Box 2 The recent divergence between the outstanding value of cross-border assets and liabilities of South African banks[1, 2]

In South Africa, the outstanding value[3] of registered banks'[4] cross-border[5] assets and liabilities[6] both increased significantly from the fourth quarter of 2019 to the first quarter of 2020,[7] similar to that experienced by banks globally, as reported by the Bank for International Settlements (BIS).[8] This, in particular, reflected the significant

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1 This box relates to South Africa's locational banking statistics, published on pages S–26 and S–27 in this edition of the *Quarterly Bulletin.*

2 The methodology used to compile South Africa's international locational banking statistics adheres to the Bank for International Settlements' (BIS) 'Reporting guidelines and practices for the BIS international banking statistics', available at https://www.bis.org/statistics/bankstatsguide.htm

3 Securities at market value, with loans and deposits at nominal value.

4 Registered banks refer to South African banks (excluding mutual banks) registered under the Banks Act 94 of 1990 and include registered local or foreign controlled domestic private sector banks and the South African branches and subsidiaries of foreign banks.

5 Cross-border refers to South African banks' foreign asset and liability positions with non-resident counterparties located outside of South Africa.

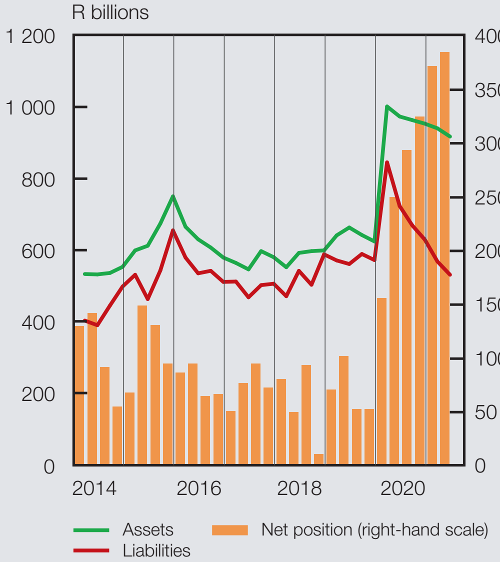
6 Cross-border assets consist of residents' claims against non-resident counterparties in domestic and foreign currency, while cross-border liabilities consist of non-resident claims on resident counterparties in domestic and foreign currency.

7 Measured as at the end of the quarter.

8 The BIS reported a noticeable increase in deposit liabilities and cross-border assets amid the COVID-19 pandemic. See 'BIS international banking statistics and global liquidity indicators at end-December 2020', available at https://www.bis.org/statistics/rppb2104.htm

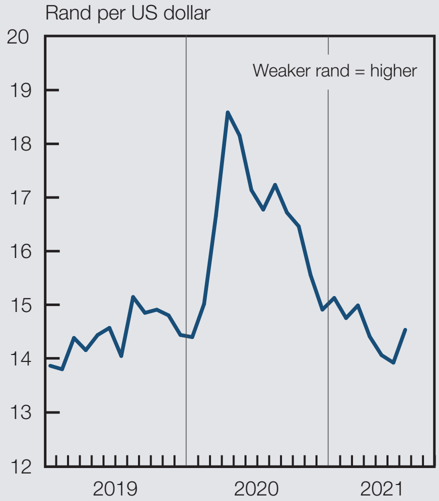
depreciation in the exchange value of the rand, largely in response to the impact of the coronavirus disease 2019 (COVID-19) on economic activity and financial markets globally. The recent divergence between the outstanding value of assets and liabilities also reflects, among other factors, the bigger impact of the exchange value of the rand on foreign assets than on liabilities due to the larger share of foreign assets denominated in foreign currency. This contributed to an increase in the placement of foreign deposits, the extension of loans and the holdings of debt securities, inclusive of new claims. With the subsequent decline in the outstanding value of liabilities exceeding that of assets, the net positive external position of banks increased to a record high in the second quarter of 2021.

