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Die
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Contents

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Inhoud

This issue in brief

Is a pension fund's investment yield influenced by the size of the fund's assets?

Although it is widely believed that size does influence return in pension fund investment, overseas research has tended to show that this is not so. This paper, by Peter Milburne-Pyle, describes the results of a study undertaken in South Africa along similar lines to studies previously undertaken in other countries. Interestingly, it points to similar general conclusions to those reached abroad.

The role of hedging in the marketing of gold

Since mid-1982, South African gold mines have been permitted to sell part of their production forward in order to secure the dollar value of their export receivables, but it has only been since 5 September 1983 that payment for gold output by the Reverse Bank has been effected in dollars and the mines have been permitted to sell dollars forward for covering purposes. The new situation created by these changes has greatly altered the position of the mines and this has affected the risks to which investors in mining shares are exposed. This paper by Graham Jones presents an outline of the theory of hedging in speculative markets and discusses its practical implications for the marketing of gold itself.

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The Krugerrand premium – an optimal strategy for the Reserve Bank

Since their issue, Krugerrands have sold at a premium above the rand equivalent of the free market gold price and this premium has persisted even since the abolition of the financial rand in February 1983. The premium needs explanation because it suggests that South African investors have a preference for gold in the form of gold coins as opposed to gold yet to be mined. Because the Reserve Bank is a monopoly supplier of Krugerrands, it could benefit from this phenomenon of the premium as long as exchange control vis-à-vis residents remains in force. David Rees examines the problem in some detail in this brief article.

Interest rates, the exchange rate and money supply in South Africa

The high rate of monetary expansion in South Africa in recent years has been a source of concern to all interested in monetary policy formulation. Fluctuations in the gold price complicate analysis and evaluation because they are outside the control of the monetary authorities but cannot escape consideration. This article, by Barr and Kantor, contains an analysis of the determination of deviations from expected interest parity which is essential to any understanding of the association between gold price changes and money supply changes since the early 1970s.

Popular myths: gilt switching

The fourteenth article in our investment basics series deals with the inadequacy of current methods of evaluating switching in the gilt-edged market. Methods are discussed as to how switches might be properly considered.

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"No man is an island, entire of itself; every man is a piece of the continent, a part of the main; if a clod be washed away by the sea, Europe is the less, as well as if a promontory were, as well as if a manor of thy friends or of thine own were; any man's death diminishes me, because I am involved in Mankind; and therefore never send to know for whom the bell tolls; it tolls for thee."

John Donne

Do we stand on the brink of a new dollar crisis? This is a question which an editorial such as this is not designed to answer, but it is a question that it can justifiably consider in present circumstances because of its relevance to the future of the South African financial system. What happens to the dollar is of importance not only because it will affect the price of the country's single largest export, namely gold, it is of importance also because it will have implications for the wider world financial system of which the South African system is only a part. Were a dollar collapse to lead to a world monetary collapse, South Africa would be swept along with everybody else in the flood of disaster that would follow, and that is something in which we would not rejoice whatever the initial favourable consequences for the gold price.

There are a number of reasons why concern about a dollar collapse today is justified despite the currency's remarkable continued strength on world exchange markets in recent months. The first of these relate to the effect of its overvaluation (in purchasing power parity terms) on the competitiveness of US exporters in world export markets. This, clearly, has fallen sharply and can only be ignored by the US authorities while the momentum of domestic economic expansion is sufficient to cause further declines in the rate of unemployment. The extent of the loss of competitiveness and the inroads into domestic markets made by imports is measured by the size of the US external trade deficit which amounted to \$12,2 billion in April alone and could be as large as \$120 billion for the whole of 1984. Such a deficit would compare with a deficit of \$57,6 billion in 1983, itself a record, and one of \$31,8 billion in 1982.

