Note on flows of funds in South Africa's national financial accounts for the year 2002

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Introduction

The national financial accounts on pages S-44 to S-53 of this issue of the *Quarterly Bulletin* present the flow-of-funds accounts for 2002. The national financial account, as part of an integrated system of economic accounts, provides a summary data set on total economic activity for the period under review and presents a means, among other things, to:
- identify surplus and deficit economic sectors;
- analyse the linkages between borrowers and lenders of funds;
- analyse the linkages between financial transactions and real economic activity; and
- guide authorities and market participants in monitoring monetary and other macro-economic developments.

This note focuses on the first three objectives and is merely illustrative[2]. An analysis of economic developments is made by summarising real and financial activity for 2002 as a whole through the national financial accounts, thus showing interrelationships among the key groups of economic agents.

Financing balance

Saving is the ultimate source of domestic finance, and consequently also of capital formation. Individual economic sectors may experience a surplus or a deficit, depending

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2 For a more comprehensive discussion of the technical aspects of South Africa's national financial accounts, consult "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.

Table 1 Financing balances[1,2], 2001 and 2002
R millions (Surplus units (+)/Deficit units (-)

	2001			2002		
	Gross saving	Gross capital formation	Net lending (+)/net borrowing (-)	Gross saving	Gross capital formation	Net lending (+)/net borrowing (-)
Foreign sector[3]	-64	-	-64	-6498	-	-6 498
Financial intermediaries	15 625	3 097	12 528	24 970	10 384	14 586
Central and provincial governments	1 492	9 205	-7 713	-1 282	11 120	-12 402
Local authorities	7 589	12 396	-4 807	4 434	13 226	-8 792
Non-financial business enterprises						
Public	23 433	14 450	8 983	32 878	15 851	17 027
Private	63 481	84 994	-24 649	85 372	103 614	-18 242
Households[4]	32 078	19 492	12 586	38 176	23 855	14 321
Total	143 634	143 634	-	178 050	178 050	-

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.

on the extent to which their saving covers their investment in fixed assets and inventories. Individual sectors may therefore be either net lenders or net borrowers in the economy. Table 1 summarises the saving and investment activity in South Africa.

Although individual sectors may experience saving deficits, for the economy as a whole investment may not exceed saving, unless supplemented by transactions with the rest of the world. In 2001 domestic net saving only marginally exceeded the financing of gross capital formation. In 2002 the situation improved and a substantial surplus was recorded on the current account of the balance of payments. This means that the net saving of the domestic surplus sectors was more than sufficient to finance the deficits of the central and provincial governments, local authorities and non-financial private business enterprises.

For 2002 gross saving by non-financial private business enterprises amounted to 8 per cent of gross domestic product. Non-financial public business enterprises and households each contributed 3 per cent of gross domestic product and financial intermediaries another 2 per cent. All these sectors raised their gross saving in 2002, while the gross saving of the sectors which usually contribute little to the national saving effort – central, provincial and local government, and the foreign sector – fell back in 2002.

Sectoral analysis

Economic units with financial surpluses are always in search of appropriate investment outlets while deficit units require additional means to finance their operations. The inter-sectoral linkages between borrowers and lenders of funds and the impact of such linkages on the system as a whole are analysed in this section, briefly reviewing each of the main institutional sectors.

Foreign sector

The foreign sector refers to all non-resident units that enter into transactions with residents and therefore represents a mirror image of South Africa's balance of payments.

For the domestic economy as a whole, as noted in Table 2, the total net acquisition of financial assets equals the total net accumulation of liabilities, with the rest of the world as the balancing item. The foreign sector balances the domestic saving-investment gap through the balance on current account of the balance of payments. In 2002 South Africa experienced a surplus of R6,5 billion on the current account – i.e. an outflow of funds or by definition net lending to the rest of the world.

