SARB stands pat amid economic and market uncertainty

Balance of risks table as per MPC statement

Dovish	Hawkish
1. SARB sees headline inflation stabilising at its midpoint target of 4.5% in the second quarter of 2025, an improvement from the March forecast, which expected inflation to reach the milestone at the end of 2025. 2. Markets still see adjustments by the US Fed in December, with other global central banks set to ease monetary policy soon, especially the ECB set to cut rates as early as June. 3. Oil prices have returned to levels seen earlier in the year, around \$80/bl after briefly exceeding \$90/bl. It is less probable for oil prices to hit \$100/bl. 4. The change in the inflation forecast reflects recent data outcomes, with CPI for March and April coming in slightly better than expected. SARB revised down food and core forecasts marginally. 5. SARB sees growth at 1.2% this year, improving to 1.6% by 2026. These projects are better than the 2023 outcome but below the longer-run averages of around 2%.	1. SARB notices persistent global inflation pressures despite headline inflation rates being generally lower than a year ago, as underlying inflation is still elevated. 2. South African inflation outcomes were worse than expected early in the year, leading to a repricing of rate expectations. Notably, there is still considerable uncertainty about the longer-run inflation outlook globally. 3. Current geopolitical tensions are elevated and far from resolved. 4. The rand's exchange rate has been particularly volatile since the March MPC meeting. 5. The changes to the SARB's inflation outlook are not significant when compared to the March forecast, and the average inflation for 2025 is only a tenth of a percentage point lower. The task of achieving the inflation objective is far from done. 6. Fuel price inflation is expected to be higher in the near term. 7. The committee is concerned about the elevated inflation expectations, with a few survey responses from businesses and trade unions believing inflation will only hit the 4.5% target in two years. 8. The SARB believes it needs to deliver on the inflation target sooner than later to re-anchor expectations. 9. The recent improvement in the domestic power supply, with no loadshedding since 26 March is a welcome development. The SARB has revised its loadshedding assumptions down, but additional revisions may be required if this performance is sustained. 10. SARB expects world food prices to rise 3.5% in 2025.

Implications for SA markets

FRA	The FRA curve notched lower after the SARB's MPC meeting and the central bank's decision to leave rates unchanged. While the statement confirms what markets have already priced in on the inflation front, the tone of the meeting came across as less hawkish. Recent ZAR appreciation and lower global oil prices have created a more favourable outlook on domestic price pressure. This year's CPI forecast was left unchanged for the previous MPC meeting, but the 2025 CPI forecast was lowered marginally. In response to the meeting, FRAs were received slightly lower as there is still a lot of uncertainty about SA's interest rate outlook. The 2x5, 4x7 and 6x9 tenors, which cover the remaining MPC meetings for 2024, notched down but are not fully pricing in any rate cuts for this year. However, there is sufficient rate cut risk priced into the 6x9, that should the ZAR stage a recovery a November cut would not be out of the question. Further out, the 12X15 vs 3m JIBAR spread is currently sitting at -22bp, while the 15X18 FRA is fully pricing in a 25bp cut. With the election outcome still set to take effect, likely over the weekend or early next week, there is scope for FRAs to move depending on how the ZAR responds.
IRS	With the exception of the two-year swap rate which has fallen, swap rates continued to trade higher post the SARB MPC meeting. The lower growth and inflation forecasts for next year are likely driving the move seen at the front-end. The SARB sees inflation for this year at 5.1%, unchanged from the March meeting, while the inflation estimate for next year was revised lower marginally to 4.5%. For GDP growth, the SARB sees slightly lower growth next year at 1.4% after this year's unchanged forecast of 1.2%. Meanwhile, a weaker ZAR has ensured that most swap rate tenors continue to rise. More pronounced movements have been observed at the long-end, resulting in the curve steepening. Looking ahead, further direction for swaps in the coming sessions will hinge on the ZAR and how it reacts to the general election outcome.
Bonds	As the market was positioned for the relatively hawkish policy statement delivered by Governor Kganyago today, and with a focus largely on the elections, we have seen a muted response within the local bond market with the outlook basically unchanged. Yields remain elevated and the cautious stance of the central bank will keep the spread over US Treasuries wide in order to ensure that investors are compensated for SA's embedded risk premium. Going forward, a favourable election outcome and an eventual shift in global monetary policy direction will be beneficial to bonds, but unless structural reforms are implemented by the government, the risk premium in SA assets will remain entrenched.
ZAR	The ZAR's reaction was muted following the SARB Governor Lesetja Kganyago's announcement of a rate hold. The local currency continued to trade over 1.00% weaker, above 18.6000/$, similar to the level it was trading before the MPC meeting. The market appears to have already fully priced in the meeting outcome. With the SARB unlikely to alter the current monetary policy stance in the coming months due to concerns about elevated inflation expectations, maintaining the favourable interest rate differentials will offer the ZAR some support. However, uncertainty surrounding the current political environment, alongside SA's fragile fiscal environment and weak economic growth, limits the local currency's ability to capitalise on those gains.

