Quarterly economic review

Introduction

The exceptional circumstances that prevailed in South Africa during the first half of 1994 affected most economic activities and caused the economic recovery to falter somewhat. Small positive growth rates were nevertheless still recorded in the output of the non-agricultural sectors in the first and second quarter of 1994 – a remarkable achievement in a country undergoing a major political transition with concomitant great uncertainty about the outcome of political developments and continued labour unrest. As it became evident that this transformation would be achieved in a peaceful manner, a more positive economic climate developed, but with the recovery still being held back by increased friction between employees and employers in wage negotiations.

Agricultural conditions also continued to play a major role in the determination of overall output. After having increased substantially in 1993, agricultural output fluctuated around this higher level in the first and second quarter of 1994; these favourable agricultural conditions contributed to a higher total output level. Most of the other main economic sectors, with the notable exceptions of mining and manufacturing, had a hand in the increase in total output in the second quarter of 1994, but the real value added by these sectors increased more moderately. This slower growth was largely the result of uncertainty regarding political developments. A decline in the number of work days, and increases in work stoppages and strikes also had an adverse effect on manufacturing output and on the throughput of ore by the gold mines. The decline in gold production could furthermore be ascribed to the mining of ore with a lower gold content owing to the rise in the gold price.

All the main expenditure components increased in the first and second quarter of 1994 and accordingly aggregate real gross domestic expenditure rose further, but at a more subdued pace. A sharper increase in real personal disposable income was mainly responsible for an accelerated growth in real durable and non-durable consumption expenditure by households. Real consumption expenditure by general government continued to rise strongly, owing mainly to spending by extra-budgetary institutions, including the former TBVC countries and self-governing states.

More important, the increase in real gross domestic capital formation (which had started from the second quarter of 1993) continued in the second quarter of 1994 and fixed investment rose more rapidly than in the second half of 1993. Although the capital expenditure on a few important projects was largely responsible for the revival in fixed investment, increases in real capital outlays were evident throughout the economy. Factors such as the rise in agricultural income, the replacement of ageing equipment, the expansion of production capacity in certain sectors and the development of some new mines led to higher capital investment in the private sector and by public corporations. Enterprises also continued to build up inventories to somewhat higher levels in the second quarter of 1994.

The exceptional circumstances that existed before and immediately after the April election, and a slowdown in export growth, also brought about more moderate growth in gross operating surpluses. This development, together with higher dividend and interest payments as well as higher tax liabilities, led to a decline in the net saving of the corporate sector. Unchanged levels of personal savings and a decline in the net dissaving by general government, however, caused the domestic savings ratio to rise marginally in the second quarter of 1994.

Up to the end of 1993 (latest information made available by the Central Statistical Service), the recovery in economic activity was unable to reverse the downward movement in total employment. Labour costs finally began to react to the low level of economic activity and at least no further increases were registered in the average annual real remuneration per worker in 1993. Moreover, the recovery in economic activity, the reduction in employment and a lower incidence of labour unrest brought about a sharp growth in labour productivity and a decline in real unit labour costs.

Unsettled conditions during the period of political transition, however, also had an adverse effect on the export volumes of manufactured goods. Despite a stronger international demand and a substantial increase in the exports of mining and agricultural products, the total volume of exports performed relatively poorly in the first and second quarter of 1994. At the same time, factors such as South Africa's high marginal propensity to import, the replacement of outdated and obsolete equipment, a rise in fixed investment and an accumulation of inventories, resulted in a sharp increase in the volume of imports. The large current account surplus (seasonally adjusted and annualised) of 1993 was accordingly cut by more than one half in the first six months of 1994.

A much more moderate capital outflow was, however, also recorded in this period largely because of an improvement in short-term capital movements. Fairly tight conditions in the domestic money market encouraged private banking institutions to supplement short-term funds by borrowing abroad. The outflow of long-term capital, on the other hand, remained at a high level. From the second half of May the total net capital outflow contracted considerably, leading to a sharp increase in the net gold and other foreign reserves of the Reserve Bank. The level of the gross foreign reserves was, however, still relatively low and equivalent to approximately only five weeks' imports of goods and services.

As a result of the deterioration in the overal balance of payments position, the nominal and real effective exchange rates of the rand decreased sharply further. This created considerable inflationary pressures: production prices, in particular, rose sharply in the second quarter of 1994. Other factors also threatened to reverse the success achieved in bringing the inflation rate down. The more important of these include increases in the prices of food, upward pressure on wages and higher international crude oil prices. Scepticism about fiscal discipline may also have contributed to a deterioration of inflation expectations.

The rate of increase in all the monetary aggregates accelerated in the first seven months of 1994. This acceleration was related to the increase in economic activity, an improvement in the cash flows of business enterprises and an increase in the liquidity preference of the private sector. Despite the relatively wide margin between banks' deposit and lending rates, which is usually conducive to disintermediation practices, the income velocity of money declined in the first and second quarter of 1994.

The growth in total domestic credit extension also accelerated significantly during the first half of 1994, because of a sharp increase in the monetary sector's credit extension to the private and public sector. Public-sector stock was taken up by the monetary institutions and the deposits of the central government, of which large amounts had been accumulated in the first half of 1993, were used to finance government expenditure. The financing of instalment sales and mortgage advances was responsible for nearly 90 per cent of the increase in the monetary institutions' credit extension to the private sector.

The drain on the foreign reserves, fears that government finance might get out of hand, higher inflation expectations and tight money market conditions, caused a sharp reversal in interest rate movements from the beginning of 1994. After having declined fairly consistently during 1992 and 1993, interest rates moved upwards from February 1994. Long-term rates increased more sharply than short-term rates, with the result that the yield curve became much steeper.

In the financial markets, the monetary authority allowed the market to reflect underlying supply and demand conditions. The money market accordingly became very tight in the first six months of 1994 and only began to ease in July and August 1994 when the overall balance of payments position improved and a part of the large agricultural crop was financed by the Land Bank from funds obtained from the Corporation for Public Deposits. Activity in the secondary bond and equity markets, as well as in the market for derivatives, remained very buoyant throughout the first eight months of 1994. New record levels in share prices were recorded in August, while the dividend and earnings yields decreased to low levels.

In the primary capital market the high and rising share prices, a shortage of scrip, and the firming of long-term interest rates, favoured share capital issues in the second quarter of 1994. The demand for new funds in the private sector, however, remained low and the value of new share issues decreased. In the primary bond market the public sector's net borrowing from the private sector dropped sharply. However, purchases by the Public Investment Commissioners and other public entities caused a substantial proportion of the borrowing requirement of the government to be financed by means of bond issues in the first four months of the fiscal year.

The government also made considerable use of shorter-term paper at lower interest rates to finance its deficit in the first four months of fiscal 1994/95. The deficit in this period equalled just less than one third of the budgeted deficit for the full fiscal year. Even after taking seasonal factors into consideration, the government's net financial position in the first four months of fiscal 1994/95 was more or less in line with the situation planned in the Budget. This was achieved despite the fact that the year-on-year rate of increase in Exchequer issues was considerably higher than the budgeted increase for the full year, owing to the large cost of the political transition financed in this period. Government revenue, however, also performed much better than envisaged in the Budget for fiscal 1994/95 as a whole. Nearly all the main categories of government revenue increased at higher rates than projected in the Budget.

Domestic economic developments

Domestic output

The recovery in economic activity, which had been interrupted briefly in the first quarter of 1994 owing to special circumstances, advanced further in the second quarter but at a much more subdued pace. Having declined at a seasonally adjusted and annualised rate of 3½ per cent from the fourth quarter of 1993 to the first quarter of 1994, *real gross domestic product* rose again at an annualised rate of approximately 2 per cent in the second quarter of 1994. This growth rate may be compared with positive annualised quarter-to-quarter growth rates that had varied between 2½ and 7 per cent in 1993. Despite the setback in the first quarter of 1994, aggregate real output in the first half of 1994 was still about 3 per cent higher than in the first half of 1993.

A *sectoral analysis* shows that these movements in total real output were heavily influenced by *agricultural conditions*. Following a decline in the first quarter of 1994, agricultural output rose at an annualised rate of 11½ per cent in the second quarter because of the harvesting of more than 50 per cent of the expected maize crop of 12,1 million tons.

In the *non-agricultural sectors* of the economy the growth in real production slowed down from an average annualised rate of 2 per cent in the second half of 1993 to only ½ per cent in the first quarter of 1994, before it accelerated slightly to 1 per cent in the second quarter. The improvement in real value added by the non-agricultural sectors in the second quarter of 1994 could be ascribed mainly to an increase in the real output of the tertiary sectors, the sector supplying electricity, gas and water and the construction industry. The physical volume of production by mining and manufacturing enterprises continued, however, to recede.

In the first two quarters of 1994 the total real output of the *mining sector* contracted at annualised rates of 3 and 4½ per cent; in 1993 it had risen by more than 2 per cent. These declines in mining output were the result of a sharp decrease in gold-mining production on account of a drop in the throughput of ore and a small decline in the gold content of ore milled. Higher gold prices led to the mining of lower-quality ore, while production was also affected by unplanned holidays, strikes and other labour-related problems. Owing largely to an increased foreign demand, the production of other mining products continued to increase in the first half of 1994.

Current estimates suggest that the real output by the *manufacturing industry* contracted at annualised rates of

Real gross domestic product

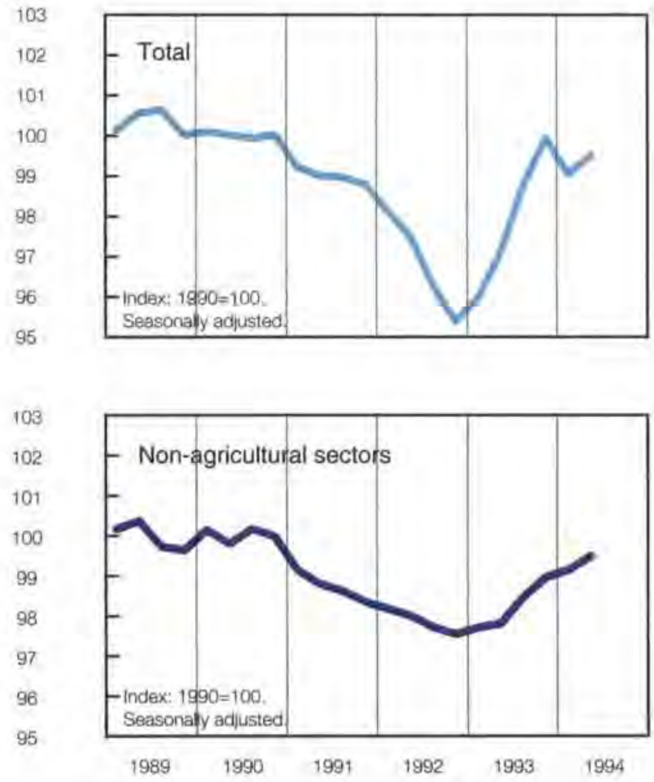


Table 1. Percentage changes in real value added by non-agricultural sectors

	1993				1994	
	1st qr	2nd qr	3rd qr	4th qr	1st qr	2nd qr
Mining	5½	2½	-½	2½	-3	-4½
Manufacturing	1½	0	5	½	-1	-½
Electricity, gas and water	7	6	7	5	2½	2
Construction	-7½	-6	0	½	1½	1½
Tertiary sector	1	-½	1½	2	1½	2½
Total non-agricultural sectors	**1½**	**0**	**2½**	**1½**	**½**	**1**

nearly 1 per cent in the first quarter of 1994 and ½ per cent in the second quarter. The disappointing performance of the manufacturing sector reflected the negative influence of a reduction in the number of work days and a rise in work stoppages on production. The number of days lost to strikes increased towards the end of the second quarter as labour unions came with demands for wage increases during wage negotiations that had been postponed earlier on account of the April elections. Some subsectors of manufacturing, such as chemicals, base metals and paper products, benefited from the increase in foreign demand and their real value added rose noticeably in the first half of 1994.

In the *other secondary sectors*, the real value added by the sector supplying electricity, gas and water rose at annualised quarter-to-quarter rates of 2½ and 2 per cent in the first two quarters of 1994 because of an increased demand arising from the electrification of lower-income residential areas. The real output of the construction sector began to recover towards the end of 1993 and grew at an annualised rate of 1½ per cent in both the first and second quarter of 1994. The increased construction activity reflected a higher demand for residential buildings and a general increase in fixed investment.

