Daniel Mminele: The globalised nature of central banking

Address by Mr Daniel Mminele, Deputy Governor of the South African Reserve Bank, at the INSEAD Alumni Association Dialogue, Pretoria, 28 May 2015.

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Introduction

Good evening, and welcome to the South African Reserve Bank.

INSEAD is internationally recognised for excellence in business education. It is not only one of the largest business schools in the world; INSEAD also has a strong tradition of promoting diversity, with close on 90 different nationalities being represented in each annual intake. I gather that the South African Alumni Association has 580 members who have attended both MBA and executive level courses at INSEAD.

It is a pleasure to host and participate in this Dialogue with you this evening, particularly in light of the fact that many of you are in senior and executive positions in large companies and hence are important stakeholders in addressing the challenges confronting our country today.

The world has become increasingly globalised. This is clearly evident in economic indicators on capital movements and foreign direct investments, international trade, technology transfers, and the expansion of cross-border activity of multinational firms. Thus, global considerations are always on the radar screen of policymakers, especially those in small open economies like South Africa. In the case of monetary policy, factors such as oil price developments, capital flows, global inflation trends, and exchange-rate developments are some of the considerations that have a bearing on policy stance determination.

However, knowing that many of you would have read our MPC statement of last week, my remarks today will not focus on policy, at least not directly. I would rather like to use this opportunity to talk about the globalised nature of central banking. In essence, my remarks will focus on how the financial crisis of 2007/08 as well as the role of international forums (such as the G-20, the International Monetary Fund, and BRICS) in responding to the crisis, have impacted on the work of central banks. This will also provide the opportunity for me to share with you the involvement of the South African Reserve Bank in these international forums, which complements the interest-rate setting mandate of the Bank.

Monetary policy before and after the crisis

Much has been written about how globalisation might impact on the work of central banks and whether it weakens the effectiveness of domestic monetary policy.

Some have argued that globalisation does indeed dilute monetary policy’s effectiveness through its impact on the structure and functioning of markets, while it also pitches global factors as more prominent drivers of domestic outcomes.

Others have pointed to the benefits emanating from risk-sharing and reduced volatility in financial markets, as globalisation, helps to increase liquidity in financial markets, for example.

As with everything, one could argue equally for both sides on the costs and benefits of globalisation, but, needless to say, impacts will differ across countries and regions depending on, among others, the level of development of their financial markets, the openness of their economies, and the credibility of their monetary and fiscal authorities. Of importance for a policymaker is understanding the influences and risks associated with globalisation and ensuring that the risks are adequately accounted for in policy formulation and implementation.

Lucas Papademos, a former Vice-President of the European Central Bank, has argued that globalisation in general does not fundamentally undermine the effectiveness of monetary policy in preserving price stability. He has acknowledged the positive effects of financial globalisation on the efficiency of financial markets, on global risk-sharing and, ultimately, on economic growth worldwide, but he has also admitted that the global financial crisis revealed a number of weaknesses in the globalised financial system, where tensions in one segment of the market in one country can rapidly spread across other markets and countries.[1]

The global financial crisis certainly elevated the subject of globalisation and its impact on the world of central banking. We now have first-hand knowledge of how financial globalisation in particular can alter the monetary policy landscape and influence the nature and magnitude of spillovers and spillbacks. Certainly, the world of central banking has undergone dramatic changes since 2007: unprecedented reductions in policy rates to the zero lower bound and beyond, and the utilisation of balance-sheet policies in non-traditional ways, which have become the norm in some advanced economies. These actions had repercussions for financial markets through increased capital flows, among others, with emerging markets bearing the brunt of these developments.

We are now being reminded that emerging markets should prepare themselves for the possibility of further market dislocations given the prevailing environment of divergent policy settings, with the Fed and the UK on paths of monetary policy tightening while the euro area and Japan are likely to maintain a loose policy stance for the immediate future.

