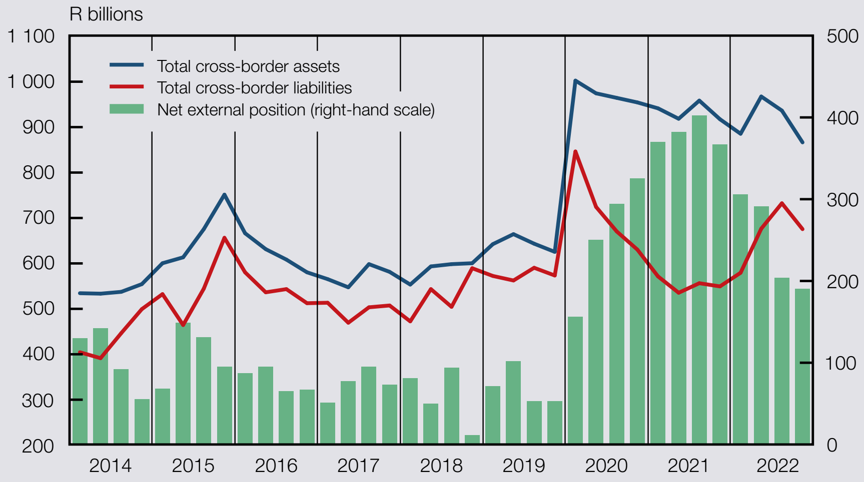
Box 1 The cross-border banking landscape[1] in South Africa since the onset of COVID-19

The aggregate cross-border activity of South African banks[2], although small[3] in comparison to the overall level of international banking activity as measured by the Bank for International Settlements (BIS), renders informative statistics to assess structural changes and associated risks such as those that have materialised since the onset of the coronavirus disease 2019 (COVID-19) pandemic. This box analyses these structural changes and underlying drivers since the onset of the pandemic.

A period of fairly stable cross-border assets and liabilities[4] was halted by COVID-19 as both increased to unprecedented levels in the first quarter of 2020 when, among other factors, the depreciation of the exchange value of the rand affected the value of foreign asset holdings and derivative contracts.[5] Thereafter, the value of cross-border assets remained elevated despite decreasing slightly in recent quarters, while the value of cross-border liabilities declined relatively quickly to pre-COVID-19 levels. The divergent movements between these assets and liabilities led to a record-high positive net external position[6] of R402 billion in September 2021 compared with an average of R66 billion for the eight quarters between March 2018 and December 2019. The positive net external position narrowed to R190 billion in December 2022 due to the subsequent increase in the value of liabilities from the second quarter of 2022. This was mostly related to an increase in the value of swap[7] and forward derivative[8] positions due to exchange rate movements as well as increases in call[9] and fixed[10] deposits and repurchase agreements.[11]

Cross-border position of South African banking sector



Source: SARB

The currency composition of cross-border assets and liabilities exposes such holdings to movements in the exchange value of the rand versus other currencies. In terms of foreign currency, the United States (US) dollar dominates both cross-border assets and cross-border liabilities. However, the total cross-border liabilities are dominated by the rand, which reduces exposure to currency movements. This partly explains the much larger increase in the value of cross-border assets than liabilities following the significant depreciation in the exchange value of the rand at the onset of the COVID-19 pandemic. Subsequently, the value of cross-border assets was further supported by, among other factors, measures by the South African Reserve Bank (SARB)

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

2 'South African banks' refers to banks registered under the Banks Act 94 of 1990 and includes registered local or foreign-controlled domestic private sector banks as well as the South African branches and subsidiaries of foreign banks. Mutual banks are excluded due to lack of cross-border activity.

3 The cross-border assets (claims) of most developed countries are approximately a third of total assets, on average, while the South African banking sector's cross-border assets and liabilities only average 13% and 10% respectively.

4 These are positions with non-resident counterparties, for example an asset (claim) or a liability against a counterparty located in a country other than South Africa.

5 A depreciation in the exchange value of the rand affects foreign asset holdings more than foreign liability holdings as a larger part of foreign assets is denominated in foreign currency than foreign liabilities.

6 The net external position is calculated as cross-border assets *minus* cross border-liabilities.

7 Swaps are financial over-the-counter (OTC) agreements between two parties who agree to exchange, over time and according to predetermined rules, streams of payment on an agreed notional principal amount.

8 Forwards are financial OTC agreements under which two counterparties agree to exchange a specified quantity of an underlying financial instrument at an agreed contract price (the 'strike' price) on a specified date.

