Economic Review July 2013

Contents:

1. The Southern African Development Community Integrated Regional Settlement System (SIRESS): What? How? and Why?

SADC has implemented SIRESS on 22nd July 2013…

1.1 Background

The Southern African Development Community (SADC) Integrated Regional Electronic Settlement System (SIRESS) is an electronic payment system developed by SADC Member States to settle regional transactions among banks within the SADC countries on a gross basis and in real time. It is meant to replace the paper-based instruments such as bank drafts and cheques and facilitate electronic transfers within SADC Member States. Paper based payment instruments are experiencing low usage, are inefficient, prone to high inherent risk in their use as opposed to the available cost-effective electronic alternatives for cross border payments and money transfers.

The SADC payments modernization project was initiated by the Committee of Central Bank Governors (CCBG) in the SADC region to achieve the objectives of the SADC Finance and Investment Protocol (FIP) which states that, *inter alia*, SADC countries should cooperate on payment, clearing and settlement systems in order to facilitate trade integration. Ultimately the FIP envisages the creation of a SADC Central bank and a common single currency. In addition to the CCBG which focuses activities from a regulatory perspective, SADC Bankers Association (BA) was established to coordinate activities of commercial banks in the SADC region in developing the financial market infrastructures and regional clearing house operators to support the utilisation of SIRESS.

A sound and robust domestic payment system is a necessary condition for an efficient and secure harmonized cross border clearing and settlement system. Therefore, SADC Member countries embarked on modernization of their national payment systems in preparation of SIRESS implementation. The rationale for the modernization of domestic systems, from the supply side, was to reduce settlement risks, enhance public confidence, promote efficiency and enable introduction of new payment instruments. For the users, the national payment systems modernization process was meant to enhance access to cost-effective instruments and minimise risks associated with counterfeiting of bank notes and fraud. The domestic payment system reform projects incorporated implementation of systems such as Real Time Gross Settlement (RTGS)[1] to ensure irreversibility, irrevocability[2] and finality of transactions settled in Central Bank money. In addition, the modernisation process has resulted in the introduction of automated clearing platform for retail payments system for small-value high-volume payments, and the exchange media and establishing effective payments system oversight structures to ensure acceptable arrangements to mitigate and manage risks while stimulating active use of these platforms.

In line with these developments, the Central Bank of Lesotho (CBL) embarked on the modernisation of the Lesotho National Payment System (NPS).[3] Against the background that an integrated cross border payment system also requires a holistic, harmonized and sound regulatory framework and a joint oversight arrangement between the participating central banks, the CCBG through SADC Secretariat embarked on examination of laws with the aim of harmonisation of the legal framework in the SADC member countries.

In achieving the vision of SADC's founding protocol of creating a common market, with a SADC central bank and a single currency; the CCBG decided to implement the 'proof of concept' in two phases. The first phase is the implementation of SIRESS within the Common Monetary Area (CMA) member states (Lesotho, Namibia, South Africa and Swaziland) where the South African Rand is used freely and trades one-to-one with the local currencies. The first phase went live on 22nd July, 2013. The second phase will open participation to the system to some of non - CMA SADC countries in October 2013. The inclusion of some of non- CMA SADC participants is meant to check the implications on foreign exchange and regulatory issues within their central banks.

Under the proof of concept, SIRESS is hosted and operated by the South African Reserve Bank (SARB) and all participants including all central banks have accounts in SIRESS as ordinary members. Thus, in SIRESS SARB is the operator of the system

[1] To facilitate large value and critical time transactions and to minimize risks in the market by ensuring finality of the payments
[2] Inability to be recalled repealed or annulled.

[3] See March 2013 Economic Review for detailed treatment

while also a participant. The participants in SIRESS must source the Rands as a trading currency from any of the SAMOS (South African Multiple Option Settlement) participants.

1.2. How does SIRESS Operate?

In order to transact through SIRESS, the entire banking system within each SADC Member State needs to have at least two settlement accounts within SIRESS. These settlement accounts are the *Continuous Processing Line (CPL*) and the *Real Time Line (RTL).* The difference between these two accounts is that on the one hand, in the CPL, transactions received in SIRESS go into processing queue that checks to see if there are sufficient funds available and if that is so, then the payment is processed. If there are no sufficient funds in the account, the paying bank could alternatively secure a temporary loan in the inter-bank money markets against suitable collateral to ensure the payment of its obligations. Alternatively, the participant may utilise the lending facilities available from its domestic Central Bank. The payments remain unprocessed until inward funds are received or the bank concerned managed to fund the account. However, at the end of settlement window, unprocessed transactions are discarded and the concerned bank is notified accordingly. The bank then has to resubmit the transaction the next business day. On the other hand, in the RTL, transactions must be prefunded. This implies that the transfers received at SIRESS without prefunding or sufficient funding in the account are rejected immediately and the bank concerned has to fund the account and re-submit the transaction.

