Note on South Africa's international investment position[1, 2]

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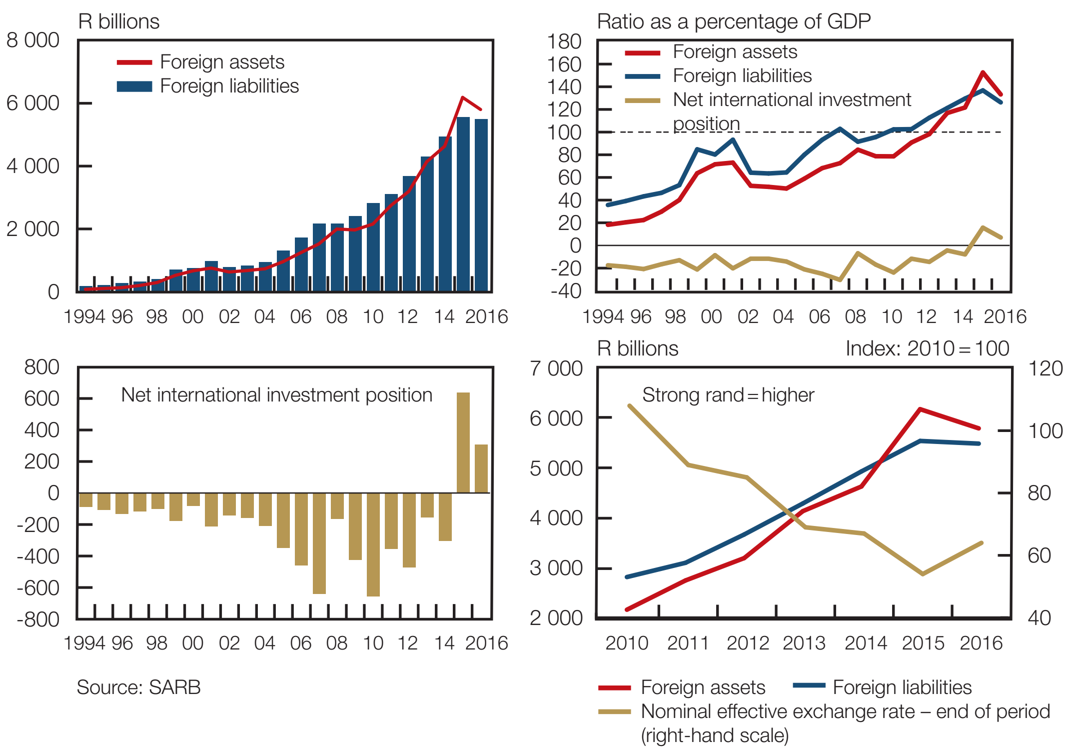
Introduction

The international investment position (IIP) of a country is a point-in-time statement of the value[3] of the residents' financial claims on non-residents (outward investment) and liabilities to non-residents (inward investment). The stock positions, or outstanding balances, of both South Africa's foreign financial assets and foreign liabilities relative to gross domestic product (GDP) increased significantly after 1994, as cross-border financial activity increased notably following the removal of trade and financial sanctions against South Africa. The net IIP is the difference between foreign financial assets and foreign liabilities, which could either be a net claim (creditor) on or a net liability (debtor) to the rest of the world.

The year 2015 marked South Africa's first positive net IIP since the inception of this statistic in 1956. The switch to a net positive asset position was brought about by the decline, on balance, of 19.7% in the nominal effective exchange rate (NEER) of the rand in 2015, together with holding (valuation) gains in South Africa's foreign financial assets due to price increases abroad. Subsequently, the net IIP narrowed in 2016, partly as a result of a strengthening in the exchange value of the rand. Changes in the exchange value of the rand have a larger effect on foreign financial assets, as they are more exposed to foreign currency-denominated financial instruments than foreign liabilities. This is brought about by rand-denominated equity liabilities and a near-equal split between foreign and domestic currency-denominated debt liabilities. The value of domestic currency-denominated debt liabilities is largely due to significant non-resident holdings of South African government bonds.

South Africa's international investment position



Source: SARB

1 The Economic Statistics Division of the Economic Research and Statistics Department of the South African Reserve Bank compiles South Africa's balance of payments according to the methodology as prescribed by the sixth edition of the International Monetary Fund's *Balance of Payments and International Investment Position Manual (BPM6)*.

2 This note is based on statistics presented in the tables on pages S–82, S–86, S–87 and S–92 to S–104 of this *Quarterly Bulletin*.

3 Financial assets and liabilities are generally valued at market value, with the exception of loans, deposits and accounts receivable or payable, which are recorded at nominal value.