The *tertiary sectors* continued to grow at a moderate rate. In the first half of 1994 the rate of increase in the real value added by the tertiary sectors accelerated from an annualised level of 1½ per cent in the first quarter of 1994 to 2½ per cent in the second quarter. This improvement was broadly based and most clearly noticeable in commerce, transportation and financial services. In the commercial sector the real value added by wholesale trade rose significantly in the first half of 1994, but the growth in motor and retail trade remained subdued. Rising business and consumer confidence following the outcome of the April elections, and steps by vehicle manufacturers to expand production contributed to an improvement in the real value added by the motor trade towards the end of the second quarter. The growth in the output of transportation, storage and communication was positively affected by a rise in the volume of foreign trade, the handling of higher agricultural output volumes, and further increases in domestic demand. As in 1993, the demand for financial services remained high in the first half of 1994 because of generally buoyant conditions in financial markets.

Domestic expenditure

Aggregate *real gross domestic expenditure*, which had increased strongly at annualised rates of 10½ and 7 per cent in the last two quarters of 1993, rose at more moderate but still high rates of 3½ and 5 per cent in the first two quarters of 1994. The further increase in real domestic expenditure in the first half of 1994 was the

Real gross domestic expenditure

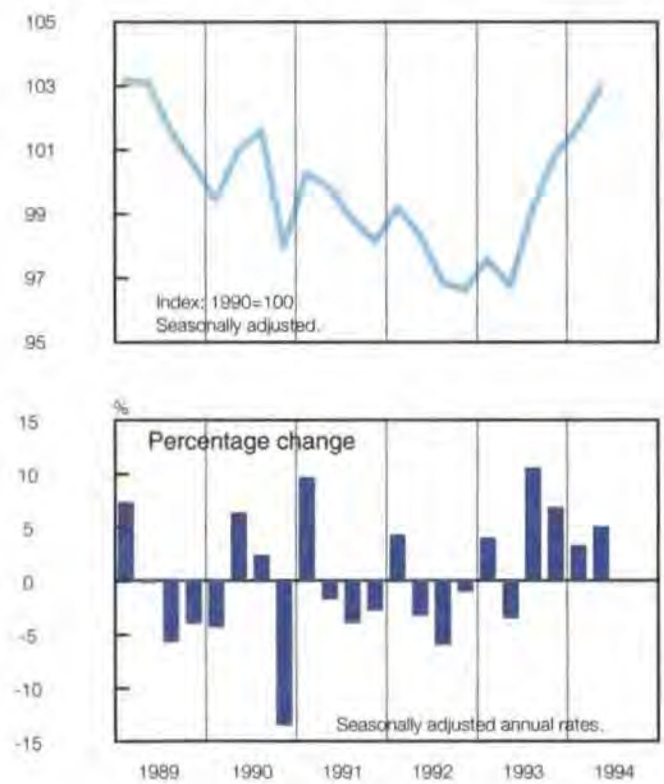


Table 2. Percentage changes in consumption expenditure by main category

	1993				1994	
	1st qr	2nd qr	3rd qr	4th qr	1st qr	2nd qr
Durable	1	1	2	4	3	4
Semi-durable	0	½	1½	3	3	3
Non-durable	1½	2	2½	2½	½	2
Services	1	½	½	2	2	1½
Total	**1**	**1½**	**1½**	**2½**	**1½**	**2½**

combined result of increases in the real outlays on consumption expenditure and capital formation.

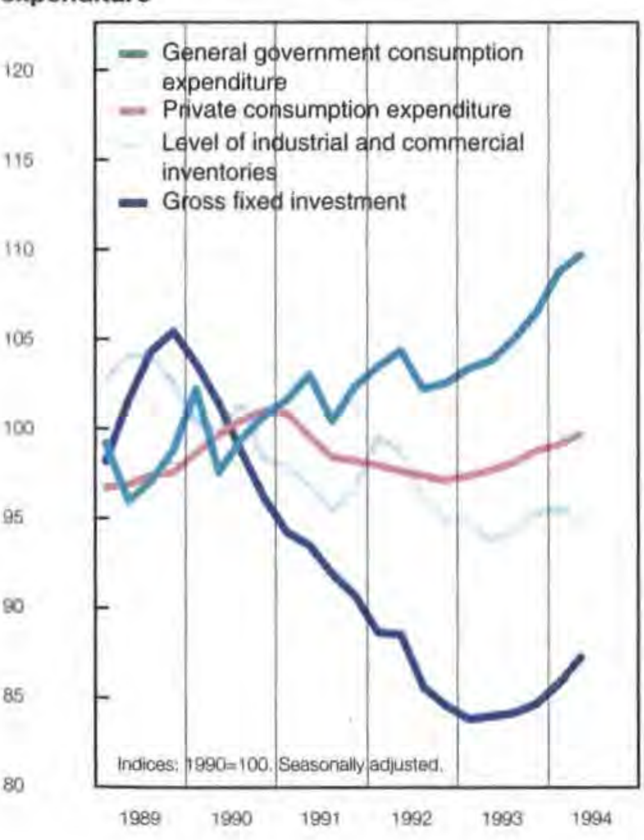
Real outlays on *private consumption expenditure* rose at an annualised rate of 2½ per cent in the second quarter, following an increase of 1½ per cent in the first quarter of 1994. This acceleration corresponded to a sharper increase in real personal disposable income and was evident in expenditure on durable and non-durable goods. The spending categories which benefited from the increase in real outlays by households were durable goods, recreational and entertainment goods, clothing and footwear, and food, beverages and tobacco. Notwithstanding this improvement in consumer spending, real private consumption expenditure per head of the population in the first half of 1994 was still almost 9 per cent lower than the recent high reached in the third quarter of 1990.

Real *consumption expenditure by general government*, which had increased at high annualised quarter-to-quarter rates of 4½ and 6 per cent in the last two quarters of 1993, rose further at annualised rates of 9 and 3½ per cent in the first two quarters of 1994. This sharp rise in the real outlays on consumption by general government was brought about by a small increase in the remuneration of employees at constant prices and much higher real expenditure on intermediate goods and services. The latter rise stemmed from an expansion in spending by several departments and entities, particularly the extra-budgetary institutions, including the former TBVC countries and self-governing states.

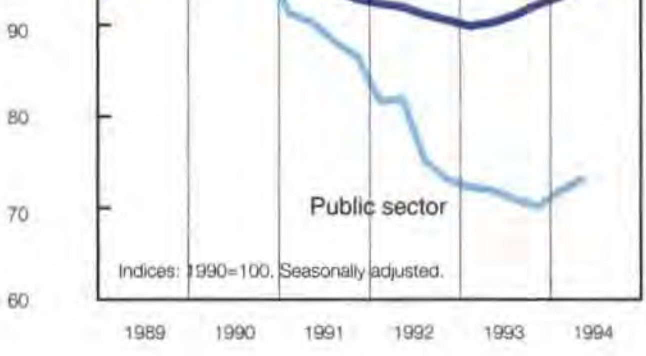
The increase that had started in real gross domestic *fixed investment* from the second quarter of 1993, continued in the second quarter of 1994. Real outlays on fixed capital formation recovered markedly from the trough in the first quarter of 1993 up to the second quarter of 1994 and the annualised percentage increase over this period amounted to 3½ per cent. Moreover, current estimates indicate that the increase in total real gross domestic fixed investment rose sharply from an upwardly revised annualised rate of 5½ per cent in the first quarter of 1994 to nearly 7 per cent in the second quarter. This increase was the net result of an expansion in real expenditure on capital goods by the private sector and public corporations, which more than offset a further decline in real capital formation by public authorities.

As indicated in the *Annual Economic Report* for 1994, the capital expenditure on a few major projects was mainly responsible for the revival in fixed investment of the *private sector*. The increase in real capital outlays in the second quarter of 1994, however, occurred throughout the economy. A marked improvement in agricultural income led to a sharp rise in fixed investment in this sector. Real fixed investment expenditure by the mining sector also continued to rise rapidly, because of

Main components of real gross domestic expenditure



Real gross domestic fixed investment



the need to replace some ageing equipment, the expansion of production capacity for certain base metals and minerals, and on-going expenditure on the development of new mines. Outlays on machinery and electrical equipment also caused rises in the fixed investment of manufacturing, financial institutions and the construction sector.

The growth in the real fixed capital formation by *public corporations* in the first two quarters of 1994 surged ahead at annualised rates of 36½ per cent and 17 per cent. This stemmed from positive growth in the investment expenditure of almost all the subsectors, but was particularly prominent in the infrastructural developments undertaken by the sectors supplying electricity and telecommunication services. The contraction in fixed investment by *public authorities* was discernible in real investment expenditure by the central government and provincial administrations, which more than offset increases in fixed investment by local authorities and business enterprises of general government.

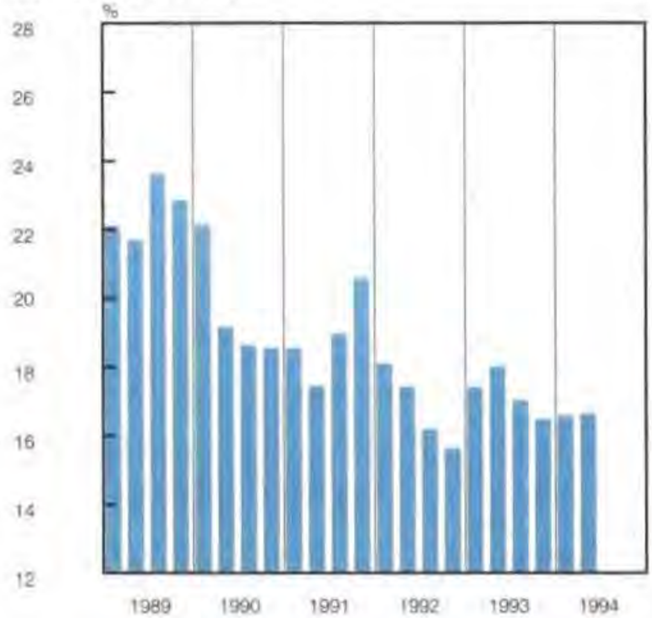
The *inventory build-up*, which had started in the second half of 1993, continued in the first six months of 1994. Stock accumulation took place mainly in agricultural stocks-in-trade because of the higher grain crops, in the mining industry, the sector supplying electricity, gas and water and commerce. Destocking in the manufacturing sector was responsible for a further contraction in the ratio of industrial and commercial inventories to gross domestic product from an already low 16½ per cent in 1993 to 16 per cent in the second quarter of 1994.

Factor income and saving

Growth in aggregate *nominal factor income* at market prices slowed down from increases, measured over four quarters, of 14 and 12½ per cent in the last two quarters of 1993 to 12½ per cent in the first quarter of 1994 and 11½ per cent in the second quarter. The continued decline in the year-on-year rate of increase in nominal factor income was due to lower growth in gross operating surpluses as well as aggregate labour remuneration. The exceptional circumstances that existed before and immediately after the April elections and the slowdown in export growth brought the rate of increase in gross operating surpluses down from 12½ per cent in 1993 to a year-on-year level of only 10½ per cent in the first half of 1994. The rate of increase in aggregate remuneration of employees also declined from 11½ per cent in 1993 to 9½ per cent in the first half of 1994 compared with the corresponding period of 1993.

After having decreased from 18 per cent in the second quarter of 1993 to 16½ per cent in the first quarter of 1994, the ratio of *gross domestic saving* to gross domestic product rose slightly again in the second quarter. This small improvement in the savings ratio could be attributed mainly to a decline in the net *dissaving by general government*, which outweighed a

Gross domestic saving as percentage of gross domestic product



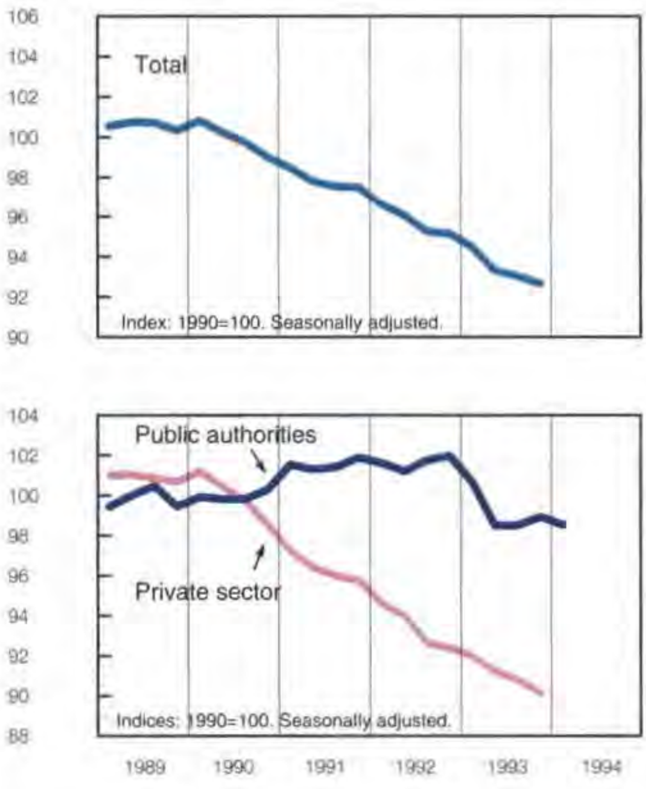
small decrease in net saving by the private sector. Owing largely to higher income from direct and indirect tax sources and reduced transfer payments to households, the increase in general government's current income was proportionally larger than the increase in current spending.

