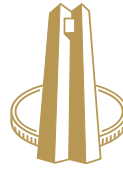


MONETARY POLICY REVIEW

APRIL 2024



SOUTH AFRICAN RESERVE BANK





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MONETARY POLICY REVIEW APRIL 2024

Preface

The primary mandate of the South African Reserve Bank (SARB) is to achieve and maintain price stability in the interest of balanced and sustainable economic growth. In addition, the SARB has a complementary mandate to oversee and maintain financial stability.

Price stability helps to protect the purchasing power and living standards of all South Africans. It provides a favourable environment for investment and job creation and supports international competitiveness. The goal of price stability is quantified through an inflation target, which is set in consultation with government. The target is a range of 3–6%, which has been in place since 2000.

The SARB has full operational independence. Monetary policy decisions are made by the SARB's Monetary Policy Committee (MPC), which is chaired by the Governor and includes the deputy governors and other senior officials of the SARB.

The inflation-targeting framework is flexible, meaning that policymakers will seek to look through temporary shocks, thereby avoiding excessive volatility in interest rates and economic output. The MPC takes a forward-looking approach to account for the time lags between policy adjustments and economic effects. MPC decisions are communicated at a press conference at the end of each meeting, accompanied by a comprehensive statement.

The *Monetary Policy Review (MPR)* is published twice a year and is aimed at broadening the public's understanding of the objectives and conduct of monetary policy. The *MPR* covers domestic and international developments that affect the monetary policy stance.

The *MPR* is presented by senior officials of the SARB at Monetary Policy Forum meetings held at major centres across South Africa in an effort to develop a better understanding of monetary policy through direct interactions with stakeholders.

Questions about the publication may be directed to Marlene Hugo at Marlene.Hugo@resbank.co.za.





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Walking a tightrope

Executive summary and overview of the policy stance

Despite considerable easing in global inflation over the past year, a range of important prices continues to rise strongly. The resulting stickiness in core inflation has slowed the path to the 2–3% inflation targets that many central banks are trying to achieve. Accordingly, as global interest rates stay high, many emerging economies continue to experience currency volatility and, often, higher-than-desired inflation. Some economies, especially in Latin America, which moved faster to tame the post-pandemic inflation surge, have been able to cut rates. At home, headline inflation has generally eased but setbacks have emerged in food and fuel prices in recent months, pushing it closer to the upper limit of the target band. As inflation risks emerge and materialise, and services prices normalise, the path back to the target midpoint is expected to take time. The repurchase (repo) rate at 8.25%, unchanged since May 2023, remains broadly consistent with persistent inflation, the uncertain domestic and global outlook, and getting back to the 4.5% midpoint over the forecast timeframe.

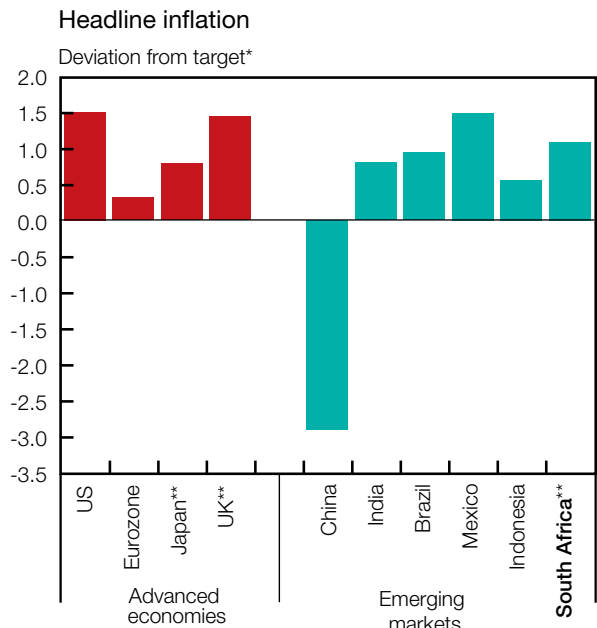
Global inflation lower but targets elusive

Since peaking at 8.7% in 2022, global inflation has declined significantly, as supply chains recovered from the pandemic and constraints eased, taking pressure out of goods, food and, later, energy price inflation. More restrictive monetary policy has helped to moderate credit demand and signalled central banks' commitment to getting inflation back to targets. While global headline inflation is projected to fall to 5.8% this year and to ease further to 4.6% in 2025, the progression has not been smooth. At the end of 2023, inflation remained at a still-high 6.4% and inflation outcomes this year have surprised to the upside. Convergence to inflation targets has slowed and become less certain.¹

The main obstacle to speedier disinflation lies in underlying or core inflation, measured as headline inflation less food and energy inflation. While core inflation has retreated from the peaks recorded in 2022, it generally remains stubbornly elevated. Part of the stickiness comes from the ongoing rotation of consumption from goods to services and the continuing recovery of profit margins, and part from the sustained demand for labour and rising wages, particularly in advanced economies.²

1 The inflation and growth figures reported in this section are, unless otherwise indicated, from the International Monetary Fund (IMF)'s World Economic Outlook (WEO) Update of January 2024.

2 See, for instance, C Jones and H Clarfelt, 'US inflation rise to 3.2% highlights "last mile" challenge for Federal Reserve', *Financial Times*, 12 March 2024. <https://www.ft.com/content/46ca8249-8b81-4f25-a852-4bf9f9852085>

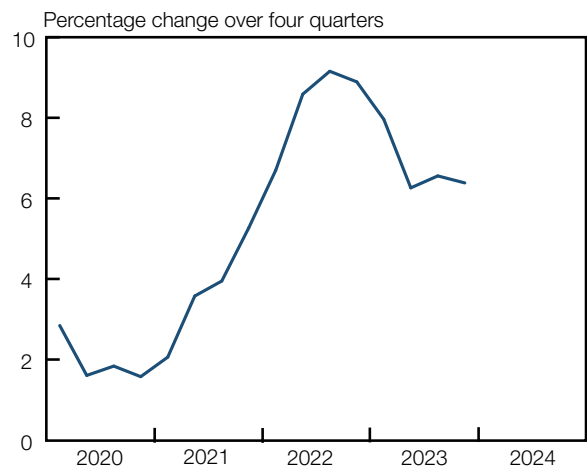


* As at Mar 2024 unless otherwise indicated

** As at Feb 24

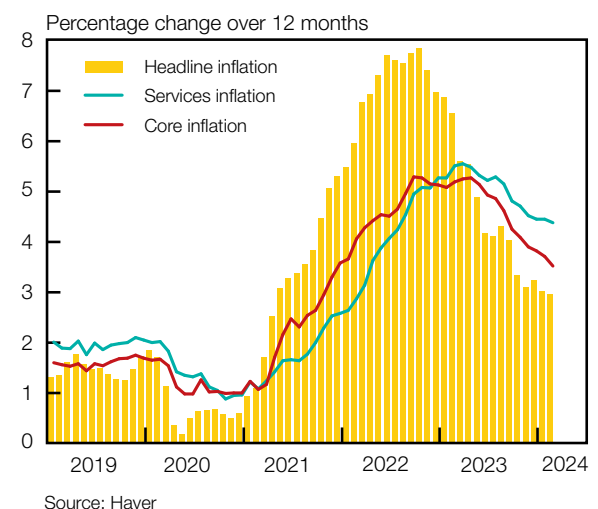
Source: Haver

Evolution of global inflation



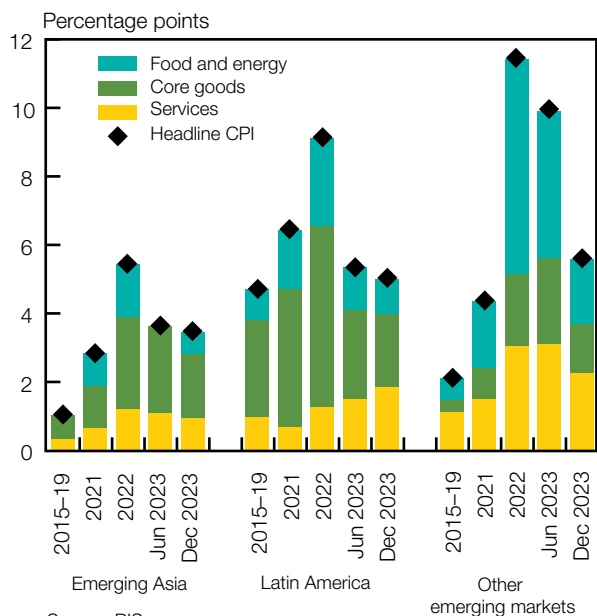
Source: Haver

Inflation in advanced economies



Source: Haver

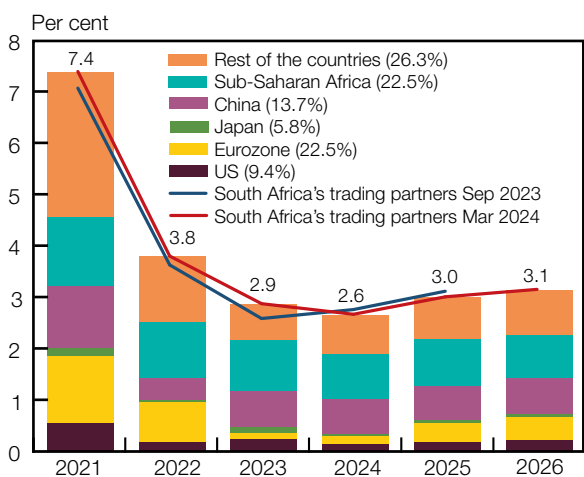
Contributions to headline inflation in emerging markets



Emerging market economies have also experienced higher-than-expected services and core goods inflation, often worsened by sustained currency depreciation.

Inflation outcomes have also been buoyed by stronger-than-expected global economic activity, which expanded by 3.1% last year. Economic growth, however, has varied across countries and has generally not been robust. The United States (US) economy expanded by 2.5% in the past year, underpinned by fiscal spending, strong consumer demand and a tight post-pandemic labour market. In contrast, economic activity in the eurozone and the United Kingdom (UK) was markedly weaker, reflecting ongoing geopolitical tensions in Eastern Europe and sharply higher energy prices. High inflation and tighter monetary policy further dampened household spending.³ Growth in emerging markets, while slightly better than previously projected, remains well below pre-pandemic trends. The clearest link from slower growth to lower inflation is found in China. In most of the rest of the world, the connection between growth outcomes and inflation is less apparent. On balance, with production levels in most economies below trend, sustained spending by governments and, in some places, the private sector has given impetus to global inflation.

Contributions to global growth*



Despite these and other efforts to support economic growth, the outlook for the global economy remains broadly subdued. Accordingly, the South African Reserve Bank (SARB) forecasts trading-partner growth to soften this year, averaging 2.6% (from 2.9% the year before) before recovering to 3.1% by 2026.

Expectations of softer economic growth in much of the world economy should provide support to disinflation. Yet, further disinflation is less certain, as seen in the recent monthly inflation outcomes in South Africa and elsewhere. Slower convergence to lower inflation raises questions about the current policy settings and their relationship to long-run neutral rates, or 'r-star'. If the interest rate consistent with stable inflation and output at potential is higher than currently estimated, then the policy stance may not be sufficient to reduce inflation. Significant uncertainty attaches to the level and evolution of r-star normally, and this problem has worsened in the post-pandemic period. Large and persistent fiscal deficits, the necessity to transition to a low-carbon global economy as well as heightened geopolitical tensions all suggest an increase in the real cost of capital.⁴ Equally, the apparent resilience in

³ Eurozone growth was estimated at 0.5% in 2023. On the reasons for weak growth in the eurozone, see European Central Bank, *Monetary Policy Statement*, press conference, Frankfurt: European Central Bank, 7 March 2024.

⁴ See G Benigno, B Hofmann, G N Barrau and D Sandri, 'Quo vadis, r*? The natural rate of interest after the pandemic', *Bank for International Settlements Quarterly Review*, Basel: Bank for International Settlements, March 2024. See also I Schnabel, 'R(ising) star?', speech by Isabel Schnabel, a Member of the Executive Board of the European Central Bank (ECB), at the ECB and its Watchers XXIV Conference session on Geopolitics and Structural Change: Implications for Real Activity, Inflation and Monetary Policy, Frankfurt, 20 March 2024. https://www.ecb.europa.eu/press/key/date/2024/html/ecb.sp240320_2-65962ef771.en.html and C Brand, N Lisack and F Mazelis, 'Estimates of the natural interest rate for the euro area: an update', *European Central Bank Economic Bulletin*, Issue 1/2024, Frankfurt: European Central Bank, February 2024.

economic activity suggests that policy today may not be as restrictive as implied by the low pre-pandemic levels of the neutral rate.

While perspectives on the unobservable r-star evolve, uncertainty about the stance of policy will continue to set the tone for monetary policy across most jurisdictions this year and generate volatility in financial markets. For emerging markets, these developments imply higher interest rates overall and a slower decline in inflation.⁵

For many economies, high public-debt levels will remain a focus of policy efforts. Reducing fiscal deficits and debt levels will rebuild fiscal space and, in a context of ongoing financing needs and inconsistent capital flows, help countries to disinflate faster.

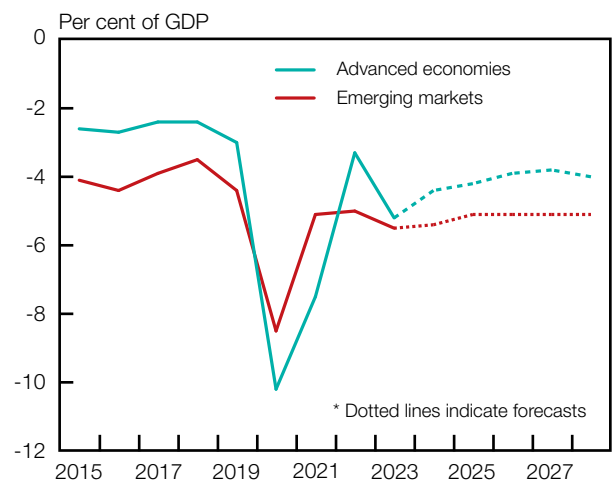
Domestic economic developments and outlook

Like the trends observed for global inflation, domestic headline inflation has come off the peak it reached in 2022, benefitting from lower oil prices and some easing in food price inflation over the past year. Headline inflation returned to the target band in June 2023 and averaged 6.0% for the year, down from 6.9% in 2022. Amid slower-than-expected disinflation in food and volatility in fuel prices, headline inflation has fluctuated in the range of 5–6% over the past six months. More recently, services inflation has risen sharply as some components normalised. These setbacks suggest that the path back to the 4.5% midpoint of the target band is likely to be bumpy and protracted.⁶

Nonetheless, headline inflation is forecast to moderate over the course of this year, averaging 5.1% for the year as food and fuel price inflation ease. Its return to the midpoint of the target band, however, is only expected in the last quarter of 2025. The slower pace of disinflation reflects a range of issues, including normalising services components and elevated inflation expectations.

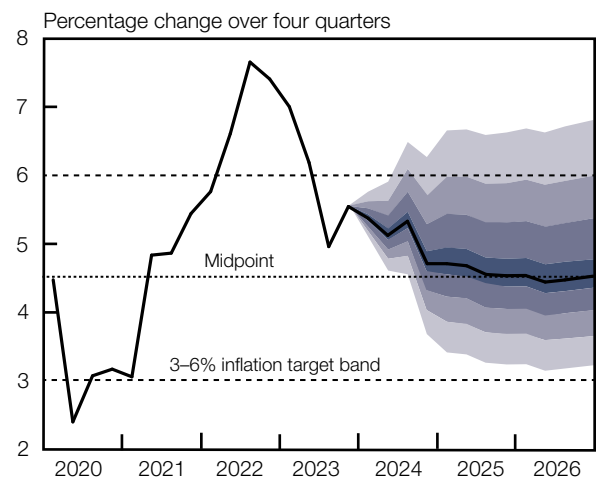
Administered prices continue to exert substantial upward pressure on headline inflation. These regulated, public sector-controlled, prices impede efforts to bring inflation down and maintain it at the midpoint of the target band; consequently, they also erode competitiveness (see Box 1).⁷ Electricity and water prices, in particular, have for several years inflated at

Fiscal balance ratio*



Source: IMF

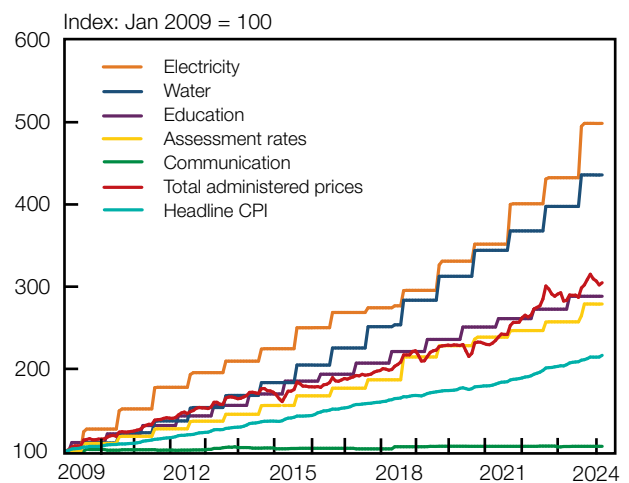
Targeted inflation forecast*



* The bands around the central projection show confidence intervals of 10%, 30%, 50% and 70%.

Sources: Stats SA and SARB

Administered prices



Source: Stats SA

5 High global interest rates limit the scope for currency appreciation to lower inflation in emerging markets. However, if r-star is underestimated, interest rates in emerging markets are lower than they should be, presenting a risk of further currency depreciation and thus higher inflation.

6 Headline inflation rose from 4.8% in August 2023 to 5.9% in October and then fell to 5.1% in December before rising again to reach 5.6% in February 2024.

7 See C Loewald, K Makrelov and E Pirozhkova, 'The short-term costs of reducing trend inflation in South Africa', *South African Reserve Bank Working Paper Series No. WP/22/08*, Pretoria: South African Reserve Bank, August 2022. <https://www.resbank.co.za/content/dam/sarb/publications/working-papers/2022/WP%202208.pdf>

rates well above the 4.5% midpoint of the inflation target band.⁸ Efficiency gains in these sectors would be important to ensuring that long-run, cost-reflective prices are achieved soon. Other administered prices, such as education and assessment rates, are influenced by headline inflation outcomes and should be more closely aligned to the target midpoint itself. Reducing headline inflation would bring down administered price inflation, creating a virtuous cycle.

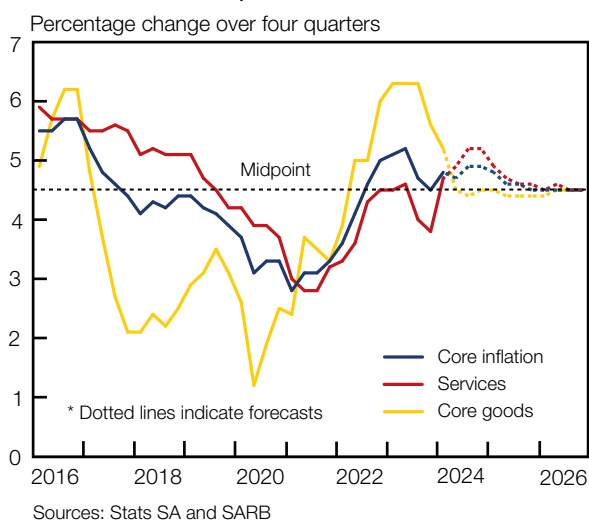
In contrast to headline inflation, core inflation has averaged closer to the midpoint of the target band for most of the past six months.⁹ Core goods prices have put upward pressure on overall core inflation, driven mostly by currency depreciation and higher imported inflation. For the most part, services inflation surprised to the downside, with housing inflation remaining muted and transport inflation easing in line with the sharp disinflation in fuel. Services prices were further kept in check by subdued real unit labour costs (ULCs). However, that trend appears to have been broken by the jump in services price inflation to 4.9% in February 2024, up from 4.0% in January.

Core inflation, however, is still expected to average 4.8% this year – the same as in the previous year – before declining slowly to the target midpoint in the final quarter of 2025. Services inflation is forecast to rise from 4.2% last year to 5.0% this year, and to remain elevated at 4.7% in 2025.

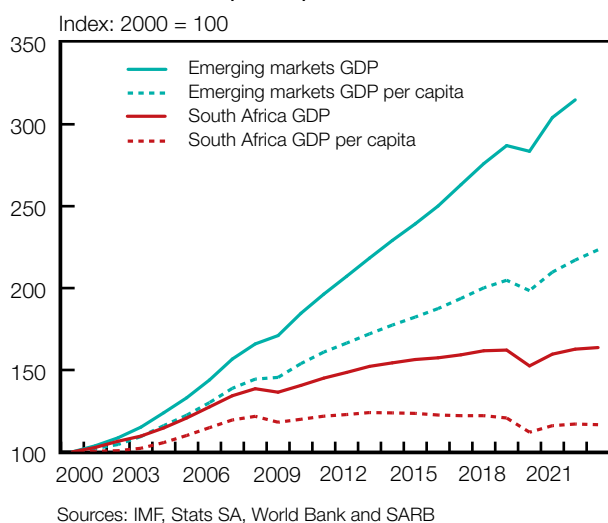
While inflation remains elevated, South Africa's output growth remains low, mainly due to an inadequate energy supply, sharply deteriorated logistics capacity as well as low confidence among businesses and households. Gross domestic product (GDP) growth slumped to 0.6% in 2023, down from 1.9% in 2022 and 4.7% in 2021. This outcome amounts to very poor output growth when measured against a growing population and labour force, with South Africa's output trajectory diverging markedly from that of its emerging market peers.¹⁰

While growth in investment and household spending helped the economy expand in the first half of 2023, their momentum subsided in the second half of the year. Investment in renewable-energy production appeared to collapse, likely indicating front-loading of spending given intense load-shedding in the first half of 2023 along with possible market saturation, and both government as well as public sector corporation investment contracted. Government consumption spending, however, grew by 2.0% for the year. Downside pressures also emanated from commodity export prices that continued to fall from the highs reached in 2022, reducing the contribution of foreign

Core inflation components*



GDP and GDP per capita



8 See Z Ismail and C Wood, 'Review of administered prices in South Africa: The petrol price', *South African Reserve Bank Special Occasional Bulletin of Economic Notes: Special OBEN/23/01*, Pretoria: South African Reserve Bank, August 2023. <https://www.resbank.co.za/content/dam/sarb/publications/special-occasional-bulletins/2023/special-occasional-bulletin-of-economic-notes-2301-review-of-administered-prices-in-south-africa-the-petrol-price-august-2023.pdf>

9 However, core inflation jumped to 5.0% in February 2024, up from 4.6% in January.

10 Domestic GDP growth fell spectacularly, and almost linearly, from 3.2% in 2011 to just 0.3% by 2019.

demand to domestic growth. Accordingly, the second half of 2023 registered markedly poor growth performance, with the economy narrowly avoiding a technical recession.¹¹

The near- and medium-term outlook is for growth to increase, albeit slowly, as electricity supply improves gradually, underpinned by the ongoing private investment in renewable-energy generation and increased maintenance by Eskom. Household consumption spending is also expected to strengthen as inflation eases, wages rise, pension savings get spent and job creation picks up with investment, helping to lift growth over the medium term.¹²

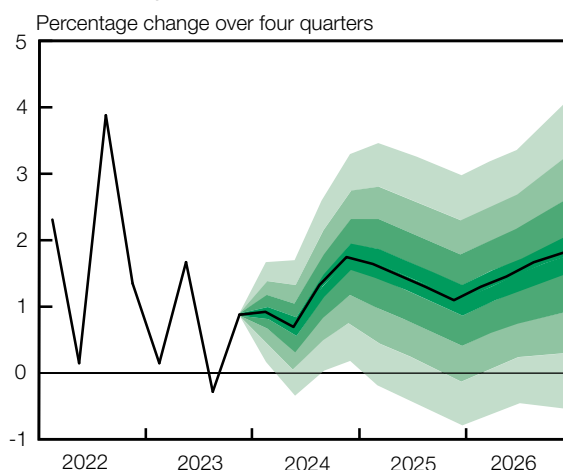
Although the full implementation of the energy and logistics sector reforms will ease the performance challenges in these network industries, inadequate electricity supply and logistical bottlenecks are expected to remain a drag on the economy. In the near term, uncertainty around the reliability of electricity supply persists as the grid remains fragile amid still-elevated unplanned outages, as evidenced by the occasional bouts of Stage 6 load-shedding earlier this year.¹³

Meanwhile, deflating commodity export prices, amid subdued growth in China and weaker global industrial commodities demand overall, will continue to weigh on domestic economic activity.¹⁴ Longer-term upside growth momentum, whether from stronger global growth or from sustained higher commodity export prices, linked say to climate change, remains hard to forecast.

The SARB projects both real GDP and potential growth to improve to 1.2% this year and to rise to 1.6% by 2026. Importantly, even if achieved, these growth rates remain well below South Africa's long-term average growth rate of about 2.0% and far below the 4.1% average growth for emerging markets in the current year projected by the International Monetary Fund (IMF).

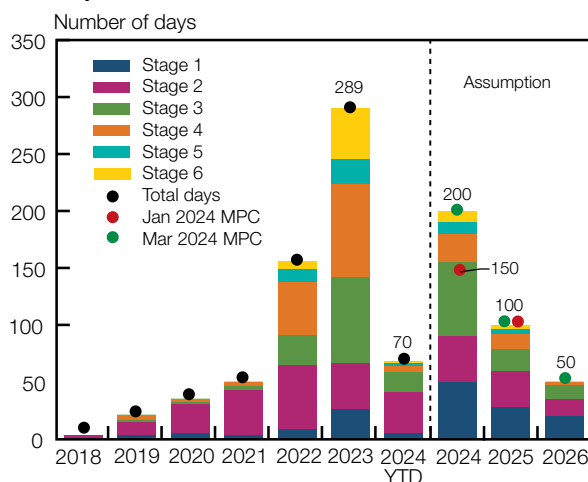
The fiscal accounts remain under pressure from sustained spending and slow revenue growth. The debt ratio remains elevated and, coupled with high borrowing costs, means that debt-service costs continue to be one of the fastest-growing

Real GDP growth*



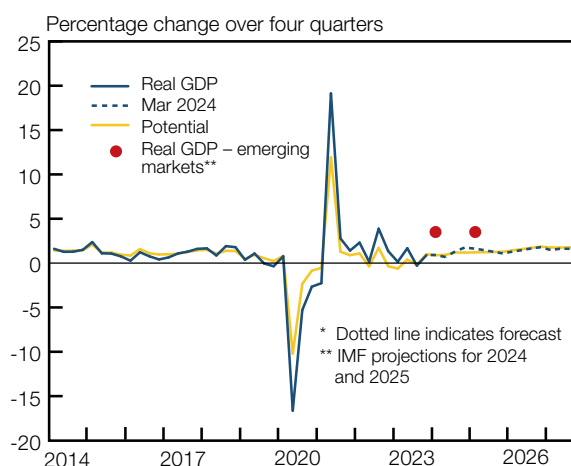
* The bands around the central projection show confidence intervals of 10%, 30%, 50% and 70%. This chart shows seasonally adjusted data, as used in the QPM. Sources: Stats SA and SARB

Days load-shed*



* Calculated as total hours load-shed divided by 24. Sources: Eskom X, ESP (app) account and SARB

GDP*



Sources: IMF, Stats SA and SARB

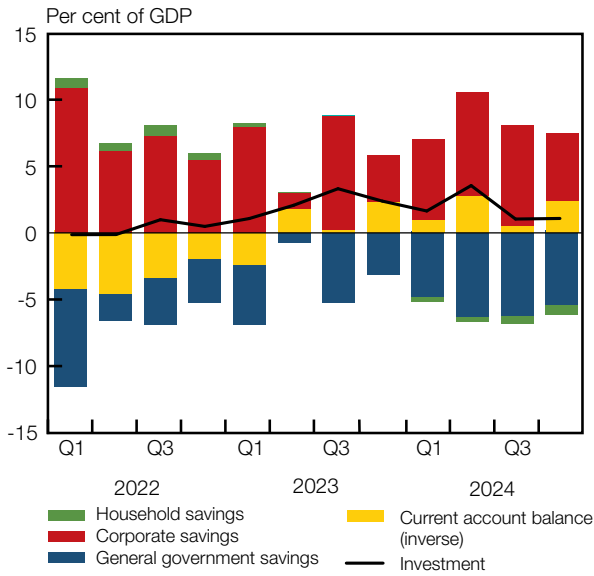
11 GDP contracted by 0.2% in the third quarter of 2023 before rebounding and growing at a muted rate of 0.1% in the fourth quarter.

12 The two-pot pension reform takes effect from 1 September 2024. It creates two pots: a *savings pot* that contains one-third of annual contributions and a *retirement pot* that contains two-thirds, with savers allowed to withdraw a portion of the savings accumulated in the savings pot. The SARB assumes a pre-tax withdrawal of R40 billion in the fourth quarter of 2024 and R20 billion per annum thereafter. This is incremental to the R100–20 billion per annum of pension withdrawal due to resignations.

13 The recent system adequacy assessment by Eskom showed that, over the next five years, electricity supply remains inadequate in all scenarios except the high energy availability factor (EAF) scenario. See Eskom, *Medium-term system adequacy outlook*, Johannesburg: Eskom, 2023.

14 South Africa's terms of trade are projected to decline to 103 index points by 2026, from 114 index points in 2022.

Investment financing



expenditure components.¹⁵ The R150 billion Gold and Foreign Exchange Contingency Reserve Account (GFECRA) drawdown should help in the near term; it has enabled National Treasury to pencil in debt peaking at 75.3% of GDP as opposed to the previous 77.7% of GDP in the *2023 Medium Term Budget Policy Statement (2023 MTBPS)*. Despite this boost, the yield curve remains steep, suggesting the importance of following through on the articulated medium-term fiscal trajectory.

