PROCEEDINGS RESUME ON 12 MARCH 2002

CHAIRPERSON: Morning Mr Mboweni. Are you ready to proceed?

TITO TITUS MBOWENI: d.s.s.

EXAMINATION BY MR POTGIETER: Mr Mboweni, will you turn to page 51 of the bundle in front of you? That is a bundle called SARB7. --- Yes.

On that page you will find a copy of your CV. Will you please take the Commission to summarise your CV? --- Yes, I will do that. I was born in Tzaneen in the Northern Province called Limpopo Province. I went to school for most of my time there. That is to three school. (indistinct) Secondary School and Bankuna High School. I wanted to go the University of Natal to study but in those days you would ask for permission of the Minister of Education to go and study at the white universities. So I was denied that permission. I subsequently went to the University of the North. I did not stay for long there and subsequently left the country for Lesotho. As a angry young man speaking (indistinct) those days, I then proceeded to study at the University of Lesotho completing a B.Hons equivalent in 1985 after which I was awarded a scholarship by the Sharpeville City Council and I proceeded to study at the University of East Anglia Norwich where I obtained an MA degree. In between I have been doing all kinds of things including learning how to shoot in Angola. I must say I was not a good soldier. Maybe that is why I am here and worked in the ANC underground for a little bit of time and I also represented the ANC in various capacities. I worked on the ANC economic policy together with my colleagues which economic policy probably has assisted to where we are today. I came back to South Africa in 1990 and worked primarily full-time for the ANC in the economic policy formulation processes and during the TEC, I represented the ANC on the sub-council of Finance (indistinct). We took a lot of power from the government of the time without the necessary responsibility. I then in 1994 was elected to parliament and appointed as Minister of Labour responsible for some of the Labour Reform Legislation. So between 1994 and 1998 I was therefore a cabinet member for Labour. In July 1998 I was appointed to the Reserve Bank as advisor to the governor and in August 1999 I was appointed governor of the Reserve Bank and the position that I still hold up today.

Mr Mboweni, at the request of the Commission, you have prepared a written statement. Is that correct? --- That is correct, sir.

Now during the course of the expert evidence last week a number of issues had been raised that called for an answer by the South African Reserve Bank - issues such as the Reserve Bank's monetary policy, the inflation targeting policy, the NOFP, your 14 October 2001 statement and so on. We have requested you through your lawyers to address these issues in your statement. Is that correct? --- That is correct.

The proceedings will therefore be curtailed as you have addressed these issues fully in your statement. I also want to mention that I see that next to you is sitting Mr James Cross who is a former senior deputy governor of the Reserve Bank. You have indicated that in so far as it may be necessary, Mr Cross will fill in and focus on certain technical issues that will form part of your evidence. Is that correct? --- Yes, there is one particular issue which I hope he may shed some light and that is the origins of the forward book - how it has been used over the years and that bit of it may be helpful for him to fill in because I was not there if anything I was busy mobilising for sanctions outside South Africa. Little did I know that I will be stuck with the problem occasioned by sanctions later but nevertheless yes, that is correct.

Mr Mboweni, in the bundle SARB7 on page 4 and further there is your statement. Will you then proceed to read the statement into the record? You may be interrupted from time to time but it will not happen too often. You may then proceed. --- Thank you very much, sir. At the outset I wish to thank the Commission for giving me this opportunity to give this evidence. I trust that what I have to say will be of some assistance to the work of this Commission and as you mentioned, sir, in order not to bearing the

Commission unduly with background information, the bank has prepared and has made available for the Commission's purposes a separate bundle of documents which I shall refer to as "the Bundle" and which is attached to this statement and it is marked SARB7. Where necessary, I will for purposes of explanation, refer to specific documents in the bundle.

The bundle contains, inter alia, documents dealing with the following specific subjects which are not dealt with at any length or at all in my submission, namely ownership of the bank, bundle at page 73.

The board of the bank, bundle at page 74.

Description of decision-making powers of the bank, bundle at pages 75 to 78.

Current functions of the bank bundle at pages 79 to 88.

The departmental structure of the bank bundle at pages 89 to 90. Aspects of the foreign exchange market bundle at pages 91 to 108D.

In light of the technical nature of the statement, a glossary of terminology relevant to my statement is included at the end of the bundle. I have in this statement referred to various .. (intervenes)

May I just interrupt there. The glossary you will find in the bundle on pages 351 to 355. You may continue. --- Yes. I have in this statement referred to various tables and graphs and I have included copies of this in the bundle at pages 53 to 72. At the request of the Commission I have also included my personal *curriculum vitae* in the bundle at pages 51 to 52 which we have already dealt with.

"The South African Reserve Bank to which I will refer as "the Bank", was established as the central bank of South Africa in 1921 in terms of the Currency and Banking Act 31 of 1920. This Act was replaced in 1944 by the South African Reserve Bank Act 29 of 1944. This made way in 1989 to the South African Reserve Bank Act 90 of 1989 ("the Act"). The Act was amended from time to time since 1989 and is currently in force. A copy of this Act and the Regulations thereto, is included in the bundle at page 109 to 163. Witness promulgation during 1994 of the Constitution of the Republic of South Africa, Act 200 of 1993, being the so-called Interim Constitution. The establishment, powers, functions and primary objectives of the Bank were recognised and enacted in sections 195, 196 and 197 of that Act. The context of the Bank's primary objectives section 196 of the Interim Constitution stipulated that -

"The primary objectives of the South African Reserve Bank shall be to protect the internal and external value of the currency in the interest of balance and sustainable growth in South Africa."

However, when the final Constitution of the Republic of South Africa, Act 108 of 1996 was enacted in that year to replace the Interim Constitution, it contained a distinct shift in emphasis in connection with the Bank's primary objective. The shift in emphasis to which I refer lies therein in section 224 of the Constitution which describes the primary objective of the Bank and no longer referring to the internal and external value of the currency. Section 224 of the Constitution stipulates that -

"The primary objective of the Bank is the protection of the value of the currency in the Interest of balance and sustainable economic growth in South Africa."

In omitting to refer to the internal and external value of the currency, it places a greater emphasis or focus upon the Bank's role in striving for domestic price stability.

During 1996 and in compliance with the aforegoing provisions of the Constitution, section 3 of the Act was more defined to read in the words of the Constitution that -

"The primary objective of the Bank shall be to protect the value of the currency of the Republic in the interest of balance and sustainable economic growth in the Republic."

In the context therefore of both the Commission's terms of reference and the primary object of the Bank as imposed by statute, I will deal in three separate parts with the following topics:

1.The autonomy and objectives of the Bank in so far as they relate to the value of the rand

2.The macro economic developments in South Africa during 2001

3.Developments in the foreign exchange market during 2001.

Autonomy and objectives of the Bank: The Bank has been given an important degree of autonomy for the execution of its responsibilities in respect of domestic monetary policy. The autonomy and objectives of the Bank are entrenched in the Constitution. The Bank in pursuit of his primary object, must therefore in terms of section 224(2) of the Constitution, reform its functions independently without fear, favour or prejudice but there must be regular consultation between the bank and the cabinet member responsible for national financial matters. That means the Minister of Finance.

As far as foreign exchange controls are concerned, the bank has far less autonomy. As I hope was explained in the statement by Mr Alexander McGreggor Bruce-Brand, general manager: Exchange Control Department of the Bank, the Bank is responsible for the day to day administration of exchange controls in the Republic of South Africa. While the Bank implement exchange controls, policy decisions rest with the government and more specifically the Minister of Finance. With regard to exchange rate policy, the bank and the government are jointly responsible for determining the framework policy. The day to day implementation of that policy is the function of the bank. However, if the day to day management of exchange rate policy would require as it did prior to July 1998, intervening in the foreign exchange market using the forward book mechanism, consultation with the government was undertaken since any losses incurred on the forward book, are for the account to the fiscus - basically the taxpayer.

In terms of section 32 of the Act, the Bank publishes a monthly statement of assets and liabilities. In addition, the Minister of Finance tables before parliament an annual report on the implementation of (indistinct) policy."

I must apologise here because this is not very clear. What we are trying to say here is that the Reserve Bank produces the annual report and in order to submit it to parliament, it has to do so through the Minister of Finance because the governor of the Bank is not in parliament. Therefore the Minister of Finance has to do the submission on or behalf .. it is just bad English there. I must apologise for that.

"The Bank is therefore accountable to parliament and by so doing to the citizens of South Africa. As governor of the Bank, I hold regular consultations with the Minister of Finance as directed by the Constitution and also as a prudent approach to macro economy policy coordination. I also have periodic discussions with members of the Portfolio Committee on Finance in parliament.

The Bank like most other central banks in the world, has a unique position in the economy as it performs various functions and duties not normally carried out by commercial banks. Although the functions of the Bank have changed and expanded over time, the formulation and implementation of domestic monetary policy, has remained one of the cornerstones of (indistinct).

The Bank has used different monetary policy frameworks over time i.e. credit sellings and credit controls in the 1970's; money supply and credit extension targets from the middle of the 1980's; money supply guidelines by the early 1990's and what was referred to as an eclectic monetary policy framework with an informal inflation target from the middle of the 1990's.

In February 2000 an official inflation target was specified for the first time and the adoption of this target entrusted a single monetary objective to the Bank, namely domestic price stability.

I issued the statement on 6 April 2000 containing details of this new monetary policy framework. A copy of this statement is included in the bundle at pages 164 to 168. With the advent of inflation targeting as a monetary policy framework, the emphasis has in compliance with the dictates of the Constitution, the way we understand it, focused on domestic price stability i.e. the attainment of inflation at lower levels in order to contribute towards balances sustainable economic growth in our country.

Inflation targeting is a monetary policy framework implying the targeting of the inflation rate directly. Other intermediate variables influencing inflation such as money supply, credit extension or the exchange rate are then not directed targeted although the obvious system played an important role in the determination of inflation."

If I may just once again emphasise that other intermediate variables influencing inflation such as money supply, credit extension or the exchange rate, are then not targeted directly although they obviously still play an important role in the determination of inflation.

Mr Mboweni, could I interrupt there? Will you turn to page 242 of the bundle? --- Yes, sir.

What you see there is the Reserve Bank's monetary policy review of March 2001. Will you then turn to page 247 forming part of this document? --- Yes.

The second paragraph on page 247. Could you just have a look at that? Would that be in accordance with what you have just stated in your statement? --- Yes.

Would you read that into the record as well, please? ---

" The inflation targeting requires nominal exchange rate flexibility. In South Africa's case a fully flexible exchange rate regime has been adopted. This means that there is no specific target for the exchange rate. It does not, however, mean that the Reserve Bank is not concerned about the exchange rate as the exchange rate changes and do fit into the inflation process. The depreciation of the currency directly affect the price of imports. Then there are the possible secondary effects where high import prices fit into wage and other price increases."

Will you then return to your statement and continue? --- Page 9. Shall I proceed?

Yes please. --- Thank you.

"The inflation targeting is a multi policy framework characterised by a public announcement of the numerical target for the inflation rate that is intended to be achieve over a specified period of time. Inflation targeting is therefore the Bank's current monetary policy framework.

Inflation for targeting purposes is measured as CPIX (MU). The MU there stands for Metropolitan and other Urban Areas. The reason why it is still Metropolitan and other Urban Areas, is because Statistics South Africa has yet developed capacity to also conduct service in rural areas on inflation. CPI is the Consumer Price Index is a measure of the general level of prices based on the cost of a typical basket of consumer goods and services. CPIX is the CPI excluding the impact of changes in mortgage interest rates."

If I could just explain the purpose to the Commission that the reason why we have excluded mortgage interest rates in the target that we use is in order to remove that component of inflation which is directly influenced by our own monetary policy decisions. So we can have a very objective measure for inflation.

"The CPI and CPIX are measured and compiled by Statistics South Africa, a body independent of the Bank once again to make sure that it is not the Bank that collects the information and uses the same measures for its purpose but this must be done by an independent body.

Technical economic terms: It should be pointed out that the decline in the exchange rate affects the domestic price level by the prices of imported goods such as all that we made reference to in the monetary policy review. If this adjustment in the domestic price level leads to an increase in inflationary expectations and further adjustments and wages in the prices of goods and services, an inflationary spiral could be the consequence threatening the inflation target.

The initial target range for the calendar year 2002 was set at an annual average of 3% to 6% of CPIX. In October 2001 subsequent targets were announced by the Minister of Finance. The target range remained unchanged for 2003 while it was set at an annual average of 3% to 5% for the calendar year 2004 and 2005.

The inflation target is set by the governor after consultations between the Bank and the National Treasury. This implies that the Bank does not have total autonomy in choosing the inflation target. The so-called goal independence but it does have independence in the monetary policy decisions in achieving the inflation targets. The so-called instruments independence.

