The Investment Analysts Journal

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Die Beleggings-Navorsers Tydskrif

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This issue in brief

The economics of information
In modern industrial economies, one of the roles of markets is to disseminate information. Indeed, from a policy point of view, this might be regarded as their most important function. Official action, therefore, which interferes with market freedom, has the effect of distorting information, and that must adversely affect efficiency. The trouble with traditional economic theory, ie equilibrium theory, is that is does not satisfactorily accommodate information as an element critical to economic processes. This is examined by Dr P. D. F. Strydom in a searching inquiry into the subject.

Portfolio theory is elegant but useless
This paper, by P. A. Bowen of the University of Natal, has as its purpose an examination of the usefulness of portfolio theory to investors, as opposed to speculators, in the real world. After examining the underlying logic of portfolio theory, the conceptual differences between it and what happens in practice, and the problems encountered in its implementation, he comes to some rather damaging conclusions. These are deserving of the attention of all academics who propound portfolio theory as a workable system.

Leverage=Risk? Empirical findings for the JSE

The relationship between market determined measures of risk and accounting decision variables used by corporate managements is clearly important in any consideration of the theory and practice of managerial finance. Unfortunately, investigation has revealed that the theoretical measures of risk developed by researchers in America have only limited practical applicability in South Africa. The problem is examined in detail in an empirical investigation reported on by Messrs Retief, Affleck-Graves and Hamma, respectively a doctoral student at the Stellenbosch Business School, Professor of Business, Cape Town, and Professor of Finance at the Stellenbosch Business School.

Bond immunisation in South Africa

Trevor Blench and Professor John Afflect-Graves examine, in this article, the risk to which investors in fixed interest securities are exposed due to changes in interest rates and how such risk may be minimised in order to assure a predetermined return over a selected target period. The technique described is of particular interest to institutional investors with calculatable future contractual obligations to policy holders and other beneficiaries.

The role of share risk measurements in the management of investment portfolios

Brian Gilbertson is well known to readers of the IAJ for his earlier contributions on market efficiency and portfolio theory. In this Investment Basics article, he deals clearly and fully with the complex matter of risk measurement and its relevance to investment management.

The Investment Analysts Journal

Twenty-fourth issue

November 1984

As we go to press with this issue of the journal, a general cut in prime overdraft rates has been announced. To the extent to which this has occurred because of a slackening in the demand for credit there is nothing to be said in contradiction of the development. However, what has the outward appearance of an adjustment to market forces, can also be seen as an accommodation to powerful protest on the part of vested interests that have not enjoyed the taste of the monetary medicine that has been administered since 2 August. In recent weeks, criticism from such interests has gathered force and it has reached a point where doubt has come to be cast on the whole De Kock experiment involving greater emphasis on market as opposed to State regulation of the economy. At best, this criticism has amounted to a veiled demand for a U-turn on the present restrictive monetary direction of the authorities. At worst it has amounted to an open call for a return to direct controls. It is being argued that South Africa is too small a country, and its socio-political problems are too complex, to permit the luxury of free markets. We should be under no illusion about what these demands amount to. They amount to nothing less than a willingness to sacrifice freedom from bureaucratic regulation on the altar of short-term expediency.

One has the impression, perhaps mistakenly, that Dr De Kock has his back to the wall and is fighting, not only to save a particular approach to monetary management, but is fighting also to save his professional reputation. Were the calls for direct controls eventually to be heeded, Dr De Kock could be forced to resign. That would be a tragedy not only for the financial sector of the economy but for the whole country.

It does not help matters that the successes of monetary policy during the past few years have been few and its failures many, but it is important that it should be understood why monetary policy has not yet yielded its promised rewards. Three reasons should be mentioned.

The first concerns the decline in the gold price and the drought, both developments beyond the control of the authorities. These developments have greatly complicated the problems of monetary management because of their effect on the balance of payments and the rand exchange rate. They would, however, have had to be faced even by officials pursuing different policies and it is doubtful whether they would have coped better in the circumstances. They might well have done a lot worse! It would be nice if monetary stability could be imposed by decree, but in a world of considerable global fluctuation this is not possible.

