Quarterly economic review

Introduction

The economic recovery in South Africa in the second half of 1993 faltered somewhat in the first quarter of 1994 and real gross domestic product contracted. This poor performance of production was, however, largely the result of a decrease in agricultural output from an exceptionally high level in the fourth quarter of 1993. Real non-agricultural output continued to expand in the first quarter of 1994, albeit at a considerably lower rate than in the second half of the preceding year. Special circumstances were probably responsible for this lower growth, such as political uncertainty, ongoing violence in the run-up to the election, work stoppages and labour unrest.

The relatively calm and peaceful conditions after the election augur well for the continuation of the economic recovery in the remainder of 1994. Various other factors also favour economic growth in the short term, such as signs of an upturn in real investment partly related to the launching of large capital projects; the good agricultural season in the summer rainfall area, where the crops are now being harvested; relatively more stable financial conditions; the re-entry of South Africa in the international economy and the normalisation of trade and financial relations with many countries; the low level of the country's foreign debt; and the revival in economic activity in industrialised countries and in international commodity prices.

Despite the decline in domestic output, aggregate real gross domestic expenditure increased further in the first quarter of 1994, but at a much more moderate rate than during the second half of 1993. This was largely due to the fact that the growth in real private consumption expenditure became more hesitant, reflecting dampened consumer confidence ahead of the election, a relatively low increase in personal disposable income and only a small rise in household credit demand. A further moderate rise was recorded in real capital formation which was fairly broadly based and caused by expenditure on major capital projects, asset replacement and some expansion of capacity. In contrast to these developments, real consumption expenditure by general government increased markedly.

The recovery in economic activity was, up to the third quarter of 1993 (latest information available), unable to reverse the downward movement in employment and employment opportunities continued to decline, particularly in the private sector. As could be expected, the rising unemployment resulted in some moderation of wage demands in 1993. At the same time, labour productivity continued to improve appreciably, with the result that nominal unit labour costs rose at a slower pace. This development was supported by a consistently conservative monetary policy stance which toned down inflation expectations. Exogenous factors, such as the relative price stability in trading partner countries, lower international oil prices and better agricultural conditions, also contributed to the attainment of a lower inflation rate.

In the first quarter of 1994 the current account surplus on the balance of payments weakened considerably because of lower exports of goods and services combined with a sharp rise in the imports of goods and services. These developments could not be offset by a rise in the value of net gold exports. Fortunately, the capital account of the balance of payments improved remarkably and only a small net outflow of capital was recorded in the quarter as a whole. A substantial inflow of capital, however, occurred in January 1994 when the large outflow in the preceding month was partly reversed. An inflow of short-term capital took place largely because the tight conditions on the domestic money market forced banks to make more use of foreign credit facilities to supplement funds. The net outflow of long-term capital, however, increased sharply due to the upfront payment in February 1994 in terms of the 1994 Debt Arrangements with foreign creditor banks, and to other fixed contractual commitments falling due for payment.

Owing to political uncertainty and ongoing violence, the capital outflow rose again dramatically in April and was only reversed in May after it became clear that the election results were generally acceptable to most South Africans. As a result of these speculative capital outflows, the net foreign reserves of the country decreased sharply and the nominal and real effective exchange rate of the rand contracted in the first four months of 1994. In May 1994 the rand depreciated further, although the net capital outflow apparently subsided.

Growth in all the money supply aggregates, which had generally been subdued in 1993, accelerated sharply in the first four months of 1994. The authorities were not unduly concerned about this development because it was mainly brought about by a shift from government deposits to private sector deposits with the banking sector. This reduction in government deposits with banks was also responsible for a more rapid expansion in total credit extension by monetary institutions in the first three months of 1994. The growth in credit extended by banks to the domestic private sector, however, receded over the first two months of 1994; it increased again rapidly in March.

After having eased somewhat in the first two months of 1994, money market conditions became very tight in the ensuing three months. These tighter conditions were mainly the result of a marked increase in notes in circulation and a decrease in the net foreign assets of the Reserve Bank. Both these developments were probably related to uncertainties and fears in the pre-election period. The Reserve Bank generally allowed the money market shortage to reflect the tight underlying demand and supply conditions. By adopting this policy stance, the Bank discouraged private banks from substituting domestic liabilities for foreign credit facilities, in an attempt to contain the outflow of capital from the country.

Reflecting the tight money market conditions and uncertainty about domestic political developments, the general downward movement in money market interest rates in 1993 lost momentum in the first two months of 1994, and these rates then hardened somewhat in the ensuing three months. The yield on long-term government stock also firmed over this period. Share price increases, on the other hand, depressed the average dividend and earnings yield on shares.

Capital market conditions remained buoyant in the first five months of 1994. The nominal value of public-sector stock traded on the Johannesburg Stock Exchange reached new record levels and the turnover of listed shares was also exceptionally high. In the primary capital market, however, relatively low levels of new-issue activity were displayed in the first quarter by borrowing entities in both the public and the private sector. These new issues were at low levels because the government had already financed its deficit before borrowing for fiscal 1993/94 and most of the large listed companies were relatively liquid and had not yet embarked on significant investment programmes.

The public-sector borrowing requirement of the government in fiscal 1993/94 was nevertheless exceptionally large owing to special transfers of the government to redeem liabilities incurred over a relatively long period of time. As a result, government debt increased by R37,5 billion in this fiscal year to a ratio of 48,7 per cent of gross domestic product at the end of March 1994. Nearly two out of every ten rand received by the government now has to be used to finance interest payments on the growing public debt.

The government was, however, very successful in containing government expenditure in fiscal 1993/94 and it came close to the Budget estimates. Most of the main categories of government revenue also performed more or less in line with, or better than, the Budget projections, with the notable exception of income tax on individuals and companies. The lower-than-expected revenue from personal income tax was mainly related to a lower rate of increase in salaries and wages than had been anticipated in the Budget. The income tax proceeds on companies actually decreased in fiscal 1993/94 because of relatively low profits still being made at the beginning of the economic recovery and the time lag between profit growth and the receipts of corporate tax.

Domestic economic development

Domestic output[1]

The growth in *real gross domestic product* turned negative in the first quarter of 1994. The revised seasonally adjusted and annualised rate of increase in real domestic output accelerated from 2½ per cent in the first quarter of 1993 to 5 and 7 per cent in the next two quarters, amounting to a still high level of 5 per cent in the fourth quarter. Current estimates indicate that domestic output contracted at an annualised rate of approximately 3½ per cent in the first quarter of 1994. At 3 per cent above the level in the first quarter of 1993, the level of domestic output was nevertheless still relatively high in the first quarter of 1994.

The poor performance of total production in the first quarter of 1994 was to a large extent due to a decline in agricultural output. A more-than-doubling of the real value added by agriculture in the course of 1993, owing to large maize and wheat crops, was followed by a drop in agricultural output in the first quarter of 1994 to approximately the average production level in the first quarter of the preceding four years. However, in view of the favourable 1993/94 season in the summer rainfall area, the downward movement in agricultural production could easily be reversed again in the next two quarters.

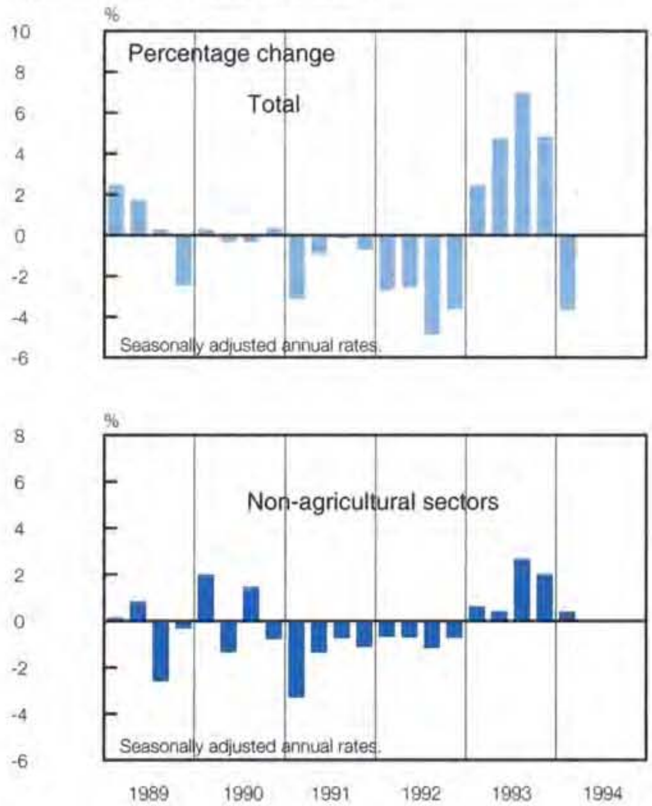
Growth in the real value added by the *non-agricultural sectors,* which had been relatively subdued in the first half of 1993 and then became much stronger in the second half of the year, slowed down again in the first quarter of 1994. Real non-agricultural output increased at an annualised rate of only ½ per cent in the first quarter of 1994 compared with an annualised increase of 2 per cent in the preceding quarter. Contrary to the fourth quarter of 1993 when all the main non-agricultural economic sectors showed positive growth, decreases were registered in the real output of mining, manufacturing and commerce.

After having increased fairly sharply at a rate of more than 2 per cent in 1993, the real output in the *mining industry* contracted at an annualised rate of 2½ per cent in the first quarter of 1994. In particular, gold production decreased on account of a lower throughput of ore and a small decline in the gold content of ore milled. As in the past, the gold mines shifted to the mining of lower quality ore with the increase in the rand price of gold. Mining production in general also suffered from labour unrest and work stoppages at several mines.

The real value added by the *manufacturing sector* declined at an annualised rate of approximately 1 per cent in the first quarter of 1994; in the second half of 1993 it had still shown signs of a sustained recovery. The weak performance in manufacturing production at the beginning of 1994 was particularly evident in the industries producing textiles, clothing and leather goods, paper and printing products, as well as machinery and transport equipment. This was to some extent related to uncertainties that pertained to the pre-election period, the lower demand for exports and somewhat higher inventory levels at the end of 1993. Reports also indicate that the production of transport equipment had been affected adversely by high absenteeism and violence. The other subsectors of manufacturing, however, continued to perform well because of the improved domestic and external demand for their products.

The further expansion of electricity services was mainly responsible for an increase at an annualised rate of 3 per cent in the real value added by the sector supplying *electricity, gas and water* in the first quarter of 1994. In 1993 the growth in the real output of this sector was even more vigorous at nearly 4 per cent. The real value added by the *construction sector* also edged up in the first quarter of 1994, following one of the worst and longest slumps this industry has experienced since the Great Depression.

Real gross domestic product



[1] Major revisions have been made to the national accounts statistics and the base year in calculating aggregates at constant prices has been changed to 1990. These revisions are discussed in "South Africa's national accounts, 1946-1993", included as a supplement to this edition of the *Quarterly Bulletin.*

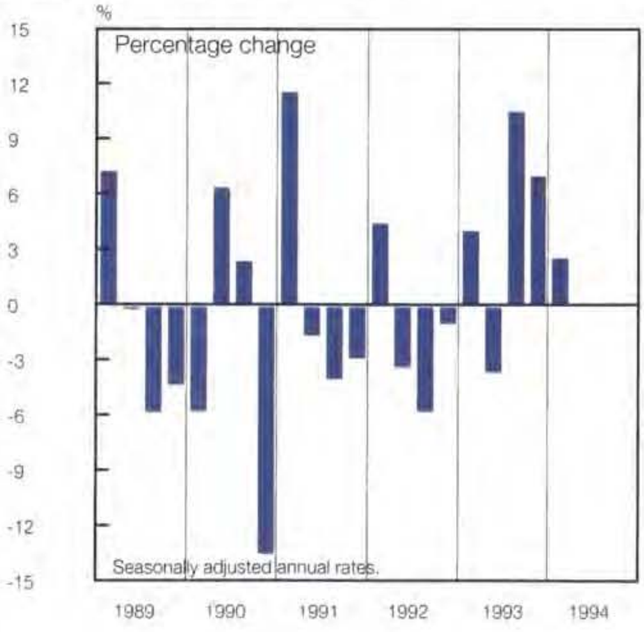
The growth in the real value added by the *tertiary sectors* rose at a steady annualised rate of 1 per cent in the first quarter of 1994, or at the same rate that had been recorded in the second half of 1993. Continued buoyancy in financial activity, a strong rise in real estate transactions, a high volume of imports and improved agricultural conditions made an important contribution to the increase in the real value added by sectors such as transport, storage and communication; finance, insurance, real estate and business services; and general government. These increases were, however, partly offset by a contraction in the real value added by commerce, reflecting the influence of violence on trade in several parts of the country.

Domestic expenditure

Aggregate real *gross domestic expenditure* increased further in the first quarter of 1994, but at a much more moderate rate than during the second half of 1993. Following relatively high annualised increases of 10½ and 7 per cent in the last two quarters of 1993, real domestic expenditure increased by 2½ per cent in the first quarter of 1994. This slower growth in real gross domestic expenditure was apparent in the real outlays on private consumption expenditure and inventory investment. In contrast, gross domestic fixed investment rose moderately, while real consumption expenditure by general government increased markedly.

The increase in real *private consumption expenditure* slowed down from annualised rates of 2 and 2½ per cent in the third and fourth quarter of 1993 to a rate of not quite 1 per cent in the first quarter of 1994. This more hesitant growth in consumption expenditure of households was evident among most of the main categories of goods and services. Although real outlays on personal transport equipment rose moderately in the first quarter of 1994, they were still some 2½ per cent below the level registered in the first quarter of 1993.

