South African Reserve Bank

Report of the South African Reserve Bank 2017/18

Presentation to the Standing Committee on Finance

15 August 2018

Agenda

1. The role of the South African Reserve Bank (SARB)
2. Macroeconomic overview and outlook
3. Highlights from the 2017/18 Annual Report

THE ROLE OF THE SARB

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
- Financial Sector Regulation Act, which came into effect in August 2017, mandates the SARB to maintain, promote and enhance financial stability in South Africa, in addition to its primary price stability mandate.

The SARB's key functions

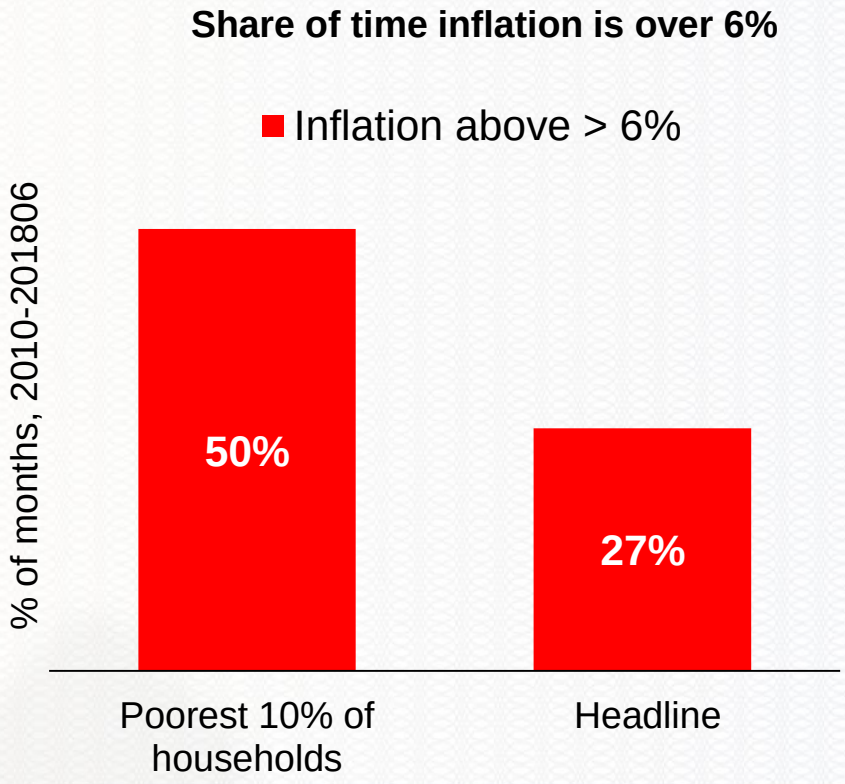
- Issues banknotes and coin
- Regulates and supervises the banking system
- Ensures the effective functioning of the National Payment System
- Manages the official gold and foreign exchange reserves of the country
- Administers the country's remaining exchange control regulations
- Acts as banker to the government

The role of monetary policy

- Ensuring price stability or low inflation is a traditional function of central banks.
- All central banks have this mandate in some form but they may use different frameworks:
  - Inflation targeting
  - Fixed exchange rate systems
  - Targeting monetary aggregates
- However, monetary policy cannot determine the long run growth potential of the economy
- Many of the SARB's functions have socio-economic impacts

Inflation tends to hit the poor harder

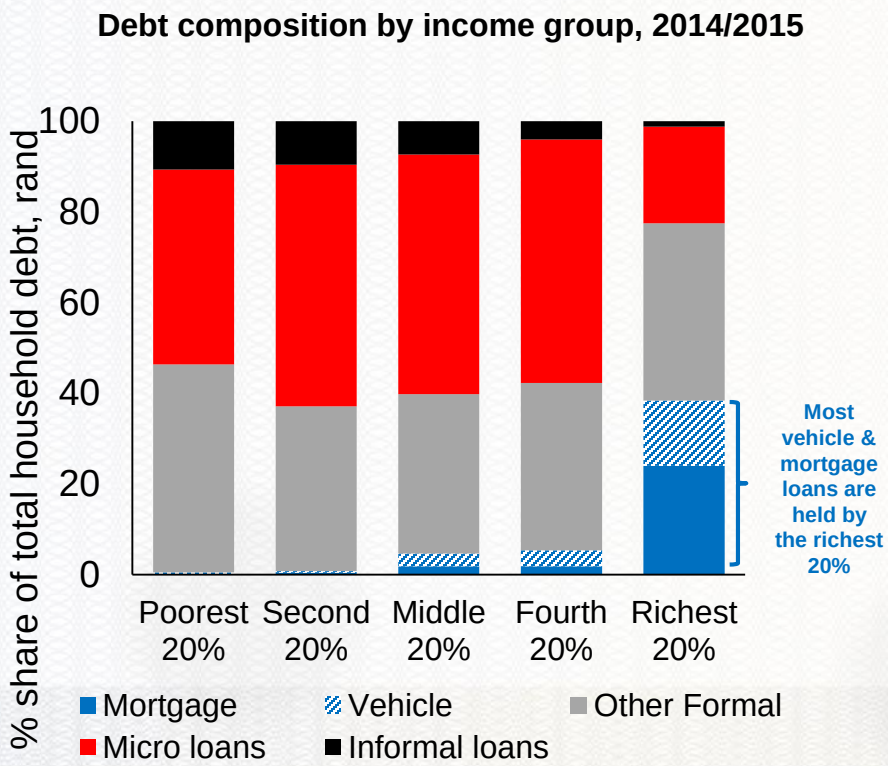
- Poorer people have less choice over spending as their consumption basket is taken up by a few basic items
- It is harder for poorer people to protect their wages and savings against inflation
- A monetary policy stance that lowers inflation can increase the expenditure of the poor



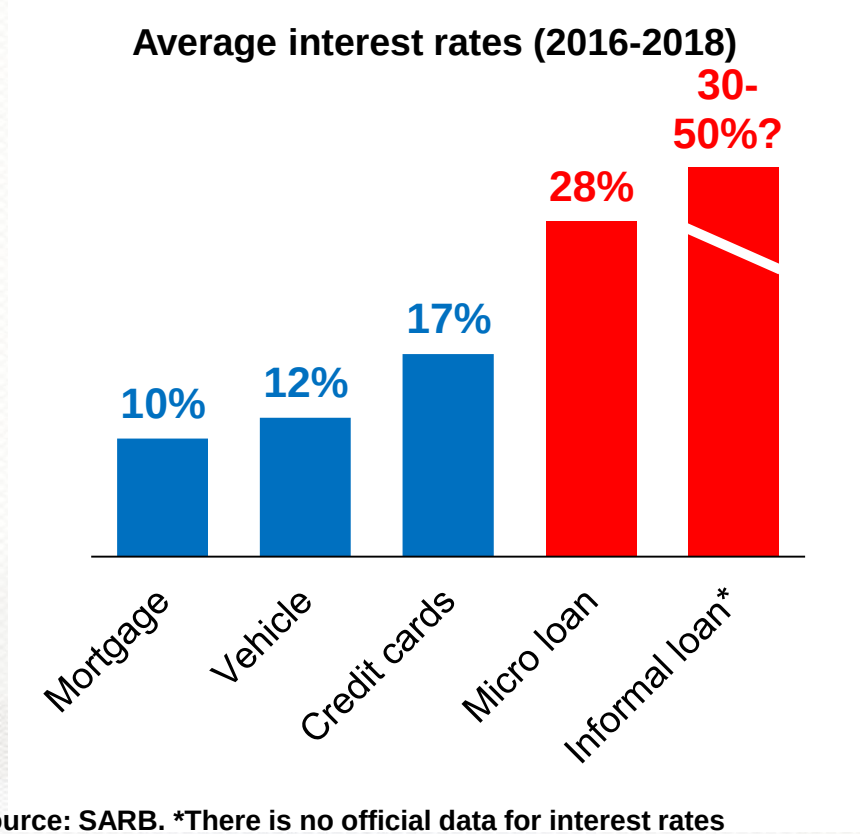
Source: STATS SA

South African Reserve Bank

South Africans at all income levels borrow – but for different things and at very different interest rates



Source: NIDS



Source: SARB. *There is no official data for interest rates on informal loans, but surveys suggest these loans pay around 30-50% annually.

Richest 20%: R173 000 per year

Richest 10%: R270 000 per year

Poorest 10%: less than R17 000 per year

South African Reserve Bank

Repo rate changes mainly affect borrowing costs for the richest 20% of households

- If the report rate is reduced by 25 or 50 basis points, people with mortgages and vehicle loans see an immediate effect
- BUT there is little or no effect on a micro loan
- micro loans and informal loans shaped by factors other than monetary policy
  - The high cost of offering loans
  - Higher risk of default
  - Lack of information about income

The framework for managing financial stability

- A framework to monitor financial stability, which includes:
  - Monitoring and mitigating against risks to financial stability
  - Stress testing the South African banking sector
  - Evaluating the impact of regulatory reforms on the financial system and providing input into global regulatory, supervisory and financial sector standards
- We have a toolkit of macroprudential instruments for the financial stability committee to apply in mitigating potential systemic risks and restore financial stability if a systemic risk occurs
- A legal framework for resolving systemically important financial institutions

The Prudential Authority (PA)

- Launched on 01 April 2018
- The role of the PA is to:
  - Promote and enhance the safety and soundness of financial institutions that provide financial products and securities services
  - Promote and enhance the safety and soundness of market infrastructure
  - Protect financial customers against the risk of financial institutions failing to meet their obligations
  - Assist in maintaining financial stability
- A Deputy Governor has been designated as the CEO of the Prudential Authority
- A Prudential Committee chaired by the Governor has oversight over the PA

Bank resolution

- VBS Mutual Bank (VBS) was placed under curatorship with effect from 17:00 on Sunday 11 March 2018.
- SizweNtsalubaGobodo was appointed as curator of the bank.
- The curator indicated that there were inadequate and questionable governance and risk management practices within the bank.
- Appointment of a senior advocate to conduct a forensic investigation into VBS.
- Repayment of all retail deposits up to R100 000 per retail depositor.
- Preliminary findings of the forensic investigation were shared with the DCPI (Hawks).
- Recently the High Court issued provisional sequestration orders against five individuals and provisional liquidation order for Vele Investments.

