



**MINISTRY: FINANCE
REPUBLIC OF SOUTH AFRICA**

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Ms G Marcus
Governor
South African Reserve Bank
PO Box 427
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0001

Dear Gill,

CLARIFICATION OF THE RESERVE BANK'S MANDATE

Let me once again congratulate you on your appointment! I look forward to working with you and your team at the Reserve Bank as we manage South Africa's response to the financial crisis and chart a new economic course to increase the economy's growth potential to the benefit of all South Africans.

The recession, and its negative impact on the lives of ordinary people, has taught us many lessons about the importance of pursuing policies that promote sustainable and balanced growth. It has also heightened the urgency for South Africa to chart a new growth path that allows the economy to achieve faster growth with more job creation.

To raise South Africa's growth potential, various studies – such as, the report by the International Growth and Advisory Panel and the report of the Commission on Growth and Development – have highlighted the importance of countercyclical macroeconomic policies combined with microeconomic reforms that increase competitiveness and reduce the cost of doing business. These studies acknowledge the crucial role of monetary policy and inflation management in supporting sustainable growth and employment, and in protecting real incomes. Countries set policy, whether explicitly or implicitly, to target a low and stable rate of inflation to reduce the long-term cost of borrowing and provide confidence about the future. This in turn stimulates investment, employment and competitiveness – particularly among exporters and import-competing industries. Low inflation is especially important to protect the living standards of workers and the poor.

As we move into the new fiscal year, I thought it important to reiterate the constitutional mandate of the South African Reserve Bank and indicate how the lessons of the recession and the reality of the aftermath should be taken into account:

1. Section 224 of the Constitution of the Republic of South Africa states:
 - (1) *The primary objective of the South African Reserve Bank is to protect the value of the currency in the interest of balanced and sustainable economic growth in the Republic.*
 - (2) *The South African Reserve Bank, in pursuit of its primary object, must perform its functions independently and without fear, favour or prejudice, but there must be regular consultation between the Bank and the Cabinet member responsible for national financial matters.*
2. Balanced and sustainable growth requires the composition of growth to be such that it does not give rise to an unsustainable balance of payments position (either surplus or deficit) or unsustainable debt burdens for the private and public sectors.
3. In exercising this mandate, the Bank should continue to pursue a target of 3 to 6 per cent for headline CPI inflation. Monetary policy should be conducted in a consistent and transparent manner within a flexible inflation targeting framework. Monetary policy acts with a lag, and for this reason should continue to focus on a medium term time horizon.
4. Notwithstanding the imperative to anchor inflation expectations, I wish to confirm that the existing framework allows for temporary deviations of inflation from the target in the event of shocks over which monetary policy has no control. While it would be important to bring inflation back to within the target range, the time frame for the adjustment should attempt to avoid unnecessary instability in output and interest rates. In such cases, the Bank is required to explain clearly to the public the policy time horizon. The policy response should have due regard to the factors that might impact on the attainment of balanced and sustainable growth. These factors include the source of the inflation shock, the size of the gap between actual and potential economic growth; credit extension and asset bubbles, employment and other labour market developments; and the stability and competitiveness of the exchange rate.
5. As government, we are fully cognizant of the fact that better alignment is needed between macroeconomic policies on the one hand, and microeconomic reforms to remove constraints to growth on the other. I can assure you the National Treasury will endeavour to manage fiscal policy in a manner that supports these aims.
6. Credible monetary policy is essential for South Africa to achieve a new growth path and more job creation. Improved communication with the public about the role of monetary policy in supporting growth will increase the effectiveness of the Bank in achieving its mandate. Ongoing assessment, discussion and commentary about our monetary policy by analysts, interested members of the public, interest groups, and the broader research community, is constructive for the emergence of a social consensus in this area over the long term.
7. The crisis has also demonstrated the importance of a stable and well-regulated financial sector. An important lesson from the crisis has been the need for central banks to have a deeper understanding of the banking sector and financial stability. This requires greater focus on both macro- and microprudential analysis, regulation and supervision. I also wish to commend the Bank for the vital role played in successfully supervising the banking sector over these difficult times, and reaffirm the role that the Bank plays in overseeing and maintaining financial stability.

In these challenging times there is a great need for our responses to be agile and dynamic. This requires vigilance, ability and strong leadership. I trust that in working together, we will be able to move closer to our goal of raising employment and living standards of all South Africans.

Yours faithfully

A handwritten signature in black ink that reads "Pravin". The signature is written in a cursive style with a large initial 'P'.

PRAVIN GORDHAN
MINISTER OF FINANCE
Date: 16 - 2 - 2010