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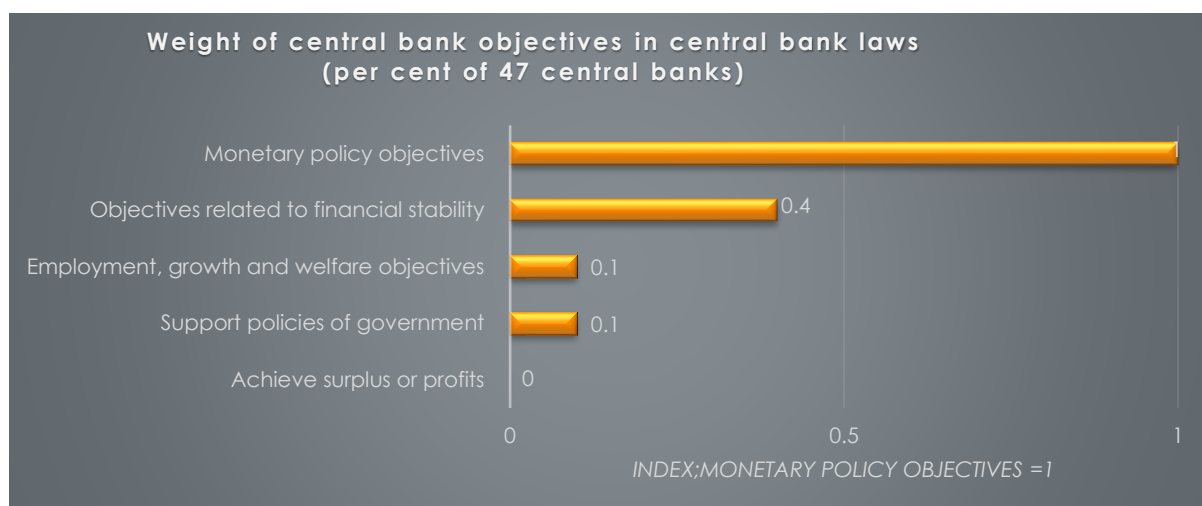
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Central banks are equal, but some are more equal than others

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Central banks have an impact on not only the goods we consume, but asset prices in general. Most central banks' goals are to stabilize the nation's currency, keep unemployment low and prevent inflation.

Figure 1: Objectives of central banks around the world



Source: BIS analysis of central bank laws

Figure 1 shows the objectives of central banks around the world. All central banks have monetary policy objectives, which deals with the supply and the circulation of money. Another objective that is important is that of financial stability. Within South Africa, to date, the primary objective has been the preservation of value through price-stability.

Mandate of Central Banks

Central banks get their authority from two sources, statutes or/and extra-statutory sources. This distinction is important because an objective enshrined in the constitution has greater legal standing than a monthly circular released by the central bank.

For brevity, the table below from the BIS shows the source of each of objective for different central banks.

Figure 2: Objectives of Central Banks

	Codified in law			Extra-statutory	
	Constitution	International Treaties	Statute	Published Statement not having force of law	Accepted Practice
Objective that include price stability					
Price Stability			Brazi, Japan, New Zealand, Turkey	Canada, Indonesia, South Africa	
Price Stability with subsidiary macro objectives		European Central Bank	European Central Bank, Poland, Thailand, United Kingdom	Australia, European Central Bank, United Kingdom, Poland	US Federal Reserve
Price Stability alongside other macro objectives			Canada, US Federal Reserve		
Objective that are equivalent to price stability					
Domestic purchasing power	Mexico		Argentina, Brazil, Mexico		
Objectives that do not expressly refer to price stability					
Monetary stability			India		
Value/Stability of currency	South Africa, Poland, Russia		Australia, Brazil, Canada, South Africa Hong Kong, Russia		
General welfare, general economic health, growth, development			Australia, Brazil		

Source: BIS

Importance of Central Banks' influence on our investment views

The difference in focus and weighting in objectives is often the source of divergence among central banks. This can result in similar market and economic conditions resulting in central banks acting differently. In an environment of falling inflation and deteriorating economic conditions, for instance, a country at full employment and a central bank placing greater weighting on macro-economic factors will be more likely to adopt an accommodative monetary stance than a central bank focused on domestic purchasing power. So, are central banks equal? The short answer is, no.

The importance of central banks is largely dependent on the extent of circulation of their currency outside of their borders. The broader this reach, the more important it is to understand their policy stance.

The dollar is the most commonly accepted means of international payments for commodities and the most common currency in international trade. It is the currency of choice for large oil producers and many commodity producers. Very few currencies are used to import various goods and services. Thus, appreciation and depreciation against these handful of currencies can have far reaching impact on seemingly unrelated goods, services and assets.

The graphs below show how much and where different currencies are used around the world.