The discussion on nationalisation of the SARB

- The SARB is one of about 6 central banks that still have private shareholders
  - There are 2 million shares in issue
  - Over the past 3 years, average profit for the SARB has been about R1.2 billion a year
  - Dividends are capped at 10 cents a share (maximum R200 000 a year)
  - 90% of any remaining surplus accrues to government
    - After setting aside contingencies, reserves, tax etc.
- The 1996 Constitution sets out the mandate of the SARB and provides for its independence

The discussion on nationalisation of the SARB (2)

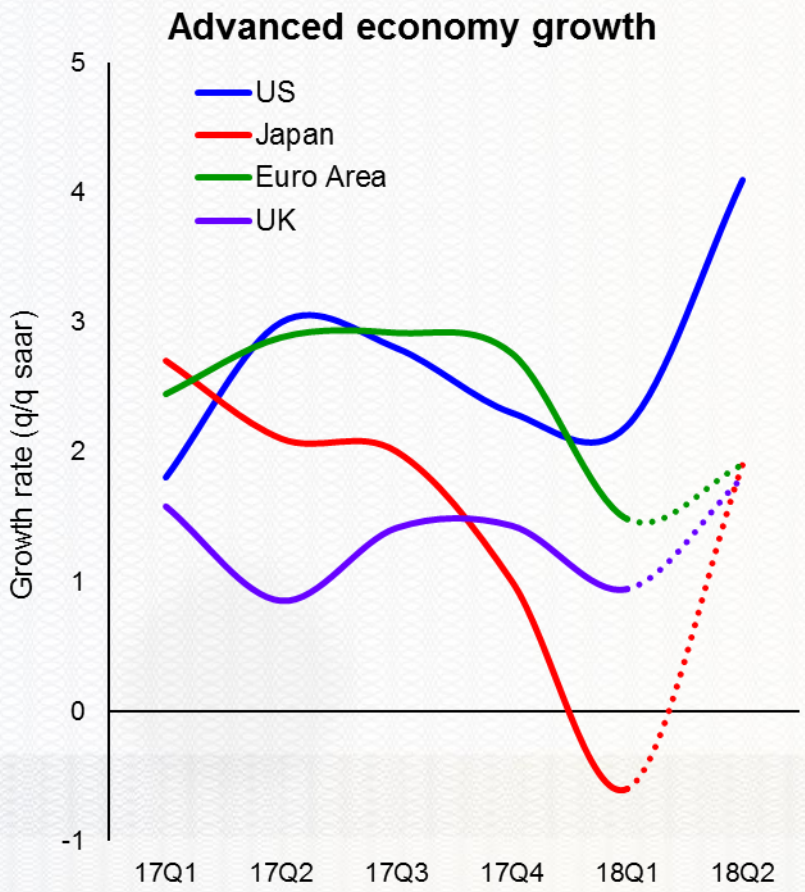
- Since 1996, there have been several legislative changes to clarify the role of shareholders, reduce the influence of shareholders, limit the rights of foreign shareholders and reduce concentration through limiting the number of shares that related parties can hold
- The board of the SARB plays a role in ensuring good governance, but plays no role in policy or regulatory decisions of the SARB
- Government appoints 8 members of the board, including the four executives, while shareholders elect 7 members to the board

MACROECONOMIC OVERVIEW AND OUTLOOK

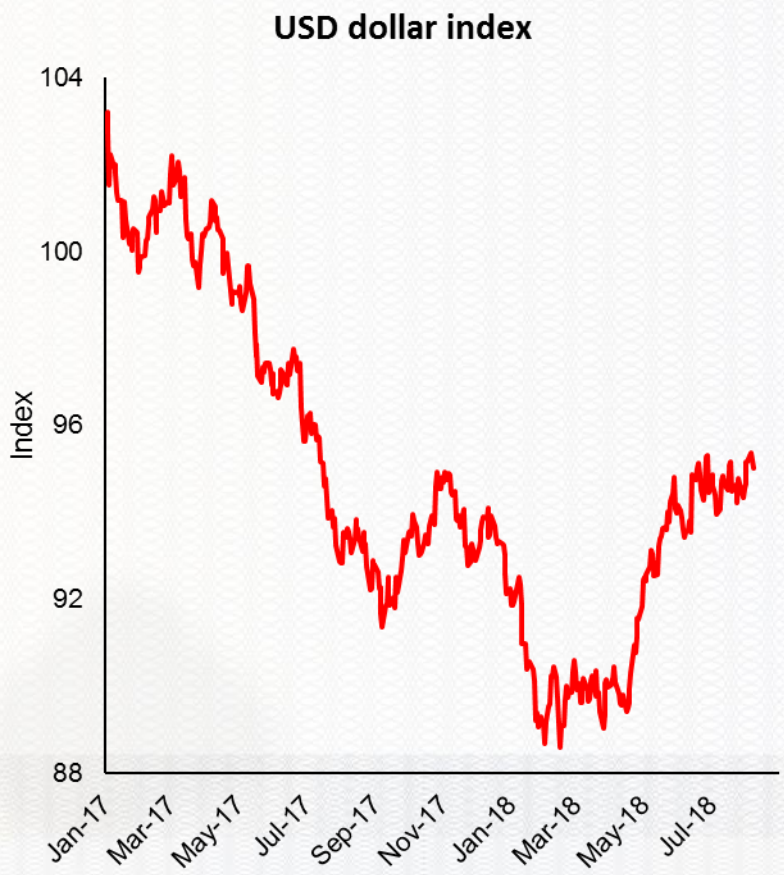
Global growth is accelerating but risks also rising

- During the second half of 2017 global economic conditions were favourable for South Africa and other emerging markets as growth in advanced economies recovered.
- However, this was not sustained in the first half of 2018 as expectations of a faster pace of monetary tightening than previously expected began to emerge as the strong US growth was sustained.
- In addition, the strong dollar effect dominated global markets, which saw a reversal of capital flows from emerging markets.
- Prices of most commodity prices declined, while international oil prices continued to increase.
- There was a marked escalation of trade tensions following changes to US trade policy.
- Over the past two weeks, emerging markets have experienced a sell off as US sanctions against Turkey and Russia weighed on risk sentiment.

US economy outperforming peers and dollar appreciating…



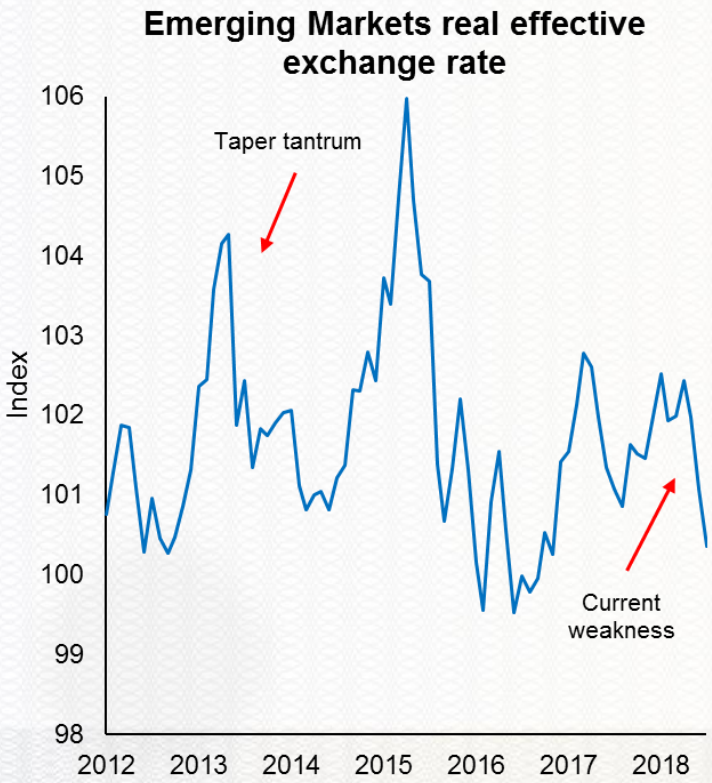
Sources: Bloomberg and Haver Analytics



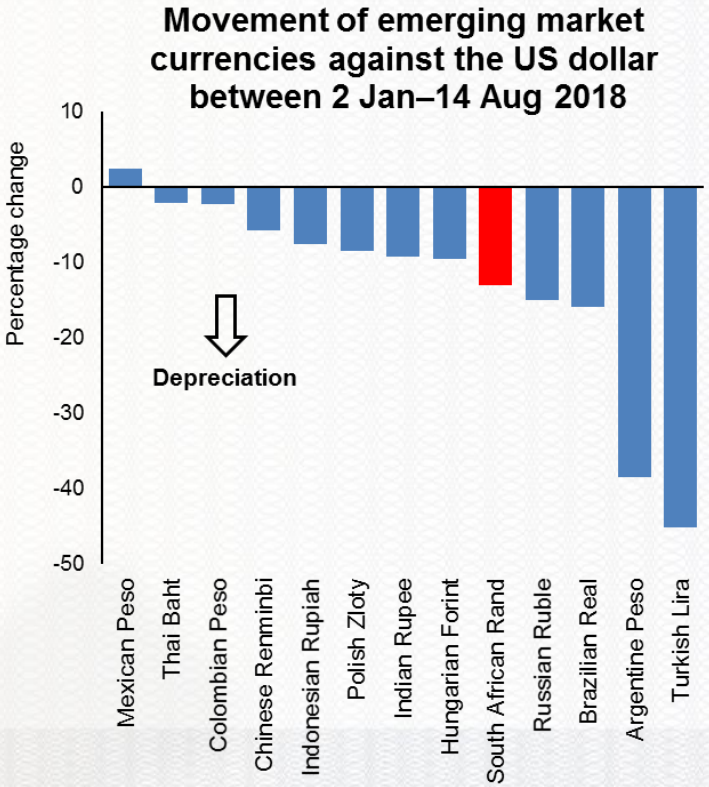
Source: Bloomberg

South African Reserve Bank

…prompting weaker exchange rates in emerging markets – with clear differentiation



