SOUTH AFRICAN RESERVE BANK

PRESS STATEMENT

18 November 2021

STATEMENT OF THE MONETARY POLICY COMMITTEE

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

Steady advances in vaccination rates have sustained confidence and the global economic recovery this year, even with further waves of the Covid-19 virus expected. Recoveries in emerging market and developing economies will continue to lag those in advanced economies, in large part due to a slower pace of vaccinations. The virus however remains one of a series of current risks to South Africa's economic growth outlook that includes rising inflation, weaker commodity export prices, stagnant investment, and the longer term impact of scarring from the pandemic and the July unrest.

The International Monetary Fund's (IMF) forecast for global gross domestic product (GDP) is 5.9% in 2021, slowing to 4.9% in 2022. The SARB's forecast for global growth in 2021 now sits at 6.3% (up from 6.2%), and is unchanged for 2022 and 2023, at

4.4%, and 3.3%, respectively.[1] GDP growth in our trading partners in 2024 is forecast to be 2.7%. Global economic conditions are now less supportive of emerging and developing economies than in much of this past year.

Although policy settings in advanced economies remain accommodative, considerably higher global inflation and rising uncertainty about the normalisation path for interest rates continue to cause financial market turmoil and capital flow volatility. Risk aversion in financial markets has increased. Economies that failed to take advantage of improved global prospects or to reduce large macroeconomic imbalances remain vulnerable.

While the domestic economy grew strongly in the first half of 2021, the second half of the year is expected to show mixed results. Overall, we forecast the economy to grow by 5.2% this year (from 5.3%), revised down due to the larger negative effect on output than was previously estimated from the July unrest and other factors. Our revised estimate for third quarter economic growth is -2.5%, compared to the previous -1.2%. For the fourth quarter, we expect a GDP outcome of 2.6%, compared to the previous 1.6%.

Despite these quarterly revisions, the annual growth rate in GDP for 2021 reflects a healthy bounceback from the economic effects of the pandemic. In the next two years, economic growth is expected to align with a low rate of potential growth. GDP is expected to grow by 1.7% in 2022 and by 1.8% in 2023, unchanged from the September forecast. GDP growth in 2024 is forecast to be 2.0%.

[1] Global growth in the QPM model is a trade-weighted average of South Africa's trading partners. The IMF's October World Economic Outlook global forecast for 2022 sits at 4.9%.

The July unrest, the pandemic and ongoing energy supply constraints are likely to have lasting effects on investor confidence and job creation, impeding recovery in labour-intensive sectors hardest hit by the lockdowns. High export prices are expected to fade, perhaps faster than previously expected. Very weak job creation will moderate household consumption. Investment will remain constrained by the high risk of further loadshedding and ongoing uncertainty. The faster vaccine rollout presents some upside risk to the growth outlook.

Overall, and after revisions, the risks to the medium-term domestic growth outlook are assessed to be to the downside.

Compared to the September meeting the output gap is broadly unchanged over the forecast period.

The current account surplus remains substantial, but is expected to be significantly smaller than our [September] previous projection, at 3.8% of GDP in 2021 (from 4.6%). Prices for important commodity exports such as rhodium, iron ore, coal and platinum have decreased in recent months, some sharply. Oil prices have increased by about 68% year to date compared to the 2020 average price. Alongside higher prices and stronger demand for imported consumer and investment goods, the commodity and oil price movements imply a smaller trade surplus. Whereas a current account surplus of 0.7% of GDP was forecast for next year (2022), we now expect a current account deficit of 0.6% of GDP.[2]

[2] The current account is expected to be in deficit of -1.8% in 2023 (from -0.3%) and -2.5% in 2024.

Although fiscal risk has eased, financing conditions remain volatile and the yield curve for rand-denominated bonds remains steep. Ten-year bond yields have shown greater sensitivity to global and domestic factors, and sit at about 9.5% at present.

For much of the year, generally favourable global financial and economic conditions and strong commodity export prices strengthened the currency above its long-run equilibrium level. In recent months, increased uncertainty about global inflation and policy settings, with a moderation in the terms of trade, have however contributed to a weaker rand exchange rate. Since the September meeting, the rand has depreciated by about 5.9% against the US dollar and now sits below its equilibrium level. The implied starting point for the rand forecast is R15.1 to the US dollar, compared with R14.47 at the time of the previous meeting.

With ongoing global supply shortages and strong demand, a wide range of prices continues to accelerate, including raw materials, intermediate inputs and food.[3] Some of these price increases have passed-through to consumer prices in major economies. Our estimate for inflation in the G3 was revised higher for 2021 to 2.9% (from 2.4%), to 2.4% for 2022 (from 2.0%) and remains unchanged at 1.8% in 2023.[4] For 2024, G3 inflation of 1.6% is forecast.