Table 2 Flow of funds: Foreign sector and combined domestic sectors, 2002

R millions

	Domestic institutional sectors	Rest of the world	Total
Net incurrence of financial liabilities	296 749	5 708	302 457
Net lending (+)/net borrowing (-)	6 498	-6 498	-
Net acquisition of financial assets	303 247	-790	302 457

The net outflow of funds was the result of increases in foreign assets held by the domestic sectors which exceeded inward non-resident financial investment. The domestic sectors increased their holdings of foreign shares and other financial assets. Gold and foreign exchange reserves held by monetary institutions excluding the Reserve Bank also increased significantly. Investment by non-residents into South Africa was mainly through an increase in their holdings of government bonds.

Concurrently, non-residents decreased their extension of trade credit and short-term loans to the domestic sectors somewhat.

Financial intermediaries

Financial intermediaries transform the bulk of 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 include both monetary and non-bank financial institutions. 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 are discussed separately.

Monetary authority

The monetary authority sector consists of the South African Reserve Bank and the Corporation for Public Deposits. The main function of this sector is to implement monetary policy, issue cash, implement foreign exchange policy and act as custodian of the international reserves.

The monetary authority interacts mostly with other monetary institutions as reflected by the increase in the level of bank loans and advances made to and received between the two sectors. Further tightening of the cash reserve requirement during 2002 contributed to the increased level of banks' deposits with the South African Reserve Bank. A significant reduction in foreign liabilities occurred when the National Treasury assumed responsibility for repaying some of the Reserve Bank's foreign liabilities early in 2002.

Other monetary institutions

The other monetary institutions sector is a consolidation of the accounts of banks, mutual banks, the Land Bank and Postbank. This sector engages in financial intermediation mainly through accepting deposits and extending loans. The abbreviated flow of funds presented in Table 3 shows that the sector was a net lender of funds in 2002.

Other monetary institutions recorded gross saving of R15,1 billion and gross capital formation of R9,6 billion in 2002. Monetary deposits with them rose by R90,5 billion during the year.

Financing of deficit sectors was effected through bank loans and advances amounting to R35,1 billion, mortgage loans to the value of R26,8 billion and gold and foreign reserves to the value of R21,1 billion. The decrease in other assets and other liabilities of this sector was, among other things, due to a decline in its exposure to derivative instruments. In 2002, other monetary institutions invested 90 per cent of their total resources in financial assets and this sector's asset flows accounted for close to half of financial intermediary asset flows and 19 per cent of total asset flows.

Table 3 Flow of funds: Other monetary institutions, 2002

Transaction items	Sources/ liabilities R millions	Uses/ assets R millions
Gross saving	15 072	
Gross capital formation		9 597
Net lending (+)/net borrowing (-)	5 475	
Net financial investment (+/-)		5 475
Net incurrence of financial liabilities	77 907	
Net acquisition of financial assets		83 382
Gold and other foreign reserves	-	21 066
Monetary deposits	90 508	3 432
Bank loans and advances	9 977	35 141
Bills, bonds and loan stock	-8 275	3 510
Mortgage loans	-	26 810
Other assets/liabilities	-14 303	-6 577
Total sources/liabilities and uses/assets	92 979	92 979
	Per cent	
Percentage of total sources used for gross capital formation	10,3	
Percentage of total sources used to acquire financial assets	89,7	
Percentage of total asset flows	18,6	
Percentage of total financial intermediary asset flows	46,6	

Public Investment Commissioners

Fulfilling a role similar to that of an asset manager, the Public Investment Commissioners received inflows of R29,3 billion in 2002. The bulk of funds was received from 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 total funds received, more than 45 per cent were in turn invested in long-term government securities, 19 per cent directly in shares and 15 per cent allocated to other external asset managers. The Public Investment Commissioners accounted for 15 per cent of the total financial intermediary asset flows.

Insurers and retirement funds

In 2002 the sector insurers and retirement funds registered a net financing surplus and accounted for 23 per cent of financial intermediary asset flows. As indicated in Table 4, this sector was therefore able to supply funds to the value of R7,6 billion, on a net basis, to the deficit sectors. As expected, member contributions accounted for the bulk of the funds available for investment in financial assets by insurers and retirement funds.

