Note on flows of funds in South Africa's national financial accounts for the year 2004

by Z Nhleko and D H Meyer[1]

Introduction

The national financial accounts, also referred to as the flow-of-funds accounts, summarise the financial relationships that exist among the monetary and financial statistics, national accounts, balance of payments and government finance. South Africa's national financial accounts for 2004 are presented on pages S-44 to S-53 of this issue of the *Quarterly Bulletin*.

This note is a concise analysis of both the real and financial activities of the various institutional sectors within the South African economy. The national financial accounts provide a framework for the analysis of lending and borrowing behaviour in the economy and economic agents' changing financial instrument preferences. Changes in the regulation of the financial system and financial markets play a crucial role in the process of financing sectoral deficits.

Institutional sector data used to compile the national financial accounts are obtained from surveys and other sources of information available to the Research Department of the South African Reserve Bank. Eleven institutional sectors are balanced individually and consolidated by way of contra-entry accounting in two-dimensional tables[2].

Financing balances

The uses of funds to invest in any sector cannot exceed saving unless it is supplemented by inflows from other sectors. The saving-investment imbalance within each of the individual sectors is resolved by net lending to or borrowing from the other sectors. Table 1 summarises the saving and investment activity in South Africa for 2003 and 2004 across the main sectors.

The foreign sector was a net supplier of funds to the domestic economy in both years as gross capital formation in the South African economy outstripped the available gross saving. Accordingly, South Africa ran current-account deficits; the extent to which domestic economic activities are funded by the rest of the world mirrors the balance on the current account of South Africa.

Private non-financial business enterprises are generally both large savers and large investors. In 2004 private non-financial business enterprises recorded gross saving equal to 8 per cent of gross domestic product and gross capital formation equivalent to 10 per cent of gross domestic product. Although private non-financial business enterprises were responsible for more than 44 per cent of total gross saving in 2004, the sector was a net borrower of funds. General government also remained a net borrower of funds, and was in fact the largest net borrower in both years under review. Financial intermediaries, public non-financial business enterprises and households were net lenders of funds.

1 The views expressed are those of the authors and do not necessarily reflect the views of the South African Reserve Bank. The 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 For a further technical analysis on the compilation of the accounts see Kock, M A and Meyer, D H. 2001: "A note on flows of funds in South Africa's national financial accounts for the year 1999." Quarterly Bulletin*, No 219, March.*

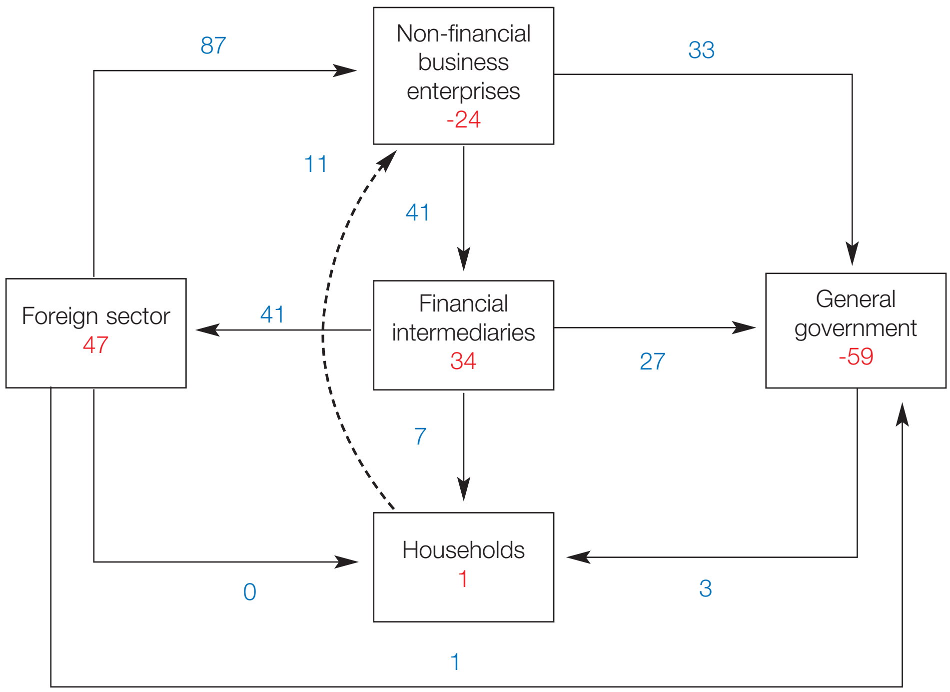
Table 1 Financing balances[1,2] 2003 and 2004
R millions Surplus units (+)/deficit units (-)

