



South African Reserve Bank

The South African Reserve Bank

**Presentation to the
Standing Committee on Finance
1 August 2017**

Agenda

1. The Role of the South African Reserve Bank
2. Macroeconomic Overview and Outlook
3. Annual Report



The role of the South African Reserve Bank

- The SARB's Constitutional Mandate:
 - To protect the value of the currency in the interest of balanced and sustainable economic growth
- Once the Financial Sector Regulation Bill (FSRB) is signed into law by the President, it will formally mandate the SARB to protect and enhance financial stability in South Africa, in addition to its primary price stability mandate

SARB's key activities

- Regulates and supervises the banking system.
 - The FSRB will establish the Prudential Authority, which will expend the SARB's regulatory responsibility beyond licensed deposit-taking institutions, and includes insurance companies
- Ensures the effective functioning of the National Payments System
- Undertakes economic data analysis and research
- Issues high quality notes and coins
- Manages the official gold and foreign exchange reserves of the country
- Administers the country's remaining exchange control regulations
- Acts as banker to the government

Role of Monetary Policy

- Ensuring price stability or low inflation is a traditional function of central banks. All central banks have this as a mandate in some form. If not the central bank, who would control inflation?
- How they do it may differ. There are different frameworks (Inflation targeting; fixed exchange rate systems; targeting monetary aggregates). Monetary policy cannot determine long run growth potential in the economy
- It therefore cannot solve the problem of structural unemployment in the economy
- Monetary policy should therefore focus on what it can do, and not what we would like it to do
- Many of the SARB's functions have a socio-economic impact

Why low inflation?

- High inflation has negative redistributive effects.
 - The poor are least able to protect themselves and inflation reduces the purchasing power of wages, savings and social pensions.
 - The wealthy have various means to hedge themselves.
- High inflation creates uncertainty about the future and adversely affects investment and consequently growth and employment creation.
 - Low inflation provides a stable environment for investment, and therefore for long term growth and investment.
 - High inflation also impacts negatively on the country's international competitiveness.

Why low inflation?

- In a high inflation environment, savers and lenders will require high nominal interest rates to induce them to save and lend. That is why we see that countries with high inflation have high nominal interest rates to compensate for higher inflation.
- Low inflation allows for low interest rates and more investment and growth.
- Currently South Africa's real and nominal interest rates are at near long-term lows, due to the relatively low inflation environment.

Table 1: Inflation and policy rates in South Africa and selected advanced economies

Country	Inflation (%)		Policy rates (%)	
	2014–2016	2017 (average)	2014–2016	2017 (latest)
United States	1.0	2.2	0.3	1.25*
Euro Area	0.2	1.7	0.1	0.00
United Kingdom	0.7	2.4	0.5	0.25
Canada	1.5	1.6	0.7	0.75
Australia	1.8	2.1	2.1	1.50
New Zealand	0.7	2.0	2.8	1.75
Sweden	0.7	1.7	-0.1	-0.50
Czech Republic	0.5	2.3	0.0	0.05
Israel	-0.2	0.5	0.3	0.10
South Korea	1.0	2.0	1.8	1.25
Taiwan	0.8	0.7	1.7	1.375
South Africa	5.7	5.8	6.1	6.75

* Upper end of range

Table 2: Inflation and policy rates in South Africa and selected emerging markets

Country	Inflation (%)		Policy rates (%)	
	2014–2016	2017 (average)	2014–2016	2017 (latest)
China	1.8	1.4	5.1	4.35
India	5.5	2.9	7.3	6.25
Indonesia	5.4	4.0	5.1	4.75
Russia	10.2	4.4	10.4	9.00
Turkey	8.1	10.9	7.9	8.00
Brazil	8.0	4.2	12.9	10.25
Mexico	3.2	5.5	3.5	7.00
Argentina	29.9	25.7	31.2	26.25
Colombia	5.1	4.7	5.2	5.75
Ghana	16.7	12.8	22.4	21.00
Nigeria	10.9	17.2	12.5	14.00
South Africa	5.7	5.8	6.1	6.75

Table 3: South Africa's inflation, prime rate and real growth

	Prime Rate	Inflation	Real Prime rate	Real GDP growth
1990s	18.9	9.9	9.0	1.4
2000s	13.2	6.8	6.4	3.6
2010-now	9.4	5.4	4.0	2.0

Table 4: Comparative inflation targets, inflation and growth outcomes

Country	Since 1990		Since introduction of inflation target		Since the global crisis	
	<i>Inflation</i>	<i>Growth</i>	<i>Inflation</i>	<i>Growth</i>	<i>Inflation</i>	<i>Growth</i>
Brazil	316.6	2.2	6.7	2.4	6.8	1.4
Chile	6.5	4.8	3.4	3.8	3.2	3.9
Colombia	11.5	3.6	5.5	3.6	3.8	4.1
Czech Rep	3.2	2.5	2.6	2.5	1.4	1.8
Hungary	11.1	1.2	4.2	2.0	2.3	1.7
Korea	3.8	5.3	2.6	3.9	1.9	3.5
Mexico	10.4	2.8	4.2	2.2	3.6	3.1
Philippines	6.1	4.3	3.9	5.4	3.1	6.3
Peru	301.0	4.4	2.8	5.6	3.1	5.2
Poland	33.1	3.3	3.4	3.7	1.4	3.1
Thailand	3.0	4.5	1.9	4.0	1.9	3.6
South Africa	7.3	2.4	5.8	3.0	5.4	2.0
Median	8.9	3.4	3.7	3.6	3.1	3.3
Mean	59.5	3.4	3.9	3.5	3.2	3.3

Table 5: Emerging market inflation targets and dates of adoption

Country	Inflation target	Date adopted
Brazil	4.5% +/- 2%	1999
Chile	3% +/- 1%	1999
Colombia	3% +/- 1%	1999
Czech Rep	2%	1998
Hungary	3% +/- 1%	2001
Korea	3% +/- 1%	2001
Mexico	3% +/- 1%	2001
Philippines	4% +/- 1%	2002
Peru	2% +/- 1%	2002
Poland	2.5% +/- 1%	1998
Thailand	0.5%-3.0%	2000
South Africa	3%-6%	2000

Why Financial Stability?

- The recent Global Financial Crisis showed the devastating effect that financial crises can have.
 - It takes years to recover from a financial crisis, as banks and households have to repair their balance sheets. This involves less bank lending, and less household spending.
- Ten years after the Global Financial Crisis, only now are the advanced economies showing signs of a sustained recovery, and a full recovery is still not assured.
- Regulating and supervising banks is part of the financial stability mandate. This involves ensuring that banks do not undertake excessively risky lending.

Why Financial Stability?

- Bank failures can also have negative impacts on the economy and on depositors in general.
- A bank failure could have systemic effects, through causing general panic among depositors, who withdraw their deposits, as well as through interlinkages between institutions. This can cause the collapse of otherwise healthy banks.
- Regulation and supervision helps maintain trust and confidence in the banking sector.
- Lender of last resort to banks with a liquidity problem thereby helpings to protect the banking system from systemic banking crisis.
- Protects depositors of the bank, and the broader economy. As seen in the African Bank saga, it does not protect the shareholders.

The role of private shareholders

- Private shareholding is an historical legacy;
- Private shareholders do not own the SARB and their rights are limited: Shareholders
- Play no role whatsoever in the setting of, or influencing the key mandates of the SARB, i.e. monetary policy or financial stability policy;
- No sway over the day-to-day management of the SARB;
- Restricted to a maximum of 10,000 shares (including associates of shareholders) out of 2 million issued shares.

The role of private shareholders

- Receive a fixed return on their shares of 10 cents per share from profits made.
 - This amounts to an overall divided payment by the Bank of R200 000 per year. 90% of the SARB's profits are transferred to government, and the remaining 10% are allocated to the SARB's reserves;
- Do not have any claim on the foreign exchange reserves of the Bank;
- Are unable, by means of a resolution or otherwise, to amend or change the SARB's affairs by deviating from the prescriptions of the South African Reserve Bank Act ("SARB Act").

The role of private shareholders

- In terms of the SARB Act, shareholders, private shareholders:
 - Approve the appointment of auditors for the SARB and their remuneration
 - Elect non-executive directors to the Board, from a vetted list. The other 8 members are appointed by the President. These include the Governor and the three deputy governors.
 - Represent an additional layer in the governance framework of the SARB, by strengthening accountability and transparency.

The role of the SARB Board

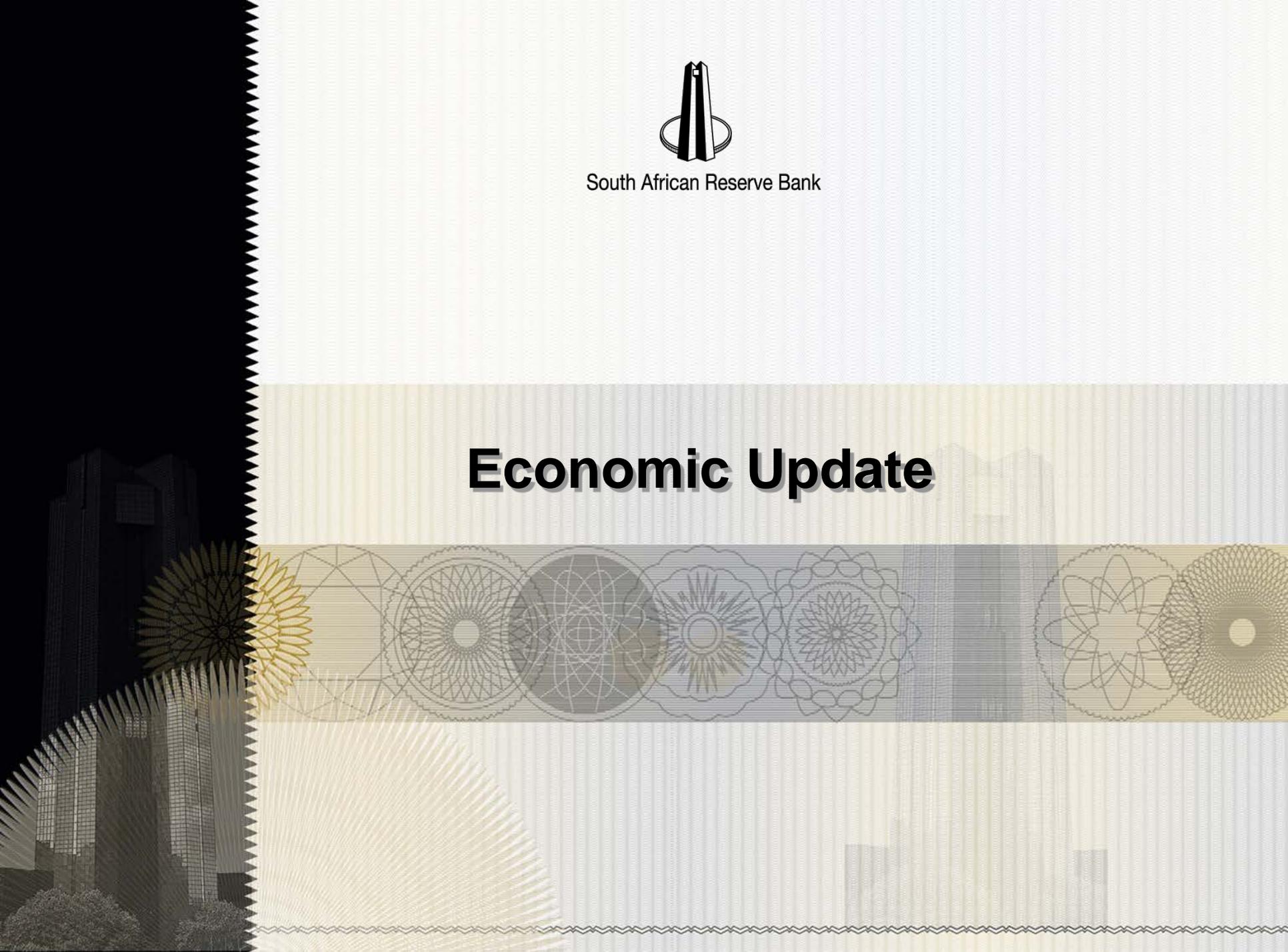
- Board itself is a corporate governance board, and has no input or say in policies related to the SARB's mandates and primary functions.
- Board's functions are limited to corporate governance issues, internal controls including auditing, staff policies and remuneration.
- The management of the business of the bank including the setting of monetary policy vests in the Governor and Deputy Governors, who are appointed by the President after consultations with the Minister of Finance and the Board.

Q & A



South African Reserve Bank

Economic Update



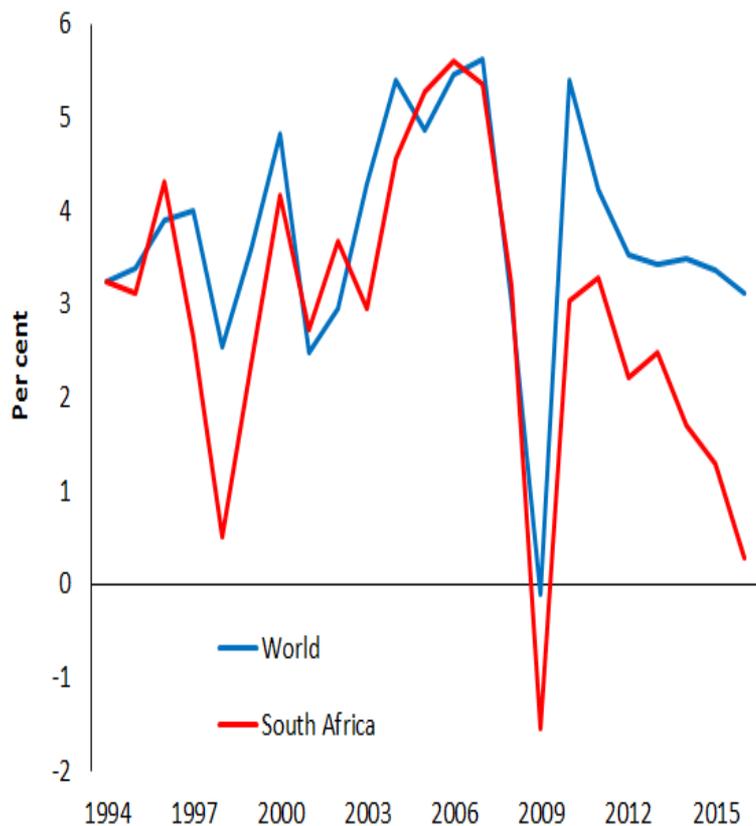
Macroeconomic Overview and Outlook

1. Global economic growth
2. How broad based is the recession in South Africa
3. Recent employment outcomes
4. Interest rates and credit extension
5. Outlook for the main drivers of inflation
6. Expectations for Q2 2017
7. Balance of Payments
8. Forecast
9. Additional slides

Global economic growth

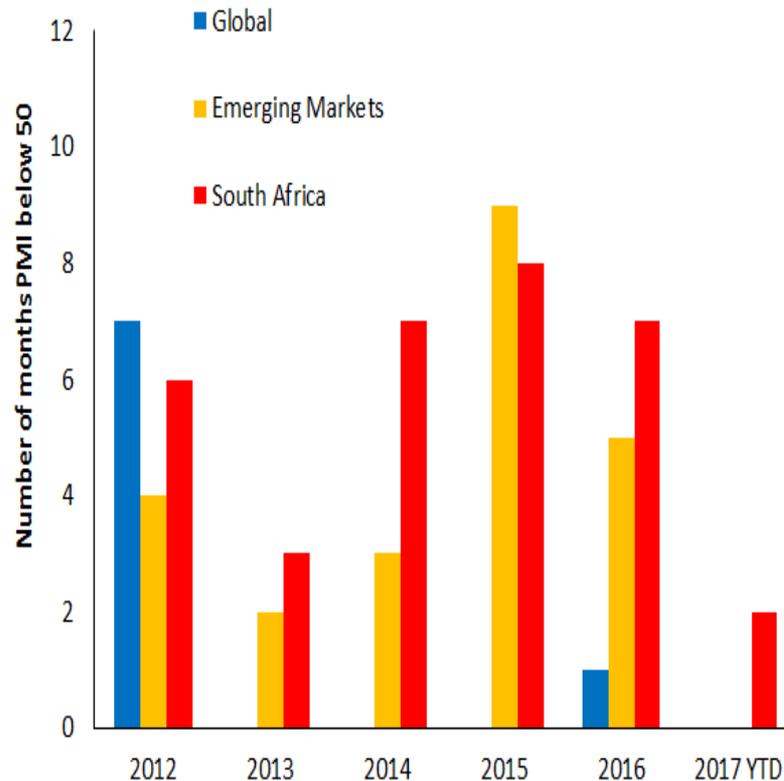
The domestic response to world growth is currently unusually weak

