

The South African Reserve Bank's new monetary policy implementation framework

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On the 8th of June 2022, the South African Reserve Bank (**SARB**) commenced with its 12-week transition to a new monetary policy implementation framework.^[1] According to the SARB, the "*Monetary Policy Committee (MPC) makes decisions on interest rates and the [monetary policy implementation framework] 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".^[2]

If the SARB's amendments to the Republic of South Africa's (**South Africa**) monetary policy implementation framework 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**)^[3] 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^[4] and which in turn ensured that the interest rate on such cash reserves was equal to the policy rate.^[5]

We understand that the Scarce-Reserve Framework worked relatively well in South Africa up until the Director-General of the World Health Organisation characterised COVID-19^[6] as a pandemic on 11 March 2020 and South Africa declared the outbreak of COVID-19 in South Africa a national disaster^[7] (**Pandemic**).

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.^[8]

On investigation, the SARB determined that South Africa's structural liquidity surplus had built up over time resulting in the Scarce-Reserve Framework being "*difficult and costly to operate*"^[9] and that the "tiered-floor" system would be a better and more cost-efficient, monetary policy implementation framework for South Africa.

Tiered-Floor System

Under the tiered-floor system (**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 (i) limiting the amount of cash reserves that they're able to deposit with the SARB (and earn interest (at the repo rate) on) and (ii) 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.^[10] Whilst South Africa is the "*first emerging market to adopt the tiered-floor framework*",^[11] the Tiered-Floor System not a new concept, and has been successfully implemented in several first world countries, such as New Zealand and Norway, and which has proven to have been effective at stabilising commercial banks' demands for cash reserves.^[12]

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,”^[13] and encourage commercial banks to deposit cash reserves with the SARB, as opposed to requiring the SARB to provide liquidity to commercial banks.

Conclusion

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

According to Rand Marchant 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.”^[14]

[1] Page 3 of the SARB’s Financial Markets Department policy document titled “Transitioning to a new Monetary Policy Implementation Framework” dated May 2022

[2] The SARB’s Press Release titled “A new framework for implementing monetary policy in South Africa” dated 27 May 2022

[3] Page 3 of the SARB’s Financial Markets Department policy document titled “A new framework for implementing Monetary Policy in South Africa”

[4] South African Reserve Bank on reforming South Africa’s monetary policy implementation framework [accessed 20 June 2022]

[5] Page 5 of the SARB’s Financial Markets Department policy document titled “A new framework for implementing Monetary Policy in South Africa”

[6] COVID-19 is defined in regulations published under section 27(2) of the Disaster Management Act 57 of 2002 as the “Novel Coronavirus (2019-nCoV) which is an infectious disease caused by a virus, which emerged during 2019 and was declared a global pandemic by the WHO during the year 2020 that has previously not been scientifically identified in humans”

[7] Government Notice No. R. 313 under the Disaster Management Act 57 of 2002 on Sunday, 15 March 2020

[8] The SARB is reforming its framework for implementing monetary policy [accessed 18 June 2022]

[9] Reserve Bank to change tack to keep up with shifting trends [accessed 20 June 2022]

[10] Pages 9 and 10 of the SARB’s Financial Markets Department policy document titled “A new framework for implementing Monetary Policy in South Africa”

[11] New policy poses rand volatility risk [accessed 20 June 2022]

[12] Page 16 of the SARB’s Financial Markets Department policy document titled “A new framework for implementing Monetary Policy in South Africa”

[13] The SARB’s Press Release titled “A new framework for implementing monetary policy in South Africa” dated 27 May 2022

[14] Reserve Bank to change tack to keep up with shifting trends [accessed 20 June 2022]



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