Holding firm at the Reserve Bank:

An interview with **Gill Marcus** (Part 1)

Gill Marcus stepped down as governor of the South African Reserve Bank ((SARB) when her term ended in November. Ben Turok had an extensive interview with her on 3 October 2014. This first part deals with changes in central banking, outside influence, and the Bank's mandate in the South African economy. Part 2 – which covers the SARB's remarkably extensive stakeholder engagement, and how monetary policy can (and cannot) respond to unemployment in South Africa – will appear in the next issue of **New Agenda**

Gill Marcus

Ben Turok: The Reserve Bank has always been a fairly conservative institution – necessarily, because of the sensitivity of what happens here – but your term as governor has seen some changes.

Gill Marcus: The role of central banks is changing and, because of the global financial crisis, we've had to rethink how we operate. The prominence of a central bank, the role it plays in society, is very different than five, 10 or 20 years ago. Twenty years ago, in the US for example, if there was a change in the interest rates, there wasn't necessarily even an announcement. The market had to decipher that something had been done.

We've also moved from an individual central bank governor having all the power to functioning much more through a Monetary Policy Committee, with much more transparency, openness and communication about the thinking behind our decisions. In that sense, the challenge for central banks over the five years that I've been governor is about how to deal with the greater uncertainty going forward and how to deal with the expanding expectations of what central banks can do.

The structure of the Bank as indicated in the organogram [see Fig. 1] 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.

Like other central banks, the South African Reserve Bank was historically very hierarchical and the governor had enormous individual power.

