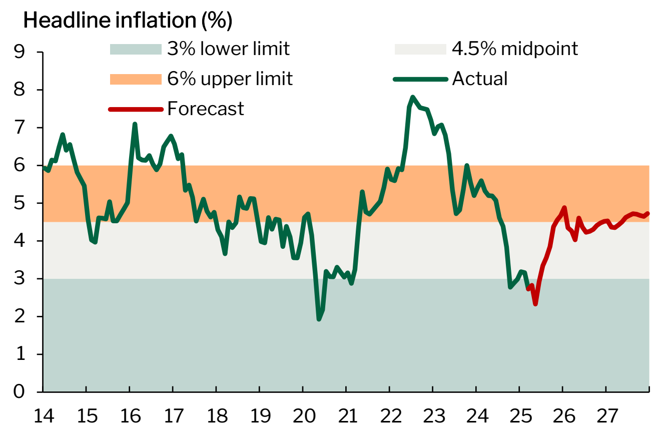
MPC Preview

ECONOMICS | SOUTH AFRICA | MONETARY POLICY

Fear of the unknown will likely keep interest rates on hold.

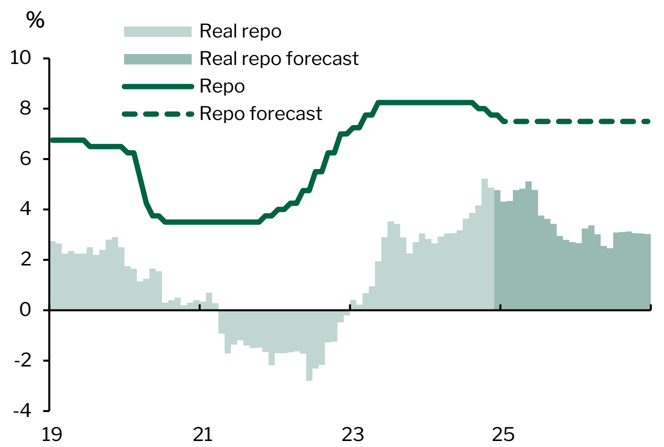
- We expect the MPC to leave interest rates unchanged at next week's meeting. That said, it is a difficult one to call. MPC members were divided on the past two decisions. As we see it, the decision hinges on how much weight the Committee places on recent price dynamics relative to potential upside risks posed to the inflation outlook by a highly unpredictable global environment.
- If the focus falls on the underlying price dynamics, a strong case can be made for further rate cuts. Recent inflation outcomes have been benign. Inflation increased slightly to 2.8% in April but remained well below the SARB's 4.5% target. More importantly, more evidence emerged of subdued underlying price pressures. As expected, food prices increased, but fuel prices declined further. Finally, the prices of around 72% of the goods and services in the consumer price index rose by less than 4.5%. As a result, core inflation eased to 3%.
- The upside risks to the outlook have also subsided since the March meeting. We still see food prices rising off last year's low base. However, a healthy summer harvest will partly contain the impact of higher global food prices, keeping the upward slope relatively shallow. International oil prices have declined sharply in recent weeks. OPEC+ and other producers increased supply as global demand prospects weakened amid increased protectionism by the US and retaliation by China. These developments are unlikely to be reversed quickly. The latest polls have Brent crude below $70 per barrel until end-2026. If they are right, weak global oil prices will be a powerful disinflationary force, directly through lower local fuel prices and indirectly by reducing operating costs in all sectors. Even the rand proved more resilient than we anticipated. The currency benefitted from some good domestic news and a lacklustre US dollar, weighed down by US tariff uncertainty and mounting fiscal concerns. The risk of renewed currency volatility remains high in the current troubled global landscape. Even so, persistent and sustained rand weakness now appears less likely given the dollar's unique woes. Consequently, our inflation forecast aligns with the SARB's projections in March, with the headline figure averaging 3.5% in 2025 and 4.5% in 2026 and 2027. In the context of a 4.5% inflation target, there is space for further cuts of around 50 bps in this cycle.

Chart 1: Inflation will remain subdued but drift higher.



