THE OUTLOOK FOR MONETARY POLICY

Address by Dr X.P. Guma to the BER Conference, 22 June 2005

1. INTRODUCTION

Chairperson, delegates, attendees, ladies and gentlemen, I have been invited to address you on a theme which is consistent with the overall object of this conference – being a consideration of “The South African Economy: Current conditions and Outlook”.

Having figuratively drawn the short straw, I have not been asked to discuss the easy part – the South African economy: current conditions. Nor have I have been invited to say something about the less easy part – the South African economy – the outlook. Instead, I have been instructed that “the title of your paper will be “The outlook for monetary policy”- as indeed it is.

2. FASHIONING AN OUTLOOK – AN ORGANISING FRAMEWORK

A rational process of fashioning a view about events that are yet to occur may begin with the identification of a framework – a structure- within which a course of action may be fashioned: from which policy may be anchored. Stated in the words of Gerhard de Kock [1]- former Governor of the SARB – (it is desirable that) “in

[1] G. de Kock (1978) “Central Banking and Financial Markets in South Africa – The need for a conceptual Framework” – Paper delivered at a Seminar on “Money and Economic Activity” organised by the School of Economics, Graduate School of Business, University of Cape Town.

every country the monetary authorities should ideally have a clearly defined and internally consistent conceptual framework for monetary policy" … the better to be able to know what the theoretical basis is for their own actions.

In the case of the contemporary South African Reserve Bank, it is common knowledge that the organising framework is that of inflation targeting. Such a framework, which has become increasingly popular amongst central banks in recent years, requires, among other things[2]: choice of a variable, to be targeted; specification of an acceptable range for this variable – in the limiting case, a single point; public announcement of the medium-term numerical targets for inflation; creation of the appropriate institutional infra-structure; selection of an appropriate rate, to quote the magisterial language of section 10(2) of the South African Reserve Bank Act (90) of 1989 "at which the Bank will discount or rediscount … various classes of bills, promissory notes and other securities,": this is currently the so-called "repo-rate".

Underlying this framework, it bears repeating, is the constitutional imperative spelled out in section 224 of the Constitution of the Republic of South Africa: namely, that 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.

3. COMMUNICATING: THE OUTLOOK

If it is accepted, as I have suggested, that the formulation of an outlook, in whatever sphere, becomes more rational when conducted in an explicit framework – a systemised set of organising

[2] Van der Merwe, E.J. (2004): Inflation Targeting in South Africa, Occasional paper No. 19, South African Reserve Bank.

principles – it is likely also true that the form, content and meaning of the framework has to be communicated if its technique, regarding policy, is to be effective. It may be instructive, therefore, to consider some of the recent academic tracts, in this context.

David Archer (June 2005: 15/16)[3] is of the view that "the key issue is credibility" – being of like mind with, but more economical with words than Carl Walsh (2003)[4] who emphatically states that "the three most important ingredients to a successful monetary policy are credibility, credibility and credibility." This is true, apparently because in contrast to the assertion by J.K. Galbraith (1974:5)[5] that "There is nothing about money that cannot be understood by the person of reasonable curiosity, diligence and intelligence…", Galbraith was resoundingly mistaken. According to Courtney N. Blackman (1999:44)[6] the role of the central bank – and by extension, monetary policy – "has proven most elusive…"

What all of this means is that in times gone by central banks, and the conduct by them of monetary policy, were surrounded by a "peculiar mystique", which, according to K. Brunner (1981)[7] "thrive(d) on a pervasive impression that Central Banking is an esoteric art", which impression was revealed, " … by an inherent impossibility to articulate its insights in explicit and intelligible words and sentences." This has now changed. Clever obfuscation is now seen for what it is and is judged accordingly: credibility of policy is

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[3] Archer, David (2005) "Central Bank Communication and the publication of interest rate projections" – Bank for International Settlements.
[4] Walsh, Carl E (2003) "Modern Central Banking: An Academic's Perspective" Central Bank of the Republic of Armenia.
[5] Galbraith, J.K. (1975) Money: <u>Whence it came, where it went</u>, Boston, Houghton Miltin Company.
[6] Courtney N. Blackman (1999) <u>Central Banking Theory and Practice</u>, Caribbean Centre for Monetary Studies.
[7] K. Brunner (1981) "The art of central banking", in H. Göppl and R. Henn (eds), Geld, Banken und Versicherungen, vol. 1 (Königstein).

to be won by the persistent exercise of obfuscation's antonym. Frameworks help, but ultimately it is credibility which matters.

Communication is, of course, multi-directional when effective: there has to be, at a minimum, a transmitter and a receiver. And in the case of monetary policy, it matters who the respective parties are.

Alan Blinder and Charles Wyplosz[8] assert, in this context, that central banks have two sets of interlocuters with whom to communicate. The first is the broad public and its political representatives and the second are the financial markets.

To the first of these audiences the central bank – as the formulator and transmitter of monetary policy - needs to communicate its basic objectives, its strategy for achieving them, and its successes and failures. It must do this in the interest of democratic accountability. But "in addition, (because) the virtues of central bank independence and price stability may not be self-evident to the body politic, the central bank must constantly make the case that its job matters …. It must address the concerns of ordinary citizens," – the interlocuters, who must first receive the message, before responding, rationally to the transmitter.

Policy must make it clear that price stability matters – not only because it is said to matter in the Constitution but also because it affects the purchasing power of our money, here at home and abroad. Price instability affects us all, to our detriment.

The second, essential audience – according to Blinder and Wyplosz - is that of the financial markets. These, they contend, need to be taught to think and process information as the central

[8] Alan Blinder and Charles Wyplosz 2004 Central Bank Talk: Committee Structure and Communication Policy

bank does itself. I agree, although my view would be stated more gently: all markets and participants therein should, in my view, be invited to think about and process information as the central bank itself does.

4. COMMUNICATING THE OUTLOOK FOR MONETARY POLICY

Chairperson, delegates, attendees, ladies and gentlemen, I wish now to conclude my address and do so very simply.

It must be obvious to all, present here, that no Executive Director of the South African Reserve Bank can – with clear conscience – subvert the framework within which policy is formulated by anticipating publically the outcome of the next, or any other, meeting of the Monetary Policy Committee of the Bank. As I have had occasion to state to many who have written to me, sought appointments or otherwise attempted to get inside information, I do not give private or public briefings about the likely trajectory of future policy.

What I can and do say is that the Monetary Policy Committee of the Bank will deliberate, in future, as it has done in the past, on the outlook for inflation and, looking forward, determine the level of short-term interest rates which it deems to be appropriate. This it will do in the context of a policy framework which has been in place since 2000; has been explained and communicated and will continue to be so explained and communicated in the various publications of the South African Reserve Bank – in particular, the Quarterly Bulletin and the bi-annual Monetary Policy Review: and in the face-to-face forums, styled, MPF's which some of its members host.

The decisions of the Committee will continue to be made available to all interested persons, natural and corporate, at a pre-announced time and place, without fear or favour, so that all interested persons can receive the information at the same time.

Monetary policy will continue to focus on the primary achievement of the objective which it is enjoined to attain in the Constitution and in the Act which gives to the Reserve Bank its mandate.

Moreover, the Monetary Policy Committee will not signal to confirm what it has done – as do so many drivers on our roads. Instead, the Monetary Policy Committee will continue to monitor all the risk factors to the inflation outcome and if the outlook changes, the Committee will review and, as usual, announce its stance. That is the outlook for the conduct of monetary policy! Regarding the policy itself, I say nothing other than this: Ma-jammoho ke ma-hata mmoho.

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