# MONETARY POLICY REVIEW

OCTOBER 2024

SOUTH AFRICAN RESERVE BANK

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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.

The *MPR* is presented by senior officials of the SARB at Monetary Policy Forum meetings held at major centres across South Africa in an effort to develop a better understanding of monetary policy through direct interactions with stakeholders.

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

# Contents

# The clearing storm

## Executive summary and overview of the policy stance

*With the pandemic surge receding, inflation is slowly returning to targets and central banks have begun normalising policy with gradual cuts in interest rates. Central banks are likely to move cautiously, however, with still sticky services and wage inflation, ongoing uncertainty about the available policy space and with an eye on possible price shocks on the horizon. South Africa's inflation has also softened, with the August print falling just below the target midpoint, while risks to the forecast have become more balanced. While headline inflation in the near term will benefit from lower fuel prices, it is expected to remain around 4.5% over the forecast period. With this backdrop, the Monetary Policy Committee (MPC) lowered the repurchase (repo) rate by 25 basis points in September 2024 to 8.0%. The economy is projected to expand by 1.1% this year, rising to 1.8% in 2026. The upgraded forecast is premised on the much-improved electricity supply, alongside a better-functioning logistics sector and lower inflation and interest rates.*

### Still riding the swells

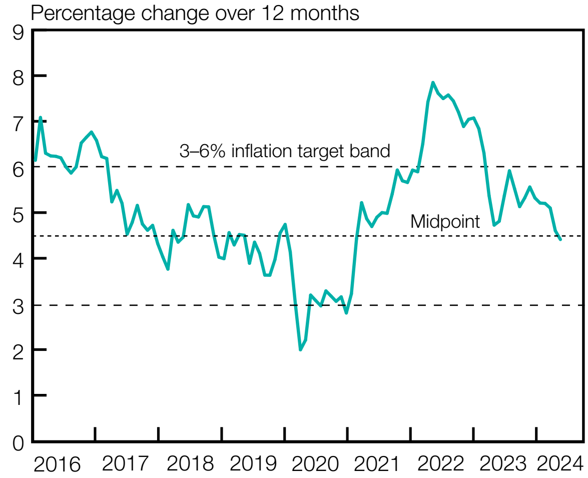
From the peak rate of 8.7% reached in 2022, global inflation continues to moderate and should get to about 5.4% this year.[1] In some countries, inflation has closed in on policy targets, allowing central banks to start easing interest rates. In others, inflation remains high. Services price inflation has remained sticky in many economies and wages elevated in some, keeping core inflation higher than is consistent with central banks' targets. A range of prices, from fuel to food, remain unstable, contributing to significant volatility in monthly inflation outcomes that has tended to increase forecast uncertainties and add inertia to disinflation. Geopolitical threats to supply chains and trade remain an ongoing concern, while high debt levels and climate change further cloud the medium-term horizon.

Over much of the past year, the path for global inflation remained unclear. Food and fuel inflation eventually decelerated and pulled headline lower. Services price increases and other parts of core inflation, however, proved resistant to slowing for much of the period, putting into question central bank policy settings. Even though policy settings were restrictive when viewed in the context of recent history, and recessions were feared, inflation outcomes suggested different interpretations. For much of the past year, uncertainty prevailed about whether policy settings were sufficient to return inflation back to target on credible time frames.

1 The inflation and growth figures reported in this section are, unless indicated otherwise, from the International Monetary Fund's (IMF) *World Economic Outlook (WEO) Update* of July 2024.

Headline inflation

Percentage change over 12 months




Sources: Stats SA and SARB

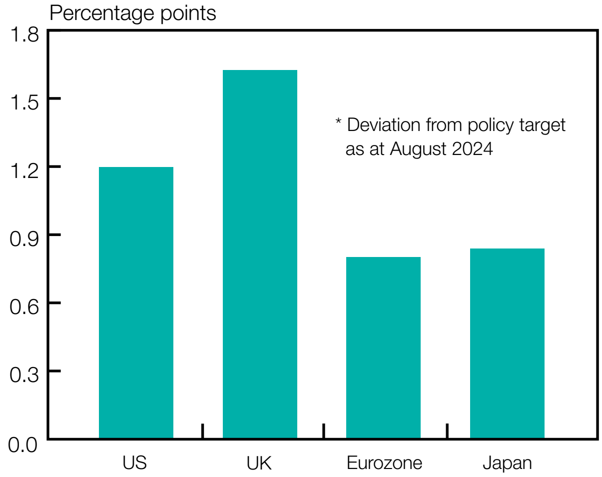
Global headline inflation momentum

Percentage change over six months*


Source: Haver

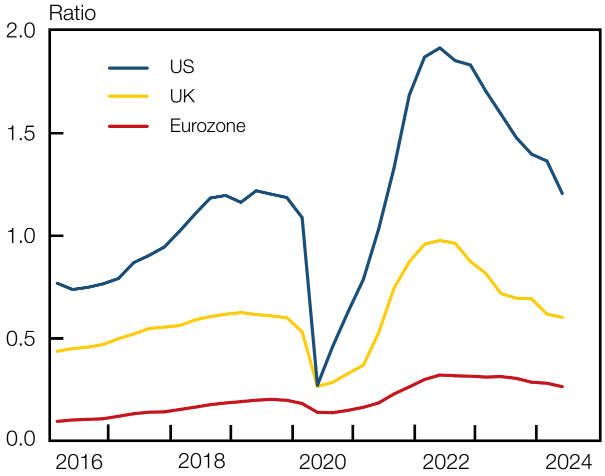
Core inflation in advanced economies*

Percentage points



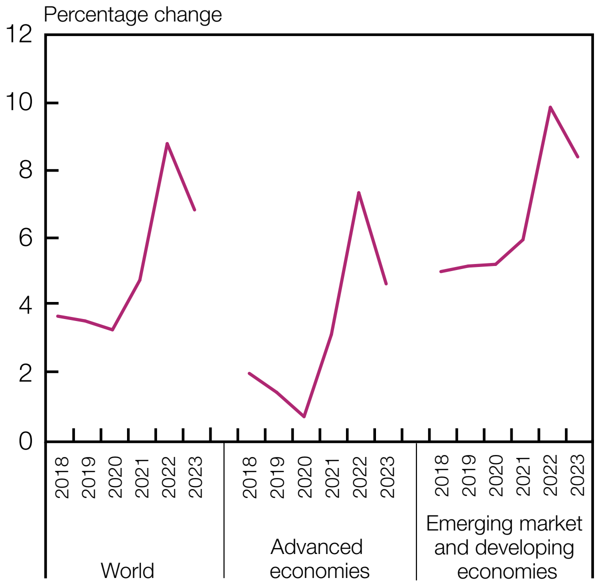

Source: Haver

Job vacancies per unemployed person



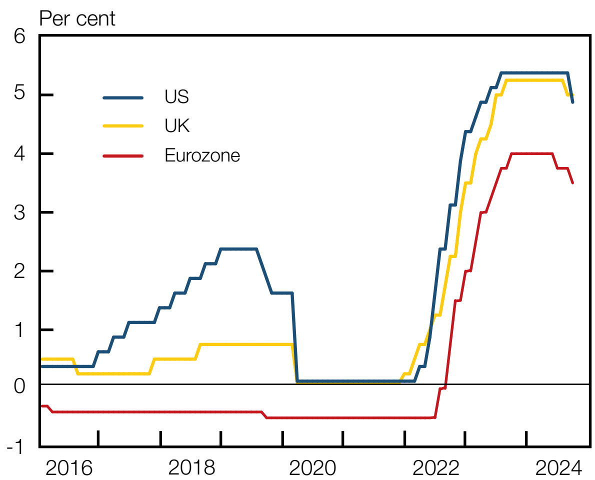

Source: Haver

Global inflation




Source: IMF

Policy rates in selected advanced economies




Source: Central banks

Part of the challenge in understanding the mixed inflation trajectory lies in the surprising resilience of the global economy. High savings by households and firms during the pandemic and aggressive fiscal expansions supported a sustained consumption of goods and then services, which drove up prices sequentially. While central banks responded to the higher inflation with restrictive policy, some prices, such as for food, fuel and commodities, were already easing. China's weaker growth helped to dampen commodity prices and reduced imported goods inflation, providing further support to economic activity in much of the world. In many places, fiscal policy remained highly expansionary.

Structural factors also played a role in keeping core inflation elevated, and some may continue to do so. Services consumption has stayed surprisingly strong even as the pandemic faded further into the background, as labour markets have remained tight. An important measure of growth and labour demand in advanced economies – the number of job vacancies per unemployed person – stayed high for much of the year in most major economies but has recently fallen towards pre-pandemic levels.

Nonetheless, the longer-term outlook remains unclear. Despite robust levels of migration working to loosen labour markets in advanced economies, ageing populations and lower participation rates suggest the opposite. The large fiscal deficits and public borrowing of the pandemic have also been prolonged, in part due to new demands for investment in energy infrastructure but also other demands for support to households. Much of this fiscal stimulus has worked against monetary policy efforts to lower inflation faster and may continue to provide support for it. More broadly, escalating demand for capital is likely to keep neutral interest rate levels well above those prevailing in the pre-pandemic era.

Such countervailing pressures and ensuing uncertainties instil caution in policymaking, a feature of central banking that is likely to remain even as disinflation continues.

The greater part of the global disinflation we have seen over the past year has occurred in advanced economies and central banks have become more confident about its trajectory. Accordingly, except for Japan, major global central banks have begun normalising policy. To date, the European Central Bank (ECB) and Bank of England (BoE) have lowered rates by a cumulative 50 basis points and 25 basis points respectively. The ECB was the first to cut in June this year, followed by the BoE in August. The United States (US) Federal Reserve (Fed) conducted its first rate cut of 50 basis points in September.

Emerging markets have experienced similar challenges of stubborn (core) inflation and volatile monthly inflation data. Where easing in policy rates has been possible, as in some Latin American economies, adverse inflation outcomes along with fiscal and political challenges have forced some of them to pause and, in the case of Brazil, to hike again, despite still high real policy rates. Emerging markets, however, should benefit from the shift in advanced economies towards greater easing. South Africa, for instance, which we discuss in greater depth in the next section, has seen a strengthening of the rand which has put significant downward pressure on inflation.

From a global perspective, monetary policy has been restrictive enough to get inflation sustainably lower, but the policy space available may be unusually limited. Estimates of neutral rates may adjust higher (Box 3), while policy missteps risk putting disinflation in doubt or even cause inflation reversals. In summary, global inflation should continue to ease, but uncertainties about its trajectory as well as the effectiveness of policy will remain high in an era of significant change.

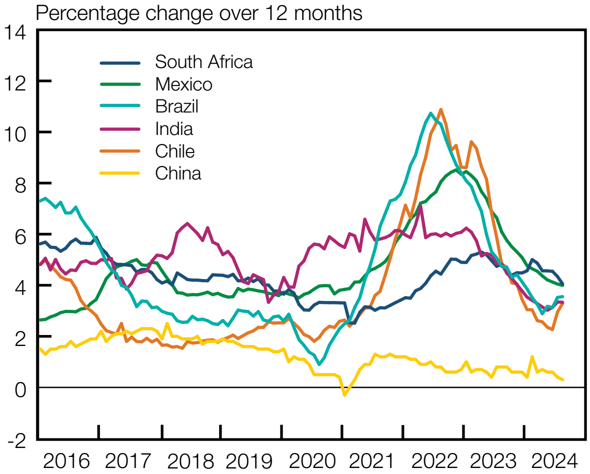
Last year, the world economy grew by 3.3%, aided by relatively strong demand and expansionary fiscal policies in advanced economies. However, activity levels varied across countries, with the US strongly outperforming its advanced economy peers, a pattern that continued into 2024. Nonetheless, that diverging growth trend has narrowed this year as activity improves in some of the laggards. Large emerging economies also exhibited diverse growth rates, with India growing robustly and China's output moderating. Because China's economic output is more commodity-intensive than any other economy, its activity slowdown has depressed commodity prices, impacting growth in commodity-exporting emerging markets such as South Africa.[2]

Risks to global growth appear balanced. While interest rate cuts should provide a boost to consumption and investment, protectionist measures and geopolitical fragmentation will likely continue to weigh on global trade.[3] The policy uncertainty associated with political developments in various regions of the world also present risks to global growth and inflation. China's recent efforts to support growth may carry upside surprises to global growth, in part through stronger commodity prices.

Equally, while the expected fiscal consolidations that are required to lower debt levels may reduce growth (and inflation) in the near term, lower inflation supports easier credit conditions, providing impetus to growth over the medium term. Over the longer term, sustainable growth will need to be achieved with a better balance between public and private demand for scarce savings.

Core inflation in selected emerging markets

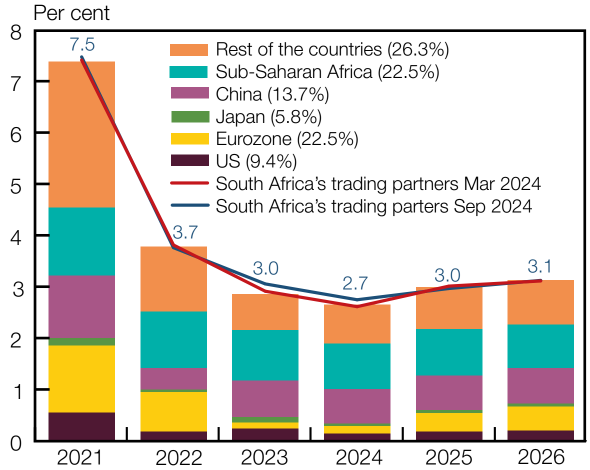
Percentage change over 12 months




Source: Haver

Contributions to trading-partner growth*

Per cent




* Weights in brackets

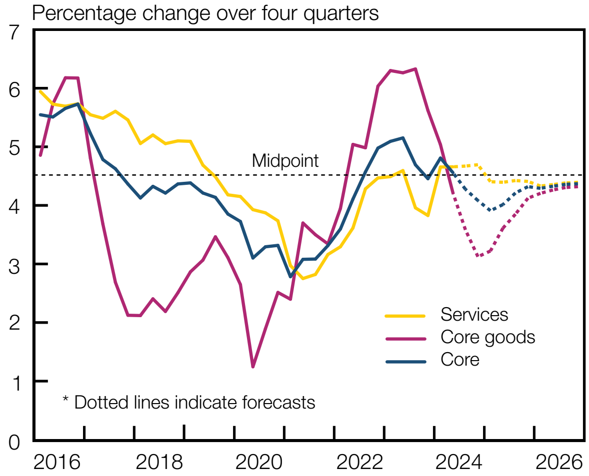
Source: SARB

2 See J Baffes and P Nagle, 'Commodity markets: Evolution, challenges, and policies', Washington DC: World Bank, 2022.

3 Organisation for Economic Co-operation and Development (OECD), *Economic Outlook, Interim Report September 2024: Turning the corner*, Paris: OECD Publishing, 2024.

Core inflation components*

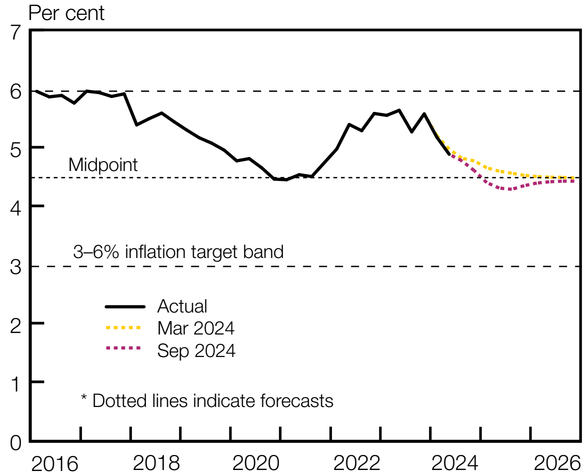
Percentage change over four quarters




Sources: Stats SA and SARB

Two-years-ahead inflation expectations: All participants*

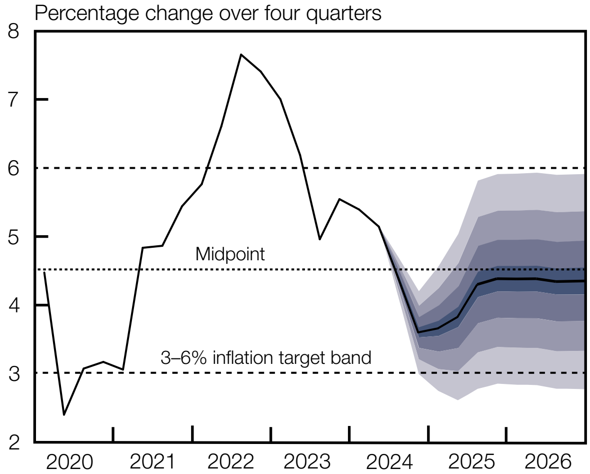
Per cent




Sources: BER and SARB

Targeted inflation forecast*

Percentage change over four quarters




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

Sources: Stats SA and SARB

Taking these and other considerations into account, the South African Reserve Bank (SARB) projects moderate trading-partner growth of 2.7% this year (from 3.0% the year before), rising to 3.1% in 2026. The somewhat muted global growth should help keep demand pressures contained, supporting the ongoing disinflation.

## Domestic economic developments

In contrast to global inflation, the domestic inflation narrative has shifted markedly in recent months. After rising and remaining sticky in the upper half of the target band for much of the review period, headline inflation dropped in July and August 2024, printing slightly below the midpoint of the 3–6% target band in August. While the turn in headline inflation reflects a range of factors including the moderation in Brent crude oil prices, the recent marked strengthening of the rand has underpinned the broad-based disinflation in fuel and goods prices.

Underlying inflation pressures, which remained elevated above the midpoint over the past year, have also eased. Core inflation, the SARB's primary indicator of underlying inflation, has since April 2024 moved closer to the midpoint, and dipped below it in July (4.3%) and further to 4.1% in August. Softer core inflation reflects the marked moderation in core goods inflation on the back of a strong rand benefitting from, among other factors, the rise in the real policy rate. Services inflation remained closer to the target midpoint over the review period, moving within a narrow range. Although components such as miscellaneous services have tended to pull services inflation higher, this was more than offset by the subdued housing and utilities component.

Meanwhile, inflation expectations held by firms, unions and financial analysts have eased appreciably this year, with two-years-ahead expectations at 4.8% in the third quarter. The recent subdued headline inflation outcomes, if sustained, should induce further declines in inflation expectations. In turn, lower inflation expectations should help to mute nominal wage growth and ultimately services inflation, although the risk of higher-than-projected wage increases due to backward indexation remains.

With both core goods and services inflation expected to ease further, core inflation is forecast to undershoot the target midpoint this year, averaging 4.4% (4.8% in 2023) and to remain below it for the remainder of the forecast horizon. Headline inflation is expected to average 4.6% (5.1% in the March forecast) in 2024 and to undershoot the target midpoint from the third quarter of this year through to the end of the forecast period.

Over the next three quarters headline inflation is expected to print in the bottom half of the 3–6% target band, averaging 3.7%. These mainly reflect strong fuel deflation and markedly lower food inflation. As these outcomes are driven mainly by supply side factors, including exchange rate strength, policy focus will be on second-round effects – an approach taken symmetrically – for upside or downside shocks.

The apparent progress on the inflation front has not been mirrored on the output dimension, yet. Growth weakened sharply over the past year, largely due to supply constraints. Load-shedding and logistical challenges, along with policy uncertainty, weighed heavily on economic activity and sentiment, depressing business credit appetite and household spending. Gross domestic product (GDP) expanded at a modest rate of 0.7% in 2023, down from 1.9% in 2022, worsening South Africa's growth gap vis-à-vis peer emerging markets for whom growth averaged 4.4% in the past year.[4]

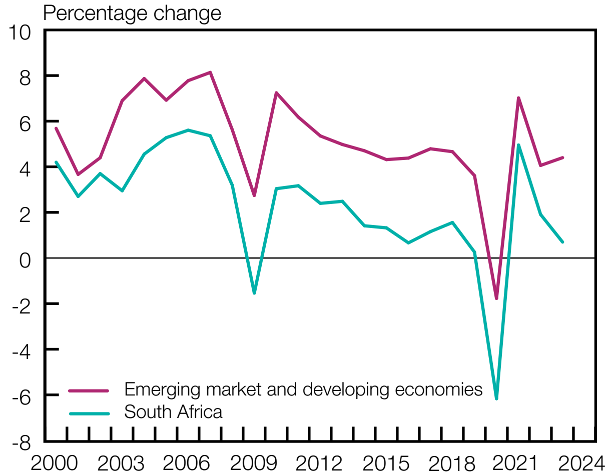
On a quarterly basis, the domestic economy recorded no growth in the first quarter of this year, followed by a modest rebound of 0.4% in the second quarter. The SARB projects near-term growth of 0.6% in the third and fourth quarters as household spending gets a boost from declining inflation and the two-pot retirement reform (Box 5) respectively.

Looking forward, South Africa's growth performance is forecast to improve. Private investment in renewable energy, increased maintenance by Eskom and transmission system development, along with reforms in ports and rail, should further reduce energy and logistical constraints. As the economy's productive potential improves and inflation eases, so too will corporate and household balance sheets, further improving sentiment and investment beyond the network sectors. The economy is expected to grow by 1.1% this year, rising to 1.8% by 2026. That growth remains well below the estimated long-run, steady-state level of 2.5%, however, is in large part because the prolonged supply-side constraints have eroded the economy's productive capacity (Box 4). Strong growth in investment will be needed to make up for that loss of capacity and jobs.

Despite the fading commodity revenue windfall and muted growth, fiscal consolidation is progressing. Considerable success was achieved in the 2023/24 fiscal year as National Treasury delivered the first primary surplus in 15 years. Meanwhile, year-to-date revenue and expenditure trends, where the main budget revenue and expenditure are up by 19.1% and 4.3% respectively, raise the prospect of another primary surplus this financial year. The boost in revenue, however, came mostly from the drawdown of the Gold and Foreign Exchange Contingency Reserve Account (GFECRA). This, along with improved sentiment following the formation of a Government of National Unity (GNU) after the May elections, has helped compress the risk premium and the yield curve. The long end of the curve has shifted lower by about 200 basis points since April 2024.

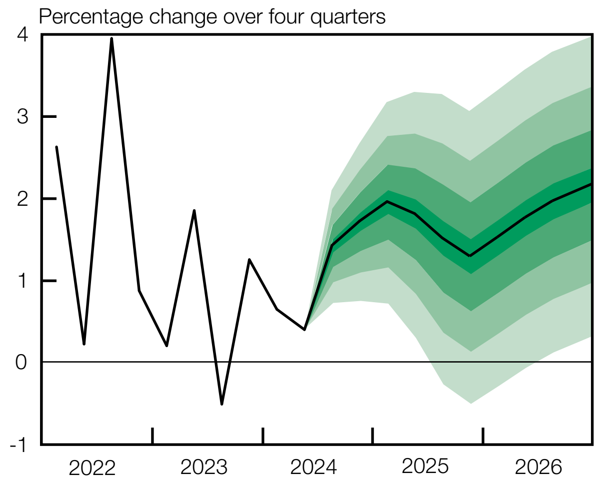
4 IMF, *WEO Update*, July 2024.

Real GDP growth: South Africa and emerging market and developing economies




Sources: IMF and Stats SA

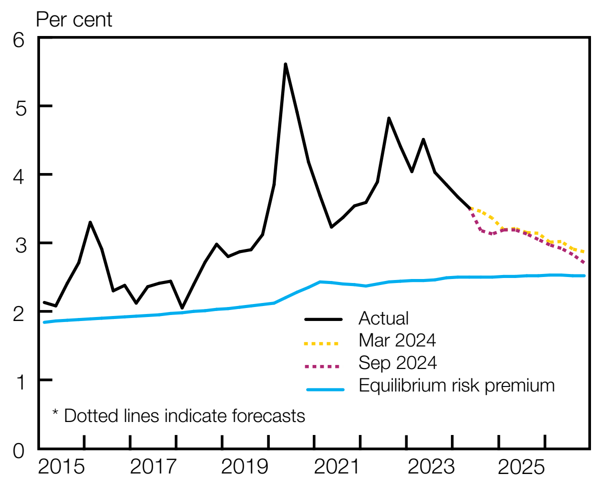
Real GDP growth*




* 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 quarterly projection model.

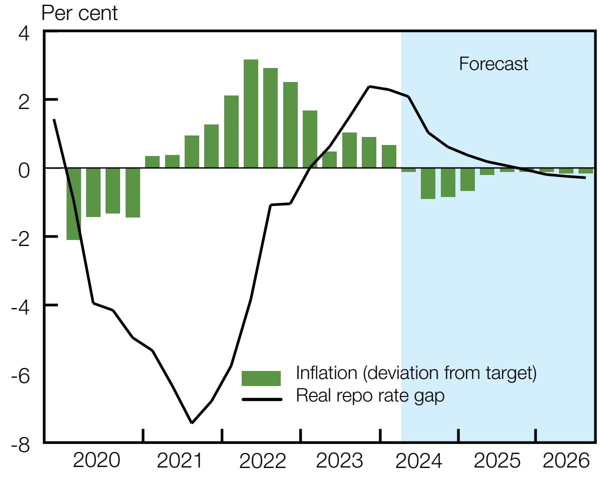
Sources: Stats SA and SARB

South Africa's risk premium*



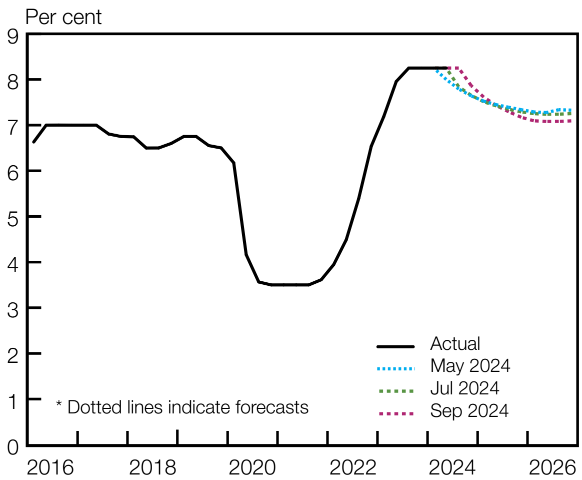

Sources: JPMorgan and SARB

Real repo rate gap and inflation deviation from target band midpoint



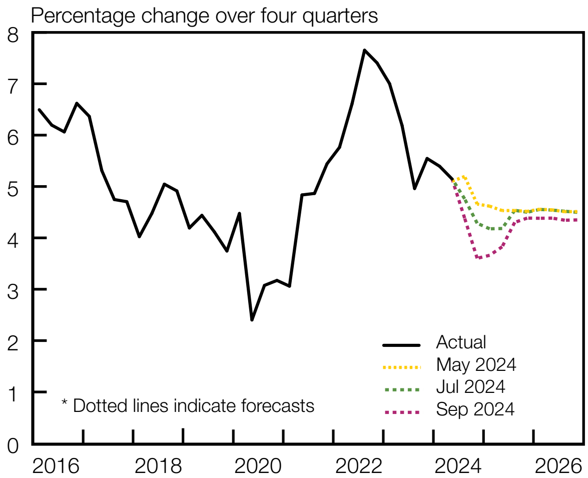

Sources: Stats SA and SARB

QPM-implied repo rate versus actual*




Source: SARB

Headline inflation forecasts*




Sources: Stats SA and SARB

## Overview of the policy stance

South Africa's inflation experience has been more muted than in much of the rest of the world, with monetary policy helping to shape those better outcomes. The start to policy normalisation in late November 2021 and the gradual move to reduce monetary accommodation helped to slow the rise in inflation at a time when pent-up demand was high and supply was severely constrained. Policy, however, remained broadly accommodative until the 50 basis point hike in May 2023.

Since then, monetary policy has been moderately restrictive, dampening growth in aggregate demand and helping to keep it in balance with constrained supply. This, along with the favourable unwinding of food and fuel prices, saw inflation soften and the inflation forecast improve significantly, especially compared to earlier in the year. For two of the three MPC meetings covered in this *Monetary Policy Review (MPR)* (May and July 2024), the policy rate was unchanged.

