BANKING IN AFRICA AND ITS FUTURE OUTLOOK

Address by Dr X.P. Guma, Deputy Governor, South African Reserve Bank,
to the African Banking Congress, 2008, Sandton Convention Centre,
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1. Distinguished guests, ladies and gentlemen, I have been asked to speak today on Central Bank perspectives on the outlook for banking in Africa, focusing in particular on the following issues: the role of central banks and major banks in regional integration; latest trends and experiences, and lessons learnt.

   Having taken note of the formidable array of speakers who are to take to the podium during the course of the day, I have taken the liberty to reduce the scope of my remarks by focusing on the situation in South Africa and the prospects for the Southern African region. Others will, no doubt, enlighten us regarding developments elsewhere.

2. <u>The role of Central Banks and major banks</u>

   South Africa currently has 20 registered banks, 14 local branches of foreign banks and 46 representative offices of foreign banks, supervision of banks being the responsibility of the Registrar of Banks, a constituent component of the South African Reserve Bank (SARB). The relationship between these two is described in the Banks Act 94 of 1990 in the following terms (Chapter II.S4):

   > "The Reserve Bank shall, subject to the approval of the Minister (of Finance) designate an officer or employee in its service as Registrar of Banks, who shall perform, under the control of the said Bank and in accordance with the directions issued by the Bank from time to time, the functions assigned to the Registrar by or under this Act …"

The SARB in turn is defined in Section 223 of the Constitution of the Republic of South Africa 1996 as "… the central bank of the Republic and is regulated in terms of an act of Parliament", and "the powers and functions of the SARB are those customarily exercised and performed by central banks …" (Section 225).

Five of the largest banks account for the greater share of the banking sector assets of R2860.5 billion as at May 2008, a pattern which has been consistent over time. The salient features of this banking sector are summarised in Tables 1 and 2.

This outcome may be viewed in contrast to the situation described by Dr A.J. Bruwer in his polemic, South Africa: A Case for a National Gold and Banking Policy (1957), although echoes of the sentiments that he expressed have some resonance in certain sections of contemporary South Africa:

> "… it becomes abundantly clear that the two British Imperial Banks … have practically a monopolistic hold on the commercial banking of the country and control over 82 per cent of its banking assets. The imperial hold on the banking and currency structure of the country was made practically complete in 1920 with the establishment of the South African Reserve Bank …." And, he continued:
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> "If South Africa today has a hopeless inferiority complex with regard to her capacity to run her own banking and currency system along national lines, the country cannot be blamed … (Preface)

Bruwer's preferred outcome was stated thus:

> "What is needed in South Africa more than a central bank (although there is no harm in retaining a bank with independent central banking powers in South Africa) is a powerful extra unit in the field of commercial banking – a unit that will be able within a minimum of time

> to enter the remotest hamlet in the country in competition with the two all-powerful Imperial banks (p.192).

I have quoted Bruwer at length for two reasons; first to indicate the fact that we must expect criticism to be directed at our financial systems from time to time, more so during periods of economic stress. Central Banks, in particular may be deemed to be purveyors of all sorts of undesired policies and actions, some being more fantastic than others.

My second reason is to remind this heterogeneous group of eminent persons with direct interest in the financial system that it is important to take into account local concerns when imagining and implementing the architecture of our financial infrastructure, subject always to the need to ensure probity, efficiency and stability in the system as a whole. What works well in one country during a particular period of time may not best be suited to another country and may be less suited to local conditions as time elapses. Stated differently, in the absence of uniform conditions, local improvisations and adjustments are, of course, to be resorted to depending upon factors such as the particular stage of development of a country, the make-up of its banking and credit structure generally, and the degree of organisation of its money market, inter alia.

At present, let it be stressed, South Africa has no inferiority complex with regard to her capacity to run her own banking and currency system and the authorities are alive to the need to do better. Let it be said also that the banking system continues to facilitate intermediation between surplus and deficit financial units – not by administrative diktat, as some would prefer. Rather, allocative efficiency is sought through the price mechanism which operates best at arms length. The role of the central bank is then multi-faceted: in particular supervising the banks, large and small alike, implementing monetary policy for the economy as a whole – within a framework of inflation targeting – and maintaining the national payment system.

2.1 Some recent developments

Three recent domestic developments warrant mention. The first two have to do with legislation, whilst the third has to do with competition.