Source: JPMorgan and Haver Analytics

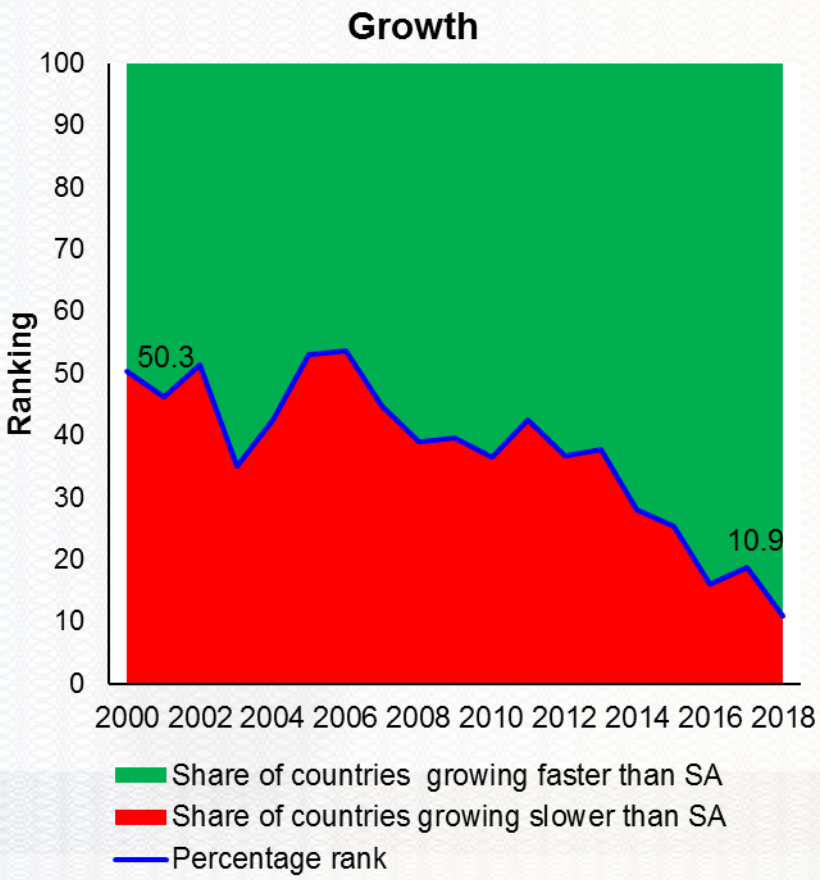


Source: Bloomberg

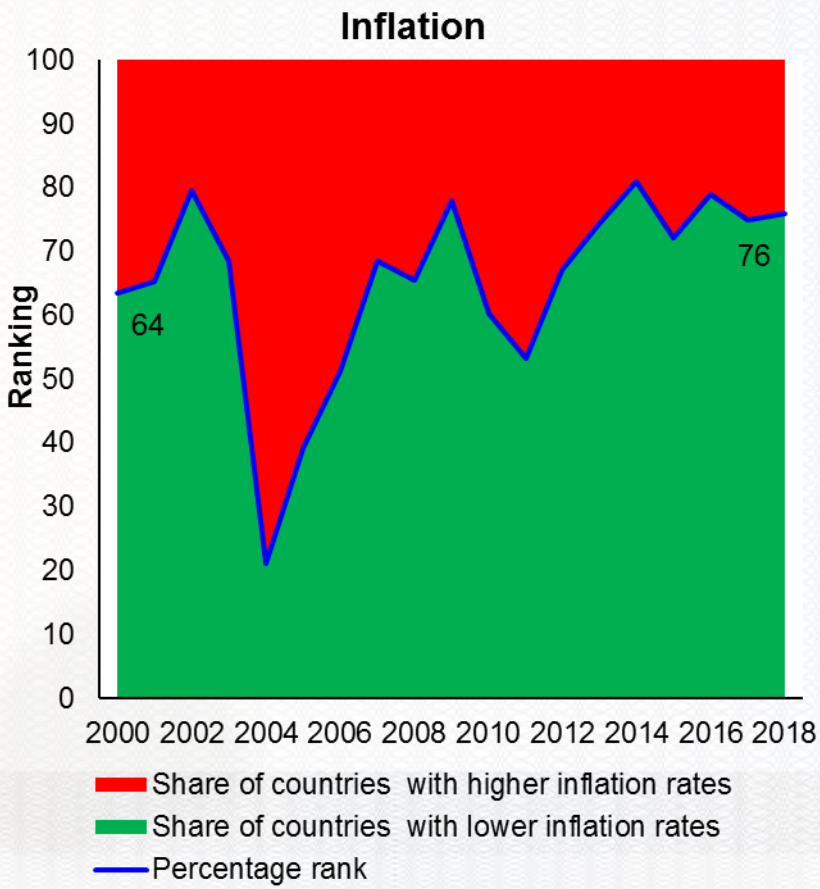
Domestic growth still too low

- Domestic GDP expanded by a moderate 1.3% in 2017 following a post-crisis low of 0.6% in 2016, largely due to a rebound in agriculture and mining.
- Improving terms of trade and more robust growth of our trading partners reduced the current account deficit to 2.5% of GDP in 2017.
- Domestic consumer price inflation decelerated rapidly throughout 2017, with notable declines in food and electricity prices.
- 2018 began with positive news of improving investor and consumer confidence as well as a stronger currency
- However, this did not translate into strong macroeconomic outcomes.

South Africa's growth and inflation ranked against the rest of the world



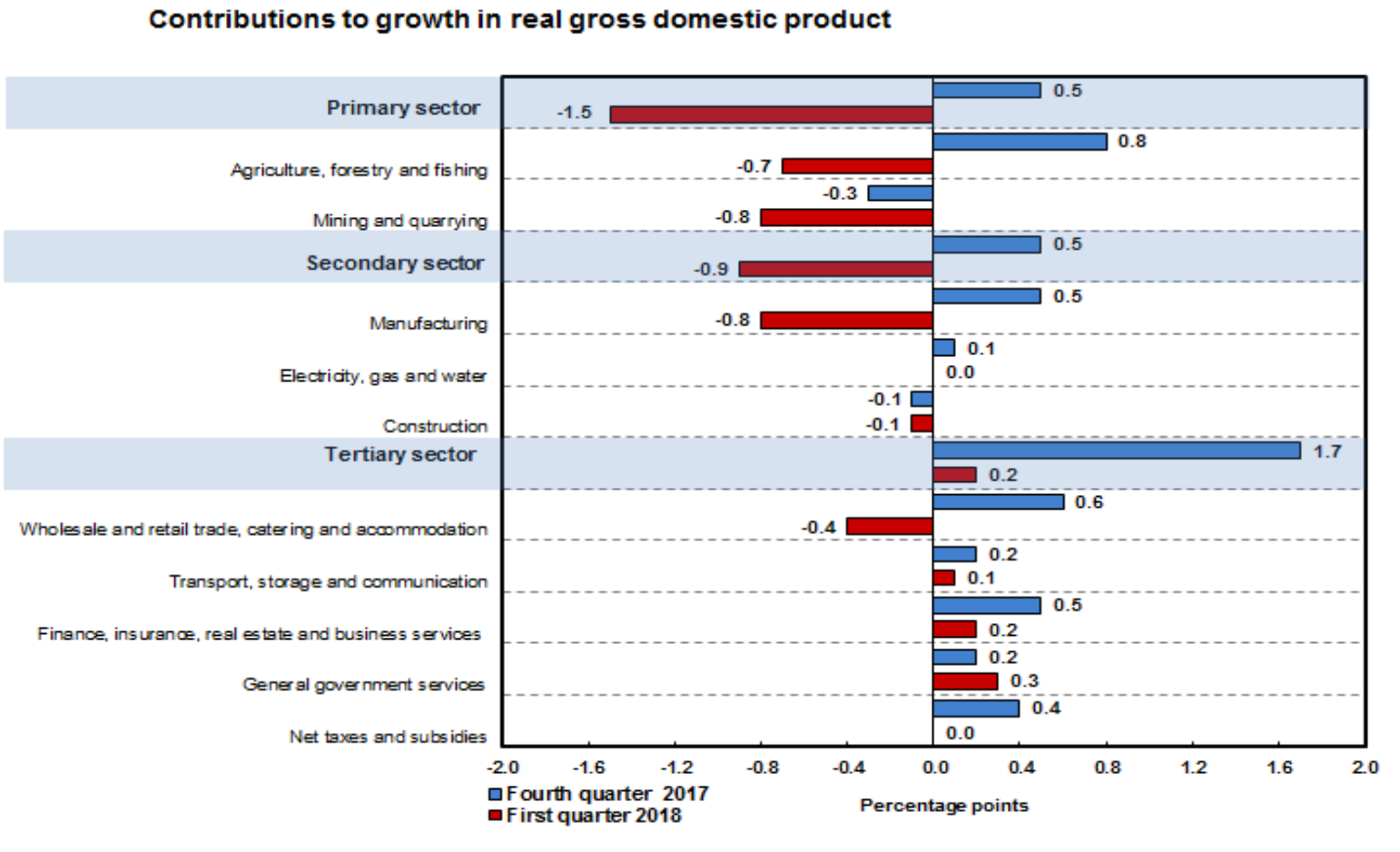
Sources: IMF and own calculations



Sources: IMF and own calculations

Given the sharp contraction in economic activity at the start of 2018, is the economic recovery still on tract…. ?

