-level analysis of interest rate pass-through in South Africa', *SARB Working Paper,* forthcoming.

low interest rates.[7] At a macroeconomic level, however, the poor investment trajectory was allayed by a massive addition to demand embodied by the very strong terms of trade. This has raised national income, supporting economic growth and fiscal revenues.

Transmission of changes in market rates to economic activity remains strong in the household sector. Total credit to households has held up and is around the 2019 level. The number of mortgage advances granted between January and August 2021 is substantially higher than the average for the period 2011–2019. The stock market has performed exceptionally well, buoyed by the global recovery, low interest rates and strong commodity prices. Rising asset prices have supported the rebuilding of household net wealth, which should further support household consumption.

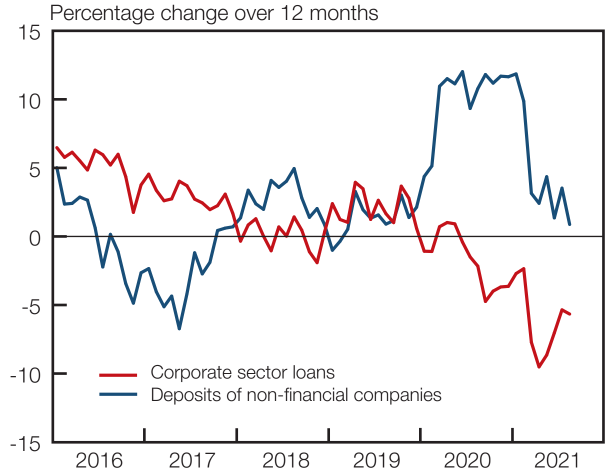
Between the March and the May meetings of the MPC the outlook for growth improved markedly. Alongside upward revisions to global growth, high frequency data implied the economy had weathered the second wave of the pandemic better than initially anticipated, leading to the annual growth estimate being revised higher to 4.2%, from 3.8% in March. The recovery, however, remained uneven across sectors, while weak investment saw medium-term growth revised marginally lower.

The inflation trajectory remained modest with headline consumer price inflation projected at 4.2% in 2021 (down from 4.3% in March), before rising to 4.4% and 4.5%, for 2022 and 2023 respectively. Core inflation remained muted and was projected to average 3.0% in 2021, before rising to 4.3% in 2023, reflecting the favourable outlook for the medium-term determinants of inflation, namely, the relatively stronger rand, ongoing moderation in ULCs, well-anchored inflation expectations and slow reversion of the output gap.

Headline inflation might have been lower had it not been for the rising food and administered prices. Higher food inflation reflected both global food shortages and rising local demand. The sharp recovery in oil prices from their 2020 lows pushed petrol price inflation to a projected 12.5% for 2021 (12.7% in March).

Real corporate sector loans and deposits

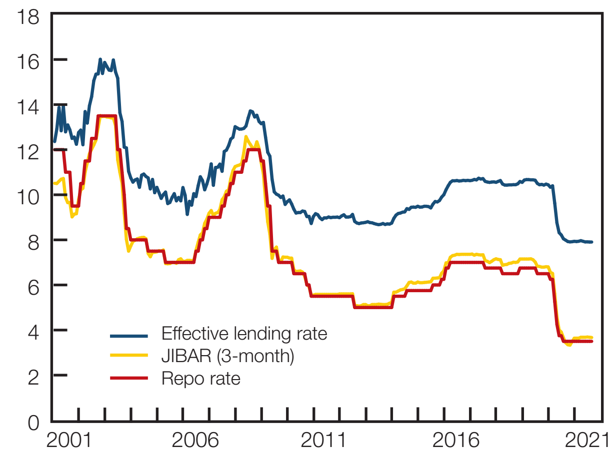
Percentage change over 12 months



Source: SARB

Repo and market rates

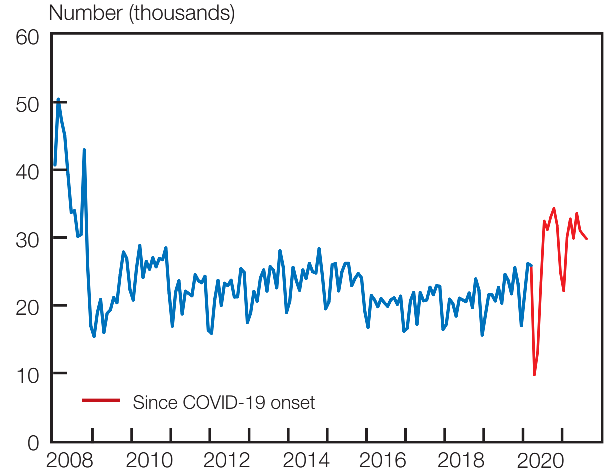
Per cent



Source: SARB

Mortgage advances granted

Number (thousands)

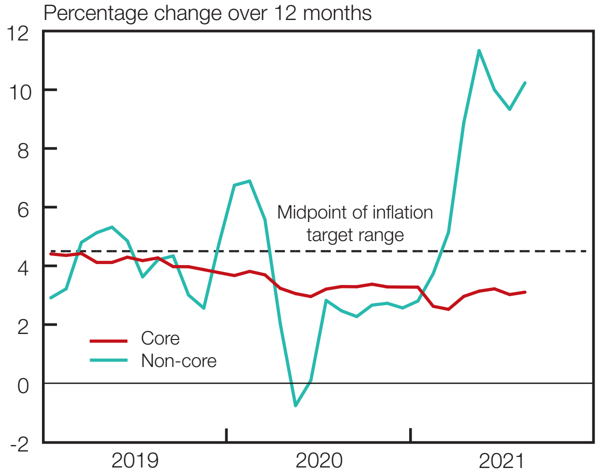


Source: SARB

7 The high commodity prices may have reduced the need for borrowing by corporates in mining and related sectors that normally borrow for investment. Equally, the continued depressed activity in some sectors and broader concerns around the investment climate may partly explain the subdued corporate borrowing.

Core and non-core inflation

Percentage change over 12 months



Sources: Stats SA and SARB

With growth stronger and inflation gradually rising to the target midpoint, the Quarterly Projection Model's (QPM) Taylor rule advised two hikes of 25 basis points each in 2021, the first in the second quarter and the second in the fourth quarter, with the nominal repo rate terminating at 6.0% by the end of 2023. The MPC, however, unanimously decided to keep the repo rate unchanged at 3.5%, keeping monetary policy settings exceptionally accommodative, and showing deference to the recovery (see Box 2). Risks of higher imported inflation, an earlier start to normalisation in the advanced economies, persistence of supply constraints and higher food and oil prices were seen outweighing the downward pressures to headline inflation emanating from the medium-term drivers of core inflation.

In the run up to the July meeting, the external environment remained supportive of domestic growth, with trading-partner growth again revised somewhat higher. Although G3 inflation for 2021 was expected to remain close to the 2% target, concerns about rising inflation in the US mounted, with markets and analysts increasingly expecting an earlier start to policy normalisation, and causing increased volatility in financial markets. The US Federal Reserve (Fed) communications, however, helped to calm the markets, shifting 'risk-off' sentiment toward 'risk-on', and aiding the flow of capital to emerging markets.

GDP data for the first quarter of 2021 affirmed the sound recovery, with growth registering a strong 4.6% compared to the May forecast of 2.7%. However, the resurgence in the virus and the resultant heightened restrictions (adjusted Level 4) that included alcohol sales limitations tempered economic activity in the second quarter, with the growth forecast consequently lowered to 1.3% (1.7% in May). The growth momentum was further curtailed by the protest actions and riots early in the third quarter. While the exact impacts remain unclear, the protest actions and riots added strongly to uncertainty, exacerbated supply bottlenecks and resulted in sharply lower output across several sectors of the economy.[8] The protest actions and riots and the stronger third wave effectively neutralised the positive external shocks and the growth momentum from the first and second quarters, leaving growth for the year unchanged at 4.2%.

The inflation outlook at the July meeting was broadly similar to the May meeting, with headline consumer price inflation generally well-contained over the forecast period. Core inflation forecasts also broadly followed the May forecasts.

8 Market analysts assess the impact to shave 0.4–0.7 percentage points off 2021 growth. Manufacturing sector output for July fell by 8.0% month-on-month and 4.1% year-on-year.

Of note, however, was the downward revision in both headline and core inflation to respectively 4.2% (from 4.4%) and 3.7% (from 4%) in 2022.

While core inflation remained muted, the first half of the year saw a sharp rise in non-core inflation, particularly food and fuel. Food inflation continued to rise since the April 2021 *Monetary Policy Review (MPR)* and was expected to peak at 6.4% in the second half of the year, before moderating somewhat, and to average 6.2% in 2021 (up from 5.4% in May). The petrol inflation forecast for the year was raised to 15.3%, up from 12.5% in May, even as the strong rand helped to mute the high oil price effect, but was projected to decelerate to 5.5% in 2022.

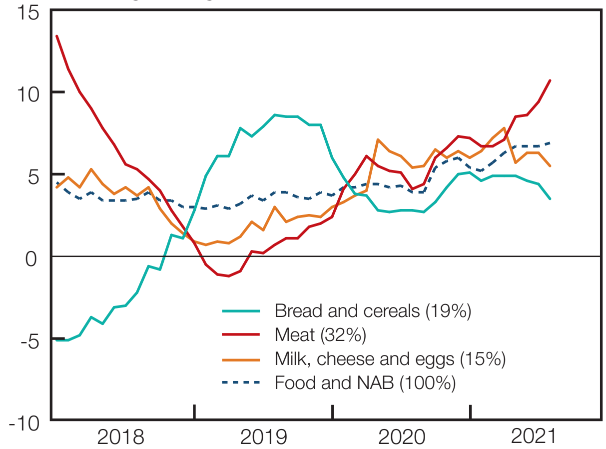
With a more subdued inflation outlook for 2022, the QPM-implied policy path suggested normalisation to only begin in the fourth quarter of 2021, with the repo rate terminating at 6.0% by the end of 2023, as in the May meeting. The MPC unanimously voted to keep the repo rate unchanged at 3.5% – the sixth time in a row. This was despite the committee assessing the balance of risks to the inflation forecast to be to the upside. The major concerns for the MPC were the elevated global and domestic producer prices, supply shortages created by disruptions to local transport networks during the July riots, elevated food and petrol inflation, imported inflation (aggravated by a weakening currency), higher domestic import tariffs and escalating wage demands.

The September meeting followed the release of the second quarter GDP data as well as the long-awaited benchmarking and rebasing of GDP. Growth quickened to 4.7% in the second quarter, significantly better than the 1.3% projected at the July meeting. However, growth for the first quarter of 2021 was revised slightly lower to 4.2% (previous release, 4.6%), while the projected growth for the third quarter was revised lower to -1.2%, reflecting the combined effects of the July riots and the relatively severe third wave of the COVID-19 virus.

The benchmarking and rebasing showed that the economy performed marginally better than was previously estimated over the past decade, and was assessed to be 11% larger in nominal terms. This has had immediate positive effects for the macro balances, particularly the fiscal deficit and the debt-to-GDP ratio, but no effect on long-term borrowing costs. The SARB's estimates of potential growth were revised slightly higher – both historically and in the outlook – but not as high as the increase in GDP, reflecting somewhat higher demand, the lower level of investment in the economy and the continuing electricity supply constraints. Consequently, the output gap was revised narrower.

Food inflation

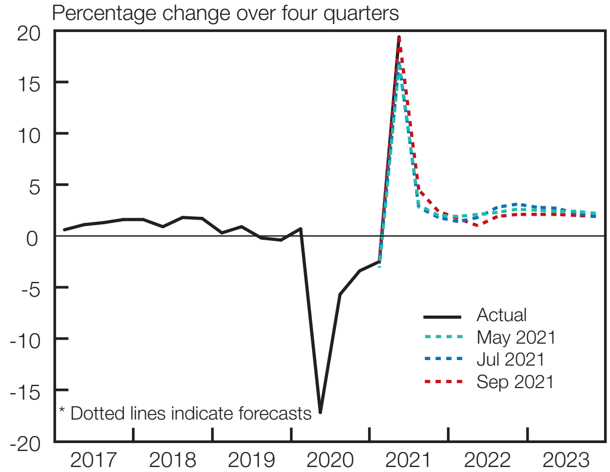
Percentage change over 12 months



Source: Stats SA

Evolution of real GDP growth forecasts*

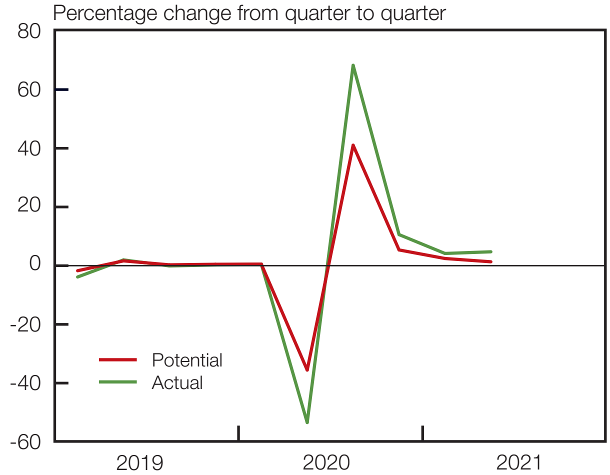
Percentage change over four quarters



Sources: Stats SA and SARB

Potential versus actual GDP growth

Percentage change from quarter to quarter

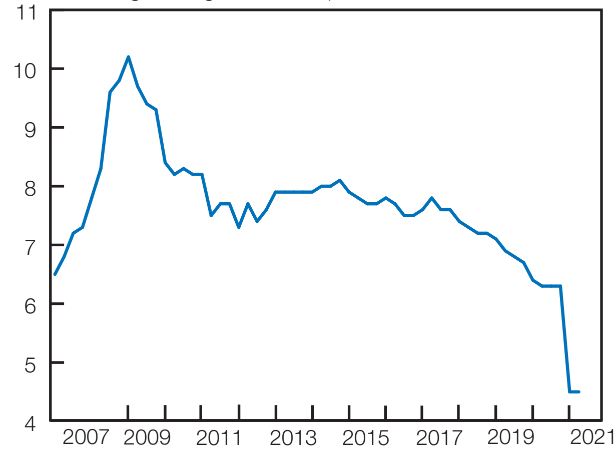


Seasonally adjusted annualised rates

Sources: Stats SA and SARB

Average level of wage settlements

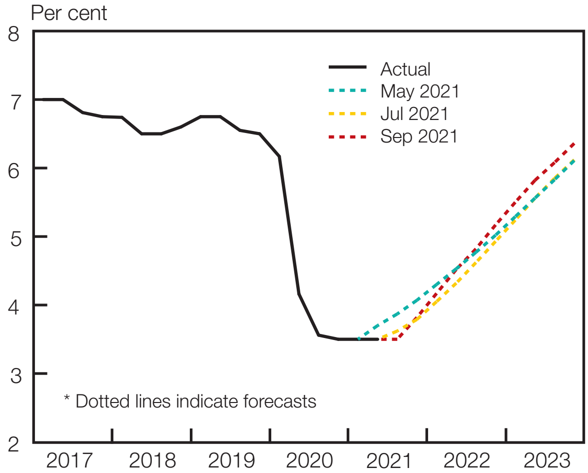
Percentage change over four quarters



Source: Andrew Levy Survey

Evolution of repo rate forecasts*

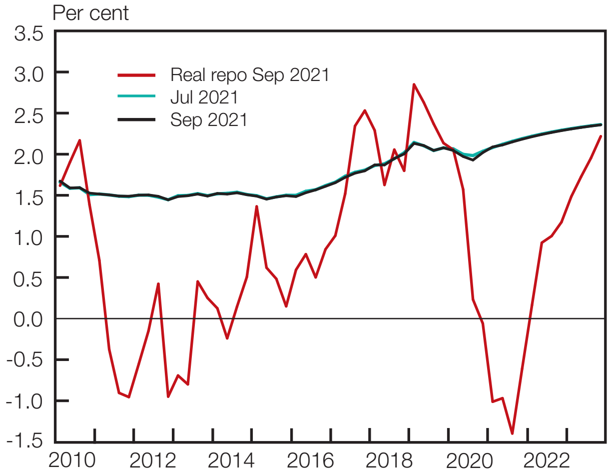
Per cent



Source: SARB

Neutral real interest rate and real repo rate

Per cent



Source: SARB

Growth in 2020 was revised higher to -6.4%, from the previously reported -7.0%, and the momentum has carried through to the current year, leading to the 2021 growth being revised higher to 5.3% (previously, 4.2%). The protest actions and riots, however, caused a slight widening of the output gap, with the consequent result that the output gap is now only expected to close at the end of 2023, same as the projection at the July meeting.

Price pressures have remained relatively contained on balance, with headline consumer price inflation projected to average 4.4% in 2021, before easing to 4.2% in 2022 and hovering around the target midpoint in 2023. Inflationary pressures have been relatively low when considering that the economy has all but recovered to the 2019 level of activity. However, headline inflation has begun to rise rather sharply, with outcomes above the target midpoint since May, and projected to remain elevated for the remainder of the year, and pressures coming from both core and non-core items.

While core inflation remains relatively muted, both core goods and services are projected slightly higher compared to the July forecast, but remain below the target midpoint. Core inflation is projected at 3.0% for 2021, up from 2.9% in July and expected to rise to 4.3% by 2023. Services continue to underpin low inflation, with housing inflating at rates well-below the target midpoint, though recent outcomes for this category show a sharp turn. Labour market pressures remain subdued while inflation expectations remain well-anchored.

Like the July forecast, the QPM advised rate normalisation to begin in the fourth quarter of 2021, with a 25-basis points hike. The repo rate is forecast to terminate at 6.4%, a slightly steeper profile relative to the July repo rate path. The steeper profile is in response to the relatively higher underlying inflationary pressures over the forecast period. Again, the MPC unanimously decided to keep rates on hold at 3.5% at the September meeting, delaying the lift-off. This is despite the MPC noting that inflation risks had tilted even further to the upside.

Compared to peer emerging markets, South Africa's inflation has remained muted for longer, creating space for the MPC to delay normalisation, and providing extended support to the recovery. [9]

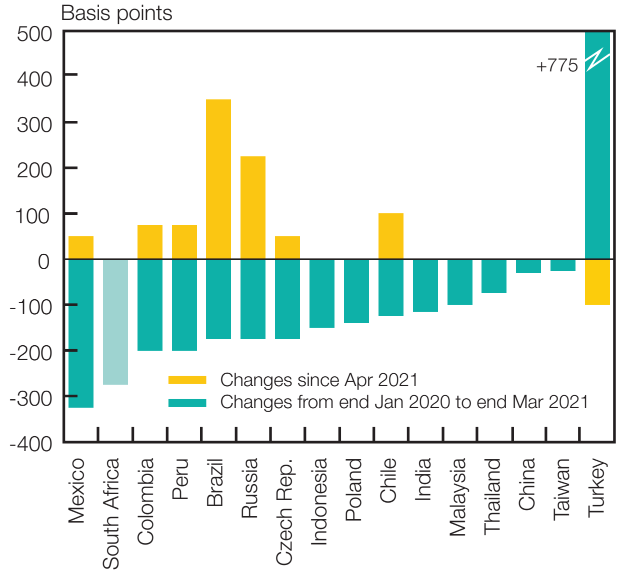
9 South Africa's divergence from peers is surprising and perhaps reflects the better-anchored inflation expectations or a stronger rand exchange rate that has reduced the effects of imported inflation or the bumper harvests that have kept food inflation relatively low despite the sharply rising global food prices, or the lingering effects of the weak demand pressures that existed pre-COVID-19.

In conclusion, the economy has continued to recover, despite the setbacks of continuing virus waves and the unrest that gripped KZN, Gauteng and Mpumalanga in July 2021. GDP has largely recovered to the 2019 level, though sectors continue to show wide variation in performance. Inflation has remained well-contained, and this modest inflation trajectory towards the midpoint of the target underpin the MPC's decisions to keep the repo rate unchanged at 3.5% over the course of the review period, and since July 2020.

However, risks to the inflation outlook have risen and become more broad-based, while real rates have become more negative as expected inflation has risen. These developments imply a need for interest rates to begin normalising. The nominal repo rate is expected to gradually rise towards its neutral level over the medium term.

Monetary policy can smooth business cycles, minimising output and price fluctuations, however, the toolkit does not include instruments to raise trend growth or lower structural unemployment – two of the main ills bedevilling the South African economy. The MPC has repeatedly highlighted the importance of structural reforms, among them, providing sufficient energy for growth, lowering the impact of administered prices on overall inflation and further de-risking the economy by stabilising public debt. Reducing these constraints should bring about more dynamism in the economy, driving potential growth higher, reducing South Africa's high structural unemployment and also lowering inflation. Permanently lower inflation would enhance South Africa's competitiveness, and would raise the prospect of borrowing costs for households and firms being permanently lower.

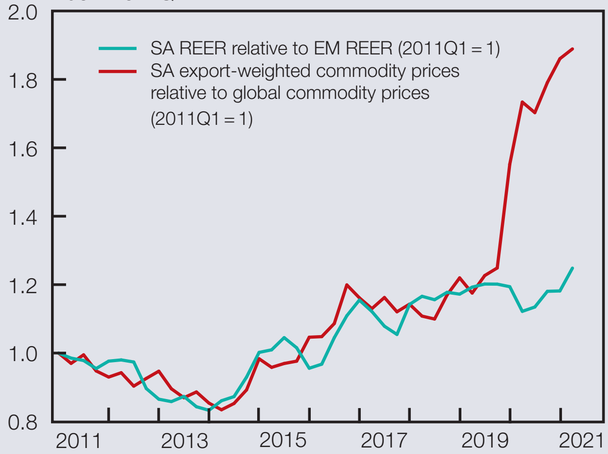
Changes to emerging market policy rates



Sources: Haver and SARB

Exchange rates and commodity prices

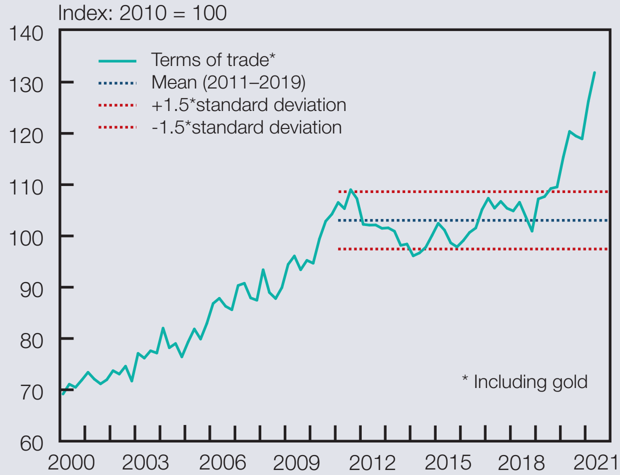
Index: 2011Q1 = 1



Sources: Haver and SARB

Equilibrium terms of trade

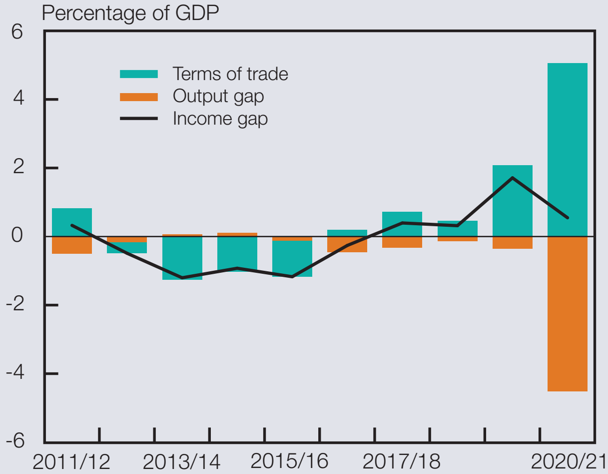
Index: 2010 = 100



Source: SARB

Cyclical revenue contributions

Percentage of GDP



Source: SARB

Box 1 The macroeconomic implications of the terms of trade surge

Commodity prices increased strongly and persistently since 2020, raising South Africa's terms of trade, lifting the current account from deficit to surplus, supporting the rand exchange rate and boosting tax revenue. These developments have also underpinned South Africa's recent growth performance.

Few other emerging markets or commodity exporters experienced similar increases, in part reflecting the broad range of South African commodity production. Mining export prices have been particularly buoyant, especially in platinum group metals (PGMs), which featured an 838.6% increase in rhodium prices and the value of PGM exports rising by 373.7% between the first quarter of 2019 and the second quarter of 2021. Other commodities, including iron ore, coal and gold have also registered strong price gains.

Together with weak imports, these strong price gains moved the current account into surplus in the third quarter of 2020, reaching 5.1%. It has remained in surplus since, ranging from 3.2% in the fourth quarter of 2020, 4.3% in the first quarter of 2021 and 5.6% in the second quarter of 2021. The current account is projected to record a 4.6% surplus for 2021, before easing back to a narrow deficit in 2023.

The real rand exchange rate also strengthened, although the real appreciation was less than might have been expected given the surge in export-weighted commodity prices.[1] The rand has historically outperformed other emerging market currencies when the South African export-weighted commodity prices outperformed international commodity prices, but this has not occurred during this upswing. This may reflect elevated fiscal risk and adverse shocks to investment and potential growth.

Higher commodity prices have also cyclically boosted tax receipts and real income. Assuming that the equilibrium terms of trade are equal to the 2011–2019 mean, the increase in the terms of trade since the end of 2018 may have cyclically boosted the budget balance by a cumulative 5.1% of gross domestic product (GDP) by the 2020/21 fiscal year.[2, 3]

The terms of trade surge has also boosted real GDP. With rising export prices, a country can either import more in volume terms for what it exports or export smaller quantities for what it imports. In other words, an improvement in a country's terms of trade increases real income and welfare (Kohli, 2004).[4] However, because real GDP is measured from the production side, it does not accurately

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1 T Janse van Rensburg and E Visser. 'Surging commodity prices explain a lot', South African Reserve Bank Economic Note No. EN/2021/16, Pretoria: South African Reserve Bank, September 2021.

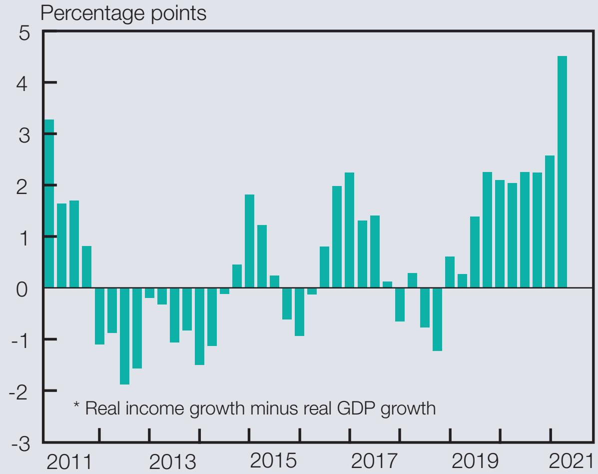
2 D Turner. 'Should measures of fiscal stance be adjusted for terms of trade effects?'. *OECD Economics Department Working Papers No. 519*, Paris: Organisation for Economic Co-operation and Development, October 2006. https://doi.org/10.1787/18151973

3 Note that this reflects the cumulative impact over several years from the equilibrium terms of trade.

4 U Kohli. 'Real GDP, real domestic income and terms-of-trade changes', *Journal of International Economics 62(1),* 2004, pp 83–106. https://doi.org/10.1016/j.jinteco.2003.07.002

capture the demand and expenditure effects of an improvement in the terms of trade, resulting in a systematic underestimation of real GDP growth. Using the methodology proposed by Kohli (2004), the South African Reserve Bank's (SARB) calculations show that real income growth has been about 2½ percentage points stronger than conventionally measured GDP growth since the final quarter of 2019 and 2.1 percentage points in 2020, suggesting that growth in 2020 was -4.3% compared to the -6.4% registered by Statistics South Africa.

Difference between command and conventional GDP growth*



Sources: Stats SA and SARB

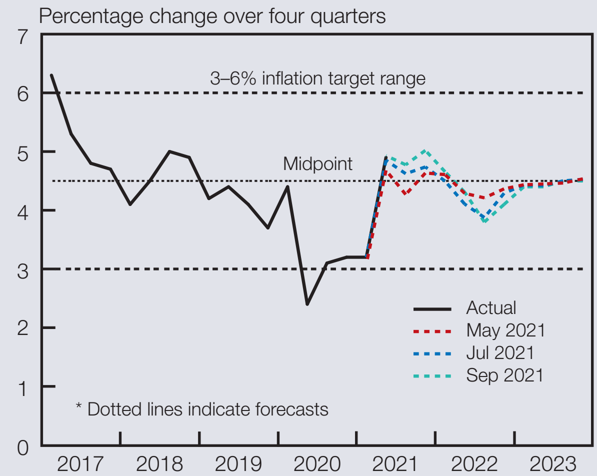
Box 2 The Quarterly Projection Model and monetary policy

Since the April 2021 *Monetary Policy Review (MPR)*, the South African economy's recovery from the COVID-19 crisis has continued apace, with gross domestic product strengthening and inflation rising from the lows of 2.1% and 2.2% in May and June 2020 respectively. As a consequence of this recovery, the South African Reserve Bank's Quarterly Projection Model (QPM) has recommended a gradual increase in the repurchase (repo) rate, to align the trajectory of the inflation rate with the target by the end of the forecast period. A rising repo rate is consistent with a gradual decrease in the amount of policy accommodation granted the economy, reflected in a negative real interest rate that becomes positive over time.

The May 2021 forecast suggested rate hikes to begin during the second quarter of 2021.[1] In subsequent meetings, the QPM continued to show rate normalisation, but shifted the initial repo moves to later in the year. These shifts in the timing of rate adjustments from meeting to meeting reflect the way unexpected outcomes for monthly inflation, changes in underlying variables, such as the exchange rate and oil prices, and other events with economic effects, such as the unrest that occurred in July, impact on the rate guidance.

