

THE STABILITY OF PRICES, AND THE PRICE OF INSTABILITY[†]

1 Introduction

It is a widely held view amongst economists that monetary policy cannot drive sustained economic growth. As argued by Milton Friedman, a central bank cannot use its control over nominal quantities to influence real quantities in the long run (Friedman, 1968). Rather than focussing on growth, the role of monetary policy is to create a stable macroeconomic environment.

With this in mind, this essay seeks to evaluate the suitability of inflation targeting (IT) as a monetary policy regime in South Africa. In the section proceeding this one, the theoretical justifications for IT are discussed. I then turn to the more empirical question of whether IT has actually worked in South Africa and elsewhere. Some commentators have criticised IT for a perceived inability to adequately deal with asset bubbles, and for being tolerant of exchange rate volatility; in Section 4 I consider whether another monetary policy regime would be better suited to South Africa.

The general conclusion of the above analyses is that IT is the most suitable monetary policy for South Africa, although its current implementation is by no means perfect. Section 5 offers some policy recommendations to strengthen South Africa's IT regime.

2 The theory of inflation targeting

Successful monetary regimes tend to focus on stability of important macroeconomic variables such as inflation, the output gap and the exchange rate. It has long been known, however, that a country with open capital markets cannot have direct control over both inflation and the exchange rate; some choice must be made between the two.

2.1 The need for a nominal anchor

Accepting low inflation as a primary goal of monetary policy, central banks have typically relied on a nominal anchor to steer policy decisions. The central bank's pledge to keep a chosen nominal variable constant or within specified boundaries helps to:

- clarify the objective of the central bank's policy, both within the central bank and to the public,
- provide a publicly visible goal according to which the central bank can communicate any changes in policy and their rationales,

[†]Entry number: 113. Word count: 3837 (excluding references).

- focus public expectations with respect to the policy goal, and subsequently other variables as well.

2.2 Why worry about inflation?

A low and stable rate of inflation is accepted as a central goal of monetary policy¹ for a number of reasons:

Historically, high inflation has been associated with substantial volatility in inflation as well. This volatility causes uncertainty in price-level expectations, making long-term economic decision-making more difficult, depressing saving and investment (Freedman and Laxton, 2009). This uncertainty can also complicate labour negotiations, a problem with particular relevance to South Africa with its highly unionised labour market. Unions and firms will want to protect themselves on opposite sides of expected inflation, an antagonism that can lead to costly deadlocks and strikes.

In addition, high inflation distorts relative prices whenever firms' price changes are not synchronised. Relative prices will not reflect relative costs of production, distorting consumer choices and leading to welfare losses (Sørensen and Whitta-Jacobsen, 2005, chap. 20).

Inflation also disproportionately affects the poor. While individuals can hedge against inflation through the use of inflation-linked financial instruments, these instruments tend not to be available to the poor, who subsequently hold a large portion of their wealth in the form of inflation-exposed cash (Romer and Romer, 1998; Easterly and Fischer, 2001).

A final concern is the distortionary effect inflation has on unindexed accounting measures and taxes. Inflation causes returns to nominal assets to be overtaxed relative to real assets, and therefore distorts investment decisions (Sørensen and Whitta-Jacobsen, 2005, chap. 20).

2.3 What is inflation targeting?

Broadly speaking, IT involves taking the inflation rate as the nominal anchor. Since current policy decisions affect inflation with a lag, this policy is better described as 'inflation-forecast targeting': the central bank forecasts a path for inflation to be used as an intermediate target, and selects an instrument path to coincide with that target at some horizon (Svensson, 2000). Thus, an inflation-targeting central bank must have a forward-looking perspective in deciding upon current instrument-setting. To this end, the measure of inflation used in the target is usually core inflation - inflation in prices that are not often reset. Since these prices are necessarily set with future inflation in mind, core inflation is a better measure of inflation inertia and medium-term expectations (Krugman, 2010).

¹See, for example, Lucas (1973), Fischer and Modigliani (1978) and Fischer (1993).

As IT gained prominence in the world of monetary policy, so it evolved, and ‘true’ IT is now considered to require five main elements (Bernanke and Mishkin, 1997), as set out in Table 1.

