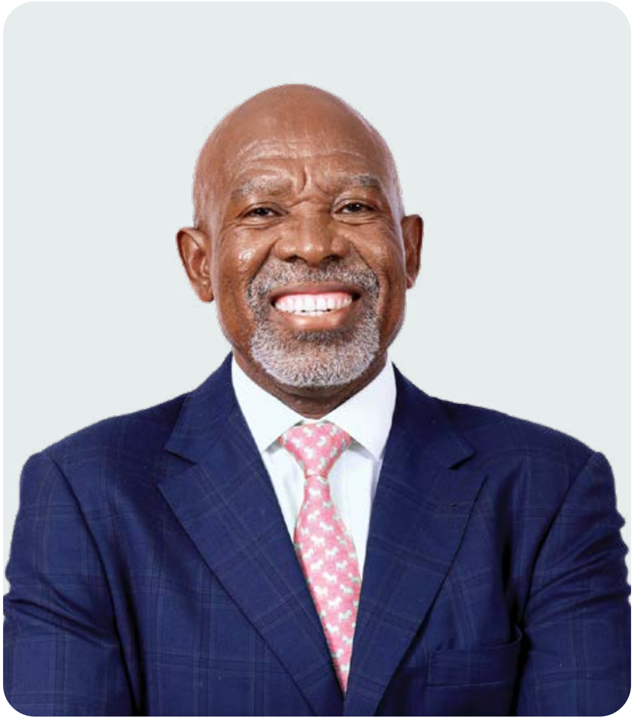
Governor's message

With inflation having been above 4.5% since May 2021, it is important that we rebuild confidence in our ability to achieve our target



Economic overview

Reflecting on the past year, global conditions remain strained and inflation has been higher than expected. Interest rates have likewise stayed high and the dollar remains strong, to the detriment of most other currencies including the rand. Geopolitical tensions have intensified, with conflict spreading in the Middle East. These are difficult circumstances for South Africa and other emerging markets.

The past year has also featured serious domestic challenges. Last year's electricity load-shedding was the worst on record. We also saw major disruptions to port and rail infrastructure. In these circumstances, the economy grew just 0.6%, one of the slowest growth rates in our modern history.

The labour market data show we have more jobs now than we did before the onset of COVID-19. Nonetheless, the unemployment rate in May 2024 is at 32.9%, compared to 28.7% in 2019 and 25.1% in 2014. This reflects an economy that is not absorbing a growing workforce.

We expect inflation to average

5.1%

this year, before stabilising at 4.5% in the second quarter of 2025.

Weak domestic growth, alongside high unemployment, has nonetheless not translated into markedly lower inflation. Headline inflation returned to our target range of 3–6% in June 2023, but has since then been stuck in the top half of that range, making no clear progress towards our 4.5% midpoint objective.

The food and fuel price shocks of 2022 and 2023 have largely passed, but we now confront higher core inflation, with services prices currently accelerating – a trend also reported for many other economies. This points to underlying inflationary pressures. We expect inflation to average 5.1% this year, before stabilising at 4.5% in the second quarter of 2025.

To achieve our target, the MPC has been holding rates at 8.25%, a level we consider restrictive. The forecast from our Quarterly Projection Model shows the policy rate easing this year, moving back towards 'normal' levels as inflation slows. The upside risks to this forecast, however, are prompting the MPC to keep rates on hold. These risks include persistently elevated rates from advanced economy central banks, especially the US Federal Reserve; higher and less stable inflation expectations; and new fuel and food price pressures.

With inflation having been above 4.5% since May 2021, it is important that we rebuild confidence in our ability to achieve our target. Looking back, South Africa's inflation performance has been relatively benign. We did not experience inflation rates as high as those in major advanced economies (for instance, US inflation peaked at 9.1%, compared with a South African peak at 7.8%). We have also not suffered double-digit inflation increases, in contrast to many of our emerging market peers.

However, our comparative performance has begun to deteriorate recently. In 2022, relative to the other Group of Twenty (G20) countries, we were right in the middle of the pack, ranking 10th. Last year we had the fourth highest rate of inflation in the G20, below only Turkey, Argentina and Russia – all countries with much more adverse monetary dynamics. International Monetary Fund (IMF) projections show we will slip to third-worst G20 country from 2026, leaving us ahead of only Argentina and Turkey. For all the pride we take in our monetary policy, at the SARB this is not much to boast about.

