



SOUTH AFRICAN RESERVE BANK

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Supply shocks, monetary policy and the 3% target

Good day.

Last month in Washington, International Monetary Fund Managing Director Kristalina Georgieva described the situation central banks face as “bad or very bad”.¹ South Africa falls into the first category: in a world of price pain, we are suffering like everyone else – but things could be worse.

We came into this shock with inflation at our new 3% target. The policy stance was reasonably well calibrated, so we did not need to make urgent changes. We have a well-tested playbook for getting inflation back to target. In my speech today I will unpack these points and discuss the outlook for monetary policy.

I will start with the recent trajectory. The last two years have been generally positive for the South African economy. There has been clear reform momentum, including the adoption of a new 3% inflation target. This progress was rewarded with lower borrowing costs, a stronger rand and improving confidence. We exited the Financial

¹ "It's not an easy thing to be a central banker these days. Why? Because for them, it's either bad or very bad at this moment of time. They're in in a tough spot. So send them a little bit of love."
https://x.com/Neil_Irwin/status/2042256427574534558

Action Task Force grey list and our credit rating was upgraded by S&P Global Ratings. Growth seemed to be steady and investment was beginning to grow again.

The global context was also quite supportive. Of course we had the challenges of fragmentation, including higher United States (US) tariffs. Nonetheless, many emerging markets – including South Africa – were enjoying higher commodity prices, renewed capital inflows, stronger currencies and lower interest rates. Global growth was proving unexpectedly resilient. The headlines may have been full of bad news but the bottom line was good. The economic data were improving.

At the same time, there were clearly risks, including those stemming from geopolitical developments.

For us as the South African Reserve Bank (SARB), those risks were top-of-mind. We did not know exactly what was going to go wrong but there seemed to be too many things that could go wrong. This led to us moving cautiously. We steered clear of bigger cuts, like 50 basis points rather than the usual 25, and we avoided cutting at every meeting. For instance, we kept rates unchanged in our January 2026 meeting.

This meant our policy stance was not immediately rendered obsolete when trouble did come with the conflict in the Middle East and the closure of the Strait of Hormuz. We had inflation at exactly 3%, with core also at 3%, in line with our new target.² This was a reasonably good starting point for confronting a severe shock.

For monetary policy, there is a well-established playbook for dealing with supply-side shocks.³ The central idea is that you look through the initial or first-round effects and focus on the second-round effects.

² This refers to Statistics South Africa's February 2026 consumer price index report, accessible here: https://www.statssa.gov.za/?page_id=1854&PPN=P0141&SCH=74011

³ R Cassim, 'Seeing like a central bank: the South African Reserve Bank, supply shocks, and the logic of higher interest rates in a world of low economic growth'. Keynote address by Dr Rashad Cassim, Deputy Governor of the South African Reserve Bank, at the ACI Financial Markets Association South Africa event, Johannesburg, 6 September 2022. <http://www.resbank.co.za/en/home/publications/publication-detail-pages/speeches/speeches-by-governors/2022/Keynote-address-by-Dr-Rashad-Cassim-Deputy-Governor-of-the-South-African-Reserve-Bank-at-the-ACI-Financial-Markets-Association-South-Africa>

First-round effects are directly linked to the shock and happen fast: the oil price goes up and then petrol and transport get more expensive. Monetary policy cannot do much about this. Our interest rate tool does not change global oil prices – and it also operates with a lag: if we move rates now, the main effects on the economy play out next year. This timeframe means you cannot do much about inflation that is suddenly going to be higher next month. It is not in the window that is relevant for monetary policy.

What *is* relevant for monetary policy is that period after the shock has passed. Even if oil prices stick at current levels, 12 months from now fuel inflation goes to zero. It can seem paradoxical, but remember we are inflation targeters, not price level targeters. Our inflation measure uses a year-on-year comparison. For example, you compare the price in May 2025 to the price in May 2026. If petrol goes from R20 a litre to R30, you have inflation of 50%. If petrol stays at R30, in May 2027 petrol price inflation will be 0%.

All this means a price shock exerts inflation pressure in the near-term but, in the policy-relevant medium term, it can push inflation lower. Statisticians call this a base effect. Indeed, because a negative supply shock makes people poorer, it can also lower inflation through an output gap effect. If fuel is more expensive but people still need transport, they cut back on other items, and that weak demand puts downward pressure on prices. So supply shocks can give you lower inflation, in time.

If this were the whole story, monetary policy would be easy. But we know from bitter experience that it is not so easy. The problem is that inflation does not always fall when the shock passes. Instead, inflation can be persistently higher. This happens when the price shock broadens out into the economy: it is no longer just the one category, like fuel, that is more expensive, but everything. We call these second-round effects, and they tend to be most visible in inflation expectations and wages. Second-round effects mark the process through which a one-off shock mutates into consistently higher inflation, which becomes entrenched as the new normal.

For central banks facing a price shock, the key is to manage the second-round effects. If a central bank has strong credibility – if everyone trusts inflation will revert to target

soon – it can be possible to look through a shock without raising rates. But the look-through strategy has pitfalls.

