South African Reserve Bank: resilient policy in an uncertain world

By Christopher Loewald and Manisha Morar[1]
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In recent years, central banks around the world have had to steer policy through an environment of heightened uncertainty. Shocks have become more frequent and varied – ranging from energy and food price volatility to geopolitical tensions, climate events, supply chain bottlenecks and sudden shifts in global financial conditions – all of which are difficult to anticipate or quantify. In South Africa, these global forces intersect with domestic challenges such as weak infrastructure and electricity supply disruptions. In this context, the South African Reserve Bank (SARB) has sought to maintain credibility and transparency while ensuring that its monetary policy decisions remain robust to a wide range of possible outcomes.

Types of uncertainty

Uncertainty takes many forms. Statistical or parameter uncertainty arises from measurement error, model estimation and forecast variance. To capture this, the SARB publishes fan charts and regularly highlights revisions to past data, reminding the public that data is never perfect (and that the future cannot be accurately predicted). Forecast error analysis is an integral part of our process – enabling us to assess the accuracy of projections and identify ways to strengthen the forecasting framework for greater efficiency and resilience.[2]

Given that the Quarterly Projection Model (QPM) is structured around output, inflation, interest rate and exchange rate gaps, uncertainty can arise at two levels: first in measuring "fundamental drivers", and second in any inference that relies on them.[3]

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[2] For instance, in the April 2025 *Monetary Policy Review*, Box 7 indicates that inflation was lower than forecast in 2024 driven by a stronger rand, lower oil prices, subdued unit labour costs and more economic slack. Beyond assumptions and starting points, monetary policy itself can also influence forecast errors, particularly when policy adjustments are not yet fully reflected in near-term projections. If, for example, interest rates are set above the level suggested by the QPM, inflation drivers may perform more favourably than expected. In this sense, the lower-than-forecast inflation outcome can partly be seen as a result of effective monetary policy.

[3] For details on the QPM, see E Pirozhkova, J Rakgalakane, L Soobyah and R Steinbach, "Enhancing the quarterly projection model", *South African Reserve Bank Working Paper Series*, no 5, June 2023. Relatedly, C Vermeulen, "The inherent uncertainties in output gap estimation: a South African perspective", *South African Reserve Bank Working Paper Series*, no 8, August 2023, underscores how real time estimates of potential output and the output gap are vulnerable to definitional uncertainty, choice of methodology and data revision. Consequently, central banks should consider a range of plausible gap estimates rather than depend on point estimates.

Recognising this highlights where judgment can be overlaid, either to compensate for model limitations or to incorporate non-model information.

For scenario uncertainty, the SARB develops alternative scenarios which show what the policy rate path would look like if certain risks materialised, under each scenario. This helps explore a range of possible trajectories when underlying conditions differ from the baseline. Results are typically expressed as deviations from the baseline forecast – for example, a higher oil price scenario might show inflation peaking 1 percentage point higher and the repo rate path 50 basis points steeper. The SARB has a long history of considering alternative scenarios. However, their (selective) publication gained prominence after the independent Bernanke Review of the Bank of England's forecasting and policy framework in April 2024, which recommended using scenarios to enhance transparency.[4]

Finally, there are "unknown unknowns" – those shocks that cannot be anticipated. Here the emphasis shifts to robustness and flexibility. The Monetary Policy Committee (MPC) relies on shorter decision horizons, data dependence and the ability to adjust policy quickly as new information becomes available.

Uncertainty in models

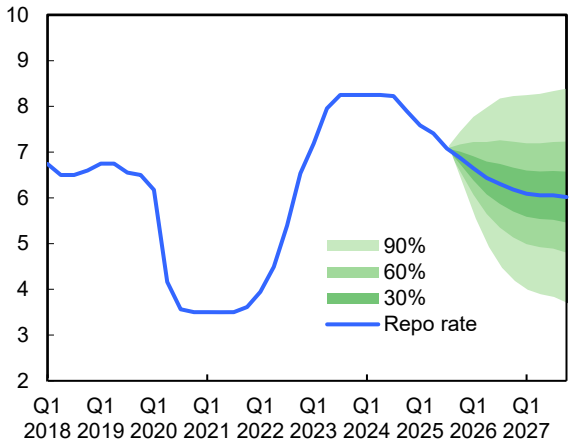
Uncertainty is incorporated into the SARB's modelling framework in several ways. At each monetary policy meeting, held six times a year, a statement on the decision is published alongside documents outlining key assumptions, forecast results and a repo rate fan chart. The fan chart shows both the historical and projected paths of the policy rate and is constructed by running the model repeatedly with shocks drawn from historical forecast errors. This process generates symmetric confidence bands at the 30, 60 and 90% levels, as shown in Graph 1. Although the symmetry means the bands do not capture any judgment about upside or downside risks, they offer a clear probabilistic representation of outcomes around the baseline projection, making the inherent forecast uncertainty explicit.

