

Diagram 14 Expert Bundle 124



(2) Short to medium term

Macro-economic factors

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15.1 An imbalance between the total disposable income and total spending of a country is reflected in the net flow of goods and services into or out of the country. These cross-border movements of goods and services, together with a net movement of international capital to and from the country, influences the demand and supply for foreign exchange in the domestic foreign exchange market.<sup>39</sup> In a market where the exchange rate should be free to find its own level, the supply of and demand for foreign

exchange are the main factors deciding the eventual level of the exchange rate. An excess supply of foreign exchange should usually be associated with an appreciation in the exchange value of the domestic currency. Conversely, a shortage of foreign exchange can be expected to cause a depreciation of the exchange rate of the domestic currency.<sup>40</sup>

15.2 Demand for, and supply of, the rand are influenced by the state of the global economy. There was a rapid decline in the performance of the international economy commencing in 2000 and continuing in 2001, the upshot of which was a decline in hard currency liquidity in the market, leading to a downward pressure on the rand.<sup>41</sup>

15.3 The effect of the attacks on the World Trade Centre and the Pentagon on 11 September 2001 was the crash in global equity markets which ensued and, in the words of Jammine: "... increased risk aversion towards emerging markets still further and the rand was once again seen to be in the firing line of this sentiment. Commodity prices plunged in expectation of a dramatic deterioration in global economic growth prospects and this affected the rand particularly hard and South Africa was seen as a predominantly commodity based economy. ... The rand's depreciation from R8.52 at

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<sup>39</sup> Mboweni [Bundle SARB \(07\) 16](#)

<sup>40</sup> Mboweni [Bundle SARB \(07\) 16](#)

<sup>41</sup> Dr I Abedian, Chief Economist, Standard Bank of South Africa, [Expert Bundle 276](#). See, too,

the time of the terrorist attack to R9.03 at the end of the month, was seen primarily as the function of South Africa's categorisation as an emerging market currency at a time when international investors were bailing out of emerging markets.”<sup>42</sup>

15.4 The deterioration in the global economy and the events of September 11, 2001 had a negative effect on the South African economy, and hence on the rand, in two material respects: the flow of capital to emerging markets reduced and after September 11 international fund managers withdrew funds from what they regarded as vulnerable economies in what was described as “flight to a safe haven”.

15.5 In the first half of 2001, despite the global downturn, domestic income grew and gross domestic expenditure was less than national disposable income. Consequently, South Africa had a surplus of exports over imports. At the same time there was an inflow of capital into the economy. Given an ample supply of foreign exchange during this period, the exchange rate of the rand showed limited variation and by the end of June 2001 was roughly at the same level as at the beginning of the year (R8 to the US dollar).<sup>43</sup>

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for example, Stals, Expert Bundle 173  
<sup>42</sup> Jammie Expert Bundle 321; Mboweni Bundle SARB (7) 16-17  
<sup>43</sup> Mboweni, Bundle SARB (07) 17

- 15.6 In the second half of 2001, domestic spending exceeded total national disposable income: excess spending over income lifted total spending to a level 1.1% higher than national disposable income in the third quarter and 0.3% higher in the fourth quarter. The excess of total domestic spending over total national disposal of income was expressed in a deficit on the current account of the balance of payments. This imbalance created a need in the forex market for an inflow of international capital in order to limit downward pressure on the exchange value of the rand. The deficit on the current account of the balance of payment, however, was not matched by any inflows of international capital into the economy.<sup>44</sup>
- 15.7 When a deficit on the current account of the balance of payments is not accompanied by an inflow of capital, the deficit is widely perceived as a major source of exchange rate instability. Where the demand for foreign exchange exceeds the supply of foreign exchange, a depreciation in the exchange rate of the rand could be expected as a normal market reaction.<sup>45</sup>
- 15.8 The following accounts are worthy of detailed analysis:-

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<sup>44</sup> Mboweni, Bundle SARB (07) 17, 20

<sup>45</sup> Mboweni Bundle SARB (07) 17; Stals Expert Bundle 173-174.

The services account in the current account of the balance of payments.<sup>46</sup>

15.8.1 The shortfall on South Africa's services account with the rest of the world widened considerably from the first to the second quarter of 2001. This higher deficit was related to inward movements of foreign direct equity investment giving rise to dividend payments on non-resident shareholdings. Investment income received from offshore equity investments made by South African companies also increased, but to a smaller extent than the increase in dividend payments. The overall deficit on the services and income account widened from a seasonally adjusted and annualised value as follows:

First quarter	R37.2 billion
Second quarter	R47.1 billion
Third quarter	R48.6 billion
Fourth quarter	R41.7 billion <sup>47</sup>

#### 15.8.2 The financial account of the balance of payments

The financial account summarises the international capital flows and covers all transactions associated with changes

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<sup>46</sup> The balance on the current account of the balance of payments is the sum of exports and imports of goods and services out of and into South Africa. The current account consists of two accounts: the trade account and the services account. The services account records income payments and receipts, such as dividends, interest and employee compensation, transportation fees for goods and passengers, travel services and other services.

