MINISTRY: FINANCE
REPUBLIC OF SOUTH AFRICA

Keynote address by Finance Minister, Mr. Pravin Gordhan at the World Federation of Exchanges 2011 General Assembly and Annual Meeting

12 October 2011

Good afternoon ladies and gentlemen.

Thank you for the invitation to speak to you today at this important gathering of the World Federation of Exchanges. We are proud to see the Johannesburg Stock Exchange host you this week, and even prouder that the JSE has been recognised as the best regulated exchange by the World Economic Forum in 2011.

Exchanges in their current form can be traced back to Amsterdam, with the creation of an exchange to trade shares in the Dutch East India Company. An in 1652, it was this very company that established a trading post in the shadow of Table Mountain, changing the course of South African history, for better and for worse.

The JSE was established as a stock exchange over 120 years ago in 1887, after the discovery of gold. It has been a member of the World Federation of Exchanges since 1963, and is the largest stock exchange in Africa, and in the top twenty in the world. It facilitates foreign investment into South Africa, as demonstrated by the many international companies listed on its board, and the very high share of foreign ownership on the JSE. It provides the ideal platform as a Gateway for Investing in Africa, and in the process, supporting the economic development of this continent. Indeed, we are open for investment in South Africa.

And of course, I also hope that you will get an opportunity to enjoy our country and its huge diversity in culture, people and climate.

It is a particularly timeous that your 51st General Assembly and Annual Meeting is taking place, in these turbulent times. The onset of the global financial crisis, and the subsequent sovereign debt problems in Europe and elsewhere, has prompted extreme levels of volatility in stock exchanges around the world. Markets tend to overreact or overshoot in response to adverse information. As noted by Keynes:

This volatility in exchanges tends to aggravate any crisis. For emerging and developing countries, this is even more so. We often tend to experience even greater volatility than the countries at the source of the problem, as can be seen in the recent volatile swings in domestic currencies. This is not to say that policy-makers do not recognise that markets play a critical signalling role, hoping for a speedy, decisive and credible action, instead of kicking the can down the road.

Today, we are faced with the enormous challenge of re-igniting world growth, creating jobs and reducing inequality and poverty. I have no doubt that stock exchanges will play a central role in our collective global efforts to stabilise the world economy and return it to a new trajectory which realizes the G20 objective of “Strong, sustainable and balanced growth”.

Exchanges have also played another and possibly equally important role. By pioneering the concept of share ownership, the market economy can empower ordinary workers to share in the growth of their companies and the broader economy.

No longer are companies controlled and owned by an elite –rather ordinary people, in most cases, can participate and grow wealth through their pension funds, mutual funds and investment vehicles.

According to a survey by the Global Pension Study, global asset allocation for pension funds stood at about 47 per cent and 33 per cent for equities and bonds respectively.

In the case of South Africa, a research by Investment Solutions and Alexander Forbes indicates that as at 2010, about 17.6 per cent of the JSE’s market value is held by pension funds.

Pension funds, in particular, are now the largest and most important single set of investors in stock exchanges globally. The pensioners of the world rely on exchanges and the instruments trading on them for a safe and happy retirement.

However, in a world that is increasingly becoming unequal both in developed and developing economies, important challenges are being raised by various stakeholders in society about increasing access and ownership to all income groups far more rapidly.

Through their listing requirements, exchanges bring substantially increased corporate governance standards; improve disclosure standards; ensure transparency; enable access to capital through a widespread shareholder base and ensure that the interests of minority shareholders are protected.

The responsibility of stock exchanges and need for regulation

Stock exchanges have an important role in creating growth, ensure that growth is shared, and to help people save. Clearly, within the context of the global financial system, stock exchanges play an obviously central role.

But with all these great powers, come great responsibility.

Though financial deregulation has brought a number of benefits to the growth and development of financial markets, financial deregulation has equally produced many problems and the need for regulation has become very important.

That very first modern stock exchange in Amsterdam played host to the tulip mania of 1652, where the price of single bulb of the Viceroy tulip rose 200 times in value over a three-month period before collapsing.

And today, 350 years later, it seems we have not learnt our lesson. In 2010, by some measures, the size of the derivatives market reached over 10 times global GDP. While derivatives play a vital role in mobilising capital more efficiently, when used inappropriately they can have devastating effects. In expressing a similar point, Warren Buffett at one point called derivatives “financial weapons of mass destruction, carrying dangers that, while now latent, are potentially lethal”. We have witnessed how lethal it can be over the past 3 years. Lethal in terms of the devastating impact it has had on many countries, and particularly through job losses in South Africa.

