South African Reserve Bank

The Role of the South African Reserve Bank

Presentation to the Standing Committee on Finance

6 September 2017

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:

- Formulates and implements monetary policy;
- Promotes financial stability, which includes acting as the lender of last resort in exceptional circumstances;
- 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;

SARB’s key activities (continue):

- 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;

SARB’s key activities (continue):

- The Public Protector’s Report questions the appropriateness of the inflation mandate, as well as our role in providing lender of last resort facilities;

- 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);

SARB’s key activities (continue):

- Many of the SARB’s functions have a socio-economic impact;
- Monetary policy cannot determine long run growth potential in the economy;
- It therefore cannot solve the problem of structural unemployment in the economy; and
- Monetary policy should therefore focus on what it can do, and not what we would like it to do.

Building Blocks to Understanding the Importance of Monetary Policy

1. Understanding of economic performance;
2. What drives trend growth;
3. What drives business cycles;
4. What role is there for monetary policy in both booms and bust; and
5. Finally, how does monetary policy work – through what transmission mechanisms and how long does take to achieve its effect.

Monetary Policy in practice

- Economic fluctuations – business cycles in the context of structural decline – major challenge since the onset of the financial crisis;
- Potential growth and output gaps starting point to assessing monetary policy;
- Understanding drivers of inflation – exchange rate, unit labour costs and supply shocks;
- Specific attention to the exchange rate and monetary policy; and
- How do we deal with supply shocks and second round effects;
- Is there a need to revisit – Monetary Transmission, Credit and Housing;
- Changing role of price formation in the economy; and
- Making sense of inflation expectations.

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.

- Low 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. (Table 1 and 2)

- 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 3)

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

	Inflation (%)		Policy rates (%)	
	2014–2016	2017	2014–2016	2017
United States	1.0	2.2	0.3	1.0
Euro Area	0.2	1.7	0.1	0.0
United Kingdom	0.7	2.4	0.5	0.3
Canada	1.5	1.6	0.7	0.5
Australia	1.8	2.1	2.1	1.5
New Zealand	0.7	2.0	2.8	1.8
Sweden	0.7	1.7	-0.1	-0.5
Czech Republic	0.5	2.3	0.0	0.1
Israel	-0.2	0.5	0.3	0.1
South Korea	1.0	2.0	1.8	1.3
Taiwan	0.8	0.7	1.7	1.4
South Africa	5.7	5.8	6.1	6.75

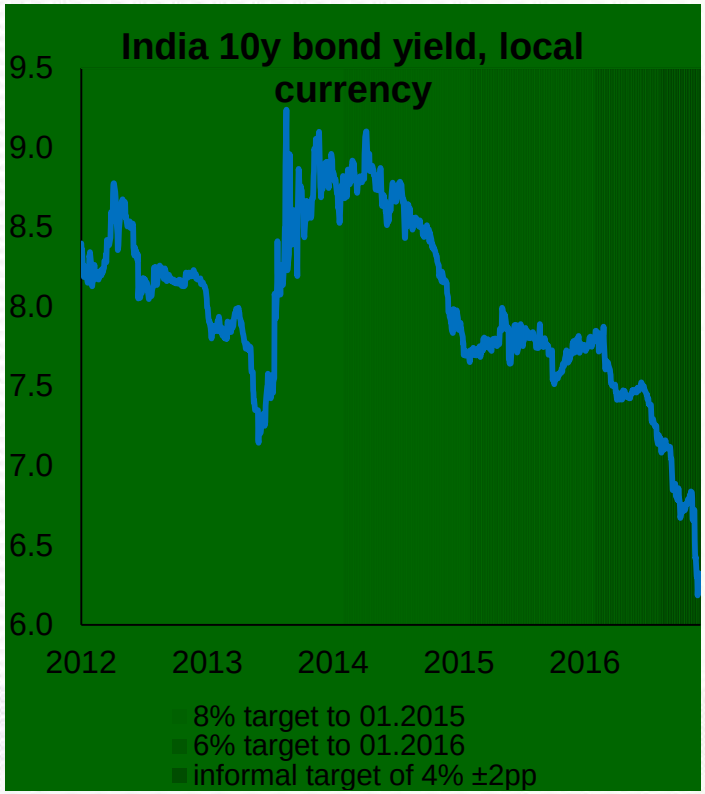
Table 2: Inflation and policy rates in South Africa and selected emerging markets

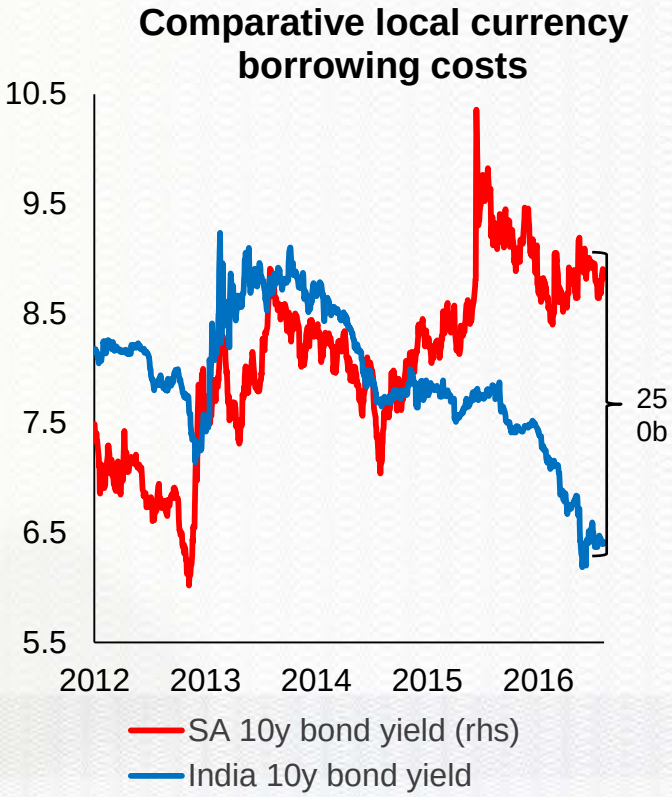
	Inflation (%)		Policy rates (%)	
	2014–2016	2017	2014–2016	2017
China	1.8	1.4	5.1	4.4
India	5.5	2.9	7.3	6.3
Indonesia	5.4	4.0	5.1	4.8
Russia	10.2	4.4	10.4	9.6
Turkey	8.1	10.9	7.9	8.0
Brazil	8.0	4.2	12.9	11.7
Mexico	3.2	5.5	3.5	6.4
Argentina	29.9	25.7	31.2	25.5
Colombia	5.1	4.7	5.2	6.8
Ghana	16.7	12.8	22.4	24.0
Nigeria	10.9	17.2	12.5	14.0
South Africa	5.7	5.8	6.1	6.75

Although the mandate should be reason enough, there are also good reasons to prefer lower inflation

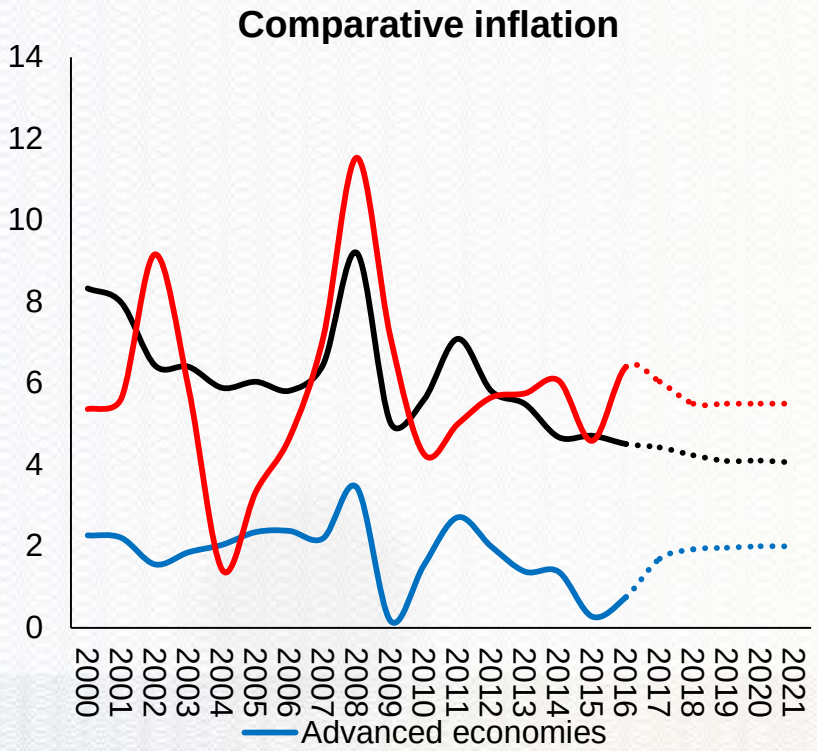
- Inflation hurts the poor
- Higher and less predictable inflation raises interest rates, especially over longer maturities
- Incomplete financial markets shorten investment time horizons
- High inflation differentials undermine profitability of investment in exporting and exacerbate currency volatility

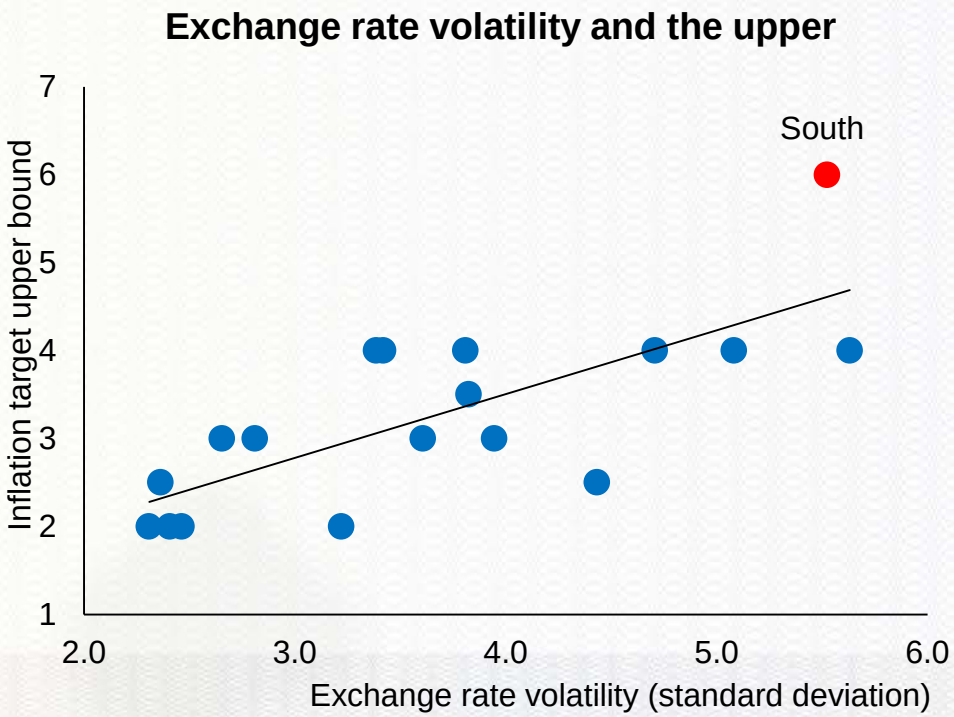
Lower, more predictable inflation would permanently lower nominal and real interest rates





Lower inflation would also have exchange rate benefits (less volatility & REER overshoots)





Based on Hassan & Redford (2015),
Du Plessis & Reid (2015)

Unlike every other EM inflation targeter of our generation, SA's target has never been revised

	Start of IT	Current Target	Starting Target	Pre-IT Inflation (5yr avg)	Post-IT inflation (w/ updated data)
			Per cent		
Brazil	1999	4.5 ± 1	8 ± 2	19.3	6.75
Chile	1999	3 ± 1	2 – 4	6.0	3.36
Colombia	1999	3 ± 1	15	17.9	5.55
Czech Republic	1998	2	5.5 – 6.5	9.4	2.63
Hungary	2001	3 ± 1	7	12.3	4.24
Mexico	2001	3 ± 1	6.5	13.8	4.23
Peru	2002	2 ± 1	1.5 – 3.5	3.3	2.80
Philippines	2002	4 ± 1	5 – 6	6.0	3.96
Poland	1998	2.5 ± 1	8 – 8.5	21.3	3.37
South Africa	2000	3 – 6	3 – 6	6.7	5.82
South Korea	2001	3 ± 1	3 ± 1	3.8	2.65
Thailand	2000	2.5 ± 1	0 – 3.5	4.3	2.24

