A short note on turnover in the South African market for foreign exchange

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1. Introduction

The Economics Department of the South African Reserve Bank started to collect data on turnover in the domestic foreign-exchange market towards the end of 1986 when international guidelines for measuring such turnover were not clearly specified. As new markets opened and existing markets became more sophisticated, the need for a better understanding of the forces driving market movements emphasised the importance of internationally accepted standards for measuring the activity in foreign-exchange markets. The Bank for International Settlements played an important role in the specification of such standards. South Africa decided to comply with these specifications and introduced a new survey form (Form B12) in March 1998 to replace the previous form (Form B15) which was discontinued at the end of April 1998.

The aim of this note is to inform the users of these statistics of the new methodology used in measuring turnover in the market for foreign exchange and to present the findings obtained from the regular Form B12 surveys in a concise format.

2. The objective of market surveys

The primary objective of Form B12 is to obtain comprehensive and reliable information concerning activity in the South African market for foreign exchange. Turnover data provide the Reserve Bank with valuable information regarding the relative importance of spot, forward and swap market activity. Market participants are identified as monetary institutions, other resident entities and non-residents. Transactions in terms of which rands are exchanged for other currencies are distinguished from transactions between third currencies. Turnover data also provide a measure of the size of the market and are used extensively by market participants in calculating market share. The data are disseminated by the Reserve Bank through the Quarterly Bulletin and the Monthly Release of Selected Data, both of which are displayed on the Internet home page of the Reserve Bank.

3. Principles and methodology

Table S-101 of this edition of the Quarterly Bulletin provides comprehensive data on turnover in the domestic foreign-exchange market in a format which is largely in accordance with the guidelines specified by the Bank for International Settlements. The coverage of the new survey was expanded to collect information on transactions where rands are exchanged for other currencies and transactions in third currencies, i.e. transactions involving the exchange of any two other currencies against each other. The inclusion of transactions in rand and in third currencies indicates the overall size of the market whereas information about transactions against the rand indicates the turnover in the segment of the market where the behaviour of the exchange rate of the rand is determined.

The information in Table S-101 reflects turnover in the domestic foreign-exchange market. This turnover is defined as the gross value of all transactions concluded on the reporting day, measured in terms of nominal or notional amounts. These turnover statistics include data on spot foreign exchange contracts, outright forward transactions and swap transactions. Option transactions are excluded. Each authorised foreign exchange dealer reports turnover data in a manner that allows transactions with other authorised dealers to be identified separately. Local interbank transactions may lead to double counting and an overestimate of turnover statistics. The aggregated raw data are therefore adjusted to eliminate double counting. The adjusted turnover totals are published as *net turnover* in Table S-101.

The most important change in the new survey concerns the treatment of swap transactions. Swap transactions are defined as transactions which involve the actual exchange of two currencies on a specific date at a rate agreed upon at the time of the establishment of the contract (the spot leg), and a reverse exchange of the same two currencies at a future date at a rate also agreed upon at the time of establishing the contract (the forward leg). In the past, the spot leg of the transaction was included as part of turnover in the spot market whereas the forward leg of the transaction was included as part of turnover in the forward market. However, according to the methodology specified by the Bank for International Settlements, only the forward leg of a transaction which has been concluded as a spot/forward swap transaction should be included in turnover.

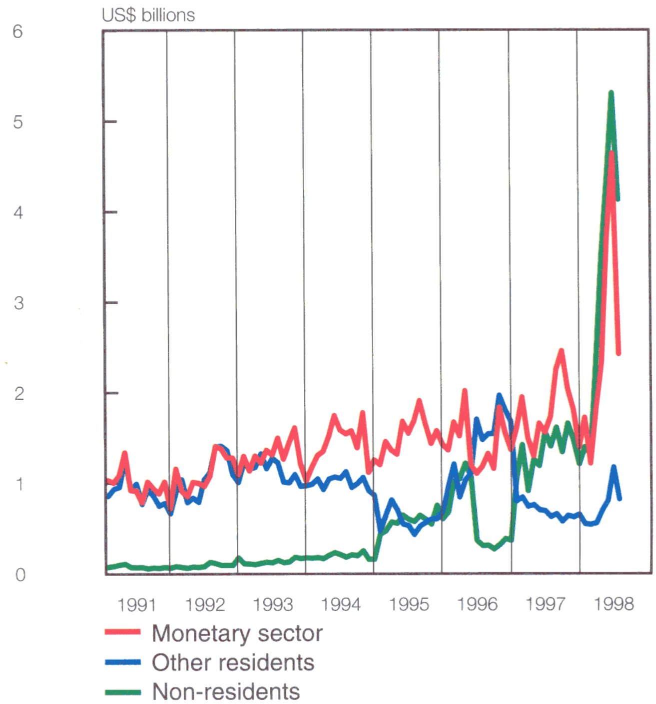
Information collected from April 1998 in terms of the new survey enabled the Bank to compile turnover statistics which are consistent with international best practice. In order to obtain a consistent time series, double counting arising from the inclusion of both legs of a swap transaction had to be eliminated for the period prior to March 1998. Adjustments for the period from January 1997 to March 1998 were based on detailed information relating to swap transactions during that period. For the period from January 1987 to December 1996 it was assumed that turnover in the swap market maintained a fixed ratio to total turnover in the spot and forward markets.