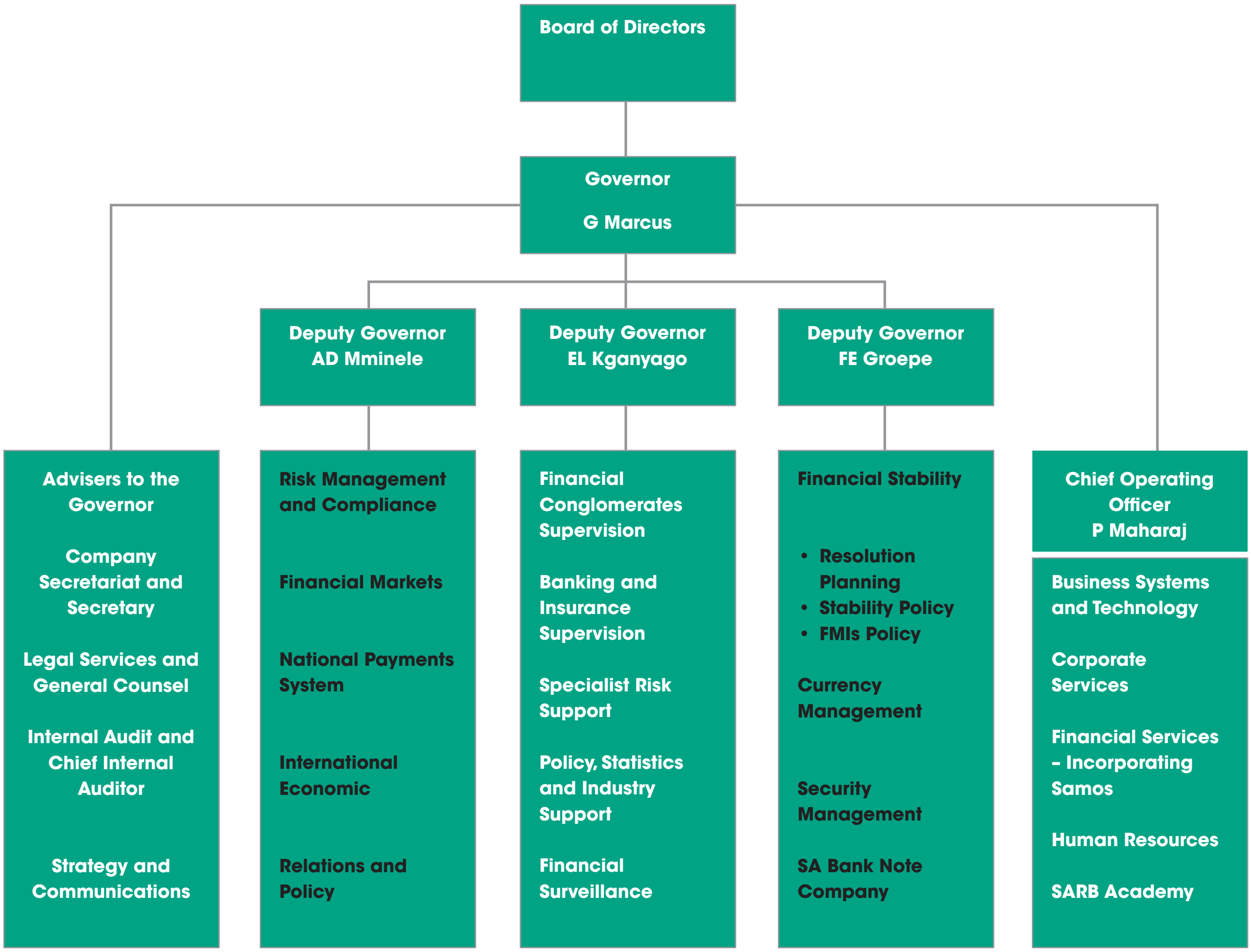

Figure 1. Structure of the South African Reserve Bank, April 2014.

What we've done over this period is, first of all – in terms of legislation and practice – make it a team, so that it's the *governors* who are responsible and not just a single governor, although the governor obviously has the ultimate responsibility.

Secondly, we've done a complete review of the organisation. Each of the controlling and enabling support functions has undertaken an organisational review to create flatter structures to enhance management responsibility and accountability, and greater efficiency. This work is ongoing.

In an environment of an expanding mandate and great uncertainty, in a situation where we've got very different technology, how do you enable people to take the appropriate decisions, and at the right levels? Historically, in most civil services – although we're not civil service – administration and management skills tended to be the route to rise in an organisation and you'd lose your technical skills. What we've now ensured, and it took a lot of time and iteration to get to that point, is that professionalism is rewarded.

Now you can earn and advance using your professional technical knowledge, and do not have to switch to a management career path to do so.

It's a very different organisational structure: more devolution of authority, more a question of individual responsibilities, professionalism, constant learning, and the ability to exercise leadership, not be a technical expert just in your own area. How do you create a central banker, someone who actually understands the interconnectedness of what you do? It's no good if you've got research that doesn't understand how financial markets work or financial markets that don't fully appreciate the implications for banking.

BT: The change has come about because of the greater volatility in the international markets?

GM: Not only that. A central bank's role is different today. Most central banks now have an explicit financial-stability mandate. Obviously, the debate is whether monetary policy is part of financial stability.

Who is Gill Marcus?

Gill Marcus was born in 1949 to parents who were committed to the anti-apartheid struggle. When the family was forced into exile in 1969, Gill worked for the ANC department of information and publicity. Having completed a B Comm degree at Unisa, she used her skill and intense style of work to further the cause of liberation.

After the unbanning of the ANC, she returned to South Africa and established the ANC's information department on a professional basis. She was a member of the national executive committee and the national working committee until 1999.

She was elected to parliament in 1994 and chaired the portfolio committee on finance until 1996, when she became deputy minister of finance. This was a very difficult period as the ANC had not prepared a transition plan for the economy and there were many adjustments to be made in the regulation of finance.

It was also the time of the shift towards greater fiscal and monetary prudence under the Growth Employment and Redistribution (GEAR) policy promoted by Minister Trevor Manuel.

From 1999 to 2004, she served as the first female deputy governor of the South African Reserve Bank.

In 2004, Marcus was appointed a professor at the Gordon Institute of Business Science and non-executive chairperson of Absa Bank, having also served as chairperson of the Financial Services Board, the Standing Committee for the Revision of the Banks Act and several other financial institutions. In 2009, she succeeded Tito Mboweni as governor of the Reserve Bank.

All this vast experience in finance, in both the public and private sectors, has been associated with the highest reputation for integrity and fairness. There has never been the slightest suggestion of impropriety, self-serving or bias, nor has her well-known support for the vision of the ANC government led to insinuations of partiality. – BT

Of course it is. You've got to think differently, you've got to be able to anticipate, you've got to understand what's happening globally, you've got to look at what is unknown.

