Quarterly economic review

Introduction

The growth in the economy, which had slackened somewhat in the first half of 1995 because of adverse weather conditions, the mining of gold-bearing ore of a lower quality and disruptions of production on gold mines, regained much of its previous momentum in the third quarter of 1995. With the notable exception of agricultural production, which was still affected by the drought in a large part of the country, fairly high rates of increase were recorded in the output of all the other economic sectors. More specifically, production in the manufacturing sector grew very rapidly, owing to a strong domestic and international demand for manufactured products, higher productivity and an expansion in the production capacity of most manufacturing enterprises. The level of real output in the motor trade was also exceptionally high, supported by factors such as consumer demand, stable labour relations and the elimination of supply constraints.

The more rapid expansion in domestic production was accompanied by a slower growth in domestic expenditure in the third quarter of 1995, resulting from smaller additions to inventories. The high interest costs of holding inventories and the anticipated final lifting of the surcharge on imports at the beginning of October probably discouraged inventory accumulation. However, domestic final demand remained firm and rose steadfastly.

A positive consumer sentiment, the ready availability of credit, a high marginal propensity to consume and the replacement of ageing equipment ensured a sturdy increase in the real outlays of households on consumer goods and services. In the third quarter of 1995 consumer demand was also supported and made more viable by a higher growth in real personal disposable income. Contrary to these developments in household consumption, the government continued to restrict the increase in its real consumption expenditure.

Total real gross domestic fixed investment continued to rise strongly in the third quarter of 1995. Moreover, this growth was not limited to specific types of economic activity, but was distributed fairly evenly over all the private production sectors. However, capital formation by public corporations and public authorities contracted further. The level of fixed investment was also still too low to lead to sustainable high levels of production growth conducive to the creation of more employment opportunities.

Employment growth responded slowly to the upturn in economic activity from the middle of 1993. This weak reaction of employment to the economic growth was to a large extent due to attempts to contain cost increases and to raise production efficiency. The increase in real unit labour costs at the beginning of the economic upturn suppressed the demand for labour. At the same time statutory requirements and regulations and strikes and work stoppages for the backing of wage demands, raised the cost of labour and impeded the employment of additional workers. An important positive development on the labour front, however, has been the fairly strong rise in labour productivity during the current economic recovery, which in the first nine months of 1995 contributed to a slower growth in nominal unit labour costs and lower inflation.

Considerable success has been achieved recently in attempts to bring down the inflation rate; increases in both the consumer and production price indices came down to levels last attained in the early 1970s or even the late 1960s. In addition to the containment of increases in production costs, the lower rate of inflation in the third quarter of 1995 could be attributed to actual decreases in the prices of foodstuffs such as meat, fresh fruit and vegetables, a relatively stable and even appreciating external value of the rand, and downward adjustments of tariffs on imported goods. Pressures on inflation, however, persist in the form of high rates of increase in domestic expenditure, rising rates of utilisation of production capacity, strong money supply and credit growth, an inflexible labour market, an uncompetitive production structure and large deficits on the accounts of the government.

The high level of domestic expenditure and particularly the rise in the demand for capital goods also led to a sharp upward movement in merchandise imports and a concomitant larger deficit on the current account of the balance of payments. Fortunately, the strong demand for imports coincided with a continued good export performance. As a ratio of real gross domestic product, real merchandise exports reached a level of 20,1 per cent in the first nine months of 1995, compared with an average level of 11,5 per cent in the 1970s. Various factors contributed to the orientation of the production structure towards the export market, such as the normalisation of international economic relations, financial assistance provided to exporters, incentives for investments in manufacturing enterprises developed specifically for the export market, and a decline in the nominal effective exchange rate of the rand which over the longer term kept more or less pace with the inflation differential between South Africa and its main trading partner countries.

In the third quarter of 1995 the deficit on the current account of the balance of payments was also contained by a sharp increase in net gold exports. This increase was almost entirely the result of a rise in the volume of gold exports, whereas the gold price in dollar and rand terms remained relatively stable. Net service and transfer payments to non-residents, however, rose sharply again because of higher dividend payments on foreign investments and an increase in tourist expenditure by South Africans in other countries.

The deficit on the current account, i.e. the shortfall between domestic investment and saving, was financed by a further large net inflow of capital. As was the case in the preceding quarter, the net capital inflow in the third quarter of 1995 consisted mainly of long-term capital. Not only did private-sector enterprises and public corporations raise large amounts of loan capital abroad, but non-residents also made substantial net purchases of securities on the Johannesburg Stock Exchange. In addition, a net inflow of short-term capital was recorded because of continued short-term borrowing abroad by banks for the financing of their activities under relatively tight domestic money market conditions. In contrast to these developments, foreign trade financing of international transactions was reduced as a result of the higher costs of forward cover.

The net inflow of capital was larger than the deficit on current account and accordingly led to a further improvement in the overall balance of payments. This enabled the Reserve Bank to reduce the foreign loans related to reserves to fairly low levels and to introduce further measures as part of the gradual relaxation of exchange controls applicable to residents.

The high level of economic activity and expenditure on consumption, investment and inventory accumulation was also primarily responsible for a continued rapid growth in the broadly defined money supply. The narrower monetary aggregates increased at much slower rates because they were probably less affected by changes in the liquidity preference of the private sector arising from expectations of interest rate changes and major adjustments in the share and bond markets. In a statistical or accounting sense, the main counterpart of the growth in the money supply was a substantial increase in bank credit extension to the private sector.

The interest rate structure changed considerably during the third quarter of 1995. After having remained on a high level in the first six months of 1995, the yield curve moved rapidly downwards in the ensuing period. Long-term yields declined more than shorter-term yields, with the result that the shape of the yield curve also flattened considerably. At the beginning of November 1995 the yield curve was therefore not only markedly lower than at the beginning of the year, but also relatively flat.

Money market conditions tightened considerably from the end of July 1995 to the end of October, owing largely to a substantial increase in government deposits with the Reserve Bank. The Reserve Bank's operations in the money market were concentrated mainly on measures to drain liquidity and maintain tight conditions. The Bank's sales of new government stock accordingly exceeded the immediate funding needs of the government sector. In addition, the Bank engaged in net open-market sales in the market. In the short term, the Reserve Bank countered large fluctuations in the money market shortage by means of adjustments in the asset portfolio of the Corporation for Public Deposits and the management of the government's deposits with the Bank.

Activity in the domestic primary bond market was dominated by issues of entities in the public sector. As a result of the high liquidity of the corporate sector, the relatively high cost of borrowing funds and the availability of capital from abroad, the funds taken up by private-sector companies through new issues of fixed-interest securities remained low. Activity in the secondary bond market increased markedly in the third quarter of 1995 as long-term yields began to drop.

The demand for funds in the primary equity market, which had shown a distinct downward trend, contracted further in the third quarter of 1995. In the secondary equity market the value of shares traded on the Johannesburg Stock Exchange continued to recover from the low level reached in the first quarter of 1995. The average price level of all classes of shares also rose gradually from a lower turning-point in February 1995 up to October. This upward correction was led by industrial shares, while the performance of prices of gold-mining shares was much more subdued.

The relatively stable conditions in the equity, bond and foreign-exchange markets as well as a greater wariness of futures transactions after the Barings incident, dampened activity on the South African Futures Exchange. The value of real estate transactions also receded in the third quarter of 1995, but the level of these transactions in the first nine months of the year was still markedly higher than in the corresponding period of the preceding year. In addition, the rate of increase in the advances on the mortgage market remained at high levels.

In the area of public finance, exceptional circumstances related to the constitutional changes continued to delay some expenditure of provincial governments and contributed to a sharp improvement in the public-sector borrowing requirement in the first six months of fiscal 1995/96 in comparison with the same period in the preceding year. Owing to these administrative problems of provincial governments, the rate of increase in general government expenditure on goods and services and transfers was exceptionally low, while interest payments by general government increased sharply. A satisfactory rise in general government revenue was mainly achieved because of the growth in income, profits, domestic expenditure and imports, combined with some increases of the tax rates applicable in fiscal 1995/96.

The Exchequer deficit in the first six months of fiscal 1995/96 was financed mainly by the issue of domestic government stock and to a lesser extent by means of a foreign loan issue and the sales of strategic oil stocks. A large part of the government stock was taken up by the non-monetary private sector, but the monetary institutions' holdings of government stock also rose sharply. Despite this increase, the net claims of monetary institutions on the government declined, because of a substantial increase in government deposits with the Reserve Bank and private banks.

Domestic economic developments

Domestic output[1]

The increase in total real gross domestic product amounted to a seasonally adjusted and annualised rate of 3 per cent in the third quarter of 1995; this followed upwardly revised growth rates of 1½ per cent in the first quarter and 2 per cent in the second quarter of 1995. The average level of real domestic output in the first nine months of 1995 was therefore 3½ per cent above the level in the first three quarters of 1994.

The acceleration in the growth of production came mainly from a strong rise in the output of the *non-agricultural sectors* of the economy. Agricultural production dropped substantially further, due to declines in the gross income of horticulture, livestock and field-crop farmers under generally very poor agricultural conditions. If agriculture is excluded, the real value

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

Real gross domestic product

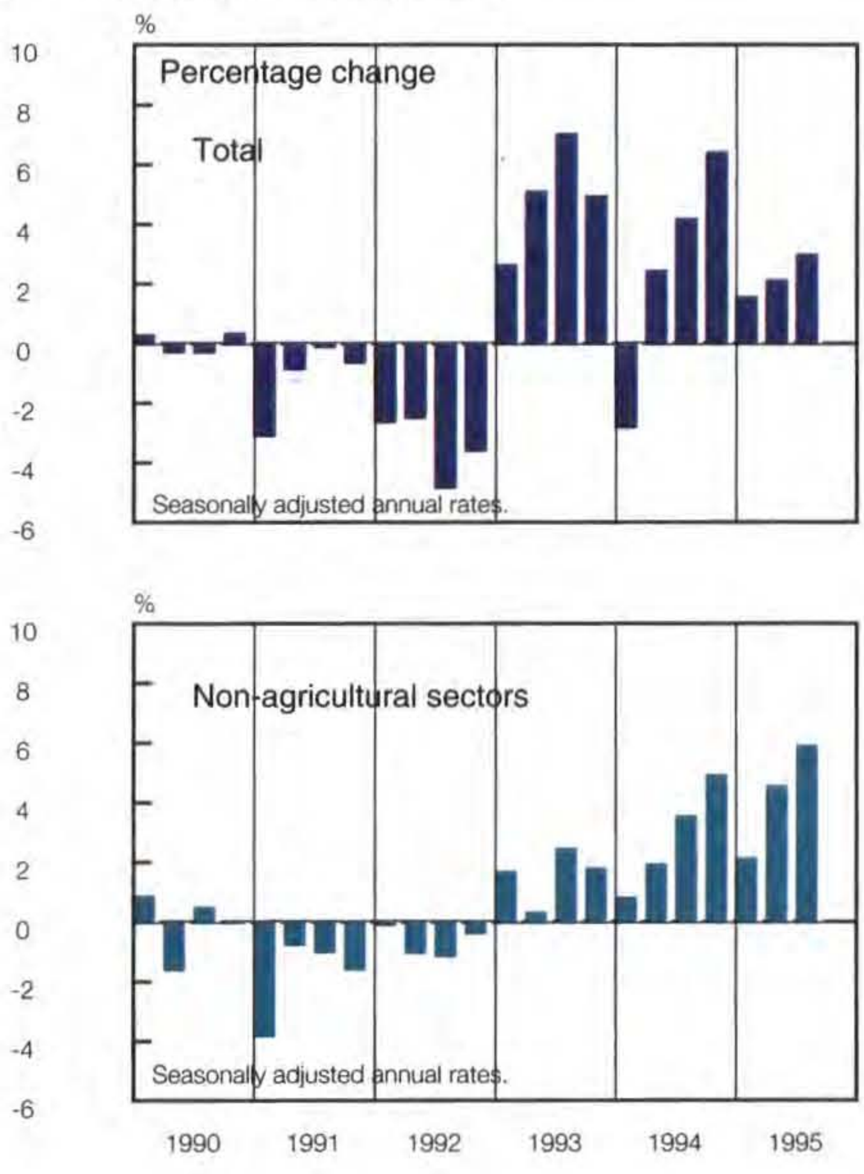


Table 1. Real gross domestic product
Percentage change at seasonally adjusted and annualised rates

