

South African Reserve Bank

South African Reserve Bank and Prudential Authority Annual Reports for 2018/19

Presentation to the Standing Committee on Finance

11 September 2019

Outline of presentation

- The role of the South African Reserve Bank (SARB)
- Macroeconomic overview and outlook
- Highlights from the SARB and Prudential Authority (PA) 2018/19 Annual Reports

THE ROLE OF THE SARB



The Bank's mandate...

- To protect the value of the currency in the interest of balanced and sustainable economic growth
- Financial Sector Regulation Act, which came into effect in August 2017, mandates the SARB to maintain, promote and enhance financial stability in South Africa

Shareholding structure, but public is the beneficiary

- The SARB is one of about 6 central banks that still have private shareholders
 - There are 2 million shares in issue
 - Over the past 3 years, average profit for the SARB has been about R1.2 billion a year
 - Dividends capped at 10 cents a share (maximum payout of R200 000 a year)
 - 90% of any remaining surplus accrues to government
 - After setting aside contingencies, reserves, tax etc.
 - 1996 Constitution sets mandate and independence

Shareholding provides members to a board with limited powers

- Since 1996, several legislative changes:
 - clarify the role of shareholders
 - limit the rights of foreign shareholders and
 - reduce how many shares can hold
- Board helps ensure good governance, but no role in policy or regulatory decisions
- Government appoints 8 members, including the four executives, while shareholders elect 7 members

The SARB's key functions

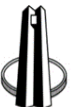
- Issues banknotes and coin
- Regulates and supervises certain entities in the financial system
- Ensures the effective functioning of the National Payment System
- Manages the official gold and foreign exchange reserves of the country
- Administers the country's remaining exchange control regulations
- Acts as banker to the government

The role of monetary policy

- Ensuring price stability or low inflation is a traditional function of central banks.
- All central banks have this mandate in some form but they may use different frameworks:
 - Inflation targeting
 - Fixed exchange rate systems
 - Targeting monetary aggregates
- Many of the SARB's functions have socio-economic impacts

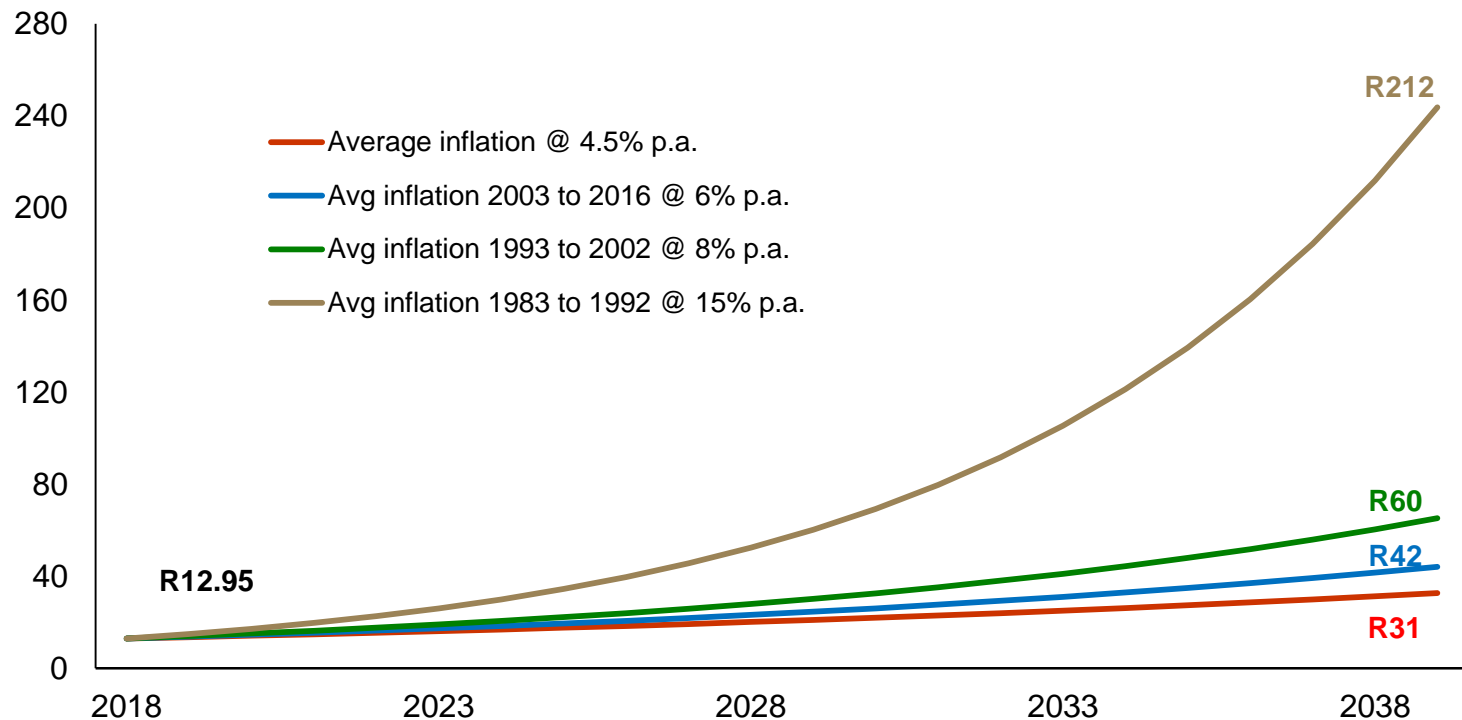
Why do we target inflation?

- Inflation is a general increase in prices
- Stats SA measures inflation using a basket of goods and services purchased by a typical household (412 individual items in the CPI)
- Low and stable inflation:
 - Protects the purchasing power of South Africans
 - Reduces uncertainty, helping firms and households plan for the future
- While monetary policy improves the environment for investment, it cannot determine its level or quality
- Protecting the value of the currency permits balanced and sustainable growth – but doesn't guarantee it

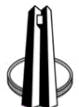


How inflation hurts...the price of bread after 20 years

Inflation rates - impact on the price of bread after 20 years



Source: SARB



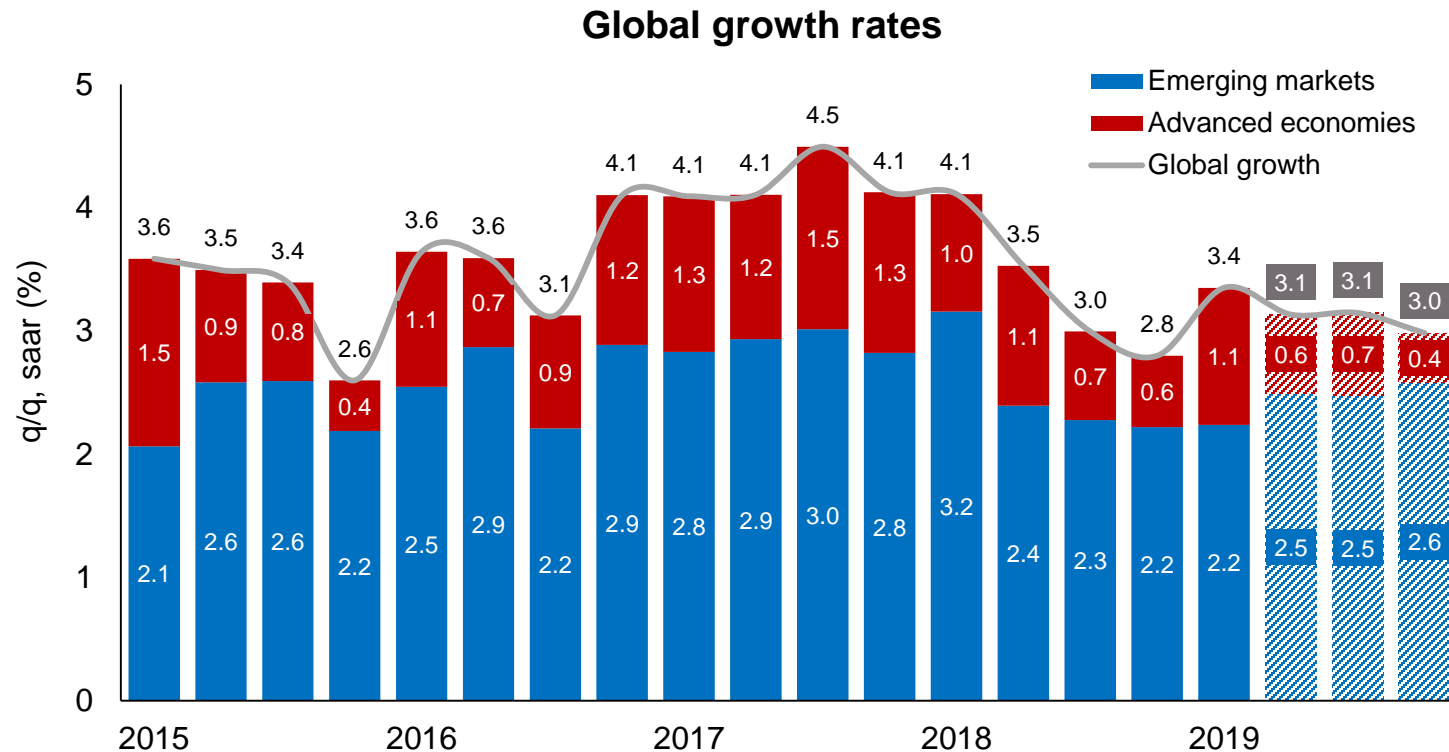
The framework for managing financial stability

- Our financial stability framework:
 - Monitor and mitigate against risks to financial stability
 - Stress test South African banks and insurers
 - Evaluate how regulatory reforms impact the financial system
 - Toolkit of macroprudential instruments to mitigate potential systemic risks and restore financial stability if needed
 - A legal framework for resolving systemically important financial institutions

MACROECONOMIC OVERVIEW AND OUTLOOK



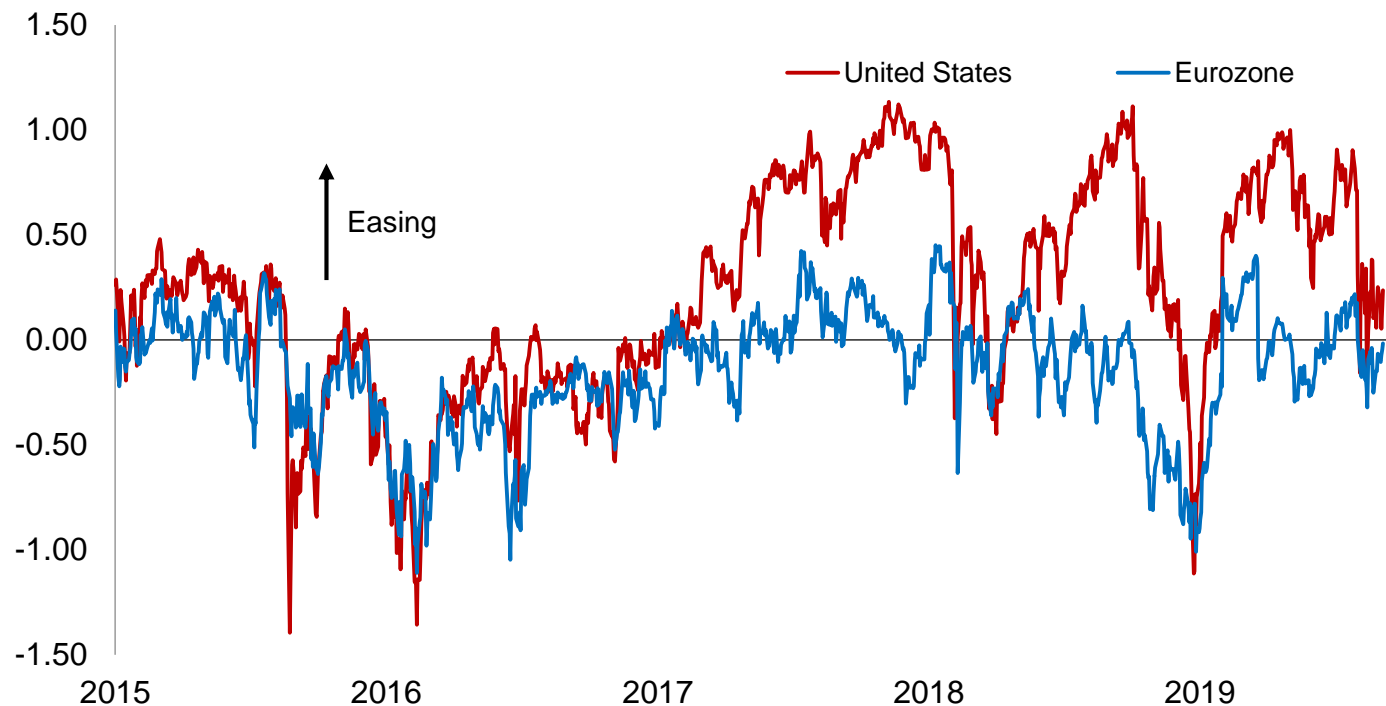
Global growth rates moderating in 2019 and into 2020



Sources: Barclays, Bloomberg, Haver, IMF, JPMorgan, Nomura and SARB

Financial conditions remain accommodative...

