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CZECH NATIONAL BANK

In this issue

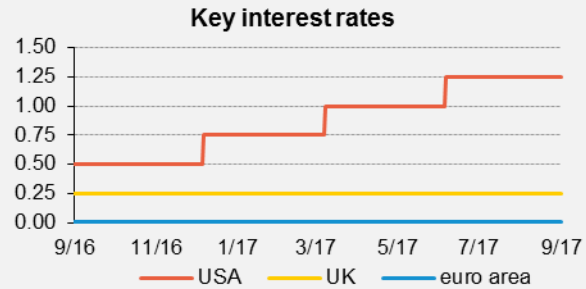
Most of the central banks under review, including the ECB, are keeping their interest rates at low levels and continuing their unconventional monetary policy programmes. The two exceptions which have already raised interest rates are to be found in North America. The first is the US Fed, which as expected raised its key rate for the second time this year and announced a more exact procedure for reducing its balance sheet. The second is the Bank of Canada, which has also increased its rates twice. With the exception of Switzerland, inflation is above 1% in all the monitored economies, but is still slightly below the inflation target in most cases. Spotlight *focuses this time on the problems of the South African economy and the situation of its central bank. In our* Selected speech*, ECB Executive Board Member Yves Mersch analyses the challenges and opportunities to central banks arising from the current rapid technological development.*

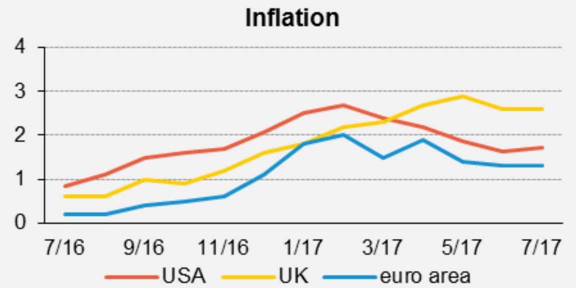
1. LATEST MONETARY POLICY DEVELOPMENTS AT SELECTED CENTRAL BANKS

Key central banks of the Euro-Atlantic area

	Euro area (ECB)	USA (Fed)	United Kingdom (BoE)
Inflation target	< 2%[1]	2%[2]	2%
MP meetings (rate changes)	20 Jul (0.00) 7 Sep (0.00)	13–14 Jun (0.25) 25–26 Jul (0.00)	15 Jun (0.00) 3 Aug (0.00)
Current basic rate	0.00%; -0.40%[3]	1.00–1.25%	0.25%
Latest inflation	1.5% (Aug 2017)[4]	1.7% (Jul 2017)	2.6% (Jul 2017)
Expected MP meetings	26 Oct 14 Dec	19–20 Sep 31 Oct–1 Nov	14 Sep 2 Nov
Other expected events	26 Oct publication of ECB staff projections	18 Oct: publication of Beige Book, Feb 2018: publication of Monetary Policy Report	2 Nov: publication of Inflation Report
Expected rate movements[6]	→	↑	→

[1] ECB definition of price stability "below but close to 2%"; [2] January 2012 definition of inflation target; [3] deposit rate; [4] flash estimate; [5] meeting associated with summary of FOMC economic forecasts and press conference given by FOMC Chairman; [6] direction of expected change in rates in next three months taken from Consensus Forecasts.





The **ECB** kept its key interest rates unchanged and confirmed its monthly asset purchase programme (APP) at EUR 60 billion. The APP will run until the end of December 2017, or beyond, if necessary. An increase in purchases is not entirely ruled out, but is not expected in the current conditions. The ECB also confirmed that it expects interest rates to remain at their present low levels well past the horizon of the APP. The ECB's current forecast for 2017 was increased slightly, foreseeing GDP growth of 2.2%. For 2018, it remains unchanged at 1.8%. The inflation forecast for this year stayed at 1.5% and that for 2018 was reduced further to 1.2%, mainly reflecting the recent appreciation of the euro.

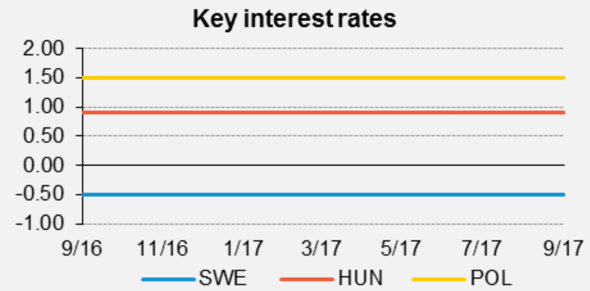
In June, the **Fed** raised its key interest rate for the second time this year – by 0.25 pp to 1.00%–1.25%. No further changes were made to rates in July. The median of the FOMC members' projections (from the June meeting) expects the key monetary policy rate to reach 1.4% this year, which may suggest one more interest rate hike in the rest of this year. Economic activity has been rising and the labour market has continued to strengthen. Inflation will remain somewhat below 2% in the short term but stabilise around 2% in the medium term. The Fed announced a strategy for reducing its balance sheet, but has yet to decide to launch it (see *News* for details).

