SOUTH AFRICAN RESERVE BANK

Address by Lesetja Kganyago,
Governor of the South African Reserve Bank,
National School of Government
12 August 2025

From fragility to strength: The role of price stability

Good evening.

Let me start today's address with two questions. First, if you compare South Africa to other countries, how do we rank in relation to growth? And second, how do we rank for inflation?[1]

As you know, economic growth in South Africa has been weak, averaging a mere 0.8% annually over the past ten years. This growth performance is worse than that of 87% of other economies.[2] The few countries doing worse than us are those that suffered major disasters, like war or macroeconomic collapse. Examples include Sudan, Lebanon and Ukraine. Given that we have had peace and basic macroeconomic stability, South Africa's growth is extremely disappointing.

What about inflation? Here again we underperform. Our average inflation rate over ten years is 5.1%.[3] This is not a catastrophe. Venezuela and Zimbabwe have excessive inflation rates of 9 000% and 251% respectively.

[1] The statistics in this section are based on the full International Monetary Fund *World Economic Outlook* database for April 2025.
[2] Using just 2024, South Africa ranks in the 12th percentile, still worse than nearly nine of 10 other countries.
[3] The precise 10-year average is 4.995%.

However, our inflation performance is still mediocre. Our price level is more than 60% higher than it was in 2015. Something that cost R60 ten years ago now costs about R100.[4]

In a nutshell, we are in the bottom 10% of the class for growth and the bottom 30% for inflation. This is not the kind of country report you want.

How did we get here, and what can we do about it?

Let us turn to macroeconomic policy.

I'll start with the path travelled by monetary policy and then discuss broader issues of macroeconomic policy interaction.

Inflation targeting in South Africa got underway in the year 2000. Like many countries, we came to inflation targeting after other approaches were tested and failed. Also like many other countries, once we started inflation targeting, we found it worked, certainly better than previous frameworks. We stopped losing money on foreign exchange interventions, inflation moved lower and interest rates also shifted down.

This was a period of serious macroeconomic reform in South Africa. In hindsight, it seems like a golden age – and inflation targeting, together with exchange rate flexibility and prudent fiscal policy that reduced debt, were the pillars of the new architecture.

By the end of the decade, the central bank had consolidated its framework and built credibility, helping the country survive the Great Financial Crisis. Indeed, at the time, that crisis seemed primarily like a failure of the North Atlantic economies, and there was considerable excitement that emerging markets would decouple from advanced economies and lead the world in growth.[5]

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[4] The consumer price index was at 61 points for 2014; by 2024 it was 99.3 points.
[5] See, for instance *The Economist*, 'The Decoupling Debate', March 2008, the blurb of which read: "As America's economy struggles to stay aloft, the developing world is learning to spread its wings."

Unfortunately, this theory did not pan out – not for South Africa, and not for other emerging market stars, like Brazil, either. In the 2000s, South Africa's economic growth averaged 3.5% a year. Between 2010 and 2016, it slowed from 3% to 1.9% to less than 1%.[6]

Initially, this was interpreted as a temporary setback. Given this diagnosis, monetary policy prescribed a low repurchase rate, generally below inflation, and the 3% to 6% target range was treated as an implicit target of 5.99%.[7]

As the decade wore on, however, it became clear that growth was not improving. The problem was larger than weak demand, and inflation pressures were intensifying. In 2013, South Africa stood out as one of the 'fragile five', the economies most vulnerable to tightening global financial conditions. Part of our weak growth problem was highlighted by the 2015 Nenegate incident, which showed the scale of waste and corruption involving state capture.

With inflation higher at around 6% and weaker economic growth, the SARB changed course. Between 2014 and 2016 interest rates rose from 5.5% to 7%. We stopped treating the top of our 3% to 6% range as the implicit target and, in 2017, communicated our preference to target the 4.5% midpoint as our objective.

A lower inflation rate would enable policy to ease and support the economy despite the various factors dragging growth down. It would also allow policy to be more flexible, even if inflationary shocks materialised. Improving the credibility of monetary policy could strategically offset the deteriorating fiscal position, slowing growth and the effects of weakened institutions.

By the end of the decade, inflation had come down nicely and inflation expectations had largely adjusted to 4.5%. Other policy adjustments helped too, in particular the

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[6] Using the International Monetary Fund *World Economic Outlook* data, South Africa's growth was 3.04% in 2010; 2.4% in 2012; 1.4% in 2014; and 0.67% in 2016.
[7] For a discussion, see L Kganyago, 'Inflation targeting at 21 – lessons for the future', 8 September 2021. Available at: https://www.resbank.co.za/content/dam/sarb/publications/speeches/speeches-by-governors/2021/gov-kganyago/A%20public%20lecture%20by%20Lesetja%20Kganyago%20Governor%20of%20the%20South%20African%20Reserve%20Bank%20at%20Stellenbosch%20University.pdf

emphasis on better capacitating the state and moving faster on reforms to the energy market.