Besides influencing monetary policy, the crisis also revealed that central banks could no longer see themselves purely as overseers of monetary policy but that this mandate had to be broadened to explicitly include financial stability. As the Bank for International Settlements has put it, "the global financial crisis has shaken the foundations of the deceptively comfortable pre-crisis central banking world".[2]

The conventional wisdom which held prior to the crisis has proved inadequate. It is now generally accepted that price stability alone is insufficient for macroeconomic stability. In addition, we now know that there is no neat separation between monetary and financial stability functions, and that if each central bank looks after its own economy, this does not automatically lead to an appropriate global monetary stance. Further, interest-rate policy alone is not enough. The regulation and supervision of financial institutions needs to go beyond a microprudential perspective towards a macroprudential orientation, with central banks playing a key role in this process.

It was the financial crisis which brought to the fore the need for greater global cooperation, not only among advanced economies but also in emerging-market economies who would prove to be the drivers of global growth during the crisis. It was for this reason that the prominence of the G-20 was raised to that of a Leaders' Summit in 2009. There was clear recognition that there needed to be greater inclusivity to effectively mitigate the damage of the financial crisis, which had clearly highlighted the vulnerability and the interlinkages of the global financial system.

The international response

Let me now turn to the work undertaken by the international forums in which the Bank is an active participant (including the G-20, BRICS, and the Bank for International Settlements),

[1] *Globalisation and central bank policies*, a speech by Lucas Papademos at the Bridge Forum Dialogue, 22 January 2008.

[2] BIS Working Papers No. 353, *Central banking post-crisis: what compass for uncharted waters?* by Claudio Borio.

with the objective of ensuring that outcomes reached are in the best interest of not only the global economy but also emerging markets, South Africa, and the region.

Since the onset of the crisis, the G-20 assumed a leading role in trying to address the consequences thereof in an effort to reduce the negative repercussions for the global economy. This entailed, inter alia, the G-20 taking the lead in addressing the shortcomings of the global financial system, enhancing financial safety nets, and, together with the Basel Committee on Banking Supervision, ensuring a more sound and stable financial and regulatory framework.

The G-20 played a prominent role in shaping the elements of the work programme of the International Monetary Fund, or the IMF. Let me highlight some of the initiatives that the IMF undertook in response to requests from the G-20.

Firstly, the IMF's lending capacity was boosted to ensure that it would comfortably meet the ever-increasing financing needs of countries hit by the global financial crisis, thereby strengthening global economic and financial stability. The G-20 agreed in April 2009 to increase the borrowed resources available to the IMF by up to US$750 billion, tripling the total pre-crisis lending resources of about US$250 billion. In April 2010, the IMF Executive Board adopted a proposal on an expanded and more flexible New Arrangements to Borrow, or NAB, under which the NAB grew to approximately US$560 billion. This included 13 new participating countries and institutions, including a number of emerging-market countries that made significant contributions to this large expansion. In April 2012, the International Monetary and Financial Committee[3] (IMFC) and the G-20 Finance Ministers and Governors jointly agreed to further enhance the IMF's resources through a new round of bilateral borrowing. This round included 35 agreements totalling US$385 billion. South Africa participated in all these initiatives and contributed US$2 billion to the 2012 initiative.

The IMF, together with the G-20, revamped its lending framework to provide greater emphasis on crisis prevention tools. For example, the Flexible Credit Line was introduced in April 2009 and enhanced in August 2010 as a lending tool and form of insurance for countries with very strong fundamentals; qualified countries can have upfront, large access to IMF resources, with no ongoing conditions given the strength of their policy frameworks. The Precautionary and Liquidity Line was also designed to meet the liquidity needs of member countries with sound economic fundamentals but with some remaining vulnerabilities.

In an attempt to strengthen its credibility and legitimacy, the IMF undertook to reform its governance structure and, in April 2008 and November 2010, agreed on wide-ranging governance reforms to reflect the increasing importance of emerging-market countries. However, the latter reforms have unfortunately not been implemented yet and continue to await ratification by the US. Nonetheless, the 14th General Review of Quotas will double the IMF's permanent resources to US$656 billion.

In recent years, the IMF has undertaken major initiatives to strengthen surveillance to respond to a more globalised and interconnected world. These initiatives include revamping the legal framework for surveillance to cover spillovers, a greater analysis of risks and financial systems, stepping up assessments of members' external positions, and responding more promptly to concerns of member countries.

All these changes were introduced with input from the G-20, and South Africa, as a member of the G-20, actively participated in these discussions and decisions.

