Note on flows of funds in South Africa's national financial accounts for the year 2003

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Introduction

The national financial accounts, also known as the flow-of-funds accounts, provide a framework for summarising financial flow data in a consistent manner and show the fundamental relationships that exist among the monetary and financial statistics, national accounts, balance of payments and government finance. South Africa's national financial accounts for 2003 are presented on pages S-44 to S-53 of this issue of the *Quarterly Bulletin.*

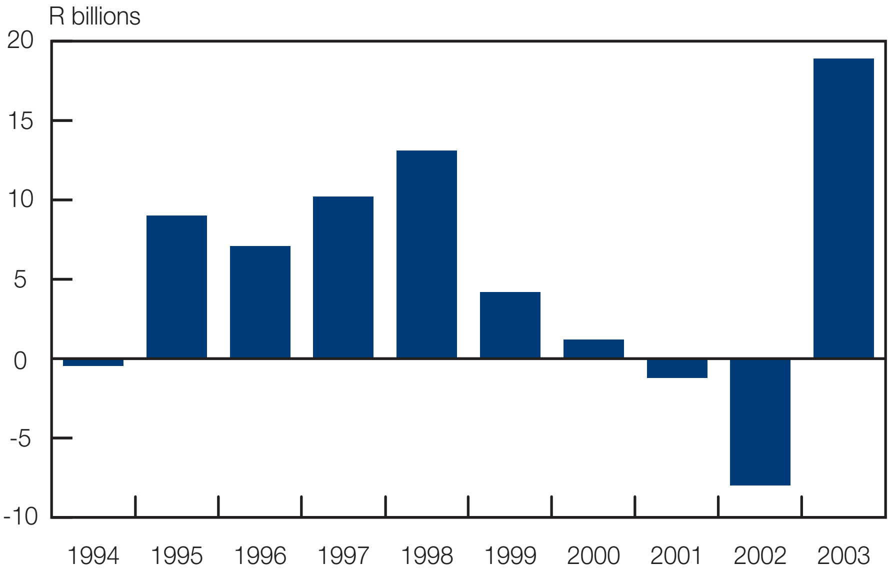
This note focuses on developments in both the real and financial activities of the key groups of economic agents in 2003. Attention is given to the analysis of the financing balances of the various economic sectors, the lending and borrowing needs among sectors and changes in the mix of financial market instruments issued and acquired.

In the compilation of the national financial accounts, institutional sector data are obtained from surveys and other sources of information available to the Research Department of the South African Reserve Bank. Eleven institutional sectors are identified and the final consolidation process entails the balancing of contra entries among the various sectors[2].

Financing balances

The flow-of-funds accounts not only show the interrelationships among the various sectors, but also indicate the extent to which domestic economic activities are funded by the rest of the world. Individual sectors may experience either saving deficits or surpluses; but for the economy as a whole, investment cannot exceed saving unless supplemented by transactions with the rest of the world. Since South Africa's reintroduction into the

Augmentation to domestic savings from the rest of the world



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 to all the reporting organisations – government departments, financial market and other public and private-sector institutions – for their co-operation in furnishing the data used for the compilation of South Africa's financial accounts.

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

global arena, the economy has frequently relied on net lending from the rest of the world. The extent to which domestic saving has been consistently augmented by inflows from the rest of the world over the past ten years is indicated in the graph on the previous page. These flows, by definition, are the mirror image of the balance on the current account of the balance of payments.

Table 1 summarises and compares the saving and investment activity in South Africa for 2002 and 2003 across all sectors. The foreign sector, which had been in a deficit in 2002, reverted to being a net supplier of funds in 2003. The domestic economy was therefore a net borrower of funds from the rest of the world in 2003.

Table 1 Financing balances[1,2] 2002 and 2003
R millions surplus units (+)/deficit units (-)

	2002			2003		
	Gross saving	Gross capital formation	Net lending (+) /net borrowing (-)	Gross saving	Gross capital formation	Net lending (+) /net borrowing (-)
Foreign sector[3]	-8 010	-	-8 010	18 548	-	18 548
Financial intermediaries	24 970	10 384	14 586	30 135	4 232	25 903
General government	3 152	24 346	-21 194	-11 231	38 871	-50 102
Non-financial business enterprises						
Public	32 878	16 519	16 359	31 909	21 965	9 944
Private	95 527	112 538	-16 062	109 033	123 350	-14 317
Households[4]	38 176	23 855	14 321	36 487	26 463	10 024
Total	187 642	187 642	-	214 881	214 881	-

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.