South Africa adopted IT in 2000 after a period of unsuccessful monetary policy based largely on discretion rather than explicit targets (Aron and Muellbauer, 2007). The SARB’s policy instrument is the repo rate (the rate at which it repurchases government securities from commercial banks), which affects inflation through its effect on the demand for credit. Additional measures have been taken to align South Africa with the features of successful IT regimes - these measures are listed in Table 1 as well.

Characteristic	Corresponding SARB policy
Public announcement of medium-term inflation targets.	CPIX ² inflation target of 3-6% announced and often publicly reiterated.
Acknowledgement that low, stable inflation is the primary goal of monetary policy.	Often reaffirmed by the SARB (see, amongst others, SARB (2002) and Gordhan (2010)).
A strategy that takes into account many variables when setting policy instruments.	Flexible framework with a medium-term inflation target, and weight on output and interest rate volatility.
High levels of transparency through communication with the public regarding goals, plans and decisions of the monetary authority.	Extensive channels of communication set up between SARB and the public, including the Monetary Policy Forums, the <i>Monetary Policy Review</i> ³ and statements after each MPC meeting explaining any policy changes and their reasons.
Mechanisms that strengthen the monetary authority’s independence in and accountability for achieving its objectives.	Constitutional mandate to achieve target. Government sets target, but SARB has independence in setting the repo rate (instrument independence, but not goal independence).

Table 1: Elements of IT regimes, and corresponding SARB policies.

²Consumer price index excluding mortgage interest costs.

³The *Monetary Policy Review* includes a ‘fan chart’ detailing the SARB’s conditional probability forecast of the path of inflation.

It is important to distinguish between strict and flexible IT. Strict IT allows only inflation to enter the monetary authority's objective function, while flexible IT permits other variables such as output to have a nonzero weight in the objective function. At present, all inflation targeters exercise some degree of flexibility (Svensson, 2010), attempting to strike a balance between the application of inflexible policy rules and potentially undisciplined monetary discretion (de Jager, 2010). The SARB practises a fairly flexible regime in terms of its policy variables, made further flexible by its inflation target being a band rather than a point.

2.4 How inflation targeting works

Some countries have used IT to bring down and stabilise previously high and volatile inflation rates. In this role of guiding gradual disinflation, the nominal target provided by IT calms inflation expectations, which in turn helps to stabilise inflation.⁴ Of course, the success of IT in such cases depends crucially on concurrent policies that promote credibility through transparency and accountability.

Of more relevance to South Africa is whether an IT regime can successfully maintain long-term stability; how well does IT smooth the business cycle?

The success of IT's response to a shock in the economy depends fundamentally on the nature of that shock, specifically whether it comes from the demand or supply side of the economy. A negative demand shock depresses output while simultaneously causing a decrease in inflation. The correct interest rate response under an IT framework is to decrease rates, the effect of which is to increase inflation *and* output back towards desired levels, a result referred to by Blanchard and Galí (2007) as a 'divine coincidence'. A regime that places greater weight on inflation in its policy rule will enjoy greater stability in both inflation and output in the wake of a demand shock.

Supply shocks present a greater challenge to inflation targeters. A negative supply shock, such as a sharp increase in the oil price, increases prices while simultaneously decreasing output. A policy that responds simply to immediate changes in the inflation rate would raise interest rates, but this would put further strain on flagging output. This is where the concepts of core inflation, target horizons and flexible IT are important: if monetary authorities believe the supply shock is temporary, they might be inclined to keep interest rates constant (or even to decrease them) if their forecast of *medium-term* inflation is still around the inflation target. In this regard, credibility is vital.⁵ Furthermore, flexible inflation targeters do place weight on fluctuations in output and employment in addition to inflation;

⁴Brazil and Chile have enjoyed particular success in this regard (Mishkin, 2000).

⁵Indeed, as noted by Rigobon (2007), a key difference between credible and non-credible central banks is the extent to which they accommodate nominal shocks.

the medium-term nature of the inflation target gives monetary authorities time to concentrate on the stability of these variables as well.

The temporary ‘first-round’ effect of a supply shock can flow through into inflation expectations and wage- and price-setting, the so-called ‘second-round’ effects of the supply shock. Since these second-round effects do influence core inflation, an IT regime must respond to them. It is important therefore that these second-round effects be minimised to avoid ‘damned if you do, damned if you don’t’ monetary policy decisions. Vigorous communication with the public by a credible central bank, emphasising the temporary nature of the supply shock and the bank’s unchanged outlook for core inflation, can help to contain inflationary expectations and therefore second-round effects as well.

