Viewpoint: SARB faces a dilemma at next MPC meeting

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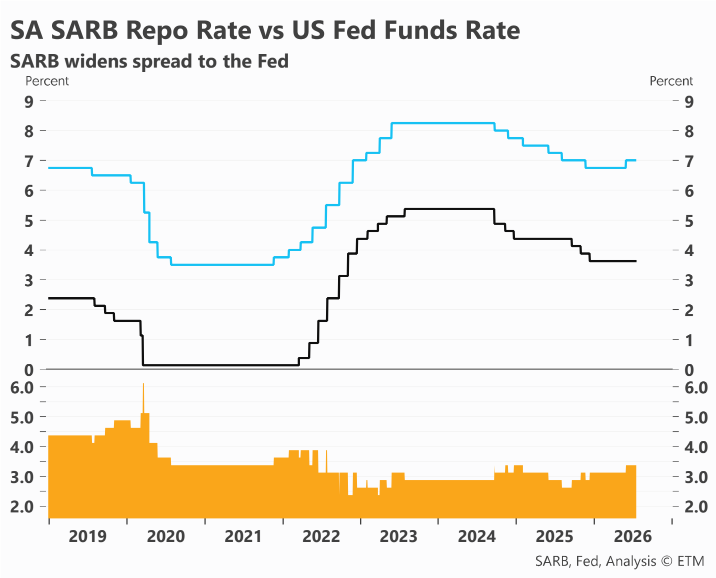
Key points

- The upcoming MPC decision two weeks ago looked like a pause. The latest depreciation of the ZAR and rise in oil prices have made the chances of a rate hike 50/50 at a minimum and may even have tilted the scales in favour of a hike, as the SARB seeks to acquire some insurance that inflation remains under control and that inflation expectations do not ramp up.
- This will likely result in a widening spread between SA and US rates, which naturally holds implications for the ZAR carry trade. Any SARB conservatism will help secure a stable price environment, in part through the credit system and in part by ensuring that the ZAR remains supported and stable.
- The SARB has already shown its preparedness to act, is independent of government and its political pressures and will want to ensure that its commitment to its lower 3% inflation target is never doubted.

BASELINE VIEW: A conservative stance by the SARB will go a long way to ensuring that the ZAR is not singled out as a vulnerable currency. Conservative monetary policy is a pillar that offers ZAR stability and will, over time, earn market respect. It is a reason why investors should not turn overly pessimistic on the ZAR, even though global financial market forces and geopolitical stresses suggest a steady rotation away from risk markets.

What was an easier decision for the SARB just turned tougher

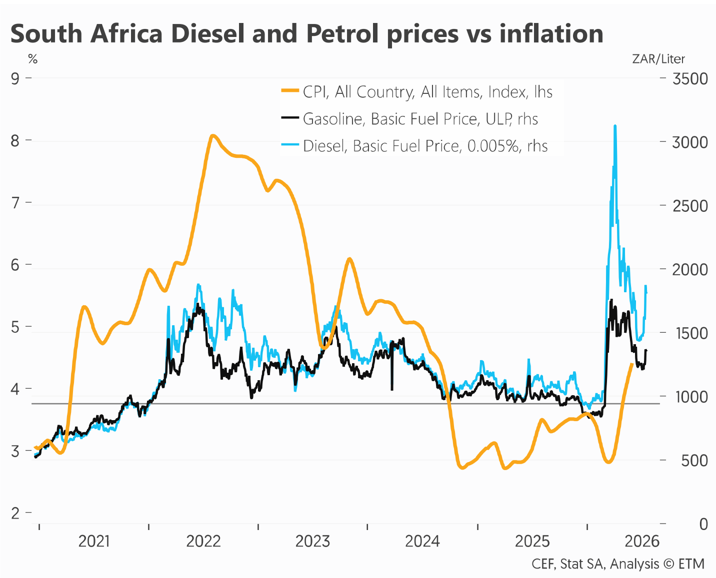


This week, the SARB has to decide on interest rates. It is a close call. Prior to the resumption of the war with Iran, traders appeared fairly comfortable with the idea that the SARB would hold off on this meeting and would rather tighten further once the scale of the impact was better understood.

That appeared to be a prudent approach and would be easily justified, especially given the Fed's decision to keep rates on hold. However, things have changed, and the SARB now faces the prospect of a more intense inflation environment resurfacing.

With oil prices trading significantly higher and the ZAR having depreciated, the prospect of a more prolonged bout of inflation now needs to be considered a challenge that must be addressed. The SARB could justify raising the spread between its repo rate and the Fed funds rate as a means of buying insurance against inflationary pressures.

ZAR's stretched valuation points to limited appreciation potential

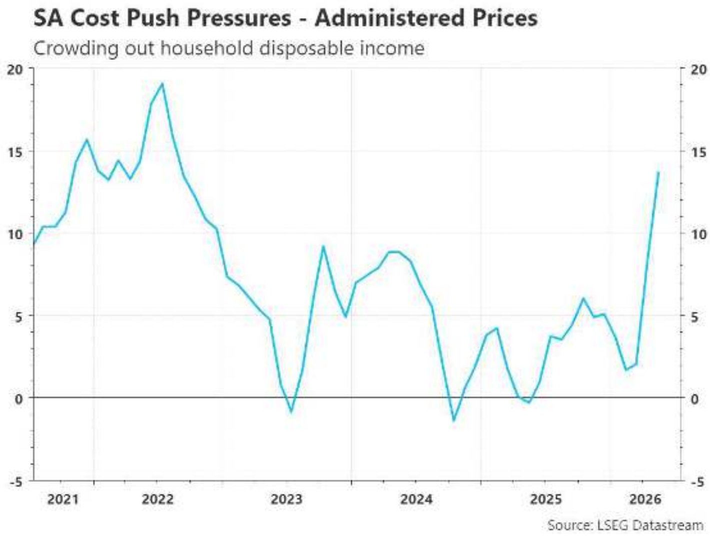


The most obvious point of pressure will be drawn through the fuel price transmission mechanism. As oil prices spike once again, so will inflation prospects. While the SARB will be aware that this is driven by another supply shock rather than through strong demand conditions, they will also be mindful of second-round effects to inflation remaining well-entrenched.