The second concerns fiscal policy. This has cut right across monetary policy and is a major cause of monetary policy veering off course. Let there be no mistake about it, notwithstanding the fact that the published deficit before borrowing has been kept within "respectable" limits in relation to money GDP. Not only have Exchequer issues risen from around 22 per cent of GDP

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Vier-en-twintigste uitgawe

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Tydens die ter perse gaan van hierdie uitgawe van die tydskrif is 'n algemene verlaging van prima oortrekkingskoerse aangekondig. In soverre dit aan 'n afname in die vraag na krediet toegeskryf kan word, kan niks teen die stap gesê word nie. Wat egter oënskynlik soos 'n aanpassing by markkragte lyk, kan ook beskou word as 'n skikking ná sterk protes van die kant van gevestigde belange wat nie van die smaak van die monetêre medisyne wat sedert 2 Augustus toegedien is nie, gehou het nie. Kritiek deur dié belange het die afgelope weke in hewigheid toegeneem en het die punt bereik waar die hele De Kock-eksperiment, wat groter klem lê op die reëling van die ekonomie deur markkragte, in teenstelling met reëling deur die staat, in twyfel getrek word. In die gunstigste geval het die kritiek op 'n bedekte eis neergekom dat 'n regsomkeer in die huidige beperkende monetêre beleid van die owerheid gemaak word. In die ergste geval het dit op 'n openlike eis om die herinstelling van direkte beheermaatreëls neergekom. Daar word aangevoer dat Suid-Afrika 'n te klein land is en sy sosio-ekonomiese vraagstukke te ingewikkeld is om die weelde van vrye markte te duld. Daar behoort by ons geen wanindruk te wees oor waarop dié eise neerkom nie. Dit kom neer op niks minder nie as bereidwilligheid om vryheid van burokratiese reëling op die altaar van korttermyngerief op te offer.

'n Mens kry die indruk, miskien verkeerdelik, dat dr De Kock met die rug teen die muur is en veg, nie net om 'n besondere benadering tot monetêre beheer te red nie, maar ook om sy professionele aansien te red. Indien daar uiteindelik aan die eise om direkte beheermaatreëls gehoor gegee sou word, mag dr De Kock gedwing word om te bedank. Dit sou 'n tragedie wees – nie net vir die finansiële sektor van die ekonomie nie, maar ook vir die hele land.

Sake word ook nie bevorder deur die feit dat die monetêre beleid gedurende die afgelope jare bra min sukses behaal het en dikwels gefaal het nie. Dit is egter belangrik om te begryp waarom die monetêre beleid nie die beloofde belonings opgelewer het nie. Drie redes dien gemeld te word.

Die eerste rede het met die daling in die goudprys en die droogte te doen, albei verskynsels waaroor die owerheid geen beheer het nie. Hierdie ontwikkelings het die uitoefening van monetêre beheer baie bemoeilik vanweë die uitwerking wat dit op die betalingsbalans en die randwisselkoers het. Hulle sou egter aanvaar moes word selfs al het amptenare 'n ander beleid gevolg, en dis te betwyfel of ander maatreëls in die omstandighede beter resultate sou behaal het. Hulle kon selfs baie swakker gevaar het! Dit sou aangenaam gewees het indien monetêre stabiliteit verorden kon word, maar in 'n wêreld waar aansienlike skommeling algemeen voorkom, is dit nie moontlik nie.

Die tweede rede het met fiskale beleid te doen. Laasgenoemde het inbreuk gemaak op monetêre beleid en is 'n belangrike rede waarom die monetêre beleid van rigting in 1980 to over 30 per cent, but the total public sector borrowing requirement (PSBR) has ballooned and could exceed 14 per cent of GDP this year. This is a far better measure of what has actually been happening because the PSBR includes all state and para-statal bodies not just the borrowing needs of the central government. In recent years these have been given the appearance of decline because borrowing by such authorities, which had previously been included in the main Budget, have been transferred elsewhere. Last March we were told that Government expenditure would rise by 11,7 per cent in 1984/5. This has now been revised upward to 21,5 per cent. On 19 September, when the new Minister of Finance announced his package of spending cuts, it was revealed that had these not been made, the increase in spending this fiscal year would have amounted to 24,4 per cent. The only real reason why the official deficit before borrowing has remained within "respectable" limits has been because tax revenue has risen together with expenditure, and it has done so because GST has been increased from 6 per cent to 10 per cent (basic foods now excluded), and because the rand exchange rate has collapsed, thus boosting the rand value of profits from exports, and particularly from exports of gold.

It is worth noting the link that now exists between the exchange rate and what happens domestically with fiscal policy. The collapse in the rand from $0,7740 to $0,6135 between end May and end July can be explained by the realisation in financial markets that the overshooting in spending was proving far worse than anyone had ever believed possible only a few months before. The further slump in the rand to $0,5000 on 30 October, dates from the moment of the Minister's spending cut announcement. Clearly, the financial markets were not persuaded that the cuts amounted to anything like what was needed to demonstrate that the underlying disequilibria, which were the heart of the problem, were being properly addressed. Yet despite this, the complaints about monetary stringency continued, and they have become louder in recent weeks.