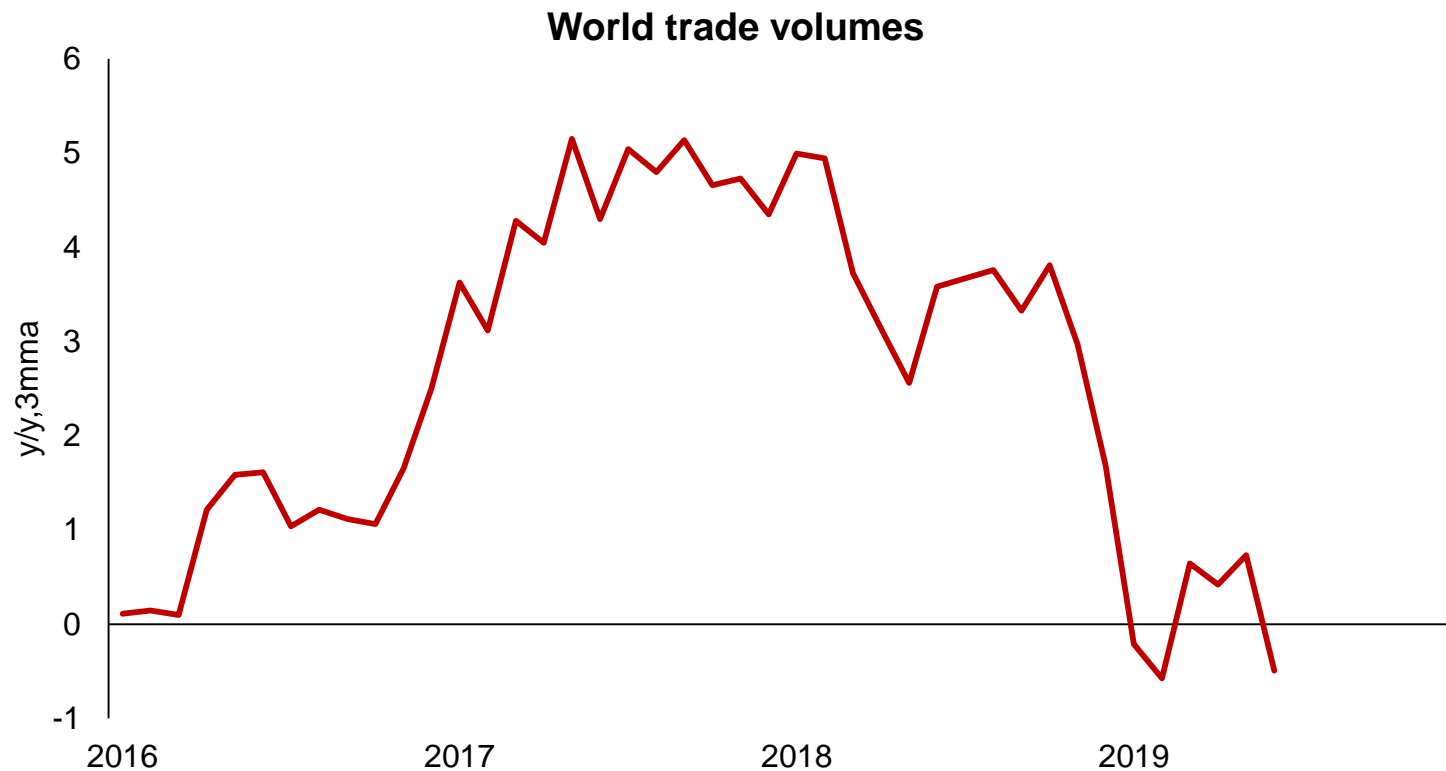
Bloomberg financial indices



Source: Bloomberg



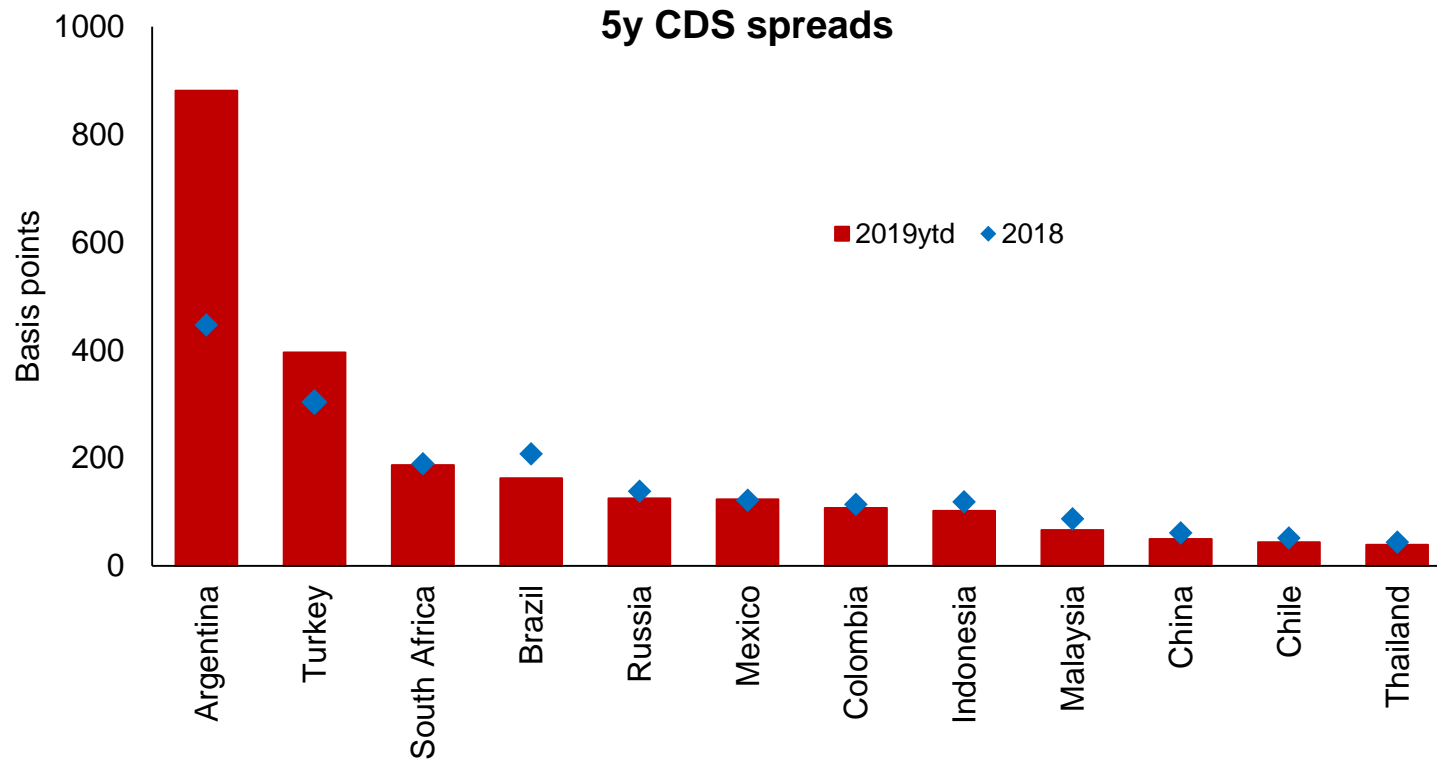
...but global trade slowing



Source: CPB world trade monitor



Stronger macro fundamentals lower borrowing costs

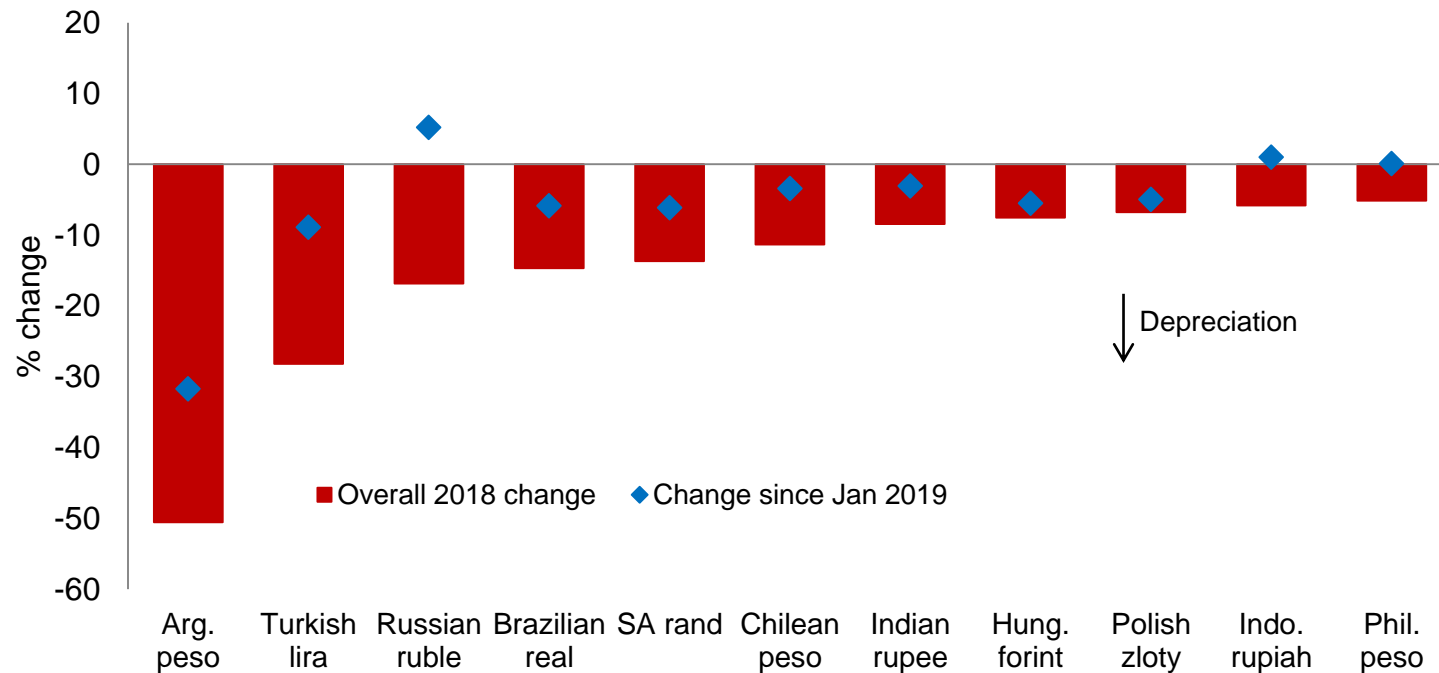


Source: Bloomberg



...and reduce currency weakness

Performance of selected EM currencies versus the USD in 2018 and 2019



Source: Bloomberg



Domestic economic outcomes weak

- Economic activity is weak, with insufficient investment and job creation
- Potential growth, an outcome of investment, remains very low
- Inflation remains within the target and risks relatively balanced, with some key exceptions – food prices and rand risk related to credit ratings
- The fiscal environment deteriorated, leading to rising bond yields and undermining business and consumer confidence