Add to that the inflationary pressures attached to administered prices, and the SARB has strong justification for ensuring that monetary policy remains tight enough to constrain the credit cycle. It will, of course, detract from FGDP growth, but that is the consequence of years of maladministration across SOEs, municipalities and the broader g9vernment than it has anything to do with the private sector.

As has been the case for decades, the state remains an overwhelming constraint on the private sector.

Administered price pressures a renewed headache for the SARB



Ahead of next week's inflation data and the SARB decision on rates, it is worth discussing the impact of administered prices. NERSA's latest impact assessment converts administrative failure into measurable national loss. The regulator already approved average 2026/27 increases of 8.76% for Eskom direct customers and 9.01% for municipalities. Its preferred treatment of disputed revenue now allows R35bn to be recovered over two years, adding 3.40% and 2.64%. NERSA estimates 41,104 job losses and almost R10bn in reduced household income.

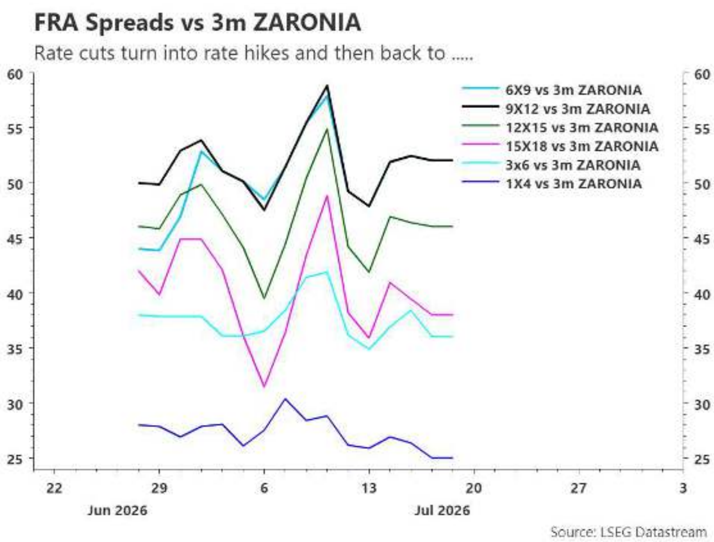
This follows errors in valuing Eskom's generation asset base, including assigning zero value to operating stations. The episode is not an unavoidable energy shock, but the socialisation of regulatory mistakes through a captive customer base compelled to repair institutional balance sheets it neither controlled nor damaged, through no fault of their own.

The inflation effect extends beyond electricity's direct weight in the consumer basket. Higher power costs raise municipal tariffs, mining and manufacturing expenses, refrigeration costs, logistics costs, retail overheads, and the cost of maintaining backup generation. Firms facing weak demand cannot always pass these increases through, so the adjustment appears through lower margins, deferred investment, reduced hiring or retrenchment. Where pass-through is possible, second-round price effects complicate the SARB's inflation task and keep real interest rates higher than they otherwise would be. Low-income households suffer most because electricity consumes a larger share of their budgets, while wealthier users can finance solar, batteries, and efficiency upgrades, accelerating an inequitable exit from the grid. This compounds severe national inequality.

Companies should therefore assume electricity inflation will remain structurally above headline inflation until governance, competition and tariff methodology improve materially. Businesses should stress-test margins against repeated high-single-digit increases, renegotiate escalation clauses, invest selectively in embedded generation and storage, and assess suppliers' exposure to municipal mark-ups and unreliable distribution.

Yet self-generation is defensive capital, not evidence of national efficiency: funds diverted into duplicating basic infrastructure cannot finance expansion, technology or employment. The emerging two-tier system also weakens Eskom's sales base, leaving poorer and smaller customers to bear a greater share of fixed costs. Without credible cost transparency, private participation and hard consequences for failure, further tariff pressure remains the rational base case today. The SARB is aware of this and will know that tightening monetary policy simply piles more misery onto households already battling inescapable administered prices.

Market positioned for rate hikes, at the Jul MPC and beyond



Ahead of next week's SARB decision, it is worth taking stock of what the futures markets are pricing in. If current rates are anything to go by, there is a strong probability that the SARB will hike at the next MPC meeting, and another rate hike could follow thereafter.

The 1X4 is currently pricing in a full 25bp rate hike, with the 9X12 pricing in a second. Of course, much will depend on whether the war continues for much longer and the ZAR price of oil becomes an increasingly serious problem over time.

The higher the probability of second-round inflationary pressures, the higher the probability that the SARB will be forced to respond. Readers will notice that expectations did not rise this week despite the rise in oil prices and the depreciation of the ZAR. The reason for that is that the market was already positioned for this.

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