General government stepped up its gross capital formation by a considerable amount and at the same time reduced saving in 2003, leading to a more-than-twofold increase in its net borrowing. *Non-financial public-sector business enterprises* and *households* recorded smaller financing surpluses. Gross saving by *non-financial private business enterprises* was insufficient to finance their own collective gross capital formation, although the shortfall was less than in 2002.

Gross saving by non-financial private business enterprises for the year 2003 amounted to 9 per cent of gross domestic product while non-financial public business enterprises and households each equalled 3 per cent of gross domestic product and financial intermediaries 2 per cent. Non-financial private business enterprises contributed more than 50 per cent of total gross saving in both 2002 and 2003.

Sectoral analysis

The national financial accounts facilitate the analysis of economic sectors from a wide variety of vantage points. The lending and borrowing needs of individual sectors and changes in their preference for financial-market instruments are briefly reviewed in this section.

Foreign sector

The foreign sector includes all non-resident units that enter into transactions with South African residents and, as such, represents the reverse image of South Africa's balance of payments.

As noted in Table 2, the domestic economy's total net acquisition of financial assets in 2003 was achieved by incurring domestic financial liabilities and receiving inflows from the rest of the world. The ultimate result was that South Africa was a net borrower from the rest of the world in order to finance the deficit of R18,6 billion on the current account of the balance of payments. In essence, the foreign sector filled the gap between domestic saving and investment.

Table 2 Flow of funds: Foreign sector and combined domestic sectors, 2003

R millions

	Domestic institutional sectors	Rest of the world	Total
Gross saving	196 333	18 548	214 881
Gross capital formation	214 881	-	214 881
Net lending (+)/net borrowing (-)	**-18 548**	**18 548**	-
Net acquisition of financial assets	471 622	51 576	523 198
Net incurrence of financial liabilities	490 170	33 028	523 198

Non-residents invested in government bonds, shares and other financial assets. They also extended a significant amount of funds to the domestic sectors through trade credit and short-term loans. Domestic sectors recorded increases in their holdings of foreign shares, long-term loans and other financial assets, while a sizeable amount in trade credit and short-term loans was repaid. Gold and foreign exchange held by other monetary institutions increased significantly in 2003.

Financial intermediaries

Financial intermediaries perform an integral financial intermediation function in the economy. These institutions accept surplus funds from ultimate savers, converting them into financial assets suitable for meeting the financing requirements of ultimate borrowers. Financial intermediaries in South Africa consist of both banks and non-bank institutions.

Five subsectors are identified, namely the monetary authority, other monetary institutions, the Public Investment Commissioners, insurers and retirement funds, and other financial institutions. Each of these is discussed below.

Monetary authority

The main functions of the monetary authority, consisting of the South African Reserve Bank and the Corporation for Public Deposits, are the formulation and implementation of monetary policy, the issuance of money, international reserves management, bank supervision and the pursuit of financial stability. This sector interacts mostly with other monetary institutions, the central government and the foreign sector.

The continuation of the restructuring of the cash reserves requirement with regard to the exclusion of vault cash held by banks, led to an increase in the amount of banks' deposits with the South African Reserve Bank. A reduction in other financial assets of the monetary authority occurred when the National Treasury compensated the Bank with R7,0 billion for part of the realised losses previously accumulated on the Gold and Foreign Exchange Contingency Reserve Account. Furthermore, the phasing out of special money-market swaps with counter foreign-currency deposits during 2003, led to a decline in other financial assets. Calculated in rand terms and adjusted for valuation, gold and other foreign exchange reserves held by the monetary authority recorded a decrease in 2003.

