



A Global Forum

# Lesetja Kganyago

in conversation with  
Ann Bernstein



In November 2020, CDE initiated a series of events to celebrate 25 years since its launch in August 1995. The series focuses on global conversations on democracy, business, markets, and development. This is the twelfth conversation in the CDE@25 series.

**Laurie Dippenaar**, founder of FirstRand, opened the event. "Tonight we are hosting the 12th event in our series celebrating what is now more than 25 years since CDE's launch in 1995. I have personally attended nine of these events and I am sure that many of you here tonight will have done the same. The speakers are of exceptional quality, and the topics are highly relevant in today's turbulent and challenging times. I recently resigned as Chairman of the organisation after 14 years. The fact that I stayed on for so long is testimony to the respect I have for CDE and the work it is doing. I am now an observer rather than an insider, but I still find their contribution to finding solutions to South Africa's challenges, absolutely vital.

"The SARB is one of South African's most important institutions. Now that I am no longer a banker, I must compliment the Reserve Bank and its governor for the vital, world class role they play in our economy. That is why I am looking forward to tonight's conversation."

**Ann Bernstein:** It's my privilege to welcome the Governor of South Africa's Reserve Bank to CDE. Governor Lesetja Kganyago is currently serving a second term since his appointment in 2014. He was deputy governor between 2011 and 2014 and director-general of the National Treasury prior to that. Until recently, he chaired the International Monetary and Financial Committee, the primary advisory board to the International Monetary Fund's board of governors.

In 2019 I was nearly run over by the Governor's car - he had been invited to give a prestigious lecture at the Peterson Institute in Washington DC and I happened to be there at the time and wanted to hear him speak and to support one of democratic South Africa's most impressive civil servants at what is the world's leading economic think tank.

My previous memorable experience with the Governor was at the WEF Africa event in Cape Town in 2013, CDE had recently issued a report on the Brazilian state bank, the BNDES and many in government and the ANC were calling loudly for such a bank for South Africa. The WEF always has a big cocktail party to start its activities and across a crowded hall, I heard a loud voice calling me. At the time the Governor was the DG of Treasury, and I am not used to being enthusiastically greeted by top people in government. He wanted to let me know - without any concern who else heard the good news - that our document on the BNDES - which did not help the poor, but subsidized large corporations - had influenced an important meeting in Pretoria and resulted in a firm decision - for then - to not start a BNDES style state bank in South Africa.

For this and many other reasons I have been one of his great fans ever since!

Governor, it is a great privilege to have you here. Welcome.

**Lesetja Kganyago:** It is good to be at CDE. I have followed the interventions you have made in our public discourse over the years with great interest.

**Ann Bernstein:** How does a young boy growing up in the rural areas get to be governor of the Reserve Bank? What were the key influences in your life, who were the mentors who helped you get to this important position?

**Lesetja Kganyago:** Growing up, I never had any notion of becoming an economist, never mind the governor of the Reserve Bank. I studied science at high school, and that is what I thought I was going to do. When it was time to go to university, I heard that most companies were looking for people who can do accounting. So, I registered for a B.Com degree, which is when I encountered economics, and I decided that I love it and would like to pursue it. I then committed myself to majoring in both accounting and economics. That was in 1987/88.

When the ANC released their constitutional guidelines for a democracy in South Africa, and change was in the air, the most articulate and relevant students seemed to be in law and the humanities. I was tempted to move to one of those faculties but a friend of mine said, "No, you are not going there, you are sticking where you are. You have to understand, one day we are going to run this country and we are going to need people with skills in this field." So, I dedicated myself to understanding economies and what makes them thrive and fail.

My first job was in banking. It is interesting that Laurie Dippenaar was the opening speaker tonight, because my first job was with Barclays Bank, a few months before it became First Rand. I was working as a banking clerk when one day I got a call to assist COSATU with its accounting system and then I got called by the ANC.