Figure 3: Distribution of OTC foreign exchange (geographical)

Geographical distribution of OTC foreign exchange turnover ¹ Net-gross basis, ² daily averages in April, in billions of US dollars and percentages													
Rank by (2016)	Country	2001		2004		2007		2010		2013		2016	
		Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
1	United Kingdom	542	31,8	835	32	483	34,6	854	36,7	726	40,8	406	36,9
2	United States	273	16	499	19,1	745	17,4	904	17,9	263	18,9	272	19,5
3	Singapore	104	6,1	134	5,1	242	5,6	266	5,3	383	5,7	517	7,9
4	Hong Kong SAR	68	4	106	4,1	181	4,2	238	4,7	275	4,1	437	6,7
5	Japan	153	9	207	8	250	5,8	312	6,2	374	5,6	399	6,1
6	France	50	2,9	67	2,6	127	3	152	3	190	2,8	181	2,8
7	Switzerland	76	4,5	85	3,3	254	5,9	249	4,9	216	3,2	156	2,4
8	Australia	54	3,2	107	4,1	176	4,1	192	3,8	182	2,7	121	1,9
9	Germany	91	5,4	120	4,6	101	2,4	109	2,2	111	1,7	116	1,8
10	Denmark	24	1,4	42	1,6	88	2,1	120	2,4	117	1,8	101	1,5
...	...												
...	...												
27	South Africa	10	0,6	10	0,4	14	0,3	14	0,3	21	0,3	21	0,3

¹Data may differ slightly from national survey data owing to differences in aggregation procedures and rounding. The data for the Netherlands are not fully comparable over time due to reporting improvements in 2013. ² Adjusted for local inter-dealer double-counting (ie "net-gross" basis).

Source: BIS

Surprisingly, the dollar is second, behind the British pound in terms of the number of places it is traded in the world, represent nearly 60% coverage of the global foreign exchange (FX). South Africa, by contrast, only displays a global reach of 0.3%.

Figure 4: Distribution of OTC foreign exchange (currency)

Currency distribution of OTC foreign exchange turnover Net-net basis, (note 1) Percentage shares of average daily turnover in April (note 2)												
Country	2001 Rank	%	2004 Rank	%	2007 Rank	%	2010 Rank	%	2013 Rank	%	2016 Rank	%
USD	1	89,9	1	88	1	85,6	1	84,9	1	87	1	87,6
EUR	2	37,9	2	37,4	2	37	2	39	2	33,4	2	31,4
JPY	3	23,5	3	20,8	3	17,2	3	19	3	23	3	21,6
GBP	4	13	4	16,5	4	14,9	4	12,9	4	11,8	4	12,8
AUD	7	4,3	6	6	6	6,6	5	7,6	5	8,6	5	6,9
CAD	6	4,5	7	4,2	7	4,3	7	5,3	7	4,6	6	5,1
CHF	5	6	5	6	5	6,8	6	6,3	6	5,2	7	4,8
CNY ³	35	0	29	0,1	20	0,5	17	0,9	9	2,2	8	4
SEK	8	2,5	8	2,2	9	2,7	9	2,2	11	1,8	9	2,2
BRL ³	17	0,5	21	0,3	21	0,4	21	0,7	19	1,1	19	1
CLP ⁴	23	0,2	25	0,1	30	0,1	29	0,2	28	0,3	30	0,2
OTH		6,6	6,6		7,7		4,7		1,6			2,1
Total		200	200		200		200		200			200

¹ Adjusted for local and cross- border inter- dealer double- counting (ie " net- net" basis). ² Because two currencies are involved in each transaction, the sum of the percentage shares of individual currencies totals 200% instead of 100%. ³ Turnover for years prior to 2013 may be underestimated owing to incomplete reporting of offshore trading in previous surveys. Methodological changes in the 2013 survey ensured more complete coverage of activity in emerging market and other currencies. ⁴ Turnover may be underestimated owing to incomplete reporting of offshore trading.

Source: BIS

The total is out of 200 because the currencies are bought and sold in pairs, at 87.6, the dollar is involved in no less than 43.8% of all FX turnover by volume. The British pound, the EUR and Japanese yen make up 33% of the FX turnover. South Africa, by contrast, represents only 0.5% of FX turnover.

In conclusion, understanding the objectives of central banks, particularly those with a significant reach, is important when building a holistic investment view. We believe that the current environment is a volatile one which is just as much driven by the policy stance of major economies globally as our local macros. Our price stability mandate requires us to adjust on the back of this. As part of our process, we therefore place a fair amount of energy in analysing and understanding economies of these influential currencies to get a greater understanding of how the SARB might react to fulfil their price stability mandate and how that will affect asset prices locally. This is particularly important in an environment where there is global search for yield and as such South Africa becomes a central consideration not only for local but foreign investors.

Glacier Research would like to thank Mishnah Seth for her contribution to this week's Funds on Friday.



Mishnah Seth
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Mishnah is a founding member of ALUWANI Capital Partners with more than 11 years in investment management, focused on Africa ex-SA markets. Her skill set and understanding of the African market dynamics makes her well placed to lead ALUWANI's Africa Strategies.