MONETARY POLICY REVIEW

APRIL 2021

SOUTH AFRICAN RESERVE BANK

SARB 100 YEARS 1921–2021

A purposeful journey

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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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Recovery progressing, but slow and uneven

Executive summary and overview of the policy stance

In parallel with global developments, the past six months have seen South Africa's economy continue its recovery from last year's 7% contraction in output caused by the spread of the COVID-19 virus. The Monetary Policy Committee (MPC) cut the repurchase (repo) rate by 2.75 percentage points between March and July 2020 in direct response to the pandemic, and has since left the repo rate steady at 3.5%, helping to support the recovery. Inflation remains well-contained, and is expected to gradually rise towards the midpoint of the 3–6% target band, reaching 4.5% by 2023. Keeping inflation low into the recovery will help contain interest rates. Recovery to the 2019 level of output is only expected in 2023, reflecting sustained headwinds to economic activity, including high long-term investment costs and electricity supply constraints.

The global economy continues to recover from the COVID-19-induced recession in 2020 despite repeated waves of the virus. Economic activity indicators for many major economies have climbed back to near pre-COVID-19 levels, reflecting optimism brought about by the launch of vaccination programmes and the magnitude of fiscal and monetary support.[1] The scale and duration of the global recession turned out better than was initially feared, with gross domestic product (GDP) contracting by an estimated 3.3% in 2020 (compared to the initial (June 2020)) forecast of a 4.9% contraction by the International Monetary Fund (IMF)).[2] In April 2021, the IMF revised its forecast of global growth for 2021 to 6%, up from 5.5% in January.

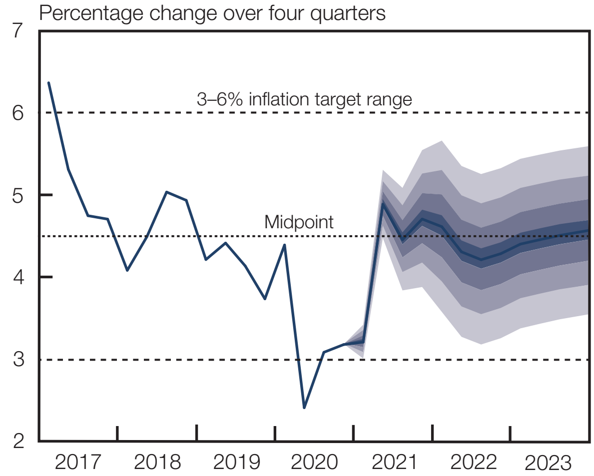
The second wave of the pandemic was strong but had minimal direct impacts on the global economy. Countries addressed second waves by implementing better-targeted and less economically-damaging lockdowns, unlike the tight restrictions implemented during the first wave. In tandem, businesses have, where possible, adapted or shifted to less contact-intensive ways of working, further insulating production activity and many jobs from restrictions on mobility and contact.

1 The US passed a US$900 billion stimulus package in December 2020 and a US$1.9 trillion package in February 2021. This was over and above the US$2.4 trillion CARES Act of March 2020, bringing the total fiscal intervention to over 25% of GDP. Japan announced an additional ¥73.6 trillion (US$708 billion) support package in December 2020, split between pure fiscal support and equity injections, loans and guarantees, taking its pure fiscal interventions to about 16% of GDP. See IMF, *Fiscal Monitor*, Washington DC: IMF, April 2021.

2 International Monetary Fund (IMF), *World Economic Outlook*, April 2021.

Targeted inflation forecast*

Percentage change over four quarters

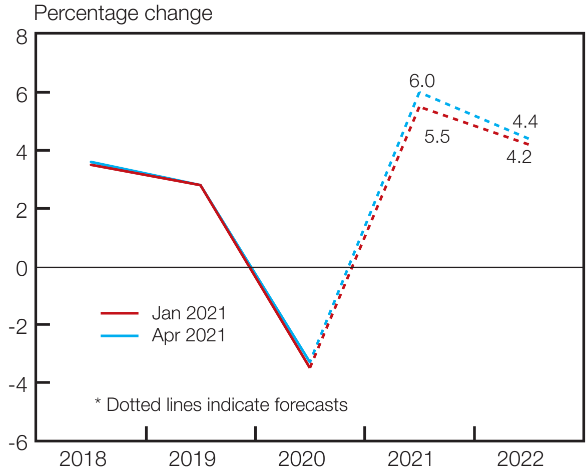


* The bands around the central projection show confidence intervals of 10%, 30%, 50% and 70%.

Sources: Stats SA and SARB

Global growth*

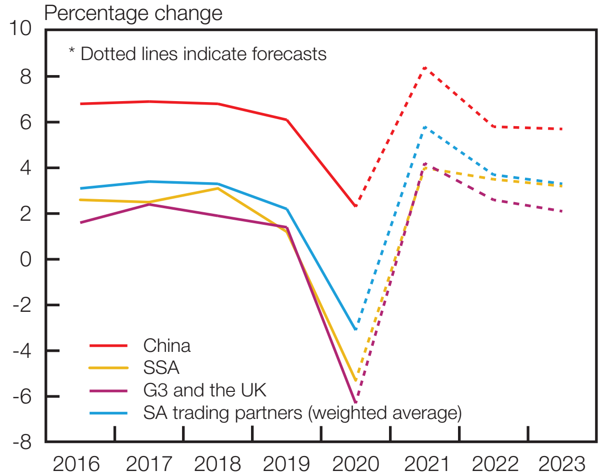
Percentage change



Source: IMF

Trading-partner real GDP growth*

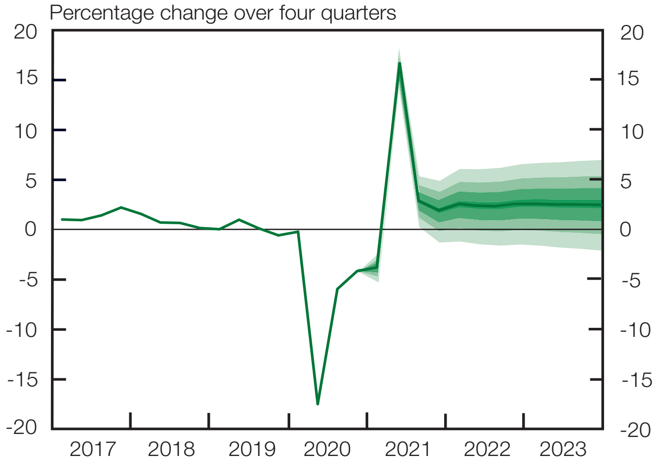
Percentage change



Source: SARB

Real GDP growth*

Percentage change over four quarters

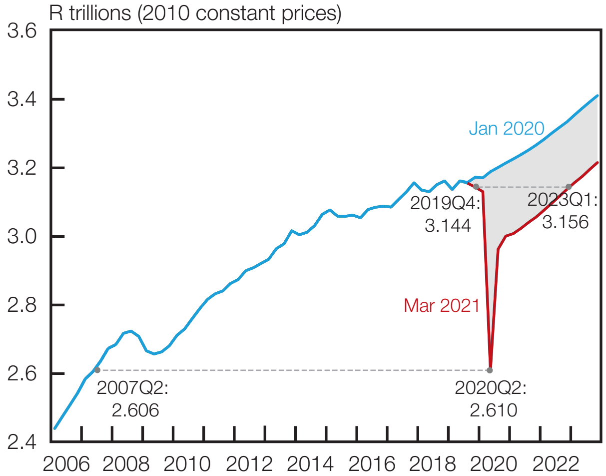


* The bands around the central projection show confidence intervals of 10%, 30%, 50% and 70%.
This chart shows seasonally-adjusted data, as used in the QPM.

Sources: Stats SA and SARB

GDP levels

R trillions (2010 constant prices)

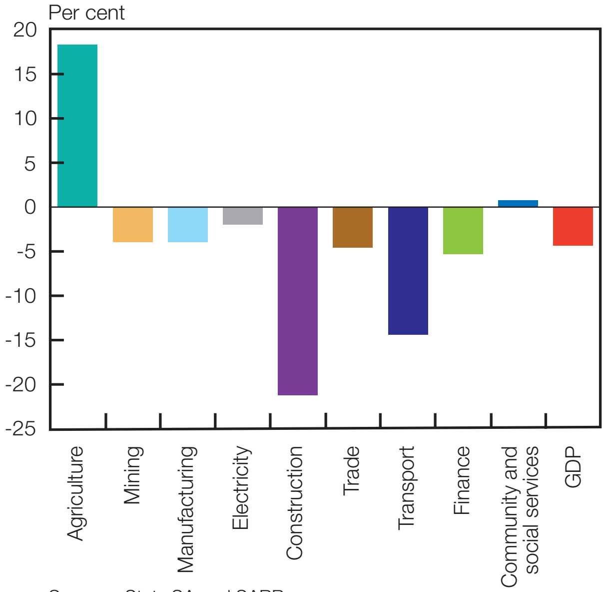


Seasonally adjusted and annualised

Sources: Stats SA and SARB

Output: 2020Q4 deviation from 2019 level

Per cent



Sources: Stats SA and SARB

A moderate rise in inflation should accompany the global recovery, accelerated by supply constraints in some instances and stronger demand, but also tempered by well-anchored inflation expectations. Inflation in the Group of Three (G3) – the United States (US), Japan and the eurozone – averaged 0.7% in 2020, rising to about 1.7% in both 2021 and 2022.[3] Inflation in the US may peak higher in the near term, at 2.4%, before slowing into 2022.[4] Emerging market inflation is also rising, and is projected to average 3.5% in 2021. Recovery has also improved the risk appetite of investors, supporting renewed capital flows to emerging markets in the second half of 2020. As seen in March, however, the threat of higher US interest rates can and will prompt bouts of risk aversion and generate volatility in capital flows.

On balance, stronger global outcomes will continue to support faster recovery in the domestic economy. The easing of lockdown restrictions, record-low interest rates and the ongoing rally in commodities supported growth in the second half of 2020 and into 2021, with the South African Reserve Bank's (SARB) forecasts for South Africa's GDP in 2021 boosted by about half a percentage point as a result of global developments.

Following the wild gyrations in quarterly output in 2020 (Q2: -51.7%; Q3: 67.3%; Q4: 6.3%), the South African economy is expected to grow by 3.8% in 2021 before easing to growth rates of 2.4% and 2.5% in 2022 and 2023 respectively. The future evolution of the COVID-19 pandemic, potential further lockdowns and delays in vaccination roll-out to the public make these projections more uncertain than usual.

Although the growth rates projected across the forecast horizon are higher than what South Africa has achieved in the recent past, the level of output is not expected to reach the 2019 level until the first quarter of 2023. As a result, the recovery will be wing-shaped, with a sharp yet incomplete initial bounce-back followed by a gradual rise towards the pre-COVID-19 level. This reflects both immediate headwinds to growth and pre-existing constraints.

Unlike most previous recessions, the recovery from pandemic conditions is uneven across sectors, raising the spectre of a K-shaped recovery. The primary sector has already recovered to pre-COVID-19 levels as of the fourth quarter, with agriculture outperforming the 2019 benchmark, strongly supported by favourable rainfall conditions that led to record maize harvests. Mining is also almost back to pre-crisis levels, buoyed by robust foreign demand and record-high commodity prices.

3 Based on the IMF's *World Economic Outlook*, April 2021. SARB's March 2021 MPC assumptions for weighted G3 inflation are 0.8% in 2020, and 1.6% in both 2021 and 2022.

4 Federal Open Market Committee, 17 March 2021. https://www.federalreserve.gov/monetarypolicy/fomcprojtabl20210317.htm

The secondary sector, however, is still to fully recover, with construction furthest behind. Recovery in the manufacturing sector has been tempered by idiosyncratic setbacks in the petroleum subsector and weak demand for non-durable goods, among other factors.[5] The tertiary sector also remained below the 2019 average as at December 2020, with the drag coming mostly from finance, transport and trade, the latter two sectors strongly influenced by tourism.

Turning to the demand side of the economy, the second half of 2020 saw household consumption rebound strongly, supported by cheaper credit and pent-up demand caused by the lockdowns. Consumption of durable goods was especially robust, while that of semi-durables remained substantially below its 2019 average.

Household spending has, more broadly, been undermined by widespread job losses, despite support from increased social transfers.[6] According to Statistics South Africa's (Stats SA) *Quarterly Labour Force Survey* (*QLFS*), of the roughly 2.2 million jobs lost in the second quarter of 2020 due to the pandemic, about 900 000 were recovered by the fourth quarter, implying net job losses of nearly 1.4 million by the fourth quarter of 2020. Job losses were skewed towards less-skilled workers, while higher-skilled workers or those who could easily work from home were relatively more protected. Most sectors mitigated job-shedding by reducing salaries and eliminating bonuses, but even here, the less-skilled workers were disproportionately affected, with 1 in 5 experiencing earnings cuts, compared to 1 in 10 for graduates (*QLFS*).

An important feature of the economy's performance in recent years has been the decline in the rate of gross fixed capital formation, which further contracted in 2020 alongside imports. With sharply higher commodity prices, modest oil prices and much lower imports of capital and consumption goods, South Africa's trade balance swung into surplus, creating an overall surplus on the current account. The current account is expected to narrow during 2021 as imports recover, before turning into a deficit in 2022, even with robust export prices.

The rise in corporate saving associated with falling investment, and the better-than-expected tax revenue growth from the strong terms of trade, provided more financing for the larger fiscal deficit.[7] In turn, the better-than-expected fiscal deficit and slower projected climb in public debt has helped, alongside more buoyant projections for global growth, to ease South Africa's risk premium. Nonetheless, the potential is high for reversals to this improvement, as the fiscal position remains sensitive to changes in the nominal wage bill and other factors.

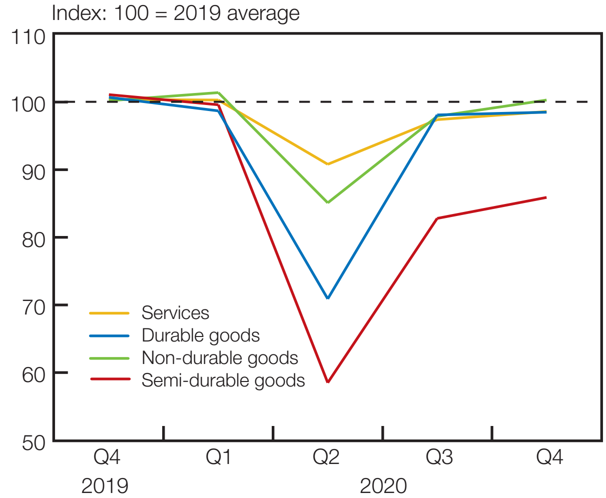
5 Two refineries experienced major accidents that disrupted production for extended periods of time.

6 By the end of 2020Q4, consumption remained 2% below the 2019 average.

7 Financing of the fiscal deficit at the expense of private investment (crowding out) implies low future growth, especially given the very low fiscal spending multipliers.

Household consumption

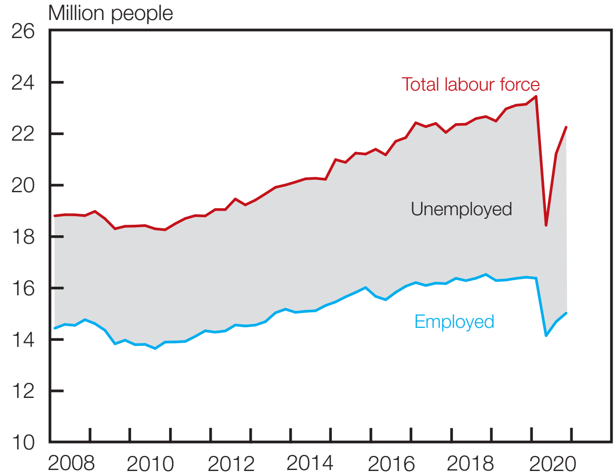
Index: 100 = 2019 average



Sources: Stats SA and SARB

Labour market

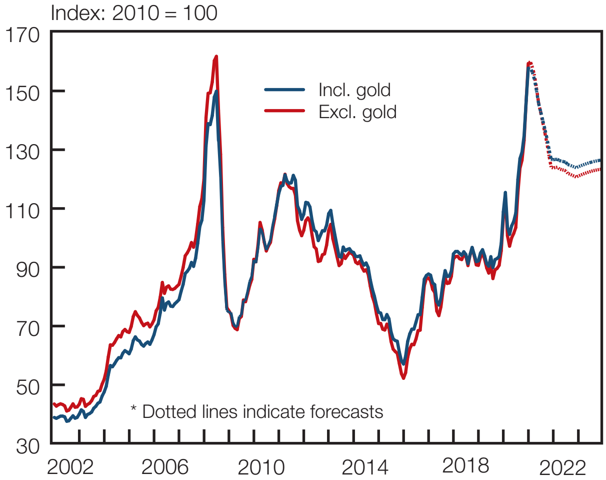
Million people



Source: Stats SA

Commodity prices*

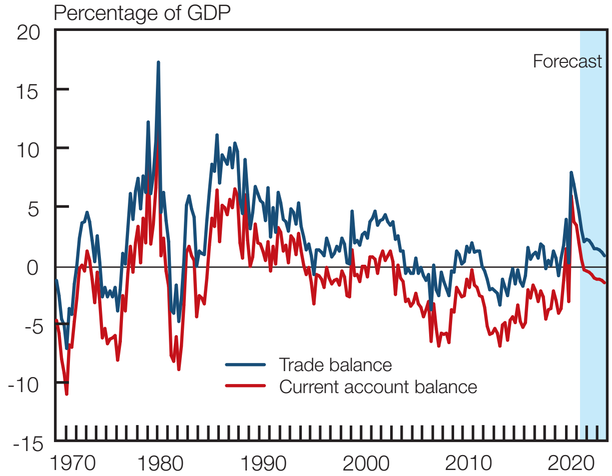
Index: 2010 = 100



Source: SARB

Trade and current account balance

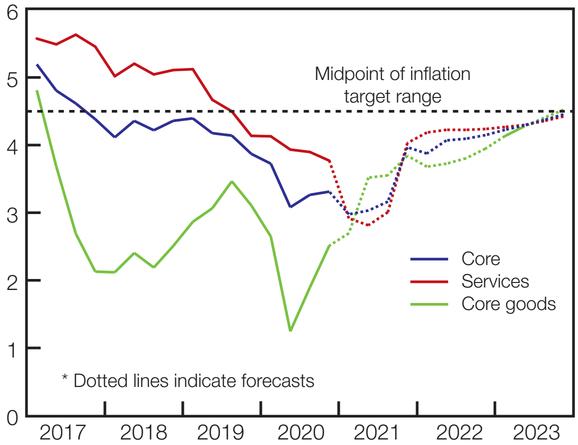
Percentage of GDP



Source: SARB

Core inflation components*

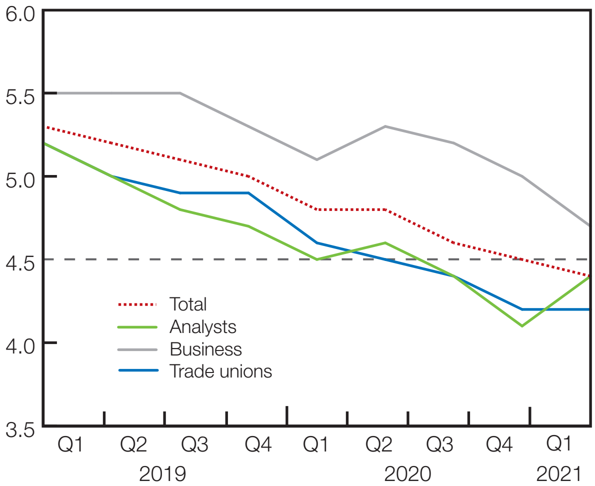
Percentage change over four quarters



Sources: Stats SA and SARB

Two-years-ahead inflation expectations

Per cent



Sources: BER and SARB

Risk can also arise from renewed global volatility, as seen in market reactions to potentially higher real interest rates in the US. A permanent rise in G3 real interest rates, all else being equal, places capital inflows at risk by lessening the attractiveness of alternative fixed-income investment destinations. A resumption of risk-on sentiment and implementation of the 2021 Budget should, other things being equal, support further improvements in the risk premium.

A broadly more supportive global environment also helped to sustain a recovery in the exchange rate of the rand, contributing, alongside deflating imported goods prices, to less inflation in the domestic economy. Inflation remained well-contained in 2020 and into 2021, with headline averaging 3.3% for the year and both January and February monthly outcomes coming out slightly below forecasts. Headline inflation further benefitted from subdued services inflation and fuel price deflation during the course of 2020, while upside pressures came primarily from food and non-alcoholic beverages (NAB).

Recent escalations in food and fuel inflation, together with base effects, will add to near-term inflation, with headline breaching the 4.5% midpoint in the second quarter of 2021 before easing somewhat into 2022.

As with headline, core inflation averaged 3.3% in 2020, kept low by continued weak housing price inflation and subdued labour market pressures.[8] Core inflation is projected to rise to 4.3% by the end of the forecast horizon (2023), with the pace of the reversion tempered by the gradual closure of the negative output gap, better-anchored inflation expectations and a less depreciated real exchange rate.

Looking back, the 2014–16 period saw inflation hovering around the 6% upper end of the target range, presenting ongoing risks of abruptly higher interest rates and undermining the credibility of policy. Since 2017, the SARB has been communicating a preference for inflation to be around the 4.5% midpoint, creating a focal point and helping to better anchor inflation expectations. While differences in the speed of convergence of expectations between business, analysts and trade unions remain, the overall effect has been positive, with an easing of inflation in response to better communication.[9]

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8 The imputations methodology used by Stats SA during the lockdown, using headline (lower than core) to impute for non-collected prices, contributed to the lower core trajectory in the middle months of 2020.

9 See, for instance, A Coco and N Viegi, 'The monetary policy of the South African Reserve Bank: stance, communication and credibility', *South African Reserve Bank Working Paper Series No. WP/20/06*, Pretoria: South African Reserve Bank, June 2020. https://www.resbank.co.za/content/dam/sarb/publications/working-papers/2020/10024/WP-2006.pdf; M Reid and P Siklos, 'Building credibility and influencing expectations: the evolution of central bank communication', *South African Reserve Bank Working Paper Series No. WP/20/08*, Pretoria: South African Reserve Bank, July 2020. https://www.resbank.co.za/content/dam/sarb/publications/working-papers/2020/10144/WP-2008.pdf

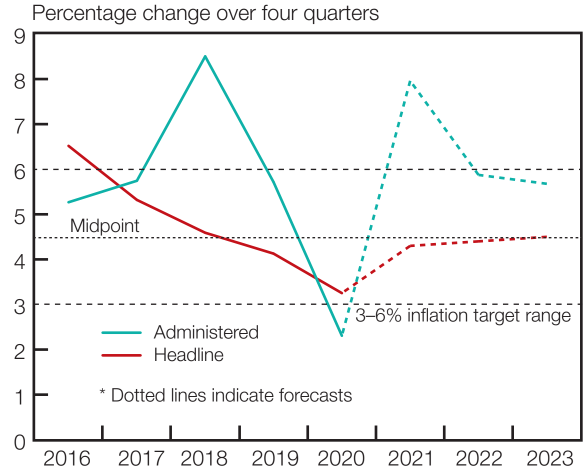
Despite this overall and longer-term improvement in the inflation profile, the inflation outlook remains subject to risk. Successive MPC meetings have noted how upside and downside risks tend to cancel each other out, leaving the risk assessment in balance. Headline inflation is expected to gradually return to about 4.5% by 2023, but this depends on an unusually wide range of factors. Food price inflation is expected to remain elevated, pulled up by rapidly rising global food prices, but favourable domestic market conditions should provide some moderation. Wage inflation, both public and private, is forecast to remain dampened by the prolonged effects of employment loss and public sector wage moderation. Lower services price inflation in particular remains an important downside risk. Permanent losses in supply capacity from firm closures and job losses, higher import prices, sovereign risk and currency depreciation are further risks to the inflation trajectory.[10]

Administered prices, particularly for water and electricity, will keep overall inflation higher than otherwise, and also present upside risks to the forecast. The administered prices consumer price index (CPI) is projected at 8% in 2021, 5.9% in 2022 and 5.7% in 2023, significantly above the 4.5% midpoint. Worse still, the 2021 increase is significantly above the upper limit of the 3–6% target band. Electricity prices are expected to increase by 13% in 2021 and by 10% in both 2022 and 2023 (see Box 8).

Although South Africa's inflation rate fell to one of its lowest rates on record in 2020 (3.3%), we remain a high-inflation economy relative to the rest of the emerging market and developing economies.[11] The 3.3% out-turn compares poorly, placing South Africa 88th out of 154 countries. As headline inflation returns to 4.5%, the gap relative to the group median is set to rise, increasing South Africa-specific risk perception and leading to generally higher interest rate levels.

Inflation*

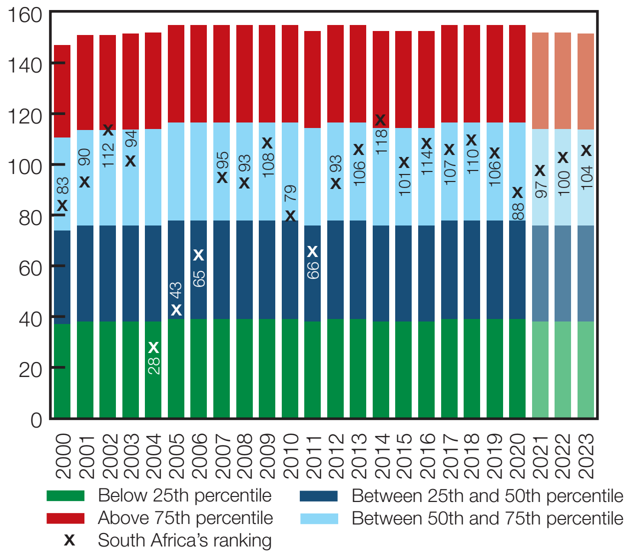
Percentage change over four quarters



Sources: Stats SA and SARB

Ranking of South Africa's inflation performance among emerging market and developing economies

Number of countries

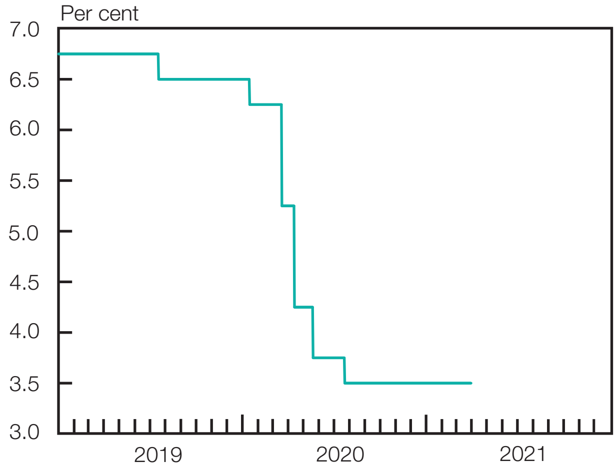


Sources: IMF and SARB

10 These risks, should they materialise, could drive headline above the 4.5% target midpoint and possibly dislodge inflation expectations away from the midpoint.

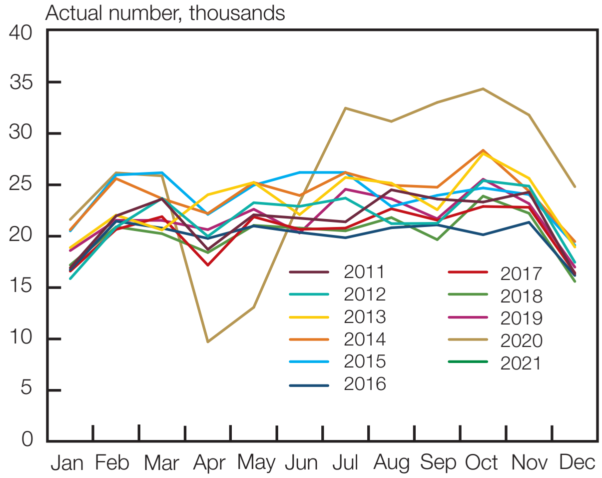
11 South Africa's relatively high inflation may be explained by, among other things, administered price inflation, sustained above-inflation government sector wage growth, and the high cost of doing business. See BusinessTech, 'The surprising reasons why South Africa's inflation has been higher than in other economies', 8 February 2020. https://businesstech.co.za/news/business/371174/the-surprising-reasons-why-south-africas-inflation-has-been-higher-than-in-other-economies/

Repo rate



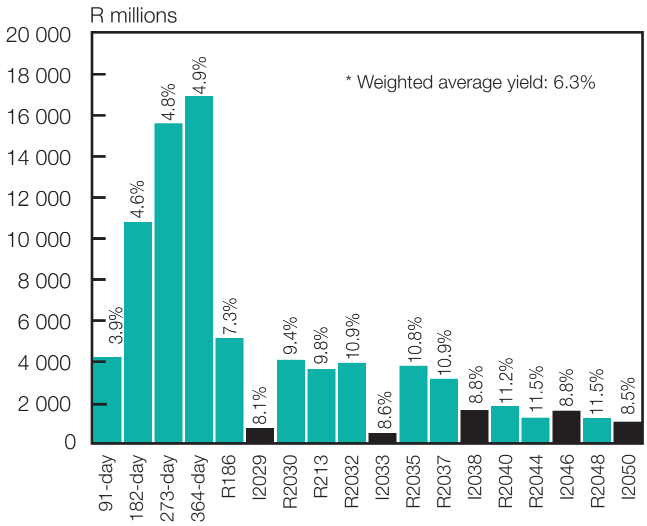
Source: SARB

Mortgage advances granted



Source: SARB

Volumes and yields of government bonds and Treasury bills (March 2021)*



Black bars are inflation-linked bonds
Source: SARB

Overview of the policy stance

The MPC left the repo rate unchanged at 3.5% in its last three meetings, monitoring the recovery, risks, and how the economy absorbs the frontloaded repo rate cuts implemented earlier in the timeline of the pandemic. Borrowing costs are at their lowest level in five decades, and the economy continues to recover, albeit unevenly across sectors.

Economic data for the second half of 2020 show how policy support fed through into activity levels. Total credit to households surpassed the 2019 level by December 2020, driven by secured credit (mainly property and vehicles).[12] A record number of mortgage advances was granted between July and December 2020. Similarly, total credit extension to corporates recovered to the 2019 level by October 2020.[13] After surging in March 2020, new loans and advances to corporates declined and remain depressed, suggesting that corporates frontloaded their borrowing early in the pandemic and are now waiting out the generally high uncertainty before taking up new loans.[14]

Perhaps the biggest beneficiary of the ultra-low short-term rates has been the public sector, which shifted most of its funding to the shorter end of the yield curve.[15] This has reduced overall public sector funding costs as well as the effective interest rate on government debt to about 6%, in sharp contrast to borrowing costs of around 9% at longer maturities.

At the time of the November 2020 MPC meeting, high-frequency data pointed to positive economic momentum, and the forecast of annual GDP growth for 2020 was revised higher to -8.0% from the -8.2% expected at the September meeting. The 2021 and 2022 growth forecasts were, however, revised down on sharply lower investment. Core inflation was revised lower for 2020 and 2021 at this meeting as services price inflation weakened, but there was little change in the longer-term forecast. The output gap was forecast to narrow to -6.3% in 2020 (from -6.5% in September) but to widen slightly in the outer period. Labour market price pressures were expected to remain subdued in light of the announced government wage freeze and with the real unit labour cost (ULC) gap in deflationary territory. Inflation expectations were around the 4.5% midpoint and were expected to moderate further to 4.2% by 2022, while the exchange rate gap was slightly less depreciated.

12 Unsecured household credit, however, has been on a declining trend since June 2020.

13 Total credit extension to corporations includes 'investment and bills', a component that is perhaps driven more by revaluations than by new credit extension.

14 This could also reflect reduced demand for working capital in light of the continued depressed activity levels in some sectors, for example in tourism and construction.

