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Monetary policy and inequality: the post-pandemic experience

Good afternoon, ladies and gentlemen.

Introduction: an era of economic shocks and rising inequality

We are just a few months away from marking a fifth full year since the first case of COVID-19 was reported. This is remarkable − in part, because we still live with the economic shocks that followed the pandemic. Labour, services and goods markets were subjected to severe dislocation and strain, prices have surged, and debt levels remain very high.

The pandemic shocks impacted widely on economic growth, industrial sectors, job creation and household incomes. As they did so, they also affected the distribution of incomes, both within and between economies. China's post-pandemic slower growth rate, for instance, will sharply slow the pace of global poverty reduction. Other effects were less direct. Comorbidities, for instance, mattered greatly for households, essential workers were more at risk, gender inequities were often reinforced, and children without resources experienced larger learning losses than others.

The economic shocks of the pandemic were not a one-off. They were sequential and often overlapped, causing additional damage. In the post-pandemic inflation surge, food price shocks and supply constraints, made worse by trade restrictions and geopolitical tensions, spilled over into other prices. These seismic effects, mixed with strong policy responses, set off the worst bout of inflation since the 1980s. At the global level, consumer price inflation was 4.7% in 2021, 8.7% in 2022, and 6.7% in 2023. The International Monetary Fund's (IMF) forecast for global inflation for this year remains high, at 5.9%.

Inflation has complex effects on the distribution of income that can change over time. Generally, inflation worsens inequality as poorer households' have less purchasing power, less access to credit markets, and have more chance of suffering income losses when jobs are shed or firms fail. If inflation is allowed to accelerate and spread, as was the case during the post-pandemic inflation surge, more households are affected negatively, and the whole economy is hit by rising interest costs, even as real income levels fall faster. Monetary policy needs to take into account the damage caused to lower income households by being robust enough to stop inflation from spiralling higher.

Today, I want to explore more fully the inequality-raising effects of the pandemic and its aftershocks, before discussing the role of monetary policy in responding to these challenges.[1]

A global pandemic, an inflation surge and stalled economic convergence

COVID-19 was a massive shock, one that put at risk the remarkable reductions in global poverty and inequality achieved over the past three or four decades. Thomas Piketty, a French economist who specialises in inequality, famously argued that global inequality rose from about 60 Gini points in 1820 to 72 points by 1910. Several major subsequent events, including the two world wars and the Great Depression, somewhat narrowed inequality, but by 2000 the world had returned to that 72 Gini point peak. Since then, the world saw income inequality fall, reaching 67 Gini points by 2020.[2]

The fall in global inequality primarily reflected convergence to the income levels of more developed economies, as poorer countries grew faster. Within countries, however, inequality has risen to levels last seen in the early 1900s − a process that seems to have accelerated in recent decades, at least measured by the income gap between the top 10% and the bottom 50% of the world's population.

The pandemic raised global inequality. One study by World Bank economists shows a 1% rise between 2019 and 2020 − the largest one-year increase in global inequality since the Asian financial crisis.[3] Although all households experienced a negative income shock during the pandemic, the top 20% fared better than those in the bottom 80%, with the top 10% experiencing the smallest shocks.

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[1] For an earlier lecture on the channels between monetary policy and inequality, see L Kganyago, 'Monetary policy and inequality', Public lecture by Lesetja Kganyago, Governor of the South African Reserve Bank, at the Nelson Mandela University, 1 August 2018. https://www.resbank.co.za/content/dam/sarb/publications/speeches/speeches-by-governors/2018/530/Nelson-Mandela-University-Public-Lecture-01-August-2018.pdf

[2] World Inequality Database, 2022. See also B Milanovic, 'The great convergence: global equality and its discontents', *Foreign Affairs*, July/August 2023. https://www.foreignaffairs.com/world/great-convergence-equality-branko-milanovic

[3] During that crisis, the Gini index rose from 69 in 1996 to 69.9 in 1999. See D Mahler, N Yonzan and C Lakner, 'The impact of COVID-19 on global inequality and poverty'. *World Bank Policy Research Working Paper No. WPS 10198*; Washington D.C., 5 October 2022.
http://documents.worldbank.org/curated/en/099250510052241154/IDU01d94e70603dc804f990b6130751d75dccb52