But just as the domestic situation was stabilising, the external environment was taking a turn for the worse. The COVID-19 pandemic hit just a few months into the new decade. It was followed by the worst global inflation surge in a generation, plus rising geopolitical risks, with wars in Ukraine and the Middle East. This year has added another crisis, that of global trade.

Despite all this turbulence, prices today are very close to where they would have been since 2020, with inflation consistently at 4.5%. Inflation expectations have stayed within our target range and are currently close to the midpoint.[8] This is a good illustration of the power of monetary policy to shape long-run inflation outcomes.

If monetary policy is the main determinant of longer-run inflation, and if South Africa is a relatively bad inflation performer, then we must take responsibility for this. That was why the independent review of monetary policy, commissioned by National Treasury, concluded that policy was not ambitious enough. We were not realising the full benefits of inflation targeting.[9]

We heard much the same message from a range of local and foreign experts at our research conference in Cape Town earlier this year. Most speakers argued that we should be aiming for 3% inflation. One even argued for 2%. We finished with a strong consensus that our inflation target should be lower.[10]

This is no great surprise. After all, the original 3% to 6% target band was meant to be narrowed to 3% to 5% and then 2% to 4%. There was no plan to have 3% to 6% last for a quarter century. Our peers have all lowered their targets. We have just been

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[8] The Bureau for Economic Research survey of inflation expectations for the second quarter of 2025 showed average expectations at 4.3% for 2026, 4.5% for 2027 and 4.4% over the next five years.
[9] The third recommendation of the report reads as follows: "The current definition of the target – a 3-6% band – is not ambitious enough and significantly reduces the benefits that the inflation-targeting framework could otherwise provide." See P Honohan and A Orphanides, 'Monetary policy in South Africa, 2007-2021', *SA-TIED Working Paper*: 208, 2022, pp 37. Available at: https://sa-tied.wider.unu.edu/sites/default/files/SA-TIED-WP208.pdf
[10] Conference materials, including videos of all the sessions, are available at: https://www.resbank.co.za/en/home/what-we-do/research/Biennial

laggards in this regard. This is why we show up as a comparatively high inflation country from a global perspective.[11]

What can we do about this?

As the International Monetary Fund has pointed out, the procedures for setting South Africa's inflation target are not transparent.[12] We can refer to precedents since 2000, when the 3% to 6% target was announced. In the 2000 *Budget Speech* former Finance Minister Trevor Manuel said: "The Governor of the Reserve Bank and I have agreed on a target band of 3% to 6%. The objective is to bring inflation within this band by 2002." However, this arrangement is not codified in law.

It is clear that the South African Reserve Bank (SARB) has a constitutional obligation to protect the value of the currency, and so we cannot accept a target that is inconsistent with price stability. However, there are advantages to setting targets as agreed on between the SARB and National Treasury. We have been consulting on such an agreement for several years now and we would like to see the existing 3% to 6% target reformed.

As the saying goes, "opportunity knocks", and over the past year that opportunity has come fast on the completion of the technical work on the optimal inflation target. Actual inflation has eased to 3%, presenting us with a chance to achieve permanenty lower inflation, at low cost – what economists call 'opportunistic disinflation'. The question was how to respond.

Given the strong case for moving to a lower target at some point, it did not make sense to ignore this. But we also did not have a new target. What we did have was an existing target range that stretched from 3% to 6% – or, as former SARB Governor Tito Mboweni liked to say, from 6% to 3%.

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[11] C Loewald, R Steinbach and J Rakgalakane, 'Less risk and more reward: revising South Africa's inflation target', *SARB Working Paper* 25/05, 2025, especially pp 7. Available at: https://www.resbank.co.za/content/dam/sarb/publications/working-papers/2025/less-risk-more-reward.pdf

[12] International Monetary Fund, 'South Africa: Central Bank Transparency Code Review', 2024. see for instance pp 24. Available at: https://www.imf.org/en/Publications/CR/Issues/2024/12/02/South-Africa-Central-Bank-Transparency-Code-Review-557776

Historically, as discussed earlier, we have aimed for different points of the range: at one point the 6% upper bound was the de facto target, and since 2017 we have focused on the 4.5% midpoint. These precedents set forth a way for the SARB's Monetary Policy Committee (MPC) to express its preference for 3% within the existing target range.

We laid the groundwork for the shift at our May MPC meeting by publishing a scenario with a 3% inflation objective. We also said in our statement that we considered this 3% scenario more attractive than the 4.5% baseline.

At our July meeting, we then formally announced our preference for inflation to settle at 3%, the bottom end of the target range, and we published a forecast to get there.