The 2.2% contraction in 2018 Q1 was the largest since the global financial crisis. Mining, manufacturing and agricultural sectors contracted the most

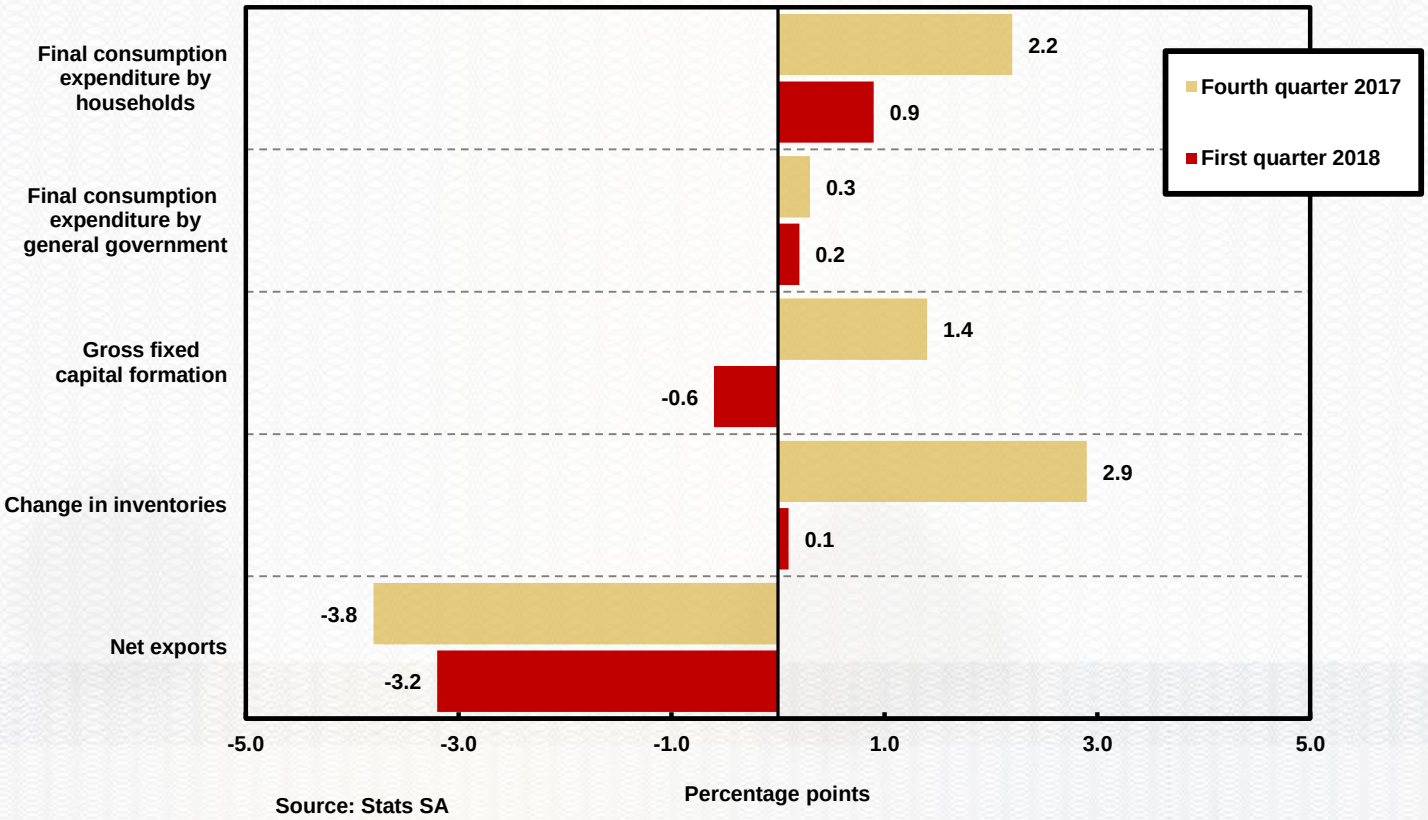


Source: Stats SA

South African Reserve Bank

The marked slowdown in growth in real Gross Domestic Expenditure in Q1 2018 was broad-based among the various expenditure components

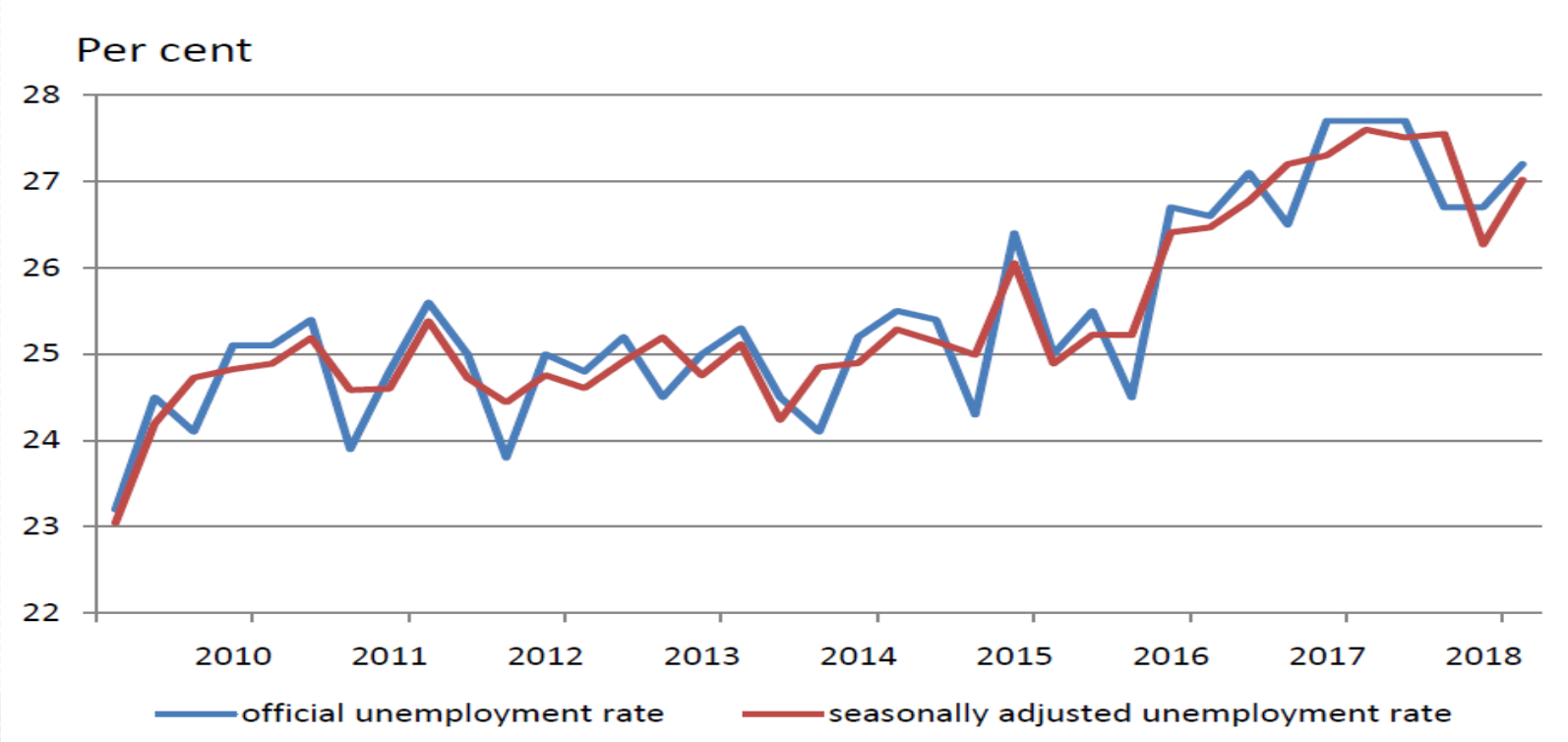
Contributions of expenditure components to growth in real gross domestic product