One can sympathise, of course, with people in the private sector feeling aggrieved. They are being hammered by some of the most severe monetary measures ever adopted in this country, and they are having to face, as a consequence, a sharp decline in business activity. But a tight monetary policy is unavoidable given what has happened on the fiscal front. Any premature monetary easing can only put the rand exchange rate more at risk because it could be taken as a signal for spending to start increasing again. Were that to happen the present gross undervaluation of the rand would be corrected not by a recovery in the exchange rate itself, but in a further and sharp rise in the domestic price level. This surely is what must be avoided although one gets the impression that inflation is still viewed here as a lesser evil compared with unemployment or social unrest. Sadly, the threat of inflation itself to job creation (which has been convincingly demonstrated over the last decade) is taken as either long-term or academic, and the link between social unrest and political grievances (the continuation of which has little *directly* to do with monetary policy) is played down.

The third reason why monetary policy has not yet provided its promised rewards in South Africa since 1980 has to do precisely with attitudes such as those just described. Because the connection between inflation and economic underperformance is viewed as distant or theoretical, greater weight is usually given to more

verander het. Dat dit so is, staan vas, ondanks die feit dat die gepubliseerde tekort voor lenings binne "aanvaarbare" perke in verhouding tot geld-BBP gehou is. Nie alleen het skatkis-uitgiftes van ongeveer 22 persent van die BBP in 1980 tot meer as 30 persent gestyg nie, maar het die totale leningsbehoefte van die openbare sektor (OSLB) skerp gestyg en kan vanjaar 14 persent van die BBP oorskry. Hierdie is 'n baie beter maatstaf van wat in werklikheid gebeur het, omdat die OSLB alle staats- en parastatale liggame insluit, en nie net die leningsbehoeftes van die sentrale owerheid nie. Dit het die afgelope jare oënskynlik gedaal, omdat lenings deur dié owerhede wat in die verlede in die hoofbegroting ingesluit was na elders oorgeplaas is. Ons is verlede Maart meegedeel dat staatsuitgawes in 1984/5 met 11,7 persent sou styg. Dit is nou opwaarts hersien tot 21,5 persent. Op 19 September, toe die nuwe Minister van Finansies sy pakket vir die besnoeiing van uitgawes aangekondig het, is daar onthul dat indien dit nie gedoen sou word nie, uitgawes in die huidige belastingjaar met 24,4 persent sou gestyg het. Die enigste ware rede waarom die amptelike tekort voor lenings binne "aanvaarbare" perke gebly het, is omdat inkomste uit belasting saam met uitgawes gestyg het en dit wel omdat AVB van 6 persent tot 10 persent (basiese voedsel nou uitgesluit) verhoog is en die randwisselkoers verswak het en sodoende die randwaarde van winste uit uitvoere, en veral die uitvoer van goud, opgestoot het.

Dit is die moeite werd om te let op die huidige verband tussen die wisselkoers en dit wat binnelands met die fiskale beleid gebeur het. Die daling van die rand van $0,7740 na $0,6135 tussen einde Mei en einde Julie kan verduidelik word deurdat die finansiële markte tot die besef gekom het dat die buitensporige besteding veel erger was as wat enigeen slegs enkele maande vantevore ooit kon voorsien het. Die verdere insinking van die rand na $0,5000 op 30 Oktober het begin toe die Minister sy maatreëls vir die besnoeiing van uitgawes aangekondig het. Die finansiële markte was klaarblyklik nie daarvan oortuig dat die besnoeiings hoegenaamd voldoende bewys was dat die onderliggende onewewigtighede, wat die kern van die probleem was, behoorlik aangepak word nie. Die klagtes oor monetêre strengheid het desondanks voortgeduur en het die afgelope weke luider geword.