This puts the role of stock exchanges at the centre of the G-20 programme to strengthen and improve the global system of financial regulation. One of the priorities from G-20 Finance Ministers and Governors has been to strengthen the role of exchanges in the trading of derivatives. Too many derivative products are traded ‘over the counter’, in dark corners far from the eyes of investors and regulators.

Strengthening transparency is a massive task. In South Africa, the draft Financial Markets Bill takes the first steps to create a trade repository. This will ensure that at the very least derivative transactions are recorded. This should allow for the better management of risk, greater transparency, and ultimately a safer overall financial system.

High frequency trading also poses substantial risks. ‘Flash crashes’ have the potential to disrupt the global financial system. This potentially compounds the adverse effects of fragile recovery, where a snippet of news can move markets.

As the global trade association for the exchange industry, representing over 97 per cent of world stock market capitalisation, your role in supporting mutual communication amongst members and developing appropriately regulated markets is absolutely crucial.

One of our most formidable challenges, I suggest, is to work towards a new paradigm where the financial system is the servant of the real economy; and not the master.

The shift into new markets such as BRICS and Africa

You are also faced by the reality of a world that is undergoing tremendous geopolitical and economic shifts, and the emergence of new champions of global growth in the BRICS.

This creates both new opportunities and new challenges – particularly the need to create new avenues particularly for South-South co-operation. There are many barriers that we need to remove to facilitate deeper co-operation amongst us. For example, some of the exchanges in BRICS countries do not allow for dual-listed structures or foreign ownership and this sometimes creates unintended blockages to enable domestic companies to grow and diversify offshore from their domestic base. They enable emerging market countries to retain ownership and control of national champion companies as they grow and become successful around the world.

The reverse is also true – sometime rules in developed markets, for example around inclusion in indices, discourage listing by companies from small countries without well-developed capital markets. This is particularly an issue for mining companies that have substantial operations in the African continent. While they may want to list on a larger exchange to raise capital, they might be constrained by tax and other rules.

We want to explore solutions for the development of our own capital markets and make it more attractive to raise capital and invest in South Africa and the rest of Africa through South Africa, while balancing such initiatives with other policy imperatives like prudential regulation of foreign exposure for financial institutions.

As part of the South African government's 'gateway into Africa' policy, South Africa allows institutional investors to invest 5 per cent of their total retail assets in African securities listed on the JSE and Bond Exchange of South Africa (BESA).Furthermore, we are looking at ways of making it more attractive for foreign companies to list on the JSE, a step that will further develop and deepen our capital markets.

So today it is perhaps appropriate that this conference which is being held in South Africa, on the African continent, and in South Africa which is a member of the BRICS countries, to create growth and development within our country.

We should remember/be more aware of the opportunities offered by Africa. An important task will be to seek ways of assisting African exchanges so that they can also become fully fledged exchanges.

An important task will be to pave way for African exchanges so they can also become fully fledged exchanges. I take the liberty of posing a challenge to the world association of exchanges to consider another chamber in which companies that are still developing their capital markets and developing stock exchanges can become exchange members with exposure to your expertise; and work with you to set up exchanges in their own environment. In that way play a crucial role in extending the kind of facilities and capabilities that the exchange may offer to smaller economies in the African economies.

At present, stock exchanges in Africa are characterised by relatively a low number of shares, which are held to a substantial extent in perpetuity by few insurance and pension funds, impacting liquidity and undermining pricing efficiency. The participation by individual savers/investors is significantly limited in a number of our markets.

With the very notable exception of our JSE, Egypt, Morocco and Mauritius, a number of African exchanges are illiquid thereby exacerbating the challenge stock market access.

The Economic Commission for Africa cited the following conditions as important for securities markets to operate with some degree of efficiency:

- a stable macro-economic environment;
- an appropriate capital market infrastructure; and
- adequate regulatory, legal and supervisory framework.

We in Africa continue to aspire to create these conditions across this continent.

I hope that this forum can partner with African exchanges as I have indicated earlier to help them grow, and become fully fledged members of this Federation.

Conclusion

I trust that your stay in South Africa will be an enjoyable one and that your deliberations during this gathering will be robust,are interesting and fruitful and certainly look forward to the solutions you have to offer to G-20 Finance Ministers about how we could get the global economy much healthier than we have at the moment.

Enjoy your stay in South Africa and thank you very much for visiting our country.