SOUTH AFRICAN RESERVE BANK

PRESS STATEMENT

EMBARGO DELIVERY

27 January 2022

STATEMENT OF THE MONETARY POLICY COMMITTEE

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

Over the past year, rising vaccination rates have sustained confidence and the global economic recovery, despite the rapid spread of the Omicron virus. Looking ahead to this year, global growth will be slower as the rebound from the pandemic fades. Growth in emerging market and developing economies will continue to lag that in advanced economies, due to a slower pace of vaccinations and other headwinds. South Africa's economy rebounded strongly from the pandemic in 2021, but going forward the growth rate will, like global growth, slow and remain subject to various risks.

The International Monetary Fund's (IMF) forecast for global gross domestic product (GDP) is unchanged at 5.9% in 2021. Global growth is expected to slow to 4.4% in 2022 (down from 4.9%). The SARB's forecast for global growth in 2021 sits at 6.2% (down from 6.3%), 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 less supportive of emerging and developing economies now than they were for most of this past year.

Although policy settings in advanced economies remain accommodative, higher global inflation is likely to accelerate normalisation of interest rates and balance sheet reductions by major central banks. It is less certain how far the normalisation process will go and the exact timing, and this uncertainty continues to cause financial market turmoil and capital flow volatility. Risk aversion in financial markets has increased. 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, but also the damage caused by the July unrest, cyber attacks and strikes. Those factors led to a downward revision to the growth forecast for the year as a whole, from the 5.2% forecast in November to 4.8%.[2]

This year and next, economic growth will remain well above a low rate of potential growth.[3] GDP is expected to grow by 1.7% in 2022. The deceleration in growth from 2021 to 2022 is primarily a result of the fading rebound from the pandemic, alongside a climbdown from high export prices. GDP growth is forecast to be 1.8% in 2023 and 2.0% in 2024.[4]

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

[2] In the third quarter of 2021, economic growth was -5.8%, compared to our previous estimate of -2.5%. For the fourth quarter, we expect a GDP outcome of 5.5%, compared to the previous 2.6%. On a not-annualised basis, the quarter-on-quarter growth rate for the third quarter was -1.5%, compared to our estimate of -0.6%. The fourth quarter is expected to be 1.4%, compared to 0.6%.

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

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

With lower export prices the economy's future demand will depend more on investment and household spending. Sustained low borrowing costs and faster economic growth have strengthened private sector investment somewhat, despite ongoing constraints from loadshedding and policy uncertainty. Household spending remains supportive, as a result of good growth in disposable income, rising asset prices, and more credit demand.

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

With the downward revision to GDP growth for 2021, the output gap is more negative over the forecast period compared to the November meeting. However, as the economy is forecast to grow faster than potential, the output gap closes steadily through to 2024.

While important commodity export prices such as for coal, iron ore, platinum, and rhodium generally decreased in the latter half of 2021, in recent weeks some prices and export values have been more buoyant. As a result, the current account surplus of the past year is expected to decline at a slower pace than at the time of the November meeting.[5] The current account deficit in 2023 and 2024 is, at this stage, forecast to be smaller than previously expected.

Although fiscal risk has eased, financing conditions remain volatile and the yield curve for rand-denominated bonds remains steep. Ten-year bond yields remain at about 9.4%.

[5] The current account surplus is expected to decline in 2022 to about 0.4% of GDP (from 3.8% of GDP in 2021). The current account is expected to be in deficit of -0.2% in 2023 (from -1.8%) and -0.6% in 2024 (from -2.5%).

For much of 2021, strong commodity export prices and generally favourable global financial and economic conditions strengthened the currency above its long-run equilibrium level. In recent months, global and domestic factors contributed to a weaker rand exchange rate and the rand now sits somewhat below its equilibrium level. The implied starting point for the rand forecast is R15.60 to the US dollar, compared with R15.10 at the time of the previous meeting.[6]

Over the past year and into this year, global supply shortages and strong demand have caused a wide range of prices to accelerate, including raw materials, intermediate inputs and food.[7] Some of these price increases have passed-through to consumer prices in major economies. Our estimate for inflation in the G3 was revised higher to 3.1% in 2021 and 2022 (up from 2.9% and 2.4%), and is revised slightly lower to 1.7% in 2023.[8] For 2024, G3 inflation of 1.6% is forecast, unchanged from the previous meeting.