A concern with any low-inflation monetary policy is time-inconsistency (Kydland and Prescott, 1977) - if expected inflation is low, the marginal cost of extra inflation is low, incentivising authorities to pursue expansionary monetary policy. Public knowledge of this incentive means that inflation expectations won’t be low in the first place, causing the system to collapse (Romer, 1996, chap. 9). Mechanisms that increase central bank transparency, accountability and independence present a cure for this problem - this is why they are such an essential part of good IT regimes, and indeed that of the SARB.

3 Experiences of inflation targeting

IT, having arisen in the early 1990s, was initially adopted by industrialised countries like New Zealand, Canada and the United Kingdom. Later, a number of emerging economies also adopted IT. It is not an insignificant observation that no country that has adopted IT has subsequently discarded it⁶; this points to IT’s feasibility, practicality and durability as a monetary policy regime. Figure 1 highlights the increasing prominence of IT amongst worldwide monetary regimes.

3.1 Inflation targeting around the world

Relative to other monetary regimes, IT is a newcomer on the scene. As a result, empirical analyses of its success are necessarily tentative, with those for emerging economies even more so. Subject to this caveat, preliminary analyses have suggested that IT has been successful for both industrialised and emerging economies.

Studies focusing on industrialised countries have found almost universally that IT has been associated with improvements in macroeconomic perfor-

⁶As Rose (2007) points out, this is a rarity in the world of monetary policy, where regimes have historically not been durable.

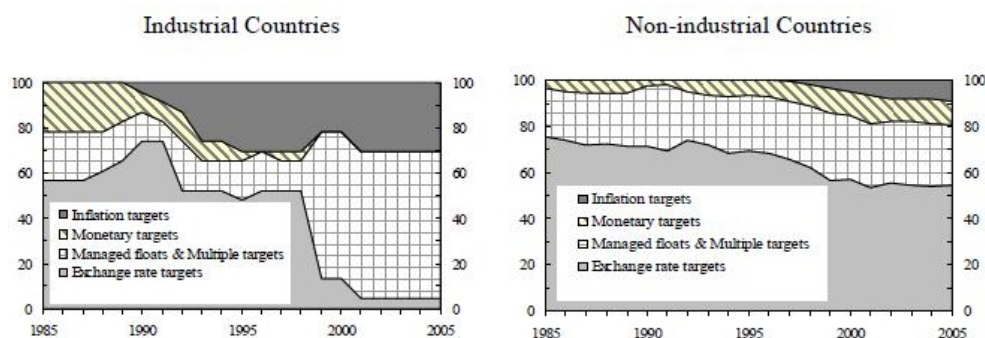


Figure 1: Evolution of the world composition of monetary policy regimes. Source: IMF (2006)

mance. While the post-1990 period was generally a successful one for most industrialised countries, with strong growth and a trend towards lower and more stable inflation rates, evidence suggests that inflation targeters enjoyed relatively more success than non-inflation-targeters (Hyvonen, 2004; Vega and Winkelried, 2005; Mishkin and Schmidt-Hebbel, 2007).

In a study involving 13 emerging market inflation targeters and 29 comparable emerging market non-targeters over the period 1990-2004, the IMF (2006) shows that, while countries in general improved macroeconomically over the sample period, inflation targeters saw even greater improvements than non-targeters in the level and volatility of: inflation, inflation expectations and output growth. These results are shown to be robust to a number of sensitivity tests, including removing countries that adopted IT with very high ($> 40\%$) inflation rates. This addresses Ball and Sheridan's (2005) objection that empirical analyses such as those cited above often simply reflect 'regression to the mean'.⁷

3.2 The South African inflation targeting experience

South Africa's experience under IT, apart from being relatively brief (2000-present), has also coincided with a number of external shocks. As a result, as with much empirical research around IT, definite conclusions are difficult to reach.

It might be instructive to consider whether stability in major economic variables has improved in South Africa under IT. Figure 2 plots headline inflation and the real output gap over the period 1990-present.