The QPM is a key input to the monetary policy process, but it is not equivalent to the Monetary Policy Committee's (MPC) role, which is to consider all the data at its disposal and assess and take a view

Evolution of headline inflation forecasts*



Sources: Stats SA and SARB

1 The QPM began hinting at policy normalisation at the November 2020 MPC meeting, where it suggested two rate hikes of 25 basis points each in the third and fourth quarter of 2021 respectively. The January forecast saw the two 25 basis point hikes brought forward to the second and third quarters of 2021, while the March forecast maintained the second quarter hike but pushed the second hike to the fourth quarter instead – a repo path mimicked by the May 2021 forecast.

on the balance of risks, before deciding on policy. That assessment of risk becomes increasingly important in an environment of heightened uncertainty, a critical feature of recent times.[2]

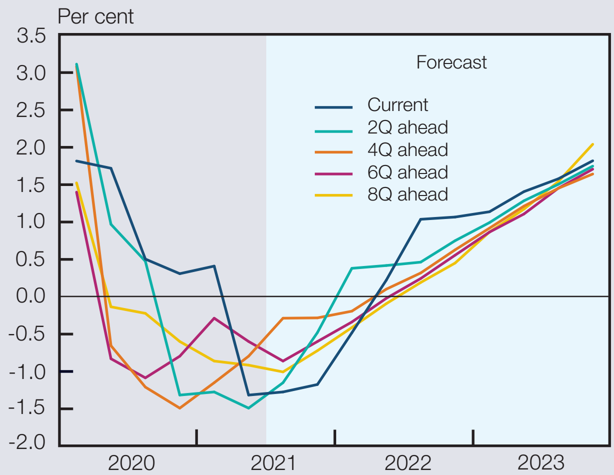
The output of the QPM is the repo rate, which is solved for in a Taylor rule that considers the difference between realised/expected output and potential output (the output gap) and the distance between expected inflation and the target. The neutral interest rate is that rate consistent with inflation at the target and a closed output gap – and both being stable. The model also includes a smoothing parameter which helps to reduce volatility in interest rates. Specifically, previous periods' interest rate decisions have an influence on future policy rates. The QPM shifts the repo rate to its neutral level over three years, reflecting the timeframes in which monetary policy impacts on inflation and a flexible approach to achieving the target, and depending on shocks to output and inflation that have occurred in the recent past.

The model is calibrated so that the level of policy accommodation is optimal at all times, in the sense of being consistent with the projected state of the economy (as measured by the inflation and output gaps).[3] In other words, the repo rate endogenously adjusts within the model to shrink the real repo rate gap as inflation converges to target and the output gap closes.[4] This minimises the risk of inflation overshooting the midpoint of the target in the medium term. Risks to the outlook for inflation are considered by the forecast team and the MPC, and are normally explicitly discussed in the MPC statement.

The real repo rate is currently negative, and the real repo rate gap has widened as expected inflation has increased, implying a strongly accommodative monetary policy stance. The real repo rate should slowly rise and turn positive in the medium term as normalisation progresses, but still policy settings will remain accommodative.

In conclusion, the QPM remains a central input to the monetary policy process. The MPC considers other data over and above the QPM forecasts to arrive at its decision, key of which is the assessment of the balance of risks. Divergences between the QPM advice and MPC policy decisions are inevitable, and do not reflect fundamental differences in how the MPC and the QPM assess the relationships between key economic variables.

Real repo rate



Sources: Bloomberg and SARB

2 The QPM forecast is staff-, and not MPC-generated. It is prepared by staff and is delivered to the MPC as a final product. The MPC does not participate in the forecast process, except for approving the assumptions that underpin the forecast.

3 The QPM's Taylor rule has the midpoint (4.5%) as the target, not the 3–6% range, and is more sensitive to deviations of inflation from target compared to output deviations, in line with international estimates.

4 The real repo rate gap is the difference between the real repo rate and the neutral real interest rate, where the real repo rate denotes the nominal repo rate adjusted for inflation one-quarter ahead.

Global recovery remains on track, but momentum shifts to advanced economies

The global economic recovery is on track for a strong rebound in 2021. Advanced economies are leading the recovery, underpinned by wider vaccination rates and expansionary fiscal and monetary policies. The growth momentum has, however, slowed for emerging market and developing economies, where activity remains constrained by COVID-19. Global inflation is rising amid strengthening activity and supply constraints, but is expected to return to lower rates of increase in 2022. Slower resolution of the supply constraints, financial vulnerabilities and the Delta variant of the COVID-19 virus are curbing economic momentum, particularly in the US and China, with implications for the global economic recovery. Further COVID-19 waves could exacerbate supply-chain disruptions and threaten global growth.

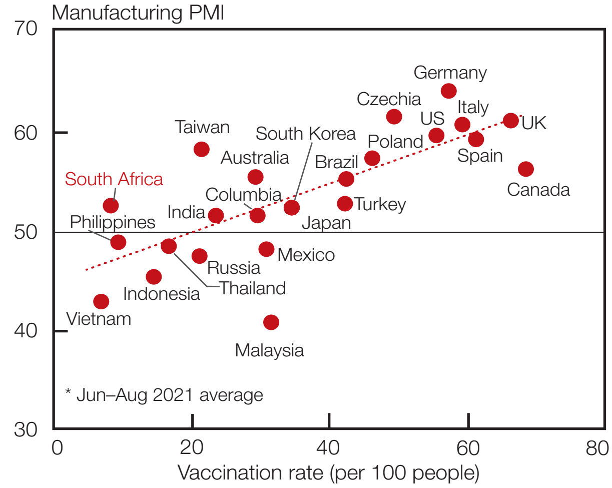
The recovery of the global economy remains on track but increasingly uneven. Countries rebounding strongly from the pandemic are pulling away from those recovering only modestly. The first group, mostly advanced economies, has around 60% of its population already fully vaccinated. The second group, largely comprising emerging market and low-income economies, is still struggling with resurgent COVID-19 infections and deaths that have resulted in a slower return to pre-pandemic activity levels. Fiscal and monetary responses to the pandemic have also varied, explaining some of the differentiation in recoveries. Whereas advanced economies have exploited the policy space afforded by low inflation and interest rates to provide extensive monetary and fiscal support, few emerging markets have had that space available.[10]

The global economy is forecast to expand by 6.0% this year.[11] Initially, the recovery was led by an early growth rebound in China as well as a strong fiscal boost in the US. However, as vaccination roll-outs accelerated, particularly across the developed world, so has the growth dividend from vaccines. Most advanced economies are expected to surpass their 2019 pre-COVID-19 growth projections this year.

10 Most major economies, including the US, Germany and the UK have extended additional fiscal support this year, while some emerging markets have begun fiscal consolidation (e.g., China).

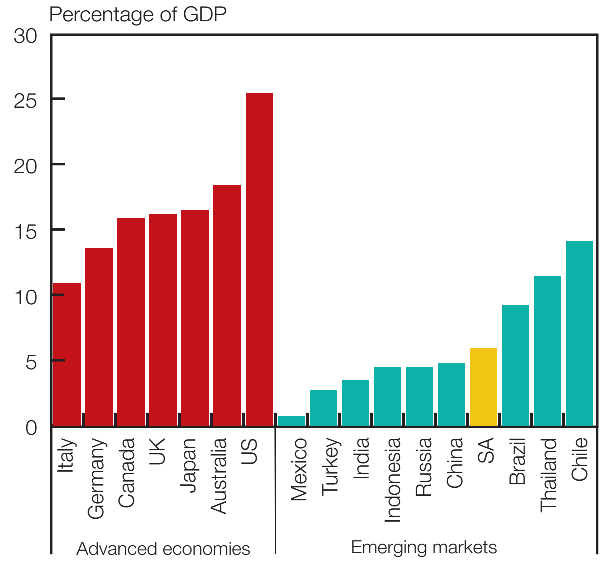
11 Forecasts are based on the IMF's *WEO Update*, July 2021.

Economic activity versus vaccination*



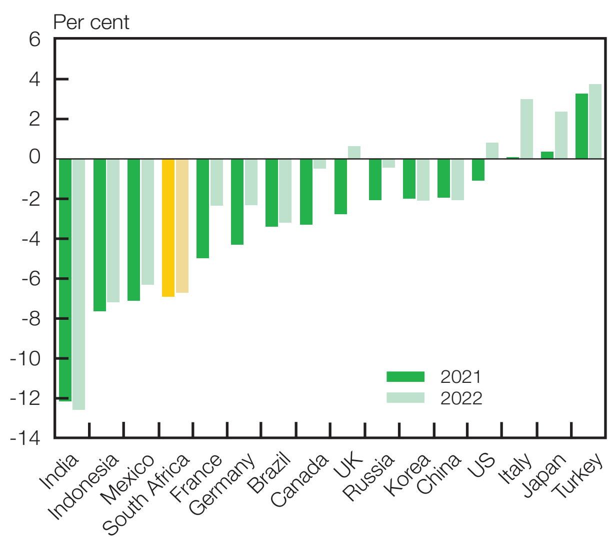
Sources: Haver, *Our World in Data* and SARB

Cumulative fiscal response to COVID-19 crisis



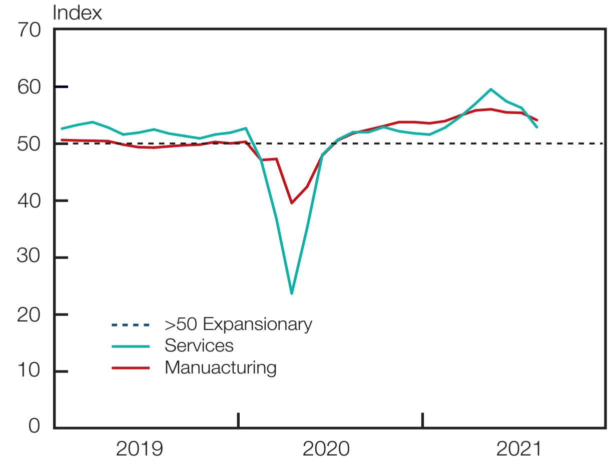
Source: IMF

GDP levels deviation from 2019 projections



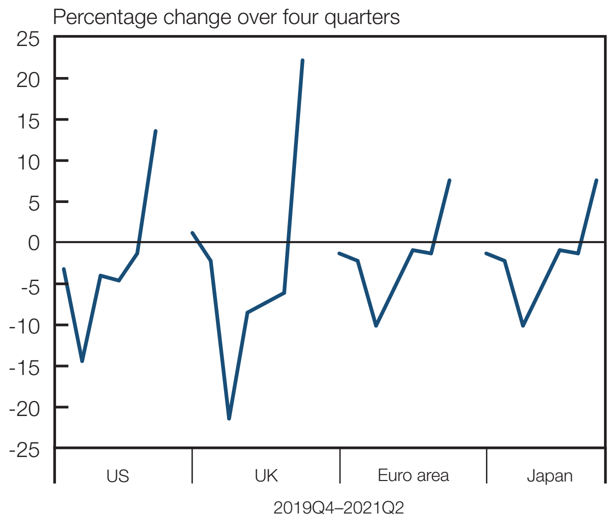
Sources: IMF and SARB

Global purchasing managers' index



Source: IHS Markit

Economic growth



Source: Haver

As lockdowns have eased over time, stronger demand, both policy-induced and a return to spending by households and firms, has triggered a global manufacturing-led rebound, pushing commodity prices to record-high levels. But lockdown-related and other supply constraints, including raw materials shortages and surging shipping costs have begun to impede further growth in manufacturing activity in major advanced economies. The strong demand and rising supply-side constraints are driving global price pressures but are expected to be temporary. The services sector, on the other hand, has been normalising more gradually, reflecting the way in which COVID-19 restrictions and vaccinations continue to impact on more labour-intensive and face-to-face activities.

Advanced economies leading the recovery

The US economy rebounded strongly in the first half of the year, accelerating by 6.3% and 6.6% respectively in the first and second quarters, and benefitting from large scale vaccination and huge fiscal stimulus. Activity has, however, moderated slightly as supply-chain constraints began to bite and stimulus effects have started to fade. Also, the total vaccination rate has slowed amid rising vaccine-hesitancy, leaving the economy susceptible to future waves of the COVID-19 virus. Nevertheless, the US economy remains on track for a sharp rebound of around 7% this year, marking its fastest pace since 1984.

Recovery in the euro area only started gaining momentum in the second quarter of 2021, following two consecutive quarters of negative growth due to stricter COVID-19 restrictions amid a slow start to vaccination. Strict mobility restrictions (for instance, on the hospitality and entertainment sectors) across the region were in place for longer than in the US, even though both were affected by the COVID-19 second wave. Once economies in the region began relaxing restrictions and re-opening, and confidence indicators started increasing, activity accelerated firmly. The UK, which boasted the strongest vaccination programme among the major advanced economies earlier in the year, experienced a strong rebound of 20.7% in the second quarter of 2021. Following a rebound in the second half of 2020, the Japanese economy contracted again at the start of the year amid resurging COVID-19 cases and renewed lockdown measures.

While the recovery in advanced economies has been solid, the resumption in activity across emerging markets has been mixed. The Chinese economy rebounded strongly from its first wave of COVID-19 infections, registering firm growth of 3.2%

and 7.7% in the first and second quarters of 2021. China's recovery was also unique with exports recovering more quickly than domestic demand. However, Chinese growth momentum has slowed as fiscal and credit stimulus measures have been largely withdrawn. Growth has disappointed in the rest of emerging Asia, reflecting slow progress in vaccination roll-outs, supply chain constraints as well as COVID-19 resurgence. After recording strong growth of 6.0% in the first quarter of this year, India's fortunes quickly reversed following a severe second wave of COVID-19 infections that resulted in growth contracting by 41.2% in the second quarter. Similar dynamics were evident in the rest of the region, where growth remained constrained in Malaysia, Thailand and Taiwan.

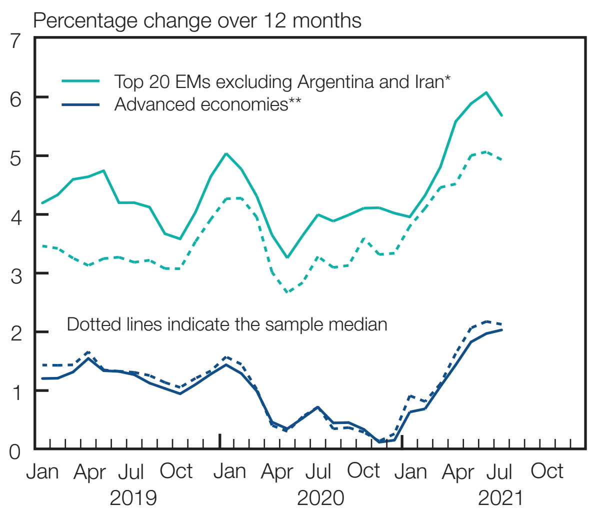
Meanwhile, growth prospects improved in other emerging market regions where high commodity prices, strengthening global demand and capital inflows created a more favourable global backdrop. Commodity exporting countries, such as Brazil and Chile, benefitted from improved terms of trade conditions, higher tax revenue collections and favourable exchange rates. The Chilean economy was among the first countries in Latin America to reach its pre-pandemic GDP level in the first quarter, partly owing to additional fiscal stimulus. The recovery across sub-Saharan Africa has been interrupted by the continued disruptions from the pandemic amid a slow pace of vaccinations and limited policy space. The region's economy is forecast to expand around 3.4% this year, lagging behind all other regions of the world.

Inflation pushing higher

Expanding demand, together with supply bottlenecks, has pushed global inflation higher in 2021. Headline consumer price inflation has accelerated sharply in the US and the eurozone, reaching multi-year highs of 5.4% and 3.0% in July and August respectively. Producer price inflation has increased sharply, raising concerns about its potential pass-through to consumer prices (see Box 4). Whereas headline inflation readings across advanced economies and emerging markets have risen this year, core inflation readings have (in most cases) remained fairly contained. However, price pressures are only likely to abate over time as supply constraints ease, global demand moderates and consumers substitute away from the high inflation goods. Inflation is expected to remain elevated into 2022 in some emerging markets, related in part to continued food price pressures, lagged pass-through from higher oil prices and continuing COVID-19 restrictions.

In 2020, across most of the world, monetary policy became highly expansionary. As 2021 progressed, many central banks started to decrease the amount of accommodation

Inflation rate

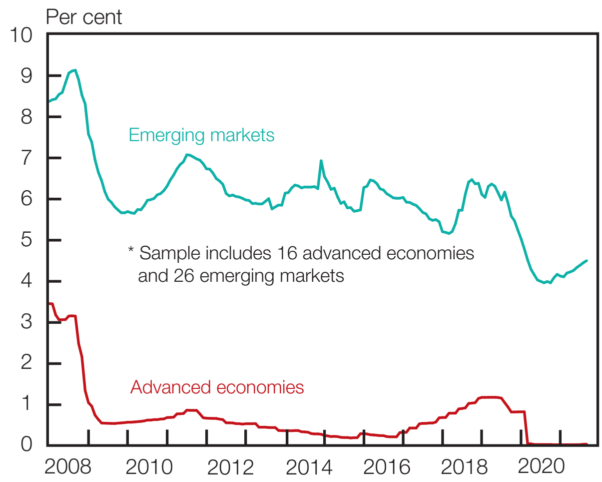


* Unweighted average of Bangladesh, Brazil, China, Colombia, Egypt, India, Indonesia, Malaysia, Mexico, Nigeria, Pakistan, Philippines, Poland, Russia, Saudi Arabia, South Africa, Thailand, Turkey, UAE and Vietnam

** Unweigted average of US PCE, Japan, euro area and UK

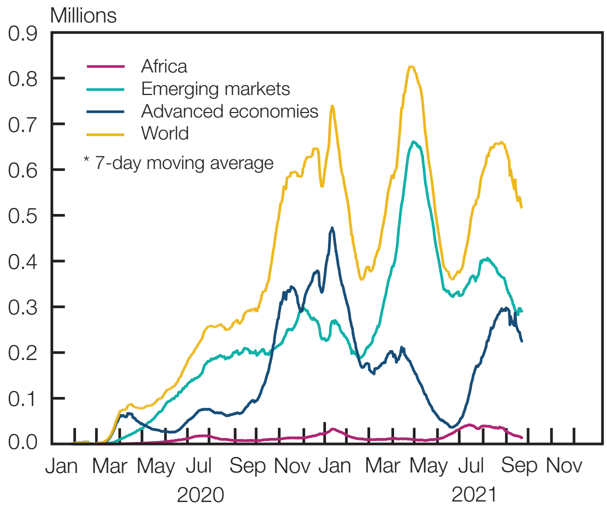
Sources: Haver and SARB

Policy rates*



Sources: Haver and SARB

New confirmed cases of COVID-19 by region*



Source: *Our World in Data*

provided, depending on their different economic paths and inflation outlooks. In advanced economies, central banks have generally looked through inflationary pressures, preferring to avoid raising interest rates until there is more clarity on price dynamics. Some major central banks, including the Bank of England and the US Fed, have indicated their intention to begin reducing the pace of their asset purchases, while others such as the European Central Bank (ECB) and the Bank of Japan are expected to continue expanding their balance sheets for some time.[12] In emerging markets, inflationary pressures have remained relatively muted, although several major emerging markets – Brazil, Russia, Hungary and Turkey – have experienced sharply higher inflation and the respective central banks have responded by tightening policy.

Risks to the recovery

Economic recoveries have been neither smooth nor consistent, in large part because uncertainties around new virus strains stall activity. Setbacks have been more common in countries where vaccination rates remained low and countries need to implement stricter containment measures. Uneven access to vaccines also raises the potential for new and more dangerous mutations of the virus and potential spill-overs from emerging markets to the highly vaccinated countries.

Higher debt levels are a growing concern for the medium-term global economic outlook. Resurgent COVID-19 cases and renewed restrictions have resulted in the deployment of additional fiscal measures, implying that fiscal consolidation across emerging markets is likely to be slower in the absence of more sustained and stronger economic growth. Slower than expected growth will lower revenue, keeping debt levels elevated, and raise the vulnerability of these economies to higher financing costs. Indeed, nearly 40% of emerging markets have had their credit ratings downgraded since the beginning of 2020. While record-high debt and fiscal deficits do not pose an immediate threat in most advanced economies, stronger growth and fiscal consolidation will be required to re-build fiscal space and ensure medium-term debt sustainability.[13]

Conclusion

The global recovery is strong, but countries are progressing at different speeds. While major advanced economies are quickly returning to their pre-pandemic levels of activity, progress across emerging markets remains slow. Addressing the uneven access to vaccines is a global policy imperative both from a health and economic standpoint. Risks to the recovery include the resurgence of COVID-19 cases and the subsequent reimposition of restrictions, supply bottlenecks and rising global price pressures. Further intensification of

12 The ECB recently announced a temporary reduction in its asset purchases, which they characterised as a 'recalibration' of their asset purchase programme, and not a taper.

13 World Bank *Global Economic Prospects*, June 2021.

Box 3 Can emerging markets absorb higher prices without damage to policy credibility?

Since the 2000s, average inflation in emerging markets has trended lower in line with declining global inflation. And, in stark contrast to crises in earlier decades, the global financial crisis and the COVID-19 pandemic have on balance been disinflationary for most emerging markets, helping to reinforce the moderating inflation trend. The recovery from the pandemic and pick-up in price inflation, however, could entrench into price formation processes in emerging market economies, setting a stern test of policy credibility. South Africa, Brazil, Russia, Turkey, Mexico, Chile and India all face intensifying inflationary pressures. Most of these economies risk inflation well above their inflation targets over the next 18 months (from the third quarter of 2021 to the fourth quarter of 2022) and have either embarked on monetary policy tightening or are weighing the need to reduce policy accommodation. Critical considerations include the nature of the near-term inflation shocks and whether they are expected to turn into more permanent inflation. Brazil, Russia, Hungary and Turkey have begun to exit from ultra-loose monetary policy stances.

Price stability and the adoption of inflation targeting frameworks

Emerging markets' headline inflation is, according to the International Monetary Fund (IMF), expected to average below 4.5% over the period 2021–2023, with lower variances common to the advanced economies.[1]

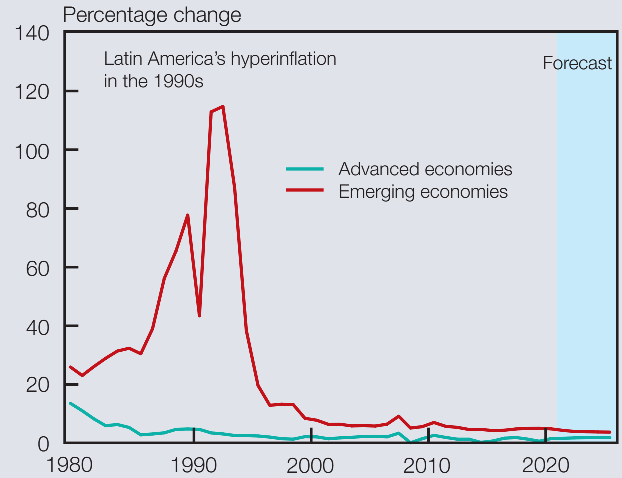
The better inflation performance is often ascribed to the widespread adoption of inflation-targeting frameworks as well as other stability-oriented policies, in particular more sustainable fiscal balances, flexible exchange rates and greater trade openness. Lower inflation has been further supported by the absence of major global supply shocks in the last two decades, suggesting that the high input cost inflation of the current recovery is a clear shift away from trend.

Policy responses to rising inflationary pressures

Rising global price pressures test inflation targeting credibility as policy makers also want to maintain support for the economic recovery from the COVID-19 pandemic. In this context, time consistency of policy becomes increasingly important, as central banks weigh policy adjustments now, to contain future inflation and expectations of higher inflation that would otherwise undermine the sustainability of the recovery. For many emerging markets, due to negative real interest rates, policy space exists to begin gradual normalisation of policy – sending a clear message about

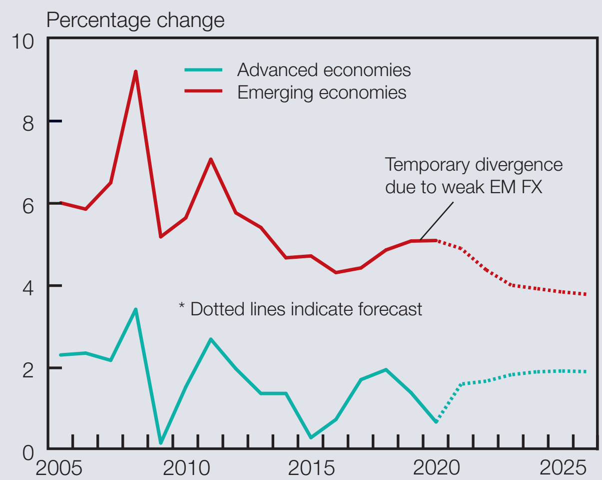
1 Following a peak reached in 2008, aggregate emerging market core inflation has declined markedly over the past 10 years. At its lowest, emerging market core inflation fell below a median (of 22 emerging markets) of 2%, which is noticeably below its record high of 5% in the early 2000s.

Headline consumer inflation



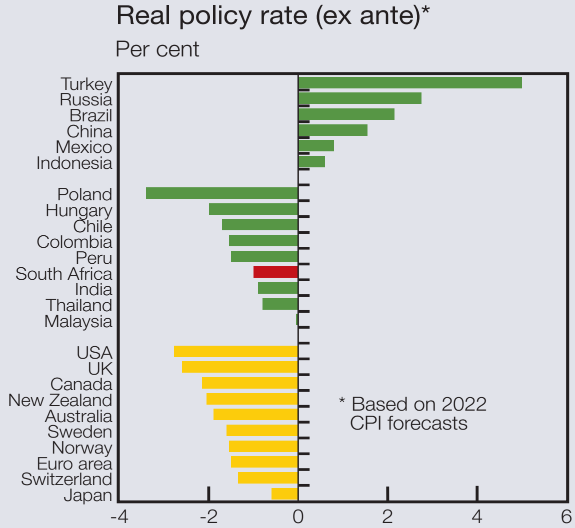
Source: IMF

Headline consumer inflation since 2005*



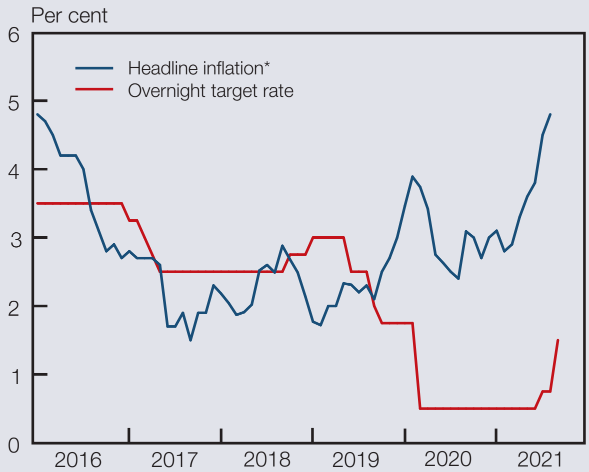
Source: IMF

Real policy rate (ex ante)*



Sources: Central banks, Consensus Economics and SARB

Chile's inflation and policy rates

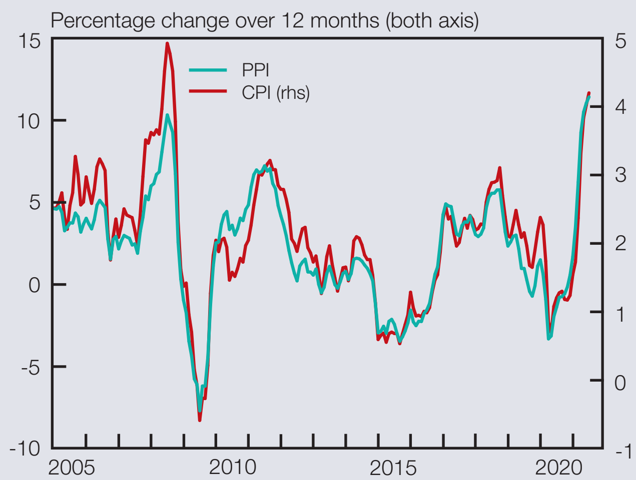


* Percentage change over 12 months

Source: Haver

future inflation while continuing to provide support. The transition to positive real rates closer to longer-term estimated neutral real rates is likely to be gradual, partly because of the benefits of the longer-run moderation in global inflation. However, this thesis will continue to be tested, as seen in the experiences of several emerging market economies, including Chile in recent months.

PPI and CPI in OECD



Source: OECD

Box 4 Are producer prices passing through to consumer prices?

A key feature of the current global reflation is a rise in producer prices that continue to accelerate as economies recover from the pandemic-induced recessions of 2020. Rising producer prices increase the risk that consumer prices globally will also increase. The Organisation for Economic Co-operation and Development's (OECD) combined producer price index (PPI) measure accelerated to 11% year-on-year in June 2021, 2.6 standard deviations above its 20-year average and the first time it has been into double-digit territory since 1988. The same trend is observed in many large emerging markets, including China, where producer inflation rose to its highest rate in more than a decade.

Beyond base effects, several factors account for this surge, including rising commodity prices, sharply higher shipping costs, and supply-demand mismatches in multiple segments of value chains. What is less clear is whether this spike will result in durably higher consumer price index (CPI) inflation.

Intuitively, rising input prices push production costs up along the entire production chain and eventually pass-through to consumer prices.[1] However, fundamental differences between the two indices mean that pass-through of PPI to CPI is typically much weaker than implied by the production approach.[2] Among the differences in the indices is that PPI typically measures only domestic prices, while

1 T E Clark, 1995. 'Do producer prices lead consumer prices?', *Economic Review, Federal Reserve Bank of Kansas City* 80(Q III), 1995, pp 25–39.

2 Ü Volkan and E Ugur, *'The relationship between consumer price and producer price indices in Turkey', International Journal of AcademicResearch in Economics and Management Sciences*, 3(1), 2013, pp 205–222.

the CPI measures the prices of both domestic and imported goods. Second, government taxes and subsidies, as well as distribution costs, affect consumer prices but not producer prices. Lastly, most PPI measures exclude services – a large share of the CPI.

Despite these differences in the construction of the indices and the relatively low share of manufacturing in advanced-economy gross domestic product (GDP), the last 15 years of OECD data show a strong correlation between year-on-year producer and consumer inflation. Much of this correlation appears to be caused by movement in tradable goods, in particular food and energy, with significant weights in both inflation measures, whereas non-tradables components are more stable.[3]

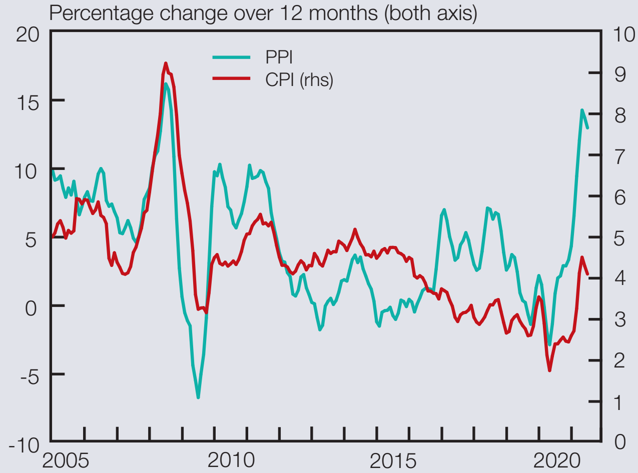
Estimates for emerging markets are harder to come by, as the methodology for measuring producer or wholesale prices varies across countries. Nonetheless, the South African Reserve Bank's (SARB) calculations based on a sample of 11 large emerging markets show a break down in the link between PPI and CPI around the middle of the past decade, and while it has resumed in recent years, the acceleration in CPI is much slower, relative to PPI, than it was in 2008. The progressive anchoring of inflation expectations in emerging markets, and a reduction in official inflation targets in some countries in the 2010s may account for the differences.