The decline in net *saving by the private sector* was caused by lower net saving of the corporate sector because of higher dividend and interest payments as well as higher tax liabilities. Net personal saving in the second quarter of 1994 remained more or less at the level of the preceding quarter and the ratio of personal saving to personal disposable income maintained its recent average rate of approximately 4½ per cent. This was slightly lower than the personal savings ratio of 5 per cent in the first half of 1993, but more or less in line with the average ratio for calendar 1993.

Employment

The recovery in economic activity has not yet succeeded in reversing the downward movement in *total employment* in the non-agricultural formal sectors of the economy. Total employment in the non-agricultural economic sectors declined uninterruptedly from the second quarter of 1990 up to the fourth quarter of 1993 (the latest information made available by the Central Statistical Service). Moreover, the rate of decrease in non-agricultural employment accelerated significantly from 0,6 per cent in 1989 to 2,5 per cent in 1993. However, the economic recovery has been able to slow down the rate of decrease in total employment. The

Non-agricultural employment



quarter-to-quarter rate of decrease in employment abated markedly from a seasonally adjusted and annualised rate of 4,8 per cent in the second quarter of 1993 to only 1,6 per cent in the fourth quarter.

The quarter-to-quarter rate of decline in employment in the non-agricultural *private sector* also decelerated from a recent high seasonally adjusted and annualised rate of 3,3 per cent in the second quarter of 1993 to 1,7 per cent in the third quarter, before accelerating again to 3,0 per cent in the fourth quarter. This brought the rate of decline in calendar 1993 to 2,5 per cent; in 1991 and in 1992 slightly larger decreases of 3,6 and 3,1 per cent respectively, had been recorded.

In contrast to the decline in employment by the private sector, employment by *public authorities* continued to increase in the period from 1990 to 1992. Only towards the end of 1992 did the rate of increase in employment by public authorities start to decline and in 1993 the workforce of public authorities was reduced by 2,5 per cent. However, in the second half of 1993 employment by public authorities rose again slightly, followed by a further decrease at a seasonally adjusted and annualised rate of 1,6 per cent in the first quarter of 1994.

The seasonally adjusted total number of *registered unemployed workers* reflected the significant reductions in total employment opportunities in the formal non-agricultural sectors of the economy and increased by 16,2 per cent in 1992 and by 8,8 per cent in 1993. However, after reaching a high point of 336 000 in September 1993, the total number of registered unemployed workers declined to 239 000 in May 1994.

Labour costs and productivity

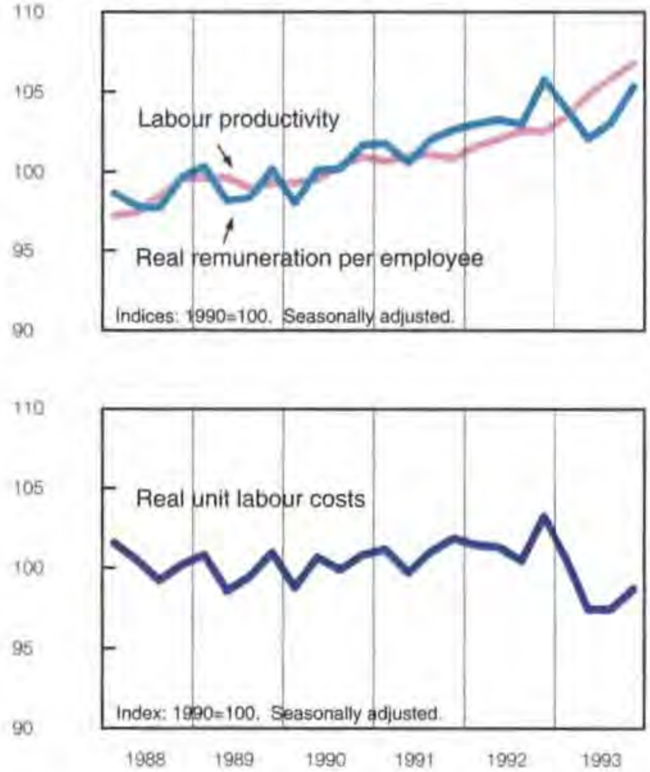
In spite of high unemployment, the rate of increase in the *nominal labour remuneration* per worker declined only moderately from a peak of 18,3 per cent in 1989 to 15,4 per cent in 1992. Only at the end of the recession did the rate of increase in nominal wages per worker come down more markedly to 10,6 per cent in 1993. The year-on-year rate of increase in the nominal wage per worker in the non-agricultural sectors also declined from a high point of 16,3 per cent in the second quarter of 1992 to only 9,2 per cent in the fourth quarter of 1993.

This downward trend in nominal wage increases was evident in the wages of workers in the private sector as well as those employed by public authorities, but the rate of increase in the wages of public-authority employees slowed down much more markedly. The year-on-year rate of increase in nominal remuneration per worker employed by public authorities declined from 18,7 per cent in the fourth quarter of 1991 to only 5,4 per cent in the fourth quarter of 1993; it then rose again, however, to 8,9 per cent in the first quarter of 1994. The year-on-year rate of increase in the nominal wage per worker in the private sector receded from 16,0 per cent in the second quarter of 1992 to 11,2 per cent in the fourth quarter of 1993. In calendar 1993 the rates of increase in the nominal remuneration per worker employed by public authorities and in the private sector came to 9,3 and 11,3 per cent respectively, compared with 21,9 and 16,7 per cent in 1989.

As a result of the high rates of increase in nominal wages, the changes in the average annual *real remuneration per worker* (as deflated by the deflator for the non-agricultural gross domestic product) remained positive throughout the period from 1989 to 1992. However, in 1993 the real remuneration per worker did not increase any further. The year-on-year rate of increase in the real remuneration per worker declined from a high of 3,0 per cent in the fourth quarter of 1992 to rates of -1,2, 0,1 and -0,4 per cent in the last three quarters of 1993.

The growth in *labour productivity* in the non-agricultural sectors of the economy accelerated from 0,3 per cent in 1990 to 1,2 per cent in 1992, and then even more significantly to 3,1 per cent in 1993. This good productivity performance in 1993 was brought about by further reductions in employment, the recovery of economic activity and a lower incidence of labour unrest. The year-on-year rate of increase in labour productivity also rose substantially from -0,1 per cent in

Non-agricultural labour productivity, remuneration and unit costs



the fourth quarter of 1991 to 4,2 per cent in the fourth quarter of 1993.

The markedly lower rate of increase in nominal remuneration of workers and the rise in real production per worker, were mainly responsible for a sharp decline in the growth of *nominal unit labour costs* from 16,9 per cent in 1990 to 7,3 per cent in 1993. The year-on-year rate of increase in nominal unit labour costs also declined from a high of 16,1 per cent in the fourth quarter of 1991 to only 4,8 per cent in the fourth quarter of 1993. This decline has had a positive impact on the profitability of businesses in the private sector, which bodes well for future investment and economic growth, provided that the current spate of labour unrest does not undo the progress already achieved.

As a result of the lower growth in nominal unit labour costs, *real unit labour costs* actually declined by 3 per cent in 1993, compared with a still positive growth in this aggregate of 0,9 per cent in 1991 and 0,7 per cent in 1992. Moreover, the year-on-year rate of decrease in real unit labour costs accelerated from 0,8 per cent in the first quarter of 1993 to 4,4 per cent in the fourth quarter - the largest decline in real unit labour costs since the fourth quarter of 1985, when a rate of 6,2 per cent was recorded.

Prices

Although significant success has been achieved during the past three years in lowering the rate of increase in the all-goods production price index and the overall consumer price index, the rates of increase in these indices are still significantly higher than the inflation rates in South Africa's main trading partners. Certain factors have also recently come to the fore which are threatening to reverse the general downward movement of inflation. The more important of these include accelerated increases in the prices of food because of the rebuilding of herds by livestock farmers and frost damage to fruit and vegetable crops in many parts of the interior. Inflation expectations are also fed by scepticism about the maintenance of fiscal discipline, upward pressure on wages, higher international crude oil prices and continued downward pressure on the exchange rate of the rand.

Largely as a result of the depreciation of the rand, the quarter-to-quarter rate of increase in the *prices of imported goods* recently accelerated sharply from a negative rate of 5,4 per cent in the fourth quarter of 1993 to 16,6 per cent in the second quarter of 1994. The rate of increase in the prices of imported goods, as measured over periods of twelve months, is still not reflecting the effect of this change. This rate of increase at first

Production prices

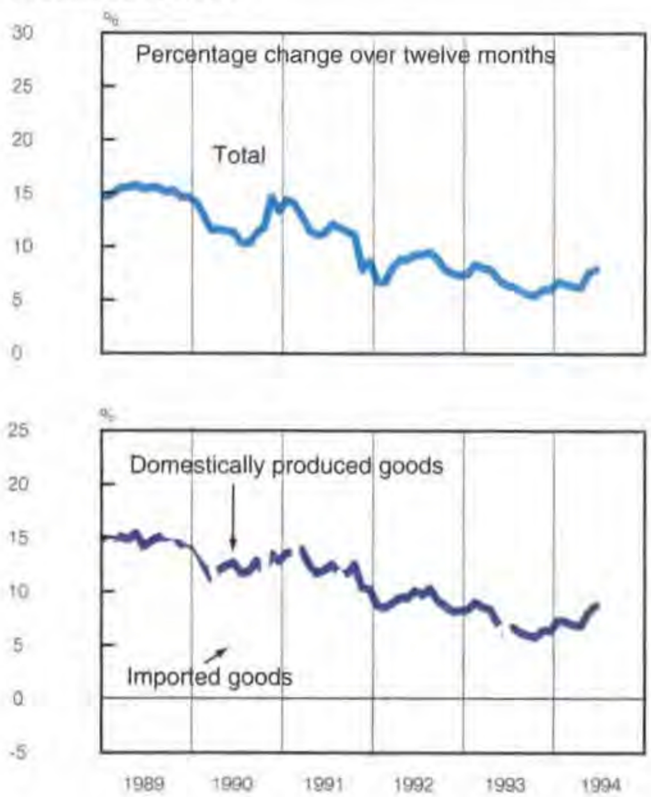


Table 3. Percentage changes in consumer prices over periods of twelve months

	Oct '91	Dec '92	Apr '93	Dec '93	Apr '94	Jul '94
Goods	18,8	12,0	12,5	9,3	6,8	9,0
Services	13,6	6,7	9,0	9,7	7,5	7,5
Total	**16,8**	**9,6**	**11,0**	**9,5**	**7,1**	**8,2**
Total, excluding food	**14,8**	**8,4**	**11,6**	**10,7**	**6,6**	**6,5**

continued to decline from a recent high point of 6,8 per cent in June 1993 to only 2,7 per cent in March 1994, before accelerating moderately to 4,4 per cent in June. Since March 1991 the rate of increase over periods of twelve months in the prices of imported goods has almost consistently been lower than the rate of increase in the all-goods production price index.

The quarter-to-quarter rate of increase in the *prices of domestically produced goods* also started to rise in 1994, viz. from 5,1 per cent in the fourth quarter of 1993 to 11,1 and 9,0 per cent in the first two quarters of 1994. The rate of increase in the prices of domestically produced goods, measured over a period of twelve months, rose only moderately at first from a low point of 5,7 per cent in October 1993 to 6,8 per cent in April 1994; however, it then accelerated much more markedly to 8,7 per cent in June. The upward movement of increases in this price index was mainly brought about by higher rates of increase in the prices of agricultural products.

Consumer prices

As a result of these changes in the prices of both imported and domestically produced goods, the quarter-to-quarter rate of increase in the *all-goods production price index* rose from 3,0 per cent in the fourth quarter of 1993 to 10,4 per cent in the second quarter of 1994. The rate of increase over twelve-month periods in the all-goods production price index also moved upwards from a low of 5,4 per cent in October 1993 to 7,9 per cent in June 1994. These rates of increase in production prices have nevertheless remained in the single-digit level range for the past thirty-two months.

