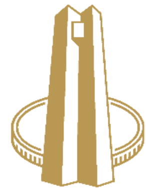
national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA



SOUTH AFRICAN RESERVE BANK

Gold and Foreign Exchange Contingency Reserve Account (GFECRA)
Frequently asked questions

In the February 2024 *Budget Review*, National Treasury (NT) described a reform to the settlement framework for the Gold and Foreign Exchange Contingency Reserve Account (GFECRA). This reform has been agreed between NT and the SARB. The core components of the reform are described in the *Budget Review.* This frequently asked questions (FAQs) document is being provided by the SARB to fill in some additional and technical details.

What is the new framework?

Under the old GFECRA settlement framework, most amounts that entered GFECRA went unsettled, and so the account grew steadily larger as a result of currency depreciation. Under the new framework, by contrast, GFECRA balances are distributed, in a ‘waterfall’ arrangement, to three ‘pools’.

The first pool is a GFECRA buffer, which will be large enough to absorb large and plausible rand appreciation shocks, without resulting in negative balances on the account. Once this pool is full, additional funds flow into a second pool, which is the SARB’s contingency reserve. This is an all-purpose equity buffer for the SARB, maintained to absorb losses, including losses from the interest costs paid by the SARB to manage liquidity when there are GFECRA payouts to NT. Once this pool is full, any remaining funds are distributed to National Treasury, on an annual basis.

What are the key principles that govern the new framework?

The new framework is governed by the following principles:

- No settlement of any balance on the GFECRA shall, at any time, undermine the policy solvency of the South African Reserve Bank.

- There shall be no sales of the foreign exchange reserves to realise GFECRA gains as long as foreign exchange reserves are below the foreign exchange reserve estimated adequacy levels.

- There shall be no settlement of an unrealised balance on the GFECRA that could plausibly be unwound by future currency reversals.

- The settlement of the credit balance on the GFECRA to the National Treasury shall be used to reduce government’s borrowing.

- Any future settlement of GFECRA funds shall be governed by an agreement and a relevant schedule.

What are the amounts going into each pool?

The GFECRA buffer is being set at R250 billion. By minimising risks that the GFECRA account turns negative, this buffer will help protect NT from having to be paid out to the account to make it positive again.

The SARB contingency reserve buffer will receive R100 billion. The goal of this transfer is to protect the SARB's policy solvency, defined as the flexibility to pursue mandates without concern for the financial position. The contingency reserve buffer will be replenished from excess GFECRA balances when available. This buffer is meant to be large enough to last through extended periods when these top-up funds from GFECRA are not available.

NT will receive R150 billion. As detailed in the *Budget Review*, this will be paid out in three tranches of R100 billion, R25 billion and R25 billion in the 2024/25 financial year and the subsequent two financial years respectively. The liquidity management costs of these payouts are expected to be around R8 billion in 2024, R10 billion in 2025 and R12 billion in 2026. The exact costs will depend on the level of short-term interest rates, and will recur indefinitely.

What will happen in future, after these amounts are settled?

The framework will govern future GFECRA balances too. Following the waterfall principle described above, if and when GFECRA grows, these funds will be retained in GFECRA to the extent necessary to maintain the GFECRA buffer. Excess funds will be distributed to the SARB's contingency reserve. When the contingency reserve is also fully stocked, the excess funds will be distributed to NT.

Future distributions to NT will likely be significantly smaller than the current R150 billion. This is because the current GFECRA balances have accumulated over a period of nearly two decades. In future, excess GFECRA growth will be distributed more regularly, resulting in smaller annual distributions.

The new framework aims to achieve orderly long-term management of GFECRA, maintaining adequate but not excessive buffers, with reduced scope for uncertainty and contention over these balances.

Is the SARB going to sell foreign exchange reserves to realise GFECRA gains?

No. We have decided not to sell foreign exchange reserves to finance the distribution to NT. Rather, this will be financed by new SARB liabilities, mainly bank reserves,

discussed in more detail below. This GFECRA reform affects how foreign currency reserves are financed, but not the quantity of foreign exchange reserves South Africa holds. In other words, it changes the liability side of the SARB's balance sheet, not the asset side. A portion of current non-interest bearing liability in GFECRA is replaced with interest-bearing bank reserves.

How is the GFECRA distribution to National Treasury being financed?

The SARB will replace a portion of the GFECRA liability, on its balance sheet, with new liabilities. Unlike GFECRA, these will be interest bearing. The most important liability will be excess reserves of banks, which are cash balances deposited at the SARB and generally remunerated at the policy rate. This means the liquidity surplus will increase. The SARB will also use other tools to manage the amount and speed at which excess reserves enter the payment system, so there will not be a direct, one-to-one connection between the amount of money paid to NT and the liquidity surplus. Funds in the Corporation for Public Deposits, which are managed by the SARB, will be important for this.

