The Investment Analysts Journal

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Die Beleggings-Navorsers Tydskrif

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Inhoud

This issue in brief

The South African forward exchange market

This is a reproduction of an address given to the Investment Analysts Society on 24 June 1980. In it Mr A. A. Ross describes the functioning of the newly established foreign exchange market in South Africa dealing specifically with the mechanism through which forward exchange rates are determined. His account is not only useful for its focus on technical detail but also for its explanation of recent developments related to changes in the exchange value of the rand and the insights it provides to the kind of problems the South African monetary authorities have had to confront.

Intervention policies of the Reserve Bank in the foreign exchange market

Prof. R. M. Gidlow's article, in contrast to that of Mr A. A. Ross, sets out to analyse the policies that have governed Reserve Bank intervention in the foreign exchange market since the publication of the interim report of the De Kock Commission in early 1979. It is also concerned with suggesting ways in which the effectiveness of such intervention policies may be improved, and discusses the benefits likely to flow from intervention and the methods of intervention most likely to prove successful. The attention the article gives to technical complexities should prove of considerable help to all concerned with a study of this esoteric subject. Clearly, it is one whose importance is going to increase with the changes in monetary policy likely to flow from the final recommendations of the De Kock Commission whose last report is due to be published in early 1981.

Options trading

This is a valuable background article on a subject that has not previously been discussed in this journal. Options trading has, of course, always been a feature of trading on The Johannesburg Stock Exchange, but it has not until now achieved a relative volume that can be compared with the volume of options trading on the more developed stock exchanges of North America or Western Europe. Mr A. F. T. Payne, now with the Graduate School of Business at Melbourne University, sets out to examine the historical development of options trading in South Africa and to discuss how the options trading might develop here in the future. He provides useful statistical support for his text, some from sources which, until now, have not been available to the general public.

A framework for reporting

It goes without saying that market efficiency depends to a very great degree on the regular disclosure of information necessary to a proper evaluation of corporate performance. Mr B. M. Gourley's article directs attention as to how financial reporting might be improved to make such evaluations possible. It presents a framework for developing a financial reporting strategy using the valuation model propounded by Stern, as a basis for discussion.

The structure of interest rates

This article by Mr G. M. W. Cross is the seventh in our "Investment basics" series and continues the discussion of interest rates started in the sixth article which appeared in the previous issue of the journal. Mr Cross covers a wide-ranging subject briefly but fully, bringing to the reader's attention the complexity and dynamic qualities of the relationship between short-term and long-term interest rates and how fluctuations in both can be exploited to improve portfolio performance.

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'This new approach has not produced the stability in monetary aggregate growth or in the economy that many had expected. On the contrary... the swings in the economy, the monetary aggregates and interest rates have been huge... Adjusting reserve growth to counter unwanted money movements (in fact) means dealing with "yesterday's" money problem by adjusting reserves today, an approach which probably adds to the instability of both. Even if the monetary aggregates grow at rates within the annual targets for all of 1980, which seems possible, the instability of the money supply and the markets make us wonder whether we can stand much more of such "success".'

**J. Henry Schroder Bank & Trust Co
New York**

October 6, 1980

In an address to the Economic Society of South Africa on 13 October 1980, Dr Gerhard de Kock, Governor-designate of the South African Reserve Bank, drew attention to a number of changes that had taken place in the world economic environment since the early 1970s which were likely to have an enduring impact on the nature of the South African business cycle and, therefore, also on the formulation of monetary policy in the Republic. Most outstanding of these changes were the redistribution between countries of payments surpluses and deficits, the world-wide increase in rates of inflation, the rise in the free market price of gold, the increase in world demand for South Africa's mineral exports and the replacement of the Bretton Woods monetary system by a system of floating exchange rates. Whereas previously cyclical fluctuations in the South African economy tended to follow the business cycle of the major industrial countries by between six and fifteen months, this no longer appeared to be the case and it now seemed as if economic upswings in South Africa would peak later and continue for longer than had previously been the case. In the past, the South African business cycle had had a fairly clear interaction with the overseas business cycle, upswings and downswings abroad, tending respectively to overlap with downswings and upswings at home, forcing, through their effects on export and import growth, counter-cyclical adjustments in official monetary and fiscal policy.

There is something, however, which is troubling about Dr De Kock's analysis because it has been presented as the background rationale for the introduction of policy changes that are likely to have the effect, on Dr De Kock's own admission, of greatly increasing the volatility of local money and capital markets. It would be unwise to believe that such volatility would be without adverse effects on

'Dié nuwe benadering het nie die stabiliteit in die groei van monetêre groothede of in die ekonomie meegebring wat baie mense verwag het nie. Inteendeel... die skommelings in die ekonomie, die monetêre groothede en rentekoerse was besonder groot... Die aanpassing van reserwegroei om ongewenste geldskommelings teen te werk, beteken inderdaad dat "gister" se geldprobleem die hoof gebied word deur reserwes vandag aan te pas, 'n benadering wat waarskynlik tot die onbestendigheid van albei bydra. Selfs as die monetêre groothede vir die hele 1980 teen koerse binne die jaarlikse streefsyfers groei, wat moontlik lyk, laat die onbestendigheid van die geldhoeveelheid en die markte ons wonder of ons veel meer van dié soort "sukses" kan verdra.'