While investment is forecast to improve, low domestic savings rates and weak export growth imply a weaker balance of payments and increased demand for foreign savings. After averaging -1.6% of GDP in 2023, the current account balance is projected to slide deeper into deficit, reaching 3.3% of GDP by 2026.

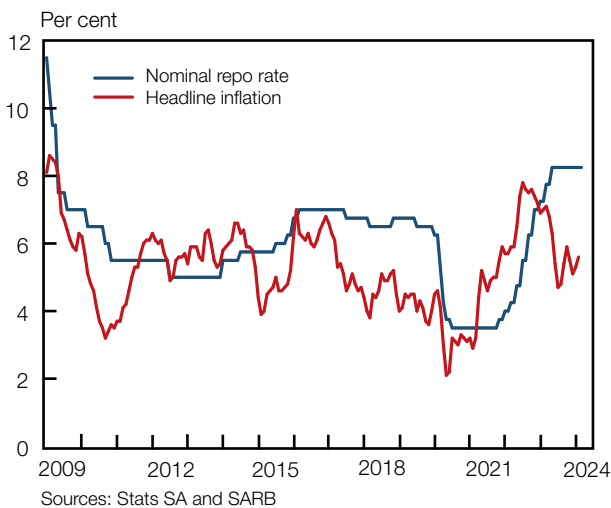
Overview of the policy stance

The six-month period covered by this *Monetary Policy Review (MPR)*, being October 2023 to March 2024, saw the SARB's Monetary Policy Committee (MPC) maintain a hold on the repo rate. This rate has now been unchanged at 8.25% for five consecutive MPC meetings. The repo rate was last adjusted in May 2023, when it was raised by 50 basis points.

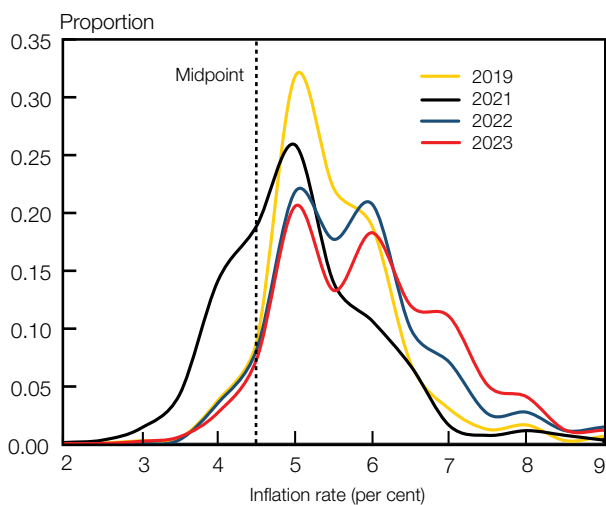
From the May 2023 MPC meeting onwards, monetary policy has been moderately restrictive. Despite the present stance, headline inflation has remained above the target midpoint for 36 consecutive months, and expectations held by the public about future inflation have remained well above 5.0%, moving in line with actual inflation outcomes. Although surveyed inflation expectations softened in the first quarter of this year, the evolution is less clear when considering the last three Bureau for Economic Research (BER) data releases together. The data paints a picture of a sideways movement. A large share of the survey participants expects inflation outcomes above 6.0% in two years' time, showing that inflation expectations remain too backward-looking. This suggests that caution should be applied to assessing the policy stance.

The degree of caution that needs to be applied to rate decisions in an uncertain and shock-prone environment is highlighted by the guidance provided over the past six months by the SARB's Quarterly Projection Model (QPM). The November 2023 and January 2024 MPC forecasts suggested rate cuts to commence in the first quarter of this year, while the March 2024 forecast suggested rate cuts to only begin in the May 2024 MPC meeting. Alongside the baseline (risk-neutral) forecast, the MPC considers a range of global and domestic scenarios that help to clarify the impact of the very wide range of potential risks to the baseline. The MPC statements over

Repo rate and headline inflation



Distribution of two-years-ahead business inflation expectations*



* Standard deviations for 2019, 2021, 2022 and 2023 are 0.97, 1.10, 1.56 and 1.53 respectively.

Sources: BER and SARB

¹⁵ The 2024 Budget estimates debt-service costs to increase at an annual average rate of 7.3% over the medium term compared with 8.8% at the time of the *2023 Medium Term Budget Policy Statement*.

time indicate the particular risks that the MPC sees as being material to the realisation of the forecast and its view of the appropriate policy rate. Had the MPC adjusted rates in line with the earlier more benign inflation forecasts, for example, inflation expectations could have worsened materially, delaying the path back to target and requiring higher rates again.

The QPM baseline forecasts move significantly as monthly inflation outcomes are registered and impact on the starting point for the forecast. Looking back over the past six months, while the annual projections for headline inflation are broadly stable, the timeframe for reaching the target midpoint shifted out by a year from the September 2023 to the March 2024 forecast. Food and services price inflation moved significantly higher than expected at the time of the September meeting.

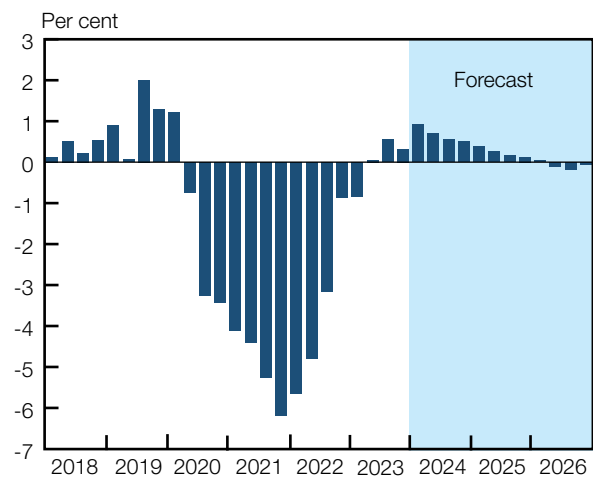
As with headline inflation, the profile for core inflation has remained broadly unchanged over the past six months, suggesting that movements in the underlying components have tended to offset each other. The March 2024 forecast has services inflation substantially higher in both 2024 and 2025 on account of elevated inflation expectations as well as normalising medical insurance and housing inflation. Meanwhile, core goods inflation is markedly lower at 4.6% this year (versus 5.2% in the September 2023 forecast) as the rate of inflation for exchange rate-sensitive core goods eases in line with falling global goods inflation and a somewhat more stable exchange rate.

The three MPC meetings covered in this *MPR* – being the November 2023, January 2024 and March 2024 meetings – had similar backdrops. The QPM forecasts showed headline inflation converging to the midpoint of the target band from 2025. Meanwhile, sticky core inflation and resilient labour markets in advanced economies suggested that global policy rates could remain ‘high for longer’, affecting the risk appetite of investors.

The MPC assessed serious upside risks to inflation in each of the three meetings, and these have remained broadly unchanged from meeting to meeting. Oil markets remained tight and supply chains strained by geopolitical tensions. At the same time, domestic food price inflation remained volatile and susceptible to El Niño weather conditions as well as load-shedding. A weaker rand, along with elevated inflation in trading-partner economies, added to imported inflation, while inflation expectations remained elevated despite the moderation in headline inflation.

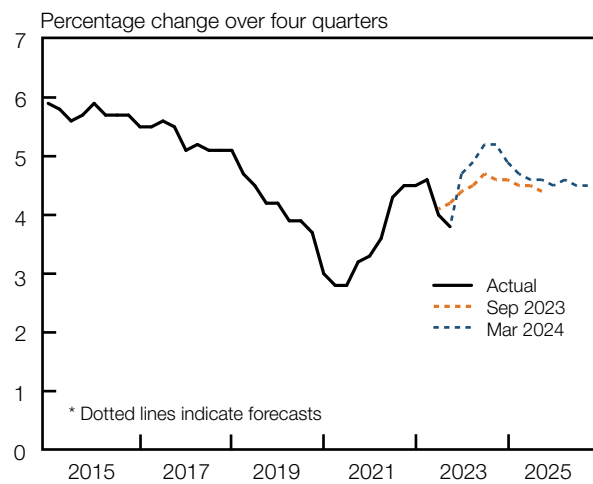
Data leading up to the March 2024 MPC meeting suggested renewed price pressures, with surprises also emanating from services inflation. Some risks that the MPC had repeatedly flagged materialised, especially rising core inflation. With

Real repo rate gap



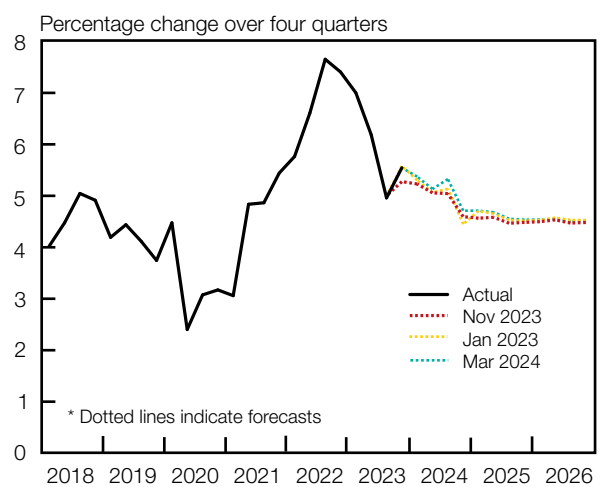
Source: SARB

Services inflation*

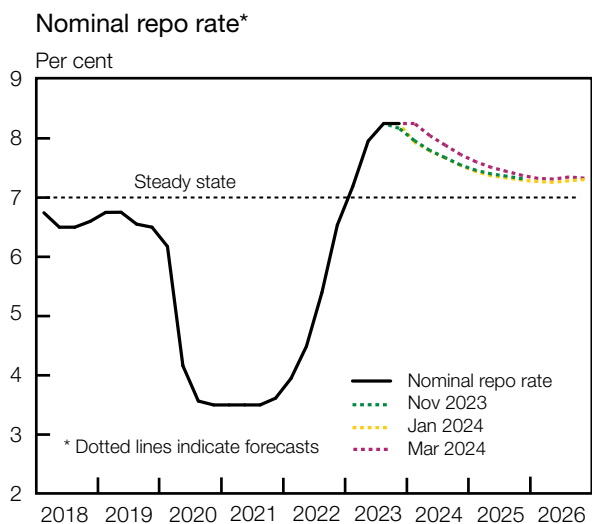


Sources: Stats SA and SARB

Headline inflation forecasts*



Sources: Stats SA and SARB



Source: SARB

the risks similar to those in previous meetings and judged to be skewed to the upside, the MPC unanimously agreed to keep the repo rate unchanged at 8.25% in each of the three meetings.

Conclusion

South Africa's inflation has fluctuated within the 5–6% range since September 2023. Uncertainty regarding the path back to the target midpoint has risen in recent months as new risks emerged while others materialised. Amid setbacks in recent domestic inflation outcomes, along with heightened uncertainty about global disinflation owing to stickiness in services inflation, markets now expect South Africa's policy rate to remain unchanged this year.

Beyond the ongoing monetary policy efforts, domestic economic conditions can be improved by achieving a more prudent public-debt level, improving the adequacy and efficiency of network industries, lowering administered price inflation, and keeping real wage growth in line with productivity gains. Competitiveness can be boosted further by, among other things, bringing South Africa's inflation in line with the inflation rates of its peer emerging markets and major trading partners to stymie the excessive real appreciation of the rand.

Box 1 Do fiscal and monetary policy complementarities matter?

South Africa's inflation target is an outlier when compared with peer emerging markets and major trading partners. This, alongside the large public-debt burden and elevated credit default risk, keeps long-term inflation risks higher than they need be, depressing domestic demand and adding to inequality.¹ Honohan and Orphanides (2022) reach similar conclusions and recommend a *point* inflation target of 3.0% for South Africa rather than the current inflation target band.²

Among other economic benefits, a permanently lower inflation profile can directly reduce borrowing costs and improve fiscal sustainability. When debt levels are high and long-term interest rates respond to increases in debt and inflation, the utility of inflation for fiscal purposes (reducing real debt levels) falls away. In that context, more efficient macroeconomic policy targets would lower real and nominal interest rates and reduce debt-service costs. Over the next three years, about R641 billion (or 15.6% of the total stock) of long-term domestic bonds will mature.³ Lower expected inflation would allow that debt to be rolled over at lower nominal and real interest rates, alongside the issuance of new debt, significantly lowering future debt-service costs. A lower inflation rate would also bring down administrative price inflation, reducing the degree of indexation in public sector spending.⁴

The economic benefits increase further as the lower inflation rate pulls down the real risk premium and real interest rate. This strengthens the economy overall, increasing revenue and accelerating the gains to the fiscal position. Less aggressive administered price inflation would also ease pressure on private sector price determination.

To test the Honohan and Orphanides proposal, the South African Reserve Bank (SARB) modelled the impact of targeting 3.0% headline inflation over a five-year timeframe. The economic growth rate decreases by about 0.3 percentage points relative to the baseline, but the decline is quickly reversed and surpassed as the growth rate strengthens by more than the initial weakening. The cost to growth in the first year comes not from a rise in the policy rate, but from a passive rise in the real rate as inflation expectations decline and the currency appreciates. The faster that inflation expectations and inflation itself moderates, the quicker the lower repurchase (repo) rate and a stronger currency flows through to the long-term market interest rate and economic growth.

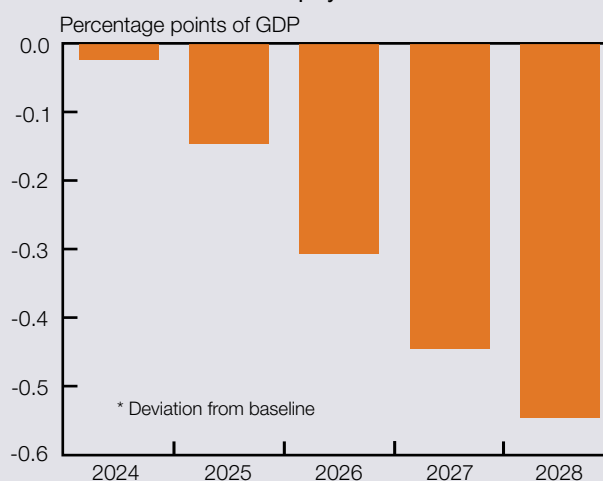
1 A Mian, 'Dependence on credit to boost demand imperils the world economy – we must correct the underlying imbalances', *International Monetary Fund Finance and Development Magazine*, March 2024, pp 26–27. See also National Treasury, *Macroeconomic Policy: A Review of Trends and Choices*, Pretoria: National Treasury, 2024. <https://www.treasury.gov.za/documents/national%20budget/2024/Macroeconomic%20Policy%20Review.pdf>

2 P Honohan and A Orphanides, 'Monetary policy in South Africa, 2007–21', *WIDER Working Paper No. 2022/29*, UNU-WIDER, March 2022. <https://satiid.wider.unu.edu/article/monetary-policy-south-africa-2007-21>

3 Over the next five years, about R1.1 trillion (or 27.2%) of all domestic debt, including inflation-linked bonds, needs to be redeemed.

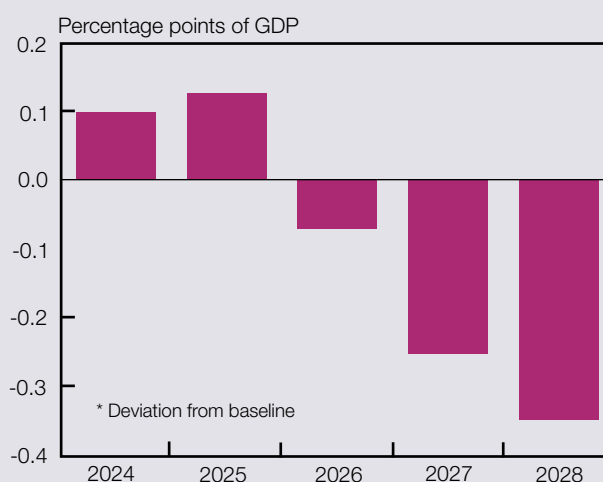
4 C Loewald, K Makrellov and E Pirozhkova, 'The short-term costs of reducing trend inflation in South Africa', *South African Reserve Bank Working Paper Series No. WP/22/08*, Pretoria: South African Reserve Bank, August 2022. <https://www.resbank.co.za/content/dam/sarb/publications/working-papers/2022/WP%202208.pdf>

Government interest payments*



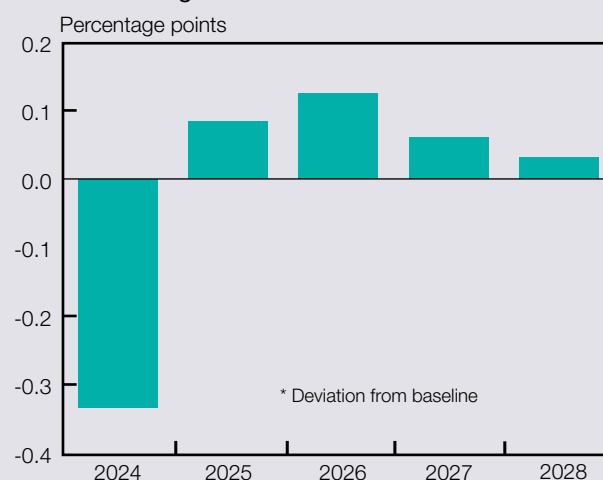
Source: SARB

Government debt*



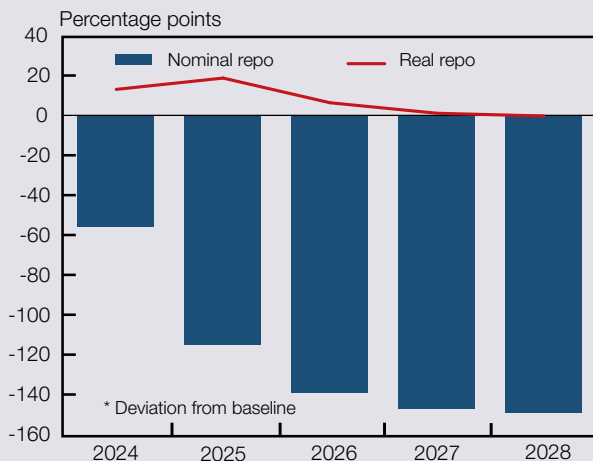
Source: SARB

Real GDP growth*



Source: SARB

Repurchase rate*



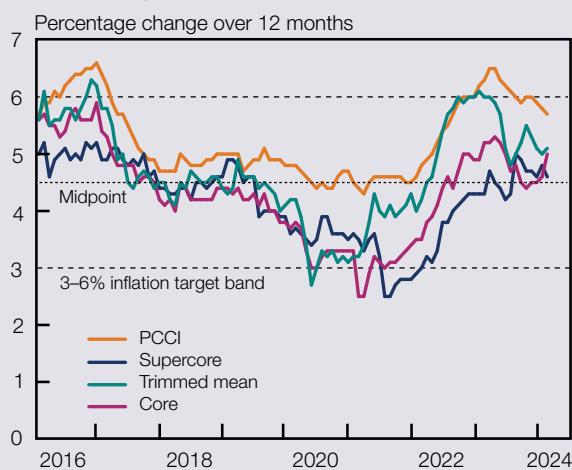
Source: SARB

The modelled estimates are consistent with South Africa's experience with sacrifice ratios (the growth cost of lower inflation), which shows them to be small, reflecting relatively high monetary policy transparency and credibility.⁵

In addition to the short-run dynamics of interest rates and inflation expectations, the longer-term effects of a permanently lower inflation rate are important. Lower inflation also helps to reduce inflation volatility and hence interest rate risk, decreasing the cost of capital and the hurdle rate for future investment. More certainty about the trajectory for prices and costs further boosts the quantity and quality of investment, generating gains for productivity. Lower inflation also supports the competitiveness of exporting and import-competing firms by decreasing the continuous real exchange rate appreciation caused by domestic prices rising faster than those of trading partners.

5 M Reid and P Siklos, 'Rationality and biases: insights from disaggregated firm-level inflation expectations data', *South African Reserve Bank Working Paper Series No. WP/23/07*, Pretoria: South African Reserve Bank, July 2023. <https://www.resbank.co.za/en/home/publications/publication-detail-pages/working-papers/2023/rationality-and-biases--insights-from-disaggregated-firm-level-i>; see also A Kabundi and M Mlachila, 'Monetary Policy Credibility and Exchange Rate Pass-Through in South Africa', *South African Reserve Bank Working Paper Series No. WP/18/04*, Pretoria: South African Reserve Bank, August 2018. <https://www.resbank.co.za/content/dam/sarb/publications/working-papers/2018/8690/WP1804.pdf>; see also A S Blinder, 'Central-Bank Credibility: Why Do We Care? How Do We Build It?', *American Economic Review* 90(5), 2000, pp 1421–1431; see also N Dincer, B Eichengreen and P Geraats, 'Trends in Monetary Policy Transparency: Further Updates', *International Journal of Central Banking No. 72*, March 2022, pp 331–348.

Underlying inflation



Sources: Stats SA and SARB

Box 2 Better demand measures of inflation still show inflation risk

Headline inflation is back in the target band but as exogenous price pressures fade, its stabilisation at the midpoint of the target band will depend more on the underlying (core) inflation trajectory. Core inflation, measured as headline inflation less the volatile components prone to transient shocks (namely food, fuel and electricity), has risen markedly from an average of 3.7% over the 2019–22 period to 4.8% in 2023. Goods prices have been a large contributor to core inflation on account of lagged global prices and a relatively weak rand, although these have eased over the past six months. More recently, after resting closer to the midpoint of the target range for the first four months of the review period (October 2023 – March 2024), core inflation jumped 0.4 percentage points to 5.0% in February 2024 on quickened normalisation of some components of the services inflation basket.

Another measure of underlying inflation, namely 'trimmed mean' inflation, which excludes components with the highest and lowest month-on-month changes (5% on either side), has risen markedly in the post-pandemic period and has fluctuated in the 5–6% range over the review period. The trimmed mean measure shows that a large share (90%) of the consumer price index (CPI) basket is still inflating above 5.0%.^{1, 2}

1 Core and trimmed mean inflation are designed to strip out the effect of transient supply shocks on headline inflation.

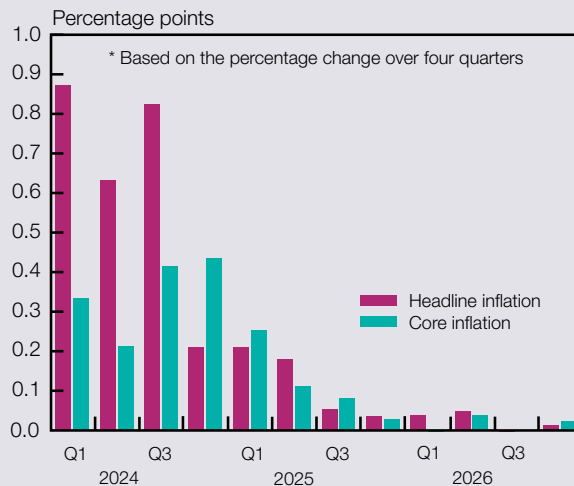
2 High trimmed mean inflation may reflect the still-elevated food and energy price inflation.

Elevated inflation pressures also emerge from the persistent and common component of inflation (PCCI) and a 'supercore' measure recently developed by the South African Reserve Bank (SARB). PCCI surged during the recovery from the pandemic, reaching a high of 6.3% in April 2023 before easing somewhat. The outcomes for PCCI have, however, remained closer to the upper limit of the target band over the review period.³ The PCCI for South Africa is obtained from a factor model consisting of 79 subcomponents of the CPI basket at the COICOP four-digit level of disaggregation. The PCCI separates out idiosyncratic changes to a price from unobserved but persistent and common components that capture underlying inflationary dynamics. The PCCI is higher than core inflation, which mainly reflects the below-average post-pandemic housing inflation and medical aid inflation.⁴ The supercore measure also shows that inflation pressures have risen as the economy recovered from the COVID-19 pandemic, with outcomes hovering slightly above the target midpoint in recent months. Supercore inflation is constructed from the core inflation basket by isolating, via a Phillips curve, those components that are sensitive to the output gap – a proxy for economic slack.⁵

However, there are fundamental differences between PCCI and supercore inflation on the one hand and trimmed mean and core inflation on the other. Perhaps most important is that exclusion-based measures (trimmed mean and core) may still reflect transitory shocks but may not carry information about persistent shocks.⁶ PCCI and supercore inflation are meant to serve as useful barometers for demand-driven inflation pressures given their close association to the degree of slack in the economy.⁷ These differences notwithstanding, the four measures broadly indicate elevated underlying inflation pressures in the domestic economy.

In summary, underlying inflation in South Africa is elevated, averaging 0.6 percentage points above the SARB's preferred 4.5% midpoint over the past six months. Alongside the upside risks to underlying inflation such as inflation expectations, the normalisation of medical aid insurance and rental housing inflation as well as currency weakness, this indicates that the job of bringing inflation back to target sustainably is not yet complete.

Headline and core inflation deviation* from midpoint



Sources: Stats SA and SARB

3 A Amaral, M Kruger, D Lekgeu and W Simbanegavi, 'PCCI of SA's CPI: Estimating the persistent and common component of inflation for South Africa', *South African Reserve Bank Economic Note*, forthcoming.

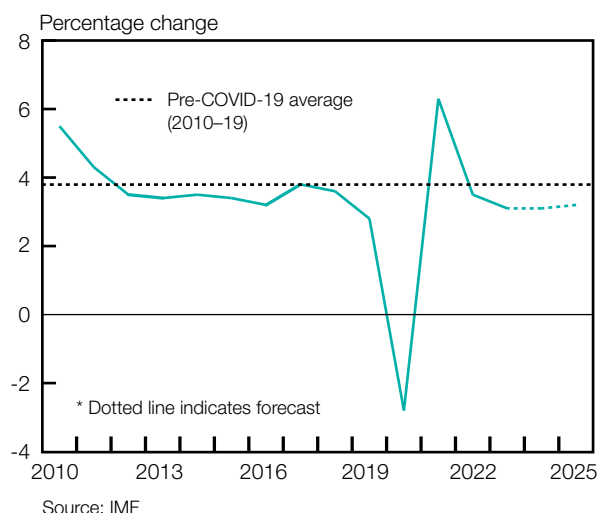
4 As of February 2024, medical aid inflation is back to its long-term average.

5 S de Kock, M G Ferreira, M Rapapali, W Simbanegavi and M Tshenkeng, 'A supercore inflation measure for South Africa', *South African Reserve Bank Economic Note*, forthcoming.

6 A Palazzi and W Simbanegavi, 'Mind second round effects! The effects of food and energy inflation on core inflation in South Africa', *South African Reserve Bank Occasional Bulletin of Economic Notes: OBEN/23/01*, Pretoria: South African Reserve Bank, June 2023. <https://www.resbank.co.za/content/dam/sarb/publications/occasional-bulletin-of-economic-notes/2023/mind-second-round-effects-the-effects-of-food-and-energy-inflation-on-core-inflation-in-south-africa-june-2023.pdf>; see also A Amaral, M Kruger and M Reid, 'Looking to the price setters: what can we learn from firm-level inflation expectations data?', *South African Reserve Bank Economic Note No. EN/2023/16*, Pretoria: South African Reserve Bank, November 2023.

7 Supercore inflation is, by construction, made up of only those CPI components that are responsive to the output gap, while PCCI captures inflation drivers that are common to all components of the CPI basket, of which economic slack is one.

Global real GDP*



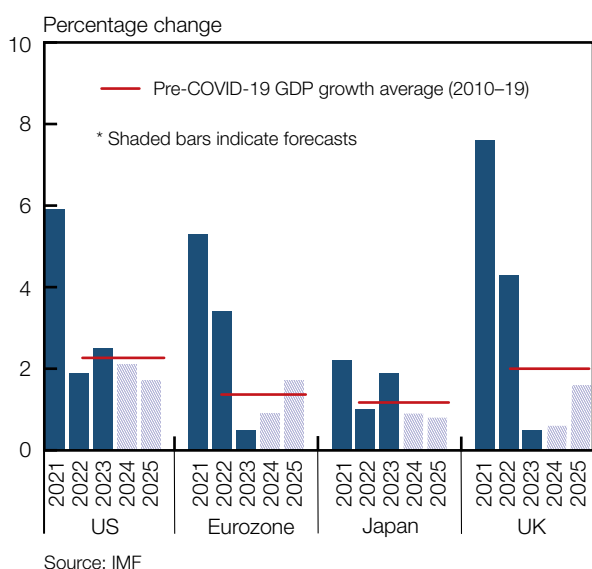
Global rates high for longer

Growth in global economic activity is expected to stabilise this year, after two years of easing, and to increase slightly next year. Meanwhile, global inflation is expected to continue to moderate but to remain above major central banks' targets in 2024, converging to targets from next year. Interest rate expectations have swung markedly over the review period, initially reflecting market exuberance about faster disinflation but recently becoming less sure of rate cuts amid signs of stickier inflation. Still, expectations are broadly for rate cuts to commence in major advanced economies in the second half of this year, but the magnitude of the expected monetary policy relief has been scaled back significantly. Risks to global inflation remain tilted to the upside amid still-tight labour markets and sticky services inflation in advanced economies.

