SOUTH AFRICAN RESERVE BANK

PRESS STATEMENT

EMBARGO DELIVERY

20 May 2021

STATEMENT OF THE MONETARY POLICY COMMITTEE

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

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

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

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

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

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

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

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

[1] Global growth in the QPM model is a trade-weighted average of South Africa's trading partners. The IMF's global forecast for 2022 sits at 4.4%.

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

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

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

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

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

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

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

Going forward, a stronger exchange rate, ongoing moderation in unit labour costs, and sustained economic slack are expected to offset higher electricity and food price inflation, keeping the headline inflation forecast relatively stable.

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

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

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

[4] The (Q1) Bureau for Economic Research (BER) survey expectations for 2021 remain at 3.9%, 4.2% for 2022, and 4.4% for 2023. Market analysts (Reuters Econometer) expect inflation to be higher at 4.2% (from 4.1%) in 2021, unchanged at 4.3 in 2022 and slightly lower at 4.4% in 2023 (down from 4.5%). Market-based rates are calculated from the break-even inflation rate, which is the yield differential between conventional and inflation-linked bonds. These now sit at 4.5% for the 5-year and 5.98% on the 10-year breakeven. 15-year breakeven inflation sits at 6.43%.

increased sharply this year and, while forecast to remain at current levels, are subject to increasing upside risk as recent data has shown.

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

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

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

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

Monetary policy continues to be accommodative, keeping financial conditions supportive of credit demand as the economy recovers from the pandemic and associated lockdowns. The 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 wage inflation low into the recovery. Such steps will enhance the effectiveness of monetary policy and its transmission to the broader economy.

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

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The next statement of the Monetary Policy Committee will be released on 22 July 2021.

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