South African Reserve Bank

Remarks by Lesetja Kganyago,
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at the annual dinner for the Heads of Foreign Missions
accredited in South Africa

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Introduction

Dean of the Diplomatic Corps, Ambassadors, High Commissioners, Counsellors and Diplomats, ladies and gentlemen – good evening.

Thank you for accepting our invitation to this annual dinner hosted in honour of the Ambassadors and High Commissioners appointed to the Republic of South Africa.

We use this dinner to share our thoughts on the developments in the South African economy, and to highlight issues of importance in the area of global and bilateral cooperation.

Tonight, I would like to focus my remarks on two important issues that are increasingly coming under threat globally, namely multilateralism and central bank independence.

The impact of technological advances on global value chains, rising inequality, extreme weather conditions related to climate change, increased cross-country migrations and escalating trade tensions have all brought multilateralism under closer scrutiny, as nationalistic tendencies and inward-looking policies gain traction. On the other hand, the difficulties related to sustaining the global growth recovery have resulted in a discourse that many believe requires broader mandates and increased action from central banks.

As with other calls for change in recent economic history, all this was spurred by a crisis.

Key global developments and international cooperation

During the most recent global financial crisis, efforts to avert a second Great Depression saw international cooperation reach a new high. Central banks acted decisively and in a coordinated manner to shore up liquidity in financial markets. In the face of continued and significant volatility and vulnerabilities in sovereign debt markets, the financial resources of the International Monetary Fund (IMF) were significantly increased and the IMF revisited its lending toolkit, making it more relevant and more effective. However, while the global financial crisis brought forth new and stronger cooperation, the post-crisis recovery has not been as strong as was hoped.

Globalisation is therefore increasingly being blamed for the lacklustre recovery in some countries and for the significant negative spillovers of the crisis across borders. Many are blaming globalisation for the lack of inclusive growth, both within and across countries.

In some countries, significant numbers of people have been lifted out of poverty and new industries have been created. In others, there have been increased job losses, especially among the middle class. Some countries have also experienced elements of deindustrialisation. Consequently, there has been a move towards populism and elected politicians are increasingly turning to protectionist policies as a solution.

Unfortunately, trade wars and protectionism are not the panacea some believe them to be. The IMF has estimated that the current and threatened United States (US)-China tariffs could cut the global gross domestic product (GDP) in 2020 by 0.5% – or about US$455 billion. To put this into perspective, the estimated loss is larger than South Africa’s annual economic output.[1]

[1] *Financial Times*, ‘Lagarde warns of trade war’s “self-inflicted wounds”’, 5 June 2019

We are already seeing the impact of trade tensions reflected in weaker trade volumes, declining investment levels, and worsening investor sentiment. The manufacturing sectors in the Organisation for Economic Co-operation and Development (OECD) countries, which have strong links to the global value chain, have been significantly influenced by the recent tariff measures.

In addition, uncertainty around future trade developments is expected to reduce OECD's business investment growth from 3.5% in 2017/18 to around 1.7% in 2019/20. As long as these trade tensions persist, the downside risks to global growth will increase.

Before more damage is done, a more integrated, cooperative and coordinated approach is required, incorporating the principles of multilateralism. Protectionist and isolationist approaches to dealing with global challenges will simply not take us very far.

In October last year, IMF Managing Director Christine Lagarde called for a 'new multilateralism' – one that is dedicated to improving the lives of *all* citizens, one that ensures that the economic benefits of globalisation are shared much more broadly, and one that focuses on accountable governments and institutions that work together for the common good. This 'new multilateralism' is key to providing the foundation for global cooperation to tackle the many transnational challenges, including managing the risks related to, among other things, climate change, cybercrime, increasing conflict and refugee flows, failures of governance, and illicit finance flows.

An essential component of global cooperation relates to the global financial safety net (GFSN). Today, the GFSN includes international reserves, bilateral swap lines, regional financing arrangements, IMF resources and market-based instruments. While the size of the GFSN is larger than it was before the global financial crisis, the adequacy and coverage of the GFSN as well as its capacity to handle future economic and financial crises continues to be debated.

South Africa and the South African Reserve Bank (SARB) have continued to be active participants in international efforts to promote constructive dialogue as we seek global solutions to global challenges. As part of this work, we interact with many of the countries that you represent, be it as a member of the IMF, the G20[2], BRICS[3], the Southern African Development Community (SADC), the Association of African Central Banks, and various standard-setting bodies and regulatory forums.

The initiatives that the SARB has been involved in since we last met include the following:

- There have been ongoing discussions about providing adequate resources to ensure that the IMF can fulfil its role at the centre of the GFSN.

- Enhancing the effectiveness of the BRICS Contingency Reserve Arrangement (CRA) has also remained top of the agenda. The CRA is a self-managed contingent reserves arrangement instituted to forestall short-term balance of payments pressures, provide mutual support, and further strengthen financial stability.

- Another priority has been strengthening the macroeconomic research capability to support the CRA.

- In the region, the SADC Real Time Gross Settlement System[4] has continued to gain momentum. Between July 2013 and February 2019, more than 1 million transactions were settled on the platform, representing a value of R5.5 trillion.

