X P Guma: Communicating reserve management and exchange rate policies – a South African perspective

Address by Dr X P Guma, Deputy Governor of the South African Reserve Bank, at the Bank of Tanzania-IMF-East AFRITAC Regional Seminar on Central Bank Communication, Stonetown, Zanzibar, 6-8 May 2008.

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1. Introduction

Chairperson, Lila Mkila, Deputy Governor of the Bank of Tanzania, distinguished participants, ladies and gentlemen; I wish to start by thanking the organisers of this seminar for their invitation to me to participate in these proceedings and to proceed on the premise that all protocol has been observed. Having said that, I must especially acknowledge Dr B. Ndulu, Governor of the Bank of Tanzania and my senior in several respects – not least in the context of the Africa Economic Research Consortium from which I benefited as a young(er) economist all those years ago, which he served with characteristic distinction.

2. Communication: of what, how?

A story is told, which I think may be appropriate to repeat here. It is said that in 1991 when Mr Mervyn King, the current Governor, joined the Bank of England he visited the former Chairman of the Federal Reserve of the United States of America to seek advice and Mr Paul Volcker obliged with a marvellous word, "mystique".

And that appears to have been the desired practice of senior central bankers of the time, "mystique". The object of their communication was to create such uncertainty as to ensure that their decisions would be treated with the kind of awe that attends the devotions of the converted. Mr Volcker, it is said, described the central bankers of the Bretton Woods system as "high priests, or perhaps stateless princes", the process by which they made monetary policy decision resembling the elusive mysteries of papal successions. That perhaps explains the sea change that has occurred in thinking about communication by central banks.

Having come of age in central banking at a different time, my purpose today is to be brief, to the point and as clear as possible. In the paragraphs which follow, I will outline the evolution of reserve management in South Africa, indicate the nature of the communication strategy which has been pursued and conclude. The interesting part, our joint deliberations, will be off the record.

2.1 Of what?

Reserve management in South Africa has occurred historically in an environment of exchange controls. These were originally introduced in 1939, together with the United Kingdom and other members of the then sterling area, as part of the emergency Finance Regulations applied by that group of countries. The original objective was to retain a free movement of funds between these countries whilst preventing "hard currency" funds from flowing out of the area to non-sterling countries.

Whilst the Sterling Area exchange controls were removed gradually after the end of the second World War, liberalisation of controls in South Africa was halted by the declaration of a State of Emergency in March 1960, and the imposition by the authorities in May and June 1961 of comprehensive measures which were intended to strengthen both the current and the capital accounts of the balance of payments. As Roger Gidlow (1995:181 et seq) states then, stricter import controls included restrictions on inheritance, gift and maintenance transfers as well as allowances for tourists and emigrants. Even more significant, capital transfers abroad by residents were disallowed while residents were called upon to declare their foreign assets and liabilities. Furthermore, the transfer of profits earned by foreign controlled companies prior to 31 December 1959 was prohibited.

Reviewing developments from the vantage point of 1996, the Governor of the South African Reserve Bank (SARB) wrote as follows (Stals, 1996-06-17): The initial non-economic factors that led to the outflows of capital from South Africa during the more than thirty years, from 1961 until the early 1990's rapidly disappeared after the announcement of the election of the Government of National Unity towards the end of 1993. Although a large amount of funds still flowed out of the country during the first half of 1994, the situation changed dramatically thereafter. In the second half of 1994, there was a net inflow of more than R9 billion into the country, and during the calendar year 1995 a further net inflow of R21,7 billion, to bring the total net inflow for the 18 months from July 1994 to December 1995 to more than R30 billion.

In April 1994, when the Government of National Unity took office, the Reserve Bank held about R7 billion in foreign reserves, but also had about R6 billion outstanding in short-term borrowings.

During the years which ensued, the SARB followed a policy of trying to stabilise the exchange rate of the rand by intervening in the domestic foreign exchange market, this being consistent with the provisions of the interim Constitution of the Republic of South Africa which required the Bank to protect the internal and external value of the currency. However, as Mminele (2007) notes, because the level of its gross reserves were fairly low, averaging around USD3,8 billion between 1990 and the end of 1997, the Bank funded its intervention through the forward market, and in the process built up an oversold forward book which, at tits highest level in 1995, amounted to USD29 billion. This exceeded the level of net reserves by a considerable margin, leaving a negative net open foreign currency position (NOFP) which reached a peak of USD23, 2 billion in August 1998; a number which is still mentioned only in hushed tones by those Reserve Bank staff who can recall those momentous times!

In 1998, the SARB ceased its intervention in the foreign exchange market, abandoned its attempts to influence the level of the exchange rate and, in addition, made a public commitment to eliminate the negative NOFP and to close out the oversold forward book. And this had the desired result. In September 1998, the level of gross reserves, at US$5,3 billion was still very small in absolute terms and relative to the net oversold forward book of approximately US$18 billion. By May 2003, the NOFP was marginally positive; but by February 2004, the positions in the oversold forward book were balanced and gross reserves had started to increase. At the time of writing, the Template on international reserves and foreign currency liquidity, which is available to all who may be interested at www.reservebank.co.za, indicates that the approximate market value of the official reserve assets as at end of March 2008 was US$34,384 billion. Chart 1, beloved of those SARB directors and staff who speak in public, illustrates these developments.

