RECALIBRATING SA'S INFLATION TARGET: CHALLENGES AND OPPORTUNITIES

SEPTEMBER 2025

CODERA ANALYTICS

National Treasury and SARB announced they are discussing an inflation target change

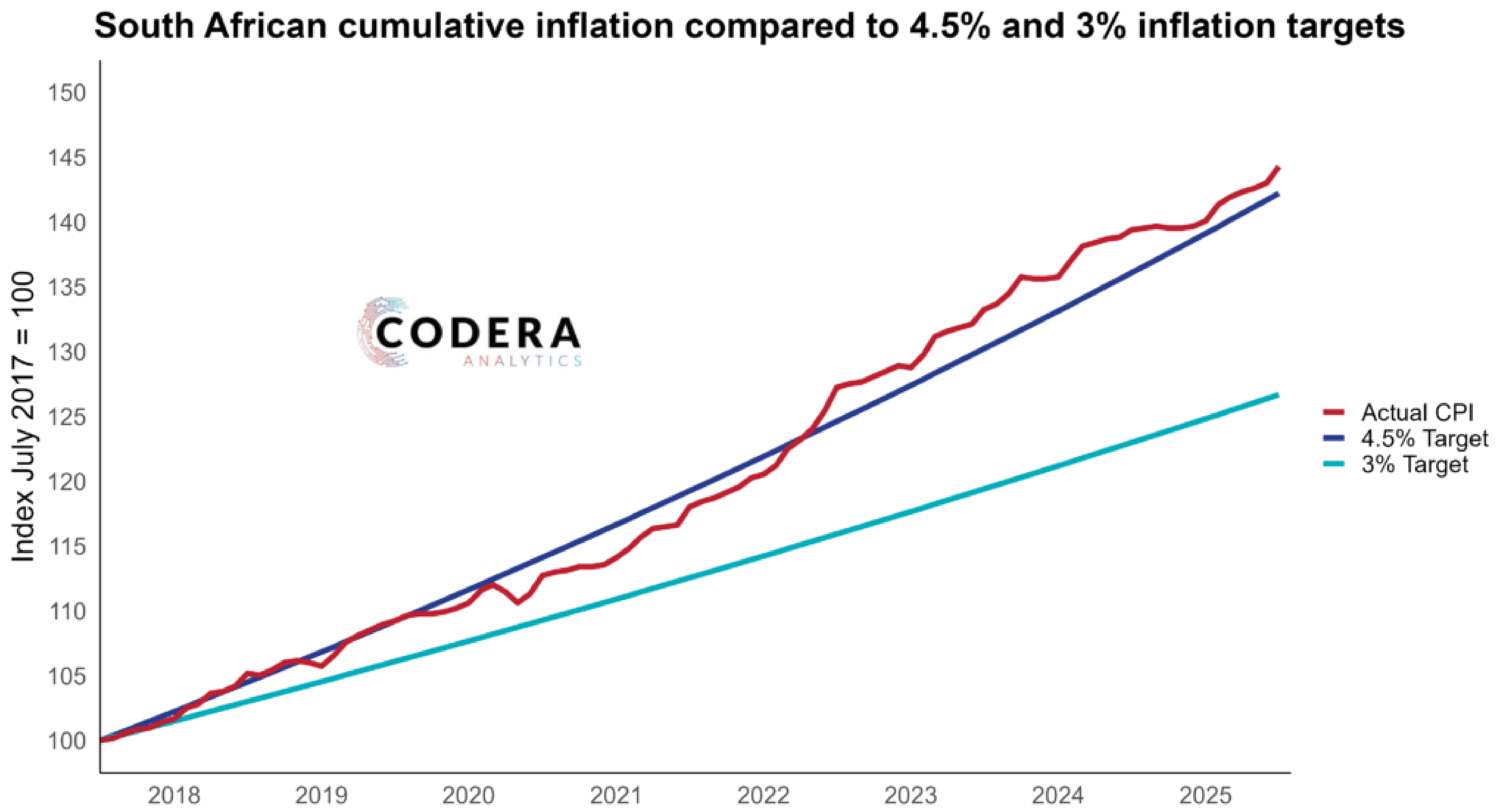
- SARB MPC surprised the market by unilaterally announcing a lower 3% preferred target on 31 July 2025

- The Finance Minister issued a press release on the same day suggesting that it is still consulting on a possible target amendment, with an announcement likely in the MTBPS in November

- 1 September 2025: Treasury and SARB issued a joint statement indicating they are working together, with "a joint technical team from SARB and Treasury finalising recommendations on the new target, expected to align with 3%"

- The target has not been formally changed - that requires agreement with the Treasury

A lower target is desirable



Source: Stats SA, EconData

Please read our paper for more discussion.

But SARB argues they can have their cake and eat it

- SARB argues an inflation target of 3% instead of 4.5%
  - July MPC: 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

Promising a lower target without coordination could prove problematic

- 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

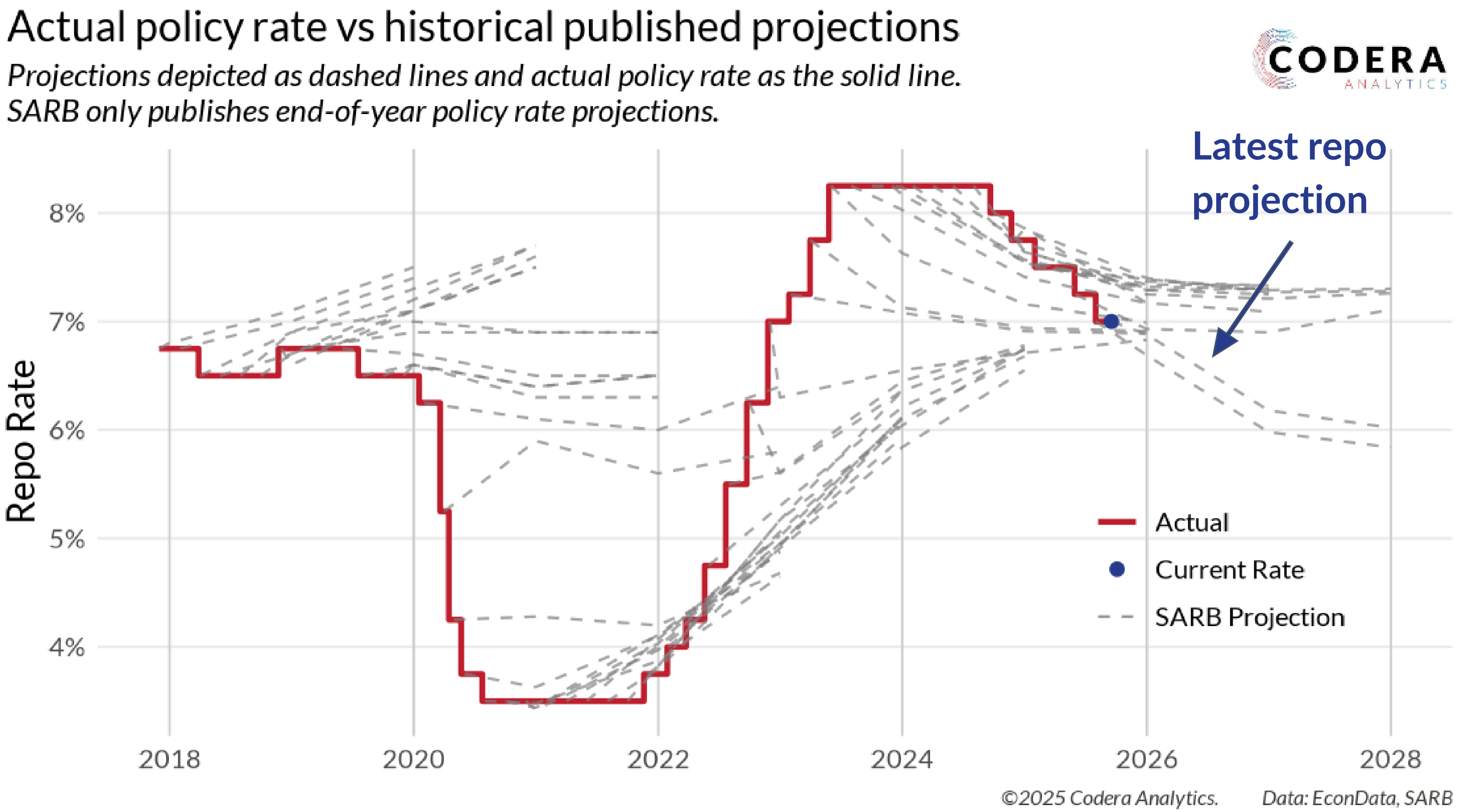
- We expect SARB will need to raise its inflation forecasts further

- There is a risk Treasury does not agree to a lower target and the fiscal outlook weakens