From the first recording of a single-digit rate of increase in nearly 15 years in December 1992, the rate of increase over periods of twelve months in the *overall consumer price index* fluctuated between 9 and 10 per cent up to March 1994. The twelve-month rate of increase in the overall consumer price index then declined substantially to only 7,1 per cent in April, when the effect of increased indirect taxes announced in the Budget for 1993/94 no longer affected it; this rate then accelerated again to 8,2 per cent in July.

The overall consumer price inflation has recently been influenced strongly by increases in the prices of food. This is clearly illustrated by the rate of increase in the consumer price index of all other goods and services (i.e. excluding food and non-alcoholic beverages), which was 1,7 percentage points lower than that of the overall consumer price index in July 1994. While the prices of most consumer goods and services rose more or less in line with the overall consumer price index, the rate of increase in the prices of food amounted to 14,9 per cent in July 1994 compared with the corresponding month in the preceding year.

Foreign trade and payments

Current account

The *surplus on the current account* of the balance of payments (seasonally adjusted and annualised), which had weakened considerably from a quarterly average of R5,7 billion in the second half of 1993 to R2,3 billion in the first quarter of 1994, improved marginally to R2,6 billion in the second quarter. The unadjusted surplus in the first half of 1994 amounted to only R0,5 billion; the surplus in the corresponding period of 1993 added up to R3,3 billion.

The relatively weak performance of the current account balance in the first half of 1994 could, however, be ascribed to exceptional circumstances. General uncertainty about the outcome of the political transition in South Africa, and labour unrest, affected both domestic production and the export volumes of manufactured goods adversely. At the same time, rising real fixed investment and an accumulation of inventories led to a sharp increase in the volume of imports. Although there is little reason to expect the volume of imports not to increase further in the second half of 1994, more stable domestic conditions and the international economic recovery could cause export volumes to perform better during this period.

Having declined from R63,6 billion in the fourth quarter of 1993 to R61,3 billion in the first quarter of 1994, the value of *merchandise exports* (seasonally adjusted and annualised) rose again to R64,7 billion, or by 5½ per cent, in the second quarter of 1994. The higher value of exports was to a large extent due to an increase of some 4 per cent in the prices of exported goods. From the beginning of 1994 export prices increased more rapidly than the prices of imported goods, with the result that South Africa's terms of trade (excluding gold) have started to rise. This improvement was related mainly to a sharp rise in international commodity prices; The *Economist's* index of international commodity prices rose by almost 42 per cent from a lower turning-point in October 1993 to July 1994. Export prices were also influenced by the depreciation of the rand against the US dollar, because South Africa's exports are primarily denominated in this currency.

The depreciation of the exchange rate of the rand and a stronger international demand with the rise in economic activity were unable to promote the exports of goods in the first half of 1994. The volume of merchandise exports rose only slightly by 1½ per cent in the second quarter of 1994; special circumstances had been responsible for a drop of 5½ per cent in the quantities of goods exported in the first quarter of 1994. This poor performance of the total volume of merchandise exports was recorded notwithstanding a substantial increase in the exports of mining and agricultural products. Particularly the exports of chemical products, machinery and electrical equipment, paper products, textiles and transport equipment contracted.

A combination of price and volume increases caused the *net gold exports* to rise moderately by 2½ per cent from the first quarter of 1994 to the second quarter. The price of gold rose from an average of R1 321 per fine ounce to R1 380 per fine ounce over the same period, while the volume of net gold exports advanced by 1 per cent. The higher rand price of gold was due to the depreciation of the rand against the dollar; the dollar price of gold receded from US$384 per fine ounce in the first quarter to $382 per fine ounce in the second quarter. In July the average rand price of gold rose strongly to R1 414 per fine ounce.

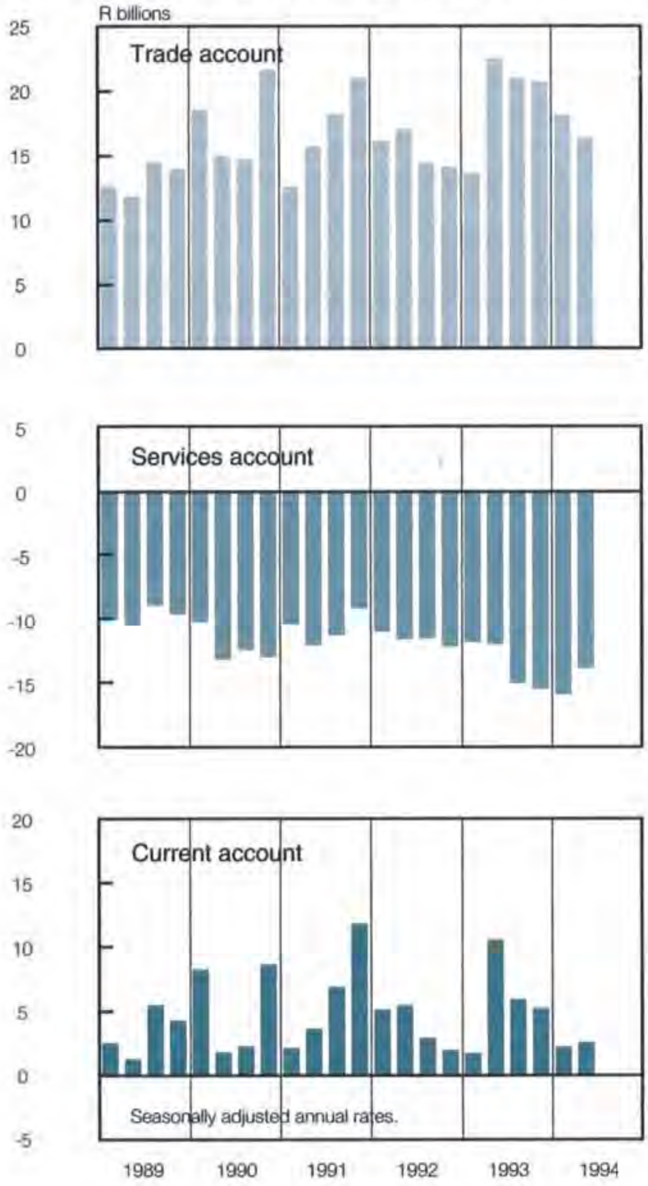
At a seasonally adjusted and annualised rate of R71,4 billion, the value of *merchandise imports* in the second quarter of 1994 was 21 per cent higher than the quarterly average for 1993. Pronounced increases were recorded in the imports of oil and manufactured products; particularly strong increases were registered in the categories chemical products, machinery and electrical equipment, transport equipment and paper products. As could be expected because of the depreciation of the

Table 4. Balance of payments on current account
Seasonally adjusted and annualised rates

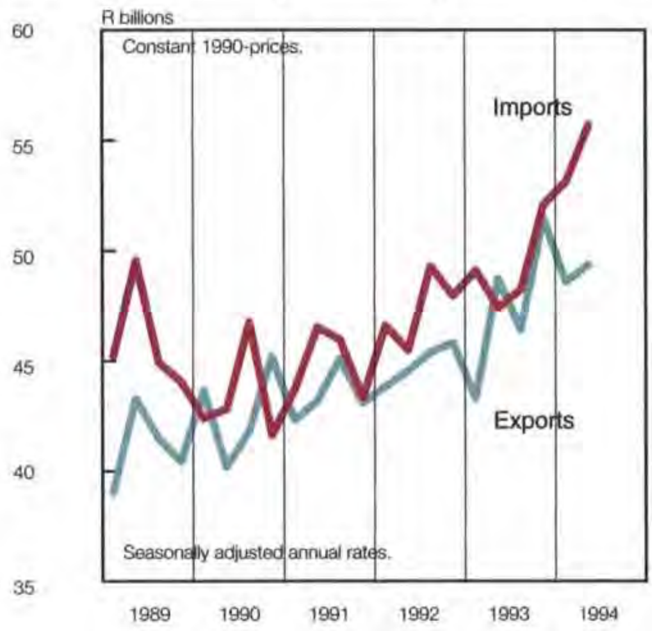
R billions

	1993					1994	
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Merchandise exports	48,6	56,2	55,8	63,6	56,1	61,3	64,7
Net gold exports	21,0	22,2	24,5	21,2	22,2	22,6	23,2
Merchandise imports	-56,1	-55,8	-59,3	-64,0	-58,8	-65,7	-71,4
Net service and transfer payments	-11,7	-12,0	-15,0	-15,5	-13,6	-15,9	-13,9
Balance on current account	**1,8**	**10,6**	**6,0**	**5,3**	**5,9**	**2,3**	**2,6**

Balance of payments: Current account



Real merchandise imports and exports



rand, a large part of the increase in the value of merchandise imports in the second quarter of 1994 was due to price increases (3½ per cent). More surprisingly, at this stage of the business cycle, import volumes expanded at a high rate of 5 per cent from the first quarter of 1994 to the second quarter. As explained in some length in the *Annual Economic Report* for 1994, the strong performance of the volume of merchandise imports in 1993 and 1994 was probably related to factors such as South Africa's high marginal propensity to import, the replacement of outdated and obsolete equipment, a rise in fixed investment and an accumulation of inventories.

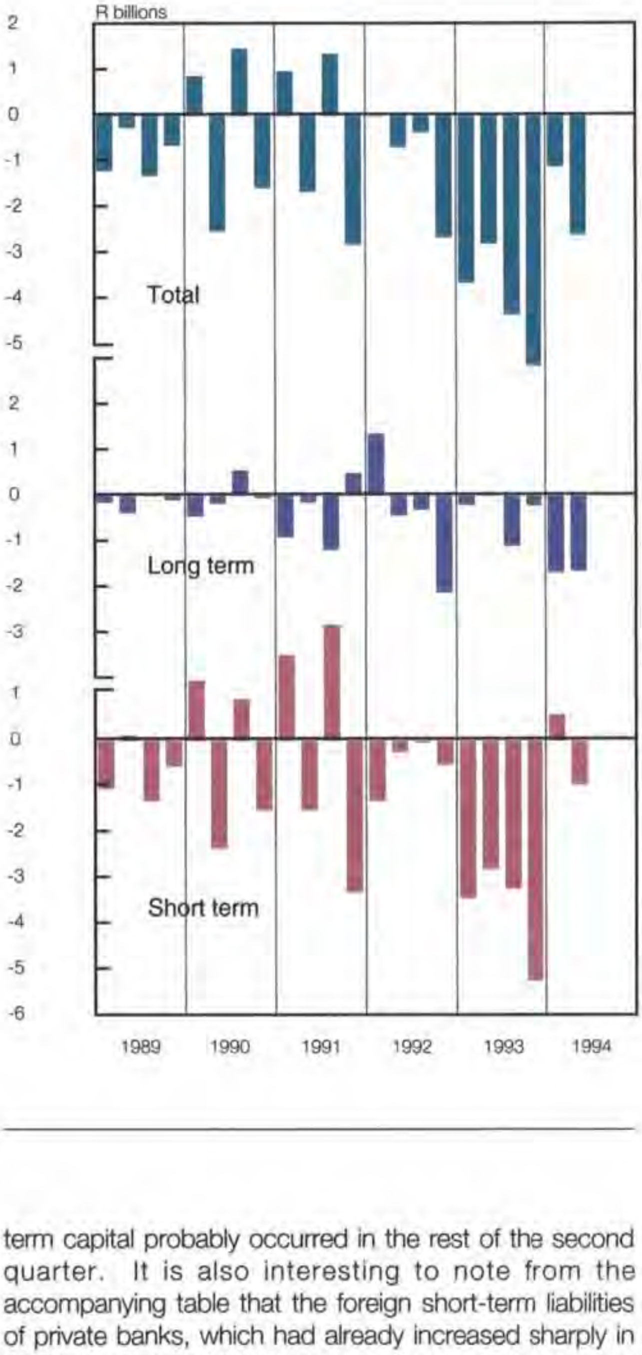
Net *service and transfer payments* to non-residents, which had increased substantially from the second half of 1993, declined by 12½ per cent from the first quarter of 1994 to the second quarter. This smaller deficit on the services account was largely the outcome of an increase in service receipts arising from foreign tourists visiting South Africa, and of a decrease in interest payments on a smaller amount of debt outstanding to non-residents.

Capital movements

The *total net outflow of capital* not related to reserves increased moderately from R1,1 billion in the first quarter of 1994 to R2,6 billion in the second quarter. In the first half of 1994 the net outflow therefore totalled R3,7 billion, which was considerably smaller than the R9,8 billion in the second half of 1993 and the R6,5 billion in the first half of that year. The outflow in the first half of 1994 was remarkably small considering that the country was undergoing a major political transformation.