The advantage of CPL over the RTL is that the former allows accounts to be funded from time-to-time during the day either from the Real Time Line (RTL) – the main settlement account – or from inter-bank loans. In this method the paying bank can also determine the amount it wishes to transfer and when it wants to make the funding switches. It also enables the bank to monitor the CPL account throughout the day and switch funds back into the RTL as and when it so wishes. Therefore, this method is used by banks when dealing with payments that do not require immediate settlement but rather settlement within the same day. In this case the paying banks request their corresponding banks to quote the Liquidity Optimization Modules (LOM) account number so that inflowing funds can be used to offset outgoing payments.

How do banks in Lesotho make electronic transfers to participants in SIRESS? In essence the banking system in the SADC region (including CMA) are connected to their settlement accounts (CPL and RTL) in SIRESS through the Society for Worldwide Interbank Financial Telecommunication (SWIFT) network, which supplies secure messaging services and interface software, to contribute to greater automation of financial transaction processes to banks, amongst others. Therefore, in order to make electronic transfers to the banking system in South Africa, Namibia or Swaziland via SIRESS a bank in Lesotho sends the SWIFT message to SIRESS to debit the paying banks' settlement accounts (either the CPL or RTL depending on the nature and urgency of the transaction the paying banks wish to make) and credit the receiving banks' settlement accounts in SIRESS. Once the inter-bank obligation has been settled the necessary electronic advices of debit and credit as well as bank statements are generated from the SIRESS and send to both the paying banks and receiving banks for verification. These advices can be used by the banks to reconcile their accounts internally.

In the context of CMA, if the paying banks do not have Rands to make transactions, the central banks in the paying banks countries would negotiate with the SARB to transfer Rands to their settlement accounts in SIRESS. Another option could be to negotiate with the commercial banks who are SAMOS participants to provide them with Rands. However, in this case the central banks have to ensure that such foreign exchange deals do not put SIRESS in jeopardy. If the transfer has been received in a currency other than the currency used in SIRESS and requires the funds to be converted into the appropriate currency the banks will conclude such a foreign exchange transaction[4]. In the case where a central bank makes a transfer to another central bank in the country of the beneficiary and requires that central bank to make the payment to the local beneficiary, the receiving central bank may send the payment into the local clearing system depending on the applicable transaction limit.

1.3 Why did SADC countries implement SIRESS?

An efficient regional settlement system directly promote cross-border trade and support regional integration by increasing speed and convenience, reducing cost, lowering payment risks and ensuring a high degree of finality of the payments. Therefore, this efficiency directly improves the circulation of goods and services and the pace of economic expansion in the region. Modernised settlements systems would improve regional trade, enhance competition, and efficiency and productivity in the region. In addition, it would help to integrate the SADC countries' financial systems and capital markets, both regionally and globally.

The regional settlement system can be used to process, clear and settle national transactions, provided it supports the national currency and oversight rules are put at the disposal of the central bank. The subsequent establishment of SADC or African single currency payments system will eliminate exchange risk and enhance the continent's intra-regional trade and investments.

Besides directly facilitating trade and regional integration, the successful implementation of SIRESS has other

[4] In the context of CMA transaction will always be concluded in Rand and therefore would not require any foreign exchange arrangements to be made. However, as the SIRESS project moves to the second phase, banks will need to make foreign exchange arrangements that suites their payment preferences.

benefits[5] that could also assist indirectly to promote intra-regional trade, and these include:

- ✓ *Facilitating sound monetary policy and liquidity management*

SIRESS as an efficient payment system ensures that settlements are done through the banking system and this improves the monetary base. This enhances the effectiveness of the monetary policy since if the monetary base is large then it implies that the central bank can easily project the liquidity conditions within the region. Hence this facilitates execution of monetary policy and management of financial conditions. From a macroeconomic perspective, an automated large-value interbank payments system facilitates establishing short-term money markets that reflect national or region wide monetary conditions at a particular time. Such markets provide more accurate information about the current state of those monetary conditions, including those relating to trade credits.

- ✓ *Enhancing monetary and financial sector integration*

SIRESS created platform for expansion of the use of formal settlement methods and this assists SADC countries to pursue open economic and trade policies, since domestic and international payments would flow more easily. This would improve movement of capital and investment and lead to more pronounced gains of intra-regional trade and economic integration. In addition, efficient payments system would link the regional centres of commerce and finance and facilitate same-day settlements.

- ✓ *Expediting customs processing and government transactions*

The implementation of SIRESS will also assist SADC member countries to expedite trade by improving the timeliness and transparency of customs processes and governments' revenue collection.

This featured article benefited from:

- ✓ Brad Gillis and Rishi Pillay.(2012). *A Review of Payments Interoperability in the Southern African Development Community Region*. Journal of Payments Strategy and Systems. 6(2).
- ✓ SADC Banking Association (2013). SADC Payment System Business Processes and Related Documents Manual. The Beige Book.
- ✓ Economic Commission for Africa (2010). Assessing Regional Integration in Africa. Payment Systems and Intra- African Trade.

[5] It should be acknowledged, however, that in the context of SADC the indirect benefits may be fully realized when Member States have reached macroeconomic convergence and achieved full integration.