A second cause for worry regarding the dollar relates to the state of the US banking system. Doubts about this have surfaced again because of the troubles of the Continental Illinois bank, the eighth largest in the US, and the dramatic rescue operation that was necessary to prevent its collapse. Although CI's problems arose because of bad debts in respect of domestic advances, the coincident announcement by Bolivia and Ecuador that they were suspending debt servicing payments to commercial banks has raised fears that other US banks with a high Latin American exposure will face liquidity difficulties also. Clearly, any loss of faith in the US banking system could have serious consequences for the maintenance of large US capital inflows irrespective of

Staan ons op die vooravond van 'n nuwe dollarkrisis? Dit is 'n vraag wat uit die aard van die saak nie in hierdie hoofartikel beantwoord kan word nie, maar gesien in die lig van huidige omstandighede is dit geregverdig om hier oorweging daaraan te skenk, aangesien dit betrekking het op die toekoms van die Suid-Afrikaanse finansiële stelsel. Wat met die dollar gebeur is nie net van belang omdat dit die prys van die land se enkele grootste uitvoer, naamlik goud, sal beïnvloed nie; dit is ook van belang omdat dit implikasies inhou vir die algehele finansiële stelsel van die wêreld, waarvan die Suid-Afrikaanse stelsel maar net 'n deel uitmaak. Indien 'n ineenstorting van die dollar aanleiding sou gee tot 'n wêreldwye monetêre ineenstorting, sou Suid-Afrika meegesleur word deur die vloed van rampspoed wat sou volg, en dit is iets waarvoor ons nie verheug sal wees nie, wat die aanvanklike gunstige gevolge vir die goudprys ook al mag wees.

Daar is 'n aantal redes waarom besorgdheid oor 'n dollarineeenstorting vandag geregverdig is ten spyte van dié geldeenheid se merkwaardige volgehoue sterkte op wêreldvalutamarkte die afgelope maande. Die eerste van dié redes hou verband met die uitwerking van die oorwaarderding daarvan (met betrekking tot koopkragpariteit) op die mededingendheid van VSA-uitvoerders op wêrelduitvoermarkte. Dit is duidelik dat dit skerp gedaal het en slegs deur die VSA-owerheid verontagsaam kan word solank die stukrag van binnelandse ekonomiese uitbreiding voldoende is om verdere afnames in die werkloosheidsyfer te veroorsaak. Die omvang van die verlies aan mededingendheid en die inbreuk wat invoere op binnelandse markte gemaak het, word gemeet aan die omvang van die VSA se buitelandse handelstekort, wat net in April op \$12,2 biljoen te staan gekom het en tot \$120 biljoen vir die hele 1984 kan wees. Só 'n tekort kan vergelyk word met 'n tekort van \$57,6 biljoen in 1983, wat al klaar 'n rekord was, en 'n tekort van \$31,8 biljoen in 1982.

Nog 'n rede tot kommer ten opsigte van die dollar hou verband met die toestand van die VSA-bankstelsel. Daar het weer eens twyfel daaroor ontstaan as gevolg van die probleme van die Continental Illinois-bank, die agtste grootste bank in die VSA, en die dramatiese reddingspoging wat nodig was om te verhoed dat dit ineenstort. Hoewel CI se probleme ontstaan het as gevolg van swak vordering ten opsigte van binnelandse voorskotte, het die samevallende aankondiging deur Bolivia en Ecuador dat hulle hul leningsdiensbetalings aan handelsbanke opskort die vrees laat ontstaan dat ander VSA-banke met 'n groot blootstelling aan Latyns-Amerika ook met likwiditeitsprobleme te kampe sal kry. Vanselfsprekend kan enige verlies aan vertroue in die VSA-

interest rate levels and such inflows are necessary to balance the deficit on current account caused mainly by the massive trade deficit already referred to. The 1984 US current account deficit is likely to be in the region of \$80 billion, less than the trade deficit because of invisible earnings.

Of course, a breakdown of the US banking system would be serious enough in itself for the whole world economy. In the early 1930s, it was the failure of the banks which really was responsible for the depression. Had it not been for the banking collapse, the recession, which had been caused initially by the Wall Street crash, would in all probability not have been long enduring. This is the view not only of Milton Friedman but of other contemporary researchers also.* And it is reasonable to assume that the Fed would provide the reserves necessary to avoid a repetition of that experience. However, the world financial system today is vastly more complex than it was fifty years ago. Beyond the US banking system is the Eurodollar market, and linked to this is a currency system which has at its centre no central bank to act as lender of last resort.