<sup>47</sup> Mboweni Bundle SARB (7) 23

of ownership in the foreign assets and liabilities of an economy. Three broad categories of investment are distinguished:

- direct investment;
- portfolio investment; and
- other investment.

15.8.3 The imbalance on the financial account of South Africa's accounts with the rest of the world changed from a surplus (or an inflow of capital) of R4.7 billion in the third quarter of 2001 to a deficit (or outflow of capital) of R1.5 billion in the fourth quarter.

(1) Direct investment

Foreign direct investment ("FDI") flows into South Africa are reflected in an increase in direct foreign liabilities. Direct investment is that category of international investment which reflects the objective of an investor in one country to obtain a lasting interest in another country. Non-residents invested direct investment capital into the South African economy during the first three quarters of 2001, but this changed to an outflow of R1.9 billion in the fourth quarter. South African companies increased their holdings of foreign direct investment assets by R5.4

billion during the fourth quarter of 2001, mainly by acquiring a dominant interest in the equity capital of foreign companies.

On a net basis, i.e. offsetting changes in direct foreign assets against changes in direct foreign liabilities, FDI changed from an inflow of R3.6 billion in the third quarter of 2001 to an outflow of R7.3 billion in the fourth quarter, thus contributing to the weakness of the rand.<sup>48</sup>

(2) Portfolio investment

Portfolio investment includes investment in equity and debt securities not classified as direct investment. Non-resident investors increased their holdings of domestic equity securities by R7.9 billion during the fourth quarter of 2001 but simultaneously reduced their holdings of domestic bonds by R10.1 billion. The net outward movement of portfolio capital totalled R3.4 billion in the fourth quarter. This raised the total net value of international portfolio capital outflows to R67.6 billion for the calendar year 2001 as a whole, compared with net outflows of R13.8 billion in 2000.<sup>49</sup>

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(3) Other investment

Other investment is the category of the international capital that includes all transactions not covered by direct investment and portfolio investment and consists of trade credits, short-term and long-term loans and cross-border bank deposits. On a net basis, other foreign investment amounted to an outflow of R29.3 billion in 2001.<sup>50</sup>

15.9 The Governor summed up the impact of macro- economic factors on the rand in 2001 as follows:

“...the macro-economic scene in South Africa in the fourth quarter of 2001 was characterised by total domestic expenditure exceeding total disposable income. The excess of total domestic expenditure over total disposable income was expressed in a deficit on the current account on the balance of payments which was not matched by an inflow of foreign investment capital into the economy. In fact, capital left the country during the fourth quarter of 2001. This is a very significant factor for the exchange rate’s behaviour during that period. Under circumstances such as these, a depreciation in the exchange value of the rand could be expected as a normal market reaction.”<sup>51</sup>

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<sup>49</sup> Mboweni Bundle SARB (7) 25

<sup>50</sup> Mboweni Bundle SARB (7) 26

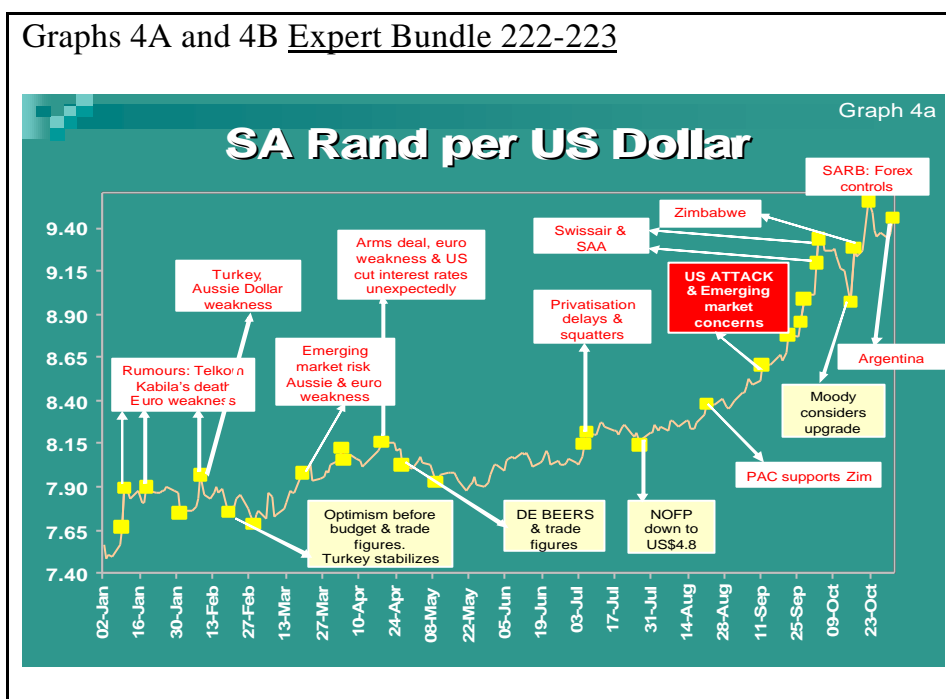
<sup>51</sup> Mboweni, Bundle SARB (7) 29

