POLICY IMPLEMENTATION

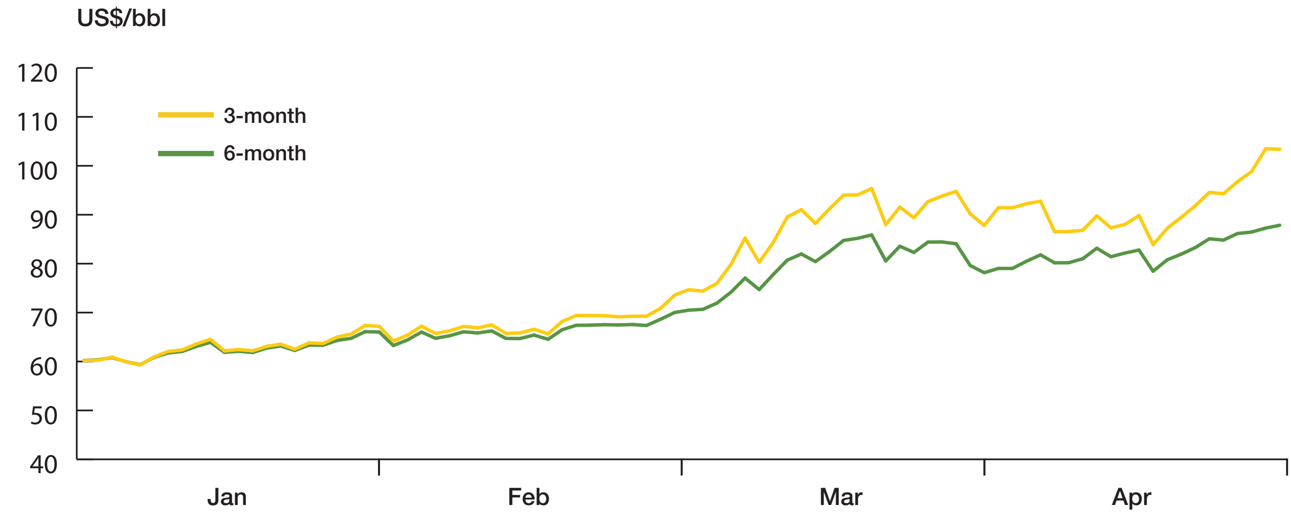
Monetary policy: Holding the line in stormy waters

Overview of the world economy

Global inflation is experiencing renewed upward pressures. The escalating conflict in the Middle East has driven global energy prices sharply higher and disrupted supply chains.

Brent crude oil and European natural gas prices have surged by more than 70% since hostilities began, and prices for fertiliser and aluminium have increased amid constrained supply. Oil futures have also moved higher, reflecting uncertainty about the adequacy of near-term supply.