Risk assessments by the MPC shifted across meetings, from being balanced in the May meeting (but with a higher inflation forecast trajectory) to being tilted to the upside in the July meeting, given a downwardly revised baseline quarterly projection model (QPM) inflation forecast profile. Common global risks included slower-than-expected global disinflation and geopolitical tensions. Domestic risks included elevated inflation expectations and lingering concerns about food and administered prices, particularly the price of electricity.[5]

Nonetheless, the inflation forecast improved significantly over this period and inflation expectations continued to ease (Box 1). In the March 2024 forecast headline inflation was seen averaging 5.1% this year and declining to 4.6% in 2025 and 4.5% in 2026. The May meeting projected headline inflation of 5.1% in 2024 and 4.5% in 2025. The July meeting forecast headline inflation of 4.9% in 2024 and 4.4% in 2025. With the baseline inflation projection easing, the QPM signaled rate cuts at each of the three meetings covered in this review. After weighing the risks to the inflation outlook, however, the MPC kept rates unchanged in the May and July MPC meetings.

The general improvement in the forecasts over the review period brought forward the point at which headline inflation was expected to reach the target midpoint and, assuming no new shocks, remain around that level. The QPM baseline forecast in the May MPC meeting had headline inflation converging to the target midpoint from 2025, but this was revised forward in the July MPC meeting to the fourth quarter of this year.

5 The quarterly projection model (QPM) baseline projection is risk-neutral, while scenarios are provided that may generate additional implications for inflation and interest rates. The Monetary Policy Committee (MPC) considers the scenarios and other factors, global and domestic, that exhibit upside or downside risks and that are then set out in the statement relative to the baseline (Box 2). Often risks that feature in scenarios end up as part of the baseline in subsequent forecasts.

The September forecast brought the convergence date further forward, to the third quarter of this year, and provided greater confidence about the near-term inflation trajectory. These revisions reflected progressively better outcomes (and projections) for all the components of headline inflation, except for electricity.

The September forecast showed headline inflation averaging 4.6% this year and undershooting the target over the medium term, while the MPC assessed inflation risks to be broadly balanced. This, along with the more muted baseline profile for inflation, prompted the MPC to lower the repo rate at the September meeting by 25 basis points, bringing the policy rate down to 8.0%. The decision moved the policy rate closer to the path projected by the QPM.[6]

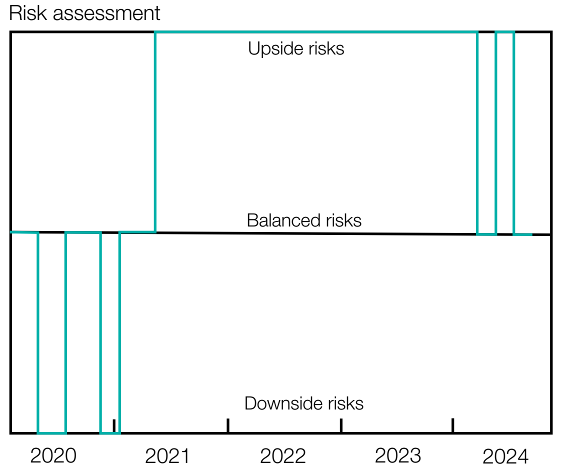
Despite the lowering of the repo rate by 25 basis points, policy is still moderately restrictive, with the real repo rate gap – a measure of the policy stance – averaging 1.6% this year. This measure of the policy stance then declines sharply to 0.3% next year and -0.1% in 2026.

## Conclusion

The continued moderation in global headline inflation over the past six months, along with signs of cooling labour markets, suggests that tight monetary policy is helping to soften demand, despite stickiness in some services inflation components. This has given central banks greater confidence that disinflation will continue, assuming no new major shocks. Accordingly, global central banks have entered an easing cycle, with the Fed joining the other major central banks this past September. Central banks, however, are taking a cautious, data-dependent, risk management approach, with modest cuts followed by pauses to assess the appropriateness of the policy stance.

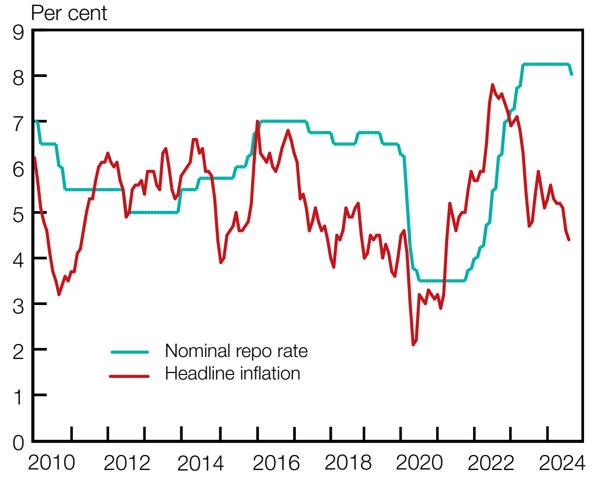
The SARB's MPC lowered the repo rate by 25 basis points at the September 2024 meeting. Policy decisions will continue to be guided by incoming data as the MPC seeks to protect the purchasing power of the rand in the interest of balanced and sustainable economic growth. Other actions that can support stronger output growth include achieving a prudent public debt level, further progress in the implementation of structural reforms and the better alignment of administered prices growth with the expected low-inflation environment.

MPC inflation risk assessment




Source: SARB

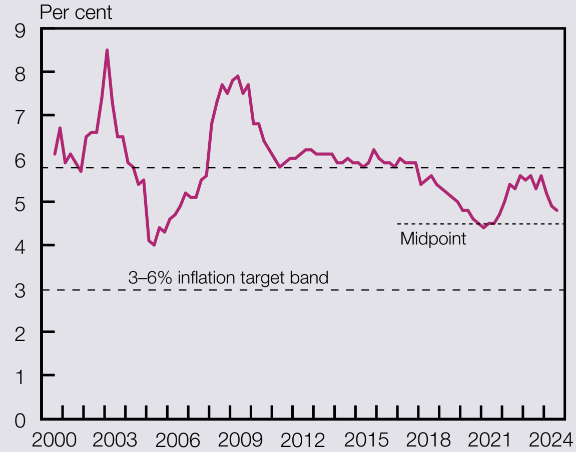
Repo rate and headline inflation




Sources: Stats SA and SARB

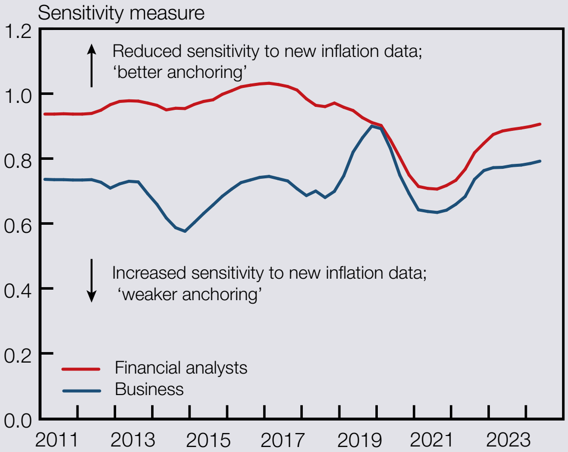
6 The QPM suggested a rate cut of 50 basis points in the May MPC forecast. With the MPC keeping the repo rate on hold, the QPM again suggested a cut of 50 basis points in the July MPC forecast and, for similar reasons, a cut of similar magnitude for the fourth quarter of this year (September and November meetings together).

Two-years-ahead inflation expectations: All participants



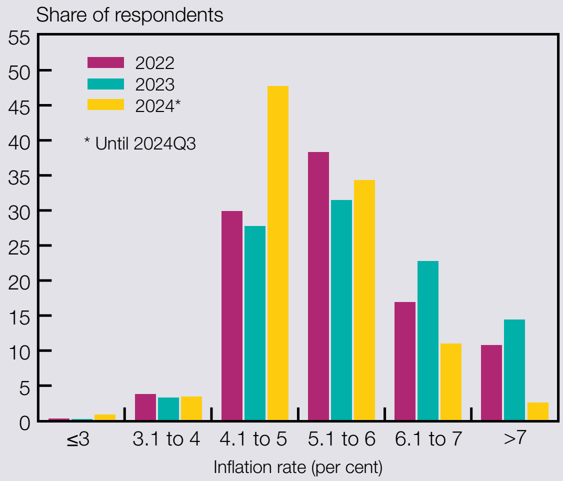

Sources: BER and SARB

Sensitivity of two-years-ahead inflation expectations to new inflation data




Sources: BER and own calculations based on Lansing and Nucera (2023)

Distribution of two-years-ahead business inflation expectations




Sources: BER and SARB

## Box 1 Floating away?

Inflation-targeting central banks set monetary policy to ensure that, in the absence of permanent shocks, inflation stabilises around the target over the medium term. A key variable in policy setting is the way in which economic agents (firms, households and the government) react to temporary and permanent shocks to inflation and output. If these agents believe the long-run forecast of the central bank (i.e. the announced inflation target), then their expectations are said to be 'anchored' and their behaviour (output and pricing decisions) will be consistent with the inflation target. This, in turn, implies that the central bank can look past temporary supply shocks, keeping interest rates more stable and reducing the short-term cost of achieving lower inflation.[1] When inflation expectations are not at the central bank's announced target, higher policy credibility is associated with their faster and less costly convergence to target.[2]

Very large and persistent shocks such as the pandemic and its aftermath, however, can unmoor expectations. As inflation surged in 2022–23, South Africa's two-years-ahead inflation expectations rose markedly and drifted away from the preferred 4.5% midpoint of the SARB's inflation target band (Box 8, April 2023 *MPR*). A key policy question is whether inflation expectations have re-anchored.

Inflation expectations are considered better anchored if they cluster around the central bank's announced target and are relatively insensitive to recent and current inflation outcomes.

Data show that the degree of anchoring improved between 2017 and 2019. This followed the South African Reserve Bank's (SARB) express communication about its preference for inflation to settle closer to the midpoint of the 3–6% target band. However, the complex nature of the pandemic, the policy responses to it, the unfolding developments in supply chains and commodities prices and how economies responded to the end of the pandemic made inflation expectations much more sensitive to current developments.[3]

More recently, with inflation falling from the highs reached in 2022, inflation expectations have also eased but remain above the target midpoint. Nonetheless, underlying analytics give reason for optimism. In particular, improved anchoring is suggested by the clustering of two-years-ahead expectations of business survey respondents. The distribution has shifted leftwards and compressed with its centre closer to the 4.5% midpoint, indicating more agreement among respondents.

The SARB policy actions, consistency in communications and credibility may have helped to reverse the de-anchoring of inflation expectations, minimising any costs of sustainably achieving the inflation target over the medium term. Nevertheless, the task of firmly anchoring expectations is not yet complete.

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1 See International Monetary Fund, 'Chapter 2: Managing Expectations: Inflation and Monetary Policy', *International Monetary Fund World Economic Outlook,* Washington DC: International Monetary Fund, October 2023.

2 See C Loewald, K Makrelov and E Pirozhkova, 'The short-term costs of reducing trend inflation in South Africa', *South African Reserve Bank Working Paper Series No. WP/22/08,* Pretoria: South African Reserve Bank, August 2022.

3 Ten-year rolling regressions of two-years-ahead inflation expectations on contemporaneous inflation outcomes are run. The sensitivity measure is obtained as one minus the coefficient estimate of contemporaneous inflation from said regression. See K Lansing and F Nucera, 'Inflation Expectations, the Phillips Curve, and Stock Prices', *Federal Reserve Bank of San Francisco Economic Letters, 2023–24,* San Francisco: Federal Reserve Bank of San Francisco, December 2023.

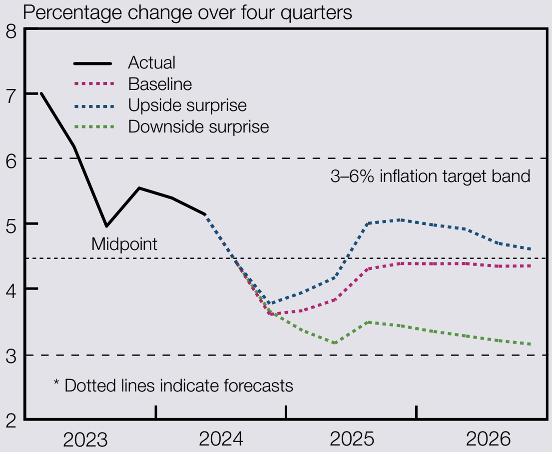
## Box 2 Inflation risk: listing or more balanced?

Monetary policy requires the forecasting of inflation and assessing the risk that it surprises higher or lower over the short, medium and longer run. These assessments are often aided by forecast scenarios, alternatives to the baseline that reflect what happens when specified risks materialise. At the September Monetary Policy Committee (MPC) meeting, the MPC assessed risks to the baseline inflation forecast to be balanced – equal probabilities that inflation would turn out higher or lower than in the baseline. This box presents the scenarios considered by the MPC at the September 2024 meeting.[1]

One scenario featured the risk of higher inflation, represented by faster electricity price inflation, stronger wage growth and rising rental inflation. The downside risk scenario considered a marked strengthening of the rand.

### Headline inflation*

Percentage change over four quarters




Sources: Stats SA and SARB

### Scenario considerations

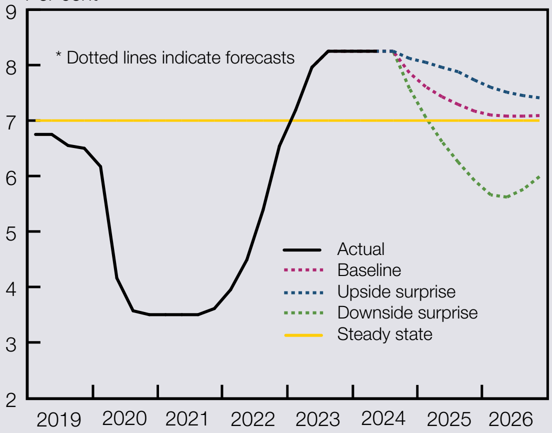
| | | Baseline | Scenario |
|---|---|---|---|
| Variable* | Electricity | 11.00% | 13.90% |
| | Wages growth | 4.30% | 5.30% |
| | Rental inflation | 3.50% | 5.00% |
| | Rand** | | 24.00% |

* Wage and rental shocks start in 2024Q4, and the electricity shock begins in 2025Q3. The table shows their annual impact in 2025.

** Nominal appreciation over the forecast period

### Nominal repo rate*

Per cent




Source: SARB

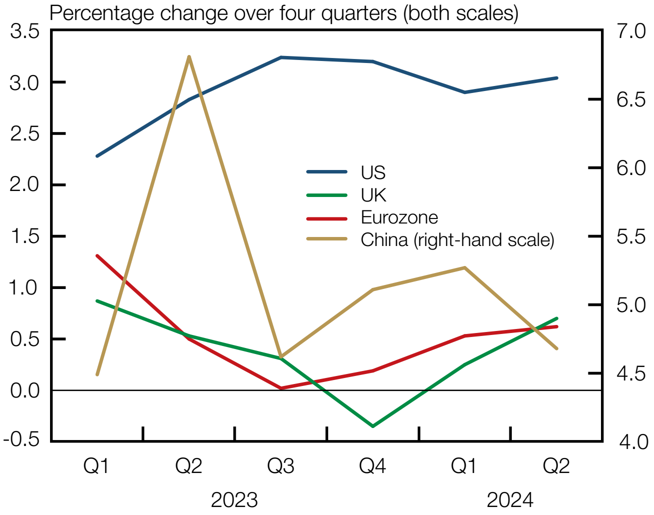
### Scenario results

| | | 2024 | 2025 | 2026 |
|---|---|---|---|---|
| Inflation | Baseline | 4.60% | 4.00% | 4.40% |
| | Upside scenario | 4.70% | 4.50% | 4.80% |
| | Downside scenario | 4.60% | 3.40% | 3.20% |
| Nominal repo (end of period) | Baseline | 7.86% | 7.17% | 7.09% |
| | Upside scenario | 8.12% | 7.73% | 7.41% |
| | Downside scenario | 7.58% | 5.92% | 5.99% |

1 Other risks considered by the Monetary Policy Committee (MPC) in recent meetings include sharply higher oil prices, rand depreciation, escalation in geopolitical tensions in the Middle East and upside/downside budget scenarios.

Real GDP growth in major economies

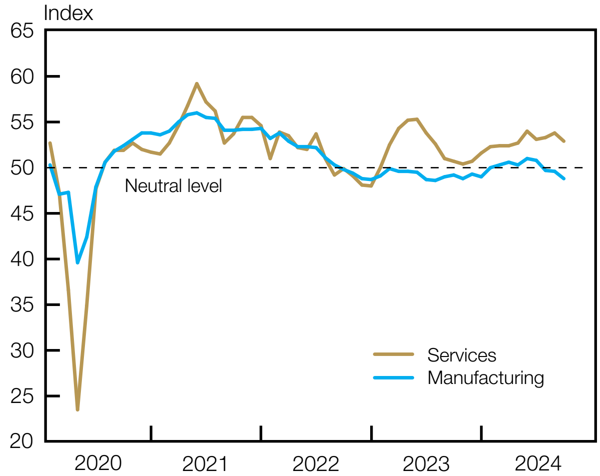
Percentage change over four quarters (both scales)




Source: Haver

Global PMI

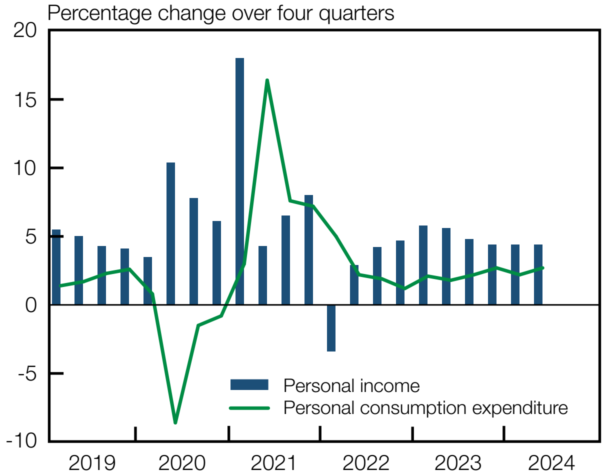
Index




Sources: JPMorgan and S&P Global

US personal income and expenditure

Percentage change over four quarters




Source: Bureau of Economic Analysis

# Global economy: Steady as she goes

*The world economy is projected to expand by 3.2% this year and by 3.3% in 2025, broadly unchanged from the pace set in 2023. Across the world's major economies, the US appears to be headed for a soft landing, underpinned by still solid household spending and labour market, while economic performance in the eurozone and China has generally disappointed. Services sectors continue to drive much of the growth in global economic activity, but this has come at a cost of stickier services inflation. Despite this stickiness, headline inflation has continued to recede on the back of much softer goods price inflation – providing room for central banks to initiate easing cycles. At this time, the future pace and depth of rate cuts remain uncertain.*

## Steady, modest growth

The global economy continues to expand at a steady yet modest pace. Manufacturing output has been broadly stable, while services sectors continue to grow. While this pattern of economic activity primarily reflects global consumption still shifting away from manufactured goods, the loss of momentum in private fixed investment, particularly in advanced economies, has also played a role. An expected turnaround in the manufacturing sector has yet to materialise. The global Purchasing Managers' Index (PMI) for manufacturing has been stuck around the neutral 50 index point level for most of this year, while new orders received by global manufacturers have remained in contractionary territory. Major manufacturers, such as Germany and China, have been especially hard hit by this stagnation. Tight lending standards of most loan categories across major advanced economies, alongside high interest rates, have additionally contributed to lower credit demand, further denting consumption of durable goods.

More service-oriented economies alternately, continue to do well. The US economy has remained resilient and continues to outperform its advanced economy peers. Spending by US households remains strong, underpinned by growth in real personal income and a still firm labour market. The recent 50 basis point reduction in the federal funds rate should provide additional impetus to economic activity. The US economy is forecast to expand by 2.6% this year before slowing to 1.9% in 2025.[7] These projected growth rates contrast sharply with the narrative that the US economy will see a hard landing next year. Instead, a soft landing appears more likely.

Outside of the US, the growth performance among advanced economies is mixed. Activity in the eurozone remains subdued due to weak domestic demand and muted manufacturing activity. However, recent rate cuts should support household

7 The inflation and growth figures reported in this section are, unless indicated otherwise, from the IMF's *WEO Update* of July 2024.

consumption, prompting expectations of a mild expansion of 0.9% for the eurozone this year. Following sharply weaker activity levels at the start of this year, momentum in the Japanese economy remains low. The economy is projected to grow by 0.7% in 2024, down from a robust growth rate of 1.9% in the previous year. On the other hand, real GDP in the United Kingdom (UK) has been recovering steadily amid firm activity in the services sector. Falling inflation and slightly lower borrowing costs should support economic activity, boosting growth to 0.7% this year, up from 0.1% in the previous year and rising to 1.5% in 2025.

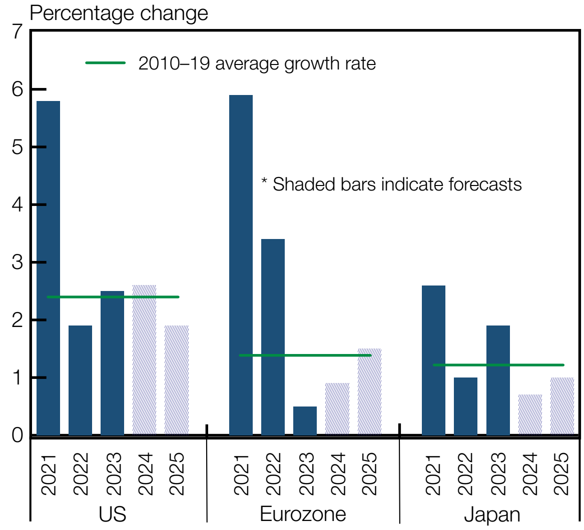
Across emerging and developing markets, Asia's economies have been an important source of growth for the world economy. The Indian economy has shown significant resilience and is expected to expand by 7.0% this year and by 6.5% in 2025, underpinned by strong household consumption spending. Economic growth in China, however, has weakened in recent quarters despite a firm start to the year. Growth in the Chinese economy is expected to slow to 5.0% this year from 5.2% in 2023, as the weakness in the property sector persists and credit demand remains muted. However, the recent stimuli by the People's Bank of China (PBoC) as well as expectations of additional fiscal measures should support output expansion. In Latin American countries, economic activity remains robust, with output largely at potential. This is despite restrictive monetary policy stances where real policy rates are well above long-term averages. Across sub-Saharan Africa, economic activity is expected to expand by 3.7% this year, largely on account of stronger growth in Nigeria (3.1%), while South Africa, at 1.1% growth this year, continues to drag the region's average lower.

## Disinflation on track but uncertainty remains

Global disinflation has progressed over the past two years despite occasional setbacks. After averaging 6.8% in 2023, global inflation is projected to soften to 5.4% this year and further to 4.4% in 2025, still well above the 2.5% average of the 2010–19 period. Disinflation has been driven primarily by goods, with prices of food, energy and some imported goods falling in most advanced economies. Meanwhile, global services inflation has remained relatively sticky, in part due to tight labour markets and reflecting an important feedback loop from wages to prices. Since services price disinflation is slow, uncertainty about the return of inflation back to target remains elevated.[8] For instance, in the US and eurozone, some components of services inflation, including rents, health and recreational services, remain well above the 2.0% inflation target and in some cases are even accelerating.[9]

Real GDP growth projections for advanced economies*

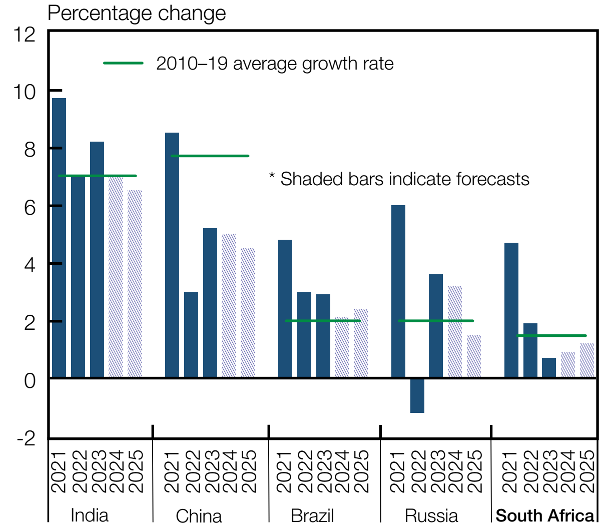
Percentage change




Source: IMF

Real GDP growth projections for emerging markets*

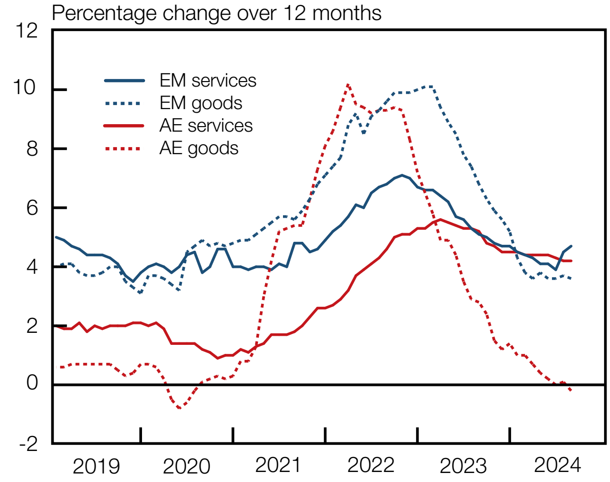
Percentage change




Source: IMF

Goods and services inflation

Percentage change over 12 months

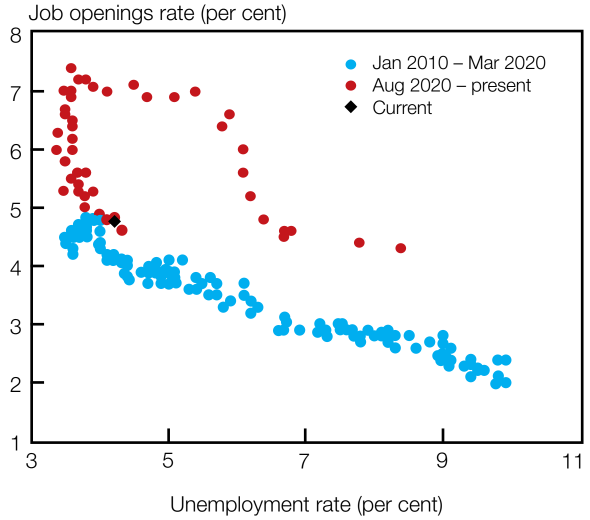



Sources: Haver and SARB

8 See P Amatyakul, D Igan and M Lombardi, 'Sectoral price dynamics in the last mile of post-COVID-19 disinflation', *BIS Quarterly Review*, Basel: Bank for International Settlements, March 2024.

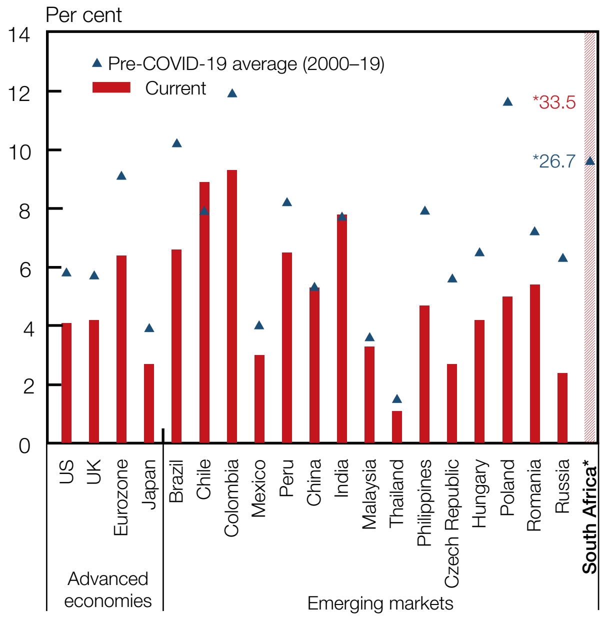
9 In August 2024, transport inflation was 9.0% in the US while insurance inflation was 9.0% in the eurozone.

