SOUTH AFRICAN RESERVE BANK

**PRESS STATEMENT**

**25 March 2021**

## STATEMENT OF THE MONETARY POLICY COMMITTEE

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

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

The International Monetary Fund's (IMF) January forecast for growth in global gross domestic product (GDP) for 2021 was revised up to 5.5%. The SARB's forecast for global growth in 2021 is now 5.8%.[1] For 2022, we expect global growth of about 3.7%.

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

Despite this more optimistic outlook, distribution of vaccines will be slow, contributing to an uneven pace of global economic recovery this year and next.

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

South Africa's economy expanded by 6.3% on a quarterly, annualised basis in the fourth quarter of 2020, and contracted by 7% for the year as a whole. The Bank's forecast for GDP for the first quarter of 2021 stands at -0.2%, down from 1.0% at the time of the January MPC meeting. With stronger quarterly outcomes for the rest of this year, the economy is expected to grow by about 3.8% (up from 3.6%).

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

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

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

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

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

Despite these generally favourable global conditions and considerable rand appreciation through the latter half of 2020 and into this year, the rand remains below its estimated long-run equilibrium value. Since the January meeting, the rand has appreciated by 1.3% on a trade-weighted basis. The implied starting point for the rand

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

forecast is R14.96 to the US dollar, compared with R15.70 at the time of the previous meeting.

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

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

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

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

The overall risks to the inflation outlook appear to be balanced. A more appreciated nominal exchange rate in recent months, and generally low pass-through, is expected to continue to moderate some inflationary pressure. The Committee additionally notes

---

[3] Our assumptions are now for oil prices to average about $62 per barrel in 2021 (up from $50) and $60 per barrel in 2022 and in 2023.

[4] The latest (Q1) Bureau for Economic Research (BER) survey expectations for 2021 eased to 3.9% from 4.2%, to 4.2% from 4.5% for 2022 and are at 4.4% for 2023. Household inflation expectations have eased further to 5.0% from 5.3%. Market analysts (Reuters Econometer) expect inflation to be higher at 4.1% (from 3.8%) in 2021, at 4.3 (from 4.2) in 2022 and unchanged at 4.5% in 2023. Market-based rates are calculated from the break-even inflation rate, which is the yield differential between conventional and inflation-linked bonds. These now sit at 4.4% for the 5-year and 5.9% on the 10-year breakeven. 15-year breakeven inflation sits at 6.8%.

the significant, but likely temporary, reduction in medical insurance price inflation this year. While global food price inflation remains high, local food price inflation is slightly lower than previously expected and should remain broadly contained due to higher local crop production. Oil prices have increased sharply this year and are expected to remain at these levels over the forecast horizon. Electricity and other administered prices remain upside risks to the inflation trajectory.

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

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

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

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

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

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

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

Lesetja Kganyago

GOVERNOR

The next statement of the Monetary Policy Committee will be released on 20 May 2021.

Contact person:

Thoraya Pandy

0824168416

media@resbank.co.za