SOUTH AFRICAN RESERVE BANK

**PRESS STATEMENT**

**22 September 2022**

## STATEMENT OF THE MONETARY POLICY COMMITTEE

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

In the wake of the Covid-19 pandemic and heightened geo-political tensions, the global economy has entered a period of persistently high inflation and weaker economic growth. Many developing economies exited the pandemic with less than full recovery and high debt levels.

Russia's war in Ukraine continues to impair production and trade of a wide range of energy, food and other commodities. The supply of energy to the Euro Area is limited as winter approaches, placing immense strain on households, businesses and governments. With rapid inflation and monetary policy normalization, the United States may also experience slower economic growth. While China's recovery from the Covid-19 lockdowns has strengthened, economic growth is expected to remain below longer-term trends.

Taking these and other factors into account, the SARB's forecast for global growth in 2022 is revised down from 3.3% in the July meeting to 3.0%, and is lowered to 2.0% (from 2.5%) for 2023.[1]

Although policy settings in advanced economies remain accommodative, policy normalization has accelerated, and higher yields are tightening global financial conditions. Asset values in major markets have declined sharply, and investor appetite for riskier assets has weakened further.

This year the SARB expects the South African economy to grow by 1.9%, (from 2.0%). Growth in the first quarter of this year surprised to the upside, at 1.7%. In the second quarter, flooding in Kwa-Zulu Natal and more extensive load-shedding contributed to a contraction of 0.7%. Growth in the third and fourth quarters is forecast to be 0.4% and 0.3%, respectively.

The economy is forecast to expand by 1.4% in 2023 and by 1.7% in 2024, above previous projections.[2] Private investment has strengthened on the back of the recovery, but public sector investment remains weak. Household spending remains supportive of growth, but is likely to soften next year. Tourism, hospitality and construction should see stronger recoveries as the year progresses.

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[1] Global growth in the QPM model is a trade-weighted average of South Africa's trading partners. Global growth in 2024 is revised down to 2.4% from 2.5% at the time of the July meeting. The International Monetary Fund's (IMF) July forecast expected global growth of 3.2% in 2022 and 2.9% in 2023. An update to the *World Economic Outlook* will be released in October.

[2] The growth forecast includes expected changes in the policy rate as given by the QPM.

With a low rate of potential, our current growth forecast leaves the output gap broadly unchanged.[3] The output gap is still expected to turn positive in the second quarter of 2023.

After revisions, the risks to the medium-term domestic growth outlook are assessed to be balanced. While negative global shocks and loadshedding will continue to create headwinds to growth, household spending and investment are more supportive.

Commodity price movements in recent months have been mixed. The export price of coal has increased alongside oil, while prices for metals have declined. While oil prices currently sit at around US$91 per barrel, we expect them to stay higher than we did in July, and to average US$105 per barrel for 2022, US$92 per barrel in 2023 and US$85 per barrel in 2024.[4]

South Africa's export commodity price basket has come down from earlier peaks and is now forecast to rise by 2.3% for the year as a whole (down from 3.2%), before falling in 2023 by about 17.6% and by a further 10.0% in 2024. As a result of these export and import developments, the current account balance is expected to register a surplus of 0.2% of GDP this year, falling to a deficit of 1.0% in 2023 and 1.6% in 2024.[5]

Although near term fiscal risk has eased on the back of better tax revenue, financing conditions for rand-denominated bonds have worsened. Ten-year bond yields currently trade at about 11.0%.

[3] Potential growth for 2022 is unchanged at 0.5%, 0.8% in 2023 and 1.1% in 2024.

[4] The Brent crude oil assumptions in July were US$108, US$92, and US$85, respectively.

[5] In July, the current account surplus for 2022 was expected to be 2.0% of GDP, 0.4% in 2023 and -0.4% in 2024.

Policy normalisation in major economies and the slowdown in China have contributed to rand depreciation in recent months. The implied starting point for the rand forecast is R16.91 to the US dollar, compared with R16.10 at the time of the previous meeting.[6]

While economic growth is slowing globally, inflation continues to surprise to the upside. Sustained policy accommodation, supply shortages and other restrictions have sharply increased the prices of many goods, services and commodities.[7] Producer price increases continue to pass-through to wages and consumer prices globally. Our estimate for inflation in the G3 is revised higher to 7.0% in 2022 (from 6.9%), up to 3.5% in 2023 (from 3.0%), and slightly higher at 2.1% in 2024.[8]

Since the previous meeting, the easing of global oil prices has contributed to a less aggressive rise in fuel price inflation for this year, at 33.7% (down from 38.8%). Further moderation in fuel price inflation is expected in 2023, averaging 1.7% (down from 5.7%). Local electricity price inflation is slightly lower at 10.9% in 2022, 8.9% in 2023, and is unchanged at 10% in 2024.

Despite reduced global food price inflation, local food price inflation is revised up and is now expected to be 8.1% in 2022 (up from 7.4%). Food price inflation is revised lower to 5.6% (down from 6.2%) in 2023 and remains unchanged at 4.2% in 2024.

The Bank's forecast of headline inflation for this year is unchanged at 6.5%. For 2023, headline inflation is revised lower to 5.3% (down from 5.7%), as a result of lower food,

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[6] The rand has depreciated by about 6.3% to the US dollar since the May meeting and 7.2% year to date.