Brent crude oil futures

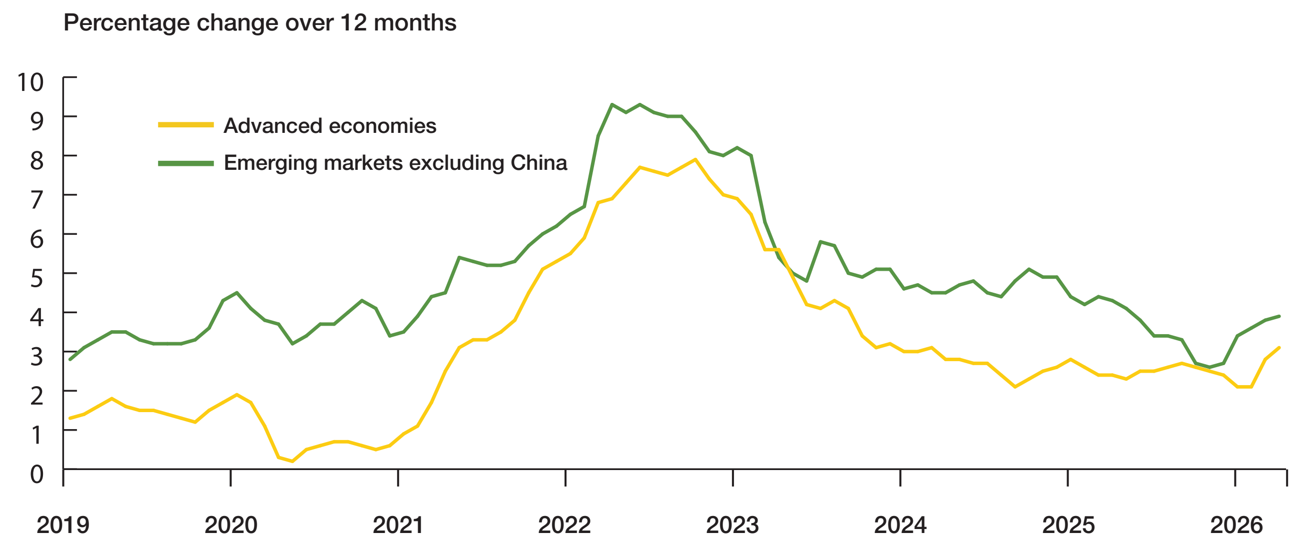


Source: Bloomberg

The past year has been characterised by further increases in geopolitical tensions, with the war between Iran, Israel and the US having a larger impact on the global economy. Bond yields have risen and equity prices have declined in both advanced and emerging economies as investors shifted into perceived safe assets. Along with higher oil prices, these factors have benefitted the US dollar. South African assets also sold off, but showed marked resilience, only partially reversing the gains from the previous six months. However, financial market volatility has subsided appreciably despite uncertainty remaining elevated.

The sudden and sharp deterioration in the inflation outlook is in stark contrast to the strong disinflation seen over the past year. Global inflation declined to an average of 4.2% in 2025, down from 5.8% in 2024, although disinflation largely stalled during the review period. Inflation remained persistently above target in most major advanced economies, reflecting sticky services price pressures and tariff-related price increases in the US, while in emerging economies, inflation reversed trend in 2026.

Headline inflation in advanced economies and emerging markets



Sources: Haver and SARB

The conflict in the Middle East has worsened the near-term inflation outlook and skewed risks to the upside. Alongside ongoing trade tensions, this may accelerate supply-chain fragmentation and add to inflationary pressures, as countries prioritise resilience over efficiency.

Given the uncertainty, central banks are still mostly on hold. However, with prices rising sharply and households being squeezed amid fading hopes of a quick end to the Middle East crisis, markets are now anticipating that major central banks will increase policy rates this year.

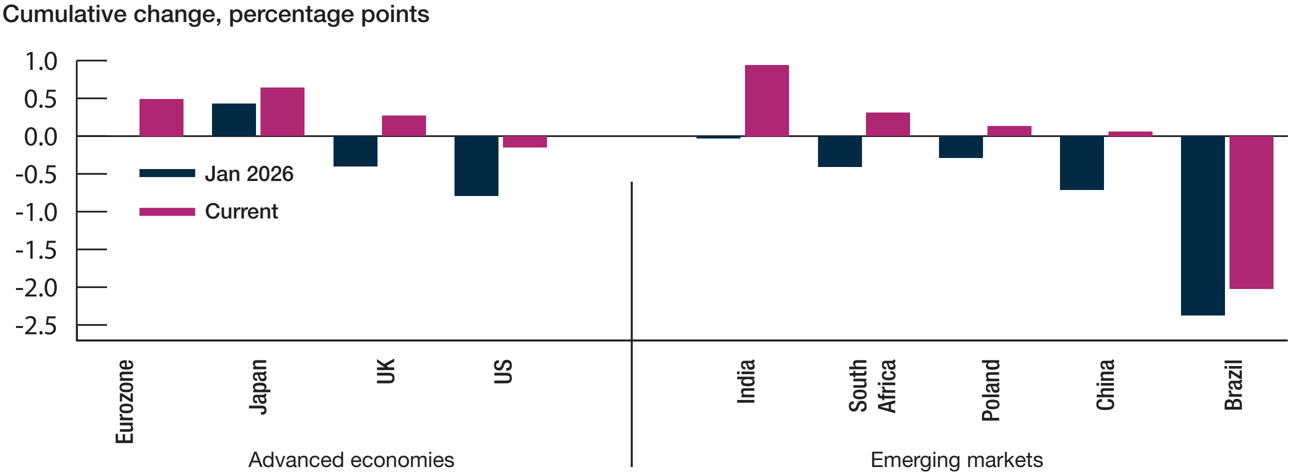
Markets that had priced in rate cuts as recently as January 2026 for this year, now expect most central banks to hike rates to fend off the looming inflationary pressures.

