SOUTH AFRICA'S FINANCIAL MARKETS WITHIN THE SOUTHERN AFRICAN SUB-REGION

Address by Mr T.T. Mboweni,
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at the Namibian Stock Exchange,
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Honoured guests,
Finalists of the schools competition,
Teachers of finalists of the competition,
Sponsors of the competition, and
Ladies and gentlemen

1. Introduction

It is with great pleasure that I present this address at your annual dinner. The initiative of the Namibian Stock Exchange (NSX) to enhance awareness of its activities in the countryside through the *Scholar Investment Challenge* is indeed a commendable one. This competition raises awareness of financial markets and investment in listed shares among the many participants drawn from a broad cross-section of the Namibian population. I am sure we have amongst the finalists in our midst today some of the stockbrokers of the future.

2. Common membership of regional initiatives

Namibia and South Africa share common membership of a number of regional co-operation initiatives. Three of these that come to mind are the Southern African Development Community (SADC); the Southern African Customs Union (SACU); and the Common Monetary Area (CMA). Moreover, the Bank of Namibia and the South African Reserve Bank are active participants in the Committee of Central Bank Governors in SADC and the Association of African Central Banks.

Of these regional co-operation initiatives, the CMA is the smallest in terms of the number of member countries. However, it is the initiative with the most direct bearing on monetary policy and financial market issues. The CMA comprises South Africa, Namibia, Lesotho and Swaziland. Previously it existed as an informal arrangement and included Botswana. In 1976 the arrangement was formalised in a series of bi-lateral agreements. At this point Botswana chose not to join the monetary area and Namibia joined after independence in 1990. Although member countries have their own currencies, these currencies trade at par and are pegged to the South African rand. Member countries also apply broadly similar exchange control measures. This currency arrangement has various implications for the CMA countries and their central banks. I wish to mention three of these today.

First, the South African Reserve Bank leads the way in setting monetary policy for the CMA countries. However we do take cognisance of the views of the partner banks in periodic meetings of the CMA governors prior to the meetings of the Monetary Policy Committee.

Secondly, South Africa has adopted inflation targeting as its nominal anchor for monetary policy in February 2000. The target is to keep CPIX inflation (that is, headline inflation excluding mortgage interest costs) within a range of 3 to 6 per cent. This policy has served the interests not only of South Africa, but also of its CMA partners, as is evidenced by the fact that the South African rate of inflation used for targeting purposes has remained inside the target range since September 2003. The CMA partner countries have also reaped similar benefits; for example, the inflation rate in Namibia has declined from 9,3 per cent in 2000 to 2,3 per cent in 2005. I will say a bit more about South Africa's monetary policy later on.

Lastly, the possibility of establishing a central bank for the CMA countries is raised from time to time. A study was conducted in 2005 under the auspices of the CCBG outlining the costs and benefits of the creation of a common central bank for the CMA countries. However, decisions in this regard will be taken by the political leaders of the CMA countries, rather than by central bankers. This is probably a matter of particular importance for our younger audience, as they might perhaps find employment at this institution one day.

4. Exchange controls and related tax amnesty

In view of the high degree of regional co-operation discussed above, it is necessary to make mention of the successful exchange controls and related tax amnesty of South Africa. This amnesty was announced by the South African Minister of Finance, Trevor Manuel, in February 2003.

The amnesty was announced against the background of an extensive system of exchange controls that have been in place in South Africa for a considerable period of time. Since democratic elections in South Africa in 1994, considerable progress has been made with the gradual liberalisation of controls. Measures included the abolition of the financial rand and the introduction of liberal foreign investment allowances for South African companies. This was particularly the case for investment in Africa. In addition, the foreign investment allowances for South African individuals have been increased over time to the current level of R2 million per individual.

The announcement of the amnesty was a next step in the gradual relaxation of exchange controls. The amnesty had as its four goals the broadening of the domestic tax base; provision of an opportunity to South Africans to regularise their affairs without fear of prosecution; provision of updated information to the South African Reserve Bank and the South African Revenue Service; and facilitation of repatriation of foreign assets to South Africa without fear of recrimination.

The amnesty succeeded beyond all expectations of the authorities. More than 42 000 people applied for amnesty and more than 99 per cent of these applicants were granted amnesty. All four stated goals of the amnesty were achieved.

