Xolile P Guma: South Africa's *Financial Stability Review* – key issues in March 2011

Introductory remarks by Dr Xolile P Guma, Senior Deputy Governor of the South African Reserve Bank, at the launch of the March 2011 *Financial Stability Review*, Pretoria, 20 April 2011.

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Members of the press, other guests and colleagues

On behalf of the South African Reserve Bank, I would like to welcome you to the release of the March 2011 edition of the *Financial Stability Review;* the fifteenth publication in this series.

The Bank knows that it is not the sole custodian of financial-system stability. Financial stability is a responsibility that it shares with other role-players and it is well placed to take a leading role. To pursue the maintenance of financially stable conditions and contain systemic risk, the Bank continually assesses the stability and efficiency of the key components of the financial system and formulates and reviews policies for intervention and crisis resolution. The assessment largely takes the form of the *Financial Stability Review*.

I turn now to the *Financial Stability Review* and highlight some of the key issues that the March 2011 edition addresses. First, the Review indicates that during the second half of 2010 global macrofinancial conditions improved broadly, although pockets of vulnerability and risk remain and significant policy challenges still need to be addressed. Global economic activity moderated somewhat as the brisk recovery phase following the global financial crisis turned into a slower and, hopefully, more sustainable recovery. The multi-speed nature of the recovery continues with subdued economic growth and high unemployment in advanced economies, and buoyant economic activity and rising inflationary pressures in many emerging market economies.

The financial risks in advanced economies that might impact on the stability of the South African financial system, and which are discussed comprehensively in the *Financial Stability Review,* are

- vulnerabilities in the euro area;
- banking-sector vulnerabilities;
- negative sentiment and declining prices in real-estate markets in a number of advanced economies; and
- a broadening of the concept of global imbalances as trade, fiscal and investment imbalances have increased.

Emerging market economies as a group remained important drivers of global economic growth in the second half of 2010 with countries in developing Asia recording the most rapid growth among all of these countries. Emerging market economies are, however, also exposed to lingering downside risks in the form of rising inflationary pressures, the possibility of sudden reversals of capital inflows and sharp increases in the level and volatility of commodity prices. In many sub-Saharan African countries economic growth has returned to pre-crisis levels, but growth prospects will depend on a sustainable recovery in the global economy. Recent political instability in the Middle East and North Africa region, and the resulting rise in oil prices, coupled with rising food prices, pose significant challenges to the economic outlook in the sub-Saharan Africa region.

Various groupings of financial authorities and international standard setters, including the Group of Twenty Forum, the Basel Committee on Banking Supervision and the Financial

Stability Board are actively contributing to initiatives to create a stronger international regulatory framework. At the same time, countries have responded by reforming national regulatory systems. The roles and responsibilities of central banks in regulating and supervising financial systems have been extended in some jurisdictions. Principles are being developed to deal with the “too-big-to-fail” moral hazard problems and to increase the capacity to absorb losses of systemically important financial institutions. In addition, regulatory gaps are increasingly being closed in various jurisdictions by extending the regulatory perimeter to include hedge funds, private equity funds and rating agencies, and more transparency and accountability in the derivatives market are envisaged. It is trusted that these initiatives will contribute to a more stable global financial system.

In South Africa, despite positive signs of economic recovery, high levels of unemployment continued to place a damper on activity in the domestic financial system. Nevertheless, the banking and insurance sectors maintained high-quality capital and liquidity buffers well above the minimum prudential requirements, and remained profitable. Gross loans and advances increased in December 2010 compared to a year ago, albeit at a moderate pace. The rising trend in the growth rate of impaired advances seems to have peaked and indications are that it may start to decline in the near future.

The high levels of capital inflows that featured in many emerging economies in 2010 and that created significant policy challenges for South Africa, reversed somewhat in the fourth quarter of 2010. This trend continued into 2011 as non-residents became net sellers of local currency bonds and equities. The way forward will depend largely on the future recovery of the global economy and the unfolding events in Europe. Recent tensions in the Middle East and North Africa countries, the substantial impact on oil prices, and developments in Japan, together with increased prospects of further monetary policy tightening in advanced economies, will be developments of which to take note.

Although household debt to disposable income remained at elevated levels and the profile of credit-active consumers worsened somewhat in the fourth quarter of 2010, the improved outlook for economic growth in 2011 could boost the confidence level of consumers in South Africa. In the corporate sector, the increase in profitability, as reflected by the gross operating surplus, and the increase in the annual growth rate of credit extended to the sector, are possible indications of a recovery in business confidence. In the property market, property price indicators have been declining over the past year, despite lower interest rates and rising real income. Job losses, which negatively affect consumers’ ability to take up new credit, might have had an impact on prospective homeowners’ ability to purchase a residence.

Recent developments enhancing the robustness of the financial regulatory environment in South Africa include reviewing the prudential framework for foreign investment by private and public pension funds, reviewing the framework for cross-border direct investment in South Africa, the release of the final draft of amendments to regulation 28 of the Pension Funds Act, and reviewing the Securities Services Act as part of a process to consolidate several financial services acts.

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