INVESTMENT MANAGEMENT IMBIZO – 2002

Address by Trevor A Manuel, MP, Minister of Finance

We are enjoined in a shared responsibility to ensure that our respective talents are deployed in ensuring a better outcome for all South Africans.

For South Africa remains a world of stark contrasts.

Sophisticated businessmen develop long-term strategies only a stone's throw away from the women developing daily survival strategies for themselves and their children.

Our banking halls glisten invitingly while the vast majority of our population remains unbanked.

Our investment markets stand shoulder to shoulder with the best in the world. Yet, many of our people rely on the vagaries of informal markets for their livelihoods.

This set of facts throws up a number of daunting challenges to all of us.

We must ensure that the enormous wealth that circulates in our financial markets does so for the benefit of all South Africans.

We must ensure that investment capital is allocated productively, otherwise we can never expect to enjoy the high sustainable growth rates required to ensure a better standard of living for all our people.

We must protect the advantage we have over many other emerging market economies that envy the depth and sophistication of our markets.

This requires us to tread very carefully.

We must ensure that our markets are appropriately regulated, though not stifled by red tape. But equally we must avoid that dangerous form of *laissez faire* that allows the poor to be condemned to further poverty through financial sophistry and the chicanery of those charged with looking after their savings.

This requires of us that we inculcate in all of us a sense of honesty and integrity. And that we underpin this with sensible regulation.

Since 1994, South Africa's financial markets have flourished

?? The market capitalisation on the JSE has risen from R388 billion at the end of 1990 to R1,8 trillion at the end of 2001. At the same time, annual turnover has risen from 6,1 per cent of market capitalisation to 34,2 per cent.

- ?? In July this year, the number of shares traded on the JSE was 12 times the level it was in 1995.
- ?? The capital market has also grown strongly, with daily turnover of R40 billion. The development of our fledgling corporate bond market is a very encouraging sign of the robustness of our financial environment.
- ?? Our wealth of financial talent is no better reflected than in the derivative markets. The number of derivative contracts written more than doubled between 1996 to 2001, while the underlying value of these deals rose more than 3 fold.

These numbers are indeed impressive. But we must not forget what we are doing.

These are an accumulation of the meagre savings of working South Africans.

These are the funds that foreigners entrust to us in good faith.

These are the funds that must fund productive investment for sustainable growth and job creation.

Government must provide a firm platform on which you can ply your trade. In turn, you do this with probity, honesty and integrity.

For when one acts dishonestly, that casts doubt on the entire system and community of investment managers.

Macroeconomic policy reform

Since 1994, Government has been striving to ensure a system of macroeconomic and fiscal management that renders it possible for your industry to move from strength to strength.

While macroeconomic reform continues to be a difficult process and contested terrain, we believe that we have come a very long way since 1994.

From being a closed, insular, inward looking society, we have embraced the global community, faced our fears and created an investment enviroment conducive to sustained economic growth and development.

Step by step, we have put in place an investor-friendly macroeconomic and fiscal environment.

In the ten years to 1994, real GDP growth rates were 0,6 per cent a year. Since 1994, annual growth has averaged 2,7 per cent, and we are forecasting growth in excess of 3,5 per cent in the medium term.

We can be proud that these forecasts are underpinned by anticipated strength in the domestic economy.

Fiscal reform has ensured sustainable debt and deficit levels, and falling interest payments, which allow for real spending growth of 4,7 per cent over the next three years. Yet, the tax reform trend of recent years is continued, with the tax:GDP ratio stabilising at 24,4 per cent of GDP.

Consolidation of the fiscal balances have provided significant room over the past few years for us to introduce targeted measures that further enhance the investment environment. Included among these are:

- R3 billion over four years for additional tax allowances for strategic investment projects.
- An accelerated depreciation programme to encourage investment.
- A wage incentive to provide impetus to the learnership programmes, thereby raising skills levels to meet the requirements of 21st century businesses.

The reduction of Government demands on the local bond market has created space in recent years for the emergence of a corporate bond market, widening the opportunity for our firms to flexibly access capital for ongoing development.

Restructuring of state assets continues to enhance the efficiency of resource allocation across the economy, raising the competitiveness of our investment environment.

While Government retains strategic stakes in many of the key assets, the restructuirng will continue with the partial privatisation of Telkom in this fiscal year.

The sharp depreciation of the currency toward the end of 2001 presented a real test of our macroeconomic strength. Despite the 34 percent depreciation of the currency in 2001, our economy responded positively to this, with exports growing strongly in 2002, regardless of slower than anticipated global growth.

Since 1994, the inflation trend has been firmly downward, providing a stable environment in which to make investment decisions and reducing the distorting effect of inflation on investment allocation decisions.

Rising inflation following the depreciation is a temporary setback for the inflation targeting framework we have set with the South African Reserve Bank. In September, the CPIX was 11,8 per cent, up from 5,8 per cent in September 2001.

