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South African Reserve Bank Special Economic Notes are a collection of descriptive and critical economic analyses with recommendations written for internal SARB discussion. They are written by staff members or fellows of the Economic Research Department and, on occasion, by consultants under the auspices of the SARB. They are released publicly on an occasional basis. This series features internal research on how oil price shocks generate second-round effects, with a specific focus on the 2026 oil price shock.

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Table of contents

1. Oil price shocks and inflation: stylised facts from historical oil shocks
Mathias Manguzvane, Koketso Mantsena and Mpho Rapapali
2. Fuel price pass-through in South Africa following the war in the Middle East
Keletso Morwane and Rudi Steinbach
3. Quantifying the pass-through of a fuel price shock to inflation expectations and inflation in an attentive environment
Anis Foresto, Monique Reid and Cobus Vermeulen
4. Oil price shocks and inflation risks: evidence from South African market pricing
Palesa Mnguni and Luchelle Soobyah
5. The first- and second-round effects of supply shocks
Witness Simbanegavi and Mokgabiso Tshenkeng
6. Waiting for wages: oil price shocks, wage expectations and wage growth in South Africa
Chloë Allison and Phumlani Mavuma

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Quantifying the pass-through of a fuel price shock to inflation expectations and inflation in an attentive environment

Anis Foresto, Monique Reid and Cobus Vermeulen

Abstract

- We estimate the impact of a 30% increase in the fuel price on the inflation expectations of firms. The fuel price shock is structurally identified from a structural vector autoregression, controlling for global and domestic factors.
- We find that distinguishing between a conventional once-off and sustained fuel price shock produces different responses. Under a sustained shock, firms' two-year ahead inflation expectations (the monetary policy horizon) rise significantly and are more persistent, dissipating only after eight quarters.
- The implied pass-through from the response of inflation expectations to inflation, based on a stylised Phillips curve relationship, reveals that the impact on inflation is larger if the shock is sustained.
- However, the strength of the expectations channel is conditional on the firm's ability to pass on increased costs. Firms' ability to pass through cost increases depends on their margins and price elasticities, and is therefore likely to vary across sectors.

1. Introduction¹

In this note, we quantify the impact of the current fuel price shock on the inflation expectations of South African firms.² We show that the response in expectations depends on whether the shock is once-off (temporary) or sustained. While a conventional once-off shock raises firms' inflation expectations at each horizon (current, one- and two-year ahead), the response at the policy-relevant two-year horizon is moderate (0.15 percentage points (pp)). However, under current conditions of persistently high fuel prices, treating the shock as once-off likely understates the true response of expectations. By extending the analysis to a sustained shock that captures the realised experience in fuel price pressures, we find a substantially larger and more persistent response at the policy horizon. Firms' two-year ahead expectations peak at

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¹ The authors gratefully acknowledge valuable comments and feedback from Theo van Rensburg and Jeff Rakgalakane that improved the quality of this economic note.

² As a robustness check, we further evaluate the impact of a fuel price shock on aggregate inflation expectations using a structural vector autoregression (SVAR). We do this to gauge whether firms' inflation expectations response is comparable to the response of aggregate economy-wide expectations over a longer sample period that combines a range of economic conditions (high and low attention regimes).

0.65 pp under a sustained shock, more than four times the peak response under a once-off shock.

The distinction between a sustained and once-off shock is important. Under certain conditions a firm could have elevated inflation expectations but not have the room to pass through higher input costs to consumers. A combination of narrow margins, greater price elasticity and strong competition suggest that following a once-off shock firms may resort to absorbing the shock, relying on inventories, for example, which would dampen pass-through to inflation (Masia 2026). However, sustained cost pressures erode firms' ability to rely on these mechanisms, increasing the likelihood that higher expectations will translate into higher prices and ultimately inflation.

To capture the possible inflationary risks from both a once-off and sustained fuel price shock, we use a stylised Phillips curve framework to isolate the inflation expectations channel and quantify the implied pass-through from the response in firms' two-year ahead expectations to inflation. The results suggest that sustained fuel price pressures have greater consequences for inflation, raising it by 0.5 pp over eight quarters through the expectations channel, whereas a conventional once-off shock raises inflation modestly by 0.12 pp over the same horizon.