15 Treasury bill issuances increased by 109% between February and October 2020 (and by 62.1% year on year in February 2021), while bonds issued only increased by 55.8% over the same period (and by 32.8% year on year).

With benign food and oil prices, the Quarterly Projection Model (QPM) saw medium-term inflation gradually returning to the 4.5% midpoint by 2023. The environment favoured low and stable prices, with the rand appreciating by 6.9% between the September and November meetings. The implied path for the policy rate generated by the QPM suggested no further repo rate cuts for 2020, but indicated an increase of 25 basis points in each of the third and fourth quarters of 2021, signalling future rates normalisation.

With the economy projected to continue on a steady recovery path, and the risks to the inflation outlook balanced, the MPC decided to keep the repo rate unchanged at 3.5% in November. The decision was not unanimous; three members voted to hold the repo rate steady while two members favoured a 25 basis points cut.

The period running up to the January 2021 meeting of the MPC exhibited signs of a stronger global recovery, particularly in the US, and despite a sharp rise in new virus cases in many advanced economies. The large fiscal stimulus packages approved in the US and Japan during December 2020 supported the continued shift of sentiment toward risk-on. Global policy rates remained accommodative, pushing increased capital flows to emerging markets, but these were modulated by risk aversion in regard to low-growth and highly indebted economies.

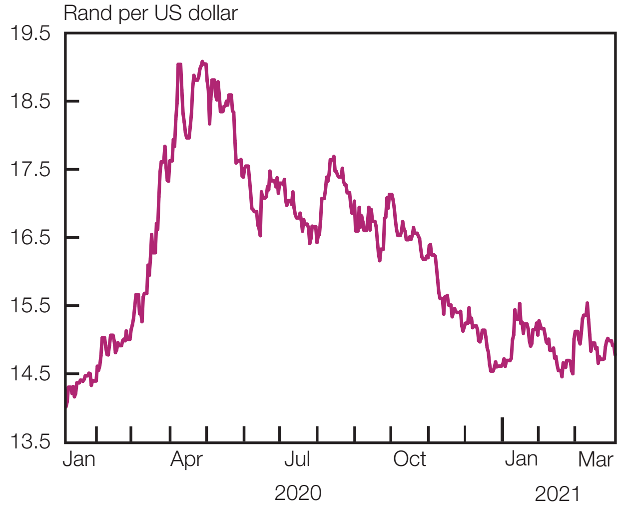
The January 2021 MPC meeting followed the release of third-quarter GDP data, which showed the economy had grown much faster than anticipated. Fourth-quarter activity was, however, tempered by a resurgence in the virus, which forced South Africa into an adjusted lockdown Level 3 – a significantly less stringent version compared to the original Level 3. The peak of this second wave coincided with a period of low economic/production activity (the December/January holidays), and the lockdowns were carefully targeted (unlike during the first wave), reducing their broader economic effects.

The January forecast saw GDP growth revised up to -7.1% (from -8%) for 2020 and to 3.6% (from 3.5%) for 2021. Potential growth was also revised slightly higher. The output gap narrowed marginally. The neutral real interest rate was adjusted a bit lower, by 0.1 percentage points, to 2.0% in 2020 and 2.1% in 2021, in line with a somewhat stronger exchange rate path and a modest improvement in the risk premium.

Core inflation came out at 3.3% in 2020, with the medium-term forecast (4.3% by 2023) remaining unchanged relative to the November MPC meeting. Services inflation was expected to detract from core in 2021, largely due to lower health insurance and housing inflation, before inflating slightly faster in 2022. The labour market remained soft, with the real ULC forecast remaining very low. Inflation expectations remained contained around the 4.5% midpoint.

Exchange rate of the rand

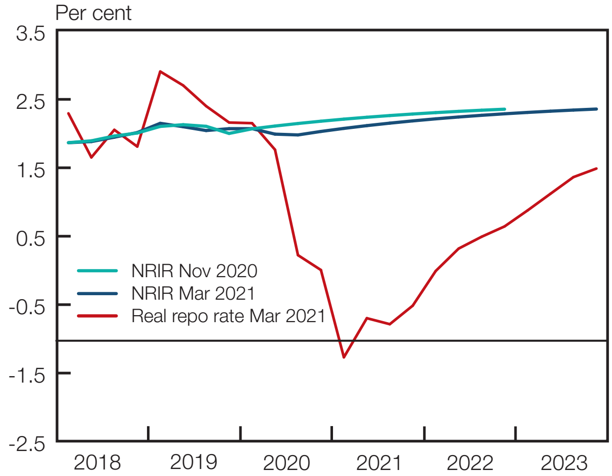
Rand per US dollar



Source: Bloomberg

Neutral real interest rate changes

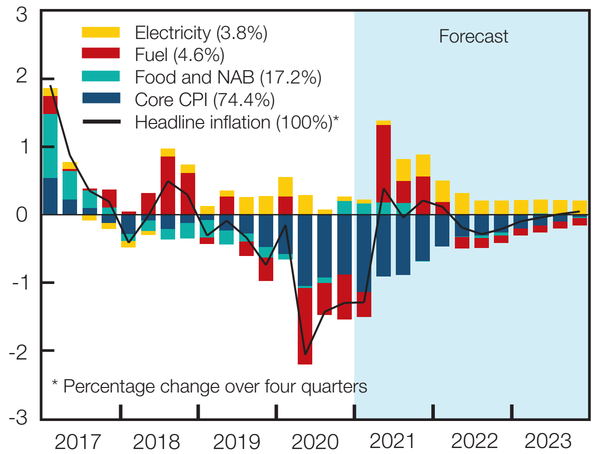
Per cent



Source: SARB

Contributions to headline deviation from midpoint

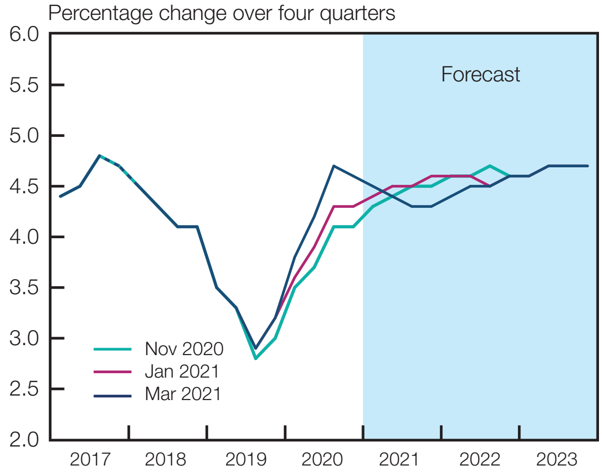
Percentage points



Sources: Stats SA and SARB

Average inflation (3–5 quarters ahead)

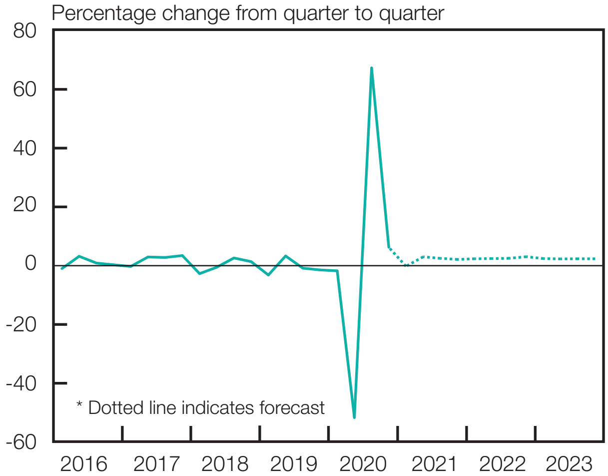
Percentage change over four quarters



Sources: Stats SA and SARB

Real GDP growth*

Percentage change from quarter to quarter

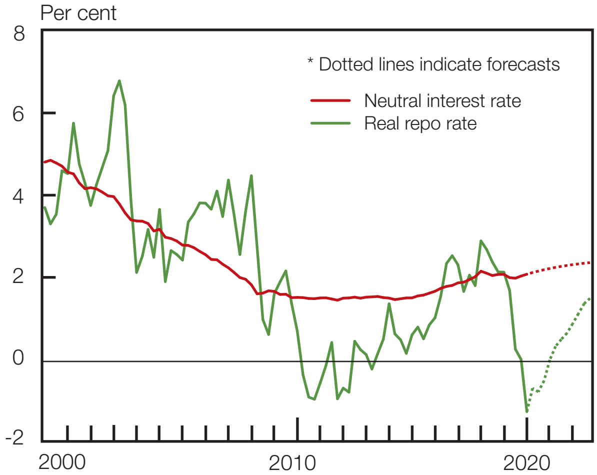


Seasonally adjusted and annualised

Sources: Stats SA and SARB

Neutral interest rate and real repo rate*

Per cent



Source: SARB

Headline inflation was projected to rise gradually from 3.3% in 2020 to reach 4.6% in 2023, 0.1 percentage points above the November profile, with 2021 higher on food and the 2022 increase due to revisions to food, core and, to a lesser extent, fuel price inflation.

As in November, the QPM's Taylor rule advised two 25 basis points hikes in the near term, the first in the second quarter of 2021 and the second in the third quarter of 2021, and a total hike of 275 basis points over the three-year forecast horizon. This normalisation of rates implied a gradual reversal of the wide real repo rate gap achieved in the depths of the crisis.

The MPC decided to keep rates on hold at 3.5% at the January meeting. It noted that monetary policy settings remained strongly accommodative, with a sustained real repo rate level well below the level of the neutral real rate. This time, too, the decision was not unanimous, with two members preferring a 25 basis points cut. The MPC highlighted food, electricity and other administered prices, as well as possible exchange rate pressures emanating from fiscal risks, as perils to inflation, but also alluded to the absence of demand pressures at the time.

The March MPC meeting was preceded by the release of the 2020 fourth-quarter GDP data. This showed that the economy grew by 6.3%, quarter-on-quarter, seasonally adjusted and annualised, well above the SARB's forecast of 5.3% and the Reuters median of 4.9%. Inflation for 2021 was revised higher to 4.3% (from 4.0% at the January meeting), driven mainly by fuel inflation as global oil prices recovered strongly. Greater stability in oil prices in the outer years of the forecast, implied that petrol price inflation eases in 2022. Rising electricity and food prices also add to headline CPI in 2021 relative to earlier forecasts.

The profile for core inflation mimics the January MPC profile, except in 2021, where core is revised lower by 0.1 percentage points to 3.3%, largely on (temporarily) lower insurance inflation. Core settles at 4.3% by the end of the forecast horizon. The drivers of core inflation virtually trace the path projected in the January MPC meeting, except for the output gap, which 'closes' by the fourth quarter of 2023.[16]

Given the steady recovery in the economy, the QPM's Taylor rule indicated two rate hikes for 2021: the first hike was seen in the second quarter (same as in January), while the second hike is now only projected in the fourth quarter (previously the third quarter). This is due to the slightly lower inflation in 2022, mostly from petrol prices easing, relative to the January MPC projections. As inflation rises to the midpoint of the target band, the repo rate is expected to rise to close the negative real repo rate gap.[17]

16 The output gap is forecast to reach -0.1% of potential GDP by the fourth quarter of 2023.

17 The real repo rate gap, a measure of the degree of monetary policy accommodation, 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. A real repo rate below the neutral real interest rate indicates that monetary policy is accommodative or expansionary, and the opposite is true when the real repo is above the neutral real interest rate.

With inflation risks balanced and the recovery fairly robust, the March MPC meeting unanimously decided to keep the repo rate unchanged at 3.5%. As in the January meeting, the MPC alluded to the exceptionally accommodative monetary policy settings and that demand pressures remain well-contained. The MPC, however, noted with concern that there was a rise in supply-side risks to the inflation outlook, particularly from administered prices.

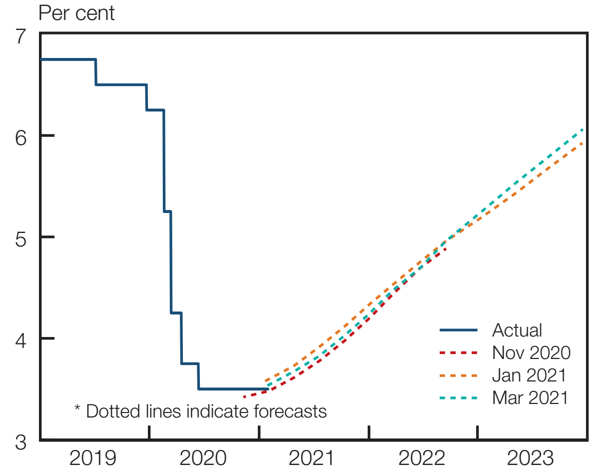
In conclusion, the worst of the COVID-19-induced economic effects continue to fade, with the recovery strengthening, albeit unevenly across sectors. Exceptionally accommodative monetary policy settings continue to support the recovery, and inflation is projected to rise to the midpoint of the target range gradually over the forecast horizon. This modest inflation trajectory underpins the MPC's decisions to keep the repo rate unchanged at 3.5% over the course of the review period.

The past year demonstrated the value of having a low and stable inflation rate and policy credibility. In the wake of repo rate cuts of half a percentage point between July 2019 and January 2020, the MPC rapidly cut the repo rate by a further 2.75 percentage points between March and July in direct response to the pandemic. This unprecedented easing of policy sharply reduced the real cost of servicing debt for households and corporates, and supported real purchasing power even as economic activity was drastically curtailed. In the context of the pandemic shock, the very low real interest rates will only gradually seep into future credit demand, consumption and investment planning as uncertainty slowly fades, incrementally pushing up output. This implies that the benefits of the stimulus, moderated by broader economic conditions and circumstances, should gradually strengthen the recovery through this year and the next.

Like many other central banks, both in advanced and in emerging economies, early and aggressive rate cuts provided extensive support before shifting to a 'wait and see' approach, monitoring how reduced rates affected the economy. With inflationary pressures remaining well-contained, rates have been kept low for longer in South Africa, in stark contrast to recent developments in some peer economies.

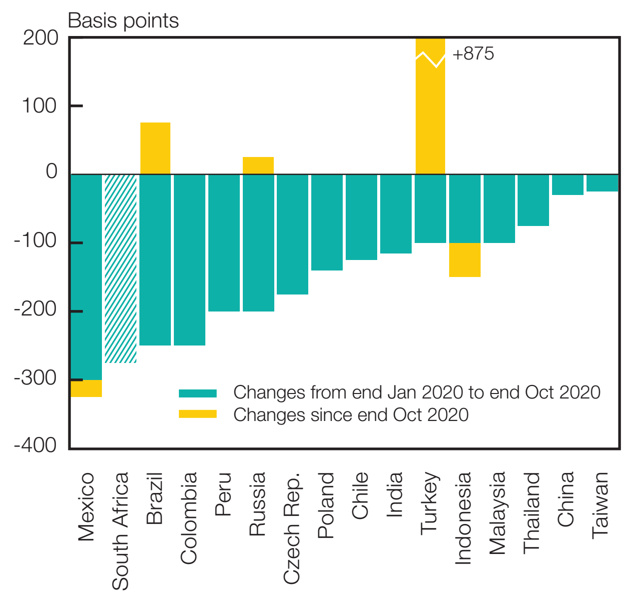
The MPC highlighted that the economic recovery can be enhanced by; further de-risking the economy by stabilising public debt, providing sufficient energy for growth, reducing the impact of administered prices on overall inflation, and keeping inflation low into the recovery. A lower-inflation domestic economy will go far in protecting the competitiveness of producers in a world of diminished inflation, and raises the prospect of borrowing costs for households and firms permanently anchored at or near the current historically lower levels.

Evolution of repo rate forecasts*



Source: SARB

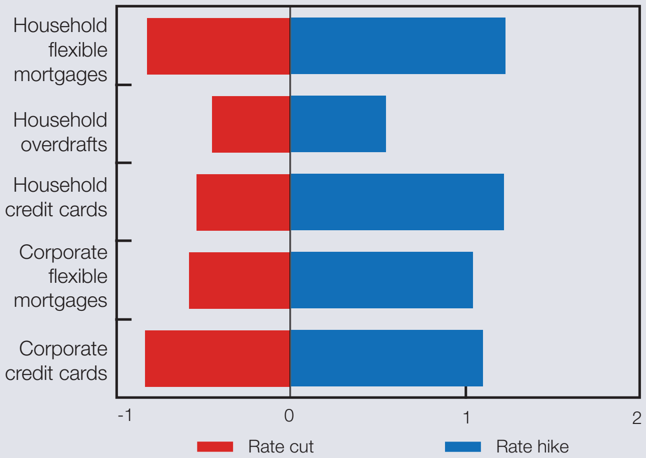
Emerging market policy rates



Sources: Haver and SARB

Box 1 Has the transmission of monetary policy been effective?

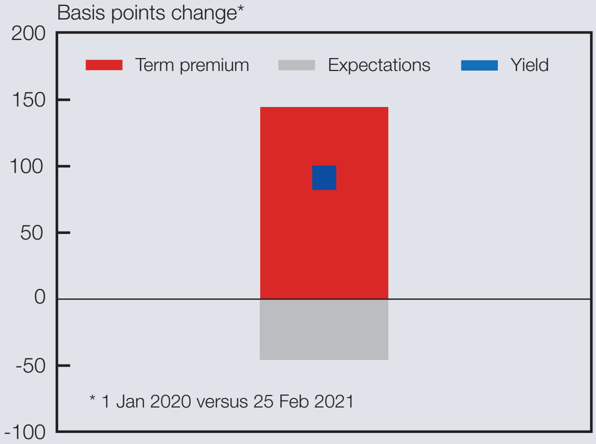
Pass-through from the repo rate to ...



Source: M Greenwood-Nimmo, D Steenkamp and R van Jaarsveld (2021, forthcoming)

10-year government bond yield decomposition

Basis points change*



Source: SARB

The primary mechanism through which monetary policy affects the real economy is the cost of bank funding and therefore the cost and availability of credit. The South African Reserve Bank's (SARB) repurchase (repo) rate serves as an anchor for the rate at which banks borrow from one another since banks can choose to borrow funds overnight at a margin over the repo rate. Other factors also influence the rates at which banks extend credit, including economic uncertainty and sovereign risk, regulatory settings affecting required holdings of liquidity, as well as the degree of competition among banks that influences interest margins.

An assessment of the pass-through from the repo rate to bank lending rates over the 2008–20 period shows close to full transmission to lending rates for most categories of bank credit.[1] This implies that the 'effective' policy stance (in the sense of what consumers actually experience) has been consistent with the policy stance of the Monetary Policy Committee.

Focusing the assessment to policy easing during the COVID-19 pandemic, evidence suggests that repo rate cuts have transmitted effectively to bank lending rates, with, for instance, the flexible residential mortgage rate declining by about 2.8 percentage points. However, there have been offsetting increases in risk and liquidity premiums that have somewhat weakened the transmission of policy to the real economy relative to the pre-COVID-19 period. This effect can best be seen in the sustained steepness in the yield curve, despite the aggressive policy easing. Long bond rates have remained high, partly because of an increase in sovereign risk reflected in the term premium. The 10-year government bond yield was about 100 basis points higher in February 2021 compared to January 2020, notwithstanding the record-low short-term rates.[2]

1 The incomplete pass-through for mortgage rates and credit cards could reflect a host of possible explanations, including unmodelled risk premiums, changes in the composition of loans and high bank concentration.

2 Updated from L Soobyah and D Steenkamp, 'Term premium and rate expectation estimates from the South African yield curve', *South African Reserve Bank Working Paper Series No. WP/20/03*, Pretoria: South African Reserve Bank, June 2020. https://www.resbank.co.za/content/dam/sarb/publications/working-papers/2020/9998/WP-2003.pdf

Box 2 Lower inflation: the role of target clarity and favourable circumstances

South Africa's inflation rate has moderated in recent years, in line with the Monetary Policy Committee's (MPC) articulation of a clear preference for the midpoint of the target range. Whereas headline inflation before the announcement averaged 5.4% (over the 2010–17 period) and was often very close to the top of the band, it has fallen to an average of 4.0% since the beginning of 2018.[1] This period of disinflation is particularly remarkable as it coincided with rand weakness, almost always a harbinger of higher inflation. Lower crude oil prices helped neutralise the inflationary impact of a weaker rand, but the experience also demonstrates how communications can help anchor inflation expectations and achieve big gains for the economy. In the absence of disinflation through the past year, interest rates could have averaged more than 2.5 percentage points higher than the 3.5% level set by the MPC, working against the economic recovery.

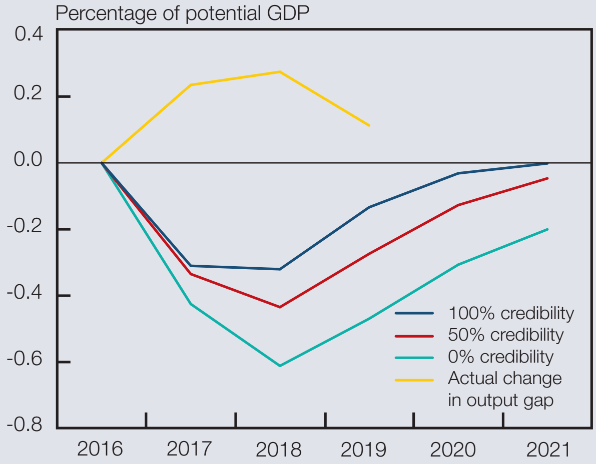
While there is broad agreement that low inflation is beneficial for an economy, aligning inflation to levels in competitor countries is often resisted, as the costs associated with lowering inflation are seen to be high. The literature, however, tells us that monetary policy credibility determines how fast expectations adjust.[2] High-credibility regimes get faster adjustment with minimal output losses, and vice versa. Thus, rapid disinflation is optimal if the new target can be effectively and credibly communicated. Also, the more forward-looking inflation expectations are, the smaller the cost of bringing inflation down to the preferred target. Gradual disinflation can build credibility over time, but it raises the overall economic costs.[3]

Using the South African Reserve Bank's Quarterly Projection Model, simulations indicated that, under a 100% monetary policy credibility scenario, it would take about one year to lower the inflation target by 1.5 percentage points (from 6.0% to 4.5%), and the output gap would close in three years, with a sacrifice ratio[4] of 0.8 percentage points of gross domestic product (GDP). In a 50% credibility scenario, the output gap would take about six years to close, and the sacrifice ratio would rise to 1.2 percentage points of GDP. In a 0% monetary policy credibility scenario, it would take about eight years to close the output gap, with a 2.1 sacrifice ratio.

Actual outcomes offer a sharp contrast to the simulations. While inflation came down to the 4.5% midpoint of the target range, there is little evidence of a cyclical output forgone over the 2017–19 disinflation period when measuring the output foregone by the change in the output gap.

Output gap scenarios

Percentage of potential GDP



Source: SARB

1 Over the 2010–17 period, the inflation rate was above the 5.5% mark more than 53% of the time and above the 5.75% mark 42% of the time.

2 Monetary policy is said to be credible when the central bank's actions are consistent with reaching its stated goals, and economic agents believe that the central bank will act in a way that ensures the realisation of those goals.

3 E Schaling and M Hoeberichts, 'Why speed doesn't kill: learning to believe in disinflation', *De Economist* 158(1), Amsterdam: De Nederlandsche Bank, March 2020. https://link.springer.com/article/10.1007/s10645-010-9136-3

4 The sacrifice ratio measures the amount of output (GDP) forgone to lower the inflation rate by 1.0%.

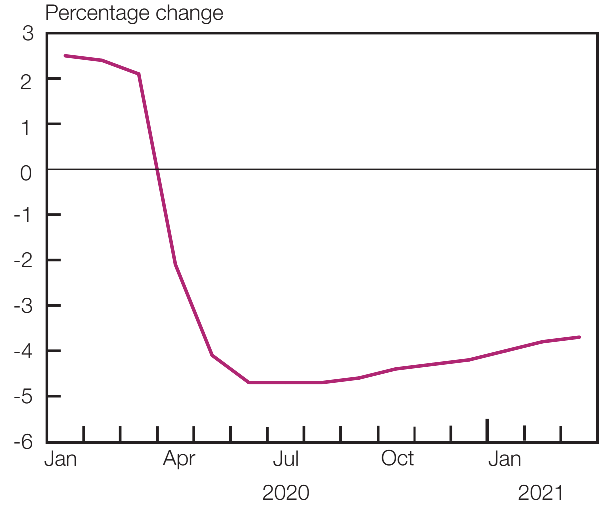
The global economy: a divergent recovery

The global economy is on a recovery path. Expansionary global fiscal and monetary conditions as well as vaccination campaigns should continue to support the recovery. Individual economies are, however, progressing at divergent speeds. Beyond the short-term outlook, the COVID-19 pandemic is likely to leave permanent scars on the world economy, including high fiscal deficits, elevated debt and weak investment. Certain sectors, such as travel and tourism, will take years to recover. Global inflation is expected to remain subdued against a backdrop of well-anchored inflation expectations and muted underlying inflationary pressures.

The path to recovery

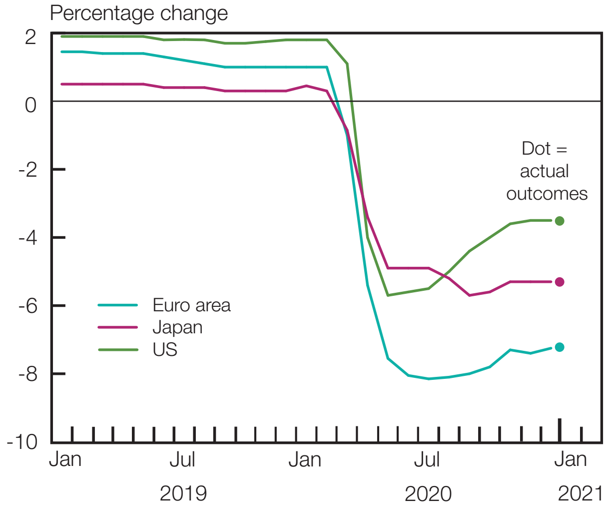
The global economy is on a recovery path after weathering the pandemic-induced recession better than expected. At the height of the COVID-19 crisis, consensus expectations were for the world economy to contract by around 4.7% in 2020. More recent global growth estimates, however, project a decline of around 3.8% in 2020, mainly due to a firm recovery across most regions of the world in the second half of the year.[18] As the recovery takes shape, considerable volatility will mark the global economic trajectory, and the long-term effects of the pandemic on the world economy will come into sharper focus. At a global level, inflation is likely to remain muted, but, in the near and medium term, supply disruptions and other factors will generate significant divergences in relative prices, in particular between global food, commodities and services prices.

Evolution of the 2020 global growth forecast



Source: Consensus Economics

Evolution of and actual 2020 real GDP growth



Source: Bloomberg

Advanced economies

The rebound across the advanced economies has been strong, underpinned by exceptionally large government stimuli – fiscal and monetary. Growth, however, has diverged across countries. According to the IMF (2021), the US economy contracted by 3.5% in 2020, compared to the initial expectation for an 8% contraction, while Japanese GDP contracted by 4.8% in 2020, less severe than the 5.8% initial expectation. These better-than-expected growth outcomes were mainly due to activity normalising faster than expected, additional government fiscal support measures in late 2020 and early 2021, expectations of earlier vaccine availability, and the continued exceptionally accommodative monetary policies of the major global central banks.

The second wave of COVID-19 infections slowed the recovery across some regions, in particular the eurozone, which tightened mobility restrictions in a targeted manner. Despite the US also experiencing a strong second wave of infections

18 The IMF's April 2021 *World Economic Outlook* has global GDP contracting by 3.3% in 2020.

at the same time, stronger growth reflected continued fiscal support and less stringent lockdowns relative to the eurozone.[19] Some European countries – such as Spain (-11%), Italy (-8.9%) and France (-8.2%) – experienced steep contractions in 2020, and eurozone economic activity is now only expected to return to 2019 levels by 2022.[20]

Emerging markets

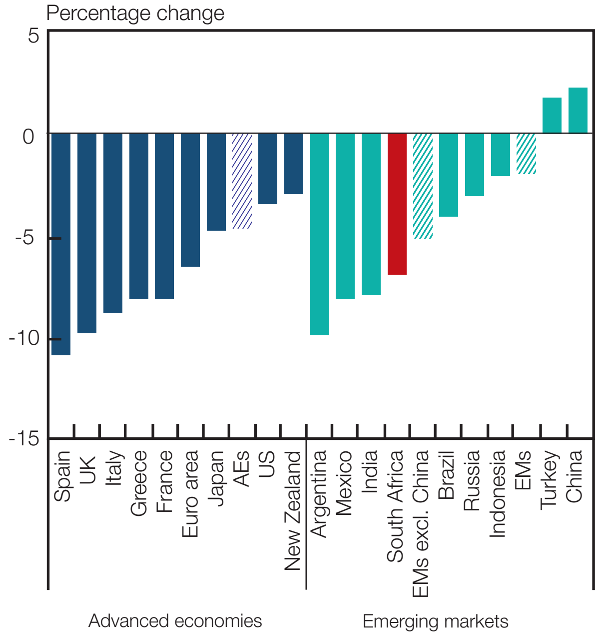
While the advanced economies have fared better than expected, the economic hit to the emerging markets was more severe than initially thought. This was mainly reflected by overwhelmed health-care systems, greater dependency on sectors such as tourism that were severely affected by the pandemic, as well as the fiscal support gap. The fiscal response in most emerging markets was much more constrained, as many of these countries entered the pandemic with little fiscal space. Whereas the fiscal stimulus of the advanced economies averaged about 16% of GDP, emerging markets could only afford an average of about 4%. And despite the relatively weak fiscal stimulus, most emerging markets are now facing high debt burdens due to loss of revenue and, in a lot of cases, unfavourable debt dynamics, many which existed prior to the pandemic.

Emerging market central banks generally responded to the pandemic with large interest rate cuts, new lending facilities and bond purchase programmes to prevent financial market dysfunctions caused by flight-to-safety disinvestments by global and sometimes domestic investors. The governance, size and duration of these bond purchase programmes have, however, been less transparent than in the advanced economies, and the effects on markets less certain.[21]

Emerging market recoveries have also been divergent. China is the only major (emerging) economy to record positive GDP growth (2.3%) in 2020, following effective containment measures, a robust public investment response as well as ample central bank liquidity provisions. Excluding China, emerging market output in 2020 is estimated to have contracted by nearly 6%, with sharp contractions recorded in Argentina (10%), Mexico (8%), India (8%) and Brazil (4.1%).

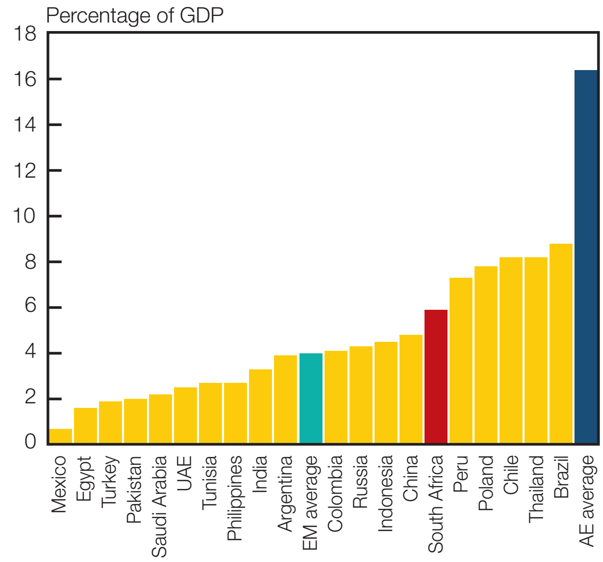
Taiwan and Vietnam performed particularly well in 2020, growing by 3.1% and 2.9% respectively, owing partly to their proximity to China but also to early containment of the pandemic and less need for heavier restrictions. Major exporters in the region, such as Malaysia and Thailand, saw their exports rebound quickly as goods consumption recovered faster than services in the advanced economies.

