Remarks by Dr Monde Mnyande, Advisor to the Governor and Chief Economist of the South African Reserve Bank, presented at the Leadership Forum of Airports Company South Africa held at the OR Tambo Sun International Hotel on 12 March 2010

1. Introduction

The improving global economic recovery provides a favourable backdrop to my remarks today and I will give a brief overview of these developments and then turn to domestic economic developments and the outlook for the South African economy. I also wish to avail myself of this opportunity to clarify recent key topical issues related to the South African Reserve Bank. And finally I will explain in some detail the Outreach Programme initiated by the Governor of the South African Reserve Bank, Ms Gill Marcus.

2. International and domestic economic developments

Although projected medium-term growth in the global economy may be somewhat lower than in previous expansions, the IMF has forecasted in its January 2010 update a stronger and more durable recovery than previously expected. There are strong indications that in most developed countries, the negative feedback loops between consumer demand and financial markets have reversed.

Pent-up demand is beginning to filter through to the real sector and this has been helped along by short- and long-term interest rates in major developed markets that are still at their lowest levels on record. The significant fiscal stimulus in many of these countries is also likely to continue for some time, although in a number of countries increasing emphasis is being placed on appropriate exit strategies from the extraordinary and unprecedented crisis-related intervention policies.

There are continued signs that the domestic economic recovery is under way following the much improved GDP growth rate for the fourth quarter of last year. However, the recovery is still expected to remain relatively subdued and below the potential growth rate of the economy for some time.

Following a two-year period of contraction in real retail trade, with a decrease of 5 per cent in 2009 as a whole, indications are that retail trade and new vehicle trade, in particular, are recovering from earlier levels. The more positive outlook is in line with the continued positive trends seen in the composite leading business cycle indicator of the Bank, which increased strongly in November and December 2010. The coincident indicator also exhibited a slight upward movement and, based on preliminary data available for January 2010, the leading indicator is expected to have increased further. This, once again, signals a positive economic performance going forward.

These trends are also in line with the more positive outlook among private-sector institutions, as reflected in the RMB/BER business confidence index which rose to an 18-month high in the first quarter of 2010. The Kagiso Purchasing Manager's Index (PMI) also rose strongly in February to 60.4 index points, indicating that the manufacturing sector continued to be the bedrock of the overall economic growth recovery in the first quarter of 2010.

The effect of the interest rate reductions since December 2008 is gradually impacting the South African housing market as reflected by the recent reversal of the tide in domestic house prices. As a result, the year-on-year rate of change in the average price of houses in the middle segment of the market, as measured by Absa, improved from a negative 4,2 per cent in April 2009 to a positive 5,1 per cent in January 2010. Similarly, the year-on-year rate of change in the average house price, as measured by First National Bank, also swung around from negative to positive rates of change. The rate of decline in the Standard Bank median house price index also moderated.

Turning now to wage-related matters, according to Andrew Levy Employment Publications, a labour consultancy, the average wage settlement rate in collective bargaining agreements amounted to 9,3 per cent in 2009, compared with 9,8 per cent in 2008. Wage increases were below inflation in 2008, but in

2009 the average wage settlement rate again exceeded targeted inflation by 2,2 percentage points, adding to the real take-home pay of the gainfully employed working men and women of our Republic.

The deceleration in the rate of increase in nominal remuneration per worker in the formal non-agricultural sector, together with an improvement in productivity, resulted in a moderation in the rate of increase in the cost of labour per unit of production, amounting to a year-on-year rate of 5,7 per cent in the third quarter of 2009.

Growth over twelve months in the broadly defined money supply (M3) decelerated throughout 2009 and reached an all-time low of 0,6 per cent in November 2009, before accelerating to 1,6 per cent in December. The weak M3 growth continued to reflect, in part, the current phase of the business cycle characterised by lower levels of economic activity and subdued levels of household incomes and corporate profits.

Twelve-month headline CPI inflation decelerated to rates approximating the upper limit of the inflation target range of 6 per cent in November and December 2009. Targeted headline inflation registered an annual average of 7,1 per cent in 2009, down from 11,3 per cent in 2008. In January 2010 headline CPI inflation amounted to 6,2 per cent. Despite this moderating trend, prices in eight of the twelve categories of consumer items still rose at rates in excess of the upper limit of the inflation target range; three of those categories registered year-on-year increases in excess of 10 per cent in January 2010. Nevertheless, headline inflation is expected to return to within the inflation target range in March 2010, and to remain within the target range during the forecast period.

CPI administered price inflation recorded a year-on-year rate of 14,5 per cent in January 2010, following price increases of 29,6 per cent in transport costs, essentially stemming from petrol price increases, 15 per cent in the housing and utilities components (due to electricity price increases amounting to 26,8 per cent), as well as education services costs rising at a rate of 10,4 per cent. When the effect of petrol is excluded from the calculation of administered prices, this year-on-year rate amounted to a still high 10,8 per cent in January 2010.

