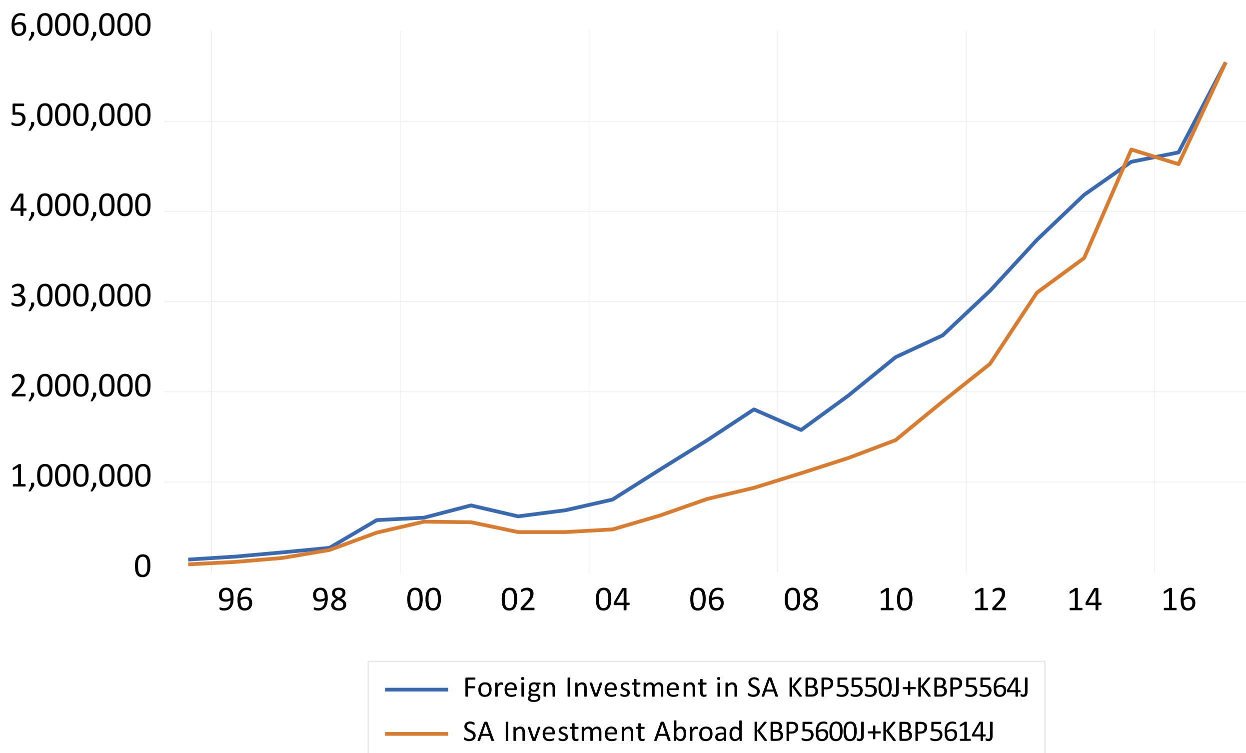
South African Foreign Investment – the balance sheets and the income statements. They tell a very different tale.

Brian Kantor

February 12th 2019

Good news is that the market value of assets held abroad by South Africans as direct investments and in portfolios offshore (R5.65 trillion at 2017 year end) now closely matches the value of SA assets owned by foreigners. (see below)

Fig 1; The value of foreign investment in SA and SA investment abroad (R millions)



Source; South African Reserve Bank and Investec Wealth and Investment[1]

