A note on flows of funds in South Africa's national financial accounts for the year 2001

by D H Meyer and Z Nhleko[1]

Introduction

South Africa's sectoral flow-of-funds accounts for 2001 are presented in the national financial accounts on pages S-44 to S-53 of this issue of the *Quarterly Bulletin*. This note highlights some of the important observations which can be made on the basis of the information presented. The note's coverage is illustrative rather than comprehensive[2].

Total economic activity in the four quarters of 2001 is summarised by the flow-of-funds accounts of South Africa and indicates how the financial flows are linked to real economic activity by associating financial data with data on saving and capital formation. It is a record of all transactions between economic agents and integrates transactions in both real and financial assets. These interrelationships between the macroeconomic accounts facilitate a comprehensive analysis of economic developments.

Financing balance

Domestic saving and investment activity in South Africa are summarised in Table 1. For individual sectors these transactions may result in either a surplus or a deficit, i.e. these sectors either become net lenders or net borrowers.

Any individual sector may experience a surplus or deficit, but by definition for the domestic economy as a whole investment may not exceed saving, unless supplemented

Table 1 Financing balances[1,2] 2000 and 2001
Surplus units (+) / deficit units (-)

R millions

	2000			2001		
	Gross saving	Gross capital formation	Net lending (+)/net borrowing (-)	Gross saving	Gross capital formation	Net lending (+)/net borrowing (-)
Foreign sector[3]	4 013	-	4 013	3 072	-	3 072
Financial intermediaries	21 903	2 483	19 420	15 625	3 097	12 528
Central and provincial governments	-13 181	10 687	-23 868	1 492	9 205	-7 713
Local authorities	6 746	10 324	-3 578	7 589	12 396	-4 807
Public business enterprises	24 556	13 583	10 973	23 433	14 450	8 983
Private business enterprises	68 445	84 326	-15 881	65 135	89 784	-24 649
Households[4]	25 785	16 864	8 921	32 078	19 492	12 586
Total	138 267	138 267	-	148 424	148 424	-

1 Gross saving plus net capital transfers less gross capital formation. Gross capital formation consists of total fixed-capital formation and total changes in inventories, before providing for consumption (depreciation) of fixed capital.
2 A positive amount reflects a net lending position and by implication a net acquisition of financial assets, whereas a negative amount reflects a net borrowing position and by implication a net incurrence of financial liabilities.
3 A positive amount reflects a surplus for the rest of the world and therefore a deficit on South Africa's balance on current account of the balance of payments. A negative amount represents a deficit for the rest of the world and a surplus on South Africa's balance on current account of the balance of payments.
4 Including unincorporated business enterprises and non-profit institutions serving households.

1 *The views expressed are those of the authors and do not necessarily reflect the views of the South African Reserve Bank. The Reserve Bank wishes to express its sincere appreciation for the co-operation of all the reporting organisations – government departments, financial market and other public and private-sector institutions – for furnishing the data used for the compilation of South Africa's financial accounts.*

2 *For a more comprehensive discussion on the technical aspects of South Africa's national financial accounts refer to:* A note on flows of funds in South Africa's national financial accounts for the year 1999 *by M A Kock and D H Meyer.* Quarterly Bulletin, *No 219, March 2001.*

by transactions with the rest of the world. Domestic net savings had to be augmented by an inflow of foreign capital in 2001 in order to finance gross capital formation. The net domestic borrowing requirement is equal, but of opposite sign, to South Africa's balance on current account of the balance of payments, including net capital transfers from the rest of the world. A deficit was recorded on the current account of the balance of payments, even though it was smaller than that experienced in 2000. This means that the financing surpluses of the financial intermediaries, non-financial public business enterprises and households were insufficient for the financing of the deficits of the central and provincial governments, the local authorities and private business enterprises.

Lower saving by financial intermediaries and private business enterprises was primarily countered by the government's increased contribution to national savings. Prudent fiscal policy and consistently higher government revenue collections contributed to the lower net borrowing requirement of the central and provincial governments in 2001. Household saving also rose somewhat in 2001.

Sectoral analysis

Beyond the net lending and/or net borrowing requirements generated by the saving and investment behaviour discussed above, the national financial account focuses on the financial flows generated by the surplus units seeking appropriate investment outlets and thereby financing the insufficient savings of deficit units.

