SOUTH AFRICAN RESERVE BANK

PRESS STATEMENT

25 May 2023

STATEMENT OF THE MONETARY POLICY COMMITTEE

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

As we approach the mid-point of the year, persistent inflation and elevated financial stability risks continue to mark a somewhat improved global growth outlook. South Africa's economic conditions, however, remain poor.

Growth prospects in Asia and Europe, while improved, remain negatively affected by Russia's war in the Ukraine and heightened geo-political tensions. The United States continues to exhibit economic resilience but also specific financial fragilities. More recent data suggests China's growth performance will remain relatively 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.

[1] Commodity export prices in USD terms fell by 0.9% in 2022. South Africa's commodity export index is forecast to *decline* by 23.7% this year, a further 10.5% in 2024, and an additional 5.4% in 2025.

While goods price inflation has eased in much of the world, core inflation continues to rise, keeping consumer price inflation from falling more sharply. We expect global financial markets to remain volatile and policy rates elevated.

Taking these and other factors into account, the SARB's forecast for global growth in 2023 and 2024 is revised higher to 2.4% (from 2.0%), and to 2.7% (from 2.5%), respectively.[2] The April World Economic Outlook of the International Monetary Fund (IMF) forecasts global growth at 2.8% and 3.0% for 2023 and 2024.

For 2023, the Bank's forecast for GDP growth is slightly higher than in March, at 0.3%. Energy and logistical constraints remain binding on South Africa's growth outlook, limiting economic activity and increase costs. We estimate loadshedding alone to deduct 2 percentage points from growth this year.

Household spending is expected to grow very modestly in real terms, in line with a positive but weak rise in real disposable income. Investment by the private sector remains positive, in part reflecting efforts to overcome constraints in energy and transport supply.[3]

Our GDP growth forecast for 2024 and 2025 is unchanged from the previous meeting, at 1.0% and 1.1%, respectively.[4]

Economic growth has been volatile for some time and prospects for growth remain uncertain. An improvement in logistics and a sustained reduction in load-shedding, or

[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 is higher at 280 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.

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

increased energy supply from alternative sources, would significantly raise growth. The rand's weakness provides some short-term benefit to the tradable sector. Conversely, alongside more modest global growth rates and a lower terms of trade, higher import prices and headline inflation create downside risks to growth. Overall, domestic and global prospects appear to be highly sensitive to new shocks.

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. This implies very modest positive pressures on inflation from the forecast growth rate.[5]

South Africa's external financing needs however are expected to rise. Despite broadly stable oil prices, import price inflation is higher. Falling export commodity prices and weaker growth in export volumes are expected to increase the current account deficit to 2.5% of GDP this year, before expanding it further to 3.1% and 3.6% of GDP, respectively, in 2024 and 2025.[6]

With reduced tax revenue, higher public sector compensation and state-owned enterprise financial needs, will put additional pressure on financing conditions for rand-denominated bonds. The risk premium charged on rand-denominated borrowing has increased sharply. Ten-year bond yields reached a high of 12.38% on the 23rd May,

[5] Potential growth is unchanged at -0.2%, 0.8% for 2024 and 1.0% for 2025.

[6] In March, a current account balance of about -2.7% of GDP was expected for the forecast period. Exports are forecast to grow in real terms by only 1.8% this year and 2.4% in 2024. Our oil price forecast is also slightly lower than in March, averaging US$85 per barrel in 2023, and unchanged at US$85 for 2024 and US$80 for 2025.

and currently trade at about 12.3%, despite the expected moderation of inflation over the forecast period.

The rand has weakened over the past year, with further sharp depreciation in recent weeks. The implied starting point for the rand forecast is R18.68 (23q2) to the US dollar, compared with R17.80 at the time of the previous meeting. Currency markets are expected to remain volatile and sensitive to idiosyncratic shocks.

At the global level, consumer price inflation in 2023 is forecast to be 7.0%, compared to 8.7% in 2022.[7] In the G3 economies, despite an easing in headline inflation, price pressures remain clearly evident in measures of core inflation, services and wages.[8] Our estimate for inflation in the G3 in 2023 is higher at 4.3% (up from 4.2%) and is unchanged at 2.1% in 2024 and 2025.[9]

The rise in South Africa's headline inflation rate has been shaped primarily by fuel, electricity and food price inflation. Compared to the previous meeting, fuel and electricity price inflation is somewhat lower and food price inflation higher.

Fuel price inflation is expected to be -2.0% in 2023 (down from -0.6%). The electricity price forecast is also lower at 11.6% this year, 13.4% in 2024, and unchanged at 10.9% in 2025.

