T T Mboweni: Overview of the South African economy

Address by Mr T T Mboweni, Governor of the South African Reserve Bank, at the 83rd ordinary general meeting of shareholders, Pretroria, 26 August 2003.

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Introduction

The South African Reserve Bank achieved considerable success on many fronts under difficult economic conditions during the past year. In the monetary field, prompt action during 2002 helped to restrain inflationary expectations as well as to maintain international confidence in the country's commitment to responsible macroeconomic policies. The strength of international confidence is reflected in the recovery in the rand's international value, which was a major factor in reining back inflationary pressures. In the process, the oversold net open foreign reserve position (NOFP) was finally expunged in May 2003.

Against this background, it has been possible to lower interest rates in recent months. Price stability, on the basis of permanent low inflation, is an essential precondition for the economy to be able to achieve sustainable potential growth rates and thereby deliver lasting improvements in living standards for all sectors of our society. The Bank therefore remains dedicated to its task of keeping inflation within the target range, and will continue to be ready to take prompt action whenever necessary to that end.

In the banking sector, financial stability has been restored after the serious liquidity problems experienced in the first half of 2002. The banking sector remains soundly capitalised and well managed, and significant progress has been made in the further application of international best practices in banking supervision. The highly-developed structure and international competitiveness of the country's financial system as a whole remains a significant national strength.

In the administration of the Bank, costs were reduced significantly and in a number of instances departments were restructured, streamlined and staff numbers reduced.

The international economic environment

The global economic recovery remains weak and fragile. Having improved towards the end of 2001 and during the first half of 2002, global economic activity suffered a setback in the second half of 2002 when business confidence was detrimentally affected by revelations of corporate accounting malpractices, further declines in equity values and the threat of war against Iraq. In the first half of 2003 equity prices generally began to rise and the war in Iraq was concluded without severely impacting on oil production. Yet growth in most of the large industrial countries failed to meet earlier expectations.

Although household spending was resilient, business investment in most advanced economies remained low. Lingering political uncertainties arising from the war in Iraq, the outbreak of Severe Acute Respiratory Syndrome (SARS) and the excess capacity in many manufacturing sectors, inhibited the expansion of investment. Consumption expenditure was supported in the USA and Europe by firm property prices and the willingness of households to incur debt. The increasing household debt burden, low personal sector saving and the widening current-account deficit of the United States, pose a threat to the strength and sustainability of the world economic recovery. In addition, economic growth in other advanced economies could be curtailed by structural problems such as inflexible labour and product markets and imbalances in welfare systems.

The economic growth rates of emerging-market economies diverged considerably during 2002 and the first half of 2003. Growth on the whole was quite robust in Asia and in the transition economies in Europe, while it was moderate in Africa and weak in Latin America. The strong growth in Asia was mainly the result of substantial inflows of foreign direct investment and the stimulation of intra-regional trade by the rapid economic expansion in China. European transitional economies benefited from increased and more diversified exports, while the growth in Africa was negatively affected by factors such as political instability, a severe drought in the northern and southern parts of the continent and the HIV/Aids pandemic. Financial constraints and socio-political events were mainly responsible for the low or negative growth of countries in Latin America.

As could be expected under these circumstances, unemployment increased in most advanced economies as well as in Latin America and Africa. Employment creation in emerging-market economies remains one of the most pressing challenges facing the world to ensure the maintenance of stability and the reduction of poverty. This requires the orderly removal of structural impediments to promote skills and create employment opportunities. Such steps should facilitate the task of monetary authorities when external shocks disturb the economies.

With the exception of parts of Latin America and some countries in Africa, global inflation remained low. Small increases in prices were recorded despite a marked rise in oil and other international commodity prices during 2002. In the first half of 2003 the rate of increase in international commodity prices levelled off and contributed to the global disinflationary trend. Japan and a few other countries in Asia actually experienced a decline in the aggregate level of prices in 2002 and the first half of 2003. The low inflation in the world is assisting South Africa in combating domestic inflation.