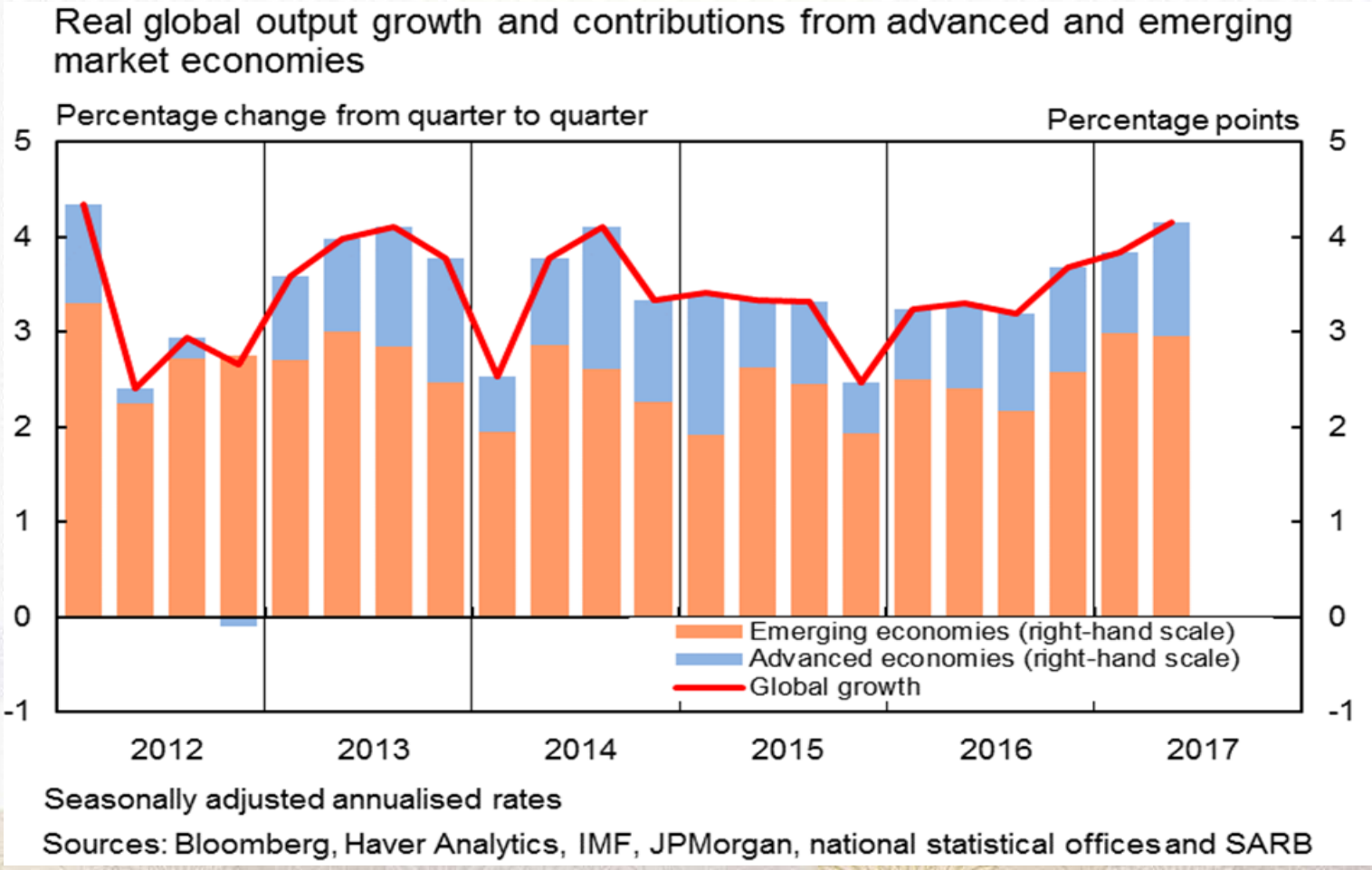
The IT framework did not trade-off growth

Period	Inflation	GDP
1986 – 2001	10.8%	1.8%
2002 – 2016	5.9%	2.9%
Change	-4.9%	+1.1%

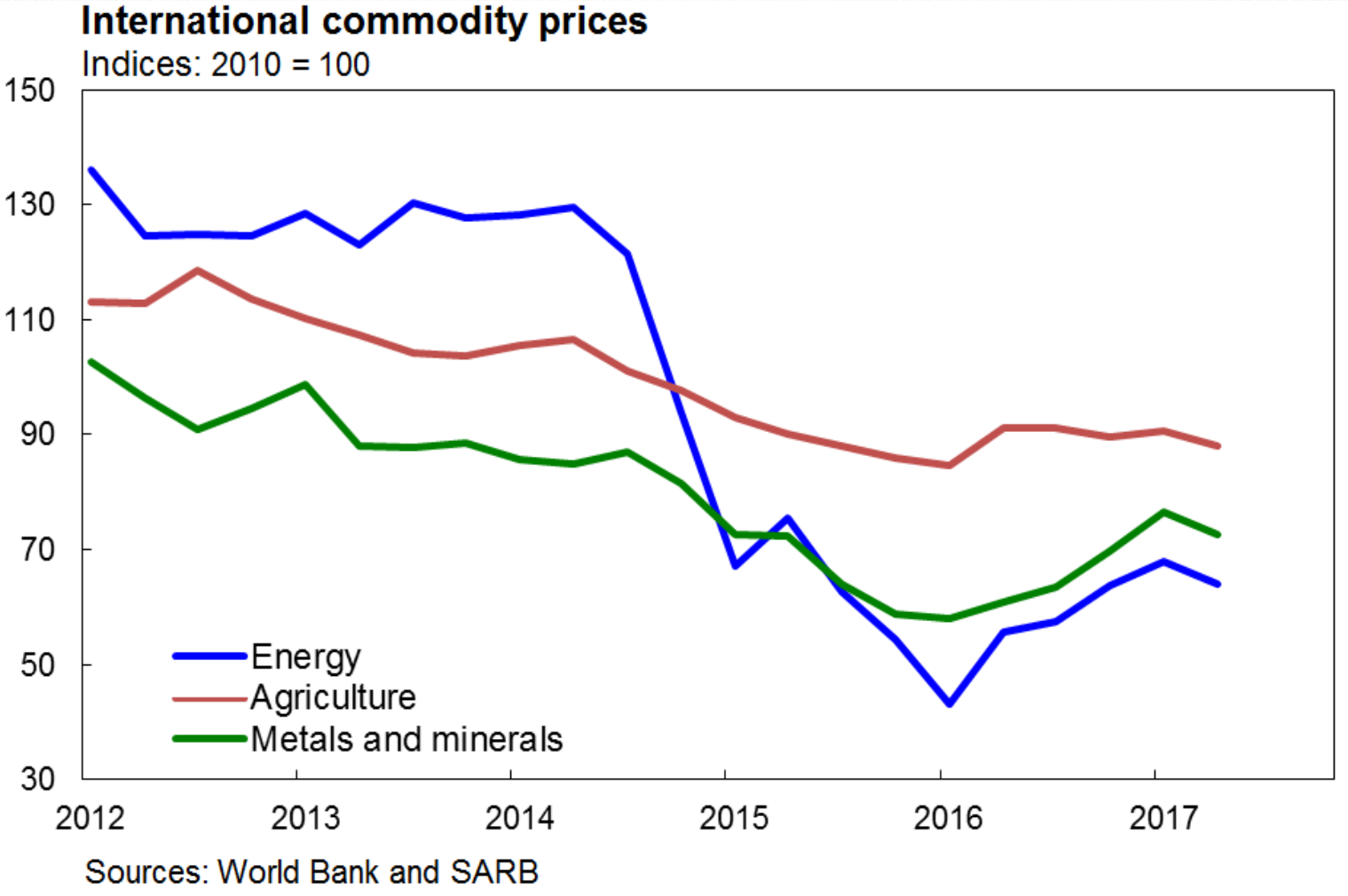
- Post IT, inflation has stabilised
- No adverse trade-off between growth and inflation
- Peru and Chile decreased their 15yr average inflation by 749% and 36% respectively
- Peru experienced an average growth increase of 3.3% and Chile a decrease of 0.7%

Macro Economic Environment

World economic growth recorded its best performance since the first quarter of 2012, expanding by 4.2% in the second quarter of 2017 as growth in especially advanced economies accelerated

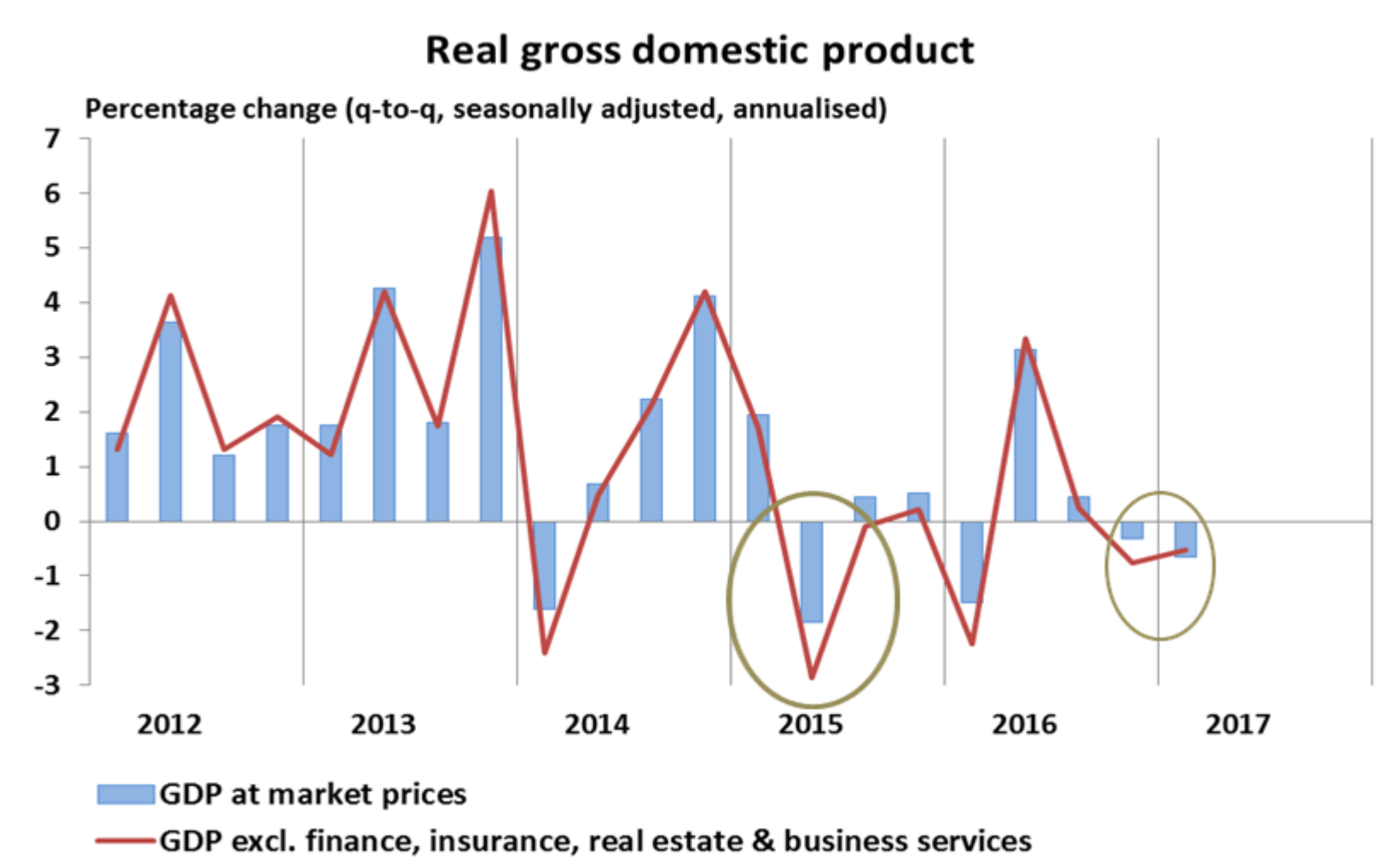


The international prices of most commodities, but especially those of energy and metals, decreased from the first to the second quarter of 2017



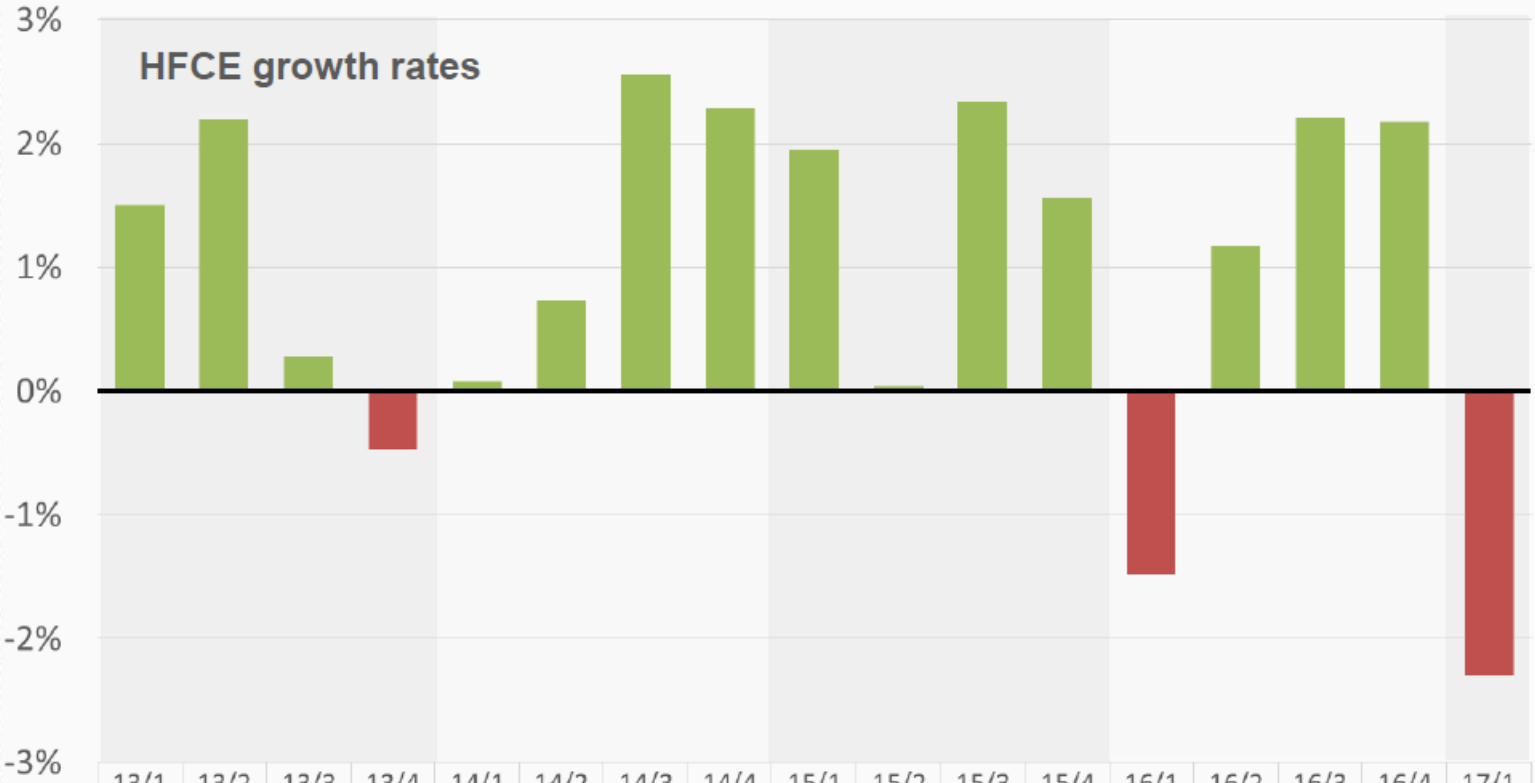
How broad-based is the recession in South Africa?

