Monetary policy under high uncertainty

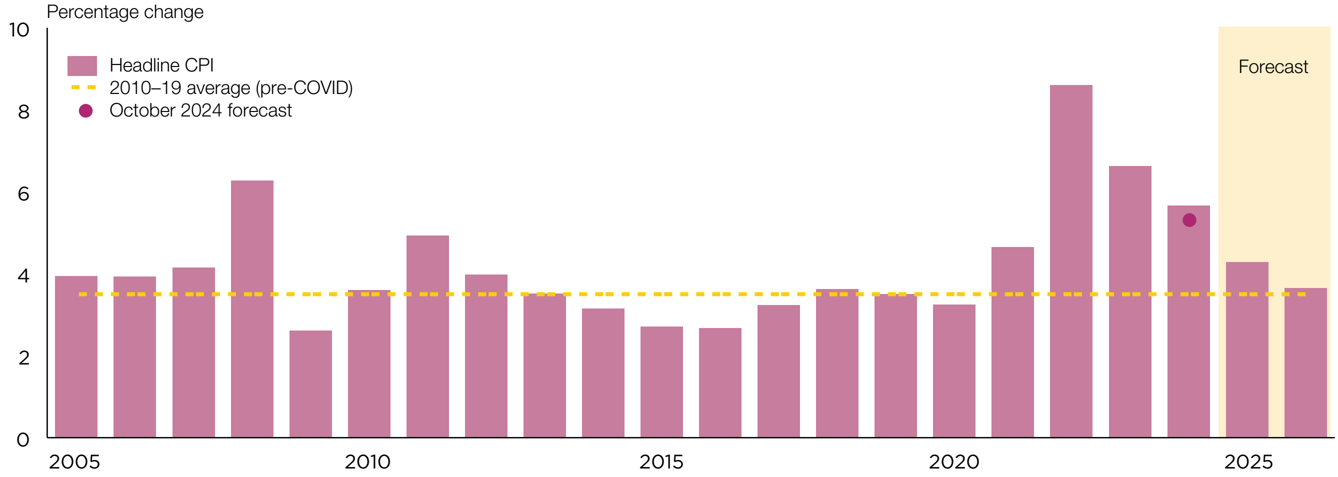
Overview of the world economy

Global inflation continued to moderate in 2024, easing to 5.7% from 6.6% in 2023 and 8.6% in 2022. Favourable price developments in food and energy, coupled with restrictive monetary policy, have underpinned this moderation. While the easing trend is expected to continue, it will not be without setbacks.

THE SARB’S PERFORMANCE

Global headline inflation is projected to average 4.3% in 2025 and 3.6% in 2026.[1] However, the disinflation process has slowed in recent months and monthly inflation outcomes have become more volatile and less consistently downward.[2]

