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Media release

**Reserve Bank will do its part to ensure competitive advantage**

Agribusinesses can rest assured that the South African Reserve Bank is committed to containing inflation.

"This will preserve our competitive advantage for exporting, secure our investment costs and create the foundation for expansion," said Lesetja Kganyago, Reserve Bank governor, at the Agbiz congress.

Kganyago explained the Bank's rational with regard to inflation. He said that inflation targeting is globally regarded as best practice in monetary policy, because it is transparent while also recognising that there is no long-run, or even medium-run, trade-off between inflation and growth.

"Instead, in the long run, price stability is a precondition for significant sustainable growth. This is also true of financial stability, which has been added to the mandate of the Bank in the aftermath of the global financial crisis.

"Inflation targeting is a framework that helps to create the conditions for a stable and investment-friendly business environment. Volatile or higher inflation outcomes increase business costs in several ways. They can push employees into demanding above-inflation wage increases, which pressure business margins. More variable inflation also increases uncertainty about the costs of business operations that can delay investment decisions. In the end, investors require higher returns for increased uncertainty, which means elevated long-term real interest rates," Kganyago said.

**Negative impact**

He added that higher inflation could have a negative impact on competitiveness. If inflation in South Africa is above that of its trading partners or export rivals, the production costs of local exports will be relatively higher. As a result South Africa will be less competitive in global markets.

This can be corrected by rand depreciation, but the rand is especially volatile and, furthermore, domestic inflation can easily erode these gains.

“Inflation targeting addresses these problems by guiding policymakers in their response to temporary supply shocks when they may permanently accelerate inflation. Is also ensures that demand-side inflation is controlled.”

**Generic advantages**

Kganyago explained that these advantages are generic and that although they apply to everyone, are particularly suited to the structure of the South African economy.

“The recent increase in the unemployment rate is a reminder of the large number of people locked out of the real economy. Fundamentally, inflation targeting is a policy framework that protects vulnerable groups in society, such as the unemployed, the poor and the elderly – basically those with a fixed or no income. Higher headline inflation affects these groups most severely as they are not able to negotiate income increases equal to inflation, nor are they able to access financial markets to acquire assets to protect themselves against inflation,” Kganyago explained.

He pointed out that the South African economy is characterised by strong pricing rigidities and resilient barriers to entry in many industries. Because of the high concentration of the economy, as well as the shortage of skilled employees, “insiders” (price and wage setters) are in a position to mark prices and wages in line with their expectations. When these price and wage setters expect higher inflation in the future, their actions make the expectations self-fulfilling, inflation duly rises and the risk of a wage-price spiral increases.

**An external anchor**

"Inflation targeting, once credible, has the capacity to break this cycle as it provides an external anchor for the insider. They focus instead on the Bank’s inflation forecast and its communication and on how and when it will achieve the inflation target. This then protects those groups that do not have the same market power as price and wage setters, such as the unemployed, non-unionised employees and small firms.

“Greater certainty and lower inflation rates remove a significant constraint that these groups face in accessing the real economy. Of course, this is only the case as long as the Bank can convince price and wage setters of its commitment to the inflation target range. The Bank keeps their inflation expectations anchored," concluded Kganyago.

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