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3 The IMF Board of Governors is advised by two ministerial committees: the International Monetary and Financial Committee (IMFC) and the Development Committee. The IMFC has 24 members, drawn from the pool of 187 governors of the IMF. The IMFC discusses matters of common concern affecting the global economy and advises the IMF on the direction of its work.

In the area of financial regulation, the G-20 has worked closely with the Basel Committee on Banking Supervision and other standard-setting bodies to agree on and implement key regulatory reforms, including ensuring resilient financial institutions, ending the "too-big-to-fail" approach, addressing shadow-banking risks, and making over-the-counter derivative markets safer. Basel III was endorsed by the G-20 in November 2010. The task of developing new standards was complex and time-consuming, requiring cross-border cooperation to ensure consistency on a multitude of issues between central banks, ministries of finance, regulators and supervisors, international organisations, and financial standard-setting bodies. While the Basle III rules have been agreed upon, the next phase of a timely, full, and consistent implementation is just as important to ensure level playing fields between jurisdictions and financial institutions and to address any unintended consequences of the reforms. Due to the globalised nature of the financial system, it will be important to continue analysing the effects of individual jurisdictions' policies on each other to understand the positive and negative spillovers.

The participation of the South African Reserve Bank

The Bank has a particular role to play in ensuring the stability and resilience of South African financial institutions and markets, thus contributing to and promoting globally stable financial systems. The Bank fulfils this responsibility on an international, regional, and domestic level. Similarly to many other jurisdictions, South Africa is also reforming its domestic financial regulatory architecture and arrangements. In addition to regulating and supervising the banking sector and overseeing the national payment system, under the proposed Twin Peaks model of regulation the Bank will also be responsible for the prudential regulation of the insurance sector and other types of financial market infrastructures, and will fulfil the function of the resolution authority. While the Bank readies itself to take on more regulatory responsibilities on the insurance side, South Africa, through its current supervisor, the Financial Services Board, is already a respected partner in the International Association of Insurance Supervisors, having been one of the seven co-founders in 1994.

Financial regulatory standard-setting bodies such as the Financial Stability Board and the Basel Committee on Banking Supervision have expanded their governance structures to be more representative and to reflect the globalised nature of the financial system. This includes considering the particular role of central banks as direct financial supervisory authorities, or where they act in an advisory role to their governments. As mentioned earlier, the Bank is actively engaged in the activities of international financial standard-setting bodies as well as the activities of the G-20 forum and the IMF. To name but two examples, in 2009 the Bank formally joined the membership of the Basel Committee on Banking Supervision and of the Committee on Payments and Market Infrastructures (formerly known as the CPSS: the Committee on Payment and Settlement Systems). Through National Treasury, South Africa has been a plenary member of the Financial Stability Board since 2010, and in early 2015 was allocated a second seat along with five other emerging-market countries at the plenary table. The Bank has assumed the position of an additional plenary member and, together with National Treasury, can use this opportunity to influence the agenda to focus on issues that especially affect emerging markets. It should, however, be clear that even before the Bank formally became a member of the above-mentioned bodies, it continuously followed and, where appropriate, aligned its own policies and procedures with the guidance and principles issued by these international standard-setting bodies.

South Africa's membership of these international standard-setting bodies is accompanied with the requirement that we comply with the standards developed by these bodies. This compliance process includes annual IMF Article IV consultations, IMF / World Bank Financial System Stability Assessments (FSSAs) and Reports on Observance of Standards and Codes (ROSCs), peer reviews by other G-20 member countries on our Framework for Economic Growth, Financial Stability Board country peer reviews, and the Basel Committee on Banking Supervision process to determine the adoption of Basel III capital and liquidity standards for banks through the Regulatory Consistency Assessment Programme (RCAP). The Financial Stability Board released its review on South Africa in 2013, the IMF completed an FSSA and three ROSCs in 2014, and the Basel Committee on Banking Supervision has almost completed its RCAP on capital and liquidity compliance.