The autonomy entrusted with the Bank in the use of monetary policy instruments implies that the Bank has to be accountable for these decisions and should therefore ensure transparency. To this end the Bank publishes monetary policy reviews on a buy annual basis while regular regional monetary policy forums are also arranged to provide a platform for discussions of monetary policy with the broader stakeholders in the community."

Again I think English eluded us there. We wanted to indicate that we hold one national policy forum in Pretoria and then regional monetary policy forums in other centres of the country.

"More importantly the Bank's annual report which is submitted to parliament combined with my regular testimonies before parliament ensure that there is a democratic structural methodology of enforcing accountability on transparency. A copy of my annual address in

August 2000 to the ordinary general meeting of the shareholders of the Bank as well as the report of the AT first ordinary general meeting of shareholders of the Bank in August 2001, are to be found at pages 169 to 241 of the bundle.

Monetary policy reviews issued in March and october 2001 are included at pages 242 to 298 of the bundle. Inflation targeting has recently become international recognised and has been adopted by a number of significant central banks around the world. Central banks in the following countries for example have adopted this framework: New Zealand being the pioneer in 1990; Chili in 1991; Canada in 1991; the United Kingdom in 1992; Sweden in 1993; Australia in 1994; The Czech Republic in 1998; Poland in 1998; Brazil in 1999; Columbia in 1999; Switzerland in the year 2000 and Thailand in the year 2000."

Mr Mboweni, before you continue, I have noted for the benefit of the commissioners that on page 248 of the bundle, again as part of the March 2001 monetary policy review, there is an elaboration of what you have stated in paragraph 24 of your statement under the heading "Inflation targeting the international experience". Do you see it there? --- Yes.

Yes, will you then continue on page 11 of your statement, paragraph 25? ---

"An inflation targeting framework was introduced in South Africa because of certain advantages such as making the objective of monetary policy clear and thereby improving planning for the private and public sectors and the public at large forming part of a formalised publicly announced and coordinated effort to control inflation in pursuit of the broader economic objectives mentioned above i.e. sustainable economic growth and development. Helping to focus monetary policy and enhancing the accountability and transparency of the central bank to the public and providing and anchor for expectations for future inflation which should influence price and wage certainly.

The Bank is responsible for achieving the inflation target through the formulation and implementation of monetary policy. The primary instrument of monetary policy available to the bank is its influence on the level of short term interest rates through our refinancing system, the so-called Repo System.

The commercial banks have to maintain cash reserve balances at the Bank based on their total liabilities. These cash reserves create a liquidity requirement in the money market. The Bank provides liquidity to the commercial banks mainly through (indistinct) transactions at a fixed Repo Rate. The Repo Rate is set upon by the Monetary Policy Committee to which I am coming to in paragraph 28.

Monetary policies decided upon by the internal bank structure referred to as the Monetary Policy Committee (MPC). It is composed of myself as governor; the deputy governors Gill Marcus and Dr Xoli Lepalo Guma; chief economist Dr Ernie van der Merwe; the advisories to the governor, Mr Petrus van Zyl; senior deputy chief economist, Mr Bennie de Jager and the deputy chief economist Mr Brian Kahn.

Making its decisions, the Monetary Policy Committee ordinarily meets over two days to deliberate the stance of monetary policy. On the second day a decision is taken on the monetary policy stance. This is explained in a statement released by the Bank. The statements released by the MPC during 2001 are to be found at pages 299 to 326 of this bundle.

The Bank's Repo Rate influences short term market interest rate in two ways. Firstly, it directly influences the national cost of funding of banks and secondly it reflects the Bank's monetary policy stance. Changes in the Repo Rate consequently impact on other interest rates in the market and can affect the exchange rate through its impact on domestic demand and capital movements."

This is an attempt to try and illustrate what we are talking about.

CHAIRPERSON: This is a slide in our bundle, is it?

MR POTGIETER: Yes, it is on page 53 of the bundle, Mr Chairman. --- This slide is in the bundle and if there is a need to explain, I can do that. I should use the pointer.

CHAIRPERSON: You can use the pointer with pleasure. --- All that I am trying to point out is that this is our current understanding of the monetary policy transmission mechanism in South Africa. So the Monetary Policy Committee really deals with the Repo Rate and our intention eventually is to influence this whole path to the inflation rate and what we are trying to indicate is that there are various channels through which the transmission mechanism moves. As I said it influences other interest rates. That will have an impact eventually on domestic demand and supply of goods and services. That will have an impact on the inflation rate. Similarly the demand and supply of goods and services will have an impact on the current account and if it is a positive influence on the current account, that will also influence changes in the reserve's position as there is capital inflows into the country. That might also influence the nominal exchange rate of the rand which will have an impact on import prices. If the influence is such that the exchange rate appreciates, it is means that the import prices will be positively influenced in the sense that imports will become less expensive and that will also fit into the inflation rate.

On the other hand it can influence money supply; influence inflation expectations and that may also influence wages and prices which will have an impact on the inflation rate. Similarly there is the other channel (indistinct) equity, land, property, (indistinct) but the critical variable is the demand and supply of goods and services which also has an impact on the inflation rate. That is how we think we understand the transmission mechanism but it is something that we continue to develop.

Page 12, paragraph 31. ---

"As far as domestic demand is concerned, firms and individuals respond to an increase in interest rates by altering the investment spending patterns (which is what I have just explained). As a result consumer spending in each capital formation should decline, lowering real aggregate demand. The volume of imports should then decline in response to the change in domestic demand. This could lead to an improvement in the current account with the balance of payments which in turn could lead to a build up of foreign exchange reserve. Driving levels of foreign exchange should usually be associated with a stronger currency (again what I have just explained).

In the case of capital movements, rising levels of domestic interest rates relative to foreign interest rates, could make domestic assets more attractive to international investor. This could lead to an increase in the net capital movements to a country, a rise in foreign reserves and a stronger domestic currency (once again which I have explained).

The precise impact of interest rates on exchange rates is, however, uncertain as the external value of the currency is affected by many other factors to which we will come later. In an inflation targeting monetary policy framework, the Repo Rate is adjusted preemptively to influence future inflation. Thus the Repo Rate is not changed to directly influence the exchange rate as the target is inflation."

And again let me explain this dear commissioners. The misperception normally in the market is that the Reserve Bank changes its stance on interest rates based on the last number published by Statistics South Africa. That is incorrect. We base our decisions on what we think the future path of inflation is going to be. That is why we talk about preempted moves to influence the future path; not to influence that which has already taken place but the future path of inflation and to that extent we do rely quite extensively on our forecasting (indistinct) at the Bank.

"In the medium to longer term, however, successful inflation targeting should also contribute to a more stable exchange rate of the rand."

I now turn to the role of the Bank in the foreign exchange market.

"It is to be expected that against the background of the move towards inflation targeting. The role of the Bank in the South African foreign exchange market has changed considerably over the years. The Bank's involvement in the forward market developed over many years not only as a consequence of intervention but also because the Bank was for many years responsible for providing cover against exchange rate fluctuations on behalf of government.

Serious efforts in the early 1980's to extricate the Bank from the forward market, proved to be difficult against the background of sanctions by which I was partially responsible against apartheid in South Africa. The interaction between isolation from the rest of the world, international sanctions, low domestic savings and low foreign reserves, necessitated the continued participation of the Bank in this forward market.

After the debt standstill in 1985, residents were increasingly reluctant to hold offshore debts because of losses suffered on revaluation of foreign debts when the exchange rate depreciated by some 31% at the time in 1985.

In view of the strict exchange control requirements, no resident was permitted to hold foreign currency and banks were permitted to do so within strict limits. Under these circumstances the Bank provided forward cover to residents in respect of their offshore exposure. The forward cover mechanism was used to encourage long term borrowing offshore as well as access to short term offshore finance.

It should be remembered that in the sanctions environment it was not possible for government to borrow in the offshore capital markets. The forward cover mechanism was thus used to enable corporate South Africa to access international credit lines. These available credit lines were to a considerable extent related to trade.

During the 1980's and most of the 1990's, the Bank was active participant in the foreign exchange market initially by virtue of its responsibility to assist with the development of a foreign exchange market in South Africa but later to assist in achieving a relatively stable exchange rate. On various occasions over the years, the bank intervened in defence of the rand. As the bank did not have adequate foreign reserves, the obligations to deliver foreign exchange into the market, were converted into forward obligations. Such interventions took place in 1996 and also in 1998.

The forward book of the Bank reflect all unsettled future foreign exchange commitments of the Bank. As described the forward book of the Bank was used, inter alia, to provide forward cover to residents in respect of their offshore loans. This resulted in oversold or negative balance on the forward book. The oversold balance implies that the Bank's commitments to deliver foreign currency at future dates, are greater than its future commitments to buy or receive foreign currency.

In addition to the above-mentioned reason for using the forward book, the forward book was also used as a way to finance intervention. Net intervention may have been viewed as forward cover provided in excess of the outstanding foreign debt of the private sector and parastatels. The Bank for example sold US dollars into the spot foreign exchange market in order to support the exchange rate of the rand and then swopped the US dollars back onto its forward book by buying US dollars spot and simultaneously selling them forward.

According to the Act all profits and losses in respect of providing forward cover, are for the account of the Government (this is part of the statement that I hope Mr Cross will clarify later).

Over the years as I shall demonstrate in part 3 of the statement, huge losses were made owing to the existence of the Net Open Forward Position, the NOFP, which is basically the difference between the forward book and the net results of the Bank and this is all for the government's account i.e. the taxpayer.

Consequently not only because of the moved inflation targeting but also because of the exposure for government's account and the consequent losses, the Bank did not intervene in the aforegoing manner in support of the rand in 2001."

If I could emphasise this:

"As I shall demonstrate in part 3 of the statement, that over years huge losses were made owing to the existence of the Net Open Forward Position, all for government's account i.e. the taxpayer. Consequently not only because of the moved inflation targeting but also because of the exposure for government's account and the consequent losses, the Bank did not intervene in the aforegoing manner in support of the rand in 2001. Any intervention would again have increased the NOFP exposing the government for further risk of loss in the future. The government would then have less money for the needy purposes of our country.

Both the Bank and the National Treasury have regularly made known their intention to reduce their participation in the forward foreign exchange market. Significant steps in this direction have already been taken and in the early 1970 the Bank withdrew from the provision of long term forward cover. Moreover in an effort to promote the development of the forward foreign exchange market in South Africa, the limits on the total amount of foreign currency that authorised dealers in foreign exchange can hold offshore, were abolished in early 1998.

I shall point out in greater detail in part 3 of the statement that the bank has succeeded in significantly reducing the NOFP in recent years and thus decreasing the government's exposure to further losses.

I now turn to part 2 of the statement which deals with the "Macro Economic Development in South Africa during 2001".

Mr Mboweni, I suggest that you also read the footnote on page 16 into the record before you deal with the Macro Economic Development in 2001. --- The print is very small. So I will have to make use of my reading glasses.

That is fine. ---

"Part 2 of this statement was prepared at a time when the estimates of the National income and expenditure accounts and the estimates of cross-border trade and financial flows were in an early stage of finalisation and are therefore still fairly tentative. The survey returns are still being awaited by the Bank from prominent firms participating in the South African economy. Financial flows obtained from this survey returns may later result in substantial revisions to some of the statistical information contained in this document."

Will you then proceed with the Introduction on page 16, paragraph 46? ---

"An imbalance between the total disposal income and total spending of a country, is reflected in the net flow of goods and services into or out of the country. These cross-border movements of goods and services together with the net movement of international capital to and from the country, significantly influence the demand and supply for foreign exchange in the domestic foreign exchange market.

In the market where the exchange rate should be free to find its own level, the supply of and the demand for foreign exchange are the main factors deciding the eventual level of the exchange rate. An excess supply of foreign exchange should usually be associated with an appreciation in the exchange value of the domestic currency. Conversely a shortage of foreign exchange could be expected to cause a depreciation in the exchange rate of the domestic currency.

After a prolonged period of rapid expansion during the 1990's, the United

States economy slowed down rather abruptly from about the beginning of the year 2001. The attacks on September 11 which destroyed the World Centre in New York and damaged the Pentagon Building in Washington DC finally pushed the United States economy into recession. As they now search economy faulted, it has dragged other economists around the world into its slump. The South African economy reacted in varying ways to the changing global economy conditions. Until the middle of 2001 total domestic income growth held up quite well in the face of the global slow down and actually accelerated from the first and second quarter of the year.

Cross domestic expenditure in the South African economy in the first half of 2001, was less than national disposable income i.e. the net income of valuable to residents of South Africa which can either be spent or saved. Therefore the country had a surplus of exports over imports i.e. a surplus on the current account with the balance of payments.

