# Quarterly economic review

## Introduction

The recovery in economic activity, which had started towards the middle of 1993 and had been fairly robust in the second half of that year, faltered somewhat in the first quarter of 1994 and did not regain its earlier vigour in the ensuing two quarters. Current projections suggest that the real gross domestic product will probably grow by only about 2 per cent in 1994, which is considerably lower than had generally been expected at the beginning of the year and also only moderately higher than the growth of 1 per cent registered in 1993.

Various factors probably contributed to the slow upturn in economic activity during 1994, including:

- lower-than-expected growth in real agricultural output because of the withholding of livestock from the market to build up herds, frost damage to vegetable production and drought-related damage to the wheat crop;
- the unsettled conditions during the run-up to the April election and the production days lost in the second quarter on account of the election and the festivities that followed;
- an increase in the total man-days lost in the first nine months of 1994 compared with the corresponding period of 1993 as a result of ongoing labour disputes and work stoppages;
- the continued undercurrent of uncertainty among the domestic and international business community about the prospect for economic stability in South Africa; and, perhaps even more seriously,
- the structural weaknesses in the economy, such as the high costs of labour in comparison with skills and training, shortages of skilled manpower, the high tax burden on individuals, the low level of domestic saving and high dissaving by the government, uncompetitive conditions and the anti-export bias in South Africa's foreign trade policies.

The continued slow growth in domestic production in the third quarter of 1994 was accompanied by a sharp increase in real gross domestic expenditure. Driven by some improvement in consumer and investor confidence, which translated into actual increases in real demand, the upward momentum in both real private consumption expenditure and real fixed investment was maintained in the third quarter. This was supported by a greater willingness among households and enterprises to incur debt. Investment in large capital projects and the electrification of lower-income residential areas also contributed to the strong growth in aggregate capital formation.

Inventories increased considerably in the third quarter of 1994. A substantial part of this accumulation of inventories probably reflected some speculative demand for imported goods based on an expected further depreciation of the rand. Accordingly, the volume of merchandise imports rose substantially further. The substantially higher level of merchandise imports in the third quarter of 1994 was accompanied by only a moderate rise in merchandise exports. The surprisingly poor export performance, against the background of a fairly rapid economic recovery in the rest of the world, seems to have been caused by disruptions in domestic production as well as by marketing strategies followed by some enterprises in order to stabilise income.

These developments, together with a substantial increase in net service and transfer payments to non-residents, resulted in a switch from a surplus on the current account of the balance of payments in the second quarter of 1994 to a large deficit in the third quarter. Over the same period a dramatic turnaround took place on the capital account of the balance of payments from a relatively large net outflow of capital not related to reserves in the first half of 1994 to a net inflow of capital of no less than R5,6 billion in the third quarter of 1994. This net inflow of capital consisted mainly of short-term funds not related to reserves, but longer-term project financing from abroad also became more readily available to South Africa.

The improvement in the capital account of the balance of payments offset the deficit on the current account and was responsible for a substantial increase in the net and gross gold and other foreign reserves of the country. It also enabled a reduction in the Reserve Bank's foreign short-term liabilities related to reserves and led to an increase in the nominal and real effective exchange rates of the rand. Despite this rise, the nominal effective exchange rate of the rand at the end of October 1994 was still 9 per cent below its level at the end of the preceding year.

The increase in domestic expenditure was also instrumental in bringing about an acceleration in the growth of money supply during 1994. This development was aided by an improvement in the cash flow of business enterprises as a result of a strengthening of company profits and a running-down of government deposits with monetary institutions which had been built up in the preceding year. At the same time, the private sector's liquidity preference rose on account of factors such as political uncertainties, expected interest rate changes and anticipated major adjustments in the share and bond markets. A preference for shorter-term deposits therefore led to an even more rapid growth in the narrowly defined than in the broadly defined money supply aggregates.

Because part of the increase in domestic expenditure was financed by means of domestic credit extension, the monetary institutions' credit extension to the non-bank private sector and to the government started to rise rapidly in 1994 and continued to increase at high rates in the third quarter of the year, mainly due to credit extended to the private business sector. The rate of increase in bank credit extension to households was also well above the rate of consumer price inflation.

The strong growth in the money supply and domestic credit extension, together with factors such as the depreciation of the rand, domestic supply-constraints in the agricultural sector and renewed higher inflation expectations, were responsible for a reversal in the downward trend in inflation rates. These changes in underlying conditions caused the Reserve Bank to shift to a more restrictive monetary policy stance in the third quarter of 1994. Reflecting the resolve of the monetary authorities to protect the value of the rand, Bank rate was increased by one percentage point on 26 September 1994.

Both short-term and longer-term interest rates and yields reacted immediately to this rise in Bank rate and moved sharply upwards. The shape of the yield curve therefore remained almost unchanged; the upward-sloping yield curve is fairly steep for paper with a maturity of up to six years and relatively flat over the rest of the maturity spectrum. This yield curve probably still reflects expectations of further upward adjustments in short-term interest rates and a rise in the inflation rate.

Although the money market shortage decreased somewhat in the third quarter of 1994, money market conditions remained relatively tight and the Reserve Bank's operations in the money market absorbed some of the liquidity in the market. Activity in the secondary bond and equity markets remained buoyant and non-residents were actively involved in both these markets. In particular, non-residents' gross purchases of shares as a proportion of the total value of shares traded, rose further and in the third quarter non-residents were involved in nearly one-third of the share turnover on the Johannesburg Stock Exchange.

The raising of funds by both the public and the private sector on the primary bond and equity markets fell back significantly in the third quarter of 1994. The decline in net new borrowing by the public sector was mainly related to the decision of the government to spread its financing needs more evenly over the financial year. The low demand of the private sector reflected the favourable cash flow position of most businesses in South Africa. Indications at the end of the third quarter and beginning of the fourth quarter of 1994 pointed to an increase in the demand for funds by the private sector.

From the information for the first seven months of fiscal 1994/95 it seems as if the government will be able to achieve its objective of reducing the Exchequer deficit before borrowing and debt repayment. Although Exchequer issues increased at a more rapid rate than planned in the Budget for the year as a whole, the rate of increase was considerably lower than the average increase in the first seven months of the preceding five fiscal years. Exchequer receipts in the first seven months of fiscal 1994/95 also increased more rapidly than foreseen in the Budget for the year as a whole.

The deficit on the Exchequer account was financed primarily by the issue of long-term government stock. Owing to the fact that the government is issuing stock with a significantly lower coupon rate than the ruling market interest rate, more stock has to be issued to satisfy the financing requirement of the government, which, of course, leads to an even sharper increase in government debt. In an effort to avoid increasing the pressure of the high cost of debt servicing on the government's finances and at the same time to try and satisfy institutional investors' preferences for a capital-market instrument with money-market qualities, a new variable-rate stock was introduced in October 1994. This stock has a maturity of four years and a coupon rate which is determined by the ruling Treasury bill tender rate plus a premium.

## Domestic economic developments

### Domestic output[1]

After having declined at a seasonally adjusted and annualised quarter-to-quarter rate of 3½ per cent in the first quarter of 1994 and having increased at a revised rate of 1½ per cent in the second quarter, *aggregate real gross domestic product* advanced slightly more strongly at a rate of 2½ per cent in the third quarter of 1994. The robust recovery in the second half of 1993 therefore tapered off considerably in the first nine months of 1994, and real gross domestic product in this period was only 2½ per cent above its level in the corresponding period of the preceding year. If the agricultural sector is excluded, the real output of the non-agricultural sectors increased by about 1½ per cent in the first nine months of 1994 compared with the first nine months of 1993.

Although a still moderate growth in domestic production was recorded in the third quarter of 1994, the recovery in economic activity became fairly widespread. Small rates of increases were recorded in all the major economic sectors, with the notable exception of the mining industry.

*Agricultural production* continued to increase at a fairly high rate in the third quarter of 1994 owing to the completion of the harvesting of a maize crop of about 12,1 million tons; in 1993 maize production had amounted to 9,0 million tons. The real value added by agriculture would have been even higher but for the withholding of livestock from the market and some serious frost damage to horticultural production.

The total real output in the *mining sector*, which had contracted at a relatively rapid rate in the first two quarters of 1994, showed little change in the third quarter. The low level of the mining output in 1994 was the combined result of lower gold and other mining production. In response to the increase in the rand price of gold, the gold mines switched again to the mining of lower-grade ore. The production of the gold mines was also adversely affected by labour disputes, but nevertheless rose slightly in the third quarter of 1994. Coal production continued to increase in the first three quarters of 1994 as a result of a strong international demand. Revised information for the other mines, however, shows that their production contracted sharply in the first nine months of 1994, owing to cutbacks in diamond-mining production, to avoid an over-supply position internationally, as well as in the production of some other minerals and metals because of adequate income levels realised from sharply rising international commodity prices and a depreciation of the rand.

The real output of the *manufacturing industry* increased somewhat in the third quarter of 1994, but was still on a relatively low level for this stage of the economic recovery. The poor performance of

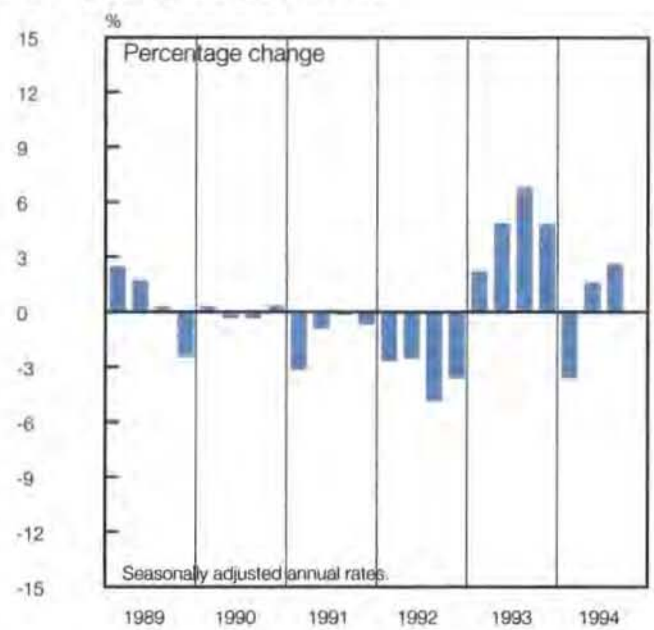
1 In accordance with normal practice during the third quarter of every year, revisions have been made to national accounts data and are incorporated in this issue of the *Quarterly Bulletin*. These revisions are based on more complete, more detailed or more appropriate data available. In addition, seasonal factors have been updated.

**Table 1. Growth in real gross domestic product by sector**

Seasonally adjusted and annualised rates

| | 1994 | | |
|---|---|---|---|
| | 1st qr | 2nd qr | 3rd qr |
| Primary sectors | -31 | -3 | -3 |
| Agriculture | -60 | 7 | 8½ |
| Mining | -6½ | -8 | 0 |
| Secondary sectors | -½ | 0 | 2 |
| Manufacturing | -1½ | -½ | 2 |
| Electricity, gas and water | 2 | 1½ | 2 |
| Tertiary sectors | 2 | 3 | 2 |
| Trade and accommodation | 2 | 4 | 2 |
| Transport, storage and communication | 2½ | 3 | 2½ |
| Financial services | 4 | 4½ | 4½ |
| **Total gross domestic product** | **-3½** | **1½** | **2½** |

**Real gross domestic product**



manufacturing enterprises from the beginning of 1994 was caused mainly by disruptions of production activity. The loss of working days on account of strikes and stay-aways increased towards the end of the second quarter and spilled over into the third quarter. Negative growth was registered particularly in the real output of the enterprises producing food products and machinery and transport equipment; the five-week-long strike in the motor industry made serious inroads on the output levels of enterprises producing transport equipment. These negative effects were cushioned to some extent by efforts towards the end of the third quarter to make up for the production losses. Some manufacturing subsectors which direct their activities towards export markets, such as those producing chemical and paper products, also profited from the international recovery and succeeded in raising their real value added yet further in the third quarter of 1994.

In the *other secondary sectors*, the real value added by the suppliers of electricity, gas and water rose further in the third quarter of 1994 because of factors such as the on-going electrification of lower-income residential areas, the recovery of economic activity and a cold and long winter. A stronger demand for residential buildings and the recent increase in fixed investment activity also led to a further increase in the real output of the construction sector.

The real value added by the *tertiary sectors* continued to increase at a steady rate in the third quarter of 1994. Although this further increase was broadly based, it was particularly evident in the value added by the transport and financial sectors. The growth in the value added by the transport, storage and communication sector was aided by the need to move bulk agricultural commodities and the strong rise in merchandise imports. The generally buoyant conditions in the financial markets, together with a revival in real-estate transactions, guaranteed strong growth in the real value added by the sector finance, insurance, real estate and business services. In the sector commerce and accommodation the rate of increase in real value added slowed down considerably to an annualised rate of 2 per cent in the third quarter of 1994 from 4 per cent in the second quarter, mainly because of supply constraints arising from the strike in the motor manufacturing industry during August and September.