Real GDP growth estimate (2020)



Sources: IMF and SARB

Emerging market fiscal response (2020)



Source: IMF

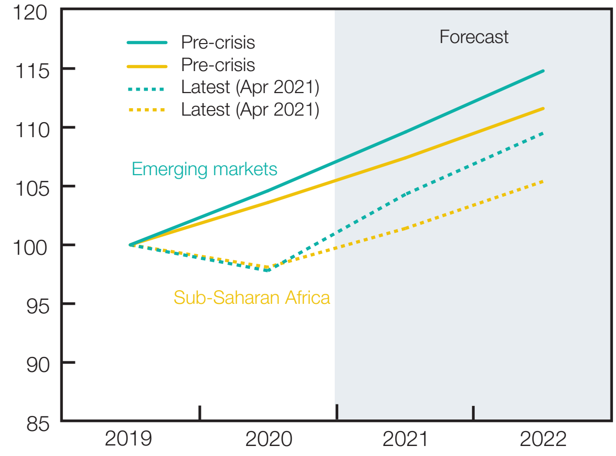
19 The philosophies were also different, with the US resisting a tightening of mobility restrictions, but also seeing the largest share of COVID-19 infections and deaths among the advanced economies.

20 International Monetary Fund, *World Economic Outlook*, Washington DC: International Monetary Fund, April 2021.

21 World Bank, *Global Economic Prospects*, Washington DC: World Bank, January 2021.

Sub-Saharan African real growth divergence

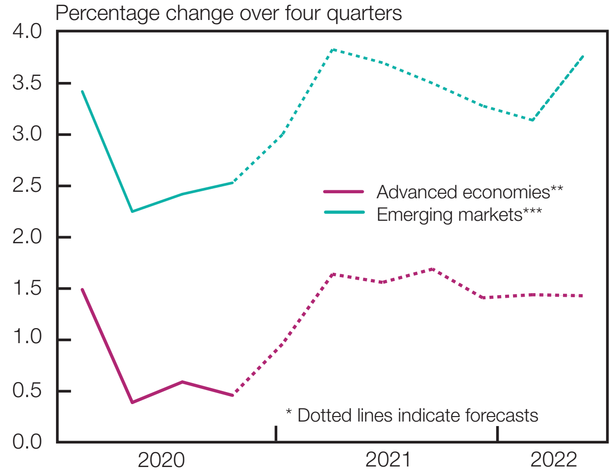
Index: 2019 = 100



Source: IMF

Inflation in advanced economies and emerging markets*

Percentage change over four quarters



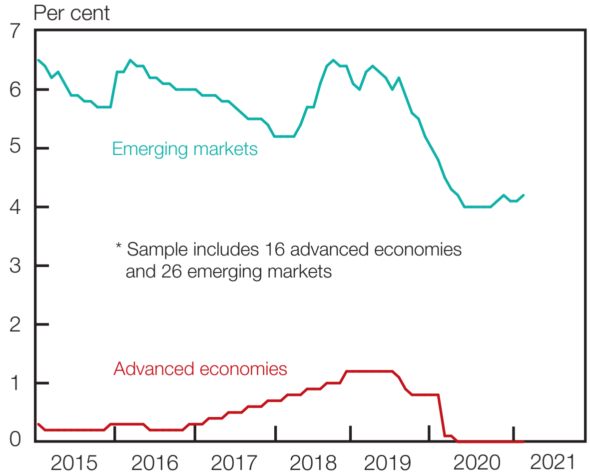
** Includes unweighted average of 15 advanced economies

*** Includes unweighted average of 21 emerging markets

Sources: Bloomberg and SARB

Policy rates*

Per cent



Sources: Haver and SARB

Unlike emerging Asia, countries across Latin America were less successful in weathering the COVID-19 wave, with GDP for the region projected to have contracted by 7%.

Like Latin America, sub-Saharan Africa (SSA) economies were heavily impacted by the pandemic, with GDP estimated to have fallen by 1.9% in 2020 (the contraction is only 0.4% if Nigeria and South Africa are excluded). The most severe impacts of the pandemic were felt in the tourism-dependent and oil-exporting economies. Mauritius' GDP, for instance, is expected to have contracted by 15.8% in 2020, and Nigeria's by 1.8%. However, the oil price has been recovering in line with the global economy, which should lift growth for oil exporters in the region.

Inflation

After declining sharply at the height of the pandemic, global inflation has been increasing modestly, reflecting the recovery in the world economy. Inflation in the G3 – being the US, Japan and the eurozone – averaged 0.7% in 2020, well below the 2% target. However, expectations are for inflation to pick up in the advanced economies, albeit at different speeds. According to the IMF (2021), inflation is expected to rise firmly to about 2.3% in 2021 in the US and at around 1.4% and 0.1% in the eurozone and Japan respectively.[22] Emerging market inflation has started to increase, and is projected to average 3.5% in 2021, which is lower than the historical average for the group.

Monetary policy remains expansionary and supportive of the global recovery. Policy rates across the major advanced economies should remain accommodative, against a backdrop of well-anchored inflation expectations and muted inflationary pressures. Emerging market central banks should also maintain their monetary support where possible, while being more limited in countries experiencing rising inflation. As of December 2020, some emerging market central banks have continued with asset purchases, while many others have paused as inflation expectations have increased.[23] Indeed, monetary tightening has begun in some major emerging markets, including Brazil, Russia and Turkey.

22 The sharp pickup in the US economy is raising fears that inflationary pressures could start to increase and spill over to the rest of the world. However, against a backdrop of elevated US unemployment (at least relative to the pre-COVID-19 level) and the negative output gap, underlying inflation pressures remain modest.

23 According to the World Bank, as of mid-December 2020, 18 emerging market central banks announced or implemented asset purchase programmes (World Bank, *Global Economic Prospects*, Washington DC: World Bank, January 2021).

Global recovery

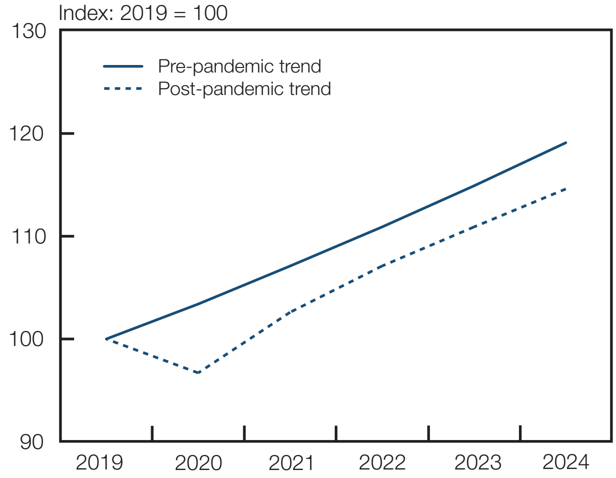
The IMF projects the global economy to expand by 6% in 2021 and by 4.4% in 2022. This represents a 0.5, and respectively, 0.2 percentage points upward revision to growth relative to the January forecasts. While these are large adjustments, they will still leave output levels below the pre-pandemic trend. The global recovery is highly dependent on the success of vaccine roll-outs. Uncertainties exist around the ramp-up of production and distribution, and the willingness of the population to get vaccinated.[24] Challenges in vaccine roll-outs, including inequitable access (particularly by the developing economies), could delay the containment of the virus and slow the recovery process.

The ongoing debate about the expected shape of the global recovery – L, U, V or W – has been supplemented by the K-shaped recovery. In the K shape, economic conditions are expected to rebound sharply for certain sectors (such as technology firms), while those affected directly by the pandemic (such as small businesses, transportation, tourism and commercial real estate) may take years to recover. Despite the reopening of economies, the recovery in travel and tourism has been slow, and will remain dependent on the successful roll-out of vaccinations.

While the global recovery is expected to gradually improve as uncertainty recedes, there are concerns that the pandemic may leave lasting scars on the global economy, particularly in the form of diminished potential growth.[25] Of particular concern is the impact the pandemic has already had through lower investment, erosion of human capital because of extended periods of unemployment, and loss of schooling, especially in emerging markets.[26] According to the World Bank, the pandemic could knock 0.6 percentage points off emerging market potential growth over the next decade.

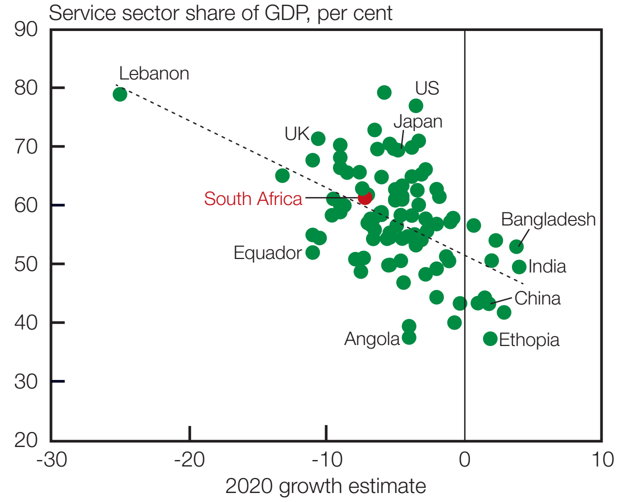
Another concern for the global outlook is the sharp increase in debt in response to the pandemic. The global government-debt-to-GDP ratio reached a new record high of 82.3% in 2020, driven by the substantial fiscal support provided by the advanced economies (US$11.8 trillion), which pushed average debt-to-GDP to 130%. In emerging markets, the ratio rose to 63%, with major increases seen in Brazil, China, India and South Africa.

Global real GDP levels



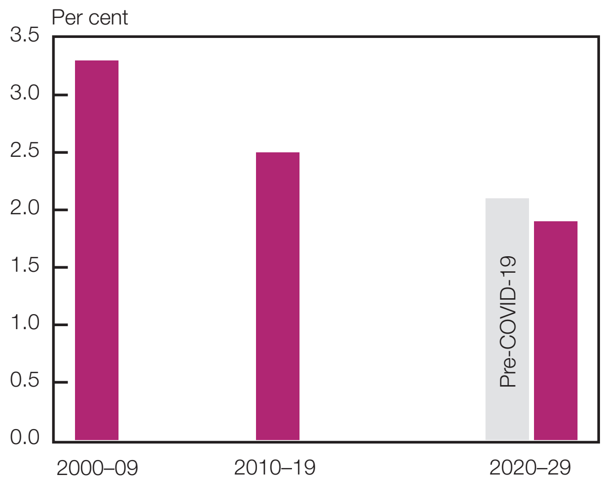
Sources: IMF and SARB

Service sector impacted by COVID-19



Sources: Bloomberg and World Bank

Global potential growth estimates



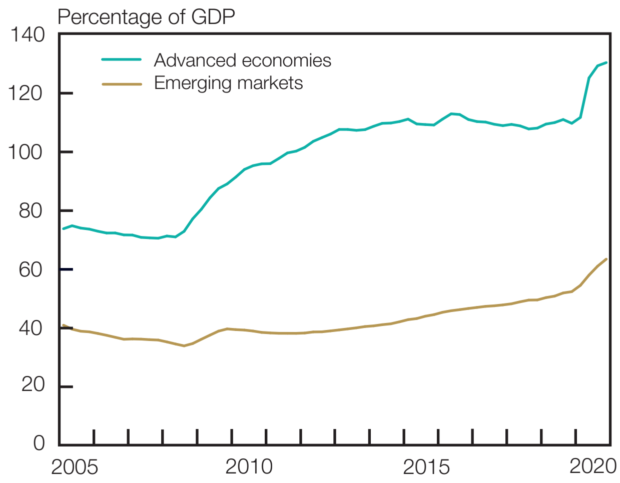
Source: World Bank

24 The World Economic Forum surveyed 18 526 participants across 15 nations and found that 73% of the participants indicated a willingness to get a COVID-19 vaccine if available.

25 World Bank, *Global Economic Prospects*, Washington DC: World Bank, January 2021.

26 A Dieppe, *Global productivity: trends, drivers and policies*, 2020.

Government debt



Source: IIF

Global debt could rise further, exacerbating debt vulnerabilities and leading to debt distress, as already seen in countries such as Chad and Zambia. Countries with weak fiscal positions and/or elevated debt levels will struggle to provide additional stimulus in the event of renewed outbreaks or to finance their deficits in the event of a strong risk-off event. However, it appears that most countries with a structural deficit saw a current account improvement in 2020, largely on higher commodity prices and weak import demand, but this is unlikely to last long as the pandemic eases and economic activity levels reach previous highs.[27]

Conclusion

A recovery in the global economy is underway, though the pace of recovery is divergent across countries. The strength of the recovery will in large part depend on monetary policy settings by the major global central banks remaining accommodative for longer, and the success of vaccine roll-outs. Risks to the recovery include large fiscal deficits, elevated debt ratios, a mutated virus resistant to the existing vaccines and heightened uncertainty. These risks, should they materialise, could prolong the return to pre-pandemic output levels.

27 The likes of Chile, Indonesia and Peru should see a narrower shortfall in 2020, while Brazil, India, Mexico and South Africa have probably posted their first surplus in years.

Box 3 Vaccination roll-out and global growth

To date, the World Health Organisation estimates that COVID-19 has infected 13% of the world's population, while 0.11% has succumbed to the virus. The global population, therefore, remains well below the threshold for natural herd immunity[1], which is estimated to be in the region of 60–90%, highlighting the key role of vaccination in reaching herd immunity at a much-reduced human and economic cost. Other than the containment of the outbreaks of the virus, governments' main focus is to reach vaccine-assisted herd immunity, as it appears to be the safest path to return to full economic activity.[2] This box assesses the state of vaccination roll-outs and the implications for the global growth outlook.[3]

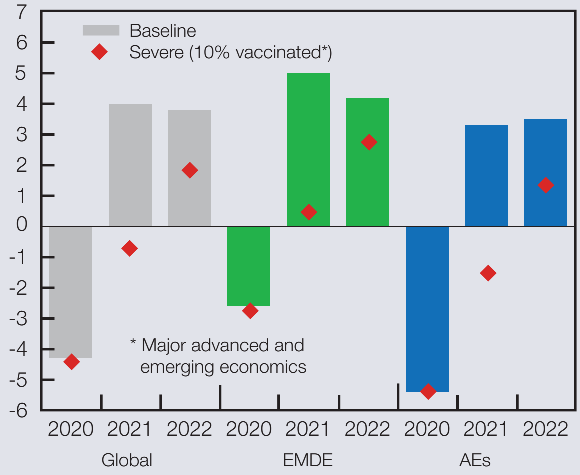
COVID-19 is unique in that it is perhaps the first disease ever that requires concurrent worldwide vaccination, putting immense pressure on vaccine production and distribution systems. As of early 2021, vaccines were in short supply, with many already reserved for the advanced economies[4], which could see the poorer countries falling behind in vaccine access and distribution.

The pace of vaccination differs vastly across countries, but generally the start has been slow. The difficulty in accessing and distributing vaccines could delay the achievement of herd immunity and thereby slow the global economic recovery. The stockpiling of vaccines by richer countries could also leave the COVID-19 Vaccine Global Access (COVAX) initiative (on which low-income countries rely) at risk of vaccine shortages. In turn, uneven access to vaccines could prolong the pandemic and raise the risk of further vaccine-resistant mutations of the virus.

A recent study has found that a delay in bringing the pandemic under control in the developing countries could wipe around US$9.2 trillion off world output in 2021, largely through the trade channel, with the advanced economies bearing the brunt of these losses.[5] This potentially has far-reaching implications for the developing economies through,

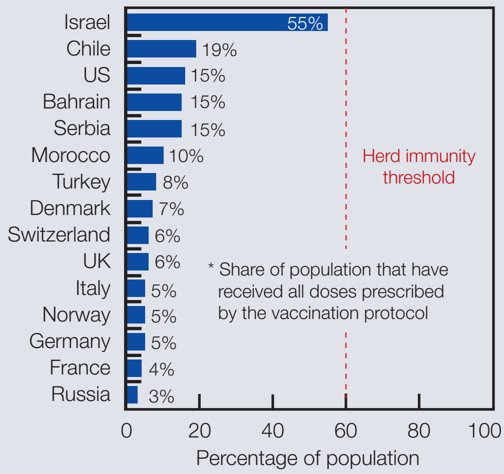
Vaccination growth scenarios

Per cent



Source: World Bank

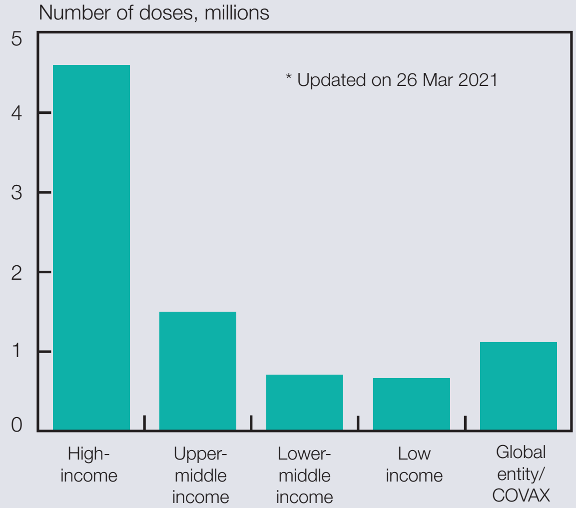
Population fully vaccinated against COVID-19* by 31 March 2021



Source: *Our World in Data*

Confirmed COVID-19 vaccine doses purchased*

Number of doses, millions



Source: Duke Global Health Institute

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1 Herd immunity is the protection from an infectious disease that happens when a population becomes immune to the disease, either through vaccination or through a previous infection with the disease.

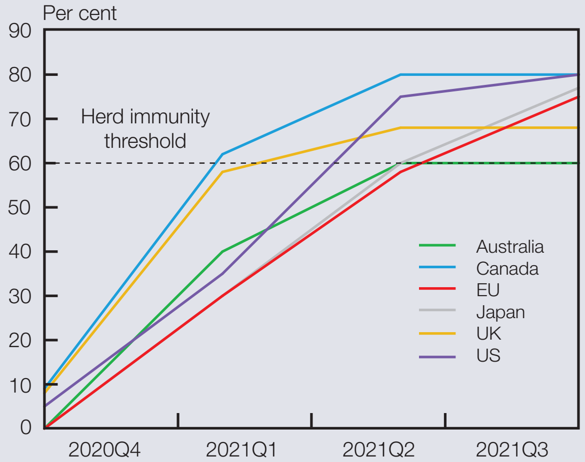
2 The World Bank's global growth scenarios for 2021 present forecasts ranging from a worst-case scenario of -1% to a best-case scenario of 5% for global growth this year, depending on the proportion of populations vaccinated in the major advanced and emerging economies.

3 Within a year of the outbreak of the pandemic, 12 vaccines had received emergency use approval, with around 89 others at an advanced stage of development – an extraordinary achievement. See C Zimmer, J Corum and S-L Wee, Coronavirus vaccine tracker. *The New York Times*, https://www.nytimes.com/interactive/2020/science/coronavirus-vaccine-tracker.html

4 The authors of an article published in *The Lancet* medical journal estimate that rich nations, representing 16% of the global population, had already secured 70% of vaccine doses as of February 2021. See O J Wouters, K C Shadlen, M Salcher-Konrad, A J Pollard, H J Larson, Y Teerawattananon and M Jit, 'Challenges in ensuring global access to COVID-19 vaccines: production, affordability, allocation and deployment', *The Lancet* 397(10278), 2021, p 1028. https://www.thelancet.com/action/showPdf?pii=S0140-6736%2821%2900306-8

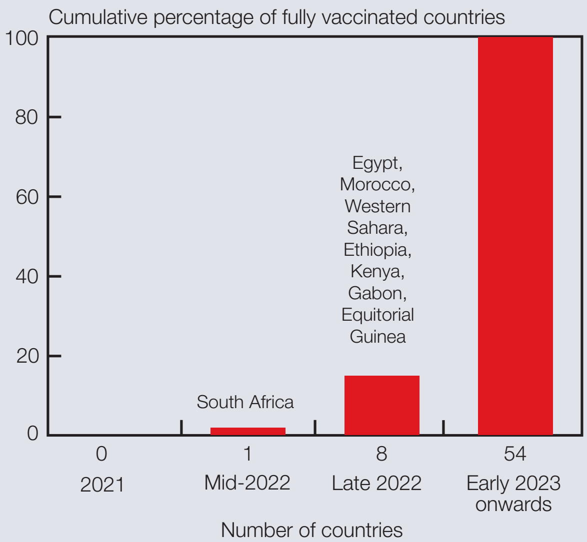
5 C Çakmakli, S Demiralp, S Kalemli-Özcan, S Yesiltas and M A Yildirim, 'The economic case for global vaccinations: an epidemiological model with international production networks', *National Bureau of Economic Research Working Paper Series No. 28395*, Cambridge: National Bureau of Economic Research, January 2021.

Forecast of vaccines



Source: Deutsche Bank

When will Africa be fully vaccinated?



Source: *The Economist*

for instance, loss of export markets, reduced growth and slippage on the sustainable development goals, as well as the direct and indirect human costs of the pandemic. The pandemic is likely to have had severe negative effects on human capital accumulation in developed and developing countries, given the difficulty in achieving widespread online learning.

The major advanced economies such as the United Kingdom and the United States are expected to reach herd immunity by the first half of 2021.[6] While inoculations in the advanced countries started in earnest around the last week of 2020, most middle-income countries are only starting their roll-out in the first half of 2021 – and the last to achieve widespread coverage could be Africa, by mid-2023 or early 2024.[7]

The pace of vaccination is currently less than optimal, and the inequities are substantial. Narrowing the gap in rolling out vaccines between nations should therefore be a policy priority. The pace is, however, expected to accelerate in the coming quarters, as (i) the initial logistical challenges at production and/or distribution level should be overcome through learning by doing, (ii) supply should increase as more vaccines are approved, and (iii) the need for stockpiling by the advanced economies is likely to decline, and some of these excess supplies could be released into the market.

Progress on vaccination and the recovery of the global economy should spur South Africa's economic recovery through the trade channel. However, the slow pace of vaccination in sub-Saharan Africa could slow recovery in the region – a major trading partner for South Africa.

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6 Deutsche Bank, *Focus Germany: outlook 2021 – contingent on the COVID cycle*, 6 December 2020.

7 Editorial, 'Africa's recovery from COVID-19 will be slow', *The Economist*, 6 February 2021.

Box 4 The 'wall of liquidity' and its potential implications

Aggressive policy responses to the COVID-19 pandemic as well as higher household and corporate savings rates have seen global monetary aggregates accelerating sharply. The South African Reserve Bank (SARB) estimates show that a United States (US) dollar-denominated combined M2 money supply aggregate for 17 of the world's largest economies rose by 19.3% year on year in January 2021, the highest reading since 2008. This stands in contrast to the 2008–09 global financial crisis which saw a sharp slowdown in monetary aggregates.

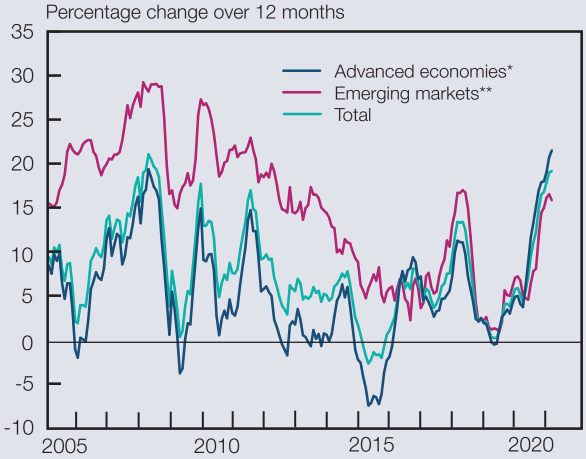
The bulk of this surge in M2 reflects increases in private sector bank deposits.[1] Government cash transfers to households and businesses (combined with a deferral of tax liabilities) occurred early in the pandemic, at a time when lockdowns limited the ability to spend or invest. With cash flowing in and taxes deferred, especially in the advanced economies, and as precautionary savings and liquidity preferences increased, households' savings rates surged. As economies reopened, savings rates started to normalise, although the second wave of the pandemic and its accompanying lockdowns has delayed that process.

As the COVID-19 pandemic is better controlled and economic activity normalises, consumption and investment out of the accumulated stock of savings could result in a stronger economic recovery and higher inflation. However, the unwinding of these large deposits could take time. Presently, in many large economies, consumer surveys indicate heightened concern about job losses and wariness of concluding big-ticket purchases. Furthermore, the surge in savings is not evenly distributed, with higher-income households, who have a lower propensity to consume, saving much more than lower-income households.[2] Equally, the distribution of companies' cash buffers may be concentrated in particular sectors, meaning that high corporate deposits may not be a good indicator of a broad-based rebound in investment once normalcy returns.

The risk of sharply higher inflation also appears to be muted.[3] As seen in the rebound from the bursting of the dot-com bubble of the early 2000s, not all episodes of money supply acceleration result in inflation. More broadly, in large economies where the pickup in money supply was particularly strong in recent quarters (Canada, Japan and the US), the correlation between monetary growth and inflation has proven weaker in

Aggregate M2 money supply

Percentage change over 12 months



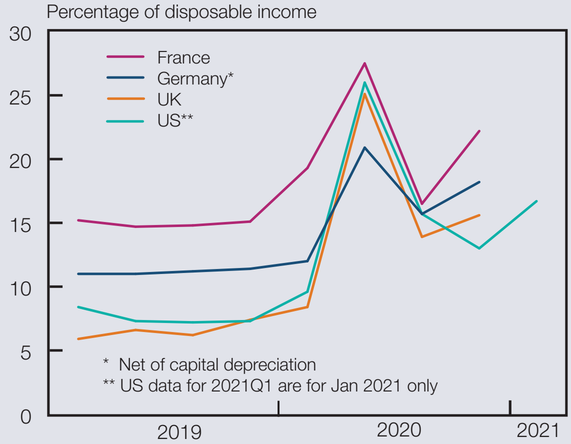
* Advanced economies include Australia, Canada, the eurozone, Japan, South Korea, the UK and the US. Data for Australia are M3 as authorities do not calculate M2.

** Emerging markets include Argentina, Brazil, China, India, Indonesia, Mexico, Russia, Saudi Arabia, South Africa and Turkey.

Sources: Haver and SARB

Household savings in selected advanced economies

Percentage of disposable income



Sources: Bloomberg, Haver and SARB

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1 OECD, 'The increase in bank deposits during the COVID-19 crisis: possible drivers and implications', *OECD Economic Outlook* 2020(2), December 2020.

2 C Nourse, J Tasker and M Garofalo, 'How has COVID affected household savings?', *Bank Overground*, Bank of England, 25 November 2020. https://www.bankofengland.co.uk/bank-overground/2020/how-has-covid-affected-household-savings; and J MacGee, T M Pugh and K See, 'The heterogeneous effects of COVID-19 on Canadian household consumption, debt and savings', *Bank of Canada Staff Working Paper No. 2020–51*, Ottawa: Bank of Canada, 27 November 2020. https://www.bankofcanada.ca/wp-content/uploads/2020/11/swp2020-51.pdf

3 See, for instance, A Haldane, 'Inflation: a tiger by the tail?'. Speech by Andy Haldane, Chief Economist and member of the Monetary Policy Committee, Bank of England, 26 February 2021. https://www.bankofengland.co.uk/speech/2021/february/andy-haldane-recorded-mini-speech-on-inflation-outlook

recent decades.[4] Factors such as the credibility of the central bank, the anchoring of inflation expectations and wage determination based on productivity growth, among other things, may limit inflation risks.

Encouragingly, the rise in deposits has allowed both low-cost credit creation where needed and some paring down of debt levels. Growth in loans and advances has remained moderate, and there are signs in some countries that households are using the 'wall of liquidity' to reduce liabilities. Equally, there is no sign that lending standards have been relaxed. Surveys suggest that banks have generally tightened criteria since the start of the pandemic. Such developments, among others, suggest a lower risk of aggressive general increases in overall inflation, although some countries are experiencing rising asset prices. These will be closely watched for implications for financial stability.

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4 Y Wen and M A Arias, 'What does money velocity tell us about low inflation in the US?', *St Louis Fed on the Economy* blog, 1 September 2014. https://www.stlouisfed.org/on-the-economy/2014/september/what-does-money-velocity-tell-us-about-low-inflation-in-the-us

Financial market developments: riding the (choppy) recovery wave

Risk appetite improved in the second half of 2020, following a period of acute market stress during the onset of the COVID-19 pandemic. Markets benefitted from a range of developments, including the development of effective COVID-19 vaccines, large-scale macroeconomic stimulus measures, the US election outcome and the finalisation of the Brexit deal. In this risk-on environment, South African assets also registered gains, despite additional lockdown restrictions and further credit-rating downgrades. Global and domestic conditions turned quite sharply during the first quarter of 2021, however, as US Treasury yields rose, pulling capital into the US and out of other markets, including South Africa.

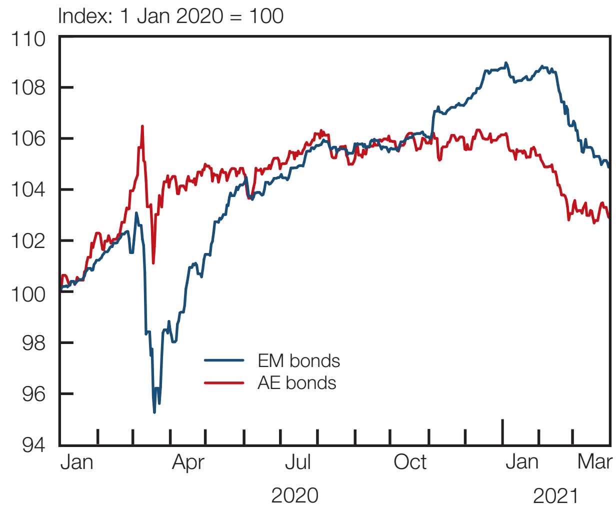
Despite the COVID-19 crisis, many asset classes recorded positive returns for 2020 as a whole. For instance, after declining by as much as 30%, mirroring the declines of the 2008/09 global financial crisis, both emerging and developed market equity indices secured gains in excess of 10% for the year. Similarly, the total return indices for emerging and developed market bonds were 5.9% and 5.3% respectively. Capital flows recovered strongly, with the Institute of International Finance (IIF) recording 12 consecutive months of net inflows into emerging market equities and debt (as of March 2021). While the sudden stop in March 2020 saw outflows of US$90 billion from emerging markets, the subsequent inflows have totalled more than US$480 billion, with the bulk flowing into China.

Volatility also subsided, with the Volatility Index (VIX) declining from a record high of 82 index points in March 2020 to end the year at 22 index points. Lower equity market volatility coincided with a rally in US stocks, which extended their gains to historic levels in February 2021, largely bolstered by the technology sector. The technology-heavy Nasdaq Composite Index's market capitalisation increased to over 60% of the S&P 500, a record high.

The US dollar weakened during the course of 2020, and traded in a fairly sideways manner into 2021. Dollar weakness did not initially serve as a windfall for emerging market currencies, given concerns over their economies and fiscal positions. Most emerging market currencies managed to recover some ground by year-end, but typically did not regain pre-COVID-19 valuations, with the JPMorgan Emerging Market Foreign Exchange Index (JPMorgan EM FX Index), for instance, ending the year 5.6% lower.