I was told that I should be one of the people to shape economic policy in South Africa, which is how I got deeper into economics, but even then, I did not think that I would end up being a governor of the Reserve Bank.

When I eventually joined the Reserve Bank in 1994, I worked as an investment manager and later as a foreign exchange trader, and then I moved to the National Treasury. At the time, I thought I would be there for two or three years and then go back to the Reserve Bank, but I stayed for 15 and a half years. So, when I got the call asking me to become the deputy governor of the Reserve Bank, I was taken aback, because that is not where I saw myself going. I even thought that I might try my luck in the private sector.

To cut a long story short, the journey that one walks shows that even someone growing up in a rural area can succeed. All the people who left my village had one thing in common: they took advantage of the opportunities offered by education. If we are to invest in the future of this country, we have to invest in the education of our young people.

**Ann Bernstein:** I couldn't agree more. To return to the SARB and jobs and growth, the central mandate of the SARB is to manage inflation. You have often said that there is a deep-seated misunderstanding in South Africa that there is some trade-off between growth and inflation. You've also said that, like other inflation-targeting central banks, the framework that you operate under already includes concerns about growth and employment. What do you mean by that?

**Lesetja Kganyago:** The authors of our Constitution were students of history, so they had foresight. The clause in the Constitution that talks about the central bank's mandate is very carefully crafted. It says the primary objective of the Reserve Bank is "to protect the value of the currency in the interest of balanced and sustainable growth". They understood that there was a trade-off between balanced and sustainable growth on the one hand and inflation, on the other.

Protecting the value of the currency is in the interest of balanced and sustainable growth, and it is very important, because it tells us that price stability is a necessary but not sufficient, condition for long-term growth.

It is a false dichotomy to say that you can either have growth or inflation. Countries that have been booming for years have had low inflation. From China to the advanced economies, those countries grew in an environment where inflation was under control. Of course, there might be a trade-off between cyclical growth and inflation in the short-term. That is where monetary policy comes in: managing those cycles. That is why in monetary policy we talk of a policy horizon of 12 to 18 months. That is where monetary policy tries to smooth out cyclical growth, but that will not affect the potential long-run growth rate of the economy.

That is why the authors of our Constitution said price stability is in the interest of balanced and sustainable growth. They understood that, over the long run, you cannot have inflation and growth.

**Ann Bernstein:** So, why should the poor care about inflation? I believe after your appointment as governor you went on a shopping spree back in your village. What was your purpose in doing that?

**Lesetja Kganyago:** I would not call it a shopping spree. I only had R380 to spend, made up of one of each of South Africa's banknotes. When I went back to my home village, I went back to my father's house, parked the car, and walked to the shop where I used to buy things every morning. I spent the R380 in that same shop. I bought a pack of mealie meal, a bottle of cooking oil, and bread.

The message to the rural people in the village was that, as a youngster walking to this shop, I used to buy a loaf of bread for 10 cents. Today, a loaf of bread costs about R10. What I was basically saying was that my job in

protecting the value of the currency is to make sure that the basic foodstuffs and other necessities that they rely on do not run beyond what the poor can afford.

The poor are more affected by inflation than anyone else. High inflation will only push the poor deeper into poverty. Some of us are privileged enough to have assets, whether they are in the form of property or they are financial assets. We can protect ourselves against inflation. When inflation rises, so do property prices. If you have financial assets, you can pick up stocks that are affordable or you could go and buy yourself government inflation-linked bonds. By so doing, you will be protected against inflation.

If you are a pensioner on a fixed income or a recipient of a social grant, in which case you can only ever expect to receive what government tells you it can afford, then when inflation occurs, your buying power diminishes. If you are employed, you can at least negotiate with your employer for a salary increase. If inflation during the year was higher than what you thought it would be, you can go back to your employer and negotiate for a second salary increase so that you do not have to wait for the next year's salary adjustments.

