NATIONAL ASSEMBLY

QUESTION FOR ORAL REPLY

QUESTION NUMBER: 156 [NO2403E]

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Mr D D van Rooyen (ANC) to ask the Minister of Finance:

Whether he has found that the Government's monetary policy of targeting low inflation, lower real interest rates and additional purchases of foreign currency (details furnished) promotes economic growth; if not, how was this conclusion reached; if so, what are the relevant details?

NO2403E

REPLY:

1. Monetary policy is the primary tool through which inflation pressures are managed in an economy. Low and stable inflation is an important determinant of the economy's competitiveness and it also helps to preserve the purchasing power of households. Permanently higher inflation carries a range of serious economic costs. It drives up interest rates, reduces competitiveness, and lowers actual and potential economic growth. It also reduces the living standards of groups less able to protect their incomes from rising prices, including the poor, workers, and those living off of fixed incomes, for example pensioners.

2. Inflation targeting provides a clear nominal anchor for monetary policy and requires the Reserve Bank to be transparent about its goals and actions. These issues are extremely important for policy credibility and for managing inflation expectations effectively. If inflation is rising and inflation expectations are not anchored, then the cost of lowering inflation becomes much higher in terms of foregone investment and exports, and lower employment.

3. The Monetary Policy Committee (MPC) implements its inflation targeting mandate in a flexible and forward-looking manner that considers a range of factors when deciding on the monetary policy stance. These factors were outlined in a letter I sent to the Governor in February 2010, I quote "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." This flexibility has clearly been demonstrated over the past three years in response to the global financial and economic crisis as the SARB has reduced interest rates by a cumulative 7 percentage points and kept them unchanged at low levels despite shocks to food and oil prices.

4. Government and its social partners can do a lot more to reduce inflation pressures in the economy by promoting competition, achieving wage moderation, and raising productivity. Along with low inflation, progress in these areas will support South Africa's international competitiveness and more rapid economic growth in the future.

5. Since inflation targeting was adopted in 2000, both the level and volatility of inflation has declined, GDP growth has also been stronger and less volatile than under previous monetary policy regimes. In recent years, external shocks to food and oil prices have temporarily driven South Africa's inflation rate above the 3-6% target range. Guided by the impact of current economic developments on future inflation prospects, the Reserve Bank remains focused on gradually reducing inflation back

within the target range. But the Reserve Bank managed interest rates with the general economic situation in mind.

6. Government's strategy of financing additional purchases of foreign currency have been important in building up South Africa's ability to weather global turmoil, such as a sudden stop in capital flows. In the current environment of global turmoil, the value of this insurance policy cannot be underestimated.