**Table 2. Growth in the components of real gross domestic expenditure**

Seasonally adjusted and annualised rates

| | 1994 | | |
|---|---|---|---|
| | 1st qr | 2nd qr | 3rd qr |
| Private consumption expenditure | 1½ | 2½ | 3 |
| Consumption expenditure by general government | 7 | 1½ | 0 |
| Gross domestic fixed investment | 3½ | 8½ | 7 |
| Gross domestic final demand | 3 | 3½ | 3 |
| Change in inventories (R billions) | 2,0 | 1,9 | 5,5 |
| Gross domestic expenditure | 1 | 5 | 9 |
| Exports of goods and non-factor services | -24½ | 7 | 18½ |
| Imports of goods and non-factor services | -13 | 22 | 52 |
| Expenditure on gross domestic product | -3½ | 1½ | 2½ |

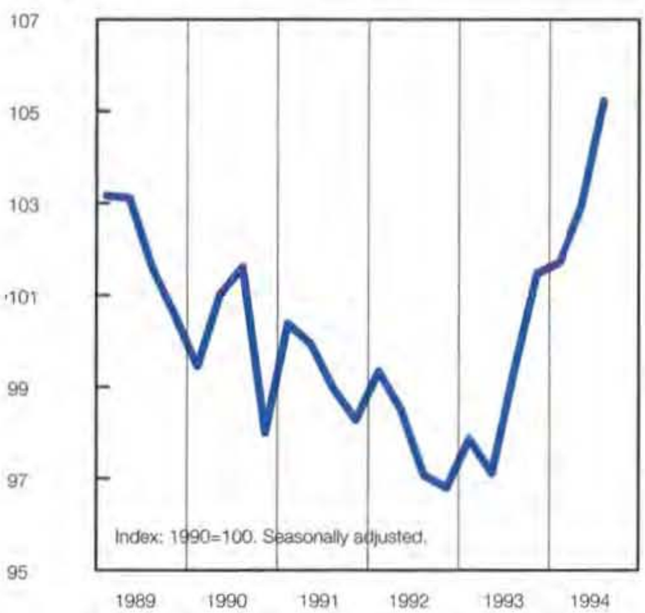
### Domestic expenditure

The moderate rise in production was accompanied by much sharper increases in *total real domestic expenditure*. Following relatively high quarter-to-quarter rates of increase that varied between 1 and 9½ per cent since the third quarter of 1993, the seasonally adjusted real gross domestic expenditure increased further at an annualised rate of 9 per cent in the third quarter of 1994. This latter increase was generally driven by some improvement in consumer and investor confidence which translated into actual increases in real demand. In addition, an increase in real inventories made a significant contribution to this high growth rate.

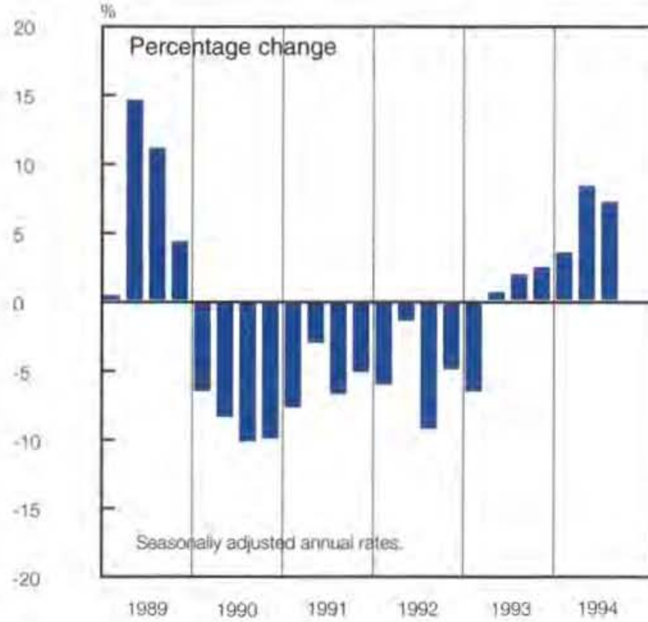
Real outlays on *private consumption expenditure* increased sharply in the first nine months of 1994 and the rate of increase in this aggregate accelerated from an annualised rate of 1½ per cent in the first quarter of 1994 to 2½ and 3 per cent in the next two quarters. Although spending on all the main categories of consumer goods and services contributed to this higher rate of increase in household consumption expenditure, expenditure on durable and semi-durable goods rose very sharply; real expenditure on these categories advanced at annualised rates of 4½ and 4 per cent, respectively, in the third quarter of 1994.

Apart from the role played by higher farm and other personal income, the higher spending levels of households during recent months were also influenced by the increased willingness of consumers to incur debt. The fall in mortgage and other interest rates from high levels in 1991 up to September 1994 eased the squeeze on the disposable income of indebted households somewhat. Having shown a distinct downward movement over the three-year period until the fourth quarter of 1993, consumer credit started to rise again in the first nine months of 1994. It would appear as if consumer confidence strengthened somewhat when developments after the election turned out to be relatively peaceful.

**Real gross domestic expenditure**




**Total real gross domestic fixed investment**




The rate of increase in real *consumption expenditure by general government* slowed down from annualised levels of 7 and 1½ per cent in the first two quarters of 1994 to almost no change in the third quarter. This slower growth was the result of a lower rate of increase in the real remuneration of employees and a much more severe curtailment in the rate of expenditure on other goods and services. The current outlays by general government in the first nine months of 1994 were nevertheless still nearly 4 per cent higher than in the corresponding period of 1993.

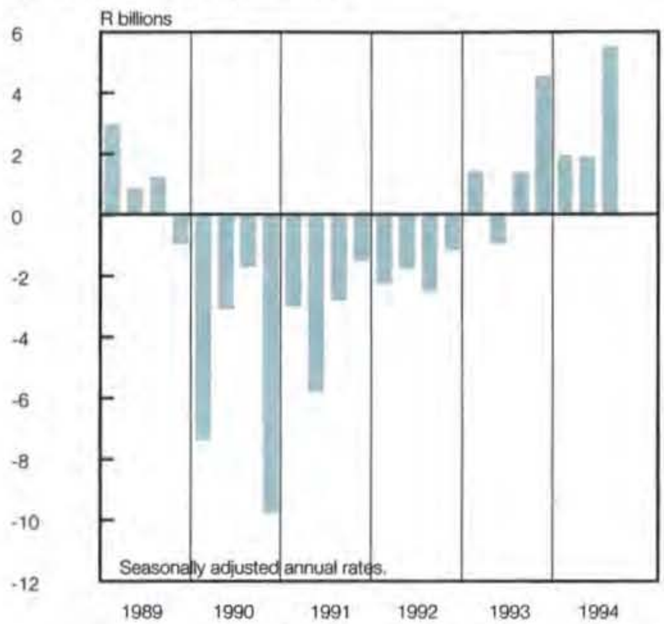
The upward momentum in *aggregate real gross domestic fixed investment* since the second quarter of 1993 was maintained in the third quarter of 1994. Current estimates suggest that increases in total real gross domestic fixed investment, at annualised rates of 3½ and 8½ per cent in the first two quarters of 1994, were followed by a further rise of 7 per cent in the third quarter. This improvement in capital formation was brought about by an expansion in real outlays on capital equipment by the private sector and public corporations, which more than offset a further decline in real gross domestic fixed investment by public authorities.

A classification of real *fixed investment by the private sector* by type of economic activity shows that the further increase in the third quarter of 1994 at an annualised rate of 4½ per cent was broadly based. Investment expenditure by agriculture and mining enterprises rose markedly and real outlays on private residential buildings accelerated from an average annualised rate of 1½ per cent in the first two quarters of 1994 to 4 per cent in the third quarter. The direct and indirect linkage effects of major capital projects currently in process were also responsible for a further, but significantly lower, increase in the capital formation of the manufacturing sector in the third quarter of 1994; an annualised rate of increase of only 1½ per cent was recorded, compared with 6½ and 8½ per cent in the second and first quarter, respectively.

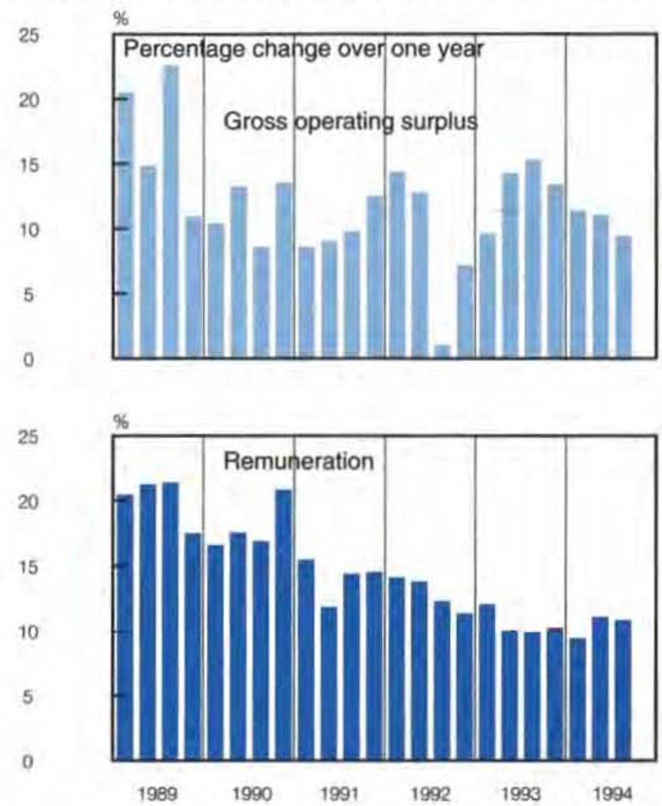
Real fixed *capital formation by public corporations* in the first three quarters of 1994 was 9½ per cent higher than in the corresponding period of 1993, owing largely to increased investment in the electrification of lower-income residential areas. On the other hand, real *fixed investment by public authorities* remained subdued in the first half of 1994 and receded further in the third quarter at an annualised rate of 2½ per cent. Cutbacks in the investment outlays of provincial governments exceeded the rise in the capital formation of the central government and local authorities.

The build-up of *inventories* during 1993 accelerated considerably in the third quarter of 1994. Expressed at constant 1990 prices, inventories increased at an annualised rate of R5,5 billion in the third quarter of 1994, against R1,9 billion in the second quarter and R2,0 billion in the first quarter of 1994. This substantial accumulation of inventories in the third quarter of 1994 coincided with a substantial rise in the volume of merchandise imports and probably reflected some speculative demand for imported goods based on an expected depreciation of the rand. The increase in inventory levels in the third

**Change in real inventories**




**Gross operating surplus and labour remuneration**




quarter of 1994 was prominent in the mining and industrial sectors and in wholesale and retail trade. The level of inventories in the motor trade, however, contracted sharply, as a result of supply problems experienced by the motor industry. Despite the build-up of inventories, the ratio of industrial and commercial inventories to non-agricultural gross domestic product remained unchanged at the level of 16 per cent since the third quarter of 1993.

**Factor income**

The growth in *aggregate nominal factor income* at market prices over a period of twelve months slowed down from an average of 13½ per cent in the first two quarters of 1994 to 11 per cent in the third quarter. This lower rate of growth could be ascribed to a slower rate of increase in both total gross operating surpluses of business enterprises, and in the *remuneration of employees*. The growth over four quarters in labour remuneration slowed down to 10½ per cent in the third quarter of 1994 from a revised 11 per cent in the preceding quarter. For the first nine months of 1994 the total remuneration of employees was about 10½ per cent higher than in the corresponding period of 1993, i.e. remuneration rose at about the same rate than in 1993 as a whole.

