JOINT MANAGEMENT OF FOREIGN RESERVES AND FUNDS IN SOUTH AFRICA

Workshop on Asset and Liability Management

Presenter: Johan Redelinghuys | Chief Director, National Treasury | 2 October 2013
• Start of building foreign reserves by South African Reserve Bank
• 2005, assistance by National Treasury
• 2010, assistance by National Treasury
• Joint management arrangements/challenges
• Benefits of assisting Reserve Bank to increase foreign reserves
Negative net reserves, Net Open Forward Position (NOFP)
2003, elimination of NOFP

- Policy decision made to eliminate NOFP
- NOFP eliminated through:
  - National Treasury international borrowing;
  - Reserve Bank foreign exchange purchases; and
  - Cash payments/bond issuance to settle losses on Gold and Foreign Exchange Reserve Account (GFECRA)
2003/04, Reserve Bank starts to accumulate foreign reserves

- Purchase of FX in domestic market by Reserve Bank
- Excess money market liquidity as a result of FX purchases sterilised through:
  - Debenture issuance;
  - Repo transactions in bonds; and
  - Cash reserve requirements of banks
- Following issues arose:
  - Ownership; and
  - Costs
    - Settlement arrangements for future GFECRA profits/losses; and
    - Ability of Reserve Bank to carry sterilisation costs
2005, start of National Treasury’s assistance to increase foreign reserves

• Rationale for National Treasury to assist the Reserve Bank:
  – There was a need to increase foreign reserves;
  – Reserve Bank could no longer carry sterilisation cost;
  – Government’s budget surplus/net negative borrowing requirement; and
  – The need to maintain issuance levels (support money/capital market liquidity)

• Cash surplus deposited with Reserve Bank to sterilise excess liquidity from FX purchases (Rand sterilisation deposits)

• Question of holding Rand deposits or FX deposits with Reserve Bank

• Ownership issue again arose
2009, National Treasury’s assistance stopped due to increasing borrowing requirement

- As a result of the global economic crisis:
  - Lower tax revenue, higher deficit, high borrowing requirement; and
  - No further assistance to increase foreign reserves due to funding pressures
- Sterilisation deposits became attractive funding source
- Use of sterilisation deposits would add to money market liquidity
- Reserve Bank allow use of part of sterilisation deposits as short-term bridging finance
2010, National Treasury assistance to increase foreign reserves resumed

• Rational for reassuming assistance:
  – Rand strengthened substantially/volatile due to large foreign capital inflows;
  – Large Foreign Direct Investment (FDI) flows could add to volatility;
  – Rand was at attractive levels to purchase FX;
  – Politically had to show commitment to stabilise Rand volatility; and
  – Reserve Bank could not afford sterilisation cost
• National Treasury agreed to assist through:
  – FX purchases using proceeds from higher domestic issuance;
  – National Treasury FX purchases kept as FX deposit at Reserve Bank for future use;
  – Supporting FX swaps by Reserve Bank to minimise impact of FDI flows;
  – Commitment by National Treasury to settle FX swaps in future; and
  – Government’s international borrowing proceeds kept as FX deposits with Reserve Bank
Joint management arrangements/challenges

- Government’s commitment to assist Reserve Bank and management arrangements of deposits needed to be formalised:
  - No formal legal agreements, agreement by letter exchange;
  - Investment mandate for FX deposits provided; and
  - Participation in Investment Committee (observer status)
- Agreement on monthly reporting framework
- Ring-fencing from rest of foreign reserves or not?
- Agreement on returns
- Unpredictability of interest returns for budget purposes
- Agree annually on an optimal level of foreign reserves and strategy to increase levels
Benefits of assisting Reserve Bank to increase levels of foreign reserves

- Accumulated surplus cash pool which could be used when markets are not accessible
  - Rand sterilisation deposits for use as bridging finance; and
  - FX deposits as bridging finance to meet FX or rand commitments
- FX deposits are natural hedge against exchange rate movement (net foreign debt)
- Unwinding of FX swaps provides cash at favorable exchange rates
- Increased awareness of:
  - Reserve Bank’s foreign reserves operation; and
  - Impact of the use of government’s deposits on monetary policy execution