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Special OBEN/24/01

South African Reserve Bank Special Economic Notes are a collection of descriptive and critical economic analyses with recommendations written for internal SARB discussion. They are written by staff members or fellows of the Economic Research Department and, on occasion, by consultants under the auspices of the SARB. They are released publicly on an occasional basis. This series features summaries of discussions that took place at the 2023 SARB's Biennial Conference.

Authorised for publication by:

Chris Loewald

February 2024

South African Reserve Bank

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Enquiries
Head: Research Department
South African Reserve Bank
P O Box 427
Pretoria 0001

Tel. no.: +27 12 313-3911
0861 12 SARB (0861 12 7272)

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Less harm, more growth

Christopher Loewald[1]

Abstract

Macroeconomic policy in South Africa has been neither austere nor orthodox. Public spending has risen in real, inflation-adjusted, terms, in nearly every year of the post-GFC era, averaging over 3% annually, and rose especially strongly over the past three years. Real interest rates have averaged around 1%, well below neutral levels. Despite this track record, calls for higher public spending and looser monetary policy abound. But with observed low fiscal multipliers, weak potential growth and a closed output gap, a stimulus package will generate more inflation and little growth. This deepens inequality as inflation erodes incomes of poorer households and makes it harder to create labour-intensive manufacturing. With debt levels and borrowing costs at historical highs, macroeconomic de-risking – reducing debt and setting a more efficient inflation target – would increase economic growth in the short and long term, and, critically, increase the impact of economic reforms in factor, energy and logistics markets on inclusive growth. Faster sustainable growth in turn increases revenue for the upgrading of public services.

1. Introduction

Between 2010 and 2019, the real repurchase rate averaged 1% and fiscal deficits 4.5%, annually. Inflation averaged 5.1% and public spending grew by a nominal 8.3% per year. Excluding state-owned enterprise spending, public spending as a share of GDP rose to 32% from the average level of 25% of the previous decade. From one decade to the next, seven percentage points more of GDP was being spent annually in the public sector (see Figures 1 and 2). Despite these increases, fiscal austerity and high interest rates are regularly blamed for an underperforming economy.[2]

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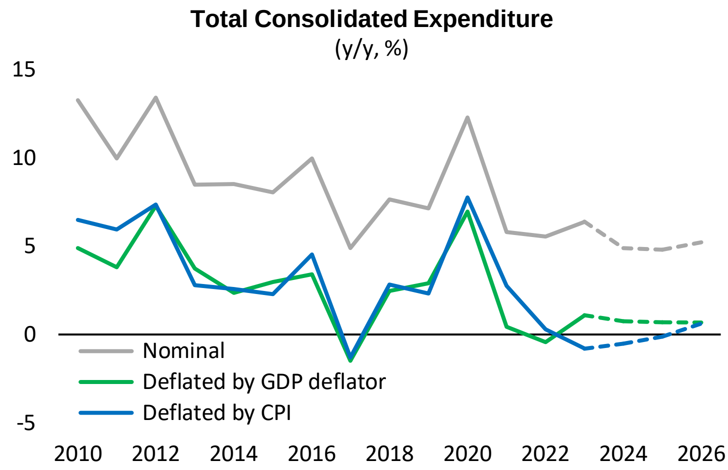
1 Christopher Loewald is the Chief Economist of the South African Reserve Bank.

2 See COSATU, 'COSATU rejects Treasury's reckless attempts to impose misguided austerity budget cuts across government'. Media release, 7 September 2023. Available at: https://mediadon.co.za/2023/09/07/cosatu-rejects-treasurys-reckless-attempts-to-impose-misguided-austerity-budget-cuts-across-government/; S Smit, 'The high cost of austerity', *Mail and Guardian*, 11 September 2023. Available at: https://mg.co.za/business/2023-09-11-the-high-cost-of-austerity/; *Business Tech*, 'Reserve Bank has lost the plot – interest rates in South Africa should be 200bps lower: economist', 24 July 2023. Available at: https://businesstech.co.za/news/business-opinion/706448/reserve-bank-has-lost-the-plot-interest-rates-in-south-africa-should-be-200bps-lower-economist/.

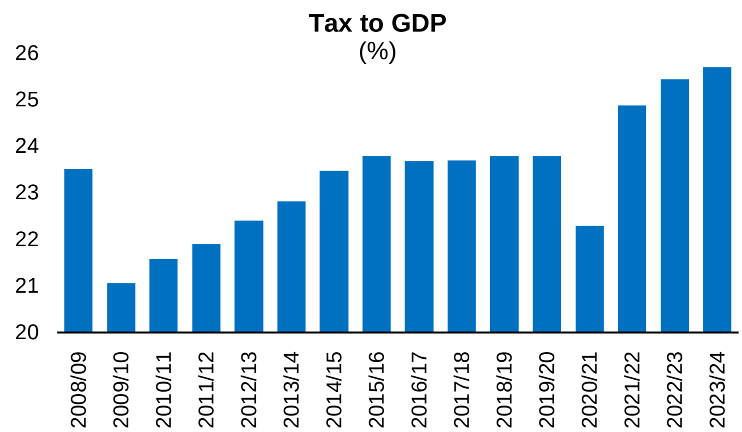
As these statistics reveal neither austerity nor even orthodoxy, it is hard to see how larger deficits or artificially low interest rates would improve sustainable growth. Fiscal multipliers are weak and with no output gap, more debt will push up already very high borrowing costs and the country risk premium. These need to decrease to get more growth out of public spending and to increase private economic activity. This note discusses why.

