South African Reserve Bank

An address by Lesetja Kganyago,

Governor of the South African Reserve Bank,

at the SANEF Nat Nakasa Awards Ceremony

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Good evening, ladies and gentlemen.

Thank you to SANEF, the South African National Editors Forum, for the invitation to address you this evening.

As we all know, South Africa is going through a turbulent period at the moment – and this puts an enormous responsibility on the press to report on and interpret events in an open and balanced way. South Africa has a long tradition of journalists, such as Nat Nakasa, fighting for and trying to preserve media freedom, particularly during the era when the freedom of the press was an anathema. It is a testament to the resilience of our institutions that the country’s post-1994 new-found press freedom endures till today, despite noises from some quarters trying to undermine it. I salute all those of you who have carried on this tradition and have been nominated for the award tonight.

You do not need the Governor of the South African Reserve Bank to tell you about your role in society. In my address this evening, I would prefer to talk about the governance of monetary policy decision-making processes and our accountability as the country's central bank.

Accountability means that we have to explain ourselves to the public. One of the most important channels through which we account to the public is the media. So our relationship with the media is of critical importance.

Some of you would have read the monetary policy statements that we publish at the conclusion of our Monetary Policy Committee (MPC) meetings; some of you would have seen me reading out the MPC statement at the press conference which is broadcast live on television. In this statement, the South African Reserve Bank (SARB) sets out how we view the state of the global and domestic economy – and how the situation impacts on our outlook for inflation. At the end of the statement, we announce the policy rate decision. This decision regarding interest rates is of enormous importance to the economy in general, and it affects most people, either directly or indirectly. This raises the question as to how these decisions are made, the governance around the MPC decision-making process, and our accountability.

Central banks are generally viewed as conservative institutions, and 'conservative' implies a reluctance to change. However, there have been significant changes in how central banks operate in the last few decades. I would like to highlight the three main aspects to this central bank evolution or, perhaps more appropriately, revolution.

The first is the move towards monetary policy independence. Many people assume that independence has been common practice since the establishment of central banks. But this is not the case. It is something that has evolved over time. In fact, the Bank of England, which in literature is often held up as the epitome of 'best practice' in central banking, was only granted monetary policy independence in 1997. Before then, all monetary policy decisions were taken by the Chancellor of the Exchequer, with the Bank of England merely implementing those decisions.

One of the theoretical rationales for an independent central bank is to avoid the so-called 'political electoral cycles' in monetary policy, which is the tendency of governments to lower interest rates or loosen monetary policy before an election and then tightening them afterwards. Having a central bank with a time horizon that is longer than the electoral cycle should ensure that monetary policy decisions are not subject to political pressures. In other words, it should avoid the possibility of taking advantage of short-term and temporary positive trade-offs which ultimately lead to longer-term pain. These cycles are well documented in a number of countries. In South Africa, the SARB reportedly lowered interest rates in advance of the Primrose by-election in 1984, only to raise them again a few weeks after the election.

The granting of operational independence to central banks has meant that monetary policy was in essence handed over to non-elected officials. Holding them accountable would require well-defined goals for monetary policy and effective channels of communication. This resulted in the second step of the revolution: a sea change in monetary policy communication. From being highly secretive institutions, central banks have become masters of communication, with communication strategy in fact now regarded as one of their policy tools. This change coincided with the evolving view of how monetary policy should be conducted. The idea that monetary policy should surprise the markets made way for the current conventional wisdom that central banks should guide the markets – and this requires open communication as well.

The third aspect of this central bank revolution is the move from a single decision maker to committee-based decision making. Historically, monetary policy decisions were generally made by the Governor, perhaps with a committee in a purely advisory role. But along with this change came the need for governance structures around the decision-making process.

I should point out that inflation-targeting frameworks emerged hand in hand with these developments, which are entirely consistent with this framework. In fact, they had a symbiotic relationship. Inflation targeting requires a clear objective for monetary policy, and independence of decision making is therefore of the essence. Inflation targeting works partly through anchoring inflation expectations, and for this, clear and credible communication is required. For credibility, there needs to be transparency of policy objectives and of decision making. Independence also requires accountability. Therefore, good governance structures relating to committee workings and decision making are also important.

While decision making by committee is not a prerequisite for inflation targeting, there are good arguments for it. It is an irony, however, that in New Zealand, the first country to adopt inflation targeting, the Governor is the sole decision maker. He does take advice from a committee, but the decision is ultimately his. This is mainly because the Policy Targets Agreement that the Governor signs with the government makes him personally responsible for achieving the target. His job is on the line if the target is missed.

There is a sizeable literature on the relative efficiency of committee-based decision making. The general conclusion appears to be that, subject to certain features being present, a committee structure outperforms individual decision making. A committee tends to pool information and ideas from a group comprising different skills and views, and it also provides insurance against extreme preferences and outcomes. One of the arguments against committees is that they tend to be inertial and over time may be subject to 'group think'.