Real gross domestic expenditure



The slowdown in the growth of real private consumption expenditure was due to heightened uncertainty ahead of the election, which dampened consumer confidence. It also reflected the relatively low growth in real personal disposable income and only a small increase in household credit demand. Pre-emptive buying by private households in anticipation of possible disruptions in the supply of consumer goods in the period leading up to the election only became evident towards the end of the first quarter. It was then too late to have had any significant impact on aggregate real outlays on private consumption in the first three months of the year.

Quarter-to-quarter rates of increase in real *consumption expenditure by general government* rose sharply to revised annualised levels (mainly because of higher than had been reported earlier outlays by provincial administrations on intermediate goods and services) from 1½ per cent in the second quarter to 6 per cent in the fourth quarter of 1993 and 9½ per cent in the first quarter of 1994. This acceleration could be attributed primarily to a significant increase in real outlays on intermediate goods and services, while real remuneration of government employees expanded only marginally. For fiscal 1993/94 as a whole real consumption expenditure by general government rose by approximately 3 per cent; in fiscal 1992/93 an increase of 1 per cent had been recorded. The ratio of government expenditure to gross domestic product therefore continued to rise from 20½ per cent to 21 per cent over the same period.

Total real gross *domestic fixed investment* is estimated to have increased further in the first quarter of 1994. After having moved along a downward trend since the middle of 1988, real outlays on fixed capital formation rose at annualised rates of 1 and 2½ per cent in the last two quarters of 1993 and by 1½ per cent in the first quarter of 1994. The further increase in the first quarter of 1994 was brought about by an expansion in real outlays on capital goods by the private sector and public corporations; capital expenditure by general government, however, declined sharply.

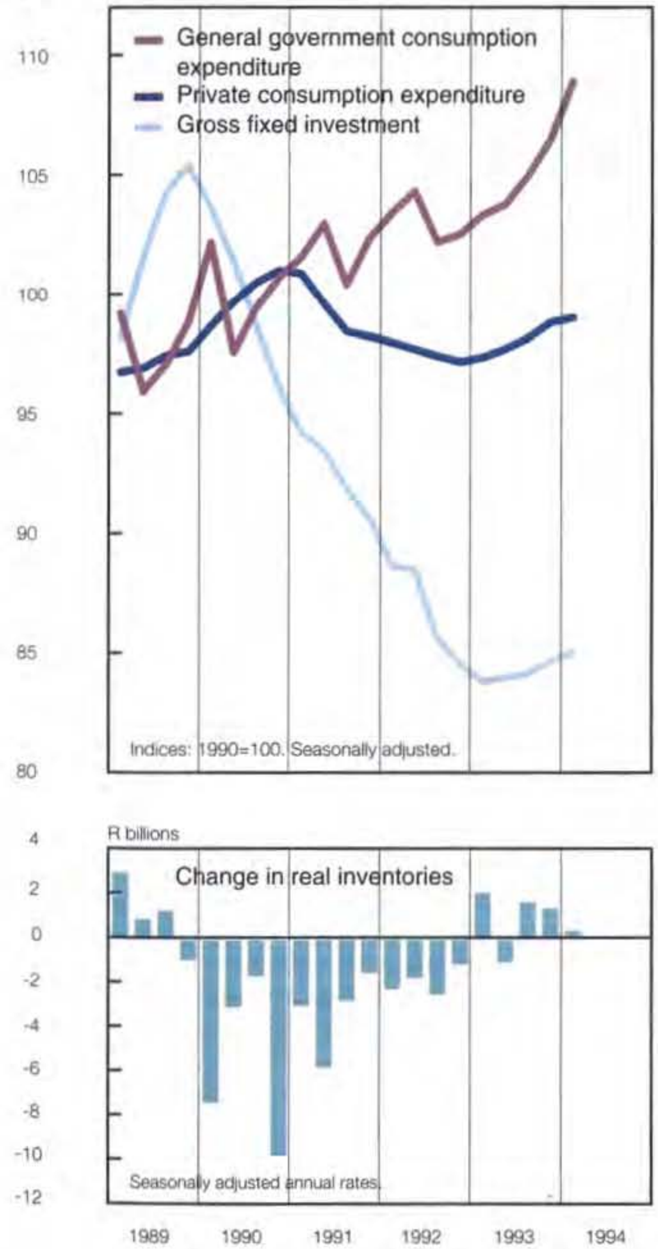
A classification of real capital formation by the *private sector* according to type of economic activity shows that the increase in the first quarter of 1994 was fairly broadly based. Investment expenditure of particularly agricultural, mining and manufacturing enterprises rose markedly. Higher real fixed investment in the agricultural sector was made possible by a rise in income brought about by improved weather conditions. The need to replace ageing agricultural equipment also led to higher capital outlays. The increase in capital formation in the mining and manufacturing sector reflected, *inter alia*, expenditure on major capital projects that had been started in 1993, asset replacement and some capacity expansions in anticipation of an increased domestic and external demand.

The increase in real fixed capital formation of *public corporations* occurred mainly in the sector responsible for transport and communication services, and more specifically from infrastructural projects undertaken by Telkom. (Transnet, Telkom and the South African Post Office were reclassified from general government business enterprises to public corporations in the latest revision of the national accounts statistics.) The excess production capacity of other public corporations was mainly responsible for the continued subdued real fixed capital investment by these institutions in the first quarter of 1994.

The decline in real gross domestic fixed investment by *general government* was caused by further cut-backs in the capital outlays of central and local government. The level of fixed investment by general government in the first quarter of 1994 was 21 per cent below its peak in the first quarter of 1989.

The moderate increase in real *inventory investment* in the first quarter of 1994 was the third consecutive quarterly increase in this aggregate. This followed an almost uninterrupted drawing-down of stocks from the beginning of 1989 to the end of 1992. The accumulation of inventories in the first quarter of 1994 coincided with an increase in import volumes and a significant decline in the demand for exports, and was particularly prominent in the mining and industrial sectors as well as in agricultural stocks-in-trade. As a result of this further rise, the ratio of industrial and commercial inventories to gross domestic product bottomed out at the very low level of 16 per cent in the second half of 1993 and edged higher to less than 16½ per cent in the first quarter of 1994.

Main components of real gross domestic expenditure



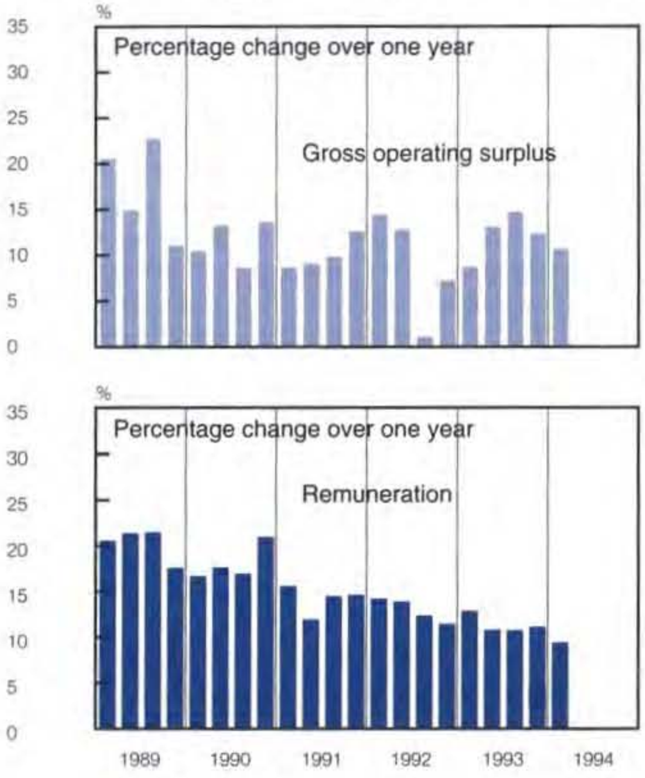
Factor income

The growth in aggregate *nominal factor income* at market prices, measured over a period of twelve months, which had risen from a low of 9½ per cent in the fourth quarter of 1992 to 12½ per cent in the fourth quarter of 1993, slowed down to 12 per cent in the first quarter of 1994. This lower rate of growth in factor income could be ascribed to slower growth in aggregate labour remuneration as well as in total gross operating surpluses.

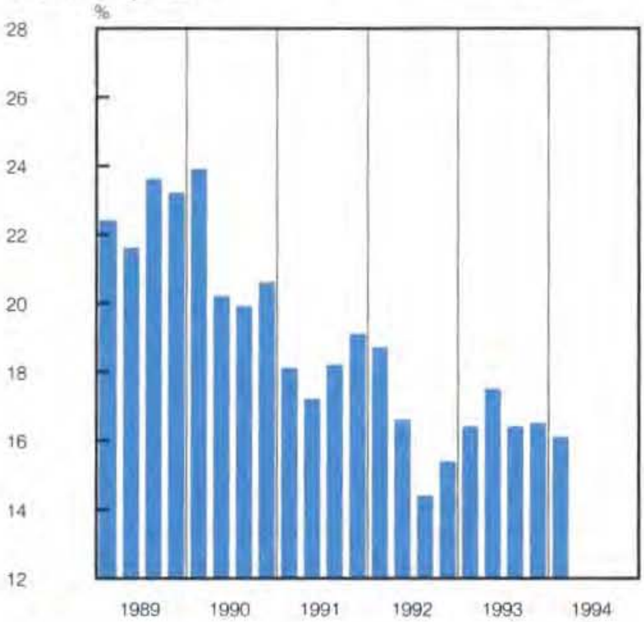
The rate of increase over four quarters in total nominal *remuneration of employees* receded marginally from 11½ per cent in the fourth quarter of 1992 to 11 per cent in the fourth quarter of 1993 and then more substantially to 9½ per cent in the first quarter of 1994. This slower increase in the total salaries and wages was particularly evident in the mining, manufacturing, commercial and the transport sectors. The more moderate growth in total remuneration of employees continued to reflect rationalisation programmes and the impact of the lower rate of inflation, which, in conjunction with the moderation of inflation expectations, led to more reasonable wage demands.

After having advanced from about 7 per cent in the fourth quarter of 1992 to 12½ per cent in the fourth quarter of 1993, the percentage change over one year in the *gross operating surplus* receded to 10½ per cent in the first quarter of 1994. This lower growth was mainly due to a decline in the operating surplus of agriculture, which had reached an exceptionally high level in the

Gross operating surplus and labour remuneration



Gross domestic saving as percentage of gross domestic product



preceding quarter. In the non-agricultural sectors of the economy the percentage change over one year in the gross operating surplus remained at a high level. Sustained sound results were particularly evident in the operating surpluses of the mining industry and the financial services sector.

Domestic saving

The ratio of gross domestic saving to gross domestic product receded further in the first quarter of 1994 to approximately 16 per cent from its already low average level of 17 per cent in 1993. The main reason for this low level of domestic saving continued to be the large dissaving of general government. Dissaving by government rose further in the first quarter of 1994 because the increase in current expenditure exceeded the higher current receipts. In particular, interest payments on government debt and consumption expenditure by government rose sharply.

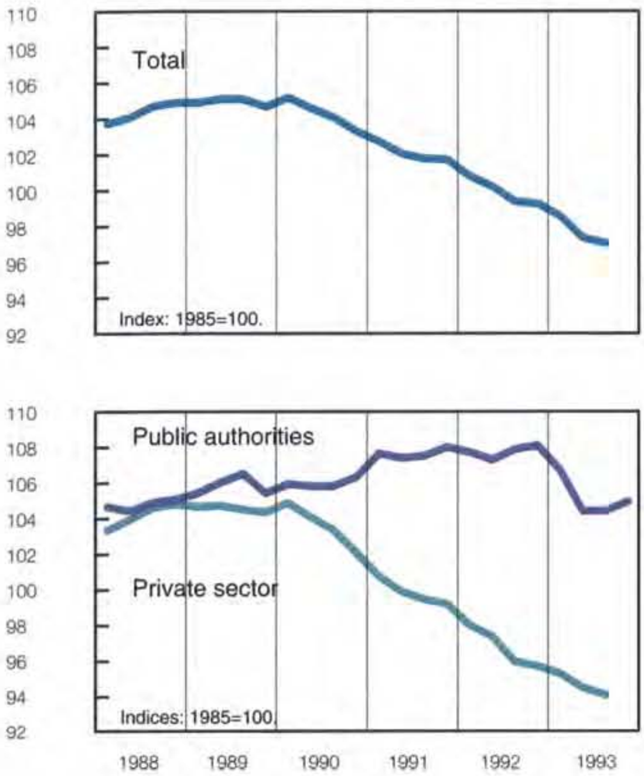
Net saving by the private sector, which had remained relatively firm during 1993, weakened slightly in the first quarter of 1994. Owing to the relatively good performance of the gross operating surplus of incorporated business enterprises in the non-agricultural sectors of the economy, net saving by the corporate sector rose moderately further in the first quarter of 1994. This increase, however, was offset by lower personal saving resulting from a decline in real income from property.

