RESERVE BANK: KEEPING AN EAR TO THE GROUND

*An interview with **Gill Marcus** (Part 2)*

This is the second part of an extensive interview **Gill Marcus** gave **Ben Turok** one month before she finished her term as governor of the South African Reserve Bank. The first part appeared in our previous issue (No. 56, 4:2014). Here, Marcus discusses the Bank's extensive engagement with internal and external stakeholders, and how monetary policy can (and cannot) respond to unemployment in South Africa

AN EYE ON THE BANKS

Ben Turok: What is the relationship between the Reserve Bank and the banking sector? When I interviewed central bank deputy-governors in Sweden and Mexico, I had the impression that it was a very close little group of people who met quite often. One said they had dinner parties...

Gill Marcus: No, we don't have dinner parties. [laughter]

BT: When you interact with the CEO of a private bank, is it a lobby meeting or a consultation or what?

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.

I think the point that you're driving at is extremely important for any central bank: to be vigilant about not becoming a "captured regulator". I have no doubt we are not captured, and that would be the furthest from their thoughts. They would not try it, certainly not as things stand.

> **We can't ask about the role of the Bank as if it is the only role player and has the tools and ability to address all the issues that face our economy. We need to have a coherence of policy from all role players.**

But you can't second-guess the detailed operations and functioning of the big banks. They have forty or fifty thousand employees, working across borders, numerous branches, global partners, etc. No matter how well you want to supervise, you can't match that strength and depth in the detail. So you have to look at the key issues and ratios. What is the frame that we create and what tools do we have to get that effect?

We have a bank supervisor, with a department of about 140 people. Their job is to look at the banks on a range of issues. Capital adequacy, for example. The global norm before the crisis for capital adequacy was about 4.5 percent of risk-weighted credit exposures. We had about 9 percent. That's what the revised global requirements are now. Capital matters. Ask why our banking system is so sound? We insisted on much higher capital. Global banks can be very highly leveraged, but we have a limit. So we set the parameters in keeping with international standards and our own assessment of the banking environment.

We indicate to banks that they can't be leveraged beyond *this*, that *this* is what we expect from liquidity, and *this* is the ratio we want on your non-performing loans. The cost-to-income ratio is closely monitored.

But we do not run the banks. What we monitor is not the detail of the banking, but the parameters within which you try to create a sound environment. For instance, we expressed our concern about unsecured lending, which was growing at 30 percent per annum. The bank supervision department engaged with bank executives and boards about the matter, and today unsecured lending by the big banks is hardly on the agenda anymore. Its growth is now in negative territory. This has other consequences for financial inclusion.

Gill Marcus

This is what we have created in terms of our concerns about sound banking. Our total capital adequacy in 2014 was 14.87 percent. Tier 1 capital was 12 percent. That is very high.

BT: And you can enforce that?

GM: Absolutely. We have the means in the law to impose penalties. If we think that you are not complying, we can add a 25-basis-point addition to what you are required to hold, which is a huge cost.

That is one relationship, the supervisory relationship with banks. We also have regular on-site meetings. We had our banking crisis in early 2000, if you remember, and we changed quite a few things after that. For instance, you can't appoint a CEO or CFO or a board member without our approval. And we can remove you. We are one of the few countries that can do that. This in itself creates an obligation and risk for the supervisors.

BT: You can remove the CEO of a bank?

GM: Once they are in, it is harder, but we can say no to the appointment. And if there were real concerns about a CEO or senior executive, the route to address that would be through engagement with the board.