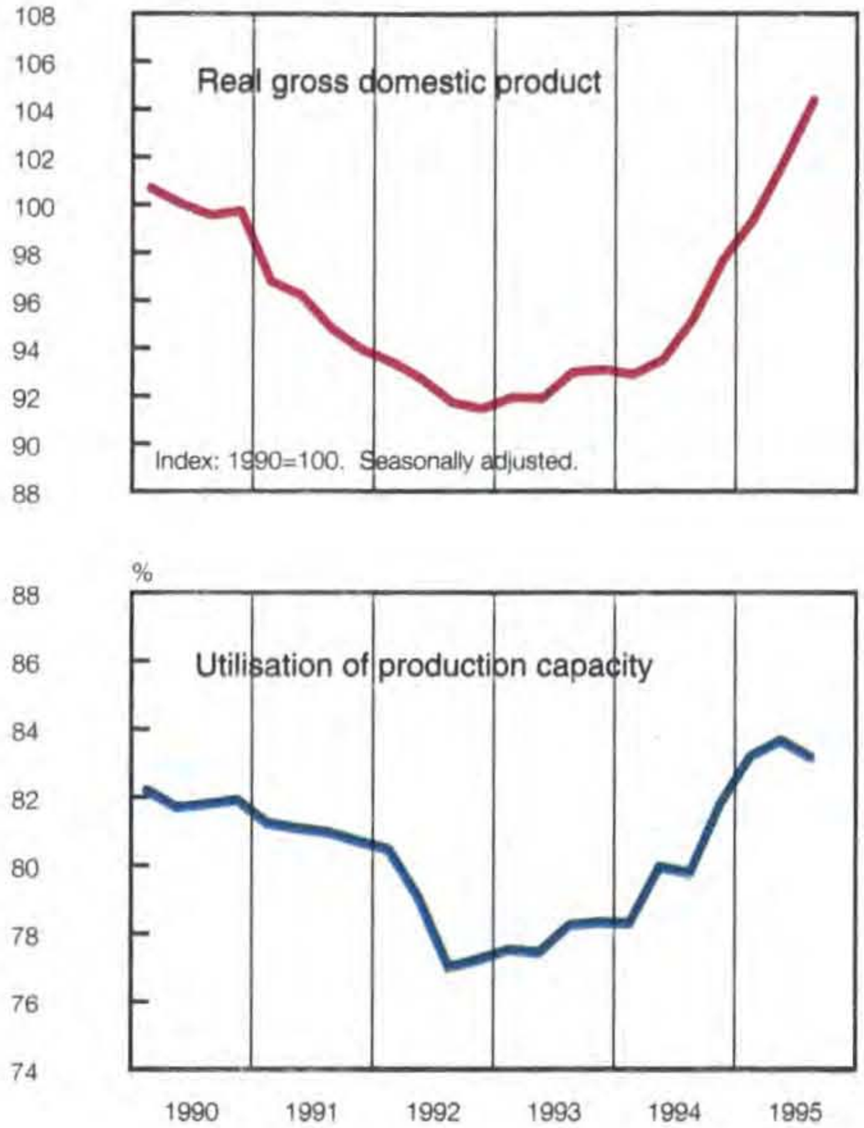
Sectors	1995		
	1st qr	2nd qr	3rd qr
Primary sector	-13	-22½	-19
Agriculture	-13	-41	-51½
Mining	-13	-9	5
Secondary sector	6½	8½	9
Manufacturing	7	10	10½
Tertiary sector	2½	4½	4
Commerce	2½	8½	7½
Transport and communication	5	6½	5
Financial services	3	4	4
Non-agricultural sectors	2½	5	6½
Total	**1½**	**2**	**3**

added by the other economic sectors, at annualised rates, increased from 2½ per cent in the first quarter of 1995 to 5 per cent in the second quarter and 6½ per cent in the third quarter. As a consequence, real output in the non-agricultural sectors during the first three quarters of 1995 was about 4 per cent higher than in the corresponding period of 1994.

After having contracted sharply in the first half of 1995, the output of the *mining sector* recovered in the third quarter and rose at an annualised rate of no less than 5 per cent. This remarkable turnaround was brought about almost entirely by an increase in gold production. Both the quantity and the quality of gold-bearing ore, which had decreased in the first six months of 1995, improved in the third quarter: the average grade of ore milled rose because of the mining of higher-grade ore, and productivity rose because of fewer public holidays and the abatement of violence and industrial action on gold mines. The mines producing coal and some base metals took advantage of the strong international demand for their products and also increased their production in the third quarter of 1995.

The high growth rates in the real output of the non-primary sectors were, however, mainly the result of the continued strong growth in the value added by the *secondary sectors*, particularly in manufacturing. Although the real value added of enterprises providing electricity, gas and water, and to a lesser extent also of enterprises involved in construction, grew strongly, the annualised growth rate in the manufacturing sector accelerated from an already high 7 per cent in the first quarter of 1995 to no less than 10½ per cent in the third quarter. The level of manufacturing output in the first nine months of 1995 was accordingly 8½ per cent higher than in the corresponding period of 1994.

Manufacturing sector



Various factors contributed to the strong output growth of the manufacturing sector, including:

- the high level of export demand, owing partly to the reintegration of South Africa into a broader spectrum of international markets;

- buoyancy in private-sector domestic final demand, which contributed almost 4 percentage points to the growth in real gross domestic product in the third quarter of 1995;

- the increased utilisation of existing production capacity in manufacturing to a level in the second quarter of 1995 that was only one percentage point below the peak reached in the previous upturn of economic activity;

- a general expansion of production capacity in most of the manufacturing activities, but more notably in the mineral beneficiation sectors, where new installations added to the production of stainless steel and aluminium; and

- an increase in productivity related to a considerable decline in the number of man-days lost on account of labour unrest in the manufacturing industry.

Activity in the *tertiary sectors* also remained strong and quarter-to-quarter growth rates in the real value added by these sectors accelerated from an annualised rate of 2½ per cent in the first quarter of 1995 to 4½ per cent in the second quarter and 4 per cent in the third quarter. The positive mood in the business sector and among consumers in general, provided impetus for continued increases in real value added by most of the various types of tertiary activities. More in particular, large increases were recorded in the real value added by the commercial sector, transport, storage and communication, and financial services.

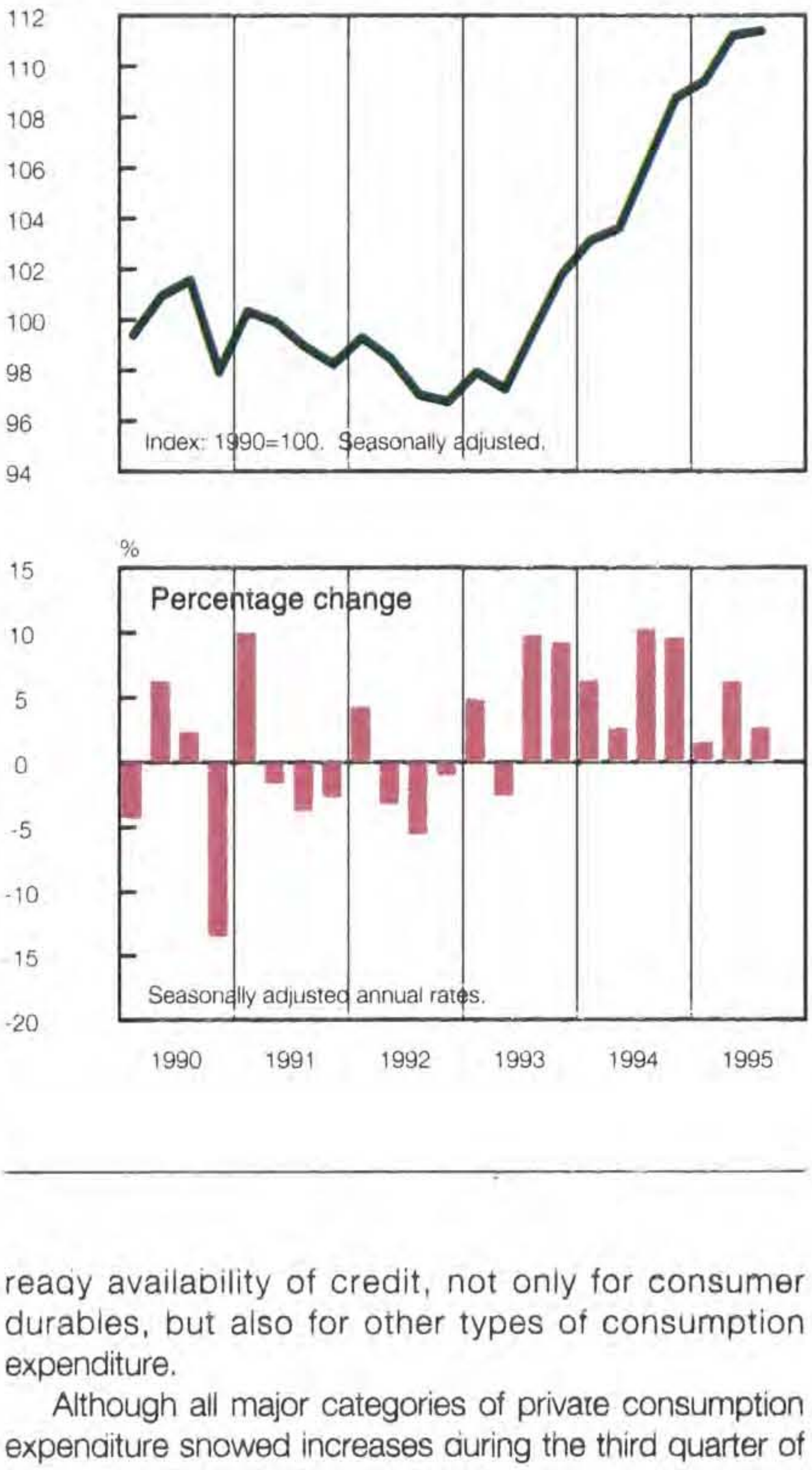
The level of real output in the *motor trade* in the third quarter of 1995 was no less than 17½ per cent higher than in the same quarter of the previous year. Factors which supported this exceptionally strong growth in the demand for new and used motor cars and commercial vehicles during the third quarter of 1995, included the strengthening of consumer demand and the significantly higher levels of business investment, an increase in the demand for motor cars from the car rental sector, stable labour relations in the automobile industry and improved levels of productivity. The containment of price increases and the much improved availability of new motor vehicles boosted activity in the motor trade further.

Domestic expenditure

The steep growth in *aggregate real gross domestic expenditure* from the middle of 1993 flattened somewhat in the third quarter of 1995. After having increased at a seasonally adjusted and annualised rate of 6 per cent in the second quarter and an average annualised rate of 5½ per cent in the two years from the middle of 1993, real domestic expenditure rose at a rate of only 2½ per cent in the third quarter of 1995. This slower growth was attributable to smaller additions to inventories. Real consumption expenditure and real gross domestic fixed investment continued to increase rapidly in the third quarter of 1995.

