Monetary policy in a world of high inflation

Stubborn inflation: Global policy rates to remain 'high for longer'

Overview of the world economy

Despite moderating from 8.7% in 2022 to 6.8% over the past year, global inflation remains high relative to the inflation targets of 2–3% that many advanced and emerging markets are trying to achieve. While monetary policy around the world has tightened and supply chains heavily impacted by the pandemic recovered, the return to inflation targets is not yet assured. Price inflation remains stubbornly elevated as reflected in the repeated setbacks that many countries, including South Africa, have experienced in recent months.

Slowing global disinflation is mainly due to inertia in core inflation, with goods price inflation high through 2023 and services price inflation sticky due to pent up demand. In emerging market economies, currency depreciation has often further delayed disinflation.

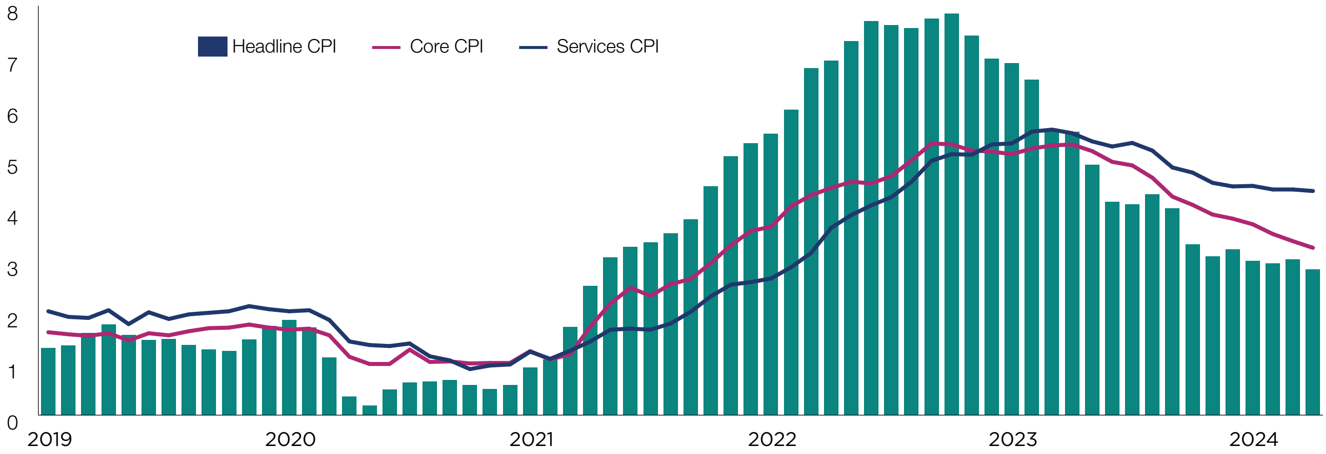
The stubbornness in inflation also reflects stronger-than-expected and sustained fiscal policy support. Inflation, and to some extent global growth at 3.2%, surprised on the upside over the past year despite high interest rates. Performance, however, varied across countries. The United States (US) outperformed its peer advanced economies. Robust growth was evident in India, while growth in China appeared to falter amid a real estate sector crisis and weak domestic demand.

Growth levels in many economies, however, still remain below pre-pandemic trends and are expected to start rising again from next year. Weaker commodities prices have impacted negatively on commodity exporting economies. The SARB projects trading-partner growth to soften this year to 2.6% (from 2.9% the previous year), before recovering to 3.1% by 2026.

Returning to the fight against inflation, restrictive monetary policy has helped moderate credit demand and signalled central banks' commitment to getting inflation back to targets. However, the apparent resilience in economic activity despite 'tight' monetary policy suggests that the neutral real interest rate may have shifted higher, raising questions regarding the current calibration of monetary policy in many jurisdictions. For many emerging markets there is the additional hurdle of currency depreciations that may add to further disinflation, implying possibly high interest rates overall.