In the G-20 forum, there is much discussion, analysis, and sharing of views on monetary policy spillovers, particularly in the current environment of increasingly divergent monetary policies by some of the advanced countries. Other topics that have received attention within the G-20 context have included oil price developments, investment spending, and tax reforms. These issues are discussed at ministerial and governor level, and these discussions certainly help in creating greater awareness of policy actions and a better understanding of the spillover and spillback effects that countries could be subjected to. The overarching focus of discussion at the G-20 more recently has been how individual member countries can devise growth strategies which would contribute to the objective of increasing global growth by an additional 2 per cent over the next five years. These strategies are continuously evaluated to ensure that they remain applicable and implementable, and they are also peer-reviewed to ensure that countries adhere to their commitments.

In addition to our involvement in the Basel Committee on Banking Supervision, the Governor attends the bimonthly meetings of the Bank for International Settlements, which provides a forum for governors and senior officials to share country experiences and to discuss the outlook for the global economy and financial markets. The Bank also participates in the Meeting of Governors from major emerging-market economies. In today's interconnected world, having such a forum to discuss issues and challenges specific to emerging-market economies is extremely valuable. Furthermore, in many instances, the Bank is the only representative from the continent and is thus able to provide an African perspective on some of the economic challenges confronting the global economy.

The Bank's interactions are not limited to international bodies but include regional bodies and less formal but equally important engagements, such as with home- and host-country supervisors through supervisory colleges and crisis management groups. To promote regional financial integration, the Bank is fully supportive of and active on committees such as the Association of African Central Banks, the SADC Committee for Central Bank Governors (CCBG), the Community of African Banking Supervisors (CABS), and the Financial Stability Board's Regional Consultative Group for sub-Saharan Africa. The work of these important committees contributes towards the development and implementation of an effective financial sector regulatory framework in Africa, and promotes growth and development on the continent.

Being in the privileged position of participating in the development of international standards and principles brings with it certain responsibilities. Those who participate in international and regional financial standard-setting bodies have the obligation to play a proactive role, to use our strengthened voice, to be ready to take constructive positions on the various reforms, and to consider the views of those countries who do not sit at the table. The Bank is fully committed to fulfilling this responsibility in all its engagements.

As you are aware, South Africa is also part of the BRICS grouping of countries. We meet ahead of G-20 meetings to exchange views on issues affecting the global economy. In addition, these countries have committed themselves to supporting one another and undertaking collaborative initiatives that will benefit BRICS as a group. In this regard, BRICS has agreed to the establishment of the Contingent Reserve Arrangement (CRA), which BRICS leaders agreed to in July 2014. The CRA is a self-managed arrangement, the purpose of which is to serve as a financial safety net, complementing existing international monetary and financial arrangements. The initial size of the CRA is US$100 billion; South Africa contributes US$5 billion and is eligible to receive US$10 billion in support. The CRA is made up of swap arrangements between the BRICS countries and will be used to forestall short-term balance-of-payments pressures, provide mutual support, and strengthen financial stability. The CRA is beneficial to South Africa as it adds a layer of financial support in times of crises. Currently, the BRICS central banks are negotiating the Inter Central Bank Agreement which operationalises the CRA; this is set to be finalised before the next BRICS Summit in Russia in July 2015.

Conclusion

The recent crisis has highlighted the importance of effective cooperation and coordination by central banks as well as the benefits of improved information-sharing between financial supervisors and central banks. The experiences of the past few years have highlighted the need to deepen our understanding of how globalisation affects both monetary policy and financial stability. This, in turn, facilitates a better assessment of the potential systemic implications of financial shocks, which should assist policymakers in addressing market tensions faced by individual institutions.

Through forums such as the G-20, the IMF, and BRICS, much work has been undertaken to strengthen the global economy and the global financial system, and to better identify, understand, and manage risks.

South Africa and the Bank, as an active participant in these international forums, always strive to ensure that the interests of the country and of the continent are represented in discussions on the global economy.

Allow me, in closing, to leave you with a plea. You have all been privileged to attend one of the world's leading business schools and have come back equipped to assume the important roles you occupy in your respective companies. With the release of the most recent unemployment figures earlier this week, which in no small measure have to do with education and skills levels, I would encourage you, if you are not already doing so, to get involved in coaching and mentorship programmes to share your insights, expertise, and experiences. We celebrated Africa Day on Monday. With the vast potential and opportunities that our continent offers, which need good business leadership to partner with governments and the public sector, would it not be nice to add, somewhere in the near future, an African INSEAD campus to the locations in Europe, Asia, and the Middle East?

Thank you.