First, amnesty applicants disclosed undeclared receipts and accruals amounting to R1,36 billion, which will increase the personal income tax base by an estimated R400 million. Secondly, applicants who disclosed previously unauthorised assets are shielded from prosecution. Moreover, the amnesty legislation also relieved banks and financial advisors from reporting responsibilities in terms of the South African Financial Intelligence Centre Act, thus protecting the applicants.

In terms of the third objective, applicants disclosed around R 68,9 billion in foreign assets, of which R 45 billion constituted unauthorised foreign assets. Fourthly, the amnesty process facilitated the repatriation of funds to South Africa.

Applicants paid a total of R 2,87 billion in amnesty levies in respect of unauthorised foreign assets. These levies amount to some 0,7 per cent of total tax collections of the central government in the 2005/06 fiscal year, and to some 2,3 per cent of personal income tax for the same period.

The successful completion of the amnesty in South Africa is a further step in the direction of complete exchange control liberalisation. The stated objective of the South African government is to proceed with a gradual relaxation of controls. Relatively few controls remain, so much so that when full abolition is announced, it will most likely be a non-event.

5. The South African financial markets

Financial market developments in South Africa have significant implications for financial markets in the region. I would therefore like to share with you some key features of the South African financial markets. Starting with the equity market, the JSE is one of the oldest stock exchanges in the world, having been established as far back as 1886. In its 120 years of existence, it has developed into the 17th biggest stock exchange in the world – a remarkable achievement for an emerging market country like South Africa.

Over recent years, there have been a number of important developments in the JSE, which contributed to its efficiency and global standing. Trading is fully automated through an electronic clearing and settlement system, the STRATE system (Share TRAnsactions Totally Electronic). The product base of the JSE has also expanded to include not only shares, but also a range of equity, commodity and interest rate derivatives.

In 2002, the JSE entered into a strategic alliance with the London Stock Exchange (LSE). This alliance led to a number of further improvements, such as the implementation of a new trading system and an indexing system that is aligned to that of the JSE, as well as the adoption of listing requirements that are in line with international best practice. These developments enhanced the profile of the JSE, in particular to international investors.

The latest development in the history of the JSE was its own demutualisation in 2005. It became a public unlisted company on 1 July 2005, and listed on its own exchange a year later.

At the end of 2005, the JSE had a market capitalisation of R3,6 trillion, with 388 companies listed on the exchange. Just over 60 of these companies are listed on at least two other stock exchanges. Some have up to seven listings, including listings on the major exchanges of the world. Turnover on the JSE has shown strong growth over recent years, increasing from an annual turnover of R22 billion in 1992 to R1 279 billion in 2005.

Alongside the equity market, the South African bond market is also formalised in the form of the Bond Exchange of South Africa (Besa), which was established 10 years ago, in 1996. As at 31 December 2005, Besa had granted a listing to 493 debt securities, issued by 71 borrowers, with a total nominal value of R637 billion – equal to just over 40 per cent of gross domestic product (GDP). All bonds have been dematerialised and trading has been fully automated.

Government bonds comprise around 60 per cent of the bonds listed on Besa, with the rest consisting of bonds issued by parastatals and corporates. Corporate bond issuances are currently increasing at a much faster rate than government bond issuances. The annual turnover on Besa has increased from R2,1 trillion in 1995 to R8,1 trillion in 2005. The annual turnover is currently about 38 times the market capitalisation, indicating good overall liquidity. In the current year to date, the turnover on Besa has already exceeded that of the full year of 2005.

Developed domestic bond markets not only provide for an additional channel for domestic savings mobilisation, they also provide valuable information to the MPC. Expected monetary policy developments are reflected in bond yields and we, in turn, get a lot of information from the bond market about market expectations concerning future monetary policy, inflation and growth.

Non-residents are active participants in the South African capital markets, accounting for around 20 per cent of daily turnover on both the JSE and Besa. In the year to the end of September, non-residents have bought a net R59 billion worth of South African equities compared to R50 billion in 2005. Net purchases of bonds have amounted to R20 billion, compared to net sales of R11 billion last year. In addition to improving the liquidity of our capital markets, these purchases help to finance South Africa's current account deficit.

The participation of non-residents in the domestic financial markets is facilitated by a liquid market for foreign exchange. The average daily turnover against rand in the South African foreign exchange market is around USD10 billion, and non-residents account for around 65 per cent of these transactions. However, one downside of such a liquid market is that it tends to make the rand (and, of course, the Namibian dollar with it) much more volatile than the currencies of other emerging-market currencies with less liquid foreign exchange markets.

