Quarterly economic review

Introduction

Economic activity and output in South Africa have now been contracting for more than four years, making the current economic downswing the longest recession of this century. The economic downturn has not only been abnormally long, it has had more serious adverse repercussions for living standards and employment than most other downswings, barring the great depression of the 1930s. Although real gross domestic product decreased more sharply in some of the previous downturns than the decrease of 4 per cent from the first quarter of 1989 to the first quarter of 1993, the current downturn started off after a long period of low economic growth. In an environment where the labour force kept rising at a rapid rate, employment opportunities in the formal sectors of the economy decreased sharply. Consequently, no fewer than 1,5 million people have been unable to find employment in the formal non-agricultural sectors of the economy since the beginning of the recession.

However, towards the end of 1992 and in the beginning of 1993 certain positive developments became apparent in the economy, including:

- Agricultural production, which had declined substantially throughout 1992 because of adverse weather conditions, recovered sharply.
- The physical volume of mining production, which had already increased slightly in 1992, rose further mainly because of higher gold production.
- The physical volume of manufacturing production began to rise.
- The number of new motor cars sold rose fairly sharply in the second half of 1992 and remained at a comparatively high level in the first five months of 1993.
- The financial environment remained relatively stable. In addition, the rand price of gold has risen sharply since September 1992 and international commodity prices have begun to rise moderately since the beginning of 1993.

It is therefore not surprising that real gross domestic product rose slightly in the first quarter of 1993. Unfortunately, there are still certain important adverse circumstances that are holding back a revival in economic activity. In particular, the economic recovery in some of the major industrialised countries is still very hesitant and wavering while economic activity in some others is still slowing down, which is not conducive to rapid export growth. Domestically, the lack of investor confidence arising from uncertainties in respect of future political developments, internal unrest and violence is probably the main deterring factor to an upturn in economic activity. Real fixed investment therefore continued to decrease in the first quarter of 1993 to a level of 15 per cent of gross domestic product. This decline in the domestic capital formation poses a serious threat to the ability of the country to strengthen its overall growth capacity.

Although private consumption expenditure rose marginally in the first quarter of 1993, consumer demand remains fragile. Factors such as decreases in real personal disposable income, generally bleak prospects for an improvement in households' finances and continuing uncertainty about job security, have created a desire on the part of many individuals to reduce the level of their indebtedness rather than to increase consumption. The proportionate spending of households on durable goods has therefore declined sharply in the 1990s – a typical characteristic of an economy in a prolonged recession.

Despite the long and severe downturn in economic activity, real unit labour costs continued to record positive rates of increase up to the fourth quarter of 1992. This not only contributed to the retrenchment of workers, but also caused a strong upward bias in production costs and prices. Inflation nevertheless slowed down markedly in response to a consistent monetary policy aimed at bringing down the rate of growth in the money supply. However, certain other factors recently started to exert upward pressure on production and consumer prices again. These factors included the sharp depreciation of the rand against most of the major currencies, and increases in education fees, indirect taxes and petrol prices. The twelve-month rate of increase in consumer prices therefore rose from levels just under 10 per cent to 11 per cent in April 1993. This upward movement in prices should be transitory, provided that these changes do not fuel expectations of accelerating price rises.

Moreover, the prevailing financial conditions should be conducive to low price increases. The rate of increase in the money supply, which had remained well within the guidelines for the growth in money during 1992, declined below the lower boundary of the new guideline range in the beginning of 1993. Although total domestic credit extension rose to levels marginally higher than the inflation rate in the first three months of 1993, the underlying conditions do not favour a sharp increase in credit extension. Important legislative and regulatory changes concerning banks' reserve asset requirements and the Reserve Bank's accommodation procedures were also made in the beginning of 1993, which should improve the operations of the financial sector and the functioning of the money market further.

Conditions in the secondary capital market remained relatively buoyant in the first four months of 1993. Share prices recovered sharply and large increases were recorded in the value of transactions in shares, fixed-interest stock and derivative instruments. In the primary capital market the amount of funds raised by borrowers in the public sector through new issues of fixed-interest securities also increased sharply. Owing to a relatively low return on investment in fixed property, political uncertainties and a drop in living standards, real estate transactions remained at a low level. Capital market interest rates, which had increased in the last quarter of 1992, initially decreased slightly in the first few months of 1993 before edging upwards again. The downward trend in money market interest rates throughout 1992 and the first two months of 1993 was subsequently also reversed somewhat by a moderate hardening of rates in the next three months.

Despite the low level of real economic activity, the surplus on the current account of the balance of payments decreased substantially to a seasonally adjusted and annualised rate of only R0,7 billion in the first quarter of 1993. This deterioration in the current account surplus could not be attributed to poor agricultural conditions; in fact, the imports of agricultural products decreased and the exports increased because of improved weather conditions. This sharp decline in the surplus on the current account was due partly to exceptional circumstances related to a decline in international oil prices, which encouraged a substantial increase in the volume of oil imports and a concomitant rise in inventory levels and in total domestic expenditure. However, the surplus was also reduced by a sharp decrease in merchandise exports, particularly in the early months of 1993. Subsequently, the monthly seasonally adjusted value and volume of merchandise exports rose again to high levels in April 1993.

A further large net capital outflow to the rest of the world of R3,7 billion was recorded in the first quarter of 1993, which brought the total net capital outflow in the six-month period from October 1992 to March 1993 to no less than R7,2 billion. Unfavourable leads and lags in foreign payments and receipts, which were related to the strength of the US dollar on international markets, the relatively low cost and ready availability of domestic trade financing and ongoing political and social uncertainty, continued to favour a decrease in the short-term foreign liabilities of the country. A further but more moderate outflow of long-term capital was also recorded in the first quarter of 1993 owing to repayments on loans in terms of the Third Interim Debt Arrangements and the redemption of maturing bearer bonds and notes.

The large net outflow of capital combined with the small surplus on the current account of the balance of payments, caused the net and gross gold and other foreign reserves to decline in the first quarter of 1993. Despite an increase of R2,4 billion in liabilities related to reserves, South Africa's total gross gold and other foreign reserves declined by R3,7 billion from the end of August 1992 to a level of R9,5 billion at the end of March 1993, or to a level equivalent to the value of 1,5 months' imports of goods and services. The deterioration in the overall balance of payments position led to a decline of 6 per cent in the nominal effective exchange rate of the rand in the first five months of 1993, implying that the real effective exchange rate of the rand also decreased sharply.

In the area of public finance, the final quarter of the fiscal year 1992/93 was characterised by a substantial increase in Exchequer issues, mainly because of assistance provided to farmers affected by the drought and a continued high level of other current expenditure. At the same time, Exchequer receipts again performed well below expectations, resulting in a considerably larger deficit before borrowing and debt repayment. This brought the public-sector borrowing requirement for fiscal 1992/93 as a whole to R32,2 billion – an all-time high. As a ratio of gross domestic product, the public-sector borrowing requirement amounted to 9,7 per cent.

Domestic economic developments

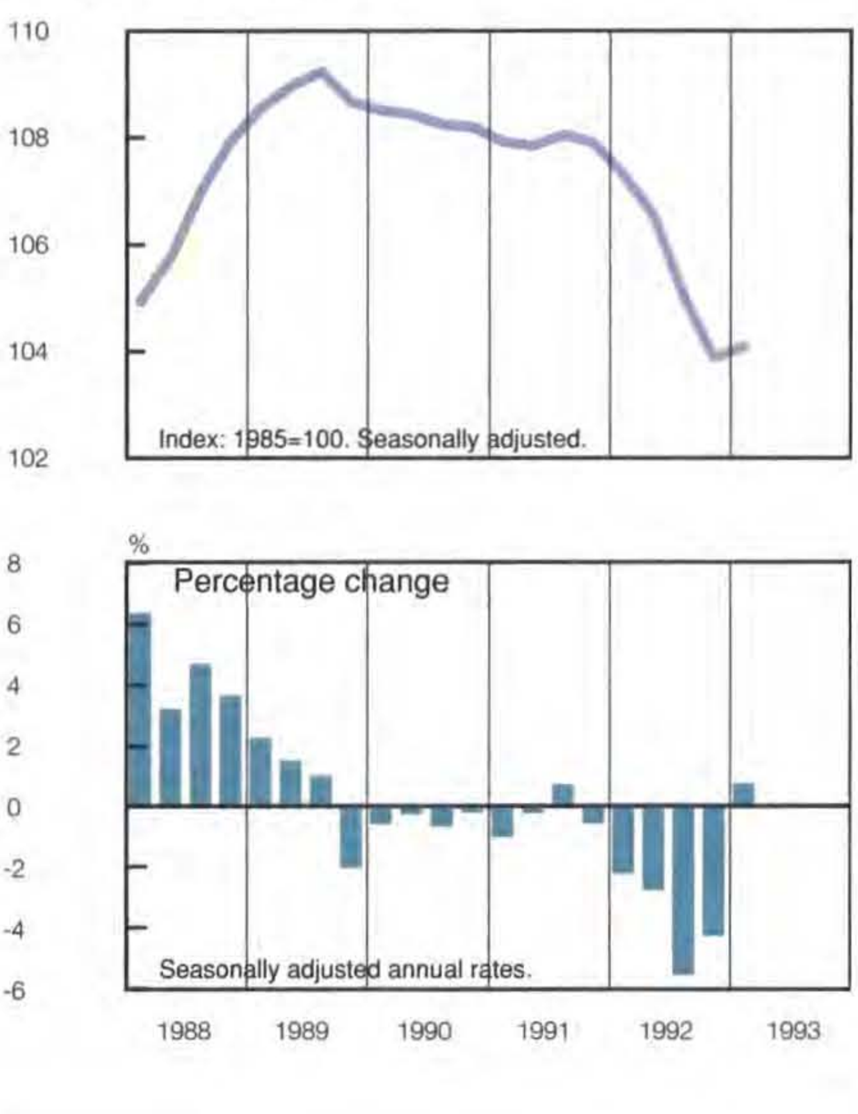
Domestic output

After having declined at seasonally adjusted and annualised rates which accelerated from 2 and 3 per cent in the first two quarters of 1992 to 5½ and 4½ per cent in the last two quarters of that year, *real gross domestic product* is estimated to have increased by nearly 1 per cent in the first quarter of 1993. Despite this rise, the level of domestic production in the first quarter of 1993 was nevertheless still 3 per cent lower than in the first quarter of 1992.

The somewhat more favourable circumstances in domestic production during the beginning of 1993 could be ascribed to an improvement in agricultural conditions and to a small increase in mining and manufacturing production. Increases in the production of these sectors neutralised decreases in real value added by other secondary sectors and by the tertiary sector as a whole.

Agricultural production, which had declined substantially throughout 1992 because of the adverse weather conditions, recovered sharply in the first quarter of 1993. This increase could be ascribed mainly to a return to more normal output levels following the failure of the wheat crop in the fourth quarter of 1992. Real agricultural output in the first quarter of 1993 was, however, still substantially lower than in the corresponding period of the preceding year.

Real gross domestic product



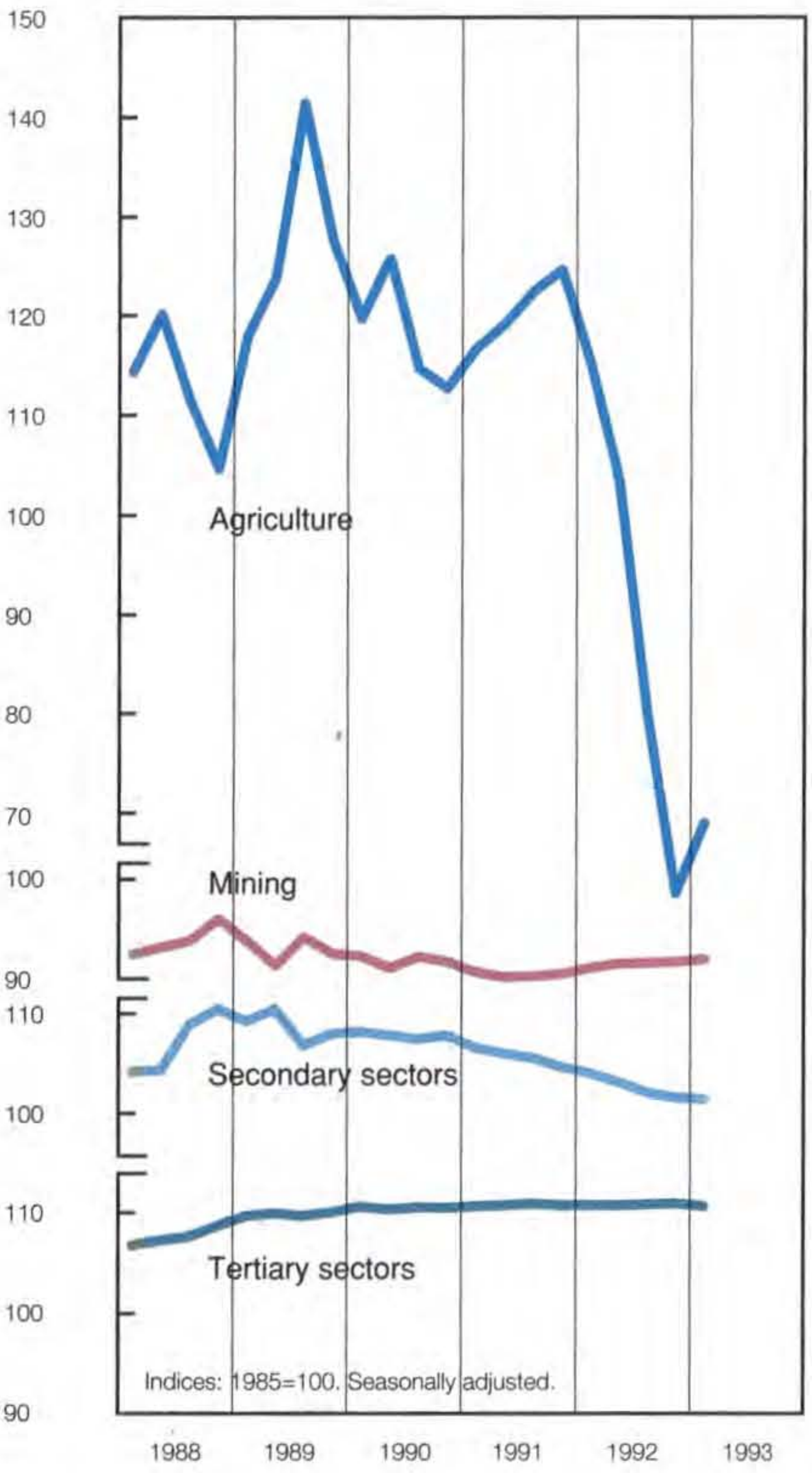
The real output of the *mining sector* rose at an annualised rate of 1 per cent in the first quarter of 1993, compared with increases at an annualised rate of about ½ per cent in both the third and fourth quarter of 1992. The further increase in real value added by mining enterprises was the net result of higher gold and diamond production, which offset a small decline in the output of other types of mines. Diamond-mining output was increased to compensate for supply disruptions in Angola and Russia, while the mining of ore with a higher gold content led to the rise in gold-mining production. A weak domestic demand and the wavering economic recovery in South Africa's major trading partner countries continued to have a negative effect on the real value added by other mining enterprises.

The real output of *manufacturers*, which had receded by 3 per cent in 1992, rose slightly in the first quarter of 1993. The increase, at a seasonally adjusted and annualised rate of about ½ per cent, in real value added by the manufacturing sector in the first quarter of 1993 was preceded by a slight improvement in the utilisation of production capacity of about 1 per cent in the fourth quarter of 1992. Manufacturing output also benefited from the production of Mossgas which came into operation towards the end of 1992, fewer work-stoppages and more man-hours worked during the first three months of 1993.

A small decrease in the real output of *other secondary sectors* was the combined result of virtually no change in value added by undertakings supplying electricity, gas and water, while real value added in the construction sector continued to decrease sharply.

The real value added in the *tertiary sectors* declined at an annualised rate of about 1 per cent in the first quarter of 1993; in the last half of 1992 small increases had been recorded in real value added by these sectors as a whole. The decline in value added by the tertiary sectors in the first quarter of 1993 took place mainly in the wholesale and retail trade, which also had a negative influence on the activities of the transportation sector; this led to a decline at an annualised rate of nearly 6 per cent in real value added by the last-mentioned sector. In contrast with these developments, real value added by the motor trade rose further because of the introduction of new models and an increase in the demand owing to expected price rises. Real value added by the financial services sectors also continued to rise in the first quarter of 1993.

Components of real gross domestic product



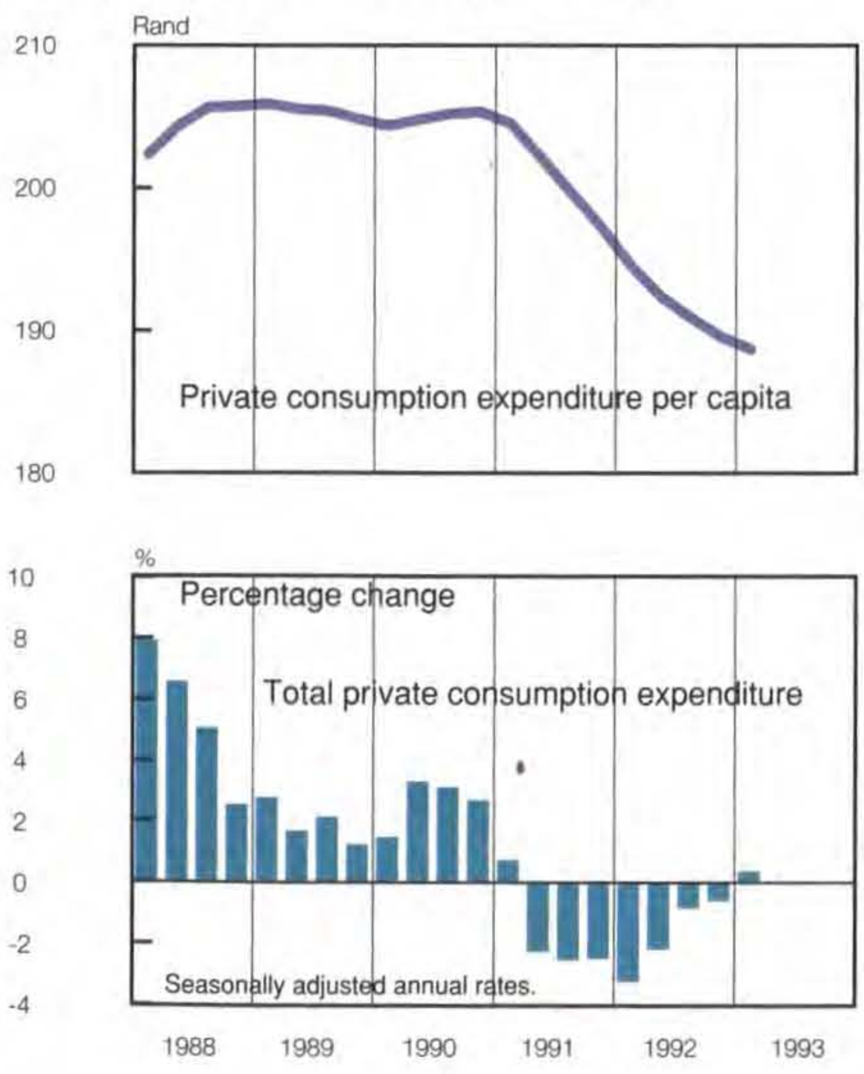
Domestic expenditure

Aggregate real *gross domestic expenditure* is estimated to have increased at an annualised rate of 8 per cent in the first quarter of 1993, following rates of decline of 4 and 8 per cent in the second and third quarter of 1992 and virtually no change in the fourth quarter. This substantial increase in domestic expenditure was mainly the result of a sharp increase in inventories valued at constant prices, which more than offset a further contraction in real domestic final demand. The rate of decline in final demand, however, slowed down markedly in the first quarter of 1993 owing to a small increase in consumption expenditure. Total real fixed investment continued to fall, albeit at a lower rate.