In South Africa, while producer prices of intermediate inputs have risen sharply in recent months, final goods prices have risen only modestly, and headline CPI even less so. The weaker correlation may be explained by the differences among the PPI baskets, with the higher inflation components having much larger weight in the intermediate PPI basket relative to the final goods PPI basket.

A continued strong long-term correlation between PPI and CPI inflation, however, suggests that once PPI inflation peaks, its CPI counterpart will follow, before subsiding. By contrast, a rise in CPI inflation that does not show in PPI would signal either a de-anchoring of inflation expectations, a stronger pass-through from wages to headline inflation or reduced competition in final goods markets – all factors with a potentially durable upside impact on underlying price trends.

EM average: PPI and CPI*

Percentage change over 12 months (both axis)

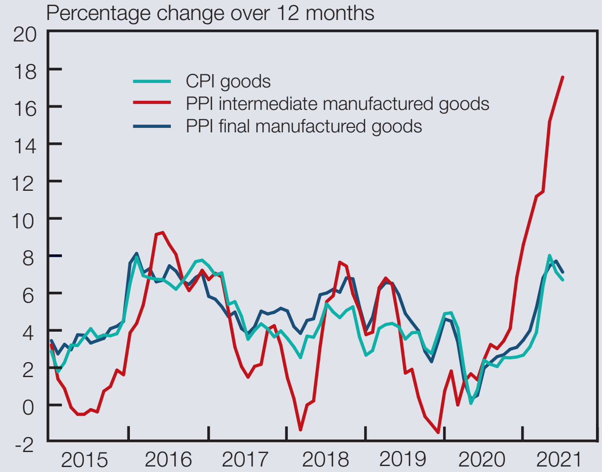


* Brazil, China, Chile, India, Indonesia, Malaysia, Mexico, Russia, Philippines, South Africa and Thailand

Sources: Haver and SARB

South African PPI and CPI goods

Percentage change over 12 months



Source: Stats SA

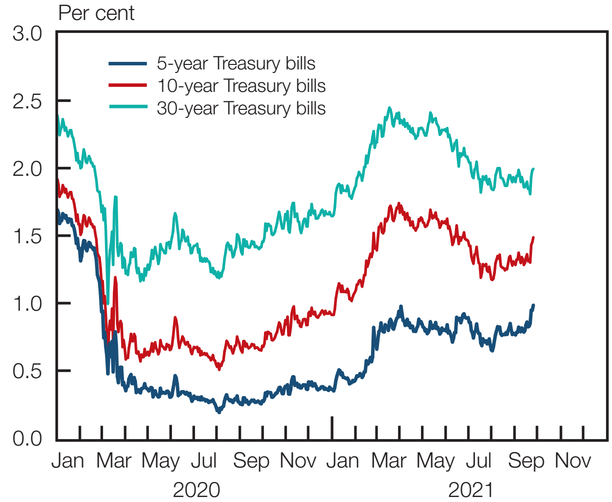
3 IMF research highlights the example of the US, where domestic factors such as the wage formation process influences mostly core services prices, while core goods prices mostly reflect global factors. See Y Abdih, R Balakrishnan and B Shang, 'What is keeping US core inflation low: insights from a bottom-up approach', *International Monetary Fund Working Paper No. WP/16/124*, Washington: International Monetary Fund, July 2016.

Financial markets: shocks and resilience

Over the past six months, South African financial markets have been buffeted by shocks, with the three most extreme being taper talk in the US, disruptions in the technology and real estate sectors in China, and July's domestic riots and looting. Although these events might have prompted sharp sell-offs of local assets, domestic financial markets have been relatively robust. Asset valuations have now fully recovered from the 2020 downturn, although asset prices have still underperformed relative to advanced economy markets, a trend also visible in many other emerging markets.

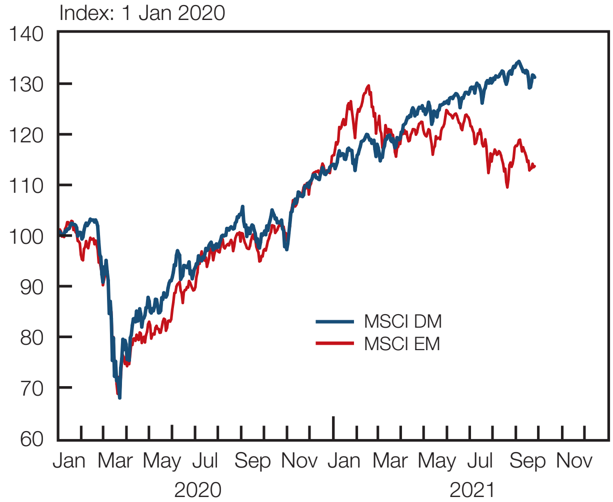
Global financial markets: a beautiful taper?

US Treasury yields



Source: Bloomberg

Global equity performance



Source: Bloomberg

In the US, the Fed has maintained a highly expansionary monetary policy stance, continuing large-scale asset purchases, and promising to keep the Fed Funds Rate close to zero for an extended period. Asset purchases are now expected to slow earlier than previously anticipated, given a surprisingly strong acceleration in inflation and a robust recovery in the US GDP, although employment rates have not yet reached pre-COVID-19 levels. The Fed has nonetheless avoided a reprise of 2013's taper-tantrum, to date, with clear guidance that smaller asset purchases do not imply interest rates are also about to rise. Concerns about the Delta COVID-19 variant have also moderated growth exuberance. Markets currently anticipate that the Fed Funds Rate will only move above the zero lower bound in early 2023, with quantitative easing (QE) tapering starting late in 2021.

While US inflation has risen above 5%, the US Treasury curve has flattened on a year-to-date basis, reflecting confidence that higher inflation will be temporary. The yield on the benchmark 10-year US Treasury bond, for instance, reached record lows of 1.18% at the beginning of August, from a 2021-high of 1.74% in April. The 30-year bond yield has declined by a similar magnitude over the past six months.

Similarly, in the eurozone, government bond yields have also eased, despite higher inflation outcomes. Euro area inflation reached 3.0% in August, yet yields have slipped back, with large portions of yield curves in negative territory. While the ECB is expected to be further from interest rate normalisation than the US Fed, the ECB has proceeded with asset-purchase reductions, or 'recalibration', ahead of its American counterpart. This has not been interpreted as a tightening of financial conditions, however, despite global market skittishness about tapering. Consistent with the relative looseness of the ECB's stance, the euro has weakened against the US dollar over the year. It remains cheap in historical perspective, while the dollar stands out as relatively expensive.

Advanced economy equities have performed well over the past six months, with the Morgan Stanley Capital International (MSCI) developed markets index hitting record highs in the second and third quarters of 2021. By contrast, the MSCI Asia Pacific index weakened due to tightening regulation on technology companies in China (falling about 30% over the year). More generally, emerging market and advanced economy equities have diverged over the past six months, having tracked each other closely since the onset of the COVID-19 pandemic.

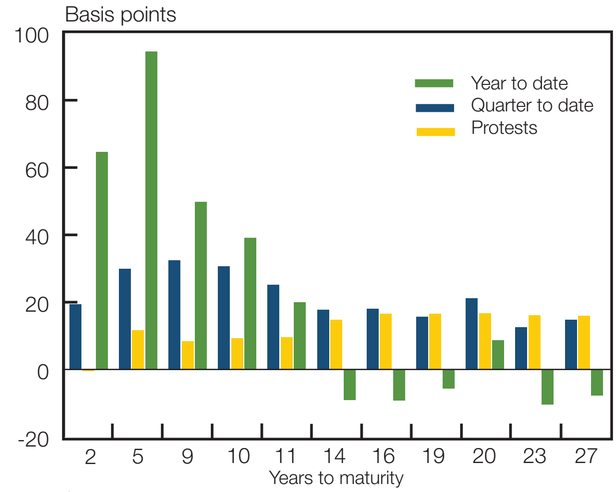
Domestic market resilience

Locally, the JSE All-Share Index reached an all-time high in July, before weakening as the Chinese technology crackdown filtered through to the local market space through the JSE-listed Naspers Ltd. JSE data shows that non-residents have sold off South African equities for most of the period. Debt distress at Evergrande, a major real estate firm in China, has also generated financial market volatility recently, although in this case there is not a close connection to local stocks via a specific firm. While the systemic financial consequences of Evergrande's liquidity crisis will probably be contained, a weaker construction sector poses challenges for China's growth model, and in turn global growth.

South African bond yields have fallen slightly over the past six months, with gains concentrated at the long end of the curve. Yields responded both to the July unrest episode and September's global unease over Evergrande and advanced-economy inflation. However, South African bond prices have still outperformed most peers over the year, supported by improved fiscal metrics and comparatively benign inflation conditions. South Africa's yield curve nonetheless remains unusually steep from an historical perspective given unresolved concerns about medium-term fiscal sustainability.

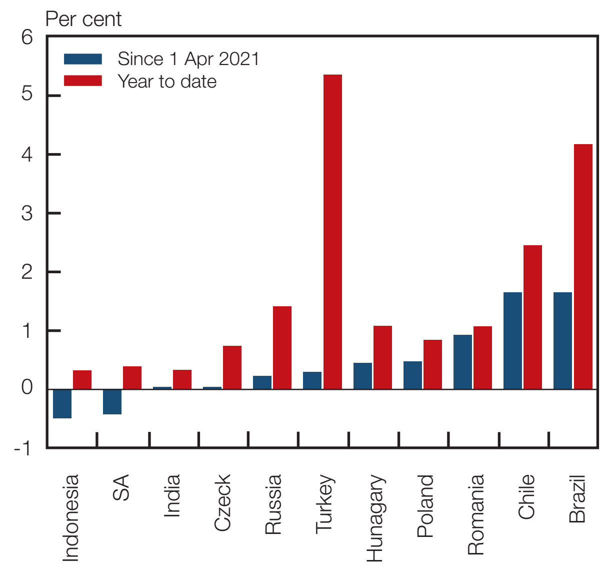
Treasury has accumulated large cash balances of around three to five times normal levels over the past 12 months, mainly due to unexpectedly strong revenue flows as well as loans from the international financial institutions (IFI) being converted to local currency. Given this ample supply of liquidity, there has been less need to accumulate more cash from issuing short-dated Treasury bills, and the overall maturity of new debt has therefore risen again, after declining during 2020. The average maturity of new bond issuance is now around 14 years, which is unusually long, especially in the emerging market space. This also explains why the long end of the South African yield curve is higher than that of peers.

Change in South African Government Bond curve



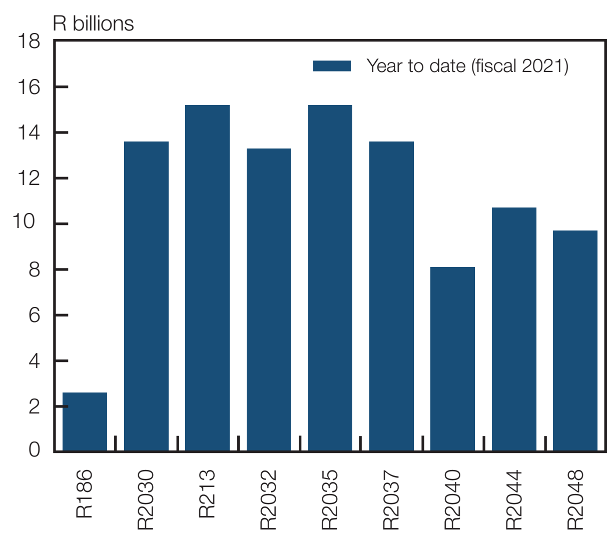
Source: Bloomberg

Change in JPMorgan GBI yields



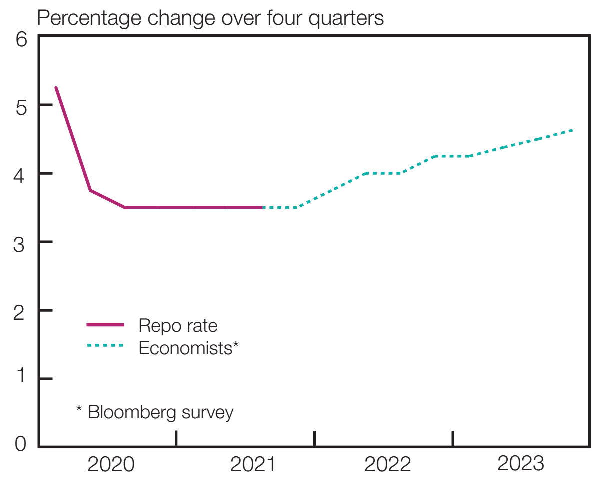
Source: Bloomberg

Government bond issuances



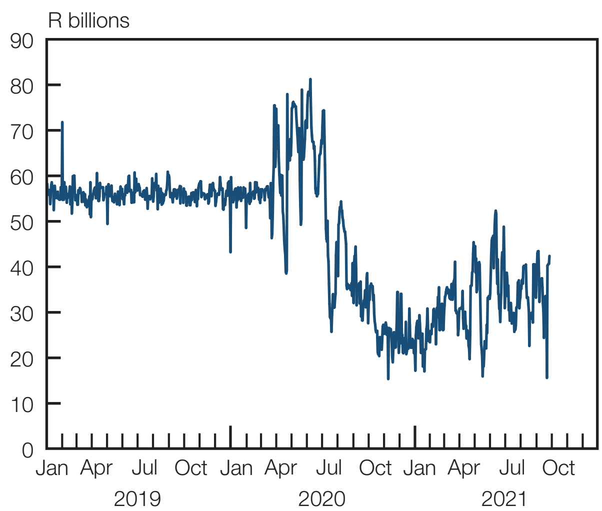
Source: National Treasury

Repo rate forecast



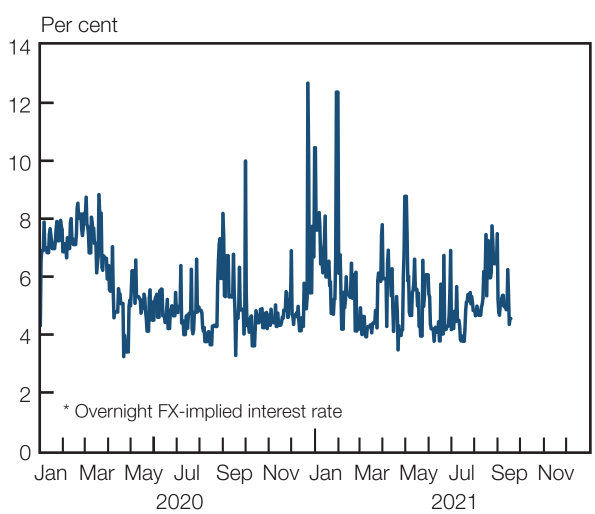
Sources: Bloomberg and SARB

Liquidity requirement



Source: SARB

FX forward market*



Source: SARB

In terms of monetary policy expectations, the Bloomberg economists poll shows the repo rate rising for the first time in the first quarter of 2022. Similarly, market expectations from forward rate agreements (FRAs) show the first hike fully priced in within six months. The FRA market indicates that the repo rate is likely to reach 4.25% by the end of 2022, in line with the median expectation of the Bloomberg survey.

The rand exchange rate has been somewhat volatile over the past six months, with no clear trend, dipping below R14 to the US dollar in May and June, weakening to above R15 in August, and then revisiting most points in that range during September. The currency is once again trading at pre-COVID-19 levels, and has even revisited pre-Nenegate levels, with the rand having been around R14.30 to the dollar at the start of December 2015. The local currency has benefitted from record terms of trade and a large current account surplus, as well as very low global interest rates.

Monetary policy implementation

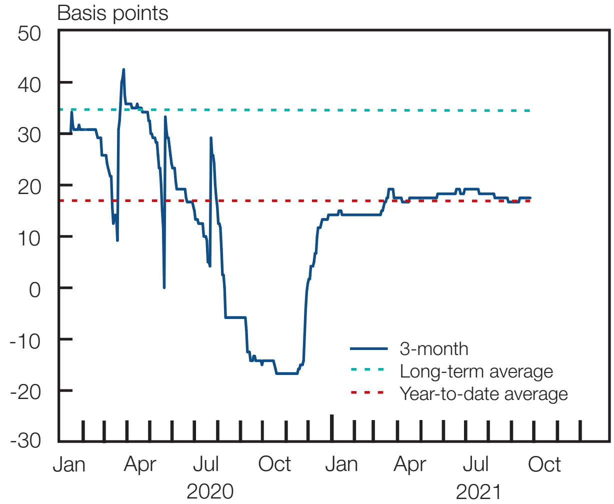
South Africa uses a shortage system for implementing monetary policy, with the SARB deliberately limiting the supply of reserve money to the market, to force banks to borrow from the SARB at the policy rate. The size of the shortage has remained smaller than it was pre-COVID-19, averaging R32 billion for the year to date, compared with R56 billion during 2019. The SARB has not yet sought to return the shortage to its pre-crisis levels, given the difficulties of sterilising more liquidity, with limited demand for some instruments and risks that over-reliance on others, especially foreign exchange (FX) swaps, would have distortionary effects on markets. That said, the SARB's liquidity draining operations remain significantly larger than they were before the pandemic, primarily to absorb the rands associated with the IFI flows, as well as other factors. Growth in notes and coin, which would normally help maintain the shortage, has also been unusually muted this year, following strong demand during 2020.

FX-implied rates, which show the cost of borrowing local currency through foreign currency swaps, have remained volatile and periodically elevated relative to the policy rate. This pattern is less extreme than it was late last year and early in 2021, where short-term FX-implied rates exceeded 12% on some days. However, these distortions are still substantial compared with the pre-COVID-19 period. To mitigate this problem, the SARB has sought to mature the IFI-related swaps, where possible, and in doing so has been willing to tolerate a smaller shortage than it did pre-COVID-19 period. The SARB has also on occasion injected liquidity for short periods to counter abrupt increases in FX-implied rates. The shortage framework nonetheless places limits on interventions to moderate FX-implied rates, as larger volumes of liquidity could compromise monetary policy transmission.

While FX-implied rates have been unusually elevated relative to the policy rate, spreads to other short-term rates have tended to be modestly lower than normal. For instance, 3-month Jibar has traded at an average of 16.9 basis points above repo for the year to date, compared with an average margin of 34.5 basis points in 2019. Some components of South African Benchmark Overnight Rate (SABOR) have also been marginally below repo, although the benchmark as a whole has tracked repo closely (supported by its FX-implied component, with a weight of 5%). These dynamics reflect a relative abundance of domestic liquidity.[14] Over the past six months, banks have continued to overfund relative to the shortage by borrowing excess amounts at the weekly repo. This has led to large end-of-day surplus positions and therefore frequent usage of the standing deposit facility, despite its punitive pricing at repo minus 100. There has nonetheless been limited uptake for the SARB's liquidity-draining debentures, with only around half the available issuance being allotted.

These trends point to inefficiencies in the shortage system for implementing monetary policy. The SARB is currently reviewing its monetary policy implementation framework to ensure that it transmits monetary policy effectively and is robust to shocks.

JIBAR spread to repo rate



Source: Bloomberg

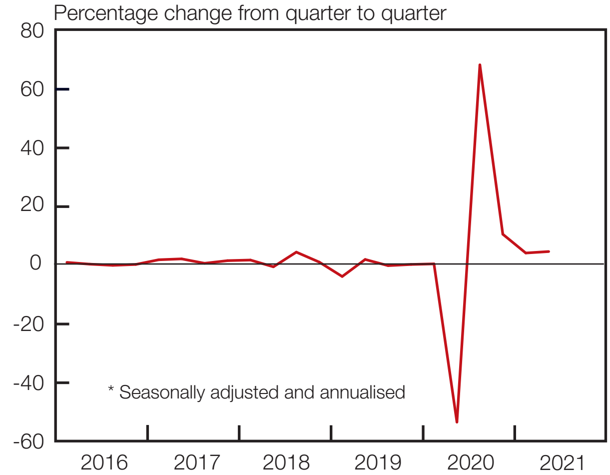
14 This implies the shortage was over-funded, with banks taking more liquidity than was required to meet reserve requirements.

The real economy: recovery losing steam?

A major rebasing of South Africa's GDP data by Stats SA shows somewhat better growth over recent years, including a smaller contraction last year, with growth revised higher to -6.4%, up from the -7.0% previously reported. The recovery broadly strengthened in 2021 despite new waves of the virus and the lockdown restrictions instituted to contain their spread. Household spending and strong terms of trade have underpinned the recovery. Households have benefited from low interest rates, sharper recovery in earnings, rebound in net wealth and low inflation. The surge in the terms of trade has raised national income, boosted the current account and buoyed fiscal revenues. The near-term fiscal outlook has improved sharply as a result, though medium-term fiscal sustainability remains subject to risks. The outbreak of political unrest, riots and looting in July, however, has set the economy back and is likely to have caused a contraction of the economy in the third quarter. Furthermore, the recovery is expected to slow over the forecast period as the rebound in demand moderates, investment appetite remains subdued and electricity shortages continue.

Real GDP growth*

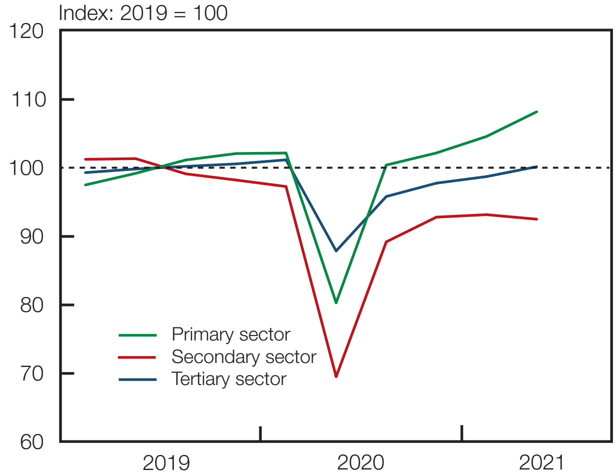
Percentage change from quarter to quarter



Source: Stats SA

Output, distance from 2019 levels

Index: 2019 = 100



Sources: Stats SA and SARB

The recent economic performance

The rebased GDP data shows that the domestic economy has recovered from the COVID-19 pandemic much faster than previously estimated, with the level of GDP around 99% of the 2019 level as of the second quarter of 2021. The strong recovery has repeatedly surprised both the SARB and market analysts to the upside, pointing to the resilience of the economy.

Following the sharp contraction and then rebound of 2020, the first two quarters of 2021 exhibited growth of 4.2% and 4.7% respectively. The July unrest is expected, by most forecasters, to result in a contraction in the third quarter output, with considerable uncertainty about its exact size. Third quarter growth estimates range from -1.2% to 2.5%. The shock to growth in the third quarter is especially damaging as it has not only slowed the growth momentum but will likely delay the complete recovery of the economy.

Although the recovery of GDP is almost complete, there remain substantial variations in performance across sectors. The primary sector, comprised of agriculture and mining, has led the recovery. Agriculture ended 2020 well above its 2019 level of output, benefitting from favourable weather conditions and remains on track for another bumper harvest in the 2021 season. Mining production is also back to its pre-pandemic level, supported by a broad-based surge in commodity prices. Platinum group metals (PGMs), particularly rhodium, experienced the largest price gains, although iron ore and gold also saw major price gains.

The secondary sector has recovered rather sluggishly, with all its subsectors still below the pre-pandemic activity levels. Construction activity is lagging far behind, while load-shedding and loss of generation capacity are impacting on manufacturing activity, together with the accidents at the Engen and Astron Energy refineries.[15] Overall, the sector remains about 10 percentage points below the 2019 activity level, whereas construction is 21 percentage points below. In the tertiary sector, the two biggest subsectors, finance and community and social services, have fully recovered. This has, despite ongoing weakness in trade and transport, pulled the tertiary sector back up to its 2019 level of output. The transport and trade sectors continue to be weighed down by the frailty in the tourism sector.

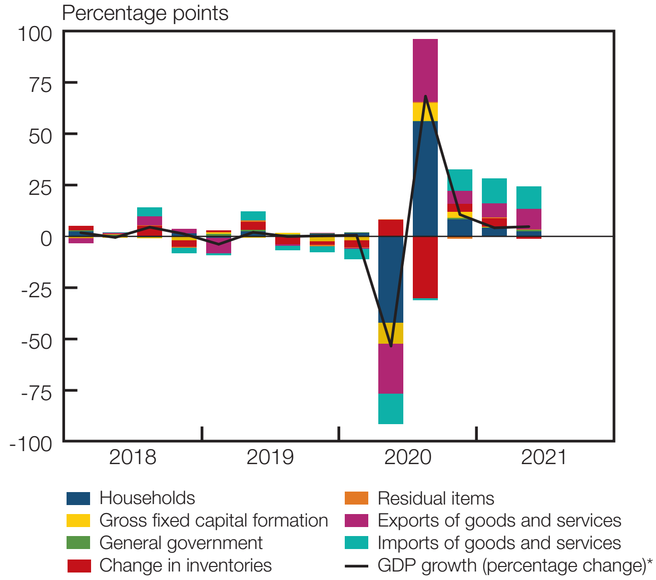
Delving into the second quarter performance, the data shows that growth was more broad-based, with 6 of the 10 sectors showing significant expansions, of particular interest being transport (30.5%), personal services (5.3%) and the trade sectors (9.3%), sectors that have shown the weakest recovery to date. Agriculture grew by 27% in the second quarter on increased production of field crops and animal feed, while mining increased at a slower pace of 8% (from 18.5% in the previous quarter). The expansions were despite the disruptive effects of the third wave of the COVID-19 virus and the associated lockdown restrictions during the quarter. Construction and manufacturing, however, contracted by 5.3% and 3.3% respectively, pointing to deep weakness in the secondary sector.[16]

From the expenditure side, the recovery momentum in the first half of 2021 was underpinned by exports and household consumption. Exports benefitted from the robust global demand for commodities and the surging terms of trade. The strong export performance amid subdued import demand saw the trade balance widen to R614 billion in the second quarter of 2021. The robust household spending seen in the latter parts of 2020 carried through to the current year, supported by higher employee compensation (which is now around pre-pandemic levels), subdued inflation and low interest rates. Household spending, however, slowed to 2.1% in the second quarter, down from 4.1% in the previous quarter, buttressed by durable goods, particularly transport, while furnishings, household equipment and maintenance moderated. The reinstatement of the SRD grant should sustain household consumption for the remainder of 2021 and first quarter of 2022, before it phases out. SARB modelling suggests that the SRD grant will raise 2021 real household consumption by 0.12 percentage points and GDP by 0.07 percentage points.

15 A combined 31% of the country's refining capacity is down, following accidents at Engen and Astron Energy refineries in 2020. The Engen refinery (17%) was permanently closed while the Astron Energy refinery is expected to resume operations in 2022.

16 Activity in the manufacturing sector was in part slowed by raw material shortages due to pandemic-induced global supply-chain disruptions and persistent electricity shortages. The COVID-19 Level 4 lockdown restrictions also negatively impacted consumer-related manufacturing industries, in particular food and beverage production.

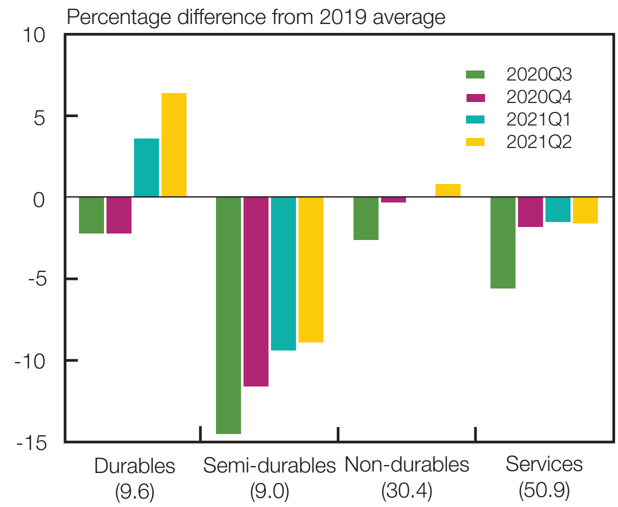
Contributions to real GDP growth



* Quarter-to-quarter at seasonally adjusted annualised rates.

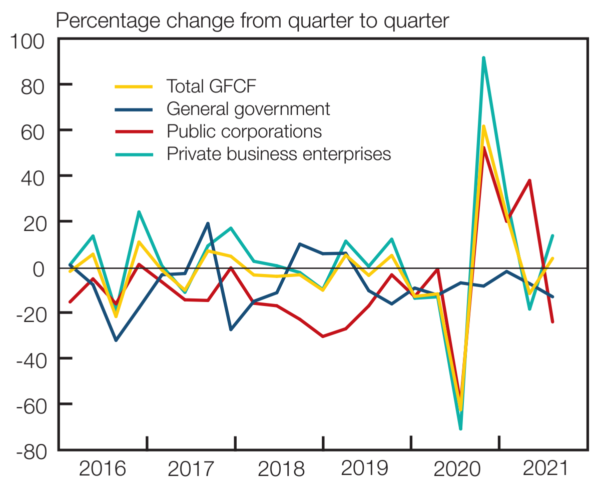
Source: Stats SA

Household spending by durability*



Sources: Stats SA and SARB

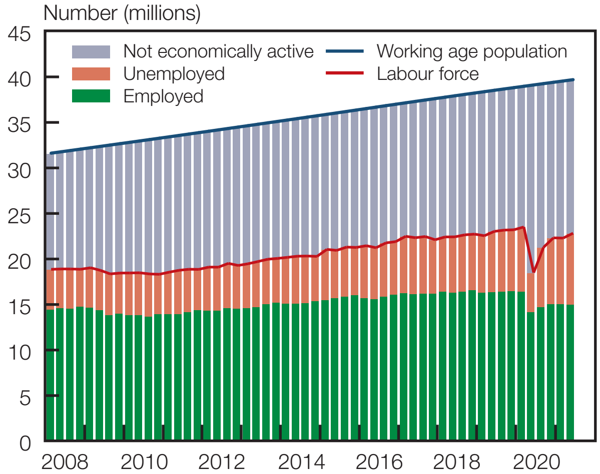
Gross fixed capital formation



Source: Stats SA

Working age population

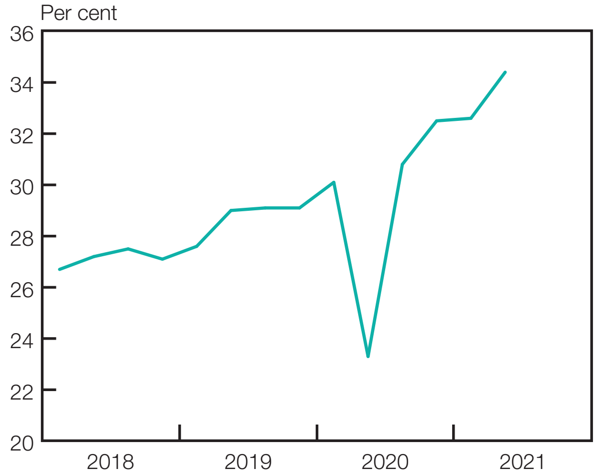
Number (millions)



Source: Stats SA

Unemployment rate

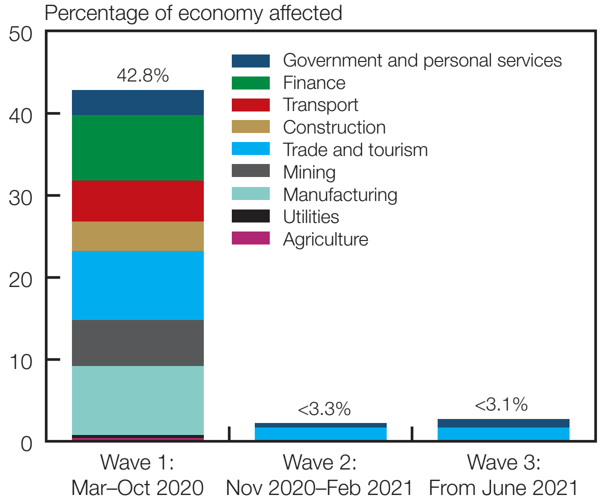
Per cent



Source: Stats SA

Lockdown impact

Percentage of economy affected



Sources: Oxford University and SARB

Despite the strong performance of exports and robust spending by households, fixed investment has remained lacklustre. The rebased data shows that gross fixed capital formation (GFCF) as a share of GDP was substantially lower over the past decade than previously recorded, and only 13.7% in 2020, its lowest level since the mid-1990s. Indeed, fixed investment remains 13.9 percentage points below pre-pandemic levels. This is one important dimension in which South Africa diverges from peer emerging markets where median investment sits around 23% of GDP, and largely explains the domestic economy's weak growth performance since the GFC.

