

Monetary Policy Shocks and Macroeconomic Fundamentals in South Africa

The objective of monetary policy may differ from one country to the other. What is rather undisputable is the fact that, the objective invariably includes price stability, external balance and sustainability of output growth. That the central banks in most countries are traditionally responsible for the conduct of monetary policy for the actualization of these goals is only a commonplace knowledge. From the very inception of its establishment, the South African Reserved Bank (SARB) has been tasked with the responsibility of implementing monetary policy in accordance with the macroeconomic policy objectives of the South African government. The SARB for example, has a mandate to achieve and maintain price stability in the interest of sustainable and balanced economic development and growth. There is no gainsaying that monetary policy has been proven as crucial for explaining output growth and inflation rate both in the short and long run. Yet debatable is whether the effects of monetary policy on these critical macroeconomic fundamentals are asymmetric in nature. In his simple monetary policy reaction function, Taylor (1993) assumes the response of the monetary authorities to be symmetric such that, positive and negative inflation and output gaps are met with equally weighted policy responses. This linear symmetric assumption has however, long been pronounced as too restrictive in the literature. That is, since the same size of monetary contractions and expansions could result in different magnitudes of policy effects. It is therefore, rather erroneous to assume that the policy goal variables such as output growth and inflation would respond symmetrically to monetary shocks.

Whether the effects of monetary policy shocks are asymmetric has important implications for the effectiveness of monetary policy and the transmission mechanism of monetary policy. For example, if a contractionary policy has a stronger effect on the economic activity than does an expansionary policy, the policymaker should be aware that the transmission mechanism of monetary policy could be different for contractionary and expansionary policies; moreover, the same size of monetary contractions and expansions could result in different magnitudes of policy effects. But in addition to the dearth of empirical literature on the asymmetric effects of monetary policy, the few extant studies have also uses variety of modeling approaches to analyze the

asymmetry. These approaches which include reduced-form equations, small- and large-scale structural models, and standard or structural vector autoregression models (VARs) have though proved to be popular particularly in the industrial countries. It has been however, recognized that standard applications of some of these tools are not well suited for capturing the nonlinear responses—in the form of either asymmetric responses that theoretical models suggest may be pervasive. To bride this gap, this proposed study intend to employs the nonlinear autoregressive distribution lag (NARDL) of Pesaran et al. (2014) to determine if output growth and inflation rates respond asymmetrically to monetary policy shocks in South Africa.