PRESS STATEMENT

23 September 2021

STATEMENT OF THE MONETARY POLICY COMMITTEE

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

A steady improvement in vaccination rates will sustain confidence and global economic growth, even with expected further waves of the Covid-19 virus. However vaccination rates are lagging in many emerging market and developing economies. Until populations develop sufficient immunity to curb virus transmission, waves of infection are likely to continue, with ongoing poor economic outcomes. At this time, the third wave of the virus infection has peaked in South Africa. The virus however is only one of a series of current risks to the economic recovery that include rising inflation, weaker commodity export prices, 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) for 2021 is 6.0%, and will be updated again in early October. The SARB's forecast for global growth in 2021 now sits at 6.2% (up from 6.1%).[1] For 2022 and 2023, we still expect global growth of 4.4%, and 3.4%, respectively. Recoveries in emerging market and developing economies are expected to lag those in advanced economies, in large part due to a slower pace of vaccinations.

Although policy settings in advanced economies remain accommodative, the spread of the Delta variant, higher global inflation, and uncertainty about the normalisation path for interest rates continue to cause financial market turmoil and capital flow volatility. Risk aversion persists where economies fail to take advantage of improved global prospects or to reduce large macroeconomic imbalances.

The domestic economy grew by 4.2% in the first quarter of 2021 and by 4.7% in the second quarter. These outcomes reflect better sectoral growth performances and robust terms of trade. Commodity prices have been extraordinarily high, sustaining income gains despite somewhat higher oil prices. While more South Africans have re-entered the jobs market as economic activity resumed, the loss of jobs suggests persistent adjustment and sustained weakness in some sectors. Household spending remains healthy, however, in line with better than expected salaries and wages, rising asset prices and low interest rates.

The Bank's forecast for fixed investment was revised up for this year but remains constrained, and, as a result of the GDP revisions by Stats SA, is lower as a share of economic activity.[2]

[1] Global growth in the QPM model is a trade-weighted average of South Africa's trading partners. The IMF's July World Economic Outlook global forecast for 2022 sits at 4.9%.
[2] Statistics South Africa released its revision on 25th August 2021. The main effect of the revisions is to the aggregate level of output in the economy, which was revised up significantly.

We expect the economy to grow by an upwardly revised 5.3% this year (from 4.2%), despite the much larger negative effect on output than was previously estimated from the July unrest. Our revised estimate for third quarter economic growth is -1.2%, compared to the previous -0.5%. Output in the manufacturing sector fell by 8.0% in July alone. Mining was up 4.1%, while land freight transport fell by 5.0% and retail output was down by 11.2%.

The July events and the pandemic are likely to have lasting effects on investor confidence and job creation, impeding recovery in labour-intensive sectors hardest hit by the lockdowns. GDP is expected to grow by 1.7% in 2022, (down from 2.3%) and by 1.8% in 2023 (down from 2.4%).

Overall, and after revisions, the risks to the medium-term domestic growth outlook are assessed to be balanced, as most of the bounceback from the recovery is now in the past. High export prices are expected to fade, while very weak job creation will slow household consumption. Investment will remain constrained by the still limited energy supply and ongoing policy uncertainty. The faster vaccine rollout presents upside risks to the growth outlook.

The current account surplus remains large, at 5.6% of GDP, reflecting high prices for mining and agricultural exports, still gradually rising oil prices, and slowly reviving demand for imported consumer and investment goods. The surplus is expected to shrink to about 0.7% of GDP for next year (2022), as exports slow and imports accelerate.[3]

[3] The current account is expected to be in surplus of 4.7% of GDP in 2021, shifting to a deficit of -0.3% in 2023.

Long bond yields have returned to pre-pandemic levels of around 9.0% on 10-year bonds. Although financing conditions have 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 strengthened the currency above its long-run equilibrium level, with a year to date appreciation of 1.5% on a trade-weighted basis. Since the July meeting, the rand has depreciated by 1%. The implied starting point for the rand forecast is R14.47 to the US dollar, compared with R14.40 at the time of the previous meeting.

