South African Reserve Bank
History, functions and institutional structure

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Introduction

This is the second edition of a booklet outlining the history, functions, institutional structure and management of the South African Reserve Bank (the SARB). This booklet provides all stakeholders of the SARB with a concise overview of its objectives and activities. A general understanding of these objectives and activities garner support for the policies, and regulatory and supervisory roles of the SARB.

The compilation of this booklet was inspired by questions about the objectives and functions of the SARB. These questions have often demonstrated that a central bank can hardly overcommunicate, as its actions are often misunderstood and even mistrusted.

This booklet was initiated to some degree by the existence of similar publications at other central banks. Inspiration was drawn in particular from the following publications with broadly the same aim as this booklet:

Scheller, H K. 2006. *The European Central Bank*: *history, role and functions*. 2nd revised edition. Frankfurt-am-Main: European Central Bank.

Schweizerische Nationalbank. 1992. *Functions, instruments and organisation*. 7th revised edition. Zurich: Swiss National Bank.

The Federal Reserve System. 2005. *Purposes and functions*. 9th edition. Washington, D.C.: Board of Governors of the Federal Reserve System.

Abbreviations

ATM	automated teller machine
BIS	Bank for International Settlements
BESA	Bond Exchange of South Africa
CCBG	Committee of Central Bank Governors
CMA	Common Monetary Area
CLS	Continuous Linked Settlement
CPI	consumer price index
CPIX	consumer price index for metropolitan and other urban areas excluding changes in mortgage interest cost
CPD	Corporation for Public Deposits
ELA	emergency liquidity assistance
FSB	Financial Services Board
GEC	Governors' Executive Committee
GDP	gross domestic product
G-20	Group of 20 countries
ICT	information and communications technology
IMF	International Monetary Fund
JSE	JSE Limited
LOLR	lender of last resort
MPC	Monetary Policy Committee
NFC	National Finance Corporation
NPS	national payment system
OECD	Organisation for Economic Co-operation and Development
PCH	Payment Clearing House
RAMP	reserves advisory and management programme
repo	repurchase
SDR	Special Drawing Right
STRATE	Share Transactions Totally Electronic
SAMOS	South African Multiple Option Settlement
SARB	South African Reserve Bank
SARS	South African Revenue Service
SARBCIC	South African Reserve Bank Captive Insurance Company Limited
SADC	Southern African Development Community
UK	United Kingdom
US	United States of America

Glossary

Bretton Woods institutions	Bank of International Reconstruction and Development (World Bank) and the International Monetary Fund

1 Establishment and early history of the South African Reserve Bank

The SARB is the central bank of the Republic of South Africa. The SARB was established in 1921 in terms of a special Act of Parliament, the Currency and Banking Act, 1920 (Act No. 31 of 1920). Owing to its unique role as a central bank, some people are under the impression that the SARB was the first banking institution to be established in South Africa. This, however, is not the case. The first bank to be established in South Africa was the Lombaard Bank in Cape Town, which opened its doors for business on 23 April 1793. Although this bank was fully owned by the Cape Colonial Government, it was established with a commercial objective, rather than as a central bank. It was closed in 1842 because, *inter alia*, it did not meet the banking requirements of the Cape Colony at the time. Its closure led to the establishment of other commercial banks.

The earliest proposals for the establishment of a central bank in South Africa were made as far back as 1879 by the Afrikaner Bond, a political party in the then Cape Colony. In the period between 1897 and the establishment of the SARB in 1921, various further calls were made for its establishment. In the early 1890s a series of articles advocating the establishment of a central bank appeared in *De Paarl*, a newspaper edited by Reverend S J du Toit, the founding leader of the Afrikaner Bond. Calls were again made for the establishment of a central bank to coincide with the establishment of the Union of South Africa in 1910. In 1912 the advantages of the establishment of a central bank were reiterated by Mr J Postmus of De Nederlandsche Bank voor Zuid-Afrika, who became Governor of the SARB in 1932.

Financial and economic turmoil in the period after the Great War (later known as World War I) demonstrated the advantages of establishing a central bank. Before one was established in South Africa, commercial banks printed their own banknotes for issue. These notes were backed fully by gold in terms of the gold standard, that is, the notes could be exchanged for gold. At the time of the establishment of the SARB, the authority of commercial banks to issue banknotes was a well-established practice internationally, albeit under "review", as banks of issue (as central banks were known initially) were established in various countries, particularly in Europe, during the latter part of the nineteenth century.

During the Great War the South African currency remained on the gold standard and commercial banks were obliged to redeem their notes for gold in terms of an arrangement where the domestic currency was pegged to the British currency (pound sterling) which, in turn, was pegged to the US dollar and, therefore, the gold price, in each instance at a fixed exchange rate. This arrangement ended in March 1919 when the pegging of the pound sterling to the US dollar came to an end, with the pound sterling depreciating by ⅓ against the US dollar and gold. As a result, gold obtained in South Africa through the conversion of banknotes at commercial banks could be sold at a premium in London. At the same time, domestic commercial banks had to buy gold at the same premium in London to provide the necessary backing for their banknotes in issue in terms of the gold standard. In response to a call on Government by commercial banks to be released of this obligation to "trade at a loss", a Gold Conference was convened in Pretoria in October 1919.

One of the resolutions of the Gold Conference was to request Government to introduce uniform bank legislation for the country, as no such legislation had been introduced since the unification of the country in 1910. Following on this proposal, the Government obtained the services of Sir Henry Strakosch, a British banker, to give effect to the recommendations of the Gold Conference. Sir Henry was instrumental in ensuring support for his proposal for the establishment of a domestic central bank.

Support for the establishment of a central bank was not unanimous. Of interest is the view of Mr H C Jorrissen, at the time General Manager (Chief Agent) of De Nederlandsche Bank voor Zuid-Afrika, that the timing was not right for the establishment of the SARB. In January 1921 he, nevertheless, accepted the position of first Deputy Governor of the SARB. Likewise Mr J P Gibson, at the time Joint General Manager of Standard Bank in South Africa, expressed his opposition to the proposal, but nonetheless accepted an appointment to the board of the SARB.

On 31 March 1920 a Select Committee, consisting of ten members of Parliament, was appointed to examine the practicalities of establishing a central bank. The Labour Party proposed the formation of a State Bank, modelled on the Commonwealth Bank of Australia, which would issue the nation's credit at a nominal rate of interest (two thirds of 1 per cent). The governing South African and Union Parties recommended that the advice of Sir Henry Strakosch be accepted and that a privately owned central bank (similar to the Federal Reserve Banks in the US) be established. The latter proposal was adopted on 2 August 1920 by 69 votes to 22. The adoption of this proposal also implied the adoption of the Currency and Banking Act, 1920 (Act No. 31 of 1920) and provided, *inter alia*, for the establishment of a central bank with the power to issue domestic banknotes for a period of 25 years. In 1944 this period was extended in perpetuity.

The legislation providing for the establishment and operations of the SARB was based on the legislation of the Federal Reserve Banks in the US and of the Charter of the Bank of Java (today the Bank of Indonesia), as the legislation of these two institutions was drafted not long before the establishment of the SARB.

The name chosen for the central bank of South Africa, the South African 'Reserve' Bank, reflects reference to the Federal 'Reserve' System, as this name was previously used only in the US. Subsequently, the word 'Reserve' has been used in the names of the central banks of Peru (in Spanish, *Reserva*), established in 1922; New Zealand, established in 1933; El Salvador (in Spanish, *Reserva*), established in 1934; India (1935); Australia (from 1945); Malawi (1964); Zimbabwe (originally the central bank of Rhodesia) (1964); Fiji (1973); Vanuatu (1980); and Tonga (1989).

The SARB opened for business on 30 June 1921, which makes it the oldest central bank in Africa. The first banknotes were issued to the public on 19 April 1922. Accordingly, commercial banks were instructed to cease issuing or reissuing their own banknotes with effect from 30 June 1922. This confirmed the achievement of one of the primary objectives envisaged for the SARB at the time of its establishment.

The achievement of the second primary objective, namely the restoration of the gold standard at the pre-war rate of exchange, has a somewhat more chequered history. At the time of its inception, the SARB had to deal with a situation where the country was nominally on a gold standard, but the system was effectively suspended. Government could issue gold certificates in exchange for gold bullion or specie or banknotes, but declare the certificates non-convertible, albeit only for a limited period.

The SARB's approach to monetary policy after its inception in 1921 was, therefore, to apply credit and interest rate policies aimed, in orthodox gold standard fashion, at bringing about the necessary conditions for an eventual return to such a standard. South Africa reintroduced the gold standard at the pre-war conversion rate on 18 May 1925. This put the South African pound on par value with the pound sterling, as the UK had returned to a gold standard, also at the pre-war conversion rate, on 25 April 1925.

The US, and subsequently many other countries, entered a period of sharp contraction in economic activity and price deflation, generally known as the 'Great Depression', following a crash in the prices of shares on the New York Stock Exchange in October 1929 and the subsequent curtailment of credit. The first use of the terminology 'depression' to describe the prevailing economic conditions is ascribed to US President Herbert Hoover. This terminology was used in 1930 because it sounded less frightening at the time than words such as ‘panic’ or ‘crisis’ to describe the economic situation. In the midst of these depressing economic conditions, the UK suspended the gold standard on 21 September 1931. South Africa also suffered the consequences of the worldwide depression but, nevertheless, decided to retain the gold standard independently from the UK. Full convertibility of banknotes for gold was retained and no restrictions were placed on the export or import of gold, resulting in large gold exports from South Africa.

The gold standard controversy duly developed into a political issue, with the Government of the day supporting it, and the opposition arguing that the gold standard should be abandoned and the domestic currency linked to the pound sterling. Owing to increased capital outflows in December 1932, South Africa abandoned the gold standard on 28 December 1932. This was considered a temporary emergency measure and South African banknotes continued to carry a promise of convertibility until 1992. Analysing the situation with the benefit of hindsight shows that South Africa should have followed the UK in abolishing the gold standard in September 1931. The policy of maintaining the gold standard exacerbated the domestic depression as the SARB had to follow a contractionary monetary policy, thereby aggravating economic hardship.

2 A brief overview of developments between 1933 and 2009

2.1 Monetary policy since 1933

As the gold standard was abolished by the end of 1932, it was necessary for the South African authorities to consider a new monetary policy framework for the country early in 1933. It was decided to link the value of the domestic currency to that of the pound sterling, which implied, *inter alia*, that the Union of South Africa became part of the Sterling Area.

At the outbreak of World War II in 1939 South Africa retained its membership of the Sterling Area and the country accepted the exchange control arrangements pertaining to Sterling Area countries. Domestic monetary policy was also supplemented by an extensive system of direct control measures to curb inflationary pressures during the war. At the end of World War II South Africa became part of the international exchange rate system agreed upon in terms of the Bretton Woods agreement, which implied that the external value of the currency and exchange rate stability remained the primary focus of monetary policy, but at the same time retained its membership and the exchange controls of the Sterling Area. In terms of the Bretton Woods agreement of fixed (but adjustable) exchange rates, the US dollar served as anchor currency for the international exchange rate system. The value of currencies was linked to the US dollar which was, in turn, linked to gold at a fixed price of US$35 per fine ounce.

South Africa left the Commonwealth when the country became the independent Republic of South Africa on 31 May 1961. A new decimal currency system with R2,00 equal to £1 was introduced in February 1961, replacing the previous system comprising the pound, shilling and penny (£/s/d). Exchange control measures initially introduced in terms of the Sterling Area agreement were expanded and adapted for South Africa's unique circumstances, with the introduction of restrictions on foreign investment by residents and on the repatriation of domestic investments by non-residents. In addition, South Africa adopted direct monetary controls aimed at limiting credit demand by the middle of the 1960s, which included the use of credit controls, credit ceilings and deposit rate control.

The Bretton Woods agreement collapsed in 1971 after inflationary pressures had developed in the US in the wake of the Vietnam War. In reaction to the collapse of the Bretton Woods agreement, major industrialised countries introduced a system of floating exchange rates. South Africa pegged the exchange rate of its domestic currency initially to the pound sterling, then to the US dollar, then to a basket of currencies and again to the US dollar (albeit at varying levels after formal devaluations in December 1971 and in September 1975), before a system of managed floating was introduced from January 1979.

The SARB replaced direct controls as the main instrument of monetary policy with market-oriented monetary policy from 1 September 1980. In terms of the revised monetary policy framework, the level of interest rates, as a reflection of the true cost of borrowed funds, played and continues to play a much more pivotal role than before. During 1986 the SARB announced the adoption of specific growth targets for a money supply aggregate as the country's monetary policy framework. The SARB adopted a broadly defined money supply growth target and set low-profile and adjustable, rather than fixed, targets. Money supply growth targets were replaced with money supply growth guidelines in the early 1990s. Eclectic monetary policy was adopted in 1996, which implied that the SARB monitored a wide range of economic indicators in the formulation of monetary policy.