Q2 real GDP rebound, but modest growth over the year

Primary sector

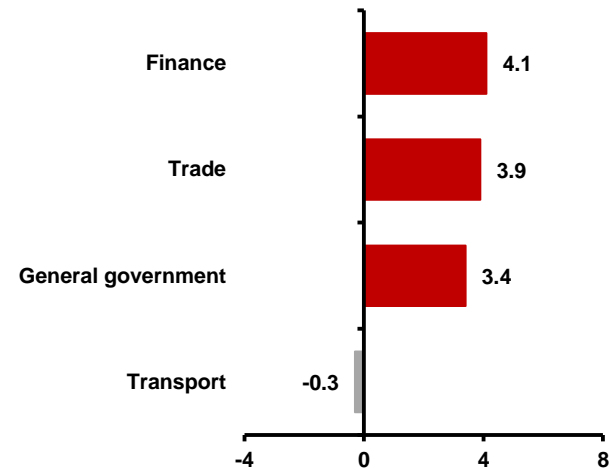
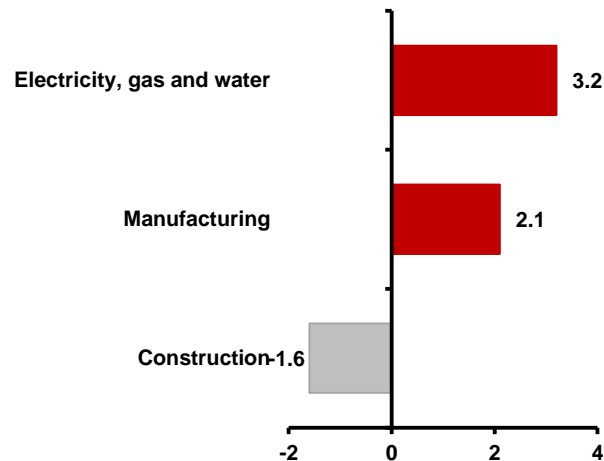
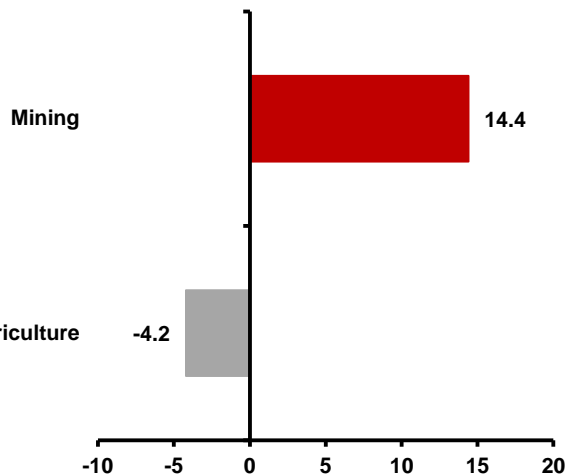
9.7%

Secondary sector

1.5%

Tertiary sector

3.0%



Primary sector:
5-year average
growth

0.3%

Secondary sector:
5-year average
growth

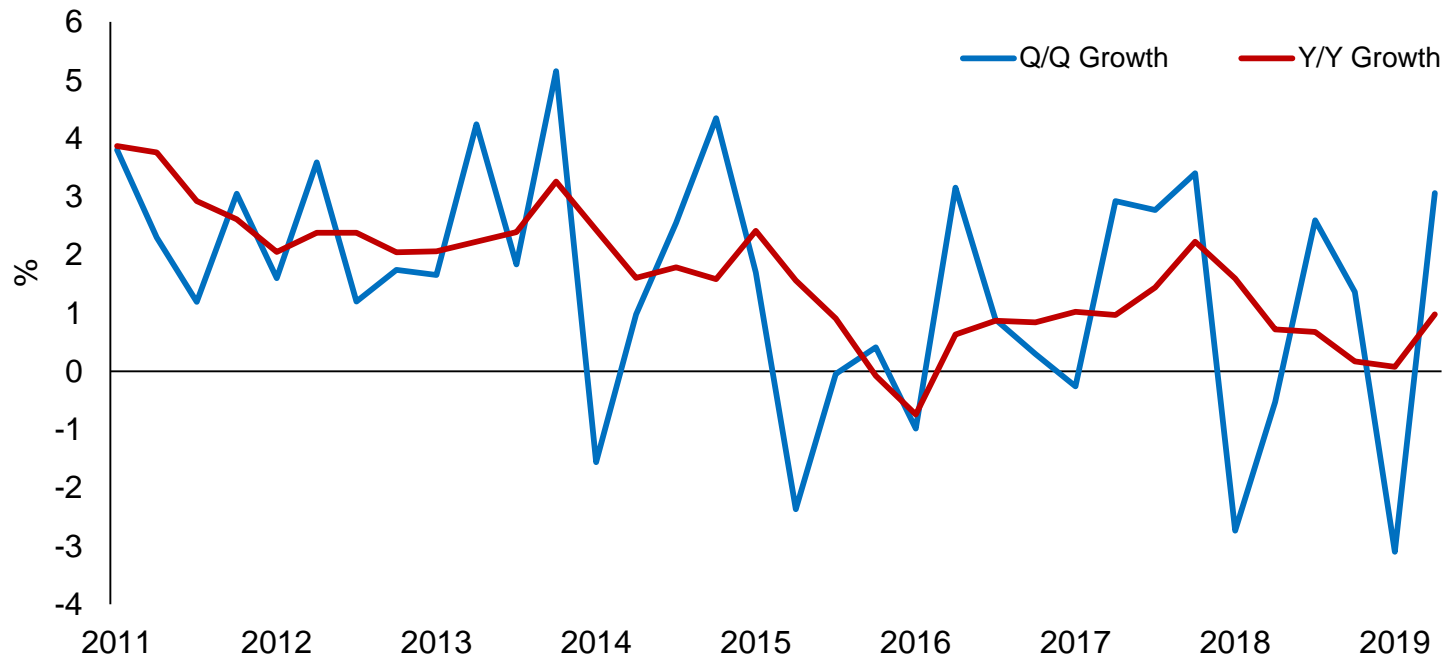
0.3%

Tertiary sector:
5-year average
growth

1.6%

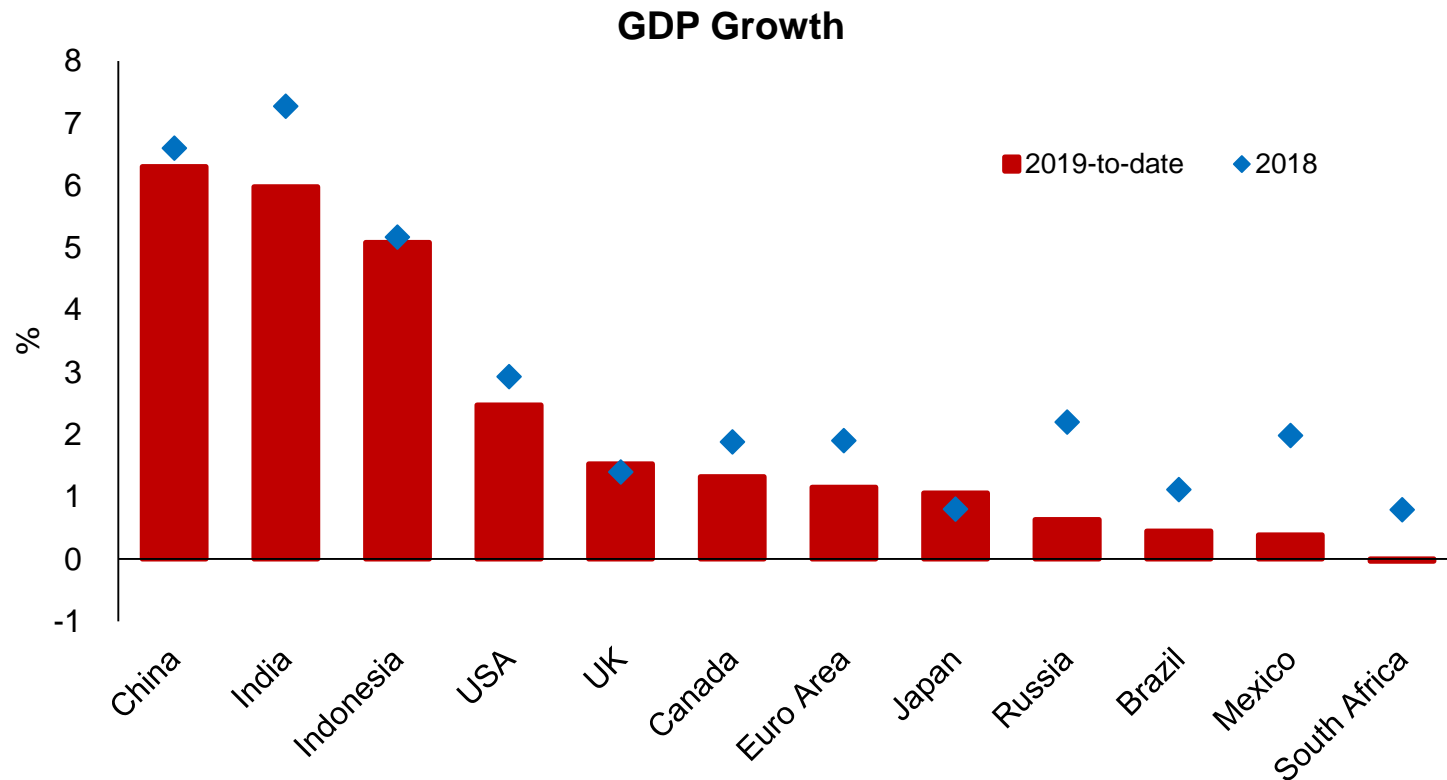
Volatility in growth, largely sector-driven

Quarterly growth rates



Source: SARB

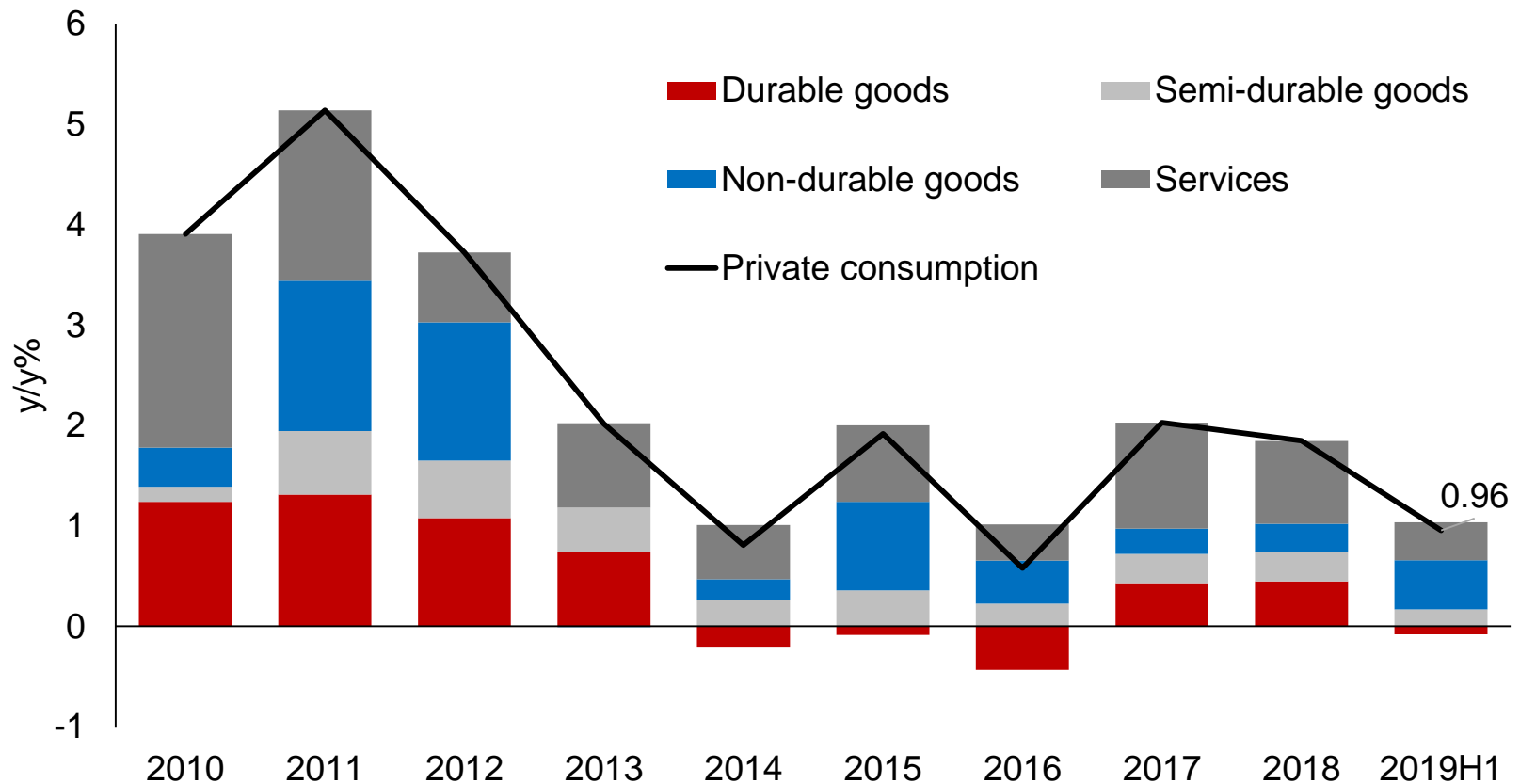
Comparative weak growth, limits capital flows