Normally, central banks deal with uncertainty, because your transmission mechanism takes 12 to 18 months to fully work through the system, and you're trying to see into the future with the decision you take now. Today you're dealing with uncertainty compounded, because the crisis has created such unknown territory. You no longer have what was normal. Nobody knows what the new normal is. What is normal growth today? We don't know. Even domestically: have we lost capacity over this crisis? And can you regulate in an era where technology can bypass regulation? There's a lot of thinking that has to be done. Therefore, for me, the role of a central bank is an evolving one, and, therefore, you can't be static in your thinking. We describe ourselves as a knowledge institution – so what is it that you have to know and what is it that you don't know?

BT: This is just not research?

GM: Not at all. It is much more than that. We have 18 departments in the bank.

BT: How many people on staff?

GM: Around 2 200.

BT: I had no idea! So it is a kind of think-tank, and you employ people who have that capability?

GM: That number includes staff for the production of notes and coins and the associated security and distribution requirements and so on. But the rest perform diverse functions, including economic and financial stability research; bank supervision; the national payments system; administering exchange controls and managing the reserves of the country, which amount to around US$50 billion; co-ordinating our international participation in bodies like the G20, IMF, the Committee of Central Bank Governors of SADC, the Bank for International Settlements (BIS), etc. We also have the usual support departments – human resources, internal audit, corporate services, IT and so on.

BT: You had not been a professional banker when you first went to the Reserve Bank. Was that a problem?

GM: The legislation requires that someone appointed as governor should have some banking experience.

BT: You have that?

GM: To some degree. When I was deputy minister [of finance] I dealt with some of the issues related to banking. Then, as deputy governor of the Bank, my role was also related to bank supervision, and I later served as chair of Absa before returning to the SARB as governor. You need to understand how the banking system works. It does not necessarily work the way we'd like it to, but I think we do understand how it works.

But the job is so much more than that. I think this is a very demanding and unique job. You can only really obtain the skills required from within a central bank and that's the way we're trying to do it. We have scholarships for kids who finish school, we have programmes for people who've done their first degree, and we take in talented people. The objective is that they stay in the Bank for their whole career. Staff turnover is very small, about 3 or 3.5 percent. That's all. But within the Bank, you can change your career. Don't forget the Bank does everything. You can say, "Okay, I'm interested in risk. I'll go to the risk department." We have created a fully-fledged risk and compliance department. You may have been in the internal audit department and you want to go to risk. You may be in the financial markets department and decide you'd really like to go into the research side. Research itself will have different elements to it: statistics, monetary policy research.

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The bank supervision department performs a wide range of regulatory and supervisory functions, and that's all expanding now because government decided to bring the regulation of insurance and financial market infrastructure into the Bank.

There's a huge challenge in what the nature of regulation is going to be. This ability to vary the work you do is one of the reasons why people have such long tenures. They don't necessarily stay in one department, but they will look for new opportunities within the Bank.

BT: What is the role of private shareholders in the Bank?
GM: When the SARB was established in 1921, the majority of central banks worldwide had private shareholders. 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. Shareholding is limited to 10 000 shares, 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 in 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.

MONEY SPINNER

BT: What does it mean when we say that a reserve bank "prints money"?
GM: There is physical money that you print. That is your money in circulation. On average, we have about R110 billion in circulation at any moment in time. It grows by about 10 percent a year. But you don't physically have to print money, because a central bank and commercial banks can create money.

BT: How does that work?
GM: Very simple. A central bank can lend to government directly by buying new issues of government bonds, or the central bank can buy other assets from the market. These actions inject money into the economy in the form of new bank deposits, which do not require printing of physical money. Similarly, banks can create money. When you go into a bank and they give you credit, they create a deposit for you to use, and in the process they have created money.

BT: What is the effect of this creation of money?
GM: If you then have too much money in your system, it could lead to excessive expenditure and inflation. We try to control this by affecting the price of credit – that is, the interest rate. In the short run, we influence the amount of liquidity in the market by injecting or mopping up liquidity. For instance, we will issue a debenture at the repo rate and the market buys that. It's a way to withdraw that extra liquidity from the system. But we are the ones who can do that. That is why the central bank is so unique.