After democratic elections in South Africa in 1994 the authorities announced a policy of gradually abolishing exchange controls. In 1995 the financial rand, an investment currency for non-residents, was abolished. This was followed by the gradual relaxation of exchange controls on domestic juristic persons and residents, which included an exchange control amnesty for natural persons. Nearly 43 000 individuals applied for, and received amnesty, in respect of previously unauthorised assets amounting to some R45 billion held abroad, despite the application of strict exchange control restrictions over residents since 1961.

Bank rate was replaced with the repo rate on 13 March 1998 as the rate at which the SARB provides liquidity to South African banks. South Africa adopted inflation targeting as a monetary policy framework in 2000. At the time, inflation targeting was used by 12 countries and is currently used by the countries listed in Table 5 on pages 64 and 65.

The inflation rate used for targeting purposes was initially specified in terms of changes in the CPIX. South Africa adopted a target range of 3 to 6 per cent per annum. Minor changes to the targeting framework have been announced from time to time since 2000. Owing to a rebasing of the South African CPI with effect from 2009, it was announced in October 2008 that changes in the CPI, rather than changes in the CPIX, would be used for inflation targeting purposes from January 2009, although the target range of 3 to 6 per cent was retained.

2.2 Institutional structure and executive

Since the inception of the SARB it was necessary to amend its enabling legislation from time to time to take cognisance of changed circumstances. After the initial legislation, the Currency and Banking Act, 1920, was amended four times before it was replaced with the South African Reserve Bank Act, 1944 (Act No. 29 of 1944). One of the main considerations in the adoption of new legislation in 1944 was that the Currency and Banking Act, 1920 entrusted the SARB with monopoly powers to issue banknotes for only 25 years, that is, until 1945. As these powers were therefore about to expire, it was necessary to reconsider the SARB's legislative framework.

The Act of 1944 was amended nine times before its replacement by the South African Reserve Bank Act, 1989 (Act No. 90 of 1989). Since 1989 this Act has been amended eight times, also to ensure that it remains aligned with the Constitution of the Republic of South Africa, 1996 (Act No. 108 of 1996), which makes provision for a central bank for the Republic of South Africa. Initially, the Act of 1989 entrusted to the SARB, as primary objectives, monetary stability and balanced economic growth in South Africa. The primary objective of the SARB in the Act was changed in 1996 to the protection of the value of the currency of the country.

The following people have served as governors of the SARB since 1921:

- Mr W H Clegg, 17 December 1920 to 31 December 1931
- Mr (later Dr) J Postmus, 1 January 1932 to 30 June 1945
- Dr M H de Kock, 1 July 1945 to 30 June 1962
- Mr (later Dr) G Rissik, 1 July 1962 to 30 June 1967
- Dr T W de Jongh, 1 July 1967 to 31 December 1980
- Dr G P C de Kock, 1 January 1981 to 7 August 1989 (the only person who died while still serving as Governor)
- Dr C L Stals, 8 August 1989 to 7 August 1999
- Mr T T Mboweni, 8 August 1999 to 8 November 2009
- Ms G Marcus, since 9 November 2009.

Mr W H Clegg was born in Bloemfontein in South Africa, but his family moved to the UK shortly after his birth, following the death of his father. Mr Clegg was a career central banker in the Bank of England, which he joined in 1886 despite the fact that he had no formal academic training in banking or economics. At the time of his appointment as Governor of the SARB, he was Chief Accountant of the Bank of England. Mr Clegg served two terms as Governor, and served one additional year to oversee the completion of the construction of the SARB's head office building on Church Square in Pretoria. After his retirement as Governor, he returned to the UK to take up an appointment as an Executive Director on the Court (board) of the Bank of England. He served in this capacity until 1937.

Dr J Postmus was appointed as the second Deputy Governor of the SARB after the retirement of his predecessor, Mr H C Jorrissen. It was the second time that he had filled a vacancy left by Mr Jorissen, as he was also appointed General Manager of De Nederlandsche Bank voor Zuid-Afrika when Mr Jorissen relinquished that position to become Deputy Governor in 1921. Dr Postmus was born in the Netherlands and moved to South Africa in 1903. He served as board member of the Bank from 9 May 1921 to 30 June 1923, when the representation of banks on the board was terminated. Upon Mr Clegg's retirement, Dr Postmus was appointed as Governor on 1 January 1932. Like his predecessor, Dr Postmus had no formal training in banking or economics, but was awarded a DCom (*honoris causa*) by the University of Pretoria in 1946.

Dr M H de Kock was appointed as Deputy Governor when Dr Postmus assumed Governorship of the SARB on 1 January 1932. Dr de Kock served as an official of the SARB from 1 January 1931, pending his appointment as Deputy Governor. He obtained a BA degree from Victoria College (today the University of Stellenbosch) and a DPhil degree in 1922 from Harvard University. Before joining the SARB, Dr de Kock served as an academic, at the Board of Commerce and Industry and at the Diamond Advisory Council. When Dr Postmus retired in 1945, Dr de Kock was appointed as Governor with effect from 1 July 1945. Dr de Kock was the author of *Central Banking* published in 1939, the first comprehensive textbook on this topic. He received honorary doctorates from the Universities of Cape Town, Natal (today KwaZulu-Natal) and Stellenbosch.

Dr G Rissik joined the SARB as a clerk in 1923. Through part-time studies at the University of Pretoria he obtained a BCom degree and passed the membership examinations of the Chartered Institute of Secretaries. He was appointed as Secretary of the Bank in 1943 and became Chief Cashier in 1950. This was followed by his appointment as Executive Assistant in 1958, Deputy Governor in 1960 and Governor in 1962. Dr Rissik received an honorary DCom degree from the University of Pretoria in 1964 and stepped down as Governor in 1967.

Dr T W de Jongh was appointed as Governor from 1 July 1967, after he had served as Executive Assistant from 1962. He obtained BSc and MSc degrees in mathematics from the University of Stellenbosch and an MA degree from Columbia University. This was followed by a DCom degree at the University of Pretoria. Before joining the SARB as its first statistician on 1 January 1946, he served at the Education Department and the Industrial Development Corporation. Dr de Jongh's appointment as statistician followed the realisation that South Africa suffered a lack of economic and financial statistics at the time. He retired as Governor on 31 December 1980.

Dr G P C de Kock, a son of Dr M H de Kock, a previous Governor, was appointed as Governor from 1 January 1981. He occupied the position until 7 August 1989. Dr de Kock completed BA and MA degrees at the University of Pretoria and MA and DPhil degrees at Harvard University. He joined the SARB as an economist in 1955. After seconded service in the Treasury and as an Alternate Executive Director of the IMF, he was appointed Deputy Governor on 1 July 1971 and Senior Deputy Governor on 1 July 1976. He was seconded from 1977 to the end of 1980 as Special Economic Advisor to the Minister of Finance, but retained his position as Senior Deputy Governor of the SARB while on secondment.

Dr C L Stals was appointed Governor on 8 August 1989. He joined the SARB as a clerk in 1955 and obtained BCom, MCom and DCom degrees through part-time studies from the University of Pretoria. He was appointed Deputy Governor on 1 April 1976 and Senior Deputy Governor on 1 January 1981. From 1985 to 1989 he relinquished his positions at the SARB and on the boards of its subsidiaries, as he was seconded to the National Treasury. After serving two terms as Governor, Dr Stals retired on 7 August 1999.

Mr T T Mboweni was appointed Governor on 8 August 1999, after serving as Advisor to the Governor from July 1998. He was reappointed on 8 August 2004 and retired on 8 November 2009. Mr Mboweni obtained a BA degree from the National University of Lesotho and an MA degree from the University of East Anglia. He was Deputy Head of the Department of Economic Policy of the African National Congress until his appointment as Minister of Labour in May 1994. Mr Mboweni serves as honorary Colonel of 1st SA Tank Regiment and was appointed as honorary professor in economics at a number of universities. He also received a number of honorary doctorates. Mr Mboweni does not use his honorary titles.

Ms G Marcus assumed duty as Governor on 9 November 2009. She obtained a BCom degree from the University of South Africa (Unisa). Ms Marcus worked for the African National Congress from 1970 to 1994, and served as its Deputy Secretary of Information. She was elected to Parliament in 1994 and chaired the Joint Standing Committee on Finance until her appointment as Deputy Minister of Finance in 1996. From 1999 to 2004 Ms Marcus served as Deputy Governor of the SARB. She was the first female to be appointed as one of the deputy governors of the SARB. From 2004 to 2007 Ms Marcus served as Professor in Policy, Leadership and Gender Studies at the Gordon Institute of Business Science (GIBS). She continued to serve as a Visiting Professor after her appointment as non-executive Chairperson of the Absa Group in July 2007. She relinquished both these positions in July 2009. Ms Marcus is patron of the Pretoria Sungardens Hospice and the Working on Fire Programme.

3 Mission statement of the South African Reserve Bank

3.1 Introduction

At the time of its first establishment, the SARB had the achievement of two clear goals in mind, which can be regarded as its mission at the time. The SARB's first aim was to restore order in the issue of domestic banknotes, a function that it still performs. Secondly, the SARB aimed to restore the gold standard, a goal that was achieved from 1925 to 1932.

In 1990 the SARB accepted a formal mission statement for the first time, which stated that its aim was to protect the internal and external value of the rand. This objective, albeit in a revised format (i.e., to protect the value of the currency), is also contained as the primary goal of the SARB in the Constitution of the Republic of South Africa, 1996. Between 2000 and 2004, the SARB's mission statement described its primary goal in the South African economic system as *the achievement and maintenance of financial stability*. From 2005 it was changed to *the achievement and maintenance of price stability*.

The Bank endeavours to remain relevant, effective and viable amidst constant change in a complex environment. After the appointment of the new Governor, the Bank assessed and, in some instances, adjusted its mission, vision, strategy, objectives and organisational philosophy. The outcome of this exercise is covered below.

3.2 Primary purpose

The primary purpose of the Bank is to achieve and maintain price stability in the interest of balanced and sustainable economic growth in South Africa. Together with other institutions, it also plays a pivotal role in promoting financial stability.

To this end the Bank is, among other functions, responsible for
- formulating and implementing monetary policy;
- issuing banknotes and coin;
- supervising the banking sector;
- ensuring the effective functioning of the national payment system;
- managing official gold and foreign-exchange reserves;
- acting as banker to the government;
- administering the country's remaining exchange controls; and
- acting as lender of last resort in exceptional circumstances.

Given its national importance and unique influence on the economic wellbeing of the general public in South Africa, the Bank promotes good corporate governance. Although it is directly accountable to Parliament, the Bank enjoys operational autonomy. The Bank is not a profit-driven institution, but strives to function efficiently. A number of corporate values specific to successful central banks apply to the Bank. These include

- maintaining trustworthiness and credibility;
- demonstrating exceptionally high degrees of integrity; and
- maintaining professionalism and excellence in the delivery of services.

In the final instance, the Bank aims to be a respected institution and a beacon of stability that follows an agile, responsive and flexible approach to its operations.

4 Ownership, legislative framework, autonomy and ultimate accountability

When the SARB was established in 1921, the majority of central banks worldwide had private shareholders (or 'stockholders' as they were occasionally called). A similar structure was introduced in South Africa. Internationally, hovewer, this approach has changed since the 1930s. Nationalisation of central banks during this period of economic hardship in the midst of the Great Depression commenced with the central bank of Denmark in 1936. After World War II, nationalisation of central banks continued in the wake of state ownership of key industries in numerous countries.

The structure of shareholding in the SARB has not been amended since its inception. It is a juristic person in terms of its own Act. The SARB and nine other central banks (Austria, Belgium, Greece, Italy, Japan, Pakistan, Switzerland, Turkey and US) have shareholders other than the governments of their respective countries.

The SARB has some 650 shareholders. Shares were delisted from the JSE on 2 May 2002 as amendments to the listings requirements of the JSE made continued listing impossible. Since delisting the shares are predominantly traded on an over-the-counter trading and transfer facility. Except for the provision of the Act that no individual shareholder may hold more than 10 000 shares of the total number of 2 000 000 issued shares, there are no other limitations on shareholding. The dividend is limited to 10c per share per annum (in total R200 000 per annum).

The SARB annually holds an ordinary meeting of shareholders at its Head Office building in Pretoria. On this occasion the Governor, as Chairperson, delivers an annual address on matters covering the state of the economy, certain aspects of monetary policy and the operations of the SARB, which are widely reported in the media. At this meeting the SARB tables a comprehensive *Annual Report* on its operations and finances for approval by shareholders. The *Annual Report* also contains a discussion of monetary policy.

At present, sections 223 to 225 of the Constitution of the Republic of South Africa, 1996, the South African Reserve Bank Act, 1991, and the regulations framed in terms of this Act, provide the enabling framework for the SARB's operations. The SARB enjoys a considerable degree of autonomy in the execution of its duties. In terms of section 224 of the

Constitution, 1996, *the South African Reserve Bank, in pursuit of its primary object, must perform its functions independently and without fear, favour or prejudice, but there must be regular consultation between the Bank and the Cabinet member responsible for national financial matters*. The independence and autonomy of the SARB are, therefore, entrenched in the Constitution, 1996.