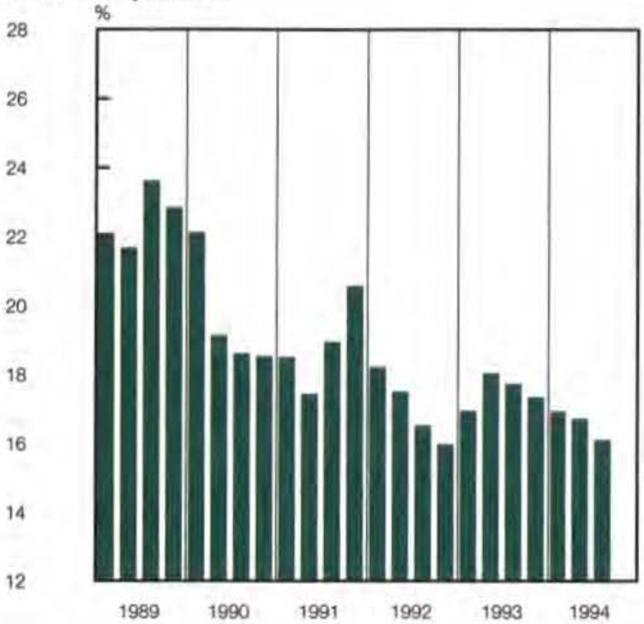
Growth in the *nominal gross operating surpluses* of business enterprises measured over a period of twelve months edged downwards from an average of 11 per cent in the first half of 1994 to approximately 9½ per cent in the third quarter. This slower growth was mainly due to a deterioration in the profitability of the mining and commercial sectors. In the gold-mining industry the better results in working revenue were neutralised by rising operating costs, while the lower rate of increase in the operating surpluses of the commercial sector reflected mainly the effects of the strike in the motor manufacturing sector, which left car dealers with severe shortages of new models. As a result of the revival of domestic final demand, the improved terms of trade and a strong international demand for South African products, the growth in the gross operating surpluses of the other sectors rose somewhat in the third quarter of 1994.

**Domestic saving**

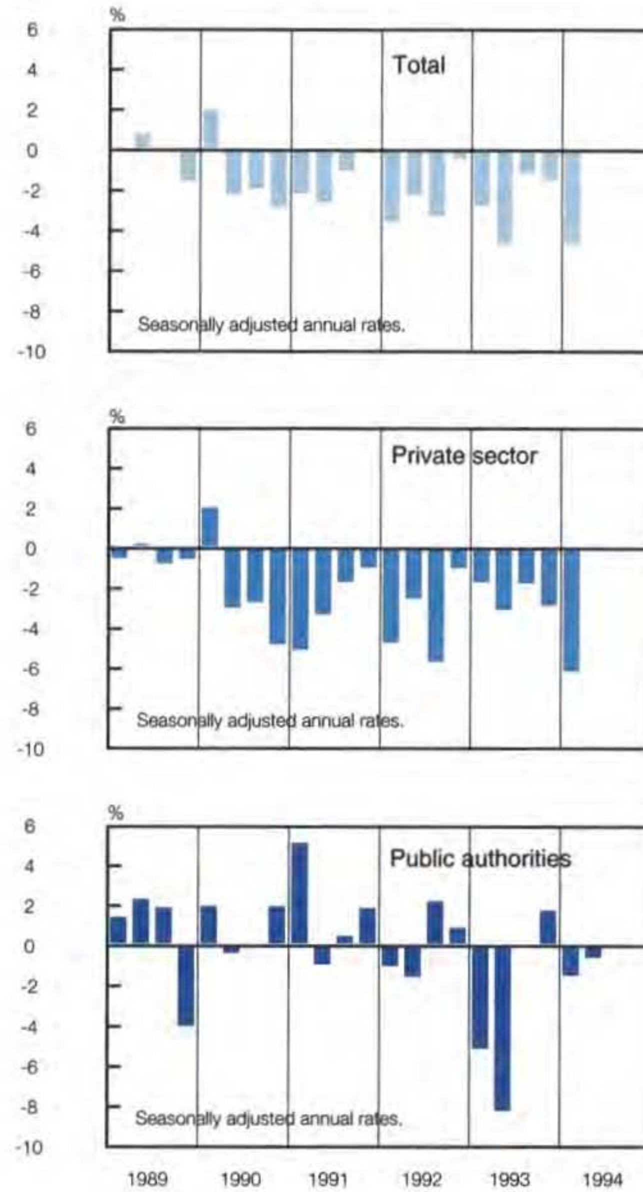
The ratio of *total gross domestic saving* to gross domestic product deteriorated further in the third quarter to a level of 16 per cent; in the first half of 1994 it had averaged 17 per cent. This contraction in the domestic savings ratio arose from the substantial increase in domestic consumption expenditure, which exceeded the growth in the aggregate current income in the economy.

Attempts by households facing slow income growth and rising tax burdens to maintain or even increase spending levels, inevitably led to lower *savings by the household sector*. The ratio of personal saving to

**Gross domestic saving as percentage of gross domestic product**




**Non-agricultural employment**




personal disposable income receded accordingly from an average of 4½ per cent in the first two quarters of 1994 to about 3 per cent in the third quarter. *Corporate saving* showed little change in the third quarter against the preceding quarter, while the *dissaving by general government* contracted slightly because the rise in tax revenue exceeded the increase in current expenditure. However, net dissaving by general government as a percentage of gross domestic product remained at a high average level of 5 per cent in the first nine months of 1994.

**Employment**

The unsteady recovery in economic activity has been unable to reverse the sharp downward movement in *total employment* in the non-agricultural formal sectors of the economy. The still generally weak economic conditions, and rationalisation programmes implemented by business enterprises to reduce costs, caused employment in the non-agricultural economic sectors to drop sharply further in the first quarter of 1994 (latest information made available by the Central Statistical Service). The decline in employment in this quarter came to a seasonally adjusted and annualised quarter-to-quarter rate of 4,8 per cent, compared with corresponding rates of decline of 1,2 and 1,5 per cent in the third and fourth quarter of 1993. The total number of employment opportunities fell back by approximately 510 000, or 9,2 per cent, from its peak in the second quarter of 1989 to the first quarter of 1994. This brought employment in the formal sector more or less back to the level which had existed at the end of 1980.

The lower employment levels in the first quarter of 1994 were mainly due to personnel reductions in the *non-agricultural private sector*. Total employment in the private sector (excluding agriculture) started to decline in the third quarter of 1989 and, with the exception of the first quarter of 1990, has declined in every subsequent quarter. Sharp decreases were recorded in the first quarter of 1994 in employment by the mining industry, construction, electricity generation, the trade sector and banks. Information available for the second quarter of 1994 indicates further, though generally smaller, retrenchments of staff in the retail and wholesale trade, banks and private road transportation.

In contrast to these developments in the private sector, the rate of decline in the employment by the *public authorities* has weakened somewhat. After having declined at seasonally adjusted and annualised rates of 5,1 and 8,3 per cent in the first and second quarter of 1993, employment by public authorities remained unchanged in the third quarter of 1993 and rose by 1,7 per cent in the fourth quarter of 1993. It then contracted again, however, at a rate of 1,5 per cent in the first quarter of 1994 and of 0,6 per cent in the second quarter owing to the privatisation of some of the agricultural marketing boards and large-scale retrenchments by public corporations.

Despite the continued decline in employment opportunities, the seasonally adjusted total number of *registered unemployed workers* declined from a high point of 335 000 in September 1993 to 280 000 in August 1994. This decrease must, however, be viewed against the unemployment rate, which has increased from 18,5 per cent in 1991 to 29,0 per cent in 1993.

### Labour costs and productivity

The rate of increase in the average *nominal remuneration per worker* in the non-agricultural sectors of the economy contracted in tandem with the decline in economic activity from its most recent high point of 18,3 per cent in 1989 to 10,6 per cent in 1993 – the lowest increase since 1978. As shown in Table 3, this downward trend accelerated considerably from the second half of 1992 and the year-on-year rate of increase in nominal salaries and wages per worker decreased from 16,3 per cent in the second quarter of 1992 to 9,2 per cent in the fourth quarter of 1993 and 9,5 per cent in the first quarter of 1994. This slower growth in salaries and wages was recorded in the remuneration of persons employed by both the private sector and public authorities. However, in the second quarter of 1994 the year-on-year rate of increase in the remuneration per worker of public authorities surged again to 20,6 per cent.

Despite the slower growth in the average nominal remuneration per employee, the *real remuneration per worker* in the non-agricultural sectors of the economy (as deflated by the price deflator for the non-agricultural gross domestic product) increased at first from 0,9 and 0,4 per cent in 1989 and 1990 to 1,9 per cent in 1992. Only in 1993 did the real remuneration per worker begin to decrease; the rate of decline averaged 0,1 per cent for the year as a whole. In the first quarter of 1994 the year-on-year rate of change in the real remuneration per worker again amounted to a positive 0,9 per cent against a negative level of 0,4 per cent in the preceding quarter. Recent demands for wage increases well above the inflation rate also do not bode well for real wage costs in the rest of 1994.

The general upward trend in real wages was, however, accompanied by higher *labour productivity*.

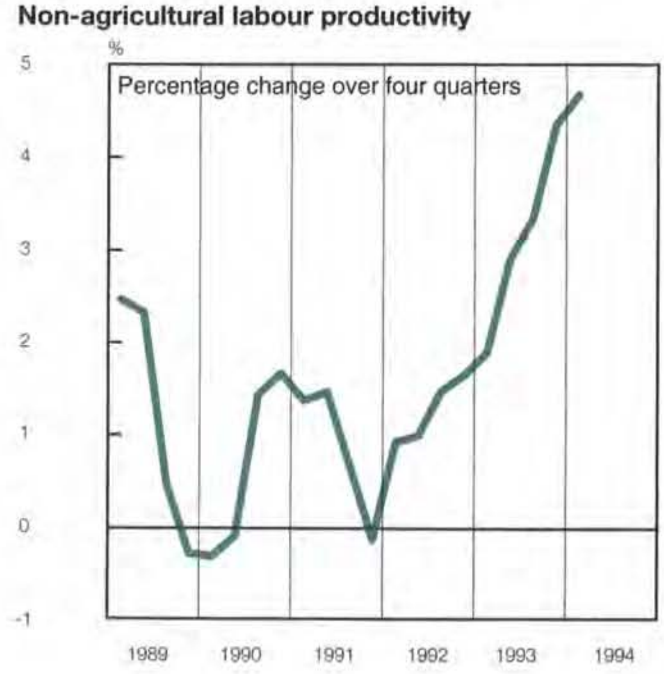
**Table 3. The year-on-year rate of increase in nominal remuneration per worker**

| Period | Private sector | Public authorities | Total |
|---|---|---|---|
| 1992: 2nd qr (peak) | 16,0 | 16,9 | 16,3 |
| 1993: 1st qr | 12,8 | 13,5 | 13,1 |
| 2nd qr | 10,5 | 8,9 | 10,0 |
| 3rd qr | 10,6 | 9,6 | 10,2 |
| 4th qr | 11,1 | 5,4 | 9,2 |
| 1994: 1st qr | 9,7 | 8,9 | 9,5 |

The rate of increase in labour productivity in the non-agricultural sectors of the economy accelerated continuously from 0,3 per cent in 1990 to 1,2 per cent in 1992 and 3,1 per cent in 1993. Initially this increase was due only to the reduction in employment, but real gross domestic product also increased later. The year-on-year rate of increase in real labour productivity accelerated from 1,0 per cent in the second quarter of 1992 to 4,1 per cent in the fourth quarter of 1993 and 4,7 per cent in the first quarter of 1994.

As could be expected with lower increases in labour remuneration and a rise in labour productivity, the rate of increase in *nominal unit labour costs* in the non-agricultural sectors of the economy dropped sharply from a peak of 16,9 per cent in 1990 to 7,3 per cent in 1993.

**Non-agricultural labour productivity**



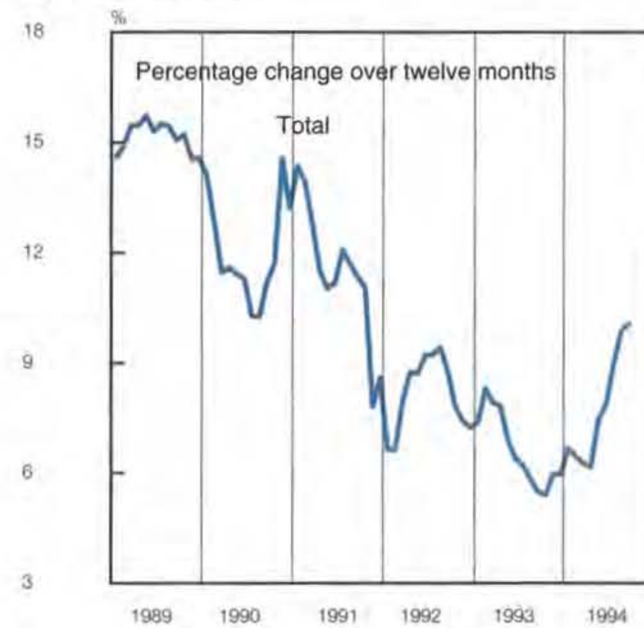
In the first quarter of 1994 the year-on-year rate of increase in nominal unit labour costs came to only 4,6 per cent. *Real unit labour costs* (as deflated by the price deflator for the non-agricultural domestic product) therefore also decreased by 3,1 per cent in 1993 and by 3,6 per cent in the first quarter of 1994 compared with the corresponding quarter of 1993.