The structure and governance frameworks of monetary policy committees differ across countries. Sometimes this is because of the legislative environment that governs the committees. In other instances, the institutional design and processes of the committee are determined by past practice and institutional culture and traditions, as well as by the mix of people and personalities.

To give some examples. In the United Kingdom, the MPC consists of internal and external members, with the latter appointed by the Chancellor. Each member is individually responsible for his or her vote and has to explain, if asked, for example by a parliamentary committee, why they voted in a particular way. In the European Central Bank (ECB), by contrast, each member state appoints one member to the Governing Council, the main decision-making body of the ECB. Each member has a vote and these votes are not revealed; the Governing Council takes collective responsibility.

The United States practice is a bit more complex. The Federal Open Market Committee (FOMC) consists of the 7 members of the Board of Governors of the

Federal Reserve System, the President of the Federal Reserve Bank of New York, and 4 of the remaining 11 Reserve Bank Presidents who serve one-year terms on a rotating basis. The Presidents of all the other Reserve Banks attend the meetings but they do not have a vote. The voting record of the FOMC is made public.

Revealing the individual members' votes does not necessarily mean that there is a democratic outcome. Alan Blinder, the former Vice Chair of the Board of Governors of the Federal Reserve System, refers the possibility of 'autocratic collegial' processes where the Chair's preference is likely to be the consensus outcome. It is well documented that under Alan Greenspan's chairmanship of the Fed, for example, there was a tradition that no more than two members would vote against the Chair's wishes. In such instances, while there is an appearance of democratic processes, the reality may be quite different.

What is the practice in South Africa? The primary goal of the SARB is the maintenance of price stability. This is confirmed in the Constitution of the country, and we have applied policy within an inflation-targeting framework since February 2000. The target in effect quantifies our constitutional mandate. The Constitution is, however, silent on how monetary policy should be conducted, and this allows for monetary policy practices to evolve over time. The 'how' is discretionary, and the Constitution gives the SARB autonomy or independence in making these policy decisions.

An MPC was first constituted in October 1999. Prior to this, decisions were made by the Governor at times that were not pre-set. Generally, announcements were a surprise, made on late Friday afternoons after the local financial markets had closed.

With the introduction of inflation targeting, practices have evolved. It is not my intention to outline all these changes here tonight, but I would rather like to focus on the current practice.

Monetary policy decisions are made by the MPC, which currently comprises six members: the Governor, the three Deputy Governors, and two other senior officials of the SARB. The composition and workings of the MPC are governed by internal terms of reference, which make provision for up to four senior officials apart from the four governors. The choice of these officials is the prerogative of the Governor, after consultation with the Deputy Governors. These appointments are not ex-officio and are therefore not automatically related to a specific position within the SARB. Rather, they are focused on the contribution that particular individuals can make to the monetary policy decision-making process. But within these constraints, we also have to be mindful of the gender composition of the MPC, which is currently all male. This explains the absence of a full complement as provided for in the terms of reference, and it is something that we are working hard at to rectify.

Every monetary policy decision is an outcome of in-depth discussion and debate. Even a 'no change' decision is a policy decision. I should also note that the monetary policy decision is not a one-off event; it is a continuous process which culminates in the MPC meeting where decisions are finally taken. We are constantly talking to each other, discussing what we see and how we interpret what we see.

These discussions are not only amongst MPC members, but also with other staff members in the SARB who keep us updated about developments. We also interact with analysts outside the SARB, and we hear what they are thinking as well. A few days before each meeting we receive further documentation prepared by various units in the SARB, so by the time we have the MPC meeting, we are well prepared!

MPC meetings last three days. The first day of the MPC meeting is devoted to discussions about global and domestic economic and financial market developments. This part of the meeting is attended by the MPC as well as about 55 other staff members. Each presentation is followed by a discussion, where we interrogate the presenters and their colleagues. All attendees are invited to contribute to this discussion. At this point, however, there is no discussion of the policy stance.

The following morning is devoted to a discussion of the forecast. These deliberations are attended by some members of the modelling team as well as about eight other senior officials, apart from the MPC members. The outputs of two of the main models are presented and discussed.

Given the centrality of the forecast, it is important to say something about the role of the forecast in the monetary policy decision-making process. Monetary policy acts with a lag. According to our models, the full impact of a change in interest rates could take between 12 and 18 months to fully work its way through the economy to impact on GDP[1] and inflation. For this reason, monetary policy decisions need to be based on the expected path of inflation and not on current inflation, which is a function of past monetary policy. The forecast is therefore of central importance and is given much attention, both in our deliberations and in our communication of the monetary policy stance.

Given this, it is important that there are appropriate governance structures around the forecast. We are aware that there is a possibility that the forecasters themselves could bias the forecast in such a way as to influence the direction of the policy stance. One way in which we ensure that this does not happen is by making the MPC members part of the process that decides on the assumptions regarding the exogenous variables of the model. This in effect makes the MPC ultimately responsible for the forecast. The assumptions can make a material difference to the outcome of the longer-term inflation forecast. These assumptions, which have to be made to cover each quarter over the three-year forecast period, include international oil prices, international commodity prices, global inflation, and the starting point for the real effective exchange rate.