2. Inflation expectations: the propagation mechanism

It is important to emphasise that inflation expectations are a channel, or propagating mechanism, through which a supply-side shock may be transmitted to other prices in the economy (Pfäuti 2026). In environments of high and volatile inflation, or elevated attention to inflation, inflation expectations are more responsive to incoming shocks that exert upward pressure on inflation, resulting in a stronger co-movement between inflation and expectations (Borio et al. 2023). The increased sensitivity of expectations to these shocks further entrenches price pressures, generating additional inflationary pressures.

2.1 Expectations formation and salience

When determining which prices elicit a response from inflation expectations, the international literature suggests that items individuals engage with frequently could influence their beliefs about future inflation outcomes (Weber et al. 2022). Research focusing on the United States found that prices consumers see frequently, particularly the oil price, have a notable effect on their expectations (Cavallo et al. 2017). It is not immediately obvious that this is generalisable across countries, because the evidence for other advanced (euro area) economies suggests that expectations do not respond homogeneously to the same prices (D'Acunto et al. 2021). In South Africa, fuel prices are likely to be salient given that a substantial portion of the population relies on motor vehicles as a means of transport (OECD 2025). Recent evidence shows that the expectations of South African firms respond to exogenous oil news shocks (Caraiani and Gupta 2026). While the contemporaneous response at the one- and two-year-ahead horizons are modest (firms' inflation expectations rise by 0.13 and 0.09 pp, respectively, in response to a one standard deviation shock), there is evidence to suggest the effects are heterogeneous across sectors. However, these estimates do not capture the persistence of the effect of the shock on expectations and, in turn, how this feeds back into headline inflation.

2.2 Corporate margins and inflation transmission

When an adverse supply shock hits, firms have two choices: absorb the increase in input costs directly into their margins, which could reduce production and lower employment, or pass through the costs onto their customers and generate further price pressures. The choice between these two options is influenced by firms' profit margins, demand elasticity for their products, and cost structures, implying that there would be sectoral heterogeneity in how firms respond to the shock (Gopinath, Itshoki and Rigobon 2010). Generally, firms operating in sectors with less elastic demand, larger margin-buffers and lower competition (implying stronger pricing power) are better able to pass through the initial shock than firms that have smaller margin-buffers, more competitive environments and highly elastic demand (Mankiw 1985). In South Africa, there is evidence to suggest firms operating in the retail and wholesale, manufacturing, and construction sectors are more likely to absorb a shock, compressing margins further, and potentially leading to a fall in production or employment (Masia 2026). The sectors most likely to add to price pressures by passing the shock on to consumers are service industries (such as restaurants and hotels) and mining, which benefits from higher commodity prices.

However, for supply shocks that result in sustained increases in salient prices, existing buffers (inventories) and margins of firms erode quickly (Auer, Burstein and Lein 2021). Under circumstances where cost pressures are sustained rather than short-lived, firms could eventually be forced to shift away from absorbing cost increases or reducing production and rather pass some of these cost increases on to their consumers (Reis 2026). Persistent pressure in these salient prices could further raise inflation expectations as firms become more attentive and adjust their beliefs based on new information, increasing the risk of further pass-through and a generalisation of price pressures (Patzelt and Reis 2024; Pfäuti 2026).

3. Empirical results: the impact of a fuel price shock on firms' inflation expectations

We estimate the impact of a fuel price shock on inflation expectations under current economic conditions. To do this, we use the Bureau for Economic Research's (BER's) disaggregated inflation expectations survey for firms over the period 2021Q1–2024Q4.³ We choose this period to assess the impact of the current fuel price shock because attention to inflation was consistently high throughout, so the results are not confounded by shifts in attention. We distinguish between these regimes to acknowledge that the response of inflation expectations is state dependent and conditional on both the economic environment and the nature of the shock, which are likely to change over time (Borio et al. 2023; Foresto, Reid and Rakgalakane 2025).

To isolate the effects of a fuel price shock, we use the fuel pump price as our variable of interest.⁴ While domestic fuel prices⁵ are highly correlated with oil price movements, pump prices are arguably more salient because they are the prices South Africans directly

³ During this sample period we have a total of 1 946 observations across all sectors.

⁴ For the once-off oil shock we assume that the price level increases before returning back to its pre-shock level in the next period, thereby simulating a non-persistent shock.