**Prices**

Despite the slower increase in nominal unit labour costs, the downward trend in inflation rates since 1991 was reversed in the first nine months of 1994. Factors such as the depreciation of the rand, domestic supply shocks in the agricultural sector, high inflation expectations and a strong growth in the money supply and domestic credit extension, caused the quarter-to-quarter rate of increase in production and consumer prices to accelerate sharply from the beginning of 1994. These rates of increase, in particular, accelerated substantially in the third quarter of 1994. (See Table 4.)

Measured over a period of twelve months, the rate of increase in both the production price index and the consumer price index reached a lower turning-point in April 1994. The rise in the *all-goods production price index* accelerated from 6,2 per cent in April 1994 to 10,1 per cent in September. This increase was largely driven by drastic increases in the prices of agricultural products, which accelerated from 6,5 per cent in February 1994 to 18,8 per cent in September, largely because of a decline in the supply of agricultural goods related to factors such as the rebuilding of livestock herds by farmers following the improvement of grazing conditions, and frost damage caused to fruit and vegetable production. Since the second quarter of 1994 the weaker exchange rate of the rand and the rising price of imported crude oil also added to the upward thrust in production prices. The rate of increase over periods of twelve months in the prices of imported goods therefore rose from a low of 2,7 per cent in March 1994 to 8,7 per cent in September.

**Production prices**



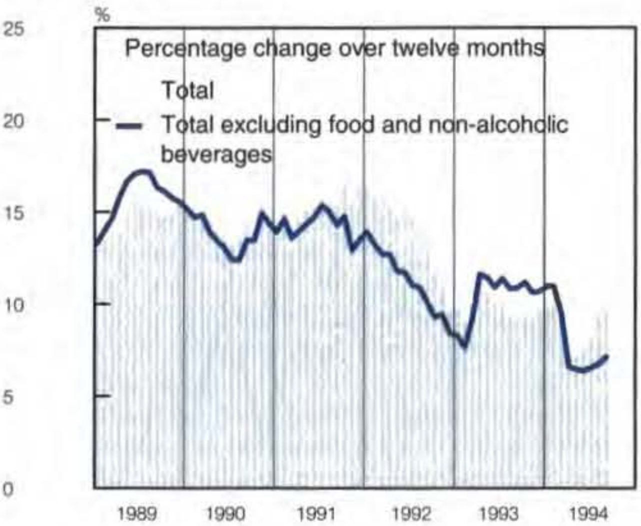

A similar rise was discernible in *consumer prices* when measured over a period of twelve months. The twelve-month rate of increase in the consumer price index rose from 7,1 per cent in April 1994 to 10,1 per cent in September. Although the prices of goods as well as services contributed to this upward movement in consumer prices, the rate of increase in the prices of goods rose by 4,8 percentage points from 6,8 per cent in April 1994 to 11,6 per cent in September, while the rate of increase of prices of services rose by only 1,4

**Table 4. The quarter-to-quarter rate of increase in production and consumer prices**

Seasonally adjusted and annualised rates

| | 1993 | 1994 | | |
|---|---|---|---|---|
| | 4th qr | 1st qr | 2nd qr | 3rd qr |
| Production prices: | | | | |
| Domestic goods | 5,1 | 11,1 | 9,0 | 14,4 |
| Imported goods | -5,4 | 3,2 | 16,6 | 14,8 |
| **Total** | **3,0** | **9,7** | **10,3** | **14,6** |
| Consumer prices: | | | | |
| Goods | 6,2 | 8,3 | 8,0 | 19,4 |
| Services | 1,2 | 6,8 | 6,7 | 16,0 |
| **Total** | **5,3** | **9,2** | **6,7** | **15,7** |

## Consumer prices




percentage points from 7,4 per cent in May 1994 to 8,8 per cent in September.

Food prices, in particular, were largely responsible for the acceleration in the rise in consumer prices. The twelve-month rate of increase in food prices began to escalate from a low of 2,4 per cent in September 1993 to 8,8 per cent in April 1994 and then jumped to a level of 21,9 per cent in September 1994. Meat price increases more than quadrupled from 7,2 per cent in September 1993 to 34,7 per cent in September 1994, while the rate of increase in the prices of vegetables soared from 8,1 per cent in April 1994 to 51,5 per cent in September. If movements in the prices of food and non-alcoholic beverages are excluded, the twelve-month rate of increase in other consumer prices remained relatively steady and rose only slightly from 6,4 per cent in May and June 1994 to 7,1 per cent in September.

## Foreign trade and payments

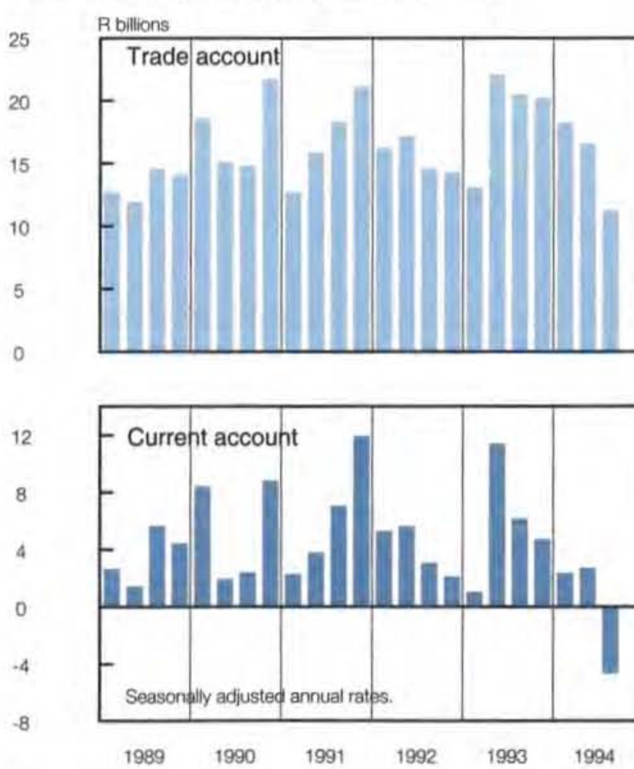
### Balance of payments on current account

Despite the relative weakness of the upturn in economic activity, the *balance of payments on current account* deteriorated substantially in the third quarter of 1994. The current account balance (seasonally adjusted and annualised) turned around from a still comfortable average quarterly surplus of R2,5 billion in the first half of 1994 to a deficit of no less than R4,8 billion in the third quarter. As a ratio of gross domestic product, this deficit amounted to 1,1 per cent.

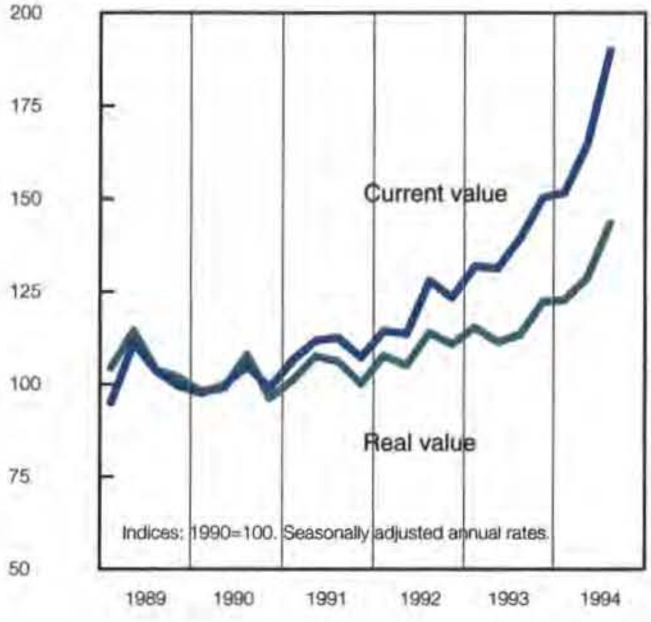
The change to a deficit on the current account of the balance of payments was mainly related to a persistently strong rise in the value of merchandise imports, which outweighed moderate increases in the value of merchandise exports and net gold exports. In addition, net service and transfer payments to non-residents, which had declined substantially in the second quarter of 1994, rose again in the third quarter.

The value of South Africa's *merchandise imports*, seasonally adjusted and annualised, advanced from R71,4 billion in the second quarter of 1994 to R82,3 billion in the third quarter, or by nearly 15½ per cent. This brought the value of merchandise imports in the first nine

## Balance of payments: Current account



**Merchandise imports**




months of 1994 to a level that was approximately 26 per cent higher than in the corresponding period of the preceding year. Although the further sharp increase in merchandise imports was fairly widespread, pronounced increases were recorded in the category manufacturing imports, and more specifically in the imports of chemical products, textiles, machinery and electrical equipment, and transport equipment.

As shown in Table 5, the substantial increase in the value of merchandise imports in the third quarter of 1994 was mainly due to a corresponding strong rise in the volume of imports which partly reflected the higher level of economic activity and capital expenditure on large capital-intensive projects. More important, the sharp rise in the volume of merchandise imports was also due to speculative purchases ahead of an expected further depreciation of the rand; this is substantiated by a strong rise in industrial and commercial inventories. The depreciation of the rand, rising international oil prices and moderate price increases in trading partner countries, caused the prices of merchandise imports to rise moderately in the third quarter of 1994.

**Table 5. Merchandise imports and exports**

Quarter-to-quarter percentage change
seasonally adjusted data

| | 1994 | | |
|---|---|---|---|
| | **1st qr** | **2nd qr** | **3rd qr** |
| Merchandise imports | | | |
| Value | 0,8 | 8,7 | 15,3 |
| Price | 0,7 | 3,6 | 3,4 |
| Volume | 0,3 | 4,9 | 11,5 |
| Merchandise exports | | | |
| Value | -4,4 | 5,5 | 6,2 |
| Price | 2,1 | 3,9 | 2,5 |
| Volume | -6,4 | 1,6 | 3,6 |

The substantially higher value of merchandise imports in the third quarter of 1994 was accompanied by an only moderate rise in *merchandise exports*. This surprisingly poor export performance against a background of a fairly rapid economic recovery in the rest of the world seemed to have been caused by special circumstances. Largely as a result of the extended strike in the automotive and related industries, the exports of transport equipment declined substantially in the third quarter of 1994. Diamond exports were also disrupted in this period by large international sales by Russia.

The volume of merchandise exports therefore rose at a much lower rate than world trade. Despite the further rise in international commodity prices and a decline in the nominal effective exchange rate of the rand, the prices of merchandise exports rose by only 2½ per cent from the second to the third quarter of 1994. This moderate increase in export prices seems to be due to the fact that a significant part of South Africa's exports is sold at contract prices, which react only with a lag to higher international commodity prices.

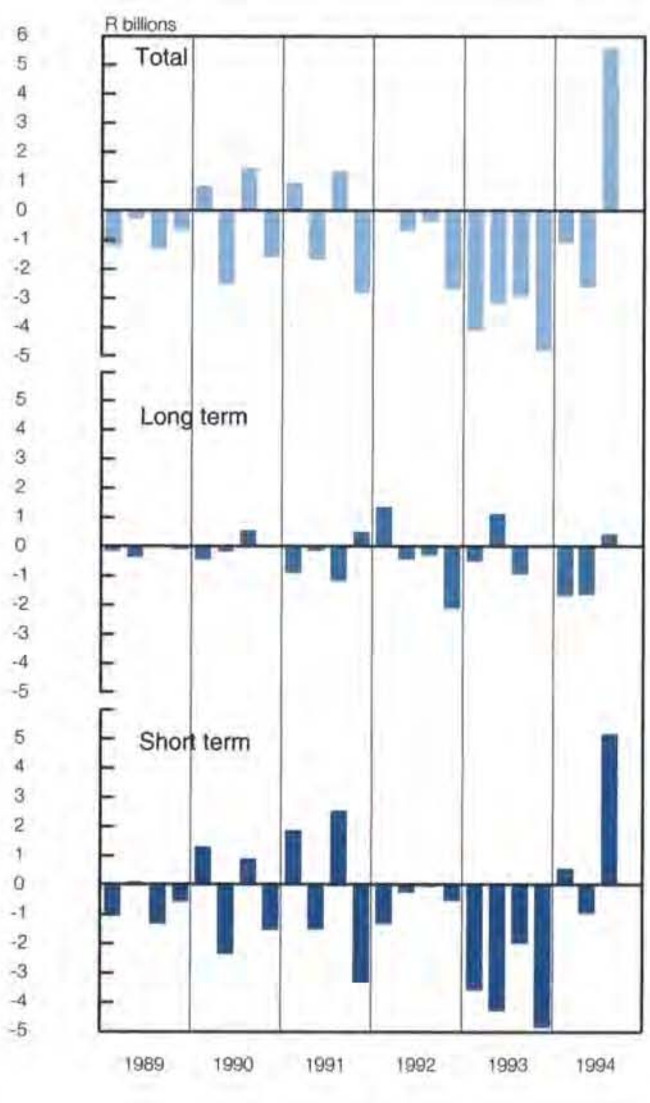
The value of *net gold exports* at seasonally adjusted and annualised rates increased from R23,2 billion in the second quarter of 1994 to R24,8 billion in the third quarter, or by 7 per cent. This increase could be attributed almost entirely to an increase in the volume of exports, which had been adversely affected in the preceding quarter by strikes and the additional public holidays. The average fixing price of gold on the London market rose only slightly from US$382 per fine ounce in the second quarter of 1994 to $386 per fine ounce in the third quarter. In rand terms, the average fixing price of gold per fine ounce rose from R1 380 to R1 391 over the same period.