Domestic and global growth



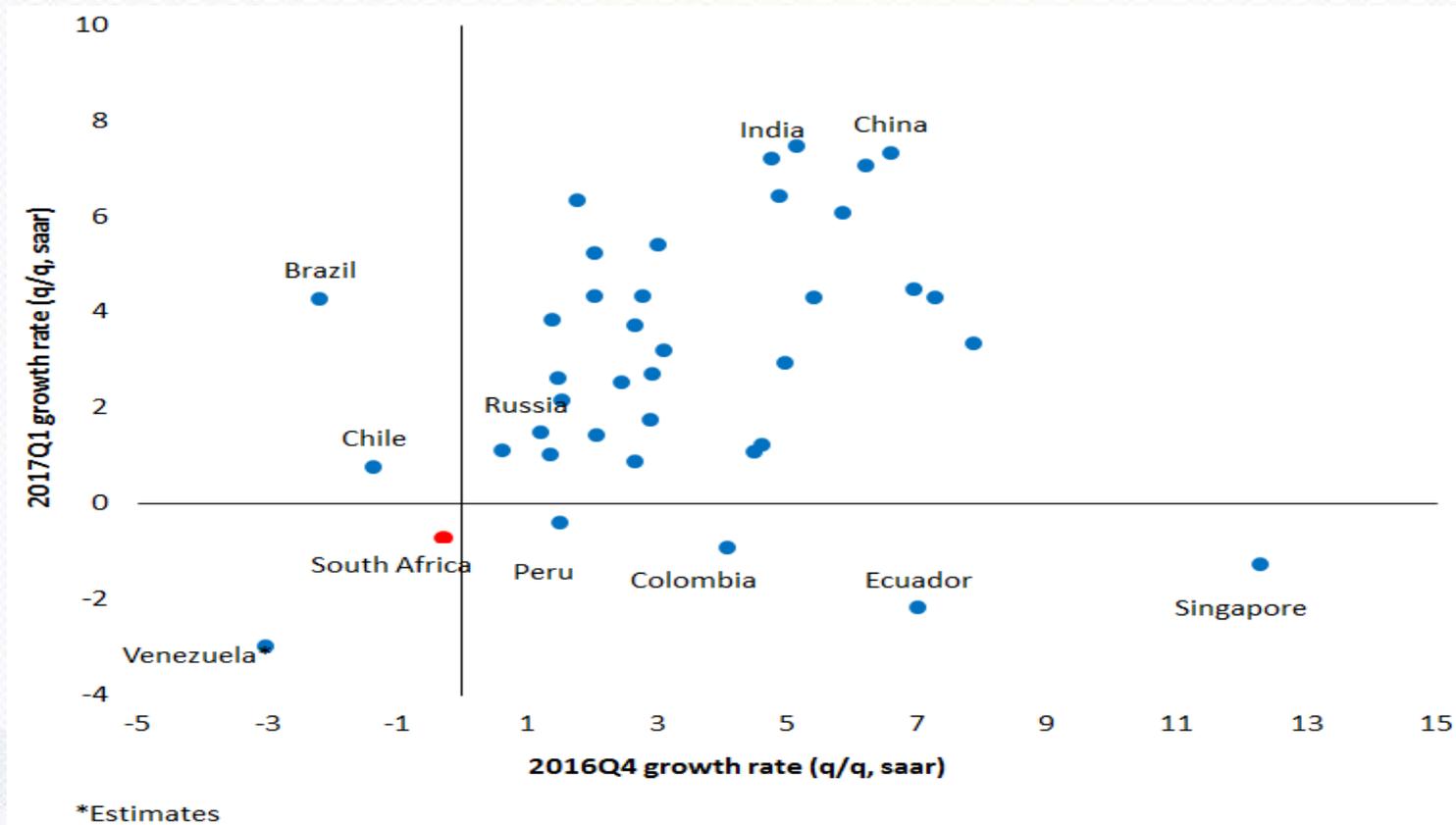
Sources: IMF and Statistics South Africa

PMIs, months below 50 level



Sources: Haver Analytics and own calculations

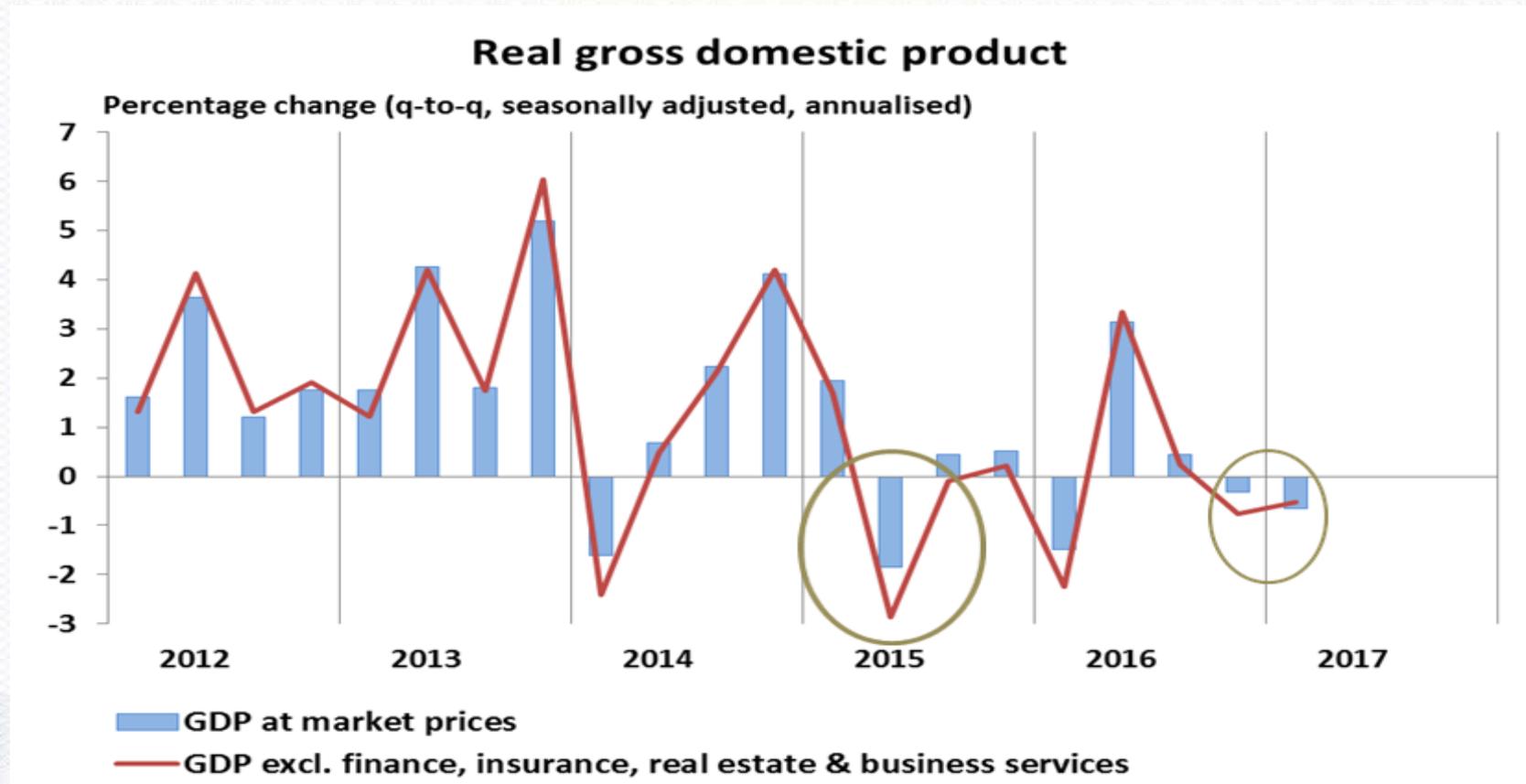
South Africa and Venezuela are the only sizeable economies currently in a recession



Sources: Statistics South Africa and national statistical offices

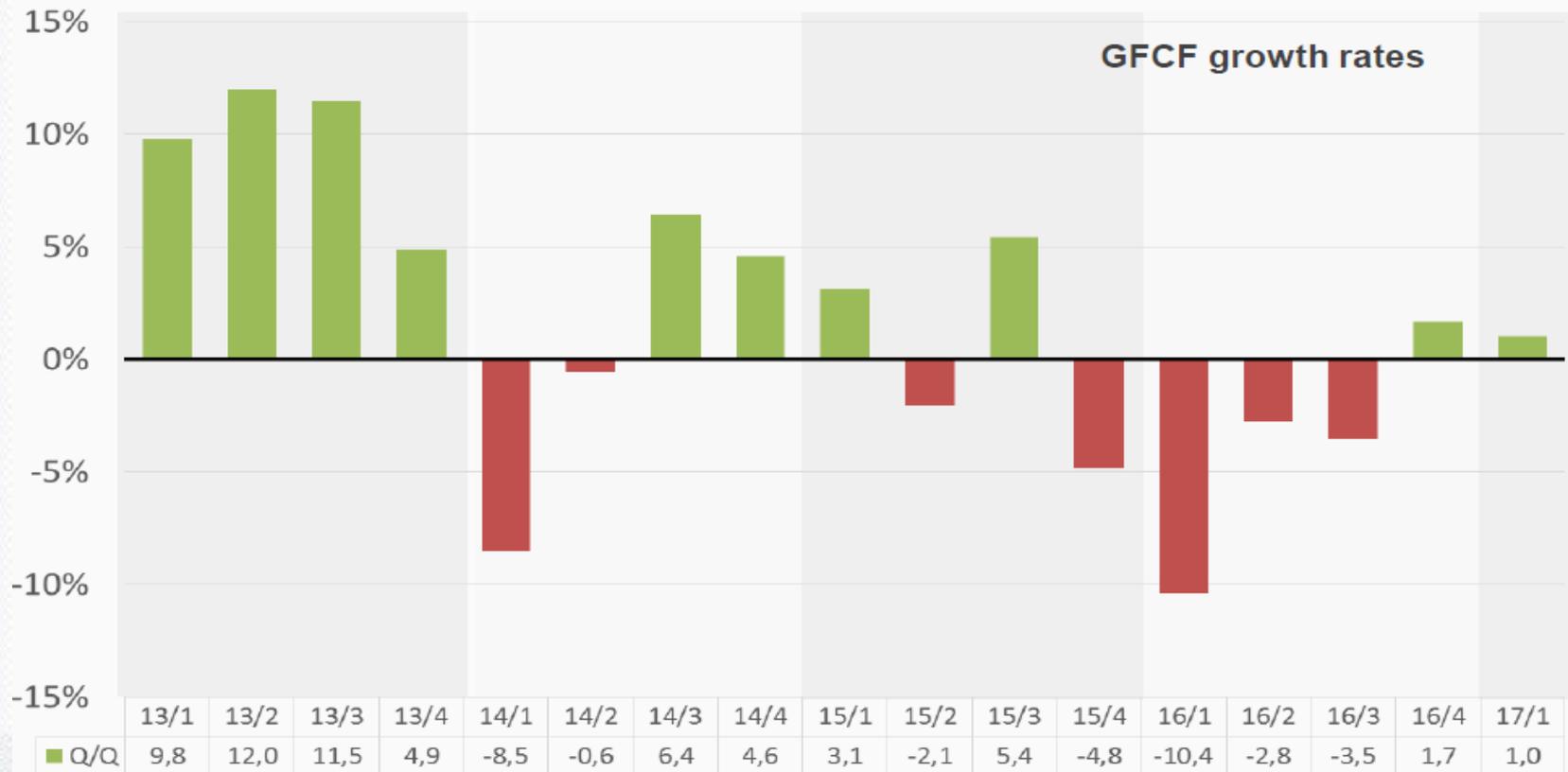
How broad-based is recession in South Africa

Real GDP would have contracted for two consecutive quarters in Q1 2017 even when excluding the finance, insurance, real estate and business services sector...



Source: Statistics South Africa

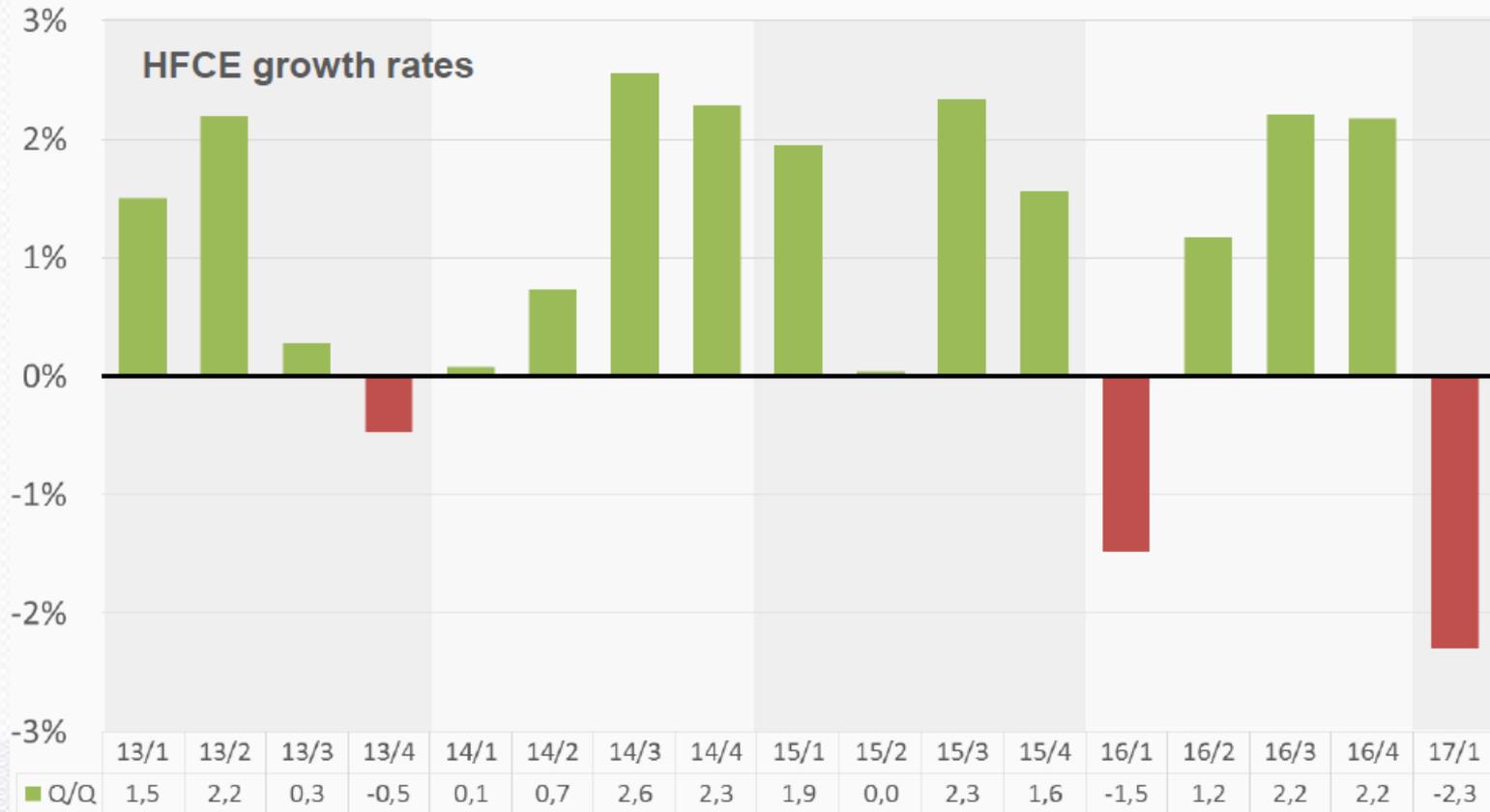
Gross fixed capital formation



Quarter to quarter, seasonally adjusted and annualised

Source: Statistics South Africa

Household Financial Consumption Expenditure



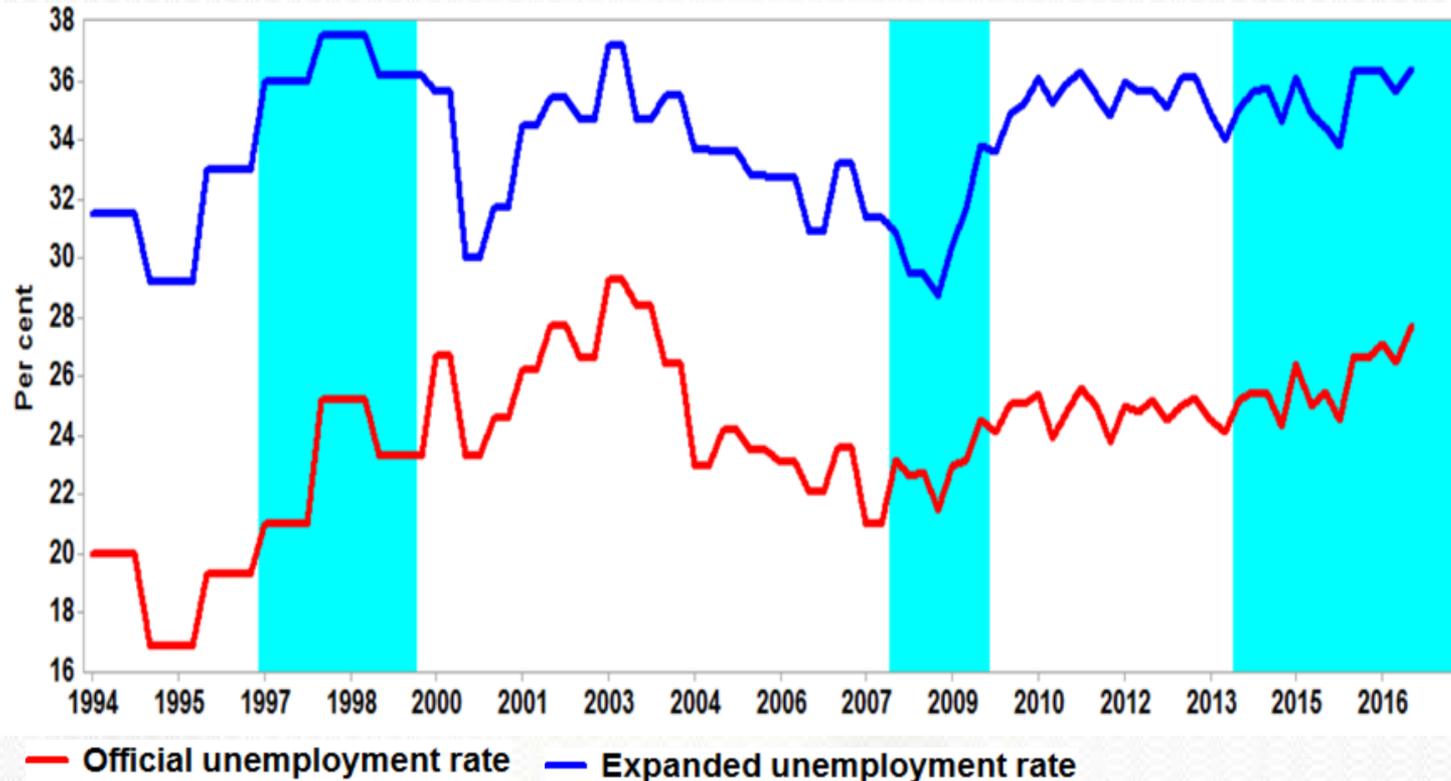
Quarter to quarter, seasonally adjusted and annualised

Source: Statistics South Africa

Recent employment outcomes

Where did job growth (as shown by the QLFS) come from?