The combination of low economic growth, increased unemployment and disinflation generally led to the adoption of expansionary monetary and fiscal policies in advanced economies. Interest rates were brought down to very low levels in most developed countries and fiscal deficits widened. However, these measures were unable to prevent some major corporate defaults. Although this exerted pressure on the world financial system, institutions were generally able to cope with the situation. Japanese banks were affected by bad debts and low profits and some banks in Europe also encountered problems. Insurance companies and pension funds fared worse than banks. Of further concern is the volatility experienced in exchange rates and its effect not only on the financial sector, but also on real economic activity. In particular, the US dollar has weakened substantially, which could have major repercussions for the world economy.

Domestic economic developments

The weakness of the US dollar was a major factor in a significant recovery in the external value of the rand. Having declined by 34 per cent on a trade-weighted basis during 2001, the nominal effective exchange rate of the rand recovered by 24 per cent in 2002 and by a further 12 per cent up to the end of July 2003. The performance of the rand was also related to South Africa's inherent economic strength and to the sound and consistent macroeconomic policies pursued by the authorities. Improved international perceptions of these strong fundamentals were reflected in a significant narrowing in spreads on internationally-traded South African bonds, and was recognised by higher ratings of the country by two major international rating agencies, which further underpinned the rand's recovery. The positive sentiment in the market was supported by attractive domestic interest rates and an increase in the country's terms of trade.

Similarly, the real effective exchange rate of the rand recovered markedly since the beginning of 2002. This index, which reflects the trade-weighted exchange rate of the rand deflated by the production price differential between South Africa and its main trading partners and competitor countries, rose by an estimated 16 per cent over the eighteen-month period up to the end of June 2003. Even after this increase the level of the real effective exchange rate of the rand was still below the index values of early 2000, i.e. before the currency market turbulence. This indicates that South African producers are fairly price competitive, but the profitability of their international transactions has, of course, fluctuated considerably over the past three years.

Domestic output could not escape the impact of the still subdued global economy. Growth in real gross domestic product slowed down from 3½ per cent in the first half of 2002 to 3 per cent in the second half and 1½ per cent in the first half of 2003. This deceleration in economic growth was spread across most sectors, with agriculture output actually contracting in the first half of 2003.

The slower growth was accompanied by an increase in aggregate employment in the formal non-agricultural sectors of the economy in 2002. An employment gain of 54 000 workers was recorded. However, preliminary indicators point to a loss in employment opportunities in the first half of 2003. Over the same period, productivity growth receded while the average remuneration per worker rose at an estimated annualised rate of 10 per cent. As a result, nominal unit labour cost continued to increase at a rate above the upper limit of the inflation target band of 6 per cent.

The decline in the rate of economic growth was due to a fall in the volume of exports, whereas domestic demand continued to increase strongly. The level of short-term interest rates seems to have had little effect on domestic demand. The rate of increase in domestic final demand declined only marginally from 4 per cent in 2002 to 3½ per cent in the first half of 2003. The annualised growth in real gross domestic expenditure nevertheless remained at 4½ per cent in the second half of 2002 and in the first half of 2003.

Growth in real household consumption expenditure slowed only slightly from an annualised rate of 3 per cent in the second half of 2002 to 2½ per cent in the first half of 2003. The sustained high growth in consumption expenditure was made possible by relatively strong increases in personal disposable income as well as by a rise in household debt. Household disposable income benefited from higher salaries and wages, improved social transfers from government and income tax reductions. At the same time, the low level of the debt-to-income ratio of households and expectations of imminent reductions in interest rates encouraged some households to incur debt. Real household consumption expenditure accordingly retained a large part of its earlier buoyancy at the cost of a significant increase in debt. The ratio of household debt to disposable income was nevertheless still relatively low at 53 per cent at the end of June 2003.

The steadfast growth in household consumption expenditure was accompanied by an annualised increase in real government consumption expenditure varying from quarter to quarter between 3½ and 4 per cent throughout the past year. These growth levels have been maintained since the beginning of 2001 and signify the greater emphasis on service delivery in government's fiscal strategy.