Other monetary institutions

The other monetary institutions sector is made up of the consolidated accounts of banks, mutual banks, the Land Bank and the Postbank. This sector is usually a financing-surplus sector or a net lender of funds as indicated in the abbreviated flow of funds presented in Table 3.

Table 3 Flow of funds: Other monetary institutions, 2003

Transaction items	Sources/ liabilities R millions	Uses/ assets R millions
Gross saving	17 099	
Gross capital formation		3 111
Net lending (+)/net borrowing (-)	13 988	
Net financial investment (+/-)		13 988
Net incurrence of financial liabilities	147 632	
Net acquisition of financial assets		161 620
Gold and other liquid foreign assets	-	56 691
Monetary deposits	106 384	2 205
Bank loans and advances	-6 395	33 891
Bills, bonds and loan stock	2 256	14 656
Mortgage loans	-	45 986
Other assets/liabilities	45 387	8 191
Total sources/liabilities and uses/assets	**164 731**	**164 731**
	Per cent	
Percentage of total sources used for gross capital formation	1,9	
Percentage of total sources used to acquire financial assets	98,1	
Percentage of total asset flows	21,6	
Percentage of total financial intermediary asset flows	59,9	
Total assets/liabilities as a percentage of GDP	13,2	

Other monetary institutions recorded gross saving of R17,1 billion and gross capital formation of R3,1 billion in 2003. Monetary deposits amounting to R106,3 billion were received and other liabilities, consisting mostly of derivative instruments, rose by R45,4 billion during the year concerned.

Intermediation of funds towards deficit sectors was effected through bank loans and advances amounting to R33,9 billion, mortgage loans to the value of R46,0 billion and bills, bonds and loan stock amounting to R14,7 billion. The movements in other assets and liabilities of this sector were partly due to the adoption of accounting standard AC133 which, among other things, requires the on-balance sheet recognition of financial asset and liability positions with regard to derivative instruments. Furthermore, other monetary institutions increased their gold and other liquid foreign assets by R56,7 billion as their role in the guardianship of liquid international assets continued to grow. In 2003, other monetary institutions invested 98 per cent of their total resources in financial assets. This sector's asset flows accounted for close to 60 per cent of financial intermediary asset flows and 22 per cent of total asset flows. This sector's total asset and liability flows amounted to 13 per cent of gross domestic product in 2003.

The flow-of-funds accounts reveal an important turning point in the credit extension tide in 2003. In 2002 the bulk of bank loans and advances were taken up by non-financial private corporate business enterprises. In 2003 the situation changed as households increasingly absorbed more bank loans and advances than the private enterprises. This could partly be attributed to favourable structural changes that afforded households greater access to the banking system, reinforced by generally declining interest rates on advances during 2003. Simultaneously, private enterprises exhibited an increased preference for financing sourced in domestic capital markets as well as short-term finance from the rest of the world.

Public Investment Commissioners

The main function of the Public Investment Commissioners (PIC) is to invest funds on behalf of public-sector entities. The bulk of funds received is from government's official pension and provident funds. In 2003 the PIC received inflows of R33,3 billion. The bulk of these funds was invested in government bonds. About 15 per cent of the increment in the PIC's financial assets was invested directly in shares, while cash holdings increased moderately in 2003. The amount allocated to other external fund managers remained virtually unchanged during the period under review. The PIC accounted for 12 per cent of the total financial intermediary asset flows; in 2002 they accounted for 15 per cent of these asset flows.

Insurers and retirement funds

The insurers and retirement funds sector recorded a net financing surplus of R10,5 billion and continued to fulfil an important role in the financial markets by accounting for 22 per cent of financial intermediary asset flows in 2003. This sector's total asset and liability flows amounted to 5 per cent of gross domestic product in 2003. As indicated in Table 4, their total indirect financing of gross capital formation through the acquisition of financial assets amounted to R61,3 billion. They received the bulk of their funds through premium contributions by members which amounted to R63,3 billion.

Healthier domestic economic conditions and a strengthening exchange rate of the rand probably contributed to a reduction in their foreign asset holdings during 2003. On balance, insurers and retirement funds preferred long-term domestic investments such as shares and government bonds during the year 2003, while their holdings of monetary deposits showed no significant change. The official pension and provident funds increased their investment portfolios with the Public Investment Commissioners by R28,3 billion.