In summary, then: the SARB now has reserves to manage. This was not always the case, for during some periods prior to 1998 what needed to be managed were negative net reserves. Second, the SARB has made a public commitment not to participate in the market for foreign exchange in an attempt to influence or to determine the nominal exchange rate. Third, exchange controls have been liberalised significantly. South Africa does not appear now to be too different from its peers among emerging market economies.

2.2 How?

The implications for communication of the afore-going narration were and remain challenging. In a situation of economic vulnerability, such as characterised South Africa at various moments in its past, the need was for the Bank to maintain a sense of calm. Statements had to be circumspect without ever inducing a sense of panic. For nobody would have been prepared to say to all and sundry: "we don't have sufficient reserves, but are still going to attempt to influence the exchange rate, so there! …"

Any student of this period in the economic history of the country will be struck by the subtle nature of the communications of this time. Consider, for example, the difference between the reporting of developments regarding reserves in the Quarterly Bulletin of the SARB. The March 1996 report reads as follows in the section on foreign reserves: "South Africa's total gross gold and other foreign reserves rose from R14,1 billion at the end of 1994 to R15,2 billion at the end of September 1995 and to R18,2 billion at the end of December 1995. After having increased by R2,2 billion in December 1995, the gross foreign reserves of the Reserve Bank decreased by R229 million in January 1996. Without taking into account the credit facilities of the monetary authority, the total foreign reserves of the country were equal to seven weeks' imports of goods and services at the end of December 1995."

Billions deflected by casual reference to a few millions: weeks of imports, not months; some numbers refer to the country; others to the Reserve Bank; others still to the monetary authority. All in Rand, not in SDR or dollar values. And these numbers, of course, do not include the credit facilities of the monetary authority, which, if included? Draw your own inference and rest assured that we are not panicking.

This may be contrasted with the confident tone of the most recent Quarterly Bulletin (March 2008) which reports on International reserves and liquidity in the following manner: Measured in US dollar, the value of the gross gold and other foreign reserves of the South African Reserve Bank (the Bank) increased from US$ 30,5 billion at the end of September to US$33,0 billion at the end of December 2007 and further to US$34,2 billion at the end of February 2008. The Bank's international liquidity position increased from US$28,4 billion at the end of September 2007 to US$31,3 billion at the end of December and further to US$32,7 billion at the end of February 2008."

Straight, to the point and, to use the current idiom of some of the young, together!

At least two things were done to manage communication during those difficult times. First, in order to ensure consistency, it was the practice for only the Governor of the Bank to address public gatherings on monetary policy. Eschewing the use of speech writers and speaking authentically and unmistakably in his own voice, the Governor, as the public face of the Bank would explain what needed to be explained adopting the tone of wounded indignation to good effect when necessary. For example, commenting on macro-economic adjustment during 1995 and 1996, the Governor (1997-09-08) wry and as caustic as decency allowed wrote, "the South African monetary authorities are indeed, <u>in retrospect</u> (my emphasis), now criticised by the International Monetary Fund for having intervened excessively in the foreign exchange market last year …. This was prompted, however, by an acute shortage of foreign exchange reserves … at the time of the currency crisis". And then added, diplomatically, "The Reserve Bank agrees with the Fund that the Bank's role in the foreign exchange market should be reduced."

This strategy had the positive effect of providing consistency in the language of communication, effectively countering the nay-sayers in the market who consistently look for evidence of policy conflict within the Bank. It said, in effect, "one Bank; one policy; one voice".

Secondly, the number of public speaking engagements was kept limited, but unspecified, with the Quarterly Bulletin, the statement on foreign reserves and the annual Governor's address to shareholders of the Bank being the only documents whose release could be announced in advance. Market participants could, therefore, be assured of a comprehensive set of data, set out in accordance with the highest international standards, in the Quarterly Bulletin and the statement of foreign reserves; and would be guided by the Governor's address on matters pertaining to exchange rate, reserve management and over-arching monetary policy. Additional information was made available on a discretionary basis.

Third, in recognition of the fact that a central bank can only be as independent as the government of the day wants it to be, regular contact was maintained with the Minister of

Finance; and the practice of briefings to be relevant Committee of Parliament was maintained.

3. Conclusion

The challenge of communicating with the general public, financial analysts, the markets and other interested parties remains. However, at present, the message which needs to be communicated is that of monetary policy in the context of inflation targeting: exchange rate and reserve management issues have lost their centrality, important as they may remain. The tension caused by substantial deviation from the desired outcome, albeit on account of a concatenation of external shocks of unprecedented magnitude, poses an on-going challenge – with regard to time-consistent policy responses and with respect to communication.

But these are matters for discussion and debate at another time. Thank you for your attention.

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