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Better if the Treasury and Reserve Bank co-ordinate proposals

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The Reserve Bank's surprise announcement that it is shifting to targeting the bottom of the 3%-6% target range without explicit National Treasury approval is understandable but not ideal. Arguably, coordination trumps a lower target.

Are the National Treasury and South African Reserve Bank ghosting one another? Ghosting, a Generation Z person will *gensplain* to you, is when two parties studiously ignore one another, like jilted ex-lovers.

The Treasury recently announced some much-needed fiscal policy reforms. These are undeniably a good idea given the complexity of budgeting under a coalition government. Many of the reforms were signalled in a thoughtful consultation paper at the time of the budget. As expected, the idea of running a debt-stabilising primary balance remains paramount.

The Bank recently published a similarly comprehensive research note on reforms to monetary policy. The key recommendation is to reduce the inflation target to 3%.

Both notes are strong pieces of analysis. But they studiously ignore one another. This is sad. It is a bit like watching two good friends slowly drift apart.

Following yesterday's announcement that the Bank will be aiming for "the bottom of the 3%-6% range" (read 3%), without the explicit approval of the National Treasury, it is clear that South Africa's fiscal and monetary policies have become uncoordinated. It would have been better if there was one line of communication on macroeconomic policy, led by the Treasury acting in lockstep with the Bank.

Recent Treasury communication on fiscal policy avoids mentioning inflation. It is as if fiscal policy is unaffected by inflation or the inflation target. The Treasury's recently published spending guidelines clearly anchor inflation at 4.5% over the next three years. If there was a discussion about reducing the inflation target, no one told the Treasury's budget team.

Similarly, the Bank's latest research goes into some depth about the benefits of lower inflation for fiscal policy but doesn't reference the Treasury's fiscal anchor process, or how a lower inflation target would impact the primary surplus target, other than to unhelpfully (but correctly) note that the Treasury will have to run even bigger primary surpluses in the short run. It does darkly warn about how Brazil's attempt to shift from a target of 4.5% to 3% was derailed by a lack of coordination between the fiscal and monetary authorities.

Of course, the Treasury may have been ghosting the Bank just because it's busy. Maintaining a primary balance requires root-and-branch reforms to spending and ongoing battles with state-owned enterprises – and all in

the middle of a geo-political storm with indiscriminate tariffs threatening to derail global growth. And there is a fragile government of national unity.

Also, it could also be argued that South Africa's current macroeconomic policy mix remains quite sensible. Monetary policy is keeping inflation around 4.5%. Fiscal policy aims to entrench a primary surplus and slowly stabilise debt. Structural reform is inching forward. A sovereign credit rating upgrade in the next year or two is not impossible.

To *gensplain* again: South Africa's got 99 problems, but inflation ain't one of them.

That said, reducing the target to 3% would be an easy win. With annual consumer inflation already at 3% in June, the costs would be minimal. Our current macroeconomic policy mix is good but entrenching a primary surplus and lowering the inflation target would make ratings agencies sit up. Interest rates would drop. It would firmly re-establish a sound macroeconomic framework and go a long way to reversing the deterioration of the state-capture years.

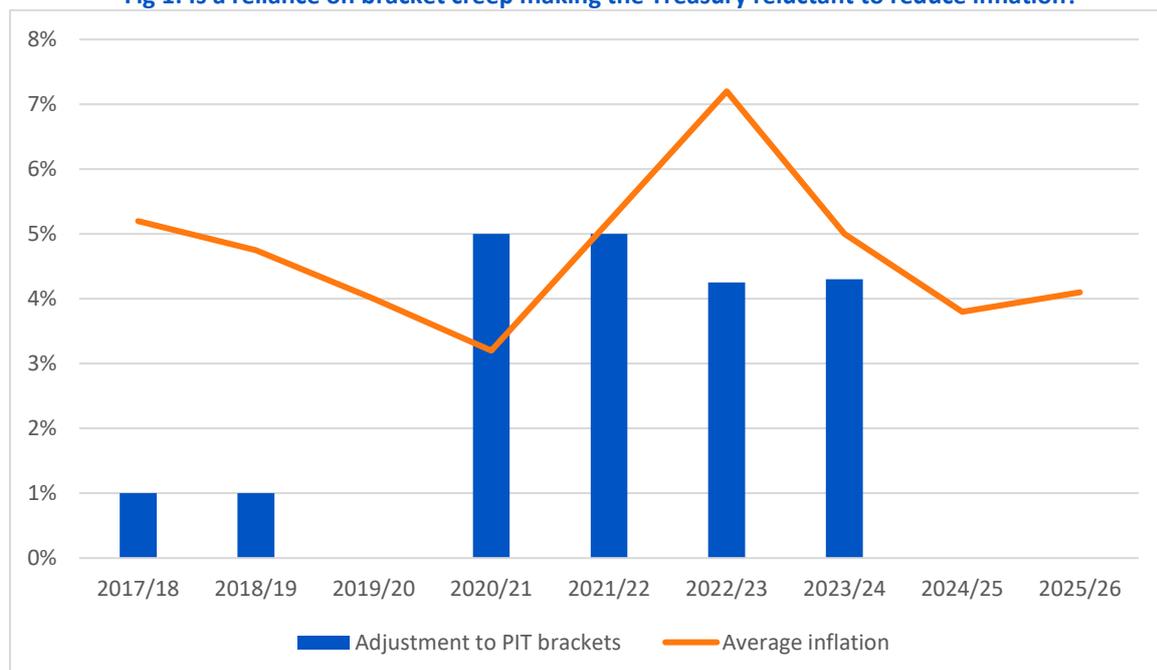
Even so, coordination trumps a lower target. It is arguably better for the two parties to agree to a higher target than for the Treasury to assume one inflation trajectory and the Bank another. If the Bank targets inflation of 3% without the Treasury's buy-in, and achieves it, then the fiscal position will worsen.

How? Well, the Treasury will continue increasing spending by 4.5% a year as before, but inflation (and hence tax revenue growth) will be closer to 3%. Given pedestrian levels of growth, this will make the Treasury's primary balance target difficult to reach. Fiscal credibility will be harmed.

The Bank also needs the Treasury's buy-in to help pull down inflation by, for example, curbing administrative prices increases and not proceeding with spending projections built around 4.5%. Without it, central bank credibility will be harmed.

A less-acknowledged point is that the Treasury has long used inflation to balance the books. The most recent budget will raise R15.5bn by not adjusting personal income tax brackets for inflation – for the second year in a row. Reducing inflation reduces the utility of continuing to milk this approach. So, asking the Treasury to embrace a 3% target means it will have to cut both their spending growth and tax revenue estimates – something that will be hard to do, politically.

Fig 1: Is a reliance on bracket creep making the Treasury reluctant to reduce inflation?



Source: Dr Carolina Meyer (2025), National Treasury

Ultimate responsibility over macroeconomic policy lies with the minister of finance. Policy is always political, and it is the minister's job to manage the politics around taxation, spending and the setting of the inflation target.

The latter is not a political fight the current finance minister Enoch Godongwana really wants to have right now. It also isn't clear that the Bank has many political allies on this issue

Despite the Bank going it alone, it would still be better if the Treasury and the Bank could come together and put out a joint macroeconomic strategy for the next decade built on fiscal prudence and monetary stability, supported by structural reforms. This could be the foundation of a credible long-term growth strategy.

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