



# South Africa's Experiences of Monetary Policy within an Inflation Targeting Policy Framework

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Presentation to: International Seminar on Monetary Policy in Emerging Markets, OECD, Paris: 28 February 2007



# Structure of the presentation

- Aspects of Inflation Targeting in South Africa.
- Assessing the performance of Inflation Targeting.
- Remaining policy challenges.
- Concluding remarks.



# Aspects of Inflation Targeting in South Africa

- The inflation target.
- Autonomy of the Reserve Bank.
- The Monetary Policy Committee.
- The inflation forecast.
- The explanation clause.



# The Inflation Target

- An inflation target was set by the Minister of Finance for the first time in February 2000 with an average inflation rate of between 3 and 6 per cent to be achieved for 2002.
- Annual targets were announced at the outset without a specific indication of the full disinflation path.
- The target has been altered several times.



# Autonomy of the Reserve Bank

- Advisory Joint Treasury/Reserve Bank Inflation Targeting Technical Committee.
- Final decision on the inflation target is reached at Cabinet level.
- Full instrument independence is maintained.



# The Monetary Policy Committee

- The MPC currently comprises seven members.
- Meetings are held on even months of the year but provision is made for unscheduled meetings.
- The MPC cycle begins approximately two to three weeks prior to the scheduled meeting.
- Decisions are made by consensus or with a majority view, without a formal vote being taken.