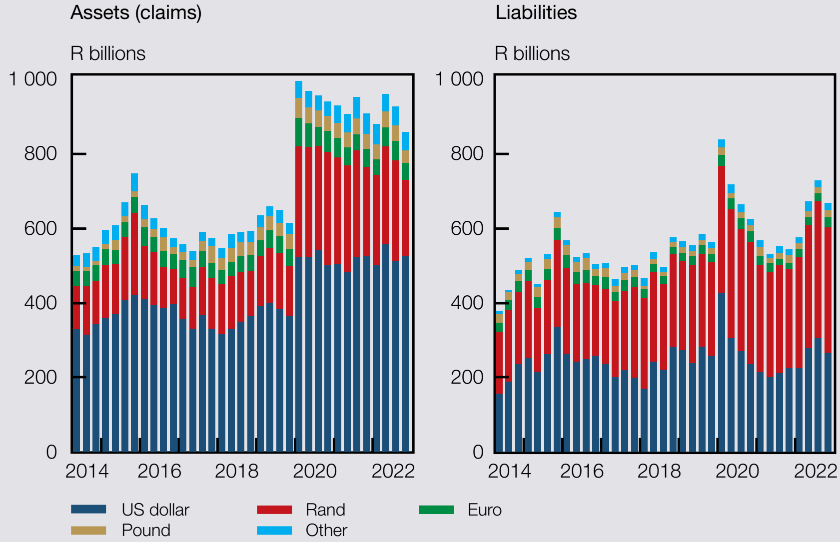
9 Call deposits have no restrictions, no fixed investment period and no notice period; they are not used to make third-party payments.

10 Fixed-term deposits have maturities ranging from one month to several years. When a fixed-term deposit is set, the funds can only be withdrawn after the term has ended or by giving a predetermined number of days' notice. If called up before the agreed term, the holder is charged a penalty.

11 Repurchase agreements are contractual arrangements involving the sale of securities for cash, at a specified price, with a commitment to repurchase the same or similar securities at a fixed price either on a specified future date or with an 'open' maturity.

to reduce the impact of the inflow of funds from the International Monetary Fund (IMF) and the World Bank in support of COVID-19 relief on domestic money market liquidity. The increase in cross-border assets of the South African banking sector reflected foreign exchange swaps by the SARB, which increased the US dollar liquidity of South African banks. Some of this excess liquidity was channelled into foreign investments by South African banks.[12]

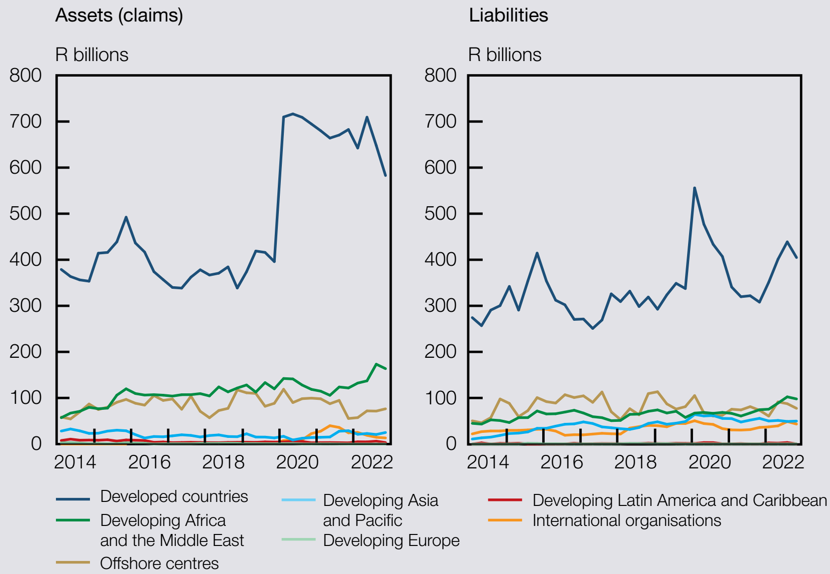
Currency composition of cross-border assets and liabilities



Source: SARB

Globally, the banking sector's cross-border assets (claims) surged during the COVID-19 pandemic as banks in most countries placed assets in developed countries, in particular the US and the United Kingdom (UK), and predominantly in the US dollar, according to the BIS.[13] Similarly, South African banks recorded a substantial increase in the value of cross-border assets placed in the US and UK, while exposure to Developing Africa and Middle East, the second-most prominent counterparty region, remained fairly stable, with Nigeria being the largest counterparty country. During the pandemic, South African banks' cross-border activity with the Developing Asia and Pacific region also increased, in particular with China.