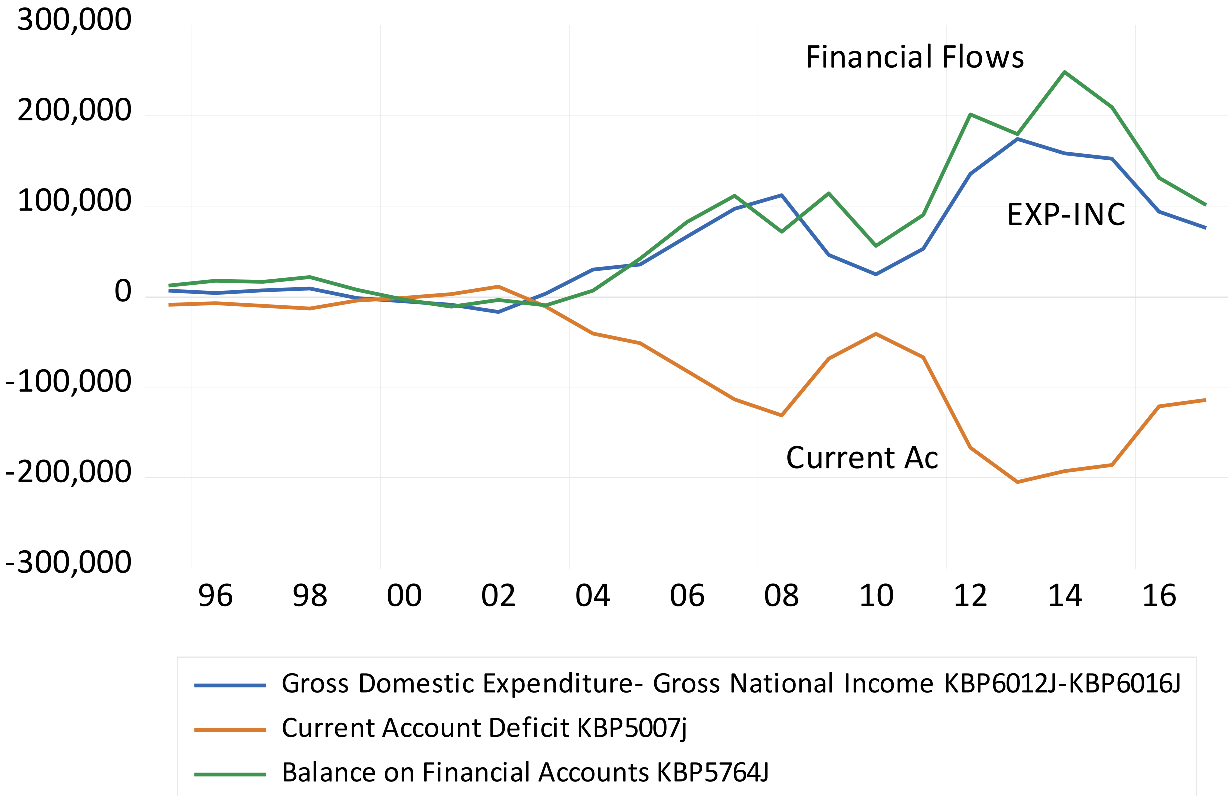
That our foreign assets are as valuable as our foreign liabilities that have grown so strongly is a very pleasing state of affairs. Especially pleasing because given that South Africans have had to give up so much of their patrimony over recent years to fund the excess of their spending over their incomes. Such financing opportunities provided by foreign savers have come with a cost to South Africans. The sacrifice that has had to be made meant giving up a share of the companies they own and by incurring more debt owed to foreigners, that has to be serviced. Or to put it another way South Africans have been borrowing more or selling assets in order to service their foreign liabilities. However these sacrifices have also served to increase the value of assets held abroad, an important development to which we will discuss further below.

---

[1] The references for the respective series are to the relevant tables in the SA Reserve Bank Data Base (KBP….) – in Fig.1 assets and liabilities refer to direct plus indirect (portfolio) investments. Government owned assets- for example Special Drawing Rights at the IMF and foreign exchange reserves are excluded as part of foreign assets. Direct investment is defined as one where one assumed controlling shareholder holds more than 10% of the shares. Portfolio investment is when a shareholder holds less than 10% of the company. It is a somewhat arbitrary cut-off and distinction.

The extra liabilities incurred to foreigners over the years- since 2002- is represented by the deficits on the current account and the surpluses on the financial accounts of the balance of payments. The current account is by definition the difference between total domestic expenditure and total incomes, including net incomes paid to or received from foreigners. The current account of the balance of payments is also by definition equal to the capital attracted to South Africa, plus or minus the change in foreign exchange held by South Africans and its agents, including the Reserve Bank and Treasury. (See figure 2 below)

Fig.2; The South African Balance of Payments, Current and Financial Account Balances



Source; South African Reserve Bank and Investec Wealth and Investment

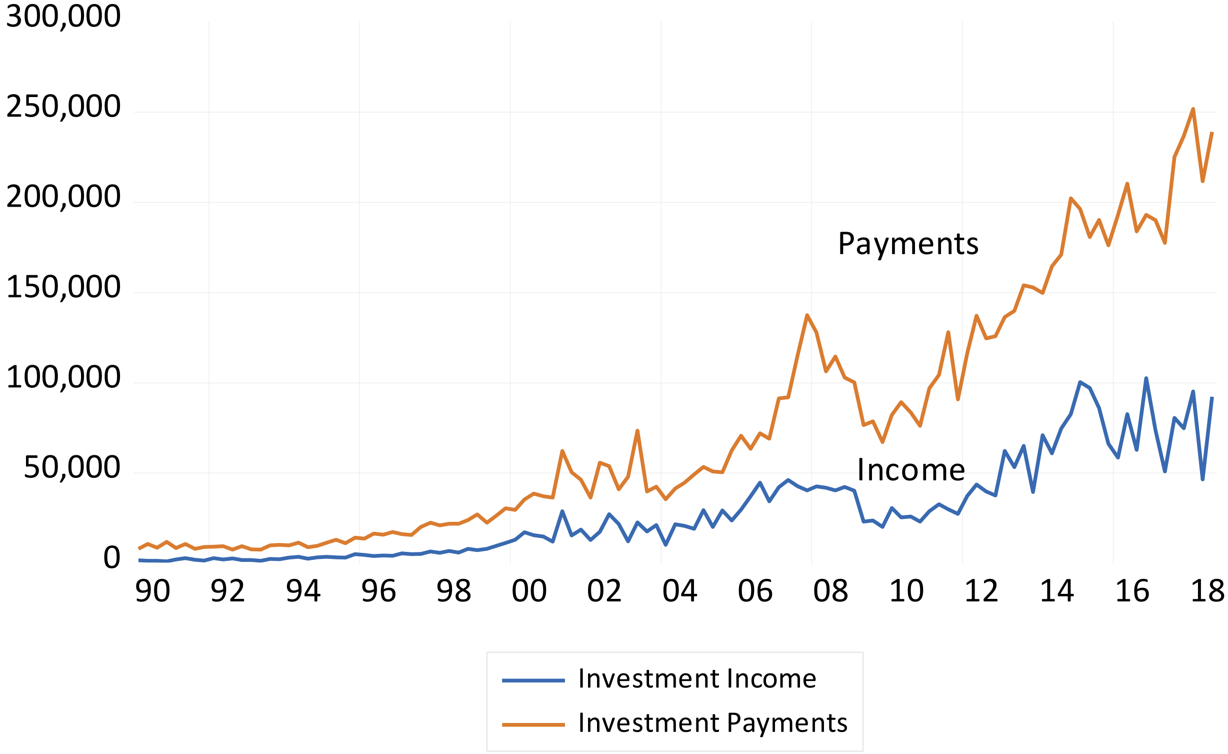
However these balance of payments and national income accounting identities, or equilibrium conditions, are the outcome of a complicated general system of equilibrating forces. Interest rates, exchange rates, prices and asset prices are in a continuous process of adjustment to changes in the supplies of and demands for goods and capital. These market developments in turn have an impact on spending, incomes and output that must balance according to the accounting conventions.