The Monetary Policy Committee (MPC) has left the repurchase rate unchanged since August 2009. While cost-push pressures in the economy, particularly electricity price increases, posed the biggest upside risk to the inflation outlook, the MPC decided to keep the monetary policy stance unchanged at its previous meeting, because the risks to the inflation outlook appeared to be fairly evenly balanced. The real repurchase rate, or repurchase rate adjusted for the Reuters one-year-ahead targeted inflation forecast, declined considerably during the past year and reached 1,2 per cent in January 2010, indicating a more accommodative monetary policy stance.

The Bank's forecast at the time of the January 2010 MPC meeting projected GDP growth to average 2,0 per cent in 2010 and 3,0 per cent in 2011. Given the improving global outlook, the forecast by National Treasury at the time of the Budget in mid-February 2010 projected GDP growth to average 2,3 per cent in 2010 and 3,2 per cent in 2011.

3. The concept of shareholding in the South African Reserve Bank

There has been much discussion in the media about the private shareholders of the South African Reserve Bank following on comments by the Secretary-General of the Governing Party Mr Gwede Mantashe. There still appears to be a lot of uncertainty notwithstanding a press release by the Bank on 25 January 2010 to clarify the matter.

To put my remarks in perspective, the central banks of, among others, Italy, Japan, Pakistan and South Africa, are institutions with shareholders other than their respective governments. The Bank is an institution created by statute, with the status of an independent legal person, which may not be liquidated other than by an Act of Parliament. Its independence is entrenched in the Constitution and it is not owned by anyone but by South

Africans. In that sense it belongs to the country as a whole and control of the SARB is exercised between its shareholders and Government in a manner whereby the latter, in normal circumstances, may exercise ultimate control over the SARB. Furthermore, the SARB Act does not grant shareholders any authority to remove directors. By virtue of the fact that the Bank is a statutory institution, the shareholders are also unable, by means of a resolution or otherwise, to amend or change the Bank's constitution.

The SARB Act determines that the Bank shall be managed by the Board and that the Governors and Deputy Governors must devote the whole of their time to the business of the Bank. The Board consists of a Governor, three Deputy Governors and three other directors, all appointed by the President of the Republic (after consultation with the Minister of Finance and the Board), and seven other directors, appointed by the shareholders. Individual shareholders are prevented from exercising undue influence over the control of the SARB by virtue of the prescription that no shareholder may hold more than 10 000 shares in the Bank. They also receive a fixed dividend at a rate of 10 cents per annum on the value of their shares held, provided that profits are realised. Voting is restricted to one vote for every 200 shares held, with a maximum of 50 votes per individual shareholder, which votes may be exercised at meetings of shareholders of the Bank.

The concept of shareholding in the Bank is based exclusively on principles of shared community representation and participation in the oversight of the Bank, for purposes of increased independence, transparency and accountability, in the ultimate interest of the general public of the RSA. SARB shareholders should therefore at all times exercise their powers in accordance with these principles and avoid any actions that could be construed as an attempt by them to abuse their undue powers for purposes of self-interest and own enrichment. The Bank has a unitary board structure.

4. The mandate of the South African Reserve Bank

On 16 February 2010 government clarified and extended the mandate of the Bank. The Minister of Finance's open letter to the Governor of the Bank noted the constitutional objective of the Bank. The Bank's primary objective is to protect the value of the currency in the interest of balanced and sustainable growth. It was also confirmed that the Bank should continue to pursue a target of 3 to 6 per cent for headline consumer price inflation, and should do so within a flexible inflation-targeting framework.

The letter reaffirmed the flexibility afforded the Bank in reacting to current and expected supply-side shocks. The flexible inflation-targeting framework involves a focus on a medium-term time horizon in getting back to the target if the economy experiences an inflation shock, thereby avoiding unnecessary instability in output and interest rates.

Policy responses should have due regard to the factors that might impact on the attainment of balanced and sustainable growth, such as the source of the inflation shock, magnitude of the gap between actual and potential economic growth, credit extension and asset bubbles, employment, and the stability and competitiveness of the exchange rate.

The events of the past three years have, once again, highlighted the importance of financial stability. The letter reaffirmed the role of the Bank in overseeing and maintaining financial stability and, in the aftermath of the global financial crisis, has now also made this financial stability role an explicit part of the Bank's mandate.

5. ACSA's tariffs

Allow me to make some brief, and somewhat uncomfortable, remarks about ACSA's application for a tariff increase. Recalling ACSA's initial request for a 132,9 per cent increase, submitted in September 2009, and the Regulating Committee's 59,9 per cent proposal in late January 2010, these numbers didn't and or don't speak easily with the 3–6 per cent inflation target set by government, which the Bank pursues, regardless of the motives behind.