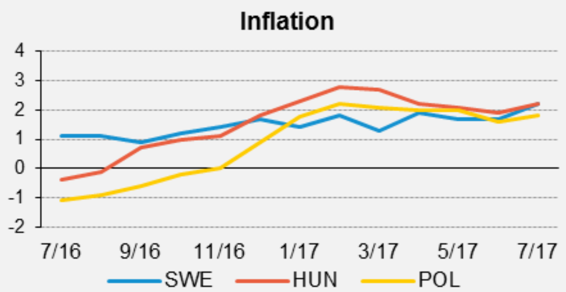
The **BoE** left its key interest rate at 0.25%. It also maintained the stock of government and corporate bond purchases at GBP 435 billion and GBP 10 billion respectively. However, two of the six MPC members voted to increase the rate by 0.25 pp. Inflation remains above the inflation target, reaching 2.6% in July. As in the previous forecast, the BoE expects inflation to rise further to 3% in October, owing mainly to the pass-through of the previous depreciation of sterling to consumer prices. In June, the BoE increased its countercyclical capital buffer rate from 0% to 0.5% (see *News* for details).

Selected central banks of inflation-targeting EU countries

	Sweden (Riksbank)	Hungary (MNB)	Poland (NBP)
Inflation target	2%	3%	2.5%
MP meetings (rate changes)	3 Jul (0.00) 7 Sep (0.00)	20 Jun (0.00) 18 Jul (0.00) 22 Aug (0.00)	4–5 Jul (0.00) 5–6 Sep (0.00)
Current basic rate	-0.50%; -1.25%[2]	0.9%; -0.05%[2]	1.50%
Latest inflation	2.2% (Jul 2017)	2.1% (Jul 2017)	1.8% (Jul 2017)
Expected MP meetings	25 Oct 19 Dec	19 Sep 24 Oct 21 Nov	3–4 Oct 7–8 Nov 4–5 Dec
Other expected events	26 Oct: publication of Monetary Policy Report	19 Sep: publication of Inflation Report	13 Nov: publication of Inflation Report
Expected rate movements[1]	→	→	→

[1] Direction of expected change in rates in next three months taken from Consensus Forecast survey; [2] deposit rate.





The **Riksbank** left its policy rate at -0.5% in both July and September and does not expect it to rise until the middle of 2018. Government bond purchases will continue during the second half of 2017 as decided in April (an increase in purchases of SEK 15 billion). Inflation has risen in recent months and reached 2.2% in July. GDP growth accelerated unexpectedly to 4% in Q2, mainly due to fixed investment and inventories. In its September forecast, the Riksbank increased its CPI inflation outlook for 2017 from 1.6% to 1.8% and its CPIF inflation outlook from 1.8% to 2.0%. With effect from September, CPIF inflation will be the target variable (see *News* for details). The Riksbank raised its GDP growth forecast for this year from 2.2% to 3.2% in July and expects 2.7% for next year.

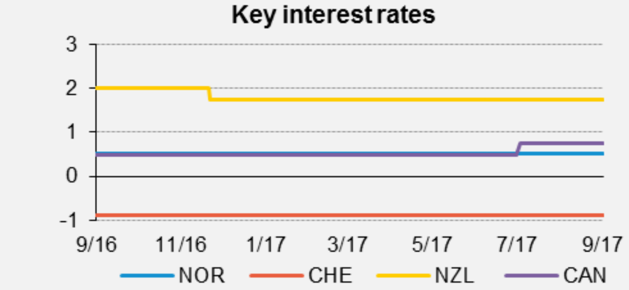
The **MNB** maintained its base rate at 0.9%, its deposit rate at -0.05% and its overnight lending rate on collateralised loans to banks at 0.9%. According to preliminary estimates, the Hungarian economy again grew at a solid pace of 3.2% in Q2 (4.1% in Q1), thanks mainly to services and industry. Growth in employment and the minimum wage is leading to a general, dynamic rise in whole economy wages. However, this has yet to translate into prices. The programme to support SMEs is continuing. Banks have raised their lending commitment by one-third, and growth in SME funding of 5%–10% is expected.

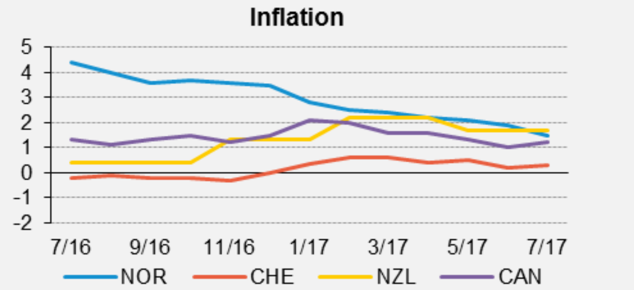
The **NBP** left its interest rate unchanged at 1.5% in both July and September. Annual economic growth again reached almost 4% in Q2, driven primarily by consumer demand supported by wage growth, consumer optimism and investment growth. Inflation reached 1.8% in July, but core inflation is still low. According to the NBP's July forecast, the economy will grow by 4% in 2017 and 3.5% in 2018. The NBP expects inflation of 1.9% in 2017 and 2% in 2018, i.e. below the inflation target.

