SOUTH AFRICAN RESERVE BANK

PRESS STATEMENT

20 July 2023

STATEMENT OF THE MONETARY POLICY COMMITTEE

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

As we enter the second half of 2023, near term prospects for the global economy are broadly unchanged, with inflation easing and growth forecasts stable. The longer-term economic outlook however remains clouded by risks to the inflation trajectory, ongoing geopolitical tensions and the effects of climate change. China's growth performance is expected to remain modest, with little benefit to commodity prices.[1] In the developing world, many economies face high debt levels, weaker economic growth and prolonged adverse financing conditions. As a result, Sub-Saharan Africa's growth prospects remain muted.

While goods price inflation has eased in much of the world, core inflation remains elevated, keeping consumer price inflation from falling more sharply. Globally,

[1] Commodity export prices in USD terms fell by 0.9% in 2022. South Africa's commodity export index is forecast to *decline* by 27.6% this year, a further 11.5% in 2024, and an additional 5.4% in 2025.

monetary policy is likely to remain focused on ensuring inflation continues to retreat, implying policy rates will stay higher. We expect markets in major financial centers to remain volatile.

Taking these and other factors into account, the SARB's forecast for global growth in 2023 is revised marginally higher to 2.5% (from 2.4%), and remains unchanged at 2.7% in 2024.[2]

While South Africa's economic conditions appear to have improved, the longer-term outlook mirrors the uncertainty of the global environment. Prices for commodity exports continue to weaken. In addition, energy supply remains unreliable and stronger El Nino conditions threaten the agricultural outlook.

For 2023, the Bank's forecast for South Africa's GDP growth is slightly higher than in May, at 0.4% (from 0.3%). Energy and logistical constraints remain binding on the growth outlook, limiting economic activity and increasing costs.[3]

From a demand perspective, spending by firms, households, public corporations and general government remains positive in real terms. Disposable income of households continues to grow, albeit slowly. Investment by the private and public sectors is revised up and the terms of trade has remained more beneficial than previously forecast. Debt service costs of households have increased to 8.4% of disposable

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

[3] The number of days of expected load-shedding is 280 days in 2023, decreasing to 150 days and 100 days, respectively in 2024, and 2025. Estimates of the average stages of load-shedding is multiplied by the number of days and then multiplied by the cost to GDP per stage-day. The cost per stage has been revised lower for stages 1 and 2. In nominal terms, these costs vary between R0-R1.2 million for stages 1 and 2 and up to R204-R899 million for stages 3 to 6, when continued on a 24 hour basis on weekdays.

income, and now sit at around the average for the past decade.[4] Although credit growth to households and corporates has slowed in recent months, it has increased in real terms compared to last year.

Our GDP growth forecast for 2024 and 2025 is unchanged from the previous meeting, at 1.0% and 1.1%, respectively.[5]

While households and firms exhibit resilience, economic growth has been volatile for some time and highly sensitive to new shocks. An improvement in logistics and a sustained reduction in load-shedding, or greater energy supply from alternative sources, would significantly increase growth.

At present, we assess the risks to the medium-term domestic growth outlook to be balanced.

Turning to inflation prospects, our current growth forecast leaves the output gap around zero over the next three years, implying little positive or negative pressure on inflation from GDP growth.[6]

South Africa's external financing needs are expected to rise due to expansion in the current account deficit. Despite somewhat lower oil prices, falling export commodity prices are forecast to result in a current account deficit of 1.9% of GDP this year (down from 2.5%), 2.9% and 3.3% of GDP in 2024 and 2025, respectively.[7]

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[4] Debt service costs are the product of prevailing interest rates and debt volumes. The average from 1994 to 2019 was 8.8%. From the beginning of the pandemic until March 2023, the average was 7.4%. In the last quarter of 2022, the average was 7.9%.

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

[6] Potential growth is revised marginally, to -0.1% in 2023 (up from -0.2%), and is unchanged at 0.8% for 2024 and 1.0% for 2025.

[7] In May, a current account balance of -2.5% of GDP was expected for the forecast period. Exports are forecast to grow in real terms by 6.2% this year (from 1.8%) and 3.4% in 2024. Our oil price forecast is also slightly

Sharply lower tax revenue, higher employee compensation and ongoing financing needs of state-owned enterprises are likely to keep the long-term cost of borrowing elevated. Despite the expected moderation of inflation over the forecast period, long-term bond yields currently trade at about 11.6%.

The rand has generally weakened over the past year, depreciating by about 5% year to date against the US dollar, and showing high volatility in response to risk-on and risk-off episodes. The implied starting point for the rand forecast is R18.52 (23q3) to the US dollar, compared with R18.73 at the time of the previous meeting.

The trajectory of South Africa's headline inflation rate has been shaped primarily by fuel, electricity and food price inflation. Compared to the previous meeting, fuel price inflation is lower at -3.1% in 2023 (from -2.0%). The electricity price forecast is unchanged at 11.6% this year, 13.4% in 2024, and 10.9% in 2025. Our food price inflation forecast for 2023 remains high but is revised lower in this meeting to 10.3% (from 10.8%), and up slightly to 5.2% in 2024 (from 5.0%).

