



SWAZILAND'S MONETARY POLICY FRAMEWORK



ECONOMIC POLICY, RESEARCH AND STATISTICS

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FOREWORD

This document presents the Monetary Policy Framework (MPF) of the Central Bank of Swaziland, in line with international best practices. The Central Bank of Swaziland has the ultimate goal of attaining price stability, stable and sound financial systems that will ensure sustainable economic growth. Swaziland's monetary policy objective, as stated in Section 4 (a) of the Central Bank Order of 1974 (as amended), is to promote monetary stability. Monetary policy formulation in Swaziland is, to a large extent, influenced by the country's membership to the Common Monetary Area (CMA). Article 2 of the CMA Agreement gives, Lesotho, Namibia, and Swaziland (LNS) the right to issue their own national currencies and their bilateral agreements with South Africa define the areas where their currencies are legal tender.

Different countries use different monetary policy regimes in their quest for price stability. These regimes can be inflation targeting, monetary base targeting, and fixed exchange rate targeting. In that regard, the intermediate goal of monetary policy in Swaziland is to maintain the fixed exchange rate with the South African Rand. This requires that the country's currency in circulation is backed by international reserves, which should be greater than the conventional

three months of import cover. Under the membership to the CMA Swaziland has little scope to undertake discretionary monetary policy in response to domestic developments and other prudential measures.

With that level of monetary policy discretion, the Central bank of Swaziland has the liberty to use the discount rate as a major policy instrument to fight domestic inflationary pressures and curb capital flight. The discount rate can be at par or at different levels with that of South Africa, depending on the domestic macroeconomic fundamentals. The other instruments which the Bank uses are the liquidity and reserve requirements, as well as open market operations. According to the Central Bank of Swaziland Order of 1974 (as amended), monetary policy decisions are taken by the Governor, in consultation with the Monetary Policy Consultative Committee (MPCC). A day after the meeting, a formal announcement of the policy decision taken is made through a press release in local media outlets and the Bank's website, along with comprehensive reasons for the decision taken.

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GOVERNOR

TABLE OF CONTENT

1.0	INTRODUCTION.....	3
1.1	Monetary Policy in Swaziland.....	3
2.0	MONETARY POLICY TRANSMISSION IN SWAZILAND.....	5
3.0	MONETARY POLICY FORMULATION	7
3.1	Monetary Policy Instruments.....	8
3.1.1	<i>The Discount Rate</i>	8
3.1.2	<i>The Reserve Requirement</i>	8
3.1.3	<i>The Liquidity Requirement</i>	8
3.1.4	<i>Open Market Operations</i>	9
3.2	Announcement of Monetary Policy Decisions	9
4.0	REVIEW OF THE MONETARY POLICY FRAMEWORK.....	9
5.0	CONCLUSION.....	10
	References	11

LIST OF FIGURES

Figure 1:	The “Impossible Trinity” in Monetary Policy	4
Figure 2:	Channels of Monetary Policy Transmission in Swaziland	6

LIST OF APPENDICES

Appendix A:	The Terms of Reference for the MPCC	12
Appendix B:	The Code of Conduct for the MPCC	14

1. INTRODUCTION

The Central Bank of Swaziland has the ultimate goal of attaining price stability, stable and sound financial systems that will ensure sustainable economic growth. This can be achieved through a sound monetary policy formulated and implemented by the Central Bank of Swaziland. This can be done by influencing the monetary variables to achieve the ultimate macroeconomic goals of the nation. In general terms, monetary policy can be defined as the actions of the central bank to control monetary variables such as money supply, interest rates, and credit availability, in order to achieve the ultimate national macroeconomic objectives of price stability, low unemployment, stable exchange rate, and economic growth (Dlamini, 2014). This document presents the Monetary Policy Framework (MPF) of the Central Bank of Swaziland.

1.1 Monetary Policy in Swaziland

Swaziland's monetary policy objective, as stated in Section 4 (a) of the Central Bank Order of 1974 (as amended), is to promote monetary stability. Monetary policy formulation in Swaziland is, to a large extent, influenced by the country's membership to the Common Monetary Area (CMA), together with

