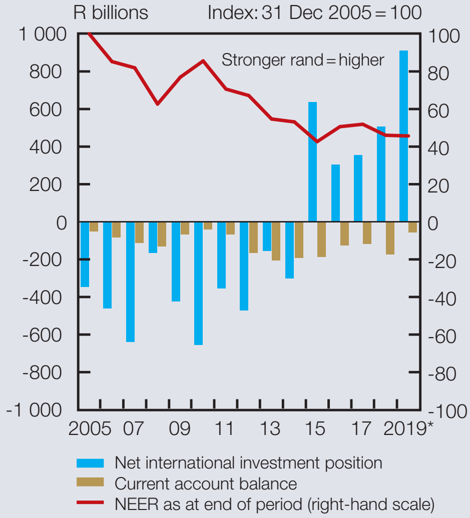
Box 3 The drivers of South Africa's international investment position[1, 2, 3]

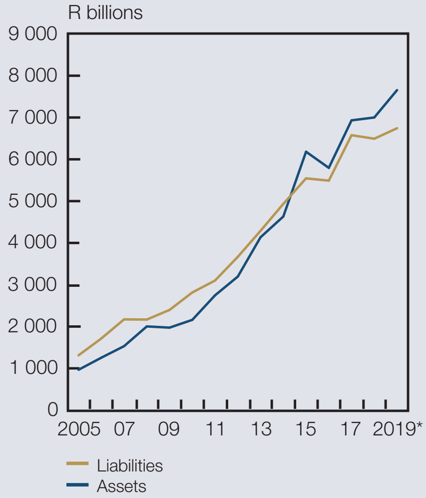
South Africa's international investment position (IIP) statistics dates back to as far as 1956, with the net IIP[4] only turning positive for the first time at the end of the third quarter of 2015. The integrated IIP statistical statement reconciles the difference between the opening and closing market values of foreign asset and liability positions over a specific period by accounting for financial account[5] transactions (flows) in financial assets and liabilities in the balance of payments,[6] revaluations due to price and exchange rate changes and also other volume changes such as write-offs.

Selected external account aggregates



* Q1 data
Sources: Stats SA and SARB

Foreign liabilities and assets of South Africa



This box discusses the drivers of the functional categories for both foreign assets and liabilities, while showing the effects of transactions and revaluations with reference to movements in domestic and foreign share prices and the nominal effective exchange rate (NEER) of the rand.

South Africa's interaction with the rest of the world through transactions as recorded in the current account[7] of the balance of payments renders the current account balance (i.e. the country's savings-investment gap). A current account deficit is financed through transactions in financial assets and liabilities recorded in the financial account, which is a driver of the foreign asset and liability positions in the IIP. Notwithstanding South Africa's persistent annual current account deficits since 2005, and the need for capital inflows through either an increase in foreign liabilities and/or a decrease in foreign assets, the stock of foreign assets (outward investment) exceeded that of foreign liabilities (inward investment) since the end of the third quarter of 2015. This caused the net IIP to switch from a net liability position of R346 billion at the end of 2005 to a net asset position of R508 billion at the end of 2018. The switch in the net IIP could largely be attributed to the effect of revaluations (accounting for changes in market values of foreign assets and liabilities due to price and exchange rate changes), which at times exceeded the contribution of financial account transactions to changes in liability and asset positions.

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1 The international investment position is a point-in-time statistical statement that shows the value and composition of the residents of a country's financial assets (i.e. claims on non-residents and gold bullion held as reserve assets) and liabilities (i.e. claims by non-residents on residents).

2 The methodology used to compile balance of payments statistics adheres to the guidelines of the *Balance of Payments and International Investment Position Manual – Sixth Edition (BPM6)* of the International Monetary Fund, available at www.imf.org/external/pubs/ft/bop/2007/pdf/bpm6.pdf

3 This box relates to the external account statistics shown on pages S–82, S–84, S–90, S–92, S–93 and S–109 of this *Quarterly Bulletin.*

4 The net IIP position is the difference between a country's foreign assets and liabilities.

5 The financial account shows the net acquisition/disposal of foreign financial assets by residents and the net acquisition/disposal of domestic assets by non-residents during a specific period.

6 The balance of payments is a statistical statement of transactions between residents and non-residents during a specific time period and consists of various sub-accounts, one of which is the financial account.