Oil prices are revised up for this year, and fuel price inflation is higher at 17.6% (up from 16.1%).[5] Local electricity price inflation for 2021 remains at 10.1%, while the

[3] World food prices continue to rise. The assumption used for the forecast for world food prices increased from 13.4% in September to 25.4% for the November meeting.

[4] The G3 comprises the United States, the Eurozone, and Japan.

[5] The forecast for fuel prices in 2022 are revised higher from 3.7% in the September meeting to 4.6% currently. For 2023 and 2024, fuel price inflation is expected to be 1.3% and 1.1%, respectively. Our assumptions are now for oil prices to average $71.5 per barrel in 2021, $73 per barrel in 2022 and $68 per barrel in 2023. An average price of $65 per barrel is expected in 2024.

forecast for 2022 and 2023 is revised up to 14.4% (from 11.8%). For 2024, electricity price inflation of 10% is expected.

The Bank's forecast reflects higher headline inflation for the 4th quarter, at 5.3% (from 5.0%). For this year and the next two years, headline consumer price inflation is revised slightly higher, to 4.5% for 2021 (from 4.4%), to 4.3% next year (from 4.2%), and to 4.6% in 2023 (from 4.5%). Headline CPI for 2024 is expected to be 4.5%.

The forecast for core inflation remains at 3.0% in 2021 and is slightly lower at 3.7% in 2022 (from 3.8%). Core inflation is expected to be slightly higher at 4.4% in 2023 (from 4.3%), and reaches 4.5% in 2024. While the economy continues to expand over the forecast period, core inflation remains subdued by low services price inflation, modest unit labour costs and exchange rates.

The risks to the short-term inflation outlook are assessed to the upside. Global producer price and food price inflation continued to surprise higher in recent months and could do so again. Oil prices have increased sharply, with current prices well above our forecasted levels for this year. Electricity prices are higher throughout the forecast and with other administered prices continue to present short- and medium-term risks. Given the moderate medium and long-term inflation projections set out above, a weaker currency, higher domestic import tariffs, and escalating wage demands present additional upside risks to the inflation forecast.

Average surveyed expectations of future inflation remain at 4.2% for 2021 and 4.4% for 2022. Market-based surveyed expectations for inflation for 2021 are broadly unchanged.[6]

While the Committee expects inflation to stay close to the mid-point over the forecast period, inflation risks have increased and the level of policy accommodation remains high.

Against this backdrop, the MPC decided to increase the repurchase rate by 25 basis points to 3.75% per year, with effect from the 19th of November 2021. Three members of the Committee preferred an increase and two members preferred an unchanged stance.

The implied policy rate path of the Quarterly Projection Model (QPM) indicates an increase of 25 basis points in the fourth quarter of 2021 and further increases in each quarter of 2022, 2023 and 2024. 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.

Given the expected trajectory for headline inflation and upside risks, the Committee believes a gradual rise in the repo rate will be sufficient to keep inflation expectations well anchored and moderate the future path of interest rates. Economic and financial conditions are expected to remain more volatile for the foreseeable future. In this uncertain environment, policy decisions will continue to be data dependent and

[6] The (Q3) Bureau for Economic Research (BER) survey expectations have not been updated and remain at 4.2%, 4.4% and to 4.5% for the three years. Market analysts (Reuters Econometer) in November expect inflation to be unchanged at 4.5% in 2021, and higher at 4.5% (from 4.4%) in 2022, and unchanged at 4.3% 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 5.08% for the 5-year (up by 25 bps since the last meeting) and 6.25% on the 10-year breakeven. 15-year breakeven inflation sits at 6.54%.

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.

Current repurchase rate levels reflect an accommodative policy stance through the forecast period, keeping financial conditions supportive of credit demand as the economy continues to recover.[7] 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.

Better anchored expectations of future inflation should keep interest rates lower for longer, and can be realised by achieving a prudent public debt level, increasing the supply of energy, moderating administered price inflation and keeping wage growth in line with productivity gains. Such steps will enhance the effectiveness of monetary policy and its transmission to the broader economy.

Lesetja Kganyago

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Monetary Committee Meetings dates for 2022:

- 27 January 2022
- 24 March 2022
- 19 May 2022
- 21 July 2022
- 22 September 2022

[7] This implies a rise in the inflation-adjusted repo rate from -1.1% for 2021, 0.5% for 2022, 1.3% for 2023, and 2.0% in 2024. The real repurchase rate calculation here is based on the 1-quarter ahead inflation forecast.

- 24 November 2022

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