At both these meetings, we also cut interest rates. And we showed that our forecasts for a 3% objective had lower rates going forward than the projections for the target midpoint.

Indeed, for 4.5%, our model shows interest rates settling roughly where they are now, at 7%. A 3% objective, by contrast, delivers an over 100 basis point reduction in interest rates. After our July meeting and the communication about the 3% objective, markets started pricing in lower future interest rates.

There is a lesson here, and that lesson is that lower inflation allows for lower rates. This logic is not always intuitive, and indeed many people think a lower target means higher rates. So let me unpack the reasoning.

In our modelling framework, the normal or neutral policy rate is about 7.25%.[13] Of this, 4.5 percentage points is inflation compensation and 2.75 percentage points is attributed to global rates plus country risk.[14]

[13] This refers to the neutral rate estimate, defined as the interest rate which neither accelerates nor slows inflation and economic activity, and which would prevail in an economy in the absence of shocks, where inflation is at target and output growth is in line with the economy's potential.
[14] For a chart of this disaggregation, see the presentation for the April 2025 *Monetary Policy Review*

How do we get that 7.25% down? If we lower inflation to 3%, then we can take 1.5 percentage points of inflation out. But lowering inflation to 3% will also reduce inflation volatility and country risk, the latter, perhaps by half a percent. As country risk and inflation falls, we could aim for a neutral policy rate of something more like 5.25%.

This is something we hope to deliver with our new preference for having inflation settle at the lower end of our 3% to 6% target range. This cannot be a promise, but it can be a serious aspiration.

Hopefully this has got you excited about lower interest rates and the practical reforms we can implement to get there. I hope you will also have noticed that the second-biggest driver of interest rates is country risk – because doing something about that brings me to the other key topic of this speech: macroeconomic policy interaction.

Much of our country risk problem is that we keep forecasting debt stabilisation and it does not happen. Relative to gross domestic product (GDP), debt has risen in every year since 2008. As National Treasury points out, we have experienced one of the fastest debt increases of any country. We also have one of the highest debt levels in comparison to our peer group.[15]

To address this, it sometimes seems that there are only painful choices: spending cuts or tax increases. But to my mind, the bigger picture is not so bad. The fiscal position may be strained but we have independent and credible monetary policy. This means we can still achieve a reasonably attractive macroeconomic mix.

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release, slide 9, available at: https://www.resbank.co.za/content/dam/sarb/publications/monetary-policy-review/2025/MPF%20presentation%20April%202025.pdf. The 4.5% inflation compensation is equivalent to the inflation target midpoint.

[15] See for instance Figure 1.3 of National Treasury's *Medium Term Budget Policy Statement* for 2024, available at: https://www.treasury.gov.za/documents/mtbps/2024/mtbps/FullMTBPS.pdf?utm_source=chatgpt.com

Specifically, if there were widespread confidence that debt levels were heading lower, this would create space for monetary policy to support growth through lower interest rates.[16]

All the drivers point in the same direction: credible fiscal consolidation would lower country risk. Improved investor confidence would also help the rand, which eases inflation. Tight fiscal policy might reduce demand but that would also be disinflationary.[17]

Imagine sitting for an Economics exam and getting the following question: "What is the correct monetary policy response for a small open economy where growth is weak, inflation is low and the fiscal authority is tightening policy?" Your professor is going to expect you to say, "looser monetary policy".

Incidentally, I have heard that students nowadays use artificial intelligence (AI) for their homework, so I posed this exact question to DeepSeek and ChatGPT. Both suggest more accommodative monetary policy.[18] I am not saying we should be using AI to set macroeconomic policy. But it is a reminder that there is a textbook solution that can be applied to our macroeconomic problems. And yet it is largely missing from our public macroeconomic conversation.

Unfortunately, rather than considering the macroeconomic mix, we sometimes get stuck debating consolidation versus growth. It is sometimes asserted that South Africa does not have a debt problem, it has a growth problem. No doubt, sustained, high

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[16] For a discussion, see in particular section 9 of C Loewald, D Faulkner and K Makrelov, 'Time consistency and economic growth: a case study of South African macroeconomic policy', *SARB Working Paper*: 20/12, 25 November 2020. Available at: https://www.resbank.co.za/content/dam/sarb/publications/working-papers/2020/10421/WP%202012.pdf

[17] In a standard Taylor rule, like the one used in the MPC's Quarterly Projection Model, weaker demand would also make the output gap more negative, putting downward pressure on interest rates.