On a quarter-to-quarter basis, growth in fixed capital formation edged-up in the second quarter of 2021 (3.7%, saar), after shrinking in the previous quarter. The main contributors to the increase were private investment in machinery and equipment, and transport, at 1.4 and 0.4 percentage points respectively, and helping to offset lower investment spending in the public sector.

Labour market conditions deteriorated further in the second quarter of 2021, despite rising employee compensation and stronger GDP growth during the quarter. Stats SA's *Quarterly Labour Force Survey (QLFS)* showed more people lost jobs (54 000) during the quarter. A decrease in employment was observed in the formal sector (375 000), led by finance, community and social services and manufacturing. The informal sector, agriculture and private households recorded employment gains. The unemployment rate increased by 1.8 percentage points to a new record high of 34.4%, driven in part by an improvement in the labour force participation rate, which rose from 56.4% to 57.5%.[17] The rise in the labour force participation rate suggests more South Africans are returning to the labour market, consistent perhaps with the stronger economic recovery.

Disruptions to the recovery

During the period under review, the economy was buffeted by negative shocks, particularly the third wave of the COVID-19 virus and the riots and looting in July. These shocks interrupted the growth momentum in the third quarter of 2021, and could also have longer lasting effects on the economy.

The third wave of the COVID-19 virus was severe and required the lockdown restrictions to be tightened to adjusted Level 4, one level higher than the tightest restrictions during the second wave of the pandemic. However, the measures were significantly less restrictive on economic activity compared to those implemented in the earlier waves, with less than 3.1% of the economy directly

17 Unemployment registered 44.4% in the second quarter of 2021 when measured using the expanded definition.

affected by the restrictions, compared to 3.3% and 42.8% during the November 2020–February 2021 and March–October 2020 lockdowns respectively. This indicates better tailored lockdown restrictions and successful adaptations by businesses and consumers to living with the COVID-19 virus. However, the food, drink and hospitality (including tourism and transport) sectors were severely impacted by the restrictions, as travel for leisure, sit-in at restaurants and alcohol sales were restricted.

The political unrest, riots, looting and disruption to economic activity that rocked the country in early July further marred the third quarter. The damage was most acute in KZN, followed by Gauteng, where the unrest was isolated to certain areas. Shopping centres and warehouses were ransacked and vandalised, trucks torched, roads blocked and communication towers damaged. Total damages are estimated at close to R20 billion, although estimates vary widely. Small business revenues collapsed in KZN and Gauteng during the week of the lootings while truck volumes on key routes in KZN and Gauteng dropped to near zero. Recovery was however swift, with both the Yoco turnover index and truck volumes returning to normal as soon as the situation calmed. Considering the immediate impacts, the riots are estimated to have shaved 0.4 percentage points off 2021 GDP. However, the economic impacts are likely to be more long-lasting, particularly if investment sentiment is adversely impacted.

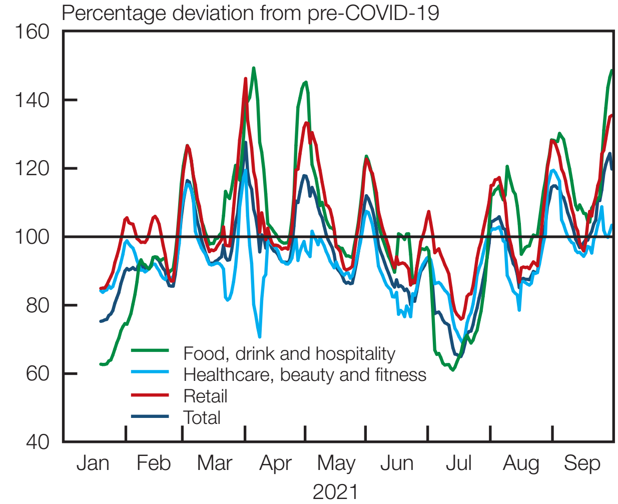
Growth outlook

Although growth has surprised to the upside during the recovery, it is expected to slow considerably over the forecast period, largely reflecting the pre-existing constraints to long-term growth. First, the recovery is largely complete, implying that growth will soon return to its long-term trend, which is low. Second, investment remains quite low, limiting the productive capacity of the economy. Third, electricity supply constraints that manifested in load-shedding during 2020 and the first half of 2021 are likely to become more binding as activity levels ramp up, restricting both activity and investment.

Following a much stronger third wave and the unrest in July, third quarter GDP is expected to contract by 1.2%. The forecast for growth in 2021 is 5.3%, and the medium-term growth is forecast at 1.7% and 1.8% in 2022 and 2023 respectively. The strong growth in 2021 is an artefact of the recovery, being driven largely by the re-opening of the economy. However, the strong growth despite the disruptions demonstrates that the economy was on track to recoup most of the output losses by the end of 2021.

Small business turnover

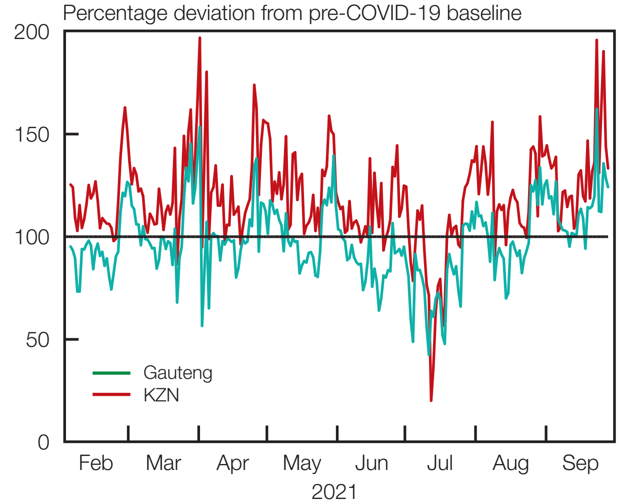
Percentage deviation from pre-COVID-19



Source: Yoco

Small business turnover index

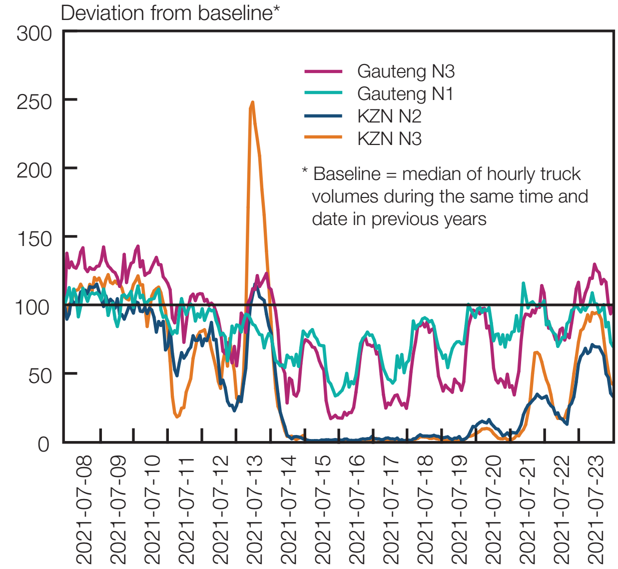
Percentage deviation from pre-COVID-19 baseline



Source: Yoco

Average truck traffic

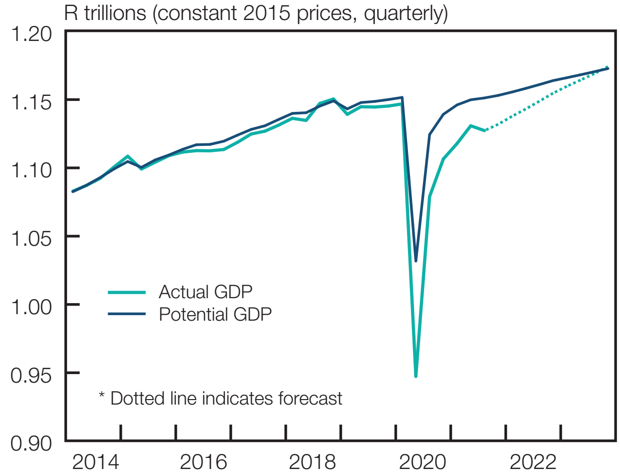
Deviation from baseline*



Sources: SANRAL and SARB

Actual and potential GDP

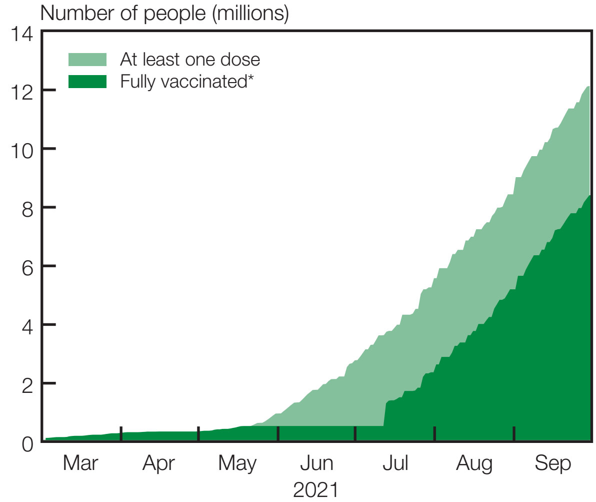
R trillions (constant 2015 prices, quarterly)



Sources: Stats SA and SARB

Vaccines administered

Number of people (millions)

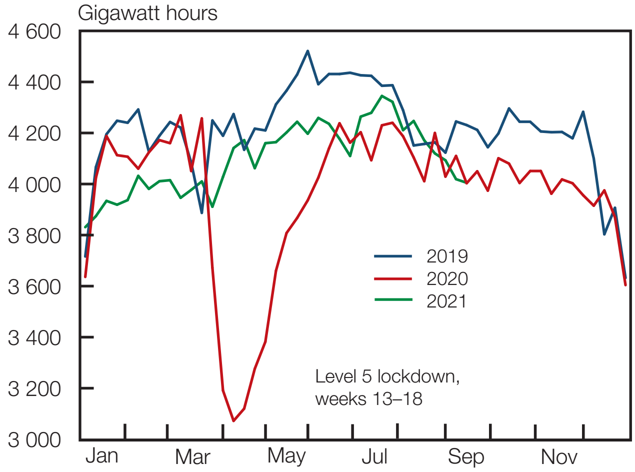


* Total number of individuals that have received a Johnson & Johnson dose or Pfizer's first and second doses.

Source: Our world in data

Net energy sent out

Gigawatt hours



Sources: Eskom and SARB

Household spending and exports are expected to continue to support growth in the medium term. Real interest rates will remain supportive of consumption and growth even as the repo rate normalises while asset markets (particularly housing and stocks) are expected to remain robust, supporting wealth accumulation. The labour market is expected to slowly recover, further lifting consumption and growth (see Box 5). Commodity prices are, however, expected to continue to revert to longer-term levels, potentially slowing export growth, while the recovery in imports would narrow the trade balance and partially reverse the terms of trade gains. Although it suggests that commodity prices have peaked, the SARB index of commodity prices projects prices remaining elevated over the medium term.

The COVID-19 pandemic and the lockdown restrictions instituted to slow the spread of the virus drove both actual and potential output sharply lower early in the past year, though they both have since recovered strongly. The virus remains a constant threat to the economy. Vaccinations should help curb future waves of the pandemic, reducing the need to tighten mobility restrictions and lowering consumer COVID-19 risk perceptions, important for the full re-opening of sectors such as transport and tourism.[18] After a slow start to the roll-out of vaccines, the pace of vaccination has quickened somewhat, with about 15% of the population fully vaccinated as of 30 September.

Growth over the medium term, just like growth over the last decade, will be hamstrung by inadequate electricity supply coupled with sharply rising tariffs. This constraint appears to have worsened over the past three years, with the severe load-shedding experienced in 2019 carried through to 2020 and 2021.[19] It is evident that the national electricity grid is not able to sustain the current demand, let alone expanded demand that would come with new investments. Electricity supply thus imposes a hard constraint on medium-term growth. The recent government initiatives to address the electricity crisis, such as permitting some municipalities to buy electricity from suppliers other than Eskom and allowing private companies to self-generate up to 100MW should help to ease electricity shortages over the medium term, but only if implementation is expedited.

Whereas the National Development Plan (NDP) argues for investment of about 30% of GDP for South Africa, realised investment is much lower, at 13.7% in 2020. Investment is expected to slowly recover, but will likely be held back by low business confidence, binding energy constraint and more

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18 Stronger bounce-back in these sectors will bolster growth and also spur labour market recovery given their high labour intensity and employment multipliers.

19 About 650 hours of load-shedding were experienced in the first half of the year, with close to 1 000 GWh of power lost, equivalent to 76.0% of the load-shedding experienced in 2020. The total energy availability factor declined further in the first half of 2021 to 61.3%, from 65.0% in 2020 and 66.9% in 2019.

broadly the slow pace of structural reforms. However, the new reforms around energy self-generation by private companies and implementation of government's major infrastructure projects should prop up investment over the medium term.[20]

Following the rebasing of GDP, potential GDP growth was revised during the September MPC. As the lockdown restrictions were eased and demand recovered, economic activity rebounded sharply even though the COVID-19 waves persisted (a supply-side response). Potential growth was last revised in January 2021, following better-than-expected growth in the third quarter of 2020. Potential growth, an unobservable variable, must be estimated from observable data. This allows the computation of yet another unobservable, the output gap, and an important component of the Taylor rule in the SARB's QPM.[21]

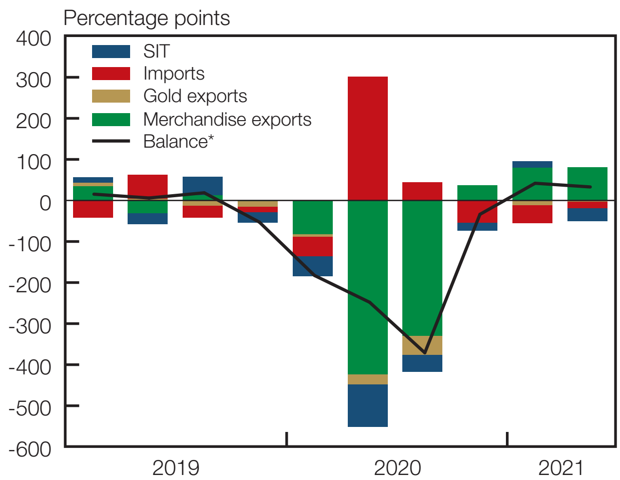
Potential GDP growth is now expected to recover from -3.1% in 2020 to 3.4% in 2021. The large swing reflects the sharp recovery in the production side of the economy, partly supported by external demand. However, low investment spending, electricity supply constraints and the slow recovery in the labour market, will limit the rise in potential GDP over the medium term, which is projected to be about 0.8% in both 2022 and 2023. With the initial COVID-19 impact slightly less severe than initially estimated, potential growth slightly lower and the recovery stronger, the output gap was revised narrower. However, the contraction in economic activity in the third quarter following the riots and looting in July has slightly widened the output gap, pushing back its closure to the end of 2023.

Macro balances

The current account

South Africa's current account balance has remained in surplus for four consecutive quarters, since the third quarter of 2020 – the longest sustained surplus in nearly two decades.[22] As a ratio of GDP, the surplus widened to 5.6% in the second quarter of 2021, from 4.3% in the previous quarter. The larger current account surplus reflects both stronger export growth on the back of surging commodity prices and a slow recovery in the demand for imported consumer and investment goods. The current account surplus is expected to widen to 4.6% in 2021, from 2.0% in 2020, moderate to 0.7% in 2022 and record a modest deficit of 0.3% 2023.

Contributions to current account balance



* Percentage change from quarter to quarter

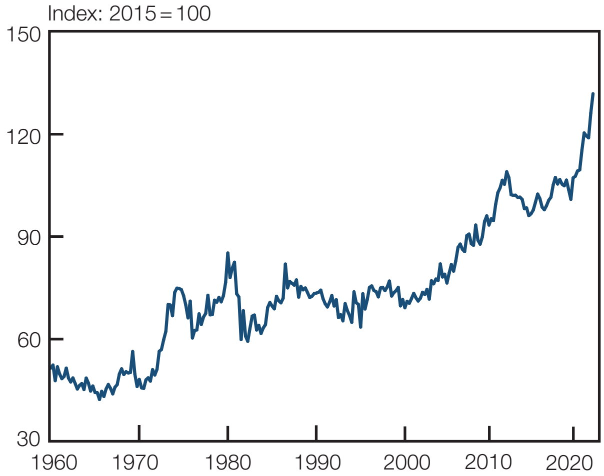
Source: SARB

20 The infrastructure investment plan, announced in 2020, includes the following priority projects, among others; Phase 2 of the Lesotho Highlands Water Project and the Crocodile Mokolo Water Augmentation Project announced in May 2021, and the South African National Roads Agency Limited (SANRAL) N2 and N3 highway upgrade announced earlier this year (February 2021). From the private sector side, projects from the fifth bid window of the Renewable Energy Independent Power Producer Procurement Programme (REIPPPP) should also support investment in the medium term.

21 Realised growth minus potential growth equals the output gap. The output gap is a common element of the monetary policy rules used by central banks globally.

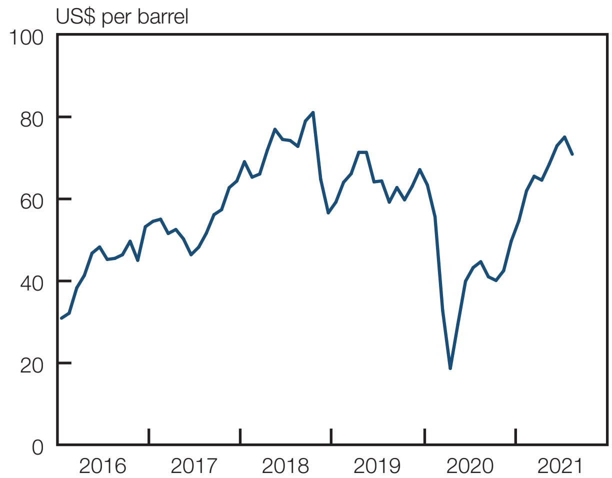
22 The last time a surplus lasted for four quarters was the period 2002Q2–2003Q1.

Terms of trade



Source: SARB

Oil price



Source: SARB

The terms of trade increased further by 4.5% in the second quarter of 2021, a slight moderation from the 6.1% increase in the previous quarter. Prices of PGMs have risen sharply since 2018, with the price of rhodium rising by more than 800% and platinum prices up by 45.2% due to a combination of scarcity and soaring global demand. However, the remarkable climb in commodity prices is starting to slow, with many commodities having turned from their peak levels as supply begins to normalise. Iron ore prices are vulnerable to increased global supply as Brazil's Vale's operation resumed amid moderating demand, particularly from Chinese and US manufacturing activity. The sharp increase in oil prices (134.0% year-on-year in the second quarter of 2021) together with the levelling-off in commodity prices should dampen the terms of trade.

A smaller component of the current account balance is the services, income and current transfer (SIT) account. The SIT account contributed negatively to the current account in the second quarter, and the shortfall on the SIT account is expected to widen further over the forecast horizon due to higher dividend payments abroad and low earnings from international tourism. Dividend payments are expected to rise in line with higher profits in the mining sector, leading to an increase in primary income payments.[23] Sentiment in the tourism sector continues to be adversely affected by rising COVID-19 waves, tighter lockdown measures and the discovery of new variants of the virus.

Gross secondary payments, dominated by Southern African Customs Union (SACU) transfers, will likely fall in the remainder of 2021 as the SACU revenue pool has been significantly reduced by the effects of COVID-19 on regional trade.

Fiscal account

Better-than-expected revenue and some expenditure reprioritisation are facilitating an improved fiscal outlook, even with the new fiscal relief package and a larger-than-budgeted public service wage agreement. Smaller fiscal deficits should help lower fiscal risk and strengthen the macroeconomic environment, with beneficial effects for long-term borrowing costs. The fiscal outlook was further boosted by the recent benchmarking and rebasing by Stats SA, which raised nominal GDP higher.

23 Payments of interest and dividends to foreign portfolio investors increased by 22.8% in the second quarter of 2021, following a 5.3% decline in the first quarter.

Additional government revenue and expenditure

R billions

Fiscal relief package	38.85
Total revenue measures for fiscal support	5.00
Social relief of distress	26.70
SASRIA	3.90
Small business	2.30
Police	0.25
SANDF	0.70
Total expenditure on fiscal relief support	33.85
Total expenditure on public sector wage bill	20.00
Total increase in main budget expenditure from fiscal support and wage bill	53.85
Less: reprioritisation	22.65
Additional expenditure	31.20

Sources: National Treasury and SARB

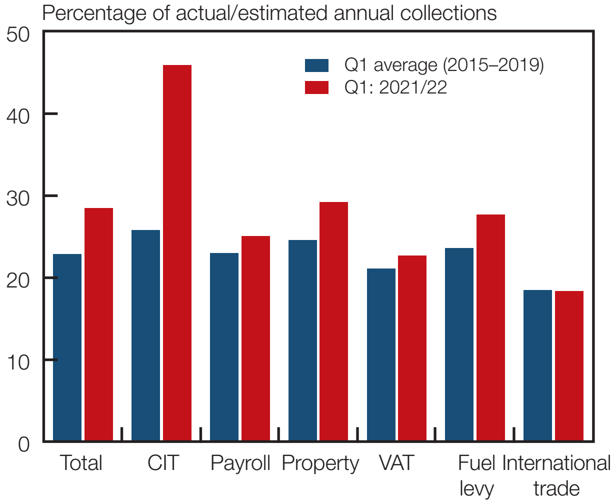
The wage settlement agreed to between the government and public sector unions includes a 1.5% increase (pay progression) for all public sector employees and an additional cash allowance of between R1 220 and R1 695 per month from 1 April 2021 until 31 March 2022.[24] Although the 1.5% pay progression was already assumed in the February 2021 fiscal framework, the cash allowance was not. As a result, the public sector wage bill in 2021/22 is estimated to increase by R18 billion–R20 billion.[25] The National Treasury has indicated that the implementation of the wage freeze will be budget neutral, financed through budget reprioritisations.

Higher commodity prices and the surge in the terms of trade have buoyed tax revenue collection. Revenue has overperformed to date, with corporate income tax (CIT) surging to record levels on supernormal profits in mining.[26] Although commodity prices appear to have peaked, prices are expected to remain elevated relative to pre-pandemic levels, at least throughout the fiscal year. Revenues are therefore expected to outperform the Budget 2021 projection, easing consolidation efforts. The SARB now expects the fiscal deficit to improve to 6.5% and 5.7% of GDP in 2021/22 and 2022/23 respectively, significantly better than the Budget 2021 projections of 9.0% and 7.4% of GDP in 2021/22 and 2022/23 respectively.

Despite better-than-expected revenue prospects for the current fiscal year, the fiscal situation remains fragile as debt levels remain high. Risks to the fiscal outlook include a sharp correction in commodity prices, much slower growth (and thus tax revenue) on the back of more severe waves of COVID-19, temporary spending becoming permanent and further fiscal support to state-owned enterprises (SOEs).

Tax revenue collection

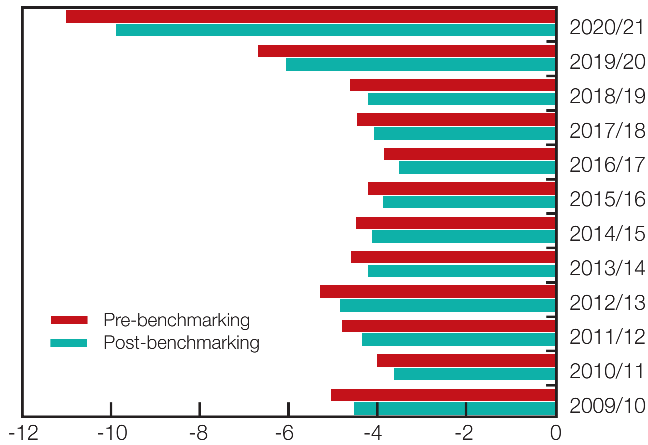
Percentage of actual/estimated annual collections



Source: SARB

Fiscal deficit

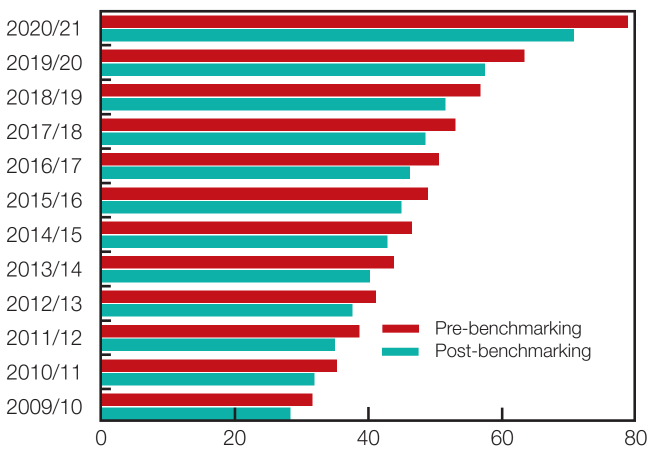
Percentage of GDP



Source: SARB

Government debt

Percentage of GDP



Source: SARB

24 If the wage agreement for 2022/23 is not reached by end of March 2022, the payment of the cash allowance will remain in force until an agreement is reached.

25 The Bureau of Economic Research (BER), *Weekly Review No. 29*. 2021. https://www.ber.ac.za/knowledge/pkviewdocument.aspx?docid=14930 (accessed 20 September 2021).

26 In the first quarter of 2021/22 the government collected 28.5% of its estimated annual revenue collection, substantially higher than the 22.9% average actual revenue collection in the first quarter of 2015–2019. CIT in first quarter amounted to almost half of what the government estimates to collect for the whole year.

Conclusion

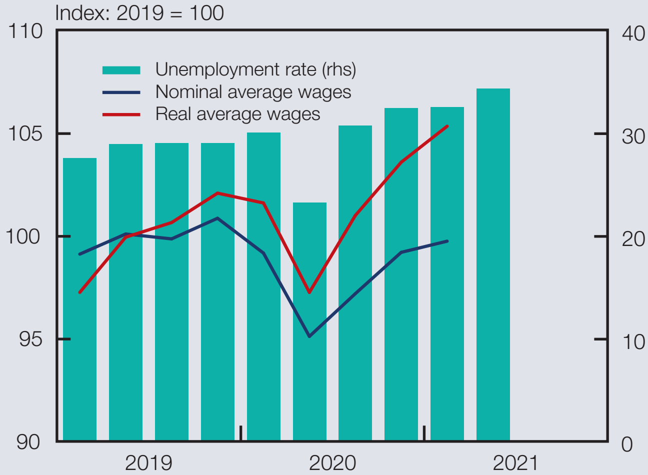
Domestic growth, though resilient, appears to be slowing, as many sectors have completed the steepest part of the climb from last year's sharp contraction and returned to around pre-pandemic levels. The recovery will continue to be supported by household spending and the expected recovery in employment. Export earnings will remain firm on the back of robust global demand for the near and medium term. The vaccine roll-out, which has picked-up pace, should support the normalisation of economic activity into 2022. The near-term fiscal outlook has substantially improved, though risks to the medium-term outlook remain. However, growth will be weighed down by weak investment and persistent electricity shortages.

Box 5 Wages recovering, jobs lagging

While the broader economic recovery from the COVID-19 pandemic has been robust, some sectors remain constrained and labour market improvements are very partial. A rebound in the labour market would enhance the durability of household consumption, supporting economic growth. Of the over 2 million jobs lost during the depth of the COVID-19 crisis in the second quarter of 2020, only about 793 000 had been recovered by the second quarter of 2021. Recovering jobs lost was always going to take time, and while there have been jobs added in some areas, on balance, the shocks to the economy suggest that the distribution of jobs across the economy may be permanently affected. More striking in the economy's bounce back is the sharp recovery in earnings to date. Whereas employment has tended to move sideways, nominal average wages in the non-agricultural sector were 5.4 percentage points above their pre-pandemic level (2019 average) by the first quarter of 2021. Real wages have also recovered well, being just 0.2 percentage points below their 2019 level.

Unemployment and average wages

Index: 2019 = 100



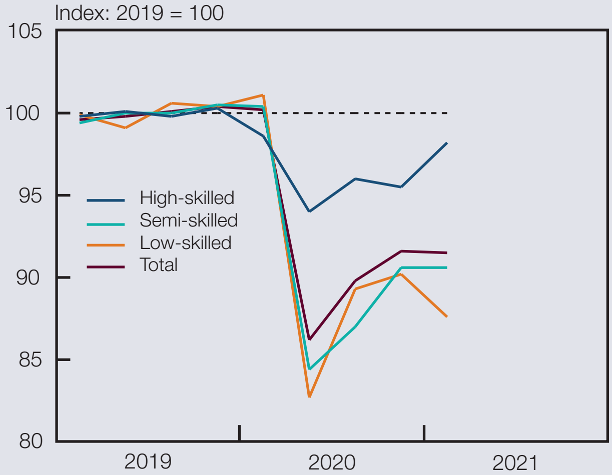
Source: SARB

Drivers of rising average wages

Higher wage growth typically serves as an indicator for stronger labour market conditions, as it signifies rising demand for labour.[1] However, the strong recovery in average wages has taken place even though the unemployment rate has risen to record-high levels (34.4% in the second quarter of 2021, from 32.6% in the previous quarter). This apparent puzzle can be explained by the composition effect and overtime work.[2]

National employment by skill level

Index: 2019 = 100



Sources: Stats SA and SARB

1 J Rubery, 'Wages and the labour market'. *British Journal of Industrial Relations* 35(3), 1997, pp 337–366.

2 Other possible explanations include segmented labour markets and relatively higher firing costs in South Africa which impinge on firms' ability to optimise their workforce on an ongoing basis.