Figure 1: Nominal and real growth in spending



Source: National Treasury, Stats SA and SARB

Figure 2: Tax to GDP rising over time



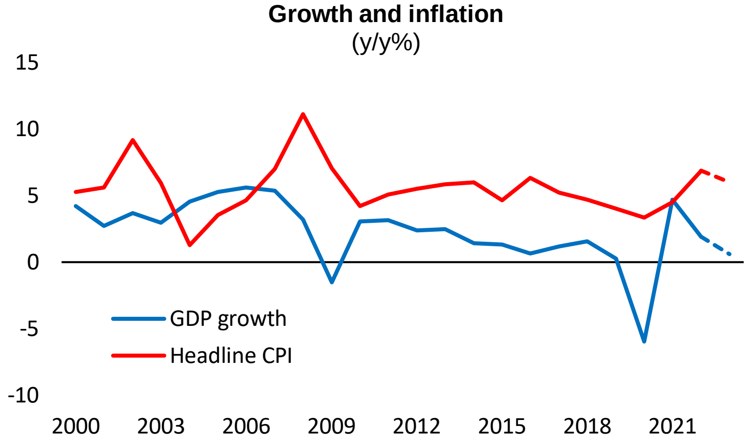
Source: National Treasury

2. The structural and distributive implications of inflation

In macroeconomic models, in the short term, an unexpected increase in demand lowers the real cost of labour and capital, and activity increases. Outside of those deflationary conditions, however, there is little robust real-world evidence for this positive relationship of inflation to growth (see Figure 3).[3] Instead, efforts to exploit the theoretical relationship usually create as many harms as benefits, resulting in few net gains. These harms come in various forms.

[3] As the Japanese case shows, substantial demand stimulus moves an economy from deflation to low but positive inflation, therefore pulling the economy out of deep recession. See H

Figure 3: Growth and inflation over the past two decades



Source: Stats SA

First, while unanticipated inflation can increase jobs in the short term, these rarely last long enough to benefit low-skilled workers. Instead, inflation sharply lowers the purchasing power of lower-income households, driving up the cost of employment, reversing the earlier gains, and making it even harder to engage in economic activity.[4] The income losses suffered are also much larger than those experienced by better-off households. This loss of income can be extreme: if we measure real income with the inflation rate experienced by the poor rather than total inflation, over the period 2005 to 2010, the poverty head count rate of the population would have been 4.5 percentage points higher.[5] The impact of inflation depends on the source of income and the basket of consumption. Where nominal wages cannot rise in line with inflation, a 1 percentage point rise in inflation lowers total real income by 1 percentage point, whereas higher-income households experience about 30% to 50% less of the rise in prices. Income is protected, while the consumption basket is less heavily weighted towards food and fuel. Generally speaking, negative economic shocks of all kinds hurt already marginalised households disproportionately more than those with formal jobs and access to finance.[6]

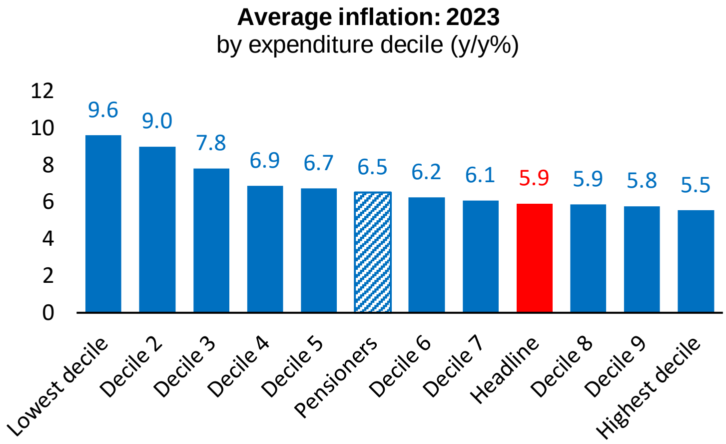
Kuroda, 'Overcoming deflation: Japan's experience and challenges ahead'. Speech at the 2019 Michel Camdessus Central Banking Lecture, International Monetary Fund (IMF), Washington DC.

4 See R Hausmann et al., 'Growth through inclusion in South Africa', CID Faculty Working Paper No. 434, 2023, Growth Lab, Harvard University. Available at: https://growthlab.hks.harvard.edu/sites/projects.iq.harvard.edu/files/growthlab/files/2023-11-cid-wp-434-south-africa-growth-through-inclusion.pdf.

5 See C Loewald and K Makrelov, 'The impact of inflation on the poor', SARB Occasional Economic Bulletin, Pretoria: SARB, June 2020. Available at: https://www.resbank.co.za/content/dam/sarb/publications/occasional-bulletin-of-economic-notes/2020/10005/OBEN-2001--The-impact-of-inflation-on-the-poor----June-2020.pdf.