Real private consumption expenditure rose at an annualised rate of slightly more than 4 per cent in the third quarter of 1995. This was broadly similar to the revised rates of increase in consumption expenditure in the first two quarters of the year. The continued strong performance of private consumption expenditure at constant prices during 1995 could to a large extent be ascribed to an acceleration in the growth of real personal disposable income from an annualised rate of less than ½ per cent in the first quarter of the year to 3 per cent in the third quarter, on account of a sharp increase in the real remuneration of employees. Such an increase in a community with a high marginal propensity to consume can be expected to lead to significant increases in household consumption outlays. This development was aided by the positive consumer sentiment and by the

Real gross domestic expenditure



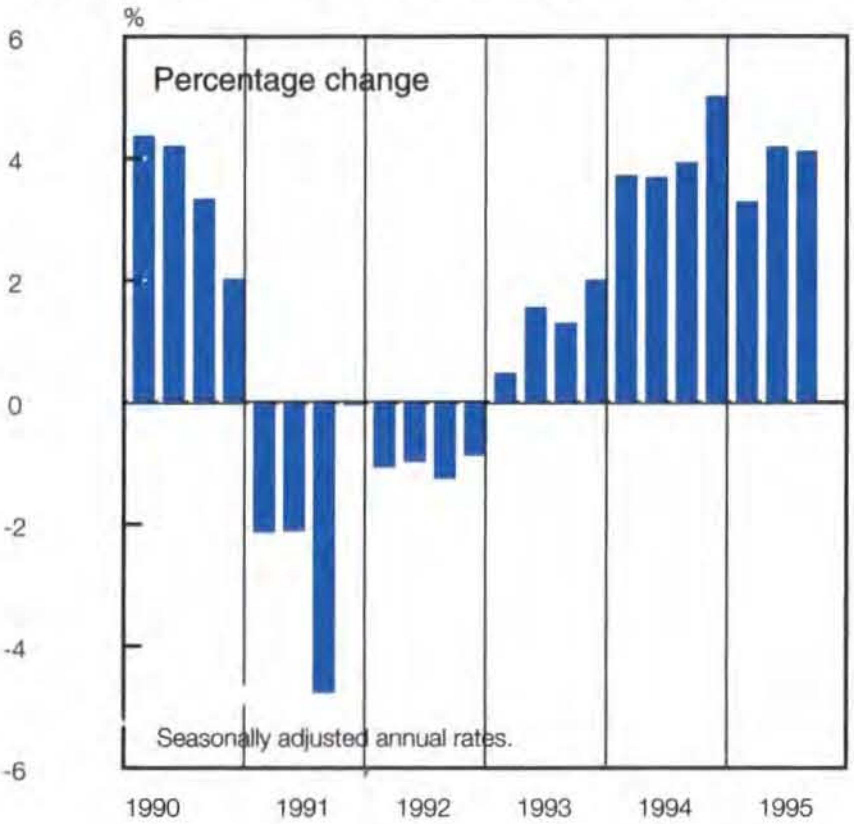
ready availability of credit, not only for consumer durables, but also for other types of consumption expenditure.

Although all major categories of private consumption expenditure showed increases during the third quarter of 1995, larger gains were recorded in outlays on durable

Table 2. Real gross domestic expenditure
Percentage change at seasonally adjusted and annualised rates

Components	1995		
	1st qr	2nd qr	3rd qr
Private consumption expenditure	3½	4	4
Consumption expenditure by general government	-1½	½	2
Gross domestic fixed investment	7	7½	7
Change in inventories (R billions)	6,8	8,7	7,7
Gross domestic expenditure	**1½**	**6**	**2½**

Total real private consumption expenditure



and semi-durable goods such as furniture and appliances, personal transport equipment, clothing and footwear. The sustained rapid increases in real expenditure on durable goods were related, *inter alia*, to an increase in replacement demand, owing to the ageing of households' stock of consumer durables during the long recession of 1989-93 and a new demand for household appliances arising from the electrification of some less developed regions in the country. Real outlays on semi-durable goods were assisted by aggressive marketing of private-label credit cards providing extended credit periods and easy repayment terms.

Real *consumption expenditure by general government* rose at an annualised rate of approximately 2 per cent, which was higher than in the preceding quarter. Government consumption outlays in the first nine months of 1995, at constant prices, was also about ½ per cent higher than in the corresponding period of 1994; this increase was much slower than the increase of 4 per cent registered in the calendar year 1994. Cutbacks were mainly made in real outlays on intermediate goods and services by general government.

Like households' real outlays on goods and services, *total real gross domestic fixed investment* continued to rise strongly in the third quarter of 1995. The annualised rate of increase in this aggregate was estimated at 7 per cent, i.e. about equal to the average growth of 7½ per cent in the first two quarters of 1995. The level of real gross fixed investment in the first three quarters of 1995 was accordingly about 11½ per cent higher than in the corresponding period of 1994.

The increase in capital formation in the third quarter of 1995 was the net result of an increase in real outlays on capital goods by the private sector and a decline in the real capital expenditure by public corporations and public authorities. The *private sector's* capital formation increased at an annualised rate of 14 per cent in the third quarter of 1995, following increases of 9½ and 13 per cent in the first two quarters of the year. The strong growth in the real fixed investment of the private sector was not limited to specific types of economic activity, but was distributed fairly evenly over all the various production sectors. A general expansion of production capacity took place in the private sector in response to factors such as the high external and domestic demand, the sharp increase in the utilisation of existing production capacity and the replacement of ageing equipment.

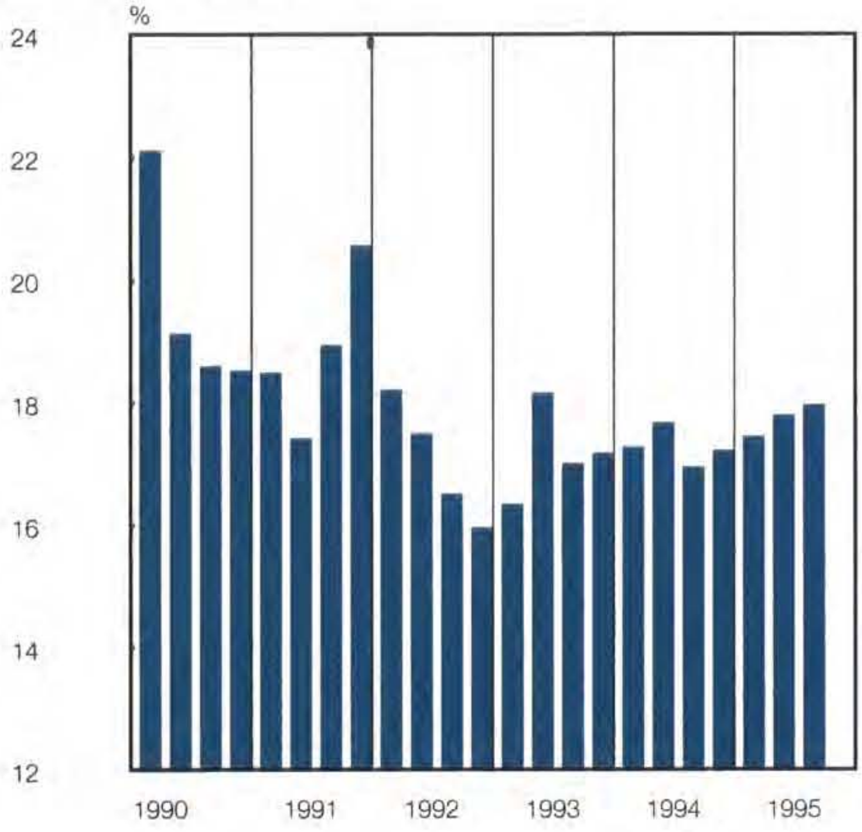
Despite higher real capital expenditure by *public corporations* in the transport and telecommunications sector, total real fixed investment by public corporations decreased substantially in the third quarter of 1995. This was mainly the result of cutbacks in capital outlays by Eskom in the wake of high levels of expenditure during 1994. Real gross domestic fixed investment by *public authorities* continued to decline in the third quarter of 1995, albeit at a lower rate than in the preceding three quarters.

The strength of the inventory cycle that has been a characteristic of the current cyclical upswing, subsided in the third quarter of 1995. Smaller net additions to *inventories* were evident in almost all the major sectors of the economy, probably indicating that the normal build-up of inventories in anticipation of a rise in sales volumes over the festive season had been delayed while the business sector was waiting for the final lifting of the surcharge on imports at the beginning of October. The slowdown in inventory accumulation could also be related to the recent sharp rise in real interest costs of inventory holdings. The ratio of industrial and commercial inventories to non-agricultural gross domestic product nevertheless increased by about 1 percentage point from the second to the third quarter of 1995 to a level of 18½ per cent.

Factor income and saving

The growth over four quarters in aggregate *nominal factor income* at market prices, which had slowed down from 14 per cent in the first quarter of 1995 to 11½ per cent in the second quarter, rose slightly to 12½ per cent in the third quarter. The year-on-year rate of increase in the first nine months of 1995 accordingly came to 13 per cent; in calendar 1994 nominal factor income rose by 12½ per cent. The continued strong rise in factor income was due to increases in both operating surpluses of business enterprises and a strengthening of the rate of increase in the remuneration of employees. Company profits continued to rise in the current recovery phase after having reached relatively depressed levels in the preceding recession. The increase in aggregate labour remuneration has averaged about 13 per cent since the

Gross domestic saving as percentage of gross domestic product



beginning of 1995, and therefore exceeded consumer price inflation by a considerable margin.

Gross domestic saving as a ratio of gross domestic product rose from 17 per cent in 1994 to approximately 18 per cent in the second and third quarter of 1995. Despite this improvement, it fell increasingly short of domestic investment; the country therefore became more dependent on foreign funds to finance the rise in investment as is reflected by a substantial increase in the deficit on the current account of the balance of payments.

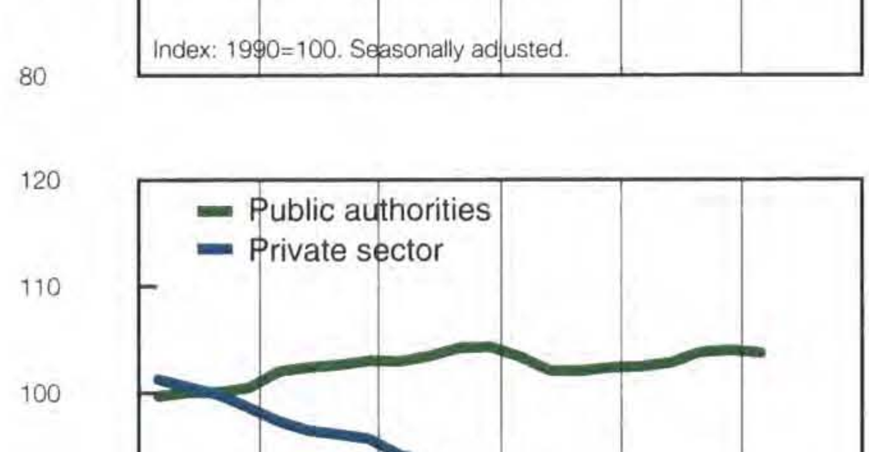
In the third quarter of 1995 the level of domestic saving was supported by a rise in corporate saving resulting from higher profitability and only moderate rises in actual cash dividend payments; businesses preferred to pay scrip dividends in the light of the Secondary Tax on Companies. Had it not been for this improvement in company saving, the savings rate would have weakened in the third quarter of 1995 because the dissaving by general government widened and personal saving relative to personal disposable income fell back to 2 per cent from an average level of 4½ per cent in 1994.

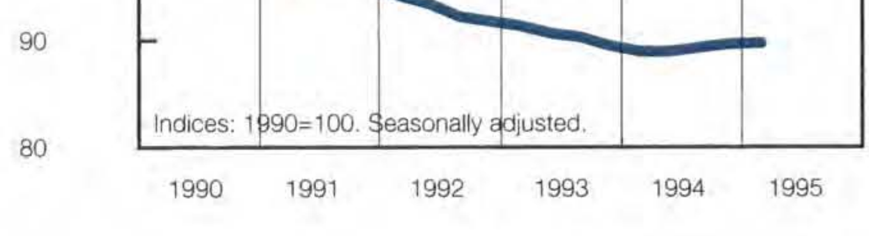
Employment

Employment growth was slow to respond to the strengthening of economic activity. After the business cycle had reached a lower turning-point in May 1993, *total employment* in the formal non-agricultural sectors continued to decline until the first quarter of 1994. Only moderate seasonally adjusted and annualised quarter-to-quarter growth rates of 0,5, 2,4 and 1,2 per cent respectively were then registered in the last three quarters of 1994. In the first quarter of 1995 (the latest quarter for which information has been made available by the Central Statistical Service) employment remained virtually unchanged. From the start of the recovery up to the first quarter of 1995 only 52 000 additional jobs have been created in the formal sectors of the economy. This gain was considerably smaller than the loss of 420 000 employment opportunities in the recession of 1989-93, with the result that the level of total employment remained low despite the higher economic growth.