7 The current account shows flows of goods and services as well as primary and secondary income between residents and non-residents.

The main drivers of South Africa's net asset position were the price increases of direct investment assets due to significant gains on a large equity investment and the asymmetric effect of a depreciation in the exchange value of the rand on foreign assets and liabilities. With a depreciation in the exchange value of the rand, the market value of assets increase more than that of liabilities because a greater portion of assets is denominated in foreign currency compared with that of liabilities. However, conditions affecting revaluations change over time while the financing of the chronic current account deficit negatively affects the net IIP.

Both the IIP and the financial account of the balance of payments have the same functional categories, namely: direct investment, portfolio investment, financial derivatives, other investment and reserve assets, which reflect relationships between counterparties and the nature of the transaction and investment. Price and exchange rate changes, as part of revaluations, affect the functional categories differently depending on the market of issue and currency denomination.

International investment position and related indicators

	31 Dec 2005 R billions	31 Dec 2018 R billions	Compounded annual growth Per cent
Net international investment position	-346	508	
Foreign liabilities (inward investment)	1 312	6 493	13.1
Direct investment	612	1 888	9.1
Portfolio investment	524	3 541	15.8
Financial derivatives	13	91	16.2
Other investment	163	972	14.7
Foreign assets (outward investment)	966	7 000	16.5
Direct investment	196	3 425	24.6
Portfolio investment	432	2 168	13.2
Financial derivatives	11	91	17.2
Other investment	196	576	8.6
Reserve assets	130	742	14.3
	Index	Index	
FTSE/JSE All-Shares Price	18 097	52 737	8.6
S&P500	1 248	2 507	5.5
Nominal effective exchange rate of the rand	126.12	58.07	-5.8

Components may not add up to totals due to rounding off

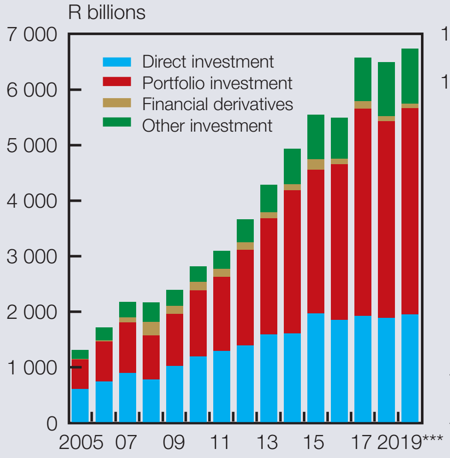
Source: SARB

Foreign direct investment liabilities comprise equity and investment fund shares as well as debt instruments, with the former only being rand denominated and the latter both rand and foreign currency denominated. Revaluations due to changes in the exchange rate of the rand are only affected by the foreign currency-denominated portion of debt instruments as part of foreign direct investment liabilities. Equity and investment fund shares of domestic direct investment enterprises are revalued to reflect both changes in the share prices on the JSE Limited as well as the reinvested earnings of unlisted companies.

Portfolio investment liabilities comprise non-resident investment in equity and investment fund shares as well as debt instruments, and accounts for the greatest portion of South Africa's foreign liabilities in the IIP. Equity and investment fund shares are exposed to revaluations due to changes in share prices, but not directly to exchange rate changes as these instruments are rand denominated. However, changes in the exchange rate of the rand do have an indirect effect to the extent that these companies' operations are exposed to foreign markets. Both rand and foreign currency-denominated debt instruments are exposed to revaluations due to changes in prices through the inverse relationship with bond yields. However, the debt exposure mainly consists of rand-denominated domestically issued government bonds which limit exposure to changes in the exchange rate of the rand to debt issued in foreign currency in international markets.

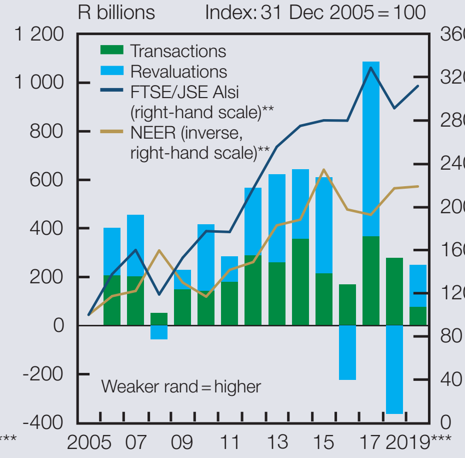
Financial derivatives can either be a liability or an asset, depending on changes in the price of the underlying instruments. Only financial derivative liability and asset positions of the domestic banking sector are recorded in the IIP and when settled at maturity it is expunged. Transactions and revaluations contribute roughly equally to changes in both foreign financial derivative liabilities and assets.