Real *consumer spending by households* advanced slightly at an annualised rate that did not quite reach ½ per cent in the first quarter of 1993. The modest improvement in real private consumption expenditure followed a consistent decrease for seven consecutive quarters which tapered off from an annualised rate of 3 per cent in the first half of 1992 to 1 per cent in the second half; this led to a decrease of about 5 per cent in real consumer outlays per head of the population for 1992 as a whole. Further decreases in real private consumption expenditure were averted by pre-emptive buying in order to avoid higher prices arising from the generally anticipated increase in the value-added tax rate. The further cut in Bank rate on 9 February 1993 and the consequent downward adjustment of mortgage rates also kept households' gross debt-servicing burden on a downward course, which could have encouraged somewhat higher spending levels.

Consumer demand, however, remains fragile with no clear sign as yet that it may move above last year's average level. The reluctance of consumers to commit future income by borrowing in order to finance major purchases probably stems from a decrease in real personal disposable income, bleak prospects for

Real private consumption expenditure



households' finances, continuing concern about job security, high unemployment and the low level of consumer confidence. These factors have created a desire by many individuals to reduce their level of indebtedness rather than to increase their consumption expenditure.

The slow growth and recent decline in real personal disposable income, the high rate of unemployment and a redistribution of income in favour of households with a relatively strong preference for current consumption, caused a significant change in household spending patterns in the 1990s. Household spending on non-durable goods and services (i.e. goods of a non-discretionary and more essential nature) namely rose from 73 per cent of total consumer spending in 1990 to 75 per cent in the first quarter of 1993. The spending allocated to durable and semi-durable goods declined accordingly from 27 per cent to 25 per cent over the same period. This type of development is typical of an economy in a long protracted recession where households are forced to spend less on more luxury-type goods.

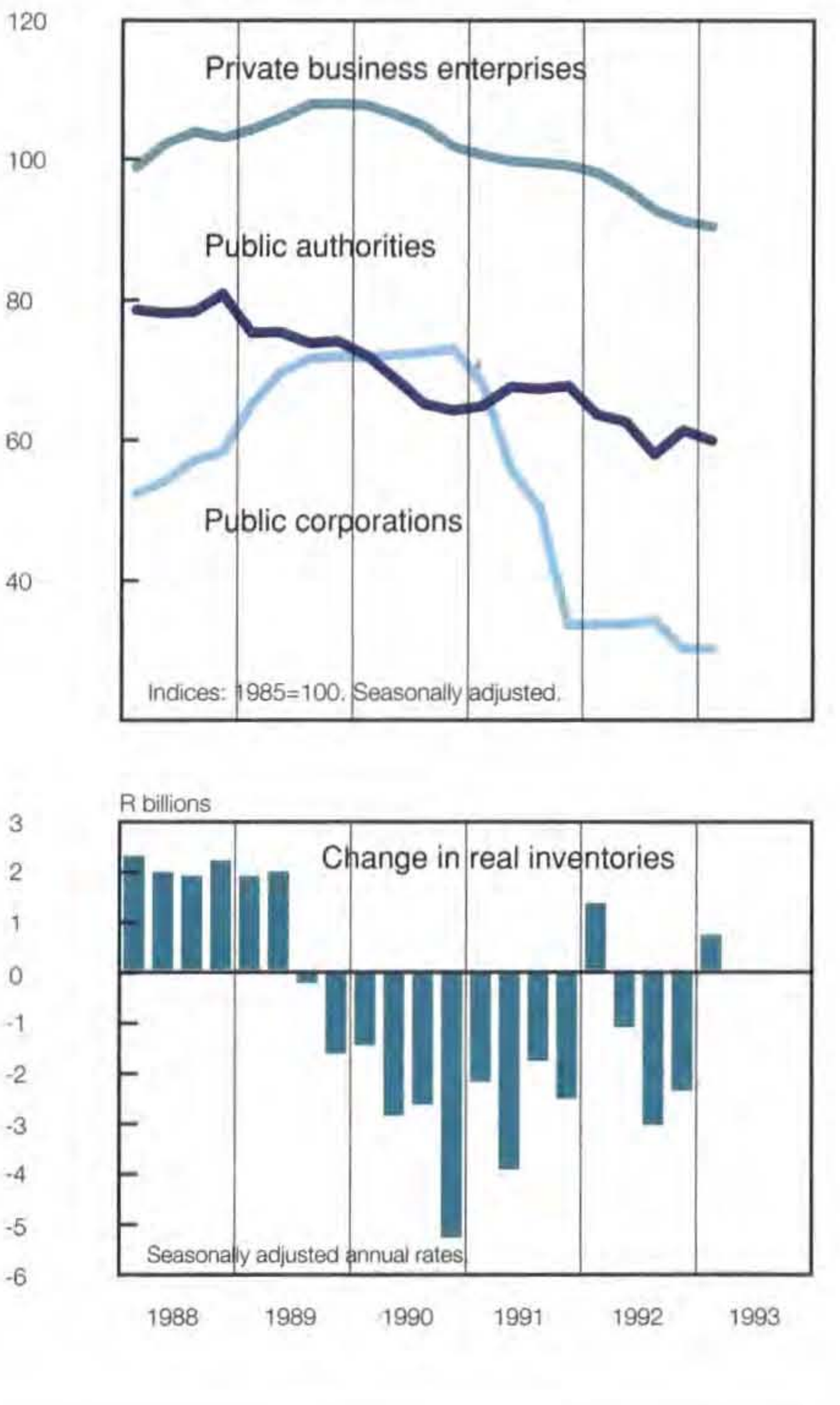
Real *consumption expenditure by general government* also increased marginally at an annualised rate of less than ½ per cent in the first quarter of 1993; in 1992 the rate of increase in this aggregate had already slowed down from 6 per cent in the first quarter to 1 per cent in the fourth quarter. The low growth in the first quarter of 1993 was due mainly to a decrease in the real remuneration of employees, which to some extent offset a rise in real outlays on intermediate goods and services. The slower growth in real government consumption expenditure brought the increase in this aggregate to only 1 per cent in the full fiscal year 1992/93; in the fiscal year 1991/92 this type of expenditure had still increased by 2½ per cent.

After having contracted by 8½ and 10 per cent in 1991 and 1992, real *gross domestic fixed investment* decreased further at an annualised rate of 4 per cent in the first quarter of 1993. The ratio of gross domestic fixed investment to gross domestic product therefore deteriorated to 15 per cent in the first quarter of 1993; in 1991 and 1992 this ratio had amounted to 18 and 16 per cent, respectively. This downturn in investment expenditure in the beginning of the 1990s was a continuation of the trend observed during the 1980s when investment began to be replaced by consumption expenditure. The decline in the domestic capital formation ratio poses a serious threat to the ability of the country to strengthen its overall growth capacity.

The recent lacklustre performance of fixed investment has probably been related largely to a lack of investors' confidence, arising from uncertainties regarding future political developments, the incessant internal violence and unrest. Also very important was the high level of unutilised production capacity, the high rate of inflation, the low level of domestic demand and the recession experienced by many of South Africa's major trading partner countries. On top of this, exogenous shocks, such as the severe drought of 1992 and the substantial decline in international commodity prices from the middle of 1988, were not conducive to investment spending.

The slower rate of decline in real fixed investment in the first quarter of 1993 was partly the result of stepped-up capital formation by Eskom and smaller declines in real investment outlays by some of the other public corporations, resulting in an increase at an annualised rate of 1½ per cent in aggregate fixed investment of public corporations. The real capital outlays of general government also rose at an annualised rate of 3½ per cent for the second consecutive quarter. In addition, the rate of decline in the real fixed capital formation by the private sector

Real gross domestic fixed investment



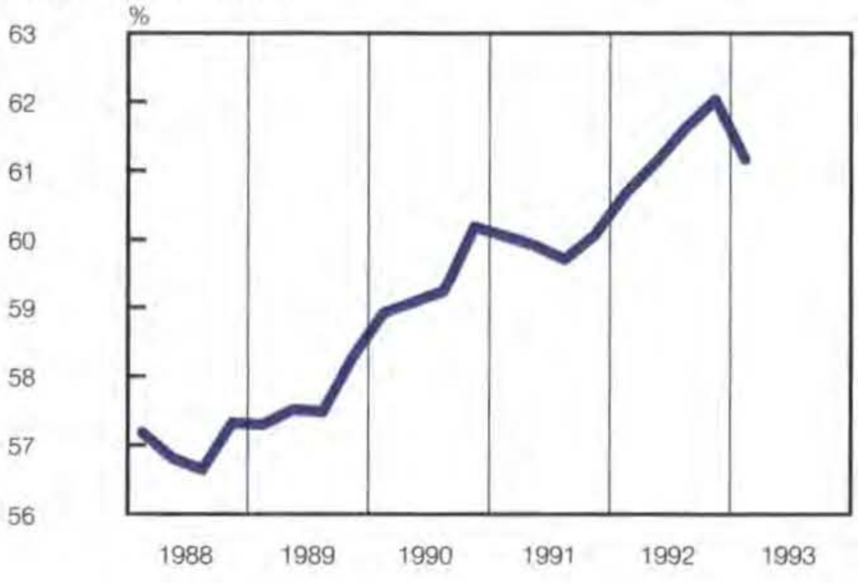
slowed down markedly from an annualised level of 6½ per cent in the fourth quarter of 1992 to slightly more than 3 per cent in the first quarter of 1993. Increases were even recorded in the fixed investment of agriculture, commerce and private residential buildings. However, fixed investment by private enterprises involved in mining, manufacturing, construction and finance continued to contract. Real capital formation by the public authorities also shrank again in the first quarter of 1993, after having registered a substantial increase in the previous quarter.

The increase in real investment in *inventories* in the first quarter of 1993 followed an almost uninterrupted drawing-down of stocks since the third quarter of 1989. The accumulation of inventories in the first quarter coincided with an increase in merchandise import volumes and a weaker demand for exports, owing to somewhat exceptional circumstances. The higher rates of inventory accumulation therefore occurred mainly in the mining, industrial and commercial sectors – more specifically in the wholesale and motor trade and in diamond stocks-in-trade. Despite the increase in industrial and commercial inventories, the ratio of these stocks to gross domestic product in the non-agricultural sectors of the economy in the first quarter of 1993 remained unchanged at the low level of 17 per cent which was reached in the fourth quarter of 1992.

Factor income
The growth in aggregate nominal factor income at market prices over a period of twelve months slowed down markedly from 14 per cent in the fourth quarter of 1991 to 8 per cent in both the fourth quarter of 1992 and the first quarter of 1993. The rate of increase in the first quarter of 1993 was well below the average annual rates of increase of 13 and 10 per cent recorded in 1991 and 1992, respectively. The lower increase in factor income in the first quarter of 1993 was the net result of a slower growth in aggregate labour remuneration and a sharper rise in total gross operating surplus.

The rate of increase in total nominal salaries and wages over a period of twelve months contracted from 16½ per cent in the fourth quarter of 1990 to 11½ per cent in the fourth quarter of 1992 and further to 10 per cent in the first quarter of 1993. A sectoral analysis shows that this slower growth in the total remuneration of employees was experienced in a number of sectors, but that it was particularly evident in the mining, manufacturing and commercial sectors. The slower growth in wage increases was brought about by more realistic demands by some trade unions because of the persistent decline in job opportunities. These developments led to a decline in the ratio of labour remuneration to gross domestic product from the high level of 62 per cent in the fourth quarter of 1992 to 61 per cent in the first quarter of 1993.

Labour remuneration as percentage of gross domestic product



The percentage change over one year in the gross operating surplus, which had receded from 14½ per cent in the fourth quarter of 1991 to a mere 3 per cent in the fourth quarter of 1992, rose quite substantially to 7½ per cent in the first quarter of 1993. This acceleration was mainly the result of strong rises in the operating surpluses of agriculture and mining. The operating surplus of agricultural undertakings obviously rose because of the improved weather conditions, while gold mines benefited from a rise in the rand price of gold, increased output volumes and the general sharp curtailment of costs in the industry. A number of companies involved in manufacturing, commerce and finance also reported improved financial results in the first quarter of 1993.

Domestic saving
The domestic savings ratio (i.e. the ratio of gross domestic saving to gross domestic product), which had decreased from nearly 24 per cent in the first quarter of 1990 to a low of 14½ per cent in the third quarter of 1992, improved slightly to 15½ per cent in both the fourth quarter of 1992 and the first quarter of 1993. These ratios can be compared with an average of 24½ per cent in the 1980s.

The low domestic savings ratios from 1991 onwards were mainly the result of substantial dissaving by general government. Total net dissaving by general government rose from R1,1 billion in 1990 to R8,6 billion in 1991 and R15,5 billion in 1992. In the first quarter of 1993 the seasonally adjusted and annualised rate of net dissaving by general government amounted to R16,0 billion. This further increase in the government's dissaving was brought about by a sharp rise in government current expenditure and only a moderate increase in government current revenue.

Gross domestic saving as percentage of gross domestic product

The recent improvement in the domestic savings ratio was therefore caused mainly by an increase in total private sector saving, and more specifically the saving of companies involved in mining and financial services. Net saving by the household sector remained depressed and the ratio of personal saving to personal disposable income receded from a high of 3 per cent in the first quarter of 1992 to 2 per cent in the first quarter of 1993.

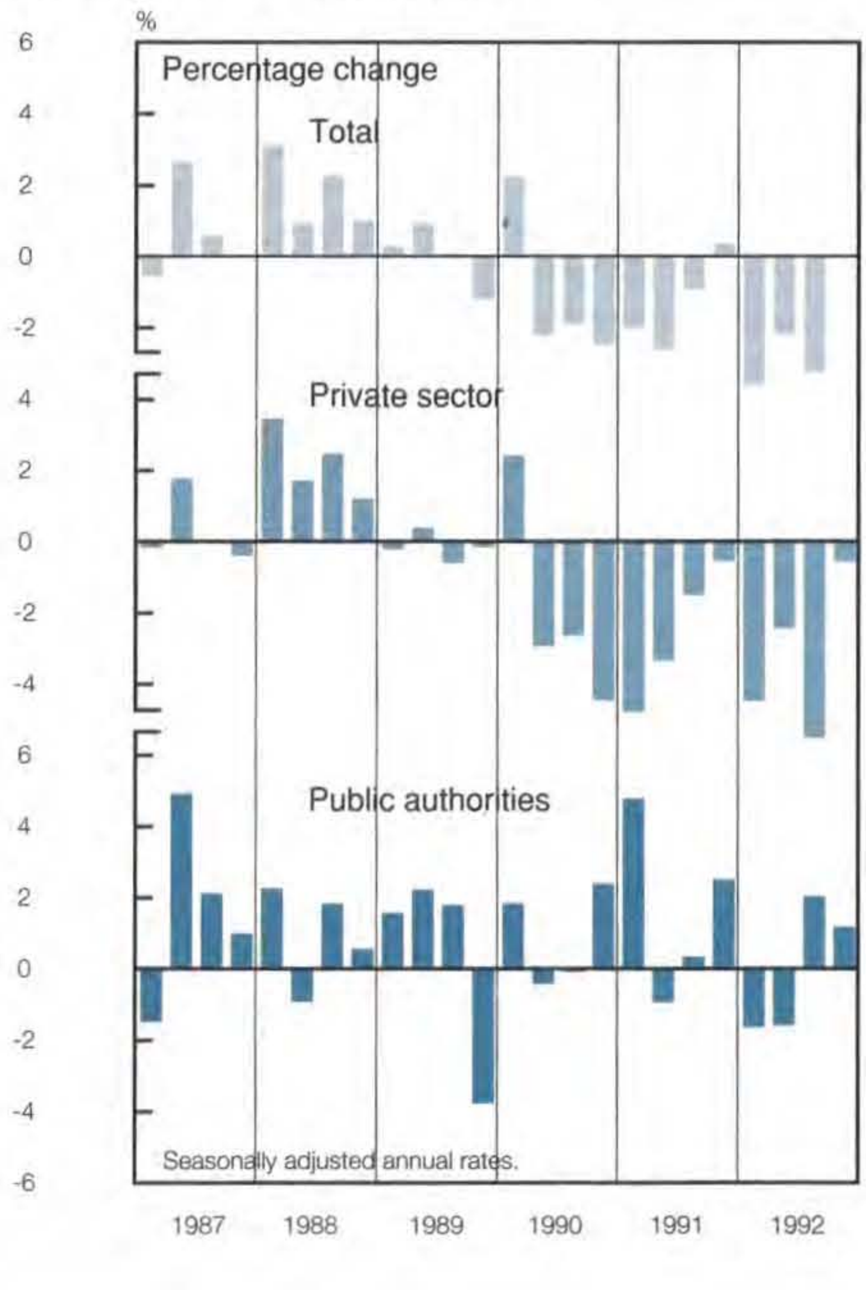
Employment

The long and later severe downturn in economic activity had a serious effect on employment in the formal sectors of the economy. *Total employment* in the non-agricultural economic sectors started to decline from the fourth quarter of 1989 and then decreased in almost every subsequent calendar quarter up to the fourth quarter of 1992. In 1992 total employment decreased very rapidly at seasonally adjusted and annualised rates of 3,7, 2,2 and 3,3 per cent in the first three quarters of the year, respectively; a sharp slowdown in personnel reductions in the private sector and an increase in employment by public authorities then caused employment to decline only slightly at a rate of 0,1 per cent in the fourth quarter.

For the year 1992 as a whole total employment in the non-agricultural sectors of the economy decreased by 2,0 per cent, i.e. at the same rate as in the preceding year and at a considerably higher rate than the decline of 0,5 per cent in 1990. Since the start of the downturn in total employment, the employment in the formal sectors of the economy, excluding agriculture, had decreased by 5,3 per cent (involving about 288 000 persons) up to the fourth quarter of 1992. At the same time, new job-seekers entered the labour market at a rate of approximately 300 000 persons per year. This means that an additional number of about 1,5 million people were unable to find employment in the formal non-agricultural sectors of the economy since the beginning of the recession.

Labour retrenchments in the *private sector* were particularly responsible for the contraction in employment opportunities. Employment in the private sector decreased at rates of 0,7 and 3,4 per cent in 1990 and 1991 and at a rate of 2,9 per cent in 1992. However, in the fourth quarter of 1992 employment in the private sector declined at a seasonally adjusted and annualised rate of only 0,6 per cent, against rates of 4,5, 2,5 and 5,6 per cent in the first three quarters of the year. This sharp slowdown was due mainly to increased employment in manufacturing, wholesale

Non-agricultural employment

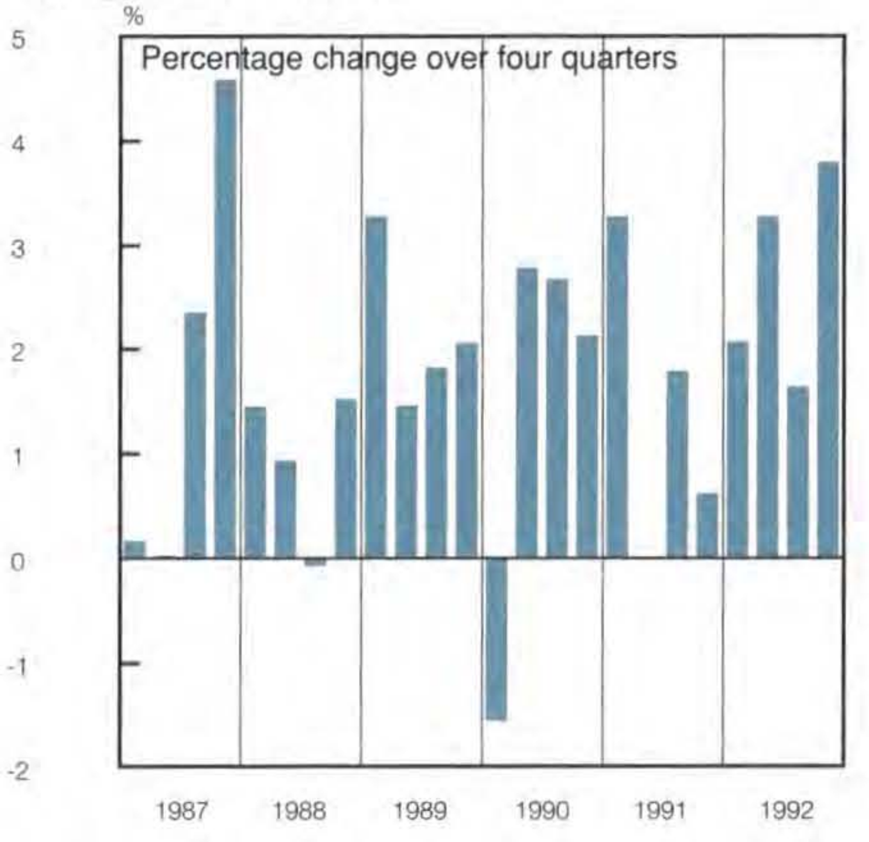


and retail trade, and the insurance industry, while a significantly lower rate of staff reductions was recorded in the mining industry.