[4] In September 2024, the MPC referenced scenarios related to an inflation under- and overshoot. In the November 2024 statement, the prospect of higher administered price inflation was explored, while another scenario envisaged a more difficult external environment, with a weaker rand and higher oil prices. In January 2025, the MPC reviewed a trade war scenario, and one of accelerated domestic reforms. In March 2025, a slowdown in the United States, alongside a weaker dollar and higher commodity prices, was an external scenario. The MPC also considered scenarios related to the loss of South Africa's African Growth and Opportunity Act (AGOA) status, and if that were to be compounded by tariffs. The most severe scenario added a sentiment shock. In May 2025, the MPC published a medium and high tariff scenario impact, as well as a scenario with a 3% inflation objective – laying the groundwork for the replacement of a 4.5% QPM baseline with a 3% anchor in July 2025. In September 2025, scenarios were considered in which inflation expectations adjusted more slowly than in the baseline. The scenarios treated expectations as more backward looking, with less attention paid to the SARB's communication.

Repurchase rate forecast

In per cent

Graph 1



* As of September 2025.

Source: SARB.

The construction of scenarios, in turn, takes into account a range of factors: exogenous shocks (such as alternative oil or food price projections), domestic risks (including shifts in government debt levels or electricity supply disruptions), global developments (for example, a weaker US dollar) and policy sensitivities (such as different repo rate paths under alternative assumptions).

Scenarios are especially powerful: they illustrate how policy might respond if risks materialise, reinforcing that policymakers are prepared and proactive rather than reactive. They also help explain why the MPC may sound more cautious or hawkish than the baseline forecast alone would suggest. At the same time, scenarios strengthen credibility by demonstrating that the SARB systematically considers uncertainty, not just the central path. For market participants, this reduces the likelihood of being surprised by policy moves. Care is taken, however, to ensure that scenarios do not mislead or become unintended focal points for expectations.

Staff members also update policymakers on market-based measures that embed investor expectations and risk premia. These include volatility indices such as the Cboe Volatility Index (VIX) and Merrill Lynch Option Volatility Estimate (MOVE), shifts in money market pricing of central bank interest rate decisions, and indices measuring trade and economic policy uncertainty.

Implications for the policy reaction function and communication

Uncertainty makes the MPC less likely to follow a mechanical Taylor-type rule approach. If uncertainty is high, policymakers may adopt a cautious stance – adjusting rates in smaller increments or waiting for more data before moving decisively.

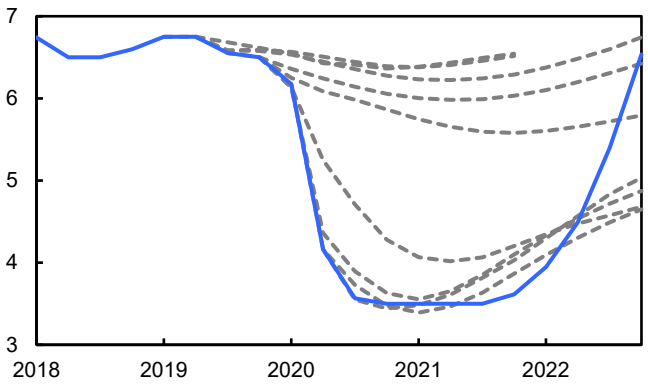
Statistics are often revised (for example, GDP, employment and trade), and real-time readings may be misleading. The MPC explicitly discusses this. The QPM baseline is robustly debated and a risk management approach is adopted – focusing not only on the baseline forecast but also on the potential costs of being wrong.

The MPC distinguishes between temporary shocks – such as one-off spikes in food or oil prices, which are often best "looked through", and more persistent or unusually large shocks that generate second-round effects on wages, inflation expectations and core inflation.

