Held in reserve:

An interview with **Gill Marcus**

Gill Marcus is the outgoing governor of the South African Reserve Bank. Ben Turok conducted this written interview with her in September 2014.

Ben Turok: The South African Reserve Bank (SARB) has recently been restructured. What have you changed, and why?

Gill Marcus: The structure of the Bank as indicated in the organogram came into effect on 1 April 2014. The functions that report to the executive and the chief operating officer were changed to better reflect the expanding mandate of the Bank and bring about better alignment of the functions while creating the necessary oversight of the policy responsibilities of the Bank.

Each of the controlling and enabling functions (support functions) has undertaken an organisational review to create flatter structures to enhance management responsibility and accountability, while promoting greater efficiency. This work is ongoing and is supported by other human resource initiatives to continuously improve the functioning of the Bank in carrying out its mandate well into the future.

Gill Marcus

BANK RELATIONS

BT: What is the origin and role of private shareholders in the Bank? I did an analysis of this a few years ago and it's quite clear that the Bank is not privately owned.

GM: When the SARB was established in 1921, the majority of central banks worldwide had private shareholders and, in fact, many were originally privately owned. A similar structure was introduced in South Africa and has remained in place since then, although many other central banks have done away with private shareholders.

Shareholders in the Bank have limited rights in terms of the South African Reserve Bank Act (the Act). Shareholding is limited to 10 000 shares – whether an individual and his/her associates or a company – entitling the shareholder to exercise a maximum of 50 votes. The intention of this limitation is to ensure that no individual, group of individuals or companies can exercise undue influence. Shareholders do not "own" the Bank, which is in fact a legal persona. Shareholders can attend the annual general meeting of the Bank, where they are entitled to vote for seven non-executive board members. A further eight members, four of whom are non-executive, are appointed by the president. This includes the governor and three deputy-governors who make up the executive of the Bank. Members of the board elected by shareholders are required to have knowledge and expertise is various areas, including commerce or finance, industry, agriculture, mining and labour. The board is a governance board, not a policy board. Shareholders are invited to attend the AGM and road shows, ask any questions at these events and, by electing non-executive directors, they have input in the governance of the Bank. Shareholders receive a fixed dividend of 10 cents per share per annum and thus have no say over monetary or dividend policy.

BT: What is the relationship of the Bank to the minister of finance and the National Treasury (NT)?

GM: The governor is required by the Act and by the Constitution to consult regularly with the minister of finance. Bilateral meeting are scheduled regularly, and there are also a number of standing committees between NT and the Bank (macroeconomics, markets, regulatory and international relations). Any legislation that the Bank would want to submit to parliament has to be done through the finance ministry.

BT: Do you report to each other?

GM: We consult with each other. In some instances, we perform agency functions for the NT: for example, with respect to exchange controls. Some issues have joint responsibility: for example, financial stability issues. Monetary policy is conducted solely by the Bank, without reporting to or consulting with the NT, while fiscal policy is the domain of the minister of