At the same time there was an inflow of capital into the economy. Given an ample supply of foreign exchange in this period, the exchange rate of the rand showed limited variation and by the end of June 2001, was roughly at the same level as at the end of December 2000. In the second half of the year, domestic spending exceeded total national disposal income. The excess of total domestic spending over total national disposal income was expressed in a deficit on the current account with the balance of payments which was not matched by any influence of international capital into the economy.

When a deficit on the current account of the balance of payments is not accompanied or matched by an inflow of capital, the deficit is widely perceived as a major source of exchange rate instability. Under circumstances such as this where the demand for foreign exchange exceeds the supply of foreign exchange, a depreciation in the exchange rate of the rand could be expected as a normal market reaction.

The size and speed of the depreciation in the closing months of the year 2001, are obviously far more difficult to explain. I suppose that is why we are sitting here in this Commission. Imbalances on the current account had to be financed. There is nothing for mahala or funded by international capital movements e.g. in the case of a deficit on the current account by borrowing from the rest of the world or by investments into South Africa by non-residents.

Domestic income is the total value of income generated in the South African economy over a given period of time. When total disposable income falls short of total domestic spending, it causes an excess of imports over exports which could adversely affect the exchange rate of the rand.

During the first half of 2001 the growth in total domestic income had apparently been left unscaled by the down turn in the global economy but by the third quarter of 2001, the domestic economic situation became more closely aligned with the world economy. Consequently the quarter to quarter economic growth at an annualized rate fell from 2% in the second quarter of 2001 to about 1% in the third quarter. In the fourth quarter of 2001, the economy regained some of its earlier vigour and quarter to quarter growth in domestic income accelerated to about 2½%. This acceleration was partly spread on by a further improvement in the international competitiveness of domestic producers and by a buoyancy in domestic spending as discussed later in this document.

The stronger growth in domestic income, was concentrated in robust output expansions in the manufacturing sector and the continuation of some growth in the services sector i.e. commerce, transport, communication and financial services. By contrast the income generated by agriculture and mining declined. The net result of these developments, was that the growth in total domestic income adjusted for inflation, slow down from 3½% in 2000 to 2% in 2001. Total spending in the economy consists of spending by households and government on goods and services, capital spending by the public and private sectors and investment spending in inventories.

Growth in aggregate domestic spending adjusted for inflation held up fairly well during 2001 reflecting a steady growth in spending by households, a slight acceleration in spending by government and a pick up in capital spending. Growth in gross domestic final demand i.e. total domestic spending excluding inventory investment, strengthened appreciably in the second half in 2001. The rate of inventory accumulation slowed down quite noticeably in the last quarter of that year.

Growth in spending by households accelerated from a quarter to quarter annualized rate of 2½% in the third quarter of 2001 to 3½% in the fourth quarter. This can mainly be attributed to a general increase in spending on new cars and other durable and semi-durable goods.

Recurrent spending by government picked up in the course of 2001 following several years of fiscal consolidation. In the third and fourth quarters of 2001 spending by government grows at annualized rates of 2½% and 3% reflecting increased spending on goods and services of a non-capital nature.

Capital spending which started to recover in 2000 following a sharp decline in 1999 strengthened during 2001 mainly in the private sector. In addition increased spending by government on infrastructural development gave further imputers to total capital spending. Parastatels by contrast, scaled down their capital spending probably, and I am not sure about this, probably as part of their preparations for future restructuring.

On account of these developments, total capital spending is estimated to have increased at a quarter to quarter annualized rate of about 5½% in the fourth quarter of 2001 compared with 3% in the third quarter.

Excess spending over income in the second half of 2001, lifted spending to a level 1,1% higher than national disposal income in the third quarter and 0,3% higher in the fourth quarter."

Graph 1 is in the bundle on page 54, Mr Chairman. --- Which is the same as this graph where the red indicates domestic spending and the blue indicates total national disposal income. So you can see what is happening there during that period towards the end of 2000 where total domestic expenditure exceeded the total for disposal income.

"This imbalance created a need in the foreign exchange market for an inflow of international capital in order to limit downward pressure on the exchange rate of the rand."

I come now to the current account of the balance of payments.

"The current account of the balance of payments is defined as the sum of exports and imports of goods and services out of and into South Africa. The current account consists of two sub-accounts namely the trade account and the services account. The trade account records transactions in merchandise imports and exports including gold whereas the services account records income payments and visits such as dividends, interest and employee compensation, transportation fees for goods and passengers, travel services and other services.

The excess of total spending over total disposal income decline somewhat in the fourth quart of 2000. This means that the deficit on the current account of balance of payments also narrowed from R10,9 billion in the third quarter of 2001 to 2,7 billion in the fourth quarter (which I think is explained - it is just a graphical explanation of what we talked about. There is a trade account over there, there is a services account here and that is the balance but as you can see we are showing that there were those changes).

As the ratio of growth domestic product, the deficit on the current account declined to 0,3% in the forth quarter of 2001, roughly from 1% in the third quarter (as you can see from the graph). For the calendar year 2001 as a whole, the deficit on the current account amounted to just R1,7 billion mainly on the account of the surpluses realised in the first half of the year (the table there is quite clear and I do not want to bother you with it. As I have mentioned there are exports including net gold exports, merchandise, imports, net service income and current transfer payments. Then the balance on the current account now for the period under discussion we are talking about those amounts which are deficits)."

Mr Mboweni, you now referred to table 1. --- Table 1, current account of the balance .. (intervenes)

It is on page 57 in the bundle. Will you whenever you refer to a graph or a table, for purposes of the record, just give us the number? In this case table 1 or graph or whatever. --- On alright. It is okay. It is alright.

"The shrinking deficit on the current account of the balance of payments in the fourth quarter of 2001, was almost entirely due to a rally in export earnings. Exports of mining products, agricultural products and manufactured goods, contributed to the higher value of goods exported in the forth quarter. In real terms that is adjusted for the effect of price increases, merchandise exports earnings fell in the forth quarter implying that the rise and export earnings was entirely a consequence of steep increases in the prices of exports.

The rand value of South Africa's net gold export increased substantially in the fourth quarter of 2001. The average realised price of gold per fine ounce rose from 2351 in the third quarter to 2856 in the fourth quarter by the volume of gold exports declined in the fourth quarter (and I must apologise for this paragraph 62. I had said that we should put this in dollars. It is easier for people to read when it is in dollars but I do not know what happened. Somebody will explain this to me later).

Reflecting in part the robustness of growth in total domestic spending, the value of merchandise imports rose significantly in the fourth quarter of 2001 partly of setting the increase in export earnings. A sharp increase in the value of imported manufactured goods, especially of machinery and electrical equipment and of vehicles and transport equipment, contributed most to the steep increase in the value of merchandised imports as indicated earlier. Imports in these types of goods are usually consistent with growth in capital spending (which we tried to explain earlier). The increased value of merchandise imports in the fourth quarter of 2001 was also largely due to higher prices after adjusting for price increases, the real value of merchandise imports fell by about 1% from the third quarter of 2001 to the fourth quarter.

Preliminary estimates indicate that net service income and current transfer payments non-residents i.e. people in organisations residing outside South Africa for services rendered, declined from R48,6 billion in the third quarter to 41,7 billion in the fourth quarter of 2001 helping to reduce the deficit on the current account of the balance of payments slightly.

The shortfall on the country services account with the rest of the world, widened considerably from the first to the second quarter of 2001. This higher deficit on the services account was related to inward movements of foreign direct equity investment in the economy in recent years giving rise to dividend pay outs to non-residents and shareholders."

I would like to repeat this.

"The shortfall on the country services account with the rest of the world, widened considerably from the first to the second quarter of 2001.

This higher deficit on the services account was related to inward movements of foreign direct equity investment in the economy in recent years giving rise to dividend pay outs to non-residents and shareholders.

Investment income received from offshore equity investments made by South African companies also increases but to a far smaller extent than the increase in dividend pay outs. The overall deficit on the services and income account widened from a seasonally adjusted and annualized value of R37,2 billion in the first quarter of 2001 to 47,1 billion in the second quarter, 48,6 billion in the third quarter and 41,7 billion in the fourth quarter.

The greater discrepancy between dividends paid to non-resident investors and received from off-shore companies, is the inevitable result of the growing interest in South Africa displayed by non-resident investors in recent years. A reasonable return on investment is required to attract inward forward investment into the country. Unless such profitably investments are matched by equally profitably offshore investments by South African companies, the negative dividend gap will continue to widen."

I now come to the financial account of the balance of payments.

"The financial account summarises the international capital flows and covers all sections associated with changes of ownership in the foreign assets and liabilities of the economy. Three broad categories of investment are distinguished, namely:

** Direct investment

*Portfolio investment

* Other investments

In order to explain this in some detail, you can see table 2 which is the net financial transactions not related to reserves. This is just to summarise what I have said but this is the net financial transaction not related to reserves. As I said direct investment portfolio investment and other investment, liabilities, change in assets, direct investment, portfolio investment and other investments. Under period of discussion, this will be what the developments have been and we can see what the situation is in the fourth quarter in particular. I will cover that just now.

"Foreign direct investment flows into South Africa are reflected in an increase in the country's foreign liabilities. Direct investment is that category of international investment which reflects the objective of an investor in one country to obtain a lasting interest in an enterprise in another country (this is just an international definition of direct investment).

Non-resident invested direct investment capital into South African economy during the first three quarters of 2001 but this changed to an outflow of 1,9 billion in the fourth quarter as indicated on the table.

The outflow of direct investment capital in the fourth quarter of 2001 resulted mainly from the delayed payment of dividends declared during the third quarter of 2001."

There is an explanatory note on that page 327 of the bundle, I will not worry too much about that note. It may confuse you. Let us focus on what I have just said now.

"South African companies increased their holdings of foreign direct investment assets by 5,4 billion during the fourth quarter of 2001 mainly by acquiring a dominant interest in the equity capital of foreign companies. These transactions are recorded as an outward movement of capital from the economy. However, for the whole of 2001 South African companies reduced their foreign assets to the value of 28,7 billion i.e. an inflow of international capital.

On a net basis that is of certain changes in direct foreign assets against changes in direct foreign liabilities. Foreign direct investments changed from an inflow of 3,6 billion in the third quarter of 2001 to an outflow of 7,3 billion in the fourth quarter thus contributing no doubt to the weaknesses of the rand.

Owing mainly to the restructuring of corporate relationships between the Anglo American Corporation and the De Beers Mining Company and the accompanying net inflow of direct investment capital in the second quarter of 2001, a net inflow of R85,9 billion in foreign direct investment capital, was recorded in 2001 as a whole (that is what we tried and show there).

CHAIRPERSON: What was that in dollars at that time? --- We will have to check that.

Is that roughly 10 billion? --- We will have to check that. We will have to do an average rate of the exchange rate and take that into account in calculating.

I ask that because of the evidence given earlier about the effect that that might have had on the NOFP, the inflow of the De Beers dollars to the NOFP and I think it would be useful if we could have a dollar amount at some stage. Perhaps after lunch. --- Yes, but what I am making a reference to is the accompanying net inflow of direct investment capital in the second quarter which will not be just .. (intervenes)

Not just .. (intervenes) --- Not this. It includes the De Beers.

Yes. --- But specifically De Beers and Anglo American inflow must have been around $2,7 billion specifically De Beers.

Right. --- I come now to portfolio investment.

"Portfolio investment includes investment in equity and debt securities not classified as direct investment as the table earlier showed.

Inflows of portfolio investment capital through the JSE Security Exchange during the fourth quarter of 2001, were fully offset by non-residents, net sales of fixed interest securities on the bond exchange of South Africa. Non-resident investors increased their holdings of domestic equity securities by R7,9 billion during the fourth quarter but simultaneously reduced their holdings of domestic bonds by R10,1 billion.

South African institutional investors and individuals increases their foreign portfolio assets by 3,3 billion in the fourth quarter of 2001. That is an outflow of capital following outward investments in the three preceding quarters. The net outward movement of portfolio capital totalled 3,4 billion in the fourth quarter. This raised the total net value of international portfolio capital outflows to R67,6 billion for the calendar year 2001 as a whole compared with net outflows of 13,8 billion in the year 2000."

So for the year 2001 we had a much greater capital portfolio outflow than in 2000.

"Portfolio capital outflow in the second quarter of 2001 reached unprecedented high levels that were also a direct consequence of the restructuring of the corporate relationship between the Anglo American Corporation and the De Beers Mining Company. Other investment is the category of international capital that includes all transactions not covered by direct investment and portfolio investment. It consists of trade, credit, short term and long term loans and cross-border bank deposits.

Other foreign investment moves out of South Africa i.e. there was a decline in foreign liabilities to the value of 1,5 billion in the fourth quarter of 2001. The bulk of this outflow was a consequent of the repayment of foreign loans by parastatel companies and the withdrawal of foreign currency denominated deposits and domestic clients and by non-resident deposit holders.