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

Household final consumption expenditure

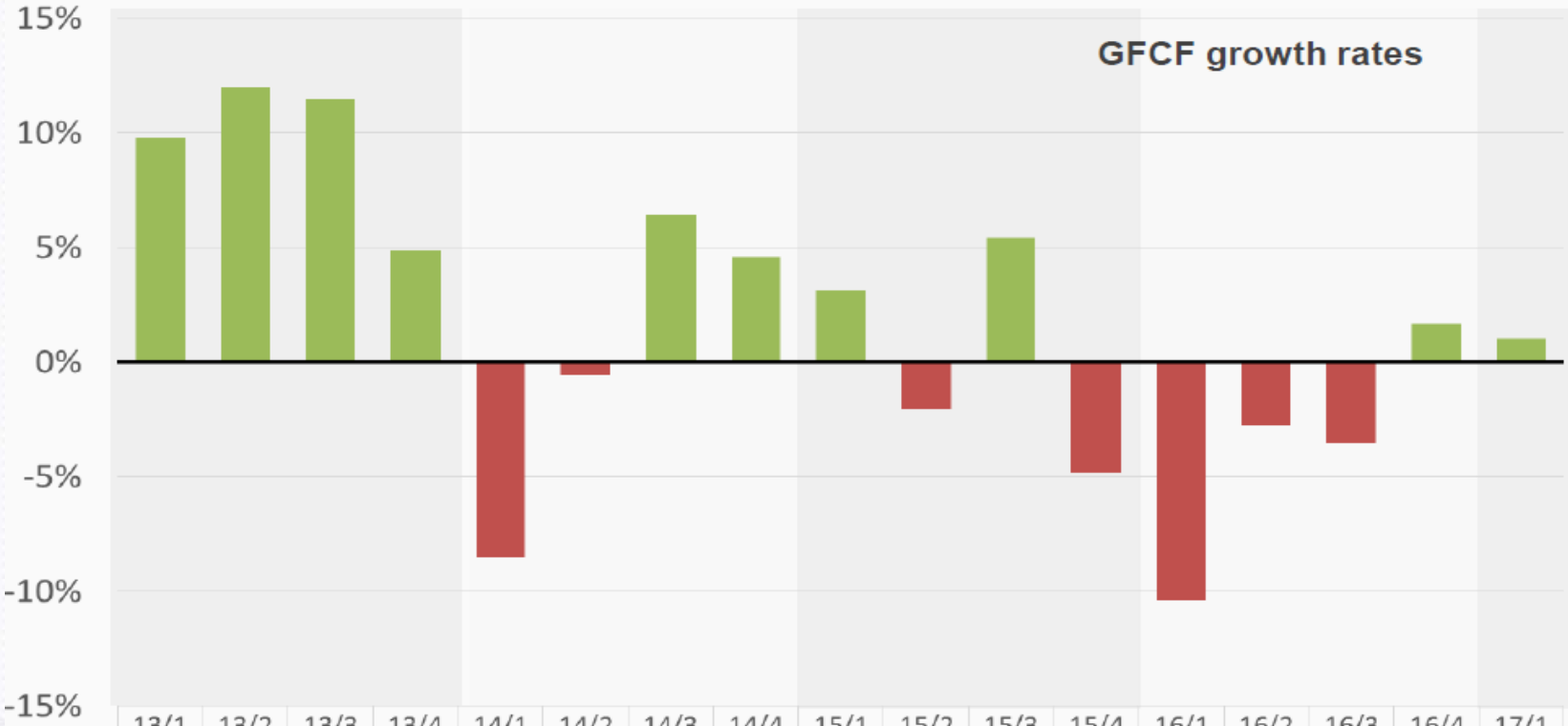


	13/1	13/2	13/3	13/4	14/1	14/2	14/3	14/4	15/1	15/2	15/3	15/4	16/1	16/2	16/3	16/4	17/1
Q/Q	1,5	2,2	0,3	-0,5	0,1	0,7	2,6	2,3	1,9	0,0	2,3	1,6	-1,5	1,2	2,2	2,2	-2,3

Quarter to quarter, seasonally adjusted and annualised

Source: Statistics South Africa

Gross fixed capital formation



	13/1	13/2	13/3	13/4	14/1	14/2	14/3	14/4	15/1	15/2	15/3	15/4	16/1	16/2	16/3	16/4	17/1
Q/Q	9,8	12,0	11,5	4,9	-8,5	-0,6	6,4	4,6	3,1	-2,1	5,4	-4,8	-10,4	-2,8	-3,5	1,7	1,0

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?

According to the household-based Labour Force Survey, total employment increased by 554 000 or 3.4% in the year to second quarter of 2017, while the number of unemployed grew by 543 000

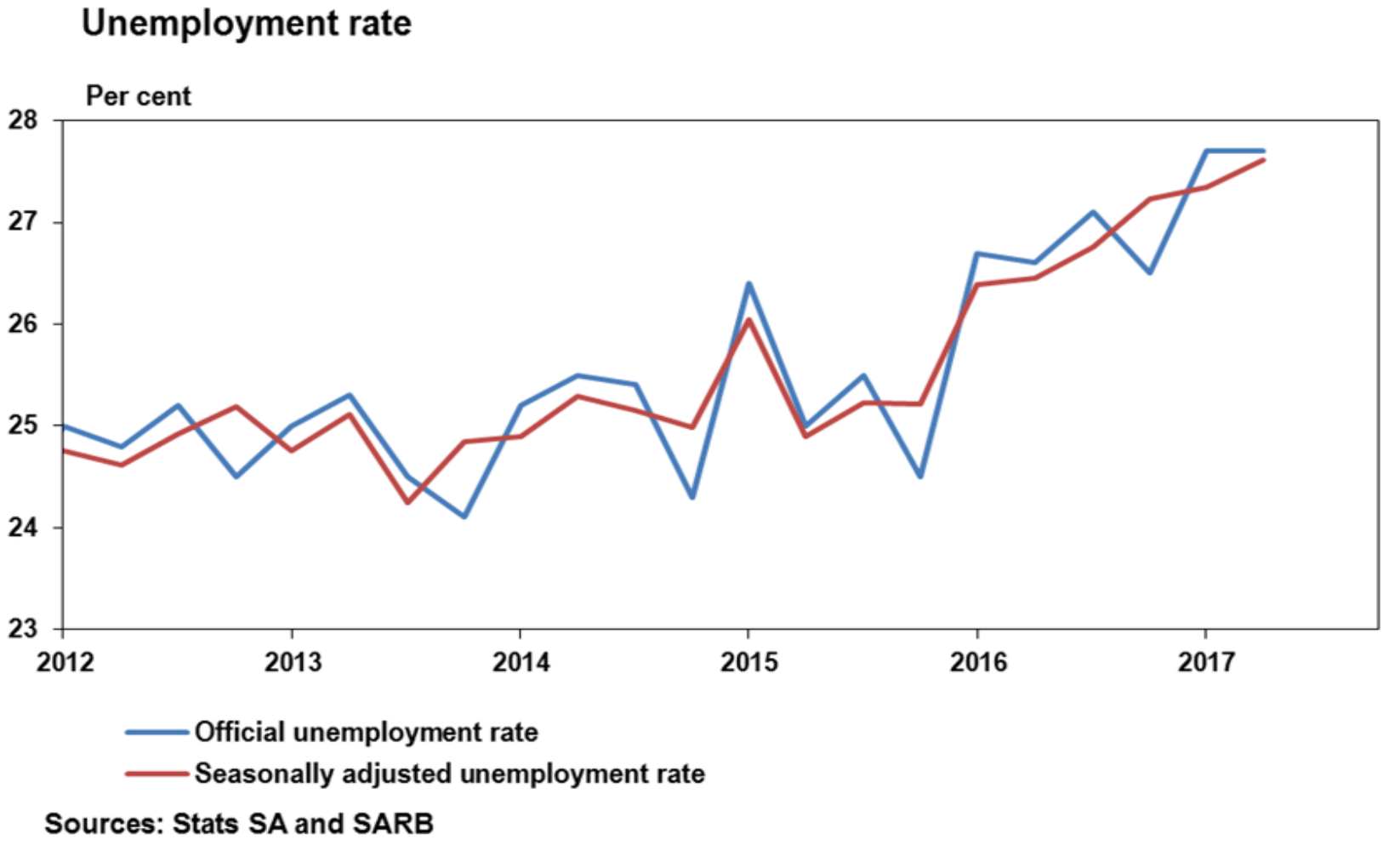
Key labour market indicators for 2017 Q2 (Thousands)

	Number		Change	
	2016-Q2	2017-Q2	Level	Per cent
Employed	**15 545**	**16 100**	**554**	**3.4**
Formal sector (non-agriculture)	10 917	11 193	275	2.5
Informal sector (non-agriculure)	2 507	2 761	254	10.1
Agriculture	825	835	10	1.2
Private households	1 296	1 311	15	1.2
Unemployed	**5 638**	**6 177**	**543**	**9.6**
Job losers	1 786	1 953	167	9.4
New entrants to job market	2 306	2 407	101	4.4
Re-entrants	304	312	8	2.8
Job leavers	277	346	69	24.7
Other	960	1 158	198	20.6
Not economically active	**15 412**	**14 941**	**-471**	**-3.1**
Discouraged work-seekers	2 526	2 361	-165	-6.5
Other (not economically active)	12 886	12 580	-306	-2.4
Official unemployment rate (%)	**26.6**	**27.7**		**1.1**
Ex	**36.4**	**36.6**		**0.2**

Source: Stats SA

nployment rate (%)

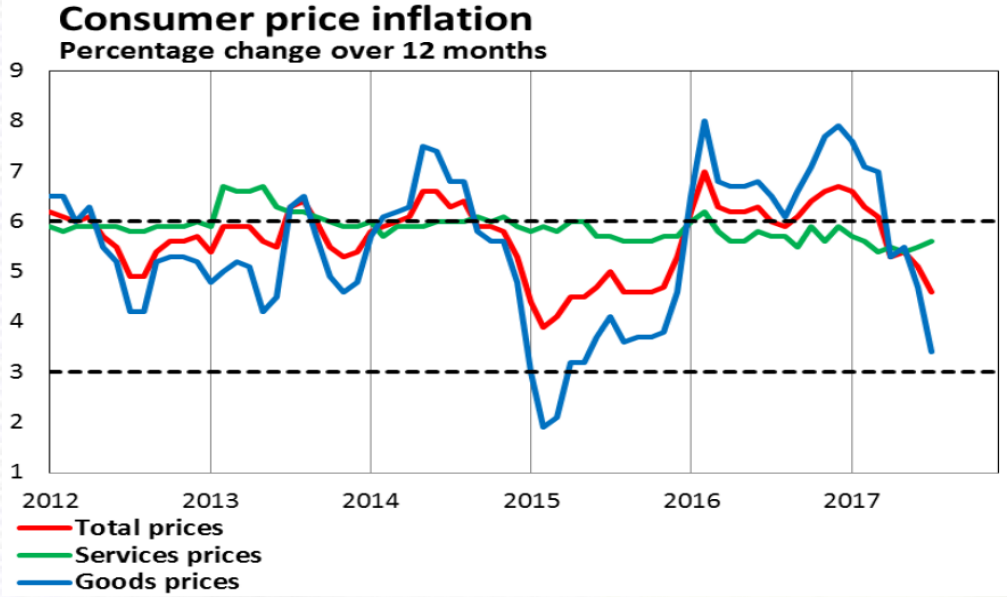
The official unemployment rate amounted to 27.7% in the second quarter of 2017, while the youth unemployment rate rose to an alarmingly high 55.9%



The near-term outlook for inflation improved further

Outlook for the main drivers of inflation

Headline CPI inflation moderated temporarily to 4.6% in July 2017 mainly on account of a decrease in petrol prices, with this benefit to be abruptly reversed in August and September



Headline CPI: all urban areas (percentage change)

	Weight	May 2017		Jun 2017		Jul 2017	
		m-o-m	y-o-y	m-o-m	y-o-y	m-o-m	y-o-y
Goods	48.70	0.5	5.5	-0.2	4.7	-0.1	3.4
Services	51.30	0.0	5.4	0.7	5.5	0.6	5.6
Total Headline CPI	**100.00**	**0.3**	**5.4**	**0.2**	**5.1**	**0.3**	**4.6**