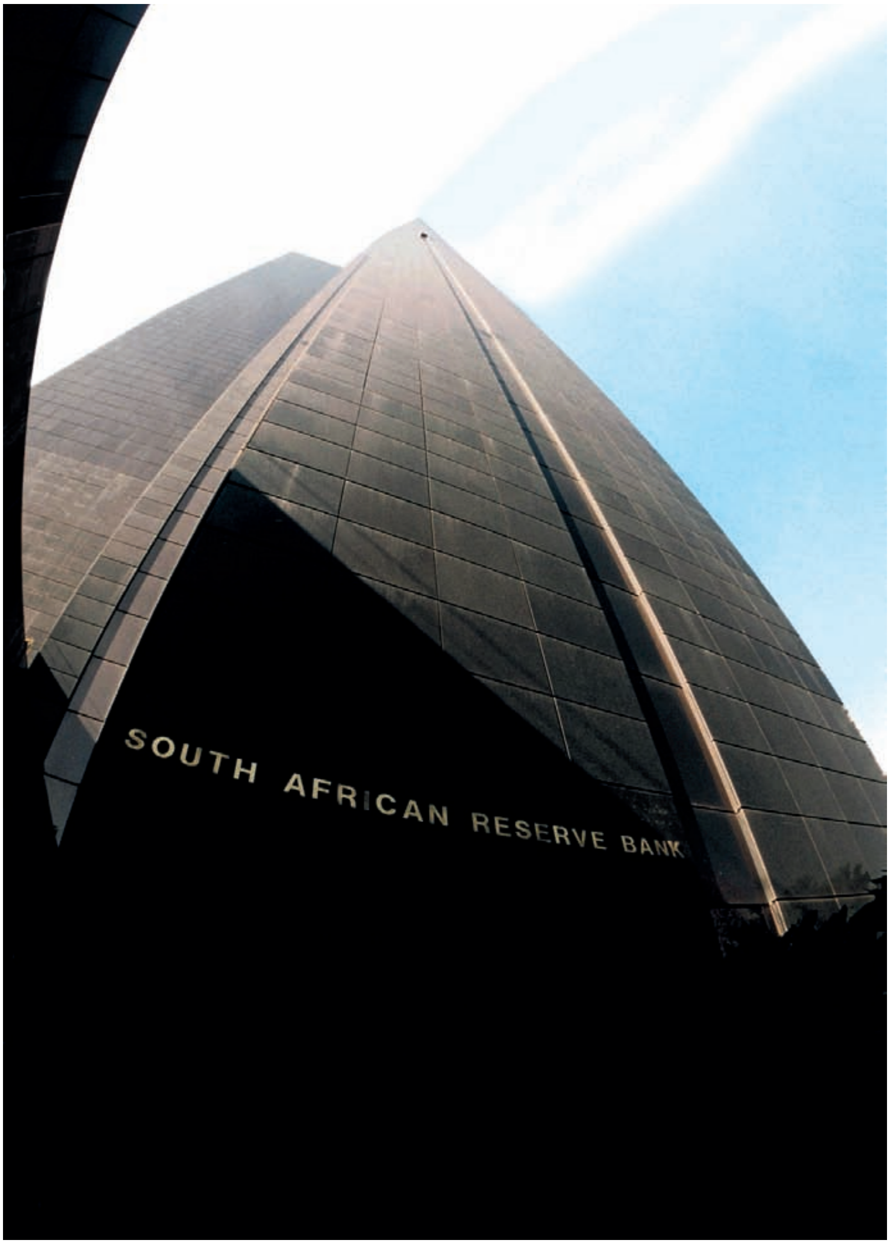
BT: That makes you very powerful.

GM: It does, and it makes you – whether governor, deputy governor or registrar of banks – very responsible. There is a lot of work that goes into that. You can never guarantee it, but you can try to see that this person is ethical and has the requisite skills. The person has to fill out a huge form and if they lie on it, then it's a criminal offence.

We learned our lesson when one of our banks got into difficulty in the early 2000s. They were behaving very badly and we could not get the CEO to step down. I was the deputy governor responsible for bank supervision at the time. We said, "You have to step down. That CEO has to go." There was one member of the board – I won't mention his name, but he was very good – who said, "Guys, you don't know what you are doing. You are going to have personal liability from here, so step down." We said that we would need to ensure we had appropriate powers so as not be in such a position again.

BT: What is the purpose of the repo rate?

GM: We artificially create a money market shortage every day so that the banks have to come to the Bank for liquidity. And that liquidity supplied to them is at the repo rate. »



BT: They buy currency from you?
GM: They borrow from us, but the degree of dependency these days is very small because they get most of their funding from elsewhere. And that is another element: you have another whole interaction with the financial-market segment of the banking sector, which deals with trading, investment banking, and all of that.