⁵ The fuel pump price represents the final price paid at the fuel service station and consists of the basic fuel price (BFP) plus domestic elements like taxes, levies, margins and other regulated costs.

experience. We identify the shock using a SVAR, specified in Equation (1). The SVAR is estimated at a quarterly frequency from 2006Q1 to 2026Q1, and controls for global oil market conditions – world oil production ($\Delta prod$), global real activity (rea) and the real price of crude oil ($\Delta brent$) – as well as domestic variables, including the rand/dollar exchange rate (Δer), fuel prices (Δpet), inflation expectations (π^e) and inflation ($\Delta \pi$) (Kilian 2009).⁶ We first extract the identified structural fuel price shock series from the SVAR, and then estimate how sensitive firm inflation expectations are to this shock using a local projection (LP) specified in Equation (2) (Jordà 2005; Barnichon and Brownlees 2019). We scale the fuel price shock to be consistent with the realised increase in the level of the fuel price (30%).⁷

$$Y_t = \sum_{l=1}^p \beta_l Y_{t-l} + A_0^{-1} \varepsilon_t \quad (1)^8$$

where $Y_t = [\Delta prod \quad rea \quad \Delta brent \quad \Delta er \quad \Delta pet \quad \pi^e \quad \Delta \pi]$.

$$\pi_{t+h}^e = \beta_{0,i} + \beta_{1,i}^h \varepsilon_{t-1}^{\Delta pet} + \beta_2^h Z_t + \vartheta_i + \tau_t + e_{i,t} \quad (2)^9$$

The LP impulse responses to a once-off fuel shock for current and one-year-ahead inflation expectations are shown in Figure 1. At the aggregate firm level, the current year expectations respond immediately and strongly, peaking at 0.32 pp.¹⁰ The one-year-ahead inflation expectations also respond immediately but more moderately (peaking at 0.16 pp). The effect of the fuel price shock is persistent, only dissipating after five quarters for the current and one-year-ahead horizons.¹¹

As monetary policy operates on a two-year horizon,¹² we assess the response of firms' two-year-ahead expectations to both a once-off shock and a sustained shock, with the latter more

⁶ The ordering follows Kilian (2009), where global oil supply conditions are predetermined relative to the demand and price of oil, while domestic financial and economic prices respond and adjust to global conditions. The structure reflects South Africa's position as a small open economy that is a price taker in the global oil market.

⁷ This is consistent with the 40% increase in the oil price, which is a routine-sized shock that the South African economy has experienced historically (Janse van Rensburg, Rakgalakane and Steinbach 2025).

⁸ As a test of robustness against our fuel price results, we extract a supply-driven oil shock using a proxy-SVAR (Mertens and Ravn 2013). We rely on the OPEC announcement surprises constructed by Känzig (2021) as our proxy for an oil shock. The surprise series captures exogenous variation in oil supply conditions by measuring the change in near-month oil futures prices in a narrow window following OPEC announcements. This allows more precise identification of the shock (reduces endogeneity), but it now only captures the supply-driven shock.

⁹ Z_t are a set of controls including four lags of our dependent variable and the change in the fuel price.

¹⁰ While current year inflation expectations are not a measure of anchoring due to their sensitivity to shocks (Aguilar, Guerra and Martinez 2024), for South Africa there is evidence to support strong contemporaneous feedback between firms' current year expectations and their medium-term forecast horizons (Amaral, Foresto and Mosoma 2026). This suggests that a sharp increase in firms' current year expectations in response to an oil shock poses a risk to the stability/anchoring of their expectations at one- and two-year-ahead horizons.

¹¹ As a robustness test, we estimate the impact of a once-off oil supply shock using the Känzig (2021) oil surprise in place of the fuel price shock; the results are reported in the annexure (Figure A1). While the peak contributions to expectations are larger at the one- and two-year horizons (0.31, 0.23 and 0.25 for current, one- and two-year-ahead) and occur with a greater delay, the confidence bands for the impulse responses using either the fuel price or the Känzig oil surprise overlap substantially, suggesting they are not different statistically.

¹² See Kydland and Prescott (1977), Rogoff (1985), and Svensson (1977).

reflective of the realised fuel price pressures experienced since the start of the US and Iran war. We assume that the fuel price remains at its peak (30% above pre-shock level) for three quarters, before gradually declining (24%, 18%, 12%, 6% and 6%) and settling just above pre-shock levels.