US Beveridge curve



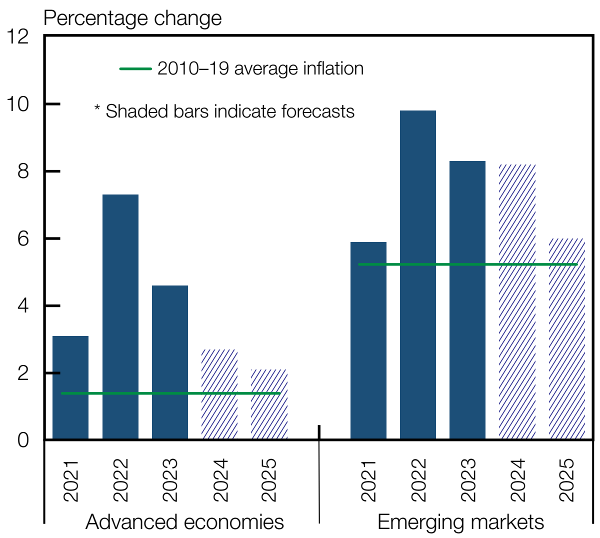

Source: Bureau of Labor Statistics

Unemployment rates




Sources: Haver and SARB

Headline inflation forecasts for advanced economies and emerging markets*




Source: IMF

While the global trend has been towards disinflation, there are some exceptions. Deflationary risks have persisted in China where inflation has remained close to 0% over the past two years as the prolonged slump in the housing market and job uncertainty continue to weigh on consumer spending. Meanwhile, a tight labour market and supply shortages due to the ongoing sanctions have reignited inflation in Russia, while strong economic activity and a depreciated currency have contributed to the recent upside surprise in Brazil's inflation.

Across the world's major advanced economies, however, labour market conditions have so far been mixed – cooling somewhat in the US but remaining relatively tight in the eurozone and UK. In the US, where quit rates soared early in the pandemic recovery as demand for labour outpaced its supply, the Beveridge curve (that links vacancies to unemployment) shifted to the right and steepened, implying a stronger bargaining power for workers. However, the US Beveridge curve has now returned closer to the levels it was before the pandemic while unit labour costs (ULCs) were only up by 0.5% year on year in the second quarter of this year. Meanwhile, high vacancy rates and lower unemployment in the eurozone have fanned labour shortages, inducing firms to hoard labour. This pattern of high vacancy rates and low unemployment is also observed in the UK. Tight labour markets, together with labour hoarding practices, could add to wage pressures while reducing productivity, raising firms' ULCs. Nevertheless, growth in negotiated wages in the eurozone slowed to 3.5% year on year in the second quarter, down from 4.7% in the previous quarter.

Labour markets also remain relatively tight in many emerging markets, with markedly low unemployment rates compared with the pre-pandemic period, especially in Mexico, the Philippines and Czech Republic. Encouragingly, evidence is building that labour markets have started to cool across major economies, but this could be a slow grind amid still strong services sector activity.

While expectations are for inflation to return to the 2.0% target in major advanced economies by the end of 2025, risks remain. Elevated services inflation amid tight labour markets and relatively high wage inflation could upend the disinflationary process. Equally, global shipping rates have risen since the start of the year, which could potentially feed into renewed supply pressures and thus goods inflation. The good news for major central banks, however, is that longer-term inflation expectations have remained generally well anchored, suggesting that monetary policy credibility remains intact.

## Global easing cycle broadens

Global monetary policy is in an easing cycle even if it is not synchronised across countries and regions. The US Fed joined the cycle in September, following rate cuts in several advanced economies, including Canada, the eurozone, UK and Switzerland. Japan, however, has been a key exception as it continues to raise rates moderately from its previously accommodative setting. Some Latin American countries have been easing interest rates since the second quarter of 2023, while a few central banks in emerging Asia have started cutting interest rates.

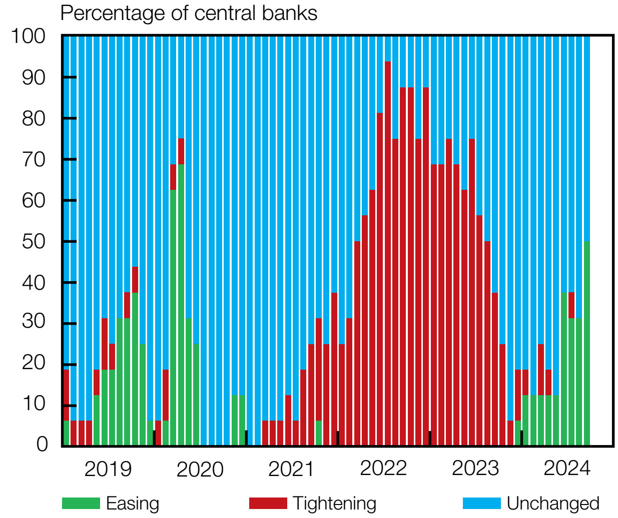
However, central banks have exhibited caution in adjusting rates due to idiosyncratic inflation dynamics, with cuts often followed by pauses. Some early interest rate cutters such as Brazil had to reverse course, raising rates again in September as inflation expectations jumped higher. Rising inflation expectations reflect concerns that despite relatively high interest rates, loose fiscal policy is inconsistent with more resilient growth and tight labour markets.

The outlook for interest rates is for a gradual easing in policy rates, with data dependency a central theme. The extent of policy easing, however, is complicated by the uncertainty surrounding estimates of the neutral rate. Across most advanced economies, current real rates are above long-run real rate averages. Compared with the neutral rates estimated during the pandemic, real rate levels suggest restrictive monetary policy conditions. Sticky inflation, however, has prompted new estimates that suggest that neutral rates have risen since the COVID-19 pandemic and are unlikely to return to the levels seen prior to the pandemic (Box 3).

## Not without risks

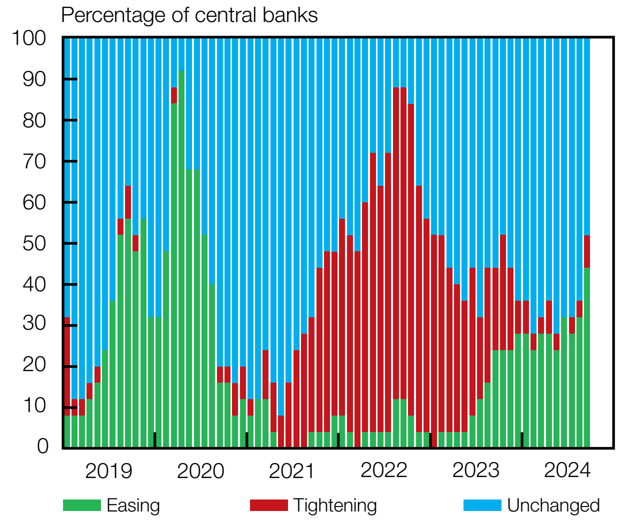
Overall, risks to the global growth and inflation outlook appear balanced. Downside risks to growth stem from a sharp slowdown or recession in the US, along with possible debt defaults given the elevated global debt level. Upside risks to inflation emanate from a lack of progress on services disinflation as well as an escalation of geopolitical tensions that could sharply increase the cost of imported goods along the supply chain. These considerations, along with the prospect of a higher r-star, raise the likelihood that interest rates will remain higher than they were before the pandemic.

Policy rate changes by advanced economy central banks*



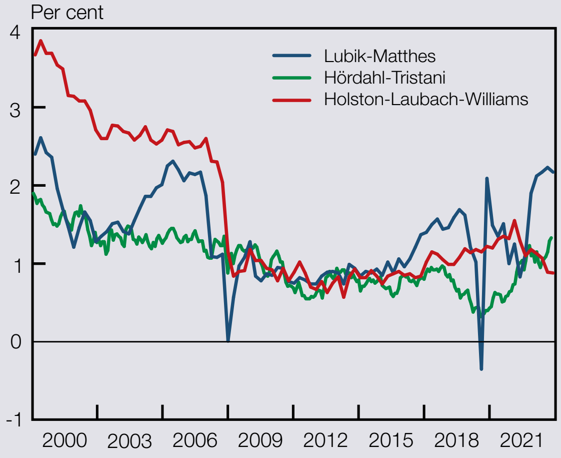

* Sample includes 16 advanced economy central banks
Sources: Haver and SARB

Policy rate changes by emerging market central banks*



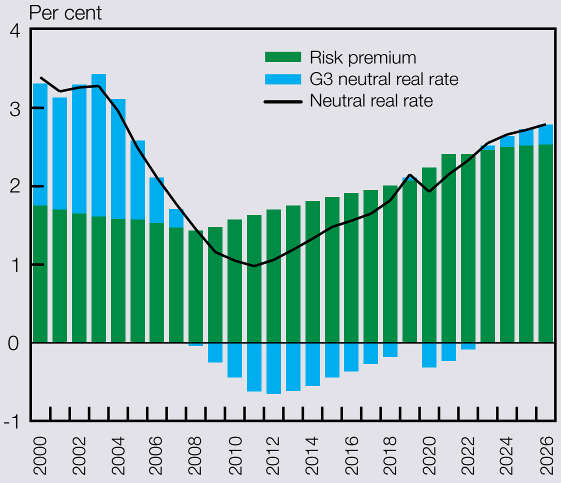

* Sample includes 25 emerging market central banks
Sources: Haver and SARB

US neutral real interest rate estimates




Source: BIS

South Africa's neutral real interest rate




Source: SARB

## Box 3 What is the speed limit?

As the post-pandemic inflation surge moderates, policy space opens for central banks to ease interest rates. Much like a speed limit that is dependent on road conditions, the r-star, or neutral real interest rate, provides guidance on the pace of tightening or easing.[1] Given an expected inflation rate, is the policy rate adding to or taking away from future inflation? R-star also serves as the point at which, in steady state, any policy normalisation should end.

A challenge lies in estimating the neutral rate with precision, especially when major shocks and structural forces, as experienced in recent years, cause large changes in economic relationships, patterns of activity and/or prompt major policy shifts. In the decade after the global financial crisis, global neutral real rates were estimated to have declined to around 0% from around 4% in the 1990s (see Box 2 in the April 2022 *MPR*).

In the wake of the pandemic, however, the massive increase in demand on global saving and sharply higher inflation have generated new estimates that show that r-star has risen.[2] A higher r-star suggests the need for higher policy rates to re-anchor inflation in the wake of the kinds of shocks that drove it up.

An additional complication with r-star presents itself to small, more open economies such as South Africa, as these are, by definition, more affected by external economic shocks, especially those emanating from large global economies and key trading partners. Relative interest rates and growth rates influence flows of capital, while relative price and income shocks impact on trade in goods and services. When small, open economies run financial deficits and need to draw on foreign savings, these interdependencies become even more important.[3]

The South African Reserve Bank's (SARB) running estimate of the neutral rate for South Africa reflects a mix of global neutral rates alongside a premium to compensate for country risk.[4] South Africa's neutral real rate declined between 2000 and 2010, reflecting a moderating global r-star and a declining risk premium on the back of the marked improvement in the country's fiscal position (fiscal surpluses in 2005/06 and a debt-to-GDP ratio falling to below 30% by 2010). However, this decline was reversed in the aftermath of

1 R-star is the real interest rate that is consistent with the economy being at full employment and inflation being stable around the target. The rise in short-term r-star is influenced by supply shocks as well as market participants' assessment of short-term interest rates. Longer-term r-star is driven by slower-changing variables such as demographics and technical progress.

2 See G Benigno, B Hofmann, G N Barrau and D Sandri, 'Quo vadis, r*? The natural rate of interest after the pandemic', *BIS Quarterly Review*, Basel: Bank for International Settlements, March 2024. See also I Schnabel, 'R(ising) star?', speech by Isabel Schnabel, a Member of the Executive Board of the European Central Bank (ECB), at the ECB and its Watchers XXIV Conference session on Geopolitics and Structural Change: Implications for Real Activity, Inflation and Monetary Policy, Frankfurt, 20 March 2024.

3 See C Loewald, 'Making sense of neutral real interest rates,' *South African Reserve Bank Occasional Bulletin of Economic Notes: OBEN/18/01*, Pretoria: South African Reserve Bank, February 2018. Global r-star is proxied by the weighted r-star for the Group of Three (G3) economies, namely, the United States, eurozone and Japan.

4 See, L Kuhn, F Ruch and R Steinbach, 'Reaching for the (r)-stars: Estimating South Africa's neutral real interest rate', *South African Reserve Bank Working Paper No. WP/19/01*, Pretoria: South African Reserve Bank, February 2019.

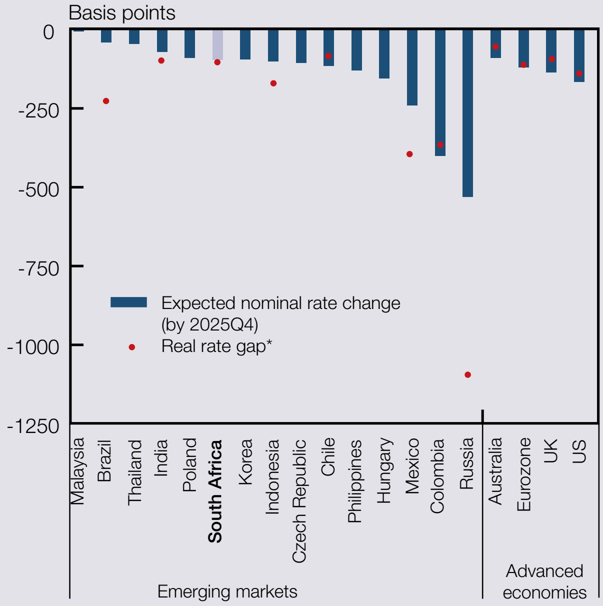
the global financial crisis as the global neutral rate started to rise and South Africa's debt position deteriorated. For over a decade, global r-star had a moderating influence on the domestic r-star, before reversing course.

### How much room to ease?

Despite the challenges of estimating neutral rates, central banks look to benchmark a 'real interest rate gap' by taking their estimates and comparing them to an ex-ante real policy rate.[5] Comparative real rate gaps are shown in the adjacent chart, helping to illustrate how domestic factors shape rates expected by the markets. The rates gap is larger in countries that are subject to idiosyncratic shocks or constraints. Russia, for instance, is exposed to price pressures linked to sanctions, while Mexico's inflation is, alongside a large fiscal deficit, highly sensitive to rates differentials with the United States (US). In South Africa and India, by contrast, smaller gaps reflect less sensitivity to global factors and better fundamentals.[6]

Overall, easing cycles are expected to vary across countries and, given data-dependency, rate paths remain uncertain, presenting risks of heightened volatility in financial markets. What seems likely, however, is that easing cycles this time will be shorter and shallower than in previous episodes, leaving rates higher than they were before the pandemic.

Interest rate expectations




* The real rate gap is computed as neutral real rate *less* real policy rate.

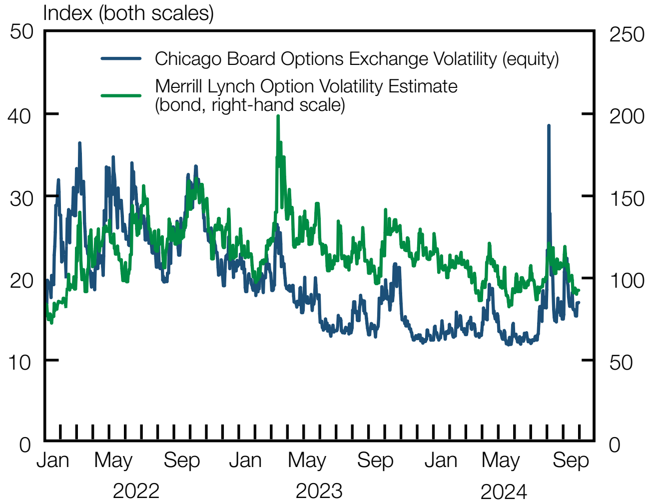
Sources: BIS, central banks and SARB

5 The ex-ante policy rate is the current policy rate less the three-quarters-ahead (end-2025) expected consumer price inflation, as per the Bloomberg median forecast.

6 For instance, the small real interest rate gap in South Africa and India reflects that interest rates were hiked by relatively less compared with peers and that the one-year-ahead expected inflation is generally higher, reflecting a higher inflation target relative to peers.

Volatility gauges

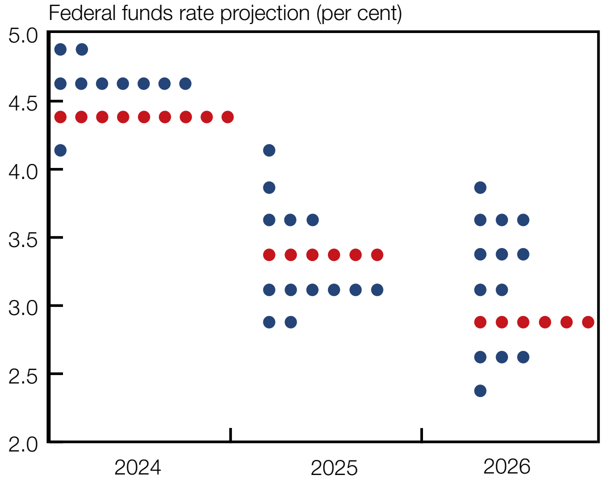
Index (both scales)




Source: Bloomberg

Federal Open Market Committee 'dots'*

Federal funds rate projection (per cent)

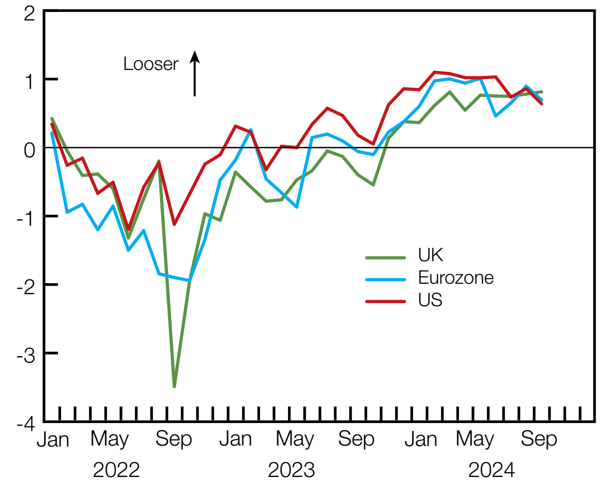



* Red dots denote the median of the 19 meeting participants

Source: US Fed

Financial conditions

Index




Source: Bloomberg

# Financial markets: less turbulence

*Apart from a spike in volatility in August 2024, global financial markets remained relatively calm over the past six months, reflecting clearer inflation outcomes and less uncertainty about future interest rate paths. With the world's major central banks finally in an easing cycle, equities trended higher and major yield curves shifted lower. Risk assets generally performed well, aided by the dollar's weakening on expectations of large cumulative Fed rate cuts. In South Africa, the post-election period was characterised by a broad-based rally in financial markets. The rand appreciated strongly and has maintained a firmer bias, supporting the disinflation process. Meanwhile, the local currency bond curve has shifted lower, with yields on longer-dated bonds declining the most. This positive sentiment, alongside cooling inflation and the 25 basis point cut at the September MPC meeting, has led markets to price in further rate cuts over the next few quarters.*

## Expectations realign

Following significant volatility in 2023 and earlier this year, financial markets have calmed over the past six months as market and rate-setter expectations have broadly aligned. All the major global central banks, except for the Bank of Japan (BoJ), are now in an easing cycle. The ECB, the first among the major central banks to cut rates, moved in June this year with a 25 basis point reduction, followed by another cut of a similar magnitude in September, while the BoE trimmed by 25 basis point in August and paused in September.[10] The Fed finally joined the ECB and BoE in September when it reduced the federal funds rate by 50 basis points. With the rate adjustments largely priced in, markets exhibited little volatility. Financial markets also responded positively to moves at the end of September by the PBoC to initiate stimulus measures and announce a cut to its seven-day reverse repo to prop up the economy.

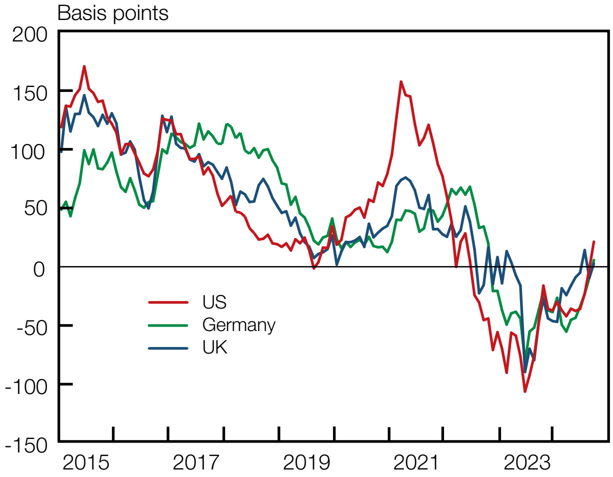
Market-implied rate expectations suggest the Fed will cut rates by a further cumulative 200 basis points by December 2025, with around 80 basis points thereof expected to be cut before the end of this year. The easing of policy by the Fed reflects stronger conviction that inflation will continue to moderate, as shown by the September 'dot-plot' marking the federal funds rate at about 4.4% by year-end, and 3.4% by the end of 2025. For the ECB and BoE, rates are expected to decline by around 150 basis points within a year.

10 By contrast, the Bank of Japan (BoJ) hiked interest rates for a second time in July and further amended the parameters of its bond purchase programme in a move to scale back some of its stimulus measures that had lasted for more than a decade.

Financial conditions have loosened significantly, reflecting eased pressures in money markets as well as debt and equity markets.[11] A shift lower in global policy rates has impacted flow dynamics in financial (especially bond) markets. Yield curves in the US, UK and Germany steepened, reflecting lower short-term interest rates. In particular, the spread between the 10- and 2-year US yields, which had been trading in negative territory for at least two years, turned positive as short-term yields declined.

Major equity bourses rose strongly in response to recent policy easing by the Fed and PBoC. Emerging market debt portfolio flows have also strengthened compared with the previous six months, notwithstanding the still elevated risks related to geopolitical tensions. However, investors remain selective. For instance, while South Africa's bond yield curve has shifted lower over the past six months, Brazil's has shifted upwards to reflect elevated inflation pressures and ongoing fiscal concerns.

Two-year minus 10-year yield spreads



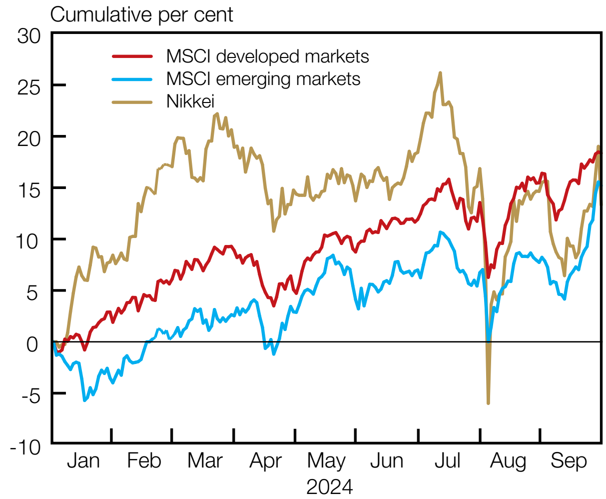

Source: Bloomberg

## Volatility subsides but markets on edge

Despite the apparent calmness, recent events suggest that markets remain on edge. Markets experienced an episode of heightened volatility at the start of August following the publication of disappointing US jobs market data that triggered a spike in recession fears. Equity markets sold off, with the impact exacerbated by the hawkishly-interpreted BoJ commentary that led to the unwinding of yen-funded carry trade positions. However, pullbacks were short-lived. Investors repositioned portfolios rather than closing them entirely. Also, economic data pointed to a US economy that was cooling as opposed to one headed into recession, again dampening market reactions.

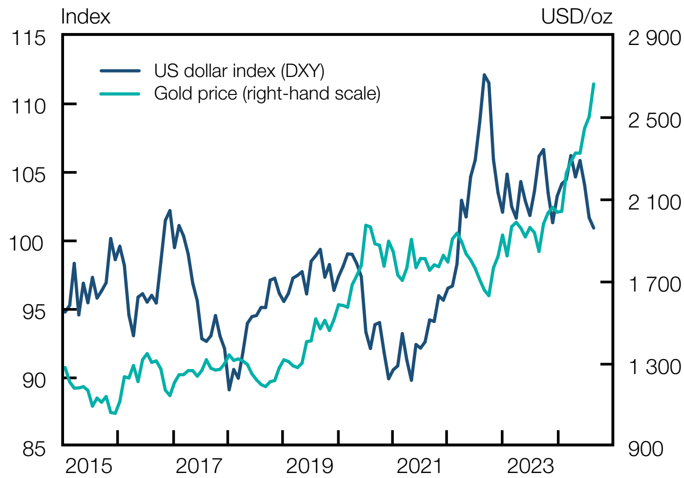
Currency markets have also adjusted in response to the increasing clarity about the trajectory for inflation, growth and policy rates. With interest rates in the US expected to decrease, the US dollar depreciated to lows last seen in the third quarter of 2023. The weaker dollar has generally supported currencies globally, with some exceptions and not without some currency volatility. Emerging and advanced economies bucking the trend of lower inflation have seen further currency weakness, while other economies that are moving in the same direction have seen stronger outcomes. The rand has made the best of the weaker US dollar, being the third-best performing emerging market currency after the Malaysian ringgit and Thai baht over the past six months. The offshore Chinese yuan also appreciated against the greenback to levels last seen in May 2023. By contrast, Latin American currencies such as the Mexican and Argentinian pesos and Brazilian real have come under pressure given the sensitivity to US rate differentials for the former and a mix of lower commodity prices and fiscal concerns weighing on the latter two.

Equity returns




Source: Bloomberg

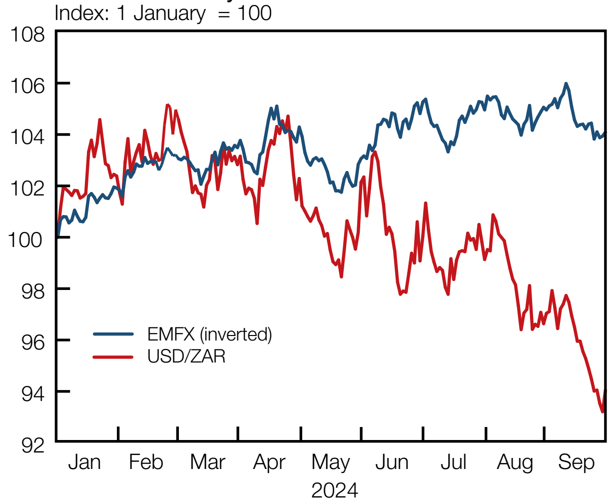
US dollar and gold price




Source: Bloomberg

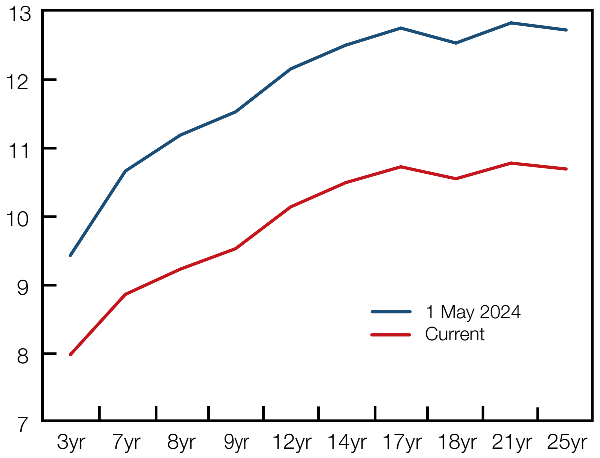
11 See also Federal Reserve Bank of Chicago, National Financial Conditions Index (NFCI): Index Points to Looser Financial Conditions in Week Ending September 20, Chicago: Federal Reserve Bank of Chicago, 2024.

South African rand has decoupled from emerging market currency basket
Index: 1 January = 100



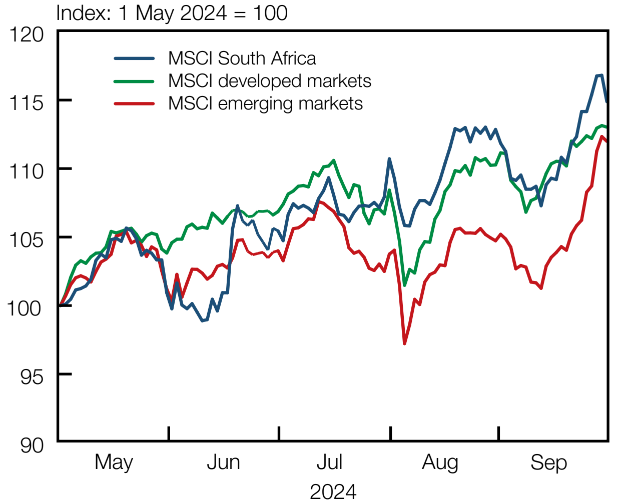

Source: Bloomberg

South African government bond yield curve
Per cent




Source: Bloomberg

MSCI Equity Index
Index: 1 May 2024 = 100




Source: Bloomberg

Going forward, expectations are that most emerging market central banks will lower interest rates further but by less than the Fed, implying widening interest rate differentials. In turn, these differentials should support further carry-trade flows, propping up emerging market currencies.[12] Markets, nonetheless, will remain responsive to macroeconomic risks, especially for economies with elevated debt levels. The focus will remain on factors that could interfere with the directions expected by investors, in particular the upcoming US elections in November.

