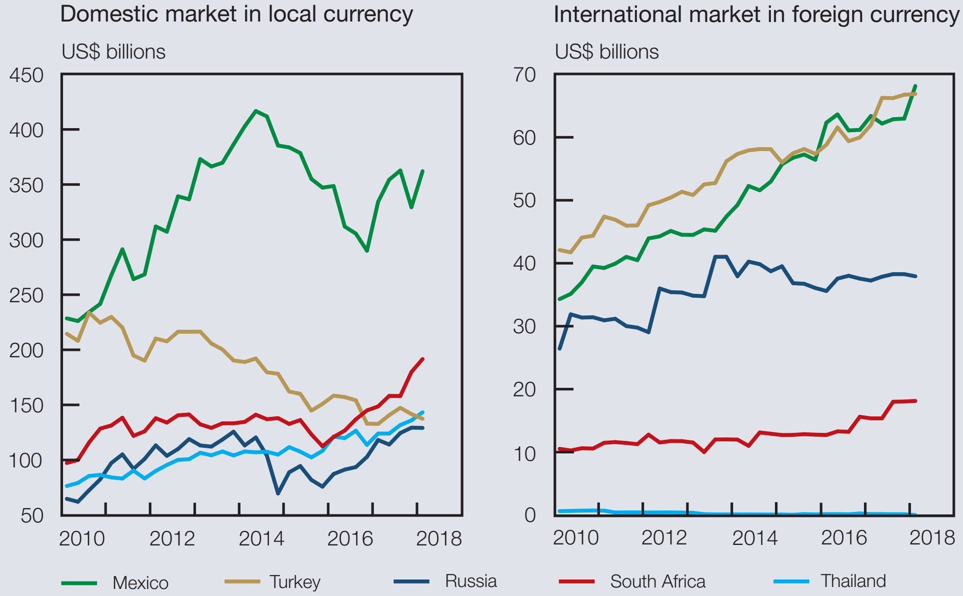
Box 2 A comparison of South Africa's general government debt securities with other emerging markets[1, 2]

In South Africa, general government's funding through debt securities is dominated by outstanding amounts of domestic market issues in local currency, which reduces the country's exposure to exchange rate risk. This is also the case in other emerging markets, such as Mexico and Russia. However, non-resident holdings of such debt increase the exposure to sudden sell-offs. In South Africa, non-resident holdings of domestic local currency-denominated debt securities comprised 42.3% of the total debt as at the end of March 2018, somewhat higher than in Mexico and Russia.

South Africa participates in the debt securities database[3] of the Bank for International Settlements (BIS) on which this cross-country analysis of outstanding amounts at nominal or face value[4] of general government[5] debt securities[6], issued in domestic and international markets, and denominated in local and foreign currency, is based.

Country comparison of general government debt securities in issue



Source: BIS

1 The data for South Africa's general government debt securities are reflected on pages S–54, S–55 and S–105 of the *Quarterly Bulletin*.

2 Four emerging market countries, namely Mexico, Thailand, Turkey and Russia were selected based on the availability of data on the Bank for International Settlements' (BIS) debt securities database and similarities regarding general government debt at nominal or face value, as well as the prevalence of both domestic issuance in local currency and international issuance in foreign currency.

3 The BIS debt securities database is harmonised based on the Handbook on Securities Statistics 2015 of the International Monetary Fund (IMF) (available at https://www.bis.org/publ/othp23.htm). Total debt securities measure issues by residents in all markets and currencies, and comprise domestic securities issued in the country where the borrower resides and international debt securities issued outside the country where the borrower resides.

4 The face value is the amount that the holder of the debt security receives at maturity and the nominal value is the face value including accrued interest not yet paid, less any repayments.

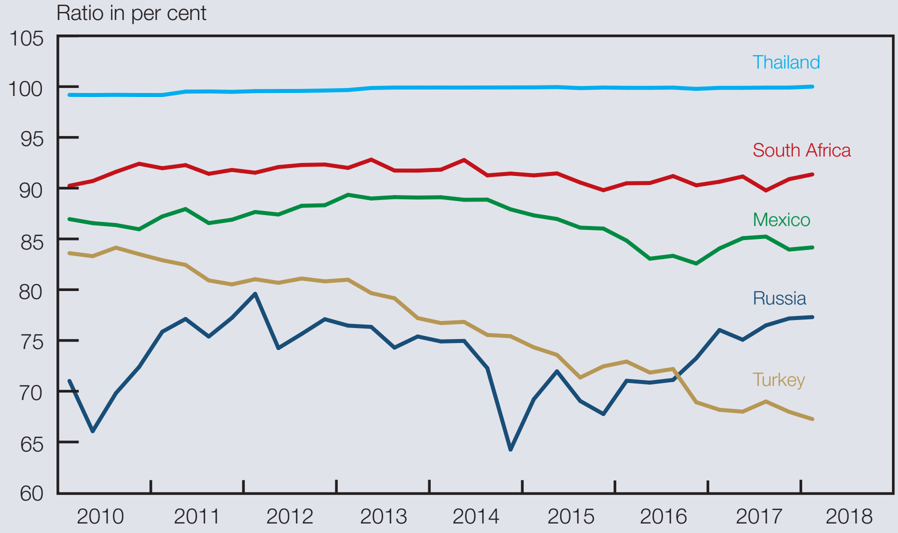
5 According to the Government Finance Statistics Manual 2014 of the IMF (available at https://www.imf.org/external/Pubs/FT/GFS/Manual/2014/gfsfinal.pdf), the general government sector consists of central, state, provincial, regional and local government units, as well as social security funds and unincorporated enterprises owned by government units that are integral parts of those units. In South Africa, general government comprises the central government, which consists of national government, social security funds and extra-budgetary institutions, as well as provincial and local governments. However, in this analysis, debt securities of South Africa's general government comprise only national and local governments.