A central bank that maintains price stability and thus pursues a low inflation policy is acting in the best interest of the poor. It is protecting the purchasing power of the currency, which is in the broader public interest. All of us end up benefiting, because you have an institution that you can count on to keep inflation in check and protect you from unpredictable price rises.

**Ann Bernstein:** I believe that you said that you would go to war to defend the independence of the central bank. Why does it matter so much? What is the role of independent institutions like the SARB in a democracy?

**Lesetja Kganyago:** In a democracy, institutions matter, but quality institutions matter even more. Institutions in our democracy have been significantly weakened. Some of them were totally gutted. That does not serve democracy.

The Reserve Bank was not spared the attacks. When we came under attack, we decided to take a stance. Our position was that the SARB is a creature of the Constitution. As governors of this institution, we were put in positions of authority and trust. South Africans expect nothing less from us. They expect us, not just to protect the institution, but to execute the mandate that they gave this institution.

There is a reason why central banks should be independent. The problem comes when there are publicly elected officials who have promised to control inflation, but when the time comes to take that difficult decision, they postpone it, because there might be an election coming, and politicians will be reluctant to inflict the short-term pain of higher interest rates for the longer term benefits of lower inflation and higher growth. When the public realises that it ended up with higher inflation than it was promised, it then expects that there will be higher inflation in future, which makes it much harder to control inflation.

To deal with this problem, you assign the responsibility of tempering inflation to an institution that is independent of the political cycle, which is given the responsibility to ensure that price stability is actually delivered.

But that is not enough. You have to deal with another problem, too: the principal-agent problem. In this case, you may have an independent institution, but it does not follow that it will always act in the public interest. So, you need a contract with society. The society is the principal here and the central bank is the agent. In South Africa, the contract between the principal and the agent is spelt out in the Constitution, which tells the agent that its job is to deliver price stability.

The implication of that is that the Reserve Bank, the agent, must be accountable to society, the principal, on what it has been tasked with doing. Central banks all over the world account to their Parliaments. In South Africa, we have taken this a step further, speaking directly to the public through our monetary policy forums. We go there to account. Every time we make a policy decision, we will communicate publicly and respond to questions about why we took particular decisions.

In short, you need independent institutions with a clear mandate, which have a contract with society to deliver against that mandate and are accountable to the country at large.

**Ann Bernstein:** Is there one example of how state capture affected you that you could share with us? Is state capture over now?

**Lesetja Kganyago:** I would not know if state capture is over, but I do know that if it comes your way, you will know it. When it came to the SARB, the way we looked at it was as follows: Why steal petty cash, why even go to the tills or safes in the National Treasury, if you can take hold of the Reserve Bank's printing press? That would facilitate much more theft.

The way in which state capture came to the Reserve Bank was very sophisticated. First, it came in the form of a motion to remove the power to license banks from the central bank, and that this power should be afforded to the Minister of Finance. We were not consulted on this.

The office for banks used to be in the Department of Finance. It was precisely because it was not working in that space that it was moved to the Reserve Bank. So, the way state capture targeted the Reserve Bank was by removing some of these powers. If you do not have the power to license banks, then you cannot have a financial stability mandate, which is the other part of our mandate.

When we saw state capture coming our way, we shut the gate and said you are not getting in here, because this institution is tasked with the responsibility of executing a constitutional mandate.

When there was a report, which was subsequently set aside by the court, that said that we must change the mandate of the Reserve Bank, we saw it as part of a systematic attack. When we decided to file those papers in court, we felt duty-bound to protect the institutions of our democracy. We felt that the SARB had to be protected in this manner.

**Ann Bernstein:** Let me move to South Africa's banks that you regulate. How did they deal with state capture? Some people argue that when they did close the Gupta accounts, they had acted late in the day and they should have done this much earlier. Is that fair?