Source: Stats SA & Nedbank

Chart 2: We suspect the MPC will hold rates steady



Source: SARB & Nedbank

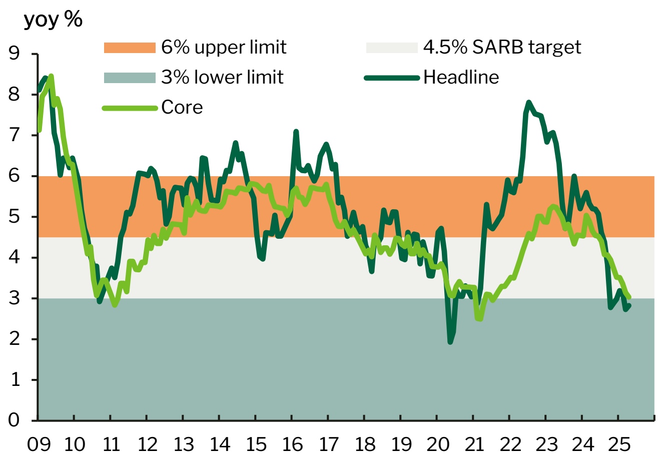
- The decision becomes murkier if MPC focuses on potential upside risks to the inflation outlook. The MPC paused in March because US policy uncertainty posed downside risks to the rand and upside risks to inflation. Since then, clarity has been elusive. US trade policy is still evolving and changing. Despite concessions to some countries, notably China, US tariffs are still higher than at any other time in its long history. While the inflation effects are not yet visible in the numbers and are largely unknown, recent indicators suggest that the US economy is losing momentum. The US Federal Reserve (Fed) and the markets are also in a standoff. The Fed has kept its policy rate on hold to assess the impact of the policy changes on inflation and economic activity. In contrast, the markets are discounting cuts of 50 bps in the second half of the year in anticipation of a faltering economy and higher unemployment. At the same time, President Trump's budget bill is making its way through the legislature, threatening to weaken America's already compromised debt metrics even further. The rising fiscal risks have alarmed global investors and soured sentiment towards US Treasuries, driving bond yields up and weighing on the US dollar. In conclusion, the risk of renewed market volatility remains high due to fragile investor sentiment, battered by the relentless barrage of US policy changes. With the switch to a lower inflation target looming, the MPC will likely wait for more clarity.

- Our central forecast is for rates to remain unchanged for the rest of this year. However, if the Fed cuts later this year, the MPC could easily follow without placing undue pressure on the currency.

Recent inflation trends

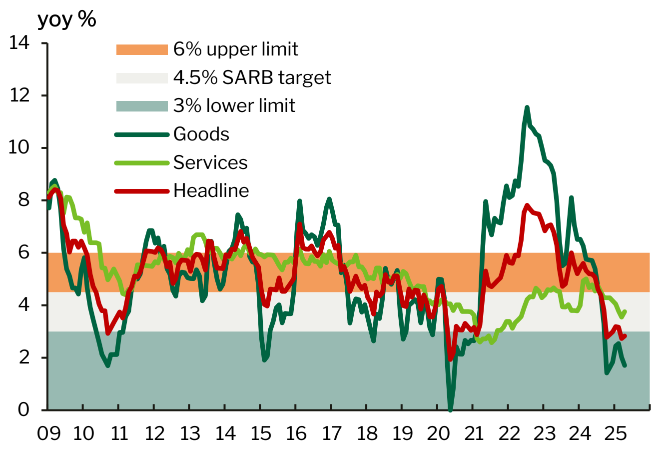
Headline inflation has remained subdued so far in 2025. It eased from 3.2% in January and February to 2.7% in March before ticking up to 2.8% in April. Falling fuel prices kept inflation in check. Local fuel prices benefitted from sharply lower global oil prices, amplified by a firmer rand relative to a year ago. Consequently, fuel price deflation intensified from 8.8% in March to 13.4% in April. However, food prices dampened the downward pressure from fuel prices. Food prices increased further off a low base in April, rising from 2.2% in February to a seven-month high of 3.3% in April. Almost all the major food products contributed to the rise. Global food prices followed the same pattern. According to the United Nations' Food and Agriculture Organisation (FAO), food price inflation accelerated from 6% yoy at the end of last year to 6.8% in March and 7.6% yoy in April.