In Figure 2, we see that the response to a once-off shock on firms' two-year-ahead expectations come with a delay, peaking at 0.15 pp, and exhibiting weak persistence. In contrast, a sustained shock elicits a much larger and more persistent response, reaching a peak of 0.65 pp after five quarters, and only dying out after eight quarters. This suggests that in attentive environments, where firms place a larger weight on new information when forming their beliefs about future prices, sustained fuel price pressures could result in significant revisions in inflation expectations at longer horizons. This makes it important to monitor relative shifts in inflation expectations beyond those sectors most exposed to the fuel shock in order to understand how the shock may become broad-based and propagate through to inflation.

Figure 1: Response of firms' inflation expectations to a once-off fuel price shock

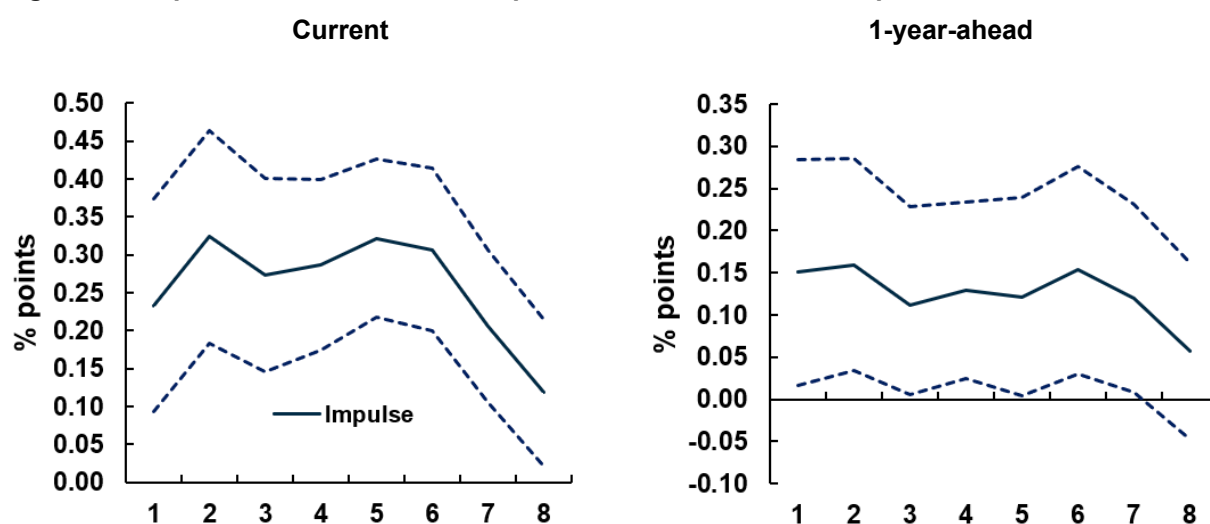
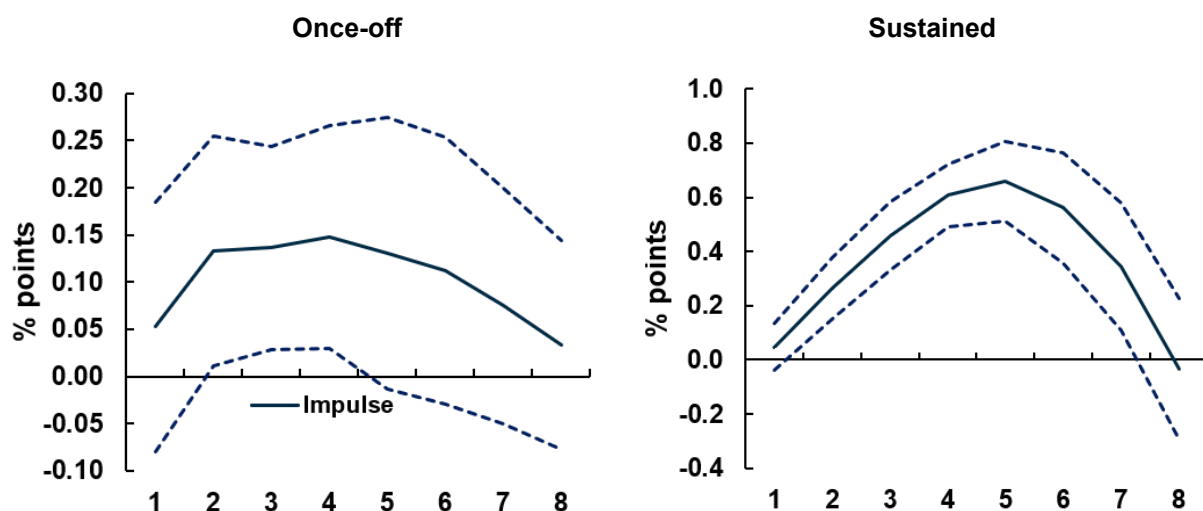


