2024 Gold and Foreign Contingency Reserve Account Defrayal Amendment Bill

Briefing for the Select Committee on Appropriations

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What is GFECRA and how is it currently managed?

- The GFECRA is an account held at the Reserve Bank (SARB). As specified in the SARB Act, it captures losses and profits on certain foreign currency transactions, protecting the SARB from currency volatility.
- The SARB Act establishes GFECRA, and empowers the Minister of Finance and the SARB Governor to settle balances by mutual agreement, and requires such balances to be paid into the National Revenue Fund (NRF).
- The last settlement of balances in this account was reached in 2003, to the value of R28 billion in favour of the SARB.
- The value of the account has since then, grown to over R500 billion due to significant rand depreciation.

What is the purpose of the 2024 GFECRA Defrayal Amendment Bill?

- This Amendment to the GFECRA Act provides for direct charges against the National Revenue Fund for the Contingency Reserve Account of the SARB.
- It also provides for a reporting of such funds, informed by a New Settlement Agreement between the Minister of Finance and the SARB Governor

…Gold and Foreign Contingency Reserve Account (GFECRA)

Why change the agreement

- The large GFECRA balance makes the SARB an outlier amongst peer central banks. It has the largest volume of liabilities to government of any central bank in the International Monetary Fund's International Financial Statistics database (relative to the size of its balance sheet). The SARB also has relatively low capital; conventionally, unrealised valuation gains contribute to a central banks' equity, but in South Africa's case these are accounted for in GFECRA.

What is the new framework?

- Under the old GFECRA settlement framework, most amounts that entered GFECRA went unsettled, and so the account grew steadily larger as a result of currency depreciation. Under the new framework, by contrast, GFECRA balances are distributed, in a 'waterfall' arrangement, to three 'pools'.
- The first pool is a GFECRA buffer, which will be large enough to absorb large and plausible rand appreciation shocks, without resulting in negative balances on the account. Once this pool is full, additional funds flow into a second pool, which is the SARB's contingency reserve. This is an all-purpose equity buffer for the SARB, maintained to absorb losses, including losses from the interest costs paid by the SARB to manage liquidity when there are GFECRA payouts to NT. Once this pool is full, any remaining funds are distributed to NT, on an annual basis.

…Gold and Foreign Contingency Reserve Account (GFECRA)

What are the key principles that govern the new framework?

- The new framework is governed by the following principles:
  - No settlement of any balance on the GFECRA shall, at any time, undermine the policy solvency of the SARB.
  - There shall be no sales of the foreign exchange reserves to realise GFECRA gains as long as foreign exchange reserves are below the foreign exchange reserve estimated adequacy levels.
  - There shall be no settlement of an unrealised balance on the GFECRA that could plausibly be unwound by future currency reversals.
  - The settlement of the credit balance on the GFECRA to the National Treasury shall be used to reduce government's borrowing.
  - Any future settlement of GFECRA funds shall be governed by an agreement and a relevant schedule.

…Gold and Foreign Contingency Reserve Account (GFECRA)

What are the amounts going into each pool?

- The GFECRA buffer is being set at R250 billion. By minimising risks that the GFECRA account turns negative, this buffer will help protect NT from having to be paid out to the account to make it positive again.
- The SARB contingency reserve buffer will receive R100 billion. The goal of this transfer is to protect the SARB's policy solvency, defined as the flexibility to pursue mandates without concern for the financial position. The contingency reserve buffer will be replenished from excess GFECRA balances when available. This buffer is meant to be large enough to last through extended periods when these top-up funds from GFECRA are not available.
- NT will receive R150 billion. As detailed in the Budget Review, this will be paid out in three tranches of R100 billion, R25 billion and R25 billion in the 2024/25 financial year and the subsequent two financial years respectively. The liquidity management costs of these payouts are expected to be around R8 billion in 2024, R10 billion in 2025 and R12 billion in 2026. The exact costs will depend on the level of short-term interest rates, and will recur indefinitely.

How is the GFECRA distribution to NT be used?

- The proceeds from GFECRA will be used to reduce government borrowing. R150 billion will be used to reduce government's borrowing by R100 billion (2024/25), R25 billion (2025/26) and R25 billion (2026/27). As a result, debt service costs will reduce by R30.2 billion over the medium-term, which is accompanied by a reduction in the growth in the stock of debt.