The weak reaction of employment to economic growth was mainly due to the *private business sector's* attempts to contain cost increases and raise efficiency in the production process. Increases in the remuneration of workers that were unrelated to productivity improvement exerted upward pressure on production costs and suppressed the demand for labour. Total employment in the non-agricultural private sector accordingly declined almost uninterruptedly from the third quarter of 1989 to the second quarter of 1994. Private-sector employment then increased at seasonally adjusted and annualised rates of 1,6 and 1,5 per cent in the third and fourth quarter of 1994, before this rate of increase slowed down to 0,4 per cent in the first quarter of 1995. This lower rate of increase was largely the result of declines in the employment of enterprises involved in manufacturing,

Non-agricultural employment

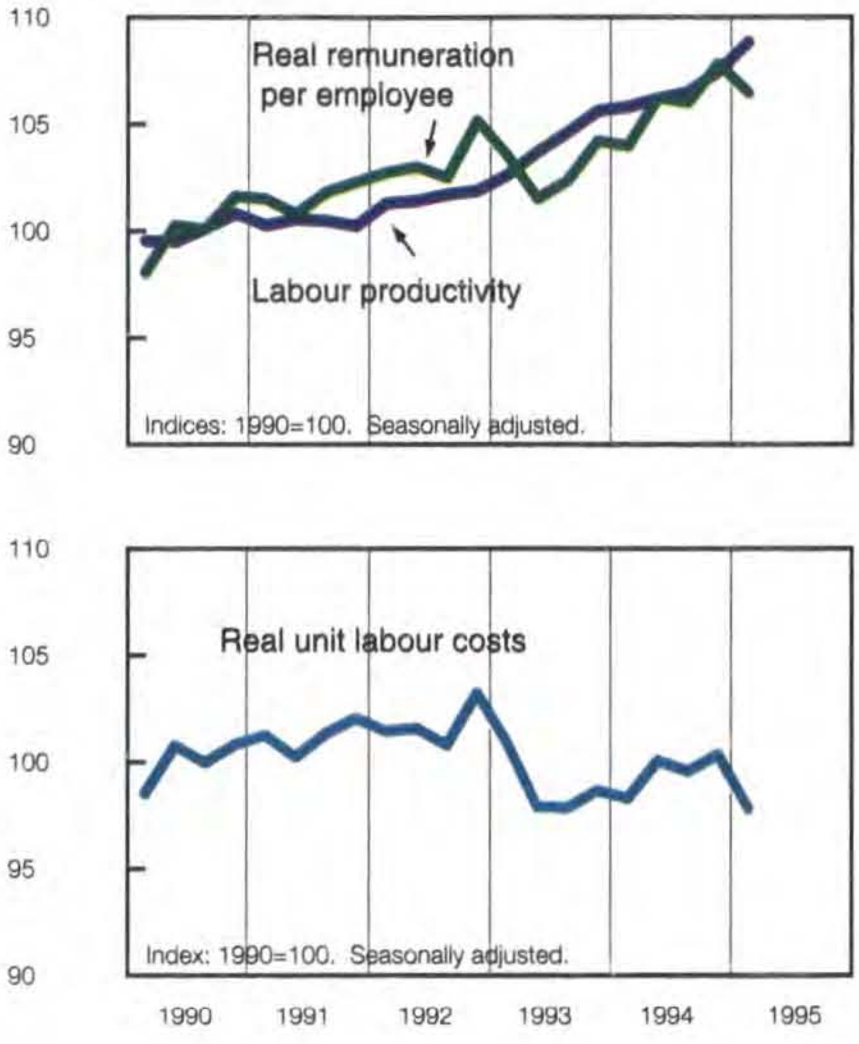




wholesale trade, private road transportation, mining and electricity generation.

In sharp contrast to these developments in private-sector employment, the total employment by *public authorities* already started to increase in the third quarter of 1993. Moreover, the quarter-to-quarter rate of increase in the total employment by public authorities accelerated from a seasonally adjusted and annualised rate of 0,3 per cent in the first quarter of 1994 to 3,9 per cent in the third quarter. It then slowed down to 0,7 per cent in the fourth quarter, before becoming negative to the extent of 1 per cent in the first quarter of 1995 on account of the early retirement of a large number of senior civil servants who were not immediately replaced.

Non-agricultural labour productivity, remuneration and unit labour costs



Labour costs and productivity

The growing excess supply of unskilled labour in South Africa since the start of the recession of 1989-93 had only a limited effect on labour remuneration. The rate of increase in *nominal remuneration per worker* in the non-agricultural economic sectors declined only moderately from 18,4 per cent in 1989 to 15,2 per cent in 1992. Although it then came down sharply to 10,5 per cent in 1993 and 11,9 per cent in 1994, these increases were still higher than the inflation rate in those years. In most years since 1989 real wage increases per worker have been higher than the rise in productivity, with a concomitant rise in real unit labour costs. This clearly indicates that rigidities exist in the labour market which prevent wages from reflecting underlying supply and demand conditions. These deficiencies will unavoidably have an adverse impact on new investments and further impair the labour absorption capacity of the South African economy.

More recently, the rate of increase over four quarters in nominal salaries and wages per worker declined from 14,6 per cent in the second quarter of 1994 to 10,8 per cent in the first quarter of 1995 (latest information available). This slower growth was mainly caused by a sharp deceleration in the rate of increase in the remuneration per worker of public authorities from the exceptionally high level at the time of the general election in April 1994. Measured over a period of four quarters, the growth rate in the remuneration per worker employed by public authorities receded from 21,3 per cent in the second quarter of 1994 to 11,2 per cent in the first quarter of 1995. The corresponding rate of increase in the nominal salaries and wages per worker in the private sector fluctuated around 10½ per cent over the same period.

Despite this downward trend, the growth in labour remuneration per worker continued to exceed the rate of

Table 3. Percentage change over four quarters in labour costs and productivity

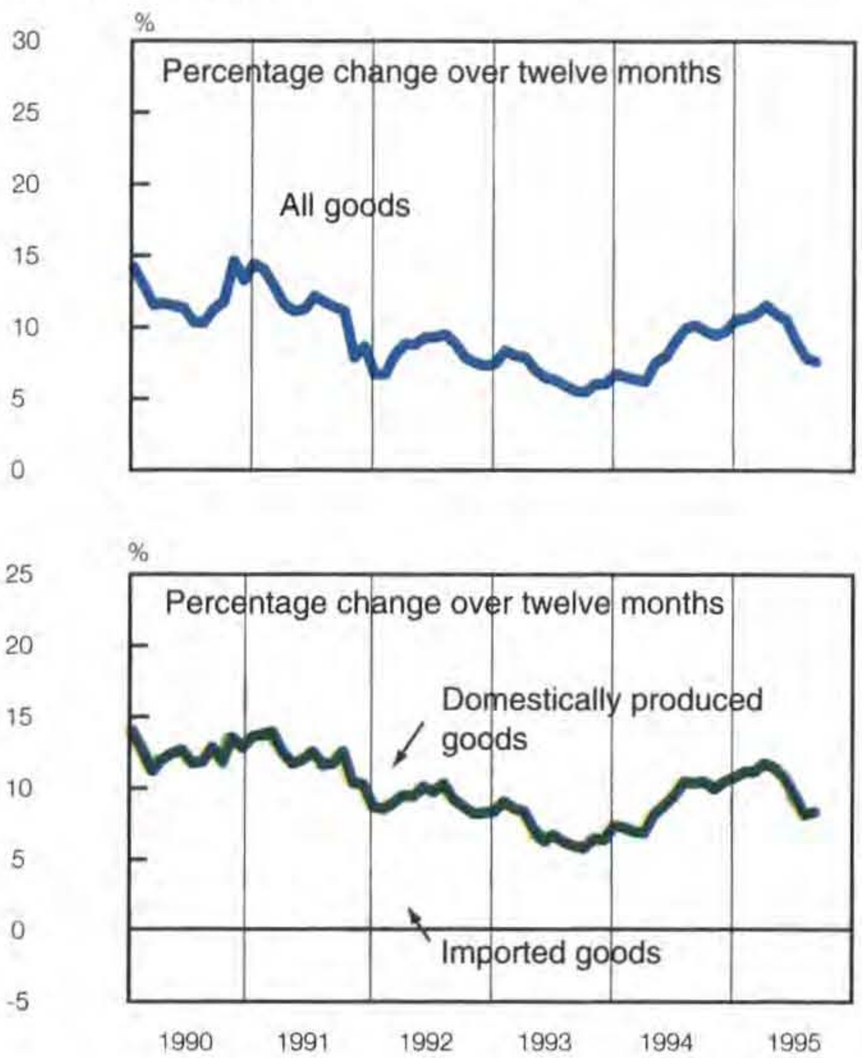
	1994				1995
	1st qr	2nd qr	3rd qr	4th qr	1st qr
Labour remuneration per worker					
Nominal	9,6	14,6	12,6	11,6	10,8
Real	0,7	4,8	3,7	3,6	1,5
Labour productivity	3,4	2,5	1,9	1,9	2,0
Unit labour costs					
Nominal	6,0	11,7	10,5	9,6	8,6
Real	-2,6	2,2	1,7	1,7	-0,5

increase in the deflator of non-agricultural gross domestic product. The growth in *real wages per worker* consequently remained positive. However, the year-on-year rate of increase in the real remuneration per worker in the non-agricultural sectors declined sharply from 4,8 per cent in the second quarter of 1994 to 1,5 per cent in the first quarter of 1995.

The growth in *labour productivity* in the non-agricultural sectors also began to subside, but was still relatively high in the first quarter of 1995. After having increased from a negative figure of ½ per cent in the fourth quarter of 1991 to 4 per cent in the fourth quarter of 1993, the rate of increase over four quarters in labour productivity contracted to a level of about 2 per cent in the last two quarters of 1994 and the first quarter of 1995.

The growth in labour productivity during 1994 was less than the rate of increase in real wages per worker, with the result that *real unit labour costs* rose on average by 0,6 per cent. These cost increases impeded the efforts of the private sector to restore profitability, as well as the creation of additional job opportunities. In the first quarter of 1995 productivity increases exceeded the rise in the real remuneration per worker; real unit labour costs therefore declined moderately by ½ per cent.

Production prices



Prices

The slower increase in nominal unit labour costs, together with an actual decline in the prices of unprocessed and manufactured food, brought about a decline in the rate of increase over a period of twelve months in the prices of *domestically produced goods* from 11,7 per cent in April 1995 to 8,3 per cent in September. Over the same period, the rate of increase over twelve months in the prices of *imported goods* receded from a high of 10,5 per cent to 4,9 per cent. These lower rates of increase in the prices of imported goods were the result of a relatively stable nominal effective exchange rate of the rand and downward adjustments to a number of import tariffs in accordance with the Uruguay Round of trade negotiations.

As a result of these changes in its two main components, the rise in the *all-goods production price index* also slowed down considerably. Measured over a period of twelve months, the rate of increase in the all-goods production price index slowed down from 11,5 per cent in April 1995 to 7,6 per cent in September. The quarter-to-quarter rate of increase in this index also decreased from a seasonally adjusted and annualised rate of 11,1 per cent in the second quarter of 1995 to only 2,7 per cent in the third quarter. However, as is clearly indicated in Table 4, this improvement in production price inflation was mainly due to developments in the prices of imported goods and food products. If these products are excluded from the production price index, the rate of increase over twelve months in the prices of other domestically produced goods continued to increase to 13,2 per cent in June 1995 before declining somewhat to 12,0 per cent in September. The high rates of increase in domestic expenditure, strong money supply and credit growth, rising rates of utilisation of production capacity in manufacturing enterprises, expectations of high inflation and efforts by businesses to restore profitability after the long recession of 1989-93, continue to sustain the underlying inflation rate.

