NEWS LETTER

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Dragon Wealth

SOUTH AFRICA: REPO RATE CUT, BUDGET 3.0, AND A NEW INFLATION TARGET ON THE HORIZON

This past month delivered a 0.25% cut in the repo rate, taking it to 7.25%, alongside a growing debate around a revised 3% inflation target and the unveiling of "Budget 3.0" by Treasury. Each of these has significant implications for the economy, the currency, and local investment portfolios.

The SARB's decision to cut the repo rate was driven by a string of surprisingly low inflation prints, a more stable global environment, and the recent appreciation of the Rand. The Bank's Quarterly Projection Model now sees the repo rate ending 2025 at 6.93%, with room for one more cut this year under the current inflation targeting regime.

However, the real story lies in the forward-looking inflation scenario. The SARB introduced projections based on a hypothetical shift to a 3% inflation target. If implemented, this could result in deeper rate cuts, up to 1.5%, bringing the repo rate down to 5.79% by 2027. Importantly, the Bank has clarified that this scenario was meant to improve transparency, not signal immediate policy change.

Nonetheless, it has succeeded in influencing inflation expectations. Lower rates would boost consumer spending, reduce government debt servicing costs, and support a mild improvement in GDP growth, potentially back towards 2%.

In parallel, Treasury's "Budget 3.0" proposal aims to reassert control over a fragile fiscal position. The revised plan addresses weaker-than-expected revenue and rising debt service costs by proposing expenditure restraint rather than tax hikes, which would have stifled an already weak recovery.

Importantly, Budget 3.0 avoids politically difficult measures like a VAT increase and instead leans on inflation-aligned fuel levies while postponing large infrastructure outlays. This more cautious approach may aid in stabilising bond yields and restore some investor confidence, though the fiscal outlook remains strained. Despite the revisions, government still faced a significant revenue shortfall of R56 billion.

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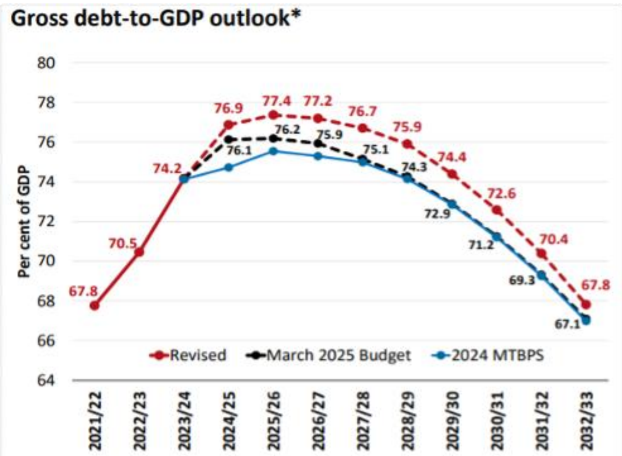

Source: National Treasury

HIGHLIGHTS

SA Cuts Rates & Eyes New Inflation Target:

- The SARB cut the repo rate to 7.25% and introduced a possible shift to a 3% inflation target, which could lead to deeper cuts by 2027.

Budget 3.0 Aims for Stability:

- Treasury's revised budget avoids tax hikes, opts for spending restraint, and widens the deficit to 4.8% of GDP, with debt now peaking at 77.4%.

Investment Outlook:

- Lower rates support bonds and rate-sensitive sectors, but global uncertainty calls for diversification.

US Debt Grows with Trump's Spending Bill:

- The "One Big Beautiful Bill Act" could add $3.8 trillion to US debt, with tax breaks for the wealthy and cuts to social programs.

The SARB's publication of inflation forecasts under a 3% target has added a new layer of complexity to the policy debate. The key takeaway is that lower inflation targets, if credible and supported by government policy, need not result in higher interest rates in the near term. On the contrary, they may enable earlier rate cuts by anchoring inflation expectations.

That said, implementation risk is high. A premature shift without political consensus or fiscal discipline could trigger volatility. A weaker Rand, driven by capital outflows or rising risk premiums, would undermine the disinflation path and delay rate cuts.

INVESTMENT IMPLICATIONS

For multi-asset portfolios, the environment remains nuanced. Lower interest rates and inflation bode well for domestic bonds, which may benefit from further yield compression, particularly on the long end of the curve as inflation expectations are revised downwards. Equities could also benefit from improved consumer and business sentiment, especially in rate-sensitive sectors like financials and consumer discretionary.

However, global risks, including US policy shifts, trade tensions, and election uncertainty remain elevated. Caution is warranted in currency-exposed assets, and maintaining offshore diversification continues to be prudent.

TRUMP'S "ONE BIG BEAUTIFUL BILL ACT" ADDS TO AMERICA'S BURGEONING DEBT BURDEN

In May 2025, the U.S. House of Representatives narrowly passed President Donald Trump's "One Big Beautiful Bill Act," a sweeping tax and spending package poised to reshape American fiscal policy. While the bill awaits Senate approval, its provisions carry significant implications for global markets, including South Africa.

The legislation seeks to make permanent several tax cuts from the 2017 Tax Cuts and Jobs Act, including reductions in individual income and estate taxes. Notably, it proposes eliminating taxes on tips and overtime pay, and allowing deductions for auto loan interest on U.S.-assembled vehicles. Additionally, the bill introduces a temporary $500 increase in the child tax credit, raising it to $2,500 through 2028.

To offset revenue losses, the bill includes significant spending cuts, notably $1 trillion from Medicaid and food assistance programs, potentially leaving millions without coverage. It also scales back clean-energy tax credits and imposes stricter qualifications for child and earned income tax credits.

Analyses by the Congressional Budget Office and the Penn Wharton Budget Model estimate that the bill could add approximately $3.8 trillion to the national debt over the next decade. Critics argue that the benefits disproportionately favour the wealthy, with the top 1% potentially receiving $600 billion in tax cuts, while low-income families could lose an average of $1,500 annually.