The average level of employment by the *public authorities* in 1992 remained almost unchanged from the level that has been reached in the preceding year, after having grown by 0,1 per cent in 1990 and by 1,6 per cent in 1991. Quarterly changes in 1992 were, however, relatively volatile: decreases at seasonally adjusted and annualised rates of 1,7 and 1,6 per cent in the first two quarters of the year were followed by increases at rates of 2,0 and 1,2 per cent in the last two quarters.

In accordance with the decline in total employment, the seasonally adjusted number of *registered unemployed workers* has increased sharply since the beginning of the current cyclical downswing. The average level of registered unemployed workers during 1992 was as much as 16,2 per cent higher than the average of 1991. In January 1993 the total number of registered unemployed persons amounted to almost 300 000.

Real remuneration per employee in non-agricultural sectors



Labour costs and productivity

Partly because the retrenched workers consisted mainly of lower-paid wage and salary-earners, the rate of increase in the average monthly *remuneration of employees* per worker remained at relatively high levels, despite more moderate wage settlements between employers and labour unions. The rate of increase in the average monthly *nominal* salaries and wages per worker declined only moderately from a recent high of 18,0 per cent in 1989 to 15,8 and 15,3 per cent in 1991 and 1992. The year-on-year rate of increase in nominal wages per worker in the non-agricultural sectors of the economy also declined only moderately from a peak of 19,1 per cent in the fourth quarter of 1989 to 14,9 per cent in the fourth quarter of 1992. The recession and the consequent growth of unemployment have therefore not exerted any significant moderating influence on the average remuneration of workers still employed in the formal sectors of the economy.

This is also evident in the growth of the average monthly nominal salaries and wages per worker in the non-agricultural *private sector*, which slowed down only slightly from 16,6 per cent in 1990 to 14,8 and 15,1 per cent in the next two years. The quarterly year-on-year rate of increase in nominal remuneration per worker in the private sector generally continued to fluctuate around 15 per cent in the current recession and amounted to 15,3 per cent in the fourth quarter of 1992.

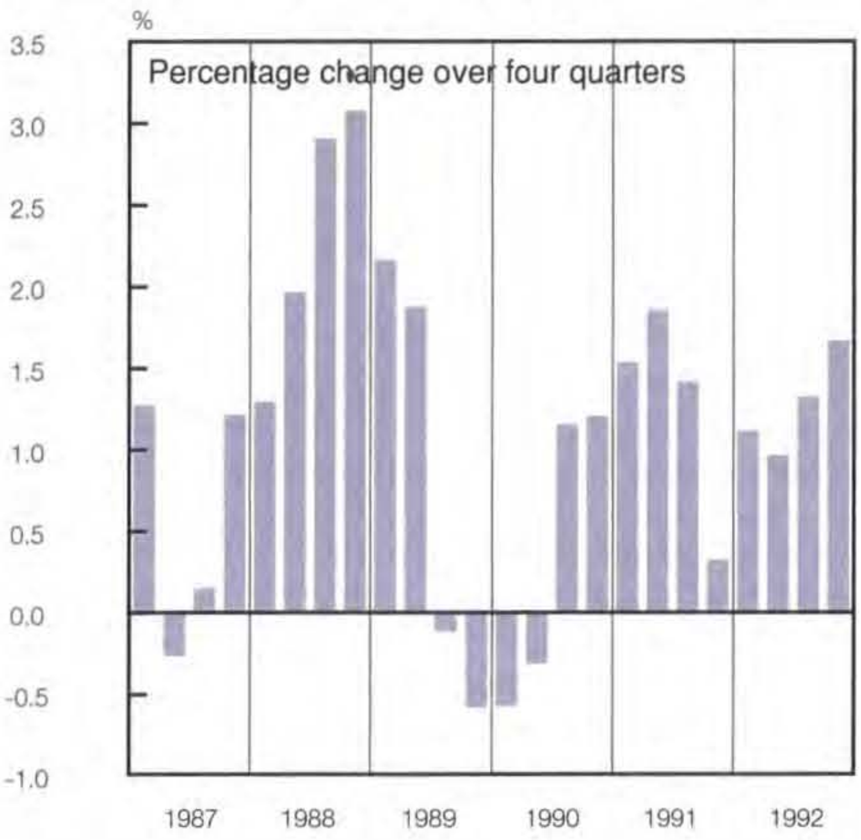
Although the rate of increase in the nominal salaries and wages per worker employed by *public authorities* declined more markedly from a high point of 21,9 per cent in 1989 to 15,4 per cent in 1992, the rate of increase in wages is still relatively high given the state of the economy. More recently, however, the year-on-year rate of increase in the nominal salaries and wages per worker employed by public authorities declined from 18,7 per cent in the fourth quarter of 1991 to 13,7 per cent in the fourth quarter of 1992.

In view of these continuous high rates of increase in the average nominal wages per employed worker along with lower rates of price increases, the rate of increase in the *real wage per worker* (as deflated by the price deflator for the non-agricultural gross domestic product) accelerated sharply from 1,4 per cent in 1991 to 2,7 per cent in 1992. With the exception of the first quarter of 1990, the real wage per worker has increased in every calendar quarter since the start of the current recession. Moreover, in the fourth quarter of 1992 the year-on-year rate of increase in the real remuneration per worker amounted to no less than 3,8 per cent; in the first three quarters of that year it had fluctuated between 1½ and 3 per cent.

The significant reduction of employment opportunities in the formal sectors of the economy, rather than an improved sense of diligence among workers, led to an improvement in *labour productivity*. The rate of increase in the observed real production per worker rose from 0,4 per cent in 1990 to 1,3 per cent in 1991 and 1992. After having declined from 1,9 per cent in the second quarter of 1991 to 0,3 per cent in the fourth quarter of 1991, the year-on-year rate of increase in labour productivity rose again to 1,7 per cent in the fourth quarter of 1992.

The rise in labour productivity caused the rate of increase in *real unit labour costs* (as deflated by the

Non-agricultural labour productivity

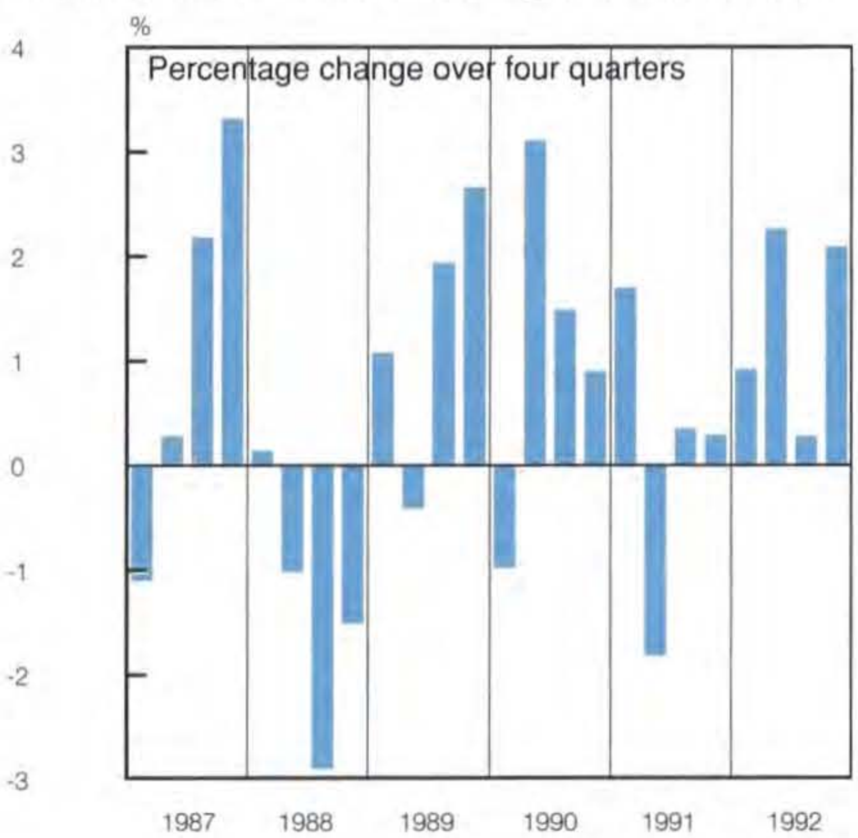


price deflator for the non-agricultural gross domestic product) to decline at first from 1,4 per cent in 1989 to 0,1 per cent in 1991. Later the rate of change in real unit labour costs accelerated again to 1,4 per cent in 1992 because of the more rapid increase in the real wage per worker during this period. The year-on-year rate of increase in the real labour costs per unit of physical output accelerated from 0,3 per cent in the fourth quarter of 1991 to 2,3 per cent in the second quarter of 1992; it then declined briefly to only 0,3 per cent in the third quarter before rising again to 2,1 per cent in the fourth quarter of 1992. Real unit labour costs, as measured over a period of four quarters, recorded positive growth rates in almost every quarter since the start of the current cyclical downswing. This inevitably contributed not only to the retrenchment of workers, but also resulted in a strong upward bias in production costs and prices.

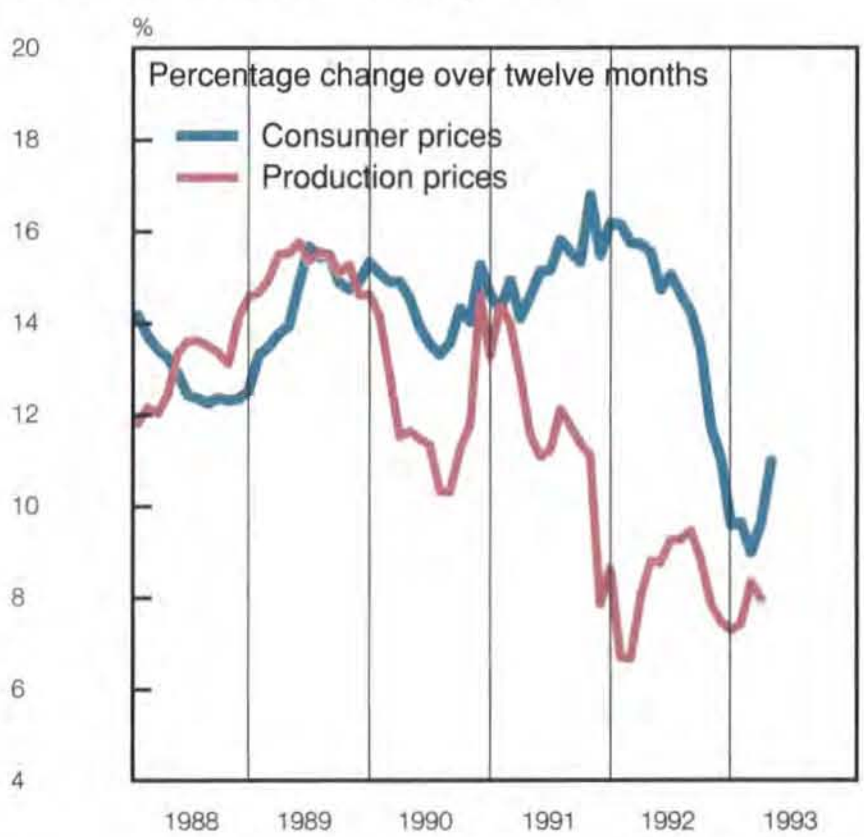
Prices

Despite the upward pressure of rising labour costs on prices, the rate of inflation slowed down markedly throughout 1992 and the first three months of 1993. The rate of increase in the all-goods *production price index* actually declined from 15,2 per cent in 1989 to a single-digit figure of 8,3 per cent in 1992 – this was the first annual single-digit rate of increase in this index since 1984. The rate of increase in production prices, measured over periods of twelve months, has maintained single-digit levels since November 1991, but accelerated recently from a low point of 6,7 per cent in January and February 1992 to 9,5 per cent in August; it then declined to 7,3 per cent in December before increasing again to 8,3 per cent in February and 8,0 per cent in March 1993. This rise in production

Real unit labour costs in non-agricultural sectors



Production and consumer prices



Percentage changes in production prices

	Domestically produced goods	Imported goods	All goods
1989	14,9	16,3	15,2
1990	12,5	10,1	12,0
1991	12,1	8,3	11,4
1992	9,1	4,2	8,3
Quarterly*			
1992			
1st quarter	4,9	-0,5	4,4
2nd quarter	11,9	10,1	11,0
3rd quarter	11,5	15,3	12,5
4th quarter	4,5	-10,1	1,4
1993			
1st quarter	6,5	4,3	6,4

* Compared with the preceding quarter at seasonally adjusted and annualised rates.

Percentage changes in consumer prices

	Goods	Services	Total
1989	5,2	13,6	14,7
1990	15,5	12,2	14,4
1991	17,0	12,6	15,3
1992	16,3	11,2	13,9
Quarterly*			
1992			
1st quarter	14,8	9,8	13,0
2nd quarter	15,3	11,4	12,7
3rd quarter	16,4	7,8	12,2
4th quarter	6,7	0,4	4,7
1993			
1st quarter	8,0	6,2	8,2

* Compared with the preceding quarter at seasonally adjusted and annualised rates.

prices was due mainly to a corresponding acceleration in the rate of increase in the prices of imported goods over periods of twelve months from negative levels of 1,9 and 0,9 per cent in the first two months of 1992 to a positive 5,6 per cent in March 1993. The rate of inflation in the prices of domestically produced goods, on the other hand, decreased from a recent high of 10,3 per cent in August 1992 to 8,5 per cent in March 1993.

In contrast with these developments in production prices, the rate of increase in the overall *consumer price index* initially accelerated from 14,4 per cent in 1990 to 15,3 per cent in 1991 before declining to 13,9 per cent in 1992. The initial wide divergence between production and consumer price inflation was due mainly to factors such as higher wage increases in the trade sector than in manufacturing, high increases in the prices of food, the manner in which a new weighting structure for the consumer price index was implemented, low increases in the prices of imported goods, sharp rises in the consumer prices of services and the introduction of the value-added tax in October 1991. Because of the many upward pressures on prices at retail level, the twelve-month rate of increase in the overall consumer price index only reached a high point of 16,8 per cent in October 1991 – eleven months after the peak in production price inflation. The rate of increase in consumer prices then declined to only 9,0 per cent in February 1993 – the lowest rate of increase since June 1978 when a rate of 8,2 per cent was recorded.

These lower inflation rates can to some extent be ascribed to the weakness of aggregate domestic demand, lower rates of increase in food prices, and a lowering of interest rates, particularly rates on mortgage bonds. More importantly, they also reflected a structural downward adjustment in price increases in response to a consistent monetary policy aimed at bringing down the rate of growth in the money supply. However, certain factors recently started to exert upward pressure on consumer prices again, such as the sharp depreciation of the rand against most of the major currencies and increases in education fees and indirect taxes. In March 1993 the rate of increase in the overall consumer price index, measured over a period of twelve months, accelerated to 9,7 per cent owing mainly to a sharp increase in the costs of educational services included in the index for this month. If the rise in the cost of education is not taken into account, consumer prices would have risen by only 8,5 per cent over the twelve months to March 1993. This was followed by a further rise to 11,0 per cent in consumer prices in April 1993 because of the introduction of a 4 percentage point increase in the value-added tax rate, increases in other indirect taxes and an increase in the price of petrol. However, this upward movement in prices should be transitory, provided that these movements do not fuel expectations of accelerating inflation.

Foreign trade and payments

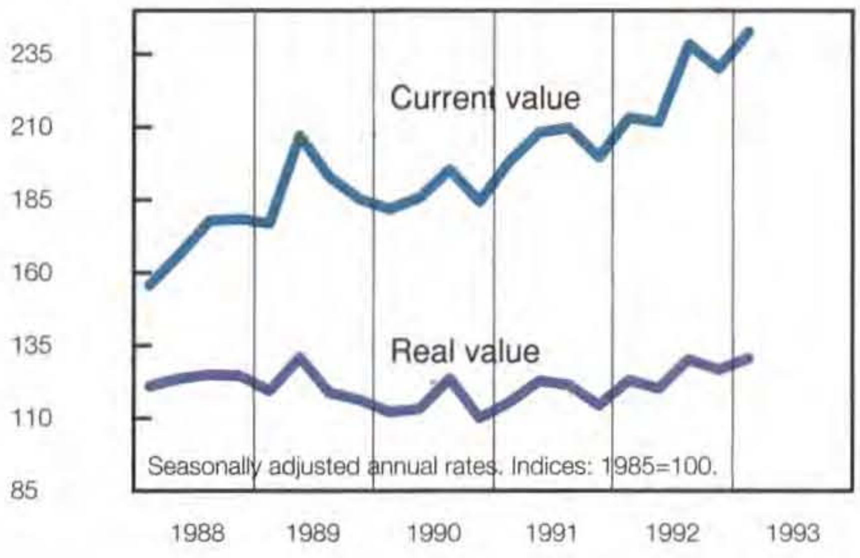
Current account balance

The *surplus on the current account* of the balance of payments (seasonally adjusted and annualised), which had declined from R5,4 billion in the first half of 1992 to R2,5 billion in the second half, deteriorated substantially to only R0,7 billion in the first quarter of 1993. In contrast with the last half of 1992, this sharp decrease in the current account surplus cannot be attributed to poor agricultural conditions; in fact, the imports of agricultural products decreased and the exports of agricultural products increased in the first quarter of 1993 compared with the fourth quarter of 1992. The smaller surplus on the current account of the balance of payments was the net result of an increase in non-agricultural merchandise imports and a decrease in non-agricultural exports, which more than neutralised the higher value of net gold exports and a decrease in net service and transfer payments to the rest of the world.