*Net service and transfer payments* to non-residents (seasonally adjusted and annualised), which had decreased from R15,9 billion in the first quarter of 1994 to R13,8 billion in the second quarter, rose again to R15,9 billion in the third quarter of 1994. These significantly higher net payments were the net result of an increase of R2,3 billion in service payments and an increase of R0,2 billion in service receipts. More specifically, the larger deficit on the services account in the third quarter was brought about by higher freight and merchandise insurance payments on account of the expansion in the value of imports and higher interest payments on account of a sharp increase in the utilisation of foreign credit facilities.

### Capital movements

A dramatic turnaround took place in the *capital account* of the balance of payments during the third quarter of 1994. Having shown throughout 1993 large net outward movements of capital, which improved moderately from a revised figure of R7,7 billion in the second half of 1993 to R3,7 billion in the first half of 1994, a net inflow of capital not related to reserves of no less than R5,6 billion was recorded in the third quarter of 1994. This substantial reversal in the capital account seems to have occurred after it had become apparent that the transition to a new political dispensation in South Africa would be achieved in a relatively peaceful manner. The net inflow of capital consisted mainly of short-term funds not related to reserves, i.e. liabilities and assets with an original maturity of less than one year. However, longer-term project financing from abroad also became more readily available to South Africa.

**Net capital movements not related to reserves**




The net movement of *short-term capital* not related to reserves (but including errors and unrecorded transactions) switched from a net outflow of R1,0 billion in the second quarter of 1994 to a net inflow of R5,2 billion in the third quarter. This substantial inflow of capital was mainly related to the relatively favourable cost and availability of foreign trade financing (mainly Euro-dollar financing) and a further significant increase in the foreign liabilities of private banks. Relatively tight domestic money market conditions induced banks to obtain foreign short-term financing, while the rise in merchandise imports favoured on-lending of foreign funds to clients. In the first nine months of 1994 the foreign short-term liabilities of private banks in South Africa increased accordingly by no less than R6,9 billion; in 1993 these liabilities had contracted by R3,3 billion. In addition, the relative weakness of the US dollar internationally also caused an inflow of short-term capital via forward cover transactions in third currencies.

Net movements of *long-term capital* also switched from an outflow of R1,6 billion in the second quarter of 1994 to an inflow of R433 million in the third quarter. This considerable improvement occurred despite the repayment of R473 million on so-called affected debt in terms of the final debt arrangements with foreign creditor banks, the redemption of R524 million affected debt converted into long-term loans outside the standstill net, and the falling due of R380 million of debt guaranteed by agencies of foreign governments.

Purchases of government stock and securities of public authorities caused the net outflow of capital of R0,3 billion from public authorities and public corporations in the second quarter of 1994 to change to a net inflow of R0,8 billion in the third quarter. Over the same period, the net outflow of long-term capital from the non-monetary private sector declined from R1,0 billion to only R37 million. This improvement in the capital flow from the private sector was due to a decline in the net sales of securities quoted on the Johannesburg Stock Exchange by non-residents from R1,2 billion in the second quarter of 1994 to only R23 million in the third quarter, which transpired through the financial-rand mechanism and which, therefore, did not affect the foreign reserves of the country.

### Foreign reserves

The substantial improvement in the capital account of the balance of payments offset the deficit on current account and was responsible for an increase of R3,3 billion in the *net gold and other foreign reserves* in the third quarter of 1994. This followed declines in the total net foreign reserves of R9,2 billion during 1993 and R3,2 billion in the first half of 1994. In October 1994 the net foreign reserves of the Reserve Bank rose further by no less than R2,4 billion. The sizable recovery in the overall balance of payments position allowed the Reserve Bank to reduce

**Table 6. Net capital movements not related to reserves**

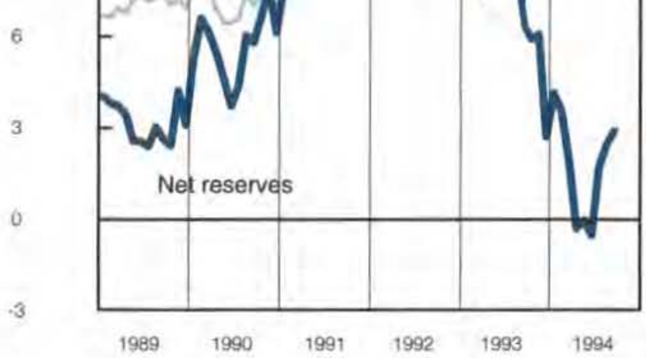
R millions

| | 1993 | 1994 | | |
|---|---|---|---|---|
| | Year | 1st qr | 2nd qr | 3rd qr |
| Long-term capital | | | | |
| Public authorities | -1 317 | -1 064 | -92 | 458 |
| Public corporations | -1 569 | -1 426 | -187 | 369 |
| Private sector | 2 614 | 809 | -1 368 | -394 |
| **Total long-term capital** | **-272** | **-1 681** | **-1 647** | **433** |
| Short-term capital | | | | |
| Monetary sector | -3 309 | 2 254 | 1 327 | 3 321 |
| Other, including unrecorded transactions | -11 440 | -1 682 | -2 285 | 1 830 |
| **Total capital movements, excluding liabilities related to reserves** | **-15 021** | **-1 109** | **-2 605** | **5 584** |

its foreign short-term liabilities related to reserves from a peak of R8,5 billion on 10 May 1994 to R3,6 billion at the end of October 1994.

Despite the redemption of reserve-related loans, South Africa's total *gross gold and other foreign reserves* nevertheless increased by R1,3 billion in the third quarter of 1994 from R9,7 billion at the end of June to R11,0 billion at the end of September. At this more recent level the gross reserves were equal to the value of about 5 weeks' imports of goods and services. In October 1994 the gross foreign reserves of the Reserve Bank advanced further by R0,9 billion. The higher foreign reserves of the Reserve Bank consisted mainly of foreign exchange holdings, while the gold reserves of the Bank declined from 4,2 million fine ounces at the end of June 1994 to 3,6 million fine ounces at the end of October.

**Foreign reserves**




### Exchange rates

Owing to the stronger overall balance of payments position and the weaker performance of the US dollar on international exchange markets, the nominal effective exchange rate of the rand rose by 3,9 per cent from 13 July 1994 to 21 November 1994. This followed a period during which the currency depreciated; the *nominal effective exchange rate* of the rand therefore still declined, on balance, by 8,6 per cent from the end of December 1993 to 21 November 1994, while the *real effective exchange rate* contracted by about 3 per cent during the first nine months of 1994.

Sharp decreases were registered in the exchange rates of the rand against most of the *major currencies* during the first eleven months of 1994, with the notable exception of the US dollar. The rand depreciated by only 4,1 per cent against the US dollar from the end of December 1993 up to 21 November 1994 because of the weakening of the dollar after the middle of the year. Over the same period, the depreciation of the rand against the other major currencies varied between 9½ and 15½ per cent.

Expectations and large-scale speculation about the possible abolition of exchange control on non-residents resulted in a persistent strengthening of

**Table 7. Changes in exchange rates of the rand**

Per cent

| | 31 Dec 1993 to 31 Mar 1994 | 31 Mar 1994 to 30 Jun 1994 | 30 Jun 1994 to 13 Jul 1994 | 13 Jul 1994 to 21 Nov 1994 | 31 Dec 1993 to 21 Nov 1994 |
|---|---|---|---|---|---|
| Weighted average | -4,1 | -6,9 | -1,5 | 3,9 | -8,6 |
| US dollar | -2,1 | -4,9 | -0,1 | 3,2 | -4,1 |
| British pound | -2,6 | -8,2 | -1,9 | 3,0 | -9,6 |
| German mark | -5,8 | -9,3 | -3,8 | 5,0 | -13,6 |
| Japanese yen | -10,2 | -8,2 | -1,6 | 4,4 | -15,4 |
| Netherlands guilder | -5,4 | -9,5 | -3,8 | 5,0 | -13,5 |
| Italian lira | -7,9 | -6,6 | -4,1 | 8,8 | -10,2 |

the exchange rate of the *financial rand* from an all-time low of R5,58 per dollar on 11 April 1994 to a high of R3,92 per dollar on 21 October 1994. As it became apparent that the authorities have no intention to abolish the financial rand before a number of preconditions have been met, the exchange rate of the financial rand gradually weakened again to R4,11 per dollar on 21 November 1994. The financial rand discount, which had narrowed from 35,7 per cent on 11 April 1994 to 10,2 per cent on 21 October, widened again to 13,8 per cent on 21 November 1994.

**Exchange rates**

## Monetary developments, interest rates and financial markets

### Money supply

The growth in the *broadly defined money supply* (M3) over periods of twelve months, which had increased rapidly in the first seven months of 1994, receded moderately during the rest of the third quarter of 1994. This rate rose from a relatively low level of 1,9 per cent in July 1993 and 7,0 per cent in December 1993 to a high of 16,9 per cent in July 1994 before falling back to 14,3 per cent in September. As a result of this relatively rapid rate of increase, the monthly values of M3 in 1994 to date exceeded markedly the upper limit of the guideline range of 6-9 per cent for the year. The seasonally adjusted value of M3 amounted to R232 billion at the end of September 1994, this being 3,8 per cent higher than the corresponding value of the upper limit of the guideline range.

The rapid growth in the money supply during 1994 was related partly to the acceleration in the growth of expenditure on consumption, investment and inventory accumulation. This was to a large extent also brought about by an improvement in the cash flow of business enterprises as a result of a strengthening of company profits and of a running-down of government deposits built up in 1993 with the monetary sector. The private sector's liquidity preference rose at the same time, *inter alia* on account of political uncertainties and expected interest rate changes, and in anticipation of major adjustments in the share and bond markets.

**Guidelines for growth in M3**

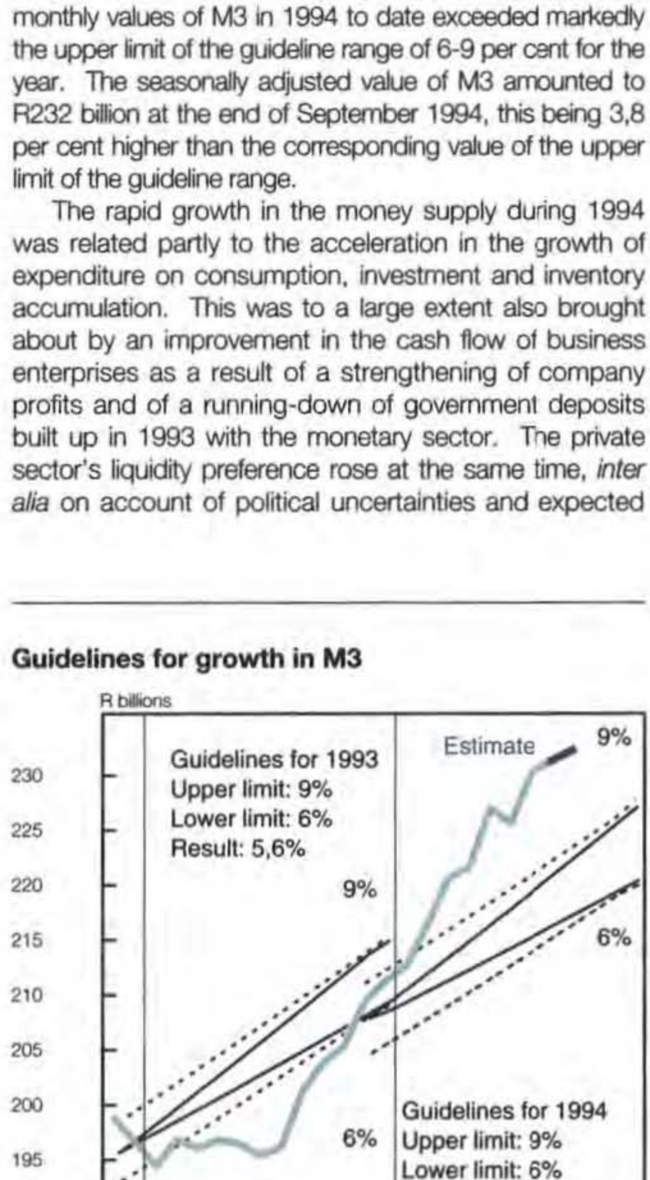



**Table 8. Twelve-month growth rate in monetary aggregates**

Per cent

| | M1A | M1 | M2 | M3 |
|---|---|---|---|---|
| December 1993 ......... | 16,6 | 6,7 | 3,9 | 7,0 |
| March 1994................ | 25,7 | 19,4 | 13,6 | 12,3 |
| June 1994.................. | 25,1 | 28,2 | 17,4 | 15,0 |
| July 1994.................... | 28,2 | 32,7 | 19,5 | 16,9 |
| August 1994............... | 24,4 | 26,7 | 19,6 | 15,1 |
| September 1994 ........ | 28,8 | 26,1 | 18,5 | 14,3 |

These factors not only caused an increase in total deposit holdings, but also a clear preference for shorter-term deposits with monetary institutions. As can be seen from Table 8, the *narrowly defined money supply aggregates* increased at a much more rapid rate than M3. Despite some attractive interest rates being offered on long-term deposits, investors' holdings of this type of deposits have shown a distinct downward movement in absolute terms during the first nine months of 1994.