6 Debt securities are negotiable financial instruments as defined in the Handbook on Securities Statistics 2015 of the IMF. In South Africa, it includes all listed debt securities of general government on the JSE Limited, national government's Treasury bills and all debt securities issued by general government in international markets.

The US dollar value of the stock of outstanding general government debt securities of the selected emerging market countries in domestic markets in local currency continued to exceed that in international markets in foreign currency. Since 2010, the outstanding amount of domestic market issues in local currency has only declined in Turkey, while Thailand's exposure to international markets remained fairly immaterial. The stock of debt in issue by Mexico and South Africa in domestic markets increased markedly over this period, while international markets remained an important source of funding for South Africa and Russia, and even more so for Mexico and Turkey which showed strong growth.

Debt denominated in foreign currency exposes general government to exchange rate risk, as the value of outstanding debt in foreign currency could increase materially when the borrower's local currency depreciates. The dominance of general government debt securities in issue in the domestic market in local currency is reflected by its ratio to total debt securities of general government for the various countries. The residual reflects the prevalence of debt in international markets and in foreign currency, which is exposed to exchange rate risk. Thailand's domestic debt securities in issue as a percentage of total debt has remained near 100% for a number of years, reflecting very limited currency exposure. Domestic debt securities also dominate in South Africa, Mexico and Russia. In South Africa's case, this is as a consequence of government setting risk benchmarks, whereby foreign debt is allocated a ceiling of 15% of total debt, and expected to be below 10% over the medium term.[7] In Mexico, the shift in financing from external to domestic debt after the Mexican peso crisis in 1994 is evident. By contrast, the share of domestic securities in Turkey has fallen steadily since 2010.

Country comparison of general government debt securities in issue in the domestic market in local currency to total debt securities

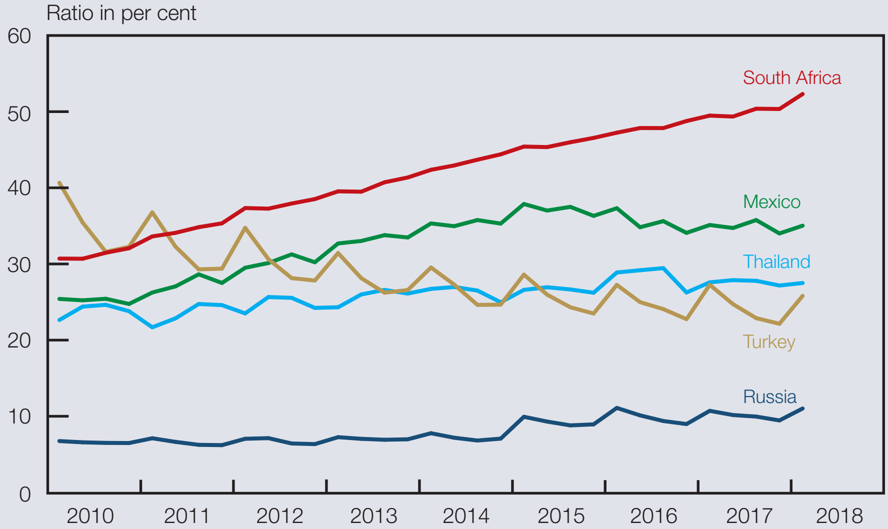


Source: BIS

The increase in the outstanding amount of total general government debt securities in the selected emerging market economies remained fairly proportionate to growth in nominal gross domestic product, in contrast to the fairly marked increased in this ratio in South Africa.

7 See the *2018 Budget Review* (Table 7.2 on page 83).

Total outstanding general government debt securities to nominal gross domestic product



Sources: BIS and IMF

Following the global financial crisis, low interest rates in advanced economies enticed foreign investors to search for higher yields in emerging market economies. However, large holdings of domestic debt securities in local currency by non-residents create external vulnerability, as exogenous events such as the tightening of monetary policy by some advanced economies and credit rating downgrades could trigger sell-offs.

In the sample of emerging market countries, foreign ownership of general government debt securities issued in domestic markets and in local currency ranged from 7.7% in Thailand to 42.3% in South Africa at the end of March 2018. This is not unique to South Africa, as non-residents' share of domestic debt securities in local currency is also relatively high in Russia and Mexico.

Total general government domestic debt securities in local currency in issue and non-residents' holdings as at 31 March 2018

	Outstanding amount (US$ billions)	Non-resident holdings (Per cent)
South Africa	191	42.3
Turkey	137	19.9
Mexico	362	31.9
Thailand	143	7.7
Russia	129	34.2

Sources: BIS, emerging market economies' central banks and National Treasury