An address by Lesetja Kganyago,
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at the 101st annual Ordinary General Meeting of the shareholders

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Introduction

We convene our 101st annual Ordinary General Meeting (AGM) more than 18 months since the first COVID-19 case was reported in South Africa, and as the third wave of virus infections has peaked. Restrictive measures have been necessary to protect human lives, with negative effects across our economy, leaving deep scars on businesses and on the economic livelihoods of many South Africans.

While the magnitude of the economic shock has been difficult to estimate, the South African Reserve Bank (SARB) responded quickly and aggressively with a broad array of actions to limit the economic damage, in line with its constitutional and legislative mandates. The policy responses included the use of monetary policy, market operations to support the functioning of financial markets, regulatory tools, as well as collaborations with other entities to provide relief to the economy and support lending to households and firms. In addition, the SARB has been contributing in global forums aimed at fostering greater international cooperation to strengthen the global financial safety net.

Monetary policy was adjusted rapidly, with the SARB's Monetary Policy Committee (MPC) cutting the repurchase (repo) rate to an all-time low of 3.5%, leaving the prime rate at a 54-year low of 7.0%. These low rates have supported household demand for credit and have cushioned corporates through low short-term rates while allowing government to take advantage of cheaper short-term debt.

Liquidity management also shifted quickly to address funding strains in the domestic financial markets through the utilisation of the repo facility at various maturities. The intraday repo facility offered R36 billion daily, while the weekly and three-month funding windows made R45 billion and R20 billion available respectively. To add liquidity and promote the continued smooth functioning of the bond market, the SARB implemented a bond-buying programme in the secondary market. The value of government bonds purchased totalled R41 billion. As a result of these actions, liquidity conditions in the money market and the government bond market normalised quickly, and market functioning was restored.

The Prudential Authority (PA) granted temporary regulatory and supervisory relief measures to enable banks to continue lending and supporting their customers. The relief measures were provided in three areas, namely: lowering the liquidity coverage ratio from 100% to 80%, lowering the minimum capital requirements, and relaxing the provisioning requirements in order to permit the restructuring of distressed loans. The PA also issued guidance to banks discouraging dividend payments and executive bonuses in 2020. This measure has since been reversed.

Finally, the SARB partnered with National Treasury and the Banking Association South Africa (BASA) to establish the Government Loan Guarantee Scheme. As at 19 June 2021, R18.39 billion in loans had already been approved by banks and taken up by small businesses under the scheme.

There has been criticism surrounding the low uptake of the loan guarantees. It is important to note that the Loan Guarantee Scheme was a backstop for cases where the commercial banking sector was unable to provide credit relief to borrowers due to high credit risk. In practice, banks responded quickly and very successfully, acting swiftly to support the firms to which they lend.

In addition, small and medium businesses appear to have been reluctant to take up more debt, especially in an environment characterised by deteriorating confidence, a sluggish recovery and heightened economic uncertainty.

Let me now turn to a reflection on recent economic developments.

Global conditions

On the global front, economic recovery is on track but uneven. The International Monetary Fund's (IMF) July *World Economic Outlook* projects a stronger recovery in both 2021 and 2022, with growth projected at 6.0% and 4.9% respectively.

The advanced economies, led by the United States (US), look set to reach pre-COVID-19 levels much sooner than their emerging and developing economy counterparts. The US continues to pursue unprecedented fiscal expansion and an accommodative monetary stance. Most recently, the European Commission passed its NextGenerationEU stimulus package, in conjunction with its Multiannual Financial Framework 2021–2027. These significant policy responses will see a fiscal injection of €2.018 trillion in European Union (EU) member states over the coming years.

Economies in sub-Saharan Africa (SSA) continue to lag their peers. Coming into the pandemic, most of these economies were already battling with a lack of policy space and sluggish implementation of reforms necessary to boost growth. Slow vaccination rates will continue to weigh on economic recovery in this region, even after the lifting of hard lockdowns. Many economies in the SSA region continue to struggle with high debt levels and conflicting policy priorities, including the need for higher health spending, the strengthening of social safety nets, improved fiscal positions and kick-starting much-needed infrastructure projects. Against this backdrop, the regional economy contracted by an estimated 1.9% in 2020. The IMF forecasts growth of 3.4% in 2021 and 4.1% in 2022 for SSA.

