SOUTH AFRICAN RESERVE BANK

PRESS STATEMENT

25 January 2024

STATEMENT OF THE MONETARY POLICY COMMITTEE

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

As the new year begins, global economic conditions remain mixed and the outlook uncertain. While headline inflation continues to ease in much of the world, core inflation remains sticky and high. Both advanced and emerging economies are likely to see modest economic growth this year, despite better than expected outcomes in 2023.[1] In most countries, reaching inflation targets, reducing fiscal deficits and containing or lowering debt levels will stay as key policy priorities. Financing conditions are expected to remain tight.

The longer-term economic outlook is also uncertain, as geo-political tensions and climate change threaten supply chains, output and prices. This uncertainty, alongside

[1] South Africa's commodity export index is forecast to *decline* by 27.3% this year, a further 11.9% in 2024, and an additional 4.9% in 2025. The index is forecast to fall by 1.6% in 2026.

high interest rates and debt, will dampen investor appetite and capital flows, resulting in volatile financial markets and asset prices.

Taking these and other factors into account, the SARB's forecast expects relatively weak global growth of 2.6% in 2024.[2]

The domestic GDP outcome for the third quarter of 2023 was weaker than expected, at a negative 0.2%. We expect the fourth quarter to show some improvement, with output expanding by 0.4%. The weaker performance of the economy in the latter half of 2023 is in line with the Bank's forecast.

The operation of ports and rail has become a serious constraint, and, alongside electricity shortages, contributed to weak output growth and higher costs last year.[3] These constraints are expected to persist, severely limiting potential growth of the economy. While we expect electricity supply to increase gradually over the longer-term, its contribution to short and medium-term growth has not been revised after the upward adjustment made at the time of the November meeting.

On the demand side, household consumption and investment have eased significantly, while government spending has been sustained. As we highlighted throughout last year, commodity export prices have receded sharply from the highs reached in 2022, reducing the contribution of foreign demand to growth.

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

[3] The number of days of load-shedding was 287 in 2023, and is still expected to decrease 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.

For 2023 as a whole, GDP growth is revised down slightly to 0.6% from the November figure of 0.8%. Our GDP growth forecast for 2024 and 2025 is unchanged from the previous meeting, at 1.2% and 1.3%, respectively.[4]

At present, we assess the risks to the medium-term domestic growth outlook to be balanced. With the weaker GDP outcome in 2023, our current growth forecast leaves the output gap marginally negative and at zero in the outer years of the forecast.[5]

Compared to many other emerging and advanced economies, the rise in South Africa's headline inflation rate was more gradual and peaked lower. However the return to target has been slow. The inflation rate remains sensitive to changes to both global and domestic supply and demand.

Due to global factors, oil prices remain generally high at around US$82 per barrel. We expect them, however, to be somewhat lower this year and next compared to the November forecast. Commodity export prices fell sharply last year, by about 27%, and are expected to fall by a further 12% this year. As a result, and despite modest economic growth, South Africa's external financing needs will increase as the current account deficit expands. We expect a deficit of 1.4% of GDP in 2023 (from 1.3%), rising to 2.8% of GDP in 2024 and 3.6% of GDP in 2025.[6]

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

[5] The potential growth forecast is unchanged from November, at 0.1% in 2023 and rising to 1.0% for 2024, 1.2% for 2025, and 1.6% in 2026.

[6] The current account deficit in 2026 is forecast to be 4.0% of GDP. Exports are forecast to grow in real terms by 4.3% this year (from 4.8%) and 3.9% in 2024. Our oil price forecast is higher than in November, averaging US$82.6 per barrel in 2023, US$82 in 2024, US$81 in 2025 and US$80 for 2026.

The uncertainties of the global environment, and various South Africa-specific factors, including sluggish growth and dependence on commodity export prices continue to weigh on the value of the currency. The rand depreciated over the past year by about 11% against the US dollar, making it one of the worst performing emerging market currencies. The implied starting point for the rand forecast is R18.65 to the US dollar, compared to R18.69 at the time of the previous meeting.

Fuel price inflation is expected to be low, averaging below 1% in 2024. Food price inflation is revised slightly higher for 2024, to 5.7%, but remains broadly unchanged over the forecast period.

Core inflation was 4.9% in 2023. The core inflation forecast for 2024 and 2025 is little changed at 4.6%, and 4.5% in 2026.