The impact on the poorest population was substantial. In 2020 alone, the number of people living below the extreme poverty line rose by over 70 million − the largest one-year increase since global poverty monitoring began in 1990. In percentage terms, the world's poorest citizens lost twice as much income in that year compared to the wealthiest 20%, instead of the expected trend of income convergence by 0.8%. Between-country inequality widened by 4.4% in 2020 alone.[4]

While the data is yet to catch up to give us a full picture, the aftermath of the pandemic, is likely to have further increased inequality. Some countries, like those in East Asia, recovered faster than others, as consumption of manufactured goods skyrocketed. However, despite the sharp recoveries in many regions, most countries' income levels remain below their pre-COVID-19 trend. Using data from the IMF, we estimate that the growth gap for advanced economies, at -0.4%, is lower than the -5.8% gap seen in emerging markets.[5]

The pandemic and its aftermath therefore widened inequality between countries, after several critical decades of income convergence. Within-country inequality, which had worsened as the return to skills and strong growth favoured the upper segments of the income distribution in most regions, saw *less* of a worsening in inequality during the pandemic, largely due to robust policy responses. The World Bank's *Poverty and Shared Prosperity* report finds that the richest countries were able to deploy the largest emergency support, broadly pre-empting the rise in poverty. Upper middle-income economies spent less, offsetting only half of the poverty impact and lower middle-income economies only offset a quarter.[6] Where countries had access to significant fiscal or monetary policy space, because of low debt levels and low inflation, they then could provide larger buffers when hit by large economic shocks. The bigger the space, the bigger the buffer that can be deployed.[7] These instances, however, turned out to be fairly rare. Most economies faced the pandemic with little policy space. And so, while these policy responses were important to the recovery from the pandemic, especially in terms of jobs and incomes, their extended use – ultra-low interest rates and a massive increase in borrowing – also set off inflation and a persistent deterioration in incomes.

With macroeconomic policy fully extended, and supply shocks constricting goods and services, inflation was bound to rise. Global consumer price inflation averaged 8.7%

[4] See D Mahler, N Yonzan and C Lakner, 2022. In particular, the Indian economy suffered very large losses, which were not offset by China's relative stability in 2020. In any case, China is now too rich to be exclusively thought of as a poor economy. For more, see A Deaton, 'COVID-19 and global income inequality'. *NBER Working Paper 28392*, DOI 10.3386/w28392, February 2021. https://www.nber.org/papers/w28392
[5] Using the IMF's GDP forecasts from July 2024 relative to the forecasts published in the October 2019 *World Economic Outlook*.
[6] World Bank, *Poverty and Shared Prosperity 2022: Correcting Course,* Washington, DC: World Bank. doi:10.1596/978-1-4648-1893-6.
[7] See K Bergant and K Forbes, 'Policy packages and policy space: Lessons from COVID-19', *European Economic Review* 158, September 2023. https://doi.org/10.1016/j.euroecorev.2023.104499

in 2022 and emerging markets experienced higher rates of inflation than advanced economies.[8] Real wages fell by 1.4% during the peak of the surge in 2022.[9]

But inflation did not need to go up by as much as it did. Temporary fiscal and monetary measures were extended around the world in an effort to sustain recovery. Inflation was the unintended consequence and, in distributional terms, became the channel through which macroeconomic stimulus would be partly paid for.[10]

South African inequality and monetary policy in the wake of the pandemic

Turning to our experience here in South Africa, it is clear the country entered the pandemic in poor shape, with a decade of stagnant economic growth, declining real income per capita, and limited fiscal space.[11]

Distributional patterns were also clearly unbalanced, with about two-thirds of the total income earned accruing to just 10% of the people. While the middle 40% earn just under 30% of the income generated, the bottom 50% of the population earns just 5% of the total income. More than 40% of our labour force earns no wage-based income at all, and about half of all South African households are grant recipients. The proportion of households reporting salaries and wages as their main source of income has risen from about 50% in 2020 to nearly 55% in 2023, but remains below the 2010−18 average of about 60%. With a Gini coefficient of about 67, and about 60 after the adjustment for taxes and grants,[12] South Africa retains a high level of inequality, primarily caused by a lack of income rooted in joblessness.[13]

In such an environment, the appeal to low interest rates is not surprising. Lower interest rates, it is argued, would support job growth and distribute money from wealthier owners of capital to poorer, lower income households. But, as I will argue later on, low interest rates may not be the best response to addressing inequality, in part because interest rates have limited direct and indirect effects on the distribution of income.