Inflation in advanced economies

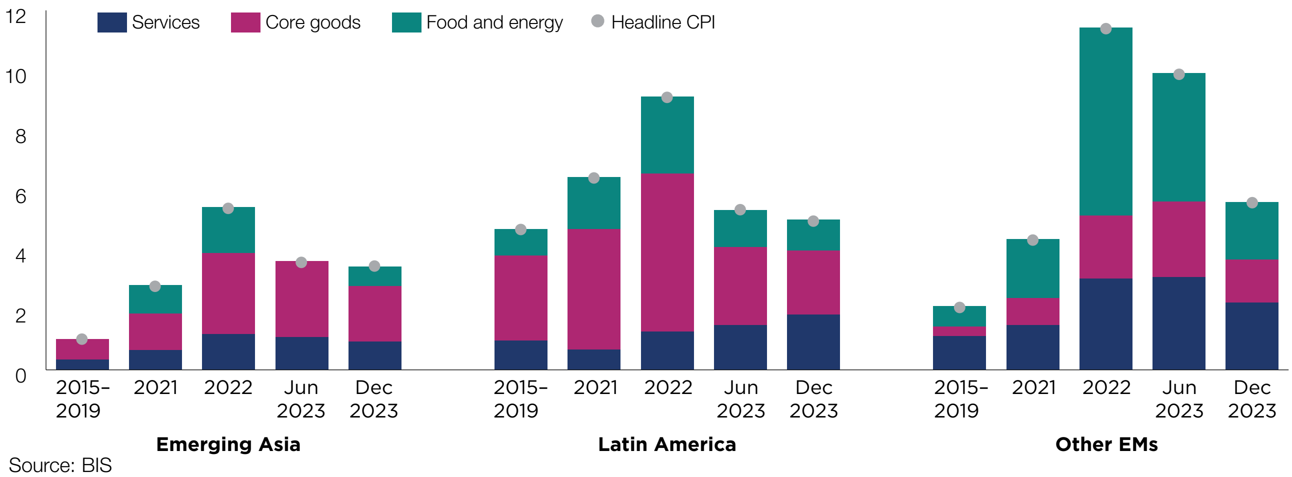
Percentage change over 12 months



Source: Haver

Contributions to headline inflation in emerging markets

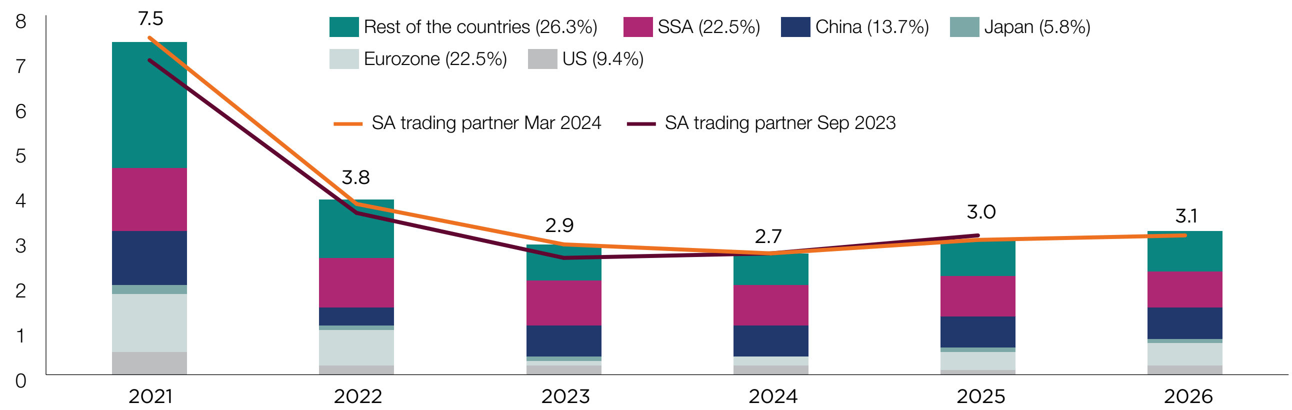
Percentage points



Source: BIS

Contribution to global growth*

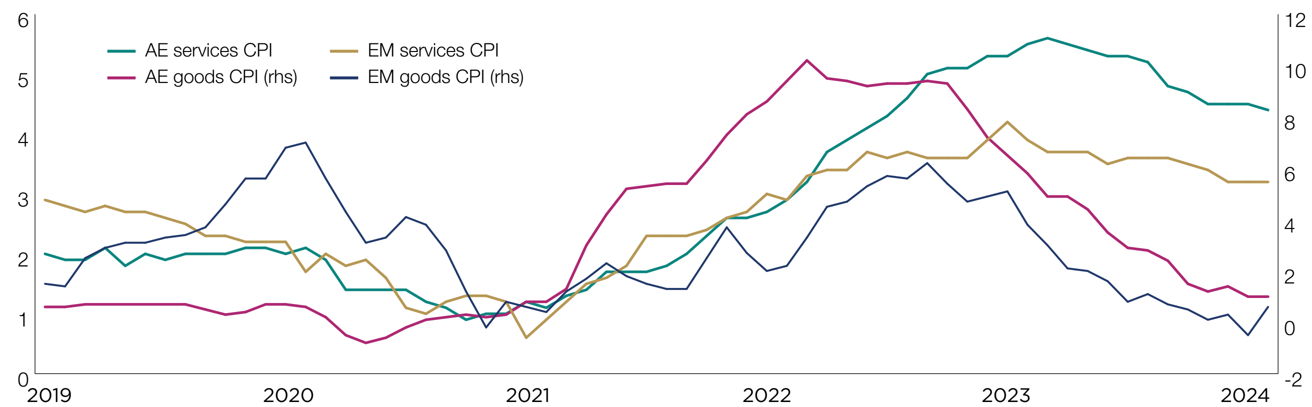
Per cent



* Weights in brackets | Source: SARB

Goods and services inflation

Percentage change over 12 months



Sources: Haver and SARB

Domestic real economy developments

Gross domestic product (GDP) growth more than halved to 0.6% in 2023, from 1.9% in 2022, as load-shedding and logistical challenges weighed on the economy. When measured against a growing population and labour force, this is a very poor outcome.

The primary sector detracted the most from GDP growth this past year, with agriculture declining by 12.2% despite favourable weather conditions and good harvests. Both load-shedding and logistical bottlenecks impacted the sector markedly, along with foot and mouth and Avian flu diseases.

In addition to supply constraints, support from the demand side was subdued as household spending and investment growth slowed in the latter half of 2023. Commodity export prices also continued to retreat from their pandemic highs, reducing the contribution of foreign demand to domestic economic activity.