The COVID-19 pandemic has caused large demand and supply shocks globally. The policy space to respond has been varied across countries, depending on pre-pandemic economic conditions as well as the risk perceptions of funders and investors. These demand-related challenges were the short-term difficulties. The longer-term challenges are harder to address as they concern supply.

The pandemic has disrupted global and domestic value chains, and has destroyed businesses and jobs. It will take time to rebuild our economies to pre-pandemic levels. Supply constraints also contribute to higher inflation, so as we recover from the pandemic, this raises the prospect that, over the medium term, monetary policy may need to retreat from its highly accommodative stance. Much of the financial market volatility we have seen in recent months reflects how markets assess these monetary policy dynamics, including how monetary policy may be constrained by negative supply shocks and impacted by the ongoing expansionary fiscal efforts.

The US Federal Reserve has indicated that the higher inflation outcomes of recent months are primarily transitory and are therefore not expected to result in permanently higher inflation. Nonetheless, the Federal Open Market Committee (FOMC) has shifted its position, perhaps signalling a somewhat earlier normalisation of monetary policy than was foreseen last year.

The European Central Bank (ECB) has finalised a revision of its strategic framework, setting a clear inflation target of 2% and thus moving away from the previous articulation of ‘below but close to 2%’. This has clarified the target and removed uncertainty about potential policy responses if inflation were forecast to rise above 2%.

Domestic conditions

Since the last AGM, we have seen the domestic economy recover faster than expected, although output remains 3.3% below real 2019 levels. The first-quarter gross domestic product (GDP) figure of 4.6% quarter on quarter (the seasonally adjusted annual rate (saar)) surprised on the upside. However, the recovery remains uneven, and is largely driven by strong performance in the finance and mining sectors. Mining has been benefitting from rising commodity prices, and manufacturing appears to be benefitting from improving global and domestic demand. Finance and trade, also linked to improving demand, appear to be closing in on the 2019 level, in step with manufacturing, while agriculture has benefitted from high rainfall and bumper harvests in 2020. However, construction and tourism-related activities remain well below their 2019 levels. Transport, impacted by reduced travel (for both commute and leisure), also remains well below the 2019 level.

The recent unrest and economic damage could, however, fully negate these better growth results, and could have lasting effects on investor confidence. As a result, our GDP growth forecast for 2021 remains at 4.2% for now. Prior to the unrest of recent weeks, the soft economic indicators were pointing to a more positive outlook.

The business confidence index measured by the Bureau for Economic Research (BER) rose to the 50-point neutral level for the second quarter of 2021 – for the first time in seven years. The Absa Purchasing Managers' Index and the SACCI trade expectations index remained in expansionary territory.

Consumer confidence, however, softened in response to uncertainty about the economic outlook and income arising from renewed COVID-19 infection rates and the slow vaccine roll-out. The recent events, electricity load-shedding and lockdowns will continue to weaken near-term sentiment in the economy and pose risks to growth.

The official unemployment rate edged up marginally in the first quarter of 2021, from 36.5% to 36.6%, as more people re-enter the labour market but job growth remains lacklustre.

Headline inflation accelerated from 4.4% in April to 5.2% in May, largely on petrol, food and base effects, before easing slightly to 4.9% in June. Core inflation remained subdued at 3.1% over this period. Risks to the inflation outlook emanate mainly from global factors such as higher food and oil prices, as well as global supply disruptions pushing up producer prices. However, a stronger exchange rate, economic slack and modest housing-led service price inflation continue to moderate inflation outcomes. Additionally, higher domestic crop production should help mitigate food inflation pressures.

Let me now turn to some factors that have impacted our financial system.

The financial stability mandate

The COVID-19 pandemic found our financial sector resilient due to continued enhancement to our regulatory and supervisory frameworks. The regulatory capital ratios for both the banking and the insurance sectors remained at roughly the same levels at the end of 2020 as they were before the onset of COVID-19. This is attributed to a moderate level of credit extension keeping profitability in the banking and insurance sectors positive, and capital retained by measures that reduced dividend payouts.

Asset prices have rebounded in line with economic activity, and the rate of loan defaults continues to stabilise. The JSE Limited (JSE) All-Share Index (Alsi) has fully recovered the losses suffered in 2020. House price growth has also improved in recent months, achieving positive real growth for the first time since 2016. While the banking sector’s loan defaults may not have peaked yet, the pace of increase slowed significantly in late 2020 amid signs that borrower debt-service capacity was improving. The value of credit restructured as a result of COVID-19 has more than halved from its peak in mid-2020.