6. The NSX and the JSE Limited

Compared to the JSE, the NSX is still young, as it was established 14 years ago in 1992. However, the establishment of an exchange represented an important step forward for Namibia in the development of its capital market, and in providing an important avenue for domestic savings mobilisation.

The success of the NSX is illustrated by the fact that by 2005 it was the second largest African stock exchange in terms of total market capitalisation and the fifth largest in terms of traded value. Currently, 28 companies are listed on the NSX; a high number of which have a dual listing on the JSE. The NSX was also the first exchange in SADC to start using the JSE's electronic trading system (the Jet system) in November 1998. Share trading on the NSX of dual-listed South African companies is settled through STRATE. The existence of dual-listings improves the liquidity and turnover on the NSX, making these shares more attractive to investors. While benefiting from its close relationship with the JSE, the NSX retains control over its own listing requirements, regulations and supervision over compliance, and can adapt these according to the requirements of the domestic economy.

The NSX and the JSE are both founder members of the Committee of SADC Stock Exchanges (COSSE). The Committee of SADC Ministers for Finance and Investment agreed to recognise COSSE as a private sector association at their meeting held on 18 July 1997 in South Africa. In terms of the aims of COSSE, the NSX and the JSE play an important role in the institutional structures of stock exchanges in SADC. Among others, COSSE has set itself the challenging goal of establishing by 2008 an integrated real-time network of the national securities markets within SADC, thus facilitating progress with the process of financial integration within the SADC region. This will pave the way towards cross-border listings and, therefore, trading and investments among the different Member Exchanges of SADC. However, like all successful developments in market infrastructure, this should also be driven by market participants, who will seek the optimum balance between cost and risk.

7. Recent monetary policy developments in South Africa

As I indicated earlier, the existence of the CMA implies that South Africa effectively determines monetary policy for the whole CMA. CPIX inflation has been within the inflation target range since September 2003 and averaged 4,3 per cent and 3,9 per cent in 2004 and 2005 respectively. Since March of this year, CPIX inflation has been steadily rising, mainly as a result of rising energy and food prices, and in August inflation increased at a year-on-year rate of 5 per cent.

Buoyant consumer demand, which increased at an annualised rate of 8 per cent in the second quarter of this year, has been posing a further risk to the inflation outlook. This demand has been fuelled by credit extension growth in excess of 25 per cent. These developments contributed to the expanding current account deficit which measured in excess of 6 cent of GDP in each of the first two quarters of this year. This is turn has contributed to the recent weakness in the rand, which has depreciated on a trade weighted basis by approximately 23 per cent since early May. This degree of depreciation, in turn, poses a further risk to the inflation outlook.

In response to these developments, the Monetary Policy Committee of the South African Reserve Bank has raised the repo rate by 50 basis points at each of the past two meetings of the Monetary Policy Committee. This change in the monetary policy stance has occurred against the backdrop of a strongly growing domestic economy. South Africa’s economic growth averaged 4,5 per cent and 4,9 per cent in 2004 and 2005 respectively. Despite the change in the monetary policy stance, we do not anticipate that growth prospects will be significantly undermined. Our focus, however, remains on the inflation target, and we will continue to strive to maintain CPIX inflation within the 3-to-6 per cent target range.

6. Conclusion

The NSX *Scholar Investment Challenge* is similar to the competition introduced 34 years ago by the JSE for South Africa schools. The competition is a major success in South Africa, and it seems to me that the same can be said about the Namibian competition. This competition teaches participants the fundamentals of investment strategies and financial markets and encourages them to develop an interest in the trading of shares on the NSX. I trust that participation in this competition has introduced new possible career choices to the participants.

The teachers accompanying the participants also deserve special recognition. Your care and commitment has laid an important foundation in the lives of the finalists. Likewise, the sponsors of the competition have made it possible for the finalists to be here today and they have also assisted in broadening the intellectual horizon of the participants in the competition. We trust that the knowledge gained about financial markets will spur many of them to greater heights in the corporate world in the future.

Naturally, only one team can win this competition, but I must stress that all participants attending tonight should really be regarded as winners. To make it to one of the top five positions in this competition is a major accomplishment. My best wishes accompany all of you in your careers ahead of you, as you have already shown your dedication to the achievement of your goals.

Thank you.