Employment growth, however, remained relatively strong in 2023, finally surpassing the jobs level that existed prior to the pandemic.[1] Nevertheless, with a larger labour force, the unemployment rate remains elevated at 32.9% in the first quarter of this year.

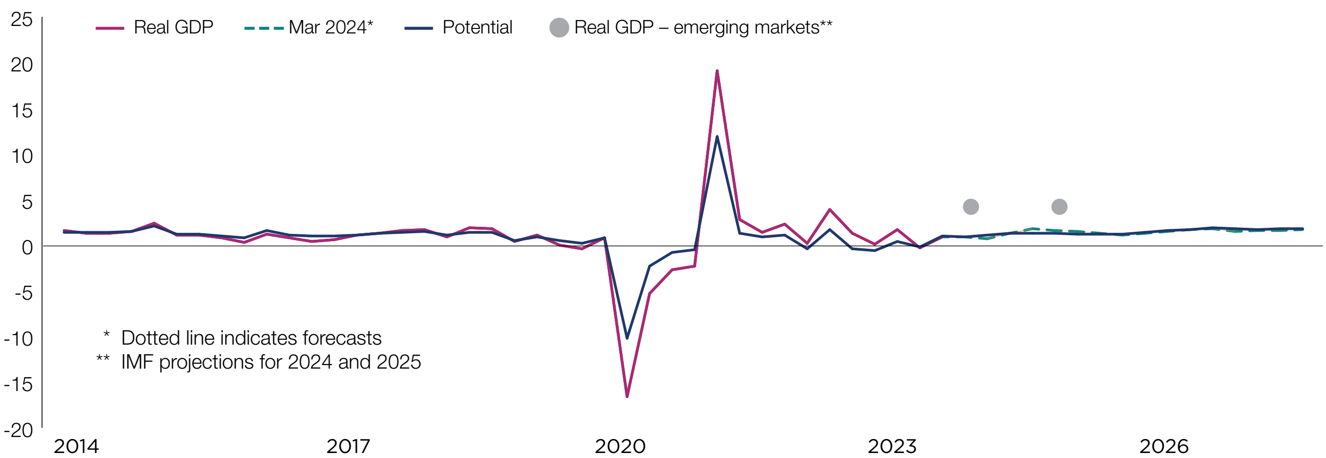
Lower commodity export receipts, combined with muted economic growth, will weigh on the fiscus, underscoring the importance of government's fiscal consolidation. Encouragingly, government managed to achieve a small primary surplus in the 2023/24 fiscal year – the first in 15 years.

Looking ahead, the domestic economy is expected to grow by 1.2% this year, rising to 1.6% by 2026. Consumption spending will be bolstered by declining inflation and the boost to real income from the two-pot pension reform. At the same time, electricity supply is also projected to improve, underpinned by the ongoing private investment in renewable-energy generation and increased maintenance by Eskom.

Meanwhile, the combination of weaker exports, improved investment and low savings rates, is expected to increase the demand for foreign savings, as reflected in a current account balance forecast that deteriorates to -3.1% of GDP by 2026, from -1.9% of GDP in 2024.