Red = Acceleration
Green = Deceleration

Source: Stats SA

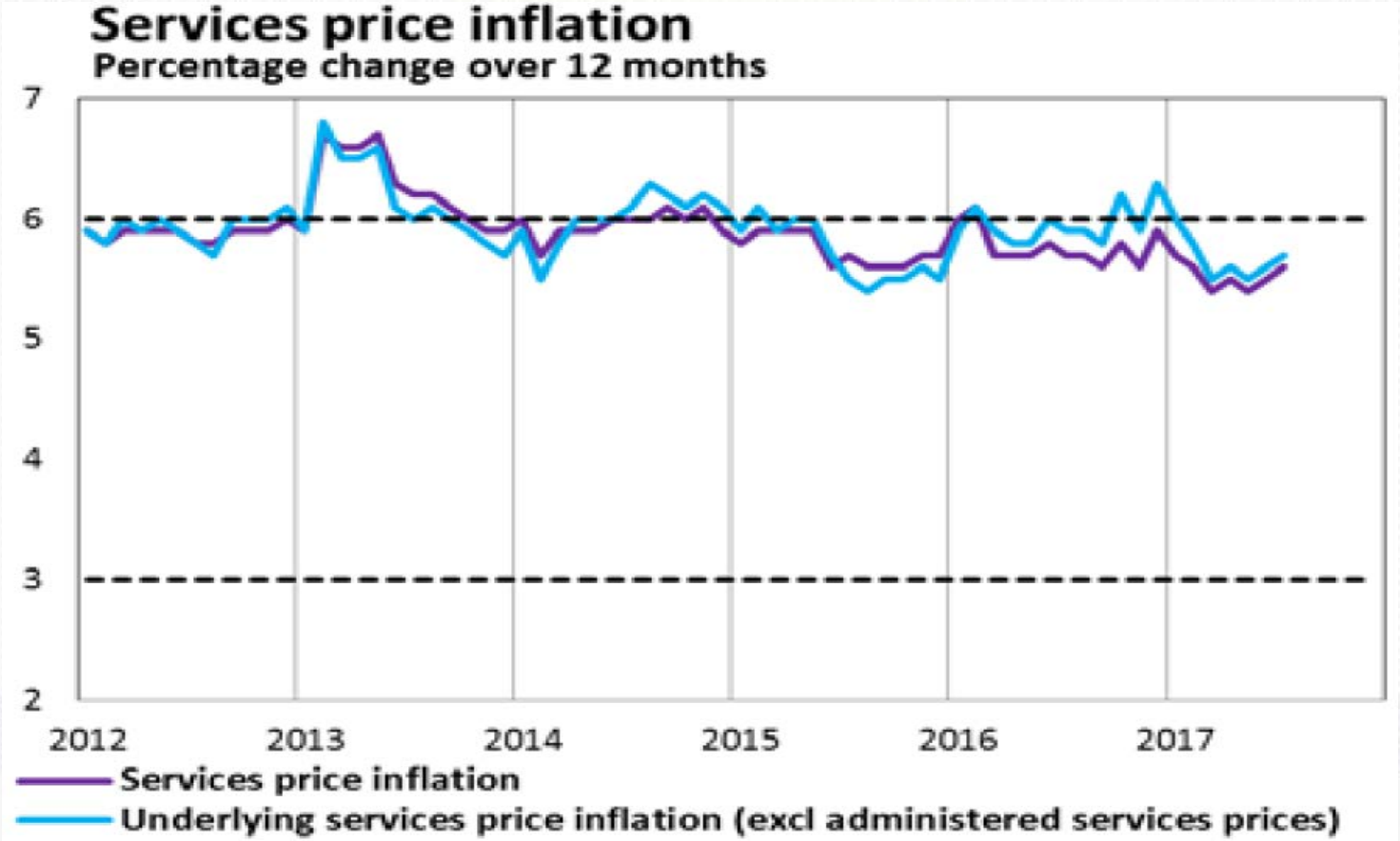
- Petrol price increases of 19 c/l in Aug and an expected 60 c/l increase in Sep will raise Headline CPI by 0.4 and 0.3 percentage points, respectively
- Food price inflation down from 7.0% in June to 6.8% in July, while meat price inflation accelerated to 14.4%
- Durable goods price inflation moderated to its lowest level in four years, amounting to 1.7% in July
- Semi-durable goods price inflation decelerated to 3% in July, with clothing and footwear price inflation having decelerated for the eighth successive month

With the exception of meat prices and alcoholic beverages prices, inflation in the prices of all other food products slowed in July 2017

	Weight	May 2017	Jun 2017	Jul 2017
Food and non-alcoholic beverages	**17.24**	**6.9**	**6.9**	**6.8**
Food	15.48	7.0	7.0	6.8
Bread and cereals	3.21	3.4	3.1	2.0
Meat	5.46	12.3	13.0	14.4
Fish	0.40	7.3	5.7	4.9
Milk, eggs and cheese	2.57	5.3	4.1	3.3
Oils and fats	0.45	-1.3	-1.7	-2.7
Fruit	0.34	5.3	3.9	-2.2
Vegetables	1.30	-2.9	-1.0	-1.4
Sugar, sweets and desserts	0.56	18.8	17.4	14.5
Other food	1.19	8.6	5.5	3.7
Non-alcoholic beverages	1.76	7.4	6.7	6.6
Alcoholic beverages and tobacco	**5.82**	**3.1**	**3.3**	**3.3**
Alcoholic beverages	3.89	2.1	2.5	2.6
Tobacco	1.93	5.2	5.2	4.8

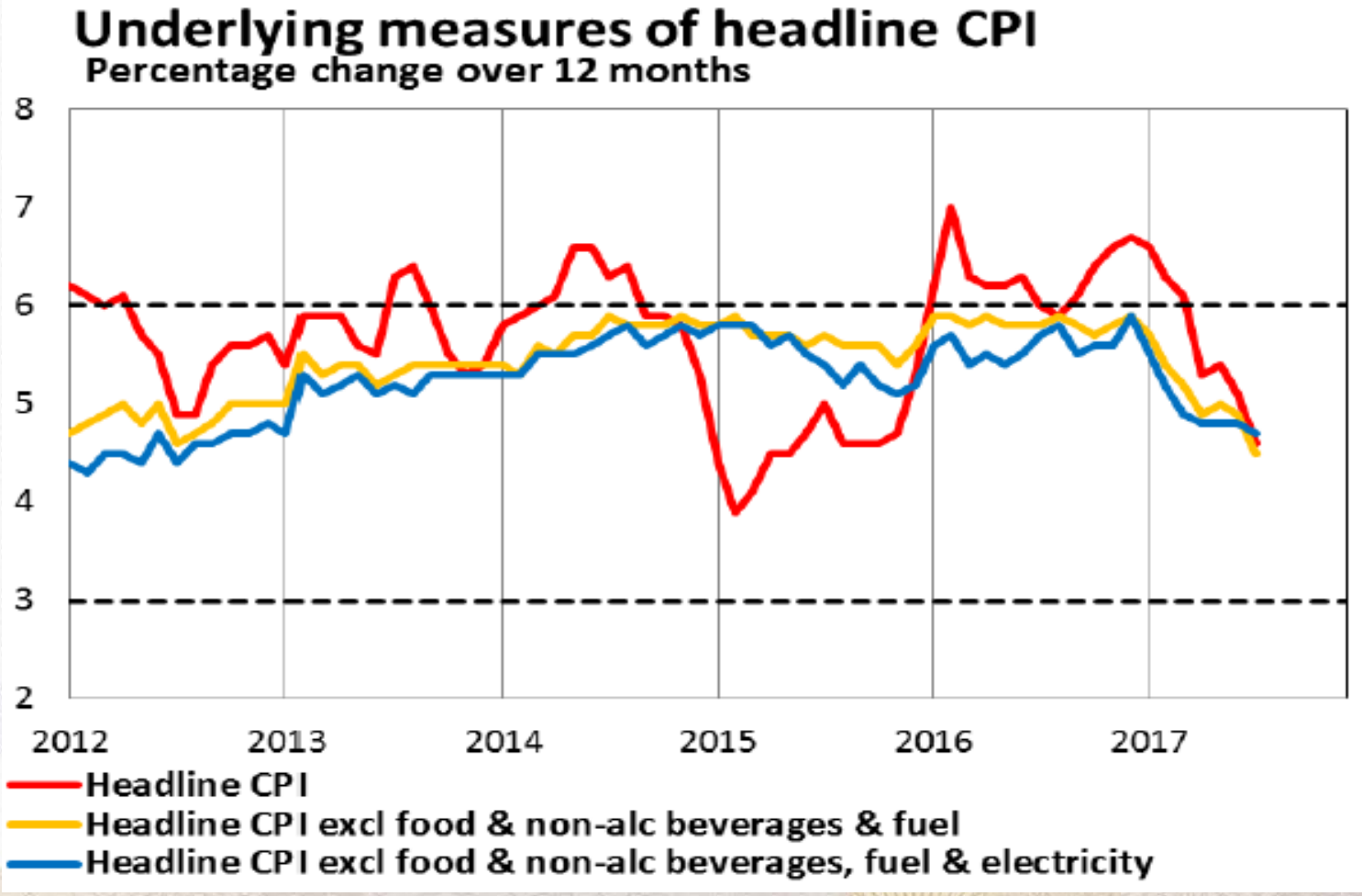
Source: Stats SA

Services price inflation accelerated to 5.6% in July 2017, driven by a doubling in funeral services price inflation to 12.4%



Source: Stats SA

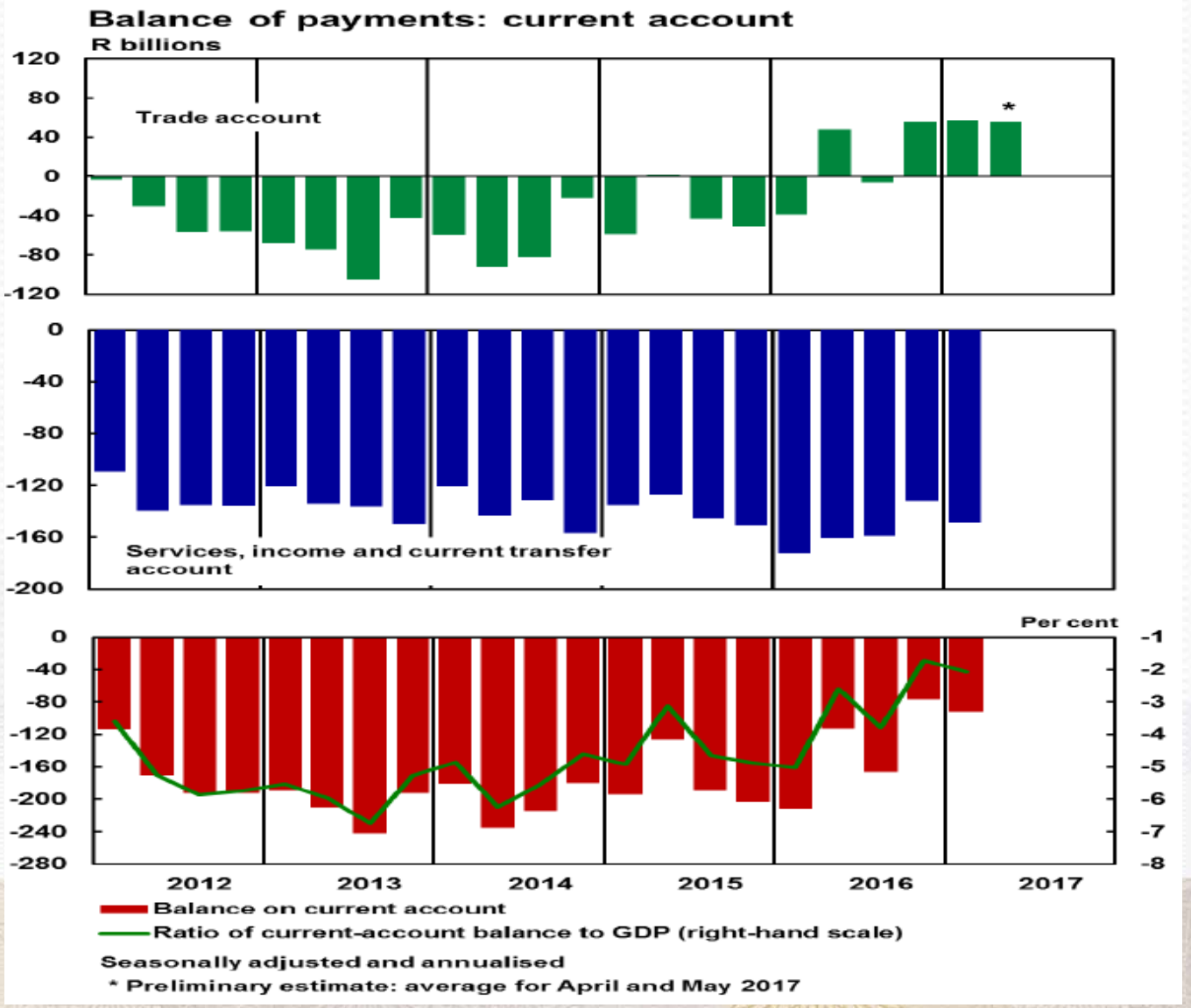
Core inflation moderated to its lowest rate in four and a half years, amounting to 4.7% in July 2017



Source: Stats SA

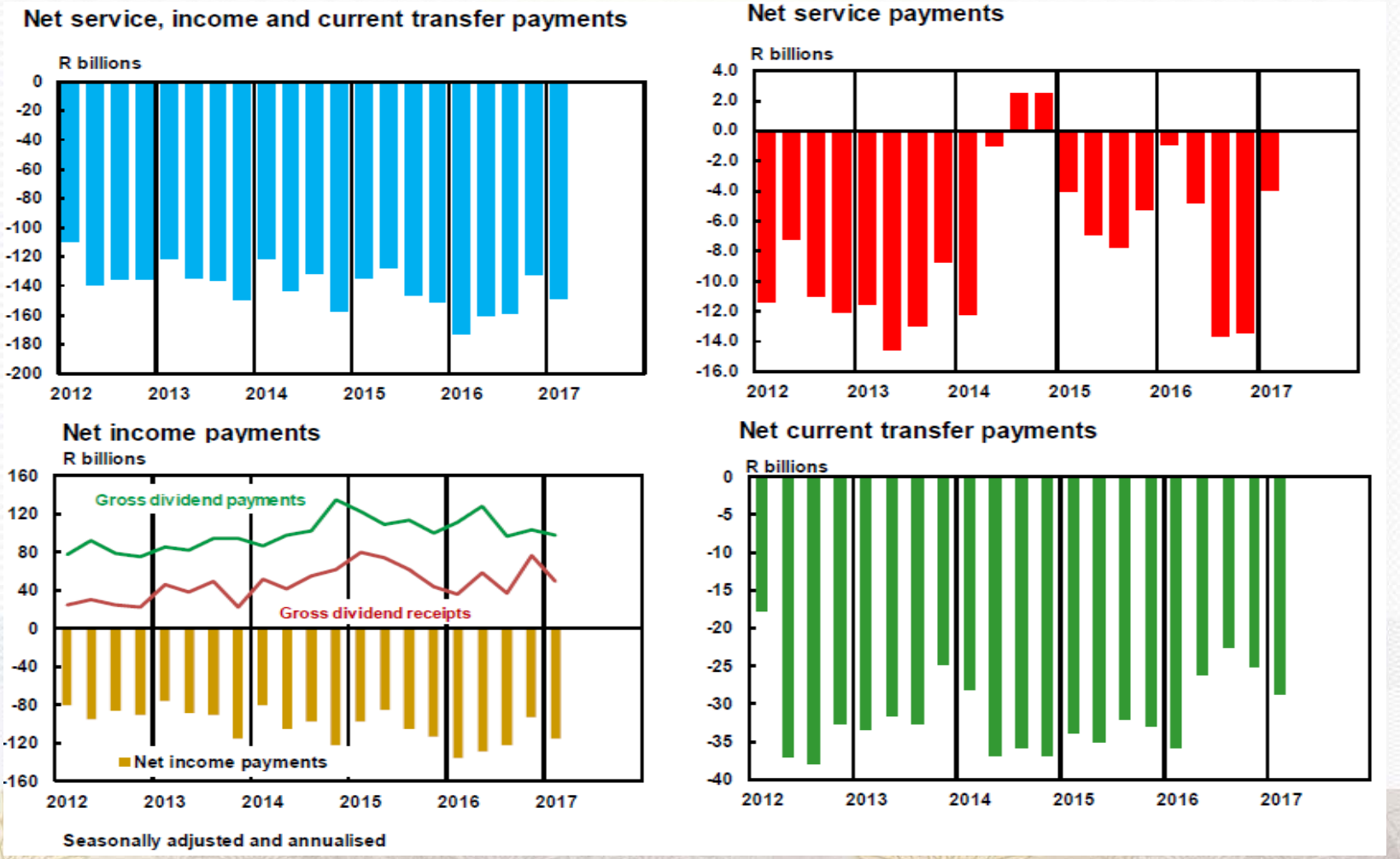
External economic accounts

Preliminary data show that South Africa's trade surplus with the rest of the world could remain broadly unchanged in Q2 2017



