Viewpoint: SARB leaves rates unchanged, amid rising ZAR risks

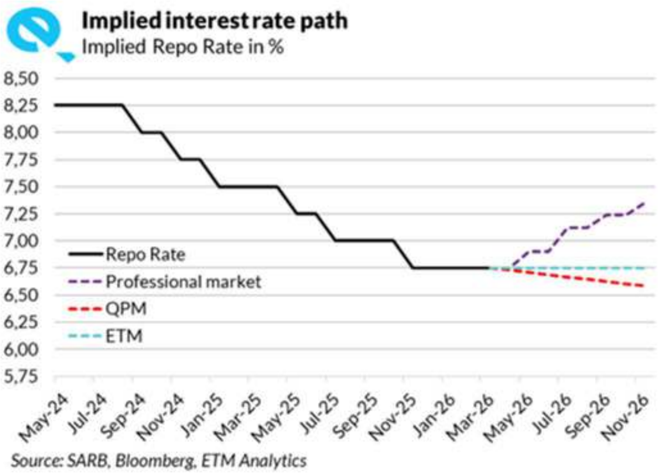
Key points

- The SARB's decision was to keep rates on hold, to maintain a steady hand, not respond to a crisis immediately, and to wait for signs that the war might extend well beyond the short term. So much of this energy and inflation shock will be determined by the duration of the war. Should it end soon, the impact would be limited and fleeting. Markets would recover quickly, and inflation would only suffer a temporary blip.
- A much longer, protracted war risks a stronger negative market reaction, plunging the global economy into recession. For SA, there are several consequences, ranging from undue volatility to fiscal deterioration and a more conservative monetary policy, all of which will undermine any investment case for SA.

BASELINE VIEW: The balance of risks has shifted quite aggressively against the ZAR over the past month. Terms of trade have collapsed, SA's growth prospects have deteriorated, fiscal risks have risen, the SARB has chosen not to respond immediately with rate hikes, and the ZAR sentiment has fallen sharply.

Although investors are currently looking past the war in the hope that it ends quickly, the risk if that it doesn't. The longer it lasts, the greater the chance the ZAR comes under significant pressure.

SARB keeps a cool head, but its conditional



The SARB delivered a unanimous hold at 6.75%, but the March MPC statement carried a distinctly more hawkish tone as the Middle East oil shock shifted risks toward higher inflation and delayed the easing cycle.

While the SARB's baseline still sees inflation returning to 3%, the QPM now pushes rate cuts into the second half of 2026 and explicitly incorporates scenarios that would require renewed tightening if energy prices remain elevated or the rand weakens materially.

The SARB complemented its baseline forecast with two adverse scenarios centred on the potential persistence of the Middle East conflict and higher oil prices.

In the first scenario, where the war lasts a few months, oil near US$100, and the rand about 5% weaker, inflation rises above 4%, and the SARB would likely need one additional rate hike this year before inflation gradually returns to target around 2027.

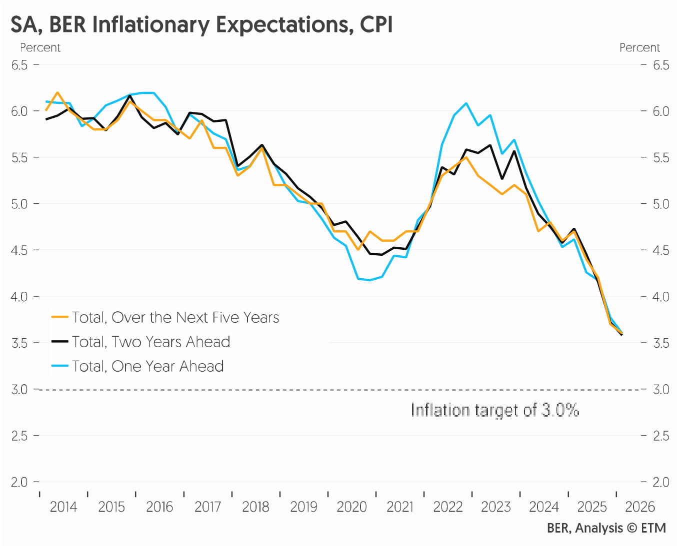
In the more severe scenario, with the conflict lasting over a year, oil remaining above US$100 and the rand weakening roughly 10%, inflation would exceed 5% and require several rate hikes, with the policy rate potentially approaching levels seen in the previous tightening cycle.