The SARB has been entrusted with the overarching monetary policy goal of containing inflation. The SARB can use any instruments of monetary policy at its disposal to achieve this monetary policy goal. This implies that the SARB has instrument independence in monetary policy implementation, but not goal independence in the selection of a monetary policy goal.

The Governor holds regular discussions with the Minister of Finance, and meets periodically with members of the Parliamentary Portfolio and Select Committees on Finance. In terms of section 32 of the Act, the SARB publishes a monthly statement of its assets and liabilities, and submits its *Annual Report* to Parliament. The SARB is, therefore, ultimately accountable to Parliament. This also ensures that the Government cannot exercise undue influence over the SARB in furthering any party-political agenda.

5 Inflation

Inflation describes a process of continuously rising prices, commonly measured as the percentage rate of increase in a price index. The word ‘inflation’ owes its origin to the Latin word *inflare*, which literally means “to blow into”, from *flare*, “to blow”. As a description of declines in the purchasing power of banknotes in circulation, the word ‘inflation’ has been in use from around the 1850s. The current understanding of the word inflation is contrasted with its earlier meanings. Today inflation is synonymous with a rise in prices, but for many years it was used to describe the declining value of paper money. An increased availability of cash will not necessarily make the public wealthier – printing more banknotes and distributing them freely to the public will simply lead to higher prices for the available goods and services. This could lead to an inflationary process if the increase in money supply is not accompanied by a rise in the production of goods and services. Increased wealth can only be derived from the increased production of goods and services.

Going back as far as the Roman Empire, inflation has been experienced in different ways over many centuries in different countries, regimes and economic systems. Diocletian tried (in vain) to curb Roman inflation in the fourth century AD. He fixed the maximum prices at which beef, grain, eggs, clothing and other articles could be sold, and prescribed the death penalty for anyone charging higher prices. This is a very early example of direct price controls aimed at containing price increases, but failed so miserably that it had to be abandoned after much bloodshed.

An ‘anti-inflationary policy’ can be described as actions taken against a rise in the general price level. The central aim of all the SARB’s policy actions is to ensure low inflation, which is aligned with its mission statement, as this ensures that the people of the country have faith and confidence in the value of the money they use. Low inflation means that the continuous rise in the general price level, that is, in the prices of all goods and services, is at such a low level that it no longer influences the decision-making of consumers and producers.

A precondition for the efficient working of a market economy is that producers and consumers must be able to identify changes in the relative prices of goods and services. The identification of changes in relative prices allows producers and consumers to take appropriate economic decisions that ensure the most efficient allocation of productive resources, especially in respect of the use of labour and machinery, and the purchase of goods and services. When all prices rise continuously, a serious problem arises. Producers and consumers can then take wrong decisions because they cannot distinguish properly between the changes in relative prices (reflecting relative scarcity) and price increases that form part of an ongoing inflationary process.

Economic efficiency is sacrificed and scarce resources may not necessarily be used efficiently during periods of continuous high inflation. High rates of inflation inevitably lead to a decline in the efficient working of a market economy. In the medium to longer term this could lead to a lower rate of growth of the economy as a whole and, therefore, low levels of employment creation. Apart from disguising changes in relative scarcity, other important disadvantages of inflation are the following:

- Losses to savers, because the capital of their savings loses value as the value of money becomes eroded by rising prices
- Losses to people with fixed incomes such as pensioners
- Increased efforts to hedge against price rises by investing in assets such as precious metals or collectables instead of focusing on production
- Resources are wasted under conditions of hyperinflation, for example, at inflation rates of more than 1 000 per cent per annum (which South Africa has, fortunately, never experienced), as prices have to be revised frequently, which is a costly procedure
- Hardship for poor people, as price increases emanating from inflation erode the buying power of their incomes.

Although it is sometimes stated publicly that higher inflation will create jobs, this is not true. Higher inflation destroys jobs in the long run. It is true, however, that policies aimed at lowering inflation might have a short-term negative effect on job creation.

In its quest to contain inflation, South Africa has adopted an inflation-targeting monetary policy approach. This policy framework was announced by the Minister of Finance in February 2000, and entrusts the SARB with the responsibility of keeping the rate of inflation between 3 and 6 per cent. In South Africa the central bank has the autonomy to adjust monetary policy, but does not have goal independence, that is, the autonomy to select its own policy goal. Its goal is to keep the rate of inflation between 3 and 6 per cent per annum. The rate of inflation is calculated by Statistics South Africa.

South Africa's CMA partner countries (i.e., Lesotho, Namibia and Swaziland) follow a policy of exchange rate targeting in keeping the exchange rates of their currencies fixed to the South African rand. The implication is that these countries indirectly follow an inflation-targeting policy, with the concomitant advantages of such a policy.

Inflation targets assist the central bank in achieving price stability by providing a nominal anchor for monetary policy and inflation expectations; enhancing the credibility of the central bank in containing inflation; and improving the transparency and accountability of monetary policy.

The adoption of an inflation-targeting framework implies that countries following such a policy are distinguished in two respects from countries following other monetary policy frameworks. First, such a policy confirms a country's commitment to achieving a particular level of inflation, specified in terms of the inflation target. This communicates the commitment of monetary policy to all stakeholders of a central bank following such a policy. Secondly, it implies that the country adopts a forward-looking policy, with expectations and projections of future inflation influencing monetary policy decisions.

Countries adopting an inflation targeting monetary policy framework have adopted either a target range or a specific numerical target point. A target range permits flexibility in the application of monetary policy, but might induce the central bank to keep inflation just below the upper limit of the range, rather than well within the range. To date no country that has introduced a policy of inflation targeting has chosen a zero rate of inflation as a target or midpoint for an inflation target range. The specification of the rate of inflation to be used for targeting purposes, and particularly the question whether any prices should be excluded from the target measure, is a matter to be considered by a country adopting an inflation target. No single practice has unanimous international support.

Table 5 shows that three inflation targeters use a single point, while eleven countries use a single-point target with a range around the target point. Ten countries use a target range. The implication is a clear preference for a range, rather than the use of a single point as target. This table shows hardly any correlation between the specification of any of the targets and the inflation rates used for targeting purposes, with large differences in the inflation rate specifications. In view of these differences, comments on the choice of a target point or range should be made only once all the relevant facts have been considered.

Over the period 1921 to 2009 average prices, as reflected by changes in the CPI, increased at an average rate of some 5,5 per cent per annum. Put differently, the implication is that today R1,00 will, on average, buy the same goods that could be bought for about 1 cent in 1921. South Africa's experience of inflation since 1961 is highlighted in Table 4. This continuous pattern of price increases over a prolonged period shows the importance of continued central bank vigilance against inflation. Table 4 also shows that the SARB has achieved considerable success in containing inflation since the adoption of inflation targeting as its monetary policy regime.

6 Summary of main functions

The next five chapters summarise the main functions of the SARB. In chapter 7 the responsibilities of the SARB for the formulation and implementation of monetary policy is explained. This function also entails responsibility for the management of South Africa's official gold and foreign-exchange reserves.

The services rendered by the SARB to the South African Government are highlighted in chapter 8. As is highlighted in that chapter, the SARB renders banking services to the central government and administers exchange control on behalf of the government.

The SARB's responsibility for the provision of economic and statistical services is explained in chapter 9. The SARB is responsible for the collection, processing, interpretation and publication of information.

The responsibilities of the SARB for the supervision of the South African money and banking system are highlighted in chapter 10. These responsibilities are wide-ranging in nature. Apart from its responsibility for bank supervision in South Africa, the SARB is also responsible for the settlement of interbank claims. In addition, the SARB serves as banker to other banks and issues banknotes and coin for use by the public. The SARB also assesses the stability and efficiency of the financial system and can assist banks experiencing temporary liquidity shortages.

The last main function of the SARB is the provision of its own internal support services. As is explained in chapter 11, this includes the provision of adequate accounting systems and ICT services, and the management of human resources.

7 Formulation and implementation of monetary policy

7.1 Formulation of monetary policy

The formulation of South African monetary policy is entrusted to the MPC of the SARB. The Governor, deputy governors and other senior officials of the SARB serve as members of the MPC. The SARB's refinancing system is the main mechanism used for the implementation of monetary policy. The repo rate is the rate of interest charged on such refinancing. The repo rate is set and reviewed at meetings of the MPC. The timetable for meetings is finalised before the beginning of each year. The general public is therefore aware of the meeting dates of the MPC well in advance. Should the need arise, however, the MPC can convene unscheduled meetings. On each occasion, the MPC meets over two consecutive days.

Economic developments are monitored continuously between meetings, particularly those developments that can have a direct impact on inflation and, therefore, on the monetary policy stance. Members of the MPC receive frequent briefing updates and consider research outputs from various domestic and international sources.

Preparation for scheduled meetings of the MPC commences three to four weeks before the date of the meeting, when members of the GEC consider the assumptions for forecasting inflation. A "suite of econometric models" is used for the purpose of forecasting inflation. Although great emphasis is placed on the forecast, it should be noted that there is no mechanical relationship between the forecast and monetary policy decisions. While forecasting is a tool used to assist with monetary policy decision-making, the final decision about the level of, and changes to, the repo rate is not based simply on the forecast.

In reaching its interest rate decision, the MPC considers various factors that influence inflation, for example (in alphabetical order), changes in administered prices; changes in wages, productivity and unit labour cost; components of domestic and external demand; exchange rate developments; import prices, money supply and credit extension; oil prices; and the expected output gap (the gap between actual and potential output). The MPC has no level or target for any of these variables and the rate of inflation is the benchmark for monetary policy decisions. In general, decisions are made by consensus and MPC members do not vote. The decision of the MPC is announced at a media conference, which is televised by the national broadcaster with a simultaneous webcast on the SARB website, and in a media statement.

7.2 Implementation of monetary policy

The refinancing system is the mechanism used by the SARB for the implementation of monetary policy. Through the refinancing system the SARB provides liquidity to banks, thereby enabling them to meet their daily liquidity requirements. In this context, 'liquidity' bears reference to the available balances of banks used for settling interbank claims through the SAMOS system, over and above their minimum level of statutory reserves. In terms of the SA Reserve Bank Act, 1989, and the regulations framed in terms of the Banks Act, 1990 (Act No. 94 of 1990), and the Mutual Banks Act, 1993 (Act No. 124 of 1993), banks are required to hold in cash a prescribed percentage of their total liabilities, as adjusted to exclude certain liabilities, on their cash reserve accounts at the SARB.

In terms of its monetary-policy implementation framework, the SARB ensures that its key policy rate (the repo rate), remains effective by compelling banks to borrow a substantial amount (i.e., the liquidity requirement or money-market shortage) from the SARB by means of repurchase transactions on which they pay the repo rate as the rate of interest. The application of a statutory cash reserve requirement is the main instrument available to the SARB to create a structural liquidity shortage in the money market.

The repo rate influences money market interest rates in two ways. First, it has an influence on the cost of funding for banks. Secondly, the level of the repo rate reflects the monetary policy stance of the SARB. Banks link the level of their prime overdraft rates to the level of the repo rate and adjust their prime overdraft rates whenever the repo rate changes. The margin between the repo rate and the prime overdraft rate is currently 3,5 percentage points. This linkage ensures that the repo rate influences the pattern and level of interest rates charged by banks, the general level of interest rates in the economy and, consequently, other economic aggregates such as money supply, bank credit extension and, ultimately, the rate of inflation.

To influence the level of liquidity in the system, the SARB transacts regularly through open-market transactions in the money market. Open-market transactions refer to trading in SARB debentures, longer-term reverse repos, foreign-exchange swaps and the movement of central Government and CPD funds between the SARB and the banking sector.

The SARB estimates the overall liquidity requirement of banks on a daily and weekly basis. The overall liquidity requirement is increased or decreased only by transactions between a domestically registered bank and the SARB. Transactions and transfers among the banks themselves or with businesses and the general public do not affect the overall liquidity requirement in the money market. In these liquidity estimates all transactions that either expand or contract the balances of banks at the SARB are taken into consideration. Such transactions include the flow of notes and coin outside the central bank; gold and foreign-exchange transactions; the flow of funds between the government's accounts held at the SARB and in the banking system; and open-market operations conducted by the SARB. These transactions are also reflected on the balance sheet of the SARB. As regards the balance sheet of the SARB, the following generally applies:

- An increase in a liability of the SARB increases the liquidity requirements of the banking sector
- An increase in an asset of the SARB decreases the liquidity requirements of the banking sector
- A decline in a liability of the SARB decreases the liquidity requirements of the banking sector
- A decline in an asset of the SARB increases the liquidity requirements of the banking sector.