Global inflation

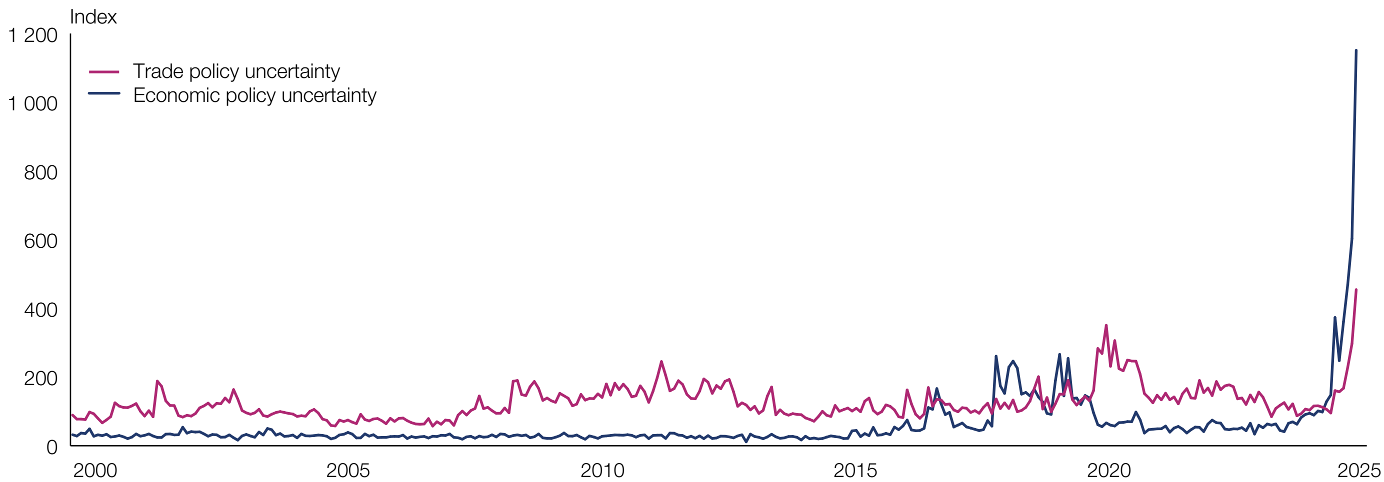


Source: IMF

Inflation continues to exceed the 2% target set by most advanced economies, largely due to sticky services inflation amid somewhat elevated household demand and wage pressures. Goods disinflation has also slowed. Additionally, new inflationary risks have emerged globally, including rising tariffs and escalating trade tensions, which pose serious risks of geoeconomic fragmentation and supply chain breakdowns. However, assessing the impact of these factors on inflation and growth is complicated by weekly policy reversals and high uncertainty about policy endpoints.

Such shocks to world trade are also likely to have negative effects on global economic growth. At this stage, it is unclear whether the inflationary effects of tariffs and fragmentation will offset the disinflationary effects of cooling labour markets and weakening global demand and growth. As a result, market sentiment has shifted, with inflation expectations rising and growth outlooks deteriorating, raising serious concerns about stagflation and ineffective policy responses.

Economic and trade policy uncertainty



Source: S R Baker, N Bloom and S J Davis. 'Measuring economic policy uncertainty'. *The Quarterly Journal of Economics* 131(4). 2016. pp1593–1636

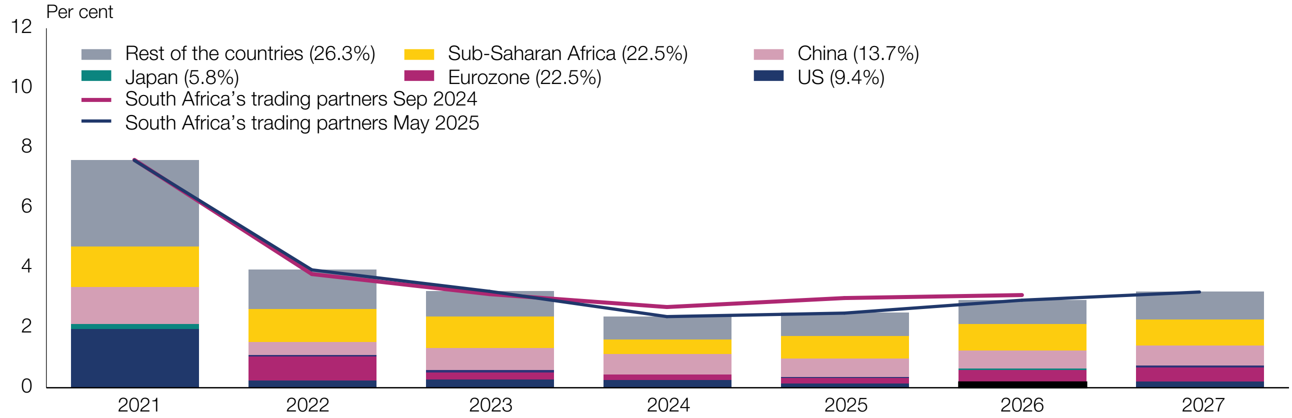
1 IMF. *World Economic Outlook (WEO) Update*. Washington DC: IMF. April 2025.
2 IMF. *WEO*. Washington DC: IMF. October 2024.

