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

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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.
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 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

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Long-term average
The credibility of monetary policy

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

Source: Bureau for Economic Research, University of Stellenbosch
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.