BT: You have powers that no ordinary bank has. And you create money by saying so. In fact, you're giving credit.
GM: Yes.

BT: What makes the US Federal Reserve Bank decide to put $85 billion into the system monthly and then withdraw it?
GM: They are not putting it into the system and withdrawing it. They are buying assets, which puts money into the system, but they are not withdrawing it at this stage. They physically buy assets like mortgage-backed securities and government bonds. They did this partly to get the economy going, but also to help certain segments of the markets that were experiencing stress, like the housing market. However, they have now stopped their asset purchase programme (or "quantitative easing", as it is often called). But at this stage they do not intend withdrawing the liquidity by selling those assets.

BT: And it's not real money?
GM: No, that's real money, because they are buying those real assets. They went into the crisis with a balance sheet of about $700 billion and it has expanded to over $4 trillion, which is unbelievable.

BT: What's the consequence of that?
GM: They'll probably just let the assets run off, in other words they will allow them to mature. They won't put it back into the system. They bought treasury bonds or whatever and when it expires, it expires, and that's it. That's why they make a lot of money, because they earn off that.

BT: That helps them in the budget process?
GM: It helps because they pay some of their profits over to Treasury, but there are risks to it. There is a risk when interest rates change.

BT: What is the mandate of the SARB compared to the US Federal Reserve?
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. Their Federal Reserve Act established the 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... In setting monetary policy, the FOMC [Federal Open Market 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.

In a flexible targeting environment, the two are not very different – except 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.


The South African Reserve Bank in Pretoria.

RESERVE BANK INDEPENDENCE

BT: Do you feel pressure from the cabinet, the president, the ANC?
GM: There is regular interaction with the minister of finance and the National Treasury, in keeping with sound practice and in terms of the SARB Act.

The president has always been available if there are matters that I wish to bring to his attention. But I have never had a call to discuss interest rate decisions – which is the core of monetary policy independence. I've never been told that they don't like what I'm saying; not the cabinet, not the party.

BT: That's a bit extraordinary.
GM: Why?

BT: This is an ANC government.
GM: It respects the role I play and what I'm doing and it doesn't interfere. Not when I was deputy governor and not when I was governor.

> Our mandate is to maintain the value of the currency – that is, achieve price stability – in the interest of balanced and sustainable economic growth.

Just to elaborate on that: in other countries, you will find that the governor can be an advisor to the president or sit in economic clusters and the cabinet. Our interaction is with the Treasury, and they don't interfere in our decision-making. It comes back to the question of what you mean by "independence". For me, an independent central bank is not a bank that is aloof from society or the economy. You're absolutely an integral part – and shaper – of that, and that's what you take into account. The way we exercise our independence is that we set monetary policy without fear or favour, short-term interest or any pressure. That pressure that you referred to has never occurred.

BT: Chris Stals [SARB governor, 1989–99] talked about autonomy, not independence.
GM: If you're autonomous, you can do whatever you like. We have instrument independence; we don't have goal independence. Inflation targeting and the "four pillars" banking system are government policies.

BT: Could you explain that?
GM: 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.

BT: What is the relationship of the Bank to the minister of finance and the National Treasury?
GM: The governor is required by the Act and by the Constitution to consult regularly with the minister of finance. Bilateral meetings are scheduled regularly, and there are also a number of joint standing committees or working groups between Treasury and the Bank. 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 Treasury, for example, with respect to exchange controls. Some issues, such as financial stability, have joint responsibility. Monetary policy is conducted solely by the Bank, without reporting to or consulting with the Treasury, while fiscal policy is the domain of the minister of 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: How does government communicate policy to you?
GM: Government policy is in the public domain. Let me explain the meeting structure. In terms of the Reserve Bank, we have a memorandum of understanding with the Treasury and we have four joint working groups: international co-ordination and relations; financial regulation; markets; and macro-economic issues. They are co-chaired by the director-general and the deputy governors or senior officials. They meet on a regular basis to say: "What are we seeing? How do we understand it?" There's an ongoing exchange of views.