In both cases, growth weakens initially due to higher costs and uncertainty, but the key message is that the SARB stands ready to tighten policy if second-round inflation pressures emerge.

The ETM view in the accompanying chart assumes the war will not drag on indefinitely and that its impact on inflation will be transitory.

Unfortunately, should the war extend well into the second half of 2026, the impact would be much more severe, nudging ETM's rate expectations higher to between current expectations of a flat outcome and what the professional market already has priced in.

Inflation expectations were well on their way lower before the war

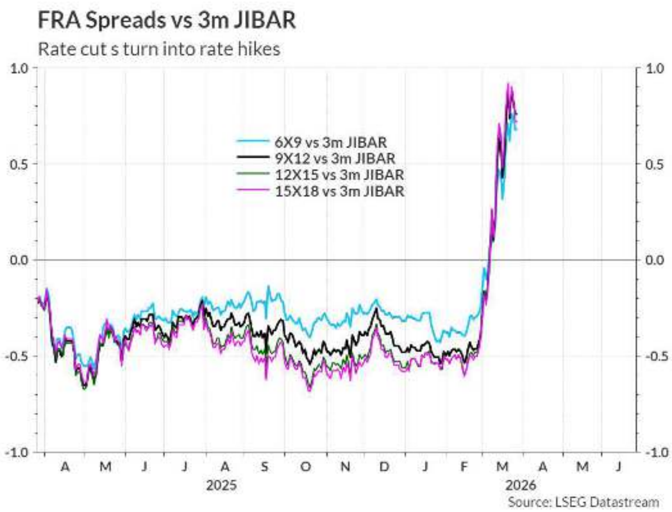


A key factor to consider, highlighted by SARB Governor Kganyago, was the steady reduction in inflation expectations towards the 3% inflation target. Ever since the new inflation target was mooted, inflation expectations have moderated, helping ensure the repo rate has been on a steady downward trajectory.

Of course, this was all recorded before the outbreak of the war, which renders this data less influential. Still, it does highlight that inflation was firmly on the way down, that the SARB has credibility, and that the market believed the SARB would achieve its 3% target before the end of the year.

In other words, the backdrop to the 3% inflation-targeting regime was solid before the war. The SARB remains committed to ensuring inflation remains under control and will respond with more restrictive monetary policy if necessary.

Rate cuts turn into rate hikes



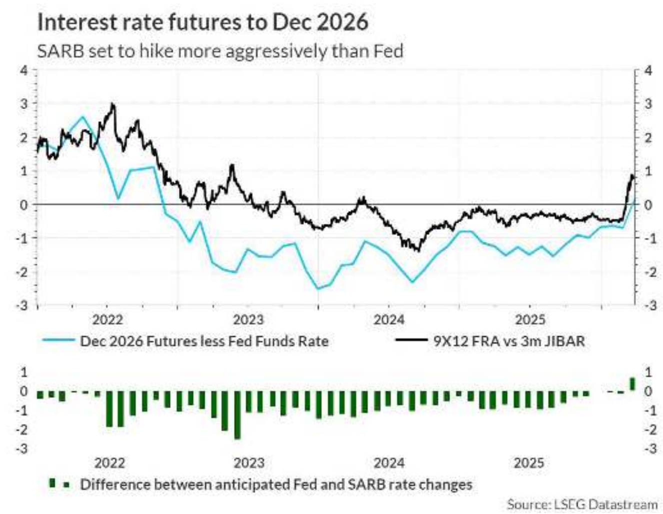
In a serious blow to households and borrowers in general, the swing around in interest rate expectations has been brutal.

Whereas the market had anticipated two 25bp rate cuts before the end of the year, investors now anticipate that the SARB might be forced to hike at least twice, and possibly three times, in 25bp increments.

At its core, it is the rand price of oil that is the main culprit, with fuel prices set to ramp higher next week, by some staggering numbers that will severely dent inflation and hurt the country's GDP growth dynamics.

According to the latest data from the Central Energy Fund, the under-recovery in fuel prices hovers around R5,80 p/ltr for 95 octane petrol and over R10,18 p/ltr for diesel. That is a staggering addition cost shock that households and businesses will have to absorb from one month to the next.

