T T Mboweni: The role of the South African Reserve Bank in the protection of consumers

Address by Mr T T Mboweni, Governor of the South African Reserve Bank, at the National Consumer Forum Conference to celebrate World Consumer Rights Day, Johannesburg, 15 March 2007.

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Honoured Guests,
Ladies and gentlemen

1. Introduction

Thank you for the invitation to address you on the occasion of the celebration of World Consumers Rights Day. As consumers we often forget that we have rights, and it is often said that South African consumers are among the most apathetic when it comes to asserting their rights. Consumers are the reason for the existence of business, and World Consumer Rights Day accordingly deservers our support.

The relevance of the theme of this conference; “holding the public and private sectors accountable” is without question. The South African Reserve Bank plays an important role in the South African economy, and our actions impact directly on consumers. It is therefore essential that institutions such as the South African Reserve Bank are fully accountable to consumers for the autonomy they enjoy. In my address to you this afternoon, I will expand on the role of the South African Reserve Bank, particularly with respect to the consumer, and, in line with the theme of the conference, I will highlight our efforts to ensure full accountability.

2. Monetary policy and the consumer

The South African Reserve Bank, like central banks in other countries, has a unique position in the economy. The operations of the Bank are governed in terms of the South African Reserve Bank Act, its associated regulations and the Constitution of the Republic of South Africa. The Act and regulations describe the framework and structure of the Bank, the way in which it is managed and the actions it may take. The Constitution prescribes that the objective of the Bank should be the protection of the currency in the interest of sustainable economic growth and development.

The Bank interprets this mandate to be the achievement and maintenance of price stability. In February 2000 an inflation targeting framework was adopted in South Africa with the inflation target being set by the Government. The Bank, therefore, in line with most inflation targeting central banks, does not have goal independence. However, in its pursuit of this target, the Bank is guaranteed operational or instrument independence. In other words, we can apply our interest rate policy without interference from government. In terms of our mandate, we have to keep CPIX inflation, (i.e. headline consumer price inflation excluding mortgage interest costs) between 3 to 6 per cent per annum on a continuous basis.

In carrying out our mandate, we have a direct impact on the consumer through the impact of monetary policy on inflation and interest rates. The question we are often asked is, why target inflation? Low inflation is in the interest of all South Africans, irrespective of whether they are consumers, business people, or retirees. Inflation, which is a continuous increase in the general price level, implies a continuous decline in the value of money, which implies an erosion of the purchasing power of consumers. The Bank aims to limit such a decline by achieving price stability. However, it is important to note that price stability does not imply that the prices of goods and services do not change at all. Relative prices in a market economy will always change in response to changes in relative scarcities, for example after a drought, food prices are likely to increase.

It is also generally the case that those consumers most vulnerable to the ravages of inflation are the poor. The wealthy members of society are in a better position to hedge against inflation for example by borrowing money to buy non-monetary assets. The wealthy often have assets that can more easily be protected against expected inflation.

Inflation has other adverse effects such as the distortion of the tax system, and also results in increased uncertainty which makes economic decision-making more difficult. High inflation is usually also accompanied by greater price variability. The confusing price signals make the price system less efficient, and the result is lower levels of investment and growth.

We are also often asked why employment or economic growth is not the primary objective of monetary policy. As noted in the Constitution, inflation is not an objective in itself, but is in the interest of sustained growth. It goes without saying that the target of monetary policy should be something that monetary policy can achieve. It is the view of the Bank that although monetary policy can impact on cyclical unemployment and growth, it cannot determine long-run trend real growth. Growth in the long run is determined by real variables and other supply-side factors, including government policies and the general macroeconomic environment that monetary policy contributes to. Monetary policy plays an important role in shaping the macroeconomic environment in which economic agents operate. The best contribution that monetary policy can make is to provide a low and stable inflation environment that is conducive to sustainable long-term growth.

The main monetary policy tool at the disposal of the Bank is the interest rate. Essentially the Bank sets the repo rate, which is the rate at which the banks borrow from us, and this in turn affects other interest rates in the economy. It could be seen as somewhat ironical that in order to protect the consumer from inflation, the means to achieve this are likely to impact negatively on consumers through higher interest rates. Unfortunately, on the part of the Bank there is no way to avoid this.

At times, the increase in interest rates to keep inflationary pressures in check has drawn some criticism particularly by borrowers who were not expecting such increases. I should note however, that depositors or savers are happy when interest rates increase. Perhaps more publicity is given to the plight of those who are negatively affected by interest rate changes. It should be emphasised that the Bank acts in the interest of all consumers, irrespective of whether they are borrowers or depositors, by setting interest rates at an appropriate level to ensure that the inflation target is achieved.

Low inflation allows for generally lower nominal interest rates. Furthermore, as the Bank builds up credibility for its inflation-fighting policies, interest rate cycles are likely to have a lower amplitude. Hopefully the strong interest rate cycles we have seen in the 1980s and 1990s are a thing of the past. By achieving sustained low inflation, we believe that interest rate adjustments can be more moderate and more certainty will result for both consumers and producers. Ultimately we would like to achieve a virtuous circle of low inflation, moderate interest rate cycles and high and sustained economic growth.

