IMPLICATIONS OF A LOWER INFLATION TARGET

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SARB argues we can have our cake and eat it

- SARB argues an inflation target of 3% instead of 4.5%
  - Would see the policy rate for 2025 fall by 50 basis points and be 150 basis points lower long-term
  - Consequently, a lower target would come at a zero/low cost.

- Credibility of SARB's analysis hinges on:
  1. Whether its assumptions around how quickly inflation expectations would re-anchor to a lower target are realistic
  2. Fiscal policy is supportive
  3. Government buys-in to a lower target

Policy implications of a lower target

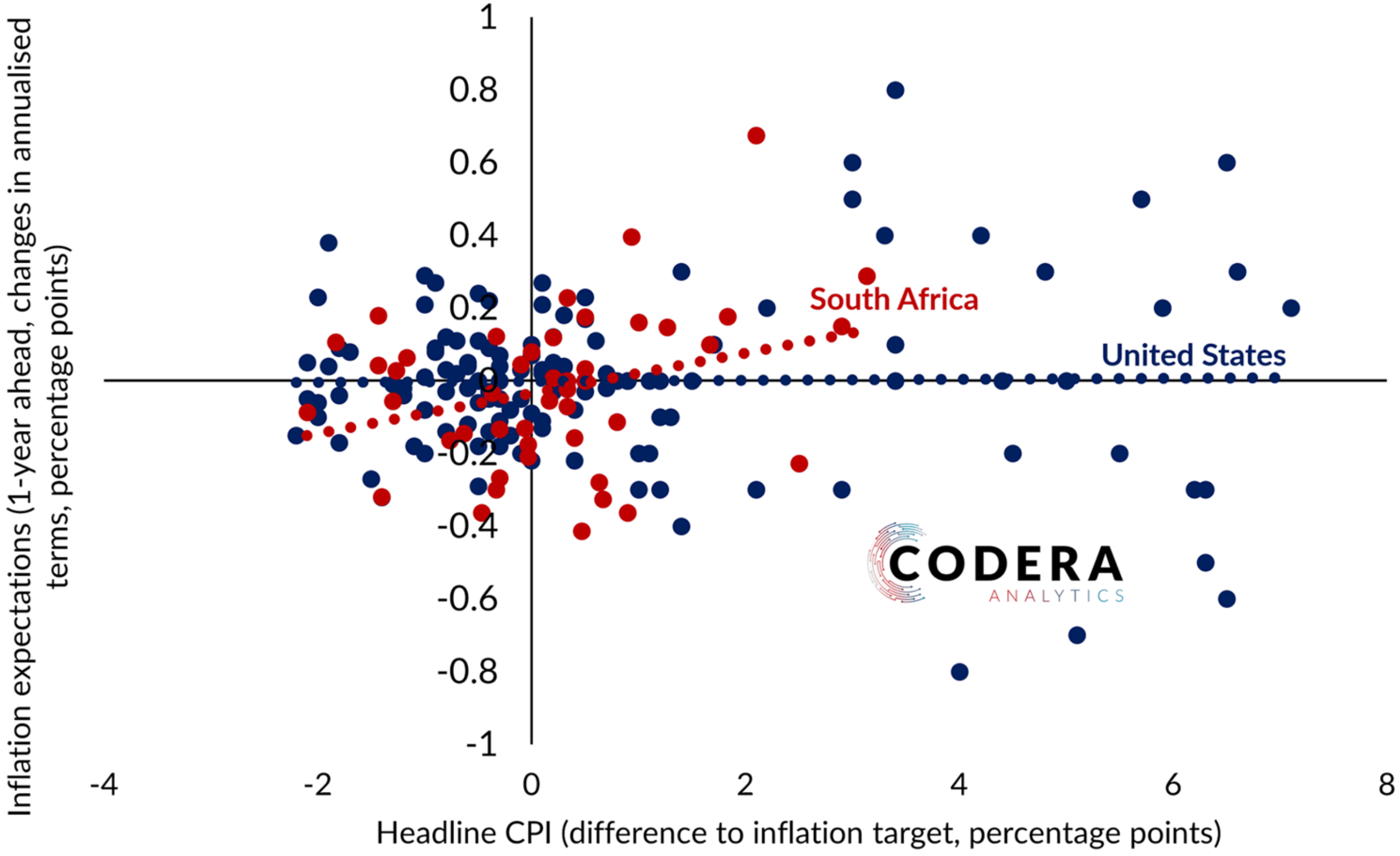
- A lower inflation target is desirable
- But promising a lower target without coordination could backfire
- Without structural reforms, inflation in parts of the economy where prices are flexible (e.g. the tradable sector) would need to undershoot whatever a new target might be
- This could imply higher costs for the private sector
- Need a team-SA approach for a low-cost transition to a lower target:
  → Social compact between govt, SARB, SOEs, relevant regulators, and labour unions
  → Government commitment to structural reform
  → Supportive fiscal policy

Please read our paper for more detail and references.