In this investment category, South Africa has increased their foreign assets by R0,3 billion i.e. the exported capital to that amount. In particular trade financing extended by South African business is to non-resident clients was stepped up in the fourth quarter of 2001 possibly in some instances to benefit from the depreciation of the rand. On a net basis other foreign investment amounted to an outflow of R29,3 billion in the year 2001."

I now come to the overall balance of payments.

"The overall balance of payments is defined as the change in the country's gold and other foreign exchange reserves owing to transactions on the current and financial accounts with the balance of payments. Gross gold and other foreign exchange reserves consist of external assets that are readily available to and controlled by the bank for the direct financing of payment in balances.

The deficit on the current account of the balance of payments and the net outflow of capital through the financial account resulted in a deficit of 2,1 billion on South Africa's overall balance of payments in the fourth quarter of 2001. This change is equivalent to a change in the country's international reserves owing to the balance of payments of sections that quarter (for this you may see graph 5 against just to put visually what we have said).

The value of South Africa's gross gold and other foreign exchange reserves i.e. international reserves before foreign loans, expressly concluded by the Reserve Bank to bolster total reserves are netted off. Accordingly declined in dollar terms from 13,3 billion US dollars at the end of September 2001 to 12,4 billion US dollars at the end of December but because of the depreciation in the exchange rate of the rand, the country's total international reserves rose in rand terms from 108,9 billion to 150,7 billion over the same period. The result was an improvement in the import cover i.e. the value of gross gold and other foreign exchange reserves relative to the value of imported goods and services. In other words there was an improvement from 20 weeks worth of imports at the end of September 2001 to 24 weeks worth of imports at the end of December 2001.

The gross gold and foreign exchange reserve holdings of the Bank remained unchanged at 7,5 billion dollars from the end of 2000 to the end of 2001 which is illustrated by the graph, the red is the South African Reserve Bank's holdings and the blue is the total holdings.

Converted into rand these holdings rose by 33,6 billion to 90,6 billion at the end of December 2001. Again owing to the exchange rate.

The short term credit facilities utilised by the Bank which are related to reserves and therefore do not contribute to changes in the imbalance on the country's external accounts, rose from 2,6 billion dollars at the end of December 2000 to 4 billion dollars at the end of September 2001 but remained unchanged until the end of December 2001 and this is also illustrated in that graph 7.

This signal that the Bank had not drawn on foreign credit lines to strengthen reserves in the last quarter of 2001. The Bank's Net Open Forward Position, the NOFP, widely seen as a serious source of exchange rate vulnerability, remained unchanged at 4,8 billion US dollars in the fourth quarter of 2001."

And as a matter of record and for the interest of the Commission, as of today the NOFP is at 2,9 billion dollars. It has come down. I now turn to exchange rate movements. I do not know whether I should proceed with it now or .. ?

CHAIRPERSON: Do you want to take the adjournment now?

MR POTGIETER: We could perhaps continue until .. either take the adjournment now or continue until to page 30 where Mr Mboweni would start with part 3.

CHAIRPERSON: I think just before we take the adjournment, you have given us the figures here for the NOFP in the fourth quarter and today. Is it possible to give us the figures for the end of the first quarter and the end of the second quarter? --- Yes, I will sort it out in the break and I will give it to you.

You can just give it to us at the end of the adjournment. --- Yes.

The Commission will adjourn until 14:00 then. --- It will help me a lot.

The last meal I had was lunch yesterday.

PROCEEDINGS ADJOURN

ON RESUMPTION

TITO MBOWENI (s.u.o.)

CHAIRMAN: Good afternoon, let us commence with the afternoon session. Mr Mboweni is still in the witness box. Mr Potgieter?

EXAMINATION BY MR POTGIETER CONTINUES: Mr Mboweni we are going to start with the heading exchange rate movements on page 28 of your statement. --- Yes thank you very much. The question was asked about what the position was or the separate quarters for the year. First quarter $9.4 billion, second quarter $5.3.

CHAIRMAN: Sorry just give that to me again? --- First quarter $9.4 billion.

9.4 yes? --- Billion dollars.

Yes. --- Second quarter $5.3 billion, third quarter $4.7 billion, fourth quarter $4.8 billion. And then today's ... (intervenes).

Then today is the $2.9. --- $2.9.

Thank you very much.

MR POTGIETER: Mr Mboweni before you proceed on page 27 of the bundle paragraph 68 the amounts in that paragraph there seems to be something wrong there. Page 27 paragraph 68. The rand figures in the last line cannot be correct, that would mean a 300% depreciation. --- No it is incorrect.

Could you ask somebody just to check that and give us the correct ... (intervenes). --- Yes no, no I have double checked it because it sounded very funny. It should be converted into rands, these holdings rose by 57.

Is that 57? --- Point zero.

Billion rand? --- Yes to R90.6 billion at the end of December 2001. It is paragraph 68.

Thank you Mr Mboweni will you then proceed on page 28. Just give us that figure again Mr Mboweni please on page 27, paragraph 68, is it 57? --- 57.

CHAIRMAN: So did the holdings rise by 57 billion to 90. --- Rose by 57 billion.

That does not seem right either. --- Rose by 57.

MR POTGIETER: Could be rose from. --- Yes.

Isn't it rose from?

MR : This is rose from, so it is ... (intervenes). --- By.

So it is 33,6 so 33,6 is right.

CHAIRMAN: So it rose from 57 to 90? Right thank you. --- Too many economists here, there are too many hands.

Yes, you need a lawyer there obviously. --- I think we need a lawyer.

Right we are at exchange rate movements. --- I now come to exchange rate movements and your attention is drawn to table 3, exchange rates of the rand. These are the percentage changes. The weight of index of the exchange rate of the rate against the basket of 14 other currencies remained broadly unchanged over the first six months of 2001, then it declined by 13.5% from the end of June 2001 to the end of September and fell further by 24% from the end of September to the end of December. That tries to indicate that is graph 8, it just shows it in graphical terms. Under the regime of freely floating exchange rates a deficit on the current account or the balance of payment coupled with a net outward movement of investment capital would technically exert downward pressure on the exchange rate of the rand. These downward pressures were probably exacerbated in the fourth quarter of 2001 by the delayed repatriation of foreign currency export proceeds or earnings and heightened risk aversion towards investment in the emerging economies. And I would like to underline there probably. A widely held view in market circles is that the uncertain political situation in Zimbabwe at the time also weighed down on the exchange value of the rand. A depreciation in the exchange value of the rand is not without its benefits. The competitiveness of domestic producers in international markets is measured by the inflation adjusted effective exchange rate of the rand improved significantly from December 2000 to September 2001. According to the latest estimate available. The monthly average inflation adjusted effective exchange rate of the rand declined by 11.9% over this period. Concluding observations. I conclude this part of my statement by observing that the macro economics seen in South Africa in the fourth quarter of 2001 was characterised by its total domestic expenditure exceeding total disposable income. The excess of total domestic expenditure over total disposable income was expressed in a deficit on the current account of the balance of payments which was not matched by an inflow of foreign investment capital into the economy. In fact capital left the country during the fourth quarter of 2001. This is a very significant factor for the exchange rate's behaviour during that period. Under circumstances such as these a depreciation in the exchange value of the rand could be expected as a normal market reaction.

The magnitude of the depreciation would however always be difficult to predict with a higher degree of accuracy. Other factors which could have contributed to the steep decline in the exchange rate of the rand in the second quarter of 2001 includes the heightened awareness of risk associated with investing in the emerging markets and the perceived political instability in southern Africa occasioned by developments in Zimbabwe. There is another potentially explanatory factors I discuss in part 3 of this statement.

Mr Mboweni in paragraph 77 second line there is a reference to the second half of 2001, when you read the second quarter did you deliberately change ... (intervenes). --- Second half.

Second half. --- Second half of 2001.

Yes will you please continue. --- I come to part 3 of my statement which is development in the foreign exchange market during 2001. Having thus completed my submission on the macro economic background to the change in the exchange rate during 2001 this final part of my submission will cover some of the factors which could have contributed to the rand's depreciation during 2001, in particular the latter part of the year. Over a longer period of time the rand could have been expected to weaken whilst an inflation differential continued to exist between South Africa and its trading partners. By virtue of decisions taken to liberalise exchange controls as well as by virtue of the policy to reduce the NOFP of the bank. What is difficult to explain however is the speed and the size of the decline which occurred from around mid year until 21 December 2001 when the rand hit a new all time low of R13.84 to the US dollar. This decline is illustrated in graph 9 which shows the exchange rate of the rand against the US dollar. I think in particular we are talking about this kind of steep movement, particularly there.

CHAIRMAN: I think just for record purposes you were indicating from about mid October or so were you, just where you started the ... (intervenes). ---

The start is somewhere, what is that. 11/9 there.

11/9, 20th of the 11, fine thank you. --- And then there (inaudible) November. It is not October sir, we are coming to October. I am coming to October. I am coming to October guns blazing. Whilst the bank certainly focuses on the US dollar rand rate that is what those things are USD/ZAR, US dollar rand rate, we also monitored closely the trade weighted index of the rand. Given the strength of the US dollar June 2001 the rate of decline in the trade weighted index was somewhat more moderate but nevertheless of concern to the bank. The percentage change in the trade weighted index is illustrated in graph 10 and the weights of the currencies included in the basket are reflected in table 9. I will just pick on some of the currencies, I only want to draw your attention to the Euro, it is about 37, - 35.7, that would indicate the degree of the trade between South Africa and Europe. I think Europe accounts for about 40% of our trade. The downward pressures on the rand's value arose from concerns regarding South Africa and southern Africa and some from contagion emanating from other regions. This should have been emerging markets. Developments in Argentina could for example have been a factor exacerbated rand weakness. This conclusion is supported by graphs 11 and 12 which show the rand's performance relative to the change rates of similarly rated countries and against those other emerging market countries. The red being the rand and then the others in the group which are rated the same as South Africa, similarly rated countries. You can see that things have been looking quite difficult for a while and say from about November 2000 we began to be an outline compared to the rest of the other countries. I now come to the net open foreign currency position. Both the national treasury and the bank have expressed their determination to reduce the NOFP as it has been perceived negatively by market participants and commentators. Including the International Monetary Fund, rating agencies and the investment banking community. I quote from the public information notice dated 9 May 2001 issued by the IMF and entitled

IMF concludes article 4 consultation with South Africa and I quote

"Directors of the IMF commended the authorities for the significant recent progress made in reducing the net open forward position NOFP, nevertheless they noted that the NOFP remains an important source of external vulnerability and that it needs to be further reduced as market conditions permit."

The full text of this public information notice can be found at page 328 to 332 of the bundle. I must indicate maybe here just as an ad lib that the IMF conducts an annual surveillance mission, not just of South Africa but all you know countries to which they think this is significant and they normally spend a lot of time with us at the end of which they write a report which is called the article 4 consultation report. But they only publish this public information notice, the rest they do not publish. I suppose if the commission wants access to that the commission could request the IMF to make you have a look to see some of the things that they make comment about.

MR POTGIETER: Yes Mr Mboweni the quote comes from page 330 of the bundle. --- Yes.

And just before you continue you are also going to refer in a moment to a statement from the Standard and Poor Rating Agency that document is not in the bundle as far as I could establish. If you could get hold of it it may be useful to hand it in. Would you then continue please. --- Thank you for that. My agreement with them was that they should include all the documents that reference is made to and that will reduce the fee from the lawyers. I also quote from the statement from the rating agent Standard and Poor on 31 May 2001 and I quote

"Although the bank's foreign exchange reserves have grown steadily since late 1998 external liquidity is unlikely to strengthen substantially in the term as the bank continues whenever market conditions allow it to mop up influence to reduce the forward book. Owing to this policy good progress has been made in reducing the

> bank's net open forward position. Looking ahead the bank will continue its stated policy of gradually reducing its net open forward position."

More over the over sold forward book which causes the negative value of the NOFP has resulted in enormous costs to the fiscus. In fact the losses on the forward book was a major contributor to the forward R3.8 billion losses incurred by the fiscus for the period 1978 to 31 December 2001 on the gold and foreign exchange contingency reserve account. Given the losses on the forward book and the negative perceptions from market participants and commentators on the one hand and the potential impact on the currency of reducing the forward book on the other the bank had a difficult choice to make. In the longer term interest of South Africa it was decided to place emphasis on reducing the NOFP. The bank has had to buy foreign exchange as prudently as possible to close off the NOFP. It is quite possible however that these imminently defensible goals of reducing the NOFP could have contributed at times to the sentiment that the rand's value is a one way (inaudible). To reiterate the bank was indeed cautious of its risk in pursuing its gold and strove to manage this risk by buying dollars selectively. The wide fluctuations in (inaudible) since 1994 are shown in graph 13. Now during 1994 is the kind of mountain that we had there. Reduce somehow in 1996 and then just to show how these markets are very (inaudible) and there was a rumour that there was an ambulance outside Tuynhuys and that the president was unwell and the rand took a knock and the bank had to try and intervene to support, but that also helped to push back the NOFP.