A fundamental part of the problem is our relatively high inflation target. South Africa has a mature inflation targeting regime, with the framework having been in place for nearly a quarter-century now. But we are the rare country that has never reformed the target. Going back to the establishment of inflation targeting in 2000, it was never our intention to keep the 3–6% range forever. Indeed, there was an announced reduction of the target, to 3–5%, which was unfortunately abandoned following the 2001 rand sell-off. This was a policy mistake and thus left us with unfinished business.

An inflation target of 3–6%, even where that is interpreted as an objective of 4.5%, is high relative to our peers. This affects our competitiveness. It also means a bad user experience for our people. An inflation rate around 4.5% forces everyone to adjust prices, wages and investments routinely to avoid losing buying power. Furthermore, not everyone has the knowledge or power to make these changes, so vulnerable people often fall behind as their incomes decline. A relatively high target also means that the rand will follow a weakening trend, always losing ground to currencies that hold their value better. As the *Macroeconomic Review* published by National Treasury in February 2024 argued, it is important to reconsider the target. South Africa can and should have lower inflation.

SARB leadership

While the SARB must face these challenges head on, it can now do so with a full complement of governors after Dr Mampho Modise joined us as a Deputy Governor in April. The terms of Deputy Governors Nomfundo Tshazibana and Rashad Cassim have also been renewed, as has my term. This ensures policy continuity at the SARB. I am grateful for the strong team of Deputy Governors at my side.

I would also like to thank Kuben Naidoo for the long and exemplary service he has given his country, in various policy roles, including his time as a SARB Deputy Governor. He has undoubtedly served the country in stellar fashion – with commitment and dedication.

We have also appointed Dr David Fowkes as the sixth member of the MPC which further bolsters our efforts to effectively execute our mandate of price stability.

SARB balance sheet developments

The SARB is undertaking important changes to its balance sheet, built around new arrangements governing the GFECRA. The new GFECRA framework, announced in February 2024, will provide the SARB with a stronger capital position. It will also allow the government to access some of the funds, which will be used to reduce borrowing. There will be no reduction of gold and FX reserves.

The previous GFECRA arrangements meant this account was likely to grow indefinitely, with gains or losses delivering little benefit for either the government or the SARB. We expect that the new framework will achieve better outcomes, through a rules-based system for GFECRA distributions. The new arrangements require certain legal processes to be completed, with most of the funds expected to flow in the second half of 2024.

Financial stability and prudential regulation

South Africa's financial system remains resilient. Through prudent management and regulation, financial institutions have generally avoided reckless credit extension and maintained adequate capital buffers. The financial system continues to be a source of strength for the economy, rather than a vulnerability.

A significant milestone for the year was the establishment of CODI in March 2023, with deposit insurance in place from April this year. South Africa has long been providing most depositors with implicit deposit protection, so they have not suffered significant losses such as in cases like the VBS Mutual Bank curatorship where 98% of depositors were covered. CODI provides explicit deposit insurance, funded by a levy on banks, to insure qualifying deposits up to R100 000. A deposit insurance scheme is global best practice and it is a welcome development that CODI is finally up and running.

We continue with the urgent work to remove South Africa from the Financial Action Task Force (FATF) greylist. National Treasury is leading a multi-agency effort to ensure South Africa addresses all the shortcomings highlighted by the FATF by the 2025 review period. The SARB is playing an important supporting role in this effort and many of the action items have already been largely or wholly addressed.

Finally, the Financial Stability Committee (FSC) has decided on an adjustment to bank capital buffers (specifically the countercyclical capital buffer, the CCyB). It will be phased in over 12 months. This will allow the SARB to provide regulatory relief to banks during financial downswings.

Payments

The SARB manages the national payment system. To make payments cheaper, faster and more reliable, we have embarked on a wide-ranging Payments Ecosystem Modernisation programme. This covers the renewal of the South African Multiple Option Settlement (SAMOS) system, faster payment capabilities and a new centralised public payments utility. These modernisation efforts will require the development of a digital financial identity for consumers, with a pilot expected to begin in June this year.

We also continue to invest in maintaining the existing SAMOS and regional Southern African Development Community real-time gross settlement (SADC-RTGS) system environments to ensure that these systems continue to serve the industry efficiently. This will include the move to the new global financial messaging standard ISO 20022 for the SADC region in June 2024.