The main refinancing (or liquidity-providing) facility available to banks is the weekly refinancing repo auction of the SARB, where liquidity is provided by means of a repo transaction. Banks borrow cash from the SARB against the security of eligible collateral, comprising all securities that qualify as 'liquid assets' in terms of the prudential liquid asset requirement, as well as all securities that constitute the all-bond index as calculated by BESA. The weekly repo has a duration of one week. The weekly auction is conducted on Wednesdays, when the SARB invites banks electronically to tender for the amounts of refinancing (i.e., liquidity) that they need. The SARB publishes a range within which the daily liquidity requirement is expected to fluctuate. The expected average range for the week is also released.

Upon maturity the transaction is reversed, that is, banks return the cash to the SARB in exchange for the securities. No actual flows of cash and securities take place. The accounts of banks held at the SARB are merely credited and debited, and the ownership of securities is transferred electronically in the Central Depository and on the Financial Instruments Register.

Although the main repo auctions provide the estimated required liquidity of banks for a week, daily square-off operations are entered into to absorb liquidity swings in the market. Such swings can be caused by, for instance, changes in the value of notes and coin in circulation, movements in the accounts of the CPD, government spending and foreign-exchange transactions.

In the case of a daily shortage, further refinancing is provided, either by means of a supplementary repo auction (conducted at the repo rate) or a standing facility repo (conducted at a rate 50 basis points above the repo rate). With these transactions the SARB also provides liquidity to banks in exchange for qualifying securities. These transactions mature on the next working day.

The SARB can also absorb daily surplus liquidity from the market by means of a supplementary reverse repo auction (at the repo rate) or a standing facility reverse repo (at a rate 50 basis points below the repo rate). These transactions also mature on the next working day and imply that the SARB provides banks with securities as collateral on an overnight basis and pays interest on the cash it absorbs.

In addition to the supplementary auctions and standing facilities mentioned above, banks have access to their cash reserve balances at the SARB for liquidity management purposes, on condition that they adhere to the reserve requirements on an average basis over the relevant maintenance period.[1] If a bank uses some of its cash reserves for a day or two (thus falling below the required amount), it has to hold additional reserves in its reserve account with the SARB thereafter to ensure that it complies, on average, with the statutory reserve requirement. This arrangement provides an additional mechanism for banks to manage their short-term liquidity needs.

7.3 Management of official gold and foreign-exchange reserves

7.3.1 Rationale for central banks holding foreign reserves

Central banks generally hold foreign reserves – assets denominated in foreign currency – for a number of reasons. First, central banks hold foreign currency to fund foreign-exchange market operations that arise as part of their broad monetary policy functions. Holding foreign reserves, therefore, gives the central bank the option to buy or sell

1 The term ‘maintenance period’ refers to the system of control used to ensure that banks comply with their statutory cash reserve requirements (currently 2,5 per cent of their liabilities). Each maintenance period commences on the fifteenth business day of a month, and there are 12 such periods in a calendar year. During each of these maintenance periods every bank should keep cash reserve balances with the SARB that equal, on average, an amount equivalent to their cash reserve requirements as calculated at the end of the month preceding the respective maintenance period.

foreign exchange that could be used to influence the level of the exchange rate.[2]

Second, central banks hold foreign reserves for transactions purposes, for example, to fund demands for foreign exchange from the public sector, such as the government wishing to repay a maturing foreign loan or to effect foreign payments. Third, holding foreign reserves serves as a buffer against international financial shocks or crises. With such holdings a central bank is able to provide liquidity in the event of extreme market movements in an attempt to maintain investor confidence in markets. The last reason relates to the potential enhancement of the country's credit rating.

7.3.2 Adequate level of foreign reserves

When the Bretton Woods system, essentially a system under which exchange rates were fixed, collapsed in the early 1970s, countries moved towards more flexible exchange rates and it was anticipated that foreign reserve requirements would be reduced. This has not proven to be the case, as many countries have still chosen to intervene in the foreign-exchange markets. Increases in exchange rate volatility may also have encouraged central banks to increase their holdings of foreign reserves.

The level of foreign reserves may be described as adequate when a central bank feels that it can achieve its selected objectives. While there are no universally applicable measures for assessing the adequacy of foreign reserves, specific country circumstances, for example, the exchange rate regime; foreign indebtedness and the maturity structure of foreign debt; the balance-of-payments position; the volatility of capital flows; the openness of the economy; and access to capital markets all impact on considerations regarding adequacy of foreign reserves.

It should be noted that an adequate level of reserves, however defined, is required for almost every country that seeks to employ the savings of other nations to develop its own economy.

7.3.3 Evolution of reserve management

In 1994 a low level of gross reserves and an oversold forward book in foreign exchange held by the SARB resulted in South Africa running a huge negative international liquidity position.[3] This forced the SARB to

2 In the case of South Africa, which follows an inflation-targeting framework, the SARB does not intervene in the foreign-exchange market in an attempt to influence the value of the currency.

3 The international liquidity position only moved into positive territory in 2003.

focus on liquidity management.[4] Over time, as accumulated reserves increased, the focus gradually shifted towards active management of these reserves, leading to the appointment of external fund managers in 1999. This was followed by participation in the World Bank's RAMP in 2005. The SARB agreed with the World Bank that a top down review of the investment process and portfolio structure of the foreign-exchange reserves was appropriate. The SARB, therefore, embarked on a detailed analysis to determine an appropriate strategic asset allocation,[5] given its reserve management objectives. Following an overall review of reserves management, a number of refinements with respect to the SARB's investment policy and changes to the governance structure were introduced.

7.3.4 Management of official foreign reserves in South Africa

The SARB holds and manages the official foreign reserves of South Africa. In common with most central banks, the SARB has the following objectives:

- *Capital preservation*: risks are controlled in a prudent manner to ensure the security of reserves
- *Liquidity requirements*: timely availablity of reserves to meet commitments without incurring significant penalties
- *Income generation*: market-related total return within a framework of acceptable risk.

With these objectives in mind, the SARB structures its foreign-exchange reserves into three tranches, namely, (1) liquidity, (2) buffer and (3) investment. The purpose of the liquidity tranche is to have relatively liquid funds for operational requirements, for example, for managing domestic liquidity. The buffer tranche is for replenishing the liquidity tranche when necessary and may be seen as fulfilling the role of holding precautionary balances. The investment tranche focuses on the enhancement of returns within a framework of a specified and prudent risk appetite.

In recent years the value of official gold and foreign-exchange reserves held by the SARB has increased significantly. As a result, the efficient management of reserves has become a key activity of the SARB, and has

4 The SARB manages the official foreign reserves of South Africa by virtue of its powers and duties as spelt out in section 10(1)s of the South African Reserve Bank Act, 1989, namely to "perform such other functions of bankers and financial agents as central banks customarily may perform".

5 Strategic asset allocation involves the determination of the appropriate asset allocation to achieve pre-determined long-term investment objectives. This process involved both historical and forward-looking analyses to determine the optimal target duration for the investment and appropriate buffer tranches of foreign reserves.

as its purpose the achievement of a satisfactory return within acceptable risk parameters. A large portion of the SARB's foreign-exchange reserves is managed internally within strict guidelines to achieve this goal, while a smaller portion is managed by external fund managers, also within strict guidelines. The external fund management programme was initiated in the late 1990s mainly to enhance reserve management capacity in the SARB through skills and technology transfer, and to provide enhanced returns. The overwhelming portion of the SARB's foreign-exchange reserves is held in very liquid form, either in deposits or securities that are of high qualtiy and readily marketable in international financial markets. That is, similar to other central banks, the SARB has maintained a conservative universe of eligible securities in its foreign reserves portfolios. Securities are denominated in a narrow range of major international currencies.

As part of its reserve portfolio, the SARB also holds bullion and gold coin. These holdings tend to be passively held, that is, not actively managed with a view to gaining a return on these assets.

8 Services rendered to Government

8.1 Banker to the Government

The SARB provides banking services to the central government, although this function has been trimmed down after the Government began holding cash balances with other banks. The SARB is responsible for the movement of government funds to, from, and between, other banks. Such movements have an effect on the cash holdings of banks and, therefore, serve as a convenient additional instrument for managing the liquidity of banks.

The SARB provides the necessary infrastructure to the South African Government to effect payments via electronic funds transfers and the clearing system. This enables Government to pay creditors, staff salaries and related expenses. The SARB also holds as part of its assets government bonds within the prescriptions of the SA Reserve Bank Act, 1989.

Other functions include assisting Government in dealing appropriately with fraudulently encashed cheques, missing cheque items and surplus cheques; liaising with commercial banks on behalf of central government; administering stop payments related to government cheques; and providing cash management facilities to government departments that hold accounts with commercial banks.

8.2 Administration of exchange controls

The SARB is responsible, on behalf of the Minister of Finance, for the day-to-day administration of exchange controls in South Africa. Exchange control regulations are legal provisions that limit the extent to which South African residents and companies may transfer funds abroad.

In line with the stated objective of a structured relaxation of exchange controls, lenient limits for foreign payments and investments by residents and local companies have been introduced in a gradual fashion over time. In 2003 and 2004 South African individuals were granted an opportunity to apply for amnesty in respect of the regularisation of their foreign assets held in contravention of exchange control regulations.

Controls over non-residents, 'affected persons',[6] and emigrants have been relaxed considerably, as is explained below.

6 'Affected persons' are body corporates, foundations, trusts or partnerships operating in South Africa, or estates, in respect of which 75 per cent or more of:
- their capital, assets or earnings may be paid to, or to the benefit in any manner of, any person who is not resident in South Africa; or
- the voting securities, voting power, power of control, capital, assets or earnings thereof, are directly or indirectly vested in, or controlled by, or on behalf of, any person who is not resident in South Africa.

The exchange control regulations empower the National Treasury to control all dealings in gold and foreign currency, and the export of gold. The administration of some of these powers is delegated to the SARB, while the export of gold is regulated by the Precious Metals Regulator in consultation with the exchange control authorities. The implication of this arrangement is that policy decisions about exchange controls are made and announced by the Minister of Finance and the National Treasury, while the SARB administers exchange controls in accordance with policy.

Comments about the suitability or otherwise of the current system of exchange controls in South Africa are often misdirected. It is often stated that the SARB should abolish exchange controls, but decision-making about the abolition of exchange controls has not been entrusted to the SARB.

In its administration of exchange controls, the SARB is assisted by a number of banking institutions in South Africa that have been appointed as Authorised Dealers in foreign exchange by the Minister of Finance. These institutions undertake foreign-exchange transactions for their own account with their clients, within limits and subject to conditions laid down by the SARB.

The current exchange control dispensation differentiates between different classes of institutions, and between institutions and private individuals in terms of types of transactions and payments abroad that are permitted.

8.2.1 Institutional investors

Exchange control limits on foreign investment by institutional investors – insurers, pension funds, collective investment schemes and investment managers – have gradually been liberalised since 1996. Foreign diversification of investment portfolios, consistent with prudential limits, has largely been achieved. The prudential regime has been further streamlined by the abolition of the pre-approval process whereby authorised dealers may effect foreign currency transfers on behalf of institutional investors, without referral to the SARB.

Retirement funds and the underwritten policy business of long-term insurers may invest up to 20 per cent of their total retail assets abroad. Investment managers registered with the FSB as discretionary managers for exchange control purposes, collective investment scheme management companies and investment-linked business of long-term insurers cannot invest more than 30 per cent of their total retail assets under management abroad.

Institutional investors can invest an additional 5 per cent of their total retail assets abroad by acquiring foreign currency-denominated portfolio assets in Africa. This can be achieved through foreign currency transfers from South Africa or by acquiring approved inward-listed instruments based on foreign reference assets of foreign entities listed on BESA or on the JSE.

Foreign companies, governments and institutions may list instruments, including derivative instruments, based on foreign reference assets, on South Africa's bond and securities exchanges.

8.2.2 South African corporates

For South African corporates there is no pre-approval process for foreign direct investment in respect of transactions totalling less than R500 million per company per annum. The investment must be in the same line of business and at least 10 per cent of the foreign target entity's voting rights must be acquired. Authorised dealers administer the directives and guidelines on these types of investment. Where the total cost of foreign direct investment exceeds R500 million per company per calendar year, an application must be submitted to the SARB for prior approval.

As an alternative mechanism of financing offshore investments or to repay existing offshore debt, applications by corporates to engage in corporate asset or share-swap transactions, and requests for share placements and bond issues offshore by locally listed companies will be considered.

Corporates that have existing approved subsidiaries abroad are allowed to expand such activities without prior approval, subject to certain conditions. Since 26 October 2004 dividends declared by offshore subsidiaries of South African corporates may be retained offshore and used for any purpose, without recourse to South Africa. Authorised Dealers may also extend foreign currency-denominated facilities to South African corporates to finance approved foreign direct investment.

South African companies, trusts, partnerships and banks are permitted to manage their foreign exposures by participating without restriction in the rand futures market on the JSE. This dispensation also extends to investment in inward-listed (foreign) instruments.

Authorised Dealers may acquire direct and indirect foreign exposure up to a macroprudential limit of 25 per cent of their total liabilities excluding total shareholders' equity. Private equity funds that are members of the South African Venture Capital Association, mandated to invest into Africa, may apply for an annual approval for such investment.