Then you have a third level. The bank supervision department reports to a deputy governor, who interacts with the banking sector as the person responsible for bank supervision. My interaction as governor is primarily with CEOs or board chairs. That is more informal, but it is not lobbying. They may try, but it is not the issue.

The question I would ask them in such engagements is: what are you seeing? The big four banks have roughly 20–25 percent of the different segments of the market. If you want to know what is happening in agriculture, you will pick it up far more quickly – before any data comes out – when they see what is happening with lending: who is not paying, whether there is financing for tractors, etc. So that can form some of the discussions: this is what we are seeing from this policy, this is where financing is going, this is our concern. You get an insight into the real economy from speaking to them.

But above all, from my point of view, it is the ability to have a CEO or board chair sit opposite you and get a sense of who they are. Because then we begin to know each other, whether you can be relied on. Should an issue of any kind arise, you know each other, and you do not only meet when there is a problem to be addressed or resolved.

BT: This is psychology.
GM: As a governor, I feel the need to know who is who in the zoo, not only in the banking and financial sector, but more broadly in the economy, the trade unions and so on. And they know that they can call me anytime, day or night, if there is any problem. Their first port of call is the registrar, but if the issue is big enough, they have got to tell me. So we will be alerted to anything that is happening – a systems problem, or something that may have happened in a foreign branch, wherever that may be. They tell us so we will know about the matter, what steps have been taken to address it, and we don't first learn about it from media reports.

BT: This seems to me a very unusual system.
GM: Most regulators and central bank governors, as far as I am aware, try to do similarly. We are certainly not unique. A lot depends on personalities, so having the right counterparts helps. This isn't about lobbying. This isn't about saying what the banking sector wants from the central bank – don't raise interest rates, or whatever. I have never had that from any bank. Not in my previous position of deputy governor and not now. But the interaction on a regular basis, unrelated

to monetary policy decisions or other events, enables me to get greater insights into the challenges that banks are facing, and what they are doing about them.

EXTERNAL ENGAGEMENT

BT: Are you influenced by investors, foreign or local?

GM: Of course you're influenced by the way they see things, but again, we don't just follow what they say.

Five years ago, the Bank started a very structured external engagement programme. For instance, we meet with local analysts and economists six or seven times a year. Each meeting lasts three or four hours with about 50 or 60 people around the table. We meet with political parties, unions, myriad organisations. In sectors such as mining or manufacturing, we'll meet with organised business and organised labour.

BT: You do a presentation ...?

GM: We usually ask them to do a presentation or to lead the discussion and tell us how they see their sector or industry, whatever they think the issues or trends are, as well as what they would like to hear about from us. And similarly with the economists. We engage with them on a wide range of issues. We're not there to lecture to them. We've taken a position not to make presentations unless they ask us. If we only talk to ourselves, we could run the risk of group-think. You want to talk to other people, to see what they see.

The discussion that's coming next is probably on water – what's happening, and the challenges of water. We'll get presenters to come for the first two hours. The second half would be about how we see things at the moment in the economy. Everyone would give their views and their expectations in a very robust discussion. It helps us. You are getting different insights into the real economy from a range of economists from the private sector and state-owned enterprises.

BT: Do you pass this information on to the Treasury?

GM: We invite them to come and they do attend. They also have their own engagement programme.

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BT: You're getting enormous feedback. Who benefits from it apart from yourselves?

GM: It benefits our engagements at a bilateral level. We try to feed that in. We invite them to come to any of our meetings. And obviously, if the Bank's team is strengthened through such interactions, then the output of the Bank, which is available to the public, is consistently of a high quality, and that is in everyone's interests.

BT: But it doesn't feed into government as a whole.

GM: Different departments participate in the various engagements. We annually meet the CEOs of the JSE top-40 companies. Last year, we attended with teams from the Bank and the National Treasury, led by Minister Pravin Gordhan, and Minister [Nhlanhla] Nene now.