Employment

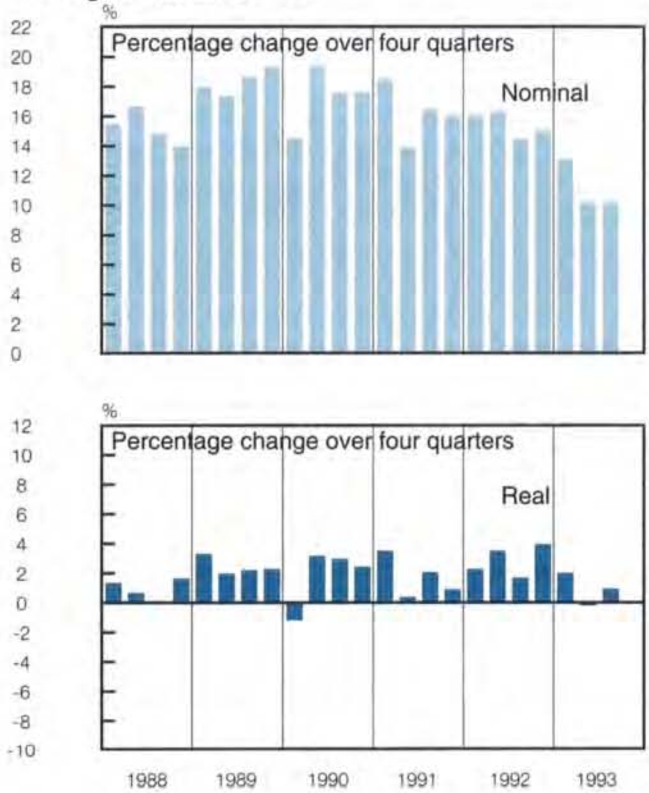
The recovery in economic activity in 1993 was unable to reverse the downward movement in *employment*. In fact, the rate of decline in the average level of employment in the formal non-agricultural sectors of the economy worsened somewhat from 2,1 per cent in both 1991 and 1992 to 2,5 per cent in the first three quarters of 1993 compared with the corresponding period of the preceding year. From the first quarter of 1989 (the start of a prolonged recession period) to the third quarter of 1993 (the latest information available) the number of employment opportunities in the formal non-agricultural economic sectors contracted by approximately 410 000; almost 8 out of every 100 positions therefore became redundant over this period.

The average level of *private-sector employment* in the first three quarters of 1993 was about 2,5 per cent below its level in the corresponding period of 1992; it declined by 3,6 per cent in 1991 and by 3,1 per cent in 1992. The quarter-to-quarter rate of decrease in employment by private enterprises (seasonally adjusted and annualised) subsided at first from 5,7 per cent in the third quarter of 1992 to 1,0 per cent in the fourth quarter; it then accelerated to 3,3 per cent in the second quarter of 1993 before slowing down again to 1,7 per cent in the third quarter.

Non-agricultural employment



Average remuneration per employee in non-agricultural sectors



Owing to a cut-back in current expenditure by general government and rationalisation programmes implemented by business enterprises in the public sector, total *employment by public authorities* declined by 2,4 per cent in 1993. Sharp declines were registered from quarter to quarter at seasonally adjusted and annualised rates of 5,1 per cent and 8,3 per cent in the first two quarters of 1993. In the third quarter of 1993 employment by public authorities remained more or less unchanged at the level of the preceding quarter and then increased by 2,0 per cent (seasonally adjusted and annualised) in the fourth quarter owing to a large increase in the employment by the self-governing territories.

The decrease in employment during the recession of 1989-1993 led to a rising number of registered unemployed workers. In 1992 the average number of registered unemployed workers rose by 16,2 per cent and in 1993 by 8,8 per cent. This brought the total number of registered unemployed to almost 290 000 in December 1993.

Labour costs and productivity

The effect of the drawn-out recession on employment resulted in some moderation of wage demands in 1993. The rate of increase in the *nominal remuneration per worker* contracted significantly from 15,4 per cent in 1992 to a year-on-year rate of 11,1 per cent in the first nine months of 1993. Although this increase still exceeds the current rate of consumer price inflation, it was nevertheless the lowest increase since 1978, when a rise of 10,6 per cent had been registered. Quarterly rates showed an even more significant decline in the growth of wages per worker: measured over four quarters it decreased from a peak of 19,4 per cent in the second quarter of 1990 to 10,2 per cent in the third quarter of 1993.

In the first three quarters of 1993 the rate of increase in the average nominal remuneration per worker in the *private sector* amounted to 11,3 per cent compared with the corresponding period of the preceding year. This was considerably lower than the increase of 15,6 per cent in 1992. The rate of increase over a period of four quarters in wages per worker in the private sector declined from a peak of 18,5 per cent in the first quarter of 1990 to 10,5 per cent in the third quarter of 1993. This significant slow-down in wage increases in the private sector was the result of low wage increases in most of the economic sectors. However, continued high rates of increase in wages per worker were recorded in retail trade, private road transportation, banks and the insurance industry.

The rate of increase in the average monthly nominal salaries and wages per worker employed by *public authorities* slowed down even more sharply from 21,9 per cent in 1989 to 14,8 per cent in 1992 and to 9,3 per cent in 1993. The year-on-year rate of increase in wages per worker employed by public authorities also decreased substantially, viz. from 22,5 per cent in the first quarter of 1991 to 5,4 per cent in the fourth quarter of 1993.

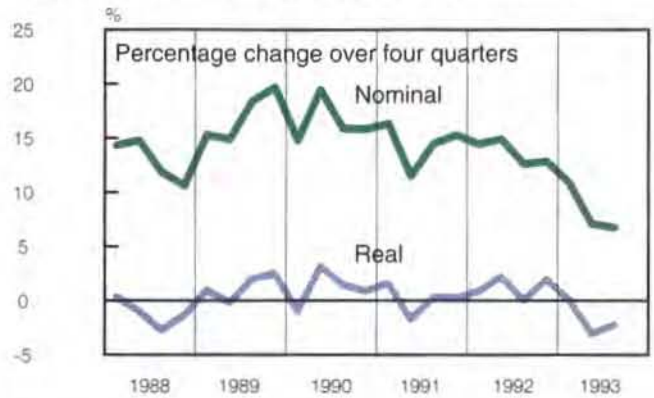
In view of the fact that the growth in nominal wages decreased more rapidly than the inflation rate, the rate of increase in the *real wage* per worker in the non-agricultural sectors of the economy dropped from 2,8 per cent in 1992 to 0,9 per cent in the first three quarters of 1993 compared with the corresponding period of 1992. The year-on-year rate of increase in the real remuneration per worker declined even more sharply from a high point of 3,9 per cent in the fourth quarter of 1992 to a negative level of 0,2 per cent in the second quarter of 1993; however, it then rose again to a positive level of 0,9 per cent in the third quarter.

Labour productivity improved considerably during the first nine months of 1993, when it was 2,5 per cent higher than in the corresponding period of the preceding year. This growth in productivity is a continuation of an upward trend already discernible from the end of 1991: the year-on-year rate of increase in the production per worker in the non-agricultural sectors of the economy accelerated from 0,5 per cent in the fourth quarter of 1991 to 1,8 per cent in the first quarter of 1993 and even more sharply to 3,1 per cent in the third quarter of 1993. The strong performance of productivity in the first nine months of 1993 was assisted by the fact that the number of man-days lost due to strikes and work stoppages was about 60 per cent lower than in the first three quarters of 1992.

The slower growth in nominal wages and a rise in non-agricultural production caused *nominal unit labour costs* to increase more slowly. After having contracted from 17,2 per cent in 1989 to 13,8 per cent in 1992, the rate of increase in nominal unit labour costs in the non-agricultural sectors of the economy declined to 8,3 per cent in the first three quarters of 1993 compared with the corresponding period of 1992. The year-on-year rate of increase in nominal labour costs per unit of physical output declined equally significantly from high points of 15,4 per cent in the fourth quarter of 1991 and 15,0 per cent in the second quarter of 1992 to 6,9 per cent in the third quarter of 1993 – the lowest level since the second quarter of 1978.

As a result of the lower rates of increase in real remuneration per worker and an improvement in productivity, the *real unit labour costs* in the non-agricultural sectors of the economy receded by 1,6 per cent in the first three quarters of 1993 as opposed to the corresponding period of 1992. On a quarterly basis, real unit labour costs also recorded negative rates of change measured over a period of one year of 2,9 per cent and 2,1 per cent in the second and third quarter of 1993, respectively.

Unit labour costs in non-agricultural sectors



Prices

For some time now both the all-goods production price index and the overall consumer price index have generally been increasing at single-digit rates. Exogenous factors such as the relative price stability in trading partner countries, lower international oil prices and better agricultural conditions undeniably contributed to this lower inflation. The increased financial stability must, however, be ascribed to a large extent to the consistent application of a conservative monetary policy that has gradually dampened inflation expectations. An increase in wage flexibility also contributed to the slowdown of price inflation.

In twenty-nine consecutive months up to March 1994 the *rate of increase over twelve months* in the *all-goods production price index* has remained at single-digit levels. Moreover, this rate of increase declined recently from 8,3 per cent in February 1993 to 5,4 per cent in October – the lowest level since January 1972 when an increase of 4,8 per cent was registered. It then edged upwards again to over 6 per cent and amounted to 6,3 per cent in March 1994. The bottoming-out in the downward movement in production price inflation was mainly due to an acceleration in agricultural and other food prices, particularly the price of red meat. A lower supply of livestock to the market because of the abundant pasturage after the high rainfall in most parts of the country pushed up prices.

Food prices were also responsible for a reversal of the downward movement in the rate of increase in the *prices of domestically produced goods*. After having slowed down from 9,0 per cent in February 1993 to 5,7 per cent in October, the rate of increase in these prices over a period of twelve months rose rapidly to 7,3 per cent in January 1994; it then receded again marginally to 6,9 per cent in March.

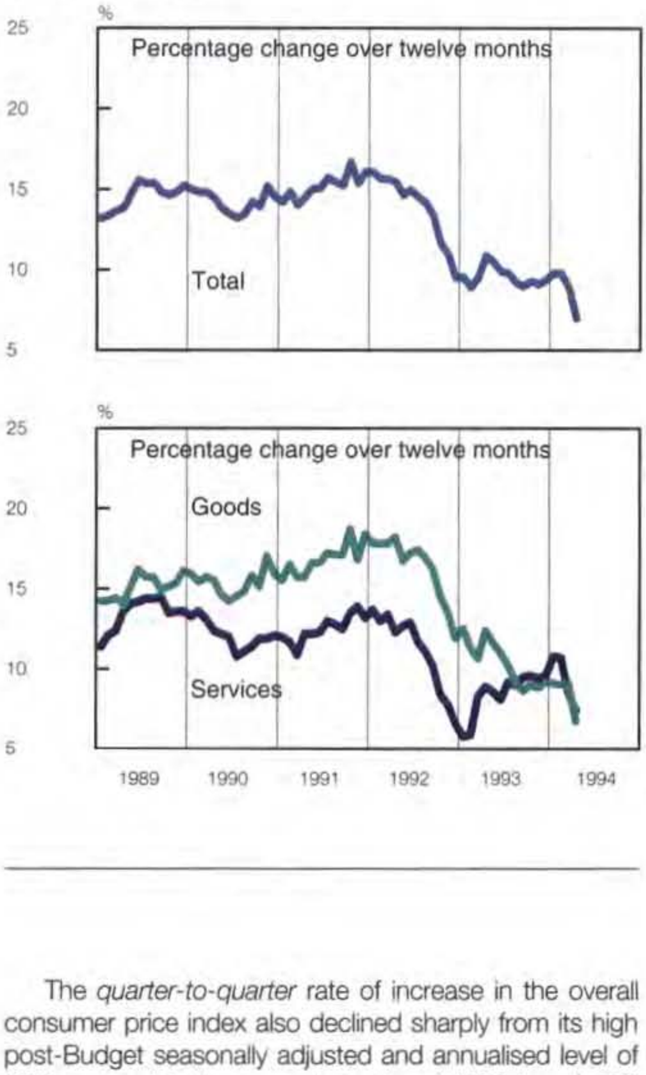
The rates of increase in the *prices of imported goods* over periods of twelve months have also been under 10 per cent since October 1991 and exceeded the measured inflation rate in the all-goods price index on only one occasion up to March 1994, namely in June 1993. Despite the depreciation in the nominal effective exchange rate of the rand, the twelve-month rate of increase in the prices of imported goods declined from a recent high of 6,8 per cent in June 1993 to 2,7 per cent in March 1994. These relatively low rates of increase were registered mainly owing to the persistent price stability in South Africa's main trading partner countries and a decrease in international crude oil prices. The twelve-month rate of increase in the weighted average wholesale price index of South Africa's six main trading partner countries decreased from 1,9 per cent in June 1993 to only 0,9 per cent in March 1994.

The *quarter-to-quarter* rate of increase in the all-goods production price index and in the price index of domestically produced goods also showed a distinct downward movement in 1993 before rising again steeply in the first quarter of 1994. The quarter-to-quarter rate of increase in the prices of imported goods, however, decreased sharply from the second quarter of 1993 and then became negative in the fourth quarter of 1993. In the first quarter of 1994 a small rate of increase was again recorded in import prices, although the rand depreciated considerably. A decline in international oil prices neutralised the effects of a lower rand exchange rate on import prices to some extent.

The *twelve-month rate of increase* in the *overall consumer price index* declined to a single-digit level of 9,6 per cent in December 1992 – the first time that this rate fell below 10 per cent since June 1978. With the exception of the period from April to June 1993, this rate of increase then remained in single digits in the ensuing months up to April 1994. From September 1993 to January 1994 this growth rate moved up slightly from 9,1 per cent to 9,9 per cent before declining again to 9,0 per cent in March. In April 1994 the rate of increase in consumer prices over a period of twelve months dropped to 7,1 per cent, when these prices were no longer affected by the increase in the value-added tax and other indirect taxes in April 1993.

From August 1993 to March 1994 the rate of increase over periods of twelve months in the prices of *consumer goods* remained fairly stable around a level of about 9 per cent; it then, however, fell to 6,8 per cent in April 1994. On the other hand, the twelve-month rate of increase in the prices of *consumer services* showed a distinct upward movement from 9,5 per cent in November 1993 to 10,8 per cent in February 1994. It then dropped to 8,6 per cent in March when the substantial increase in school fees in the corresponding month of the preceding year no longer affected this rate of increase in the prices of services, and to 7,5 per cent in April 1994 when the effect of increases in indirect taxes in 1993 fell away.