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[8] At the peak of the inflation surge, prices accelerated by 9.8% in emerging markets versus 7.3% in advanced economies. Once outliers are adjusted for, the difference in inflation rates between emerging market commodity exporters (15.8%) and importers (15.3%) is less discernible.

[9] Median real wage growth for 42 economies in 2022. See International Labour Organization, *Global Wage Report, 2022-23*, April 2024.

[10] See B English, K Forbes and Á Ubide, *Monetary Policy Responses to the Post-Pandemic Inflation*, Centre for Economic Policy Research, 2024. https://cepr.org/publications/books-and-reports/monetary-policy-responses-post-pandemic-inflation

[11] The terms of trade were relatively good and inflation easing, but fiscal policy was already extended and debt was rising.

[12] See V Sulla, P Zikhali and P Cuevas, 'Inequality in Southern Africa: an assessment of the Southern African Customs Union'. Washington, D.C.: World Bank Group, 2022. http://documents.worldbank.org/curated/en/099125303072236903/P1649270c02a1f06b0a3ae02e57eadd7a82. South Africa nonetheless has a very progressive tax system and a grant payment system that supports 27.8 million people (or 48% of the total population). In fact, while the bottom 50% of South Africans earn 63 times less than the top 10% before taxes, this ratio falls to 24 times after income taxes are paid. The numbers also do not fully account for non-monetary support provided by the state, such as free basic education, water and electricity to low-income and indigent households.

[13] Here, income is measures after pension and unemployment payments and benefits received by individuals, but before other taxes paid and transfers received. Source: *World Inequality Report.*

As the pandemic spread in early 2020, the Monetary Policy Committee (MPC) lowered the policy rate to 3.5% − a multi-decade low. The cuts to achieve this were rapid and large.[14]

The credit extension record over the period up to the end of 2021 tells us something about how monetary policy transmits. The post-lockdown surge in secured lending was aimed primarily at big ticket items: by the end of 2021, credit agreements larger than R400 000 were up by about 28%, while smaller agreements − those for R20 000 or less − contracted by 17.5%. The biggest decrease in loans was observed for smaller amounts of R1 500 or less, which fell by 72%. In contrast, most lending − about 91% − was for the higher, top 25% of income households.[15]

Poorer households typically borrow for short periods of time, and usually at very high interest rates. Despite the much lower policy rate, loans to this group decreased. Secured, less risky loans for mortgages and vehicles are less than 2% of low-income household debt. Informal debt or micro-loans comprise 64% of their borrowing, but because this credit is typically very expensive and short term, it is also much less sensitive to the interest rate cycle.[16]

It is clear then, that the very large interest rate cuts during 2020 had a much smaller impact on alleviating the interest burden for lower income households, with much of the benefit accruing to higher income households.[17]

The pandemic experience also reminded us that monetary conditions can drive up inequality through asset price inflation. Not surprisingly, equity prices plunged in the first year of the pandemic. Their recovery came in stages. First, they took off when it became clear that vaccines worked and companies could borrow at ultra-low rates. They entered a second stage of stabilisation when inflation started to rise, in part because input cost inflation could now be passed on to consumers. Finally, they rocketed higher when the inflation spike appeared to be easing, in anticipation of easier monetary conditions.[18]

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[14] At one point, the MPC cut the repurchase rate by 2 percentage points within two weeks.
[15] These are individuals earning R15 000 or more. More detail is available in the National Credit Regulator's *Consumer Credit Market Report*, which is published quarterly: https://www.ncr.org.za/index.php/publications/consumer-credit-market-report-ccmr
[16] See K Singh and D Fowkes, 'Monetary policy and borrowing costs for different household income groups', *SARB Occasional Bulletin of Economic Notes OBEN20/01*, June 2020. https://www.resbank.co.za/content/dam/sarb/publications/occasional-bulletin-of-economic-notes/2020/10006/OBEN-2001--Monetary-policy-and-borrowing-costs-for-different-household-income-groups----June-2020.pdf
[17] It is worthwhile remembering that these higher income individuals are typically employed in the formal sector and generally have more scope to cut spending in other areas to pay higher interest rates than poorer households.
[18] Although bond prices are supposed to offset this effect, they have been acting unusual lately (thanks in part to the demand for shorter maturities). See https://www.wsj.com/finance/investing/the-bond-regime-change-that-is-whacking-stocks-in-six-charts-8bae3ffb?mod=article_inline