Regional counterparty composition of cross-border assets and liabilities



Source: SARB

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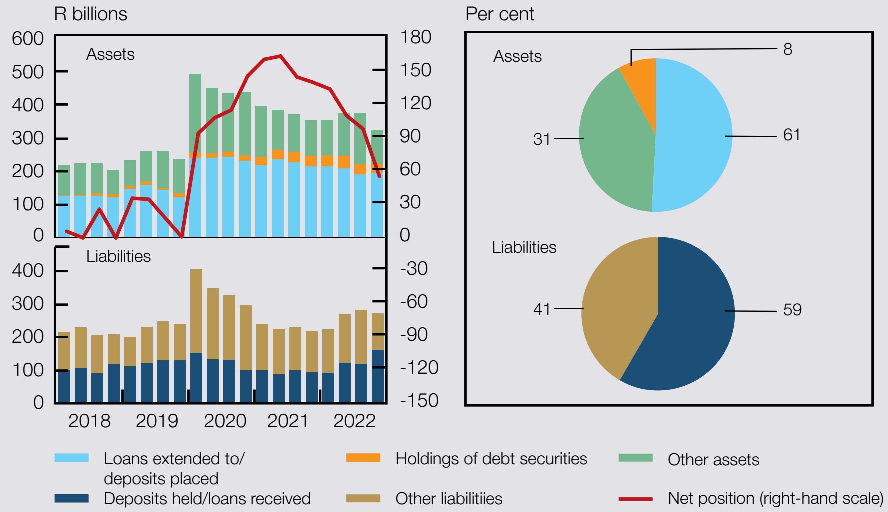
12 These foreign investments included Treasury bills of the US, Europe and the UK, as well as Canadian sovereigns and the placement of deposits with non-resident banks.

13 See https://www.bis.org/statistics/rppb2007.pdf

South African banks' largest cross-border exposure in terms of both assets (claims) and liabilities to a single jurisdiction is against the UK, with positions held mostly in the US dollar. As a prominent international banking hub, a large share of this reflects activity of banks from other countries with affiliates in the UK. South African banks' cross-border assets (claims) and liabilities with the UK amounted to R324 billion and R270 billion respectively at the end of December 2022. A fairly balanced and, at times, negative net external position with the UK turned into a significant positive net external position at the onset of COVID-19 before it deteriorated gradually although not returning to pre-COVID-19 levels.

South African banks' cross-border exposure against the UK*

Distribution as at December 2022



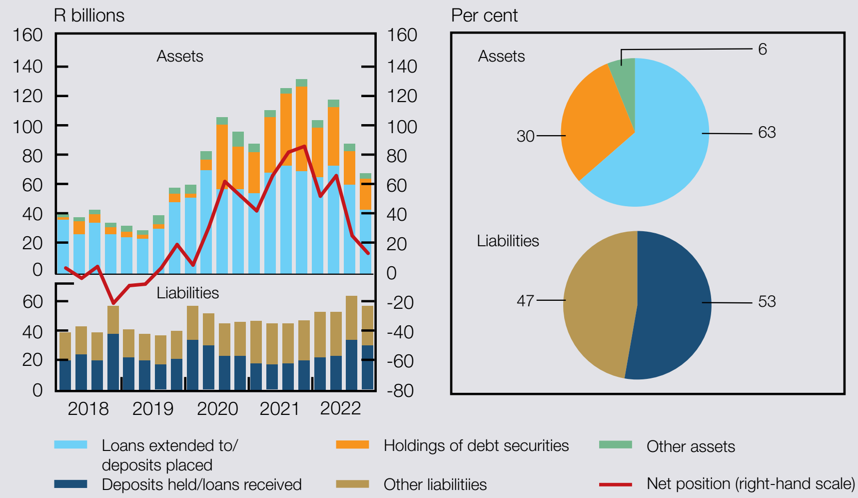
Source: SARB

* Holdings of debt securities issued by South African banks are not available per counterparty region as the identification of current holders is challenging, especially if the securities are held via custodians and are actively transacted in financial markets.

South African banks' second-largest counterparty exposure in terms of both assets (claims) and liabilities is with the US, with the asset position increasing significantly since the start of the COVID-19 pandemic. More recently, the value of cross-border US assets decreased to R70.0 billion, with liabilities amounting to R57.0 billion at the end of December 2022.