Surrounded by stubborn inflation and the emergence of new risks, central banks worldwide have adopted a more cautious approach, implementing smaller-than-expected rate cuts. In emerging markets, inflation volatility has also kept rate cuts modest, while countries like Japan, Brazil and Russia have had to raise rates due to signs of inflation expectations becoming de-anchored.

The stubbornness of inflation suggests that demand has been somewhat resilient, partly reflecting expansionary fiscal policies and relatively strong wage growth buoyed by robust labour markets. This resilience may also reflect less traction from monetary policy – if neutral interest rates have risen, then policy is less disinflationary than central banks assume. As a result, interest rates are likely to remain above their pre-pandemic levels for longer, as central banks look to anchor inflation back to targets. Nonetheless, and despite the less sanguine view of inflation risks, modest policy adjustments by major central banks are still expected this year.

Contributions to trading-partner growth*

The chart shows South Africa's major trading partners and their weighted contributions to South Africa's trading-partner growth.



* Weights in brackets (Percentages may not add up to 100 due to rounding.)
Source: SARB

Turning to economic activity, global growth averaged 3.3% in 2024, though individual country performances varied greatly. This past year, the US again stood out among advanced economies, achieving a 2.8% growth rate, largely driven by strong consumer spending. In contrast, the eurozone faced challenges as weak fixed investment and a lacklustre manufacturing performance weighed on economic output. Emerging markets gave a mixed performance, with India maintaining impressive growth while China struggled with weak demand, placing a drag on its economic activity.

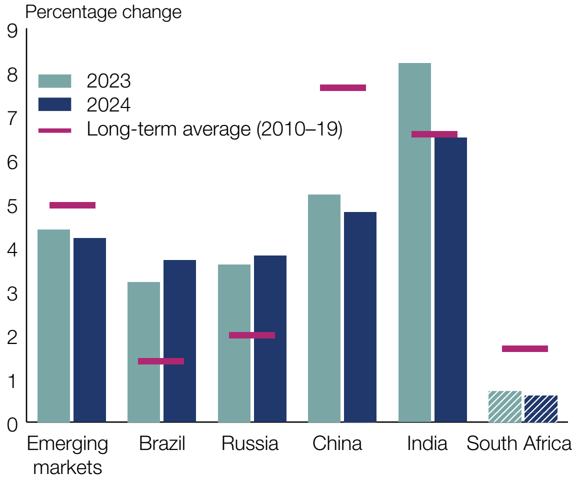
The outlook for the near to medium term, however, has shifted markedly, with trading-partner growth now seen much weaker due to the impacts of tariffs and trade tensions on supply chains and demand as well as the effects of uncertainty on economic activity more generally. Slower trading-partner growth also reflects more muted growth in some of South Africa's key trading partners in sub-Saharan Africa, which have been affected by subdued performance in commodity exports. The SARB forecasts trading-partner growth of only 2.5% this year, broadly unchanged from the previous year, and to rise slightly to 2.9% next year.[3] Nevertheless, downside risks to global growth have increased, aggravated by the ongoing trade tensions and tariff increases.

3 IMF. *WEO Update*. April 2025. (The IMF projects global growth to decline to 2.8% this year, from 3.3% in the previous year, and to rise to 3% in 2026.)

Domestic real economy developments

Economic activity in South Africa remained subdued, with growth slowing to 0.5% in 2024 compared with 0.7% in 2023. Despite improvements in electricity supply and stabilisation in logistics, the domestic economy continues to face challenges such as high costs of production, including energy and operating expenses, alongside a decline in competitiveness. Growth in economic activity was particularly weak when compared to other emerging market peers.