The GFECRA payout will, in many ways, replicate the payout of the National Treasury Sterilisation Deposit Account (NTSDA) in early 2023. The NTSDA represented NT deposits be kept at the SARB to help drain liquidity created when foreign exchange reserves are purchased. As NT withdrew those funds, the SARB did not sell foreign exchange reserves, but rather replaced the NTSDA financing with new excess reserves of banks. This increased the money market surplus; some of the funds were also drained with other tools. In both cases, NT withdrew part of its contribution to financing foreign exchange reserves. The SARB replaced this contribution with new financing and this mostly, but not entirely, took the form of larger SARB liabilities with the commercial banks and a larger money market surplus.

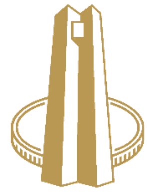
How will the GFECRA distribution to National Treasury be used?

The proceeds from GFECRA will be used to reduce government borrowing. R150 billion will be used to reduce government's borrowing by R100 billion (2024/25), R25 billion (2025/26) and R25 billion (2026/27). As a result, debt service costs will reduce by R30.2 billion over the medium-term, which is accompanied by a reduction in the growth in the stock of debt.

How did you decide on the split over the three years?

The decision on the split over the three years was informed by various scenarios that were considered as part of government's funding strategy. These scenarios were optimised to ensure that there is a positive impact on the gross borrowing requirement and debt service costs, and that the impact can be sustained over the medium-term.

national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA



SOUTH AFRICAN RESERVE BANK

Is the SARB distributing unrealised gains, and if so, is that a problem?

Many, but not all, central banks apply a principle of never distributing unrealised gains. The rationale for this is that unrealised gains are paper profits, which can be eliminated by market movements, and which are therefore risky to pay out.

In the South African case, exchange rate appreciation could sharply reduce GFECRA balances. Precedents for this include the rand appreciations of 2017–2018 and 2021. However, with a track record of higher inflation than in advanced economies, the risk of prolonged appreciation is low, limiting the extent of appreciation. The GFECRA buffer will protect against episodic appreciation eroding the size of the account, with only more predictable, depreciation-driven gains being re-allocated.

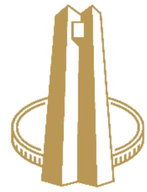
A further feature of this framework is that, following to the waterfall principle, unrealised gains are only distributed to the SARB's contingency reserve. Valuation accounts are a standard component of central bank equity; indeed, the SARB has two valuation accounts in its existing equity (for property holdings and its stake in the Bank for International Settlements). What is being distributed to NT is excess SARB equity. Again, it is not uncommon for central banks to pay governments such excess funds.

Will there be changes to the SARB Act?

No. The SARB Act establishes GFECRA, empowers the Minister of Finance and the SARB Governor to settle positive balances by mutual agreement, and requires such balances to be paid into the National Revenue Fund. Under the new framework, GFECRA remains in place, and the Minister and SARB Governor exercise their discretion on settlement through an agreement, consistent with the previous GFECRA settlement framework. Any movement of funds from GFECRA will take them through the National Revenue Fund, as required by the SARB Act. An amendment of the 2003 GFECRA Settlement Act will be used to provide legal authorisation for funds to be paid back to the SARB, for the contingency reserve, as required by the new framework.

Will this be inflationary?

No. An increased supply of bank reserves would be inflationary only if the SARB did not intervene to manage this liquidity. The SARB has a toolkit available for liquidity management – a toolkit which was strengthened by the reform of the monetary policy implementation framework in 2022. Controlling interest rates with a larger liquidity supply is more costly, and this is an important reason that the SARB requires a larger contingency reserve. But the Monetary Policy Committee (MPC) is still able to use the



interest rate tool to achieve its inflation objective. The SARB stands ready to deploy its tools, as necessary, to maintain price stability.

Will details of the higher liquidity surplus and bank quotas be published?

Yes. As before, for instance with the NTSDA drawdown, the larger liquidity surplus will be phased in gradually, with banks' quotas expanded in line with the larger liquidity supply. The expansion of the surplus will follow a timeline published in advance, as a Notice on the SARB's website. This will help banks anticipate and manage the change in liquidity.

The SARB will also use other tools to drain some of the GFECRA liquidity from the market, to further limit any impact on financial conditions.

Jointly issued by:

The National Treasury and the South African Reserve Bank

Enquiries: media@treasury.gov.za and media@resbank.co.za