Chart 3: Inflation remains below the SARB's 4.5% target



Source: Stats SA

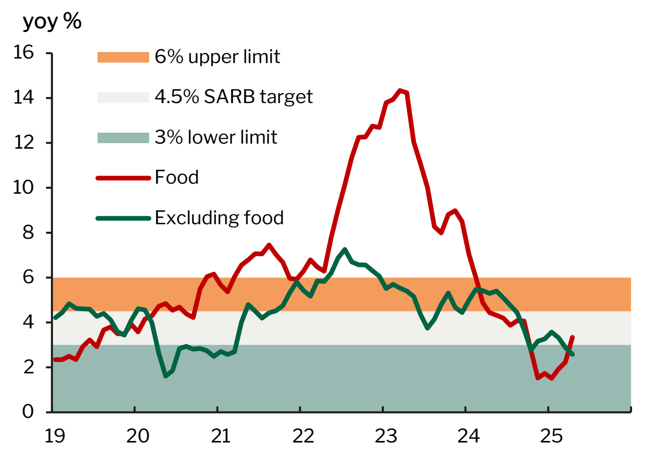
Chart 4: Services ticked up, but goods relapsed



Source: Stats SA

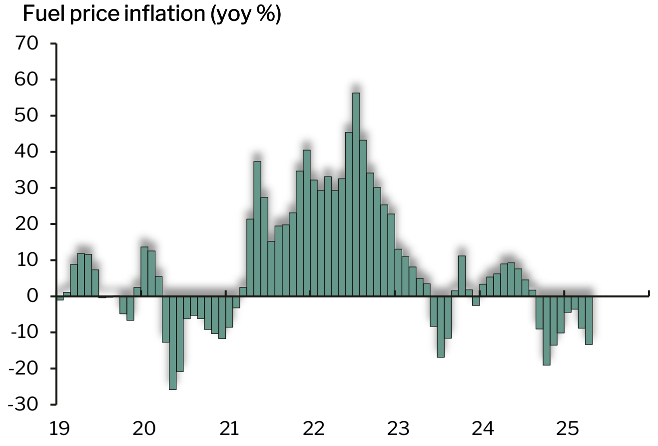
Despite the upturn in food inflation, underlying price pressures remained contained, mainly reflecting easing supply-side constraints, but also relatively subdued domestic demand. Core inflation, which excludes food and energy costs, moderated to 3% in April, its lowest level since July 2021. Core has been below the SARB's 4.5% target for 10 consecutive months. Goods inflation slowed to a five-month low of 1.7% in April, while services inflation moderated to an equally tame 3.8%.

Chart 5: Upturn in food inflation continued



Source: Stats SA

Chart 6: Fuel price deflation intensified



Source: Stats SA

Even administered prices (excluding fuel), which have been a significant source of inflation over the past decade, eased from 7.7% in February to 6.2% in April. Within this category, the main culprit is electricity tariffs, which are still rising at double digits. Nonetheless, electricity and other fuels also softened somewhat from 11.9% in March to 11.6% in April.

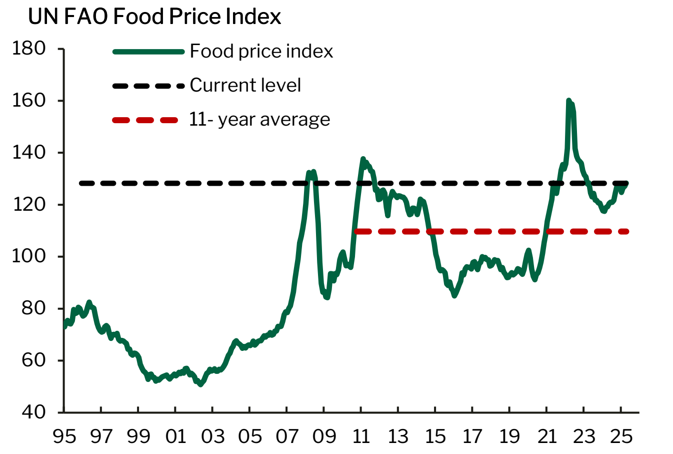
Although inflation nudged higher in April, the modest lift was isolated to food, while disinflation continued in most other goods and services. The prices of just over 72% of all goods and services in the consumer price index rose by less than 4.5%.

Our inflation forecasts.

