South African Reserve Bank

Address by Governor Gill Marcus
to the
Ordinary General Meeting of Shareholders
of the South African Reserve Bank
8 December 2010

Dear Shareholders,
Members of the Board,
Deputy Governors,
Ladies and Gentlemen,

Today is an opportunity for us, together, to consider a very serious overview of where the Bank stands in terms of its internal organisation, its relationship with shareholders, and its role in the South African economy as we move into what will undoubtedly be a very challenging 2011 for the world and South Africa.

In the proceedings so far today we have endeavoured to address the questions you have asked as they relate to the work of the Bank and arising from the *Annual Report* and Financial Statements. While there are still a number of matters that will be addressed towards the end of the agenda, we trust that the open interaction marks a new beginning in the relationship with Bank shareholders who, in our view, have a vital role to play in ensuring independence, good governance and accountability.

I wish to assure everyone here today of two things:

- firstly, that this meeting is compliant and in line with the regulations governing Ordinary General Meetings of the Bank, as elaborated upon earlier, and

- the Board, Executive and staff of the Bank will continue to act in the best interests of South Africa without fear or favour, and do so professionally, upholding the highest standards of governance and ethics.

We are very grateful and express our appreciation to a number of people and institutions for the professional and highly committed manner in which the amendments to the SARB Act, which led to the postponement of this year's OGM, were drafted, taken through an elaborate process of open and thorough consultation, and enacted into law. Allow me specifically to mention in this connection the Minister of Finance, Pravin Gordhan, the National Treasury led by Lesetja Kganyago, and Parliament, the chairperson of the standing committee on finance, Thaba Mufamadi and the chairperson of the select committee of finance in the NCOP, Charel de Beer, and their members."

By passing these amendments, Parliament – as the democratically elected representative of the people of South Africa – has made it unequivocally clear that it regards the South African Reserve Bank as a national asset with an indispensable role in serving the economy and the people of our country. In so doing, Parliament has underlined that the Reserve Bank is and must remain independent, and able to work in the interests of South Africa and of all South Africans.

These are very significant signals to all who believe that the long term stability of our economy is central to what we must achieve to ensure that South Africa continues to develop, thereby offering steadily increasing numbers of our people the realistic prospects of a better life. This reconfirms that a better life for ever- increasing numbers of South Africans in a prosperous and stable country is a goal worth pursuing each and every day.

To those of us who pursue that goal via an association with the South African Reserve Bank – whether as serious minded shareholders, members of the Board, or employees of the Bank – Parliament's faith in the SARB as signalled by the amendments to the Act also represent a very grave responsibility.

Ladies and Gentlemen,

We at the Bank intend to continue to take that responsibility very seriously. In everything we do. Not least because of our understanding of the significant ongoing challenges facing the global economy, and with it the challenges facing the South African economy as we move into 2011.

We as South Africans have not been and are still not immune to those challenges and to the international situation because we are not an island. We are part of the global economic system and the serious difficulties facing many countries become – in one way or another – our challenges too.

While the annual general meeting would normally be the occasion for a detailed analysis of all of the elements affecting the South African economy, we do not plan to do so today. We felt it more appropriate to use this occasion to lay a firm foundation on which we can build our interaction for the future. It is nevertheless appropriate to look at some of the economic issues which have faced us in the year since President Zuma appointed me to this position, and which are likely to face us in the years ahead.

Analysing the economic environment in which we operate also provides the essential backdrop against which we can look at and more clearly define the role the Bank must play as the international community works to emerge from the greatest economic crisis since the Crash of 1929.

The context in which the Bank had to conduct its operations in the past year remained extremely challenging. During 2009, the world economy began to emerge from the widespread recession that began in the latter part of 2008. After a promising start to the year, the recovery in the advanced economies has become more hesitant, following the withdrawal of the fiscal stimulus in the United States (US), the sovereign debt crisis in the euro area, and widespread fiscal consolidation in the region.

The current uncertainties in Ireland continue to raise questions about the outlook for euro area growth (noting that the region grew by only 0,4 per cent in the third quarter of 2010) and concerns about systemic risk in the banking sector. The international environment therefore remains characterised by heightened risk and uncertainty, and these developments indicate that we have not yet emerged from the crisis.

The economic and political ramifications of fiscal austerity programmes are of particular concern, not only because of their potential to derail the recovery in other regions, but also because of South Africa’s close and significant trading relationship with Europe. It appears that growth in the US is likely to remain low for longer as monetary policy actions attempt to combat the threat of deflation and persistently high unemployment. The global banking system has improved somewhat, but serious risks remain.

