South African Reserve Bank

Financial Markets Department

Record of proceedings of the Financial Markets Liaison Group (FMLG) meeting held at the Head Office of the South African Reserve Bank (SARB), Pretoria, 24 May 2016

Members who attended	Attendance by invitation	Apologies from members
Daniel Mminele (Chairperson), **SARB** Videshree Rooplall (Secretary), **SARB** Leon Myburgh, **SARB** Callie Hugo, **SARB** Charles Nevhutanda, **SARB** Anthony Julies, **National Treasury** Roy Havemann, **National Treasury** Andrew Hall, **Standard Bank** David Kinsey, **Standard Bank** Stuart Leslie, **Standard Bank** Lourens van Rensberg, **Investec** John Chemaly, **Nedbank** George Kerby, **Nedbank** William van Rijn, **Nedbank**	Alta Joubert, **SARB** Aadila Hoosain, **SARB** Stephen Charles, **FirstRand/RMB** Kim Silberman, **Standard Bank** Robyn MacLennan, **Standard Bank**	Tim Masela, **SARB** Peter Wharton-Hood, **IBA** Andries du Toit, **FirstRand/RMB** Theo Thomas, **FirstRand/RMB** Mike Harvey, **Absa Capital** Garth Klintworth, **Absa Capital** Clive Sindelman, **Investec** Peter Lane, **Nedbank**

Summary of discussions

1. Possible impact of a sovereign credit rating downgrade on South Africa

1.1 A presentation was made by a bank on the macroeconomic and financial market impact on South Africa (SA) in the event of a sovereign credit rating downgrade to sub-investment grade by Standard & Poor's (S&P) in June 2016.

1.2 S&P's revised rating methodology attaches a higher weighting to gross domestic product (GDP) per capita, compared to the other rating agencies that focus more on fiscal responsiveness.

1.3 SA's population growth rate is estimated to be 1,7 per cent. For real per capita GDP growth to average at least 1,0 per cent, potential GDP would need to rise from its current level of 1,4 per cent to 2,7 per cent. In order not to downgrade SA's sovereign rating to BB+ on 3 June 2016, S&P would have to decide whether SA's real GDP growth rate will return to between 2.5, per cent and 3,0 per cent over the medium term.

1.4 On average, leading up to a downgrade, countries saw GDP growth of 2,0 per cent or less. After a downgrade, growth took a long time to recover. SA's GDP growth, leading up to a potential downgrade, appears similar to the average.

1.5 On the current account side, on average, countries ran deficits in the lead-up to a downgrade. After the actual downgrade and owing to currency weakness and higher interest rates, the deficit tends to compress rapidly.

1.6 Weaker GDP growth and higher interest rates are likely to weigh on the corporate bond market. Issuance typically falls when interest rates rises, as the market becomes less attractive for issuers in a challenging economic environment. There has been buoyant issuance, supported by record bank issuance due to regulatory requirements (e.g. Basel III's Net Stable Funding Ratio). However, on the whole, softer issuance is expected this year, regardless of a downgrade. Issuance could soften further if interest rates rise following a downgrade.

1.7 South Africa's credit risk, reflected in the five-year credit default swap spread, has risen rapidly over the past year, indicating that the downgrade has been largely priced in by the financial markets.

1.8 On average, local bond yields moved higher ahead of a downgrade and trended lower after the actual downgrade. SA's 10-year local currency bond yield has followed a similar pattern in the months leading to a possible downgrade. Similarly, on average, currencies tended to depreciate ahead of a downgrade and appreciate post the actual downgrade. The exchange rate of the rand has behaved in a similar fashion ahead of a potential downgrade.

2. **Committee Mapping Project:** The committee map was distributed to FMLG members for comment. The next step would entail the SARB having consultations with the National Treasury (NT) and Financial Services Board (FSB) to decide if the committee structure needs to change, and if so, to agree a way forward for the restructuring of market committees. The new structure could possibly affect the role of the FMLG and the SARB's interaction with market participants in general.

3. **FMLG and Sub-committee Members' Survey:** The SARB presented the results of its survey of FMLG and subcommittee members', conducted in May 2016. The total participation rate in the survey was 57 per cent, with FMLG member participation at 80 per cent. The results indicated that most members understood and applied the FMLG's Terms of Reference. Furthermore, members had a good understanding of the role of the FMLG and each sub-committee and, what was expected of them. Members were generally in agreement that various initiatives discussed were making a valuable contribution to market structure and development in the SA financial system. Member comments and suggestions from the survey as well as additional research done by the SARB on market contact groups in other jurisdictions would be duly considered by the SARB in trying to improve the functioning of the FMLG and its sub-committees.