Over the medium term, inflation will slow, as the effects of the depreciation dissipate and the currency strengthens, falling below 6 per cent toward the end of next year.

In this context, we agreed with the Governor that the inflation target should remain 3-6 per cent in 2004. As we consolidate our gains in the fight against inflation, we will consider further downward adjustments to the targets.

Exchange control liberalisation

Exchange control liberalisation forms an important component of our reintegration with the world economy. As has been broadly recognised internationally, a gradual approach to capital account liberalisation is advisable and should occur late in the process of economic reform.

Prerequisites include a stable macroeconomic environment, a sound and well-regulated financial system and social safety nets to help protect the poor from the potential costs of globalisation.

While we are still contemplating the findings of the Rand Commission, we have felt comfortable enough to relax exchange controls again in the MTBPS. We have noted that a number of South African firms are doing exceedingly well across the length and breadth of the African continent.

Accordingly, and consistent with our commitments to NEPAD, we have announced considerable liberalisation of the investment limits for fixed investment on the African continent.

Investors may now use South African funds to finance new approved direct investment in Africa of R2 billion (up from R750m) and may use top-up funding for expanding existing approved investments. Together these relaxations send very strong signals about our commitment to assist responsible development on the continent.

Prudential regulation

Our gradual approach to exchange control continues to serve us well and we are complementing the development and implementation of prudential regulation standards, especially for institutional investors and asset managers On this front, we firmly believe that the right way to go is to embody our institutional investors offshore allowances within an enhanced framework of prudential regulatory requirments. This is an accepted international approach. We are working toward giving an indication of the way ahead at the next budget speech.

Two related issues are worth mentioning here. Firstly, is the need for more informed and accountable trustees of investment funds, particularly pension funds. It is accepted that we want our trustees to follow prudent investment strategies and that they should be held legally accountable for negligent conduct when dealing with investors funds. Secondly, is the need for an improved culture of regulatory compliance amongst institutional investors, and asset managers. This extends to even the veracity of financial data on the investment of funds, and just as important, the timeous and regular delivery of

such data. As an industry you need to improve in this regard. I know you can do better.
At the same time as we liberalise and permit offshore investment, we owe to ourselves to invest wisely. And as many an offshore investor over the past year can tell you, - “the grass is not always that greener across the blue ocean”. Many people who invested offshore lost money in real terms. We should therefore reexamine our way of thinking that seems to say for many that local investments do not offer real inflation beating returns.

We remain a savings-shy country, and many of us remain people of little faith in our own country and its wealth creating potential. In this context, we all acknowledge that there is a fair amount of nation-building that needs to happen on the investment front. So that foreign investors can see that South Africans believe in the future of their country to such an extent that hard earned disposable income is invested locally. This scenario is starkly different to the perceptions we create and signals we send as a nation when South Africans take huge sums all over the world. In the long run, it might actually be bad for our ability to attract foreign direct investment.

Our ability to attract sustainable direct investment is direclty connected to our investment rating. Since 1994, South Africa has gone from strength to strength in this regard.

From languishing in a very uncertain environment in 1994 where no rating agency was prepared to give us an investment grade rating, South Africa now enjoys investment grade ratings from Standard and Poor, Fitch and Moody’s.

Our ability to obtain investment grade ratings is underpinned by prudent macroeconomic and fiscal management and the robustness of our financial sector, including the regulation thereof.

All of these rest on the transparency of our fiscal management framework and the ability of our financial system to withstand shocks.

While we can augment our individual saving with foreign saving, history and experience elsewhere tells us that we cannot rely on foreign capital for all our investment needs.

A critical obstacle to higher levels of saving is to raise the domestic savings rate. At less than 16 per cent of GDP, domestic saving is inadequate to fund the levels of investment required for sustainable economic growth of the magnitude required to significantly reduce unemployment and raise income levels.

Government has diligently reduced the level of dissaving in the public sector since 1994. however, we urgently need to raise the level of private saving in general and household saving in particular to underpin our initiatives to support an investor-friendly environment.

In August, I set out a number of challenges to the participants of the Financial Sector Summit.

We must seek to bring all South Africans into the financial environment. So that every South Africa who wants one can have a bank account, and can save for a brighter future.

The investment environment we have been talking about extends right across the spectrum – from the largest corporations to the smallest businesses. In fact, in many senses, these small businesses have the capacity to generate more jobs for a given level of investment and must remain firmly in our sights for support.

Ongoing development of our economy depends on networks of trust.

Savers must be able to trust those charged with the management of their funds.

Investors must be able to trust the managers of the firms in which they invest and have instruments to hold them to account.

Pensioners must be able to trust their trustees.

Just as economic agents find they can increasingly trust their government.

We are obliged to ensure that the standards and codes we have regulating behaviour in our financial markets protects us from systemic risk. But just as importantly is the human element of greed that must be managed to ensure that we invest prudently and wisely.

I thank You.