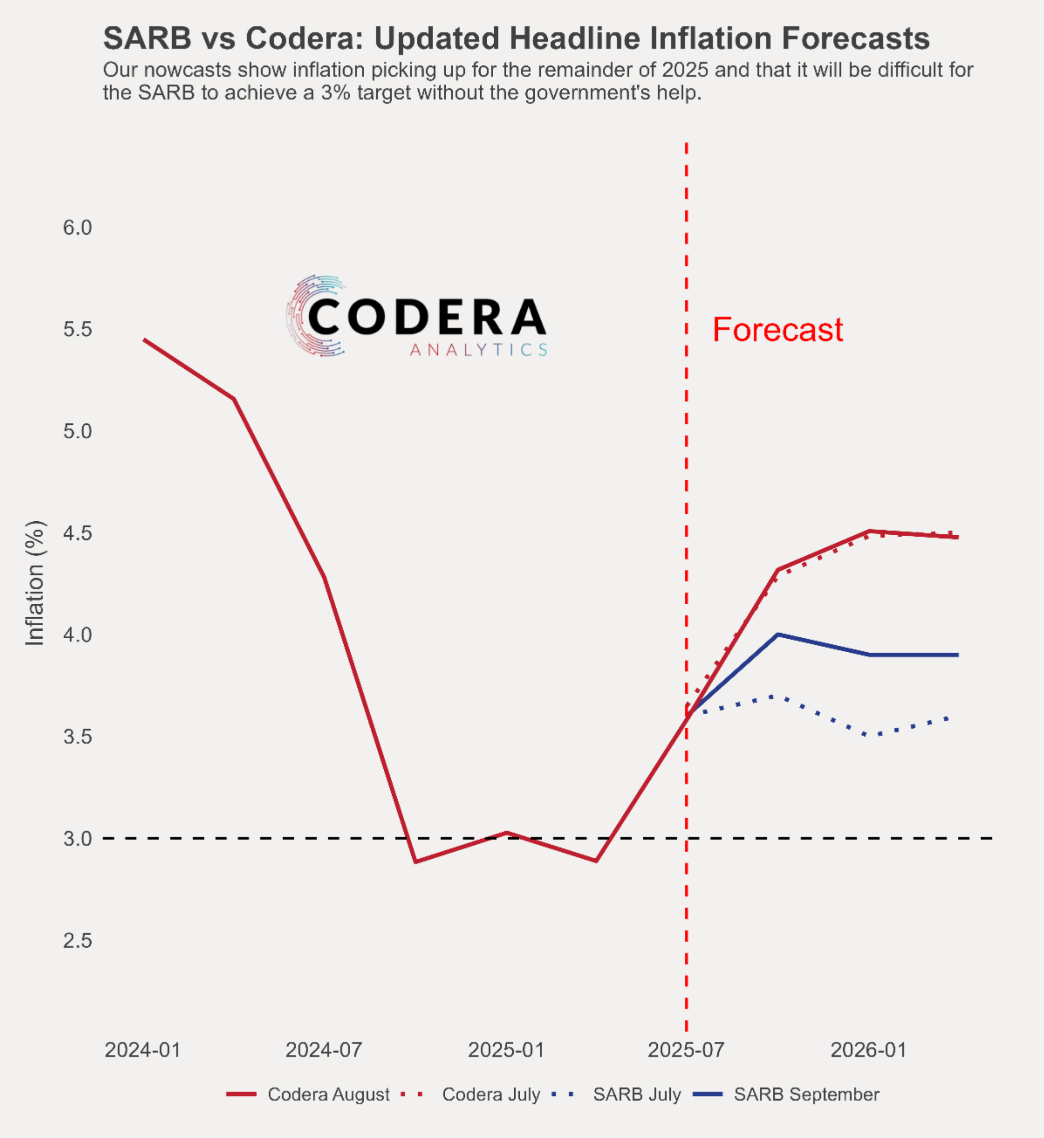
- Need a team-SA approach for a low-cost transition to a lower target:
  → Social compact between govt, SARB, SOEs, regulators, & labour
  → Government commitment to structural reform
  → Supportive fiscal policy

Please read our paper for more detail and references.

SARB projects further policy rate cuts



We expect SARB will need to raise its CPI forecasts (some more)

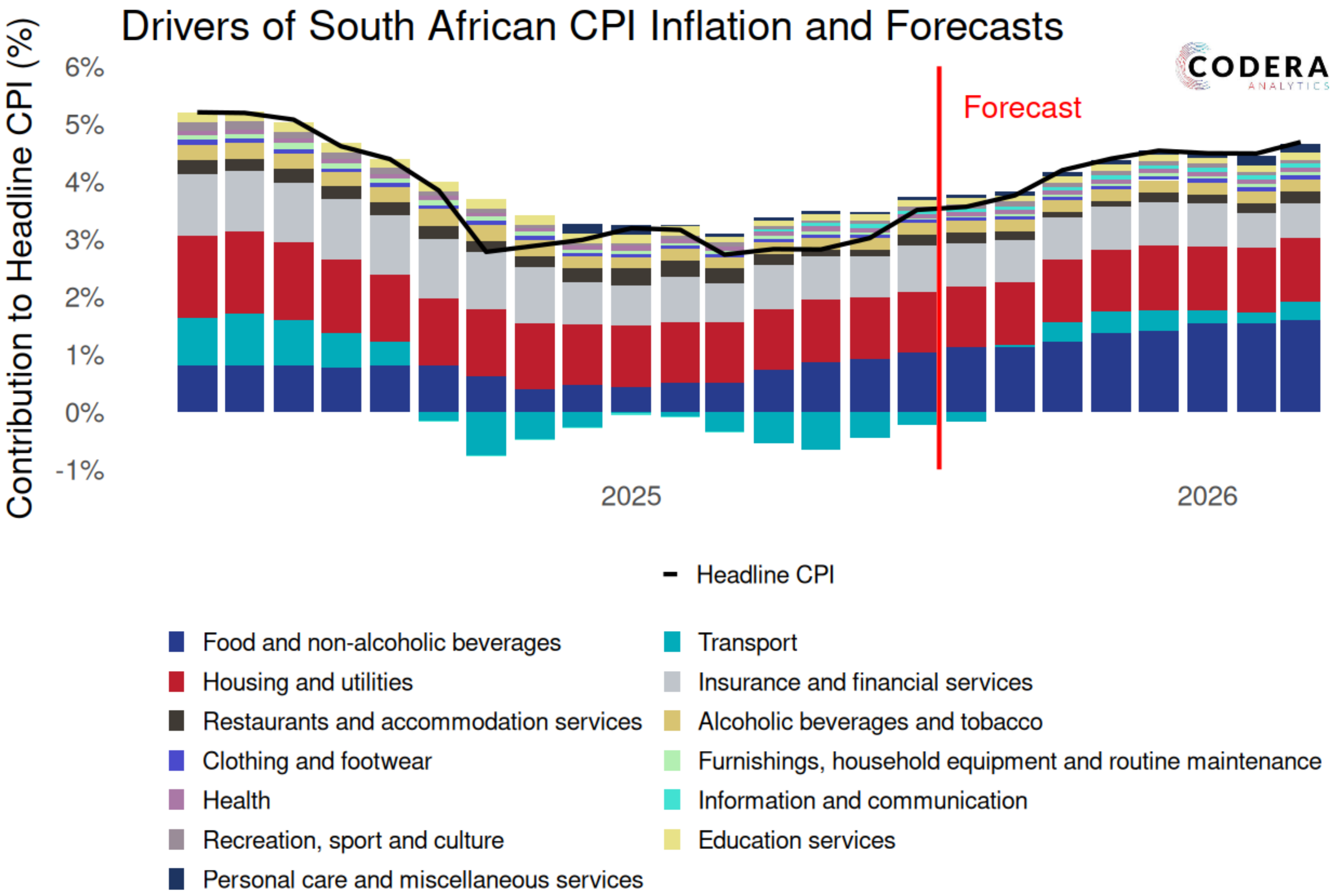


- SARB raised its forecasts at Sept MPC after lowering in July

- Significant administered price inflation is largely baked in for the next 12 months
  - Higher production costs (e.g., water & electricity) make this unlikely

NOTE: Codera's forecasts have been averaged over each quarter to align with the SARB MPC forecast frequency. Forecast date: 10 Sept 2025.

We expect headline to return to close to 4.5% by end-2025



Source: Stats SA, EconData, Codera Analytics.

