MNI South African Reserve Bank Review: May 2025

Executive Summary:

- **The MPC voted 5-1 to cut rates by 25bp; the dissenter sought a 50bp cut.**
- **The SARB revised its growth and inflation forecasts lower, with balanced risks.**
- **A scenario assuming a lower +3% Y/Y inflation target was discussed at the meeting.**

Key Links:

- **MPC Statement**
- **Press Conference**
- **Forecast Report**
- **Tariff Scenario Report** and **3% Target Scenario Report**

Key Takeaways: Target Revamp Talk Gains Traction

The South African Reserve Bank (SARB) resumed monetary easing, with the Monetary Policy Committee (MPC) voting 5-1 to reduce the repo rate by 25bp to 7.25%. Although consensus was split between a 25bp cut and a hold (albeit leaning towards the former), the dissenter cast their vote in favour of a 50bp cut. The decision came on the back of downward revisions to growth and inflation forecasts, with the MPC assessing the risks to both as balanced overall. Governor Lesetja Kganyago signalled that the work on revising the inflation target is at an advanced stage, revealing that the MPC discussed a scenario with a +3.0% Y/Y CPI objective, which would be 'more attractive than the +4.5% baseline.'

Although the 25bp rate cut matched consensus, the dovish 5-1 vote split came as dovish a surprise. None of the six policymakers voted for a hold, even as a sizeable minority of analysts pencilled it in. The decision was underpinned by a reduction in global uncertainty (with a reference to its 'extreme levels' dropped from the statement), a dovish adjustment to the outlook for global interest rates, as well as disinflationary macroeconomic developments at home. The SARB pointed to early signs of weakness in the economy in 1Q2025, with the outlook for growth trimmed accordingly. It further noted that inflation was 'well contained' and headline inflation undershot the target again, resulting in downside revision to the inflation outlook. Furthermore, the rand's exchange rate has recovered markedly and 'conditions seem more settled than they did in March'. This gave the MPC sufficient comfort to cut rates again.

In an interesting twist, the SARB revealed that the meeting involved a discussion of alternative forecast scenarios. The first one assumed an escalation in global trade tensions, which would weigh on South Africa's economic growth, while fuelling inflation through the exchange-rate channel. The MPC concluded that 'in these conditions, monetary policy tightens to stabilise the macroeconomy', which could be interpreted as a sort of conditional forward guidance. The second scenario assumed a lower inflation target of +3.0% Y/Y, illustrating the opportunity 'to lock in lower inflation at low cost (…) now that inflation has slowed.'

The +3% Y/Y inflation objective scenario marks a milestone in ongoing work on revising the existing inflation-targeting framework. The SARB has been signalling that the current +3.0-6.0% Y/Y target is too high and too wide, but most analysts have been sceptical about the potential for quick transition to a point-target as low as +3.0%. Fed with this assumption, the Quarterly Projection Model (QPM) showed an interest-rate path with a lower terminal level, owing to a stabilisation of inflation expectations at a lower level, despite the initial headwinds to growth. The MPC explicitly flagged its preference for resetting the inflation target to +3.0% Y/Y and said it would 'also consider scenarios with a 3% objective at future meetings.' The inclusion of this scenario in the SARB's forecasting might be the first step towards its eventual implementation. The SARB did not mention whether, when push comes to shove, the transition would be immediate or more gradual.

With the SARB signalling surprising conviction about its most recent interest-rate cut, alongside the fact that benign inflation dynamics, headwinds to growth in 1Q2025 and a stronger rand exchange rate spoke in favour of the move, we expect the central bank to continue loosening policy going forward. Commenting on where the SARB is, Deputy