South African banks' cross-border exposure



Source: SARB

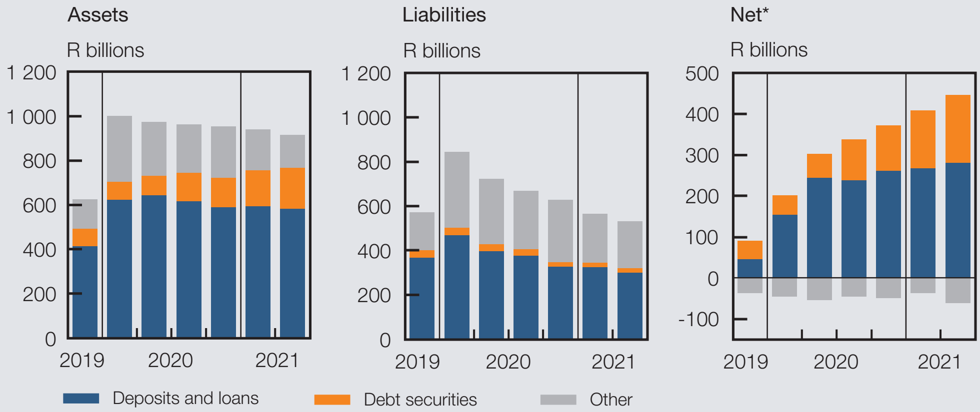
Exchange rate



This box analyses the drivers of the recent divergence between bank's cross-border assets and liabilities by unpacking the different dimensions of the underlying statistics.

When disaggregating cross-border assets and liabilities by financial instrument, the increase in assets in the first quarter of 2020 was, in general, evenly split between deposits placed and loans extended on the one hand and other assets on the other hand, whereas on the liability side, other liabilities were more dominant than deposits and loans received. Other assets and other liabilities predominantly comprised derivative positions, and at the end of the first quarter of 2020 contributed 91.0% and 79.6% respectively. The change in derivative positions reflects foreign exchange and asset price movements amid the onset of the COVID-19 pandemic. On a net asset basis, the largest increase in the first quarter of 2020 was in deposits placed and loans extended, followed by debt securities held, both of which increased throughout the period under review, whereas other instruments maintained a net liability external position.

Financial instruments



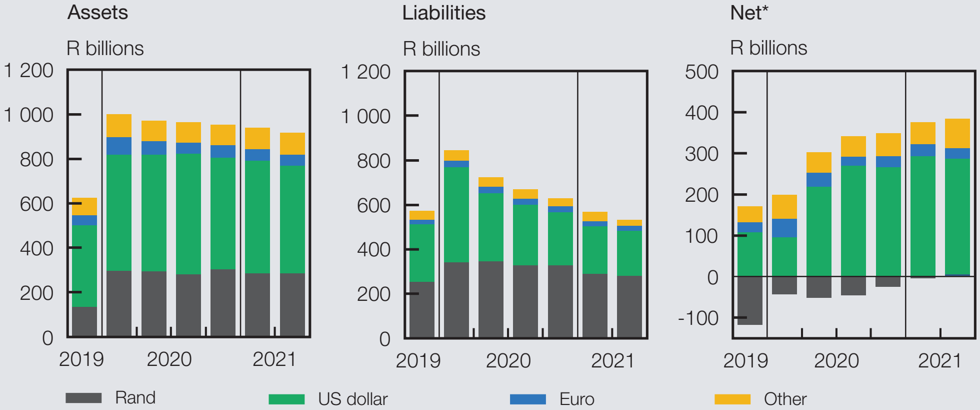
* Positive value = net asset; negative value = net liability

Source: SARB

After the unprecedented increase in the first quarter of 2020, the value of assets remained elevated while the value of liabilities reverted to pre-COVID-19 levels. The sustained high of assets partly reflected investment in short-term debt securities and the placement of surplus foreign currency positions from cross-currency foreign exchange swap transactions in the money market through repurchase transactions, hence the increase in loan assets.

The currency composition shows that heightened risk awareness at the onset of the pandemic favoured both United States (US) dollar-denominated assets and liabilities. This was supported by the US Federal Reserve's US dollar liquidity injection, which contributed to the attractiveness of shorter-term US dollar/rand trades. In addition, investors funded rand investments through short-term foreign currency swaps instead of outright purchases of the rand. The currency exposure to both US dollar assets and liabilities increased significantly in the first quarter of 2020. However, as the exposure to US dollar assets was maintained throughout the period under review, along with a decline in US dollar liabilities, the net asset position in US dollars increased, whereas the net liability position in rands decreased.