Yet let us imagine an alternative state of affairs- undertake a counter factual -as it may be described. Had the SA economy not been able to attract the foreign capital it has attracted, in exchange for assets sold and debts incurred, South Africans would not have been able to spend more than their incomes, as they have done successfully since 2002. Had we not attracted the foreign savings (capital) we have, the exchange rate would have been weaker than it has been, interest rates and inflation would have been higher and expenditure and income levels would have been lower. The gap between spending and incomes would also have been a smaller one. That is to say the current account deficit would have been a smaller one. It might even have been in surplus had incomes and expenditure been depressed enough for want of foreign capital. This would have meant less not greater economic welfare- only a not to be wished for smaller current account deficit and less capital imported.

Yet despite the extra liabilities South Africans have incurred over the years since 2002 and the assets we have sold to foreign investors, we appear no less (net) asset rich than we were. The market (rand) value of our foreign assets has grown rapidly fully in line in line with our growing burden of liabilities also measured in rands to foreigners. The capital value of our assets abroad has grown rapidly enough to compensate for our having to give up so much of what we own to foreigners. This must be regarded as a great investment success story that we will identify more fully below. Suffice to say that something has gone very right in the investments South Africans have made abroad.

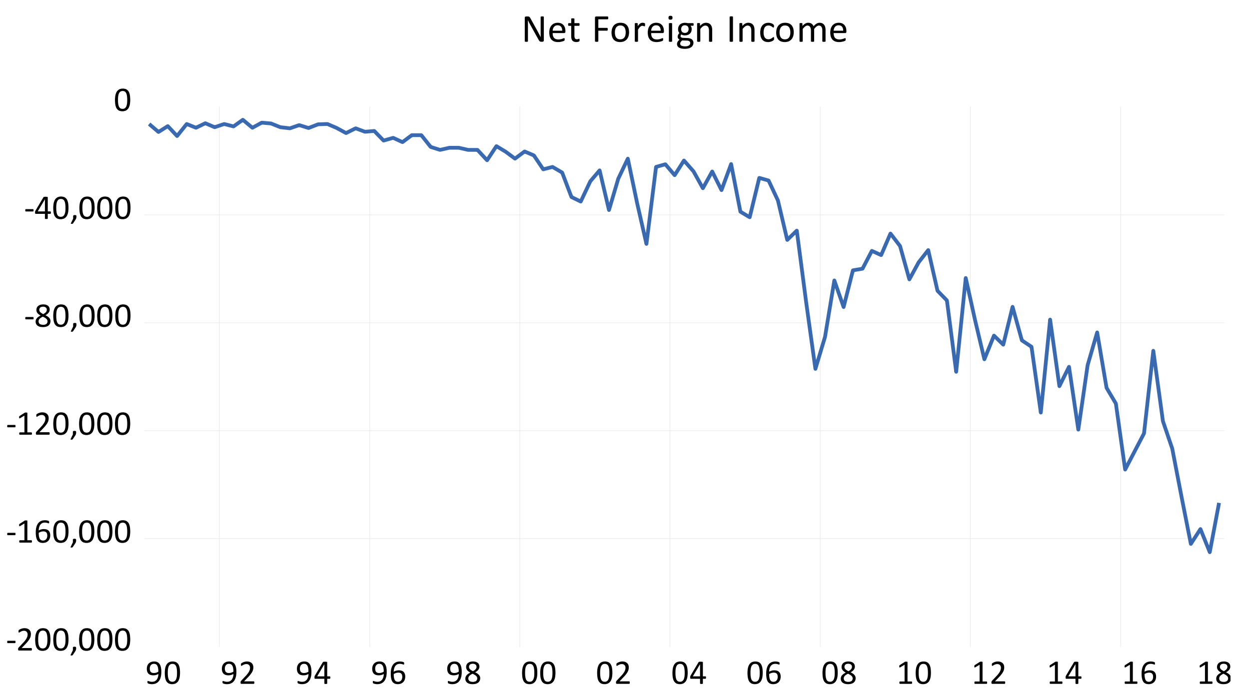
What is perhaps less pleasing is that South Africans still pay out far more in interest and dividends to foreign share and debt holders than they receive from their foreign investments- about R160b more was paid out in 2018 to foreign holders of SA assets than was received by South Africans on their foreign portfolios.