Source: Stats SA

South African Reserve Bank

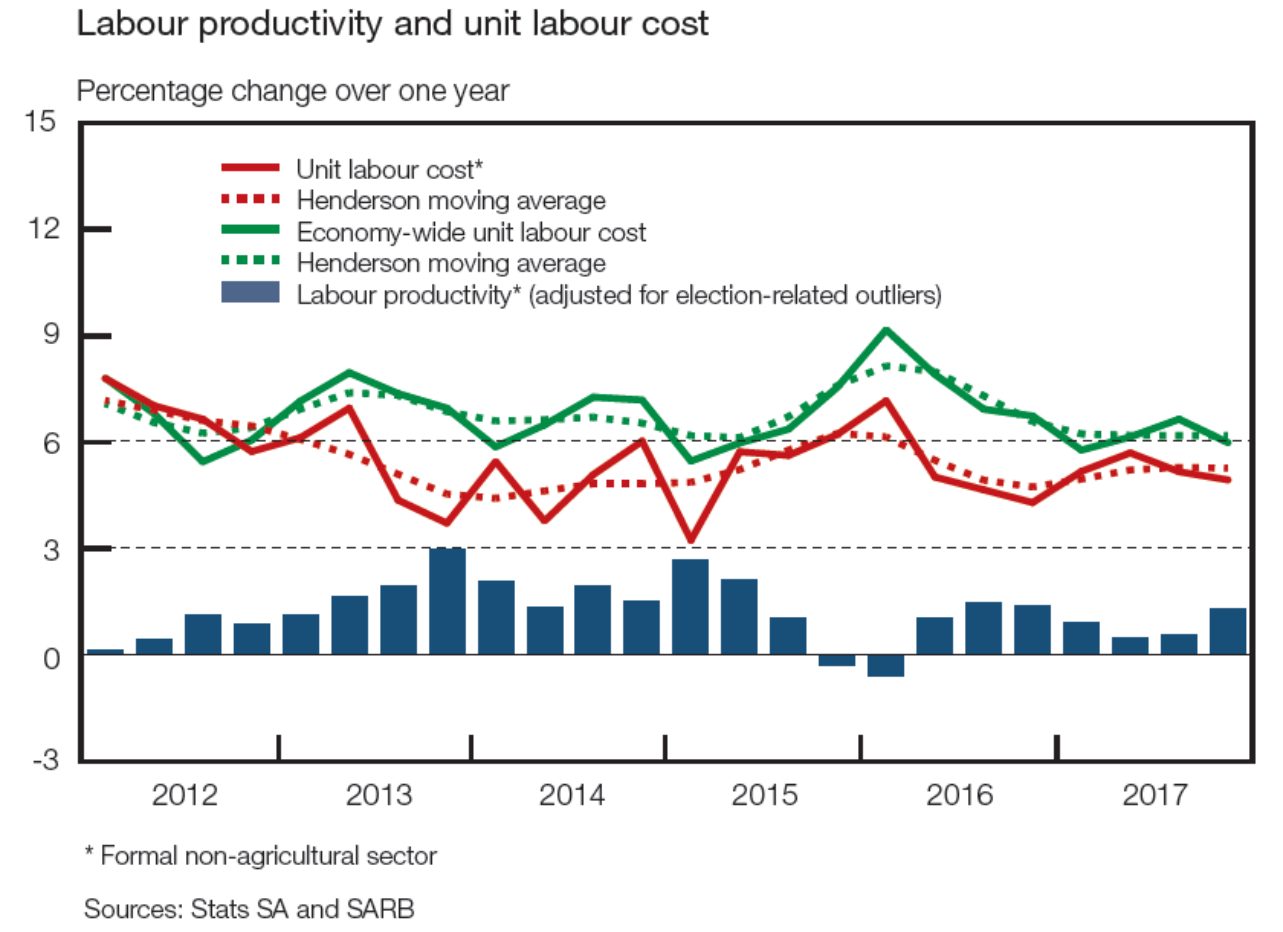
South Africa's official unemployment rate was 27.2% in Q2 2018, somewhat lower the 27.7% in the same period in the previous year



Source: Stats SA

South African Reserve Bank

Growth in nominal unit labour costs continue to outpace formal non-agricultural *labour productivity* growth

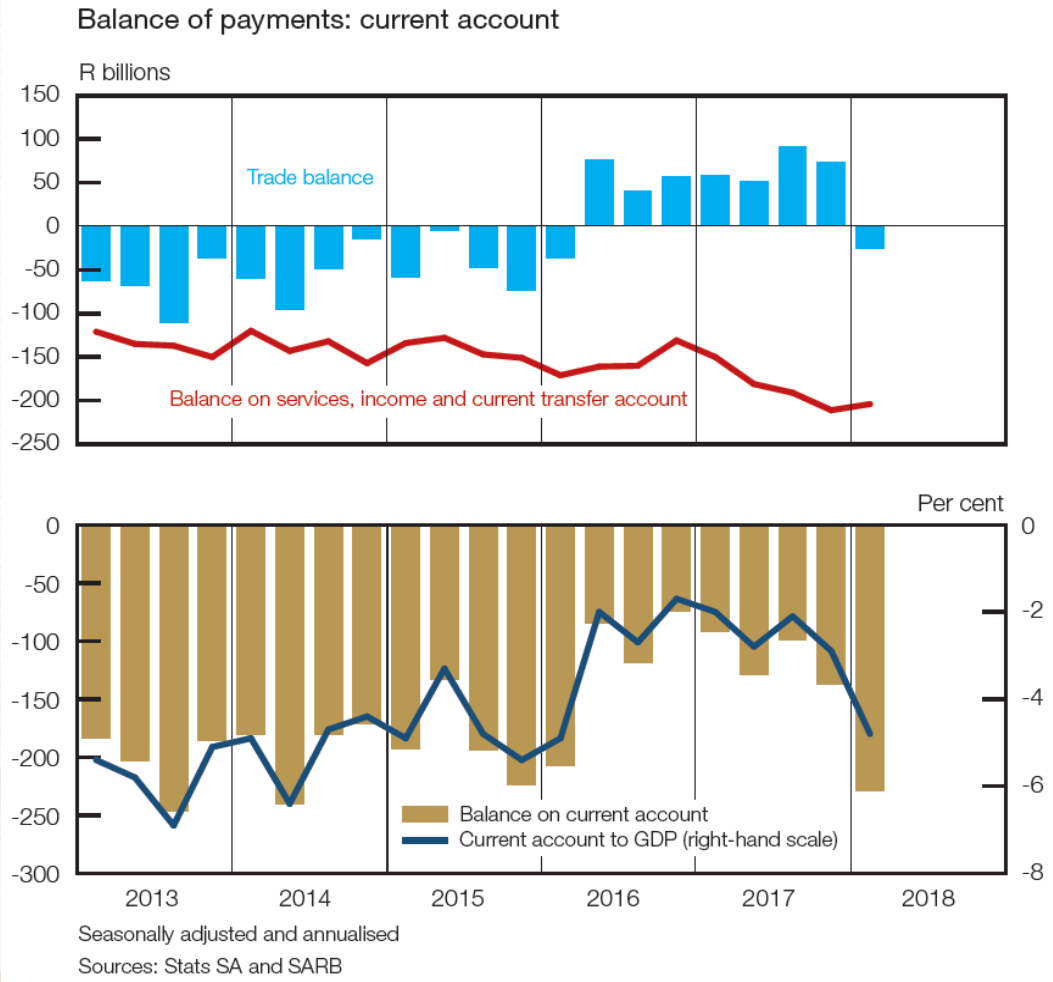


South African Reserve Bank

Slow recovery in household consumption but pressure from taxes and fuel price increases in 2018

	2016	2017	Q1 2018
Real household consumption	0.7%	2.2%	1.5%
Credit extension to HH (Before seasonal adjustment)	0.7%	3.8%	1.4%*
Real disposable income	1.9%	2.8%	0.2%
Household debt to disposable income	74.1%	72.0%	71.7%
*** Not annualised**			

South Africa's *trade balance* switched from a surplus of R74 billion in Q4 2017 to a deficit of R25 billion in Q1 2018, resulting in a significant widening of the deficit on the *current account* from 2.9% of GDP to 4.8% of GDP over the period



South African Reserve Bank

The net inflow of capital on the financial account of the balance of payments increased from R50.3 billion in Q4 2017 to R53.2 billion in Q1 2018