Currency

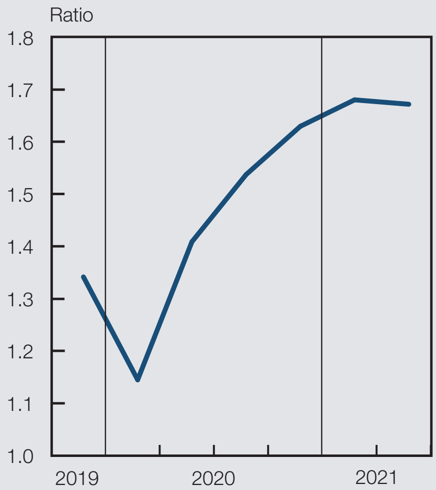


* Positive value = net asset; negative value = net liability

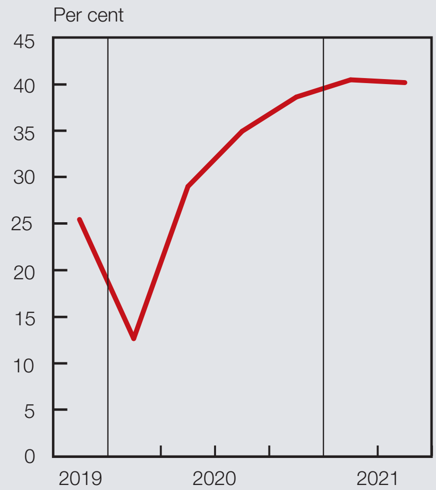
Source: SARB

The divergent movement between cross-border assets and liabilities denominated in foreign currency increased both the net foreign currency position[9] – which indicates how foreign currency assets increased more than liabilities – and the foreign currency margin,[10] with the latter increasing sharply from 13% in the first quarter of 2020 to 35% in the third quarter of 2020, and then more gradually in the ensuing three quarters.

Net foreign currency position



Foreign currency margin



Source: SARB

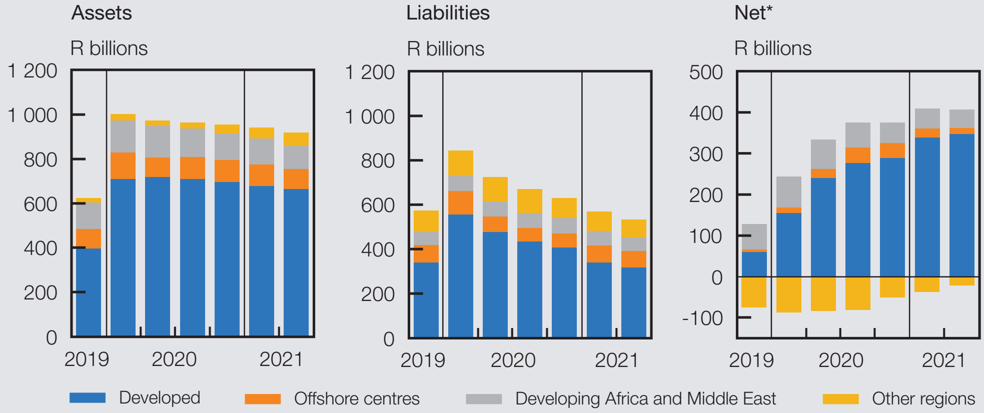
Globally, cross-border claims on and liabilities towards developed economies, denominated mostly in US dollars and mainly against the United Kingdom and the US, increased exponentially, according to the BIS. This was also the experience in South Africa, with both asset and liability positions against developed economies

9 The net foreign currency position constitutes cross-border assets and domestic assets denominated in foreign currency *divided* by cross-border liabilities and domestic liabilities denominated in foreign currency.

10 The foreign currency margin is calculated as 100 *minus* cross-border liabilities and domestic liabilities denominated in foreign currency *divided* by cross-border assets and domestic assets denominated in foreign currency. This is the margin by which foreign exchange assets exceeds foreign exchange liabilities. A positive value reflects a positive natural hedge and a negative value a negative hedge.

dominating, along with a growing net asset position. On a net basis, South Africa recorded a net negative liability position against other regions.

Counterparty region



* Positive value = net asset; negative value = net liability

Source: SARB

Cross-border assets as a percentage of total assets increased from 10.6% in the fourth quarter of 2019 to 14.0% in the second quarter of 2021, while cross-border liabilities as a percentage of total liabilities steadily decreased from 9.5% to 8.0% over the same period, widening the divergence.