Other selected inflation-targeting countries

	Norway (NB)	Switzerland (SNB)	New Zealand (RBNZ)	Canada (BoC)
Inflation target	2.5%	0–2%	2%	2%
MP meetings (rate changes)	22 Jun (0.00)	15 Jun (0.00)	22 Jun (0.00) 10 Aug (0.00)	12 Jul (+0.25) 6 Sep (+0.25)
Current basic rate	0.50% -0.50 reserve rate[1]	from -1.25 to -0.25%[2]; -0.75%[3]	1.75%	1.00%
Latest inflation	1.5% (Jul 2017)	0.5% (Aug 2017)	1.7% (2017 Q2)	1.2% (Jul 2017)
Expected MP meetings	21 Sep 26 Oct	14 Sep	28 Sep 9 Nov	25 Oct 6 Dec
Other expected events	21 Sep: publication of Monetary Policy Report	20 Sep: publication of Monetary Policy Report	9 Nov: publication of Monetary Policy Statement	25 Oct: publication of Monetary Policy Report
Expected rate movements[4]	→	→	→	→

[1] Only on reserves exceeding the quota; [2] chart displays centre of band; [3] negative sight deposit rate on banks' account balances held at the SNB, graded according to balance amounts; [4] direction of expected change in rates in next three months taken from Consensus Forecasts or, in the case of New Zealand, from RBNZ survey.





The **NB** left its interest rate at 0.50% at its June meeting and expects it to be stable during 2018 and rise gradually in 2019. Economic growth in 2017 will probably be slightly higher than the bank had expected, while inflation will be slightly lower. House price inflation has slowed in recent months, but the risks associated with the property market and household debt persist. The Ministry of Finance, acting on advice from the NB, kept the countercyclical capital buffer rate for banks unchanged at 2%, effective 31 December 2017.

At its June meeting, the **SNB** left the target range for its monetary policy rate (3M LIBOR) at between -1.25% and -0.25%. The rate on banks' account balances with the SNB also remained unchanged at -0.75%. The SNB is still communicating its willingness to intervene in the foreign exchange market as necessary and its long-standing view that the Swiss franc is overvalued. The SNB's GDP growth forecast for this year is unchanged at 1.5%. The bank anticipates inflation of 0.3% this year. For 2018, it slightly lowered its forecast from 0.4% to 0.3%, and for 2019 it expects 1.0%. The countercyclical capital buffer rate is set at 2%.

The **RBNZ** left its official rate at 1.75% in June and August. According to the RBNZ, monetary policy will remain accommodative for a considerable period. GDP growth in 2017 Q1 was lower than it had expected, but the growth outlook remains positive, supported by accommodative monetary policy, strong population growth and a fiscal stimulus. Inflation stood at 1.7% in Q2. It is expected to decline temporarily in 2018. House price inflation is moderate, partly reflecting previous LTV ratio restrictions by the RBNZ and related tighter lending conditions.

The **BoC** raised its key interest rate by 0.25 pp to 0.75% in July and again to 1.00% in September. The unexpected September hike was due to much faster GDP growth than expected (4.5% in Q2, as against expectations of just 3.7%). Inflation fell to 1.2% in July, but the BoC considers this decline to be temporary and expects a return to the 2% target by the middle of 2018. Measures of core inflation are in the range of 1.3%–1.7%. The bank projects the output gap to close at the end of 2017, i.e. earlier than anticipated in the April forecast.

2. NEWS

Riksbank switches to new target variable and introduces variation band

At its September meeting, the Riksbank decided as expected to switch to targeting inflation as measured by the CPIF, i.e. the consumer price index with a fixed interest rate on mortgages. This replaced the previous targeting of CPI inflation. The bank also introduced a variation band of ±1 pp around the inflation target (see the June CBM for an explanation of these changes). The changes do not entail any change to the Riksbank's monetary policy.

Randal Quarles nominated to Fed Board of Governors

President Trump nominated Randall Quarles to one of the three vacant seats on the Board of Governors of the Federal Reserve System for a full term (i.e. expiring in 2032), and to be Vice Chairman for Supervision for four years. This function was created by Congress after the financial crisis but has not yet been officially filled; the banking supervision function was covered by Daniel Tarullo, who resigned this April (see the March CBM). Quarles served at the Treasury in the George W. Bush administration and is currently managing director of private investment firm The Cynosure Group. In the past he has criticised some US banking regulations. His nomination has to be approved by the Senate.