The rate of increase in real fixed capital formation picked up during 2002 and reached an annualised level of 9 per cent in the second half of the year. This rate then receded to a still high 8 per cent in the first half of 2003, brought down by a decline in the fixed investment of the agricultural sector associated with lower profits of farmers because of the marked drop in the prices of some key agricultural products. Other sectors continued to spend large amounts on the replacement of obsolete capital equipment and the development of new ventures. This demonstrates that positive expectations and sound fundamentals can sometimes carry more weight in fixed investment decisions than the level of short-term interest rates.

In contrast to the continued strong growth of domestic demand, exports performed less well. In fact, the volume of exports of goods and non-factor services declined by 1½ per cent in 2002 and by a further 2½ per cent in the first half of 2003. With the exception of receipts from tourists visiting South Africa, the exports of other goods and services were negatively affected by the decline in global economic activity. In 2002 the decline in the volume of exports coincided with an increase in the volume of imports. Despite a decrease in crude oil imports, the volume of total imports continued to increase in the first half of 2003. The terms of trade strengthened in both 2002 and the first half of 2003, while net dividend and interest payments declined. These developments could nevertheless not prevent the balance on the current account from reverting from a surplus in 2002 to a deficit of 1 per cent of gross domestic product in the first half of 2003.

This deficit was more than neutralised by a financial inflow from the rest of the world consisting mainly of foreign direct investment, borrowing by the South African government in international capital markets and net inflows of other portfolio capital. As a result, the gold and other foreign reserves of the country rose from US$12,6 billion at the end of 2001 to US$18,5 billion at the end of June 2003.

On the monetary and financial fronts, the main developments during the past eighteen months can be summarised as follows:

1. The rate of increase in the monetary aggregates slowed down significantly. For instance, the growth in the broadly defined money supply (M3) measured over periods of twelve months declined from around 19 per cent in the early part of 2002 to less than 13 per cent in December 2002 and to single-digit rates during most of the first six months of 2003. The weaker demand for money reflected a slowdown in inflation and a weaker growth in real income.

2. The public's demand for bank credit remained resilient. Having declined from 12,5 per cent in June 2002 to 7,8 per cent in December, the twelve-month growth rate in banks' total loans and advances to the domestic private sector picked up again to 12,7 per cent in June 2003. The continued buoyancy in the demand for bank credit by the private sector was supported by relatively low debt levels, expectations of a decline in interest rates and ongoing increases in the prices of houses, flats and townhouses.

3. The money market continued to be relatively liquid. The Reserve Bank mainly used foreign exchange swaps, Reserve Bank debentures and reverse-repurchase agreements to drain surplus liquidity, while the phasing out of the banks' vault cash holdings forming part of their

required cash reserves also contributed towards this end. The daily liquidity requirement of banks was maintained at around R11 billion by these measures.

4. Short-term interest rates began to move downwards from April 2003. Having increased by about 400 basis points in conjunction with the repo rate during the first nine months of 2002 and then stabilising at this higher level for the next six months, short-term rates declined by approximately 200 basis points up to the end of July 2003.

5. Private-sector companies made increased use of the primary bond market to finance activities. With subdued share prices and the cost of funding in the money market higher than in the bond market, several companies issued bonds. The outstanding value of private-sector loan stock listed on the Bond Exchange of South Africa therefore increased from R29 billion in June 2002 to R42 billion in June 2003.

6. Long-term bond yields trended downward from late March 2002, reflecting the market's favourable view of the long-term prospects for inflation and the impact of a small public-sector borrowing requirement. In combination with the high level of short-term interest rates, this led to a sharply inverted yield curve. However, after the reduction in the repo rate in June 2003, the shape of the yield curve began to normalise.