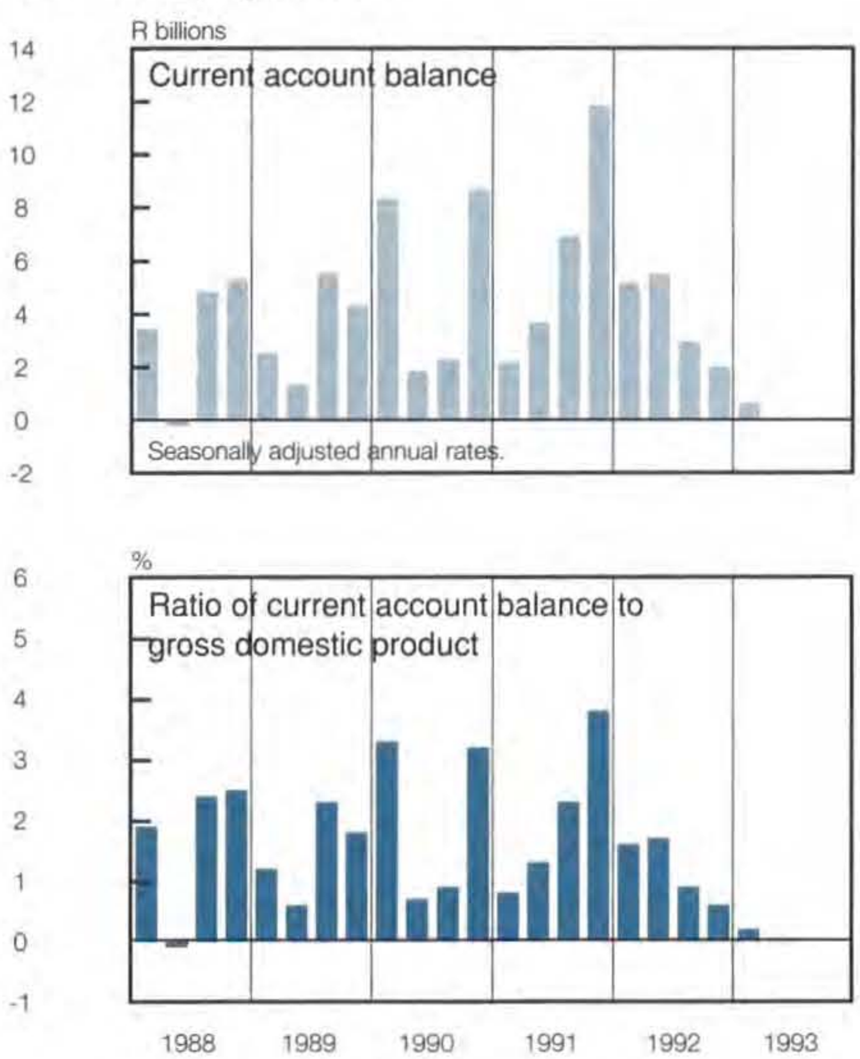
Taken at a seasonally adjusted and annualised rate, the value of *merchandise imports* increased from R53,4 billion in the fourth quarter of 1992 to R56,4 billion in the first quarter of 1993, or by 5½ per cent. If agricultural imports are excluded, the value of other merchandise imports rose by no less than 9 per cent in the first quarter of 1993. This sharp rise in the value of imports was due to increases in both the prices and the volume of imported goods. Despite a sharp depreciation of the rand, import prices rose by only 2½ per cent in the first quarter of 1993. This relatively small rise in import prices was brought about mainly by a decline in international oil prices. At the same time, the lower oil prices encouraged a substantial increase in the volume of oil imports, which contributed significantly to a rise of 3 per cent in the total volume of merchandise imports from the fourth quarter of 1992 to the first quarter of 1993. If the imports of agricultural and mineral products are left out of account, it is estimated that the volume of other imports decreased by about 6 per cent in the first quarter of 1993.

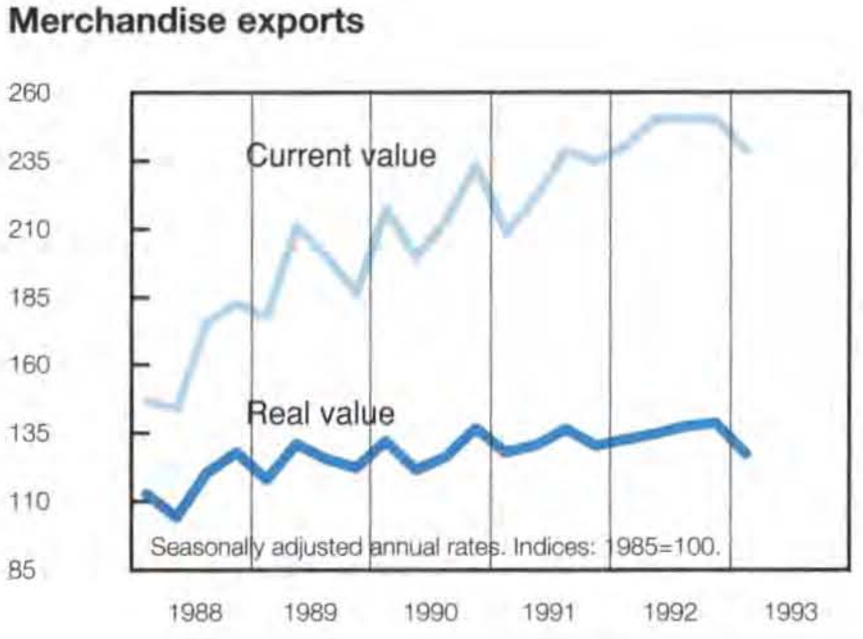
A substantial decline of 8 per cent in the volume of exports was responsible for a decrease of 4½ per cent in the value of *merchandise exports* in the first quarter of 1993. Although declines were recorded in most of the major export categories, with the notable exception of agricultural products, particularly large decreases occurred in the exports of ferro-chrome, copper, wool, sugar and manufactured goods. The volume of merchandise exports as a ratio of gross domestic product therefore declined from 21½ per cent in the fourth quarter of 1992 to 19½ per cent in the first quarter of 1993. This poor export performance in the first quarter of 1993 was probably related to continued subdued economic conditions in the major industrialised countries and the oversupply of many metals and minerals on international markets. However, on a monthly basis the seasonally adjusted and annualised value of merchandise exports

Merchandise imports



Balance of payments





increased from a low of R44,8 billion in January 1993 to R63,9 billion in April, implying that the volume of exports also rose sharply from February to April 1993.

The average price level of merchandise exports increased by 4 per cent from the fourth quarter of 1992 to the first quarter of 1993. This sharp rise in the rand price of exports was partly the result of a moderate increase in international commodity prices. More importantly, export prices rose owing to a decline in the nominal effective exchange rate of the rand, which averaged about 2½ per cent in the first quarter of 1993.

The value of *net gold exports*, seasonally adjusted and annualised, which had declined from R20,4 billion in the third quarter of 1992 to R18,2 billion in the fourth quarter, increased to R21,1 billion in the first quarter of 1993. This sharp rise was the combined result of price and volume increases. The volume of net gold exports rose by 6½ per cent in the first quarter of 1993, mainly on account of a higher grade of ore milled. Although the gold price per fine ounce fell back from US$338 in the fourth quarter of 1992 to $329 in the first quarter of 1993, the average fixing price in rand per fine ounce rose from R1 002 to R1 029 over the same period because of the depreciation of the rand against the US dollar. Increased inflationary expectations, a weaker US dollar and a strong demand in the Far East for gold then caused the gold price to strengthen considerably from the beginning of April; it averaged $342 or R1 084 per fine ounce in April 1993 and $366 or R1 162 in May 1993, and traded at $379 on 31 May 1993.

Net service and transfer payments to non-residents, at a seasonally adjusted and annualised rate, contracted from an abnormally high level of R12,2 billion in the fourth quarter of 1992 to R11,2 billion in the first quarter of 1993. This improvement was the result of a decrease of R0,6 billion in service payments and an increase of R0,4 billion in service receipts. More particularly, it resulted from lower expenditure by South Africans travelling abroad and higher dividend income on investments in other countries.

Capital account

The capital account of the balance of payments, which had deteriorated substantially in the second half of 1992, showed a further *large capital outflow* in the first quarter of 1993. The total net capital outflow not related to reserves increased from an already high level of R3,5 billion in the fourth quarter of 1992 to R3,7 billion in the first quarter of 1993 – its highest level since the fourth quarter of 1991 and roughly more than twice as large as the quarterly average outflow of R1,6 billion recorded during 1992.

The net outflow of *short-term capital* (including unrecorded transactions, but excluding reserve-related liabilities) amounted to R3,5 billion in the first quarter of

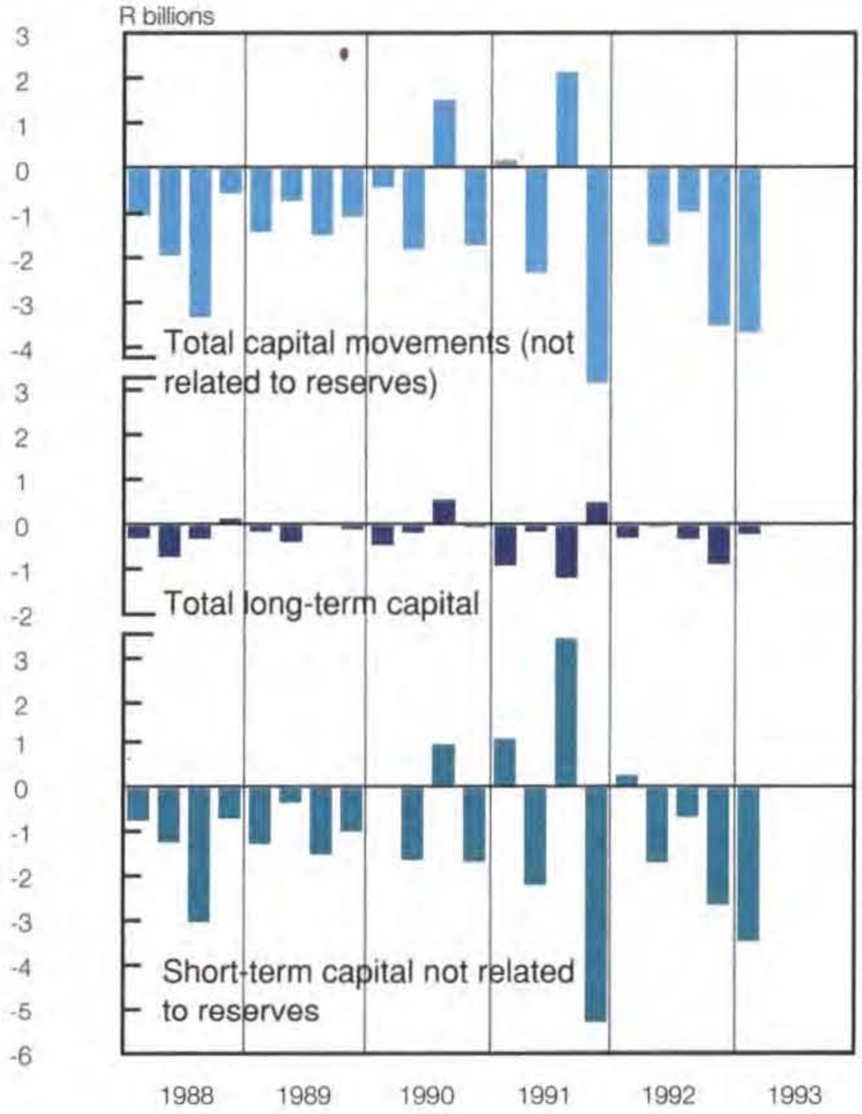
Balance of payments on current account

Seasonally adjusted annual rates

R billions

	1992					1993
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr
Merchandise exports	47,5	49,6	49,5	49,4	49,0	47,2
Net gold exports	18,1	16,7	20,4	18,2	18,4	21,1
Merchandise imports	–49,5	–49,2	–55,4	–53,4	–51,9	–56,4
Net service and transfer payments	–10,9	–11,6	–11,5	–12,2	–11,6	–11,2
Balance on current account	**5,2**	**5,5**	**3,0**	**2,0**	**3,9**	**0,7**

Net capital movements



1993; in the fourth quarter of 1992 the net outflow of short-term funds had amounted to R2,6 billion. Unfavourable leads and lags in foreign payments and receipts, the relatively low cost and ready availability of domestic trade financing and ongoing political and social uncertainty, continued to favour a decrease in the short-term foreign liabilities of the country.

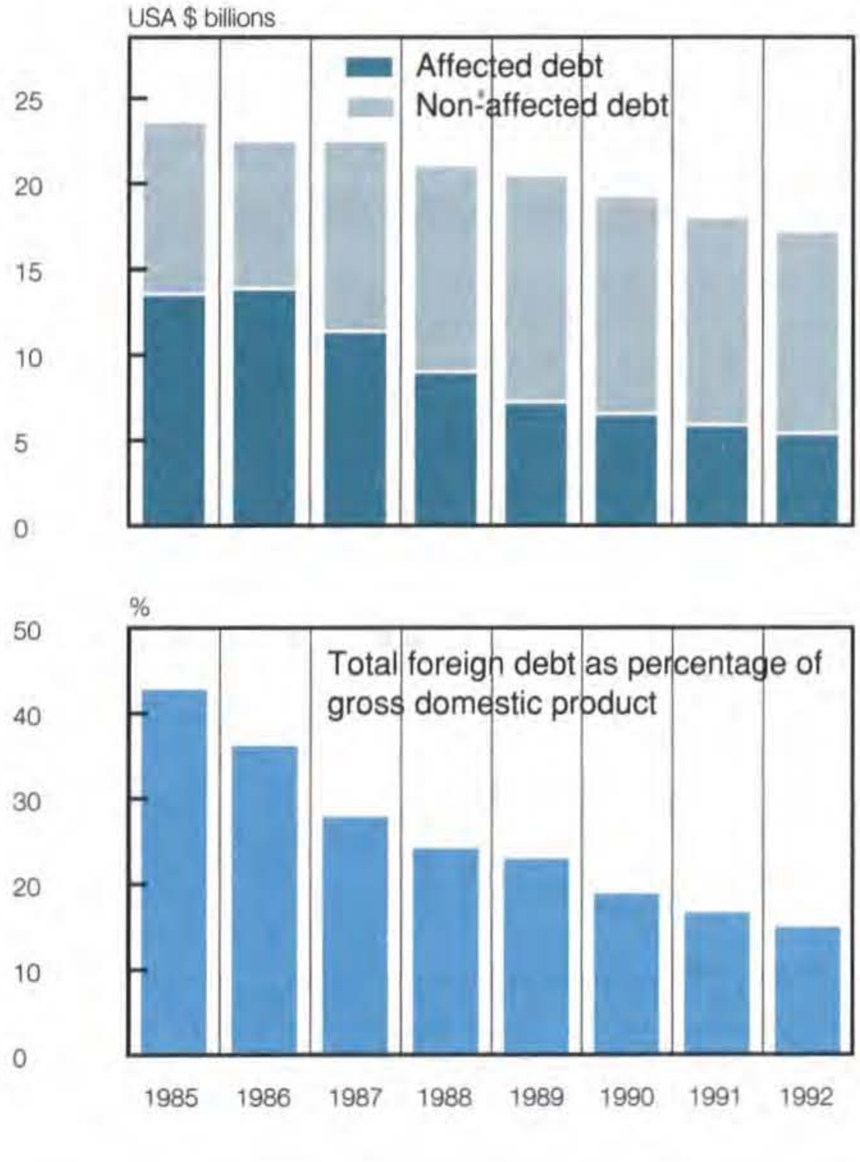
The net outflow of *long-term capital* contracted from R0,9 billion in the fourth quarter of 1992 to R0,2 billion in the first quarter of 1993. This outflow was due mainly to the repayment of R550 million to foreign creditors in terms of the Third Interim Debt Arrangements in February 1993 and the redemption of bearer bonds and notes to the amount of R600 million in March. Net purchases by non-residents of securities listed on the Johannesburg Stock Exchange were partly responsible for a registered net inflow of long-term capital of R0,4 billion in the first quarter of 1993. (These purchases are recorded on a gross basis in the balance of payments and do not represent an actual rise of foreign reserves because they are offset by contra-entries against other items of the capital account.)

Foreign debt

As a result of the continued net repayments on South Africa's foreign liabilities, the *total outstanding debt* of the country declined further from US$18,1 billion at the end of 1991 to $17,3 billion at the end of 1992. Valued at the exchange rates of the US dollar at 31 August 1985, South Africa's foreign debt has been reduced from $23,7 billion at the beginning of the standstill arrangements to $15,8 billion at the end of 1992. Foreign debt as a ratio of gross domestic product amounted to just more than 15 per cent at the end of 1992; this ratio came to almost 43 per cent at the end of 1985.

The so-called *affected foreign debt* also decreased further from $6,0 billion at the end of 1991 to $5,5 billion at the end of 1992. Valued at the exchange rates of 31 August 1985, the affected debt was reduced by $8,5 billion from the beginning of the standstill arrangements to the end of 1992. No less than $3,5 billion has been repaid on affected debt in terms of the interim debt arrangements concluded with foreign creditor banks. The rest of the reduction in affected debt was brought about by conversions to longer-term loans falling outside the net and by debt-equity swaps.

Total foreign debt



South Africa's *non-affected debt* also declined, viz from \$12,1 billion at the end of 1991 to \$11,8 billion at the end of 1992. However, valued at the exchange rates prevailing on 31 August 1985, the non-affected debt increased from \$10,1 billion at the end of August 1985 to \$10,7 billion at the end of 1992.

Foreign reserves

The large net outflow of capital not related to reserves and the small surplus on the current account of the balance of payments caused South Africa's total *net gold and other foreign reserves* to decline by R3,3 billion in the first quarter of 1993 – slightly more than the decrease of R3,1 billion recorded in the fourth quarter of 1992. Taking into account an increase of R1,1 billion in South Africa's reserve-related liabilities and positive valuation adjustments of R0,5 billion, the total *gross gold and other foreign reserves* declined by R1,7 billion in the first quarter of 1993.

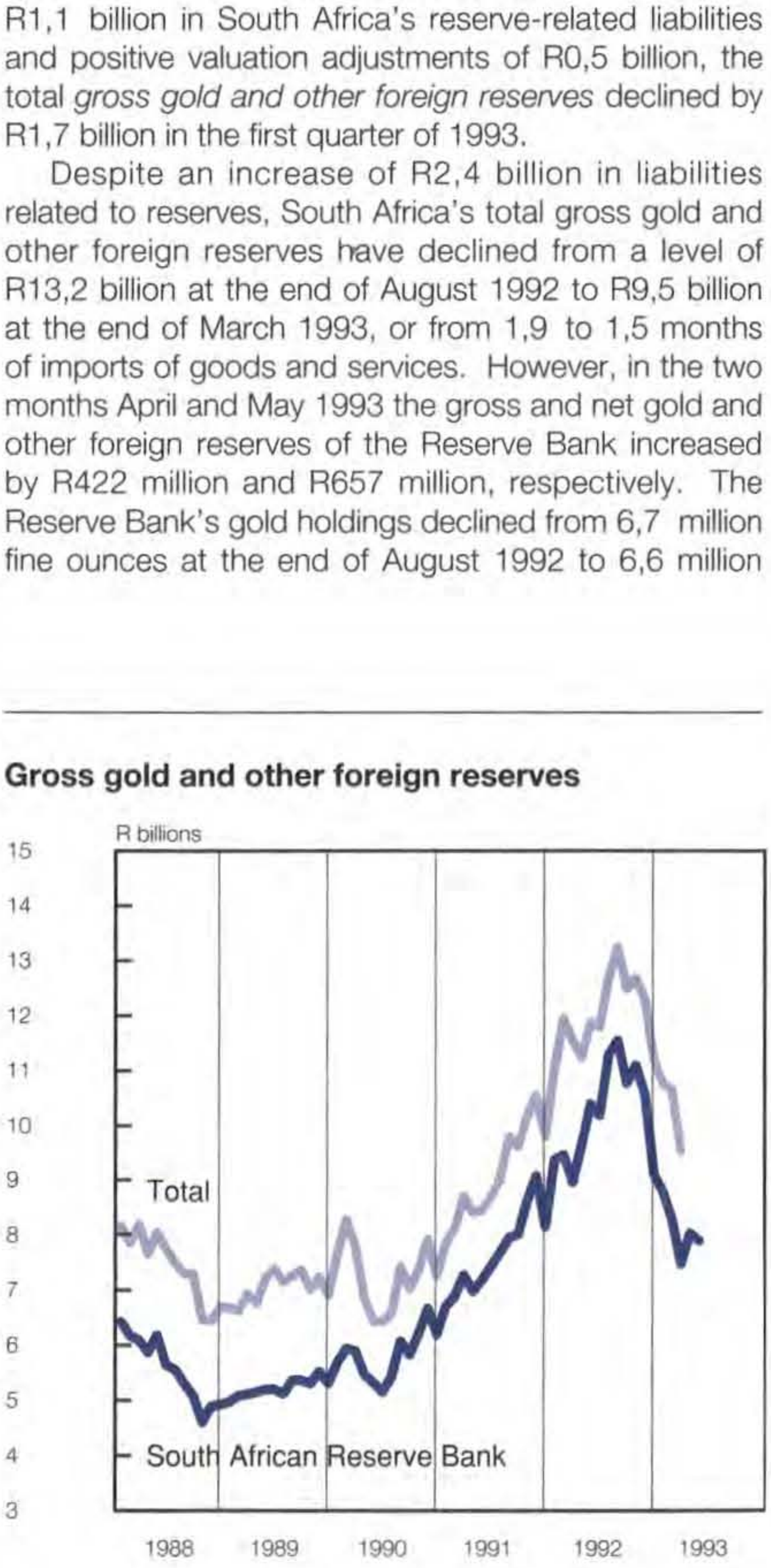
Despite an increase of R2,4 billion in liabilities related to reserves, South Africa's total gross gold and other foreign reserves have declined from a level of R13,2 billion at the end of August 1992 to R9,5 billion at the end of March 1993, or from 1,9 to 1,5 months of imports of goods and services. However, in the two months April and May 1993 the gross and net gold and other foreign reserves of the Reserve Bank increased by R422 million and R657 million, respectively. The Reserve Bank's gold holdings declined from 6,7 million fine ounces at the end of August 1992 to 6,6 million fine ounces at the end of 1992 and to 5,2 million fine ounces at the end of May 1993.