CHAIRMAN: You are indicating in 1996. --- Yes 1996.

MR POTGIETER: Mr Mboweni it is okay if you use the red light but will you also for purposes of the record just say what you are referring to, give a date or some fixed point on your graph otherwise whenever they read the record in three months time the commissioners will not know where your red light was. --- I see. But if I describe it properly they will see the red light. And (inaudible).

CHAIRMAN: And then in 1998 is that Asian contagion crisis as I understand it when it went up again. --- 1998 is the Asian contagion which is - where is 98 over there?

Yes a bit to the right. --- And then rose up to that peak somewhere there. That is what you can call the Mboweni legacy.

And then the dollar exchange rate in the other direction. --- And the exchange rate - but as far as the NOFP is concerned. Now this graph shows that during times when market conditions were deemed to be not conducive the pace or the reduction of the NOFP was slowed down or the process of reduction was even suspected. During 2001 the bank purchased foreign exchange proceeds which emanated from a large - from a number of large transactions. The bulk of the proceeds from these transactions therefore did not directly influence the value of the exchange rate as they would have done if the foreign exchange proceeds had been sold directly into the foreign exchange market. The total purchases amount to around US$4.4 billion and were related to government's foreign bond issues and to large corporate transactions. These transactions contributed to the decline in the NOFP to US$4.8 billion as at the end of 2001. Such declines are perceived positive in the market as a major negative influence on the currency is being addressed and removed. Had the bank allowed the proceeds of these large corporate transactions to flow through the market the rand could have appreciated significantly. The market had been expecting a sizeable amount of the foreign exchange proceeds according to South Africa shareholders to be sold off for rand in the market which expectation initially provided some support for the rand. Upon confirmation that the bulk of these proceeds or such proceeds were to be the subject of a once off transaction with the bank for the purpose of reducing the NOFP market perceptions of rand weakness could have been reinforced. I conclude this section. I wish to stress that the reduction of the NOFP was a deliberate policy choice given the undoubted benefit that such reduction would have over the longer term for perceptions towards the rand. Unfortunately purchasing foreign exchange to achieve this end will imply that the rand's ability to appreciate is somewhat constrained. The bank has and will strive to minimise any negative impact on the market resulting from such transactions to reduce the NOFP. This issue was also addressed on 14 October 2001 statement, which I shall ... (intervenes).

Mr Mboweni it may be a good idea to refer to your statement. It is on page 340 of the bundle. 340 to 341. --- Yes.

You deal with the NOFP on page 340 at the bottom of the page. I suggest that you read that paragraph 6 for the record as well.

MS QUNTA: Mr Potgieter are you asking the governor to deal with it now because I notice that he is going to on page 39 of the bundle he is going to deal with it. Are you asking him to bring forward dealing with that statement?

MR POTGIETER: He is dealing with the NOFP now, this section here deals simply with the NOFP and nothing else.

MS QUNTA: No but you have asked him to refer to his statement, are you merely asking for a reference to the page number or are you asking him to deal with it now, to talk about it.

MR POTGIETER: I suggest Mr Mboweni it seems to me to be important that you read into the record the - from the last paragraph on page 340.

MS QUNTA: Oh I see. --- 340.

MR POTGIETER: 340. --- I was saying that the bank has and will strive to minimise any negative impact ... (intervenes).

No, page 340. --- No I know, yes I want to make the connection particularly for the sake of some people.

"The bank has and will strive to minimise any negative impact on the market resulting from past transactions to reduce the NOFP. This issue was also addressed in my 14 October 2001 statement."

In that statement I say amongst other things that the net open foreign currency position NOFP has declined from $24.2 billion at the end of September 1998 to $4.8 billion. Given the negative perceptions resulting from the NOFP the Reserve Bank reduced its position by purchasing foreign currency in the domestic foreign exchange market which may have contributed to the depreciation of the rand over this period. That is what we say there. The operative term there though is may, not did.

And also the next paragraph if you do not mind. --- (Inaudible).

Next paragraph on 341 the South African ... --- I am coming back to this matter though Mr Potgieter but I will proceed.

"The South African government's exposure to foreign currency risk including the NOFP and the percentage of GDP is now with those prevailing in certain (inaudible) countries. With the NOFP at a more comfortable level any perceived vulnerability declined significantly. The Reserve Bank is consequently in a position to alter its approach in dealing with the NOFP at that period."

Thank you Mr Mboweni then to revert to your statement on page 34, you were busy with the last part of paragraph 89 from the word "finally". --- Yes. And finally in terms of this part I would like to add that addressing the issue of the NOFP forms part and parcel of dealing with some of the sad consequences of our apartheid past in this country. There it is written the unfortunate part of this country's history is diplomatic. The reality is the sad part of our apartheid past and I think you should call a spade a spade or a big spoon then. Now I come to exchange control liberalisation. Although Mr Alexander McGregor Bruce-Brand general manager of the bank's exchange control department in his statement previously delivered to the commission has already provided an overview of exchange controls, I would like to make some brief comments now in this regard. Perhaps most importantly the fact that exchange controls are a reality. They were inherited from this past that I made reference to. It is only with major changes taking place in South Africa over the last decade that bold steps have been taken to integrate South

Africa into a globalising world. In particular exchange control on residents and on-residents have been relaxed substantially. These steps have made - they have met with general acclaim. The policy of gradually liberalising exchange controls has also played a role in attracting foreign capital inflows. Sometimes with concomitant benefits in the form of technology transfers to South Africa. These inflows were obviously supportive of the rand's value. Details regarding investment flowed by private individuals, corporates and institutional investors are set forth at pages 333 to 337 of the bundle. Key figures have been extracted from that document to give an indication of the magnitude of approved investments off shore by residents, private individuals. Private individuals in terms of their investment allowances transferred approximately R7 billion over the period 22 February 2001 to 31 December 2001. February to December. Corporate in terms of foreign direct investments transferred approximately R13.5 billion from South Africa over the period 22 February 2001 to 31 December 2001. Institutional investors, since 21 February 2001 institutional investors have been allowed to acquire foreign portfolio investments up to the limits defined by way of foreign currency transfers based on a percentage of the previous year's inflow of funds. Statistics reported to the exchange control department of the bank show that R3.8 billion had been executed. Even taking the current exchange rate of some R11,50 per US dollar these flows amount to huge capital outflows in dollar terms, US dollar terms. It is virtually impossible to estimate the exact extent to which exchange control liberalisation has contributed to rand witness but there can be no doubt as the figures above suggest that it could at times have been an important structural factor.

CHAIRMAN: Mr Mboweni presumably that depends on whether, what the inflows are? --- Yes, this position is based on, that is why I used the suggestive not the definitive. The reason being that in theory as your liberalise exchange controls yes your resident might take money out of the country but that also non-residents could be putting money into the country, in particular the perceived view environment much freer and therefore very good for business, that is the theory. And that is based on the assumption that everybody is patriotic. That they are not just going to see a huge outflow of money. I now come to the impact of globalisation. The re-entry of South Africa into the globalised financial markets and the opening up international competition led to a sharp increase in the participation by non-residents in the domestic financial markets. Non-residents are now responsible for about one third of the turnover on the JSE Securities Exchange SA, and approximately one eighth of the volumes on the South African bond exchange. This has caused share and bond prices as well as the exchange rate of the rand to be increasingly influenced by developments in the rest of the world, particularly developments in the emerging markets. These transactions by non-residents contributed materially to substantial increases in financial sector activity. Turnover on the South African bond exchange for example increased from 2 trillion in 1995 to 12.4 trillion in the year 2001. While the total value of shares traded on the stock exchange rose from 63 billion to 606 billion over the same period. In the rand foreign exchange market volumes the volumes increased from a net average daily turnover of some \$2.7 billion in 1995 to some \$7.3 billion in 2001. (Inaudible) of non-residents also resulted in greater volatility in capital flows, for example non-resident net purchases of shares on the JSE Securities Exchange SA at first increased from R5.3 billion in 1995 to R26.2 billion in 1996 and R40.6 billion in 1999 before declining to R17.4 billion in 2000 and R29.8 billion in 2001. The net purchase of bonds on South African bond exchange were even more volatile. At first this net purchases also increased from R3.4 billion in 1996 to R14.8 billion in 1997. Then foreigners of non-residents on a net basis sold bonds to the value of 9.8 billion in 1998 and bought back 14.3 billion in 1999. They again became net sellers of bonds to the amount of 20.2 billion in 2000 and 25.9 billion in 2001. The point that we are trying to make there is that the sharp fluctuations in portfolio investments of non-residents could have contributed materially to greater volatility in the exchange rate of the rand. I now come to the current account of the balance of payments. Developments on the current account of the balance of payments were discussed in part 2 of this statement, when I pointed out that the third and fourth quarters of 2001 so the current accounts of the balance of payments slipping into deficit. This development obviously added to the demand for foreign exchange and technically speaking could have contributed to the downward pressure of the value of the rand. Risk aversion. Risk aversion reflects the particular stance of the investors in the international market in respect of the amount of risk they are willing to take. When investors move into risk aversion mode they tend to avoid taking on additional risk and typically reweight their portfolios towards less risky (inaudible) for example US Treasury Bonds. The onset of the period of rapid depreciation in the rand's value coincided with an increase in risk aversion as reflected in the Jeffrey Morgan Emerging Markets Bond Index spreads over comparable US Treasury. The graph there is just to try and show the risk aversion but the important point is that there is an increase in risk aversion. That graph may not help very much. The increase in risk aversion could also have played a role in the outflows experience via non-residents sales of South African bonds and (inaudible). The extent of this risk aversion was understandably worsened by the tragic events in America on 11 September 2001. It was only in early December that this EMBI, that is the Jeffrey Morgan Emerging Market Bond Index spread tightened significantly indicating a reduction in risk aversion. This reduction in spread also reflected a reweighing of the index which accorded Argentina a lesser weight. Possible further factors contributing the rand weakness. Further to the facts already stated the statement would be incomplete if no reference was made to a number of other possible causes of rand weakness, again possible causes. These other factors which we believe may have contributed to rand weakness are based on discussions with the banks, correspondent banks and interaction with foreign investors. Regional instability particularly in Zimbabwe could have played some role in the weakening of the rand from May 2000 and also since June 2001. Much as it is known that South Africa cannot be compared to Zimbabwe or that Zimbabwe is not a province of South Africa it seems to be a factor influences residents and non-residents perceptions towards the currency. If you ask me which sort of residents are influenced by these perceptions I would probably say that those residents with money would be the ones influenced as I mentioned. Other factors that are regularly mentioned in the market are perceptions about unemployment, HIV/Aids, crime and the lack of progress with further privatisation. The slow pace of land reform and the lack of investment incentives some of which one can dispute but this is what they say. I do not necessarily agree with all the factors but this is what they say when they talk to us. These factors certainly fall outside the control of the bank but they should be mentioned as possible factors contributing to negative perceptions regarding prospects for the country and thus towards the currency. Some South Africans are nervous because of these factors and use any available opportunity to diversify their assets. It is true for individuals as well as corporates. Non-residents also become wary of investing here and needless to add South Africa has to face fierce competition to attract foreign investment to our shores. Market perceptions are a significant contributory factor to decision making and consequently directly influencing the judgment that would underpin a specific trading behaviour in the foreign exchange market. I now come to speculative activities. Speculative activity is not only difficult to define but it is also extremely difficult to determine the effect of such transactions on the exchange rate. If it implies transactions entered into based on a view of the future value of the currency then most foreign exchange transactions will have a speculative element in them, for example a decision to hedge against currency risk by an importer may be based on an exchange rate focus and the resulting forward purchase of US dollars would have an impact on the rand's exchange rate. If speculative activities is defined to include only transactions by certain parties which are not based on some fixed firm and ascertain commitment then another set of transactions would obviously be caught within this definition. South African authorised dealers are allowed to trade the rand for their own accounts in the inter bank market. Their activity adds liquidity to the market enabling customers to execute transactions easily. Whilst both resident and non-resident clients run overboard positions in foreign currency against the rand the South African authorised dealers who are on the other side of these positions - that should have been rand I beg your pardon, did not run huge positions against the rand. Let me read that again. Their activity adds to the market enabling customers to execute transactions easily. Whilst both resident and non-resident clients ran overboard positions in foreign currency against the rand the South African authorised dealers who are on the other side of these positions did not run huge positions against the rand. The authorised dealers aggregate net positions amounted to less than 1% of their net qualifying capital in 2001. The statutory limit for these positions is 10% of net qualifying capital. Other residents are not allowed to unfettered access to the foreign exchange market. Besides residents diversifying their assets abroad they do have a further impact on the exchange rate in the manner they lead and lag their payments abroad and accruals from abroad. This does not refer only to cash flows in and out of South Africa but also to decisions regarding the hedging of future transactions. In the second quarter of 2001 the total exports of goods and services from South Africa at a seasonally adjusted annualised rate amounted to some R328 billion with imports of goods and services amounting to almost the same. Even if a small portion of this sizeable amounts is involved in leads and lags it is obvious that it could have a noticeable effect on the exchange rate in a sense importers and exporters alike are in a position where they can legitimately take sizeable positions by virtue of their views on the rand's prospects. They have the same impact on the rand as pure speculative (inaudible) activity would. It is evident from information furnished to the bank by the authorised dealers that there was a gradual increase in the foreign exchange balances of South African corporates at the authorised dealers over time, and I do not want to go into the CFC accounts because Mr Bruce-Brand dealt with that. At the end of 1999 for example these balances amounted to $995 million and increased to $1.981 million at the end of December 2000. During the year 2001 these balances increased by a further $644 million to a balance of some $2625 million on 31 December 2001. This could be interpreted to mean that exporters were lagging the sales of foreign exchange proceeds. This in itself may not imply that exporters were not adhering to the 180 days dispensation in terms of the exchange controls. It is noteworthy in any event that no significant changes occurred in the last six months of 2001. Details regarding the outstanding aggregate balances on the CFC accounts for the year 2001 are included at pages 338 in the bundle. Owing to the relatively free access that non-residents particularly banks enjoyed in the US dollar/rand foreign exchange market they are certainly in a position to speculate on the rand. The estimated overboard position in foreign exchange of non-resident banks with authorised dealers increased by about US$2 billion from the end of June 2001 up until the end of August 2001. There is the graph that, graph 15 tries to show the statement I have just made. Some of these amounts might represent speculation but it is impossible to determine how much as there are various other reasons why non-residents banks might buy foreign exchange against the rand. They or their customers could choose to invest in South Africa on a hedged basis which is acceptable. South Africa has the mixed blessing of having more liquid financial market than many other emerging markets, consequently in times of international crisis South Africa's financial markets could be used as a proxy hedge for exposures to other emerging market countries. That is on the assumption that emerging markets currencies, that is on the assumption that the currencies of emerging markets will move in the same direction. The rand could be sold to provide a hedge for the currency risk in these other emerging markets. This would however be in contravention of the exchange control rules since there are no underlying South African commitments. Some of these non-residents view the rand as an international hedge currency and through their established emerging markets trading desks prefer to trade the rand on a proprietary basis, that is for their own account. This is also contrary to the existing exchange control rules since there is no underlying commitment. Foreign investors have very sizeable exposures to South Africa, even though it is reported that most foreign investors and equities do not hedge the currency risk it cannot be guaranteed that some of them do not. Thus it is quite plausible that a portion of $2 billion mentioned above represent legitimate hedging by foreign investors who because concerned about the rand's weakness. Against this background however it is still possible to under estimate the role of non-resident banks in the rand foreign exchange market. These banks trade rands very actively and they represent some 55% of the total turnover in the rand foreign exchange market, (inaudible). It is perhaps worth pointing out that despite the fact that most of the activity of non-resident banks take place in the swop market. There were net buyers of rand in the sport and forward markets during the year 2001. It is possible however that aggressive trading by non-resident banks could scare South Africans into following their lead. This conclusion provided the rational of the bank's 14 October statement to ensure that only legitimate transactions take place. Now I come to what I am told is a popular subject. The events surrounding 14 October 2001 statement by the Reserve Bank and culminating in the joint statement issued on 21 December 2001 by myself and the minister of finance. As mentioned earlier a copy of the statement of 14 October 2001 is enclosed at pages 339 to 341 of the bundle. A concomitant exchange control circular D342 as well as a resulting letter sent by the authorised dealers to their correspondent banks are also found at pages 342 to 345 of the bundle. The issue of enforcing existing exchange controls has been extensively discussed in the bank and the national treasury over a long period of time. This issue was for instance discussed at a strategic planning session of the governor of the Reserve Bank from 1 to 3 March 2001 as shall appear in an extract of the minutes from that session inserted at page 346 of the bundle. Now I need to just do something here, if you will give me the permission. In fact this matter of the - of seeing to what who could do to arrest the decline in the currency, had also been discussed way back, I recall when the handing over process was occurring, that is between myself and the previous governor from April 1999 we had agreed that I should take over the bulk of the internal management of the bank and as part of doing that I recall a number of strategic planning meetings at which we discussed this matter. One at Mount Sheba in Mmpumalanga, the other at what is this place next to (inaudible).