By contrast, the emerging market economies, particularly in Asia and Latin America, appear to have recovered from the crisis. In a number of instances the strong growth in demand, coupled with pressures from higher commodity prices, has resulted in a reappearance of inflationary pressures. As a consequence, the monetary policy stance in a number of emerging markets has moved into tightening mode. But it is as yet unclear whether the strong growth in these regions can be sustained against the backdrop of weak growth in the industrialised economies.

Domestically, the recovery has been fragile, with disappointing growth despite the boost from the Fifa World Cup, and growth is expected to average below 3 per cent in 2010. Although household consumption expenditure is showing signs of recovery, growth in private sector gross fixed capital formation remains extremely subdued. During the third quarter of 2010 the mining sector rebounded from its marked second quarter contraction, but both the manufacturing and construction sectors remained under pressure.

Monetary policy remained accommodating during the past financial year against the backdrop of an improved inflation outlook and the relatively weak domestic economy. Headline consumer price inflation returned to within the inflation target range of 3 to 6 per cent in the first quarter of 2010, and declined to 3,2 per cent in September before increasing to 3,4 per cent in October. The Bank's forecast is for inflation to remain within the target range for the remainder of the forecast period until the end of 2012. Since the onset of the crisis, the repurchase (repo) rate has been reduced by 650 basis points. The most recent change was a 50 basis point reduction in November 2010, when the improved inflation environment provided some space for an additional monetary stimulus to the economy without jeopardising the achievement of the inflation target.

The Bank remains committed to pursuing its objective of price stability within a flexible inflation targeting framework in the interest of balanced and sustainable economic growth and employment in South Africa.

The global environment has had a pervasive impact on many of the activities of the Bank, as well as on its strategic direction. The recent crisis has demonstrated the need for central banks to have a clear focus on issues related to financial stability, in addition to a focus on inflation. The Bank has participated in discussions in international forums, and these interactions have highlighted the fact that while the need to have a financial stability focus is agreed upon, the modalities of intervention are not clear-cut. During the year, financial stability also became an explicit focus of the deliberations of the Monetary Policy Committee (MPC). In order to ensure coherence and co-ordination with monetary policy actions, the membership of the Financial Stability Committee was reconstituted and the mandate of the Committee enhanced.

Reforms of the supervisory and regulatory environment of the banking sector have also received increased attention at the global level, and these developments will impact on the domestic banking system. The Bank has participated in the deliberations of the IMF, World Bank, G20 and the Basel Committee on Banking Supervision (Basel Committee), which is drafting amendments to the existing *International Convergence of Capital Measurement and Capital Standards: A Revised Framework* (Basel II), the working groups of the Financial Stability Board at the Bank for International Settlements (BIS), and the regular bimonthly meetings of central bank governors held at the BIS. The South African banking system was one of the few that did not experience a crisis in 2008, mainly due to appropriate regulation, and monitoring and supervision of the sector. South African banks remain well capitalised, and capital adequacy ratios are currently in excess of the minimum proposed in the new reforms. The proposals pertaining to liquidity may be challenging, but are not insurmountable.

The past year has also seen a significant flow of capital to emerging-market economies in the face of persistently low policy interest rates in advanced economies. This trend was reinforced by rising commodity prices and a decline in global risk aversion in general. South Africa was also a beneficiary of these flows, which has resulted in a marked appreciation of the trade-weighted rand exchange rate. The Bank took advantage of these inflows to add to its foreign-exchange reserves which, although at historically high levels, are still relatively low compared with other emerging-market countries. However, the need to sterilise the impact of these purchases of foreign exchange on domestic liquidity resulted in the Bank reporting an after-tax loss of R1,05 billion during the financial year under consideration.

Thus, in essence, we are seeing a fragile global economy that is experiencing significant stresses and strains. Domestically, the economic landscape is one of the lowest real interest rates in 30 years, inflation that looks likely to remain in the target band to the end of the forecast period of 2012, a currency that has continued to appreciate on a trade-weighted basis, the export-led sectors remaining under pressure, slow growth and significant unemployment. Working to ensure a cohesive, co-ordinated macro-economic policy is part of the challenge as we enter the second decade of the 21st century.

Ladies and Gentlemen,

The international and domestic economic climate makes it very clear that the Bank must focus all of its energies and all of its human capacity on the job at hand – making the SARB's unique and indispensable contribution to the management of the economy.

This is a time to focus on ensuring that our internal policies and procedures are in place and functioning in such a way as to provide maximum support and guidance for our day to day operations.

But it is particularly a time to focus on our core business at the heart of the economy. Which is why it is very pleasing indeed to be able to report to you that this has been an intense and demanding year of reviews, of assessments of weaknesses and strengths, and of realignment of our internal policies, procedures, and structures. We have also worked to strengthen the relationship and interaction with the Minister of Finance and the National Treasury.

Allow me to illustrate some of the organisational milestones that the Bank has achieved over the past year.