The nominees for the two other open seats on the Board of Governors are widely understood to be Marvin Goodfriend, an economist, and Bob Jones, a banker. The President will also have to decide on two more replacements soon, as Vice Chair Stanley Fischer, whose term was due to expire in June, suddenly resigned in early September, effective in mid-October, and the term of Chair Janet Yellen expires in April.

Fed unveils balance sheet cuts

At its June meeting the FOMC raised interest rates and gave a first clear outline of its plan to reduce its portfolio (see the June CBM for more about the Fed's balance sheet cuts). It approved an Addendum to its September 2014 normalisation principles and plans specifying monthly caps on the amount of bonds that will not be reinvested after maturing. However, the Addendum does not say when the normalisation process will start (in its statement, the FOMC only states that it expects to begin the normalisation this year). For Treasury securities, the cap will be USD 6 billion per month initially and will increase in steps of USD 6 billion every three months over one year until it reaches USD 30 billion. For MBS, it will be USD 4 billion per month initially and will increase in steps of USD 4 billion every three months over one year until it reaches USD 20 billion. The caps will remain in place once they reach their respective maximums until the FOMC decides that the Fed's balance sheet is adequately reduced.

Fed reacts to suggestions of inflation target change

A group of prominent economists (Joseph Stiglitz, David Blanchflower, Narayana Kocherlakota, and Brad DeLong, among others) in June sent an open letter to the Fed questioning the current level of the inflation target (they themselves suggest a higher target, hence the informal name of this group: "Fed Up"). They suggest that the Fed should appoint a "blue ribbon commission" to revise the central bank's inflation target and other monetary policy parameters. Fed Chair Janet Yellen commented on the letter during a press conference and said that setting the inflation target is one of Fed's most critical decisions and the Fed will certainly be reconsidering it at some future time.

Jackson Hole 2017 symposium focuses on supporting global economy

This year's August economic policy symposium of central bankers, policymakers, academics and economists in Wyoming discussed the theme of fostering a dynamic global economy. The speeches, papers and remarks related, among other things, to long-term sustainability and the effects of international trade on income inequality. The symposium began, as usual, with opening remarks given by Fed Chair Janet Yellen. The other participants included ECB President Mario Draghi, IMF Economic Counsellor Maurice Obstfeld and numerous academics, for example Carmen M. Reinhart from Harvard University, Chang-Tai Hsieh from University of Chicago and Alan J. Auerbach from University of California-Berkeley.

The speeches of the heads of the two most important world central banks had been eagerly anticipated, but both avoided the topic of monetary policy. Janet Yellen's opening remarks focused on financial stability issues and the importance of post-crisis financial regulations. She mentioned that the Fed regularly evaluates the regulatory framework and its effect on economic conditions in order to adjust it if needed, but that any adjustments should be modest and preserve the resilience of the financial system. She did not talk about the reduction of the Fed's balance sheet. Mario Draghi in his remarks emphasised the importance of open markets and the significance of open trade, investment and financial flows in the diffusion of new technologies and productivity growth, but pointed out the importance of regulation of cross-border financial flows and regulatory convergence across countries.

BoE increases UK countercyclical capital buffer rate

The Bank of England increased the UK countercyclical capital buffer (CCyB) rate from 0% to 0.5%, with binding effect from June 2018. This step had been preceded by a reduction of the CCyB rate from 0.5% to 0% last year following the EU referendum to allow banks to draw on their substantial capital and liquidity buffers as necessary in order to cushion shocks. The June increase therefore returns the CCyB rate to its original level, and according to remarks made by Governor Carney it confirms that domestic risks are now back at their standard levels. The FPC also announced that it expects to increase the rate to 1% at its November meeting.

Changes to Norwegian central bank act proposed

An advisory commission of the Norwegian Ministry of Finance, appointed in 2015, this June submitted its final report and proposal for a new Norwegian central bank (NB) act. The commission was chaired by former NB governor Svein Gjedrem. It suggests the following changes: (i) the current eight-member Executive Board appointed by the government should be replaced by an independent five-member committee for monetary policy and financial stability, (ii) the management of the Government Pension Fund Global (GPFG) should be entrusted to a separate statutory entity demerged from NB, (iii) Norway's finance ministry should gain new powers to oversee NB, and the legislation should be amended to give NB a more precise mandate (to "maintain monetary stability" and also promote "the stability of the financial system and an efficient and secure payment system"), (iv) NB should be given the power to decide when to use macroprudential tools; for example it should get responsibility for setting banks' countercyclical capital buffer. The report is currently in consultations and, according to a statement, NB will participate in the consultation round.