8.2.3 Private individuals resident in South Africa

Residents of South Africa who are over the age of 18 years qualify for a private individual foreign capital allowance of up to a total amount of R4 million, subject to clearance by SARS, and reporting of the transfer of funds abroad to the exchange control authorities. A single discretionary allowance of R750 000 per year may be apportioned for travel, gifts, loans, study allowance, donations to missionaries and maintenance.

8.2.4 Blocked assets of emigrants

A system of blocking emigrants' domestic assets in South Africa was introduced in 1961 when South Africa left the Sterling Area. In line with the gradual relaxation of exchange controls since 1994, this system has also been reviewed periodically.

Emigrants who have not fully utilised the foreign capital allowance of R4 million can apply to transfer abroad the balance of up to an amount of R4 million per individual. The same principles apply up to a limit of R8 million per family unit. Assets exceeding these respective limits are placed in blocked accounts in South Africa, although income earned on such assets may be taken out of the country.

Blocked assets of emigrants can be used locally for approved purposes. Emigrants wishing to take blocked assets out of South Africa must apply for permission to transfer such assets abroad. Approval is subject to an exit levy of 10 per cent on the amount exceeding the overall limits of R4 million or R8 million respectively, released for transfer abroad.

8.2.5 Local financial assistance to affected persons, non-residents (foreign ownership of domestic entities) and emigrants

To improve access to domestic credit in financing foreign direct investment in South Africa or for domestic working capital requirements, there are no restrictions on amounts that can be borrowed locally by affected persons or non-residents. Affected persons and non-residents who use funds for the acquisition of residential properties in South Africa and certain other financial transactions, such as portfolio investments, securities lending, hedging or repurchase agreements, are restricted to borrow up to a limit equal to amounts introduced into South Africa in terms of a 1:1 ratio. Emigrants are subject to a 1:1 ratio in respect of local borrowing for any transactions.

8.2.6 CMA

Although member countries of the CMA have their own currencies, these currencies are fixed at par to the South African rand. The South African rand serves as anchor for the currencies of the CMA because of the dominant role of the South African economy in the CMA. South Africa's GDP comprises some 95 per cent of the GDP of the CMA. Owing to the free flow of capital, the CMA partner countries apply exchange controls similar to the controls applied in South Africa.

Exchange controls are viewed as an impediment to the optimal functioning of the domestic economy. The complete removal of exchange controls, therefore, remains the ultimate objective of the South African authorities. It will, however, be necessary to ensure that cross-border foreign-exchange transactions continue to be recorded and monitored, even after such removal.

9 Provision of economic and statistical services

The SARB collects, processes, interprets and publishes statistics and other information. The SARB annually publishes, *inter alia*, four *Quarterly Bulletins*, two *Monetary Policy Reviews*, an *Annual Report*, an *Annual Report* of the Bank Supervision Department, an *Annual Economic Report* and two *Financial Stability Reviews*. The data these publications contain are a major source of information for policy-makers, analysts and researchers.

9.1 Collection

The SARB uses two types of mainframe databases to support the collection and processing of economic statistics. One is an institutional database where information on banking, the financial and money markets, balance of payments, and national accounts is managed. This is updated via surveys that are conducted either monthly, quarterly or annually. Other basic economic information is captured and edited in the time series database as it becomes available.

Various statistical techniques are employed in the estimation and aggregation of statistical information, and time series are regularly analysed to improve quality and relevance. Trends in the data are also monitored and movements explained.

9.2 Compilation and processing of statistics and research

The SARB became officially responsible for the compilation of South Africa's balance of payments in 1965. The balance of payments comprises two main groups of accounts, namely (1) the current account and(2) the capital and financial account. The former account pertains to goods and services, income and current transfers, while the latter account pertains to various capital flows and transfers.

The SARB also compiles and publishes the GDP quarterly according to the expenditure approach. This responsibility of compiling the GDP is shared with the National Accounts Division of Statistics South Africa, which compiles the GDP according to the production approach.

The SARB compiles comprehensive information on South Africa's financial markets and non-bank financial intermediaries, and the national financial account. This involves data collection and processing of South Africa's bond, equity and derivative markets, bank and non-bank financial institutions, and the analysis of the flow of funds between the sectors of the economy, based on data compiled from surveys of all financial institutions.

The SARB calculates various monetary aggregates (M0, M1A, M1, M2, M3). Monetary analysis entails establishing the accounting counterparts to changes in the M3 money supply. These include changes in net foreign assets, net claims on the government sector, claims on the private sector, and changes in net other assets and liabilities. Changes in money-market conditions and money-market and related interest rates are also monitored. These include the repo rate, overdraft rates on current accounts, discount rates and various deposit rates.

Another responsibility of the SARB is to record the transactions of the public sector. The Statement of Revenue, Expenditure and Borrowing comprises the revenue and expenditure of the national government. The expenditure generally exceeds the revenue. The ways in which this deficit is financed are also analysed. A consolidated account of the revenue and expenditure of general government, which includes the consolidated central government, provincial governments and the local authorities, is also compiled. The total debt of the national government is monitored on a monthly basis, and is classified according to domestic and foreign ownership distribution.

Activities in the labour market and information on price changes are also analysed. This includes changes in the production and consumer prices, as well as changes in the prices of imported goods and goods produced in South Africa. As an indication of inflation, these price indices are some of the key variables influencing monetary policy decisions. To identify economic statistics that can serve as reliable indicators of business cycle changes, the cyclical behaviour of a large number of time series over a long uninterrupted period is studied. Changes in individual time series may lead, coincide with, or lag behind changes in the general business cycle.

The SARB is also involved in a variety of research activities. These include the construction and maintenance of econometric models to assist the SARB in the formulation of policy; applied research into monetary policy issues; interaction on behalf of the SARB in various regional and multilateral institutions; and the monitoring of international economic conditions and developments.

In addition to the publications mentioned earlier, further means of information dissemination by the SARB include various key indicators and other statistical data that are updated on the SARB's website as soon as they are released, so as to keep the South African public and the international community updated. This research and information dissemination also informs the MPC in monetary policy formulation and decision.

10 Supervision of the South African money and banking system

10.1 Bank supervision

The SARB is responsible for bank regulation and supervision in South Africa, the purpose of which is to achieve a sound and efficient banking system in the interests of the people who deposit funds with banks, and the economy as a whole. This function is performed in terms of either the Banks Act, 1990, or the Mutual Banks Act, 1993. The SARB is also responsible for certain supervisory responsibilities of co-operative banks established in terms of the Co-operative Banks Act, 2007 (Act No. 40 of 2007). The South African banking sector is concentrated, with the four main banks controlling more than 80 per cent of bank deposits.

Banks are important to the economy of a country for several reasons. First, they act as intermediaries through which the funds of surplus units (savers) can be made available to deficit units (borrowers) in order to finance productive activities. This lending takes place in terms of a fractional reserve system, which implies that only a portion of funds received on deposit is held in reserves and the balance can be borrowed by customers of banks. Secondly, banks provide a whole range of financial services to the public without which an economy cannot function smoothly. Thirdly, banks are important because they serve as the channel by means of which monetary policy decisions are transmitted to the rest of the economy. Banks therefore need to be regulated or supervised.

Most countries have a banking supervision authority and although the principles involved are largely the same, supervisory authorities may differ in respect of their degree of autonomy, relationships with other financial regulators and supervisory approaches or methods employed. In the case of South Africa this function is entrusted to the SARB, which issues banking licences to institutions registered to function as banks.

10.1.1 Background to banking regulation and supervision

Within the legislative framework pertaining to banks, reference is made to "regulation" and to "supervision". These two functions can be described as follows:

- "Regulation" refers to the creation and maintenance of a legal framework within which institutions are licensed to operate as banks, subject to prudential rules and practices
- "Supervision" refers to the process of monitoring the control systems, activities and financial condition of banks to ensure that they are always within limits of prudent banking practice as set out in the prudential regulations.

The South African banking industry is characterised by international links through correspondent banking relations with off-shore banks and international institutional investments in domestic banks. A prerequisite, therefore, is that the best international standards of regulation and supervision should be applied to South African banks. This ensures entry for South African banks into foreign markets and a continued interest of foreign institutions in the domestic market.

It is important to guard against any unauthorised usage of the word 'bank' in the name of any institution. The SARB acts against persons who are not registered as banks but who conduct illegal deposit-taking activities. Complaints received or information supplied with regard to possible contraventions of the provisions of the Banks Act, 1990, pertaining to the conduct of suspected illegal deposit-taking activities are investigated and action is taken if activities contravene the Banks Act, 1990.

Although the relevant provisions of the Banks Act, 1990, are clearly aimed at investor protection, depositors also have a responsibility to ensure the safety of their investments. The SARB's investor awareness programme plays an important role in this regard. Occasionally, the SARB conducts public awareness campaigns aimed at warning the general public about risks involved in depositing money with, or entrusting funds to, unlawful deposit-taking institutions. Usually these campaigns are run in collaboration with the FSB.

10.1.2 Entry criteria and licensing policy

Since the banking system plays an important role in the South African economy, banking stability is crucial. Consequently, an application for authorisation to establish a bank has to meet entry criteria and prudential standards. The Banks Act, 1990, and the regulations relating to banks framed in terms of this Act, prescribe the format of an application for authorisation to establish a bank. Many details are required in a specified format, and a complete and comprehensive application in terms of the Banks Act, 1990, usually results only from a carefully planned and diligently executed project, often involving consultants who specialise in this field. The processing of an application entails not only an analysis of the application, including financial projections, but also consultation with other regulators and authorities. The following are important entry criteria:

- *Public interest considerations*: As the establishment of a bank should be in the public interest, applicants are expected to make a worthwhile contribution to banking services and competition in South Africa and not merely add to the number of banks. Although applicants do not have to offer a full range of banking services, they are expected to maintain a significant presence in South Africa and to add some depth to the local banking sector.

- *Ownership and control*: A bank should have appropriate regard for the interests of its depositors. Therefore, no single shareholder (or group of shareholders) should be in a position to exercise undue influence over the policies or operations of a bank. The shareholding structure should not be a source of weakness and should minimise the risk of contagion from activities conducted by other entities or shareholders. Banking and non-banking activities should be separate, with appropriate divisions between them.

- *Fit and proper management*: Banks should be governed and managed only by directors and management with proven ability and integrity to pursue the interests of shareholders without harming the interests of depositors. The management and directors proposed in an application to establish a bank should have relevant banking experience and skills to conduct the proposed business.

- *Corporate governance, audit and internal control*: Any application for the establishment of a bank should demonstrate the ability of the applicant to maintain appropriate corporate governance, management, internal control and risk management systems, including internal audit. Provision should also be made for a compliance officer to monitor and limit all the risk exposures of the proposed bank as from the day on which it commences operations. The operating controls and risk management procedures have to be consistent with the proposed strategy of the bank. The proposed bank has to be capable of producing all required statutory and prudential information in an accurate and timely fashion from the start of banking operations.

- *Internal structure*: The proposed bank's internal structure should be sound in terms of generally accepted management principles and the proposed group structure should not be detrimental to the bank or to effective supervision of the bank. Among other issues, a foreign bank wishing to establish a locally incorporated bank (or branch) should be subject to acceptable supervisory arrangements in its country of origin and be in good standing with that supervisor.

- *Capital and financial conditions*: A bank should be established with financial strength demonstrated by adequate capital and sustainable profitability. Initial capital should be from a known and legitimate source, and should not be borrowed money. Furthermore, a proposed bank has to adhere to capital-adequacy, cash reserve and liquidity ratios, among other prudential requirements. Therefore, an applicant has to submit an acceptable business plan, incorporating realistic and sustainable projections of the scope, scale and specialisation of operations, cash flows and earnings for the first three years of the proposed bank's operations.

An assessment of whether the applicant demonstrates the commitment and ability to establish a bank, and to ensure its viability against intense market competition is of paramount importance in reviewing an application.

10.1.3 Managing distress in banks

The procedures for handling distress in banks differ significantly in many respects from those embodied in ordinary company and insolvency laws. The rationale for this differential treatment arises from two broad considerations relating to the nature and functions of banks:

- The intermediation function is necessary in order to facilitate savings flow in the economy, but causes banks to take a risk posture that is systemically adverse in nature. In the intermediation process banks acquire liquid and certain liabilities (deposits), and create illiquid and uncertain assets (bank loans). The nature of banks' business contracts is therefore such that they create major systemic risks.
- The maintenance of public confidence in the stability of the banking system is the cornerstone of the process of financial intermediation. The emergence of liquidity or solvency problems in a particular bank can threaten confidence not only in that particular bank, but also, because of the possibility of contagion, in the safety and stability of the system as a whole. South Africa does not have a deposit insurance scheme in terms of which depositors are guaranteed the repayment of any portion of their deposits in the event of a bank experiencing financial distress.