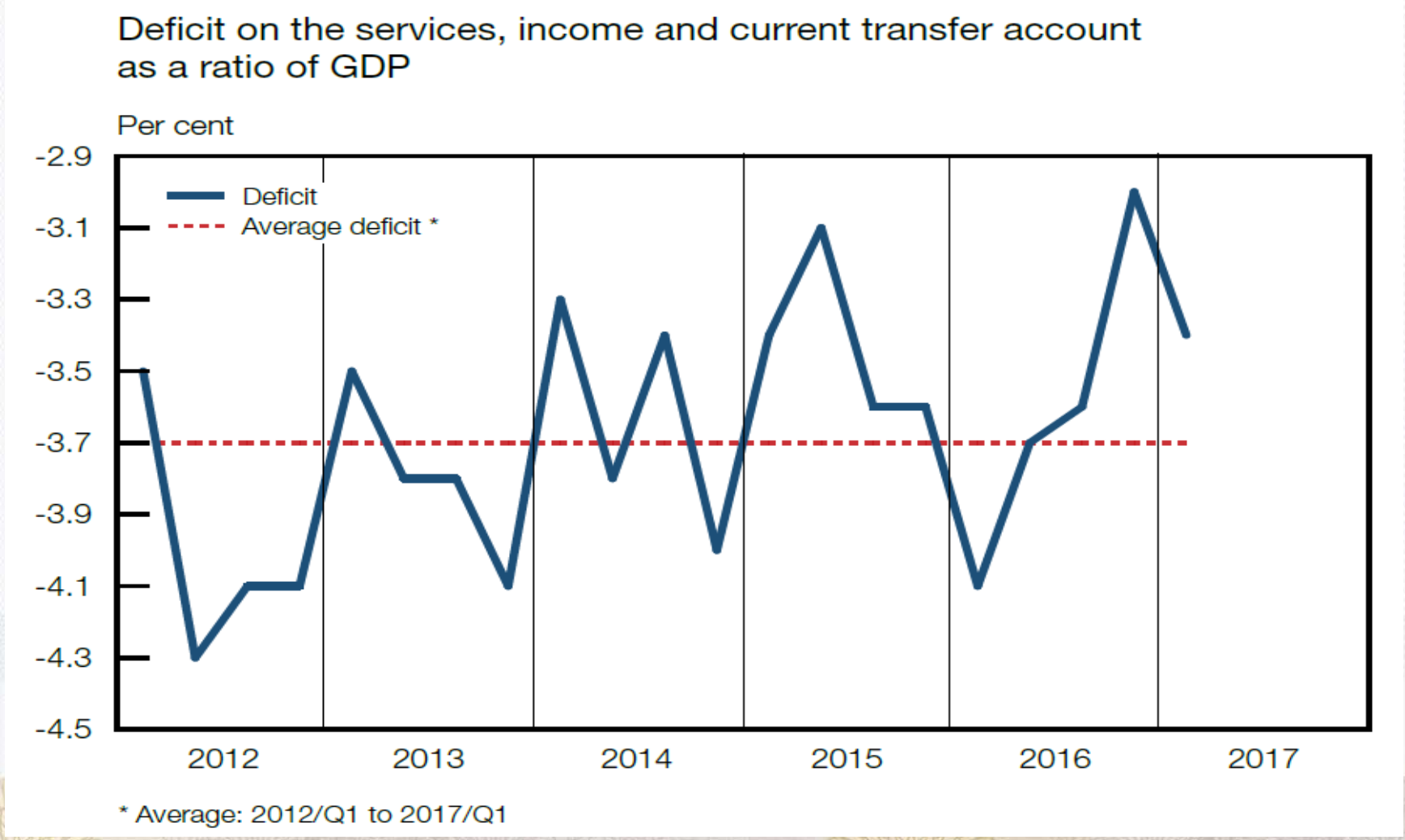
Sources: Statistics South Africa and SA Reserve Bank

The shortfall on the services, income and current transfer account widened in the first quarter of 2017 as both net income and current transfer payments increased



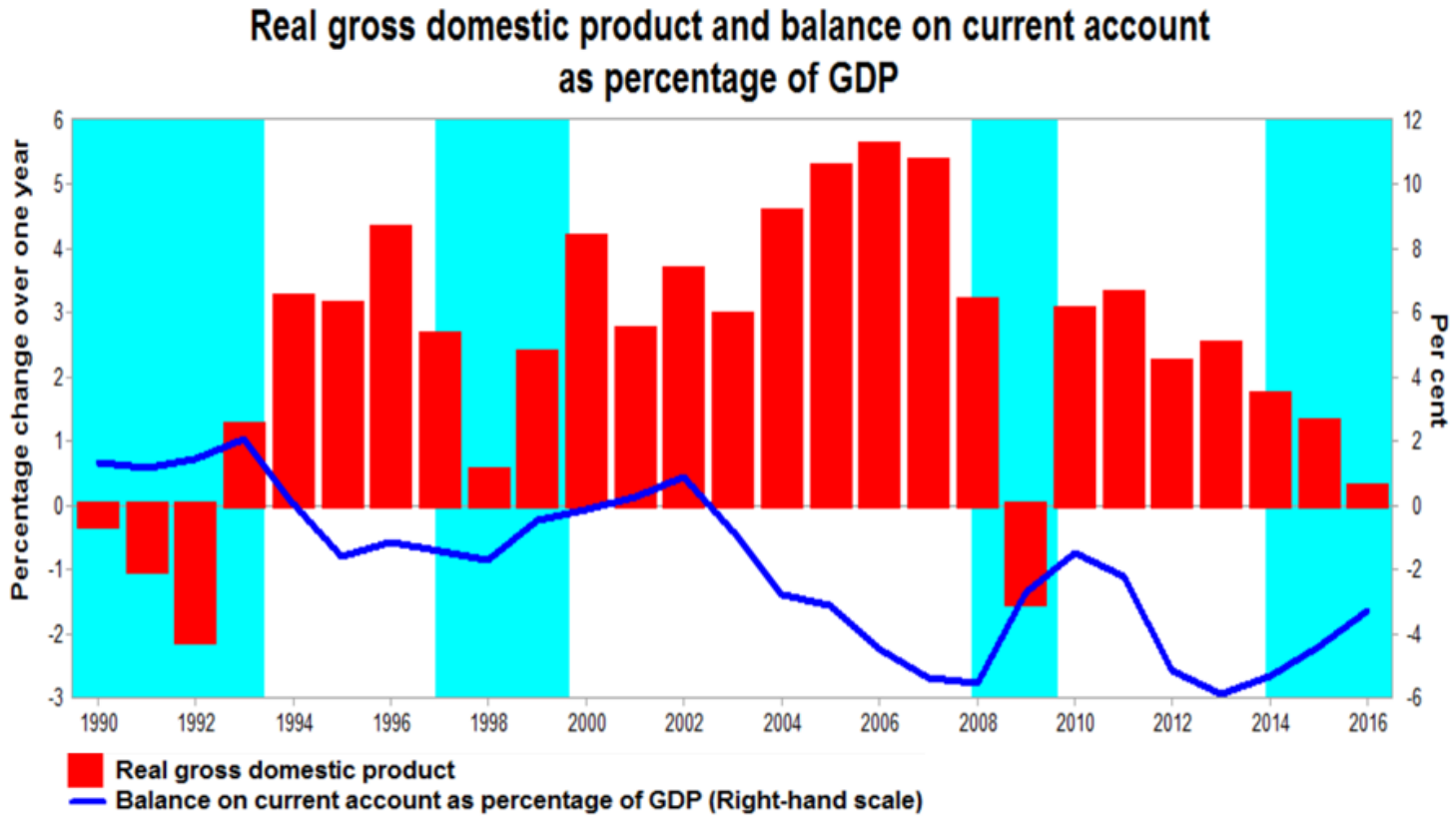
Source: SARB

Despite the marked widening in the deficit on the services, income & current transfer account as a ratio of GDP in the first quarter of 2017, it remained smaller than its medium-term average



Sources: Statistics South Africa and SA Reserve Bank

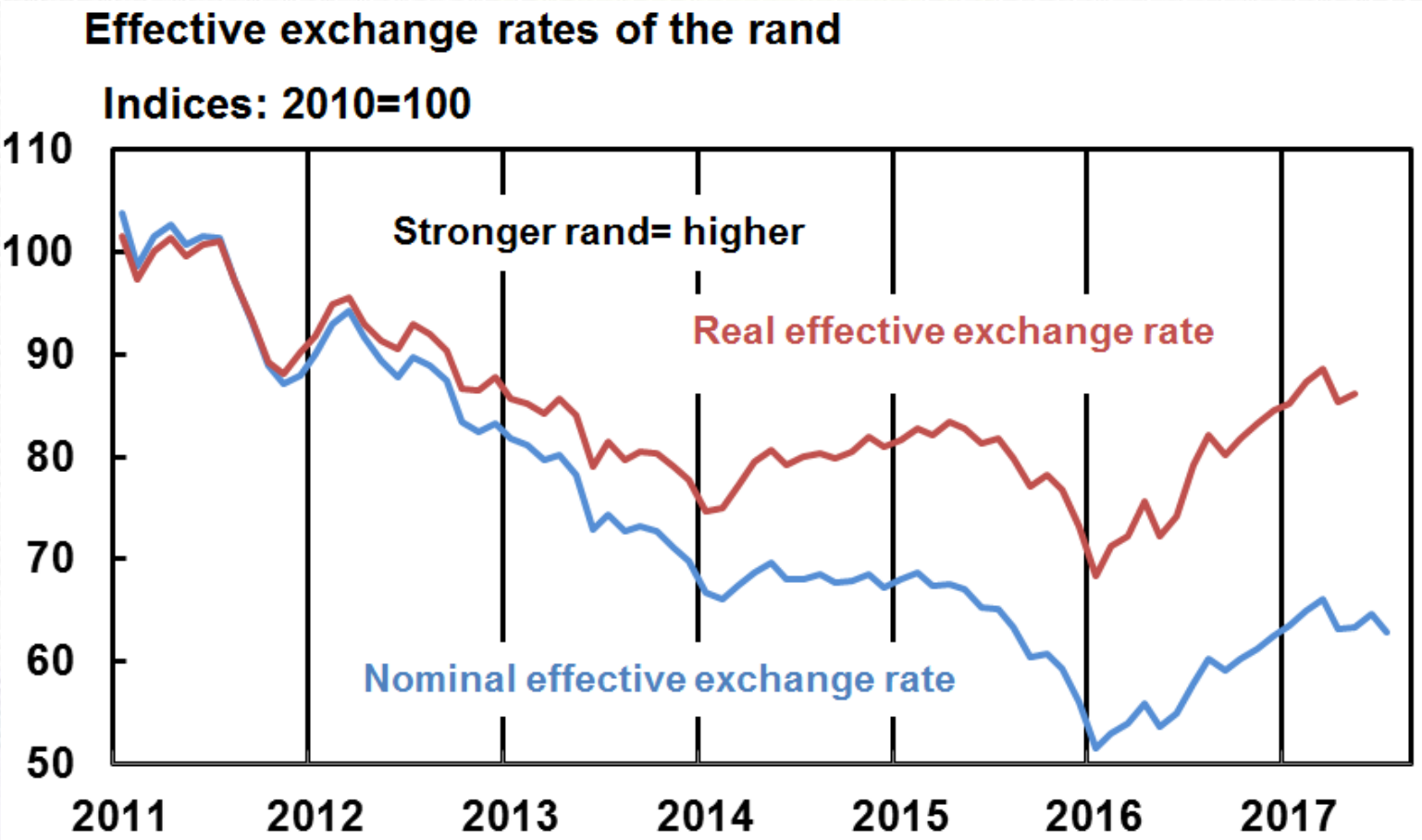
Historically, the evolution of the deficit on the current account of the balance of payments is closely tied to the stance of the business cycle with deficits more likely to decline during downward phases in business activity