Exchange rates

Owing to the weaker overall balance of payments position and the strong performance of the US dollar on international exchange markets up to the middle of February 1993, the *nominal effective exchange rate of the rand* declined by 3,8 per cent during the first quarter of 1993 and by a further 2,2 per cent to the end of May 1993. Although the rand depreciated moderately against most of the major currencies during this period, substantial declines of 6,2 per cent and 17,2 per cent were recorded against the British pound and Japanese yen, respectively. The *real effective exchange rate of the rand* decreased by 2,8 per cent during the first quarter of 1993.

As in the past, developments in the exchange rate of the *financial rand* were again very sensitive to the political situation in South Africa. After having appreciated by 7,0 per cent in the first quarter of 1993 with the increased foreign interest in South African gold-mining shares, the exchange rate of the financial rand depreciated again by 8 per cent from 10 to 19 April 1993 because of the assassination of Mr Chris Hani and subsequent events. It then recovered in April before depreciating, on balance, in May. In the first five months of 1993 the financial rand appreciated by 5,7 per cent against the US dollar, and the discount on the financial rand narrowed from 37,2 per cent at the end of December 1992 to 31,0 per cent on 31 May 1993.

Gross gold and other foreign reserves



Changes in exchange rates of the rand

%

	31 Dec '91 to 31 Dec '92	31 Dec '92 to 31 Mar '93	31 Mar '93 to 31 May '93	31 Dec '92 to 31 May '93
Weighted average	–4,3	–3,8	–2,2	–6,0
US dollar	–10,2	–3,9	0,2	–3,7
British pound	10,9	–2,6	–3,7	–6,2
German mark ...	–4,4	–3,4	–1,2	–4,6
Japanese yen ...	–10,8	–10,0	–8,0	–17,2
Netherlands guilder	–4,7	–3,3	–1,5	–4,7
Italian lira	15,2	5,3	–8,6	–3,8
Financial rand ...	–34,7	7,0	–1,3	5,7

Financial markets

Changes in financial structure

Important legislative and regulatory changes were made to the operations of the financial sector in the beginning of 1993. These changes *inter alia* included:

- the renaming of deposit-taking institutions as banks;
- the transfer of the provisions relating to the banks' minimum reserve balance with the Reserve Bank from the Banks Act to the South African Reserve Bank Act;
- the introduction of a new basis for the calculation of the minimum reserve balance and liquid-asset requirements;
- the removal of the liquid-asset status of bankers' acceptances;
- a revision of the system of accommodation provided by the Reserve Bank; and
- considerable progress with the implementation of a system of Tax and Loan Accounts.

The Deposit-taking Institutions Amendment Act, No 9 of 1993, which was gazetted on 10 March 1993, changed the term "deposit-taking institutions" (the collective term for the former banks, discount houses and equity building societies) to banks. As a result, the Deposit-taking Institutions Act, No 94 of 1990, was also renamed the Banks Act. The Amendment Act also repealed the provisions relating to the maintenance by banks of a minimum reserve balance with the Reserve Bank; but at the same time the South African Reserve Bank Act, No 90 of 1989, was amended to incorporate the provisions relating to banks' minimum reserve balances with the Reserve Bank. The minimum reserve requirements of the banks were transferred to the Reserve Bank Act because these provisions are regarded as serving as a monetary policy instrument. Future changes in these requirements may therefore be interpreted more unambiguously as representing changes in the stance of monetary policy.

The calculation of the minimum reserve balance and liquid asset requirements was changed to a fixed proportion of the value of *total* liabilities of the banks as from the reporting date relating to March 1993 (i.e. fifteen business days after the end of the month). These requirements were previously based on the value of short-term liabilities of the banks. In order to assist certain banks whose short-term liabilities are smaller than their longer-term liabilities, it was decided that the change in the calculation of the minimum reserve balance requirement (excluding the additional reserve requirement of one percentage point on which interest is earned) will be phased in over fifteen months. The basic requirement was reduced from 4 per cent of short-term liabilities in February 1993 to 3 per cent of short-term liabilities in March 1993, followed by the phasing-in by 0,1 percentage point per month to 1,5 per cent of total liabilities in July 1994. The immediate effect of this phasing-in of requirements was a reduction in the required minimum reserve balances of the banks with the Reserve Bank by about R1,0 billion on 26 April 1993 (i.e. the fifteenth business day in April 1993). This obviously had an expansionary effect on money market liquidity (although to a lesser extent than the decrease in the reserve balance requirement because the vault cash holdings of some banks exceeded their minimum reserve requirement) and also contributed to a significant decline in the so-called monetary base (MO) in April.

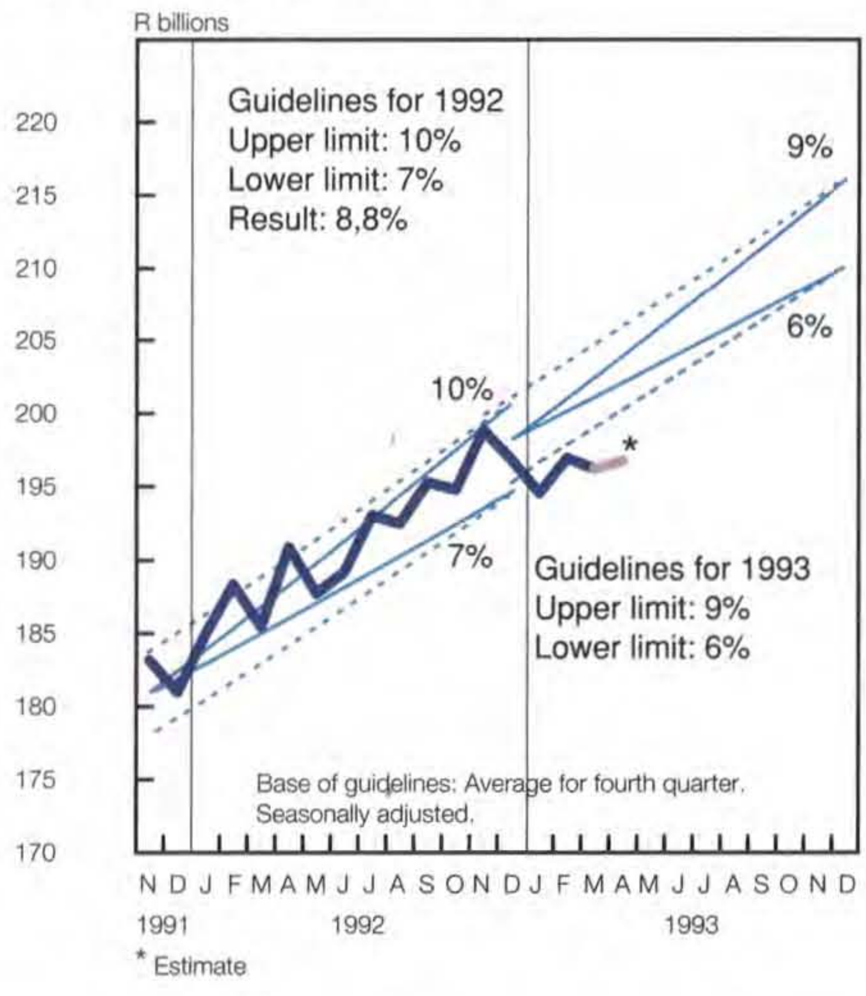
The liquid asset requirement of 20 per cent of short-term liabilities of the banks was changed to 5 per cent of total liabilities, with effect from the fifteenth business day in April 1993 and without a phasing-in period. In terms of the Deposit-taking Institutions Amendment Act, bankers' acceptances no longer fall within the ambit of the definition of liquid assets and the Reserve Bank announced that from 1 May 1993 bankers' acceptances would no longer be rediscounted at the discount window.

Moreover, the Reserve Bank introduced a simplified system of accommodating cash shortages in the money market with effect from 1 May 1993. The former system of rediscounting certain approved assets was replaced by a system of overnight loans against the collateral of government stock, Treasury bills, Reserve Bank bills and Land Bank bills with an outstanding maturity of less than 92 days, at Bank rate. A second category of these securities, with a maturity of 92 days and longer, but shorter than three years, qualifies as collateral for overnight loans at a rate of one percentage point above Bank rate. Accommodation against collateral of other forms of security, such as bank-endorsed bills and long-term government stock, will be made available only in exceptional circumstances, at a discretionary or negotiated rate and for a limited period. In view of the exclusion of bankers' acceptances as acceptable collateral for overnight loans, the Reserve Bank deliberately reduced the money market shortage at the beginning of May so as to assist the banks in adjusting to the new system. The change from a system of rediscounting to a system of overnight loans for accommodating money market shortages also effectively reduced the effective minimum cost of accommodation by 0,5 per cent per annum from 1 May 1993, although the official Bank rate remained unchanged.

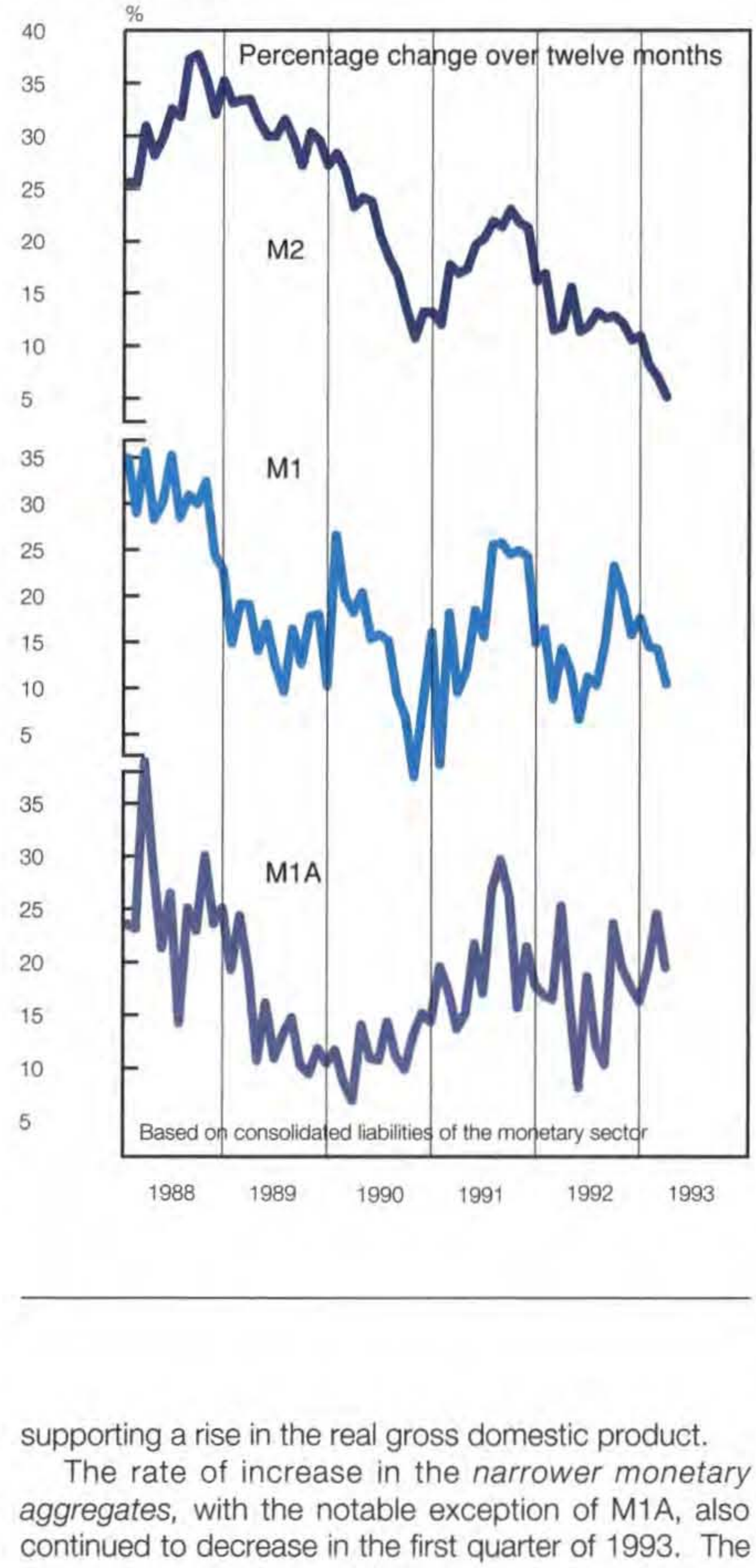
Money supply

The growth in the major monetary aggregates receded further during the first quarter of 1993. The rate of increase in the money supply, which had remained well within the money supply guidelines for 1992, actually declined further to below the lower limit of the new money supply guidelines in the beginning of 1993. The

Guidelines for growth in M3



Money supply



further slow-down in the growth of the monetary aggregates could be attributed mainly to the depressed domestic economic conditions, the relatively restrictive monetary policy stance, and the weakening in the overall balance of payments position of the country. Some disintermediation, induced by relatively wide margins between banks' deposit and lending rates, and the consolidation of some clients' deposits and borrowings under flexible mortgage facilities, may also have depressed money supply growth.

After having declined on balance from 12,7 per cent in December 1991 to 8,0 per cent in December 1992, the twelve-month growth rate of the broadly defined money supply (M3) decreased even further to 5,3 per cent in January 1993 and 5,2 per cent in February, but then increased slightly to 5,7 per cent in March 1993. Preliminary estimates for April 1993 indicate that the growth in M3 over twelve months then decreased to the low level of 3,4 per cent. These rates of increase were well below the lower limit of the money supply guidelines for the growth in M3 in 1993, which had been set on 8 February 1993 at a level ranging from 6 to 9 per cent for the period from the fourth quarter of 1992 to the fourth quarter of 1993. These guidelines conform to the Reserve Bank's objective of reducing the rate of inflation further, while at the same time supporting a rise in the real gross domestic product.

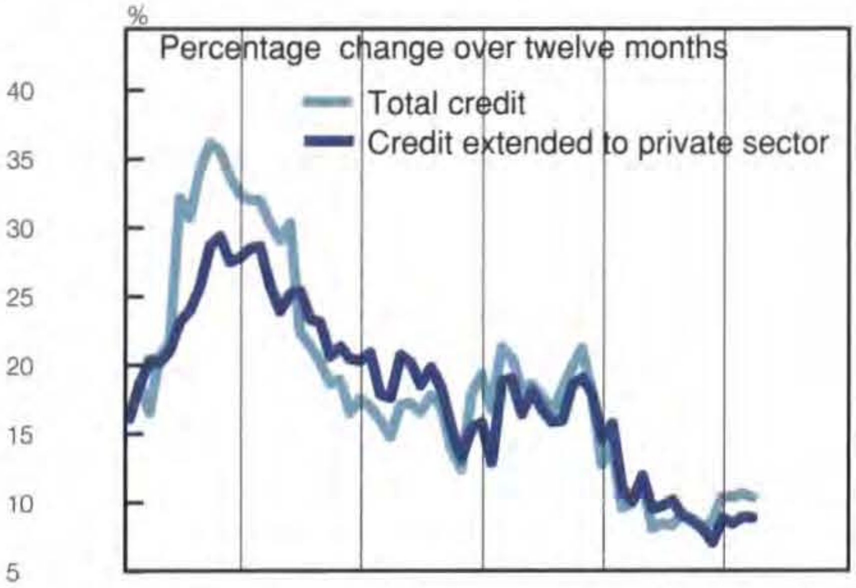
The rate of increase in the *narrower monetary aggregates,* with the notable exception of M1A, also continued to decrease in the first quarter of 1993. The growth rates of M1 and M2 over periods of twelve months decreased from peak values of 23,2 and 12,8 per cent in September 1992 to 17,5 and 10,9 per cent in December 1992 and further to 10,4 and 5,1 per cent in March 1993. In contrast with these developments, the corresponding growth rate of M1A, which had decreased from 23,6 per cent in September 1992 to 16,2 per cent in December 1992, rose again to 19,4 per cent in March 1993. This rise in the growth of M1A was a continuation of the shift to shorter-term deposits with the banking sector, which had already become evident in the second half of 1992. In particular, cheque and transmission deposits with banks (especially those of public enterprises, public corporations and unincorporated businesses) and notes and coin in circulation outside the monetary sector, increased markedly in the first quarter of 1993.

The *main counterparts* (in a statistical or accounting sense) of the relatively small increase of R1,7 billion in M3 from the end of December 1992 to the end of March 1993, were increases of R2,4 billion in monetary institutions' claims on the private sector and of R3,7 billion in their "net other assets". These increases were neutralised to a large extent by decreases in the net gold and other foreign reserves of R3,3 billion and in monetary institutions' net claims against the government sector of R1,1 billion.

Credit extension by monetary institutions

The growth in *total domestic credit extended* by the monetary sector over a twelve-month period, which had decreased from 12,6 per cent in December 1991 to 8,0 per cent in October 1992, accelerated somewhat to 10,3 per cent in March 1993. This modest rise in the rate of credit extension to levels marginally higher than the inflation rate was due partly to an increase in the net claims of the monetary institutions on the government sector and the fact that certain banks became less accommodating in extending further credit to certain clients in the process of active credit-risk management in an environment of rising bad debts, increasing insolvencies and closure of a large number of businesses. More importantly, a lower demand for credit related to the recessionary conditions, lower inflation and the relatively high cost of borrowing was the predominant cause for the slower growth in domestic credit extension.

Credit extended by monetary institutions

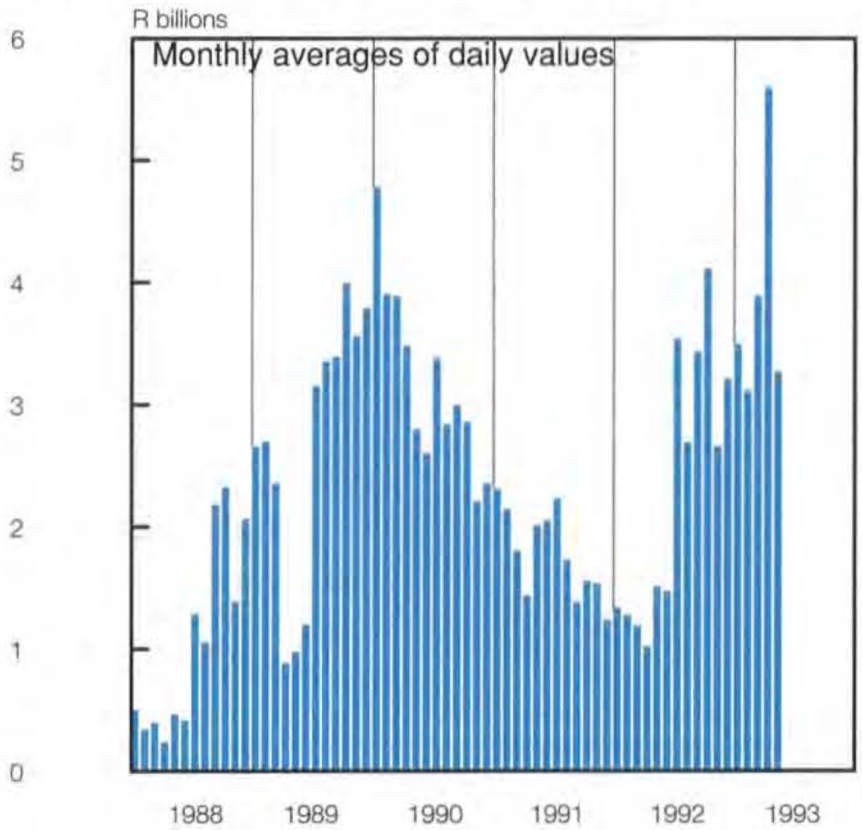


The rate of increase over twelve months in *credit extended to the domestic private sector*, which had declined from 14,5 per cent in December 1991 to 7,0 per cent in November 1992, accelerated again to 8,8 per cent in March 1993. This upward trend in credit extension was related to a rise in the purchases of new motor vehicles as a result of the introduction of a number of new models and pre-emptive purchases in anticipation of an increase in the value-added tax rate. The rates of increase in hire-purchase credit and mortgage advances therefore rose somewhat, but the growth rates over a period of twelve months in credit extended in the form of "other" loans and advances (including overdrafts) were negative throughout the first quarter of 1993.