- SARB forecasts core to converge to 3% in the long run, while Codera expects core to rise to over 3.5% in 2025Q4

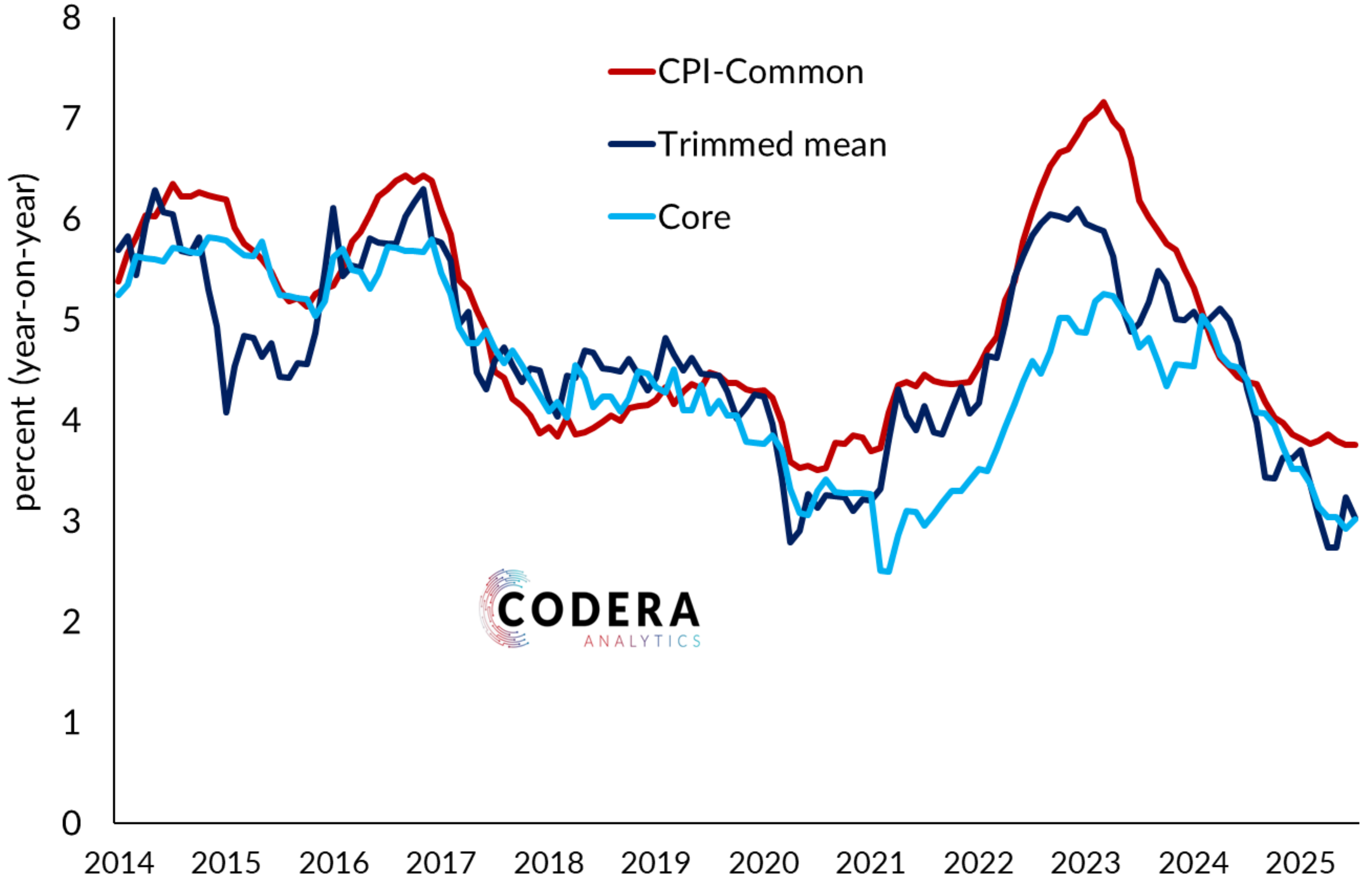
- Our headline forecasts are conditioned on some ZAR depreciation and stable global oil prices

- August's downward surprise driven by food

NOTE: Forecast date: 10 Sept 2025.

Our measure of underlying inflation suggests there is more inflation pressure than exclusion measures

Underlying inflation measures for South Africa

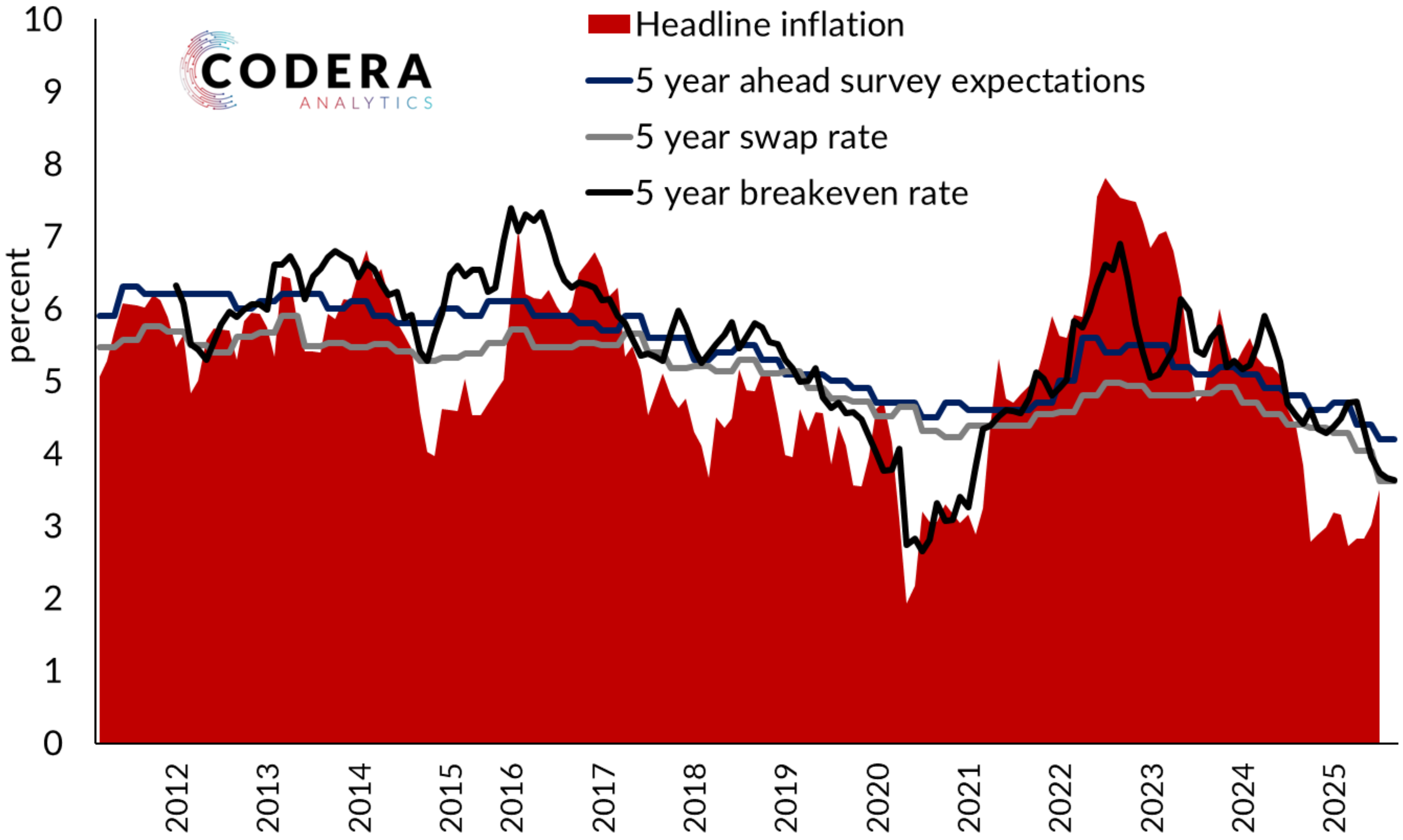


Source: Statistics South Africa, EconData, Codera Analytics. CPI-Common measure is based on a factor model drawing on CPI data at eight-digit level of disaggregation.