Covid-19 highlighted the SARB's capacity to recalibrate monetary policy in response to unprecedented uncertainty. Faced with a sharp contraction in output and heightened financial market stress, the MPC responded forcefully, reducing the repo rate by 300 basis points in the first half of 2020. As illustrated in Graph 2, the solid blue line (that is, the actual policy rate) diverged from the QPM's implied paths (dashed lines) for meetings between July 2019 and July 2020, reflecting the MPC's judgment-based response as opposed to a mechanical application of model guidance. Unscheduled MPC meetings were held, and extraordinary liquidity measures were introduced to stabilise markets. At the same time, communication was stepped up through press briefings and explanatory statements.

QPM-implied rate path vs policy rate

In per cent — Graph 2



* Dotted lines indicate implied policy rate path from the QPM's Taylor rule for various MPC meetings in 2019 and 2020.

Source: SARB.

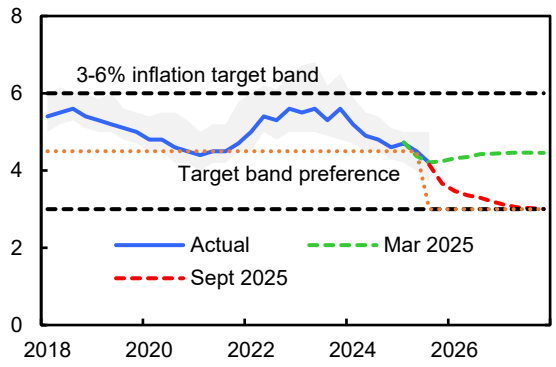
Relatedly, forward guidance is typically qualitative. Hard numerical commitments – for example, pledging that "rates will remain at X until Y" – risk undermining credibility if conditions change abruptly. Instead, predictability is fostered through a systematic framework: an explicit inflation targeting regime, transparent forecasts, fan charts and regular communication of the balance of risks. At the same time, the MPC retains discretion to respond flexibly to shocks not well captured by models, such as load-shedding, geopolitical events or rand volatility.

If we consider the recent past, the SARB began explicitly emphasising a 4.5% midpoint target – within the official 3 to 6% inflation band – in 2017. Through consistent communication and greater transparency around the forecasting model, inflation expectations were gradually anchored lower. Importantly, disinflation was not driven by recessionary dynamics – that is, it did not result from aggressive interest rate hikes or a sharp contraction in demand. While growth was admittedly weak over this period, the primary causes lay in structural constraints, indicating that the disinflation process itself had only a limited impact on growth. Importantly, the anchoring of expectations has helped reduce domestic uncertainty by limiting the risk of second-round effects. As of July 2025, the MPC's preference is to target inflation at the lower bound of the range. Under this baseline, inflation expectations for analysts, businesses and trade unions are forecast to moderate further, as shown in Graph 3, as credibility in the SARB's commitment to price stability strengthens. By aligning more closely with global norms, the revised inflation objective will help to lower domestic borrowing costs, lower the volatility of inflation and create a more stable environment for investment and long-run growth.[5]

Two-year-ahead inflation expectations: all groups

In per cent

Graph 3



* Shaded region indicates interquartile range of survey respondents; dotted lines indicate forecasts.

Sources: Bureau for Economic Research; SARB.

Other recent research reinforces the importance of central bank communication as a policy instrument.[6] Specifically, credible communication around inflation targeting and central bank independence can lower perceived risk, reduce borrowing costs and improve the transmission of policy. These findings underline that in an

[5] See C Loewald, R Steinbach and J Rakgalakane, "Less risk and more reward: revising South Africa's inflation target", *South African Reserve Bank Working Paper Series*, no 5, May 2025. Relatedly, Box 1 in the October 2025 *Monetary Policy Review* notes that, when decomposed, inflation expectations have, since 2017, been driven predominantly by a forward-looking component – proxied by the inflation target – rather than by a backward-looking component, namely headline inflation. This indicates credible policy anchoring and suggests that a shift to a lower target could occur without destabilising expectations.

[6] See for instance, E Pirozhkova, G Ricco and N Viegi, "Trouble every day: monetary policy in an open emerging economy", University of Pretoria, *Department of Economics Working Paper Series*, no 42, September 2024.

emerging market context, effective communication does more than explain decisions – it actively shapes financial conditions and enhances resilience under uncertainty.

Conclusion

The South African experience highlights how a central bank can embed uncertainty considerations into each stage of decision-making and communication. By combining formal modelling, scenario analysis, judgmental overlays and qualitative forward guidance, the SARB strives to balance credibility with flexibility.

The broader lesson is that while uncertainty can never be eliminated, central banks can demonstrate resilience in the way policy responds to it. Through clear and consistent communication, the SARB works to keep expectations anchored and build trust in its policy approach.