Resilient global growth

Global economic growth is expected to reach 3.1% this year, the same as in 2023.¹⁶ While economic activity in the US and India is forecast to remain firm, most advanced and emerging economies, including China, are set to grow more slowly than they did in the decade leading up to the COVID-19 pandemic. On a sectoral view, a strong rebound in the services sector over the past two years has supported global growth even as manufacturing activity weakened. Some improvement in the global manufacturing sector is now expected, recovering from the lows of the past few years.¹⁷

Real GDP growth projections for advanced economies*



Advanced economies are forecast to expand at broadly the same pace as in the past year. Country experiences differ, however, with the US outperforming all the major advanced economies, underpinned by firm consumer demand and a still-buoyant labour market. Meanwhile, a modest expansion in output is expected for the eurozone and the UK. Subdued growth in the eurozone partly reflects sustained effects from higher relative energy costs.¹⁸ Regarding the UK and Japan, consumption remains soft and muted growth rates of 0.6% and 0.9% respectively are projected for this year.

Growth in output has also bottomed out in emerging markets. Output growth is expected to average 4.1% again this year, and to rise to 4.2% over the coming year. The rate of expansion in economic activity remains below the pre-pandemic trend, reflecting persistent weak growth in some large economies.

16 Forecasts are from the International Monetary Fund's January 2024 World Economic Outlook projections.

17 In the US, for instance, the Institute for Supply Management's (ISM) manufacturing new orders index is well ahead of the inventory index, which typically implies a pickup in the overall Purchasing Managers' Index (PMI) manufacturing index. Similarly, net export growth from Asia has also increased, suggesting a rise in global goods demand.

18 Citi's research illustrates that Europe's large exposure to the Russia-Ukraine energy shock may have resulted in a relative loss of industrial competitiveness vis-à-vis emerging Asia; see Citi, 'China's Manufacturing Glut and its Global Ramifications', *Emerging Markets Economic Outlook and Strategy*, New York: Citi, 16 February 2024.



China's economy is expected to slow this year, weighed down by the ongoing weakness in the property sector and subdued household consumption demand. Uncertainty remains about the impact of recent fiscal stimulus measures and modest credit easing.¹⁹ India, however, remains a 'bright spot' in the world economy, with resilient domestic demand anticipated to propel the economy to 6.5% growth this year and the next. Meanwhile, growth is expected to soften markedly in Latin America as high interest rates take their toll on economic activity, with Brazil's economy expanding by 1.7% this year, down from 3.1% in the previous year.²⁰ Economic growth in sub-Saharan Africa (SSA) is forecast to expand by 3.8% this year, helped by modest improvements in the region's two largest economies: Nigeria and South Africa.

The last mile in disinflation could be harder

Although global inflation has declined significantly over the past two years, the return of inflation to central bank targets is, however, not assured, as the pace of disinflation has slowed markedly. The disinflationary process has largely occurred in the goods basket, benefitting from lower food and energy costs, easing global supply conditions as well as restrictive monetary policy.²¹ Meanwhile, inflation for the core basket has remained relatively sticky across a range of both advanced and emerging market economies, owing to elevated services price increases.

Sustained strong demand for some services in advanced economies has prevented inflation for this component from falling more strongly. Services inflation remained elevated in February this year at 5.0%, 4.0% and 6.1% in the US, the eurozone and the UK respectively. In turn, robust services demand has underpinned labour market strength, providing a feedback loop back to inflation. House price growth, housing-related and non-housing services inflation across advanced economies all remain elevated. As noted by the Bank for International Settlements (BIS), services inflation is typically more persistent and harder to slow compared with goods price inflation.²²

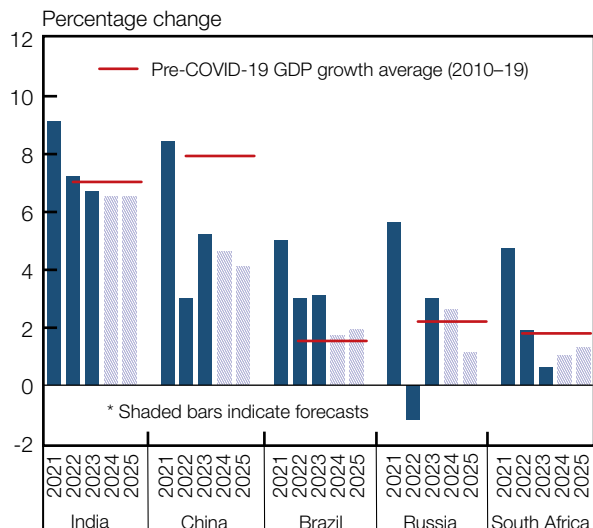
¹⁹ Growth of 4.6% in 2024 is projected, from 5.2% in the previous year. According to Barclays Research, fiscal stimulus measures amounting to approximately 1.6% of GDP were announced by the Chinese government and include: 1) an increase of CNY1 trillion in special treasury issuance to support post-disaster recovery and reconstruction and to enhance disaster prevention, reduction and relief capabilities (announced in October 2023), and 2) building more affordable housing and renovating urban villages (announced in November 2023) equivalent to another CNY1 trillion. In addition, plans to expand China's semiconductor manufacturing capacity remain on track. See Barclays Research, *China: Build it and they will come*, 11 January 2024.

²⁰ Latin America is expected to grow at 1.9% this year, from 2.5% in 2023.

²¹ Decompositions of inflation drivers suggest that the reversal of negative supply shocks accounts for a large share of the global disinflationary trend witnessed thus far. See P Pasimeni, 'Supply or demand, that is the question: Decomposing eurozone inflation', *Intereconomics* 57(6), 2022, pp 384–393.

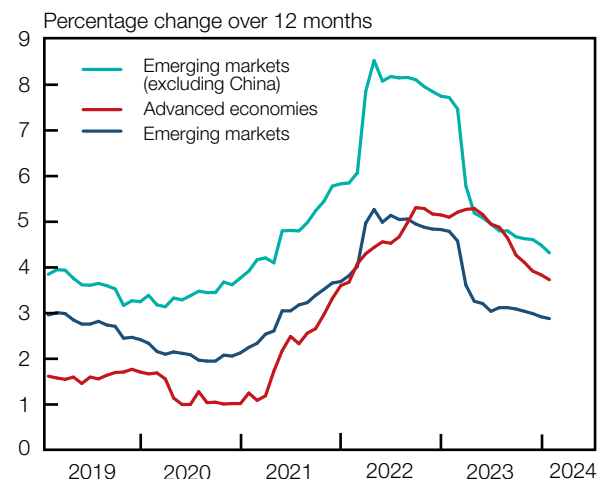
²² See P Amatyakil, D Igan and M Lombardi, 'Sectoral price dynamics in the last mile of post-Covid-19 disinflation', *Bank for International Settlements Quarterly Review*, Basel: Bank for International Settlements, March 2024.

Real GDP growth projections for emerging markets*



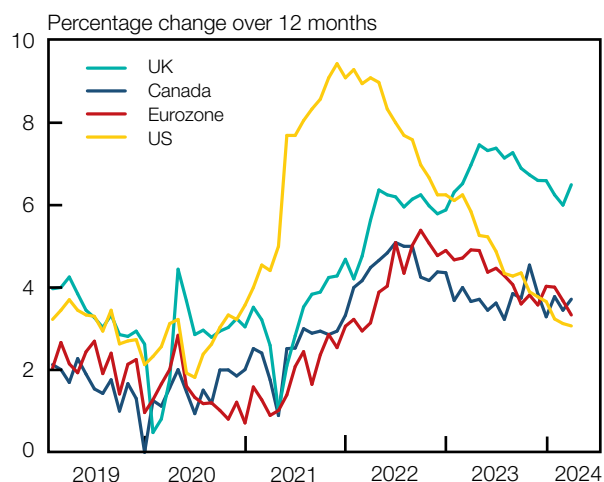
Source: IMF

Core inflation



Sources: Haver and SARB

Wage tracker



Source: Indeed Hiring Lab

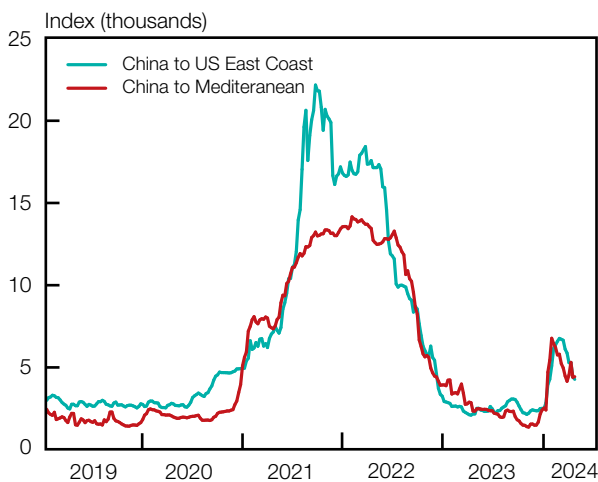
The persistence of services inflation in part reflects the sector's high labour intensity and sensitivity to wage dynamics. Wages are still rising at rates inconsistent with productivity growth and inflation targets. For instance, compensation per employee in the eurozone grew by 4.5% year on year in the fourth quarter of 2023, which was a slight decline from the 4.7% realised in the third quarter.

At the same time, in emerging markets, headline inflation has fallen steadily as the larger weight of food and energy costs in the inflation baskets of these economies mostly fuelled the disinflationary trend. Core inflation in emerging markets has also fallen faster than in advanced economies, while still remaining elevated. Labour markets have also not been as tight as in advanced economies, which has reduced the feedback between the goods (and services) and labour markets.

Several risks to global inflation remain or are emerging. A resurgence in goods inflation either due to a pick up in manufacturing demand or due to rising costs of supply would further delay the achievement of inflation targets. Shipping costs have risen recently due to disruptions in maritime traffic associated with geopolitical tensions in the Middle East and the drought-induced restrictions on freight shipping in waterways, especially the Panama Canal. In addition, production costs are expected to rise on account of geo-economic fragmentation and the reconfiguration of supply chains.²³

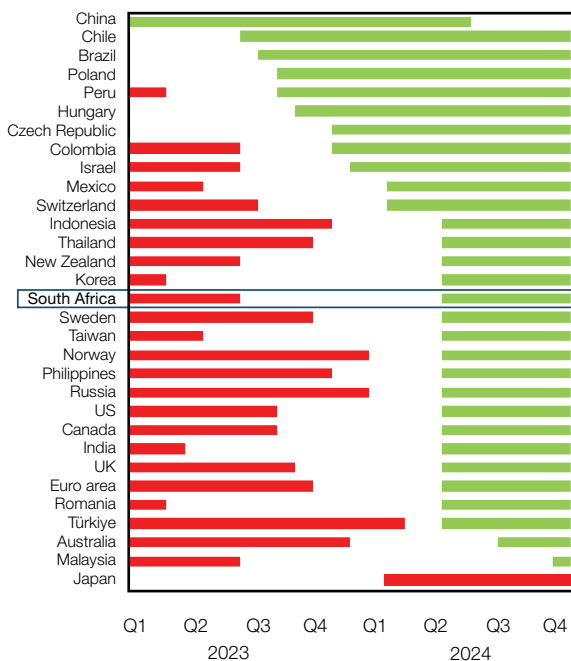
Baseline forecasts across most major central banks are for inflation to converge to targets by 2026. The US Federal Reserve (Fed) forecasts median core personal consumption expenditure (PCE) inflation at 2.6% this year, declining to 2.2% next year, while the European Central Bank (ECB) projects eurozone inflation lower at 2.3% this year, stabilising at the target next year. In the UK, inflation is expected to average 2.5% in 2025.

Selected ocean container freight



Source: Bloomberg

Timeline of central bank monetary cycles



Sources: Bloomberg and central banks

Timing of rate-cutting cycles uncertain

Although policy rates have likely peaked in most major economies, the exact timing of the rate-cutting cycles remains unclear. Recent commentary by both the US Fed and the ECB suggests that the commencement of interest rate cuts will be delayed due to higher inflation. While central banks have remained steadfast about persistent inflation risks, markets were initially over-optimistic about faster disinflation, pricing in significant rate cuts in the first half of this year. They have, however, become more aligned with central banks lately, with rate cut expectations and magnitudes scaled back appreciably. Nonetheless, expectations are broadly for central banks to start easing interest rates some time this year. Japan, however, remains the global outlier, having lifted its policy rate in March 2024 – the first time since 2016.

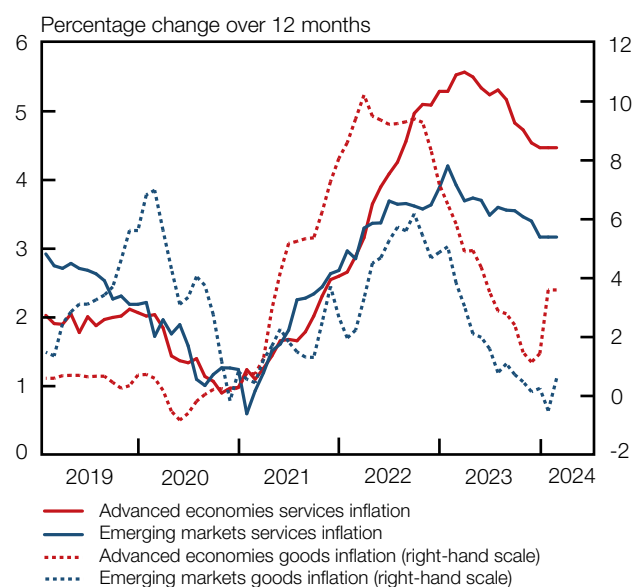
²³ Geo-economic fragmentation can be defined as a 'policy-driven reversal of economic integration between or among a set of countries, often guided by strategic considerations'. See S Aiyar et al., 'Geoeconomic Fragmentation and the Future of Multilateralism', *International Monetary Fund Staff Discussion Notes: SDN/2023/001*, Washington, D.C.: International Monetary Fund, January 2023.

With the exception of some early movers in Latin America that began cutting rates in the past year, emerging markets are more broadly expected to cut rates from the second half of 2024 and in line with slowing inflation. Brazil and Chile have been cutting rates since the second half of last year and are anticipated to ease rates further through to the end of the year given the still-elevated real policy rates. Similarly, China has been applying multiple easing levers since last year, and the consensus expects most other central banks in Asia to start cutting rates too in 2024.²⁴

Risks to the outlook

Risks to the global growth outlook are broadly balanced. While faster disinflation in advanced economies and a faster recovery in China's property sector could cause upside surprises to global economic activity, a stall in disinflation or a resurgence in inflation amid persistent tightness in labour markets and renewed supply-chain tensions could achieve the opposite. At the same time, a further weakening in China's growth could have material spillover effects to the global economy (see Box 4). Meanwhile, geopolitical tensions could impact on energy prices and the costs of goods supply, presenting serious threats to global disinflation. Further risks to disinflation could also emanate from policy mistakes by central banks. There is also the prospect that rapid advancements in artificial intelligence (AI) could enhance overall productivity, boosting global growth and lowering global inflation, particularly services price inflation.²⁵ With advanced economies impacted more by AI technology than emerging markets, the benefits are expected to accrue mostly to major economies.²⁶

Goods and services inflation



Sources: Haver and SARB

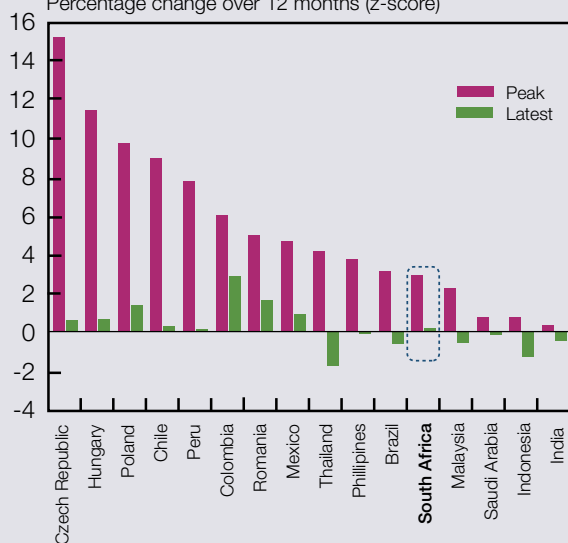
²⁴ Policy easing in China is distinct from the rest of emerging markets as China has not had an inflation problem, and thus has not raised rates, in the post-pandemic period.

²⁵ See BNP Paribas, 'The global economic impact of AI', *BNP Paribas Markets 360*, Paris: BNP Paribas, 9 November 2023.

²⁶ Research by the International Monetary Fund suggests that nearly 60% of the labour markets in advanced economies would be impacted by artificial intelligence, compared to 40% in emerging market economies. See K Georgiva, 'AI Will Transform the Global Economy. Let's Make Sure It Benefits Humanity', International Monetary Fund blog, 14 January 2024. <https://www.imf.org/en/Blogs/Articles/2024/01/14/ai-will-transform-the-global-economy-lets-make-sure-it-benefits-humanity>

Headline inflation

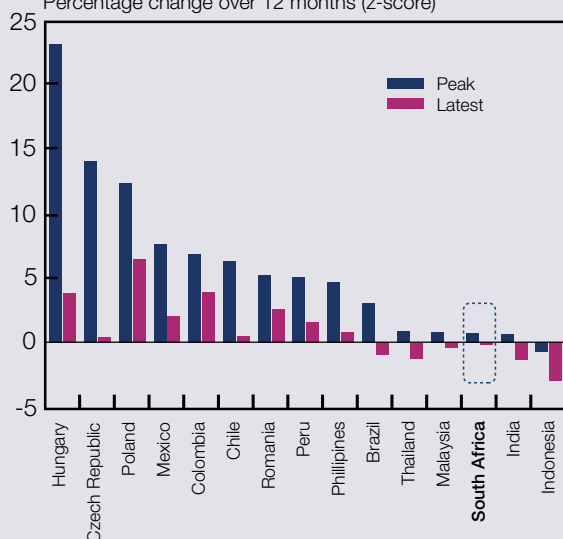
Percentage change over 12 months (z-score)



Source: Haver

Core inflation

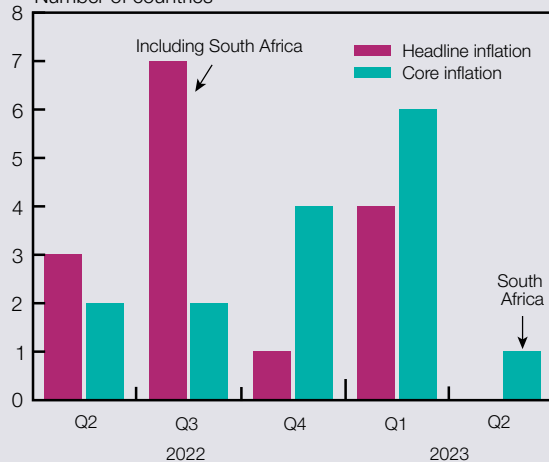
Percentage change over 12 months (z-score)



Source: Haver

Timing of emerging market inflation peak

Number of countries



Source: Haver

Box 3 Explaining the diverse inflation performance across emerging markets

With the notable exception of China, inflation across medium to large emerging markets surged to multi-decade highs in 2022–23, driven by common shocks to global energy and food markets as well as the COVID-19-induced global supply bottlenecks. Despite the common sources, the relative size of the inflation surge, both in headline and in core terms, differed markedly across countries, pointing to the role played by domestic factors.¹

While all emerging markets saw inflation retreat in the past two years as the global shocks dissipated, those that had seen the strongest increase also generally saw the fastest decline. By and large, central banks that had maintained exceptionally accommodative stances saw the strongest rise in core inflation. However, where adequate corrective action was taken – in the form of a swift shift to above-average real rates – core inflation also receded fairly quickly.

Regionally, there was significant dispersion in the timing of inflation peaks across emerging markets. Eastern European countries saw outsized inflation peaks as the Russia-Ukraine war weighed heavily on their currencies, alongside steep energy price increases. Meanwhile, core inflation is taking longer to normalise, potentially reflecting second-round effects and the enduring impacts of the prolonged period of negative real policy rates. Latin American countries also faced early and sharp rises in inflation amid relative exchange rate weakness in 2020–21 as well as stimulative policies (monetary and fiscal) that closed output gaps quickly, adding to core inflation pressures. However, the sharp increases in policy rates eventually saw disinflation take root in the region.² In contrast, Asian economies, apart from India and the Philippines, experienced relatively shallow and delayed inflation peaks, reflecting more stable currencies (which reduced pass-through price pressures), better-controlled demand/supply imbalances (due to the gradual relaxation of lockdowns) and a slower return of real gross domestic product (GDP) to pre-pandemic levels.³

Similar trends are also evident in South Africa where headline inflation rose to a peak of 7.8% in July 2022, mostly in response to the same global shocks, before moderating as these drivers subsided. Still, in both headline and especially core inflation terms, the peak deviation of inflation from the 2010s norms was low by emerging market standards. The somewhat muted surge in domestic inflation mostly reflects low food inflation pass-through from global prices, relatively well-anchored inflation expectations and a timely policy response by the South African Reserve Bank (SARB).

- 1 We express the 2022–23 peak in year-on-year inflation in standard deviations from the 2010–19 mean (the z-score) to allow for comparison. A z-score is also applied to the latest inflation reading to see how far inflation has normalised.
- 2 For example, in Brazil, the ex-ante real policy rate (headline inflation *minus* inflation expectations one year ahead) rose to 9.7% in July 2023 (the highest since 2006) while it peaked at 7.25% in Chile in June 2023 compared with a previous record high of 4.7% in 2008. In Mexico, the real policy rate rose to a peak of 7.5% in January 2024, well above the previous high of 4.4% in 2019.
- 3 In all the Asian countries included in our sample, the latest reading of seasonally adjusted real GDP remains below the 2015–19 trend.



Box 4 Will Chinese growth sink the global economy and commodity prices?

Growth in China is expected to soften again this year to 4.6%, from 5.2% in 2023.¹ The persistent weak demand problem is exacerbated by a deepening property crisis, elevated household debt, rising youth unemployment as well as financially constrained local governments.² One result has been a sharp deceleration in prices, with consumer prices experiencing their most rapid decline in 15 years in January 2024, falling 0.8% year on year. These developments raise the question of how the growth slowdown in China, and the attendant deflationary pressures, may impact on global growth and inflation.

China is both a major importer and a major exporter, with its exports accounting for more than 15% of global exports. Slowing domestic demand saw China's non-energy imports decline by 6.2%, while its exports fell by 7.5%, over the past year. In the same period, global exports fell by 0.9%.³ A weaker Chinese economy weighs on global trade and economic activity. A more pronounced growth slowdown (a 1.0% decline) could shave about 0.2 percentage points off global growth this year.⁴

Spillovers from China to the rest of the world, however, are still relatively small and differentiated across economies. For instance, a 1.0% negative growth shock in China detracts less than 0.2% off Asia's growth, 0.25% off sub-Saharan Africa's (SSA) growth and has an almost insignificant impact for Europe, with the relatively larger impacts for Asia and SSA reflecting China's dominance as a trading partner for these regions.⁵

Larger effects may accrue to major exporters of industrial commodities to, and net importers of manufactures from, China. For South Africa, declining Chinese industrial output adds downside pressures to commodity export prices and depresses the country's terms of trade.⁶ Calculations by the South African Reserve Bank show that a 1.0% decline in China's industrial production which results in a 5.0% fall in commodity prices deteriorates South Africa's terms of trade by 2.0% after three quarters. On the other hand, China's growing presence in South Africa's imports may contribute towards lower producer and consumer price inflation in the domestic economy.⁷

1 International Monetary Fund, *World Economic Outlook*, Washington, D.C.: International Monetary Fund, January 2024.

2 See, for instance, JPMorgan, 'China Outlook 2024: Bear with it', *JPMorgan Research*, New York: JPMorgan, 5 February 2024.

3 S Jean, A Reshef and G Santoni, 'Dominance on World Markets: The China Conundrum', *CEPII Policy Brief No. 44*, Paris: CEPII, December 2023.

4 See the World Bank's January 2024 *World Economic Prospects*.

5 D Furceri, J T Jalles and A Zdzienicka, 'China Spillovers: New Evidence from Time-Varying Estimates', *International Monetary Fund Spillover Notes*, Washington, D.C.: International Monetary Fund, November 2016. For sub-Saharan Africa (SSA), see C Keller, M C Babic and A Utsav, 'Deflating Dragon, Inflating Shunto', *Barclays: Global Economics Weekly*, February 2024.

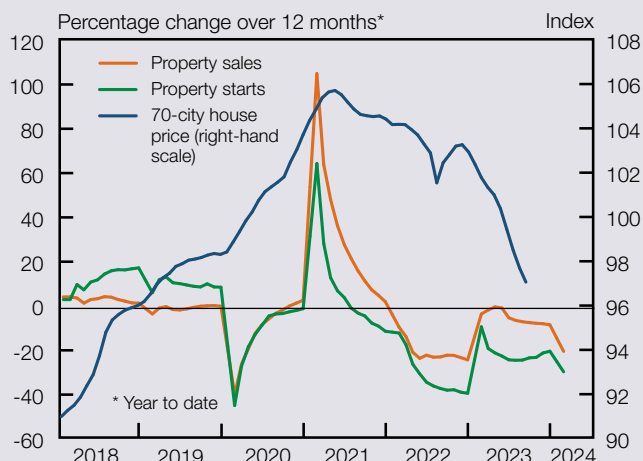
6 See for instance, C Kolerus, P N'Diaye and C Saborowski, 'China's footprint in global commodity markets', *International Monetary Fund Spillover Notes*, Washington, D.C.: International Monetary Fund, September 2016.

7 See L Edwards and R Jenkins, 'The impact of Chinese import penetration on the South African manufacturing sector', *Southern Africa Labour and Development Research Unit (SALDRU) Working Paper Series No. 102*, Cape Town: SALDRU (University of Cape Town), July 2013. https://www.opensaldru.uct.ac.za/bitstream/handle/11090/618/2013_102.pdf?sequence=1

At a global level, deflation in China may help global disinflation via merchandise trade, but the impact on consumer prices is likely to be limited.⁸

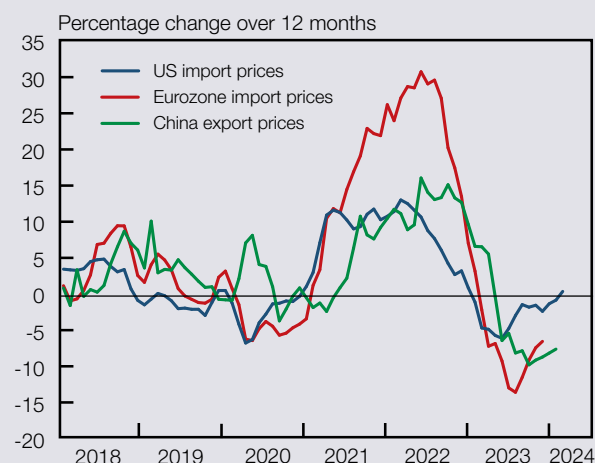
8 See H Qiao and M Ouyang, 'Will China export deflation to the world?', *Bank of America Global Research*, 16 January 2024.

China real estate



Source: China National Bureau of Statistics

Import and export prices

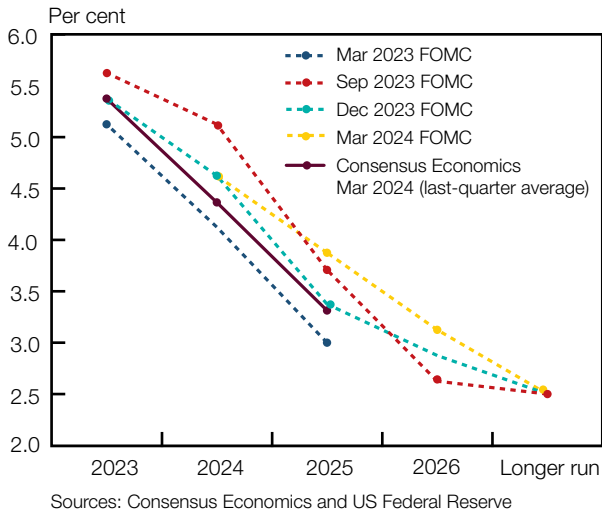


Source: Haver

Tilting too far? Financial markets and interest rate expectations

The past six months have seen substantial shifts in financial markets' expectations of global monetary policy adjustments. Recently, markets have aligned more closely with central bank views that uncertainty about the pace of disinflation remains, and are now pricing in fewer rate cuts, spread further out in time. At the same time, the conviction has strengthened that economies will not slow sharply but instead will achieve a 'soft landing'. This, in turn, has spurred a rally in global equities led by the US and European bourses. For South Africa, markets now expect interest rates to remain elevated for most of this year in line with more persistent domestic inflation. Meanwhile, renewed weakness in bonds and rand volatility indicate the ongoing concern around weak growth, fiscal sustainability and other domestic factors that can prove to be obstacles to disinflation.

Evolution of the Fed dot plots

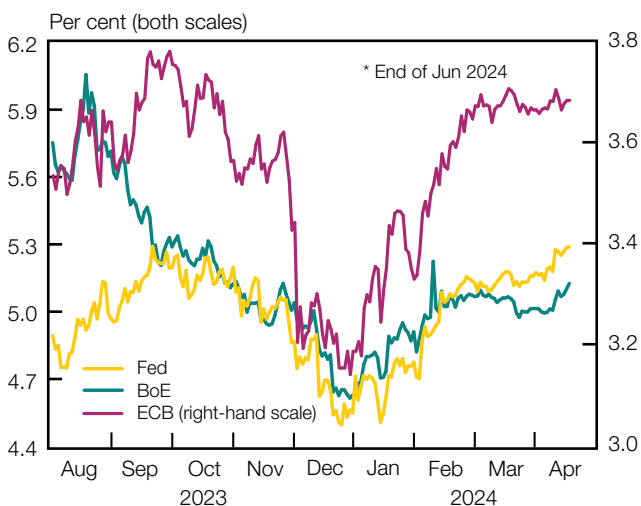


Global policy settings and financial conditions

Nominal policy rates remain high across many jurisdictions, with most of the major global central banks holding rates steady for extended periods as they continue to monitor the disinflation process. For instance, the Federal Open Market Committee (FOMC) left the Fed funds rate unchanged in the 5.25–5.50% range for a fifth consecutive meeting in March 2024 while the ECB has kept its main refinancing rate steady at 4.50% since the September 2023 meeting. Having completed their hiking cycles, central banks have been communicating firmly that their decisions would remain data-dependent and that policy easing would require clear evidence that inflation was declining sustainably towards central bank targets.