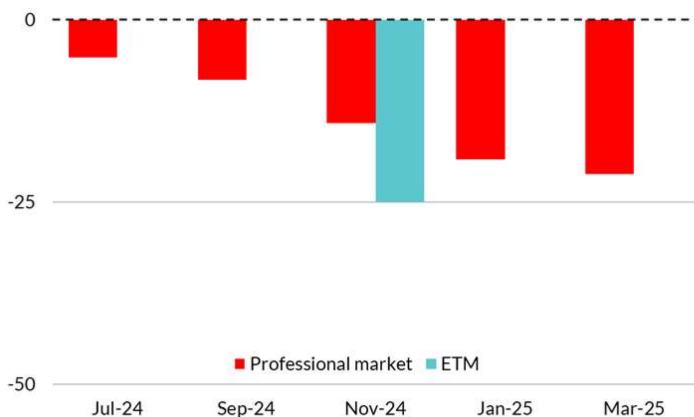
Bottom Line

- Consistent with expectations, the SARB's MPC unanimously decided to keep the benchmark repo rate unchanged at 8.25% for a sixth consecutive meeting. The central bank also kept its growth and inflation estimates for this year unchanged, and maintained that risks to their outlooks were broadly balanced.

Analysis

- Unsurprisingly, the MPC's decision to keep the repo rate unchanged at 8.25% for a sixth consecutive meeting was unanimous. Against a backdrop of still-tight global monetary conditions, investors remain judicious over where they invest their capital. South Africa's risk profile may have improved slightly in recent months, but it remains weak. Accordingly, interest rates need to stay relatively high to compensate investors for exposing their portfolios to the country's idiosyncratic risk.
- That is to say that there is little scope to cut rates at the moment. Not only is headline inflation still above the 4.5% midpoint of the SARB's target range, but the ZAR also remains too vulnerable to risk cutting rates ahead of major central banks. Doing so would likely trigger an inflation-stoking currency selloff at a time when price pressures are not yet under control.
- On the topic of the ZAR, the SARB noted some concern over its recent volatility: *"The exchange rate of the rand has been particularly volatile since the previous MPC. It briefly appreciated to a 10-month high against the dollar last week. The starting point for our forecast is R18.57."* It said that the currency market remains *"focused on the direction of domestic policy,"* alluding to uncertainty around the outcome of this week's elections. The SARB added that *"conditions remain uncertain, but we expect greater clarity in due course."* It was thus reluctant to make any big policy changes until after the election dust has settled, although it was never expected to cut rates before Q4.
- Interestingly, the SARB's inflation outlook improved ever so slightly. While it still sees inflation averaging 5.1% in 2024, its 2025 forecast was lowered from 4.6% to 4.5%. Inflation is now expected to stabilise at 4.5% in Q2 of next year, which marks an improvement on the end-2025 expectation as per the March MPC meeting's forecast. On the whole, the SARB maintained that the improvements in its inflation forecasts reflect recent data outcomes, with the March and April CPI prints coming in better than expected.
- Looking ahead, the balance of risks to the inflation forecast is also assessed to be broadly balanced at present. However, the SARB noted concern over elevated inflation expectations. It said that *"high inflation expectations require that we deliver on our target sooner rather than later, to re-anchor expectations."*
- As for the economic outlook, the SARB left its GDP growth forecasts for 2024, 2025, and 2026 unchanged at 1.2%, 1.4%, and 1.6%, respectively. It also maintained that risks to the growth outlook were broadly balanced, but said that economic activity indicators for the first quarter have been coming in worse than expected despite reduced load-shedding. Therefore, should load-shedding resume to some degree in the months ahead, the SARB's growth forecast would need to be revised lower. More broadly, the forecasts still suggest that the economy will likely remain in the sub-2% lull that it was stuck in for years before the post-pandemic recovery, with structural growth issues mounting.

Outlook for interest rate moves
Implied interest rate move per meeting in bp



Source: Bloomberg, ETM Analytics

Going forward

- The SARB is navigating extremely uncertain and fluid economic conditions, and will likely remain highly data-dependent and reactive through the months ahead. However, official forecasts continued to point to policy normalisation, with interest rates expected to ease into more neutral territory by next year. Specifically, the QPM model predicts a repo rate of 7.64% by year-end (down from 7.72% previously), 7.34% by end-2025 (versus 7.37% previously), and 7.33% by end-2026 (unchanged). This implies two rate cuts this year, followed by at least one next year before settling on a rate pause. This is slightly more dovish than ETM's expectation, which is for just one 25bp rate cut in Q4 of this year, followed by two or three more in 2025.

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