GDP

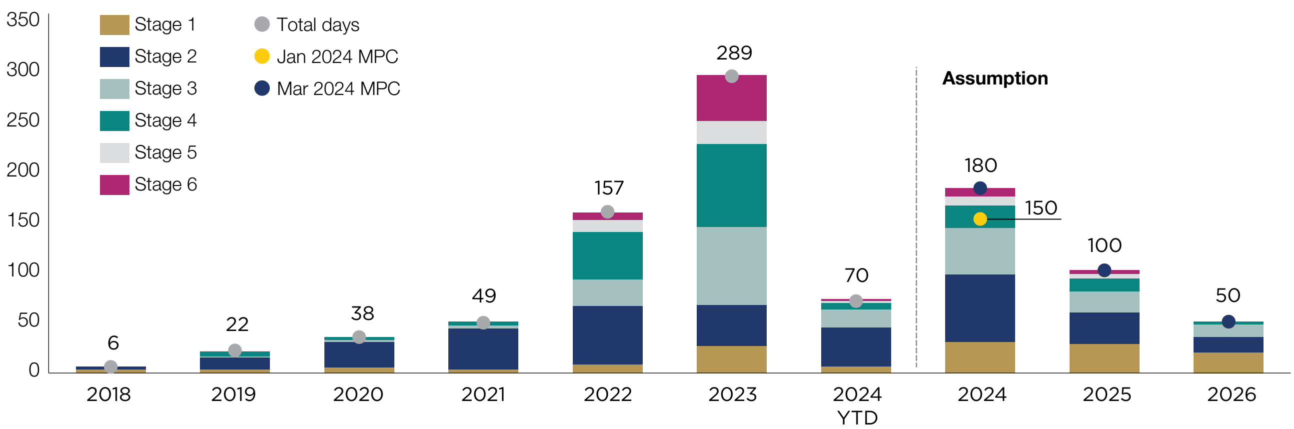
Percentage change over four quarters



Sources: IMF, Stats SA and SARB

Frequency of load-shedding

Number of days*



* Calculated as total hours of load-shedding/24.
Sources: ESP app, Eskom X account and SARB

1. Based on non-seasonally adjusted data from Stats SA.

Inflation dynamics

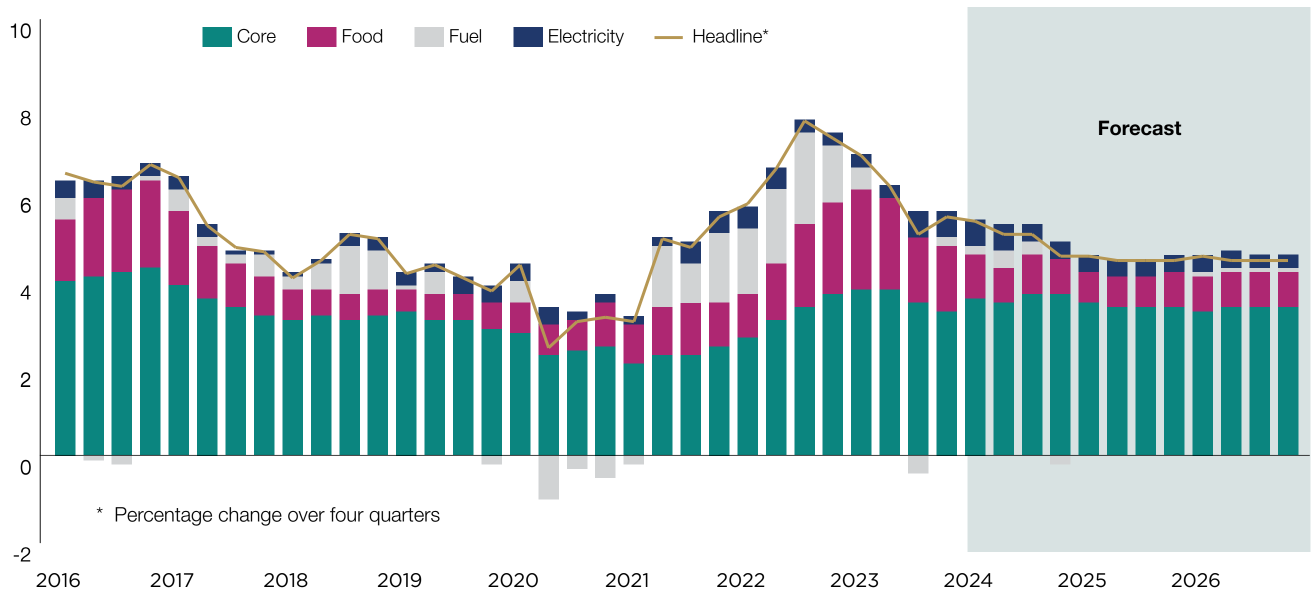
In line with the global trend, South Africa's headline inflation decelerated over the past year and averaged 6.0% in 2023, down from 6.9% in 2022. Since September 2023, however, headline inflation has fluctuated in the 5–6% range, with monthly setbacks amid slower-than-expected disinflation in food and volatility in fuel prices.[2]

Core inflation jumped 0.4 percentage points to 5.0% in February 2024 as services inflation gained momentum, but has softened somewhat since then. Core inflation is forecast to average 4.7% this year (4.8% in 2023), and to slowly revert to the target midpoint over the medium term, reflecting the normalisation of some components such as housing and medical insurance inflation.

