MONETARY POLICY PREFERENCES AND INFLATION TARGETING RULES

by
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A thesis
submitted in partial fulfilment of the
requirements for the degree of

PhD (Economics)

in the

Faculty of Economic and Management Sciences

at the

University of Pretoria

2011
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Declaration

“I declare that the Thesis, which I hereby submit for the degree PhD Economics at the University of Pretoria, is my own work and has not previously been submitted by me for a degree at another university.”
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ACKNOWLEDGEMENTS

I would like to convey sincere thanks to my supervisor Dr Ruthira Naraidoo for his guidance, support and patience ensuring a successful completion of the thesis. I wish to thank my co-supervisor Prof. Rangan Gupta for the valuable comments and suggestions. I wish to thank the academic staff and my fellow classmates at the Department of Economics at University of Pretoria for the positive interaction throughout the years. I also wish to thank everyone who made a positive contribution. Most of all, special thanks to my mother and the entire family.
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ABSTRACT

The aim of the thesis is to address issues concerning modelling and evaluation of monetary policy by obtaining targeting rules from optimisation techniques using welfare loss functions that capture asymmetries and zone targeting behaviours. The motivation is that the specification of the most widely used monetary policy rule, i.e. the Taylor rule, may not adequately capture the stylised key features of monetary policy practice as has been shown by Nobay and Peel (2003), Aksoy et al. (2006) and Boinet and Martin (2008). The thesis also addresses the importance of the behaviour of certain financial asset prices and their implications in monetary policy decision making. It also analyses the impact of uncertainty about the true state of the economy on domestic interest rates.

First, the response of monetary policy to deviations of inflation and output from their target values based on a framework that allows asymmetric and zone targeting monetary authorities’ preferences is estimated.1 Second, the monetary policy reaction function, which is augmented with a comprehensive index that collects and synthesises information from the financial asset markets is estimated for South Africa based on a framework that allows asymmetric and zone targeting monetary authorities’ preferences.2 Third, the impact of uncertainty about the state of the economy on monetary policy in South Africa using a framework that allows asymmetric and zone targeting monetary authorities’ preferences is analysed.

The main findings are that the monetary authorities’ response towards inflation is zone symmetric and their response to output fluctuations is asymmetric. The second major finding is that the conditions in the financial asset markets form an important

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1 Published in Economic Modelling
2 Published in South African Journal of Economics
information set for the monetary authorities and that the monetary authorities pay close attention to the conditions in these markets by placing an equal weight on financial asset markets booms and recessions. The empirical results also reveal a significant impact of uncertainty about the state of the economy on domestic interest rates during the inflation targeting period and that the monetary authorities exhibit discretionary behaviour when implementing monetary policy under uncertainty.

The thesis contributes to the body of knowledge in the field of economics by addressing important issues in monetary policy design and conduct using a framework that capture the stylised key features of monetary policy practice. All these issues are important in design and conduct of monetary policy. They are currently debated at many central banks including South Africa.
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