Money market conditions and Reserve Bank operations in the money market

Money market conditions, which had eased moderately in the last two months of 1992, tightened considerably in the first four months of 1993. However, in May 1993 these conditions eased significantly. The average daily *level of accommodation* at the discount window increased from R3,2 billion in December 1992 to R3,9 billion in March 1993 and further to R5,6 billion in April; it then declined sharply to R3,3 billion in May. The tight money market conditions that prevailed during the first four months of 1993 were also reflected by the amount of accommodation at month-ends, which increased from R3,8 billion at the end of December 1992 to R3,9

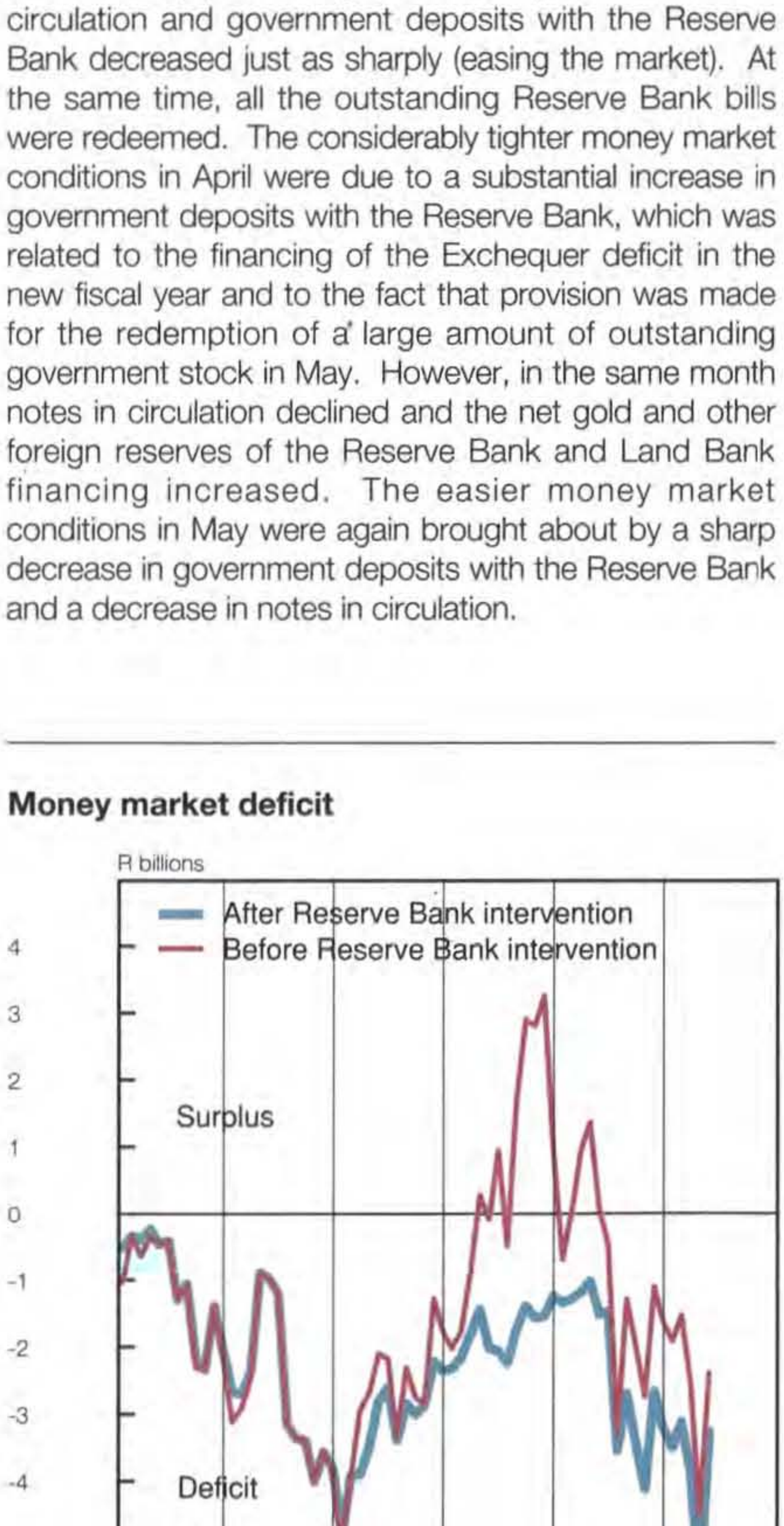
Accommodation at the discount window



billion at the end of March 1993 and R5,4 billion at the end of April. On 15 April 1993 the daily level of accommodation at the discount window reached a peak of R6,8 billion, but then declined to R3,4 billion at the end of May.

Although the amount of accommodation increased by only R0,1 billion from the end of December 1992 to the end of March 1993, the *factors affecting* money market conditions displayed considerable fluctuations in this period. The net gold and other foreign reserves and the financing of the Land Bank by the Reserve Bank and the Corporation for Public Deposits namely decreased substantially (narrowing the market), while notes in circulation and government deposits with the Reserve Bank decreased just as sharply (easing the market). At the same time, all the outstanding Reserve Bank bills were redeemed. The considerably tighter money market conditions in April were due to a substantial increase in government deposits with the Reserve Bank, which was related to the financing of the Exchequer deficit in the new fiscal year and to the fact that provision was made for the redemption of a large amount of outstanding government stock in May. However, in the same month notes in circulation declined and the net gold and other foreign reserves of the Reserve Bank and Land Bank financing increased. The easier money market conditions in May were again brought about by a sharp decrease in government deposits with the Reserve Bank and a decrease in notes in circulation.

Money market deficit



The *actions of the Reserve Bank* in the money market during the first four months of 1993 consisted mainly of neutralising short-term fluctuations by adjusting the asset portfolio of the Corporation for Public Deposits and by selling Treasury bills and government stock for Exchequer funding. The amount of Treasury bills allotted at the weekly tender was eventually increased from R250 million at the end of December 1992 to R400 million on 30 April 1993. Gross sales of government stock by the Reserve Bank amounted to R52,3 billion during the first four months of 1993, compared with R17,5 billion during the corresponding period in 1992 and R112 billion in 1992 as a whole. Partly because of the role of the Reserve Bank as a "market maker" in government stock, the yield on long-term government stock receded during the course of 1992 to a level below the corresponding yield on Eskom stock. *Net* sales of government stock by the Reserve Bank during the first four months of 1993 amounted to R4,3 billion; in the corresponding period of 1992 these sales had been slightly higher at R5,1 billion. In view of the new system of accommodation from the beginning of May, the Reserve Bank deliberately eased money market conditions during the first half of May by means of buy-back arrangements, so as to facilitate the change-over to the new system.

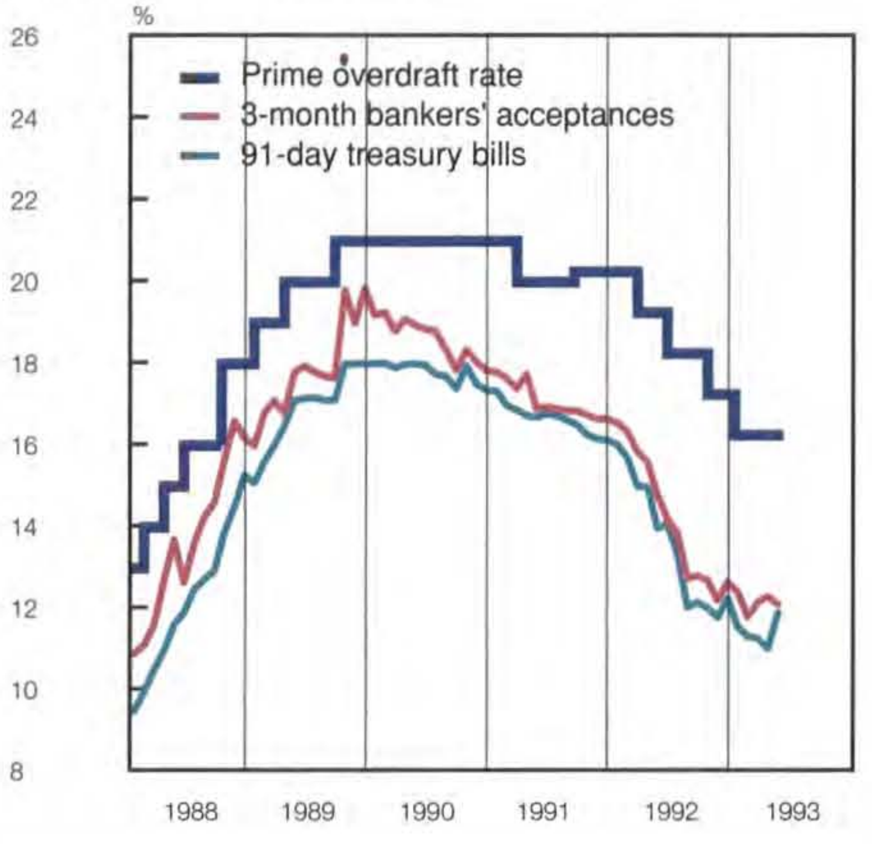
Money market interest rates

The downward trend in money market interest rates throughout 1992 continued during the first two months of 1993, but interest rates then hardened moderately in March and April 1993. This was clearly reflected in the rate on *three-month liquid bankers' acceptances*, which declined from 16,40 per cent in December 1991 to 12,40 per cent in December 1992 and further to 12,15 per cent at the end of January 1993. After the reduction of Bank rate on 9 February, this rate receded further to 11,60 per cent at the end of that month. This money market rate fell into disuse in March 1993, with the announcement that the liquid-asset status of bankers' acceptances was to fall away from 1 May 1993.

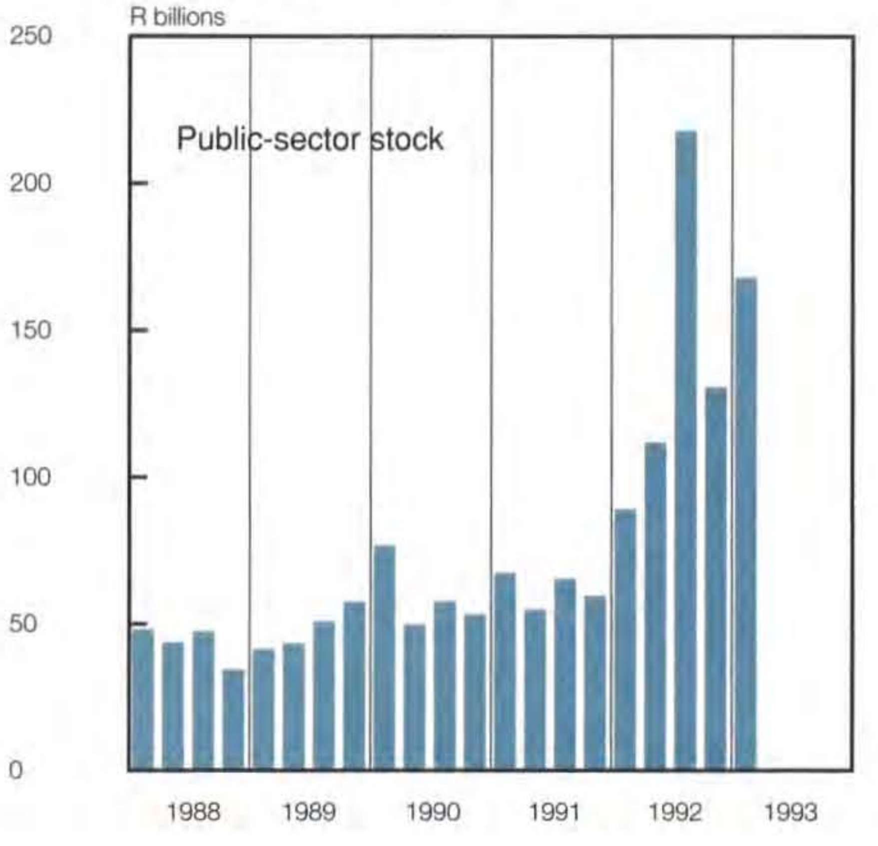
The general movement in most money market rates was also reflected by changes in the rate on *three-month non-liquid bankers' acceptances*, which declined from 12,65 per cent at the end of December 1992 to 11,80 per cent at the end of February 1993 and then increased again to 12,30 per cent at the end of April. In view of the easier money market conditions in May 1993, the rate of three-month bankers' acceptances receded again to 12,10 per cent on 31 May 1993.

Most other money market interest rates also declined during January and February 1993 and then rose somewhat in the next two months. For instance, the *tender rate* on six-month *Treasury bills* decreased from 11,50 per cent at the end of December 1992 to 11,03 per cent at the end of February 1993 and then

Short-term interest rates



Stock exchange transactions



rose to 11,30 per cent at the end of April. In contrast with these developments, the three-month Treasury bill rate continued to decline from 12,09 per cent to 11,32 and 11,02 per cent over the same period. This rate then moved up in May to 11,90 per cent at the end of the month, because the new accommodation procedures proved to be more effective than the previous one.

The prime lending rate of banking institutions followed the reduction of Bank rate on 9 February and was lowered by one percentage point to 16,25 per cent, with effective dates ranging from 15 February to 2 March 1993 at the various banks. The inflation-adjusted prime lending rate of the banks increased from 3,5 per cent in December 1991 to 7,0 per cent in December 1992; it then receded again to 6,0 per cent in March 1993 due to the decrease in the nominal prime lending rate and an increase in the inflation rate. On account of the higher rate of inflation recorded in April as a result of the increase in indirect taxes, the inflation-adjusted prime rate receded to 4,7 per cent.

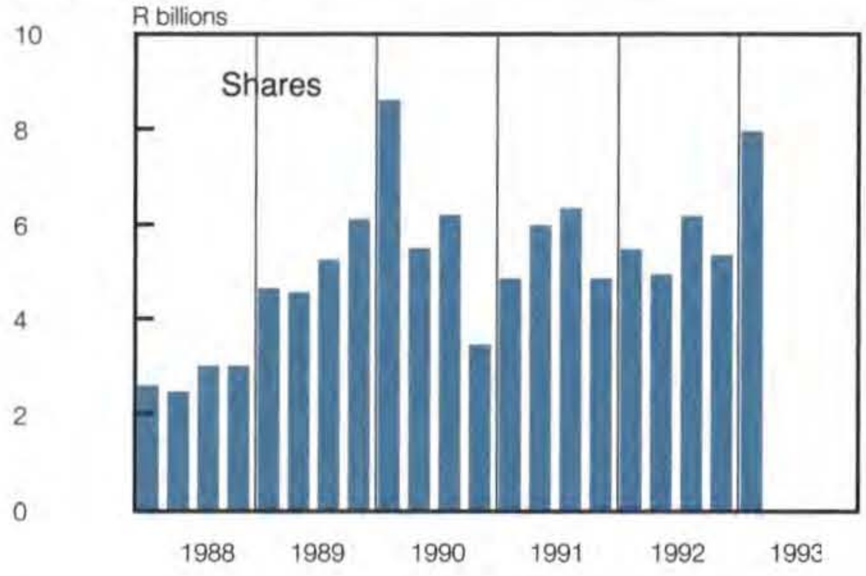
Capital market activity

Conditions in the *secondary capital market*, which had been characterised by a slight decrease in trading activity in the fourth quarter of 1992, improved markedly in the first quarter of 1993. Share prices recovered sharply and large increases were recorded in the value of transactions in shares, stocks and derivative instruments.

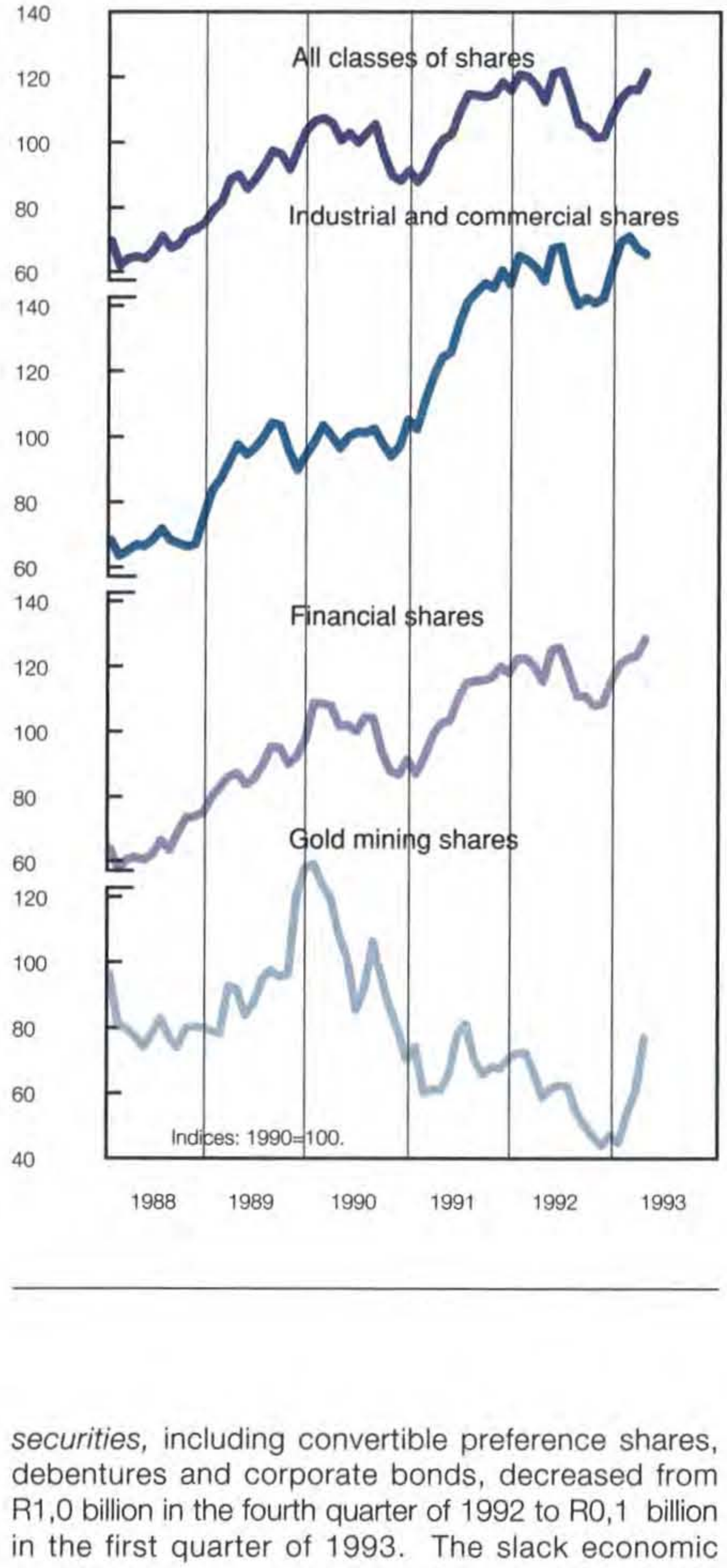
The value of *public-sector stock* traded on the Johannesburg Stock Exchange, which had declined from R218,3 billion in the third quarter of 1992 to R131,1 billion in the fourth quarter, increased again to R168,3 billion in the first quarter of 1993. This good turnover was strongly influenced by a decline in long-term interest rates related to a low demand for funds stemming from sluggish economic growth and lower inflationary expectations. In April 1993 the value of transactions in public-sector stock decreased somewhat to R50,8 billion from an average monthly level of R56,1 billion in the first quarter of 1993, largely because of the smaller number of trading days in this month.