Inflation is observed to have decreased under IT, from a 1990-2000 average of 9.0% to a 2000-2010 average of 6.2%. Volatility in inflation and

⁷Ball and Sheridan (2005) point out that emerging countries that adopted IT often did so because they had problems with high and volatile inflation. They therefore had more room for improvement than other countries in the typical sample.

the output gap have also decreased under IT, though only negligibly. It is important to note that the 2000-2010 period saw a number of significant external shocks, including an exponential rise in the oil price. As a result, it is difficult to compare volatility over the two periods; longer sample periods would afford more robust observations.

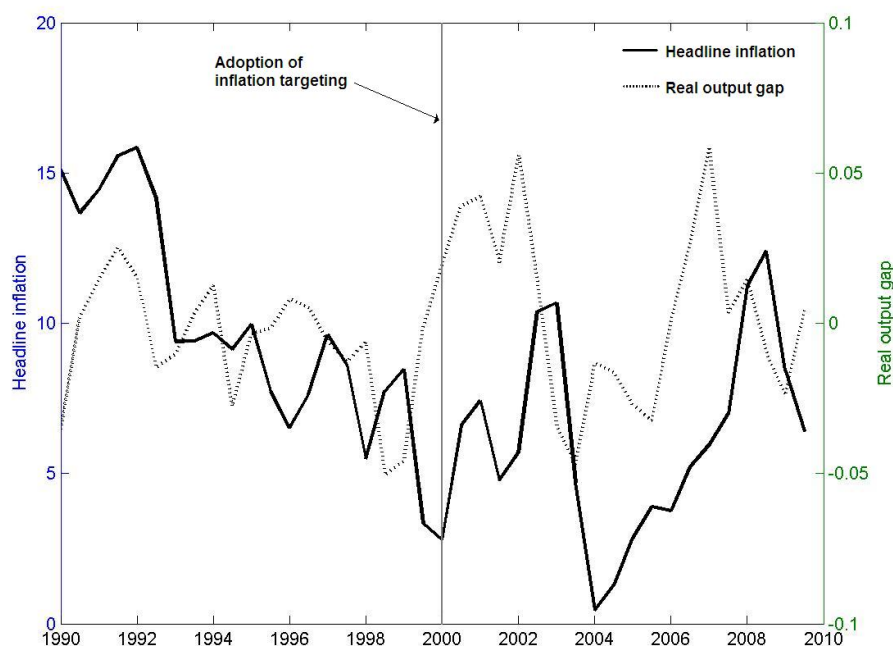


Figure 2: Evolution of headline inflation and the real output gap (scaled so that real GDP in 1990 = 1) over the period 1990-present. Source: author's calculations using data from SARB (2010).

Another measure of the success of IT is its ability to establish credibility in monetary authorities. Under IT, the SARB's transparency and accountability have improved immensely. As Aron and Muellbauer (2007) note, inflation expectations amongst trade unions, analysts and markets have converged under IT, importantly within the target band as well. Rigobon (2007) cites the sizeable decrease in exchange-rate pass-through for CPI and PPI under IT as strong evidence for the central bank's increased credibility. Aron and Muellbauer (2007) compare the steady handling of the 2001 exchange rate shock under IT, where the market was guided by the central bank's clear and well-communicated priorities, with the poor handling of the 1998 exchange rate shock under a less transparent monetary regime.

It is worth noting the positive feedback between IT and credibility: IT helps to improve the credibility of monetary authorities, which in turn helps the monetary authorities in running a successful IT regime. The improved credibility of the SARB therefore bodes well for future policy success.

4 Criticisms of, and alternatives to inflation targeting

4.1 Should we fix the exchange rate?

One of the major criticisms levelled at South Africa's IT regime is that it has little control over the exchange rate. A fluctuating exchange rate, or one that is persistently overvalued, can have negative repercussions for international trade and investment, and so, some say, the SARB should focus more on the exchange rate.

A point that should be made clear from the outset is that an IT regime does not ignore the exchange rate. Since a depreciation in the exchange rate tends to place upward pressure on inflation, while an appreciation has the opposite effect, a regime that is concerned (even solely) with inflation would respond to movements in the exchange rate.