7. The recovery in the external value of the rand was mirrored to a considerable extent by movements in share prices on the JSE Securities Exchange South Africa. Expectations of the impact of the exchange rate of the rand on corporate profitability, together with the gloomy international sentiment among equity investors, led to a marked decline in domestic share prices. From a high point on 22 May 2002, the all-share price index declined by 37 per cent to a recent low point on 25 April 2003. Subsequently, share prices recovered by 20 per cent to the end of July.

Public finance

A more expansionary fiscal policy stance has been adopted by government since the 2001 Budget, while the policy remained supportive of lowering inflation and promoting stability. This cautious expansionary fiscal stance is set to be maintained over the medium term to increase the long-term growth capacity of the economy. Government's main goal is reducing unemployment and ensuring that economic growth and development benefit all communities.

In accordance with this policy stance, government's deficit was well-contained in the fiscal year 2002/03. The non-financial public-sector borrowing requirement amounted to only 1 per cent of gross domestic product in that year. This was made possible by continued strong growth in revenue collections and considerable discipline applied to government expenditure. On account of the low deficit and a downward revaluation of foreign-currency denominated loans, the ratio of government's outstanding debt to gross domestic product declined from 46 per cent at the end of March 2002 to 41 per cent at the end of March 2003.

Monetary policy

Monetary policy was dominated in the past year by having to respond to the inflationary pressures arising from exogenous shocks in the form of a substantial depreciation in the external value of the rand in late 2001 and a sharp rise in international oil prices. These shocks were mainly responsible for a surge in the twelve-month rate of increase in the consumer price index for metropolitan and other urban areas excluding interest on mortgages (CPIX) from a low of 5,8 per cent in September 2001 to a peak of 11,3 per cent in October and November 2002. The twelve-month rate of increase in the all-goods production price index also rose from 7,8 per cent in September 2001 to a level of 15,4 per cent in August and September 2002.

As a result, the Monetary Policy Committee was obliged to increase the repo rate by 400 basis points in total during the first nine months of 2002. These increases were prompted by the fact that the inflationary pressures, which were at first mainly confined to rising food and energy prices, became more broadly based and in the end not only influenced the prices of goods but also the prices of services which are not directly affected by exchange rate developments. The increase in the repo rate was further based on factors such as rising inflation expectations, increasing nominal unit labour costs and high growth in money supply and bank credit extension.

The Monetary Policy Committee concluded at its meeting in November 2002 that the level of interest rates was appropriate to avert an inflation spiral. Although it was still unclear at that time whether inflation had peaked, the repo rate was kept unchanged because a number of developments indicated that inflationary pressures could begin to abate. These included a decline in the quarter-to-quarter production price index from 26,0 per cent in the first quarter of 2002 to 11,2 per cent in the third quarter; a strengthening in the external value of the rand; a decline in international oil prices; slower growth in bank credit extension; and a deceleration in the pace of growth in the more broadly defined money supply aggregates.

Given the time lag between a change in monetary policy and its ultimate impact on inflation, the increases in the repo rate were unable to prevent the breaching of the inflation target of 3 to 6 per cent for 2002. In South Africa it is estimated that it takes between 18 and 24 months for a change in short-term interest rates to fully impact on the rate of increase in consumer prices. In 2002 the rate of increase in the CPIX averaged 9,3 per cent, or 330 basis points above the upper limit of the target.

Apart from the direct monetary policy steps that were taken during 2002, the Minister of Finance announced in October that the inflation target of 3 to 5 per cent for 2004 and 2005 would be adjusted and that the target for 2004 would be set at 3 to 6 per cent. Subsequently, it was announced that the target for 2005 would remain at this level and that the target for 2006 would be made public in October 2003. These announcements were made in recognition of the fact that the exogenous shocks had thrown the downward path of inflation off course and that an excessively tight monetary policy with high short-term costs in terms of output losses should be avoided as far as possible.