SARB likely to hike more aggressively than the Fed



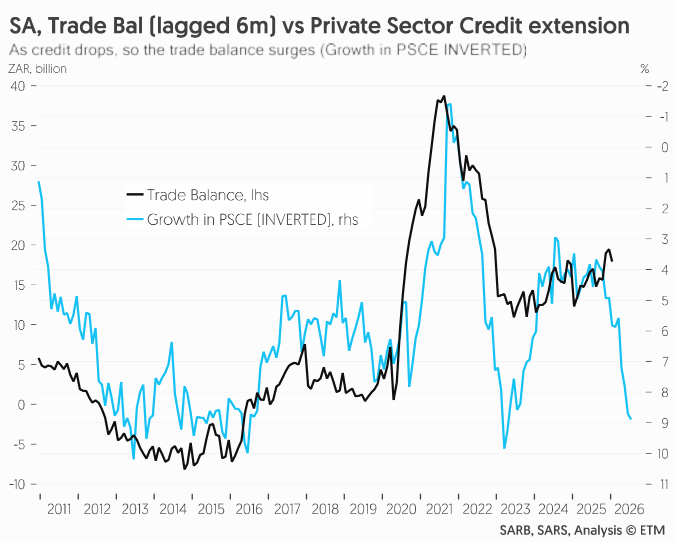
It therefore follows that SA's interest rates are likely to rise more sharply than those of the US. It is to be expected in a jurisdiction where volatility levels are generally higher.

What it also means is that in a world of heightened risk aversion, riskier markets will need to adjust towards higher yields to compensate investors for the additional risk.

At face value, that is reflected in the widening spread between South African and US interest rates, which ultimately implies that the ZAR will offer a more positive carry than it does now.

Given that portfolio flows into the bond market play such an important role in determining currency direction, this will influence the ZAR's performance over time, even if, in the short term, the ZAR depreciates due to negative speculation. However, another factor is less spoken of.

Rate hikes hold implications for credit extension and, in turn, the trade balance



Just before the war, growth in private-sector credit extension surged to 9% y/y (blue line). This was a significant development, as it had profound implications for the trade balance.

As the accompanying chart shows, the greater the demand for credit, the worse the trade balance tends to be. According to this chart, the trade balance was about to deteriorate sharply.

The logic of this chart is that as demand for credit accelerates, a country starts to live beyond its means through borrowing.

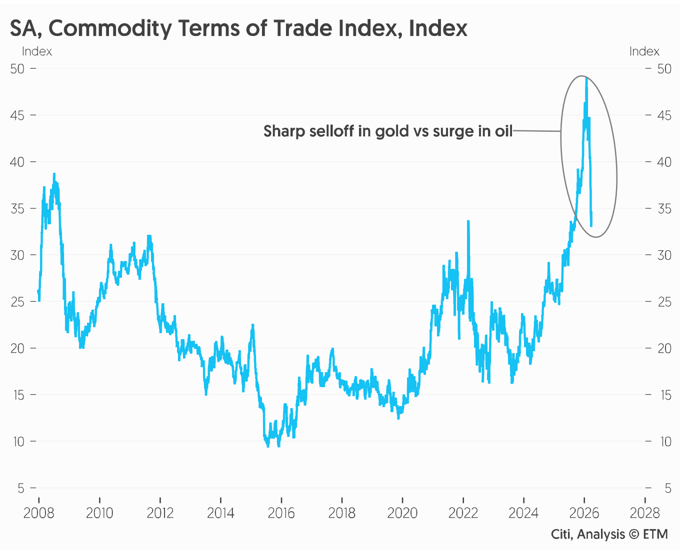
As it does so, demand for imports tends to rise. Those imports are driven by both household and business demand for credit.

The eruption of war and the energy price shock that has emerged because of it mean that the probability of interest rate hikes might well temper consumptive and investment demand. General growth conditions will likely deteriorate, which should, ironically, help the trade balance improve and lend the ZAR a more resilient undertone.

There have been several examples in South Africa's history where this relationship has eventually translated into a ZAR recovery, so the message to readers is clear.

While the ZAR might respond negatively to a rise in risk aversion, related to the war, it stands a more than even chance of recovering thereafter. For exporters, the strategy should be obvious. Use bouts of ZAR depreciation to lock in more attractive forward rates.

SA's terms of trade collapse will necessarily offset the trade balance effect



Not that there is ever a good time for war, but the timing of this war has coincided with a major correction in commodity prices.