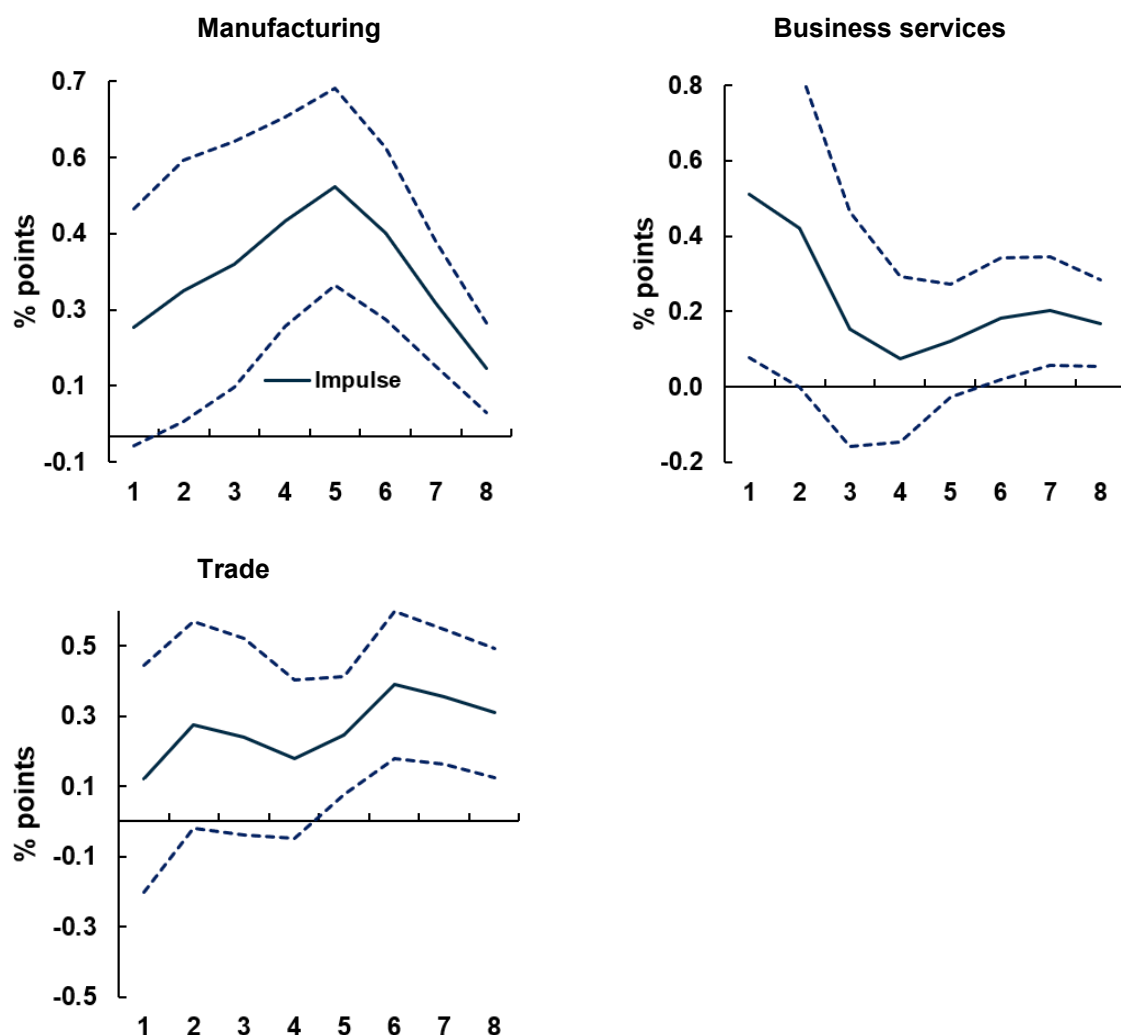
Figure 2: Response of firms' two-year-ahead expectations to a once-off and sustained fuel price shock



Source: Authors' own calculations. Dotted lines represent 90% confidence intervals.