In considering whether the central bank should intervene in the foreign exchange market to stabilise the currency, I first consider the extreme case of fixing the exchange rate, before considering whether policy should involve a more eclectic⁸ mix of goals.

The major attraction of fixed exchange rates is that they provide a simple nominal anchor while simultaneously reducing the currency risk component in domestic interest rates. The extensive worldwide experience of fixed exchange rate regimes has also highlighted their main weaknesses. A country that pegs its currency to another, but keeps capital markets open, has to align its interest rate with that of the anchor country to prevent arbitrage. As a result, it loses the ability to use monetary policy to react to domestic shocks, and in addition exposes itself to shocks in the anchor economy, often leading to output volatility.

The central bank must constantly be ready to buy or sell foreign reserves in the foreign exchange market at the predefined rate. The temptation of devaluing to stimulate demand is ever-present; if the central bank lacks credibility, speculation of an impending devaluation can force these foreign exchange interventions to be sizeable.

Increasingly mobile capital markets have made defending exchange rates in the face of speculation more and more expensive, causing fixed exchange rate regimes that were once stable in a world of less mobile capital markets to be inherently fragile nowadays (Eichengreen, 1994; Svensson, 1994). In an

⁸Proponents might say 'holistic'.

influential paper, Obstfeld and Rogoff (1995) emphatically proclaim that ‘it is folly to try to recapture the lost innocence of fixed exchange rates’. While the authors do point out that the expansion of world capital markets does not *technically* render fixed exchange rate regimes impossible⁹, they note that the costs of defending the currency, in terms of reserves and the complete subordination of other goals¹⁰, are so high as to make fixed exchange rates *practically* infeasible. This holds even more true for emerging economies, which generally suffer more instability.

The problems with pegged currencies apply equally to crawling pegs - exchange rate regimes where the currency is allowed to depreciate gradually along a predetermined (and precommunicated) path - since speculation around *unannounced* devaluations can (and does) occur.

The above analyses suggest that fixed exchange rates are only feasible in countries that have maintained them historically, and over time developed complementary institutions that have entrenched credibility in the monetary authorities. The level of credibility required to sustain a fixed exchange rate regime these days is much higher than that needed to target other goals like inflation, and it is difficult to see how a developing economy like South Africa could, if it were to adopt a fixed exchange rate regime, achieve such high levels of credibility so quickly as to prevent initial (likely crippling) speculative attacks, a doubt echoed by Jonsson (1999).

Furthermore, there is no obvious candidate for an anchor currency. South Africa’s economy is not highly integrated with any of the more stable economies of the world, and pegging the Rand to any of their currencies (or a basket thereof) would result in our suffering their (separate) economic shocks, while being unable to adequately address our own.

Target bands for the exchange rate seem like a comfortable middle ground - *prima facie* they reduce the opportunity for one-way bets against the central bank, while still ruling out extreme fluctuations in the exchange rate. In addition, other goals of monetary policy need not be completely subordinated. Indeed, a first pass suggests that a country could have target bands for both the exchange rate and inflation.

Historically, however, such exchange rate bands have merely postponed the problem - when a band’s boundary is reached, all the problems of a fixed exchange rate become relevant again. Furthermore, the dangers the economy would face if near the boundaries (more specifically, speculation that the exchange rate could move close to the boundaries) have the effect of

⁹The central bank needs at most enough reserves to ‘buy back’ the monetary *base* to defend against a speculative attack.

¹⁰To defend its currency against a major speculative attack, a country with a fixed exchange rate regime must generally spike interest rates, causing havoc in the banking system and plunging the economy into recession. The other option is to give in to the speculation and devalue. This damages credibility, increasing the probability of future speculative attacks.

destabilising the exchange rate in the middle of the band as well (Obstfeld and Rogoff, 1995). Indeed, virtually all of the countries that have tried to combine IT with exchange rate bands, including Chile, Israel, Poland and Hungary, have encountered conflicts between the two policy targets, usually resulting in a widening of the exchange rate band, and its eventual abandonment (Leiderman and Bufman, 2000; Morande and Schmidt-Hebbel, 2000). In any case, South Africa's ability to manoeuvre the exchange rate is severely limited by its relatively small level of foreign reserves (Akinboade et al., 2003).

Flexible exchange rates therefore represent the only sustainable option for South African policy.

