SOUTH AFRICAN RESERVE BANK

PRESS STATEMENT

30 March 2023

STATEMENT OF THE MONETARY POLICY COMMITTEE

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

As we enter the second quarter of the year, sticky inflation, sluggish growth and now elevated financial stability risks mark the global economy. Despite somewhat better growth outcomes in the first months of the year, we see no material easing of difficult global economic conditions.

Russia's ongoing war in the Ukraine weighs heavily on European growth prospects, while financial conditions in the United States continue to tighten. The growth outlook for China has improved but is likely to remain modest by historical standards. Many economies in the developing world face weaker economic growth and prolonged adverse financing conditions.[1] With inflation and policy rates remaining higher for

[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).

longer, and new weaknesses emerging in financial institutions, we expect global financial markets to remain volatile.

Taking these and other factors into account, the SARB's forecast for global growth in 2023 is revised higher to 2.0% (from 1.6%).[2] Growth in 2024 is revised slightly lower to 2.5% (from 2.6%). The International Monetary Fund's (IMF) January update forecast global growth at 2.9% in 2023 and 3.1% in 2024. That forecast will be updated in April.

The South African economy contracted by 1.3% in the fourth quarter of 2022, considerably worse than expected at the time of the January meeting. The contraction was broad-based, consistent with the extensive load-shedding experienced in the final three months of the year. For the whole of last year, GDP growth of 2.0% was achieved, compared to the 2.5% previously expected.

For 2023, the Bank's forecast for GDP growth is lowered slightly to 0.2% from the 0.3% expected in January. As a result of extensive load-shedding and logistical constraints, the supply performance of the economy remains severely impaired. As previously noted, these constraints deduct 2 percentage points from growth this year.

Over the forecast period, we expect household spending and investment to grow modestly, even as loadshedding and uncertainty continue to weigh heavily on consumption and investment decisions.[3] Private sector investment is expected to remain positive, in large part reflecting efforts to overcome constraints in energy and

[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 in 2023 remains unchanged at 250 days, 150 days and 100 days, respectively in 2023, 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.

transport supply. The SARB's commodity price index, which in historical terms still remains above its long-run average, is forecast to continue to ease.

As a result of these factors, the economy is forecast to expand by 1.0% in 2024 (up from 0.7%) and by 1.1% in 2025 (up from 1.0%).[4]

Economic growth has been volatile for some time and prospects for growth appear even more uncertain than normal. An improvement in logistics and a sustained reduction in load-shedding or increased energy supply from alternative sources would significantly raise growth. Further upside risks to growth could emerge from a stronger recovery in China, if commodity export prices rise. Downside risks however emanate from more modest global growth rates and the lower terms of trade and trade volumes that would follow.

Overall, the risks to the medium-term domestic growth outlook are assessed to be balanced. Nonetheless, the domestic and global outlook appears to be highly sensitive to new shocks. Core inflation remains high in much of the world and financial vulnerabilities have re-emerged to create new headwinds.

Turning to inflation prospects, our current growth forecast leaves the output gap around zero, implying little positive or negative pressures on inflation from expected growth.[5]

South Africa's external financing needs however are expected to rise. With a sharply lower export commodity price index, stable oil prices, and somewhat weaker growth

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

[5] Potential growth for 2022 was revised higher to 0.7%, and lowered in 2023 to 0.0%. It is also revised lower to 0.6% for 2024 (from 1.1%) and to 1.1% for 2025 (down from 1.6%).

in export volumes, the current account balance is forecast to deteriorate to a deficit of 2.7% of GDP for the next three years.[6]

Weaker commodity prices and higher state-owned enterprise financing needs will put pressure on financing conditions for rand-denominated bonds. Ten-year bond yields currently trade at about 11.2%, despite the expected moderation of inflation over the forecast period.

The rand has generally weakened over the past year. Recent weeks have seen further sharp depreciation and then some reversal as sentiment shifted abruptly in the wake of policy decisions in some major advanced economies. The implied starting point for the rand forecast is R18.06 (23q2) to the US dollar, compared with R17.32 at the time of the previous meeting. Currency markets are expected to remain volatile.

While headline inflation eased in major economies (G3) in December, price pressures remain clearly evident in measures of core inflation, services and wages. In the G3 economies, consumer prices rose by 7.5% in 2022. Our estimate for inflation in the G3 is higher at 4.2% in 2023 (up from 4.0%) and 2.1% in 2024 (up from 1.8%) and unchanged at 2.0% in 2025 (up from 1.9%).[7]

The rise in South Africa's headline inflation rate has been shaped primarily by fuel, electricity and food price inflation. Fuel price inflation last year averaged 34.4% and is

[6] In January, a current account balance of about -1.8% of GDP was expected for the forecast period. Exports are forecast to grow in real terms by only 1.8% this year and 2.3% in 2024. Commodity export prices rose by 1.4% in 2022. South Africa's commodity export index is forecast to decline by about 20% this year, and a further 11.7% in 2024, before stabilising somewhat in 2025. Our oil price forecast is also slightly lower than in January, averaging US$87 per barrel in 2023. The Brent crude oil assumptions are US$85 for 2024 and US$80 for 2025 (unchanged).