But SA has backward-looking inflation expectations

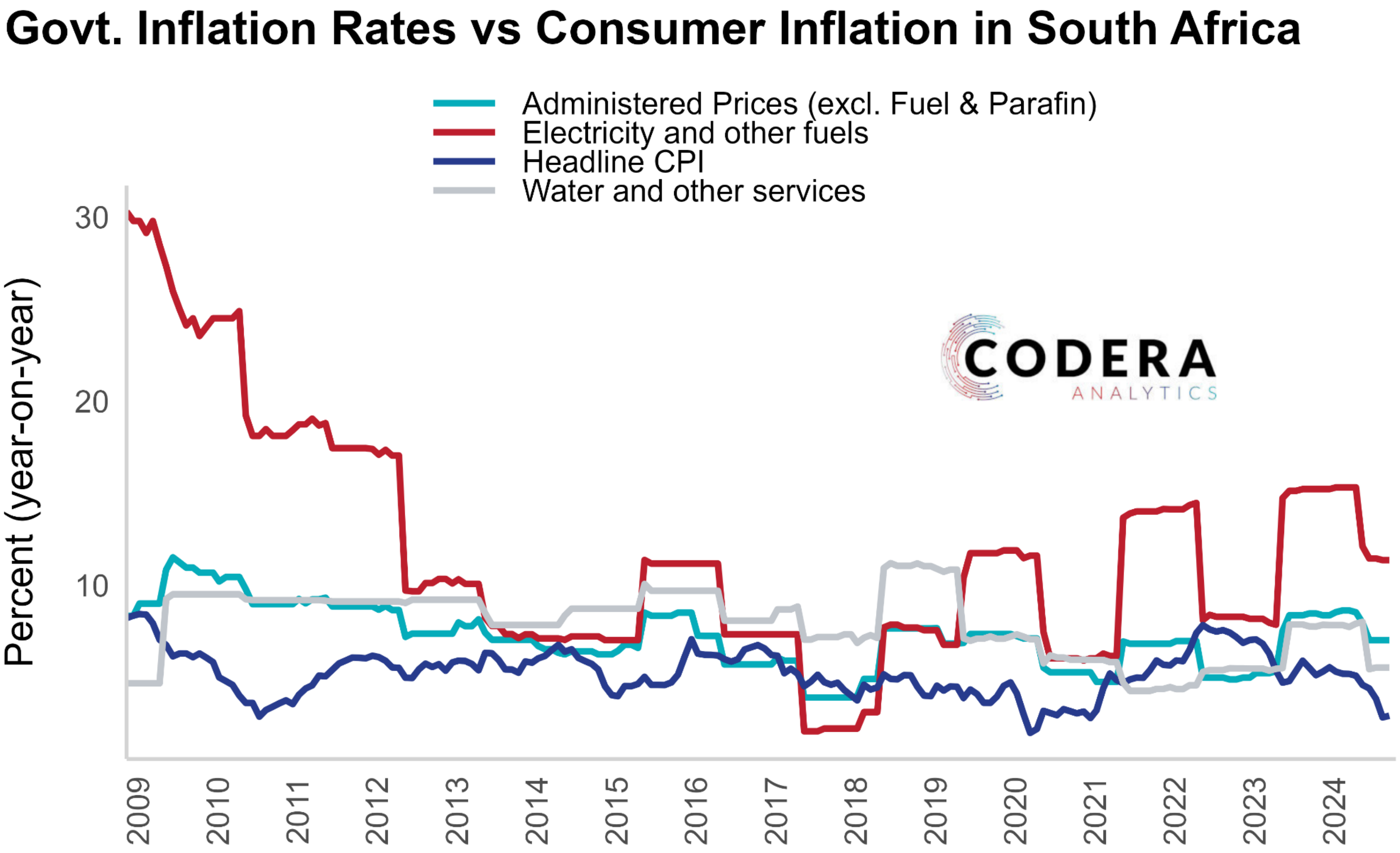
- Expectations have been more backward-looking than SARB assumes.
- Backward-looking expectations observable in wage outcomes which have been above target, particularly for the public sector.
- Rates would not fall if SARB's assumption about rapid re-anchoring is wrong.