The increase in the total net capital outflow from the first quarter of 1994 to the second quarter was mainly due to a turnaround in *short-term capital* movements (not related to reserves but including errors and unrecorded transactions) from a small inflow to an outflow during this period. Uncertainties surrounding the election process, and leads and lags in foreign payments and receipts related to the weak performance of the rand, were probably mainly responsible for this change. From changes in the foreign exchange reserves and in South Africa's external trade it appears as if this outflow was concentrated mainly in April and that an inflow of short-

Net capital movements not related to reserves



term capital probably occurred in the rest of the second quarter. It is also interesting to note from the accompanying table that the foreign short-term liabilities of private banks, which had already increased sharply in the first quarter of 1994, rose yet further in the second quarter. Fairly tight conditions in the domestic money market encouraged these institutions to supplement their funds from abroad.

The net outflow of *long-term capital* in the second quarter of 1994 amounted to approximately R1,6 billion, which was of the same order as the outflow in the previous quarter. The outflow of long-term capital in the second quarter consisted mainly of repayments on government-guaranteed loans of R0,5 billion, and of affected debt converted into long-term loans outside the so-called standstill net in terms of the debt arrangements with foreign creditor banks, that were falling due. In addition, non-residents were net sellers of securities listed on the Johannesburg Stock Exchange to an amount of R0,7 billion in the second quarter of 1994; these sales were, of course, offset by corresponding inflows in other items on the balance of payments because they were made through the financial-rand mechanism. More important, however, new long-term funds of about R0,4 billion were raised abroad by the private sector and public entities in the second quarter of 1994.

Foreign reserves

The total net outflow of capital not related to reserves in conjunction with the relatively 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 R2,3 billion in the second quarter of 1994. Following a decline of R0,9 billion in the first quarter of 1994, the total net foreign reserves decreased by R3,2 billion in the first half of 1994. The further decrease in the net foreign reserves of the country in the second quarter was mainly concentrated in April; a decrease of only R0,3 billion was recorded in May and June. Moreover, in July and August 1994 the net foreign reserves of the Reserve Bank increased by no less than R2,7 billion.

The total *gross gold and other foreign reserves* declined by R0,6 billion in the second quarter of 1994; this amount was considerably smaller than the decrease in the net foreign reserves because of continued reserve-related borrowing by the Reserve Bank to the net amount of R1,8 billion. At the end of June 1994 the total gross gold and other foreign reserves added up to R9,7 billion; this was equivalent to about five weeks' imports of goods and services. The gross gold and other foreign reserves of the Reserve Bank increased again by R0,8 billion in July and August 1994 to a level of R7,9 billion at the end of August.

Gross gold and other foreign reserves of the South African Reserve Bank

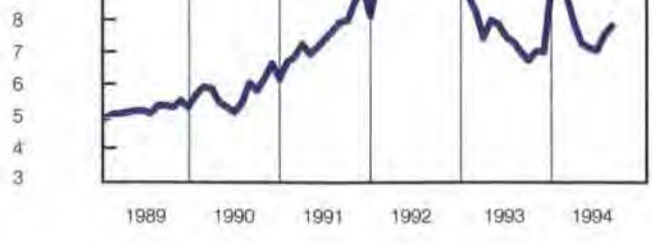


Table 5. Net capital movements (not related to reserves)
R millions

	1993					1994	
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Long-term capital							
Public authorities	-119	-597	-738	-619	-2 073	-253	-309
Public corporations	-526	-132	-140	-876	-1 674	-483	-438
Private sector	441	750	-224	1 280	2 247	-945	-900
Total long-term capital	-204	21	-1 102	-215	-1 500	-1 681	-1 647
Short-term capital							
Monetary sector	-1 799	-1 033	652	-629	-2 809	2 254	1 327
Other, including unrecorded transactions	-1,652	-1 787	-3 900	-4 625	-11 964	-1 682	-2 286
Total capital movements, excluding liabilities related to reserves	**-3 655**	**-2 799**	**-4 350**	**-5 469**	**-16 273**	**-1 109**	**-2 606**

Exchange rates

The ailing foreign reserve position of the country and socio-political uncertainties caused the *nominal effective exchange rate* of the rand to decline by 4,1 per cent in the first quarter of 1994 and by a further 8,3 per cent from 31 March 1994 to 13 July 1994. Over this period the rand depreciated against all the major currencies. The rise in the foreign reserves of the Reserve Bank, intervention in the market for foreign exchange by the monetary authority and a weaker dollar owing to rising interest rates in several industrial countries, subsequently brought about an increase in the weighted average value of the rand of 3,4 per cent from 13 July 1994 to 31 August 1994. In the first eight months of 1994 the nominal effective exchange rate of the rand accordingly declined by 9,1 per cent.

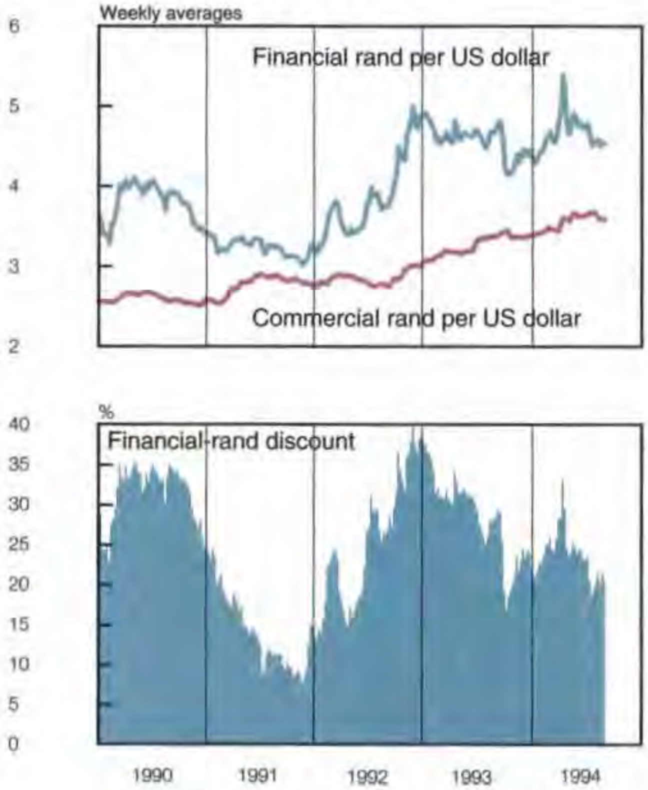
The decline in the nominal effective exchange rate of the rand during the first seven months of 1994 exceeded the inflation differential between South Africa and its main trading partners. The *real effective exchange rate* of the rand therefore declined by 7,5 per cent from December 1993 to July 1994.

In the *financial-rand market* concern over political developments, labour unrest and profit-taking led to a sharp depreciation of the financial rand in the beginning of 1994 to an all-time low of R5,58 per dollar on 11 April 1994. As it became apparent that the political transition would be achieved peacefully, the financial rand appreciated again to R4,55 per dollar on 2 May 1994. In

Table 6. Changes in exchange rates of the rand
%

	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 31 Aug 1994	31 Dec 1993 to 31 Aug 1994
Weighted average	-4,1	-6,9	-1,5	3,4	-9,1
US dollar	-2,1	-4,9	-0,1	1,9	-5,2
British pound	-2,6	-8,2	-1,9	4,0	-8,7
German mark	-5,8	-9,3	-3,8	4,7	-13,9
Japanese yen	-10,2	-8,2	-1,6	4,4	-15,3
Netherlands guilder	-5,4	-9,5	-3,8	4,8	-13,6
Italian lira	-7,9	-6,6	-4,1	6,4	-12,2

Exchange rates of the rand



the subsequent period the financial rand traded within a range of between R4,45 and R4,93 per dollar, fluctuating sharply at times on unfounded rumours that the financial-rand mechanism would be abolished. On 31 August 1994 the exchange rate of the financial rand reached R4,50 per dollar and the financial-rand discount amounted to 20,2 per cent.

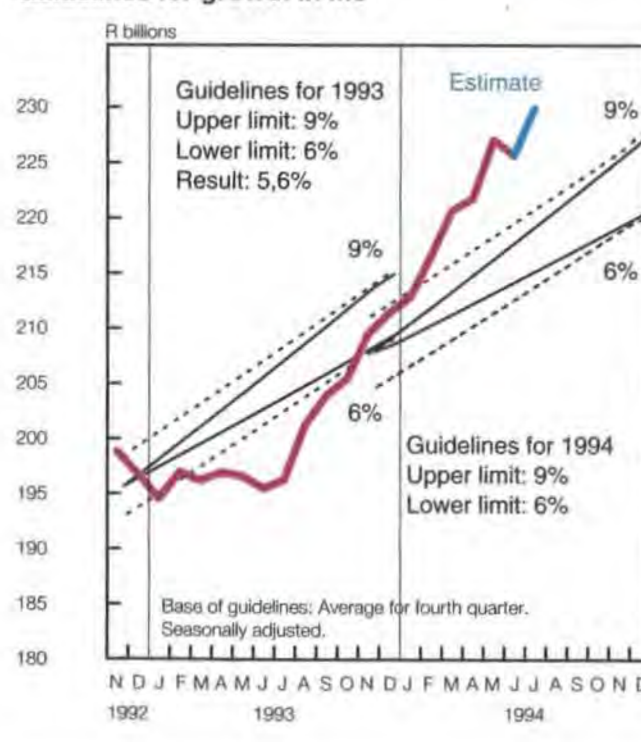
Monetary developments, interest rates and financial markets

Money supply

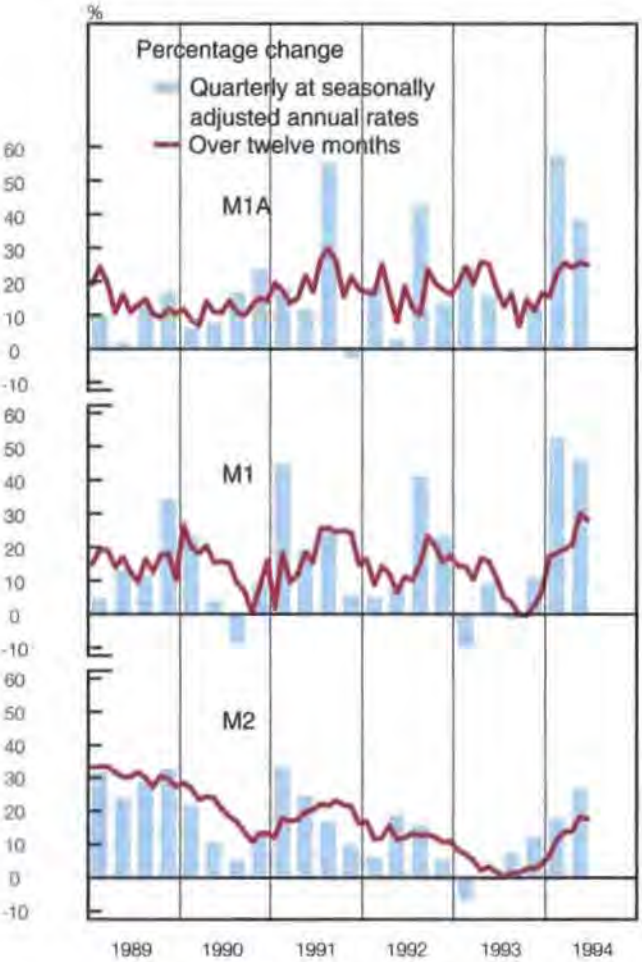
The rate of increase in all the monetary aggregates accelerated in the first seven months of 1994. This was clearly reflected in the rate of increase in the *broadly defined money supply (M3)* over periods of twelve months, which rose from 7,0 per cent in December 1993 to 15,0 per cent in June 1994 and a preliminarily estimated 16,7 per cent in July. As a result of this more rapid growth, the monthly values of M3 in 1994 to date lay markedly above the upper limit of the guideline range of 6-9 per cent which had been set for the year. The estimated seasonally adjusted value of M3 amounted to R229,9 billion at the end of July 1994, which was R9,4 billion or 4,3 per cent higher than the corresponding value of the upper limit of the guideline range.