By the time of the March 2003 meeting of the Monetary Policy Committee it was clear that the rise in inflation had been contained. The twelve-month rate of increase in CPIX had fallen to 9,3 per cent and that of the production price index to 6,2 per cent. In addition, the growth in money supply and bank credit extension had come down to single-digit levels and the rand had recovered remarkably in the second half of 2002. Despite this more positive picture, some other developments caused the Monetary Policy Committee to remain cautious about changing the policy stance prematurely. In particular, the Committee was influenced by the fact that the meeting took place on the day that the war in Iraq started. At that stage it was uncertain what the impact of the war would be on the global economy, and more specifically on oil prices. Other considerations that led to the decision to keep the repo rate unchanged included concerns about the level of wage settlements, rising unit labour costs, large increases in some administered prices and a forecast that CPIX inflation would be close to the upper limit of the inflation target in 2004.

At its June 2003 meeting the Monetary Policy Committee was confronted by a revision of the inflation figures by Statistics South Africa. Although the turning point and the pattern of change between the previous and the revised monthly series coincided fairly closely, the revision brought about almost a 2 percentage point lower than originally estimated year-on-year increase in the CPIX for the early months of 2003. The revision affected the inflation outlook as well as the Reserve Bank's forecast. Taking this revision and more recent economic developments into consideration, the Bank's forecast indicated that the inflation rate would move within the target range during the second half of 2003 and would come close to the mid-point of the target range in 2004.

A number of other factors also influenced the decision to reduce the repo rate by 150 basis points at this meeting. First, the end of the war in Iraq had brought greater stability to the oil market. Second, it was clear that the exchange rate of the rand was maintaining its recovered levels in spite of continued volatility. Third, there were clear signs that inflation pressures emanating from abroad would remain weak. Finally, inflation expectations had declined in South Africa and domestic conditions generally favoured disinflation.

Another development at this meeting was the decision to increase the number of meetings of the Monetary Policy Committee from four to six per year. The previous decision to limit the number of scheduled meetings to four was prompted by the argument that the meetings should coincide with the availability of quarterly data. However, this led to long intervals between some meetings. It was therefore decided that even if the latest quarterly data were not available at each meeting, there should be enough high-frequency statistics to take informed decisions. More frequent meetings should have the added advantage of reducing the fear of sudden and unexpected interest rate adjustments, and in this way promote monetary policy transparency further.

On 14 August 2003, the Monetary Policy Committee announced a further reduction of 100 basis points in the repo rate to a level of 11 per cent. This decision was taken because the decline in the inflation rate continued to be in line with the Reserve Bank's projections and the inflation outlook generally remained favourable. However, the Committee expressed concern about the high rates of increase in some administered prices, the level of wage settlements, the continued strong performance of domestic demand and the acceleration in money supply growth in the second quarter of 2003.

Exchange rate policy

Exchange rate policy was left unchanged in the past year. As in the preceding year, the determination of the external value of the rand was left to the market and the Bank did not intervene in the foreign-exchange market to affect the exchange rate. Although the Bank would prefer to have a strong rather than a weak rand from an inflation perspective, it does not have a target for the exchange rate. As has been emphasised on numerous occasions, it is not the Bank's policy to intervene in the market to affect the level or the direction of change of the exchange rate of the rand.

The exchange rate of the rand was quite volatile during the past year. Unfortunately, this seems to be a fact of life for most emerging-market economies and even for some of the more advanced economies irrespective of the monetary policy frameworks that they have adopted. Although the Bank would, of course, prefer to have greater exchange rate stability, fluctuations in the external value of the rand are unavoidable in the current international monetary system of generally floating exchange rates. We know from experience that even if the rand was pegged to another currency or to a basket of currencies, it would still float against most currencies and fluctuate widely at times.

The authorities can only aim at creating underlying economic conditions that are conducive to exchange rate stability. One of the factors that has contributed to the large fluctuations of the rand in the past has been the large oversold NOFP of the Bank. The Bank's stated objective has been to eliminate this open position, which stood at US$ 23,2 billion at the end of September 1998. During the past year the Bank purchased fairly modest amounts of foreign currency in the market at appropriate times, and also delivered the proceeds of the government's global eurobond issue of US$ 1,25 billion in May 2003 against the oversold forward exchange book of the Bank. These transactions converted the oversold NOFP of US$ 1,8 billion in mid-2002 to an overbought position of US$ 0,9 billion at the end of July 2003. Having removed this perceived vulnerability, the price discovery process in the foreign-exchange market has been displaying a better two-way trading pattern.