Turning to global growth, the world economy demonstrated resilience over the past year, absorbing US tariff increases and broader geopolitical tensions with minimal loss of momentum. Global growth is estimated at 3.4% in 2025, remaining unchanged from 2024.[9]

This resilience was underpinned by expansionary fiscal policies in major economies, easing monetary conditions and robust investment in AI assets.

However, downside risks to growth have risen materially. Elevated energy prices and renewed supply disruptions raise near- to medium-term stagflation risks. The SARB projects trading partner growth of 2.6% in 2026, rising to 2.8% and 3% in 2027 and 2028 respectively.

Market implied policy rate expectations*



*One-year ahead

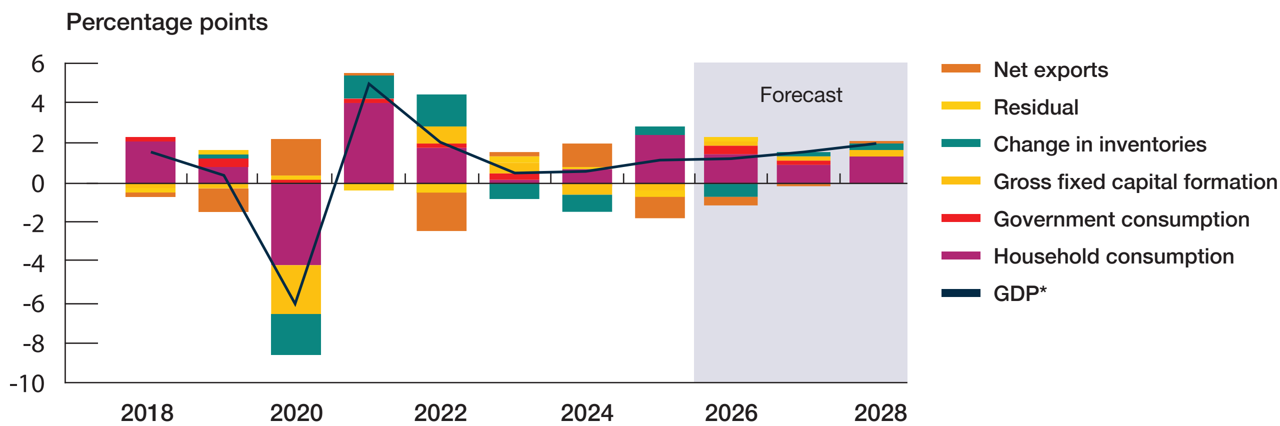
Sources: Bloomberg, IMF, various central banks and SARB

Domestic real economy developments

South Africa's domestic economy also showed resilience over the past year, expanding by 1.1%, more than double the previous year's pace. Nevertheless, growth remains well below its long-term rate of 2% to 2.5% and still compares poorly to the 4% average for emerging economies. This growth rate is far too low to meet South Africa's development goals outlined in the National Development Plan 2030.

Easing inflation and lower interest rates supported household consumption and lifted domestic economic activity. Spending was further bolstered by equity-related wealth gains and two-pot retirement withdrawals. By contrast, investment detracted from growth despite positive momentum in the second half of the year.

Contributions to real GDP growth



*Percentage change

Sources: Stats SA and SARB

9 IMF, *World Economic Outlook*, April 2026.

Quarter on quarter, output expanded by 0.3% in the third quarter and by 0.4% in the fourth quarter of 2025, with this momentum expected to continue into early 2026.