- Our CPI-Common measures captures broad-based inflation pressure

Inflation expectations still have a way to fall

Inflation and long term inflation expectations in South Africa



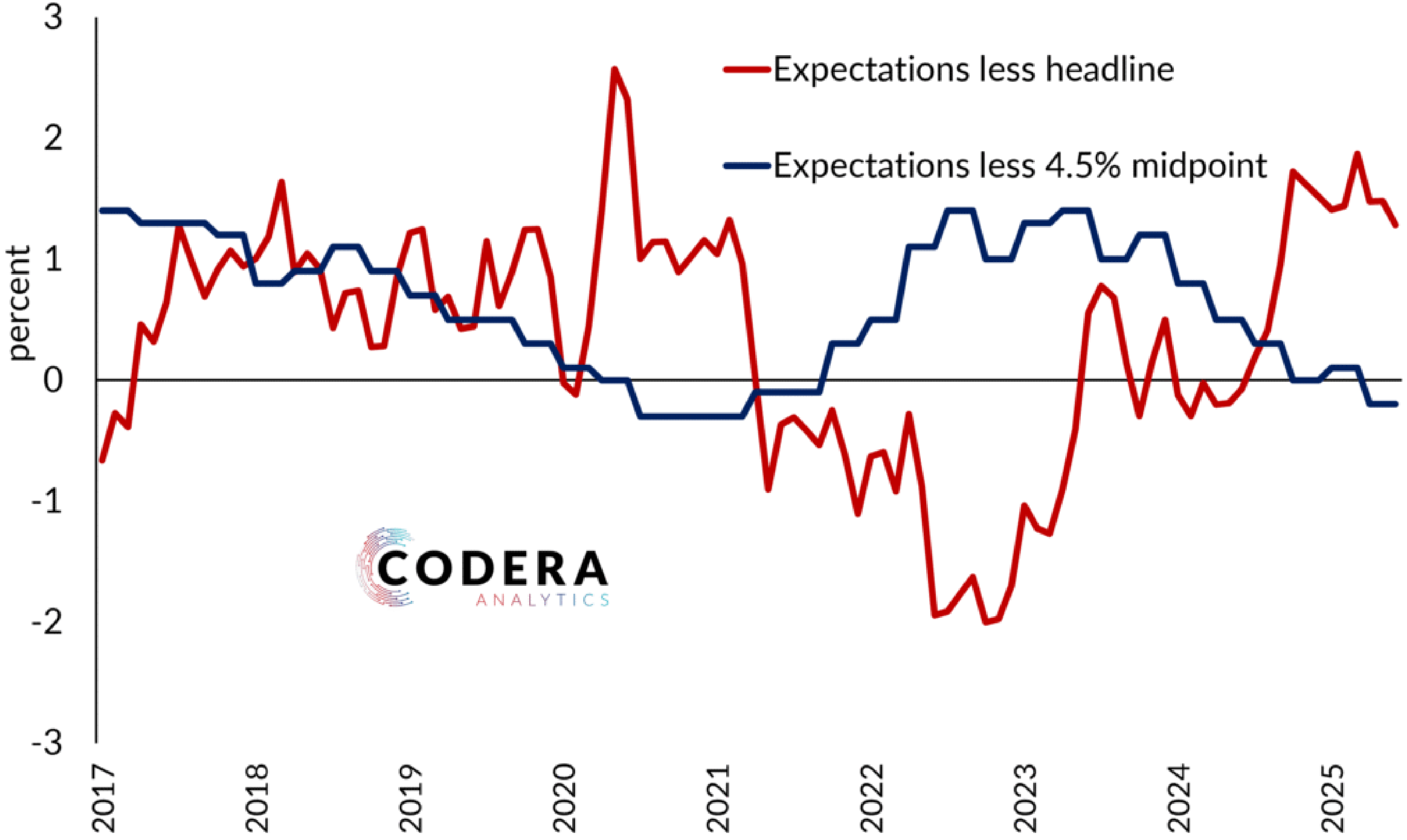
Source: Bloomberg, Stats SA, SARB, BER. Breakeven rate calculated as the closest nominal government bond to the inflation-linked bonds minus the inflation-linked bond.

- Survey-based and market-based long-term measures of inflation expectations in South Africa have declined slightly

- But remain above inflation outcomes

SA has backward-looking inflation expectations

Deviation between 1 year ahead inflation expectations and current headline CPI inflation in South Africa

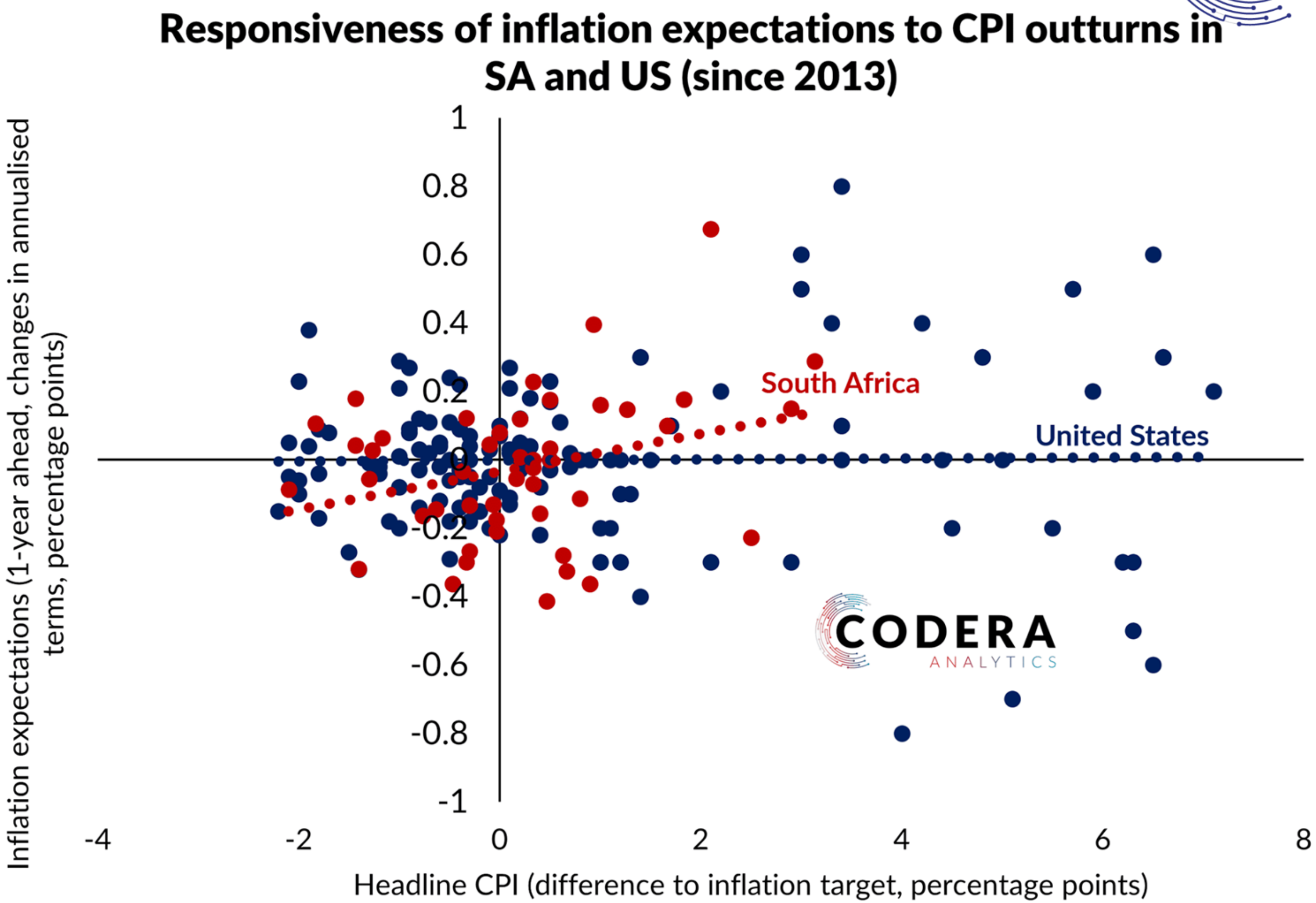


Source: Stats SA, SARB, BER, EconData.

- It took around four years (and helped by an unprecedented pandemic shock) for expectations to converge temporarily, reflecting the slow-moving nature of entrenched inflation perceptions
- The post-pandemic cost of living crisis saw inflation expectations unanchor once again, and only again converge on the target in late 2024 as the inflation cycle turned