We expect inflation to hover below 3% until June before drifting moderately higher in the year's second half. Even so, inflation will remain relatively benign, ending the year just below 5% and averaging 3.5% in 2025. The upward trend will continue next year, with inflation averaging around 4.5% in 2026 and 2027.

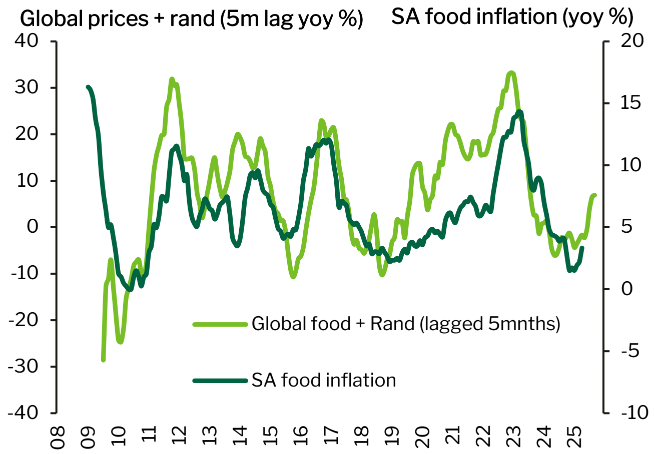
Upward pressure will likely flow from food prices rising further off a very low base. Local food prices are hovering around their troughs and will start picking up, but increased domestic food supply should provide some counterweight. Increased slaughtering due to foot-and-mouth disease in some regions will keep red meat prices in check while good rains across the country appear set to boost field crop production. Most of the upward force will come from rising import costs as global food prices increase and the rand weakens relative to the stronger levels reached in the second half of last year. The 12.7% increase in electricity tariffs will also add to inflation. The anticipated recovery in consumer demand could translate into mild price increases in some markets, particularly services, as companies try to restore eroded profit margins.

Chart 7: Global food prices are rising again



Source: UN FAO

Chart 8: Local food prices tend to lag global trends



Source: Stats SA, UN FAO, Nedbank calculations

In contrast, subdued fuel prices and easing supply-side constraints will exert downward pressure. We expect fuel price deflation to continue until mid-2026. However, the rate of decline will moderate as the low base kicks in towards the end of this year and into next year. Global oil prices have fallen sharply over the past two months and are widely expected to remain relatively subdued. Finally, domestic operating costs are still normalising on fewer power outages and logistics failures relative to 2023. Ongoing structural reforms will likely embed some of these cost reductions and also allow the economy to grow a little faster without triggering renewed disruptions and the resultant cost and price pressures.

Revisiting the balance of risks to the inflation outlook

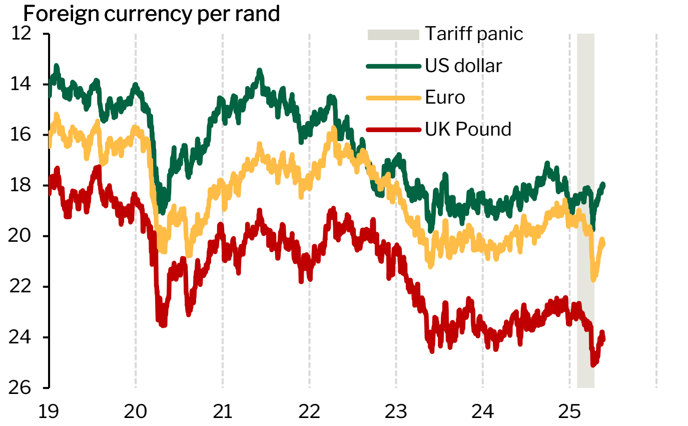
The balance of risks to our inflation forecast probably still rests on the upside. Some of this stems from the low base, which could amplify potential shocks. The country's fragile public infrastructure is still a source of concern. Despite some progress with structural reforms, critical infrastructure remains strained and unreliable. In recent years, there has been evidence of a cascading effect. Just as the government tackles one or two stress points, like electricity and logistics, other failures pop up, like the collapse of municipal services and water supply. In addition, progress has been slow and patchy. Consequently, the efficiency gains have been too marginal and uneven to materially reduce operating costs and lift the price competitiveness of domestic companies. Moreover, we are not entirely sure what level of economic activity the country can sustain without a repeat of the 2023 setbacks. Although not highly probable, it is still possible that moderately faster economic growth could again trigger significant disruptions, aggravate operating costs, and force companies to pass these on to consumers.