Responsiveness of inflation expectations to CPI outturns in SA and US (since 2013)



Source: Statistics South Africa, BER, EconData. Trading Economics. SA Headline is quarterly (year-on-year) and US is monthly (year-on-year).

Driven by government inflation > headline



Source: Statistics SA, EconData.

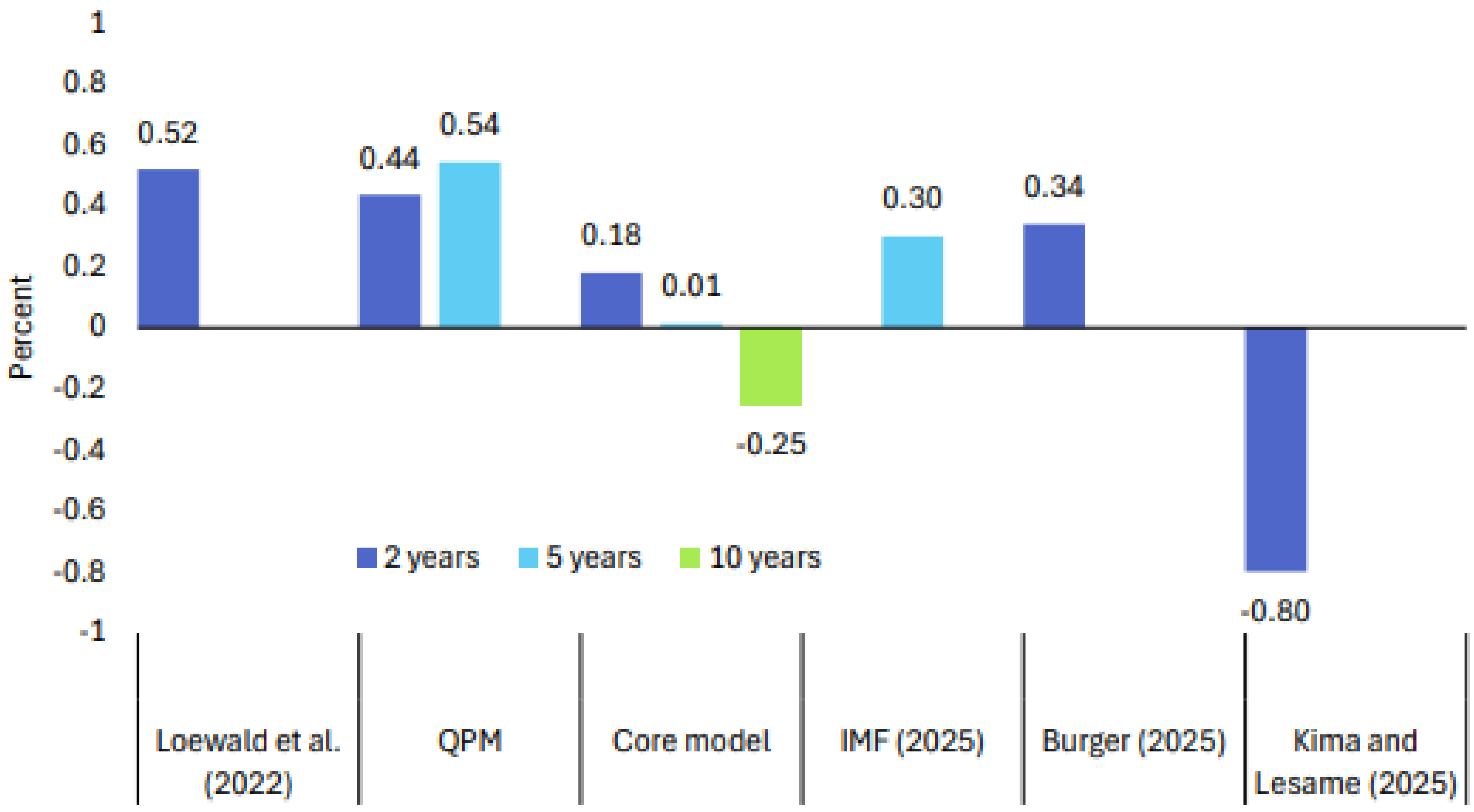
Administered price inflation averaged 7.1% (or 7.3% excluding fuel) since 2009.