Very low interest rates and the rise of paper wealth help to explain headlines showing that, globally, more billionaires were created during 2020 than the sum of billionaires created in the two previous decades, with a billionaire created every 30 hours.[19]

Despite this attractive-looking rise in paper wealth, ultra-low interest rates typically end up undermining the short-run increase in growth that they cause. Such rates reduce saving and prop up low-productivity zombie firms − companies which are only viable with cheap debt. This, in turn, limits productivity growth and constrains more sustainable firms from expanding. The job creation effects of these misallocations of capital are far-reaching, not least because they imply an economy that will struggle to recover jobs lost during big shocks, like the pandemic.

In our case, nearly 2.3 million jobs were lost, many affecting lower-income households, and pushing many of the poorest households, of which only 45% have one or more employed member, deeper into poverty.[20] One in every four (or 250 000) domestic workers lost their jobs, alongside another half a million lower-skilled workers in other occupations.[21] Individuals whose highest level of education is less than Grade 12 (matric) or an equivalent accounted for more than 70% of the employment losses, despite representing only 45% of pre-pandemic employment.[22]

The post-pandemic labour market recovery has been slow.[23] The unemployment rate, while falling from the highs reached during the pandemic, is still 33.5%. The number of jobs lost during the pandemic have since been recovered, but the labour force grows all the time, meaning we need significantly more job creation.

Unfortunately, major supply-side constraints, such as insufficient electricity and logistical constraints, have limited how much economic activity we can muster. The result is that output growth has averaged just 0.3% on a quarterly basis since 2021. While firms have slowly added back employees to the workforce, weak productivity places a cap on how much additional labour can be added.

Monetary policy cannot do much in such conditions. In fact, the more we try to loosen policy and use money illusion to reduce real wages and stimulate employment growth,

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[19] See Oxfam International, 'Pandemic creates new billionaire every 30 hours − now a million people could fall into extreme poverty at same rate in 2022', 23 May 2022. https://www.oxfam.org/en/press-releases/pandemic-creates-new-billionaire-every-30-hours-now-million-people-could-fall

[20] According to the National Income Dynamics Study 2017, Wave 5, available at: http://www.nids.uct.ac.za/. According to the National Income Dynamics Study, or NIDS, 7 million people account for the richest 20% of households. These households tend to be relatively small (1.93 people per home) and almost 80% of these households have at least one employed member. The annual General Household Survey shows that most of these individuals are considered highly skilled and are employed in the formal sector, whose earnings are primarily from employment (rather than grants).

[21] Stats SA's Quarterly Labour Force Survey.

[22] Also see T Köhler et al., 'COVID-19 and the labour market: estimating the effects of South Africa's national lockdown', Development Policy Research Unit, School of Economics, University of Cape Town, February 2021.

[23] According to the Quarterly Labour Force Survey, employment levels only reached their pre-pandemic level in mid-2023, and the labour absorption rate (which measures the proportion of the working-age population that is employed) remains below pre-COVID levels. Although the firmed-based *Quarterly Employment Statistics* shows a more rapid improvement in employment levels, technical adjustments related to the recent re-benchmarking exercise by Stats SA suggest that the employment improvement is less robust.

the more we run into an inflation problem. This pushes up interest rates and squeezes sectors, firms, and jobs created in the loosening period. Ironically, it is when inflation rates are low that we see much accelerated productivity and jobs growth, as was the case in the early 2000s.