MR POTGIETER: Grasskop, close to Grasskop isn't it?

CHAIRMAN: Oh Annoridge. --- Yes. There at Mount Grace is the kind of place we go for strategic planning sessions.

I notice yes, I am envious. --- Then at Walkersins where there is also trout fishing so we can talk and can fish at the same time and a whole range of other places. I pause and say this so that the notion that we just woke up one morning felt aggrieved to one reason or the other and issued a statement must be dispelled. Which notion I gather exists among certain quarters. Now the bank was aware of the various explanations for the rand's weakness in recent years. This would include exchange control liberalisation and the bank binds sport foreign exchange to reduce the NOFP. Over shorter periods there is no doubt that the decisions by importers and exporters to lead or lag their foreign exchange payment and sales play an important role in causing volatility. The impact of this more fundamental and legitimate factors influencing the exchange rate was and is certainly acceptable to the authorities. This is a legitimate transaction. More concern were comments from the market that speculative transactions particularly by non-residents were adding to volatility and rand weakness. The bank was informed that investors and other emerging markets with less liquid financial markets were using South African market as a proxy head for weakness in other countries. The bank really had no choice but to either abolish the remaining exchange controls in total or to apply the existing rules and regulations equitably to all. The bank became increasingly concerned that excessive volatility in the foreign exchange market during the third quarter of 2001 exacerbated by the tragic events on 11 September 2001 negatively influenced inflation, business decisions and the economy as a whole and therefore issued a statement on 14 October 2001. It was stated that and I quote

"The bank stands ready to take appropriate firm steps against trading activities still consistent with existing rules and regulations. The enforcement of existing rules serves to ensure that only legitimate transactions take place in the foreign exchange market. This does not restrict for example the ability of a non-resident investor to either hedge or repatriate the sale of proceeds from an investment in South Africa. He does however exclude the financing of short rand positions in the domestic market which is consistent with the requirements that domestic borrowing by non-resident investors is subject to certain restrictions. This communication should not be construed as an attempt to restrict the activities of banks in the South African market provided the idea to the existing rules and regulations."

The bank believes that applying the existing rules and regulations, to exclude speculative trading from our foreign exchange markets will reduce volatility in the rand's exchange rate and would be to the benefit of the non-resident investors in South African's alike. I must indicate that dear commissioners that when we were about to issue this statement we thought it prudent that we invite the chief executives of South African banks or of banks registered in South Africa, that would be both domestic banks and foreign banks which have a presence here, the chief executive plus their head of treasury and indeed we duly invited them on a Sunday afternoon which I gather they did not like but there was work to do, invited them to the bank, we explained to them what we are about to do. There were only two banks which raised their hands to speak. The first one was Citibank which raised a concern that our action could result in the development of the off-shore, off-shore market on which the Reserve Bank will have no jurisdiction. I do not want to go back to that, I think Mr McCauley dealt with that in some detail. And that question was raised by I think the head of treasury from Citibank. The second hand that was raised was that of Deutsche Bank who raised a concern in their view that we were targeting the wrong target by wanting to enforce existing rules and that maybe the target was somewhere else. They did not indicate to us what that target was, I wish they had at the time, they did not. Maybe during this commission they will still indicate what the target is.

Those were the only two ... (indistinct) that raised their hands and outside the meeting the only - there was only one person who came to me to say they would have rather we abolish the exchange controls on that day, that when they came to the meeting they thought this was going to be the day Mboweni abolished the exchange controls. Therefore, that is not my responsibility, it is the minister of finance's. So that then happened that day. So I thought I should say that now.

"Notwithstanding the explicit emphasis that the South African authorities remained committed to the orderly and gradual process of relaxation of exchange controls, the statement appears to have been somewhat, and deliberately misinterpreted by some market participants."

And I want to emphasise that "deliberately", because the statement was very clear how they would have misunderstood that, I do not understand. It was not written in Shangaan, it was written in English, they understand. They seem to have read into the statement that the stricter enforcement of existing exchange controls amounted to an effective tightening of such controls. There are nothing of the sorts.

"It was subsequently noted that many market participants, both locally and off-shore became sensitive regarding issues relating to exchange controls. The bank had been in communication with the foreign exchange market in order to explain the rationale behind the statement of 14 October once again. While such consultations were underway some off-shore banks might have decided as a precautionary measure to avoid finding themselves in contravention of exchange control rules, to reduce their level of activity in South African's foreign exchange markets. This may have well contributed to a decline in liquidity which is discussed below.

It should be noted, however, that the causality could have been the other way, that is sharp movements in the rand's value could have created uncertainly leading to the widening in bid offers ... (indistinct) and the reduction in the liquidity."

I in fact also must indicate that immediately after issuing the statement, if the commission will recall, the rand actually strengthened, now it is strengthened, and it is initially strengthened.

"In terms of figures reported in the bank nett daily turnover in the rand foreign exchange market had declined from an average level of $7,4 billion U.S. in October 2001 to 5,5 billion in November, but increased again to a level of $6,1 billion during December.

The most significant decline was in the shop market where the average daily turnover declined from an average of $5,8 in the first ten months to an average of $4,3 billion U.S. for the last two months. The turnover of non residents, the most significant participants in this market, declined from $3,6 billion to $2.3 billion U.S. respectively. Despite these lower activity levels in the domestic foreign exchange market it is perhaps too early to establish conclusively that turnover has declined on a sustainable basis, especially given that December turnover figures tend to be somewhat distorted in the South African foreign exchange market during the holiday period.

Whilst it is accepted that turnover alone is not a perfect measure of liquidity, it does represent a reasonable proxy. When ... (indistinct) together with the widening of the bid offer spread from 50 points to at times 1000 points it appears that liquidity in the foreign exchange market could have been affected. The issue of liquidity also arises when considering volatility. One month historical volatility of the rand's exchange rate against the U.S. dollar increased from a level of 9,1% in the first nine months of 2001 to an average of 20,5% for the last quarter. These volatilities reached a high of 55% at the end of December 2001."

It is, however, not possible to ... (indistinct) changes in this valuables to a single reason or event, but it is plausible that the interpretation of the 14

October statement could have been a contradictory factor as I mentioned earlier. In fact, I am told that even up to today there are still some very senior economists in South Africa who have decided to interpret the statement as the tightening of exchange controls instead of the enforcing of the existing controls, very, very educated people.

"As indicated earlier it is similarly difficulty to be definitive about the degree of speculative activity in the foreign exchange market. Whilst such activity cannot be excluded as an explanatory factor of the rand weakness, the rate of the depreciation of the currency may well have given rise to legitimate hedging transactions. The Minister of Finance and I were concerned by the rate of deprecation and issued a joint statement on 21 December 2001."

MR POTGIETER: The joint statement is on page 347. --- The statement is on page 347 of the bundle.

"The statement focused on the solid macro economic fundamentals and on the prudent policies being employed by the authorities. The statement's concluding paragraph read as follows:

'In this uncertain environment many experts and commentators have emerged, all with views and policy advice. While constructive input from stakeholders is always appreciated it is important to point out that much of the volatilities driven by sentiment and opportunity. It is in times such as these that we should respond as a country, with full confidence in ourselves and the policies we have adopted.'"

In conclusions Commissioners I wish to conclude and summarise the final part of my statement by observing that:

"The rand exchange rate obviously came under a great deal of pressure in the latter half of 2001. If developments in the balance of payments are taken into account as well as other issues already mentioned, including the fact that market participants would ten to trade according to the view that the rand is vulnerable, thereby adding further to pressures in the rand, this depreciation in the value of the rand was not altogether unexpected. Admittedly the severity and the speed of the decline was surprising and of great concern. If the bank had been aware of illegitimate transactions which may have had the effect of adversely affecting the value of the rand, it would have investigated them and taken appropriate action. It is recognised in the bank that the best defence of a currency is prudent macro economy policies accompanied by structural and micro economic reforms where appropriate. Given the inflation targeting monetary policy framework under which the bank operates it was not considered inappropriate to hike interest rates in defence of the currency, nor was it considered appropriate intervening the foreign exchange market in the manner as explained above, through the forward book to support the value of the currency."

