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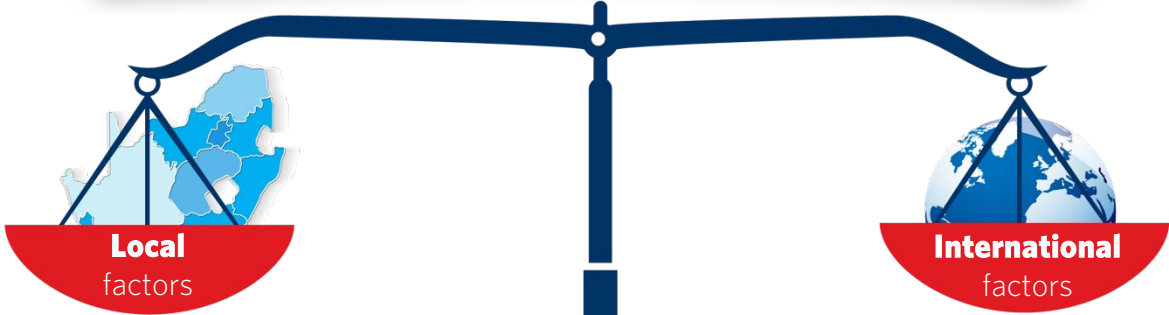


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# Monetary Policy Review: Decisions aligning with the 3% objective

## Forces shaping local monetary policy



**Over the past six months:**

- Contained domestic inflation, averaging around 3%.
- Firmer rand and lower oil prices have led to lower fuel prices.
- Meat and vegetable prices have surged due to animal diseases and adverse weather conditions.
- South African Reserve Bank (SARB) revised its inflation objective from 4.5% to 3% in July 2025.
- Modest economic growth.

**Expected developments:**

- SARB expects inflation to rise to 3.6% in 2026, before falling back to the 3% objective by 2027.
- Subdued core price pressures and easing inflation expectations.

**Over the past six months:**

- Resilient global economy despite trade tensions and geopolitical conflicts.
- Disinflation on the back of moderating energy and food prices as well as a weaker dollar.
- Trade tariffs and uncertainty influenced cautious monetary policy.

**Expected developments:**

- Growth to slow in the second half of 2025 as the momentum from front-loaded exports fades.
- Inflation is projected to continue easing but risks remain. Inflation to stabilise at targets by the end of 2026, except for the United States (US).
- Trade imbalances likely to keep tariffs in focus.

### Analytical studies

- The stress tests suggest that the 3% inflation objective is robust against typical economic shocks and can be achieved without excessive reliance on interest rates.
- While inflation shocks continue to influence SA's inflation path, core inflation and unit labour costs have become less sensitive to these shocks over time, allowing the SARB to maintain more stable interest rates and look through temporary price pressures.
- The macro impact of US tariffs on SA is modest, but sectoral effects could be large. GDP could decline by 4 percentage points (pp) in 2026 while employment could drop by 40 000.
- Since the pandemic, non-labour income has become an important driver of real disposable income growth.

### Interest rate path

- The SARB cut the policy rate by 50 basis points over the past six months (April to October 2025) to 7%.
- The SARB will closely track the effects of past rate cuts and watch for inflation risks, especially from regulated prices, like electricity. The SARB's focus will remain on anchoring inflation expectations at the revised 3% inflation objective.
- The SARB is likely to maintain a cautious approach. While we don't anticipate further rate cuts for 2025, an earlier rate cut cannot, nevertheless, be ruled out.
- Global central banks are expected to cautiously cut rates with rates likely remaining higher for longer.

## 3% inflation objective seen as credible and attainable

After the Monetary Policy Committee's (MPC) July 2025 announcement to stabilise inflation at 3%, the SARB conducted a stress test.

The results indicated that a 3% inflation objective is achievable under normal inflationary shocks, without excessive reliance on interest rates.

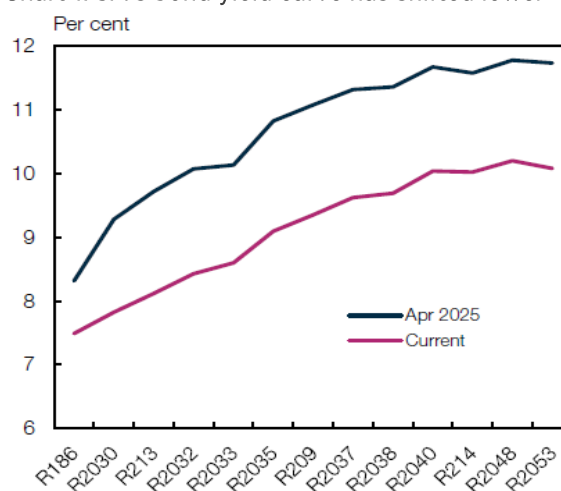
When standard shocks to key factors, such as unit labour costs, exchange rates and prices for oil, food, electricity and administered items, were applied, headline inflation generally remained within 1 percentage point of the 3% target during the first year. Inflation expectations also remained stable around 3% under each scenario, suggesting that they are well-anchored and primarily influenced by the forward-looking target rather than past inflation rates.