Services inflation in 2023 was 4.2%. The forecast for 2024 services price inflation remains unchanged at 4.8%.

Core goods inflation was 6.1% in 2023, and is forecast to ease to 4.5% this year.[7] While average salaries grew less than expected in the latter half of 2023, they are forecast to hit long-term averages for the rest of the forecast period.[8]

Headline inflation was 6.0% in 2023. With few significant changes to the forecasts for underlying components, headline inflation for 2024 is expected to ease to 5.0%, to 4.6% in 2025, and to 4.5% in 2026.

[7] 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 4.5% in 2025, and 4.4% in 2026.
[8] Average salaries are expected to rise by 3.9% in 2023 (down from 4.6), 6.1% in 2024, and by 5.5% in 2025 and in 5.4% in 2026. Unit labour costs are forecast to have risen by an estimated 4.7% in 2023 and to rise by 4.4% in 2024 and 2025. In 2026, unit labour costs are forecast to increase by 4.3%.

While our baseline inflation forecast is of continued gradual moderation in global and domestic inflation, the risks to the outlook are still assessed to the upside.

Better than expected global growth last year and ongoing geo-political tensions this year serve to keep global oil markets tight. Despite some improvements, advanced economies continue to experience strong wage growth and elevated core inflation.

South Africa's imported goods inflation increased strongly last year, and despite some better recent outcomes, remains sensitive to currency weakness. Recent increases in egg and potato prices remind us that domestic food price inflation remains unpredictable and high. Electricity prices and logistics constraints continue to present clear inflation risks. With fuel and food price inflation remaining volatile, risk still attaches to the forecast for average salaries. Housing and services prices more broadly, and in contrast, may continue to provide some downside relief to the inflation risk profile.

Sticky inflation in G3 economies implies that their average policy rates will remain elevated, at about 4.3% in 2024 compared to the 1.1% average rate seen in 2022.[9] These tighter global financial conditions raise the risk profile of economies needing foreign capital. South Africa's long-term cost of borrowing is expected to remain high. Despite moderating inflation, long-term bond yields currently trade around 12%.

The rise in inflation in 2022 generally resulted in higher inflation expectations across markets, businesses and households in 2023. Medium and longer-term market expectations for inflation remain elevated.[10] The December survey of the Bureau for

[9] The G3 is the United States, Japan and the Euro Area. G3 interest rates averaged 3.9% in 2023, and are expected to be 4.3% in 2024, 3.4% in 2025, and 2.2% in 2026.

[10] At the median, market analysts (Reuters Econometer) in January 2024 expect inflation to average 5.0% in 2024 and 4.5% in 2025. Market-based rates are calculated from the break-even inflation rate, which is the

Economic Research shows average inflation expectations increased to 5.7% for 2024. Achieving permanently lower inflation and interest rates requires inflation expectations to be closely anchored to the mid-point of the target band.[11]

Against this backdrop, the MPC decided to keep the repurchase rate at its current level of 8.25% per year. The decision was unanimous.

At the current repurchase rate level, policy is restrictive, consistent with the inflation outlook and the need to address rising inflation expectations.[12] Serious upside risks to the inflation trajectory from global and domestic sources are evident and, as noted earlier, the economic outlook is highly uncertain.

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. Future committee decisions will be data dependent and sensitive to the balance of risks to the outlook.

Guiding inflation expectations back towards the mid-point of the target band will improve the economic outlook and reduce borrowing costs. Since early 2020, the Committee has recommended additional means of strengthening economic conditions, including achieving a prudent public debt level, increasing the supply of energy, keeping administered price inflation low and real wage growth in line with productivity gains. Such steps would also strengthen monetary policy effectiveness and its transmission to the broader economy.

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yield differential between conventional and inflation-linked bonds. The 5-year breakeven now sits at about 5.1%.

[11] The BER Q4 2023 survey of inflation expectations indicated inflation at 5.7% in 2024 (from 5.5%) and 5.6% for 2025 (up from 5.3%).

[12] The forecasted trajectory for the repurchase rate implies an inflation-adjusted repo rate of 2.6% in 2023 and 3.1% in 2024. The real repo level for 2025 is expected to be 2.8% and 2.7% in 2026. The real repurchase rates calculated here are based on the 3-quarter ahead inflation forecast and are annual average rates.

Lesetja Kganyago

GOVERNOR

The next statement of the Monetary Policy Committee will be released on 27 March 2024.

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