Unemployment Rate

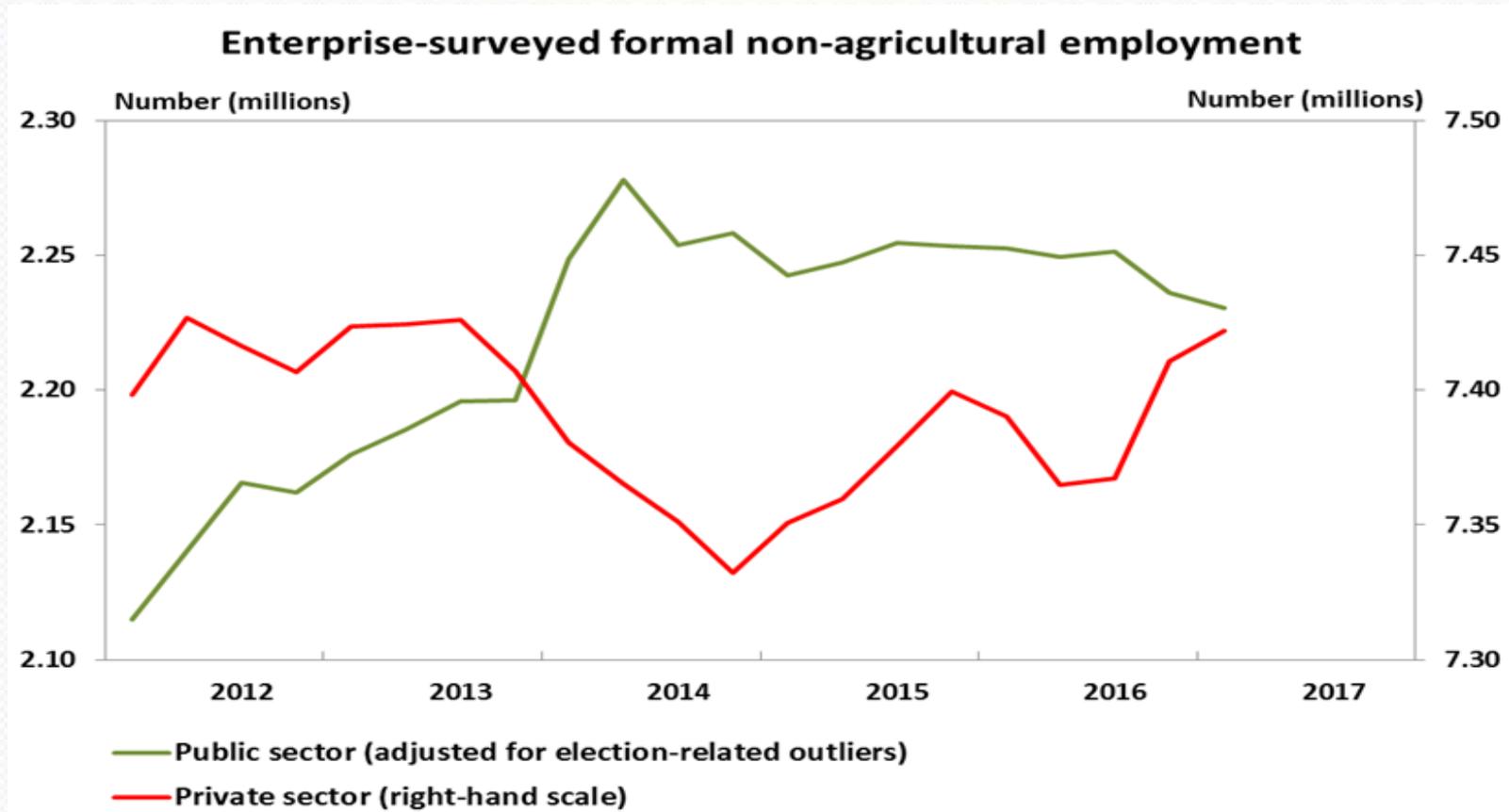


Shaded areas indicate downward phases of the business cycle

The official unemployment rate rose to 27.7% in Q1 2017, while the expanded unemployment rate which includes discouraged job-seekers amounted to 36.4%

Sources: Statistics South Africa and SA Reserve Bank

Unemployment

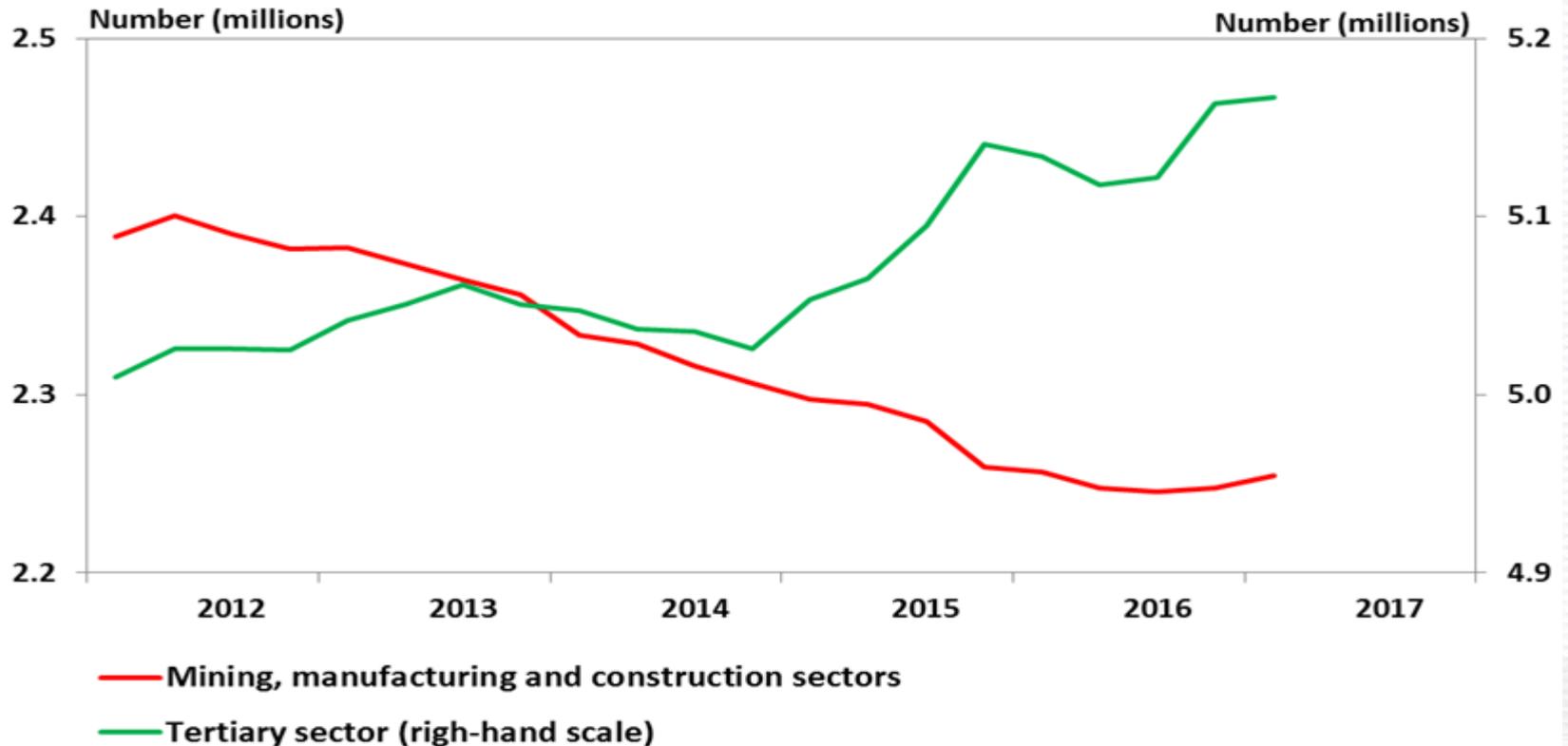


Source: Statistics South Africa

Formal non-agricultural employment increased marginally in Q1 2017 as private-sector employment increased somewhat

Moderate employment gains were made in the mining, construction and trade sectors in Q1 2017

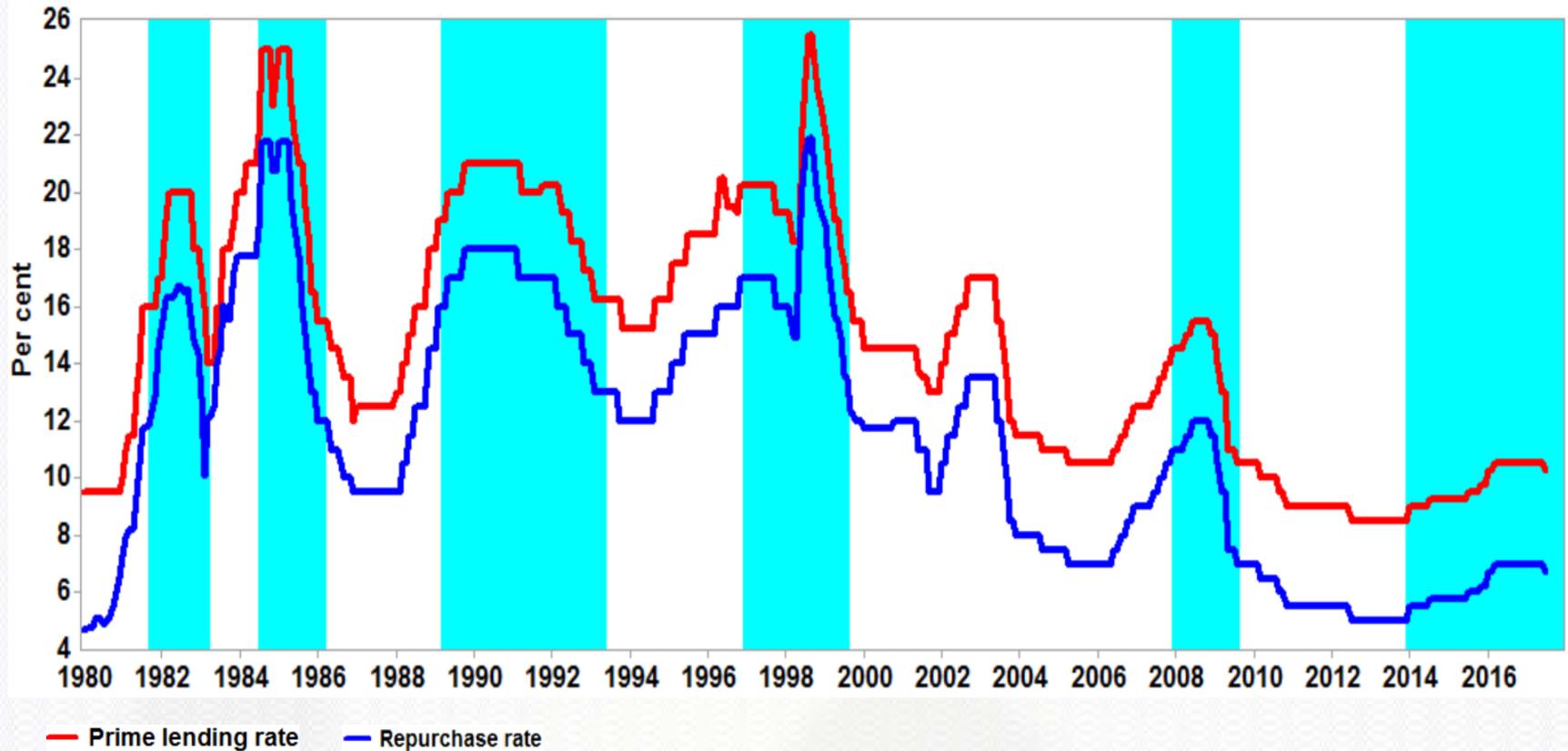
Formal non-agricultural private-sector employment



Source: Statistics South Africa

Interest rates and credit extension

Interest rates in South Africa

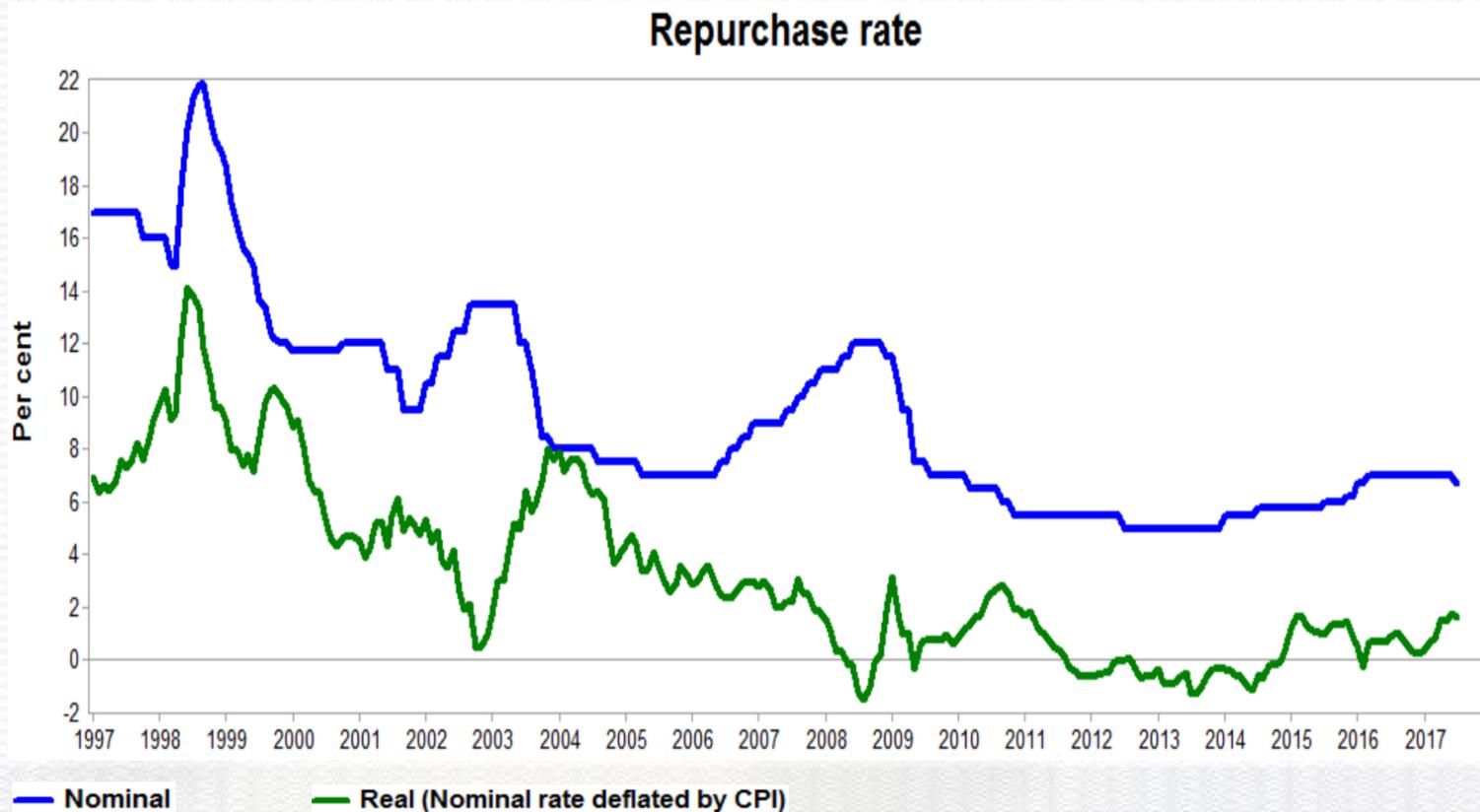


Shaded areas indicate downward phases of the business cycle

Source: SA Reserve Bank

Interest rate cycles are interrelated with the stance of the business cycle

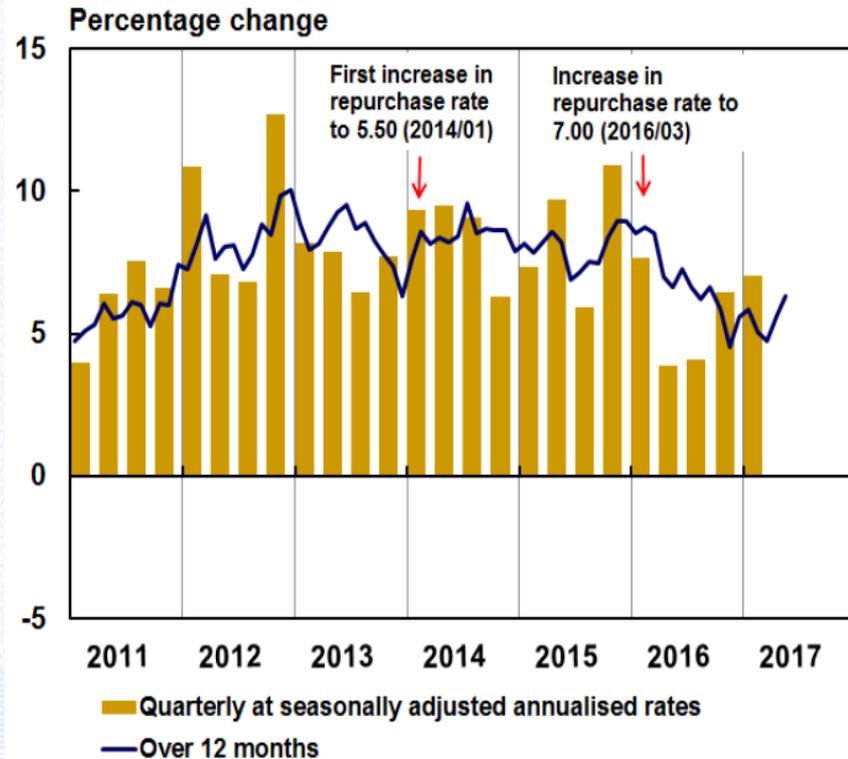
Maintaining positive real rates are prudent for the containment of inflationary pressures in an economy



