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The term spread, inflation and economic activity in a simple model of the monetary transmission mechanism

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Abstract

This paper presents a simple and transparent framework for the monetary transmission mechanism of the South African economy based on the model by Rudebusch and Svensson (1999). This model is extended to consider the long rate and the credit channel in the transmission mechanism. Firstly, we find that the credit channel plays a significant role in the transmission mechanism. Secondly, despite the backward looking nature of the model, impulse responses reveal that the term spread predicts output and inflation in the South African economy.

Keywords: term spread, credit channel, interest rate channel.