The reasons why the dollar has been so strong during the first half of 1984 have to do with the fact that inflation in the US has remained effectively below 5 per cent per annum while nominal interest rates have been well above this figure. In short, real interest rates have been high in both absolute and relative terms in America. Also, improved growth in the real economy has encouraged capital inflows. But the danger is real that interest rates will have to continue rising if loan funds are to be attracted via the balance of payments and there would seem to be a limit to the extent to which interest rate levels can be pushed upwards without provoking further third world suspensions of debt servicing payments. Interestingly, the demand for credit in the US has been strong, despite the fact that real interest rates have been high, because returns on equity have been sufficient to compensate even for this. But high equity returns have been the consequence of rapid recovery from a very low level of capacity utilisation (69 per cent). This is now approaching the point (85 per cent) where the operating leverage effect will again begin to weaken.

As capacity utilisation increases and as unemployment falls (it is currently around 7,5 per cent of the workforce) the danger of a resurgence of inflation is bound to increase also. What worries many financial analysts in the US, is that a monetising of part of the huge Federal Government deficit (expected to be in the region of \$170 to \$180 billion this year) will add to inflation through a ballooning effect on the monetary stock. Monetising would become unavoidable were the Treasury to be unable to get the funds it required through the issue of long-dated securities without pushing interest rates up to unacceptable levels.

Of course, there is another and less pessimistic scenario. There need not be a dollar collapse if the present rise in US interest rates is sufficient to cool down the economy, if a moderate easing of the dollar is sufficient to restore US export competitiveness and if the third world debt problem is contained by *ad hoc* rescheduling with or without interest rate capping. A cooling of the US economy coincident with improved growth in the rest of the OECD area would probably result in an orderly downward adjustment of the US trade deficit. But that is in the short term, ie between now and 1986. What remains a source of nagging concern is the long-term position of the third world countries. They are in structural deficit on BoP current account and no amount

bankstelsel ernstige gevolge vir die handhawing van groot VSA-kapitaalinstromings inhou, ongeag rentekoerspeile, en dié instromings is nodig om die tekort op lopende rekening, hoofsaaklik as gevolg van die geweldige handelstekort, te balanseer. Die VSA se tekort op die lopende rekening vir 1984 sal waarskynlik ongeveer \$80 biljoen wees, wat minder is as die handelstekort, as gevolg van onsigbare verdienste.

Natuurlik sou 'n ineenstorting van die VSA-bankstelsel op sigself al ernstig genoeg wees vir die hele wêreldekonome. In die vroeë dertigerjare was dit die mislukking van die banke wat in werklikheid vir die depressie verantwoordelik was. Was dit nie vir die ineenstorting van die banke nie, sou die resessie, wat aanvanklik deur die Wallstraat-ineenstorting veroorsaak is, na alle waarskynlikheid nie so lank geduur het nie. Dit is nie net die beskouing van Milton Friedman nie, maar ook van ander hedendaagse navorsers.* En dit is redelik om te veronderstel dat die "Fed" die reserwes sal verskaf wat nodig is om 'n herhaling van dié ondervinding te vermy. Die hedendaagse finansiële stelsel van die wêreld is egter ontsettend meer kompleks as wat dit vyftig jaar gelede was. Anderkant die VSA-bankstelsel lê daar die Eurodollarmark, en gekoppel daaraan is 'n valutastelsel wat geen sentrale bank as kern het om as kredietverlener in laaste instansie op te tree nie.

Die redes waarom die dollar gedurende die eerste helfte van 1984 so sterk was, het te doen met die feit dat inflasie in die VSA effektief onder 5 persent per jaar gebly het terwyl nominale rentekoerse heelwat bokant dié syfer was. Kortom, reële rentekoerse in Amerika was absoluut en relatief gesproke hoog. Dan het verbeterde groei in die reële ekonomie ook kapitaalinstromings aangemoedig. Maar daar bestaan 'n wesenlike gevaar dat rentekoerse sal moet voortgaan om te styg om leningsfondse deur middel van die betalingsbalans te lok, en dit wil voorkom of daar perke is aan die mate waarin rentekoerspeile opwaarts gedruk kan word sonder om verdere opskortings van leningsdiensbetalings deur die derde wêreld uit te lok. Dit is interessant dat die vraag na krediet in die VSA sterk was ten spyte van die feit dat reële rentekoerse hoog was, aangesien die opbrengs op ekwiteit voldoende was om selfs dit te vergoed. Maar hoë ekwiteitopbrengste was die gevolg van spoedige herstel van 'n baie lae peil van kapasiteitbesetting (69 persent). Dit nader nou die punt (85 persent) waar die besettingshefboomuitwerking weer sal begin verswak.

