SOUTH AFRICAN RESERVE BANK

PRESS STATEMENT

26 January 2023

STATEMENT OF THE MONETARY POLICY COMMITTEE

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

As this year commences, high inflation and weak economic growth continue to shape global conditions. Russia's war in the Ukraine drags on and recession risks remain elevated in the Euro Area, even though energy constraints have eased. Growth prospects for the United States this year are lower. The growth outlook for China has improved but is likely to remain modest by historical standards. In the developing world, a number of economies face debt distress, exacerbated by tighter global financial conditions.[1]

Last year, higher than expected headline inflation and rising core inflation led major central banks to accelerate the normalisation of policy rates. With advanced economy interest rates likely to increase in the near term, we expect financial asset prices globally to remain volatile.

[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).

Taking these and other factors into account, the SARB's forecast for global growth in 2023 is revised slightly lower to 1.6% (from 1.9%).[2] We expect better growth in 2024 at 2.6% (from 2.4%). The International Monetary Fund's (IMF) global growth forecast will be updated later this month.

While the South African economy grew by a relatively strong 1.6% in the third quarter of 2022, the expansion was not broad-based. We forecast no growth in the fourth quarter. For the whole of last year, GDP growth of 2.5% is expected (up from 1.8%).

For 2023, and as a result of extensive load-shedding and other logistical constraints, the Bank now forecasts GDP growth of only 0.3%. Given the scale of load-shedding, the Bank estimates that it deducts as much as 2 percentage points from growth in 2023, compared to the previous estimate of 0.6 percentage points.

Over the medium term, the forecast takes into account ongoing high levels of load-shedding, and more modest household spending and investment growth than previously. Investment is still positive, but is revised down due to weaker confidence and lower expected growth. With declining commodity prices, exports are also forecast to be less robust. The forecast incorporates an assumption of increased load-shedding in each year compared to what was pencilled-in at the time of the November meeting.[3]

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[2] Global growth in the QPM model is a trade-weighted average of South Africa's trading partners. Global growth in 2024 is forecast higher at 2.6% (from 2.4%), before rising to 3.1% in 2025, unchanged from the November meeting.

[3] The number of days of expected load-shedding in 2023 has been increased to 250 days from 100 daysIn 2024 the number of days was revised up to 150 days from 40 days. Load-shedding of 100 days has been assumed for 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.

As a result of these factors, the economy is forecast to expand by 0.7% in 2024 (down from 1.4%) and by 1.0% in 2025 (down from 1.5%).[4]

While economic growth has been volatile for some time, prospects for growth appear even more uncertain than normal. A material reduction in load-shedding would significantly raise growth. There could also be higher investment in alternative energy sources as firms and households offset the impact of load-shedding. Upside risks to global growth could also arise from reduced geo-political tensions, a stronger recovery in China, and consequential increases in commodity export prices.

With a lower rate of potential, our current reduced growth forecast leaves the output gap around zero, implying little positive or negative impact on inflation from expected growth.[5]

After the downward revisions to the GDP forecast, the risks to the medium-term domestic growth outlook are assessed to be balanced.

As expected for some time, commodity export prices continue to trend gradually lower. While oil prices increased somewhat at the end of last year, compared to November, our oil price forecast is slightly lower, averaging US$89 per barrel in 2023.[6] South Africa's export commodity price basket is expected to continue to decrease, by about 18% this year, and stabilise in 2025.[7]

[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%).

[6] The Brent crude oil assumptions are US$85 for 2024 and US$80 for 2025 (unchanged).

[7] Commodity export prices rose by 1.4% in 2022.

As a result of weaker export outcomes and prospects, the current account balance is estimated to have been -0.7% of GDP in 2022, and forecast to deteriorate to about -1.8% for the next three years.[8]

Although fiscal risk eased over the past year, weaker commodity prices and rising state-owned enterprise financing needs could reverse that positive outcome. Financing conditions for rand-denominated bonds remain tight. Ten-year bond yields currently trade at about 10.3%, despite the expected moderation of inflation over the forecast period.

Policy normalisation in major economies and slower global growth last year contributed to depreciation of many emerging market currencies, including the rand. In recent months, while better global growth prospects have increased appetite for riskier assets, the rand has been less buoyant than other currencies. The implied starting point for the rand forecast is R16.92 (23q1) to the US dollar, compared with R17.68 at the time of the previous meeting.

Globally, economic growth has slowed and prices decreased for some goods and transport services. While headline inflation eased in major economies in December, price pressures continue to spread from goods to services and wages.[9] Our estimate for inflation in the G3 is unchanged at 7.3% in 2022 and slightly lower to 4.0% in 2023 (from 4.1%). The forecast for 2024 is lower at 1.8% (from 2.1%).[10]

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[8] In November, a current account balance of -0.2% of GDP was expected for 2022, -1.5% in 2023 and -1.9% in 2024.

[9] Inflation in agricultural commodities decelerated to 0.1% in 2022Q4 (from 8.7% in 2022Q3) due to vegetable oils and cereals components. This year global food inflation is expected to be in deflation (after registering 14.3% in 2022) due to base effects and improving supply constraints.