Net financial transactions

R billions

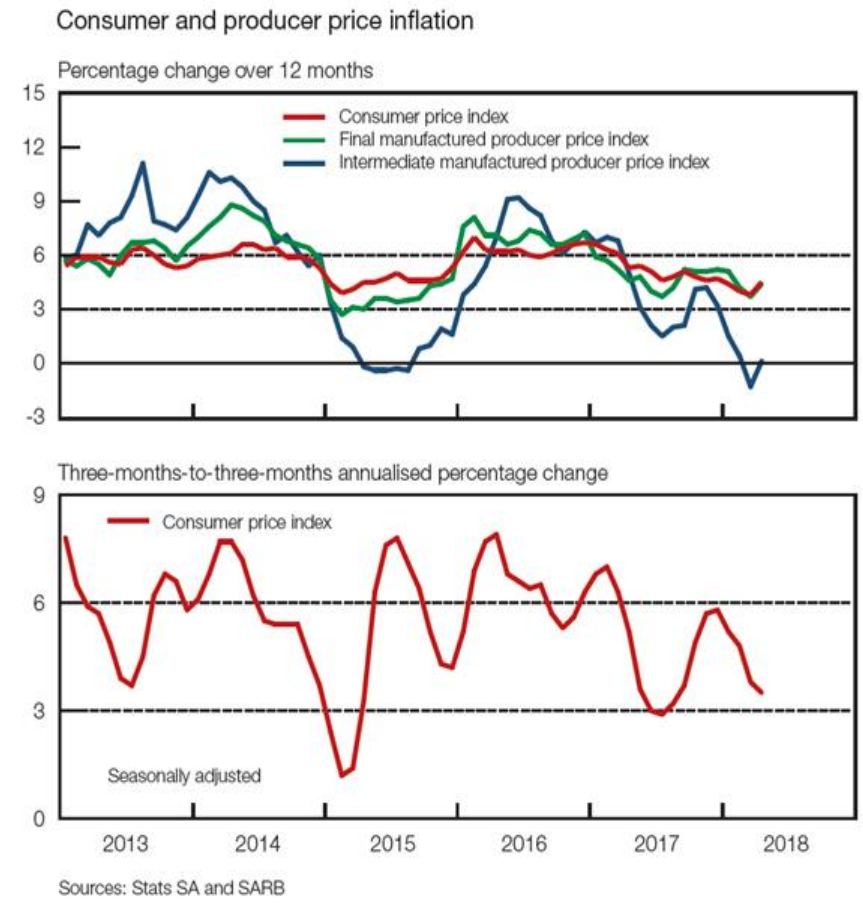
	2017					2018
	Q1	Q2	Q3	Q4	Year	Q1
Change in liabilities						
Direct investment	9.1	5.9	16.2	-13.5	17.7	10.5
Portfolio investment	25.9	74.7	83.9	94.3	278.8	89.4
Financial derivatives	-90.9	-59.6	-37.8	-39.1	-227.4	-59.5
Other investment	44.8	-28.4	49.8	-5.6	60.6	2.4
Change in assets						
Direct investment	-11.2	-31.7	-58.4	3.2	-98.1	-20.5
Portfolio investment	-19.2	-8.0	-16.8	-14.5	-58.5	-15.6
Financial derivatives	90.6	58.4	33.3	40.9	223.2	53.0
Other investment	-35.4	-0.4	-33.3	-0.5	-69.6	-21.1
Reserve assets	14.2	-1.1	-23.7	-14.9	-25.5	14.6
Total identified financial transactions*	27.9	9.7	13.1	50.3	101.1	53.2
As a percentage of gross domestic product	*2.5*	*0.8*	*1.1*	*4.2*	*2.2*	*4.5*

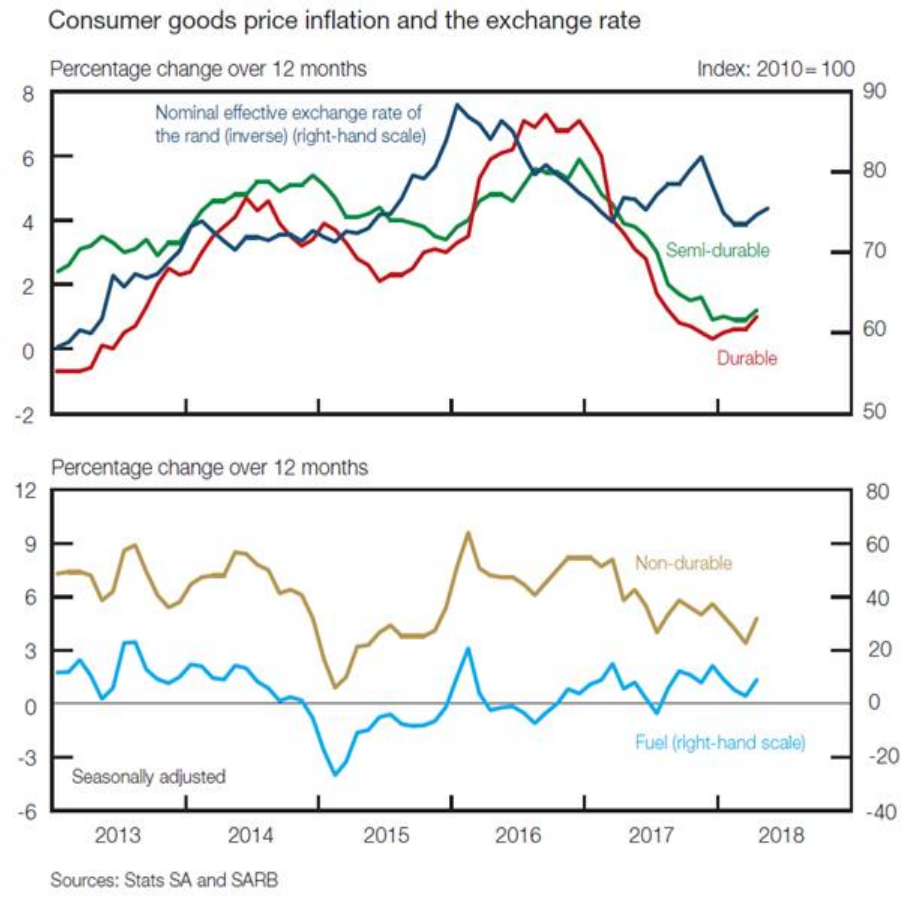
* Excluding unrecorded transactions
Inflow (+) outflow (-)

Source: SARB

Inflation outcomes surprise on the downside in the first half of 2018…

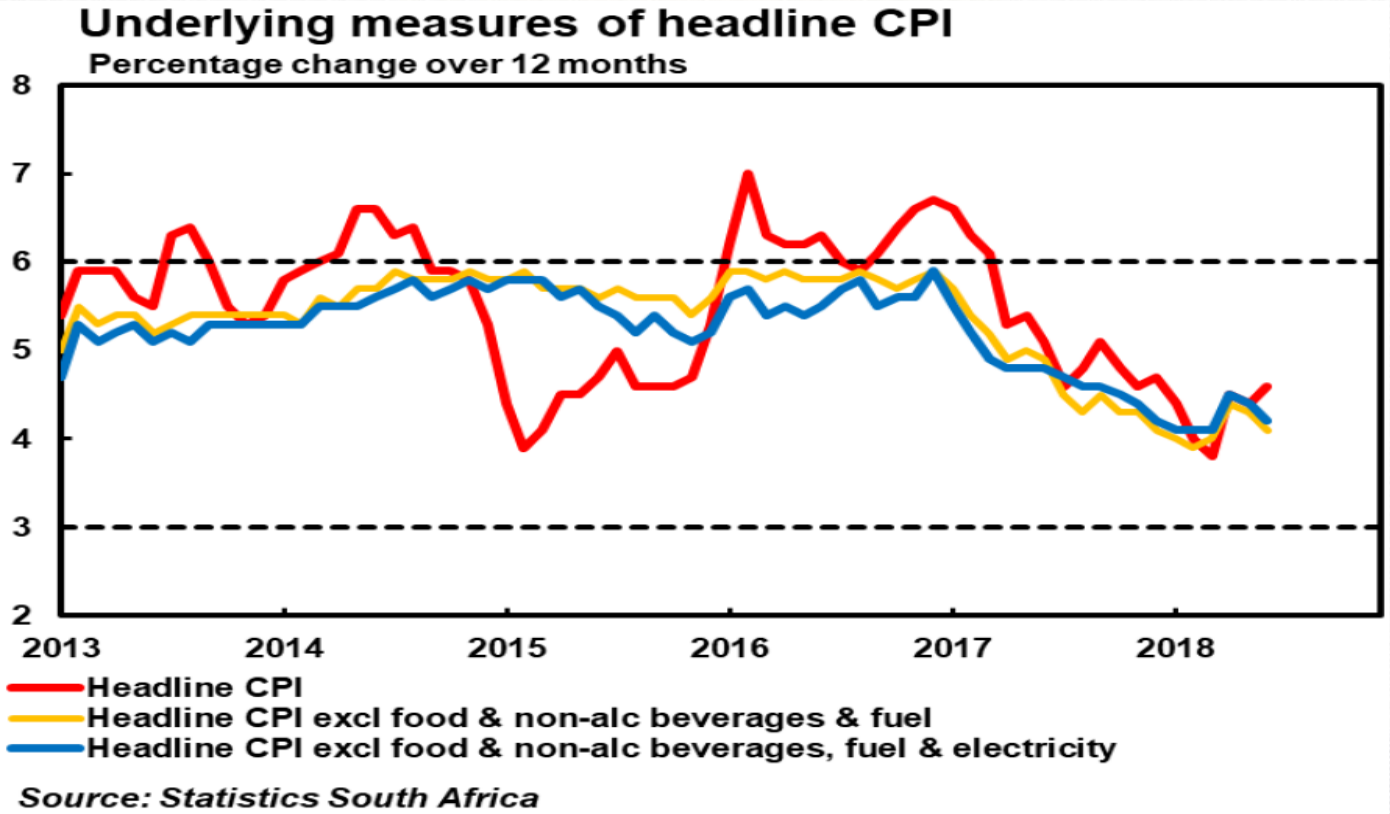
Domestic consumer price inflation slowed further in the first quarter of 2018 to a low of 3.8% in March, before accelerating to 4.6% in June





