Viewpoint: SARB's prudence bolsters ZAR resilience

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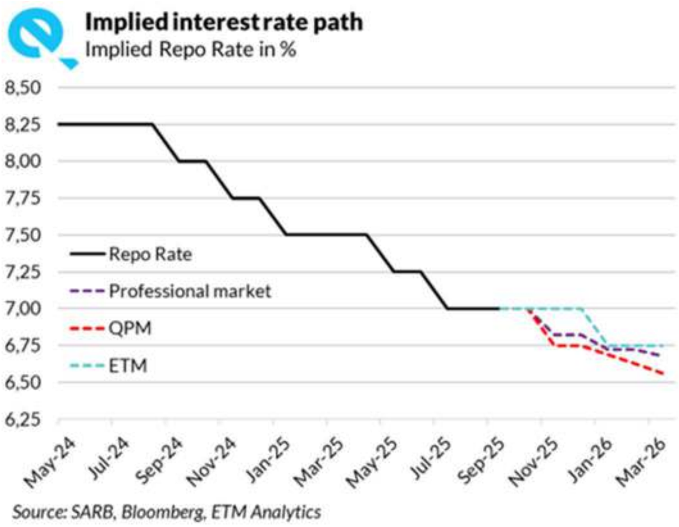
Key points

- Although South Africa's inflation remains contained, the SARB has opted to keep policy tight in order to ensure that it continues to make progress toward its goal of bringing inflation down to its new preferred target of 3%, while also ensuring inflation expectations remain suppressed.
- ETM's resilience framework shows that the ZAR's resilience has improved over recent months, with the SARB's monetary prudence a key driver of this. Given the central bank's push for a lower inflation target, and the subsequent short-term policy implications, the ZAR's resilience is likely to remain bolstered through monetary policy prudence. A higher resilience score points to the possibility of further ZAR appreciation given the negative outlook for the USD, while also limiting any potential depreciation during periods of adverse market conditions.

BASELINE VIEW: The SARB has resisted the urge to ease monetary policy further in its efforts to anchor inflation and inflation expectations closer to 3%. While some might bemoan keeping interest rates at such elevated levels, the benefits will be material over the medium- to longer-term. Higher real interest rates, lower overall inflation, and attractive returns compared to global peers will bolster the ZAR's resilience at a time when global economic uncertainty remains elevated.

SARB leaves rates unchanged amid uncertainty over inflation outlook



The SARB left interest rates unchanged at the September MPC meeting. The vote was split: four members opted for no change, while two preferred a 25bp rate cut.

The outcome matched our estimates and the broader consensus within the market. However, there were some interesting developments, including a shift higher for inflation estimates across the forecast horizon.

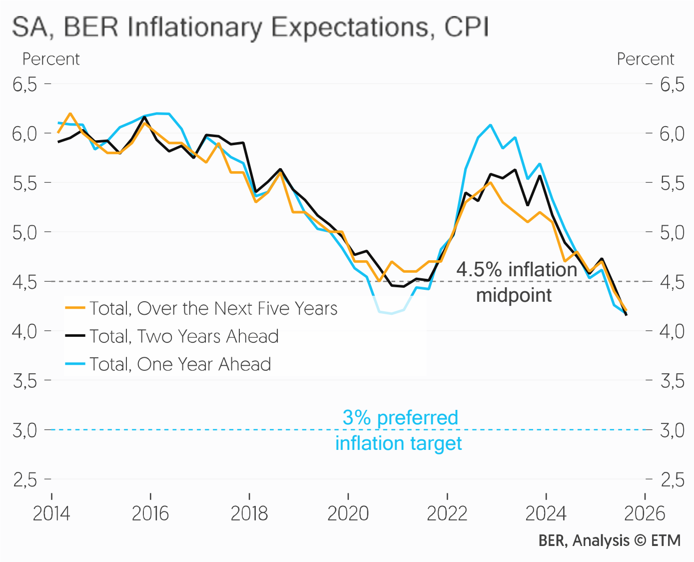
Specifically, headline inflation is expected to rise over the next few months, peaking at around 4% in Q4 2025, with the bank's forecast incorporating a higher electricity price inflation rate of nearly 8% rather than 6%, given the recent pricing correction by NERSA.

The Bank highlighted how structural inefficiencies in administered pricing continue to erode purchasing power and weigh on growth. Sector-specific reforms are needed to boost efficiency, rather than tolerating higher inflation as the SARB pushes for the official adoption of a lower inflation target. Any structural reforms that take place would benefit the economic growth outlook and the ZAR.

Economic growth forecasts were also revised higher, while the QPM output shifted to suggest one fewer 25bp rate cut through 2027. The QPM suggests that a rate cut at the November MPC meeting is still possible.

The market has adjusted its expectations for further rate cuts, now expecting just one more by the March 2026 meeting. ETM's expectations align with this as we see the next cut in early 2026, although we do not rule out a November cut if inflation surprises to the downside.

