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“REUTERS ECONOMIST OF THE YEAR” AWARD CEREMONY
11 AUGUST 2004

“SOUTH AFRICA AS A FINANCIAL CENTRE FOR AFRICA”

INTRODUCTION

Good morning ladies and gentlemen, economists, analysts, portfolio managers, investment bankers, financial journalists and other members of what we can term the financial sector “community”.

Thank you to Reuters for the invitation to share a few thoughts with you this morning. The topic I have chosen is one that I hope will speak to the hearts and minds of many of the members of this community present here today. It speaks of the environment we operate in - this shared South African financial sector of ours. It speaks of where we have come from, what we have achieved and, most importantly, what we have yet to achieve. I’d like to share some views on the opportunities that exist out their, and my belief that they are intricately linked to the future of our continent.

ACHIEVEMENTS THUS FAR

The recent behavior of the Rand seems to have put many economists into early retirement, but some of you here today may remember that prior to the JSE's own "Big Bang" of 1995, it was one of the most illiquid exchanges in the world. Sanctions, interlocking shareholdings, and the buy-and-hold strategy of institutions all contributed to low liquidity. Similarly, the domestic bond market migrated to electronic trading on the Bond Exchange of South Africa as recently as 1996.

The re-entry of South Africa into global financial markets and the opening-up to international competition led to an exponential increase in activity in our domestic capital markets. This explosion in trading volumes and foreign participation added significant impetus to investment in new technologies, new products and compliance with international norms and standards. But it also led to a flurry of new entrants into the sector and an injection of fresh talent and expertise.

The result of all of this has been impressive growth in the financial sector. Over the five years to 2002, the financial sector grew at a real rate of 7.7% per year, more than twice as fast as the economy as a whole. Financial sector employment grew by about a fifth during the course of the 1990s. With an output of roughly 9% of GDP, the financial services sector is some 81% larger than the mining sector. In short, finance has been one of the most dynamic sectors of the South African economy during the past decade, accounting for almost a quarter of overall growth.

THE CHALLENGE

However, despite being the largest financial centre on the continent, South Africa's capital markets have yet to play a significant role in channeling debt and equity capital to where it is needed for African infrastructure projects, direct investment and government finance.

Current levels of domestic savings and foreign capital inflows in Africa fall far short of the capital needed to achieve NEPAD goals of sustained growth of 5-6 per cent per year.

In many countries in the region, domestic savings levels are hampered by the fact that critical long-term investment institutions like pension funds, banks and life insurers are weakly developed or absent. This is compounded by thin domestic capital markets, which make it difficult for institutional investors to invest soundly. Parastatals, private firms and infrastructure projects in these economies have very limited opportunities to raise long-term capital.

Thus, the development of South Africa's financial sector has the potential to aid not only the domestic economy, but also the Africa region. A strong regional financial centre can help cater to the capital needs of the region, especially if African entities are a key focus rather than a global afterthought.

From another perspective, while global integration has clearly boosted South Africa's financial markets in terms of liquidity, technology and talent, it will continue to expose our domestic markets to the challenge of global competition, especially from global financial centres. The tendency of capital to look for low costs (arising from economies of scale in trading, clearing and settlement), high quality skills and high capital raising capacity tends to result in the consolidation of finance into a few international financial centres.

It is far from clear that a consolidation of capital raising capacity solely in the developed world is to the advantage of the African region. What is needed is a financial hub especially focused on the needs and circumstances of the region, much in the same way that Singapore and Hong Kong cater for the capital needs of the Asian continent. Developing South Africa as a Financial Centre for Africa is thus not only a competitive strategy in terms of maintaining a financial market of global significance, but also leveraging on current strengths to best achieve the development goals of the continent.

THE RESPONSE

International financial centres tend to have a foundation in common. Elements include political stability, free markets, and what is best described as the rule of commercial law. On all these fronts, South Africa does well.

Of course, not all countries that possess these qualities can be financial centres. To be a successful financial center requires a virtuous cycle of liquidity, foreign institutions and a deep pool of foreign talent. This cycle yields a continuous process of increased efficiency, product innovation and lower costs.

Recognising the development challenges faced in Africa and the huge contribution that South Africa’s financial markets could play in supporting this development, our government endorsed the development of a strategy to position South Africa as a Financial Centre for Africa. A multi-year process of co-operation led by the National Treasury and involving the major financial regulators, exchanges and industry bodies has resulted in a draft strategy aimed at positioning South Africa’s financial sector as the most competitive, cost effective, efficient and liquid market on the continent. Elements of the strategy have already been put in place; others are still in the process of planning.

The FCA strategy has six broad pillars, namely:

- Opening South Africa’s markets to African and global issuers
- Global lowest trading costs and trading risk
- Global leadership in investor protection
- Developing key new markets
- A world-class pool of financial talent
- A global hub for financial business process outsourcing

The power of the strategy lies in the following:

- Firstly, the strategy is not focused on transient considerations: each of the six pillars embodies a goal that will remain critical as South Africa’s financial centre grows.
- Secondly, these goals are self-reinforcing in terms of supporting a virtuous cycle of improvement and growth in financial service provision.
- Lastly, each of the goals independently is of considerable value to the South African economy and its development path.

(1) Opening South Africa’s markets to African and global issuers

In this year’s Budget Speech, the Minister of Finance announced the opening of South Africa’s capital markets to foreign and African issuers. This marks a significant milestone in South Africa’s reintegration into the global economy, promoting inward investment and capital market development.

There is no control on investment by non-residents, and as far as residents are concerned, control is shifted from the market to the investor, where the level of investment allowed is increasingly determined by prudential considerations.

Final details of the inward listing criteria are being put in place, with the first listings expected to take place within the next month.