We do not interfere or have any say in their decisions around tax, budgets, deficits or anything else. They don't have any say about monetary policy. But we try to see what is happening in both areas and how they influence each other. You take it into account.

That results in regular meetings between the minister and the governor and the teams, as well as when something is happening; if you're going to the IMF or the G20 to discuss the kind of positions, whether it's a country position or a monetary or fiscal question. It's not "How are you exercising fiscal policy?" or "How are you exercising monetary policy?", but "What is influencing the economy?" and trying to ensure that we have a common basis of understanding of what we are seeing.

However, with respect to monetary policy, as I mentioned earlier, we do not have goal independence. Government sets the target, and we have independence in carrying out that mandate.

BT: And if you thought that they set a bad inflation target?

GM: It would be an iterative process. It's their decision, but they wouldn't set it without having discussions and taking into account the macro-economy. It's an issue that would be discussed in the macro-economic committee, so our views would be heard. The committee then makes recommendations to the governor and minister, but ultimately it is government that decides the target.

MONETARY POLICY EFFECTS

BT: How does inflation targeting affect the real economy? How does it relate to the 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. In the long run, excessively low interest rates 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. 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 have an impact on cyclical growth, the translation into employment is not necessarily automatic.

BT: Concerning the exchange rate: we don't seem to intervene. 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.

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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. When the US slows, it does impact 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 had an impact 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; 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 policy makers are increasingly sensitive to these spillover effects, ultimately they will make decisions in the interest of the US economy.

> 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.

THE IMF AND RATING AGENCIES

BT: What about the World Bank and the IMF? To what extent are you beholden to them?
GM: We are not beholden. We do some courses with the IMF, and there are technical agreements and so on. We are a member of the IMF and they therefore conduct annual Article IV consultations with us, and give us their views on the economy.

BT: To what extent are you influenced by what they say?
GM: It depends. For example, we have just finished our Article IV consultation process with the IMF and we have just finished a financial stability assessment programme. They assist us in terms of techniques for doing some things, such as stress testing, and then how you measure those stress tests and to what degree you push it. They have people who are doing this, so you get technical assistance at that level.

In terms of positions that they take, obviously they have influence because other people read their reports as well. If we agree with them, that's fine. But if we don't, we tell them very clearly. So I would say they influence because they bring extraordinary technical skills into the equation. But because we are not in an IMF lending programme, they cannot impose any policies on us.

BT: They don't push on policy?
GM: They try to, in a sense. But their big issue – if you read what they're saying at this point in time – is that we are not making the right structural adjustments. They would point out how they see the risks. They do make suggestions and indicate what they think should be done, but as we are not subject to a lending programme; they cannot force it on us. And I think the approach has significantly improved under Christine [Lagarde, IMF managing director].

BT: The rating agencies are commenting…
GM: They are always commenting and that is their role. They are a different kettle of fish from the IMF, completely different. As you know, we've had big differences with them in the recent period. Moody's has just finished their rating. They're going to announce the outcome in the next few weeks.

BT: They threaten you!
GM: What I'm saying is, they don't influence you directly, but they take decisions that affect your whole country.

BT: Exactly, a threat. They say they're going to downgrade you if you don't do a, b and c.
GM: They usually set out the factors that would lead to an upgrade or downgrade with regard to country ratings. They indicate their concerns about such factors as debt-to-GDP ratios, your current account deficits, fiscal deficits, growth and unemployment.

BT: Does it affect your decisions, policy choices? Do you think, "If we do this, they're going to do that"?
GM: No, we don't. You can't conduct policy simply to please the rating agencies. But what you need to do is take account of the issues that they raise. Are there measures we can take to address the issues they raise? They are often the very issues we are grappling with anyway.

Let's take the current situation. The agencies have expressed concern about the size of the fiscal deficit. Treasury has imposed an expenditure ceiling to manage this – not to please the rating agencies, but because it's actually the right thing to do. If the rating agency says, "You need higher interest rates", we say, "On taking account of the economic situation, we actually believe the appropriate policy is the following…" You can't have higher interests rates because the agencies think you should have them. We wouldn't do that.

NOTE

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.