Despite the caution displayed by major central banks, the relatively fast fall in inflation through much of the past year induced considerable market optimism, resulting in the pricing of large rate cuts by the Fed and the ECB for the first half of this year and further out. This resulted in a loosening of global financial conditions, which have moved away from the restrictive levels reached in the latter half of 2023.

Advanced economy implied policy rates*



Discerning policy direction

As the implied US policy rates declined significantly in December 2023, renewed impetus was given to equities values, and markets around the world rose.²⁷ The MSCI Advanced Economy and MSCI Emerging Market indices increased by 5.2% and 5.0% respectively year to date.

²⁷ Other factors may also have played a role, including the resilience of corporate profits and the dynamism of tech stocks (e.g. the 'Magnificent Seven' stocks).

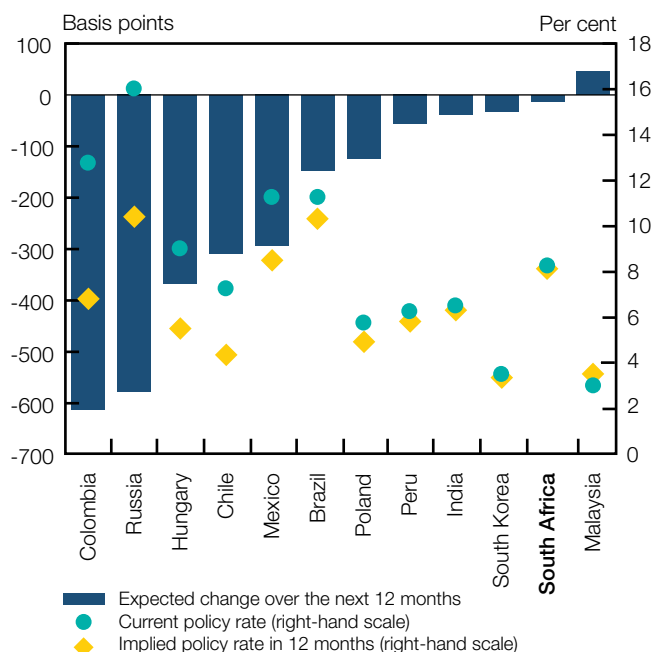
This exuberance stands in some contrast, however, to central banks' official positions that have repeatedly cautioned against excessive optimism that inflation would continue to ease without setbacks. For instance, the Fed dot plots show that more FOMC participants assessed the path of inflation higher at the March 2024 meeting than at the time of the December 2023 meeting. In addition, virtually all the FOMC participants projected core inflation to average above the 2.0% target by the end of 2025, indicating that recent inflation data had raised uncertainty regarding the path of inflation.

Over time, however, and amid mounting evidence from recent data releases of slowing disinflation, markets are now broadly aligned with central bank projections for inflation. Interest rates are now expected to stay elevated throughout much of this year, both because the timing of rate cuts has been pushed out and because the size of the cuts has been scaled back. The US Fed, the ECB and the Bank of England (BoE) are now all expected to cut rates later this year, with the ECB currently expected to move first, in June. These expectations contrast with earlier views that cuts would start in the first half of 2024; at one point, for example, markets had anticipated a Fed cut as early as March.

Despite 'high for longer' US rates, the dollar has depreciated modestly over the past six months, with almost all the major advanced economy currencies correspondingly stronger. Sovereign bonds of advanced economies have been volatile, with rates generally trending higher since the start of the year, if still well below the highs reached in October last year.²⁸ Global equities, by contrast, have been buoyant, with the S&P 500, Euro Stoxx 50 and Nikkei 225 all achieving record highs in March 2024.

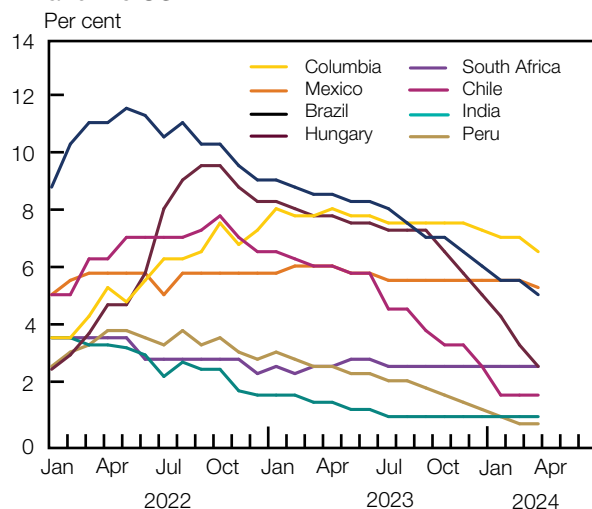
The performance of emerging market currencies has diverged markedly since the previous *MPR*, with some gaining against the US dollar over this period, albeit with some prominent exceptions, including the Chinese yuan. The varied performance reflects divergent growth outturns and other domestic idiosyncrasies as well as the diverse monetary policy stances and interest rate expectations. Desynchronisation in monetary policy commenced this past year as the early and fast hikers have been able to cut rates (along with expectations of additional cuts) to prevent real interest rates from rising further amid falling inflation. Meanwhile, some emerging markets continue to face high and persistent inflation. With policy rates expected to remain elevated in the major advanced economies, especially in the US, real interest rate differentials have compressed, exerting depreciation pressure on currencies.

Emerging market policy rate expectations over the next 12 months



Sources: Bloomberg and SARB

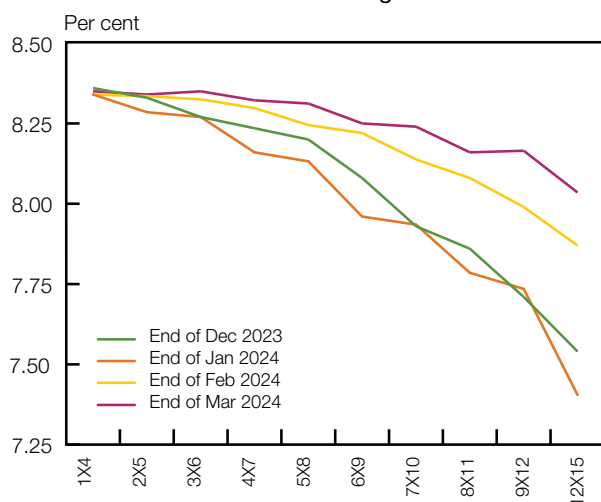
Interest rate differential between emerging markets and the US



Sources: Central banks

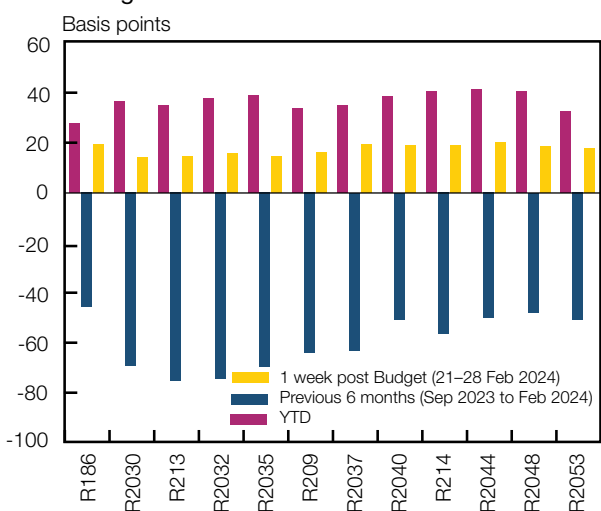
²⁸ The US 10-year bond yield fell to 3.8% at the end of 2023, from a high of 5.0% in late October, before edging higher again in early March 2024.

South Africa's forward rate agreement curve



Sources: Bloomberg and SARB

Change in the SAGB curve



Sources: Bloomberg and SARB

Morgan Stanley Capital International Index

Index: 1 Sep 2023 = 100



Source: Bloomberg

South African financial market developments

Despite the modest weakness of the US dollar and an increased appetite for risk assets, the rand remained weak over the review period, reflecting global and domestic idiosyncratic risks.

Domestic policy rate expectations have evolved similarly to those of global money markets. At the end of 2023, forward rate agreement (FRA) rates indicated that South Africa's policy rate would be lowered in the first half of 2024. However, the FRA curve has since shifted higher, reflecting the slowing pace of domestic disinflation and implying that rate cuts would be deferred to early 2025. This contrasts with the surveyed expectations of analysts, which indicate two to three rate cuts in the second half of 2024.

While South African government bonds (SAGBs) initially also benefitted from the improvement in risk sentiment, yields remain sticky, particularly at the long end of the curve. Bonds weakened in the week after the February 2024 Budget Speech, despite government reaffirming fiscal consolidation measures and announcing a withdrawal of R150 billion from the GFECRA to reduce borrowing over the next three fiscal years. Intuitively, given its positive impact on the public-debt ratio, the GFECRA announcement should have compressed local bond yields. This underwhelming yield outcome likely indicates either that markets are taking time to assess the full impact of the move or that markets also require a clear reduction in bond issuance before yields reprice.²⁹

After buying R11.2 billion worth of South African bonds in the final three months of 2023, non-residents turned net sellers of R12.7 billion worth of SAGBs in the first quarter of this year. The strong performance in the October to December 2023 window was driven by high-yield-seeking non-resident investors amid heightened optimism about the loosening of monetary policy in advanced economies. However, bond purchases reversed this year, as yields on assets in advanced economies rose and domestic risks increased.

Over the past six months, and despite the more favourable global backdrop for part of that period, non-resident investors were net sellers of rand equities, disposing of R70 billion worth of South African equities.

²⁹ While there has been a modest reduction in weekly nominal bond issuance, there has also been a larger increase in non-competitive auction allocations. In the primary market, the allocation was raised from 20% to 30%, and on the electronic trading platform (ETP) from 30% to 45%. Non-competitive auctions provide primary dealers with an option to acquire bonds, on Thursdays, at the yields from the Tuesday auctions. If prices rise between Tuesday and Thursday, the option is in the money, and primary dealers will generally exercise it, implying a potentially higher funding cost for government. The opposite is true if prices fall between Tuesday and Thursday. This system provides an incentive for banks to function as primary dealers, making a market in government bonds.



Domestic monetary operations

There have been few notable developments in monetary policy implementation over the past six months. The money market surplus has averaged just over R80 billion recently, near the middle of the R60–100 billion range in which the SARB aims to keep the supply of excess reserves.³⁰ Market rates have been tracking the policy rate closely: secured interbank rates (on the Strate platform) have been around 0.05% below the policy rate recently, while the 3-month Johannesburg Interbank Average Rate (Jibar) has compressed to around 0.1% above the repo rate and foreign exchange (FX)-implied rates have likewise been close to, if narrowly above, the policy rate.

Later this year, the money market surplus is likely to diminish somewhat as funds for the Corporation for Deposit Insurance (CODI), South Africa's new deposit insurance scheme, flow into the SARB, which is the initial manager of these resources. The surplus is then likely to expand with the distribution of the GFECRA funds to National Treasury. The timelines for this operation are, however, yet to be finalised. As the SARB has noted before, it is the interest rate set by the MPC, rather than changes in the quantity of bank reserves, that defines the monetary policy stance.

³⁰ Banks are obliged to hold unremunerated reserves worth 2.5% of liabilities, as adjusted. As of March 2024, required reserves were just over R150 billion. Since mid-2022, the SARB has operated a surplus system for monetary policy implementation, which means that the SARB does not have to drain excess liquidity. Instead, it remunerates these balances at the policy rate. The total supply of reserves is the sum of required and excess reserves. Together with notes and coin, of around R165 billion, these constitute M0, or 'base money', which totalled R377 billion in February 2024.

Box 5 The ebb and flow of portfolio investment

Foreign investors expand the pool of potential buyers of South African government bonds (SAGBs) and generally push up prices, enabling the public sector to fund itself at relatively lower costs. When credit ratings change, however, institutional buyers also change, in line with their different investment mandates. South Africa's inclusion in the World Government Bond Index (WGBI) in April 2012, for example, was followed by a sustained rise in foreign investor holdings of SAGBs. These holdings peaked at 43.0% of outstanding SAGBs in 2018, up from 9.0% in 2006. However, faltering growth and rising sovereign risk in the late 2010s, alongside a less supportive global environment, saw non-resident investors begin either reducing holdings or buying fewer SAGBs.¹ This process was accelerated by the exclusion of South Africa from the WGBI in April 2020 following downgrades to sub-investment grade and brought non-resident holdings to 25.0% of all SAGBs issued by the end of 2023.²

As foreign investors buy less, the domestic financial sector tends to absorb more. Domestic insurers, local pension funds and other financial institutions, especially unit trusts, increased their share of the (rising) SAGB stock to 51.0% by the end of 2023, up from 45.0% at the end of 2019.³ While unit trust holdings increased sharply, the proportion held by insurers and pension funds declined over the period – even though their absolute holdings still grew.⁴ Meanwhile, domestic banks' holdings have risen by 5.0 percentage points since 2019, reaching 21.0% by the end of 2023. Despite this

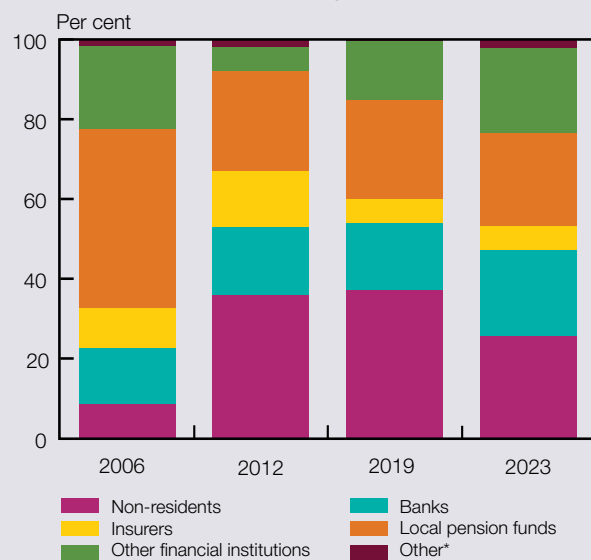
- 1 See M Amstad, E Remolona and J Shek, 'How do global investors differentiate between sovereign risks? The new normal versus the old', *Bank for International Settlements Working Paper No. 541*, Basel: Bank for International Settlements, January 2016. <https://www.bis.org/publ/work541.pdf>
- 2 According to National Treasury, in absolute terms, non-resident holdings rose from R713 billion in 2018 to R899 billion in 2023.
- 3 This, however, is still well below the 76.0% share at the end of 2006. Between 2006 and 2019, non-resident holdings increased by 29 percentage points while domestic non-bank holdings fell by the same magnitude, allowing for more diversified portfolios by domestic investors.
- 4 National Treasury data shows that holdings by insurers and local pension funds increased from R483 billion at the end of 2017 to R933 billion by the end of 2023.

marked increase, sovereign bond holdings by South African banks remain low by international standards (an average holding of 35% in a sample of 12 emerging markets). Larger holdings of bonds by domestic banks reflect in part the higher returns compared to depressed foreign yields and helped to offset the rise in local yields caused by less foreign demand, in turn helping to keep government's borrowing costs from rising further.⁵

The achievement of government's announced fiscal consolidation targets should enhance fiscal credibility and raise demand for bonds over the medium run, while limiting supply, with positive effects on yields.

- 5 Bond yields across the curve jumped up by between 160 and 200 basis points following South Africa's exclusion from the WGBI in early 2020. Holdings by domestic banks increased by 2.3% and 3.2% in the first and second quarters of 2020 respectively.

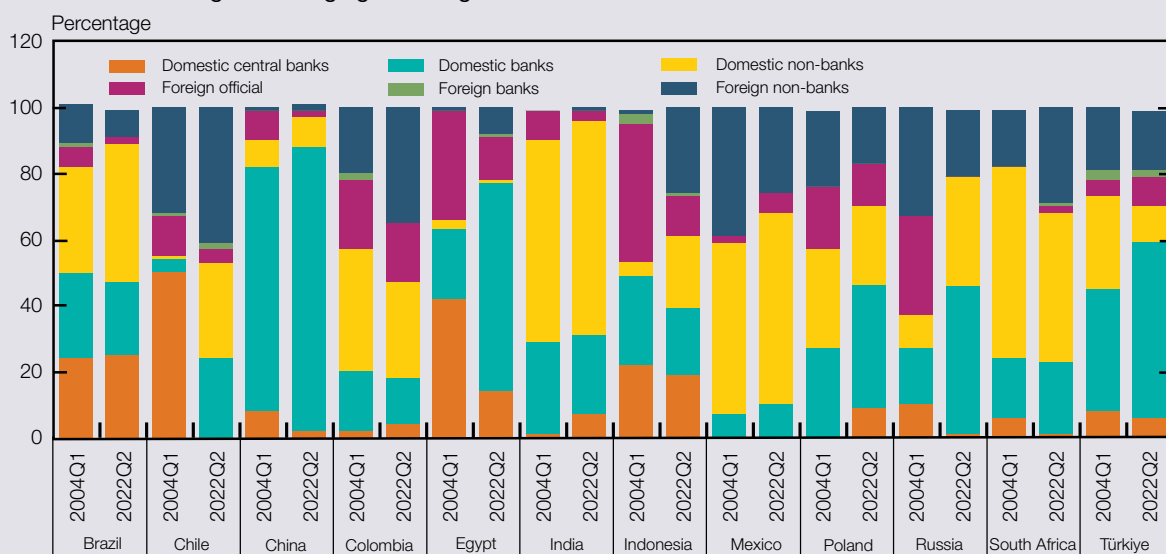
Government bond holdings



* 'Other' includes the public, private and personal sectors.

Sources: National Treasury and SARB

Investor holdings of emerging market government debt



Sources: IMF and SARB

Box 6 A reform for all seasons?

The shocks of the post-global financial crisis era prompted central banks in major advanced economies to expand their balance sheets massively with central bank reserves, to help ease deflationary pressures, to provide liquidity to address market stress and financial stability, and to reduce frictions in payment systems.^{1, 2}

Very short-term interest rates in these economies are set by the central bank, with less interbank activity between banks themselves and with large central bank deposits or reserves on commercial bank balance sheets. In the United States (US), reserves have grown by US\$3.49 trillion over the 2008–24 period, while they have increased by £1.15 trillion and €3.45 trillion in the United Kingdom (UK) and the eurozone respectively.

However, excess reserves can also generate costs. The post-pandemic period, in particular, saw rapid growth in both money supply and inflation in the wake of balance sheet expansions, prompting more recent efforts to scale them back. When economic activity achieved more normal levels, the additional liquidity increased returns to lending and encouraged banks to extend new credit.^{3, 4}

Some financing stresses can emerge, as the distribution of reserves and not the absolute quantity begins to matter more, especially for smaller banks which had less access to reserves.⁵ The distribution of excess reserves and demand for them may be challenging to forecast with precision, and some major central banks have taken steps to increase the number of liquidity management instruments at their disposal.^{6, 7, 8, 9}

1 See M Bech, A Martin and J McAndrews, 'Settlement Liquidity and Monetary Policy Implementation – Lessons from the Financial Crisis', *Federal Reserve Bank of New York Policy Review*, New York: Federal Reserve Bank of New York, 2019.

2 See R Greenwood, S Hanson and J Stein, 'The Federal Reserve's Balance Sheet as a Financial Stability Tool', *Economic Symposium Conference Proceedings (Federal Reserve Bank of Kansas City)*, Jackson Hole, September 2016.

3 See European Central Bank, *What is excess liquidity?*, Brussels: European Central Bank, December 2017.

4 See V Acharya, R Chauhan, R Rajan and S Steffen, 'Liquidity dependence: why shrinking central bank balance sheets is an uphill task', *Economic Symposium Conference Proceedings (Federal Reserve Bank of Kansas City)*, Jackson Hole, August 2022.

5 See C Borio, 'Getting up from the floor', *Bank for International Settlements Working Paper No. 1100*, Basel: Bank for International Settlements, May 2023.

6 See L K Logan, 'Impact of Abundant Reserves on Money Markets and Policy Implementation', speech by Lorie K Logan, Executive Vice President of the Federal Reserve Bank of New York, during the Securities Industry and Financial Markets Association Webinar, 15 April 2021. <https://www.newyorkfed.org/newsevents/speeches/2021/log210415>

7 See G Afonso, M Cipriani, A Copeland, A Kovner, G la Spada and A Martin, 'The market events of mid-September 2019', *Federal Reserve Bank of New York Staff Report No. 928*, New York: Federal Reserve Bank of New York, 2021.

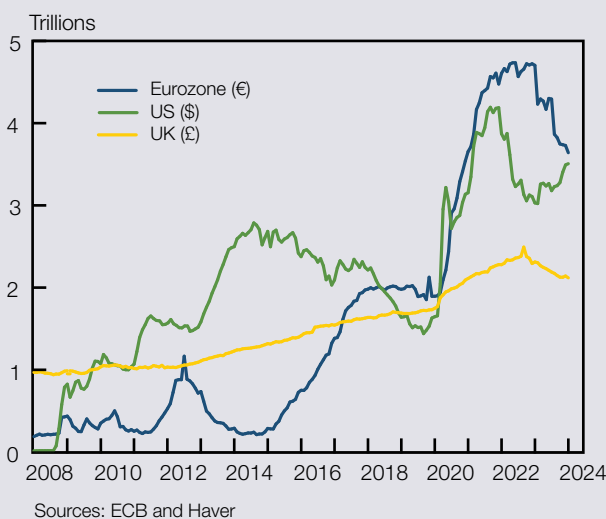
8 See I Schnabel, 'The Eurosystem's operational framework', speech by Isabel Schnabel, Member of the Executive Board of the European Central Bank, at the Money Market Contact Group meeting, Frankfurt am Main, 14 March 2024.

9 See P Aberg, M Corsi, V Grossmann-Wirth, T Hudepohl, Y Mudde, T Rosolin and F Schobert, 'Demand for central bank reserves and monetary policy implementation frameworks: the case of the Eurosystem', *European Central Bank Occasional Paper Series No. 282*, Brussels: European Central Bank, September 2021.

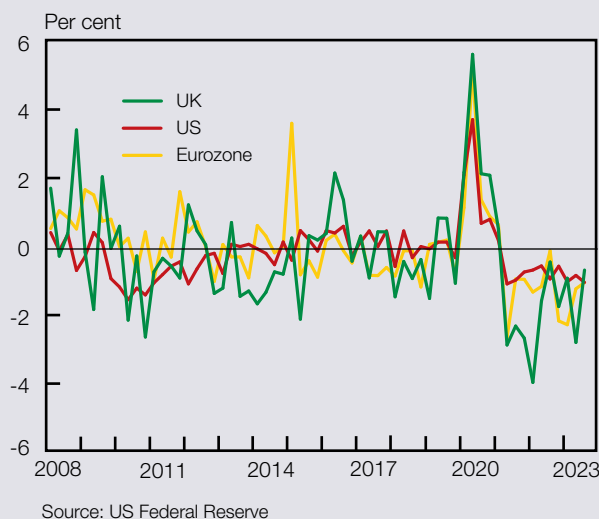
South Africa recently moved to an ample reserves system as its 'new' monetary policy implementation framework. To mitigate some of the challenges associated with an excess reserves framework, South Africa introduced a tiered floor rather than a pure floor system. In a tiered floor, banks still trade in the interbank market to avoid attracting penalties (repurchase (repo) rate less 100 basis points) when they exceed their quota. This permits circulation of reserves.

Growing central bank reserves has enabled some advanced economies to better address deflation and provide liquidity when demand for safe assets accelerates. In more normal times, the use of central bank balance sheets is more nuanced, and best practice in operationalising central bank reserves is evolving. In inflationary conditions, and where local-currency assets are not necessarily the safest, surplus liquidity systems are likely to require more instruments to limit risks to financial market efficiency, monetary policy objectives and financial stability.

Central bank reserves



Credit to GDP growth in advanced economies



Real economy: a low ebb

The South African economy expanded by 0.6% in 2023 as momentum from the post-pandemic recovery dissipated. While the first half of the year saw modest upside surprises, growth in the second half was derailed by logistical challenges and electricity-supply constraints. Growth is forecast to reach 1.2% this year, benefitting from less intense load-shedding and a recovery in household spending. Looking ahead, economic activity levels are expected to pick up as load-shedding eases further, with growth reaching 1.6% by the end of the forecast period. The implementation of structural reforms in the energy and logistics sectors remains key to restoring the economy's full productive potential.

Recent economic developments

Domestic economic growth slowed to 0.3% year on year in the final six months of 2023 after expanding by 0.9% in the first half of the year, reflecting serious headwinds to economic activity. Load-shedding persisted in the second half of the year while binding logistical challenges came to the fore, disrupting economic activity.³¹ On the whole, annual GDP growth slowed to 0.6% in 2023 – a sharp decline compared with the 1.9% annual outturn for 2022.

At a sectoral level, the main drag on the economy came from the primary sector, weighed down by agriculture. Despite an ample field crop and harvest this past year, energy shortages affected irrigation and farm operations, especially in horticulture.³² At the same time, a recurrence of biosecurity issues, especially foot and mouth disease in cattle and Avian flu in poultry, negatively impacted on the livestock subsector.³³ These adverse shocks were exacerbated by inefficiencies at ports and resulted in agriculture contracting by 12.2% in 2023.³⁴

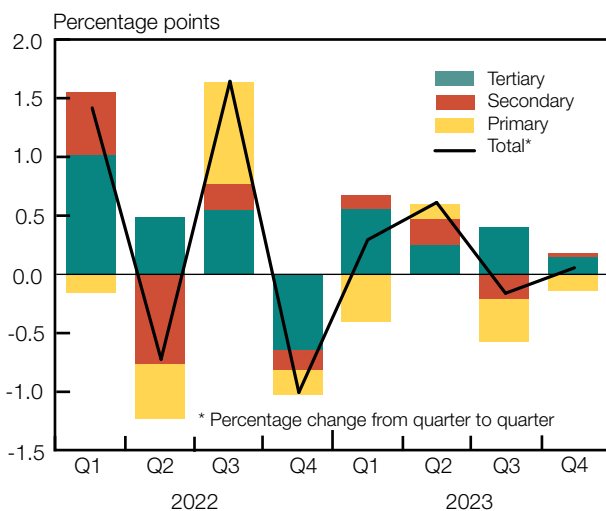
The secondary sector grew modestly in the second half of 2023, in part reflecting some easing in load-shedding during the period. However, the three sectors – manufacturing, electricity and construction – all remain well below their pre-pandemic levels, with output generally volatile.³⁵ The largest subsector, manufacturing, showed some improvement, as

Real GDP



Source: Stats SA

Sectoral contributions to GDP



Source: Stats SA

31 Logistical challenges over the past year included the marked deterioration in the performance of rail and port operations as well as road freight (trucking) disturbances along the N3 highway, which is the main road freight corridor from Gauteng to the Durban harbour.

32 Output in the primary sector fell by 10.7% year on year in the second half of 2023 compared with an expansion of 1.1% in the first half of the year.

33 W Sihlobo, 'Key challenges that constrained SA's agricultural fortunes in 2023', *Agricultural Economics Today*, 30 December 2023.

34 Mining grew by 0.6% in the second half of the year as it benefitted from improved production in coal, platinum group metals (PGMs), chromium and diamonds.

35 Manufacturing declined by 1.1% in the third quarter and increased by 0.2% in the fourth quarter. The electricity sector improved in both quarters, growing by 0.3% and 2.3% in the third and fourth quarters respectively. Construction fell by 3.3% and 1.4% in the respective quarters.

utilisation of production capacity rose by 0.4 percentage points to 78.4% in the second half of the year. Meanwhile, the tertiary sector contributed a full percentage point to the 0.6% outturn, as transport, finance and personal services all expanded.³⁶ The transport sector was the bright spot across all sectors, especially in the fourth quarter, driven by land and air transport as well as other general transport services.³⁷ By contrast, stagnant demand and higher borrowing costs weighed on wholesale and retail trade.

Logistical constraints remain a severe disruptor to economic activity, adding to the drag from load-shedding. Operations at commercial ports have progressively deteriorated and rail operations have been interrupted by widescale maintenance issues as well as cable theft and vandalism. The declining volume of goods transported by rail, alongside falling port productivity, has affected Transnet and its core clientele, particularly the bulk commodity producers.³⁸ Load-shedding and the uncertainty associated with it continues to inhibit growth, notwithstanding some improvements coming from the greater use of alternative energy sources and the return to service of three Kusile units with a combined capacity of approximately 2 400 megawatts (MW).

With activity levels more subdued in the second half of the year, the reasonably good job creation seen since 2021 slowed, with employment contracting by 0.2% in the final quarter of 2023. Over the review period, the finance and construction sectors experienced the largest employment gains, bolstered by activity in the alternative-energy space.³⁹ The strong employment gains have allowed the economy to recover the jobs lost during the pandemic, with both total employment and formal non-agricultural employment now surpassing their 2019 levels, on a non-seasonally adjusted basis. Nevertheless, the unemployment rate remained elevated at 32.2% in the final quarter of 2023.