This is a vital element of the FCA strategy, allowing African firms, finance institutions and sovereigns alike to access our markets for the long-term capital they need for development.

There are also other, less tangible, benefits to these inward listings. African companies can now be part of the JSE’s market indices, potentially increasing the scale of capital they can access, but also raising their profile amongst the analyst community. Developing a critical mass of analysts and investment advisors dedicated to the African continent is going to be critical.

(2) Global lowest trading costs and trading risk

This pillar of the strategy sets an ambitious yet achievable goal for South Africa: capital markets trading at the lowest cost and lowest risk on the globe.

This goal requires actions by both the private sector and Government. It is central to becoming a regional financial centre.

Trading costs comprise explicit costs, which consist of brokerage, fees and taxes, and implicit costs, which are the cost to the trader of an adverse movement in the price due to the trader’s own trade. The less liquid a market, the higher these implicit costs will be.

In order to achieve our goal of lowest trading costs, the explicit costs need to be tackled, thereby increasing liquidity and, indirectly, addressing the implicit costs.

Explicit costs need to be monitored and understood from a competitive point of view. Government will continue to assess its contribution to these costs in terms of transaction taxes. But it also requires a competitive environment for brokerage and other trading fees. The introduction of the Security Services Bill later this year will pave the way for greater competition in the provision of capital market services and trading fees.

(3) Global leadership in investor protection

The extent of investor protection in a market has become a key determinant of the perceived risk of trading in that market. South Africa's markets, and in particular the JSE, have taken a global lead in the main aspects of investor protection, including reporting standards, disclosure, corporate governance and protection of minority rights.

The marked improvement in perceptions of insider trading in our markets is testimony to the progress that has been made. Revisions to auditing rules and the Companies Act, plus the consolidation of security services regulation under the Security Services Bill, are just some of Government's efforts that will further this cause.

(4) Developing key new markets

Financial centres need to provide a fertile and supportive environment for the development of new markets. This is achieved by a combination of a vibrant private sector, a regulatory regime that allows for experimentation and innovation, and intelligent use of the scale and policy instruments of the public sector.

Key markets requiring development, including rollout to African users, are:

- Corporate debt, both in the form of debt securities and credit derivatives, and including project finance;
- Securitisation of various financial flows, including those related to mortgage and consumer finance; and
- A regional market in agricultural risk.

All three types of new markets fall within the FCA strategy and will be a focus of co-operative effort between Government and the private sector.

(5) World-class pool of financial talent

International financial centres rely heavily on financial sector talent, which can be sourced outside the country. Readily available skills give firms flexibility in constructing teams for developing products and servicing clients. A deep talent pool is a self-perpetuating advantage. The availability of talent attracts firms to the centre, and the job opportunities attract further talent. An immigration of talent is thus often not at the expense of jobs for local candidates, but can create a greater number of opportunities and transfer of skills.

Skills policy for a financial center has two aspects: increasing the supply of local high-quality talent; and accommodating the cross-border flow of staff and recruitment. Such a strategy includes:

- Encouraging large-scale and high-quality local skills formation in key financial capabilities.
- Allowing for the immigration of foreign talent. The recently revised Immigration Act heralds a marked change in immigration policy. Used to its full potential, the Act allows for the cross-border flows necessitated by an international financial center, by creating a number of permits that allow for a wide range of skills inflow situations. The financial sector is encouraged to apply for appropriate quota permit and exceptional skills category definitions.

(6) A global hub for financial business process outsourcing

Lastly, considerable potential exists to position South Africa as a preferred location for processing financial transactions and for managing global call centres, activities known collectively as business process outsourcing (BPO).

Financial sector BPO, the largest component of overall BPO, is projected to achieve $47 billion in global revenues this year, and to grow dollar revenues by 11% annually. Cross-border, as opposed to in-country, financial sector BPO is growing even faster, as low communications costs enable first-world financial institutions to avail themselves of low-cost, high-quality services located in developing countries. Flourishing financial sector BPO in South Africa would be an employment-intensive complement to other financial centre activities.

A number of South African government entities have been working hard to attract BPO business to South Africa. The Department of Trade and Industry has been particularly active in this regard. In addition BPO has received high-profile mention in the President's State of the Nation speech last year and in the agreement reached in June 2003 at the Growth and Development Summit. Despite these efforts, anchor firms have not yet committed to South Africa, and our industry remains small by international standards. Telecommunication prices remain a key constraint. The challenge is to more effectively co-ordinate Government resources to position the country for financial sector BPO, particularly transaction processing, we see our biggest role as creating an environment conducive for the BPO.

CONCLUSION

In conclusion, some of the elements of this strategy have been put in place already. Others have yet to be finalised. The strategy as a whole will be released shortly for public comment, following internal processes and approval.

Collectively, it’s a strategy aimed at building on the strengths of South Africa’s financial sector and extending the benefits of a well-regulated, liquid, competitive and efficient market to all African investors, issuers and intermediaries.

But it is not a strategy that is a substitute for sound national financial systems in Africa. Indeed, this remains a critical priority that South Africa actively supports through technical assistance and co-operation. At the same time, Africa’s economies cannot wait the slow maturing of national financial markets to provide the necessary channel for large scale foreign capital flows for development. Only a regional financial center will be in a position to provide these services in the foreseeable future.

South Africa has the scale economies in our financial markets to be positioned as the provider of capital and other financial services to the entire continent. It also has an investor community that is familiar with the African context.

Yes, the growth in our financial sector has been impressive over the last ten years. But from my perspective, this is only the beginning.

I sincerely hope that, five years from now, I will be invited back to attend the ceremony for Reuters’ “African Economist of the Year” awards.

Thank you