At a global level, a wide range of prices is accelerating, including raw materials, intermediate inputs and food. This reflects both global supply shortages and strong demand. This has passed-through to consumer prices in some major economies. Our estimate for inflation in the G3 was revised higher for 2021 to 2.4% (from 2.2%) and remains the same in the outer years.[4]

Oil prices are revised up for this year, and petrol price inflation is higher at 16.1% (up from 15.3%).[5] Local electricity prices are lower at 10.1% (down from 10.5%).

Headline consumer price inflation for 2021 is revised slightly higher to 4.4% (up from 4.3%), and remains unchanged at 4.2% in 2022 and 4.5% in 2023.

The forecast for core inflation is revised higher to 3.0% in 2021 (up from 2.9%) and to 3.8% in 2022 (up from 3.7%). Core inflation is expected to be 4.3% in 2023, unchanged from the July forecast.

[4] The G3 comprises the United States, the Eurozone, and Japan. G3 inflation for 2022 is 2.0% and 1.8% for 2023.

[5] The forecast for petrol prices in 2022 are revised down from 5.5% in July to 3.7% currently. Our assumptions are now for oil prices to average $69 per barrel in 2021 and $67 per barrel in 2022 and $65 in 2023.

The Bank's forecast reflects higher headline inflation for the rest of this year, before moderating in 2022. Compared to the July meeting, and taking into account higher household consumption and less investment from the recent GDP revisions, the output gap is narrower historically and over the forecast period.[6]

While economic activity continues to expand over the forecast period, a rise in core inflation is moderated by the current strength of the exchange rate and modest unit labour costs.

The risks to the short-term inflation outlook are assessed to the upside. Rapid global producer price and food price inflation have surprised to the upside in recent months and could do so again. Oil prices have become more volatile in recent weeks and could rise beyond our expectations. Electricity and other administered prices also continue to present short-term risks. Given the medium and long-term projections set out above, a weaker currency, higher domestic import tariffs, and escalating wage demands present further longer-term upside risks to the inflation forecast.

Average surveyed expectations of future inflation remain unchanged at 4.2% for 2021 and 4.4% for 2022. Market-based expectations for inflation are slightly higher for 2021 at 4.4% (up from 4.3%) and stable over longer horizons.[7]

---

[6] The GDP revisions resulted in a higher level of output, consumption and lower investment, among other changes. Upward revisions to potential growth were not as large as the GDP level revisions, implying somewhat higher demand and therefore a smaller output gap than estimated pre-revision. For 2020, the output revisions also implied more of a negative supply shock than previously estimated, which then reversed in 2021, resulting in re-estimates of the output gap for each of these years.

[7] The (Q3) Bureau for Economic Research (BER) survey expectations remain unchanged at 4.2%, 4.4% and to 4.5% for the three years. Market analysts (Reuters Econometer) in September expect inflation to be higher at 4.4% (from 4.3%) in 2021, and unchanged at 4.4% in 2022, and lower at 4.2% 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 4.79% for the 5-year and 5.98% on the 10-year breakeven. 15-year breakeven inflation sits at 6.31%.

With largely unchanged inflation expectations and even with continued upside risks, the Committee expects inflation to stay close to the mid-point over the forecast period.

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 the fourth quarter of 2021 and further increases in each quarter of 2022 and 2023.

These repurchase rate levels reflect a highly accommodative policy stance through the end of the forecast, keeping financial conditions supportive of credit demand as the economy continues to recover.[8] 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 could keep interest rates lower for longer, and can 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

[8] This implies a rise in the inflation-adjusted repo rate from -1.0% for 2021 to about 0.6% for 2022 and 1.5% for 2023. The real repurchase rate calculation here is based on the 1-quarter ahead inflation forecast.

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 18 November 2021.

Contact person:

Thoraya Pandy

0824168416

media@resbank.co.za