As noted in the South African Reserve Bank's Financial Stability Review, March 2008, the Banks Amendment Act, No. 20 of 2007, was promulgated and assented to in 2007 following extensive consultation with relevant stakeholders over a number of years and came into effect on 1 January 2008. The amended legal framework gives effect to current international standards and best practice relating to banking supervision and regulation, and in particular to the new capital framework as envisioned in Basel II. In addition, the financial services industry is currently being subjected to an assessment conducted by the IMF and World Bank under the Financial Sector Assessment Programme, or FSAP.

Second, as part of its efforts to improve access to finance, South Africa is moving towards a co-operative banking regulatory framework in order to advance the social and economic welfare of South Africans. Significant progress has been made to date, including the recent promulgation of the Co-operative Banks Act, No. 40 of 2007. The applicable supervisory bodies are in the process of establishing the required developmental and supervisory structures. The Act and the Regulations are likely to be implemented concurrently during 2008.

Third, the Competition Commission of South Africa has recently completed an Enquiry into Competition in Banking : at present, only the Executive Overview has been released and is currently being studied.

Finally, in this regard, the Bank for International Settlements (BIS) released its Annual Report last week, noting in particular the rapid deterioration in the stability of financial markets during the past year. Most notable, in the view of the BIS, was the "onset of turmoil in the US market for sub-prime mortgages which rapidly affected many other financial markets …."

In the case of South Africa, however, the effects of this turmoil in international financial markets, so far, have been indirect. They have been felt primarily in the form of volatility in the domestic financial markets and in the form of increased pricing for off-shore funding.

In theory, international contagion could also be transmitted through the international exposures of the South African financial system. In the event, however, this has not materialised as the financial sector had very little direct exposure to the US sub-prime market. Moreover, as has been indicated earlier, the banking sector in South Africa has capital in excess of the regulatory requirement, operates within a regulatory environment which is fully compliant with the Basel II regulatory framework: and is subject to robust supervision by the Registrar.

3. Regional economic arrangements

As is well known, South Africa is a member of three regional organisations in the Southern Africa region, these being the Common Monetary Area (CMA) (with Lesotho, Namibia and Swaziland); the Southern African Customs Union (SACU), with Botswana and the CMA countries; and the Southern Africa Development Community, SADC, whose members include all SACU members as well as Angola, Democratic Republic of Congo, Madagascar, Malawi, Mauritius, Mocambique, Tanzania, Zambia and Zimbabwe.

The CMA, at present, allows each member to have its own currency, these being pegged one-to-one to the South African Rand which circulates as legal tender throughout the Area. Each member state, except South Africa, is required to maintain foreign reserves equivalent in value to the total amount of local currency issued. The reciprocal obligation of South Africa is then to pay seignorage to the other countries in proportion to the Rand circulating within their respective regions. For consistency, moreover, exchange controls are harmonised throughout the region.

Most of the major South African banks have a presence in each of the member countries of the CMA as indicated in table 3: but, as of now, none of the home-grown banks in Lesotho, Namibia, and Swaziland have yet established a presence in South Africa.

Regarding SACU, it is the case that negotiations leading to the current arrangement and reserve-sharing formula were finalised in 2002; ratified in a formal treaty in 2004 and the provisions were first implemented in 2005. Revenue, deriving in essence from the implementation of a common external import tariff structure for the Union and from excise taxes collected, is apportioned among the member states in accordance with a formula which has three components: namely, a customs component, an excise component and a development component. During the three years of operation, South Africa's contribution to the SACU revenue pool has amounted to approximately 98 per cent whilst South Africa has, in effect, retained the bulk of the excise component – which typically amounts to about 50 per cent of the total; the balance has then been transferred to the other SACU member states, constituting a charge on the services account of South Africa's balance of payments; an income in the services account of the balance of payments accounts of the other SACU member states. With imports rising rapidly in recent years, import duties collected have also been buoyant and the total amount paid over to the governments of Lesotho, Namibia and Swaziland has risen threefold over the past five years.

Within SADC, recent developments have been guided by the Memorandum of Agreement (MOU) on macro-economic convergence, signed in August 2002 on the one hand; and the Regional Indicative Strategy Development Plan (RISDP), on the other.

The MOU identifies the following indicators as convergence criteria and proposes the timetable indicated in Table 4 for their achievement, whilst Table 5 adumbrates the timetable for achievement of the quantitative targets for the so-called secondary macro-economic indicators.

Stated in words, the SADC convergence criteria require member states to achieve the following by 2018: an inflation rate of less than 3 per cent per annum; a budget-deficit-to-GDP ratio of less than 3 per cent; a ratio of public-sector debt to GDP of less than 60 per cent and a ratio of the deficit on the current account of the balance of payments to GDP of less than 5 per cent. Table 5 can be interpreted in similar fashion, mutatis mutandis.