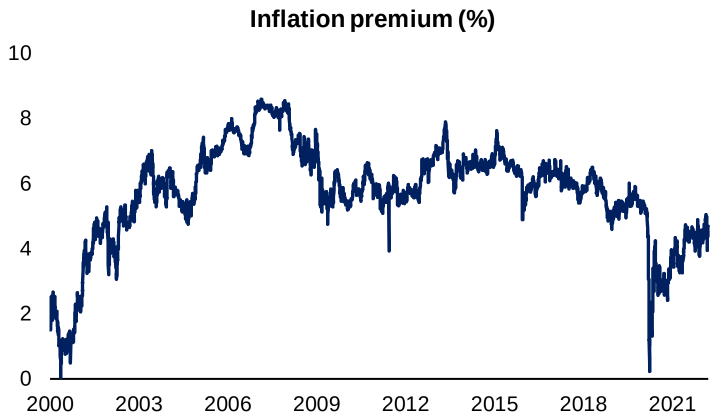
6 For further discussion on the inflation tax, see E Cardoso, 'Inflation and poverty', NBER Working Paper no. 4006, 1992, Washington DC: National Bureau of Economic Research. Available at: https://www.nber.org/papers/w4006. For an analysis on the distributive impact in South Africa, see K Mayijima, 'Monetary policy, inflation, and distributional impact: South Africa's case', IMF Working Paper No. 2021/078, 2021, Washington DC: IMF. Available at:

Figure 4: Inflation is highest for the poor



Second, higher inflation increases interest rates as economic agents of all kinds anticipate more inflation in future. If inflation rises by 1%, a corresponding 1.25 percentage point rise in interest rates is needed to reverse the spike. This increases the debt service cost on outstanding debt, which currently sits at 62% of disposable income (net of tax). As inflation rises however so do all interest rates at all maturities. This rise in the cost of borrowing for all maturities occurs whether or not there is a rise in the short-term policy rate and will be larger if there is no policy rate response. This can be seen clearly in the way in which inflation premiums have risen and yield curves have shifted up across many economies where inflation control is in some doubt.[7]

Figure 5: Inflation premium starting to rise



Source: SARB

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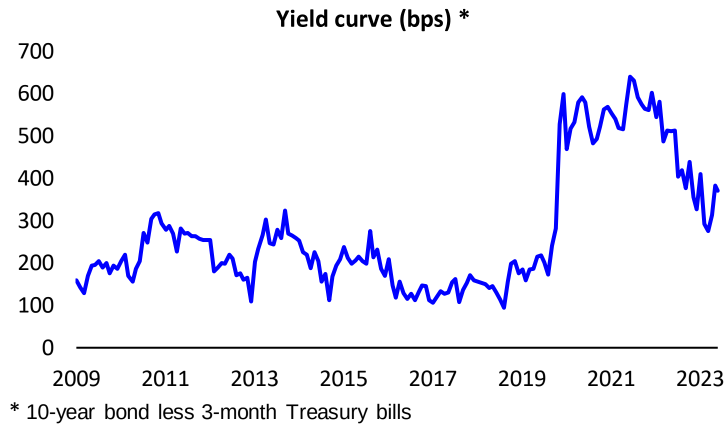
https://www.imf.org/en/Publications/WP/Issues/2021/03/19/Monetary-Policy-Inflation-and-Distributional-Impact-South-Africas-Case-50282.

7 For a basic primer, see H Levy, 'The yield curve and expected inflation', *Financial Analysts Journal* 38(6), 1982, pp. 37–42.

Figure 6: Yield curve historically steep



Source: Bloomberg

Third, as seen in the mid-2000s, when inflation is low, real growth from borrowing and consumption will be stronger. But such booms are rarely sustainable without growth in investment and productivity, and indeed that one wasn't as demand exceeded supply and inflation accelerated. The economic impact of spending more today (and the cost of financing it) depends critically on whether and how it improves the future capacity of the economy to grow. Enhancing long-term growth will attract cheaper finance, whereas consumption for its own sake is less likely to do so.

Contextualising policy and its potential effects in an economy is clearly important, helping identify what really happens when policy levers get pulled. In particular, starting conditions and structural features of an economy matter greatly for outcomes. For instance, when economic growth is weak and saving is low, expanding demand quickly pitches the external account into deficit that requires financing from abroad. The fiscal expansion might increase consumption, but unless there is a negative output gap, it would work directly against lower interest rates and a competitive real exchange rate that might increase investment.[8]

The implications of continuously pushing on the macro string are far-reaching, not least in a job creation record that is skewed away from labour-intensive manufacturing export sectors. Excess demand stimulus creates some kinds of jobs, but many are lost (or never contemplated) as inflation and an appreciated exchange rate undercut the growth of non-commodity exports. But this kind of stimulus also constrains the growth of services jobs as overall GDP is lower and depresses indirect services jobs derived from the human and physical

