

Monetary Policy Instruments

The Bank mainly uses four monetary policy instruments, namely; the discount rate, reserve requirement, liquidity requirement and open market operations.

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.

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, and further ensures 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. 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.

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.