After having decreased from R6,2 billion in the third quarter of 1992 to R5,4 billion in the fourth quarter, the value of *shares traded* on the Johannesburg Stock Exchange increased to R8,0 billion in the first quarter of 1993. This higher turnover was brought about by increases in both the prices and the volume of shares traded. The decline in short-term interest rates, increased net purchases of shares by non-residents, and the higher rand price of gold, gave the share market considerable support. In April the value of shares traded receded slightly but in May the turnover of shares increased sharply when renewed fears of higher inflation in the United States and other market developments initiated a strong surge in the international demand for gold and a sharp rise in the gold price.

Stock exchange transactions



Share prices



The average monthly *price level* of all classes of shares increased by 19,3 per cent in the five months from December 1992 to April 1993, following a decline of 16,5 per cent in the preceding five months. The recovery in share prices was at first led mainly by increases in the prices of industrial, commercial and financial shares. From February 1993 share prices of gold-mining companies also started to increase sharply, with the result that the monthly average price level of gold-mining shares in April 1993 was 74,8 per cent higher than in November 1992. However, in April 1993 the average price level of all classes of shares was still 0,4 per cent below the peak reached in June 1992.

Non-residents were net purchasers of public-sector stock to the amount of R0,3 billion in the first four months of 1993 after having been net sellers to a similar amount in the last four months of 1992. Purchases of public-sector stock by non-residents increased with the firming of long-term rates and the weakening of the financial rand in March and April 1993. The sharp recovery in share prices, the weaker financial rand and the rising interest of non-residents in gold-mining shares, led to a sharp increase in non-residents' net purchases of shares from R0,6 billion in the last four months of 1992 to R1,8 billion in the first four months of 1993.

In the *primary capital market* the amount of funds raised by borrowers in the *public sector* through new issues of fixed-interest securities increased sharply in the first quarter of 1993 in contrast with the normal seasonal pattern during the course of a fiscal year. The value of these issues amounted to R7,5 billion in the first quarter of 1993, compared with R0,5 billion in the corresponding quarter of 1992 and R0,3 billion in the fourth quarter of 1992.

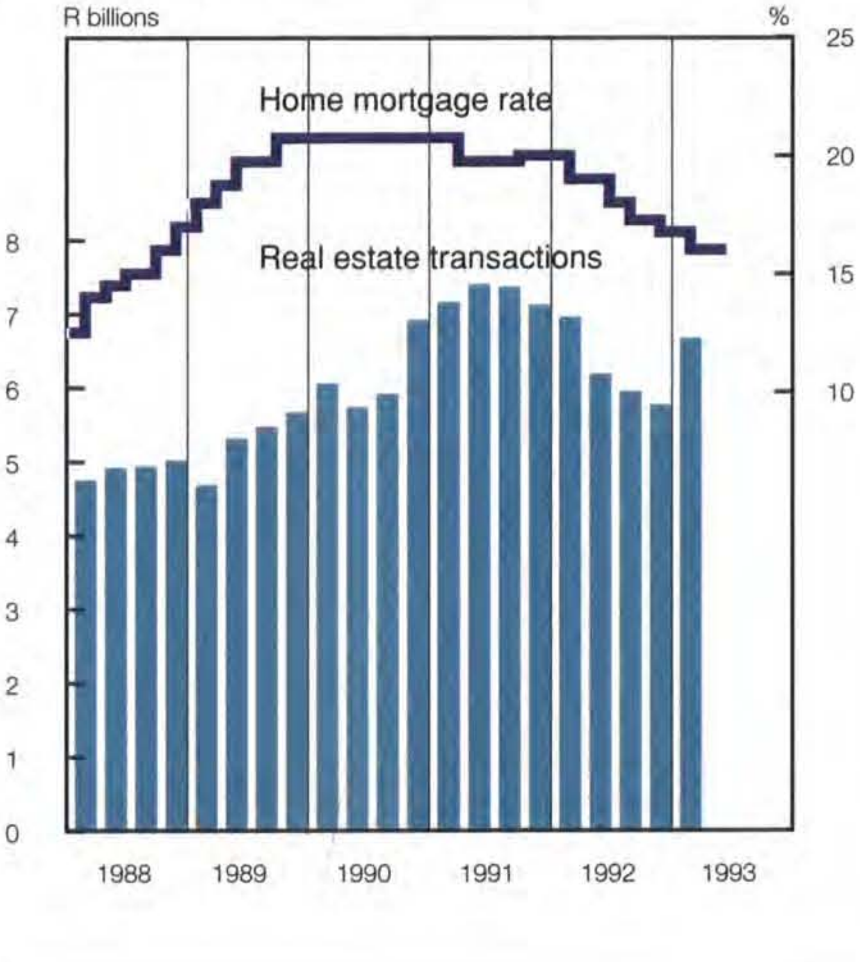
The value of funds taken up by companies in the *private sector* through issues of *fixed-interest securities,* including convertible preference shares, debentures and corporate bonds, decreased from R1,0 billion in the fourth quarter of 1992 to R0,1 billion in the first quarter of 1993. The slack economic conditions were not conducive to new *share issues* either, but these issues did increase somewhat in the first quarter of 1993 as conditions in the share market improved and share prices recovered. The value of net new issues of ordinary shares by listed companies amounted to R1,9 billion in the first three months of 1993; in the last quarter of 1992 such issues had risen to R1,7 billion.

In the *mortgage market* leading banking institutions continued to promote this type of borrowing by providing special concessions to clients in respect of the costs associated with bond cancellation, bond registration and the valuation of fixed property. Even so, the amount of mortgage advances paid out by banking institutions in the first quarter of 1993 at R8,6 billion, was slightly less than the R9,1 billion in the fourth quarter of 1992.

The seasonally adjusted value of *real estate transactions* increased from R5,8 billion in the fourth quarter of 1992 to R6,3 billion in the first quarter of 1993. Despite this increase, the level of transactions in fixed property was still 10 per cent lower than that in the first quarter of 1992. The low level of transactions in fixed property was due to the relatively low return on investments in this market, the decline in real personal disposable income in the current recession and the general uncertainty about political developments in South Africa. The number of property transactions accordingly decreased by 17 per cent from the first quarter of 1992 to the first quarter of 1993, while the average price of such transactions rose by 9,4 per cent over the same period.

Uncertainty regarding future share price movements was mainly responsible for the substantial increase in the total value of *futures contracts* from R13,7 billion in the fourth quarter of 1992 to R21,8 billion in the first quarter of 1993. Contracts in share indices therefore also represented 98,3 per cent of the total value of futures contracts in the first quarter of 1993. In March 1993 an all-time monthly high of R9,6 billion was recorded in transactions in futures contracts, before they fell back to R5,3 billion in April.

Real estate transactions



The value of trade in *options* on index futures contracts increased from a monthly average of R45 million in the last two months of 1992 to R103 million in the first quarter of 1993. Although trade in options on futures contracts only started on 16 October 1992, the open interest of 44 268 contracts in options on index futures as on 15 March 1993 surpassed the open interest in all futures contracts.

Despite continued efforts to promote traded options on shares, activity on the Johannesburg Stock Exchange's *Traded Options Market* remained very low. Only 145 contracts with an underlying value of R0,9 million were traded in January 1993, followed by 10 contracts with a value of R70 000 in February. In March and April 1993 no options were traded in this market. In the stock market fewer options were also traded in the first quarter of 1993 than in the previous quarter.

Capital market yields and interest rates

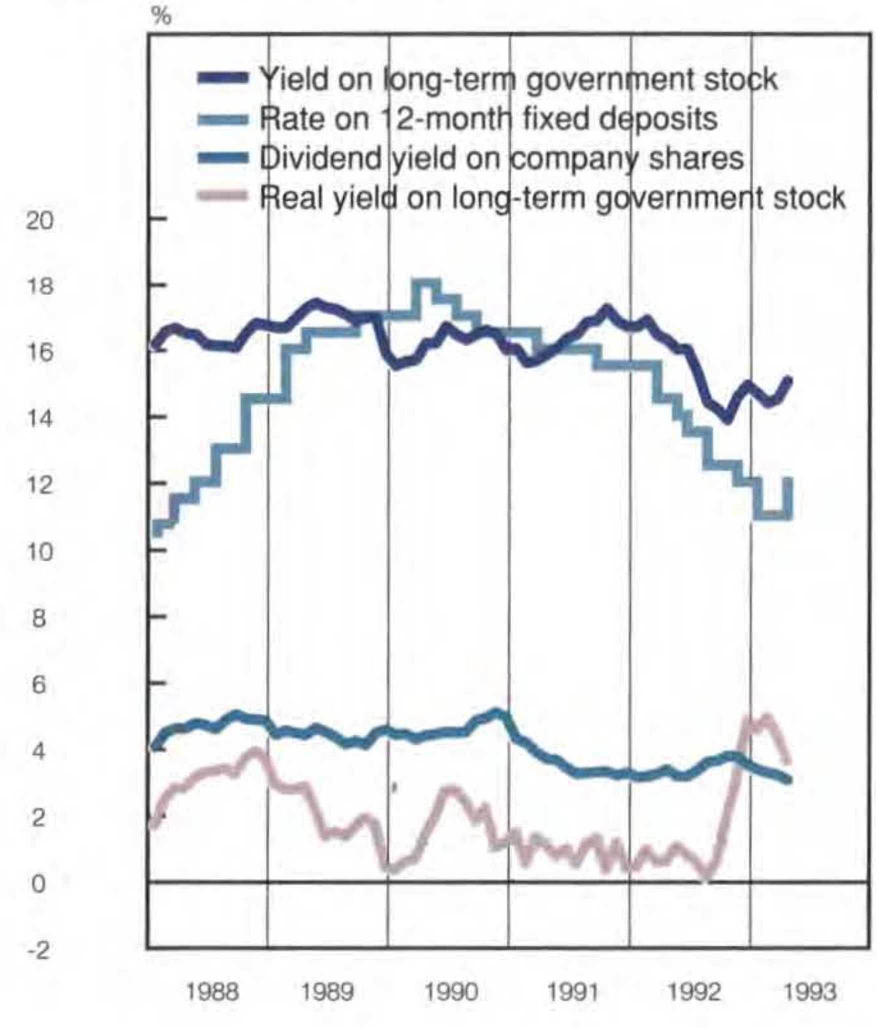
The monthly average yield on *long-term government stock*, which had increased from 13,9 per cent in October 1992 to 14,9 per cent in December, decreased initially in 1993 to 14,4 per cent in February 1993. The larger-than-expected borrowing requirement of the government, higher inflationary expectations that emerged from the Budget proposals, and political developments, then caused this yield to rise to 15,0 per cent in April 1993. Despite this rise, the higher inflation rate brought the average real yield on government stock down from 4,82 per cent in December 1992 to 3,62 per cent in April 1993.

After the lowering of Bank rate on 9 February 1993, the predominant *mortgage bond rate* was reduced by 0,75 percentage points to 16,00 per cent as from 1 March 1993. The banks lowered their longer-term deposit rates simultaneously. The *interest rate on deposits of twelve months,* for example, was reduced by one percentage point to 11,0 per cent in February 1993. Some banking institutions then increased this rate again to 12,0 per cent in April; others followed suit towards the middle of May. The twelve-month deposit rate provided depositors with a negative real pre-tax yield of 0,01 per cent in April 1993.

The higher average level of share prices depressed the average *dividend yield* on all classes of shares further from 3,67 per cent in the fourth quarter of 1992 to 3,27 per cent in the first quarter of 1993 and to 3,05 per cent in April 1993. The average *earnings yield* on all classes of shares (excluding gold-mining shares) also decreased, namely from 8,13 per cent in the fourth quarter of 1992 to 7,19 per cent in the first quarter of 1993 and to 6,87 per cent in April 1993.

The maximum permissible *finance charges rates* as determined in terms of the Usury Act, were reduced with effect from 12 March 1993 from 26 to 25 per cent

Capital market interest rates and yields



in respect of money lending, credit and leasing transactions for amounts of more than R6 000 (but not exceeding R500 000), and from 29 to 28 per cent in respect of amounts up to R6 000.

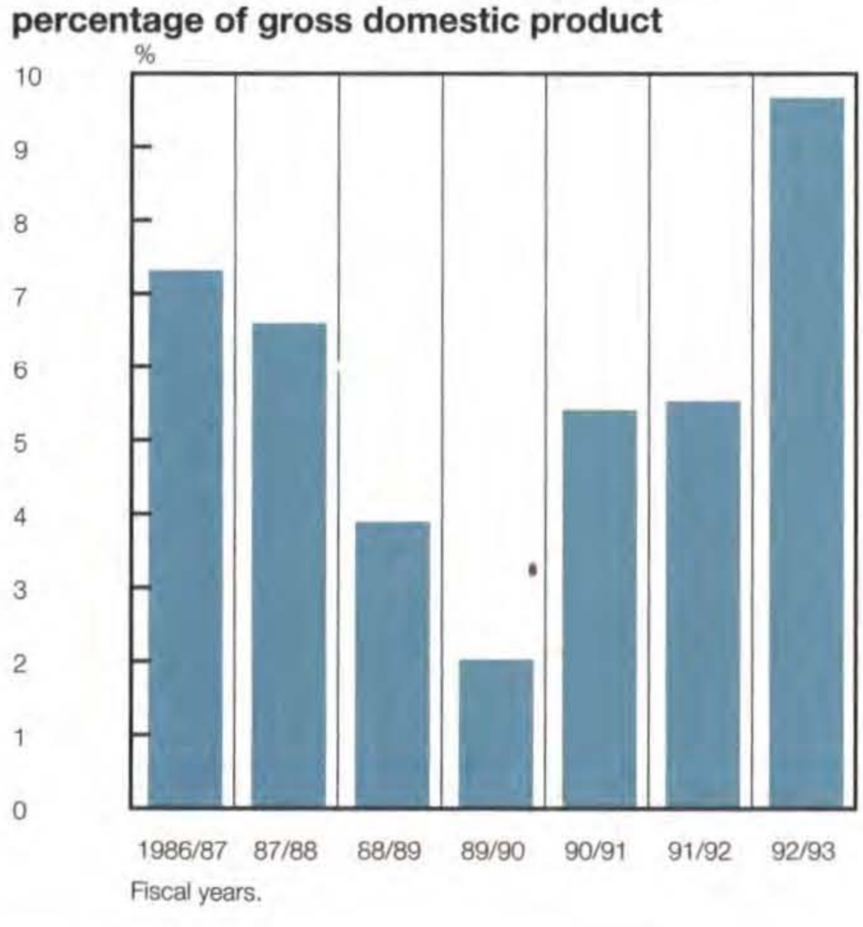
Public finance

Public-sector borrowing requirement

The *public-sector borrowing requirement* (i.e. the deficit before borrowing and debt repayment of the consolidated Central Government, provincial administrations, local authorities and non-financial public enterprises), which had declined from R10,2 billion in the September quarter of 1992 to R4,7 billion in the December quarter, increased sharply again to R10,7 billion in the final quarter of fiscal 1992/93. This brought the public-sector borrowing requirement for fiscal 1992/93 as a whole to R32,2 billion – an all-time high. As a ratio of gross domestic product, the public-sector borrowing requirement in fiscal 1992/93 amounted to 9,7 per cent, compared with the already high levels of 5,5 per cent in fiscal 1991/92 and 5,4 per cent in fiscal 1990/91.

This deterioration in the finances of the public sector was the net result of divergent movements in the finances of the *different tiers of government*. Provincial administrations and extra-budgetary institutions (including the TBVC countries and the self-governing states) recorded surpluses totalling R0,6 billion in fiscal 1992/93, while the deficit before borrowing of the local authorities and the non-financial public enterprises amounted to R1,4 billion. The substantial increase in the public-sector borrowing requirement was, however, caused mainly by a deterioration in the finances of the Main Budget during fiscal 1992/93, particularly in the last quarter of the fiscal year.

Public-sector borrowing requirement as percentage of gross domestic product



Exchequer account in final quarter of fiscal 1992/93

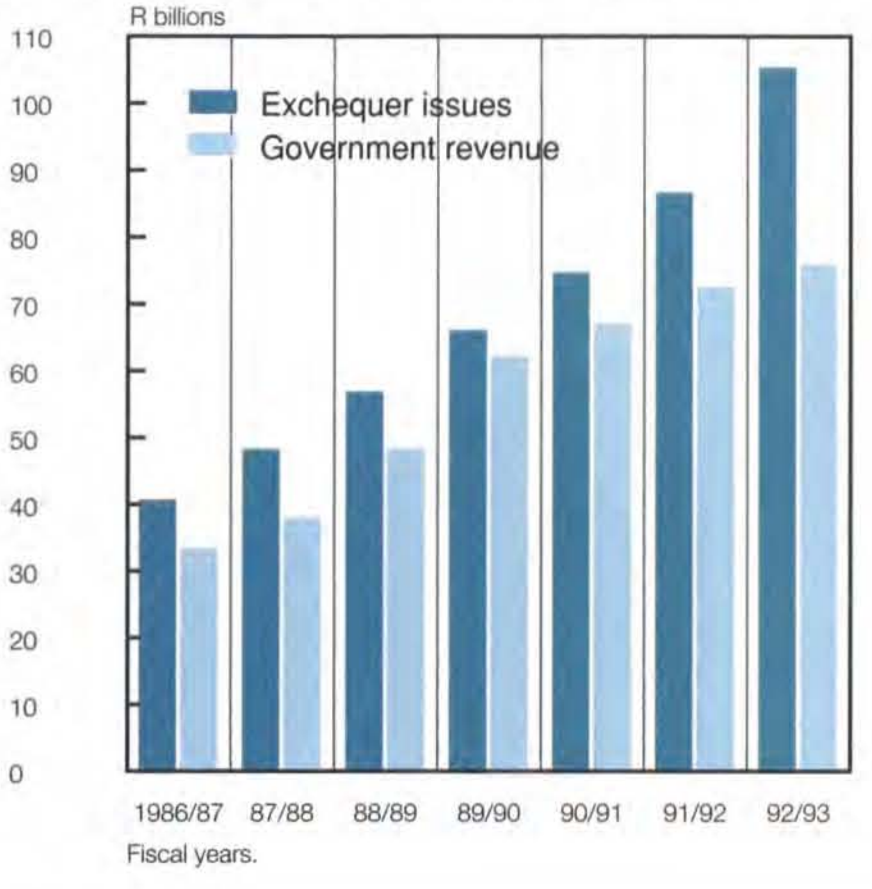
After having increased more or less in line with Budget projections in the first nine months of fiscal 1992/93, the year-on-year rate of increase in Exchequer issues rose to no less than 31,6 per cent in the final quarter. Exchequer receipts, on the other hand, continued to perform well below expectations and rose by only 5,9 per cent in the last quarter of the fiscal year compared with the corresponding quarter in the preceding year. The Exchequer deficit before borrowing and debt repayment therefore amounted to R9,1 billion in the March quarter of fiscal 1992/93, or to a very high proportion of 10,7 per cent of gross domestic product. This deficit was financed by means of the following instruments:

	R millions
Government stock (including discount)	10 818
Treasury bills	-3 632
Foreign loans	-33
Non-marketable securities	-30
Decrease in available cash balance	2 023
Total financing	9 146
Plus: Transfers from the National Supplies Procurement Fund and the Central Energy Fund	1 036
Proceeds from privatisation	108
Less: Discount on new issues of government stock	1 221
Total net financing	**9 069**

Outcome of the Budget for fiscal 1992/93

The actual outcome of the government's finances for the fiscal year 1992/93 was considerably more expansionary than had been envisaged in the Budget. *Exchequer issues* to government departments amounted to R105,1 billion in fiscal 1992/93, which was 4,4 per cent higher than the original Budget estimates. The rate of increase in government expenditure came to 21,6 per cent in fiscal 1992/93, compared with 16,1 per cent in the preceding year and an average annual rate of 16,4 per cent in the past five fiscal years. This represented an increase of about 11 per cent in real government expenditure if this expenditure is deflated by the consumer price index. Because the increase in government expenditure was considerably higher than the increase in domestic production, the ratio of government expenditure to gross domestic product rose from 28,1 per cent in fiscal 1991/92 to 31,5 per cent in fiscal 1992/93. However, the sharp increase in government expenditure was due mainly to drought relief provided to the farming community. If drought-related expenditure of R3,4 billion is not taken into account, the rate of increase in Exchequer issues to government departments amounted to 17,7 per cent in fiscal 1992/93, which was only marginally higher than the original Budget estimate and the average rate of increase over the past five years.