## South African financial market developments

The past six months saw a marked turnaround in the performance of domestic financial assets. A combination of improved global risk appetite and the unwinding of the political risk premium embedded in local assets has buoyed domestic financial markets. The rand outperformed most emerging market currencies, appreciating by 8.8% since the time of the previous *MPR* and by 5.9% on a year-to-date basis.[13]

Yields on local currency government-issued instruments declined across the term structure, with those in the belly and long-end of the bond curve declining by nearly 200 basis points. The spread between the 3-year and 30-year South African government bonds fell below 300 basis points for the first time since June 2023, implying a flatter yield curve and a moderation in borrowing costs across the economy. A narrower country risk premium and lower inflation expectations renewed demand for rand assets by non-resident investors, further pushing yields down. Maintaining progress on inflation and growth as well as reducing the borrowing needs of the public sector, could cheapen financing further, given the still low level of non-resident investment in the country (currently holding a low 24.6% of outstanding government bonds). On a year-to-date basis, non-resident investors have bought a cumulative (net) total of R36.9 billion worth of South African government bonds, compared with net sales of R8.8 billion in the same period last year.

South African equities have also outperformed both developed markets and emerging markets since April. Despite heightened local market volatility in the period leading up to the election, South African equities rallied following the formation of the GNU. The JSE All Share Index rose 13.2% from April to reach a record high of 84 553 index points. South African markets performed even better in dollar terms. The MSCI South Africa Index has increased by 13.5% since April compared with gains

12 The Institute of International Finance noted in its September Capital Flows Tracker report that lower US rates can reduce the cost of borrowing in dollars, which in turn may ease funding conditions for emerging markets and further support investment flows.

13 Emerging market currencies have on aggregate depreciated by 3.9% on a year-to-date basis but performance has been almost flat since the last *MPR*.

of 5.5% for the broad MSCI Emerging Market (EM) benchmark and 6.9% for the broad MSCI Developed Market (DM) Index. However, JSE sector performance was mixed, with the financial and banking indices up by 29% and 31% respectively (record highs) while the resources and mining indices declined by 2.2% and 4.0% respectively, with industrials in between.

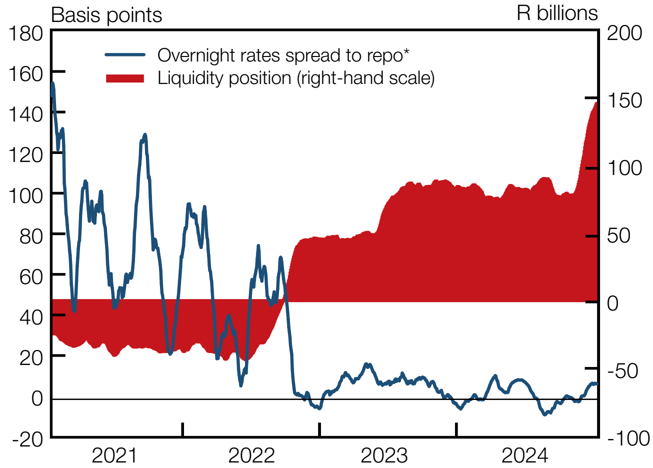
The government issued two new bonds on 10 September 2024, namely the R2033 and R2038, maturing on 31 March 2033 and 31 March 2038 respectively. These bonds have lowered the average maturity of the bond curve from 16.8 years to 14.9 years while smoothing out the redemption profile. Both were offered at R1.25 billion and they cleared close to the interpolated market rates.[14]

Regarding market operations, the implementation of the new GFECRA framework, along with the transfer of the funds to National Treasury, resulted in the surplus liquidity level doubling to R160 billion over the review period. With market conditions improving generally, there were no distortions observed in price formation in money markets and in the funding behaviour of banks in the secured and unsecured interbank market. Overnight call deposit rates for large corporate clients and funding rates in the foreign exchange (FX) forward market have been little changed.

Domestic policy rate expectations have evolved in a similar fashion to those observed in offshore markets, where central banks have either cut or are expected to cut interest rates. In South Africa, policy rate expectations implied from forward rate agreements (FRAs) indicate one more repo rate cut of 25 basis points for 2024 following the cut at the September 2024 MPC meeting. This is a noticeable shift in expectations since the previous *MPR*, but not out of line with changes in South Africa's macroeconomic outlook.

14 Interpolation is achieved by using other established bonds yields that are in sequence with the unknown bond. It is used to estimate the potential yield of a security.

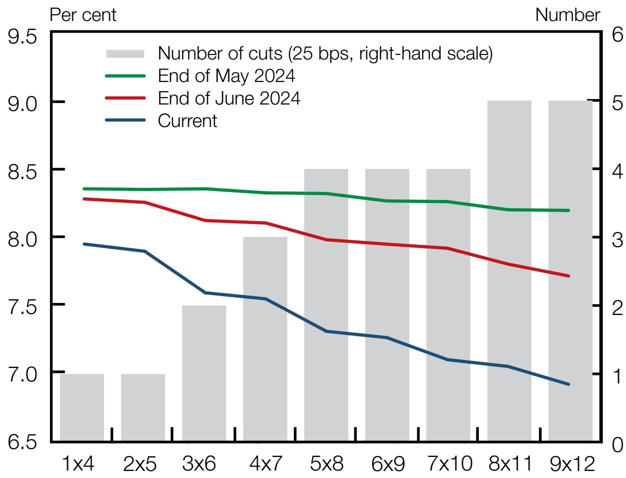
Liquidity position and short-term rates




* 20-day moving average

Sources: Bloomberg and SARB

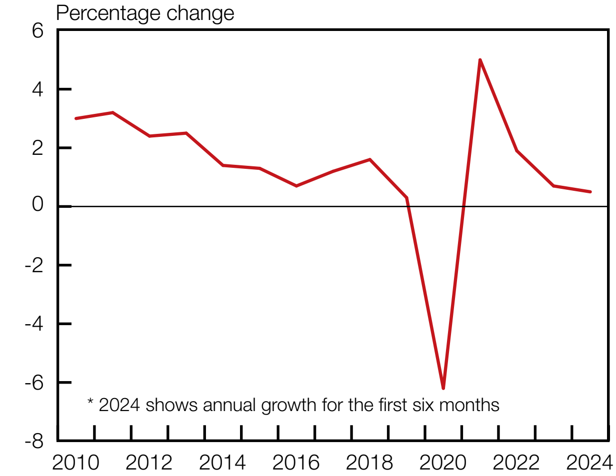
South Africa's forward rate agreement curve




Sources: Bloomberg and SARB

Real GDP growth*

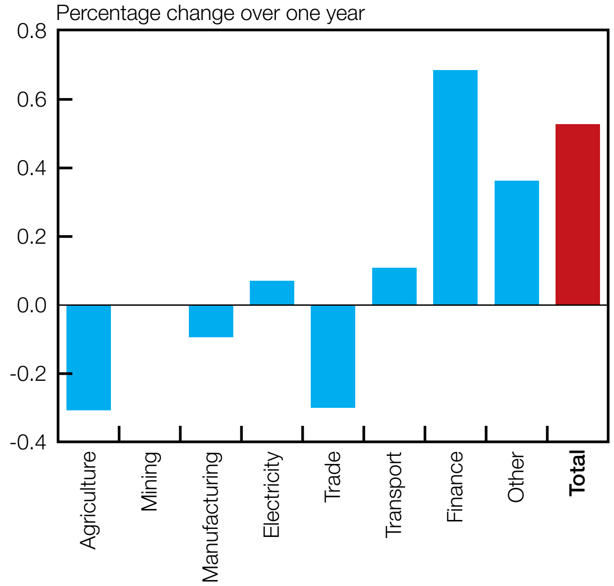
Percentage change




Source: Stats SA

Contributions to real GDP growth in 2024H1

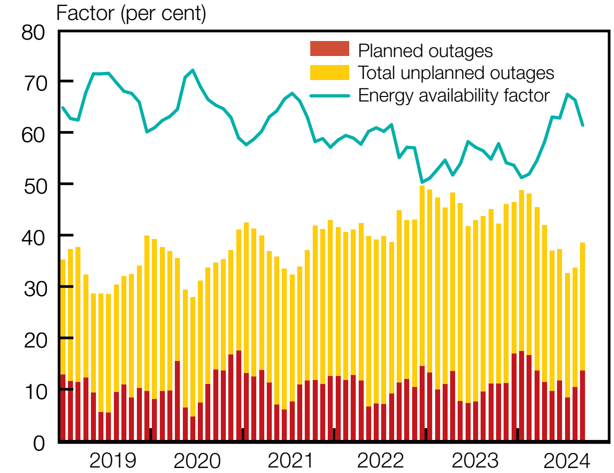
Percentage change over one year




Source: Stats SA

Eskom energy availability factor, planned and unplanned outages

Factor (per cent)




Sources: Eskom and SARB

# Real economy: smoother sailing?

*The domestic economy grew by 0.5% year on year in the first half of this year. Household spending and government consumption both supported growth while investment contracted. The high prevalence of load-shedding in the first quarter and logistical bottlenecks constrained economic activity greatly. Going forward, output is expected to expand at a progressively increasing pace as the economy's productive potential gradually lifts. The much improved electricity supply, declining inflation and interest rates as well as the pension withdrawals are among the factors supporting growth from the second half of this year. Real GDP growth is projected to average 1.1% this year up from 0.7% in the previous year, rising to 1.8% by the end of the forecast period. Further progress in the implementation of structural reforms, alongside sustaining the financing gains explored in the previous chapter, would continue to help improve the growth trajectory of the economy.*

## Recent economic developments

The South African economy grew by 0.5% year on year in the first six months of 2024 as the weak growth momentum from the past year carried over into the current year.[15] Electricity supply inadequacies, along with logistical bottlenecks, were a binding constraint over the past year, severely limiting economic activity. While electricity supply has registered a remarkable improvement from the second quarter of this year, with load-shedding suspended for over six months and counting, this improvement is yet to fully reflect in economic activity. The slow pick-up in activity reflects various factors, including subdued sentiment by both households and firms, high costs of production as well as weak domestic and global demand.[16] Other network industry challenges as well as possible scarring caused by the prolonged constraints to investment in productive capacity have also acted as drags to activity expansion.

At the broad sector level, the strength of economic activity was mixed. The primary sector contracted by 4.1%, reflecting poor outcomes in the agricultural and mining sectors. The El Niño-induced mid-summer drought reduced summer grains and oilseed production, while mining production suffered from logistics and falling prices.[17]

15 On a quarter-on-quarter basis, the economy recorded no growth in the first quarter, followed by a modest rebound of 0.4% in the second quarter.

16 See Minerals Council South Africa, Mining Input Cost Inflation July 2024, Johannesburg: Minerals Council South Africa, 2024. See also Minerals Council South Africa, Mining production declined again in Q2 2024, Johannesburg: Minerals Council South Africa, 2024.

17 For a detailed discussion of the sectoral growth outcomes see South African Reserve Bank, *Quarterly Bulletin*, September 2024; pp 6-11, Pretoria: South African Reserve Bank.

The secondary sector also subtracted from GDP growth over the review period. This is despite all the subsectors growing in the second quarter, with construction posting its first expansion since the first quarter of 2023.

The tertiary sector, which grew by 1.4% year on year in the first six months of this year, underpinned domestic economic growth during the period. Finance, which accounts for nearly a quarter of total GDP, was the bright spot, contributing 0.7 percentage points to growth on an annual basis. However, the trade sector contracted – consistent with the muted sentiment by new vehicle dealers and furniture retailers.[18] Constrained real disposable income, along with elevated borrowing costs during the first half of the year, mostly explains the poor performance.

Despite a generally weak economic environment the economy continued to create employment opportunities. Total employment grew by 2.7% in the first half of this year compared with the same period in 2023. The rise in employment despite very muted GDP growth (0.5%) attests to South Africa's high growth elasticity of employment and suggests significant scope to reduce unemployment should economic growth rise appreciably on a sustained basis. The SARB expects further gains in employment over the medium term as business sentiment and economic growth benefit from the relaxation of supply-side constraints.

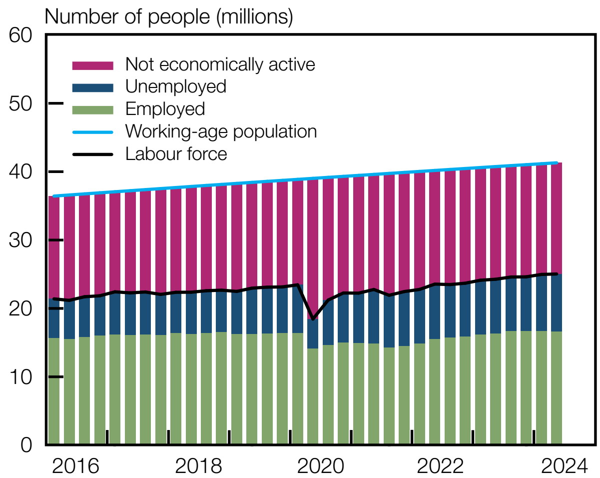
Real household spending growth was subdued in the first six months of this year, increasing by just 0.4% on an annual basis. The outlook for household spending has improved, however, with consumer confidence edging higher in both the second and third quarters of this year. Indeed, consumer confidence is at its highest in five years, indicating some optimism on the back of easing inflation and the anticipation of further interest rate relief.[19]

In contrast to the household sector, investment disappointed hugely, with real total gross fixed capital formation (GFCF) falling by 5.2% year on year in the first half of this year. Indeed, investment spending by all organisations is still below pre-pandemic levels. While private investment, the largest component of GFCF, benefitted significantly from embedded generation-related spending amid high levels of load-shedding over the past two years, activity in this market has slowed sharply. This likely reflects a slower approval process for projects as well as improved grid stability. Meanwhile, public sector capital spending continues to be weighed down by the fragile positions of state-owned enterprises combined with underspending on capital projects due to governance and capacity challenges in government.

18 See Bureau for Economic Research, ABSA Manufacturing Survey 2024Q2: quarterly analysis of activity in retail, wholesale and motor trade, Stellenbosch: Bureau for Economic Research, 2024.

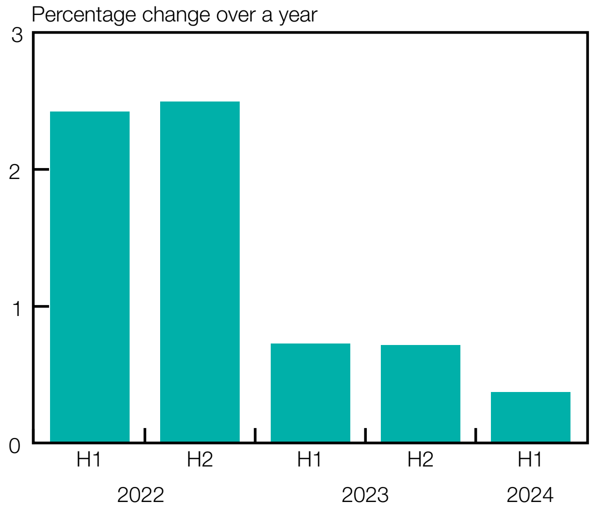
19 See Bureau for Economic Research, FNB/BER Consumer Confidence Index 2024Q3: quarterly analysis of consumer expectations, Stellenbosch: Bureau for Economic Research, 2024.

### Labour market trends



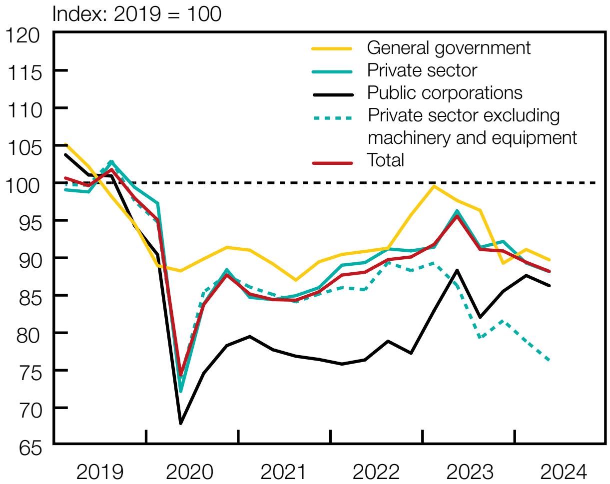

Source: Stats SA, Quarterly Labour Force Survey

### Growth in real household spending




Source: Stats SA

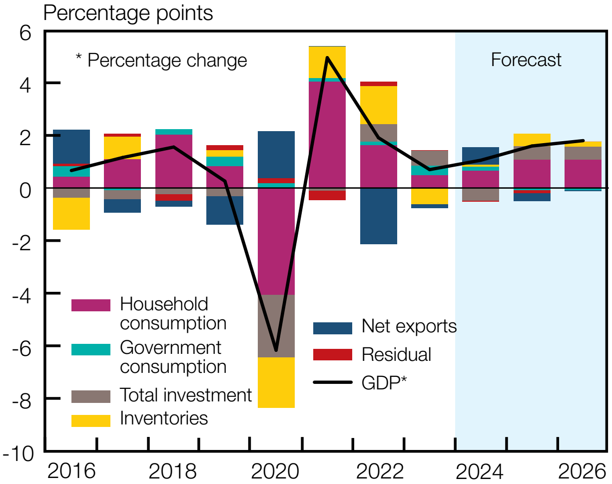
### Real gross fixed capital formation




Source: Stats SA

On the whole, while the economy expanded in the first six months of the year, the growth rate remains low. However, slightly better growth is expected in the second half of this year, in line with improved private sector sentiment, sustained gains in energy supply and stabilisation in ports and rail logistics.

Contributions to real GDP growth



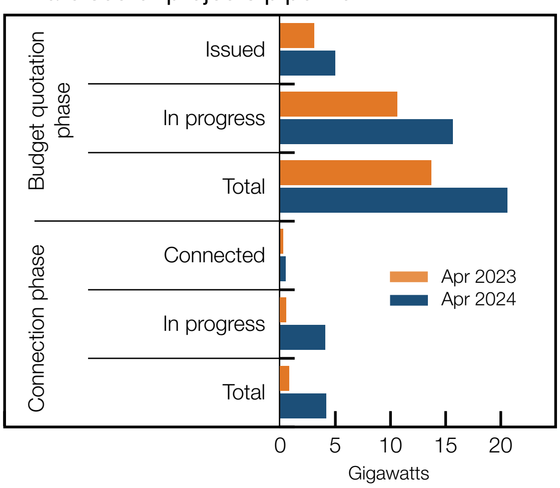

Sources: Stats SA and SARB

## Growth outlook

The SARB's baseline forecast projects economic activity to pick up over the medium term, underpinned by household spending and investment. Various factors, including the two-pot retirement reform and higher real salaries as inflation moderates, should support household consumption (Box 5). Meanwhile, capital spending on embedded generation projects should remain supportive of GFCF over the forecast period considering the large project pipeline in the budget quotation phase. In addition, the somewhat improved terms of trade should help stabilise output in mining and the economy more broadly. The forecast, however, remains constrained by a modest potential growth rate, a result of the erosion of productive capacity over time reflected in very weak investment growth rates (Box 4).

By contrast, the domestic economic environment has improved significantly since the start of the second quarter of this year, reflecting the sustained electricity supply as well as a steady improvement in business sentiment and conditions following the formation of a GNU. Load-shedding has been suspended since 26 March this year, while the energy availability factor (EAF) has risen closer to the desired 70% level. Electricity supply should be further bolstered by new generating units (Koeberg Unit 2 and Medupi Unit 4) that are expected to come online over the coming months. Accordingly, the SARB has adjusted its assumptions on load-shedding, which no longer detracts from GDP growth over the medium term.[20] The remaining 0.1 percentage point loss pencilled in for 2024 is in stark contrast to the 0.6, 0.2 and 0.04 percentage point deductions projected in the April 2024 *MPR*. On the logistics front, the Logistics Crisis Committee is expected to stabilise port and rail operations in the near term and to gradually improve their performance in the outer years of the forecast horizon.[21]

Private sector projects pipeline




Source: National Treasury

Among the expenditure components, household consumption spending is projected to remain the main driver of growth over the medium term, underpinned by a strengthening household balance sheet and improved sentiment. Real spending by households is forecast to grow by 1.0% in 2024 and by 1.6% in 2025 and 2026.

Although investment is projected to contract this year, it is forecast to recover and contribute positively to growth in the outer years of the forecast period. The recovery will mainly be driven by increased capital spending on embedded generation projects, where plants with a combined capacity of approximately 10 gigawatt (GW) are expected to become

20 Some load-shedding is still expected but only at stages 1 and 2. The SARB assumes minimal to no adverse growth impacts from this level of load-shedding given the adaptations by industry.

21 See Department of Transport, *Roadmap for the Freight Logistics System in South Africa*, Pretoria: Department of Transport, December 2023.

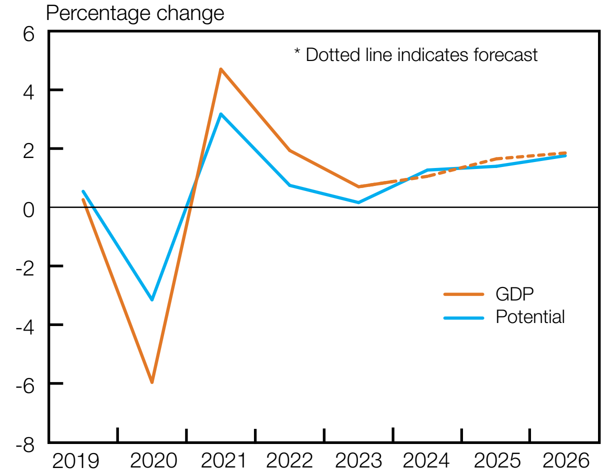
commercially operational by the end of 2026.[22] Moreover, the large number of projects in the budget quotation phase suggests that embedded generation will continue to underpin investment well beyond the current forecast horizon. The pace of investment, however, will be determined by grid access which appears to be a binding constraint, particularly in the provinces where most renewable generation is focused, namely the Northern Cape, Eastern Cape and Western Cape.[23]

Growth over the medium term will also benefit from the slightly improved terms of trade. South Africa's commodity export prices have deflated less than initially projected, while imports are softer. The higher trend for the terms of trade is projected to sustain over the forecast horizon.

Consistent with the improved economic environment, the SARB revised its real GDP growth projection slightly higher to 1.6% (1.4% in the April *MPR*) and 1.8% (1.6%) in 2025 and 2026 respectively. Potential output is also revised higher to 1.4% (1.2%) and 1.8% (1.6%) respectively over the same period.

Real GDP and potential growth*

Percentage change




Sources: Stats SA and SARB

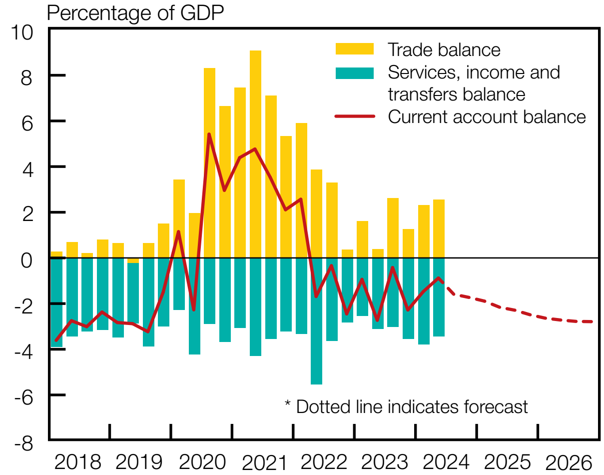
# Macro balances

## Current account and its drivers

As the economy slowed in the first half of 2024, the current account deficit narrowed to 1.2% of GDP from 1.8% of GDP in the first half of 2023. Despite a larger deficit on the services, income and transfers (SIT) account, the trade surplus increased as the terms of trade stabilised and imports remained muted. While the smaller current account deficit is not expected to persist as economic growth and import demand pick up, it should remain contained from modest government consumption and stronger exports. The current account deficit is now seen averaging 1.4% (2.1% in the April *MPR*) this year, deteriorating to 2.7% (3.3%) by 2026.

Current account balances

Percentage of GDP




Source: SARB

## Fiscal balances

Despite economic conditions remaining subdued, the first five months of the 2024/25 fiscal year saw total main budget revenue increase sharply by 19.1% year on year. This improvement mostly reflected the GFECRA windfall of R100 billion in July and August.[24] Total gross tax collections, however, rose by only 4.3% over the same period, mainly driven by personal income tax (PIT) revenue, while fuel, value-added tax (VAT) and corporate income tax (CIT) weighed down total tax receipts.[25]

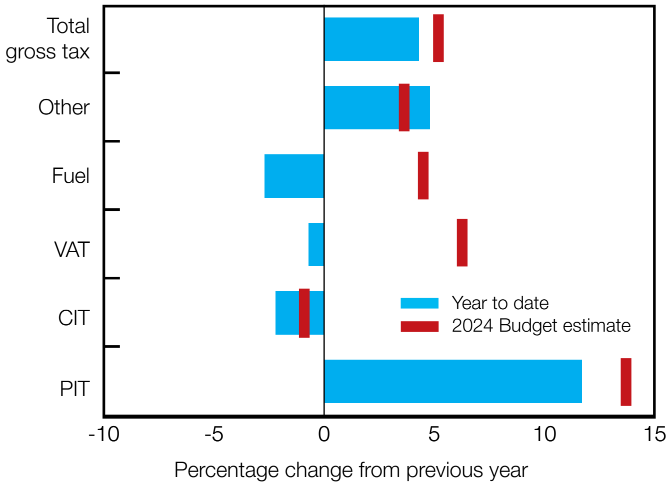
22 See National Treasury, Operation Vulindlela Phase 1 Review, Pretoria: National Treasury, 2024.

23 See D Erasmus, 'Pipeline for grid-connected renewable energy project surges to 134GW'. BusinessLIVE, 25 August 2024.

24 Excluding the GFECRA distribution, main budget revenue increased by only 3.6% in the first five months of 2024/25. See National Treasury, 'Statement of the national government's revenue, expenditure and borrowing'. Media Release, 30 September, Pretoria: National Treasury, 2024.

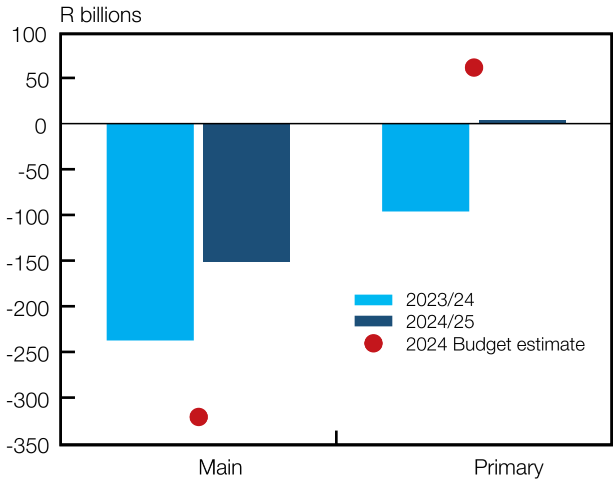
25 Personal income tax (PIT) was boosted by salary increases and bonus payments, while the decline in corporate income tax (CIT) likely reflects reduced mining sector profitability. A decline in fuel receipts may reflect the reduced fuel consumption due to the suspension of load-shedding. Finally, net value-added tax (VAT) receipts were weighed down by higher refunds.

Gross tax revenue growth




Source: National Treasury

Year-to-date budget balances




Source: National Treasury

Government spending has remained relatively contained year to date, consistent with the articulated fiscal consolidation framework. The main budget expenditure rose by a modest 4.3% in the first five months of the current fiscal year, in part reflecting reduced debt-service costs. The current revenue and expenditure trends are consistent with the projected primary surplus of 0.8% of GDP in 2024/25, which is double that achieved in 2023/24.

However, the forecasted fiscal position is not without risks. Financial challenges in critical state entities may warrant fiscal support, while an above-inflation public sector wage increase during the upcoming negotiations may add to spending pressures.[26] On the revenue side, low profitability in the mining sector, along with slower economic growth, could drive revenue shortfalls.

## Conclusion

The marked improvement in grid stability, along with the upbeat sentiment following the formation of the GNU, should improve near-term economic outcomes. Activity should be further buoyed by the recovery in demand on the back of easing financial pressures on households and better investment prospects. Accordingly, the economy is forecast to expand by 1.1% in 2024, rising to 1.8% by 2026. These growth projections, however, remain sensitive to further progress in the implementation of structural reforms in the energy and logistics sectors.