South African Reserve Bank

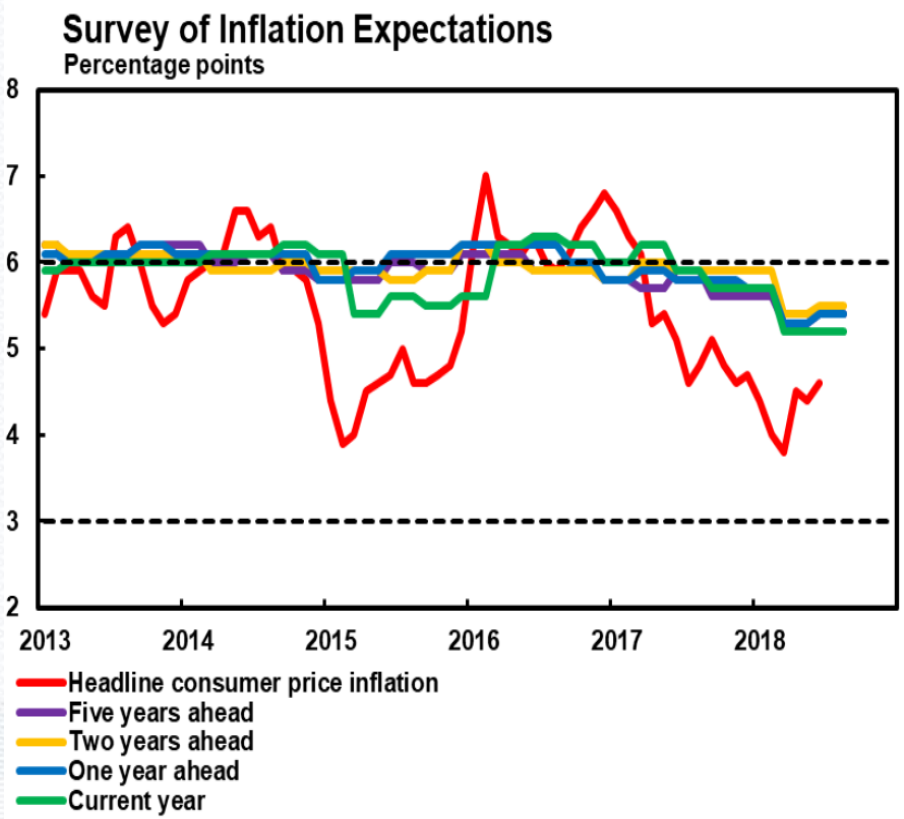
Core inflation slowed to 4.1% in March 2018 – its lowest rate in six years – before accelerating to 4.5% in April following the VAT increase, subsequently decelerating to 4.2% in June



- Early indications from monthly data is that VAT not fully passed through

South African Reserve Bank

Average headline inflation expectations moderating



Source: Bureau for Economic Research, Stellenbosch University

Headline consumer price inflation expectations

(Per cent, as surveyed in the second quarter of 2018)

Average inflation expected for:	Financial analysts	Business representatives	Trade union representatives	All surveyed participants
2018	4.9	5.5	5.4	5.2
2019	5.1	5.6	5.5	5.4
2020	5.1	5.7	5.7	5.5
The next five years	5.1	5.7	5.3	5.4

Source: Bureau for Economic Research, Stellenbosch University

Inflation and growth projections

Summary tables of the QPM projections									
Percentage change	Actual						Forecast		
(unless otherwise indicated)	2012	2013	2014	2015	2016	2017	2018	2019	2020
1. Targeted inflation	5.6%	5.7%	6.1%	4.6%	6.3%	5.3%	***4.8%***	***5.6%***	***5.4%***
2. Underlying inflation	4.6%	5.2%	5.6%	5.5%	5.6%	4.7%	***4.6%***	***5.5%***	***5.3%***
3. Gross domestic product	2.2%	2.5%	1.8%	1.3%	0.6%	1.3%	***1.2%***	***1.9%***	***2.0%***

Projections as at July 2018 MPC meeting

In summary

- The South African economy remains vulnerable
  - The recovery in economic activity is expected to be weak and choppy, especially as consumer demand (a historical driver of upswings) slowed anew in Q2 2018.
  - Fixed investment is also not expected to pick up meaningfully in 2018...
  - Weak demand should prevent an acceleration in consumer and capital goods imports, which is expected to contain the current account deficit during the remainder of 2018
- GDP growth is expected to be modest in 2018 and should be much lower than initial expectations.
  - The projected average growth rates of 1.2% for 2018, 1.9% in 2019 and 2% in 2020

In summary (2)

- While inflation remains within the inflation target band, risks are on the upside
- The main risks to inflation include:
  - The weakening exchange rate
  - Rising oil prices and increasing electricity prices
  - Remuneration increases in excess of inflation and productivity
- Anchoring inflation expectations at the mid-point of the inflation target range will ensure that inflation remains firmly within the inflation targeting range, thus limiting the need for MPC action.

HIGHLIGHTS FROM THE ANNUAL REPORT

About the SARB Annual Report 2017/18

- The Annual Report provides readers with
  - a holistic account of the SARB's strategy
  - performance and
  - impact on society
- It contains financial and non-financial information that is material to the SARB's ability to sustainably implement its mandate

Strategic Plan to deliver the SARB's mandate

- Five strategic focus areas
- Together with supporting strategic objectives
- Cross-cutting activities
- Organisational capacity and capability objectives

	SFA 1	SFA 2	SFA 3	SFA 4	SFA 5
Value proposition	**Maintain headline inflation within the target range**	**Protect and enhance financial stability to achieve a safer financial system**	**Promote and enhance the safety, soundness, and integrity of regulated financial institutions**	**Enhance the South African economy's resilience to external shocks**	**Ensure cost effective availability and integrity of notes and coin**
Unique to SFA	Maximise monetary policy effectiveness Anchor inflation expectations	Enhance the crisis management and resolution framework Develop frameworks for systemic risk identification, monitoring, and mitigation through policy action	Improve and enhance the regulatory, supervisory and oversight framework of the NPS Develop, improve, and integrate the supervision of regulated financial institutions	Maintain an optimal level of reserves and enhance their management Establish mechanisms to effectively manage the impact of external shocks	Optimise the notes and coin supply chain Enhance the quality and integrity of notes and coin

Cross-cutting

- **Leverage and maximise the Bank's participation in regional and international forums**
- **Improve targeted internal and external stakeholder communication and engagement**
- **Improve the strategy management process, strategic risk management and alignment with performance management**
- **Improve the enterprise information management and analytics processes**
- **Establish and embed cybersecurity processes**

Building blocks

- **Provide fit for purpose technology solutions to enable our strategic processes**
- **Attract, develop and retain critical skills and competencies to drive our strategic processes**
- **Improve our organisational effectiveness by reducing bureaucracy, silos and becoming more flexible and agile**
- **Embed a culture of performance and innovation led by a team driven by our values**

Financial highlights

Group results

- **Profit after taxation**

  Profit attributable to the parent of R2 164 million is R962 million higher than the previous year of R1 202 million.

- Increase in profits attributed to improved profitability at African Bank (R981m increase) and the SA Mint due to increased Kruger Rand sales (R122m increase), offset by reduced profitability at the SABN (R117m reduction).

Profit breakdown	Group (R'm)	
	2018	**2017**
CPD	91	74
SA Mint (attributable to parent)	421	299
SABN	-13	130
Subsidiaries' profit contribution	**499**	**503**
Share of profit/(loss) attributable to associate	424	-556
Less intercompany dividends	-150	-150
SARB's net profit after taxation	1 391	1 405
Total Group profit attributable to the parent	**2 164**	**1 202**

ABHL impact

- Dividend of R0.2million paid to shareholders as required by the SARB Act.
- Transfer of R1.4 billion to the SARB Contingency Reserve.

South African Reserve Bank

Human resources highlights

- Conducted two employee surveys to gain insight on how the SARB can improve the employee experience
- Total SARB staff composition is 72% black and 28% white. Top management is 50% black and 50% white.
- Spent R35 million on training and development, reaching 80% of the workforce
- The coverage ratio of critical roles improved to 80%
  - (2016/17: 68%)
- Regrettable turnover ratio improved to 1.17%
  - (2016/17: 1.46%)

Social initiatives

- Granted external bursaries to tertiary students in the amount of R5.9 million
  - (2016/17: R4.2 million)
  - Of the 58 students granted bursaries, 49 are black (African, Coloured and Indian) and 33 are women.
- Extended the MPC Schools Challenge to seven provinces, with schools in the Eastern Cape, North West and Northern Cape provinces participating for the first time. The challenge will be extended to KwaZulu-Natal and the Western Cape provinces during the 2018/19 financial year.

Fintech & SARB Initiatives

- **December 2016** - Established together with National Treasury an Intergovernmental Fintech Working Group (IFWG). Comprises NT, FSCA, FIC, SARB & Competition Commission

- **August 2017** - Established a dedicated SARB Fintech unit since August 2017

- **During 2017/8** - Active participants on FSB Fintech Innovation Network and BIS CPMI Digital Innovation Working Group. Contribution to papers on fintech for e.g.
  - *Impact of fintech on financial stability;*
  - *Distributed ledger technology in payment, clearing and settlement;*
  - *Central bank issued digital currencies;*
  - *Risks related to crypto-assets and;*
  - *Financial stability considerations of initial coin offerings and digital token sales.*

1. Successfully co-hosted IFWG Outreach (April 2018)

Workshopped 3 topics with Fintech community:

(i) private crypto-assets & ICOs;

(ii) financial deepening &;

(iii) Innovation hubs & sandboxes.

