Note on the redefinition of gold and other foreign reserves in the balance of payments

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Introduction

A country's international reserve position is a key component of the balance of payments statistics. Recent developments necessitated reconsideration of the appropriateness of the international reserve asset definition used in South Africa. This note introduces the amended definition to users of economic statistics, and indicates which data series in the statistical tables of the *Quarterly Bulletin* have been changed.

Current concept

According to the fifth edition of the International Monetary Fund's *Balance of Payments Manual,* international reserves consist of those external assets that are readily available to and effectively controlled by the monetary authorities. The reserve assets should be available to the monetary authorities, should the need arise to provide liquidity to the foreign exchange market.

South Africa's *gross international reserve assets* currently comprise official gold and other foreign exchange reserves of the South Africa Reserve Bank (the Bank) and the central government, as well as the foreign currency assets of the South African private banking sector. The rationale for including the international reserves of the private banking sector was that the foreign currency assets of the private-sector banks were effectively under the control of the monetary authorities. The exchange control rules and regulations, for instance, required that the placement of foreign currency holdings should be in the name of the domestic authorised dealer (bank) concerned, should be with another bank and should be restricted to the range of assets prescribed by the exchange control authorities.

A related concept in the balance of payments area is South Africa's *net international reserves.* This is currently derived by deducting the so-called liabilities related to reserves – the Bank's foreign borrowing, as well as the foreign loan commitments of the central government to international organisations – from the gross international reserves. Changes in such foreign borrowings are deemed not to result from the normal balance of payments transactions, but from the need to ensure an adequate level of gross international reserves and, on occasion, to ensure an adequate supply of foreign-currency liquidity to the foreign exchange market. It should be noted that the foreign liabilities of the private banking sector do not form part of the liabilities related to reserves, but are reflected in the category "other investment liabilities" in the financial account of the balance of payments.

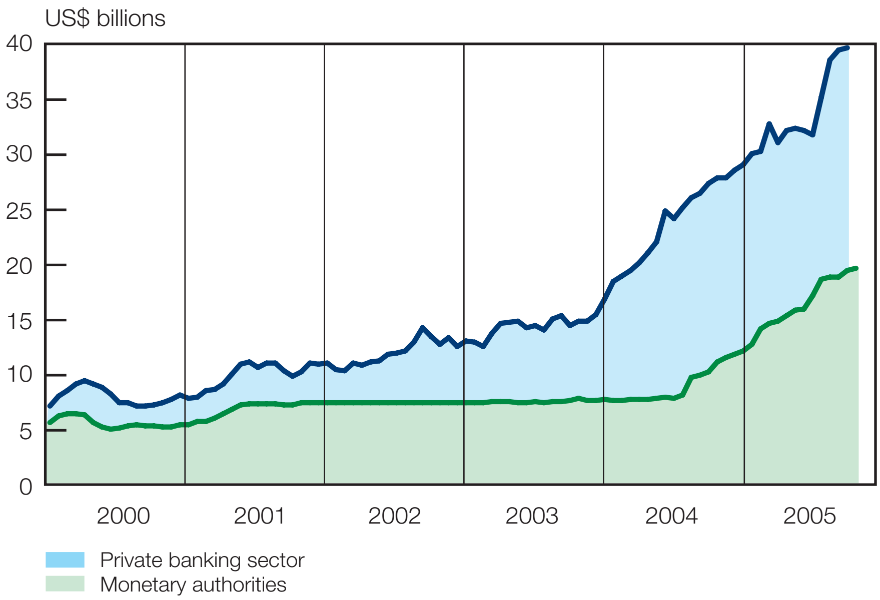
Revised international reserve asset concepts

In the 2005 *Medium Term Budget Policy Statement,* the Minister of Finance announced steps to further ease the exchange controls imposed on banks, as part of the shift from exchange controls to the prudential regulation of banks' foreign exposures. South African banks would henceforth be allowed to hold foreign assets with a value of up to 40 per cent of their domestic regulatory capital. Foreign assets invested outside Africa would be restricted to 20 per cent, while assets invested in Africa could constitute up to the entire 40 per cent.

This further relaxation of the exchange control measures brought matters to the point where, in the judgement of the Bank, the foreign currency assets of the private banking sector could no longer reasonably be considered as subject to the authorities' direct and effective control. Accordingly, only the international reserve assets of the South African Reserve Bank and those of the central government will in future be considered as the official international reserve assets of the country. Changes in the international reserves of the private banking sector will, therefore, in future be recorded in the category "other investment assets" in the financial account of the balance of payments.

The level of gross international reserves including and excluding the international reserve assets of the private banking sector are shown in the graph below, illustrating that in recent months the foreign currency assets of the private banking sector were of similar magnitude to the holdings of foreign assets by the Bank and the central government.

Gross gold and other foreign reserves



Adopting the narrower concept of foreign reserve assets implies that the net reserve position will in future truly reflect the foreign reserve position of the monetary authorities. Furthermore, South Africa's official foreign reserve position will be directly comparable with the official gross foreign reserve position of other countries. At the same time, the concern that the net reserves concept was defined in an asymmetric way, by taking into account both foreign assets and liabilities of the monetary authorities but only foreign assets of the private banking sector, will no longer be valid.