26 See BusinessTech, 'Wage crisis looms as unions look for double-digit salary hikes'. BusinessTech, 8 August 2024.

## Box 4 Slow-fading scars

Large economic shocks raise or lower economic output and can shift its rate of growth. In most cases output returns to its previous level and trend growth rate once the shock dissipates. However, some shocks can result in a permanent loss of economic output and a persistent change in the growth rate.[1] Have the large adverse shocks to hit the South African economy in recent years – the COVID-19 pandemic, electricity load-shedding, logistical bottlenecks, July 2021 unrest and floods in KwaZulu-Natal in 2022 – scarred the economy and caused permanent output losses that cannot be reversed?

Comparing actual output growth to the output that would have prevailed had the shock not occurred suggests a significant loss and a persistent decline in the economy's productive potential.[2] To return to the counterfactual GDP level by the end of 2026, the economy would need to grow at 3.2% annually on average – more than double the 1.4% annual average growth rate currently projected.

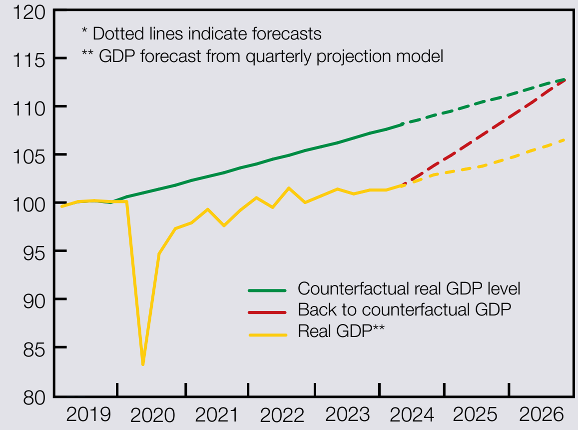
The prospects for recovering from economic scarring would improve with a sustained increase in investment. To date, total real gross fixed capital formation remains well below its pre-COVID level and real net investment has declined progressively over the past decade.[3]

The energy- and logistics-intensive sectors such as manufacturing and mining, along with construction, show large and persistent real output losses following a temporary rebound in 2021, remaining 9.0%, 6.0% and 26% below 2019 levels respectively. Manufacturing and mining output will need to grow at an annual average rate of 3.2% and 4.2% respectively to converge back to the counterfactual gross value-added level over the forecast horizon.

The economy's growth potential is projected to average 1.4% over the forecast horizon against a steady-state potential growth rate of 2.5%. This compares poorly to South Africa's emerging market trading partners, whose potential growth estimates range between 2.0% and 6.5% over the same period.

### Real GDP*

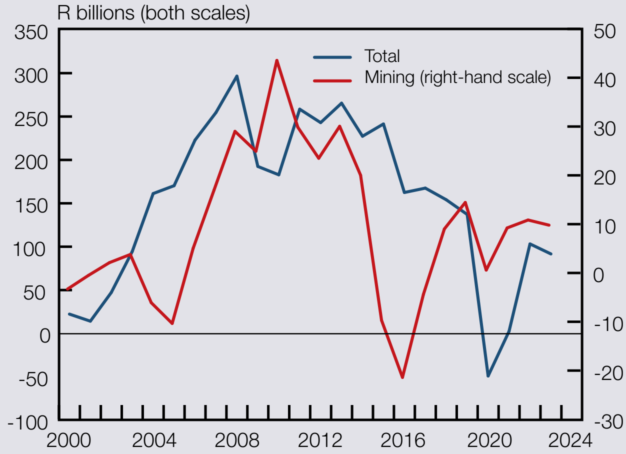
Index: 2019 = 100




Sources: Stats SA and SARB

### Real net investment

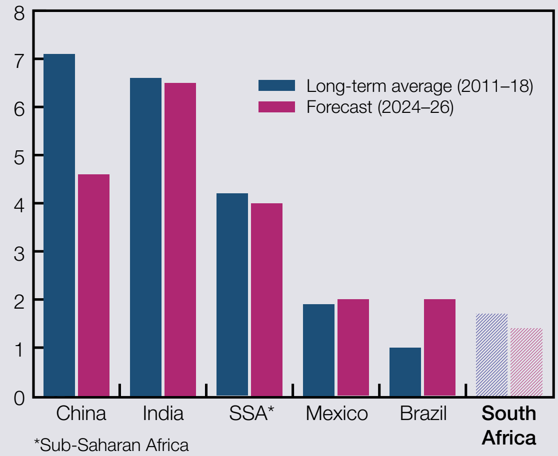
R billions (both scales)




Sources: Minerals Council South Africa and SARB

### Potential GDP growth for emerging market trading partners

Per cent




*Sub-Saharan Africa

Sources: Stats SA and SARB

1 See M Ball, 'Long-term damage from the great recession in OECD countries', *National Bureau of Economic Research Working Paper 20185*, Cambridge: National Bureau of Economic Research, May 2014; also see D Aikman, M Drehmann, M Juselius and X Xing, 'The scarring effects of deep contractions', *BIS Working Papers No. 1043*, Basel: Bank for International Settlements, October 2022, and L Fornaro and M Wolf, 'The scars of supply shocks: Implications for monetary policy', *Journal of Monetary Economics 140* (supplement), 2023, pp s18–s36.

2 See M Larch, P Claeys and W van der Wielen, 'The scarring effects of major economic downturns: The role of fiscal policy and government investment', *European Investment Bank Working Paper No. 2022/14*, Luxembourg: European Investment Bank, November 2022.

3 Real net investment is real total fixed investment less the depreciation of existing capital stock.

## Box 5 Two-pot retirement reform: A shot in the arm for household spending[1]

South Africa's two-pot retirement savings reform allows employees to withdraw a portion (one-third) of their pension savings without having to resign first. From 1 September 2024, all retirement fund contributions are split between three components (or 'pots'); namely the (i) *vested component* containing all accumulated retirement fund contributions made until 31 August 2024;[2] (ii) *savings component* containing one-third of all net annual retirement contributions made after the implementation date, including the once-off seed capital transfer from the vested component;[3] and (iii) *retirement component* containing the remaining two-thirds of all net annual retirement contributions made after the implementation date.[4]

In the short term, pension fund withdrawals are expected to boost household real disposable income and thus consumption. Two possible withdrawal scenarios are considered here.[5] The high withdrawal scenario assumes an additional pre-tax R100 billion will be withdrawn in the fourth quarter of 2024, followed by withdrawals of R40 billion per annum thereafter. In the moderate withdrawal scenario (more likely), a pre-tax withdrawal of R40 billion in the fourth quarter of 2024 is assumed and R20 billion per annum thereafter.

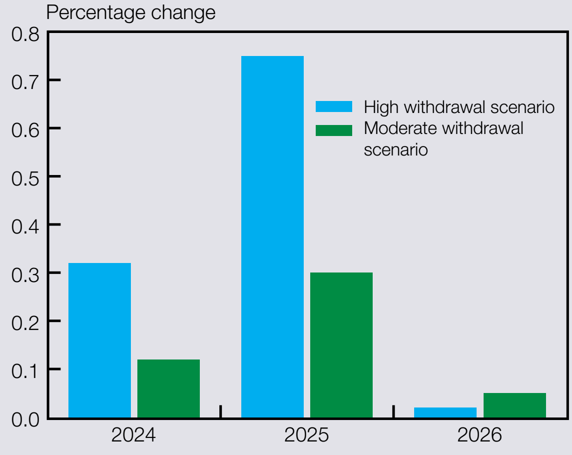
The overall economic impact of the new pension reform is sensitive to the size of the aggregate withdrawal. Under a high withdrawal scenario, consumption increases significantly, rising by 0.8 and 1.8 percentage points in 2024 and 2025 respectively before reverting to the baseline (pre-two-pot retirement impact). Spurred by stronger household spending, gross domestic product (GDP) growth edges higher by 0.3 and 0.7 percentage points respectively over the same periods, before returning to the baseline in 2026. Unsurprisingly, in an environment of constrained supply, the stronger demand lifts inflation, which rises by 0.2 and 0.3 percentage points in 2025 and 2026 respectively relative to the baseline. The rise in inflation triggers a repurchase (repo) rate response, with the repo rate increasing by 0.6 and 0.9 percentage points in 2025 and 2026 respectively relative to the baseline to prevent the inflation impulse from entrenching – impacting the cost of capital to firms and borrowing costs for households.

A smaller increase in real household spending and GDP growth is anticipated in the moderate withdrawal scenario, with GDP growth only gaining 0.1 and 0.3 percentage points in 2024 and 2025 respectively.[6] This scenario has more muted inflationary impacts, with headline inflation ticking up by about 0.1 percentage points in both 2025 and 2026. Accordingly, the repo rate response is also muted, at 0.2 and 0.4 percentage points in 2025 and 2026 respectively.

In both scenarios the growth benefits are temporary while the inflation impacts appear to linger. While the two-pot retirement reform provides some short-term relief to distressed consumers, there are potential downsides. First, should the withdrawal rates turn out to be much higher, the rise in inflation would be substantial, potentially requiring a commensurate policy response. Such an outcome would undermine both household consumption and corporate investment in the near to medium term, weighing on economic activity. Second, the higher the withdrawal rates the less funds will be available at retirement age, implying lower household consumption in the longer run. Relatedly, the reduced total saving would, other things being equal, raise the cost of capital and depress investment and ultimately the economy's productive capacity in the medium to long run.

**Real GDP growth**

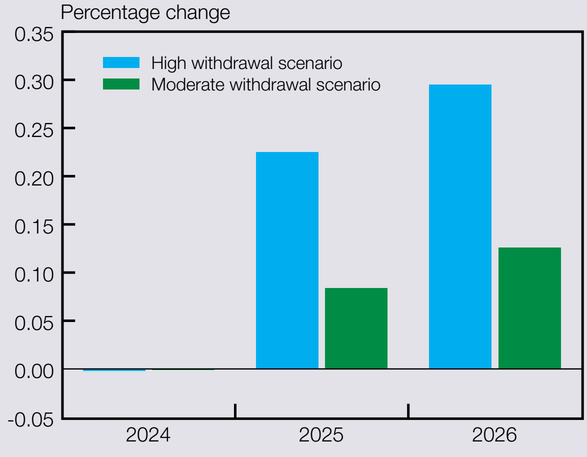
Percentage change




Source: SARB

**Inflation**

Percentage change




Source: SARB

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1 See N Nesengani, R Ehlers, M Choonoo, A van Niekerk and T Janse van Rensburg, 'Likely near-term macroeconomic impact of the implementation of the two-pot retirement saving system', *South African Reserve Bank Special Occasional Bulletin of Economic Notes: Special OBEN/24/02*, Pretoria: South African Reserve Bank, August 2024.

2 In addition, a once-off seed capital transfer of 10% (capped at R30 000) of an individual's vested funds will be made to their savings 'pot' after the implementation date. The remaining funds stay invested, with access to these funds still only permitted after retirement or upon resignation, as per the current legislation.

3 Individuals will have access to funds in their savings 'pot' before retirement and without having to resign, restricted to one withdrawal per tax year and taxed at an individual's marginal tax rate.

4 This pot prohibits access to these funds before retirement.

5 These withdrawals are additional to the R100 billion to R120 billion per annum of pension withdrawals associated with resignations.

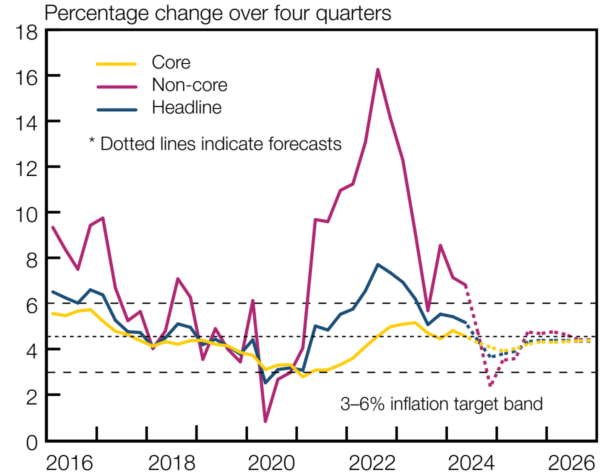
6 Real household spending increases by roughly 0.3 and 0.7 percentage points in 2024 and 2025 respectively.

# Price developments: resetting the anchor

*After remaining sticky in the 5–6% range for much of the review period, headline inflation declined to 4.4% in August 2024. The softer reading marks the first time in over three years that headline inflation fell below the target midpoint. With oil prices lower and the rand strengthening, falling fuel prices have played a critical role in pulling headline inflation down. Other major components of the consumer price inflation (CPI) basket have also slowed, including, importantly, food price inflation and imported goods prices. The SARB now expects headline inflation to average 4.6% this year, down from 5.1% in the April* MPR*. Going forward, in the absence of upside risks materialising, headline inflation is forecast to undershoot the target midpoint through to 2026.*

Headline inflation and its components*

Percentage change over four quarters




Sources: Stats SA and SARB

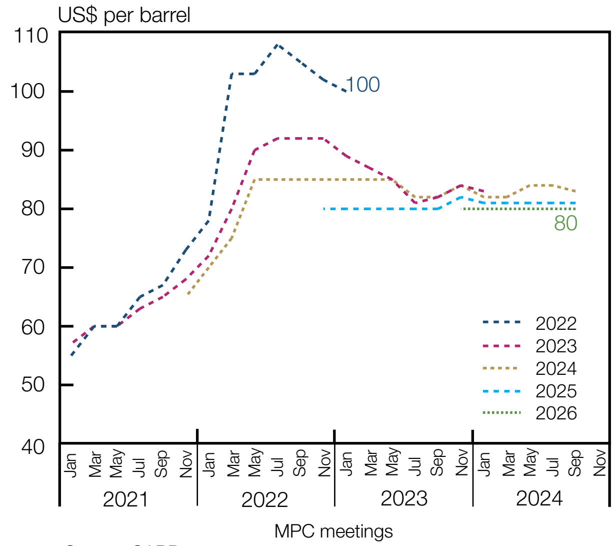
## Oil prices and fuel inflation

Despite some volatility, particularly in the earlier months of the review period, Brent crude oil prices have largely supported domestic disinflation. After surging to US$90 per barrel in April 2024 as heightened geopolitical tensions in the Middle East increased supply constraint fears, oil prices moderated as fears of a larger conflagration subsided. More recently, downgrades to future global growth rates have caused oil prices to soften further, averaging US$74 per barrel in September 2024 despite OPEC+ members (members of the Organization of the Petroleum Exporting Countries (OPEC) plus other oil-producing countries) extending their voluntary production cuts. Over the review period, Brent crude oil prices have averaged US$84 per barrel. The beneficial impact of softer oil prices has been accentuated by the recent strengthening of the rand, resulting in successive months of fuel price reductions and thus easing fuel price inflation.

According to the US Energy Information Administration (EIA), the oil market is currently undersupplied by about a million barrels a day. Voluntary production cuts by OPEC+ members have been kept in place, providing support to prices despite broadly weaker demand for oil, exemplified by modest growth in China, the world's largest oil importer.[26] In the medium term, supply and demand in the oil market is expected to remain relatively tight, keeping the forecast assumption for Brent crude oil prices at an average of US$83 per barrel this year and US$81 per barrel over the medium term.

Evolution of oil price forecasts

US$ per barrel



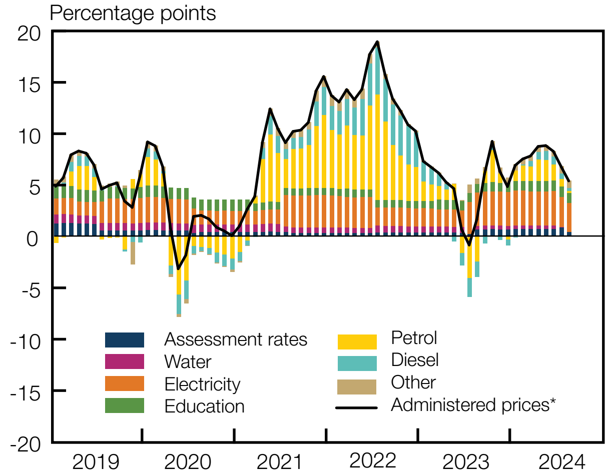

Source: SARB

## Administered price inflation

In line with historical trends, administered price inflation continues to exert upward pressure on headline inflation. Administered price inflation has averaged 7.6% year to date and

Contributions to administered price inflation

Percentage points



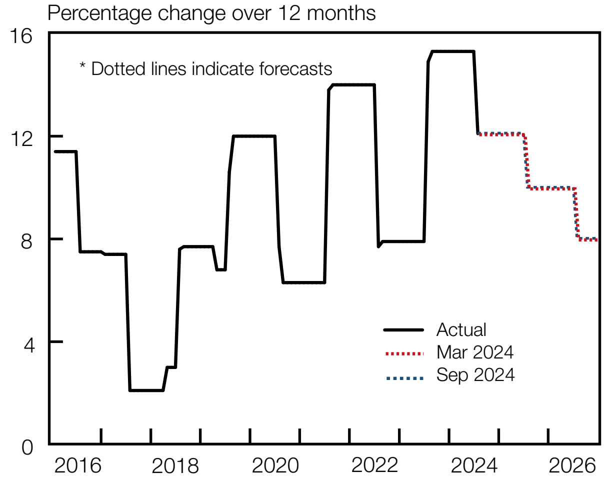

* Percentage change over 12 months

Sources: Stats SA and SARB

26 US Energy Information Administration, *Short-term Energy Outlook (STEO)*, Washington DC: US Energy Information Administration, September 2024.

Electricity prices*

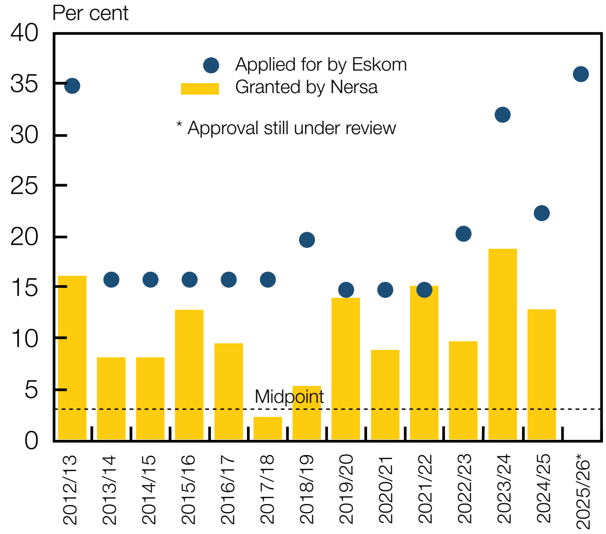
Percentage change over 12 months




Sources: Stats SA and SARB

Electricity tariffs: requested versus granted

Per cent




Source: Eskom

is projected to average 5.9% for the whole year. The trajectory for administered price inflation is primarily shaped by electricity price inflation. For instance, electricity has contributed almost half (3.2 percentage points) of the year-to-date administered headline number, much higher than its relative weight of 22.1% in the administered prices basket.

Electricity prices have risen by an average of 12.1% per year since 2009, against a rise of 5.3% per year for headline inflation over the same period. This sharp rise in electricity prices is meant to bring them to more cost-reflective levels to increase supply. Electricity price inflation is forecast to average 13.6% this year before slowing to an average of 9.0% by the end of the review period, in line with municipal budget projections. Considering the annual increases (July/August of the current year to June the following year), electricity price inflation moderated to 11.5% in August from 15.3% the year before.

In recent years, Eskom's revenue applications have been above 20.0%, with the approved tariff increases markedly above the midpoint of the 3–6% inflation target band. This trend is expected to continue and, given its large weight of nearly a quarter of the administered price basket, presents risks to the administered inflation outlook.

Fuel price inflation, projected at 0.6% again this year, will once more support a slower rise in administered price inflation. However, this muted fuel inflation mostly reflects the moderation in the basic fuel price (BFP), a component determined by the Brent crude oil price and the rand exchange rate – which are wholly determined by market forces (the truly administered components in the fuel price basket include fuel taxes, levies and margins). If the BFP is excluded from fuel price inflation, administered price inflation is markedly higher at 7.5% in 2024.

Meanwhile, inflation for water tariffs and assessment rates has trended lower. Water tariffs eased by 2.1 percentage points to 7.5% this year. Assessment rates also moderated, coming in at 5.0% in August (compared with 8.4% the year before).

Given the 'indexation' of most administered costs to headline inflation, the easing trend for headline inflation bodes well for administered price inflation going forward.[27] Lower headline inflation should lead to a decline in administered price inflation, in turn reinforcing the downward shift in headline inflation in a virtuous cycle.[28] SARB projections are for administered price inflation to average 5.1% (3.1% if electricity is excluded) over the forecast horizon.

27 K Walsh, 'Review of administered prices in South Africa: Municipal rates and taxes', *Special Occasional Bulletin of Economic Notes: Special OBEN/23/01*, Pretoria: South African Reserve Bank, August 2023.

28 C Loewald, K Makrelov and E Pirozhkova, 'The short-term costs of reducing trend inflation in South Africa', *South African Reserve Bank Working Paper Series No. WP/22/08*, Pretoria: South African Reserve Bank, August 2022.

## Food and non-alcoholic beverages inflation

Food and non-alcoholic beverages (NAB) inflation eased over the past six months, reflecting favourable conditions at home and abroad. The containment of avian influenza (bird flu) and foot and mouth disease, a stronger rand exchange rate and the absence of load-shedding have all helped ease domestic price pressures, while the deflationary global agricultural commodity prices added further disinflationary impetus. Food and NAB inflation slowed to 4.7% in August 2024 from 5.1% in March this year.

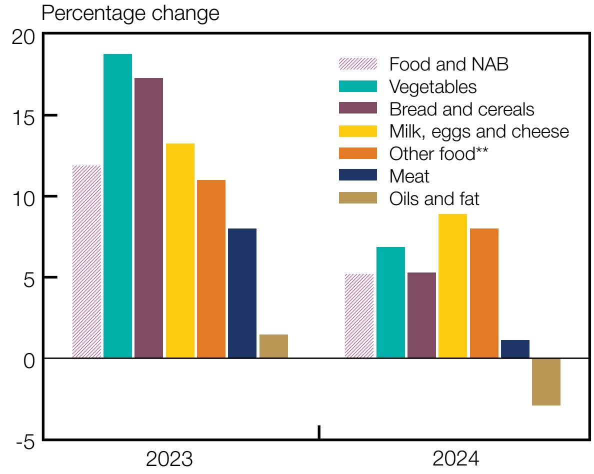
The decline in food inflation over the past year was broad-based. By August 2024, 46.2% of the food basket inflated at rates below the target midpoint, up from 15.4% a year earlier. However, food inflation appears to have bottomed out as it ticked up marginally in August 2024.

Food inflation has benefitted from lower price increases for meat, vegetables as well as milk, eggs and cheese. Meat supply has improved mainly on increased slaughter activity, along with the containment of the bird flu in poultry. The foot and mouth disease in cattle has also largely been contained. At the same time, the suspension of load-shedding has reduced the spoilage in milk, eggs and cheese, while enabling irrigation and thus increased supply of vegetables.[29] Although meat inflation is expected to edge slightly higher in the coming months, it is only projected to average 1.2% this year. However, bread and cereals inflation has been climbing in recent months following a sharp jump in white maize spot prices amid concerns over possible drought-related shortages.[30] This rise follows a 13-month deceleration streak through to May of this year, where inflation for this category bottomed at 3.9%. The SARB expects inflation for vegetables, milk, eggs and cheese as well as bread and cereals to average 4.8%, 7.4% and 5.3% respectively in 2024.

Food and NAB inflation has been downwardly revised to 4.7% in 2024 (5.5% in the April *MPR*). While near-term price pressures are anticipated due to the El Niño-induced summer drought, the prospect of a return to wetter La Niña conditions during the 2024–25 summer crop season should keep food price pressures contained.

### Food inflation comparison*

Percentage change



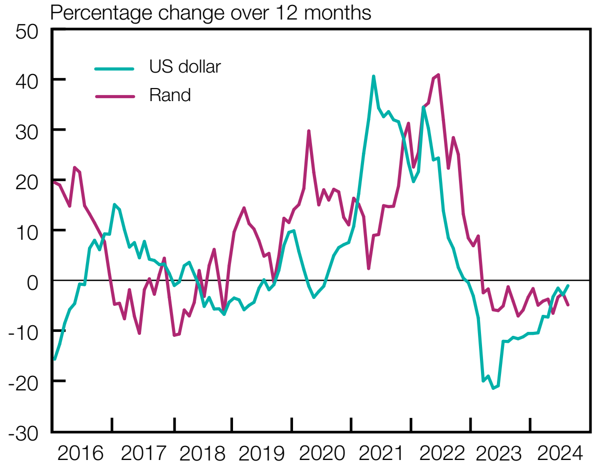

* Average from January to August

** Other food includes fish, fruit, sugar, sweets and desserts and NAB

Source: Stats SA

### Global food commodity price index

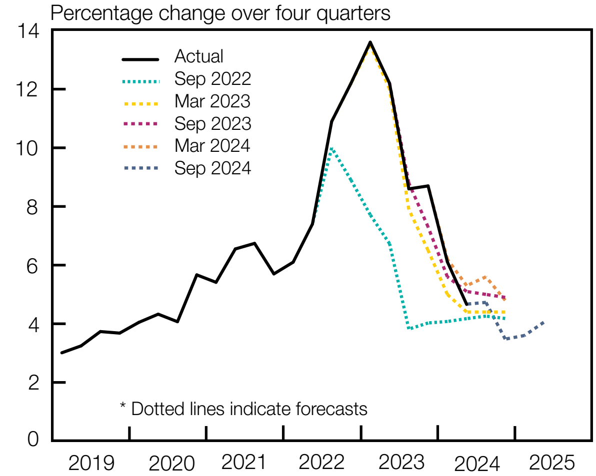
Percentage change over 12 months




Source: FOA

### Food and NAB inflation*

Percentage change over four quarters




Sources: Stats SA and SARB

29 Vegetables inflation slowed to 4.4% in August 2024 from a peak of 23.6% in October 2023.

30 The white and yellow maize harvest for the 2023–24 season is estimated at 6.1 million and 6.7 million tonnes respectively, a decrease of 28.5% and 15.2% respectively when compared with the previous season.