	2003			2004		
	Gross saving	Gross capital formation	Net lending (+) /net borrowing (-)	Gross saving	Gross capital formation	Net lending (+) /net borrowing (-)
Foreign sector[3]	16 761	-	16 761	47 127	-	47 127
Financial intermediaries	30 135	4 232	25 903	41 204	7 020	34 184
General government	-11 231	38 871	-50 102	-20 786	37 887	-58 673
Non-financial business enterprises						
Public	33 877	22 949	10 928	34 720	24 044	10 676
Private	106 966	120 480	-13 514	106 981	141 736	-34 755
Households[4]	36 487	26 463	10 024	33 521	32 080	1 441
Total	212 995	212 995	-	242 767	242 767	-

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 is 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 is 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.

The accompanying diagram depicts a condensed sector-to-sector net flow-of-funds analysis showing the main financial relationships among the various sectors. The net lending or borrowing positions of the various sectors are shown inside the boxes and the

Net intersectoral flow of funds, 2004
R billions



inter-sectoral flow of funds are shown outside the boxes. The net lending or borrowing position of the sectors is calculated by treating inflows as negatives and outflows as positives. Financial intermediaries played a pivotal role in the financial system and interacted with all sectors as they received R41 billion from private and public non-financial business enterprises and transferred R27 billion to the general government. The bulk of foreign funding in 2004 went to non-financial business enterprises as they were able to attract an R87 billion net flow from the foreign sector. A net flow of R33 billion was recorded from non-financial business enterprises to the general government in 2004.

Sectoral analysis

In the process of financing shortfalls or allocating savings, certain patterns of behaviour develop in the various economic sectors. The lending and borrowing needs of individual sectors and changes in preference for financial markets instruments are briefly reviewed in this section.

Foreign sector

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

Table 2 Flow of funds: Foreign sector and combined domestic sectors, 2004

R millions

	Domestic institutional sectors	Rest of the world	Total
Gross saving	195 640	47 127	242 767
Gross capital formation	242 767	-	242 767
Net lending (+)/net borrowing (-)	**-47 127**	**47 127**	-
Net acquisition of financial assets..............................	477 176	104 435	581 611
Net incurrence of financial liabilities	524 303	57 308	581 611

In 2004 South Africa was a net borrower of funds from the rest of the world in order to finance the deficit of R47,1 billion on the current account of the balance of payments. As depicted in Table 2, this meant that the domestic economy's total incurrence of financial liabilities exceeded its net acquisition of financial assets by a similar amount. Net inflows from the rest of the world served to fill the gap between domestic saving and investment. These inflows occurred mainly as non-residents increased their holdings of domestic shares and extended trade credit and short-term loans to domestic sectors. Gold and foreign exchange reserves held by the monetary authority[3] increased significantly in 2004.

3 *For an analysis on the recent redefinition of the country's gold and foreign reserves see Motsumi, L and Balance of Payments Division. 2005. "Note on the redefinition of gold and other foreign reserves in the balance of payments."* Quarterly Bulletin, *No 238, December.*

Financial intermediaries

As depicted in the diagram at the beginning of this note, financial intermediaries play a pivotal financial intermediation role in the economy. These institutions convert deposits and investments into financial asset and liabilities that attract financial flows from entities with surplus funds while meeting the financial requirements of those seeking funding. Financial intermediaries in South Africa are grouped into five subsectors and consist of both banks and non-bank institutions. The five subsectors are the monetary authority, other monetary institutions, the Public Investment Corporation, insurers and retirement funds, and other financial institutions. These are discussed individually in the following paragraphs.

Monetary authority

The monetary authority sector consists of the South African Reserve Bank and the Corporation for Public Deposits. While fulfilling its functions such as formulation and implementation of monetary policy, bank supervision and international reserves management, this sector interacts mostly with other monetary institutions, the central government and the foreign sector.