An analysis of inter-sectoral interaction through financial transactions indicates how transactions by one sector impacts on the system as a whole. Each sector is briefly analysed.

Foreign sector

The account of the foreign sector is compiled from the point of view of the rest of the world and is as such a mirror image of the balance of payments, which is drawn up from the point of view of the South African economy. The foreign sector refers to all non-resident units that enter into transactions with residents and, within the financial account framework, its primary function is to balance the domestic saving-investment gap – i.e. through imbalances on the current account of the balance of payments of South Africa.

The total net acquisition of financial assets equals the total net accumulation of liabilities, leaving transactions with the rest of the world as the balancing item. In 2001, as noted in Table 2, the net accrual of financial assets by the domestic institutional sectors amounted to R530,9 billion and the net increase in their financial liabilities amounted to R534,0 billion. The difference of R3,1 billion represents net borrowing from the rest of the world[3].

3 "Borrowing" in this context should be interpreted in the widest sense, including new share investment.

Table 2 Flow of funds: foreign sector and combined domestic sectors, 2001

R millions

	Domestic institutional sectors	Rest of the world	Total
Net incurrence of financial liabilities	533 952	49 121	583 073
Net lending (+)/net borrowing (-)	-3 072	3 072	-
Net acquisition of financial assets	530 880	52 193	583 073

The foreign sector's net contribution to saving in the South African economy was mainly effected through non-residents' increased holdings of ordinary shares, but trade credit and other short-term loans and monetary deposits also increased. The sustained purchases by international investors of shares listed on the JSE Securities Exchange SA reflected the country's favourable weighting in emerging-market equity indices. Total inflows from the rest of the world was, however, dampened by significant net sales of government bonds by offshore investors as volatility in the market for foreign exchange and protracted rand weakness, together with the decline in domestic bond yields during most of 2001, eroded returns relative to that offered elsewhere.

Financial intermediaries

Financial intermediaries are at the centre of the flow-of-funds system. These institutions transform funds received from surplus entities (lenders) into a variety of financial instruments structured to suit the requirements of deficit entities (borrowers). The financial intermediaries identified in South Africa's national financial accounts extend beyond monetary institutions and include non-bank financial institutions, which have played an increasingly important role in recent years. The financial intermediaries sector consists of five subsectors, namely the monetary authority, other monetary institutions, Public Investment Commissioners, insurers and retirement funds, and other financial institutions. Each of these will be discussed seperately.

Monetary authority

In exercising its functions of implementing monetary policy, issuing money, executing foreign exchange policy and holding international reserves the monetary authority, consisting of the South African Reserve Bank and the Corporation for Public Deposits, interacts mostly with other monetary institutions, the central government and the foreign sector. The monetary authority increased its gold and other foreign reserves somewhat during 2001 despite a substantially weaker rand towards the end of the year. Banks increased their deposits at the Reserve Bank in 2001, partly because of an effective tightening of the cash reserve requirements. The close interaction between the monetary authority and the banking sector is reflected by the loans and advances that were made to and received from other monetary institutions. Additional funds were also acquired from the foreign sector, mainly in the form of a syndicated loan.

Other monetary institutions

The other monetary institutions sector engages in financial intermediation mainly through accepting deposits and extending loans. This sector reflects the consolidated accounts of the banks, mutual banks, the Land Bank and Postbank. As reflected in the abbreviated flow of funds presented in Table 3, this sector experienced a substantial increase in financial intermediation in 2001.

Other monetary institutions recorded gross saving of R11,1 billion and gross capital formation of R2,8 billion in 2001. However, the value of non-financial transactions was small compared with the huge financial flows. An increased preference for more secure investments, due to volatility in financial markets, ensured that monetary deposits increased by R94,9 billion. Additional funds were also acquired through the issuance of bills and bonds as well as trade credit and other short-term loans. Intermediation to deficit sectors was effected through bank loans and advances amounting to R53,9 billion, mortgage loans of R32,7 billion and gold and foreign reserves to the value of R18,8 billion. The rise in other assets and other liabilities of this sector was mainly concentrated in derivatives instruments. In 2001, the other monetary institutions invested 98,3 per cent of their total resources in financial assets and this sector's asset flows accounted for 48,0 per cent of financial-intermediary asset flows and 22,2 per cent of total asset flows.

