Remarks at the Inauguration of the Governor of the Reserve Bank of South Africa, Mr. Tito Mboweni

by
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1. It is an honor, a privilege, and a singular pleasure, to speak tonight on behalf of the International Monetary Fund at this celebration. We meet to pay tribute to the outgoing Governor, Chris Stals, who has devoted a lifetime of service to South Africa and the Reserve Bank, and who has over the years played a critical role in steering the economy through sometimes very turbulent waters-not least during the ten years of his Governorship, which coincided with the political transition and the global crisis of the last few years. It must be with a great sense of satisfaction that he completes his term, with inflation coming under control, the exchange rate reasonably stable, and South Africa well into the process of reinserting itself in the global economy. He has surely earned the gratitude of his countrymen, just as he has earned international recognition as one of the leading central bank governors of our time.

2. On this occasion, meeting in this way, we are also implicitly paying tribute to the remarkable men and women who, after many years of struggle, have brought about a democratic transition in South Africa-a transition that has been more peaceful and more successful than anyone had a right to expect. In that regard, Mr. President, we salute you as their leader and their representative, and wish you well as you confront the challenges that your nation faces, and seek to develop, mobilize and channel the energy and talents of all the people of South Africa in dealing with them.

3. And of course we meet also to congratulate the incoming Governor, Tito Mboweni, on his appointment, to wish him well as he takes up the full responsibilities of his office-and to subject him to some probably unnecessary words of advice. The job of a Governor is not an easy one, for more so than in most aspects of life, it involves a frequent tension between doing what is expedient in the short run and what is best for the medium and long run. Sometimes, as in the United States at present, the results of having done the job well over the years are obvious to all, and the head of the central bank is both widely respected and popular; more often, the Governor can at best hope to be respected.

4. Mr. Governor: You take office at a time when the worst of the recent global crisis appears to be over, but not yet at a time of economic tranquility, for some emerging market countries still face market pressures, emerging market bond spreads are still very high, and imbalances remain among the economies of the leading industrial countries. Nonetheless, it

is probably a good occasion to draw a few of the preliminary lessons of the crisis.

5. Chief among them are:

- **Sound macroeconomic policies work**. In Brazil and Russia, the crisis reflected the persistence of large fiscal deficits and growing government debts. These governments also showed themselves at critical stages to be incapable of carrying out much needed fiscal reforms. Contrast this with South Africa's pursuit of prudent fiscal policies, its implementation of budgetary reforms (in the form of the medium term expenditure framework - MTEF) and an overhaul of tax administration, and its anti-inflationary monetary policy.

- **Countries need a strong, well-regulated financial system**. In Asia, although country circumstances varied, the crisis reflected to an important extent financial system weakness. While crises may occur even when the financial system is sound, as in Brazil, the extent of the crisis is importantly affected by the strength of the financial system. In this regard, because South Africa's banking system is sound and well-regulated, it was able to withstand the shocks from the large increase in interest rates and the substantial depreciation in the currency during the time of the crisis.

- **For countries not willing or able to peg their currencies extremely hard, flexible exchange rates work best.** The crises in Thailand, Indonesia, Korea, Russia, and Brazil, were all associated with exchange rates that had been more or less fixed. Other hard-hit countries, among them South Africa, Mexico, and Turkey, used their exchange rates to absorb part of the adjustment burden, and suffered less.[2] Increasingly the lesson is being drawn that countries integrated into the international capital markets should go to the extremes, either a tightly pegged rate as in Argentina and Hong Kong, or a floating rate.

- **Globalization is here to stay.** That is to say, the approach to economic management based on openness to and increasing integration with the rest of the world, and on vigorous structural reforms aimed at strengthening the economy and the role of market forces in it, has not been abandoned, but if anything strengthened. At the height of the crisis, critics argued for the imposition of capital controls and closing off to the outside world. However, in confronting the crisis, virtually all policy makers in emerging markets, including those in South Africa, rejected the call to close their economies, thereby signaling their conclusion that integration with the world economy is the best way to grow. Their commitment places a heavy obligation on the industrialized countries and the international institutions to improve the operation of the international financial system - but I do not intend to discuss tonight the ongoing important work on the reform of the international financial architecture.

6. Rather, let me turn to South Africa, and ask where your country stands, relative to the crisis, and in the context of globalization. As you all know only too well, South Africa was not left untouched by the crisis in emerging markets. However, South Africa fared relatively better than other countries: the decline in output, the increase in eurobond risk premiums, and the depreciation of the currency in the immediate aftermath of the crisis were all considerably less in the case of South Africa than in the average emerging market experience. Indeed, South Africa was one of only a few emerging market economies that

did not require an IMF program nor the use of Fund resources during this period.