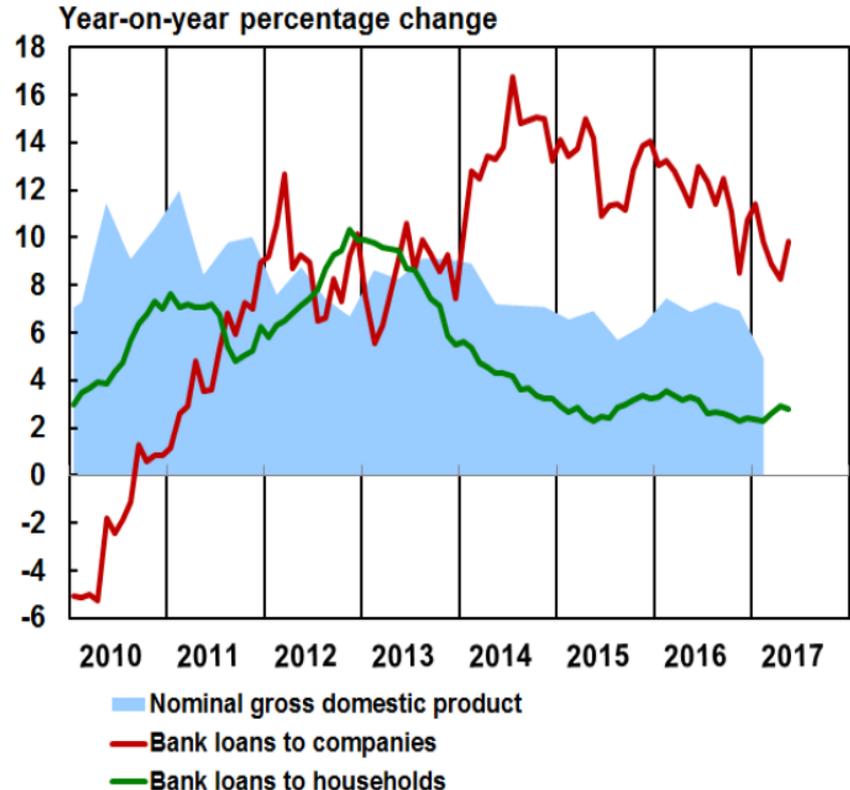
Sources: SA Reserve Bank and Statistics South Africa

Growth in total loans and advances to the domestic private sector improved marginally from March 2017 to May, after it had moderated during the course of 2016

Total loans and advances to the private sector



Growth in bank loans to companies and households and in gross domestic product



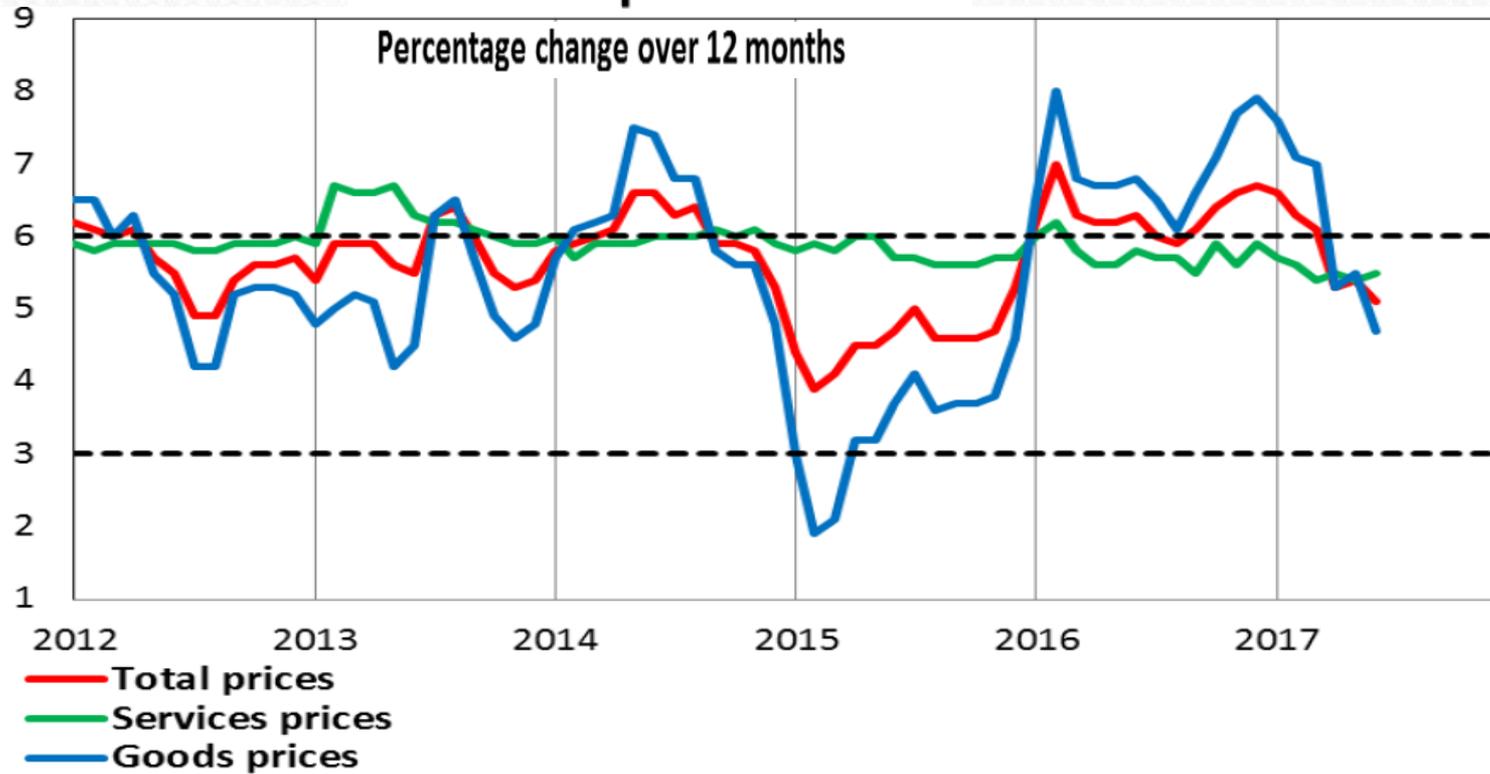
Source: SA Reserve Bank

The near-term outlook for inflation improved further

Outlook for the main drivers of inflation

Headline and measures of underlying inflation slowed in recent months

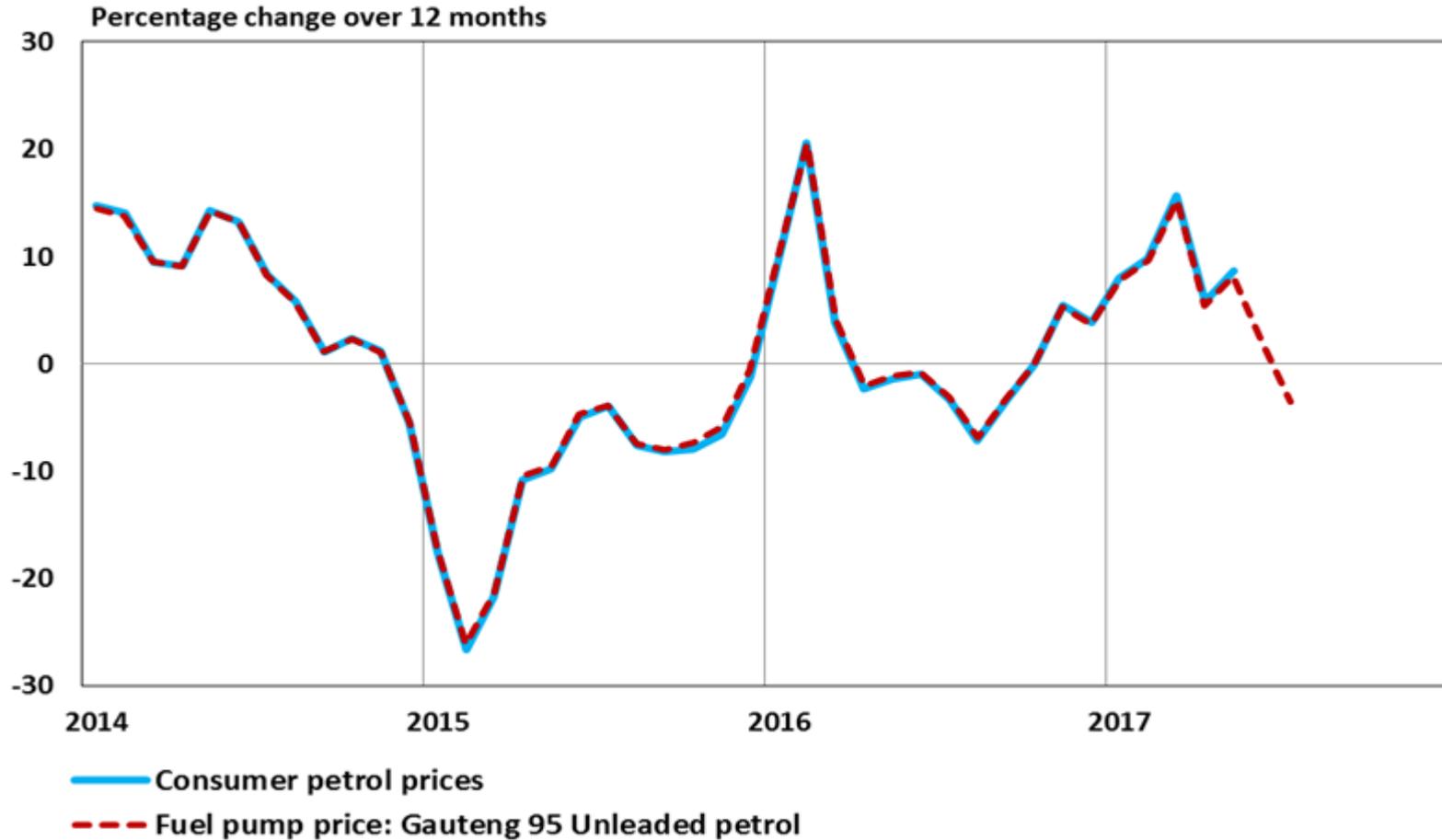
Consumer price inflation



Source: Statistics South Africa

Petrol price inflation will slow notably up to July 2017 and is expected to subtract 0.7 percentage points from the July headline inflation rate, compared with the rate in May

Petrol price inflation



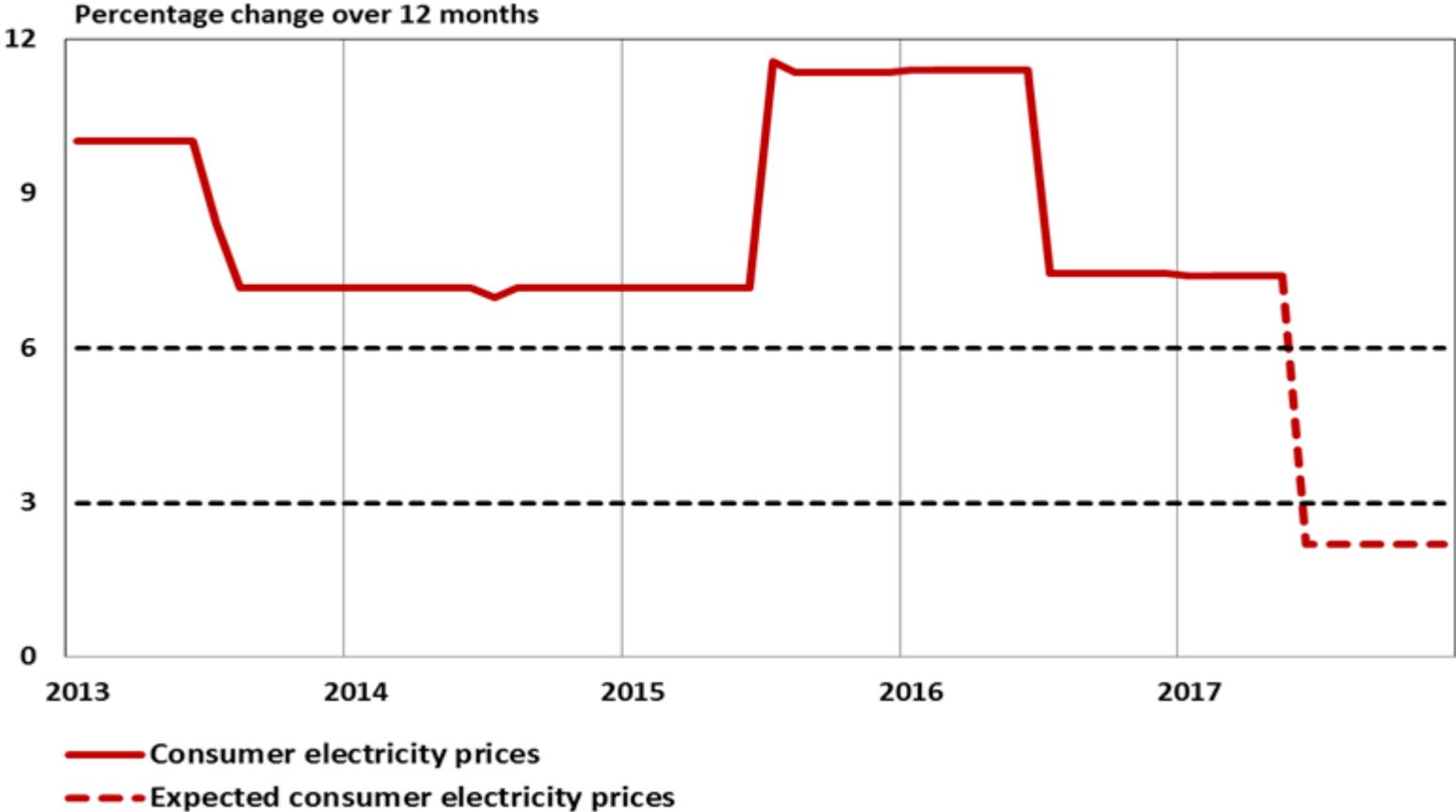
Source: Statistics South Africa



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Electricity price inflation will slow notably in July 2017 and is expected to subtract 0.2 percentage points from the July headline inflation rate, compared to the rate in May

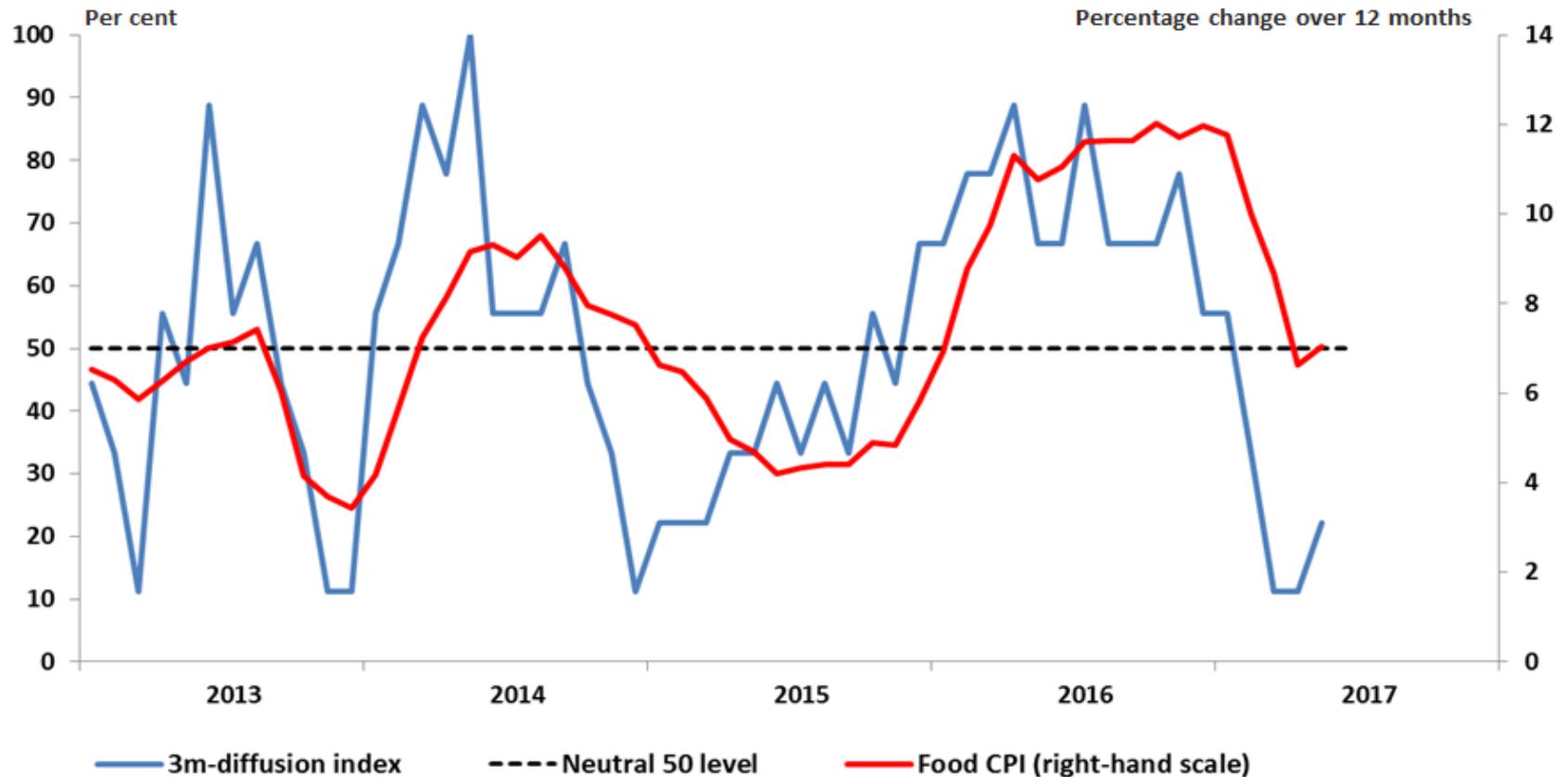
Electricity price inflation



Source: Statistics South Africa

The slowdown in consumer food price inflation since December 2016 has been fairly widespread among the various food price subcomponents

