SOUTH AFRICAN RESERVE BANK

**PRESS STATEMENT**

**19 May 2022**

## STATEMENT OF THE MONETARY POLICY COMMITTEE

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

In recent months, the Omicron variant has transmitted globally and a major war started in Europe. The economic costs of the corona virus generally continue to fall, as most economies remained open despite the rapid spread of the Omicron variant. China's response to the new covid-19 outbreak and the sustained invasion of Ukraine by Russia will however weigh heavily on global economic growth and contribute to higher inflation. The war has impaired the production and trade of a wide range of energy, food and other commodities and will continue to do so for some time.

As a result of these factors, the International Monetary Fund (IMF) reduced its global growth forecast for 2022 to 3.6%. The SARB's forecast for global growth in 2022 is revised down from the March meeting to 3.5% (from 3.7%), and for 2023 is lowered to

2.7% (from 2.8%).[1] The economy of the Euro Area is also expected to weaken significantly this year and next. For 2024, global growth remains unchanged at 2.7%.[2]

Dramatically higher oil, commodity and food prices, additional constraints to trade and finance, and rising debt costs, worsen economic conditions for most emerging and developing economies.

Although policy settings in advanced economies remain broadly accommodative, policy normalization by major central banks and higher yields have tightened global financial conditions. Investor appetite for riskier assets is weaker and asset values in major markets have declined sharply. Economies that failed to take advantage of better global conditions or to reduce large macroeconomic imbalances remain vulnerable to currency depreciation and capital outflows.

Last year saw the ongoing recovery of the South African economy from the pandemic, expanding by 4.9%. The economy is expected to grow by 1.7% in 2022, revised down from 2.0% at the time of the March meeting. This is due to a combination of short-term factors, including the flooding in Kwa-Zulu Natal and the continued electricity supply constraints. Growth in output in the first quarter of this year is expected to be 3.6%, stronger than the 3.2% expected at the time of the March meeting.[3]

The economy is forecast to expand by 1.9% in both 2023 and 2024.[4] At these rates, growth remains well above a low rate of potential, impacted by loadshedding,

[1] The International Monetary Fund's (IMF) April forecast for global growth in 2023 is 3.6% and 3.4% for 2024.

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

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

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

infrastructure and policy constraints.[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 disposable income, rising asset prices, and low interest rates. Private investment has also proved to be more resilient than previously expected. Tourism, hospitality and construction should see stronger recoveries as the year progresses.

Overall, and after revisions, the risks to the medium-term domestic growth outlook are assessed to be balanced. With potential growth and expected GDP growth revised somewhat lower for this year, the output gap is unchanged over the forecast period. The output gap is expected to turn positive after the third quarter of 2023.

Although important commodity export prices such as for coal, iron ore, platinum, and rhodium generally decreased in the latter half of 2021, they surged higher with the war. Oil prices spiked to around US$130 per barrel in the early days of the conflict. While oil prices currently sit at about US$110 per barrel, we expect them to stay higher than we did in March and to average US$103 per barrel for 2022, US$90 per barrel in 2023 and US$85 per barrel in 2024.[6]

South Africa's export commodity price basket is forecast to rise by 9.5% for the year as a whole (up from 8.0%), keeping the terms of trade elevated, before gradually falling in 2023 and 2024. As a result of these export and import price developments, the

[5] Potential growth for 2022 is 0.6% (down from 0.8%), 0.9% (from 0.8%) in 2023 and unchanged at 1.1% in 2024.

[6] The Brent crude oil assumptions in March were US$103, US$80, and US$75, respectively.

current account surplus is expected to reach 2.1% of GDP this year, easing to 0.8% in 2023 and around 0.0% in 2024.[7]

Although fiscal risk has eased on the back of better tax revenue and reduced borrowing needs, 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, and have remained around that level.