Fig. 3; Payments to foreign investors in SA and receipts from assets owned by South Africans abroad (R million)



Source; South African Reserve Bank and Investec Wealth and Investment

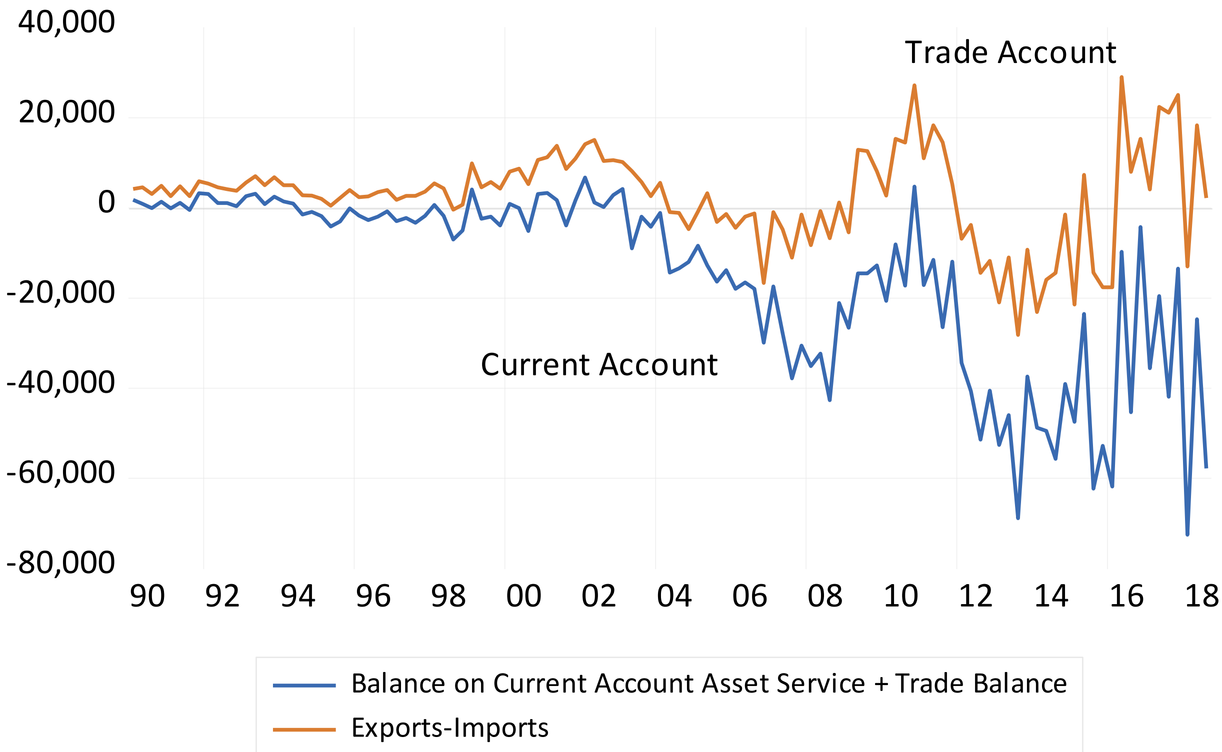
Fig. 4; South African Balance of Payments – Net investment income



Source; South African Reserve Bank and Investec Wealth and Investment

This R160 billion net payment abroad is a very large part of the current account deficit on the balance of payments in 2018. The trade account of the balance of payments, the difference between the goods and services we supply the world with and the goods and services we draw upon world markets to supplement domestic supplies are in rough balance. It is paying out dividends and interest that turns the current account into deficit and the capital account into surplus. (see figure 5 below)

Fig.5; The SA Balance of Payments – Trade and Current Account Balances (R million Quarterly Data)