Household consumption was subdued in 2023, growing by 0.7% for the year – a sharp slowdown from the 2.5% reported in 2022, with the weakness concentrated in the non-durables subsector (food, beverages and tobacco).

Over the past two years, private sector spending on machinery and equipment, largely energy self-generation, has underpinned gross fixed capital formation (GFCF) growth. GFCF increased

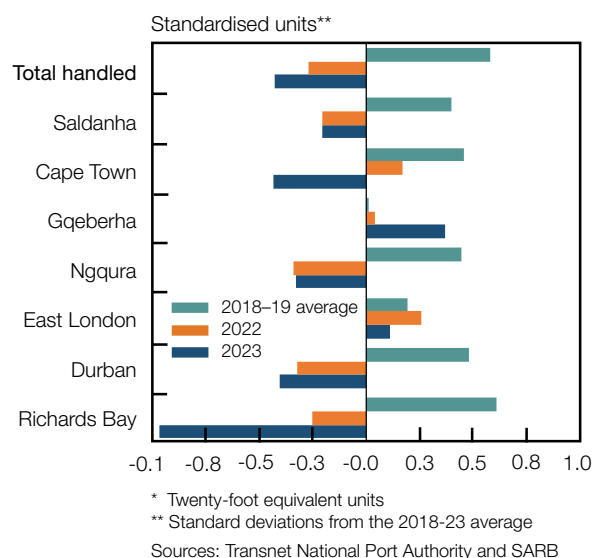
36 The sector grew by 1.4% year on year in the second half of 2023 compared with the 1.2% achieved in the first half of the year.

37 The transport sector grew by 2.9% quarter on quarter and contributed 0.2 percentage points to GDP growth in the fourth quarter. Apart from the substitution towards truck transportation and away from the underperforming rail system, demand for road transport was fuelled by increased online trade. See the BER's 2023 Other Services Survey for the fourth quarter of 2023.

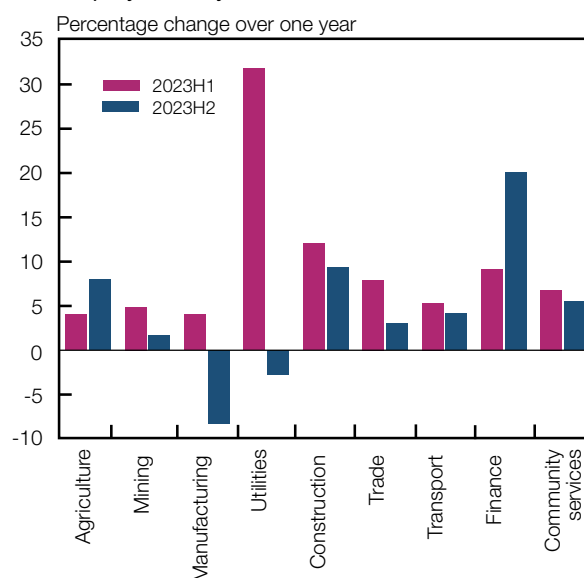
38 See Transnet, *Freight Rail Report*, Johannesburg: Transnet, 2023; see also Transnet, 'Transnet fully focused on dealing with delays at ports', media release, Johannesburg: Transnet, 20 November 2023; also see Y Panchia, 'Derailed: SA economy hinges on possible Transnet turnaround', *Mining Review Africa*, 17 October 2023.

39 Employment in the finance and construction sectors grew by 20.1% and 9.3% respectively in the last six months of 2023 on a year-on-year basis. See Statistics South Africa's *Quarterly Labour Force Survey* for the fourth quarter of 2023.

TEUs* handled at South African ports

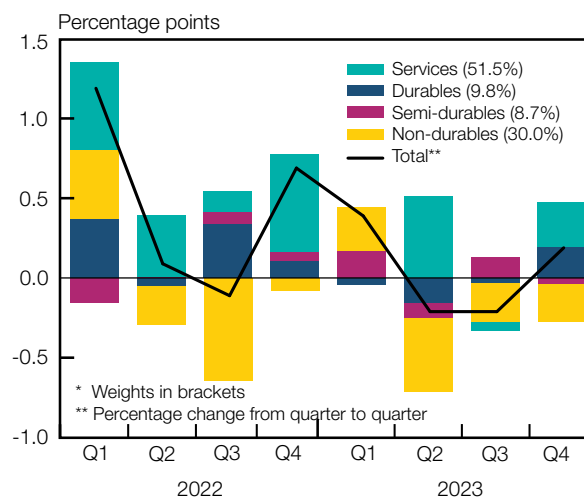


Employment by sector

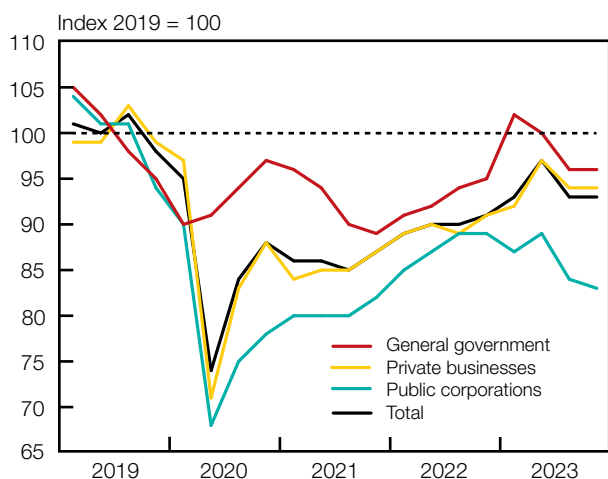


Source: Stats SA

Contributions to personal consumption expenditure*

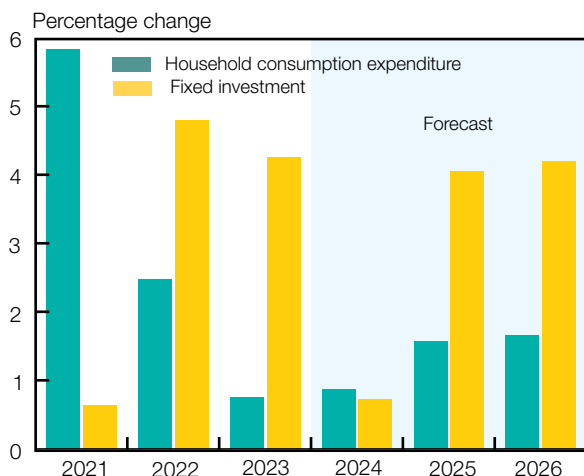


Gross fixed capital formation by sector



Source: Stats SA

Household consumption and fixed investment



Sources: Stats SA and SARB

by 4.2% in 2023 – a slight decline from the 4.8% recorded in 2022, but with the momentum tailing off in the second half of the year.⁴⁰ Capital spending by public corporations slowed significantly over the past year, remaining well below the 2019 levels, dragged down by the fragile financial positions of most of the large state-owned companies.⁴¹

Growth outlook

Growth over the medium term will continue to be buoyed by household spending as well as investment, albeit at muted levels. The two-pot pension system and higher real salaries linked to falling inflation should provide support to household consumption, while spending on embedded-generation projects and public sector capital projects should spur GFCF.

The intensity of load-shedding subsided in the final quarter of 2023 and remained muted through the first quarter of this year. Nonetheless, the grid remains fragile, as demonstrated by the ramp-up in load-shedding around the middle of February this year. Despite remaining a serious risk to growth, electricity supply is expected to gradually improve, as alternative energy sources expand and are added to the grid by Eskom.⁴² The SARB projects load-shedding to shave 0.6, 0.2 and 0.04 percentage points from growth in 2024, 2025 and 2026 respectively – lower than the 0.8 and 0.4 percentage points for 2024 and 2025 respectively in the October 2023 MPR.

Approval of the *Freight Logistics Roadmap* in December 2023 suggests that important reforms in this space are gaining momentum.⁴³ Analysis by National Treasury shows that implementing reforms to ease the various binding constraints to economic activity would raise potential growth by at least 2.0 percentage points, with logistical reforms alone adding at least 0.3 percentage points.⁴⁴

Household consumption – the largest expenditure component in GDP – should strengthen as inflation and borrowing costs fall over time.⁴⁵ Real disposable income is also expected to benefit from the projected growth in total compensation of about 1.8% per year. Still, a further boost to consumption will

40 Investment contracted by 3.8% and 0.2% in the third and fourth quarters of 2023 respectively.

41 See I Odendaal, 'What is happening with fixed investment?', media release, Cape Town: Old Mutual, 19 October 2023.

42 Operation Vulindlela assesses a total potential of at least 12 gigawatt (GW) in new capacity following the electricity sector reform of 2022, of which 4 343 MW are expected over the next three years. See the Operation Vulindlela progress reports for 2023. Meanwhile, an additional power unit of 800 MW at Kusile is expected to be commissioned for commercial operation in the next few months.

43 The road map's priority interventions include returning locomotives to service, collaborating with law enforcement to enhance safety and security, and implementing a capital investment programme to facilitate expansion plans. See Department of Transport, *Freight Logistics Roadmap*, Pretoria: Department of Transport, December 2023.

44 National Treasury, *Economic transformation, inclusive growth, and competitiveness: Towards an Economic Strategy for South Africa*, Pretoria: National Treasury, 2019.

45 The QPM-implied repo rate declines gradually over the medium term, ending the forecast period just slightly above its neutral level.

emanate from the two-pot retirement reform which will take effect on 1 September 2024.⁴⁶ Accordingly, real spending by households is forecast to grow by 0.9% in 2024, rising to 1.6% in both 2025 and 2026.

While investment is expected to strengthen, headwinds remain and should be addressed to get stronger outcomes. In all, the SARB forecasts investment to expand by 0.7% this year, and by 4.1% and 4.2% in 2025 and 2026 respectively.

The gradual relaxation of the electricity-supply constraint, along with better investment outcomes and improved household balance sheets, should lift both sentiment and activity levels. Accordingly, the SARB forecasts real GDP to expand by 1.2%, 1.4% and 1.6% in 2024, 2025 and 2026 respectively. Meanwhile, potential growth, which averaged 0.1% in 2023, rises to 1.0%, 1.2% and 1.6% in the same respective years. These growth outcomes, however, remain highly sensitive to the realisation of the ongoing supply-side reforms.

Macro balances

The current account and its drivers

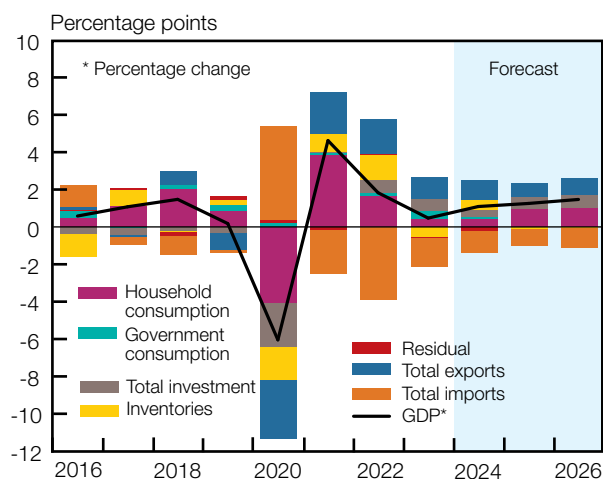
The sharp decline in South Africa's commodity export prices from their 2021–22 highs, together with elevated import prices (particularly of oil), has dragged the trade account closer to its long-run average. With the services, income and transfer (SIT) account having remained around its long-term average, this sharp correction in the trade account pulled the current account balance back into deficit already in the second quarter of 2022, and it has remained in deficit since. The current account balance as a percentage of GDP recorded a deficit of 1.6% in 2023 and is forecast to deteriorate further over the medium term, ending the forecast period at 3.3%, compelling South Africa to seek more external funding.

Over the review period, the trade account benefitted from the narrowing in the manufacturing account despite mining exports that continued to weaken in the face of logistical challenges and weaker commodity export prices. This was mainly on the back of lower imports, particularly in the machinery and equipment subsector, while manufacturing exports, especially motor vehicles, were elevated. Although the self-generation drive is still ongoing, the front-loading of investments encouraged by government's solar investment incentives, alongside the slight improvement in load-shedding this year, means that machinery and equipment imports are unlikely to increase as rapidly as they did in the past year during the surge in rolling blackouts.⁴⁷

⁴⁶ Under moderate assumptions about withdrawals from the new pension system, the SARB projects real household spending to increase by about 0.3 and 0.7 percentage points in 2024 and 2025 respectively. See N Nesengani, R Ehlers, M Choonoo, A van Niekerk and T Janse van Rensburg, 'The two-pot retirement saving system: economic impacts?', *South African Reserve Bank Economic Note*, forthcoming.

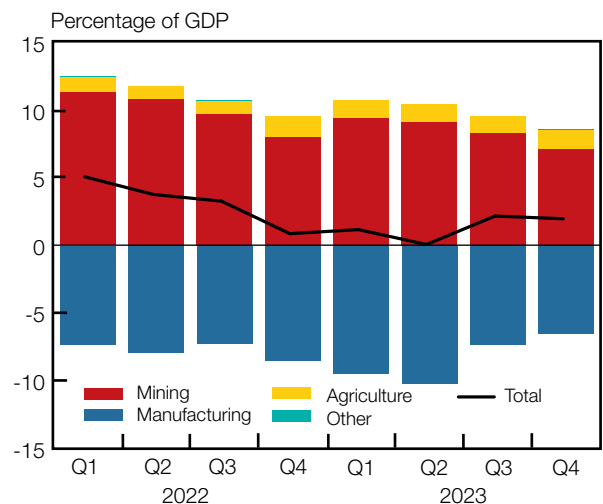
⁴⁷ The enhanced renewable-energy tax incentive for businesses, announced in the 2023 Budget and valid until March 2025, provides for a reduction in taxable income by 125% of the cost of the renewable-energy assets used for electricity generation.

Contributions to GDP



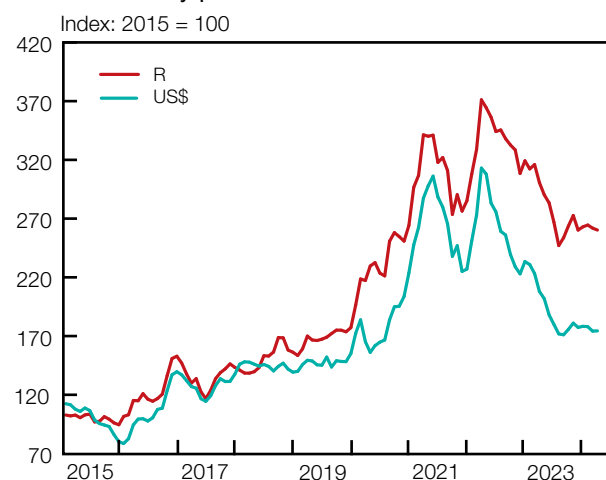
Sources: Stats SA and SARB

Trade account



Source: SARB

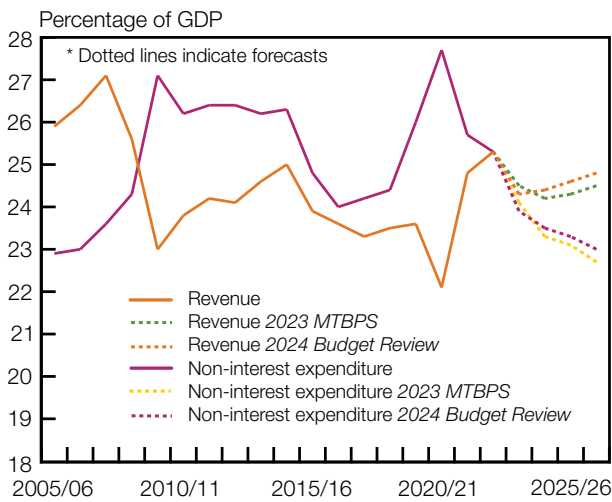
Commodity price index



Source: SARB

Fiscal balances

Main budget revenue and non-interest expenditure*



Source: National Treasury

The *2024 Budget Review* presented a substantial improvement in the fiscal outlook on the back of a large funding transfer of R150 billion from GFECRA earmarked for reducing government borrowing. National Treasury now projects public debt to peak at 75.3% of GDP in 2025/26, down from 77.7% at the time of the *2023 MTBPS*. Nevertheless, public debt remains concerningly high, as reflected in an elevated risk premium as well as high long-term borrowing costs.

Tax revenue over the medium term is projected higher by R66.1 billion relative to the *2023 MTBPS*. The increase is accounted for mostly by fiscal drag.⁴⁸ However, the projected commodity prices will remain a risk to the revenue position. Meanwhile, the expenditure outlook over the next three fiscal years was adjusted upwards by R24.6 billion compared with the *2023 MTBPS*.⁴⁹ Considering the revenue and expenditure components together, the fiscal deficit improves from 4.7% of GDP in 2023/24 to 3.4% in 2026/27. However, the fiscal balance is subject to risks such as support to ailing state-owned companies and higher-than-budgeted wage bill growth over the medium term.⁵⁰

Conclusion

Near-term domestic economic activity remains weak amid subdued household spending and investment as well as the underperformance of core economic infrastructure in the form of energy-supply inadequacy and logistical bottlenecks. After recording low growth of 0.6% in 2023, the economy is forecast to expand by 1.2% in 2024, rising to 1.6% by 2026. These projected growth rates are, however, especially sensitive to the implementation of structural reforms in the energy and logistics sectors.

48 A further boost to revenues is expected from the two-pot retirement reform. This, however, is not in the baseline.

49 Non-interest expenditure is higher by R54.8 billion while debt-service costs are expected to decline by R30.2 billion over the medium term relative to the *2023 MTBPS*.

50 L Siboyi, L Soobyah, M Tshenkeng and N Bambani, 'Budget 2024: risks underlying the fiscal position', *South African Reserve Bank Economic Note No. EN/24/03*, Pretoria: South African Reserve Bank, March 2024.

Box 7 The outsized impact of short-run shocks on gross domestic product forecasts in 2023

Economic forecasting depends on future economic variables behaving in similar ways to their past relationships. Forecasting becomes far more difficult when large economic shocks occur.¹ This box assesses the accuracy of the South African Reserve Bank’s (SARB) gross domestic product (GDP) growth forecast for 2023.

While South Africa’s GDP grew by a very low 0.6% in 2023, this poor growth rate was hard to foresee long before the year started. The January 2023 forecast, the first of the year, was the first sign of just how large the negative growth shock of accelerated load-shedding was going to be. Prior to the January 2023 Monetary Policy Committee (MPC) meeting, GDP growth for 2023 was forecast above 1.0%, reflected in a root mean square error (RMSE) of around 1.4 percentage points.² Forecast accuracy improved substantially after the January 2023 MPC meeting, as indicated by the RMSE falling to 0.3 percentage points, reflecting a better understanding of the economic shocks dragging growth lower.³

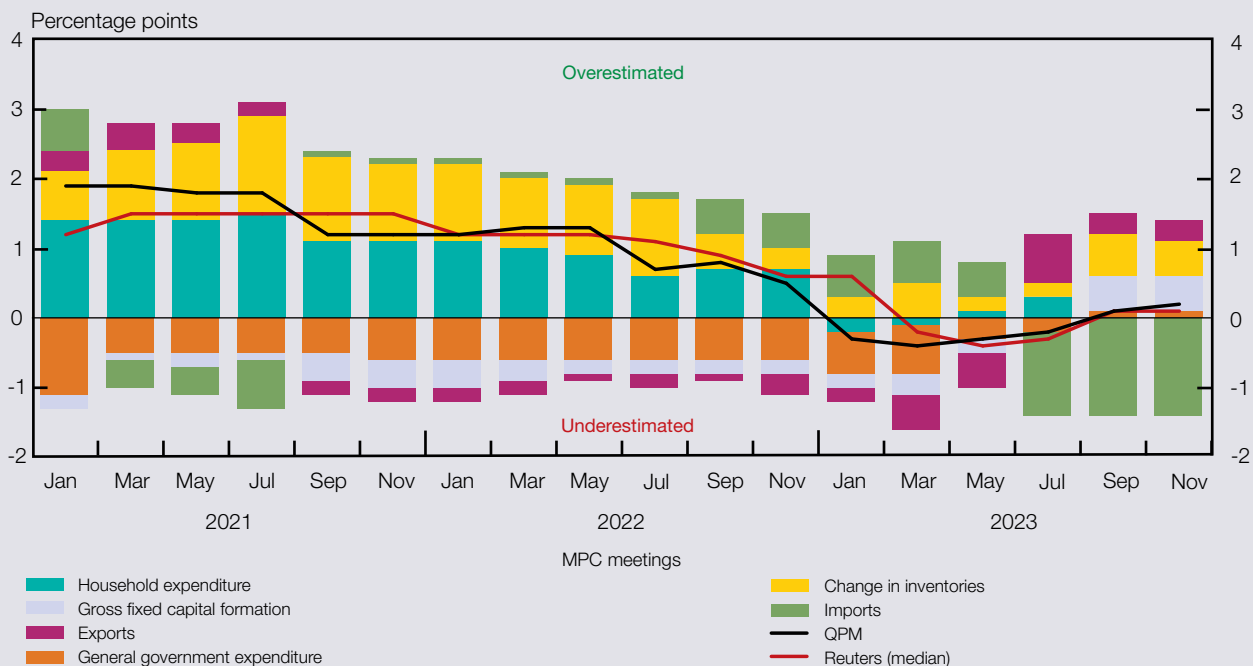
Household spending was overstated in most forecasts prior to 2023, as were company inventory holdings. Higher-than-expected inflation undermined real disposable income, while companies relied on the drawdown of inventories to mitigate supply disruptions arising from more intensified load-shedding and logistical impediments.

Meanwhile, exports, investment spending and government consumption were mostly understated. Exports turned out higher in line with South Africa’s trading partners’ growth, particularly growth in the United States. Investment in renewable-energy projects picked up more strongly than expected in response to worsening load-shedding and to government investment incentives for renewable-power generation.

In conclusion, the overestimation of the 2023 GDP growth mostly reflects unanticipated shocks. The SARB’s forecast errors are broadly similar to the Reuters median, suggesting common sources of error.

- 1 South Africa experienced large economic shocks in the form of record-high load-shedding, sharply binding logistics constraints, an acute decline in the terms of trade and financial pressure on consumers.
- 2 A lower value for the root mean square error (RMSE) is preferred as this indicates better forecasting accuracy for the model. The Reuters median RMSE is 1.3 percentage points over same period.
- 3 The forecast errors for the SARB and the Reuters median were largely similar, being 1.7 (1.5), 1.1 (1.0) and 0.3 (0.3) percentage points for the SARB (and the Reuters median) at the two-, one- and current-year-ahead horizons respectively.

Contributions to the 2023 GDP forecast errors (forecast minus actual)



Sources: Stats SA and SARB

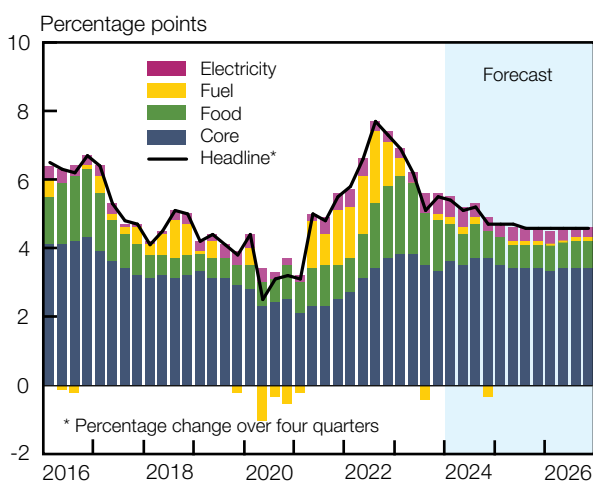
Price developments: disinflation path less certain

Headline inflation returned to the target range in 2023, averaging 6.0% for the year, down from 6.9% in 2022. However, the disinflation momentum has slowed, with headline inflation hovering in the 5–6% range over the past six months amid still-elevated food inflation and fuel price volatility. Pressure has also emanated from core inflation which has shown strong momentum in recent months, having remained closer to the midpoint of the target band for most of the period. Headline inflation is forecast to moderate to 5.1% in 2024 and to converge to the midpoint over the medium term, as food, fuel and core price inflation slows.

Headline inflation eased gradually over the past year, but with monthly setbacks occurring in the year to date. Despite the strong disinflation in goods prices, which largely explains the moderation over the past year, slower-than-expected disinflation in food and volatility in fuel prices continue to frustrate the easing trend. Food inflation averaged higher in 2023 than in 2022 due to local factors such as excessive rains, intensifying load-shedding and the outbreak of the Avian flu, despite softer global agricultural commodity prices filtering through to domestic prices.

The elevated headline inflation over the past year also reflected a relatively strong rise in core inflation, which averaged 0.5 percentage points above the 4.3% outturn for 2022. For much of 2023, core inflation remained closer to the midpoint of the target band, with higher core goods inflation offset by more subdued services inflation, and with the outcomes aligning well with the SARB's forecasts. However, in recent months and amid some moderation in core goods inflation, services price inflation has strengthened on the back of monthly insurance outcomes and wage data.

Contributions to headline inflation



Source: Stats SA

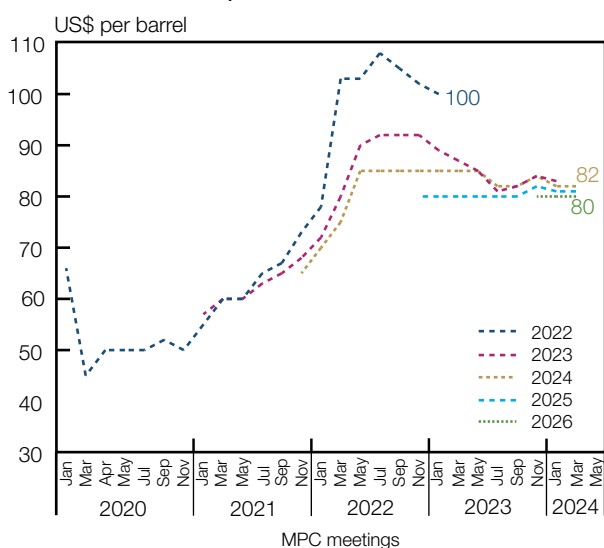
Oil prices and fuel inflation

Fuel prices look set to continue shaping global inflation outcomes. Brent crude oil prices dropped by 17.8% year on year in 2023, with prices averaging US\$80 per barrel in the first half of the year. The latter half of the year, however, saw a resurgence in prices as the Organization of the Petroleum Exporting Countries (OPEC) tightened supply and conflict erupted in the Middle East, driving prices up to an average of US\$85 per barrel. So far in 2024, Brent crude oil prices have averaged US\$84 per barrel, but with prices currently sitting around US\$90 per barrel.

Administered price inflation

Historically, the regulated price component of the inflation basket has risen at rates above the upper limit of the target band, averaging just under 7.0% per annum between 2013 and 2022. Over the same period, headline inflation averaged 5.1% per annum. The divergence underscores the pressure that

Evolution of oil price forecasts



Source: SARB



administered prices exert on overall inflation. In the past year, administered price inflation more than halved to 4.8%, down from 14.0% in 2022. The sharp moderation, however, was not the result of an overall shift in the drivers of administered inflation, but rather of lower oil prices which resulted in fuel inflation dropping by 33.7 percentage points to 0.6% between 2022 and 2023.

Because fuel inflation reflects international oil prices and exchange rate effects, it can distort administered price inflation overall.⁵¹ Administered price inflation excluding the basic fuel price (BFP) averaged 6.3% last year, up from 5.4% in 2022, and is expected to average 6.5% over the medium term.

Electricity price inflation climbed further to 11.7% in 2023 – a percentage point increase from the 2022 average. For the current year, the National Energy Regulator of South Africa (NERSA) has approved a 12.74% increase in electricity prices, which comes into effect in July and will run through to June of 2025. The persistent large increases in electricity prices over the past 15 years mean that this component has an outsized influence on administered price inflation. Electricity prices are expected to continue rising at rates above the upper limit of the inflation target range over the medium term, in part reflecting a normalisation of prices to more cost-reflective levels. The SARB forecasts electricity prices to increase by 12.0% in 2024 and to average 10.0% over the medium term.

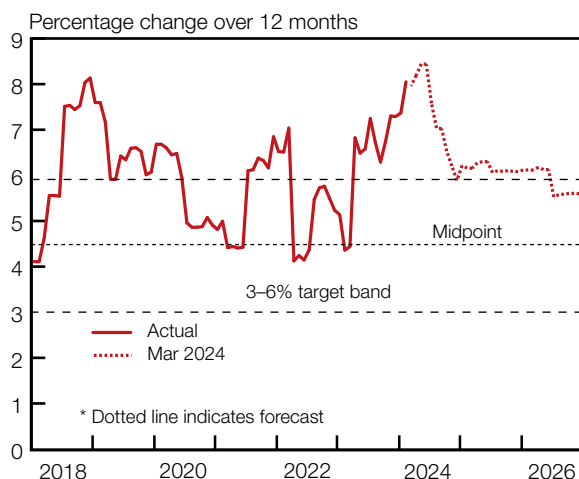
Meanwhile, other administered prices, including rates and taxes as well as water tariffs, also continued to rise. Over the review period, assessment rates nearly doubled to 8.4% (from 4.3% the year before), while water tariffs rose to 9.6%. The SARB expects inflation in these categories to remain elevated in 2024.