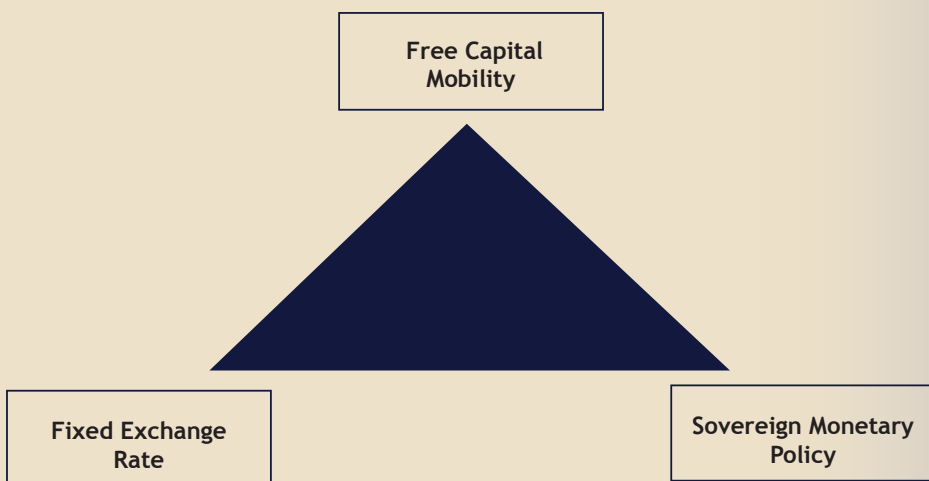
Lesotho, Namibia (since 1992), and South Africa. The CMA came into force in 1986. Article 2 of the CMA Agreement gives Lesotho, Namibia, and Swaziland (LNS) the right to issue their own national currencies and their bilateral agreements with South Africa define the areas where their currencies are legal tender, their own countries. The South African Rand, however, is legal tender in all members of the CMA. Since the Rand is legal tender in all CMA countries (but the currencies of the three small CMA members are not legal tender in South Africa), South Africa compensates them for forgone seigniorage, based on an agreed formula.

By issuing own currencies, the LNS countries became responsible for their own monetary policies and assume control of their own financial institutions. According to the agreement, Swaziland's currency (the Lilangeni) is pegged on a one-to-one basis to the South African Rand (which freely floats with other major currencies). Therefore, keeping the exchange rate peg serves as an intermediate goal for monetary policy in Swaziland. To support this exchange rate policy, Swaziland has to keep the level of foreign exchange

reserves equivalent to, or above the conventional international standard of three months of imports of goods and services. Over and above the fixed exchange rate regime that exists, there is also free flow of capital within the CMA region. Given the above conditions, the rule of ‘impossible trinity’ creeps in and dictates important monetary policy implications for the country.

According to the theory of the ‘impossible trinity’ shown in Figure 1 (also known as triangle of impossibilities or the trilemma), a country cannot have a pegged exchange rate regime, free capital mobility and autonomy in its monetary policy all at the same time (Al-Raisi et al, 2007). A country can only do two of these three things.

Figure 1: The “Impossible Trinity” in Monetary Policy



Thus given Swaziland’s membership to the CMA, free movement of capital and the exchange rate peg imply limited scope to undertake discretionary monetary policy in response to domestic developments.

This does not imply a lame-duck central bank. The decision to maintain membership of the CMA becomes one of the critical policy considerations by the Kingdom of Swaziland. Movements of the central bank’s major policy

tool (the discount rate) mirrors that of South Africa by dictatorship of the ‘impossible trinity’. The Central Bank is empowered to vary such a policy stance depending on domestic macroeconomic fundamentals.

The CMA agreement ‘Multilateral Monetary Agreement, MMA’, gives improved financial integration. For example, the LNS states have access to the developed South African capital and money markets, but only through prescribed investments or approved securities that can be held by financial institutions in South Africa, and no restrictions

can be imposed on the transfer of funds, whether for current or capital transactions, to or from any member country (Article 3). Although the LNS countries have the right to authorise foreign currency transactions of local origin, the MMA (Article 5) requires their exchange control regulations to be in all material aspects similar to those in effect in South Africa. The CMA is not a full monetary union. There is no common central bank, no common pool of reserves, and no regional surveillance of domestic, particularly fiscal and structural policies.

2. MONETARY POLICY TRANSMISSION IN SWAZILAND

All monetary policy instruments have their own limits. The use of any policy tool has to ensure it achieves the required reaction of other macroeconomic variables. How it filters to the wider economy is termed monetary policy transmission mechanism (MPTM): the process through which monetary policy decisions are transmitted into economic activity and prices. This process is one that links central

