SOUTH AFRICAN RESERVE BANK

South African Reserve Bank (SARB) Biennial Conference 2025

25 Years of Inflation Targeting: Lessons for the Future

Overview

The SARB's biennial conference took place from 27–28 March, assessing the successes, challenges and lessons learnt over the past 25 years of inflation targeting. Discussions focused on how these insights should shape future global macroeconomic policies and the implications for inflation targeting in South Africa.

Inflation targeting as the global monetary policy standard

Today, inflation targeting is the global monetary policy standard, a point Claudio Borio of the Bank for International Settlements (BIS) emphasised in his keynote address, with price stability recognised as a precondition and key building block for sustained growth and prosperity. Initially implemented in economies like New Zealand, Canada and the United Kingdom to combat macroeconomic instability, inflation targeting replaced monetary policy frameworks that focused on intermediate targets such as money supply or exchange rates. Today, 73 countries are using inflation targeting. Almost all advanced economies use a 2% inflation target, while the majority of emerging markets that have adopted inflation targeting aim for closer to 3%. José Darío Uribe, also from the BIS, highlighted the success of inflation targeting in Latin America, noting its effectiveness in reducing high inflation and macroeconomic instability of the 1980s and 1990s, while also coping with the challenges and policy stresses associated with large negative shocks, including the 2008–09 global financial crisis and the COVID-19 pandemic.

Governor Lesetja Kganyago in his opening remarks highlighted that South Africa was an early adopter of inflation targeting, implementing it in 2000 after the large costs, and ultimate failure, of the South African Reserve Bank's (SARB) previous eclectic approach to monetary policy. Since then, the South African economy has experienced lower inflation, with rates averaging less than 5% since the Monetary Policy Committee announced a clear preference for the midpoint of the target range in late 2017. Inflation expectations have declined and become better anchored. As a result, South Africa enjoys much lower interest rates and less macroeconomic volatility. This stability has provided the country with the policy space to quickly and aggressively respond to economic shocks and crises when they occur.

Lower inflation but not price stability in South Africa

Yet South Africa's inflation and inflation target remains too high, and the 3–6% band too wide, leading to uncertainty about the actual inflation rate targeted by the SARB. Moreover, both the inflation outcomes and the target do not align with the Volker/Greenspan definition of price stability as mentioned by, among other speakers, Borio and veteran economist Donald Kohn, where "inflation is so low and stable over time that it does not materially enter into the decisions of households and firms". As a result, the 4.5% midpoint within a 3–6% target range is not ambitious enough, a key point emphasised by economics professor Athanasios Orphanides, who noted from his work on South Africa's inflation targeting framework, that this high target generates persistent economic costs and prevents South

Africa from achieving genuine price stability that can unlock efficiency gains, facilitate long-term planning and provide a boost to investment spending and productivity. Orphanides also reiterated a recommendation from the monetary policy review (Honohan and Orphanides (2022)) to adopt a lower inflation target of 3%, motivated by the economic costs of South Africa's relatively high current inflation target when compared with other emerging economies.

Conference presentations and panel discussions supported a lower inflation target. Economics professor Stephen Hall's presentation concluded that an inflation rate of 2–3% would be optimal for South Africa, reflecting the long-term growth benefits from lower inflation, reduced volatility and the exchange rate gains from aligning more closely to inflation rates in South Africa's major trading partners and emerging market peers. While much of the theoretical literature posits that the economically optimal inflation rate is close to zero, Hall pointed out that targeting 2–3% allows for relative price adjustments and accommodates downward nominal rigidities, while also mitigating concerns about reaching the zero-lower bound.

The long-term gains from lower inflation

The conference discussions consistently highlighted the substantial long-term benefits of lower inflation. Kohn emphasised the importance of reducing uncertainty, making it easier to plan (as inflation becomes less of a factor in decision-making), encouraging higher investment, boosting productivity and supporting stronger long-term growth. There are also external benefits, such as dampening exchange rate risks and reducing currency volatility, which supports competitiveness. Finally, the interventions from Kganyago, Orphanides and others highlighted the significant fiscal benefits of lower inflation, not only through stronger economic growth but by lowering interest rate premiums and borrowing costs. These prospective fiscal gains could help ease the significant refinancing demands the government is facing at a time when borrowing costs are high.

Achieving low inflation also alters the price formation process. Borio spoke about the advantages of achieving a low inflation regime, arguing that when inflation is low, price pressures mostly reflect sector-specific price changes, with wages and prices loosely linked at low inflation rates. As price- and wage-setters become rationally inattentive, low inflation becomes self-stabilising. The divergent experiences of Chile and South Africa over the past 25 years, highlighted by Sebastian Barnes of the Organisation for Economic Co-operation and Development and Nicola Viegi of the University of Pretoria, provided a tangible example of the potential economic and welfare gains from systematically targeting lower inflation. In Chile, where the inflation target is 3%, prices have risen by about 140% since 2000, compared with a 260% increase in South Africa. Chile's economic growth has also been much stronger. A critical benefit of lower inflation is its role in sustaining purchasing power and protecting the welfare of non-economically active individuals and households, as well as those living on income grants, low wages and fixed incomes, a recurring theme during the conference.

Are we overstating short-term costs?

While the long-term benefits of lower inflation are compelling, the debate around lowering South Africa's inflation target often emphasises the potential economic costs associated with policy-induced disinflation. For instance, the presentation of International Monetary Fund's Rafael Portillo indicated that advanced economies facing post-pandemic inflation saw minimal costs of disinflation. Similarly, Orphanides, Hall, Phillipe Burger (University of the Free State) and Viegi all suggested that South Africa's sacrifice ratio (i.e. the cost of reducing inflation) is either low, zero, or even negative. Studies into the effect of targeting 4.5% inflation from late 2017 onwards also shows no adverse output cost.