GDP: South Africa versus emerging markets



Sources: IMF and Stats SA

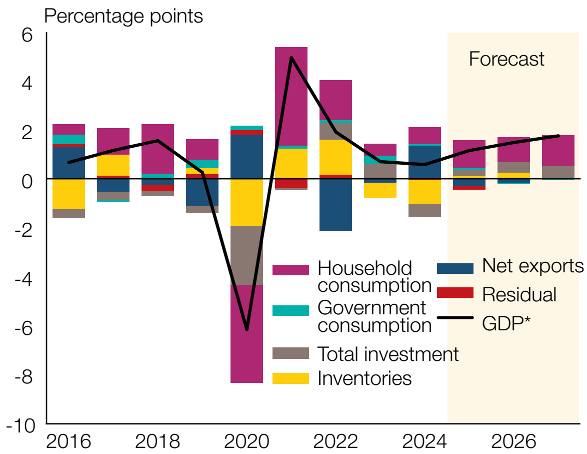
On the supply side, the tertiary sector, notably the finance subsector which expanded by 4% in the second half of 2024, once again led economic growth. However, the primary and secondary sectors struggled, largely due to a poor agricultural performance and the hysteresis effects from load-shedding and logistical constraints affecting mining, manufacturing and construction, among other sectors. Overall, economic activity remains lacklustre, with six of the 10 economic sectors contributing negatively to growth during this period.

Support from demand and spending was also limited as the lingering effects of supply bottlenecks and muted output growth impacted investments, which contracted by 3.7% over the past year. On the other hand, consumer spending grew, lifting growth in gross domestic expenditure. A favourable combination of low inflation, interest rate cuts and withdrawals from the two-pot pension system helped improve real incomes, credit demand and affordability. Additionally, government consumption also contributed to growth this past year.

Looking ahead, growth is expected to continue to be supported by household consumption spending, despite the pull from fiscal drag and muted employment growth. Investment is projected to rebound to 1.8% this year and to rise to 3.4% by 2027. The rest of the components of gross domestic product (GDP) are forecast to have a broadly neutral impact on growth.

The economy is expected to grow by 1.2% in 2025, advancing to 1.8% by 2027. Potential growth is also seen weaker at 1.1% this year, gradually rising to 1.7% by 2027, as the effects of Operation Vulindlela reforms take time to reflect in economic activity, particularly investment. Nonetheless, uncertainties surrounding global trade tensions and tariff increases remain significant risks to domestic growth prospects.[4]

Contributions to real GDP growth



* Percentage change
Sources: Stats SA and SARB

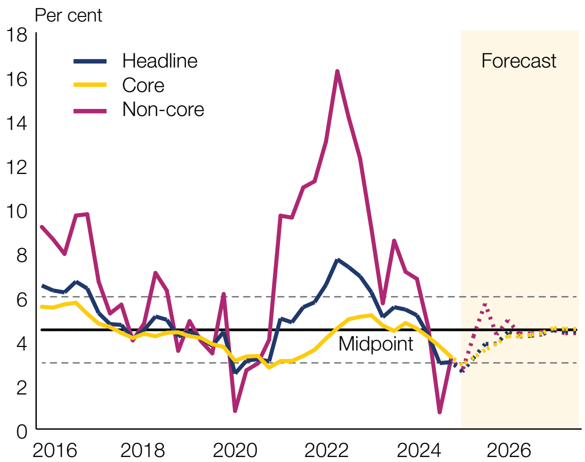
Inflation dynamics

South Africa's headline inflation decelerated sharply during the second half of 2024, reaching 2.8% in October and stabilising around 3% thereafter. The decline was broad-based, affecting both core and non-core inflation rates.[5] Factors contributing to this disinflation included lower food and fuel price inflation as well as rand appreciation. On average, headline inflation for 2024 was 4.4%, marking a decline from 6% recorded in 2023.

