South Africa's banking system is changing

By Natalie Scott and Kyra South

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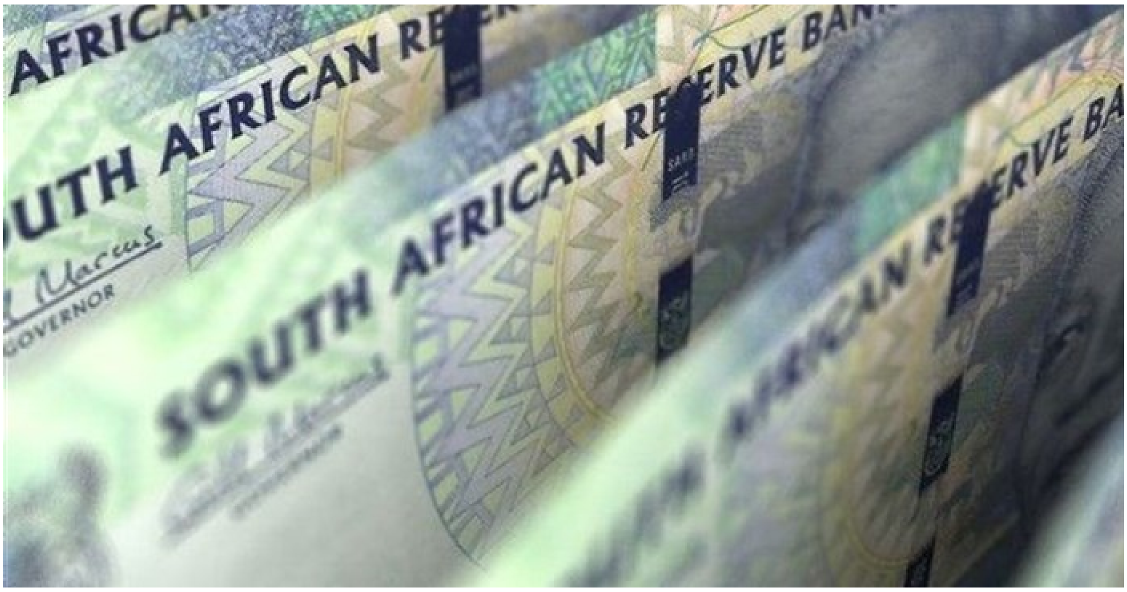
On 8 June 2022, the South African Reserve Bank (Sarb) commenced with its 12-week transition to a new monetary policy implementation framework.



Source: 123RF

According to the Sarb, the “Monetary Policy Committee (MPC) makes decisions on interest rates, and the [monetary policy implementation framework (MPIF)] is the mechanism through which these decisions are made effective and transmitted through the South African economy.

"The amendments to the framework are technical in nature and will affect how monetary policy is implemented but will not affect the inflation target range or the interest-rate decisions of the MPC."

If the Sarb’s amendments to the Republic of South Africa’s MPIF are only technical in nature, why is it important to know what these amendments are?

Scarce-reserves framework

Historically, the Sarb implemented the shortage or classical cash-reserve system for implementing monetary policy (scarce-reserves framework) which ensured that there was a shortage of cash reserves in the market and that a limited amount of cash reserves were available to commercial banks.

Commercial banks were thus required to source additional cash reserves from the Sarb at the repurchase (repo) rate, which in turn ensured that the interest rate on such cash reserves was equal to the policy rate.

We understand that the scarce-reserves framework worked relatively well in South Africa up until the director-general of the World Health Organization characterised Covid-19 as a pandemic on 11 March 2020 and South Africa declared the outbreak of Covid-19 in South Africa a national disaster .

During the pandemic, the Sarb implemented measures to relieve the liquidity squeeze that the pandemic placed on commercial banks and noted in the latter half of 2020 that liquidity in the market had largely normalised, save in relation to the money-markets, where the liquidity shortage was consistently smaller than it was before the start of the pandemic.

On investigation, the Sarb determined that South Africa’s structural liquidity surplus had built up over time resulting in the scarce-reserves framework being “difficult and costly to operate“ and that the “tiered-floor” system will be a better and more cost-efficient, monetary policy implementation framework for South Africa.

Tiered-floor system

Under the tiered-floor system, the Sarb will provide a surplus of cash reserves to satisfy commercial banks’ demand for cash reserves and will place quotas on all commercial banks firstly limiting the amount of cash reserves that they’re able to deposit with the Sarb (and earn interest (at the repo rate) on) and secondly preventing the hoarding of cash reserves.

By introducing quotas to the tiered-floor system, the Sarb hopes to encourage commercial banks to lend some of their excess cash reserves to other commercial banks thereby alleviating the pressure on the Sarb as sole liquidity provider.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While South Africa is the “first emerging market to adopt the tiered-floor framework”, the tiered-floor system is not a new concept, and has been successfully implemented in several first-world countries, such as New Zealand and Norway, where it has proven to have been effective at stabilising commercial banks’ demands for cash reserves.

The Sarb expects that the implementation of the tiered-floor system (with quotas) will “provide the Sarb with a resilient and efficient framework for implementing monetary policy in South Africa,” and encourage commercial banks to deposit cash reserves with the Sarb, as opposed to requiring the Sarb to provide liquidity to commercial banks.

But what does the change to South Africa’s monetary policy implementation framework mean for investors?

According to Rand Merchant Bank, a division of FirstRand Bank Limited, the “change in the MPIF will have implications for fixed-income investors, since it is likely to result in changes to the supply and demand of certain instruments, and consequently, structural adjustments to market reference rates.

"The overall effect, especially at the short end, is an expected reduction in spreads over the repo rate."

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