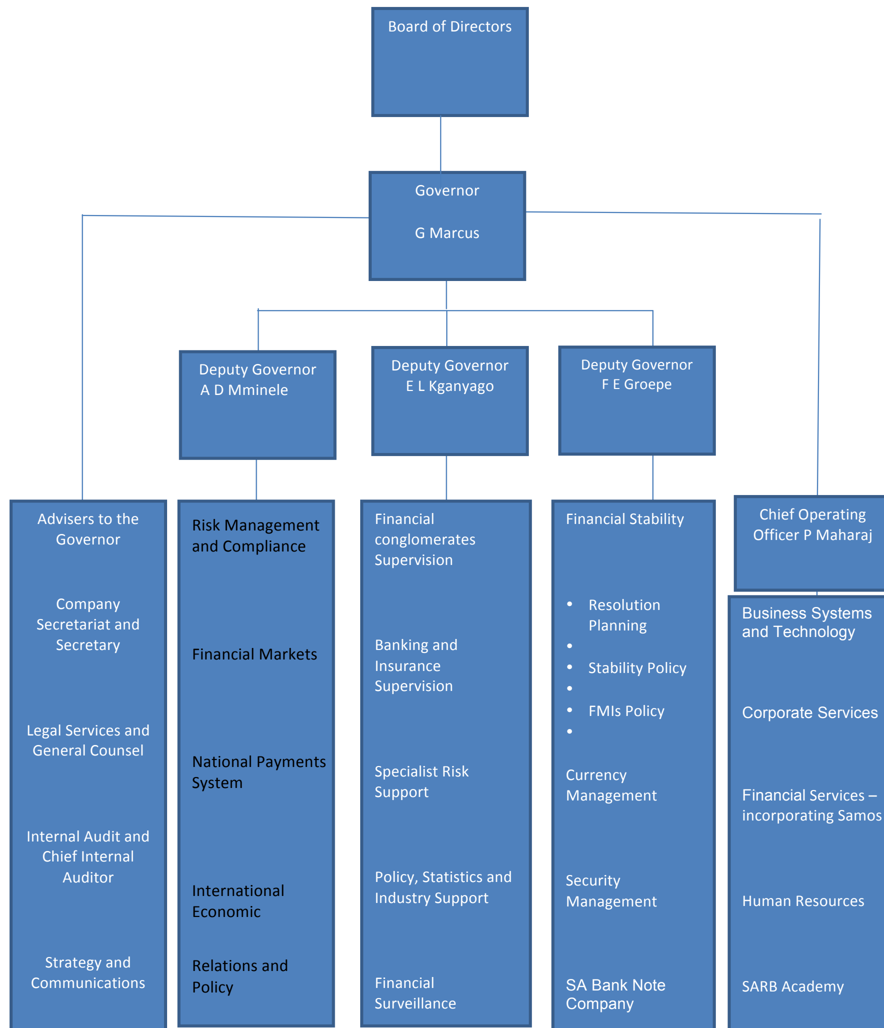

Figure 1. Structure of the South African Reserve Bank

finance.[1] The inflation target is set by government, but it is the responsibility of the Bank to independently determine how to achieve the target.

BT: When I interviewed the deputy-governor of the Swedish Reserve Bank, I met people who had worked at different times in their treasury, reserve bank and private banks. This circulation seemed to be normal there. Is this our practice – the circulation of elites, if you like?
GM: There are a number of staff members who have worked in the Bank or the Treasury and, as their own career choices, sought employment in the other institution. Likewise, people have left the Bank to join the private sector. This is not something that is planned, but a result of individual decisions made by staff members. Staff turnover in the Bank tends to be very low.

BT: I found in various countries, like Mexico and Sweden, that there are frequent private meetings between the governor of the reserve bank and the heads of the private banks. They feel it's important to exchange views and information at an informal level. What are the formal and informal relations between the SARB and private banks in South Africa?
GM: There is a range of interactions. A formal relationship exists in the sense that the Bank, as the Registrar of Banks, is the regulator and supervisor of the banking sector. There are also interactions relating to the various functions we perform: for instance, with the financial markets. There are also more informal relationships, and I regularly meet individually with the CEOs to exchange views.

BT: Our study distinguished between the Bank's goal independence and its operational independence. What is your view?
GM: The Bank has operational independence, as enshrined in the Constitution, with respect to monetary policy. It does not, however, have goal independence. Currently, with an inflation-targeting framework, the government sets the target, and we have operational independence to achieve this goal. What this means

in practice is that government cannot dictate interest rate policy to us once the inflation target is set.

However, independence does not mean that we are an ivory tower (or granite tower, in this case). We are not independent of the economy or society, and we take the broader interests of the economy into consideration when making monetary policy decisions. This is entirely consistent with a flexible inflation-targeting framework, and with the letter written to the Bank by the minister in 2010, in which the flexible nature of the inflation-targeting framework was restated.

