Bulletin warns UK's Brexit process could hit SA banks' balance sheets

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If London loses its prominence as a financial gateway to Europe as a result of the Brexit process, South African banks could well feel the effect because the UK represents more than a third of their global assets and liabilities.

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This is according to the Reserve Bank's latest *Quarterly Bulletin*. As usual, it is a treasure trove of information on SA's cross-border exposures and the details of its balance of payments, as well as on the domestic economy and its performance.

One of the strengths of SA's banks is that they are not very dependent on foreign funding, unlike banks in many other emerging markets. A box in the *Bulletin* on the cross-border activity of SA's banks shows that their total holdings of foreign assets continued to exceed their foreign liabilities by a substantial margin at the end of December. That keeps them in a net lending position, which indicates an absence of reliance on foreign funding for the domestic banking sector as a whole, says the bulletin.

The bank's data show that the bulk of cross-border assets of South African banks are held in developed countries and their exposure to single counterparty countries is dominated by the UK, which accounted for 37% of banks' international assets and 35% of their international liabilities.

However, the UK's Brexit decision saw SA's banks decrease their exposure to the UK in the second half of 2016 and the bank says that while it is probably too early to predict the effect of Brexit on banks' balance sheets, it will remain an important focus area in the months to come.

Banks are the source of some of the financial crossborder flows that the *Bulletin* details in the balance of payments statistics. In 2016 the only inflows that were positive in net terms were portfolio inflows, into SA's bond market in particular. However, equity market inflows were also higher than they would otherwise have been in the fourth quarter after the Bank improved the way it classified flows on the financial account of the balance of payments. It had found that some of the flows it had previously classed as "unrecorded" were in fact equity market inflows that had not been visible because of the many dual listings of JSE-listed companies.

Foreign direct investment was again negative on a net basis, with outward direct investment by South African companies investing abroad exceeding inward investment into SA by foreign companies, as it has done since 2014.

But the big story of Wednesday's *Bulletin* was the lower than expected current account deficit for the fourth quarter and the year.

This was thanks to improvements in both the trade side of the current account and the services and income side, which reflects cross-border payments and receipts including items such as tourism and royalty payments as well as dividends and interest paid to investors, whether to South African investors with assets abroad or foreign investors with assets in SA.

A box in the *Bulletin* traces the trends in dividend payments to foreign investors , which tend to track the performance of the economy quite closely. They reached a record high of 3.7% of GDP at the height of the boom in 2007 but were only 2.5% in 2016, down from 2.8% in 2015.

The slower growth in dividend payments to nonresidents over the past two years has contributed materially to lowering the deficit on the current account of the balance of payments, said the bulletin. Growth in the number of foreign tourists also gave the services side of the current account a boost, with travel receipts up 11% in 2016 after growth of just 4% in 2015.

However, the big swing factor in the current account is the trade account, which went from deficit to surplus as export revenues lifted and imports fell. Higher mining and vehicle exports prompted much of the improvement in the quarter.

But Reserve Bank figures show how far mining exports have declined in importance, from 57.7% of SA's exports in 2010 to 48.1% in 2016. Over that period agriculture's contribution to exports rose from 5.5% to 7.7% (drought notwithstanding) while manufacturing has climbed from 35.9% to 42.1%, much of which is accounted for by vehicle exports.

Source: *Business Day*