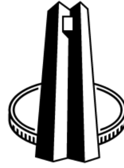

SOUTH AFRICAN RESERVE BANK

PRESS STATEMENT

EMBARGO DELIVERY

19 November 2020

STATEMENT OF THE MONETARY POLICY COMMITTEE

Issued by Lesetja Kganyago, Governor of the South African Reserve Bank

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

As expected, second quarter GDP outcomes for most economies were massively negative. Third quarter recoveries have generally been robust and economies will continue to recover in the fourth quarter. The International Monetary Fund (IMF) now expects global gross domestic product (GDP) to contract by about 4.4% this year.

Although global GDP forecasts improved from September, it is probable that global growth will be revised somewhat in coming months.[1]

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

Locally, further easing of lockdown restrictions has supported economic growth, with high frequency indicators continuing to show a pickup in economic activity during August and September. The Bank's forecast of third quarter GDP growth has been revised up to 50.3% quarter on quarter, seasonally adjusted and annualised. The growth rate for the full year is now expected to be -8.0%, compared to the contraction of 8.2% expected at the time of the September. South Africa's terms of trade remain robust. Commodity export prices are high, while oil prices remain generally low.

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

Overall, risks to the growth outlook are assessed to be balanced, but this is tentative and open to adjustment given the wide range of shocks hitting the economy,

[1] Global growth in the QPM model is a trade-weighted average of South Africa's trading partners. For 2020 this is now at -3.9% (up from -4.2% in September) and revised down to 4.5% for 2021. Based on the October 2020 World Economic Outlook, the IMF expects global growth of 5.2% in 2021.
[2] Compared to 3.9% and 2.6%, respectively, in September.

uncertainties involving the effectiveness of policy, and the sensitivity of sentiment to news flow. The somewhat stronger growth in 2020 and a small downward revision to growth in 2021 implies little change in the size of the output gap over the forecast period, compared to the September meeting.

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

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

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

[3] Measured by the EMBI+ premium over emerging market averages and as an absolute value over time.

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

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

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

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

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

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

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

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

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

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

Lesetja Kganyago

GOVERNOR

The next statement of the Monetary Policy Committee will be released on 21 January 2021

Monetary Committee Meetings dates for 2021:

19 – 21 January

23 – 25 March

18 – 20 May

20 – 22 July

21 – 23 September

16 – 18 November

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