Summary of macroeconomic research views:

- **Inflation:** Headline CPI rose marginally in April, to +2.8% y/y from +2.7% y/y in March, driven by higher food inflation. Core inflation, which excludes volatile food and energy prices, decelerated in April to +3.0% y/y from +3.1% y/y in March. The ZAR price of fuel rose slightly in May, but not enough to raise broader price pressures. This supports further low CPI readings going forward, allowing the SARB the perfect opportunity to lower the inflation target to 3%.

- **Repo rate:** The SARB resumed its monetary easing cycle in May, cutting the repo rate by 25 basis points to 7.25%. The SARB also revised its inflation forecasts lower, now projecting 3.2% for 2025 and 4.2%-4.4% through 2027, citing a stronger rand, lower oil prices, and the scrapping of VAT hikes. However, growth expectations were downgraded, with 2025 GDP now seen at just 1.2%.

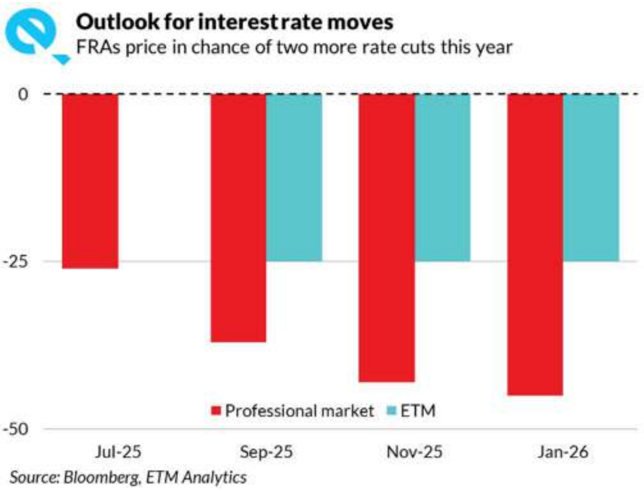
- **Government Finances:** South Africa's fiscal outcomes are expected to worsen in the 2025/26 fiscal year, with the latest Budget projecting a deficit of -4.8% as a percentage of GDP from -4.6% recorded in 2024/25. The key to turning around SA's precarious fiscal position will be the implementation of structural reforms.

- **GDP Growth:** SA's GDP grew by just 0.1% q/q in Q1, slowing from 0.4% in Q4. Y/y growth held steady at 0.8%. Without a second consecutive quarter of robust agricultural growth (+15.8%), overall GDP would have contracted. Particularly concerning is the significant decline across the productive sectors as mining output and manufacturing shrank fell by 4.1% and 2.0% respectively.

- **Currency:** The ZAR was the third-best-performing emerging market currency in May as risk sentiment improved on the back of easing US-China trade tensions, improved GNU relations and a rise in carry attractiveness. Furthermore, indications that SA's inflation target will likely decline also supported the currency.

- **Offshore conditions:** In May, global financial markets experienced a robust rebound following the turbulence caused by the April tariff shocks. While trade tensions between the US and China eased, there are indications that tensions are escalating again as Trump accuses China of violating the trade agreement. In the US, longer-term Treasury yields rose significantly, reflecting investor concerns over unsustainable high levels of US debt, which looks set to increase by $2.4tn over the next ten years.

Interest rate indicators:

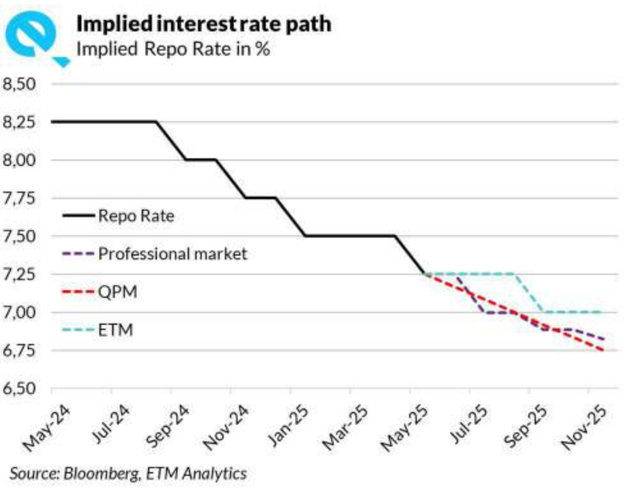


The SARB resumed its monetary policy easing cycle last month, cutting the Repo Rate by 25bp to 7.25% at its May MPC meeting. The vote among MPC members was split 5-1, with the dissenting voice favouring a 50bp rate cut.

The dovish shift in the statement and split vote certainly suggests that more interest rate cuts could be on the cards in the coming months. The proviso is that global financial market volatility will need to ease to allow the SARB room to cut rates further without negatively impacting currency dynamics.

The other factor to consider is the expected lowering of the SARB's inflation target. Recently, Fin Min Godongwana has confirmed that no decision has been made yet, but all signs currently point toward a shift toward a target rate of 3% for inflation.

In its press releases, the SARB provided scenarios that would take into account a drop in the target to 3%, indicating that this will more than likely be the outcome. The question now is just regarding the timing of the announcement.



The sooner the better for such an announcement. With inflation contained, it would be easier to prevent future significant increases to inflation expectations rather than trying to rein them back by hiking interest rates in what will almost certainly be a weak economic growth backdrop.

In the markets, FRAs have positioned for another rate cut at the July MPC meeting, with the chance of a follow-up cut between September and January priced between 50% and 80%.

ETM's view is slightly more conservative, given that an announcement regarding an inflation target change would require higher interest rates over the short term. If the ZAR remains resilient and global conditions remain relatively stable, there may be scope for one more rate cut before the inflation target is altered, in our view.

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