[7] The UN FAO food index declined sharply in July, falling by 8.6% month to month, largely on the back of an agreement to reopen Black Sea ports. Consequently, the assumption used for the forecast for USD-denominated world food prices in 2022 was revised lower from 22.3% to 17.8%.

[8] The G3 comprises the United States, the Eurozone, and Japan. The latest CPI inflation in the respective components sits at 8.3%, 9.1% and 3.0%.

fuel and core inflation forecasts for next year. Headline inflation of 4.6% is expected in 2024 (down from 4.7%).

Our forecast for core inflation is unchanged at 4.3% in 2022, and lower than previously expected at 5.4% (down from 5.6%) in 2023. The forecast for 2024 is also slightly lower at 4.8% (from 4.9%). Services price inflation is broadly unchanged. Core goods price inflation however is forecast lower in each year, largely due to a lower starting point for vehicles and non-alcoholic beverages inflation.[9] Average salaries are forecast to rise by less than at the time of the July meeting, at 5.1% in 2022, 6.7% in 2023 and 5.6% in 2024.[10]

The risks to the inflation outlook are assessed to the upside. While global producer price and food inflation has eased, Russia's war in the Ukraine continues, with adverse effects on global prices. Oil prices increased strongly from the start of the war, to around US$130 per barrel, and may rise again from today's level as stresses in energy markets intensify. Electricity and other administered prices continue to present clear medium-term risks. Given below-inflation assumptions for public sector wage growth and high petrol and food price inflation, considerable risk still attaches to the forecast for average salaries.

Higher than expected inflation has pushed major central banks to accelerate the normalisation of policy rates, tightening global financial conditions and raising the risk profiles of economies needing foreign capital. G3 interest rate levels for the forecast

[9] Core goods refers to total CPI goods excluding food and NAB, fuel and energy, whereas services include all surveyed services within the CPI basket. Core goods inflation is expected to be 4.8% in 2022 (down from 5.2%), 5.5% in 2023 (down from 5.9%), and 4.9% in 2024 (down from 5.1%).

[10] Average salaries were expected to be 5.6%, 7.3%, and 5.7% at the time of the July meeting.

period are now expected to be somewhat higher than in July.[11] On balance, and with few exceptions, capital flows and market volatility will be elevated for emerging market assets and currencies. The rand depreciated by about 3.0% to the USD since the July meeting, and additional tightening of global conditions will present further risks to the currency.

The risks to inflation identified over the past year have been realized, pushing up South Africa's headline inflation rate and inflation expectations. Average surveyed expectations of future inflation have increased to 6.5% for 2022 and 5.9% for 2023.[12] Expectations for inflation based on market surveys have increased to 6.7%.[13] Long-term inflation expectations derived from the break-even rates in the bond market have moderated slightly to about 7%.[14]

In the second quarter of this year, headline inflation breached the target range and is expected to remain above it until the second quarter of 2023. By the fourth quarter of 2024, we expect headline inflation to revert to the mid-point of the target range, on the back of declining fuel and food inflation. The forecast takes into account the policy rate trajectory indicated by the Bank's Quarterly Projection Model (QPM). 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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[11] The weighted average of G3 policy rates is forecast to be 3.1% in 2023 (up from 3.0%) and 3.2% in 2024 (up from 3.1%).

[12] For 2024, the BER survey of inflation expectations in Q3 moderated to 5.4% (from 5.6%). The Q2 survey had 2022 expected inflation at 6.0% and 5.6% for 2023.

[13] Market analysts (Reuters Econometer) in September at the median expect inflation to be higher at 6.7% (from 6.5% in July) in 2022, 5.4% (5.0% from July) in 2023 and 4.6% in 2024 (4.4% from July).

[14] 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 about 6.90% for the 5-year and 6.92% on the 10-year breakeven. 15-year break-even inflation sits at 7.0%.

Against this backdrop, the MPC decided to increase the repurchase rate by 75 basis points to 6.25% per year, with effect from the 23rd of September 2022. Three members of the Committee preferred the announced increase. Two members preferred a 100 basis points increase.

The level of the repurchase rate is now closer to the level prevailing before the start of the pandemic. The revised repurchase rate path remains supportive of credit demand in the near term, while raising rates to levels more consistent with the current view of inflation risks. The aim of policy is to anchor inflation expectations more firmly around the mid-point of the target band and to increase confidence of hitting the inflation target in 2024.[15]

Guiding inflation back towards the mid-point of the target band can reduce the economic costs of high inflation and enable lower interest rates in the future. Achieving a prudent public debt level, increasing the supply of energy, moderating administered price inflation and keeping wage growth in line with productivity gains would enhance the effectiveness of monetary policy and its transmission to the broader economy.

Economic and financial conditions are expected to remain more volatile for the foreseeable future. In this uncertain environment, monetary 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. The Bank will continue to closely monitor funding markets for stress.

[15] The forecasted trajectory for the repurchase rate implies a rise in the inflation-adjusted repo rate from -1.7% for 2021 to -1.7% for 2022, 1.4% for 2023, and 2.2% in 2024. The real repurchase rate calculation here is based on the 1-quarter ahead inflation forecast and are annual average rates.

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The next statement of the Monetary Policy Committee will be released on 24 November 2022.

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