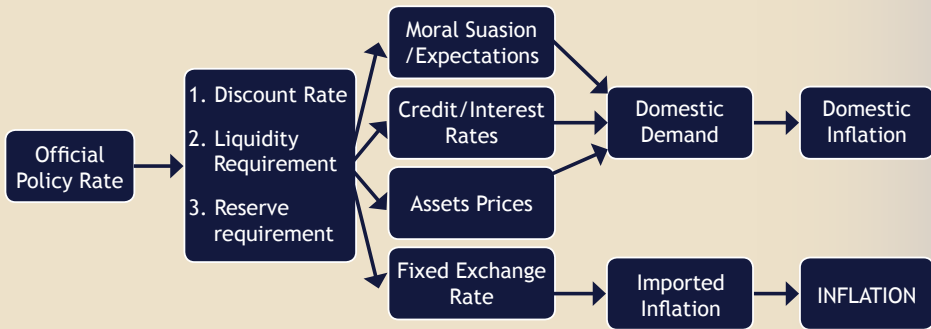
banks’ operational targets (usually short term interest rates) to its intermediate targets (medium and long-term interest rates, broad money, credit, and exchange rate) and eventually to its goal targets (stable inflation and output). Literature on the monetary policy transmission mechanism identifies five main channels of monetary policy transmission; interest rate channel, credit channel, asset price channel,

expectations channel, and exchange rate channel (Horvath et al., 2006).

Dlamini and Skosana (2016) found the existence of monetary policy transmissions in three channels, which are the interest rate, credit and asset price channels. Expectations,

though not easy to model, exists due to moral suasion being one of the instruments to guide monetary policy. The study concluded that it is in the application of the combined policy toolkit that the Bank can have an impact on inflation over the long term.

Figure 2: Channels of Monetary Policy Transmission in Swaziland



Source: Central Bank of Swaziland

Figure 2 shows the channels of monetary policy in picture form. Three of the channels are linked to domestic demand, while the exchange rate channel (maintenance of the peg) is linked to imported inflation. Due to the size of the economy and its membership to the CMA, a sizable amount of its inflation is imported from South Africa since the country sources most of imports from South Africa.

The credit channel, which is directly linked to the interest rate channel, mostly influences the pricing of retail financial products, particularly the cost of borrowing and savings. Whenever the Bank changes the discount rate, commercial banks accordingly adjust their savings and lending rates. Theoretically, firms and individuals respond to the change in commercial bank rates by altering their spending and investment

decisions. A change in the discount rate therefore is expected to induce a change in savings and investment choices. Changes in household and business demand patterns eventually filter through to output and domestic inflation. Thus, the credit channel is the most important channel in Swaziland in terms of influencing domestic inflation.

For the asset price channel, an increase in the official rate results in individuals having less money to spend because of the erosion of disposable income. Whenever investors borrow to invest in stocks and bonds, a

tightening of monetary policy will result in fewer funds being available for equity and bond investments, Ceteris paribus, the prices for bonds and stocks will decline as demand decreases, resulting in reduced household wealth, less spending, and then filter through to output and domestic inflation. However, this channel is not very strong for the country as a greater percentage of stocks and bonds are held by institutional investors, and not by households. These three channels are therefore important in the transmission of monetary policy to real variables in Swaziland.

3. MONETARY POLICY FORMULATION

According to the Central Bank of Swaziland Order of 1974 (as amended), monetary policy decisions are taken by the Governor, in consultation with the Monetary Policy Consultative Committee (MPCC). Members of the MPCC are the Governor (Chairman), Deputy Governor, and five additional members (including the Assistant Governor), who shall have recognised experience in monetary and financial

matters. The MPCC meets at least once every two months to advise the Governor on an appropriate policy stance. The MPCC also considers inflation forecasts at its meetings, which are revised prior to every MPCC meeting. The members of the MPCC are bound by a Code of Conduct (Annex A). All matters relating to monetary policy in the country remain the responsibility of the Governor.

3.1 Monetary Policy Instruments

3.1.1 The Discount Rate

The main policy tool that the Bank uses to influence monetary conditions in the country is the discount rate, which moves almost in tandem with the South African Reserve Bank's (SARB) repo rate. The discount rate is the interest rate at which commercial banks borrow money from the Central Bank, in turn, affects other interest rates in the economy. Changes to the discount rate are influenced by the following factors; the SARB's repo rate, domestic inflation, credit extension, and other domestic variables, as well as international economic conditions.

3.1.2 The Reserve Requirement

The Central Bank acts as an umbrella bank for all the banks in the country, therefore all the banks are obliged by law to have accounts with the CBS. Such accounts are called cash reserve requirement (CRR) accounts. The banks are required to keep a certain percentage (currently at 6 per cent) of their deposit at the Central Bank. The CRR accounts help to facilitate the clearing and settlement of inter-bank transactions such as cheque clearing. It also facilitates transactions between the

Central Bank and commercial banks. It also helps to protect liquidity and safety of banks. The CRR therefore acts as a monetary policy instrument, i.e. increasing/decreasing the CRR affects banking liquidity and credit extension. Research by Dlamini and Skosana (2016) found that a change of the CRR has a significant effect on the trajectory of inflation outcomes. Raising the CRR induces a decline of inflation outcomes and vice versa. The Bank will now review the CRR at least once a year.