Source: OECD

Household consumption positive, less on durables

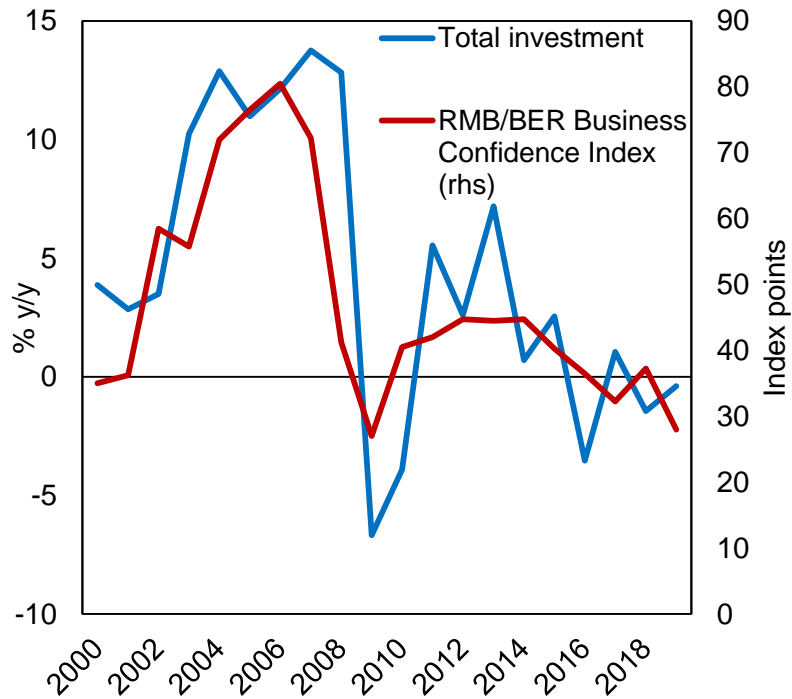
Contributions to HCE growth



Source: Statistics South Africa

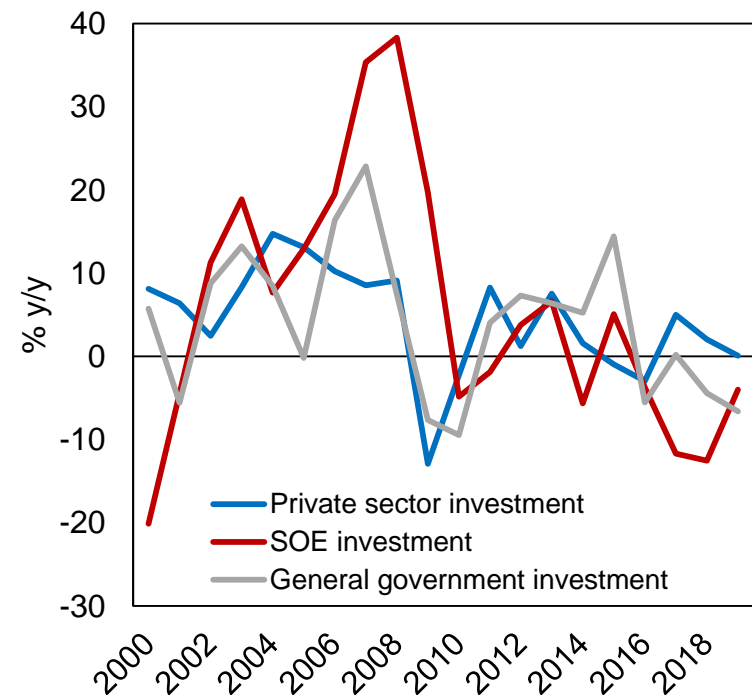
Confidence low, hitting investment, reducing growth

BER business confidence index and investment



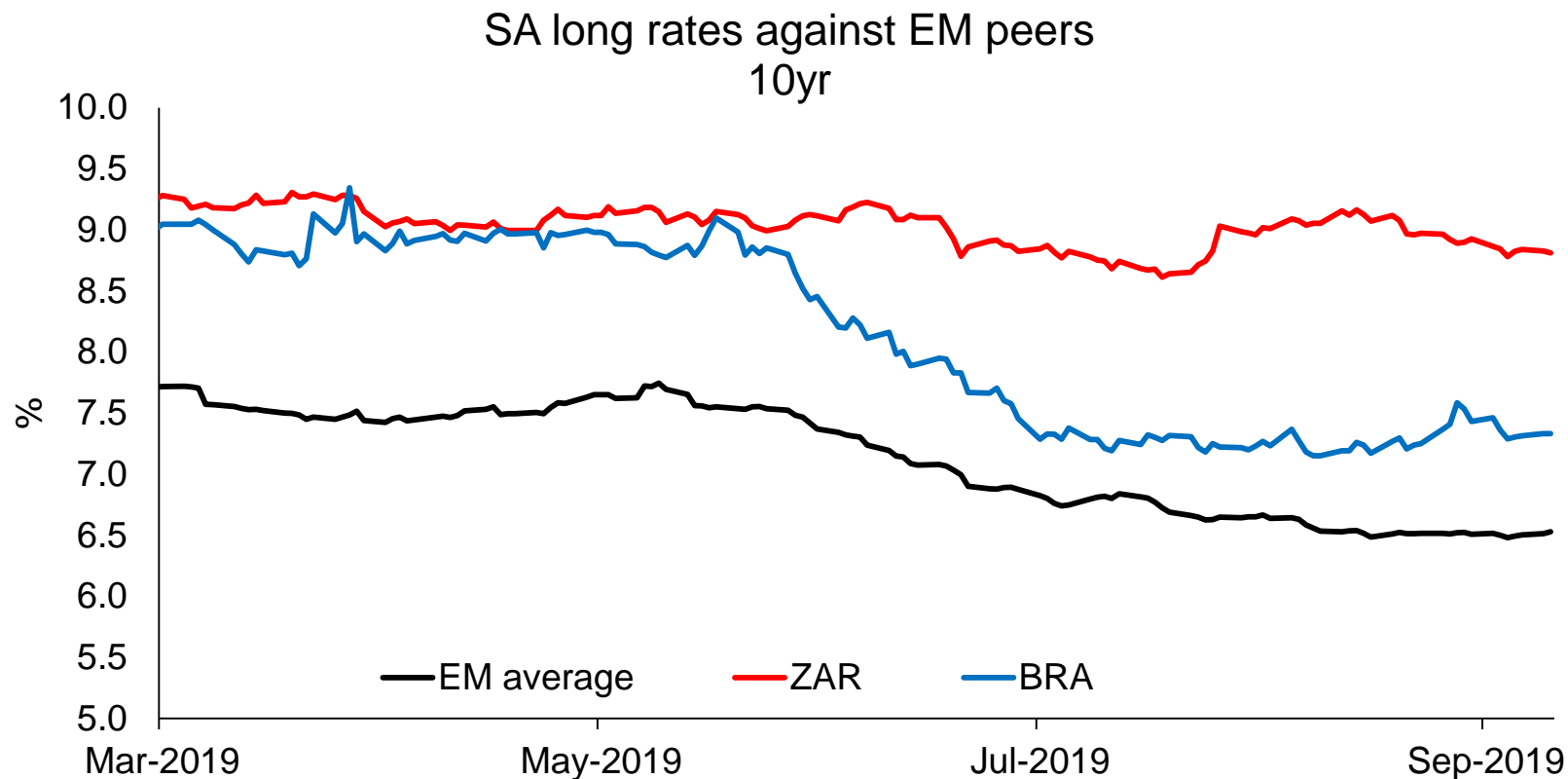
Source: SARB, BER

Government, SOE and private investment



Source: SARB

Borrowing costs still higher than EM peers



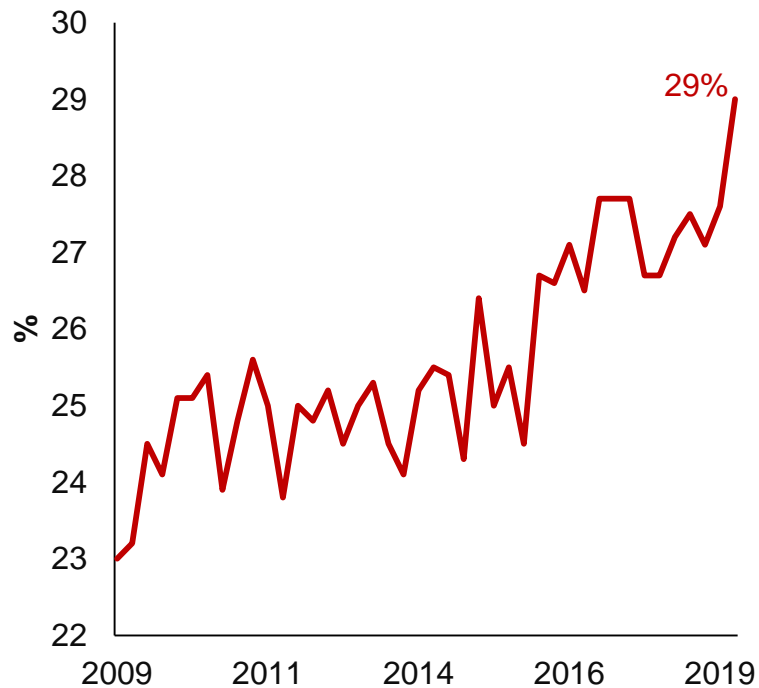
EM comprise: BRA, CHL, CHN, IND, IDN, MYS, MEX, NGA, PER, PHL, POL, RUS & TUR

Source: Bloomberg



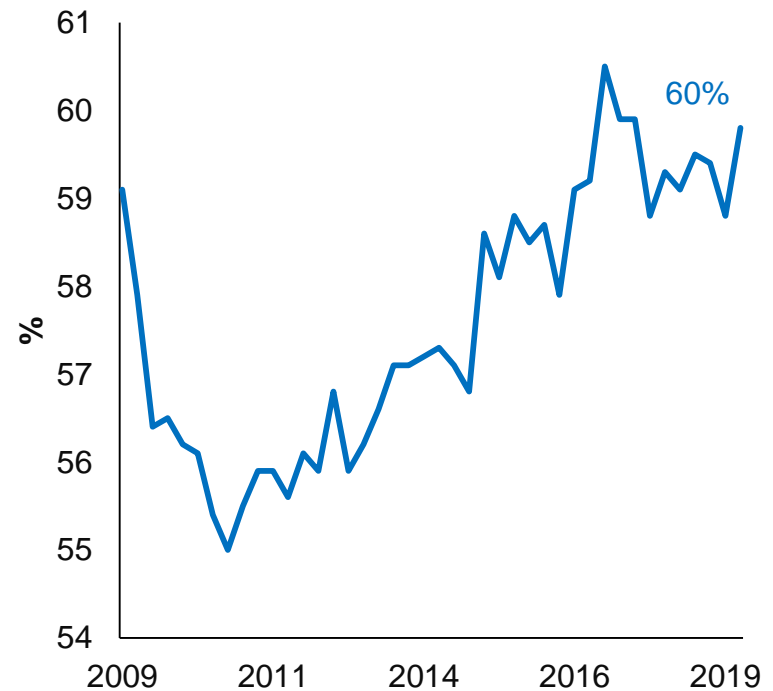
Unemployment up, mostly as labour participation rises