Moving beyond the aggregate, we consider the sensitivity of firms' inflation expectations by sector.¹³ The analysis is limited to those sectors for which the BER sample is large enough.¹⁴ In Figure 3, we observe that manufacturing and trade (wholesale and retail) firms respond to the fuel price shock quickly (peak response after five quarters for manufacturing and six quarters for trade). The increase in expectations for both sectors persists for some time before dying out.¹⁵ The expectations of business services react significantly to the fuel price shock in the first period, but the shock dissipates quickly.

Figure 3: Sectoral response of current year expectations to a once-off fuel price shock



Source: Authors' own calculations. Dotted lines represent 90% confidence intervals.

¹³ For our sectoral analysis, we have a total of 665 observations in manufacturing, 561 in trade and 260 in business services. These sample sizes are large enough to provide credible and robust insights as they represent the majority of the BER's sample (Reid, von Fintel and Foresto 2026). For other sectors of interest (i.e. transport and construction), the sample sizes are not large enough to provide a meaningful or significant estimate.

¹⁴ For more details on the sectoral breakdown of the BER's firm survey, see Reid, von Fintel and Foresto (2026).

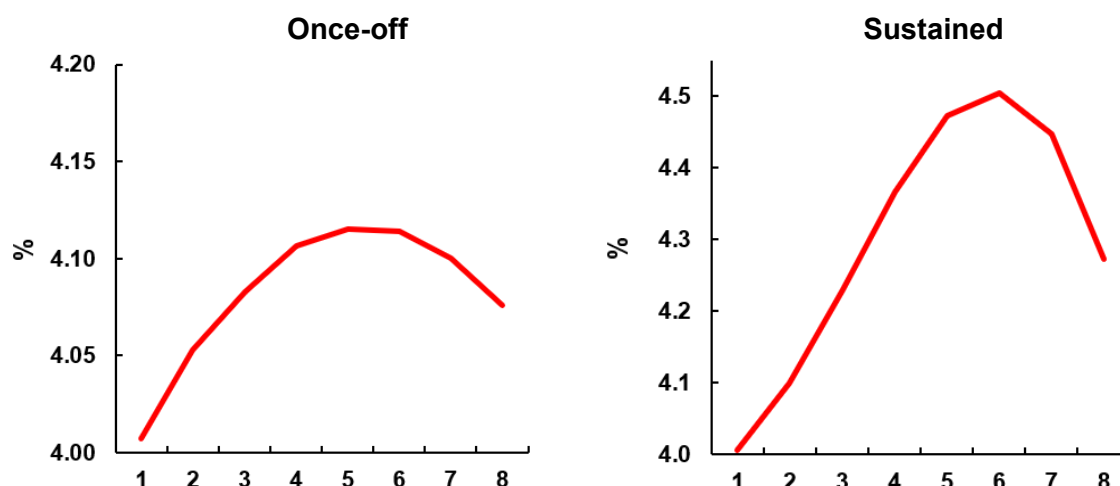
¹⁵ Considering our proximity from the initial shock and the frequency with which expectations are surveyed, our results suggest that expectations will increase between Q3 and Q4 of 2026.

4. Expectations pass-through to inflation

To provide a sense of the propagation mechanism through the expectations channel, we simulate the pass-through of both a once-off and a sustained fuel price shock to inflation via firms' two-year-ahead inflation expectations in a Phillips curve framework (Foresto, Reid and Rakgalakane 2025). Using the April 2026 inflation print (4.0%) as our starting point, we project pass-through to begin quickly following the initial shock to inflation expectations. For the once-off shock (Figure 4, left panel), the total contribution to headline inflation is a modest 0.12 pp after eight quarters, while the sustained shock's effect through expectations has larger consequences for headline inflation (Figure 4, right panel), peaking at 0.5 pp after six quarters before the impulse response converges to zero at the end of the horizon.

