BUSINESS

Government may dip into reserve funds

Debate rages over tapping into R459bn to plug funding gap

BL PREMIUM

29 OCTOBER 2023 - 06:53

Reserve Bank deputy governor responsible for financial markets, Rashad Cassim. Picture: ROBERT TSHABALALA

Finance minister Enoch Godongwana could hint at the government possibly drawing from a R459bn special reserve account to augment revenue shortfalls when he delivers the medium-term budget policy statement (MTBPS) on Wednesday.

Business Times understands that there has been a meeting with the minister, the National Treasury and the Reserve Bank to discuss the account and the implications of drawing from it.

Well-placed insiders said Godongwana was likely to acknowledge the existence of the Gold and Foreign Exchange Contingency Reserve Account (GFECRA) on Wednesday but plans on whether the government would seek to use the money to fund the gap between revenue and expenditure would be outlined only in the budget speech in February.

A fierce debate has been raging since 84 economists, academics, professionals and 24 civil society organisations wrote an open letter to the finance minister, urging him to "immediately close the budget mismatch by drawing on reserves". The signatories include Trade & Industrial Policy Strategies economist Neva Makgetla, the Human Sciences Research Council's Peter Jacobs and Council for Scientific and Industrial Research chief engineer Keith Ferguson.

But the deputy governor responsible for financial markets at the Bank, Rashad Cassim, has again warned that tapping into this reserve will have serious cost implications for the economy, the Bank and the country.

Cassim said GFECRA drawdown amounts were unrealised gains. The implication is a portion of this money could quickly be reduced by shifts in the exchange rate. On average, about R100bn was volatile annually due to exchange rate fluctuations.

"Distributing these profits without selling foreign exchange reserves would entail monetisation of the balances, which implies substantial liquidity management costs for the Bank.

"It is important to emphasise that the GFECRA balances are not a windfall that can be enjoyed with no further costs."

Cassim said central banks retain some gains in their reserve accounts as a buffer against future losses that would otherwise weaken their balance sheets.

"In global practice, valuation gains are not simply and straightforwardly remitted to governments as profits; they are also employed to finance foreign exchange reserves to fortify the central bank's balance sheet."

He said a standing committee co-chaired by him and the Treasury director-general meets to discuss matters related to the GFECRA. If there was a recommendation made to the finance minister and the governor on drawing from the account, further work would have to be undertaken to determine how best to manage the associated costs.

The Treasury is under pressure to make provision for a continuation of the R350 social relief of distress grant beyond 2023, and to budget for higher public sector wages next year. State-owned entities are also seeking bailouts, with Transnet having already asked for a R47bn equity injection. It also wants the government to absorb R61bn of its R130bn debt.

Economists are divided on the merits of drawing from the GFECRA; those who support the measure say that the money should be channelled to infrastructure investment, including recapitalising Transnet.

Gilad Isaacs, executive director and co-founder of the Institute for Economic Justice, said while the concerns of those against drawing from the GFECRA should be taken seriously, using the mechanism to fund Transnet would benefit the economy.

"We have supply constraints. If we invest in Transnet, which can move various goods and people at a more cost-effective rate, that will bring inflation down. Investing in the supply side has a positive inflationary benefit and there is no evidence that plugging financial gaps will be inflationary," he said.

> **" We could draw down prudently by two-thirds — but there are no good economic, technical or legal reasons not to use it "**
>
> *- Gilad Isaacs, Institute for Economic Justice*

Isaacs said that while the mechanism accumulated as unrealised gains, it could be drawn on, and the Bank could raise the liquidity required without selling exchange reserves. He said this was not legally complex and could be done reasonably and responsibly.

"I don't think we should draw down entirely on this. It would be prudent to keep a share for future exchange rate fluctuations. It accrues on movement in gold and foreign exchange. We could draw down prudently by two-thirds — but there are no good economic, technical or legal reasons not to use it," Isaacs added.

While it was understandable that critics of employing the GFECRA did not trust politicians to spend the money wisely, arguing that it must be kept out of government hands purely on this basis was "inherently undemocratic", and the Bank had no mandate to restrict government access to such resources.

"I don't see a need to alter the Reserve Bank Act or other extraordinary measures. It seems fairly straightforward and no-one who has cautioned that this is complex has substantiated [that view] in any meaningful way," he said.

Redge Nkosi, executive director at research and advisory firm Firstsource Money, said shifting money to the government for spending on infrastructure, public services and catalytic projects was a good investment and critics were using “misguided scarecrow tactics”.

“Preferably, it should go to investments that will yield returns over time. Infrastructure is a good starting point. [Social] grants are fine, but we already have allocations there. We have challenges in infrastructure, health and development,” Nkosi said.

Duma Gqubule, economist and founding director of the Centre for Economic Development and Transformation, said South Africa was free to use the GFECRA and other means — including the R110bn surplus in the Unemployment Insurance Fund — to raise money without getting into debt.

“I just find it difficult to understand. At a broader point, there are many options that we could use to kick-start the economy. Our foreign exchange reserves are way in excess of standards. We can tap into it, so I am not sure what opponents are referring to.”

Peter Attard Montalto, MD of research and consulting firm Krutham, is sceptical the Treasury will tap into the account or that the finance minister will even mention it in the medium-term budget, as spending and revenue issues are the focus of the budget.

He said given that no-one wanted to sell reserves, the Bank would end up having to print money but then reabsorb it elsewhere with the Treasury covering the liquidity management cost, “and it still being much cheaper than issuing new bonds”.

Efficient Group economist Dawie Roodt said he generally disagreed with the notion of using the GFECRA for this purpose, adding that the rand’s volatility could shift South Africa’s liability considerably in a short time.

“They say that belongs to the state and must be paid to the state and they are not wrong. But if they pay those profits to the state and then the rand appreciates and the Bank makes a loss, who is responsible?”

Roodt added the Bank would have to sell dollars to realise a profit, which would lead to it having fewer dollars and then

“ I just find it difficult to understand. At a broader point, there are many options that we could use to kick-start the economy. Our foreign exchange reserves are way in excess of standards. We can tap into it, so I am not sure what opponents are referring to ”

- Duma Gqubule, economist and founding director of the Centre for

having to buy more.

Economic Development and Transformation

"If they give R460bn to the state and they spend all of it, all of a sudden there is R460bn more in the system. The Bank will have to take it out and will sell debentures. They will have to pay interest on the money that they took out of the system because the state spent it."

Roodt said the only long-term answer to South Africa's economic quandary was stronger growth, more economic activity, a more competent government and less corruption.

Citadel chief economist Maarten Ackerman said while countries such as China that are "in a different ball game" in terms of reserves had considerable resources, the figure of R459bn was not far from Eskom's total debt a few years ago, and this funding "won't take South Africa very far".

"We've seen before with other countries that you have to be a big player to dip into your reserves. It sounds like a lot of money, but the reality is that when the market starts to move, we can deplete that very quickly. If we are saving it for a rainy day, we should keep it for when we really need it," Ackerman said.

Market Report - 17 Nov 2023 | The close

2 days ago

8:01

Next video

25:10

Stock Watch - 16 Nov 2023 | The Close

3 days ago

8:14

Market Report - 16 Nov 2023 | The Close

3 days ago

6:16

Watch: Emira's distributable earnings...

3 days ago

Watch: Invest
15% jump in I

3 days a