However, the highly unsettled global landscape still poses the most significant upside risks to the inflation outlook. Of course, the source of unease is the dramatic and rapid changes in US trade and other economic policies under the second Trump administration. The original fear was that higher US tariffs and retaliation by China and other countries would disrupt global supply chains, aggravate cost and price pressures, keep US interest rates elevated, undermine international trade, and slow global economic activity. We expected the likely adverse impact of US policy on China and the world economy to heighten risk-off sentiment among international investors, leading to further dollar strength and renewed pressure on emerging market currencies, including the rand. Instead, the acute uncertainty created by the relentless barrage of US policy changes has weighed down the US dollar.

The rand: Holding up but still vulnerable

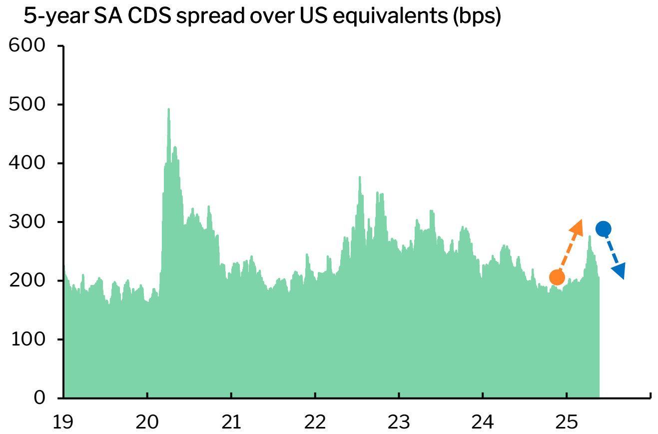
The rand has held better than we expected but remains vulnerable. The currency has been more volatile than most other emerging market currencies, tracking the wild swings in global risk appetites that followed every twist and turn in US trade and fiscal policies. The rand plunged in the immediate aftermath of President Trump's reciprocal tariffs announcements, but then systematically recouped most of these losses as the US walked back its most extreme tariff measures. In this regard, the tariff compromise between the US and China steadied investor sentiment and facilitated the rand's pullback. Better domestic news also contributed. The Government of National Unity still exist. The ANC and DA largely overcame their prolonged spat over the proposed VAT increase. The major rating agencies gave the government the benefit of the doubt, maintaining the country's credit rating and outlook. The Deputy President suggested that a lower inflation target is imminent. National Treasury finally tabled the National Budget on their third try. On the same day, a South African delegation led by President Ramaphosa survived a Zelensky-type ambush by President Trump with the country's dignity mostly intact. President Ramaphosa indicated that the delegation made progress in healing the country's fractured ties with the US in constructive talks behind the scenes.

