Statement on relaxation of liquid asset requirements for banking institutions

Issued by Dr. Gerhard de Kock, Governor of the South African Reserve Bank

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In its Second Interim Report on *The Building Societies, the Financial Markets and Monetary Policy*, the Commission of Inquiry into the Monetary System and Monetary Policy in South Africa made the following recommendations regarding minimum cash reserve and liquid asset requirements for banking institutions:

- That the minimum *basic* liquid asset ratios be reduced gradually from the present 30, 20 and 5 per cent of short, medium and long-term liabilities to the public, respectively, to 20, 15 and 5 per cent, respectively;
- that all *supplementary* liquid asset requirements be phased out;
- that the minimum *basic* cash reserve balance with the Reserve Bank be set at 8 per cent of short-term and 4 per cent of medium-term liabilities;
- that the Reserve Bank be given the right to call for *supplementary* cash reserve balances against both short and medium-term liabilities; and
- that the Reserve Bank be authorised to pay interest on reserve balances.

It was also pointed out that these recommendations would form only part of the Commission's proposals in respect of banks in its forthcoming Final Report and should therefore not be viewed in isolation.

In accordance with these recommendations, it has now been decided, as a first step, to reduce the liquid asset requirements for banking institutions with immediate effect as follows:

In the case of the nine largest banks, the required liquid asset holdings will be reduced from 54 to 48 per cent of short-term liabilities to the public and from 34 to 28 per cent of medium-term liabilities. For all other banking institutions the liquid asset requirements will be reduced from 50 to 48 per cent in the case of short-term liabilities to the public and from 30 to 28 per cent in the case of medium-term liabilities. These changes will have the effect of removing the remaining discrimination between "large" and "small" banks in respect of their legal financial requirements.

Based on the figures for the end of May 1983, these changes should reduce the total required liquid assets of banking institutions by about R1 000 million.

The reduction of the banks' liquid asset requirements is *not* intended as a relaxation of monetary policy with a view to stimulating total spending. It should instead be viewed as a logical consequence of the present process of transition from a liquid asset to a cash reserve system of credit control. Under the new system now taking shape, the monetary authorities will influence the ability of the banks to create money mainly by such market-oriented policies as public debt management, open-market operations and rediscount policy, and not by operating on the banks' liquid asset holdings as in former years. By itself, the present reduction in the liquid asset requirements should therefore not materially influence the credit-creating ability of the banking system.

Clearly, however, the *timing* of the new move has been influenced by the recent tightening of money market conditions and the resultant upward pressure on interest rates, as well as by the expected new seasonal tightening towards the end of August. Under these circumstances, the reduction of the liquid asset requirements from their present abnormally high levels should serve to ease the situation and to reduce the upward pressure on interest rates in two main ways: Firstly, it should reduce the *effective* cost of funds to the banks. And, secondly, it should free around R1 000 million of liquid assets for use by the banks to meet severe seasonal pressure on their cash resources. In this way it should assist both the banks and the monetary authorities in dealing with possible sharp and disruptive seasonal fluctuations in money market conditions in the weeks ahead. The precise effect it will have on interest rates will, of course, depend in large measure on the extent and the cost of accommodation granted by the Reserve Bank to the market.

It must be emphasised that it remains the policy of the monetary authorities to reduce the rate of increase of the money supply and to accept such interest rate changes as may be necessary to make this policy effective – all as an essential part of the official strategy against inflation.