Outreach

With the COVID disruptions behind us, the SARB has now resumed in-person outreach initiatives. These activities include our monetary policy and financial stability forums, our countrywide 'Talk to the SARB' events, and our popular MPC Schools Challenge. Employee volunteerism has also resumed, with staff giving their time at four schools for students with special learning needs.

Strategy

The SARB is heading into the final year of our five-year strategy cycle. This provides an opportunity to reflect on progress and consider how best we can position ourselves for the next five years. Accordingly, the work to plot out our Strategy 2030, under the auspices of a Strategy Deep Dive, is now underway.

Over the past year, we have achieved three of our five strategic focus areas (SFAs), while the remaining two SFAs have been partly achieved. Global and domestic economic conditions have once again impacted the achievement of SFA 1, with headline inflation still above the 4.5% midpoint, even though inflation moved back within the 3–6% target range during the year. Meanwhile, for SFA 4, the indicators for external resilience still show some shortcomings.

International commitments

Over the past year, South Africa hosted the BRICS Finance Ministers and Central Bank Governors meeting and co-chaired the BRICS Finance Track. Next year, South Africa will host the G20 and work is already underway to prepare for this global event. The G20 presidency is a prestigious role but it also comes with challenges. Given divergent views on geopolitical issues, the 2023 meetings ended without a formal communiqué. We hope we will be able to achieve progress on the many shared interests, especially on the Finance Track.

I am pleased with the steady progress of the Financial Stability Board (FSB) in implementing the G20 Roadmap to enhance cross-border payments. As co-chair of the Cross-border Payment Coordination Group, we aim to improve efficiencies in cross-border payments dealing with high costs, slow speed and limited access and transparency. We hope this will drive economic growth, investment and trade in Africa. This work has also been a focal point of the FSB's Regional Consultative Groups (RCGs) for sub-Saharan Africa which I also co-chair. We have been hard at work to expand our efforts beyond the membership of the G20, focusing on global and regional financial stability, an increase in sovereign indebtedness and the implications of the FSB's work programme for the respective regions.

Our people

Over the past year we continued our diversity and inclusion (D&I) journey in the quest to ensure that every employee in the SARB has a sense of purpose and belonging. We completed another crucial phase of the D&I journey and are now in the process of embedding the principles of the programme. It is only by doing that we learn; enablement and coaching will take us a step further in incorporating the D&I principles into our daily behaviour.

To improve our staff experience, in line with digital transformation, we have implemented a cloud-based human resource solution. Our Ways of Work programme has fully socialised the hybrid work principles; these practices have been fully rolled out in a way that allows us to continue meeting our commitments to the South African public.

Conclusion

These are without a doubt challenging times for South Africa and for the rest of the world. There are protracted conflicts underway in a number of regions; geopolitical fractures are spreading; extreme weather patterns are a stark reminder of the impact of climate change; global inflation is still elevated; and global interest rates are remaining high for longer.

The domestic economy faces chronic challenges of high unemployment and low growth, driven mainly by supply-side problems such as load-shedding and other infrastructural gaps. At the same time, there is a silver lining that some of South Africa's strengths are beginning to take shape.

There are serious efforts underway to stabilise government debt and raise growth, for instance by transforming the power sector. These projects are crucial to the future of this country. After many years of disappointing economic performance and fiscal outcomes, many have adapted to stagnation and rising indebtedness. There are real prospects of a turnaround.

Throughout this challenging period, the SARB has maintained its independence, fulfilled its mandates and remained a credible institution. We are accountable to the people of South Africa and will from time to time face criticism, which is normal in a democratic society like ours.

Still, I am often reminded in engagements both at home and abroad, that the SARB is the cornerstone of South Africa's macroeconomic stability. At a time of acute global stress, good central banking is also the leading explanation for why most middle-income countries, like South Africa, have not fallen into deep crises. We have spent many years constructing an independent, credible central bank, and this effort is paying off.

The Board, Deputy Governors and staff of the SARB have much to be proud of, and I am grateful to them all for the dedication, energy and talent they display in carrying out their duties. Public service is about doing something bigger than yourself, and we all feel proud of what we do for the people of South Africa.

E L (Lesetja) Kganyago
Governor of the SARB