Core inflation declined by 0.5 percentage points, averaging 4.3% in 2024 compared with 4.8% in 2023. The decline was driven by a strong rand, which reduced the cost of imported goods, along with monetary policy settings that better managed demand and mitigated second-round effects from the earlier rises in food and fuel inflation.

Headline inflation is projected to average 3.2% this year, increasing to 4.2% in 2026 before reverting to the target midpoint by 2027. This muted trajectory reflects lower inflation projections across all key components of headline inflation, supported by a favourable starting point, lower assumptions for fuel and electricity price increases and a relatively strong rand exchange rate. The trajectory of core inflation is forecast to closely track headline inflation. Inflation risks appear balanced overall, with trade policy uncertainties and potential rand depreciation posing as the main upside risks.

Core versus non-core inflation*



Sources: Stats SA and SARB

4 This works through both the direct effect on SA exports to the US and indirectly via weaker global growth.
5 Core inflation excludes volatile items such as food, non-alcoholic beverages, fuel and electricity, while non-core inflation includes these items.

Monetary policy decisions

The MPC has reduced the policy rate by a cumulative 100 basis points since September 2024, bringing it down to 7.25%. These rate reductions have brought the policy rate closer to its estimated neutral level, despite the current environment of elevated risks and a higher long-term inflation-neutral rate.

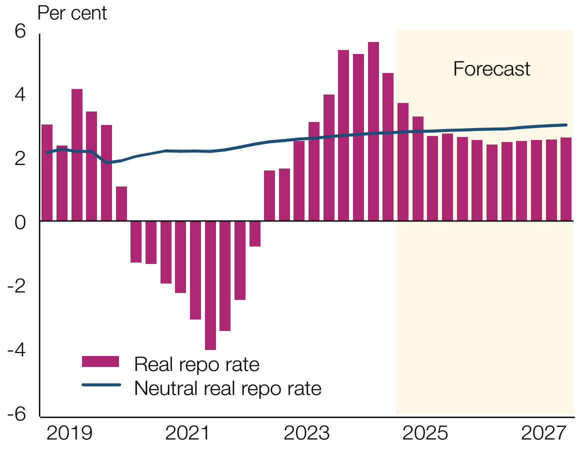
While inflation and its medium-term outlook are assessed to be moderate, there are growing risks due to domestic uncertainties and global trade tensions, reducing confidence in the stability of inflation over the medium term. The SARB remains committed to maintaining low and stable inflation to support balanced and sustainable economic growth.

Recently, discussions have emerged regarding whether South Africa's current inflation target midpoint of 4.5% is consistent with price stability and whether adjusting it to a lower rate might help secure the current trend of low inflation. Analyses undertaken by the SARB, NT and other experts highlight significant potential benefits from reducing the inflation target to 3%. Modelling by the SARB for the May MPC meeting supports this, indicating that inflation expectations could decline quickly given the recent history of inflation hovering around the lower end of the target band, along with enhanced SARB credibility.

Consequently, borrowing costs would fall more significantly under the 3% scenario compared to the baseline forecast over the projected period.

The joint SARB-NT team is almost done with its work on the inflation target and will soon present its recommendations to the Governor and the Minister of Finance.

Real repo and neutral real repo rates



Source: SARB

Governance structure

MONETARY POLICY COMMITTEE
(meets every two months)

Chairperson
Governor of the SARB

Members[6]
DG R (Rashad) Cassim
DG N (Nomfundo) Tshazibana
DG M (Mampho) Modise
Head of ERD
C (Christopher) Loewald

Adviser to the Governors
D (David) Fowkes

Responsibilities

The MPC drives the SARB's responsibilities to achieve and maintain price stability by:

- reviewing economic data, including forecasts, and deciding the appropriate interest rate needed to deliver the SARB's mandate and meet the inflation target; and
- engaging with stakeholders and the public on its monetary policy decisions in the press conference that follows each meeting and various Monetary Policy Forums (MPFs).

6 Other than the DGs, the members of the MPC are appointed by the Governor after consultation with the DGs.