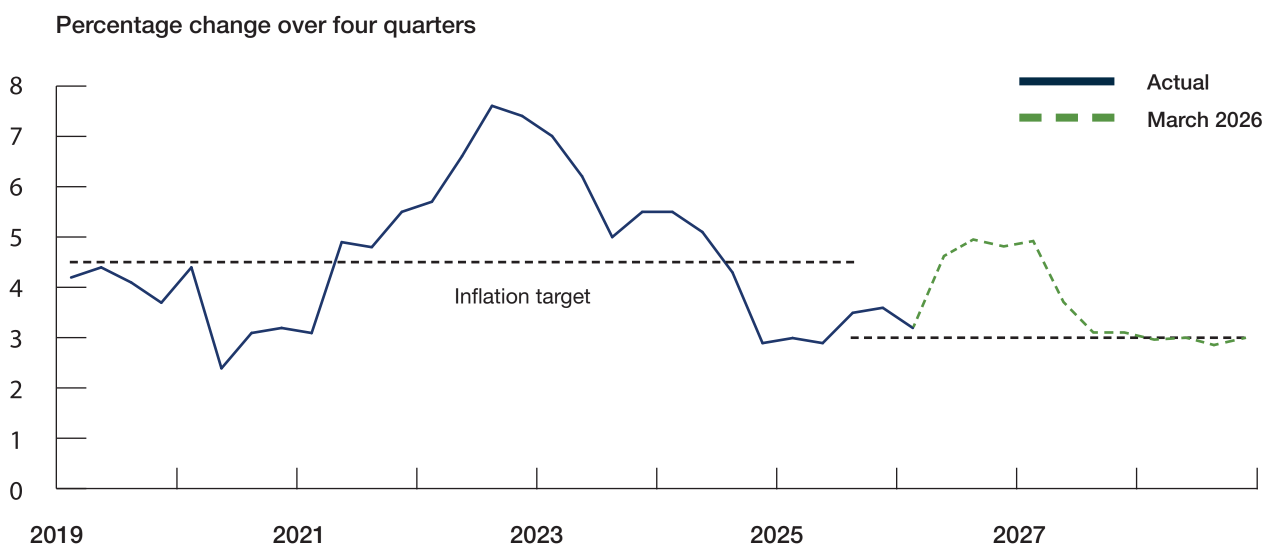
Looking ahead, the domestic economy is forecast to grow by 1.2% in 2026, rising to around 2% by 2028, broadly in line with potential GDP growth. Household consumption and investment spending are expected to drive this growth. However, downside risks have increased, as acute increases in fuel prices and overall inflation could significantly erode real disposable income and weaken household spending.

Inflation dynamics

Domestic headline inflation remained contained, close to 3% over the review period, and eased to the 3% target in February 2026. However, the outlook has shifted markedly due to the conflict-induced fuel price shock. Headline inflation jumped to 4% in April 2026, from 3.1% in March. The conflict-related headwinds (i.e. sharply higher oil prices and rand depreciation) are expected to push domestic inflation temporarily above target in the near term, averaging 4.4% in 2026, before easing to target from 2028.

Up until the start of the conflict, inflation was relatively subdued, reflecting broad-based moderation across both core and non-core components. Inflation averaged 3.2% in 2025, its lowest annual outcome in over two decades, extending the pronounced disinflation following the 2022 peak. Disinflation benefitted from favourable tailwinds, particularly muted Brent crude oil prices, contained food price inflation and a stronger rand exchange rate. It was also supported by a moderately restrictive monetary policy stance that helped curb second-round effects from earlier food and fuel inflation as well as sharply higher electricity price increases.

Headline inflation forecast *



* Dotted line indicates forecast

Sources: Stats SA and SARB

Core inflation also averaged 3.2% in 2025, with subdued core goods inflation partially offsetting firmer services inflation. Core goods benefitted from a stronger rand and muted global goods prices. Meanwhile, upside pressure on services inflation mostly emanated from health insurance and rental costs. Inflation expectations declined markedly, reaching a record low of 3.6% in the first quarter of 2026, following the adoption of the 3% inflation target. Easing inflation expectations and muted unit labour cost growth have exerted downside pressure on services inflation.