7. That South Africa was able to withstand the financial crisis relatively well is attributable to its policy strengths-its prudent macroeconomic policies, sound, well regulated banking system, and flexible exchange rate system-that I mentioned earlier. In addition, your country is well positioned in other important respects to maximize the benefits from globalization: it has very advanced, liquid capital markets; a stable, democratic political system; advanced telecommunications and other infrastructure; and a sophisticated industrial base.

8. The country has made progress in trade liberalization, capital account liberalization, competition policy, establishing codes of good fiscal practice, and strengthening financial system regulation towards international best practice. Under the Growth, Employment, and Redistribution (GEAR) Strategy it is committed to moving ahead with other key structural reforms. There is also a noteworthy commitment to eliminate corruption.

9. Still, there is need for further action on structural reform: trade liberalization, especially in terms of simplifying the tariff structure and moving forward on trade liberalization initiatives with regional partners. An acceleration of the privatization program in order to improve the efficiency of public enterprises and catalyze foreign investment would be beneficial, provided proper provision is made to protect those who would be hurt during the process. Last but not least, reforms in the labor market are needed that would encourage firms to employ more labor and move towards more labor-intensive production techniques. In this regard, the government's intention to review recent legislation to eliminate features that inhibit employment creation is welcome. At the same time, no one is forgetting that there also needs to be a powerful thrust to develop human capital, requiring reforms in education, health care (including an all out campaign to stem the HIV/AIDS epidemic), skills development and training. And no one should forget either the need for a social safety net, to help those least equipped to deal with or temporarily hurt by the perpetual process of economic adjustment.

10. Now let us turn closer to home, to monetary policy, and ask, so to speak, whether there is the need for an anchor for monetary policy -- and here I am not referring to the personas of Mr. Stals or Mr. Mboweni, although each is well suited for the job. Rather I am talking about the growing international trend towards the adoption of an inflation targeting framework. The Finance Minister has announced the intention to adopt such a framework, which is, I believe, both feasible and desirable for South Africa. South Africa satisfies the important prerequisites for the successful implementation of inflation targeting: there is no fiscal dominance of monetary policy, no formal objective of targeting the nominal exchange rate; there is an independent central bank; and capital and money markets are sufficiently developed. The change would also help remove potential uncertainties about the monetary policy objectives of the Reserve Bank, and it would enhance the transparency of monetary policy.

11. Although the formal inflation targeting approach has been in operation for no more than a decade, the evidence of its success continues to mount. The approach has succeeded in part because it provides an excellent solution to the old debate over rules versus discretion in monetary policy: the central bank has discretionary power in dealing with changing circumstances, but it is given a clear rule about the goals of policy. Inflation

targeting has succeeded too because it deals well with two of the key dilemmas that confront any central bank, especially one in an open emerging market economy. The first dilemma is the short run tradeoff between output and inflation. A central bank cannot ignore the tradeoff, for in the short-run, monetary policy *does* affect output. In the first instance, in the face of demand shocks, inflation targeting is fully consistent with a policy that stabilizes the business cycle. And second, if the target is inflation at a reasonable horizon, say one to two years ahead, the monetary policy maker has the ability to take output effects into account, while never escaping its obligation to control inflation. The second dilemma is the short run tradeoff between the exchange rate and inflation. Monetary policy makers in small open economies -- and sometimes in big economies too -- are always subject to pressures to intervene in the exchange markets, in one direction or the other. Inflation targeting says the behavior of the exchange rate *should* be taken into account in formulating monetary policy, but only to the extent that changes in the exchange rate affect domestic inflation. And even so, that response would more often take the form of changes in interest rates than of interventions in the foreign exchange markets. It is thus good news that South Africa intends to move towards inflation targeting within the next few months.

12. Mr. Governor: You take over a central bank that, under Chris Stals' leadership, has successfully confronted a lengthy period of extraordinary turbulence. We are confident that under your leadership, it will continue to enhance its reputation as a strong central bank that presides, with political independence and technical expertise, over a successful monetary policy, defined in a new framework, aimed at financial and price stability. This is the best contribution the Reserve Bank can make towards the growing and prosperous economy that South Africans deserve and can have - and we wish you every success as you take on this critically important task.

1 These remarks were prepared for delivery at the inauguration of Tito Mboweni, and the retirement of Chris Stals, as Governor of the South African Reserve Bank, Midrand, August 7 1999. I am grateful to Trevor Alleyne of the IMF for his inputs.

2 In fact, with the rand having depreciated by 12 percent in real effective terms in the 12 months prior to the crisis, there was no general perception that the currency was misaligned.