Table 4 Flow of funds: Insurers and retirement funds, 2003

	R millions
Financing balance	**10 491**
Net incurrence of financial liabilities	**50 856**
Members' interest in the reserves of retirement and insurance funds	63 281
Other liabilities	-12 425
Net acquisition of financial assets	**61 347**
Monetary deposits	-87
Other deposits	27 079
Public Investment Commissioners	28 313
Foreign deposits	-3 594
Other	2 360
Bills and bonds	-3 588
Short-term government bonds	-11 276
Long-term government bonds	5 967
Other	1 721
Other loan stock and preference shares	508
Domestic	7 220
Foreign	-6 712
Shares	26 128
Domestic	28 869
Foreign	-2 741
Other assets	11 307
	Per cent
Percentage of total asset flows	8,1
Percentage of total financial intermediary asset flows	22,4
Total assets/liabilities as a percentage of GDP	4,9

Other financial institutions

Other financial institutions consisting of, among others, unit trusts, participation bond schemes, finance companies and financial public enterprises, acquire funds and carry out investments through sales of units in unit trusts, lending and similar activities. Within these institutions unit trusts experienced the liveliest financial activity in 2003.

As depicted in Table 5, other financial institutions received funds from both domestic and foreign investors amounting to R39,5 billion. Households remained the dominant investor group, contributing a sizeable amount of deposits to these financial institutions in 2003. A preference for investment in monetary deposits was evident, while investments in shares and other loan stock and preference shares were responsible for 21 per cent of the growth in total assets. As in the case of the insurers and retirement funds, domestic investment was favoured relative to foreign investment. The increase in other assets also included the extension of loans to other entities. This sector accounted for 18 per cent of the total financial intermediary asset flows in 2003 compared with 13 per cent in 2002. The total asset and liability flows of other financial institutions amounted to 4 per cent of gross domestic product in 2003.

Table 5 Flow of funds: Other financial institutions, 2003

	R millions
Financing balance	**721**
Net incurrence of financial liabilities	**47 482**
Deposits received	39 542
Trade credit and short-term loans	1 213
Other loan-stock and preference shares	108
Long-term loans	6 105
Other liabilities	514
Net acquisition of financial assets	**48 203**
Monetary deposits	17 282
Other deposits	2 276
Foreign deposits	2 476
Other	-200
Bills and bonds	-3 667
Short-term government bonds	6 285
Long-term government bonds	-2 130
Other	-7 822
Trade credit and short-term loans	-499
Other loan stock and preference shares	2 375
Domestic	2 947
Foreign	-572
Shares	7 879
Domestic	13 198
Foreign	-5 319
Other assets	22 557
	Per cent
Percentage of total asset flows	6,3
Percentage of total financial intermediary asset flows	17,5
Total assets/liabilities as a percentage of GDP	3,9

Central and provincial governments

Increased gross capital formation and capital transfers to other sectors resulted in an increase in the financing deficit of the central and provincial governments from around R12,4 billion in 2002 to R30,6 billion in 2003. An amount of R62,9 billion was raised in the financial markets through the net incurrence of financial liabilities to finance this deficit.

As depicted in Table 6, the central and provincial governments were able to finance a significant portion of their deficits through the issuance of bonds, mainly in the domestic market. Capital raised in the domestic sectors amounted to R67,1 billion. Marketable government bonds to the value of R46,1 billion were issued in 2003, of which R10,6 billion were foreign issues. In total, the central and provincial governments reduced their reliance on foreign financing by repaying more debt than they issued in these markets.

Table 6 Flow of funds: Central and provincial governments, 2003

	R millions
Financing balance	**-30 623**
Net acquisition of financial assets	32 293
Net incurrence of financial liabilities	62 916
Net incurrence of financial liabilities by financial instrument	**62 916**
Treasury bills	6 500
Short-term government bonds	-3 863
Long-term government bonds	49 944
Non-marketable government bonds	-6 584
Other	16 919
Financing by sector	**62 916**
Foreign sector	-4 213
Public Investment Commissioners	22 024
Insurers and retirement funds	-5 299
Other financial institutions	5 525
Other domestic sectors	44 879

Local governments

Local governments recorded an overall financing deficit of R19,5 billion in 2003. The deficit was financed by borrowing mainly in the domestic markets. Coupled with its borrowing activities to finance the deficit was the reduction of the sector's extension of trade credit and short-term loans as well as other assets.