Unemployment rate



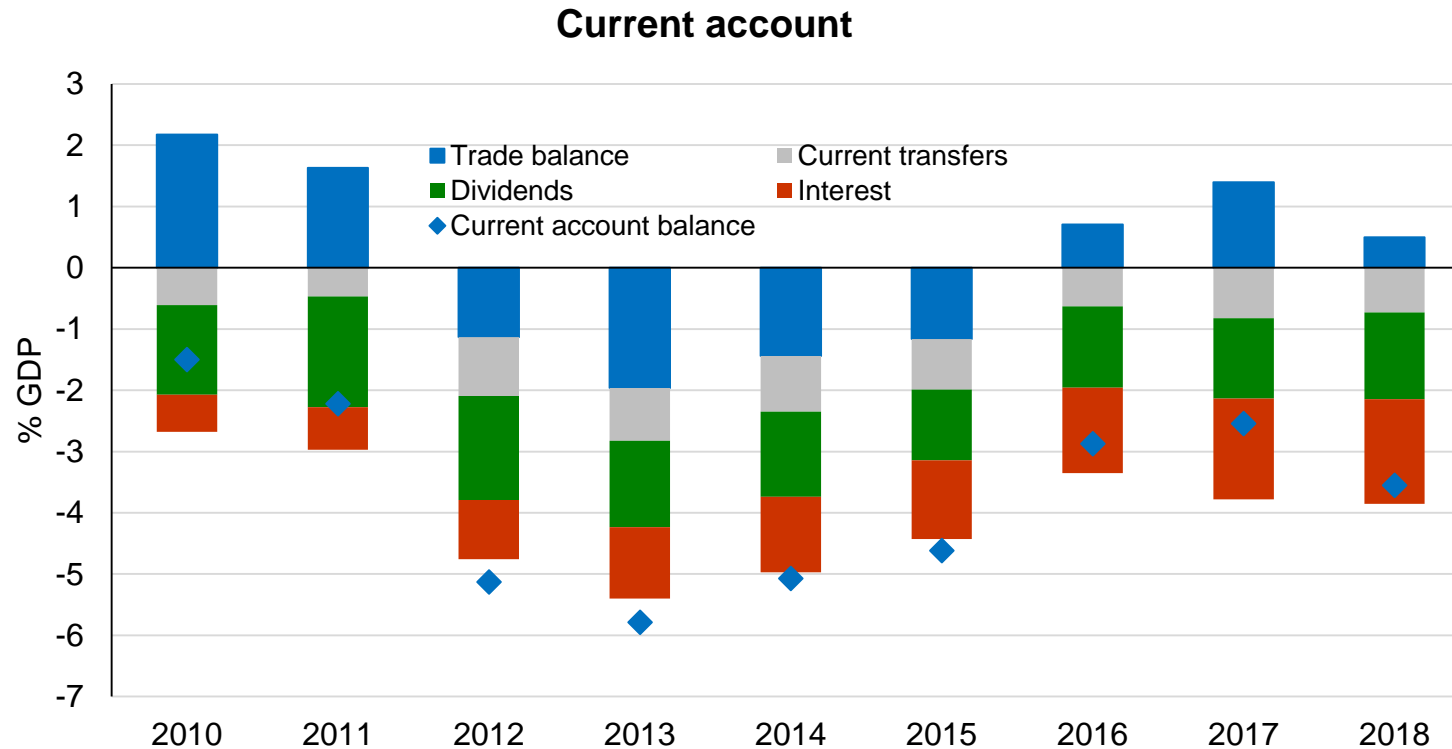
Source: QLFS

Labour market participation rate



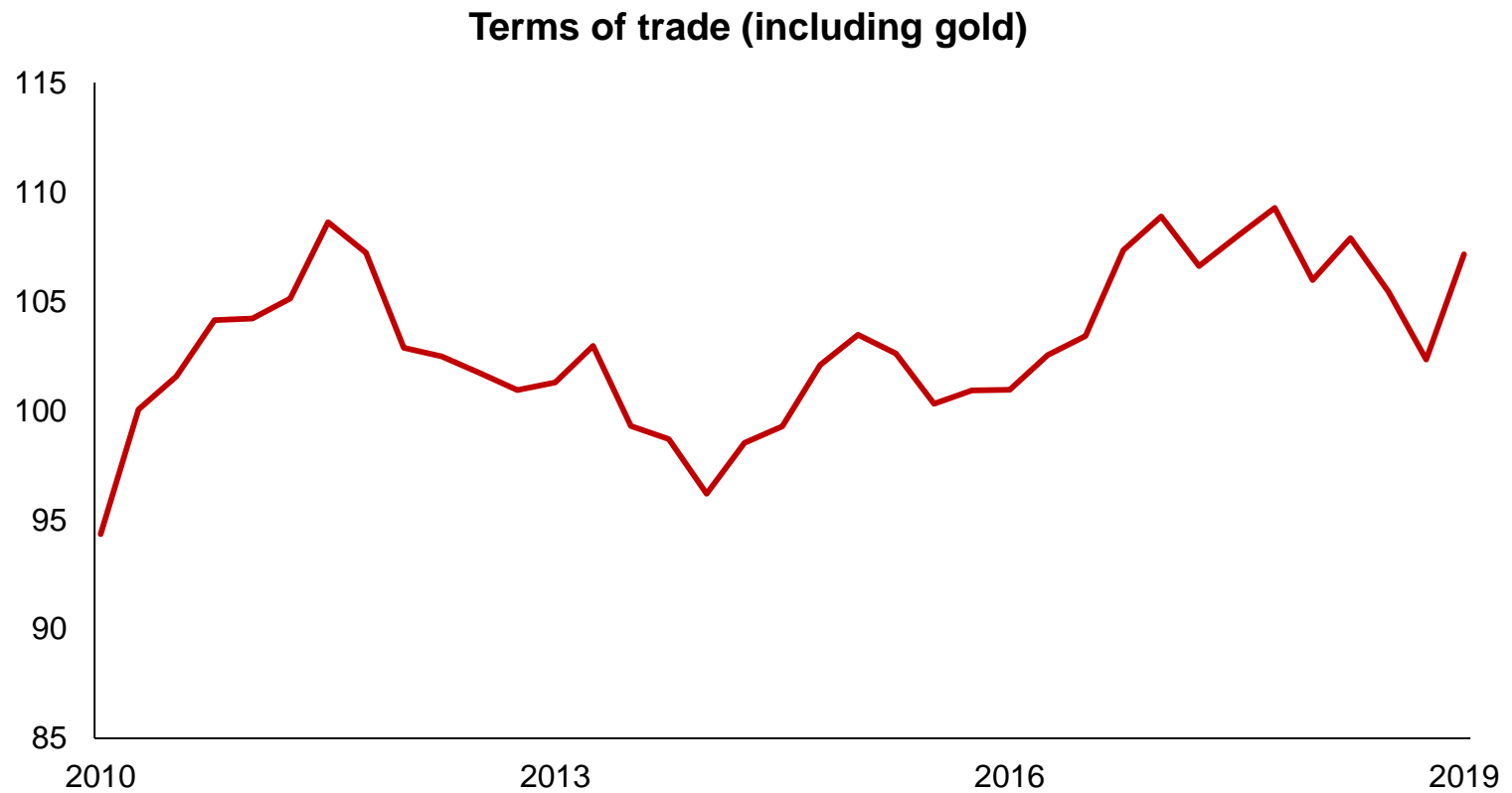
Source: QLFS

Current account deficit, as interest payments high



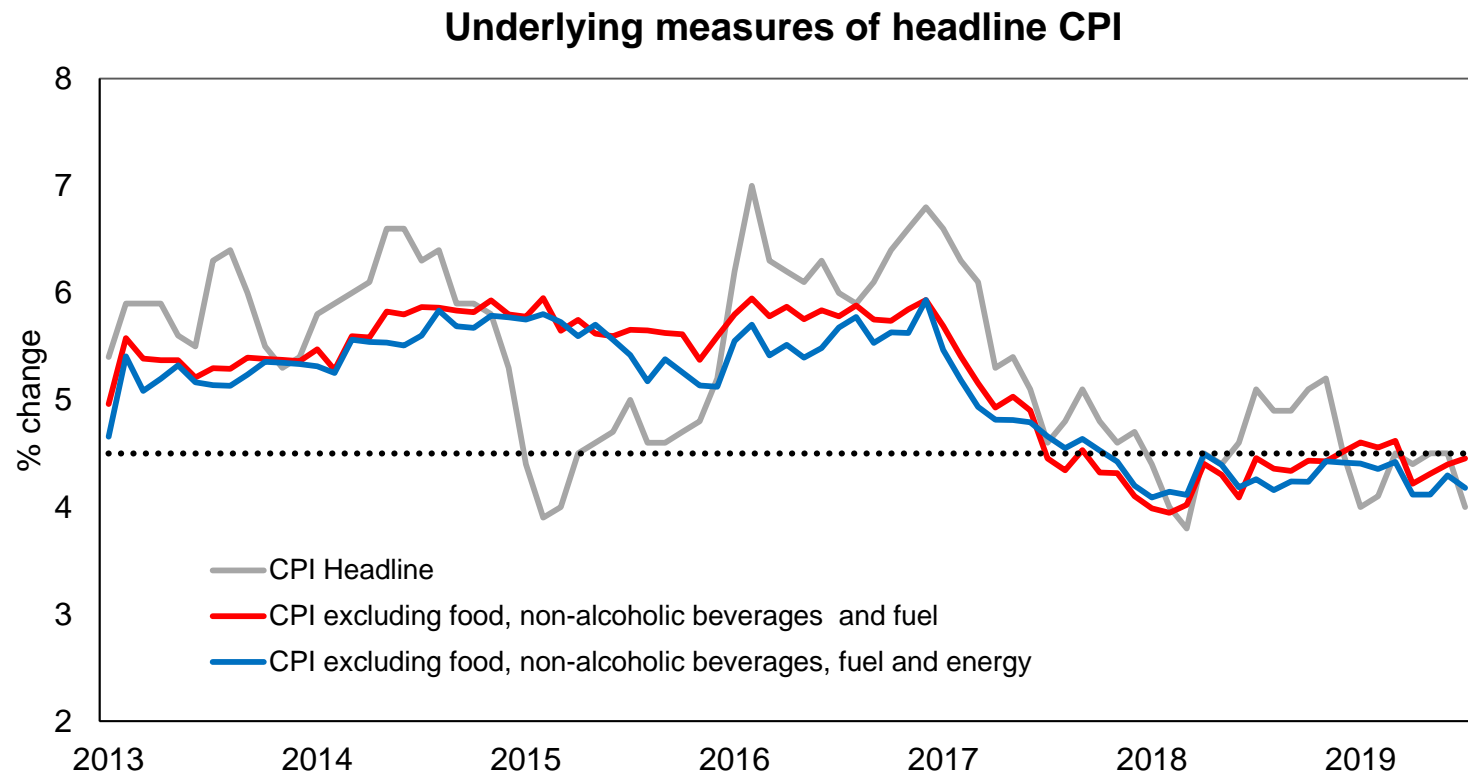
Source: SARB

With strong terms of trade, implies exports constrained



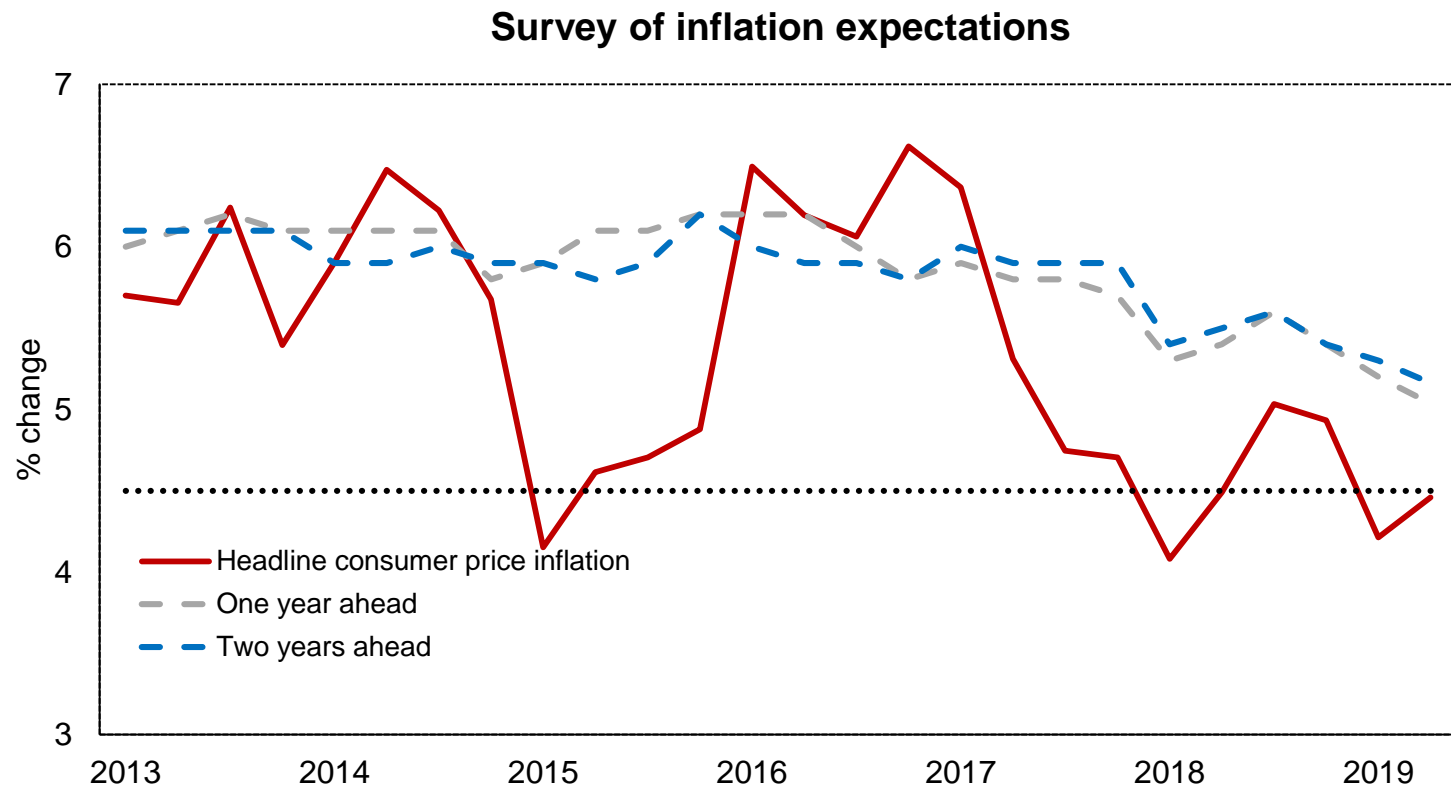
Source: SARB

Headline inflation around midpoint of the range



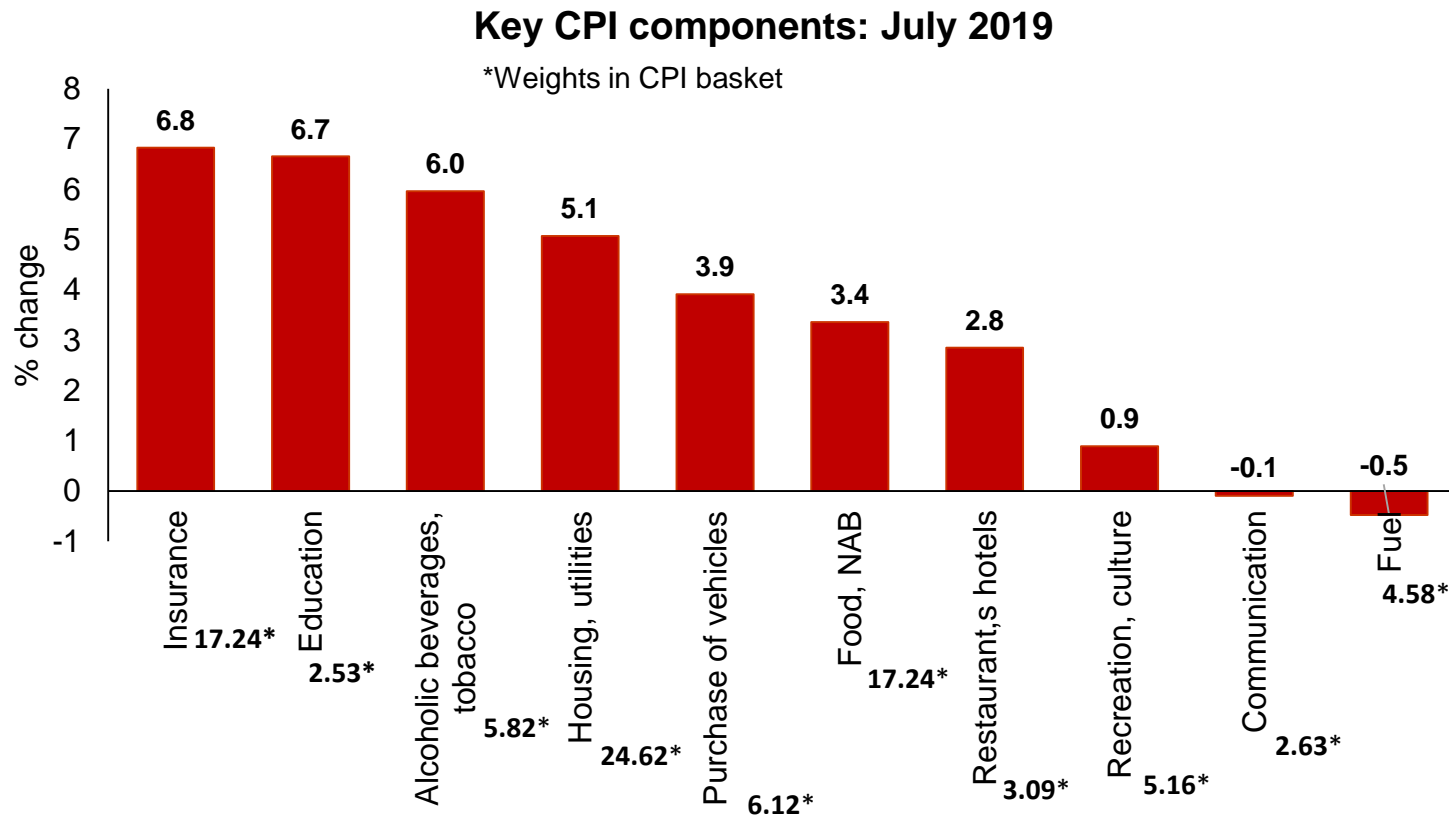
Source: Statistics South Africa

Inflation expectations moderated but above midpoint



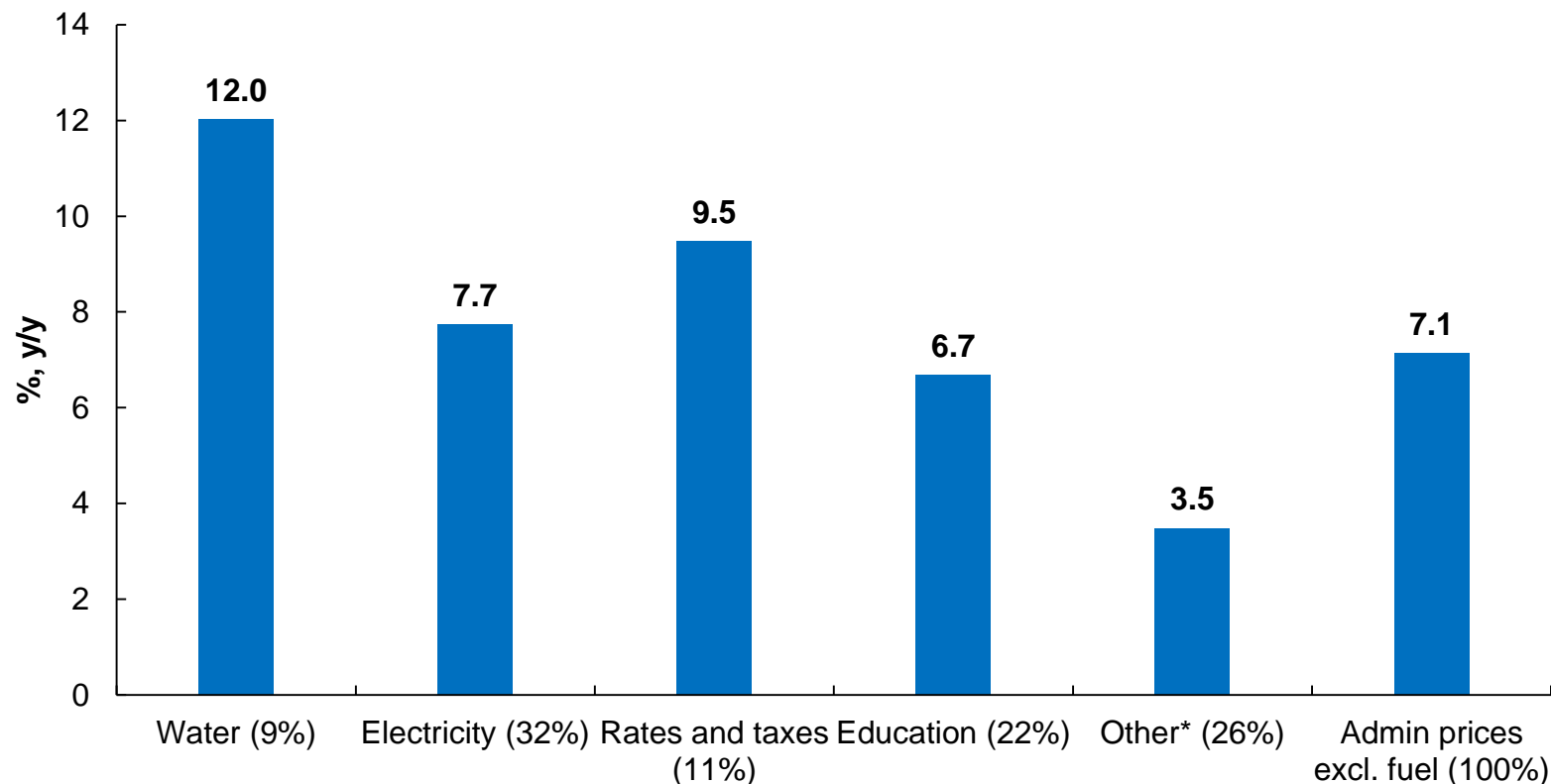
Source: Statistics South Africa, BER

Inflation still high in some categories and food prices a risk



Most admin price components are well-above the inflation target midpoint

2019 YTD



Figures in brackets are weights.

*Other includes: Trains (1%); Motor licence and registration fees (3%); Communication (20%); University boarding fees (1%); TV licences, SABC (1%).



Growth projected to recover slowly

Summary tables of the QPM projections

Percentage change (unless otherwise indicated)	Actual						Forecast		
	2013	2014	2015	2016	2017	2018	2019	2020	2021
1. Targeted inflation	5.7%	6.1%	4.6%	6.3%	5.3%	4.6%	4.4%	5.1%	4.6%
2. Underlying inflation	5.2%	5.6%	5.5%	5.6%	4.7%	4.3%	4.4%	4.7%	4.5%
3. Gross domestic product	2.5%	1.8%	1.2%	0.4%	1.4%	0.8%	0.6%	1.8%	2.0%

Projections as at July 2019 MPC meeting

Improving the growth outlook...

- Global growth unlikely to become more supportive:
 - US/China trade tensions and Brexit negative impact
 - Geopolitical tensions issues affecting commodity prices
- Getting domestic environment right:
 - Ensuring a sustainable fiscal framework and commit to macro stability
 - Reducing supply side disruptions such as load-shedding, strikes, etc.
 - Improve policy certainty across domains