Consumer prices



The *quarter-to-quarter* rate of increase in the overall consumer price index also declined sharply from its high post-Budget seasonally adjusted and annualised level of 16,8 per cent in the second quarter of 1993 to only 5,3 per cent in the fourth quarter; it then accelerated to 9,2 per cent in the first quarter of 1994. This higher rate of increase in the first quarter of 1994 was brought about mainly by a significant rise in food prices and to a lesser extent also in the costs of transportation, communication and medical services.

Foreign trade and payments

Current account

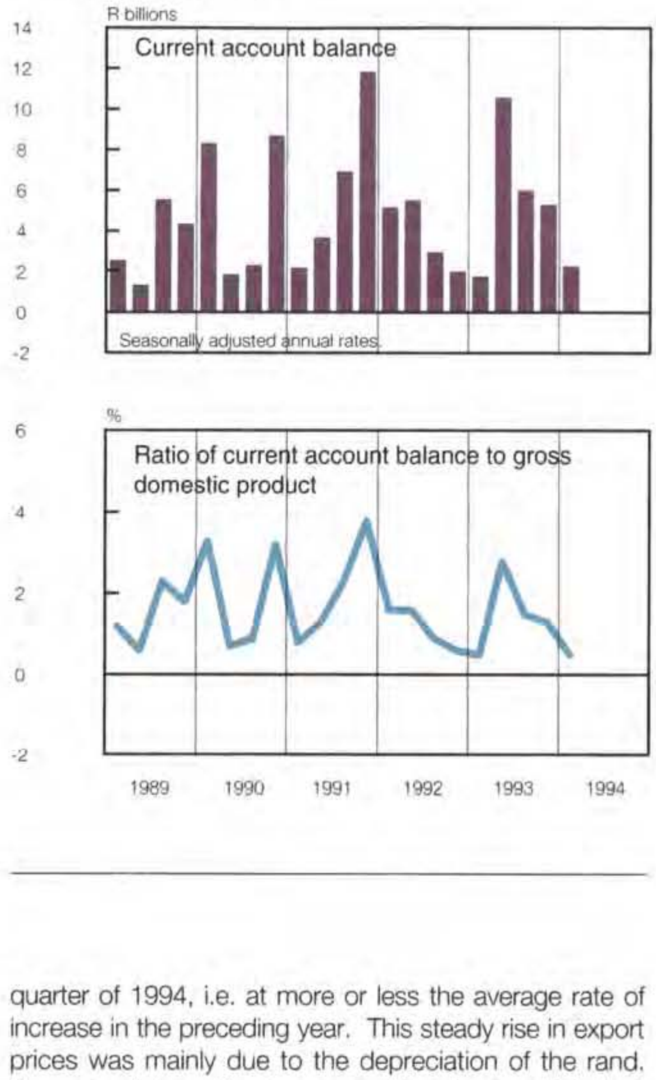
The surplus on the current account of the balance of payments decreased considerably from R1,2 billion in the fourth quarter of 1993 to roughly R0,2 billion in the first quarter of 1994. After adjustment for seasonal influences and measured at an annualised rate, the surplus on the current account contracted from R5,3 billion to R2,3 billion over the same period. As a percentage of gross domestic product, the surplus on current account amounted to 0,6 per cent in the first quarter of 1994; this ratio averaged 1,5 per cent for 1993 as a whole. The substantial weakening in the current account surplus was the combined result of lower merchandise exports, higher merchandise imports and a further increase in net service and transfer payments to non-residents, which could not be neutralised by a rise in the value of net gold exports.

The value of *merchandise exports* (seasonally adjusted and annualised), which made a major contribution to the revival of economic activity in 1993, receded by 3,7 per cent to R61,3 billion in the first quarter of 1994. Sharp decreases were recorded in the exports of manufactured goods, particularly in the categories machinery and electrical equipment, transport equipment and chemical products. The exports of precious and semi-precious stones also contracted, whereas the exports of mineral products and agricultural goods continued to rise.

A drop of 5½ per cent in the volume of goods exported was mainly responsible for the lower value of exports in the first quarter of 1994; in the fourth quarter of 1993 an exceptionally sharp increase of nearly 11 per cent had been registered in export volumes. The volume of merchandise exports in the first quarter of 1994 was therefore still about 12 per cent above its level in the first quarter of 1993. In rand terms export prices rose by 2 per cent from the fourth quarter of 1993 to the first quarter of 1994, i.e. at more or less the average rate of increase in the preceding year. This steady rise in export prices was mainly due to the depreciation of the rand. However, international commodity prices, which had begun to move upwards slightly at the end of 1993, progressed further in the first quarter of 1994.

After having declined from R24,5 billion in the third

Balance of payments



Balance of payments on current account

Seasonally adjusted annual rates

R billions

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

quarter of 1993 to R21,2 billion in the fourth quarter, the seasonally adjusted and annualised value of *net gold exports* recovered again to R22,6 billion in the first quarter of 1994. This increase could be attributed to a higher gold price. The rand price of gold per fine ounce rose from an average of R1 262 in the fourth quarter of 1993 to R1 321 in the first quarter of 1994; the average fixing price of gold per fine ounce improved slightly from US$374 to $384 over the same period. In the ensuing two months the average rand price of gold advanced even further to reach R1 383 per fine ounce in May, while the dollar price retreated to $381 per fine ounce. On the other hand, the volume of net gold exports declined by about 5 per cent in the first quarter of 1994 on account of the lower domestic production of gold.

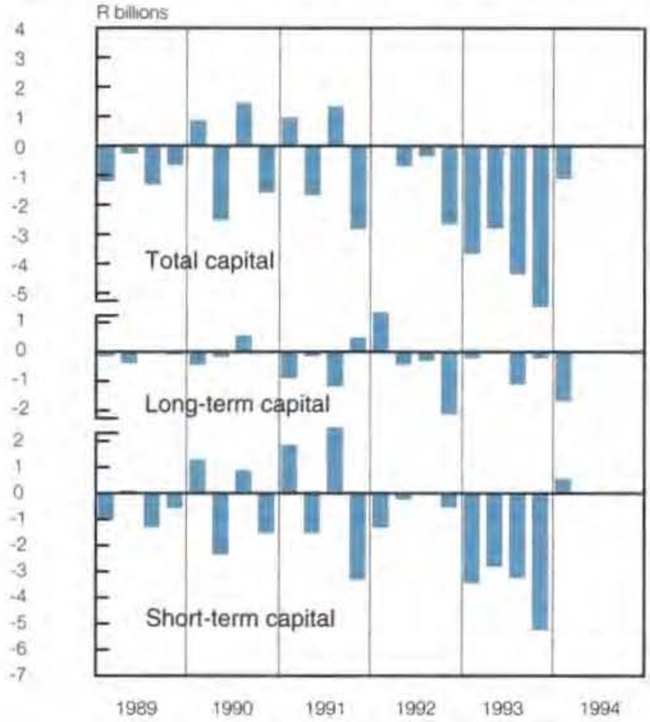
The value of *merchandise imports* (seasonally adjusted and annualised), which had risen sharply from the second quarter of 1993, rose further by 2½ per cent to R65,7 billion in the first quarter of 1994. This increase was due to both higher import prices and volumes. The prices of imported goods rose by only ½ per cent, despite the depreciation of the rand. As already indicated, a sharp rise in non-oil import prices was partly countered by the decline in international oil prices and relatively stable prices in South Africa's trading partner countries. Import volumes rose by 2 per cent in the first quarter of 1994, mainly because of pronounced increases in the imports of machinery and electrical equipment and precious stones and metals.

Net service and transfer payments (seasonally adjusted and annualised) rose somewhat further to R15,9 billion in the first quarter of 1994; in 1993 these payments had increased from R11,7 billion in the first quarter to R15,5 billion in the fourth quarter. Gross service payments increased in the first quarter of 1994, mainly on account of higher interest payments to non-residents and a further increase in tourist and travelling expenses by South Africans abroad, whereas gross service receipts declined as a result of lower travel receipts from non-residents.

Capital movements

The capital account of the balance of payments was characterised by a surprisingly small *total net outflow of capital* in the first quarter of 1994, i.e. in a period of transition to a new political dispensation in which violence and uncertainty were still rife. Following large net outflows of R4,4 billion and R5,5 billion in the last two quarters of 1993, the net outflow of capital not related to reserves but including unrecorded transactions declined to R1,1 billion in the first quarter of 1994. This smaller net outflow of capital included fixed repayment obligations on foreign debt both inside and outside the standstill net, indicating that some of these commitments may have been rolled over or that South Africa had obtained new loans abroad. Unfortunately, in April 1994 the capital account again deteriorated considerably as the elections drew closer and certain political parties had not yet

Net capital movements not related to reserves

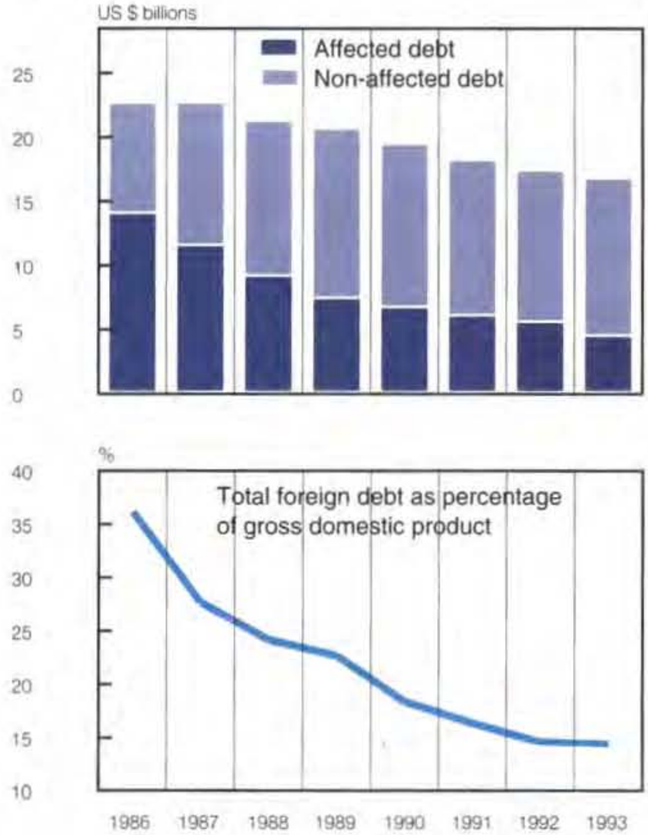


indicated whether they would participate. The change in net foreign reserves of the country indicate that a large net capital outflow probably took place again during this month. Some of these outflows, however, may have been reversed again in May 1994.

As could be expected, the dramatic improvement in the capital account was mainly registered in *short-term capital* not related to reserves but including unrecorded transactions. Having shown outflows since the fourth quarter of 1991, short-term capital movements changed from a net outflow of R5,3 billion in the fourth quarter of 1993 to a net inflow of R0,6 billion in the first quarter of 1994. This remarkable reversal in the short-term capital flows could be attributed to a turnaround from a net outflow of R0,6 billion to a net inflow of R2,2 billion in the foreign short-term liabilities of private banks over the same period. This switch partly reflected a back-flow in January 1994 of an exceptionally large amount of short-term funds that flowed out of the country in December 1993. The tighter conditions on the domestic money market probably also forced banks to make greater use of foreign credit facilities to supplement their funds. A net outflow of R1,7 billion was still recorded in other short-term capital in the first quarter of 1994; this was, however, significantly smaller than the outflow in the second half of 1993.

In contrast to these favourable developments, the net outflow of *long-term capital* increased substantially from R0,2 billion in the fourth quarter of 1993 and an average quarterly outflow of R0,4 billion in the year as a whole to R1,7 billion in the first quarter of 1994. Included in this amount, are net purchases by non-residents of securities listed on the Johannesburg Stock Exchange which totalled R1,2 billion in the first quarter of 1994. These purchases were, however, neutralised by net sales of gilts of R1,3 billion by non-residents through authorised banks, i.e. by so-called "over-the-counter" transactions rather than directly on the stock exchange. Although these transactions in securities by non-residents did not affect the level of the gross foreign reserves of the country because they were concluded through the financial rand mechanism, they indicate that the net outflow of other long-term capital came to about R1,6 billion in the first quarter of 1994. This net outflow of capital was affected by the upfront payment of R1,6 billion in terms of the 1994 Debt Arrangements with foreign creditor banks, the repayment of R0,8 billion on debt converted to medium- and long-term loans outside the standstill net as well as the redemption of loans of R0,5 billion guaranteed by foreign governments.

Total foreign debt



Foreign debt

Despite the large net outflow of capital not related to reserves (the identified capital flows plus errors and unrecorded transactions) in 1993, South Africa's *total outstanding foreign debt* (excluding debt subject to financial rand and blocked rand Exchange Control Regulations) was reduced further by only $0,6 billion to $16,7 billion at the end of the year. This was partly due to the fact that South Africa's reserve-related foreign borrowing amounted to R7,4 billion, while part of the capital outflow was due to an increase in foreign assets. A comparison of changes in foreign debt and capital flows, however, also confirm that a large part of the indicated capital outflow in 1993 could not be identified, i.e. the balancing item "errors and unrecorded transactions" was large.

Valued at the exchange rates of the US dollar against other currencies as at 31 August 1985, South Africa's total foreign debt was reduced from $23,7 billion at the beginning of the standstill arrangements to $15,8 billion at the end of 1993. In terms of rand, South Africa's foreign debt decreased from R65,8 billion to R56,7 billion over the same period. As a ratio of gross domestic product, South Africa's foreign debt amounted to only 14,2 per cent at the end of 1993; at the end of August 1985 this ratio was 42,5 per cent.