The desire for a stable macro-economic environment is one to which most policy-makers would assent. Clearly, though, there will be a need to re-assess the quantitative dimensions of the desired end-state if severe macro-economic dislocation is to be avoided in the period which is to extend beyond 2012, in terms of the SADC timetable.

Conclusion

To conclude:

1. South Africa has a well regulated banking system, well capitalised, compliant with Basel II and largely unaffected by contagion arising from the financial market turmoil which started in the sub-prime market of the United States of America last year.

2. The relevant South African authorities maintain vigilance with regard to further development of the banking and financial system. Evidence of this

is to be found in recent regulatory pronouncements, in particular changes to the regulations under the Banks Act and legislation intended to extend access to finance, or as Dr Bruwer would have it, to “enter the remotest hamlet in the country …”

3. South Africa, today, does not have a hopeless inferiority complex with regard to the capacity to run her own banking and currency system.

4. Regional integration is an objective of the governments of the Southern African region and should provide further impetus for enhanced economic growth and an environment in which existing and new banks, adhering to the dictates of probity, can thrive through competition at arms-length contributing to and being guided by market forces. The current uni-directional flow of investments by banks surely presents a welcome challenge to those entrepreneurs of lofty ambition.

5. In the absence of uniform conditions, monetary authorities in their respective jurisdictions will have to improvise, adapting their practices to local conditions. They must expect to be criticised, sometimes vilified for doing their work, particularly during times of economic adjustment.

6. There is no short cut to development or to sustainable regional integration. These take time, consistent application and nimble adaptation. So too with banking in Africa.

Table 1: Key banking sector indicators - May 2008

	Jan 2008	Feb 2008	Mar 2008	Apr 2008	May 2008
Total assets (R bn)	2 663.2	2 758.1	2 827.4	2 790.8	2 860.5
Total assets: year-on-year growth (%)	27.0	27.7	29.9	26.5	28.8
Gross loans and advances (R bn)	2 103.2	2 175.0	2 209.7	2 194.6	2 241.6
Gross loans and advances: year-on-year growth (%)	19.2	19.3	19.3	17.4	19.2
Cost-to-income ratio (%)	47.0	54.3	46.7	48.1	50.6
Capital adequacy ratio (%)	11.69	11.94	12.19	12.34	12.39
Impaired advances* (R bn)	44.4	46.2	47.9	49.5	55.7
Impaired advances* as % of total loans and advances	2.0	2.0	2.2	2.3	2.5
Specific credit impairments as % of impaired advances	39.7	40.6	40.7	40.3	37.3

Source: Bank Supervision Department

* Advances in respect of which a bank raised a specific impairment

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Table 2: Distribution of total banking sector assets – May 2008

	R bn	%
Standard Bank	721.8	25.2
Absa	638.9	22.3
FirstRand	552.9	19.3
Nedbank	476.9	16.7
Investec	165.5	5.8
Other	304.5	10.7
Total banks	**2,860.5**	**100.0**

Source: Bank Supervision Department

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Table 3: South African Bank presence in CMA and SACU countries - March 2008

Country \ Bank	Standard Bank	Absa	FirstRand	Nedbank
	As % of bank assets	As % of bank assets	As % of bank assets	As % of bank assets
Botswana[1]	0,99	-	6,8	-
Lesotho[2]	0,42	-	0,09	0,35
Namibia[2]	1,56	-	2,0	1,07
Swaziland[2]	0,36	-	0,18	0,26

Source: Bank Supervision Department

1 - Southern African Customs Union (SACU)

2 - Southern African Customs Union (SACU) and Common Monetary Area (CMA)

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Table 4: Macroeconomic convergence targets

Indicator \ Year	2008	2012	2018
Inflation (% p.a.)	<10	<5	<3
Deficit[1]/GDP (%)	<5	<3	<3
Debt/GDP (%)	<60	<60	<60
Current account[2]/GDP (%)	<9	<9	<3

Notes: 1. *Deficit* means the public sector deficit
2. External current account, excluding official transfers

Source: SADC Secretariat

Table 5: Other macroeconomic targets

Indicator / Year	2008	2012	2018
Economic growth (% p.a.)	7	7	7
External reserves (month of imports)	3	>6	>6
Central bank credit to Government (% of tax revenue)	10	5	5
Domestic saving/ GDP (%)	25	30	35
Domestic investment/ GDP (%)	30	30	30

Source: SADC Secretariat

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