SA has backward-looking inflation expectations

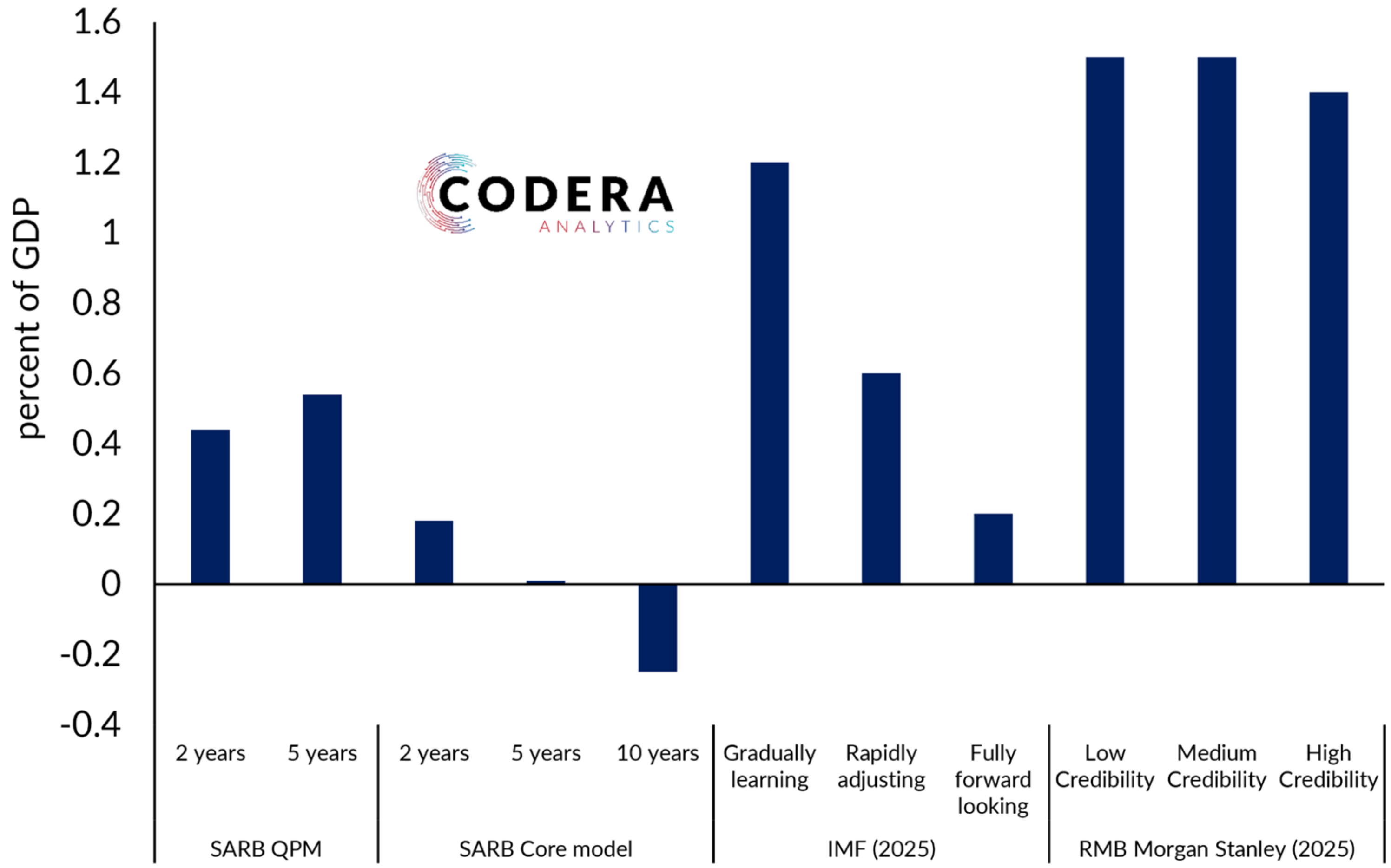
- Expectations have been more backward-looking than SARB assumes.
- Backward-looking expectations observable in wage outcomes which have been above target, particularly for the public sector.
- Rates cannot fall sustainably if SARB's assumption about rapid re-anchoring is wrong.



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

SARB assumes transition costs will be low

Sacrifice ratio estimates for South Africa



Source: IMF (2025), RMB Morgan Stanley Research (2025), SARB (2025), Codera Analytics

- **SARB assumes immediate re-anchoring of expectations and lower nominal path for rates: estimates of the sacrifice ratio 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.**

- **SARB's take represents a 'best case' scenario, not the most realistic scenario**

- Please read our paper for more detail and references.

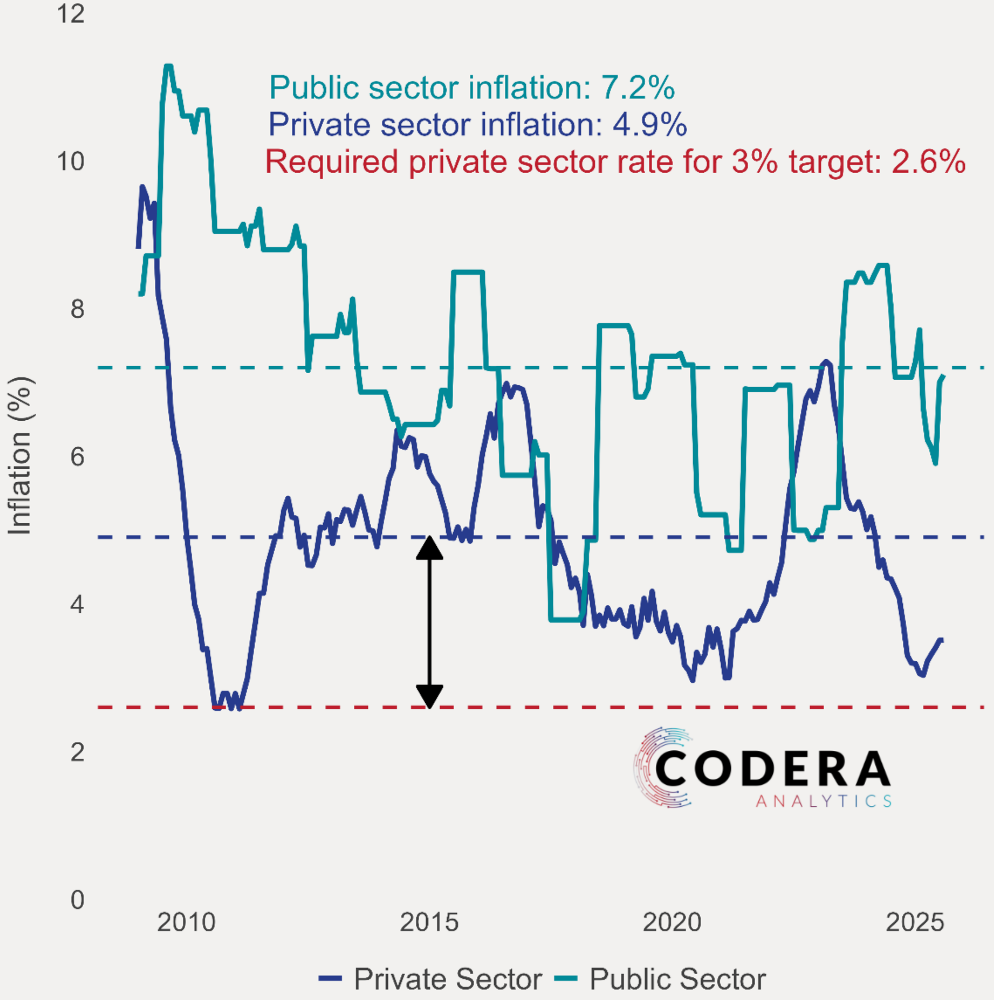
And private sector will bear the costs

- Significant increases in government-set costs are likely to hinder inflation expectations settling at 3% in the medium-term

- Implication is that private sector will need to bear the adjustment burden

Public vs Private Sector Inflation

Public sector inflation* reflects price changes of goods and services administered by government, such as public education fees, public transport fares, electricity, and municipal taxes and levies. The private sector accounts for around 90% of the consumer inflation basket, and the public sector just under 10%. Given the wedge between public and private inflation and stickiness of public sector inflation, private sector inflation needs to fall to around 2.6% to meet a 3% inflation target.

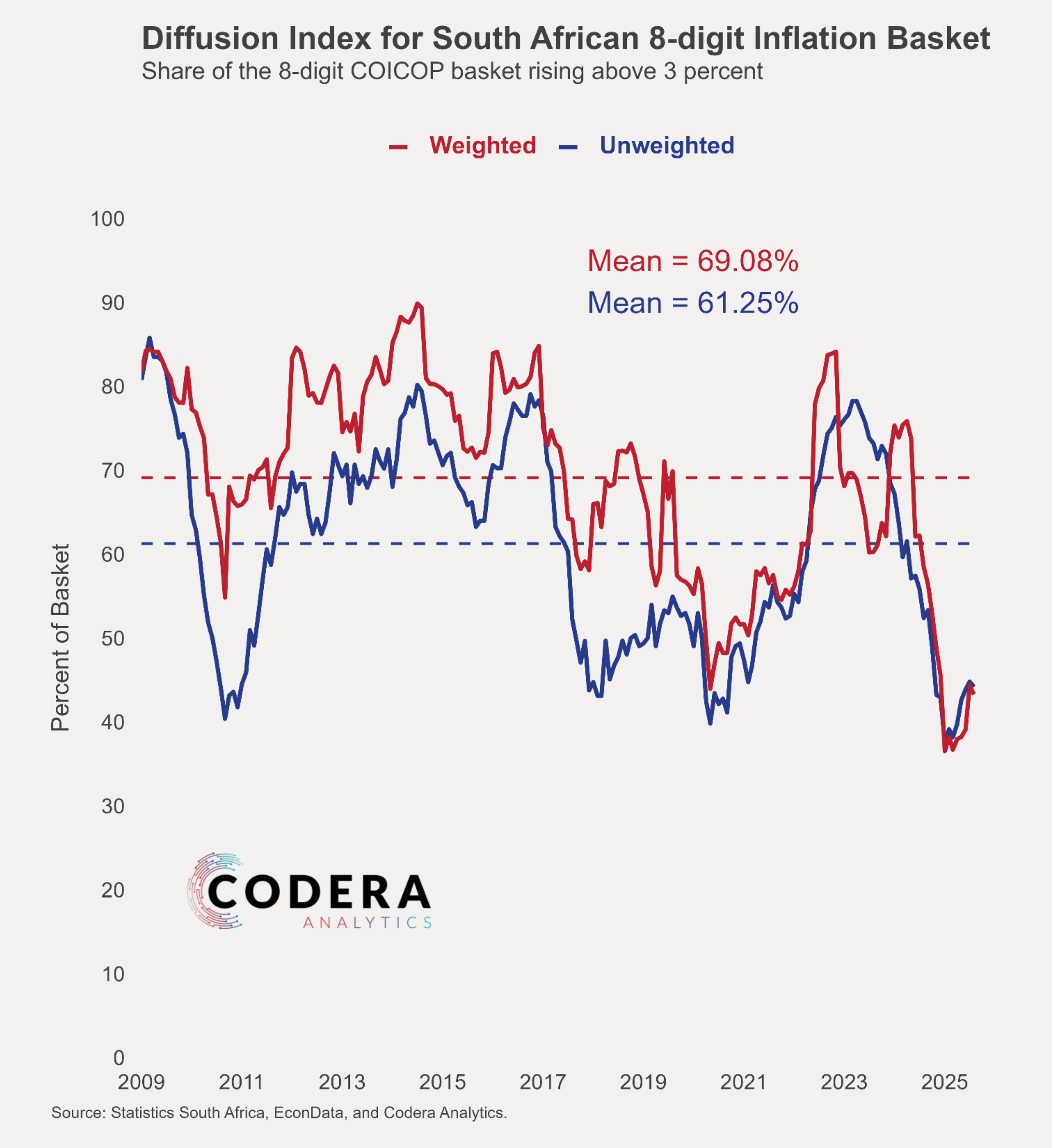


Source: StatsSA, EconData, and Codera Analytics.