Oil prices are revised up for this year, and fuel price inflation is higher at 13.7% (up from 4.6%).[9] Local electricity price inflation for 2021 was 10.2%, while the forecast for 2022 is revised up to 14.5% (from 14.4%) and remains at 12.4% in 2023. For 2024, electricity price inflation of 10% is expected, unchanged from the previous meeting.

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[6] The rand has appreciated by about 1.5% to the US dollar since the November meeting.

[7] World food prices continue to rise. The assumption used for the forecast for USD-denominated world food prices increased from 13.4% in September to 25.4% for November and to 28% for the January meeting.

[8] The G3 comprises the United States, the Eurozone, and Japan. The latest CPI inflation in the respective components sits at 7%, 5% and 0.6%.

[9] For 2023 and 2024, petrol price inflation is expected to be -0.1% and 1.7%, respectively. Our assumptions are now for oil prices to average $78 per barrel in 2022 and $72 per barrel in 2023. An average price of $70 per barrel is expected in 2024.

Headline inflation in 2021 came out at 4.5%. The Bank's forecast of headline inflation for this year is revised higher to 4.9% (from 4.3%). Headline inflation is expected to be 4.5% in 2023 and in 2024.

Core inflation was 3.1% in 2021, and is forecast to rise to 3.8% in 2022 (up from 3.7%). With the economy expanding faster than potential over the forecast period, core inflation is projected to rise to 4.5%, despite a still low rate of services price inflation and unit labour costs. Core inflation forecasts for 2023 and 2024 are unchanged at 4.4% and 4.5%.

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. Oil prices increased strongly through 2021 and are up sharply year to date. Current oil prices sit well above forecasted levels for this year. Electricity and other administered prices continue to present short- and medium-term risks. Given the moderate medium and long-term inflation projections set out above, higher domestic import tariffs, stronger services inflation, and higher wage demands present additional upside risks to the inflation forecast.

A particular risk arises from the possibility of a faster normalisation of global policy rates than is currently built into the forecast, which assumes some rate hikes to begin around June of 2022. Added to this is the risk that quantitative tightening will occur more quickly than previously expected, leading to stronger capital flow reversals from riskier assets such as emerging market debt.

Average surveyed expectations of future inflation have increased to 4.8% for 2022 (from 4.4%). Market-based surveyed expectations for inflation have also increased to 4.8%.[10]

In the near term, headline inflation has increased well above the mid-point of the inflation target band, and returns close to the mid-point in the fourth quarter of 2022. 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% per year, with effect from the 28th of January 2022. Four members of the Committee preferred an increase and one member preferred an unchanged stance.

The implied policy rate path of the Quarterly Projection Model (QPM) indicates gradual normalisation in the first quarter of 2022, and into 2023 and 2024, given the inflation forecast. 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. However, economic and financial conditions are expected to remain more volatile for the foreseeable future. In

[10] The (Q4) Bureau for Economic Research (BER) survey expectations rose above the target midpoint to 4.8% (4.4%) for 2022 and 4.7% (4.5%) for 2023. Market analysts (Reuters Econometer) in January expect inflation to be higher at 4.8% (4.5%) in 2022, 4.5% (4.3%) in 2023 and 4.4% in 2024. 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 4.8% for the 5-year and 5.93% on the 10-year breakeven. 15-year breakeven inflation sits at 6.4%.

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.

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.[11] 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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The next statement of the MPC will be released on 24 March 2022.

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[11] This implies a rise in the inflation-adjusted repo rate from -1.4% for 2021 to 0.0% for 2022, 1.0% for 2023, and 1.8% in 2024. The real repurchase rate calculation here is based on the 1-quarter ahead inflation forecast.