Treasury ONE
Optimising Your Cash Flows

etm ANALYTICS

Summary of macroeconomic research views:

- **Inflation:** Headline inflation eased by slightly less than expected in January to 3.5% y/y from 3.6%. The softer reading marks continued progress toward the SARB's 3% inflation target, validating the timing of its mandate shift. Looking ahead, inflation is likely to ease further in February. However, further out, much will depend on how long the Middle East war continues and whether ZAR deprecation is sustained or not.

- **Repo rate:** Given the latest developments in the Middle East, which have pushed oil and the ZAR upwards, it is possible that inflation could rise to 4% in March; the SARB will likely keep interest rates unchanged later this month.

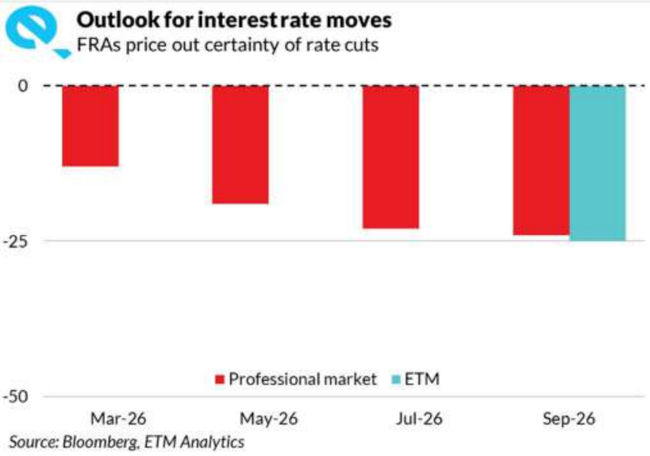
- **Government Finances:** While the ytd budget deficit has narrowed to -R312.6bn from -R347.8bn a year earlier, the gross borrowing requirement has worsened to -R444.7bn, largely due to heavy redemptions of maturing government debt. Stronger revenues offer fiscal relief, yet doubts remain over whether the government can sustain consolidation and rein in spending.

- **GDP Growth:** Q/Q seasonally adjusted growth declined slightly from 0.9% in Q2 to 0.5% in Q3. Gross fixed capital formation (GFCF) improved moderately, largely driven by transport. Alongside the improvement in exports, one suspects that the impact of Operation Vulindlela on restructuring the transport sector is beginning to yield fruit. Nonetheless, growth remains fairly pedestrian overall, at around 1%, suggesting that further reforms are necessary to boost the economy.

- **Currency:** The ZAR appreciated by 1.3% against the USD, 1.7% against the EUR and 2.9% against the GBP in February even as the geopolitical risk started rising into the month-end as the US built up its military presence in the Middle East. The ZAR gained following the tabling of the Budget. However, much of SA's fiscal relief depends on volatile, uncertain commodity prices. Into March, risk-off sentiment due to the war in the Middle East has led the ZAR to weaken along with other emerging market currencies. ZAR weakness will be tempered somewhat by the rise in gold prices driven by safe-haven demand, which will feed through into SA's terms of trade. However, a prolonged war has the potential to keep the ZAR under pressure. ETM's indicators suggest that the volatility the ZAR is currently experiencing could see the USD-ZAR spike significantly further and unwind most of the ZAR's appreciation over the past six months.

- **Offshore conditions:** Renewed uncertainty around Trump's tariff agenda intensified after the Supreme Court overturned his emergency tariffs. Trump then implemented a 15% tariff globally. Meanwhile, late-January FOMC minutes struck a hawkish note and signalled caution on further rate cuts, which underpinned the US dollar. That support has strengthened further as escalating geopolitical risks in the Middle East and the prospect of inflationary pressures from surging oil prices have fuelled a sharp rally in the US dollar. The conflict will keep uncertainty levels high and market volatility elevated.

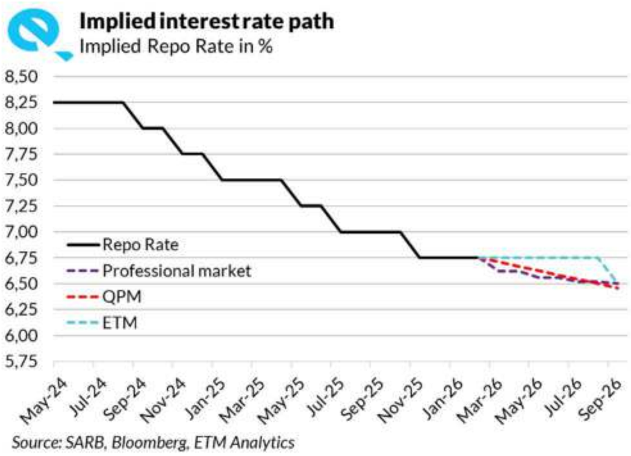
Interest rate indicators:



The conflict in the Middle East has prompted a major rethink of the market's expectations for further rate cuts from the SARB. Unsurprisingly, movement in the FRA market remains highly dependent on the ZAR's performance and current oil price dynamics.

The higher the oil price in ZAR, the lower the probability of a rate cut this year, and we have already seen a major repricing.

Not even the longer-dated FRAs fully price in a rate cut anymore, with the tenor covering the September MPC meeting pricing in just under 25bp of cuts. The 1x4 FRA, which covers this month's meeting, has just under 13bp of cuts priced in, which is likely to reduce further unless we get a strong ZAR recovery and a retreat in global oil prices.



If oil prices spike significantly further, FRA rates might even price in a rate hike. Whether the market tilts towards rate hikes again will depend on how protracted this war becomes. The longer the conflict continues without signs of de-escalation, the greater the risk of global stagflation, leaving central banks in a tricky position.

The current situation justifies the SARB's decision to keep interest rates unchanged in January, while vindicating the QPM's more cautious rate path ahead as the central bank aims to keep inflation expectations anchored around the 3% target.

Given the recent spike in oil and the expected inflation pressures that come with it, it is likely we will see another cautious decision this month, with the tone to shift even more toward the hawkish side to cement the view that the SARB is not afraid to act if needed to ensure its new inflation target is met.

Looking further out, if the situation stabilises, the SARB may resume easing depending on how the ZAR recovers and oil prices retreat. However, the situation remains extremely fluid at the moment, and the outlook for interest rates will likely be determined on a meeting-by-meeting basis as the situation is assessed at the time.

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