When lower-wage workers disproportionately lose jobs, average wages rise, with the wage bill more fully reflecting the earnings of higher paid workers who remain employed and creating an illusion of high wage growth.[3] Employment of low-skilled workers fell by 13.1% year-on-year in the first quarter of 2021 and remained 12.4 percentage points below the pre-pandemic level.[4] Job losses among high-skilled workers (0.5%) were less severe and employment has also recovered relatively faster for this group.

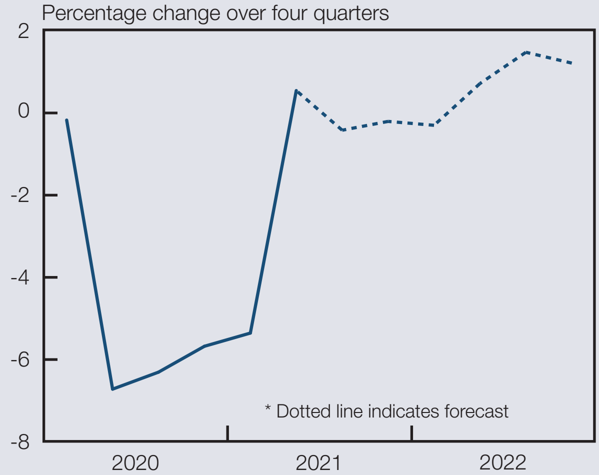
Rising average wages can also be explained by firms' reliance on overtime work to meet growing demand. Overtime payments in the formal non-agricultural sector increased by 8.6% in the first quarter of 2021. Increased use of overtime work – a short-term response to rising demand – enable firms to produce more output and support higher worker earnings, without committing to expanding permanent jobs.

Hiring new employees comes at a cost, and the higher these costs are relative to the overtime wage rate, the more willing employers are to delay hiring, contributing to low labour utilisation.[5] Addressing the low labour utilisation in South Africa requires policy efforts to be directed at improving the transition from school to jobs, enhancing product market reforms for increased competition, creating public (and private) institutions to enhance job matching and increasing labour market flexibility.[6]

The South African Reserve Bank (SARB) forecasts total non-agricultural employment (public and private sector) to increase by 1.9% year-on-year in the third quarter of 2021, after declining by 5.4% in the first quarter. Over the medium term, employment is expected to decline by 1.4% in 2021, before ticking-up to 0.8% and 1.4% in 2022 and 2023 respectively.[7]

Total employment

Percentage change over four quarters



Sources: Stats SA and SARB

3 E E Crust, M C Daly and B Hobijn, 'The illusion of wage growth'. *Federal Reserve Bank of San Francisco (FRBSF) Economic Letter No. 2020(26)*, 2020, pp 1–5.

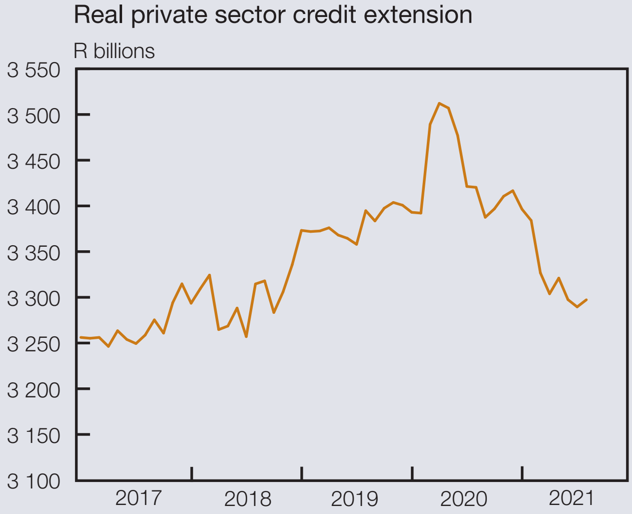
4 Skill classifications are guided by ILO ISCO definitions using occupation data from Stats SA in the following groupings: higher skilled: managers, professionals and technicians. Semi-skilled: clerk, sales and services, craft and related trade, skilled agriculture and plant and machine operator. Lower skilled: elementary and domestic work.

5 R G Ehrenberg, 'The impact of the overtime premium on employment and hours in US industry'. *Economic Inquiry No. 9(2)*, 1971, pp 199–207.

6 C Loewald, K Makrelov and A Wörgötter, 'Addressing low labour utilisation in South Africa', *Economic Research Southern Africa Policy Paper No. 27*, May 2021. http://www.econrsa.org/system/files/ publications/policy_papers/policy_paper_27.pdf.

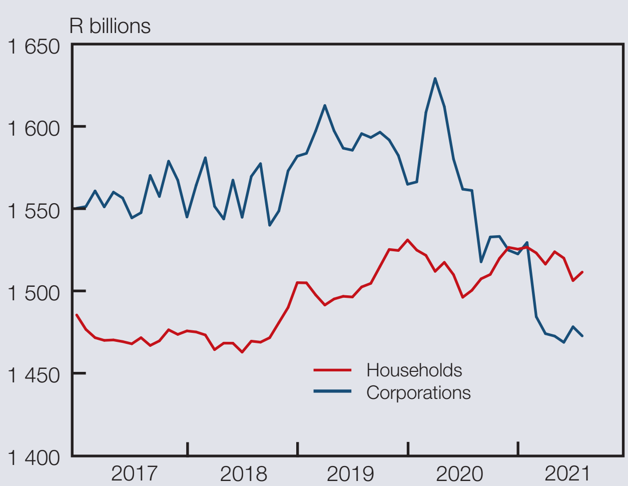
7 The employment forecasts are from the September 2021 Monetary Policy Committee meeting.

Real private sector credit extension



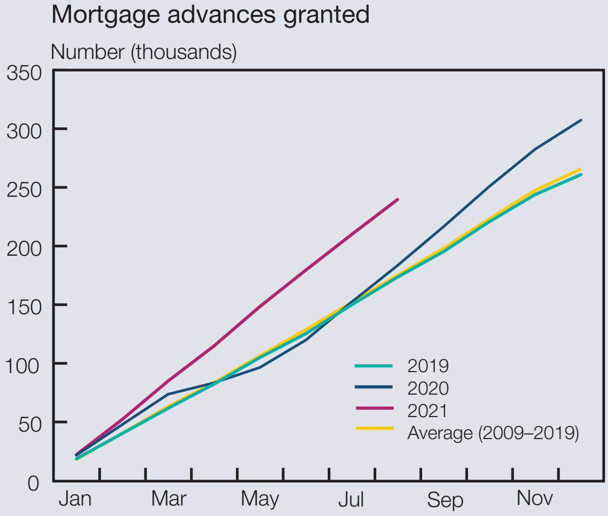
Source: SARB

Real loans and advances



Source: SARB

Mortgage advances granted



Source: SARB

Box 6 Credit extension: a tale of diverging trends

Despite stronger household borrowing over the past year, total private sector credit extension is down by 3.6% year-on-year in real terms in August. This is because corporates have substantially reduced their borrowing since the onset of the COVID-19 pandemic.[1] The credit channel is an important vehicle for monetary policy transmission. This box discusses the credit extension trends following the sharp (275 basis points) reduction in the repurchase (repo) rate between April and July 2020.

The sharp reduction in the prime lending rate lowered debt service costs, boosted real income and improved credit affordability for borrowers. Outstanding household debt climbed convincingly between July and December 2020, then held steady until May 2021, before softening between June and August this year. Changes in the demand for mortgage advances, which account for about 60% of total loans and advances to households, explain the upswing and the subsequent slowing in credit growth. Mortgages still registered 2.4% year-on-year growth in real terms in August 2021, while instalment sales agreements (ISAs) (mostly vehicle financing) – the next largest category – also maintained positive year-on-year growth in August (0.9%).[2] Record-low borrowing costs combined with low average house prices at the onset of the pandemic encouraged greater interest in mortgage borrowing.[3] Mortgage applications and approvals have risen sharply during the first half of 2021, and remained well-above the averages for the period 2011–2019. Anecdotal evidence and the elevated rental vacancy rates (13.3% and 13.2% in the first, and respectively, the second quarter of 2021) suggest that the favourable conditions enabled some tenants to upgrade to owner-occupiers.

Corporate credit, on the other hand, has presented a near mirror image. Following a spike in April last year (which was partly elevated by a single once-off corporate deal and partly due to firms seeking additional liquidity while faced with uncertainty in the months ahead), corporate borrowing slowed sharply. Several factors have likely contributed to this. First, the initial decline in borrowing likely stemmed from the heightened uncertainty due to COVID-19 and lockdown restrictions, with firms taking a wait-and see approach.[4,5] Second, the post-global financial crisis (GFC) decade of slow growth may have fed the hesitation to invest while facing an

1 Corporates constitute about 50% of total private sector credit extension.

2 On a month-on-month basis, the mortgage debt stock rose by 0.4% in August while ISA credit extension rose by 0.6%.

3 As of March 2020, FNB's house price index was only 0.3% above its 2019 average, or -3.8% when adjusted for inflation.

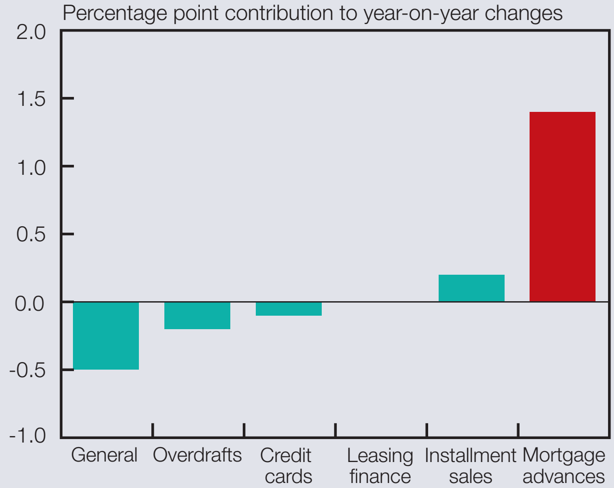
4 The RMB/BER business confidence index (BCI) sank to an all-time low in the second quarter of 2020 (5 index points). While it has bounced back well in the quarters since then, it still reflects conservative sentiment (at 50 in the second quarter of 2021) relative to the history of the series (historical peaks recorded in the 1980s and 1990s).

5 Banks also took a more cautious approach to lending and monitored their risks and exposures more closely.

uncertain future, resulting in higher-than-average corporate savings. Third and in the same spirit, some corporates took the cautious approach further still and used the low interest rate environment to pay down existing debt and reduce their debt service costs. Fourth, high commodity prices have provided additional liquidity to corporates, particularly those associated with commodity supply chains who would normally borrow for investment, reducing their borrowing needs. Finally, reduced demand from the businesses that remain on tenterhooks (especially in transport and tourism) or lost demand from those that closed in the wake of the crisis may have also fed into lower corporate borrowing numbers.

The stronger recovery in economic activity should strengthen sentiment about future economic growth and thus demand for credit. Reforms that lower the cost of doing business, improve the investment climate more generally, or increasing the economy's labour utilisation rate, should support higher growth and thus demand for credit.

Real household credit subcomponents*



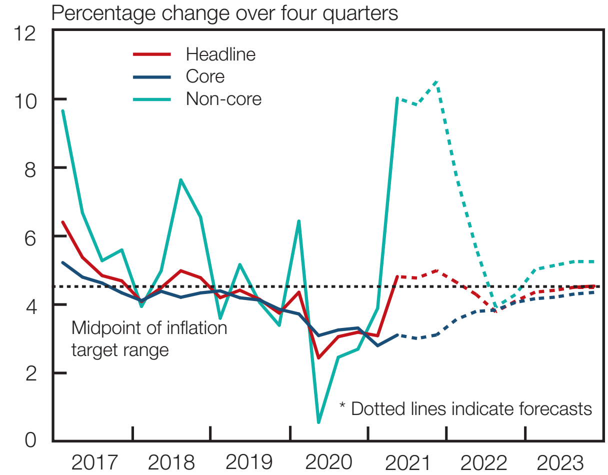
Source: SARB

Price developments: headline inflation anchored by core inflation, but for how long?

After reaching a low of 2.9% in February 2021, headline consumer price inflation quickened to 5.2% in May, before moderating again somewhat. Much of the upward pressure on headline inflation has stemmed from higher food and administered price inflation. Despite sharply higher monthly headline inflation outcomes, the medium-term trajectory looks moderate, anchored by relatively low core inflation and expectations of future inflation. The muted core inflation is underpinned by weakness in big-ticket items such as housing, medical insurance and education. Core inflation is forecast to average 3.0% in 2021, rising to 3.8% in 2022 and 4.3% in 2023. Headline inflation is expected to remain around the target midpoint and to settle at 4.5% by 2023. Like in advanced economies, however, risks to the inflation outlook are evident and will require careful consideration by the MPC.

Core versus non-core inflation*

Percentage change over four quarters



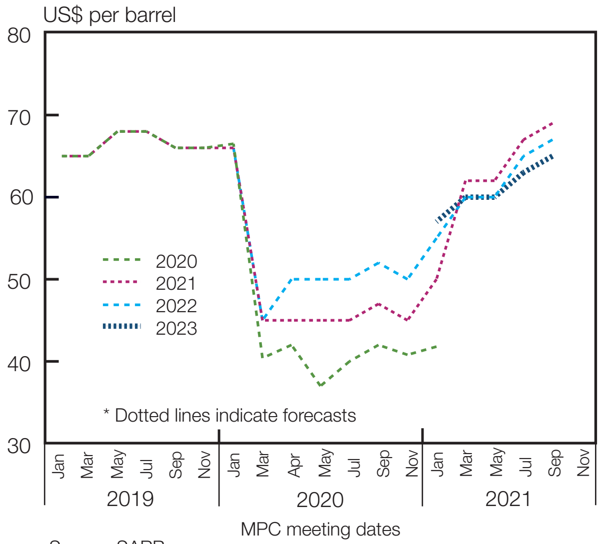
Sources: Stats SA and SARB

Since the April *MPR*, headline inflation shifted higher as goods price inflation accelerated as part of the global and domestic economic recovery. Goods inflation, which averaged 2.6% in 2020, turned sharply higher and averaged 5.2% during the first half of 2021, while services inflation, which averaged 3.9% in 2020, moderated to 2.9% over the same period. Within goods inflation, higher outcomes have largely been driven by food and fuel inflation, with fuel inflation compounded by base effects from very low prices last year. Food and fuel price inflation have averaged 6.2% and 14% respectively since the start of this year.

Lower inflation outcomes for education, medical insurance and housing have kept services (and core) inflation muted. Core inflation has also benefitted from the rand's strength, subdued labour market pressures and relatively well-anchored inflation expectations. Core inflation has remained close to the lower limit of the target band, pulling down on headline inflation. However, the increases in goods inflation this year far outweighed the deceleration in services inflation, with the result that headline inflation has risen above the target midpoint.

Evolution of oil price forecasts*

US$ per barrel



Source: SARB

Oil prices and fuel inflation

The strong recovery of the global economy has underpinned the continued rally in oil prices, supported by supply restrictions. Brent crude oil averaged US$75 per barrel in July 2021, higher than the June average of US$73 per barrel, and much higher than the US$65 recorded in March 2021. While prices appear to have levelled-off in August, at US$71, as the COVID-19 Delta variant passes, global demand is expected to strengthen once again, lifting prices. Oil prices are expected to average US$69 in 2021, US$67 in 2022 and US$65 in 2023, a large upward revision relative to the April *MPR* projections.[27]

27 In April, Brent crude oil was expected to average US$62 in 2021 and US$60 in both 2022 and 2023.

The sharp movements in oil prices since the beginning of the year have reflected almost immediately in the domestic petrol prices, with pump prices rising from R16.32 per litre in March 2021 (for Gauteng) to R18.34 per litre in September 2021, despite a simultaneous appreciation of the rand during this period. Fuel price inflation is expected to average 16.1% in 2021, lifting headline consumer price inflation higher. Thereafter, fuel inflation is expected to slow to 3.7% in 2022 and 2.9% in 2023, supported by the dissipation of the high base effects of 2021 and some moderation in Brent crude oil prices in 2022.

Food and non-alcoholic beverages inflation

Although South Africa continues to enjoy bumper harvests, food and non-alcoholic beverages (NAB) inflation has continued to rise since the April *MPR*, surging to 6.9% in August 2021, its fastest yearly growth rate since June 2017. The recent food price pressures have been broad-based, with nearly three quarters of the components within the food and NAB basket registering inflation above the 4.5% target midpoint. The recent surge in domestic food prices is on account of both domestic and global factors.

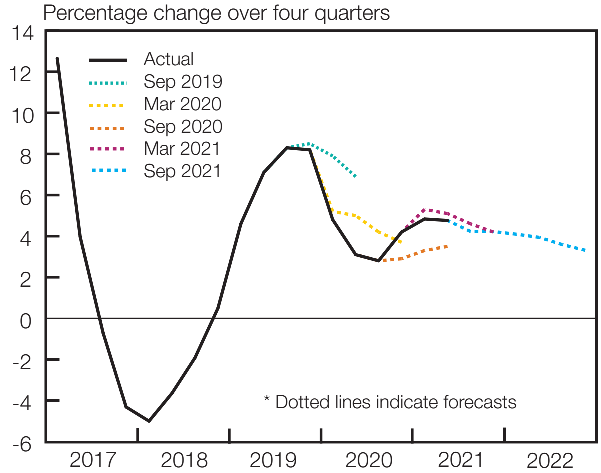
Bread and cereals inflation slowed in recent months, from 5.1% in January to 3.5% in August 2021, as global crop harvests improved, particularly in Argentina and on prospects of a good harvest in the US as well as slowing demand in China. The Southern Africa region, a major export market for South African maize, also realised a bumper harvest in the 2020/21 season. As a result, foreign demand for the bumper South African maize harvest has moderated. The SARB's current forecast is for bread and cereals inflation to average 4.5% in 2021 (0.3 percentage points lower than the April *MPR* forecast) before gradually declining to an average of 3.7% in 2022.

In the food and NAB basket, meat has been a major source of upward pressure on headline inflation over the past year. Meat inflation has been rising since September 2020, and has remained above the 6% upper limit of the inflation target range for 10 consecutive months. The August reading of 10.7% is by far the highest since February 2018. Beef and poultry have been the largest contributors to the surge in meat inflation, with beef prices soaring to double digits at 12.8% in August.[28] A key driver of this has been the decline in slaughtering activity as farmers rebuild herds following drought conditions in some parts of the country (Eastern, Northern and Western Cape as well as central Karoo), increased fodder availability, and rising input costs such as fuel, fertilisers and herbicides. With regard to poultry, high feed costs and the base effects from the low prices in the second half of 2020 have kept prices elevated. Against this backdrop, meat inflation is expected to average 8.2% in 2021, before moderating to 6.7% in 2022.

28 Beef accounts for 27.0% of the meat basket.

Evolution of bread and cereals inflation forecasts*

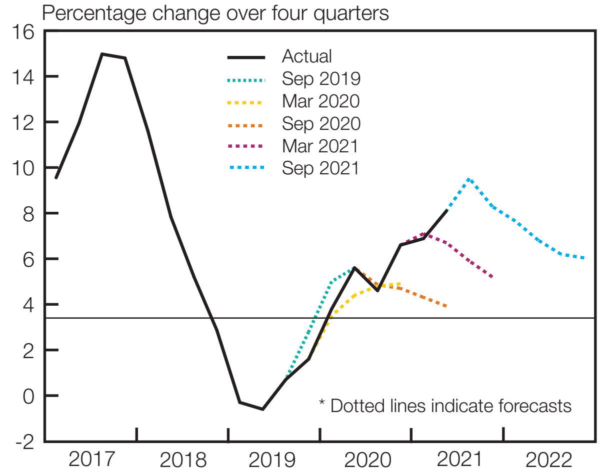
Percentage change over four quarters



Sources: Stats SA and SARB

Evolution of meat inflation forecasts*

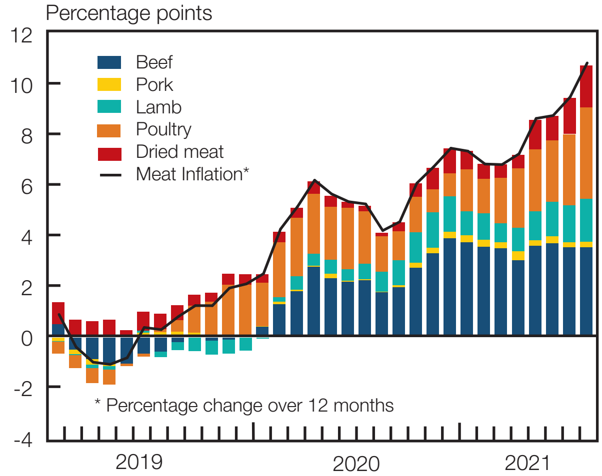
Percentage change over four quarters



Sources: Stats SA and SARB

Contributions to meat inflation

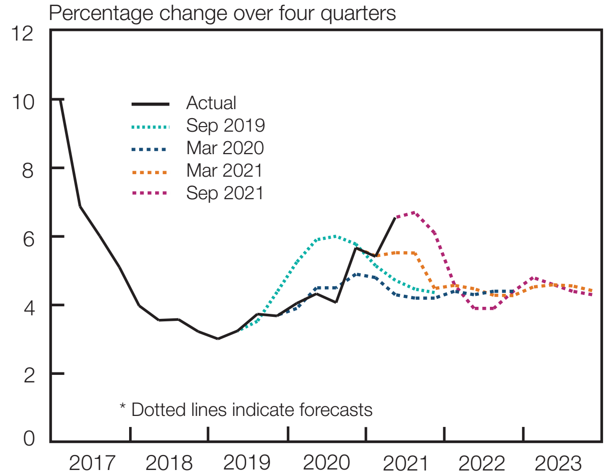
Percentage points



Sources: Stats SA and SARB

Evolution of food and NAB inflation* forecasts

Percentage change over four quarters



Sources: Stats SA and SARB

Food inflation pressures have also emanated from sugar and oils and fats as high global prices pass-through into the domestic market (see Box 7). Domestic sugar prices surged to 8.7% in May on reduced global sugar output. Sugar prices have since moderated somewhat following improved production prospects in India. Oils and fats inflation hit a multi-year high of 22.4% in July on tight global supplies and remain elevated. Milk, cheese and eggs inflation has remained sticky, averaging 6.6% in the first half of 2021, reflecting high input costs and stronger demand.

In summary, food inflation is revised up to 6.2% in 2021 (previously 5.2%), driven higher by meat, sugar and oils and fats inflation, but slightly lower to 4.2% in 2022, down from the 4.4% projected in the April *MPR*. Bread and cereals inflation is expected to slow further, and easing global food prices should pull food and NAB inflation lower. Meat, global sugar and vegetable oils prices, however, pose an upside risk to domestic food inflation.

Consumer food price inflation (September 2021 forecasts)

Percentage change over four quarters, March 2021 forecasts in brackets

	Actual			Forecast	Actual		Forecast			
	Weight	2010–20*	2020*	2021*	2021Q1	2021Q2	2021Q3	2021Q4	2022Q1	2022Q2
Food and non-alcoholic beverages	17.24	5.7	4.5	6.2	5.5	6.5	6.7	6.1	4.6	3.9
				(5.2)	(5.4)	(5.5)	(5.5)	(4.5)		
Bread and cereals..................	3.21	5.2	3.7	4.5	4.8	4.8	4.2	4.2	4.1	3.9
				(4.8)	(5.3)	(5.1)	(4.6)	(4.2)		
Meat	5.46	6.0	5.2	8.2	6.9	8.1	9.5	8.3	7.7	6.8
				(6.2)	(7.1)	(6.7)	(5.9)	(5.2)		
Beef..................................	1.44	6.5	8.2	11.9	13.3	12.5	12.9	8.9	8.8	8.5
				(10.4)	(13.3)	(11.3)	(9.9)	(7.3)		
Poultry	2.12	5.7	4.4	6.1	4.1	6.1	7.3	7.0	5.4	4.9
				(3.9)	(4.1)	(4.1)	(3.6)	(4.0)		
Vegetables	1.30	5.5	2.0	3.7	0.7	6.5	4.3	3.2	3.6	3.2
				(2.8)	(0.9)	(3.4)	(3.3)	(3.5)		

* Annual average percentage change

Sources: Stats SA and SARB

Core inflation

Over the review period, core inflation has remained muted, averaging 3.1% in the second quarter of 2021, from 2.8% in the first quarter, supported by lower services inflation. Housing inflation edged up slightly in the second quarter of 2021, but remains relatively weak, and continues to pull core inflation lower. Consequently, despite core goods providing some upward pressure, core inflation is expected to remain subdued over the forecast horizon, averaging 3.0% in 2021, before edging up to 4.3% in 2023.

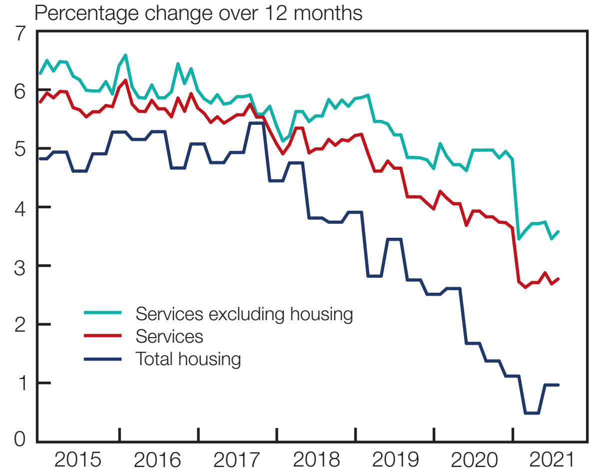
Housing is a large component of services inflation, hence price developments in this item tend to drive services inflation dynamics.[29] Lower housing inflation continues to anchor services inflation lower. The supply of rental space may have increased as property purchases accelerated, but more modest price inflation could also reflect reduced demand as the new 'work-from-home' culture allows some people to relocate away from areas of work.[30] The market is currently experiencing excess supply of rental space, with rental vacancy rates remaining elevated at 13.2% in the second quarter, down slightly from a peak of 13.3% in the first quarter. However, housing inflation appears to have bottomed out at 0.5% in the first quarter of 2021, after a prolonged descent since 2017, picking up to 0.9% in the second quarter. The SARB expects housing price inflation of 0.9% for 2021 and 2.1% for 2022, underpinned by the expected slow recovery in employment, elevated vacancy rates and subdued rental escalations in Gauteng and Western Cape provinces.

After averaging 2.1% in 2020, core goods inflation is expected to rise to 3.6% in the last quarter of 2021, exerting some upward pressure on core inflation. On a year-to-date basis, alcoholic beverages and tobacco, vehicles and spare parts and accessories have increased by 1.2, 1.0 and 5.4 percentage points from their respective 2020 outcomes.[31] Stats SA techniques for handling missing goods prices between April and August 2020 imputed prices using the exceptionally low headline inflation, affecting about a quarter of the core goods basket, artificially driving core goods inflation lower. The base effects from this artificially low core goods inflation are now partly driving inflation in this category. As these base effects dissipate over the remainder of 2021, acceleration in core goods inflation is expected to slow, but the expected rand depreciation in the second half of 2021 would at least partially offset this. Nonetheless, inflation in this category is expected to remain below the five-year average of 4.0% during 2021.

Following the announcement of a 5.9% price increase in July, by Discovery, medical inflation increased to 5.9% in the July CPI. This was the second time that medical insurance was surveyed this year, after the earlier survey in February 2021 where inflation registered 4.7%, slightly lower than the SARB's estimate of 5.0% at the time. For 2021, total insurance inflation is now expected at 4.8% compared to the 4.6% that was estimated in the April 2021 *MPR*. However, the 'low'

Services inflation

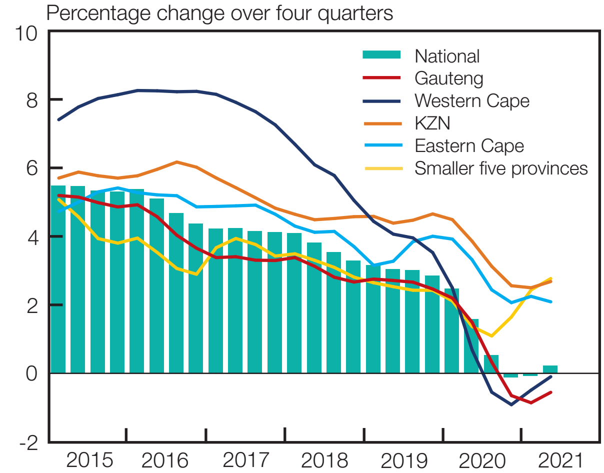
Percentage change over 12 months



Sources: Stats SA and SARB

Rental escalations by province

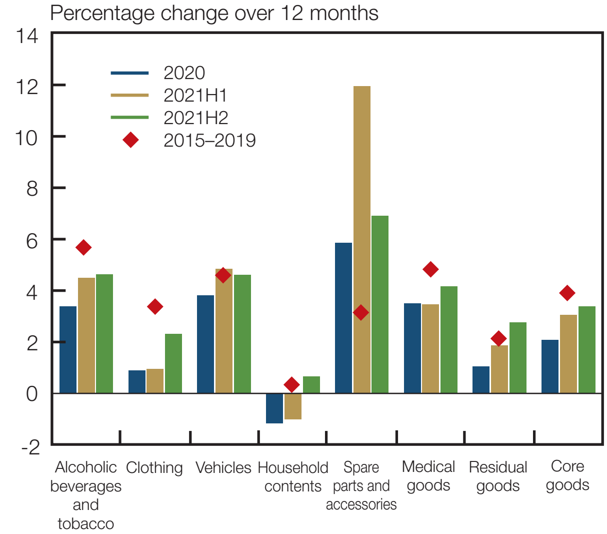
Percentage change over four quarters



Source: TPN Credit Bureau

Goods inflation

Percentage change over 12 months



Sources: Stats SA and SARB

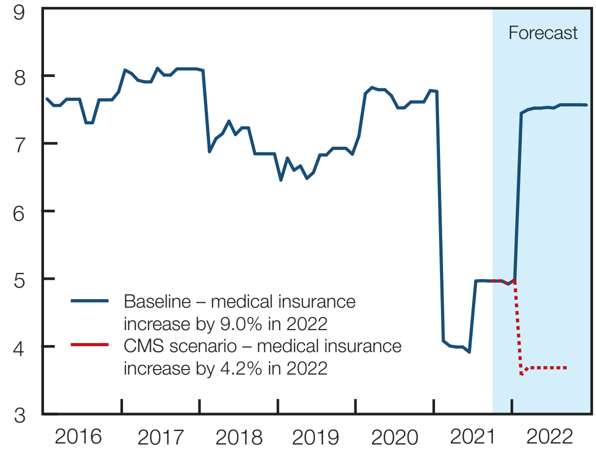
29 The housing inflation category (i.e. owners' equivalent rent and actual rentals) has a large weight of 23.0% in core inflation and over 32% in services inflation.