The higher preference of the private sector for depository investments was also reflected in a decline in the *income velocity of M3*. Notwithstanding the relatively wide margins between banks' deposit and lending rates (such margins usually being conducive to disintermediation practices), the income velocity of M3 decreased by 3,8 per cent from the third quarter of 1993 to the third quarter of 1994.

The *main counterparts* (in a statistical or accounting sense) of the R21,2 billion increase in M3 in the first nine months of 1994 were an increase in the monetary institutions' claims on the private sector and in their net claims on the government sector. This was offset to some extent by a decrease in their net foreign assets and in their so-called "net other assets and liabilities".

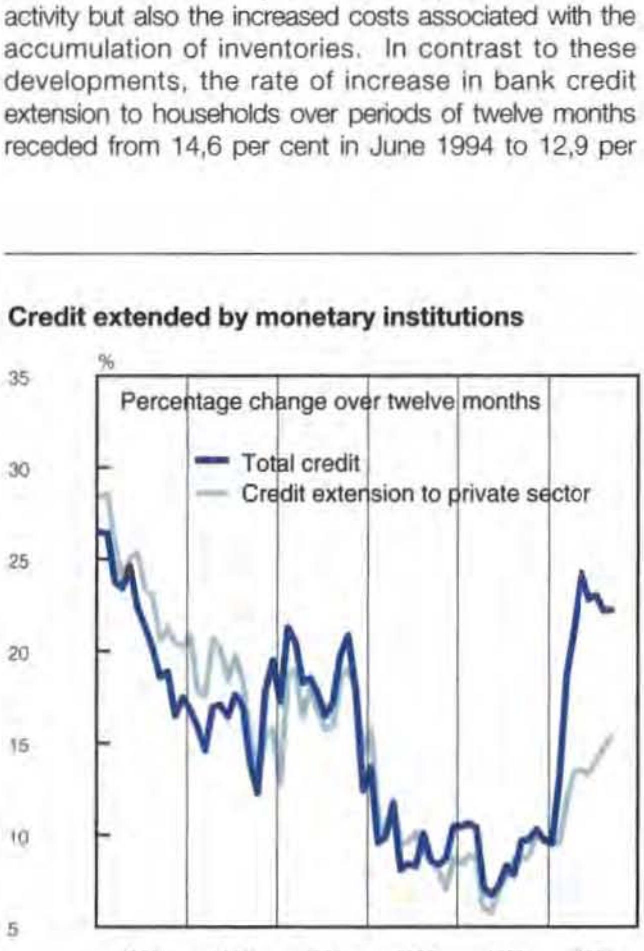
### Credit extension

The rate of increase in *total domestic credit extension* by monetary institutions, which had surged from 9,6 per cent in December 1993 to 24,2 per cent in May 1994, contracted marginally to a still high 22,2 per cent in September 1994. The high rate of credit extension in the first nine months of 1994 was the result of a sharp rise in the credit extension to the non-bank private sector as well as in the monetary sector's net claims on the government. The issuing of special government stock of R7,5 billion to the Reserve Bank, in partial redemption by the government of the outstanding balance on the Gold and Foreign Exchange Contingency Reserve Account in March 1994, distorted the increase in bank credit extension to the government; this stock issue caused a shift in the statistical counterparts of M3 from changes in "net other assets and liabilities" to changes in net claims on the government sector without any funds actually flowing to the government. However, even if this transaction is disregarded, there was still a sharp rise in the monetary institutions' net claims on the government in the first nine months of 1994, due to a decline in government deposits held with the banking sector.

The twelve-month rate of increase in *domestic credit extension to the non-bank private sector* by monetary institutions increased from 9,7 per cent in December 1993 to 15,3 per cent in September 1994. Compared with other periods of economic recovery, credit extension to the private sector is following a more or less normal cyclical pattern, but it did react fairly quickly to the upturn in economic activity. The growth rates in credit extension were also well above the rates of consumer price inflation, indicating an increase in real credit extension to the private sector.

The continued high level of credit extension to the private sector in the third quarter of 1994 was mainly due to credit extended to the private business sector. Measured over a period of twelve months, the growth rate in credit extension to the private business sector increased from 15,1 per cent in June 1994 to 18,3 per cent in September 1994. This continued high level of credit extension not only reflected the upturn in economic activity but also the increased costs associated with the accumulation of inventories. In contrast to these developments, the rate of increase in bank credit extension to households over periods of twelve months receded from 14,6 per cent in June 1994 to 12,9 per cent in September, probably reflecting expected lower wage and salary increases and fears of future tax increases and interest rate hikes.

**Credit extended by monetary institutions**




An analysis by *type of credit* of the monetary institutions' claims on the domestic private sector reveals that the R33,8 billion increase in total credit extension over the twelve months to September 1994 was mainly due to increases of R15,5 billion in mortgage advances, R5,4 billion in instalment sales credit and R9,5 billion in overdrafts and other loans and advances.

The rate of increase over twelve months in mortgage advances remained at a level of about 17 per cent throughout the first nine months of 1994, despite the fact that the banks scaled down the active promotion of this type of credit extension somewhat in the third quarter of 1994 by announcing their unwillingness to include legal costs in the principal amount of the mortgage loan. However, the flexibility of some of the mortgage schemes and the comparatively low interest rates charged on these advances, ensured their continued popularity with the public.

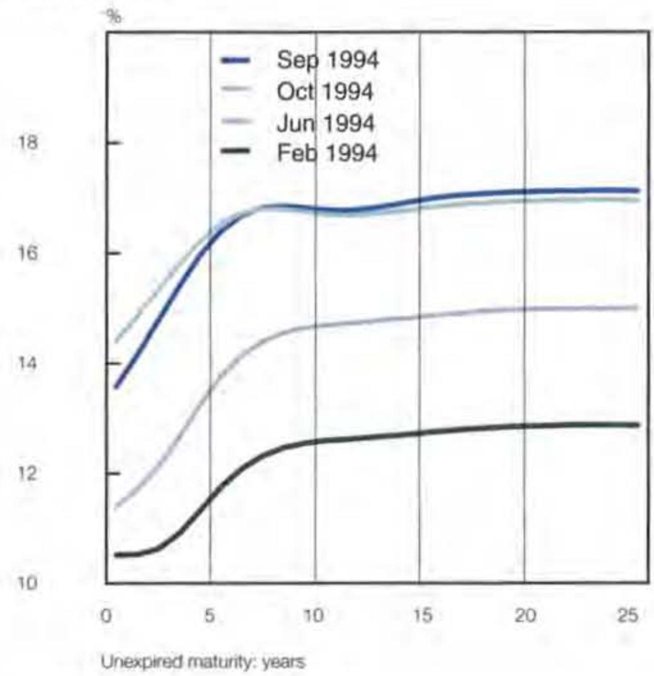
Special-rate vehicle finance packages by banks, and rising car sales, contributed to the acceleration in the rate of increase over a twelve-month period in instalment sales credit from 18,0 per cent in December 1993 to 23,5 per cent in June 1994 and 24,7 per cent in September. The growth rate over twelve months in leasing finance, which had increased somewhat from 6,8 per cent in December 1993 to 8,4 per cent in June 1994, declined to 5,9 per cent in September. The corresponding growth rate in overdraft and other loans and advances showed a similar pattern, increasing at first from 8,4 per cent in December 1993 to 13,4 per cent in July 1994 and then decreasing marginally to 12,4 per cent in September.

**Interest rates and yields**

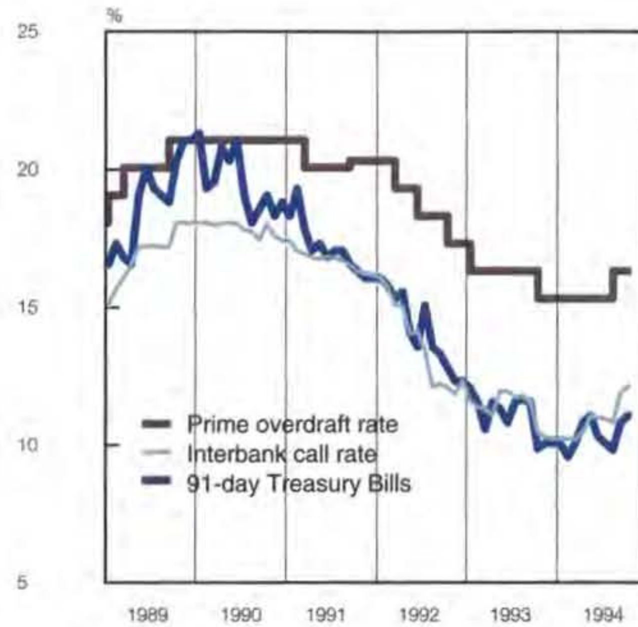
From February 1994 interest rates and yields have continued to move upwards in South Africa over the whole maturity spectrum. Notwithstanding an increase of one percentage point to 13 per cent in Bank rate on 26 September 1994, the shape of the *yield curve* remained more or less unchanged in the subsequent month; the upward-sloping yield curve therefore remained steep for paper with a maturity of one to six years and relatively flat over the rest of the maturity range. This yield curve probably still indicates further expectations of upward adjustments in short-term interest rates and a rise in the inflation rate.

After having hardened from February to May 1994, *money market rates* softened somewhat in the subsequent three months. This was clearly reflected in the rate on interbank call money, which rose from 9,5 per cent at the end of February 1994 to 11,0 per cent at the end of May before falling again to 9,75 per cent at the end of August. Money market rates, however,

**Yield curves**




**Short-term interest rates**




reacted immediately to the higher Bank rate and the rate on interbank call money rose to 10,75 per cent at the end of September and to 11,0 per cent at the end of October. The other money market interest rates showed more or less similar changes over this period.

*Capital market yields* also reacted quite strongly to the increase in Bank rate. The yield on long-term government stock increased sharply further from 16,32 per cent just before the announcement of the change in Bank rate to 16,74 per cent after the increase; at the end of October 1994 this yield amounted to 16,7 per cent. The monthly average yield on long-term government stock in October 1994 was 4,7 percentage points higher than in January 1994. The strong upward pressure on domestic long-bond rates in the first ten months of 1994 was caused by factors such as uncertainties pertaining to political developments, concerns about the government's large financing needs and increasing domestic inflation fears. The real rates on long-term government stock (i.e. nominal rates adjusted for the prevailing year-on-year inflation rate) rose accordingly, namely from 2,1 per cent in January 1994 to 6,5 per cent in June 1994, but then contracted slightly to 6,1 per cent in September with the improvement in the foreign reserves of the country.

Following the increase in Bank rate, the *banks' prime lending rate* was raised by one percentage point to 16,25 per cent from 26 September 1994. As a result of the acceleration in the rate of inflation, the real or inflation-adjusted prime lending rates of banks rose only slightly from 5,4 per cent in August 1994 to 5,5 per cent in September. Even after the increase in Bank rate, the current level of the real prime lending rate of the banks is considerably lower than the level of 7,7 per cent in April 1994.

The twelve-month *deposit rate of banks* was also adjusted upwards by one percentage point to 11,5 per cent in September 1994. Bidding more aggressively for longer-term deposits, some banks increased their twelve-month deposit rates further to between 12,0 and 12,25 per cent in October 1994. Some banks also offered very favourable rates on five-year fixed deposits, increasing progressively to as much as 19,5 per cent during the final year of the deposit and averaging some 15½ per cent per annum.