Direct government-related categories make up over 30% of the total CPI basket, so achieving a lower target would require that private sector components remain below 3%, putting pressure on the tradables side of the economy.

SARB argues transition costs would be very low

- SARB's estimates of the sacrifice ratio (that captures the extent to which lower inflation requires the sacrifice of output) range between zero to 0.5% of GDP
- Our estimates and those from IMF point to a steeper post-COVID Phillips curve, implying higher disinflation costs than SARB assumes.

Figure 16: The cost of disinflation: a comparison of sacrifice ratio estimates

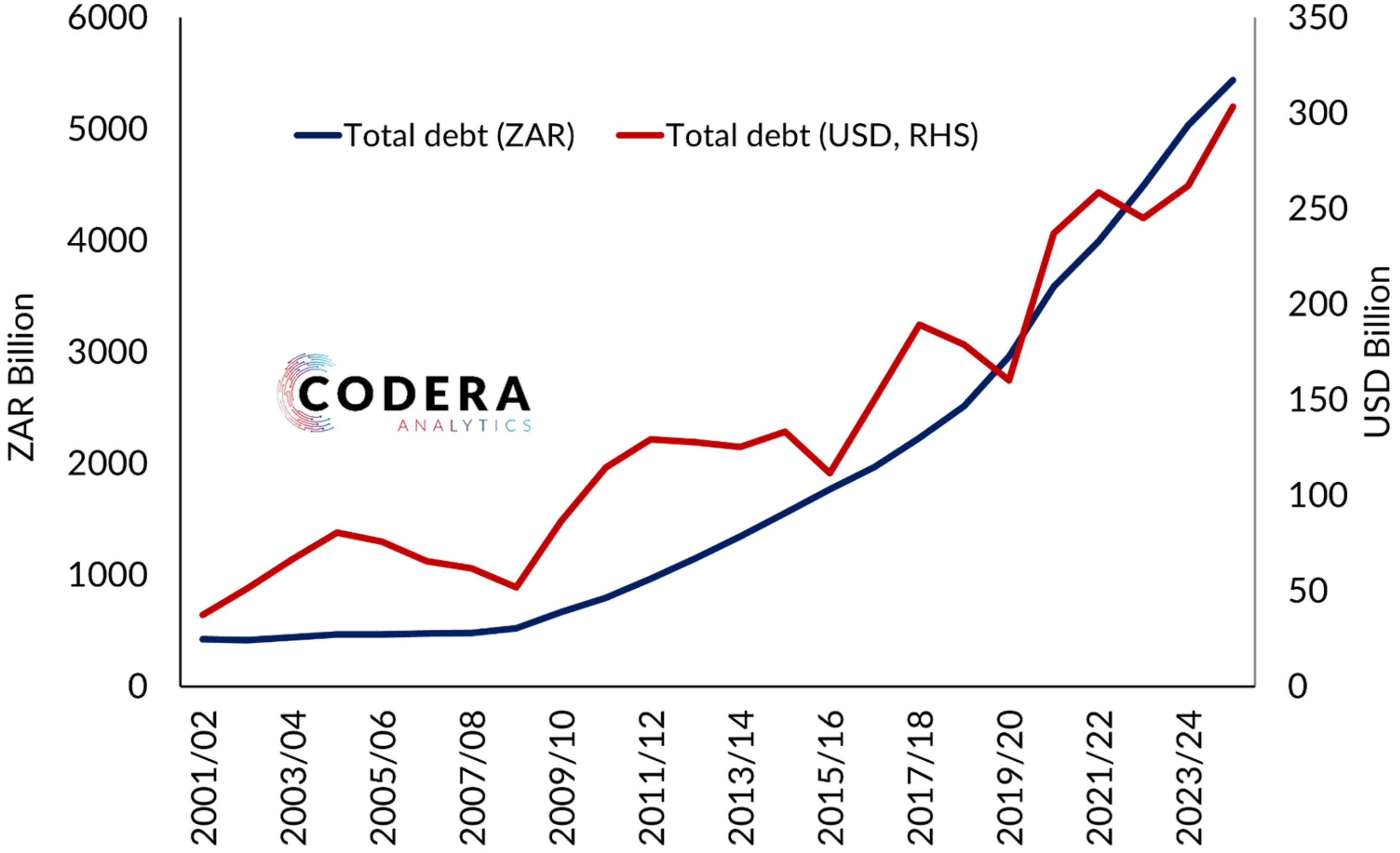


Source: Burger (2025), Kima and Lesame (2025), IMF (2025) and SARB

How does the SARB’s analysis stack up?