Namate kapasiteitbenutting toeneem en namate werkloosheid afneem (dit is tans ongeveer 7,5 persent van die arbeidskorps) sal die gevaar van 'n herlewing van inflasie na alle waarskynlikheid ook toeneem. Wat baie finansiële ontleders in die VSA tot kommer stem, is dat 'n omsetting in geld van deel van die groot Federale Regeringstekort (wat na verwagting dié jaar naasteby \$170 - \$180 biljoen sal wees) tot inflasie sal bydra deur middel van 'n inflerende uitwerking op die monetêre voorraad. Omsetting in geld sou onvermydelik word indien die Tesourie nie in staat sou wees om die fondse wat hy nodig het te verkry deur middel van die uitreiking van langtermynneffekte sonder om rentekoerse tot onaanvaarbaar hoë peile op te druk nie.

Daar is natuurlik 'n ander, minder pessimistiese, scenario. Daar hoef nie 'n dollarineenstorting te wees nie, indien die huidige styging in VSA-rentekoerse voldoende is om die ekonomie te laat afkoel, indien 'n matige verruiming van die dollar voldoende is om VSA-uitvoermededingendheid te herstel en indien die skuldprobleem van die derde wêreld deur ad hoc-herkedulering, met of sonder groter terugbetalings, bekamp kan word. 'n Afkoeling van die VSA-ekonomie, gepaard met verbeterde groei in die res van die OESO-gebied, sal waarskynlik 'n ordelike aanpassing na onder van die VSA-handelstekort tot gevolg hê. Maar dit is op die kort termyn, d.i. tussen nou en 1986. Wat steeds 'n bron van tergende kommer is, is die langtermynposisie van die lande van die derde wêreld. Struktureel het hulle

of international financial fiddling is likely to change that. Nor will the fundamental deficit position be changed by the cyclical improvement currently being experienced because of the upswing in US, Western European and Japanese demand for LDC exports. Any correction in the US balance of payments deficit will necessarily involve a shifting of deficit onto others, and the LDCs are not well positioned to evade the consequences.

However, structural deficits with developing countries should not in themselves be a problem. Indeed, they are what one would expect. Growing economies lacking an adequate capital base must be capital importers. This has been so with South Africa, and other countries not yet as advanced industrially are no different. The problem has to do with how such deficits are financed. Ideally they should be financed by risk capital, or at least largely by such capital. They have not been so financed because of third world ideological resistance and multinational concern about expropriation. Going the loan capital route, and especially in putting so much emphasis on short-term financing, has imposed an enormous strain on Western commercial banks, and it is this that now needs attention. The point is that the commercial banks have reached the near limit of their LDC lending capacity and will have from now on to contain the proportion of LDC debt in their portfolios of advances if there is not to be a serious deterioration in their lending ratios.

The involvement of the commercial banks on so large a scale anyway was not ideal but was the way things happened after the oil crises of 1973/74 and 1979/80. The recycling of Opec surpluses would better have been done by international agencies such as the IMF and the World Bank or by government agencies in the developed countries. Such agencies, now, will have to assume a greater financing role if there is to be any chance of an enduring solution. Alternatively, but perhaps less likely, would be a change in third world attitudes and policy designed to welcome, and to make secure from the threat of expropriation, the risk capital that would be the proper financing alternative. We are beginning, perhaps, to see a glimmer of hope in this direction (witness the Nkomati Accord and the opening up of Mozambique to private investment from South Africa), but it is too soon yet for the drawing of firm conclusions here.

The really important lesson to be drawn, however, from the whole problem of third world debt financing relates not to banking technicalities but to something else. The world we live in cannot be compartmentalised any longer. The prosperity of industrialised countries cannot be maintained separately from the poverty of the third world. If third world countries are not given access to the markets of industrialised countries, they (the LDCs) will not be able to service their debts, and if debts are not serviced, ultimately the prospect of a collapse of the world financial system will have to be faced. This is the significance of the statement quoted at the beginning of our editorial.