[10] The G3 comprises the United States, the Eurozone, and Japan. The latest CPI inflation in the respective components sits at 6.5%, 9.2% and 4%. We expect G3 inflation of 1.9% in 2025.

Although South Africa's fuel price inflation for last year averaged 34.5%, it is expected to be -2.7% in 2023 (down from 0.7%). Local electricity price inflation has been revised higher at 12.9% in 2023, 14.5% in 2024, and 10.9% in 2025.

While global food price inflation continues to ease, local food price inflation is revised up again in part due to the lagged impact of the weaker exchange rate. Food price inflation reached 9.2% in 2022 and is now expected to be 7.3% in 2023 (up from 6.2%) and 4.4% in 2024 (up from 4.2%).

Headline inflation in 2022 came out at 6.9%. The Bank's forecast of headline inflation for 2023 is unchanged at 5.4% and is slightly higher at 4.8% for 2024. In 2025 we still expect headline inflation of 4.5%.

Our forecast for core inflation is somewhat lower at 5.2% in 2023 (down from 5.5%) and 4.7% in 2024 (down from 4.8%). Services price inflation in 2023 is forecast to be 5.1%, lower than the 5.5% previously expected, on the back of lower public transport services, housing rental price inflation and owners equivalent rent. Core goods inflation is also forecast somewhat lower for this year at 5.5% (from 5.7%).[11] The forecast for core inflation in 2024 and 2025 is largely unchanged at 4.7% and 4.5%, respectively.

[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 was 5.0% in 2022 and is expected to be 4.8% in 2024 and 4.5% in 2025.

The forecast for average salary growth is broadly unchanged.[12] Despite a benign unit labour cost outcome in 2022, lower productivity and higher inflation expectations raise the forecast for this year and next.[13]

While core inflation in December came out significantly better than expected, increases in electricity and food price inflation and higher headline inflation for 2022 as a whole keep the headline inflation forecast elevated in the near and medium-term.

Risks to the inflation outlook are assessed to the upside. Despite some easing of global producer price and food inflation, global price levels remain elevated and Russia's war in the Ukraine continues. The oil market is expected to remain tight, particularly as China's economy rebounds. Electricity price inflation has shifted significantly higher this year and next and other administered prices continue to present clear medium-term risks. Domestic food price inflation continues to surprise higher and may again. Load-shedding may have broader price effects on the cost of doing business and the cost of living. Given sticky petrol and food price inflation, considerable risk still attaches to the forecast for average salaries and hence for the trajectory of core inflation.

G3 interest rate levels for the forecast period are similar to those projected in November, averaging 3.7% in 2023 (up from 3.6%), 3.3% in 2024, and 2.4% in 2025. Tightened global financial conditions have raised the risk profiles of economies needing foreign capital. While the rand appreciated in December alongside other emerging market currencies, it has depreciated by about 1.6% against the USD year

[12] Average salaries were expected to be 5.3%, 6.7%, and 5.4% for 2022, 2023 and 2024 at the time of the November meeting. For the January meeting, the respective figures are 5.2%, 6.9%, 5.5%, and 4.7% for 2025.
[13] Unit labour costs are forecast to have grown by 3.6% in 2022, below the forecast of 4.4%. They are expected to rise by 7.7%, 5.3% and 4.1%, respectively, in 2023, 2024, and 2025. Productivity per unit of labour is lower due to reduced expected output.

to date. Given deteriorated growth prospects, the risk of currency weakness has increased.

Inflation expectations increased strongly over the past year. Average expectations of future inflation surveyed in the fourth quarter of 2022 increased to 6.1% for 2023 and 5.6% for 2024.[14] Expectations for inflation in 2023 based on market surveys sit at 5.5%.[15] Long-term inflation expectations derived from the 5-year break-even rates in the bond market have moderated to about 5.0%.[16]

In the second quarter of 2022, headline inflation breached the upper end of the target range, and is forecast to remain above it until the second quarter of this year. Headline 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 25 basis points to 7.25% per year, with effect from the 27th of January 2023. Three members of the Committee preferred the announced increase. Two members preferred a 50 basis points increase.

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

[15] At the median, market analysts (Reuters Econometer) in January expect inflation to be higher at 5.5% (from 5.4% in November) in 2023, 4.7% in 2024 and 4.7% in 2025.

[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 4.95% for the 5-year and 5.91% on the 10-year breakeven. 15-year break-even inflation sits at 6.41%.

The revised repurchase rate remains supportive of credit demand in the near term, while raising rates to levels more consistent with the current view of inflation and risks to it. 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.[17]

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 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 30 March 2023.

[17] The forecasted trajectory for the repurchase rate implies a rise in the inflation-adjusted repo rate from -1.7% in 2021 to -1.9% in 2022, 2.0% for 2023, and 2.3% in 2024. The real repo level for 2025 is expected to be 2.4%. The real repurchase rate calculation here is based on the 1-quarter ahead inflation forecast and are annual average rates.

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