While administered prices influence headline inflation, headline inflation also bears on administered price inflation as it affects the operating costs for public sector entities, including municipalities and state-owned corporations that provide regulated services. Employee-related expenses (including staff benefits, bonuses and overtime) are a key driver of operating costs, and these are generally indexed to inflation.⁵² Large increases in operating expenditure require equally large increases in revenue and, in the absence of the disciplining effects of market competition, this adds upward pressure on administered prices. The immediate implications are three-fold. First, permanently lower headline inflation will structurally lower the rate of increase in administered prices given indexation. Second, more efficiency-oriented cost recovery frameworks should be considered to ensure incentive compatibility

51 Components in the fuel price basket that are regulated include fuel taxes, levies and margins.

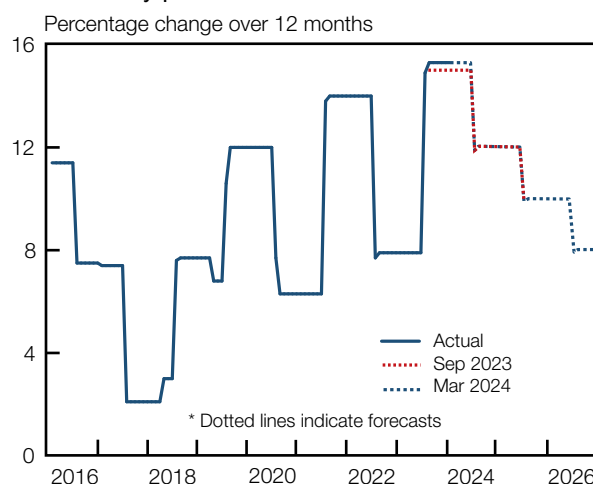
52 K Walsh, 'Review of administered prices in South Africa: Municipal rates and taxes', *South African Reserve Bank Special Occasional Bulletin of Economic Notes: Special OBEN/23/01*, Pretoria: South African Reserve Bank, August 2023. <https://www.resbank.co.za/content/dam/sarb/publications/special-occasional-bulletins/2023/special-occasional-bulletin-of-economic-notes-2301-review-of-administered-prices-in-south-africa-municipal-rates-and-taxes-august-2023.pdf>

Administered prices excluding the basic fuel price*



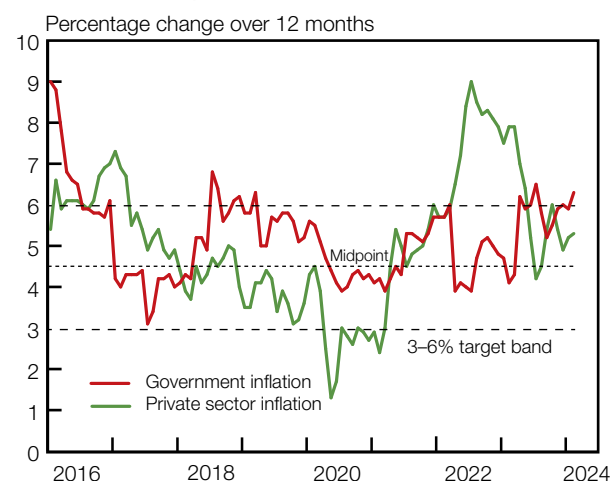
Sources: Stats SA and SARB

Electricity prices*



Sources: Stats SA and SARB

Inflation comparison



Sources: Stats SA and SARB

for administered service providers. Third, where possible, competition should be introduced to drive efficiencies and enhance value for money for consumers.

Food and non-alcoholic beverages inflation

Domestic food and non-alcoholic beverages (NAB) inflation accelerated in 2023 despite global agricultural commodity prices experiencing deflation throughout the year. The divergence between global and domestic food inflation initially reflected the delayed pass-through of easing global food inflation and a weaker rand exchange rate. However, despite the passage of time and some stabilisation of the rand, food price disinflation did not materialise to the anticipated degree, pointing to domestic idiosyncrasies as reasons for the elevated food inflation.

In 2023, food and NAB inflation rose sharply and averaged 10.7%, up from 9.2% in the previous year. Food and NAB inflation peaked at 14.0% in March 2023 and has moderated markedly to 6.1% in February 2024 – its lowest since April 2022.

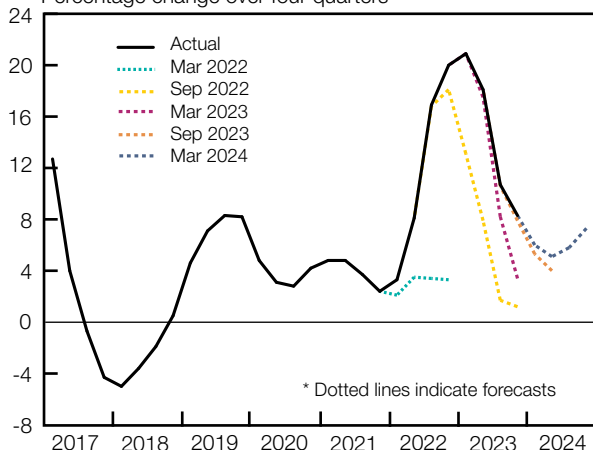
The acceleration in food inflation last year was broad-based, with over 87% of the subcomponents inflating at rates above the 4.5% midpoint of the inflation target band. Nevertheless, the bulk of the pressure emanated from increases in the prices of bread and cereals, meat, vegetables as well as milk, cheese and eggs. However, inflation for bread and cereals as well as meat moderated markedly in the latter half of the year and into early 2024.⁵³ The decline in inflation for bread and cereals reflects the eventual pass-through of lower global prices to the domestic economy while lower meat inflation is on account of improved slaughter rates and somewhat subdued demand. Bread and cereals as well as meat inflation are forecast to average 6.1% and 3.7% in 2024 respectively.

While the impact of vegetables as well as milk, cheese and eggs inflation has been relatively small historically, inflation for these two components accelerated strongly in 2023. Their combined contribution to food inflation more than doubled in 2023 compared with 2022.

The effects of domestic idiosyncrasies – such as inclement weather, load-shedding and biosecurity challenges related to the Avian flu – largely explain why food and NAB inflation remained high. Excessive rains affected vegetable yields and prices, and also degraded the road infrastructure. Load-shedding impacted on irrigation schedules as well as the cooling of milk tanks, both lowering yields and increasing spoilage.⁵⁴ Inflation for milk, cheese and eggs was further aggravated by the outbreak of Avian flu that led to a shortage of eggs in the latter months of the year.

Bread and cereals inflation*

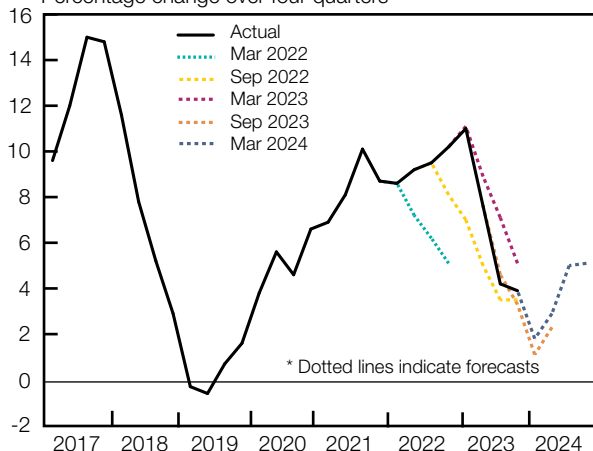
Percentage change over four quarters



Sources: Stats SA and SARB

Meat inflation*

Percentage change over four quarters



Sources: Stats SA and SARB

53 Bread and cereals as well as meat inflation averaged 14.2% and 6.5% in 2023 respectively. These components eased over the review period to 6.1% and 1.5% respectively in February 2024.

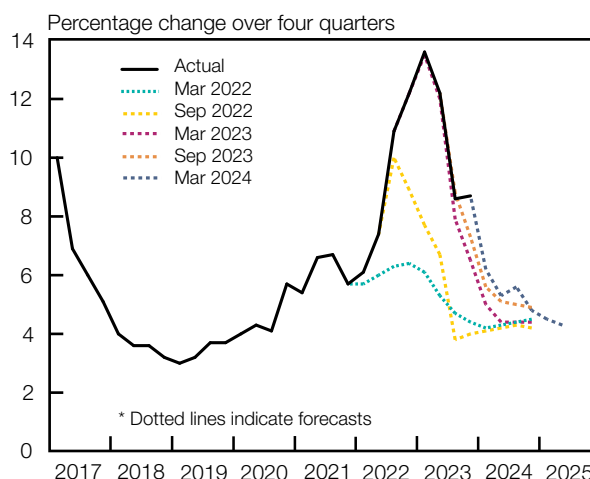
54 Potatoes were particularly hard-hit by load-shedding. Inflation for potatoes peaked at 64.6% in October 2023 and moderated to 32.8% in February 2024.



Vegetables inflation eased sharply to 9.4% in February 2024 from its peak of 23.6% in October 2023 amid improved supply. Milk, cheese and eggs inflation, however, remains elevated at 12.0% in February 2024 (from 12.4% in October 2023). Inflation for these components is expected to decelerate further, averaging 3.8% and 6.8% for vegetables as well as milk, cheese and eggs respectively this year.

Overall, the baseline forecast is for food and NAB inflation to moderate to 5.5% this year and to fluctuate around the target midpoint from 2025. However, upside risks have emerged due to the El Niño-related drought over the past summer. The maize harvest for the 2023–24 season is now expected to decline by 25% year on year, which has seen a sharp jump in the spot prices for maize recently.

Food and NAB inflation*



Sources: Stats SA and SARB

Consumer food price inflation (March 2024 forecasts)

Percentage change over four quarters, September 2023 forecasts in brackets

	Actual			Forecast	Actual		Forecast			
	Weight	2013–23	2023*	2024*	2023Q3	2023Q4	2024Q1	2024Q2	2024Q3	2024Q4
Food and non-alcoholic beverages	17.14	6.7	10.7	5.5	8.7 (8.8)	8.7 (7.3)	6.2 (5.6)	5.3 (5.1)	5.6	4.8
Bread and cereals.....	3.16	6.8	14.2	6.1	10.7 (10.6)	8.3 (7.9)	6.0 (5.3)	5.1 (4.0)	5.8	7.3
Meat	5.42	6.5	6.5	3.7	4.2 (4.6)	3.6 (3.3)	1.8 (1.1)	2.9 (2.2)	5.0	5.4
Beef.....	1.42	6.5	3.0	1.7	-0.6 (0.4)	-2.0 (-1.1)	-1.9 (-2.1)	0.0 (1.1)	3.9	5.1
Poultry.....	2.09	7.2	9.7	6.4	7.8 (8.1)	9.2 (7.3)	6.0 (3.7)	6.0 (3.0)	7.1	6.4
Vegetables	1.27	7.4	19.2	3.8	16.8 (16.0)	21.5 (12.6)	9.2 (5.6)	3.8 (1.8)	3.6	-1.0

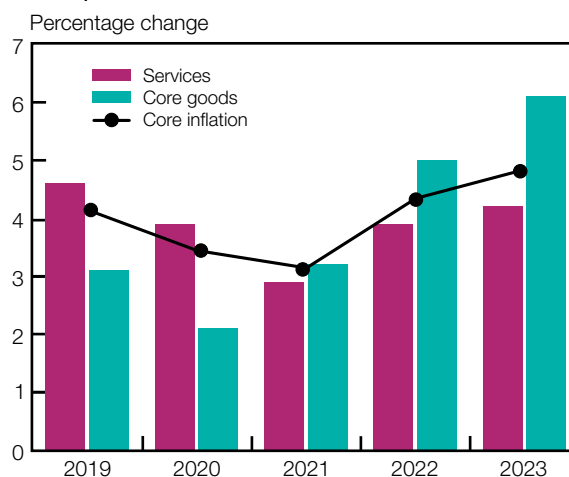
* Annual average percentage change

Sources: Stats SA and SARB

Core inflation

Core inflation accelerated for a second consecutive year in 2023, averaging 4.8%, compared with 4.3% and 3.1% in 2022 and 2021 respectively. After hovering around the midpoint for the first four months of the review period, core inflation jumped up 0.4 percentage points to 5.0% in February 2024. Despite the relative stability in core inflation, its constituent components, especially core goods, have been significantly more volatile. The QPM forecasts core inflation to average 4.8% this year and to only settle at the midpoint in the final quarter of 2025, with the slower convergence attributable mainly to elevated services inflation.

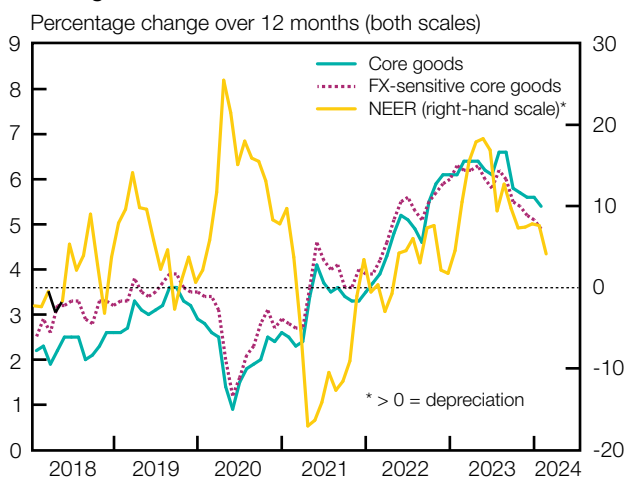
Components of core inflation



Source: Stats SA



Core goods inflation



Core goods inflation rose significantly in 2023, averaging 6.1% for the year, up from 5.0% in 2022. This rise was primarily due to a combination of higher global goods inflation and a depreciated rand, pushing up large-weight, exchange rate-sensitive items such as vehicles as well as alcoholic beverages and tobacco.⁵⁵ Core goods inflation is forecast to slow to 4.6% in 2024 and to fluctuate around the target midpoint from 2025, in part benefitting from favourable base effects.

Services inflation also gained momentum in the past year, to 4.2%, from a relatively low 3.9% in 2022, adding upward pressure to core inflation. At the start of 2024, however, services inflation accelerated for the first time in four months, registering 4.0% in January before jumping to 4.9% in February on a higher-than-expected increase in medical insurance inflation. Subdued services inflation over the review period reflects lower transport services inflation (in line with the moderation in fuel inflation) and housing inflation which remains well below its long-term trend.⁵⁶

⁵⁵ Inflation for motor vehicles averaged 7.7% in 2023 (6.0% in 2022) and remained above the target range at 7.0% in February 2024, while the 2023 outcome for alcoholic beverages and tobacco inflation matched the 5.9% outcome of the prior year.

⁵⁶ Housing inflation, with a weight of 32.0% in the services basket, averaged 2.9% between October 2023 and February 2024 against its long-term inflation rate of 3.6%.

Headline inflation (March 2024 forecasts)

Percentage change over four quarters, September 2023 forecasts in brackets

	Weight	Actual		Forecast	Actual		Forecast			
		2013–23*	2023*	2024*	2023Q3	2023Q4	2024Q1	2024Q2	2024Q3	2024Q4
Headline inflation	100.00	5.2	6.0	5.1	5.0	5.5	5.4	5.1	5.3	4.7
				(5.1)	(5.1)	(5.4)	(5.3)	(5.2)		
Core inflation**	74.40	4.6	4.8	4.8	4.7	4.5	4.8	4.7	4.9	4.9
				(4.7)	(4.8)	(4.8)	(4.7)	(4.7)		
Rentals***	16.49	3.6	2.7	3.4	2.8	2.8	3.2	3.5	3.5	3.7
				(4.3)	(2.9)	(3.5)	(4.2)	(4.5)		
Insurance	9.89	6.9	5.9	7.7	6.2	5.2	8.0	7.6	7.7	7.7
				(7.8)	(6.2)	(6.2)	(8.1)	(7.9)		
Education	2.62	6.7	5.6	5.8	5.7	5.7	5.8	5.8	5.8	5.8
				(5.8)	(5.7)	(5.7)	(5.8)	(5.8)		
Vehicles	5.91	4.8	7.7	5.3	8.3	7.9	7.1	5.6	4.5	4.0
				(5.5)	(8.3)	(7.7)	(7.1)	(5.7)		
Fuel	4.82	7.3	0.6	1.4	-9.3	3.4	4.8	3.7	3.2	-5.5
				(5.8)	(-9.0)	(2.4)	(7.4)	(8.1)		
Electricity	3.63	8.7	11.7	13.5	15.2	15.3	15.3	15.3	12.0	12.0
				(13.4)	(15.0)	(15.0)	(15.0)	(15.0)		

* Annual average percentage change

** CPI excluding food, non-alcoholic beverages, fuel and electricity

*** Combines actual rentals and owners' equivalent rent

Sources: Stats SA and SARB



Services inflation is expected to rise strongly this year, averaging 5.0% for the year, before slowly returning to the midpoint over the forecast period. The elevated trajectory is mainly due to a sharp rise in medical insurance inflation and an expected normalisation in housing inflation towards its longer-term average. Medical insurance inflation surged to 12.9% in February 2024 – a 6.0 percentage points jump compared with January. Medical insurance inflation is forecast at 10.4% for the full year, up from 7.5% in 2023 and 4.3% in 2022.

Medium-term inflation outlook

Over the medium term, inflation is shaped primarily by inflation expectations, the real rand exchange rate, ULCs and the output gap.

Inflation expectations provide guidance to price and wage setting, with direct implications for inflation.⁵⁷ Since the previous *MPR*, the BER's surveyed inflation expectations have generally moved sideways, but well above the 4.5% mark. Survey respondents currently see two-years-ahead inflation at 5.2%, down from 5.6% in the fourth quarter of 2023.

The rand exchange rate continues to be an important source of inflationary pressure through its impact on imported inflation. The starting point for the rand to the US dollar exchange rate was R18.88 at the March 2024 MPC meeting (R18.45 at the September 2023 MPC meeting). The implied rand/US dollar exchange rate is, however, expected to appreciate by about 2.2% by the end of the forecast period. Meanwhile, the SARB's QPM predicts that, relative to its equilibrium, the real effective exchange rate (REER) of the rand will improve from a starting-point undervaluation of 6.7% to an overvaluation of 1.7% by the end of the forecast period, reducing pressures on core inflation.

Another potential source of inflationary pressure over the medium term is labour market dynamics. Price pressures emanating from the labour market are measured using a combination of the ULC gap and nominal ULC growth, with a greater weight assigned in the QPM to the latter.⁵⁸ The SARB forecasts nominal salaries to increase by 5.6% in 2024 and to slow to 5.4% in 2026.⁵⁹ Subdued real wage growth, higher productivity growth (in line with the projected better growth outcomes) as well as nominal ULC growth around the target midpoint over the medium term all suggest that labour market contributions to inflation remain around the midpoint of the target band.⁶⁰

57 A Amaral, M Kruger and M Reid, 'Looking to the price setters: what can we learn from firm-level inflation expectations data?', *South African Reserve Bank Economic Note No. EN/2023/16*, Pretoria: South African Reserve Bank, November 2023.

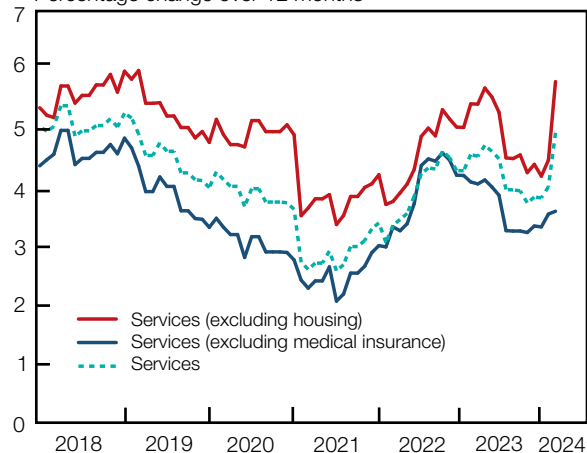
58 The ULC gap measures the difference between productivity-adjusted real wages and its equilibrium level, while nominal ULC growth determines whether wage increases or productivity decreases contributed towards inflationary pressures. Nominal ULC growth is expected to average 3.8% in 2024, 4.5% in 2025 and 4.3% in 2026.

59 Real salary increases are expected to average 0.4% in 2024 from -1.6% in 2023 before rising to 0.9% in the outer years.

60 Productivity growth is forecast to average 1.8% in 2024, 1.0% in 2025 and 1.1% in 2026.

Services inflation

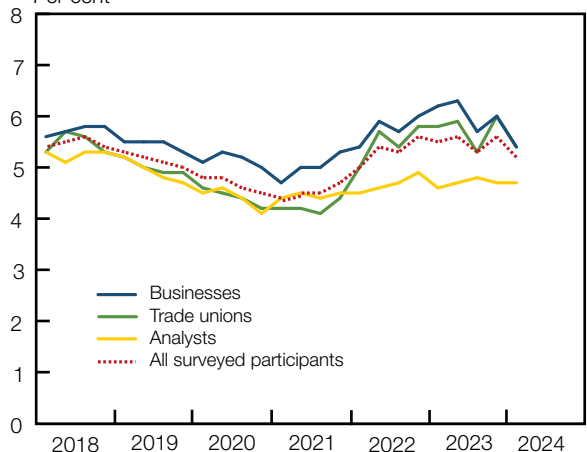
Percentage change over 12 months



Sources: Stats SA and SARB

Two-years-ahead inflation expectations

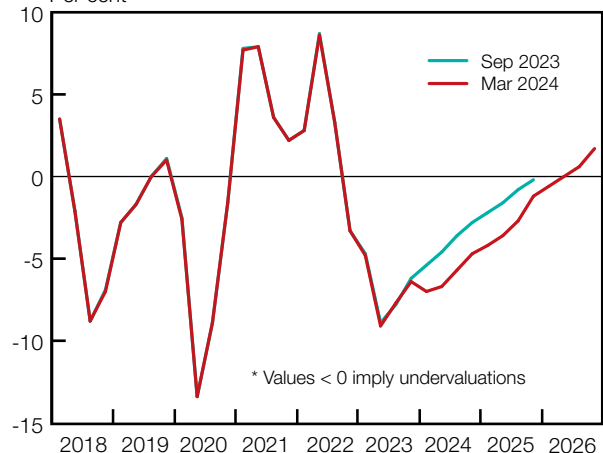
Per cent



Source: BER

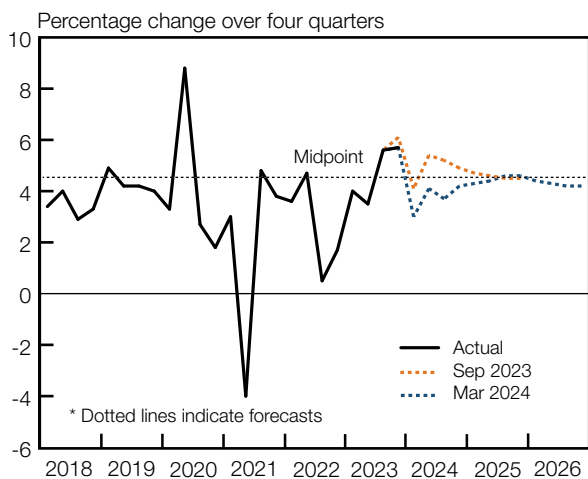
Real effective exchange rate gap*

Per cent



Source: SARB

Unit labour cost forecasts*



Source: SARB

The QPM projects that demand and supply conditions reflect a fine balance between modest upward and downward inflationary pressures, with the output gap forecast to average close to 0.0% over the forecast period. The closure of the output gap explains, in part, the return of core inflation closer to the midpoint over the medium term.

Conclusion

Sharply lower fuel inflation throughout most of 2023 was primarily responsible for headline inflation’s decline back into the target band. While food inflation moderated throughout the past year, it remains elevated, largely reflecting domestic idiosyncrasies. The expectation is for food inflation to slow further this year as biosecurity risks recede and load-shedding eases somewhat. However, smaller crop projections following the El Niño-related drought over the past summer may pose some upside risk to food prices over the medium term. Meanwhile, core inflation is expected to remain elevated at 4.8% this year, as the disinflation pressures in core goods are countered by stronger inflationary forces in the services basket. The SARB forecasts headline inflation to remain elevated at 5.1% this year, to ease to the midpoint of the 3–6% target band by the fourth quarter of next year, and to oscillate around this point for the remainder of the forecast horizon.



Box 8 Weaker growth in 2023, but more inflation than forecast

The South African Reserve Bank (SARB) continuously evaluates its inflation forecast errors to facilitate learning and improve future forecasts. This box accounts for the inflation forecast errors of 2023.

Inflation in 2023 averaged 6.0%. This outcome was substantially above the SARB's forecasts from earlier Monetary Policy Committee (MPC) meetings with a root mean square error (RMSE) of 1.5 percentage points at a two-years-ahead horizon.¹ However, the errors improved in later MPC meetings as the shocks of 2022 and 2023 became visible, resulting in the RMSE improving to 0.8 and 0.1 percentage points at the one- and current-year-ahead horizons respectively.² Food and core goods inflation stand out as key drivers of upside surprises.

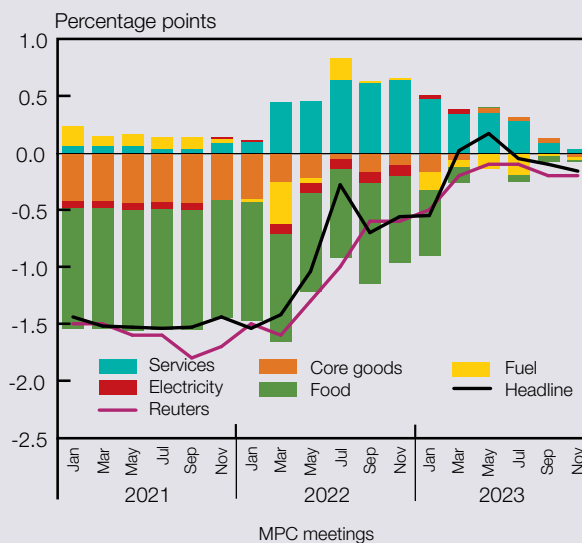
Persistent errors in food inflation were initially due to the large unanticipated shock to global food prices in 2022 which was caused by the Russia/Ukraine war, and later the result of the slower-than-expected pace of disinflation. The rand was more depreciated, while new domestic shocks emerged during the year, as discussed in the main text.

Unlike food inflation, which was underestimated throughout the period, core inflation was at first understated and then overstated. Higher-than-expected outcomes in core goods inflation reflected currency depreciation and a higher exchange rate pass-through, coupled with elevated global goods inflation.

Core inflation was later overstated as services inflation surprised lower, reflecting muted outcomes in housing inflation (which constitutes nearly a third of the services basket), coupled with lower-than-historical-average normalisation of key components such as medical insurance and education fees. Subdued labour market price pressures, alongside a negative but slowly closing output gap, also moderated services inflation.³

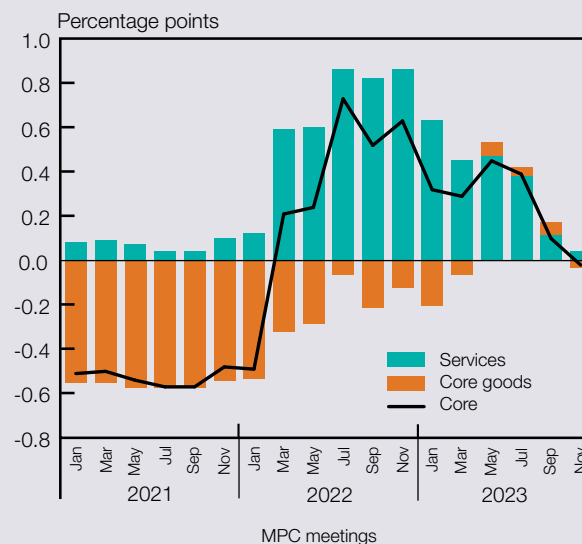
Unanticipated shocks invariably impair the accuracy of forecasts and require forecasts to be augmented by other data when making policy, especially in periods of extraordinary uncertainty. The SARB's MPC evaluates inflation forecasts alongside a 'balance of risks' assessment, which intends to minimise policy mistakes.

2023 headline inflation forecast errors



Sources: Stats SA and SARB

2023 core inflation forecast errors



Sources: Stats SA and SARB

1 The root mean square error (RMSE) is a measure of forecast accuracy which ensures that errors in opposite directions do not cancel each other out.

2 This was somewhat better than the Reuters median RMSE of 1.6, 1.0 and 0.2 percentage points at the two-, one- and current-year-ahead horizon respectively.

3 Wages surprised on the downside with limited backward indexation observed, against a forecast assumption of inflation-linked wage adjustments in line with historical outcomes.

Conclusion

Recent inflation data suggests that the path back to central bank targets has slowed and become more uncertain. Disinflation has slowed on account of sticky services inflation across a wide range of economies, notwithstanding tighter monetary policy in many jurisdictions. Forecasts by most of the major central banks, including the Fed and the BoE, indicate that a return of inflation to target has been pushed further out to 2026. Inflation remains uncomfortably high in emerging markets too, with equally slow returns to central bank targets.

The stubbornness of inflation raises the question of whether monetary policy is appropriately calibrated: where is the elusive r -star in relation to the real policy rates? A higher post-pandemic r -star may explain the relatively slow disinflation seen up to now and seems likely to keep rates at current levels for longer than previously expected. The uncertainty about rates has, in turn, sustained volatility in financial markets, adversely impacting on capital flows, currencies and inflation rates in emerging markets.

Stickiness has also been a feature of South Africa's inflation, with headline inflation remaining wedged in the 5–6% range since September 2023. With some of the risks associated with services inflation having materialised, and an increase of other services components (including housing) to more normal levels expected, uncertainty regarding the path of disinflation has increased.