This pass-through estimate only captures the component of expectations responding to the fuel price shock. One caveat is that we have not controlled for other channels or mechanisms that could influence headline inflation based on the behaviour of expectations, nor do we control for any feedback from inflation back to expectations.¹⁶ Therefore, this result likely represents a lower bound of the true transmission from the shock to expectations into inflation.

Figure 4: Implied pass-through of two-year-ahead inflation expectations to headline inflation



Source: Authors' own calculations.

5. Concluding policy remarks

We find that a 30% once-off fuel price shock would raise firms' current year, one-year-ahead and two-year-ahead inflation expectations by up to 0.32, 0.16 and 0.15 pp within two to five quarters.¹⁷ A sustained fuel price shock results in a more substantial and persistent response, raising firms' two-year-ahead expectations by up to 0.65 pp at the peak before dying out after eight quarters.

¹⁶ This simulation does not control for other conventional channels in the Phillips curve that could influence the path of inflation. These include the exchange rate, economic slack (goods and labour market) and lags of inflation itself.

¹⁷ The peak mean response from inflation expectations to an oil price shock is larger at the one- and two-year-ahead horizons (0.25 and 0.23) as the shock does not control for the exchange rate or fuel and diesel price effects explicitly. This may suggest that the oil price shock could capture or conflate the effect of these distinct channels on firms' beliefs about future prices.

Focusing on inflation expectations in isolation does not fully capture the transmission of the shock. While some sectors may have elevated expectations, they may be unable to pass on price increases as a result of narrow margins, stronger competition or higher price elasticities, leading them to absorb the costs or reduce production (Masia 2026). However, the more sustained the shock, the more firms' ability to absorb the cost increase directly or reduce production is eroded, necessitating some degree of pass-through to consumers.

The longer the shock lasts, the larger the direct inflationary pressures through energy and production costs are bound to be, while inflation expectations are likely to respond to these pressures. In addition, persistent higher input costs may mean that firms' buffers to absorb cost increases narrow, which may result in stronger pass-through from expectations to inflation. To keep inflation expectations well anchored, monetary policy may therefore need to be tighter for longer.

Annexure

Annex A: Robustness check using aggregate data

As a robustness check, we extend the analysis beyond firms to evaluate the impact of a once-off fuel price shock on economy-wide expectations across firms, trade unions and financial analysts. To this end, we examine the propagation of a fuel price shock to aggregate inflation expectations over a larger sample, which combines a range of economic conditions, through a parsimonious SVAR.¹⁸ The shock identification process follows a standard recursive Cholesky ordering, placing the fuel price first, followed by inflation expectations, and then inflation, implying that fuel price shocks are contemporaneously exogenous to domestic variables, while expectations and inflation may respond immediately to fuel price shocks. This ordering posits that expectations are more forward-looking and update immediately in response to a fuel price shock. The shock simulated below is scaled to match our LP estimates, corresponding to a 30% year-on-year increase in the fuel price. Impulse responses are reported with 95% percentile bootstrap confidence intervals and are shown in Figure A1.

The once-off fuel price shock produces a meaningful response in aggregate inflation expectations across all expectations horizons. Current year expectations respond strongly, increasing by 0.50 pp after three quarters. One- and two-year-ahead expectations rise moderately by 0.23 pp and 0.18 pp, respectively. As with our LP's firms-only results, the effect of a once-off shock on expectations is persistent and remains elevated over the impulse horizon. The aggregate results over a larger sample (with varying economic conditions) corroborate our LP estimates, suggesting that the relationship between the fuel price and inflation expectations is relatively stable and predictable.

