Xolile P Guma: South Africa's macroprudential policy framework and economic overview

Introductory remarks by Dr Xolile P Guma, Deputy Governor of the South African Reserve Bank, at the launch of the March 2010 Financial Stability Review, Pretoria, 28 April 2010.

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Members of the press, other guests and colleagues,

The Financial Stability Department has existed since 2001, its task being to identify possible threats to financial stability and suggest ways in which these could be mitigated. In pursuit of this objective the department, on behalf of the Bank, publishes the *Financial Stability Review* semi-annually. Today the Bank releases the March 2010 edition of this publication.

Following the international financial crisis, the financial stability responsibilities of various central banks have become more explicit. The financial crisis has demonstrated, in general, that, although microprudential supervision makes a valuable and indispensable contribution to financial stability, it may be insufficient on its own to ensure systemic financial stability. For this reason, a macroprudential approach to policy formulation is necessary to complement microprudential supervision, and in fact monetary policy. The aim of such a policy would be to smooth the impact of the economic cycle on the financial system and contain the build-up of systemic risks in the financial system as a whole. The Bank is, therefore, currently in the process of developing an integrated framework for a macroprudential policy approach to achieve its financial stability objective, and to help co-ordinate financial stability policy of other authorities.

The global financial crisis has also led to wide-ranging debate on the need to enhance the international regulatory framework in order to strengthen the global financial system and improve its resilience to shocks. The proposals for reform have gone beyond banking sectors and have been expanded to include insurance industries, rating agencies, hedge funds and accounting standards.

Since the release of the September 2009 Financial Stability Review, the risks to global financial stability have eased and systemic risks have continued to subside as the global economic recovery has gained momentum. The recovery has been instrumental in moderating earlier high levels of uncertainty. Financial stability, nevertheless, remains to some extent, fragile in many economies, including those emerging-market economies hardest hit by the crisis. Advanced economies, in particular, are still faced with the challenge of repairing damaged financial systems, on the one hand, and introducing regulatory reform, on the other. Relatively conservative monetary and fiscal policies and structural reforms before the global financial crisis have helped many African countries to withstand the effects of the crisis better than during previous crises. The main risk facing Africa remains a stalling of the global economic recovery. This could place downward pressure on commodity prices, which could also undermine government revenues and raise public debt to unsustainable levels.

In South Africa, economic performance started improving in the third quarter of 2009 and continued at a markedly stronger pace in the fourth quarter, as the economy gradually emerged from the recession. Confidence in the financial services sector increased further in the fourth quarter of 2009, boosted mainly by higher levels of confidence among investment managers and life insurers.

The banking sector continued to maintain levels of capital well above the minimum prudential requirement. Despite the recovery in real economic activity, bank loans and advances contracted during the period under review. The contraction in credit extension had both demand and supply-side elements. On the demand side, it would appear that households continue to be reluctant to incur more debt, while on the supply side lending standards have remained tight. Although credit losses had been increasing consistently over the past two years, the pace of deterioration in the asset quality of banks moderated during the second half of 2009. Banking profitability dropped somewhat during the second half of 2009, but efficiency has remained fairly stable over this period.

The financial strength of long-term insurers in South Africa was assessed as being generally sound, based on the capital-adequacy levels. Other financial soundness indicators for typical long-term insurers, however, suggest that this sector continued to experience some strain. Financial conditions in the short-term insurance sector also deteriorated during the fourth quarter of 2009. In line with developments in international equity markets, the upward trend in the domestic equity market, which started in March 2009, continued in the second half of the year.

Business confidence increased in the fourth quarter of 2009, following persistent declines since the third quarter of 2006. The improvement in business confidence is consistent with some of the other leading indicators that generally precede a recovery in economic activity, and currently herald an improvement in economic conditions. Other indicators for the corporate sector, however, confirmed that the sector was still under pressure.

Confidence in the residential property market also showed some signs of recovery. In addition, the decelerating growth in mortgage advances, as reported by banks, bottomed out in December 2009 and started to show signs of an upward trend. The business operations of non-residential building contractors were, however, still constrained by a lack of demand for building work.

The household sector experienced some financial strain as job losses constrained disposable income. Although most indicators show that the decline in the real economy had bottomed out in the first half of 2009, consumers were, until the third quarter of 2009, still somewhat pessimistic about the prospects for future performance of the economy and its impact on their finances. The elevated rate of unemployment continued tight lending conditions and a need to address weaker household balance sheets are expected to continue to impact consumption expenditure negatively. Also, on average, the credit standing of consumers has continued to deteriorate.

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.