These considerations have led to the realisation that banks deserve special protection in times of distress. The policy followed in South Africa is not aimed at zero failure of banks. Instead, the objective is to resolve problems in banks effectively and to ensure that depositors with failing banks recover as much of their deposits as possible, in order to maintain the confidence of investors in the banking system. If a bank has to exit from the banking system, this has to occur with the minimum market disruption possible.

In essence, the policy is that a bank with temporary liquidity problems may be assisted, provided it is solvent. An insolvent bank, however, cannot be allowed to continue operations, since its problems are very likely to become worse. Such a bank should exit from the system in an orderly and efficient manner that minimises losses to depositors and that does the least harm to confidence in the banking system. Managing distress in banks is described in more detail in section 10.6.

10.2 Settlement of interbank claims

The SARB provides for final real-time electronic settlement of interbank claims, emanating from non-cash payments (e.g., cheques) made in the economy, via the SAMOS system. In addition, the SARB oversees the safety and soundness of the NPS through the introduction of settlement risk reduction measures as and when required. The settlement risk reduction measures are aimed at minimising possible systemic risk emanating from, *inter alia*, the settlement default (inability or lack of funds to settle obligations) of one or more settlement banks.

An example of an interbank obligation is a cheque payment. This can be explained by means of a simplified example: a customer of bank A settles a debt by means of a cheque payment to a customer of bank B. The cheque is deposited at bank B, and bank B must recover the funds from bank A on behalf of its customer. Provided that its customer has the necessary funds available, bank A has an obligation, on behalf of its customer, equal to the value of the cheque to bank B.

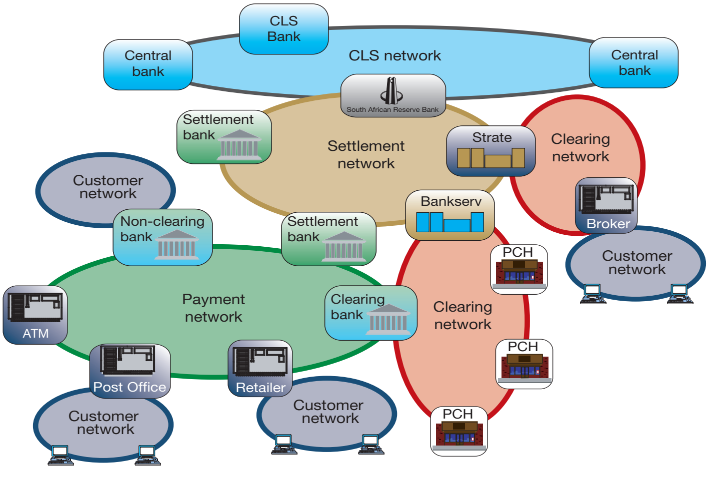
The NPS encompasses all of the systems, mechanisms and instruments that enable the transfer of funds from one banking account to another. The payment system, therefore, includes the entire payment process from payer to beneficiary in the NPS. The proliferation of new computer technology, electronic communication and globalisation has resulted in a rapid change in the payments landscape in South Africa and in most countries.

There are a number of participants in the NPS, each with specific roles and responsibilities. These entities fall within the oversight responsibility of the SARB in order to mitigate risks introduced into the payment system. Oversight of the payment system covers the following entities:

- *Clearing and settlement banks*: As at December 2009 there were 22 commercial banks (in addition to the SARB and CLS Bank) participating in the clearing and settlement arena in South Africa. These banks either issue payment instruments to their clients, acquire payment instrument transactions on behalf of their clients, or both. Because of their participation, the banks build up interbank obligations in respect of each other which, in turn, require final and irrevocable settlement in central bank money. To facilitate this settlement, the SARB provides, operates and manages the SAMOS system.

- *PCH system operators*: These entities are responsible for collecting and processing payment instruments, and determining interbank obligations. Bankserv is responsible for the retail environment, which includes all payment instruments currently available to the clients of banks, while STRATE determines the obligations arising from financial markets, such as the bond and equities markets.
- *Third person payment service providers*: Where a payment is due, these entities act as agents and accept payments on behalf of beneficiaries. In certain instances these entities may arrange that a retailer or another entity accepts payments on their behalf. A typical example is the collection of payments in respect of utility bills.
- *Payment system operators*: These operators process payment instructions for any two or more participants within the payment system. They operate the information technology required to process payments.
- *CLS system*: This system is a worldwide industry initiative to reduce risks associated with cross-currency transactions by settling the two legs of a foreign-exchange transaction simultaneously. Foreign-exchange settlement risk is the risk that originates once a currency has been irrevocably paid by one party and thereafter the counter-party fails to meet its obligation in terms of the transaction. The South African rand is one of 17 major currencies traded in CLS.

Figure 1 The payment system network



The entire payment system comprises a vast and sophisticated infrastructure that links numerous networks. These networks (Figure 1) commence at the customer interface with the retailers and brokers, where the front-end point-of-sale devices and computer systems link to back-office systems. These, in turn, link to their acquiring banks' systems or trading systems in the case of the brokers. From these networks, transactions and transaction data are moved to the PCH system operator networks for processing prior to entering the settlement network where settlement takes place. For transactions that involve foreign-exchange transactions, a further network links South Africa to the CLS system operating from London.

10.3 Banker of other banks

The SARB holds the cash reserves that banks are legally required to hold with the SARB. It has the authority to change the minimum cash reserves that banks are required to hold, and can use such adjustments as an instrument of monetary policy.

In addition, the SARB assumes responsibility for domestic rand payments to customers of foreign central banks. Surplus funds in the accounts of these banks are invested with the CPD.

10.4 Banknotes and coin

The SARB has the sole right to make, issue and destroy banknotes and coin in South Africa. The South African Mint Company, a subsidiary of the SARB, mints all the coins on behalf of the SARB. The South African Bank Note Company, another subsidiary of the SARB, prints all banknotes on behalf of the SARB. Section 11 of this booklet highlights the activities of the SARB's subsidiaries.

As mentioned earlier, since 28 December 1932 banknotes could no longer be exchanged for gold at the SARB. This implies that the value of banknotes is based solely on trust. People use banknotes and accept them for payment of debts because they trust that they will, in turn, be able to purchase goods and services to the face value of the banknotes. One of the main consequences of inflation is an erosion of people's trust in the face value of banknotes and coin.

The SARB is responsible for bulk distribution of banknotes and coin. Banks are responsible for the collection of banknotes and coin from the SARB for onward distribution to their cash centres, branches and ATM's for distribution to the public. To perform this function, the SARB has seven branch offices, namely in Bloemfontein, Cape Town, Durban, East London, Johannesburg, Port Elizabeth and Pretoria North. These branches are responsible for ensuring the availability of good-quality banknotes to meet public demand. The branches also settle claims for mutilated banknotes.

The demand for banknotes and coin is determined by the general public. It makes virtually no difference from the SARB's broad monetary policy perspective whether the public holds cash, demand deposits at banks or has pre-arranged but unutilised credit lines. The potential supply of banknotes and coin to the public, however, is limited by banks to the extent that the public is only permitted to withdraw cash held as deposits or draw cash against pre-arranged credit facilities.

To provide an efficient service to banks and satisfy their requirement for banknotes, the SARB ensures that there is sufficient storage capacity in branch vaults to meet the normal demand for notes and for exceptional or seasonal demands. In ensuring that only banknotes of good quality remain in circulation, branches are equipped with electronic note-processing machines. These machines determine which notes can be re-issued, while soiled notes are shredded.

The branches of the SARB, the South African Police Service and commercial banks co-operate in combating the counterfeiting of banknotes.

10.5 Financial system stability

The SARB assesses the stability and efficiency of key components of the South African financial system. The SARB's approach to financial system stability places considerable reliance on market forces to achieve financial system stability. Any intervention should, therefore, be at the minimum level needed to contain systemic risk. Safeguarding of financial system stability requires adequate information about the behaviour of financial market participants, regardless of the institutional arrangements.

The prudential regulation and supervision of banks assist and complement the SARB in its pursuit of financial system stability. It has, however, become increasingly clear that the financial system may be vulnerable as a result of inherent imbalances between the real and financial sectors of the economy. Such vulnerabilities would not be revealed by the supervision of individual institutions. For this reason the SARB and other central banks have gradually placed increased emphasis on macroprudential aspects of financial stability. Financial system stability cannot be achieved by the SARB in isolation. All financial system participants should act in ways that enhance the robustness of the financial system, which, of course, requires good and reliable information about trends and developments in the financial system.

Notwithstanding the best efforts of central banks and other regulators to detect and prevent instability, financial sector crises can still occur. Under these circumstances the SARB liaises with the National Treasury and other regulators such as the FSB in planning and co-ordinating the responses of the authorities to alleviate the impact of financial crises on the real economy. This includes the development and maintenance of safety-net policies and procedures, and the co-ordination of contingency planning for systemic crisis resolution. The social cost of financial system failure usually exceeds the private costs, which justifies the role of central banks as the source of emergency liquidity assistance in times of banking liquidity problems.

10.6 Provision of temporary standby liquidity assistance to banks and exit policy

At the first emergence of signals that a bank is potentially experiencing distress, corrective action is taken. The exact type of action differs from case to case, and is not prescribed in any detail in South African banking legislation. Actions may range from a discussion of the area of concern at a routine or special prudential meeting with senior management of the bank, to formal sanctions and fines, prohibitions on further expansion of activities and increases in the capital requirement. The ultimate sanction would be withdrawal of the banking licence.

When a bank experiences financial difficulty, a special investigation is conducted to establish beyond doubt whether it suffers from a liquidity or a solvency problem. If the bank's liquidity shortage is of a temporary nature and does not affect its solvency, the SARB will then decide, in the interests of the stability of the banking system, whether or not to provide temporary emergency liquidity assistance (ELA) against appropriate security provided by the bank. The twofold objectives of such assistance are to

- provide some breathing space to an institution facing problems with short-term funding in order to enable it to implement corrective measures; and
- prevent illiquidity from precipitating a situation of insolvency and to prevent the contagion effect of bank runs.

The ELA function should be distinguished from the SARB's normal liquidity provision facilities through the daily repo auctions. Decisions on ELA assistance are made on a case-by-case basis, taking into consideration the implications of a bank failure for the stability of the monetary and financial systems of South Africa.

The SARB's ELA function is totally compatible with its objectives. Universally, central banks are tasked with the function of promoting, supporting and maintaining overall financial stability. Because financial stability is essential for economic growth and as a minimum prerequisite for sustainable economic development in the long term, the primary objective of ELA is to ensure monetary and financial system stability.

10.6.1 Preconditions for ELA

The basic precondition for the provision of ELA is the judgement of the SARB that if it were to be deprived of liquidity assistance, the failure of an illiquid banking institution would damage the stability of the monetary or financial system (i.e., systemic risk would result). In addition, a number of preconditions for ELA would apply. These preconditions include that

- the institution has a sufficient margin of solvency;
- the ELA would be collateralised adequately;
- the institution has sought other reasonable available sources of funding before seeking ELA;
- the shareholders of the institution have made all reasonable efforts to provide liquidity and/or solvency support as a demonstration of their own commitment to the institution;
- there is no evidence at first sight that the management is not fit and proper, or that the liquidity problem is due to fraud; and
- the institution has developed, and is committed to, the implementation of a viable plan of appropriate remedial action to deal with its liquidity problems.

As a measure of whether an institution has a sufficient margin of solvency, the SARB will generally require the institution to demonstrate that, after making an adjustment for any additional provisions that might be necessary, it maintains a capital-adequacy ratio that is appropriate for its operations. Usually, these calculations will be the subject of a due diligence review instituted by the SARB.

10.6.2 Instruments used to provide ELA

The South African Reserve Bank Act does not allow the SARB to make any unsecured loans to banks. Therefore, all ELA loans have to be fully collateralised. However, there is no prescription regarding the exact form or order of preference that such collateral should take.

The SARB would under normal circumstances provide emergency liquidity assistance against the most liquid and less risky assets of banks. These would typically include high-quality marketable securities, such as negotiable certificates of deposit (NCD's), government bonds, Treasury Bills and high-quality non-government bonds. However, these assets may sometimes not be adequate to secure the amount of ELA required. In such cases, the SARB could also grant credit against the security of the institution's asset portfolio.

The decision whether ELA is provided to a bank, the amount that is provided and the assets that are accepted as collateral are determined on a case-by-case basis, depending on the degree of systemic risk and the specific characteristics of the troubled bank.

Since the purpose is to provide the institution with temporary breathing space to resolve its difficulties, ELA would in normal circumstances be provided only on a short-term basis. However, the SARB could extend the duration of such assistance, at its discretion, depending on the situation.

Interest on ELA support would usually be charged at a rate sufficiently high to maintain incentives for management to resolve the bank's difficulties, but not at a level that would defeat the purpose of the facility, namely, to prevent illiquidity from precipitating insolvency.