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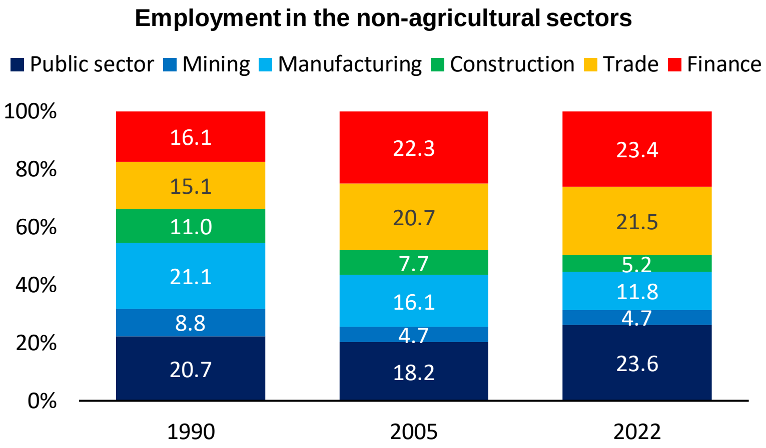
8 South Africa's investment and export to GDP ratios sit at 16% and 27% of output respectively, versus the 25% and 35% achieved by a typical emerging market. These ratios compare poorly against fast-growing economies (and even worse when including savings ratios). For an extended analysis, see C Loewald, D Faulkner and K Makrelov, 'Time consistency and economic growth: a case study of South African macroeconomic policy', SARB Working Paper Series, WP/20/12, Pretoria: SARB, November 2020. Available at: https://www.resbank.co.za/content/dam/sarb/publications/working-papers/2020/10421/WP%202012.pdf.

capital-intensive sectors in which South Africa has comparative advantage (finance, agriculture and mining).[9]

Figure 7: Sectoral breakdown of jobs



Sources: Stats SA and SARB

Economic growth should be thought of as additions of capital stock, labour use and productivity gains, and should broadly reflect population growth. The economy should be able to absorb the growing labour supply, with inefficiencies in factor markets determining the rate of unemployment. Each of these factor markets, the productivity of labour and capital, and how they become more efficient can be easily undermined, and in various ways. Spatial inefficiencies lower living standards and raise the cost of supplying labour.[10] Wage indexation that drives a wedge between productivity and real pay costs disadvantages less-skilled workers and reduces labour demand and productivity. A low throughput of well-educated students into the job market weakens the labour supply and its potential productivity. Insufficient energy supply limits economic activity and higher inflation raises the cost of capital. The list goes on. And there is nothing in this list that will be made better by unsustainable fiscal or monetary policies.

Diversification to more labour-intensive, non-traditional exports can in the first instance be helped by doing no macroeconomic harm. Many smaller economies grow fast by importing cheap intermediate imports, adding competitive labour and producing exports to take advantage of vast global markets. These economies don't need to dominate global markets,

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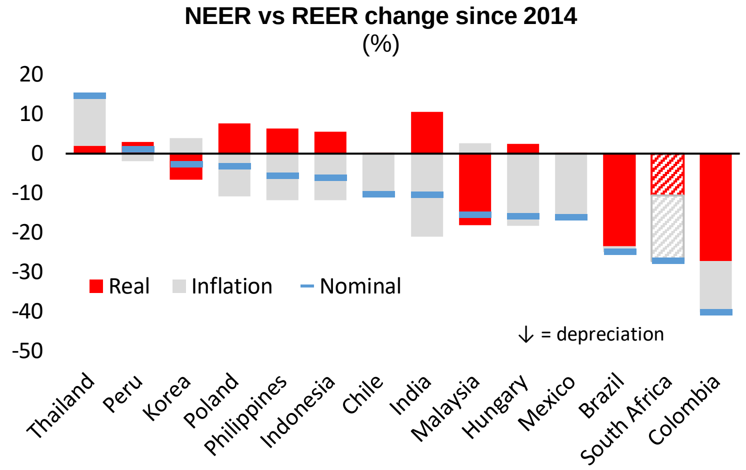
9 It is tempting to include automobiles here, but on balance reducing the heavy subsidisation to production would lower prices (by 25% or more) for automobiles and create more services jobs than currently exist in manufacturing. See D Kaplan, 'Manufacturing in South Africa over the last decade: a review of industrial performance and policy', *Development Southern Africa*, 21(4), 2004, pp. 623–644. Available at: https://www.tandfonline.com/doi/pdf/10.1080/0376835042000288824.

10 See C Loewald, K Makrelov and A Wörgötter, 'Addressing low labour utilisation in South Africa', SARB Working Paper Series, WP/21/09, Pretoria: SARB, June 2021. Available at: https://www.resbank.co.za/content/dam/sarb/publications/working-papers/2021/WP%202109.pdf.

but do need to be competitive enough to sell successfully into it using the skills they have (rather than the ones they wish they had).[11]

The export-oriented, small, open economy growth models are well understood around the world, but are counter-intuitive to old-school, closed economy textbooks that feature efficient labour and capital markets and few constraints to borrowing. Instead, the small, open economy growth model focuses on the need to grow domestic demand sustainably and fight inflation, both of which require good microeconomic-level policies. Without them, the inflation arising out of a demand and supply imbalance is aggravated in price rigidities, such as price and wage indexation, a feature notably rooted in public sector.[12]

Figure 8: South Africa's real effective exchange rate depreciation eroded by inflation



Source: BIS

3. Really not-existing austerity

In this context, we need to be as wary of mischaracterisations of policies as of the claims that throwing one or two levers somewhere will make macroeconomic and microeconomic dynamics suddenly add up to faster growth. As in monetary policy, there are trade-offs and balances to strike in fiscal policy in order for it to contribute sustainably to economic growth.

