



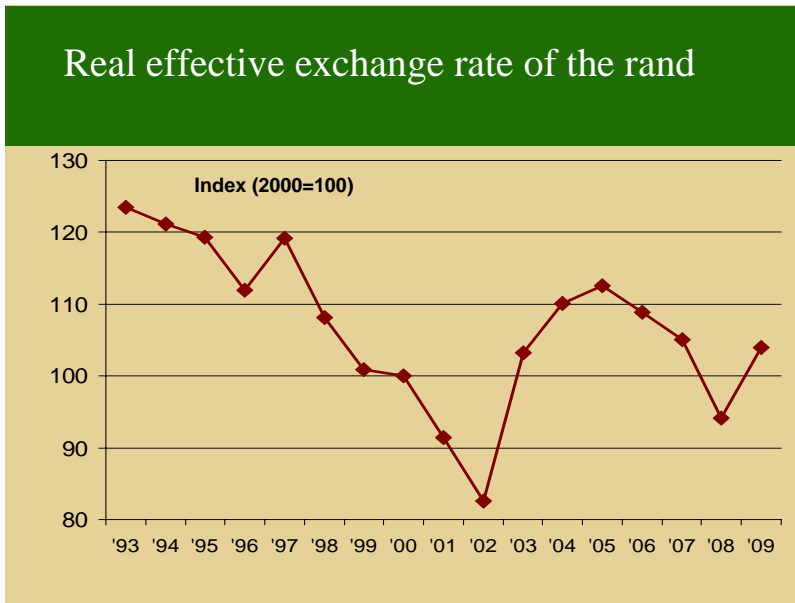
FLIGHTS **STREAM**

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Rand exchange rate in good shape

The rand has performed remarkably well in the midst of global financial instability and an imminent restructuring of capital markets.

The accompanying figure confirms the resurgence of the local currency during the first quarter of 2009, with a significant strengthening against all of the world's major currencies. The exchange rate referred to in the figure is a trade-weighted, indexed figure (in rand terms) and takes account of inflation differentials between South Africa and its major trading partners.



The five currencies that dominate the basket are the euro, US dollar, Chinese yuan, British pound and Japanese yen. In combination, these four countries and the Euro zone account for approximately 83% of the trade represented by the basket of currencies.

An explanation for the recent strength of the currency is to be found in the relative attraction of South Africa as an investment destination – both from the perspective of direct investment and capital market instruments.

In 2008, net foreign direct investment (FDI) flows into South Africa amounted to a staggering R103.5 billion, breaking the previous all-time record of R85.8 billion, recorded in 2001. The figure for last year represents a thirteen-fold increase over the average net inflow of FDI between 1994 and 2007.

It seems that certain aspects of the contagion in global financial markets may prove to be to the benefit of emerging market economies that possess fundamental macro-economic stability (including South Africa).

Specifically, international fund managers are still receiving vast amounts of contractual savings every month (mainly pension fund contributions), whilst some of the avenues for investment have dried up.

Two examples are the markets for credit default swaps (CDS) and asset-backed securities (ABS). The latter essentially involves assets involving a monthly revenue stream via the repayment of housing loans, vehicle instalments and credit cards.

The ABS market in the US has virtually collapsed. According to the American Securitization Forum, a total of \$863.6 billion of ABSs were issued in 2007. In 2008, this figure had declined by more than 81% and, during the first quarter of 2009, had declined by another 95%.

Regarding the CDS market, which relies heavily on an active market for corporate securities, attempts are being made by European central bankers to clear most of the contracts in this niche financial sector, which is currently exempt from sufficient regulation and oversight. Currently, transactions in the CDS market are done on an over-the-counter basis and do not require an official exchange or regulation.

The market for CDS mushroomed from its inception in 2007 to an estimated value of \$45 trillion in 2007. To put this figure in perspective, it represents more than three times the size of the US economy and has clearly developed into much more than an insurance technique against corporate defaults.

The world's capital markets and investment banking fraternity are slowly but surely coming to grips with the need for significantly enhanced levels of transparency, particularly with regard to high-risk collateralised debt instruments. This process will not be sudden and promises to involve several years of debate between regulators and financial institutions. In the interim, it stands to reason that the array of investment options has become less-diversified. As an inference, traditional avenues for investment will become relatively more attractive.

South Africa's attraction as a destination for direct and portfolio investment is enhanced, *inter alia*, by the following:

- Fiscal stability (the public debt/GDP ratio has more than halved from 48% in 1996 to 23% today)
- Monetary stability (inflation has declined to structurally lower levels and is expected to fall within the Reserve Bank's target range of 3% to 6% by the third quarter of 2009)
- A sustained period of positive real GDP growth, which stretched to 16 successive years in 2008
- An increase of more than 37% in real household disposable income since the 1994-elections
- Relatively high bond yields, combined with favourable investment ratings

- An equity market that is offering exceptionally good value in terms of a combination of potential future capital gains, high dividend yields and low price/earnings ratios
- Prospects for enhanced regional socio-political stability in the Southern African region
- Exceptionally favourable global publicity through the hosting of the Confederations' Cup finals (soccer), the "Mini" Cricket World Cup, the Indian Pro-20 Professional Cricket League and the 2010 Soccer World Cup finals

It is a fallacy to view the sizeable current account deficit as a serious macro-economic problem. Balance of payments data (see the table) confirm the consistent increase in the country's foreign exchange reserves over the past five years, with each current account deficit being comfortably exceeded by financial account inflows and other capital transfers.

Balance of payments (R bn)			
	Current account	Financial account & other	Change in forex reserves
1993	9	-9	0
1994	0	2	2
1995	-9	14	5
1996	-7	2	-5
1997	-10	28	18
1998	-13	16	3
1999	-4	18	14
2000	-1	13	12
2001	3	31	34
2002	10	-34	-25
2003	-14	1	-13
2004	-45	75	30
2005	-62	110	48
2006	-110	158	48
2007	-146	192	46
2008	-169	262	93

One of the key reasons for the widening current account deficit (since especially 2004) is related to the imports of capital equipment and machinery, without which the country would not be able to expand its future base for economic growth. These data also offer the most obvious explanation for the relative strength of the rand exchange rate – old-fashioned demand and supply!

Undue concern over the current account deficit by the country's economic policy makers poses the threat of limiting the growth rate of capital formation (through relatively high interest rates), whilst also inhibiting export growth (through an overvalued currency).

Although exports will remain under pressure for most of the year, the prospects for sustained financial account inflows should facilitate a relatively stable exchange rate, which should keep inflation in check and will underpin the current declining interest rate cycle.