One is that shocks have a bad habit of travelling in groups. If you commit to looking through shocks, and then two or three arrive one after another, trust in low inflation starts to fade. For instance, if you have a temporary fuel price shock that lasts a year but, three months in, you also have a food price shock, and on top of that the exchange rate weakens, you do not get 12 months of higher inflation and then lower inflation. You get waves of higher inflation with no end in sight. In this context, it is probable that price and wage setters will start to make decisions as if they live in an economy with persistently higher inflation. And this is a self-fulfilling prophecy.

Another pitfall is that committing to a look-through strategy ties your hands. The future is full of surprises. If you keep your options open, you can easily change course when surprises happen. If you give away optionality by insisting that you will ignore shocks coming from the supply side, the pivot becomes more embarrassing. You can end up sticking with the wrong strategy for too long.

The last thing you want to do is insist that only demand-side inflation matters for monetary policy, and never supply-side inflation. Supply-side shocks can move expectations and countries can develop inflation problems without ever facing clear demand-side pressures.

For this reason, central banks have done better by taking responsibility for inflation in general, rather than trying to ignore shocks. The famous example is the German Bundesbank, which did better than other major central banks, like the US Federal Reserve and the Bank of England, at managing the inflation pressures of the 1970s

and 1980s.⁴ Indeed, the superior performance of the Bundesbank was important for the development of inflation targeting.⁵

A third problem is assessing the starting point correctly. If you say you are going to look through shocks, that is usually understood as not raising rates. But, as economists, we know that real interest rates matter: it is not just the nominal interest rate but the rate adjusted for inflation. If your starting point is a loose stance and the real rate then falls further as inflation rises, that is a very different policy setting to a starting point with a tight stance. “Do nothing” can be bad advice for one starting point and good for another.

These pitfalls were all on display during the post-COVID global inflation surge. It was not just one shock, it was fuel and food and supply chains and exchange rates all together. Policymakers and commentators got into a big debate between ‘Team Transitory’ and ‘Team Persistent’. Sometimes people were so identified with their positions in that dispute it was hard to acknowledge new data.⁶ And the starting point was very loose monetary policy to deal with the COVID-19 crisis. In South Africa, we had the lowest policy rate on record. For all these reasons, it made sense to raise rates – and countries that delayed tightening regretted it.

After that inflation crisis, emerging markets were widely recognised for understanding the shock better and responding more proactively than their peers in rich countries.⁷ This reflected long experience dealing with supply shocks, and the knowledge that second-round effects are better dealt with pre-emptively. If you delay, by the time the

⁴ A Beyer, V Gaspar, C Gerberding and O Issing, ‘Opting out of the great inflation: German monetary policy after the breakdown of Bretton Woods’. Discussion Paper Series 1: Economic Studies No 12/2009, Deutsche Bundesbank, 2009.

<https://www.bundesbank.de/resource/blob/703498/ec2175c2d17383a8eaac23de524622ce/mL/2009-05-19-dkp-12-data.pdf>

⁵ B S Bernanke and I Mihov, ‘What does the Bundesbank target?’, National Bureau of Economic Research Working Paper No. 5764, Cambridge, MA: National Bureau of Economic Research, September 1996. https://www.nber.org/system/files/working_papers/w5764/w5764.pdf

⁶ P Krugman, ‘Everything’s coming up soft landing’. The New York Times, 14 July 2023 (Opinion). <https://www.nytimes.com/2023/07/14/opinion/inflation-economists-soft-landing.html>

⁷ See, for example: T Evdokimova, P Nagy-Mohácsi, O Ponomarenko and E Ribakova, ‘Breaking down success: how emerging market central banks have outperformed the Fed and ECB’. VoxEU (CEPR), 23 February 2024. <https://cepr.org/voxeu/columns/breaking-down-success-how-emerging-market-central-banks-have-outperformed-fed-and-ecb>

second-round effects manifest, you are behind the curve – and you need to move more aggressively to try and catch up, which creates extra pain.

This experience underscored the point that good policy, in the face of supply shocks, cannot be reduced to ‘look through the shock’. A more sophisticated reaction would have the following characteristics:

First, policymakers should look through first-round effects but not second-round effects.

Second, policymakers should respond timeously. This requires a judgement call about whether second-round effects are likely, which is the difficult part – but there are clues. Second-round effects are more likely when there are large and overlapping shocks. Second-round effects are also more likely when inflation expectations are not well anchored at the target.

Third, policymakers should assess the current stance of policy and decide what that starting point means in the context of a shock.

Applying these guidelines, what can we say about South African monetary policy at this juncture?

It is logical to begin with the starting point. As I said, this crisis is finding us with policy moderately restrictive and with inflation at target. Real rates may be falling as inflation rises, but we also have tighter financial conditions. Markets were pricing in rate cuts this year but have now dropped those expectations. For example, the 1-year Treasury bill rate was 6.95% at the end of February and 7.76% at the end of April. This is some implicit tightening, even without the SARB raising rates.

