## Views and Comments on recent monetary policy issues in South Africa

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7 August 2007

## Outline

1. Reflections on the MPC statements in 2007
2. Highlights of the March 2007 Quarterly Bulletin (SARB)
3. Implications for Monetary Policy

## Reflections on the MPC statements in 2007

### February 2007

- Improved outlook on inflation with CPIX expected to peak at 5.6% in 2007
- Strong consumer demand sustained by asset price growth
- Rising meat prices expected to be main contributor to food price inflation
- Robust credit extension growth to corporate sector increased to 31.8% (from 27,6%)
- Credit extension to private sector declined to 24.3% (from 26.1%)

MPC statement – April 2007

- Deteriorated outlook on CPIX inflation despite the observed reduction from 5.6% to 5.3%
- Food price hikes expected despite the observed decline in meat price inflation from 16% to 13.9%; meat prices highest contributor
- Also: clothing, footwear and furniture prices declined during Feb 2007
- Adverse development in "administered prices"

- Continuous growth in private sector credit extension:

1. Growth in twelve month bank loans rose to 27.7% (from 27.0%)
2. Asset backed credit growth, leasing finance and total number of household loans declined
3. Ratio of household debt to disposable income rose to 74% with a steady increase in the cost of financing

Comment

- BER SUN survey of inflation expectations
- Expectations conditioned on what information set?
- CPIX forecasts based on what?

MPC statement – June 2007

- CPIX inflation breached the 6% upper target limit fueled by strong increases in food and petrol prices
  - excluding food and energy, CPIX inflation would have been 4,6%
  - Petrol prices increased in a year on year basis from 7.9% (March) to 15.5% (April)
- Strong upward trend in prices broadly (cost push)
  - not mainly demand driven; also price of services

- Prices of household consumables (school fees, insurance premia, parking fees?) increased
- Clothing, footwear and furniture prices, recreation, entertainment continued downward trend
  - Evidence that consumers already adjusted principally?
- Rise in producer price inflation to 11.1% (from 9.5% in March) highest since Dec 2002
  - Again this pressure on CPIX inflation does not appear 2b consumer-driven?

- Private sector credit extension grew from 26.2% (March) to 27.4% (April)
- Mortgage advances, leasing finance and installment sales increased (real growth or nominal growth)
- Corporate sector credit extension accounted for strongest increase in banking lending
  - The increased cost of borrowing pushes product prices (non tradable goods even higher)
  - What % advances finance cpix basket items?

## CPIX forecasts by MPC (2007/2008)

| Feb 2007 | April 2007 | June 2007 |
|---|---|---|
| peak at 5,6% in 2007 | Below the upper level in 2007 | marginally exceed 6% target level |
| Average at 4.7% in 2008 | Average at 5.1% in 2008 | Peak at 6.3% in 2008 |

### Actual CPIX developments in 2007

| Feb - April | April - June |
|---|---|
| Declined to 5.2% | CPIX hike to 6.3% |

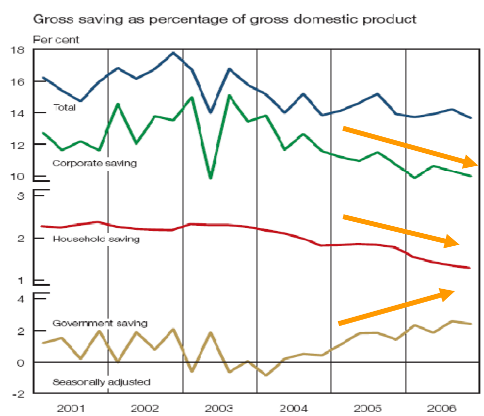
Statement of the MPC

## Part II
## Highlights of the March 2007 Quarterly Bulletin (SARB)

## Domestic expenditure

- Real consumption expenditure by households:
  - Growth in real expenditure on semi-durable goods declined
  - Real Expenditure on non-durables increased
  - Slow growth on food, beverages & tobacco as well as household consumer goods
  - Strong growth in spending on household fuel & power, medical & pharmaceutical products as well as petroleum products

- Real disposable income of households grew at a slower rate
  - Ratio household debt to household disposable income increased from 73% to 73.75%
- Developments in Gross Savings as % of GDP
- zero sum game – see graph