3. SPOTLIGHT: SOUTH AFRICA AND ITS PROBLEMS

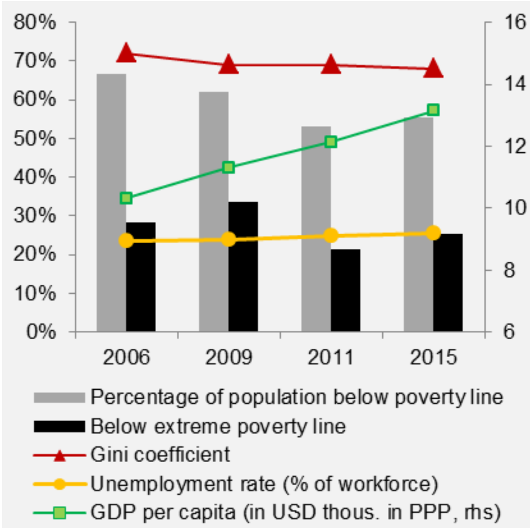
South Africa is one of the leading African nations in terms of stability of institutions and industrial development. However, it is still grappling with the legacy of apartheid in the form of vast social differences which persist more than 20 years after the regime was abolished. The country is therefore implementing reforms to kickstart economic growth and to reduce widespread poverty and unemployment.

The first part of this article addresses the economic situation in South Africa and the problem areas that are hindering growth there. The second part summarises the history and functioning of the South African Reserve Bank (SARB), including its failure to communicate the switch to inflation targeting, which is still affecting the public perception and credibility of the SARB.

South Africa and the legacy of apartheid

South Africa is one of the 30 largest economies in the world in terms of GDP (PPP) and, as the second-largest economy in Africa (behind Nigeria), generates around 25% of the GDP of Sub-Saharan Africa. It has rich deposits of non-renewable resources, most notably gold, platinum, diamonds, coal and iron ore. These commodities account for around 60% of its exports. On the other hand, it lacks oil, which makes up the largest part of its imports (16%). Exports and imports both represent about 30% of GDP in South Africa. The country's major export partners are the states of Sub-Saharan Africa (around 28% of exports), the EU (23%), China (9%) and the USA (8%). China is the largest importer to South Africa (almost 20% of imports). Other pluses include a developed infrastructure, an advanced manufacturing sector and a well-functioning banking sector and financial markets. In 2011, South Africa joined the group of major emerging economies (Brazil, Russia, India and China), thus changing the name of the group to BRICS.

South Africa is still dealing with the legacy of apartheid,[1] especially in the social inequality area. Compared with other African nations, it has relatively high and rising GDP per capita, but faces high rates of poverty and unemployment and has one of the highest levels of income inequality in the world as measured by the Gini coefficient.[2]



Source: Stats SA, EIU

In the years following the introduction of democracy in 1994, the government focused on stabilising public finances, reducing inflation and attracting foreign capital. GDP growth (which fluctuated around 3% and rose to almost 6% in 2004), coupled with solid macroeconomic

[1] South Africa introduced an official policy of racial segregation in 1948, and only mounting international pressure in the 1980s forced it to relax it. The regime was abolished in 1989 and the first general elections in which all ethnic groups were allowed to vote were held in 1994. The elections were won by the African National Congress (ANC), which remains in power to this day, and the ANC president and anti-apartheid revolutionary Nelson Mandela became the nation's president. South Africa's current president, ANC president Jacob Zuma, was elected in 2009. The upcoming presidential elections (2019) are currently a source of heightened political tensions in the country and have resulted, among other things, in a temporary 8% depreciation of the currency and a downgrading of the country's rating.

[2] GDP per capita in South Africa exceeded USD 13,000 in PPP in 2016, while the average for the Sub-Saharan African countries is less than USD 4,000 and the average for Africa as a whole is only just over USD 5,000. According to the national definition, 56% of South Africans live below the poverty line, with 64% of Black Africans and 1% of whites lying under this threshold, while 25% of the population live below the extreme poverty line. The unemployment rate in South Africa was 27.7% in 2017 Q1 (up 5 pp compared to 2008), and as high as 54.4% in the 15–24 age category. The Gini coefficient, which takes values of between zero and 100% (with 100% indicating the greatest inequality), was 68% in 2015, having decreased from 72% in 2006 (Poverty Trends in South Africa, Statistics South Africa, 2017).

policy, helped to combat poverty. However, following the global economic crisis in 2008 and the slump in commodity prices in 2011–2012, GDP growth gradually slowed to 1.3% in 2015 and just 0.3% in 2016. The South African economy fell into technical recession in early 2017 after recording two consecutive quarters of falling GDP.[3]

How to restart economic growth and reduce poverty?

Today, South Africa is facing the challenge of implementing structural reforms to restart economic growth and reduce poverty and social inequality. With presidential elections looming in 2019, the government is putting an increasing emphasis on reforms to reduce inequality. However, previous legislative efforts to introduce equality in the areas of mining and quarrying and land ownership, for example, have increased uncertainty and reduced investment.[4] Another major reform is the planned introduction of a nationwide minimum wage in May 2018. However, the current large grey economy is giving rise to concerns about how effective the minimum wage will be and whether it will instead lead to a fall in official employment and a firm-driven shift of more employees into the grey economy, where they will stay on low wages.