As is also illustrated in Table 4, the recent decline in the prices of imported goods and food products brought about an actual decrease in the quarter-to-quarter rate of change in the prices of consumer goods. Largely as a result of these price developments, the quarter-to-quarter increase in the *overall consumer prices index* declined from a seasonally adjusted and annualised rate of 10,9 per cent in the second quarter of 1995 to only 1,7 per cent in the third quarter – the lowest increase since the second quarter of 1968. The quarter-to-quarter underlying inflation rate (as measured by the overall consumer price index, excluding food and non-alcoholic beverages, the costs of homeownership and value-added tax) also declined sharply from a seasonally adjusted and annualised rate of 8,9 per cent in the second quarter of 1995 to only 5,8 per cent in the third quarter. Contrary to the progress made in lowering inflation in these indices, the corresponding rate of

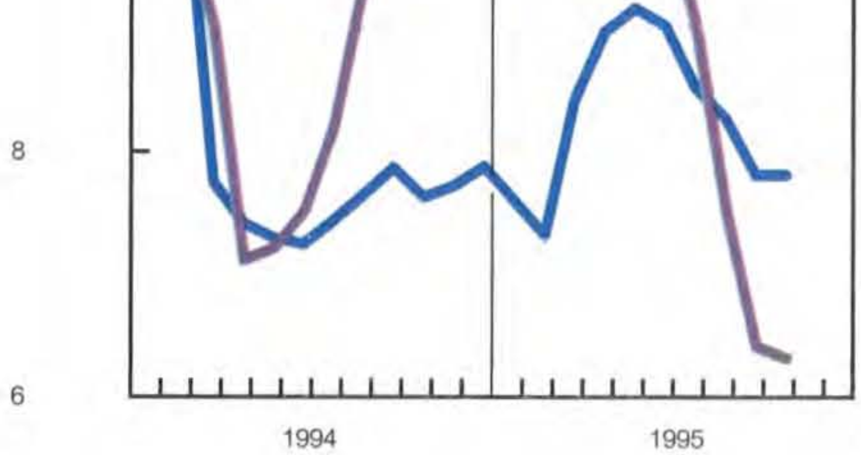
Table 4. Consumer and production price indices
Quarter-to-quarter changes at an annualised rate

	1995 1st qr	1995 2nd qr	1995 3rd qr
Production price indices			
Domestically produced goods	13,4	10,7	2,8
Imported goods	12,7	12,6	-0,3
All goods	13,2	11,1	2,7
Domestically produced goods excluding food	12,7	16,0	10,0
Consumer price indices			
Goods	7,1	9,9	-2,7
Services	9,2	13,5	12,5
All goods	8,9	10,9	1,7
Underlying inflation rate	10,1	8,9	5,8

increase in the prices of services declined only moderately.

The rate of increase over twelve months in the overall consumer price index also declined from a high of 11,0 per cent in April 1995 to only 6,3 per cent in October. Owing to a contraction in the prices of food such as meat, fresh fruit and vegetables, the rate of increase over periods of twelve months in the prices of consumer goods dropped from 10,9 per cent in April 1995 to only 3,7 per cent in October 1995. The corresponding rate of increase in the prices of consumer services fell back much more moderately from 11,9 to 10,2 per cent over the same period. More significant is the decline in the year-on-year underlying inflation rate from its recent peak of 9,2 per cent in May 1995 to 7,8 per cent in September and October.

Consumer price index



Foreign trade and payments

Current account

The *deficit on the current account* of the balance of payments, which had increased from R0,7 billion in the fourth quarter of 1994 to R3,4 billion in the second quarter of 1995, amounted to R3,5 billion in the third quarter. In the first nine months of 1995 the cumulative deficit on the current account accordingly totalled R9,1 billion. Taken at a seasonally adjusted and annualised rate, the deficit on the current account decreased somewhat from R12,5 billion in the second quarter of 1995 to R11,5 billion in the third quarter, or from 2,6 to 2,3 per cent of gross domestic product. This somewhat better performance of the current account was the net result of a substantial increase in merchandise and net gold exports, which offset increases in merchandise imports and net service and transfer payments to non-residents.

Owing mainly to an increase in the volume of goods exported, the value of South Africa's *merchandise exports* rose by 4 per cent from the second to the third quarter of 1995. Substantially higher exports of coal, copper and chrome ore were neutralised to some extent by lower international diamond sales, while the exports of agricultural and manufactured products remained more or less on the level of the previous quarter. The prices of exported goods rose only marginally in the third quarter because of the appreciation in the weighted average value of the rand.

The continued good export performance brought the increase in the volume of exports to 20 per cent in the first nine months of 1995 compared with the corresponding period in the preceding year. As a ratio of real gross domestic product, merchandise exports at constant prices rose further to a level of 20,1 per cent in the first nine months of 1995. This can be compared with a ratio of 17,7 per cent in 1994 and a low of 10,7 per cent in 1984. In the past twelve years an increasingly larger proportion of production therefore became geared

Balance of payments: Current account

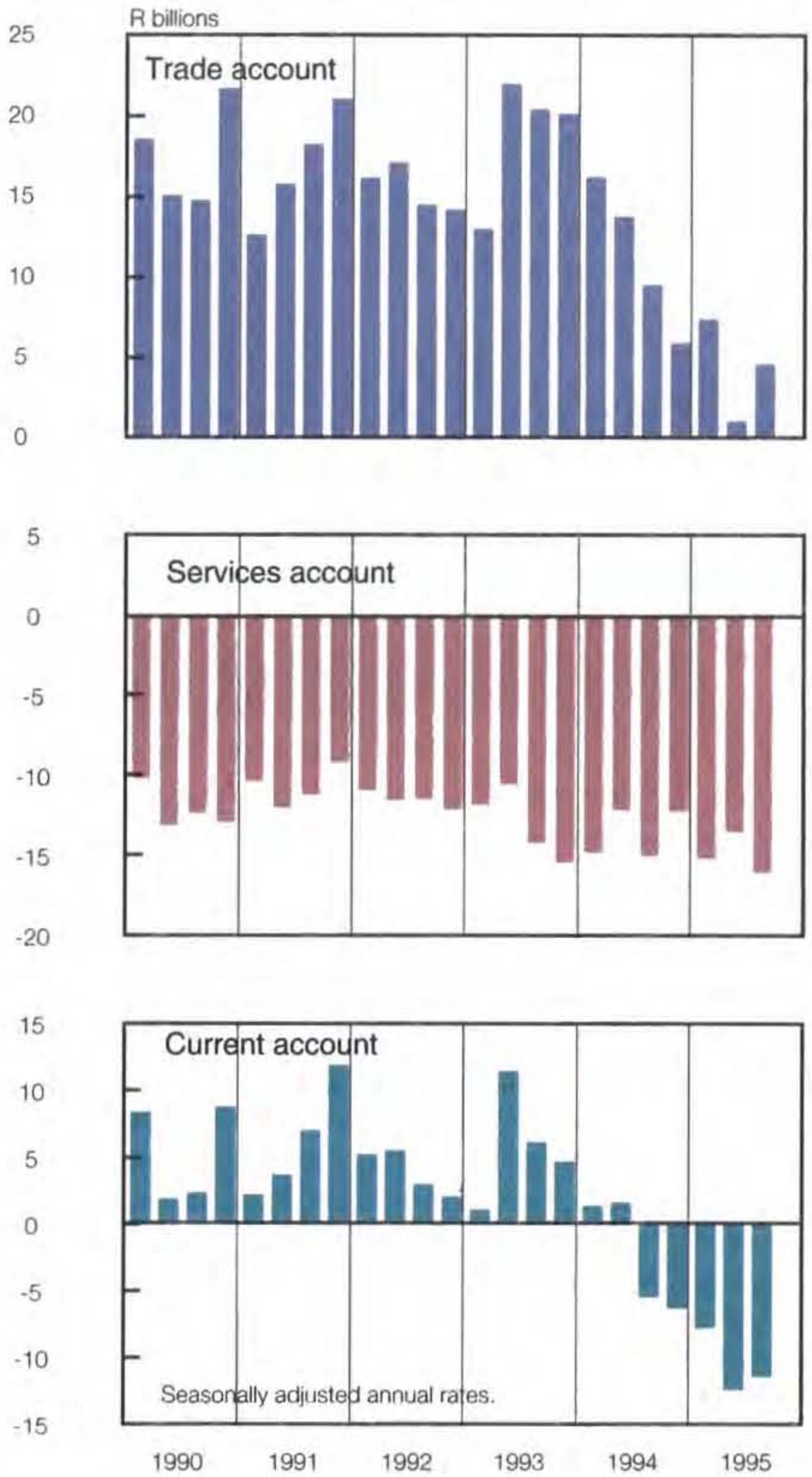
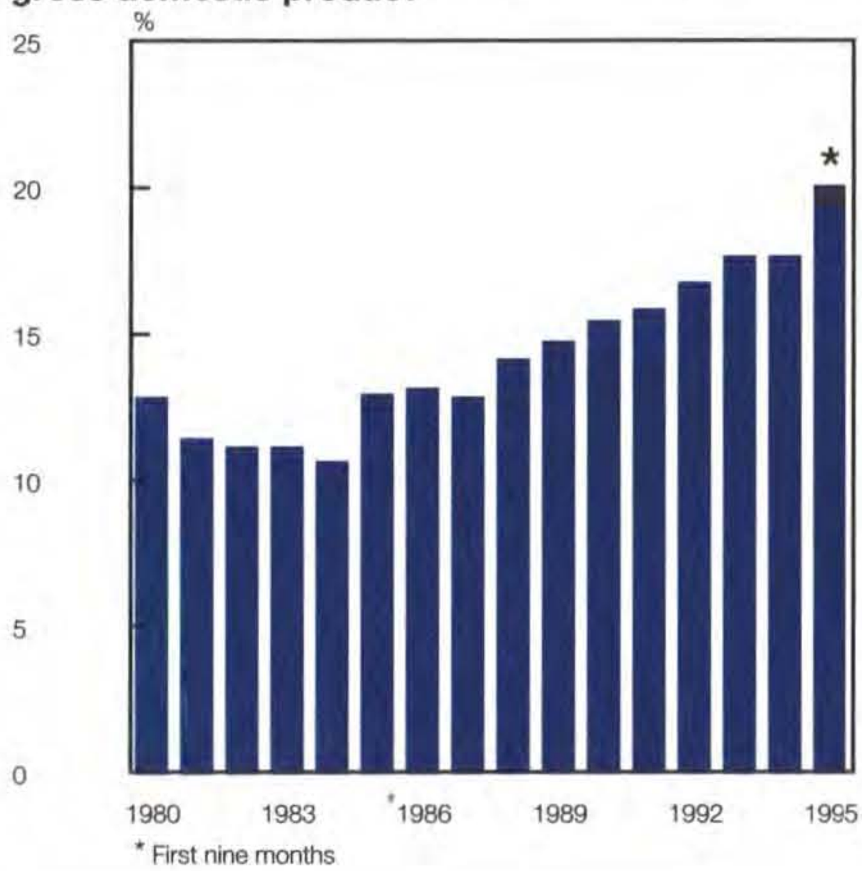


Table 5. Balance of payments on current account
Seasonally adjusted and annualised rates
R billions

	1994	1995		
	Year	1st qr	2nd qr	3rd qr
Merchandise exports	65,0	81,8	79,4	82,6
Net gold exports	22,6	20,0	19,3	23,3
Merchandise imports	-76,3	-94,4	-97,7	-101,4
Net service and transfer payments	-13,5	-15,2	-13,5	-16,0
Balance on current account	**-2,2**	**-7,8**	**-12,5**	**-11,5**

Real merchandise exports as percentage of gross domestic product



towards the export market. This relatively rapid export growth could be attributed to factors such as:

- the opening up of new international markets with more vigorous growth than the traditional outlets of South African exports;

- the gradual lifting of sanctions and trade embargoes against South Africa;

- the assistance received by exporters under the general export incentive scheme;

- the recent conclusion of various new multilateral and bilateral trade agreements;

- the low level of domestic economic activity and excess production capacity which existed during the larger part of this period and which encouraged domestic producers to find other outlets for their products;

- a decline in the nominal effective exchange rate of the rand, which more or less kept pace with the inflation differential between South Africa and its main trading partner countries; and

- the coming into production of certain manufacturing enterprises that were developed specifically for the export market.