This brings me to the direct effects of inflation on households. Persistently high price inflation means that the overall consumer basket is about 26% higher than its pre-pandemic level. Some basic food items like rice, tomatoes, beans, eggs and toothpaste are as much as 70% more expensive. To put this into context, had prices for these staples continued to rise at our targeted 4.5% inflation rate, these prices would be more than 30% cheaper than they are today.[24]

Households across the country have had to reprioritise their spending, made more difficult for families on or near the food poverty line.[25] By May 2023, the food poverty line, which measures the food basket of a typical low-income household, had risen by 35% compared to its pre-pandemic level. The fastest rising single component of inflation in 2023 was food, which accounts for around 50% of low-income households' budgets, compared to 10% for higher income households. Higher income households spend far more on lower inflation services. This implies a change in relative prices with big effects on inequality.[26]

A final channel for inequality's rise in the wake of the inflation surge comes through wages and salary income. Statistics South Africa (Stats SA) data shows that between 2017 and 2022, the median monthly salary for high-skilled workers increased by about R1 000, while the increase was a more modest R500 for semi-skilled and unskilled labourers. But when you adjust for the inflation rates that would be typically faced by households in each income bracket, we find that real wages are either flat or negative.[27] For most people, the rise in inflation is a straight deduction from their purchasing power.[28]

Conclusion: post-pandemic lessons

Finally, let me conclude by drawing on some high-level lessons from the pandemic.

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[24] For the overall food and non-alcoholic prices category, prices would be 12% cheaper, and prices would be 3.2% cheaper for the overall headline CPI basket. According to our 4.5% target, prices should have increased by 21.9% between December 2019 and June 2024. Food prices have increased by 38%, while the headline basket has risen by 26%.

[25] See C Loewald and K Makrelov, 'The impact of inflation on the poor', *SARB Occasional Bulletin of Economic Notes, OBEN/20/01,* June 2020. https://www.resbank.co.za/content/dam/sarb/publications/occasional-bulletin-of-economic-notes/2020/10005/OBEN-2001--The-impact-of-inflation-on-the-poor----June-2020.pdf

[26] See D Gros and F Shamsfakhr, 'Inflation and Inequality', European Parliament, PE 747.845, May 2023. https://www.europarl.europa.eu/RegData/etudes/IDAN/2023/747845/IPOL_IDA(2023)747845_EN.pdf

[27] For skilled workers, who typically fall under expenditure deciles 9-10, real wages have fallen by about 10.7% between 2019 and 2022. For semi-skilled workers (expenditure deciles 5-8), real wages have fallen by 4.3%. For unskilled workers (expenditure deciles 1-4), real wages have risen by 1.5%. For this last group, deflating incomes with inflation experienced by deciles 1 and 2 incomes only yields -0.5% real wage growth. The income by skill level is based on the Quarterly Labour Force Survey. See Stats SA, 'Monthly earnings in South Africa 2017-2022', Report No. 02-11-20 (2017-2022), May 2024. https://www.statssa.gov.za/publications/02-11-20/02-11-202022.pdf.

[28] The solution here would not be to raise wages, which would undermine South Africa's competitiveness. Rather, lower inflation would help maintain competitiveness and support household budgets.

First, while we live in a world characterised by large economic shocks that need to be offset with policy, we need to be more aware of the long-term consequences of them. There is no question that the pandemic needed large fiscal and monetary responses, but where there is little policy space, policy must be agile to avoid problems that emerge. In the wake of the pandemic, globally, debt is now too high, inflation has been high and persistent, and these have had further negative effects on economic growth and inequality. Not being agile with policy has cost us dearly, as very modest global economic growth forecasts suggest.

If you do not build buffers before a crisis, you can deliver much less stimulus when the emergency arrives. The quality of stimulus is also more limited, because the benefits of policy support in a fragile macroeconomy are diluted by side-effects such as larger risk premiums and capital outflows. This means you need the discipline, in ordinary times, to strengthen your buffers, rather than doing everything you can get away with, and simply hoping nothing goes wrong. Something will go wrong. There are always crises.

Second, inflation, which until recently, the world had seen less of, is a very serious problem. Over the past decade, both inflation rates and interest rates were low in many major economies. In this period, many people, including central bankers, stopped worrying much about inflation. They worried about deflation; they worried about other interesting subjects separate to their core missions.[29] The post-pandemic surge in inflation came as a big surprise. But what we have learnt should be no surprise. People strongly dislike high inflation, and much prefer price stability.

