# T T Mboweni: Globalisation and implications for monetary policy in South Africa

Speech by Mr T T Mboweni, Governor of the South African Reserve Bank, at the Gala Banquet of the Independent News & Media International Advisory Board, Cape Town, 6 February 2002.

*   *   *

## 1. Introduction

In December last year, I was invited to give evidence on globalisation before the Economic Affairs Sub-Committee of the House of Lords, Westminster. I was naturally pleased with the invitation and took advantage of the occasion to engage the Lords and Ladies about how globalisation impacts on the fortunes of developing countries or the so-called emerging markets.

All of us use the term globalisation everyday and so do the Lords and Ladies at the House of Lords. Everyone has their understanding of what the term is all about and how globalisation impacts on all of us. The Lords and Ladies wanted to know from me what the positives and negatives of globalisation were on South Africa.

This evening, at this gala banquet for such a gathering of eminent persons of the International Advisory Board of the Independent media group, I can only highlight certain aspects of globalisation in order to contribute to the table discussions, fully aware that after such intensive meetings all of us want a relaxed evening.

I have of late often wondered what the difference in substance is between globalisation and imperialism. After some casual analysis, it seems that the two differ with respect to colonisation, division of the world into spheres of influence and the intensity and level of the dominance of finance capital in the world economy.

Globalisation could generally be taken to encompass the more liberalised and increased flow of goods, services, capital and finance across national economies. Globalisation is therefore not a new phenomenon. The degree of economic integration in the world has been rising over time. Technological progress has improved transportation and communications, enhanced information awareness and information processing, and has set the stage for new products and innovations. These developments make it much easier for national markets to be globally integrated.

Although these markets still do not form a global village, they have become so interdependent that they are changing the environment in which economic activity takes place. This new economic environment has, however, also brought about certain disadvantages, such as large reversals in international capital flows and financial contagion even on those countries with sound economic fundamentals. These developments have led to protests against "global capitalism". Demonstrations against globalisation are particularly strong at meetings of the IMF, World Bank, G8 and the World Economic Forum. Despite these demonstrations, global economic integration today is far greater than it has ever been and is likely to become even stronger in the coming years.

## 2. The impact of globalisation on South Africa

The re-entry of South Africa into the globalised financial markets and the opening up to international competition led to a sharp increase in the participation by non-residents in the domestic financial markets. Non-residents are now responsible for about one-third of the turnover on the JSE Securities Exchange SA and approximately one-eighth of the volumes on the South African Bond Exchange. This has caused share and bond prices, as well as the exchange rate of the rand to be increasingly influenced by developments in the rest of the world – particularly in emerging markets.

These transactions by non-residents contributed materially to substantial increases in financial sector activity. Turnover on the South African Bond Exchange, for example, increased from R2,0 trillion in 1995 to R12,4 trillion in 2001, while the total value of shares traded on the stock exchange rose from R63 billion to R606 billion over the same period. In the foreign exchange market volumes increased from a net average daily turnover of US$2,7 billion in 1995 to US$9,6 billion in 2001. Market activity was still fairly brisk in November and December last year, with the net average daily turnover averaging US$8 billion.

Integration into the world financial markets required a major restructuring of the institutional arrangements in the South African capital markets. The JSE Securities Exchange SA introduced reforms to provide for corporate ownership, foreign ownership of stockbrokers, dual capacity trading, negotiated commissions, and electronic screen trading. The securities exchange is continuing to improve its facilities by providing for the immobilisation and dematerialisation of shares, and for improved clearing and settlement arrangements.

These changes and the substantial increase in portfolio investments and trade finance by non-residents contributed to a large inflow of capital but also resulted in greater volatility in the capital movements between South Africa and the rest of the world. A nearly consistent net outflow of capital of R48,3 billion in the period from 1984 to the middle of 1994 was turned around to a net inflow of capital of R61,3 billion from 1995 to 2000. However, this inflow of capital fluctuated sharply from R16,6 billion in 1995 to R3,0 billion in 1996, R21,3 billion in 1997, R8,8 billion in 1998, R29,3 billion in 1999 and R8,2 billion in 2000.