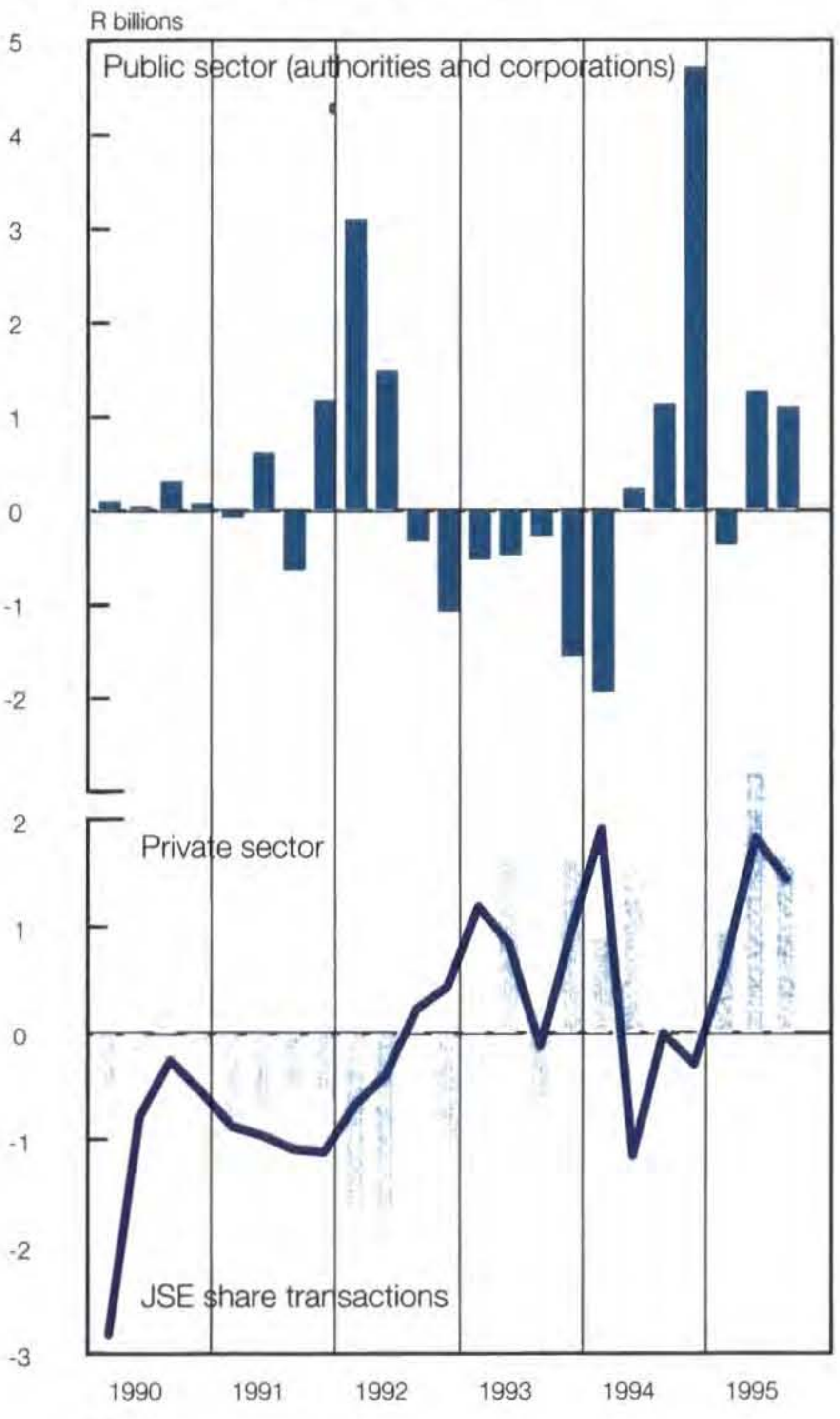
In the third quarter of 1995 the growth in merchandise exports was supported by a recovery in *net gold exports*. Following a continued decrease from a seasonally adjusted and annualised value of R24,8 billion in the third quarter of 1994 to R19,3 billion in the second quarter of 1995, the value of net gold exports rose to R23,3 billion in the third quarter. The increase of 21 per cent in gold exports in the third quarter of 1995 was almost entirely the result of a rise in the volume of gold exports. The relatively stable exchange rate of the rand and the dollar price of gold led to a small decline in the average gold price per fine ounce from R1 413 in the second quarter of 1995 to R1 402 in the third quarter.

These developments on the current account were counterbalanced somewhat by increases of 3,8 and 4,6 per cent respectively in the value and volume of *merchandise imports* in the third quarter of 1995. The rise in import volumes from the second to the third quarter of 1995 was primarily accounted for by increased imports of mineral products and machinery and electrical equipment. Import prices declined by about 1 per cent in the third quarter of 1995, following relatively moderate

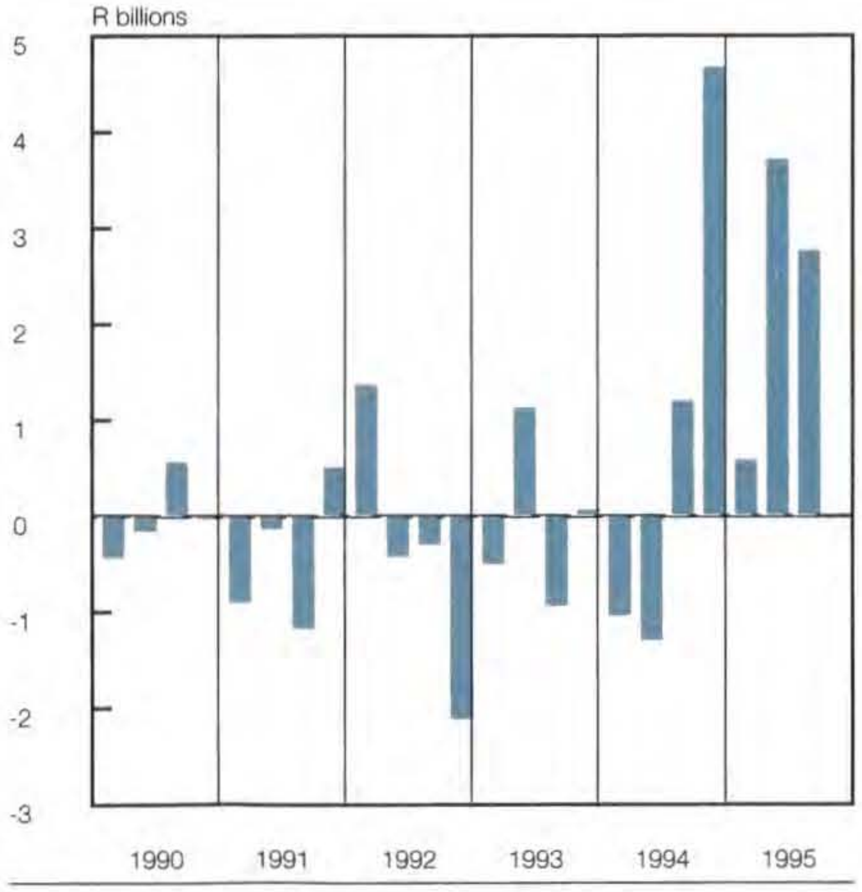
Table 6. Net capital movements not related to reserves
R billions

	1994	1995		
	Year	1st qr	2nd qr	3rd qr
Long-term capital				
Public authorities	3,5	-0,1	1,5	-
Public corporations	0,6	-0,3	-0,2	1,0
Private sector	-0,6	1,0	2,4	1,7
Total	**3,5**	**0,6**	**3,7**	**2,7**
Short-term capital	1,9	4,8	0,7	1,3
Total capital	**5,4**	**5,4**	**4,4**	**4,0**

Long-term capital movements



Total



increases of approximately 3 per cent in each of the preceding two quarters. Slightly higher international oil prices were more than offset by the increase in the nominal effective exchange rate of the rand.

Net service and transfer payments to non-residents (seasonally adjusted and annualised), which had dropped from R15,2 billion in the first quarter of 1995 to R13,5 billion in the second quarter, rose sharply to R16,0 billion in the third quarter. This increase was mainly caused by higher dividend payments on foreign investments, together with an increase in travel expenditures of South Africans in other countries.

Capital account

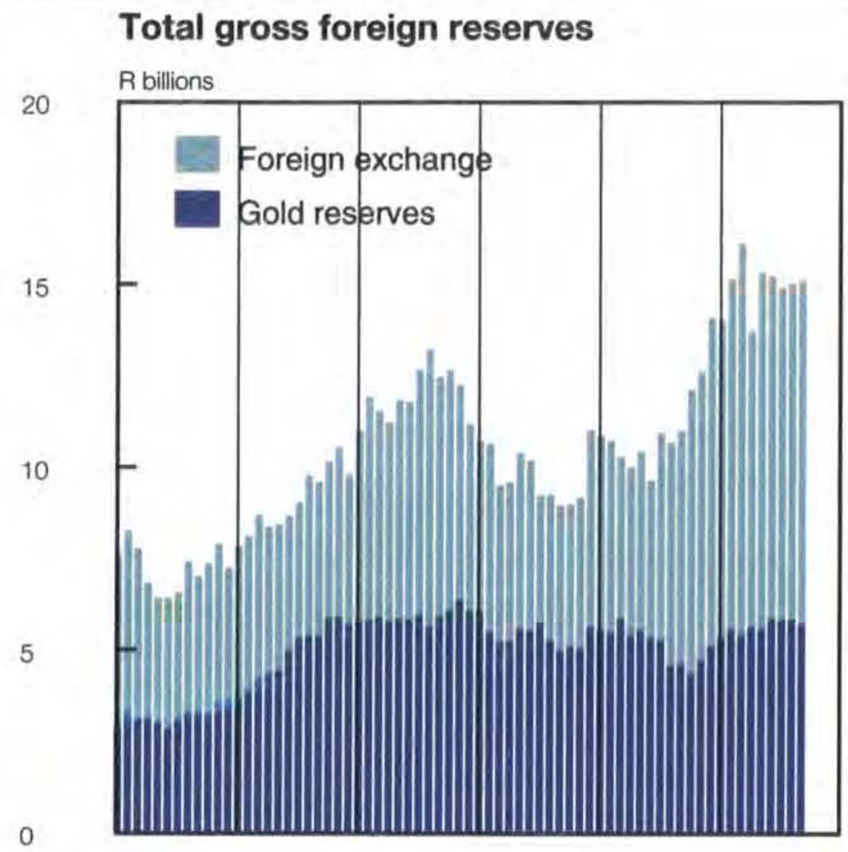
After a *total net capital inflow* had been experienced since the second half of 1994, a further net capital inflow of R4,0 billion was recorded in the third quarter of 1995. The total net capital inflow during the first nine months of 1995 therefore amounted to R13,8 billion and from the third quarter of 1994 to R22,8 billion.

