SOUTH AFRICAN RESERVE BANK

PRESS STATEMENT

24 March 2022

STATEMENT OF THE MONETARY POLICY COMMITTEE

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

Since January, the Omicron wave of the covid-19 virus has transmitted globally with diverse social and economic outcomes. Despite the high infection rate, many economies remained open and, with some exceptions, the economic costs of the virus continue to fall. Even as the economic impact of the pandemic fades, the outbreak of war in February between Russia and Ukraine is expected to reduce global economic growth and contribute to higher inflation. The war will likely impair production of a wide range of energy, food and other commodities and further disrupt global trade.

The SARB's forecast for global growth in 2022 is revised down to 3.7% (down from 4.4%), and for 2023 is lowered to 2.8% (from 3.3%), as a result of the war and the ongoing spread of the virus in Asia and elsewhere.[1] For 2024, global growth is unchanged at 2.7%.[2] Dramatically higher oil, commodity and food prices, additional

[1] The International Monetary Fund's (IMF) January forecast for global growth in 2022 was 4.4%. The April forecast for 2022 will be released in a few weeks.

[2] Global growth in the QPM model is a trade-weighted average of South Africa's trading partners.

constraints to trade and finance, and rising debt costs, create more adverse economic conditions for most emerging and developing economies.

Although policy settings in advanced economies remain broadly accommodative, the onset of policy normalization by major central banks and higher inflation has tightened global financial conditions. Investor appetite for riskier assets is lower. Economies that failed to take advantage of better global conditions or to reduce large macroeconomic imbalances remain vulnerable.

Last year saw the ongoing recovery of the South African economy from the pandemic, expanding by 4.9% for 2021 as a whole, marginally higher than the 4.8% we had forecast in January.

The South African economy is expected to grow by 2.0% in 2022, revised up from 1.7% at the time of the January meeting. This is due to a combination of factors, including stronger growth in 2021 and higher commodity export prices. Growth in output in the first quarter of this year is likely to be significantly stronger than expected at the time of the January meeting.[3]

GDP growth is forecast to be 1.9% in both 2023 and in 2024.[4] Economic growth at these rates remains well above a low rate of potential growth still constrained by loadshedding and policy uncertainty.[5] Investment by the government sector has weakened significantly in recent years and that of public corporations is forecast to be very modest. Household spending remains supportive, as a result of good growth in

[3] The January forecast for first quarter growth was 2.1%, seasonally adjusted and annualised. This has been revised up to 3.2%.

[4] The growth forecast includes expected changes in the policy rate.

[5] Potential growth for 2022 and 2023 is estimated at 0.8%, rising to 1.1% in 2024.

disposable income, rising asset prices, and low interest rates, while private investment has also proved to be more resilient than previously expected.

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

With the low rate of potential growth at present and the upward revision to GDP growth for 2022 and 2023, the output gap closes faster over the forecast period compared to the January meeting. The output gap is expected to turn positive after the third quarter of 2023.

While important commodity export prices such as for coal, iron ore, platinum, and rhodium generally decreased in the latter half of 2021, they increased again late in January and have surged further with the outbreak of hostilities in Europe. Oil prices spiked to around US$130 per barrel in the early days of the conflict before easing somewhat. We expect oil prices to average US$103 per barrel for 2022, US$80 per barrel in 2023 and US$75 per barrel in 2024.[6] South Africa's commodity price basket is forecast to rise by 8% for the year as a whole, keeping the terms of trade elevated, before falling sharply in 2023. As a result of these export and import price developments, the current account surplus is expected to increase to about 3% of GDP this year, before easing to 1.6% in 2023 and 0.8% in 2024.[7]

Although fiscal risk has eased, financing conditions remain tight and the yield curve for rand-denominated bonds is steep. Ten-year bond yields increased to about 10.3% in late February, before easing back to around 9.7% at present.

[6] The Brent crude oil assumptions in January were US$78, US$72, and US$70, respectively.

[7] In January, the current account surplus was expected to decline in 2022 to about 0.4% of GDP and to be in a deficit of -0.2% in 2023 (from -1.8%) and -0.6% in 2024 (from -2.5%).