There is a meeting next week in New York, organised by the JSE with the Bank and with the Treasury, where we go to meet investors. We try to meet before that, to ask CEOs to come and discuss how we see the country, what we want to say, what our challenges are to attract investors. So that is another whole layer of meetings. Then we meet the investors – and this not only a one-to-one. There can be 10 or 20 people around the table, each representing a different investment house. It's me, the deputy governors, two advisors – seven of us – who run that. We can meet together or separately.

This is our job. We make the time to do it, with all the other things that we do. So if you ask, "do investors influence you?", of course they do ¬– in the sense that hearing their concerns help us to form our opinions. But we do not blindly follow what they say. In any case, they often differ in their views from each other, and they have different interests. There is a note kept from every meeting listing the questions, issues and their key concerns.

MAKING MONETARY POLICY

GM: When we take a decision on monetary policy, all of this comes together. We have an almost daily discussion about what is happening with the numbers. Between us, we try to ensure that there is a common base of assessment – not a common understanding or interpretation, but we have common knowledge.

When we come to a MPC [monetary policy committee] meeting, we take three days. On day one, we have about 50 people on average. They rotate a little bit so there is inclusion. We take the people who are working on the presentations, young people, middle skill, top skill, people from the financial markets department, from the research department, bank supervision – to get people engaged in the ideas. That first day goes through a whole range of things. What is happening with the » global economy, with global markets, the domestic economy and domestic markets, bank supervision, and the real economy? The real economy takes a huge amount of our time. We go through those details thoroughly.

The second day has a reduced number of people. We then look at our modelling and our forecasts and at different scenarios. How do certain variables impact on the real economy? What are the expectations for inflation or growth or investment? Then we have the third element, which is still a broader group than the monetary policy committee, but small, which, having all of this before us, considers how we see the outlook, not only for inflation, but for other factors as well, such as growth and employment. What do we think the situation will be 18 to 24 months ahead? And then the third day has only the members of the monetary policy committee, and that is where the decision is taken.

We try to have a challenging environment in which to have the discussion. I am very keen that no one should come in to the final meeting with a fixed position. You must listen to what other people are saying. You must be able to change your mind. One of the reasons why we don't have published minutes is to allow this frank exchange. If you have published minutes, then you have who-said-what and a commitment and a pre-commitment – and then you don't have listening.

In the meeting of the MPC, we are all equal. There is no casting vote of a governor, no special position. A governor can't tell you, "This is my theory and your decision should be in keeping with my view." There are seven members and each one gives a view and the majority view prevails. A governor can be outvoted if the view of the majority is different. It is a very intense process and, I think, unbelievably thorough. Everybody feels comfortable saying what they think needs to happen. There can be three for a raise and four against and there is no animosity, no aggro.

PROBLEM POLICIES

BT: South African financial institutions are said to be so strong. Why is that expertise not in other areas of the economy?

GM: I think it is. I don't think there is lack of expertise. Our mining expertise is brilliant, although mining is battling at the moment for different reasons. The motor manufacturers will tell you that South African motor vehicle manufacturing is on par with that of Germany. There's a whole range of areas in science and technology that South Africa is highly proficient in. We have superb skills in medicine, cutting edge in many ways. Our accounting and legal professions are highly regarded.

BT: So why do we complain all the time about skills?

GM: We don't have enough skills, but that doesn't mean that we don't have the competence. I think we don't draw sufficiently on the skills that we have.

How do we broaden the skill base? We've got a number of challenges because we want transformation, quite rightly, and we don't have a broad enough education base – particularly in maths and science – to give us the output that we want. Just take economics; you can't do economics today without maths and stats. The number of people who are black or female, especially black females, going into the economics profession is very small.

If you ask why skills are so strong in the financial sector, it's because that's where the money is. If you look around the world today, the focus has moved from the real economy into the financial sector. Is that bad? Not necessarily, but the one should not be at the expense of the other, and South Africa has a crying need to grow and develop the real economy.