*Fuel (i.e., petrol and diesel) is excluded from public sector inflation.

So SARB has a lot more work to do

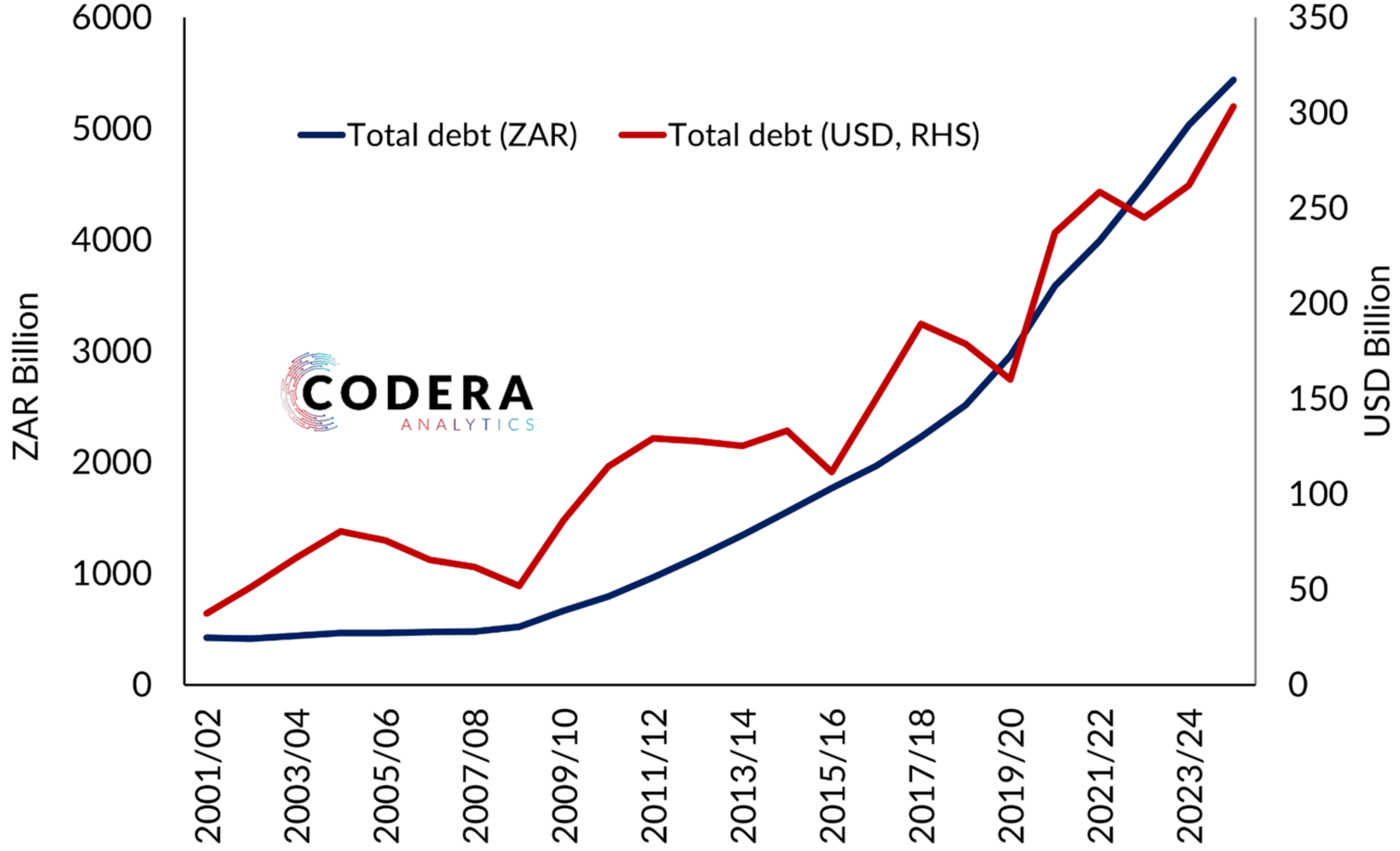
- 2/3rds of components historically rose by more than 3%
- Codera expects the proportion to rise from current lows



Inflation expectations, neutral and fiscal response to drive adjustment costs

- 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
- Fiscal balance will be under pressure from divergence between expenditure and revenue growth, reduced opportunity to use bracket creep and depend on reforms of state owned enterprises and municipal finances

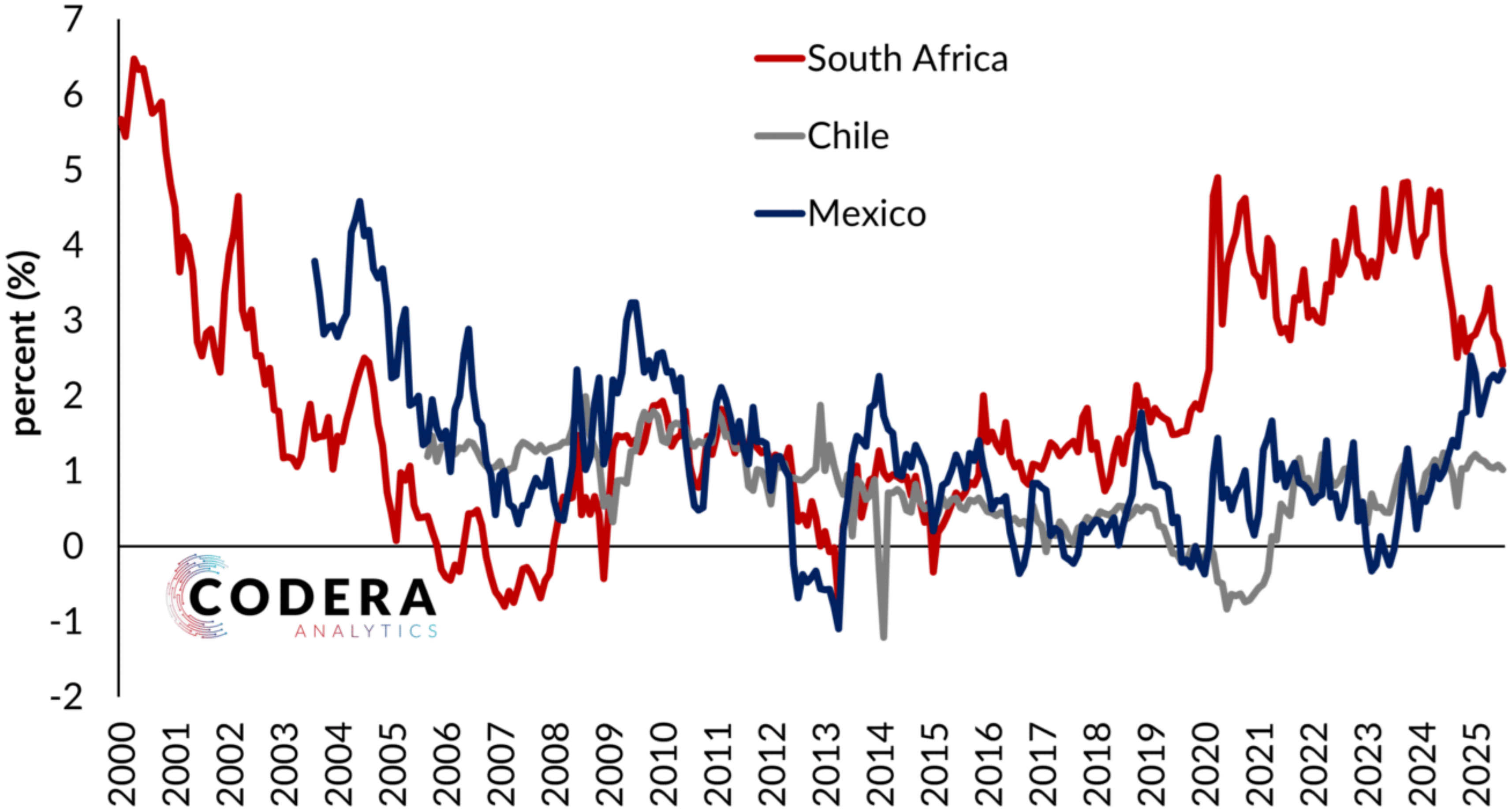
General government debt issued (South Africa)