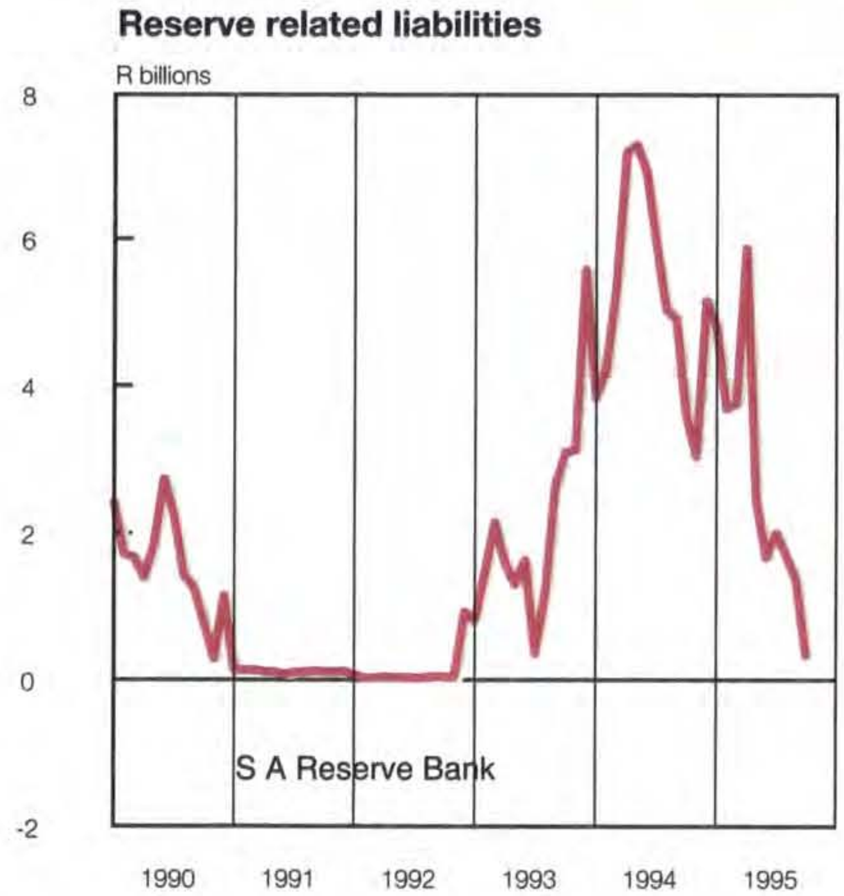
As had been the case in the preceding quarter, the net capital inflow in the third quarter of 1995 consisted mainly of *long-term capital* (i.e. funds with an original maturity of longer than one year). However, the net inflow of long-term capital contracted from R3,7 billion in the second quarter of 1995 to R2,7 billion in the third quarter. This sizable inflow of capital was mainly due to private-sector capital movements. More specifically, non-residents were net purchasers of securities on the Johannesburg Stock Exchange to the amount of R1,7 billion. Other long-term loans raised abroad by private-sector institutions exceeded their repayments on debt converted into long-term loans and on renegotiated debt in terms of the standstill arrangements negotiated with foreign creditor banks. In addition, public corporations were net importers of long-term loan capital to a net amount of R1,0 billion in the third quarter of 1995.

Net *short-term capital* movements not related to reserves, which had declined from an inflow of R4,8 billion in the first quarter of 1995 to R0,7 billion in the second quarter, increased again to R1,3 billion in the third quarter. This relatively large inflow of funds was mainly related to continued short-term borrowing of banks for the financing of their activities in view of the relatively tight conditions in the domestic money market. Contrary to these developments, the utilisation of short-term trade finance from abroad by the private sector changed around to a net outflow of capital. This development was probably related to the higher costs of forward cover charged by banks in the so-called "private" market from the middle of July 1995.

Foreign reserves

The net inflow of capital was more than enough to cover the deficit on the current account, with the result that the country's *net gold and other foreign reserves* rose by R0,5 billion in the third quarter. In the first nine months of





1995 the total net gold and other foreign reserves have therefore advanced by no less than R4,7 billion. In October 1995 the net gold and other foreign reserves of the Reserve Bank increased by R1,2 billion.

In view of this improvement in the overall balance of payments position, the South African Reserve Bank reduced its outstanding *foreign loans related to reserves* from R1,6 billion on 30 June 1995 to R1,4 billion at the end of September; at the end of October 1995 the outstanding amount on these loans came to only R0,3 billion. In addition to this amount, the country owes R3,4 billion to the International Monetary Fund, which is also classified as a reserve-related loan.

The country's *gross gold and other foreign reserves* declined by R83 million in the third quarter of 1995 to a level of R15,2 billion at the end of September 1995. These foreign reserves were equal to almost six weeks' imports of goods and services. The Reserve Bank's gross gold and other foreign reserves rose by R172 million in October 1995 to R12,0 billion at the end of the month. The Bank also continued to reduce its gold holdings over the four months to October 1995: the gold reserves have now shrunk from 4,76 million fine ounces at the end of December 1993 to 4,44 million fine ounces at the end of October 1995. As a proportion of the total foreign reserves, the gold component dropped from 51 per cent to 37 per cent over the same period.

The market in foreign exchange

As a result of the further normalisation of South Africa's international financial relations and the substantial expansion of trade and capital flows with the rest of the world, the average net *daily turnover* in foreign exchange (purchases and sales in the six main currencies in the spot and forward market, adjusted for double-counting arising from local interbank business) increased sharply from US$4,0 billion in the fourth quarter of 1994 to $4,9 billion in the second quarter of 1995 and $5,2 billion in the third quarter. This substantial rise in activity occurred in both the spot and forward exchange market.

Following the measures introduced by the authorities on 13 July 1995 as part of the gradual relaxation of exchange controls applicable to residents and the relatively stable performance of the external value of the rand, the composition of the transactions in the *forward exchange market* changed quite significantly. On that date it was announced that the Reserve Bank would only provide short-term forward cover to authorised dealers against documentary evidence of off-shore finance and that the Bank would leave the development of the so-called private forward exchange market to exporters and importers in conjunction with authorised exchange dealers. In practice this decision had three important consequences, namely:

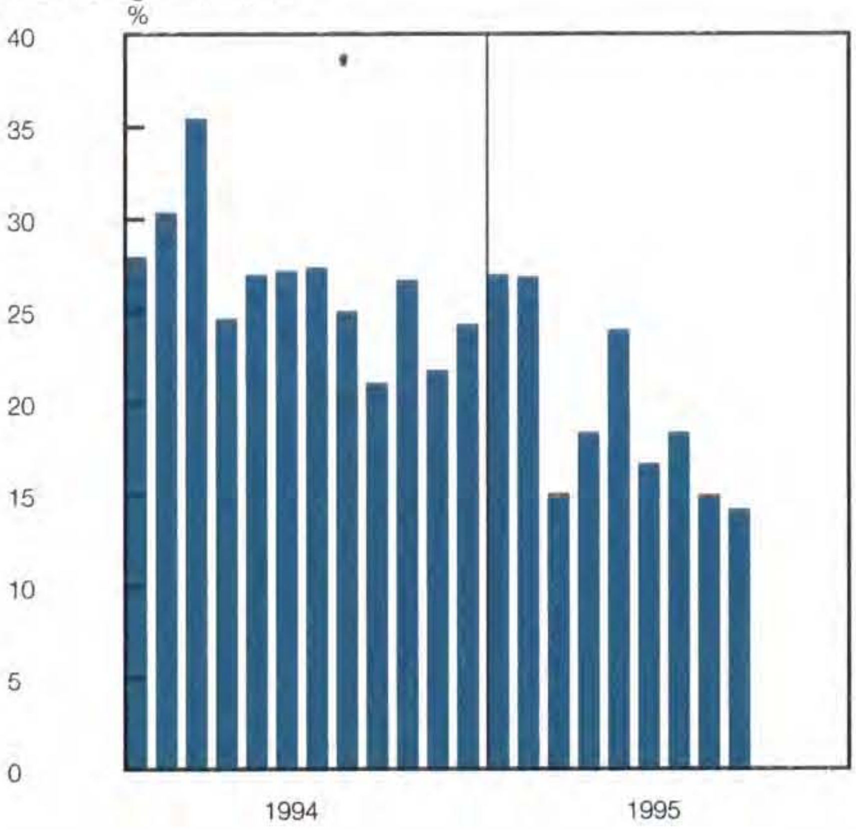
– Firstly, the premium quoted on forward exchange transactions in the "private" market rose above that at which the Reserve Bank provides forward cover.

– Secondly, the share of the Reserve Bank in total forward transactions declined sharply from 18,4 per cent in July 1995 to 14,2 per cent in September 1995.

– Thirdly, the net oversold short-term forward book of the Reserve Bank declined by $5,7 billion from the end of March 1995 to the end of November 1995.

Considerable success was also achieved by the other measure to relax exchange control announced at the

The Reserve Bank's share in the forward exchange market



same time, namely the decision that insurance companies, pension funds and unit trusts would be allowed to undertake foreign investments by way of *swap arrangements* with foreign investors that provide for the exchange of part of these institutions' existing asset portfolio for foreign assets. In the period since this decision was taken on 13 July 1995 up to the middle of November 1995 the Reserve Bank has approved asset swaps to the amount of R5,6 billion. These transactions have allowed institutional investors to diversify their portfolios without any net loss of foreign exchange reserves to the country.

The continued improvement in the overall balance of payments position of the country led to a strengthening of the *nominal effective exchange rate* of the rand by 1,8 per cent during the third quarter of 1995 and by a further 0,4 per cent to the end of October 1995. If the Reserve Bank had not intervened by purchasing dollars in the market, the external value of the rand would have appreciated even more. The rise in the nominal exchange rate of the rand over this period countered the decline in the previous period to some extent, resulting in a net decline of 4,2 per cent in the nominal effective exchange rate of the rand in the first ten months of 1995; in 1994 as a whole, the nominal weighted average value of the rand had decreased by 8,5 per cent.

The relatively stable but slightly upward movement of the rand in the four-month period from July to October 1995 was characterised by marginal appreciations against most of the currencies of South Africa's main trading partner countries, except the US dollar and Italian lira. Strong intervention by the Bank of Japan, supported by the Federal Reserve Bank of New York and the Bundesbank, caused the Japanese yen to depreciate against the US dollar. The exchange rate of the rand therefore appreciated by no less than 20 per cent against the yen from the end of June 1995 to the end of October 1995.

The *real effective exchange rate* of the rand increased by about 3½ per cent from June 1995 to August 1995. This more or less cancelled out the decline in this index during the first six months of 1995, with the result that the real effective exchange rate in August was virtually equal to the level reached in December 1994.

Monetary developments, interest rates and financial markets

Money supply

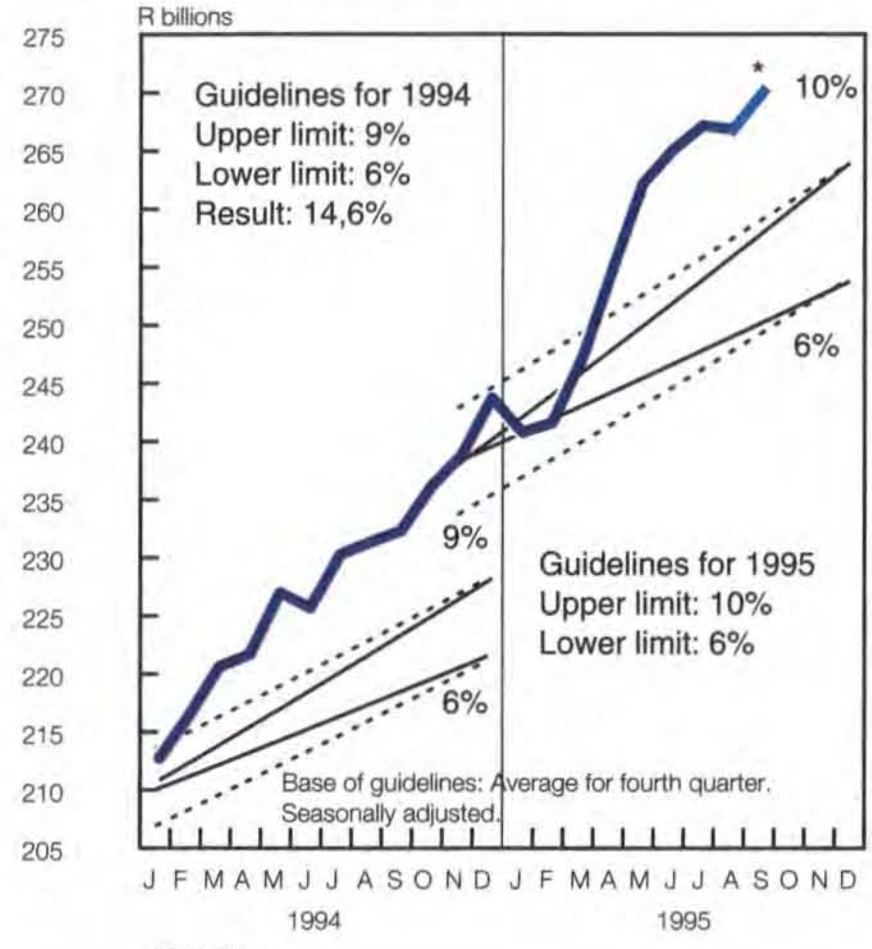
The twelve-month rate of increase in the *broadly defined money supply (M3),* which had accelerated from a lower turning-point of 11,8 per cent in February 1995 to 16,8 per cent in June, remained on this high level and receded only slightly to 16,1 per cent in September 1995. As a result of this rapid growth, the seasonally adjusted monthly values of M3 were above the upper limits of the guideline range from March 1995. In September 1995 the seasonally adjusted value of M3 was R11,6 billion or 4,5 per cent higher than the value of the upper limit of the guideline "cone". The growth in the seasonally adjusted value of M3, at an annualised rate and measured from the base of the guideline year, came to 15,7 per cent in September; this was considerably higher than the upper limit of the guideline range of 10 per cent, which took into account the expected higher real economic growth in South Africa and a reduction in the rate of inflation.