Take the current situation in Europe. One of the challenges a central bank has, at this point in time, is that the money it keeps creating and putting into the system goes out to the banks and back into the central bank. It doesn't touch the real economy. You are trying to get things started and you can't get it into the real economy. Part of the challenge is that the real economy itself is changing. Not necessarily for the better. Look at the role of agriculture in this country, which used to have a much higher percentage of GDP. Is it something we ought to be focusing on? Absolutely.

> **"The cost of money is not the main problem. We could kill this economy in one fell swoop if there was a dogmatic approach that only took account of inflation.**

BT: Pravin Gordhan always said that a good project will find the money.

GM: If you turn to Eskom today and say, "This is our energy requirement over the next five to seven years; you need to expand by this amount in coal and power stations." If you commit to purchasing the energy that is created, the money is likely to be there tomorrow – but there may also be tariff increases, as has been the case.

BT: Really? Domestic or borrowed?

GM: Of course you're going to borrow it. But it's there, because there's a return if an energy supplier guarantees that it will purchase the energy produced from that power station.

BT: So why don't they do it?

GM: Ask them. What is absolutely clear is that the lack of sustainable, reliable and affordable energy is costing the economy dearly, and will continue to do so for some time to come. China builds a power station a year. And now it is said that there is likely to be another three years of no energy? How are we going to get growth? You can't. We simply cannot take this long to build and deliver on key projects.

WHAT MONETARY POLICY CAN'T DO

BT: I think our economy is in serious trouble.
GM: I don't think it is fully understood just how serious it is.

BT: What is your gut reaction as governor to the unemployment statistics?
GM: They are horrendous.

BT: What do you do?
GM: The question is: what can monetary policy do for employment? We can impact on cyclical employment, but not on the underlying structural employment.

BT: Joseph Stiglitz, Dani Rodrik and some others argue against being too harsh about reducing inflation because that creates austerity.
GM: Absolutely. But *are* we being harsh?

BT: Well, you tell me.
GM: No. Real interest rates are negative. The cost of money is not the main problem. We could kill this economy in one fell swoop if there was a dogmatic approach that only took account of inflation. Take the five years that I have been governor. The policy interest rate has come down from double digits to the lowest it has been in 30 years. Even with our increases of 50 basis points and 25 basis points earlier this year, it is still the lowest in 30 years. The real policy interest rate at the moment is negative. We are very sensitive to the cyclical impact of our policies on employment, which is part of our flexible inflation targeting approach.

BT: So you are saying that the economy is not suffering because of that.
GM: I don't think so. What would help with unemployment? First of all, jobs.

BT: Jobs are created by money.
GM: Jobs are created by investment and growth. Our problem is not simply a lack of access to affordable finance. Why is gross fixed capital formation (GFCF) in the last quarter negative – minus 2.5 percent – from the private sector?

BT: Government also.
GM: No, government investment is positive.

BT: Not much.
GM: Don't forget the weighting in it is roughly two-thirds: 65 percent private sector, 35 percent government. So even if government is positive, it is the private sector investment that is critical to raise the overall GFCF. And it should be the private sector creating jobs, not the government.

BT: We know why the private sector is not investing.
GM: Why?

BT: It is political.
GM: No, I really don't agree with you. I think there may be an *element* of that, and I think that we are our own worst enemy in a lot of this. The public discourse in this country – from all players – is something that is decidedly uncomfortable. You want to beneficiate? The one thing you are going to need for beneficiation is energy. From current statements it does not look like we are going to have sustainable and affordable energy in the next five years.

BT: There are ways of getting energy if you are desperate. Look at Billiton – they manufacture their own energy.
GM: They've also closed down their plants. Look at Richards Bay. There is a comprehensive problem to resolve. Some companies may be able to make energy themselves – but for an average company? If you want to put your money in, you want to know you'll have sustainable, affordable and reliable energy. Housing is regarded as one of the key issues we face, but houses need electricity. Who is going to invest in anything that requires energy until we have certainty of energy supply? The central bank can do nothing about that, absolutely nothing.