30 Higher unemployment since the onset of the COVID-19 crisis could also have forced people out of renting or into co-living.

31 Alcoholic beverages increased from 3.4% in 2020 to 4.6% (year-to-date average), vehicle prices increased from 3.8% to 4.8% (year-to-date) and spare parts and accessories prices increased from 5.9% to 11.3% (year-to-date average).

Insurance inflation

Percentage change over 12 months



Sources: Stats SA and SARB

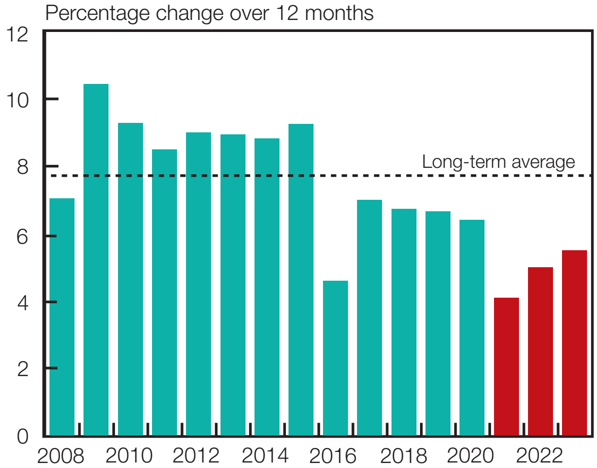
Electricity prices*

Percentage change over 12 months

Sources: Stats SA and SARB

Education inflation

Percentage change over 12 months



Sources: Stats SA and SARB

(by historical standards) price increases are likely temporary as they reflect the reduced expenditures and large capital reserves accumulated as a result of significant declines in general admissions and elective procedures (suspended by the Health Minister) in 2020.[32]

Medical schemes are yet to announce their 2022 annual contribution price changes. The Council for Medical Schemes (CMS) has requested schemes to limit their increases to 4.2%, but the effect of this for 2022 will remain unclear as the CMS has no mandate to set scheme prices.[33] Medical aid schemes with adequate reserves may keep their price increases minimal. The SARB's forecast incorporates a 9.0% increase in medical insurance for 2022, which is the long-term average increase for this sector.

Administered prices

Administered or regulated prices have often inflated at rates well-above the upper limit of the inflation target band, keeping headline inflation elevated. This trend continues, with administered price inflation averaging 7.4% between January and August 2021, primarily due to high fuel and electricity price inflation. Core administered price inflation, which excludes fuel and electricity, has been more muted, averaging 4.1% during the same period. Electricity prices increased by 13.8% in July 2021, compared to the 7.7% rise in July 2020, and somewhat below the SARB's forecast of 14.6% in April.[34] Property rates and water tariff inflation have been somewhat lower than expected, resulting in administered price inflation projected to reach an annual average of 8.7% in 2021, before slowing to 6.2% and 5.2% in 2022 and 2023 respectively.

Electricity inflation is forecast at 10.0% in both July 2022 and 2023, in line with the expectations of some of the main Metropolitan municipalities. Property rates are projected at 3.5% while water tariffs are expected to rise by 6.9%. These rates are lower than the averages for 2020, and the SARB's earlier forecasts.[35]

While price inflation for education was high after the GFC, it has moderated somewhat and is expected to remain so over the forecast horizon. Lower inflation outcomes, around 4.0% in recent months, were driven by primary education for which prices rose by 2.5% in March 2021 (compared to 7.3% a year

32 https://www.businessinsider.co.za/regulatory-filings-show-massive-jump-in-medical-scheme-surpluses-as-spending-drops-2021-1

33 https://businesstech.co.za/news/lifestyle/510756/medical-aids-in-south-africa-asked-to-cap-price-increases-for-2022/

34 It appears that while the majority of municipalities reported a 14.6% increase, some reported slightly lower increases, driving the average lower.

35 The annual average inflation for property rates for 2020 is 5.4%. The SARB's forecast prior to the July release was 4.0% for July 2021 until June of 2022, 0.5 percentage points higher than the July outcome of 3.5%. Water tariffs were expected at 7.6% in July this year but came out at 7.0%. Water tariffs averaged 10.2% for 2020.

earlier). Tertiary education prices inflated considerably faster at 5.1% in March 2021 (from 4.7% in March 2020), while university boarding fees increased by 6.5% in the same period (from 5.9% in March 2020). Looking ahead, education inflation for March 2022 and 2023 is projected higher at 5.0% and 5.5% respectively.

Administered price inflation remains a major driver of headline inflation and a structural impediment to South Africa realising permanently lower inflation. Many of the administered items, including water, electricity and fuel serve as inputs into the production process. Consequently, higher administered price inflation contributes to raising the cost structure of the economy.

Medium-term outlook

Medium-term inflation in the QPM is determined by inflation expectations, the output gap, the exchange rate gap and the ULC gap. These gaps reflect departures from long-run equilibria that cause inflation to deviate from target (here 4.5%). The QPM sets a policy path for the repo rate, conditioned on the size of the misalignments, to close these gaps and bring inflation back to target. At every point in time, these gaps are subject to economic shocks, which in turn affect the policy rate path.

Headline inflation (September 2021 forecasts)

Percentage change over four quarters, March 2021 forecasts in brackets

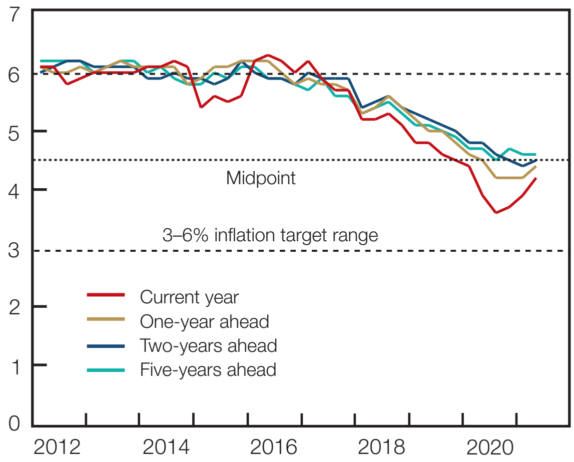
	Actual			Forecast	Actual		Forecast			
	Weight	2010–19*	2020*	2021*	2021Q1	2021Q2	2021Q3	2021Q4	2022Q1	2022Q2
Headline inflation	100.00	5.2	3.3	4.4	3.2	4.9	4.8	5.0	4.7	4.3
				(4.3)	(3.2)	(4.9)	(4.5)	(4.7)	(4.6)	(4.3)
Core inflation**	74.43	4.7	3.3	3.0	2.8	3.1	3.0	3.1	3.6	3.8
				(3.3)	(3.0)	(3.3)	(3.3)	(3.6)	(3.9)	(4.1)
Rentals***	16.84	4.8	2.0	0.9	0.9	0.6	1.0	1.2	1.6	2.1
				(1.4)	(1.1)	(1.2)	(1.5)	(1.7)		
Insurance	10.06	7.4	7.6	4.8	5.4	4.0	4.9	4.9	7.1	8.2
				(4.3)	(5.4)	(4.3)	(4.3)	(4.3)		
Education	2.53	7.9	6.4	4.4	5.6	4.1	4.1	4.1	4.4	4.9
				(4.4)	(5.6)	(4.0)	(4.0)	(4.0)		
Vehicles	6.12	3.0	3.8	4.7	4.0	5.7	5.0	4.7	4.8	4.5
				(4.0)	(4.0)	(5.2)	(4.0)	(3.5)		
Fuel	4.58	8.3	-7.0	16.1	-3.5	28.5	18.0	24.8	13.9	4.7
				(12.7)	(-3.4)	(29.5)	(11.5)	(16.8)		
Electricity	3.75	10.8	9.1	10.1	6.3	6.3	13.8	13.8	13.8	13.8
				(9.7)	(6.3)	(6.3)	(13.0)	(13.0)		

* Annual average percentage change
** CPI excluding food, NAB, fuel and electricity
*** Combines actual rentals and owners' equivalent rent

Sources: Stats SA and SARB

Inflation expectations*

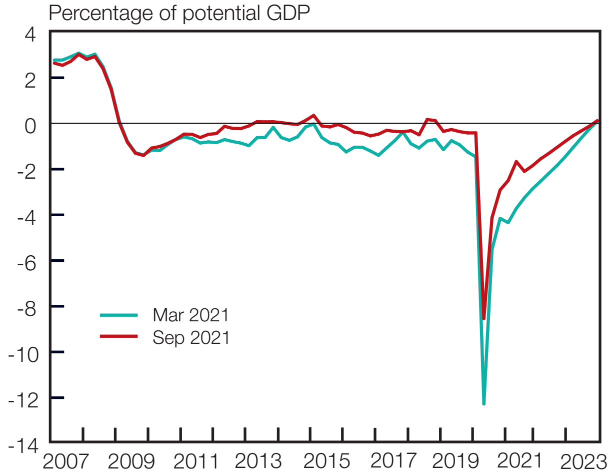
Per cent



Sources: BER and SARB

Output gap estimates

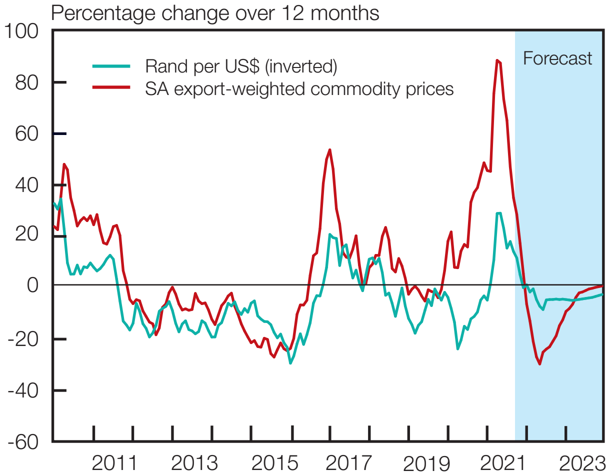
Percentage of potential GDP



Source: SARB

Exchange rate and commodity prices

Percentage change over 12 months



Source: SARB

Inflation expectations

At present, inflation expectations appear to remain well-anchored. The BER inflation expectations survey for the third quarter of 2021 shows two-years ahead inflation expectations at 4.5%, while the current-year inflation expectations are at 4.2%, unchanged from the second quarter outcome, but a slight increase over the first quarter outcome (3.9%). This rise in inflation expectations is likely due to higher food and fuel inflation (i.e. non-core goods). Equally, producer prices have risen sharply though pass-through to consumer prices remains low. Nonetheless, this remains a source of risk for shifts in inflation expectations.

Demand pressures

In the QPM, economic slack is measured by the output gap or the difference between observed economic activity levels and estimates of the full utilisation of productive capacity (potential economic activity). Estimates of potential activity are invariably imprecise, and shocks like the GFC or the COVID-19 pandemic radically increase uncertainty around the exact level of economic slack, and ultimately inflation forecasts (see Box 8).

Since the April *MPR*, the SARB's estimate of the output gap – both contemporaneous and historical – has narrowed considerably due to lower investment growth rates and higher actual levels of output calculated in the recent rebasing and benchmarking exercise by Stats SA.[36] The upward historical revision to the GDP outcomes results in a smaller starting point for the output gap estimations, and because this revision is larger as it progresses through time, the gap is narrower over the full-time horizon of the revisions.

For the forecast, however, the deterioration in GDP growth, related to factors such as the extended lockdowns and the social unrest of July 2021, delays the closing of the output gap. The output gap is expected to close in the fourth quarter of 2023.

Exchange rate

The rand exchange rate plays an important role in medium-term inflation dynamics as it can amplify or dampen the impacts of imported inflation in the domestic economy. Since the April 2021 *MPR*, the rand has appreciated by 1.8%, and may be somewhat overvalued relative to its equilibrium. On a quarterly basis, the second quarter of 2021 averaged R14.12 per dollar compared to the forecast of R15.73 per dollar at the March 2021 MPC. The nominal effective exchange rate, measured using a weighted average of a group of three biggest advanced economies (US, euro area and Japan), is 14 percentage points more appreciated compared to the March 2021 forecast.

36 Stats SA. 25 August 2021. National Accounts: Sources and Methods. http://www.statssa.gov.za/publications/Report%2004-04-04/Report%2004-04-042021.pdf

The terms of trade have played a major role in the rise in the value of the currency, but so too has global investor risk-on appetite amid faster than anticipated economic recovery. Rand appreciation over the last two quarters translates to less inflationary pressures relative to the April *MPR*.[37]

Labour market

Inflationary pressures emanating from labour market developments are measured using the real ULC gap – the difference between real wage outcomes and productivity growth. Productivity growth faster than a given real wage increase reduces inflationary pressures, while real wage increases greater than a given productivity growth rate increase inflation pressure.[38]

Despite considerable volatility in output, employment and compensation data, ULCs appeared to moderate in 2020 and into 2021. This has resulted in a negative real ULC gap in the QPM that implies little inflationary pressures arising from the labour market, an outcome that appears consistent with developments in many other economies during the pandemic. The forecast for this gap has remained low for the past year, and is a key contributor to the moderate inflation expected over the outer years of the forecast. In recent quarters, stronger nominal and real wage growth have been somewhat negated by productivity gains. In terms of public sector wages, the forecast at the April *MPR* had anticipated a wage bill freeze as announced by the Minister of Finance during the *2020 Medium Term Budget Policy Statement*. The out-turn remains largely in line with those estimates and should exert downward pressure to wage inflation.

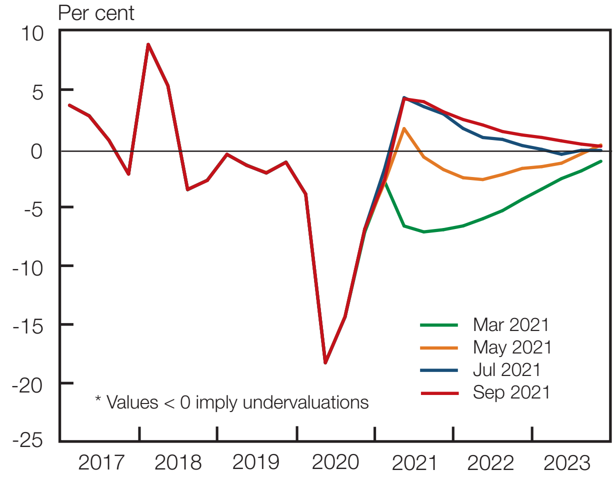
Conclusion

Headline consumer price inflation remains relatively well-contained despite the sharp increases since the April 2021 *MPR*. Food and fuel inflation drove the May rise in headline CPI to peak at 5.2%, while core inflation has remained muted, helping to anchor inflation lower than would have otherwise been the case. However, the stronger recovery and narrower output gap are expected to raise core inflation over the medium term. Headline inflation is expected to average 4.4% for the year, and to moderate to 4.2% in 2022, before rising to the 4.5% target midpoint in 2023. Risks to medium-term inflation have sharply increased, including elevated producer prices, the persistence of supply constraints and high food and oil prices.

37 In fact, given the extent of the 2021 second quarter exchange rate appreciation and the degree of overvaluation, the forecast is for an overvalued currency throughout the forecast period despite a nominal depreciation over the same period.

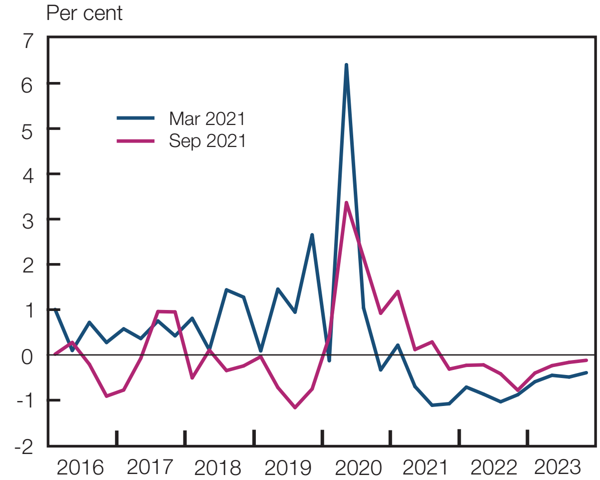
38 More formally, the real ULC gap is considered inflationary if the real wage deviation from its equilibrium is more than the gain in productivity.

Real effective exchange rate gap forecasts*



Source: SARB

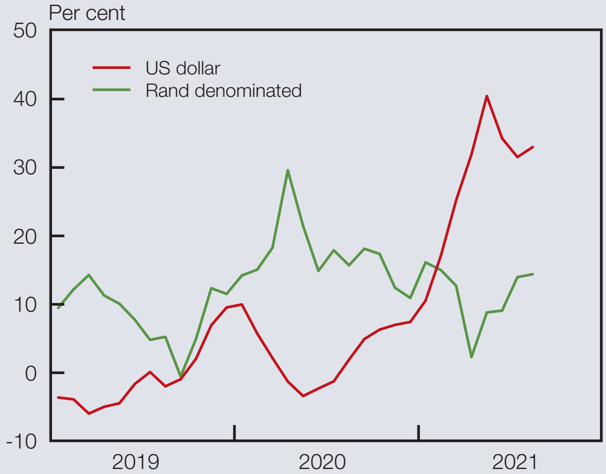
Unit labour cost gap



Source: SARB

FAO global food price inflation

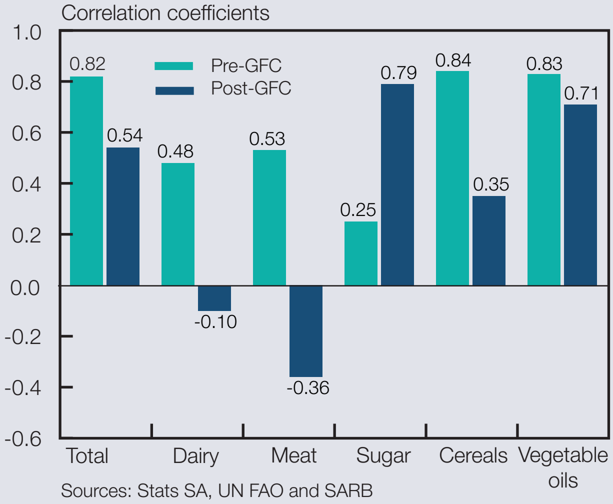
Per cent



Sources: Haver, UN FAO and SARB

Link between global and domestic food prices

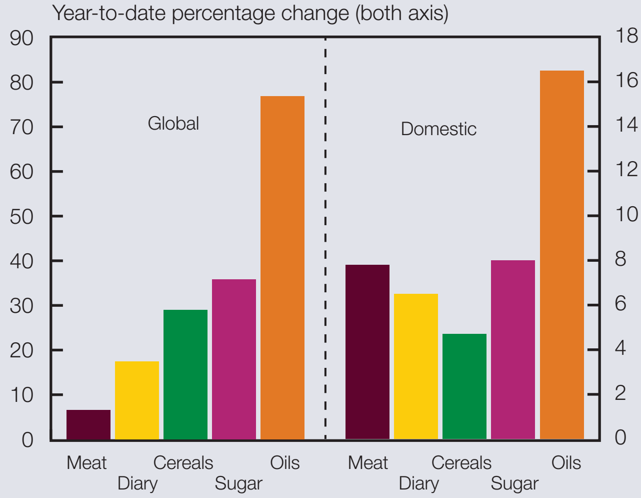
Correlation coefficients



Sources: Stats SA, UN FAO and SARB

Global and domestic food prices

Year-to-date percentage change (both axis)



Sources: UN FAO and Stats SA

Box 7 High global food prices: a risk to domestic inflation?

While South Africa largely produces enough food for domestic consumption, local markets are well integrated with global markets. Local food prices respond to global factors mediated by exchange rate movements and domestic market imbalances that shift pricing between import and export prices. As a result, global price developments are a key consideration for food price inflation forecasting and monetary policy.

Why are global prices surging?

Global food prices have risen sharply over the past year, with the dollar-denominated United Nations (UN) Food and Agricultural Organization's (FAO) food price index surging to a multi-year high of 40.4% in May 2021, before moderating slightly.[1] High crude oil prices, strong import demand from China and lower crop harvests in Europe, parts of the United States and South America (due to adverse weather conditions), partly explain the surge. Other drivers include the COVID-19-induced labour shortages in Malaysia that continue to curb palm oil production and unfavourable weather conditions in Brazil pushing up global sugar prices. Stronger demand for grains and sugarcane from biofuels have also pushed prices higher, while lockdowns have disrupted supply chains. These adverse effects are exacerbated by rising logistics costs.

Domestic prices also rising

In tandem with global food prices, domestic food and non-alcoholic beverages (NAB) inflation has risen strongly, despite bumper harvests. The recent food inflation is broad-based, with almost three quarters of the food basket increasing beyond the 4.5% target midpoint, keeping headline consumer price inflation elevated. Food price inflation, however, may have peaked at 6.9% in August 2021, the highest reading since June 2017.

Despite global integration, local factors have become more important in explaining food inflation. Focusing on the five components that make up the UN FAO food price index (meat, grains, sugar, vegetable oils and dairy products), the correlation coefficient declined from 0.82 pre-global financial crisis (GFC) to 0.54 post-GFC, suggesting that changes in global food prices have become less informative about the trajectory for domestic food prices. Dairy and meat products reveal a complete breakdown in global and domestic price co-movement, reflecting South Africa's self-sufficiency in these food groups. The correlation also declined sharply for cereals, for which South Africa is a net exporter of maize, though domestic grain prices tend to broadly follow international prices.

Domestic oils and fats prices continue to move closely with global prices, while the correlation increased sharply for sugar, relative to the pre-GFC period. Despite the small weights for oils and fats and sugar in the food and NAB basket (2.6% and 3.2% respectively) the sharp rise in the international prices of these commodities in recent months (FAO sugar rose by 58% in April and oils by 124% in May 2021) lifted domestic sugar prices up to 8.7% in May, and oils and fats prices to a multi-year high of 22.4% in July 2021.

1 In rand terms, the UN FAO index has increased by much less, cushioned by the relatively stronger rand.

Outlook

Global agricultural food prices are expected to ease as energy prices stabilise and supply chains regularise, Chinese demand slows and weather conditions in major growing regions improve. Indeed, global food prices have begun to moderate, at least on a month-on-month basis, and this should filter through to domestic food price inflation in the coming months.[2] Upside risks to global food inflation remain, however, in the form of potentially higher crude oil prices, continued adverse weather events or other supply-side shocks (e.g. further COVID-19 waves) in major food producing regions.

2 The recent increases in domestic food and NAB inflation are largely driven by local factors. For example, sticky domestic meat inflation is underpinned by reduced slaughtering activity.

Box 8 Unpacking the large 2020 inflation forecast errors

The COVID-19 pandemic has posed unique challenges for macroeconomic forecasting. Most forecasting models rely on past relationships among observational data to project future states. With a large shock as COVID-19, some relationships will have (temporarily) broken down, implying that forecasts made on past relationships alone could lead to substantial errors.

An error decomposition using the different drivers of headline inflation shows upside errors on headline inflation, largely driven by fuel and core services inflation, especially for forecasts generated prior to the shock. Together, these components account for about 90% of the error on headline.[1]

The errors in fuel inflation derive from the unexpected collapse in global oil prices, which reached a low of US$12.50 per barrel in April 2020. This resulted in a sharp drop in domestic fuel prices, to R12.22 per litre[2] in May 2020, from R15.84 in March 2020, despite a simultaneous depreciation of the rand.

In services, the sharper-than-expected deceleration in housing inflation (with a weight of 32.8%) created a forecast error of 0.5 percentage points.[3] The average error in core goods inflation reached 1.3 percentage points. This is largely attributable to Statistics South Africa's (Stats SA) imputation techniques for handling missing data from April to August 2020, which effectively reduced the core goods basket by carrying over the petrol price shock to core goods inflation. This affected about 25% of the core goods basket.

The output gap was not a large contributor to the upside error. The rebased data from Stats SA confirms that the extent of weak demand caused by the pandemic (i.e. period since the April 2020 Monetary Policy Committee (MPC) meeting) was overstated as the economy was not as badly impacted as the old gross domestic product (GDP) data suggested.[4] Another big contributor is the model residual, which reflects the inflation drivers not clearly explained by the model structure, and reveals how difficult it can be for models to explain very large shocks.[5] Augmenting the model with 'outside information' as the shock is more clearly seen in the data, however, helps to minimise future model errors.

1 Analysts on the *Reuters survey* also had large forecast errors, comparable to that of the SARB.

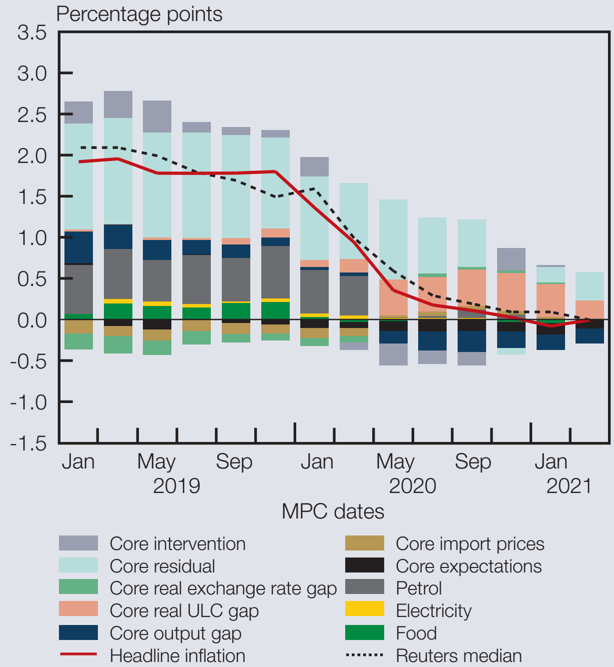
2 For Gauteng, 95 unleaded petrol.

3 Throughout the box, forecast error represents the average error on the annual 2020 figure between the January 2019 MPC and January 2021 MPC, unless stated otherwise.

4 To calculate the error on the output gap, the September 2021 MPC output gap (estimated using the latest GDP data) was used versus those in the previous MPCs (estimated using 2010-based GDP). See real economy chapter for more details on the revisions to the output gap.

5 The model is estimated based on past long run relationships which do not capture unforeseen events such as the global financial crisis (GFC) and COVID-19 shocks.

Contributions to 2020 inflation error (forecast-actual)



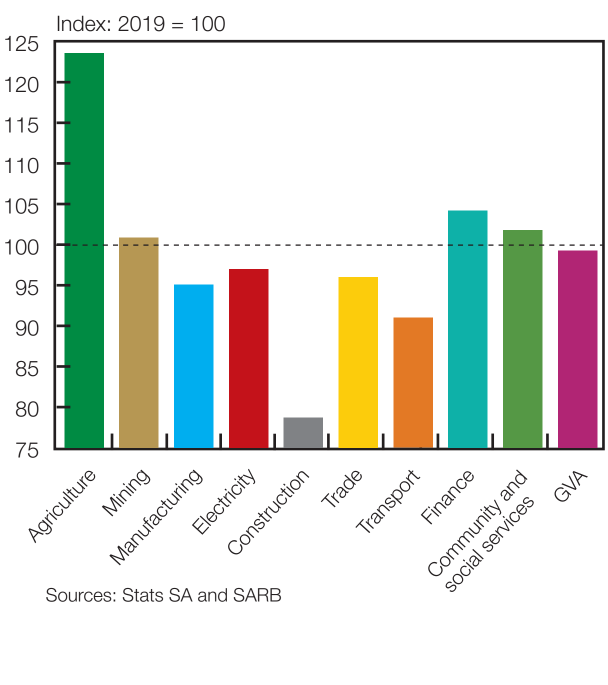
Sources: Stats SA and SARB

Conclusion

Despite the severe economic recession in 2020, the effects of the COVID-19 pandemic on the global economy are slowly fading. The recovery of the global economy has been robust, underpinned by unprecedented stimuli – both fiscal and monetary, and more recently supported by widespread vaccination roll-out. Growth rates of 6.0% and 4.9% are projected for 2021 and 2022 respectively.[39] The recovery has correlated strongly with access to vaccines, which has been uneven. Advanced economies, which on average have achieved higher rates of vaccination, show greater growth momentum in 2021 while developing economies, with lower vaccination rates, have had their growth projections for 2021 slashed as the COVID-19 Delta variant has spread.

The domestic economy has rebounded strongly following the 6.4% contraction in 2020. The benchmarked and rebased GDP data show that economic activity is largely back to the pre-pandemic level, indicating that the recovery had been underestimated. Despite the broad recovery, construction, manufacturing, transport and trade sectors remain below the 2019 levels, reflecting the lingering effects of the COVID-19 waves. The riots and looting in July have set the recovery back and may have caused a contraction of the economy in the third quarter. Notwithstanding these setbacks, the economy is expected to grow at 5.3% in 2021, the highest annual growth rate since 2007.

Output: 2021Q2 compared to 2019 level



Sources: Stats SA and SARB

The robust recovery of the domestic economy was underpinned by a combination of record-low borrowing costs, strong fiscal support, including social relief measures, and high commodity prices and surging terms of trade. Together, these factors raised real incomes of households and corporates, eased debt repayment pressures and, for those facing binding budget constraints, boosted real consumption. Government benefitted from the low interest rates through lower costs of borrowing while the fiscal position was further buoyed by high commodity prices.

To provide impetus to the recovery, the MPC held the repo rate unchanged at 3.5% over the past six months, bringing to seven the number of meetings over which the repo rate was left unchanged. Inflation is projected at 4.4% in 2021 and 4.2% in 2022, before edging back to the target midpoint by 2023. The relatively benign medium-term inflation outlook underpins the MPC's decisions to hold rates lower for longer with deference

39 IMF *WEO Update* (July 2021).

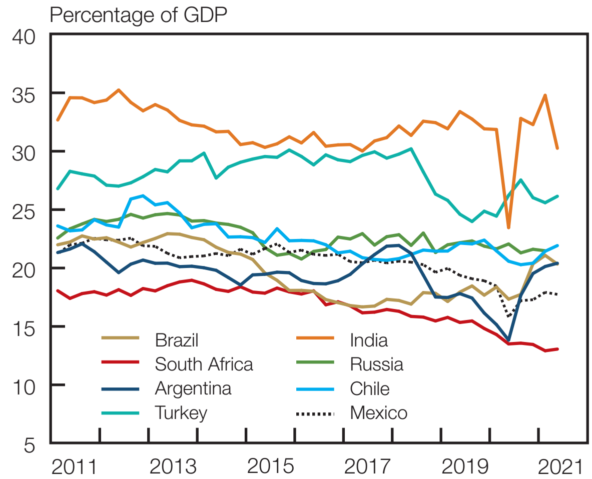
to the recovery. However, the stronger than expected recovery in economic activity suggests that underlying price pressures may be stronger than initially thought. With inflation around the target midpoint and the output gap closing, the repo rate needs to adjust to its estimated neutral level over the medium term, to reduce the stimulus and keep inflation contained. Delaying the lift-off could see the monetary policy authorities playing catch-up with inflation, potentially destabilising the relatively well-anchored inflation expectations.[40]

The output gap has been revised narrower following the benchmarking and rebasing of GDP, reflecting the higher GDP growth and the slight upward adjustment to potential growth. Lower investment and electricity supply constraints explain the modest adjustment to potential growth, despite stronger GDP outcomes. Investment is weaker than previously estimated and significantly lower than peer emerging market comparators, reflecting a myriad of constraints, including inadequate electricity supply, inefficiencies in key infrastructure sectors, skills shortages, regulatory burdens and weak product market competition. These bottlenecks raise the cost of doing business and act as brakes on new investment.

