FUNDAMENTALS

SOUTH AFRICA MPC UPDATE
LOWERING THE INFLATION TARGET

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IN BRIEF

- The Monetary Policy Committee (MPC) of South African Reserve Bank (SARB) lowered its repo rate by 25bps to 7.25% in its May 2025 meeting with effect from 30 May 2025. This rate decision aligns with consensus expectation of an easing stance. The specific rate cut stance was favoured by a majority of the policymakers, 5 out of 6, with the sole dissent favouring a higher 50bps cut

- The monetary policymakers, as anticipated, trimmed lower their growth expectations, largely on headwinds from the external sector given the strides around structural reforms domestically. For 2025, the SARB lowered its growth projection from 1.7% in March 2025 MPC to the current 1.2%.

- Inflation forecasts have been revised lower in the latest projections, reflecting stronger South African Rand assumptions and lower global oil prices which more than offset the impact of the proposed fuel levy that was introduced following the shelving of the VAT hike.

- As expected, and from recent rhetoric from officials, the MPC meeting decisively considered inflation targeting under a 3.0% regime. Accompanying the usual press statement were materials from the SARB Biennial Conference that was held late March 2025. Specifically, the Conference's overarching theme was the inflation target that has been dominant in recent MPC meetings

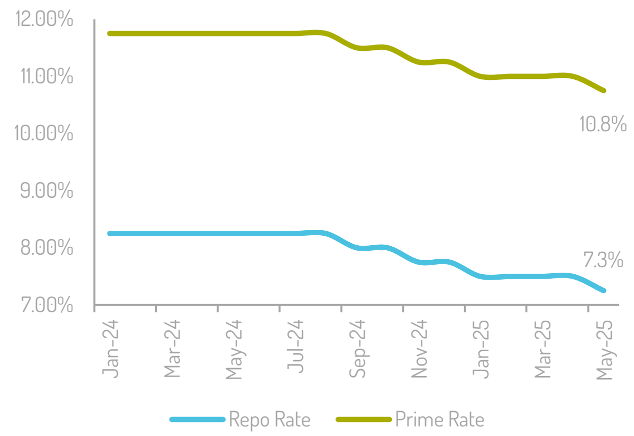
- What remains unclear is the inflation target band, although the SARB's preference has been for a tighter band than the current 300bps band of between 3.0% and 6.0% with a mid-target of 4.5%. Given the statement was loaded with "w*e would like to see inflation expectations move lower towards the bottom end of our target range*", this tips the odds of a 3.0%-point target, in our view, but the overall preference of a narrow band looks still on the cards.

- Given the much lower terminal repo rate under the 3.0% inflation target scenario compared to the baseline, this suggests a transition timeframe to effect the lower inflation target, in our view. This was also the case with the transition of about 2 years with the previous announcements of inflation targeting tweaks.

Rate cut as MPC incorporates scenarios

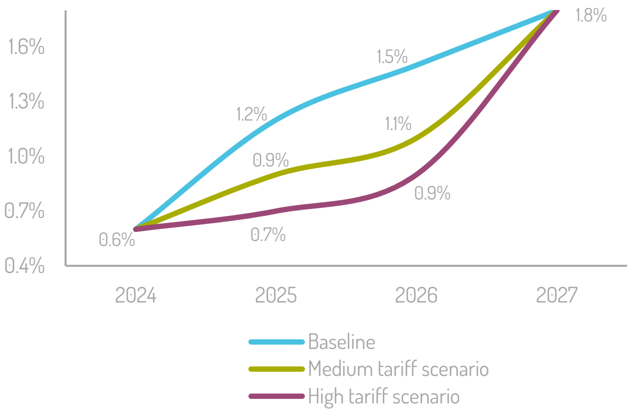
The Monetary Policy Committee (MPC) of South African Reserve Bank (SARB) lowered its repo rate by 25bps to 7.25% in its May 2025 meeting and effective 30 May 2025. This rate decision aligns with consensus expectation of an easing stance. The specific rate cut stance was favoured by a majority of the policymakers, 5 out of 6, with the sole dissent favouring a higher 50bps cut. The policymakers assessed the risk to domestic growth to be balanced, following the lowering of the growth forecasts, whereas flagged the volatile global economic conditions since the March 2025 MPC meeting. Out of necessity, the MPC also incorporated scenarios under escalating trade tariffs and a 3.0% inflation target regime.