> **"Who is going to invest in anything that requires energy until we have certainty of energy supply? The central bank can do nothing about that, absolutely nothing.**

Talk about skills. I've already said I think that we have huge skills and expertise, but not in sufficient quantities. But what are we doing on immigration? If you can explain the current immigration policy to me, I would love to hear it.

I will give you an example, in the Bank, right now. We had brought in skills. Because of the mathematics that is required for our modelling, we really need expertise from other central banks. We have a very good team, about 20 to 30 people, but we brought in this really top-class person from Canada. He was declared a "prohibited immigrant" (PI). We can't get him back for a year.

We can't ask about the role of the Bank as if it is the only role player and has the tools and ability to address all the issues that face our economy. We need to » have a coherence of policy from all role players. Take for example the statement – and I don't know the standing of this – that 50 percent of land will now go to the farmworker.

We all recognise how critical and emotional the land issue is, given the extensive dispossession that occurred. But which 50 percent? Do you halve the water? Do you halve the house and outbuildings? Who is defined as the farmworker? Do you know that it is being reported that there is already slowing of lending to farmers? Farmers are already reportedly stopping payment on capital goods because they don't know if they are going to have their farm or not. If I owe money on my tractor, do I stop paying? And if I want to finance my next crop: is it a long-term crop or a short-term crop? Because I don't know what is going to happen.

What is already happening, if you look at the numbers, is that farmworkers are being driven off the land *again*, which happened with the Security of Tenure Act. There are huge consequences to conditions of uncertainty.

So when you ask what we need to do, our central question – and I have said this frequently – is that you have to have co-ordination and coherence of policy that understands the real economy and can drive the transformation that is required. To me, the real question about inflation is: who does it hit the hardest? It hits the person who is not working, or on a fixed low income, because their price of bread changes, their cost of transport and basic requirements rises and impacts disproportionally. So high inflation really matters.

BT: While other people can afford it.
GM: If you are in a higher income bracket, you can better afford it. Food and transport tends to be a smaller percentage of your living costs. The lower the income, the higher the inflationary costs, because that portion of your expenditure basket is different. This is the difference. We talk about "inflation" and "the cost of living". Inflation isn't differentiated but your cost of living is different. Whether it is the cost of food, electricity prices or fuel or transport or e-tolls, it hits the cost of living at the low end. That is of real concern to us, but it is not our province.

> **"If I owe money on my tractor, do I stop paying? And if I want to finance my next crop: is it a long-term crop or a short-term crop? Because I don't know what is going to happen... Farmworkers are being driven off the land *again*, which happened with the Security of Tenure Act. There are huge consequences to conditions of uncertainty.**

So some commentators say that you can have high inflation. Who is it going to hit and to what end? Will it make a difference? The advanced economies are trying to get some inflation because they can then float away some of their debt – but don't forget that they are coming off a very, very low base. They are trying to get to 2 percent because the challenge in Europe is deflation.

INTERNATIONAL ENGAGEMENTS

BT: How do you relate to the international banking community?
GM: The South African Reserve Bank has a significant relationship with the international community. It is not only with the international private-sector banks, many of which have a presence in South Africa, but with the central banks at a range of levels. I think it is probably one of the best, most useful aspects of the role of governor.

We split our international engagements between all of us. The IMF and World Bank and G20 are largely the responsibility of one deputy governor. The Financial Stability Board is largely another deputy governor. Some of the seminars are attended by a third deputy governor. The OECD [the Organisation for Economic Co-operation and Development] will be a particular person in the bank. My area is the Basel Committee and the Financial Stability Board (FSB). I serve on the steering committee of the FSB and Lesetja [Kganyago, SARB deputy governor and governor-elect at the time of the interview] serves on the plenary.[1]

Let's start with local. First of all, the Common Monetary Area (CMA) [which includes South Africa, Lesotho, Namibia and Swaziland]. The four CMA governors meet three or four times a year. We try to meet before the Monetary Policy Committee meeting, so that we can see what is happening in our CMA countries. We will have a presentation on the economic outlook from each country and we look to see what is impacting. Obviously, our impact will be much bigger on the other three countries. And then we have a presentation at the MPC regarding what is happening in the CMA. Not every meeting, but at three or four out of the six.