Sharply higher oil prices and heightened uncertainty around the duration of the conflict have greatly worsened the near-term inflation outlook. The extent of the fuel price shock raises the risk that price and wage increases could depart from usual patterns and significantly strengthen

second-round effects. For instance, a sustained Brent crude oil price above US$100 per barrel could raise headline inflation substantially higher this year and complicate reaching the target over the forecast period.

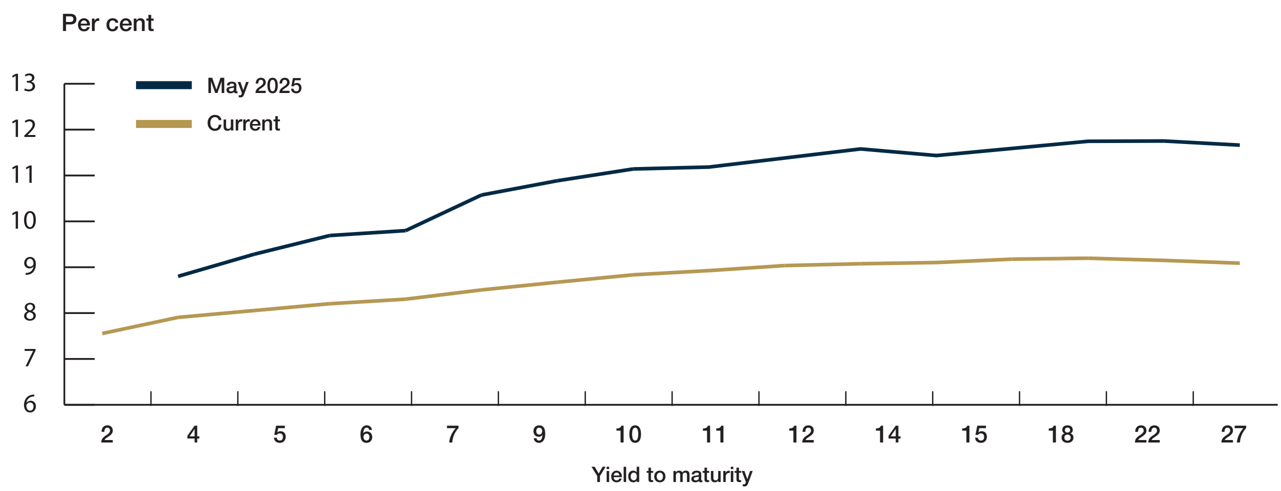
Lower inflation target already delivering

The more contained inflation outlook partly reflects the benefits of recent macroeconomic reforms. South Africa's removal from the FATF greylist in October 2025, the adoption of a lower inflation target and a credible fiscal consolidation path have marked meaningful de-risking milestones.

With reduced risk, Standard & Poor's Global upgraded South Africa's credit rating – the first such upgrade from a major agency in nearly two decades. Moody's followed by upgrading South Africa's credit outlook to positive in May 2026, further showing confidence in the domestic economy. The yield curve has flattened and shifted downward, significantly lowering borrowing costs for government and the broader economy.[10] Despite the substantial sell-off in emerging market assets following the onset of the conflict in the Middle East, the South African Government Bond yield curve has shifted only modestly higher and remains well below its March 2025 level, indicating resilience. The rand has also benefitted from improved macroeconomic fundamentals and, although it depreciated somewhat when the conflict started, remains relatively strong at around R16.40 to the US dollar.[11]

In a nutshell, the inflation target reform and other efforts have resulted in lower debt-servicing costs, while the rand's resilience implies less inflationary pressure from the oil price shock. This provides more room for domestic macroeconomic policy to focus on supporting growth and economic resilience.

South African bond yield curve



Source: Bloomberg

10 A lower inflation target and reduced inflation have decreased the inflation risk premium in loan contracts and reinforced investor confidence in the domestic fixed-income market.
11 In the past year the rand gained over 13% against the US dollar and strengthened to below R16.00 to the dollar in late January 2026.