Headline inflation is projected to be lower at 5.1% this year. However, its return to the target midpoint is only expected in the second quarter of 2025, with the slower reversion reflecting the above-mentioned core inflation pressures and elevated administered price inflation.

Contributions to headline inflation

Percentage points



Sources: Stats SA and SARB

2. Inflation moderated to 5.1% in December 2023 from 5.9% in October, before accelerating to 5.6% in February 2024.

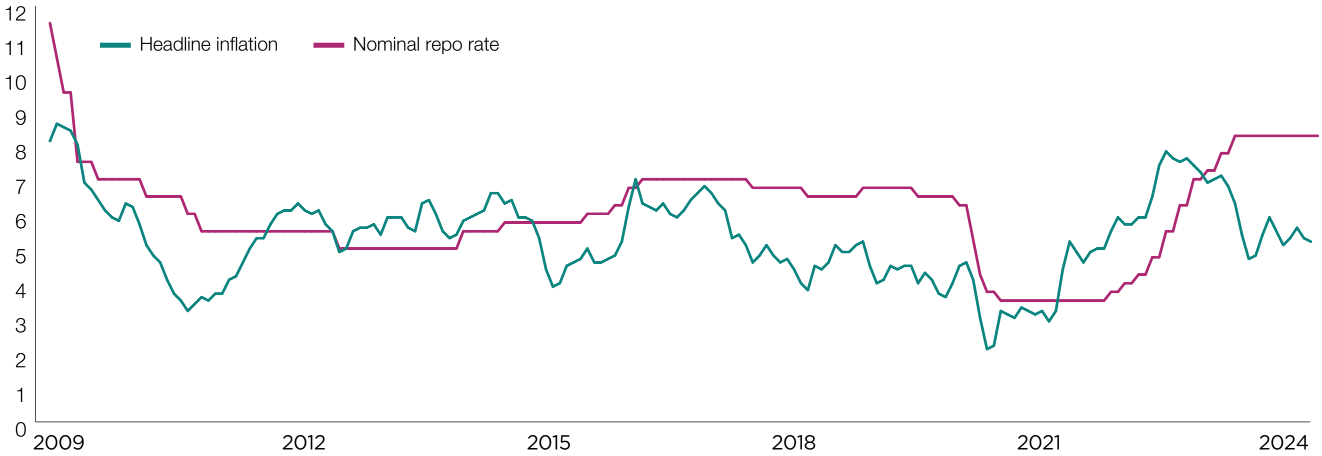
Monetary policy decisions

The MPC has kept the repurchase (repo) rate unchanged at 8.25% over the past six MPC meetings. The repo rate was last changed in May 2023 when it was raised by 50 basis points and is currently judged to be moderately restrictive.

Despite the tighter policy stance, headline inflation has remained above the target midpoint for 36 consecutive months and inflation expectations persist above 5.0%. The expectations of future inflation need to be better anchored at the midpoint of the target band, an effort that should be achieved with the current policy stance, stronger productivity growth and a moderating credit risk premium for the economy as a whole. The MPC will maintain its focus on ensuring the appropriate transmission of monetary policy to the economy and guiding inflation down to a sustainable rate.

Repo rate and headline inflation

Per cent



Sources: Stats SA and SARB

Governance structure

MONETARY POLICY COMMITTEE (meets every two months)

Chairperson
Governor of the SARB

Members[3]

DGs and the Head of ERD
C (Christopher) Loewald

Adviser to the Governors
D (David) Fowkes

Responsibilities

The MPC drives the SARB's responsibilities to achieve and maintain price stability by:

- reviewing economic data, including forecasts, and deciding the appropriate interest rate needed to deliver the SARB's mandate and meet the inflation target; and
- engaging with stakeholders and the public on its monetary policy decisions in the press conference that follows each meeting and various Monetary Policy Forums (MPFs).

3. Other than the DGs, the members of the MPC are appointed by the Governor after consultation with the DGs.