Statement regarding the revaluation of South Africa's official gold reserves

*Issued by Senator the Honourable O. P. F. Horwood, Minister of Finance**

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On more than one occasion in the past I have stated that, once the proposed new Articles of Agreement of the International Monetary Fund came into effect, the gold holdings of the South African Reserve Bank would be revalued at market related prices. The new Fund Articles came into operation on 1 April this year, which means, among other things, that the official price of gold has been abolished and that the monetary authorities of Fund member countries are now legally free to buy and sell gold at market related prices. I therefore propose to proceed immediately with the planned gold revaluation, and I hereby announce that South Africa's official gold reserves will be revalued with effect from tomorrow, 11 April 1978.

Under the old IMF system of so-called "stable but adjustable exchange rates", South Africa, like all other member countries, had to declare a fixed "parity" price of gold in terms of its own currency. In addition, legal provision was made in South Africa for a "statutory" price at which the Reserve Bank had to value its gold holdings. This latter price was based on the parity price but set at a slightly lower level to provide for the costs incurred by the Bank in realising gold on overseas markets.

The statutory price was determined by Section 8 of the Currency and Exchanges Act, No. 9 of 1933 and, in the event of devaluations or revaluations of the currency, this price was usually changed by means of proclamations under Section 9 of the same Act. The last occasion on which this happened, was on 25 October 1972, when the statutory price was fixed at its present level of R29,55 per fine ounce, based on a parity price of R29,75 per fine ounce. When the rand was devalued in September 1975, the parity and statutory prices were not adjusted in accordance with the usual practice, as the IMF par value system had by that time already fallen into disuse.

Now that the new Fund Articles have come into operation and the official price of gold has been abolished, the South African rand, like all other Fund member currencies, no longer has a gold parity. The existing South African statutory price of R29,55 therefore no longer has any international legal basis. Moreover, since the gold price on the private market is currently about five times higher than the present South African statutory price, the latter has clearly become totally unrealistic. I have therefore decided that the time has now arrived to value South Africa's official gold holdings on a market related basis.

The necessary legal provision for the revaluation of our official gold holdings was made last year when Parliament passed the South African Reserve Bank Amendment Act, 1977. As provided for in Section 6 of that Act, the State President has today, by Proclamation in the Government Gazette, determined that the sections of the Act relating to revaluation and related matters, namely Sections 3 and 5, will come into operation on 11 April 1978.

Under the new IMF Articles there is no prescribed method of valuing official gold holdings. For the time being, many countries will probably continue to value their gold reserves at the old official price, a practice which will, no doubt, be encouraged by those who wish to reduce the monetary role of gold. However, countries such as France, Italy and Australia have already revalued their gold reserves on a market related basis, using different methods, and now that the new Articles are in operation I would not be surprised if several other countries were to follow suit.

After consultation with the Reserve Bank, I have decided that the new statutory or valuation price for the Reserve Bank's gold holdings will normally be fixed at the end of every calendar month at a level equal to the average of the last ten London fixing prices during that month, less 10 per cent. The first price to be determined according to the latter formula, with effect from tomorrow, will be R141,97 per fine ounce, which at the present rand-dollar exchange rate is equivalent to the average of the last ten London fixing prices in March, less 10 per cent, namely \$163,27 per fine ounce.

This is just one of several different valuation methods which could have been employed, but for a central bank which actually deals in gold on a substantial scale, this method has the advantage that the valuation price will tend to follow the movements of the market price reasonably closely. The 10 per cent deduction merely constitutes conservative bookkeeping designed to minimise the chances of the statutory price *exceeding* the market price by any significant amount for any length of time. In practice, therefore, the Reserve Bank's gold holdings will normally still be undervalued, but, of course, to a much smaller extent than at present.

I shall be taking this action under the new Section 17A(1) of the South African Reserve Bank Act, 1944, as amended, which comes into operation tomorrow and which confers upon the Minister of Finance the power to change the statutory price from time to time after consultation with the Reserve Bank. It follows from this that, if deemed desirable, I can at any time amend the valuation formula which I have just outlined.

In present circumstances, the proposed revaluation of the Reserve Bank's gold holdings will naturally result in a large book profit. The Bank at present holds nearly

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9,5 million ounces of gold, which at the old price of R29,55 is valued at about R280 million. At the new statutory price of R141,97 this gold will have a value of about R1 348 million. This means that the revaluation profit on the Bank's actual gold holdings will be about R1 068 million. To this must be added the profit on the gold involved in the Bank's existing swop arrangements. In total, the revaluation profit will then amount to about R1 690 million.

In terms of Section 8 *bis* of the Currency and Exchanges Act of 1933, any such profit shall accrue to the Government. This section is now being repealed, but the same principle is carried over into the new Section 17A of the Reserve Bank Act which comes into operation tomorrow. In terms of this latter section the Reserve Bank will be required to establish a new Gold Price Adjustment Account, in which it shall account for any profit or loss relating to gold as a result of a change in the statutory price as well as any difference between the statutory price and the price at which it buys or sells gold, after due allowance for handling and realisation costs. The gold revaluation profit will therefore immediately be credited to this Account.

From the point of view of monetary and fiscal policy, the way in which the large initial gold revaluation profit is to be used, is a matter of the greatest importance. The use of any significant part of this profit to finance government spending could, for example, have adverse consequences for the balance of payments and, in the long run, also for the rate of inflation. Using the gold revaluation profit in this way would increase the money supply substantially and be tantamount to using the printing press. It is therefore desirable to "sterilise" the profit to the fullest possible extent. The sections of the Reserve Bank Amendment Act which come into operation tomorrow have specifically been designed to provide for such sterilisation, while simultaneously serving certain other useful purposes.