HIGHLIGHTS FROM THE SARB AND PA 2018/19 ANNUAL REPORTS



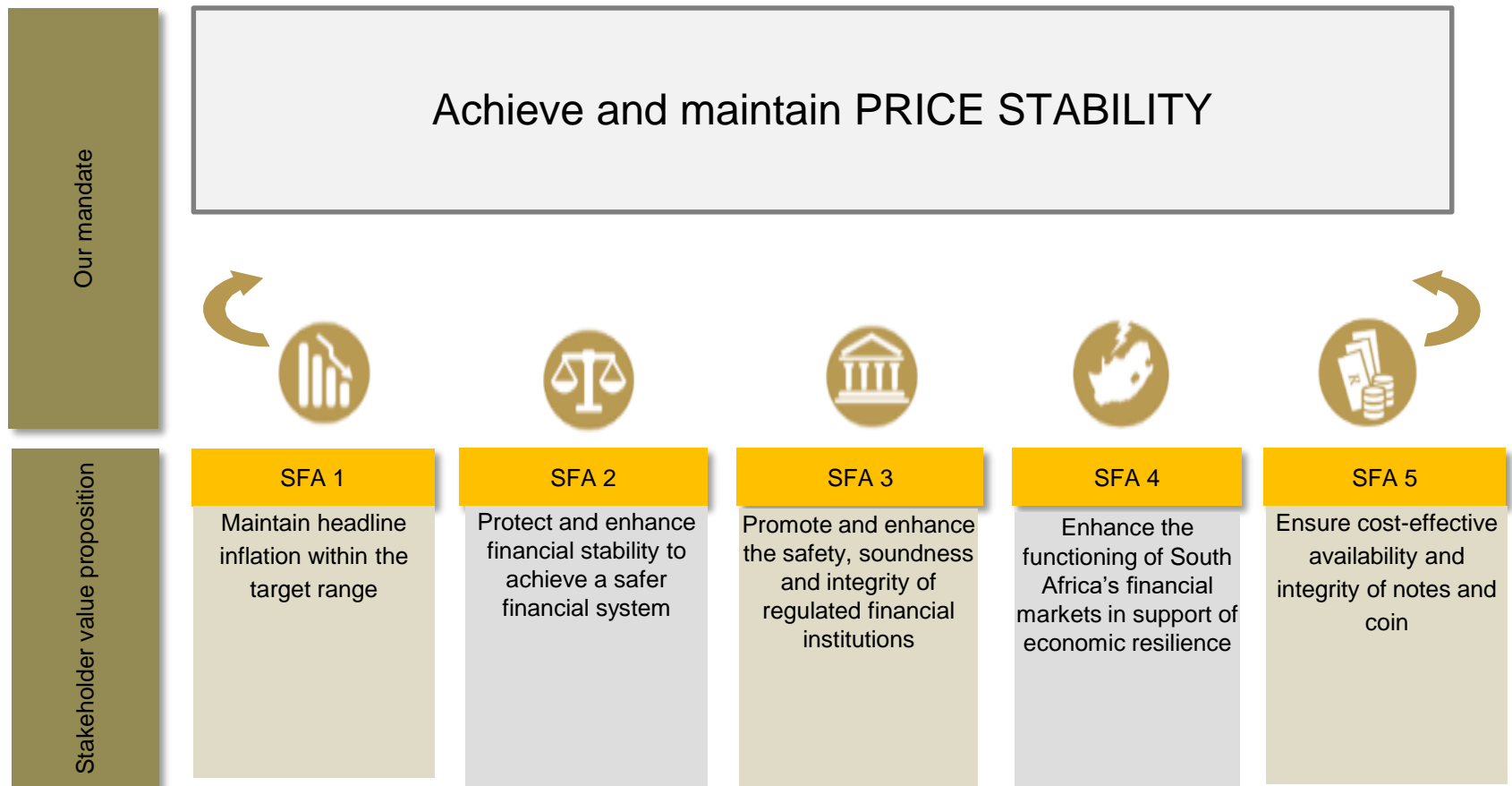
About the SARB Annual Report 2018/19

- The Annual Report provides readers with:
 - a holistic account of the SARB's strategy
 - performance; and
 - impact on society
- It contains financial and non-financial information that is material to the SARB's ability to sustainably implement its mandate

The mandate expressed operationally in a strategic plan

- Five strategic focus areas
- Together with supporting strategic objectives
- Cross-cutting activities
- Organisational capacity and capability objectives

Five strategic focus areas



2018/19 strategic performance

SFA	Performance
SFA 1 Maintain headline inflation within the target range	Inflation remained within the target range at 4.7% and is projected to remain within the target range over the three-year forecast horizon. Inflation expectations also remain within the target range for the next 24 months.
SFA 2 Protect and enhance financial stability to achieve a safer financial system	No systemic risk events occurred in the financial system. The Governor and Minister of Finance agreed a macroprudential policy framework, including the toolkits and policies to be applied by the SARB to prevent and identify systemic risks and to respond to a systemic event when it occurs.
SFA 3 Promote and enhance the safety, soundness and integrity of regulated financial institutions	The Prudential Authority was successfully launched in 2018 and the relevant institutions were gradually integrated into the Prudential Authority. The programme to establish and embed the Prudential Authority is largely on track. There were no failures of systemically important financial institutions (SIFIs), although some smaller institutions were placed under specific regulatory action.
SFA 4 Enhance the functioning of South Africa's financial markets in support of economic resilience	Broadening the scope of this SFA beyond reserves management to strengthen economic resilience has been a key focus for the year. The cross-cutting research agenda will take this work forward and it is expected that additional measures may be formulated for SFA 4 going forward. Reserves accumulated were below planned levels at December 2018, partly due to a delay in finalising the reserve accumulation strategy.
SFA 5 Ensure cost-effective availability and integrity of notes and coin	The currency-producing subsidiaries delivered all notes and coin orders effectively, both for the SARB and the international export market. The quality of banknotes fit for re-circulation was however below the desired level.



Financial highlights

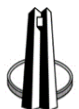
- Profit of R5.8b was R3.6b higher than the previous year of R2.2b
- The South African Mint net profit after tax of R0.7b, which is a R0.3b increase compared to R0.4b last year, from stronger Krugerrand sales
- The SABN significantly higher profit after tax of R0.2b, compared to a net loss after tax of R13m last year, as a result of increased production volumes
- African Bank impacted positively, contributing R0.5b to group profits

Profit breakdown

	Group (R'm)	
	2019	2018
CPD	92	91
SA Mint (attributable to parent)	666	421
SABN	156	(13)
Subsidiaries' profit contribution	914	499
Share of profit/(loss) attributable to associate	547	424
Less intercompany dividends	(250)	(150)
SARB's net profit after taxation	4 610	1 391
Total Group profit attributable to the parent	5 821	2 164

← African Bank Impact

- Dividend of R0.2m (or 0,0043% of SARB profits and 0.0034% of total Group profits) was paid to shareholders as required by the SARB Act



Social investment and support

1. Education

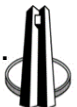
- ❑ 79 bursaries offered at various level of study from first to final year to young people with a total spend of R13 million.
- ❑ Support of academic research with the following programmes with a total spend of R9.3 million:
 - ❑ Chair of economic journalism
 - ❑ Chair of Financial stability
 - ❑ Financial Stability research
 - ❑ Chair of financial journalism
 - ❑ Chair of Monetary policy
- ❑ Monetary Policy Committee Schools Challenge - A national competition for Grade 12 Economics learners on how the SARB set repo rate policy in all 9 provinces. 396 schools participated, with a total spend of R5 million.

2. Employee Volunteerism

- ❑ Offer infrastructural support to special needs schools in all provinces.
- ❑ Mandela Day - Encourage staff to participate in the commemoration of Nelson Mandela day.
- ❑ Total spend R3 million.

3. Preferential Procurement

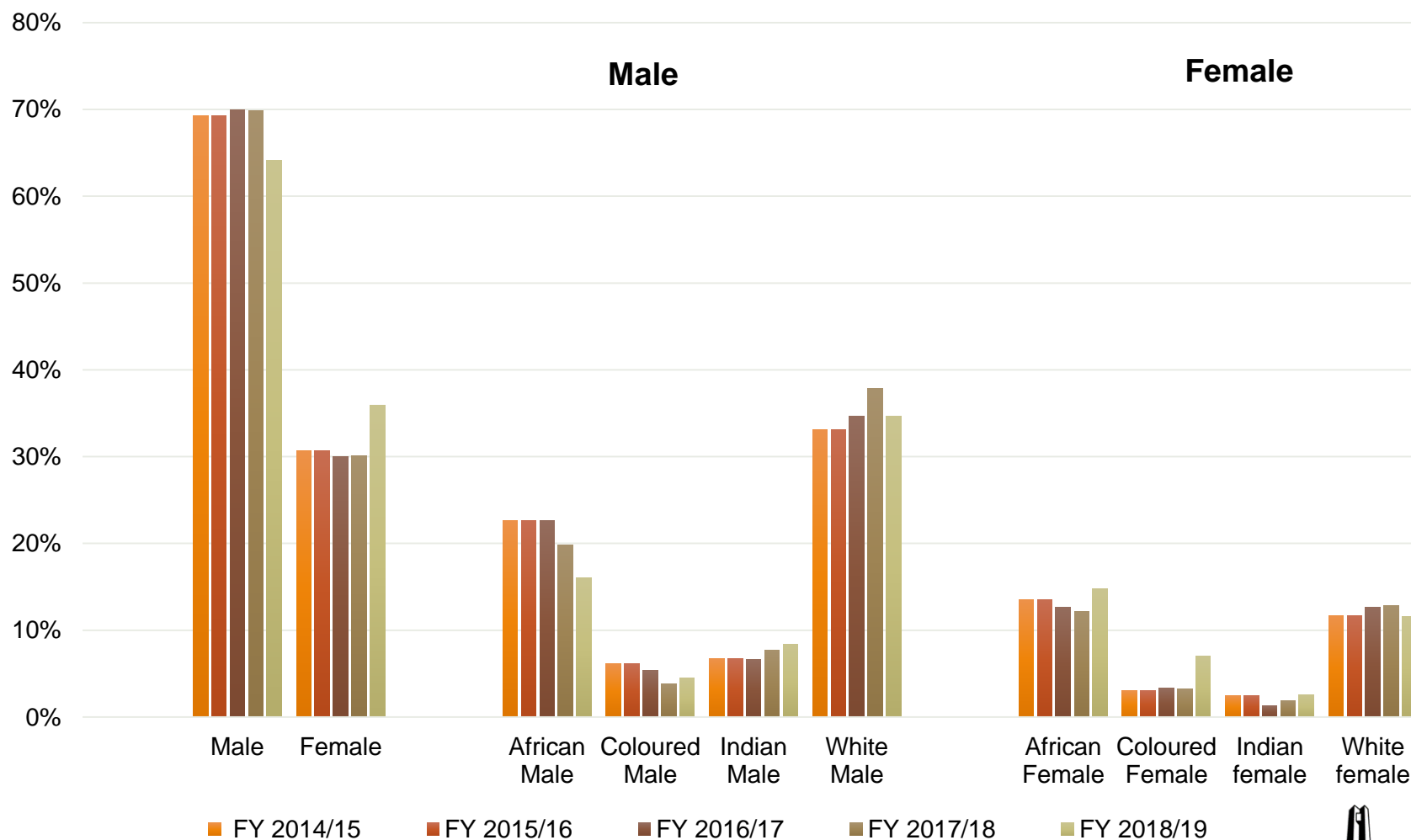
- ❑ B-BBEE performance progressed well from 13.4 points in FY 2015/16 to 19 points in FY 2018/19. This is mainly attributable to increased focus in sourcing awards to BO and BWO businesses.
- ❑ Inclusive procurement - The Bank continues to target some of its procurement spend on Qualifying Small Enterprise (QSE) suppliers.