Consumer food price inflation & three-month diffusion index of consumer food price components

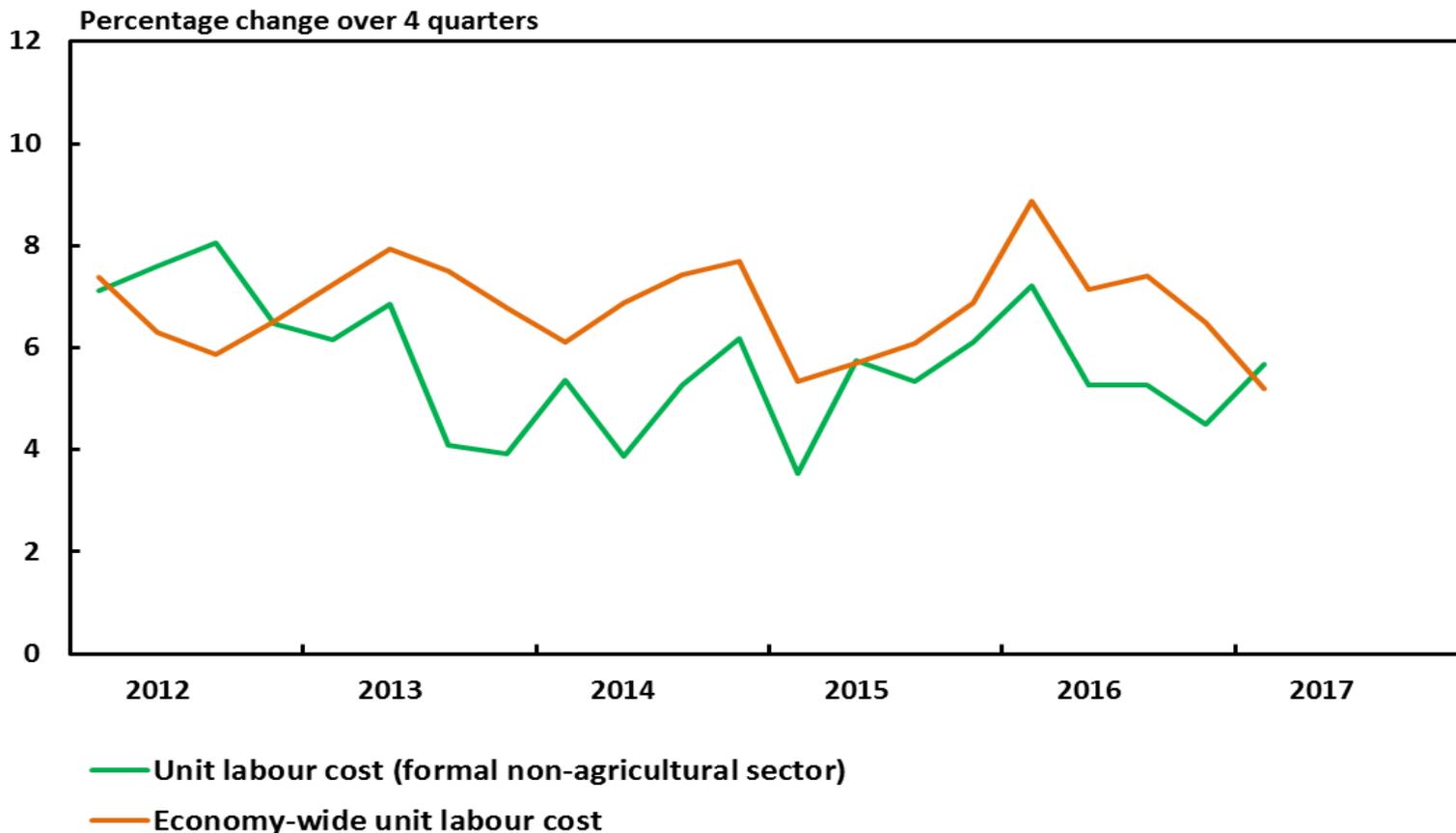


Sources: Statistics South Africa and SA Reserve Bank



Despite the uptick in formal non-agricultural unit labour cost growth in Q1 2017, both measures of nominal unit labour cost have trended lower over the past year

Nominal unit labour cost

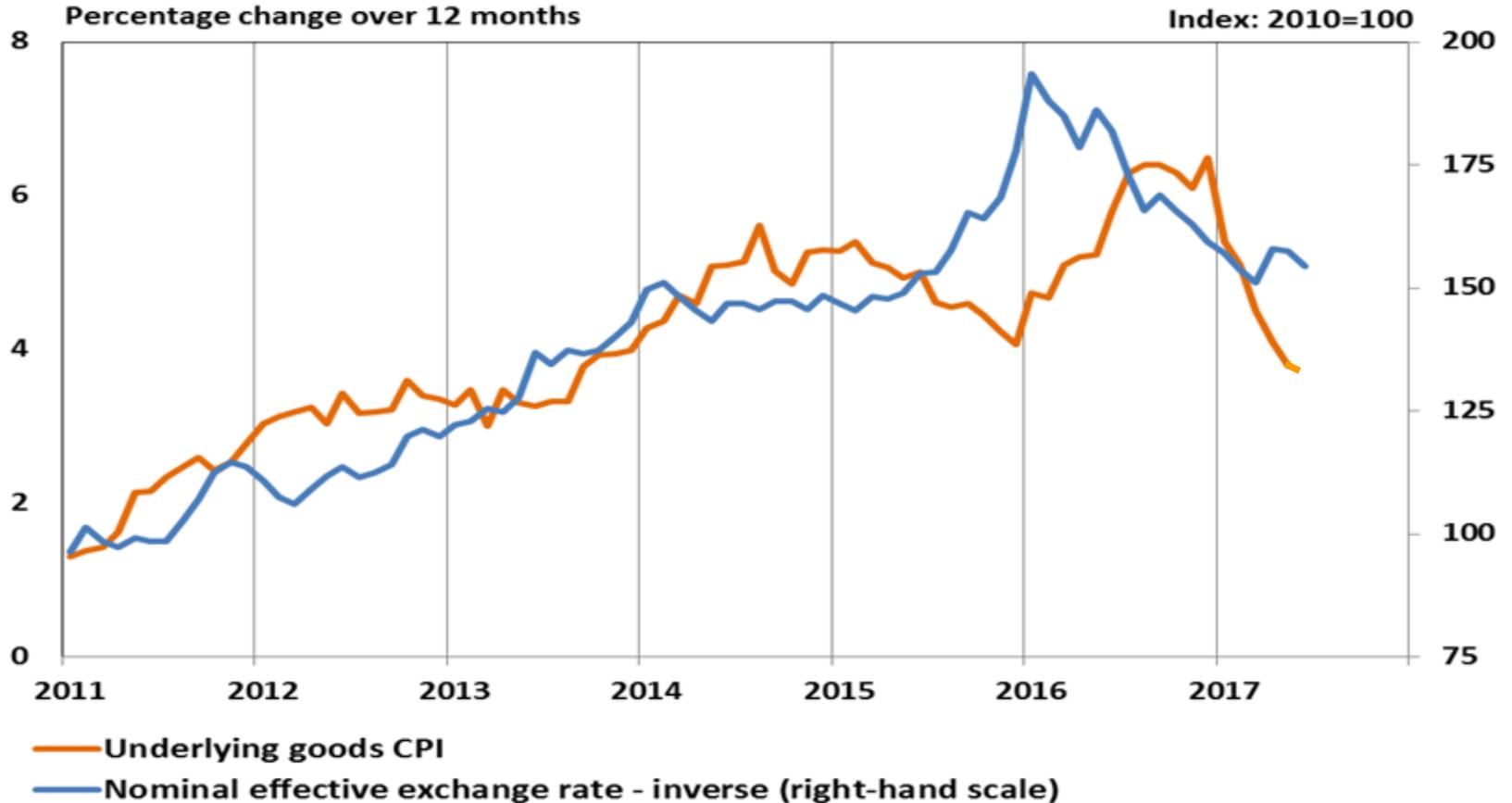


Source: Statistics South Africa



The appreciation in the exchange value of the rand since early 2016 has contributed significantly to the recent moderation in CPI inflation, particularly for underlying goods

Underlying goods price inflation and the NEER

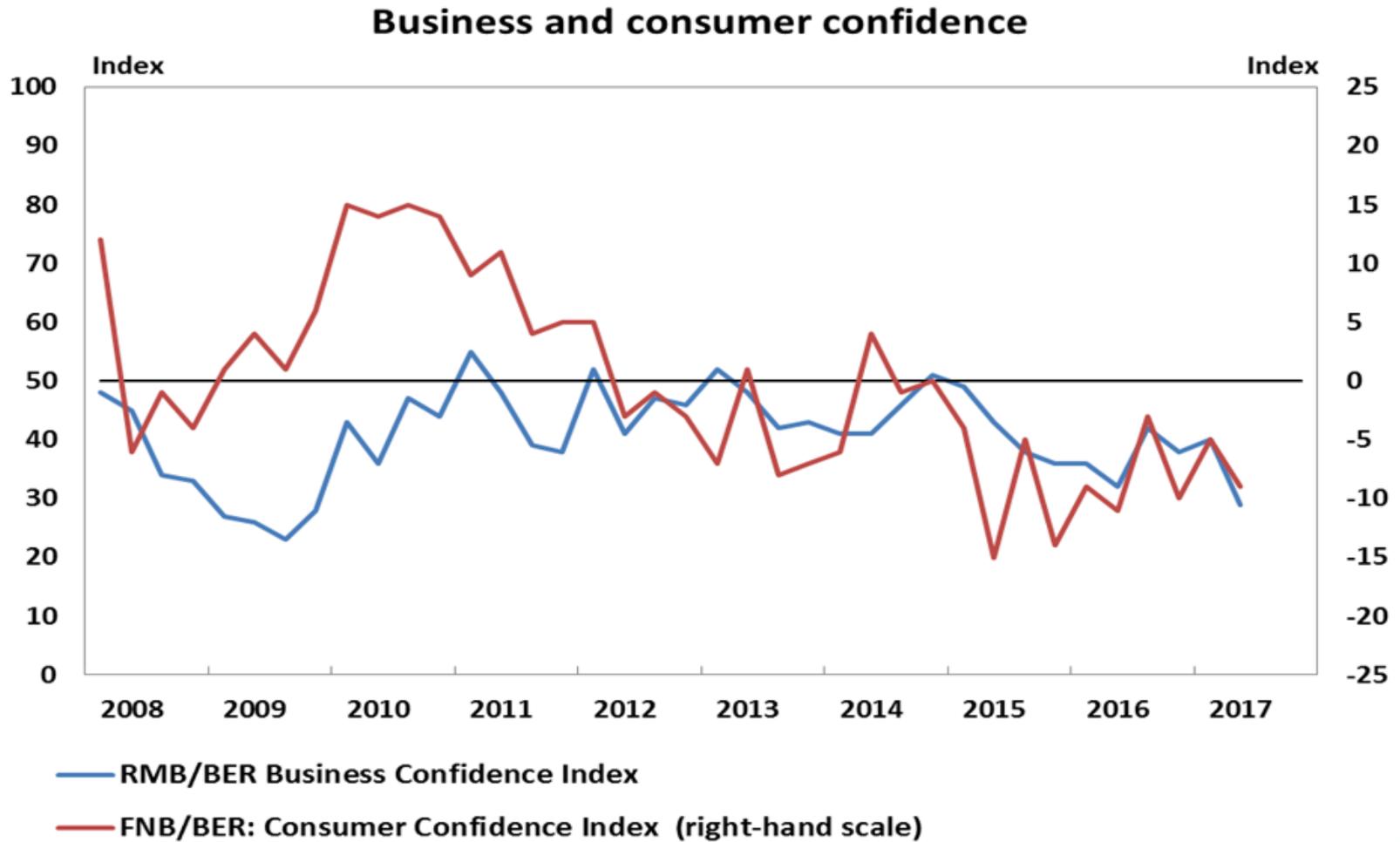


Sources: Statistics South Africa and SA Reserve Bank



Expectations for Q2 2017
Is there a disconnect between real economic indicators and confidence?