**J. Henry Schroder Bank & Trust Co
New York**

6 Oktober 1980

In 'n toespraak voor die Ekonomiese Vereniging van Suid-Afrika op 13 Oktober 1980 het dr Gerhard de Kock, aangewese President van die Suid-Afrikaanse Reserwebank, die aandag gevestig op 'n paar veranderings wat sedert die vroeë sewentigerjare in die ekonomiese milieu van die wêreld plaasgevind het en wat waarskynlik 'n langdurige uitwerking op die aard van die Suid-Afrikaanse besigheidsiklus sou hê, en dus ook op die formulering van monetêre beleid in die Republiek. Die opvallendste van dié veranderings was die herverspreiding tussen lande van betalingsurplusse en -tekorte, die wêreldwye styging in inflasiekoerse, die styging in die vrye markprys van goud, die toename in die wêreldvraag na Suid-Afrika se mineraaluitvoere en die vervanging van die Bretton Woods- monetêre stelsel deur 'n stelsel van swewende wisselkoerse. Terwyl vorige sikliese skommelings in die Suid-Afrikaanse ekonomie geneig het om die besigheidsiklus van die groot nywerheidslande met tussen ses en vyftien maande te volg, wil dit voorkom of dit nie meer die geval is nie, en dit lyk of ekonomiese opgange in Suid-Afrika later 'n hoogtepunt sal bereik en langer sal duur as wat voorheen die geval was. In die verlede het die Suid-Afrikaanse besigheidsiklus 'n taamlik duidelike wisselwerking met die oorsese besigheidsklus getoon; ongange en neergange in die buiteland het en geneig om onderskeidelik gedeeltelik saam te val met neergange en opgange hier te lande, wat deur middel van hulle werking op uitvoer- en invoergroei, teensikliese aanpassings in amptelike monetêre en fiskale beleid afgedwing het.

Daar is egter iets in dr De Kock se ontleding wat hinder, aangesien dit aangebied is as die agtergrondsmotivering vir die instelling van beleidsveranderings wat, soos dr De Kock self erken, waarskynlik die uitwerking sal hê om die onbestendigheid van plaaslike geld- en kapitaalmarkte domestic economic activity in South Africa and on the general maintenance of a rate of real GDP increase adequate to the socio-political requirements of the country. In the US, as the quotation at the head of this editorial makes clear, grave misgivings are already being expressed about the present preoccupation with the regulation of money supply growth to the seeming exclusion of fluctuations in interest rates. Unfortunately, it is not only stock and share prices which are adversely affected by exaggerated interest rate fluctuations. Spending on new capital formation too is discouraged by the higher risk premiums which then become operative and it is new capital formation which both the US and South Africa require if their economic development is to be maintained.

The suggestion that the gold price now fluctuates on a plateau permanently higher than that which previously applied could encourage a complacency about the possibility of a re-run of the events of 1974/75. The growth rate of the South African economy then had risen to a level that was clearly in excess of that which could be sustained in the long run and the same is the case now. The danger, therefore, again exists of our being forced into an economic downswing by world events over which we have little control. A worsening of the present American recession through its effects on US inflation, the US trade balance and activity levels in other major Western economies, could conceivably have an adverse effect on the gold price comparable in proportions to the adverse effect that materialised five years ago when the price declined from nearly $200 an ounce to close to $100 an ounce in a matter of twenty months. All that would be required would be some clearing of the political clouds currently hanging so threateningly over the world economic scene. The South African balance of payments today is stronger than it was in 1975 and so is our reserve position, but there can be no gainsaying that our dependence on the gold price for the maintenance of our recovered state of economic well-being has been greatly increased over the past year.

The reshuffling of the world's economic cards to which Dr De Kock referred has indeed resulted in South Africa being dealt a new and much improved hand. We do have aces today which we sorely lacked in the middle 1970s. But the value of an ace depends not only on the cards in one's own hand. It depends, too, on the distribution of cards in the hands of other players. Despite our apparent economic strength, we need still to be cautious, allowing sufficiently in our policy formulations at corporate and national level, for adverse possibilities as to allow for adjustment that is not needlessly painful should adjustment become necessary.

Fluctuations in money and capital markets derive from the basic instability of the expectations of market participants and it is right that these should be given full freedom of expression. Certainly, doubts can be raised as to the wisdom of intervention which seeks to hide the instability of expectations through direct interest rate controls. But monetary and fiscal authorities have a responsibility for encouraging stability in levels of economic activity and it should not be out of place for them, in exercising that responsibility, to endeavour, through their own economic action, to influence business expectations in a manner encouraging of long-term industrial development.