That is the first engagement; the second is SADC [the Southern African Development Community]. South Africa chairs the SADC central bank governors' meetings, known as the Committee for Central Bank Governors (CCBG). There are 15 countries and we meet two or three times a year, plus a strategy session. We look at the issues per country and as they affect the region as a whole. We have well established working groups on financial markets, banking sector regulation, economic convergence, targets in terms of debt-to-GDP ratios, deficits, etc.

BT: Do you talk about corruption?
GM: We do. But again, it tends not to be an issue simply for the central banks, but country issues. Our challenge is the central banks' ability to meet with the ministers of finance to ensure a coherent regional approach.

BT: Why?
GM: Central bank governors play different roles in different countries and their ability to influence economic policy varies. Some of them are advisors, some sit on economic policy committees, or even in the cabinet. We are trying to get a sense of a regional approach. As SADC, we have advised the African Union that we do not agree with a single [continental] central bank and a single currency at this stage. It is supposed to happen in two years' time. We need to learn the lessons of the crisis in Europe: other things should be done first, such as trade and fiscal matters.

BT: The bank comes after the trade?
GM: It must. First you develop the ability for trade interactions and regional growth, and then you look at what the monetary arrangements should be. Not the other way around. The biggest problem in Europe is that they don't have fiscal co-ordination, only monetary. Each country does its own fiscal policy, but you have a common monetary policy. So you can do nothing about your currency, but you don't deal with the fiscal decisions, with what needs to be done. It is back-to-front.

Then we have the Association of African Central Banks, in which we also participate. We meet once a year. So that is the continental level.

BT: The ECA [United Nations Economic Commission for Africa] claims that one of the reasons for 6 percent growth in Africa is that monetary and banking systems have been much improved across the continent. Is that true?
GM: I think it is true, but there is also much greater stability and interaction and I think that has mattered as well.

Then you have the G20, which has a range of meetings that include central bank governors and deputy governors, looking at questions of economic growth and global financial challenges and developments. Our big issues there are co-ordination and taking account of the views of emerging markets and what emerging markets need. We are the only country from the African continent in the G20.

We are not that involved with the World Bank, mainly the IMF. There again, it's a question of keeping in touch with and contributing to the issues. There are very often side meetings, so for example, you will have a side meeting of the BRICS at the G20 or IMF meetings. Then there is the BRICS, in which we are active.

BT: Do you support the new BRICS Bank?
GM: South Africa does. I think it will take time to get to critical mass, but it is a welcome and important initiative that also demonstrates the joint commitment of the five countries.
BT: It will release some resources, surely?
GM: It should. That process is run by the Treasury. The contingency reserve arrangement (CRA) is a central bank agreement that creates the means to access some reserves if needed. I think that is very helpful. But that's central-bank driven, so when the Treasury and the Bank go to Washington now, they will have a side meeting on the CRA. It allows for us to have a very good interaction between the governors of the countries.

Then you come to the BIS [Bank for International Settlements], which is really my area. It has a range of functions and working groups, and we participate as much as possible. Our view is that they have not always taken sufficient account of impacts on emerging markets. We have succeeded in putting a range of issues on the agenda in this regard.

We also ensure that our teams of staff get exposure to this wide array of meetings. The BIS meets every two months and you might have six or eight meetings over the two days. It's very, very demanding. I think they are absolutely invaluable meetings. They prepare very good documentation and it is a frank discussion of the people around the table.

BT: You produce a lot of research, especially on the real economy. Can't we get access to that?
GM: We are trying to do more, both for internal development and as a means of communication. We do publish some of our research on the web, but part of the challenge is that you can't just publish – it has to be fit for publication. It has to be peer reviewed, it has to be critiqued, it has to be at a certain level. We are moving in that direction.

NOTE

1. 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. The Basel Committee on Banking Supervision (BCBS) is an international forum for banking supervision, which is located at the Bank for International Settlements (BIS) in Basel, Switzerland. The BIS is an international organisation of central banks. NA

Pics: Gill Marcus, South African Reserve Bank