The role of household and firm heterogeneity in the South African Reserve Bank's monetary policy deliberations

South African Reserve Bank

1. Monetary policy transmission channels

The various channels of monetary policy transmission all seem to be active and relatively strong in South Africa. These channels are: savings-investment; cash-flow; balance sheet; bank lending; exchange rate; expectations. It is difficult to say whether activities or pricing decisions are more affected.

Households especially, but also firms, typically borrow at floating rates linked to the policy rate, chiefly for mortgages and vehicle loans. Pass-through is therefore rapid and complete, for both household and corporate borrowing.

On the balance sheet channel, South African households mostly save contractually, with pension savings then inaccessible until retirement (although this relationship has loosened recently, with the adoption of the Two-Pot system in late 2024). This arrangement may weaken households' willingness to raise consumption in response to wealth gains affecting these savings, given that this wealth is relatively inaccessible.

The exchange rate channel is significant, although since the introduction of inflation targeting pass-through from exchange rate movements to inflation appears to have declined to low levels (below 0.2)(Kabundi and Mbelu 2016; Miyajima 2019). This may reflect better anchoring of inflation expectations to the target (discussed further below). It is also worth noting that savings-investment imbalances, especially for a low-saving economy like South Africa, will tend to manifest in current account strain that prompts rand weakness (an example is the 2013 taper tantrum). Strictly speaking, this is a saving-investment problem, but inflation manifests through an exchange rate channel.

Regarding output and the exchange rate, exports have not been responsive to a relatively weak rand over an extended period (most of the time since about 2014). This may reflect a shared cause, where exchange rate weakness is caused by other growth-negative factors. For instance, "state capture" phenomena such as the "Nenegate" crisis, when the finance minister was abruptly removed, caused rand depreciation and simultaneously depressed household and consumer confidence.

Inflation expectations have become an important intermediate target for monetary policy. The South African Reserve Bank (SARB) has sponsored a comprehensive survey of inflation expectations for more than two decades (Reid, von Fintel, and Foresto 2024). This valuable data source shows how expectations have become more centred on the target, over time, with the distribution of expectations also narrowing. Expectations unfortunately still show a significant backward-looking component.

2. Role of household heterogeneity

The SARB has studied household heterogeneity in some depth, although this work is not revisited routinely at Monetary Policy Committee (MPC) meetings.

South Africa is marked by high levels of inequality. This has several consequences for monetary policy transmission and for understanding inflation:

- While South Africans across the income spectrum use debt, it is only relatively rich South Africans – those in the upper two deciles of the income distribution – whose debt tracks the policy rate closely. This is because these groups account for almost all mortgage, vehicle and credit card lending. Poorer South Africans are much less exposed, at least directly, to changes in the policy rate. (By contrast, poorer South Africans are highly exposed to inflation.)
- South Africa's economy has been relatively skill-intensive, and skills shortages have constrained growth. In understanding employment dynamics, it is therefore often useful to compare employment rates for skilled, semi-skilled and unskilled workers separately. These metrics are tracked routinely by the statistics department.
- The consumer price index uses "plutocratic" rather than "democratic" weights, and the basket it tracks therefore reflects the consumption patterns of a relatively rich household (around the 95th percentile of the income distribution).

The data on household debt patterns are incomplete. The National Credit Regulator data do not capture unregistered credit providers. They are also reported using nominal income brackets that have not been updated for many years. Given inflation, this means the brackets no longer correspond to the income groups they were originally chosen to distinguish. The NIDS database provides better insights into household finances, but the survey is not conducted regularly (the last one was undertaken in 2020). There is no Public Credit Register, although the various relevant regulators have signed a memorandum of understanding to establish one (International Monetary Fund. Monetary and Capital Markets Department 2022).

3. Role of non-financial firm heterogeneity

Heterogeneity of non-financial firms is not a subject that receives significant attention in monetary policy setting.

South Africa is remarkable for its relatively low degree of business informality for its income level (Asmal et al. 2024). Although this has some disadvantages, it also means a relatively large proportion of businesses are part of the formal sector and participate in the financial system. This tightens connections to monetary policy.

As the National Treasury has argued in a recent review, the desirable direction of financial development is to move beyond a system where almost everyone has a bank account, and where unsecured credit is widely available, mainly to support consumption, to a system where the financial system helps build and protect wealth (National Department of Treasury. Republic of South Africa 2023). For instance, credit is more readily available to private individuals than to small businesses, and entrepreneurs must sometimes rely on personal loans to finance their enterprises. (South Africans also tend to underinvest in insurance that would protect assets, although funeral insurance is widespread.) These are not monetary policy concerns, in the narrow sense.

4. Heterogeneity and monetary policy decisions

The SARB's models, used to advise the MPC, do not capture heterogeneity in firms and households.

Surveys, such as our survey of inflation expectations, capture different social groups (such as trade unions, households and businesses) but do not reflect more fine-grained distinctions.

Heterogeneity analysis has not been influential in individual monetary policy decisions.

Senior policymakers, such as the Governor, have given speeches centred on heterogeneity subjects, such as the relationship between inequality and monetary policy (See links in the next section). Heterogeneity rarely features in MPC statements or the biannual *Monetary Policy Reviews*.

5. Distributional effects of monetary policy

Monetary policymakers have been at pains to communicate that inflation hurts the poorest South Africans especially, and that an inflation-fighting monetary policy is therefore pro-poor.

It is difficult to say whether distributional effects or transmission effects of heterogeneity have received more emphasis. The two themes have often been interwoven.

The central bank's mandates do not explicitly incorporate distributional effects. The constitutional mandate obliges the SARB to protect the value of the currency in the interests of balanced and sustainable growth. "Balanced" growth could, arguably, include considerations of distribution. That said, the SARB has given effect to its constitutional mandate using a flexible inflation targeting framework, which simplifies decision-making into a relatively straightforward Taylor rule-type decision-making system. The SARB has argued that delivering on its inflation target, over time, is necessary but not sufficient for achieving balanced and sustainable growth, and other policy areas must also contribute to achieve economic flourishing. As noted above, the SARB has also emphasised that low inflation has benefits for poorer South Africans.

The themes raised above have been communicated publicly in speeches and research pieces. (Kganyago 2018, 2024; Loewald & Makrelov 2020; Singh & Fowkes 2019)

6. Measures to address heterogeneity

We have not identified monetary policy tools that address heterogeneity. South African monetary policy is made using a conventional short-term interest rate tool to deliver on an inflation target (in a flexible way). However, the SARB has attempted to apply a layered communication strategy to reach different stakeholders, for instance through "Talk to the SARB" forums throughout the country and through social media postings, with mixed success. To the extent that monetary policy communication affects inflation expectations, these communications can also be thought of as a monetary policy tool.

Since the Covid-19 pandemic, with the support of the SARB the National Treasury has deployed a series of loan guarantee schemes (LGS). These were aimed, variously, at supporting businesses through the pandemic; helping rebuild after Covid (and after the Kwazulu-Natal civil unrest of 2021); and in encouraging solar power generation to mitigate electricity shortages. However, these schemes had low uptake; there was also declining uptake over each new LGS iteration. This may point to failures in scheme design, insufficient risk appetite from the fiscal authority or an incorrect diagnosis of market failures (so that private markets successfully met needs without government intervention). Given these failings, LGS initiatives are unlikely to become a fixture of the policy landscape.

References

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