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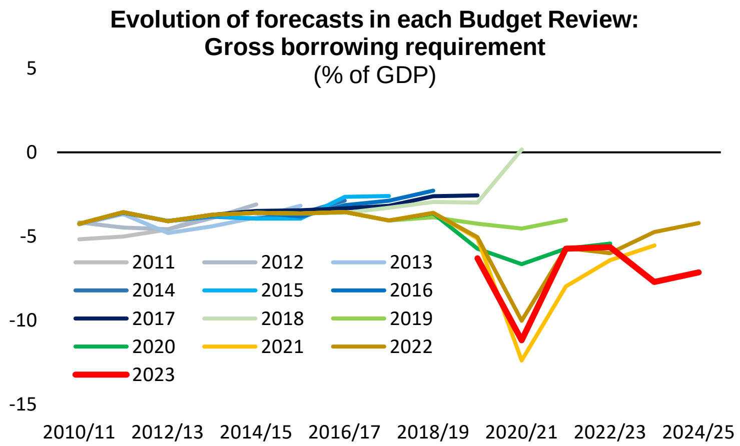
11 See M Stern and Y Ramkolowan, 'Understanding South Africa's trade policy and performance', SARB Working Paper Series, WP/20/17, Pretoria: SARB, August 2021. Available at: https://www.resbank.co.za/content/dam/sarb/publications/working-papers/2021/WP%202117.pdf.

12 On average, the effects of public wage shocks on private sector wages are stronger and more persistent in countries where the public sector (as share of total employment) is relatively large. The impact on the consumer price level is also larger and more persistent in countries with higher bargaining (or union) coverage and in countries with a greater degree of centralisation of wage bargaining. See C Abdallah, D Coady, and L Jirasavetakul, 'Public-private wage differentials and interactions across countries and time', IMF Working Paper Series No. 064, 2023, Washington DC: IMF. Available at: https://www.elibrary.imf.org/view/journals/001/2023/064/article-A001-en.xml.

The more dramatic claims that there are easy fiscal solutions to growth or that nothing can possibly be done to become sustainable are equally wrong.[13]

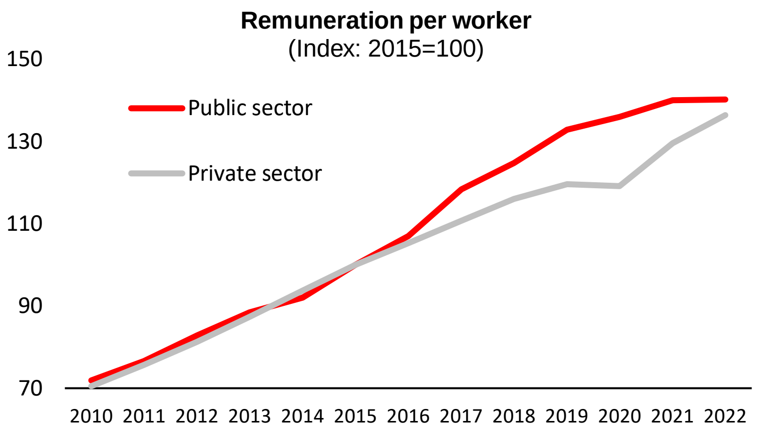
First, South Africa has seen a lot of spending and inflation that belies the claim of really-existing austerity. In inflation-adjusted real terms, public spending has increased in almost every year in the last 20. Public debt as a ratio of output has tripled from 24% to 72% in 15 years; stabilisation of the debt tends to be pushed up to a higher level (77.7%), at a later period.[14] As Figure 9 below shows, budgeted deficits almost always exceeded actual outcomes, both in nominal terms and as a share of output, as spending continued to exceed expenditure caps.

Figure 9: Expected budget balance against outcomes



Source: National Treasury

Figure 10: Public vs private sector compensation



Source: SARB

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13 For an argument on South Africa's "austerity" measures, see M Sachs, R Amra, T Madonko and O Willcox, 'Austerity without consolidation: fiscal policy and spending choices in Budget 2023', SCIS Working Paper Series, No. 60, 2023, Public Economy Project, Southern Centre for Inequality Studies, Johannesburg: University of the Witwatersrand. Available at: https://wiredspace.wits.ac.za/server/api/core/bitstreams/d7b51cba-da16-4deb-8190-f3732672cdf6/content.

14 According to National Treasury, *Medium-Term Budget Policy Statement* (2023). Available at: https://www.treasury.gov.za/documents/mtbps/2023/mtbps/FullMTBPS.pdf.

Between 2014 and 2018, in what has been considered South Africa's strongest push to rein in public deficits, the primary balance improved by 1.3 percentage points of GDP and the structural deficit by 0.5 percentage points of potential GDP.[15] This change isn't meaningful by any comparative standard: relative to the 62 countries that underwent some sort of fiscal consolidation during the last decade, South Africa's change in its structural balance was only slightly better than Argentina's performance.[16] In contrast, Portugal and Spain narrowed their primary balances by more than 7% of output, and their structural budget balances by about 8.7% during the eurozone crisis. In these cases, at the peak of their consolidation efforts, output gaps widened to about 7–9% of potential output. By contrast, South Africa's efforts to reduce public deficits are insignificant and have had no clear impact on economic growth.[17] We simply have not seen the same economic outcomes that a country with austerity would experience.[18] One of the reasons for this is that the policy framework's floating exchange rate pushes off the point of crisis, which is so easily reached when the exchange rate is fixed.[19]

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15 Estimates of the structural deficit are from the IMF, based on the methodology developed by A Fedelino, A Ivanova and M Horton, 'Computing cyclically adjusted balances and automatic stabilisers', Technical Notes and Manuals 09/05, 2009, Fiscal Affairs Department, Washington DC: IMF.