Consumer food price inflation (September 2024 forecasts)

Percentage change over four quarters, March 2024 forecasts in brackets

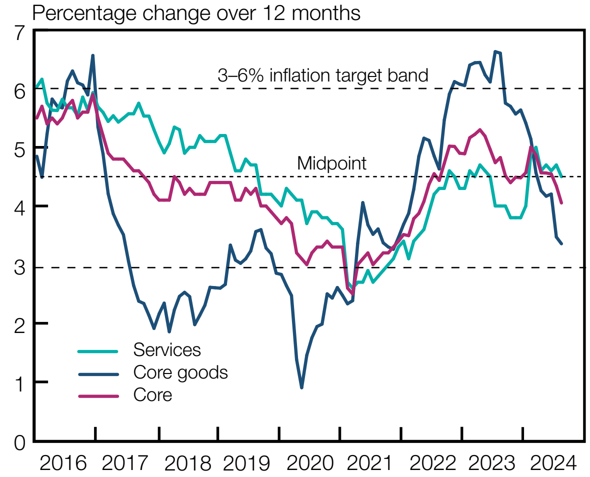
| | Actual | | | | | Forecast | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Weight | 2013–23 | 2023* | 2024Q1 | 2024Q2 | 2024Q3 | 2024Q4 | 2024* | 2025Q1 | 2025Q2 |
| Food and non-alcoholic beverages | 17.14 | 6.7 | 10.7 | 6.1 | 4.7 | 4.7 | 3.5 | 4.7 | 3.6 | 4.1 |
| | | | | (6.2) | (5.3) | (5.6) | (4.8) | (5.5) | | |
| Bread and cereals.................. | 3.16 | 6.8 | 14.2 | 5.8 | 4.5 | 5.4 | 5.5 | 5.3 | 5.9 | 6.0 |
| | | | | (6.0) | (5.1) | (5.8) | (7.3) | (6.1) | | |
| Meat ...................................... | 5.42 | 6.5 | 6.5 | 1.5 | 0.7 | 1.5 | 1.3 | 1.2 | 2.4 | 4.3 |
| | | | | (1.8) | (2.9) | (5.0) | (5.4) | (3.7) | | |
| Beef.................................. | 1.42 | 6.5 | 3.0 | -2.4 | -1.4 | 0.2 | 0.9 | -0.7 | 0.9 | 3.2 |
| | | | | (-1.9) | (0.0) | (3.9) | (5.1) | (1.7) | | |
| Poultry............................... | 2.09 | 7.2 | 9.7 | 5.7 | 3.0 | 3.5 | 2.9 | 3.8 | 3.8 | 5.8 |
| | | | | (6.0) | (6.0) | (7.1) | (6.4) | (6.4) | | |
| Vegetables ............................. | 1.27 | 7.4 | 19.2 | 9.3 | 6.6 | 5.3 | -1.3 | 4.8 | 3.6 | 2.5 |
| | | | | (9.2) | (3.8) | (3.6) | (-1.0) | (3.8) | | |

* Annual average percentage change

Sources: Stats SA and SARB

Components of core inflation

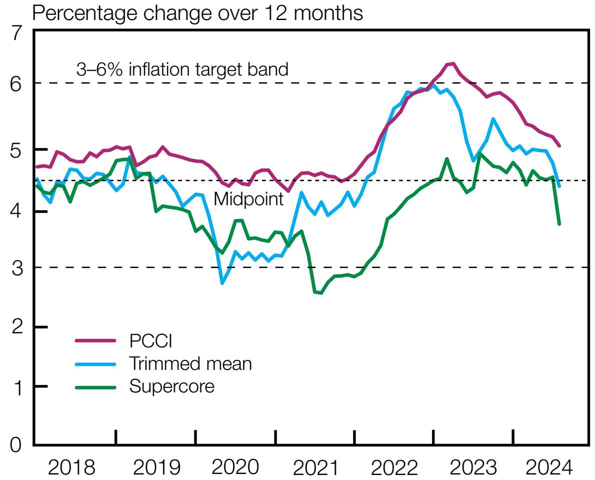
Percentage change over 12 months




Sources: Stats SA and SARB

Measures of underlying inflation

Percentage change over 12 months




Sources: Stats SA and SARB

## Core inflation

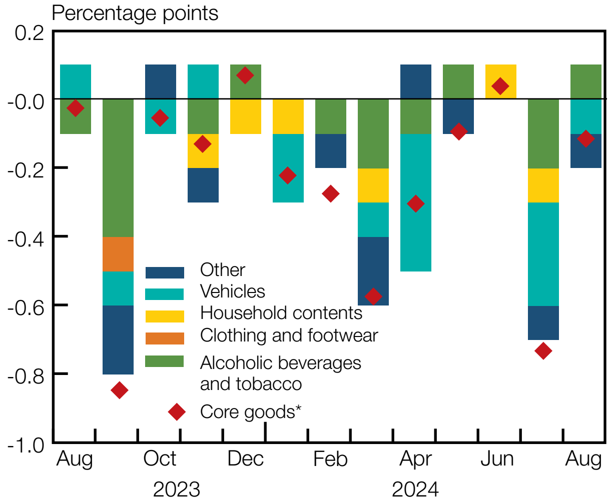
South Africa's core inflation remained well contained through the pandemic inflation surge, averaging 0.3 percentage points above the target midpoint at its peak (both in 2022 and 2023). The relatively contained core inflation during the height of the global inflation surge countered the upward price pressures from the sharply higher food and fuel price increases, mitigating the acceleration of overall headline inflation. Owing to muted core inflation, headline inflation peaked at 7.8%, while many emerging markets saw inflation reach double digits. Indeed, South Africa fared better even against the major advanced economies such as the US, eurozone and UK where headline inflation peaked in the 9–11% range.

Year to date, core inflation has averaged 4.6%, with the past three outcomes at, or below, the midpoint. Core goods inflation has decelerated markedly over the past six months, pulling down on core inflation. Despite some volatility earlier in the year, services price inflation also slowed in recent months, assisting the decline in core inflation. Along with easing core inflation, the other measures of underlying inflation, namely trimmed mean inflation, supercore inflation and the persistent and common component of inflation (PCCI), also point to softening inflation pressures. This indicates that demand and supply have been brought into better balance, thanks to a moderately restrictive monetary policy stance along with the dissipation of some supply shocks (Box 6). Projections are for core price inflation to undershoot the target midpoint from this year through to 2026.

Since it peaked at 6.6% in August 2023, core goods inflation has decelerated sharply, shaving off 3.2 percentage points over the year to August 2024. Core goods inflation has benefitted from softening global goods inflation and a stronger rand exchange rate over the review period, along with base effects.

Despite some setbacks, services inflation also generally eased. While some large-weight components of the services basket such as medical insurance inflation have normalised to pre-pandemic levels, others continue to play catch-up. Housing, a big-ticket item, has continued to surprise to the downside (2.9% in August 2024, against the SARB's expectation of 3.4%). Nevertheless, the SARB expects housing inflation to increase in line with the projected expansion in economic activity and a relatively tight rental market (Box 7). Services price inflation is forecast higher at 4.7% this year, up from 4.2% in 2023 but to slightly undershoot the target midpoint in the outer years of the forecast, reflecting subdued inflation expectations and ULCs.

Contributions to change in core goods inflation




* Change in year-on-year rate compared to previous month
Sources: Stats SA and SARB

Headline inflation (September 2024 forecasts)

Percentage change over four quarters, March 2024 forecasts in brackets

| | Actual | | | | | Forecast | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Weight | 2013–23 | 2023* | 2024Q1 | 2024Q2 | 2024Q3 | 2024Q4 | 2024* | 2025Q1 | 2025Q2 |
| Headline inflation | 100.0 | 5.2 | 6.0 | 5.4 | 5.1 | 4.4 | 3.6 | 4.6 | 3.7 | 3.8 |
| | | | | (5.4) | (5.1) | (5.3) | (4.7) | (5.1) | | |
| Core inflation** | 74.4 | 4.6 | 4.8 | 4.8 | 4.6 | 4.3 | 4.1 | 4.4 | 3.9 | 4.0 |
| | | | | (4.8) | (4.7) | (4.9) | (4.9) | (4.8) | | |
| Rentals*** | 16.5 | 3.6 | 2.7 | 3.1 | 3.2 | 3.0 | 3.2 | 3.1 | 3.2 | 3.5 |
| | | | | (3.2) | (3.5) | (3.5) | (3.7) | (3.4) | | |
| Insurance | 9.9 | 6.9 | 5.9 | 8.2 | 8.1 | 8.3 | 8.3 | 8.2 | 8.3 | 8.7 |
| | | | | (8.0) | (7.6) | (7.7) | (7.7) | (7.7) | | |
| Education | 2.6 | 6.7 | 5.6 | 6.0 | 6.3 | 6.3 | 6.3 | 6.2 | 6.2 | 6.0 |
| | | | | (5.8) | (5.8) | (5.8) | (5.8) | (5.8) | | |
| Vehicles | 5.9 | 4.8 | 7.7 | 7.0 | 5.3 | 4.0 | 3.5 | 4.9 | 3.7 | 4.0 |
| | | | | (7.1) | (5.6) | (4.5) | (4.0) | (5.3) | | |
| Fuel | 4.8 | 7.3 | 0.6 | 5.0 | 8.6 | -1.3 | -8.9 | 0.6 | -3.7 | -4.5 |
| | | | | (4.8) | (3.7) | (3.2) | (-5.5) | (1.4) | | |
| Electricity | 3.6 | 8.7 | 11.7 | 15.3 | 15.3 | 12.1 | 12.1 | 13.6 | 12.1 | 12.1 |
| | | | | (15.3) | (15.3) | (12.0) | (12.0) | (13.5) | | |

* Annual average percentage change
** CPI excluding food, non-alcoholic beverages, fuel and electricity
*** Combines actual rentals and owners' equivalent rent

Sources: Stats SA and SARB

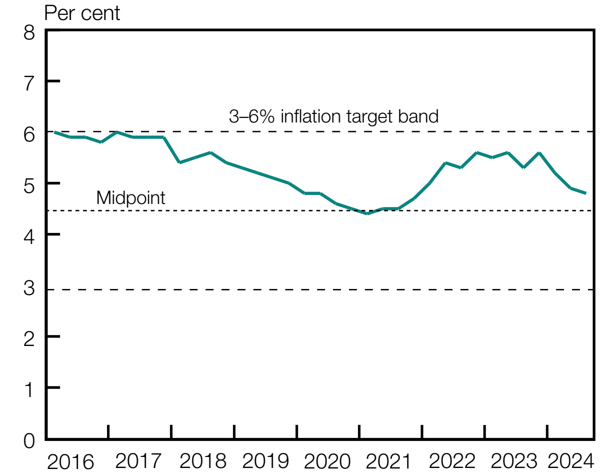
## Medium-term inflation outlook

Within the QPM, the medium-term inflation outlook is determined by inflation expectations, the output gap, exchange rate gap and ULCs.

Inflation expectations dynamics feed into inflation by serving as a gauge for both price and wage setters in the economy.[31]

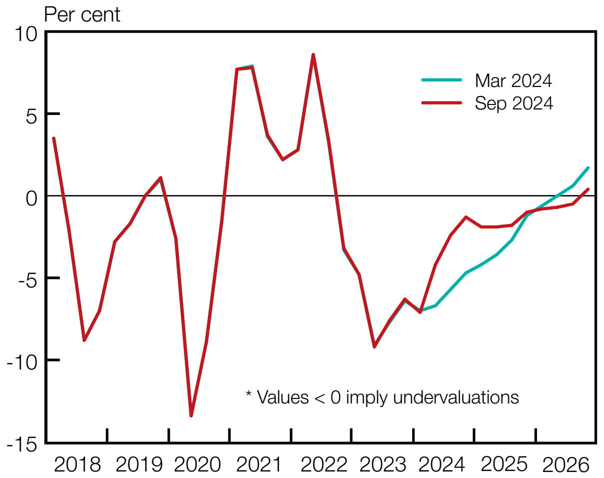
31 A Amaral, M Kruger and M Reid, 'Looking to the price setters: what can we learn from firm-level inflation expectations data?', *South African Reserve Bank Special Occasional Bulletin of Economic Notes: Special OBEN/24/01,* Pretoria: South African Reserve Bank, April 2024.

Two-years-ahead inflation expectations:
All participants



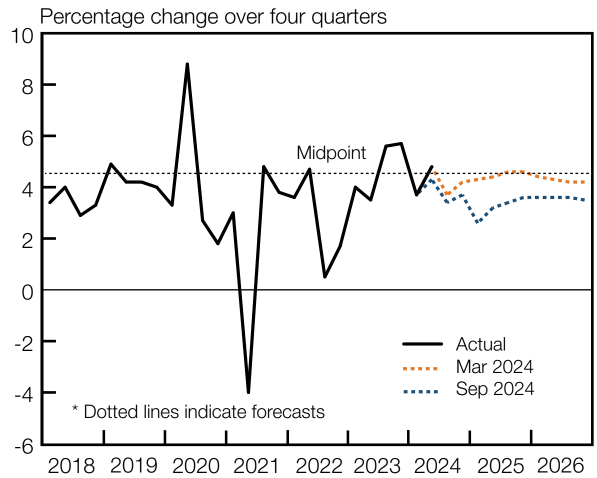

Source: BER

Real effective exchange rate gap*




Source: SARB

Unit labour cost*




Source: SARB

After peaking at 5.6% in the fourth quarter of 2023, the Bureau for Economic Research's (BER) two-years-ahead surveyed expectations have moderated for three consecutive quarters to reach a multi-year low of 4.8% in the third quarter of this year.[32] Nevertheless, surveyed expectations remain above the SARB's preferred 4.5% midpoint, indicating that the goal of lowering and anchoring expectations at the midpoint is not yet complete.

The output gap, which captures the extent of demand pressures on inflation, is negative and wider in the near term, but closes by the end of the forecast period. The negative output gap is consistent with the projected undershoot in core inflation. The closing output gap towards the end of the forecast period reflects declining inflation, along with the expected further policy easing, that provides a lift to household and investment spending.

Medium-term inflation dynamics are also shaped by movements in the rand exchange rate, which can raise or lower the impact of imported inflation on headline. The rand appreciated over the review period, as reflected in the improved starting point for the rand to the US dollar (R18.04 at the September 2024 MPC meeting compared with R18.88 at the March MPC meeting).[33] Despite the strong showing in recent weeks, the rand is projected to depreciate slightly (0.8%) over the medium term, falling to an average of R18.19 by the fourth quarter of 2026. Meanwhile, the real rand exchange rate, with a starting point undervaluation of 2.4%, is expected to be inflationary but progressively less so as the undervaluation shrinks, resulting in a marginal overvaluation of 0.4% by the final quarter of the forecast period. The improvement in the real rand should help mitigate some imported inflationary pressures.

The labour market has continued to surprise on the downside, with wage growth not matching the SARB's expectations of backward indexation. This may reflect the weakness in the labour market, where employment growth has been muted due to weak economic activity. Over the medium term, productivity is expected to rise at a faster pace than real wages, in line with the projected stronger GDP growth; hence, the ULC gap is forecast to remain negative throughout the forecast period. Nominal ULC growth is also forecast to undershoot the target midpoint, averaging 3.5% over the forecast horizon, lending further support to lower inflationary pressures.[34]

32 Two-years-ahead inflation expectations averaged 5.2% and 4.9% in the first and second quarters of 2024 respectively. However, the average expectations mask the wide dispersion across the different groups, with business expectations, at 5.2% in the third quarter, still way above the target midpoint.

33 See discussion in the financial markets chapter for the drivers of the rand appreciation.

34 Nominal ULC growth determines whether inflationary pressures are the result of wage increases or productivity decreases. Growth in real salaries is projected at 1.0% in 2024 from -1.3% in 2023, and to average 0.6% over the forecast period, while productivity growth is expected to rise to 1.9% in 2024 from -0.3% in 2023, and to average 1.4% over the medium term.

## Conclusion

Headline inflation decelerated strongly in recent months, with the latest outcome slightly undershooting the target midpoint. Disinflation has benefitted from dissipating domestic cost shocks as well as the continued transmission of a moderately restrictive monetary policy stance. Over the medium term, core inflation is expected to remain muted amid subdued wage pressures, easing inflation expectations and a relatively strong rand exchange rate. The QPM baseline projection indicates an undershoot of the target midpoint in both 2025 and 2026. Risks to this inflation outlook are assessed to be balanced.

### Box 6 Supply shocks 'under the hood' of personal consumption inflation

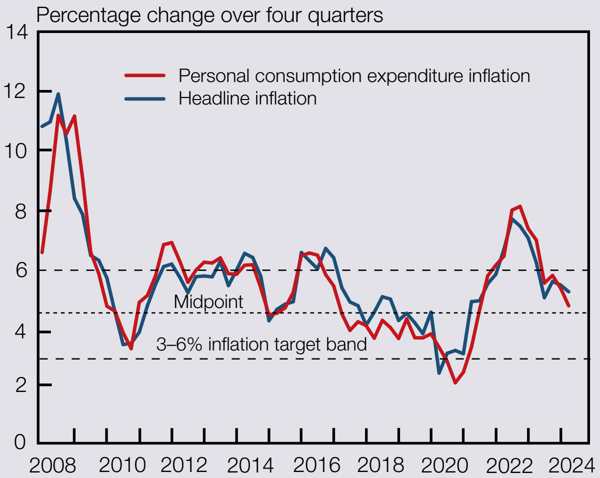
Between October 2023 and July of this year headline inflation averaged 5.4% before decreasing by a full percentage point, dropping just below the target midpoint in August. Key to understanding the effectiveness of monetary policy is getting a clear sense of the demand and supply sources of inflation. This box decomposes South Africa's personal consumption expenditure (PCE) inflation (the prices paid for goods and services consumed by households) into its demand and supply drivers following the methodology of Shapiro (2022).[1]

PCE inflation rose sharply in 2022, peaking at 8.1% in the fourth quarter of that year. The surge in inflation is generally attributed to a recovery in demand and multiple, large and often overlapping global and domestic supply shocks.[2] Since the highs of 2022, inflation showed considerable inertia, only slowly returning to the 4.5% target midpoint.

The decomposition shows that the demand-driven component of PCE inflation returned closer to pre-pandemic levels this year and is not the main reason for slower disinflation. Rather, the slower remission of supply shocks mostly explains the relative stickiness in inflation over the past year, as reflected in the still elevated supply-driven component of PCE inflation.

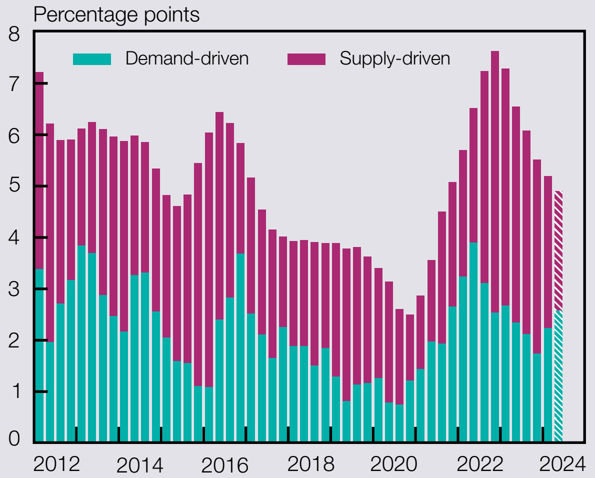
The further unwinding of supply shocks provides impetus to the near- and medium-term disinflation seen in the current forecast.

**Inflation**




Source: Stats SA

**Contributions to personal consumption expenditure inflation***




* Percentage change over four quarters (three-quarter centred moving average; latest quarter not a full average)

Sources: Stats SA and SARB

1 The personal consumption expenditure (PCE) inflation decomposition entails running reduced-form vector autoregressions (VARs) of price and quantity equations for each of the 22 PCE categories and using the residuals to classify inflation in each category as demand- or supply-driven. See A Shapiro, 'Decomposing Demand- and Supply-driven Inflation', *Federal Reserve Bank of San Francisco Working Paper Series 2022(18)*, San Francisco: Federal Reserve Bank of San Francisco, October 2022.

2 Global supply chain disruptions were exacerbated by Russia's invasion of Ukraine and further worsened by geopolitical tensions, especially in the Middle East. Domestic supply shocks included load-shedding, El Niño, animal disease outbreaks and a sharply depreciated currency.

## Box 7 Muted housing inflation but how sustainable?

Housing inflation in South Africa has trended well below its long-term average in recent years, averaging 2.7% in 2022 and 2023 and 3.1% year to date. Subdued housing inflation has helped to keep services and thus core inflation contained, easing pressures on headline inflation. Meanwhile, homeownership costs have risen strongly in recent years, reflecting the large increases in municipal rates and taxes, other costs as well as interest rates. The rental market has also tightened sharply in the wake of the pandemic.[1] These cost escalations and demand recovery do not appear to be reflected in housing inflation but suggest upside risks to this important component of consumer prices.

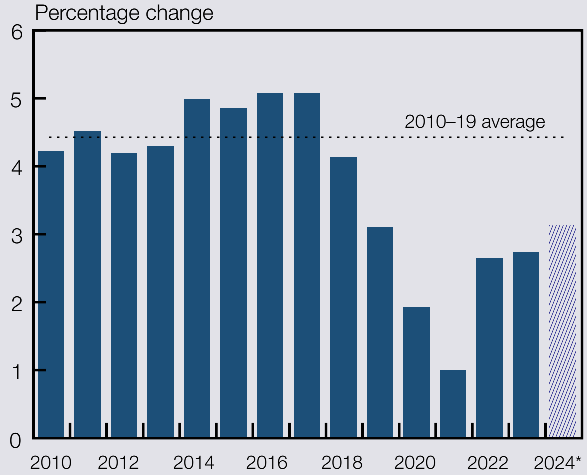
Market indicators of rental escalations, including the PayProp and TPN rental series, show rental inflation rising significantly after the pandemic. The divergence between the official and market measures of rental inflation presents upside risk of a catch-up over the medium term, considering their historically strong co-movement. Indeed, over the past three years the SARB had expected rental inflation to return to its long-term average, but it has repeatedly surprised to the downside.

One way of explaining this inconsistency between housing inflation and squeezed supply is that landlords are keeping prices low to increase occupancy rates, which may be a bigger priority at this juncture compared to cost recovery. But this raises questions about how sustainable such an approach is. How long will landlords continue to 'subsidise' tenants and take a lower return on their capital when vacancy rates are historically low and the rental market tight? Equally, with stronger economic growth over the medium term, demand for rentals should rise and vacancy rates tighten further, turning it into a lessors' market. In addition, the supply of rental housing units is unlikely to increase much over the near to medium term as activity in the residential building sector remains depressed.[2] This constellation of factors may present an opportunity for landlords to escalate rentals markedly, both to balance supply and demand and to recoup lost earnings.

Thus, despite the downside surprises to housing inflation over the past three years, risks remain tilted to the upside. Materialisation of these risks could push core inflation higher and dent the recent easing trend for headline inflation, given the large weight of housing in the consumer price index (CPI) basket.

### Housing inflation

Percentage change

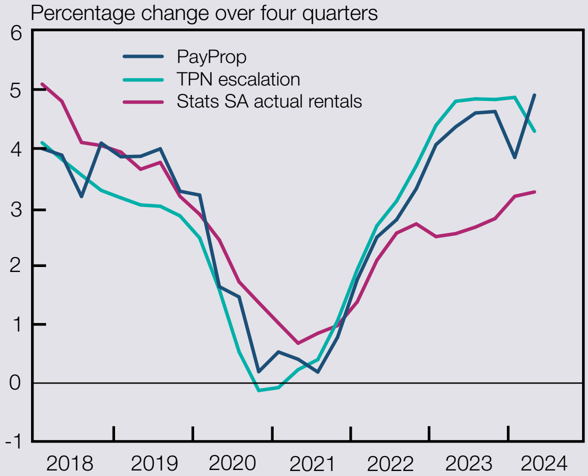



* Average from January to August

Source: Stats SA

### Rental inflation

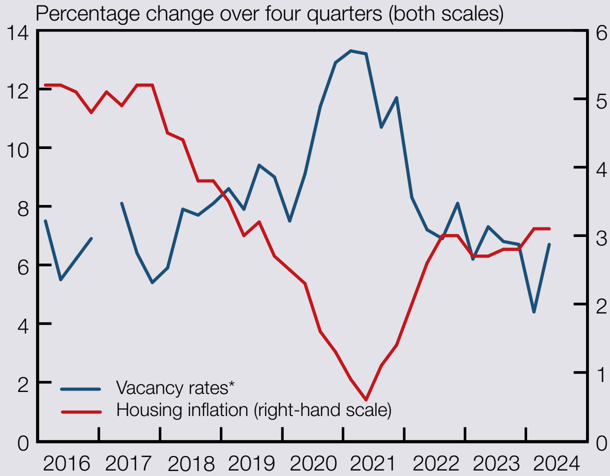
Percentage change over four quarters




Sources: PayProp, Stats SA and TPN Credit Bureau

### Vacancy rates and housing inflation

Percentage change over four quarters (both scales)




* Data for 2017Q1 not available

Sources: TPN Credit Bureau and Stats SA

1 Homeownership costs are composed of mortgage costs, cost of maintenance for the property along with property taxes, levies and insurance costs. Mortgage repayments are up 39.8% while other homeownership costs have averaged about 8.6% between November 2021 and May 2023. Rental prices increased by a modest 3.7% on average over the same period. See S Knox, M Mofokeng and W Simbanegavi, 'A confluence of factors drives mortgage impairments higher', *South African Reserve Bank Economic Note No. EN/2024/114*, Pretoria: South African Reserve Bank, August 2024.

2 Statistics South Africa (Stats SA) data show that both residential building plans passed and units completed recorded negative outcomes for 7 out of the past 10 quarters. See Stats SA, 'Selected building statistics of the private sector as reported by local government institutions', August 2024.

# Conclusion

Global inflation continues to moderate, suggestive of the final ebbing of the pandemic and the subsequent recovery. Subdued inflation momentum, along with signs of cooling labour markets, has provided greater confidence to central banks that inflation will stabilise at targets. Accordingly, major global central banks have begun normalising policy.

However, the disinflation process has not been smooth, nor is it even complete. Inflation remains above target in many countries and some central banks had to reverse their easing to deal with renewed inflationary pressures. In many places, underlying inflation – especially in services prices and wages – is proving resistant to further moderation, while some economies continue to experience robust consumption and economic growth despite elevated borrowing costs. Accordingly, the pace and quantum of rate cuts over the coming year will continue to diverge across countries and regions. What appears to be common across both advanced and emerging economies is that central banks are moving carefully, and deliberately, as they look to incoming data to guide future policy direction. Presently, data suggest relatively tight policy stances, but also that the room to manoeuvre with policy is limited.

Assuming no major new shocks to the world economy, the disinflation process should gradually progress and monetary conditions ease further. The stickiness of core inflation, however, suggests that long-run neutral interest rates are unlikely to fall back to the levels they were before the pandemic. Very high public debt levels, adverse demographics in much of the world and climate change all represent structural impediments to much lower neutral rates. Geoeconomic fragmentation, driven by political contestation, presents large additional risks to capital flows, supply chains and trade. Technological advances, propelled forward by artificial intelligence, and the need for cheaper renewable energy may offset or accentuate these pressures.[35]

With inflation risks on the global horizon, central banks and fiscal authorities will need more sustainable policy settings. Governments and central banks need to create policy space (through fiscal consolidations and stabilising inflation at targets) to be able to support stronger growth over the medium to longer term.

South Africa's inflation has softened in the past two months and the outlook has improved markedly. The rand appreciation has added impetus to the disinflation process, which had, until now, been driven by a moderately restrictive monetary policy stance, slowing global goods price increases and the subsidence of the various domestic idiosyncrasies such as load-shedding and animal diseases.

This confluence of favourable shocks has given the MPC greater confidence that inflation and inflation expectations will stabilise around the target midpoint. Indeed, the QPM's baseline forecast indicates a sustained undershoot of headline and core inflation as well as inflation expectations over the forecast period. With this backdrop, the MPC lowered the repo rate by 25 basis points in September 2024, leaving the policy stance still moderately restrictive.

Declining inflation coupled with the interest rate relief, two-pot retirement reform and improved electricity supply, should bolster sentiment and spur growth in household spending and investment. While near-term growth remains muted, the economy is projected to expand at a somewhat faster pace in the outer years of the forecast as the drag from electricity supply is lifted and other supply-side bottlenecks become less binding. This, however, is premised on further progress on structural reforms.

As the energy constraint and logistical bottlenecks become less binding, the attention shifts to other constraints that depress business sentiment and hold back investment, and thus growth. Long-term borrowing costs remain high, mostly reflecting high public debt levels. Further progress on fiscal consolidation would reduce corporate investment costs, minimise crowding-out of the private sector and create fiscal space to support public investment programmes. Other actions that can support better growth outcomes include the better alignment of administered price increases with the projected low-inflation environment, ensuring that public sector real wages rise in line with productivity and progress in the implementation of broader structural reforms, including in education, water and electricity distribution.

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35 Technological advances that raise the productivity of capital would imply higher neutral rates.

# Statement of the Monetary Policy Committee

30 May 2024

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

We had an uncertain start to 2024, but recently, developments have been somewhat more positive.

Inflation outcomes were worse than expected early in the year, leading to a repricing of rate expectations. There is still considerable uncertainty about the longer-run inflation outlook, globally. That said, inflation outcomes in the United States (US) have been more benign recently and markets still see some room for adjustments by the US Federal Reserve this year. We may also see easing by other major central banks.

Meanwhile, oil prices are back to where they were at the start of the year, close to US$80 per barrel, after briefly exceeding US$90 per barrel. Although geopolitical tensions are far from resolved, some of the more adverse economic scenarios, such as oil prices above US$100 per barrel, appear less probable now. Our own forecast suggests oil prices will remain near their current levels.

The exchange rate of the rand has been particularly volatile since the previous Monetary Policy Committee (MPC) meeting.[1] It briefly appreciated to a 10-month high against the US dollar last week. The starting point for our forecast is R18.57 against the US dollar.[2] Markets remain focused on the direction of domestic policy, a theme that has dominated many investor conversations over the past few months. Conditions remain uncertain, but we expect greater clarity in due course.

Turning to the outlook, we now see inflation stabilising at our 4.5% target objective in the second quarter of next year. This is an improvement on our March forecast, which was to only reach this milestone at the end of 2025. The changes to the outlook, however, are not large when compared to our March forecast. Average inflation for 2025 is only a 10th of a percentage point lower. The task of achieving our inflation objective is not yet done.[3]

The change in our inflation forecast mostly reflects recent data outcomes, with the CPI releases for March and April turning out slightly better than expected. We have revised down our 2024 food and core forecasts marginally.

Fuel price inflation is now expected to be higher, in the near term, but it improves for 2025. This helps our forecast to get to the target midpoint sooner.