Non-financial public corporate business enterprises

The non-financial public corporate business enterprises sector recorded a net financing surplus of R9,9 billion in 2003. Not only were these enterprises able to finance their gross capital formation, but they were also able to channel excess funds to deficit sectors. This was done through increasing their holdings of long-term government bonds, increasing trade credit extended to other entities and increasing their monetary deposits. The surplus was therefore not only utilised to reduce this sector's own financial liabilities, but also to finance deficit sectors in 2003.

Non-financial private corporate business enterprises

Table 7 shows that non-financial private corporate business enterprises recorded a financing deficit of R14,3 billion in 2003 – a significant improvement from the R21,0 billion deficit recorded in 2002. The deficit was funded in the financial markets through the issuance of shares, bills, bonds and loan stock as well as mortgage loans, trade credit and short-term loans. Excess funds were deposited with monetary institutions, invested in foreign shares and other financial assets. The gross capital formation of R123,4 billion represented more than half of the total gross domestic capital formation in 2003 and, as such, indicates the important contribution made by this sector towards real economic activity. The total asset and liability flows of non-financial private corporate business enterprises amounted to 16 per cent of gross domestic product in 2003.

Table 7 Flow of funds: Non-financial private corporate business enterprises, 2003

Transaction items	Sources/ liabilities R millions	Uses/ assets R millions
Gross saving	107 766	
Capital transfers	1 267	
Gross capital formation		123 350
Net lending (+)/net borrowing (-)	-14 317	
Net financial investment (+/-)		-14 317
Net incurrence of financial liabilities	93 233	
Net acquisition of financial assets		78 916
Monetary deposits	-	34 866
Other deposits	2 339	228
Bank loans and advances	19 943	-
Trade credit and short-term loans	49 386	-24 972
Bills, bonds and loan stock	9 157	7 069
Shares	30 369	-11 224
Domestic	27 233	-25 255
Foreign	3 136	14 031
Long-term and mortgage loans	13 857	4 867
Other assets/liabilities	-31 818	68 082
Total sources/liabilities and uses/assets	**202 266**	**202 266**
	Per cent	
Percentage of total sources used for gross capital formation	61,0	
Percentage of total sources used to acquire financial assets	39,0	
Percentage of total asset flows	26,6	
Total asset/liabilities as a prcentage of GDP	16,2	

Households

Households recorded a financing surplus and, as such, provided funds to deficit sectors in 2003. Households had access to additional funding through bank loans and other advances, and mortgage loans. In 2003 households increased their interest in retirement and life funds and their deposits with banks and other financial institutions, such as unit trusts.

Summary and conclusion

The acquisition of financial assets and the incurrence of financial liabilities in 2003 by the various economic sectors occurred against the backdrop of declining interest rates and a slower rate of increase in the general price level (inflation). The growing credibility of the inflation-targeting monetary policy framework and a reduction in inflation expectations influenced the financial decision-making processes in the South African economy, some of the consequences being reflected in the flow of funds.

The analysis of South Africa's national financial accounts for the year 2003 reveals that:

- the acquisition of domestic financial assets by foreigners exceeded the acquisition of foreign assets by South Africans, resulting in a net inflow of funds from the rest of the world to South Africa;

- the continued restructuring of the cash reserve requirements by the South African Reserve Bank led to an increase in deposits of the banking sector with the South African Reserve Bank;
- a shifting of credit extended by banks to households away from non-financial private corporations;
- an increased preference by general government for financing the net borrowing requirement in the domestic financial markets;
- the continued and growing importance of the other financial institutions sector in the financial intermediation process;
- the significant contribution made by non-financial private business enterprises towards gross capital formation; and
- the continued importance of households as net providers of funds to deficit sectors.

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