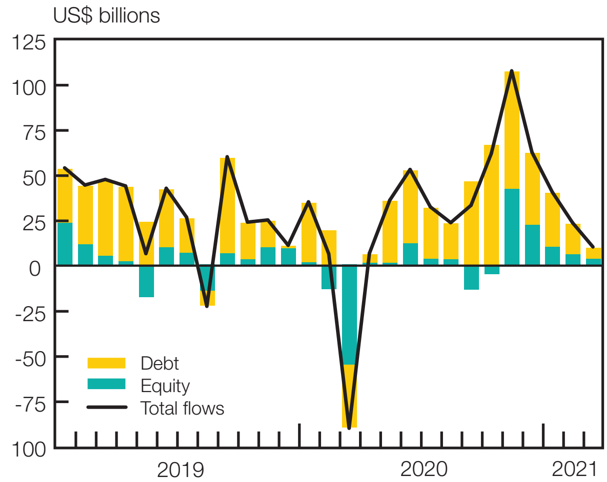
The first quarter of 2021 saw a significant increase in volatility, however, particularly for US Treasury notes, amid higher economic growth and inflation expectations. The yield on the 10-year Treasury note surpassed 1.5% for the first time since March 2020 in February, and the Merrill Lynch Option Volatility

Total bond returns: EMs versus AEs



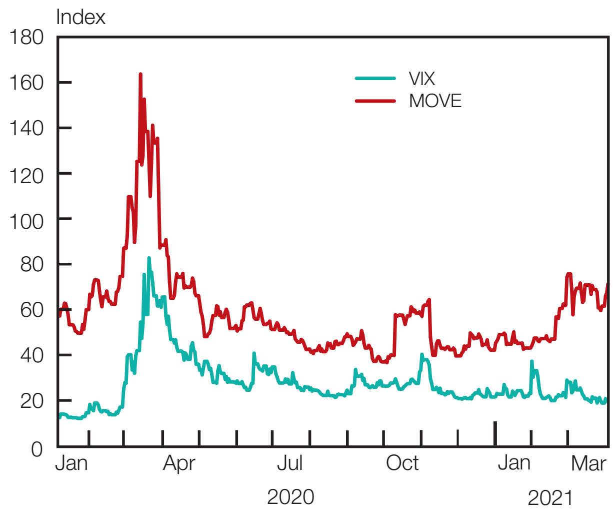
Sources: Bloomberg and SARB

EM portfolio flows



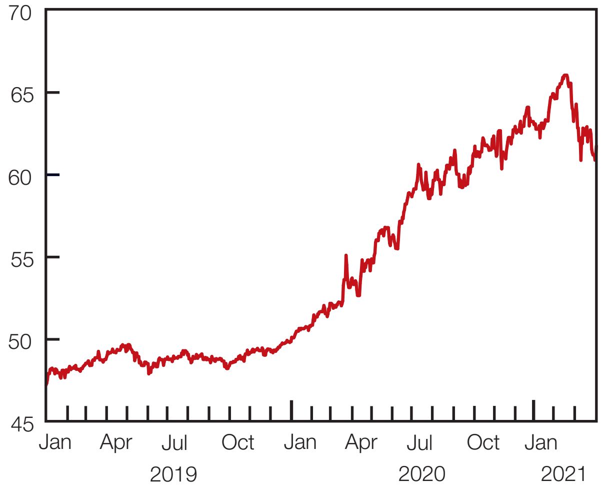
Source: IIF

VIX and MOVE volatility indices



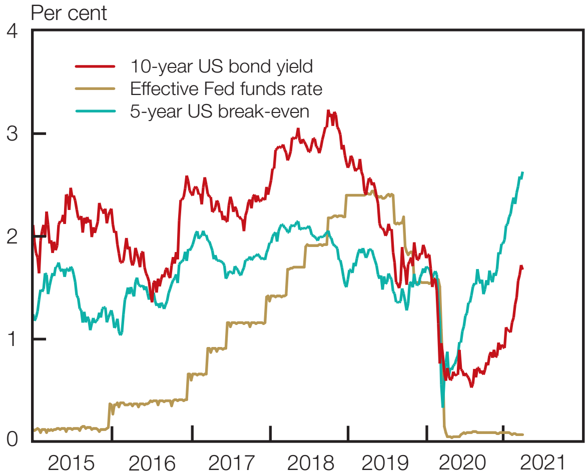
Sources: Bloomberg and SARB

Nasdaq market capitalisation/S&P 500 market capitalisation



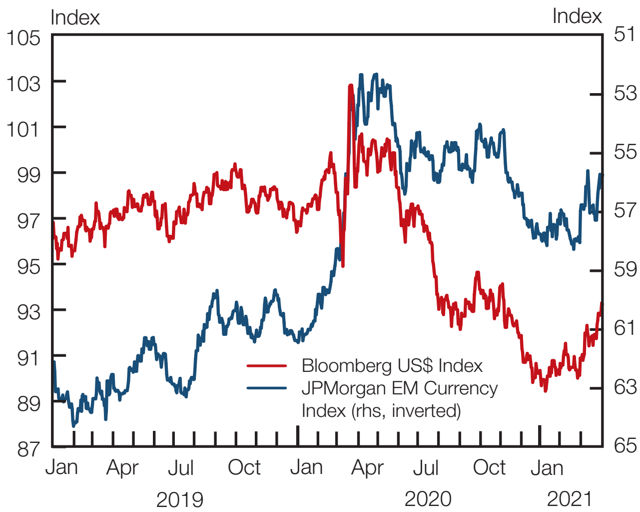
Sources: Bloomberg and SARB

Selected yields and interest rates



Source: Bloomberg

US dollar and emerging market FX indices



Source: Bloomberg

Estimate (MOVE) Index, a gauge for Treasury market volatility, rose to nearly one-year highs. The increase in yields coincided with gains across commodity markets and other barometers of demand. Volatility in US bond markets also fed through to stock markets, with the Nasdaq declining by around 10% from its February peak. European government bond yields also rose, as expectations of a rate cut eased.

In these circumstances, the JPMorgan EM FX Index reversed its 2021 gains, while emerging market bond yields rose over 5%, according to the JPMorgan Government Bond Index (JPMorgan GBI) for local currency. Higher developed market bond yields appear to have eroded the premium that emerging market assets offer investors relative to safe havens.

Domestic financial market developments

Global gains in the second half of 2020 also benefitted South African markets, despite domestic macroeconomic challenges. This progress stalled, however, with the March 2021 sell-off.

In November 2020, South Africa's sovereign credit rating was further downgraded by both Fitch Ratings Inc. (Fitch) and Moody's Investors Service (Moody's), with both agencies also maintaining a negative outlook. Although these developments were not fully anticipated, the market reaction at the time was fairly muted. It may be the case that investors had already taken into account South Africa's earlier exclusion from the World Government Bond Index (WGBI) and the worsening of its sovereign credit rating to sub-investment grade.

Non-resident investors returned to the domestic bond market towards the end of 2020[28], although they remained net sellers of bonds and equities for the period starting March 2020. Yields at the longer end of the domestic bond curve have declined since the previous *Monetary Policy Review (MPR)*, given expectations of reduced supply (and possibly following the strong sell-off in longer-dated bonds previously). At the same time, government significantly increased its shorter-dated debt issuance in the 2020/21 fiscal year, taking advantage of both investor demand and lower funding costs. For the current fiscal year, government anticipates a faster pace of deficit reduction relative to the October estimates and, relatedly, a reduction in net issuance.

28 According to National Treasury, foreign holdings of domestic bonds increased to 30.3% in February 2021, having risen gradually from a multi-year low of 29% in October 2020.

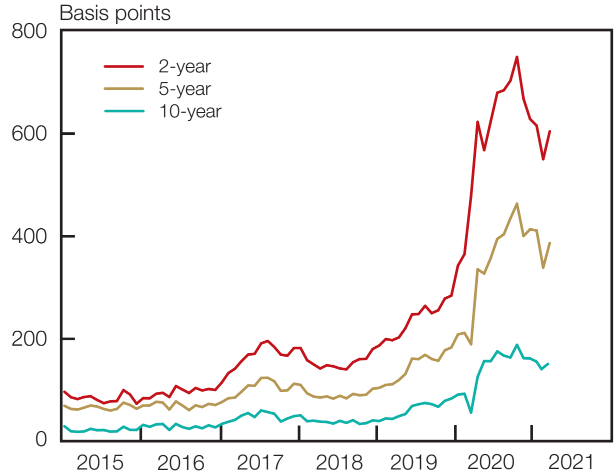
While the initial bond market reaction to the Budget announced on 24 February 2021 was positive, this was tempered by global developments. The spread between long- and shorter-dated bond yields has remained wide, as has the gap between South Africa's local currency domestic bond yields and emerging market averages.[29] Indeed, this gap has widened notably since 2019, when South Africa's fiscal deterioration intensified, as shown, for instance, by the JPMorgan GBI.

Separately, the JSE Limited (JSE) All-Share Index (Alsi) ended 2020 in positive territory, and extended its advance to reach a peak in February 2021. Gains were led primarily by mining sector stocks on the back of strong commodity price increases. Conversely, the property, retail and banking sectors continued to underperform, as a generally weak economic climate weighed on the earnings outlook. The returns of the JSE Alsi remained positive on a year-to-date basis.

As mentioned in the previous *MPR*, the SARB implemented various measures to provide liquidity to the money market from the onset of the pandemic.[30] While the take-up of crisis facilities was significant in March 2020, usage declined over time amid enough cash in the system. This was evidenced by commercial banks' negotiable certificate of deposit (NCD) bid-offer spreads, which returned to pre-crisis levels as early as May. The 3-month Johannesburg Interbank Average Rate (Jibar) dipped below the official policy rate between mid-August and late December, when sufficient liquidity generally drove short-term interest rates lower, but has since traded at a positive spread. By contrast, implied rates were temporarily higher in the foreign exchange (FX) forward market, where there have been shortages of liquidity (discussed in Box 5).

South African yield spreads to 30-year domestic bond

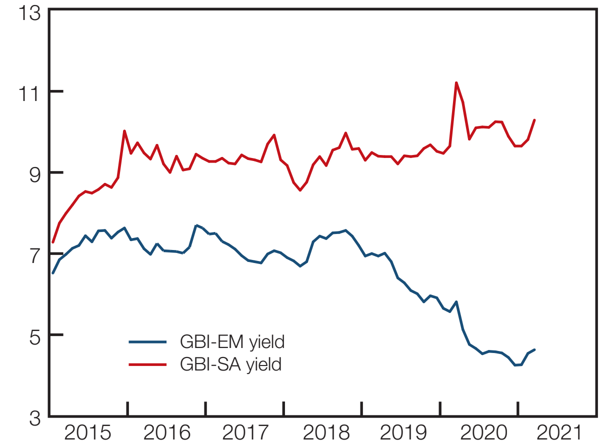
Basis points



Sources: Bloomberg and SARB

JPMorgan GBI (local currency) bond indices

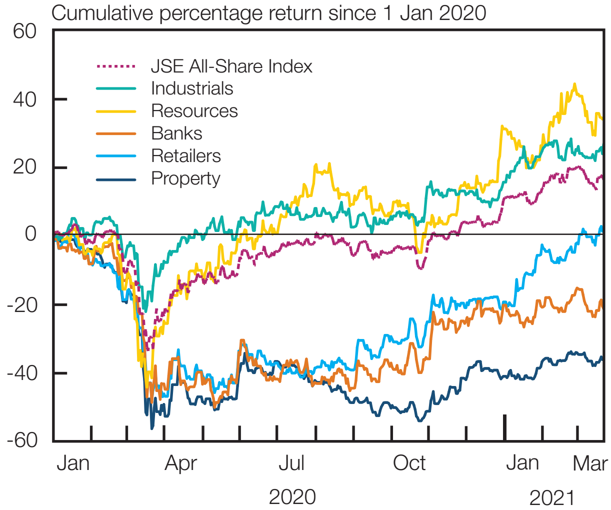
Per cent



Source: Bloomberg

Equity performance

Cumulative percentage return since 1 Jan 2020

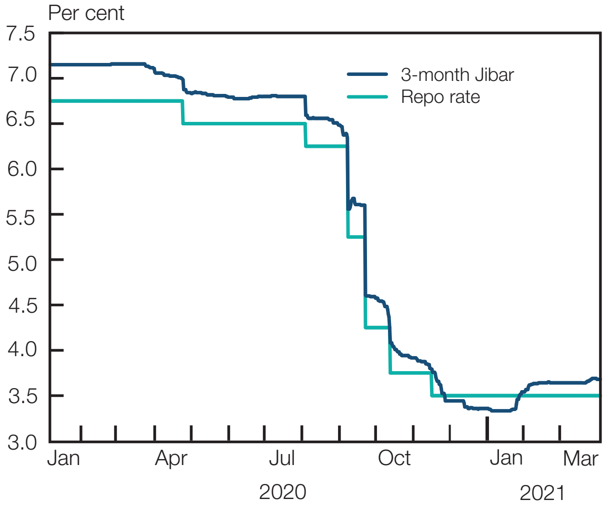


Sources: Bloomberg and SARB

29 Historically low short-term rates should, through the term structure of interest rates, lower longer-dated rates. However, this channel is likely intermediated by the term premium, on account of elevated fiscal risks and the resultant sovereign downgrades.

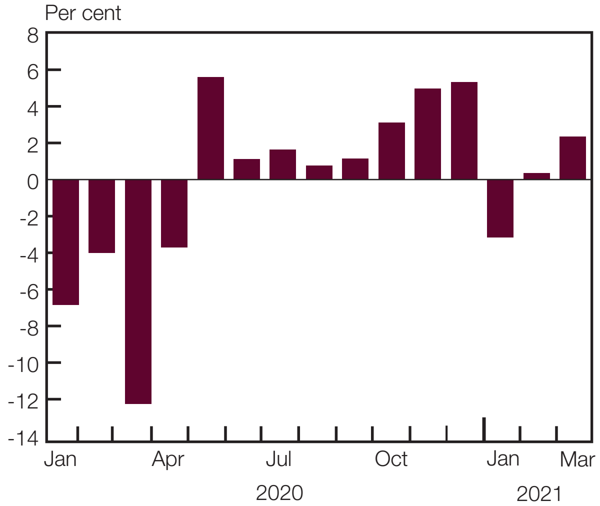
30 The SARB's measures included offering daily Intraday Overnight Supplementary Repurchase Operations (IOSROs) and term repurchase facilities, an adjustment to the interest rates on standing facilities (SFs), deviation from the targeted R56 billion weekly money market shortage, and secondary market government bond purchases to alleviate the observed dysfunction in that market. Liquidity operations were gradually unwound as conditions started to normalise. Specifically, the SF interest rates were adjusted to their standard levels in mid-August 2020: the SF repo/lending rate was adjusted to the repo rate plus 100 basis points, and the SF reverse repo/deposit rate was adjusted to the repo rate less 100 basis points. The three-month term repo facility and the IOSROs were discontinued in December 2020 and February 2021 respectively, and the main Wednesday repurchase auction amount reverted to R56 billion in February 2021.

3-month Jibar and repo rate



Source: Bloomberg

Rand against the US dollar, monthly performance



Source: Bloomberg

In tandem with its emerging market peers, the rand recouped most of its 2020 losses, particularly in the final quarter, after depreciating to a record low of R19.30 against the US dollar in April 2020. While the rand has weakened against the dollar since the start of this year, it has nonetheless been one of the best-performing emerging market currencies over the past six months, reflecting its high beta status.

Generally, emerging market assets have benefitted from the easy financing conditions worldwide at a time when emerging market current account deficits have narrowed and inflation is below longer-term averages. Despite this, the potential remains for sharp swings in market sentiment given the possibility of a declining degree of government and central bank support, which keeps concerns of 'tantrum' episodes intact. New virus strains, an uneven global economic recovery and precarious fiscal positions also warrant caution on the outlook for riskier assets.

Box 5 The problem of high foreign exchange-implied interest rates

There are a number of different markets where financial institutions can source the rand. One of these is the foreign exchange (FX) swap market, where borrowers can swap FX (i.e. the United States (US) dollar) for the local currency. Under normal conditions, the borrowing rates in this market would track the repurchase rate, which is the benchmark for short-term rand borrowing. Over the past six months, however, the short-term FX-implied rates have been volatile and sometimes very elevated – at one point briefly exceeding 12%.

This behaviour is unusual, both from a historical perspective and relative to South Africa's peer countries. While a range of explanations has been offered, there are two that appear especially important.

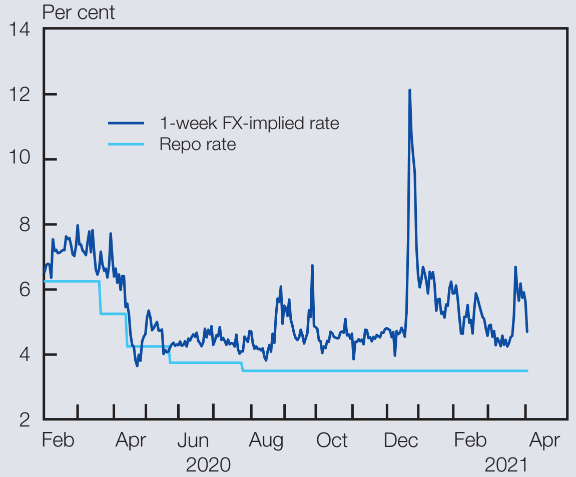
- First, markets have been abundantly supplied with the US dollar, and market players have been reluctant to absorb more. Dollars have been plentiful due to the Federal Reserve's swap lines, quantitative easing and other interventions, in contrast with the early-2020s period where dollars were scarce. Given the current account surplus in South Africa, local demand for dollars has also been unusually subdued. Furthermore, segmentation between markets has prevented unusually high rates in the forward market from being arbitraged away, despite abundant supplies of rand liquidity in the money market. For instance, internal bank limits on foreign currency positions have made it difficult for FX desks to source rands from cash-flush money market desks.
- Second, an already-strained FX forward market was then overwhelmed by the South African Reserve Bank's (SARB) use of FX swaps to sterilise loans from international financial institutions. These funds were transferred directly to the SARB in foreign currency, which the SARB swapped into rands using the forward market. Those rands, in turn, were deposited into National Treasury's tax and loan accounts with banks, while dollars became part of South Africa's FX reserves. These arrangements left the overall rand liquidity in the system unchanged, but, as noted above, this liquidity did not flow smoothly from the cash market into the forward market.

To address these distortions, the SARB has injected rand liquidity into the forward market, focusing on month-end periods when distortions have been largest. These injections were ramped up in December 2020 and January 2021, after smaller interventions in September and November 2020.[1]

From late February 2021, the FX-implied rates have moderated, but the SARB will continue to monitor this market closely and will respond as appropriate to curb extreme movements in FX-implied rates. Such interventions might also require additional tools, and the SARB continues to study options for mitigating extreme movements in FX-implied rates, although no further instruments have been adopted at this stage.

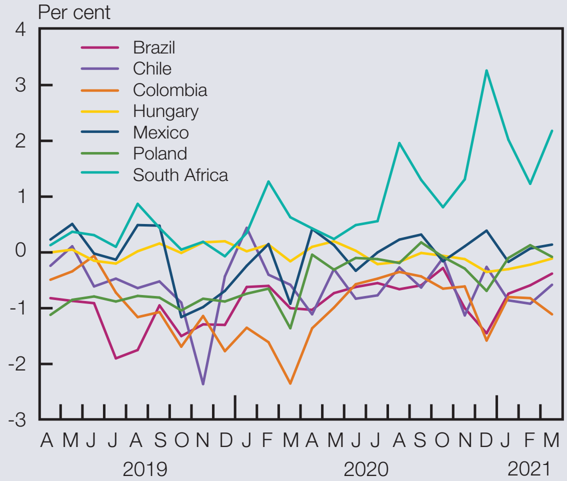
1 Injecting further rand liquidity into the market, however, reduces the money market shortage, which is the basis for monetary policy transmission. Nonetheless, short-term liquidity injections are viable, especially around the end of the month, when they are offset by a higher demand for notes and coin (which expands the shortage). The SARB has also matured some of its swaps, returning rand liquidity to the forward market.

FX-implied rate



Source: SARB

Spread of FX-implied rates over policy rates



Sources: Bloomberg and Haver

Box 6 Green funding opportunities

With the adaptation and mitigation costs of greening economies falling but still high, efficient and transparent financial markets will play an important role in ensuring that the use of greener technologies is funded as cheaply as possible. The calculation of climate-related risks and changing regulatory environments provide support for the development of new financial instruments and markets.

Over the next three years, transition costs are estimated at roughly 1.5% of global gross domestic product.[1] The annual issuance of green bonds may reach US$620–720 billion, and outstanding securities issuances could reach US$4.7–5.6 trillion by 2035.[2] The global issuance of green debt is expected to reach US$500 billion in 2021.[3]

The demand for green financial instruments is also reflected in the strong growth of environmental, social and governance (ESG) equity and fixed-income instruments, which attracted record inflows in Europe and the United States (US) in 2020, outperforming non-ESG funds.[4] Green bonds dominate the sustainable debt market. Global policy efforts – such as the European Union's adoption of the Green Taxonomy Regulation in 2020 and introduction of the Sustainable Finance Disclosure Regulation in 2021, as well as the climate policy agenda of the new Biden administration in the US – provide further support.

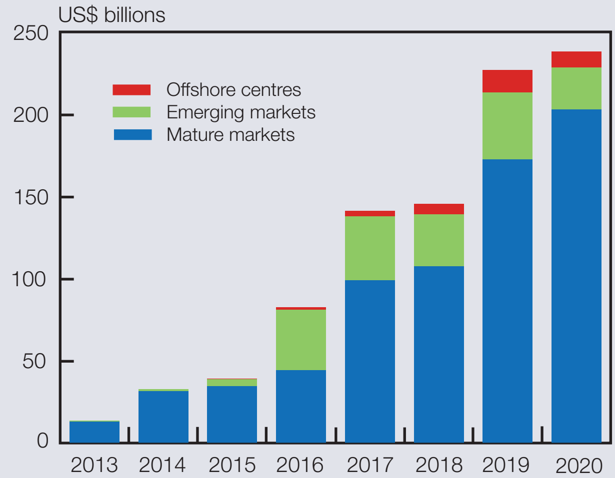
Market development will require a variety of interventions, including support for the development of green-bond indices, the standardisation and harmonisation of principles for green-bond listing across jurisdictions, and ways to reduce transaction and funding costs.[5]

These financial instruments can help tap funding for South Africa's own green transition and large infrastructure needs, especially given its limited fiscal space and low domestic savings.[6] Rising global demand for green investments and the well-developed local capital market can support local issuance of green funding instruments. Domestic institutions such as the Development Bank of Southern Africa are taking advantage of these opportunities, but the local market for green funding remains small.

Growing the market and attracting more (green) foreign funding depends as much on the financial sector regulatory framework as on South Africa's broader policy environment. The best macro policy option to attract funding is maintaining macroeconomic stability (low and stable inflation) and using the fiscal space well. Policy should enable accurate pricing of negative climate-change externalities to better align with investment incentives. Micro policy reforms, which aim to improve the ease of doing business for both local and international investors and try to open up sectors dominated by public companies to competition, provide new green investment opportunities. Missing out on the global green-funding boom and transitioning too slowly will leave South Africa overtaken by other countries and unable to generate the jobs of the future or of the past.[7]

Issuance of green bonds

US$ billions



Sources: IIF and SARB

1 A Turner, 'The costs of tackling climate change keep on falling'. *Financial Times*, 11 December 2020. https://www.ft.com/content/33bb3714-93cf-4af5-9897-e5bf3b013cb7

2 Organisation for Economic Co-operation and Development, *Mobilising bond markets for a low-carbon transition,* Paris: Organisation for Economic Co-operation and Development, 2017.

3 B Nauman, 'Analysts expect as much as $500bn of green bonds in bumper 2021'. *Financial Times*, 4 January 2021. https://www.ft.com/content/021329aa-b0bd-4183-8559-0f3260b73d62

4 Goldman Sachs, 'ESG is no longer optional, but approaches differ across asset managers', *Goldman Sachs Equity Research*, 2021.

5 M Carney, 'Resolving the climate paradox', during an Arthur Burns memorial lecture at the Bank of England, London: Bank of England, 22 September 2016.

6 The Climate Policy Initiative estimates that South Africa faces R2 trillion of transition risks in net present value terms over the period 2013 to 2035, mainly associated with carbon-intensive industries such as coal.

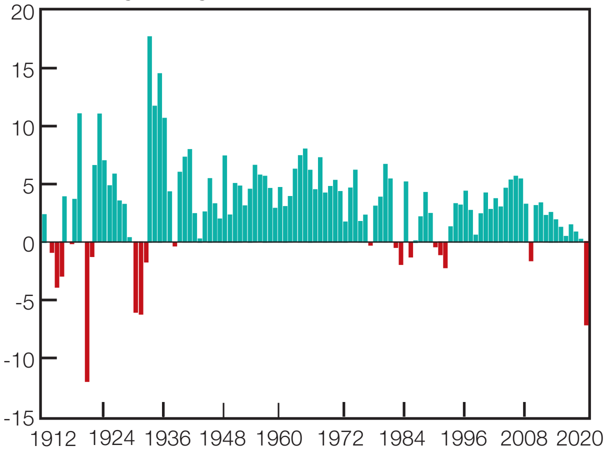
7 See, for instance, C Arndt, C Loewald and K Makrelov, 'Climate change and its implications for central banks in emerging and developing economies', *South African Reserve Bank Working Paper Series No. WP/20/04*, Pretoria: South African Reserve Bank, June 2020. https://www.resbank.co.za/content/dam/sarb/publications/working-papers/2020/10001/WP-2004.pdf

The real economy: uneven recovery across sectors

COVID-19 is the worst shock to the South African economy since the Great Depression of the 1930s, with the economy contracting by 7% in 2020 and unemployment rising to record highs. The economy has recovered faster than expected, though the recovery is uneven across sectors and remains fragile. Elevated terms of trade have supported macro balances, with the current account surplus at its highest level in 32 years and tax revenue overperforming relative to previous projections. The broad distribution of vaccines should accelerate the normalisation of economic activity. However, structural constraints – including insufficient energy supply, the regulatory burden and skills constraints – will impede a faster recovery over the medium term, while the fiscal outlook remains sensitive to the nominal wage bill trajectory and other risks.

Real GDP growth

Percentage change



Sources: Stats SA and SARB

How the COVID-19 shock hit the economy

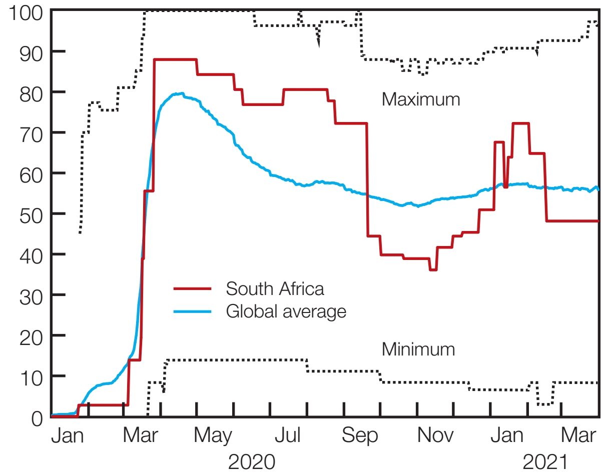
The COVID-19 shock that hit the economy late in the first quarter of 2020 was severe and instant as the country immediately went into a hard lockdown. The lockdown, initially expected to be short-lived, has persisted for the rest of 2020 and into 2021, with varying degrees of stringency. The initial lockdown was the most stringent, and its effect on the economy was sharp: economic activity stalled, and GDP contracted by an annualised 51.7% on a seasonally adjusted quarter-on-quarter basis during the second quarter of 2020.

The impact of the COVID-19 pandemic was broad-based, although the sectors that were unable to operate remotely experienced the steepest losses during the second quarter of 2020. This was especially true for activity in the primary and secondary sectors, such as mining (72%) and manufacturing (74.9%), but also for the tertiary sector, including transport (69.4%) and trade (67.6%). Usually, contractions in the tertiary sector during recessions are less extreme than in the primary and secondary sectors. However, the COVID-19 recession is atypical: it differs from other recessions both in terms of its origins (policy directive) and in terms of its nature (a halt in activity for most of the economy).

The partial reopening of the economy during the third quarter of 2020 caused a large improvement in GDP, with the economy expanding by 67.3% on an annualised basis. The economic rebound continued through the fourth quarter, though at a much slower pace, as economic activity continued to normalise, but also due to the resurgence of the pandemic late in the fourth quarter. Despite these improvements, the contraction in the second quarter had been so deep that by the end of the fourth quarter GDP remained 4.2% smaller than it was in the previous year. For the year as a whole, output contracted by 7%, making 2020 the worst year for growth since 1920.

Lockdown stringency index

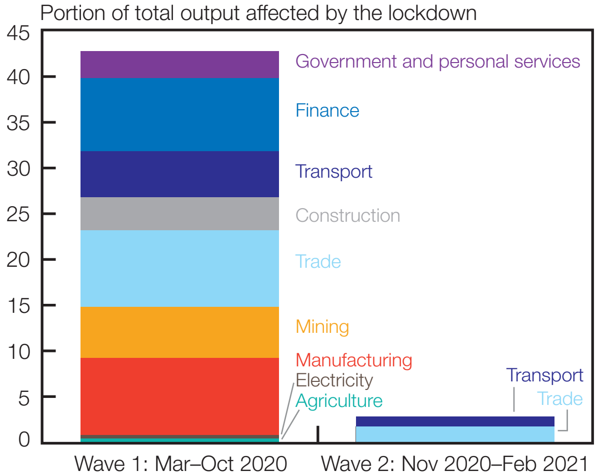
Index



Sources: Oxford COVID-19 Government Response Tracker and SARB

The sharp negative effects of the pandemic on the economy also reflected in the labour market, where the already elevated rate of joblessness was exacerbated. According to the *QLFS*, more than 2.2 million people lost their jobs during the second quarter of 2020. In an effort to minimise job-shedding and to reduce job match destruction, most economic sectors, except for the government sector and utilities, implemented salary and bonus cuts during the height of the pandemic. The *QLFS* notes, however, that workers with less than a matric education not only experienced more job losses; they were also twice as likely to experience earnings cuts as those with graduate qualifications.

Lockdown sectoral impact

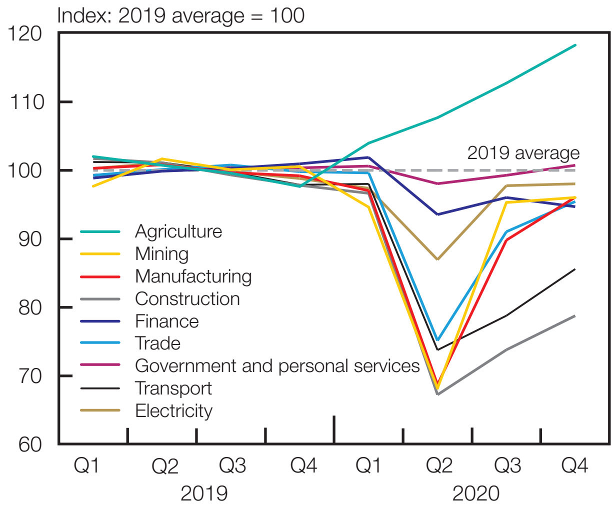


Sources: Oxford University, Stats SA and SARB

Since many individuals were unable to search for jobs during the most stringent episodes of the lockdown, the labour force participation rate declined sharply, artificially lowering the official unemployment rate from 30.1% in the first quarter of 2020 to 23.3% in the second quarter. The labour force has not fully recovered yet, with about 1.2 million people still not back in the labour market by the fourth quarter.

The second wave of the COVID-19 pandemic, which began late in the fourth quarter of 2020, straddled into 2021, with more lockdown measures implemented under the risk-adjusted Level 3 'lite' until the end of February. The measures – which included the closure of land borders, the reintroduction of curfews, and a ban on the consumption of alcohol – once again pushed South Africa's lockdown stringency higher relative to the global average. Still, these measures were significantly less severe than the measures implemented during the first wave of the pandemic, with less than 2.8% of the economy affected during the November 2020–March 2021 lockdown compared to 42% during the March–October 2020 lockdown. The lockdowns were also carefully targeted during the second wave, which helped to minimise economic effects. This suggests that the economy may now have adapted to 'operating' with the COVID-19 virus.