Another barrier to boosting growth in South Africa is the high proportion of state-owned firms in key areas such as electricity generation, telecommunications and transport. Barriers to the entry of private firms into these sectors are resulting in weak competition, low efficiency and economic problems in state-owned firms (subsidised from the state budget) and widespread corruption. At the end of 2016, the government adopted a new proposal on governance and remuneration in these firms as one step towards eradicating corruption. Corruption should also be reduced by an electronic public procurement system introduced in April 2016.

Insufficient access to credit for low-income households and SMEs is another drag on eliminating economic inequality and boosting economic growth. In order to increase financial inclusion, the central bank granted three new banking licences to retail banks last year.

The independent central bank and its monetary policy

The South African Reserve Bank (SARB) was founded in 1921. Its powers and functions are governed by the South African Reserve Bank Act of 1989 and its primary objective is enacted in the Constitution of 1996, which, among other things, provides for the central bank's independence and autonomy. The primary objective of the SARB is to achieve and maintain price stability in the interest of balanced and sustainable economic growth in the country.[5] The bank can use any instruments of monetary policy to achieve this goal. This implies that it has operational independence. The inflation target is set by the government (after consultation with the SARB). The bank also promotes stability of the financial system in the country, supervises banks, issues banknotes and coins, ensures the effective functioning of the national payment system and performs other usual central bank functions.

The South African banking sector as a whole is in good condition, is well capitalised and, thanks to its conservative approach (lending only to low-risk and wealthy firms and charging high fees for financial services), is profitable. It is also relatively closed – the three new banking licences mentioned above were the first to be granted by the central bank in 11 years. Nonetheless, as banking services spread among the less well-off, the SARB must safeguard

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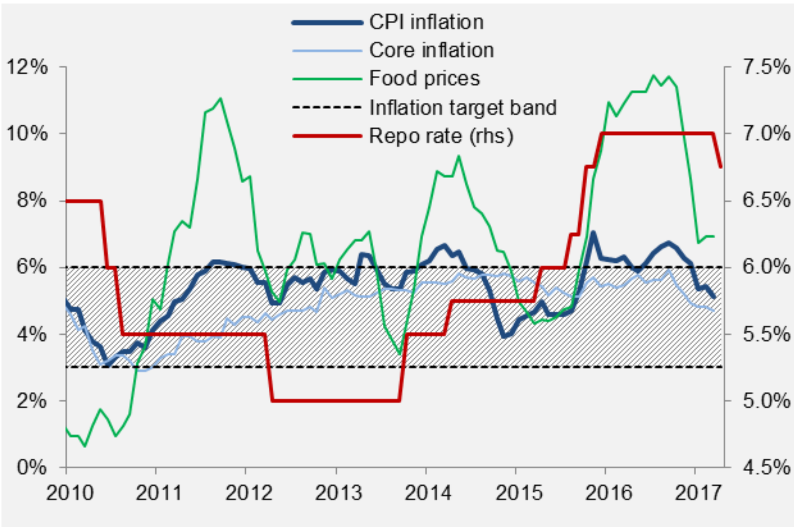
[3] Annualised quarterly GDP growth amounted to -0.3% in 2016 Q4 and -0.6% in 2017 Q1. GDP recorded slight growth (of 2.5%) in 2017 Q2.
[4] These include a draft Land Expropriation Act and a draft Mining Charter introducing race ratios in favour of the black population and a draft Mineral and Petroleum Resources Development Act enabling the state to gain shares in new private companies in this area. However, the draft laws have led to a fall in investment activity in these sectors.
[5] South Africa's ombudsman unexpectedly challenged the SARB's mandate in June 2017, recommending that parliament change the Constitution and the SARB focus on the socio-economic well-being of the citizens rather than pursuing stability of the currency and keeping inflation under control. Her report was strongly opposed not only by SARB representatives, who emphasised the importance of inflation targeting, but also by some politicians. The SARB requested a judicial review of the proposal and the court overturned the ombudsman's recommendation in August.

financial stability and bring about a reduction in the excessive debt of some households. To increase financial stability, the government in August adopted a major reform of the regulatory principles applying to the South African financial sector.[6] The central bank is currently working on a new macroprudential framework containing, for example, the implementation of a countercyclical capital buffer.

Since its establishment, the SARB has always had private shareholders and is one of just a few privately owned central banks.[7] At the Annual General Meeting, the governor provides the shareholders with information on the bank's financial results in the Annual Report, which also contains a section on monetary policy. The bank is headed by a Board of Directors consisting of 15 directors, led by the governor. The governor, three deputy governors and four other directors are appointed by South African president after consultation with the minister of finance. The remaining seven directors are elected by the SARB's shareholders.

Since February 2000, inflation targeting has been the SARB's monetary policy regime.[8] The inflation target is set as a band of 3%–6%. Inflation expressed by the CPIX (i.e. the consumer price index adjusted for mortgage interest payments) was initially the target variable, but the CPI has been used since 2009. The SARB's main monetary policy instrument is the seven-day repo rate.