## Employment

- Public sector employment gains marginally outperformed the gains in the private sector
- Non-agricultural employment rose by approx 528 000 jobs
- Employment in the manufacturing sector fell slightly since 3rd quarter of 2006
  - Electricity generating sector suffered most substantial loss in employment opportunities

## Prices

- CPIX inflation accelerated considerably since mid 2006
- Petrol and food price hikes are the main catalysts for this development (see table below
  - Unfavorable weather patterns (drought) pushed up the maize price
- Production price inflation more than doubled since 2006

Inflation in CPIX components
Percentage change over one year

| | Weights | 2005 | 2006 |
|---|---|---|---|
| Transport running cost | 5,7 | 14,1 | 12,8 |
| Alcoholic beverages and tobacco | 3,1 | 8,1 | 8,0 |
| Food and soft drinks | 26,9 | 2,2 | 6,6 |
| *Services excluding housing and transport* | 16,5 | 6,2 | *4,5* |
| *Housing services* | 13,4 | 5,9 | *3,6* |
| *Other goods (not included elsewhere)* | 17,5 | 3,0 | 3,5 |
| Transport services | 3,9 | 1,9 | 2,8 |
| Furniture and equipment | 3,2 | -0,5 | -1,5 |
| Vehicles | 5,7 | -1,2 | -0,7 |
| Clothing and footwear | 4,1 | -3,4 | -7,3 |
| *Total CPIX* | 100,0 | 3,9 | *4,7* |

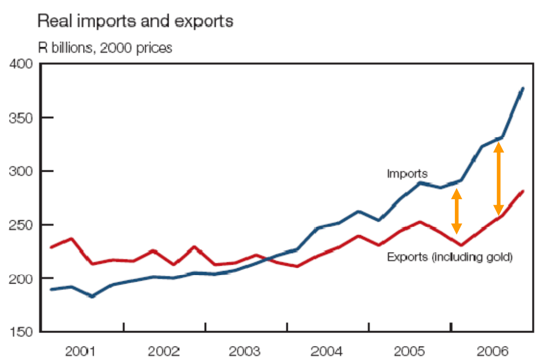
Italics denote values inside the inflation target range of between 3 and 6 per cent in 2006

## Comment

- “Other goods” carry second highest weight of the total CPIX with a significant contribution to the inflation hike
- not clear what those goods are
- Whose interests do they represent?

## Foreign Trade

- Strong demand for imported goods has continued since 2006 and deteriorated the current account
- Crude oil imports caused a 100% growth in the volume of imports from 7% (excluding) to 14% (including)
- CA deficit financed but terms of trade deteriorated slightly since 2006




## Implications for monetary policy

Most salient question given the current development :

Which components of borrowing are more sensitive to interest rates and how much do these components feed into the inflation that the Reserve Bank is trying to fight?

## The Missing Money and Non-inflationary Taxes

Definition of non-inflationary taxes ("nonift"):

The change in the cost of borrowing solely attributable to the monetary authority's response (by raising or lowering the rediscount rate) to anticipated changes in inflation.

In a competitive environment the amount of 'nonift' that banks can pass onto their customers versus absorb is an indication of relative market power.

In South Africa banks seem to able to pass on the full cost of "nonift"

Ultimately banks are left with uncollected money which boosts their lending capacity and thus undermines the SARB's monetary policy objectives

Consequence: banks earn higher profits which are passed on to investors in the form of dividends (windfall gains)

Investors' consumption profile is permanently raised via windfall gains thus fuelling inflation

Within the SA context where the distribution of investors is skewed towards the rich, "nonift" also becomes a regressive tax

Consequence: the poor carry the burden of inflation and are likely to be drawn into a debt spiral.