Better monthly outcomes have led to a downward revision in our forecast for core inflation to 5.2% in 2023 (previously 5.3%), 4.9% (from 5.0%) and 4.5% (from 4.6%) in 2024 and 2025, respectively. Services price inflation in 2023 is expected to come in at 4.8% (down from 4.9%). Core goods inflation, while still elevated, is also revised

lower than in May, averaging US$81 per barrel in 2023, and unchanged at US$82 for 2024 and US$80 for 2025.

slightly lower for this year at 6.2% (from 6.3%).[8] Growth in average salaries and unit labour costs is lower in 2023 and 2024 and slightly higher in 2025.[9]

With core goods and food inflation lower in the near term, headline inflation for 2023 is revised down to 6.0% (from 6.2%). The headline inflation forecast for 2024 also decreases to 5.0%, before stabilising at 4.5% in 2025.

Risks to the inflation outlook are assessed to the upside. Headline inflation at a global level continues to moderate, but food price inflation remains high and oil markets remain tight. Despite recent easing in some food price components, domestic food price inflation is still elevated at 11% in June and the risk of drier weather conditions in coming months has increased. In the absence of sustained and consistent increases in energy supply, electricity prices continue to present clear inflation risks. Load-shedding and logistics constraints may also have broader effects on the cost of doing business and the cost of living. Given uncertain fuel and food price inflation, considerable risk still attaches to the forecast for average salaries.

Sticky inflation in major economies suggests that average interest rates in these economies will remain high.[10] As a result, tighter global financial conditions are likely to persist, raising the risk profile of economies needing foreign capital.

Higher inflation outcomes have generally resulted in elevated inflation expectations across businesses and households, while market-based expectations have eased

[8] Core goods refers to total CPI goods excluding food and NAB, fuel and electricity, whereas services include all surveyed services within the CPI basket. Core goods inflation is expected to be 5.1% in 2024 and 4.3% in 2025.
[9] Average salaries are expected to rise by 6.6% in 2023, 6.1% in 2024, and by 5.2% in 2025, compared to 6.8%, 6.5%, and 4.9%, at the time of the May meeting, respectively. Unit labour costs are forecast to rise by 6.0%, 5.3% and 4.6%, respectively, in 2023, 2024, and 2025.
[10] G3 interest rates average 4.0% in 2023, 3.9% in 2024, and 2.6% in 2025.

recently.[11] The Bureau for Economic Research survey released in July shows average inflation expectations of 6.5% for 2023 (from 6.3% in the first quarter). Expectations for inflation in 2023 based on market surveys are currently 5.9%, and near-term break-even rates have decreased to around 4.5%.[12] Longer-term expectations remain elevated.

Headline inflation returned to the upper end of the inflation target range in June, and is forecast to sustainably revert to the mid-point of the target range by the third quarter of 2025. The forecast takes into account the policy rate trajectory indicated by the Bank's Quarterly Projection Model (QPM).

Against this backdrop, the MPC decided to keep the repurchase rate at its current level of 8.25% per year. Three members of the Committee preferred to keep rates on hold and two preferred an increase of 25 basis points.

At the current repurchase rate level, policy is restrictive, consistent with elevated inflation expectations and the inflation outlook. Serious upside risks to the inflation outlook remain. In light of these risks, the Committee remains vigilant and decisions will continue to be data dependent and sensitive to the balance of risks to the outlook.

The policy stance aims to anchor inflation expectations more firmly around the mid-point of the target band and to increase confidence of attaining the inflation target sustainably over time.[13] The MPC will seek to look through temporary price shocks

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[11] The BER Q2 2023 survey of inflation expectations indicated inflation at 6.5% in 2023 (up from 6.3% in Q1) and 5.9% for 2024 (up from 5.8% in Q1) and 5.6% in 2025.

[12] At the median, market analysts (Reuters Econometer) in July expect inflation to remain at 5.9% in 2023, 4.9% in 2024 and 4.4% in 2025 (from 4.6%). Market-based rates are calculated from the break-even inflation rate, which is the yield differential between conventional and inflation-linked bonds. The 10-year breakeven now sits at about 6.1%. The 15-year break-even inflation rate sits at 7.3%.

[13] The forecasted trajectory for the repurchase rate implies a rise in the inflation-adjusted repo rate from -1.4% in 2022, to 2.7% in 2023, and 3.0% in 2024. The real repo level for 2025 is expected to be 2.7%. The real

and focus on potential second round effects and the risks of de-anchoring inflation expectations.

Guiding inflation back towards the mid-point of the target band reduces the economic costs of high inflation and will achieve lower interest rates in the future. Since early 2020, the Committee has recommended additional and indirect means of lowering inflation that are within the reach of the public sector, including 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 would strengthen monetary policy effectiveness and its transmission to the broader economy.

The repo rate projection from the updated QPM remains a broad policy guide, changing from meeting to meeting in response to new data and risks.

Lesetja Kganyago

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The next statement of the Monetary Policy Committee will be released on 21 September 2023.

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repurchase rates calculated here are based on the 3-quarter ahead inflation forecast and are annual average rates.