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

SA yields remain high, driven by a high term premium

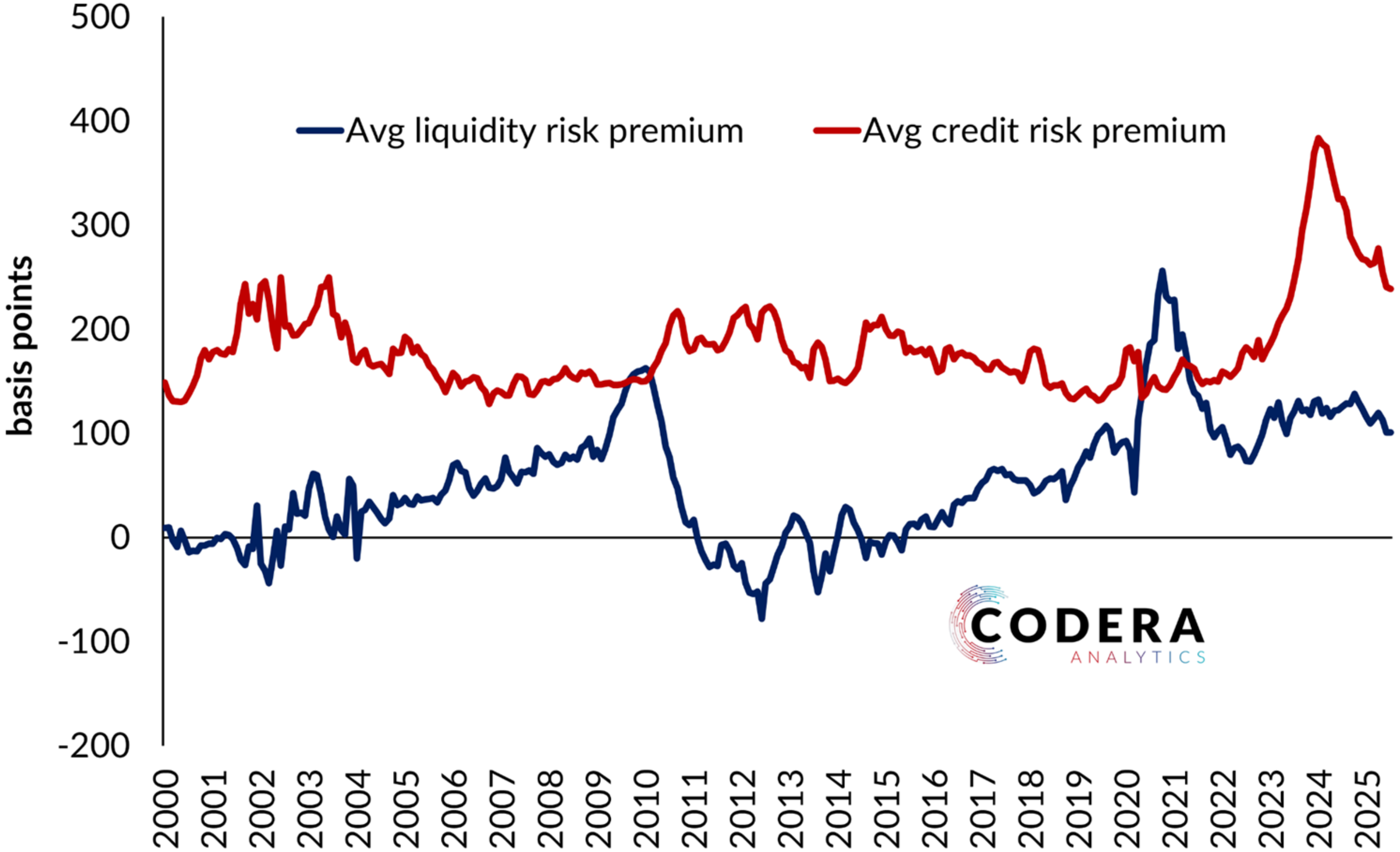
Estimates of term premia embedded in 10-year sovereign yields in selected emerging markets



Note: Our approach for estimating the other term premia is based on Adrian, Crump, and Moench (2013) and described in Erasmus, R., Steenkamp, D. 2022. Term Premium Estimation for South Africa. Journal of Applied Economic Sciences, Volume XVII, Winter, 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.

Reflecting large credit and liquidity premia

South African government bond liquidity and credit risk premia

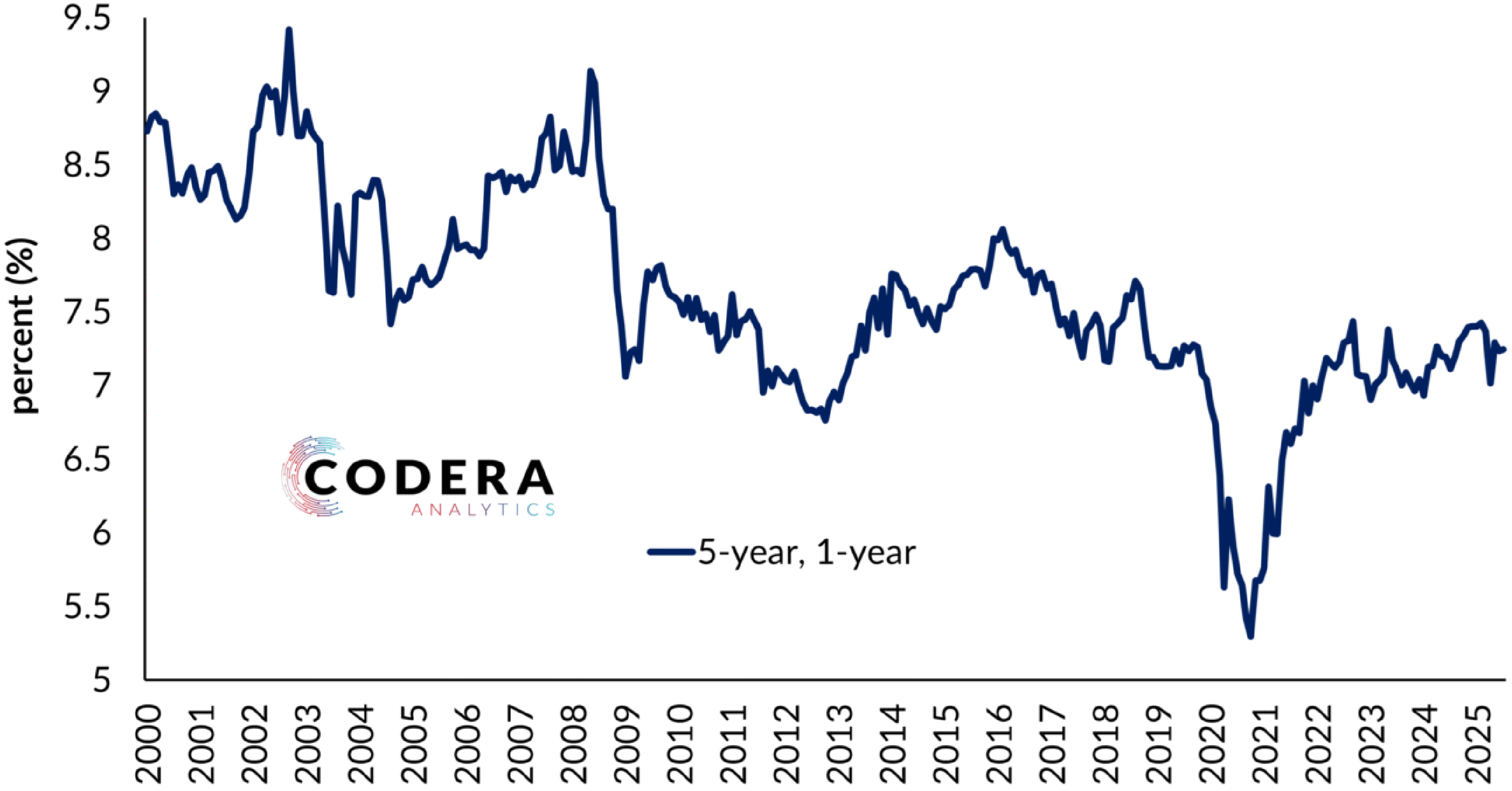


Source: Updated using the approach of Jens H. E. Christensen & Daan Steenkamp, 2025. "Joint estimation of liquidity and credit risk premia in bond prices with an application," Working Papers 11074, South African Reserve Bank.