Shaded areas indicate downward phases of the business cycle

Sources: Statistics South Africa and SA Reserve Bank

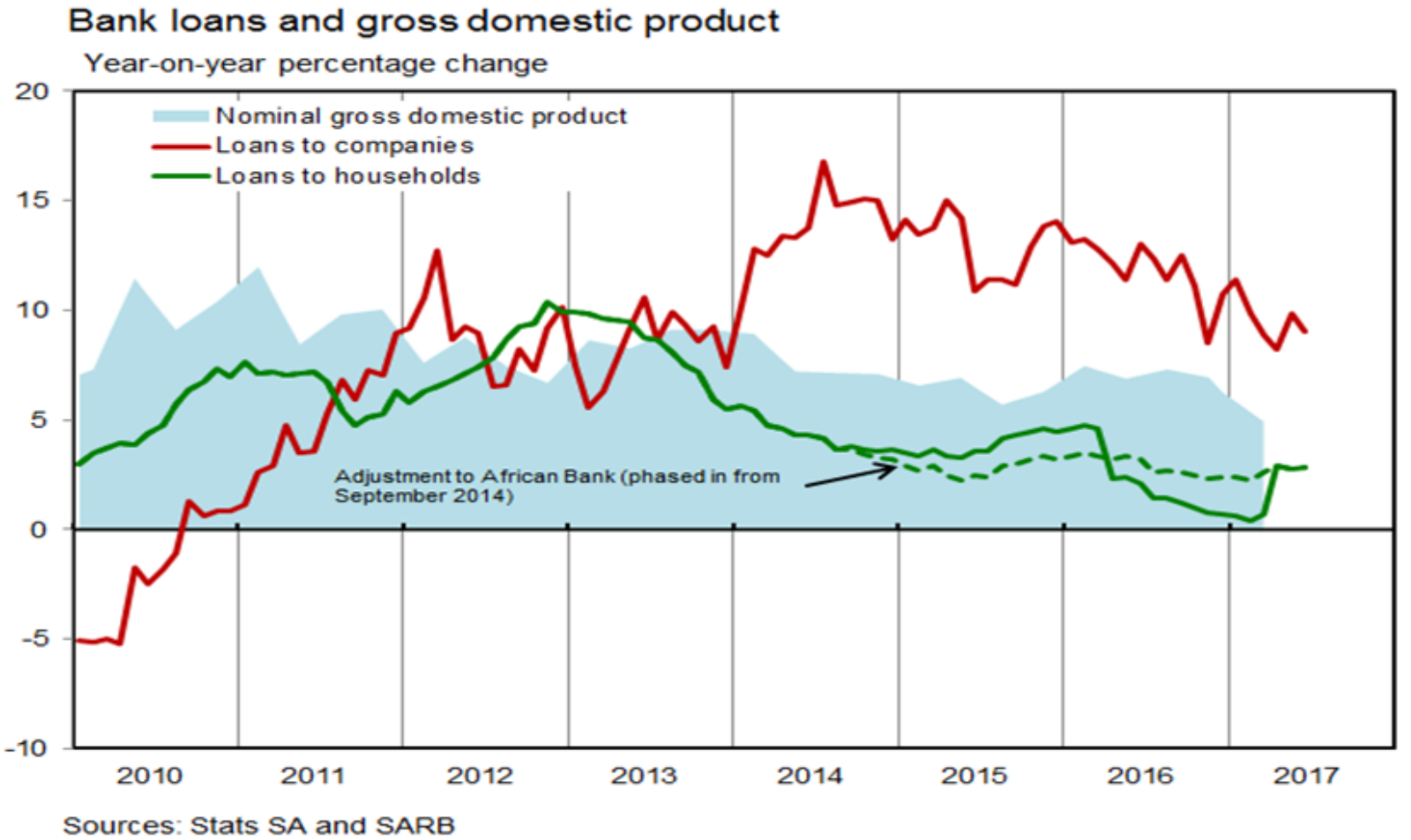
The nominal effective exchange rate of the Rand depreciated in July and August 2017 as uncertainty surrounding domestic political developments persisted



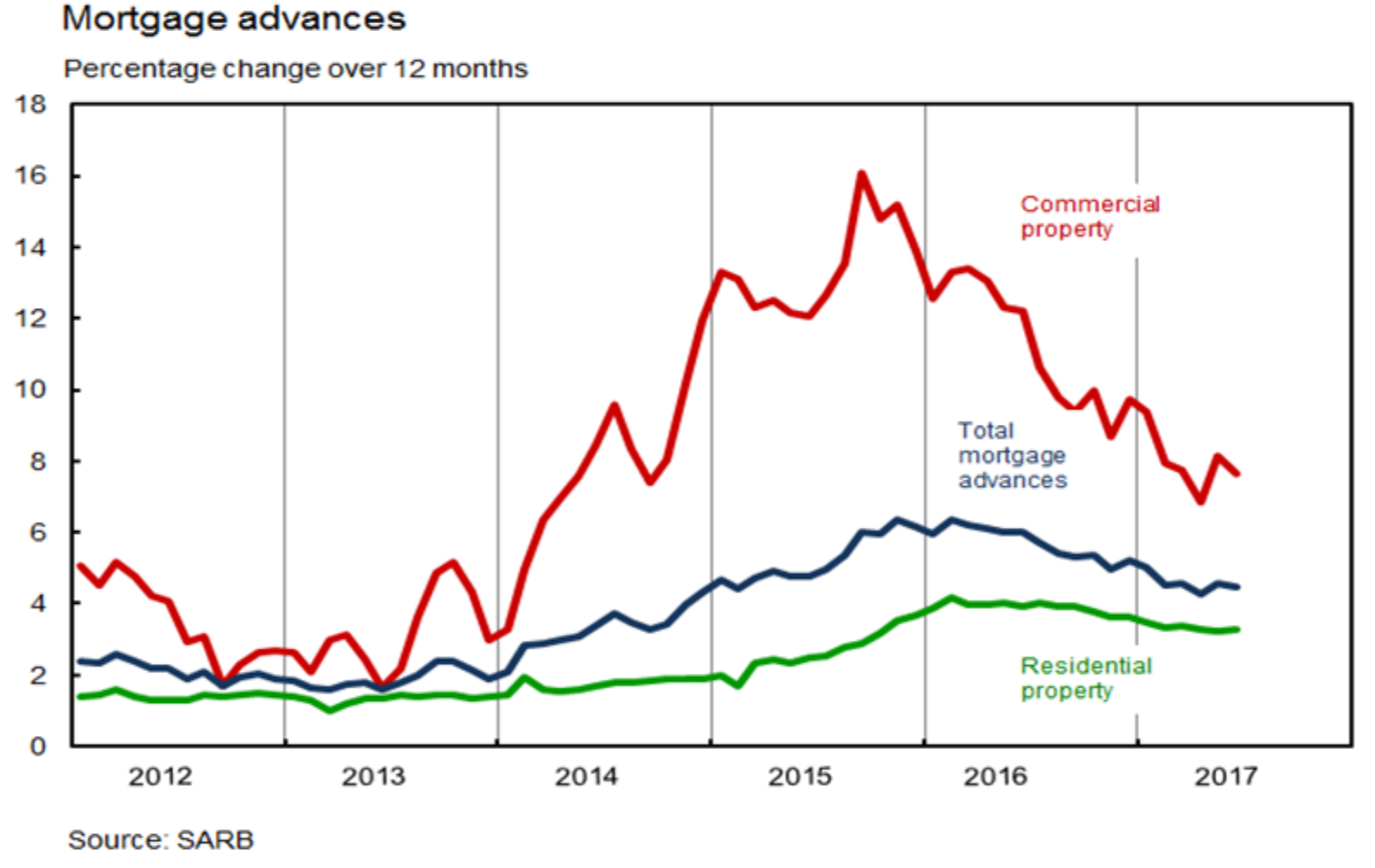
Source: SARB

Monetary developments

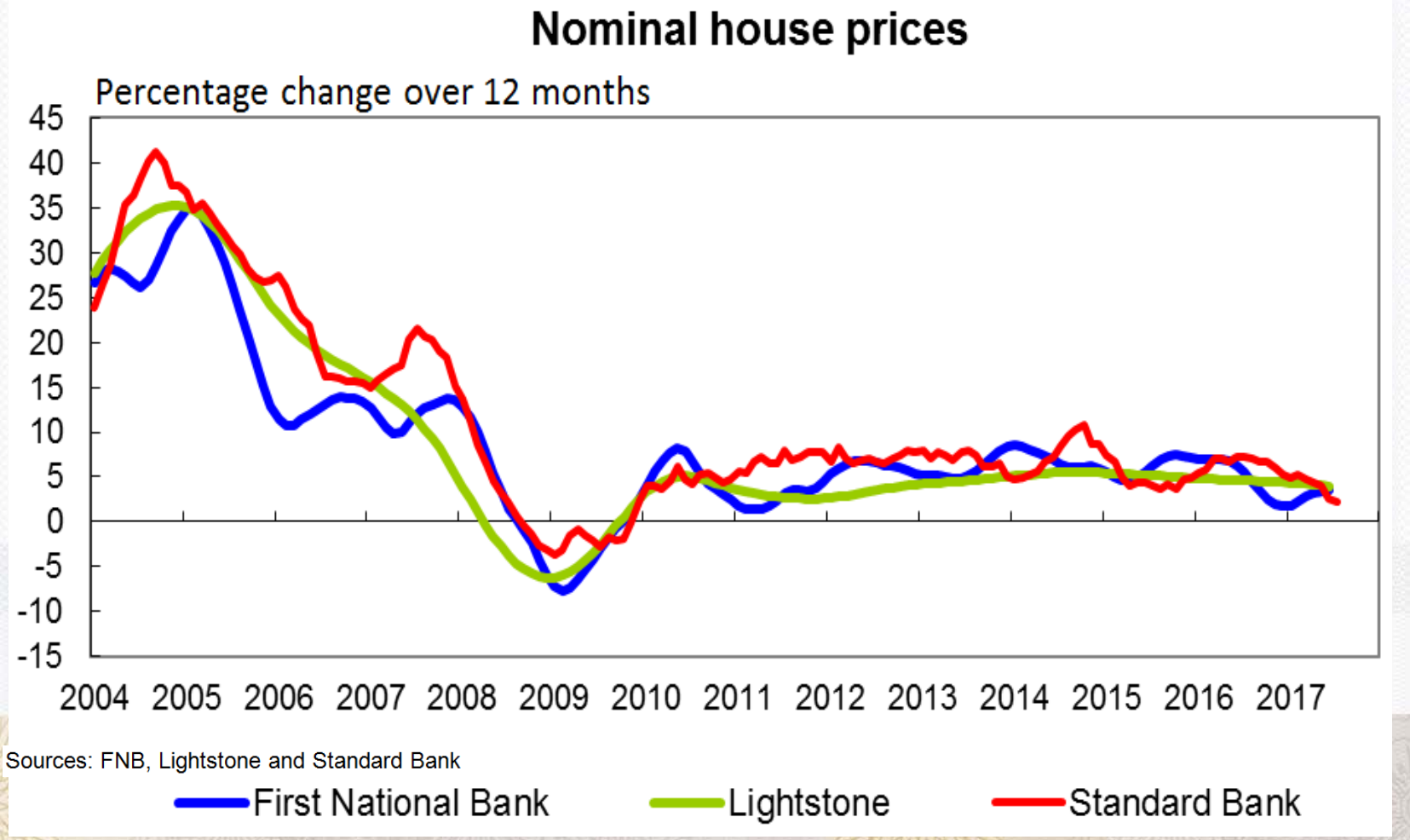
Growth in total loans and advances to the domestic private sector has trended lower in recent years as credit extension to households remained weak and that to the corporate sector also losing momentum



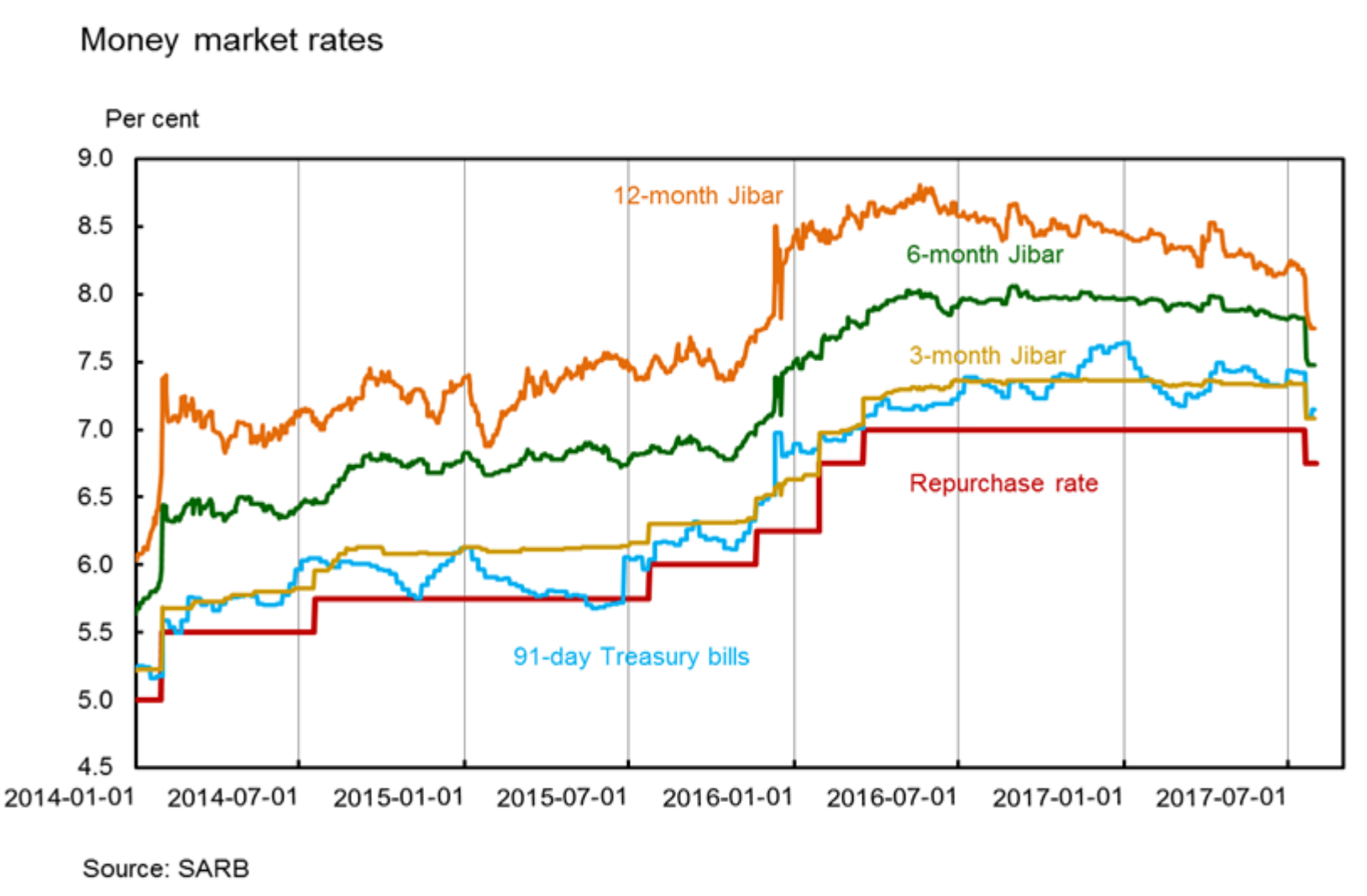
Growth in total mortgage advances decelerated further in recent months as especially that on commercial property slowed, and that on residential property fluctuating at around 3% during the first seven months of 2017