Despite inflation remaining closer to the upper limit of the target band, the MPC has kept the repo rate unchanged at 8.25% since May 2023, in part reflecting the weight given to growth considerations. Monetary policy has remained moderately restrictive since May 2023, with the recent increases in headline inflation loosening its bite somewhat. Inflation expectations remain well above the midpoint of the inflation target band and need to be better anchored if headline inflation is to stabilise and policy settings are to shift to neutral.

South Africa continues to face the challenges of persistent inflation and a stagnant economy. The anaemic growth primarily reflects energy-supply inadequacies, along with logistical bottlenecks. While the constraints to growth associated with network industries will remain evident in the near term, expectations are that the worst is behind us, as reforms in both the energy and the logistics sectors gather pace. Economic activity is also constrained by high long-term borrowing costs, reflecting South Africa's high volume of borrowing. Elevated borrowing costs have persisted for over a decade, dampening confidence among businesses and households. As borrowing moderates in line with the medium-term fiscal trajectory and better-anchored inflation expectations, more currency stability and lower inflation should open space for lower short-term interest rates on a sustained basis. The SARB expects the private sector to gain confidence and economic growth to strengthen gradually in the next few years.



Statement of the Monetary Policy Committee

23 November 2023

Issued by Lesetja Kganyago, Governor of the South African Reserve Bank,
at a meeting of the Monetary Policy Committee in Pretoria

As we approach the end of the year, easing headline inflation and modest economic growth remain the dominant global economic trends of this past year. Output in the eurozone is poor, while the robust growth seen in North America is likely to moderate. China's growth performance is still weak, with few benefits for global commodity prices.¹ Across most regions, monetary policy will continue to focus on achieving inflation targets, while high debt levels will require fiscal consolidation efforts. In the developing world, financing conditions are expected to remain tight and growth moderate.

The longer-term economic outlook, however, remains uncertain. Weaker household consumption and falling property prices may drag on growth for a sustained period. Climate change and geopolitical tensions threaten supply chains, output and prices.

With high interest rates and uncertainty, financial markets and asset prices are expected to remain volatile, dampening investor appetite and capital flows.

Taking these and other factors into account, the South African Reserve Bank's (SARB) forecast for global growth in 2023 is broadly unchanged at 2.7% (from 2.6%) and 2.6% in 2024.²

While South Africa's electricity load-shedding has declined, domestic growth in the near term is likely to remain muted. Energy and logistical constraints are still binding on economic activity and generally increase costs.³ We expect electricity supply to increase gradually over the medium term, however, helping to raise our forecast for output growth in 2024, 2025 and 2026.

Spending by firms, households, public corporations and general government remains positive in real terms, on an annual basis. The disposable income of households is expected to grow, albeit slowly. The investment forecast for the year was revised up to 7.7% in September. Credit

growth to households and corporates has slowed in recent months, but remains positive.⁴

Gross domestic product (GDP) growth for 2023 is revised slightly upward to 0.8% from the September figure of 0.7%. Our GDP growth forecast for 2024 and 2025 is increased from the previous Monetary Policy Committee (MPC) meeting, to 1.2% and 1.3% respectively, in large part due to an expected decrease in load-shedding.⁵

While households and firms exhibit some resilience, economic growth has been volatile and highly sensitive to new shocks. A sustained reduction in load-shedding, or greater energy supply from alternative sources, would significantly increase growth. The operations of ports and rail, however, have become a serious constraint.

At present, we assess the risks to the medium-term domestic growth outlook to be balanced, as demand continues to run ahead of the constrained supply environment. As a result, our current growth forecast leaves the output gap marginally positive.⁶

Turning to the inflation outlook, South Africa's headline inflation rate has increased more gradually than in many other emerging and advanced economies. Nonetheless, South Africa's inflation rate remains sensitive to shocks.

While volatile in recent weeks, oil prices have increased over the year and commodity export prices have moderated further. South Africa's external financing needs will increase as the current account deficit expands from a forecasted 1.3% of GDP this year (from 2.0%) to 2.6% of GDP in 2024 and to 3.5% of GDP in 2025.⁷ The smaller deficit this year is the result of significantly better-than-expected trade outcomes in the third quarter.⁸

The rand weakened over the past year, depreciating by about 9.5% against the United States (US) dollar. The lack of sustained economic growth and dependence on

1 South Africa's commodity export index is forecast to *decline* by 27.9% this year, by a further 11.5% in 2024 and by an additional 5.0% in 2025. The index is forecast to fall by 1.7% in 2026.

2 Global growth in the Quarterly Projection Model (QPM) is a trade-weighted average of South Africa's trading partners.

3 The number of days of expected load-shedding is 300 in 2023, decreasing to 150 days and 100 days respectively in 2024 and 2025. Estimates of the average stages of load-shedding are multiplied by the number of days and then multiplied by the cost to gross domestic product (GDP) per stage-day. The cost per stage was revised lower at the March 2023 Monetary Policy Committee (MPC) meeting. In nominal terms, these costs vary between R0.0 million and R1.2 million for stages 1 and 2, and go up to R204–899 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 Although growth in the claims on the domestic private sector has slowed from 8.4% year on year in January 2023 to only 4.6% year on year in September, real credit extension for the year to September is 0.3% above the average for calendar year 2022.

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

6 Potential growth is 0.1% in 2023 (up from 0.0%) and rising to 1.0% for 2024, 1.2% for 2025 and 1.6% for 2026.

7 The current account deficit in 2026 is forecast to be -4.0% of GDP. Exports are forecast to grow in real terms by 4.8% this year (from 4.5%) and by 2.9% in 2024. Our oil price forecast is higher than in September, averaging US\$84 per barrel in 2023 and in 2024 before easing to US\$82 for 2025 and US\$80 for 2026.

8 Agricultural exports as well as vehicle and parts exports were up, while there was a sharp drop in machinery and electrical goods imports.

commodities is reflected in the high volatility of the currency in response to global risk-on and risk-off episodes. The implied starting point for the rand forecast is R18.76 to the US dollar, compared to R18.45 at the time of previous meeting.

Compared to September, fuel price inflation is broadly unchanged for 2023, but lowered from 5.8% to 3.2% in 2024.

Our food price inflation forecast for 2023 remains high at 10.6% (from 10.4%). The forecast for 2024 is slightly higher at 5.5%.

Better monthly outcomes have led to a marginal downward revision in our forecast for core inflation to 4.8% in 2023 (previously 4.9%) and to 4.6% in 2024 (from 4.7%). The core inflation forecast for 2025 remains at 4.5%. The new 2026 core forecast is also 4.5%. Services inflation in 2023 is now expected to come in at 4.3% (from 4.4%) before rising to 4.8% in 2024 (up from 4.6%). Core goods inflation remains elevated but is revised lower for this year to 6.0% (from 6.3%).⁹ Growth in average salaries and unit labour costs is forecast to be somewhat lower than at the time of the September meeting.¹⁰

With few significant changes to underlying components, headline inflation for 2023 is revised down slightly to 5.8% (from 5.9%). The headline inflation forecast for 2024 is 5.0% (down from 5.1%) before stabilising at 4.5% in both 2025 and 2026.

While our baseline inflation forecast has improved, risks to the inflation outlook are still assessed to the upside.

Even as global headline inflation moderates, oil markets are tight and core inflation is sticky. Despite the recent easing in some food price components, domestic food price inflation remains volatile, and increased in October to 8.7%. El Niño conditions present longer-term concerns. Imported goods inflation has increased over the year and, despite some better recent outcomes, remains sensitive to currency weakness. Electricity prices continue to present clear inflation risks and, with logistics constraints, are likely to 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 policy rates in the G3 economies will remain high, at about 4.3% in 2024 compared to the 1.1% average rate seen in 2022.¹¹ These tighter global financial conditions will raise the risk profile of economies needing foreign capital. Sharply lower tax revenue, higher employee compensation and the ongoing financing needs of state-owned enterprises are expected to keep South Africa's long-term cost of borrowing elevated. Despite an expected moderation in inflation, long-term bond yields currently trade around 12%.

Higher inflation has generally resulted in elevated inflation expectations across markets, businesses and households. Market-based expectations for inflation in 2023 are currently 5.8%, while the near-term break-even rates have dipped to 4.3%.¹² Medium- and longer-term market expectations for inflation remain elevated. The September survey of the Bureau for Economic Research shows average inflation expectations lower at 6.1% for 2023. The MPC, however, would prefer to see expectations anchored at the midpoint of the inflation target band.¹³

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

At the current repo 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 MPC 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 Quarterly Projection Model (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 midpoint of the target band and to increase confidence of attaining the inflation target sustainably over time.¹⁴ The MPC will seek to look through any temporary price shocks and focus on potential second-round effects and the risks of de-anchoring inflation expectations.

Guiding inflation back towards the midpoint of the target band reduces the economic costs of high inflation and will achieve lower interest rates in the future. Since early 2020,

9 Core goods refers to total consumer price index (CPI) goods excluding food and non-alcoholic beverages (NAB), fuel and electricity, whereas services include all surveyed services within the CPI basket. Core goods inflation is expected to be 4.5% in 2024, 4.4% in 2025 and 4.5% in 2026.

10 Average salaries are expected to rise by 4.6% in 2023 (down from 5.4%), by 6.0% in 2024 and by 5.4% in both 2025 and 2026. Unit labour costs are forecast to rise by 4.6%, 4.5% and 4.4% respectively in 2023, 2024 and 2025. In 2026, unit labour costs are forecast to increase by 4.3%.

11 The G3 interest rates average 3.9% in 2023, 4.3% in 2024 and significantly higher at 3.4% in 2025 (up from 2.8%).

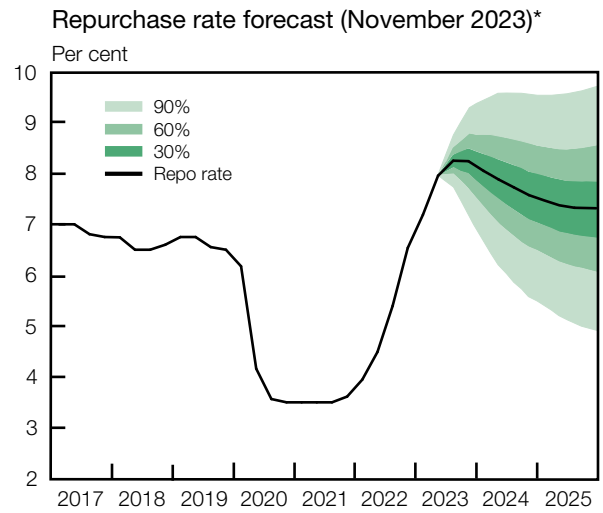
12 At the median, market analysts (Reuters Econometer) in November expect inflation to average 5.8% in 2023, 4.9% in 2024 and 4.6% in 2025. Market-based rates are calculated from the break-even inflation rate, which is the yield differential between conventional and inflation-linked bonds. The 10-year break-even inflation rate now sits at about 6.1%. The 20-year break-even inflation rate sits at 7.2%.

13 The Bureau for Economic Research (BER) Q3 2023 survey of inflation expectations indicated inflation at 6.1% in 2023 (from 6.5% in Q2), 5.5% for 2024 (from 5.9% in Q2) and 5.3% in 2025. BER's next release is in the second week of December.

14 The forecasted trajectory for the repurchase (repo) rate implies a rise in the inflation-adjusted repo rate from -1.3% in 2022 to 2.7% in 2023 and 3.2% in 2024. The real repo rate level for 2025 is expected to be 2.9%. The real repo rates calculated here are based on the three-quarters-ahead inflation forecast and are annual average rates.



the MPC has been recommending additional means of lowering inflation that are within the reach of the public sector, including achieving a more prudent public-debt level, increasing the supply of energy, and keeping administered price inflation low and real wage growth in line with productivity gains. Such steps would strengthen monetary policy effectiveness and its transmission to the broader economy.



* The uncertainty bands for the repo rate are based on historical forecasting experience and stochastic simulations in the QPM. The bands are symmetric and therefore do not reflect any assessment of upside or downside risk.

Source: SARB

Summary of assumptions: Monetary Policy Committee meeting on 23 November 2023*

1. Foreign sector assumptions

	Actual		Forecast			
	2021	2022	2023	2024	2025	2026
1. Real GDP growth in South Africa's major trading-partner countries	7.2%	3.8%	2.7%	2.6%	3.1%	3.1%
	(7.0%)	(3.6%)	(2.6%)	(2.7%)	(3.1%)	
2. Output gap in South Africa's major trading-partner countries (ratio to potential GDP).....	-1.0%	0.2%	0.1%	-0.2%	0.0%	0.2%
	(-0.9%)	(0.0%)	(-0.2%)	(-0.2%)	(0.4%)	
3. Change in international commodity prices in US\$ (excluding oil).....	46.0%	-0.9%	-27.9%	-11.5%	-5.0%	-1.7%
	(46.0%)	(-0.9%)	(-28.4%)	(-12.0%)	(-5.1%)	
4. Brent crude (US\$/barrel)	70.7	100.4	84.0	84.0	82.0	80.0
	(70.7)	(100.4)	(82.0)	(82.0)	(80.0)	
5. Change in world food prices (US\$).....	28.1%	14.2%	-13.1%	0.5%	2.6%	1.5%
	(28.1%)	(14.2%)	(-12.2%)	(1.7%)	(3.2%)	
6. Change in international consumer prices.....	3.3%	7.4%	4.6%	2.5%	2.1%	2.0%
	(3.3%)	(7.4%)	(4.5%)	(2.4%)	(2.1%)	
7. International policy interest rate.....	0.1%	1.1%	3.9%	4.3%	3.4%	2.2%
	(0.1%)	(1.1%)	(4.0%)	(4.1%)	(2.8%)	

2. Domestic sector assumptions

	Actual		Forecast			
	2021	2022	2023	2024	2025	2026
1. Change in electricity price	10.2%	10.7%	11.7%	13.5%	10.9%	8.9%
	(10.2%)	(10.7%)	(11.6%)	(13.4%)	(10.9%)	
2. Change in fuel taxes and levies.....	6.1%	2.9%	1.8%	2.1%	4.3%	4.2%
	(6.1%)	(2.9%)	(1.8%)	(2.0%)	(4.6%)	
3. Potential growth.....	3.2%	0.5%	0.1%	1.0%	1.2%	1.6%
	(3.2%)	(0.5%)	(0.0%)	(0.8%)	(1.0%)	
4. Inflation target midpoint.....	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%
	(4.5%)	(4.5%)	(4.5%)	(4.5%)	(4.5%)	(4.5%)

Notes

a. Shaded areas indicate forecast assumptions.

b. The figures in brackets represent the previous assumptions of the Monetary Policy Committee.

* For an explanation of foreign sector assumptions and domestic sector assumptions, see pages 54 and 55.

Summary of selected forecast results: Monetary Policy Committee meeting on 23 November 2023

Selected forecast results (quarterly)

Year-on-year percentage change

	2023				2024				2025				2026				Steady state
	5.8 (5.9)				5.0 (5.1)				4.5 (4.5)				4.5				
1. Headline inflation	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	4.5
	7.0	6.2	5.0	5.3	5.2	5.1	5.0	4.6	4.6	4.6	4.5	4.5	4.5	4.5	4.5	4.5	
	(7.0)	(6.2)	(5.1)	(5.4)	(5.3)	(5.2)	(5.3)	(4.7)	(4.6)	(4.5)	(4.4)	(4.5)					
2. Core inflation	2023				2024				2025				2026				4.5
	4.8 (4.9)				4.6 (4.7)				4.5 (4.5)				4.5				
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	
	5.1	5.2	4.7	4.4	4.6	4.5	4.6	4.6	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5	
	(5.1)	(5.2)	(4.8)	(4.8)	(4.7)	(4.7)	(4.8)	(4.6)	(4.5)	(4.5)	(4.4)	(4.4)					

Notes

- Shaded areas indicate the forecasts of the Monetary Policy Committee.
- The figures in brackets represent the previous forecasts of the Monetary Policy Committee.

Selected forecast results (annual)

	Actual		Forecast				Steady state
	2021	2022	2023	2024	2025	2026	
1. GDP growth.....	4.7%	1.9%	0.8%	1.2%	1.3%	1.6%	2.5%
	(4.7%)	(1.9%)	(0.7%)	(1.0%)	(1.1%)		
2. Output gap (ratio to potential GDP).....	-1.9%	-0.5%	0.1%	0.2%	0.2%	0.1%	0.0%
	(-1.9%)	(-0.5%)	(0.2%)	(0.3%)	(0.3%)		
3. Change in nominal effective exchange rate.....	9.9%	-2.3%	-12.0%	-1.0%	0.4%	0.4%	2.5%
	(9.9%)	(-2.3%)	(-11.4%)	(0.2%)	(0.5%)		
4. Change in real effective exchange rate.....	11.1%	-3.2%	-10.9%	1.5%	2.8%	2.9%	0.0%
	(11.1%)	(-3.2%)	(-10.2%)	(2.8%)	(2.9%)		
5. Real exchange rate gap.....	5.4%	2.9%	-7.7%	-6.2%	-3.5%	-0.7%	0.0%
	(5.4%)	(2.9%)	(-6.9%)	(-4.1%)	(-1.2%)		
6. Repurchase rate (end of period).....	3.61%	6.54%	8.17%	7.55%	7.32%	7.30%	7.00%
	(3.61%)	(6.54%)	(8.24%)	(7.57%)	(7.31%)		
7. Neutral real interest rate.....	2.1%	2.3%	2.5%	2.7%	2.8%	2.8%	2.5%
	(2.1%)	(2.3%)	(2.5%)	(2.6%)	(2.7%)		
8. Current account balance (ratio to GDP).....	3.7%	-0.5%	-1.3%	-2.6%	-3.5%	-4.0%	
	(3.7%)	(-0.5%)	(-2.0%)	(-3.0%)	(-3.4%)		

Notes

- The September MPC forecast was generated using the updated QPM. For more details on the updated QPM, see E Pirozhkova, J Rakgalakane, L Soobyah and R Steinbach, 'Enhancing the Quarterly Projection Model', *South African Reserve Bank Working Paper Series No. W/P/23/05*, Pretoria: South African Reserve Bank, June 2023.
- The nominal effective exchange rate (NEER) is based on the bilateral exchange rates of South Africa's three largest trading partners (the eurozone, the US and Japan). The bilateral exchange rates are weighted by export trade weights.
- The nominal exchange rate steady state is estimated using the Purchasing Power Parity (PPP) condition, which links the depreciation of the nominal exchange rate to the inflation differential between South Africa and abroad. Given that the real effective exchange rate (REER) depreciation is zero at steady state, the nominal exchange rate will therefore depreciate by 2.5% per year in steady state, reflecting the inflation (target) differential between domestic (4.5%) and foreign (2.0%) inflation.
- The REER is the NEER deflated by the consumer price differential between South Africa and the trade-weighted CPI of the eurozone, the US and Japan.
- The real exchange rate gap signifies the extent to which the real exchange rate deviates from its estimated equilibrium level. A positive gap shows an overvaluation of the currency, and vice versa.
- The repo rate at the end of the period refers to the average for the last quarter of the year. The nominal repo rate steady state is calculated as the sum of South Africa's inflation target (4.5%) and the steady state neutral real interest rate (2.5%).
- The neutral real interest rate (NRIR) is the policy rate *minus* inflation, which prevails when the economy is fully in balance, with inflation at target and output at potential. The policy stance is measured as either tight or loose based on whether actual rates are above or below this neutral rate respectively. The steady state NRIR is calculated as the sum of the respective steady states for the G3 NRIR (0.5%), South Africa's risk premium (2.0%) and the change in the REER (0.0%). Before the steady state is reached, it is possible for the REER equilibrium to appreciate or depreciate, so this value can have a non-zero value over the medium term. It is nonetheless always zero in the long run.
- The steady state is the long-run value in the model. While model equilibriums can have different values over the medium term, as conditions change, all equilibriums eventually reach a steady state, where they stabilise.
- The forecast of the current account balance is obtained from the SARB's Core Macroeconometric Model.
- Shaded areas indicate the forecasts of the Monetary Policy Committee.
- The figures in brackets represent the previous forecasts of the Monetary Policy Committee.



Statement of the Monetary Policy Committee

25 January 2024

Issued by Lesetja Kganyago, Governor of the South African Reserve Bank,
at a meeting of the Monetary Policy Committee in Pretoria

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 the advanced and the 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 geopolitical tensions and climate change threaten supply chains, output and prices. This uncertainty, alongside 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 South African Reserve Bank's (SARB) forecast expects relatively weak global growth of 2.6% in 2024.²

The domestic gross domestic product (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 SARB's forecast.

The operations of ports and rail have 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 the 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 2023 Monetary Policy Committee (MPC) 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.

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 the 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

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 United States

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

2 Global growth in the Quarterly Projection Model (QPM) is a trade-weighted average of South Africa's trading partners.

3 The number of days of load-shedding was 287 in 2023, and it is still expected to decrease to 150 days and 100 days respectively in 2024 and 2025. Estimates of the average stages of load-shedding are multiplied by the number of days and then multiplied by the cost to gross domestic product (GDP) per stage-day. The cost per stage was revised lower at the March 2023 Monetary Policy Committee (MPC) meeting. In nominal terms, these costs vary between R0.0 million and R1.2 million for stages 1 and 2, and go up to R204–899 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 The growth forecast includes expected changes in the policy rate as given by the QPM.

5 The potential growth forecast is unchanged from November 2023, at 0.1% in 2023 and rising to 1.0% for 2024, 1.2% for 2025 and 1.6% for 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 by 3.9% in 2024. Our oil price forecast is higher than in November 2023, averaging US\$82.6 per barrel in 2023, US\$82 in 2024, US\$81 in 2025 and US\$80 in 2026.



(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 at 4.5% for 2026.

Services inflation in 2023 was 4.2%. The forecast for the 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 the underlying components, headline inflation for 2024 is expected to ease to 5.0%, to 4.6% in 2025 and to 4.5% in 2026.

While our baseline inflation forecast is one 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 the ongoing geopolitical tensions this year serve to keep global oil markets tight. Despite some improvements, the 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. The 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 the 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 the moderating inflation, long-term bond yields currently trade at 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 Economic Research shows that 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 midpoint of the target band.¹¹

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

At the current repo 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 Quarterly Projection Model (QPM) remain a broad policy guide, changing from meeting to meeting in response to new data. Future MPC decisions will remain data-dependent and sensitive to the balance of risks to the outlook.

Guiding inflation expectations back towards the midpoint of the target band will improve the economic outlook and reduce borrowing costs. Since early 2020, the MPC has

7 Core goods refers to total consumer price index (CPI) goods excluding food and non-alcoholic beverages (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 have risen by 3.9% in 2023 (down from 4.6%) and to rise by 6.1% in 2024, by 5.5% in 2025 and by 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 both 2024 and 2025. In 2026, unit labour costs are forecast to increase by 4.3%.

9 The G3 is the United States (US), Japan and the eurozone. The 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.

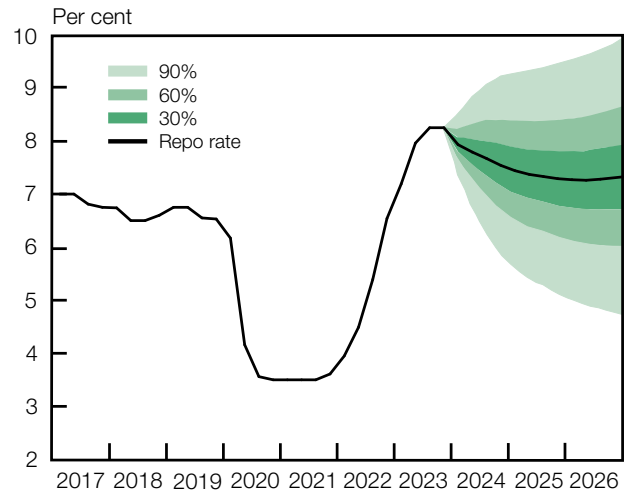
10 At the median, market analysts (Reuters Econometer) in January expect inflation to average 5.0% in 2024 and 4.5% in 2025. Market-based rates are calculated from the break-even inflation rate, which is the yield differential between conventional and inflation-linked bonds. The five-year break-even inflation rate now sits at about 5.1%.

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

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

been recommending additional means of strengthening economic conditions, including achieving a more prudent public-debt level, increasing the supply of energy, and 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.

Repurchase rate forecast (January 2024)*



* The uncertainty bands for the repo rate are based on historical forecasting experience and stochastic simulations in the QPM. The bands are symmetric and therefore do not reflect any assessment of upside or downside risk.

Source: SARB

Summary of assumptions: Monetary Policy Committee meeting on 25 January 2024*

1. Foreign sector assumptions

	Actual		Forecast			
	2021	2022	2023	2024	2025	2026
1. Real GDP growth in South Africa's major trading-partner countries	7.3%	3.8%	2.7%	2.6%	3.1%	3.1%
	(7.2%)	(3.8%)	(2.7%)	(2.6%)	(3.1%)	(3.1%)
2. Output gap in South Africa's major trading-partner countries (ratio to potential GDP).....	-0.9%	0.2%	0.1%	-0.2%	0.0%	0.2%
	(-1.0%)	(0.2%)	(0.1%)	(-0.2%)	(0.0%)	(0.2%)
3. Change in international commodity prices in US\$ (excluding oil).....	46.0%	-0.9%	-27.3%	-11.9%	-4.9%	-1.6%
	(46.0%)	(-0.9%)	(-27.9%)	(-11.5%)	(-5.0%)	(-1.7%)
4. Brent crude (US\$/barrel)	70.7	100.4	82.6	82.0	81.0	80.0
	(70.7)	(100.4)	(84.0)	(84.0)	(82.0)	(80.0)
5. Change in world food prices (US\$)	28.1%	14.2%	-13.7%	-0.3%	3.1%	1.5%
	(28.1%)	(14.2%)	(-13.1%)	(0.5%)	(2.6%)	(1.5%)
6. Change in international consumer prices	3.3%	7.4%	4.5%	2.5%	2.1%	2.0%
	(3.3%)	(7.4%)	(4.6%)	(2.5%)	(2.1%)	(2.0%)
7. International policy interest rate.....	0.1%	1.1%	3.9%	4.3%	3.4%	2.2%
	(0.1%)	(1.1%)	(3.9%)	(4.3%)	(3.4%)	(2.2%)

2. Domestic sector assumptions

	Actual		Forecast			
	2021	2022	2023	2024	2025	2026
1. Change in electricity price	10.2%	10.7%	11.7%	13.5%	10.9%	8.9%
	(10.2%)	(10.7%)	(11.7%)	(13.5%)	(10.9%)	(8.9%)
2. Change in fuel taxes and levies.....	6.1%	2.9%	3.1%	6.4%	4.1%	3.9%
	(6.1%)	(2.9%)	(1.8%)	(2.1%)	(4.3%)	(4.2%)
3. Potential growth	3.2%	0.5%	0.1%	1.0%	1.2%	1.6%
	(3.2%)	(0.5%)	(0.1%)	(1.0%)	(1.2%)	(1.6%)
4. Inflation target midpoint.....	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%
	(4.5%)	(4.5%)	(4.5%)	(4.5%)	(4.5%)	(4.5%)

Notes

- a. Shaded areas indicate forecast assumptions.
b. The figures in brackets represent the previous assumptions of the Monetary Policy Committee.
* For an explanation of foreign sector assumptions and domestic sector assumptions, see pages 54 and 55.

Summary of selected forecast results: Monetary Policy Committee meeting on 25 January 2024

Selected forecast results (quarterly)

Year-on-year percentage change

	2023				2024				2025				2026				Steady state
	5.9 (5.8)				5.0 (5.0)				4.6 (4.5)				4.5 (4.5)				
1. Headline inflation	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	4.5
	7.0	6.2	5.0	5.6	5.3	5.1	5.1	4.4	4.7	4.7	4.5	4.5	4.5	4.6	4.5	4.5	
	(7.0)	(6.2)	(5.0)	(5.3)	(5.2)	(5.1)	(5.0)	(4.6)	(4.6)	(4.6)	(4.5)	(4.5)	(4.5)	(4.5)	(4.5)	(4.5)	
2. Core inflation	2023				2024				2025				2026				4.5
	4.9 (4.8)				4.6 (4.6)				4.6 (4.5)				4.5 (4.5)				
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	
	5.1	5.2	4.7	4.5	4.7	4.5	4.7	4.7	4.6	4.6	4.5	4.5	4.5	4.6	4.5	4.5	
	(5.1)	(5.2)	(4.7)	(4.4)	(4.6)	(4.5)	(4.6)	(4.6)	(4.5)	(4.5)	(4.5)	(4.5)	(4.5)	(4.5)	(4.5)	(4.5)	

Notes

- Shaded areas indicate the forecasts of the Monetary Policy Committee.
- The figures in brackets represent the previous forecasts of the Monetary Policy Committee.