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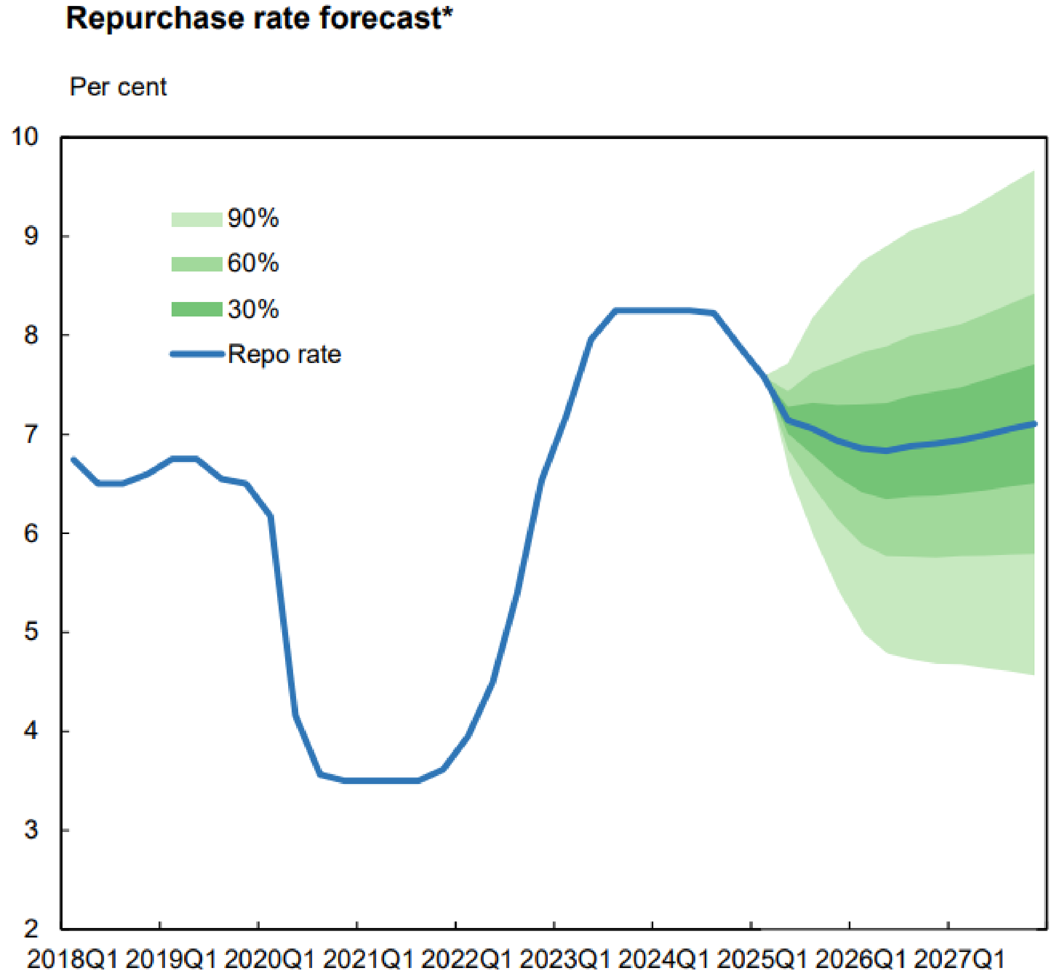
Governor Rashad Cassim clarified that the central bank is not committing to an easing cycle in the current unstable environment and will stick with its risk-based, data-dependent approach. He added that the SARB has now reduced the restrictiveness of monetary policy as planned and is in the broadly conceived neutral zone (with the repo rate around 7%). We see potential for a further fine-tuning of the repo rate to 7%, should benign inflation conditions remain in place, with the rate outlook further down the road dependent on the changes to the inflation targeting regime.

As for the target, the final call is with the Finance Minister, who would have to rally political support behind a formal decision to replace the quarter-century old framework relying on a relatively wide target range, with a focus on the +4.5% Y/Y mid-point introduced in 2017. The SARB's messaging ramps up pressure on Godongwana to facilitate the process, directly addressing his earlier concerns about future benefits and the costs of transition. It can now be expected that the new target could be announced within the coming months.

SARB Interest-Rate Forecast



*The uncertainty bands for the repo rate are based on historical forecasting experience and stochastic simulations in the Quarterly Projection Model (QPM). The bands are symmetric, and therefore do not reflect any assessment of upside or downside risk. For details on the QPM see 'Enhancing the Quarterly Projection Model', South African Reserve Bank Working Paper Series No. WP/23/05, June 2023.

Source: SARB

Analyst Views (Alphabetical Order)

BER: SARB Sees Scope For Further Easing And Ramps Up +3% Target Talk

- They write that they expected a split decision, so the dovish tilt with all six members voting for a cut (and one even preferring a 50bps cut) was surprising but welcome.
- In their view, the clear signalling around moving to a 3% inflation target is positive and removes uncertainty.

Goldman Sachs: Next Cut Expected In July Amid Benign Inflation Outlook

- The SARB cut its repo rate by 25bp from 7.50% to 7.25%, in line with their forecast and consensus expectations (consensus was split between a 25bp cut and a hold, with a minority forecasting the latter). However, the 5-1 split vote with one dovish dissent for a 50bp cut – which Goldman had argued for in contrast to the market baseline for 1-2 hawkish dissents – and the lowering of both growth and inflation forecasts, represent a significant dovish shift compared to the March MPC.
- With a more benign inflation outlook than the SARB in the medium term, combined with the dovish shift as well as downward revisions in both growth and inflation forecasts today, they continue to expect – with increased confidence – that the SARB will cut its repo rate by 25bp in July. Meanwhile, although the timing remains uncertain, they also see the possibility for two more cuts beyond July.