The *debt not payable* in terms of the debt arrangements with foreign creditor banks was reduced from $5,5 billion at the end of 1992 to $4,4 billion at the end of 1993; at the beginning of the debt standstill $13,6 billion was affected by the arrangements. The *debt payable* in terms of the proclamation rose from $11,8 billion at the end of 1992 to $12,3 billion at the end of 1993, owing largely to borrowing by the authorities in support of the level of the foreign reserves.

Foreign debt of South Africa*
$ billions

	31 Aug 1985	31 Dec 1992	31 Dec 1993
Affected debt			
Public sector	2,7	1,8	1,3
Monetary sector	8,8	2,1	1,6
Other	2,1	1,6	1,5
Total	13,6	5,5	4,4
Non-affected debt			
Public sector	7,3	5,0	6,3
Converted long-term loans	-	4,8	4,5
Other	2,8	2,0	1,5
Total	10,1	11,8	12,3
Total foreign debt	**23,7**	**17,3**	**16,7**

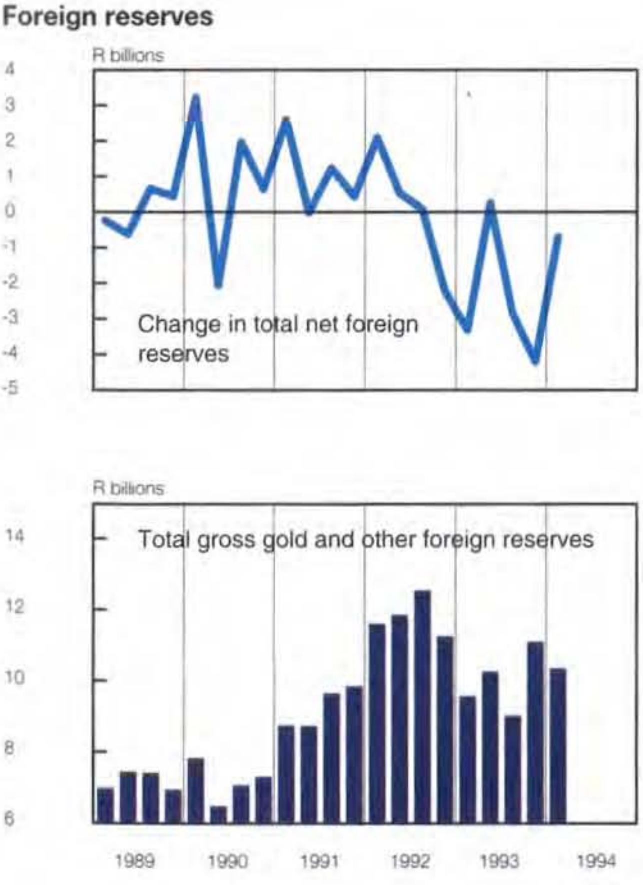
* Excluding blocked rand accounts, ordinary and non-redeemable preference shares, quoted domestic debentures and quoted domestic loan stock.

Foreign reserves

As a result of the relatively small net outflow of capital, the total *net gold and other foreign reserves* of South Africa fell by R0,9 billion in the first quarter of 1994; substantially less than the decline of R4,3 billion that had been recorded in the fourth quarter of 1993. In April 1994, however, the net gold and other foreign reserves of the Reserve Bank dropped by no less than R2,2 billion in one month before declining further by R0,4 billion in May.

The decline in net foreign reserves adjusted for valuation adjustments of R0,2 billion led to a decrease of approximately R0,7 billion in the total *gross gold and other foreign reserves* to a level of R10,3 billion at the end of March 1994. These reserves were equivalent to the value of about 5½ weeks' imports of goods and services. In the subsequent two months the Reserve Bank's gross gold and other foreign reserves declined further by R0,8 billion, reaching a level of R7,2 billion at the end of May 1994. The gold reserves of the Bank amounted to 4,4 million fine ounces at the end of May 1994, i.e. marginally lower than the 4,8 million fine ounces at the end of December 1993.

Foreign reserves



Changes in exchange rates of the rand

%

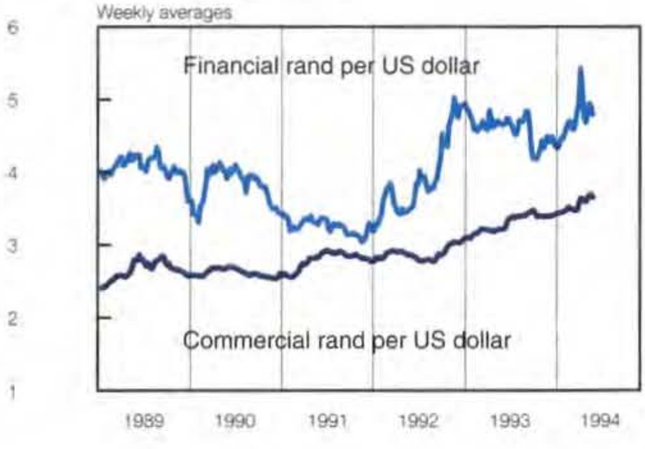
	31 Dec '92 to 31 Dec '93	31 Dec '93 to 31 Mar '94	31 Mar '94 to 31 May '94
Weighted average	-8,7	-4,1	-4,4
US dollar	-10,1	-2,1	-4,0
British pound	-7,7	-2,6	-5,6
German mark	-3,4	-5,8	-5,5
Japanese yen	-19,4	-10,2	-2,2
Netherlands guilder	-3,8	-5,4	-5,7
Italian lira	4,2	-7,9	-5,1

Exchange rates

Owing to political uncertainty and ongoing violence in the run-up to the election in South Africa, the *nominal effective exchange rate* of the rand declined by 4,1 per cent during the first three months of 1994 and by a further 4,4 per cent until 31 May 1994. This brought the decline in the nominal effective exchange rate to 8,4 per cent in the first five months of 1994, compared with a depreciation of 8,7 per cent during 1993 as a whole. Although the rand depreciated sharply against most of the major currencies during the first five months of 1994, exceptionally large declines of 12,3 per cent and 12,6 per cent, respectively, were recorded against the Japanese yen and the Italian lira.

The sharp decline in the nominal effective exchange rate of the rand in the first quarter of 1994 was more than sufficient to make up for the differential in the inflation rates between South Africa and its main trading partner

Exchange rates of the rand



countries; the *real effective exchange rate* of the rand in March 1994 was therefore 2 per cent below its level in December 1993. Since the end of 1992 the real effective exchange rate of the rand has declined by nearly 6½ per cent.

Having appreciated on balance by 13,1 per cent during the course of 1993, the exchange rate of the *financial rand* depreciated by 12,4 per cent during the first quarter of 1994. Concern over violence-related incidents, political uncertainty and profit-taking, however, then caused the financial rand to fluctuate widely in the ensuing two months. On 11 April 1994 the financial rand traded at an exchange rate of R5,58 per dollar – the lowest level since its introduction on 24 January 1979 – before appreciating to R4,74 per dollar on 31 May 1994. The financial rand discount narrowed accordingly from 35,7 per cent to 23,8 per cent over the same period.

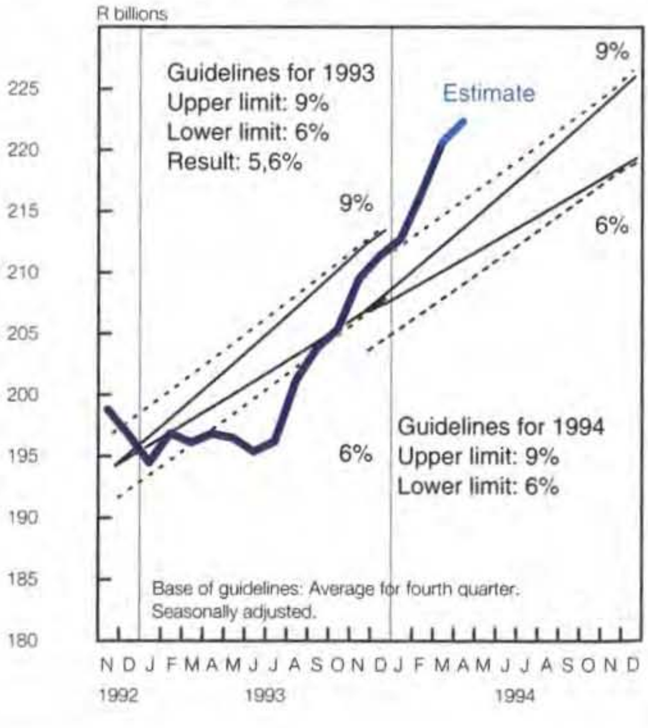
Financial markets

Money supply

Growth in the money supply, which had generally been subdued during 1993 and only started to show a moderate upward movement in the second half of the year, increased more rapidly in the first three months of 1994. The twelve-month rate of increase in the *broadly defined money supply (M3)* decreased from 8,0 per cent in December 1992 to only 1,9 per cent in July 1993; it then rose steadily to 7,0 per cent in December 1993 and to 12,3 per cent in March 1994. However, the quarter-to-quarter rate of increase in M3 (seasonally adjusted and annualised) decreased moderately from 18,1 per cent in the fourth quarter of 1993 to 15,5 per cent in the first quarter of 1994. Preliminary estimates indicate that the growth in M3 over twelve months remained high in April 1994 because it was measured from a low level in April 1993.

In view of this acceleration in the growth of money supply, the rate of increase in M3 exceeded the upper limit of the *new money guideline range* in the first four months of 1994. The Governor of the Reserve Bank announced on 25 March 1994 that the authorities had decided to keep the money supply growth guidelines for 1994 at their rates for the preceding year, i.e. a guideline range of 6 to 9 per cent growth in M3 from the fourth quarter of 1993 to the fourth quarter of 1994 will apply.

Guidelines for growth in M3



In maintaining these guidelines, monetary policy should best serve the requirements of monetary stability and a recovery in the domestic economy, because these growth rates in money supply should:

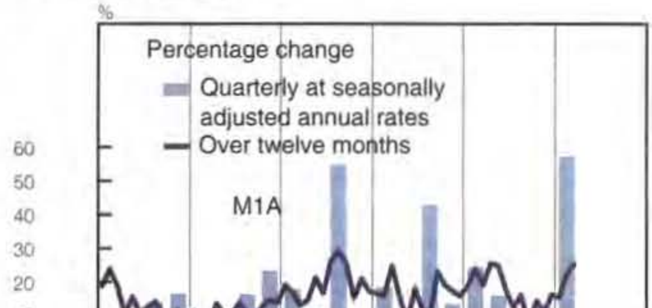
- not restrict the real growth in the economy which only came under way in 1993, nor stimulate it artificially;
- not facilitate further outflows of capital in an already vulnerable balance of payments situation;
- continue to apply downward pressure on inflation, which is still high compared with the inflation rates in most industrialised countries; and
- allow sufficient scope for total monetary expenditure to increase, taking into account the scope for some further increase in the income velocity of money.

As in the past, the monetary authorities emphasised that they did not intend to follow a rigid money rule linked to the guidelines at all times. The Reserve Bank would rather continue to evaluate the growth in money supply against the broader underlying conditions before deciding whether changes in money supply growth justified a shift in the monetary policy stance. In accordance with this approach, the recent acceleration in the growth of money supply did not elicit an increase in Bank rate because it was largely brought about by a shift from government deposits (not part of money supply) to private sector deposits (included in money supply) with monetary institutions. This shift in deposits was also largely responsible for a decline of 2,0 per cent in the income velocity of M3 in the first quarter of 1994, despite more or less unchanged margins between lending and average deposit rates of banks.

The rates of increase over periods of twelve months in the *narrower monetary aggregates* also declined to relatively low levels in 1993, but then rebounded in the final months of 1993 and in the first three months of 1994. The twelve-month growth rate in M1A fluctuated considerably in 1993, but declined on balance from 16,2 per cent in December 1992 to 6,9 per cent in September 1993; it then increased to 16,6 per cent in December 1993 and to 25,7 per cent in March 1994. The rate of increase in M1 over periods of twelve months receded from 17,5 per cent in December 1992 to -0,5 per cent in October 1993, before increasing to 6,7 per cent in December 1993 and to 19,4 per cent in March 1994. Similarly, the twelve-month growth rate in M2 declined from 10,8 per cent in December 1992 to 0,1 per cent in July 1993, but increased again to 3,9 per cent in December 1993 and to 13,6 per cent in March 1994.

The *main counterparts* (in a statistical or accounting sense) of the R12,5 billion increase in M3 during the first three months of 1994 were increases of R14,8 billion in the monetary institutions' net claims on the government sector and R7,1 billion in these institutions' claims on the private sector. In contrast to these developments, the net foreign assets (including gold) and the "net other assets" of the monetary sector decreased by R3,1 billion and R6,3 billion in the first quarter of 1994.