- South Africa's total stock of issued government debt has risen by 12.4% per year at a compound annual growth rate since 2002/3
- SARB’s estimates are conditioned on an optimistic outlook for fiscal policy, with a debt service cost projection that moves in the opposite direction to those from Budget 3.0

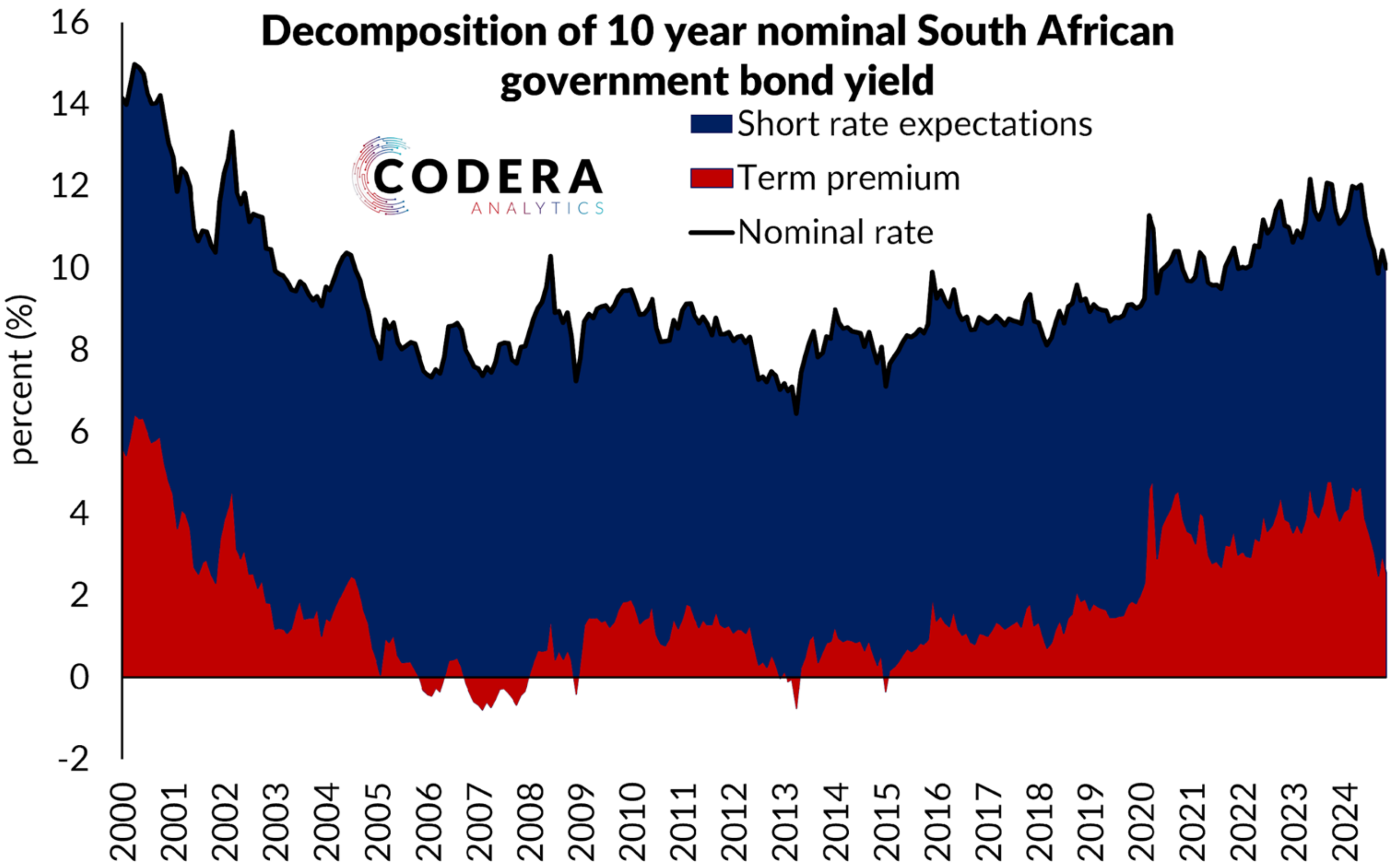
General government debt issued (South Africa)



Source: National Treasury, SARB, EconData, Oakhaven Capital, Codera Analytics. Nominal bonds, inflation linkers, Treasury Bills less cash balances.

How does the SARB's analysis stack up?

