

**FOR
AGENDA**

SM/08/268
Correction 1

August 21, 2008

To: Members of the Executive Board
From: The Acting Secretary
Subject: **South Africa—Selected Issues**

The attached corrections to SM/08/268 (8/18/08) have been provided by the staff.

Factual Errors Not Affecting the Presentation of Staff's Analysis or Views

Page 8, Table I.2, top panel, "Korea" column, row 1: for "0.617" read "1.624"
row 2: for "12.02" read "13.68"
row 3: for "0.184" read "0.233"
row 4: for "0.89" read "0.66"
row 5: for "0.001" read "0.003"
row 6: for "0.29" read "0.84"
row 7: for "0.086" read "0.071"
row 8: for "3.68" read "2.74"
row 9: for "0.605" read "0.654"
row 10: for "189" read "121"
row 12: for "Aug '76" read "Jan '88"

Page 8, Table I.2, top panel, "Turkey" column, row 12: for "Jan '03" read "Jan '04"

Page 8, Table I.2, bottom panel, "Korea" column, row 1: for "0.621" read "1.747"
row 2: for "11.39" read "14.69"
row 3: for "0.133" read "0.038"
row 4: for "0.5" read "1.28"
row 5: for "0.001" read "0.957"
row 6: for "0.25" read "1.66"
row 7: for "0.088" read "0.002"
row 8: for "3.25" read "0.62"
row 9: for "0.621" read "0.680"
row 10: for "189" read "121"
row 12: for "Aug '76" read "Jan '88"

Page 8, Table I.2, bottom panel, “Turkey” column, row 12: for “Jan ‘03” read “Jan ‘04”

Questions may be referred to Mr. Cuevas, AFR (ext. 34523).

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

Att: (1)

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Department Heads

differentiated responses to relative price inflation and underlying inflation. A simple model of this type is the following:⁵

$$i_t = \alpha + \beta_{und} \pi_t^{und} + \beta_{rel} r_t + \lambda z_t + \gamma y_t + \varepsilon_t \quad (1)$$

In expression (1), i_t is the nominal policy interest rate; π_t^{und} is underlying inflation in the last 12 months, z_t is the nominal *depreciation* of a country's currency during the same period, y_t is the output gap, and r_t is an indicator of relative price movements for key products (food and fuel). Underlying inflation, as noted previously, denotes the rate of inflation excluding food and fuel items. The relative price variable is constructed as the residual from an auxiliary regression of headline inflation against underlying inflation—and thus reflects the component of the change in oil and food prices that is uncorrelated to changes in the prices of all other goods. In richer countries where food has a small weight in the headline price index, underlying inflation should be a more satisfactory predictor of headline inflation, reducing the usefulness of r_t (see the appendix for a fuller explanation).⁶

11. **One might expect to see $\beta_{rel}=0$ and $\beta_{und} > 0$ in equation (1) in cases where inflation expectations are well anchored and underlying inflation is less vulnerable to relative price shocks**—that is, where Mishkin's crucial assumption holds. But his is not something one should expect across the board, because even if a bank is focused on second round effects only, known sensitivity of underlying inflation to relative price shocks could motivate $\beta_{rel} > 0$.

⁵ Taylor's (1993) pioneering work on policy rules had an even simpler rule, including on the right hand side only general inflation and the output gap.

⁶ The use of this variable permits us to include in the analysis countries for which indices of food and fuel prices were not available. Were such information available, one could substitute the growth in that index for r_t in expression (1). The estimated regression coefficients and their interpretation would be different, but the information contained in the analysis would be the same.

Policy Interest Rate as in Equation 1 with OLS on lagged right-hand-side variables

Source: IMF staff estimates based on central bank and statistical institute data.
Coefficients in boldface are significant at the right-hand-side 5 percent level or better. Regressions constants not shown.
* Residuals from a regression of headline inflation on underlying inflation and a constant.

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