Monetary aggregates



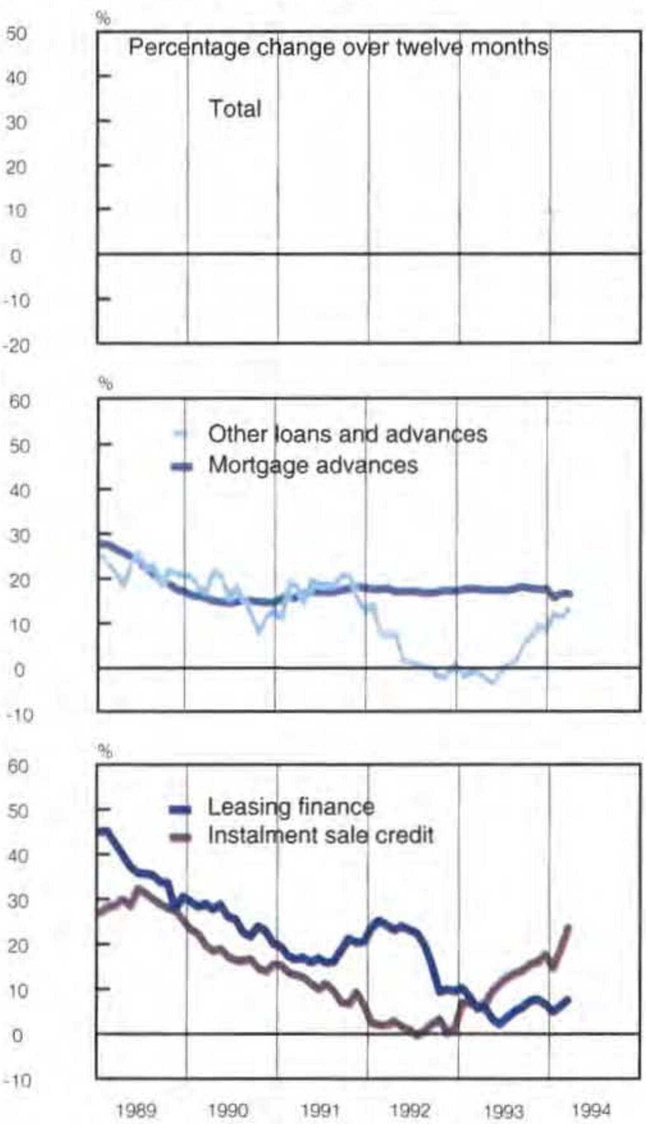
The large increase recorded in the monetary sector's net claims on the government sector and the large decrease in "net other assets" in the first quarter of 1994 were distorted by the issuing of a stripped coupon government stock to the Reserve Bank in March 1994. Government stock amounting to R7,5 billion (included in the monetary sector's net claims on the government) was issued to the Bank to redeem losses incurred for the account of the Treasury on the Gold and Foreign Exchange Contingency Reserve Account (included in "net other assets"). If these stock issues are not taken into consideration, the monetary sector's net claims on the government sector nevertheless still increased by R7,3 billion in the first quarter of 1994, which could largely be attributed to a decline of R7,2 billion in government deposits with the monetary sector during this period.

Credit extension

The reduction of government deposits with banks was also mainly responsible for the sharp acceleration in the growth of *total credit extension* (i.e. credit extension to the private sector and net claims on the government) by the monetary institutions in the first three months of 1994. After having risen from a trough of 6,7 per cent in May 1993 to 9,6 per cent in December, the rate of increase over twelve months in total domestic credit extension by banks rose much more rapidly to 12,9 per cent in February 1994 and 19,2 per cent in March. This latter rate of increase was also affected by the issuing of the stripped coupon government stock to the Reserve Bank.

The growth in credit extended by the monetary institutions to the *domestic private sector* over a twelve-month period declined from 8,7 per cent in December 1992 to a low of 5,7 per cent in May 1993 before increasing to 9,7 per cent in December 1993. This growth rate receded somewhat to 9,4 per cent in February 1994, but accelerated to 11,8 per cent in March 1994.

Credit extension to the private sector



An analysis of monetary institutions' claims on the private sector by *type of credit* shows that the rate of increase over twelve months in *mortgage advances* remained at a relatively high level. Since the beginning of 1991 the twelve-month growth rate in mortgage advances has averaged 17,3 per cent. This remarkable performance in mortgage lending was to a large extent due to the banks' active promotion of this credit facility on account of the low capital requirements that apply to it. In view of the flexibility of some of the mortgage schemes and the comparatively low interest rates on mortgage advances, these accounts have been used increasingly by many banks' clients to finance the purchases of durable and other consumer goods.

As shown in the accompanying table, credit in the form of *instalment sales* has increased at very high rates since the second half of 1993. This could mainly be ascribed to rising car sales, "special rate" vehicle finance schemes that were introduced by banks, and higher instalment sales to farmers. The rise in *"other loans and advances"* (mainly overdrafts) reflected to some extent the upturn in real consumption expenditure, but was probably also due to distress borrowing by some smaller and medium-sized enterprises after a long period of negative economic growth. The rise in the growth in *leasing finance* that was discernible in the second half of 1993, tapered off in the first three months of 1994.

Credit extension to the private sector by main type of credit

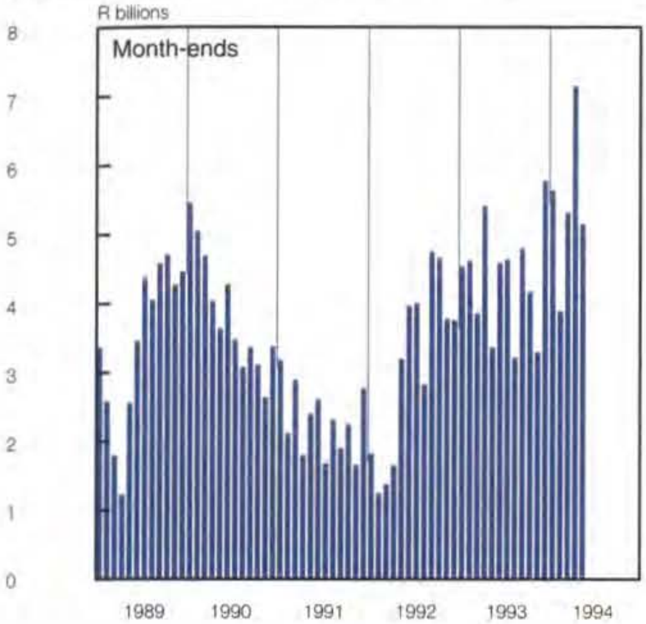
Percentage change over twelve months

	Dec '92	Jun '93	Dec '93	Mar '94
Mortgage advances...........	17,3	17,5	17,7	16,6
Instalment sales....	1,5	11,4	18,0	23,9
Leasing finance.....	9,6	2,2	6,8	7,7
Other loans and advances...........	0,9	-0,7	8,4	13,1

Money market conditions

After having tightened considerably in December 1993, money market conditions eased in February 1994, but then became very tight in the ensuing three months. These changes were reflected in the amount of *accommodation* at month-ends, which decreased from R5,8 billion at the end of December 1993 to R3,9 billion at the end of February 1994 before rising again to R5,3 billion and R7,1 billion at the end of the next two months. Money market conditions remained relatively tight in May although the amount of accommodation decreased to

Accommodation at the discount window



R5,2 billion at the end of May 1994. The relative tightness in the money market forced many of the banks to borrow from the Reserve Bank at a rate of 13 per cent (i.e. at one percentage point above Bank rate), because of a lack of paper qualifying for the lower rate.

The easing of money market conditions in February 1994 was mainly the result of a substantial drop in government deposits with the Reserve Bank. Although these deposits decreased further in March, a marked increase of R2,0 billion in notes and coin in circulation in March and April and a decrease of R3,0 billion in the net foreign assets (including gold) of the Reserve Bank then accounted for the tightening of money market conditions. Both these developments were probably related to uncertainties and fears regarding political stability in South Africa in the period leading up to the election of a government of national unity. In May 1994 notes in circulation decreased again and the net foreign assets of the Reserve Bank increased by R0,2 billion as perceptions improved.

Action of the Reserve Bank in the money market

The Reserve Bank generally allowed the money market shortage to reflect underlying demand and supply conditions. By adopting this policy stance, the Bank made it more arduous for the private banks to substitute domestic liabilities for foreign credit facilities and thereby discouraged the capital outflow from the country. Certain adjustments were, however, made in the *asset portfolio of the Corporation for Public Deposits* by selling the corporation's financial assets in the money market. During the first five months of 1994 these transactions had a tightening effect of about R2,1 billion on money market conditions. In addition, in April and May, net sales of *Treasury bills* were increased to R445 million, which had a tightening effect on money market conditions to the extent that it caused an increase in government deposits at the Reserve Bank. This was achieved by increasing the sale of three-month Treasury bills in the weekly tender from R300 million to R400 million from 8 April 1994.

However, the monetary authorities also increased the Reserve Bank's *own portfolio of government stock* with R1,2 billion during the first five months of 1994 through normal open-market transactions, which again eased money market conditions somewhat. The Bank's holdings of government stock recorded in its balance sheet showed a much more substantial rise owing to the already mentioned stripped coupon government stock acquired from the government.

Gross sales of *government stock* by the Reserve Bank totalled R59 billion in the first five months of 1994, compared with R71 billion in the corresponding period in 1993 and R178 billion in 1993 as a whole. Net sales of these stocks by the Reserve Bank during the first five months of 1994 were R2,5 billion; in the corresponding period of 1993 these net sales were equal to R7,6 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 R6,9 billion in the first five months of 1994.

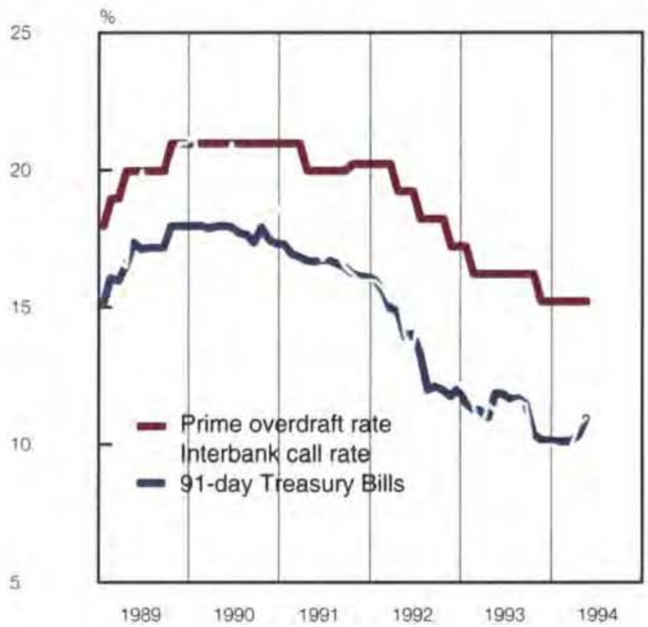
Money market interest rates

The general downward movement in *money market interest rates* lost momentum during late 1993 and in the first two months of 1994; these rates then hardened somewhat in March, April and May, reflecting the relatively tight money market conditions and uncertainty about political developments in South Africa. This was clearly reflected in the rate on *inter-bank call money*, which decreased from 12,25 per cent at the end of December 1992 to 10,00 per cent at the end of December 1993 and to 9,50 per cent at the end of February 1994; it then rose again to 10,75 per cent at the end of April. This rate subsequently hardened slightly to 11,00 per cent at the end of May.

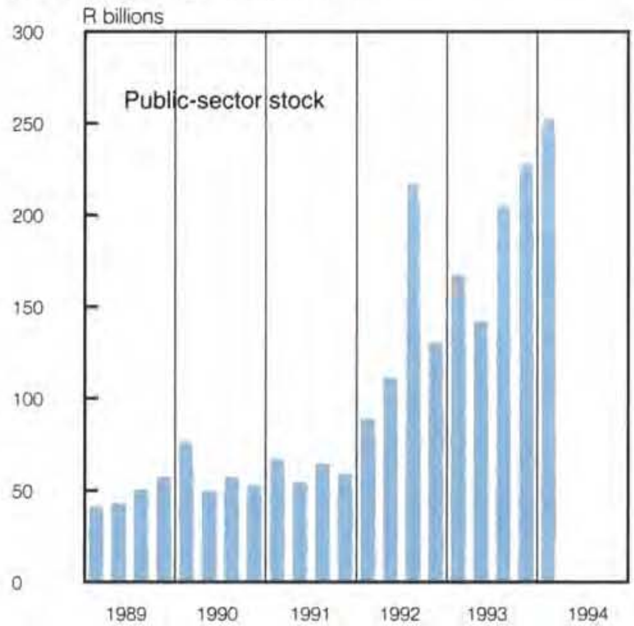
The rate on *three-month bankers' acceptances* showed a similar movement and declined from 12,65 per cent at the end of December 1992 to 10,15 per cent at the end of December 1993; it then remained more or less at that level in the next three months. In April it started increasing fairly sharply to 10,55 per cent at the end of the month and reached 11,05 per cent on 31 May 1994.

Both *Bank rate* and the private banks' *prime lending rates* remained unchanged during the first five months of 1994. Deposit rates of banks were, on average, also not adjusted in the first quarter of 1994, but firmed somewhat in the ensuing two months. The margin between lending and deposit rates therefore at first moved sideways

Short-term interest rates



Stock exchange transactions



before narrowing in April and May 1994. Although the banks maintained an unchanged prime lending rate of 15,25 per cent, the inflation-adjusted or real prime lending rate increased from 5,2 per cent in December 1993 to 7,7 per cent in April 1994, because of a decline in the inflation rate as measured by changes in the current consumer price index.