**Money market**

The relatively tight *money market conditions* that prevailed in the first six months of 1994, eased considerably in the third quarter. Accommodation at month ends contracted from R6,5 billion at the end of June 1994 to R3,3 billion at the end of August before increasing again to R3,9 billion at the end of September 1994. In October the accommodation provided to the money market by the Reserve Bank rose further to R4,7 billion at the end of the month. The average daily level of accommodation granted by the Reserve Bank initially also decreased considerably from a peak of R5,5 billion in May 1994 to R2,5 billion in September, rising marginally again to R2,7 billion in October 1994.

**Table 9. Money market conditions**
R millions

| | 1994 | | | |
|---|---|---|---|---|
| | 1st qr | 2nd qr | 3rd qr | October |
| Accommodation – beginning of period | -5 778 | -5 314 | -6 506 | -3 929 |
| Change in: | | | | |
| Notes and coin (increase -) | -1 341 | 41 | -369 | -192 |
| Net foreign assets | 124 | -378 | 3 379 | 1 494 |
| Government deposits with SARB (increase –) | 3 416 | -1 435 | 1 415 | -2 086 |
| Net other assets of SARB and CPD | -1 735 | 580 | -1 848 | 19 |
| Accommodation – end of period | -5 314 | -6 506 | -3 929 | -4 694 |

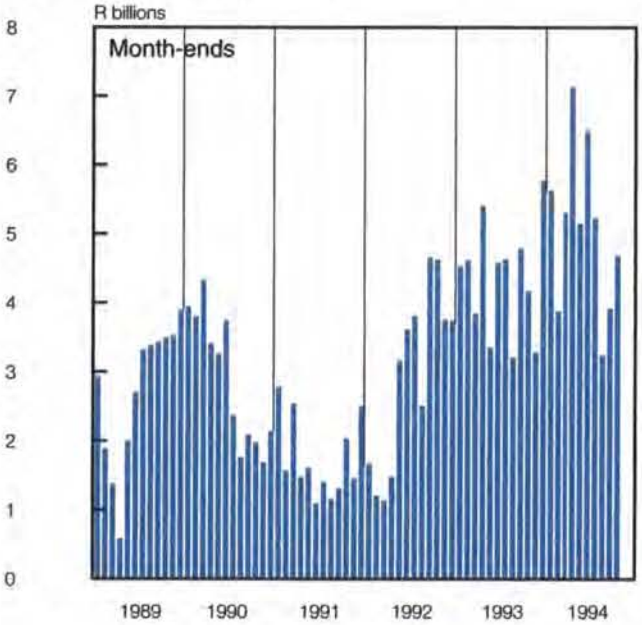
As shown in Table 9, the relatively easier money market conditions since July 1994 were brought about mainly by an increase in the net foreign assets of the Reserve Bank. In the third quarter of 1994 a decline in government deposits with the Reserve Bank also aided these easier conditions; in October 1994, however, government deposits with the Reserve Bank rose sharply again.

After having been generally neutral during the first seven months of 1994, the *Reserve Bank's operations* in the money market had a net tightening effect on liquidity. In August 1994 the Reserve Bank issued special Treasury bills amounting to R1 billion to assist in the funding of the government deficit and to counter the easing effect of adjustments in the asset portfolio of the Corporation for Public Deposits on money market conditions. The changes in the asset portfolio of the Corporation for Public Deposits had a net easing effect of R1,5 billion in the third quarter of 1994. In October 1994 the Reserve Bank also entered into foreign exchange swaps with the private sector to the value of R1,8 billion in order to drain liquidity from the money market.

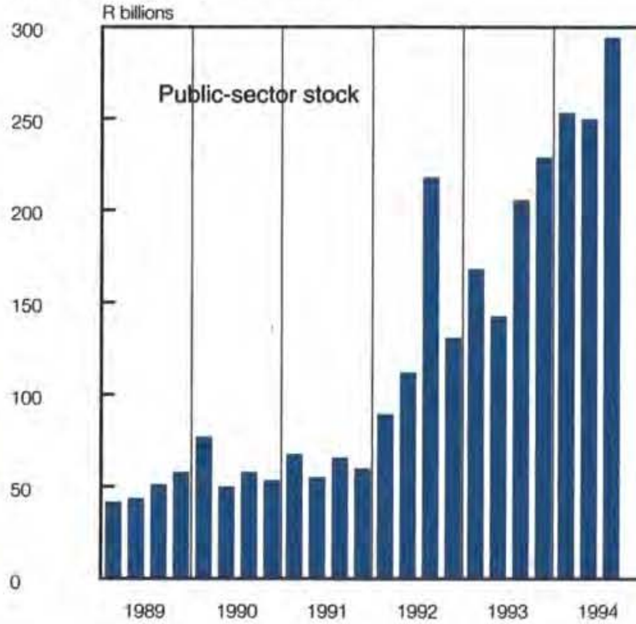
**Bond market**

Net new borrowing by the public sector in the *primary bond market* fell back significantly from R7,3 billion in the second quarter of 1994 to R4,1 billion in the third quarter. This brought the new issues of public-sector stock to R11,4 billion in the first half of fiscal 1994/95, compared with R26,7 billion in the corresponding period of the preceding year.

**Accommodation at discount window**




**Stock exchange transactions**



Activity in the *secondary bond market* remained very buoyant in the third quarter of 1994; the value of public-sector stock traded on the Johannesburg Stock Exchange rose sharply further from the already high level of R250 billion in the second quarter of 1994 to R295 billion in the third quarter. In October 1994 trading activity decreased to R81 billion from an all-time high of R115 billion in September 1994 because the yield on long-term government stock stabilised at substantially higher levels than at the beginning of the year and created uncertainty about likely future changes. The lively bond market conditions were due to a large extent to the active promotion of the market by the Reserve Bank, which entered into transactions on a large scale in government stock as well as government stock options to raise liquidity.

*Non-residents* were net purchasers of public-sector stock to the amount of R1,0 billion in the first ten months of 1994. Although non-residents' participation in the bond market is relatively low at about 1 per cent of the total value of gilts traded, they continued to have an important effect on price movements in the market.

**Equity market**

The demand for funds in the *primary equity market* remained low and new issues of securities by listed private-sector companies were insignificant. Even though conditions remained favourable for share-capital issues throughout the first ten months of 1994 (long-term rates firmed and share prices remained high and even increased further), the value of rights issues of ordinary shares by listed companies declined sharply from levels reached in 1993. This could to a large extent be ascribed to the wait-and-see attitude adopted by companies prior and subsequent to the election. Despite a rise in fixed investment, a number of companies still shelved capital projects and allowed their cash holdings to increase sharply. However, indications are that some companies began shifting gear during the last part of the third quarter of 1994 and the beginning of the fourth quarter. A few companies also broadened their activities internationally and raised capital on foreign markets by means of convertible Eurobond issues denominated in dollar.

**Stock exchange transactions**


In the *secondary equity market* the value of shares traded on the Johannesburg Stock Exchange remained at a comparatively high level of R17,6 billion in the third quarter of 1994, which was only slightly lower than the all-time record quarterly level of R20,7 billion in the first quarter of 1994. This brought the increase in the market's turnover to 87 per cent for the first three quarters of 1994, compared with the same period of 1993. Despite a substantial rise in share prices, the increased activity caused the value of shares traded as a ratio of market capitalisation to increase from 6,3 per cent over the twelve-month period to September 1993 to 9,0 per cent over the twelve-month period to September 1994.

*Non-residents* continued to be active participants in the secondary equity market. In terms of the total value of shares traded, non-residents' gross purchases of shares also increased from 18,5 per cent in the first quarter of 1992 to 31,4 per cent in the third quarter of 1994. However, in the course of the first nine months of 1994, their transactions changed from net purchases of shares of R2,2 billion in the first quarter to net sales of shares to amounts of R1,2 billion and R0,3 billion in the next two quarters.

The majority of international portfolio investors regards South Africa's equity market as being expensive in relation to current growth prospects. The historically high price-earnings ratio and real interest rates, the low dividend yield of only 2,18 per cent in October 1994, the low level of liquidity in the equity market and the dual currency system are seen as major impediments to significantly increased levels of non-resident share investment in South Africa. However, as shown in Table 10, the price-earnings ratio of South African shares is still relatively low in comparison with those of the so-called emerging markets. A further positive factor that may favour non-residents' purchases of South African equities is that South Africa is now included in key global stock-market indices and many international portfolios that are linked to these indices have only a small or no exposure to South African equities at present.

In the first nine months of 1994 *share price increases* in South Africa outperformed those of most of the emerging markets. The average share-price level in September 1994 was no less than 52 per cent above that of September 1993 and no less than 91 per cent above the

**Table 10. Price-earnings ratios on emerging markets**

| Country | 1992 | 1993 |
|---|---|---|
| Argentina | 40,4 | 61,4 |
| Malaysia | 22,8 | 48,2 |
| Taiwan | 22,9 | 39,7 |
| Singapore | 19,5 | 37,3 |
| Thailand | 16,3 | 26,1 |
| Turkey | 11,4 | 25,8 |
| Hong Kong | 13,1 | 21,6 |
| Chile | 14,3 | 21,6 |
| Greece | 8,7 | 20,1 |
| Mexico | 13,5 | 18,8 |
| South Korea | 10,8 | 16,0 |
| South Africa | 12,9 | 14,8 |
| Brazil | 8,5 | 9,2 |

lower turning-point in October 1992. This sharp upward movement in share prices was underpinned by the impressive performance of gold-mining and mining-financial shares. However, the turn-about in the gold price and the increasing uncertainty about the outlook for the local equity market and the extent of the economic recovery in South Africa led to a correction of 2,5 per cent in the average price index of all classes of shares in October 1994.

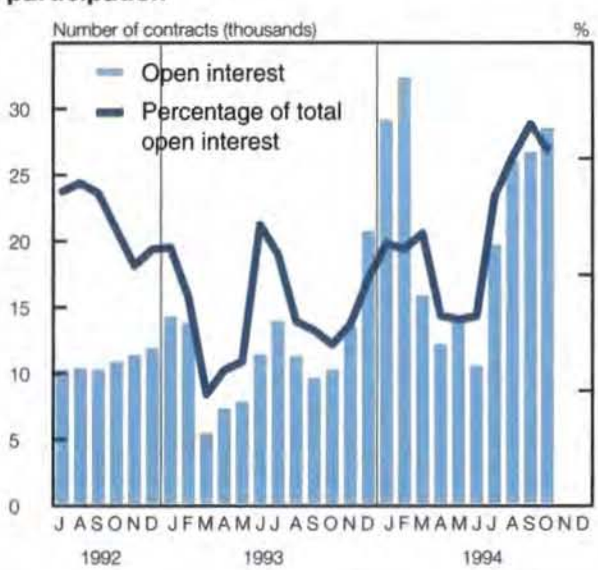
**Other financial markets**

After reaching an all-time high of 1,2 million contracts in the first quarter of 1994, turnover in the formal derivative *market for equity futures* fell back somewhat to 0,9 million and 1,0 million contracts in the ensuing two quarters. Trade in futures contracts in share indices was stimulated in the months leading up to October 1994 by the fluctuating gold price, uncertainty regarding political developments and increased involvement of non-residents. Non-residents' participation in the formal market increased from 11 per cent of open interest in January 1994 to 16 per cent in September 1994.

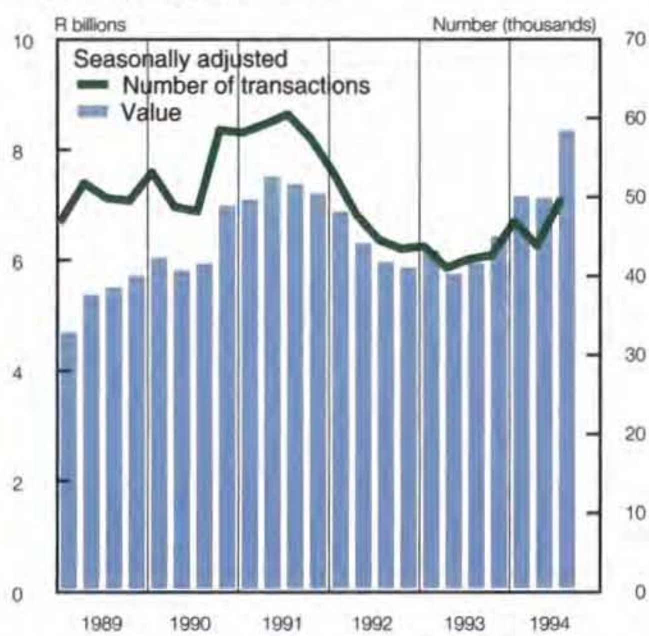
Equity futures contracts continued to dominate trade on the South African Futures Exchange throughout the first ten months of 1994 and there was little evidence of any significant shift from equity futures contracts to contracts based on other underlying instruments such as fixed-interest securities. The number of *options on index futures* contracts in the first ten months of 1994 was 178 per cent above its level in the corresponding period of the preceding year. However, the year-on-year rate of increase in both futures and options traded on the South African Futures Exchange showed a distinct downward movement in the course of 1994 to a still high level in October 1994.