Business and consumer confidence both decreased in the second quarter of 2017

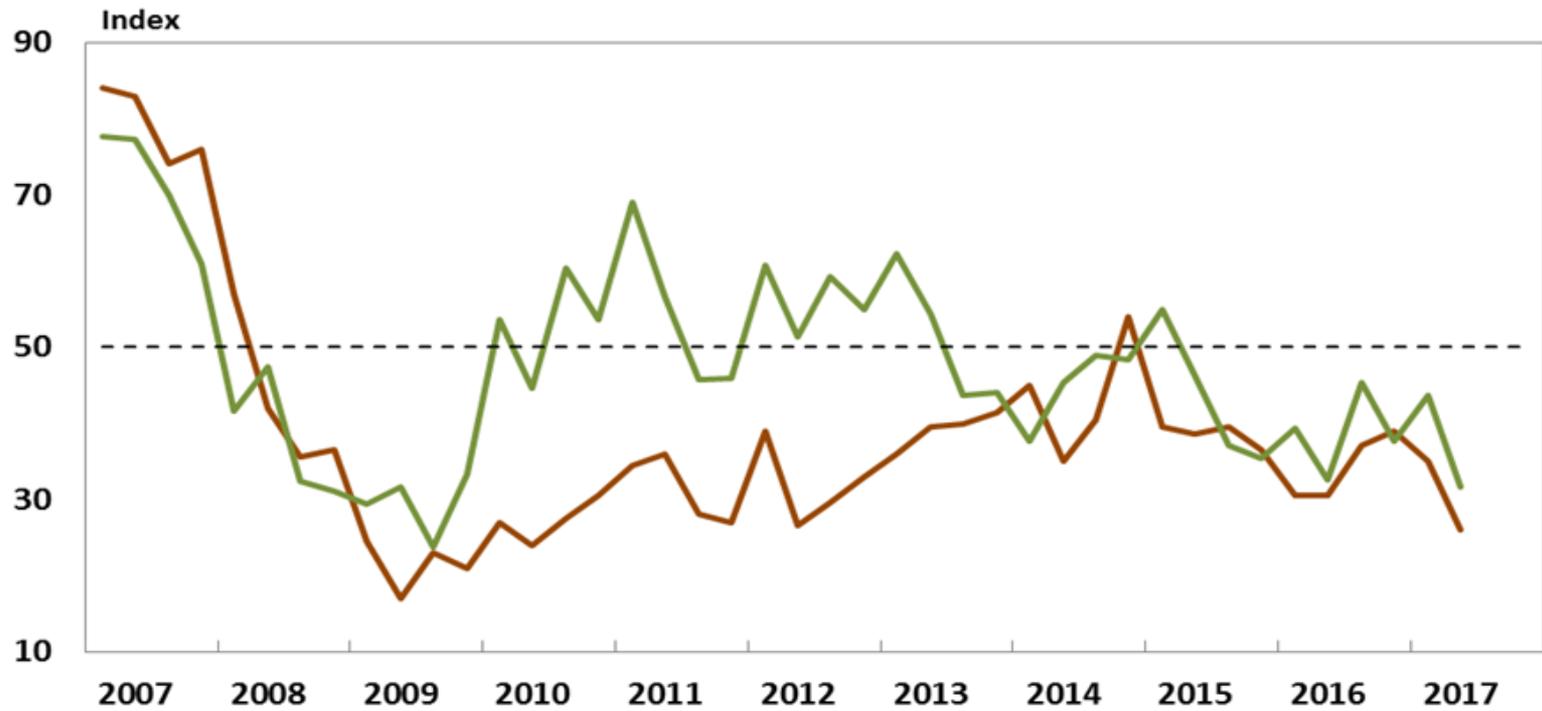


Source: Bureau for Economic Research



Confidence fell in all 5 of the sectors surveyed by the BER in Q2 2017

RMB/BER Business confidence index



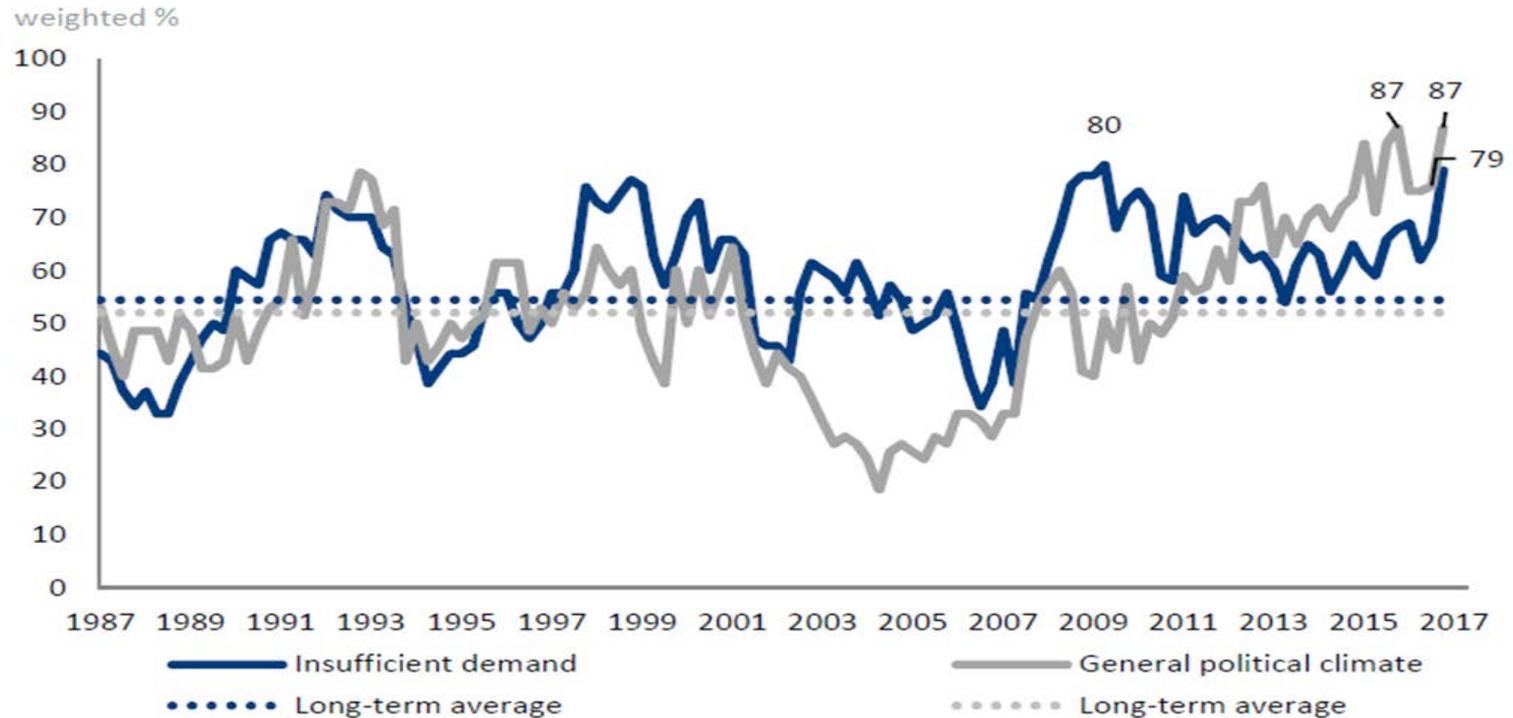
- Manufacturing & building contractor confidence
- Wholesale, retail & new vehicle dealer confidence

Source: Bureau for Economic Research



Business Confidence

Constraints to business confidence



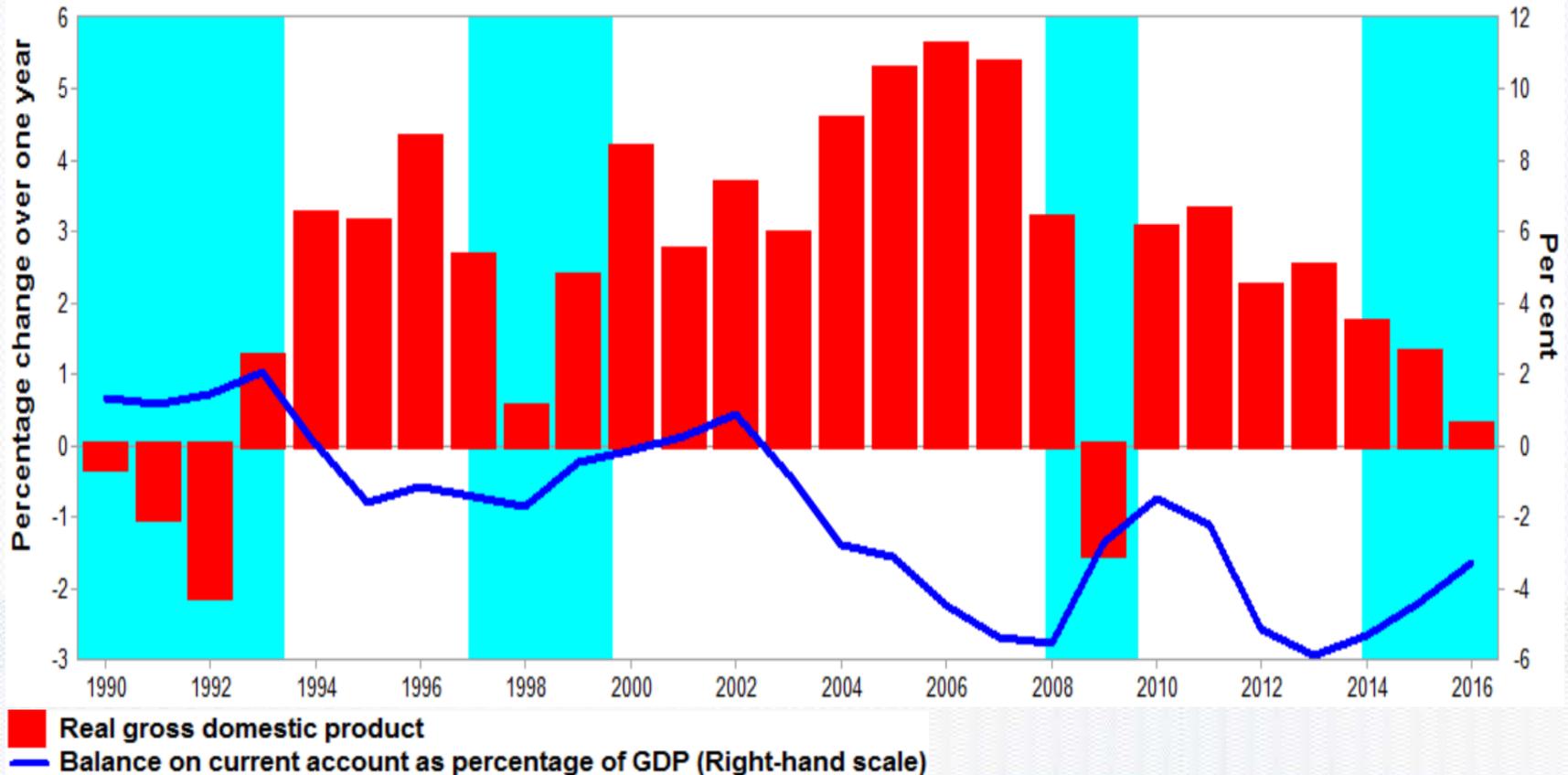
Source: Bureau for Economic Research

Both the political climate and insufficient demand as constraints to business conditions in the manufacturing sector increased notably in Q2 2017

Balance of Payments

Real GDP and BoP

Real gross domestic product and balance on current account as percentage of GDP

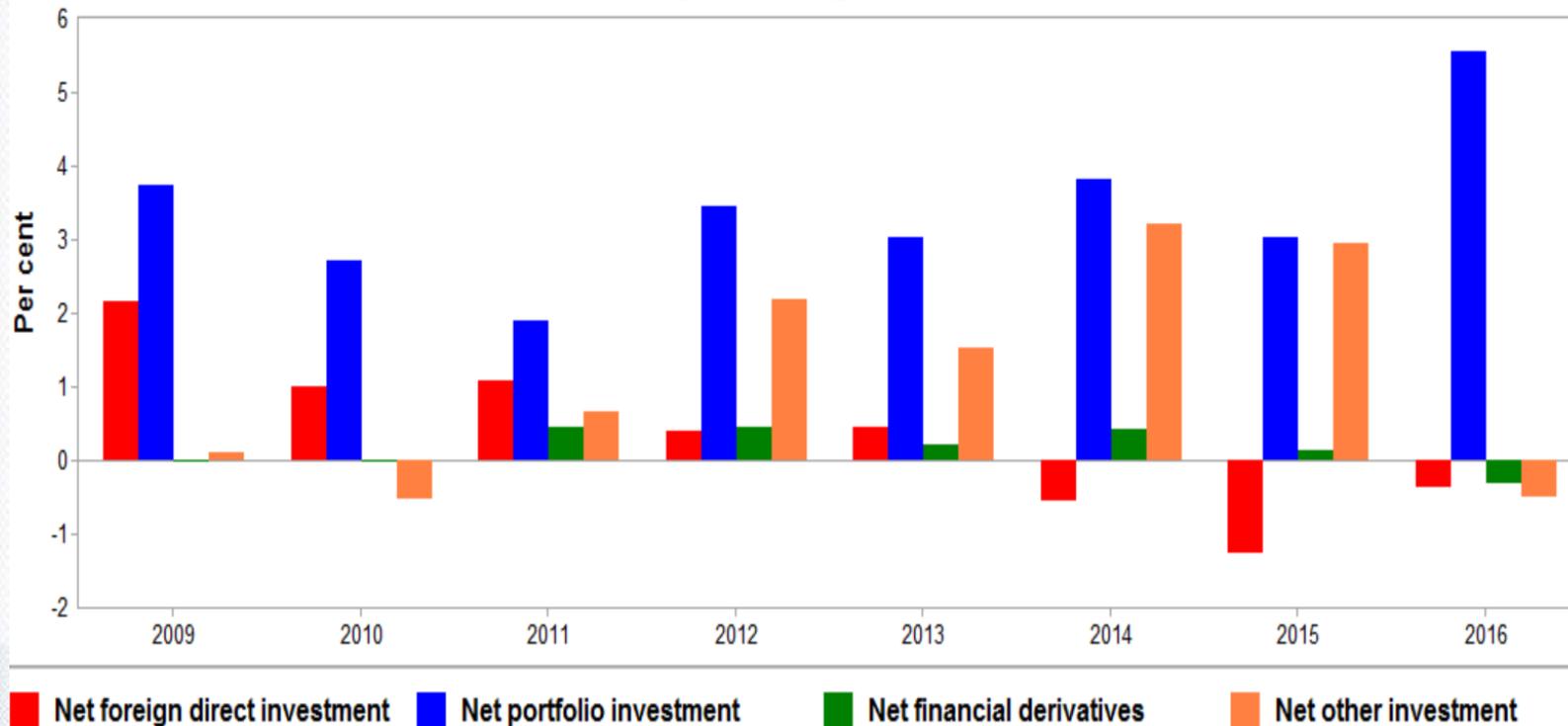


Shaded areas indicate downward phases of the business cycle

Sources: Statistics South Africa and SA Reserve Bank

Financial Account: BoP

Components of the financial account of the balance of payments
as percentage of GDP