With the oversold NOFP now expunged, the Bank has shifted its focus to reducing its oversold forward book and to seeking over time to strengthen the official foreign exchange reserve position. The balance on the oversold forward book stood at US$ 4,1 billion at the end of July 2003, compared with US$ 7 billion at the time of the previous annual meeting of the Bank.

In accordance with the policy of a phased and gradual dismantling of exchange controls, the Minister of Finance announced further exchange control relaxations in his Budget Speech on 26 February 2003. These included a new dispensation for offshore portfolio investments, a mechanism for unwinding the pool of emigrants' blocked funds and an exchange control amnesty.

Stability in the banking sector

The liquidity problems experienced by smaller banks and the eventual erosion of the deposit base of some of the bigger banks in the first half of 2002, were resolved in a satisfactory manner during the past year. In this process, however, certain consequences for the banking industry could not be avoided. The activities of two of the larger banks, Saambou Bank Limited and BoE Bank Limited, were merged with those of the big domestic banks. In addition, the reluctance of depositors to place funds with smaller banks caused some of these banks to cancel their banking registrations, while others redesigned their ownership structures and downsized their balance sheets.

The turbulence experienced in the banking sector therefore resulted in a consolidation of activities before a return to stability was achieved. At the end of June 2003, approximately 83 per cent of total deposits by the public landed in the vaults of the big four banks. These changes have also made it more difficult to start new banks or for small banks to remain in business. This could affect the availability of operational capital for new entrepreneurs, which is highly essential for economic development. Small banks are often more willing than bigger banks to finance high-risk ventures because they are more versatile and can more easily target niche markets.

Despite these developments, South Africa's banking system remains sound. Banks operating in the country are well capitalised, with an average risk-weighted capital adequacy ratio of 12,4 per cent at the end of June 2003. Moreover, 35 banks holding 98 per cent of total banking assets have capital adequacy ratios exceeding the statutory minimum of 10 per cent. The liquidity of the banking sector was also generally adequate. The average daily amount of liquid assets held in June 2003 exceeded the minimum requirement by about 20 per cent.

Growth in the total assets of banks moderated appreciably during 2002, but grew rapidly in the first six months of 2003 because of changes in regulatory and accounting practices that require many off-balance sheet items to be included in balance sheets. However, the quality of assets remained high. Non-performing loans amounted to nearly R25 billion at the end of June 2003, which represented only 2,6 per cent of total loans and advances. The provisions made by banks for non-performing loans were also adequate.

Although household debt to disposable income rose in the first half of 2003, this ratio is still well below the average of the preceding five years. The ratio of corporate debt to profits, which is an indication of the debt-servicing capacity of businesses, increased from 5,4 per cent in the second quarter of 2002 to 6,4 per cent in the second quarter of 2003. This ratio is above the average of the past five years, probably because of a decline in corporate profits as well as an increase in corporate debt.

Banks continue to be managed well. The average efficiency ratio improved in the past year, as did the return on equity and assets. A special independent investigation concerning corporate governance has confirmed that South Africa’s leading banks are committed to high standards of management. The banks adhere broadly to international best practice. Certain suggestions were nevertheless made to improve the functioning of banks. The major deficiency that the investigation encountered was that some of the boards of banks are too big to operate cohesively. It was therefore suggested that the size of boards should preferably be restricted to 16 members and that the number of executive directors should ideally not exceed four.

Although continued vigilance is required to ensure that banks comply with evolving standards, there are no major concerns in this regard. Banks are well on course to bringing their risk-management systems and data models in line with what could be required for compliance with Basel II in 2007. This new capital accord is a radical reform of the previous one and will have an impact on banks in areas such as regulatory capital, credit and operational risk management, and data and disclosure requirements. Banks are positive about complying with the new accord and regard it as a strategic challenge. The application of the new framework will require the re-engineering of supervision processes and organisational structures. In collaboration with other supervisors, the Bank is developing an implementation strategy for Basel II.