The Editor

'n tekort op hulle betalingsbalans op die lopende rekening, en dis onwaarskynlik dat enige mate van internasionale finansiële gepeuter dit sal verander. Verder sal die fundamentele tekortposisie ook nie verander word deur die sikliese verbetering wat tans ondervind word as gevolg van die toename in die vraag na MOL-uitvoere in die VSA, Wes-Europe en Japan nie. Enige regstelling in die VSA-betalingsbalanstekort sal noodwendig 'n oordra van die tekort na ander lande behels, en die MOL'e verkeer nie in 'n goeie posisie om die gevolge vry te spring nie.

Strukturele tekorte by ontwikkelende lande behoort egter nie op sigself 'n probleem te wees nie. Dit is inderdaad wat 'n mens te wagte moet wees. Groeiende ekonomieë wat nie 'n voldoende kapitaalbasis het nie, moet kapitaalvoerders wees. Dit was die geval met Suid-Afrika, en ander lande wat industrieel nog nie so gevorderd is nie, verskil geensins nie. Die probleem het te make met hoe dié tekorte gefinansier word. Ideaal gesproke moet dit deur middel van risikokapitaal, of in elk geval grootliks deur middel van sodanige kapitaal, gefinansier word. Dit was nie die geval nie as gevolg van ideologiese weerstand deur die derde wêreld en veelvolgige besorgdheid oor onteiening. Die inslaan van leningskapitaalpaadjie, en veral die beklemtoning van korttermynfinansiering, het 'n geweldige stremming op Westerse handelsbanke geplaas, en dit is dié kwessie wat nou aandag moet geniet. Dit gaan hier om die feit dat die handelsbanke byna die perk van hulle MOL-leenkapasiteit bereik het en voortaan die verhouding van MOL-skuld in hulle voorskotportefeuljes sal moet inperk om 'n ernstige verslegting in hulle leenverhoudings te voorkom.

Die betrokkenheid van die handelsbanke op so 'n groot skaal was in elk geval nie ideaal nie maar was maar net die verloop van dinge na die oliekrisis van 1973/4 en 1979/80. Die hersirkulering van OPEC-surplusse moes eerder deur internasionale instellinge soos die IMF en die Wêreldbank of deur staatsinstellinge in die ontwikkelde lande waargeneem gewees het.

Dié instellinge sal nou 'n groter finansieringsrol moet aanneem om enigsins 'n kans op 'n blywende oplossing te bied. 'n Ander moontlikheid, wat egter miskien nie so waarskynlik is nie, is 'n verandering in die houdings van die derde wêreld en 'n beleid wat daarop ingestel is om die risikokapitaal wat die behoorlike finansierings-alternatief sou wees te verwelkom en teen die bedreiging van onteiening te beveilig. Ons begin miskien nou 'n straaljie van hoop in dié rigting te sien (waarvan die Nkomati-ooreenkoms op die oopstel van Mosambiek vir private belegging deur Suid-Afrika getuig), maar dit is nog te vroeg om in dié opsig tot besliste gevolg-trekkings te geraak.

Die werklike belangrike les wat daar egter te leer is uit die hele probleem van die leenkapitaalfinansiering van die derde wêreld hou nie verband met tegniese bank-besonderhede nie, maar met iets anders. Die wêreld waarin ons leef kan nie meer in kompartemente verdeel word nie. Die welvaart van geïndustrialiseerde lande kan nie afsonderlik van die armoede van die derde wêreld gehandhaaf word nie. Indien die lande van die derde wêreld nie toegang tot die markte van geïndustrialiseerde lande gebied word nie sal hulle (die MOL'e) nie hulle leningskuld kan bybring nie, en indien leningskuld nie betaal word nie, sal die vooruitsig van 'n ineenstorting van die wêreld se finansiële stelsel in die gesig gestaar moet word. Dit is waarin die belang van die aanhaling aan die begin van ons hoofartikel lê.

Die Redakteur

*See *The Great Depression, 1929-38: Lessons for the 1980s* by the French economist Christian Saint-Etienne (published by the Hoover Institution, Stanford) and reviewed by Samuel Brittan in the London Financial Times, 31 May 1984.

*Kyk *The Great Depression, 1929-38: Lessons for the 1980s* deur die Franse ekonoom Christian Saint-Etienne (uitgegee deur The Hoover Institution, Stanford) en geresenseer deur Samuel Brittan in die London Financial Times, 31 Mei 1984.