[7] The G3 comprises the United States, the Eurozone, and Japan. The latest CPI inflation in the G3 sits at 6.0%, 8.5% and 3.3%.

expected to be -0.6% in 2023 (up from -2.7%). The electricity price forecast is unchanged at 12.9% in 2023, 14.5% in 2024, and 10.9% in 2025.

Local food price inflation is revised up again despite global food prices falling in dollar terms, in part due to the lagged impact of the weaker exchange rate.[8] Food price inflation is now expected to be 9.9% in 2023 (up from 7.3%) and 4.5% in 2024 (up from 4.4%).

Our forecast for core inflation is largely unchanged at 5.1% in 2023 (previously 5.2%) and 4.8% and 4.5% in 2024 and 2025. Services price inflation in 2023 is forecast to be 4.9%, lower than previously expected. Core goods inflation, however, is forecast higher for this year at 5.9% (up from 5.5%).[9] The forecast for average salary growth and unit labour costs is somewhat lower in 2023 and higher in 2024 and 2025.[10]

With core goods and food higher in the near term, headline inflation for 2023 is revised significantly higher to 6.0% (up from 5.4%). Despite this, food and fuel inflation are expected to ease, resulting in a headline forecast of 4.9% for 2024 and 4.5% in 2025.

Risks to the inflation outlook, however, are assessed to the upside. Despite some easing of producer price and food inflation, global price levels remain elevated. Russia’s war in the Ukraine and China’s economic rebound are expected to keep the global oil market relatively tight. Electricity prices and other administered prices

[8] Inflation in agricultural commodities decelerated to 0.1% in 2022Q4 (from 8.5% in 2022Q3) due to vegetable oils and cereals components. This year, global food inflation is expected to be in deflation (after registering 14.2% in 2022) due to base effects and improving supply constraints.

[9] 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 4.9% in 2024 and 4.5% in 2025.

[10] Average salaries were expected to be 6.9%, 5.5%, and 4.7% for 2023, 2024 and 2025 at the time of the January meeting. The March figures are 6.4%, 6.2%, and 5.1%, respectively. Unit labour costs are forecast to rise by 6.1%, 6.0% and 4.4%, respectively, in 2023, 2024 and 2025. Productivity per unit of labour is lower due to reduced expected output.

continue to present clear short and medium-term risks. Domestic food price inflation surprised higher again in February, and risks of drier weather conditions have increased. Load-shedding may additionally have broader price effects on the cost of doing business and the cost of living, in particular as diesel consumption increases. Given sticky petrol and higher food price inflation, considerable risk still attaches to the forecast for average salaries.

Interest rate levels in major economies are higher than were projected in January, averaging 3.8% in 2023 (up from 3.7%), 3.5% in 2024, and unchanged at 2.4% in 2025. Tighter global financial conditions raise the risk profiles of economies needing foreign capital, leading generally to weaker currencies. South Africa's risk premium is sharply higher and will likely remain elevated over the forecast period. Given load-shedding, upside inflation risks, and larger external financing needs, further currency weakness appears likely.

Inflation expectations increased strongly over the past year. Average expectations of future inflation surveyed in the first quarter of this year increased further to 6.3% for 2023 and 5.8% for 2024.[11] Expectations for inflation in 2023 based on market surveys are 5.8%.[12] Long-term inflation expectations derived from the 5-year break-even rates in the bond market sit at 5.27%.[13]

Headline inflation breached the upper end of the target range in the second quarter of 2022, and is forecast to remain above it until the third quarter of this year. Headline

[11] The BER Q4 2022 survey of inflation expectations indicated inflation at 6.1% in 2023 (up from 5.9% in Q3)) and 5.6% for 2024 (up from 5.3% in Q3).

[12] At the median, market analysts (Reuters Econometer) in March expect inflation to be higher at 5.8% (from 5.6% in February) in 2023, 4.7% in 2024 and 4.7% in 2025.

[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 about 5.27% for the 5-year and 6.25% on the 10-year breakeven. 15-year break-even inflation sits at 6.91%.

inflation is only expected to sustainably revert to the mid-point of the target range by the fourth 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 50 basis points to 7.75% per year, with effect from the 31st of March 2023. Three members of the Committee preferred the announced increase. Two members preferred a 25 basis points increase.

The revised repurchase rate is now less accommodative and is more consistent with the current view of risks to inflation. The aim of policy is 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.[14]

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

[14] The forecasted trajectory for the repurchase rate implies a rise in the inflation-adjusted repo rate from -2.0% in 2022, to 1.6% for 2023, and 2.0% in 2024. The real repo level for 2025 is expected to be 2.4%. The real repurchase rates calculated here are based on the 1-quarter ahead inflation forecast and are annual average rates.

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.

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GOVERNOR

The next statement of the Monetary Policy Committee will be released on 25 May 2023.

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