In terms of Section 8 *ter* and 8 *quater* of the Currency and Exchanges Act, which are now also being repealed, any profits or losses made by the Reserve Bank on its foreign currency holdings, its forward exchange contracts and its foreign currency borrowings are also for the account of the Government. In all these cases, as in the case of gold losses or profits, this principle is to be carried over into the amended Reserve Bank Act, namely in the new Sections 17B and 17C. With effect from tomorrow, the Reserve Bank will be required to establish and manage, in addition to the new Gold Price Adjustment Account, also a Foreign Exchange Adjustment Account and a Forward Exchange Contracts Adjustment Account. These accounts will be similar to the accounts kept by the Bank in the past to give effect to the provisions of Sections 8 *ter* and 8 *quater* of the Currency and Exchanges Act.

A new and significant requirement is, however, included in the new Section 17D of the Reserve Bank Act. This section provides that any credit or debit balance on the three adjustment accounts specified in the Act shall at the close of each financial year of the Bank, or at such other times as the Bank and the Treasury may determine, be transferred to a new Gold and Foreign Exchange Contingency Reserve Account to be established and managed by the Bank on behalf of the Treasury.

It is further provided in Section 17D that any credit balance on this new Contingency Reserve Account shall accrue to the Government as a profit, but shall be carried forward in this Account until such time as the Treasury and the Bank deem it desirable to credit such profit or any part thereof to the State Revenue Fund. Similarly, any debit balance on this Account shall be a loss for the Government and shall be carried forward until the Treasury and the Bank deem it desirable to settle the outstanding balance.

When the relevant sections of the Reserve Bank Amendment Act come into operation tomorrow, all credit and debit balances presently existing on the accounts kept by the Bank for the purposes of the Currency and Exchanges Act, will also be transferred to the new Contingency Reserve Account.

The amounts involved here are substantial. The total amount owed by the Government to the Bank in respect of losses on foreign exchange holdings, gold transactions and forward exchange contracts is at present R1 134 million. In addition, account must be taken of the potential further loss, at present exchange rates, on existing forward exchange contracts, particularly in respect of foreign loans by public corporations denominated in German marks and Swiss francs. These losses could be substantial and, when they materialise, will also be a charge on the Government.

In these circumstances, the logical way to sterilise the gold revaluation profit is for the Government to use part of this profit to settle its outstanding debit balances on the accounts to which I have referred, and to transfer the rest of the profit to the new Gold and Foreign Exchange Contingency Reserve Account. In this manner two birds will be killed with one stone.

To attain these objectives the Treasury and the Reserve Bank have therefore decided, in terms of the new Section 17D(1) of the Reserve Bank Act, that the initial gold revaluation profit, which will in the first instance automatically be credited to the Gold Price Adjustment Account, will thereafter also be transferred to the new Contingency Reserve Account. The net effect of all these credits and debits will be to wipe the slate clean as far as the three adjustment accounts are concerned and to leave a credit balance in the new Contingency Reserve Account of R556 million.

With effect from tomorrow, the Reserve Bank will also terminate the present gold marketing arrangements under which it buys gold from the mines at the old official parity price and subsequently pays them a premium on gold sold by it on their behalf in private markets. In future the Bank will buy gold outright from the mines at current market prices according to an agreed formula, which makes provision for the deduction of a small realisation charge by the Bank to cover freight, insurance and related costs.

Now that the official price of gold has been abolished by international agreement, the existing arrangements in regard to gold sold in terms of the Mozambique Convention will also be terminated with effect from 11 April 1978. This means that the gold mines will no longer have to dispose of a portion of their output, via the Reserve Bank, to the Mozambique authorities *at the old parity price*, in order to comply with the section of the Convention dealing with the deferred pay of mine workers from Mozambique. In future the mines will receive the *market price* for all the gold sold by them to the Reserve Bank. This will obviously benefit both the gold mining industry and the balance of payments.

I turn finally to the effect of the gold revaluation on the official foreign reserves. Since South Africa always holds a substantial portion of its official foreign reserves in the form of gold, the past practice of valuing the Reserve Bank's gold holdings at only R29,55 per ounce has obviously resulted in a gross undervaluation of the total reserves. This has at times created misleading impressions about South Africa's reserve position. The decision now taken to revalue the gold holdings at market related prices will not, of course, by itself strengthen our reserves in any real sense – throughout the period of undervaluation there has, in effect, been a "secret reserve". But the use of the new valuation method will produce more realistic published reserves which will reflect the true state of affairs more accurately.

Following tomorrow's gold revaluation, the Reserve Bank's gold and other foreign reserves will amount to about R1 700 million, compared with R634 million at the end of March 1978. To this must be added the reserves of the central government and the rest of the banking sector, which will bring the figure for South Africa's total gold and other foreign reserves to the vicinity of R1 830 million, compared with R761 million at the end of February 1978.

Mr. Speaker, I believe all Members of the House will agree that the simultaneous introduction of the new gold valuation formula, the new gold marketing arrangements and the new legal provisions regarding the Reserve Bank's accounting system, represents an important milestone in South Africa's monetary history. It marks the end of one era and the beginning of another. The so-called Bretton Woods international monetary system has come and gone. But gold is alive and well, and the steps I have announced today serve as yet another indication of its enhanced monetary role in a world of inflation and currency turmoil.