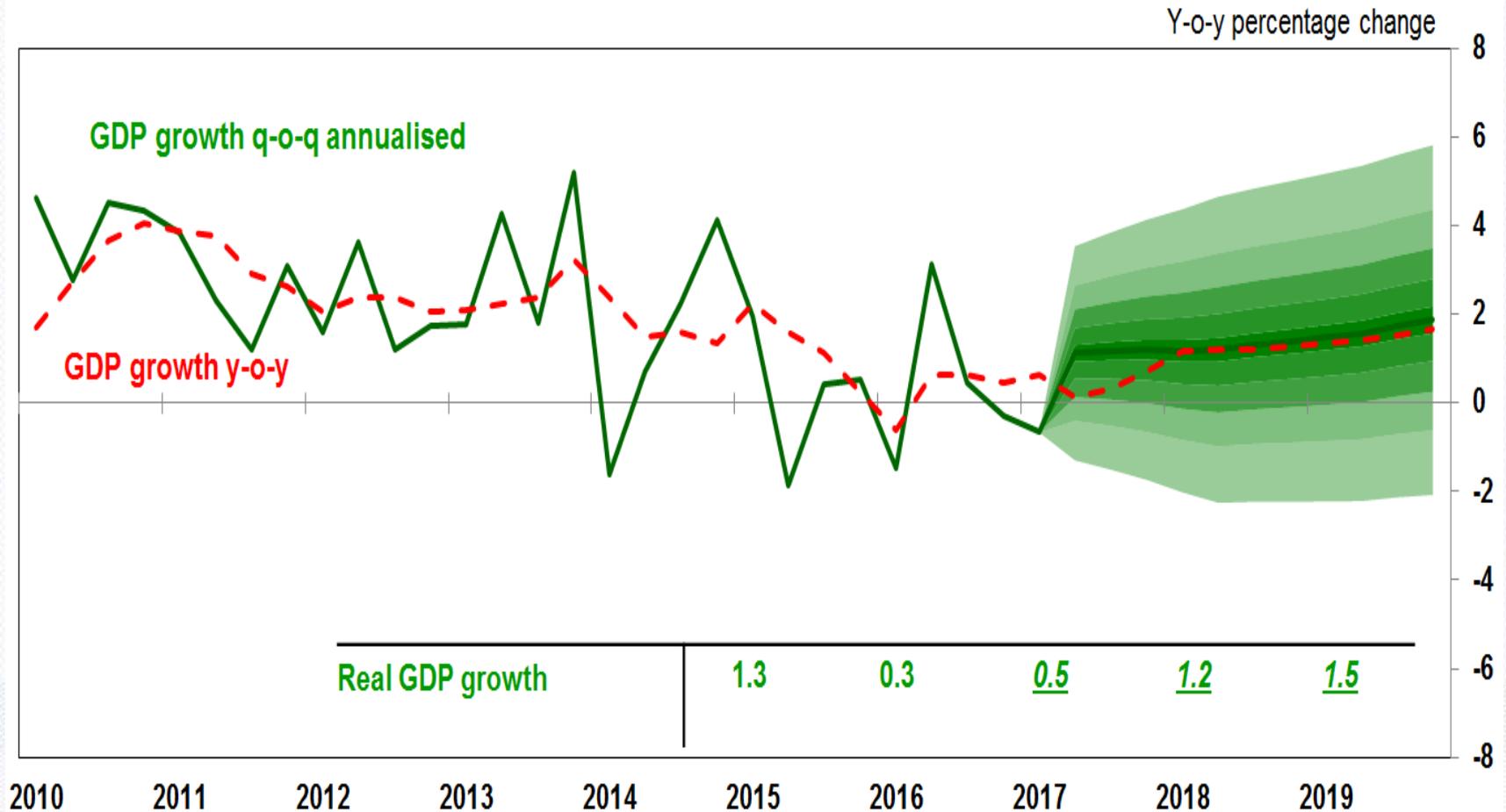


Sources: Statistics South Africa and SA Reserve Bank

Forecast

Real GDP growth outlook

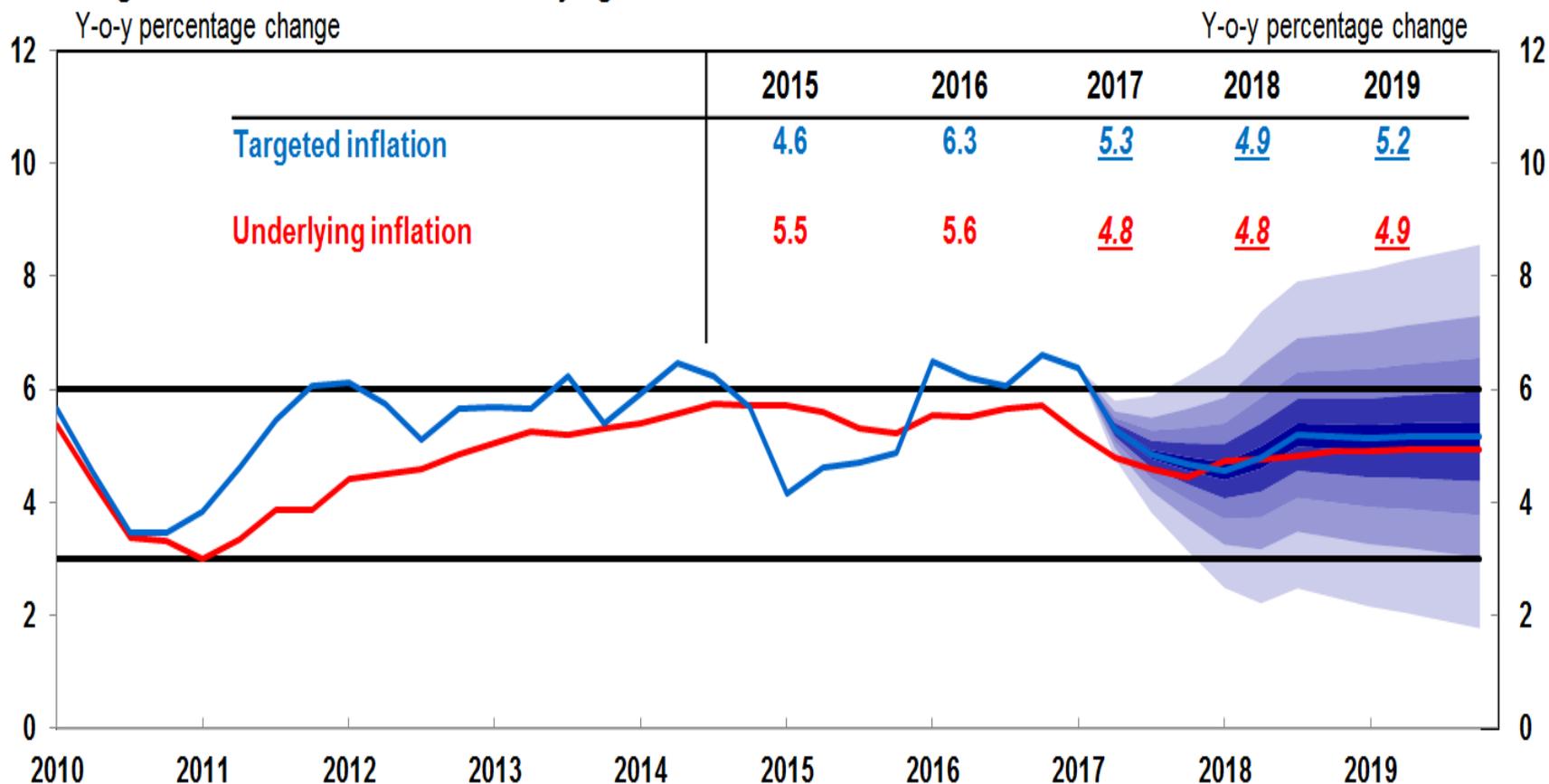
GDP growth fan chart



Inflation outlook



Targeted inflation fan chart and underlying inflation



Sources: Statistics South Africa and SA Reserve Bank

Summary

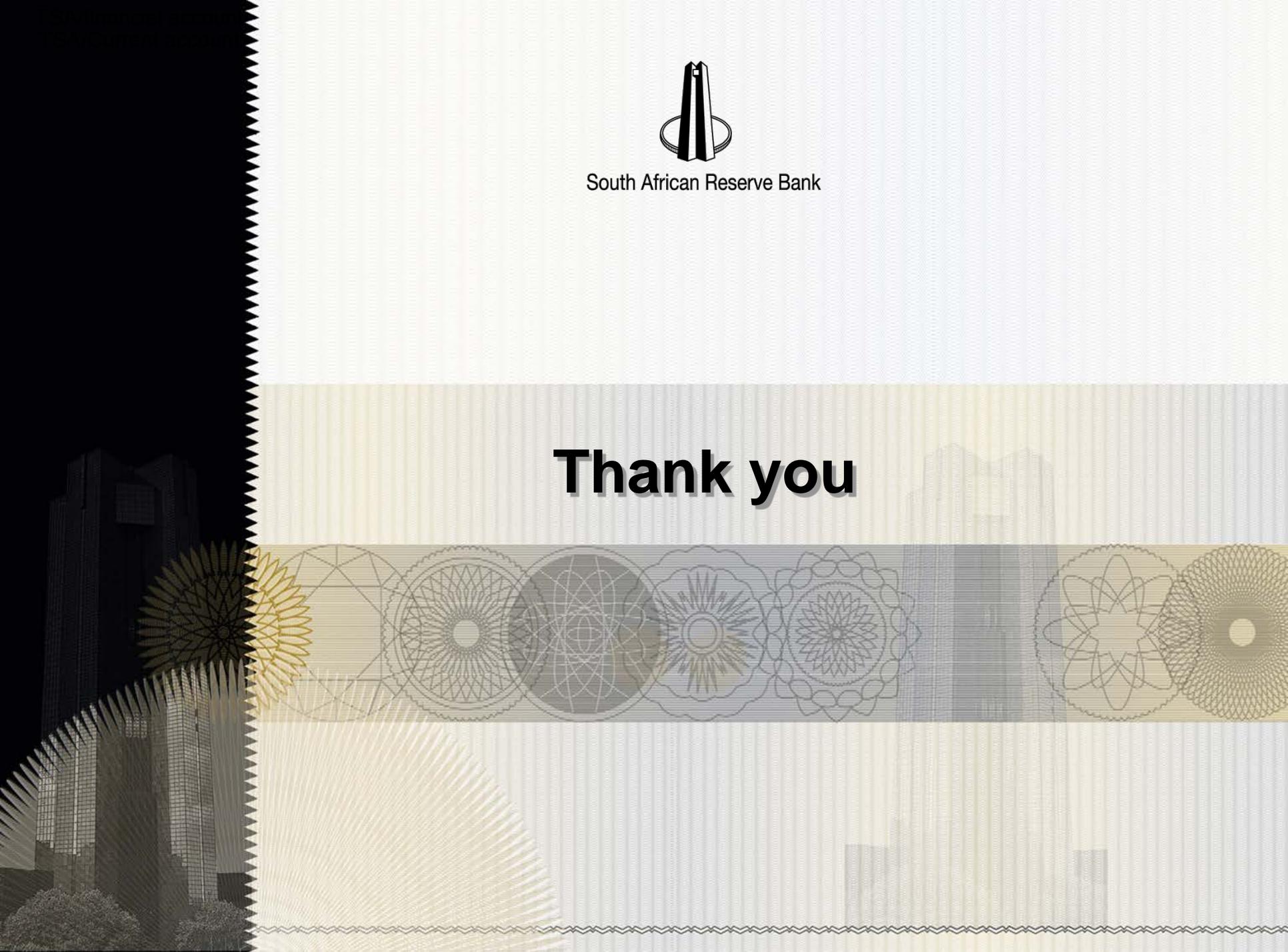
- The contraction in real GDP in Q1 2017 was broad-based
- Confidence and sentiment indicators weakened further in Q2 2017, possibly exaggerated somewhat by the political environment
- Household-surveyed employment increased in the year to Q1 2017, but the unemployment rate rose further
- The near-term outlook for CPI inflation improved further.





South African Reserve Bank

Thank you

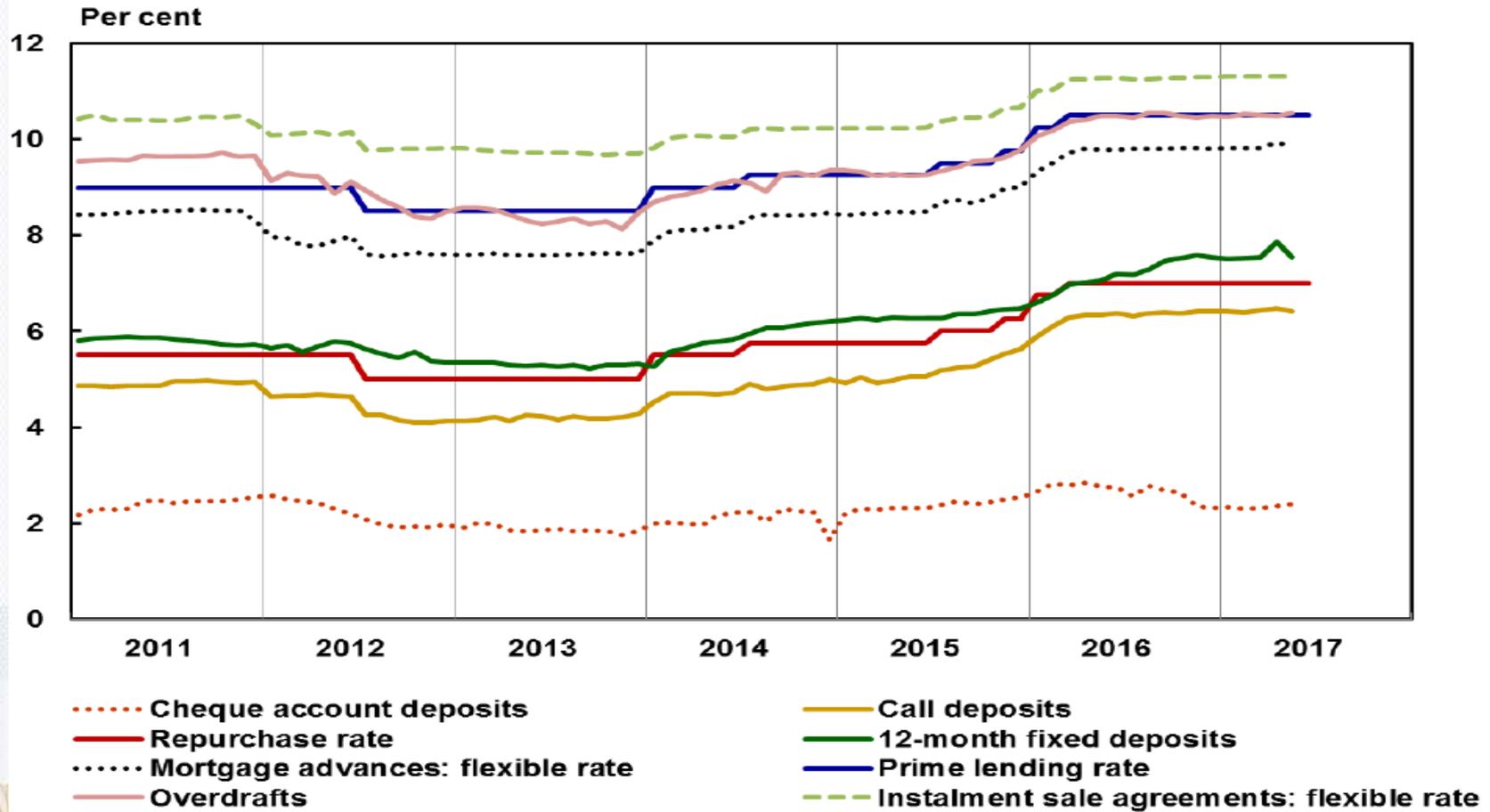


Additional slides



The deposit and lending rates of banks continue to follow changes in the policy rate relatively closely

Selected bank deposit and lending rates



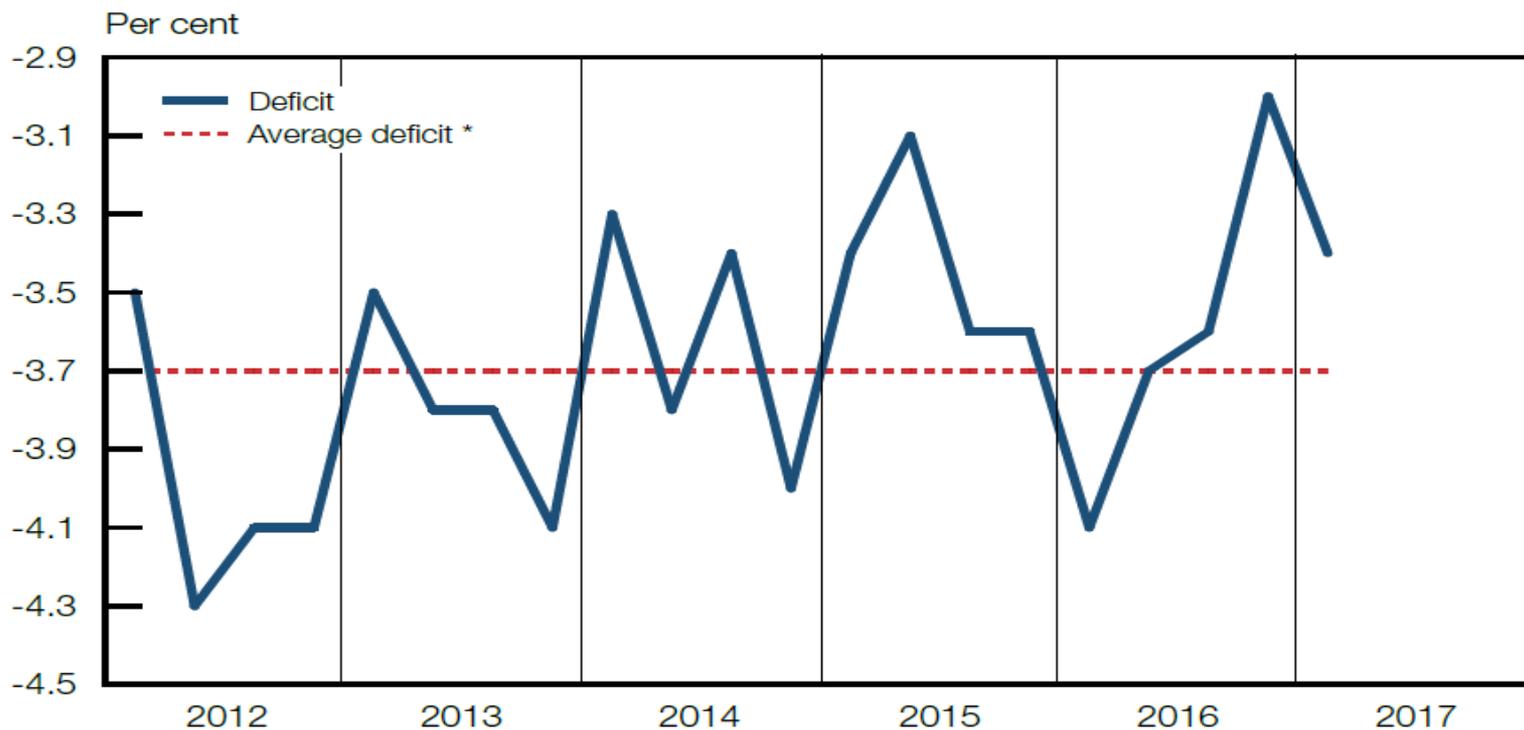
Source: SA Reserve Bank



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The deficit on the services, income & current transfer account widened markedly in Q1 2017, but remained smaller than its medium-term average

Deficit on the services, income and current transfer account as a ratio of GDP



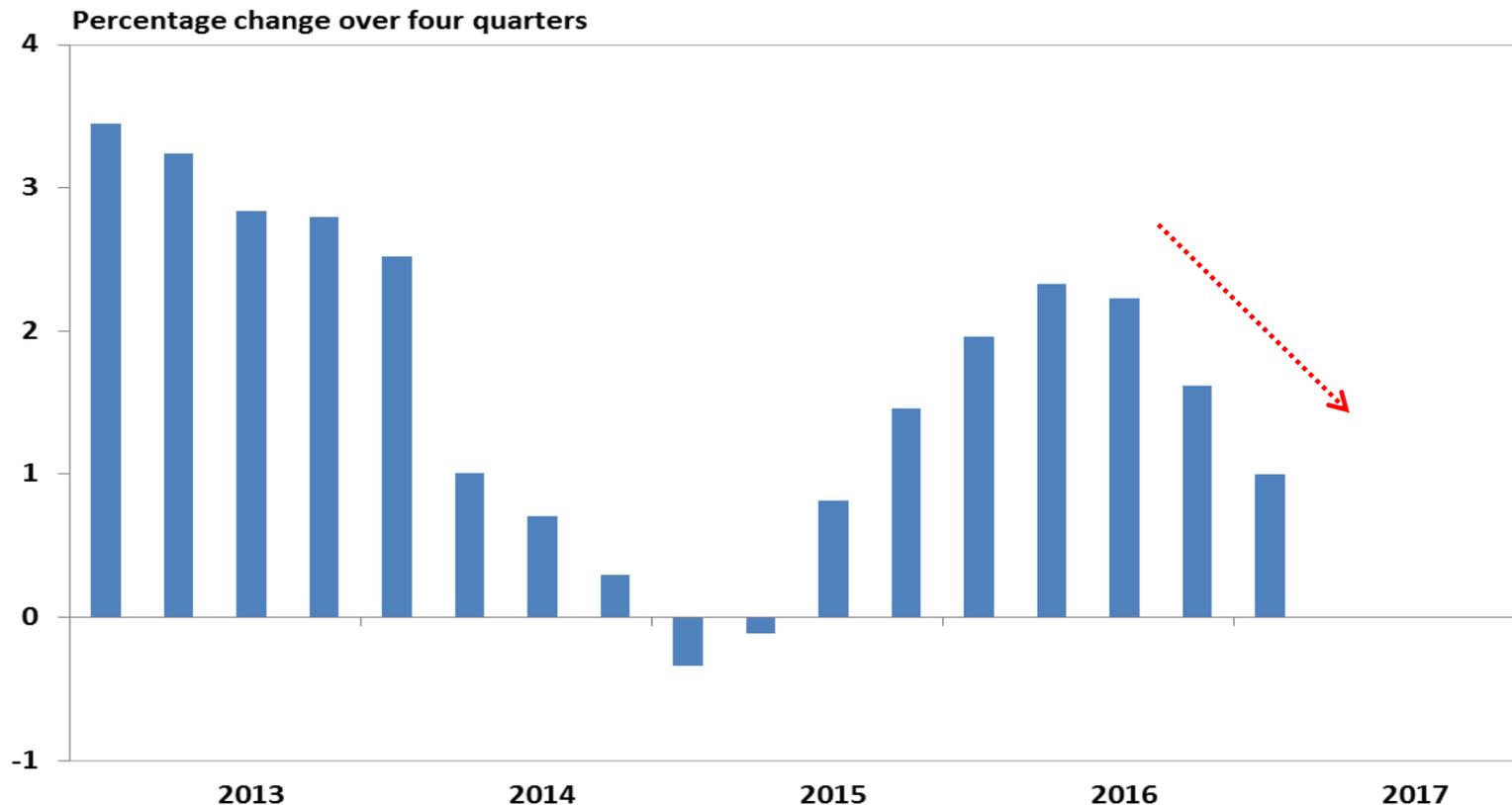
* Average: 2012/Q1 to 2017/Q1

Sources: Statistics South Africa and SA Reserve Bank



Year-on-year growth in real final consumption expenditure by general government slowed from 2.3% in Q2 2016 to 1.0% in Q1 2017