10.6.3 ELA for branches of foreign banks

The policy outlined earlier applies to the provision of liquidity to locally incorporated authorised institutions whose failure might have systemic implications. Normally it would not be the policy of the SARB to provide ELA to branches of foreign banks operating in South Africa. This recognises that the liquidity of a branch cannot readily be divorced from that of the parent bank. It follows, therefore, that the parent of a branch, supported if necessary by ELA in the parent's home country, would be expected to provide enough funding to enable the branch in South Africa to meet its obligations. If the parent were unable to do so, there would be no alternative but for the branch to close its operations in South Africa. In such circumstances, the SARB would consider whether to use its powers under section 69 of the Banks Act, 1990, to appoint a curator to take control of the affairs, business and property of the branch in South Africa.

The SARB might, however, provide financial assistance to a branch with funding problems in three circumstances:

- For purposes of normal liquidity accommodation in special circumstances, the SARB might accept foreign collateral of equivalent standing to that eligible for daily repos in order to provide liquidity to branches of foreign banks operating in South Africa. For example, central government paper of most member countries of the OECD would be acceptable for this purpose.

- The SARB might swap South African rand for US dollar held by the branch if no suitable counterparty can be found in the market.

- The SARB might provide urgently required bridging finance on a secured basis to a branch, pending the branch's receipt of funds from its parent. This would be done only if the SARB is satisfied that the funds would indeed be forthcoming from the parent and if the home-country supervisor has given assurances to that effect.

10.6.4 Funding support requiring specific approval from the Minister of Finance

Based on the criteria set out above, the SARB would provide ELA at its discretion. When the criteria are not met, funding support would be provided only with the specific prior approval of the Minister of Finance. This would include situations where
- the institution is unable to comply with the preconditions for ELA set out earlier. This would involve more serious situations falling outside what the SARB would consider to justify ELA;
- it is considered necessary to provide funding support that exceeds the ELA support criteria set out earlier; and
- the institution concerned cannot provide eligible security as prescribed.

Any funding provided in these circumstances would have to be considered on merit in the light of the implications for systemic stability. In addition, the SARB would consider whether to appoint a curator under section 69 of the Banks Act, 1990, to safeguard the assets of the institution, and to protect the interests of depositors and other creditors.

10.6.5 Default situations

Should ELA not be repaid on maturity or the SARB not be prepared to roll over the funding, the SARB would have to consider a number of other options. This includes the option of recommending to the Minister of Finance that the bank in distress be placed under curatorship. A curator will be appointed to a bank only if deemed to be desirable in the public interest, after consultation with, and with the written consent of, the chief executive officer or the chairperson of the board of directors of the bank concerned. The future of a bank that is placed under curatorship depends on its particular circumstances. If the bank is insolvent, the decision to support it through capital injections or other measures resides with the Government. Such a decision would take into consideration the public cost of possible financial instability resulting from a bank failure, compared to the public cost of supporting such a bank.

11 Support services

11.1 Accounts

To fulfil its responsibilities, the management of the SARB has established and maintains an adequate and effective system of financial control and ensures the required compliance. This system provides reasonable assurance about the integrity and reliability of financial and management information, and is based on the established written policies and procedures of the SARB.

Policies and procedures are implemented by trained and skilled staff, and duties are appropriately assigned. All staff members are required to maintain the highest level of ethics in ensuring that the activities of the SARB are conducted in a manner that is beyond reproach. Systems are in place to ensure the safeguarding of, and control over, assets, the economical and efficient use of resources allocated, and the effective performance of all functions.

The SARB generates income from its activities. This income does not only cover the cost of operations, but the SARB also makes a profit. After allowing for certain provisions, payment of company tax on profits, transfers to reserves and dividend payments of not more than 10 cents per share per annum to shareholders, the surplus of the SARB's earnings is paid to Government.

11.2 Audit function

In order to assist with broad controls, the SARB has an internal audit function. The primary objective of the internal audit function is to evaluate independently the corporate business risks of the SARB and its subsidiaries, and to provide objective assurance and consulting services regarding the adequacy and effectiveness of the system of control, governance and accounting processes.

The internal audit function is performed in accordance with the International Standards for the Professional Practice of Internal Auditing of the Institute of Internal Auditors. The scope of internal audit work includes assessment of the various components of the system of control, focusing on the reliability and integrity of financial and operational information; effectiveness and efficiency of operations; safeguarding of assets; accomplishment of established objectives; and compliance with laws, regulations, contracts and procedures.

The SARB is also subject to an annual external audit. Two external audit firms annually submit a joint audit report on the accounts of the SARB.

11.3 Human resources

As at 31 March 2010 the SARB employed 2 117 people. The particular nature of the activities of the SARB necessitates specialised knowledge in many areas. In order to ensure an adequate knowledge base at all times, the SARB invests significantly in staff training, maintains succession plans for key personnel and is committed to remunerating staff on a market-related basis.

Training and development offered to staff range from basic adult education and training to courses in core business, management and leadership. The SARB also finances the tertiary education of staff, and the dependants of staff members and pensioners of the SARB.

The SARB's training and development extend beyond its own employees. Through the SARB College a number of high-level workshops and seminars are presented for specific niche markets. The SARB College is regarded as a key partner for international training institutions to offer capacity-building interventions on the African continent. The SARB College co-operates with central banks in the SADC region and international training institutions such as the IMF and World Bank institutes. The SARB College also manages the SARB's cadet training programme.

11.4 Corporate support

In the performance of its functions as a central bank, the SARB requires facilities, buildings and services that cater for its unique requirements. The SARB occupies its own head office building, and its branch offices are also accommodated in its own buildings. The SARB's property portfolio is reviewed and improved on a regular basis to ensure that it still meets the SARB's requirements. At a corporate level the management of assets other than property owned by the SARB is also important, as the SARB owns, *inter alia*, an extensive art collection.

The SARB also requires substantial ICT support. In the main the SARB ensures the internal provision of ICT services, but relies on external service providers and consultants whenever required. The optimal utilisation of ICT is viewed as an important instrument to enhance the productivity of the SARB's staff.

The SARB has an internal legal function with responsibility for, *inter alia*, the review and safekeeping of contracts, and the management of the SARB's over-the-counter share trading facility and register of shareholders.

The SARB is responsible for the provision of secretarial services to its board of directors, board committees and to various internal committees. An additional responsibility is the annual arrangement of the SARB's ordinary general meeting of shareholders.

The SARB complies with health, safety and environmental legislation, and is committed to safeguarding the interests and well-being of employees. The SARB acknowledges the importance of its responsibilities, and is committed to ensuring that a healthy and safe working environment is maintained at all times. This is ensured through the regular commissioning of compliance assessments and environmental studies by external specialist organisations, accompanied by the implementation of corrective actions if required.

Extensive critical business and technology testing and exercise of procedures and corrective alignment are carried out on an ongoing basis to ensure business continuity management in the SARB. The SARB contributes towards the establishment and maintenance of resilient business continuity capacity within the broader financial sector, including the cash management industry.

12 Subsidiaries of the South African Reserve Bank

To ensure the proper functioning of the SARB and the optimal discharge of its responsibilities, over a period of some 60 years some of the SARB's activities have been organised in subsidiary companies. Although this was not initially the case with all the subsidiaries, the SARB is currently the sole owner of its subsidiaries.

The SARB's first subsidiary was the NFC, which commenced operations on 20 September 1949. The NFC was established with the aim of deepening the domestic money market, thereby ensuring the utilisation of capital in the best economic interests of South Africa. The NFC accepted as liabilities deposits from Government and quasi-government institutions, and invested mainly in Treasury bills and other government securities. The liquidity of the NFC was guaranteed in terms of an agreement that the SARB would discount its holdings of Treasury bills, as and when required, at the rates at which the NFC acquired the bills.

The CPD was established as a subsidiary of the SARB in 1984 after the dissolution of the NFC. The CPD is governed by the Corporation for Public Deposits Act, 1984 (Act No. 46 of 1984). The CPD accepts call deposits from the public sector and invests the funds in short-term money-market instruments and special Treasury bills. With the permission of the Minister of Finance, the CPD may also accept call deposits from other depositors. All funds invested with the CPD and the interest earned are payable on demand.

The CPD is managed and controlled by its board of directors, appointed by the Minister of Finance. The SARB is responsible for the investments and administration of the daily business operations of the CPD.

When the decision was made in 1958 to print South African banknotes domestically rather than abroad as was the practice at the time, the SARB and a British banknote printer, Bradbury Wilkinson, established as a joint venture company, the South African Bank Note Company (Pty) Ltd, with the sole objective of printing banknotes for South Africa. Suitable factory premises for printing banknotes were erected and the domestic production of banknotes commenced in 1961 at the time when South Africa adopted a decimal currency.

As the shareholding of Bradbury Wilkinson in the joint venture company was subsequently taken over by the SARB, the South African Bank Note Company (Pty) Ltd is currently one of the four wholly owned subsidiary companies of the SARB. The South African Bank Note Company prints all the banknote denominations currently in use in South Africa and also prints banknotes for neighbouring countries. It has a separate management structure and functions as an independent subsidiary. The members of its board are appointed by the board of the SARB.

The history of minting coins in South Africa goes back to the period when South Africa comprised four separate regions that later became provinces of the Union of South Africa. A government mint was established in Pretoria in 1890. This mint commenced with the domestic production of coin in 1892.

After unification of South Africa in 1910 the country used British coin as well as coin of the Zuid-Afrikaansche Republiek. The latter remained legal tender until 1938, while British coin remained legal tender until 1961. Coining operations in Pretoria evolved into the South African Mint, which was established in 1923, and functioned as a division of the central government. When the Government sold the South African Mint to the SARB in 1988, it was decided to house the coining activities in a wholly owned subsidiary company, the South African Mint Company (Pty) Ltd.

The South African Mint is responsible for the manufacturing of all circulation coins issued in South Africa and also produces coin for other countries. This company also produces the Krugerrand and the Natura and Protea coins. Numismatic coins are sold by the SA Mint, while the Rand Refinery has, since the inception of the Krugerrand, played a major role in its issuing. The SA Mint is an independent subsidiary with its own board (appointed by the board of the SARB) and management structure.

The youngest of the SARB's subsidiaries is the SARBCIC Ltd, a captive insurer licensed to carry out short-term insurance business in terms of the Short-term Insurance Act, 1998 (Act No. 53 of 1998) for, and on behalf of, the SARB and its subsidiary companies. SARBCIC's primary purpose is to provide an efficient risk transfer mechanism, thereby reducing dependency on external insurers and optimising expenditure on insurance over the long term. In terms of conditions for its registration, SARBCIC may only issue insurance policies to cover risks of the SARB and its subsidiary companies, including risks related to its pension and/or provident funds (first-party risks).

SARBCIC is managed and controlled by a board of directors that is appointed by the SARB. One of SARBCIC's directors, who is a full-time permanent staff member of the SARB, is appointed to serve as its Chief Executive Officer. The SARB is responsible for the management of the company, which includes responsibility for the investments and administration of its daily business operations.

13 International and regional co-operation

In the SARB's relations with multilateral institutions, considerable focus is placed on participation in key forums such as the G-20 and the Bretton Woods institutions. The G-20 deliberates on the global economic and financial outlook, fiscal elements of growth and development in G-20 member countries, policy issues pertaining to commodity cycles and financial stability, and Bretton Woods reform.

As the host of the Secretariat of the CCBG in SADC, the SARB supports the implementation of CCBG projects. As a consequence, progress is visible in the legal, payment system, information technology, macroeconomic and banking supervision committees. This progress is shared with the parliamentary finance committees in SADC countries through the ratification of the Finance and Investment Protocol, a key instrument for the advancement of regional economic integration in SADC. SADC's ultimate aim is the establishment of a regional central bank and the introduction of a single currency for all SADC countries.

The SARB is one of only two African central banks with membership of the BIS in Basel, Switzerland. The BIS serves, *inter alia*, as a forum for central bank governors to discuss matters of mutual interest.

14 Communication supporting the implementation of monetary policy

The SARB understands that monetary policy will only be supported if it is understood by the SARB's various stakeholders. The most important of these stakeholders are (in alphabetical order) the business community, Government, labour, media, Parliament, public, shareholders of the SARB and staff members of the SARB.

The most important initiative to improve communication and transparancy about the formulation of monetary policy was the establishment of the MPC with responsibility for setting the repo rate. The MPC introduced certainty about adjustments in monetary policy in as much as

- responsibility for monetary policy decision-making is entrusted to the MPC;
- the MPC meets at predetermined intervals and on predetermined dates, published up to a year in advance;
- any element of surprise about the timing of monetary policy decisions (although not about the decision itself) is removed;
- a detailed statement accompanies the announcement of the MPC's decision. Although the minutes of the MPC meeting are not released, the statement details the rationale and assessment of economic conditions that led to the decision; and
- the MPC's decision is announced after each meeting at a media conference and in a media statement. In conjunction with a local national television network and by means of a webcast, the SARB broadcasts the MPC announcement live after each meeting to ensure that everyone receives the information about the decision on interest rates simultaneously.