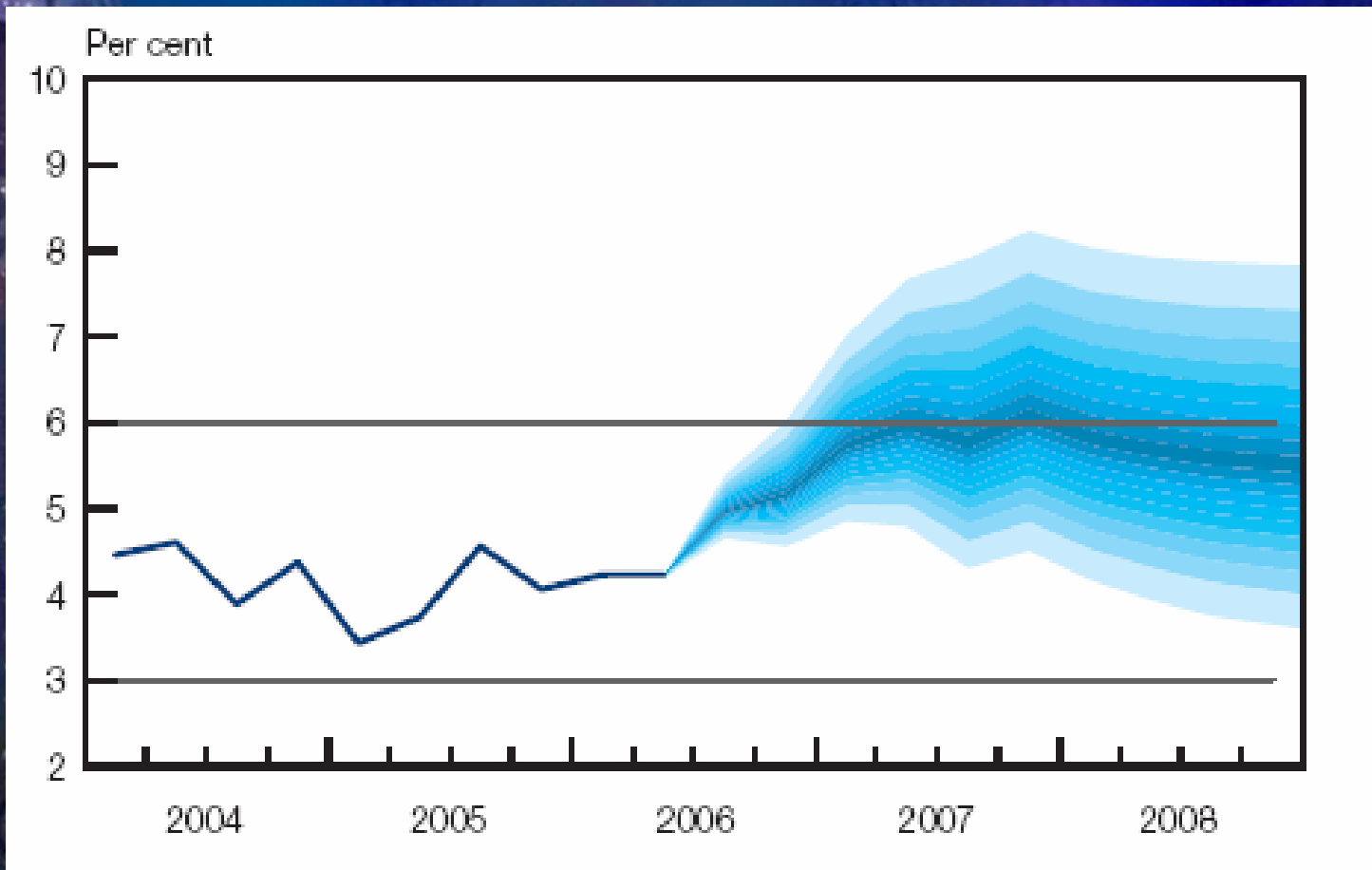


# The Inflation Forecast

- The MPC monitors a number of factors that influence inflation.
- No target for any of these variables other than for CPIX.
- Greater emphasis is given to the inflation forecast than in the past.
- The MPC uses a fan chart to assess the risks inherent in the forecast.



# CPIX forecast



# The Explanation Clause

- An “escape clause” at the inception of inflation targeting was designed to create more transparency.
- In November, 2003, the SARB in consultation with the National Treasury rephrased it to an “explanation” clause for more flexibility and clarity.



# Assessing the performance of Inflation Targeting in South Africa

- Potential benefits foreseen in adopting inflation targeting.
- The evolution of key indicators.
- The credibility of monetary policy.
- Monetary Policy Transparency.



# Potential benefits foreseen in adopting inflation targeting

- Clarify the objective of monetary policy.
- Provide an anchor for inflation expectations.
- Provide a formalised, publicly announced and co-ordinated effort to contain inflation.
- Enhance accountability and improve monetary policy transparency.