The structure of South Africa's IIP dictates dividend and interest receipts from foreign financial assets and payments on foreign liabilities, with net income receipts and payments significantly affecting the balance on the current account of the balance of payments. On balance, net investment income payments persist despite a positive net IIP. This is due to the dominance of low-yielding dividend receipts on account of the high exposure to equity assets and relatively low interest rates on foreign debt assets. This effect is exacerbated by the larger exposure to debt liabilities as well as a significant interest rate differential due to higher interest rates on domestic rand-denominated debt. This explains the coexistence of a positive net IIP and a deficit on the income balance of the current account.

The overall deficit on the current account of the balance of payments is financed by the net inflow of capital as measured by the balance on the financial account. The financial account flows, or transactions between residents and non-residents in a specific time period, comprise the net incurrence of liabilities (net of inflows and outflows) or the net acquisition of financial assets (net of inflows and outflows). This contributes to the change in the foreign financial asset position and the foreign liability position in the IIP. This linkage between the transactions in the financial account and the balances in the IIP comes together in the integrated IIP, which reconciles the opening and closing balances of the IIP. The difference between the opening and closing IIP balances could be decomposed into financial account transactions and other changes in stock positions. The latter consists of revaluations due to both price movements of financial assets and liabilities (holding gains and losses) and exchange rate fluctuations, as well as other volume changes, such as write-offs or reclassifications. South Africa does not yet compile an integrated IIP due to different data sources being used for the IIP and the financial account, such as dedicated surveys and administrative data, and difficulty in bringing the variety of sources together and measuring the population as a whole. The source data also limits the data dimensions of the financial account to only functional categories, financial instruments and resident institutional sectors, as it does not provide for a non-resident counterparty country breakdown or allocation to kind of economic activity, as in the case of the IIP.

The decomposition of foreign financial assets and foreign liabilities in the IIP by the various dimensions and subclassifications mentioned above facilitates the analysis of an economy's international economic relationships and external vulnerability. The only difference in data dimensions between foreign financial assets and foreign liabilities is that the latter are also disaggregated by kind of economic activity.

The functional dimension subclassifies foreign financial assets and foreign liabilities into direct, portfolio and other investment as well as financial derivatives, with reserve assets as an additional asset category. A direct investment relationship is established with equity holdings of 10% or more of the voting rights exerting significant influence, and with control at more than 50%. Under these conditions, and inclusive of transactions between fellow enterprises and affiliates,[4] all equity and debt instruments are classified as direct investment. Cross-border holdings of negotiable equity and debt securities other than direct investment are classified as portfolio investment. Other investment comprises loans, deposits, trade finance and special drawing rights (SDRs) with the International Monetary Fund on the liability side, and with reserve assets separate on the asset side.

The financial instrument dimension subclassifies foreign financial assets and foreign liabilities into equity and investment fund shares which represent a residual claim on assets; debt instruments and securities requiring payment of the principal and/or interest; deposits with banks; loans where a creditor lends directly to a debtor; trade credit and advances; SDRs; and reserve assets.

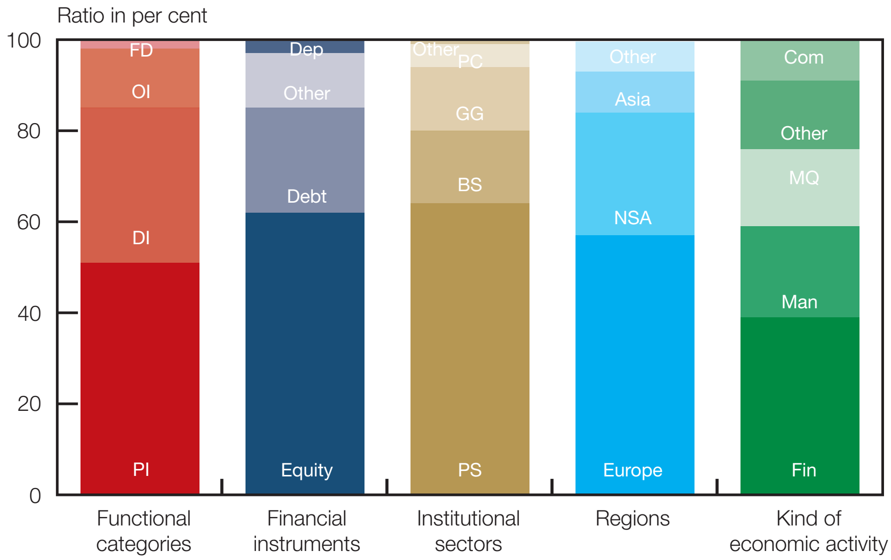
The institutional sector dimension subclassifies the resident counterparties to foreign financial assets and foreign liabilities into the private non-banking sector, which comprises non-financial and financial corporations whose principal activity is the production of goods and the provision of financial services; monetary authorities; banks; general government; and public corporations.