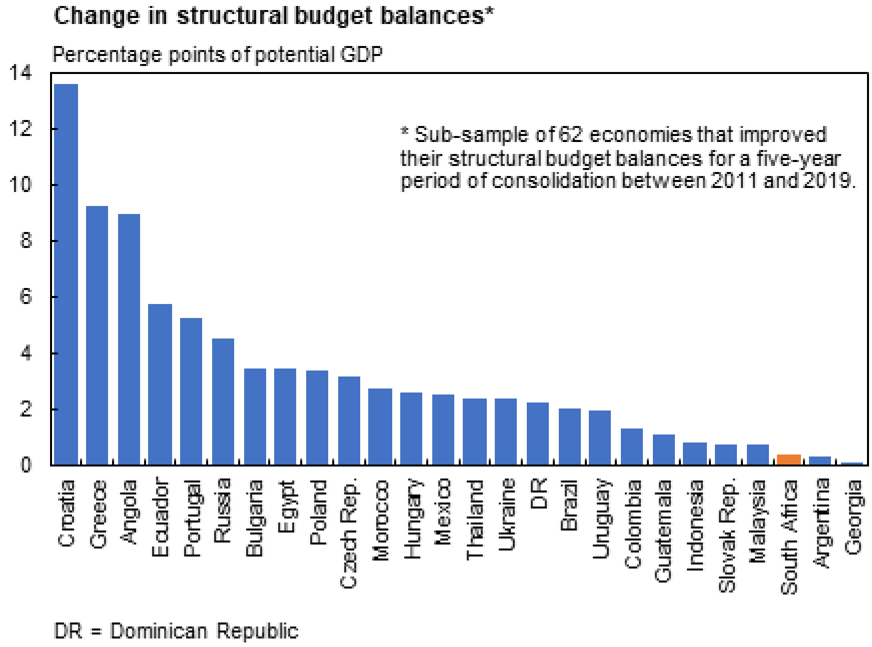
16 South Africa was only one of five consolidator countries that did not see a stabilisation in its debt ratio. The others are Angola, Argentina, Brazil and Ecuador.

17 A typical consolidator reduced its structural budget balance by 2.8 percentages points (pp) of potential output versus South Africa's 0.4pp adjustment. This is primarily due to South Africa's inability to rein in expenditure: spending over that period fell by just 0.6pp versus a typical consolidator's 2.2pp reduction. Instead, the main policy tool for South Africa's consolidation was raising taxes, with revenues as a share of output rising by 1.5pp. Importantly, disinflation over the period does not appear to be a major reason for South Africa's relative underperformance, with the country's 1.5pp disinflation over the period in line with the median 1.6pp decrease. See T Radebe (forthcoming), 'Comparative perspective on South Africa's fiscal consolidation'.

18 This is true even when we consider the different effects a tax-based versus expenditure-based austerity would have on income. See C Favero, F Giavazzi, and A Alesina, *Austerity: when it works and when it doesn't*, 2019 (Princeton University Press). Available at: https://www.jstor.org/stable/j.ctvc77f4b.

19 See J E Gagnon and M Hinterschweiger, 'Fiscal policy and exchange rate regimes', in *Flexible exchange rates for a stable world economy*, 2011 (Washington, DC: Peterson Institute for International Economics), pp. 207–211. Available at: https://www.piie.com/publications/chapters_preview/6277/07iie6277.pdf.

Figure 11: Comparative perspective on fiscal consolidation



Source: IMF

Second, while unbridled expansion won't deliver any significant benefit, a fiddle around the margins approach to spending won't either. Marginal additions to spending will not add up to a sustainable growth trajectory when debt service costs are growing so fast and when the impact of spending on potential growth is so low. It is these higher debt levels that crowd out other fiscal priorities, because service costs for the debt level rise much faster than nominal GDP (15% last year alone and closer to 19% this year). Debt costs have doubled as a percentage of total public spending (to 15.2%). If debt service costs were half as high, there would be an additional R154 billion (or 2.3% of GDP) of resources available to government.[20]

At present, three areas of spending attract particular attention. One is the addition of loan financing to state-owned enterprises, in particular Transnet and Eskom, to pay back debt. This should become sustainable spending, in the sense that the borrowing for it is paid back with more energy, easing logistics constraints, and therefore leads to better growth.[21]

The second is the set of pandemic commitments, in particular the social transfers. Given the raft of studies showing that social transfers have had little impact on job creation, these should at a minimum be targeted to reduce unintended consequences such as a further rise in the

20 In a sample of 110 countries, South Africa's projected r-g gap of 2.5 percentage points is lower than only Mexico (2.9pp), Brazil (2.8pp), Oman (5.7pp) and Kuwait (4.8pp). For analysis of South Africa's debt sustainability, see R Havemann and H Hollander, 'Fiscal policy in times of fiscal stress: or what to do when r > g', WIDER Working Paper 2022/52, 2022, Helsinki: UNU-WIDER. Available at: https://www.wider.unu.edu/publication/fiscal-policy-times-fiscal-stress.

