

Lesetja Kganyago: South Africa's Financial Stability Review – key issues in September 2012

Introductory remarks by Mr Lesetja Kganyago, Deputy Governor of the South African Reserve Bank, at the launch of the September 2012 Financial Stability Review, Pretoria, 24 October 2012.

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1. Welcome and introduction

Members of the press,

Guests,

Colleagues,

Ladies and gentlemen.

Welcome to the release of the September 2012 edition of the *Financial Stability Review*. The *Financial Stability Review* has been published semi-annually since 2004 to promote a stable financial system.

In addition to its primary objective of price stability, the Bank has a mandate to oversee and maintain financial stability. In pursuit of this mandate and to 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.

Through the publication of the *Financial Stability Review* the Bank endeavours to communicate its assessment of potential risks to financial system stability and the mitigation thereof.

The Bank also hopes to enhance the understanding of, and encourage informed debate on these complex and challenging matters related to financial stability.

2. Key issues from the September 2012 *Financial Stability Review*

2.1 International macro-financial developments

Since the publication of the March 2012 *Financial Stability Review* global economic growth has remained weak and the volatility in global financial markets persisted.

The negative prospects for economic growth in advanced economies are not only affecting emerging-market economies in various ways, but are also posing serious threats to global financial stability.

Downside risks to growth such as elevated levels of unemployment, continued uncertainty for a lasting solution in the euro area, and the threatening fiscal cliff in the United States present serious challenges to financial systems globally.

The programmes of increased liquidity provisioning by central banks in the United States, Europe, Japan and the United Kingdom would hopefully mitigate these threats.

Although emerging market economies remain important drivers of global economic growth, concerns about the structural nature of the economic slowdown in China have led to fears that the slowdown may be protracted and may have significant economic and financial implications for other emerging market economies in particular.

The volatility in capital flows to emerging economies has also increased as global uncertainty causes regular changes in the risk appetite of investors.

Impediments to global economic growth are also challenging the resilience of economic growth in sub-Saharan Africa.

2.2 Domestic macro-financial developments

The uncertain and subdued global economic environment also negatively impacted on real economic activity in South Africa. As a result the Bank's forecasts of growth in real GDP for 2012 and 2013 have been revised down.

Although confidence in the financial services sector has recovered strongly in 2009 and remains at high levels, confidence still has not returned to its pre-crisis level.

The banking sector plays a key role in the stability of the South African financial system and remained stable during the first half of 2012:

- the sector remained adequately capitalised in terms of the current minimum regulatory requirements;
- banks continued to post healthy profitability numbers, supported by generally improved quality of assets;
- although the banking sector's total unsecured gross credit exposure increased further in the first half of 2012, it remains only about 10 per cent of total gross credit exposure of the sector;
- the sector's credit exposure to counterparties with legal jurisdiction in the GIIPS countries (Greece, Italy, Ireland, Portugal and Spain) remained insignificant with negligible exposure to sovereigns;
- draft 2 of the proposed amended Regulations relating to Banks, incorporating all Basel III related changes, was published in August in preparation of the adoption of Basel III as from 1 January 2013 in South Africa.

The life insurance industry maintained adequate capital buffers, and healthy increases in income contributed positively to confidence levels in the industry.

The Financial Services Board as the regulator of insurance companies is in the process of implementing the Solvency Assessment and Management framework for the insurance sector. This framework is aimed at enhancing the soundness of domestic insurance companies and protecting policyholders through a risk-based solvency regime.

The domestic bond market generally performed strongly in the first half of 2012, underpinned by South Africa's inclusion in Citibank's World Government Bond Index.

Domestic financial markets, nevertheless remained vulnerable to global oil and food price shocks as well as to domestic concerns following turmoil in the labour market.

As important clients of banks, conditions in the corporate and household sectors play an important role in gauging the stability of the financial system:

- in the corporate sector much needed investment is still lacking, but recent data suggest a slight but broad based recovery in business confidence in the third quarter;
- the household sector's appetite for debt seems to be increasing further, but data show that their savings portion of disposable income also increased, albeit only marginally;
- the declining trend in consumer confidence was borne out by a weakening Consumer Financial Vulnerability Index as well as a decline in the FNB/BER consumer confidence index;

- in addition, residential real-estate market activity remained under strain as growth in mortgage advances by banks remained subdued, also negatively impacting profitability and confidence in the building and construction sector.

2.3 *Infrastructural and regulatory developments*

Regulatory reforms currently in the process of being investigated or implemented that would enhance the robustness of the financial regulatory environment in South Africa include:

- progress made with the implementation of a twin peaks model of financial regulation in South Africa;
- enhanced standards for bank capital and liquidity through the implementation of Basel III;
- the development of legislation for risk-based supervision of insurance groups;
- the strengthening of resolution regimes;
- resolution planning for systemically important financial institutions.

Internationally, the harmonisation of standards and principles for payment, clearing and settlement systems applied to systemically important payment systems and financial market infrastructures is also being investigated, while the oversight and regulation of shadow banking are being strengthened.

2.4 *Concluding remarks*

The South African financial system has proved to be relatively resilient in the wake of a volatile and uncertain global environment and some domestic socio-economic concerns;

Although the recent conjuncture is uncertain and several challenges remain, the financial system is generally sound.

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 invite you to engage with the *Review* as part of the important process of ongoing debate on financial stability.