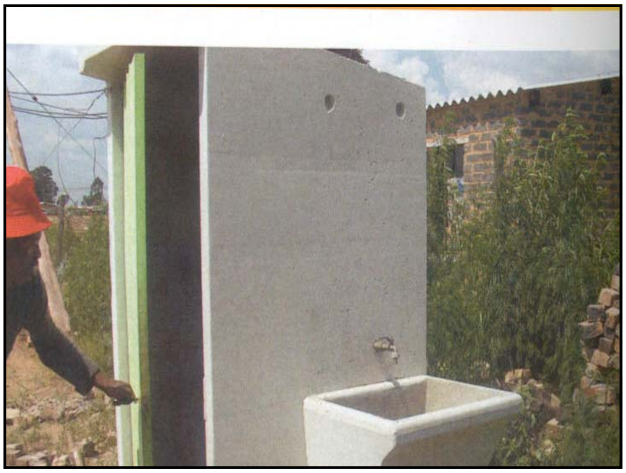
## Implication

The social welfare effect induced by "nonift" must be weighed against a reduction in aggregate credit growth

The uncollected money when collected can be ploughed back in the form of R&D on climate and agric research, alternative energy research, mass transit systems, other supply side mgmt issues (Sci & Tech); the missing link in the inflation fight

## Saving in South Africa

- The fault dear Brutus is not in our stars but in ourselves…
- the one thing that will utterly destroy the new capitalism is the serious practice of deferred gratification….Daniel Bell, "The cultural contradictions of capitalism"



## Saving & direct investment

- We save too little/ not enough
- What are the different ways of measuring **savings** in developing countries?
- How do institutions influence saving?
- What are other factors that affect saving?
- What are the factors that influence **savings**?

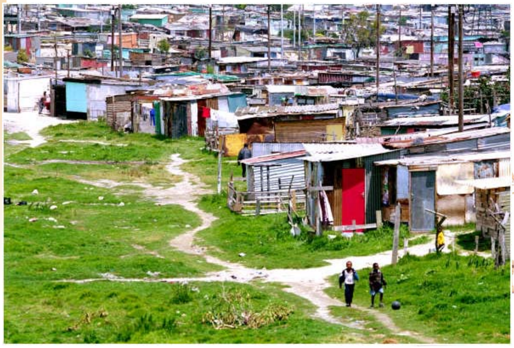
- Definitional problems can be gleaned from use of variables
- Dependency ratio
- Investment in education is consumption
- Yet it builds human capital
- Intergenerational considerations in saving/bequeath motive

## Basics on saving

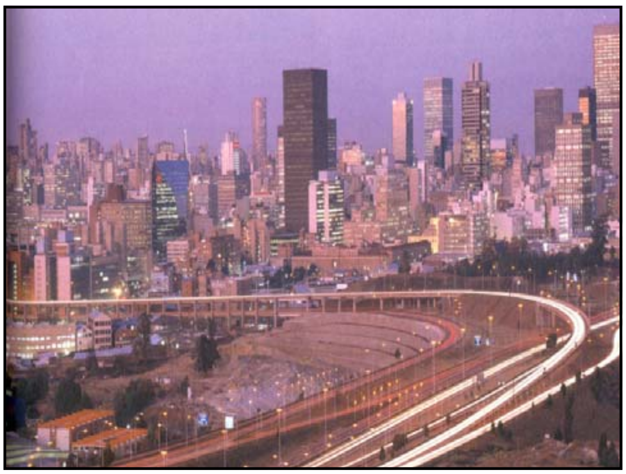
- Saving does not depend on income
- Savings depends on income
- Self control as a lens on why we spend too much save too little, borrow too much on costly credit
- Others include impatience, emotion, context

- Homo economicus and homo psychologicus
- Role of economic structures and processes
- Preference formation: material acquisitions and satisfactions are prioritized: Affluenza

Infrastructure Backlog



By Prof Melvin Ayogu



- In a world in which goods = language thru which identities are crafted, displayed, and understood
- Then, wants & constraints may symbolize aspirations for freedom from the power relationships that oppress in daily chores including gender, race, class, sexuality

- Moments of binge sustain and rehearse such hopes of liberation, regardless of its unrealism
- So, the tendency in the mainstream literature to locate self-control problems in cognition overlooks the extent to which they are framed, elaborated and sustained …contemporary consumer culture

- Contributions to Economic Analysis and Policy 4(1), 2005 by Stephen Wu
- Cross country evidence show that those who believe that they have little freedom over their lives are also less likely to save.
- The results hold after controlling for number of demographics and behavioral factors; across income and wealth levels
- Definition: Fatalism: how people perceive the effects of past and current actions on future outcomes.