The large inflow of funds over the past few years has enabled the Reserve Bank to increase the official reserves of the country from the equivalent of 6 weeks' worth of imports of goods and services in 1994 to 20 weeks' worth at the end of September 2001. The increase in the country's official reserves in recent years also made it possible to substantially relax exchange controls.

South Africa's re-entry into the international economy and structural changes implemented in the country provided a platform for improved economic growth. An uninterrupted series of 17 quarterly increases in the real gross domestic product came to an end in the third quarter of 1998 when total real value added in the economy declined at an annualised rate of 12 per cent. This setback was short-lived and aggregate output recovered in subsequent quarters. For the period 1994 to 2000, growth in the real gross domestic product averaged 2½ per cent.

Trade reforms and the restructuring of some domestic assets increased domestic competition. However, the higher growth in domestic production was achieved with only a moderate increase in total employment, while employment in the formal non-agricultural sectors continued to decline – an issue of extreme concern to all of us.

The re-integration of the South African economy was accompanied by shifts in the economic structure of the country. The relative share of agriculture in gross domestic product declined from 5 per cent in 1994 to 4 per cent in 2000. The share of mining in gross domestic product therefore declined from 7½ per cent in 1994 to 6 per cent in 2000.

Although the contribution of the manufacturing sector to GDP has declined from 21 per cent in 1994 to 18,5 per cent in 2000, the real value added by this sector grew by an annual average of 2 per cent for the same period. The sector was buoyed by strong consumption spending from 1994 to 1997. Trade reform increased manufacturers' access to international markets, but at the same time increasingly exposed the sector to competition. The rollout of infrastructure to previously disadvantaged communities ensured continued growth in the electricity, gas and water sector since 1994.

The tertiary sector's share of gross domestic product increased significantly from 60 per cent in 1994 to 65 per cent in 2000. This growth can be attributed to an expansion of the transport sector, improved telecommunications infrastructure and growth in the financial and business services sector. Growth in the latter sub-sector was driven by the intermediation of large capital inflows, a substantial investment in the local market by foreign financial institutions and an increased cross-border provision of financial services.

## 3. Challenges of globalisation in South Africa

Globalisation offers people the opportunity to improve the quality of their lives through increased trade and financial integration among countries, lower communication and transport costs and technological change. However, these opportunities are mainly available to those people who are highly educated or have highly developed skills and have access to well-functioning labour and capital markets. Many people are not as privileged and are therefore excluded. South Africa's challenge has been to ensure that the marginalised parts of the community are included in the process of growth and development. Government's key priorities have therefore been investing in people through better schooling, skills development, extending municipal infrastructure, targeting support for industrial clusters, small business development, strategic trade linkages, extending electrification and telecommunication networks.

## 4. Globalisation and monetary policy

The reintegration of South Africa into the world economy and the liberalisation of financial markets also have important implications for structured finance. As Bill McDonough president of the New York Federal Reserve Bank pointed out in 1998: "The technology for processing information and making this information widely available has fundamentally altered the way the world channels saving into investment. No longer does the global economy rely primarily on loans from commercial banks to meet its financing and investment needs. Rather, more than ever before, the global economy of today looks to funds from the fixed-income and related capital markets to intermediate its credit needs. Because the global capital markets have become so important in the credit intermediation process, the economic well-being of us all depends on the orderly flow of funds in these markets. The flow of these funds, in turn, increasingly relies on price signals generated by trading activity that takes place daily in these markets. The reliance on secondary market trading for price discovery constitutes the fundamental difference between funds from securities markets and loans from banks."