Furthermore, when it comes to other elements of our mandate – for example, financial stability – this is very often a shared responsibility. It often involves the fiscus, and therefore we cannot act independently in all instances. To reiterate: we see independence as the exercising of our best judgement in setting monetary policy in the interests of the economy without interference or undue influence.

POLICY MANDATE

BT: What is the mandate of the SARB compared to the US Federal Reserve? Is there a difference, and why?

GM: Our mandate is to maintain the value of the currency – that is, achieve price stability – in the interest of balanced and sustainable economic growth. In their Federal Reserve Act, the US Congress established the statutory objectives for monetary policy as maximum employment, stable prices and moderate long-term interest rates.

But it is important to understand the "maximum employment" objective, as it does not differ very much from our own views. According to the Fed website:

> The maximum level of employment is largely determined by *nonmonetary factors* that affect the structure and dynamics of the job market. These factors may change over time and may not be directly measurable. As a result, the FOMC [Federal Open Market Committee] does not specify a fixed goal for maximum employment; rather, the FOMC's policy decisions must be informed by its members' assessments of the maximum level of employment, though such assessments are necessarily uncertain and subject to revision… In setting monetary policy, the Committee seeks to mitigate deviations of inflation from its longer-run goal and *deviations of employment from the Committee's assessments of its maximum level*. These objectives are generally complementary. However, under circumstances in which the Committee judges that the objectives are not complementary, it follows a balanced approach in promoting them, taking into account the magnitude of the deviations and the potentially different time horizons over which employment and inflation are projected to return to levels judged consistent with its mandate. (emphasis added)

In a flexible-targeting environment, the two are not very different – except that it makes clear that our overriding mandate is price stability. The US has a dual mandate, but it is clear from their recent communications that their concern for unemployment is subject to inflation remaining under control.

BT: How does inflation targeting affect the real economy? How does it relate to international debate about stimulus versus austerity in monetary policy?

GM: Our view is that the long-term structural or potential growth of the economy is determined by real variables such as productivity growth, infrastructure, skills, etc. It is not determined by monetary policy, as excessively low interest rates in the long run lead to inflation and no real effects. However, in the short run, monetary policy can have an impact on the real economy. In other words, it can affect the amplitude of the cycle around the long-term growth trend.

The current international debate around monetary policy is focused on stimulus to return economies to pre-crisis levels, or thereabouts. The transmission differs in different countries, but monetary stimulus is not generally seen as determining longer-term potential output, but as a means to get economies back to potential output (i.e. a cyclical effect). There is some debate whether the "new normal" implies lower potential output in some economies. There are many who fear that this ultra-accommodative monetary policy could be inflationary, but even those who do not think this to be the case generally believe that, once normal levels of potential output are achieved, monetary policy will normalise as well.

Similarly, in South Africa we have an accommodative stance (negative policy rate) to help with the normalisation of growth rates. In instances where austere fiscal policies are in place (because of the unsustainability of fiscal positions), loose monetary policy is required as a counter to prevent excessive contraction of the economy. I should point out that, although we may directly impact on cyclical growth, the translation into employment is not necessarily automatic.

BT: Concerning the exchange rate: we seem not to be intervening. Or do we intervene indirectly?

GM: We have a flexible exchange rate system, and we do not intervene in order to achieve a specific exchange rate outcome. However, our level of reserves is considered to be lower than optimal (for example, in terms of the IMF [International Monetary Fund] metrics, we are just below the low end of the adequacy range), so we have increased our reserves over time. This we do on an ad hoc basis when there are strong inflows. This may help to prevent excessive appreciation, but it has not been done with the intention of achieving a specific exchange rate outcome. Since the rand has been on a depreciating trend, we have

not been accumulating reserves, and any changes in reserves have been a result of valuation changes. We are not intervening indirectly either.

BT: To what extent are we captive of US policy decisions and trends?

