Mr. Stals considers the issues of the relaxation of exchange controls and raising finance on the foreign bond market Speech given by the Governor of the South African Reserve Bank, Dr. Chris Stals, at a luncheon of the Institute of Directors in Southern Africa in Pretoria on 16/7/97.

1. The relaxation of exchange controls

The extension of the relaxation of exchange controls to private individuals as from 1 July 1997, marked a further step in the Government's committed programme of gradually phasing out all restrictions on the movement of funds between South Africa and the rest of the world.

The present system of exchange controls was introduced in South Africa over many years, starting from 1961, and was mainly intended to provide some protection to the domestic economy against the adverse effects of non-economic developments in South Africa, and international reactions that followed internal developments. Since these non-economic factors were removed during 1993 and 1994, following the major social and political reforms in our country, justification for the retention of the exchange controls also disappeared. In the new situation, the retention of exchange controls became counter-productive and, in a more open and freer economic environment, created undesirable distortions in the allocation of resources.

There was, therefore, general consensus that South Africa should remove exchange controls as quickly as possible, and some advisers even thought that it should be done in a one-off "big bang" approach. How desirable such an approach might have been, particularly for financial operators in the market, realism forced the Reserve Bank and the Government to opt for a gradual but determined phasing-out programme. The major constraint on the authorities had been the limited amount of foreign exchange reserves available to the country that were required for the conversion of South African rand assets into foreign currencies.

Developments over the past few years enabled us to move rather fast with the removal of the exchange controls. Large inflows of foreign funds, mostly in the form of portfolio investments made by non-residents in South African equities and bonds, and inflows of short-, medium- and long-term loan capital made it possible not only to replenish the country's net foreign reserves from a zero-level in April 1994 to more than R20 billion now, but also to remove more than 50 per cent of the exchange controls that existed three years ago. These relaxations required large amounts of funds, for example to enable South African resident companies to invest about R20 billion in foreign direct investment projects, and to enable institutional investors to diversify about R30 billion of their investments in foreign currency denominated assets. Over the three year period from the beginning of 1994 up to the end of 1996, the total net inflow of capital, that is taking account of non-resident capital inflows and resident capital outflows, showed a net gain for South Africa of almost R30 billion. The substantial capital inflows into South Africa therefore enabled us to achieve our objectives with the replenishment of the official foreign reserves, and the gradual relaxation of the exchange controls.

The future programme with the removal of the remaining exchange controls will, as over the past three-and-a-half years, be very dependent on a continuation of net capital inflows from the rest of the world. The capital inflows will, as a matter of fact, not only determine the pace of the removal of the remaining exchange controls, but also the rate of economic growth and development in the country. For South Africa it is of vital importance therefore that we shall continue to make our markets and our economy attractive to foreign investors.

We may ask ourselves what foreign investors are looking for before they decide to invest in a country. What prompted them, over the past few years, to make such huge investments in South Africa? They are obviously looking for stable political and social conditions in a country. The ANC Government has certainly established itself as a stable government and has founded a credible track record with the management of the economy. Crime and violence remains a worrying aspect of the social system, and many foreign investors still prefer not to commit themselves for too long a period in making their investments here.

On the economic side, the globalisation of the world financial markets is a process that countries such as South Africa cannot stay out of. Operators in these global markets are defining their own economic criteria for the assessment and comparison of countries where they can invest huge amounts of funds administered by them. These criteria may sometimes seem to be rather superficial, but they are basic. For example, the Maastricht criteria require members of the European Union to maintain a deficit on their budgets of not more than 3 per cent of gross domestic product. Total government debt should not be more than 60 per cent of gross domestic product. The rate of inflation in each participating member country should not be too far out of line with the average rate of inflation in all the participating member countries.

These criteria are now being applied very generally across the board by many global fund investors when they assess the attractiveness of countries for investment purposes. It is therefore not just a whim of the South African Minister of Finance to reduce the deficit on the Budget of the South African Government to 4 per cent this year. Likewise, it is not just an over-ambitious target of the Reserve Bank to bring inflation in South Africa more in line with the average rate of inflation in the economies of our major trading partners. These are directives and requirements from the international investor community -- those investors that enabled us to achieve the results of the past three years with the exchange control relaxation and the improved economic conditions in general. They will also determine the course of the further relaxation in exchange controls and in the economic development of our country over the next few years.

Because of the importance of foreign investment for South Africa, it is essential that foreign investors shall also be well-informed of the South African economy, and its potential to absorb new foreign investment. The recent decline in the gold price created a lot of nervousness in the market for foreign exchange. This is an unfortunate development that can have serious adverse implications for the gold mining industry. Its effect on the balance of payments, however, should be judged against a total level of exports of goods and services that now exceeds R150 billion per annum, with gold contributing less than 18 per cent of the total, and a total capital inflow through the Bond Market and Stock Exchange that was double the value of the gold production in the first six months of 1997.

The average gold price last year was equal to US $388 per fine ounce, and South Africa’s total gold exports amounted to 15.75 million ounces. Should the present price of $320 be maintained for a full year, the loss in foreign exchange on the balance of payments will amount to R4.5 billion, or less than 3 per cent of total exports. Relative to the volatility of the net capital movements, the amount should not create any undue pressure on the rand/foreign currency exchange rate. Part of this loss can also be made up with an increase in the volume of production and with increases in other exports. We should also not be too negative for some recovery of the gold price before the end of this year. If anything, the recent decline in the gold price provides further evidence of how important it is for South Africa to continue to attract more foreign investment into the country, particularly in the form of long-term direct investments.

2. Raising finance on the foreign bond market

The South African Government recently made two further very successful issues in international capital markets. An issue in the Samurai Yen market raised the equivalent of $357 million for seven years, and an issue in the American Yankee market provided an amount of $500 million for a twenty-year period. Both these loans were raised at relatively attractive interest rates.

The international private financial markets have developed very rapidly in recent years, and now provide for the needs of many types of borrowers. Only sovereign borrowers, however, and large multinational corporations will be able to raise funds through public issues in these markets.

Many other types of foreign loan facilities are, however, available to other borrowers. It is known that the Reserve Bank is at present busy negotiating for a syndicated loan with a group of foreign banking institutions for $1½ billion. Smaller borrowers can, of course, also negotiate loans on a bilateral basis with one of the many foreign banking institutions that provide their services in the South African markets.

It is fairly easy for reputable and established South African organisations at this stage to raise foreign funds. Non-residents are no longer affected by the remaining exchange controls, and accept the credibility of the South African authorities in their determination gradually to remove the remaining controls. One major constraint, however, is provided by the volatility of exchange rates, even amongst the major currencies of the world. It is not only the South African rand that showed great volatility over the past year, but also many other currencies. The exchange rate between the Deutsche Mark and the US dollar, for example, changed from $1=1.54DM at the beginning of January 1997, to $1=1.79DM today, i.e. a change of 16.2 per cent. At this stage, the Malaysian ringgit, the Thai baht, the Indonesian rupiah, the Philippine peso and the Czech koruna are all under pressure from international currency speculators.

South African borrowers of foreign funds will therefore most probably prefer to cover foreign borrowings with forward exchange contracts, which will eliminate any cost advantages from lower interest rates in other countries. We nevertheless believe that it is in the interest of the South African economy to make use of foreign finance where available, as this will enable the country to maintain a higher rate of economic development. We are indeed confident that, if carefully managed, the relaxation of exchange controls for residents will not lead to an overall net outflow of capital from the country. New investments by non-residents should continue to exceed the outward investment by residents.