'n Mens kan natuurlik simpatiseer met die privaatsektor wat verontreg voel. Hulle word met van die strafste monetêre maatreëls wat nog in dié land toegepas is gemoker, en moet gevolglik 'n skerp daling in sakebedrywighede in die gesig staar. Maar 'n streng monetêre beleid is onvermydelik in die lig van dit wat aan die fiskale kant plaasgevind het. Enige voortydige monetêre verslapping sal die randwisselkoers net in gevaar stel, omdat dit beskou sal word as 'n teken dat besteding weer kan begin styg. Indien dit sou gebeur, sou die huidige geweldige onderwaardering van die rand reggestel word, nie deur die herstel van die wisselkoers self nie, maar deur 'n verdere, skerp styging in binnelandse pryspeile. Dit moet stellig voorkom word, hoewel mens die indruk kry dat inflasie hier te lande steeds as 'n kleiner euwel beskou word indien dit met werkloosheid of burgerlike oproer vergelyk sou word. Die bedreiging wat inflasie self vir die skepping van werkgeleenthede inhou, geniet ongelukkig (soos die afgelope dekade oortuigend bewys is) òf 'n langtermyn- òf 'n akademiese beskouing, en die verband tussen burgerlike oproer en politieke griewe (waarvan die voortsetting weinig direk te doen het met monetêre beleid) word op die agtergrond gehou.

immediate problems. Balance of payment problems, in particular, have tended to be given priority when these have become pressing. Yet deeper analysis reveals that the problem of inflation and the problems of the balance of payments are inextricably linked. Without coming to terms with excessive inflation (excessive in terms of intercountry comparisons as well as in absolute terms), there can be no *lasting* correction of our balance of payments difficulties. Social unrest is to be deplored and must be taken seriously. But it should not be used as a red herring to justify a compromising of needed resolution with respect to macroeconomic management. Too frequently in the recent past, "political" pressure has been brought to bear on the monetary authorities to soften their stand on policy at the precise moment when their actions were beginning to have the right effect.

It must be hoped that what is now being witnessed in the cutting of short-term interest rates, is not another example of the effectiveness of this "reverse" moral suasion. If it is, the time will be short (twelve to eighteen months perhaps) before interest rates will have to be raised again, and then to levels even higher than they are now. It should not be expected that South Africa can solve, in sixteen weeks of monetary stringency, problems which have taken up to six years to solve in developed economies abroad. This is not to argue in favour of a needless drawing out of deflation here. Every job lost is to be lamented in a country where so many people live close to the breadline. The argument in favour of "vasbyt" is that the correction it would involve would be shorter, and in the end less damaging, both to employment and to stability.

The editor

Die derde rede waarom die monetêre beleid in Suid-Afrika sedert 1980 nog nie die beloofde belonings opgelewer het nie, het presies te doen met houdings soos dié wat hierbo beskryf is. Aangesien die verband tussen inflasie en ekonomiese onderprestasie as ver verwyderd of teoreties beskou word, word groter gewig gewoonlik aan meer onmiddellike probleme geheg. Veral betalingsbalansprobleme was geneig om groter voorkeur te kry wanneer dit dringend geword het. 'n Deegliker ontleding bring egter aan die lig dat die inflasieprobleem en betalingsbalansprobleme onafskeidbaar van mekaar is. As daar nie 'n oplossing vir oormatige inflasie (oormatig wat vergelykings met ander lande betref en in absolute terme) gevind word nie, kan ons betalingsbalansprobleme nie blywend reggestel word nie. Burgerlike oproer is te betreur en moet met erns bejeën word. Dit moet egter nie gebruik word om die aandag af te trek ter regverdiging van 'n kompromis wat betref die nodige besluite ten opsigte van makroëkonomiese beheer nie. "Politieke" druk is al te dikwels in die verlede op die monetêre owerheid uitgeoefen om sy beleidstandpunt te verander presies op die tydstip toe sy optrede die regte uitwerking begin toon het.

Hopelik is die verlaging van korttermynrentekoerse nie nog 'n voorbeeld van die doeltreffendheid van dié "teenoorgestelde" morele oorreding nie. Indien wel, sal dit slegs 'n kort rukkie duur (miskien twaalf tot agtien maande) voordat rentekoerse weer verhoog sal moet word, en dan wel tot 'n vlak wat die huidige peil selfs oorskry. Daar moet nie verwag word dat Suid-Afrika probleme, wat in ontwikkelde ekonomieë in die buiteland tot ses jaar geduur het om opgelos te word, binne sestien weke van die monetêre strengheid sal oplos nie. Hiermee word nie 'n pleidooi ten gunste van die onnodige uitrekking van deflasie hier te lande gelewer nie. Elke werkgeleentheid wat verloor word, moet betreur word in 'n land waar so baie mense feitlik net die bestaansminimum het. Die argument ten gunste van "vasbyt" is dat die regstelling wat dit behels korter en op die langer duur minder nadelig vir werkverskaffing en stabiliteit sal wees.

Die redakteur