Significant deposits amounting to R13,6 billion were made by banks with the South African Reserve Bank in 2004 in order to comply with the cash reserve requirement. The monetary authority took advantage of the strength of the exchange value of the rand to increase its foreign exchange reserves. Calculated in rand terms and adjusted for valuation, gold and other foreign exchange reserves held by the monetary authority increased by R40,5 billion in 2004.

Realised losses incurred by the South African Reserve Bank in conducting its foreign exchange operations, which were previously accumulated on the Gold and Foreign Exchange Contingency Reserve Account, were reduced by R7,0 billion by the National Treasury in 2004, thereby improving the balance sheet of the monetary authority sector. Movements in other monetary flows not related to money supply led to significant declines in other financial assets.

Other monetary institutions

The other monetary institutions sector comprises the consolidated accounts of banks, mutual banks, the Land Bank and the Postbank. Table 3 shows that this sector was a financing-surplus sector and therefore able to provide funds, on a net basis, to other sectors.

Other monetary institutions incurred financial liabilities of R111,3 billion during the period under review, of which R115,4 billion were monetary deposits. Supported by the low interest rate environment as well as a robust real-estate market, the intermediation of funds to deficit sectors was effected mainly through loans. Bank loans and advances amounting to R44,4 billion and mortgage loans to the value of R80,9 billion were extended to deficit sectors during 2004. Other monetary institutions also reduced bills, bonds and loan stock in issue.

Other monetary institutions increased their gold and other foreign assets by R12,5 billion in 2004. This amount no longer forms part of the official reserves of South Africa and for the purposes of the flow of funds is now included in deposits with other foreign institutions.

In 2004, other monetary institutions invested 96 per cent of their total resources in financial assets. This sector's asset flows accounted for close to 40 per cent of financial intermediary asset flows and 15 per cent of total asset flows. The sector's total asset and liability flows amounted to 9 per cent of gross domestic product in 2004.

Table 3 Flow of funds: Other monetary institutions, 2004

Transaction items	Sources/ liabilities R millions	Uses/ assets R millions
Gross saving	17 544	
Gross capital formation		5 230
Net lending (+)/net borrowing (-)	12 314	
Net financial investment (+/-)		12 314
Net incurrence of financial liabilities	111 345	
Net acquisition of financial assets		123 659
Monetary deposits	115 394	3 510
Deposits with other institutions	-	13 984
Foreign	-	12 498
Domestic	-	1 486
Bank loans and advances	-50	44 424
Bills, bonds and loan stock	-945	13 713
Mortgage loans	-	80 875
Other assets/liabilities	-3 054	-32 847
Total sources/liabilities and uses/assets	**128 889**	**128 889**
	Per cent	
Percentage of total sources used for gross capital formation	4,0	
Percentage of total sources used to acquire financial assets	96,0	
Percentage of total asset flows	15,0	
Percentage of total financial intermediary asset flows	37,0	
Total assets/liabilities as a percentage of GDP	9,0	

The flow-of-funds account for this sector highlights the steep increase of bank loans and advances as well as mortgage loans in 2004. These were mainly taken up by the household sector whose willingness to utilise credit facilities was raised by the favourable economic conditions and enhanced affordability of credit.

Public Investment Corporation[4]

The main function of the Public Investment Corporation is to invest funds on behalf of public-sector entities. The largest scheme looked after is the government employees' pension and provident funds. The Public Investment Corporation received inflows of R41,3 billion in 2004 and invested R8,7 billion of this amount in domestic shares and R13,4 billion in government bonds. The Public Investment Corporation increased the amount allocated to external fund managers in 2004. The share of the Public Investment Corporation in financial intermediation is gradually declining, as reflected in the corporation accounting for 12 per cent of the total financial intermediary asset flows in 2004; in 2003 the sector accounted for 13 per cent of these asset flows and in 2002 for 15 per cent.

4 The Public Investment Commissioners was corporatised in April 2005, and renamed Public Investment Corporation in the flow of funds

Insurers and retirement funds

Insurers and retirement funds recorded a net financing surplus of R7,9 billion in 2004, lower than the R10,5 billion recorded in 2003. Despite the smaller surplus compared with the previous year, insurers and retirement funds accounted for over a quarter of financial intermediary flows and was outdone only by other monetary institutions. As indicated in Table 4, the insurers and retirement funds received the bulk of their funds through premium contributions by members amounting to R52,3 billion in 2004.