This change in the way that savings are channelled to investments has resulted in greater volatility in international capital movements. Recent non-resident transactions on our Bond Exchange are a clear reflection of this greater volatility in international capital flows. In such a situation, it is more important than ever before to create and maintain a sound environment for investment in a country. This makes it more imperative for monetary policy to pursue clearly stated objectives. Increasingly throughout the world, central banks are pursuing price stability as their basic policy focus. Where countries have high rates of inflation which are out of line with the rest of the world, disruptive capital flows could occur because of fears of currency misalignments.

The closer integration of the world economy has therefore focused the ultimate objective of monetary policy and made it even more important to attain this objective. It should, however, also be realised that such a policy stance does not provide unconditional protection against speculative capital outflows. External economic shocks or perceived poor policy measures can still trigger a reversal in capital movements. Monetary policy cannot prevent these reversals. International investors make their decisions on the basis of a wide variety of developments, including price stability. The best approach that central banks can follow is to pursue financial stability in a transparent and accountable manner so that they can at least forestall any uncertainties in this regard.

Although the objective of monetary policy has been better focussed within the context of globalisation, the integrated world economy has resulted in a more complex mechanism for transmitting monetary policy. The relationship between changes in interest rates, money supply and inflation has become less clear under these new conditions, compared with the period when South Africa was more isolated from external influences. As a result of large international capital flows, the effects of policy changes are being transmitted to a greater extent through critical indicators such as bond yields and exchange rates.

These changes in the transmission mechanism of monetary policy have reduced the credibility of the money supply as an intermediate guideline for policy. The integration of financial markets and financial innovations made the demand-for-money function less stable. This was clearly reflected in a consistent decline in the income velocity of circulation of M3 of about 13 per cent from 1994 to 2000. The income velocity of circulation of M3 continued to decline strongly in the first three quarters of 2001. The money supply accordingly became a less reliable anchor for monetary policy.

Volatile capital movements further complicate the transmission mechanism under floating exchange rates, because of the impact that exchange rate changes have on the foreign transactions of a country. In a closed economy, the transmission mechanism runs from increases in the repo rate and other short-term interest rates through to longer-term interest rates and asset prices and then to aggregate demand and prices. The open economy version of the transmission mechanism under floating exchange rates runs from interest rates, to nominal exchange rates, to the absolute and relative prices of tradeable goods and eventually to the prices of non-tradeable goods.

In view of this more complicated transmission mechanism in a reintegrated global economy, the Reserve Bank has had to reconsider the framework that it applied in pursuing price stability. Informal inflation targeting using intermediate money supply guidelines was obviously no longer suitable in the changed international environment. In February 2000 the authorities therefore decided to adopt inflation targeting as the formal monetary policy framework of the South African Reserve Bank. In addition, considerable effort was made to increase the transparency of monetary policy.

## 5. Conclusion

Global economic integration has led to new and more complex relationships between macroeconomic variables. There have been significant changes in innovation and productivity which call for revisions of the existing economic models. Global economic integration allows new macroeconomic conditions to be transmitted rapidly and extensively through new channels. Central banks increasingly confront new and rapidly changing technologies and methods of payment. There are several kinds of uncertainty and, therefore, different types of information are needed. These include information on the current state of the economy and information on how the monetary policy instruments affect inflation and economic activity.

From the above discussion it is apparent that although the reintegration of South Africa in the world economy has brought many advantages to South Africa, it has also forced more discipline on the management of the economy and on business enterprises. In an international economy any doubts about the appropriateness of economic policy, quickly become apparent in international investors' decisions. Ill-judged economic policy measures can lead to painful adjustments forced on economies through the actions of participants in the markets.

I remain optimistic about the benefits our country will derive from engaging in the globalisation process and the constructive role that monetary policy will play in this process by ensuring financial stability.

We are also witnessing the global acceptance by political leaders of the independence of central banks as a critical factor for credible monetary policy. There are greater responsibilities on all sides. Just as the public sector is being called upon to change and improve codes of good practice, so too the private sector has to follow suit by complying with these international norms and codes of good practice.

I thank you.