SARB's independence and lower inflation expectations support ZAR



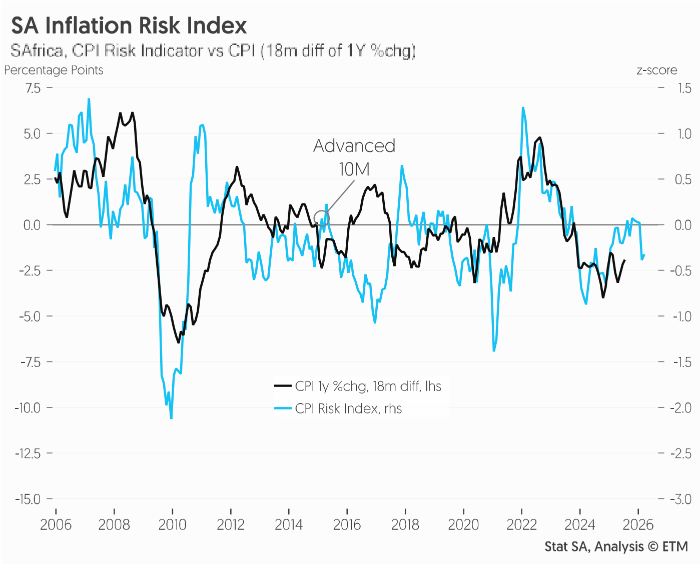
It is no coincidence that the significant decline in inflationary expectations to below the 4.5% midpoint of the official 3% to 6% inflation target has coincided with the SARB's push to move the official inflation target to a more internationally aligned 3%.

While the SARB has not yet managed to find agreement with the National Treasury regarding formalising the lower inflation target, it has asserted its independence as it targets its preferred 3%.

This undoubtedly played a part in its unchanged interest rate stance yesterday. A central bank asserting its independence is ZAR positive. In the same breath, investors will be keeping a close eye on the government's position and any attempts to broaden its mandate outside of the scope of monetary policy, which could be viewed as interference in the SARB.

The SARB highlighted that lower inflation expectations reflect a growing acceptance of lower inflation, playing an important role in the SARB's transition to a 3% target.

ETM's Inflation Risk Index suggests pressures to remain contained



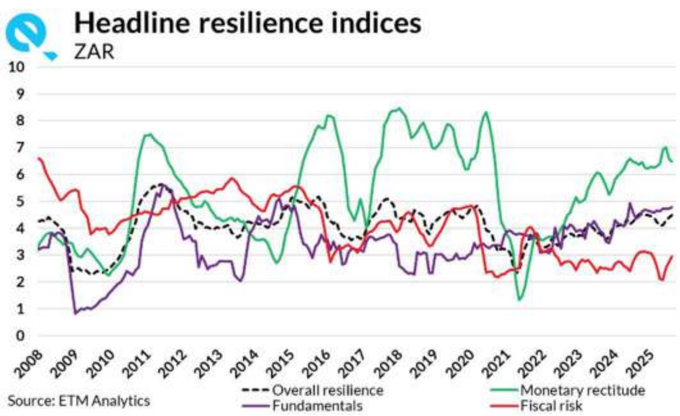
While there was the risk of a rate cut at the September MPC meeting, the SARB's push to anchor inflation expectations near its preferred target of 3% meant that the majority of MPC members favoured keeping policy tighter, at least for now.

SA's current macroeconomic and financial market conditions still favour looser monetary policy, but the uncertainty regarding the timing of the inflation target shift has likely pushed out the timeframe. Currently, inflation remains low but faces risks from higher administered prices.

These risks were deemed enough to raise the SARB's inflation forecasts across the board, albeit keeping them below 4.00% through 2027.

Beyond administered price increases, inflation pressures should remain fairly muted, based on our inflation risk indicator, as seen to the left. Market expectations, meanwhile, as judged by breakeven rates, are at record lows, while the BER's survey indicates that the average estimate for inflation for 2025 is just 3.8%.

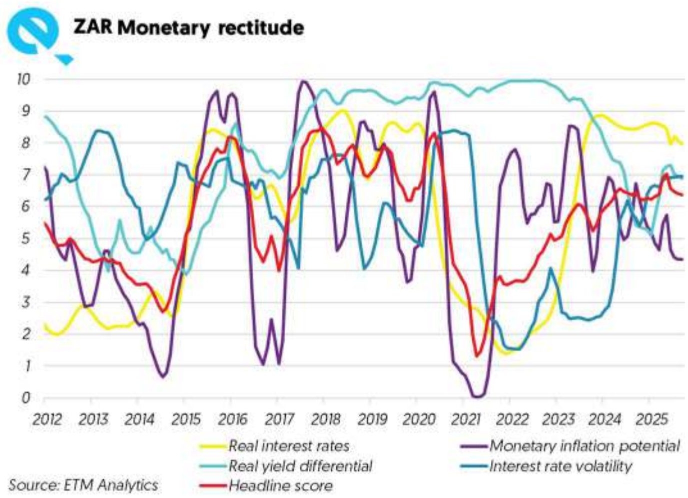
ZAR resilience improving, monetary rectitude doing the heavy lifting



As we have often noted, the SARB's prudent monetary policy has contributed significantly to the ZAR's resilience. Given SA's strong terms of trade and trade account surplus, fundamentals have improved, while fiscal prudence has improved to some degree but remains the weakest of the three major pillars of resilience.

This highlights the extent to which the government needs to press ahead with structural reforms to rein in the country's rising debt levels. Any progress on this front would be ZAR positive, but in the absence of any meaningful reforms, fiscal risk continues to weigh on the performance of the ZAR. A key contributor to monetary policy's impact on the ZAR has been the shift in inflation expectations as discussed above.

Real rates to remain elevated amid SARB conservatism



This week's MPC meeting was a show of commitment toward a more conservative stance in order to achieve inflation near the 3% preference while keeping expectations anchored. Given risks such as administered prices, however, the SARB will need to run with healthy, positive real interest rates, which will enhance the ZAR's resilience and discourage any negative speculation against it.

As seen in the adjacent chart, the contribution of real interest rates toward ZAR resilience is at its highest levels since the COVID crisis, before the last cutting cycle began. If the SARB remains cautious, inflation will remain contained and real rates will continue to be supportive of the ZAR.

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