The near-term fiscal outlook has brightened as revenue has overperformed. Debt and fiscal balances have improved, benefitting from the higher commodity prices and surging terms of trade, as well as stronger GDP growth over the past year. There, however, remain material risks to the medium-term fiscal outlook, including a sharp correction in commodity prices, growth slowing towards the low potential growth rate and temporary spending becoming permanent. The 2021 Budget sets out a fiscal trajectory that, if implemented, would help stabilise public debt.

Beyond the recovery, the MPC has highlighted the importance of structural reforms in assuring higher and sustainable growth in South Africa. Providing sufficient energy for growth, reducing the impact of administered prices on overall inflation and stabilising public debt, among other things, would improve the investment climate. The domestic economy would also benefit from permanently lower inflation, which would help better anchor inflation expectations, reduce volatility of the rand and permanently lower the neutral interest rate, with immediate feedthrough to borrowing costs.

Gross fixed capital formation of selected emerging markets



Sources: Haver and SARB

40 The MPC has repeatedly emphasised the data-dependent nature of its decision-making and will continue to closely monitor the changing data. Indeed, the committee will begin to face a trade-off of an earlier gradual normalisation or a steeper repo rate trajectory on the back of a delayed lift off.

Statement of the Monetary Policy Committee

20 May 2021

Issued by Lesetja Kganyago, Governor of the South African Reserve Bank, at a meeting of the Monetary Policy Committee in Pretoria

The steady rate of vaccination in many countries has lifted projections for global economic growth and boosted confidence, significantly. Vaccination rates have not been uniform, however, with many emerging and developing countries lagging behind. This uneven vaccination roll-out will weigh heavily on some countries more than others and on economic activity in sectors that are more dependent on close contact, such as travel, tourism, hospitality and leisure.

Until vaccination is widespread and populations develop sufficient immunity to curb virus transmission, it is expected that waves of infection will continue. As indicated by South Africa's public health authorities, a third wave of virus infection is probable in the near future.

The International Monetary Fund's (IMF) April forecast for global gross domestic product (GDP) for 2021 was revised up to 6.0%. The South African Reserve Bank's (SARB) forecast for global growth in 2021 now also sits at 6.0%.[1] For 2022, we expect global growth of about 3.8%.

Although policy settings in advanced economies remain accommodative, higher global inflation and greater uncertainty about world interest rates has contributed to more recent financial market and capital flow volatility. This reflects persistent risk aversion, especially for emerging market economies that fail to take advantage of improved global prospects or run large macroeconomic imbalances.

Following an expansion of 6.3% in the fourth quarter of 2020, the SARB's forecast for South Africa's first quarter growth stands at 2.7%, much stronger than the 0.2% contraction expected at the time of the March meeting. The economy is expected to grow by 4.2% in 2021 (up from 3.8%).

The stronger growth forecast for 2021 reflects better sectoral growth performances and a more robust terms of trade in the first quarter of this year. Despite rising oil prices and a higher total import bill, commodity prices have risen to new highs, strengthening income gains to the economy. Household spending is expected to be healthy this year, in line with the easing of lockdown restrictions and low interest rates.

Getting back to pre-pandemic output levels, however, will take time. Supply responses remain muted in some sectors harder hit by the pandemic. Investment, while stabilising, remains constrained. GDP is expected to grow by 2.3% in 2022 and by 2.4% in 2023, little changed since the March meeting.

Overall, and after upward revisions, the risks to the domestic growth outlook are assessed to be balanced. Moderate growth in household spending is expected over the forecast horizon and global conditions are generally supportive of growth. Slow progress on vaccinations, limited energy supply and policy uncertainty continue to pose downside risks to growth.

The large current account surplus at present reflects good growth and higher prices for exports, still moderate prices for imported oil, and slowly reviving demand for imported consumer and investment goods. This surplus is expected to give way to a modest current account deficit by next year (2022), as exports slow and imports accelerate.[2] Although financing conditions have modestly improved and fiscal risk has eased, the yield curve for rand-denominated bonds remains steep.

The generally favourable global conditions and strong commodity export prices have led to the appreciation of the rand through the latter half of 2020 and into this year, moving the currency close to its long-run equilibrium level. Since the March meeting, the rand has appreciated by 4% on a trade-weighted basis. The implied starting point for the rand forecast is R14.46 to the US dollar, compared with R14.96 at the time of the previous meeting.

Headline consumer price inflation averaged 3.3% in 2020. The forecast for 2021 is slightly lower at 4.2% (down from 4.3%) and for 2022 and 2023 unchanged at 4.4% and 4.5% respectively.

In 2020, core inflation also averaged 3.3%. The forecast for 2021 is lower at 3.0% (down from 3.3%) and unchanged for 2022 and 2023 at 4.0% and 4.3% respectively.

At a global level, a wide range of prices is accelerating, from raw materials to intermediate inputs to food, reflecting both global supply shortages and rising demand. Oil prices were revised up sharply in the previous forecast, and remain unchanged, resulting in petrol price inflation of 12.5% for 2021 (down slightly from 12.7%).[3] Electricity prices are significantly higher at 10.6% for 2021 (up from 9.7%).

Going forward, a stronger exchange rate, ongoing moderation in unit labour costs and sustained economic slack are expected to offset higher electricity and food

1 Global growth in the Quarterly Projection Model (QPM) is a trade-weighted average of South Africa's trading partners. The IMF's global forecast for 2022 sits at 4.4%.

2 The current account is expected to be in surplus of 2.0% of GDP in 2021, shifting to a deficit of 0.6% in 2022.

3 Our assumptions are now for oil prices to average about US$62 per barrel in 2021 and US$60 per barrel in 2022 and in 2023.

price inflation, keeping the headline inflation forecast relatively stable.

Expectations of future inflation have broadly stabilised at around 4.0% for 2021 and 4.2% for 2022. Market-based expectations for inflation are slightly lower for 2021 and over longer horizons.[4]

The overall risks to the inflation outlook appear to be to the upside. Housing-led services price inflation may continue to surprise to the downside. Food price inflation, already very high globally, has also been more moderate than expected in the South African market, due to a stronger exchange rate and robust crop production. Domestic and global producer price inflation have been rising. Further risks could arise from higher domestic import tariffs and escalating wage demands. Despite generally low pass-through, a weaker rand would create additional upside risk to inflation, alongside the ongoing risk from electricity and other administered prices. Oil prices have increased sharply this year and, while forecast to remain at current levels, are subject to increasing upside risk as recent data has shown.

Compared to the March meeting, a higher growth forecast implies a small further narrowing of the output gap over the forecast period.

The policy stance and repurchase rate level remain highly accommodative and will remain so even with steps taken to normalise interest rate levels in response to rising inflation. With inflation expectations remaining stable, and despite inflation risk increasing, the Monetary Policy Committee (MPC) still expects inflation to be contained in 2021, before rising to around the midpoint of the inflation target range in 2022 and 2023.

Against this backdrop, the MPC decided to keep rates unchanged at 3.5% per annum. The decision was unanimous.

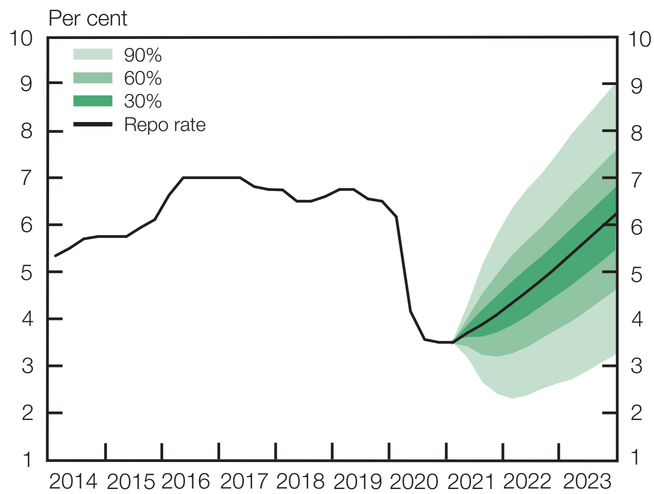
The implied policy rate path of the QPM indicates an increase of 25 basis points in each of the second and fourth quarters of 2021.

Monetary policy continues to be accommodative, keeping financial conditions supportive of credit demand as the economy recovers from the pandemic and associated lockdowns. The SARB has ensured adequate liquidity in domestic markets and will continue to closely monitor funding markets for stress. In addition, regulatory relief provided to banks continues to support lending to households and firms.

Important macroeconomic gains would be realised by achieving a stable public debt level, increasing the supply of energy, moderating administered price inflation and keeping wage inflation low into the recovery. Such steps will enhance the effectiveness of monetary policy and its transmission to the broader economy.

Economic and financial conditions are expected to remain volatile for the foreseeable future. In this uncertain environment, policy decisions will continue to be data dependent and sensitive to the balance of risks to the outlook. The MPC will seek to look through temporary price shocks and focus on second round effects. As usual, the repo rate projection from the QPM remains a broad policy guide, changing from meeting to meeting, in response to new data and risks.

Repurchase rate forecast (May 2021)



The uncertainty bands for the repo rate are based on historical forecasting experience and stochastic simulations in the QPM. The bands are symmetric and do not reflect any assessment of upside or downside risk.

Source: SARB

4 The (Q1) Bureau for Economic Research (BER) survey expectations for 2021 remain at 3.9%, 4.2% for 2022 and 4.4% for 2023. Market analysts (Reuters Econometer) expect inflation to be higher at 4.2% (from 4.1%) in 2021, unchanged at 4.3 in 2022 and slightly lower at 4.4% in 2023 (down from 4.5%). Market-based rates are calculated from the break-even inflation rate, which is the yield differential between conventional and inflation-linked bonds. These now sit at 4.5% for the five-year and 5.98% on the 10-year breakeven. 15-year breakeven inflation sits at 6.43%.

Summary of assumptions: Monetary Policy Committee meeting on 20 May 2021*

1. Foreign sector assumptions

	Actual			Forecast		
	2018	2019	2020	2021	2022	2023
1. Real GDP growth in South Africa's major trading-partner countries	3.3%	2.2%	-2.8%	6.0%	3.8%	3.4%
	(3.3%)	(2.2%)	(-3.1%)	(5.8%)	(3.7%)	(3.3%)
2. Output gap in South Africa's major trading-partner countries (ratio to potential GDP)	0.6%	0.4%	-2.8%	-1.5%	-0.2%	0.7%
	(0.6%)	(0.4%)	(-2.7%)	(-1.6%)	(-0.4%)	(0.3%)
3. Change in international commodity prices in US$ (excluding oil)	11.5%	-1.1%	25.4%	40.8%	-20.3%	-0.6%
	(11.5%)	(-1.1%)	(25.5%)	(23.3%)	(-13.0%)	(0.0%)
4. Brent crude (US$/barrel)	71.0	64.4	41.8	62.2	60.0	60.0
	(71.0)	(64.4)	(41.8)	(62.0)	(60.0)	(60.0)
5. Change in world food prices (US$)	-2.2%	-0.8%	3.1%	5.2%	0.8%	1.4%
	(-2.2%)	(-0.8%)	(3.1%)	(4.5%)	(1.7%)	(1.4%)
6. Change in international consumer prices	2.0%	1.4%	0.7%	2.0%	2.1%	2.4%
	(2.0%)	(1.4%)	(0.7%)	(1.6%)	(1.6%)	(1.8%)
7. International policy interest rate	0.9%	1.1%	0.2%	0.0%	0.0%	0.0%
	(0.9%)	(1.1%)	(0.2%)	(0.0%)	(0.0%)	(0.0%)

2. Domestic sector assumptions

	Actual			Forecast		
	2018	2019	2020	2021	2022	2023
1. Change in electricity price	5.2%	9.6%	9.1%	10.6%	12.1%	10.0%
	(5.2%)	(9.6%)	(9.1%)	(9.7%)	(11.4%)	(10.0%)
2. Change in fuel taxes and levies	8.9%	5.8%	5.7%	5.2%	4.9%	4.7%
	(8.9%)	(5.8%)	(5.7%)	(5.1%)	(4.9%)	(4.7%)
3. Potential growth	0.7%	0.3%	-2.5%	1.6%	0.9%	0.9%
	(0.7%)	(0.3%)	(-2.5%)	(1.6%)	(0.9%)	(0.9%)
4. Inflation target midpoint	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%
	(4.5%)	(4.5%)	(4.5%)	(4.5%)	(4.5%)	(4.5%)
5. Neutral real interest rate	1.9%	2.1%	2.0%	2.1%	2.3%	2.3%
	(1.9%)	(2.1%)	(2.0%)	(2.1%)	(2.3%)	(2.3%)

Notes

1. Shaded areas indicate forecast assumptions.
2. The figures in brackets represent the previous assumptions of the Monetary Policy Committee.

* For an explanation of foreign sector assumptions and domestic sector assumptions, see pages 62 and 63.

Summary of selected forecast results: Monetary Policy Committee meeting on 20 May 2021*

Selected forecast results (quarterly)

Year-on-year percentage change

	2020				2021				2022				2023			
	3.3 (3.3)				4.2 (4.3)				4.4 (4.4)				4.5 (4.5)			
1. Headline inflation	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
	4.4	2.4	3.1	3.2	3.1	4.7	4.3	4.6	4.6	4.3	4.2	4.4	4.4	4.4	4.5	4.5
	(4.4)	(2.4)	(3.1)	(3.2)	(3.2)	(4.9)	(4.5)	(4.7)	(4.6)	(4.3)	(4.2)	(4.3)	(4.4)	(4.5)	(4.5)	(4.5)
	2020				2021				2022				2023			
	3.3 (3.3)				3.0 (3.3)				4.0 (4.0)				4.3 (4.3)			
2. Core inflation	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
	3.7	3.1	3.3	3.3	2.8	3.1	3.0	3.3	3.8	3.9	4.1	4.2	4.2	4.2	4.3	4.4
	(3.7)	(3.1)	(3.3)	(3.3)	(3.0)	(3.3)	(3.3)	(3.6)	(3.9)	(4.1)	(4.1)	(4.1)	(4.2)	(4.3)	(4.4)	(4.5)

Notes

1. Shaded areas indicate the forecasts of the Monetary Policy Committee.
2. The figures in brackets represent the previous forecasts of the Monetary Policy Committee.

Selected forecast results (annual)

	Actual			Forecast		
	2018	2019	2020	2021	2022	2023
1. GDP growth	0.8%	0.2%	-7.0%	4.2%	2.3%	2.4%
	(0.8%)	(0.2%)	(-7.0%)	(3.8%)	(2.4%)	(2.5%)
2. Output gap (ratio to potential GDP)	-0.9%	-1.0%	-5.9%	-3.2%	-1.9%	-0.4%
	(-0.9%)	(-1.0%)	(-5.9%)	(-3.5%)	(-2.0%)	(-0.5%)
3. Change in nominal effective exchange rate	-1.0%	-7.0%	-12.8%	7.8%	-3.3%	-0.1%
	(-1.0%)	(-7.0%)	(-12.8%)	(2.1%)	(-2.4%)	(0.7%)
4. Change in real effective exchange rate	1.4%	-4.5%	-10.6%	10.0%	-1.3%	1.5%
	(1.4%)	(-4.5%)	(-10.6%)	(4.9%)	(0.3%)	(3.4%)
5. Real exchange rate gap	2.0%	-1.3%	-10.8%	-1.0%	-2.3%	-0.8%
	(2.0%)	(-1.3%)	(-10.8%)	(-5.9%)	(-5.6%)	(-2.3%)
6. Repurchase rate (end of period)	6.60%	6.50%	3.50%	4.07%	5.02%	6.11%
	(6.60%)	(6.50%)	(3.50%)	(3.99%)	(4.95%)	(6.07%)
7. Current account balance (ratio to GDP)	-3.5%	-3.0%	2.2%	2.0%	-0.6%	-1.3%
	(-3.5%)	(-3.0%)	(2.2%)	(1.3%)	(-0.8%)	(-1.3%)

Notes

1. The nominal effective exchange rate (NEER) is based on the bilateral exchange rates of South Africa's three largest trading partners (the euro area, the US and Japan). The bilateral exchange rates are weighted by export trade weights.
2. The real effective exchange rate (REER) is the NEER deflated by the consumer price differential (between South Africa and the trade-weighted CPI of the euro area, the US and Japan).
3. The real exchange rate gap signifies the extent to which the real exchange rate deviates from its estimated equilibrium level. A positive gap shows an overvaluation of the currency, and vice versa.
4. The forecast of the current account balance is obtained from the SARB's Core Macroeconometric Model.
5. Shaded areas indicate the forecasts of the Monetary Policy Committee.
6. The figures in brackets represent the previous forecasts of the Monetary Policy Committee.

Statement of the Monetary Policy Committee

22 July 2021

Issued by Lesetja Kganyago, Governor of the South African Reserve Bank, at a meeting of the Monetary Policy Committee in Pretoria

Despite steady improvements in vaccination rates, stronger confidence and better global economic growth, the COVID-19 pandemic continues to weigh on global prospects. Vaccination rates are lagging in many emerging market and developing countries. Until populations develop sufficient immunity to curb virus transmission, waves of infection are likely to continue. As indicated by South Africa's public health authorities, a third wave of virus infection is currently peaking. Additionally, by raising uncertainty and reducing investor confidence, the recent unrest in parts of the country is likely to slow our ongoing recovery.

Lockdowns and other restrictive measures that remain in place in a number of countries will continue to weigh on economic activity, particularly in sectors dependent on close contact, such as travel, tourism, hospitality and leisure. The International Monetary Fund's (IMF) April forecast for global gross domestic product (GDP) for 2021 is 6.0%, and will be updated later this month. The South African Reserve Bank's (SARB) forecast for global growth in 2021 now sits at 6.1%.[1] For 2022, we expect global growth of 4.4% and 3.4% in 2023. Recoveries in emerging market and developing economies are expected to lag those in advanced economies, in large part due to a slower pace of vaccinations.

Although policy settings in advanced economies remain accommodative, the spread of the Delta variant, higher global inflation and uncertainty about the normalisation path for interest rates continue to cause financial market and capital flow volatility. This is reflected in persistent risk aversion, especially towards emerging market economies that fail to take advantage of improved global prospects or run large macroeconomic imbalances.

The domestic economy grew by 4.6% in the first quarter of 2021, much stronger than the 2.7% expected at the time of our May meeting. That outcome reflected better sectoral growth performances and robust terms of trade. Commodity prices have remained high, sustaining income gains despite higher oil prices.

However, recent unrest and economic damage could have lasting effects on investor confidence and job creation. The unrest is estimated to have fully negated the better growth results from the first quarter, resulting in an unchanged estimate of 4.2% for growth in 2021.

The direct and indirect costs of recent events will likely further slow South Africa's economic recovery. Although some sectors, notably mining and manufacturing, have largely recovered to pre-pandemic levels, production remains muted in sectors harder hit by the pandemic and in regions now affected by the unrest. The SARB's investment forecast was revised up for this year but remains constrained. Household spending is still expected to be healthy, in line with better than expected salaries and wages, rising asset prices and low interest rates.

GDP is expected to grow by 2.3% in 2022 and by 2.4% in 2023, unchanged since the May meeting.

Overall, and after revisions, the risks to the medium-term domestic growth outlook are assessed to be balanced. High export prices, stronger household incomes and a somewhat better investment outlook are backed up by generally supportive global conditions, despite ongoing financial volatility. Recent events in the country, their impact on vaccinations, a longer than expected lockdown, limited energy supply and policy uncertainty pose downside risks to growth.

The current account surplus remains substantial and reflects good growth and higher prices for exports, still moderate prices for imported oil, and slowly reviving demand for imported consumer and investment goods. This surplus is expected to give way to a modest current account deficit by next year (2022), as exports slow and imports accelerate.[2] Although financing conditions have improved and fiscal risk has eased, the yield curve for rand-denominated bonds remains steep. Long bond yields have returned to pre-pandemic levels of around 9.0% on 10-year bonds.

The generally favourable global conditions and strong commodity export prices have kept the currency close to its long-run equilibrium level, with a year-to-date appreciation of 4% on a trade-weighted basis. Since the May meeting, the rand has depreciated by 0.5% on a trade-weighted basis. The implied starting point for the rand forecast is R14.40 to the US dollar, compared with R14.46 at the time of the previous meeting.

At a global level, a wide range of prices is accelerating, including raw materials, intermediate inputs and food, reflecting both global supply shortages and rising demand. So far, this has had relatively limited pass-through to consumer prices. Our estimate for inflation in the G3 economies was revised slightly higher for 2021 to 2.2% (from 2.0%) and lower in the outer years.[3]

1 Global growth in the Quarterly Projection Model (QPM) is a trade-weighted average of South Africa's trading partners. The IMF's global forecast for 2022 sits at 4.4%.

2 The current account is expected to be in surplus of 3.7% of GDP in 2021, shifting to a deficit of 0.1% in 2022.

3 The G3 comprises the United States, the eurozone and Japan.

Oil prices are revised up, and petrol price inflation is sharply higher at 15.3% (up from 12.5%).[4] Local electricity prices are unchanged at 10.6%.

Headline consumer price inflation for 2021 is revised slightly higher to 4.3% (up from 4.2%), and revised lower to 4.2% (from 4.4%) in 2022. For 2023, headline consumer price inflation remains unchanged at 4.5%.

The forecast for core inflation is revised lower to 2.9% in 2021 (down from 3.0%) and to 3.7% in 2022 (down from 4.0%). Core inflation is expected to be 4.3% in 2023, unchanged from the May forecast.

The SARB's forecast reflects higher food and petrol prices that push up near-term headline inflation, before moderating in the latter half of this year and into 2022. Compared to the May meeting, the current growth forecast implies a wider output gap in the near term. While economic activity strengthens over the forecast period, the current exchange rate level and modest growth in unit labour costs contain the expected rise in core inflation.

The risks to the short-term inflation outlook are assessed to the upside, despite weaker than expected services inflation outcomes in recent months. Rapid global producer price inflation and supply shortages created by disruptions to local transport networks increase these inflation risks. Food price inflation, already very high globally, surprised to the upside in recent months. Petrol, electricity and other administered prices also continue to present short-term risks.

Average surveyed expectations of future inflation have increased by 0.3 percentage points, to 4.2% for 2021 and by 0.2 percentage points, to 4.4% for 2022. Market-based expectations for inflation are slightly higher for 2021 and lower over longer horizons.[5]

Given the medium and long-term projections set out above, a weaker currency, higher domestic import tariffs and escalating wage demands present longer-term upside risks to the inflation forecast.

Despite higher expectations and continued upside risks, the MPC expects inflation to be contained in 2021 and 2022, before rising to around the midpoint of the inflation target range in 2023.

Against this backdrop, the MPC decided to keep rates unchanged at 3.5% per annum. The decision was unanimous.

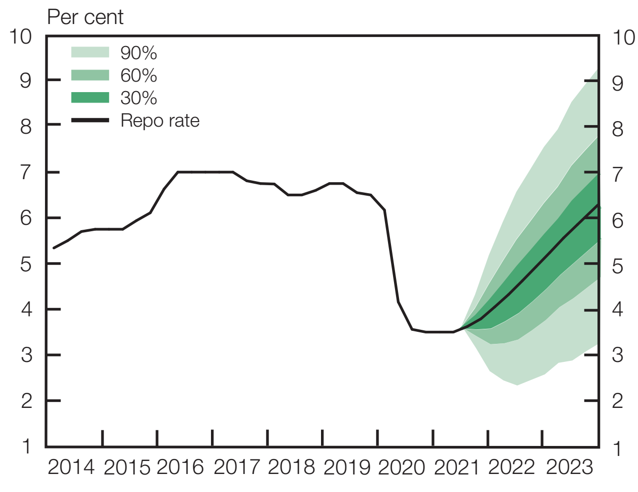
The implied policy rate path of the QPM indicates an increase of 25 basis points in the fourth quarter of 2021 and in each quarter of 2022.

These repurchase rate levels reflect a highly accommodative policy stance through the end of 2022, keeping financial conditions supportive of credit demand as the economy recovers from the pandemic and associated lockdowns.[6] The SARB has ensured adequate liquidity in domestic markets and will continue to closely monitor funding markets for stress. In addition, regulatory relief provided to banks continues to support lending to households and firms.

Better anchored expectations of future inflation could keep interest rates lower for longer, and can be realised by achieving a stable public debt level, increasing the supply of energy, moderating administered price inflation and keeping wage inflation low into the recovery. Such steps will enhance the effectiveness of monetary policy and its transmission to the broader economy.

Economic and financial conditions are expected to remain volatile for the foreseeable future. In this uncertain environment, policy decisions will continue to be data dependent and sensitive to the balance of risks to the outlook. The MPC will seek to look through temporary price shocks and focus on second round effects. As usual, the repo rate projection from the QPM remains a broad policy guide, changing from meeting to meeting in response to new data and risks.

Repurchase rate forecast (July 2021)



The uncertainty bands for the repo rate are based on historical forecasting experience and stochastic simulations in the QPM. The bands are symmetric and do not reflect any assessment of upside or downside risk.

Source: SARB

4 The forecast for petrol prices in 2022 has been revised up from 3.9% in May to 5.5% currently. Our assumptions are now for oil prices to average US$66 per barrel in 2021 and US$65 per barrel in 2022 and US$63 in 2023.

5 The (Q2) Bureau for Economic Research (BER) survey expectations for 2021 rose to 4.2% (up from 3.9%), to 4.4% from 4.2% for 2022, and to 4.5% from 4.4% for 2023. Market analysts (Reuters Econometer) in July expect inflation to be higher at 4.3% (from 4.2%) in 2021, and 4.4% in 2022, up from 4.3%, and unchanged at 4.4% in 2023. Market-based rates are calculated from the break-even inflation rate, which is the yield differential between conventional and inflation-linked bonds. These now sit at 4.6% for the five-year and 5.88% on the 10-year breakeven. 15-year breakeven inflation sits at 6.37%.

6 This implies a rise in the inflation-adjusted repo rate from about -1.0% for 2021 to about 0.5% by the end of 2022. The real repurchase rate calculation here is based on the one-quarter ahead inflation forecast.

Summary of assumptions: Monetary Policy Committee meeting on 22 July 2021*

1. Foreign sector assumptions

	Actual			Forecast		
	2018	2019	2020	2021	2022	2023
1. Real GDP growth in South Africa's major trading-partner countries	3.3%	2.2%	-2.8%	6.1%	4.4%	3.4%
	(3.3%)	(2.2%)	(-2.8%)	(6.0%)	(3.8%)	(3.4%)
2. Output gap in South Africa's major trading-partner countries (ratio to potential GDP)	0.8%	0.6%	-3.3%	-1.6%	0.4%	1.5%
	(0.6%)	(0.4%)	(-2.8%)	(-1.5%)	(-0.2%)	(0.7%)
3. Change in international commodity prices in US$ (excluding oil)	11.5%	-1.2%	25.5%	48.1%	-20.8%	-1.8%
	(11.5%)	(-1.1%)	(25.4%)	(40.8%)	(-20.3%)	(-0.6%)
4. Brent crude (US$/barrel)	71.0	64.4	41.8	66.7	65.0	63.0
	(71.0)	(64.4)	(41.8)	(62.2)	(60.0)	(60.0)
5. Change in world food prices (US$)	-2.2%	-0.8%	3.1%	12.8%	-2.8%	1.5%
	(-2.2%)	(-0.8%)	(3.1%)	(5.2%)	(0.8%)	(1.4%)
6. Change in international consumer prices	2.0%	1.4%	0.7%	2.2%	2.0%	1.8%
	(2.0%)	(1.4%)	(0.7%)	(2.0%)	(2.1%)	(2.4%)
7. International policy interest rate	0.9%	1.1%	0.2%	0.0%	0.0%	0.1%
	(0.9%)	(1.1%)	(0.2%)	(0.0%)	(0.0%)	(0.0%)

2. Domestic sector assumptions

	Actual			Forecast		
	2018	2019	2020	2021	2022	2023
1. Change in electricity price	5.2%	9.6%	9.1%	10.6%	12.1%	10.0%
	(5.2%)	(9.6%)	(9.1%)	(10.6%)	(12.1%)	(10.0%)
2. Change in fuel taxes and levies	9.9%	5.8%	5.7%	5.3%	4.9%	4.7%
	(8.9%)	(5.8%)	(5.7%)	(5.2%)	(4.9%)	(4.7%)
3. Potential growth	0.7%	0.3%	-2.5%	1.6%	0.9%	0.9%
	(0.7%)	(0.3%)	(-2.5%)	(1.6%)	(0.9%)	(0.9%)
4. Inflation target midpoint	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%
	(4.5%)	(4.5%)	(4.5%)	(4.5%)	(4.5%)	(4.5%)
5. Neutral real interest rate	1.9%	2.1%	2.0%	2.1%	2.3%	2.3%
	(1.9%)	(2.1%)	(2.0%)	(2.1%)	(2.3%)	(2.3%)

Notes

1. Shaded areas indicate forecast assumptions.
2. The figures in brackets represent the previous assumptions of the Monetary Policy Committee.

* For an explanation of foreign sector assumptions and domestic sector assumptions, see pages 62 and 63.

Summary of selected forecast results: Monetary Policy Committee meeting on 22 July 2021*

Selected forecast results (quarterly)

Year-on-year percentage change

	2020				2021				2022				2023			
	3.3 (3.3)				4.3 (4.2)				4.2 (4.4)				4.5 (4.5)			
1. Headline inflation	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
	4.4	2.4	3.1	3.2	3.2	4.9	4.6	4.7	4.5	4.1	3.9	4.3	4.4	4.4	4.5	4.5
	(4.3)	(2.4)	(3.1)	(3.2)	(3.2)	(4.7)	(4.3)	(4.6)	(4.6)	(4.3)	(4.2)	(4.4)	(4.4)	(4.4)	(4.5)	(4.5)
	2019				2020				2021				2022			
	3.3 (3.3)				2.9 (3.0)				3.7 (4.0)				4.3 (4.3)			
2. Core inflation	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
	3.7	3.1	3.3	3.3	2.8	3.1	2.8	2.9	3.3	3.6	3.8	4.1	4.2	4.2	4.3	4.4
	(3.7)	(3.1)	(3.3)	(3.3)	(2.8)	(3.1)	(3.0)	(3.3)	(3.8)	(3.9)	(4.1)	(4.2)	(4.2)	(4.2)	(4.3)	(4.4)

Notes

1. Shaded areas indicate the forecasts of the Monetary Policy Committee.
2. The figures in brackets represent the previous forecasts of the Monetary Policy Committee.