Table 3 Flow of funds: other monetary institutions, 2001

Transaction items	Sources/ liabilities R millions	Uses/ assets R millions
Gross saving	11 058	
Gross capital formation		2 813
Net lending (+)/net borrowing (-)	8 245	
Net financial investment (+/-)		8 245
Net incurrence of financial liabilities	153 945	
Net acquisition of financial assets		162 190
Gold and other foreign reserves	-	18 836
Monetary deposits	94 928	3 907
Bank loans and advances	2 334	53 949
Bills, bonds and loan stock	6 291	18 216
Mortgage loans	-	32 747
Other assets/liabilities	50 392	34 535
Total sources/liabilities and uses/assets	165 003	165 003
	Per cent	
Percentage of total sources used for gross capital formation	1,7	
Percentage of total sources used to acquire financial assets	98,3	
Percentage of total asset flows	22,2	
Percentage of total financial-intermediary asset flows	48,0	

Public Investment Commissioners

The main function of the Public Investment Commissioners is to act as asset manager for the government's official pension and provident funds and, to a lesser extent, social security funds, other government funds and trust accounts of households. Of the amount of R32,0 billion received by the Public Investment Commissioners in 2001 the bulk was channelled into fixed-interest securities. In a period when global risk aversion led to net sales of bonds by non-residents, the Public Investment Commissioners acted as counterweight by acquiring domestic government bonds. A small amount was also invested in shares while about a third of the funds was allocated to other external asset managers, mostly in the insurance industry, whereas deposits at other monetary institutions were reduced.

Insurers and retirement funds

Insurers and retirement funds accounted for 19,2 per cent of financial-intermediary asset flows, surpassed only by the other monetary institutions sector.

These contractual savings institutions were responsible for 8,9 per cent of total asset flows in 2001. As indicated in Table 4 this sector is usually a financing surplus sector. In 2001 this sector was able to supply funds, on a net basis, to the deficit sectors: transactions in financial assets exceeded transactions in financial liabilities by R2,8 billion. Member contributions accounted for the bulk of the amount available for investment in financial assets by insurers and retirement funds. The official pension and provident funds increased their investment portfolios at the Public Investment Commissioners by R31,4 billion. The rest of the insurer and retirement fund industry, on balance, increased their cash holdings at banks and decreased their exposure to bills, bonds and equities.

Table 4 Flow of funds: insurers and retirement funds, 2001

	R millions
Financing balance	2 845
Net incurrence of financial liabilities	62 860
Members' interest in the reserves of retirement and insurance funds	54 277
Other liabilities	8 583
Net acquisition of financial assets	65 705
Monetary deposits	12 468
Other deposits	43 714
Public Investment Commissioners	31 405
Foreign deposits	2 585
Other	9 724
Bills and bonds	-8 113
Short-term government bonds	11 317
Long-term government bonds	-17 199
Other	-2 231
Other loan stock and preference shares	2 032
Domestic	6 434
Foreign	-4 402
Shares	-1 669
Domestic	-5 510
Foreign	3 841
Other assets	17 273
	Per cent
Percentage of total asset flows	8,9
Percentage of total financial-intermediary asset flows	19,2

Other financial institutions

The other financial institutions sector includes all other non-bank financial intermediaries that acquires funds and carry out investments through sales of units, lending and similar activities. This sector includes, among others, unit trusts, participation mortgage bond schemes, finance companies and financial public enterprises. For 2001, financial activity in this sector resulted mainly from inflows to unit trusts. Inflows from institutional investors equalled those of individuals and thereby supported the financial activity of this sector. The spread of assets indicated a distinct preference for investment in shares, followed by an increase in deposits with monetary institutions and acquisition of bills and bonds.

General government: central government and provincial governments

Increased saving through fiscal rectitude and improved revenue collection enabled the central government and provincial governments to limit their financing deficit to R7,7 billion for the calendar year 2001. An amount of R42,7 billion was raised in the financial markets through the net incurrence of financial liabilities; however, of this amount R35,0 billion flowed through to the acquisition of financial assets – mainly an accumulation of bank deposits.