Nonetheless, the MPC remains concerned that inflation expectations are elevated. After three years[4] of inflation being above 4.5%, few survey respondents, especially from businesses and trade unions, now believe that inflation will be at 4.5% in two years' time.

Although the MPC assesses the inflation forecast risks to be broadly balanced at present, high inflation expectations require that we deliver on our target sooner rather than later in order to re-anchor expectations.

Turning to the growth outlook, economic activity indicators for the first quarter have been coming in worse than expected, despite reduced electricity load-shedding. However, these higher-frequency data can be volatile. We expect slightly weaker first-quarter growth, but this will be offset by better second-quarter growth.[5] We still forecast GDP growth of 1.2% this year. The growth numbers for the outer years also remain unchanged.

We assess the risks to the growth outlook as balanced.

The recent improvement in the power supply, with no load-shedding since 26 March, is a welcome development. We have revised our load-shedding assumption down, but additional revisions may be required if this performance is sustained.[6]

Overall, our forecasts show a modest acceleration in growth over the next few years, alongside a gradual stabilisation of inflation at our target. However, uncertainty is unusually elevated at the moment.

1 Since the previous MPC, the rand has traded in a range of R19.32/US$ (April 19) to R18.05/US$ (May 22).

2 The rand is the third-best performing major emerging market currency for the period since the previous MPC. It is fifth for the year to date.

3 The July 2023 forecast had inflation at 4.5% by 2025Q3. September 2023 forecasted it to be reached in 2025Q2, which is the last time this was moved up. Subsequently, November 2023 had it at 4.5% by 2025Q3; January 2024 by 2025Q3; and March 2024 by 2025Q4.

4 Headline inflation was 4.4% in April 2021 and 5.2% in May 2021. Headline inflation has been above 4.5% for every subsequent print, a period of 36 months.

5 The 2024Q1 growth rate has been marked down to 0.2% from 0.4% quarter on quarter (q/q); at the same time, 2024Q2 has been marked up, from 0.4% to 0.7% q/q.

6 The number of load-shedding days has been reduced from 200 days to 180, where a day is 24 hours of load-shedding and not any calendar day with load-shedding. The projected cost to GDP from load-shedding for 2024 is down to 0.5 percentage points (pp), from 0.6pp in the March forecast, and declines to 0.2pp for 2025 and 0.04pp for 2026.

Considering this outlook, the MPC decided to keep the repo rate unchanged at 8.25%. The decision was unanimous.

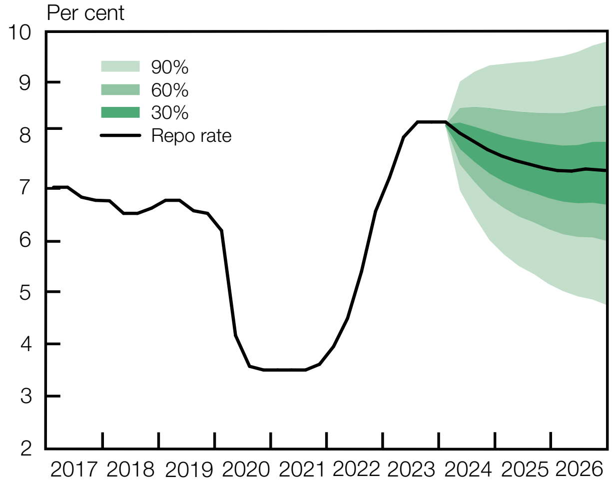
The forecast continues to see policy normalisation, with rates easing into more neutral territory by next year. As before, the rate path from the quarterly projection model (QPM) remains a broad policy guide, changing from meeting to meeting.

Decisions of the MPC will continue to be data dependent and sensitive to the balance of risks to the outlook.

We are committed to stabilising inflation at the midpoint of the target band. Achieving this outcome will improve the economic outlook and reduce borrowing costs.

Finally, we reiterate the views of the Committee on additional measures that would improve economic conditions. These include reaching a prudent public debt level, improving the functioning of network industries, lowering administered price inflation and keeping real wage growth in line with productivity gains.

**Repurchase rate forecast (May 2024)***




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

Source: SARB

# Summary of assumptions: Monetary Policy Committee meeting on 30 May 2024*

## 1. Foreign sector assumptions

| | Actual | | | Forecast | | |
|---|---|---|---|---|---|---|
| | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 |
| 1. Real GDP growth in South Africa's major trading-partner countries | 7.4% | 3.8% | 2.9% | 2.7% | 3.0% | 3.1% |
| | (7.3%) | (3.8%) | (2.9%) | (2.6%) | (3.0%) | (3.1%) |
| 2. Output gap in South Africa's major trading-partner countries (ratio to potential GDP) | -1.0% | 0.1% | 0.2% | -0.1% | -0.1% | 0.0% |
| | (-0.9%) | (0.1%) | (0.1%) | (-0.1%) | (-0.1%) | (0.1%) |
| 3. Change in international commodity prices in US$ (excluding oil) | 46.0% | -0.9% | -27.3% | -10.4% | -4.6% | -1.4% |
| | (46.0%) | (-0.9%) | (-27.3%) | (-10.7%) | (-4.7%) | (-1.5%) |
| 4. Brent crude (US$/barrel) | 70.7 | 100.4 | 82.6 | 84.0 | 81.0 | 80.0 |
| | (70.7) | (100.4) | (82.6) | (82.0) | (81.0) | (80.0) |
| 5. Change in world food prices (US$) | 28.1% | 15.0% | -13.8% | -3.1% | 3.5% | 1.5% |
| | (28.1%) | (14.2%) | (-13.7%) | (-1.3%) | (3.1%) | (1.5%) |
| 6. Change in international consumer prices | 3.3% | 7.4% | 4.5% | 2.6% | 2.1% | 2.0% |
| | (3.3%) | (7.4%) | (4.5%) | (2.5%) | (2.1%) | (2.0%) |
| 7. International policy interest rate | 0.1% | 1.1% | 3.9% | 4.3% | 3.4% | 2.2% |
| | (0.1%) | (1.1%) | (3.9%) | (4.3%) | (3.4%) | (2.2%) |

## 2. Domestic sector assumptions

| | Actual | | | Forecast | | |
|---|---|---|---|---|---|---|
| | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 |
| 1. Change in fuel taxes and levies | 6.1% | 2.9% | 3.1% | 5.8% | 3.7% | 4.0% |
| | (6.1%) | (2.9%) | (3.1%) | (5.4%) | (3.8%) | (4.0%) |
| 2. Potential growth | 3.2% | 0.5% | 0.1% | 1.1% | 1.2% | 1.6% |
| | (3.2%) | (0.5%) | (0.1%) | (1.0%) | (1.2%) | (1.6%) |
| 3. 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%) |
| 4. GWh load-shed | | 11 724 | 24 693 | 11 472 | 5 904 | 2 352 |
| | | (11 724) | (24 693) | (12 840) | (5 904) | (2 352) |
| 5. Load-shedding GDP impact (%, points) | | -0.7 | -1.5 | -0.5 | -0.2 | -0.04 |
| | | (-0.7) | (-1.5) | (-0.6) | (-0.2) | (-0.04) |

Notes

a. Shaded areas indicate forecast assumptions.
b. 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 51 and 52 respectively.

# Summary of selected forecast results: Monetary Policy Committee meeting on 30 May 2024

## Selected forecast results (quarterly)

Year-on-year percentage change

| | 2023 | | | | 2024 | | | | 2025 | | | | 2026 | | | | Steady state |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 6.0 (6.0) | | | | 5.1 (5.1) | | | | 4.5 (4.6) | | | | 4.5 (4.5) | | | | |
| 1. Headline inflation | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | |
| | 7.0 | 6.2 | 5.0 | 5.5 | 5.3 | 5.1 | 5.2 | 4.7 | 4.6 | 4.5 | 4.5 | 4.5 | 4.6 | 4.5 | 4.5 | 4.5 | 4.5 |
| | (7.0) | (6.2) | (5.0) | (5.5) | (5.4) | (5.1) | (5.3) | (4.7) | (4.7) | (4.7) | (4.6) | (4.5) | (4.5) | (4.5) | (4.5) | (4.5) | |
| | 2023 | | | | 2024 | | | | 2025 | | | | 2026 | | | | |
| | 4.8 (4.8) | | | | 4.7 (4.8) | | | | 4.6 (4.6) | | | | 4.5 (4.5) | | | | |
| 2. Core inflation | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | |
| | 5.1 | 5.2 | 4.7 | 4.5 | 4.8 | 4.5 | 4.7 | 4.9 | 4.7 | 4.6 | 4.6 | 4.5 | 4.5 | 4.5 | 4.5 | 4.5 | 4.5 |
| | (5.1) | (5.2) | (4.7) | (4.5) | (4.8) | (4.7) | (4.9) | (4.9) | (4.8) | (4.6) | (4.6) | (4.5) | (4.5) | (4.5) | (4.5) | (4.5) | |
| | 2023 | | | | 2024 | | | | 2025 | | | | 2026 | | | | |
| | 10.7 (10.7) | | | | 5.1 (5.5) | | | | 4.3 (4.3) | | | | 4.5 (4.5) | | | | |
| 3. Food CPI | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | |
| | 13.6 | 12.2 | 8.6 | 8.7 | 6.1 | 4.8 | 5.1 | 4.4 | 4.1 | 4.3 | 4.3 | 4.4 | 4.6 | 4.4 | 4.5 | 4.5 | 4.5 |
| | (13.6) | (12.2) | (8.6) | (8.7) | (6.2) | (5.3) | (5.6) | (4.8) | (4.5) | (4.3) | (4.2) | (4.3) | (4.5) | (4.4) | (4.5) | (4.5) | |
| | 2023 | | | | 2024 | | | | 2025 | | | | 2026 | | | | |
| | 0.6 (0.6) | | | | 3.9 (1.4) | | | | 0.3 (0.7) | | | | 1.4 (1.2) | | | | |
| 4. Fuel CPI | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | |
| | 10.6 | -0.2 | -9.3 | 3.4 | 5.0 | 8.6 | 6.3 | -3.5 | 0.6 | -0.7 | 0.4 | 0.9 | 1.4 | 1.1 | 1.5 | 1.6 | 4.5 |
| | (10.6) | (-0.2) | (-9.3) | (3.4) | (4.8) | (3.7) | (3.2) | (-5.5) | (-0.8) | (1.3) | (1.1) | (1.1) | (1.0) | (1.0) | (1.3) | (1.5) | |
| | 2023 | | | | 2024 | | | | 2025 | | | | 2026 | | | | |
| | 11.7 (11.7) | | | | 13.0 (13.5) | | | | 10.5 (10.9) | | | | 8.9 (8.9) | | | | |
| 5. Electricity CPI | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | |
| | 7.9 | 7.9 | 15.2 | 15.3 | 15.3 | 15.3 | 11.0 | 11.0 | 11.0 | 11.0 | 10.0 | 10.0 | 10.0 | 10.0 | 8.0 | 8.0 | 4.5 |
| | (7.9) | (7.9) | (15.2) | (15.3) | (15.3) | (15.3) | (12.0) | (12.0) | (12.0) | (12.0) | (10.0) | (10.0) | (10.0) | (10.0) | (8.0) | (8.0) | |

Notes

a. Shaded areas indicate the forecasts of the Monetary Policy Committee (MPC).
b. The figures in brackets represent the previous forecasts of the MPC.

## Selected forecast results (annual)

| | Actual | | | Forecast | | | Steady state |
|---|---|---|---|---|---|---|---|
| | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | |
| 1. GDP growth | 4.7% | 1.9% | 0.6% | 1.2% | 1.4% | 1.6% | 2.5% |
| | (4.7%) | (1.9%) | (0.6%) | (1.2%) | (1.4%) | (1.6%) | |
| 2. Output gap (ratio to potential GDP) | -1.9% | -0.5% | -0.1% | -0.1% | 0.1% | 0.0% | 0.0% |
| | (-1.9%) | (-0.5%) | (-0.1%) | (0.0%) | (0.1%) | (0.0%) | |
| 3. Change in nominal effective exchange rate | 9.9% | -2.4% | -11.4% | -0.4% | 0.3% | 0.4% | 2.5% |
| | (9.9%) | (-2.4%) | (-11.5%) | (-1.6%) | (0.7%) | (0.9%) | |
| 4. Change in real effective exchange rate | 11.2% | -3.0% | -10.3% | 2.0% | 2.6% | 3.0% | 0.0% |
| | (11.2%) | (-3.0%) | (-10.3%) | (0.9%) | (3.2%) | (3.4%) | |
| 5. Real exchange rate gap | 5.4% | 2.9% | -7.0% | -5.0% | -2.4% | 0.5% | 0.0% |
| | (5.4%) | (2.9%) | (-7.0%) | (-6.0%) | (-2.9%) | (0.4%) | |
| 6. Unit labour cost | | 2.6% | 4.9% | 4.5% | 4.6% | 4.3% | 4.5% |
| | | (2.6%) | (4.9%) | (3.8%) | (4.5%) | (4.3%) | |
| 7. Repurchase rate (end of period, i.e. fourth quarter ) | 3.61% | 6.54% | 8.25% | 7.64% | 7.34% | 7.33% | 7.00% |
| | (3.61%) | (6.54%) | (8.25%) | (7.72%) | (7.37%) | (7.33%) | |
| 8. Neutral real interest rate | 2.2% | 2.3% | 2.5% | 2.6% | 2.7% | 2.8% | 2.50% |
| | (2.1%) | (2.3%) | (2.5%) | (2.6%) | (2.7%) | (2.8%) | |
| 9. Current account balance (ratio to GDP) | 3.7% | -0.5% | -1.6% | -1.9% | -2.7% | -3.1% | |
| | (3.7%) | (-0.5%) | (-1.6%) | (-2.1%) | (-2.7%) | (-3.3%) | |

Notes

a. The nominal effective exchange rate (NEER) is based on the bilateral exchange rates of South Africa's three largest trading partners (the eurozone, US and Japan). The bilateral exchange rates are weighted by export trade weights. The implied starting point for the rand forecast is R18.57 to the US dollar.

b. The nominal exchange rate steady state is estimated using the Purchasing Power Parity (PPP) condition, which links the depreciation of the nominal exchange rate to the inflation differential between South Africa and abroad. Given that the real effective exchange rate (REER) depreciation is zero at steady state, the nominal exchange rate will therefore depreciate by 2.5% per year in steady state, reflecting the inflation (target) differential between domestic (4.5%) and foreign (2.0%) inflation.

c. The REER is the NEER deflated by the consumer price differential between South Africa and the trade-weighted CPI of the eurozone, US and Japan.

d. 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.

e. The unit labour cost (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.

f. The repo rate at the end of the period refers to the average for the last quarter of the year. The nominal repo rate steady state is calculated as the sum of South Africa's inflation target (4.5%) and the steady-state neutral real interest rate (NRIR) (2.5%).

g. The NRIR is the policy rate *minus* inflation, which prevails when the economy is fully in balance, with inflation at target and output at potential. The policy stance is measured as either tight or loose based on whether actual rates are above or below this neutral rate respectively. The steady-state NRIR is calculated as the sum of the respective steady states for the Group of Three (G3) NRIR (0.5%), South Africa's risk premium (2.0%) and the change in the REER (0.0%). Before the steady state is reached, it is possible for the REER equilibrium to appreciate or depreciate, so this value can have a non-zero value over the medium term. It is nonetheless always zero in the long run.

h. The steady state is the long-run value in the model. While model equilibriums can have different values over the medium term, as conditions change, all equilibriums eventually reach a steady state, where they stabilise.

i. The forecast of the current account balance is obtained from the SARB's Core Macroeconometric Model.

j. Shaded areas indicate the forecasts of the Monetary Policy Committee (MPC).

k. The figures in brackets represent the previous forecasts of the MPC.

# Statement of the Monetary Policy Committee

18 July 2024

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

As we move into the second half of the year, global inflation continues to ease. The very rapid price increases of 2022 and 2023 have receded. However, inflation in most economies has yet to stabilise in line with targets. For example, in June, consumer price inflation was 3% in the United States (US), and 2.5% in the euro area, still above those economies' 2% targets. Services and wage price inflation has proven stubborn, underpinned by resilient economic activity and low unemployment rates across major economies.

Clearly, the battle against inflation is not yet won and for this reason global interest rates remain elevated.

At the same time, there has been some policy divergence, which reflects different country circumstances.

Since our last meeting, policy rates were lowered in Canada, Switzerland and the euro area, but kept unchanged in the US, United Kingdom (UK) and Japan. Among emerging markets, countries that have lowered inflation more, especially in Latin America, have been able to cut policy rates more. A concern for central banks, however, is that lower inflation outcomes have not always been sustained.[1]

Turning to South Africa, economic performance in the first half of the year was disappointing. The economy contracted slightly in the first quarter, by 0.1%, and recent data, including last week's mining and manufacturing numbers, have caused us to trim our second quarter growth estimate modestly, to 0.6%.[2] Over the medium term, we expect somewhat faster growth, supported by a more reliable electricity supply and improving logistics, among other factors.[3] Our revised growth projections nonetheless remain below longer-run historical averages, of about 2%. The risks to this forecast are assessed as broadly balanced, with ample scope for structural reforms to lift growth further over the medium term.

On the inflation front, the most recent headline print, for May, was 5.2%, unchanged from April and still in the top half of our target range. The outlook, however, has improved somewhat. Headline consumer price inflation for this year is now projected at 4.9%, compared to 5.1% at the previous meeting.[4] Over the next few quarters, headline inflation is expected to dip below the 4.5% midpoint, mainly because of fuel and food prices. This outlook is supported by the stronger rand. The implied starting point for our forecast is R18.35 to the US dollar.[5] Over the medium term, we continue to see inflation stabilising at 4.5%, with core inflation remaining close to this midpoint objective throughout.[6]

For inflation expectations, the latest survey results show average expectations at 5% next year and 4.9% two years ahead, still uncomfortably above the SARB's 4.5% objective and above our own inflation forecasts. However, all categories of respondents lowered their inflation expectations from the previous survey.[7] We anticipate further progress as inflation slows, helping to re-anchor expectations firmly at 4.5%.[8]

While the forecast has improved, the balance of risks is assessed to the upside.

Against this backdrop, the Monetary Policy Committee (MPC) decided to keep the repo rate unchanged at 8.25%. Four members preferred an unchanged stance and two preferred a reduction of 25 basis points.

In discussing the stance, MPC members agreed that restrictive policy remains appropriate to stabilise inflation at 4.5%. The Committee assessed that an unchanged stance remained appropriate, given the inflation risks. Some members, however, were of the view that the inflation outlook had improved enough to reduce the degree of restrictiveness.

1 For example, between April and May, euro area inflation rose to 2.6% from 2.5%. In Brazil, inflation increased to 4.2% in June from 3.9% in May.

2 The previous projection was for growth of 0.7%.

3 The GDP impact of load-shedding in 2024 has been reduced to -0.2 percentage points (pp), from an estimated -0.5pp in the May forecast. It is -0.1pp for 2025 (compared with -0.2pp previously), and 0pp for 2026 (-0.04pp previously). This contrasts with an estimated -1.5pp for 2023.

4 Headline inflation is expected to average 4.8% in 2024Q3 and 4.3% in 2024Q4.

5 The implied starting point was R18.60 in the May forecast.

6 Core inflation averages 4.6% for 2024, 4.4% for 2025 and 4.5% for 2026.

7 Market-based measures of inflation expectations have similar dynamics. These break-even rates have declined recently, but remain generally above the midpoint. Shorter-term expectations (5 years) are at 4.6%; longer-term (10 year) expectations are at 5.7%.

8 The quarterly projection model's (QPM) forecast for two-years-ahead inflation expectations stabilises at 4.5% by 2025Q1.

Global interest rates remain high, especially in the US, and rates may stay higher for even longer than markets currently anticipate. This presents risks to the currency outlook.

Domestically, inflation expectations do not yet reflect the 4.5% midpoint objective over the medium term. While expectations are moving in the right direction, they continue to show the impact of the recent inflation surge.

We remain concerned about administered prices. We have had to mark up electricity inflation for this forecast round even as other categories shifted lower.

Services price inflation also remains uncomfortably above the midpoint.

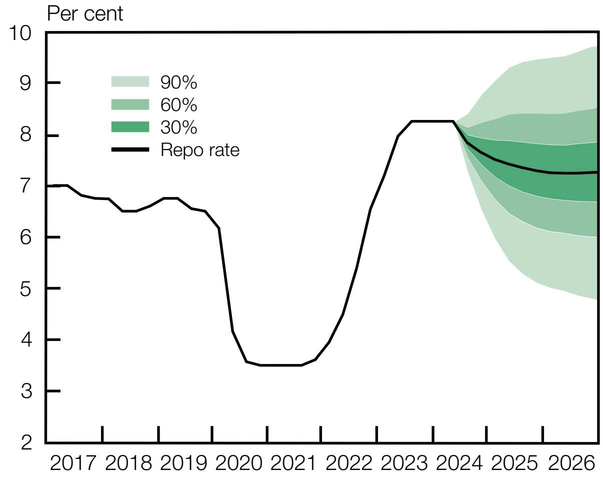
The forecast continues to see rates easing into more neutral territory by next year. As before, the rate path from the quarterly projection model (QPM) remains a broad policy guide, changing from meeting to meeting.

Decisions of the MPC will continue to be data dependent and sensitive to the balance of risks to the outlook.

We are committed to stabilising inflation at the midpoint of the target band. Achieving this outcome will improve the economic outlook and reduce borrowing costs.

Finally, we reiterate the views of the Committee on additional measures that would improve economic conditions. These include reaching a prudent public debt level, improving the functioning of network industries, lowering administered price inflation and keeping real wage growth in line with productivity gains.

Repurchase rate forecast (July 2024)*




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

Source: SARB

# Summary of assumptions: Monetary Policy Committee meeting on 18 July 2024*

## 1. Foreign sector assumptions

| | Actual | | | Forecast | | |
|---|---|---|---|---|---|---|
| | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 |
| 1. Real GDP growth in South Africa's major trading-partner countries | 7.4% | 3.7% | 3.0% | 2.7% | 3.0% | 3.1% |
| | (7.3%) | (3.8%) | (2.9%) | (2.7%) | (3.0%) | (3.1%) |
| 2. Output gap in South Africa's major trading-partner countries (ratio to potential GDP) | -1.0% | 0.1% | 0.2% | -0.1% | -0.1% | 0.0% |
| | (-0.9%) | (0.1%) | (0.2%) | (-0.1%) | (-0.1%) | (0.0%) |
| 3. Change in international commodity prices in US$ (excluding oil) | 46.0% | -0.9% | -27.3% | -6.5% | -4.5% | -1.7% |
| | (46.0%) | (-0.9%) | (-27.3%) | (-10.4%) | (-4.6%) | (-1.4%) |
| 4. Brent crude (US$/barrel) | 70.7 | 100.4 | 82.6 | 84.0 | 81.0 | 80.0 |
| | (70.7) | (100.4) | (82.6) | (84.0) | (81.0) | (80.0) |
| 5. Change in world food prices (US$) | 28.1% | 15.0% | -13.8% | -2.8% | 3.5% | 1.5% |
| | (28.1%) | (15.0%) | (-13.8%) | (-3.1%) | (3.5%) | (1.5%) |
| 6. Change in international consumer prices | 3.3% | 7.4% | 4.5% | 2.6% | 2.1% | 2.0% |
| | (3.3%) | (7.4%) | (4.5%) | (2.6%) | (2.1%) | (2.0%) |
| 7. International policy interest rate | 0.1% | 1.1% | 3.9% | 4.2% | 3.3% | 2.2% |
| | (0.1%) | (1.1%) | (3.9%) | (4.3%) | (3.4%) | (2.2%) |

## 2. Domestic sector assumptions

| | Actual | | | Forecast | | |
|---|---|---|---|---|---|---|
| | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 |
| 1. Change in fuel taxes, levies and margins | 6.1% | 2.9% | 3.1% | 5.1% | 3.3% | 4.0% |
| | (6.1%) | (2.9%) | (3.1%) | (5.8%) | (3.7%) | (4.0%) |
| 2. Potential growth | 3.2% | 0.6% | 0.2% | 1.2% | 1.3% | 1.7% |
| | (3.2%) | (0.5%) | (0.1%) | (1.1%) | (1.2%) | (1.6%) |
| 3. 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%) |
| 4. GWh load-shed | | 11 724 | 24 693 | 5 832 | 2 832 | 600 |
| | | (11 724) | (24 693) | (11 472) | (5 904) | (2 352) |
| 5. Load-shedding GDP impact (%, points) | | -0.7 | -1.5 | -0.2 | -0.1 | 0.0 |
| | | (-0.7) | (-1.5) | (-0.5) | (-0.2) | (-0.04) |

Notes

a. Shaded areas indicate forecast assumptions.
b. 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 51 and 52 respectively.

# Summary of selected forecast results: Monetary Policy Committee meeting on 18 July 2024

## Selected forecast results (quarterly)

Year-on-year percentage change

| | 2023 | | | | 2024 | | | | 2025 | | | | 2026 | | | | Steady state |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1. Headline inflation | 6.0 (6.0) | | | | 4.9 (5.1) | | | | 4.4 (4.5) | | | | 4.5 (4.5) | | | | |
| | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | |
| | 7.0 | 6.2 | 5.0 | 5.5 | 5.4 | 5.1 | 4.8 | 4.3 | 4.2 | 4.2 | 4.5 | 4.5 | 4.6 | 4.5 | 4.5 | 4.5 | 4.5 |
| | (7.0) | (6.2) | (5.0) | (5.5) | (5.4) | (5.1) | (5.2) | (4.7) | (4.6) | (4.5) | (4.5) | (4.5) | (4.6) | (4.5) | (4.5) | (4.5) | |
| 2. Core inflation | 2023 | | | | 2024 | | | | 2025 | | | | 2026 | | | | |
| | 4.8 (4.8) | | | | 4.6 (4.7) | | | | 4.4 (4.6) | | | | 4.5 (4.5) | | | | |
| | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | |
| | 5.1 | 5.2 | 4.7 | 4.5 | 4.8 | 4.6 | 4.6 | 4.6 | 4.4 | 4.4 | 4.5 | 4.4 | 4.5 | 4.5 | 4.5 | 4.5 | 4.5 |
| | (5.1) | (5.2) | (4.7) | (4.5) | (4.8) | (4.5) | (4.7) | (4.9) | (4.7) | (4.6) | (4.6) | (4.5) | (4.5) | (4.5) | (4.5) | (4.5) | |
| 3. Food CPI | 2023 | | | | 2024 | | | | 2025 | | | | 2026 | | | | |
| | 10.7 (10.7) | | | | 4.9 (5.1) | | | | 4.2 (4.3) | | | | 4.5 (4.5) | | | | |
| | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | |
| | 13.6 | 12.2 | 8.6 | 8.7 | 6.1 | 4.6 | 4.8 | 4.1 | 3.8 | 4.2 | 4.2 | 4.5 | 4.7 | 4.5 | 4.6 | 4.5 | 4.5 |
| | (13.6) | (12.2) | (8.6) | (8.7) | (6.1) | (4.8) | (5.1) | (4.4) | (4.1) | (4.3) | (4.3) | (4.4) | (4.6) | (4.4) | (4.5) | (4.5) | |
| 4. Fuel CPI | 2023 | | | | 2024 | | | | 2025 | | | | 2026 | | | | |
| | 0.6 (0.6) | | | | 2.4 (3.9) | | | | -0.1 (0.3) | | | | 1.5 (1.4) | | | | |
| | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | |
| | 10.6 | -0.2 | -9.3 | 3.4 | 5.0 | 8.6 | 1.9 | -5.2 | -1.4 | -2.8 | 2.6 | 1.1 | 1.4 | 1.2 | 1.6 | 1.7 | 4.5 |
| | (10.6) | (-0.2) | (-9.3) | (3.4) | (5.0) | (8.6) | (6.3) | (-3.5) | (0.6) | (-0.7) | (0.4) | (0.9) | (1.4) | (1.1) | (1.5) | (1.6) | |
| 5. Electricity CPI | 2023 | | | | 2024 | | | | 2025 | | | | 2026 | | | | |
| | 11.7 (11.7) | | | | 13.5 (13.0) | | | | 10.9 (10.5) | | | | 9.0 (9.0) | | | | |
| | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | |
| | 7.9 | 7.9 | 15.2 | 15.3 | 15.3 | 15.3 | 12.0 | 12.0 | 12.0 | 12.0 | 10.0 | 10.0 | 10.0 | 10.0 | 8.0 | 8.0 | 4.5 |
| | (7.9) | (7.9) | (15.2) | (15.3) | (15.3) | (15.3) | (11.0) | (11.0) | (11.0) | (11.0) | (10.0) | (10.0) | (10.0) | (10.0) | (8.0) | (8.0) | |

Notes

a. Shaded areas indicate the forecasts of the Monetary Policy Committee (MPC).
b. The figures in brackets represent the previous forecasts of the MPC.