3.1.3 The Liquidity Requirement

Commercial banks only keep a certain portion of the deposits as cash available for immediate withdrawal, hence the CRR accounts. The rest is invested in liquid assets like bonds and treasury bills. The new ratio which now includes the CRR and liquid assets is called the liquidity requirement (LR). When the Central Bank changes this ratio (currently at 25 per cent) it automatically changes the availability of loanable funds, hence it is also an important monetary policy tool. Just like the CRR, this ratio was found by the research to have a significant influence in the movements of inflation. The LR would be reviewed at least once per year.

3.1.4 Open Market Operations

Open Market Operations (OMO) forms part of the arsenal of tools that the Bank uses to manage liquidity in the economy. Through OMO, the Bank buys and sells debt securities in the market to influence the liquidity conditions. The central bank also has a discretionary deposit facility that allows commercial banks to deposit short term funds (overnight to 1 month) with the Central Bank of Swaziland. Since interest rates offered on this facility can be varied, the deposit facility can be used as a policy instrument to influence liquidity conditions in the banking system and the extent of external capital flows.

3.2 Announcement of Monetary Policy Decisions

The day after an MPCC meeting, a formal announcement of the policy decision taken is made through a press release in local media outlets and the MPCC statement posted on the Central Bank's website. The statement covers comprehensive reasons for the decision taken as well as the effective date. It is expected that immediately after such an announcement, commercial banks will also adjust their prime lending rate, based on the outcome of the announcement. In future, a live press conference immediately after the MPCC would be held to pronounce the decision taken.

4. REVIEW OF THE MONERY POLICY FRAMEWORK

The Monetary Policy Framework (MPF) would be reviewed at least once every three (3) years.

5. CONCLUSION

To have a meaningful effect on inflation, the Central Bank of Swaziland will use all policy tools at its disposal. The policy tools include, but not limited to, discount rate, liquidity requirement, reserve requirement, open market operations and monetisation programme. But the implementation of monetary policy is more forward-looking and of a medium-term orientation. Such insures that timely action is taken to address any potential threats to price stability. The medium-term orientation reflects the existence of economic shocks, the consequences of which monetary policy cannot control without inducing excessively high volatility in real activity and interest rates.

Overall, the medium-term orientation of monetary policy is guided by the objective of price stability. It helps policy making concentrate on the relevant economic shocks, that is on shocks and economic developments that monetary policy can effectively address. The working definition of inflation being simply ‘too much

money chasing too few goods’. Whilst simplistic in nature, it helps cement the monetarist view in addressing variability in prices due to shocks, either demand or supply-side. A medium-term orientation also effectively guarantees that monetary policy itself does not become a source of economic fluctuations and helps the Central Bank avoid misguided reactions to short-term developments.

The overall objective of monetary policy is to ensure price and financial stability. That makes the intermediate goal being to maintain the peg between the Lilangeni and the South African Rand. Linked to this would be to ensure the level of reserves is greater than three (3) months of imports of goods and services, with the long-term target of six (6) months of import of goods and services. It is evident that membership to the CMA has worked in supporting macroeconomic stability as well as dampening the effects of shocks to the currency. As such maintaining membership to the CMA is a monetary policy goal.

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APPENDIX 1

TERMS OF REFERENCE OF THE CENTRAL BANK OF SWAZILAND MONETARY POLICY CONSULTATIVE COMMITTEE

1. Background Information

The Monetary Policy Consultative Committee (MPCC) was established under the Central Bank of Swaziland (CBS) Order of 1974 (as amended on the 31st October 2004), Section 43. It was operationalised through a Memorandum prepared by CBS in an attempt to interpret the applicable provisions of the CBS Order and National Constitution.

The MPCC considers matters relating to monetary policy pursued by the Central Bank of Swaziland and facilitates an exchange of views among its members. It acts as an advisory body to the Governor on the appropriate monetary policy stance. The Governor of the Central Bank of Swaziland is expressly declared the sole legal determiner and public announcer of the rates for discounts, rediscounts and advances (interest rates as a monetary policy instrument).

2. Composition of the MPCC

The MPCC shall consist of:

- a) the Governor, who shall be the Chairman or the Deputy Governor or the Assistant Governor;

- b) no more than five additional members appointed by the Minister of Finance with recognized experience in monetary and financial matters.

3. Secretariat

The General Manager, Economic Policy Research & Statistics, will lead the Secretariat of the MPCC.