Orphanides, Viegi and Hall argued that leaning on Phillips Curve analysis to assess the costs of disinflation overlooks the critical role of inflation targeting in influencing expectations. They asserted that a credible commitment to lower inflation could minimise or even negate short-term transition costs without raising unemployment.

However, challenges arise from nominal rigidities such as administered prices and wages, while fiscal outcomes impact monetary policy choices. Large budget deficits and rising debt levels have pushed up sovereign risk premiums, generated underlying currency pressures and underpinned a sustained rise in the neutral rate. These themes featured prominently in the panel of private sector economists, alongside Burger's presentation.

Wages were less of a focus at the conference, given that recent wage outcomes have been more closely aligned with inflation, reflecting the private sector's sensitivity to economic conditions and fiscal constraints on government wage increases. This alignment is evident in the subdued growth of unit labour costs. On the other hand, administered prices were a significant topic, as these public finance-related price pressures, an inefficient tax on the economy, complicate disinflation efforts in South Africa. Yet, it was argued that the relationship between administered prices and headline inflation is bidirectional, suggesting that a sizeable component of administered prices would quickly respond to a lower target.

The path to lower inflation and price stability

When a central bank is credible, it can achieve disinflation through changes in inflation expectations rather than large output costs or loss of jobs. This suggests that the potential output costs from lowering the inflation target to 3% would be relatively small. Several speakers noted that better anchored inflation expectations, reduced exchange rate pass-through and decreased inflation volatility indicate improvements in the SARB's credibility and communication. The private sector economist panel, including Razia Khan, Mamokete Lijane, Elna Moolman and Andrea Masia confirmed that the SARB is regarded as a bastion of prudent monetary policy and macroeconomic stability by both domestic and emerging market investors.

One possible option would be to adopt a glide path towards the lower target, setting smaller annual steps towards the eventual goal. Some speakers, including Hall and Burger were sympathetic to this strategy, suggesting it would minimise the risks to the SARB's credibility from missing the new target, while providing a timeframe for complementary fiscal consolidation and structural reforms to occur alongside disinflation.

However, the risks with this approach are clear. These include the challenges of communicating annual changes in the inflation target to price- and wage-setters, which could jeopardise credibility and impede the decline in inflation expectations, and political economy risks that can interrupt the path towards a lower inflation target. Brazil's current difficulties and Kganyago's reflections on South Africa's experience in the early 2000s – when an initial plan to gradually lower the inflation target to 2–4% was abandoned – caution against this approach.

Rather, Kohn and economics professor Refet Gürkaynak argued that building credibility requires a clear goal, such as a point target that provides a concrete nominal anchor for inflation expectations. This can be complemented by policy actions that strongly tilt the inflation path downward towards the new target, but within a sufficiently long targeting horizon (such as the three-year inflation forecast horizon) to enable flexibility. In considering the appropriate policy response, both Borio and Kohn highlighted the role an asymmetric policy reaction function can play in supporting the transition to lower inflation by responding more aggressively when inflation overshoots the target and being more tolerant when it undershoots. In doing so this would help to ensure that the self-sustaining role of low inflation takes hold.

Additional reforms can facilitate the reduction of the inflation target and ensure that long-term benefits of lower inflation are realised sooner. For example, Sebastian Barnes suggested that productivity-enhancing reforms can help boost growth and keep inflation low, citing Italy's experience. For South Africa, this would include budgetary measures aimed at securing sustainable public finances, fiscal consolidation and debt stabilisation, alongside structural reforms to address bottlenecks in network sectors that have added to inflation. However, Kohn and Uribe noted that, while these reforms would be beneficial, they are not necessary conditions for implementing a lower inflation target. Central banks will never have the ‘right’ conditions to adopt or lower the inflation target. Lowering the inflation target would itself help to moderate administered price growth and alleviate fiscal pressures through lower debt-service costs.

Inflation targeting for a changing world

Despite its successes, inflation targeting faces numerous challenges. Crises have tested the resilience of inflation targeting and the independence of central banks, with expanding policy priorities creating conflicts between the primary mandate of price stability and other goals, such as financial stability. Borio argued that the complexity of these challenges emphasises the need for long-term policy horizons, a better understanding of the interaction between business cycles and financial cycles, and a realistic view of the capabilities and limitations of monetary policy.

The discussion on the benefits of low inflation comes at a time when the global economy and central banks are grappling with post-pandemic inflation surges. The challenge lies in disentangling the effects of supply-side shocks from demand-side pressures. This was a key feature of the presentations from economics professor Swati Dhingra and Portillo, with both outlining the implications for inflation dynamics and the monetary policy response. They also questioned whether central banks have the appropriate analytical tools to address evolving shocks, with Dhingra flagging those issues related to supply chains and granular trade interdependencies.

The post-pandemic experience has shown that inflation targeting frameworks need to be robust to alternative economic environments. Most speakers reflected on the significant volatility affecting the global outlook, including the risks from tariffs, trade tensions, geopolitical fragmentation, deglobalisation, demographics, high debt levels and climate change. These factors suggest that structural inflation drivers are shifting, potentially leading to higher long-term interest rates and marking a departure from the stability seen during the Great Moderation.

For South Africa, the lessons appear clear. In his summation of the conference, Kganyago argued that the current inflation target is too high and inconsistent with price stability. Lower inflation could bring substantial economic benefits, including permanent fiscal gains. The costs of transitioning to lower inflation are likely to be minimal, particularly if there is strong central bank credibility. Establishing a concrete point target, such as 3% for example, to be met within a sufficiently long-time horizon, offers the strongest case for ensuring flexibility while quickly anchoring inflation expectations at the new target and realising the gains from lower inflation.