As already indicated, the financing of the *mortgage market* remained at high levels in the first nine months of 1994. Greater optimism and confidence in South Africa's future after the peaceful political transition led to a higher demand for both residential and commercial property. The value of *real estate transactions*, which had moved sideways in the second quarter of 1994, increased sharply by 16,9 per cent to R8,3 billion in the third quarter.

**Futures exchange transactions: non-resident participation**




**Real estate transactions**



Average residential *property prices* started to firm significantly towards the end of the second quarter and rose sharply in the third quarter. The average price of all property transactions in the third quarter was also 19,8 per cent higher than a year earlier. These price increases were favourably influenced by increased affordability, because the mortgage rate in the third quarter of 1994 was still about 0,4 percentage points lower than in the corresponding quarter of 1993. However, soon after the increase in Bank rate, the banks announced that their predominant mortgage bond rate was to be increased by 1,0 percentage point to 16,25 per cent from 1 October 1994 for new home loans and from 28 October to 1 November 1994 for existing home loans.

## 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 governments, local authorities and the non-financial government enterprises and public corporations) declined from R9,7 billion in the first quarter of the fiscal year (i.e. the second quarter of the calendar year) to R3,9 billion in the second quarter of fiscal 1994/95. This brought the total public-sector borrowing requirement to R13,6 billion in the first six months of fiscal 1994/95, or to 6,3 per cent of gross domestic product. In the corresponding period of fiscal 1993/94 the public-sector borrowing requirement amounted to R14,1 billion or 7,3 per cent of gross domestic product.

The borrowing requirement of the *non-financial public corporations* turned around from a small deficit of R66 million in the first half of fiscal 1993/94 to a surplus of R226 million in the first half of fiscal 1994/95. The deficit of *general government* also contracted from R14,1 billion to R13,8 billion over the same period. As indicated in Table 11, only the extra-budgetary institutions, provincial governments and local governments contributed to the lower borrowing requirement of general government.

The improvement in general government's finances in the first half of fiscal 1994/95 could be attributed to the fact that the year-on-year rate of increase in general government revenue at 18,0 per cent exceeded the rate of increase of 14,0 per cent in general government expenditure. As a ratio of gross domestic product, general government expenditure nevertheless rose from 36,7 per cent in the first half of fiscal 1993/94 to 37,3 per cent in the first half of fiscal 1994/95.

**Public-sector borrowing requirement as percentage of gross domestic product**

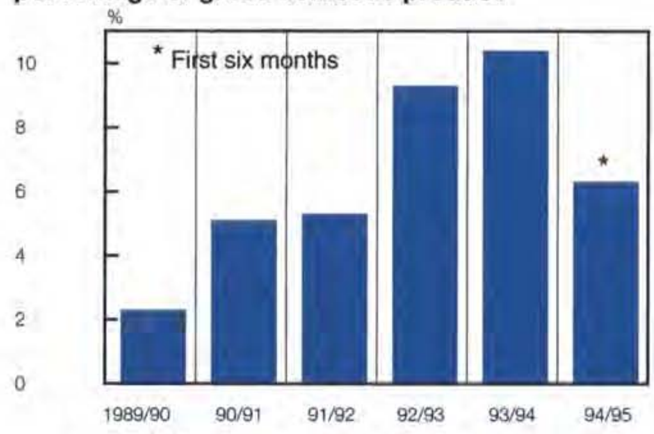
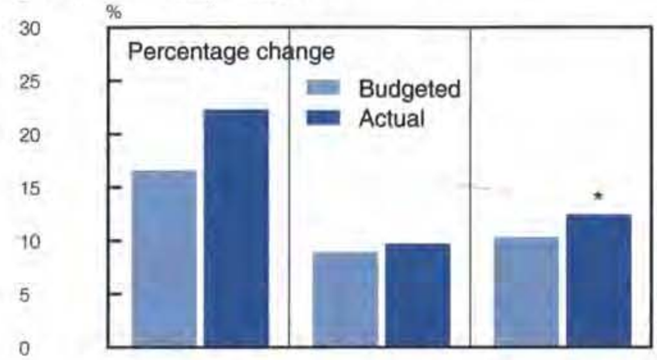


**Table 11. Borrowing requirement of general government**

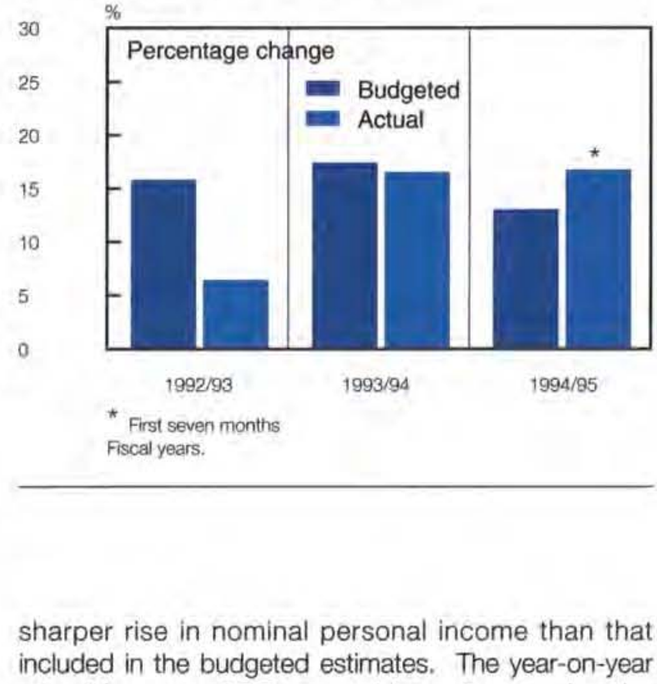
R millions

| | First half of fiscal 1993/94 | First half of fiscal 1994/95 |
|---|---|---|
| Main Budget | -14 509 | -15 194 |
| Extra-budgetary institutions | -944 | -56 |
| Social security | -42 | -53 |
| **Central government** | **-15 495** | **-15 303** |
| Provincial government | 1 664 | 1 684 |
| Local government | -230 | -170 |
| **General government** | **-14 061** | **-13 789** |

**Budgeted and actual exchequer issues to government departments**




**Budgeted and actual revenue**




* First seven months
Fiscal years.

### Exchequer account

From the information for the first seven months of fiscal 1994/95 it seems as if the government will be able to achieve its objective of reducing the deficit before borrowing and debt repayment as envisaged in the Budget. Both Exchequer issues and Exchequer receipts, however, increased more rapidly than foreseen in the June 1994 Budget.

The year-on-year rate of increase in *Exchequer issues* to government departments (adjusted to reflect cash flows) in the first seven months of fiscal 1994/95 amounted to 12,3 per cent, which was much higher than the budgetary provision of 10,2 per cent for the year as a whole. This rate of increase was, however, well below the corresponding average rate of increase of 17,4 per cent in the first seven months of the preceding five fiscal years. As a ratio of gross domestic product, Exchequer issues to government departments in the first half of fiscal 1994/95 were equal to 32,4 per cent, which was higher than the 31,5 per cent in the corresponding period of the preceding fiscal year. Moreover, this already high level of expenditure does not include planned government expenditure of R2,5 billion from the Reconstruction and Development Fund, of which R1,9 billion has already been allocated but not yet spent.

*Exchequer receipts* (excluding proceeds from privatisation) in the first seven months of fiscal 1994/95 were 16,6 per cent above the level in the first seven months of 1993/94, against a budgeted increase of only 12,9 per cent for the fiscal year as a whole and an average rate of increase of 14,3 per cent for the corresponding period in the preceding five fiscal years. As a ratio of gross domestic product, Exchequer receipts rose from 23,6 per cent in the first half of fiscal 1993/94 to 25,4 per cent in the first half of fiscal 1994/95.

The higher-than-budgeted rate of increase in government revenue could be attributed to sharp increases in inland revenue as well as in the receipts from customs and excise duties. Inland revenue performed better than envisaged in the Budget because of a sharper rise in nominal personal income than that included in the budgeted estimates. The year-on-year rate of increase of 7,0 per cent in customs and excise duties in the first seven months of fiscal 1994/95, compared with a budgeted increase of only 2,6 per cent for the fiscal year as a whole, was due to the income arising from a substantial increase in the value of merchandise imports, and which more than offset the loss in revenue from the abolition of the import surcharge on all capital and intermediate goods from 23 June 1994.

The net result of these changes in income and expenditure was a deficit of R15,6 billion on the Exchequer account before borrowing and debt repayment in the first seven months of fiscal 1994/95. As a ratio of gross domestic product, the deficit came to 7,0 per cent in the first half of fiscal 1994/95; for the full fiscal year a ratio of 6,6 per cent had been foreseen and in the corresponding period of the preceding year a ratio of 7,8 per cent had been registered. The deficit for the first seven months of fiscal 1994/95 amounted to 53,5 per cent of the budgeted deficit for the year as a whole.

**Table 12. Financing of Exchequer deficit in the first half of fiscal 1994/95**

| | R millions |
|---|---|
| Government stock: | |
| Public Investment Commissioners | 10 105 |
| Monetary institutions | 3 076 |
| Non-monetary private sector | 8 121 |
| Foreign sector | -10 |
| Discount | -7 395 |
| **Total** | **13 897** |
| Treasury bills | 401 |
| Foreign loans | -83 |
| Non-marketable securities | -860 |
| Money market instruments | 2 |
| Decrease in available cash balances | 1 763 |
| **Total net financing** | **15 121** |

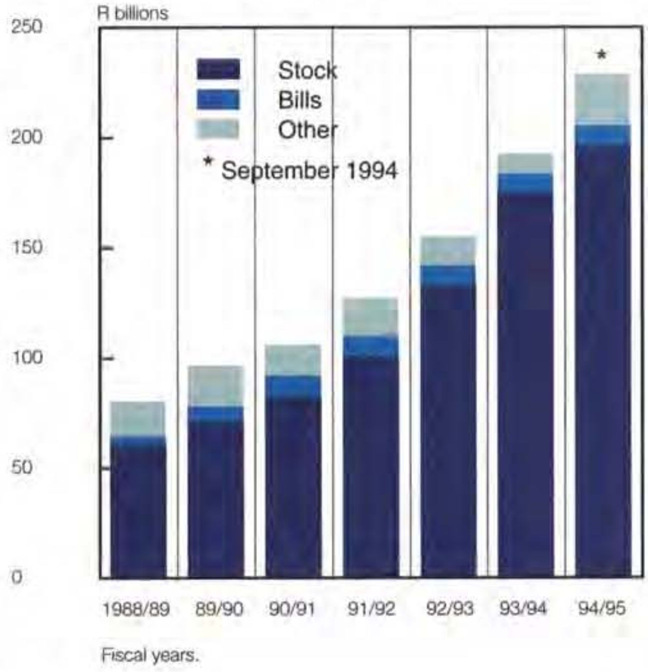
which was also considerably lower than the average ratio of 63,9 per cent for the corresponding period in the preceding five fiscal years.

As shown in Table 12, the deficit for the first half of fiscal 1994/95, and the very large discount on government stock of R7,4 billion, were *financed* primarily by the issue of long-term government stock. Most of this government stock was again taken up by the Public Investment Commissioners and the non-monetary private sector. Owing to the fact that the government is issuing stock with a substantially lower coupon rate than the ruling market interest rate, the discount on government stock increased from 6,5 per cent of the value of total stock issues in fiscal 1993/94 to 34,7 per cent in the first half of fiscal 1994/95. However, if the government had issued government stock at about the ruling market interest rate, it would have placed additional pressure on the government's short-term cash flow through higher interest payments; these interest payments have already accounted for 15,7 per cent of government expenditure in the first half of fiscal 1994/95.

The high discount, however, has the disadvantage that more stock has to be issued to satisfy the financing requirement of the government, which, of course, leads to an even sharper increase in *government debt*. The discount, together with the deficit, was therefore responsible for an increase in government debt from R192,1 billion or 48,6 per cent of gross domestic product at the end of March 1994 to R228,4 billion or 54,6 per cent of gross domestic product at the end of September 1994.

In an effort to avoid increasing the pressure of the high cost of debt servicing on the government's finances and at the same time to satisfy institutional investors' preferences for a capital market instrument with money market qualities, a new *variable-rate stock* was introduced in October 1994. This stock has a maturity of

**Composition of outstanding government debt**




four years and a coupon rate that is determined quarterly by the ruling Treasury bill tender rate plus a premium. On 10 November 1994, approximately R1,9 billion had already been raised by means of this new debt instrument. More than half of this financing, however, was provided by the banks.