PRESS STATEMENT

21 September 2023

STATEMENT OF THE MONETARY POLICY COMMITTEE

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

Since our last meeting, near term prospects for the global economy are broadly unchanged. Inflation has eased over the course of the year but a further slowdown in inflation looks less certain. Growth forecasts remain muted. The longer-term economic outlook is, however, clouded by persistent risks to the inflation trajectory, the negative effects of climate change and ongoing geopolitical tensions. In the developing world, financing conditions are expected to remain tight and growth modest.

While goods price inflation has eased in much of the world, core inflation remains elevated and oil prices have increased significantly, keeping consumer price inflation from falling further. Globally, monetary policy is likely to remain focused on ensuring inflation continues to retreat. We expect markets in major financial centres to remain volatile.

Across major advanced economies, growth remains stronger in the United States than in Europe. Higher-for-longer policy rates and extended fiscal positions are expected to weigh on growth prospects for some time. China's growth performance is expected to remain modest, with little benefit to commodity prices.[1] Taking these and other factors into account, the SARB's forecast for global growth in 2023 is broadly unchanged at 2.6% (from 2.5%) and remains at 2.7% in 2024.[2]

Despite considerable reprieve in the winter months, South Africa's electricity load-shedding has increased and prices for commodity exports continue to weaken. In the near term, stronger El Niño conditions threaten the agricultural outlook, while global climatic events present additional risks. 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, on an annual basis. Disposable income of households continues to grow in the forecast, albeit slowly. Debt service costs of households have increased to about 8.4% of disposable income, close to the average for the past decade.[4] Although credit growth to households and corporates

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[1] Commodity export prices in USD terms fell by 0.9% in 2022. South Africa's commodity export index is forecast to *decline* by 28.4% this year, a further 12.0% in 2024, and an additional 5.1% in 2025.

[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 310 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 was revised lower in the March 2023 MPC meeting. 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. This will be assessed further as new data and information is received.

[4] Debt service costs are the product of prevailing interest rates and debt volumes as a percentage of disposable income. The average from 1994 to 2019 was 8.7%. From the beginning of the pandemic until March 2023, the average was 7.4%. In the first quarter of 2023, the average was 8.4%.

has slowed in recent months, it has increased in real terms compared to last year. The forecast for investment for the year is revised up to 7.7% (from 4.4%).

These supply and demand trends enabled an upward revision to the Bank's forecast for GDP growth to 0.7%, from the July figure of 0.4%. 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 some resilience, economic growth has been volatile 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 marginally positive, implying little pressure on inflation from GDP growth.[6]

Oil prices have increased in recent months and commodity export prices have moderated further. South Africa's external financing needs will increase as the current account deficit expands from a forecasted 2.0% of GDP this year (from 1.9%), to 3.0% of GDP in 2024 and to 3.4% of GDP in 2025.[7]

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

[6] Potential growth is 0.0% in 2023 (up from -0.1%) and unchanged at 0.8% for 2024 and 1.0% for 2025.

[7] Exports are forecast to grow in real terms by 4.5% this year (from 6.2%) and 3.0% in 2024. Our oil price forecast is also slightly higher than in July, averaging US$82 per barrel in 2023, and unchanged at US$82 for 2024 and US$80 for 2025.

Sharply lower tax revenue, higher employee compensation and ongoing financing needs of state-owned enterprises are expected to keep the long-term cost of borrowing elevated. Despite the forecasted moderation of inflation, long-term bond yields currently trade around 12.6%.

The rand has weakened over the past year, depreciating by about 10% year to date against the US dollar, and is showing high volatility in response to risk-on and risk-off episodes. The implied starting point for the rand forecast is R18.45 (23q4) to the US dollar, compared with R18.13 at the time of the previous meeting.