The official pension and provident funds increased their investment portfolios with the Public Investment Commissioners by R26,5 billion.

Table 4 Flow of funds: Insurers and retirement funds, 2002

	R millions
Financing balance	7 623
Net incurrence of financial liabilities	37 404
Members' interest in the reserves of retirement and insurance funds	53 447
Other liabilities	-16 043
Net acquisition of financial assets	45 027
Monetary deposits	**5 501**
Other deposits	**27 151**
Public Investment Commissioners	26 470
Foreign deposits	-304
Other	985
Bills and bonds	**-12 958**
Short-term government bonds	-13 834
Long-term government bonds	-3 326
Other	4 202
Other loan stock and preference shares	**-188**
Domestic	6 687
Foreign	-6 875
Shares	**3 615**
Domestic	5 792
Foreign	-2 177
Other assets	**21 906**
	Per cent
Percentage of total asset flows	9,1
Percentage of total financial intermediary asset flows	22,7

The insurers and retirement funds industry generally decreased investment in bills, other loan stock and preference shares. The redemption by government of short-term fixed interest securities in the fourth quarter of 2002 contributed to a decline in the short-term bonds held by insurers and retirement funds. Foreign investment declined noticeably in the wake of global uncertainties and a stronger exchange rate of the rand.

Other financial institutions

The other financial institutions sector reflects the consolidated accounts of all non-bank financial intermediaries that acquire funds and carry out investments through sales of units in unit trusts, lending and similar activities. This sector consists of, among other things, unit trusts, participation mortgage bond schemes, finance companies and financial public enterprises. Financial activity in this sector during 2002 resulted mainly from inflows to unit trusts.

As can be seen in Table 5, the sector received funds from investors amounting to R15,8 billion. Other financial institutions focused their activity on extending trade credit and short-term loans to other institutions amounting to R11,7 billion. The rest of the funds were held in monetary deposits and invested in bills and shares. This sector accounted for 13 per cent of the total financial intermediary asset flows in 2002.

Table 5 Flow of funds: Other financial institutions, 2002

	R millions
Financing balance	697
Net incurrence of financial liabilities	25 958
Deposits received	15 801
Trade credit and short-term loans	1 290
Other loan-stock and preference shares	780
Long-term loans	-1 969
Other liabilities	10 056
Net acquisition of financial assets	26 655
Monetary deposits	**18 378**
Other deposits	**-4 077**
Foreign deposits	-4 113
Other	36
Bills and bonds	**-5 654**
Short-term government bonds	-1 285
Long-term government bonds	-9 368
Other	4 999
Trade credit and short-term loans	**11 684**
Other loan stock and preference shares	**123**
Domestic	816
Foreign	-693
Shares	**3 559**
Domestic	4 371
Foreign	-812
Other assets	**2 642**
	Per cent
Percentage of total asset flows	5,3
Percentage of total financial intermediary asset flows	13,4

General government: Central government and provincial governments

Increased gross capital formation and capital transfers to other sectors resulted in an increase in the central and provincial governments' financing deficit from R7,7 billion in the calendar year 2001 to R12,4 billion in the calendar year 2002. As depicted in Table 6, an amount of R11,9 billion was raised in the financial markets through the net incurrence of financial liabilities to finance this deficit.

In 2002 the foreign sector contributed substantially to the financing needs of the central and provincial governments, especially through their holding of government bonds. Capital raised in the foreign sector amounted to R35,3 billion. The Public Investment Commissioners contributed a further R10,2 billion to the financing needs of central and provincial governments.

A substantial portion of the financing requirements for 2002 was funded through the issuance of non-marketable government bonds to the value of R21,1 billion, of which R15,7 billion were foreign issues. This partly offset the large redemptions of short-term government bonds and low domestic issuance of long-term government bonds during 2002. The redemption of short-term government bonds in the last quarter of 2002 led to a reduction in the level of such instruments held by institutional investors.