4. Main features of the South African market for foreign exchange

As already indicated, the local market for foreign exchange can be divided into the "rand market" and the "third currency market". The rand market is the dominant one, representing almost 80 per cent of total turnover. Of the remaining 20 per cent, about 18½ per cent is conducted between the US dollar and other currencies and 1½ per cent between the German mark and other currencies (see Graph 1).

An analysis of turnover in the rand market by type of participant shows the increasing role that non-resident parties are playing in the South African foreign-exchange market (see Graph 2). This is particularly evident during periods when the domestic market is highly volatile, as was the case in the first half of 1996,

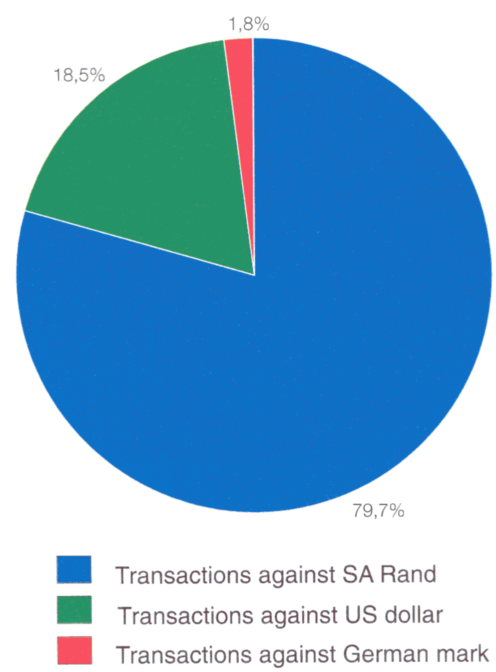
Graph 2: Average net daily turnover in the South African foreign-exchange market by type of transactor



towards the end of 1996 and early in 1997, and again during May to July 1998. The behaviour of resident participants outside the monetary sector is also heavily influenced by volatility in the market for foreign exchange. During periods of a strong depreciation of the rand, resident non-bank entities with an exposure in foreign currency tend to cover themselves so as to contain the cost of future commitments. Accordingly, the value of their involvement in the market increased strongly from an average daily turnover of US$0,6 billion in 1995 to an average daily turnover of US$1,4 billion in 1996. In the more stable conditions of 1997 these levels averaged US$0,7 billion, before increasing again to a level of US$1,2 billion in June 1998.

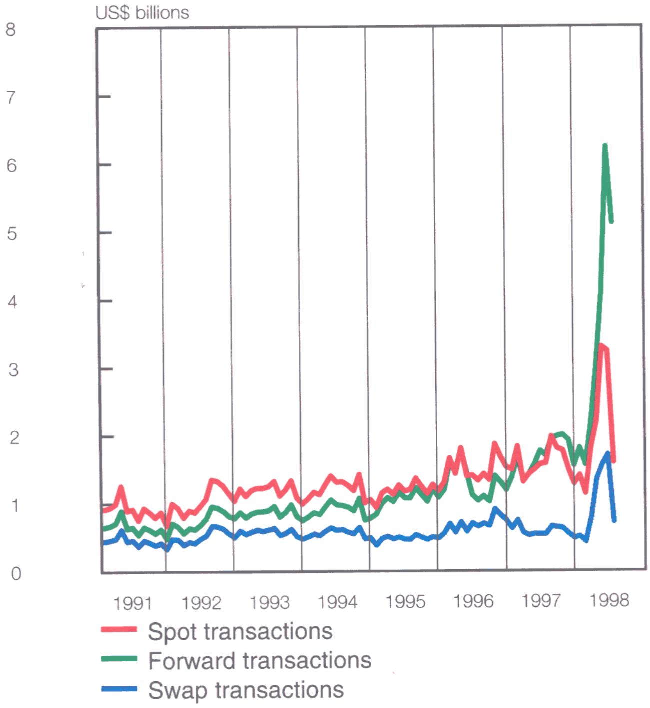
Until the middle of 1997, activity in the domestic market for foreign exchange was dominated by transactions in the spot market (see Graph 3). Spot trades are highly standardised transactions in a very liquid market. From the middle of 1997 swap transactions began to overtake spot transactions as the dominant kind of transaction in the market. The main purpose of foreign-exchange swaps is to manage liquidity and currency risk by executing foreign exchange transactions at the most appropriate moment. The need to manage liquidity and reduce currency risk is particularly pressing during times when there are large movements in the exchange rate of a currency. Such situations occurred in South Africa in

Graph 1: The composition of the total net average daily turnover in the South African foreign-exchange market



Calculations are based on the average turnover for the period April to July 1998

Graph 3: Average net daily turnover in the South African foreign-exchange market by type of transaction



1996, 1997 and in the first half of 1998, resulting in an increase in swap turnovers.

In summary: The information contained in Table S-101 of this edition of the Quarterly Bulletin presents time series data on the value of turnover in the domestic market for foreign exchange, in accordance with internationally accepted specifications.