4.2 Should we target asset prices?

The recent financial crisis has raised questions around the extent to which monetary policy should react to movements in asset prices¹¹, with IT being accused of being particularly inept in dealing with asset bubbles.

Firstly, it must be noted that IT does already respond to asset price movements insofar as they signal changes in expected inflation. Since asset prices, aggregate demand and inflation expectations tend to move in the same direction, interest rate responses under an IT framework will induce the correct stabilisation response with respect to each in the face of asset price instability. Moreover, because asset price shocks fall primarily on the demand side of the economy, standard neoclassical business cycle theory suggests that IT is a particularly good policy to play this countercyclical role (Sørensen and Whitta-Jacobsen, 2005, chap. 20). Price stability and financial stability can be highly complementary objectives; IT provides a unified framework to address both. Furthermore, public knowledge that a credible central bank systematically addresses asset price movements countercyclically under an IT framework can help to reduce the 'irrational exuberance' that leads to bubbles in the first place.

Of course, critics of IT are not ignorant of the above argument, and they contend that monetary authorities should provide responses to asset price movements over and above those dealing with inflationary expectations. In other words, central banks should *target* asset prices to some degree. The difficulty with such a strategy is that in reality it is nearly impossible to know whether a movement in asset prices is the result of fundamental factors or nonfundamental factors.¹² As Mishkin (2007) notes, to assume

¹¹Here I do not consider exchange rates, which, although technically asset prices, have been considered in the previous subsection. 'Asset prices' in this section refers primarily to prices reflected in stock markets and the like.

¹²Or indeed, both. If it were not already difficult enough to distinguish between fundamental and nonfundamental movements, it would surely be impossible to accurately quantify the two if asset price movements were a result of both. A correctly tailored re-

that monetary authorities can distinguish between fundamental and non-fundamental movements is to assume that they have better information and predictive ability than the private sector. This is not to deny the existence or damaging effects of asset price bubbles - the point is that, without an informational advantage over private markets, monetary authorities would be as likely to mispredict the presence or absence of a bubble as private markets, and as a result would frequently be mistaken. A unified strategy of IT allows the central bank to respond to asset booms and busts without getting into the murky business of deciding what is fundamental and what is not (Bernanke and Gertler, 2000).

Finally, the charge that IT is particularly inept at dealing with asset price bubbles implicitly suggests that other regimes would be more successful in this regard. This is by no means clear. The most obvious alternative, exchange rate targeting, would almost certainly be less successful in dealing with asset price shocks, since defence of the exchange rate would require interest rate movements that are *perverse* to the objective of containing a financial crisis. For example, the large interest rate spikes required to defend against speculation of devaluation during a currency crisis would *exacerbate* financial crises by depressing asset prices, putting pressure on banks, and slowing the rate of economic activity. Indeed, as Bernanke and Gertler (2001) point out, fixed exchange rate regimes have a notorious record of numerous and severe financial crises.

To be clear, it is not my contention that policy in general should not concern itself with asset prices, only that the role of *monetary* policy in this regard should limit itself to the inflationary repercussions of asset price movements. Monetary policy alone cannot protect the economy from the ravages of boom and bust cycles.¹³ Solid countercyclical fiscal policy, designed to help instill public confidence in economic fundamentals, should be practised hand-in-hand with IT to mitigate the severity of business cycle fluctuations resulting from asset price instability. In addition, prudent regulation that limits the risk exposure of banks and corporations, in particular by discouraging excessive leverage, has been shown by the recent crisis to be vital (The Economist, 2010).

sponse under an asset-price-targeting framework would then be impossible. Furthermore, credibility would be difficult to maintain in the face of such hit-or-miss decisions - the central bank is likely to be made to look foolish by trying to predict and control prices that are inherently unpredictable (Mishkin, 2007).

¹³Even if rising prices in, say, the housing market are deemed to be unsustainable, there are much more effective instruments to deflate the perceived bubble than monetary policy, including regulation of loan-to-value ratios and minimum mortgages (Svensson, 2010).

5 Policy recommendations

South Africa's IT regime, as monetary regimes go, is still in its infancy, and there is substantial room for improvement. This section presents some recommendations for strengthening the Reserve Bank's IT regime.