Monetary policy stance and decisions

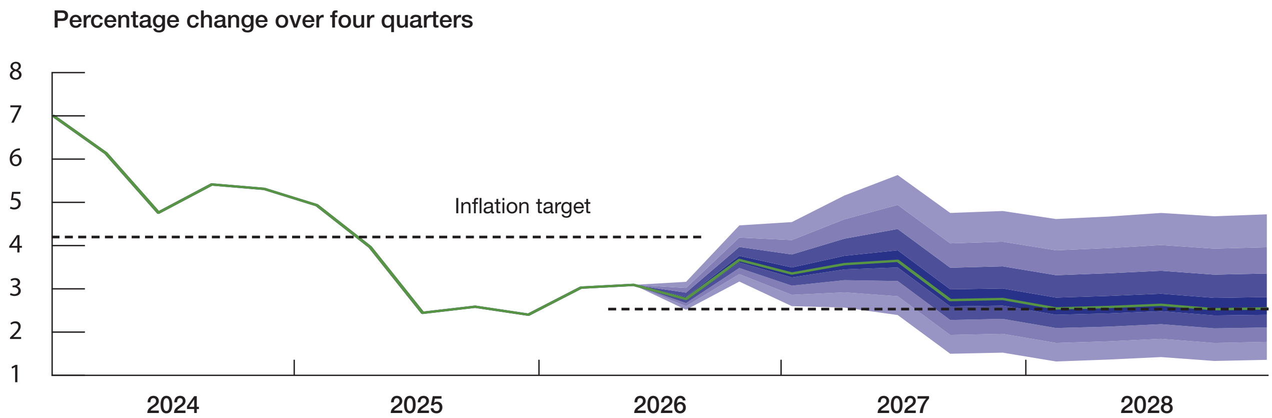
After reducing the policy rate by 25 basis points to 6.75% in November 2025 and keeping rates unchanged at the January and March 2026 meetings, the MPC raised the policy rate by 25 basis points at its May 2026 meeting. The increase in the policy rate was on account of a marked deterioration in the inflation outlook. Prior to the May increase, rates had been lowered by a cumulative 150 basis points since September 2024. The policy stance has become less restrictive than it was in March, reflecting higher expected inflation.

The January decision was mainly cautious, given heightened geopolitical uncertainty and the need to monitor near-term inflation and inflation expectations. The Quarterly Projection Model (QPM) had suggested scope for a further rate cut in the first quarter of 2026 (January and March MPC meetings). The committee's approach, however, emphasises risk assessment and judgement around the QPM baseline forecast, rather than mechanical reliance on model outcomes. By the May meeting, the near-term inflation outlook had deteriorated materially.

Sharp increases in oil and commodity prices, uncertainty regarding the duration of the conflict and the extent of supply chain disruptions, together with the risk of second-round effects, all significantly increased upside risks to inflation. The rand also depreciated as investors sought safe-haven assets. Against this backdrop, the MPC raised the policy rate by 25 basis points to 7% at its May 2026 meeting.

Scenarios considered in the March and May 2026 MPC meetings included higher oil prices relative to the baseline and a strong El Niño shock as well as non-linearities in wage-setting and inflation expectations. Importantly, in most of the scenarios inflation still returns to target by the end of 2028. This provides confidence that, with appropriate policy settings, the oil shock may delay, but not derail, the achievement of the 3% inflation target.

Targeted inflation forecast*



* The bands around the central projection show confidence intervals of 10%, 30%, 50% and 70%.
This chart shows seasonally-adjusted data, as used in the QPM.

Sources: Stats SA and SARB

Governance structure

MONETARY POLICY COMMITTEE
(meets every two months)

Chairperson
Governor of the SARB

Committee members
DG R (Rashad) Cassim
DG N (Nomfundo) Tshazibana
DG M (Mampho) Modise

Head of ERD
K (Konstantin) Makrelov
(Replacing C (Christopher) Loewald who retired with effect from 1 March 2026)

Adviser to the Governors
D (David) Fowkes

Responsibilities

The MPC drives the SARB's responsiblities 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.