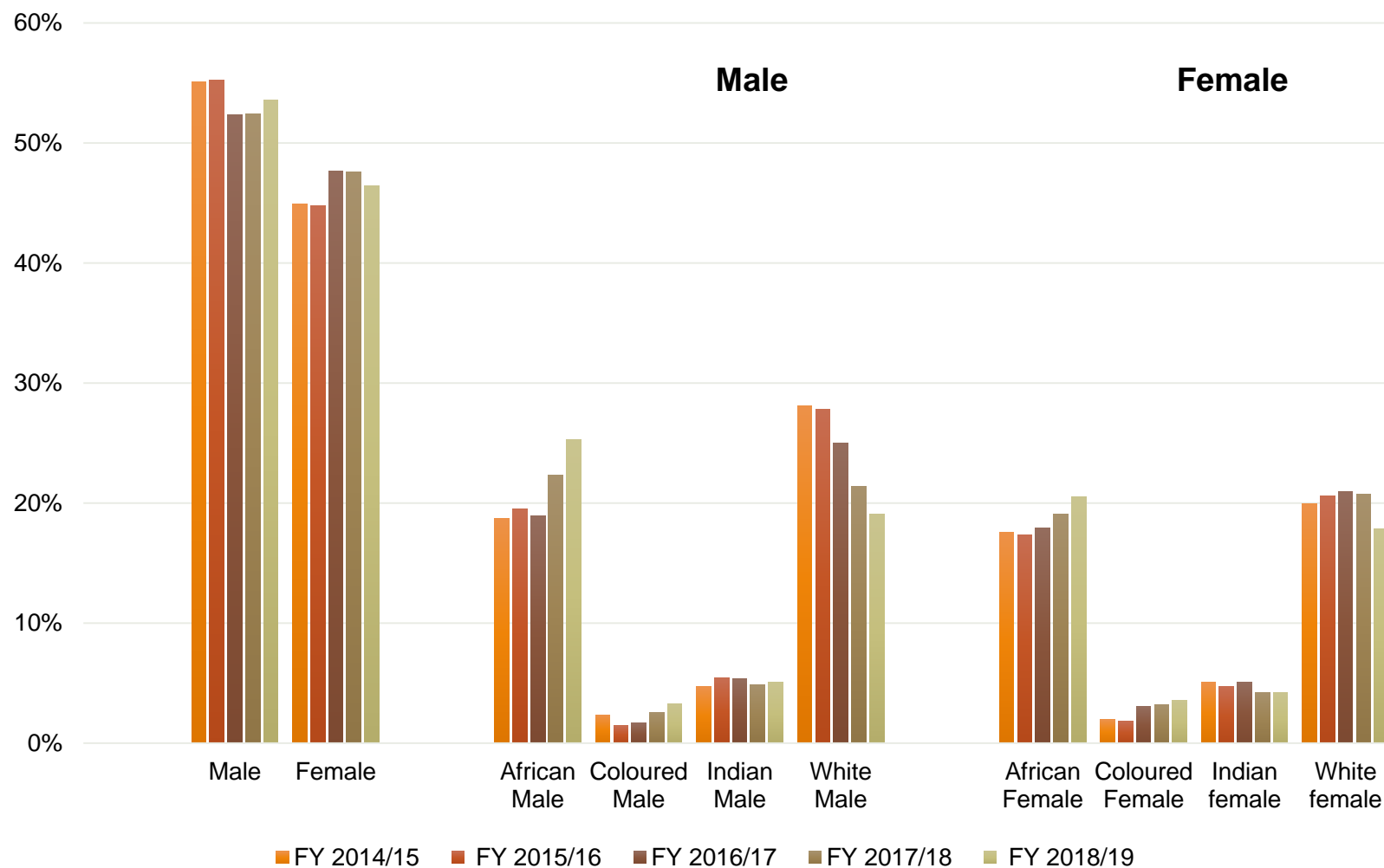
Human resources highlights

- The Bank conducted two employee engagement surveys to gain insight on how it can improve employee experience. There has been a positive year on year movement in the employment engagement survey
- The Bank's total staff composition is 74% Black and 26% White.
 - Executive management (GEC) is 100% Black (African, Coloured and Indian)
 - Top management is 55% Black and 45% White
 - Senior management is 64% Black and 34% White
- The Bank spent R54.9 million on training and development. This equates to 2 118 employees (99.6%) attending a training intervention in FY 2018/19
- The coverage ratio of critical roles improved to 91% in FY 2018/19
 - (2017/18: 80%)
- Regrettable turnover ratio is 1.32% in FY 2018/19
 - (2017/18: 1.17%)

Staff composition – Top management



Staff composition – Senior management



The Prudential Authority

Established on 1 April 2018, as a juristic person, operating within the administration of the SARB:

The PA comprises four departments:

Banking, Insurance
and FMI Supervision

Financial
Conglomerate
Supervision

Policy, Statistics and
Industry Support

Risk Support

The PA Vision

Achieve a safer financial system through excellence in prudential regulation and supervision

The PA team

The PA consists of 242 staff members with qualifications and experience in banking, insurance, actuarial science, law, policy, governance, commerce and finance

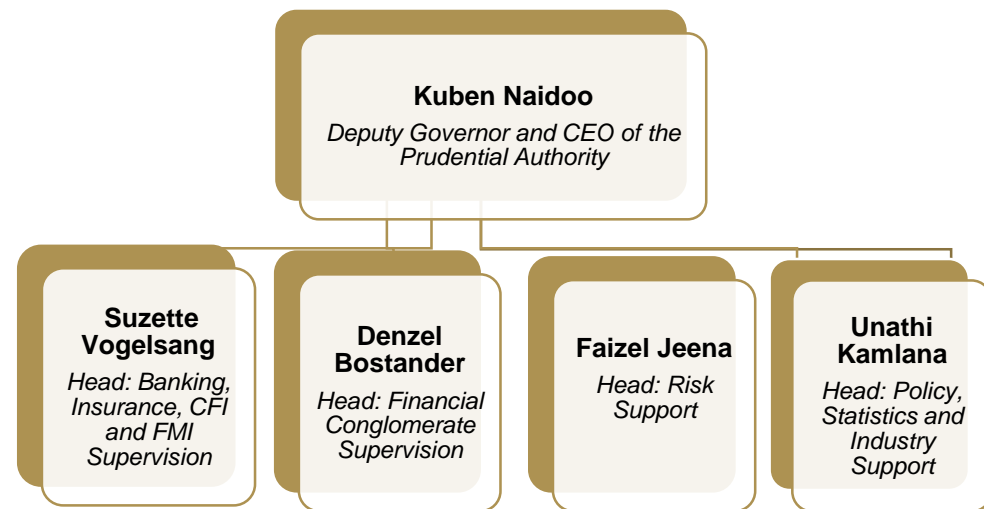
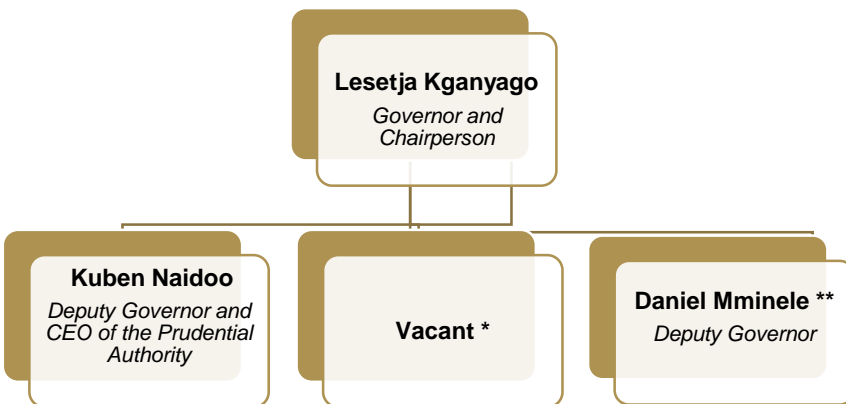
The Prudential Authority: Governance structures

Prudential Committee

- Responsible for the general oversight of the management and administration of the PA to ensure that it is effective and efficient

Prudential Authority Management Committee

- Responsible for the general operations and management of the PA regarding policy as well as regulatory and supervisory matters



- Effective 31 January 2019, Mr F E Groepe resigned as Deputy Governor and as a member of the Prudential Committee

* * Retired with effect from 30 June 2019

The Prudential Authority: Progress made during the year

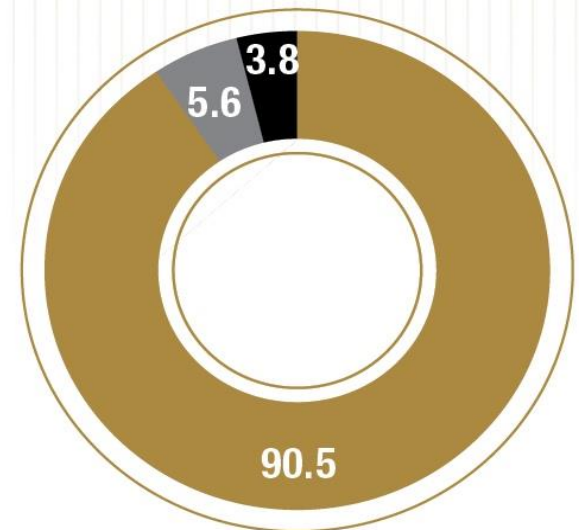
- The PA went live on 1 April 2018 with the successful integration of staff from three regulatory authorities.
- The PA finalised and adopted its Supervisory Framework.
- Certain elements of the regulatory and supervisory framework for financial conglomerates and significant owners have been distributed for external consultation.
- The publication of the Regulatory Strategy, 2018-2021.
- The implementation of the Insurance Act 18 of 2017 and related Prudential Standards for insurance companies on 1 July 2018.
- The conclusion of memorandums of understanding with various regulatory bodies.
- The release of a notice regarding the submission of statutory returns for financial market infrastructures.
- The publication of a draft Prudential Standard containing transitional arrangements for co-operative financial institutions.
- The release of the inaugural annual report for the PA on 25 June 2019.

The Prudential Authority: Banks

- The South African banking sector is dominated by five large banks, which collectively held **90.5%** of the total banking sector assets as at 31 March 2019.
- Local branches of international banks accounted for **5.6%** of banking sector assets at the end of March 2019.
- Other banks represented **3.8%** at the end of March 2019.

	March 2018 R billions	March 2019 R billions	% change
Total assets	5 201	5 654	8.70
Total equity	449	470	4.67
Impaired advances (increase primarily due to IFRS9)	128	159	23.98

March 2019



- Five largest banks
- Local branches of foreign banks
- Other banks

- The LCR remained above the minimum requirement during the period under review, and amounted to 142.4% at the end of March 2019, mainly due to an increase in high-quality liquid assets.



The Prudential Authority: Mutual Banks

- The sector remained profitable during the period under review, although a declining trend in profitability was evident
- Total mutual banking assets increased to R3 136 million
- The total capital adequacy ratio for the sector remained stable at 23.10%
- Overdue loans improved to R6 million (2018: R8 million)

The Prudential Authority: Insurers

R million	Life insurers	Non-life insurers	Composite reinsurers
Total net premiums (six months ending 31 Dec 18)	281 355		
Total gross premiums (six months ending 31 Dec 18)		74 582	6 784
Total assets	3 011 459	197 262	33 835

The PA must, within a period of two years from the effective date, i.e. 1 July 2018, convert the registration of all previously registered insurers to a licence in accordance with the Insurance Act.

The Prudential Authority: Co-operative financial sector

- Co-operative Banks (Co-op Banks) have always been regulated by the SARB
- The PA now regulates both Co-operative Financial Institutions (CFIs) and Co-op Banks, having taken over the regulatory oversight of CFIs from the Co-operative Banks Development Agency (CBDA)

The CFIs reflected in the below table were registered by the CBDA and are in the process of reapplying for registration with the PA

	Number		Members		Deposits R millions		Assets R millions	
February*	2018	2019	2018	2019	2018	2019	2018	2019
Co-operative banks	3	4	3 246	4 321	R128.8	R145.3	R153.5	R177.4
CFIs	23	22	24 618	23 170	R128.6	R149.1	R180.4	R192.1
Total	26	26	27 864	27 491	R257.4	R294.4	R333.9	R369.5

* The financial year-end of all co-operative banks and CFIs is 28 February.

The Prudential Authority: Financial Market Infrastructures

The PA is responsible for the prudential supervision of market infrastructures. This category includes:

- Exchanges;
- Central securities depositories;
- Clearing houses;
- Central counterparties; and
- Trade repositories

Exchanges	Central securities depositories	Clearing houses
<ul style="list-style-type: none">• JSE Limited• A2X (Pty) Ltd• ZAR X (Pty) Ltd• 4 Africa Exchange (Pty) Ltd• Equity Express Securities Exchange	<ul style="list-style-type: none">• Strate (Pty) Ltd• Granite	<ul style="list-style-type: none">• Strate (Pty) Ltd• JSE Clear

The Prudential Authority: Illegal deposit taking

Unregulated insurance activities are split between the PA and the Financial Sector Conduct Authority (FSCA)

PA	FSCA
<ul style="list-style-type: none"> Investigating registered insurers that are conducting business or classes of policies that they are not registered to deal with 	<ul style="list-style-type: none"> Investigating entities conducting business without being registered to do so

Illegal deposit taking



The 'business of a bank' is **comprehensively defined** in the Banks Act, summarised as the acceptance of, soliciting of, or advertising for, **deposits from the general public** as a regular feature of the business

- Unregistered persons are prohibited from deposit-taking activities**

Illegal deposit taking schemes investigated: 1 April 2018 – 31 March 2019

Investigations carried over from the previous financial year	20
New investigations	2
Finalised investigations	16
Current investigations	6

The Prudential Authority: Resolution management

The following entities were placed under curatorship during the period under review:

- VBS Mutual Bank: Curatorship 11 March 2018 and Liquidation: October 2018
- Nzalo Insurance Services Limited and Bophelo Life Insurance Company Limited: Provisional winding-up on 12 February 2019.
- Insure Group Managers, which collects premiums for insurers: Voluntary curatorship by the FSCA with the concurrence of the PA.
- Lion of Africa Insurance Company Limited: Licence suspended on 13 November 2018.

African Bank

- The 'new' African Bank, which was launched on 4 April 2016, continued to operate in a stable manner in the period under review. As at March 2019, its total assets were reported at R28.2 billion and its total deposits at R17.9 billion. The PA is the regulator for African Bank, with SARB being a shareholder. Requests have been received from potential buyers to purchase the bank and any such proposal(s) will be for the consideration of the shareholders, which includes SARB, and National Treasury.

The Prudential Authority: Where to next?

2018-2021 Current mandate

- Banks
- Mutual Banks
- Co-operative Banks
- Insurers
- Co-operative Financial Institutions
- Market infrastructures
- Credit providers prudential through the National Credit Regulator and the FSCA

2021-2024 Medium term mandate

- Pension funds
- Collective investment schemes
- Friendly societies

During the next year the PA will be implementing numerous Prudential Standards applicable to the industries it regulates

Questions and answers