There is a danger in the emerging conventional wisdom of monetarism which damns all intervention in a blanket fashion and delegates to markets (so frequently quite short

grootliks te laat toeneem. Dit sou onverstandig wees om te glo dat dié onbestendigheid nie enige nadelige uitwerking sou hê op binnelandse ekonomiese bedrywigheid in Suid-Afrika en op die algemene handhawing van 'n koers van reële BBP-styging wat toereikend vir die sosiopolitieke behoeftes van die land is nie. Soos blyk uit die aanhaling bo-aan hierdie rubriek, word ernstige twyfel reeds in die VSA uitgespreek ten opsigte van die huidige besorgdheid oor die regulering van die groei van geldhoeveelheid tot skynbare uitsluiting van skommelings in rentekoerse. Ongelukkig is dit nie net effekte- en aandelepryse wat nadelig beïnvloed word deur oormatige rentekoersskommelings nie. Besteding aan die vorming van nuwe kapitaal word ook ontmoedig deur die hoër risikopremies wat dan in werking tree en dit is die vorming van nuwe kapitaal wat die VSA sowel as Suid-Afrika nodig het om hulle ekonomiese ontwikkeling vol te hou.

Die bewering dat die goudprys nou op 'n vlak skommel wat permanent hoër is as wat voorheen van toepassing was, kan 'n onbekommerde houding teenoor die moontlikheid van 'n herhaling van die gebeure van 1974/75 meebring. Die groeikoers van die Suid-Afrikaanse ekonomie het destyds tot 'n peil gestyg wat duidelik hoër was as wat op die lang duur gehandhaaf kon word, en dit is ook nou die geval. Die gevaar bestaan dus weer dat ons deur wêreldgebeure waaroor ons min beheer het, in 'n ekonomiese neergang ingedwing kan word. 'n Verergering van die huidige Amerikaanse resessie kan begryplikerwys, deur middel van die uitwerking daarvan op inflasie in die VSA, die VSA-handelsbalans en bedrywigheidspeile in ander groot Westerse ekonomieë, 'n nadelige uitwerking op die goudprys hê wat na verhouding vergelyk kan word met die nadelige uitwerking wat vyf jaar gelede verwesenlik is toe die prys binne twintig maande van byna $200 per ons tot byna $100 per ons gedaal het. Al wat nodig is, is dat die politieke stormwolke wat tans so dreigend oor die ekonomiese toneel van die wêreld hang, ietwat moet opklaar. Die Suid-Afrikaanse betalingsbalans is tans sterker as wat dit in 1975 was, en dit is ook die geval met ons reserweposisie, maar daar kan nie ontken word dat ons afhanklikheid van die goudprys vir die handhawing van ons herstelde toestand van ekonomiese welvaart oor die afgelope jaar grootliks verhoog is nie.

Die herskommeling van die wêreld se ekonomiese kaarte waarna dr De Kock verwys het, het inderdaad tot gevolg gehad dat Suid-Afrika 'n nuwe en heelwat verbeterde hand ontvang het. Ons beskik vandag oor ase waaraan ons in die middelsewentigerjare 'n groot tekort gehad het. Maar die waarde van 'n aas hang nie net af van die kaarte in jou eie hand nie. Dit hang ook af van die verspreiding van die kaarte in die hande van ander spelers. Ondanks ons klaarblyklike ekonomiese krag, moet ons nogtans versigtig wees en by die formulering van ons beleidsrigtings, op maatskappy- sowel as landsvlak, voldoende voorsiening maak vir nadelige moontlikhede en ook vir aanpassing wat nie onnodig pynlik is nie, indien aanpassing nodig sou word.

Skommelings in geld- en kapitaalmarkte is die gevolg van die basiese onbestendigheid van die verwagtinge van deelnemers aan die mark en volkome uitdrukkingsvryheid kom hulle toe. Daar kan sekerlik twyfel uitgespreek word oor die raadsaamheid van ingryping met die doel om die onbestendigheid van verwagtinge deur middel van direkte rentekoersbeheer te verbloem. Maar die monetêre en fiskale owerheid het 'n verantwoordelikheid om stabiliteit in die peile van ekonomiese bedrywigheid aan te moedig focused in their assessments), the sole responsibility for deciding what in the long-term our economic priorities should be. If through a preoccupation with money supply we fall into the trap of actually encouraging money and capital market instability, we may once again reap a whirlwind.

The Editor

en dis nie misplaaste optrede as hulle in die nakoming van dié verantwoordelikheid poog om deür middel van hulle eie ekonomiese optrede besigheidsverwagtinge te beinvoled op 'n wyse wat langtermynnywerheidsontwikkeling aanmoedig nie.

Daar bestaan 'n gevaar in die opkomende konvensionele monetêre denke wat alle ingryping voor die voet verdoem en aan markte (wat so dikwels kortsigtig in hulle waardeskattings is) die alleenverantwoordelikheid opdra om te besluit wat ons ekonomiese prioriteite op die lang termyn moet wees. As ons as gevolg van 'n beheptheid met geldhoeveelheid in die slagyster trap deur in werklikheid die onbestendigheid van die geld- en kapitaalmark aan te moedig, kan ons weer eens 'n storm maai.

Die Redakteur