Communication about the implementation of monetary policy is also enhanced by the publication of a *Monetary Policy Review*. The Review appears twice a year and is discussed at Monetary Policy Forums. The SARB hosts such forums twice a year in all the provinces of South Africa. The Review analyses developments in, and factors influencing inflation; assesses recent policy developments; considers the outlook for inflation and reports on the MPC's assessment of inflation and the SARB's inflation forecast. It provides an *ex post* insight into matters on which the MPC deliberated.

The SARB published *Annual Financial Statements* until 2002, but reporting and disclosure in the statements improved to such an extent that the report was renamed *Annual Report and Financial Statements* with effect from the publication of the statements for 2003. The name was changed to *Annual Report* in 2006. The revised name reflects its nature, in as much as the SARB reports on matters much broader than only its financial affairs. The *Annual Report* attracts considerable media attention, enhancing the accuracy of reporting on the activities of the SARB.

Other forms of external communication used by the SARB include briefing sessions with media representatives, and speeches by the Governor, deputy governors and other senior officials of the SARB. In addition, the SARB's website is used extensively to alert the media, market participants, staff and the general public to important matters pertaining to the SARB.

The staff magazine of the SARB, *BankIndaba*, is published regularly. It is used to improve communication with, and among, staff members.

15 Governance

To fulfil its responsibilities, the management of the SARB has established and maintains an adequate and effective system of internal control and ensures compliance therewith. This internal control system, which is designed to provide sufficient assurance about the integrity and reliability of financial and management information, is based on the established written policies and procedures of the SARB. Policies and procedures are implemented by trained and skilled staff, and duties are appropriately segregated. All staff members are required to maintain the highest level of ethics in ensuring that the practices of the SARB are conducted in a manner that is beyond reproach.

The SARB is committed to the principles and complies to a significant degree with the requirements of the *King Report on Corporate Governance* (King III).

15.1 Board and Board Committees

15.1.1 Board of Directors

The SA Reserve Bank Act, 1989, as amended, provides for a board of directors with fifteen members. Among them are the Governor and three deputy governors, who are appointed by the President of the Republic for five-year terms. Four other directors are appointed by the President for three-year terms. The remaining seven directors, of whom one represents agriculture, one labour, one mining, two industry and two commerce or finance, are elected by shareholders for three-year terms. The Governor and deputy governors manage the daily affairs of the SARB, as they are the most senior executives with full-time responsibility for its workings.

The board of directors meets regularly to ensure that the functions that it has delegated to executive management through a structured framework are implemented. This structured framework includes receiving reports from various board committees and subcommittees, chaired by non-executive directors, and from the GEC, which is responsible for the day-to-day management of the SARB.

15.1.2 Non-executive Directors' Committee

The Non-executive Directors' Committee comprises the non-executive directors of the SARB. The primary function of the committee is to assist the board in fulfilling its legal and fiduciary obligations and responsibilities, and to enhance corporate governance matters and practices.

15.1.3 Audit Committee

The Audit Committee is a subcommittee of the board and the SARB's external and internal auditors have unrestricted access to the Chairperson of this committee. The committee reviews the financial statements and underlying accounting policies, the effectiveness of management information, other systems of internal control and the internal audit function.

15.1.4 Remuneration Committee

The Remuneration Committee, also a subcommittee of the board, reviews human resources matters and remuneration practices and policies.

15.1.5 Risk Committee

The Risk Committee reviews the risk management processes applicable to the operations of the SARB and recommends areas that internal and external auditors should review.

15.2 GEC

The Governor and deputy governors, in their capacity as executive directors of the SARB, are responsible for the day-to-day management and policy decisions of the SARB except those reserved for the board. The SARB has a GEC with responsibility for the consideration of policy issues (other than monetary policy) and other executive management matters.

16 Contact details

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17 Financial and statistical overview, and data tables

The financial year of the SARB runs from 1 April to 31 March. The *Annual Report* is published in September.

17.1 Statement of assets and liabilities of the SARB

In terms of section 32(1)(a) of the SA Reserve Bank Act, 1989, the SARB publishes a statement of its assets and liabilities on a monthly basis. This statement is released electronically on the website of the SARB (http://www.reservebank.co.za) on the fifth business day after month-end.

The asset-and-liability structure of the SARB reflects its functions. The *liabilities* can be classified as follows:

Notes and coin in circulation, which reflects the total value of notes and coin outstanding as at the date of the statement. This figure provides only an estimate of the amount of cash held by the public, because some portion of these notes and coin is held by banks as vault cash.

Government deposits, comprising deposits of the Treasury. This includes the rand proceeds of IMF SDRs of the South African Government that are held by the SARB as part of its total gold and foreign assets.

Banks' deposits, consisting of reserve accounts of banks that they are obliged to hold at the SARB in terms of their reserve requirements, and current deposits that are held for the clearing of accounts between banks.

Other deposits, including mainly the accounts of international organisations, foreign banks, foreign governments and the CPD.

Foreign loans and deposits, comprising foreign loans incurred by the SARB and foreign deposits placed at the SARB.

Other liabilities, consisting of a wide variety of items including remittances in transit, accrual accounts for interest and discounts receivable, notes of other banks for which the SARB has assumed liability, and accounts related to the gold and foreign asset holdings of the SARB.

The *assets* reported on the balance sheet of the SARB can be classified as follows:

Gold and foreign assets, consisting of the gold and SDR holdings of the SARB and foreign assets comprising mainly working balances with other central banks and foreign banks, call deposits and foreign investments.

Fixed assets represent the current value of the SARB's investment in fixed assets for own use.

Accommodation to banks reflects the SARB's monetary policy activities.

Loans and advances include loans and overdrafts granted by the SARB.

Table 1 Statement of assets and liabilities, 31 May 2010

Liabilities	R
Share capital	2 000 000
Reserve fund	395 163 919
Notes and coin in circulation	74 509 772 443
Deposits:	
Government SDR deposit account	20 202 865 028
Government: Other	67 372 263 575
Banks	52 882 790 039
Other	14 367 598 272
Foreign loans and deposits:	
Government	25 742 516 976
Other	2 689 968 912
Other liabilities	87 608 790 318
	345 773 729 482
Assets	
Gold	37 461 169 904
SDR holdings	20 233 794 080
Foreign assets reserves (excl.SDRs)	261 263 722 229
Total gold and foreign assets	**318 958 686 213**
Domestic assets:	
Fixed assets	735 904 577
Loans and advances:	
Government	0
Other	530 277 400
Accommodation to banks:	
Repurchase agreements	14 490 466 438
Utilisation of cash reserves	390 797 441
Securities:	
Government	8 435 159 416
Other	279 000 006
Other assets	1 953 437 991
	345 773 729 482
Rand per fine ounce	9 331,27
Gold holdings in fine ounces	4 014 587

Source: SARB website

Securities consist of the SARB's portfolio of investment in a broad range of securities such as government bonds.

Other assets, consisting of a large number of balances, such as remittances in transit, prepaid expense accounts and balances on the accounts related to the gold and foreign asset holdings of the SARB.

The notes to statement of assets and liabilities explain the rand price per ounce at which the SARB's gold holdings are valued for reporting purposes and the SARB's gold holdings in fine ounces as at reporting date.

17.2 Staffing

As at 31 March 2010 the SARB employed 2 117 people. These employees were spread as follows over the SARB's various departments:

Table 2 Staff complement as at 31 March 2010

Department	Permanent staff	Contract workers	Total
Executive Management	46	2	**48**
Bank Supervision	106	1	**107**
Business Systems and Technology	172	19	**191**
Corporate Services	198	4	**202**
Currency and Protection Services (including branches)	835	41	**876**
Exchange Control	156	0	**156**
Financial Markets	104	0	**104**
Financial Services	76	0	**76**
Financial Stability	20	0	**20**
Human Resources	62	4	**66**
Internal Audit	47	0	**47**
Legal Services	30	1	**31**
National Payment System	24	0	**24**
Research	147	1	**148**
SARB College	10	11	**21**
Total staff complement	2 033	84	2 117

Source: SARB

It is a stated objective of the SARB to transform the racial and gender composition of its workforce to reflect the demographics of South Africa. The SARB has made considerable progress with this objective over the past decade, as is evidenced by the table on the next page, reflecting the composition of the SARB's staff complement by 31 March 2010:

Table 3 Workforce profile by gender and race as at 31 March 2010

Broad band	Male				Female				
	African	Coloured	Indian	White	African	Coloured	Indian	White	Total
General Management	24	3	7	42	11	4	1	8	**100**
Senior Professional and Management	32	9	8	83	27	4	5	33	**201**
Professional and Vocational Management	65	12	9	102	74	14	14	87	**377**
Junior Professional and Supervisory	103	25	11	69	97	24	15	165	**509**
Trainee Professional and Clerical	215	42	15	66	147	50	16	103	**654**
General Worker	101	7	1	11	62	7	0	3	**192**
Total permanent	**540**	**98**	**51**	**373**	**418**	**103**	**51**	**399**	**2 033**
Non-permanent	27	6	1	15	24	2	1	8	**84**
Total	**567**	**104**	**52**	**388**	**442**	**105**	**52**	**407**	**2 117**

Source: SARB

17.3 Inflation data

Table 4 Average inflation rates of South Africa, 1921–1930 to 2001–2009

Period	Inflation rate Per cent
1921–1930	-3,2
1931–1940	-0,1
1941–1950	4,8
1951–1960	3,5
1961–1970	2,7
1971–1980	10,7
1981–1990	14,7
1991–2000	9,0
2001–2009	6,2

Source: SARB website; SARB calculations

Table 5 Inflation targets in 2009

Table 5a Countries that adopted inflation targets up to 1999 (before South Africa)

Country	Date of adoption	Specification of inflation rate used for targeting purposes*	Current target Per cent
Australia	1993	Average of quarterly weighted median CPI and trimmed mean CPI, which excludes mortgage interest costs	2–3
Brazil	1999	Extended headline inflation (also known as IPCA), which excludes mortgage interest costs	4,5 (+/- 2,5)
Canada	1991	CPI excluding eight volatile components (e.g., energy prices) and the effect of changes in indirect taxes and subsidies on the remaining components	1–3
Chile	1999	Headline inflation (related to the *Unidad de Fomento*)	2–4
Colombia	1999	Headline inflation excluding food	5 (+/- 0,5)
Czech Republic	1998	Headline inflation excluding regulated prices and indirect taxes	3 (+/- 1)
Israel	1997	Headline inflation	1–3
New Zealand	1990	CPI excluding impact of goods and services tax and credit services, which exclude mortgage interest costs	1–3
Poland	1999	Headline inflation measured quarterly, which excludes all owner-occupied housing (e.g., mortgage interest cost), food prices and fuel prices	2,5 (+/- 1)
South Korea	1998	Headline inflation, excluding petroleum and agricultural products other than grain (also known as core inflation)	2,5–3,5
Sweden	1993	CPI excluding household mortgage interest expenditure and the effects of changes in indirect taxes and subsidies	2 (+/- 1)
United Kingdom	1992	CPI excluding energy, food and tobacco, and CPI excludes cost of owner-occupied housing (e.g., mortgage interest costs)	2

Table 5b Countries that have adopted inflation targets since 2000

Country	Date of adoption	Specification of inflation rate used for targeting purposes*	Current target Per cent
Hungary	2001	Headline inflation, which excludes owner-occupied housing and mortgage interest costs	3,5 (+/- 1)
Ghana	2007	Headline inflation, which excludes mortgage interest costs	14,5–17,5
Iceland	2001	Headline inflation, which excludes housing interest costs	2,5
Indonesia	2005	Headline inflation, which excludes mortgage interest costs	5,5 (+/- 1)
Mexico	2001	Headline inflation, which excludes mortgage interest costs	3 (+/- 1)
Norway	2001	CPI adjusted for tax and interest changes and excluding energy products and excise duties (a.k.a. CPI-ATE)	2,5
Peru	2002	Headline inflation	2,5 (+/- 1)
Philippines	2002	Headline inflation measured quarterly	5–6
Romania	2005	Headline inflation	3,5** (+/- 1)
Slovak Republic	2005	Headline inflation	3,5 (+/- 1)
South Africa	2000	CPI for all urban areas	3–6
Thailand	2000	Core CPI measured quarterly, excluding raw food and fuel, while CPI also excludes mortgage interest costs and owner-occupied housing	0–3,5

* Information about the specification of the target by the different countries is not readily available for purposes of this comparison, particularly because no single international specification for the CPI used to measure inflation has been universally adopted. The result is, therefore, that two countries using "headline CPI" show differences in the items included in or excluded from headline inflation. Inflation is measured monthly by these countries except where specified otherwise.

** Romania uses a declining target range, that is, a target of 3,8 per cent for 2008, 3,5 per cent for 2009 and 2010, and 3,0 per cent for 2011.

Sources: Adapted from Allen et al., 2006; Amoah and Mumuni, 2008; BIS, 2006: 76; OECD, 2002; Roger and Stone, 2005: 9, 46 and 47; Rossouw, 2009; Vega and Winkelried, 2005: 165; central bank and government websites; research by SARB, electronic mail and facsimiles to and from selected central banks.

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