As described in some detail in the *Annual Economic Report* for 1994, this acceleration in the growth of the money supply was brought about by an increase in economic activity, an improvement in the cash flow of business enterprises and an increase in the liquidity preference of the private sector. Higher company profits and a decrease in government deposits with banks to finance the purchases of goods and services from the private sector, contributed to a large flow of cash to the

Guidelines for growth in M3



Monetary aggregates



private business community. The liquidity preference of the private sector rose at the same time because of political uncertainties, expected interest rate changes and expectations of major price adjustments in the share and bond markets. The uncertain political and investment climate made itself felt, not only in an increase in total deposit holdings, but also in a clear preference for shorter-term deposits with monetary institutions.

The higher liquidity preference of the private sector during the first half of 1994 was also reflected in the twelve-month growth rates in the *narrower monetary aggregates*. The growth rates over twelve months in M1A and M1 accelerated from 16,6 per cent and 6,7 per cent in December 1993, to 25,1 per cent and 28,2 per cent in June 1994, respectively. Similarly, the corresponding growth rate in M2 rose sharply from only 3,9 per cent to 17,4 per cent over the same period. The higher liquidity preference of the private sector is also demonstrated in Table 7, which shows that the private sector's cheque and transmission deposits and other demand deposits increased sharply, whereas their long-term deposits with the monetary sector actually declined in absolute terms.

The *main counterparts* (in a statistical or accounting sense) of the R14,2 billion increase in M3 in the first half of 1994 were as follows:

		R billions
Net foreign assets		-6,3
Government sector: net claims		14,8
Gross claims	11,0	
Government deposits (increase -, decrease +)	3,8	
Claims on the private sector		10,9
Net other assets and liabilities		-5,2
Total change in M3		**14,2**

These amounts were distorted by the issuing of special government stock of R7,5 billion to the Reserve Bank, which caused a shift in the statistical counterparts from changes in "net other assets and liabilities" to changes in the gross and net claims on the government, without affecting the overall change in M3. However, if this stock issue is not taken into consideration, the monetary sector's net claims on the government sector still increased by R7,3 billion during the first half of 1994.

Table 7. Deposits of the private sector with the monetary sector

	Coins and banknotes in circulation	Cheque and transmission deposits	Other demand deposits	Other short- and medium-term deposits	Long-term deposits	M3
Total outstanding as at						
31 Dec 1993 (R billions)	10,5	35,8	30,1	102,5	32,0	211,0
30 June 1994 (R billions)	11,4	41,1	38,5	106,0	28,1	225,2
Change from Dec 1993 to June 1994 (R billions)	0,9	5,3	8,4	3,5	-3,9	14,2
Percentage change from Dec 1993 to June 1994	8,4	14,8	28,1	3,4	-12,1	6,7

Despite the relatively wide margins between banks' deposit and lending rates which are usually conducive to disintermediation practices, the *income velocity of M3* declined by about 2 per cent in the first half of 1994. This was probably also indicative of the higher liquidity preference of the private sector during this period.

Credit extension

The growth in the *total domestic credit extension* accelerated significantly during the first half of 1994 because of a sharp increase in the monetary sector's credit extension to the private sector as well as a marked increase in the monetary sector's net claims on the government. The twelve-month growth rate in total domestic credit extension increased from 9,6 per cent in December 1993 to 18,7 per cent in March 1994 and even further to 22,7 per cent in June. In contrast to the increase in the money supply, the rate of increase in total credit extension in the first half of 1994 was affected by the above-mentioned special government stock issue to the Reserve Bank. If this change in stock holding (which was not new credit extension, but merely a reclassification of existing assets of the monetary sector) is not taken into account, the growth rate in total credit extension over the twelve months up to June 1994 still amounted to the high figure of 19,2 per cent.

The rate of increase over twelve months in the monetary sector's credit extension to the *private sector* rose from 9,7 per cent in December 1993 to 13,4 per cent in April 1994, before declining slightly to 13,2 per cent in June. In real terms (i.e. adjusted by the rate of inflation, as measured by changes in the consumer price index) the growth rate in credit extension to the private sector initially remained negative in January and February 1994; it then became positive in March and rose to 5,4 per cent in June 1994.

An analysis of the monetary institutions' claims on the private sector by *type of credit* (see Table 8) indicates that the R10,9 billion increase in credit extension to the private sector during the first half of 1994 could be attributed mainly to increases of R7,2 billion in mortgage advances and R2,4 billion in instalment sales credit financing. These two forms of credit extension were responsible for about 88 per cent of the increase in credit extended to the private sector in the first six months of 1994. Leasing finance and the so-called "other loans and advances" made smaller contributions to the total increase in credit extension to the private sector; the monetary sector's holdings of investments and bills discounted actually decreased in this period.

The rate of increase over twelve months in mortgage advances declined somewhat during the first half of 1994 from 17,7 per cent in December 1993 to 16,8 per cent in June 1994. However, banks' active promotion of this credit facility on account of the low capital requirements applicable to it, kept the increase in absolute terms on a high level. In contrast to this development, the twelve-month growth rate of credit provided on instalment sales rose from an already high rate of 18,0 per cent in December 1993 to 23,9 per cent in March 1994 and to 23,5 per cent in June. Rising new car sales, banks' "special rate" vehicle finance schemes and a substantial increase in this type of credit used for the purchase of second-hand passenger cars, were mainly responsible for the high rates of increase in the financing of instalment sales.

The twelve-month rates of growth in "other loans and advances" (including overdrafts) and in leasing finance also increased, on balance, during the first six months of 1994, but at more moderate rates. These growth rates in "other loans and advances" and in leasing finance advanced from 8,4 per cent and 6,8 per cent in December 1993 to 12,3 per cent and 8,4 per cent in June 1994, respectively.

Credit extension to the private sector

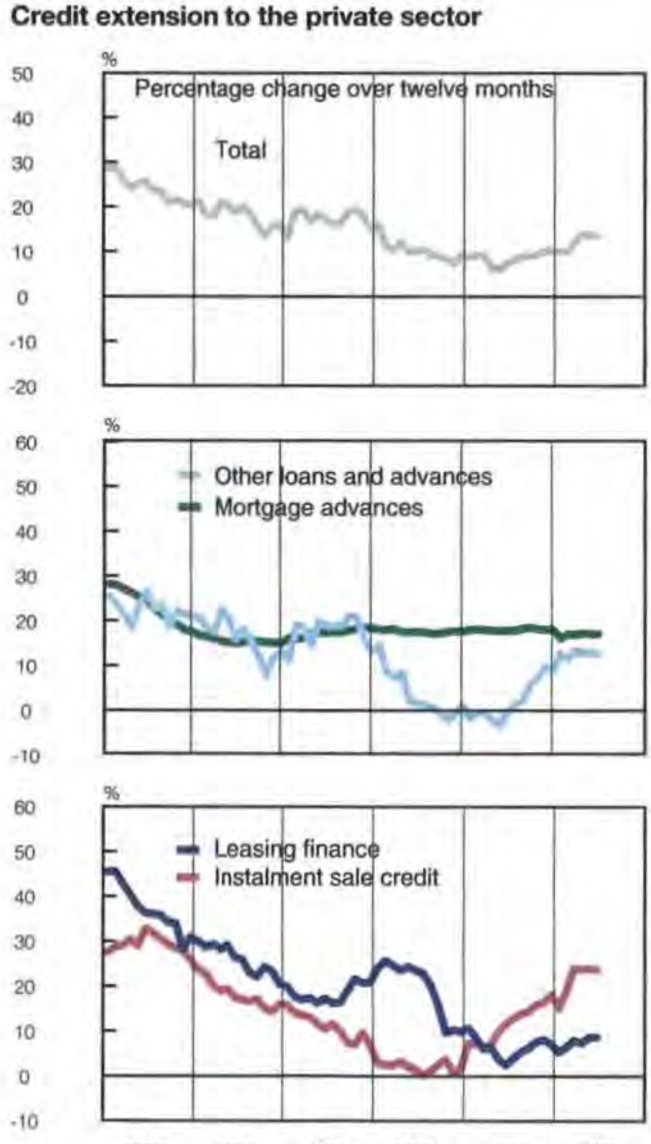


Table 8. Credit extension to the private sector

	Investments and bills discounted	Instalment sales credit	Leasing finance	Mortgage advances	Other loans and advances	Total
Total outstanding as at						
31 Dec 1993 (R billions) ..	14,6	23,1	15,5	97,0	79,6	229,8
30 June 1994 (R billions).	13,9	25,5	15,7	104,2	81,3	240,7
Change from Dec 1993 to June 1994 (R billions)	-0,7	2,4	0,2	7,2	1,7	10,9
Percentage share of increase in total credit extension from Dec 1993 to June 1994......	-6,0	22,4	2,3	65,7	15,6	100,0

Interest rates

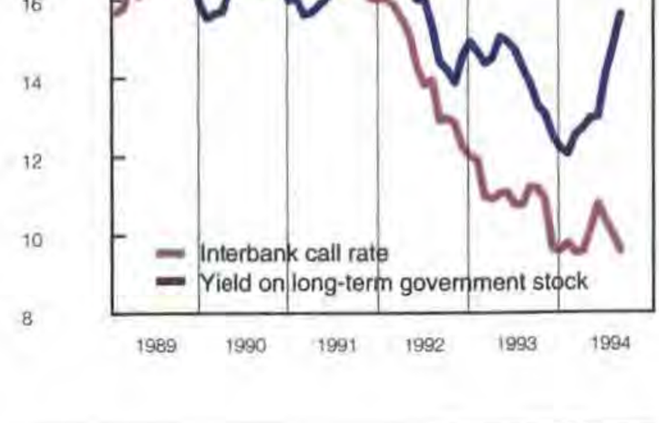
The draining-away of foreign reserves in the beginning of 1994, fears that government finance might get out of hand and crowd out the private sector, net sales of domestic loan stock by non-residents, higher inflation expectations, upward adjustments in bond rates in the rest of the world, and relatively tight money market conditions, caused a sharp reversal in interest rate movements from the beginning of 1994. After having declined fairly consistently during 1992 and 1993, interest rates moved sharply upwards from February 1994 without any changes being announced in Bank rate. In particular, longer-term rates increased by about 3 percentage points in the first eight months; shorter-term rates generally showed a much more moderate increase of only about 1 percentage point, leading to a considerably steeper yield curve.

The monthly average *yield on long-term government stock*, which had declined from 15,0 per cent in April 1993 to 12,1 per cent in January 1994, subsequently reverted to 15,6 per cent in August 1994. This increase, together with a lower rate of inflation, caused the monthly average real yield on long-term government stock to increase from 2,0 per cent in January 1994 to 6,1 per cent in July 1994.

At first *money market interest rates* also hardened considerably in the period from February 1994 to May, but softened again in the subsequent three months as increases in the net foreign assets of the Reserve Bank alleviated the tight money market conditions. This general course of money market rates was clearly reflected in the rate on interbank call money, which rose from 9,50 per cent at the end of February 1994 to 11,00 per cent at the end of May; it then receded again to 9,75 per cent at the end of August 1994. Other money market interest rates performed in more or less the same manner. The tender rate on three-month Treasury bills, for instance, remained at a level of about 10,17 per cent in the first three months of 1994 before increasing to 11,00 per cent at the end of May; it then declined again to 10,73 per cent at the end of August 1994.

The *banks' prime lending rate* on overdrafts remained unchanged at 15,25 per cent during the first eight months of 1994. As a result of the lower inflation rate, the inflation-adjusted or real prime lending rate of the banks rose from 5,2 per cent in December 1993 to 6,5 per cent in July 1994. Although the banks' prime lending rate was kept unchanged, their predominant *rate on twelve-month fixed deposits* (which is regarded as indicative of deposit rate behaviour in general) was lowered by half a percentage point to 10,5 per cent in February 1994. This, therefore caused the margin between the prime overdraft rate and the twelve-month deposit rate to widen from 4,25 per cent to 4,75 per cent in February 1994. The twelve-month deposit rate

Interest rates and yields



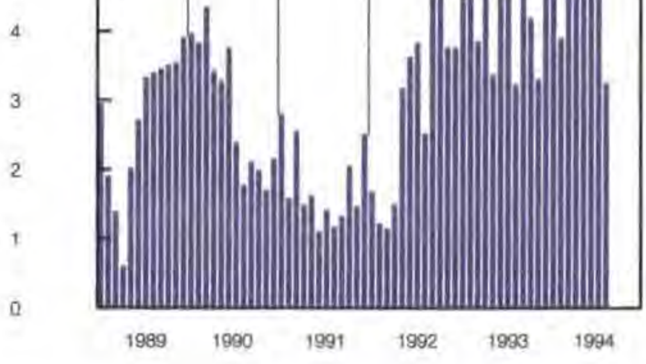
provided depositors with a positive *real* pre-tax yield of 2,1 per cent in July 1994.