4. Duties of the MPCC

The purpose of the MPCC is to consider and advise on matters relating to the monetary policy pursued by the Central Bank of Swaziland. This includes other matters included within the responsibilities of the Central Bank of Swaziland, which may have an impact on future monetary policy path. It acts as a platform for the exchange of views among the members on monetary policy issues.

5. Manner of decision-making

Decisions of the Committee shall be taken by consensus. Where such consensus does not exist, the final decision shall be taken by simple majority.

6. Decision on Monetary Policy

The final monetary policy decision [on the appropriate discount rate] shall be taken by the Governor.

7. Terms of office

The MPCC members, with the exception of the Governors, shall hold office for a period not exceeding three years, but are eligible for re-appointment.

Members shall at all times adhere to the MPCC Code of Good Conduct attached to these terms of reference. Members shall demonstrate their commitment to the Code by signing it upon appointment and at the first meeting of any calendar year.

8. Frequency of meetings

The MPCC shall meet at least six times a year to deliberate on monetary policy matters and propose, to the Governor and the Board of Directors, the appropriate stance of monetary

policy for the next subsequent two months.

The dates of the MPCC meetings shall be communicated to all members within the first two months of each calendar year.

The Chairman may call for extraordinary meetings of the MPCC as and when required.

9. Meeting quorum

Four members, including the Governor or the DG or the AG (as duly authorised), shall constitute a quorum. In case MPCC members are not forming a quorum, the Chairman reserves the right to take a decision whether to continue with the meeting.

10. Public Announcement of the Decision on the Discount Rate.

After each MPCC meeting, CBS shall publish, through a Press Statement, its discount rate decision within reasonable time.

MONETARY POLICY CONSULTATIVE COMMITTEE CODE OF GOOD CONDUCT

1. Fundamental Principles and Core Values

Monetary Policy Consultative Committee (MPCC) members shall act with loyalty to the CBS; be honest, objective and impartial as well as subscribe to the highest standards of professional ethics, diligence, good faith and integrity. These include avoiding any action or inaction, which could in any way impair the CBS's capacity to carry out its duties or compromise its standing in the community and its reputation for integrity, fairness, honesty and independence.

2. Declaration of interests

- (a) To assist in the fulfilment of obligations in relation to conflicts of interests, MPCC members shall, upon appointment, make a full written disclosure of the nature of their direct or indirect interests which may give rise to conflict of interest.
- (b) The matters to be covered by the member's statement shall include, but not be limited to, the disclosure of:

- i. any financial or business interest of the member and that of his or her immediate family members; and/or
 - ii. investments in companies, partnerships or joint ventures.
- (c) An update of such a statement on an annual basis shall be provided to the Chairman of the MPCC.

3. Conflict of interest

In the performance of their duties, MPCC members shall avoid any situation that may give rise to a conflict of interest. No discrepancies may exist between a member's official responsibilities and any kind of personal or external interests which could jeopardise his or her impartiality and integrity in performing his or her responsibilities. Acceptance of gifts and favours that have the appearance of influencing their performance should be avoided.

4. Confidentiality

Members are required to maintain strict confidentiality of the information discussed at MPCC meetings and not to divulge

any confidential information obtained in the performance of their duties; provided that such confidentiality shall be lifted one year after they have ceased to be members of the MPCC. Members shall also avoid any situation where they might be perceived as having acted with the benefit of knowledge not available to the general market, for their own interests.

5. Compliance

- a) Deviation from the standards of this Code shall be dealt with as misconduct on the part of the member concerned and such a member will be disciplined in accordance with the rules and procedures of the CBS.
- b) Compliance with this Code will be monitored by the Chairman of the MPCC. If MPCC members (or members of the public) become aware or suspect that a member of the MPCC has, or may have, contravened this Code, this information should be reported immediately to the Chairman, preferably in writing and in a confidential manner. The Chairman shall initiate a mechanism to investigate the alleged breach

at his own violation or upon request.

- c) For the duration of any investigation into any allegation of a contravention of this Code, the Chairman reserves the right to suspend the member concerned from carrying out duties for the MPCC and CBS.
- d) Any investigation into a suspected or possible contravention of this Code shall be kept confidential.

6. Immunity from personal liability

The MPCC members shall not be personally liable for any civil or criminal proceedings, arrest, imprisonment or damages for anything done in the discharge of their duties unless it is established that it was done in bad faith.

7. Independence

- a) MPCC members shall be independent from any political influence in the performance of their duties.
- b) The MPCC members shall not act as delegates or representatives of any interest groups or industry in the discharge of their duties.

NOTES

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