[18] ChatGPT: "In a small open economy facing weak growth, low inflation, and simultaneous fiscal tightening, the appropriate monetary-policy response is to pursue a more accommodative stance in order to stabilize aggregate demand and anchor inflation expectations." DeepSeek: "For a small open economy facing weak growth, low inflation, and fiscal tightening, the optimal monetary policy response should aim to stimulate demand without triggering capital flight or currency instability."

growth could solve our debt problem. But it does not follow that the economy is capable of flourishing in the context of fiscal fragility.[19]

Instead, we need to appreciate how our growth problem is *endogenous* to our fiscal situation. It is growth negative to have a high and rising tax burden – especially where the quality of spending is low. It hurts to have high long-term borrowing costs and a sub-investment grade credit rating. These factors help explain why fiscal multipliers in South Africa are so small. Extra government spending does little or nothing for total output.[20]

This shows why growth on its own will not solve our fiscal problems without fiscal adjustment. It is also the reason we absolutely cannot attempt an expansionary strategy that aims for growth at the expense of macroeconomic stability, with the justification that growth will itself be stabilising in the end. The best thing we could do for growth, on top of structural reforms, is to deal decisively with the country risk premium. It is not growth *or* stabilisation; it is growth *through* stabilisation. And that is because de-risking the economy, in addition to boosting confidence, would open up monetary policy space.

This way of thinking also raises new funding opportunities for government. Our recent fiscal debates have mostly focused on growth, revenue and spending: how fast can the economy grow, how much more tax can be extracted and what should happen to spending? But there is a fourth consideration, which is how debt is financed. All these are the preserve of National Treasury.

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[19] On the austerity-stimulus debate, see J Bianchi et al, 'Fiscal stimulus under sovereign risk', 2023, and references therein. Available at: https://www.nber.org/system/files/working_papers/w26307/w26307.pdf

[20] T Janse van Rensburg, S de Jager and K Makrelov. 'Fiscal multipliers in South Africa after the Global Financial Crisis', *SARB Working Paper*: 21/07, 2021. Available at: https://www.resbank.co.za/en/home/publications/publication-detail-pages/working-papers/2021/fiscal-multipliers-in-south-africa-after-the-global-financial-cr

We all know debt financing is a huge spending item, 5% of GDP, more than spending on health, policy and basic education.[21] This reflects a large stock of debt. But it also reflects the interest rates on that debt.[22]

I have already covered what keeps the short-term policy rate high. But long-term rates are even higher: the 10-year bond yield is just below 10%, about 300 basis points above the short-term rate. Our 2048 bond is higher still. As economists say, our yield curve is very steep. This reflects risks that are not present in the overnight cash rate, mainly credit risk. You are asking investors to lock in exposure for decades, and endure losses if debt does not stabilise and rates rise further. They are willing to bear that risk – but at a high price.

With nominal GDP growing at about 5%, paying 10% interest to borrow long term, eventually crowds out private investment and other government spending priorities. If we borrow to pay only interest on existing debt, we open ourselves up to a debt spiral. There are some unwise responses to this fact, like urging the SARB to monetise government debt. But there are also some constructive responses.

If we can reduce interest rates through permanently lower inflation, and by de-risking, we can finance debt at lower costs. This would make a big difference. Just to put some indicative numbers on this, for a debt stock of R5 trillion, every percentage point you save in interest is worth R50 billion. By contrast, a one percentage point increase in value-added tax raises about R30 billion.[23] And we could realistically save on debt costs.

It is not my role to set the issuance strategy. That is the work of National Treasury. But good monetary policy can help create opportunities for fiscal policy, which a nimble debt manager could seize. The objective should be unlocking a virtuous circle, where lower interest rates improve fiscal dynamics, and better fiscal dynamics in turn lower

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[21] See E Godongwana, *Budget Speech*, 12 March 2025. Available at: https://www.treasury.gov.za/documents/national%20budget/2025/speech/speech.pdf, p. 3

[22] This helps explain why South Africa's debt-service costs are significantly higher than those of peers, as demonstrated in National Treasury, *2025 Budget Review*, 12 March 2024, pp 1–2 Available at: https://www.treasury.gov.za/documents/national%20budget/2025/review/FullBR.pdf

[23] Based on Table 4.3 of the March 2025 *Budget* Review, available at: https://www.treasury.gov.za/documents/National%20Budget/2025/review/FullBR.pdf

rates. Doing this requires a macroeconomic set up where the SARB and National Treasury play complementary roles.

Ladies and gentlemen, to conclude, there are clear microeconomic problems behind our unfavourable growth performance. The proper response to this is structural and governance reforms, which are ongoing. It is vital that these continue at pace. There is no chance we can develop a flourishing economy without reliable infrastructure and functional municipalities.

In addition to these microeconomic reforms, there is a significant opportunity to achieve a better macroeconomic mix. With a lower inflation target and fiscal policy that firmly prioritises debt stabilisation, we could achieve sustainably lower interest rates. This would give monetary policy more space to support growth, and it would give fiscal policy respite from high debt costs.

South Africa is a macroeconomic underperformer. But with the right reforms we could do much better.

Thank you.