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What happens to scenarios when the solid ‘big stuff’ suddenly changes?

Shannon Bold & Lisette IJssel de Schepper

The Bureau for Economic Research (BER) has used a macroeconomic forecasting model since 1981. At the risk of making our job sound too easy, you feed it historic data, make assumptions about some parts of the future and the model does the rest. Of course there is more to it, but the assumptions are key.

Until recently, we could safely assume that the “bigger stuff” was solid. One could be sure, for instance, that the South African Reserve Bank would implement monetary policy to hit its target, or that National Treasury would focus on fiscal consolidation to level out debt, and that global macro policies would be slow to change.

US President Donald Trump has, of course, tossed out the global playbook, but even our domestic macro policies have been in flux. We have had three national budgets this year and though the inflation target has not officially changed, we all know the Bank is not aiming for 4.5% anymore.

We try to encapsulate this volatility when we build our macroeconomic scenarios. These scenarios are more than numbers. Like our baseline, they must be informed by a robust, coherent narrative that explains why the numbers move as they do. Rooted in theory but shaped by judgement, they help make sense of complexity.

At the BER, we start with a coherent baseline forecast, which is a single, consistent set of numbers from our macroeconomic model. We then ask: what are the most relevant risks to this baseline, domestically and globally? Based on these foreseeable risks, we build plausible “high road” and “low road” alternatives. Because our scenarios begin with narratives, they are easier to understand and more useful for planning than simply applying arbitrary shocks to the model.

The inflation target shift has big implications for the economy and lies at the centre of our baseline forecast and two alternative scenarios (though there are many moving parts).

Baseline: Slower growth, lower inflation - but not yet 3%

Our (mid-July) baseline assumes monetary and fiscal policy will remain tight for the foreseeable future. It expects that a shift to a 3% inflation target will occur over time, meaning that real interest rates will stay restrictive with cuts only when inflation expectations settle near this lower target. Meanwhile, the Treasury will focus on controlling spending to stabilise rising debt.

This dual squeeze creates a contractionary environment, weighing on growth. After a weak 2024, we expect modest GDP growth of just below 1% in 2025, before ticking up slightly over the medium term. Consumer spending and investment remain subdued, with global uncertainty playing a dampening role (on exports too).

Fortuitously, in our baseline we did expect the process of moving to a 3% target to be fairly messy. Coordination between the Bank and Treasury is crucial and, at the moment, lacking.

High-road scenario: early buy-in, early benefits

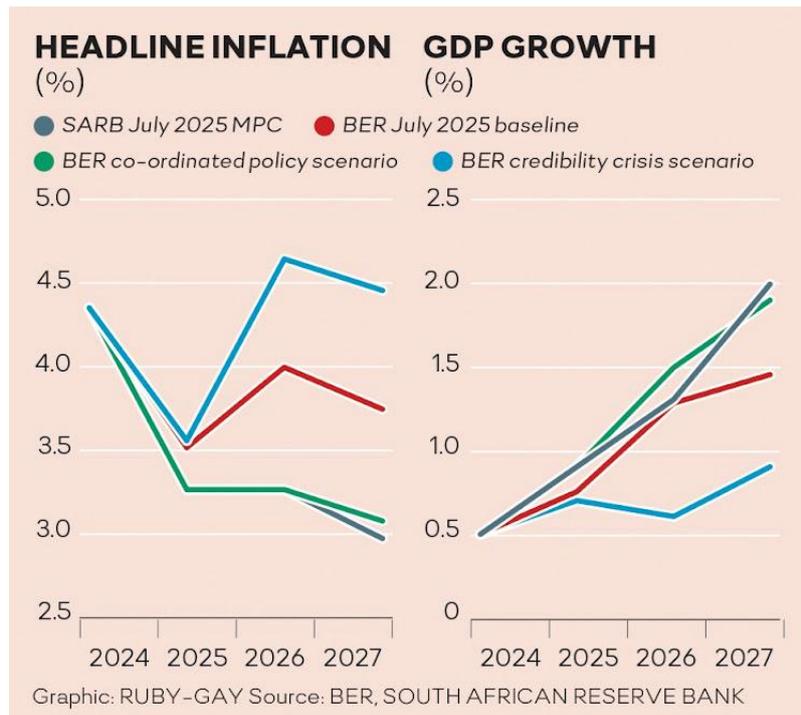
In our optimistic case, which broadly aligns with Bank's baseline forecast, Treasury embraces the 3% target soon and aligns its fiscal framework accordingly by revising down spending growth and reinforcing fiscal anchors. This cooperation strengthens Bank's disinflation efforts, so inflation converges to 3% sooner, allowing interest rates to be cut earlier. Lower borrowing costs support household spending and investment. The rand strengthens, reducing imported inflation and restoring confidence.

Despite some near-term pain, GDP grows closer to 2% over the medium term. Apart from lower inflation hurting nominal income, government revenue benefits from faster real growth, easing fiscal consolidation and lowering debt servicing costs. This creates a virtuous cycle, improving fiscal sustainability and resilience.

Low-road scenario: credibility crisis and prolonged pain

In the downside case, Treasury disregards the 3% target and sticks with a forward-looking inflation assumption of around 4.5%. This disconnect undermines the Bank's credibility, inflation expectations stay higher, and inflation remains sticky at around 4.5%.

To get inflation down, the Bank keeps rates higher for longer but despite higher rates, the rand weakens, increasing the cost of imports and external debt. Capital inflows slow, causing financial volatility. Growth stagnates closer to 1%, unemployment rises, and fiscal metrics worsen. This scenario increases the economy's vulnerability to shocks and limits policy options.



Why scenarios matter

These scenarios don't predict the future; they represent just three among countless possibilities. A common saying in forecasting is that once you release a forecast, it's already outdated, as so many moving parts must align. But what scenario planning does do is help businesses, policymakers, and investors prepare for risks and opportunities by exploring possibilities rather than relying on just one "most likely" outcome.

A model cannot tell you everything. Our model results are combined with insights from business and consumer surveys, close contact with clients, and in-depth interviews with key figures in the private and public sectors. This bottom-up process provides depth and consistency, allowing us to capture complex shifts, like the inflation target change, within fully modelled, coherent narratives.

Whether the Bank's unilateral 3% target move signals a new consensus or causes damaging incoherence remains to be seen. The future hangs as much on issues of credibility and coordination as it does on the technical merits of the target shift.

For economists and forecasters, this is a pivotal moment in how we think about domestic macroeconomic policy. For decision-makers, it highlights the critical role of scenario planning.

For the BER, it reminds us that the best forecasts come not just from models, but from robust narratives that are built on a deep understanding of the economy with all its idiosyncrasies, risks, and opportunities.

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CONTACT US

Email: lisette@sun.ac.za

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