Selected forecast results (annual)

	Actual			Forecast		
	2018	2019	2020	2021	2022	2023
1. GDP growth	0.8%	0.2%	-7.0%	4.2%	2.3%	2.4%
	(0.8%)	(0.2%)	(-7.0%)	(4.2%)	(2.3%)	(2.4%)
2. Output gap (ratio to potential GDP)	-0.9%	-1.0%	-5.9%	-3.2%	-1.8%	-0.4%
	(-0.9%)	(-1.0%)	(-5.9%)	(-3.2%)	(-1.9%)	(-0.4%)
3. Change in nominal effective exchange rate	-1.0%	-7.0%	-12.8%	11.5%	-3.4%	-3.6%
	(-1.0%)	(-7.0%)	(-12.8%)	(7.8%)	(-3.3%)	(-0.1%)
4. Change in real effective exchange rate	1.4%	-4.5%	-10.6%	13.6%	-1.4%	-1.1%
	(1.4%)	(-4.5%)	(-10.6%)	(10.0%)	(-1.3%)	(1.5%)
5. Real exchange rate gap	2.0%	-1.3%	-10.8%	2.2%	0.9%	-0.2%
	(2.0%)	(-1.3%)	(-10.8%)	(-1.0%)	(-2.3%)	(-0.8%)
6. Repurchase rate (end of period)	6.60%	6.50%	3.50%	3.79%	4.93%	6.12%
	(6.60%)	(6.50%)	(3.50%)	(4.07%)	(5.02%)	(6.11%)
7. Current account balance (ratio to GDP)	-3.5%	-3.0%	2.2%	3.7%	-0.1%	-0.9%
	(-3.5%)	(-3.0%)	(2.2%)	(2.0%)	(-0.6%)	(-1.3%)

Notes

1. The nominal effective exchange rate (NEER) is based on the bilateral exchange rates of South Africa's three largest trading partners (the euro area, the US and Japan). The bilateral exchange rates are weighted by export trade weights.
2. The real effective exchange rate (REER) is the NEER deflated by the consumer price differential (between South Africa and the trade-weighted CPI of the euro area, the US and Japan).
3. The real exchange rate gap signifies the extent to which the real exchange rate deviates from its estimated equilibrium level. A positive gap shows an overvaluation of the currency, and vice versa.
4. The forecast of the current account balance is obtained from the SARB's Core Macroeconometric Model.
5. Shaded areas indicate the forecasts of the Monetary Policy Committee.
6. The figures in brackets represent the previous forecasts of the Monetary Policy Committee.

Statement of the Monetary Policy Committee

23 September 2021

Issued by Lesetja Kganyago, Governor of the South African Reserve Bank, at a meeting of the Monetary Policy Committee in Pretoria

A steady improvement in vaccination rates will sustain confidence and global economic growth, even with expected further waves of the COVID-19 virus. However, vaccination rates are lagging in many emerging market and developing economies. Until populations develop sufficient immunity to curb virus transmission, waves of infection are likely to continue, with ongoing poor economic outcomes. At this time, the third wave of the virus infection has peaked in South Africa. The virus, however, is only one of a series of current risks to the economic recovery that include rising inflation, weaker commodity export prices and the longer-term impact of scarring from the pandemic and the July unrest.

The International Monetary Fund's (IMF) forecast for global gross domestic product (GDP) for 2021 is 6.0%, and it will be updated again in early October. The South African Reserve Bank's (SARB) forecast for global growth in 2021 now sits at 6.2% (up from 6.1%).[1] For 2022 and 2023, we still expect global growth of 4.4% and 3.4% respectively. Recoveries in emerging market and developing economies are expected to lag those in advanced economies, in large part due to a slower pace of vaccinations.

Although policy settings in advanced economies remain accommodative, the spread of the Delta variant, higher global inflation and uncertainty about the normalisation path for interest rates continue to cause financial market turmoil and capital flow volatility. Risk aversion persists where economies fail to take advantage of improved global prospects or to reduce large macroeconomic imbalances.

The domestic economy grew by 4.2% in the first quarter of 2021 and by 4.7% in the second quarter. These outcomes reflect better sectoral growth performances and robust terms of trade. Commodity prices have been extraordinarily high, sustaining income gains despite somewhat higher oil prices. While more South Africans have re-entered the jobs market as economic activity resumed, the loss of jobs suggests persistent adjustment and sustained weakness in some sectors. Household spending remains healthy, however, in line with better-than-expected salaries and wages, rising asset prices and low interest rates.

The SARB's forecast for fixed investment was revised up for this year but remains constrained, and, as a result of the GDP revisions by Statistics South Africa (Stats SA), is lower as a share of economic activity.[2]

The economy is expected to grow by an upwardly revised 5.3% this year (from 4.2%), despite the much larger negative effect on output than was previously estimated from the July unrest. Our revised estimate for third quarter economic growth is -1.2%, compared to the previous -0.5%. Output in the manufacturing sector fell by 8.0% in July alone. Mining was up by 4.1%, while land freight transport fell by 5.0% and retail output was down by 11.2%.

The July events and the pandemic are likely to have lasting effects on investor confidence and job creation, impeding recovery in labour-intensive sectors hardest hit by the lockdowns. GDP is expected to grow by 1.7% in 2022 (down from 2.3%), and by 1.8% in 2023 (down from 2.4%).

Overall, and after revisions, the risks to the medium-term domestic growth outlook are assessed to be balanced, as most of the bounce back from the recovery is now in the past. High export prices are expected to fade, while very weak job creation will slow household consumption. Investment will remain constrained by the still limited energy supply and ongoing policy uncertainty. The faster vaccine roll-out presents upside risks to the growth outlook.

The current account surplus remains large, at 5.6% of GDP, reflecting high prices for mining and agricultural exports, still gradually rising oil prices, and slowly reviving demand for imported consumer and investment goods. The surplus is expected to shrink to about 0.7% of GDP for next year (2022), as exports slow and imports accelerate.[3]

Long bond yields have returned to pre-pandemic levels of around 9.0% on 10-year bonds. Although financing conditions have improved and fiscal risk has eased, the yield curve for rand-denominated bonds remains steep.

The generally favourable global conditions and strong commodity export prices have strengthened the currency above its long-run equilibrium level, with a year-to-date appreciation of 1.5% on a trade-weighted basis. Since the July meeting, the rand has depreciated by 1%. The implied starting point for the rand forecast is R14.47 to the US dollar, compared with R14.40 at the time of the previous meeting.

At a global level, a wide range of prices is accelerating, including raw materials, intermediate inputs and food. This reflects both global supply shortages and strong demand. This has passed through to consumer prices in some major economies. Our estimate for inflation in the Group of Three (G3) was revised higher for 2021 to 2.4% (from 2.2%) and remains the same in the outer years.[4]

1 Global growth in the Quarterly Projection Model (QPM) is a trade-weighted average of South Africa's trading partners. The IMF's July *World Economic Outlook* global forecast for 2022 sits at 4.9%.

2 Statistics South Africa released its revision on 25 August 2021. The main effect of the revisions is to the aggregate level of output in the economy, which was revised up significantly.

3 The current account is expected to be in surplus of 4.6% of GDP in 2021, shifting to a deficit of 0.3% in 2023.

4 The G3 comprises the United States, eurozone and Japan. G3 inflation for 2022 is 2.0% and 1.8% for 2023.

Oil prices are revised up for this year, and petrol price inflation is higher at 16.1% (up from 15.3%).[5] Local electricity prices are lower at 10.1% (down from 10.5%).

Headline consumer price inflation for 2021 is revised slightly higher to 4.4% (up from 4.3%), and remains unchanged at 4.2% in 2022 and 4.5% in 2023.

The forecast for core inflation is revised higher to 3.0% in 2021 (up from 2.9%) and to 3.8% in 2022 (up from 3.7%). Core inflation is expected to be 4.3% in 2023, unchanged from the July forecast.

The SARB's forecast reflects higher headline inflation for the rest of this year, before moderating in 2022. Compared to the July meeting and taking into account higher household consumption and less investment from the recent GDP revisions, the output gap is narrower historically and over the forecast period.[6]

While economic activity continues to expand over the forecast period, a rise in core inflation is moderated by the current strength of the exchange rate and modest unit labour costs.

The risks to the short-term inflation outlook are assessed to the upside. Rapid global producer price and food price inflation have surprised to the upside in recent months and could do so again. Oil prices have become more volatile in recent weeks and could rise beyond our expectations. Electricity and other administered prices also continue to present short-term risks. Given the medium and long-term projections set out above, a weaker currency, higher domestic import tariffs and escalating wage demands present further longer-term upside risks to the inflation forecast.

Average surveyed expectations of future inflation remain unchanged at 4.2% for 2021 and 4.4% for 2022. Market-based expectations for inflation are slightly higher for 2021 at 4.4% (up from 4.3%) and stable over longer horizons.[7]

With largely unchanged inflation expectations and even with continued upside risks, the MPC expects inflation to stay close to the midpoint over the forecast period.

Against this backdrop, the MPC decided to keep rates unchanged at 3.5% per annum. The decision was unanimous.

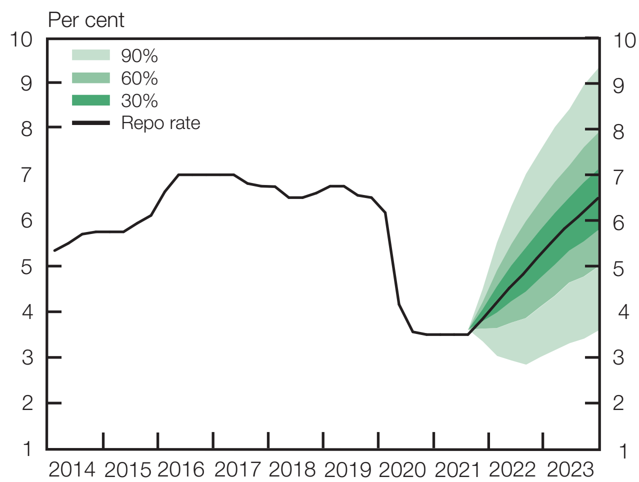
The implied policy rate path of the QPM indicates an increase of 25 basis points in the fourth quarter of 2021 and further increases in each quarter of 2022 and 2023.

These repurchase rate levels reflect a highly accommodative policy stance through the end of the forecast, keeping financial conditions supportive of credit demand as the economy continues to recover.[8] The SARB has ensured adequate liquidity in domestic markets and will continue to closely monitor funding markets for stress. In addition, regulatory relief provided to banks continues to support lending to households and firms.

Better anchored expectations of future inflation could keep interest rates lower for longer and can be realised by achieving a stable public debt level, increasing the supply of energy, moderating administered price inflation and keeping wage inflation low into the recovery. Such steps will enhance the effectiveness of monetary policy and its transmission to the broader economy.

Economic and financial conditions are expected to remain volatile for the foreseeable future. In this uncertain environment, policy decisions will continue to be data dependent and sensitive to the balance of risks to the outlook. The MPC will seek to look through temporary price shocks and focus on second round effects. As usual, the repo rate projection from the QPM remains a broad policy guide, changing from meeting to meeting in response to new data and risks.

Repurchase rate forecast (September 2021)



The uncertainty bands for the repo rate are based on historical forecasting experience and stochastic simulations in the QPM. The bands are symmetric and do not reflect any assessment of upside or downside risk.

Source: SARB

5 The forecast for petrol prices in 2022 is revised down from 5.5% in July to 3.7% currently. Our assumptions are now for oil prices to average US$69 per barrel in 2021 and US$67 per barrel in 2022 and US$65 in 2023.

6 The GDP revisions resulted in a higher level of output, consumption and lower investment, among other changes. Upward revisions to potential growth were not as large as the GDP level revisions, implying somewhat higher demand and therefore a smaller output gap than estimated pre-revision. For 2020, the output revisions also implied more of a negative supply shock than previously estimated, which then reversed in 2021, resulting in re-estimates of the output gap for each of these years.

7 The (Q3) Bureau for Economic Research (BER) survey expectations remain unchanged at 4.2%, 4.4% and to 4.5% for the three years. Market analysts (Reuters Econometer) in September expect inflation to be higher at 4.4% (from 4.3%) in 2021, unchanged at 4.4% in 2022 and lower at 4.2% in 2023. Market-based rates are calculated from the break-even inflation rate, which is the yield differential between conventional and inflation-linked bonds. These now sit at 4.79% for the five-year and 5.98% on the 10-year break-even. The 15-year break-even inflation sits at 6.31%.

8 This implies a rise in the inflation-adjusted repo rate from -1.0% for 2021 to about 0.6% for 2022 and 1.5% for 2023. The real repurchase rate calculation here is based on the one-quarter ahead inflation forecast.

Summary of assumptions: Monetary Policy Committee meeting on 23 September 2021*

1. Foreign sector assumptions

	Actual			Forecast		
	2018	2019	2020	2021	2022	2023
1. Real GDP growth in South Africa's major trading-partner countries	3.3%	2.2%	-2.9%	6.2%	4.4%	3.4%
	(3.3%)	(2.2%)	(-2.8%)	(6.1%)	(4.4%)	(3.4%)
2. Output gap in South Africa's major trading-partner countries (ratio to potential GDP)	0.8%	0.6%	-3.1%	-1.4%	0.4%	1.5%
	(0.8%)	(0.6%)	(-3.3%)	(-1.6%)	(0.4%)	(1.5%)
3. Change in international commodity prices in US$ (excluding oil)	11.5%	-1.2%	25.5%	48.3%	-20.1%	-2.7%
	(11.5%)	(-1.2%)	(25.5%)	(48.1%)	(-20.8%)	(-1.8%)
4. Brent crude (US$/barrel)	71.0	64.4	41.8	69.0	67.0	65.0
	(71.0)	(64.4)	(41.8)	(66.7)	(65.0)	(63.0)
5. Change in world food prices (US$)	-2.2%	-0.8%	3.1%	13.4%	-3.1%	1.5%
	(-2.2%)	(-0.8%)	(3.1%)	(12.8%)	(-2.8%)	(1.5%)
6. Change in international consumer prices	2.0%	1.4%	0.7%	2.4%	2.0%	1.8%
	(2.0%)	(1.4%)	(0.7%)	(2.2%)	(2.0%)	(1.8%)
7. International policy interest rate	0.9%	1.1%	0.2%	0.0%	0.0%	0.1%
	(0.9%)	(1.1%)	(0.2%)	(0.0%)	(0.0%)	(0.1%)

2. Domestic sector assumptions

	Actual			Forecast		
	2018	2019	2020	2021	2022	2023
1. Change in electricity price	5.2%	9.6%	9.1%	10.1%	11.8%	10.0%
	(5.2%)	(9.6%)	(9.1%)	(10.6%)	(12.1%)	(10.0%)
2. Change in fuel taxes and levies	9.9%	5.8%	5.7%	5.8%	5.7%	4.7%
	(9.9%)	(5.8%)	(5.7%)	(5.3%)	(4.9%)	(4.7%)
3. Potential growth	1.2%	0.3%	-3.1%	3.4%	0.8%	0.8%
	(0.7%)	(0.3%)	(-2.5%)	(1.6%)	(0.9%)	(0.9%)
4. Inflation target midpoint	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%
	(4.5%)	(4.5%)	(4.5%)	(4.5%)	(4.5%)	(4.5%)
5. Neutral real interest rate	1.9%	2.1%	2.0%	2.1%	2.3%	2.3%
	(1.9%)	(2.1%)	(2.0%)	(2.1%)	(2.3%)	(2.3%)

Notes

1. Shaded areas indicate forecast assumptions.
2. The figures in brackets represent the previous assumptions of the Monetary Policy Committee.

* For an explanation of foreign sector assumptions and domestic sector assumptions, see pages 62 and 63.

Summary of selected forecast results: Monetary Policy Committee meeting on 23 September 2021*

Selected forecast results (quarterly)

Year-on-year percentage change

	2020 3.3 (3.3)				2021 4.4 (4.3)				2022 4.2 (4.2)				2023 4.5 (4.5)			
1. Headline inflation	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
	4.4	2.4	3.1	3.2	3.2	4.9	4.8	5.0	4.7	4.3	3.8	4.1	4.4	4.4	4.5	4.5
	(4.4)	(2.4)	(3.1)	(3.2)	(3.2)	(4.9)	(4.6)	(4.7)	(4.5)	(4.1)	(3.9)	(4.3)	(4.4)	(4.4)	(4.4)	(4.5)
	2020 3.3 (3.3)				2021 3.0 (2.9)				2022 3.8 (3.7)				2023 4.3 (4.3)			
2. Core inflation	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
	3.7	3.1	3.3	3.3	2.8	3.1	3.0	3.1	3.6	3.8	3.8	4.1	4.2	4.2	4.3	4.4
	(3.7)	(3.1)	(3.3)	(3.3)	(2.8)	(3.1)	(2.8)	(2.9)	(3.3)	(3.5)	(3.8)	(4.1)	(4.2)	(4.2)	(4.3)	(4.4)

Notes

1. Shaded areas indicate the forecasts of the Monetary Policy Committee.
2. The figures in brackets represent the previous forecasts of the Monetary Policy Committee.

Selected forecast results (annual)

	Actual			Forecast		
	2018	2019	2020	2021	2022	2023
1. GDP growth	1.5%	0.1%	-6.4%	5.3%	1.7%	1.8%
	(0.8%)	(0.2%)	(-7.0%)	(4.2%)	(2.3%)	(2.4%)
2. Output gap (ratio to potential GDP)	-0.1%	-0.3%	-4.0%	-2.0%	-1.2%	-0.2%
	(-0.9%)	(-1.0%)	(-5.9%)	(-3.2%)	(-1.8%)	(-0.4%)
3. Change in nominal effective exchange rate	-1.0%	-7.0%	-12.8%	11.4%	-2.6%	-3.7%
	(-1.0%)	(-7.0%)	(-12.8%)	(11.5%)	(-3.4%)	(-3.6%)
4. Change in real effective exchange rate	1.4%	-4.5%	-10.6%	13.5%	-0.5%	-1.2%
	(1.4%)	(-4.5%)	(-10.6%)	(13.6%)	(-1.4%)	(-1.1%)
5. Real exchange rate gap	2.0%	-1.3%	-10.8%	2.1%	1.8%	0.5%
	(2.0%)	(-1.3%)	(-10.8%)	(2.3%)	(0.9%)	(-0.2%)
6. Repurchase rate (end of period)	6.60%	6.50%	3.50%	3.82%	5.17%	6.36%
	(6.60%)	(6.50%)	(3.50%)	(3.79%)	(4.93%)	(6.13%)
7. Current account balance (ratio to GDP)	-3.0%	-2.6%	2.0%	4.6%	0.7%	-0.3%
	(-3.5%)	(-3.0%)	(2.2%)	(3.7%)	(-0.1%)	(-0.9%)

Notes

1. The nominal effective exchange rate (NEER) is based on the bilateral exchange rates of South Africa's three largest trading partners (the euro area, the US and Japan). The bilateral exchange rates are weighted by export trade weights.
2. The real effective exchange rate (REER) is the NEER deflated by the consumer price differential (between South Africa and the trade-weighted CPI of the euro area, the US and Japan).
3. The real exchange rate gap signifies the extent to which the real exchange rate deviates from its estimated equilibrium level. A positive gap shows an overvaluation of the currency, and vice versa.
4. The forecast of the current account balance is obtained from the SARB's Core Macroeconometric Model.
5. Shaded areas indicate the forecasts of the Monetary Policy Committee.
6. The figures in brackets represent the previous forecasts of the Monetary Policy Committee.

Foreign sector assumptions

1. **Trading-partner gross domestic product (GDP) growth** is broadly determined using the Global Projection Model (GPM), which is adjusted to aggregate the GDP growth rates of South Africa's major trading partners on a trade-weighted basis. Individual projections are done for the six largest trading partners, namely the euro area, the United States (US), the United Kingdom (UK), Japan, China and India. Other countries considered, although with small weights, are Brazil, Mexico and Russia. The remaining trading partners are grouped into the 'Rest of Countries' bloc. Since sub-Saharan Africa is also a major trading region for South Africa (but does not have a bloc in the GPM), it is modelled separately and then combined with the aggregate of all the countries in the GPM to make up total trading-partner growth.

2. As with GDP growth, the **output gap** is determined using the GPM and is adjusted in a similar way. The output gap is driven by a combination of country-specific domestic factors, external factors and financial-real linkages (beyond interest rate and exchange rate effects). Domestic factors include expectations of future demand and medium-term interest rates. External factors include exchange rate impacts on demand, direct spillovers through trade with trading-partner countries and foreign demand.

3. The **commodity price index** is a weighted aggregate price index of the major South African export commodities.

4. The **Brent crude oil price** is expressed in US dollars per barrel. The assumption incorporates supply and demand dynamics as well as oil inventories (of all grades). The assumption is also informed by projections from the US Energy Information Administration, the Organization of the Petroleum Exporting Countries (OPEC) and Reuters.

5. **World food prices** is the composite food price index of the United Nations (UN) Food and Agriculture Organization (FAO) in US dollars. It is weighted using average export shares, and represents the monthly change in the international prices of a basket of five food commodity price indices (cereals, vegetable oil, dairy, meat and sugar). World food price prospects incorporate selected global institution forecasts for food prices and imbalances from the anticipated trend in international food supplies relative to expected food demand pressures.

6. **International consumer prices** are also broadly determined using the GPM. The index is an aggregate of the consumer price indices of the euro area, the US and Japan, weighted by their relative trade shares. Consumer prices are determined for each of these economies by accounting for inflation expectations, demand pressures, and pass-through from changes in the relevant exchange rate. Other institutional forecasts for international consumer prices are also considered.

7. **International policy interest rates** are again broadly determined using the GPM. Interest rates are a weighted average of the policy rates of the euro area, the US and Japan. They are individually determined by a 'Taylor-type' monetary policy rule. The communications of the relevant central banks and other institutional forecasts are also considered.

Domestic sector assumptions

1. The **electricity price** is an administered price measured at the municipal level with a weight of 3.75% in the headline consumer price index (CPI) basket. Electricity price adjustments generally take place in the months of July and August of each year, and the assumed pace of increase over the forecast period reflects the multi-year price determination agreement between Eskom and the National Energy Regulator of South Africa (NERSA), with a slight adjustment for measurement at the municipal level.

2. **Fuel taxes and levies** are the total domestic taxes and costs included in the price of fuel paid at the pump. They include the Road Accident Fund (RAF) levy, the fuel levy, retail and wholesale margins, the slate levy, and other minor levies. The two major taxes, which are set by the Minister of Finance in the annual National Budget, are the RAF levy and the fuel levy. The income generated by the RAF levy is utilised to compensate third-party victims of motor vehicle accidents, while the fuel levy is used to provide funding for road infrastructure.

3. **Potential growth** is derived from the South African Reserve Bank's (SARB) semi-structural potential output model. The measurement accounts for the impact of the financial cycle on real economic activity, and introduces economic structure via the relationship between potential output and capacity utilisation in the manufacturing sector (*SARB Working Paper Series No. WP/14/08*).

4. The **midpoint of the inflation target range** is 4.5%. The official inflation target range is 3–6%.

5. The **neutral real interest rate (NRIR)** is the interest rate consistent with stable inflation and output in line with the economy's potential. This variable is the basis for judging whether a given policy stance is expansionary, contractionary or neutral.

Glossary

Advanced economies: Advanced economies are countries with high gross domestic product (GDP) per capita, diversified exports, and close integration into the global financial system.

Balance of payments: This is a record of transactions between the home country and the rest of the world over a specific period of time. It includes the current and financial accounts. See also 'Current account' below.

Brent crude: Brent crude is a light and sweet blend of oil from five different fields in the North Sea. The price of Brent crude is one of the benchmark oil prices in international markets.

Budget deficit: A budget deficit indicates the extent to which government expenditure exceeds government revenue.

Business and consumer confidence: These are economic indicators that measure the level of optimism about the economy and its prospects among business managers and consumers.

Commodities: Commodities can refer to energy, agriculture, metals and minerals. Major South African-produced commodities include platinum and gold.

Consumer price index (CPI): The CPI provides an indication of aggregate price changes in the domestic economy. The index is calculated using a number of categories forming a representative set of goods and services bought by consumers.

Core inflation: Core generally refers to underlying inflation, excluding the volatile elements (e.g. food and energy prices). The South African Reserve Bank's (SARB) forecasts and discussions refer to headline CPI excluding food, non-alcoholic beverages (NAB), fuel and electricity prices.

Crude oil price: This is the United States (US) dollar price per barrel of unrefined oil. See also 'Brent crude' above.

Current account: The current account of the balance of payments consists of net exports (exports less imports) in the trade account as well as the services, income and current transfers.

Emerging markets: Emerging markets are countries with low to middle income per capita. They are advancing rapidly and are integrating with global (product and capital) markets.

Exchange rate depreciation (appreciation): Exchange rate depreciation (appreciation) refers to a decrease (increase) in the value of a currency relative to another currency.

Exchange rate pass-through: This is the effect of exchange rate changes on domestic inflation (i.e. the percentage change in domestic CPI due to a change in the exchange rate). Changes in the exchange rate affect import prices, which in turn affect domestic consumer prices and inflation.

Forecast horizon: This is the future period over which the SARB generates its forecasts, typically between two and three years.

Gross domestic product (GDP): GDP is the total market value of all the goods and services produced in a country. It includes total consumption expenditure, capital formation, government consumption expenditure and the value of exports less the value of imports.

Gross fixed capital formation (investment): The value of acquisitions of capital goods (e.g. machinery, equipment and buildings) by firms, adjusted for disposals, constitutes gross fixed capital formation.

Headline consumer price index (CPI): Headline CPI refers to CPI for all urban areas, as measured on a monthly basis by Statistics South Africa (Stats SA). Headline CPI is a measure of price levels in all urban areas. The 12-month percentage change in headline CPI is referred to as 'headline CPI inflation' and reflects changes in the cost of living. This is the official inflation measure for South Africa.

Household consumption: This is the amount of money spent by households on consumer goods and services.

Inflation (growth) outlook: This outlook refers to the evolution of future inflation (growth) over the forecast horizon.

Inflation targeting: This is a monetary policy framework used by central banks to steer actual inflation towards an inflation-target level or range.

Monetary policy normalisation: This refers to the unwinding of an unusually accommodative monetary policy. It could also mean adjusting the economy's policy rate towards its real neutral policy rate.

Neutral real interest rate (NRIR): The NRIR is the level at which the real interest rate will settle once the output gap is closed and inflation is stable.

Nominal effective exchange rate (NEER): The NEER is an index that expresses the value of a country's currency relative to a basket of other (trading-partner) currencies. An increase (decrease) in the NEER indicates a strengthening (weakening) of the domestic currency with respect to the selected basket of currencies. The weighted average exchange rate of the rand is calculated against 20 currencies. The weights of the five major currencies are as follows: the euro (29.26%), the Chinese yuan (20.54%), the US dollar (13.72%), the Japanese yen (6.03%), and the British pound (5.82%). Index: 2010 = 100. See also 'Real effective exchange rate' below.

Output gap/potential growth: Potential growth is the rate of GDP growth that could theoretically be achieved if all the productive assets in the economy were employed in a stable inflation environment. The output gap is the difference between actual growth and potential growth, which accumulates over time. If this is negative, then the economy is viewed to be underperforming and demand pressures on inflation are low. If the output gap is positive, the economy is viewed to be overheating and demand pressures are inflationary.

Policy rate: A policy rate is the interest rate used by a central bank to implement monetary policy.

Productivity: Productivity indicates the amount of goods and services produced in relation to the resources utilised in the form of labour and capital.

Real effective exchange rate (REER): The REER is the NEER adjusted for inflation differentials between South Africa and its main trading partners. See also 'Nominal effective exchange rate' above.

Repurchase (repo) rate: This is the policy rate that is set by the Monetary Policy Committee (MPC). It is the rate that commercial banks pay to borrow money from the SARB.

Real repo rate: This is the nominal repo rate, as set by the MPC, adjusted for expected inflation.

Terms of trade: This refers to the ratio of export prices to import prices.

Unit labour cost (ULC): A ULC is the labour cost to produce one 'unit' of output. This is calculated as the total wages and salaries in the non-agricultural sector divided by the real value added at basic prices in the non-agricultural sector of the economy.

Abbreviations

AE	advanced economy
BCI	business confidence index
BER	Bureau for Economic Research
CIT	corporate income tax
CMS	Council for Medical Schemes
COVID-19	coronavirus disease 2019
CPI	consumer price index
ECB	European Central Bank
EM	emerging market
FAO	Food and Agriculture Organization
Fed	Federal Reserve
FRA	forward rate agreement
FX	foreign exchange
G3	Group of Three (United States, euro area and Japan)
GBI	Government Bond Index
GDP	gross domestic product
GFC	global financial crisis
GFCF	gross fixed capital formation
GPM	Global Projection Model
IFI	international financial institutions
IMF	International Monetary Fund
ISA	instalment sales agreements
Jibar	Johannesburg Interbank Average Rate
KZN	KwaZulu-Natal
MPC	Monetary Policy Committee
MPR	*Monetary Policy Review*
MSCI	Morgan Stanley Capital International
NAB	non-alcoholic beverages
NDP	National Development Plan
NEER	nominal effective exchange rate
NERSA	National Energy Regulator of South Africa
NRIR	Neutral Real Interest Rate
OECD	Organisation for Economic Co-operation and Development
OPEC	Organization of the Petroleum Exporting Countries
PCE	personal consumption expenditure
PGM	platinum group metal

PMI	Purchasing Managers' Index
PPI	producer price index
QE	quantitative easing
QLFS	*Quarterly Labour Force Survey*
QPM	Quarterly Projection Model
RAF	Road Accident Fund
REER	real effective exchange rate
REIPPPP	Renewable Energy Independent Power Producer Procurement Programme
repo (rate)	repurchase (rate)
SABOR	South African Benchmark Overnight Rate
SACU	Southern African Customs Union
SANRAL	South African National Roads Agency Limited
SARB	South African Reserve Bank
SIT	services, income and current transfer
SOE	state-owned enterprise
SRD	social relief of distress
Stats SA	Statistics South Africa
UAE	United Arab Emirates
UK	United Kingdom
ULC	unit labour cost
UN	United Nations
US	United States
WEO	*World Economic Outlook*