5.1 Transparency

Although substantial improvements in monetary policy transparency have been achieved under IT, the SARB still falls short of Svensson's (1997) optimal policy. Currently, the SARB's intermediate target is not observable from its fan charts without knowledge of its forecasting models; opening these models to public scrutiny would be a step towards greater transparency, accountability and credibility (du Plessis, 2005).

5.2 The inflation target

The SARB has been given a medium-term target band of 3-6%. The reason given for the target being a band rather than a point is that it allows the SARB more flexibility (van der Merwe, 2004; Gordhan, 2010). However, it is certainly not a necessary condition for the Reserve Bank to exercise flexible IT - the 'flexible' part comes from the relative weights the central bank places on variables other than inflation, and the horizon given for achievement of the target. In any case, as argued by du Plessis (2003), the upper end of the band has 'hardened'. Moving to a point target somewhere in the upper end of the band¹⁴ would help clarify the Reserve Bank's mandate, anchor expectations with greater success and lead to enhanced credibility in monetary authorities.

5.3 Price and wage setting

The most glaring problem with respect to price-setting is government's constant inability to set administered prices in line with inflation targets, with the Eskom price hikes being a recent example. Since administered prices account for almost a quarter of CPI, this places huge pressure on the SARB, and has accounted for many of the unsatisfactory inflation outcomes suffered in the past few years (du Plessis, 2005).

In addition, while most countries that adopt IT do so along with labour market reforms, South Africa's labour market rigidity continues to prevent fluid transmission of wage and price signals through the economy. Indeed, the South African labour market has become even less flexible since the adoption of IT, and wage agreements well in excess of growth in labour productivity are commonplace.

¹⁴A point target can still be allowed a certain tolerance level. Indeed, this is the form of IT practised by most inflation targeters - a point target is chosen, and an accepted level of short-term deviation from that target is specified.

Fedderke et al. (2007) also find significant price mark-ups in South African industry relative to other countries, suggesting a lack of competition. Improved enforcement of competition policy, as well as greater trade-openness, could help to reduce this pricing power, resulting in lower prices and some weight off the back of the SARB.

5.4 Indexed tax systems

Indexing capital gains, so that they are correctly deflated before being taxed, will prevent the distortions of investment decisions mentioned in Section 2.2.

5.5 Summary of suggested reforms

In a similar format to du Plessis (2005), I present a summary of my policy recommendations, along with a (subjective) measure of their priority (1 = highest, 5 = lowest) and cost¹⁵ (1 = lowest, 5 = highest), and an indication of the relevant authority that would be required to lead each reform.

Reform	Priority	Cost	Responsible institution(s)
Set administered prices in line with inflationary expec.	1	4	National Treasury Department of Public Works
Liberalise labour markets	1	5	Parliament
Publish forecasting model	2	2	SARB
Promote competition in industry	3	2	Dpt of Trade & Industry Competition Commission
Change target from band to a point	3	3	National Treasury
Index capital gains tax	4	2	National Treasury

Table 2: Summary of recommendations for strengthening the Reserve Bank's IT regime, along with a suggested priority and a predicted cost for each, and the responsible authority for carrying out the reform.

¹⁵Taking into account risk, resource and political capital costs.

6 Conclusions

In this essay I have argued that IT, though not cost-free, is the best policy to ensure macroeconomic stability in South Africa. Though a relatively new monetary policy regime, IT has worked well in both industrialised and emerging economies, and preliminary observations in South Africa suggest that it has improved the SARB's credibility, laying a good foundation for greater stability in the future.

A fixed exchange rate is not a viable alternative; it would be impossible for the SARB to build up the credibility required to ward off initial devastating speculative attacks, and the cost of further defending against such attacks in the modern world of highly mobile capital markets would negate any benefits such a regime might possibly bring. South Africa does not presently have enough foreign reserves to exert any significant control over the exchange rate, and such intervention would in any case be suboptimal.

I have also argued that monetary policy should respond to asset price movements only insofar as they signal changes in inflationary expectations. It is silly to think that monetary authorities could identify non-fundamental movements in asset prices better than private markets could, and in any case there are better instruments to deal with such movements than those available to monetary policy.

Acknowledging that the SARB's current implementation of IT is not perfect, some reforms were suggested, focussing on increased transparency, more regular price-setting and indexation of the tax system.

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