Capital market activity

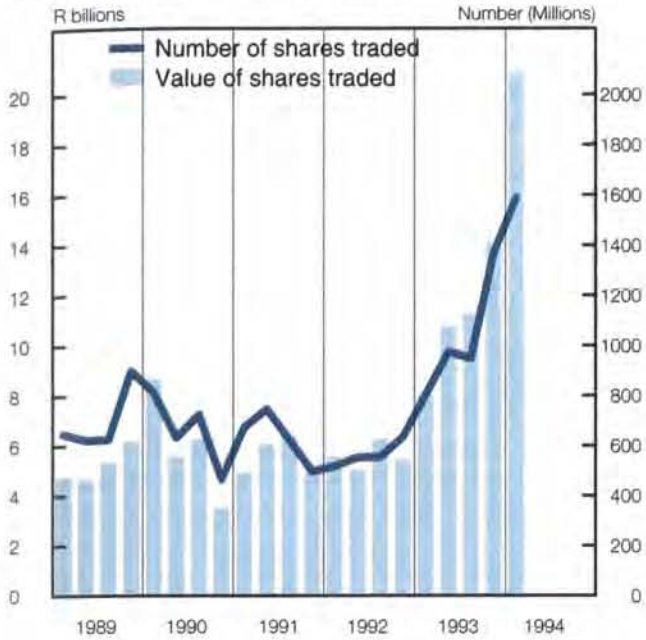
Trading activity on the Johannesburg Stock Exchange, which had been buoyant throughout 1993, increased sharply further in the first quarter of 1994. After having increased from R168,3 billion in the first quarter of 1993 to R229,2 billion in the fourth quarter, the nominal value of *public-sector stock* traded on the stock exchange rose further to R253,5 billion in the first quarter of 1994. The higher value of stock traded was strongly influenced by volatility in long-term interest rates as a result of uncertainties on the political front and measured inflation that was higher than expected. In April 1994 the value of transactions in public sector stock decreased somewhat to R54,1 billion, from an average monthly value of R84,5 billion in the first quarter of the year. This decrease could largely be attributed to the smaller number of trading days in April. After the election of the new government and the comparatively peaceful way in which this had come about, the value of public-sector stock traded rose again to R93,0 billion in May.

Non-residents were *net sellers* of public-sector stock on the Johannesburg Stock Exchange in the first quarter of 1994. These net sales came to R0,6 billion; in the fourth quarter of 1993 non-residents had still been net purchasers of public-sector stock to an amount of R0,3 billion. Sales of public-sector stock by non-residents increased significantly with the firming of long-term rates in February and March 1994, but subsided somewhat in the ensuing two months when expectations began to arise that the rates might have peaked.

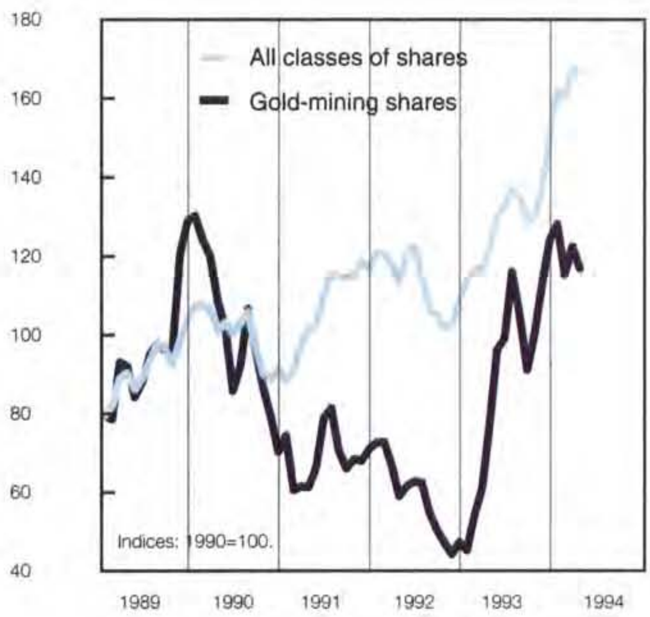
The value of *shares* traded on the Johannesburg Stock Exchange increased from R8,0 billion in the first quarter of 1993 to R14,1 billion in the fourth quarter and R20,9 billion in the first quarter of 1994. The high turnover in the first three months of 1994 was the combined result of increases in both the prices and the number of shares traded. In April 1994 the value of shares traded receded to R5,5 billion from an average monthly value of R7,0 billion in the first three months of the year. This decline was also related to the smaller number of trading days and uncertainty regarding political developments. In May 1994 the value of shares traded increased again to R6,1 billion.

The monthly average of *prices of all classes of shares* increased by 19,6 per cent in the first five months of 1994. In May 1994 the level of share prices was therefore 77,3 per cent above the lower turning-point in October 1992. Industrial, commercial and financial shares continued to perform well. The prices of gold shares, however, fell by 9,5 per cent from a peak in January 1994 to May.

Stock exchange transactions



Share prices



The continued upward movement in share prices, the weak financial rand and the increasing interest of overseas-based investment funds in the emerging South African market, led to a high level of *shares purchased by non-residents* on the Johannesburg Stock Exchange in the first quarter of 1994. In fact, non-residents' net purchases of shares increased from R0,9 billion in the last quarter of 1993 to R2,1 billion in the first quarter of 1994. However, downward corrections on some of the larger stock exchanges in industrialised countries and uncertainty about the socio-political conditions in South Africa caused non-residents to become net sellers of shares on the Johannesburg Stock Exchange to the value of R0,7 billion in April and May 1994.

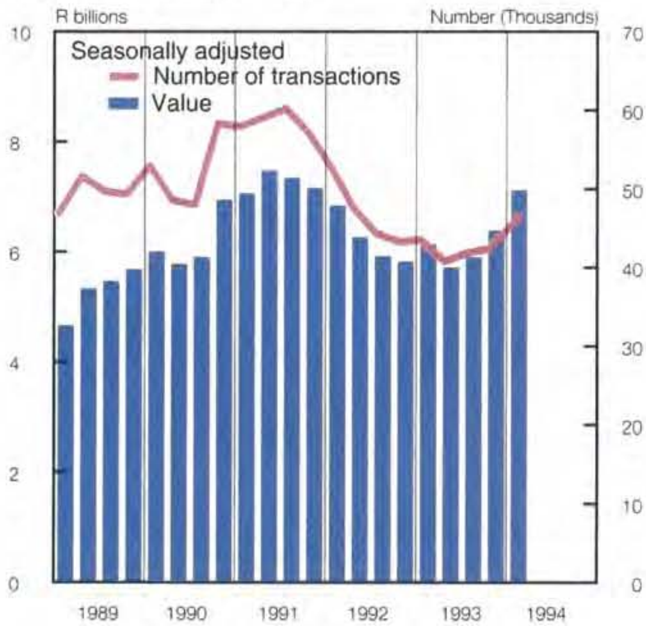
In the *primary capital market* relatively low levels of new-issue activity were displayed in the first quarter of 1994 by borrowing entities in both the public and the private sector. The *public sector* did not raise any funds through issues of *fixed-interest securities* in the first quarter of 1994, but actually repurchased own securities to the amount of R2,0 billion. The value of funds acquired by companies in the *private sector* through issues of *fixed-interest securities* (including convertible preference shares, debentures and corporate bonds) decreased from R0,3 billion in the fourth quarter of 1993 to a negligible R25 million in the first quarter of 1994. New *share issues* remained slack in the first quarter of 1994 as a result of the fact that many listed companies have become flush with cash and are relatively free of debt, often as the counterpart of very low inventory levels and an ageing capital stock. New issues of shares dropped from R1,0 billion in the fourth quarter of 1993 to R0,9 billion in the first quarter of 1994, also because most listed companies had not yet embarked on significant investment programmes.

In the *mortgage market* the average monthly value of mortgage advances paid out by banks decreased slightly from R3,5 billion in the fourth quarter of 1993 to R3,2 billion in the first quarter of 1994. The banks' total holdings of mortgage loans increased further from R92,9 billion at the end of December 1993 to R96,1 billion at the end of March 1994. As already pointed out above, this increase does not necessarily reflect a rise in construction activity or real estate transactions, because it may also have been used to finance ordinary consumer expenditure.

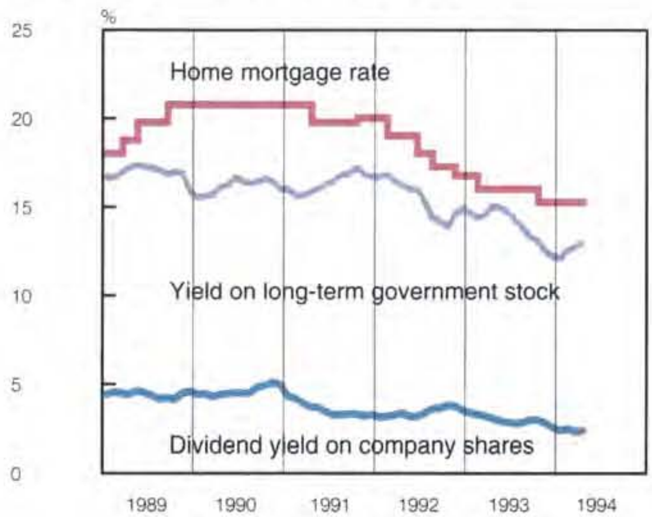
The seasonally adjusted value of *real estate transactions* nevertheless increased from R6,4 billion in the fourth quarter of 1993 to R7,1 billion in the first quarter of 1994. Although this was partly due to a small increase in the average price of such transactions, the number of transactions in fixed property also increased by 10 per cent over the same period. The higher level of transactions in fixed property was due to an increase in the demand for commercial property as well as residential property in certain regions.

Increased uncertainty regarding future share and commodity price movements was mainly responsible for the increase of 69,3 per cent in the number of *futures contracts* traded in the first four months of

Real estate transactions



Capital market interest rates and yields



1994, compared with the corresponding period of the preceding year. In March 1994 the number of these contracts reached an all-time monthly high of about 468 000 before falling back to 226 000 in April and 299 000 in May. Contracts in share indices continued to represent an overwhelming proportion of the number of futures contracts. The number of *options* on index futures contracts in the first four months of 1994 was more than four times higher than the level in the corresponding period of the preceding year. At the end of May 1994 the open interest in index futures contracts and in options on index futures contracts was 87 500 and 363 500 contracts, respectively.

Capital market yields and interest rates

After having declined from 15,03 per cent in April 1993 to 12,07 per cent in January 1994, the monthly average *yield on long-term government stock* rose to 12,97 per cent in April and 13,02 per cent in May. This rise probably reflected uncertainties pertaining to political developments, net sales of domestic loan stock by non-residents, a firming in long-term interest rates in certain major economies and the market's concerns about the government's financing needs that may be associated with its reconstruction and development programme. In view of these higher long-term rates and a decrease in the inflation rate as measured by changes in the consumer price index, the real yield on government stock increased sharply from 2,0 per cent in January 1994 to 5,5 per cent in April.

Despite the fact that the *predominant mortgage bond rate* remained unchanged at 15,25 per cent from November 1993, the banks lowered their long-term deposit rates. The *twelve-month deposit rate*, for instance, was reduced by 0,5 per cent to 10,5 per cent in February 1994. This lower rate provided depositors with a positive *real* pre-tax yield of 3,2 per cent on interest receipts in April 1994.

The higher average level of share prices in the first five months of 1994 depressed the average *dividend yield* on all classes of shares further from 2,53 per cent in December 1993 to 2,16 per cent in May 1994. The average *earnings yield* on all classes of shares (excluding gold-mining shares) also decreased from 5,95 per cent in December 1993 to 5,18 per cent in May 1994.

The maximum permissible *finance charges rates*, as laid down in terms of the Usury Act, were reduced with effect from 24 December 1993 from 25 to 23 per cent in respect of money lending, credit and leasing transactions for amounts of more than R6 000 (but not exceeding R500 000), and from 28 to 26 per cent in respect of amounts up to R6 000. This brought the total reduction in these rates during 1993 to 3,0 percentage points.

The *standard interest rate* applicable to loans granted by the State out of the State Revenue Fund (Exchequer Act, Act No. 66 of 1975) was lowered from 14,75 per cent to 13,5 per cent on 1 November 1993, and in three further steps to 12,5 per cent on 1 February 1994. This rate was then raised to 13,25 per cent with effect from 1 March 1994, but lowered to 13,00 per cent with effect from 1 April 1994. It was increased again, to 13,75 per cent, with effect from 1 May 1994.

The *official rate of interest*, as defined by the Income Tax Act, was reduced by 1 percentage point to 14 per cent with effect from 1 February 1994.

Public finance

Public-sector borrowing requirement

The *public-sector borrowing requirement* (i.e. the deficit before borrowing and debt repayment of the consolidated central government, provincial administrations, local authorities and non-financial public enterprises), which had shown a downward movement from R7,9 billion in the June quarter of 1993 to R6,2 billion in the December quarter, soared to R21,1 billion in the March or final quarter of fiscal 1993/94. For the fiscal year as a whole the public-sector borrowing requirement therefore totalled R41,9 billion, or 26 per cent more than the already high level of R33,3 billion of the preceding year. As a ratio of gross domestic product, the public-sector borrowing requirement was equal to 10,6 per cent in fiscal 1993/94.

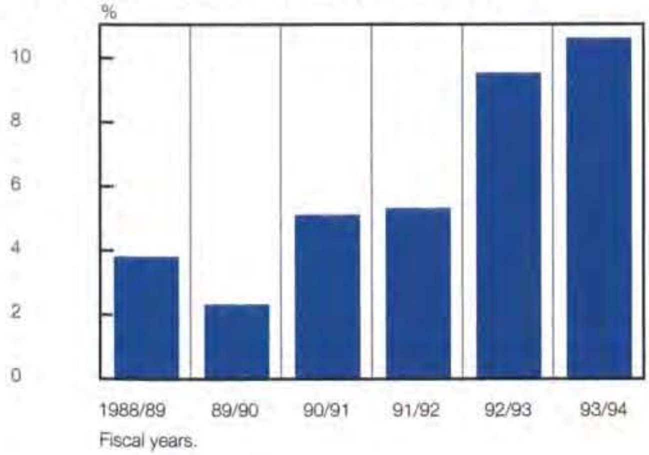
The exceptionally high borrowing requirement of the public sector in fiscal 1993/94 was largely due to *special transfers* of the government to redeem liabilities incurred over a relatively long period of time, i.e. not only in fiscal 1993/94. A transfer of R7,5 billion was namely made to the Gold and Foreign Exchange Contingency Reserve Account to reduce deficits on this account dating back to the late 1980s. In addition, a transfer of R6,9 billion was made to the government employees' pension funds, and a transfer of R0,4 billion to the closed pension funds, in respect of commitments arising from retrenchments and actuarial shortfalls. If these transfers of R14,8 billion are excluded from the public-sector borrowing requirement, the borrowing needs of the public-sector in fiscal 1993/94 were equal to R27,0 billion, or to 6,8 per cent of gross domestic product.