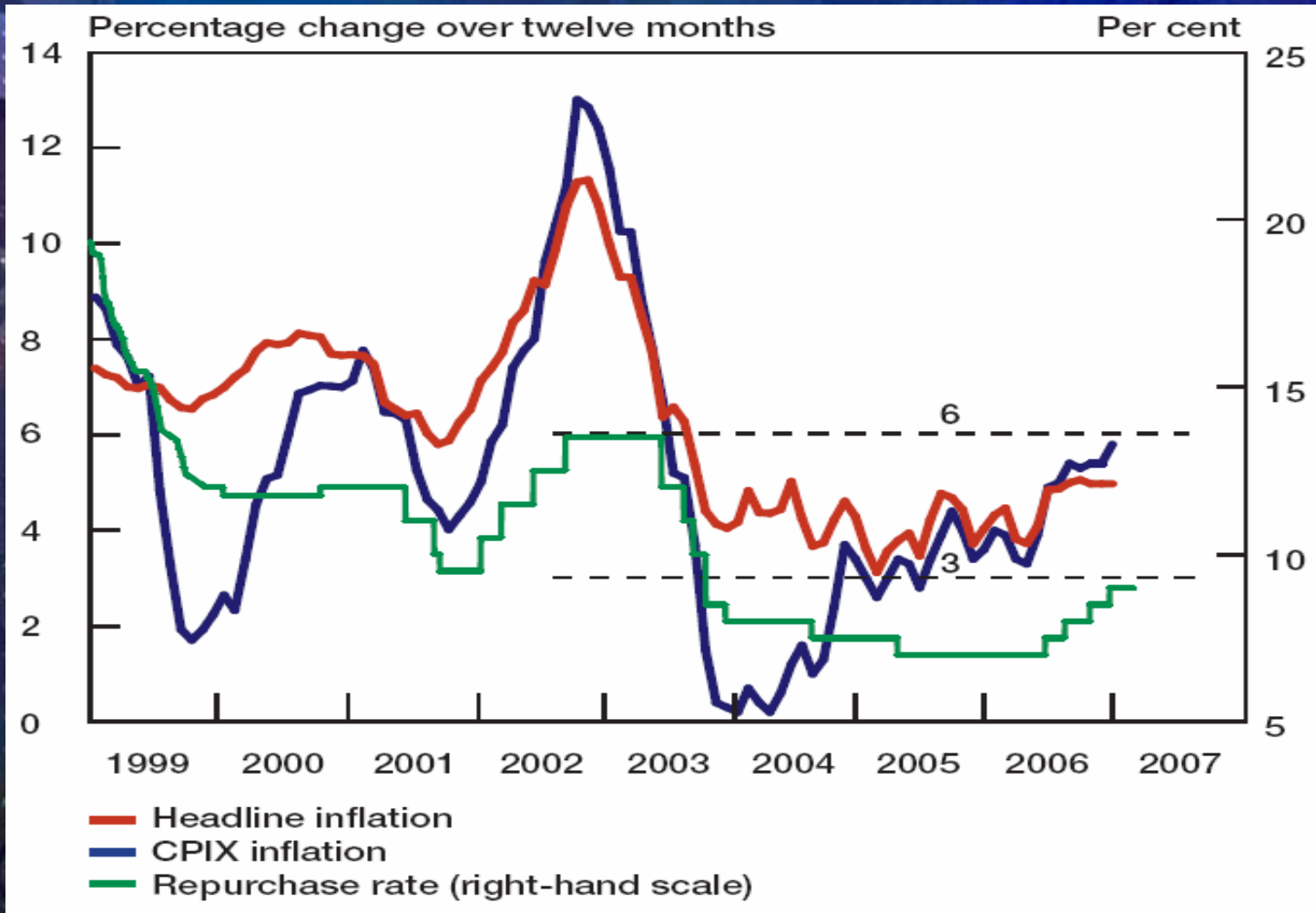


## The evolution of key indicators

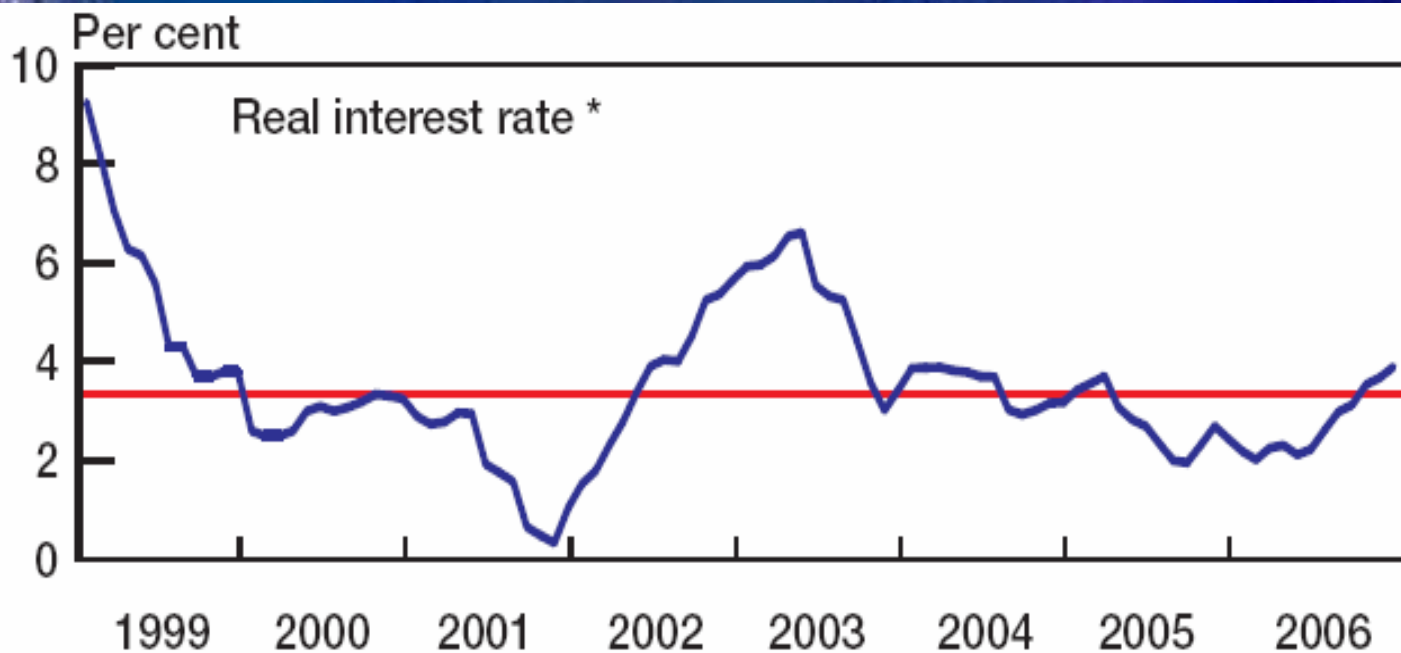
- Greater stability in real and nominal interest rates given the less vigorous response to events.
- The volatility of headline CPI, initially rose substantially.
- The volatility of output growth remained very similar to that of the pre-inflation targeting period.
- The growth rate improved.
- The average level of real rates declined significantly.