REPO RATE AND PRIME RATE



SOURCE: SOUTH AFRCAN RESERVE BANK

REAL GDP GROWTH PROJECTIONS

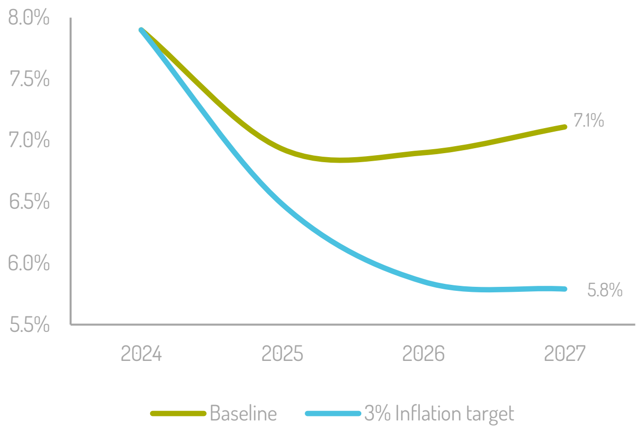


SOURCE: SOUTH AFRCAN RESERVE BANK

Baseline and tariff scenario forecasts show growth pessimism

The monetary policymakers, as anticipated, trimmed lower their growth expectations, largely on headwinds from the external sector given the strides around structural reforms domestically. For 2025, the SARB lowered its growth projection from 1.7% in March 2025 MPC to the current 1.2%. The growth projections assumed under the tariff scenarios imply much lower growth this year and in 2026. Nevertheless, growth is projected to pick up to 1.8% in 2028 under all scenarios.

REPO RATE PROJECTIONS



SOURCE: SOUTH AFRCAN RESERVE BANK

Inflation forecasts have been revised lower in the latest projections, reflecting stronger South African Rand assumptions and lower global oil prices. Unlike the March 2025 MPC meeting, the revised projections excluded the proposed 0.5% VAT hike that was shelved off in the FY26 Budget announced last week but incorporated the proposed higher fuel levy. Notwithstanding the higher fuel levy, the stronger exchange rate and lower commodity prices have improved the inflation profile favourably. Given this lower inflation projection, the Quarterly Projection Model showed a much lower repo rate expectation although much lower under the 3.0% inflation target.

Lower inflation target, a 'when' and not 'if'

As expected, and from recent rhetoric from officials, the MPC meeting decisively considered inflation targeting under a 3.0% regime. Accompanying the usual press statement were materials from the SARB Biennial Conference that was held late March 2025. Specifically, the Conference's overarching theme was the inflation target that has been dominant in recent MPC meetings. From our assessment of the Conference materials and the press briefing rhetoric, it is a matter of 'when' and not 'if' a 3.0% inflation target is formally adopted by the SARB.

What remains unclear is the inflation target band, although the SARB's preference has been for a tighter band than the current 300bps band of between 3.0% and 6.0% with a mid-target of 4.5%. Given the statement was loaded with "w*e would like to see inflation expectations move lower towards the bottom end of our target range*", this tips the odds of a 3.0%-point target, in our view, but the overall preference of a narrow band looks still on the cards. As highlighted in previous SARB engagements, the monetary authorities reiterated that a change in the inflation target will also be jointly communicated with the National Treasury. We think buy-in from the National Treasury is also likely to ameliorate the administered price setting going forward and also midwife the political process around this imminent change. Nevertheless, there is no requirement for a Parliamentary intervention to effect a lower inflation target, other than a preset agreement between the National Treasury and the SARB.

Given the much lower terminal repo rate under the 3.0% inflation target scenario compared to the baseline, this suggests a transition timeframe to effect the lower inflation target, in our view. This was also the case with the transition of about 2 years with the previous announcements of inflation targeting tweaks. From the literature presented at the Biennial Conference, the monetary authorities cited a favourable sacrifice ratio, which is likely to give them luxury of time to implement the pivot to a lower inflation target, given the lack of clarity on when the announcement will be made.

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