Further simulations using a broader range of possible shocks demonstrated that, in most cases, inflation would stay close to the 3% objective. Only in more extreme cases, correlated shock scenarios (described as a "perfect storm"), did the model predict inflation might rise above 7% or drop below 0%.

Financial markets appear to be validating the SARB's credibility. Since April 2025, the term premium (the extra yield that investors require to hold a longer-term

bond) on SA's 10-year government bond has declined steadily, diverging from trends in major economies where long-term yields have risen. The drop reflects a lower inflation risk premium, particularly after the July MPC meeting, when yields fell by over 20 basis points.

Chart 1: SA's bond yield curve has shifted lower



Source: SARB

This combination of empirical robustness and market endorsement signals growing confidence that the 3% inflation objective is both credible and attainable, in our view.

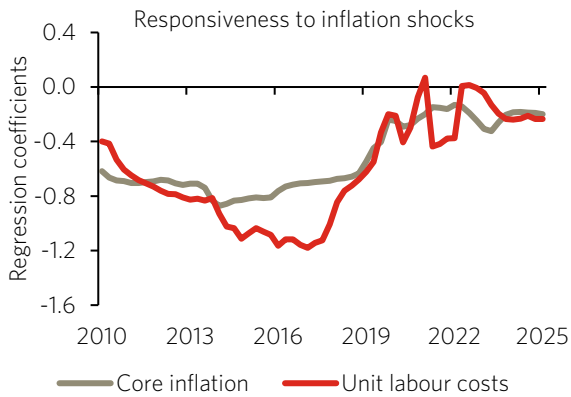
## More stability in core inflation allows for more stable interest rates

SA's inflation path continues to experience temporary pressures. The recent food price shocks drove headline inflation above 3%. In September 2025, meat prices surged by 11.7% from 3% in April 2025 due to a foot-and-mouth disease outbreak, poultry import restrictions and drought, while vegetable prices increased following heavy rains and crop disruptions. However, as weather conditions return to normal, cattle slaughtering resumes and import bans are lifted, these inflationary pressures are expected to ease, supporting the broader disinflation trend.

The SARB noted a notable shift in core inflation dynamics.

Core inflation and unit labour costs have become less sensitive to inflation shocks over time (see chart 2), thanks to better-anchored wage and inflation expectations.

**Chart 2: Wages and underlying inflation are less sensitive to inflation shocks**



Source: SARB, Momentum Investments

This reduced sensitivity allows monetary policy to remain focused on the medium-term target, enabling the SARB to look through and maintain stable interest rates.

On the external front, the depreciation of the US dollar which was driven by global growth convergence, expectations of US interest rate cuts and a shift in investor preference away from dollar assets has boosted the rand and helped ease imported inflation. The dollar's future depends on upcoming rate cuts and potential economic or trade disruptions, though its value continues to be supported by strong US financial markets.

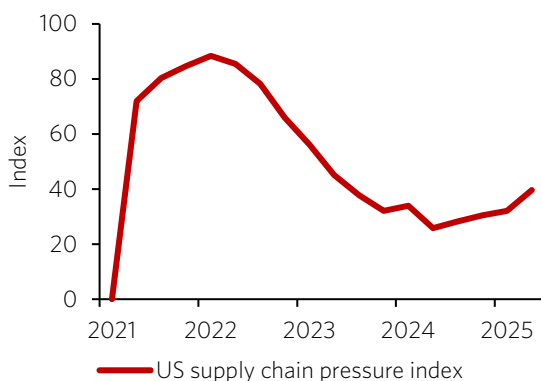
## SA faces a modest macro impact from tariffs but a policy response remains essential

Global trade is being reshaped by rising protectionism, leading to more fragmented supply chains and shifting trade dynamics. Recent years have seen a surge in supply chain pressures (see chart 3), driven by the pandemic, the war in Ukraine and escalating tariffs, which have accelerated trends like reshoring, nearshoring and friendshoring. The Organisation for Economic Co-operation and Development (OECD) warns that supply chain changes could reduce world trade by up to 18% and cut global real GDP by about 5%, potentially reversing many of the productivity and price benefits gained from globalisation.

SA has also been impacted as the US imposed a 30% import tariff on most SA exports on 7 August 2025, effectively ending SA's preferential access under the African Growth and Opportunity Act (AGOA) and the Generalised System of Preferences.

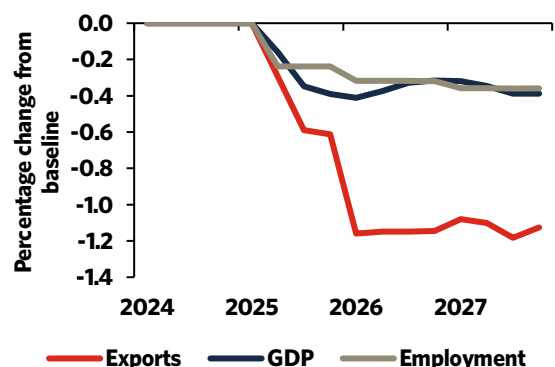
“The SARB estimates that the tariffs could reduce domestic output growth by 0.4pps in 2026 (see chart 4), while economy-wide employment could drop 40 000 below the baseline.”