## Selected forecast results (annual)

| | Actual | | | Forecast | | | Steady state |
|---|---|---|---|---|---|---|---|
| | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | |
| 1. GDP growth | 4.7% | 1.9% | 0.7% | 1.1% | 1.5% | 1.7% | 2.5% |
| | (4.7%) | (1.9%) | (0.6%) | (1.2%) | (1.4%) | (1.6%) | |
| 2. Output gap (ratio to potential GDP) | -1.9% | -0.8% | -0.2% | -0.3% | 0.0% | 0.0% | 0.0% |
| | (-1.9%) | (-0.5%) | (-0.1%) | (-0.1%) | (0.1%) | (0.0%) | |
| 3. Change in nominal effective exchange rate | 9.9% | -2.4% | -11.4% | 0.4% | 0.7% | 0.3% | 2.5% |
| | (9.9%) | (-2.4%) | (-11.4%) | (-0.4%) | (0.3%) | (0.4%) | |
| 4. Change in real effective exchange rate | 11.2% | -3.0% | -10.3% | 2.6% | 2.9% | 2.8% | 0.0% |
| | (11.2%) | (-3.0%) | (-10.3%) | (2.0%) | (2.6%) | (3.0%) | |
| 5. Real exchange rate gap | 5.4% | 2.9% | -7.0% | -4.6% | -2.6% | -0.6% | 0.0% |
| | (5.4%) | (2.9%) | (-7.0%) | (-5.0%) | (-2.4%) | (0.5%) | |
| 6. Unit labour cost | | 3.3% | 4.8% | 4.6% | 4.3% | 4.3% | 4.5% |
| | | (2.6%) | (4.9%) | (4.5%) | (4.6%) | (4.3%) | |
| 7. Repurchase rate (end of period, i.e. fourth quarter) | 3.61% | 6.54% | 8.25% | 7.65% | 7.29% | 7.25% | 7.00% |
| | (3.61%) | (6.54%) | (8.25%) | (7.64%) | (7.34%) | (7.33%) | |
| 8. Neutral real interest rate | 2.2% | 2.32% | 2.55% | 2.65% | 2.72% | 2.79% | 2.50% |
| | (2.1%) | (2.32%) | (2.54%) | (2.64%) | (2.72%) | (2.79%) | |
| 9. Current account balance (ratio to GDP) | 3.7% | -0.5% | -1.6% | -1.7% | -2.5% | -3.0% | |
| | (3.7%) | (-0.5%) | (-1.6%) | (-1.9%) | (-2.7%) | (-3.1%) | |

Notes

a. The nominal effective exchange rate (NEER) is based on the bilateral exchange rates of South Africa's three largest trading partners (the eurozone, US and Japan). The bilateral exchange rates are weighted by export trade weights. The implied starting point for the rand forecast is R18.35 to the US dollar.

b. The nominal exchange rate steady state is estimated using the Purchasing Power Parity (PPP) condition, which links the depreciation of the nominal exchange rate to the inflation differential between South Africa and abroad. Given that the real effective exchange rate (REER) depreciation is zero at steady state, the nominal exchange rate will therefore depreciate by 2.5% per year in steady state, reflecting the inflation (target) differential between domestic (4.5%) and foreign (2.0%) inflation.

c. The REER is the NEER deflated by the consumer price differential between South Africa and the trade-weighted CPI of the eurozone, US and Japan.

d. 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.

e. The unit labour cost (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.

f. The repo rate at the end of the period refers to the average for the last quarter of the year. The nominal repo rate steady state is calculated as the sum of South Africa's inflation target (4.5%) and the steady-state neutral real interest rate (NRIR) (2.5%).

g. The NRIR is the policy rate, minus inflation, which prevails when the economy is fully in balance, with inflation at target and output at potential. The policy stance is measured as either tight or loose based on whether actual rates are above or below this neutral rate respectively. The steady-state NRIR is calculated as the sum of the respective steady states for the Group of Three (G3) NRIR (0.5%), South Africa's risk premium (2.0%) and the change in the REER (0.0%). Before the steady state is reached it is possible for the REER equilibrium to appreciate or depreciate, so this value can have a non-zero value over the medium term. It is nonetheless always zero in the long run.

h. The steady state is the long run value in the model. While model equilibriums can have different values over the medium term, as conditions change, all equilibriums eventually reach a steady state, where they stabilise.

i. The forecast of the current account balance is obtained from the SARB's Core Macroeconometric Model.

j. Shaded areas indicate the forecasts of the Monetary Policy Committee (MPC).

k. The figures in brackets represent the previous forecasts of the MPC.

# Statement of the Monetary Policy Committee

19 September 2024

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

As we move towards the end of the year, global inflation is slowing and nearing targets.[1] Given these gains, major central banks have lowered rates. We saw the European Central Bank cut again last week, the Bank of England eased in August and the United States (US) Federal Reserve reduced rates last night. The US dollar has also cooled off in recent months, providing some respite for other currencies, including the rand.

Despite these welcome developments, central banks are moving carefully and policy stances remain relatively tight. Economic activity in major economies has been resilient, even as inflation eases. Underlying measures of inflation have also fallen less than headline, primarily because of elevated housing inflation and robust wage growth.

The case for caution is further bolstered by the difficult and unpredictable geopolitical environment, with risks of inflationary shocks through trade restrictions and supply chain disruptions, among other factors.

Overall, global conditions have become more favourable, but there are still risks. A 'soft landing' is looking more likely after the worst inflation surge in a generation, but it is not inevitable. The financial market volatility of early August was a reminder of the fragilities and uncertainties in the system.

For these reasons, central banks are approaching the endgame with caution.

Turning to South Africa, output was marginally below our expectations for the first half of the year.[2] We expect improvements in the second half, with growth of 0.6% in both quarters.[3] This reflects rising confidence, in part due to a stable electricity supply. We also expect extra spending given the withdrawals from the new two-pot retirement system, although some of these funds will be absorbed by debt repayments and tax.

For the medium term, our growth projections have once again edged higher. The upgraded forecast is premised on better-functioning network industries, especially electricity, alongside broader reform momentum.[4] Since potential growth is higher in the forecast, supply and demand remain broadly balanced, even as growth accelerates. The pace of growth nonetheless remains below longer-run averages of around 2%.

A particular concern is investment, which has been contracting for four consecutive quarters. A stronger investment performance is a prerequisite for sustained higher growth and, although we continue to expect an investment recovery, its scale and speed will be a key indicator of South Africa's longer-run economic prospects.

The risks to the growth outlook are assessed as balanced.

Moving to inflation, headline eased to 4.4% in August, a three-year low, and close to the middle of our target range. Our forecast suggests this progress will be sustained, with inflation contained below the 4.5% midpoint of our range through to the end of the forecast horizon, in 2026.

In the near term, we continue to see a dip in headline inflation, supported by the stronger exchange rate and lower oil prices. The implied starting point of the rand is R18.04 to the US dollar, an appreciation of nearly 2% relative to our July assumption.[5] This contributes to fuel price deflation, which helps keep headline inflation below 4% through the first half of next year. As usual, we will look through this near-term supply shock, focusing on the medium-term outlook.

Lower headline inflation also reflects a better food price outlook, with inflation for this category below the midpoint through 2025 and 2026. However, these benefits are partly offset by higher electricity prices, with an expected inflation rate more than double that of headline.

For core inflation, we expect the trajectory to be slightly below 4.5% over the medium term. Again, this is primarily due to the exchange rate, which affects core mainly through import prices.

Services inflation, meanwhile, is expected to stabilise near the midpoint early next year, after a stretch of prints above 4.5%. This partly reflects subdued housing inflation, which has accelerated less than expected this year.[6] Lower inflation expectations also contribute to the improved services outlook.

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1 For instance, headline inflation for August was 2.2%, in both the euro area and United Kingdom (UK), and 2.5% for the US, all against targets of 2%.

2 The July forecast anticipated growth of 0.6% in 2024Q2, versus an outcome of 0.4%. However, first-quarter growth was revised up to 0% from -0.1%, so the level of GDP was only 0.1% below our expectations in 2024Q2.

3 This refers to the quarter-on-quarter, seasonally adjusted measure. The year-on-year rates are 1.4% and 1.7% for 2024Q3 and 2024Q4 respectively.

4 The estimated GDP impact of load-shedding has been cut back to -0.13 percentage points (pp) for 2024 and 0pp for 2025 and 2026. This contrasts with -0.18pp, -0.05pp and 0pp for those years respectively as of the July Monetary Policy Committee (MPC) meeting. The estimated 2023 impact is -1.5pp.

5 The starting point for the July forecast was R18.35 per US dollar.

6 Housing inflation slowed unexpectedly, from 3.3% to 2.9%, in the June CPI. This item is surveyed quarterly.

According to the latest survey, these expectations are still in the top half of the target range, at 4.8% for both 2025 and 2026.[7] They are nonetheless moving – slowly – in the right direction.[8] As long as headline inflation stabilises at lower levels, we anticipate further progress in re-anchoring expectations around the middle of our target range.[9]

The risks to inflation are assessed as balanced.

Against this backdrop, the MPC decided to reduce the policy rate by 25 basis points to 8% per annum, with effect from 20 September.

In discussing the stance, MPC members considered an unchanged stance, a 25 basis point cut and a 50 basis point cut. The MPC ultimately reached consensus on 25 basis points, agreeing that a less restrictive stance was consistent with sustainably lower inflation over the medium term.

The forecast sees rates moving towards neutral next year, stabilising slightly above 7%. As before, the rate path from the quarterly projection model remains a broad policy guide, changing from meeting to meeting. Decisions of the MPC will continue to be data dependent and sensitive to the balance of risks to the outlook.

There are scenarios where inflation could undershoot the baseline forecast, if oil prices are lower or the exchange rate appreciates further. Conversely, inflation could be higher than our baseline forecast given scenarios such as higher housing costs, larger electricity price increases, or wage increases that outrun inflation and productivity growth. Meanwhile, food inflation is a source of uncertainty, despite recent improvements.

Global conditions pose additional challenges. Geopolitical risks are heightened and could generate further economic shocks. Policy uncertainty is also elevated in various parts of the world. Both trade restrictions and debt levels are rising and might go much higher. This mix could add significant inflationary pressure to the world economy, generating tighter financial conditions for South Africa and other countries.

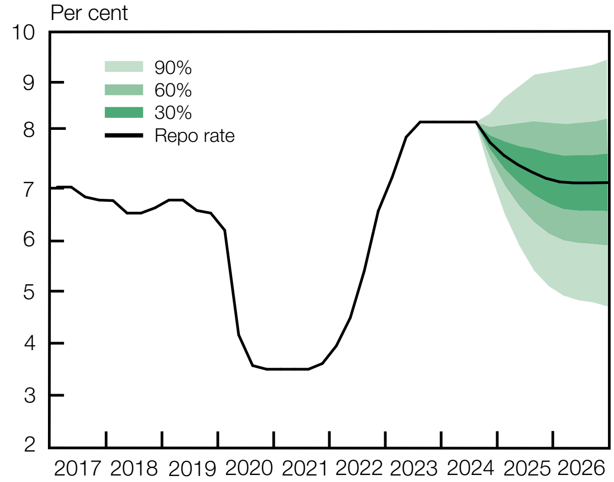
For the time being, South African assets have performed relatively well. The rand has strengthened during the year, more than most peer currencies, while long-term yields have moderated and spreads over US rates have narrowed.[10] These moves have reversed some of the deterioration experienced since 2020.

Given a potentially adverse external environment, however, it is crucial to sustain domestic reform momentum. This entails both structural reforms to support growth capacity and macroeconomic efforts to rebuild fiscal and monetary buffers.

The MPC's main contribution is to deliver low and stable inflation, with well-anchored inflation expectations.

We also recommend additional measures that would improve economic conditions. These include reaching a prudent public debt level, further repairing and strengthening network industries, lowering administered price inflation and keeping real wage growth in line with productivity gains.

Repurchase rate forecast (September 2024)*




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

Source: SARB

7 Market-based measures of inflation expectations have also moderated. Since the previous MPC meeting, shorter-term expectations (5 years) have declined to 4.3%, while longer-term expectations (10 years) have fallen to 5.3%.

8 Average expectations declined by 0.2pp for 2024 and 2025, and 0.1pp for 2026, in the third-quarter survey.

9 The forecast projects that two-years-ahead expectations will reach 4.4% in 2026, fractionally below the midpoint.

10 For instance, the yield on the R2035 bond have moved from about 11.4% at the start of 2024 to a peak of about 12.5% in April, and subsequently down to around 10.3% as of mid-September.

# Summary of assumptions: Monetary Policy Committee meeting on 19 September 2024*

## 1. Foreign sector assumptions

| | Actual | | | Forecast | | |
|---|---|---|---|---|---|---|
| | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 |
| 1. Real GDP growth in South Africa's major trading-partner countries | 7.4% | 3.7% | 3.0% | 2.7% | 3.0% | 3.1% |
| | (7.3%) | (3.7%) | (3.0%) | (2.7%) | (3.0%) | (3.1%) |
| 2. Output gap in South Africa's major trading-partner countries (ratio to potential GDP) | (-1.0%) | 0.2% | 0.3% | -0.1% | -0.1% | 0.1% |
| | (-0.9%) | (0.1%) | (0.2%) | (-0.1%) | (-0.1%) | (0.0%) |
| 3. Change in international commodity prices in US$ (excluding oil) | 46.0% | -0.9% | -27.3% | -6.5% | -4.5% | -1.8% |
| | (46.0%) | (-0.9%) | (-27.3%) | (-6.5%) | (-4.5%) | (-1.7%) |
| 4. Brent crude (US$/barrel) | 70.7 | 100.4 | 82.6 | 83.0 | 81.0 | 80.0 |
| | (70.7) | (100.4) | (82.6) | (84.0) | (81.0) | (80.0) |
| 5. Change in world food prices (US$) | 28.1% | 15.0% | -13.8% | -3.4% | 2.8% | 1.5% |
| | (28.1%) | (15.0%) | (-13.8%) | (-2.8%) | (3.5%) | (1.5%) |
| 6. Change in international consumer prices | 3.3% | 7.4% | 4.5% | 2.6% | 2.1% | 2.0% |
| | (3.3%) | (7.4%) | (4.5%) | (2.6%) | (2.1%) | (2.0%) |
| 7. International policy interest rate | 0.1% | 1.1% | 3.9% | 4.2% | 3.3% | 2.2% |
| | (0.1%) | (1.1%) | (3.9%) | (4.2%) | (3.3%) | (2.2%) |

## 2. Domestic sector assumptions

| | Actual | | | Forecast | | |
|---|---|---|---|---|---|---|
| | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 |
| 1. Change in fuel taxes, levies and margins | 6.1% | 2.9% | 3.1% | 5.1% | 3.3% | 4.0% |
| | (6.1%) | (2.9%) | (3.1%) | (5.1%) | (3.3%) | (4.0%) |
| 2. Potential growth | 3.2% | 0.6% | 0.2% | 1.2% | 1.4% | 1.8% |
| | (3.2%) | (0.6%) | (0.2%) | (1.2%) | (1.3%) | (1.7%) |
| 3. 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%) |
| 4. GWh load-shed | | 11724 | 24694 | 4344 | 504 | 240 |
| | | (11724) | (24694) | (5832) | (2832) | (600) |
| 5. Load-shedding GDP impact (%, points) | | -0.7 | -1.5 | -0.1 | 0.0 | 0.0 |
| | | (-0.7) | (-1.5) | (-0.2) | (-0.1) | (0.0) |

Notes

a. Shaded areas indicate forecast assumptions.
b. 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 51 and 52 respectively.

# Summary of selected forecast results: Monetary Policy Committee meeting on 19 September 2024

## Selected forecast results (quarterly)

Year-on-year percentage change

| | 2023 | | | | 2024 | | | | 2025 | | | | 2026 | | | | Steady state |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 6.0 (6.0) | | | | 4.6 (4.9) | | | | 4.0 (4.4) | | | | 4.4 (4.5) | | | | |
| 1. Headline inflation | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | |
| | 7.0 | 6.2 | 5.0 | 5.5 | 5.4 | 5.1 | 4.4 | 3.6 | 3.7 | 3.8 | 4.3 | 4.4 | 4.4 | 4.4 | 4.3 | 4.3 | 4.5 |
| | (7.0) | (6.2) | (5.0) | (5.5) | (5.4) | (5.1) | (4.8) | (4.3) | (4.2) | (4.2) | (4.5) | (4.5) | (4.6) | (4.5) | (4.5) | (4.5) | |
| | 2023 | | | | 2024 | | | | 2025 | | | | 2026 | | | | |
| | 4.8 (4.8) | | | | 4.4 (4.6) | | | | 4.1 (4.4) | | | | 4.3 (4.5) | | | | |
| 2. Core inflation | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | |
| | 5.1 | 5.2 | 4.7 | 4.5 | 4.8 | 4.6 | 4.3 | 4.1 | 3.9 | 4.0 | 4.2 | 4.3 | 4.3 | 4.3 | 4.4 | 4.4 | 4.5 |
| | (5.1) | (5.2) | (4.7) | (4.5) | (4.8) | (4.6) | (4.6) | (4.6) | (4.4) | (4.4) | (4.5) | (4.4) | (4.5) | (4.5) | (4.5) | (4.5) | |
| | 2023 | | | | 2024 | | | | 2025 | | | | 2026 | | | | |
| | 10.7 (10.7) | | | | 4.7 (4.9) | | | | 3.9 (4.2) | | | | 4.2 (4.5) | | | | |
| 3. Food CPI | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | |
| | 13.6 | 12.2 | 8.6 | 8.7 | 6.1 | 4.7 | 4.7 | 3.5 | 3.6 | 4.1 | 3.9 | 3.9 | 4.3 | 4.2 | 4.2 | 4.2 | 4.5 |
| | (13.6) | (12.2) | (8.6) | (8.7) | (6.1) | (4.6) | (4.8) | (4.1) | (3.8) | (4.2) | (4.2) | (4.5) | (4.7) | (4.5) | (4.6) | (4.5) | |
| | 2023 | | | | 2024 | | | | 2025 | | | | 2026 | | | | |
| | 0.6 (0.6) | | | | 0.6 (2.4) | | | | -0.6 (-0.1) | | | | 1.8 (1.5) | | | | |
| 4. Fuel CPI | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | |
| | 10.6 | -0.2 | -9.3 | 3.4 | 5.0 | 8.6 | -1.3 | -8.9 | -3.7 | -4.5 | 3.3 | 2.9 | 1.9 | 1.6 | 1.8 | 1.8 | 4.5 |
| | (10.6) | (-0.2) | (-9.3) | (3.4) | (5.0) | (8.6) | (1.9) | (-5.2) | (-1.4) | (-2.8) | (2.6) | (1.1) | (1.4) | (1.2) | (1.6) | (1.7) | |
| | 2023 | | | | 2024 | | | | 2025 | | | | 2026 | | | | |
| | 11.7 (11.7) | | | | 13.6 (13.5) | | | | 11.0 (10.9) | | | | 9.0 (9.0) | | | | |
| 5. Electricity CPI | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | |
| | 7.9 | 7.9 | 15.2 | 15.3 | 15.3 | 15.3 | 12.1 | 12.1 | 12.1 | 12.1 | 10.0 | 10.0 | 10.0 | 10.0 | 8.0 | 8.0 | 4.5 |
| | (7.9) | (7.9) | (15.2) | (15.3) | (15.3) | (15.3) | (12.0) | (12.0) | (12.0) | (12.0) | (10.0) | (10.0) | (10.0) | (10.0) | (8.0) | (8.0) | |

Notes

a. Shaded areas indicate the forecasts of the Monetary Policy Committee (MPC).
b. The figures in brackets represent the previous forecasts of the MPC.

## Selected forecast results (annual)

| | Actual | | | Forecast | | | Steady state |
|---|---|---|---|---|---|---|---|
| | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | |
| 1. GDP growth | 4.7% | 1.9% | 0.7% | 1.1% | 1.6% | 1.8% | 2.5% |
| | (4.7%) | (1.9%) | (0.7%) | (1.1%) | (1.5%) | (1.7%) | |
| 2. Output gap (ratio to potential GDP) | -1.9% | -0.8% | -0.3% | -0.4% | -0.2% | -0.1% | 0.0% |
| | (-1.9%) | (-0.8%) | (-0.2%) | (-0.3%) | (0.0%) | (0.0%) | |
| 3. Change in nominal effective exchange rate | 9.9% | -2.4% | -11.4% | 1.4% | 1.0% | -0.3% | 2.5% |
| | (9.9%) | (-2.4%) | (-11.4%) | (0.4%) | (0.7%) | (0.3%) | |
| 4. Change in real effective exchange rate | 11.2% | -3.0% | -10.2% | 3.4% | 2.9% | 2.0% | 0.0% |
| | (11.2%) | (-3.0%) | (-10.3%) | (2.6%) | (2.9%) | (2.8%) | |
| 5. Real exchange rate gap | 5.4% | 2.9% | -7.0% | -3.8% | -1.6% | -0.4% | 0.0% |
| | (5.4%) | (2.9%) | (-7.0%) | (-4.6%) | (-2.6%) | (-0.6%) | |
| 6. Unit labour cost | | 3.3% | 4.8% | 3.6% | 3.2% | 3.6% | 4.5% |
| | | (3.3%) | (4.8%) | (4.6%) | (4.3%) | (4.3%) | |
| 7. Repurchase rate (end of period, i.e. fourth quarter ) | 3.61% | 6.54% | 8.25% | 7.86% | 7.17% | 7.09% | 7.00% |
| | (3.61%) | (6.54%) | (8.25%) | (7.65%) | (7.29%) | (7.25%) | |
| 8. Neutral real interest rate | 2.2% | 2.32% | 2.55% | 2.66% | 2.72% | 2.79% | 2.50% |
| | (2.1%) | (2.32%) | (2.55%) | (2.65%) | (2.72%) | (2.79%) | |
| 9. Current account balance (ratio to GDP) | 3.7% | -0.5% | -1.6% | -1.4% | -2.2% | -2.7% | |
| | (3.7%) | (-0.5%) | (-1.6%) | (-1.7%) | (-2.5%) | (-3.0%) | |

Notes

a. The nominal effective exchange rate (NEER) is based on the bilateral exchange rates of South Africa's three largest trading partners (the eurozone, US and Japan). The bilateral exchange rates are weighted by export trade weights. The implied starting point for the rand forecast is R18.04 to the US dollar.

b. The nominal exchange rate steady state is estimated using the Purchasing Power Parity (PPP) condition, which links the depreciation of the nominal exchange rate to the inflation differential between South Africa and abroad. Given that the real effective exchange rate (REER) depreciation is zero at steady state, the nominal exchange rate will therefore depreciate by 2.5% per year in steady state, reflecting the inflation (target) differential between domestic (4.5%) and foreign (2.0%) inflation.

c. The REER is the NEER deflated by the consumer price differential between South Africa and the trade-weighted CPI of the eurozone, US and Japan.

d. 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.

e. The unit labour cost (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.

f. The repo rate at the end of the period refers to the average for the last quarter of the year. The nominal repo rate steady state is calculated as the sum of South Africa's inflation target (4.5%) and the steady-state neutral real interest rate (NRIR) (2.5%).

g. The NRIR is the policy rate *minus* inflation, which prevails when the economy is fully in balance, with inflation at target and output at potential. The policy stance is measured as either tight or loose based on whether actual rates are above or below this neutral rate respectively. The steady-state NRIR is calculated as the sum of the respective steady states for the Group of Three (G3) NRIR (0.5%), South Africa's risk premium (2.0%) and the change in the REER (0.0%). Before the steady state is reached, it is possible for the REER equilibrium to appreciate or depreciate, so this value can have a non-zero value over the medium term. It is nonetheless always zero in the long run.

h. The steady state is the long-run value in the model. While model equilibriums can have different values over the medium term, as conditions change, all equilibriums eventually reach a steady state, where they stabilise.

i. The forecast of the current account balance is obtained from the SARB's Core Macroeconometric Model.

j. Shaded areas indicate the forecasts of the Monetary Policy Committee (MPC).

k. The figures in brackets represent the previous forecasts of the MPC.

# 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 eurozone, United States (US), United Kingdom (UK), Japan, China and India. Other countries considered, although with small weights, are Brazil, Mexico and Russia. The remaining trading partners are grouped into the 'Rest of Countries' bloc. Since sub-Saharan Africa is also a major trading region for South Africa (but does not have a bloc in the GPM), it is modelled separately and then combined with the aggregate of all the countries in the GPM to make up total trading-partner growth.

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

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

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

5. World food prices is the composite food price index of the Food and Agriculture Organization (FAO) of the United Nations (UN) 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 eurozone, 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 eurozone, 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 3.63% 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/18/02)*.

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.

6. In projecting **load-shedding** costs, the forecast considers the intensity and timing of load-shedding (whether it is a higher or lower stage, and whether it occurs during office hours or not). Higher stages of load-shedding, during office hours, are more costly.

# 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 SARB's 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.

**The monetary base (M0):** M0 comprises total banknotes and coin in issue and in circulation outside of the South African Reserve Bank (SARB), net of issuance and removal from circulation, plus banks' required cash reserves as well as their excess cash reserves and other deposits at the SARB in rand

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

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

**Nominal effective exchange rate (NEER)**: The NEER is an index that expresses the value of a country's currency relative to a basket of other (trading-partner) currencies. An increase (decrease) in the NEER indicates a strengthening (weakening) of the domestic currency with respect to the selected basket of currencies. The weighted average exchange rate of the rand is calculated against 20 currencies. The weights of the five major currencies are as follows: the euro (30.68%), Chinese yuan (24.53%), US dollar (10.56%), Japanese yen (4.95%) and Indian rupee (4.85%). Index: 2015 = 100. See also 'Real effective exchange rate' below.

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

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

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

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

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

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

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

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

# Abbreviations

| | |
|---|---|
| AE | advanced economy |
| BER | Bureau for Economic Research |
| BFP | basic fuel price |
| BIS | Bank for International Settlements |
| BoE | Bank of England |
| BoJ | Bank of Japan |
| bps | basis points |
| CIT | corporate income tax |
| CPI | consumer price inflation |
| DM | developed market |
| DXY | US dollar index |
| ECB | European Central Bank |
| EAF | energy availability factor |
| EIA | Energy Information Administration |
| EM | emerging market |
| EMFX | emerging market foreign currencies |
| FAO | Food and Agriculture Organization |
| Fed | US Federal Reserve |
| FRA | forward rate agreement |
| FX | foreign exchange |
| G3 | Group of Three (United States, eurozone and Japan) |
| GDP | gross domestic product |
| GFCF | gross fixed capital formation |
| GFECRA | Gold and Foreign Exchange Contingency Reserve Account |
| GNU | Government of National Unity |
| GPM | global projection model |
| GW | gigawatt |
| Haver | Haver Analytics |
| IMF | International Monetary Fund |
| MPC | Monetary Policy Committee |
| MPR | Monetary Policy Review |
| NAB | non-alcoholic beverages |
| NEER | nominal effective exchange rate |
| NERSA | National Energy Regulator of South Africa |
| NFCI | National Financial Conditions Index |
| NRIR | neutral real interest rate |
| OECD | Organisation for Economic Co-operation and Development |
| OER | owners' equivalent rent |
| OPEC | Organization of the Petroleum Exporting Countries |
| OPEC+ | OPEC members plus other oil-producing countries |
| PBoC | People's Bank of China |
| PCCI | persistent and common component of inflation |
| PCE | personal consumption expenditure |
| PIT | personal income tax |
| PMI | Purchasing Managers' Index |

| | |
|---|---|
| pp | percentage points |
| PPP | Purchasing Power Parity |
| QPM | quarterly projection model |
| RAF | Road Accident Fund |
| REER | real effective exchange rate |
| repo (rate) | repurchase (rate) |
| r-star | long-run real neutral interest rate |
| SARB | South African Reserve Bank |
| SIT (account) | services, income and transfers (account) |
| Stats SA | Statistics South Africa |
| STEO | Short-term Energy Outlook |
| UK | United Kingdom |
| ULC | unit labour cost |
| UN | United Nations |
| US | United States |
| USD | US dollar |
| VAR | vector autoregression |
| VAT | value-added tax |
| WEO | World Economic Outlook |
| ZAR | South African rand |