The introduction of inflation targeting in South Africa led to a decrease in average inflation, which had been fluctuating around 9% in the 1990s. After the switch to the new regime, inflation dropped to 6% in 2001–2009[9] and fell further to 5.3% in 2010–2016. The exchange rate also became less volatile and GDP growth went up.



Source: SARB

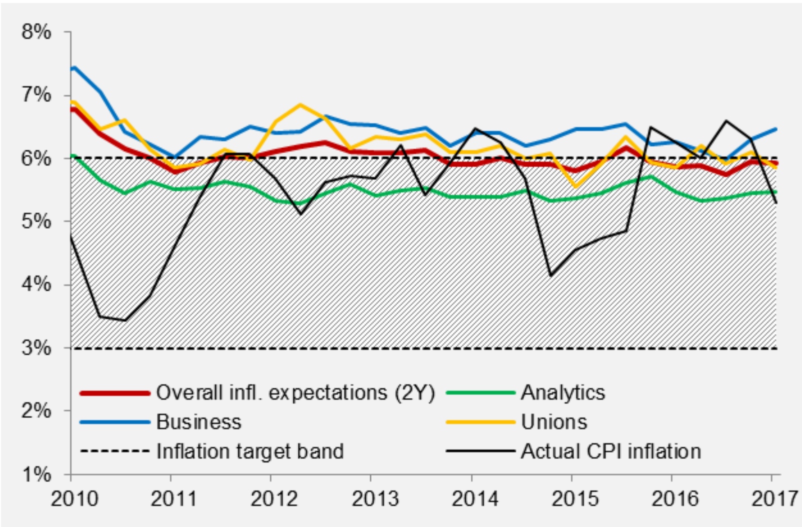
CPI inflation has long been close to the upper boundary of the target band, while core inflation (i.e. inflation adjusted for prices of food, energy and fuels) has long been within the target band. In 2016, inflation exceeded the upper boundary of the band, due mainly to the impacts of a drought a year earlier on food prices (which rose by 10.5% on average in 2016). The SARB increased its key monetary policy rate in several steps by 0.75 pp to 7% at the start of 2016. It left it at this level until July 2017, when it lowered it to 6.75% due to falling inflation. Inflation has been going down since early 2017. It returned into the target band in April and dropped further to 4.6% in July. The inflation outlook is also low due to slow economic growth.

[6] Financial Sector Regulation Act.
[7] The SARB's shares are fixed in number (at 2 million) and are divided among around 650 shareholders. Shareholding is limited only in terms of the number of shares per shareholder. The bank's owners may thus include foreign entities. Political efforts are being made to transfer the SARB to state ownership. If the December conference of the ANC approves this plan, the party is likely to amend the SARB Act next year in parliament. However, any change in ownership should not affect the SARB's independence.
[8] After it was established, the SARB worked successively with the gold standard and pegs to other currencies (GBP, USD) and a basket of currencies. In the 1980s it switched to a free float and monetary aggregate targeting. In 1996, it started to monitor multiple indicators when formulating monetary policy, and in 2000 it adopted inflation targeting.
[9] Although inflation surged above the upper boundary of the target range in 2002–2003 and 2006–2008, these fluctuations were caused by exogenous shocks in the form of major changes in the exchange rate and global growth in oil and food prices.

The Monetary Policy Committee (MPC), which is chaired by the governor, decides on the SARB's monetary policy stance at meetings held six times a year. A detailed explanation of the decision taken by the MPC is published after the meeting and announced at a press conference. The SARB publishes a Monetary Policy Review (MPR) twice a year. This Review is aimed at explaining monetary policy, describing the factors that affect the forecast and forecasting key variables. The central bank presents it at Monetary Policy Forums held in the relevant months in all the provinces of South Africa. At the end of each quarter, the bank also publishes a Quarterly Bulletin in which it describes current economic developments. These publication and communication activities reflect the SARB's efforts to raise awareness of monetary policy among shareholders, business representatives, trade unions and the general public.

A communication skeleton in the closet

The SARB's current intensive communication work seems to be an effort to make up for the failed communication of the switch to inflation targeting. According to the SARB's former governor,[10] this switch lacked sufficient explanation of the new monetary policy regime to experts and the general public, who did not sufficiently embrace the importance of keeping inflation in check. The SARB did not adequately explain the benefits of low inflation and did not defend the fact that flexible inflation targeting is not inimical to growth. As a result, the public shows distrust in, and resistance to, the regime at times of interest rate increases, especially if the country is tackling high unemployment, poverty and low growth. The bank must thus repeatedly defend its reasons for keeping inflation under control, as has been apparent this year (see footnote 4). On the other hand, the public still has excessive expectations about how much the central bank can do as regards structural reforms and employment.