GM: We follow some trends in the US economy, but not directly or blindly. The US is still the dominant global economy, and the old saying, that "when the US sneezes, the rest of the world catches a cold", still applies to some extent. So when the US slows, it does impact on the rest of the world, but the extent will depend very much on the trade links. So Mexico would follow US growth trends more closely than we do, and we follow European growth trends more closely.

Furthermore, we are affected by what happens in the US financial markets and US monetary policy. US quantitative easing and low interest rates meant that money left the US in search of yield, and that impacted on our interest rates and exchange rate as well. The end of quantitative easing and the prospect of US monetary policy normalisation will mean that the process is reversed, and in such circumstances our interest rates are likely to have to increase. This will happen much more quickly with longer-term rates that are market determined. But short-term rates can diverge to some extent because monetary policy (the Bank) acts directly on them, and a flexible exchange rate allows us some space to set interest rates independently of the US. We may not follow the trends exactly, but we are affected by what they do and the spillover effects of their policies. Although US policymakers are increasingly sensitive to these spillover effects of their actions, ultimately they will make decisions in the interest of the US economy.

RATING THE BANKING SECTOR

BT: The downgrading of our banking system by Moody's rating agency took people by surprise. We have so often said that we have a very sound banking system and international agencies have agreed. Why did Moody's downgrade us? How serious is that?

GM: Ratings are important because they can have an impact on the cost of funding of banks.

Moody's recently downgraded Capitec by two notches and the four major banks by one notch, and put them all on review for further downgrades. Although Investec was not downgraded, it is on review for a further downgrade.

The basis for the downgrade of the four banks' local-currency deposit ratings was twofold: first, on the basis of the weak economy that would reduce the quality of their assets and weigh on the banks' financial performance; and second, because the burden-sharing restructuring plan for ABL [African Bank] announced by SARB is "a clear indication of a reduction in the likelihood of systemic support being provided in the event of need, in a manner that would fully protect creditors". Moody's argued that that there is a risk that this approach would be followed in resolving problems with other banks, should such a situation arise. This is despite the fact that the resolution was in line with evolving international best practice – known as the "key attributes" and developed by the Financial Stability Board[2] – of bailing-in creditors so that the costs of a bank failure are not only borne by the taxpayer. In addition, at the time, some of the bonds were trading at a 60 percent discount, so the ultimate resolution of a 10 percent haircut was seen to be highly favourable.

Both Fitch and S&P [Standard and Poor's] kept the ratings unchanged.

According to Fitch, the banks' ratings are capped by the sovereign rating, and the banks would be downgraded if the sovereign were downgraded. In their view, "the propensity to support banks is weakening in South Africa with the impending adoption of resolution legislation. But a moderate likelihood of support for systemically important banks will remain. Its approach to factoring in state support for systemically important banks does not change, despite African Bank's resolution" (Reuters, 26 August 2014).

S&P also did not follow the Moody's move:

> "At the moment they (the banks) are on a stable outlook and we've got no plans in the immediate future to change the ratings on institutions outside an economic shock or an industry-wide shock," S&P credit analyst Matthew Pirnie told Reuters. Pirnie said it made its ratings decisions on South African banks using a different measure to Moody's. "In a long time we have not placed government support into the ratings of South African banks because... the banks are pretty good in comparison to the country they operate in. We don't believe that the African Bank failure poses a systemic risk, therefore we wouldn't move down specifically because of that." (Reuters, 21 August 2014)

We believe the banking sector remains sound, and the demise of ABL was not a reflection of the banking system in general. ABL followed a unique business model, very different even to Capitec, which is the other bank that is exposed to unsecured lending.

NOTES

1. Monetary policy relates to the supply of money in the economy, e.g. through setting interest rates. Fiscal policy deals with government revenue (mainly taxes) and expenditure.
2. The Financial Stability Board (FSB) is an international body created by the G20 in 2009 to identify problems in the global financial system and oversee action to address them.