**Chart 3: Mild re-emergence in supply chain price pressures**



Source: SARB, Momentum Investments

**Chart 4: Modest macroeconomic impact of US trade tariffs on SA**



Source: SARB, Momentum Investments

Moreover, these higher tariffs threaten to weaken SA's integration into global value chains, particularly in specialised industries, like automotive manufacturing.

Ongoing supply-chain disruptions also raise the risk of higher inflation through expectations which is a challenge for central banks.

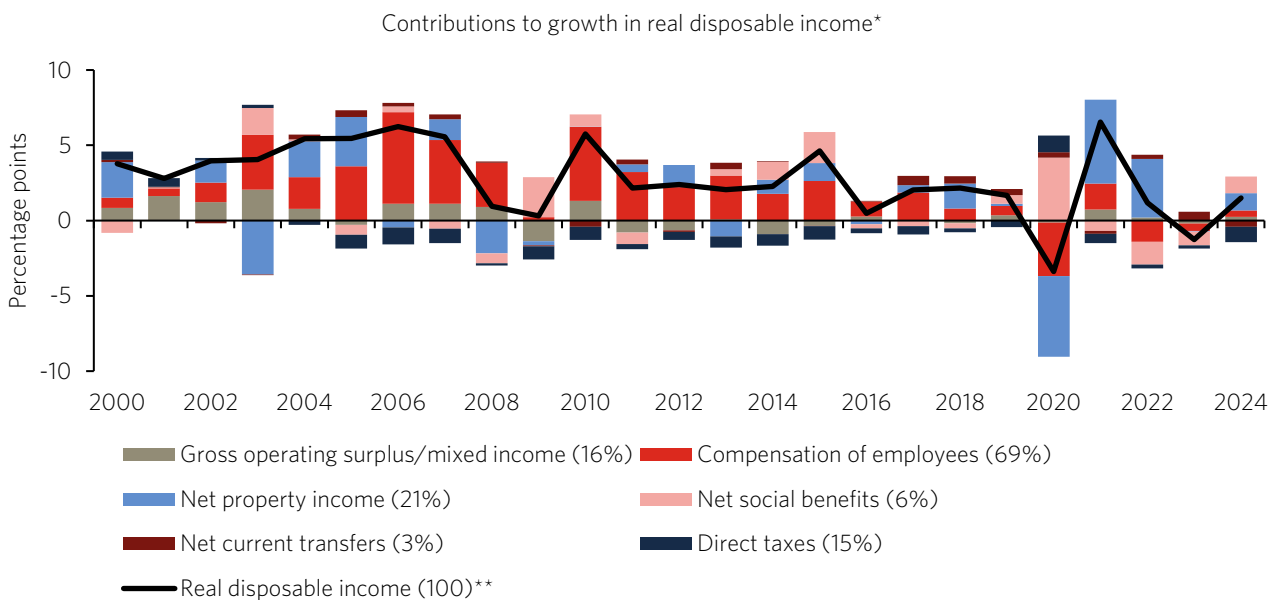
To maintain competitiveness and support growth, the country must accelerate structural reforms, diversify its export markets and deepen trade within Africa.

### The rising role of non-labour income in disposable income complicates monetary policy

Real disposable income grew by 1.5% over the past year, but the SARB highlights that its composition has shifted notably since the pandemic. Compensation of employees, historically the main driver, accounted for only 27% of this growth, down from an average of 86% in the previous decade.

“ Instead, non-labour income, mainly net property income and social benefits, including two pot withdrawals, has become increasingly important in driving households' real disposable income growth (see chart 5). ”

Chart 5: Non-labour related income becoming a bigger contributor to real disposable income



Source: SARB, Momentum Investments

\* Weights in brackets

\*\* Percentage change

Property-related income has been lifted by strong dividend payouts, gains in the residential property market and a strong performance in the equity market.

Despite these compositional changes, the link between income and household spending remains broadly stable, possibly reflecting temporary stability in property income or the short time period which elapsed since the

structural shift began as noted by the SARB. This evolving income landscape has important implications for monetary policy: as household spending becomes increasingly reliant on more volatile non-labour income sources, consumption could become less predictable and more sensitive to changes in financial market

conditions or government policy. The SARB may therefore need to monitor these shifts closely, as the effectiveness and transmission of monetary policy could be affected by the changing drivers of disposable income.

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### **SARB likely to maintain a cautious stance**

While core inflation remains well anchored and food price pressures are expected to ease, we believe a cautious monetary policy stance is still warranted. The evolving household income composition and global uncertainties, including trade disruptions and currency volatility, need to be assessed. Maintaining vigilance allows the SARB to respond promptly to any second-

round effects, ensuring that the 3% inflation target remains credible and attainable.

We expect the SARB to keep the repo rate unchanged at 7% through the remainder of the year and potentially cut by 25 basis points to 6.75% in 2026, with a further cut of 25 basis points, early in 2027.