Non-financial public enterprises registered a small surplus on their income and expenditure accounts in fiscal 1993/94; the large public-sector borrowing requirement in that year was therefore brought about entirely by the deficit before borrowing and debt repayment of *general government*. Provincial administrations were the only government bodies that had a surplus on their consolidated income and expenditure accounts in fiscal 1993/94. As in the preceding year, the borrowing requirement of local authorities amounted to R0,9 billion in fiscal 1993/94. In contrast, the borrowing needs of extra-budgetary entities (including the TBVC countries and self-governing states) rose from only R0,1 billion in fiscal 1992/93 to R2,9 billion in fiscal 1993/94. The worsening in the financial position of the extra-budgetary institutions was mainly the result of a substantial reduction in net transfer receipts from the Main Budget. The borrowing requirement on the Main Budget nevertheless increased substantially, owing to the above-mentioned extraordinary transfers that were made in the final quarter of fiscal 1993/94.

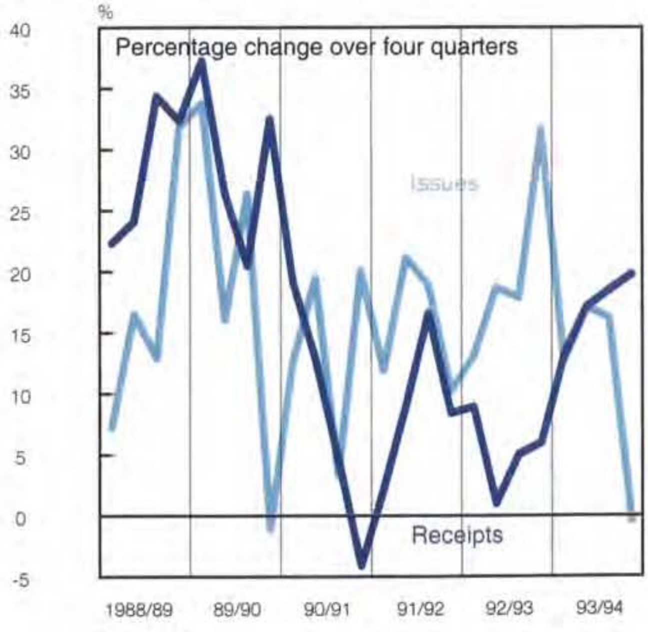
Exchequer account in final quarter of fiscal 1993/94

The level of *Exchequer issues* (including changes in the balance on the Paymaster-General Account and other adjustments made to reflect actual cash flows) in the final quarter of fiscal 1993/94 was 0,5 per cent lower than in the last quarter of 1992/93, compared with year-on-year rates of increase that rose from 12,7 per cent in the June quarter of 1993 to 16,2 per cent in the December quarter. The decline in this rate in the final quarter of fiscal 1993/94 could be attributed mainly to the

Public-sector borrowing requirement as percentage of gross domestic product



Exchequer issues and receipts



exceptionally high rate of increase in Exchequer issues experienced in the corresponding quarter of the preceding year owing to drought relief provided to the farming community. Measured from quarter to quarter, the annualised rate of increase in Exchequer issues amounted to no less than 18,7 per cent, i.e. the quarter-to-quarter rate of increase in the final quarter was, therefore, considerably higher than in the preceding three quarters of the year.

The year-on-year rate of increase in *Exchequer receipts* (excluding the proceeds from privatisation), which had increased from 13,0 per cent in the June quarter of 1993 to 18,4 per cent in the December quarter, rose even further to 19,7 per cent in the final quarter of fiscal 1993/94. This continued good performance by government receipts was mainly due to the recovery in the domestic economy, which led to higher proceeds from nearly all major categories of taxation.

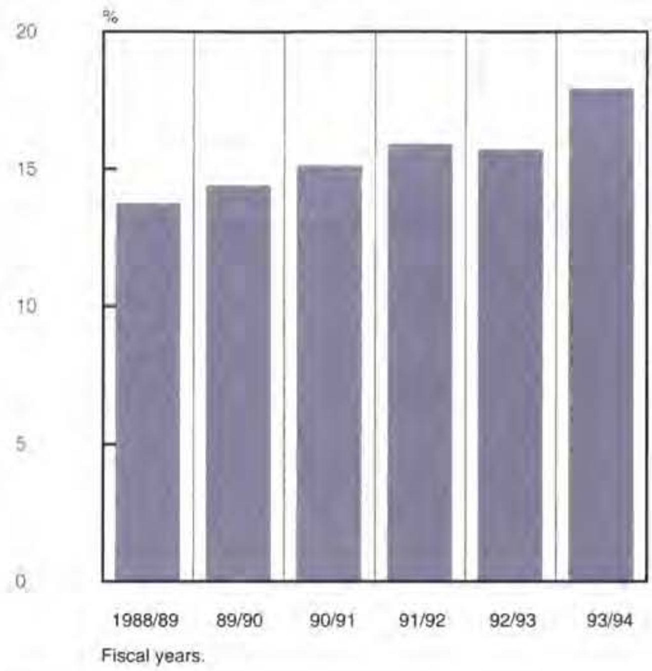
The *Exchequer deficit* before borrowing and debt repayment amounted to R4,8 billion, or 4,9 per cent of gross domestic product in the closing quarter of fiscal 1993/94. This deficit, and the transfers made to the Gold and Foreign Exchange Contingency Reserve Account and the government employees' and closed pension funds, were financed largely by means of the issue of government stock (R14,8 billion), a decrease in the available cash balances of the government (R5,3 billion) and transfers made from the National Supplies Procurement Fund and the Central Energy Fund (R1,4 billion). The government redeemed Treasury bills to an amount of R1,7 billion and made further small net repayments on foreign loans and non-marketable securities in the last quarter of fiscal 1993/94.

Exchequer account for fiscal 1993/94

The more rapid growth in *Exchequer issues* in the final quarter of fiscal 1993/94 brought issues for the year as a whole to R114,8 billion, or to 0,6 per cent more than the original Budget estimates. The rate of increase in government expenditure in fiscal 1993/94 amounted to 9,3 per cent, which was considerably lower than the rate of increase of 21,7 per cent in fiscal 1992/93. If drought-related aid payments of R3,4 billion are not taken into account in fiscal 1992/93, the rate of increase in government expenditure in fiscal 1993/94 still amounted to only 12,9 per cent. This rate of increase in government expenditure was much lower than the average rate of increase of 17,0 per cent in the preceding five fiscal years.

The favourable outcome in total Exchequer issues in fiscal 1993/94 was achieved despite a substantial increase in contractual interest payments on government debt. Interest payments totalled R20,6 billion in fiscal 1993/94, which was no less than 24,7 per cent higher than in the preceding fiscal year. If these interest payments are excluded from Exchequer issues, the other issues in fiscal 1993/94 were only 10,6 per cent higher

Interest on government debt as percentage of total government expenditure



than in fiscal 1992/93 (also adjusted for drought-related aid payments). As a percentage of total government expenditure, interest payments rose to 17,9 per cent in fiscal 1993/94; this ratio amounted to 15,7 per cent in the preceding year, and to 3,9 per cent in 1975/76. What makes this further increase in interest payments even more troublesome, is the fact that it does not include the discount incurred on the issuing of government marketable securities.

Seeing that the increase in government expenditure was lower than the increase in the nominal gross domestic product, the ratio of government expenditure to gross domestic product decreased from 30,1 per cent in fiscal 1992/93 to 29,1 per cent in fiscal 1993/94. This development is, of course, in accordance with the government's standing long-term objective of reducing the share of the government in the economy.

Total *government revenue* amounted to R88,0 billion in fiscal 1993/94. This was 16,1 per cent higher than the revenue collections for fiscal 1992/93, and only R0,2 billion lower than the budgeted amount. After having declined for three consecutive years, government income as a ratio of gross domestic product rose from 21,7 per cent in fiscal 1992/93 to 22,3 per cent in fiscal 1993/94, owing largely to a rise in the proceeds from indirect taxation. Indirect tax as a percentage of total government income increased from 40,3 per cent in fiscal 1992/93 to 45,3 per cent in fiscal 1993/94.

As shown in the accompanying table, most of the main categories of government revenue performed more

Exchequer receipts 1993/94
Percentage change

	Budgeted	Actual outcome
Value-added tax	43,1	44,5
Income tax	11,6	6,4
Companies	1,0	-6,7
Individuals	15,5	11,6
Customs and excise duties	10,0	10,6
Customs duty (including surcharge)	5,9	14,9
Fuel levy	12,1	11,5
Excise duty	11,1	11,2

or less in line with, or better than, the Budget projections, with the notable exception of income tax on individuals and companies. The lower-than-expected revenue from personal income tax was mainly related to a lower rate of increase in salaries and wages than had been anticipated in the Budget. Income tax on companies was the only category of taxation that showed an actual decline over the fiscal year; this decrease was probably caused by the relatively low profits in the year of assessment and the reduction in the tax rates applicable to companies. As anticipated, the proceeds from value-added tax rose sharply in the fiscal year with the four percentage points increase in this tax rate.

The net result of these changes in expenditure and income was a *deficit before borrowing and debt repayment* of R26,8 billion in fiscal 1993/94; in the Budget the deficit had been estimated at R25,9 billion. As a percentage of gross domestic product, the deficit before borrowing amounted to 6,8 per cent. After taking net transfers of R13,4 billion and the discount on new issues of government stock of R2,7 billion into consideration, the total financing needs of the Exchequer came to R43 billion in fiscal 1993/94.

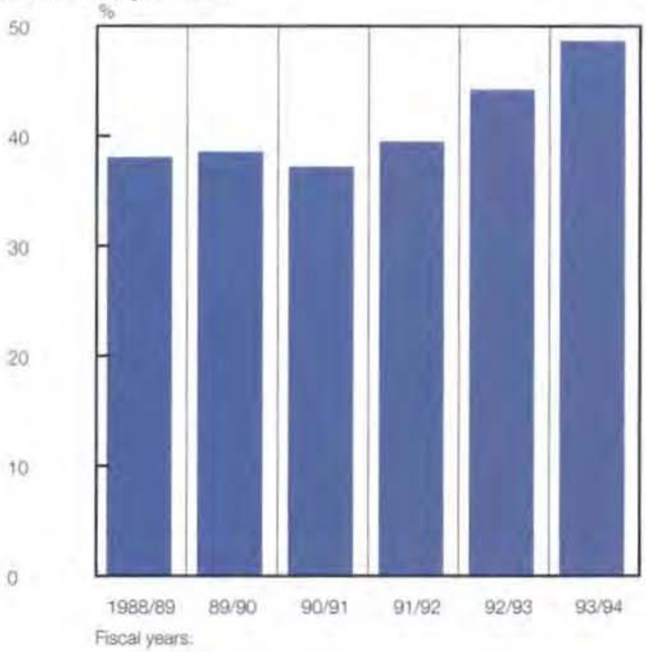
The *borrowing requirement* of the government in fiscal 1993/94 was largely met by issuing government stock to a net amount of R41,8 billion and by a decrease of R1,8 billion in the available cash balances of the government, while small net repayments were made on outstanding Treasury bills, foreign loans and non-marketable securities. As shown in the accompanying table, the funds for the financing of the government deficit were mostly obtained from the Public Investment Commissioners and the non-monetary private sector. However, the net claims of the monetary institutions on the government also rose by R15,3 billion, owing to the stripped coupon government stock issue of R7,5 billion to the Reserve Bank in order to reduce the deficit on the Gold and Foreign Exchange Contingency Reserve Account, a decrease of R0,2 billion in the deposits of the Exchequer and Paymaster General with the monetary sector, and purchases of government stock (mainly long-term paper) to the amount of R7,6 billion.

Financing of government deficit by type of lender, fiscal 1993/94

Type of lender	R millions
Public Investment Commissioners	14 528
Non-monetary private sector	13 164
Monetary institutions	15 625
Corporation for Public Deposits	312
Other monetary institutions	15 313
Foreign sector	-319
Total gross financing	42 998
Plus: Transfers from the National Supplies Procurement Fund and the Central Energy Fund	1 406
Less: Transfers to the Gold and Foreign Exchange Contingency Reserve Account	7 500
Transfers to the government employees' pension funds and closed pension funds	7 340
Less: Discount on new issues of government stock	2 722
Total net financing	**26 842**

Despite a total gross financing requirement of R43,0 billion, total *government debt* increased by R37,5 billion to R192,1 billion from the end of March 1993 to the end of March 1994. Valuation adjustments to government debt were not the only reason for the difference between

Total government debt as percentage of gross domestic product



the increase in government debt and the total financing requirement. The difference was also due to a reduction in the available cash balances of the government, extra-ordinary transfers received, and a drawing on the International Monetary Fund (which is a part of the government debt but not of financing). At the same time, the deficit on the Gold and Foreign Exchange Contingency Reserve Account already formed part of government debt as it is calculated by the Reserve Bank. As a ratio of gross domestic product, government debt nevertheless rose from 44,2 per cent at the end of fiscal 1992/93 to 48,7 per cent at the end of fiscal 1993/94.

Exchequer account in April 1994

In April 1994 the Exchequer issues to government departments (adjusted to reflect cash flows) were 15,3 per cent higher than in April 1993, while Exchequer receipts increased by 36,7 per cent over the same period. This substantial rise in Exchequer receipts could, however, be ascribed to the exceptional low level of these receipts that had been recorded in April 1993. The deficit before borrowing and debt repayment amounted to R3,7 billion in April 1994.