At the same time, inflation expectations are not firmly anchored at 3%. The new target is less than a year old. We have made good progress in that time, building credibility at 3%, but we have not completed the journey.⁸

Overall, it is not the ideal starting point, but it could be worse. Higher real rates, tighter financial conditions and the enhanced monetary policy credibility created by the new target probably balance the fact that expectations are not anchored at 3%. It is a broadly neutral set of initial conditions.

Moving on to the question of large and overlapping shocks. We are experiencing the biggest jump in fuel price inflation in the history of inflation targeting. Fuel is going from deflation to double-digit inflation.⁹ There is no doubt this is a large shock. Whether we will see multiple shocks is less certain.

The rand exchange rate has been surprisingly resilient so far. It depreciated in March but then recovered to roughly pre-crisis levels. Many of our peers have had similar experiences. The broad resilience of emerging market currencies may well be due to weakening global trust in the US dollar and the need of investors to diversify portfolios. It is not that they are abandoning the dollar but nowadays no one wants to be all-in on the dollar either. Exchange rate dynamics therefore look somewhat reassuring. But it will matter what the other central banks do. It is hard to sit out a global tightening cycle.¹⁰

A bigger problem is food prices.¹¹ The Middle East conflict has large implications for fertilisers and diesel, both critical components of food supply chains. We are also

⁸ On the adjustment of expectations, see: A Foresto, M Reid, R Steinbach and J Rakgalakane, 'The role of inflation expectations in the path to 3%: understanding expectations formation and calibrating the models', South African Reserve Bank Working Paper Series No. WP/26/10, Pretoria: South African Reserve Bank, April 2026. <https://www.resbank.co.za/content/dam/sarb/publications/working-papers/2026/26-10/inflation-expectations.pdf>

⁹ The change is about 20 percentage points, from fuel inflation of -8.7% in March to a projected +11.4% in April.

¹⁰ On this theme, see: J Thomson 'BoT likely to hike rates if others do, says assistant governor'. *Central Banking*, 9 April 2026. <https://www.centralbanking.com/central-banks/monetary-policy/7975560/bot-likely-to-hike-rates-if-others-do-says-assistant-governor>

¹¹ Millions will go hungry if the Strait of Hormuz stays closed'. *The Economist*, 16 April 2026. <https://www.economist.com/international/2026/04/16/millions-will-go-hungry-if-the-strait-of-hormuz-stays-closed>

looking at a possible El Niño pattern next year, which means drier growing conditions in southern Africa. Persistently higher food inflation on top of the fuel shock would pose serious risks to inflation expectations.

In these conditions, we will be studying the data very carefully, both to assess how these variables are playing out and to see if there is early evidence of underlying inflation starting to move. We can look for this evidence in measures like surveys of inflation expectations, wage indicators and core inflation data.

Complicating the task is the problem that global conditions are highly uncertain. The shock is only about two months old and at any moment there could be some newsflash or social media post that causes a big move. Negotiations could be off, or on. The Strait of Hormuz could be open, or closed again. The next move could be devastating attacks on civilian infrastructure, or a ceasefire.

Given the risks to inflation and the uncertainty, it makes sense for us to keep our options open. In our next few meetings, we will have to make tough decisions about whether second-round effects are coming or whether we have enough space to look through. As ever, we are not going to pre-commit to a path and give up optionality. We cannot offer certainty about our next steps. Instead, we want to maximise certainty about where inflation is going – specifically, that it is going back to target.

To support this, like many other central banks we are finding scenarios helpful. For these exercises, we lay out different possible futures and then show how policy is likely to respond. The idea is to clarify the reaction function, so our stakeholders can then watch how events unfold and understand how we are likely to respond.

Our most recent projections, from our March meeting, included a benign baseline where rates were unchanged; an intermediate scenario, where they rose a little; and an adverse scenario, where they rose more.¹² All these forecasts had inflation coming back to target over time. That is really our most important message: although we

¹² These scenarios are detailed in Box 1 of the April 2026 *Monetary Policy Review*, available here: <https://www.resbank.co.za/content/dam/sarb/publications/reviews/monetary-policy-review/2026/april.pdf>

cannot do much about higher inflation right now, we are very committed to getting inflation back to 3%, just where we had it before the shock hit.

Ladies and gentlemen, to conclude, there is nothing South Africa did to create this problem. At the same time, it is our problem to deal with. As a small open economy, and as an oil importer, we are going to get hurt. Our job as policymakers is to minimise the pain, keeping focused on our long-run objectives.

It is unfortunate that this shock is hitting during the transition to the new, lower inflation target. Until now, that transition was going about as smoothly as we could have hoped. It seemed we were going to complete the disinflation soon, perhaps this year.¹³ Now this process will take longer.

At the same time, it is a big plus to go into this shock with record-low inflation expectations and monetary credibility as strong as it has ever been.

If we do have to raise rates, it will be to sustain low and stable inflation, and all the benefits that brings. The lower target helped give us lower borrowing costs and a stronger rand. Some of those gains were reversed with the shock, but not fully and not for long. These gains are valuable and we do not intend to lose them.

Thank you.

¹³ In our modelling framework, that neutral level is estimated at about 6% currently, nominal, compared with a current policy rate of 6.75%.