**Lesetja Kganyago:** There were some at the time who said they acted too hastily. The banks have got to attract clients so they may be reluctant to act against them. Also, at the time, government was mostly opposed to the actions the banks were taking. The legislation against money laundering in South Africa emanates from international standards set by the Financial Action Task Force, which were translated into our domestic law, and one expects banks to abide by the laws of the land. It was a weird situation where the government was complaining about the banks implementing the government's own laws!

**Ann Bernstein:** Do you think we have enough competition in the banking sector? What role might a state bank play that is not being played by commercial banks already?

**Lesetja Kganyago:** The classic way in which we think about competition is that there must be a large number of buyers and a large number of sellers, such that not one of them can influence the price on their own. But that is not the only way to ensure competition, and in some circumstances it can be counterproductive.

The South African banking system is very competitive. Part of it has to do with the fact that we have an activist Competition Commission. Our banking sector is very concentrated, but there is a history to this concentration. Every time there is a banking crisis, there is a consolidation of institutions. There are maybe one or two South African banks that have been there since the beginning. Many of them have taken over weaker banks. In one case, it was an amalgamation of several banks that came together. The end result is that we have ended up with high levels of concentration.

If you have to have competition in the provision of financial services, you're going to have to have new entrants. But those new entrants will find it difficult to take on the established banks because of this concentration. As such, the competition in financial services comes from two interesting forces.

The first one is from the fintech space, where players are using technology to provide niche financial services, whether in payments or credit, and in that way, they take on the big players. But the big competition for the banks will come from Big Tech companies: Amazon, Apple, Google, etc.

You asked what the role of a state bank would be. I do not know, but I can tell you the state currently owns a retail bank called the Post Bank, an infrastructure bank called the Development Bank of Southern Africa, an

industrial bank called the Industrial Development Corporation, an asset manager, the largest one in Africa, called the Public Investment Corporation, and the state is underwriter to the largest pension fund in Africa, called the Government Employee Pension Fund. There are other public sector pension funds, too.

More than 80% of people in South Africa have access to financial services. So, if a state bank comes in, I suppose it might end up bringing in the remaining 20%. It is not clear what ill the state bank is trying to cure. As a regulator, we say that the state must apply for a banking licence like everybody else. A bank needs to have adequate capital and liquidity, but if it meets the criteria, we will license it.

I can tell you, and you can ask American or European banks that came into the South African financial services industry, South African banks know how to compete.

I would like to see the state play in that space and compete with not only South Africa banks, but also big international banks that are now becoming active here.

**Ann Bernstein:** People with views like yours are often called fiscal conservatives who favour austerity. There are people in South Africa who say that austerity and fiscal consolidation is unnecessary, and that South Africa can afford much more public spending. What would be the consequences of abandoning fiscal consolidation and turning on the spending taps?

**Lesetja Kganyago:** Fortunately, that is Minister Enoch Godongwana's problem. As the Minister of Finance, he will have to engage those arguments. I do not know of a country that has an austerity budget, and yet is looking at a deficit of 14 per cent of GDP. But let me tell you where the Central Bank comes in on this subject.

Our monetary policy stance is not austere; it has been accommodative since we were first hit by this Covid-19 shock. We have provided accommodation within the context of our mandate. We have been able to support households and firms. The fiscal situation makes this more and more difficult.

First, when the deficit was projected to be 14 per cent of GDP, the government was borrowing the entire pool of the nation's saving. That meant there was nothing left to finance investment. Luckily, South Africa is an open economy, so we continue to attract foreign savings, so there were capital flows coming in via the bond markets. But when you have to attract foreign savings, they are priced according to the risk of investing in the country. That is reflected in the risk premium, which is what South Africa pays above what advanced economies are paying. Our risk premium shot through the roof last year. It has since come back down close to equilibrium, but it is still high. When there is no fiscal consolidation, the general cost of borrowing in this economy rises, and as a result, firms struggle to get investment going, because the rates are simply too high.