Source: BER, SARB

According to one study (Kabundi, Schaling and Some, 2015), the insufficient explanation of the inflation targeting regime has probably also affected inflation expectations.[11] They remain close to the upper boundary of the inflation target. Of the three groups of respondents, it is usually only the expectations of analysts, who react to the SARB's monetary policy and forecast, that are within the target band. The inflation expectations of business people and trade unions, i.e. price setters, are above the upper boundary of the target band because these groups probably prefer to take into account past inflation, including short-term volatility, and do not see the SARB's monetary policy as credible. The authors of the study thus recommend that the SARB improve its transparency when formulating monetary policy, better explain the inflation pressures it identifies and signal its responses to such pressures more clearly.

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[10] SARB conference "Fourteen years of inflation targeting in South Africa", 2014, opening speech, Gill Marcus. Markus was SARB Governor in 2009–2014, so inflation targeting was adopted during her term of office.

[11] The overall inflation expectations used by the SARB are summarised from the findings of the Bureau for Economic Research for three categories of the population: analysts, business people and trade union representatives. The uncertain anchoring of expectations and its causes are analysed, for example, by A. Kabundi, Schaling, E. and Some, M., Monetary policy and heterogeneous inflation expectations in South Africa, SARB 2015.

Conclusion

The South African Reserve Bank is moving about in tougher terrain than is usual for central banks in advanced countries. On the one hand, it must set the monetary policy parameters so as to maintain monetary stability to the best of its knowledge and using the instruments at its disposal. On the other hand, it is still in a situation where it must explain to experts and the general public the importance of keeping inflation in check and the principles of the functioning of the inflation targeting regime. At the same time, it must explain the central bank's powers and options for supporting economic growth, implementing structural reforms and reducing unemployment. In other words, it has to explain that its options are more than limited in these areas. If the general public does not understand the central bank's role in society, the SARB will not have sufficient credibility, and without credibility its monetary policy instruments will ultimately be only partially effective.

4. SELECTED SPEECH: CENTRAL BANKING IN TIMES OF TECHNOLOGICAL PROGRESS

The challenges and opportunities to central banks arising from rapid technological development were outlined by Yves Mersch, Member of the ECB's Executive Board, in his speech at the Central Bank of Malaysia Monetary Policy Conference in Kuala Lumpur in July 2017.

Mersch sees a perennial challenge for monetary policy in the impact of technological progress on productivity growth, which affects the rate of return on investment and hence the level of equilibrium interest rates. Other challenges stem from the impact of new technologies on pricing. Complications can arise already when measuring inflation. The short shelf-life of some articles and discounting of older editions can create downward bias in price indices. Pricing online services can also be problematic. Some services do not even have a monetary charge and customers pay via providing data. The speed at which prices change and e-shops' ability to tailor individual prices further complicate the compilation of price indices. On the other hand, web-scraping technology simplifies price monitoring.

Technological changes to price-setting behaviour also have much broader relevance for central banks. The speed and extent that inflation reacts to shocks affects the optimal monetary policy response. E-commerce can erode the monopolistic power of suppliers and reduce their mark-ups. This can be viewed as a flattening of the Phillips curve, meaning a given change in the output gap has a weaker impact on inflationary pressures. Conversely, lower menu costs for producers and lower search costs for consumers can lead to more frequent price changes and a steeper Phillips curve. E-commerce may also restrict the ability of businesses to set prices that deviate substantially from those of large retailers in reaction to idiosyncratic shocks. This may stifle competition over the longer term. Overall, the impact of e-commerce on the Phillips curve is uncertain. Moreover, the development of global value chains may change the influence of global inflation on domestic inflation and the degree of exchange rate pass-through.

The effects of technology run deeper than just price setting. Modern communication methods enable remote provision of services and greater flexibility in working practices. There is a notable shift in the interaction between employers and employees. For some workers it is a positive development, but for others it means insecurity affecting their income and spending. More individualised roles can also weaken the ability of collective bargaining. These changes could lower the NAIRU, changing the relationship between unemployment and wage pressure.

In the area of payment systems, Mersch mentioned the importance of innovations in protecting the currency from counterfeiters. He also highlighted the continuing importance of cash and argued for its preservation. In his opinion, policymakers should only take actions necessary for the fulfilment of the price stability mandate. The abolition of cash is not such a step. The introduction of innovations, such as Digital Base Money, must be preceded by a thorough examination of their benefits and functionality so that confidence in the currency and the central bank is not lost. Besides, the role of central banks is not to drive technological adoption in the general public, but to enable changing preferences to be fulfilled in a secure fashion.

In a section about safeguarding central banks' operations, Mersch briefly discussed the need to protect data from technological incursions and computer networks against virus outbreaks, as payment systems are dependent on the network. Adopting the latest technological advances in security is not only appropriate, but vital.

Technological changes impact the whole of society. Mersch advises central banks to be prudent and forward-looking when approaching the respective challenges. They should adapt policies to take into account technology-driven socio-economic changes, adopt appropriate technology that supports the functions of central banks and anticipate technological risks. Technological progress, if used appropriately, can help to improve central banks' operations and efficiency.

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