# Headline inflation, CPIX and the Repurchase rate



# Real interest rate

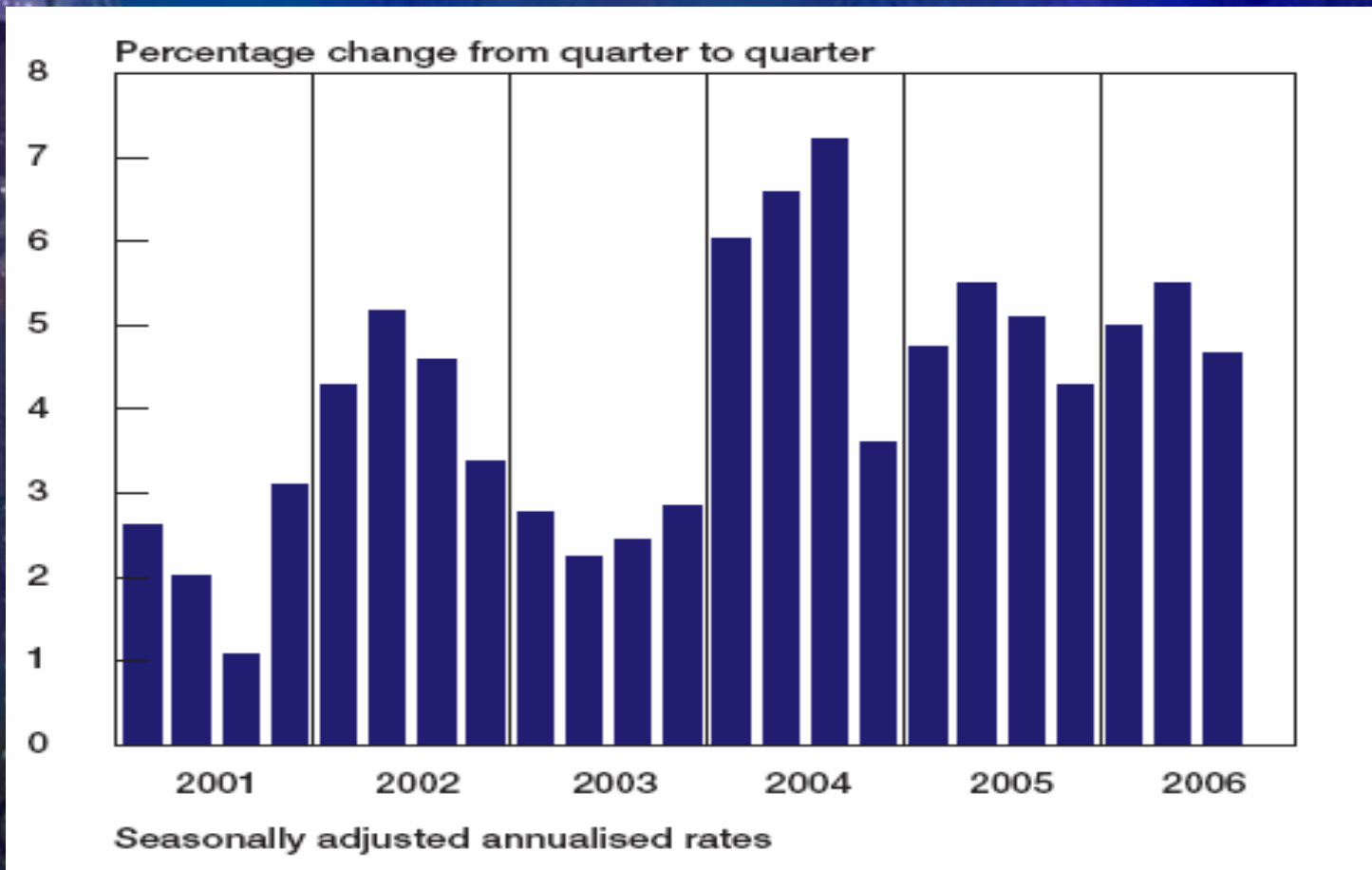


\* Using average of inflation for past and future 12 months to adjust nominal 3-month interest rate