Table 4 Flow of funds: Insurers and retirement funds, 2004

	R millions
Financing balance	**7 932**
Net incurrence of financial liabilities	**86 669**
Members' interest in the reserves of retirement and insurance funds	52 309
Other liabilities	34 360
Net acquisition of financial assets	**94 301**
Monetary deposits	20 386
Other deposits	38 725
Public Investment Corporation	35 843
Foreign deposits	-818
Other	3 700
Bills and bonds	26 854
Short-term government bonds	1 115
Long-term government bonds	26 864
Other	-1 125
Other loan stock and preference shares	689
Domestic	1 084
Foreign	-395
Shares	-14 402
Domestic	-16 902
Foreign	2 500
Other assets	32 349
	Per cent
Percentage of total asset flows	11,0
Percentage of total financial intermediary asset flows	27,0
Total assets/liabilities as percentage of GDP	7,0

Uncertain global market and risk containment considerations contributed to a preference for investment in those domestic financial instruments carrying limited risk. This was reflected in significant increases in holdings of government bonds and monetary deposits, while investments in shares decreased in the year 2004. The official pension and provident funds increased their investment portfolios with the Public Investment Corporation by R35,8 billion. This sector's total asset and liability flows amounted to 7 per cent of gross domestic product in 2004.

Other financial institutions

Other financial institutions comprise, among other things, collective investment schemes, finance companies and public financial enterprises. Collective investment schemes, in turn, comprise unit trusts and participation bond schemes. Unit trusts dominate the activities of the other financial institutions sector. The sector acquires funds and carries out investments through sales of units in unit trusts, purchasing of securities, lending and similar activities. Table 5 shows that during 2004 other financial institutions received funds from investors amounting to R42,4 billion. Institutional investment with unit trusts grew at a faster pace than that of households and made non-financial business enterprises the largest contributors to the financial activity of the other financial institutions sector in 2004.

Table 5 Flow of funds: Other financial institutions, 2004

	R millions
Financing balance	**12 642**
Net incurrence of financial liabilities	**43 196**
Deposits received	42 384
Long-term loans	1 523
Other liabilities	-711
Net acquisition of financial assets	**55 838**
Monetary deposits	36 274
Other deposits	3 929
Foreign deposits	4 016
Other	-87
Bills and bonds	135
Short-term government bonds	-1 562
Long-term government bonds	-721
Other	2 418
Trade credit and short-term loans	4 387
Other loan stock and preference shares	5 504
Domestic	5 149
Foreign	355
Shares	19 818
Domestic	23 874
Foreign	-4 056
Other assets	-14 209
	Per cent
Percentage of total asset flows	7,0
Percentage of total financial intermediary asset flows	16,0
Total assets/liabilities as percentage of GDP	4,0

Similar to insurers and retirement funds, other financial institutions also preferred investment in the domestic financial markets. Their investment in 2004 focused on monetary deposits and shares. Smaller investments in domestic loan stock and preference shares as well as foreign deposits also occurred. This sector accounted for 16 per cent of the total financial intermediary asset flows in 2004, somewhat lower than the 18 per cent recorded in 2003. The total asset and liability flows of other financial institutions amounted to 4 per cent of gross domestic product in 2004.

Central and provincial governments

In 2004 the financing deficit of the central and provincial governments amounted to R33,2 billion or 2 per cent of gross domestic product, a ratio similar to 2003. To finance the deficit, financial assets were increased by R6,2 billion while an amount of R39,3 billion was raised in the financial markets, as represented in Table 6.