Chart 9: The rand recovered all lost ground against the USD



Source: LSEG

Chart 10: SA's risk premium has declined in recent weeks

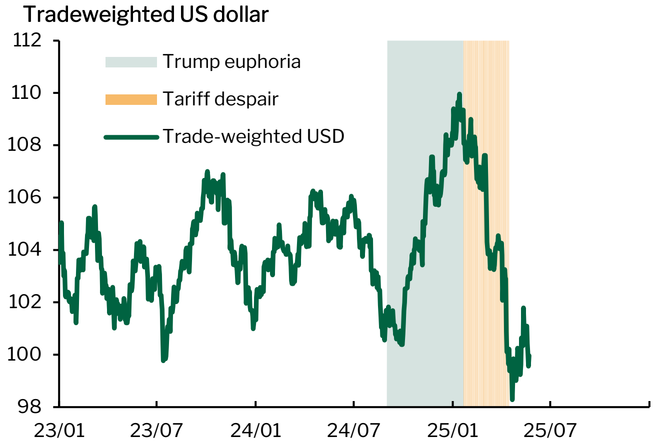


Source: LSEG

The most significant boost to the rand likely came from the continued malaise of the US dollar. The dollar appears to be grappling with a confidence crisis of its own. First, Trump's dramatic foreign policy realignments unsettled international investors. Then, the chaotic rollout of the trade policy rattled the markets. On this score, the Trump administration took the world on a rollercoaster ride from the low of the sweeping Liberation Day tariffs to the relief of the sudden concessions and unexpected delays, leaving most dazed and confused. It is still unclear what US trade policy will ultimately look like. This uncertainty continues to obscure the outlook for inflation, interest rates and economic growth. The markets are betting that the imminent economic pain will overshadow the inflationary consequences of the tariffs. Consequently, they expect a 50-bps cut in US interest rates later this year. The US Fed is not so sure. It left its policy rate unchanged in May, waiting to see how the changes impact inflation and employment. While the Fed held steady, most other advanced countries eased monetary policy further. Despite the widening interest rate differentials, the US dollar barely moved.

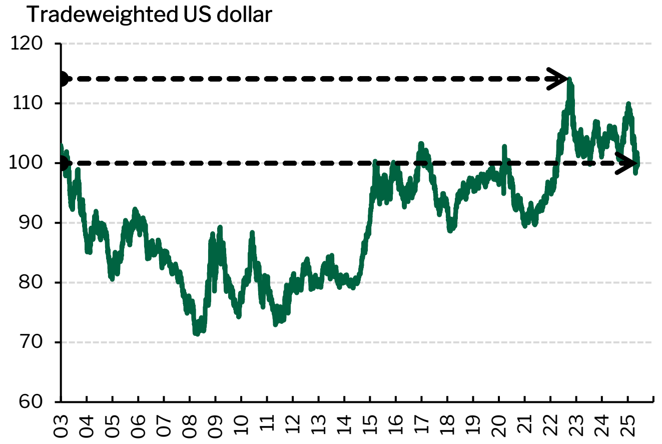
As we write, another storm is brewing. President Trump's 'big, beautiful' budget bill is progressing through the legislature. The bill includes huge tax relief and significant cuts to key social programmes. However, rating agencies and bond investors do not expect the spending cuts to compensate for the tax relief. Consequently, the bill will add to America's bloated budget deficit and mounting debt burden. This week, Moody's became the last of the three major rating agencies to strip the US of its triple-A credit rating. While the downgrade has little practical impact, the country's unsustainable fiscal path soured sentiment towards US Treasuries, especially at the longer end of the curve. All these shocks weighed on the US dollar.

Chart 11: The US dollar still lacks upward traction



Source: LSEG

Chart 12: The dollar remains at relatively strong levels



Source: LSEG

In our minds, the question is whether the dollar's woes are merely a normal correction from the lofty valuations at the height of the Trump trade or the beginning of a more prolonged slump due to fading market trust in US political and economic leadership. President Trump is ringing too many changes too quickly for the markets to absorb. The utter unpredictability of the Trump administration's next move may be driving a deeper malaise towards the US assets, chipping away at the US exceptionalism and the US dollar's safe-haven status. While some cracks have appeared in the greenback's armour, there is still no obvious alternative, and it remains backed by the most liquid financial markets and the most competitive economy. That said, we do not expect US policy to settle any time soon. While we did not foresee the extreme volatility of the past two months, we expected the dollar to experience some correction in the first half of the year, followed by a sideways drift to the end of the year. We still see the dollar treading water for the rest of the year. As a result, we expect the rand to hold relatively steady against a sluggish greenback.

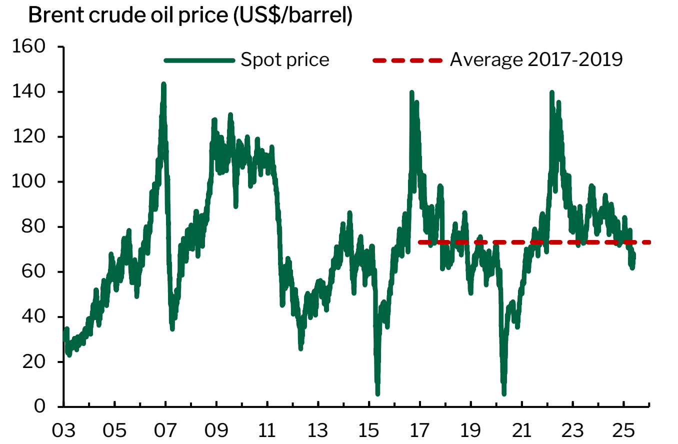
In conclusion, the downside risks to the rand have faded since the last MPC meeting. We expect the rand to become a source of mild inflationary pressure later this year. However, US policy is far from settled, and the consequences remain unknown. Until some clarity emerges, risk appetites will remain fragile and volatile. Sudden bouts of risk-off sentiment could still hurt the rand more than we currently anticipate.