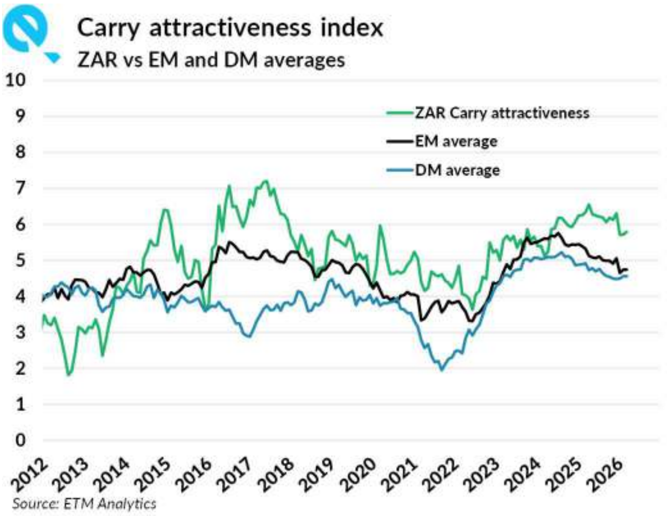
It may be that traders have responded to expectations of a collapse in demand for the minerals that SA exports, or that a one-sided market needed to reset.

It may even be that losses sustained in other markets necessitated liquidating long gold positions to help fund liquidity shortages.

Whatever the reason, this has left the ZAR more vulnerable. In the same way that the surge in the terms of trade helped propel the ZAR to ever stronger levels, the opposite also holds true.

Against this backdrop, ZAR traders need to consider the impact this will have and whether it will more than offset the weaker credit growth that would likely follow a rise in interest rates.

ZAR Carry attractiveness eroding, but so too for DM ane EM currencies



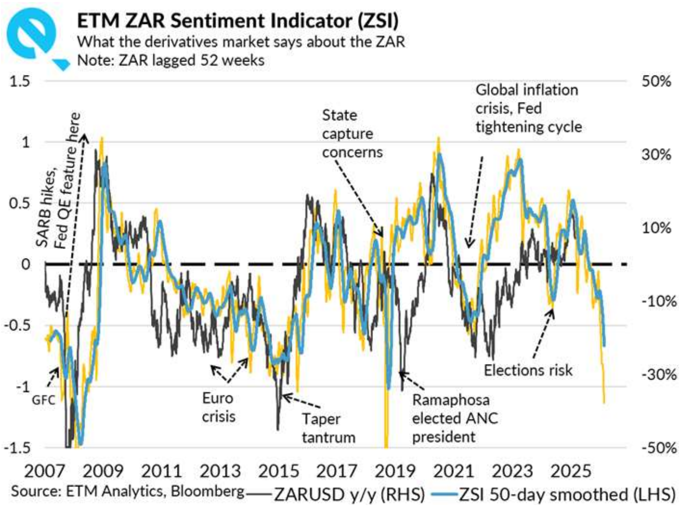
SA's carry attractiveness will likely be the deciding factor in how things unfold. Several factors are undermining the ZAR's carry attractiveness, including, but not limited to, the sharp deterioration in SA's terms of trade and the anticipated jump in inflation following the surge in fuel prices.

Furthermore, the rise in currency volatility and the ZAR's recent overvaluation do not help matters much either.

However, as is always the case in such times, while we could make a case for SA's terms of trade deteriorating, one needs to see it in the context of other currencies too. Notably, the accompanying chart shows that while the ZAR's carry attractiveness has deteriorated, so too have the EM and DM averages.

In relative terms, that means that SA's carry attractiveness will support the ZAR at the margin, although regular readers will know that this will not determine short-term direction, but rather the broader directional bias affected by some of the subcomponents to this index as listed above.

ZAR Sentiment Indicator neatly reflects the market's fears



In conclusion, many forces are tugging at the ZAR at the moment. They are not all negative, but, on balance, the tide appears to have turned against the ZAR in the short term.

This appears to be neatly reflected in ETM's ZAR Sentiment Indicator, which has collapsed to the lowest levels seen since 2019.

That is a significant development and suggests that the ZAR remains vulnerable to some uncomfortable volatility.

It also means that if this war does not end soon, and SA's terms of trade continue to deteriorate, the balance of forces will shift quite powerfully against the ZAR.

For now, the risk is of unwanted volatility that forces the SARB's hand. In the short term, there is not much the SARB can do other than remain vigilant in its communication to the market and maintain a more conservative stance. In time, should rates rise, the tide can turn back in the ZAR's favour.

Analyst(s):

George Glynos

Get in touch with us!

research@etmanalytics.com