21 For estimates of the impact of the energy crisis on growth, see T Janse van Rensburg and K Morema, 'Reflections on load-shedding and potential GDP', Occasional Bulletin of Economic Notes, OBEN 2301, 2023, Pretoria: SARB. Available at: https://www.resbank.co.za/content/dam/sarb/publications/occasional-bulletin-of-economic-notes/2023/oben-2301-reflections-on-load-shedding-and-potential-gdp-june-2023.pdf.

supply cost of labour.[22] Neither loan financing to state-owned enterprises nor the social transfers are necessarily permanent increases to spending, but they do carry major risks of having little economic impact, while further changing the composition of the fiscus to even more consumption and even less investment. In the case of the social transfers, job creation would be far better delivered with good housing, transport and education services that permanently lower the supply cost of labour.

The third area of spending concern is public sector compensation, which is where efforts to manage a smaller than expected fiscal envelope focused, though less effectively than portrayed. This is a larger challenge than the others given weak fiscal multipliers and the strong rise in compensation already seen.[23] Although total compensation of employees has moderated over the last two years as nominal GDP surged, this really shows just how stable compensation spending has been despite the pandemic and poor real growth rates – the collapse in growth had no effect on public employment. The slowdown in compensation in real terms is almost entirely a private sector phenomenon, going back to 2015. The public sector saw sustained increases in real compensation of 2.6% per year starting already in 2012 and running up to 2019.

4. Inflation, fiscal metrics and debt service costs: towards macroeconomic de-risking

A rise in inflation is often said to have positive effects on the fiscus as revenues increase and expenditure remains constant, while the real debt stock declines. However such an improvement in the fiscal position is temporary and ultimately self-defeating. Higher inflation gets indexed into nominal wages and spending schedules, increasing borrowing costs and sovereign debt yields, permanently. The real cost of borrowing rises across the economy with predictable costs to economic growth, and as debt service costs accelerate, the public sector is able to buy less in real terms – less labour, less goods and less services.[24]

In short, and in the same way as with job creation, surprise inflationary shocks provide at best only a temporary benefit to the primary balance and high debt levels. In the GFC and its deflation, policymakers tried to engineer positive inflation, rather than create it by surprise. The fiscal position would be best served by credible and ambitious fiscal targets and a lower, more credible inflation target and rate. These would immediately improve inflation expectations,

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22 For instance, see H Bhorat, T Köhler and D de Villiers, 'Can cash transfers to the unemployed support economic activity? Evidence from South Africa', Development Policy Research Unit Working Paper 202301, 2023, Cape Town: University of Cape Town. Available at: https://commerce.uct.ac.za/sites/default/files/media/documents/commerce_uct_ac_za/1093/DPRU%20WP202301.pdf.

23 See T Janse van Rensburg, S de Jager and K Makrelov, 'Fiscal multipliers in South Africa after the global financial crisis', SARB Working Paper Series, WP/21/07, 2021, Pretoria: SARB. Available at: https://www.resbank.co.za/content/dam/sarb/publications/working-papers/2021/WP%202107.pdf.

24 See S Arslanalp and B Eichengreen, 'Living with high public debt', Paper presented at the Jackson Hole Symposium: Structural Shifts in the Global Economy, 24–26 August 2023. Available at: https://www.kansascityfed.org/Jackson%20Hole/documents/9749/Living_With_High_Public_SA_Sep_2_2023.pdf.

lowering long-run debt costs, sovereign credit risk and yields, and make it easier to achieve a better fiscal balance. A lower target would also reduce the inflation cost of the floating currency, reducing its corroding effect on competitiveness.[25]

What else can monetary policy do to help the deteriorating fiscal position? Some have argued for a direct bond-purchasing programme, where the SARB buys long-term bonds, and finances the purchases by issuing central bank reserves remunerated at the repo rate.[26] This is clearly not free money, as remunerated liabilities are created on the SARB balance sheet. The SARB in effect issues short-term debt instead of the National Treasury. Not only is this a poor precedent for fiscal transparency, but the Bank has already implemented an excess reserves liquidity system for the economy. This in principle satisfies all demand for reserves that the banking sector might need in the case of large negative economic or financial shocks.

Higher central bank reserves increase settlement balances, an asset on their balance sheets that allow commercial banks to increase the creation of new deposits for borrowers. It is also for this reason that, outside of deflationary conditions, the direct purchase of equities and bonds when a country is above the zero lower bound raises inflation risk, creates moral hazard and transfers the risk to the SARB's balance sheet while bailing out investors.[27] Issuance of treasury bills does not inherently have this additional implication in the short term as reserves rise and deposits rise.

