

## **We're importing inflation by accumulating dollar reserves**

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There has been much talk about the central bank's focus on controlling inflation. This has been used to justify the hikes in interest rates we have had over the past 18 months. However a bizarre situation is occurring where the central bank is actually encouraging dollar-led inflation through the continual purchase of dollars and sale of rands into the forex market.

Over the past 18 months the Canadian dollar and the Australian dollar have appreciated by 13% and 15% respectively against the US dollar, whilst the rand has depreciated by 11% over the same period, despite our economy being driven by the same fundamentals (high commodity prices). What impact can this have? The price of a barrel of crude oil, in Aussie dollar terms, is up only 13% during this period whereas in rands it is up an enormous 49%!

By following a policy of a weaker rand, or one pegged to the dollar, we are importing US dollar-led inflation. The argument that this enables us to maintain a competitive manufacturing base is completely destroyed by the fact that inflation is immediately used by organised labour to push for higher wage increases (as we have seen this past year). This immediately raises our cost of production, nullifying the effect of the weaker currency. Devaluing one's currency has never proved to be a long term sustainable way to build an export franchise (the example of Zimbabwe being a case in point).

So we sit in a curious position of an institution that is on the one hand pushing up inflation in the domestic economy through a policy of continuous reserve accumulation and, at the same time, punishing mainly the consumer with a series of interest rate hikes to supposedly reduce inflation. As long as food and energy prices continue to rise inflation expectations will remain high. Only when these factors start to taper off should we see a return of inflation to the 3% to 6% band. This fascination with building reserves and keeping a weaker rand only serves to damage the inflation psyche of the public at large, and one cannot ignore the cost to the fiscus that is being incurred as the public carries the high domestic interest rate cost to fund the buying of low-yielding dollars.

Dollar reserves over the past 18 months have grown from \$23.8 billion to \$32.8 billion - a growth rate of 32%. Why are we still building these? To sterilise this reserve the fiscus has to borrow in rands (at ever increasing rates) and earn a much lower US dollar rate. This means the taxpayers who are suffering from higher interest rates also have to pay (through their taxes) for the pleasure of importing inflation.

It is time that the central bank and the treasury begin to think more about all the available options to control the inflation scourge and how to deal with a world where a weak dollar is

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prevalent. Our largest trading partner is the Euro block where we have seen an enormous 32% decline in the value of the rand over the past 18 months. No wonder the cost of the new

Eskom power stations continue to rise, as all the technical equipment is imported from Europe. We will be living with that cost inflation for the next 30 years!

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