The first two months of this year featured a weaker rand exchange rate, resting somewhat below its equilibrium level. Since then, and despite less favourable global conditions, stronger commodity export prices have appreciated the currency, and helped to dampen price pressures. The implied starting point for the rand forecast is R15.41 to the US dollar, compared with R15.60 at the time of the previous meeting.[8]

As the global economy rebounded from the pandemic, aggressive policy easing and supply shortages have increased prices of many goods and commodities.[9] These price increases have passed-through to services prices, wages, and consumer prices in major economies. Our estimate for inflation in the G3 is revised higher throughout the forecast period, to 5.6% in 2022 and to 3.0% in 2023 (up from 3.1% and 1.7%), before moderating to 2.3% in 2024 (from 1.6%).[10]

Oil prices are revised up further for this year, and fuel price inflation is higher at 26.1% (up from 13.7%). Local electricity price inflation is revised down to 11.0% for 2022 (from 14.5%) and to 9.2% in 2023 (from 12.4%). For 2024, electricity price inflation of 10% is expected, unchanged from the previous meeting.

As a result of higher global food prices, local food price inflation is also revised up and is now expected to be 6.1% in 2022 (up from 4.8%), and 5.1% in 2023 (up from 4.6%). Food price inflation is forecast to ease to 4.4% in 2024 (down from 4.6%).

The Bank's forecast of headline inflation for this year is revised higher to 5.8% (from 4.9%), primarily due to the higher food and fuel prices. While food prices will stay

[8] The rand has appreciated by about 3.4% to the US dollar since the January meeting.

[9] World food prices continue to rise. The assumption used for the forecast for USD-denominated world food prices in 2022 is revised higher from -2.3% to 6.8%.

[10] The G3 comprises the United States, the Eurozone, and Japan. The latest CPI inflation in the respective components sits at 7.9%, 5.3% and 0.9%.

high, fuel price inflation should ease in 2023, helping headline inflation to fall to 4.6%, despite rising core inflation.

Core inflation is forecast to increase to 4.2% in 2022 (up from 3.8%), to 5.0% in 2023 (from 4.4%), before easing somewhat to 4.7% in 2024 (from 4.5%). Core goods and services price inflation is forecast higher throughout the horizon, and services price inflation exceeds the mid-point of the target by the fourth quarter of this year.

The risks to the 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, particularly if the war in the Ukraine persists into the growing season. Oil prices increased strongly through 2021 and are up again sharply year to date, propelled higher also by the war and economic sanctions. Electricity and other administered prices continue to present short- and medium-term risks. Higher diesel and coal prices may result in upward revisions to our electricity price forecast for 2023. Given below-inflation assumptions for public sector wage growth and higher petrol and food price inflation, considerable risk attaches to a still moderate nominal wage forecast.

Global financial conditions are more volatile at present and with higher than expected inflation, has pushed major central banks to start the normalisation of global policy rates. On balance, and with some exceptions, capital flow volatility is expected to remain high for riskier assets such as emerging market debt and currencies.

Average surveyed expectations of future inflation have increased to 5.1% for 2022 (from 4.8%). Market-based surveyed expectations for inflation have also increased to

5.5%.[11] Long-term inflation expectations derived from the break-even rates in the bond market have also increased.[12]

In the near-term, headline inflation has increased well above the mid-point of the inflation target band, and is forecast to breach the target range in the second quarter. Headline inflation then returns close to the mid-point in the second quarter of 2023, taking into account the policy rate trajectory indicated by the Bank's Quarterly Projection Model (QPM). Some risks to the inflation outlook, like food and fuel, have been realised, and other risks, such as currency volatility and capital flow reversals, have become more pronounced.

Against this backdrop, the MPC decided to increase the repurchase rate by 25 basis points to 4.25% per year, with effect from the 25th of March 2022. Three members of the Committee preferred the announced increase and two members preferred a 50 basis point rise in the repo rate.

The implied policy rate path of the QPM, given the inflation forecast, indicates gradual normalisation through to 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.

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 sensitive to the balance of risks to the outlook. The MPC will seek

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[11] The (Q4) Bureau for Economic Research (BER) survey expectations rose above the target midpoint to 5.1% (4.8%) for 2022 and 5.0% (4.7%) for 2023. Market analysts (Reuters Econometer) in March expect inflation to be higher at 5.5% (5.0%) in 2022 unchanged at 4.4% in 2023 and lower at 4.4% (4.5%) in 2024.

[12] 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 6.0% for the 5-year and 6.5% on the 10-year breakeven. 15-year break-even inflation sits at 6.7%.

to look through temporary price shocks and focus on potential second round effects and the risks of de-anchoring inflation expectations.

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.[13] The Bank has ensured adequate liquidity in domestic markets and will continue to closely monitor funding markets for stress.

Better anchored expectations of future inflation could support lower interest rates, 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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The next statement of the Monetary Policy Committee will be released on 19 May 2022.

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[13] The forecasted trajectory for the repurchase rate implies a rise in the inflation-adjusted repo rate from -1.5% for 2021 to -0.9% 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 and are annual average rates.