- We have not only reviewed and updated all board policies, but agreed that this will be an annual exercise to ensure that we remain up to date with best practice and that we constantly evaluate our effectiveness and compliance.

- We are in the process of reviewing the Bank's internal policies, with our human resource policies at the heart of this process.

- We have instituted a new Board Risk and Compliance Committee, specifically tasked with oversight of all aspects of risk and compliance which might affect the Bank.

- Within the Bank we have created a new Risk Management and Compliance Department to mirror this responsibility for managing our risk and ensuring compliance.

- The executive and Board have examined the Bank's practices and procedures against the backdrop of the King III Code of Governance Principles. This led to an assessment of where we meet the criteria embodied in the Code, where we do not yet meet them, where we need to take measures to improve our ability to comply, as well as where we should not meet them because of the legal specifications in the SARB Act or the specific nature of our work as accepted practice in central banking internationally. In such instances the Bank will adopt the approach of comply or explain.

- We have also finalised an ethics policy and are in the process of taking it through a series of discussions with staff. At the same time we are developing a common understanding of the values that all of us working in the SARB aspire and commit to. We will be finalising both of these processes in the first months of the new year.

- We have restructured the Bank's communications component and upgraded it to a full Department, which includes responsibility and significant capacity for strategy development. This will give us the capacity to ensure that our regular engagements with shareholders can be more frequent and productive than hitherto. Among other things, we will be expanding our annual shareholder road show next year to include Durban, and if significant numbers of shareholders believe it would be useful to do so, we are very open to considering a second annual shareholders' road show

- The creation of the communications and strategy department ensures that we have the intellectual and implementation capacity to drive, among other things, organisational design and change management.

- Perhaps most importantly of all within our review process, we have initiated a thorough assessment and realignment of our systems for planning and managing succession. This is because it is crystal clear how very dependant an organisation of this nature is on its people. And allow me to take this opportunity to express appreciation for the sterling work the employees of the Bank are doing. By and large, they are the epitome of professionalism, dedication and competence.

- Because we stand or fall with our people, we are acutely aware of the centrality to our long term viability of strategies which
    - build on recruitment best practices able to establish and keep freshly supplied a talent pool with sufficient depth
    - includes consistent training and mentoring
    - encompasses highly competent career planning for every individual
    - ensures an approach to retention which motivates the very best to make their long term careers with the Bank, and
    - centres on ensuring that the Bank remains a workplace and career of choice, able to attract and keep the right people.

Ladies and Gentlemen,

I hope that you will agree with me that we are on the right road, taking the steps necessary to ensure that the Bank, its policies, and its practices are in line with international central banking best practice.

We are making this major effort because we believe that having the right structures, the right people, and the right approaches are and will continue to be essential elements of our ability and capacity to fulfil our mandate, and ensure stability during a time of significant uncertainty and the current global economic difficulties.

You will find more detail on our new structures and many of the other measures we are taking to strengthen the Bank's capacity in the *Annual Report*. Everyone should have received a copy, at the latest when you arrived here today. Please let a staff member know during the break if you have not received one, and we will ensure that you do.

Reading the *Annual Report*, you will notice that we have changed its design and content from previous years. We have done this in a further effort to ensure that our structures, our approaches, and our work can be more easily understood by and transparent to as wide a cross section of South Africans as possible.

You, the shareholders, have been a particular focus of our rethink of the *Annual Report*. We would be very grateful to have your views and feedback on the new approach, in particular ways in which we can constantly improve the information made available to you.

The focus on openness and transparency which becomes visible in the newly designed *Annual Report* is something we are working to entrench across the board in the Bank's dealings with shareholders, with stakeholders, and with everyone else who has a legitimate interest in what we do and how we do it.

While matters arising from the annual financial statements have been addressed earlier today, there are a number of specific issues that have been raised by shareholders that I shall deal with after the scrutineers report and the results of the election have been presented.

I would like to acknowledge a number of people, who have supported the Bank in the year under review.

I wish to thank President Zuma and the Presidency, the Government and Parliament for their continued support. The Bank has maintained a sound working relationship with the National Treasury and I wish to thank Finance Minister Pravin Gordhan, Deputy Minister Nhlanhla Nene, Lesetja Kganyago, the Director-General of the National Treasury, and all his staff for their ongoing support and co-operation.

Sincere thanks are also due to the members of the Board of the Bank for their tireless efforts in ensuring appropriate corporate governance. The successes achieved in dealing with the challenges of the past year are due to the continued dedication and commitment of the deputy governors, management and staff of the Bank. I wish to thank them all for their contributions and I am confident that these efforts will ensure that the challenges we face in the coming year will be met with the professionalism, skill and hard work required.

I also wish to thank Dr Renosi Mokate, who retired as Deputy Governor on 31 July 2010, for her service to the Bank.