Output (distance from 2019 levels)



Sources: Stats SA and SARB

The recovery

The economy entered the recovery phase during the second half of 2020, after a difficult first half. The recovery has, however, been relatively slow and uneven across sectors. The primary sector appears to have been the least affected, with overall growth in 2020 at -5.3%. The agricultural sector, which grew at 13.1% in 2020, benefitted from bumper crops and the eased lockdown regulations for the sector. Recovery in the mining sector continues to benefit from high commodity prices and a favourable exchange rate. The rest of the economy, however, has seen a more muted recovery, with all but two sectors (agriculture as well as government and personal services) still below the 2019 output level. The construction sector is furthest behind, followed by transport. The pivot towards remote working could further affect the recovery of the construction sector, while the transport and tourism sectors remain subdued as individuals travel less, with international travellers particularly wary of the 501.V2 variant of the virus.[31]

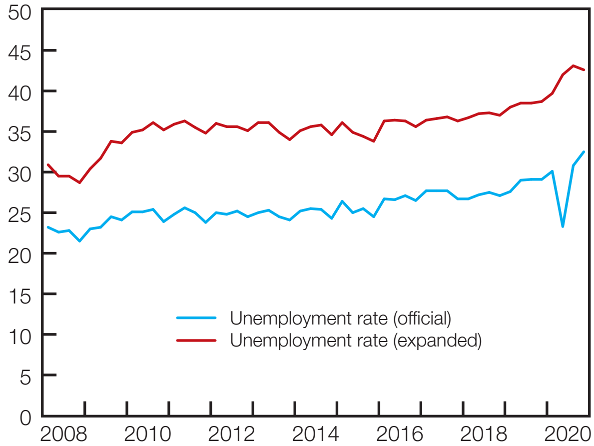
As the economic recovery progressed, so, to some extent, has the labour market, with 3.8 million individuals returning to the labour market by the fourth quarter. Of these, only about 900 000, or 24%, managed to find employment, leaving about 1.4 million jobs still missing relative to the first quarter of 2020. The unemployment rate is now at 32.5%, its highest level since the *QLFS* began in 2008.[32] The broader definition of unemployment, which is less distorted by volatility in the labour force participation rate, has shown signs of moderation, although at 42.6% remains extremely elevated.

The largest driver of growth in the second half of 2020 was household consumption, which benefitted from a favourable credit environment. Households entered the crisis after a long period of deleveraging, with debt as a share of disposable income at just 71.5% in mid-2017, which created space for households to take in new credit. With interest rates at their lowest in five decades, the easing of lockdowns saw a strong rebound in household consumption, including of mortgages, durable goods and vehicles.[33] Mortgage applications and approvals rose strongly, and significantly outpaced those in 2019. Mortgage debt increased in real terms by 0.4% during 2020, despite a substantial slowdown in mortgages during the closure of the deeds office at the height of the first wave of the pandemic. Anecdotal evidence suggests that the consumption recovery has been uneven along the income spectrum, with higher-income consumers more able to take advantage of the low interest rates.

Credit extension to the corporate sector followed a different pattern to that for the household sector. Corporates frontloaded their credit needs early on, with credit surging by 5.4% month on month during March 2020, in the lead-up to the lockdown. Corporates then abruptly slowed their uptake of credit, hesitant to take on new debt while facing high uncertainty.[34] By December 2020, total loans and advances to corporates fell 2.4% shy of their December 2019 level, although total credit to corporates, which includes investment and bills, had recovered to pre-pandemic levels.

Unemployment rates

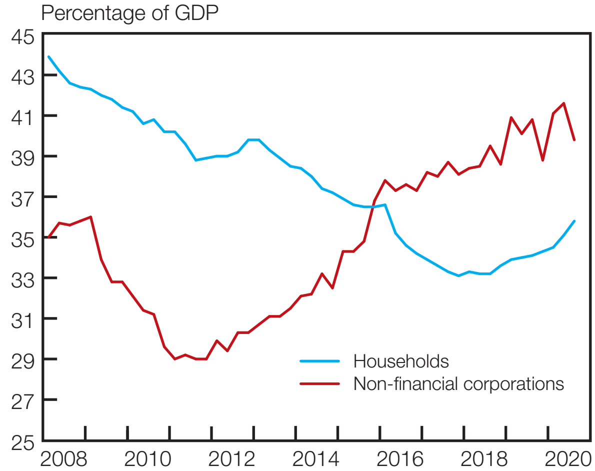
Per cent



Source: Stats SA

Credit to the non-financial private sector

Percentage of GDP



Source: BIS

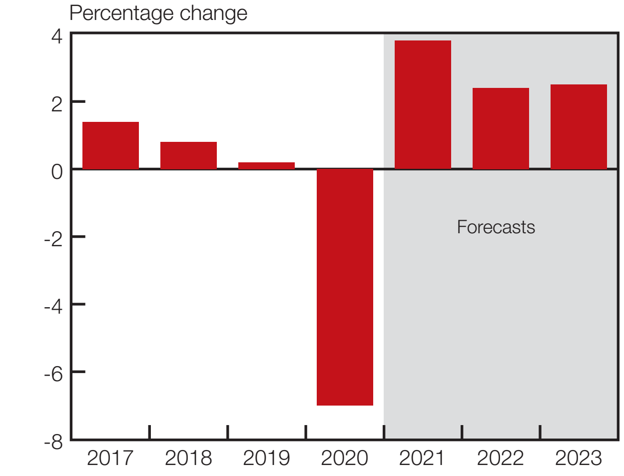
31 The implementation of government's infrastructure investment programme should, on the margin, help lift recovery in the construction sector.

32 Stats SA has been collecting household labour market data since 1993 with the annual *October Household Survey*. This survey was replaced in 2000 with the semi-annual *Labour Force Survey*, which was used until 2007. According to this survey, the previous peak in unemployment was during February 2003, at 30.8%.

33 Debt-service costs as a ratio of disposable income fell to just 7.7% in 2020Q4, the lowest rate since 2006.

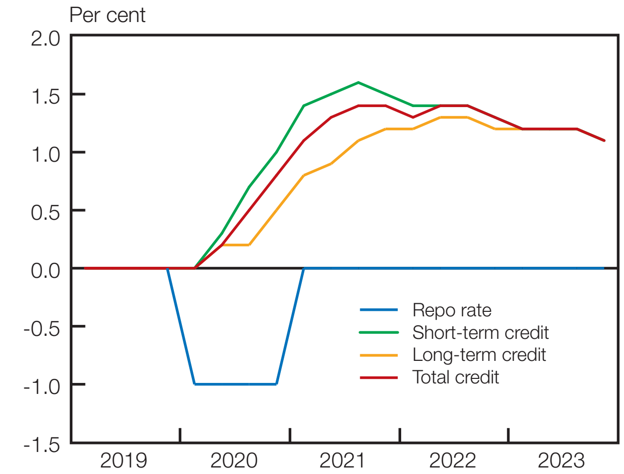
34 Unlike households, corporates entered the COVID-19 pandemic relatively more leveraged, at least relative to the global financial crisis in 2008, with corporate debt reaching almost 40% of GDP by 2019. See the BIS's online statistics on the credit to the non-financial sector. https://www.bis.org/statistics/totcredit.htm?m=6%7C380%7C669

Real GDP growth



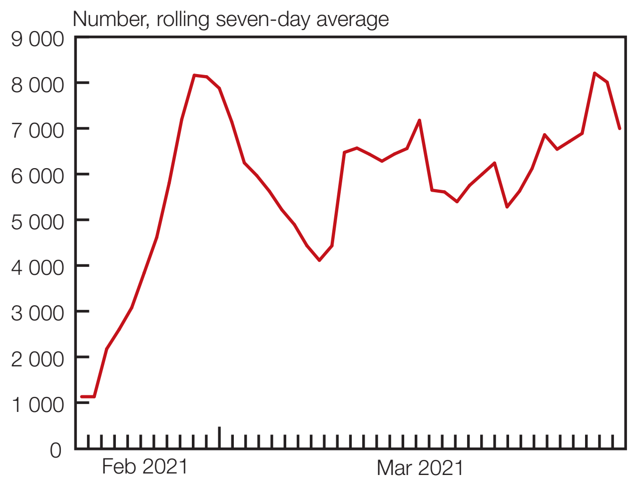
Sources: Stats SA and SARB

Impact of interest rate cuts on credit extension



Source: SARB

Daily COVID-19 vaccine doses administered



Source: *Our World in Data*

The growth outlook

With a relatively strong recovery that has surprised on the upside in both the third and the fourth quarters of 2020, the SARB expects GDP growth to average 3.8% in 2021 before moderating to 2.4% and 2.5% in 2022 and 2023 respectively. Near-term GDP growth (2021Q1) is projected at -0.2%, quarter-on-quarter, seasonally adjusted and annualised, weighed down by the second wave of the COVID-19 pandemic and the lockdowns that were implemented, as well as load-shedding.

Historically speaking, growth during 2021 will be at its highest rate since 2007 and much higher than the 2015–19 average of 0.8%. However, the outperformance during 2021 is largely a statistical artefact. The big increase in 2021 is from a very low starting point, so the base effect is larger than usual.[35] Indeed, the output level is only expected to reach pre-COVID-19 levels during 2023.

The low interest rates and the vaccine distribution should support the recovery over the forecast horizon. The large interest rate cuts implemented last year are still filtering through the economy, with their peak effects expected in 2021. While measuring the precise impact of policy rate cuts on growth is difficult, and the current times are by no means ‘normal’, with higher-than-usual uncertainty, these effects should be expected to carry through, as the pickup in mortgage applications suggests. The cuts will linger in the system for some time, boosting growth in the outer period.

Vaccinations should help curb future waves of the pandemic, lower uncertainty and reduce disruptions to economic activity over the medium term. The vaccine roll-out has been slow so far, with complications arising from the efficacy of certain vaccines against the dominant 501.V2 strain of the virus as well as vaccine shortages. The SARB assumes that about 10% of the population will be vaccinated by the end of the second quarter of 2021, slowly rising to 67% by the middle of 2022. A more rapid roll-out would quicken the return to ‘normalcy’, particularly for sectors such as travel and tourism. Bringing tourism and transport back to full activity levels would raise the economy’s potential growth (a reversal of the adverse supply shock to these sectors). However, until herd immunity is reached, future waves of the virus will continue to affect the economy, although the impacts are likely to become smaller with each wave as the economy adjusts to its new way of operating and as an increasingly large share of the population develops natural immunity from exposure to the virus.

Potential growth is an important concept in macroeconomic policy as it defines the economy’s growth ‘speed limit’, meaning the maximum sustainable output that an economy

35 Because the contraction in GDP during 2020 was so large, any return to more ‘normal’ levels of activity will look significantly larger when analysed on a year-on-year basis.

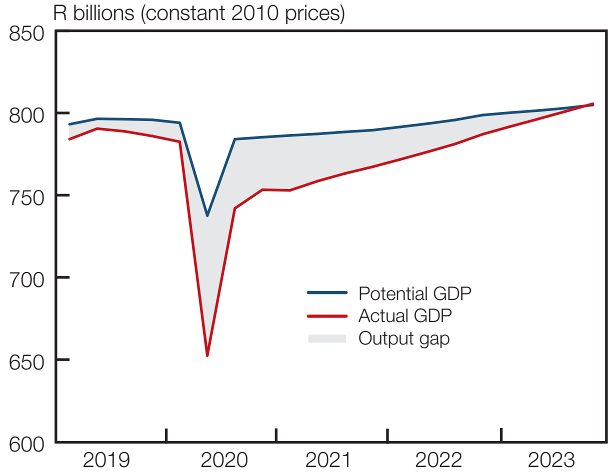
is capable of producing under full employment conditions with inflation stable.[36] Potential growth is an unobservable variable which must be estimated from observable data. Realised growth minus potential growth equals the output gap, another unobservable, and one component of the monetary policy rules used by central banks.

The COVID-19 shock affected the domestic economy's potential GDP level as the lockdowns (temporarily) withdrew capital and labour from economic activity – a supply-side shock. Firm closures and unemployment reduced incomes for workers, reducing demand for goods and services.[37] In addition, the high uncertainty, mobility restrictions and health concerns made consumers circumspect about spending, further constraining demand. In the absence of reliable data as to which of the two is dominant, the QPM treated the pandemic as a roughly equal split between demand and supply shocks, meaning that half of the low growth in 2020 is attributed to the closure of businesses while the other half is attributed to reduced demand.

In the face of exceptionally high uncertainty about the evolution of the pandemic, the SARB's forecasting team made more revisions than usual to potential GDP growth, as it had to rely on high-frequency data to gauge the underlying state of the economy.[38] The most recent revision was made during the January 2021 MPC meeting, following the release of GDP data for the third quarter of 2020. Potential GDP growth is now expected to recover from -2.5% in 2020 to 1.6% in 2021 before moderating to just 0.9% for both 2022 and 2023. Revisions to potential growth meant revisions to the output gap too, which is now expected to close over time, from -5.9% of potential GDP in 2020 to just -0.5% in 2023.[39]

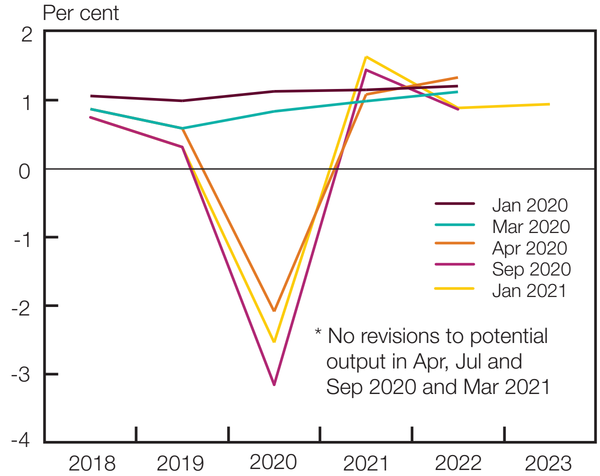
One of the reasons why potential GDP does not rise faster is the persistence of electricity shortages. Despite very low economic activity, load-shedding during 2020 was the worst annual performance on record, and this trend is likely to continue through 2021. The total energy availability factor in South Africa is around 60%, and is expected to remain near these levels over the next five years, placing a cap on the pace of economic growth.[40]

Real GDP and the output gap



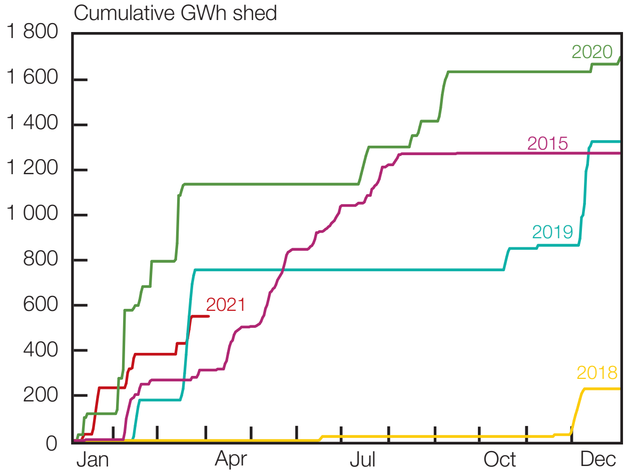
Sources: Stats SA and SARB

Evolution of potential GDP growth*



Source: SARB

Load-shedding



Sources: EskomSePush (app), Eskom Twitter account and SARB

36 T Powell, L Sheiner and D Wessel, 'What is potential GDP, and why is it so controversial right now?' *The Brookings Institution – The Hutchins Center Explains Series*, 22 February 2021. https://www.brookings.edu/blog/up-front/2021/02/22/what-is-potential-gdp-and-why-is-it-so-controversial-right-now/

37 This could potentially lead to a further supply contraction.

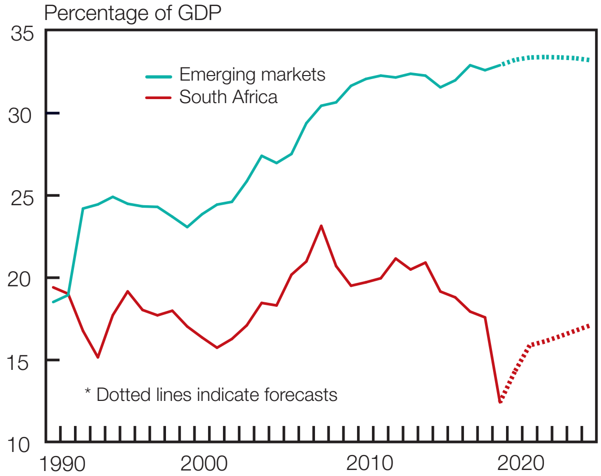
38 Revisions to potential growth usually follow data releases by Stats SA, which give an indication of how the economic shock is progressing.

39 The output gap is projected at -0.1% in 2023Q4.

40 The Council for Scientific and Industrial Research (CSIR) argues that the minimum requirement to assure reliability for South Africa is 72%. J G Wright and J R Calitz, 'Setting up for the 2020s: addressing South Africa's electricity crisis and getting ready for the next decade', CSIR presentation, 2020. https://researchspace.csir.co.za/dspace/handle/10204/11282

Investment*

Percentage of GDP

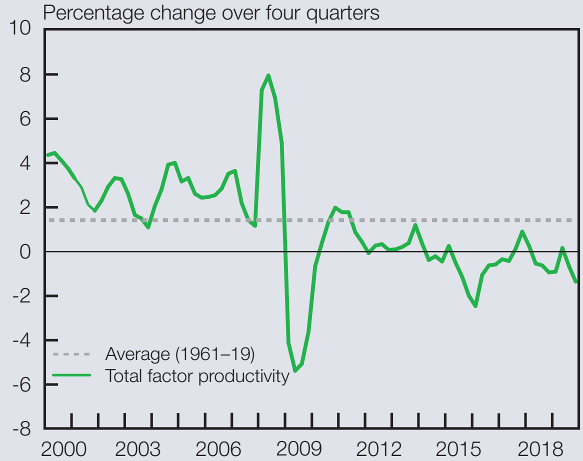


Source: IMF

Another reason for low potential growth is weak investment, which currently stands at 15% of GDP, much lower than its long-run average of 22% and significantly below the emerging market average. Gross fixed capital formation by the public sector was already weak before the pandemic. Private sector business enterprises were hit hard during the pandemic, and investment recovery is expected to be slow as firms remain constrained by low business confidence, persistent electricity shortages and high long-term borrowing costs.

TFP growth

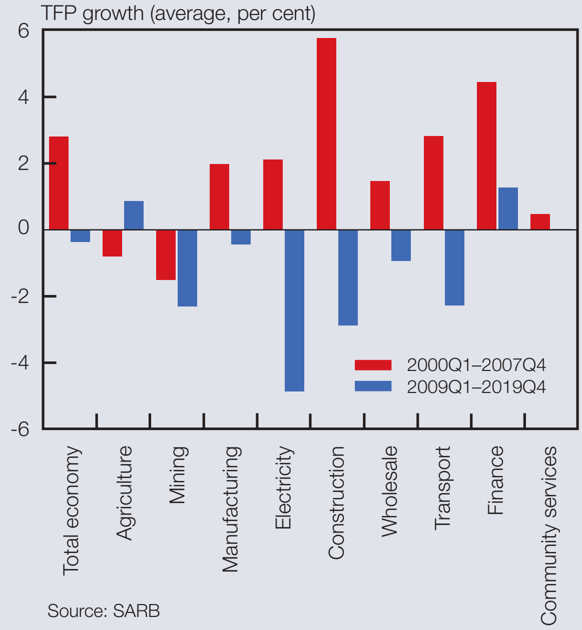
Percentage change over four quarters



Source: SARB

Benchmark TFP growth estimates

TFP growth (average, per cent)



Source: SARB

Box 7 What can total factor productivity tell us about South Africa's weak growth?[1]

Total factor productivity (TFP) growth is a measure of the efficiency with which inputs into production (e.g. labour and capital) are used to produce economic output. It is defined as the growth in output that cannot be explained by the accumulation of inputs. An industry-level production function helps to identify poorly-performing sectors and suggests where reforms could have a more meaningful impact.

TFP growth is estimated from a Cobb–Douglas production function with two factors of production: labour and capital. The results show that TFP growth has slowed since the global financial crisis (GFC), growing at -0.36% for the period 2009Q1–2019Q4, down from 2.8% during 2000Q1–2007Q4[2] and significantly below the long-run average of 1.4%.

While TFP growth was positive for all industries (except agriculture and mining) during the period 2000Q1–2007Q4 (a pre-GFC period), it declined for all sectors except agriculture, finance and community services after the GFC. These trends hold true for the different post-GFC sample periods, except the sub-period 2011Q1–2015Q4, where the manufacturing, wholesale trade and construction sectors show relatively better growth performance.

The electricity and mining sectors experienced the largest slowdown in productivity growth after the GFC, while manufacturing and wholesale trade experienced the smallest. Much of the fall in productivity is explained by weaker output. Electricity production grew by -0.15% per annum during the post-GFC period, compared to 3.3% pre-GFC.

1 This box builds on J Pain, M Rapapali and D Steenkamp, 'Industry TFP estimates for South Africa', *South African Reserve Bank Occasional Bulletin of Economic Notes No. OBEN/20/02*, Pretoria: South African Reserve Bank, November 2020. https://www.resbank.co.za/en/home/publications/publication-detail-pages/occasional-bulletin-of-economic-notes/2020/1001212

2 The full sample period is 2000Q1–2019Q4 to exclude the COVID-19 shock in 2020.

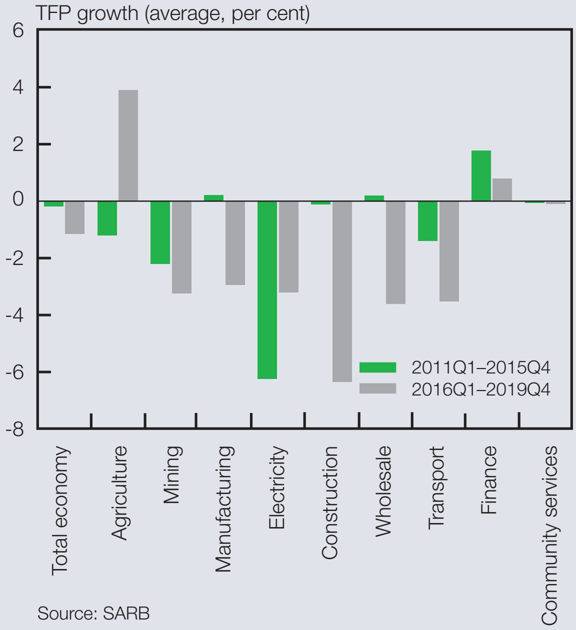
Manufacturing TFP growth has also been adversely affected by low investment, in particular the decline in the acquisition of machinery and equipment responsible for innovation (according to the World Bank), and weak competition.[3, 4]

The broader contribution of TFP to economic growth underscores the criticality of innovation, investment, and efficiency gains. From 2009 onwards, the contribution of TFP to output growth ranged between 20% and 50%. The decline in TFP growth across most industries raises concerns over the capacity of the economy to grow more rapidly on a sustainable basis, particularly as the country emerges from the COVID-19 pandemic. Structural reforms, particularly those aimed at raising the efficiency of the infrastructure sectors, as well as the strengthening of skills, domestic competition and the use of technology in production, should support higher TFP growth.

3 World Bank, *South Africa economic update: innovation for productivity and inclusiveness*, Washington DC: World Bank, 2017.

4 V Thakoor, 'Market power, growth and inclusion: the South African experience', *International Monetary Fund Working Paper Series No. WP/20/206*, Washington DC: International Monetary Fund, September 2020. https://www.imf.org/en/Publications/WP/Issues/2020/09/25/Market-Power-Growth-and-Inclusion-The-South-African-Experience-49761

TFP growth estimates for split post-GFC periods



Source: SARB

Macroeconomic balances

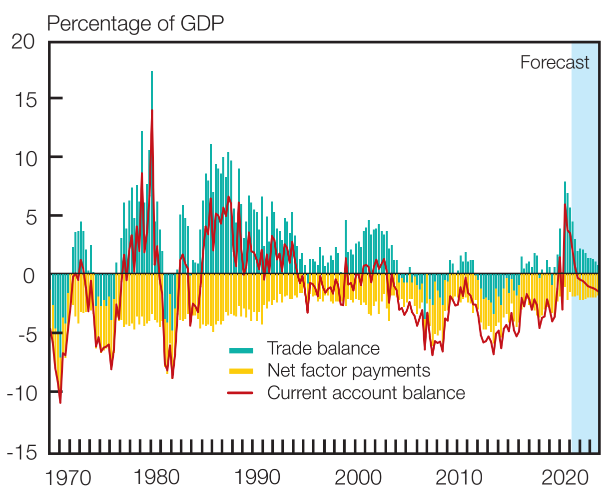
The current account

South Africa enjoyed one of the largest current account surpluses during 2020, with its ratio to GDP swinging from a 2.9% deficit in the second quarter of 2020 to a 5.9% surplus during the third quarter, a 32-year high. Within the South African context, current account surpluses do not occur often: the current account has been in deficit nearly two-thirds of the time since 1960 and 86% of the time since 1994. The 2020 surplus is, however, expected to be temporary, and should narrow from its average of 2.2% in 2020 to 1.3% in 2021, before reverting to a deficit, averaging 0.8% and 1.3% in 2022 and 2023 respectively. The current account benefitted from the exceptionally favourable terms of trade in 2020, supported by strong commodity exports and subdued imports.

The current account deficit should be smaller than historical averages as the trade balance is expected to remain in surplus throughout the forecast horizon, counteracting the downward pressure from the services, income and transfers balance.

The terms of trade are strongly influenced by the prices for Platinum Group Metals (PGMs), which have increased fivefold since 2018. When these commodities are excluded, South Africa's commodity price basket is much more moderate, increasing by only 8%. Palladium and rhodium prices are expected to fall over the forecast horizon as the market shortage in these metals begins to narrow. Nonetheless, they are expected to remain above their long-run averages as demand for catalytic converters remains buoyant on climate imperatives. These strong commodity prices have helped to push exports to 30% of GDP, a 12-year high.

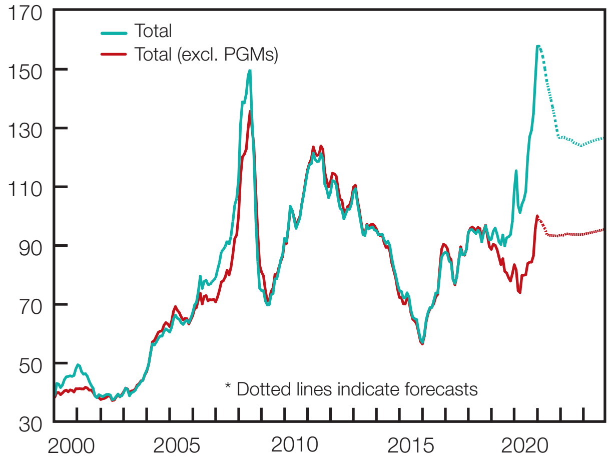
Current account balance



Source: SARB

Commodity prices

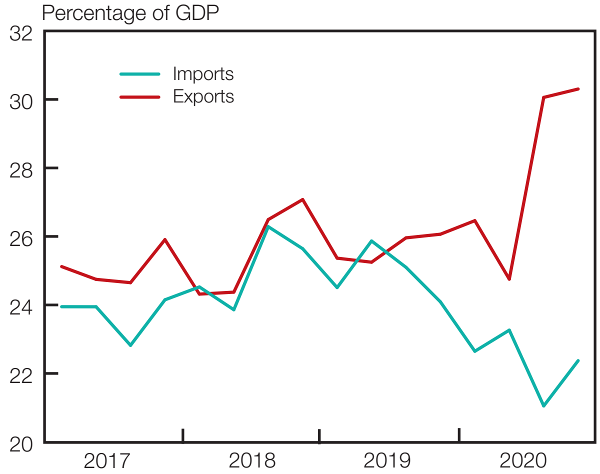
Index: 2010 = 100



Source: SARB

External trade

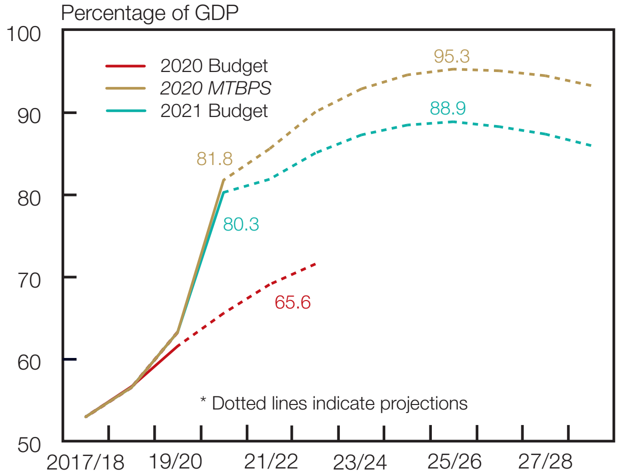
Percentage of GDP



Sources: Stats SA and SARB

Gross loan debt*

Percentage of GDP



Source: National Treasury

The recovery in oil demand (and prices) should moderate South Africa's terms of trade, despite the large price gains by the PGMs. During April 2020, the price of Brent crude oil collapsed to just US$23 per barrel as global activity came to a standstill. These low oil prices, together with a weak domestic demand for fuel, halved oil imports from 7% of GDP in 2019 to just 3.5% in 2020, boosting the trade balance. In line with the recovery in the global economy, oil prices have now risen to pre-pandemic levels, dampening the terms of trade and pushing oil imports back towards their long-run average.

The services, income and transfers account will likely widen over the forecast horizon after narrowing slightly to -3.6% of GDP during 2020, compared to its 2010–19 average of -3.8%, primarily on reduced distribution of profits abroad.[41] With uncertainty about the course of the pandemic receding and the economic recovery gaining steam, firms have since resumed the distribution of profits abroad. At the same time, the balance on the interest account widened to -1.7% of GDP versus the long-run average of -1.3%, and is expected to continue widening in line with rising interest payments to non-resident debt holders. The services account had a wider-than-usual balance during 2020 at -0.8% compared to the 2010–19 average of -0.3% as spending by foreigners on travelling collapsed and is only expected to improve when international travel recovers. Finally, the transfers balance remained close to its long-run average of just under 1% of GDP. The recent collapse in imports will likely see a moderation in Southern African Customs Union (SACU) payments over the forecast horizon to about 0.4% of GDP.

The fiscal account

The fiscal situation in South Africa remains precarious as debt levels have remained stubbornly elevated for an extended period of time. The 2021 Budget expects gross national debt to stabilise at 88.9% of GDP in 2025/26 compared to 95.3% of GDP projected in the 2020 *Medium Term Budget Policy Statement (MTBPS)*. Debt-service costs remain elevated and are estimated to absorb 22% of revenue by 2023/24. The better-than-expected debt profile follows from a faster-than-expected narrowing in the main budget deficit, which is projected to reduce to 12.3% of GDP in the current fiscal year from the 14.3% 2020 *MTBPS* forecast, before narrowing further to 6.5% of GDP in 2023/24.

Tax revenue is projected to overshoot by about R100 billion in the current fiscal year relative to the 2020 *MTBPS*. The stronger-than-expected revenue is on account of corporate income tax (CIT) payments as well as the better-than-expected rebound in value-added tax (VAT) and customs revenues as domestic consumption recovered. Provisional CIT payments

41 The ratio of dividends paid (abroad) to GDP halved to just 1.2% compared to the post-global financial crisis average of 2.5%.