The National Treasury understands this well. I will leave them a to build a case for fiscal consolidation. There is no doubt that, in the aftermath of what we have seen, we have to rebuild our defences. In 2008/09, there was a global financial crisis. South Africa entered it with ample fiscal space and we used that space to respond to the crisis, but we never rebuilt our defences. So, when we were hit by the coronavirus shock, we had zero fiscal space. The burden of providing a response ended up falling on the central bank's shoulders.

**Ann Bernstein:** Picking up on the pandemic, what is your view on how South African banks dealt with the pandemic? One question I have heard is how banks can make such large profits during the pandemic when many firms went out of business. On the other hand, the banks said that they lent a lot of money to their clients because they needed it.

**Lesetja Kganyago:** South African corporates are sitting on a lot of cash. They went into a cash preservation mode as the coronavirus crisis hit. Cash balances went up in the aftermath of the shock. At the moment, the bulk of that cash is with the mining companies. What does that tell us?

If there is no investment taking place and corporates are sitting on cash, you only have to look at the business confidence indicators to see that you have a problem. The North-West University's Policy Uncertainty Index has been above 50 for some time now which indicates a high level of uncertainty.

Besides this, there is the uncertainty with respect to the Covid shock. We do not know if this thing is behind us – if anything, it looks like we must learn how to live with it.

That means that risk models must be reviewed so that you adjust your returns based on the risks associated with this virus being part of our lives.

How did the banks respond to this shock? When Covid-19 hit our shores, our banks had ample liquidity and capital buffers. The Reserve Bank allowed the banks to dip into their buffers to allow them to support households and firms.

We also provided guidance that said, in effect, if the client had been of good standing, a bank could make special allowances and help them through the crisis. The total amount of support that the banks offered in this manner during 2020 was R800 billion. I know that there has been a lot of focus on the loan guarantee scheme. Comparing this to what the banks were offering to their clients is like comparing chalk and cheese.

The Central Bank also imposed a quid pro quo. We told the banks we will provide you with this capital relief, but you shall not declare dividends and you shall not pay bonuses. A lot of South Africans in the low-to-middle-income category moved from rental housing and started purchasing their own houses. That shows that the kind of relief that was provided made its way into the real economy.

**Ann Bernstein:** I want to move to an issue you have been talking about for quite a while. You have said that if South Africa wants growth, we have to talk about trade-offs. Can you expand and explain your concerns and why you are making these strong statements about reform?

**Lesetja Kganyago:** Economics is about trade-offs. When you are governing, you have the right to choose which trade-offs to make. To govern is to choose. When there are trade-offs, there will be losers and winners in the short term, but in the long term, society is the beneficiary. When we think of these trade-offs, we must think of them not only in the present, but intertemporally.

When we make choices as a society, we cannot allow the excesses and the desires of this generation to be at the expense of generations that come after us. What has been happening is that the generation of today has made choices that seemed to benefit us but have left the next generation with a massive debt burden. We call that intergenerational inequity.

But there are also trade-offs in the present, such as those between consumers and producers, producers and workers, etc. You have to strike a balance. If you are a monetary authority, the trade-offs are about dealing with cyclical growth and inflation in the short term and making sure that your decisions do not have an impact on the long-term price stability mandate. If you are a fiscal authority, the decisions you make might end up being between consumption and infrastructure. If you borrow to finance infrastructure, the generation that comes after might accept the greater debt burden because of what we have left for them. If you borrow to finance consumption, however, you have consumed goods and services and later generations have nothing as a result. There is no such thing as a free lunch. There are only difficult decisions to be made. What policymakers tend to do is to give an impression that society can have everything it needs and wants, when we know that the resources to meet the needs and wants of society are limited.

As it stands, the number of taxpayers in South Africa has shrunk. The number of people who earn above a threshold of R750,000 has shrunk. To finance society's needs and wants, we would be taking a finite amount in taxes out of the economy, but we can also only borrow so much. Those trade-offs must be confronted by government, by people who are elected. To govern is to choose.

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