4. Feedback from sub-committees/task teams

4.1 The Money-Market Subcommittee (MMS)

4.1.1 Supplementary auctions: The re-introduction of the supplementary auctions in the SARB's end-of-day square-off processes was implemented on 11 March 2016. However, since then, banks have generally not participated in the supplementary auctions. The SARB would have discussions with individual banks on this matter.

4.1.2 Proposal to widen the interest rate spread of the standing facilities:

The SARB had considered the reasons for end-of-day market inefficiencies and decided to keep the prevailing standing facility rates unchanged. Specific solutions for separate causes of these inefficiencies would be finalised in due course.

4.1.3 Strate collateral management system and secured interbank market:

The operationalisation of the secured interbank market was discussed, with members expressing a need to develop an industry-wide operational notice regarding processes to be followed to ensure the efficiency of the secured interbank market. The operational notice was expected to formalise the timing of the interbank clearing and collateral to be used. A special working group was formed to formalise the functioning of this market. The working group met on 25 April 2016.

4.1.3 Money-market yield curve: The Association for Savings and Investment South Africa (Asisa) raised a concern that the Johannesburg Stock Exchange (JSE) encountered difficulty in "harvesting" Negotiable Certificates of Deposits (NCD) screen rates for maturities longer than 12 months from banks' NCD trading screens, used to calculate and publish a money-market yield curve. Strate would engage with Asisa on the money-market curve they currently use to value the collateral in their collateral management system.

4.1.4 Calculation of credible benchmark money-market rates:

The Reference Rate Working Group (RRWG), under the auspices of the MMS, continued to deliberate on the calculation of credible benchmark money-market rates to contribute towards the enhancement of transparency in the money market. The SARB reworked its initial proposals for discussion purposes on the calculation of specific reference rates. However, challenges remain, mainly around compliance with the International Organization of Securities Commissions (IOSCO) principles regarding surveillance, validation, etc. According to the latest Official Sector Steering Group (OSSG) Progress Report, progress has been slow with regard to the development of new benchmark rates globally.

4.1.5 Jibar review project (analysis of the banks' funding data):

The SARB completed its analysis of the banks' funding data. The key findings were as follows:

(i) Banks predominantly funded themselves through wholesale deposits. Negotiable Certificates of Deposits (NCD's), mostly longer-term, comprised the second largest source of funding;

(ii) NCD issuance was concentrated in the medium- to longer-term area (that is, six to twelve months), while wholesale and "other" deposits dominated short-term funding;

(iii) There was a mismatch between the aggregate volume of derivative and non-derivative contracts that reset against the three-month Jibar and the volume of NCD's that are used to calculate the Jibar rate on which these contracts reset; and

(iv) The trends identified in the analyses of the banks' funding data were largely anticipated, indicating that Jibar is potentially vulnerable and questions could be raised on its credibility and whether it meets the IOSCO principle on Data Sufficiency. The results of the Jibar review project would be discussed at the next meeting of the RRWG and proposals for the revision of Jibar would be submitted to the FMLG in due course.

4.2 The Fixed Income & Derivatives (FI&D) Subcommittee

4.2.1 Financial Markets Act (FMA): The FMA, which requires mandated clearing, was also discussed by the committee. It was noted that the FMA would also require reporting to a trade repository, however, there was still no clarity on who the repository would be. Central clearing would require banks to post both initial and variation margin on all OTC derivative positions. This was likely to impact the market from 1 March 2017 for new transactions. The current FMA draft margin rules were not aligned with IOSCO principles.

4.3 The Foreign Exchange (Forex) Sub-committee

4.3.1 Foreign exchange futures position close-out process: The JSE reported that the foreign exchange futures position close-out process was successfully implemented. Market participants proposed some minor adjustments to the process, which would possibly offset any unforeseen consequences of the current process. The JSE also indicated that there had been requests to extend the aforementioned process to include two additional currency pairs, namely EURZAR and GBPZAR. This initiative was subsequently approved by the regulators and was set to go live at the next close out on 15 June 2016.

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