- Fiscal risks could offset gains from a lower target if government credibility weakens

Our estimates suggest neutral rates have not yet responded

Codera estimate of South Africa's market-implied neutral interest rate based on sovereign bond yields

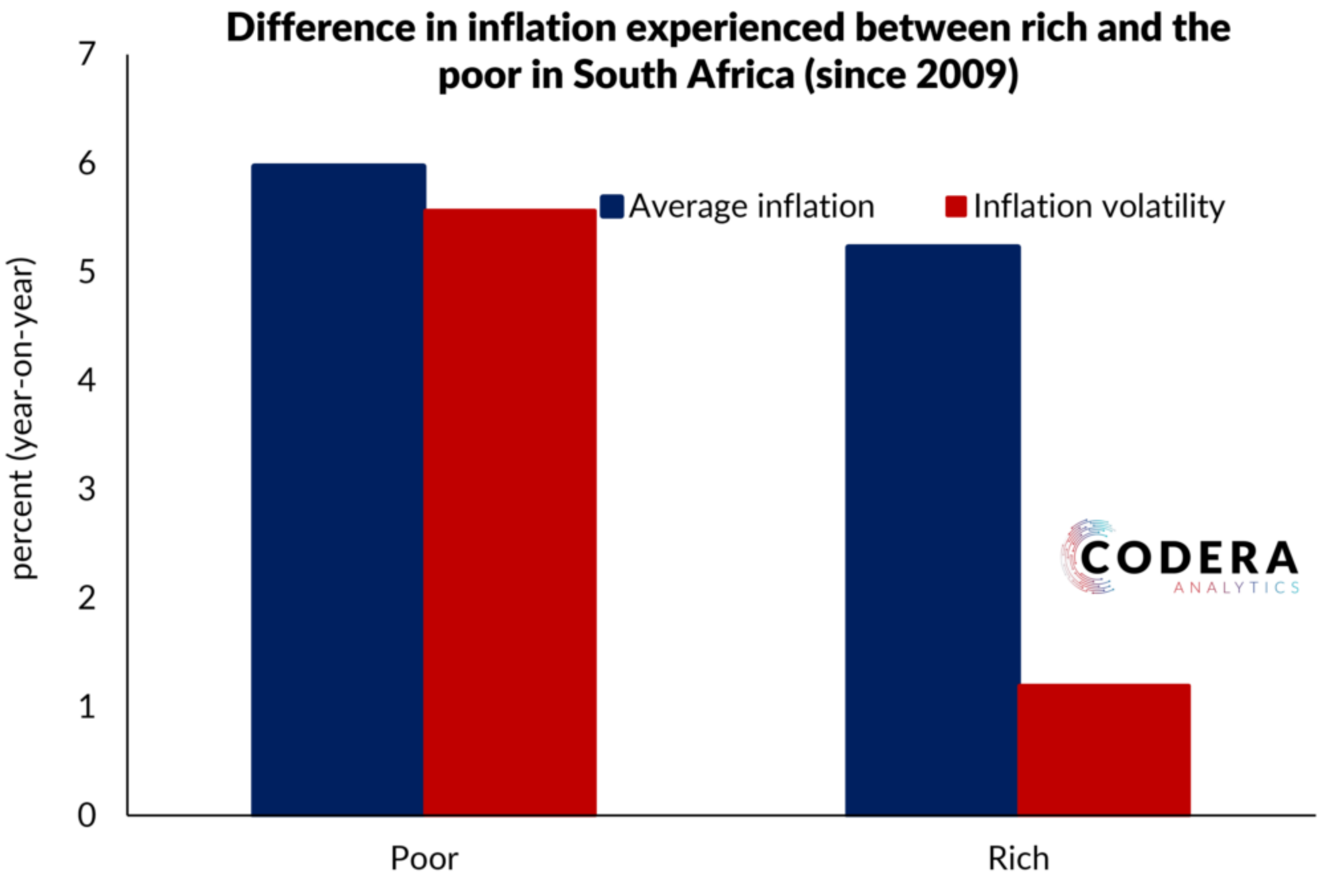


Source: Codera Analytics. Calculated as an implied a 5-year, 1-year forward interest rate (indicative of where 5 year interest rates are expected to be 1 year hence) using estimated risk neutral rates embedded in government bond curves using the term premium model of Adrian, Crump, and Moench (2013) as described in Erasmus, R., Steenkamp, D. 2022. Term Premium Estimation for South Africa. Journal of Applied Economic Sciences, Volume XVII, Winter, 4(78).

- Our estimate implies that monetary policy is currently not as tight as the MPC argues, as the policy rate is 7%.
- Instead, bond market pricing suggests that the current policy stance is broadly consistent with a neutral stance.
- Some early evidence of inflation expectations coming down

Clear SARB communication crucial for low cost transition

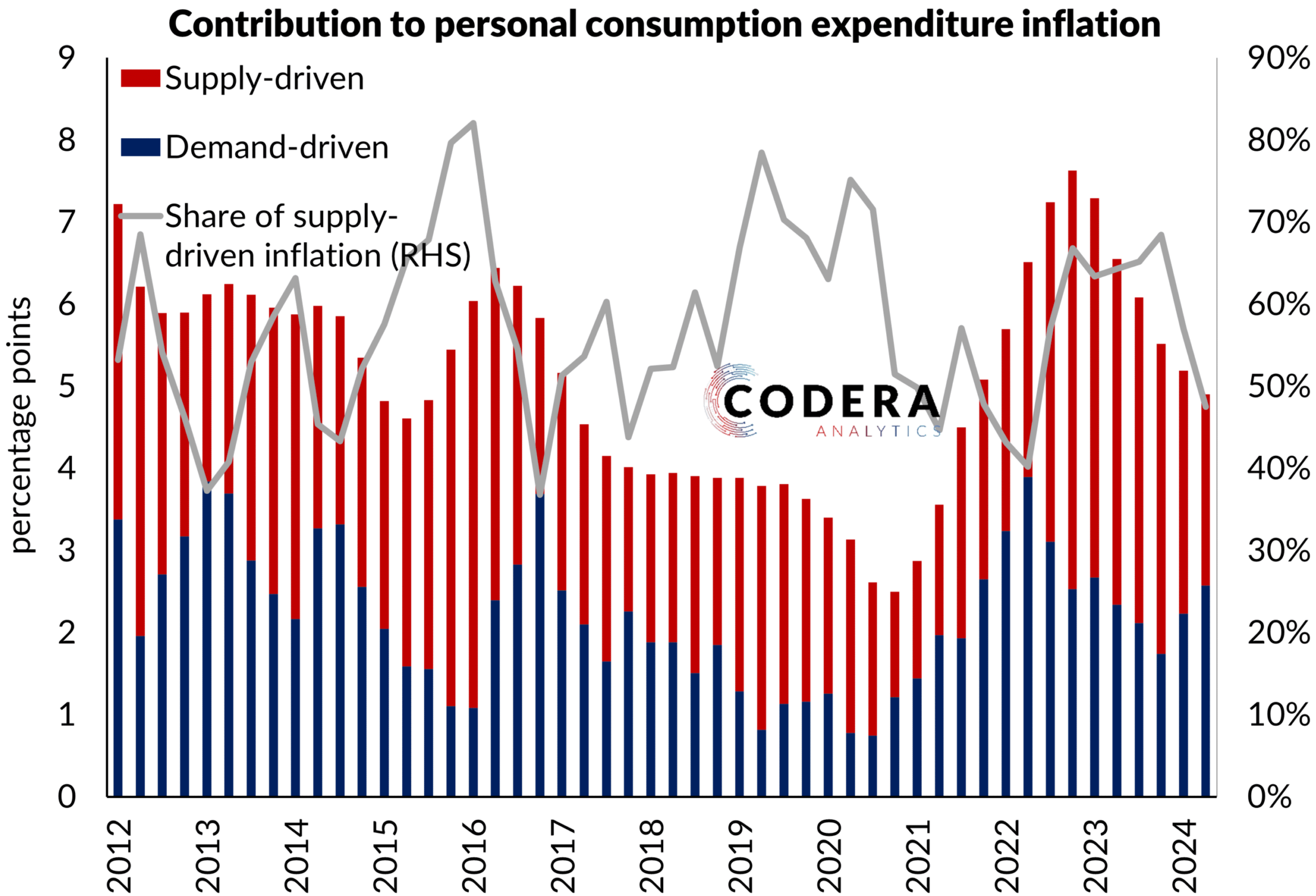
- Poor households face higher average inflation and nearly 5 times more inflation volatility than the rich, given differences in inflation drivers (e.g. larger weight on food for poor)
- This creates a communication challenge for the SARB, given differences in the inflation experienced by different households and firms
- Alignment of target to inflation experiences and importance of interpreting economic drivers of underlying inflation pressures to support policy credibility
- Importance of coordination with National Treasury and government buy-in



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.

Supply shocks very important in SA



- Inflation sensitive to imported/supply shocks (e.g. weather)
- Importance of supply side reforms and correctly identifying shocks when assessing stance of policy
- SARB must explain how policy should address inertial price and wage settings

Source: SARB

INFO@CODERA.CO.ZA

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