HSBC: SARB's Approach Supportive for ZAR

- They note that the rate cut may appear small given inflation is below the target range of +3.0-6.0% Y/Y and USD/ZAR is below 18.0. However, the decision illustrates again the SARB's structural policy approach whereby actions are not taken opportunistically but by considering long-term trends and risks. Such an operational framework is clearly ZAR-positive and one of the reasons behind HSBC's constructive view on the currency.
- They deem it worth noting that SARB's projections continue to imply a very limited scope for further rate cuts. Policymakers believe the monetary policy could be seen as 'more or less' neutral given an estimated neutral rate close to 7.0%. It seems the SARB is not envisaging to make monetary conditions accommodative (i.e. cutting the policy rate below 7.0%). One of the key reasons is probably related to the SARB's wish to lower its inflation target. During the press conference, Governor Lesetja Kganyago explained extensively why the inflation target should be lowered, possibly to 3.0%. He argued that a lower target would mean lower interest rates and stronger economic growth ahead.
- Mr Kganyago believes the timing is appropriate to minimise the costs that would arise with such a change. The SARB has presented an alternative scenario were the inflation target to be +3.0%. In such a scenario, the policy rate would fall to 6.0% instead of staying above 7.0% as in the baseline scenario. Growth would be weaker in the near term but would accelerate as interest rates are lowered over the medium term.
- Overall, HSBC believe that the monetary policy decision, the prudent communication around the monetary policy outlook, and the credible arguments about the benefits of a lower inflation target are ZAR-supportive. That said, the ZAR has performed very well lately and probably priced in many positives. Therefore, they see a limited downside potential for USD/ZAR until there is greater clarity on the inflation targeting framework.

JP Morgan: Dovish 25bp Cut With One Member Preferring a 50bp Drop

- They note that the MPC delivered the expected 25bp cut to take the repo rate to 7.25%, but the meeting was substantially more dovish than expected. One member voted for a 50bp policy rate reduction and the QPM-projected repo rate for end-2025 was lowered to 6.93% (from 7.25%). Moreover, the statement and subsequent Q&A substantially scaled back the typically cautious tone.
- The SARB sent the strongest signal yet of an imminent inflation target change, in line with JP Morgan's expectations of an announcement within the next two or three months. They note that it is relevant that the Governor confirmed in the written statement (not just the Q&A) that technical work on the inflation target change was at an advanced stage. Following extensive engagement between National Treasury and the SARB, (final) recommendations from the technical team are due to be submitted to the Finance Minister and the Governor, who would then take a decision. Seemingly the main outstanding work is the mechanism of time frame and the glide path (if any) to the lower target. The Governor indicated that the efforts to obtain

political backing would be left in the hands of the Finance Minister, which JP Morgan do not expect to be an issue despite growth concerns.
- In JP Morgan’s view, an underlying key assumption behind the 3% modelling is a strong forward-looking component of inflation expectations and the anchoring by a credible central bank. The timing also serves to lock in the advantage of currently low inflation, reducing the trade-offs. The Governor stressed that lower inflation and a lower inflation target begets lower (not even temporarily higher) inflation. JP Morgan continue to look for a further interest rate cut in September, but acknowledge risks that it may now be delivered already in July, particularly should the target change be announced in the interim.

Nedbank: MPC Delivers 25bp Cut

- Nedbank write that the votes reflect a remarkable about-turn from the caution that dominated the March meeting. Unsurprisingly, the benign inflation outcomes of recent months, a very subdued inflation outlook and the rand's unexpected resilience in the face of global uncertainty tilted the debate in favour of further easing.
- While Nedbank expected the MPC to hold rates steady, they felt that the inflation dynamics supported further monetary easing. On the merits, the decision was the right one. Most measures of inflation are well below the current +4.5% Y/Y target. Key drivers of the outlook also look benign. Global growth prospects have dimmed, China is exporting chunks of deflation, and international supply chains are coping with the US's erratic tariff policies. Excess supply and soft demand are weighing down global oil prices. The surplus will likely remain in place for some time, keeping oil prices in check. Despite the US Fed's caution, America's fiscal and tariff uncertainties unexpectedly hurt the dollar. These concerns are unlikely to be resolved quickly, suggesting that a sudden and sustained resurgence in the dollar now appears less likely. Finally, the domestic economy remains frail. Structural changes are happening too slowly to lift production meaningfully, while consumers are still cautious as interest rates remain relatively high. They suspect the economy stalled altogether in Q1. Moreover, they forecast GDP growth of only +1% Y/Y this year. Against this context, they have changed their interest rate forecast to reflect another 25bp cut later this year. If the markets are right and the US Fed cuts rates by 50bp in response to slowing US growth, the MPC will also have the space to ease more aggressively.
- The MPC took the opportunity to address the uncertainty around how the prospect of a lower inflation target would affect interest rates. The SARB wants the target to be reduced to +3% Y/Y. The Governor reiterated that a lower inflation target would lower interest rates through falling inflation expectations. To test this, the SARB ran with the Quarterly Projection Model with a +3% target as the objective. The results recommended the latest 25bp cut and reflected a policy rate of just under 6% rather than the baseline's 7%.