- In addition, we have successfully collaborated with the European Central Bank, the Bank of England and the Bundesbank to develop certain skills of SARB staff members and to share and transfer knowledge in areas related to the SARB's domestic and regional work.

[2] Group of Twenty (Finance Ministers and Central Bank Governors)
[3] Brazil, Russia, India, China, South Africa
[4] Previously known as the SADC Integrated Regional Electronic Settlement System (SIRESS)

The independence of central banks and the South African Reserve Bank's role in the South African economy

Another topic that has been prominent over the past two years or so, and which seems to be gaining momentum, relates to central bank independence. In the words of Kenneth Rogoff, 'with the global rise of populism and autocracy, central bank independence is under threat'.[5] This applies to many countries, developing and advanced, including South Africa.

South Africa's disappointing economic performance over the past 10 years has contributed to growing calls for the expansion of the mandate of the SARB to directly stimulate growth and address unemployment.

The SARB's mandate, which is to achieve and maintain price stability in the interest of balanced and sustainable growth, is enshrined in the Constitution. In this regard, by keeping prices stable, the SARB creates the necessary economic environment for sustainable growth and development. An economy with stable inflation provides certainty, improves planning, and therefore supports consumer, business and investor confidence, which are essential in driving economic activity that facilitates growth and employment creation. Lower prices also support South Africa's competitiveness in global trade.

The inflation-targeting framework has served South Africa well. It has helped us achieve lower inflation and therefore lower interest rates. It has also increased the transparency of monetary policy, and made the SARB more accountable for its actions. We have come a long way from the days when the Governor could decide on interest rates in his office on a Friday afternoon, and not even publicise his decision, let alone his goals or reasons.

In terms of inflation, South Africa has joined many other emerging markets in getting inflation down to fairly low single-digits. In the 1980s our average inflation rate was 15%. It was nearly 10% through the 1990s. Since the introduction of inflation targeting,

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[5]Kenneth Roggof (2019, April) "How central bank independence dies" Available at: https://www.project-syndicate.org/onpoint/how-central-bank-independence-dies-by-kenneth-rogoff-2019-05

in 2000, inflation has averaged just over 6%, at the top of our target range but still substantially lower than in the preceding decades. It has also fallen further in recent years, to about the middle of our target range – the average last year was 4.6%, and we expect 4.5% this year.

Lower inflation means we can have lower interest rates. This is an economic relationship that makes a lot of sense, because lenders expect to be compensated for inflation, but it is often underappreciated in debates about inflation and the inflation target. The historical experience shows us we should take this point seriously: in the 1980s the SARB's average policy rate was around 13%. In the 1990s it was nearly 16% - with a lot of volatility, including spikes over 20%, because policymakers sometimes tried targeting the exchange rate, which is a much more difficult target than inflation. The repo has averaged 8% over the inflation targeting period, and just 6% since the Global Financial Crisis. As I always remind people, if you want lower rates, you need lower inflation. We see this process working once again at the moment: our forecast model indicates inflation will be close to 4.5% over the next few years, which is where we want it – in the middle of our target range. Given the weak economy, our model suggests we might have room to cut rates over the next year or so.

While the SARB recognises the role that macroeconomic policy has to play in the economy, the primary contribution monetary policy can make to growth is smoothing output fluctuations over the business cycle. The current challenges constraining economic growth are primarily structural in nature. To ensure that monetary policy settings have a sustained positive impact on growth, they should be appropriately supported by other macroeconomic policies.

The longer-term costs of higher inflation and a deterioration in inflation expectations have potentially adverse impacts on policy credibility, consumer purchasing power, borrowing costs, and the global competitiveness of South African firms.

To make a marked impact on potential output and employment levels, what is required is the implementation of prudent macroeconomic policies underpinned by credible structural policy initiatives. Tough times call for tough actions.

Monetary policy is not a substitute for structural reform. Price and financial stability is, however, key to ensuring that any structural reform agenda is successfully implemented. The SARB remains committed to fulfilling its mandate in this regard.

Conclusion

Allow me to conclude.

Many of the existing and emerging challenges confronting the global economy today require the strengthening of cross-border cooperation. We therefore need to strengthen our resolve to seek rules-based multilateral solutions. In a highly interconnected world, unilateral action, especially in the systemically relevant economies, is not the solution to fixing trade imbalances. Instead, it undermines confidence, increases adverse spillover effects, and ultimately reduces global growth.

Central banks and monetary policy have come under increased attention around the world recently. There are expectations that monetary policy should shoulder more responsibilities in addressing growth constraints. However, these expectations need to be based on the constitutional or legislative mandates of central banks. They also need to acknowledge the merits of central bank independence in safeguarding macroeconomic and financial stability, which is key in ensuring that the economy is on a sustainable growth path.

In this regard, I would like to reiterate that the SARB remains committed to fulfilling its primary mandate of maintaining price stability in the interest of balanced and sustainable economic growth. In addition, we will pursue this objective 'without fear, favour or prejudice', as the Constitution calls upon us to do so.

Thank you.