4 A direct investment relationship also exists between enterprises that do not control or influence one another if both are under the influence or control of the same direct investor.

The country and region dimension give a geographical breakdown of residence of the non-resident counterparties. South Africa's foreign liabilities are also presented by the kind of economic activity that receives funding.

An analysis of the foreign liability position as at the end of 2016 shows the dominance of portfolio and direct investment. Portfolio investment provides significant funding for the current account deficit and is related to the prevalence of equity and debt securities, with the latter reflecting non-resident holdings of government bonds issued in domestic currency, and with general government as the resident counterparty. The private non-banking sector is the sector with the largest foreign liabilities. Europe is South Africa's largest non-resident creditor counterparty. Most of the foreign funding is destined for the finance, insurance, real estate and business services sector, followed by manufacturing.

Composition of foreign liabilities as at 31 December 2016



Functional categories
PI: portfolio investment
DI: direct investment
OI: other investment
FD: financial derivatives

Financial instruments
Equity: equity and investment fund shares
Debt: debt instruments and securities
Other: loans, trade credit, SDRs and financial derivatives
Dep: deposits

Institutional sectors
PS: private non-banks
BS: banks
GG: general government
PC: public corporations
Other: monetary authorities and SDRs

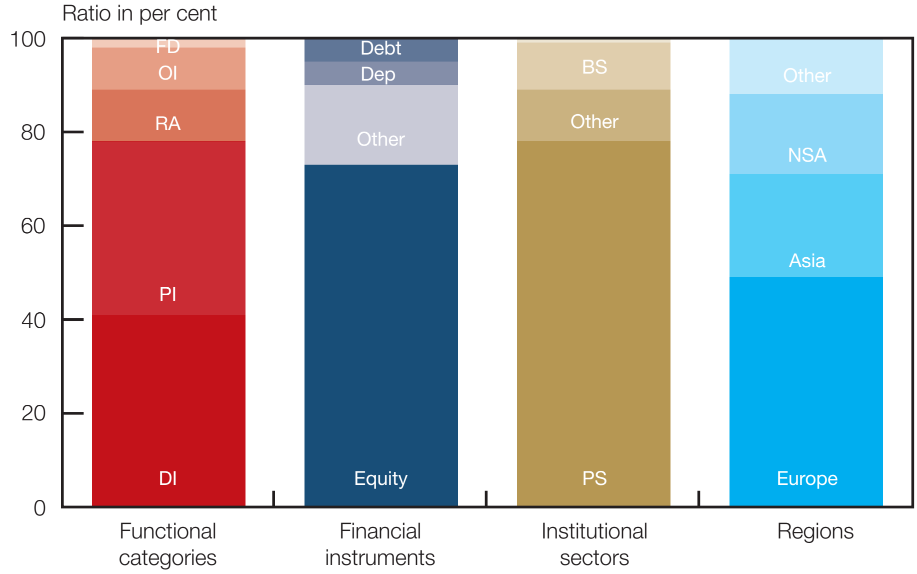
Regions
Europe
NSA: North and South America
Asia
Other: Africa, Oceania, international organisations and unidentified countries

Kind of economic activity
Fin: finance, insurance, real estate and business services
Man: manufacturing
MQ: mining and quarrying
Other: agriculture, forestry, hunting and fishing; electricity, gas and water; construction; wholesale and retail trade, catering and accommodation; and transport, storage and communication
Com: community, social and personal services

Source: SARB

The foreign financial assets position as at the end of 2016 shows the dominance of direct investment, reflecting a domestic technology investment company's significant holding gains from the appreciation in the market price of an investment abroad. This also contributed to the significant allocation to equities and the footprint of the private non-banking sector as resident counterparty, as well as non-resident counterparty exposure to Asia.

Composition of foreign assets as at 31 December 2016



Functional categories
DI: direct investment
PI: portfolio investment
RA: reserve assets
OI: other investment
FD: financial derivatives

Institutional sectors
PS: private non-banks
Other: monetary authorities, general government and public corporations
BS: banks

Financial instruments
Equity: equity and investment fund shares
Other: loans, trade advances, financial derivatives, and gold and foreign exchange
Dep: deposits
Debt: debt instruments and securities

Regions
Europe
Asia
NSA: North and South America
Other: Africa, Oceania, international organisations and unidentified countries

As at the end of 2016, the value of South Africa's foreign portfolio and other investment assets was less than foreign liabilities of the same categories, but a positive net position on direct investment, together with reserve assets, was more than enough to render an overall positive net IIP position. In value terms, net equity assets and debt liabilities dominated. In terms of resident institutional counterparty sectors, only the private non-banking sector and the monetary authorities' foreign assets exceeded foreign liabilities. South Africa also has more foreign liabilities than financial foreign assets in relation to Europe and North and South America. These comparisons shed some light on foreign asset and liability mismatches.