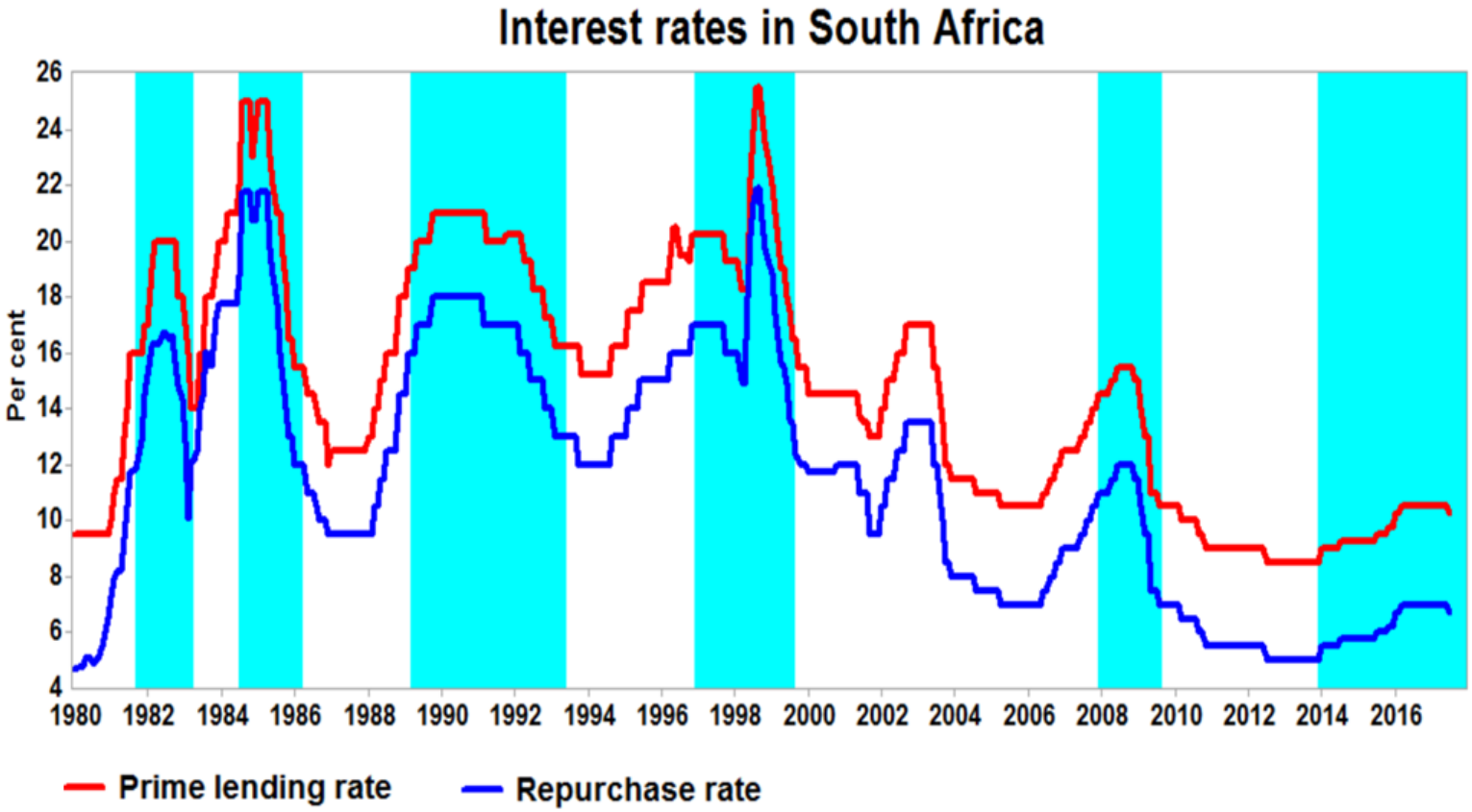
Residential property prices continued to grow at a subdued pace within an environment of weak domestic activity, low consumer confidence, slow growth in household disposable income and high unemployment



After lowering the repurchase rate by 25 basis points effective from 21 July 2017 by the MPC, alongside an improved near-term inflation outlook, money market rates across the various maturities followed suite



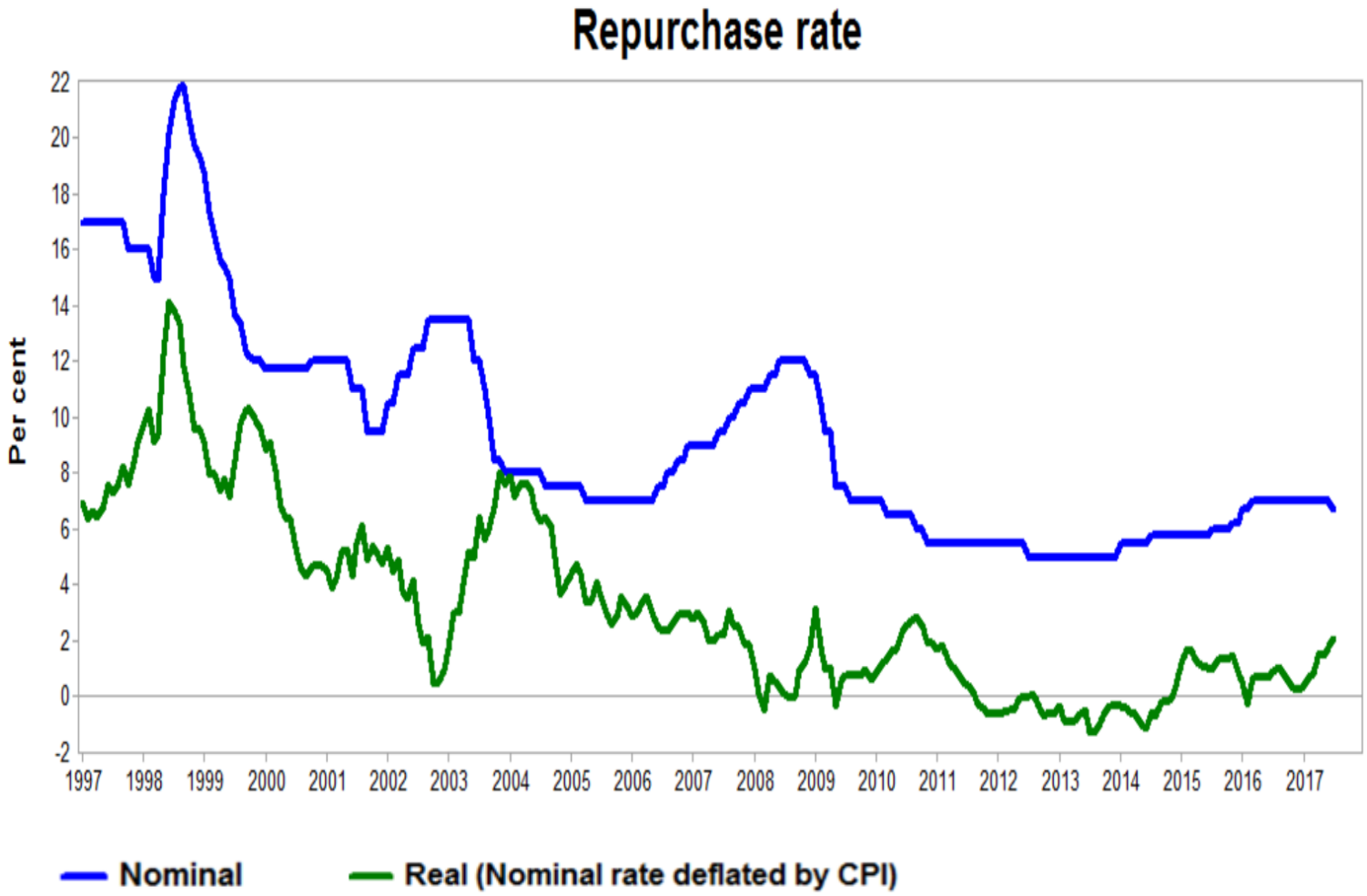
Interest rate cycles are interrelated with the stance of the business cycle



Shaded areas indicate downward phases of the business cycle

Source: SA Reserve Bank

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

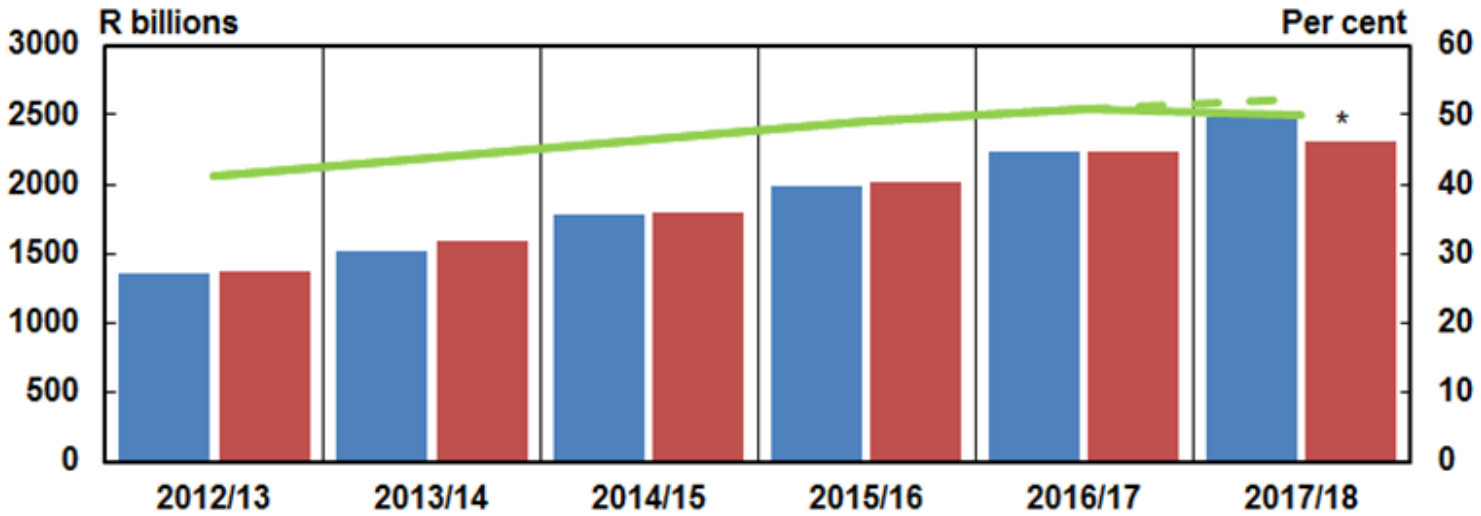


Sources: SA Reserve Bank and Statistics South Africa

Public finance

National government total gross loan debt (domestic and foreign currency-denominated) increased to R2.3 trillion as at 30 June 2017, as the stock of especially domestic currency-denominated debt increased

Total gross loan debt of national government



As at 31 March of each fiscal year

* As at 30 June 2017

Originally budgeted

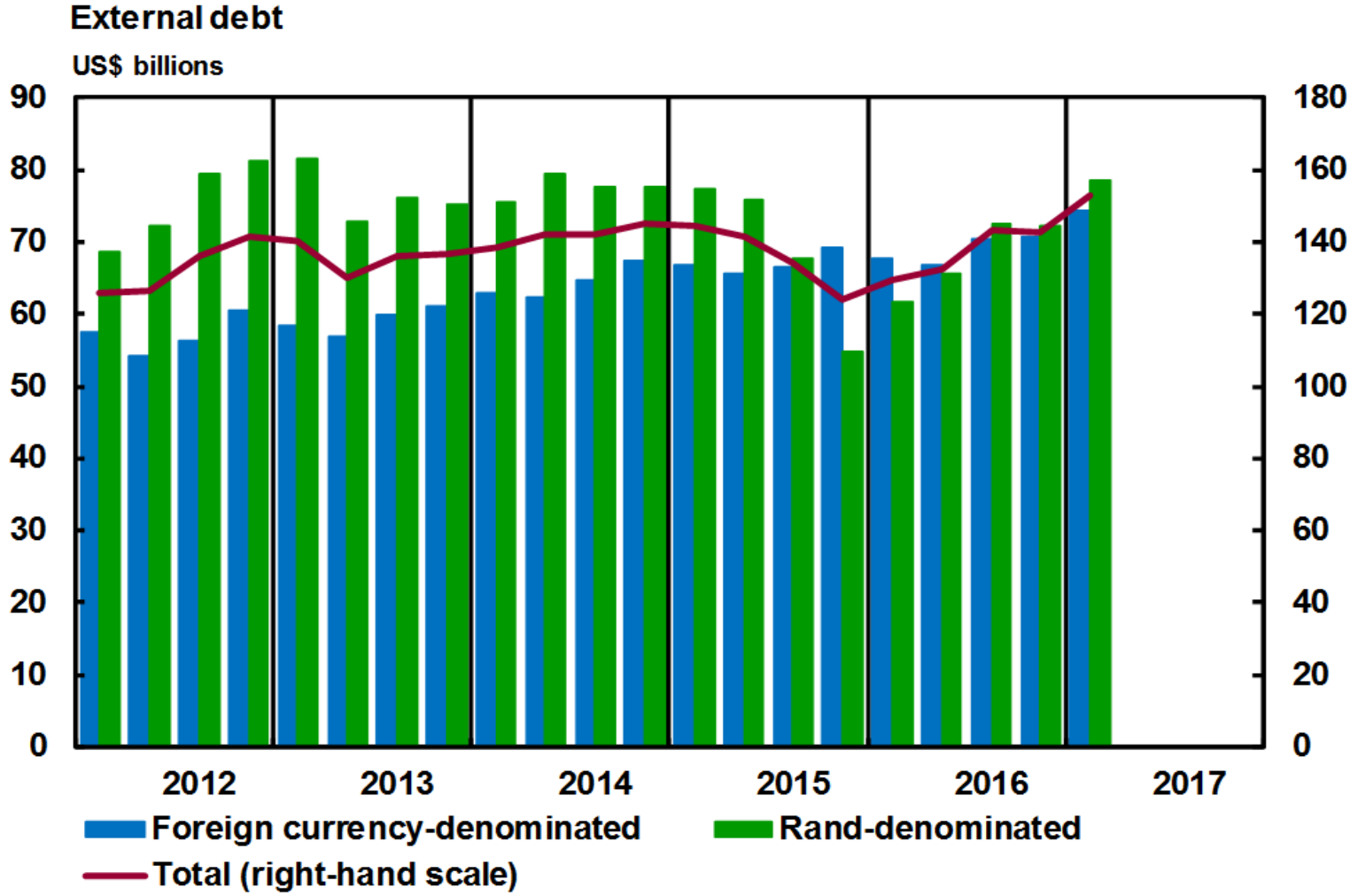
Actual

Actual: Total Debt-to-GDP ratio (right-hand scale)