Global oil prices: Fundamentals support lower prices

Global oil prices could pose further downside risks to the inflation outlook. Brent crude fell by 15.4% mom to $65.3 per barrel by the end of April before rising slightly to $64.45 by mid-May. Over the year to date, oil prices have declined by 13.6%. Subdued global demand and excess supply are mainly to blame. Increased protectionism and prolonged policy uncertainty will likely undermine global trade volumes and general economic activity. At the same time, the structural shift towards electric vehicles will continue in most countries, further dampening oil demand. China recorded record sales of electric cars in April. At the same time, US oil production remains robust. Rising market share by the US and other competitors convinced OPEC+ countries to increase production. Starting in July, the group plans to raise output by 411 000 barrels per day. Consequently, supply will likely exceed demand, leading to a buildup in inventories. The US Energy Information Administration (EIA) expects Brent crude oil to average $66 per barrel in 2025, down 18.5% from 2024, and to drop to only $59 per barrel in 2026. Market forecasts show a similar trajectory and level for 2025 but reflect a more gradual decline in 2026. The Reuters poll forecasts an average of $68.98 in 2026 and $67.12 in 2027.

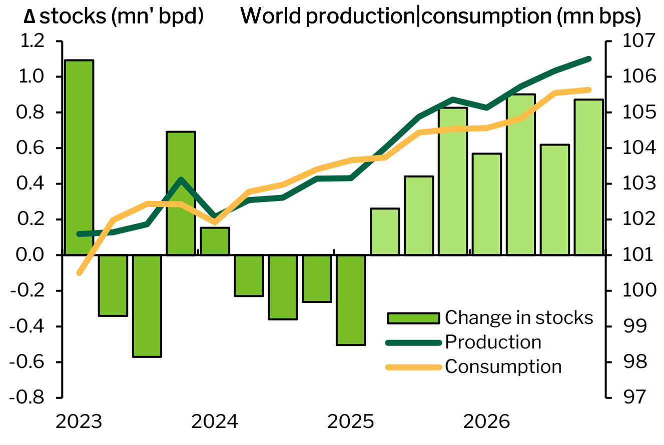
Falling oil prices will be a powerful source of disinflation, overshadowing the impact of a softer rand. However, international oil markets are finely balanced and vulnerable to renewed geopolitical conflicts in oil-producing regions.

Chart 13: Global oil prices came under significant pressure



Source: LSEG

Chart 14: EIA's forecast of the world oil market



Source: EIA

Monetary policy implications

With inflation well below the SARB's 4.5% target and expected to remain relatively subdued, we believe there is room for further monetary policy easing. The upside risks to the inflation outlook have subsided since the last MPC meeting. The rand recouped most of its earlier losses, and global oil prices declined sharply. However, US trade and fiscal policies are still evolving and changing. Despite concessions to some countries, notably China, US tariffs will still be much higher than at any other time since the Great Depression. The inflation effects are not yet visible in the numbers, but confidence is faltering, and the economy is losing momentum. The US Federal Reserve (Fed) and the markets are also sending conflicting signals. The Fed has kept its policy rate on hold to assess the impact of the policy changes on inflation and economic activity. In contrast, the markets are discounting cuts of 50 bps in the second half of the year in anticipation of a faltering economy and higher unemployment. At the same time, President Trump's budget bill threatens to weaken America's already compromised debt metrics even further. The rising fiscal risks have alarmed global investors and soured sentiment towards US Treasuries, driving bond yields up and weighing on the US dollar. The dollar's unexpected woes have helped facilitate the rand's pullback. Given the unpredictability of the Trump administration and the frayed state of investors' nerves, uncertainty and volatility appear to be the only certainties. With the world adrift and a lower inflation target looming, the MPC will likely follow the Fed's lead and wait for clarity. Our central forecast is for rates to remain unchanged for the rest of this year. However, if the Fed cuts later this year, the MPC could easily follow without placing undue pressure on the currency.

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