South Africa's foreign liabilities



Source: SARB

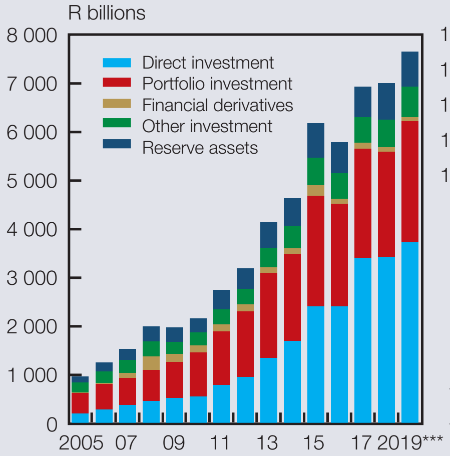
Transactions in, and revaluation of, foreign liabilities*



* The absolute annual change in the value of financial derivative assets is included in the valuation adjustment
** End of period
*** Q1 data

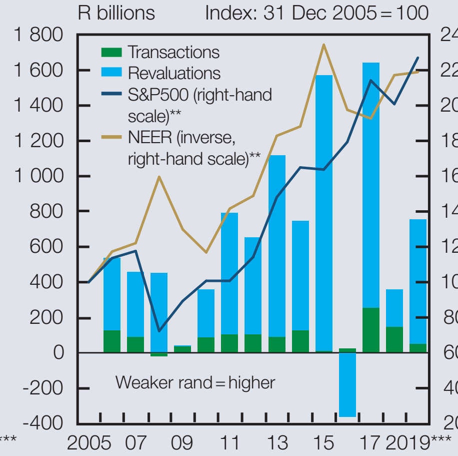
Other investment liabilities comprise currency and deposits, short- and long-term loans, trade credits, other accounts payable, and special drawing rights, some of which are denominated in rand and others in foreign currency. Only the foreign currency-denominated portion is exposed to exchange rate revaluation effects. These instruments are priced at nominal value and are thus not exposed to price changes.

South Africa's foreign assets



Source: SARB

Transactions in, and revaluation of, foreign assets*



* The absolute annual change in the value of financial derivative assets is included in the valuation adjustment
** End of period
*** Q1 data

Direct investment assets comprise equity and investment fund shares as well as debt instruments, with the former only foreign currency-denominated and the latter consisting of both rand and foreign currency-denominated debt owed to South African entities by a non-resident direct investor or direct investment enterprise. Direct investment assets grew more than any other foreign liability and asset functional category from the end of 2005 to the end of 2018. This is mostly attributable to a significant revaluation gain from the increase in the share price of a sizable investment by a South African company. The revaluation of equity and investment fund shares of foreign direct investment enterprises is influenced by changes in the share prices of such listed companies and the reinvested earnings of unlisted companies as well as exchange rate changes, since these assets are all foreign currency-denominated. The foreign currency-denominated portion of debt is affected by exchange rate changes.

Portfolio investment assets comprise resident investment in both equity and investment fund shares as well as debt instruments that are predominantly denominated in foreign currency, exposing it to revaluations due to changes in the exchange rate. These financial instruments are mostly listed on foreign bourses and exposed to revaluations from changes in share and bond prices. Compounded annual growth of 5.5% in the S&P500 Index and the decline of 5.8% in the NEER together contributed to a significant revaluation of South Africa's portfolio investment assets from the end of 2005 to the end of 2018.

Other investment assets consist of currency and deposits, short- and long-term loans, trade credits and other accounts payable, most of which are denominated in foreign currency and exposed to exchange rate revaluations. However, with all these instruments priced at nominal value, there are no revaluations necessary due to price changes.

Reserve assets are mostly affected by revaluations due to exchange rate changes and less so owing to changes in the prices of the underlying financial assets, which largely result from movements in international bond yields and significantly less from changes in the price of gold.