The commodity export price surge appreciated the value of the currency. The rand has since depreciated strongly from April due to the start of policy normalisation in major economies and the slowdown in China's economy. The implied starting point for the rand forecast is R15.88 to the US dollar, compared with R15.41 at the time of the previous meeting.[8]

As the global economy rebounded from the pandemic, continued policy accommodation and supply shortages increased prices of many goods and commodities.[9] These prices have been given fresh impetus from further transport delays, supply constraints and food export restrictions. Producer price increases have passed-through to wages and consumer prices in major economies. Our estimate for inflation in the G3 is revised higher to 6.3% in 2022 (from 5.6%) and down to 2.7% in

[7] In March, the current account surplus for 2022 was expected to be about 3.0% of GDP, 1.6% in 2023 and 0.8% in 2024.

[8] The rand has depreciated by about 7.4% to the US dollar since the March 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 6.8% to 15.3%.

2023 (from 3.0%), before moderating to 2.0% in 2024 (from 2.3%).[10] The IMF expects global inflation of 7.4% in 2022 and 4.8% in 2023.[11]

Oil prices are revised up further for this year, and fuel price inflation is higher at 31.2% (up from 26.1%). Local electricity price inflation is unchanged at 11.0% in 2022, 9.2% in 2023, and 10% in 2024.

As a result of higher global food prices, local food price inflation is also revised up and is now expected to be 6.6% in 2022 (up from 6.1%), and 5.6% in 2023 (up from 5.1%). Food price inflation is forecast to ease to 4.2% in 2024 (down from 4.4%).

The Bank's forecast of headline inflation for this year is revised higher to 5.9% (from 5.8%), primarily due to the higher food and fuel prices. While food prices will stay high, fuel price inflation should ease in 2023, helping headline inflation to fall to 5.0%, despite slightly higher core inflation. Headline inflation of 4.7% is now expected in 2024.

Core inflation is forecast lower at 3.9% in 2022 (down from 4.2%) due to lower services price inflation. Our forecast for core inflation in 2023 and 2024 is slightly higher at 5.1% (from 5.0%), and 4.8% (from 4.7%), respectively. Core goods inflation is forecast higher throughout the horizon, while core services inflation is unchanged in 2023 and 2024.

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 may do so

[10] The G3 comprises the United States, the Eurozone, and Japan. The latest CPI inflation in the respective components sits at 8.3%, 7.5% and 1.2%.

[11] The IMF expects advanced economy inflation of 5.7% and emerging market economy inflation of 8.7% in 2022.

again. Russia's  war in the Ukraine is likely to persist for the rest of this year and may have significant further effects on global prices. Oil prices increased strongly from the start of the war and may rise more as stresses in energy markets intensify. 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.

Higher than expected inflation has pushed major central banks to accelerate the normalisation of global policy rates, tightening global financial conditions.  On balance, and with some exceptions, capital flow and market volatility is expected to remain for emerging market assets and currencies.  Alongside currency depreciation, other risks to the inflation outlook, such as elevated food and fuel prices, have been realised.

Average surveyed expectations of future inflation have increased to 5.1% for 2022 (from 4.8%).  Expectations for inflation based on market surveys have increased to 5.9%.[12]  Long-term inflation expectations derived from the break-even rates in the bond market have also increased.[13]

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 closer to the mid-point in the fourth quarter of 2024,

[12] The (Q1) 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 May expect inflation to be higher at 5.9% (5.5%) in 2022, 4.7% (4.4%) in 2023 and 4.5% (4.4%) in 2024.

[13] 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 5.93% for the 5-year and 6.65% on the 10-year breakeven. 15-year break-even inflation sits at 6.91%.

taking into account the policy rate trajectory indicated by the Bank's Quarterly Projection Model (QPM).

Against this backdrop, the MPC decided to increase the repurchase rate by 50 basis points to 4.75% per year, with effect from the 20 of May 2022. Four members of the Committee preferred the announced increase and one member preferred a 25 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 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.[14] 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

[14] 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, 1.2% 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.

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.

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The next statement of the Monetary Policy Committee will be released on 21 July 2022.

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