Selected forecast results (annual)

	Actual		Forecast				Steady state
	2021	2022	2023	2024	2025	2026	
1. GDP growth.....	4.7%	1.9%	0.6%	1.2%	1.3%	1.6%	2.5%
	(4.7%)	(1.9%)	(0.8%)	(1.2%)	(1.3%)	(1.6%)	
2. Output gap (ratio to potential GDP).....	-1.9%	-0.5%	-0.1%	0.0%	0.0%	0.0%	0.0%
	(-1.9%)	(-0.5%)	(0.1%)	(0.2%)	(0.2%)	(0.1%)	
3. Change in nominal effective exchange rate.....	9.9%	-2.4%	-11.7%	-0.2%	0.1%	0.4%	2.5%
	(9.9%)	(-2.4%)	(-12.0%)	(-1.0%)	(0.4%)	(0.4%)	
4. Change in real effective exchange rate.....	11.2%	-3.0%	-10.5%	2.2%	2.5%	2.9%	0.0%
	(11.2%)	(-3.0%)	(-10.9%)	(1.5%)	(2.8%)	(2.9%)	
5. Real exchange rate gap.....	5.4%	2.9%	-7.3%	-5.1%	-2.6%	0.3%	0.0%
	(5.4%)	(2.9%)	(-7.7%)	(-6.2%)	(-3.5%)	(-0.7%)	
6. Repurchase rate (end of period).....	3.61%	6.54%	8.25%	7.54%	7.29%	7.30%	7.00%
	(3.61%)	(6.54%)	(8.17%)	(7.55%)	(7.32%)	(7.30%)	
7. Neutral real interest rate.....	2.1%	2.3%	2.5%	2.7%	2.8%	2.8%	2.5%
	(2.1%)	(2.3%)	(2.5%)	(2.7%)	(2.8%)	(2.8%)	
8. Current account balance (ratio to GDP).....	3.7%	-0.5%	-1.4%	-2.8%	-3.6%	-4.0%	
	(3.7%)	(-0.5%)	(-1.3%)	(-2.6%)	(-3.5%)	(-4.0%)	

Notes

- The nominal effective exchange rate (NEER) is based on the bilateral exchange rates of South Africa's three largest trading partners (the eurozone, the US and Japan). The bilateral exchange rates are weighted by export trade weights.
- The nominal exchange rate steady state is estimated using the Purchasing Power Parity (PPP) condition, which links the depreciation of the nominal exchange rate to the inflation differential between South Africa and abroad. Given that the real effective exchange rate (REER) depreciation is zero at steady state, the nominal exchange rate will therefore depreciate by 2.5% per year in steady state, reflecting the inflation (target) differential between domestic (4.5%) and foreign (2.0%) inflation.
- The REER is the NEER deflated by the consumer price differential between South Africa and the trade-weighted CPI of the eurozone, the US and Japan.
- The real exchange rate gap signifies the extent to which the real exchange rate deviates from its estimated equilibrium level. A positive gap shows an overvaluation of the currency, and vice versa.
- The repo rate at the end of the period refers to the average for the last quarter of the year. The nominal repo rate steady state is calculated as the sum of South Africa's inflation target (4.5%) and the steady state neutral real interest rate (2.5%).
- The neutral real interest rate (NRIR) is the policy rate *minus* inflation, which prevails when the economy is fully in balance, with inflation at target and output at potential. The policy stance is measured as either tight or loose based on whether actual rates are above or below this neutral rate respectively. The steady state NRIR is calculated as the sum of the respective steady states for the G3 NRIR (0.5%), South Africa's risk premium (2.0%) and the change in the REER (0.0%). Before the steady state is reached, it is possible for the REER equilibrium to appreciate or depreciate, so this value can have a non-zero value over the medium term. It is nonetheless always zero in the long run.
- The steady state is the long-run value in the model. While model equilibriums can have different values over the medium term, as conditions change, all equilibriums eventually reach a steady state, where they stabilise.
- The forecast of the current account balance is obtained from the SARB's Core Macroeconometric Model.
- Shaded areas indicate the forecasts of the Monetary Policy Committee.
- The figures in brackets represent the previous forecasts of the Monetary Policy Committee.



Statement of the Monetary Policy Committee

27 March 2024

Issued by Lesetja Kganyago, Governor of the South African Reserve Bank,
at a meeting of the Monetary Policy Committee in Pretoria

Since the start of the year, we have seen persistent global inflation pressures. Headline inflation rates are generally lower than they were a year ago, but underlying inflation is still elevated. Goods inflation has declined significantly, as supply shocks wear off, but there is evidence of stronger inflation in services across a range of economies. Meanwhile, unemployment rates remain low, especially in the United States.

In these circumstances, major global central banks are expected to cut rates at a slower pace, and to start cutting at a later stage. A few emerging market central banks have been reducing rates already, but these economies had the largest hikes previously, and their interest rates are now well above inflation. The Monetary Policy Committee (MPC) also noted that the Bank of Japan has moved its policy rate into positive territory, increasing interest rates for the first time since 2007.

Turning to South Africa, the economy performed worse than expected in the fourth quarter of last year, expanding by just 0.1%. Growth for 2023 as a whole was 0.6%.

The main reason for this bad performance was supply-side problems. Electricity load-shedding was worse than in previous years.¹ Port and rail problems also emerged as binding constraints on output.

Our forecasts indicate a modest growth acceleration from this year as these supply-side constraints relax. In particular, we expect that the load-shedding burden will ease somewhat. And while we estimate that electricity shortages took 1.5 percentage points off gross domestic product (GDP) last year, we think this will moderate to 0.6 percentage points this year and 0.2 percentage points in 2025.

Overall, we see growth at 1.2% this year, improving to 1.6% by 2026. These projections are better than the 2023 outcome but below longer-run averages, which are around 2%.²

The risks to this growth forecast appear balanced.

Turning to inflation, South Africa had a more gradual acceleration in inflation than many of its peer countries, with a lower peak, after COVID-19. However, the return to target has been slow.

The most recent inflation numbers show yet another delay on the way back to our 4.5% objective, with headline up to 5.6% in February. This is nearer to the top of our target range than to the midpoint. Core inflation also rose, to 5.0%.

This rise in core inflation was due to an acceleration in services, led by the medical aid component. Services inflation is now at its highest since 2019. This suggests that South Africa is joining the global trend of services, rather than goods, becoming a major source of inflation.

We still see headline inflation heading back to 4.5%. However, given the extra inflation pressure, headline now reaches the target midpoint only at the end of 2025, later than previously expected. As a result, the policy rate in our baseline forecast also starts normalising later.

In assessing this forecast, the MPC noted a range of risks.

Inflation expectations have moderated in the latest survey. This is welcome, but the two-years-ahead expectations are still in the top half of our target range.³ Expectations are projected to ease towards our 4.5% objective as inflation slows, but we have little margin to absorb shocks as long as expectations are high.

Regarding food prices, we are at a difficult juncture. Last year, food inflation hit its highest levels since 2008. Food inflation has now slowed. But this is a critical time in the growing season, and it has been unusually hot and dry, which may cause food inflation to pick up again.

Considering the exchange rate, the rand has been trading somewhat weaker than we expected at our last MPC meeting. This is partly due to interest rates in the major advanced economies staying high for longer. The local currency is also under pressure from weakening terms of trade. Furthermore, investors see significant near-term domestic uncertainty. We view the exchange rate as undervalued.

On balance, the various risks to the inflation forecast are skewed to the upside.

Against this backdrop, the MPC decided to hold the repurchase rate (repo rate) unchanged at 8.25%. The decision was unanimous.

1 Load-shedding in 2023 was worse than in other years both in terms of the number of days and in terms of the volume of gigawatts shed.
2 The average growth rate for 1980–2022 was 2.1% based on the International Monetary Fund's World Economic Outlook database.
3 According to the inflation expectations survey conducted by the Bureau for Economic Research.

At this level of rates, the policy stance is considered restrictive, consistent with the inflation outlook and the need to address elevated inflation expectations.

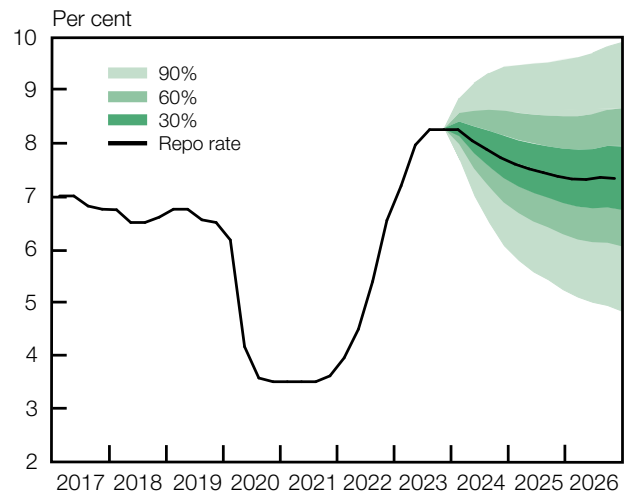
The inflation and repo rate projections from the Quarterly Projection Model remain a broad policy guide, changing from meeting to meeting in response to new data.

The MPC's decisions will continue to be data-dependent and sensitive to the balance of risks to the inflation outlook.

Stabilising inflation at the midpoint of the target band (4.5%) would improve the economic outlook and reduce borrowing costs.

Finally, we reiterate the views of the MPC on additional measures that would improve economic conditions. These include achieving a more prudent public-debt level, improving the functioning of network industries, lowering administered price inflation, and keeping real wage growth in line with productivity gains.

Repurchase rate forecast (March 2024)*



* The uncertainty bands for the repo rate are based on historical forecasting experience and stochastic simulations in the QPM. The bands are symmetric and therefore do not reflect any assessment of upside or downside risk.

Source: SARB

Summary of assumptions: Monetary Policy Committee meeting on 27 March 2024*

1. Foreign sector assumptions

	Actual			Forecast		
	2021	2022	2023	2024	2025	2026
1. Real GDP growth in South Africa's major trading-partner countries	7.4%	3.8%	2.9%	2.6%	3.0%	3.1%
	(7.3%)	(3.8%)	(2.7%)	(2.6%)	(3.1%)	(3.1%)
2. Output gap in South Africa's major trading-partner countries (ratio to potential GDP).....	-1.0%	0.1%	0.1%	-0.1%	-0.1%	0.1%
	(-0.9%)	(0.2%)	(0.1%)	(-0.2%)	(0.0%)	(0.2%)
3. Change in international commodity prices in US\$ (excluding oil).....	46.0%	-0.9%	-27.3%	-10.7%	-4.7%	-1.5%
	(46.0%)	(-0.9%)	(-27.3%)	(-11.9%)	(-4.9%)	(-1.6%)
4. Brent crude (US\$/barrel)	70.7	100.4	82.6	82.0	81.0	80.0
	(70.7)	(100.4)	(82.6)	(82.0)	(81.0)	(80.0)
5. Change in world food prices (US\$)	28.2%	15.0%	-13.7%	-1.3%	3.1%	1.5%
	(28.1%)	(14.2%)	(-13.7%)	(0.3%)	(3.1%)	(1.5%)
6. Change in international consumer prices	3.3%	7.4%	4.5%	2.5%	2.1%	2.0%
	(3.3%)	(7.4%)	(4.5%)	(2.5%)	(2.1%)	(2.0%)
7. International policy interest rate.....	0.1%	1.1%	3.9%	4.3%	3.4%	2.2%
	(0.1%)	(1.1%)	(3.9%)	(4.3%)	(3.4%)	(2.2%)

2. Domestic sector assumptions

	Actual			Forecast		
	2021	2022	2023	2024	2025	2026
1. Change in fuel taxes and levies.....	6.1%	2.9%	3.1%	5.4%	3.8%	4.0%
	(6.1%)	(2.9%)	(3.1%)	(6.4%)	(4.1%)	(3.9%)
2. Potential growth.....	3.2%	0.5%	0.1%	1.0%	1.2%	1.6%
	(3.2%)	(0.5%)	(0.1%)	(1.0%)	(1.2%)	(1.6%)
3. Inflation target midpoint.....	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%
	(4.5%)	(4.5%)	(4.5%)	(4.5%)	(4.5%)	(4.5%)

Notes

- a. Shaded areas indicate forecast assumptions.
b. The figures in brackets represent the previous assumptions of the Monetary Policy Committee.
* For an explanation of foreign sector assumptions and domestic sector assumptions, see pages 54 and 55.

Summary of selected forecast results: Monetary Policy Committee meeting on 27 March 2024

Selected forecast results (quarterly)

Year-on-year percentage change																	
	2023				2024				2025				2026				Steady state
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	
1. Headline inflation	6.0 (5.9)				5.1 (5.0)				4.6 (4.6)				4.5 (4.5)				4.5
	7.0	6.2	5.0	5.5	5.4	5.1	5.3	4.7	4.7	4.7	4.6	4.5	4.5	4.5	4.5	4.5	
	(7.0)	(6.2)	(5.0)	(5.6)	(5.3)	(5.1)	(5.1)	(4.4)	(4.7)	(4.7)	(4.5)	(4.5)	(4.5)	(4.6)	(4.5)	(4.5)	
2. Core inflation	4.8 (4.9)				4.8 (4.6)				4.6 (4.6)				4.5 (4.5)				4.5
	5.1	5.2	4.7	4.5	4.8	4.7	4.9	4.9	4.8	4.6	4.6	4.5	4.5	4.5	4.5	4.5	
	(5.1)	(5.2)	(4.7)	(4.5)	(4.7)	(4.5)	(4.7)	(4.7)	(4.6)	(4.6)	(4.5)	(4.5)	(4.5)	(4.6)	(4.5)	(4.5)	
3. Food CPI	10.7 (10.7)				5.5 (5.7)				4.3 (4.2)				4.5 (4.5)				4.5
	13.6	12.2	8.6	8.7	6.2	5.3	5.6	4.8	4.5	4.3	4.2	4.3	4.5	4.4	4.5	4.5	
	(13.6)	(12.2)	(8.6)	(8.9)	(6.9)	(6.1)	(5.4)	(4.3)	(4.3)	(4.2)	(4.2)	(4.3)	(4.4)	(4.4)	(4.5)	(4.5)	
4. Fuel CPI	0.6 (0.4)				1.4 (0.6)				0.7 (1.6)				4.5 (4.5)				4.5
	10.6	-0.2	-9.3	3.4	4.8	3.7	3.2	-5.5	-0.8	1.3	1.1	1.1	1.0	1.0	1.3	1.5	
	(10.6)	(-0.2)	(-9.3)	(2.9)	(1.7)	(3.1)	(3.4)	(-5.1)	(2.0)	(1.7)	(1.4)	(1.4)	(1.3)	(1.3)	(1.5)	(1.6)	
5. Electricity CPI	11.7 (11.7)				13.5 (13.5)				10.9 (10.9)				8.9 (8.9)				4.5
	7.9	7.9	15.2	15.3	15.3	15.3	12.0	12.0	12.0	12.0	10.0	10.0	10.0	10.0	8.0	8.0	
	(7.9)	(7.9)	(15.2)	(15.3)	(15.3)	(15.3)	(12.0)	(12.0)	(12.0)	(12.0)	(10.0)	(10.0)	(10.0)	(10.0)	(8.0)	(8.0)	

Notes

- Shaded areas indicate the forecasts of the Monetary Policy Committee.
- The figures in brackets represent the previous forecasts of the Monetary Policy Committee.



Selected forecast results (annual)

	Actual			Forecast			Steady state
	2021	2022	2023	2024	2025	2026	
1. GDP growth	4.7%	1.9%	0.6%	1.2%	1.4%	1.6%	2.5%
	(4.7%)	(1.9%)	(0.6%)	(1.2%)	(1.3%)	(1.6%)	
2. Output gap (ratio to potential GDP)	-1.9%	-0.5%	-0.1%	0.0%	0.1%	0.0%	0.0%
	(-1.9%)	(-0.5%)	(-0.1%)	(0.0%)	(0.0%)	(0.0%)	
3. Nominal effective exchange rate	9.9%	-2.4%	-11.5%	-1.6%	0.7%	0.9%	2.5%
	(9.9%)	(-2.4%)	(-11.7%)	(-0.2%)	(0.1%)	(0.4%)	
4. Real effective exchange rate	11.2%	-3.0%	-10.3%	0.9%	3.2%	3.4%	0.0%
	(11.2%)	(-3.0%)	(-10.5%)	(2.2%)	(2.5%)	(2.9%)	
5. Repurchase rate (end of period, i.e. the fourth quarter)	3.61%	6.54%	8.25%	7.72%	7.37%	7.33%	7.0%
	(3.61%)	(6.54%)	(8.25%)	(7.54%)	(7.29%)	(7.30%)	
6. Neutral real interest rate	2.2%	2.3%	2.5	2.6%	2.7%	2.8%	2.5%
	(2.1%)	(2.3%)	(2.5%)	(2.7%)	(2.8%)	(2.8%)	
7. Current account balance (ratio to GDP)	3.7%	-0.5%	-1.6%	-2.1%	-2.7%	-3.3%	
	(3.7%)	(-0.5%)	(-1.4%)	(-2.8%)	(-3.6%)	(-4.0%)	

Notes

- The nominal effective exchange rate (NEER) is based on the bilateral exchange rates of South Africa's three largest trading partners (the eurozone, the US and Japan). The bilateral exchange rates are weighted by export trade weights.
- The nominal exchange rate steady state is estimated using the Purchasing Power Parity (PPP) condition, which links the depreciation of the nominal exchange rate to the inflation differential between South Africa and abroad. Given that the real effective exchange rate (REER) depreciation is zero at steady state, the nominal exchange rate will therefore depreciate by 2.5% per year in steady state, reflecting the inflation (target) differential between domestic (4.5%) and foreign (2.0%) inflation.
- The REER is the NEER deflated by the consumer price differential between South Africa and the trade-weighted CPI of the eurozone, the US and Japan.
- The real exchange rate gap signifies the extent to which the real exchange rate deviates from its estimated equilibrium level. A positive gap shows an overvaluation of the currency, and vice versa.
- The repo rate at the end of the period refers to the average for the last quarter of the year. The nominal repo rate steady state is calculated as the sum of South Africa's inflation target (4.5%) and the steady state neutral real interest rate (2.5%).
- The neutral real interest rate (NRIR) is the policy rate *minus* inflation, which prevails when the economy is fully in balance, with inflation at target and output at potential. The policy stance is measured as either tight or loose based on whether actual rates are above or below this neutral rate respectively. The steady state NRIR is calculated as the sum of the respective steady states for the G3 NRIR (0.5%), South Africa's risk premium (2.0%) and the change in the REER (0.0%). Before the steady state is reached, it is possible for the REER equilibrium to appreciate or depreciate, so this value can have a non-zero value over the medium term. It is nonetheless always zero in the long run.
- The steady state is the long-run value in the model. While model equilibriums can have different values over the medium term, as conditions change, all equilibriums eventually reach a steady state, where they stabilise.
- The forecast of the current account balance is obtained from the SARB's Core Macroeconometric Model.
- Shaded areas indicate the forecasts of the Monetary Policy Committee.
- The figures in brackets represent the previous forecasts of the Monetary Policy Committee.

Foreign sector assumptions

1. **Trading-partner gross domestic product (GDP) growth** is broadly determined using the Global Projection Model (GPM), which is adjusted to aggregate the GDP growth rates of South Africa's major trading partners on a trade-weighted basis. Individual projections are done for the six largest trading partners, namely the eurozone, the United States (US), the United Kingdom (UK), Japan, China and India. Other countries considered, although with small weights, are Brazil, Mexico and Russia. The remaining trading partners are grouped into the 'Rest of Countries' bloc. Since sub-Saharan Africa is also a major trading region for South Africa (but does not have a bloc in the GPM), it is modelled separately and then combined with the aggregate of all the countries in the GPM to make up total trading-partner growth.
2. As with GDP growth, the **output gap** is determined using the GPM and is adjusted in a similar way. The output gap is driven by a combination of country-specific domestic factors, external factors and financial-real linkages (beyond interest rate and exchange rate effects). Domestic factors include expectations of future demand and medium-term interest rates. External factors include exchange rate impacts on demand, direct spillovers through trade with trading-partner countries and foreign demand.
3. The **commodity price index** is a weighted aggregate price index of the major South African export commodities.
4. The **Brent crude oil price** is expressed in US dollars per barrel. The assumption incorporates supply and demand dynamics as well as oil inventories (of all grades). The assumption is also informed by projections from the US Energy Information Administration, the Organization of the Petroleum Exporting Countries (OPEC) and Reuters.
5. **World food prices** is the composite food price index of the United Nations (UN) Food and Agriculture Organization (FAO) in US dollars. It is weighted using average export shares and represents the monthly change in the international prices of a basket of five food commodity price indices (cereals, vegetable oil, dairy, meat and sugar). World food price prospects incorporate selected global institution forecasts for food prices and imbalances from the anticipated trend in international food supplies relative to expected food demand pressures.
6. **International consumer prices** are also broadly determined using the GPM. The index is an aggregate of the consumer price indices of the eurozone, the US and Japan, weighted by their relative trade shares. Consumer prices are determined for each of these economies by accounting for inflation expectations, demand pressures and pass-through from changes in the relevant exchange rate. Other institutional forecasts for international consumer prices are also considered.
7. **International policy interest rates** are again broadly determined using the GPM. Interest rates are a weighted average of the policy rates of the eurozone, the US and Japan. They are individually determined by a 'Taylor-type' monetary policy rule. The communications of the relevant central banks and other institutional forecasts are also considered.



Domestic sector assumptions

1. The **electricity price** is an administered price measured at the municipal level with a weight of 3.63% in the headline consumer price index (CPI) basket. Electricity price adjustments generally take place in the months of July and August of each year, and the assumed pace of increase over the forecast period reflects the multi-year price determination agreement between Eskom and the National Energy Regulator of South Africa (NERSA), with a slight adjustment for measurement at the municipal level.
2. **Fuel taxes and levies** are the total domestic taxes and costs included in the price of fuel paid at the pump. They include the Road Accident Fund (RAF) levy, the fuel levy, retail and wholesale margins, the slate levy and other minor levies. The two major taxes, which are set by the Minister of Finance in the annual national budget, are the RAF levy and the fuel levy. The income generated by the RAF levy is utilised to compensate third-party victims of motor vehicle accidents, while the fuel levy is used to provide funding for road infrastructure.
3. **Potential growth** is derived from the South African Reserve Bank's (SARB) semi-structural potential output model. The measurement accounts for the impact of the financial cycle on real economic activity, and introduces economic structure via the relationship between potential output and capacity utilisation in the manufacturing sector (*SARB Working Paper Series No. WP/18/02*).
4. The **midpoint of the inflation target range** is 4.5%. The official inflation target range is 3–6%.
5. The **neutral real interest rate (NRIR)** is the interest rate consistent with stable inflation and output in line with the economy's potential. This variable is the basis for judging whether a given policy stance is expansionary, contractionary or neutral.

Glossary

Advanced economies: Advanced economies are countries with high gross domestic product (GDP) per capita, diversified exports and close integration into the global financial system.

Balance of payments: This is a record of transactions between the home country and the rest of the world over a specific period of time. It includes the current and financial accounts. See also 'Current account' below.

Brent crude: Brent crude is a light and sweet blend of oil from five different fields in the North Sea. The price of Brent crude is one of the benchmark oil prices in international markets.

Budget deficit: A budget deficit indicates the extent to which government expenditure exceeds government revenue.

Business and consumer confidence: These are economic indicators that measure the level of optimism about the economy and its prospects among business managers and consumers.

Commodities: Commodities can refer to energy, agriculture, metals and minerals. Major South African-produced commodities include platinum and gold.

Consumer price index (CPI): The CPI provides an indication of aggregate price changes in the domestic economy. The index is calculated using a number of categories forming a representative set of goods and services bought by consumers.

Core inflation: Core generally refers to underlying inflation, excluding the volatile elements (e.g. food and energy prices). The SARB's forecasts and discussions refer to headline CPI excluding food, non-alcoholic beverages (NAB), fuel and electricity prices.

Crude oil price: This is the United States (US) dollar price per barrel of unrefined oil. See also 'Brent crude' above.

Current account: The current account of the balance of payments consists of net exports (exports less imports) in the trade account as well as the services, income and current transfers.

Emerging markets: Emerging markets are countries with low to middle income per capita. They are advancing rapidly and are integrating with global (product and capital) markets.

Exchange rate depreciation (appreciation): Exchange rate depreciation (appreciation) refers to a decrease (increase) in the value of a currency relative to another currency.

Exchange rate pass-through: This is the effect of exchange rate changes on domestic inflation (i.e. the percentage change in domestic CPI due to a change in the exchange rate). Changes in the exchange rate affect import prices, which in turn affect domestic consumer prices and inflation.

Forecast horizon: This is the future period over which the SARB generates its forecasts, typically between two and three years.

Gross domestic product (GDP): GDP is the total market value of all the goods and services produced in a country. It includes total consumption expenditure, capital formation, government consumption expenditure and the value of exports less the value of imports.

Gross fixed capital formation (investment): The value of acquisitions of capital goods (e.g. machinery, equipment and buildings) by firms, adjusted for disposals, constitutes gross fixed capital formation.

Headline consumer price index (CPI): Headline CPI refers to CPI for all urban areas, as measured on a monthly basis by Statistics South Africa (Stats SA). Headline CPI is a measure of price levels in all urban areas. The 12-month percentage change in headline CPI is referred to as 'headline CPI inflation' and reflects changes in the cost of living. This is the official inflation measure for South Africa.

Household consumption: This is the amount of money spent by households on consumer goods and services.

Inflation (growth) outlook: This outlook refers to the evolution of future inflation (growth) over the forecast horizon.

Inflation targeting: This is a monetary policy framework used by central banks to steer actual inflation towards an inflation target level or range.

The monetary base (M0): Comprises total banknotes and coin in issue and in circulation outside of the South African Reserve Bank (SARB), net of issuance and removal from circulation, plus banks' required cash reserves as well as their excess cash reserves and other deposits at the SARB in rand

Monetary policy normalisation: This refers to the unwinding of an unusually accommodative monetary policy. It could also mean adjusting the economy's policy rate towards its real neutral policy rate.

Neutral real interest rate (NRIR): The NRIR is the level at which the real interest rate will settle once the output gap is closed and inflation is stable.

Nominal effective exchange rate (NEER): The NEER is an index that expresses the value of a country's currency relative to a basket of other (trading-partner) currencies. An increase (decrease) in the NEER indicates a strengthening (weakening) of the domestic currency with respect to the selected basket of currencies. The weighted average exchange rate of the rand is calculated against 20 currencies. The weights of the five major currencies are as follows: the euro (30.68%), the Chinese yuan (24.53%), the US dollar (10.56%), the Japanese yen (4.95%) and the Indian rupee (4.85%). Index: 2015 = 100. See also 'Real effective exchange rate' below.



Output gap/potential growth: Potential growth is the rate of GDP growth that could theoretically be achieved if all the productive assets in the economy were employed in a stable inflation environment. The output gap is the difference between actual growth and potential growth, which accumulates over time. If this is negative, then the economy is viewed to be underperforming and demand pressures on inflation are low. If the output gap is positive, the economy is viewed to be overheating and demand pressures are inflationary.

Policy rate: A policy rate is the interest rate used by a central bank to implement monetary policy.

Productivity: Productivity indicates the amount of goods and services produced in relation to the resources utilised in the form of labour and capital.

Real effective exchange rate (REER): The REER is the NEER adjusted for inflation differentials between South Africa and its main trading partners. See also 'Nominal effective exchange rate' above.

Repurchase (repo) rate: This is the policy rate that is set by the Monetary Policy Committee (MPC). It is the rate that commercial banks pay to borrow money from the SARB.

Real repo rate: This is the nominal repo rate, as set by the MPC, adjusted for expected inflation.

Terms of trade: This refers to the ratio of export prices to import prices.

Unit labour cost (ULC): A ULC is the labour cost to produce one 'unit' of output. This is calculated as the total wages and salaries in the non-agricultural sector divided by the real value added at basic prices in the non-agricultural sector of the economy.

Abbreviations

AI	artificial intelligence
BER	Bureau for Economic Research
BFP	basic fuel price
BIS	Bank for International Settlements
BoE	Bank of England
CODI	Corporation for Deposit Insurance
COICOP	classification of individual consumption by purpose
CNY	Chinese Yuan
CPI	consumer price index
EAF	energy availability factor
ECB	European Central Bank
<i>EN</i>	<i>Economic Note</i>
ETP	electronic trading platform
FAO	Food and Agriculture Organization (United Nations)
Fed	Federal Reserve (United States)
FOMC	Federal Open Market Committee
FRA	forward rate agreement
FX	foreign exchange
G3	Group of Three
GDP	gross domestic product
GFCF	gross fixed capital formation
GFECRA	Gold and Foreign Exchange Contingency Reserve Account
GPM	Global projection model
GW	gigawatt
Haver	Haver analytics
IMF	International Monetary Fund
Jibar	Johannesburg Interbank Average Rate
M0	base money
MPC	Monetary Policy Committee (South African Reserve Bank)
<i>MPR</i>	<i>Monetary Policy Review</i>
<i>MTBPS</i>	<i>Medium Term Budget Policy Statement</i>
MW	megawatt
NAB	non-alcoholic beverages
NEER	nominal effective exchange rate
NERSA	National Energy Regulator of South Africa
NWU	North-West University
<i>OBEN</i>	<i>Occasional Bulletin of Economic Notes</i>
OPEC	Organization of the Petroleum Exporting Countries
PCE	Personal consumption expenditure
PCCI	persistent and common component of inflation
PGM	platinum group metal
PMI	Purchasing Managers' Index
PPP	purchasing power parity



RAF	Road Accident Fund
REER	real effective exchange rate
repo (rate)	repurchase (rate)
RMSE	root mean square error
r-star	long-run real neutral interest rate
SA	South Africa
SAGB	South African government bond
SALDRU	Southern Africa Labour and Development Research Unit
SARB	South African Reserve Bank
SIT (account)	services, income and transfer (account)
S&P	Standard & Poor's
SSA	sub-Saharan Africa
Stats SA	Statistics South Africa
TEU	twenty-foot equivalent unit
UK	United Kingdom
ULC	unit labour cost
UN	United Nations
US	United States
WEO	World Economic Outlook
WGBI	World Government Bond Index
WP	<i>Working Paper</i>
YTD	year to date