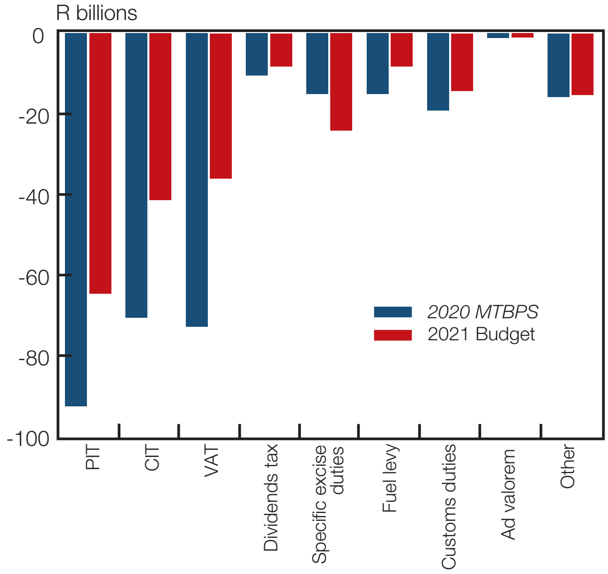
from mining surged, buoyed by high commodity prices and a favourable exchange rate. Sectors that service the mining sector (e.g. machinery and equipment, motor vehicles, energy and services) should benefit from the high commodity prices through their economic linkages with the mining sector.

The 2021 Budget commits to reining in spending, reducing it by R264.9 billion in the medium term. Fiscal spending, however, remains sensitive to such eventualities as further support to state-owned enterprises (SOEs), the still-to-be-finalised public sector wage dispute, and the evolution of the COVID-19 pandemic, all of which remain uncertain.

Conclusion

After enduring the largest contraction in annual GDP in a century in 2020, the South African economy is on a recovery path, with GDP growth in the third and fourth quarters surprising on the upside. Growth in the first quarter of 2021 is, however, projected to disappoint. Although the economy has recovered faster than expected thus far, the labour market remains subdued. The terms of trade are expected to continue supporting the trade balance and tax revenue performance, though not enough to maintain a current account surplus beyond 2021. While the growth outlook is positive, risks include electricity supply constraints, more waves of the COVID-19 pandemic and higher long-term borrowing costs.

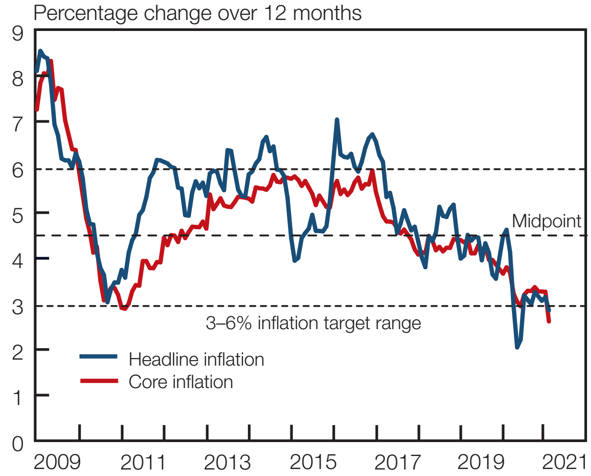
Broad-based tax gains in 2020/21



Source: National Treasury

Headline and core inflation

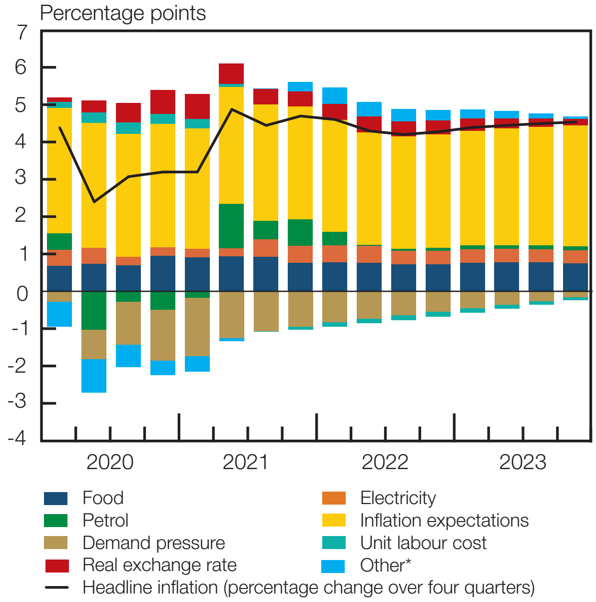
Percentage change over 12 months



Sources: Stats SA and SARB

Contributions to headline inflation

Percentage points

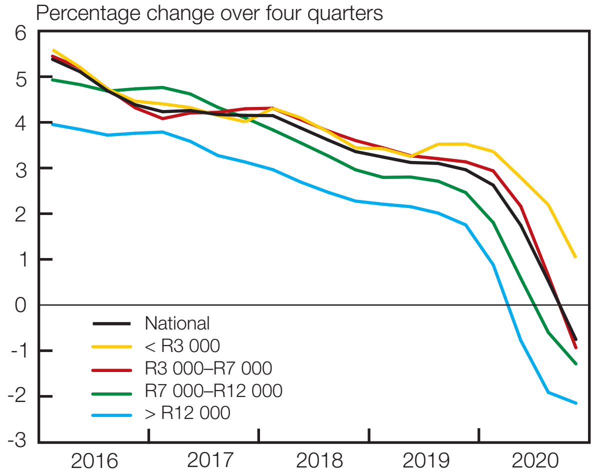


* Includes direct import price pressures and forecast interventions.

Sources: Stats SA and SARB

Rental per value band

Percentage change over four quarters



Source: TPN Credit Bureau

Price developments: supply-side pressures the main risk to the outlook

Headline inflation averaged 3.3% in 2020 – a record annual low for targeted CPI. Despite this low average, inflation was relatively volatile, driven by lockdown-related imputations, municipal adjustments for electricity, declining rental prices, and petrol and food prices. From July onward, inflation hovered at around 3%. Core inflation decelerated in 2020, with both core goods and services now considerably below the midpoint of the target range. This weakness should continue in 2021, as big-ticket items – such as medical insurance and housing – are subdued, and most items are expected to recover only gradually in line with the general economy. The major sources of upward pressure to headline are food, fuel and electricity.

Inflation remained well-contained in 2020, staying closer to the lower limit of the target range since March. Inflation breached the lower limit of the target range for two consecutive months in 2020 – May and June – partly on account of methodological innovations by Stats SA to impute for goods whose sales were banned during the lockdown. Inflation also dipped below 3% in February 2021. However, prices of the volatile components have begun edging up since the latter part of 2020.

Food and NAB inflation accelerated in the latter part of 2020, from 3.9% in September to 6% in December, and should remain above the target midpoint in 2021, partly driven by global supply-side factors. Food inflation should moderate on a good domestic harvest and improvement in regional food harvests, which should soften external demand.

Fuel inflation has been climbing on higher global oil demand as economies recover. Domestic fuel price inflation is expected to rise from -3.4% in 2021Q1 to 29.5% in 2021Q2 on higher global oil prices and base effects from last year, contributing 1.5 percentage points to headline inflation. The July increase in electricity price inflation is projected at 13%, up from 6.2%, with further double-digit increases projected in the outer forecast period.

The QPM currently has core inflation remaining below the midpoint throughout the forecast horizon – averaging 4.3% in 2023 on lower wage pressures, less exchange rate pressure, and a faster deceleration in inflation expectations than previously expected. However, rising food, fuel and electricity prices have headline inflation settling at the midpoint of the target range by 2023.

Core inflation

Housing dynamics are important in understanding services inflation. This item weighs over 32% in services (23% in core), and has driven the most recent deceleration in services inflation. The rental market remains lacklustre.[42] The supply of rental space has been exceeding demand since 2019, and the gap has widened recently as lower interest rates have driven some tenants into purchasing property, given the reduced gap between rentals and mortgage repayments. For other tenants, reduced earnings or employment losses have resulted in early cancellations of rental agreements, driving vacancy rates up to 13% by the start of 2021 from 7.5% at the start of 2020. With a glut of rental housing and declining affordability, rental escalations are expected to remain muted. In light of the above, housing inflation is projected to decline from 1.3% in the fourth quarter of 2020 to 1.1% in the first quarter of 2021 before rising to 1.7% in the fourth quarter of 2021. This is in line with the expected slow improvement in employment and salaries, and the general economic climate.

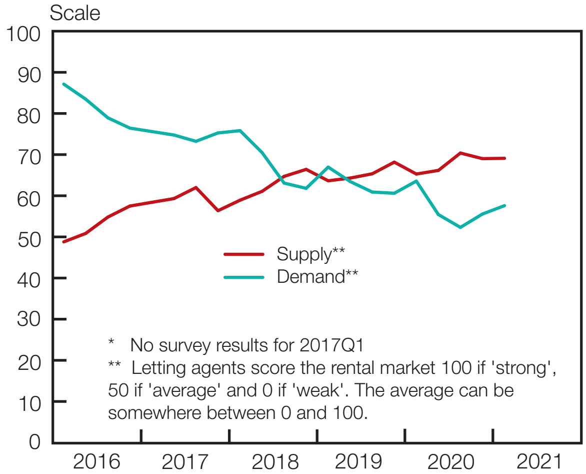
Insurance accounts for nearly a fifth of services in the CPI. Medical insurance, the largest insurance item, recorded inflation of 4.7% in February 2021, down from 9.5% last year.[43] Discovery's July 2021 increase is still to come; the exact hike will be announced in May but it is expected to be at or below 5.9%. Should Discovery hike by 5.9%, this would add 0.6 percentage points to medical insurance inflation, and the average for 2021 would be 5%. Going into 2022, medical inflation could be higher on increased utilisation, as people take up previously postponed elective procedures. In addition, the Council for Medical Schemes has added the COVID-19 vaccine to the Prescribed Minimum Benefits list, which means that medical aids will have to pay for it, adding pressure to medical insurance costs. Services inflation should average 3.3% in 2021, 4.2% in 2022 and 4.3% in 2023.

Core goods inflation averaged 2.1% in 2020, below the five-year average of 3.3%. Lower core goods inflation is partly the result of lockdown-related imputations, which primarily affected five months of CPI data releases (April to August 2020) and about

42 Owners' equivalent rent, the imputed value of owner-occupied housing, is proxied by rental inflation for comparable dwellings.

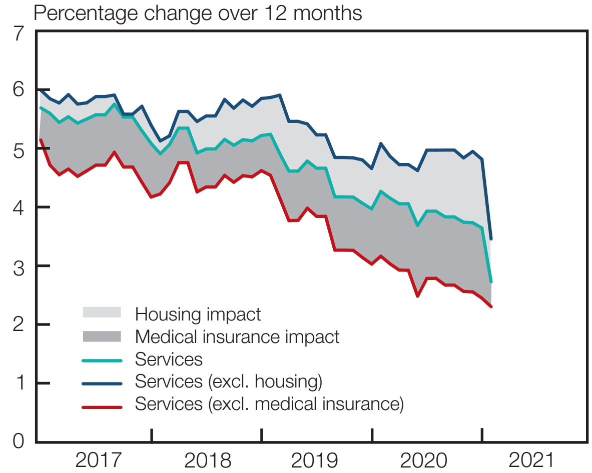
43 Similarly to medical insurance, medical goods and services have moderated, likely because of lower utilisation.

Supply and demand of rental space*



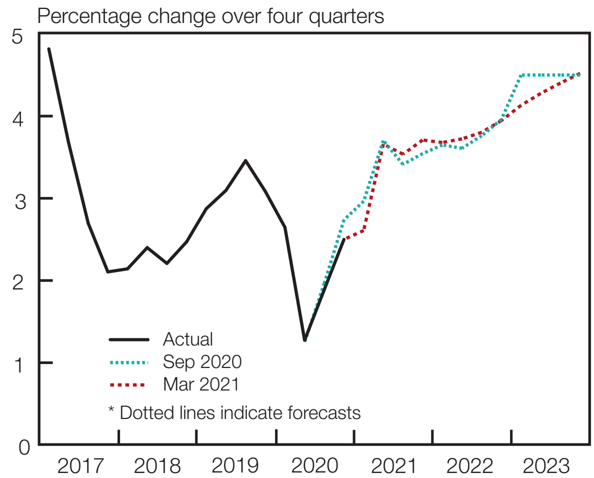
Source: TPN Credit Bureau

Services inflation



Sources: Stats SA and SARB

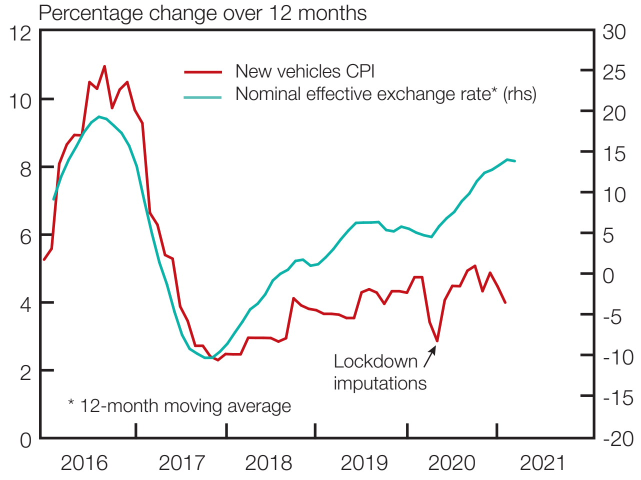
Core goods inflation*



Sources: Stats SA and SARB

New vehicle CPI versus NEER

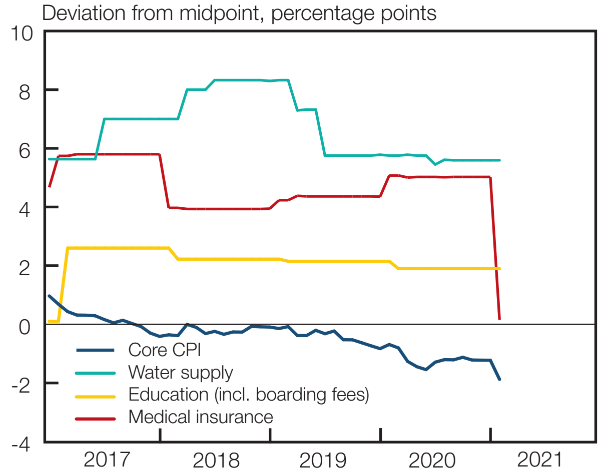
Percentage change over 12 months



Sources: Stats SA and SARB

CPI items with above-midpoint inflation

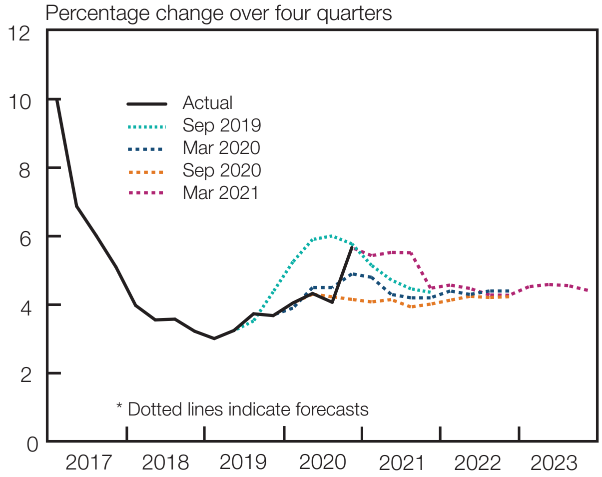
Deviation from midpoint, percentage points



Sources: Stats SA and SARB

Food and non-alcoholic beverages inflation*

Percentage change over four quarters



Sources: Stats SA and SARB

25% of the core goods basket.[44] Even after these imputations, vehicle inflation remains muted, despite rand depreciation and accelerating manufacturing prices. The near-term outlook was for vehicle inflation to rise from 3.5% in the first half of 2020 to 5.4% in the second half of 2020, but it only rose to 4.2%, reflecting weak local demand. Core goods inflation is expected to rise to 3.4% in 2021, mainly on base effects, then to 3.8% in 2022 and 4.3% in 2023.[45]

A set of core CPI items remain above the midpoint of the inflation target range: water, medical insurance and education. Water inflation alone, currently at 10.1% (for July 2020 to June 2021), adds 0.08 percentage points to upward core pressure. Medical insurance inflation is much lower but still above the target midpoint, adding 0.02 percentage points. Lastly, the education inflation gap is currently at 1.9% (March 2020 to February 2021), adding 0.06 percentage points, but this item should also be lower this year.

Food and NAB inflation

Following a prolonged period of food inflation being below the target midpoint (December 2017 to September 2020), it quickly accelerated in October 2020, and is now closer to the upper limit of the target range. The increase from 4% in the third quarter of 2020 to 5.7% in the fourth quarter was the result of a broad-based rise in food and NAB prices. Global food prices also accelerated in 2020, with the La Niña weather event and food stockpiling placing pressure on markets. The United Nations (UN) Food and Agriculture Organization (FAO) food price index recorded inflation of 24.6% in March 2021, the highest in almost 11 years. Domestically, food prices tend to record higher month-on-month changes towards the festive season (October to January): an average of 0.7% versus 0.3% during the other months of the year. Although the relationship between local and global food inflation is weak on average, there are times when they correlate strongly – which has been the case during COVID-19.

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44 While imputations have continued, the basket of goods covered by the imputations has progressively shrunk as lockdown restrictions eased, hence the emphasis on the first five months of the lockdown.

45 Durable goods inflation has already recovered to pre-lockdown levels, supported by easier funding conditions.

Domestic grain prices have been on an upward trajectory in recent months. The spot price for white maize was R3 600 in October, the highest since December 2016 and closer to import parity prices, while yellow maize was R3 479, the highest since July 2016. South Africa, a net exporter of maize, recorded a bumper crop of 15.4 million tonnes during the 2019/20 season, 37% higher than in the 2018/19 season. Ordinarily, a bumper crop season translates into lower domestic grain prices, but this was not the case in 2019/20.

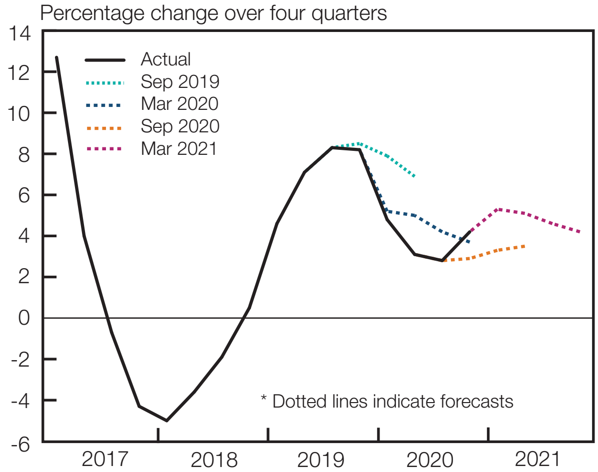
Firstly, global grain prices increased amid tight supply conditions and strong global demand. Secondly, demand was stronger for South African maize in Southern Africa and the Far East region (Asia), pushing up domestic prices closer to the higher international prices. As a result, agricultural trade exports reached the second-highest level on record: US$10.2 billion in 2020, 3% higher than in 2019. Meanwhile, imports fell by 8% between 2019 and 2020 due to higher spot prices for wheat, rice and palm oil.[46]

Going forward, bread and cereals inflation is expected to remain elevated, at least in the first quarter of 2021, before moderating gradually. This outlook is shaped by expectations of a large summer grain harvest in the 2020/21 season and a good harvest across the Southern Africa region, softening external demand pressures.[47]

With respect to meat, the recent price increases have been broad-based and mainly driven by domestic factors. Slaughtering activity in the beef market was weaker towards the end of 2020 due, in part, to good rains and cheaper cattle feed costs, pushing meat prices higher. Poultry prices increased between March and July, coinciding with the higher poultry import tariffs which increased from 37% to 62%. Meat inflation is expected to moderate from current levels, supported by already-improving slaughtering activity and the base effect from poultry inflation.

Bread and cereals inflation*

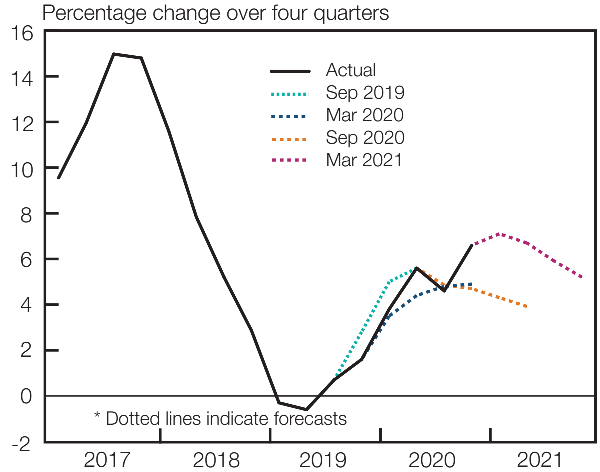
Percentage change over four quarters



Sources: Stats SA and SARB

Meat inflation*

Percentage change over four quarters



Sources: Stats SA and SARB

46 The wheat import tariff was increased temporarily in September 2020, from R517 to R832 per tonne, in response to international prices falling below local prices, but has since been deactivated.

47 Although South Africa and the Southern Africa region received above-average rainfall in the 2020/21 agricultural season, this is not expected to negatively affect crop yields. See W Sihlobo, 'Reflections on South Africa's agriculture and food price inflation path in 2021', *Agriculture Economics Today*, 4 March 2021. https://wandilesihlobo.com/2021/03/04/reflections-on-south-africas-agriculture-and-food-price-inflation-path-in-2021/

Lastly, oils and fats have also contributed to the recent increases in food inflation. The spot price for sunflower seed was R9 272 per tonne in January 2021, almost double the price in 2019. Anecdotal reports suggest that farmers substituted some sunflower seed hectares for maize because of the favourable maize prices, but some normalisation should occur as maize prices moderate.

Overall, food inflation is expected to remain above the midpoint of the target range in the first quarter of 2021 at 5.4%, averaging 5.2% in 2021, 4.4% in 2022 and 4.5% in 2023. Risks to the outlook include input cost pressures (such as electricity) as well as transportation costs (such as fuel).

Consumer food price inflation (March 2021 forecasts)

Percentage change over four quarters; September 2020 forecasts in brackets

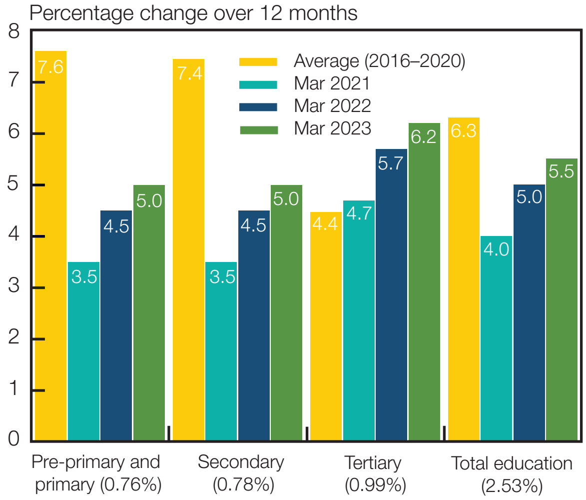
	Actual			Forecast	Actual		Forecast			
	Weight	2010–20*	2020*	2021*	2020Q3	2020Q4	2021Q1	2021Q2	2021Q3	2021Q4
Food and non-alcoholic beverages	17.24	5.7	4.5	5.2	4.0	5.7	5.4	5.5	5.5	4.5
					(4.2)	(4.2)	(4.1)	(4.1)		
Bread and cereals	3.21	5.2	3.7	4.8	2.8	4.2	5.3	5.1	4.6	4.2
					(2.8)	(2.9)	(3.3)	(3.5)		
Meat	5.46	6.0	5.2	6.2	4.6	6.6	7.1	6.7	5.9	5.2
					(4.9)	(4.7)	(4.3)	(3.9)		
Beef..................................	1.44	6.5	8.2	10.4	7.3	12.3	13.3	11.3	9.9	7.3
					(7.6)	(7.8)	(5.8)	(3.2)		
Poultry	2.12	5.7	4.4	3.9	3.9	2.7	4.1	4.1	3.6	4.0
					(5.0)	(4.0)	(4.3)	(4.1)		
Vegetables	1.30	5.5	2.0	2.8	2.1	4.3	0.9	3.4	3.3	3.5
					(1.9)	(2.7)	(2.9)	(3.7)		

* Annual average percentage change

Sources: Stats SA and SARB

Education inflation

Percentage change over 12 months



Sources: Stats SA and SARB

Administered price inflation

Administered prices are prices determined or influenced by government or a government agency, without any reference to market forces (Stats SA). They include education, fuel and electricity prices.[48] Except for fuel, which is generally volatile, administered prices have tended to rise at rates significantly above the midpoint of the target range. Recently, the Minister of Higher Education proposed that tuition fee increases be capped at 4.7% and boarding fee increases at 6.7%. Several universities have announced increases in line with this proposal; some even lower. Primary and secondary schools will also, on average, implement smaller increases.[49] In the October 2020 *MPR*, a 6.4% fee increase was projected for

48 Presently, Stats SA does not distinguish between public and private education, and treats both as administered prices.

49 School Governing Body associations have advised that member schools should consider either a 0% or a minimal fee increase for 2021, and inflation-linked increases in the medium term.

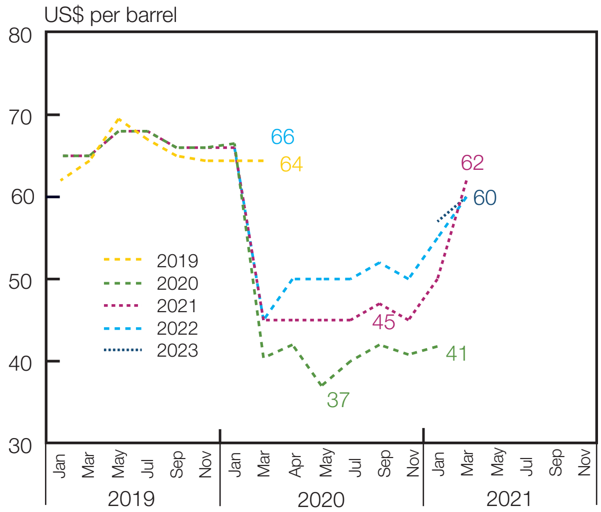
March 2021. This has been subsequently lowered to 4% in 2021, 5% in 2022 and 5.5% in 2023.[50]

Oil prices have continued to rally, following a low of US$36 per barrel in October 2020 amid renewed lockdowns.[51] Brent crude oil averaged US$65 per barrel in March 2021, slightly higher than the US$62 per barrel average in February. The relatively benign economic impacts of the second COVID-19 wave, the global vaccine roll-out, additional supply reductions, optimism around the latest US fiscal stimulus package as well as the recent inventory drawdowns are supportive of a higher price.[52] Over the longer term, oil prices should remain below the 2019 average of US$64, averaging US$62 in 2021 and US$60 in both 2022 and 2023.

The sharp increase in oil prices has driven domestic petrol prices higher, from R14.86 per litre in October 2020 (for Gauteng) to R17.32 per litre in April 2021, despite a simultaneous appreciation of the rand during this period. Fuel inflation is expected to reach 2.2% in March 2021 from -9.2% in October 2020. The fuel tax increase of 27c announced in the national Budget was slightly lower than the 31c expected by the SARB, and has therefore not affected the inflation outlook. The higher oil prices as well as the large base effect from last year mean that fuel prices will lift headline inflation this year, temporarily driving headline above the 4.5% target midpoint in the second quarter of 2021. Fuel prices are expected to average 12.7% in 2021, 3% in 2022 and 2.3% in 2023.

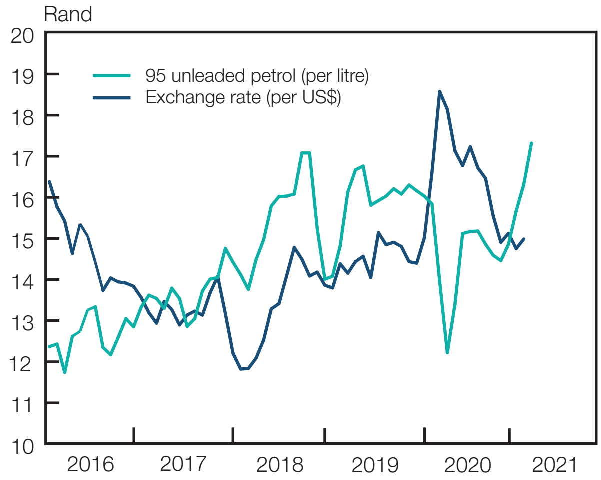
Electricity inflation is another source of inflation risk. The electricity price increase is projected at 13% in July 2021 and 10% in both July 2022 and July 2023. The risks to the electricity inflation outlook are mixed.

Evolution of oil price forecasts



Source: SARB

Unleaded petrol price in Gauteng



Sources: Bloomberg and Central Energy Fund

50 Education fees are surveyed in March, so annual averages are different. Annual inflation is 4.4% in 2021, 4.8% in 2022 and 5.4% in 2023.

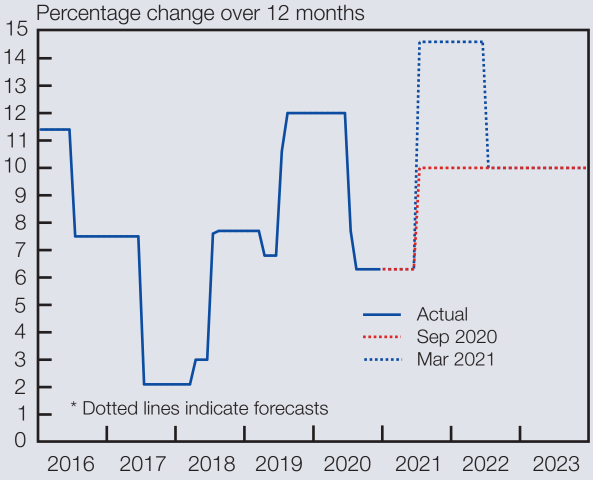
51 While oil reached its lowest price of US$23 per barrel in April 2020, at the height of the global lockdown, US$36 per barrel of Brent crude is the lowest price during the period from October 2020 to March 2021.

52 Saudi Arabia reduced its outbut by 1 million barrels per day between February and April 2021.

Box 8 Electricity price inflation scenarios

Electricity prices*

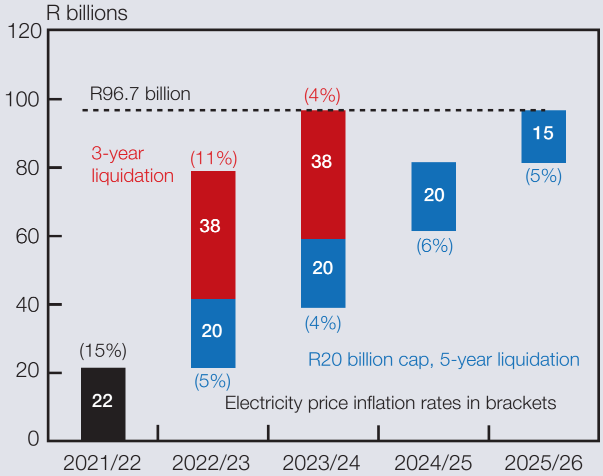
Percentage change over 12 months



Sources: Stats SA and SARB

Electricity tariff hike scenarios

R billions



Source: SARB

Municipal cost structure for electricity provision (2021/22)

Expenses	Weight	Increase	Guideline to municipalities
Bulk purchases....................	76.0%	17.8%	13.5*
Repairs and maintenance....	6.2%	4.4%	0.3*
Salaries	4.0%	6.5%	0.3*
Other expenses..................	13.9%	4.0%	0.5*
Total..................................	100.0%		14.6%

* Percentage points

Source: NERSA

After increasing by 6.2% in 2020, electricity price inflation is set to return to double-digit levels this year. Usually, electricity prices are adjusted with multi-year price determination (MYPD)- and Regulatory Clearing Account (RCA)-approved revenues, but in 2020 Eskom successfully disputed some of the previous decisions of the National Energy Regulator of South Africa (NERSA) in court. The High Court rulings in favour of Eskom as well as the most recent RCAs and supplementary revenue application, concluded in 2020 and 2021, leave a sum of R96.7 billion in additional revenue due to Eskom, to be recovered through electricity tariff hikes.[1] While the amount at stake is now known, there is still uncertainty as to how quickly this sum will be recouped.