## Perceptions

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16.1 A number of witnesses testified that during the latter half of 2001 there was a negative perception about South Africa and its currency, the rand. The Governor, for example, testified that regional instability, particularly in Zimbabwe, could have played some role in the weakening of the rand from May 2000 and also from June 2001. Other factors which the Governor said were regularly mentioned in the market were perceptions about unemployment, HIV/Aids, crime, the lack of progress with further privatisation, labour reform and investment incentives.<sup>52</sup> Mr Luüs, in addition to the factors mentioned by the Governor, added others, some of which were high and rising levels of unemployment, threatening socio-economic stability; a perceived lack of labour market flexibility, compounding the unemployment problem and being detrimental to higher productivity growth; low savings and fixed capital formation levels, constraining the

economy's long-term growth potential; dissatisfaction amongst poverty stricken people because of growing economic illiquidity; the civil service was considered to be bloated and inefficient; the country's infrastructure, notably railways and roads, was not being maintained properly<sup>53</sup>. The factors, negative and positive, which might have impacted on the rand are shown graphically:

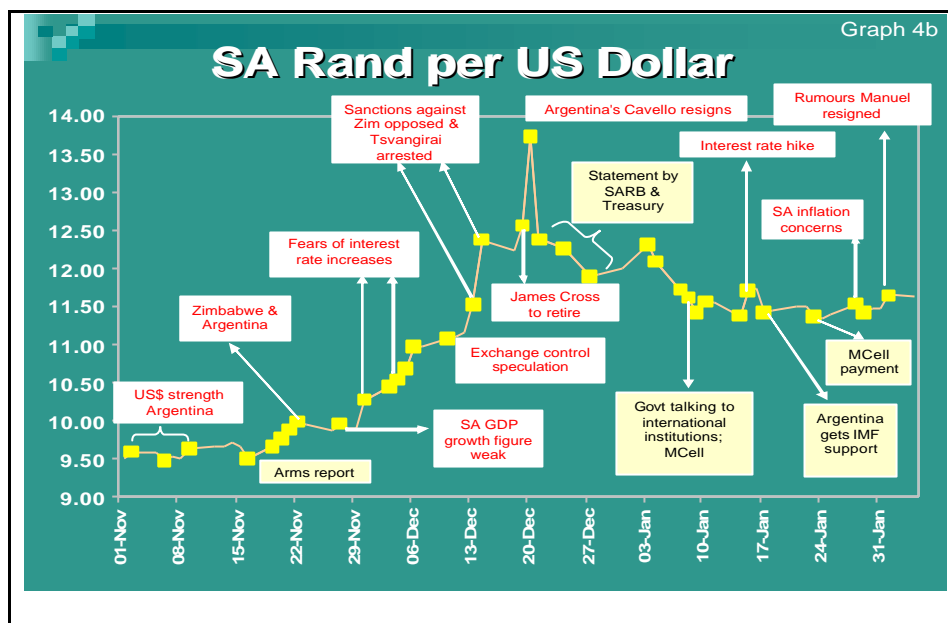


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Mboweni, Bundle SARB (7) 38

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Evidence of Mr CW Luüs, Chief Economist, ABSA Group Ltd, Expert Bundle 210, 211



## 16.2 Privatisation

Conservative estimates had put the foreign currency inflows from privatisation in the 2001/2002 budget as R18 billion. The actual proceeds were only R2.3 billion. In Dr Abedian's words: "This had both perceptual and forex inflow implications. The rand had to be priced accordingly."<sup>54</sup> Dr Jammie emphasised the importance of privatisation from the point of view of foreign investors: they "saw privatisation almost as a litmus test of the government's commitment to investor friendly economic policies".<sup>55</sup>

## 16.3 Exchange Controls

A view is that the exchange control regulations which are still in force potentially deter foreign investment because foreigners

<sup>54</sup> Abedian Expert Bundle 275-6

<sup>55</sup> Jammie Expert Bundle 315. See, too Luüs, Expert Bundle 211-212

believe that the gradual or sudden removal of such controls would lead to a gradual or sudden further depreciation of the rand; the partial lifting of exchange controls over the years has probably made the enforcement of the remaining measures much more difficult; and remaining exchange controls are rendering the rand a weak currency because of the fear that comprehensive exchange controls may again be implemented at any time.<sup>56</sup>

(3) Short term

The role of the Reserve Bank

17 Exchange Rate Management

17.1 McCauley testified that few countries are indifferent to the exchange rate. While the objectives of managing an exchange rate differ, there are six established objectives of exchange rate management:

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<sup>56</sup>

Luis Expert Bundle 213; see, too, Gouws, Record 94