Real final consumption expenditure by general government

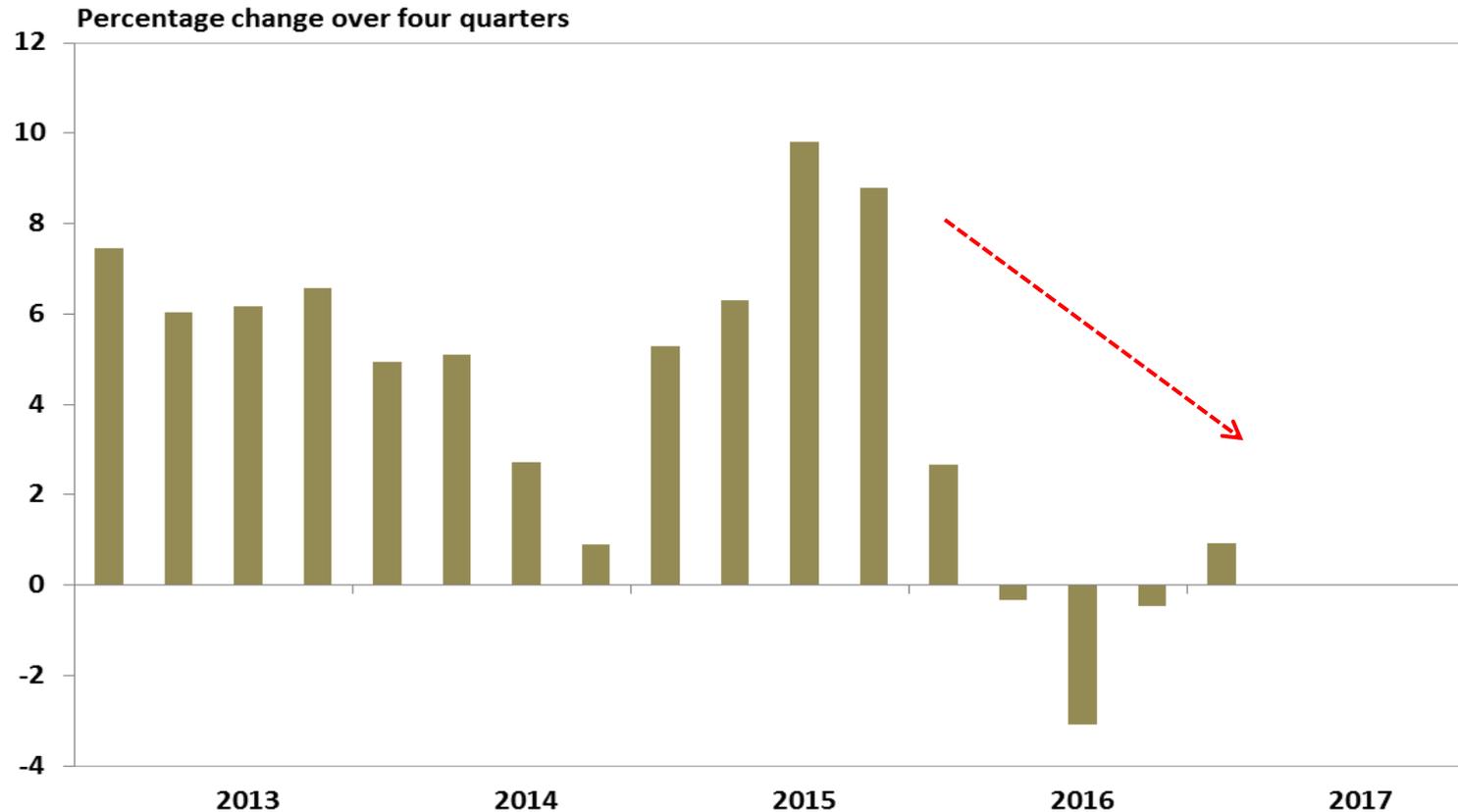


Source: Statistics South Africa



Year-on-year growth in fixed investment by the public sector accelerated somewhat in Q1 2017, but remained much weaker than its recent peak of 9.8% in Q3 2015

Real gross fixed capital formation by the public sector



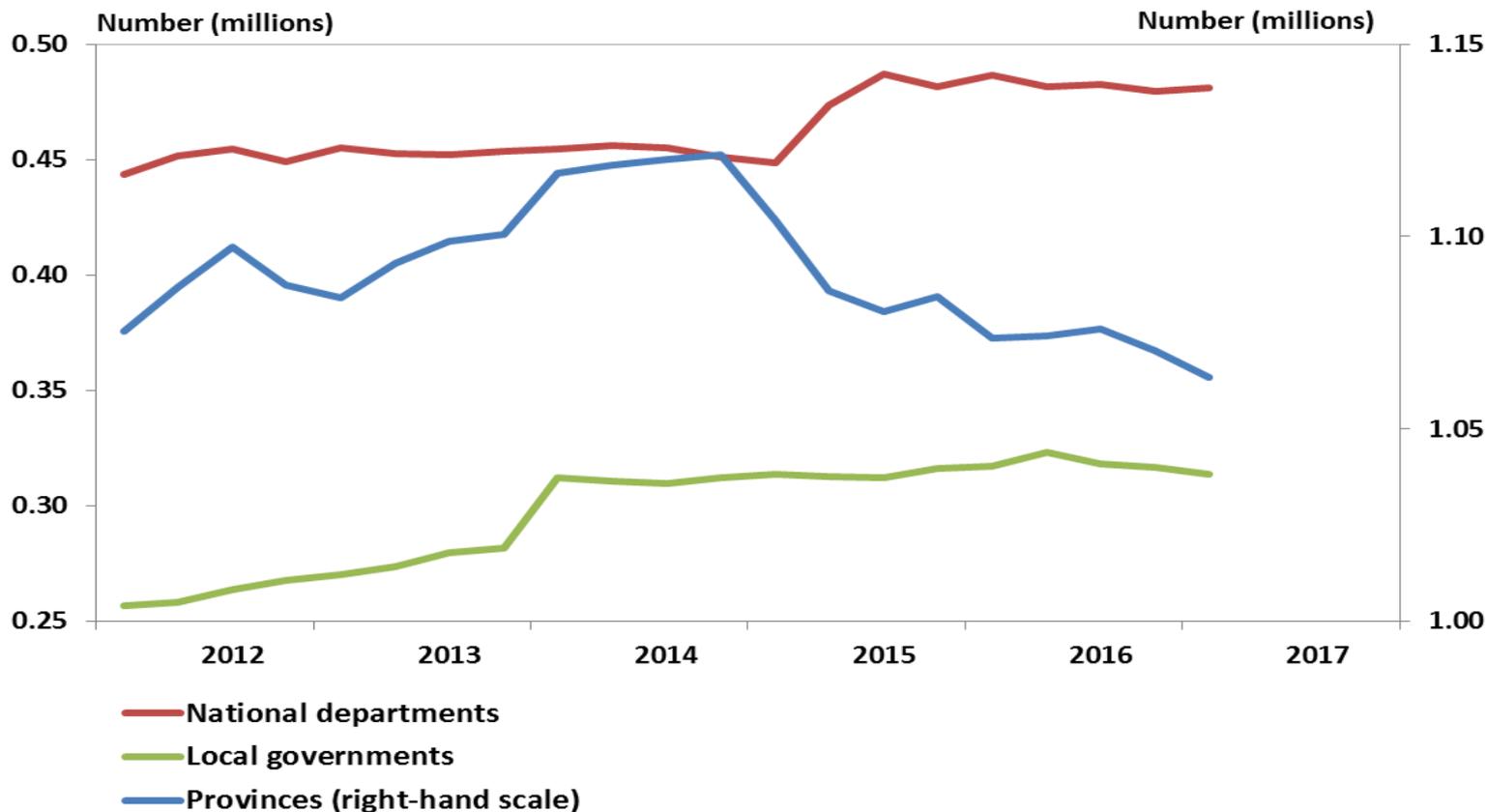
Source: Statistics South Africa



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Public-sector employment decreased by 2.1% from a recent peak in Q2 2014 up to Q1 2017, with job losses occurring mostly at provincial level

Public sector employment

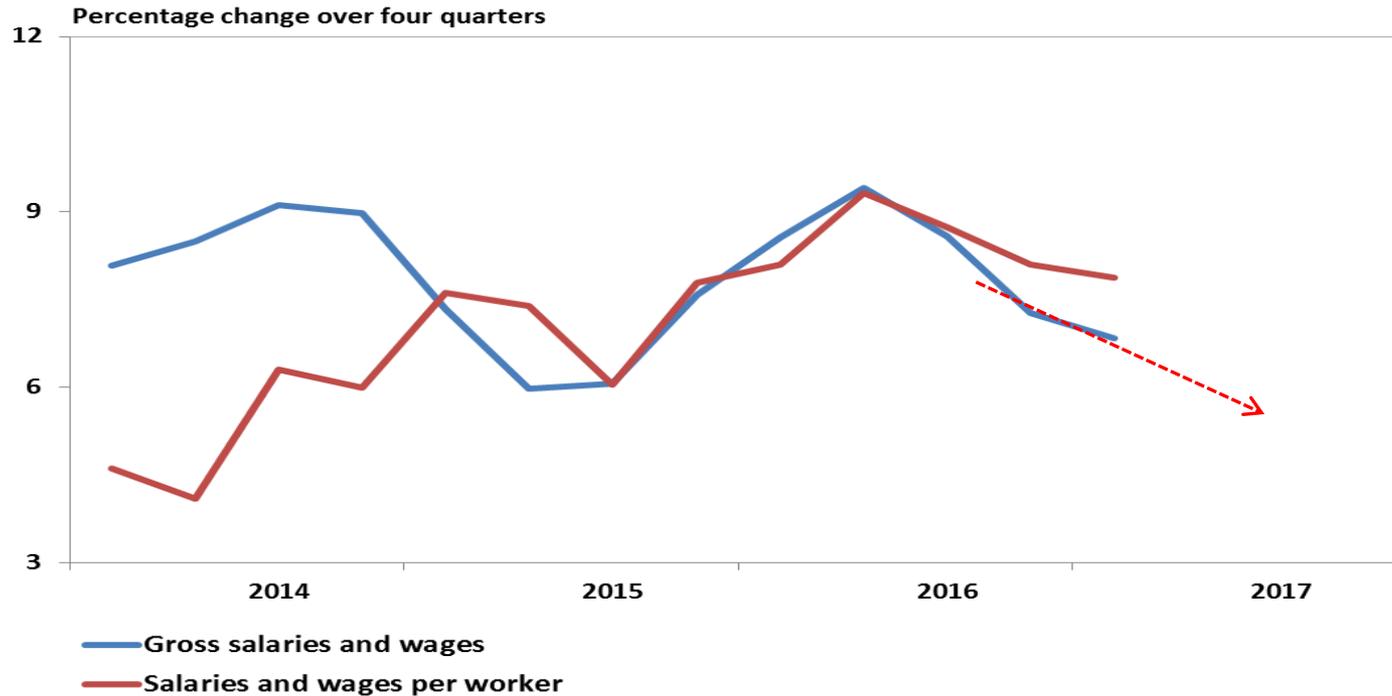


Source: Statistics South Africa



Public Sector Wages

Public sector remuneration



Source: Statistics South Africa

Since Q3 2016, growth in total public-sector remuneration has slowed at a slightly faster pace than growth in public-sector remuneration per worker



Q & A



SARB Strategy

<http://resbank.onlinereport.co.za/2017/index.html>



Strategic Focus Area 1

SFA	STRATEGIC OBJECTIVE	PERFORMANCE MEASURE	2016/17		NOTES	
			ACTUAL	TARGET		
SFA 1	Maintain headline inflation within the target range	Headline inflation versus target	X	6.30% (Average for the financial year 2016/17)	3-6%	Note 1

Performance Key	✓	Target achieved	X	Target not met	→	Progress made but target not yet met
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Strategic Focus Area 2

SFA	STRATEGIC OBJECTIVE	PERFORMANCE MEASURE	2016/17		NOTES	
			ACTUAL	TARGET		
SFA 2	Protect and enhance financial stability to achieve a safer financial system	Policy action based on a set of macroprudential indicators (mitigation of vulnerabilities)	✓	<ul style="list-style-type: none"> ➤ Published the macroprudential policy paper. ➤ Held an information session with industry and received comments. 	Develop a macroprudential policy framework in consultation with industry.	Note 2
		Framework for measuring systemic risk	X	<ul style="list-style-type: none"> ➤ The research proposal for a systemic risk measurement (SRM) toolkit was not completed 	Approval of a macroprudential SRM toolkit.	
		Measures implemented for the effective supervision, regulation and oversight of financial market infrastructures (FMIs)	✓	<ul style="list-style-type: none"> ➤ FMI policy paper approved. 	Approval of a policy framework for the systemic surveillance of FMIs.	



Strategic Focus Area 2 (continue)

SFA	STRATEGIC OBJECTIVE	PERFORMANCE MEASURE	2016/17		NOTES	
			ACTUAL	TARGET		
SFA 2 (cont.)		Mechanism implemented for the coordination of crisis management	→	<ul style="list-style-type: none"> ➤ A contract to conduct the simulation exercise is in place. ➤ Completed the draft Special Resolution Bill for systemically important financial institutions (SIFIs). 	Complete the planning for the crisis simulation exercise and publish the Special Resolution Bill for industry comment.	<i>Note 2</i>



Strategic Focus Area 3

SFA	STRATEGIC OBJECTIVE	PERFORMANCE MEASURE	2016/17		NOTES	
			ACTUAL	TARGET		
SFA 3	Promote and enhance the safety, soundness and integrity of regulated financial institutions	Percentage of financial institutions that meet or exceed quantitative prudential standards (SIFIs)	✓	100%	100% or specific regulatory action.	Note 3
		Weighted percentage of financial institutions that meet or exceed quantitative prudential standards for non-SIFIs	✓	100%	Satisfied that no specific regulatory action is required	
		Financial institutions with sound governance and risk management practices	✓	100%	100% of institutions fully compliant or under specific regulatory action.	
		Compliance with the Principles for Financial Market Infrastructures (PFMIs)	X	➤ Assessment not undertaken	Assess baseline compliance.	



Strategic Focus Areas 4 and 5

SFA	STRATEGIC OBJECTIVE	PERFORMANCE MEASURE	2016/17		NOTES	
			ACTUAL	TARGET		
SFA 4	Enhance South Africa's resilience to external shocks	Level of official gold and foreign-exchange reserves	→	➤ Adequate reserves accumulated.	Level of reserves accumulated.	Note 4
SFA 5	Ensure cost effective availability and integrity of notes and coin	On-time in-full fulfilment of orders from the cash industry	✓	100%	100% of orders fulfilled within agreed timelines as stipulated in service level agreements.	Note 5
		Incidence of counterfeiting measured in parts per million (ppm)	✓	10 ppm	Less than 15 ppm.	



Notes on performance – Note 1

<p>SFA 1</p> 	<p>Maintain headline inflation within the target range</p>	<p>The average inflation rate for the 2016/17 financial year was at 6.3% and outside the target range, therefore the SARB did not achieve its measure of success for SFA 1. As per the March 2017 Monetary Policy Committee (MPC) forecast, the inflation rate is expected to come back within the target range in the second quarter of 2017.</p>
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Strategic objectives

<p>Maximise monetary policy effectiveness</p>	<p>The SARB is establishing a cross-functional policy-focused research agenda and committee.</p>
<p>Anchor inflation expectations</p>	<p>The SARB continues to enhance its visibility in the public domain through the publication assumptions that enables better understanding of the SARB's forecasts as well as economic notes. The SARB is also implementing a stakeholder engagement strategy. These initiatives will assist to improve the anchoring of inflation expectations.</p>



Note 2

<p>SFA 2</p> 	<p>Protect and enhance financial stability to achieve a safer financial system</p>	<p>Of the four measures of success for SFA 2, the following two were not met:</p> <ul style="list-style-type: none"> • The SRM toolkit: an ongoing initiative which will be completed in 2017/18. • The crisis simulation exercise: the SARB has started the planning process to undertake a crisis simulation exercise and this will be completed in 2017/18.
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Strategic objectives

<p>Enhance the crisis management and resolution framework</p>	<p>The SARB established a crisis planning working group which is overseeing the preparatory work for the first crisis simulation exercise. It also drafted the Special Resolution Bill which includes proposal to establish a pre-funded deposit insurance scheme.</p>
<p>Enhance financial stability monitoring and policy frameworks</p>	<p>The SRM toolkit was not approved.</p>
<p>Ensure that the regulatory, supervisory and oversight framework of the NPS is sound</p>	<p>The SARB completed the development of the NPS oversight framework and received approval to apply the framework.</p>



Note 3

SFA 3



Promote and enhance the safety, soundness and integrity of regulated financial institutions

Of the four measures of success for SFA 3, only the compliance assessment against the PFMI was not met due to the delay in the finalisation of the FSRB.

Strategic objectives

Develop, improve and integrate the supervision of regulated financial institutions

Embedding the Prudential Authority is critical to achieving this strategic objective. Despite the delay in the finalisation of the FSRB, the SARB has developed the new Prudential Authority regulatory strategy and supervisory blueprint, and is refining the financial conglomerate supervision paper. In addition, the SARB finalised the amendments to the Financial Intelligence Centre Act (FICA) and addressed the shortcomings highlighted by the assessment programme for banks and insurance providers.



Note 4

SFA 4 	Enhance South Africa's resilience to external shocks	Adequate levels of official gold and foreign-exchange reserves were accumulated.
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Strategic objectives

Maintain an optimal level of reserves and enhance their management	The Strategic Asset Allocation was approved and the compilation of the risk budget and review of the fund management programmes are in progress.
Establish mechanisms to effectively manage external shocks	A framework to manage shocks is being developed. While progress is behind target, the Crisis Reaction Manual for Financial Markets is in the process of being finalised and will be incorporated into the SARB's Crisis Management and Resolution Framework.



Note 5

<p>SFA 5</p> 	<p>Ensure cost effective availability and integrity of notes and coin</p>	<p>Both measures of success for this SFA were achieved. The quality of the notes is testament to the quality of the security features embedded in the currency.</p>
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Strategic objectives

<p>Optimise the notes and coin supply chain</p>	<p>This strategic objective is measured by calculating buffer stocks against an appropriate level, where the buffer stock level should be below the target. The buffer stock level target for notes was achieved but not the target for coins.</p>
<p>Enhance the quality of notes and coin</p>	<p>This strategic objective is measured by the percentage yield of fit notes in circulation, where the percentage yield should be above the target. A 92% yield was achieved against a target of 90%. In addition, the cash management strategy has been finalised and will be implemented during 2017/18.</p>



Q & A