Forecasts of electricity price inflation in 2020 settled on 10% increases for July of both 2021 and 2022, equating to average electricity inflation of 8.8% and 10% for each of these forecast years, respectively.[2] It now appears that the revenue increase for 2021/22 will be capped at R21.5 billion, which raises the tariff hike by 10.1 percentage points, amounting to a 15.1% hike in tariffs for direct users. Electricity price inflation of 14.6% for the period July 2021 to June 2022 is now expected, up from the 13% anticipated during the March 2021 MPC meeting.[3] The expectation for July 2022 remains unchanged at 10%.

The cumulative tariff increase will be R92.3 billion in 2022/23 and 2023/24. Together with the R21.5 billion allowed in 2021/22, this is R17 billion above the sum allowed by the courts and recently approved RCAs. The risks to the current forecast are mixed because outcomes could still surprise either way, depending on how quickly NERSA allows Eskom to recover the revenues owed, or depending on Eskom's new applications.[4] If NERSA were to continue capping increases at around R20 billion, then electricity price inflation would amount to 5.2% and 3.9% in each of the outer financial years. In fact, in such a scenario, it would take NERSA just short of five years, including the current financial year, to recover all the proposed amounts (compared to the less than three years in the current forecast). Should NERSA choose to recover these amounts in exactly three years, inflation in the outer forecast years would amount to 10.7% and 3.9% respectively.

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1 This includes the allowable revenues determined during the three previous RCA processes, and NERSA's decision to include the R69 billion bailout from National Treasury as 'revenue' for Eskom.

2 The annual averages differ because electricity is surveyed in July, not at the start, of each year.

3 Stats SA surveys municipalities in its CPI methodology. Bulk purchases constitute the majority of municipality costs, while salaries and other operational costs make up the rest.

4 Eskom should make concurrent RCA applications, which happen each year, and a new MYPD should be put in place. In forecasting electricity price inflation, we assume that the municipal bulk purchase price is the same as that for direct users, and that all other costs remain constant. Also, we assume that sales revenues grow at the same rate as the average of the past five years.

The main sources of inflationary pressures in the economy can be decomposed into public and private CPI components.[53] The CPI items affected by the public sector – which include electricity, water and fuel taxes – had an average inflation of 4.9% in 2020, while private sector inflation averaged 2.8%. The 2020 out-turn for headline, 3.3%, could therefore have been lower had it not been for higher public CPI. Although public CPI recently decelerated to about the midpoint, the gap between public and private CPI remains wide.

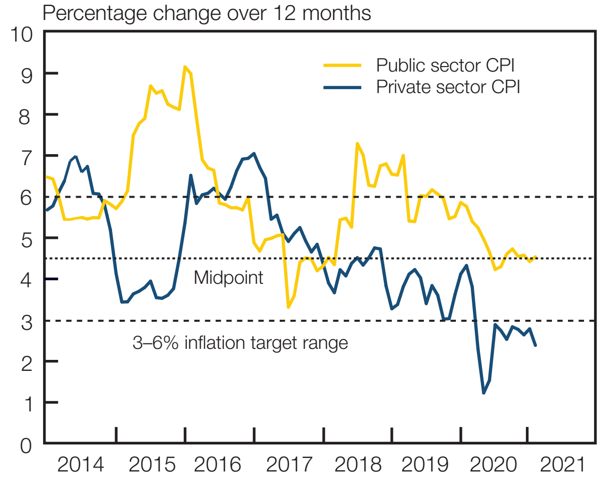
Medium-term inflation outlook

The QPM considers four key drivers of the medium-term inflation outlook, namely ULCs, the exchange rate, inflation expectations and the output gap. Over the medium term, these drivers are integral to closing the gap between observed inflation and the midpoint of the target range.

53 Public sector CPI includes the usual administered prices (such as education and electricity), but adds other items that are heavily affected by government (such as alcoholic beverages and tobacco). It also considers fuel taxes instead of fuel prices, making the index less volatile than the administered prices. Private sector CPI is headline CPI less public sector CPI.

Public versus private inflation

Percentage change over 12 months



Sources: Stats SA and SARB

Headline inflation (March 2021 forecasts)

Percentage change over four quarters; September 2020 forecasts in brackets

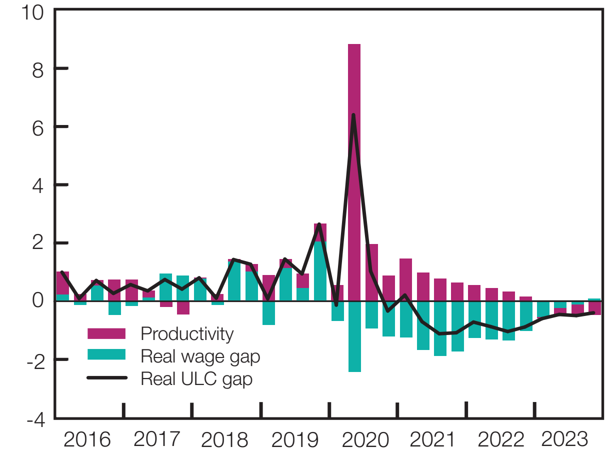
	Actual			Forecast	Actual		Forecast			
	Weight	2010–20*	2020*	2021*	2020Q3	2020Q4	2021Q1	2021Q2	2021Q3	2021Q4
Headline inflation	100.00	5.0	3.3	4.3	3.1	3.2	3.2	4.9	4.5	4.7
					(3.2)	(3.3)	(3.4)	(4.6)		
Core inflation**	74.43	4.6	3.3	3.3	3.3	3.3	3.0	3.3	3.3	3.6
					(3.3)	(3.4)	(3.5)	(3.8)		
Rentals***	16.84	4.2	2.0	1.4	1.6	1.3	1.1	1.2	1.5	1.7
					(1.5)	(1.1)	(0.8)	(0.8)		
Insurance	10.06	7.4	7.6	4.3	7.6	7.7	5.3	4.1	4.0	4.0
					(7.6)	(7.7)	(7.7)	(7.6)		
Education	2.53	7.8	6.4	4.4	6.4	6.4	5.6	4.0	4.0	4.0
					(6.4)	(6.4)	(6.4)	(6.3)		
Vehicles	6.12	3.1	3.8	4.0	4.1	4.2	3.9	5.0	3.8	3.4
					(4.7)	(6.5)	(6.8)	(7.7)		
Fuel	4.58	6.9	-7.0	12.7	-5.9	-10.0	-3.4	29.5	11.5	16.8
					(-5.8)	(-5.5)	(-4.4)	(17.8)		
Electricity	3.75	10.7	9.1	9.7	6.7	6.3	6.3	6.3	13.0	13.0
					(6.7)	(6.3)	(6.3)	(6.3)		

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

Sources: Stats SA and SARB

Contributions to the unit labour cost gap

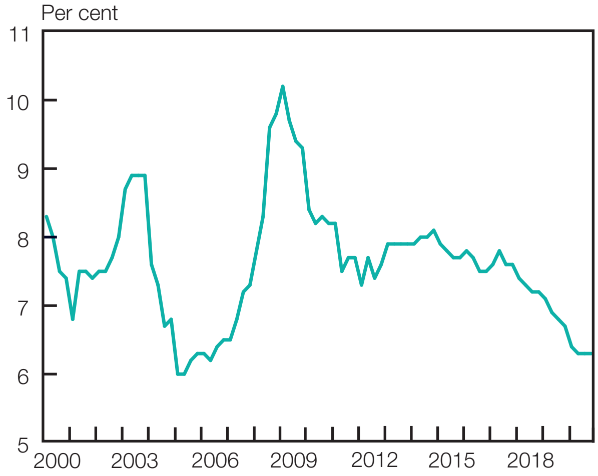
Percentage points



Source: SARB

Andrew Levy survey: average level of wage settlements

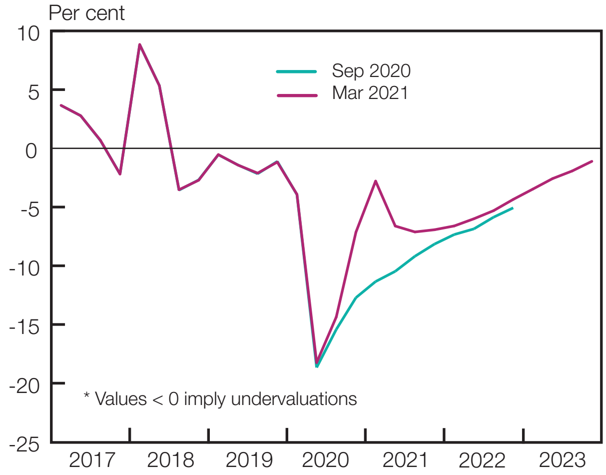
Per cent



Source: Andrew Levy

Real effective exchange rate gap forecasts*

Per cent



Source: SARB

The QPM uses the real ULC gap to measure the inflationary pressures from the labour market. This measure gauges the inflationary impact of real wage increases in excess of productivity growth. Since the October 2020 *MPR*, the near-term forecast for the real ULC gap has declined, as real wages were lower than expected and productivity increased in line with the upward surprise in GDP growth of 2020Q3. The inflation forecast assumes an ongoing public sector wage freeze. On average, this subtracts 0.5 percentage points per year from total (aggregate) nominal wage inflation until 2022. Meanwhile, private sector wage adjustments are expected to rebound only gradually as corporate cash flows recover from the pandemic effects.

Nominal wage growth is now forecast at 0% (previously -1.4%) in 2020, 3.8% (previously 3.4%) in 2021, 5.1% (previously 5.5%) in 2022, and 6% in 2023. These subdued employee compensation numbers are consistent with other market indicators. For example, the average wage settlement outcome from the Andrew Levy survey in 2020Q4 was 6.3%. Similarly, the 2021Q1 Bureau for Economic Research (BER) survey of salary increase expectations for 2021 and 2022 indicated 4.3% and 4.7% respectively.

The exchange rate gap is defined by deviations of the real exchange rate from the level consistent with fundamentals (the real exchange rate equilibrium). The real exchange rate gap has improved throughout the forecast horizon, reflecting a more appreciated nominal effective exchange rate (NEER) as well as depreciation in the real exchange rate equilibrium, which is driven by local fiscal risks. The balance is a less undervalued exchange rate, applying less pressure to inflation and thereby supporting a lower pass-through.

Inflation expectations are a crucial driver of longer-term inflation.[54] Since 2017, inflation expectations have moderated closer to the midpoint of the target range. This is in line with the explicit guidance from the MPC on where it prefers inflation to be. Specifically, the two-years-ahead expectations reached the midpoint of the target range a quarter earlier than anticipated, at the time of the September 2020 MPC meeting. They are projected to remain close to the 4.5% midpoint throughout the forecast period. However, the challenge will be the inflationary pressures emanating from non-core items (electricity, food and petrol inflation), which could possibly trigger expectations of higher inflation.[55]

54 In the QPM, inflation expectations are treated as a blend of backward- and forward-looking elements, with the backward-looking portion derived from the BER's two-years-ahead survey results and the forward-looking component based on the model's own inflation forecasts.

55 The second-round effects from these items are rather muted. SARB studies find that a 1% shock to food, fuel and electricity drives ULCs up by 0.4% a year after the shock and raises core inflation by 0.2%.

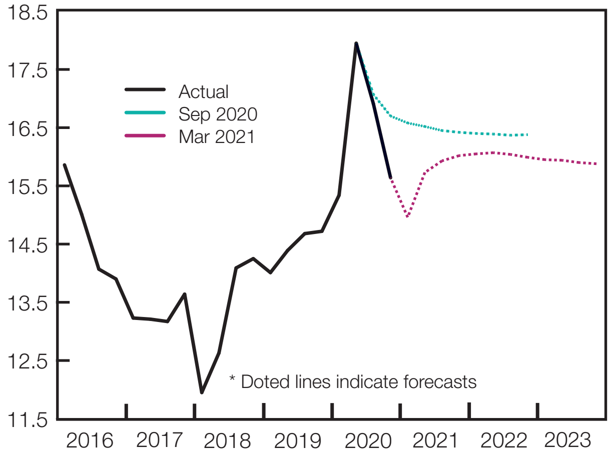
The output gap captures the extent of demand pressures on inflation. The wider the output gap, the weaker the demand pressures, and hence the more it exerts downward pressure on inflation. The COVID-19 shock has led to a significant widening of the output gap, from -1.5% of potential growth in 2020Q1 to -12.3% in 2020Q2, but this narrowed to -4.2% in 2020Q4. The implied peak impact of the 2020Q2 output gap, expected five quarters after the shock (i.e. in 2021Q3), should be a 1.9 percentage points drop in inflation, other things being equal. However, this will likely be tempered by limited space for additional economic slack to impact inflation, varying degrees of demand slack across sectors, and supply-side inflationary pressures. The forecast anticipates the output gap to 'close' by the end of the forecast period, which should assist with a rise in inflation towards the midpoint of the target range.

Conclusion

Headline inflation was close to the bottom of the target range in 2020, mostly on core inflation weakness and fuel deflation. A rise in volatile CPI components leads headline inflation to temporarily breach the target midpoint in the second quarter of 2021. Over the medium term, core inflation should rise from the current lows, assisted by ULC gap pressures and a narrowing output gap, and headline is projected to settle at the 4.5% midpoint in 2023.

Nominal exchange rate*

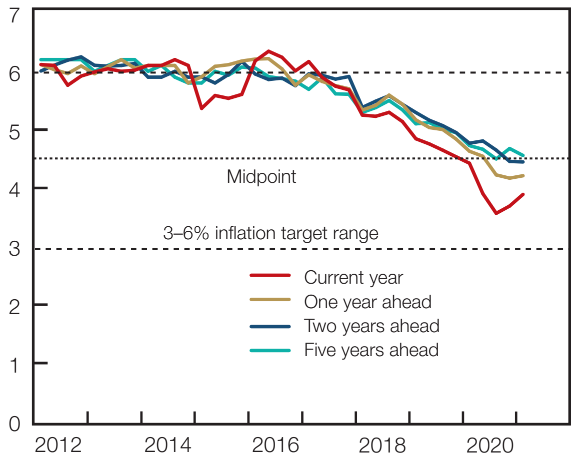
Implied rand/US$



Source: SARB

Inflation expectations

Per cent



Sources: BER and SARB

Box 9 The SARB's Disaggregated Inflation Model versus Big Data models

Near-term inflation forecasts are an important input into the South African Reserve Bank's (SARB) monetary policy framework. The SARB's forecasting team employs the Disaggregated Inflation Model (DIM) to generate near-term forecasts, which provide the one-quarter-ahead starting-point projection. The Quarterly Projection Model (QPM) utilises this forecast as input to generate the medium-term inflation projection. These inflation forecasts, together with the output gap forecasts, feed into the QPM's Taylor rule, determining the model-implied path of interest rates to meet the SARB's preferred 4.5% inflation target, the midpoint of the 3–6% target range, over the forecast horizon. To ensure credible and reliable forecasts, the SARB is continually evaluating and improving its models for forecast accuracy and bias.

As part of model development, assessments are conducted of the relative performance of advanced forecasting methods, making use of machine-learning techniques and Big Data to better understand the drivers of inflation and, hopefully, improve inflation forecasts.

The table below compares the forecasting performance of the DIM to the best-performing model among the suite of Big Data models considered.[1] This Big Data model includes 16 of the 46 consumer price index (CPI) items currently included in the DIM, at a four-digit level of disaggregation of headline inflation.[2] Unlike the DIM, Big Data models do not incorporate off-model information such as the tariff adjustments approved by the National Energy Regulator of South Africa (NERSA), the announced university fee increases and medical scheme contribution hikes.

Comparing the root mean square error (RMSE), we find that the SARB's DIM with off-model information outperforms the Big Data model. Basically, SARB staff 'interventions' to incorporate the latest information and analysis improve the DIM forecasts significantly.

From April to August 2020, the period when most of the lockdown-related CPI imputations were in place, the forecasting performance of the DIM was relatively similar to the median forecasts of market analysts, as surveyed by Bloomberg – both had an RMSE of 0.12. These forecasts were also reasonably accurate from January 2020 until February 2021, with an RMSE of 0.14, the largest forecast error occurring in October 2020 when food and non-alcoholic beverages (NAB) inflation was underestimated. In terms of bias, the SARB errors are fairly balanced. Inflation is overestimated 57% of the time and underestimated 43% of the time.

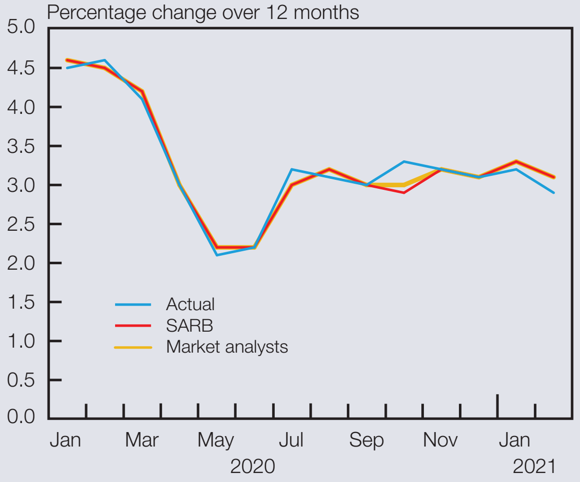
In summary, the SARB's DIM produces fairly accurate forecasts for near-term inflation, which should provide confidence to the SARB policymakers and other stakeholders.

1 The DIM is a seasonal model, weighing up CPI component forecasts. Big Data models use penalised likelihood functions and Bayesian techniques to exclude the CPI items without significant predictive power for headline inflation.

2 A four-digit classification considers bread and cereals instead of brown bread, which is an eight-digit classification. The Big Data models in our suite use data at four-, five- and eight-digit classifications.

SARB versus market analysts inflation forecasts

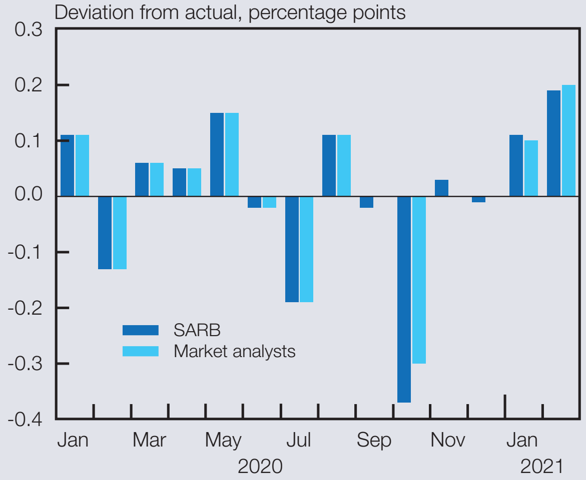
Percentage change over 12 months



Sources: Bloomberg and SARB

SARB versus market analysts inflation forecasts

Deviation from actual, percentage points



Sources: Bloomberg and SARB

Root mean square errors

Sample: January 2008 to July 2020

	1 month ahead	2 months ahead	3 months ahead	4 months ahead	6 months ahead	12 months ahead
Best-performing Big Data model	0.35	0.49	0.43	0.54	0.70	1.11
SARB DIM	0.35	0.55	0.68	0.78	0.85	1.05
SARB DIM including off-model information	0.15	0.26	0.41	0.54	0.71	0.88

Source: B Botha, R Burger, K Kotzé, N Rankin and D Steenkamp, 'Big Data forecasting of South African inflation', *South African Reserve Bank Working Paper Series,* forthcoming.

Conclusion

The COVID-19 pandemic, a global health crisis, morphed into a massive economic shock. The economic effects have been sharply differentiated across economies, in terms of both the intensity of economic contraction and the unevenness of the subsequent recovery.

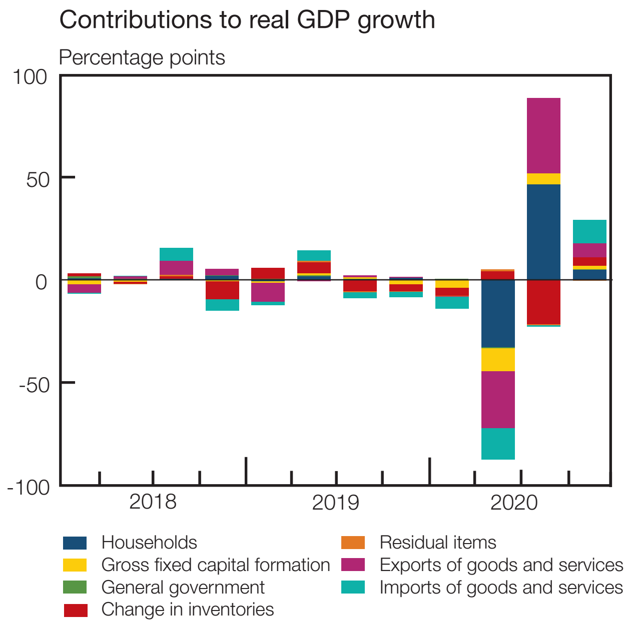
After suffering a 7% contraction in GDP in 2020, the South African economy is on a recovery path. The third- and fourth-quarter GDP growth out-turns have been robust, with GDP reaching about 96% of its 2019 level by the fourth quarter of 2020. The robustness of the recovery to date has surprised both the SARB and the markets, though it remains uneven across sectors.

The primary sector has led the recovery. Both agriculture and mining performed exceptionally well, supported by good rainfall in 2020 and, respectively, a rally in commodity prices. The tourism and transport sectors, on the other hand, remain further behind in their recovery.

The MPC responded to the COVID-19 shock by aggressively lowering the repo rate, cutting it by a cumulative 2.75 percentage points between March and July 2020. The resultant lower borrowing costs have supported credit extension to both households and corporates, and have spurred a recovery in consumption, with durable goods showing a sharp recovery from the lows observed in the second quarter of 2020. The low interest rates have helped to ease debt repayment pressures, boosting the real purchasing power of households and corporates. Government has also benefitted from the low interest rates through lower costs of borrowing.

The MPC held the repo rate unchanged at 3.5% in its November 2020, January 2021 and March 2021 meetings, as the recovery gained momentum. Growth is expected to reach 3.8% in 2021, while output is only expected to recover to the 2019 level in 2023. Inflation is expected to gradually rise to the midpoint of the target range by 2023, in line with the recovery in the economy. The return of inflation to target will require rates normalisation to close the real interest rate gap.

The slow recovery to the 2019 level of output indicates constraints in the economy that predate the COVID-19 pandemic. The constraints include inadequate electricity supply, inefficiencies in key infrastructure sectors, skills shortages, the regulatory burden faced by enterprises and weak competition. These raise the cost of doing business or the cost of restructuring in the face of major shocks to the business environment, impacting on competitiveness. The inadequate supply of electricity not only affects the level of production now; it also serves as a disincentive to new investment, affecting the country's future growth.



Source: Stats SA

Ease of doing business scores

Source: World Bank

The constrained fiscal space also serves as an obstacle to the recovery, and to stronger growth more generally, through its effects on long-term borrowing costs as well as confidence. The fiscal trajectory articulated in the 2021 Budget commits to arresting the fiscal deterioration, and policy space will increase and risk decrease as Budget targets are met or exceeded.

In considering the shape of the economic recovery going forward, the MPC has highlighted the importance of several factors, in particular: further de-risking the economy by stabilising public debt, providing sufficient energy for growth, reducing the impact of administered prices on overall inflation, and keeping inflation low into the recovery. A lower-inflation domestic economy will go far in protecting the competitiveness of producers in a world of diminished inflation, and raises the prospect of borrowing costs for households and firms permanently anchored at or near the current historically low levels.

Statement of the Monetary Policy Committee

19 November 2020

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

Since the September meeting of the Monetary Policy Committee (MPC), it has become clear that COVID-19 infections will occur in waves of higher and lower intensity, caused in large part by pandemic fatigue and lapses in safety protocols. The virus is spreading rapidly in parts of North America and Europe, and hotspots have emerged in some parts of South Africa. While we have learnt how to better manage the risks of transmission and the design of lockdowns, these waves of infection will continue for some time. Fresh spread of the virus and reimposed lockdowns will extend the time needed for economies to get back to pre-pandemic activity levels. Despite the welcome development in November of successful vaccine trials, global distribution of vaccines is likely to be slow, resulting in a modest pace of global economic growth into 2021.

As expected, the second-quarter gross domestic product (GDP) outcomes for most economies were massively negative. Third-quarter recoveries have generally been robust, and economies will continue to recover in the fourth quarter. The International Monetary Fund (IMF) now expects global GDP to contract by 4.4% this year. Although global GDP forecasts have improved from September, it is probable that global growth will be revised somewhat in the coming months.[1]

While financial asset prices have been volatile for much of the year due to pandemic-related developments and geopolitical events, recent weeks have seen markets strengthen. Capital flows to emerging markets have generally picked up when compared to the outflows experienced in March and April, and global policy rates look set to remain accommodative. Nonetheless, pronounced levels of risk aversion are likely to persist through 2021, particularly where economies fail to grow or where they run large external imbalances, fiscal deficits and high debt levels.

Locally, the further easing of lockdown restrictions has supported economic growth, with high-frequency indicators continuing to show a pickup in economic activity during August and September. The South African Reserve Bank's (SARB) forecast of third-quarter GDP growth has been revised up to 50.3% quarter on quarter, seasonally adjusted and annualised. The growth rate for the full year is now expected to be -8.0% compared to the contraction of 8.2% expected at the time of the September meeting.

South Africa's terms of trade remain robust. Commodity export prices are high, while oil prices remain generally low.

Getting back to pre-pandemic output levels will, however, take time. Sharply lower investment this year by both the public and the private sectors will weigh on growth prospects in the coming years. GDP is now expected to grow by 3.5% in 2021 and by 2.4% in 2022.[2]

Overall, the risks to the growth outlook are assessed to be balanced, but this is tentative and open to adjustment, given the wide range of shocks hitting the economy, uncertainties around the effectiveness of policy, and the sensitivity of sentiment to news flows. The somewhat stronger growth in 2020 and the small downward revision to growth in 2021 implies little change in the size of the output gap over the forecast period compared to the September meeting.

The accommodative policies in many advanced economies and the improved economic outlook have supported a partial recovery in global financial markets. But this has so far resulted in only a trickle of fresh capital flows to emerging markets, and financing conditions remain uncertain. South Africa's high public financing needs have been met instead by local private sector savings and borrowing from international financial institutions. Yields have eased in recent months due to higher purchases of sovereign bonds by resident investors, including banks, alongside the SARB's liquidity management operations. However, the yield curve remains exceptionally steep, reflecting elevated levels of risk associated with high public borrowing needs.[3]

Better global economic and financial conditions have seen the rand appreciate by 6.9% since the September meeting. The rand has, however, depreciated by 8.7% against the United States (US) dollar since January, and remains below its estimated long-run equilibrium value. The implied starting point for the rand forecast is R16.50 to the US dollar, compared with R16.90 at the time of the previous meeting.

The SARB's headline consumer price inflation forecast averages 3.2% in 2020, is slightly lower than previously forecast at 3.9% in 2021, and remains at 4.4% in 2022. The forecast for core inflation is lower at 3.3% in 2020 and 3.4% in 2021, and remains stable at 4.0% in 2022.

1 Global growth in the QPM is a trade-weighted average of South Africa's trading partners. For 2020, this is now at -3.9% (up from -4.2% in September), and it has been revised down to 4.5% for 2021. Based on the October 2020 *World Economic Outlook*, the IMF expects global growth of 5.2% in 2021.

2 Compared to 3.9% and 2.6% respectively in September.

3 Measured by the Emerging Markets Bond Index (EMBI+) premium over emerging market averages and as an absolute value over time.

The overall risks to the inflation outlook appear to be to the downside in the near term and balanced over the medium term. Global producer price inflation and oil prices remain low.[4] Local food price inflation is expected to remain contained. The MPC additionally notes the significant but likely temporary reduction in medical insurance price inflation for next year. Given the low pass-through, the risks to inflation from currency depreciation are expected to stay muted. However, additional exchange rate pressures could result from heightened fiscal risks. While no demand-side pressures are evident, electricity and other administered prices remain a concern.

Importantly, the expectations of future inflation continued to moderate this year, and have shifted slightly below the midpoint of the target band for 2021. The market-based expectations for short- and medium-term inflation have eased slightly, while longer-term inflation expectations remain higher.[5]

The MPC notes that the slow recovery will keep inflation below the midpoint of the target range for this year and the next. Unless the risks outlined earlier materialise, inflation is expected to be well-contained over the medium term, remaining below but close to the midpoint in 2021 and 2022.

Against this backdrop, the MPC has decided to keep rates unchanged at 3.5% per annum. Two members preferred a 25 basis points cut, and three preferred to hold rates at the current level.

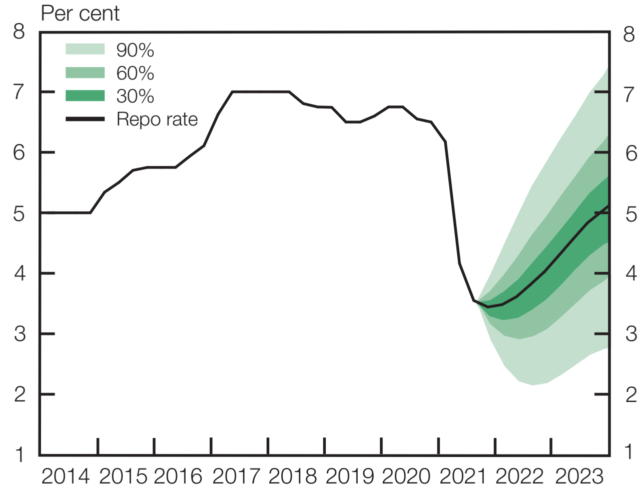
The implied policy rate path of the Quarterly Projection Model (QPM) indicates no further repurchase (repo) rate cuts in the near term, and two increases of 25 basis points in the third and fourth quarters of 2021.

Monetary policy has eased financial conditions, and has improved the resilience of households and firms to the economic implications of COVID-19. It continues to be accommodative. The SARB has taken important steps to ensure adequate liquidity in the domestic markets. Regulatory capital relief has also been provided, sustaining lending by financial institutions to households and firms.

Monetary policy cannot, however, improve the potential growth rate of the economy or reduce fiscal risks on its own. These should be addressed by implementing prudent macroeconomic policies and structural reforms that lower costs generally and increase investment opportunities, potential growth and job creation. Consistently aligning administered prices and productivity-adjusted wage setting with projected inflation would generate important macroeconomic gains. Such steps would 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 highly 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 any temporary price shocks and will 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 (November 2020)



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 Our assumptions are now for oil prices to average about US$40 per barrel in 2020, rising to US$45 per barrel in 2021 and US$50 per barrel in 2022.

5 The latest Bureau for Economic Research (BER) survey has expectations for 2020 down by 0.3 percentage points to 3.6% and to 4.2% (from 3.9% and 4.5%) for 2021. Five-years-ahead inflation expectations have eased from 4.7% to 4.5%. Household inflation expectations are down from 6.2% to 5.9%. Market analysts (Reuters Econometer) expect inflation to remain unchanged at 3.3% for 2020, lower to 3.9% in 2021, and remain unchanged at 4.4% in 2022. Market-based rates are calculated from the break-even inflation rate, which is the yield differential between conventional and inflation-linked bonds. These sit at 3.15% for the five-year break-even and at 4.91% on the 10-year break-even; the 15-year break-even inflation sits at 6.1%.