Estimates: *2017 Budget Review*

Source: National Treasury

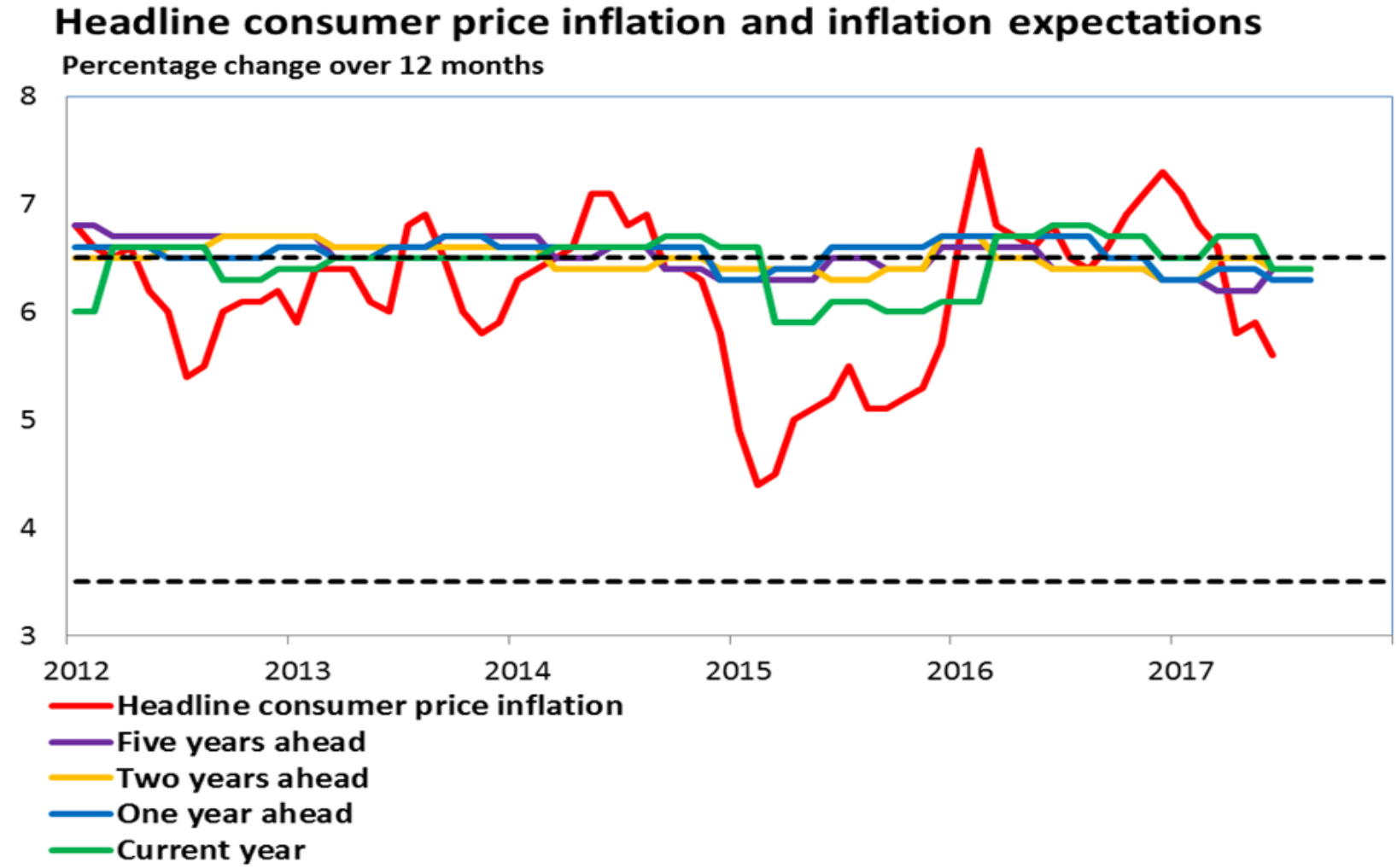
South Africa's total outstanding external debt increased to US$153 billion at the end of Mach 2017, mainly due to substantial purchases of rand-denominated government bonds by non-residents



Source: SARB

Inflation expectations and forecasts

Inflation expectations remain clustered around the top end of the inflation target range



Source: Bureau for Economic Research, Stellenbosch University

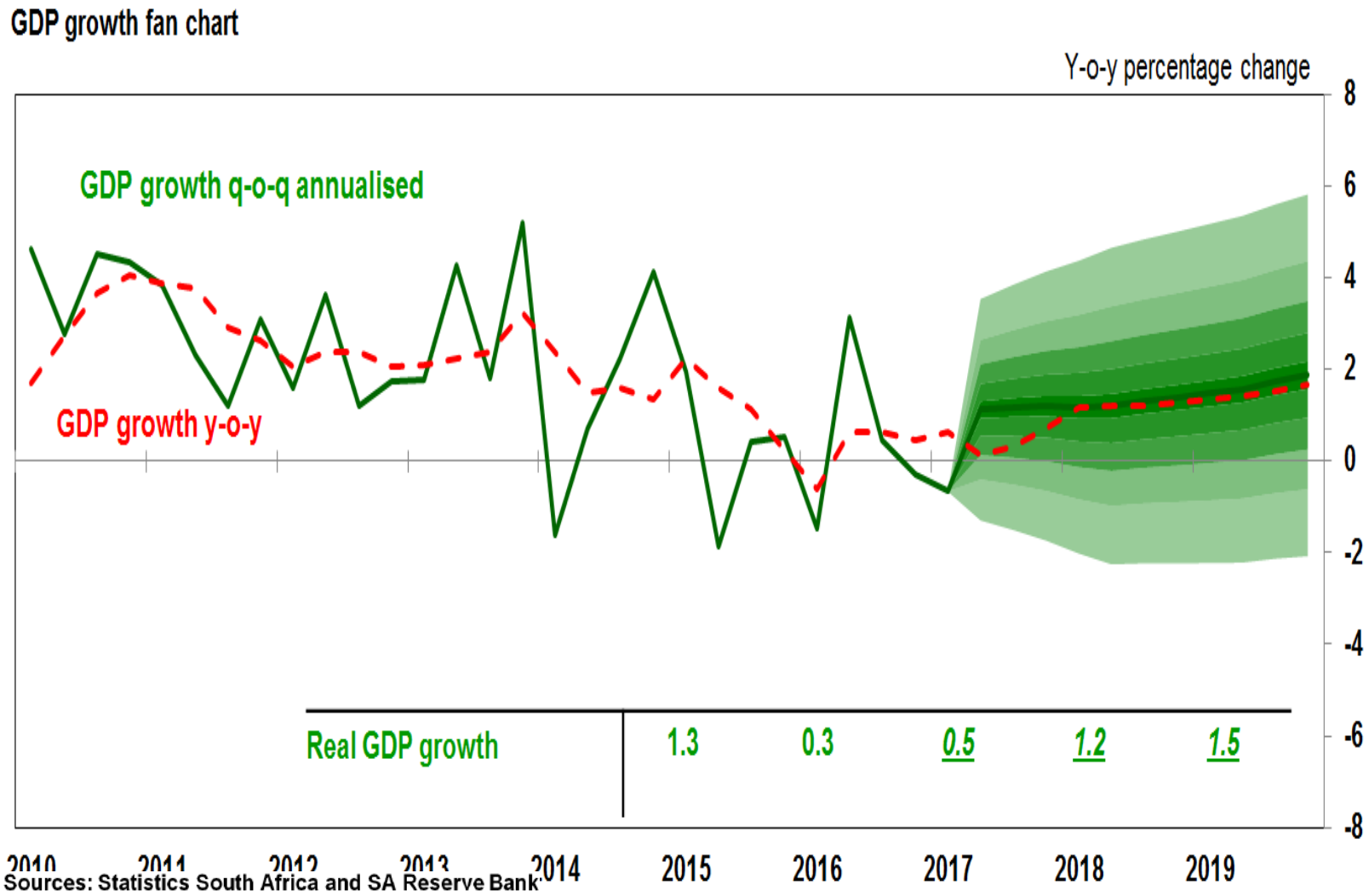
Headline consumer price inflation expectations

Per cent, as surveyed in the second quarter of 2017

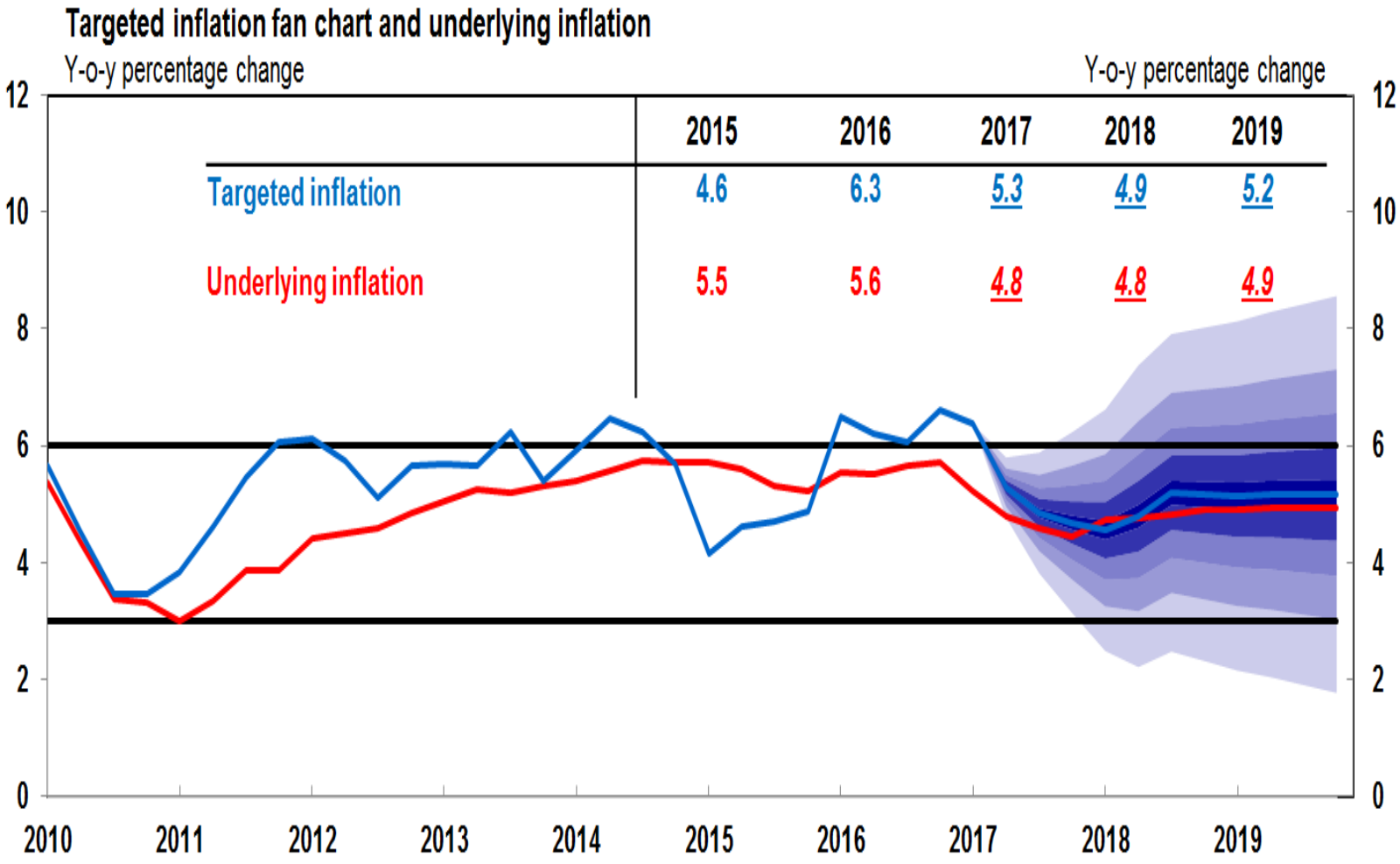
Average inflation expected for:	Financial analysts	Business representatives	Trade union representatives	All surveyed participants
2017	5.4	6.3	6.0	5.9
2018	5.1	6.4	5.9	5.8
2019	5.5	6.5	5.9	5.9
Next five years	5.5	6.3	5.8	5.9

Source: BER

Real GDP growth outlook: July 2017



Headline CPI forecast: July 2017



Sources: Statistics South Africa and SA Reserve Bank

Summary

- Second-quarter 2017 world economic growth recorded its best performance since the first quarter of 2012;

- SA emerged from a technical recession in the second quarter of 2017, while the leading indicator suggests muted growth prospects for the remainder of the year;

- Confidence and sentiment indicators weakened further in the second quarter of 2017, possibly exaggerated somewhat by the political environment;

- Household-surveyed employment increased in the year to second quarter of 2017, but the unemployment rate remains alarmingly high;

- Growth in credit extension remains weak;

- Headline inflation is expected to remain within the target range; and

- Government finances are strained with a high demand being placed on the fiscus within a depressed economy.

Thank you