The trajectory of South Africa's headline inflation rate has been shaped primarily by fuel and food prices. Compared to the previous meeting, fuel price inflation is significantly higher at 0.4% in 2023 (from -3.1%), rising to 5.8% in 2024. Our food price inflation forecast for 2023 remains high and largely unchanged at 10.4% (from 10.3%). The forecast for 2024 also remains unchanged at 5.2%.

Better monthly outcomes have led to a downward revision in our forecast for core inflation to 4.9% in 2023 (previously 5.2%) and to 4.7% in 2024 (from 4.9%). The core inflation forecast for 2025 remains at 4.5%. Services inflation in 2023 is expected to come in at 4.4% (down from 4.8%), primarily a result of lower public transport inflation outcomes. Core goods inflation remains elevated and is revised slightly up for this year to 6.3% (from 6.2%).[8] Growth in average salaries and unit labour costs is lower in 2023 and 2024. In 2025, salaries are slightly higher.[9]

[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 5.2% in 2024 and 4.4% in 2025.
[9] Average salaries are expected to rise by 5.4% in 2023, 5.9% in 2024, and by 5.4% in 2025, compared to 6.6%, 6.1%, and 5.2% at the time of the July meeting, respectively. Unit labour costs are forecast to rise by 4.7%, 4.9% and 4.6%, respectively, in 2023, 2024, and 2025.

With services inflation lower in the near term, headline inflation for 2023 is revised down to 5.9% (from 6.0%). The headline inflation forecast for 2024 increases slightly to 5.1%, before stabilising at 4.5% in 2025.

Risks to the inflation outlook are assessed to the upside. At a global level, headline inflation continues to moderate, but food price inflation remains high, oil markets have tightened significantly, and core inflation looks sticky. Despite recent easing in some food price components, domestic food price inflation was still elevated at 8% in August and the risk of drier weather conditions in coming months has increased. We expect food price inflation to moderate further in the near term, but with high risk that it picks up later in 2024. In the absence of sustained 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 implies that average interest rates in major 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 has generally resulted in elevated inflation expectations across businesses and households. The Bureau for Economic Research survey released in September shows average inflation expectations lower at 6.1% for 2023. The Committee however would prefer to see expectations anchored at the mid-point of the target band.[11] Expectations for inflation in 2023 based on market surveys are currently

[10] G3 interest rates average 4.0% in 2023, 4.1% in 2024, and 2.8% in 2025.

[11] The BER Q3 2023 survey of inflation expectations indicated inflation at 6.1% in 2023 (from 6.5% in Q2) and 5.5% for 2024 (from 5.9% in Q2) and 5.3% in 2025.

5.8%, and near-term break-even rates have increased to around 5.1%.[12] Longer-term market expectations for inflation remain elevated.

Headline inflation returned to below the upper end of the inflation target range in June. In coming months, we expect headline inflation to rise somewhat, before sustainably reverting to the mid-point of the target range in 2025.

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 the inflation outlook and elevated inflation expectations. Serious upside risks to the inflation outlook remain. In light of these risks, the Committee remains vigilant and stands ready to act should risks begin to materialise. Decisions will continue to be data dependent and sensitive to the balance of risks to the outlook. The inflation and repo rate projections from the updated QPM remain a broad policy guide, changing from meeting to meeting in response to new data and risks.

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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[12] At the median, market analysts (Reuters Econometer) in September expect inflation to average 5.8% in 2023, remain at 4.9% in 2024 and 4.5% 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 6.9%. The 15-year break-even inflation rate sits at 7.4%.

[13] The forecasted trajectory for the repurchase rate implies a rise in the inflation-adjusted repo rate from -1.3% in 2022, to 2.6% in 2023, and 3.2% in 2024. The real repo level for 2025 is expected to be 2.9%. The real repurchase rates calculated here are based on the 3-quarter ahead inflation forecast and are annual average rates.

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 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 real wage growth in line with productivity gains. Such steps would strengthen monetary policy effectiveness and its transmission to the broader economy.

Lesetja Kganyago

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The next statement of the Monetary Policy Committee will be released on 23 November 2023.

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