JOINT MANAGEMENT OF FOREIGN RESERVES AND FUNDS IN SOUTH AFRICA

Workshop on Asset and Liability Management

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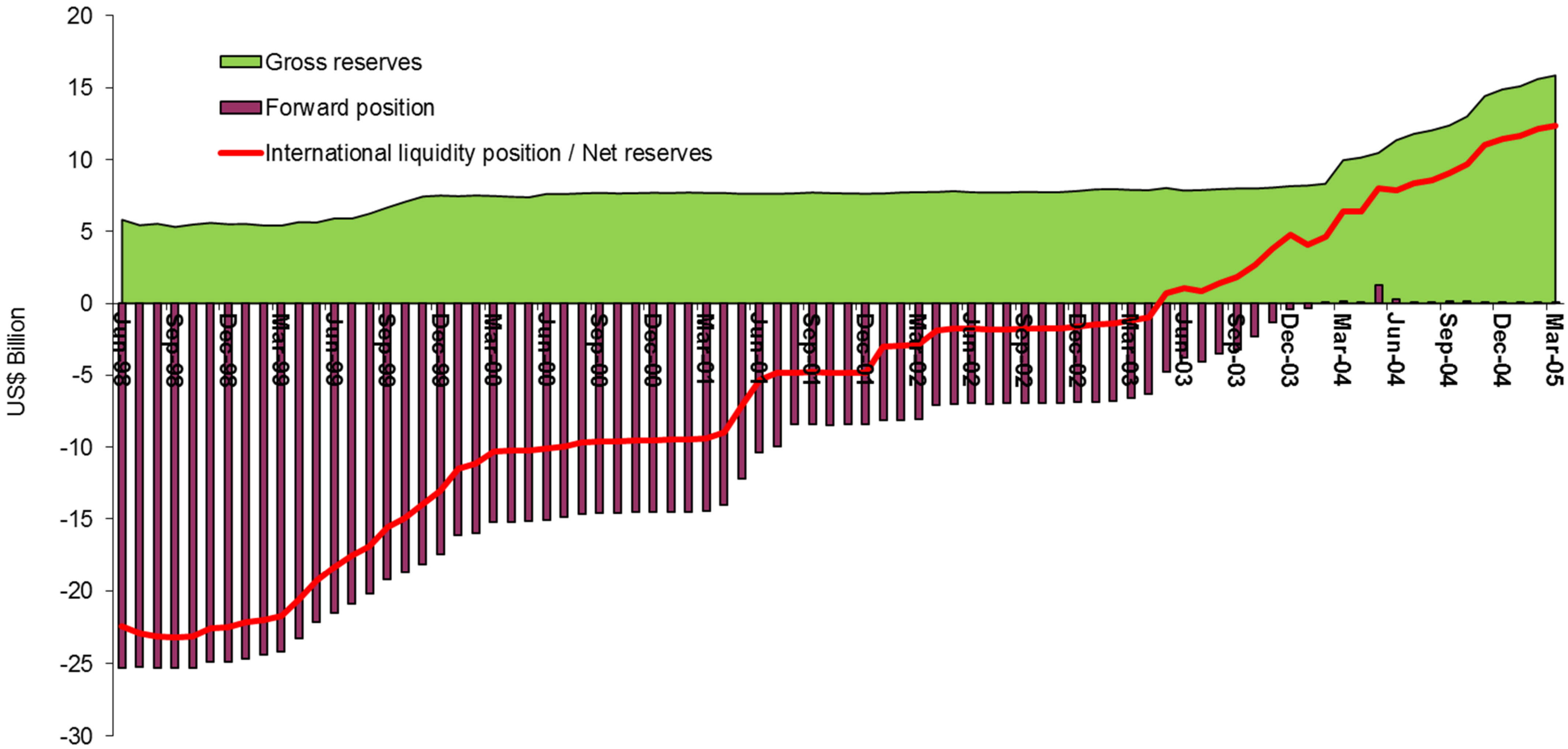
Content

- 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

2010, National Treasury assistance to increase foreign reserves resumed (cont)

- 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