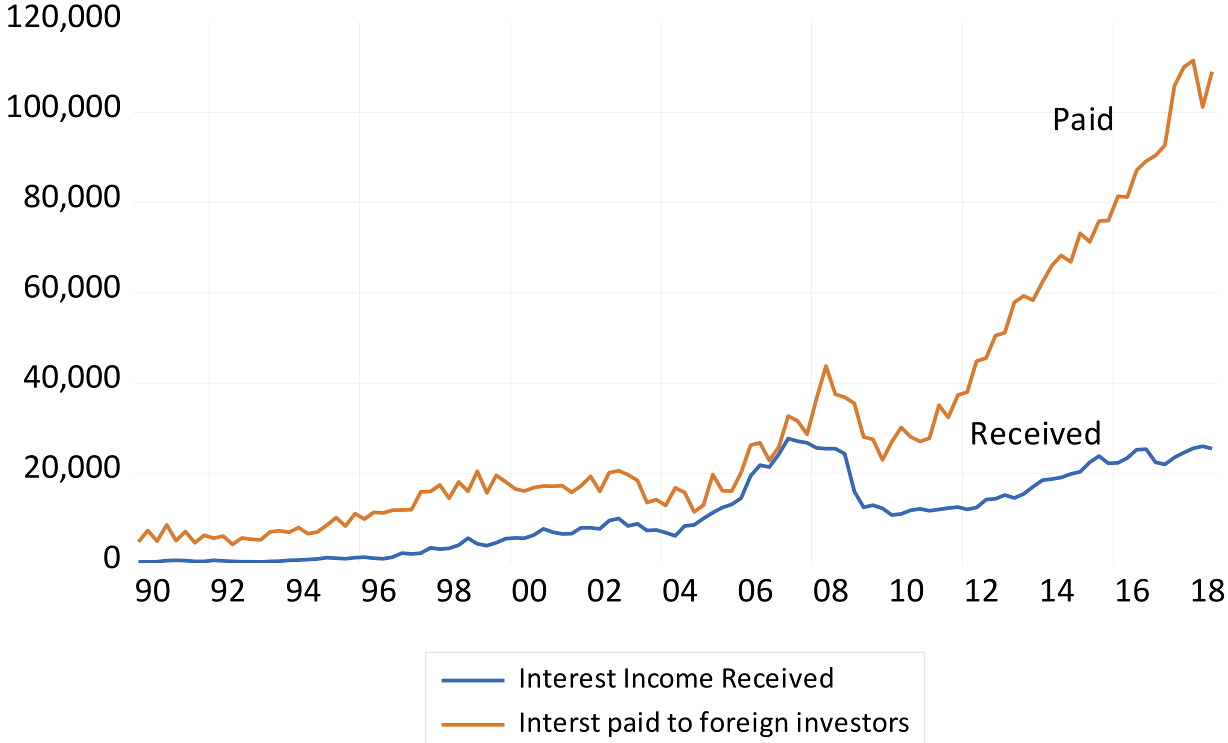
Source; South African Reserve Bank and Investec Wealth and Investment

Given the equivalent value of the assets and liabilities on the SA balance sheet it follows that the running yield on the SA portfolio held abroad must be significantly lower than the yield received in dividends and interest by foreign investors in SA. The yield earned by foreign investors in SA is of the order of 5% p.a. while the SA portfolio held abroad has a yield of only about 1% p.a. Though in 2005 and 2006 when the SA economy was growing strongly, the respective yields were about the same. Since then, after a brief interruption by the Global Financial Crisis of 2008-09, succeeded by persistently slower SA economic growth, the yield on SA assets held abroad has stabilized at the 5% rate while the yield on the SA offshore portfolio has stabilized at about the much lower 1% per annum rate.

We show below that much of the income paid to foreign investors in SA is in the form of interest rather than dividends. Over R100 billlion was paid in interest in 2018 to offshore investors. Very little interest is paid to direct foreign investors in SA - those with a controlling stake in a South African operation. Much of the interest paid is paid to portfolio investors in SA government debt- the high yield on which might well be in low double digits. That interest rates on rand denominated RSA debt is so high is a burden that all South African borrowers and taxpayers are required to accept.

Were the SA government able to borrow on more favourable terms- terms that would reflect less pessimism about the direction of the rand and inflation in SA - the deficit on the current account of the balance of payments (other things held equal) might decline. But it is not a smaller current account deficit that should be sought. That is equivalent to the argument that SA would benefit from attracting less capital. Rather it should be understood that a lower risk adjusted required return for the capital we do attract, is a worthy objective of economic policy. It would attract more capital to help improve growth rates and would be accompanied by a larger current account deficit