Exchequer issues and government revenue

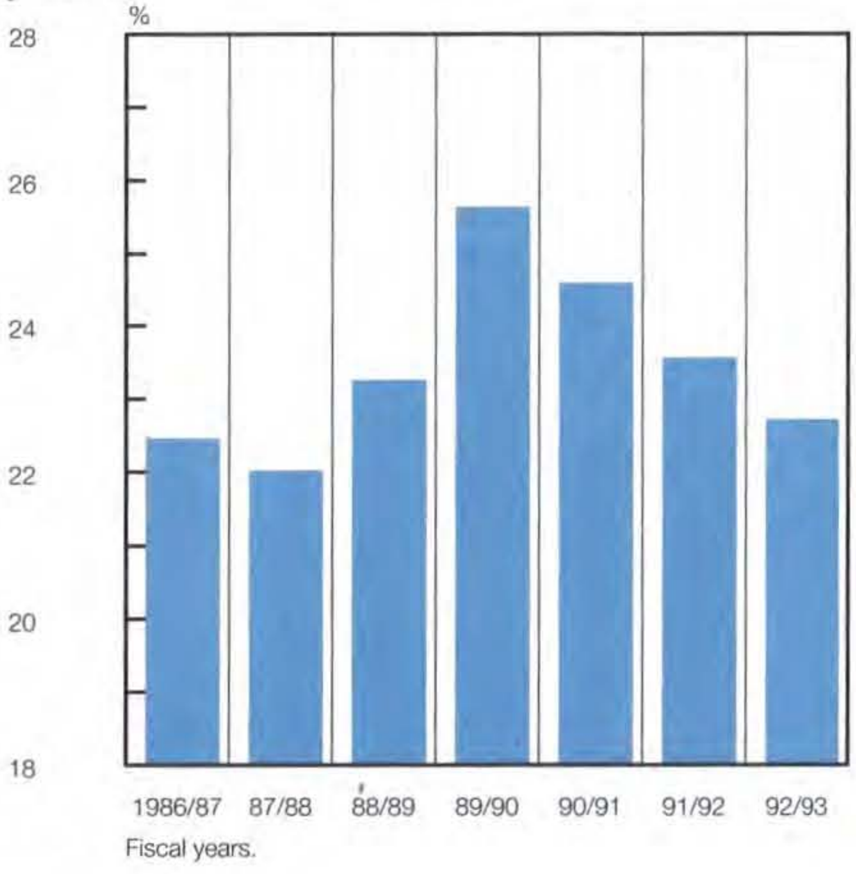


Total government revenue (on a basis comparable to the Budget) amounted to R75,7 billion for fiscal 1992/93, or to only 4,7 per cent more than the revenue collected in fiscal 1991/92. The Budget for 1992/93 had provided for revenue of R84,7 billion, or for an increase of 15,7 per cent over the preceding year's income, which means that revenue was R9,1 billion or 10,7 per cent less than the original Budget estimate. Various factors probably contributed to this poor performance of revenue, including the length and severity of the downswing in economic activity, a lower value-added tax rate than originally planned, the exemption of certain foodstuffs from value-added tax, the drought in the country and the continued recession in the economies of most of South Africa's major trading partners.

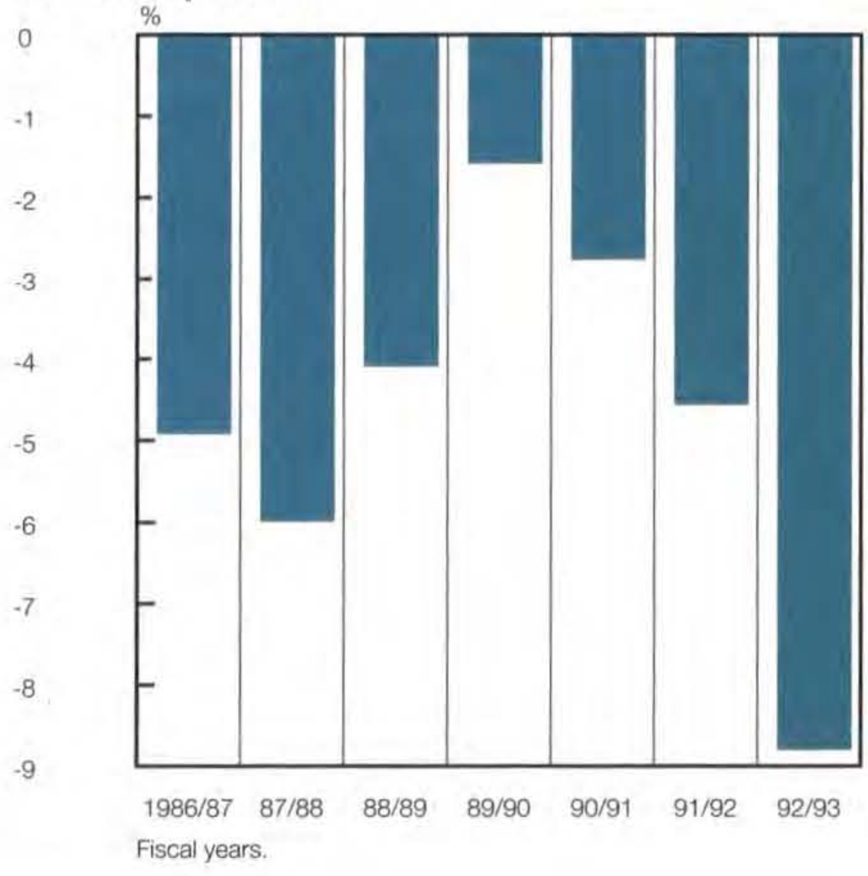
As a result of these factors, government revenue as a ratio of gross domestic product continued to decline from a peak of 25,6 per cent in fiscal 1989/90 to 22,7 per cent in fiscal 1992/93. Moreover, the declining trend in this ratio was accompanied by a sharp decrease in the proportion of government income from indirect taxes. Indirect taxes as a percentage of total government receipts decreased, for instance, from a peak of 42,1 per cent in fiscal 1988/89 to 36,9 per cent in fiscal 1992/93. This stands in sharp contrast with the declared government objective of raising the share of indirect tax in total tax revenue.

The proceeds from value-added tax fell substantially short of Budget projections. As shown in the

Total revenue as percentage of gross domestic product



Deficit before borrowing as percentage of gross domestic product



Government revenue, 1992/93

Percentage change

	Budgeted increase	Actual increase
Fuel levy	27,6	30,9
Other customs and excise	29,5	8,7
Total customs and excise	28,4	21,7
Income tax on companies	5,4	5,3
Personal income tax	22,5	7,3
Value-added tax	12,1	–7,7
Total inland revenue	14,3	2,3
Total income	15,7	4,7

accompanying table, the proceeds from value-added tax were 7,7 per cent lower than the income from general sales tax and value-added tax in the preceding year, whereas the Budget had provided for an increase of 12,1 per cent. With the notable exception of income from the fuel levy, all the other major income items also performed less favourably than envisaged in the Budget. Total inland revenue in particular rose by only 2,3 per cent in fiscal 1992/93, owing to lower-than-budgeted receipts from income tax on both companies and (especially) individuals. The revenue from personal income tax as a ratio of total government revenue nevertheless rose from 29,4 per cent in fiscal 1988/89 to 40,0 per cent in fiscal 1992/93.

The higher-than-expected expenditure and the considerably lower-than-expected income for fiscal 1992/93 led to a *deficit before borrowing and debt repayment* of R29,4 billion, or 8,8 per cent of gross domestic product. This ratio was nearly double the originally budgeted estimate of 4,5 per cent and the deficit was financed mainly by the issuing of new government stock (R32,3 billion) and a decrease in the available cash balance of the government (R6,2 billion). The funds were obtained from the following sources:

	R millions
Public Investment Commissioners	13 996
Non-monetary private sector	17 597
Monetary institutions	1 101
Corporation for Public Deposits	-2 497
Other monetary institutions	3 598
Foreign sector	808
Total gross financing	33 502
Less: Discount on new issues of government stock	4 081
Total net financing	**29 421**

As a result of the substantial Budget deficit before borrowing, *government debt* rose by no less than 22,2 per cent in fiscal 1992/93 to R154,7 billion at the end of March 1993. As a ratio of gross domestic product, government debt increased from 41,2 per cent at the end of fiscal 1991/92 to 46,4 per cent at the end of fiscal 1992/93. In the 1980s this ratio averaged 34,1 per cent. The recent substantially increasing trend in government debt, together with a concomitant increase in interest payments, indicates that the current state of the governmental finances is not sustainable in the long term and that a better balance between tax revenues and expenditure is required to ensure overall financial stability.

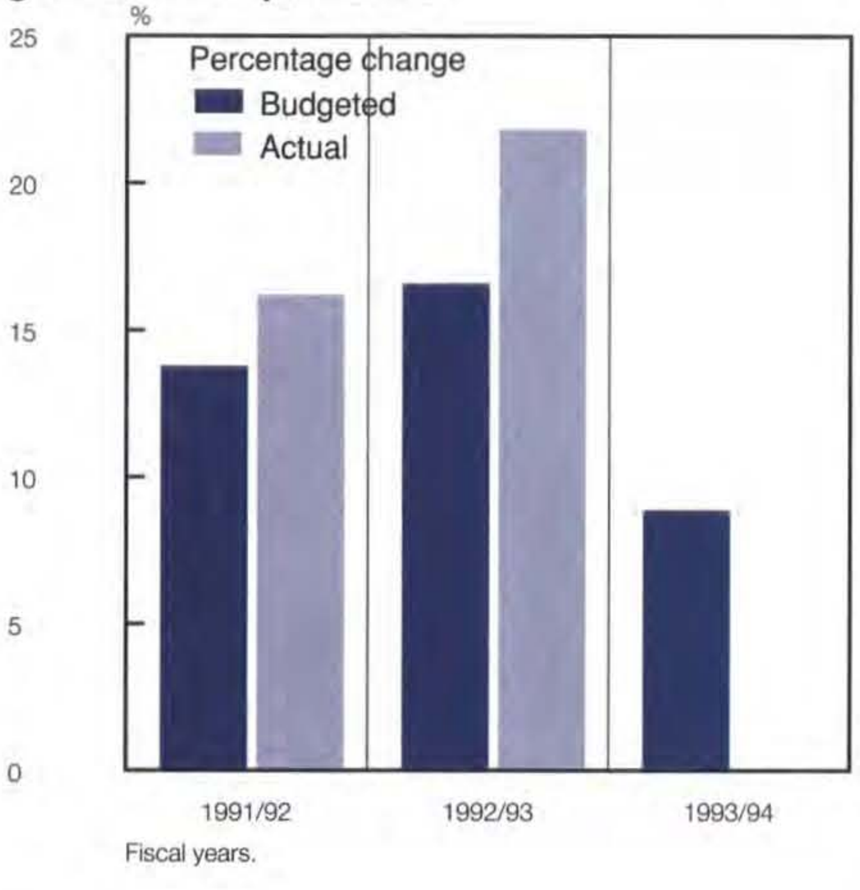
The Budget for 1993/94

In his presentation of the Budget for fiscal 1993/94 to Parliament on 17 March 1993, the Minister of Finance stated that he was guided by *two main principles* in preparing the Budget, namely the need for discipline and the need for growth. The Minister also stated that "sustainable worthwhile growth can only proceed from a thoroughly disciplined base". The Budget therefore took into consideration the need to restructure the economy, but at the same time it was felt that the following matters needed immediate attention:

- the reduction of the government's budget deficit;
- the downscaling of government consumption expenditure;
- the development of high-priority infrastructure by the government in appropriate fields;
- the promotion of employment through the creation of a favourable investment climate and the encouragement of greater labour intensity; and
- the allocation of funds to high-priority areas in affordable socio-economic development.

In order to achieve these objectives, the growth in *government expenditure* was restricted to only 8,8 per cent and expenditure was budgeted to amount to R114,2 billion in fiscal 1993/94. Exchequer issues to government departments as a percentage of gross domestic product should therefore decline from 31,5 per cent in fiscal 1992/93 to 30,7 per cent in fiscal 1993/94. Considerable emphasis was also placed on restricting the growth in *current government expenditure* to only 6,5 per cent. Such a relatively low growth rate in current expenditure was budgeted despite an estimated increase of 26,4 per cent in interest payments on the government debt. This implied that almost 17,4 per cent of total government expenditure in fiscal 1993/94 would have to be set aside for debt servicing, clearly indicating to what extent accumulated budget deficits can inhibit the reallocation of resources. The low growth in current government expenditure will only be achieved if salary and wage increases in the civil service can be restricted to 5 per cent, if there is hardly no growth in the expenditure on other goods and services, and if the

Budgeted and actual exchequer issues to government departments



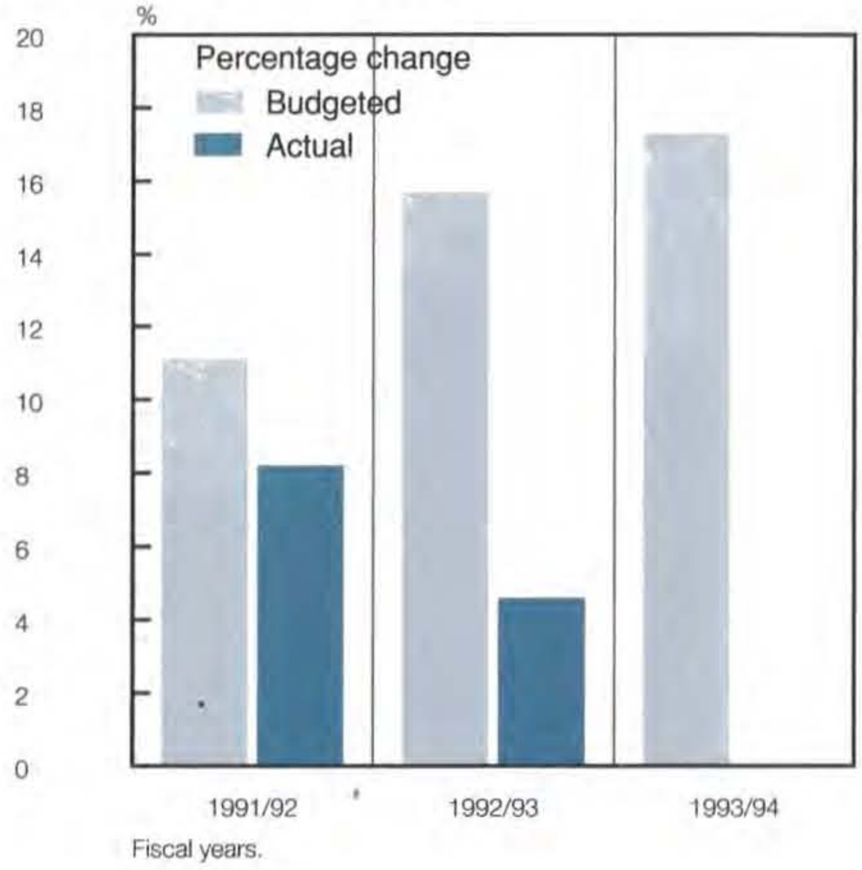
current transfers of the central government decrease by 7,5 per cent.

In contrast to the small growth projected in current government expenditure, the Budget provided for an increase of 27,6 per cent in total nominal *capital expenditure*, excluding capital transfers and loans to other general government institutions and funds. The largest part of this projected capital expenditure will be spent on education, health care and police, with 43,6 per cent of capital spending going to social services.

A *functional classification* of government expenditure also indicates that the government continued to promote expenditure on social services and that the total expenditure on these services is projected to expand by 17,7 per cent in fiscal 1993/94. The share of total expenditure allocated to social services would accordingly rise from 41,3 per cent in 1990/91 to a projected 44,0 per cent in 1993/94. Over the same period the share of protection services in total expenditure (especially expenditure on defence) is estimated to contract from 21,8 per cent to 17,9 per cent.

Total *ordinary revenue* was budgeted to rise by 17,3 per cent to R88,2 billion in fiscal 1993/94. This should result in an increase in total government revenue as a ratio of gross domestic product from 22,7 per cent in 1992/93 to 23,7 per cent in 1993/94 – which would mean a reversal of the declining trend described above. In order to bring this about, the revenue side of the Budget was characterised by the following:

Budgeted and actual revenue



- No adjustments were made to the income tax rates applicable to individuals. Income tax receipts from this source are nevertheless expected to increase by 15,5 per cent to R37,6 billion, owing mainly to fiscal drag.
- The company tax rate was lowered from 48 to 40 per cent of taxable income, but an additional tax of 15 per cent on distributed profits was introduced. Income from company taxes is expected to increase by 1,0 per cent to R12,0 billion.
- The rate at which value-added tax is levied was increased from 10 to 14 per cent as from 7 April 1993, but the zero-rating applicable to certain goods was extended to cover a wider range of foodstuffs. The income from value-added tax in fiscal 1993/94 should accordingly rise by 43,1 per cent, to R24,9 billion.
- The levy on petrol and diesel fuel was increased by 6 cents per litre from 2 April 1993. It was further proposed that 1 cent per litre of the fuel levy on both petrol and diesel be allocated to the Regional Services Councils as a new source of income. The income from the fuel levy should increase by 12,1 per cent to R7,6 billion in fiscal 1993/94.
- The exemption limits for the payment of transfer duty were increased by 20 per cent to R60 000 for residential houses and flats and to R24 000 for unimproved land. The rates at which transfer duty is paid, were also increased.
- Stamp duty on "ordinary" agreements and contracts was abolished.
- The excise duties on certain goods were increased, leading to an expected increase of 11,1 per cent in total excise duties to R4,9 billion in fiscal 1993/94.

Despite this substantial rise in government revenue, the *deficit before borrowing and debt repayment* for the fiscal year 1993/94 was estimated at R25,9 billion. After taking loan redemptions of R6,8 billion into account, the total financing requirement of the government could amount to R32,7 billion. The deficit, excluding loan redemptions, will be financed as follows:

	R millions
Government stock (excluding discount)	24 897
Bonds	50
Foreign loans	-110
Treasury bills	500
Total	25 337
Plus: Transfers from the National Supplies Procurement Fund and the Central Energy Fund	685
Changes in cash balances (increase-, decrease+)	-78
Total financing	**25 944**

Exchequer account in April 1993

Exchequer issues (after the usual adjustment for changes in the balance on the Paymaster-General Account) rose by 11,0 per cent in April 1993 against the same month in the preceding year, or at a rate higher than budgeted. In contrast with the projected sharp increase in government revenue, Exchequer receipts in April 1993 were 1,3 per cent lower than in April 1992. Owing to these lower-than-budgeted receipts and higher-than-budgeted expenditures, the Exchequer deficit before borrowing and debt repayment amounted to R4,2 billion in April 1993, or to a considerably higher level than the average monthly deficit of R2,3 billion in fiscal 1992/93. It was also substantially higher than the deficit before borrowing and debt repayment of R3,2 billion in April 1992.