— Long-term average



# Real Gross Domestic Product

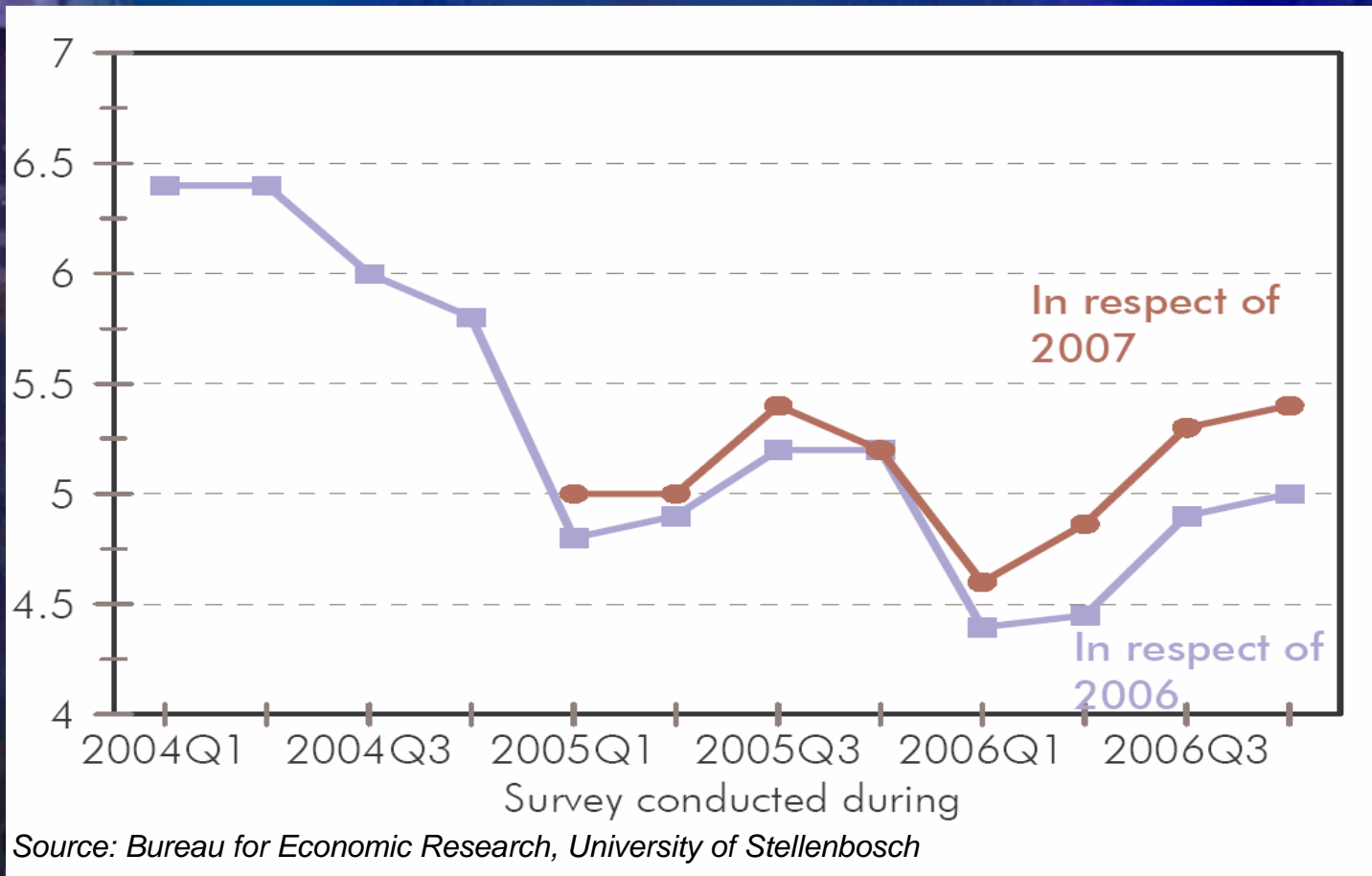


## The credibility of monetary policy

- Inflation expectations have converged to the target.
- Monetary policy credibility to agents has improved significantly.



# CPIX inflation expectations



# Monetary Policy Transparency

- Central bank transparency in South Africa has improved greatly under inflation targeting.
- The government determines a specific target range for a particular price index to be achieved within a specific time frame.
- Major improvements in the Bank's communication with the public and markets.



## Inflation forecast errors

- The accuracy of the forecasts for CPIX inflation when using the Bank's models is compared favourably with alternative forecasts.
- Results show that the forecast prepared by the Bank's core model performs consistently better over the one, two and three-quarter-ahead forecast period.
- The Bank's forecasting performance compares well with that of reputable agencies.



## Remaining policy challenges

- To bring the inflation rate down to the level of South Africa's major trading partners (at this stage no time frame has been set for this by Government).
- Some aspects have been identified as being important to further improving the monetary policy framework.
- Central bank's in emerging market countries have to ensure that their conduct of monetary policy is entirely consistent with best international practice.



# Concluding remarks

- The “best” monetary policy framework for a particular country should ultimately be chosen by the authorities of that country.
- There have been important gains in the performance of monetary policy in South Africa since the adoption of inflation targeting.
- The sustained application of prudent macroeconomic policies is bearing fruit and will contribute to sustained financial stability.

