

Statement issued by Dr C.L. Stals, Governor of the South African Reserve Bank, on exchange control and on the forward foreign exchange market

13 July 1995

1. Foreign investment by South African institutional investors

In announcing the abolition of the financial rand system on 10 March 1995, the Minister of Finance alluded to the demand for foreign assets by various types of institutional investors to enable them to achieve a wider spread of their assets. The Reserve Bank subsequently made a submission to the Government and proposed some further relaxations of the exchange controls, which were recently approved by the Cabinet.

In order to assist insurance companies, pension funds and unit trusts in achieving this goal, it has been decided to allow such institutions at this juncture to invest a portion of their assets abroad. This will enable the relevant institutional investors to better serve the interests of their clients, that is, the wider public. It should be noted that these institutions, on a combined basis, at present administer approximately R500 billion of funds, with negligible investments in foreign assets. Having regard to the relatively low level of the country's foreign reserves, currently around R12,5 billion, approval cannot be granted at this stage for an open-ended transfer abroad of foreign currency for investment purposes.

On the advice of the South African Reserve Bank, the Government has therefore decided, as a first step, to allow institutions of the nature outlined above to put forward to the exchange control authorities proposals whereby they can obtain foreign investments by way of swap arrangements providing for the exchange with foreign investors of part of their existing asset portfolios for foreign assets. The principles involved will also be discussed with the Financial Services Board to ensure that all legal requirements, for example, in respect of domestic asset cover, are adhered to. Proposals by these institutions, incorporating measures to safeguard the foreign exchange reserves against the subsequent withdrawal from South Africa of the reciprocal non-resident investments, may now be submitted for consideration to the Exchange Control Department of the South African Reserve Bank. Each application will be dealt with on its own merit. If permitted by future increases in the foreign reserves, these swaps may also be supplemented by cash allocations to the South African institutional investors for the purpose of acquiring foreign assets.

This arrangement should be seen as a further step in the process of gradually easing exchange control.

2. Forward foreign exchange market

In terms of long-standing arrangements, the Reserve Bank has for many years provided forward cover in

foreign exchange for both payers and recipients of foreign exchange, linked to South Africa's international transactions in goods, services and capital. The Reserve Bank has determined rates for forward cover of different maturities, based on the differences between South African and comparable international interest rates. Profits and losses on these transactions have been for the account of the Treasury.

Both the Department of Finance and the Reserve Bank have from time to time expressed a desire for the Reserve Bank to reduce its involvement in the forward foreign exchange market when circumstances allow. Owing to the foreign exchange problems that South Africa has experienced since 1985, including large obligations to redeem foreign debt and the low level of the country's net foreign reserves, no progress has been made during this period towards achieving this objective.

In view of the political changes that have taken place in South Africa, followed by the normalisation of South Africa's international economic and financial relationships and the improvement in the foreign reserve position, it has now become desirable to reassess the Reserve Bank's role in the forward foreign exchange market. Steps are now being considered to start decreasing the Bank's involvement in the short-term forward market. It is the intention of the Bank in future:

- (a) only to provide forward cover to authorised dealers against documentary evidence of foreign financing transactions; and
- (b) to leave it to exporters and importers of goods and services to develop a "private" forward market in conjunction with the authorised dealers – the Reserve Bank may from time to time decide to participate in this market, but then at its own initiative.

The market has already been encouraged to develop along these lines, and the Reserve Bank's quoted rates for forward cover will soon be restricted to underlying offshore financing transactions approved by the Bank. Details of acceptable transactions will be made available by the Bank to the authorised dealers in foreign exchange within the next few days. Follow-up steps will be taken in due course to further reduce the Reserve Bank's involvement in the forward foreign exchange market, for example, by gradually quoting less favourable rates for foreign financing transactions.

Where necessary, the exchange control rules and regulations pertaining to asset swaps and to the

forward market will be amended in due course. Once the private market, supported by the authorised dealers, has been more firmly established and can function without regular Reserve Bank participation, the further revision of the relevant rules and regulations will be considered.