Detailed report:

http://www.resbank.co.za/Lists/News%20and%20Publications/Attachments/8641/IFWG%20Reportsml%205%20July%202018.pdf

2. Proactive effort to distil DLT potential (Project Khokha)

(June 2018)

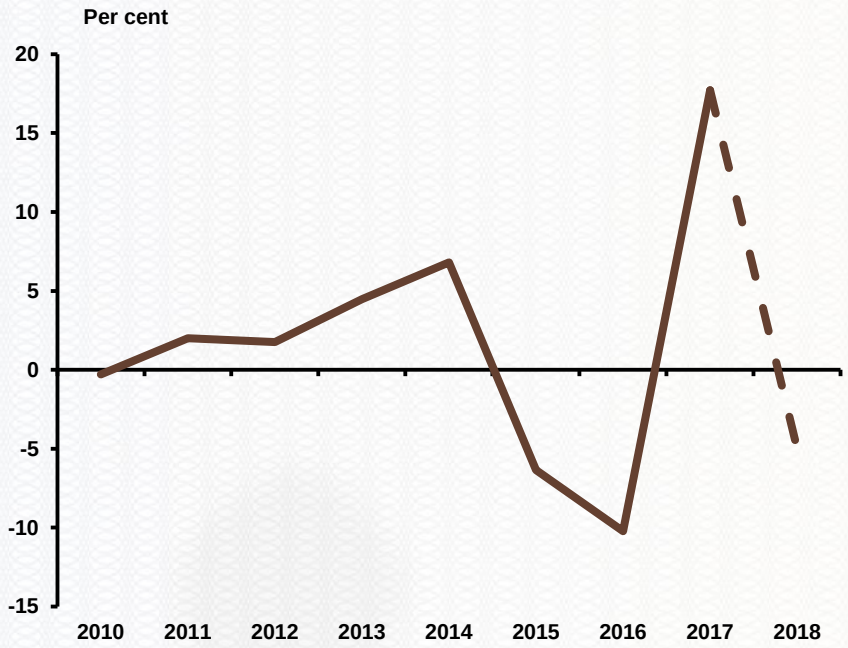
Detailed report:

http://www.resbank.co.za/publications/detail-item-view/pages/publications.aspx?sarbweb=3b6aa07d-92ab-441f-b7bf-bb7dfb1bedb4&sarblist=21b5222e-7125-4e55-bb65-56fd3333371e&sarbitem=8491

Questions and answers

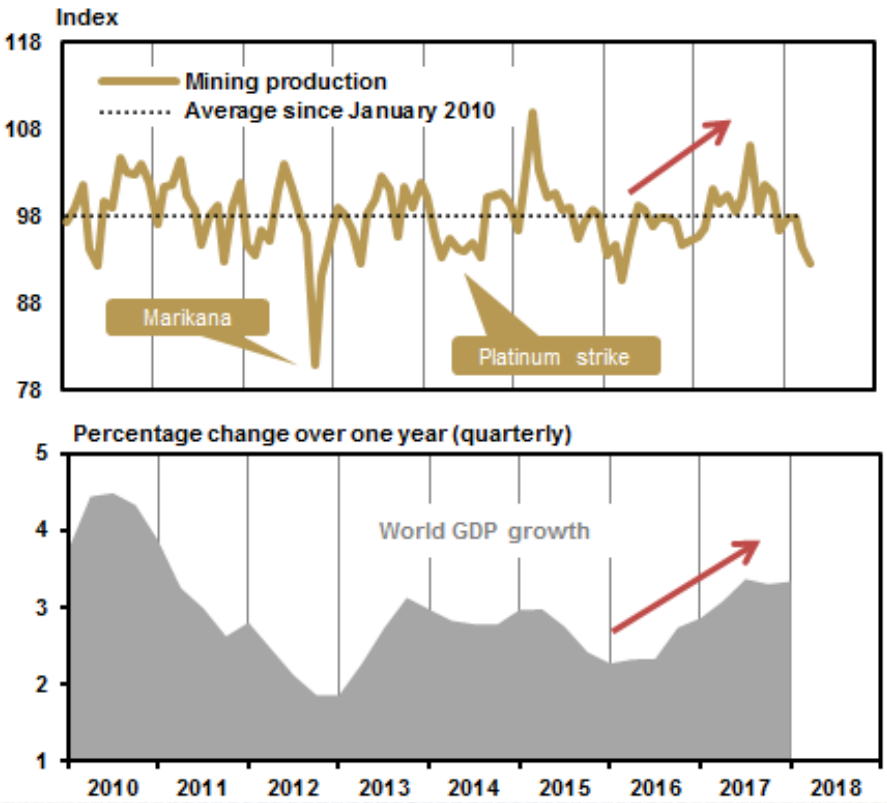
The primary sector is not expected to contribute meaningfully to GDP growth in 2018

Annual percentage change in gross value added by the agricultural sector



Source: Stats SA

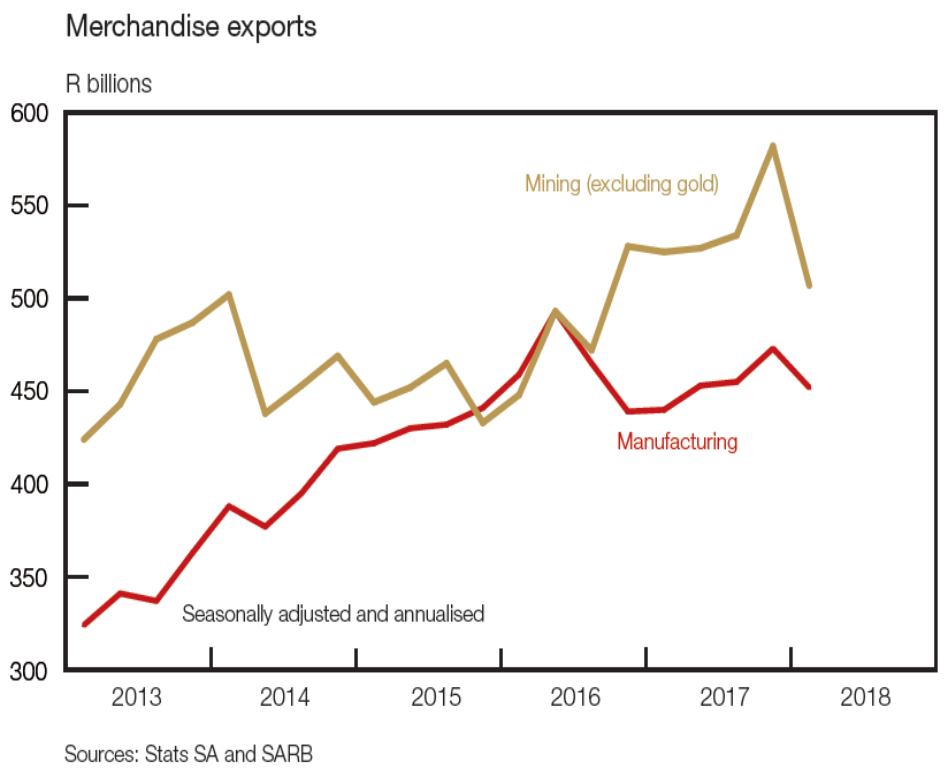
Mining production and world GDP growth

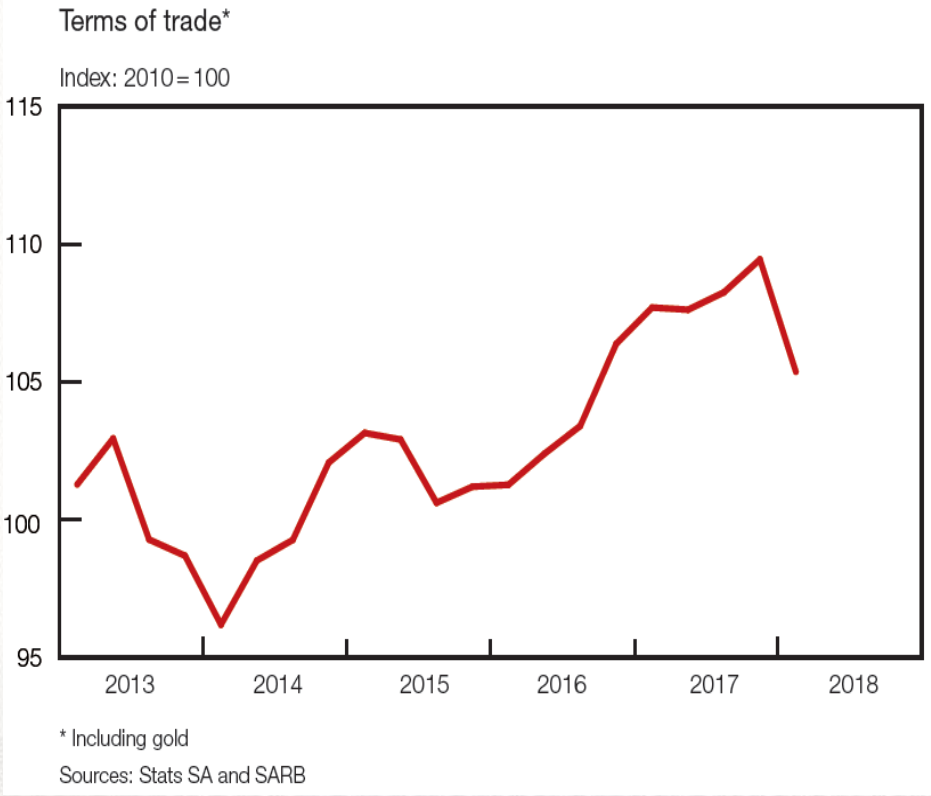


Source: World Bank, Stats SA and SARB

South African Reserve Bank

The value of *mining* exports in particular decreased strongly in Q1 2018, weighed down by the sharp decline in the rand price of mining commodities, which contributed to a significant deterioration in the *terms of trade*





South African Reserve Bank

External debt developments…