Summary of assumptions: Monetary Policy Committee meeting on 19 November 2020*

Foreign sector assumptions

	Actual			Forecast		
	2017	2018	2019	2020	2021	2022
1. Real GDP growth in South Africa's major trading-partner countries	3.4%	3.3%	2.2%	-3.9%	4.5%	3.7%
	(3.4%)	(3.3%)	(2.2%)	(-4.2%)	(4.7%)	(4.0%)
2. Output gap in South Africa's major trading-partner countries (ratio to potential GDP)	0.1%	0.6%	0.4%	-3.4%	-1.9%	-0.5%
	(0.0%)	(0.4%)	(0.4%)	(-4.0%)	(-2.2%)	(-0.2%)
3. Change in international commodity prices in US$ (excluding oil)	18.2%	11.5%	-1.1%	21.6%	2.4%	-3.2%
	(18.2%)	(11.1%)	(-0.9%)	(13.3%)	(-4.4%)	(2.7%)
4. Brent crude (US$/barrel)	54.2	71.0	64.4	40.8	45.0	50.0
	(54.2)	(71.0)	(64.4)	(42.0)	(47.0)	(52.0)
5. Change in world food prices (US$)	6.6%	-2.2%	-0.8%	0.9%	1.9%	2.2%
	(6.6%)	(-2.2%)	(-0.8%)	(-1.4%)	(3.4%)	(1.5%)
6. Change in international consumer prices	1.7%	2.0%	1.4%	0.7%	1.3%	1.5%
	(1.7%)	(2.0%)	(1.4%)	(0.8%)	(1.4%)	(1.5%)
7. International policy interest rate	0.5%	0.9%	1.1%	0.2%	0.0%	0.0%
	(0.5%)	(0.9%)	(1.1%)	(0.2%)	(0.0%)	(0.0%)

Domestic sector assumptions

	Actual			Forecast		
	2017	2018	2019	2020	2021	2022
1. Change in electricity price	4.7%	5.2%	9.6%	9.1%	8.2%	10.0%
	(4.7%)	(5.2%)	(9.6%)	(9.1%)	(8.2%)	(10.0%)
2. Change in fuel taxes and levies	8.3%	8.9%	5.8%	5.7%	5.0%	5.0%
	(8.3%)	(8.9%)	(5.8%)	(5.7%)	(5.0%)	(5.0%)
3. Potential growth	1.2%	0.7%	0.3%	-3.2%	1.4%	0.9%
	(1.2%)	(0.7%)	(0.3%)	(-3.2%)	(1.4%)	(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	1.7%	1.9%	2.1%	2.1%	2.2%	2.3%
	(1.7%)	(1.9%)	(2.1%)	(2.1%)	(2.2%)	(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 61 and 62.

Summary of selected forecast results: Monetary Policy Committee meeting on 19 November 2020*

Selected forecast results (quarterly)

Year-on-year percentage change

	2019				2020				2021				2022			
	4.1 (4.1)				3.2 (3.3)				3.9 (4.0)				4.4 (4.4)			
Headline inflation	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
	4.2	4.4	4.1	3.7	4.4	2.4	3.1	2.9	3.2	4.3	3.8	4.2	4.4	4.4	4.4	4.5
	(4.2)	(4.4)	(4.1)	(3.7)	(4.4)	(2.4)	(3.2)	(3.3)	(3.4)	(4.6)	(4.0)	(4.2)	(4.3)	(4.4)	(4.4)	(4.5)
	2019				2020				2021				2022			
	4.1 (4.1)				3.3 (3.4)				3.4 (3.7)				4.0 (4.0)			
Core inflation	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
	4.4	4.2	4.1	3.9	3.7	3.1	3.2	3.3	3.2	3.5	3.4	3.5	3.9	4.0	4.0	4.1
	(4.4)	(4.2)	(4.1)	(3.9)	(3.7)	(3.1)	(3.3)	(3.4)	(3.5)	(3.8)	(3.7)	(3.8)	(3.9)	(3.9)	(4.0)	(4.2)

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		
	2017	2018	2019	2020	2021	2022
GDP growth	1.4%	0.8%	0.2%	-8.0%	3.5%	2.4%
	(1.4%)	(0.8%)	(0.2%)	(-8.2%)	(3.9%)	(2.6%)
Output gap (ratio to potential GDP)	-0.9%	-0.9%	-1.0%	-6.3%	-4.2%	-2.7%
	(-0.9%)	(-0.9%)	(-1.0%)	(-6.5%)	(-4.0%)	(-2.3%)
Change in nominal effective exchange rate	9.9%	-1.0%	-7.0%	-13.5%	-0.2%	0.2%
	(9.9%)	(-1.0%)	(-7.0%)	(-14.0%)	(-0.1%)	(0.7%)
Change in real effective exchange rate	13.7%	1.4%	-4.5%	-11.4%	2.3%	3.0%
	(13.7%)	(1.4%)	(-4.5%)	(-11.9%)	(2.5%)	(3.5%)
Real exchange rate gap	1.2%	2.0%	-1.3%	-12.1%	-9.4%	-6.4%
	(1.2%)	(2.0%)	(-1.3%)	(-12.7%)	(-9.8%)	(-6.3%)
Repurchase rate (end of period)	6.75%	6.60%	6.50%	3.42%	3.97%	4.88%
	(6.75%)	(6.60%)	(6.50%)	(3.44%)	(4.03%)	(5.03%)
Current account balance (ratio to GDP)	-2.5%	-3.5%	-3.0%	0.5%	-1.7%	-2.1%
	(-2.5%)	(-3.5%)	(-3.0%)	(-1.0%)	(-1.9%)	(-2.2%)

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

21 January 2021

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

Since the November meeting of the Monetary Policy Committee (MPC), a second wave of COVID-19 infections has peaked in South Africa and in many other countries. It is expected that these waves of infection will continue until vaccine distribution is widespread and populations develop sufficient immunity to curb virus transmission.

Although the virus will continue in new waves, the roll-out of vaccines is expected to boost global growth prospects generally. We have therefore revised global growth for 2021 higher.[1] However, global distribution of vaccines is likely to be slow, creating an uneven pace of global economic recovery in 2021. The International Monetary Fund (IMF) had forecast global gross domestic product (GDP) to have contracted by 4.4% in 2020 and to expand by 5.2% in 2021; their new forecasts will be released on 26 January 2021.

While financial asset prices were volatile for much of the past year due to pandemic-related developments and geopolitical events, recent months have seen markets strengthen. Capital flows to emerging markets have generally picked up when compared to the outflows experienced in March and April last year. Although global policy rates look set to remain accommodative, risk aversion is likely to persist through 2021, particularly where economies fail to take advantage of improved global prospects or run large macroeconomic imbalances.

In the third quarter of 2020, the South African economy grew by 66.1% quarter on quarter, seasonally adjusted and annualised, compared to the South African Reserve Bank's (SARB) expected 50.3% growth. The growth rate for the full year is now expected to be -7.1%, compared to the contraction of 8.0% expected at the time of the November meeting. However, our projection for the fourth quarter of 2020 is expected to be lower than previously forecast. And while the lockdown restrictions currently in place are considerably less restrictive than in 2020, we expect growth in the first quarter of 2021 to remain muted.

Despite very robust terms of trade and stronger exports, getting back to pre-pandemic output levels will take time. Sharply lower public and private investment last year and continued weakness in 2021 will weigh on growth prospects. GDP is now expected to grow by 3.6% in 2021 and by 2.4% in 2022.[2] GDP growth of 2.5% is expected in 2023.

Overall, the risks to the domestic growth outlook are assessed to be balanced. Global growth, vaccine distribution, a low cost of capital and high commodity prices are supportive of growth. However, new waves of the COVID-19 virus are likely to periodically weigh on economic activity, both globally and locally. In addition, constraints to the domestic supply of energy, weak investment and uncertainty about the vaccine roll-out remain serious downside risks to domestic growth.

The accommodative policies in many advanced economies and the improved economic outlook continue to support the recovery in global financial markets and some strengthening in international capital flows. So far, this has resulted in a trickle of fresh capital flows to South Africa. Financing conditions remain uncertain, as reflected in the exceptionally steep yield curve.[3]

These favourable global conditions have seen the rand appreciate by 1.7% since the November meeting. However, since January 2020, the rand has depreciated by 8.0% against the United States (US) dollar, and remains below its estimated long-run equilibrium value. The implied starting point for the rand forecast is R15.70 to the US dollar, compared with R16.50 at the time of the previous meeting.

Headline consumer price inflation averaged 3.3% in 2020, in line with the SARB's expectation, and is the lowest rate since 2004. The SARB's forecast for 2021 is slightly higher at 4.0% (up from 3.9%), and is 4.5% (up from 4.4%) for 2022. The forecast for 2023 is 4.6%. Core inflation also averaged 3.3% in 2020. The forecasts for 2021 and 2022 are unchanged at 3.4% and 4.0% respectively. In 2023, core inflation is expected to be 4.3%.

Despite an upward revision to potential growth, higher growth in 2020 and in 2021 implies a small narrowing of the output gap over the forecast period, compared to the November meeting. Global producer price inflation, food price inflation and oil prices have risen.[4] The more appreciated nominal exchange rate in recent months is, however, expected to moderate some inflationary pressure.

1 Global growth in the QPM is a trade-weighted average of South Africa's trading partners. For 2020, this is now at -3.6% (up from -3.9% in November), and it has been revised up to 5.0% for 2021. Based on the October 2020 *World Economic Outlook*, the IMF expects global growth of 5.2% in 2021.

2 Compared to 3.5% and 2.4% respectively in November.

3 Measured by the Emerging Markets Bond Index (EMBI+) premium over emerging market averages and as an absolute value over time.

4 Our assumptions are now for oil prices to average about US$50 per barrel in 2021, rising to US$55 per barrel in 2022 and US$57 per barrel in 2023.

The overall risks to the inflation outlook appear to be balanced in the near and medium term. Local food price inflation is higher but is expected to remain broadly contained. The MPC additionally notes the significant but likely temporary reduction in medical insurance price inflation this year. Given the low pass-through, the risks to inflation from currency depreciation are expected to stay muted. However, additional exchange rate pressures could result from fiscal risks. While no demand-side pressures are evident, electricity and other administered prices remain serious concerns.

The expectations of future inflation appear more stable after sustained moderation last year, although those of households continue to moderate from quite high levels. The market-based expectations for short- and medium-term inflation have eased slightly, while longer-term inflation expectations remain higher.[5]

The MPC notes that the slow economic recovery will help keep inflation below the midpoint of the target range for this year and the next. Unless the risks outlined earlier materialise, inflation is expected to be well-contained in 2021, before rising to around the midpoint in 2022 and 2023.

Against this backdrop, the MPC has decided to keep rates unchanged at 3.5% per annum. Two members preferred a 25 basis points cut, and three preferred to hold rates at the current level.

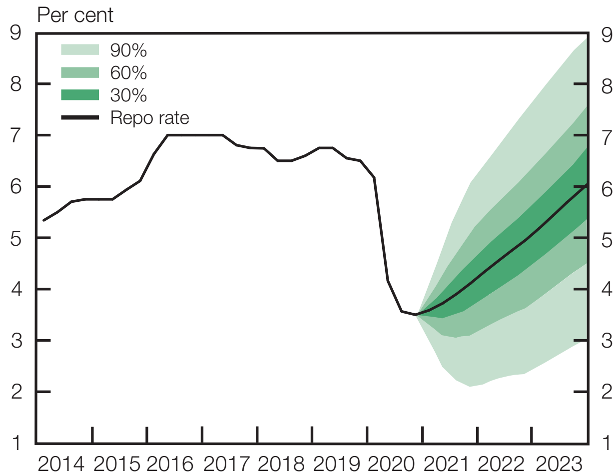
The implied policy rate path of the Quarterly Projection Model (QPM) indicates two increases of 25 basis points in the second and third quarters of 2021.

Monetary policy has eased financial conditions, and has improved the resilience of households and firms to the economic implications of COVID-19. It continues to be accommodative. The steps taken by the SARB have ensured adequate liquidity in the domestic markets. In addition, the regulatory relief provided to banks has sustained lending to households and firms.

While monetary policy will continue to support the economic recovery, a faster growth rate depends on implementing prudent macroeconomic policies and structural reforms. Lower administered prices and productivity-adjusted wage setting aligned to projected inflation would also generate important macroeconomic gains. Such steps would 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 highly 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 any temporary price shocks and will focus on second-round effects. As usual, the repurchase (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 (January 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 latest Bureau for Economic Research (BER) survey expectations for 2020 are 0.1 percentage points higher at 3.7%, unchanged in 2021 at 4.2%, and 0.1 percentage points lower in 2022 at 4.5%. Household inflation expectations have eased further to 5.3% from 5.9%. Market analysts (Reuters Econometer) expect inflation to remain unchanged at 3.3% for 2020, lower to 3.8% in 2021, and lower to 4.2% in 2022. Inflation is expected to be 4.5% 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 sit at 3.2% for the five-year break-even and at 5.0% on the 10-year break-even; the 15-year break-even inflation sits at 6.2%.

Summary of assumptions: Monetary Policy Committee meeting on 21 January 2021*

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%	-3.6%	5.0%	3.8%	3.4%
	(3.3%)	(2.2%)	(-3.9%)	(4.5%)	(3.7%)	
2. Output gap in South Africa's major trading-partner countries (ratio to potential GDP)	0.2%	-0.1%	-2.8%	-2.5%	-1.0%	0.0%
	(0.6%)	(0.4%)	(-3.4%)	(-1.9%)	(-0.5)	
3. Change in international commodity prices in US$ (excluding oil)	11.5%	-1.1%	25.4%	14.8%	-13.0%	-0.5%
	(11.5%)	(-1.1%)	(21.6%)	(2.4%)	(-3.2%)	
4. Brent crude (US$/barrel)	71.0	64.4	41.8	50.0	55.0	57.0
	(71.0)	(64.4)	(40.8)	(45.0)	(50.0)	
5. Change in world food prices (US$)	-2.2%	-0.8%	2.5%	2.9%	1.5%	1.5%
	(-2.2%)	(-0.8%)	(0.9%)	(1.9%)	(2.2%)	
6. Change in international consumer prices	2.0%	1.4%	0.8%	1.5%	1.5%	1.7%
	(2.0%)	(1.4%)	(0.7%)	(1.3%)	(1.5%)	
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%)	

Domestic sector assumptions

	Actual		Forecast			
	2018	2019	2020	2021	2022	2023
1. Change in electricity price	5.2%	9.6%	9.1%	8.2%	10.0%	10.0%
	(5.2%)	(9.6%)	(9.1%)	(8.2%)	(10.0%)	
2. Change in fuel taxes and levies	8.9%	5.8%	5.7%	5.5%	5.0%	4.7%
	(8.9%)	(5.8%)	(5.7%)	(5.0%)	(5.0%)	
3. Potential growth	0.7%	0.3%	-2.5%	1.6%	0.9%	0.9%
	(0.7%)	(0.3%)	(-3.2%)	(1.4%)	(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%)	
5. Neutral real interest rate	1.9%	2.1%	2.0%	2.1%	2.3%	2.3%
	(1.9%)	(2.1%)	(2.1%)	(2.2%)	(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 61 and 62.

Summary of selected forecast results: Monetary Policy Committee meeting on 21 January 2021*

Selected forecast results (quarterly)

Year-on-year percentage change

	2020 3.3 (3.2)				2021 4.0 (3.9)				2022 4.5 (4.4)				2023 4.6			
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	4.5	4.0	4.3	4.5	4.5	4.5	4.6	4.6	4.6	4.5	4.5
	(4.4)	(2.4)	(3.1)	(2.9)	(3.2)	(4.3)	(3.8)	(4.2)	(4.4)	(4.4)	(4.4)	(4.5)				
	2020 3.3 (3.3)				2021 3.4 (3.4)				2022 4.0 (4.0)				2023 4.3			
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	3.1	3.4	3.4	3.7	3.8	4.0	4.1	4.3	4.4	4.3	4.3	4.3
	(3.7)	(3.1)	(3.3)	(3.3)	(3.2)	(3.5)	(3.4)	(3.5)	(3.9)	(4.0)	(4.0)	(4.1)				

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
GDP growth	0.8%	0.2%	-7.1%	3.6%	2.4%	2.5%
	(0.8%)	(0.2%)	(-8.0%)	(3.5%)	(2.4%)	
Output gap (ratio to potential GDP)	-0.9%	-1.0%	-6.0%	-3.9%	-2.3%	-0.7%
	(-0.9%)	(-1.0%)	(-6.3%)	(-4.2%)	(-2.7%)	
Change in nominal effective exchange rate	-1.0%	-7.0%	-12.8%	0.5%	-1.1%	0.3%
	(-1.0%)	(-7.0%)	(-13.5%)	(-0.2%)	(0.2%)	
Change in real effective exchange rate	1.4%	-4.5%	-10.6%	3.0%	1.8%	3.0%
	(1.4%)	(-4.5%)	(-11.4%)	(2.3%)	(3.0%)	
Real exchange rate gap	2.0%	-1.3%	-10.9%	-7.6%	-5.8%	-2.8%
	(2.0%)	(-1.3%)	(-12.1%)	(-9.4%)	(-6.4%)	
Repurchase rate (end of period)	6.60%	6.50%	3.50%	4.11%	4.95%	5.93%
	(6.60%)	(6.50%)	(3.42%)	(3.97%)	(4.88%)	
Current account balance (ratio to GDP)	-3.5%	-3.0%	2.1%	0.0%	-1.6%	-1.6%
	(-3.5%)	(-3.0%)	(0.5%)	(-1.7%)	(-2.1%)	

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

25 March 2021

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

Since the January meeting of the Monetary Policy Committee (MPC), a second wave of COVID-19 infections has come and gone, with lockdown restrictions further reduced. Until vaccination is widespread and populations develop sufficient immunity to curb virus transmission, it is expected that these waves of infection will continue. As indicated by public health authorities, a third wave of COVID-19 infections is probable in the coming months. Despite further expected waves, the start of vaccinations in many countries has lifted projections for global economic growth and boosted confidence significantly.

The International Monetary Fund's (IMF) January forecast for growth in global gross domestic product (GDP) for 2021 has been revised up to 5.5%. The South African Reserve Bank's (SARB) forecast for global growth in 2021 is now 5.8%.[1] For 2022, we expect global growth of about 3.7%. Despite this more optimistic outlook, the distribution of vaccines will be slow, contributing to an uneven pace of global economic recovery this year and the next.

Financial markets have generally improved, in line with stronger growth and expectations that the policy settings in the advanced economies will remain accommodative. Capital flows to emerging markets increased in December and January. However, in recent weeks, renewed uncertainty resulted in more volatility in flows and currencies. This reflects considerable sensitivity to risk, particularly where economies fail to take advantage of improved global prospects or run large macroeconomic imbalances. Even though global policy rates are likely to remain accommodative, risk aversion will persist.

South Africa's economy expanded by 6.3% on a quarterly, annualised basis in the fourth quarter of 2020, but contracted by 7.0% for the year as a whole. The SARB's forecast for GDP for the first quarter of 2021 stands at -0.2%, down from 1.0% at the time of the January MPC meeting. With stronger quarterly outcomes for the rest of this year, the economy is expected to grow by about 3.8% (up from 3.6%).

Getting back to pre-pandemic output levels will take time. While the recent lockdown restrictions have proved less constraining to economic activity, load-shedding has been substantial, and consumption moderated after December. Rising oil prices have increased the economy's total import bill, offsetting some income gains from stronger terms of trade.

The sharply lower public and private investment last year and continued weakness in 2021 will weigh on growth prospects. GDP is expected to grow by 2.4% in 2022 and by 2.5% in 2023, unchanged since the January meeting.

Overall, the risks to the domestic growth outlook are assessed to be balanced. Global growth, progress in vaccination, a low cost of capital and high commodity prices are all supportive of growth. However, new waves of the COVID-19 virus are likely to weigh on economic activity, both globally and locally. In addition, the ongoing constraints to the domestic supply of energy as well as uncertainty about the vaccine roll-out continue to pose downside risks to growth.

The large current account surplus at present reflects good growth and higher prices for exports, moderate prices for imported oil, and very weak demand for imported consumer and investment goods. This surplus is expected to give way to a modest current account deficit as the year progresses.[2]

Despite the recent volatility, on balance, the accommodative policies in many advanced economies and the improved economic outlook will support global financial markets and strengthen international capital flows. This broad improvement in the global environment resulted in net capital inflows to South Africa in December and January, before giving way to net outflows in recent weeks. Although financing conditions have improved modestly and fiscal risk has eased, the yield curve for rand-denominated assets remains steep.

Despite these generally favourable global conditions and considerable rand appreciation through the latter half of 2020 and into this year, the rand remains below its estimated long-run equilibrium value. Since the January meeting, the rand has appreciated by 1.3% on a trade-weighted basis. The implied starting point for the rand forecast is R14.96 to the United States (US) dollar, compared with R15.70 at the time of the previous meeting.

Headline consumer price inflation averaged 3.3% in 2020. The forecast for 2021 is higher at 4.3% (up from 4.0%), and slightly lower for 2022 at 4.4% (down from 4.5%). The forecast for 2023 is 4.5% (down from 4.6%).

1 Global growth in the QPM is a trade-weighted average of South Africa's trading partners. For 2020, this is now at -3.1% (up from -3.6% in January), and for 2021, it has been revised up from 5.0% to 5.8%. The IMF's global forecast for 2022 sits at 4.2%.

2 The current account is expected to be in a surplus of 1.3% of GDP in 2021, shifting to a deficit of 0.8% in 2022.

Core inflation also averaged 3.3% in 2020. The core inflation forecast for 2021 is slightly lower at 3.3% (down from 3.4%), and unchanged for 2022 and 2023 at 4.0% and 4.3% respectively.

Oil prices have been revised up sharply in the forecast, resulting in higher petrol price inflation at 12.7% for 2021, compared to 4.4% at the time of the January meeting.[3] Electricity prices are significantly higher at 9.7% for 2021 (up from 8.1%).

Expectations of future inflation eased further in the first quarter of this year. The inflation expectations of households continue to moderate from quite high levels. The market-based expectations for short-term inflation are lower, but have increased for the medium- and longer-term horizons.[4]

The overall risks to the inflation outlook appear to be balanced. The more appreciated nominal exchange rate in recent months and the generally low pass-through are expected to continue moderating some inflationary pressure. The MPC additionally notes the significant, but likely temporary, reduction in medical insurance price inflation this year. While global food price inflation remains high, local food price inflation is slightly lower than previously expected, and should remain broadly contained due to higher local crop production. Oil prices have increased sharply this year, and are expected to remain at these levels over the forecast horizon. Electricity and other administered prices remain as upside risks to the inflation trajectory.

While no demand-side pressures are evident at present, higher growth in 2021 and no change in the potential growth rate implies a faster narrowing of the output gap over the forecast period, compared to the January meeting.

Unless the risks outlined earlier materialise, inflation is expected to be well-contained in 2021, before rising to around the midpoint of the inflation target range in 2022 and 2023.

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

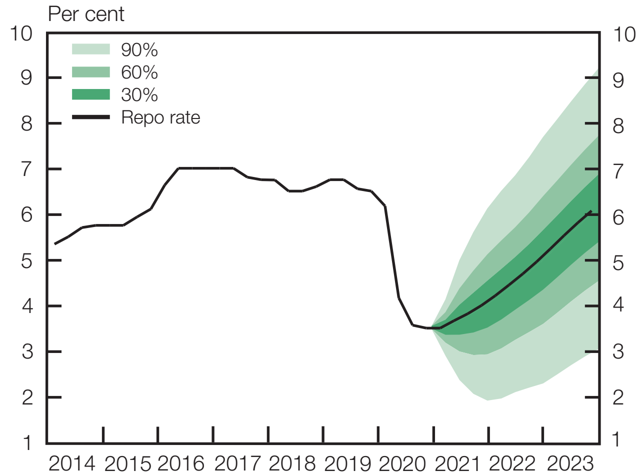
The implied policy rate path of the Quarterly Projection Model (QPM) indicates an increase of 25 basis points in each of the second and fourth quarters of 2021. Compared to the previous meeting, the shift in the rate path from the third to the fourth quarter is due to somewhat lower inflation in 2022.

Monetary policy continues to be accommodative, keeping financial conditions supportive of credit demand as the economy recovers from the pandemic and the associated lockdowns. The SARB has ensured adequate liquidity in the domestic markets, and will continue to closely monitor the funding markets for stress. In addition, the 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 inflation low into the recovery. Such steps would 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 any temporary price shocks and will focus on second-round effects. As usual, the repurchase (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 (March 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

3 Our assumptions are now for oil prices to average about US$62 per barrel in 2021 (up from US$50) and about US$60 per barrel in both 2022 and 2023 (up from US$55 and US$57 respectively).

4 The latest (2021Q1) Bureau for Economic Research (BER) survey expectations have eased from 4.2% to 3.9% for 2021 and from 4.5% to 4.2% for 2022; they are at 4.4% for 2023. Household inflation expectations have eased further to 5.0% from 5.3%. Market analysts (Reuters Econometer) expect inflation to be higher at 4.1% (from 3.8%) in 2021, at 4.3% (from 4.2%) in 2022, and unchanged at 4.5% 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 4.4% for the five-year break-even and at 5.9% on the 10-year break-even; the 15-year break-even inflation sits at 6.8%.

Summary of assumptions: Monetary Policy Committee meeting on 25 March 2021*

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%	-3.1%	5.8%	3.7%	3.3%
	(3.3%)	(2.2%)	(-3.6%)	(5.0%)	(3.8%)	(3.4%)
2. Output gap in South Africa's major trading-partner countries (ratio to potential GDP)	0.6%	0.4%	-2.7%	-1.6%	-0.4%	0.3%
	(0.2%)	(-0.1%)	(-2.8%)	(-2.5%)	(-1.0)	(0.0%)
3. Change in international commodity prices in US$ (excluding oil)	11.5%	-1.1%	25.5%	23.3%	-13.0%	0.0%
	(11.5%)	(-1.1%)	(25.4%)	(14.8%)	(-13.0%)	(-0.5%)
4. Brent crude (US$/barrel)	71.0	64.4	41.8	62.0	60.0	60.0
	(71.0)	(64.4)	(41.8)	(50.0)	(55.0)	(57.0)
5. Change in world food prices (US$)	-2.2%	-0.8%	3.1%	4.5%	1.7%	1.4%
	(-2.2%)	(-0.8%)	(2.5%)	(2.9%)	(1.5%)	(1.5%)
6. Change in international consumer prices	2.0%	1.4%	0.8%	1.6%	1.6%	1.8%
	(2.0%)	(1.4%)	(0.8%)	(1.5%)	(1.5%)	(1.7%)
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%)

Domestic sector assumptions

	Actual			Forecast		
	2018	2019	2020	2021	2022	2023
1. Change in electricity price	5.2%	9.6%	9.1%	9.7%	11.4%	10.0%
	(5.2%)	(9.6%)	(9.1%)	(8.2%)	(10.0%)	(10.0%)
2. Change in fuel taxes and levies	8.9%	5.8%	5.7%	5.1%	4.9%	4.7%
	(8.9%)	(5.8%)	(5.7%)	(5.5%)	(5.0%)	(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 61 and 62.

Summary of selected forecast results: Monetary Policy Committee meeting on 25 March 2021*

Selected forecast results (quarterly)

Year-on-year percentage change

	2020				2021				2022				2023			
	3.3 (3.3)				4.3 (4.0)				4.4 (4.5)				4.5 (4.6)			
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	4.5	4.7	4.6	4.3	4.2	4.3	4.4	4.5	4.5	4.5
	(4.4)	(2.4)	(3.1)	(3.2)	(3.2)	(4.5)	(4.0)	(4.3)	(4.5)	(4.5)	(4.5)	(4.6)	(4.6)	(4.6)	(4.5)	(4.5)
	2020				2021				2022				2023			
	3.3 (3.3)				3.3 (3.4)				4.0 (4.0)				4.3 (4.3)			
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	3.0	3.3	3.3	3.6	3.9	4.1	4.1	4.1	4.2	4.3	4.4	4.5
	(3.7)	(3.1)	(3.3)	(3.3)	(3.1)	(3.4)	(3.4)	(3.7)	(3.8)	(4.0)	(4.1)	(4.3)	(4.4)	(4.3)	(4.3)	(4.3)

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
GDP growth	0.8%	0.2%	-7.0%	3.8%	2.4%	2.5%
	(0.8%)	(0.2%)	(-7.1%)	(3.6%)	(2.4%)	(2.5%)
Output gap (ratio to potential GDP)	-0.9%	-1.0%	-5.9%	-3.5%	-2.0%	-0.5%
	(-0.9%)	(-1.0%)	(-6.0%)	(-3.9%)	(-2.3%)	(-0.7%)
Change in nominal effective exchange rate	-1.0%	-7.0%	-12.8%	2.1%	-2.4%	0.7%
	(-1.0%)	(-7.0%)	(-12.8%)	(0.5%)	(-1.1%)	(0.3%)
Change in real effective exchange rate	1.4%	-4.5%	-10.7%	4.9%	0.3%	3.3%
	(1.4%)	(-4.5%)	(-10.6%)	(3.0%)	(1.8%)	(3.0%)
Real exchange rate gap	2.0%	-1.3%	-10.9%	-5.9%	-5.6%	-2.3%
	(2.0%)	(-1.3%)	(-10.9%)	(-7.6%)	(-5.8%)	(-2.8%)
Repurchase rate (end of period)	6.60%	6.50%	3.50%	4.00%	4.95%	6.07%
	(6.60%)	(6.50%)	(3.50%)	(4.11%)	(4.95%)	(5.93%)
Current account balance (ratio to GDP)	-3.5%	-3.0%	2.2%	1.3%	-0.8%	-1.3%
	(-3.5%)	(-3.0%)	(2.1%)	(0.0%)	(-1.6%)	(-1.6%)

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 (SSA) 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 neutral real 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 the output gap is negative, 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
Alsi	All-Share Index
BER	Bureau for Economic Research
BIS	Bank for International Settlements
CARES Act	Coronavirus Aid, Relief and Economic Security Act
CIT	corporate income tax
COVAX	COVID-19 Vaccine Global Access
CPI	consumer price index
CSIR	Council for Scientific and Industrial Research
DIM	Disaggregated Inflation Model
ECB	European Central Bank
EM	emerging market
EMBI+	Emerging Market Bond Index Plus
EMDE	emerging market and developing economy
ESG	environmental, social and governance
EU	European Union
FAO	Food and Agriculture Organization
Fed	Federal Reserve
Fitch	Fitch Ratings Inc.
FX	foreign exchange
G3	Group of Three (United States, euro area, Japan)
GDP	gross domestic product
GFC	global financial crisis
GPM	Global Projection Model
Haver	Haver Analytics
IIF	Institute of International Finance
IMF	International Monetary Fund
IOSRO	Intraday Overnight Supplementary Repurchase Operation
Jibar	Johannesburg Interbank Average Rate
JPMorgan EM FX Index	JPMorgan Emerging Market Foreign Exchange Index
JPMorgan GBI	JPMorgan Government Bond Index
JSE	JSE Limited
Moody's	Moody's Investors Service
MOVE (Index)	Merrill Lynch Option Volatility Estimate (Index)
MPC	Monetary Policy Committee
MPR	*Monetary Policy Review*
MTBPS	*Medium Term Budget Policy Statement*
MYPD	multi-year price determination
NAB	non-alcoholic beverages
NCD	negotiable certificate of deposit
NEER	nominal effective exchange rate (of the rand)

NERSA	National Energy Regulator of South Africa
NRIR	neutral real interest rate
OPEC	Organization of the Petroleum Exporting Countries
PGM	Platinum Group Metal
PIT	personal income tax
QES	*Quarterly Employment Statistics*
QLFS	*Quarterly Labour Force Survey*
QPM	Quarterly Projection Model
RAF	Road Accident Fund
RCA	Regulatory Clearing Account
REER	real effective exchange rate
repo (rate)	repurchase (rate)
rhs	right-hand scale
RSME	root mean square error
SA	South Africa(n)
SACU	Southern African Customs Union
SARB	South African Reserve Bank
SFs	standing facility
SOE	state-owned enterprise
S&P	Standard & Poor's
SSA	sub-Saharan Africa
Stats SA	Statistics South Africa
TFP	total factor productivity
UAE	United Arab Emirates
UK	United Kingdom
ULC	unit labour cost
UN	United Nations
US	United States
VAT	value-added tax
VIX	Volatility Index
WGBI	World Government Bond Index