Nonetheless, material risks to financial stability still exist, and we continue to monitor them. They relate to the durability of the economic recovery, the high and rising level of public debt in South Africa, and the potential for global financial conditions to shift abruptly.

Operational matters

The work that we have to do as a central bank also includes ensuring that our national payment system remains robust and that we keep up with changes brought about by advancements in financial technology (fintech) that result in new payment methods.

During the reporting period, the SARB’s National Payment System Department launched the real-time gross settlement (RTGS) system renewal programme. The RTGS system enables payments by members of the public, merchants and corporates as well as government entities through accounts held by their banks at the SARB. With the renewal programme, the SARB aims to widen access to payment services, enhance competition through the leveraging of technology developments, reduce the cost of the system, lower the transaction fees, and make the system more flexible and adaptable to relevant changes in the financial sector.

Earlier this year, the Intergovernmental Fintech Working Group published a position paper on crypto-assets. The paper provides a road map for putting in place a framework for regulating crypto-assets in South Africa, through the regulation of crypto-asset service providers. The paper makes 25 recommendations related to cross-border financial flows, consumer protection and market abuse, as well as containing money-laundering and combating the financing of terrorism.

The second phase of Project Khokha, through which the SARB practically explores the potential impact of distributed ledger technology on financial markets, is also nearing its final stages. The final report will be published by the end of September 2021.

As we look to the future, the SARB, like many other central banks, has embarked on a central bank digital currency (CBDC) feasibility study. The objective of the study is to investigate if it would be feasible, appropriate and desirable for the SARB to issue a CBDC to be used for retail purposes, complementary to cash, in South Africa.

Our centenary

Although this is the 101st AGM, this year marks 100 years of the SARB's existence.

Over the past century, we have steered through the devastating impact of the Great Depression, the deadliest war in history (World War II), institutionalised racial segregation, the oil crisis of the 1970s, the dawn of democracy in South Africa, the global financial crisis, threats to the SARB's independence and, today, the COVID-19 pandemic – the worst virus outbreak since the Spanish flu in 1918.

This year, we also celebrate the rand's 60th birthday, 25 years of central bank independence following the adoption of South Africa's Constitution in 1996, and 21 years of inflation-targeting.

In celebration of its centenary, the SARB has launched a commemorative R5 circulation coin. The coin illustrates the journey of the currency minted by the SARB from the iconic 'tickey' to a glimpse of the future 10c coin.

We also held a virtual ceremony, shared with our stakeholders, former Governors and, importantly, our staff. We were honoured to host the leadership of yesteryear, including Dr Chris Stals, Minister Tito Mboweni and Ms Gill Marcus. There were also messages from BASA, the IMF and the Bank for International Settlements (BIS). The messages reflected a deep respect and admiration for the institutional strength of the SARB.

In October this year, the SARB, together with the BIS, will be hosting a virtual Biennial Conference, themed 'Policy challenges after the pandemic'. The conference will explore some of the main challenges that central banks and macroeconomic policymakers are facing in the wake of COVID-19.

Conclusion

In closing, I have to express my gratitude to, and would like to commend, the hard-working staff of the SARB. When we convened last year, I outlined measures to transition our staff to working from home. I am happy to report that, while most of our staff members continue working from home, they are well-equipped and have been able to continue executing their respective tasks fully. We are working with the health authorities to allow for SARB staff to be vaccinated across the country.

The impact of COVID-19 on our health system, on our society and on our economy has been enormous, drawing parallels to the Spanish flu of 1918. The institutional framework through which the SARB exercises its functions has enabled us to respond to the economic impact of the crisis with scale and with speed, while balancing short-term and longer-term trade-offs.

To rebuild our economy, jobs need to be created. Businesses must be restarted and new ones must be established to align with the changing economic needs. Investment decisions need to be taken. Our national policy frameworks must facilitate and enable those basic economic decisions, consistently and sustainably, providing cost-effective and reliable network services, education, and many other quality public services.

As we navigate through this current storm, a multi-pronged policy approach is required, with all institutions of government responding in line with their defined roles. The SARB will continue to play its part and deploy its tools, as appropriate, in accordance with its mandate, to continue providing support to the South African economy and building buffers to enable us to navigate any new storms that may come.

As we look to the next 100 years, we remain committed to anchoring our work in a strategy that takes account of the fast-changing economic environment.

This is a time to rebuild; this is a time to repair – making our economy fairer, more dynamic, and inclusive of all South Africans.

Thank you.