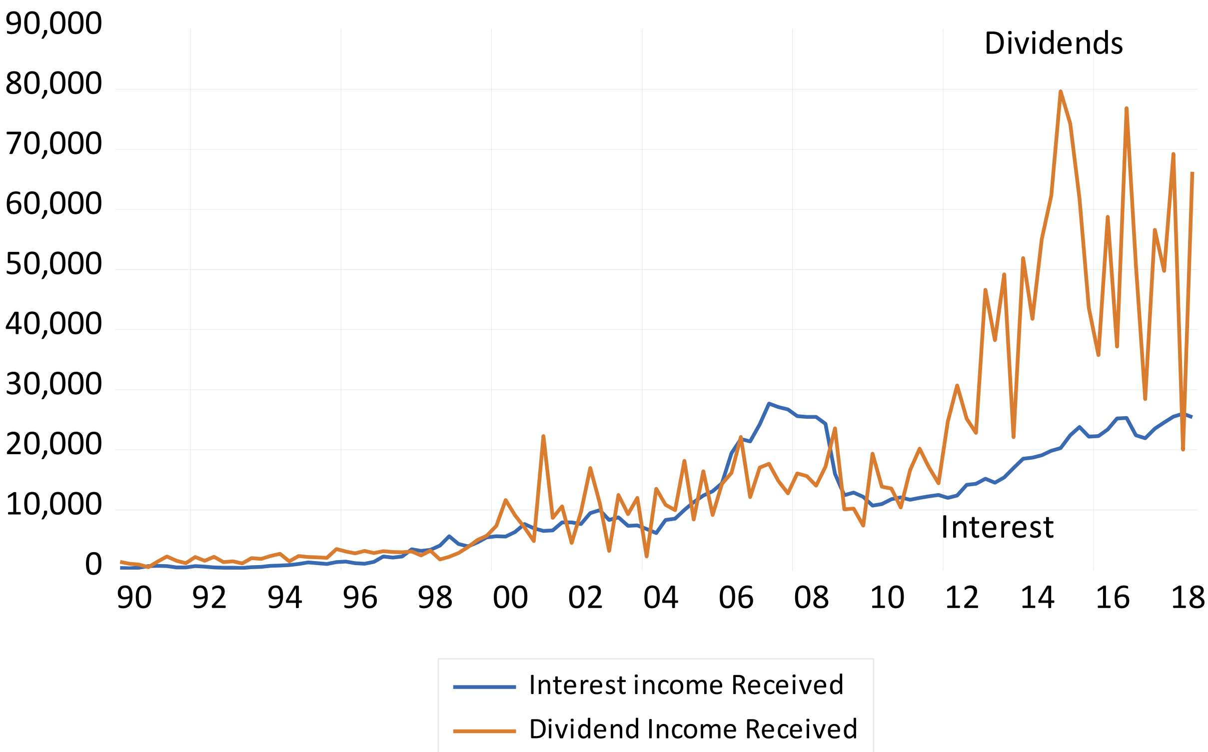
Fig.6; Balance of Payments- interest paid and received



Source; South African Reserve Bank and Investec Wealth and Investment

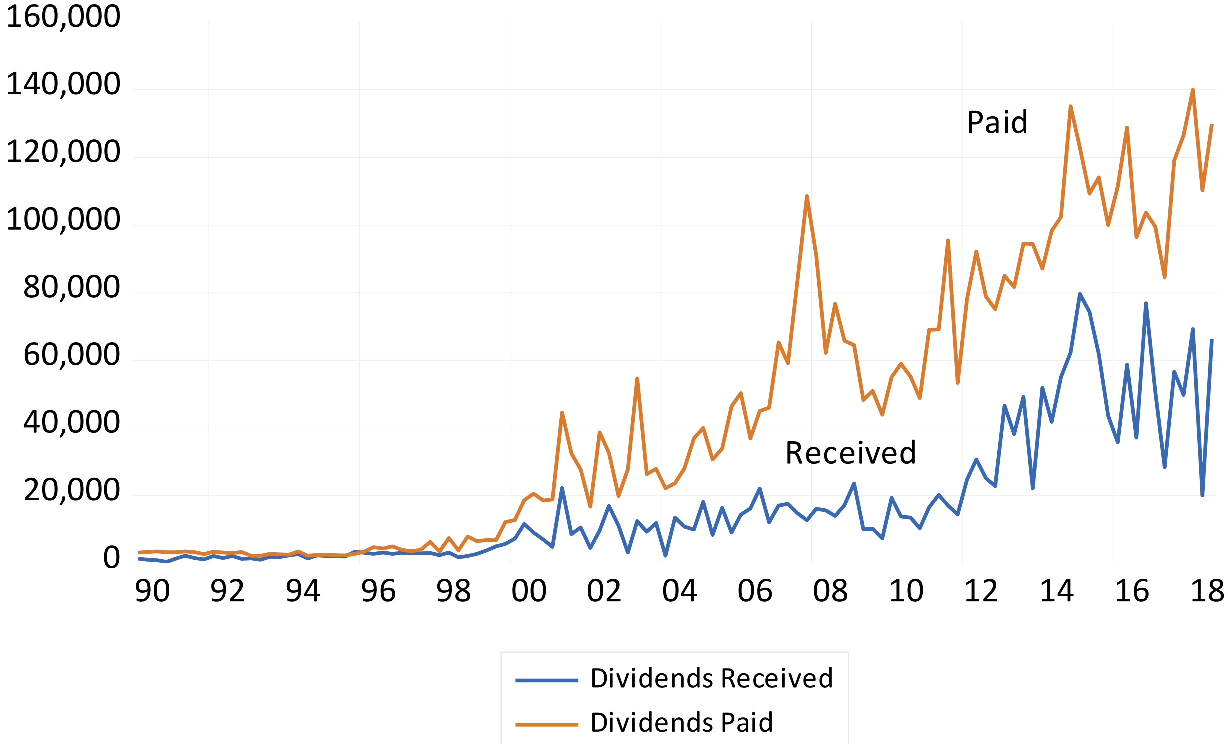
The dividends and interest income received by SA investors abroad is more balanced as may be seen. The deficit on dividend income is also a smaller one than the net interest payments made abroad.