South African banks' cross-border exposure against the US*

Distribution as at December 2022



Source: SARB

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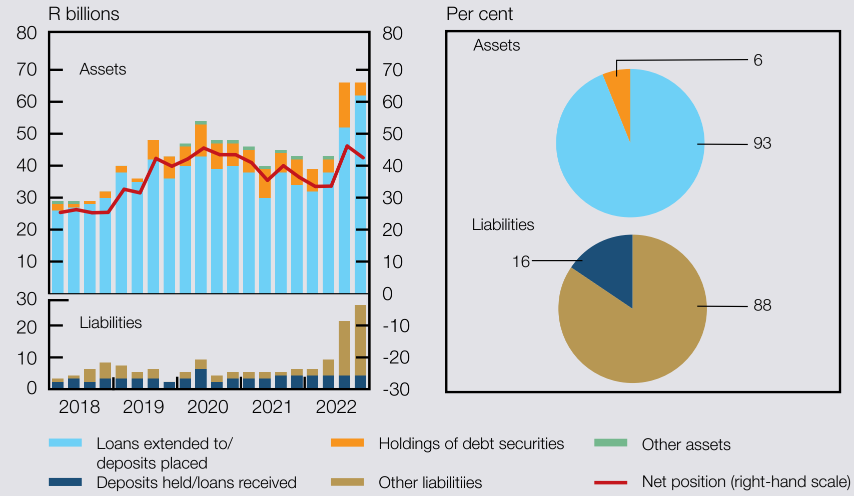
The elevated level of total cross-border assets (claims) against both the UK and the US since the onset of COVID-19 mostly reflected loans extended to and/or deposits placed with foreign banks, increases in inter-office positions[14] as well as increased holdings of foreign debt securities. South African banks placed funds with highly rated foreign banks, which increased their nostro[15] balances, and as collateral placements and investments in high-quality liquid assets (HQLA)[16] such as foreign Treasury bills and bonds.

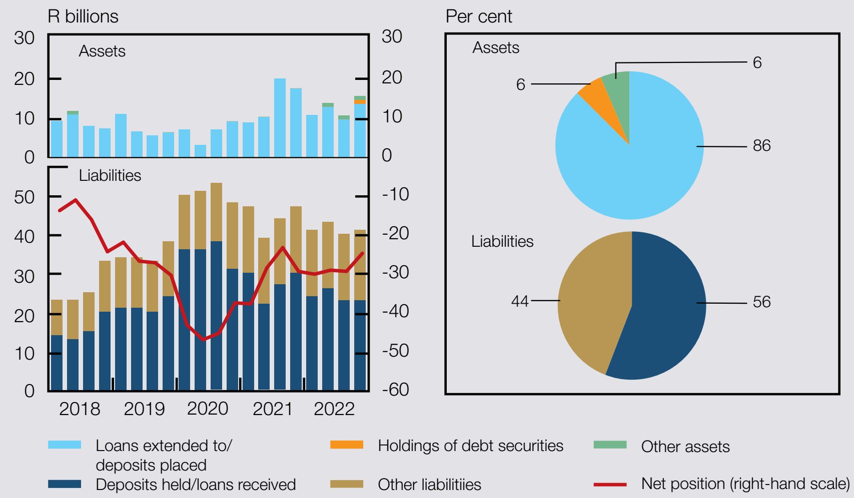
South African banks' cross-border exposure against Nigeria* | **Distribution as at December 2022**



Source: SARB

* Holdings of debt securities issued by South African banks are not available per counterparty region as the identification of current holders is challenging, especially if the securities are held via custodians and are actively transacted in financial markets.

South African banks' cross-border exposure against China* | **Distribution as at December 2022**



Source: SARB

* Holdings of debt securities issued by South African banks are not available per counterparty region as the identification of current holders is challenging, especially if the securities are held via custodians and are actively transacted in financial markets.

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14 Inter-office positions are all positions between any combination of the parent bank and its relevant branches or subsidiaries, including positions vis-à-vis relevant subsidiaries in South Africa but excluding inter-branch transactions between different offices of a bank in South Africa.

15 A nostro account refers to an account that a South African bank holds in a foreign currency in a foreign bank.

16 HQLA are assets that can easily and immediately be converted into cash at little or no loss of value. The liquidity coverage ratio (LCR) requirement under the Basel III regulations requires banks to hold HQLA sufficient to cover 100% of their stressed net cash requirements over 30 days.

South African banks' growing positive net external position with Nigeria moderated at the onset of COVID-19. This has changed more recently as South Africa's positive net external position began to increase again in the aftermath of the COVID-19 pandemic. This partly reflected the expansion of South African-domiciled multinationals into Africa. The South African banking sector's cross-border assets (claims) against Nigeria mainly reflected loans extended to and deposits placed with Nigerian banks at an average of 93% of total cross-border assets against Nigeria between the first quarter of 2020 and the fourth quarter of 2022.

South African banks' cross-border assets generally exceed their cross-border liabilities in the case of most countries. However, China is one of the few countries with which South African banks have a negative net external position. This is mainly due to inter-office positions of two domestic branches of prominent Chinese-domiciled banks. Most of the noticeable increases in cross-border assets in China towards the latter part of 2021 were due to the depreciation in the exchange value of the rand as well as increases in syndicated term loans.