These arguments also hold for the more recent appetite to draw down on the gold and foreign exchange contingency reserve account (GFECRA). One way of doing this involves selling foreign currency reserves outright, which the fiscal authority uses to either issue less debt or increase spending. The net debt of the country does not change, however, just the composition of the debt (fewer foreign currency assets and rand liabilities), with the gain being the interest saving. Another method is to forego the sale of foreign currency assets and issue central bank reserves to commercial banks, which then credit government deposits. The catch in both instances is that the rand now transferred to government deposits at commercial banks should be sterilised to prevent a rise in inflation and currency weakness. Without this, the risk of flight

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25 The long-term benefits of disinflation outweigh its costs. See C Loewald, K Makrelov and E Pirozhkova, 'The short-term costs of reducing trend inflation in South Africa', SARB Working Paper Series, WP/22/08, 2022, Pretoria: SARB. Available at: https://www.resbank.co.za/content/dam/sarb/publications/working-papers/2022/WP%202208.pdf.

26 See C Fratto et al., 'Unconventional monetary policies in emerging markets and frontier countries', IMF Working Paper, WP/21/14, 2021, Washington, DC: IMF. Available at: https://www.imf.org/en/Publications/WP/Issues/2021/01/22/Unconventional-Monetary-Policies-in-Emerging-Markets-and-Frontier-Countries-50013.

27 For the argument against QE in EMDEs, see D Laxton and C Y Rhee, 'Lessons from unconventional monetary policy for small open economies and emerging markets', Presentation for the Jackson Hole Economic Symposium, August 2022. Available at: https://www.kansascityfed.org/documents/9089/Governor_Rhee_Remarks.pdf.

For the South African case in particular, see D Fowkes, 'Not so easy: why quantitative easing is inappropriate for South Africa', SARB Working Paper, WP/22/05, 2022, Pretoria: SARB. Available at: https://www.resbank.co.za/en/home/publications/publication-detail-pages/working-papers/2022/NotsoeasywhyquantitativeeasingisinappropriateforSouthAfrica.

to safer assets increases (increasing rand volatility) or commercial banks reduce credit spreads and lending accelerates, both tending to higher inflation.

The macroeconomic test of tapping GFECRA or changing the composition of the debt depends on whether it leads to more inflation and currency depreciation. If it does, we earn a short-term, temporary benefit (lower interest payments in the near term) for a long-term, permanent loss, again. We should not be surprised by bond trader enthusiasm for this, as higher bond prices in the very short term are exchanged for lower prices later on as the long-term cost of sterilisation gets built into the policy framework.

Other recommendations, such as credit allocations and prescribed assets for the state would both produce large deadweight losses and further reduce the efficiency of the public sector.[28] In almost all cases where such policies were implemented, the public balance sheet was worse off, and inflation soared, a reminder that just because one *can* implement unconventional monetary policy doesn't mean one *should*.[29]

5. Conclusion

What is clear from the many economic diagnostics of South Africa is that our network and factor markets are inefficient, resulting in, among other problems, uncompetitive pricing and high unemployment. Taking steps to make these into functioning, efficient markets would go a long way to increase job creation, in turn decreasing the macroeconomic incentive to take on more debt. Lower inflation and less borrowing would cut interest costs for the public and the private sector, generating benefits to the sovereign risk premium, the currency, and back to inflation and rates in a beneficial spiral of effects. Lower debt service costs on its own could free up major fiscal resources that can be better targeted at service delivery, in turn lowering the cost of economic activity generally and expanding it.

This is a virtuous circle, but trying to set it off by squeezing more out of monetary and fiscal expansion hasn't worked, and won't, especially in the absence of more specific reforms to factor markets. Spurring inclusive and sustainable growth requires deep reforms, particularly in product and labour markets, as well as in the digital and climate transitions.[30]

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28 See policy recommendation by G Isaacs, Z Mncube, L Mdutyana and K Ramburuth, 'Is South Africa heading for a "fiscal crisis"?' IEJ Policy Brief, 2023, Institute for Economic Justice. Available at: https://www.iej.org.za/wp-content/uploads/2023/10/IEJ-policybrief-MTBPS-20231.pdf.

29 See R Gürkaynak, 'Unconventional monetary policies for EMDEs: uses and consequences – practical questions and some answers', Presentation at the SARB 2023 Biennial Conference, Cape Town. Available at: https://www.resbank.co.za/content/dam/sarb/what-we-do/research/biennial-conference/updated/presentations/3b.%20Session%203%20-%20Refet%20Gurkaynak.pdf.

30 See National Treasury, 'Economic transformation, inclusive growth, and competitiveness: a contribution towards a growth agenda for the South African economy', 2019. Available at: https://www.treasury.gov.za/comm_media/press/2019/towards%20a%20growth%20agenda%20for%20sa.pdf. For a progress report, see the Presidency and National Treasury, 'Operation Vul'indlela progress update: Q3/Q4 2023 report', 2023. Available at: https://www.stateofthenation.gov.za/operation-vulindlela, For a comparative perspective, see

In short, the effectiveness of our macroeconomic policy and how we think about what to do in the macro space is closely shaped by the workings of the micro-economy. Macroeconomic policies helped to ease the way to post-GFC and post-pandemic recoveries, but they are not quick fixes to the long-run growth and job creation problems of this economy. Finding solutions to the economic challenges would benefit from clearer sighting of how macroeconomic and microeconomic policies actually work. Reform momentum has increased and many important ones are under way. We should be careful to nurture that momentum, ensure that reforms progress, and back them up with sensible long-term macroeconomic goals.

OECD, 'Economic policy reforms 2023: going for growth', 2023. Available at: https://www.oecd.org/publication/going-for-growth/2023/.