As shown in Table 5, a substantial portion of the financing needs for 2001 was funded through the issuance of short-term government bonds to the amount of R24,3 billion. Large redemptions of long-term government bonds during the first quarter of 2001 and a preference for foreign bond issues limited the availability of these instruments to domestic investors. However, net sales of bonds by non-residents in the domestic market ensured a steady supply of bonds to resident investors in the secondary market. Notwithstanding the foreign bond issues, the contribution of the foreign sector to the financing needs of the central and provincial governments decreased on a net basis – new capital raised in the international primary bond market was to a large extent offset by net sales of bonds by non-residents in the domestic secondary bond market – while that of the domestic sectors, with the exception of insurers and retirement funds, increased.

Table 5 Flow of funds: central government and provincial governments, 2001

	R millions
Financing balance	-7 713
Net acquisition of financial assets	35 036
Net incurrence of financial liabilities	42 749
Net incurrence of financial liabilities by financial instrument	42 749
Treasury bills	-7 548
Short-term government bonds	24 294
Long-term government bonds	1 258
Non-marketable government bonds	1 332
Other	23 413
Financing by sector	42 749
Foreign sector	-12 472
Public Investment Commissioners	25 729
Insurers and retirement funds	-5 533
Other financial institutions	9 963
Other domestic sectors	25 062

General government: local authorities

Local authorities recorded an overall financing deficit in 2001. The financing of this deficit was made possible through a reduction in financial assets, which exceeded a simultaneous reduction in financial liabilities. This was enabled by reducing short-term loans advanced and a decline in the outstanding balances of sundry debtors.

Non-financial public corporate business enterprises

The savings of non-financial public-sector enterprises exceeded their gross capital formation by a wide margin in 2001. This enabled these institutions to allow for a reduction in financial liabilities, such as bank loans and advances and long-term and mortgage loans. Excess funds were made available to other sectors through trade credit and short-term loans, purchases of bills, bonds and loan stock, as well as increased deposits with other financial institutions.

Non-financial private corporate business enterprises

As indicated in Table 6, non-financial private corporate business enterprises experienced a financing deficit in 2001. The financing deficit of R24,7 billion was funded in the financial markets through issuing equity capital on both domestic and international bourses, through bank loans and advances, as well as through other long and short-term loans and credit facilities. The funding arranged in this way exceeded the financing deficit of this sector and the excess was deposited with monetary institutions and channelled to shares, trade credit, short-term loans and other assets.

Table 6 Flow of funds: non-financial private corporate business enterprises, 2001

Transaction items	Sources/ liabilities R millions	Uses/ assets R millions
Gross saving	64 546	
Capital transfers	589	
Gross capital formation		89 784
Net lending (+)/net borrowing (-)	-24 649	
Net financial investment (+/-)		-24 649
Net incurrence of financial liabilities	129 592	
Net acquisition of financial assets		104 943
Monetary deposits	-	38 889
Other deposits	4 321	-3 857
Bank loans and advances	24 598	-
Trade credit and short-term loans	16 518	35 721
Bills, bonds and loan stock	18 386	5 780
Shares	51 557	10 958
Domestic	5 115	6 372
Foreign	46 442	4 586
Long-term and mortgage loans	14 012	-6 648
Other assets/liabilities	200	24 100
Total sources/liabilities and uses/assets	194 727	194 727
	Per cent	
Percentage of total sources used for gross capital formation	46,1	
Percentage of total sources used to acquire financial assets	66,6	
Percentage of total asset flows	26,2	

Households

Households continued to be net providers of funds to deficit sectors in 2001. A financing surplus, together with access to funding through bank loans and advances, mortgage loans and trade credit, enabled households to increase their interest in retirement and life funds and their deposits with banks and other financial institutions, such as unit trusts.

Summary and conclusion

The analysis of South Africa's national financial accounts for the year 2001 reveals the following:

- a lower net borrowing requirement of the central government;
- an increased borrowing requirement of private business enterprises;
- the foreign sector's net contribution to saving in the South African economy through sustained portfolio flows where net purchases of shares exceeded net sales of government bonds;
- the preference for monetary deposits, due to the volatility in financial markets, and the associated increase in the financial activity of the other monetary institutions;
- the growing importance of the other financial institutions sector in the portfolio diversification of institutional investors;
- the government's preference for funding through foreign bond issues which limited the domestic supply of long-term bonds;
- net sales of bonds by offshore investors helped to satisfy the domestic demand for fixed-interest securities;
- the continued strong financial position of non-financial public corporate business enterprises; and
- the continued importance of households as net providers of funds to deficit sectors.

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