SOUTH AFRICAN RESERVE BANK

**PRESS STATEMENT**

**24 November 2022**

## STATEMENT OF THE MONETARY POLICY COMMITTEE

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

High inflation and weak economic growth continue to shape global conditions alongside monetary and fiscal policy responses. Russia's war in the Ukraine drags on, impairing trade and raising prices of a wide range of energy, food and other commodities. Growth in the United States is set to weaken, and remains low in China. Although energy constraints have eased somewhat in the Euro Area, recession risk is high. Additionally, a number of developing economies face debt distress, exacerbated by tighter global financial conditions.[1]

Policy normalisation has accelerated and monetary conditions are likely to tighten further to ensure inflation declines from its current high rates. With long-term borrowing costs high and fiscal positions extended, there is less policy space available for major counter-cyclical efforts to increase economic growth. In several economies, including South Africa, ongoing consolidation of fiscal positions will support disinflation. Asset

[1] According to the IMF's October 2022 Global Financial Stability Report, eight low-income countries are in debt distress and 30 are at high risk of distress (out of 69 countries considered low-income countries—among which, there are some frontier markets).

values in major markets have also declined sharply, and investor appetite for riskier assets remains weak.

Taking these and other factors into account, the SARB's forecast for global growth in 2023 is revised lower to 1.9% (from 2.0%).[2] The International Monetary Fund's (IMF) October's forecast for global growth is 3.2% in 2022 and 2.7% in 2023.

We now expect the South African economy to grow by 1.8% (from 1.9%) this year. Despite considerable volatility in monthly indicators, GDP growth of 0.4% is still expected in the third quarter. Fourth quarter growth is forecast to be only 0.1%, largely due to record load-shedding.

Over the medium term, and despite stronger private investment, the forecast takes into account lower commodity prices, higher inflation and interest rates. On the supply side, the forecast incorporates an assumption of increased load-shedding, which could deduct 0.6 percentage points in 2023.

As a result of these factors, the economy is forecast to expand by 1.1% in 2023 (from 1.4%) and by 1.4% in 2024 (from 1.7%), below previous projections.[3] GDP growth of 1.5% is forecast for 2025.

With a low rate of potential, our current growth forecast leaves the output gap slightly larger in the near term, before closing in the third quarter of 2023.[4]

[2] Global growth in the QPM model is a trade-weighted average of South Africa's trading partners. Global growth in 2024 is forecast unchanged at 2.4%, before rising to 3.1% in 2025.

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

[4] Potential growth for 2022 is revised lower at 0.4%, 0.5% in 2023 and unchanged at 1.1% in 2024. For 2025, potential growth is forecast at 1.5%.

After revisions, the risks to the medium-term domestic growth outlook are assessed to the downside.

Commodity price movements in recent months have been mixed, with oil prices relatively stable and export prices lower. Compared to September, our oil price forecast is broadly unchanged, averaging US$102 per barrel for 2022 and US$92 per barrel in 2023.[5] South Africa's export commodity price basket has come down from earlier peaks.[6]

As a result of weaker export developments, the current account balance is expected to be -0.2% of GDP this year, falling to -1.5% in 2023 and -1.9% in 2024.[7] The current account balance in 2025 is expected to be -2.1% of GDP.

Although near term fiscal risk has eased on the back of better tax revenue, a weaker commodity price trajectory than currently expected could increase risk. Financing conditions for rand-denominated bonds have been generally tight and more volatile in recent months. Ten-year bond yields currently trade at about 10.7%.

Policy normalisation in major economies and the slower growth in China have contributed to depreciation of many emerging market currencies, including the rand. The implied starting point for the rand forecast is R17.76 (22q4) to the US dollar, compared with R16.91 (22q3) at the time of the previous meeting.

[5] The Brent crude oil assumptions in September were US$105, US$92, and US$85, respectively. The current forecast is for oil prices remains unchanged at US$85 for 2024 and is US$80 for 2025.

[6] Commodity export prices are now forecast to rise by 1.2% for the year as a whole (down from 2.3%), before falling in 2023 by about 18.1% and by a further 11.0% in 2024.

[7] In September, a current account balance for 2022 was expected to be 0.2% of GDP, -1.0% in 2023 and -1.6% in 2024.

Globally, economic growth is slowing and prices have fallen for some goods and transport services. However, price pressures continue to spread from goods to services and wages.[8] Our estimate for inflation in the G3 is revised higher to 7.3% in 2022 (from 7.0%), and 4.1% in 2023 (from 3.5%). The forecast for 2024 is unchanged at 2.1%.[9]

Even though South Africa's fuel price inflation for the year remains exceedingly high, some easing of global oil prices has led to forecast revisions in the last few MPC meetings. Fuel price inflation for this year is now forecast at 33.3% (down from 33.5%), falling to 0.8% in 2023 (down from 1.1%). Local electricity price inflation is slightly higher at 10.7% in 2022, 9.0% in 2023, and is unchanged at 10% in 2024.