Following international corporate failures, accounting and auditing standards have been revised or are being overhauled. As part of the ongoing endeavours to ensure the quality and transparency of financial reporting, a shift was made during the past year away from historical cost to fair value accounting of financial instruments, i.e. the application of Accounting Statement AC 133. As indicated earlier, this led to a substantial increase in the reported total assets of banks. A Ministerial Panel for the Review of the Accounting Professions’ Bill is revising the regulations applicable to auditors and accountants.

Although all these standards are aimed at promoting the integrity of financial markets and institutions and ensuring stability, there is some concern about the management of the transition and the ultimate cost of complying with the increase in legislation that affects banks. Preparing for Basel II is in itself a considerable task. Combined with the onerous requirements of new anti-money laundering and anti-terrorist funding legislation, corporate governance standards and impending community reinvestment legislation, it increases the risk that banks could lose sight of their main business objectives. Non-bank financial institutions may also not escape this burden. South Africa’s recent accession to the Financial Action Task Force (FATF) on money laundering will affect the operations of almost all financial firms.

Another challenge facing the banking sector is to provide broader access to affordable financial services. A large portion of the population still does not have access to banking facilities. The challenge of broadening access to finance has to be addressed with deference to the regulatory objective of achieving a high degree of economic efficiency and consumer protection in the economy. This will require a balance between the introduction of changes to achieve the objective of greater participation and the maintenance of financial stability.

The financial sector is in the process of developing a Financial Sector Black Economic Empowerment Charter to promote increased black ownership of and access to financial firms. As in the case of the

Mining Charter, the key elements of the Financial Sector Charter are likely to include ownership, career and procurement opportunities, and human resources development. We support this process.

Moreover, ever since the attacks on the World Trade Centre on 11 September 2001, the need for multilateral co-ordination to ensure continuity in financial systems has been high on the agenda of the banking sector. The Bank has assisted in the establishment of a Financial Sector Contingency Forum for such contingency planning. A key objective of the forum is to identify crisis events that may threaten the stability of the South African financial sector and to develop appropriate plans, mechanisms and structures to mitigate such potential threats and manage crisis events.

Regional economic co-operation

The promotion of regional economic co-operation in Africa generally and in the Southern African Development Community (SADC) more specifically continues to form part of the major activities of the South African Reserve Bank. The Bank fully supports the New Partnership for Africa's Development (Nepad) goals of accelerated growth and sustainable development, poverty eradication and reversing the marginalisation of Africa in the globalisation process. We will continue to play an active role towards the realisation of these ideals.

The Bank has also participated actively in the Committee of Central Bank Governors in the SADC region during the past year. The major initiatives undertaken included the establishment of a Common Monetary Area Cross-border Payment Oversight Committee; the implementation of a cross-border foreign exchange recording system in Namibia, Swaziland and Zimbabwe; significant progress in the harmonisation of national payment systems, information and communication technology capacity, banking supervision and exchange control; and agreement on the promotion of the focus on price stability as an appropriate and realisable target of macroeconomic convergence as a prerequisite for monetary integration.

Internal administration

In order to achieve the objective of price and financial stability and to ensure that all activities are conducted efficiently, a number of changes were again made to the internal administration of the Reserve Bank in the past year. In particular, the reduction of costs without loss of productivity received high priority. Staff and operational costs were thoroughly scrutinised to minimise expenses. A moratorium was placed on appointments with effect from 1 August 2002 to reduce staff numbers. Moreover, voluntary early retirement packages were also offered during April 2003 to 282 staff members aged 50 and older to curtail costs. A total of 173 responses have been received to date, of which 114 staff members indicated that they accept the offer.

A number of initiatives were launched in the area of information and communication technology focusing on cost reduction and improved efficiency. The renewal of the mainframe and the improved management of the network infrastructure will result in significant cost saving over time, address future capacity requirements and improve the availability and reliability of the Bank's infrastructure.