At times it is possible that the actions of consumers could threaten the inflation target, and it our responsibility to take appropriate action. In the past three years we have seen household consumption expenditure increasing to extremely high levels. Credit extension by banks has been rising at very high rates, and household indebtedness has also increased to record highs. Some of this can be explained by a number of positive developments in the economy apart from lower interest rates. These include stronger household balance sheets, higher real incomes and increased employment. Our monetary policy actions in the second half of last year were in part an attempt to dampen the inflationary potential of this higher consumption expenditure.

There are other dangers emanating from excessive borrowing, particularly when interest rates start to rise and consumers find themselves overcommitted. In accepting credit, consumers should understand their rights and not fall prey to aggressive marketing of credit. For this reason we are gratified that the banks have adopted a code of good conduct in the marketing of credit. The National Credit Act, to be implemented in the middle of this year will provide further protection to consumers. There are however always two sides to every transaction, and consumers should also act responsibly when taking on further debt.

3. Accountability of the Bank

As noted earlier, our operational mandate is to keep CPIX inflation between 3 to 6 per cent and the Bank has autonomy in the conduct of monetary policy. It is well recognised that autonomy goes hand in hand with accountability. Thus, one of the primary measures of accountability relates to how the bank has performed in relation to its operational mandate.

Monetary policy has been successful in achieving the inflation target since September 2003 when CPIX moved to within the target range. This allowed for a reduction in the repo rate by 650 basis points between June 2003 and April 2005. In 2006, in response to perceived risks to the inflation outlook, the Monetary Policy Committee increased the repo rate by 50 basis points at four consecutive meetings from June. Despite this adjustment, economic growth has remained strong and we expect growth rates of around 5 per cent to be sustained. Although monetary policy cannot claim all the credit, its contribution to the economy's robust growth performance over the last couple of years is well recognised in many circles.

Our accountability extends beyond simply achieving the inflation target. Since the announcement of an inflation target in South Africa, any ambiguity about the ultimate goal of monetary policy has been removed. The smooth conduct of an inflation targeting framework implies a great deal of trust and confidence on the part of the public in a central bank's ability and determination to achieve the target. Without this credibility in the eyes of the public, a central bank's policy goal is not easily achievable. Since the introduction of an inflation targeting policy framework, the Bank has introduced a number of initiatives to improve transparency and communication with all its stakeholders to enhance the credibility of monetary policy. In fact, communication plays an important role in fulfilling the Bank's obligation of accountability. For example, decisions of the Monetary Policy Committee (MPC) are announced after each meeting at a televised media conference, where the motivation for the decision is explained. Media representatives also have an opportunity to question the monetary policy decision and the policy stance.

The publication of a bi-annual *Monetary Policy Review* also broadens the understanding of the aims and conduct of monetary policy. The *Review* analyses developments in and factors influencing inflation, assesses recent policy developments and considers the outlook for inflation. In conjunction with statements after MPC meetings, this publication sheds more light on monetary policy deliberations.

Monetary policy and broader economic issues are discussed with stakeholders at Monetary Policy Forums, hosted bi-annually in Bloemfontein, Cape Town, Durban, East London, Gauteng, Kimberley, Mafikeng, Polokwane, Port Elizabeth and Nelspruit. These Forums provide for discussions on monetary policy over a broad geographical spectrum and involve a large cross-section of stakeholders, including trade union representatives, analysts, academics, the media and the general public.

The Bank is ultimately accountable to Parliament as the representative body of all the people in South Africa, and an annual report is submitted to Parliament. I also meet periodically with members of the Parliamentary Portfolio Committee on Finance. After the publication of the Bank's *Quarterly Bulletin*, a presentation is made to the Committee highlighting the contents of the *Bulletin*, and I answer questions put by the Committee.

In addition to our accountability to Parliament, we also report to our shareholders. The Bank has had shareholders since its inception in 1921, but the legislation is drafted in such a way that no single shareholder can exercise any undue influence over the activities of the Bank. The structure of shareholders adds an additional degree of accountability, in as much as the Bank publishes an *Annual Report* that is tabled, discussed and approved at the Annual General Meeting of shareholders.

The Bank publishes an abridged version of the annual *Governor's Address* to shareholders at the Annual General Meeting in six official languages of South Africa in a variety of newspapers and magazines. This ensures that the *Address* is accessible to all stakeholders in the Bank.

The importance of communication within an inflation targeting framework is without question. Communication is a critical part of monetary policy since it can lead to more effective policy by influencing expectations. The challenge for the Bank is to ensure maximum efficiency and consistency of its communication. As I have outlined, it is clear that the communications strategy of the Bank is directed at a broad spectrum of individuals and institutions. From time to time our actions may be misinterpreted or misunderstood but we shall nevertheless endeavour to undertake whatever communication is necessary to ensure that the trust of the general public in the Bank is maintained.

4. Conclusion

The Constitution does not deal specifically with the rights of consumers, but deals with the rights of consumers to meet their basic needs which include adequate food, clothing, drinking water, electricity, education, health care and shelter. The National Consumer Forum identifies some important rights of the consumer that supports their endeavours to achieve their basic needs. These range from educational rights to ensure informed decision making on the part of consumers to the rights of individuals to raise views on matters of concern to consumers. The choice of a variety of quality goods and services at competitive prices has also been identified by National Consumer Forum as one of the fundamental rights of consumers. The mandate of the Bank of maintaining price stability, that is keeping inflation at low levels, goes a long way toward ensuring competitive pricing practices in the South African economy.

I thank you.