Let me read it the way it is there.

"... nor was it considered appropriate to intervene in the foreign exchange markets to support the value of the rand by means of the forward book. The bank did express its concern in a statement by myself on October 14, about the recent volatility in the domestic foreign exchange market as the interests of South Africans and non-resident investors are of paramount importance. It was also further appropriate to enforce existing exchange controls rules for non-residents to ensure that only legitimate transactions take place in the foreign exchange market. Also contained in this statement was a very positive announcement regarding future purchases of foreign exchange to reduce the NOFP."

Just for the record, we say that we would no longer be buying dollars in the sport markets in order to reduce the NOFP, but that we will use the proceeds from the Government's privatisation programme and also their sovereign issues to reduce the NOFP. Very positive statement.

As I indicated in the joint statement issued by myself and the minister on the 21st December 2001 the positive economic fundamentals were again reiterated. This is the burden of my submission Commissioner and I pause here.

Mr Mboweni, I think you have read everything, but in so far as you may have missed a paragraph, or in so far as you may not have referred to a table or a graph, do you confirm the content of your statement and the graphs and tables? --- Yes, I do confirm.

Mr Mboweni, when I consulted with you last Saturday in Pretoria you told me that you were warned by your officials that was being friendly at the consultation by the time we get here I may turn into a "goggo". Well, I do not intend to turn into a "goggo", I have no further questions for you. --- I will have been more worried if you turned into a mamba. (Laughter.)

MS QUNTA: The NOFP was mentioned to us by every single witness we had last week.. --- Yes.

They came in their individual capacities, but they were from the commercial line and except for Dr Jammine who gave evidence on Friday, but I recall that even he mentioned the NOFP as the contributor, in their views to the lack of liquidity, specifically the latter half of 2001. Dr Stals did indicate to us though, that there is a misperception in the market. I have not - certainly I have not been able to understand clearly, what he indicated is that in trying to stabilise the currencies previously markets were taken out of the currency market by the Reserve Bank, utilising that to reduce the NOFP, but his view was - in fact he said that is what he knows. It is put back into the market at a later stage, so it is a circular movement of dollars, it is not in effect taking the dollars out of the market. You have not dealt with that specifically. Are you able to confirm Dr Stals's view or explain it? Because in fact subsequent to that the expert witnesses have confirmed in fact, have reiterated their ... (indistinct) that it is a question of taking dollars out of the market which would increase the liquidity. --- I - well, I am fully aware that this is a Commission in terms of the Commissions Act, and also fully aware that central bank governors present and future and so on are unlikely to contradict one another. I would like to say that my ... (indistinct) of the NOFP position is as I have stated here. Is there any differences that I will not want to dwell on them myself, I want no headline Mboweni v Stals tomorrow, so I would like to stick to what is here. What happens is that we have got this NOFP which, as I have said, in a sense is Government taking the market risk of the exchange rate on behalf of market participants, it is there. Any losses arising as a result, for example, the depreciating exchange rate, that accrue ... (indistinct) the account of the Government. They indicated a magnitude that are involved and we thought it prudent, as I indicated, partly as a response to the need to get this thing down and reduce Government's cause, but also because the people in the market were saying that the existence of this large NOFP position made the currency very vulnerable. Now, what will normally happen of course, dollars come into the market, up until 14 October. We bought some of the dollars, not all, we bought some of the dollars that came in to have reduce that position. Now if you move from the position that in September 1998 the NOFP was around 23.5 - .5 billion U.S. dollars, if you move from that position and come to the fact that at the end of the year 2002 that NOFP has declined from that level to $4,8 billion.

2001. --- 2001. You cannot escape the conclusion that the Reserve Bank itself took a sizeable amount of dollars from the market. So that can be escape and we do make reference to that in our statement. Now, when James Cross comes later on he is going to give you some of the technical background, but what I want to say to you is that this is what has happened at the NOFP, we have reduced it and as I say in the statement this could have contributed, because in other words we - by buying dollars we are selling something, we are selling rand into the market. So that could have contributed. Basic law of supply and demand, but as I mentioned in the statement, you know there must be other factors that play, which we also tried to touch on them. Now, when the market participants kept on saying to us the manner in which you are reducing the NOFP might be a problem for the exchange rate, that you know maybe you should leave the dollars in the market and so on. We reacted then by saying on 14 October, that from then onwards, given the fact that we have reduced the NOFP already significantly we would then no longer buy dollars in the sport market and we would leave that to the market, in response to their own requests, and also noticing that the NOFP really had become a very small and no longer a major issue, and that we would instead reduce the NOFP in future from the future proceeds from privatisation and Government ... (indistinct) issues.

Now of course, well, what is the expression? Nobody ever promised anybody an nice garden party, the very same people who are complaining about the NOFP being large, that we should reduce it, today speak with forked tongues, they are the ones now criticising us for reducing the NOFP, are sad, very sad. Sad commentary on our people, very sad.

MS QUNTA: Just a last question. At your meeting of 14 October the author - were all the authorised dealers present or the majority of the authorised dealers? --- I think the majority of the authorised dealers could have been there, if not all. Ja, the majority, and/or the biggest players in the market were there.

I have no further questions.

MR GANTSHO: Thank you Governor, your views are clear on a number of issues that I would have liked you to address. Just two clarification questions. The first one relates to the statement you have just made that people are now critical of the reduction of the NOFP. The evidence that we heard was contrary to that, people were not - particular witnesses are really critical of the reduction, but they were critical of the manner in which the NOFP was reduced, others are arguing that they you should have kept the markets guessing and not conveying clear views as to when you are going to reduce it and how you are going to reduce it. What is your view on that? ---(Laughter - words spoken in a foreign tongue.) You know the - now there are only two ways of reducing this NOFP, one is you buy dollars in the sport market and log them into the NOFP, into the forward book and then you reduce the NOFP, that is one method. The other method could be a combination of the first and also buying the proceeds from the Government's sovereign issues and the privatisation. If anybody has any other idea I will welcome it, I will really welcome it. There is no point in people just criticising and not coming with suggestions. I will really welcome any other approach. Now, nobody at the time when we were reducing the NOFP said to us, no, no, no, don't do it like that, look man you are moving too fast, we have a different approach that I am aware of. The proposals that I know of were those that related to Government borrowing in the off-shore markets i.e. issuing some special bonds over a longer period of time. At the end of the day it is Government borrowing and what concerns me is that when people have been saying for a long time, if you - if you had some interest as students we will just go back and check what did Azar Jammine say in the period since 1998 about the NOFP, I am sure - I do not know whether he gave you a bundle of things that is said about him. You might pick up that he has said this thing is a course of vulnerability and so on and the sword of Damocles over our heads, please get rid of this thing. He would have said so in the same way as I am sure ... (indistinct) Abadian would have said so and I do not know who the other fellows are, would have said the same thing, and we would have agree with them that this thing is a source of vulnerability let us remove it. The mechanisms, as I have said, there are only those, if there are others somebody should come and talk to me about it, I welcome it.

Thank you Governor. The last clarification question relates t paragraph 117 on page 46 of your statement where you are giving the reason or one of the reasons for your statement of 14 October, and you read the second sentence of that paragraph:

"It was felt appropriate to enforce existing exchange controls on non-residents to ensure that only legitimate transactions take place in the foreign exchange market."

Are you alluding to some illegitimate transactions that may - that might have taken place before your statement or let me put the question differently and say your observation afterwards have those types of transactions reduced after your statement.? --- Well, let me put it this way to the Commission. We were concerned that there might be certain transactions which may not be according to the rules. In that kind of environment with such huge spreads and volatility one is to try and find out what is exactly driving this volatility, and to the extent that there could have been any transactions taking place outside the rules, we just wanted to say to people we are quite convinced that you are overrating according to the rules, but in case you are not operating according to the rules, beware that the rules are there. That is the point that we are trying to make and I think, I do not want to prescribe to the Commission what you must do, but I think when the bank's calm you may be interested to notice why is it that they are starting withdrawing from the market, what is it that we had ... (indistinct) that they were doing, such that then the enforcement of the rules means that they do not want to play the market. It is like all of us know that when the speed limit says 120 we must travel at 120 and that if you travel - your speed is above 120 kilometres per hour you are going to be arrested. If the traffic department said people we have a suspicion that some of you may not travel at 120 kilometres per hour that from now onwards we are going to enforce the rules, are you going to park your car at home? You should not park your car at home. If you parked your car at home it means there is something wrong that you have been doing. But you know hopefully this Commission can help us as well to answer the question.

CHAIRPERSON: Further questions? Thank you Mr Mboweni. --- It was quite easy, I thought (laughter). Thank you very much, I thought - I was looking forward to private sector questions. Thanks a lot, it was really a great pleasure for us to be here and hopefully we can contribute something to finding the truth. Thank you very much.

Mr Cross, are you going to give some insight into the NOFP or has enough been said?

MR CROSS: Mr Chair, most of it has been said, if I could elucidate a little bit perhaps on madam Commissioner's questions, I could perhaps just embroider that a bit and give you some of the history regarding the NOFP, that is what I basically prepared for.

CHAIRPERSON: Perhaps what you should just first do is take the oath and then it will be evidence that you are giving.

JAMES HADLOCK CROSS d.s.s.

CHAIRPERSON: Please sit. Yes Mr Cross, what would you like to add? --- Mr Chair, just to look at some of the history regarding the forward book and what the risks represented to the market at the time and how the risks have been reduced. The paper that the bank submitted has given those details, quite a few of them. I wish just to emphasise certain points in order to address mainly the request that you Chair put to Mr Ginsberg after Dr Stals's testimony. If I could have the first graph. Thank you. This looks at the nominal effect of the exchange rate of the rand over a very long period of time and specifically looks at times of volatility in the currency and what I wanted to demonstrate by putting this up is that the volatility surrounding the events of 1985 was extreme to say the least and actually outweighed quite significantly the volatility of both the episodes in 1998 and the latest episode in 2001.

Secondly the build-up of the forward book took place post the dead standstill in September of 1985 and at that time the country's debt in foreign exchange was actually very close to where it is as at the end of 2001. It was a total of $24 billion and I have rounded the dollars off, so I am not writing ,6 or ,5. $24 billion's worth of debt. At the time the Reserve Bank had a forward book of $12 billion U.S. and that meant that somebody in the economy probably had an outstanding uncovered foreign exchange position totalling 10 billion, not one player, but many many people and it subsequently emerged after the dead standstill that there were Government agencies, there were large corporations that had large uncovered positions and the point that you make is that the type of crisis that was experienced at 1998 in Asia, in 1997 in Asia, was in fact experienced by South Africa for different reasons back in the mid eighties. It was at that stage Mr Chairman, that the bank provided this additional $10 billion's worth of forward cover to the market, the outstanding amount, and Dr Stals actually referred to that in his testimony.

One thing would be useful, and that is to look at the size of that 10 billion dollars relevant to the size of the economy at that stage and to remind ourselves that we - there was a re-introduction of the dual currency which meant that non-residents wishing to sell or purchase an asset in South Africa, had to do so from another non-resident, they could not deal with the South Africans, so we had a dual currency. The financial account or capital account of the balance of payments went through a separate currency, and the current account, commercial transactions went through the commercial currency which was the rand.

Secondly the country had no access to capital markets at all. Thirdly the Government obviously - the country had no access to borrowing from the IMF or other official agencies. So in order to balance the macro economic equation which reads that savings minus investment must equal the equality exports minus imports. You must have sufficient foreign exchange to cover that. The country could only use one mechanism to raise capital and Mr Mboweni in his testimony referred to that and that was giving forward cover to the private sector to use trade credits to raise credit for the country and for any deficit on our macro equation as we went year to year, the only way we could cover that deficit was by raising capital by the private sector and some

... (indistinct) were able to do so for longer term, for purchases of things like power generators or aircraft and so on, but the bank had to provide the forward cover for that.

That is the history and that is how the forward build built up. What is important, if we can just move to the next line please, is to realise that we had a situation - that slide is probably too small for the Commissioners, could you just fetch the next one, I will use the next one instead, thank you. We had a situation where this large forward book was actually a surrogate for what would have been IFM borrowing, would have been capital market borrowing and the exchange rate risks that the Government was carrying might have been carried in a different format which would have been understood today by the markets, whereas the oversold forward book was definitely and is definitely still not properly understood by the markets. So coming back to how we ran the forward book in the bank here is an example. Our nett reserves in the first line in the start date are say $5 billion, roughly where they are today, the forward book is minus $8 billion there short and that gives us an overall position of 3 billion, 2,9, which is what Mr Mboweni gave us.