Global food price inflation has declined. However, local food price inflation is revised up due in part to the weaker exchange rate and is now expected to be 8.8% in 2022 (up from 8.1%). Food price inflation is revised higher to 6.2% (from 5.5%) in 2023 and unchanged at 4.2% in 2024.

The Bank's forecast of headline inflation for this year and next is slightly higher at 6.7% and 5.4%, respectively. In 2024 and 2025, we expect headline inflation of 4.5%.

Our forecast for core inflation is unchanged at 4.3% in 2022, and is higher than previously expected at 5.5% (from 5.4%) in 2023. The forecast for 2024 is unchanged at 4.8%, and 4.5% is projected for 2025. Services inflation is broadly unchanged, and continues to be driven by expected spillover effects and steadily rising unit labour

[8] Inflation in agricultural commodities decelerated sharply in 2022Q3 with the UN FAO Food Price index (FPPI) increasing by 8.7% (compared to 25.5% increase in 2022Q2), helped lower by a sharp decline in cereals and vegetable oils. Consequently, the assumption used for the forecast for USD-denominated world food prices in 2022 was revised lower from 17.8% to 14.7%.

[9] The G3 comprises the United States, the Eurozone, and Japan. The latest CPI inflation in the respective components sits at 7.7%, 10.6% and 3.7%. We expect G3 inflation of 2.0% in 2025.

costs. Core goods price inflation is forecast somewhat higher at 5.7% for next year.[10] The forecast for average salary growth is broadly unchanged.[11]

Risks to the inflation outlook are assessed to the upside. Despite easing of global producer price and food inflation, Russia's war in the Ukraine continues, with adverse effects on global prices generally. The oil market is expected to remain tight, with upside risk to prices. Electricity and other administered prices continue to present clear medium-term risks. Given low public sector wage assumptions, 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. This has tightened global financial conditions and raised the risk profiles of economies needing foreign capital. G3 interest rate levels for the forecast period are now expected to be significantly higher than in September.[12] On balance, and with few exceptions, capital flow and market volatility will be elevated for emerging market assets and currencies. While the rand has recovered somewhat, it has depreciated by about 7% year to date against the USD.

Inflation expectations increased strongly over this year and remain high. Expectations of future inflation surveyed in the third quarter of this year had earlier increased to 6.5% for 2022 and 5.9% for 2023.[13] Expectations for inflation in 2022 based on market

[10] 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, 5.7% in 2023, 4.9% in 2024, and 4.5% in 2025.

[11] Average salaries were expected to be 5.1%, 6.7%, and 5.6% for 2022, 2023 and 2024 at the time of the September meeting. For the November meeting, the respective figure are 5.3%, 6.7%, 5.4%, and 4.8% for 2025.

[12] The weighted average of G3 policy rates is forecast to be 3.6% in 2023 (up from 3.1%), 3.4% in 2024, and 2.4% in 2025.

[13] For 2024, the BER survey of inflation expectations in Q3 moderated to 5.3% (from 5.4%). The Q3 survey had 2022 expected inflation at 6.5% and 5.9% for 2023.

surveys have increased to 6.8%.[14] By contrast, long-term inflation expectations derived from the 5-year break-even rates in the bond market have moderated to 5.27%.[15]

In the second quarter of this year, headline inflation breached the upper end of the target range, and is forecast to remain above it until the second quarter of 2023. Headline inflation is only expected to sustainably revert to the mid-point of the target range by around the second quarter of 2024. 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.

Against this backdrop, the MPC decided to increase the repurchase rate by 75 basis points to 7% per year, with effect from the 25th of November 2022. Three members of the Committee preferred the announced increase. Two members preferred a 50 basis points increase.

The level of the repurchase rate is now above the level prevailing before the start of the pandemic. The revised repurchase rate remains supportive of credit demand in the near term, while raising rates to levels more consistent with the current view of inflation and risks to it. The aim of policy is to anchor inflation expectations more firmly

[14] Market analysts (Reuters Econometer) in November at the median expect inflation to be higher at 6.8% (from 6.7% in September) in 2022, 5.4% in 2023 and 4.6% in 2024.

[15] 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 5.27% for the 5-year and 6.14% on the 10-year breakeven. 15-year break-even inflation sits at 6.43%.

around the mid-point of the target band and to increase confidence of attaining the inflation target sustainably over time.[16]

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.

Lesetja Kganyago

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The next statement of the Monetary Policy Committee will be released on 26 January 2023.

The MPC dates for 2023 are as follows:

24 – 26 January 2023

28 – 30 March 2023

[16] The forecasted trajectory for the repurchase rate implies a rise in the inflation-adjusted repo rate from -1.5% in 2021 to -1.0% in 2022, 1.7% for 2023, and 2.3% in 2024. The real repo level for 2025 is expected to be 2.4%. The real repurchase rate calculation here is based on the 1-quarter ahead inflation forecast and are annual average rates.

23 – 25 May 2023

18 – 20 July 2023

19 – 21 September 2023

21 – 23 November 2023.

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