

of 14 October 2001 and could satisfy themselves that they were able to comply with the exchange control regulations.⁸⁸

25.11 There has been much evidence given by the authorised dealers on the impact of the meeting of 14 October 2001 and the circulars issued thereafter. The evidence has not yet been concluded and will accordingly be canvassed in detail in the final report.

Speculation

Introduction

26 The first point is that speculators have a necessary role to play in the forex market. Dr Stals said that in a well developed market there is a need for short, medium and long-term investors and for buyers and sellers of a variety of spot and forward instruments. The speculator has an important part to play in an effective price discovery mechanism,

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De Villiers Record 388

based on the principles of demand and supply operating in an amorphous market.⁸⁹ Mr Luüs testified that speculators are usually required for the efficient functioning of markets. He quoted Marc Levinson, who stated in his book, *Guide to the Financial Markets*: “Although speculation is often derided as an unproductive activity, it is essential to the smooth functioning of the market. By buying and selling contracts with great frequency, speculators vastly increase liquidity, the supply of money in the markets. Without the liquidity that speculators provide, the futures market would be less attractive to hedgers because it would be more difficult to buy and sell contracts at favourable prices.”⁹⁰ Ms Ramos said in her evidence that not all speculation is bad. Speculators can help in making a healthy market. She added a word of caution by referring to what John Maynard Keynes said in 1939 in his seminal work, *The General Theory of Employment, Interest and Money*: ‘Speculators may do no harm as bubbles on a steady stream of enterprise. But the position is serious when enterprise becomes the bubble on a whirlpool of speculation.’” Ms Ramos added that it is a matter of balance: “Speculators can help make a liquid market while there is a healthy demand for and supply of assets or currency, and where the burden of the spread is tight. The deeper the more liquid the market, the more likely it will be that speculators will be bubbles on a steady stream. However, in thin markets or in one-sided markets, as was the

⁸⁸ De Villiers [Record 383](#)

⁸⁹ Stals, [Expert Bundle 177](#)

⁹⁰ Luüs, [Expert Bundle 214](#)

case in the rand market in November [2001] and particularly in December, speculators will have a greater impact, even with very small transactions.”⁹¹

27 The second point is that speculative activity is difficult to define. As pointed out by the Governor, if speculation implies transactions entered into based on the view of the future value of a currency, then most forex transactions would have a speculative element in them. If speculation is defined to include only transactions which are not based on some fixed and ascertained commitment, then a narrower set of transactions would be caught within the definition.⁹²

28 Mr McCauley drew a distinction between “hedgers” and what he called “pure short sellers” or “naked shorts”. The former class of person would include a multinational company that has a long position in South Africa: it has bought dollars and invested the dollars in a factory in South Africa. If it becomes concerned about the value of the rand, it would hedge that long position by selling the rand forward against the dollar.⁹³ A “pure short seller” or “naked short”, by contrast, is an institution such as an investment fund that has no ongoing business in

⁹¹ Ramos, Record 718

⁹² Mboweni, Bundle SARB (7) 38-39

⁹³ McCauley Record 28

South Africa and which “could put on the short basically looking to profit if the rand goes down”.⁹⁴

29 Mr De Villiers defined speculation as any transaction in which a trader acts as principal. Market-making can be viewed as speculation because the market-maker trades as principal and has to provide a price for a currency to a counter party. The price will be speculative in nature because “you will move it up and down according to what you perceive that the counter party is going to do with you.”⁹⁵ Day-to-day speculation in the form of market making and technical trading is a necessary function for any market. It helps a market to be efficient and obviously helps people who needs hedges to hedge properly and cheaply. Speculation which has a negative connotation probably refers “... to the long directional trading where traders take the long-term position of shorting the rand against the dollar and they do it for large amounts.”⁹⁶

30 The third point is one made by Dr Abedian. He testified that financial markets are neither efficient nor socially optimal. They are structurally prone to short-lived as well as prolonged “bubbles” in which prices and quantities could deviate from private and socially optimal levels. Information plays a vital role in such markets. As such, financial

⁹⁴ McCauley Record 29

⁹⁵ De Villiers Record 367-8

markets are largely vulnerable to information manipulation, rumours and speculation. Given costly and imperfect information, a large number of players in these markets may adopt a “herd mentality”, following bigger players who can afford the investment in information gathering or will have the critical mass to obtain information. Institutional arrangements for remuneration are commonly and justifiably “performance-orientated”. Despite a variety of checks and balances in the financial markets, such remuneration frameworks tend to exacerbate the vulnerability of these markets to short term bubbles.⁹⁷

- 31 The fourth point that a number of witnesses made was that it would be extremely difficult to determine the effect of speculative transactions on the exchange rate.⁹⁸ A total of approximately 5.6 million foreign exchange transactions took place in 2001.⁹⁹ Mr Gouws expressed the view that to attribute the fall in the rand to a number of specific transactions would be very difficult and perhaps pointless in the light of the magnitude and complexity of developments since early September 2001.¹⁰⁰ Dr Stals made a similar point. He said that in a market with a turnover of at times more than USD 10 billion per day, it would be

⁹⁶ De Villiers Record 376

⁹⁷ Abedian Expert Bundle §2.8 p 261

⁹⁸ Mboweni Bundle SARB (7) 38

⁹⁹ Ms Ramos Record 701

¹⁰⁰ Gouws Expert Bundle 117

extremely difficult to discover and identify individual transactions with malicious intentions.¹⁰¹

32 It seems to the Commission that one should distinguish between two classes of transactions, as identified by the Governor:-

- transactions entered into based on a view of the future value of a currency; and
- transactions which are not based on some fixed and ascertained commitment.

In the former class of transactions, would fall the transactions of authorised dealers, non-residents and resident importers and exporters.

32.1 Authorised dealers

South African authorised dealers are allowed to trade the rand for their own account in the inter-bank market. This form of forex trading is known as “proprietary trading”. During 2001 the authorised dealers did not run huge positions against the rand. Their aggregate open positions amounted to less than 1% of their net qualifying capital in 2001. The statutory limit for those positions is 10% of net qualifying capital.¹⁰²

An authorised dealer, being a market maker, can be given a position by virtue of a deal being struck. The position which he is

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Stals Expert Bundle 177