2. Featured Definition: *Commodities*

In the broadest sense, the word commodity refers to any traded good. A narrower definition of commodities, as used in daily economic and financial media reports, is confined to natural resources or raw materials. They are classified into minerals (gold, platinum, uranium, zinc etc), energy (coal, crude oil, and natural gas), and agricultural products (maize, rubber, fibres, etc). Commodities are typically uniform in quality and lack product differentiation. It is for this reason that there is a global price or benchmark for most of them. Different commodities are produced by different countries depending on their natural resource endowments and they are normally purchased by firms (both in developed and developing countries) as intermediate goods or inputs in the production of final goods. From the food people eat (maize, wheat, etc) clothes (fibres such as cotton) they wear to the cars (metals) they drive and fuel that power their homes and industries (oil, coal, etc) are all made, at least in part, from the world's natural resources.

3. Featured Economic Event:
The Approval of the Framework for SADC Macroeconomic Convergence Surveillance Mechanism (MCSM)

Article 4 of the SADC Finance and Investment Protocol (FIP) states that SADC Member States shall work together to converge on stability-oriented economic policies. Pursuant to some provisions of the FIP, the Ministers responsible for Finance and Investment approved the establishment of Peer Review Panel (PRP)[6] to drive and monitor this process.

The mandate of the PRP is to ensure that the economic policies and practices of SADC Member States conform to the agreed macroeconomic convergence targets set out by the Member States. This procedure is referred to as the *SADC MCSM.* The main aim of SADC MCSM is to foster the adoption of economic policies and economic management standards and practices that will facilitate regional economic and financial integration. This is with the overarching aim of economic growth, sustainable development and poverty alleviation, and thereby improve the standard and quality of lives of the citizens of the Member States. To this end, the SADC Member States met in Maputo, Mozambique on the 15th to 18th May 2013 and, among other things, considered and approved the framework for the SADC MCSM. This framework is meant to facilitate the implementation of the Peer Review based joint surveillance mechanism using SADC existing structures as well as to

[6] The panel consisting of the committee of Ministers responsible for Finance and Investment; and Central Bank Governors from each of the State Parties

monitor the implementation of the SADC Macroeconomic Convergence Programme. In the spirit of peer-to-peer review process, Lesotho and Malawi volunteered to be pilot countries to be peer reviewed.

At the same meeting, Angola and Namibia volunteered to be lead examiner/reviewer members of the review teams. This peer-to-peer review process is expected to commence sometime next year - 2014. Nevertheless, before this process could take place Member States would need to review the macroeconomic convergence targets to make them attainable by Member States given their economic situation in the region

.

Table 1: Primary and Secondary Convergence Indicators and Targets

Primary Convergence Indicators and Targets	**2008**	**2012**	**2018**
Inflation	$< 10\%$	$< 5\%$	$< 3\%$
Fiscal deficit	$< 5\%$	$< 3\%$	$< 3\%$
Public debt	$< 60\%$	$< 60\%$	$< 60\%$
Secondary Convergence Indicators and Targets	**2008**	**2012**	**2018**
Current account balance	$< 9\%$	$< 9\%$	$< 3\%$
Economic growth	7%	7%	7%
External reserves	3%	6%	6%
Central Bank credit to government	10%	5%	5%
Domestic savings(% of GDP)	25%	30%	35%
Domestic investment(% of GDP)	30%	30%	30%

Source: Report of the Peer Review Panel (PRP) (2013)

This featured event benefited from:

- ✓ SADC (2012). Framework for Surveillance of Macroeconomic Convergence. Macroeconomic Convergence Surveillance Mechanism.
- ✓ Makhetha, M. and Fuma, M. (2013). Mission Report of the 2nd Meeting of Peer Review Panel in SADC - held in Maputo, Mozambique. Staff Reports. Central Bank of Lesotho.

4. Featured Descriptor: *Seasonal Adjustment*

Seasonal adjustment is the process of identifying and eliminating periodic fluctuations or swings in statistics (data) caused by systematic, persistent, predictable and identifiable events such as natural factors, administration conditions, social and cultural factors which occur during a year/month/quarter/week/day or movements in supply and demand related to changing seasons.

This procedure is performed based on the assumption that a time series can be decomposed into three invisible components, namely; the trend cycle, seasonal and irregular components. It is done to observe the cyclical, underlying trend and other non-seasonal movements in the series in order to understand the development of the economy or an indicator over time which would otherwise be overshadowed by seasonal components.

Therefore, *seasonally adjusted* (s.a.) data represents data that has been modified to account for seasonal fluctuations. Many economic phenomena such as agricultural production and household consumption, the size of the labor force, the levels of employment and unemployment, and other measures of labor market activity undergo fluctuations due to seasonal events including changes in weather, harvests, major holidays, and school schedules. Since these seasonal events follow a more or less regular pattern each year, their influence on statistical trends can be eliminated by seasonally adjusting the statistics from month (quarter) to month (quarter) to allow the users of such statistics to base their analysis on trend and business cycle movements only. A seasonal adjustment is therefore made to obtain a clear picture of the general trend.

This featured descriptor benefited from:

- ✓ Mihkel Tšht (2011). Quality of Seasonally Adjusted Time Series. *Quarterly Bulletin of Statistical Estonia*.