Fig.7; Interest income and dividends received (R millions)



Source; South African Reserve Bank and Investec Wealth and Investment

Fig.8; Dividends paid and received (R millions)



Source; South African Reserve Bank and Investec Wealth and Investment

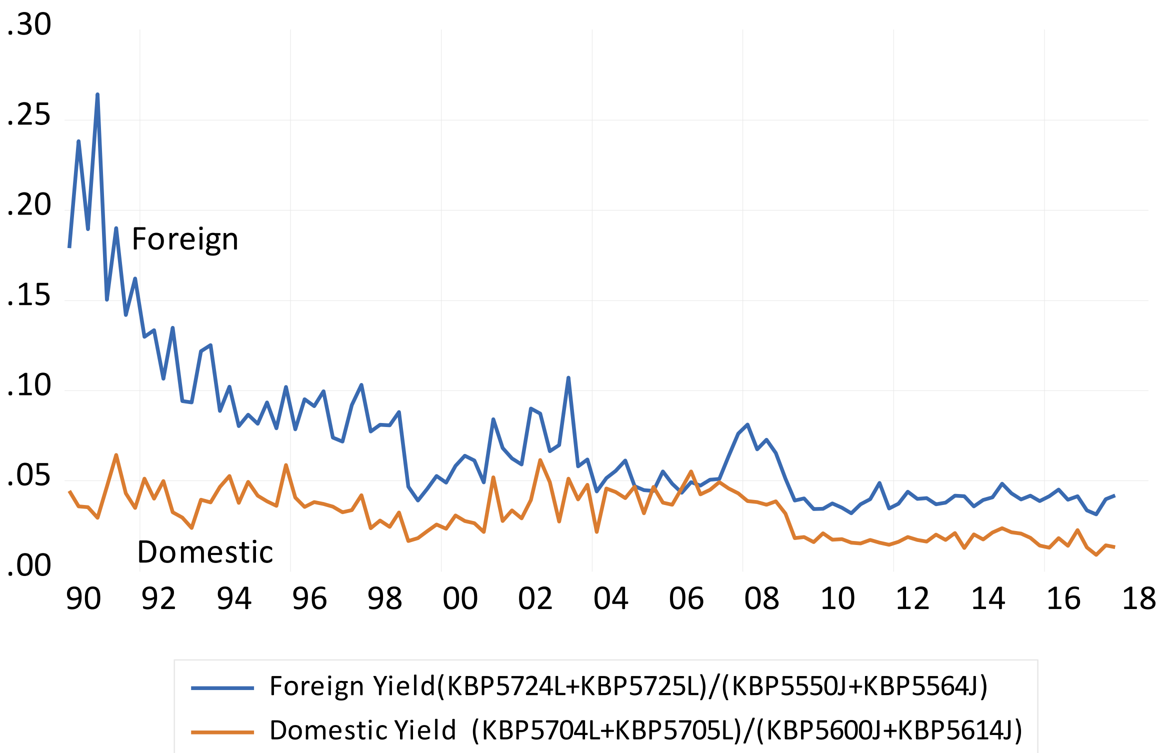
Worthy of notice is that the yield to foreign investors from the average SA asset they held has declined from over 20% in the early nineties to about 5% by 2005 and has remained about this rate in recent years. This decline in the average yield on investments in SA surely reveals less foreign investor anxiety about the capital value of their SA assets. That is compared to the days when the outlook for the SA economy and so the value of its stock of capital upon which foreign investors had a claim, was much less certain and the capital stock much more threatened by violent protest.

Yield can be paid effectively out of capital that is expected to have a short life. Or in other words high yields may be regarded as a repayment of capital that is not expected to have a long economic life. Capital repayment can very easily be described in the books of companies as interest or dividend payments or transferred away as unsustainably large flows of cash to head offices. The conversion of SA to a true democracy clearly reduced risks to owners of capital.

This average yield, the ratio of income to capital value, stable since 2008, is calculated by dividing investment income by the market value of the assets held. It does not indicate any growing reluctance of foreign controlled companies to reinvest cash in South Africa and pay out more of their cash to shareholders. The payout ratio on the JSE (dividends/over earnings) has however increased over recent years.

By contrast, when the outlook for capital growth is more promising, current yield can be postponed to help create capital if the prospects for investment are regarded as promising. The low yield of only 1% p.a. realized on assets owned by South Africans abroad indicates that SA investors in assets abroad must be hopeful of capital gains on their offshore investments and are prepared to sacrifice current yield to the purpose of capital growth.

