SOUTH AFRICAN RESERVE BANK

PRESS STATEMENT

19 September 2024

STATEMENT OF THE MONETARY POLICY COMMITTEE

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

As we move towards the end of the year, global inflation is slowing and nearing targets.[1] Given these gains, major central banks have lowered rates. We saw the European Central Bank cut again last week, the Bank of England eased in August, and the US Federal Reserve reduced rates last night. The US dollar has also cooled off in recent months, providing some respite for other currencies, including the rand.

Despite these welcome developments, central banks are moving carefully, and policy stances remain relatively tight. Economic activity in major economies has been resilient, even as inflation eases. Underlying measures of inflation have also fallen less than headline, primarily because of elevated housing inflation, and robust wage growth.

The case for caution is further bolstered by the difficult and unpredictable geopolitical environment, with risks of inflationary shocks through trade restrictions and supply chain disruptions, among other factors.

Overall, global conditions have become more favourable, but there are still risks. A ‘soft landing' is looking more likely, after the worst inflation surge in a generation, but it is not inevitable. The financial market volatility of early August was a reminder of the fragilities and uncertainties in the system.

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[1] For instance, headline inflation for August was 2.2%, in both the Euro area and the UK, and 2.5% for the United States, all against targets of 2%.

For these reasons, central banks are approaching the endgame with caution.

Turning to South Africa, output was marginally below our expectations for the first half of the year.[2] We expect improvements in the second half, with growth of 0.6% in both quarters.[3] This reflects rising confidence, in part due to a stable electricity supply. We also expect extra spending given withdrawals from the new Two-Pot retirement system, although some of these funds will be absorbed by debt repayments and tax.

For the medium term, our growth projections have once again edged higher. The upgraded forecast is premised on better-functioning network industries, especially electricity, alongside broader reform momentum.[4] Because potential growth is higher, in the forecast, supply and demand remain broadly balanced, even as growth accelerates. The pace of growth nonetheless remains below longer-run averages, of around 2%.

A particular concern is investment, which has been contracting for four consecutive quarters. A stronger investment performance is a pre-requisite for sustained higher growth, and although we continue to expect an investment recovery, its scale and speed will be a key indicator of South Africa's longer-run economic prospects.

The risks to the growth outlook are assessed as balanced.

Moving to inflation, headline eased to 4.4% in August, a 3-year low, and close to the middle of our target range. Our forecast suggests this progress will be sustained, with inflation contained below the 4.5% midpoint of our range through to the end of the forecast horizon, in 2026.

In the near term, we continue to see a dip in headline inflation, supported by the stronger exchange rate and lower oil prices. The implied starting point of the rand is R18.04 to the US dollar, an appreciation of nearly 2% relative to our July

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[2] The July forecast anticipated growth of 0.6% in 2024Q2, versus an outcome of 0.4%. However, first quarter growth was revised up to 0% from -0.1%, so the level of GDP was only 0.1% below our expectations in 2024Q2.
[3] This refers to the quarter-on-quarter, seasonally adjusted measure. The year-on-year rates are 1.4% and 1.7% for 2024Q3 and 2024Q4, respectively.
[4] The estimated GDP impact of loadshedding has been cut back to -0.13pp for 2024, and 0pp for 2025 and 2026. This contrasts with -0.18pp, -0.05pp and 0pp for those years, respectively, as of the July MPC. The estimated 2023 impact is -1.5pp.

assumption.[5] This contributes to fuel price deflation, which helps keep headline below 4% through the first half of next year. As usual, we will look through this near-term supply shock, focusing on the medium-term outlook.

Lower headline inflation also reflects a better food price outlook, with inflation for this category below the midpoint through 2025 and 2026. However, these benefits are partly offset by higher electricity prices, with an expected inflation rate more than double that of headline.

For core inflation, we expect the trajectory to be slightly below 4.5% over the medium term. Again, this is primarily due to the exchange rate, which affects core mainly through import prices.

Services inflation, meanwhile, is expected to stabilise near the midpoint early next year, after a stretch of prints above 4.5%. This partly reflects subdued housing inflation, which has accelerated less than expected this year.[6] Lower inflation expectations also contribute to the improved services outlook.

According to the latest survey, these expectations are still in the top half of the target range, at 4.8% for both 2025 and 2026.[7] They are nonetheless moving – slowly – in the right direction.[8] As long as headline inflation stabilises at lower levels, we anticipate further progress in re-anchoring expectations around the middle of our target range.[9]

The risks to inflation are assessed as balanced.

Against this backdrop, the MPC decided to reduce the policy rate by 25 basis points, to 8% per annum, with effect from 20 September.

In discussing the stance, MPC members considered an unchanged stance, a 25-basis point cut, and a 50-basis point cut. The MPC ultimately reached consensus on 25

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[5] The starting point for the July forecast was R18.35 per US dollar.
[6] Housing inflation slowed unexpectedly, from 3.3% to 2.9%, in the June CPI. This item is surveyed quarterly.
[7] Market-based measures of inflation expectations have also moderated. Since the previous MPC meeting shorter-term expectations (5 years) have declined to 4.3%, while longer term expectations (10 years) have fallen to 5.3%.
[8] Average expectations declined by 0.2pp for 2024 and 2025, and 0.1pp for 2026, in the 3rd quarter survey.
[9] The forecast projects that 2-year ahead expectations will reach 4.4% in 2026, fractionally below the midpoint.

basis points, agreeing that a less restrictive stance was consistent with sustainably lower inflation over the medium term.

The forecast sees rates moving towards neutral next year, stabilising slightly above 7%. As before, the rate path from the Quarterly Projection Model remains a broad policy guide, changing from meeting to meeting. Decisions of the MPC will continue to be data dependent, and sensitive to the balance of risks to the outlook.

There are scenarios where inflation could undershoot the baseline forecast, if oil prices are lower or the exchange rate appreciates further. Conversely, inflation could be higher than our baseline forecast given scenarios such as higher housing costs, larger electricity price increases, or wage increases that outrun inflation and productivity growth. Meanwhile, food inflation is a source of uncertainty, despite recent improvements.

Global conditions pose additional challenges. Geopolitical risks are heightened and could generate further economic shocks. Policy uncertainty is also elevated, in various parts of the world. Both trade restrictions and debt levels are rising, and might go much higher. This mix could add significant inflationary pressure to the world economy, generating tighter financial conditions for South Africa and other countries.

For the time being, South African assets have performed relatively well. The rand has strengthened during the year, more than most peer currencies, while long-term yields have moderated and spreads over US rates have narrowed.[10] These moves have reversed some of the deterioration experienced since 2020.

Given a potentially adverse external environment, however, it is crucial to sustain domestic reform momentum. This entails both structural reforms to support growth capacity, and macroeconomic efforts to rebuild fiscal and monetary buffers.

The MPC’s main contribution is to deliver low and stable inflation, with well-anchored inflation expectations.

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[10] For instance, the yield on the R2035 bond have moved from about 11.4% at the start of 2024, to a peak of about 12.5% in April, and subsequently down to around 10.3% as of mid-September.

We also recommend additional measures that would improve economic conditions. These include reaching a prudent public debt level, further repairing and strengthening network industries, lowering administered price inflation, and keeping real wage growth in line with productivity gains.

Lesetja Kganyago

GOVERNOR

The next statement of the Monetary Policy Committee will be released on 21 November 2024.

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