Money market

Money market conditions remained relatively tight during the first six months of 1994, but eased somewhat in the ensuing two months. This was clearly reflected in the amount of accommodation at month-ends, which fluctuated considerably during this period but increased, on balance, from R5,8 billion at the end of December 1993 to R6,5 billion at the end of June 1994; it then decreased only moderately to R5,2 billion at the end of July 1994 and much more substantially to R3,3 billion at the end of August.

The high but fluctuating money market shortage in the first six months of 1994 was mainly due to the volatility of the Reserve Bank's net foreign asset holdings. The net foreign assets of the Reserve Bank (as adjusted to reflect their effect on the money market) initially increased by R2,1 billion in January 1994, declined by R3,4 billion in the following three months and increased again by R1,0 billion in May and June 1994. These changes were reinforced by movements in the amount of notes and coin in circulation outside the Reserve Bank, which rose abnormally strongly by R2,0 billion in March and April 1994 (the months before and during the election) but decreased again by R0,6 billion in the ensuing two months. The tightening effect of these two factors was neutralised to some extent by a decline in government deposits with the Reserve Bank during this period.

Accommodation at the discount window



The easing of money market conditions in July and August 1994 was mainly the result of a substantial increase in the Reserve Bank's net foreign assets of R3,0 billion. The financing of the harvests in the summer rainfall areas by the Land and Agricultural Bank also contributed to these easier conditions, because an amount of R0,8 billion was obtained by the Land Bank from the Corporation for Public Deposits.

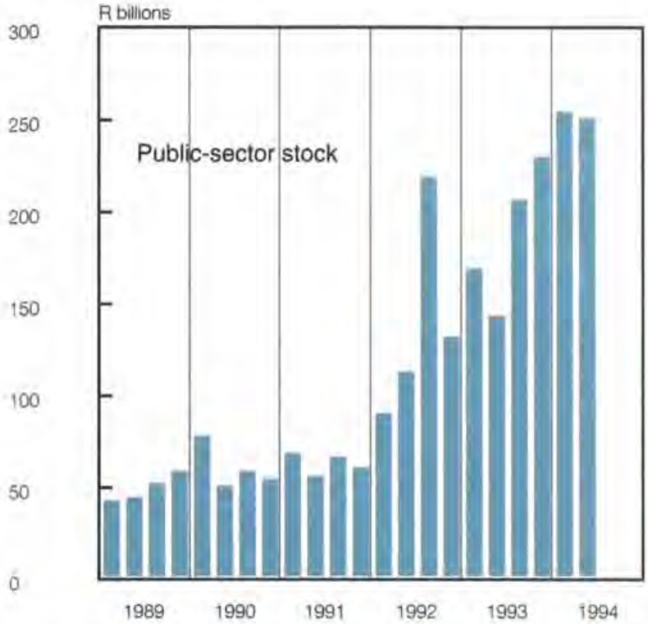
The *Reserve Bank's actions* in the money market were generally neutral, allowing the money market shortage to reflect underlying supply and demand conditions. By allowing the market to remain tight, the Reserve Bank discouraged the capital outflow from the country, because it made it more difficult for private banks to switch from foreign to domestic financing of trade transactions. The Bank's actions mainly consisted of the management of government deposits between the Exchequer Account at the Reserve Bank and the Tax and Loan Accounts at private banks, especially from the beginning of the new fiscal year in April. The Bank also adjusted the asset portfolio of the Corporation for Public Deposits in the first half of 1994, with a net tightening effect of R2,0 billion on money market conditions. This was partly countered by an increase in the Reserve Bank's own portfolio of financial assets for open market operations to the amount of R0,3 billion. However, the Bank's total holding of government stock, as recorded on its balance sheet showed a much more substantial increase, because of the special government stock issue referred to earlier.

In July and August 1994 the portfolio of the Corporation for Public Deposits increased by R1,8 billion, but the money market shortage initially shrank by a considerably smaller amount because a large part of the amount received by the Public Investment Commissioners was deposited with the monetary authority. During this period the government deposits with the Reserve Bank also began to decline, on balance, by R1,8 billion, as a result of the demand for funds by the government. This, of course, led to an easing of money market conditions.

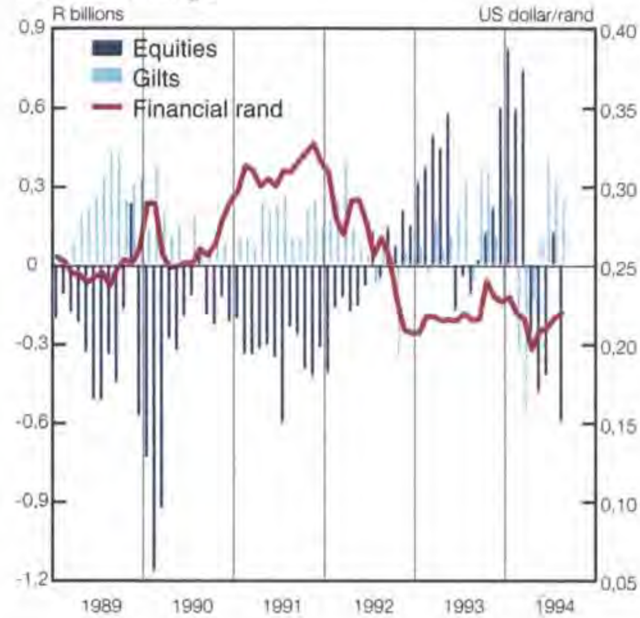
Bond market

In the *primary bond market*, the net new borrowing by the public sector from the private sector through issues of fixed-interest securities amounted to R4,4 billion in the first half of 1994; in the first half of 1993 no less than R19,4 billion of government stock had been taken up by private organisations and individuals. This considerable decline in the net borrowing of the public sector from the private sector was mainly due to net purchases of government stock by public-sector entities. If the net purchases of these entities of R14,3 billion are taken into account (including net purchases of R12,3 billion by the Public Investment Commissioners, but excluding the special government stock issue to the Reserve Bank), the net issues of the public sector to the market as a whole came to R18,7 billion in the first half of 1994 and to R9,7

Stock exchange transactions



Non-residents' net transactions on the stock exchange



billion in the first quarter of fiscal 1994/95. A substantial proportion of the government's borrowing requirement had therefore already been satisfied by bond issues in the first three months of the fiscal year.

Activity in the *secondary bond market* also remained very buoyant in the first half of 1994 and the value of *public-sector stock traded on the stock exchange* rose from R229 billion in the fourth quarter of 1993 to a new record level of R254 billion in the first quarter of 1994; it then fell back marginally to R250 billion in the second quarter. This moderately lower turnover in the second quarter of 1994 was probably related to special circumstances, such as a smaller number of trading days. The firming of the yield on long-term government stock, however, may have underpinned the volume of trade in this quarter. In July and August 1994 the monthly turnover averaged R90 billion, which was slightly higher than the monthly average value of R83 billion in the second quarter of the year.

Non-residents continued to be active participants in the secondary bond market during the first eight months of 1994. From February to April 1994 non-residents were net sellers of public-sector stock, but their net purchases in the ensuing period exceeded these sales. In the first eight months of 1994 non-residents were therefore net purchasers of public-sector stock to an amount of R0,3 billion.

The *Reserve Bank* also remained an active participant in the bond market in accordance with its objective of promoting an active secondary market in government stock. Gross sales of government stock by the Reserve Bank totalled R113 billion in the first eight months of 1994; these sales were moderately lower than the level of R118 billion in the corresponding period of the preceding year. Net sales of government stock by the Reserve Bank during the first eight months of 1994 came to R13,3 billion; in the corresponding period of 1993, such net sales had amounted to R11,1 billion. The Reserve Bank's trading in government stock options increased from a monthly average of R5,3 billion in 1993 to a monthly average of R7,6 billion in the first eight months of 1994.

Equity market

In the *primary equity market*, factors such as high and rising share prices, a shortage of scrip and the firming of long-term interest rates favoured share capital issues in the first half of 1994. The demand for new funds, however, remained low. The value of rights issues of ordinary shares of listed companies on the stock exchange accordingly fell from R2,9 billion in the last half of 1993 to R1,6 billion in the first half of 1994. Scrip dividends and bonus shares issued, on the other hand, rose considerably in the first half of 1994, being encouraged, among other things, by the secondary tax on the distributed profits of companies.

In the *secondary equity market*, the value of shares traded on the Johannesburg Stock Exchange nearly doubled from a monthly average of R3,6 billion in 1993 to R6,2 billion in the first eight months of 1994. Increased optimism associated with the greatly improved profitability of companies, large-scale buying and selling by non-residents and a higher demand for shares by institutional investors, made important contributions to these high turnovers. Compared with the stock exchanges of most industrialised countries, the liquidity on the Johannesburg Stock Exchange is nevertheless still low.

In contrast to the decline in *share prices* on most of the world's leading stock exchanges from the beginning of 1994, the average price index of all classes of shares on the Johannesburg Stock Exchange continued to rise. Declines were shown at first only by the prices of gold-mining shares, but even these prices recovered in July and reached a seven-year high in August 1994. The average price of all classes of shares actually reached a new record high in August 1994; this average price level then was no less than 90 per cent above its lower turning-point in October 1992.

Mirroring the increase in share prices, the average *dividend yield* on all classes of shares decreased sharply from 2,53 per cent in December 1993 to 2,14 per cent in August 1994. The average *earnings yield* on all classes of shares (excluding gold-mining shares) also decreased from 5,95 per cent to 5,04 per cent over the same period.

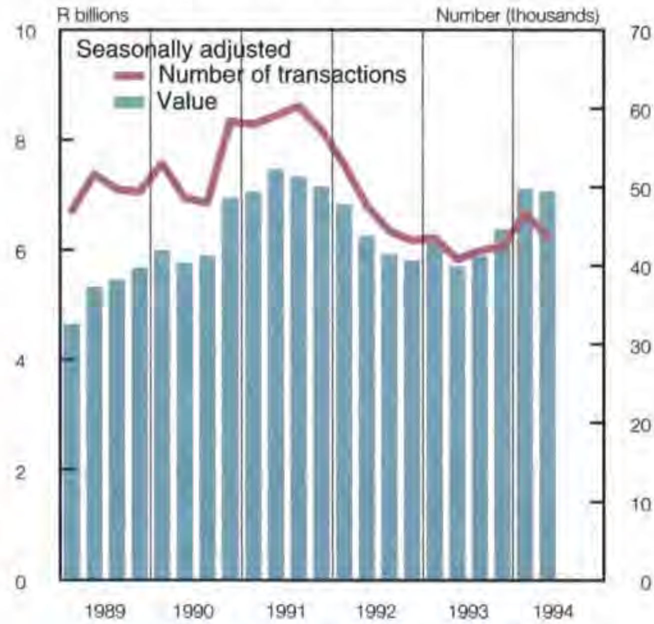
The lifting of sanctions against South Africa, the sharp recovery in share prices, the weak financial rand, and the higher gold price, led to increased involvement of *non-residents* on the Johannesburg Stock Exchange. Total share purchases by non-residents as a percentage of total turnover increased from 22 per cent in 1992 to 29 per cent during the first eight months of 1994. In 1994 the net transactions of non-residents fluctuated widely. After having been net purchasers of shares to an amount of R2,1 billion in the first quarter of 1994, non-residents became net sellers to an amount of R1,2 billion in the second quarter; in July and August 1994 they were net sellers to an amount of R0,5 billion.

Other financial markets

Equity futures contracts continued to dominate the formal derivative market in the first half of 1994. Transaction levels were boosted by the lively domestic share market, uncertainty regarding political developments and a high level of non-resident participation. These factors were responsible for an all-time high turnover of 1,2 million equity futures contracts in the first quarter of 1994, which fell back somewhat to 0,9 million contracts in the second quarter. Contracts based on underlying instruments, such as interest rate contracts, remained at relatively low levels.

In the first half of 1994 the trading in the number of *options* on equity futures contracts reached 1,7 million, which was almost three times the trading of 0,6 million contracts in the first half of 1993. The significant growth in open positions in futures and options contracts on the South African Futures Exchange indicated that the formal futures market was increasingly serving the hedging needs of the financial community. At the end of August 1994 the open interest in equity futures contracts and in options on equity futures contracts was 86 315 and 446 393 contracts, respectively. Based on the mark-to-market prices of equity futures and options at the close of business on 31 August 1994, the total open interest was worth R5,9 billion.