If we deliver under our forward book to - just to make sure that there is no confusion from the previous testimony, if we deliver from the forward book, $1 billion to the market there, we would reduce our nett reserves by $1 billion to four, the forward book would reduce to seven, but most importantly the risk position does not change and that is what the Governor has just referred to in saying that the only way in which we could reduce that risk position there, which was at $24 billion was to buy either from the markets or from the Government. Assuming we did buy from the spot market, a $2 billion from the spot markets, we then would have ended up with reserves of six, a forward book unchanged at seven, they had gone up by two, because we have bought them, would have left us with the reduced position of $1 billion. If we then delivered those dollars under the forward book at a later stage, just to emphasise what happens then, we would reduce the reserves once again to four, where they were. We would, however, now have a reduced forward commitment of five which would end up with a reduced position of one.

Could we move on to the next slide please. Looking at the impact of the forward book. It is instructive to note that between December 1988 and September 1998 it looks as though you had exactly the same amounts outstanding. I am going to cover the interim period now, and it goes back to the graph that the Government demonstrated where Mr Mandela was perceived to be ill and so on, on that graph, but we had up to - from there for those ten years we had a large amount of risk which the Government was taking on behalf of the markets and how large that was I will demonstrate a little later from a table which we will use.

In 1995 the dual currency mechanism was abolished and that meant that purchases and sales by non residents of any assets in this country, either shares or bonds were going to be channelled by the unitary exchange rate and that was going to make a difference to our reserves. In other words a large inflow from the purchase of bonds or shares would make a difference to the reserves and that meant that the bank would start reducing its forward book and could start untying the forward book. After the introduction of the - or the abolishing of the dual exchange rate in March 1995 there was a significant amount of euphoria and the bank was able to make a significant reduction to the forward book in a matter of 12 months, and from - if one looks at the period from March 1995 where the book was 25,8 billion, by March 1996 it had reduced to 8,5 billion, a huge amount of reduction.

Could we have the next slide please. Thanks. That is just illustrated here, there we were there, and then March 1996. Immediately here in March 1996, the moment there was an event, what actually happened here was the risk position that Government had been carrying at 25 billion was reduced by purchasing from the market the difference, mainly some small amounts of that were purchased from Government issues abroad, mainly the purchases came from the market. That immediately meant that the market was carrying significantly more risk than it was carrying in March 1995, ... (indistinct) amount of risk the market was now carrying. At the first hint of a problem the exchange rate started depreciating immediately. That was Mr Mandela's perceived illness at the time. And that is - what the bank did to stop that was immediately return of what it had bought there, some 17 billion, it returned the book to 22 billion, in other words it put back something like 16, 15/16 billion. Now, in doing that - sorry, I beg your pardon, it put back about 14 billion. In doing that it stopped a massive depreciation of the rand, although the rand still went from a level of 350 up to 480 and back to about 450 after the bank finished this intervention. That means that a large amount of risk, 14 billion, had been taken on again by the Government, replaced in the market and that only contained a depreciation from 350 to 450.

Then in 1997, after this episode here, the bank was again successful in reducing the position by almost $10 billion. That came from good portfolio inflows, mainly shares and bonds, and also euro/rand activity in the euro markets. Again September - or rather in the middle of 1998, round about - really it was April/May 1998 we had the Russian crisis and as the Governor pointed out in the testimony South Africa was largely used as a surrogate hedge for speculators who had positions in Russia and were unable to deal in the Russian markets, the Russian markets had broken down, they had actually been closed and they were unable to deal. So what they did was we were told this by the market, we do not have factual information, but the market informed us that they had used the country as a surrogate hedge and it shorted the rand in order to try and make back some of the money they lost. Again the bank reacted, this time in two ways, it replaced what it had bought, slightly more than it had bought, in fact an extra billion dollars more than it had bought up to that point in time. It immediately replaced that in the market in a matter of months. Secondly interest rates were hiked by 7% in real terms, immediately and this only resulted in containing the depreciation from a level of just around five rand to a dollar, to a peak of around 6,80, 6,90 and then returned it to an exchange rate of around 5,80, moving slightly towards the six level after a period of time, but we have settled around six. Again, having returned out position to exactly where we were ten years prior, almost to the billion dollars.

Now, subsequent to 1998 ... (intervenes)

CHAIRPERSON: Sorry, just for the record purposes, so what you are saying is that September 1998 after the NOFP had gone up to 23,2 billion the currency was contained at what was it about? --- Six.

About six? --- About six, ja. Subsequent to this there was the shift in policy, basically there was a decision taken to reduce the NOFP as we could by market mechanisms to zero. If one recalls at that time those same - that same public information notice of that time, September, was - the IMF was highly critical of the country for having intervened and used the forward book again to intervene and we were under some pressure to reduce the book. That was again, we did that by - the book was reduced significantly in the next year, 1999 and the book was reduced by around $9 billion in 1999, and after that we had a situation where we came down from 22 billion in December 1998 to 13 billion in December 1999, and during that year the exchange rate actually appreciated on a trade ... (indistinct) basis by just under 1%, by 0,6. No change in the exchange rate, so the market was happy to accept that risk back from the Government and from the bank.

However, we then ran into events which started to occur in 2000 which basically was the regional instabilities that we were suffering at the time and we reduced in the following year, from December 1999 from 13 billion we reduced to 9,5 billion. That was a small reduction compared to the year before, but because of the regional events, the markets informed us of that and other issues. The rand depreciated on a trade weighted basis by 12,4%.

Then came the year 2001, which is the subject to this Commission inquiry. In the first half of the year, as were evidenced earlier by the figures given to the Chairman, there was hardly any reduction in the NOFP, the reduction came - well actually not in the first half, reduction came towards the end of the first half of the year in the second quarter, mainly from the proceeds of the De Beers deal. Mr Chairman, I just want to say at this point in time that if one views the amount of risks that were being transferred, the absolute amount of risk that was transferred from the market to the bank and the Government and the taxpayer, back to the market, to and fro, and compares them with the real flows in our economy, the real flows in our economy paled into insignificance. If one looks at the surpluses on the financial account for the year 2000 and 2001 they amount to 9 billion for the year 2000 and we had a current account deficit there of around 3,7, ... (indistinct) amount to 7 billion for the year 2001 and we had a current account deficit of round 1,7 billion. So a nett amount of around 6 billion in both those years and if you just take the De Beers transaction, just the purchase of that one that was in excess of 22 billion and that was only about 10% of what we were playing with in total.

And the reason I am making these points so laboriously Chair is that we just must realise the size of this position vis a vis the underlying economic transactions, and also that in 1985 had the Government not taken on that 10 billion dollar's worth of risk there would have been an enormous depreciation of the rand in those days, just as we have bought back the currency right at the end of this period there has been a significant depreciation of the rand. $10 billion in those days was about one third of the trade of the country, $10 billion today is only about one sixth of the trade of the country.

But going back then to the examples. Could I have the next slide please? This is a table, and this is somewhat of what Dr Stals was eluding to madam Commissioner. This is a table which we drew up from BIS figures and from IMF figures, and we tried to use this table to demonstrate to the markets that the NOFP was a phenomena that we were carrying which historically amounted to - as a result of historic events which I have just described, but that our risks in carrying this NOFP were not unlike the risks of many other countries and we tried to emphasise that looking at the forward book of the bank in isolation is not the right thing to do. You have to look at the external currency risks of the Government, in other words the total risks, their off-shore borrowing, the book of the bank and any derivative transactions. There are no derivative transactions, so in our case, in this country's case it was the Government borrowing plus the forward book. And to try and demonstrate that there were many countries where there is an excess of external, of foreign currency liabilities for account of Government over the level of the reserves and there we took the reserves as published, not the nett reserves, just the reserves as published in the IFP stats. We then expressed the difference here, if you take the case of Australia, the external debt as of June 2000 when these figures were last published was some $27,6 billion U.S. The international reserves 16,7, that meant that their liabilities exceeded their assets and as a percentage of their gross domestic product which is expressed there, it was an amount equal to 2%, 2,8% of gross domestic product. We did the same exercise for South Africa at the time. We said here we have external debt of 7,9, close on $8 billion U.S., international reserves of 7,4 on a gross basis. A GDP of 125 and that gave us 0,4, below Australia's figure. Then we included the forward book which at that point in time was much higher than it is today and at a level of a forward book of around 10 billion it came to 8,5% of GDP, but what we were trying to demonstrate was that many other countries had similarly exposures. Canada's exposure was 16,9%, equivalent of their GDP, Spain 5,2, Italy 18,3, Portugal 7,8 and so on down the table. Belgium 17,8, Greece 27,8, Egypt 17,4, Tunisia 46 and so on. And our figure of 8,5, including the forward book was not that bad, but if you looked at the Reserve Bank's balance sheet only it looked bad and that is what the markets did and that is why we did not use the tool of intervention again.

Mr Chairman, when you intervene your bark has to be as good as your bite. You have to be able to say I am going to sell foreign currency today and if it does not achieve what I want to achieve I am going to sell it tomorrow maybe and the next day maybe as well, and you have to be believed, if the central bank, if we got involved in selling either reserves or through the forward book, that risk position that I showed, of 3, would then just have escalated, and the market knew unequivocally that the IMF had dictated or not dictated, but had decreed that we should buy this back. We had said that we wanted to buy it back. So the simple answer was whatever you sell you are going to have to buy back in the next two or three months and therefore intervention would be a completely blunt tool. That is why the bank would not choose - one of the reasons why the bank did not choose intervention.

Could I have the next slide please. I just want to concentrate once more on Australia's position and talk a little bit about like with like.(?) In viewing the progress of the rand against the dollar and against on a trade weighted basis, one also has to have an idea of what the Governments of other countries have done with their risks over the same period of time, and I used the example here of Australia. This comes from their website. In April of 1998, and this is in Australian dollars, in billions of Australian dollars, April of 1998 the Central Bank had 21,5 billion in reserves, an outstanding forward book of just over two and therefore a nett position of 19,3, but that was a positive position and not a negative position. There is a huge difference between those two. In the ensuing period where it was noted by Mr McCauley and some other market participant, I think Mr Abedian as well, that the Australian dollar also depreciated quite a lot during this period. The Central Bank moved their forward book up from 2 billion to 29 billion and that brought their nett position from 19 billion close to 6,7 billion plus. It means that they intervened by about 12,4 billion here. They intervened to give risk back to the - rather to take risk out of the market on behalf of the market, in other words Government took back on some risk. We went completely the other way. In that same period we bought back from the markets around 15,8 billion worth of risk. In other words we gave it back to the market. So where the Government in Australia took on additional risks, we went completely the other way and actually this is a huge success story for this country, because going back, if the forward book had still been outstanding today the re-valuation Mr Chairman of that forward book would have been absolutely horrendous, and it would have equalled, if you go back to that table, it would have equalled 25% of our GDP for total foreign exchange exposures. That is what I would have wanted to add today to what Mr Mboweni had said.

CHAIRPERSON: Yes, any questions?

MR POTGIETER: No questions Mr Commissioner. Could I just ask, may we insert these graphs in this bundle, page 356 up to page 362?

CHAIRPERSON: Yes, let us do that.

MS QUNTA: So we number it 356.

CHAIRPERSON: 356.

MS QUNTA: I just have one question on this, what Mr Potgieter has now said will be 356, you have got a graph here of the month to month change of the effective exchange rate. We have heard evidence last week that the rate of depreciation in the second half of the year where the rand depreciated for instance in 20 days by 40% was unprecedented in say the last 20 years. Now, you have indicated here that 1995 up to the period 1998 with the Asian crisis and also 2001, but on the graph you have it only goes up to 2000. --- No.

Oh, 2001. --- Actually yes.

Ja, okay thanks, but can I just confirm that that is in fact what you are saying and then could you then explain to the Commission what happens in 1985 and are the conditions prevailing then with the dual currency and the issue of globalisation whether that period can be comparable to 2001? --- Madam Chair, in terms of total market size and global exposure definitely not, in other words the country was completely insulated from global events, in that non-residents could not deal in our market post September 1985, they were banned from dealing in our market basically. If they wanted to buy or sell an asset they had to do that amongst one another, which was the financial rand exchange rate, it usually traded at a discount of around 30% to the commercial rand exchange rate. So the conditions were completely different, we could not - as a country we could not be used as a proxy hedge at all. We were not exposed to globalisation in any way, in fact we were isolated globally and on an increasing basis isolated globally and the situation is that external forces on the rand would have been actually fairly limited. One thing that has to be said though is that prior to September 1985, there was a period from March 1983 to September 1985 where the dual exchange rate had been abolished, and that led to a lot of this volatility that you see on the graph here, and that was one of the reasons for the re-introduction of exchange control on non-residents and reintroduction of the dual exchange rate madam Commissioner.

Thank you.

CHAIRPERSON: Thank you very much Mr Cross. The Commission adjourns until 10:00 tomorrow morning.

PROCEEDINGS ADJOURN

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