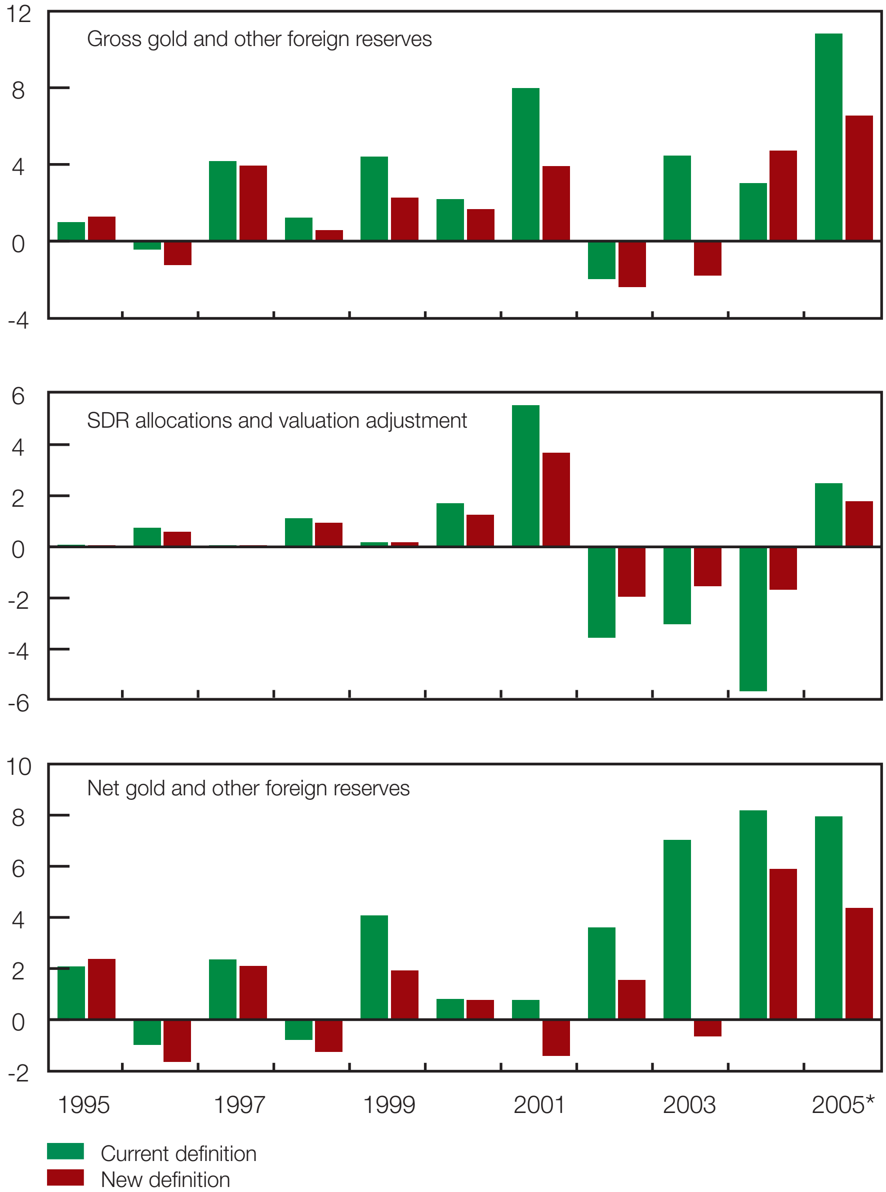
Related to redefining the levels of the gross and net reserves, the *changes in the net international reserves owing to balance of payments transactions* were also revised. The accompanying graph illustrates the difference between these changes using the current and new reserve definition.

The strong increases in the net international reserves owing to balance of payments transactions since 2002 were largely due to the significant accumulation of foreign exchange reserves by the private banks. Moving to the new definition of reserves therefore, involves recording significantly smaller increases in the net foreign reserves than before.

Incorporating the changes in the international reserve assets of the private banking sector in the "other investment asset" category of the financial account of the balance of payments did not affect the magnitude of *unrecorded transactions* in the balance of payments. The adjustment to the change in the net international reserves owing to balance of payments transactions was offset by an equal adjustment to the balance on the financial account.

Change in foreign reserves

US dollar billions



* January - October

Dissemination of revised data

The analytical statement of the balance of payments was revised since 1960 in order to conform to the guidelines of the fifth edition of the *Balance of Payments Manual* of the IMF. The revised data series are available on the Bank's website. Below is a summary of the *Quarterly Bulletin* tables and items on the balance of payments that were affected by the revisions.

Page	Balance of payments items
S86, 87:	Changes in gross gold and other foreign reserves now exclude foreign assets of the private-sector banks. SDR allocations and valuation adjustments now involve foreign assets and liabilities of the monetary authorities only. Changes in net gold and other foreign reserves owing to balance of payments transactions now relate only to the monetary authorities. Changes in other investment assets now include changes in foreign assets of the private-sector banks. Adjustments to the balance on the financial account correspond to the adjustments to the change in net foreign reserves.
S92, 93:	Foreign assets: Other investment assets of the banking sector now include the foreign-currency assets of private banks.
S108:	Rest of monetary sector (i.e. private banking sector) is now omitted from the table, and gross foreign reserves are reduced accordingly.
S152:	The import cover ratio of reserves is now lower on account of the narrower reserve definition adopted.