Real estate transactions



As already indicated, the financing of the *mortgage market* remained at high levels in the first half of 1994, despite the decision of banks to stop carrying mortgage registration costs and valuation fees and to curtail mortgage loading (where the stated purchase price of a home exceeds the actual price paid). The measure of uncertainty in the property market before and after the elections in April 1994 and the unchanged predominant mortgage bond rate of 15,25 per cent, did not prevent the value of *real estate transactions* in the first six months of 1994 from increasing by 19,9 per cent above the level in the corresponding period of the preceding year. This increase was due to a rise in the number as well as the average price of such transactions over the same period.

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 non-financial public enterprises) amounted to R9,6 billion in the first quarter of fiscal 1994/95 (the second quarter of the calendar year 1994), compared with R8,0 billion in the first quarter of fiscal 1993/94. Although a relatively large public-sector borrowing requirement in the first quarter of a fiscal year is a seasonal feature of the public-sector finances, the deficit of 9,3 per cent of gross domestic product in the first quarter of fiscal 1994/95 was well in excess of the average ratio of 8,3 per cent in the corresponding period of the preceding two fiscal years.

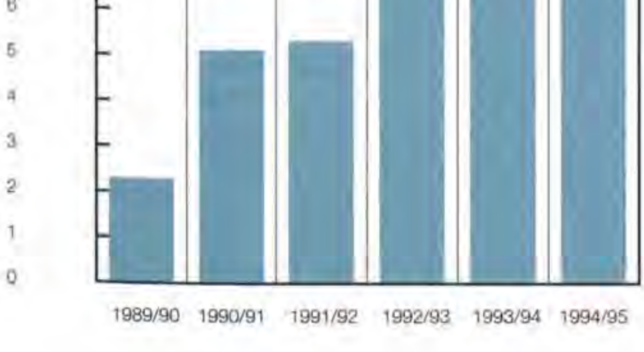
The large public-sector borrowing requirement in the first quarter of fiscal 1994/95 could be attributed mainly to a sharp increase in the *expenditure of general government* (i.e. the consolidated central government, provincial governments and local authorities); the borrowing requirement of the non-financial public corporations totalled only R0,3 billion in the first quarter of fiscal 1994/95. Although the year-on-year rate of increase in total general government expenditure, at 17,9 per cent, was only marginally higher than the rate of 16,8 per cent in the corresponding quarter of the preceding year, this rise in expenditure was recorded in an economy with considerably lower price inflation. As a ratio of gross domestic product, the total expenditure and net lending of general government increased from 34,7 per cent in the first quarter of fiscal 1993/94 to 36,7 per cent in the first quarter of fiscal 1994/95. Part of this rapid rise in expenditure was due to a substantial increase in capital expenditure; however, as a percentage of the total expenditure of general government, capital expenditure still amounted to only 8,5 per cent. Expenditure on goods and services (excluding labour remuneration) was the major contributor to this rapid rise in general government expenditure.

Total *income of general government*, as a percentage of gross domestic product, also increased sharply from 26,2 per cent in the first quarter of fiscal 1993/94 to 27,7 per cent in the first quarter of fiscal 1994/95. This outcome was the result of an increase in the ratio of tax revenue to gross domestic product, while the ratio of non-tax revenue decreased marginally.

In comparison with the first quarter of fiscal 1993/94, the financial position of all *levels of general government*, with the notable exception of local authorities and provincial governments, deteriorated in the first quarter of fiscal 1994/95. At R0,7 billion in the first quarter of fiscal 1994/95, the borrowing requirement of local authorities was slightly lower than the R0,8 billion in the corresponding quarter of fiscal 1993/94. The surplus of the provincial governments (including the former TBVC countries and self-governing states) increased from R0,9 billion in the first quarter of fiscal 1993/94 to R2,0 billion in the first quarter of fiscal 1994/95, while the small surplus of the extra-budgetary institutions declined from R0,4 billion in the first quarter of fiscal 1993/94 to R0,3 billion in the first quarter of fiscal 1994/95.

The borrowing requirement on the *Main Budget* totalled R10,8 billion in the first quarter of fiscal 1994/95; in the corresponding period of the preceding year it had been considerably lower at R8,4 billion. This larger borrowing requirement on the Main Budget arose from a sharp increase in expenditure, related mainly to the transition process to a new political dispensation, which was not fully offset by the higher-than-estimated increase in revenue.

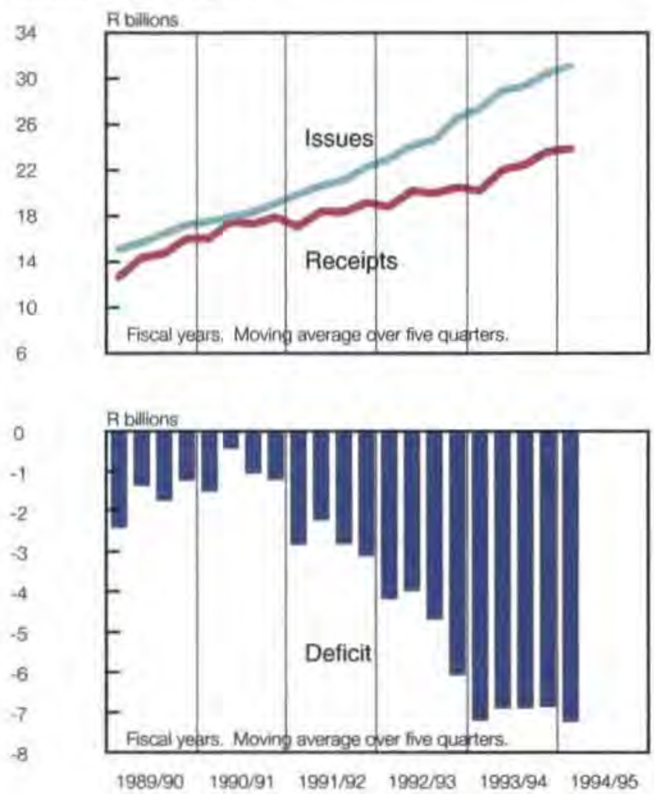
Public-sector borrowing requirement as percentage of gross domestic product



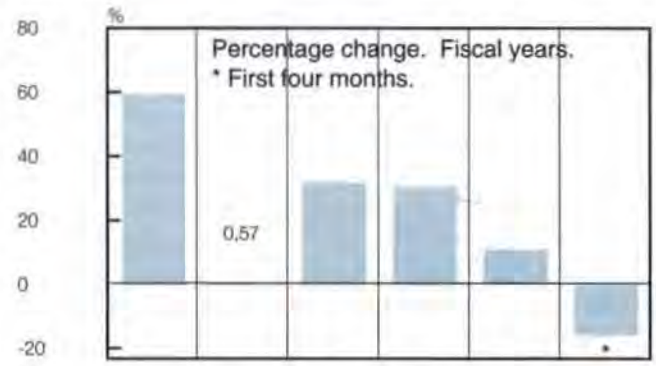
Exchequer account

Exchequer issues to national government departments (adjusted to reflect cash flows) in the first quarter of fiscal 1994/95 were 21,5 per cent higher than in the first quarter of the preceding year. This rate of increase was well above the average year-on-year rate of increase of 16,9 per cent in the corresponding period of the preceding five fiscal years and also markedly higher than the 10,2 per cent provided for in the Budget for fiscal 1994/95 as a whole. If Exchequer issues in July 1994 are also taken into account, the year-on-year rate of increase for the first four months of fiscal 1994/95 was

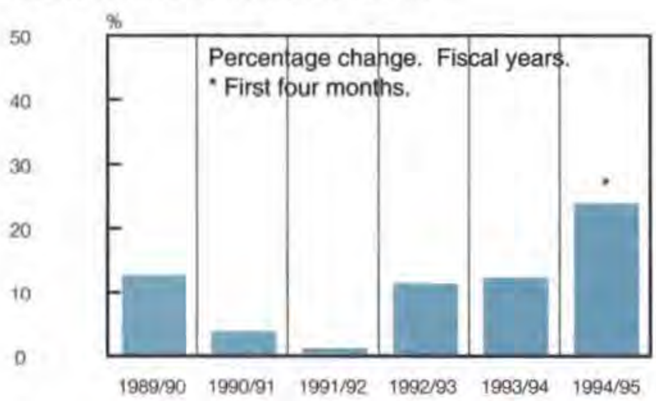
Exchequer account



Fuel levy



Customs and other excise duties



considerably lower at 16,9 per cent, but still uncomfortably high in relation to the expected growth in nominal gross domestic product over the same period. The issues in the first four months of fiscal 1994/95 did not, however, include any expenditure on the Reconstruction and Development Programme, which will start only later in the year.

The level of *Exchequer receipts* in the first four months of fiscal 1994/95 amounted to R34,0 billion, which was 23,5 per cent above the level in the corresponding period of fiscal 1993/94. A large part of this increase was, however, due to income not spent in the previous year and carried forward to the current fiscal year. If these so-called surrenders are excluded, the year-on-year rate of increase in government revenue came to 20,4 per cent in the first four months of fiscal 1994/95. This was nevertheless still considerably higher than the average year-on-year rate of increase of 15,9 per cent in the preceding five years and substantially higher than the budgeted increase of 12,9 per cent for fiscal 1994/95 as a whole.

As shown in Table 9, the higher-than-expected increase in Exchequer receipts during the first four months of fiscal 1994/95 was discernible in nearly all the main categories of government revenue. In particular, the rate of increase in customs and excise duties was substantially higher than budgeted for the full fiscal year. These higher customs and excise receipts were registered despite an actual decline in receipts from the fuel levy and were related mainly to a substantial increase in merchandise imports; the proceeds from customs and excise still included receipts from the surcharge on

Table 9. Percentage increase in Exchequer receipts

	Budgeted increase for fiscal 1994/95	Actual increase in April-July 1994
Exchequer receipts (excluding surrenders)	12,9	20,4
Customs and excise duties	2,6	17,0
Inland revenue	14,8	21,0
Income tax	16,5	22,9
Value-added tax	15,3	13,0

intermediate and capital goods, which was abolished only near the end of June 1994. Income tax receipts also performed exceptionally well and could show a further improvement during the remaining eight months of fiscal 1994/95 as the collections of the transition levy become fully effective. However, the rate of increase in value-added tax was lower than the budgeted percentage rise for the fiscal year as a whole, probably reflecting a lower-than-projected aggregate demand in the first four months of fiscal 1994/95.

The net result of the transactions on the Exchequer account was a *deficit before borrowing and debt repayment* of R9,2 billion in the first four months of fiscal 1994/95. This shortfall equalled 31,3 per cent of the budgeted deficit of R29,3 billion for the year as a whole. As a ratio of gross domestic product, the deficit before borrowing and debt repayment amounted to 10,5 per cent in the first quarter of fiscal 1994/95.

New long-term government stock continued to be the primary *debt-financing instrument*. In the first four months of fiscal 1994/95 the issuing of the new government stock totalled R9,3 billion, or 32,5 per cent of the expected borrowing requirement for the fiscal year as a whole. This ratio of net long-term government stock issues to the government's borrowing requirement was considerably smaller than the average ratio of 53,8 per cent in the preceding five fiscal years. In the past, the government followed the practice of funding the highest possible part of its financing needs as early as possible in the new fiscal year. This tended to lead to excessive borrowing in the first few months of the fiscal year, and to large build-ups of inactive government balances. In the current fiscal year this procedure was not followed.

As a result of a strong demand for paper at the shorter end of the maturity spectrum, the government also made considerable use of the issue of Treasury bills to meet its financial needs in the first four months of fiscal 1994/95. The net issue to the market of this paper, on which interest rates were also considerably lower than on long-term stock, amounted to no less than R2,1 billion in the first four months of fiscal 1994/95. As could be expected, a large part of this paper was taken up by private monetary institutions. The Exchequer deficit before borrowing and debt repayment was nevertheless financed largely by funds raised from the non-monetary sectors. However, private insurers and pension funds took up only R11 million of the net issues of government stock in the first four months of fiscal 1994/95, compared with an average of R3 942 million in the corresponding period of the preceding five fiscal years.

The total government debt increased from R192,2 billion at the end of March 1994 to R222,7 billion at the end of July 1994. A substantial portion of this increase (R15,3 billion) could be attributed to the inclusion of the debt of the former TBVC countries and self-governing states, which was transferred to the South African national government. Some of these loans may, however, be transferred to regional authorities if they can be matched with assets that have been created in a specific region.

Table 10. Financing of Exchequer deficit by type of lender in the first four months of fiscal 1994/95

Type of lender	R millions
Public Investment Commissioners	5658
Non-monetary private sector	4772
Foreign sector	-141
Monetary institutions	3122
Monetary authority	1639
Other monetary institutions	1483
Total gross financing	13411
Less: Discount on new issues of governmentstock	4257
Total net financing	**9154**