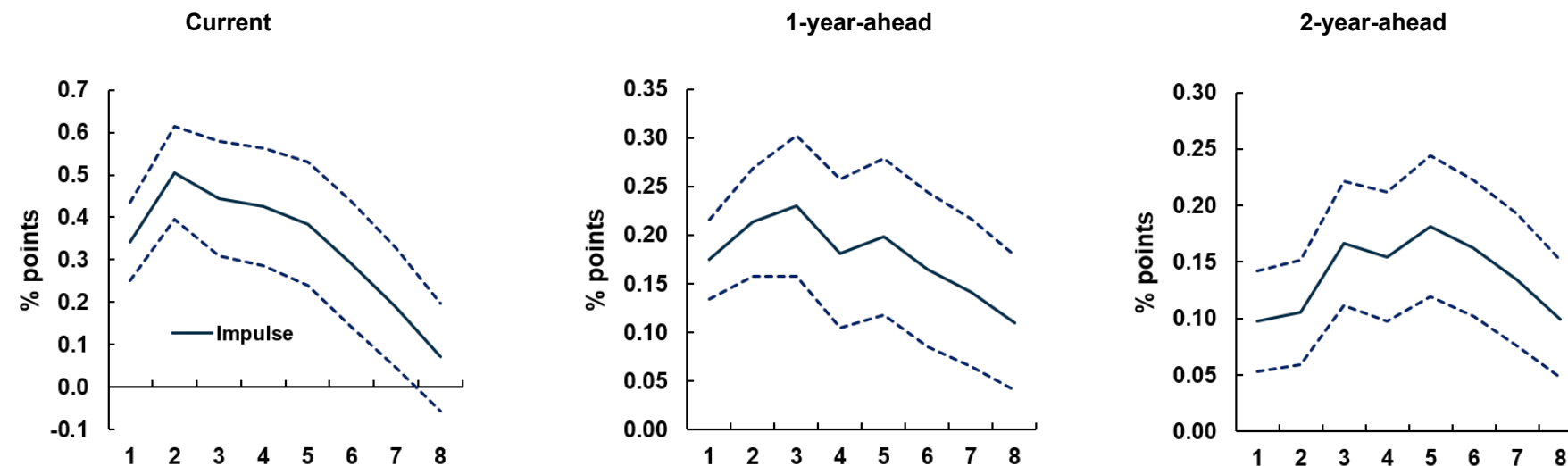
To enable easy comparison of the main results in this paper and recent estimates by Caraianni and Gupta (2026), we summarise and report these in Table A1. While it is important to note that the three approaches differ in a few ways (e.g. sample period, shock measure and inflation expectations measure), the estimates of the responsiveness of inflation expectations are reasonably robust.

A few caveats are worth noting. Firstly, the results in the table are all for a once-off fuel price shock. As shown earlier in this note, a sustained shock, conditional on the conflict persisting,¹⁹ could increase inflation expectations further, making it important to monitor distributional dynamics and their implications for persistence in both expectations and inflation. Secondly, the models isolate the fuel price shock, while other developments, such as El Niño and broader macroeconomic conditions, may also affect inflation expectations. The Quarterly Projection Model accounts for a wider set of factors, while Masia (2026) conditions on these factors and forecasts inflation expectations peaking at 3.8% in 2027Q2 and inflation at 6.1% in 2026Q3. Therefore, because we isolate a once-off fuel price shock, our expectations channel pass-through estimates (Figure 4) likely represent a lower bound of the true inflationary impact.

¹⁸ This SVAR is estimated over 2003Q1–2026Q1.

¹⁹ The sharp drop in oil prices in June 2026 was expected to result in lower fuel prices and inflation expectations. However, domestic fuel prices remain elevated, while National Treasury's temporary fuel subsidy relief is gradually being withdrawn. Future developments in inflation expectations are therefore contingent on how quickly fuel prices retreat.

Figure A1: Responses of aggregate expectations to a once-off fuel price shock



Source: Authors' own calculations. Dotted lines represent 95% confidence intervals.

Table A1: Robustness of pass-through estimates to a once-off shock

	Peak response (current year expectations)	Peak response (1-yr-ahead expectations)	Peak response (2-yr-ahead expectations)	Shock measure	Measure of inflation expectations	Sample period
Caraiani and Gupta (2026)	-	0.13 (not an impulse)	0.09 (not an impulse)	Oil news	Firms	2000Q2–2023Q4
LP	0.31 (Q5) 0.32 (Q2)	0.23 (Q6) 0.16 (Q2)	0.25 (Q5) 0.15 (Q4)	Oil price Fuel price	Firms	2021Q1–2024Q4
SVAR	0.29 (Q3) 0.50 (Q2)	0.18 (Q3) 0.23 (Q3)	0.12 (Q6) 0.18 (Q6)	Oil price Fuel price	Aggregate*	2003Q1–2026Q1

* Aggregate expectations refer to inflation expectations aggregated across financial analysts, firms and labour unions.

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