In reviewing the implementation of the Bank's cash handling strategy, the average overnight notes-held-to-order limit for commercial banks was increased, the service arrangements for Mpumalanga and Limpopo provinces were terminated, and a levy was introduced on banknotes deposited and withdrawn by banks. The Bank's seven branches have met all the distribution and circulation requirements of banks and the cash industry. The overall productivity of the branches has kept track with established requirements and their processing of banknotes averaged 95 per cent of the installed capacity.

Strategies to combat the counterfeiting of banknotes and coin are being developed. In line with international best practice, the Bank will enhance the security features of banknotes in the near future to deter counterfeiting. A decision has also been made to introduce a new R5 coin in response to the counterfeiting of such coins.

Significant progress has been made to strengthen the Bank's ability to oversee the safety and soundness of the payment system and to strengthen its regulatory framework. In aligning South Africa's payment system practices and arrangements with international developments, discussions have taken place with domestic banks and the Continuous Linked Settlement Bank in London. The aim is to reduce foreign exchange settlement risk through the synchronisation of the settlement of the two legs of a foreign exchange transaction in a single time zone. The Bank also entered into negotiations with the Bankers Services Company (Bankserv) to determine the feasability of transferring the ownership and operation of the SARB-link network to Bankserv to reduce costs.

In a further effort to avoid duplication and save costs, the former Money and Capital Market Department and International Banking Department were merged into one new department, the Financial Markets Department. The merger reflected the increased integration of South Africa into global financial markets, which made a distinction between domestic and international financial markets less relevant. The merger had the added benefit of facilitating and improving the co-ordination of monetary policy implementation, while allowing for a more efficient allocation of human resources.

Cost saving was also an important objective in the operations of the Bank’s subsidiaries. As a result of the current and projected low domestic and international demand for coin, the staff of the SA Mint Company (Pty) Limited was reduced by some 40 per cent through a combination of natural attrition, early retirements and a retrenchment programme. In addition, the management of the SA Mint was restructured to improve efficiency. In the SA Bank Note Company (Pty) Limited marketing was intensified to increase capacity utilisation. The marketing initiatives paid off with the award of two further banknote printing contracts from African countries.

The training and development of staff continue to be important objectives of the Bank. In this regard the South African Reserve Bank College again played a major role by offering a variety of learning programmes. The various departments also put considerable effort into on-the-job training of staff members. The Bank is further committed to achieving its objectives for staff transformation by 2005, and reports annually on its progress to the Department of Labour in terms of the Employment Equity Act, No 55 of 1998.

In keeping with the decision of the shareholders on 25 April 2002 to terminate the listing of the Bank on the JSE Securities Exchange South Africa, an Over-the-counter Share Transfer Facility for trading Reserve Bank shares was established. This facility has delivered the desired results and 87 registrations in respect of 240 237 shares were effected up to 31 March 2003.

Finally, the extensions to the head office building, which were started in 2001, were completed. The building now meets the Bank’s requirements in respect of office space, parking and conference facilities. Staff members who had to work in other buildings or who had to be relocated to other premises for the duration of the building alterations, have been moved back to the head office building.

Acknowledgements

All these improvements in the functioning of the Reserve Bank could only be achieved with the help of other persons and institutions. In conclusion, I therefore want to thank everyone who assisted the Bank to accomplish its objectives. In this regard I have to name the Presidency, the Government and Parliament for their support of our work.

I also wish to express my appreciation to the Board of Directors of the Reserve Bank, including the deputy governors, for their commitment to the Bank. In particular, I want to thank Dr M T de Waal, who retired from the Board, for his contributions over the past years. Last but not least, I want to thank the management and staff of the Bank for the outstanding way in which they performed their duties. They have responded with vigour to all the challenges we have encountered and have demonstrated commitment and high professionalism in performing their work.

This is a truly remarkable institution to be associated with.

Thank you.