Local food price inflation is revised up again, in part due to the lagged impact of the weaker exchange rate and despite global food prices falling in dollar terms.[10] Food

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[7] IMF, World Economic Outlook, April 2023.

[8] In the G3 economies, consumer prices rose by 7.4% in 2022.

[9] The G3 comprises the United States, the Eurozone, and Japan. The latest CPI inflation in the G3 sits at 4.9%, 7.0% and 3.5%.

[10] This year, global food inflation is expected to be in deflation of -9.9% (down from -8.7% in March) and after registering 14.3% inflation in 2022.

price inflation is now expected to be 10.8% in 2023 (up from 9.9%) and 5.0% in 2024 (up from 4.5%).

Our forecast for core inflation is revised up to 5.3% in 2023 (previously 5.1%), 5.0% (from 4.8%) and 4.6% (from 4.5%) in 2024 and 2025, respectively. Services price inflation in 2023 is expected to come in at 4.9%, unchanged from the previous meeting. Core goods inflation, however, is higher for this year at 6.3% (up from 5.9%).[11] Growth in average salaries and unit labour costs is higher in 2023 and 2024 and slightly lower in 2025.[12]

With core goods and food higher in the near term, headline inflation for 2023 is revised up to 6.2% (from 6.0%). Headline inflation for 2024 also increases to 5.1%, before moderating to 4.5% in 2025 on the back of easing food and fuel inflation.

Risks to the inflation outlook are assessed to the upside. Despite easing of producer price and food inflation, global price inflation remains high. Global oil markets are expected to remain tight, with upside risk to prices. Electricity prices and other administered prices continue to present clear short and medium-term risks. Domestic food price inflation continues to be elevated, and the risk of drier weather conditions in coming months has 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 food price inflation, considerable risk still attaches to the forecast for average salaries.

[11] 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 5.2% in 2024 and 4.5% in 2025.

[12] Average salaries are expected to rise by 6.8% in 2023, 6.5% in 2024, and by 4.9% in 2025, compared to 6.4%, 6.2%, and 5.0%, at the time of the March meeting, respectively. Unit labour costs are forecast to rise by 6.9%, 6.1% and 4.3%, respectively, in 2023, 2024, and 2025.

Average interest rate levels in major economies are higher than were projected in March.[13] Tighter global financial conditions raise the risk profiles of economies needing foreign capital, leading generally to weaker currencies. Given upside inflation risks, larger domestic and external financing needs, and load-shedding, further currency weakness appears likely.

Higher inflation outcomes have resulted in elevated inflation expectations.[14] Expectations for inflation in 2023 based on market surveys are 5.9%.[15] Long-term inflation expectations derived from the 5-year break-even rates in the bond market have sharply increased to about 6.5% (up from 5.3%).[16]

Headline inflation is forecast to remain above the upper end of the inflation target range until the third quarter of this year, and will only sustainably revert to the mid-point of the target range by the second 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 increase the repurchase rate by 50 basis points to 8.25% per year, with effect from the 26th of May 2023. The decision was unanimous.

At the current repurchase rate level, policy is restrictive, consistent with elevated inflation and risks. The policy stance aims to anchor inflation expectations more firmly

[13] G3 interest rates average 3.8% in 2023, 3.6% in 2024, and 2.5% in 2025.

[14] The Q2 survey is released in July. The BER Q1 2023 survey of inflation expectations indicated inflation at 6.3% in 2023 (up from 6.1% in Q4) and 5.8% for 2024 (up from 5.6% in Q4) and 5.5% in 2025.

[15] At the median, market analysts (Reuters Econometer) in May expect inflation to be higher at 5.9% (from 5.8% in March) in 2023, 4.9% in 2024 (up from 4.7%) and 4.6% in 2025 (down from 4.7%).

[16] 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 6.24% for the 5-year and 7.0% on the 10-year breakeven. 15-year break-even inflation sits at 7.76%.

around the mid-point of the target band and to increase confidence of attaining the inflation target sustainably over time.[17]

Guiding inflation back towards the mid-point of the target band can reduce the economic costs of high inflation and achieve lower interest rates in the future. Reaching 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.

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. 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 20 July 2023.

[17] The forecasted trajectory for the repurchase rate implies a rise in the inflation-adjusted repo rate from -2.1% in 2022, to 1.8% in 2023, and 2.4% in 2024. The real repo level for 2025 is expected to be 2.5%. The real repurchase rates calculated here are based on the 1-quarter ahead inflation forecast and are annual average rates.

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