Statement on cash reserve requirements for banking institutions

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Earlier this year, the Reserve Bank introduced a number of changes affecting the minimum cash reserve and liquid asset requirements for banking institutions, and also the arrangements for the provision of accommodation by the Reserve Bank to banking institutions at the discount window. These included:

- a new simplified basis for the calculation of the banks' minimum cash reserve and liquid asset requirements. The new basis includes all the liabilities of the banks without making any distinction between short, medium and long-term liabilities. Banks are, however, allowed to deduct from total liabilities their issued share capital and accumulated reserves;

- a new narrower definition of liquid assets which excludes bankers' acceptances, promissory notes and negotiable loan levy certificates.

- In the light of these changes, new lower levels were set for the minimum cash reserve and liquid asset requirements, as follows:

- In respect of the cash reserve requirement, the minimum was reduced in April 1993 from 4 to 3 per cent against the banks' short-term liabilities, and a gradual phasing-in programme was agreed to which would, over a period of fifteen months, further reduce the basic requirement to 1,5 per cent of short-term liabilities, and raise the requirement against all other liabilities from zero to 1,5 per cent. The existing supplementary minimum cash reserve requirement of 1 per cent of short-term liabilities, on which a market-related interest is paid by the Reserve Bank, was retained for all banks.

- In respect of liquid assets, a minimum requirement of 5 per cent against banks' total liabilities, as reduced, was introduced with effect from April 1993.

At the same time, the Reserve Bank changed the method of providing accommodation at the discount window from rediscounting acceptable money market paper to extending overnight loans against the collateral of acceptable paper. In this regard, the Bank announced that it would in future provide accommodation only on the following basis:

- Overnight loans would be extended at Bank rate against the collateral of Treasury bills, government stock, Reserve Bank bills and Land Bank bills — all with an outstanding maturity of less than 92 days.

- Overnight loans would be extended at Bank rate plus one per cent against the collateral of Treasury bills, government stock, Reserve Bank bills and Land Bank bills — all with an outstanding maturity of 92 days and longer, but shorter than three years.

- Accommodation against collateral of other forms of security, such as bank-endorsed bills and long-term government stock, would be made available in exceptional circumstances only, at a discretionary or negotiated rate and for a limited period.

Finally, with the co-operation of the Department of Finance, arrangements were made for the transfer of at least part of government deposits from the Exchequer account with the Reserve Bank to government deposit accounts with private banking institutions. In this way, large temporary shifts of money market funds from the market to the Reserve Bank and vice versa can be avoided, thus reducing the need for banks to borrow large amounts of funds from the Reserve Bank for relatively short periods of time to neutralise the disrupting effect of such shifts on market liquidity.

The present position is therefore as follows:

- As from 20 August 1993, the minimum cash reserve requirement against the short-term liabilities of all banking institutions will have been reduced, in terms of the announced programme set out above, to 2,5 per cent, and the requirement against other liabilities will then reach 0,5 per cent.

- As at the end of July 1993, a total amount of R6 billion had been transferred from the Exchequer account with the Reserve Bank to the newly opened government deposit accounts with private banking institutions.

- The new method of accommodation at the discount window has also been implemented since 1 May 1993.

These new arrangements are intended to improve the efficacy of monetary policy in the longer run, and are also in line with the approach of greater emphasis on risk management in the implementation of prudential financial requirements for banking institutions. As part of this approach, the regulatory authorities are now engaged in a special study of risk exposures involved in securities trading in the South African financial markets. There is some concern about the inequities that, under the present arrangements, arise from prescribed financial requirements for these types of transactions when executed by registered

banking institutions, and when executed by other non-bank securities dealers in the market place, respectively. To ensure fair and equal competition among all participants in this market, a more general risk-based capital requirement may have to be introduced for all securities dealers, including the managers of funds.

The Reserve Bank is furthermore of the opinion that, from a monetary policy point of view, some further easing in the cash reserve requirements for banking institutions can be justified at this stage. The new accommodation procedures placed an effective upper limit on the total amount of accommodation that banking institutions can readily obtain at the discount window. Although the recent transfer of government deposits from the Reserve Bank to the banking sector served to reduce the money market shortage, banks still borrowed on average R2,8 billion per day from the Reserve Bank last month. On 30 July 1993, the money market shortage actually amounted to R4,7 billion, forcing the banks to borrow from the Reserve Bank in the second tier of accommodation facilities at a rate of one per cent above Bank rate.

Most of the financial statistics that have become available during the past several weeks have indicated a need for some easing in the overall monetary policy stance, with the exception of the gold and foreign exchange reserves which have remained under pressure. There are, however, also encouraging prospects for some improvement in the foreign reserves position in the near future. Against this background, a premature reduction of Bank rate could be risky, but some easing of the cash reserve requirements to take account of both the structural problems in securities trading and the need for a mild relaxation of monetary policy can be justified at this stage.

The Reserve Bank has therefore decided to introduce the following adjustments to the minimum cash reserve requirements for all banking institutions, to become effective from the reporting date as determined in terms of the Banks Act in respect of the month ending 31 August 1993:

1. Banks will be allowed, as an interim measure and pending the introduction of more uniform financial prudential requirements for all securities dealers, to deduct from their total liabilities not only their capital and reserves, but also inter-bank liabilities and those repurchase agreements that are mainly used for the funding of securities trading, before calculating their minimum cash reserve requirements. (Please note: This concession does not affect the formula for the calculation of the minimum liquid asset requirements.)

2. The minimum cash reserve to be held against the short-term liabilities as reduced, which will shortly amount to 2,5 per cent, will be fixed at 1,5 per cent for the reporting month of August 1993, and will be further reduced by 0,1 per cent for each subsequent month until the level of 1 per cent is reached for the reporting month of January 1994.

3. The minimum cash reserve to be held against the other liabilities of each banking institution, which will shortly amount to 0,5 per cent, will be increased by 0,1 per cent per month until the level of 1 per cent will be reached for the reporting month of January 1994.

4. The supplementary cash reserve balance with the Reserve Bank of 1 per cent of short-term liabilities, on which interest is paid, will be retained for the time being.

This further reduction in the overall cash reserve requirement for the banks will release an amount of approximately R1 billion of their cash reserves immediately, and also means that the ultimate target for the reserve requirement, which will now be reached in February 1994, has been set at a lower level of 1 per cent, instead of at the previous level of 1,5 per cent.

It is also reconfirmed, once again, that the Reserve Bank regards the variable cash reserve requirement as a useful instrument for monetary policy purposes. A new basis of financial prudential controls for securities trading will therefore have to be found that will in future not impinge on the ability of the monetary authorities to change the minimum cash reserve requirement for banks in the light of changing monetary policy objectives.

The required notices to give effect to these changes will be published in the Government Gazette shortly.