Introductory remarks by Dr X.P. Guma, Senior Deputy Governor of the South African Reserve Bank, at the launch of the September 2010 *Financial Stability Review*

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Members of the press, guests and colleagues

On behalf of the South African Reserve Bank, I would like to welcome you to the release of the September 2010 edition of the *Financial Stability Review*. The Bank has been publishing its *Financial Stability Review* on a bi-annual basis since 2004, and this is the fourteenth publication of its kind. The *Financial Stability Review* aims to identify and analyse potential risks to financial system stability, communicate such assessments and stimulate debate on pertinent issues. The Bank recognises that it is not the sole custodian of financial system stability, but believes that it can contribute significantly towards a larger effort to achieve stability involving the government, other regulators, self-regulatory agencies and financial market participants.

As a result of the recent global financial and economic crisis there have been considerable developments that have influenced, and quite radically changed, the theoretical thinking about financial stability and its integration with the other tasks of central banks. The extraordinary measures taken to resolve the most impaired financial systems have changed the thinking about a central bank's role in financial crisis management. The very high fiscal cost of resolving the crisis and stimulating growth when it led to a global slowdown has also caused politicians to be more involved with the inevitable process of regulatory reform that has followed. Several of the most affected jurisdictions have announced substantial changes to their financial regulatory policy processes and regulatory structures, and the manner in which these are integrated with monetary and macroeconomic policies.

Not only have more powers been given to some central banks to monitor and coordinate financial stability, but governments in some jurisdictions have chosen to oversee the process of resolving "too big to fail" financial institutions in future crises. Common features of most of the thinking reflected in recent discussion forums, literature and structural changes are an increased emphasis on the formulation of macroprudential policy and tools, and a recommendation for the creation of an independent policy decision-making structure to help consider financial stability issues and integrate any necessary policy decisions with monetary policy.

Crucial to the approach to be developed by the Bank is the concept of macroprudential policy. There have been many different attempts to define this concept and the Bank for International Settlements recently referred to "an orientation or perspective of regulatory and supervisory arrangements that is systemic rather than institutional".[1] A macroprudential approach *firstly*, has a time dimension which deals with how risk evolves over time, with procyclicality as the primary source of risk. *Secondly*, it has a cross-sectional dimension dealing

[1] Borio, C. 2010. *Implementing a macroprudential framework: blending boldness and realism,* Bank for International Settlements, July.

with how risk is allocated within the financial system at a given point in time, with common exposures and inter-linkages between financial firms as the primary sources of risk. In simple terms, a macroprudential policy approach is therefore one where fiscal, monetary and regulatory policy are all aimed at either changing or countering the collective behaviour of financial institutions in order to reduce the systemic risk emanating from such behaviour. This is a very complex task which poses big challenges for policymakers and regulators.

I turn now to the *Financial Stability Review* and the key issues it addresses. During the first half of 2010 downside risks to the steady economic recovery and improving macrofinancial conditions rose sharply in advanced economies. Concerns about the fiscal positions of a number of euro area countries soon turned into a sovereign debt crisis. Reprieve only set in with the announcement of a comprehensive rescue package by the joint European authorities and the International Monetary Fund.

In emerging market economies GDP growth has been robust and incentives for capital inflows are expected to remain strong. As a result asset-price bubbles, financial market instability and uncertainty and fragility of financial systems in general, present risks to the outlook in emerging economies. Generally, conditions in the global financial system are still influenced by above-normal levels of uncertainty, highlighting the fact that the process of repairing impaired financial systems is far from complete.

In South Africa, despite positive signs of economic recovery, employment continued to decline, placing a significant damper on the domestic financial system. Nevertheless, the banking and insurance sectors maintained high-quality capital buffers well above the minimum prudential requirements, and remained profitable. Growth in bank credit granted has begun to increase, the growth rate in impaired advances is decelerating and lending standards of banks are showing signs of loosening. Although indications are that initial expectations of a vigorous recovery in real economic activity were too optimistic, business confidence rebounded in the third quarter of 2010.

Despite the negative sentiment brought about by rising unemployment, the level of consumer confidence remained almost unchanged in the second and third quarters of 2010, following a strong recovery in the first quarter. Consumers also remained optimistic about the prospects for the economy as a whole, although they were still somewhat reluctant to commit to the purchase of durable goods.

Current developments in enhancing the strength of the financial regulatory environment include the publication of the Companies Amendment Bill, with the purpose of improving the administration and effectiveness of the Companies Act; the South African Reserve Bank Amendment Act to enhance the Bank's governance framework and to uphold its public interest role; and the proposed draft Banks

Amendment Bill, taking into account new international best practices and standards as issued by the Basel Committee on Bank Supervision, and to align the provisions of the existing Banks Act with the new Companies Act.

In addition to international efforts to strengthen the overall robustness of the regulatory environment, some countries have responded by reforming national regulatory systems. These reforms include the extension of central banks' powers with regard to supervision, market conduct and consumer protection; the provision of more appropriate structures and policy instruments to assess and mitigate "systemic risks"; the need to address the "too-big-to-fail" moral hazard problems associated with systemically important financial institutions; and the need to close the regulatory gaps that were prevalent in the build-up to the financial crisis. Although some countries are proceeding with regulatory changes, a degree of international convergence around a common international framework is needed.

I have briefly highlighted the key issues raised in the *Financial Stability Review*. More detailed analyses are available in the publication itself, and will be highlighted by the authors' presentations. I trust that you will find these interesting, stimulating and relevant to the current environment and invite you to provide comment as part of the important process of ongoing debate on financial stability.

Thank you.