As I have argued, inflation is especially damaging to incomes and worsens inequality. In 2022, inflation-related protests occurred across every region of the world.[30] The starkly negative effects of inflation tend to emerge suddenly, but as I have pointed out, the reality is that the effect of inflation on incomes, economic growth and inequality are not always obvious, nor direct. The channels through which it operates can be short and long term, with differential impacts across society. In South Africa's own experience, we have seen them playing themselves out through the composition of the consumption basket, through credit responses and interest rates, and via the real exchange rate, among others.

Third, macroeconomic policy responses to shocks need to be adjusted faster as unintended and long-term costs start to emerge. It should not have taken the global community two years to realise that a massive supply contraction, combined with sustained and even larger demand expansion through debt issuance, would be hugely inflationary and carry other negative economic and social costs. Part of the challenge

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[29] R Rajan, 'For central banks, less is more', *Finance and Development,* March 2023. https://www.imf.org/en/Publications/fandd/issues/2023/03/Central-Banks-less-is-more-raghuram-rajan

[30] See T Carothers and B Feldman, 'Economic anger dominated global protests in 2022'. Carnegie Endowment for International Peace. 8 December 2022. https://carnegieendowment.org/posts/2022/12/economic-anger-dominated-global-protests-in-2022?lang=en.

here is that we are wired to focus on the short term at the expense of the long term. We forget that keeping inflation low and stable supports growth in the medium to long run.

Nonetheless, there have been examples of better policy. Many emerging markets managed the post-pandemic inflation surge more effectively than others and returned to growth more rapidly. In South Africa, improved policy credibility and communication allowed for effective inflation management with smaller policy rate increases compared to what was required in other countries.[31]

Finally, central banks cannot be the only game in town. There is only so much that can be achieved with monetary policy. We cannot deliver all the social progress we all desire. We can create a base for it; we can help navigate the economy through crises; but not more. We are often encouraged to do more, but I think this fundamentally speaks to the limitations of our state capacity. Changing interest rates is certainly easier than improving education, managing urbanisation or ending load-shedding. Our inequality problem is really about chronic skill and geographical mismatches, and product market structures and labour market that are designed to protect insiders.[32] Tackling these issues will not be easy, but it is here where the real solutions lie, not with monetary policy.

What really matters for inequality is economic growth, job creation and productivity growth. These outcomes occur when markets function effectively, when the costs of economic activity are clear and stable, and when essential public services and network industries work to reduce the cost of economic activity. Inefficiencies or failures in these areas can be likened to a negative supply shock, similar to the pandemic restrictions, but slower-moving, more insidious, and more damaging.

In the wake of the pandemic, our homegrown supply constraints continue to drive up inflation. Our flexible inflation-targeting framework helps us to see through the temporary inflation effects, but not the permanent ones. The upshot is that if we want better growth and less inequality, significant improvements in our supply environment are necessary. This will create the space for monetary policy to play a more supportive, enabling and appropriate role in achieving economic progress.

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[31] See S Merrino, 'Wage inequality under inflation-targeting in South Africa', *SARB Working Paper Series No. WP/21/18*, 2 September 2021. https://www.resbank.co.za/en/home/publications/publication-detail-pages/working-papers/2021/WageinequalityunderinflationtargetinginSouthAfrica and K Miyajima, 'Monetary policy, inflation, and distributional impact: South Africa's case". *IMF Working Paper No. 2021/078*, 19 March 2021. https://www.imf.org/en/Publications/WP/Issues/2021/03/19/Monetary-Policy-Inflation-and-Distributional-Impact-South-Africas-Case-50282.

[32] See C Loewald, N Spearman and A Wörgötter, 'Less sacrifice: from collective to competitive price coordination in the South African economy', *SARB Working Paper Series No. WP/23/06*. https://www.resbank.co.za/en/home/publications/publication-detail-pages/working-papers/2023/less-sacrifice--from-collective-to-competitive-price-coordinatio
Also see N Viegi and V Dadam (2023). 'Investigating unemployment hysteresis in South Africa', *SARB Working Paper Series No. WP/23/04*, 11 December 2023. https://www.resbank.co.za/en/home/publications/publication-detail-pages/working-papers/2023/investigating-unemployment-hysteresis-in-south-africa

Fortunately, as demonstrated by our country's ability to tackle load-shedding, we can resolve complex problems with the right focus. I look forward to the same energy and intelligence being applied to our other major challenges.