- Fiscal risks could offset gains from a lower target if government credibility weakens
- SARB's take represents a 'best case' scenario, not the most realistic scenario



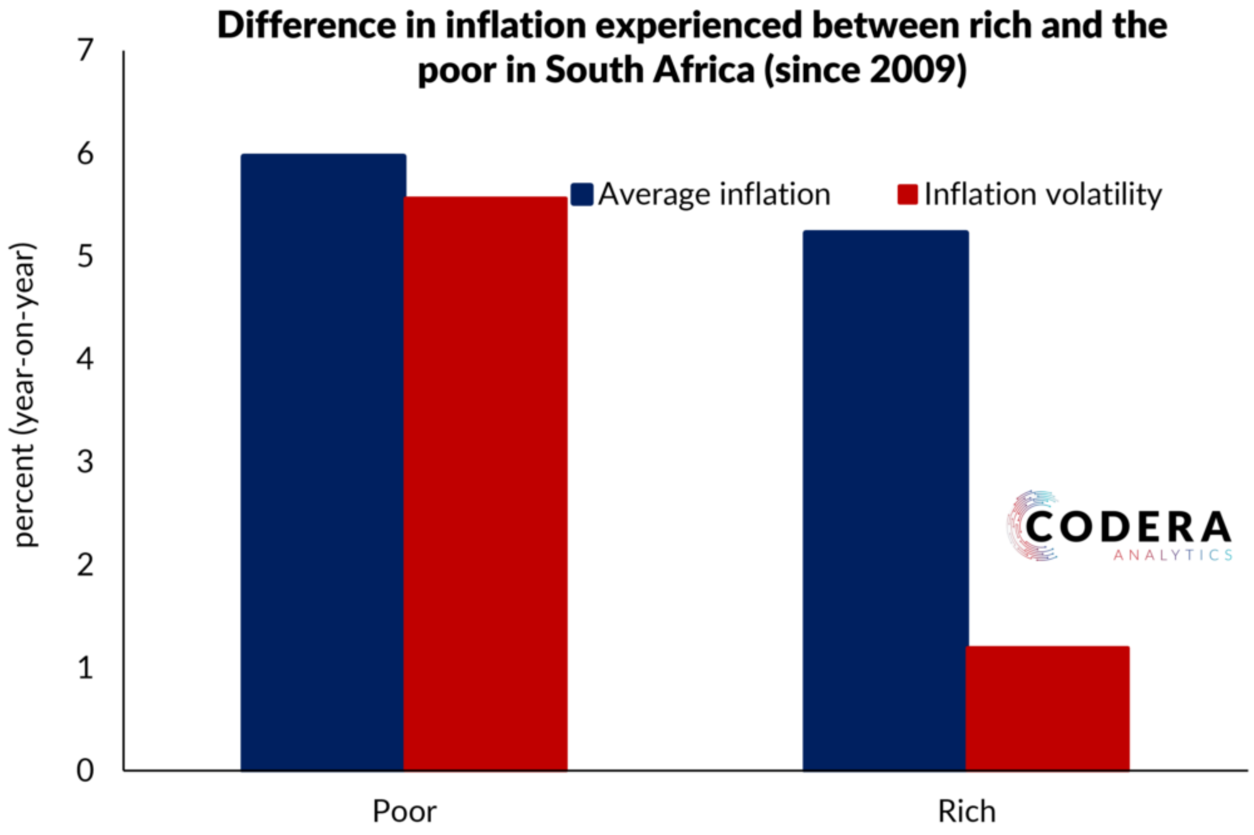
Note: Our approach for estimating the other term premia is described in Erasmus, R., Steenkamp, D. 2022. Term Premium Estimation for South Africa. Journal of Applied Economic Sciences, Volume XVII, 4(78): 347 – 350. The term premium is the difference between the nominal 10-year sovereign bond yield and average expected short rates over that horizon and captures sovereign bond market liquidity risk, sovereign credit risk and inflation uncertainty.

Clear SARB communication crucial for low cost transition

- Poor households face higher average inflation and nearly 5 times more inflation volatility than the rich, given differences in inflation drivers (e.g. larger weight on food for poor).

- This creates a communication challenge for the SARB, given differences in the inflation experienced by different households and firms.

- Alignment of target to inflation experiences and importance of interpreting economic drivers of underlying inflation pressures to support policy credibility.



Source: Stats SA, EconData, Codera Analytics. Expenditure decile 10 is the richest 10% of households and decile 1 the poorest 10% of households.

Please read our paper for more detail and references.

INFO@CODERA.CO.ZA

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