The assumptions are finalised at a meeting about two weeks before an MPC meeting. In the interest of transparency, these assumptions of the exogenous variables are published as an annexure to monetary policy statement. The SARB's core model has also been published, and this allows analysts to compare forecasts and understand the source of the differences in forecasts that may arise.

I should also emphasise that we do not follow the forecast in a mechanical way. If we did, we could simply hand over the decision to a computer which would tell us the appropriate policy path to follow in order to ensure that inflation is brought back into

[1] gross domestic product

target within an appropriate and achievable time horizon. We know that models are merely an approximation of reality and are therefore prone to error. Furthermore, we know that the assumptions that we make could also turn out to be incorrect. Each MPC member would have their own view about the risks to the assumptions and therefore to the forecast. Ultimately, we have to rely on our own judgement.

Following the presentation of the forecast, the MPC has a session with a few key staff to get their views. Thereafter, the MPC members meet on their own, where they review the highlights of the previous two days. The MPC then meets on the following morning, where each member sets out his view of the economy and policy preference. This is not a repeat of the facts, but rather an assessment of how the information received confirms our priors and how it affects the assessment of the risks to the outlook.

After a presentation by each MPC member, the other members can raise questions or debate issues raised in the presentation. The debates that follow the presentations are inevitably robust. But while there are disagreements, the atmosphere is collegial and marked by mutual respect.

There have been instances where members changed their policy stance after these debates, but this was because they had been convinced by other arguments, not because of pressure from peers or from the chair. It has been a long-standing tradition of the MPC that the views of the majority carry the day. A vote different to that of the Governor is not regarded as 'dissent’, but rather as an expression of a different viewpoint, which is encouraged. In the event that the preferences are evenly split, the Governor has the casting say.

Disagreements at South Africa's MPC are quite common and reflect an absence of group think. Of the past 16 meetings, only half were unanimous. In the other seven, there were 4-2 splits on three occasions, 5-1 splits on three occasions, and a 3-3 split on one occasion. On one occasion, three members preferred a 50 basis point increase, two preferred a 25 basis point increase, and one preferred no change in the policy rate.

The preferences are revealed in the monetary policy statement, although we do not reveal individual member preferences. As I noted earlier, there are different practices in this respect. Our view is that identifying the individual votes would place excessive focus on the individual rather than on the decision. While we do allow for different opinions and views, we take collective responsibility once a decision is made.

An important part of accountability is the communication of the decision. We do this in various ways. First, we do not publish the transcripts of the MPC meetings. There is much debate globally about this. Experience in other countries shows that publishing the transcripts of committee deliberations could stifle debate and result in an excessive reliance on prepared statements that are read out. We do, however, release a statement at the end of each meeting. The statement outlines how the MPC sees the economy, the reasons for its policy stance, the assessment of the risks, the voting preferences, as well as some qualitative forward guidance. The statement is read out at a press conference that is televised live on a number of channels; it is also streamed live on the SARB website. All MPC members constitute the press conference panel, and questions are taken from the press and other analysts who can dial in.

Accountability and transparency are further enhanced through the biannual publication of the *Monetary Policy Review* (*MPR*), in which an in-depth analysis of the monetary policy stance is presented. The *MPR* is launched at a national Monetary Policy Forum (MPF), with all MPC members on the panel; the launch is open to all interested stakeholders. The MPF is usually attended by more than 300 people. Thereafter, a series of regional MPFs is conducted, with at least one MPC member as chair, at about nine different venues around the country.

As part of our communication strategy, we also arrange stakeholder engagements. We regularly meet with foreign and domestic asset managers and investors. Our outreach programme includes different groups from the broader society. These include trade unions, business associations and political parties. We also have an economic round-table discussion with economic analysts every alternate month, and we engage regularly with the academic community. Ultimately, we are accountable to Parliament. The SARB's Annual Report is presented to the parliamentary Standing

Committee on Finance, and we report to the committee whenever requested by Parliament to do so.

Last but not least, the press and general news media are an integral part of our communication strategy. Not only do the media report what we say, but they also interpret (and in some cases misinterpret) what we say. In order to improve the understanding of our thinking, and to encourage accurate coverage, the MPC meets with editors from the main publications at least twice a year, and once a year with senior journalists. And in order to enhance the quality of financial journalism, the SARB sponsors a Chair in Financial Journalism at Rhodes University.

The steps towards communication and transparency undertaken by central banks and the SARB in particular have been significant. While we have our own communication strategies, we cannot do this without close interaction with the press and broader media. We depend on each other. The press in South Africa has a proud tradition of being open, vibrant and questioning. I am sure that you, present here this evening, will carry on this tradition. My heartiest congratulations go to the winner of the award.

Thank you.