INFLATION TARGETING AND ITS IMPACT ON MONITORY POLICY: A SOUTH AFRICAN INSIGHT

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Abstract

The main task of macro-economic policy is the promotion of sustainable high economic growth, the creation of employment opportunities, the containment of inflation, improvement of the living conditions of all the residents of a country, and the elimination of unjustifiable discrepancies in the distribution of income amongst our people. These economic objectives can best be obtained amongst other things in a stable financial environment. Financial instability is a major obstacle in the fulfilment of this task. Stable financial conditions should be maintained throughout the various phases of the business cycle to attain maximum economic development.

Inflation could only have an effect on the rate of unemployment if it could somehow affect the real wage in the economy. That is not impossible, since the real wage is determined by the marginal productivity of labour in a competitive system.

A number of countries have successfully adopted inflation targeting monetary policy frameworks in recent years. It is a framework based on hitting an inflation target, and if it is considered that the target is going to be missed, then determining whether a change in policy stance is called for. In this paper I briefly assess the viability of implementing inflation targeting monetary policy framework in South Africa.

Monitory policy in South Africa is conducted by the South African Reserve Bank. Those who have lived in South Africa in the past 3 decades witnessed dramatic uncontrollable price increase, convincing the government to take serious measures pertaining to supply and demand of money.

This paper analyzes the impact of inflation targeting on monitory policy in general, with a special focus on South Africa as a developing country, highlighting the main strategic approaches implemented as well as the obstacles facing the developing countries and South Africa in particular.

Key words: inflation, banks, financial management.
JEL classifications: G00, G20, G21, G22.

Inflation Targeting: Government Approach

The Reserve Bank in 1999, Tito stated that it is advisable to move away from the "eclectic" or informal inflation-targeting monetary policy framework to formal inflation targeting. This change is necessary because the eclectic framework has at times created uncertainties about Reserve Bank decisions and actions, which were perceived as being in conflict with the stated guidelines for the growth in money supply and bank credit extension (SA Government Press, 2000).

On 23 February 2000 the Minister of Finance announced in the Budget Speech that the government had decided to set an inflation target range of 3 to 6% for the year 2002. The Reserve Bank has therefore formally adopted an inflation-targeting monetary policy framework. This means that the monetary authorities are now targeting the rate of inflation directly instead of following the previously applied "eclectic" monetary policy approach in which intermediate objectives still played a prominent role. In this statement, the new monetary policy framework is explained in more detail. The question may be asked whether the adoption of inflation targeting will lead to a more effective monetary policy (SA Government Press: 2000).

The Phillips Curve

The idea of a trade-off between inflation and unemployment, or more generally between inflation and growth is one of the most deep-rooted in economics and elsewhere. The general idea is that

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