Fig.9; Average yield on foreign owned SA assets and assets owned abroad by South Africans (% p.a)



Source; South African Reserve Bank and Investec Wealth and Investment [2]

Any appreciation of the SA balance of payments and the mix of SA foreign assets and liabilities must have full regard to the role played by Naspers. Naspers made a direct investment in Tencent, a fabulously successful Chinese internet company with a listing in Hong Kong. In the

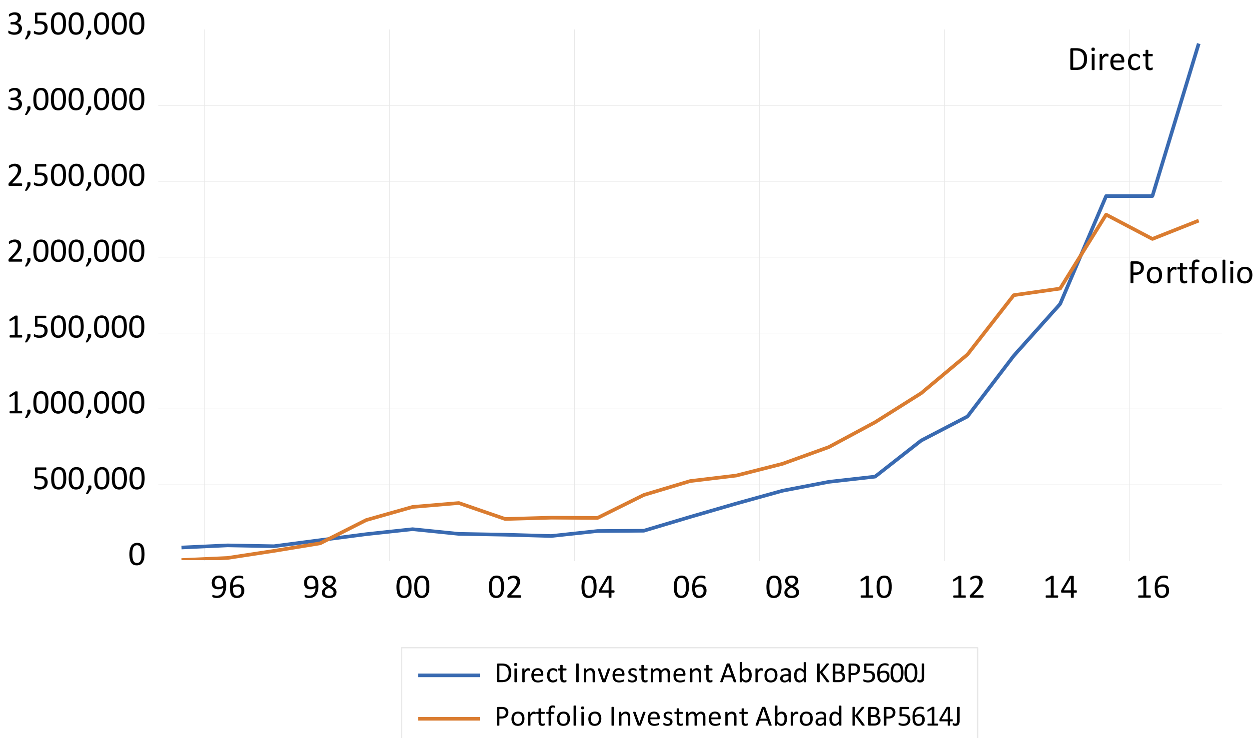
[2] the references are to the relevant tables in the SA Reserve Bank Data Base – in this case to income from direct plus indirect (portfolio) investments that is compared to value of direct and indirect investments

listing of foreign assets owned by South Africans by country, total direct investment by South Africans in China was recorded as R2,041 billion rand. Almost all of which represented the value of the shares held in Tencent by Naspers. This valuation was equivalent to 36% of all the direct and portfolio investments held abroad by South Africans abroad of R5651b, as at the 31st December 2017. Naspers is no ordinary company and is investment in Tencent must be regarded as of major macro-economic significance

Naspers acquired its 33% share in Tencent in the early 2000's – more precisely in the dividends paid by Tencent- rather than in the company itself, which is confined to Chinese citizens. The dividends paid by Tencent have grown strongly over the years and its share price even more strongly- reducing the dividend yield to shareholders, including Naspers and so the average yield on SA investments made abroad. The dividend yield on a Tencent share is currently a mere 0.25% - a mere quarter of one per cent.

The Naspers effect on the value of SA direct investments abroad is demonstrated in the figure below. It shows how much more rapidly the rand value of SA direct investments abroad have increased- compared to the value of portfolio investments made

Fig 10; SA Investment Abroad; Direct and Portfolio Investments (R millions)



Source; South African Reserve Bank and Investec Wealth and Investment

The South African balance sheet, increasingly exposed to offshore markets, could clearly benefit from more Tencent type investment success stories. But they are not easily found, as the mammoth ongoing investment programme undertaken by Naspers indicates.

The irony is perhaps that had South Africans been willing to sell their Naspers shares to foreign investors and invested the proceeds in much higher yielding alternatives offshore, the balance of payments would have looked better. The economy might have accordingly been regarded as less fragile- less exposed to the withdrawal of foreign capital- but the total returns earned by South African shareholders-minus Naspers-would have been a lot lower though their personal balance sheets would have been impaired. Exchanging the prospect of capital gains in Naspers for lower yield by holding on (in part) to their Naspers shares has served South African investors very well. It has been a big plus for the economy. It is not so obviously beneficial to the balance of payments accounts as conventionally interpreted.

There is a further implication of the Naspers success story. The value of the investment in Tencent by a company under South African jurisdiction is a national asset of macro-economic significance. It is inconceivable that the control of such an asset would be allowed to migrate away. A secondary, not a primary listing of Naspers abroad, is however consistent with the national interest.