Unfortunately one must point out that such high increases, including the above 20 per cent Eskom price increases, are bad for the economy, inflation and inflation expectations, and are unquestionably not ideal from a central bank's perspective.

However, we have noted that ACSA has undertaken huge capital expansion projects and, for the good of our nation state, these have to be paid for. The Bank also recognises the need for any enterprise to conduct its finances in a sustainable way. Nevertheless, the airport infrastructure will be there for a number of decades, and the Bank would argue that the tariff increases related to the cost of such assets should be phased-in gradually rather than being front-loaded.

6. The South African Reserve Bank Outreach Programme

Throughout the world, the functions and roles of central banks have come under the spotlight following the global financial crisis. In an effort to open up communication lines and quell misconceptions about what central banks can and cannot do, the Governor of the South African Reserve Bank has embarked on an Outreach Programme, led by myself and a team of the Bank's devoted economists. Through this initiative the Bank endeavours to improve the interaction with different sectors and groups in the South African economy. Through these engagements we seek to obtain a deeper understanding of the views held by various stakeholders through interactive discussions.

The SARB regards communication as an integral part of its business and an important instrument in carrying out the government's mandate. The recent global financial crisis and the subsequent economic recession have spawned unprecedented worldwide policy debates. Central banks find now, more than ever, the need to reach out and actively engage with stakeholders.

Areas of discussion in the Outreach Programme include policy-making and socio-economic issues. The Bank already employs various tools, including a wide range of regular and *ad hoc* publications, speeches to various groups, biannual monetary policy forum meetings hosted by members of the M P C in all provinces, and various forms of interaction through the media. This programme will add to these ongoing initiatives.

The Bank has segmented the full spectrum of stakeholders and has in place dedicated economists per segment in order to optimise and strengthen its bilateral relationships with the stakeholders. The sectors include corporate economists and market analysts, the labour movement and social sector, the financial services sector, commerce and industry, and agriculture.

The critical functions performed by the SARB place it at the centre of the South African economy. We are, and have been, very much aware of the fact that the decisions we take and implement impact on all South Africans. As a consequence, we see communication with the widest possible range of stakeholders as part of our responsibilities, and thus look forward to working with you in this regard.

The Outreach Programme of the SARB strives to improve transparency in terms of the following:

- Create awareness and understanding of the SARB's contribution to the national agenda through its proper implementation of monetary policy
- Enhance the SARB's understanding of the economy
- Debate the implications of domestic and global economic developments
- Focus discussions on coordinating, sequencing, complimentarity and cohesion of economic policy
- Emphasise the need for and importance of good quality economic data for monetary policy implementation.

5. Conclusion

Fundamental to our sources of economic growth are labour and education. As Governor Gill Marcus stated in her bilateral meeting with the Young President's Organisation (YPO), yesterday, "…the SARB identifies with the pursuit for a common national vision and serves in the interest of the nation." It is essential that the business community, government, the labour movement and communities together focus on children and youth development.

She challenged us to think about the following questions: How do we create a sense of self-worth, especially among children and the youth, a majority of whom neither have the base nor the means? How realistic are the aspirations of the majority of South African children and what role can we play in helping the youth to be ready to identify and seize opportunities and become responsible and productive citizens of the future? For South Africa to realise a knowledge-based, competitive economy, it needs an educated, skilled and informed populace, not a certificated one. As Michael Spence summed it up in his book[1] (1974) "education may be unproductive in itself - if the social rate on investment in schooling to society as a whole maybe zero."

The Bank identifies with Eustace Davies' (2003)[2] assertion that

> "We cannot allow such a large number of South Africans to remain unemployed: we need to take decisive action now to promote job creation, and to offer the hope of economic betterment to the millions who are jobless and unskilled."

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[1] Spence, A. M. *Market Signalling: Informational Transfer in Hiring and Related Screening Processes*. Cambridge: Harvard University Press. 1974.

[2] Davies, E. *Jobs for the Jobless: Special Exemption Certificates for the Unemployed.* The Free Market Foundation, Johannesburg. December 2003.

For us to realise the national vision, employers and workers have to strive to find a common understanding. I urge business in particular, that where opportunities to employ people present themselves, business should not be afraid to take into service more people; capitalisation of production does not always have to be the first option as a way of avoiding unionised labour. Employers should seek to engage with workers and unions to enlighten them about how business works and why it is pursued in a particular way. These efforts will assist to build trust and to open communication lines.

Finally, I would like to wish ACSA every success with the important responsibilities related to the upcoming 2010 FIFA World Cup. The sterling work that has been done in ensuring timely completion of world-class airport facilities deserves much praise and ACSA has, in this way, made a huge contribution to the improvement of South Africa's infrastructure. This will, without doubt, form an important part of the base that is required for sustainable economic growth and development in the years ahead.

I thank you.