Table 6 Flow of funds: Central government and provincial governments, 2002

	R millions
Financing balance	-12 402
Net acquisition of financial assets	-524
Net incurrence of financial liabilities	11 878
Net incurrence of financial liabilities by financial instrument	11 878
Treasury bills	-3 453
Short-term government bonds	-12 677
Long-term government bonds	3 041
Non-marketable government bonds	21 130
Other	3 837
Financing by sector	11 878
Foreign sector	35 347
Public Investment Commissioners	10 240
Insurers and retirement funds	-17 950
Other financial institutions	-11 083
Other domestic sectors	-4 676

General government: Local authorities

Local governments recorded an overall financing deficit of R8,8 billion in 2002. The financing of the deficit occurred through both foreign and domestic borrowing, mostly in the form of trade credit and short-term loans.

Non-financial public corporate business enterprises

The non-financial public corporate business enterprises sector recorded a net financing surplus of R17,0 billion in 2002. The surplus was not only utilised to finance deficit sectors, but also to reduce this sector's own financial liabilities. This was done through the net redemption of their securities and by reducing long-term and mortgage loans and other financial liabilities. Investment in real assets, amounting to R15,9 billion, exceeded investment in financial assets by a wide margin.

Non-financial private corporate business enterprises

Non-financial private corporate business enterprises experienced a financing deficit in 2002. As indicated in Table 7, the financing deficit of R18,2 billion was funded in the financial markets through trade credit and short-term loans and bills, bonds and loan stock. Excess funds were deposited with monetary institutions, invested in foreign shares and channelled to the extension of trade credit and short-term loans. This sector's gross capital formation of R103,6 billion represented 58 per cent of total gross domestic capital formation in 2002, highlighting its importance in the real economy.

Households

Households were net providers of funds to deficit sectors in 2002. They recorded a financing surplus and also had access to additional funding such as mortgage loans, short-term loans and trade credit. Households were able to maintain their interest in retirement and life funds and succeeded in increasing their deposits with banks and other financial institutions.

Table 7 Flow of funds: Non-financial private corporate business enterprises, 2002

Transaction items	Sources/ liabilities R millions	Uses/ assets R millions
Gross saving	84 034	
Capital transfers	1 338	
Gross capital formation		103 614
Net lending (+)/net borrowing (-)	-18 242	
Net financial investment (+/-)		-18 242
Net incurrence of financial liabilities	56 602	
Net acquisition of financial assets		38 360
Monetary deposits	-	46 708
Other deposits	-4 939	-21 741
Bank loans and advances	7 610	-
Trade credit and short-term loans	15 121	18 444
Bills, bonds and loan stock	27 195	-18 383
Shares	*7 823*	*7 676*
Domestic	*5 440*	*-3 120*
Foreign	2 383	10 796
Long-term and mortgage loans	1 033	-15 033
Other assets/liabilities	2 759	20 689
Total sources/liabilities and uses/assets	141 974	141 974
	Per cent	
Percentage of total sources used for gross capital formation	73,0	
Percentage of total sources used to acquire financial assets	27,0	
Percentage of total asset flows	28,4	

Summary and conclusion

The analysis of South Africa's national financial accounts for 2002 reveals the following:

- Increased outward foreign investment by domestic sectors was evidenced by a net outflow of funds to the rest of the world;
- tightening of reserve requirements by the South African Reserve Bank occasioned an increase in deposits by private banks at the Reserve Bank;
- increased issuance of securities by banks expanded the scope of available investment opportunities;
- central government's net borrowing requirement increased and was largely satisfied by foreign borrowing and bond issues abroad;
- the continued strong financial position of non-financial public corporate business enterprises was accompanied by a fairly high level of capital formation by this sector; and
- households continued to be net providers of funds to deficit sectors.

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