Table 6 Flow of funds: Central and provincial governments, 2004

	R millions
Financing balance	**-33 170**
Net acquisition of financial assets	6 162
Net incurrence of financial liabilities by financial instrument	**39 332**
Treasury bills	9 273
Short-term government bonds	3 142
Long-term government bonds	33 798
Non-marketable government bonds	-2 346
Other	-4 535
Financing by sector	**39 332**
Foreign sector	1 698
Public Investment Corporation	14 460
Insurers and retirement funds	28 655
Other financial institutions	1 479
Other domestic sectors	-6 960

The financing included the issuance of R9,3 billion in Treasury bills and R36,9 billion in government bonds. Financing occurred mainly in the domestic market, accounting for R37,6 billion of the total amount raised. The Public Investment Corporation and the insurers and retirement funds were the two main sectors which took up new issuances of instruments in 2004.

Local governments

Local governments recorded a substantial overall financing deficit of R25,5 billion in 2004, almost equalling that of central government. They financed this deficit by raising funds in the domestic financial markets through issuing securities and taking up loans and trade credit from financial institutions. They also supplemented their equitable share from national government by collecting rates, fines and levies.

Public non-financial corporate business enterprises

The public non-financial corporate business enterprises sector recorded a net financing surplus of R10,7 billion in 2004. With its capital spending still relatively low, the sector was therefore able to finance its gross capital formation and remained with excess funds to channel to deficit sectors. The excess funds, together with a decrease in financial assets, made it possible for this sector to reduce its financial liabilities by a significant amount.

Private non-financial corporate business enterprises

Private non-financial corporate business enterprises recorded a financing deficit of R34,8 billion in 2004, significantly higher than the deficit of R6,7 billion recorded in 2003. In order to finance the deficit, the sector utilised a wide range of funding alternatives in the financial markets. This included the issuance of shares mainly in foreign financial markets, bank loans, non-bank long-term loans and mortgage loans, as well as the issuance of bills, bonds and loan stock. Excess funds were deposited with monetary institutions and other non-bank financial institutions while some investment also flowed into foreign shares. However, the gross capital formation of R141,7 billion represented almost 60 per cent of the total domestic gross capital formation in 2004 and, as such, indicates the continued importance of this sector towards real economic activity. The total asset and liability flows of private non-financial business enterprises amounted to 14 per cent of gross domestic product in 2004.

Table 7 Flow of funds: Private non-financial corporate business enterprises, 2004

Transaction items	Sources/ liabilities R millions	Uses/ assets R millions
Gross saving	105 926	
Capital transfers	1 060	5
Gross capital formation		141 736
Net lending (+)/net borrowing (-)	-34 755	
Net financial investment (+/-)		-34 755
Net incurrence of financial liabilities	86 699	
Net acquisition of financial assets		51 944
Monetary deposits	-	4 778
Other deposits	-1 976	13 984
Bank loans and advances	14 561	-
Trade credit and short-term loans	40 156	-13 749
Bills, bonds and loan stock	13 752	-7 499
Shares	49 739	15 105
Domestic	-1 396	-82
Foreign	51 135	15 187
Long-term and mortgage loans	29 568	4 134
Other assets/liabilities	-59 101	35 191
Total sources/liabilities and uses/assets	**193 685**	**193 685**
	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	23,0	
Total asset/liabilities as percentage of GDP	14,0	

Households

The gross saving of households in 2004 was just sufficient to finance their gross capital formation. Households took up more credit as they accessed additional funding through mortgage loans, other bank loans and advances. The growth in mortgage advances to households both reflected and contributed to the strong growth in house prices in 2004. Households' interest in retirement and life funds continued to rise while excess funds were deposited with banks and other financial institutions, such as unit trusts. Investment also flowed into shares issued by other institutions.

Summary and conclusion

The environment of lower inflation and interest rates provided a stable setting within which flow-of-funds decisions could be made and, coupled with the firm exchange value of the rand, boosted domestic financial market activity in 2004.

In conclusion, the analysis of South Africa's national financial accounts for the year 2004 reveals the following:

- the continued interest of non-resident investors in South African financial assets resulting in a net inflow of funds from the rest of the world;
- the rising gold and foreign exchange reserve holdings of the monetary authorities aided by the strength of the exchange value of the rand;
- continued buoyancy of credit extended by banks to households, alongside a more modest expansion in credit to private non-financial corporate business enterprises;
- continued preference by general government to finance its net borrowing requirement predominantly in the domestic financial markets;
- the significant contribution of private non-financial business enterprises towards capital formation; and
- the continued importance of financial intermediaries as net providers of funds to deficit sectors.

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