Although this rapid growth in the money supply was primarily brought about by the higher level of economic activity in 1995 as reflected in the high rate of increase in expenditure on consumption, investment and inventory accumulation, other developments in the financial markets probably also contributed to this increase in M3. In 1995 the liquidity preference of the private sector rose strongly because of expected interest rate changes and major adjustments in the share and bond markets. This was reflected in an increase in the deposits of insurers and pension funds with banks from R16,8 billion at the end of December 1994 to R21,1 billion at the end of September 1995. Over this same period banks became increasingly involved in the management of assets for third parties, which contributed to an increase in the banks' issues of negotiable certificates of deposits (included in the money supply) from R28 billion to R50 billion. To the extent that these activities did not merely represent a shift in the deposits between private-sector parties, they also contributed to the rise in the money supply.

Table 7. Percentage change in money supply over twelve months

Period		M1A	M1	M2	M3
1994:	Dec	24,8	23,7	20,6	15,7
1995:	Jan	14,8	13,8	17,0	13,0
	Feb	7,1	12,2	13,6	11,8
	Mar	6,6	10,4	12,6	12,2
	Apr	11,6	9,4	15,8	14,9
	May	11,3	7,3	15,6	15,9
	Jun	17,0	7,8	15,6	16,8
	Jul	15,1	7,2	13,1	15,8
	Aug	11,6	9,2	10,3	15,1
	Sept	12,9	12,7	11,5	16,1

Guidelines for growth in M3



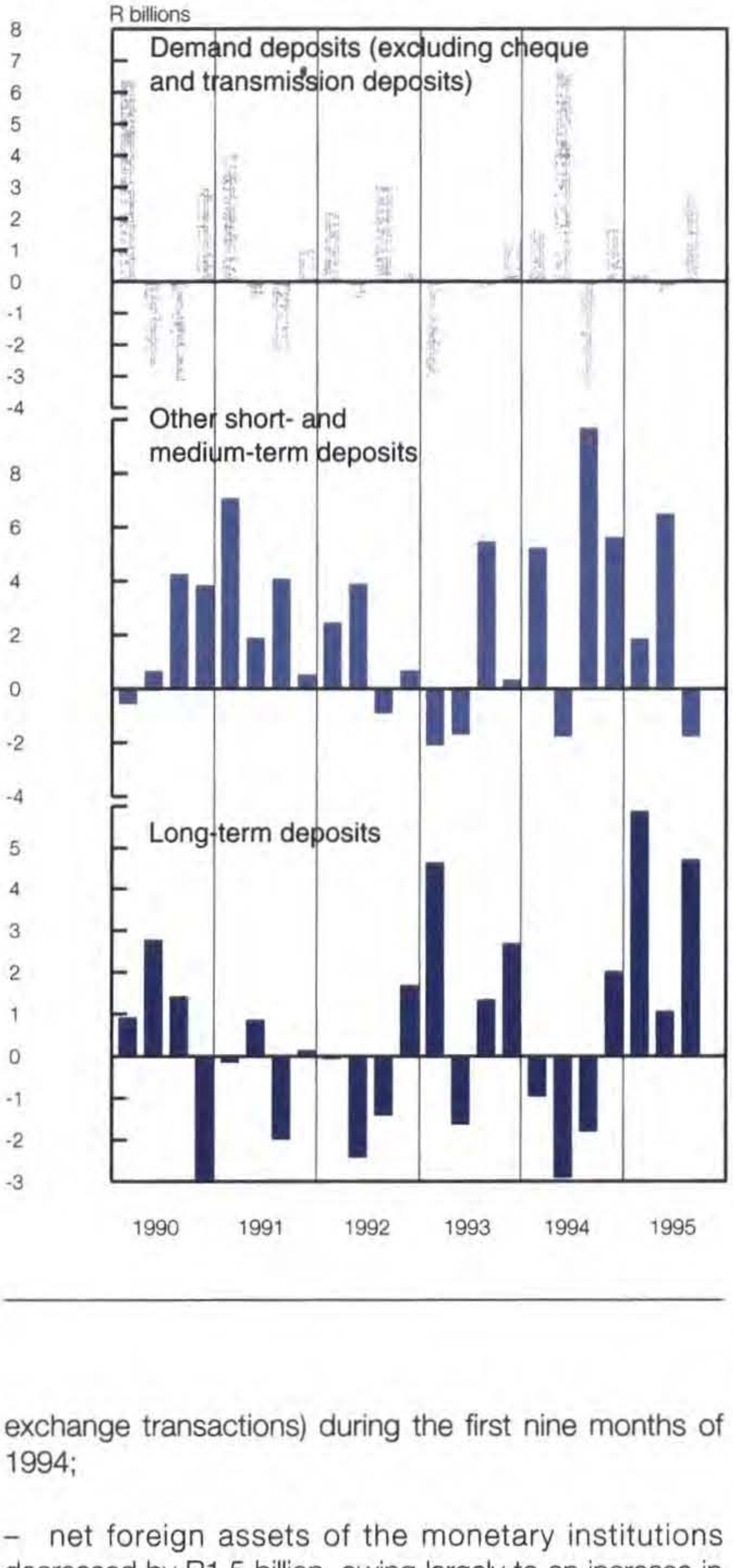
The growth rates in the *narrower monetary aggregates,* with the notable exception of M1, had a more or less similar growth pattern, but reached considerably lower levels than the rate of increase in M3. The twelve-month rate of increase in M1 continued to decline from a peak of no less than 32,7 per cent in July 1994 to a low level of 7,2 per cent in July 1995, before increasing again to 12,7 per cent in September. The relatively faster growth in M3 than in the narrower monetary aggregates in the third quarter of 1995 was due to a shift from shorter-term deposits to long-term deposits with the monetary sector, particularly when expectations of an imminent decline in long-term interest rates began to build up during the third quarter.

In a statistical or accounting sense, the behaviour of the *main counterparts* of M3 varied considerably in the first nine months of 1995:

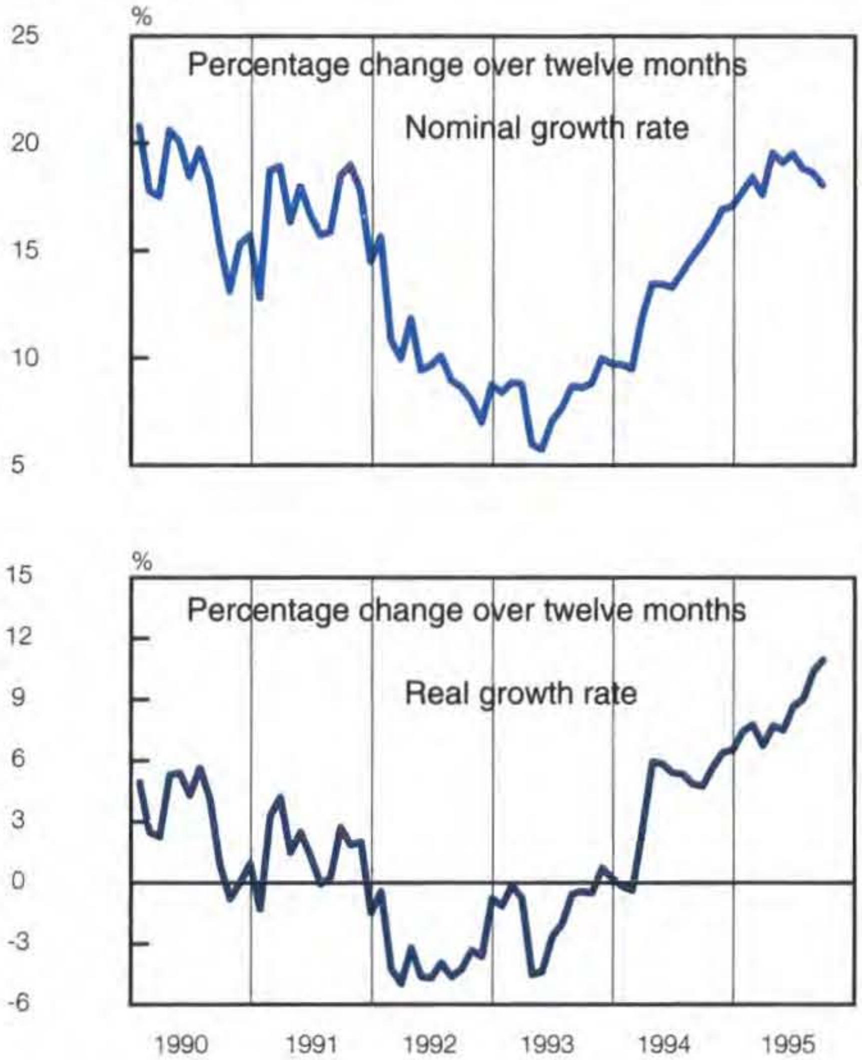
- claims on the private sector dominated the overall position and increased by no less than R32,4 billion, i.e. by more than the increase of R25,3 billion in M3;

- net claims on the government sector decreased by R6,4 billion, compared with an increase of R6,1 billion (excluding the special government stock issued to the Reserve Bank as compensation for the deficit on foreign

Changes in components of M3



Credit extension by monetary institutions to private sector



exchange transactions) during the first nine months of 1994;

- net foreign assets of the monetary institutions decreased by R1,5 billion, owing largely to an increase in the short-term liabilities of private banks outstanding to non-residents; and

- so-called "net other assets and liabilities" increased moderately by R0,8 billion.

Credit extension

The rate of increase over twelve months in *total domestic credit extension* of the monetary sector (i.e. credit extended to the private sector and net claims on the government sector) rose from a low of 13,0 per cent in March 1995 to 15,7 per cent in July 1995, but declined again to 12,3 per cent in September 1995. A temporary increase in the monetary institutions' net claims on the *government sector* from R13,4 billion in March 1995 to R20,4 billion in May contributed to the acceleration in the growth of total credit extension, but these net claims subsequently contracted again to R9,1 billion in September 1995.

Boosted by a strengthening in consumer confidence after the peaceful outcome of the political transition and the general improvement in economic conditions, the twelve-month growth rate in the credit extension of monetary institutions to the *private sector* rose further from 18,0 per cent in December 1994 to 19,5 per cent in June 1995; it then receded somewhat to 18,0 per cent in September 1995. These monthly growth rates exceeded the rate of inflation as measured by changes in the consumer price index, and the twelve-month rate of increase in real credit extension to the private sector amounted to 10,9 per cent in September 1995.

An analysis of monetary institutions' claims on the private sector by *type of credit* shows that about 88 per cent of the increase in credit extension to the private sector during the third quarter of 1995 consisted of increases in mortgage advances, overdrafts and other loans and advances, and instalment sales credit. Factors that favoured the high growth in these types of credit included the relatively low capital requirements and credit risk of mortgage advances, the flexibility of mortgage schemes, the comparatively low interest rates on mortgage advances, a sharp increase in expenditure on consumer durables (particularly purchases of new and used motor vehicles) and the preference of many business enterprises for overdraft facilities when in need of bridging finance.

Interest rates and yields

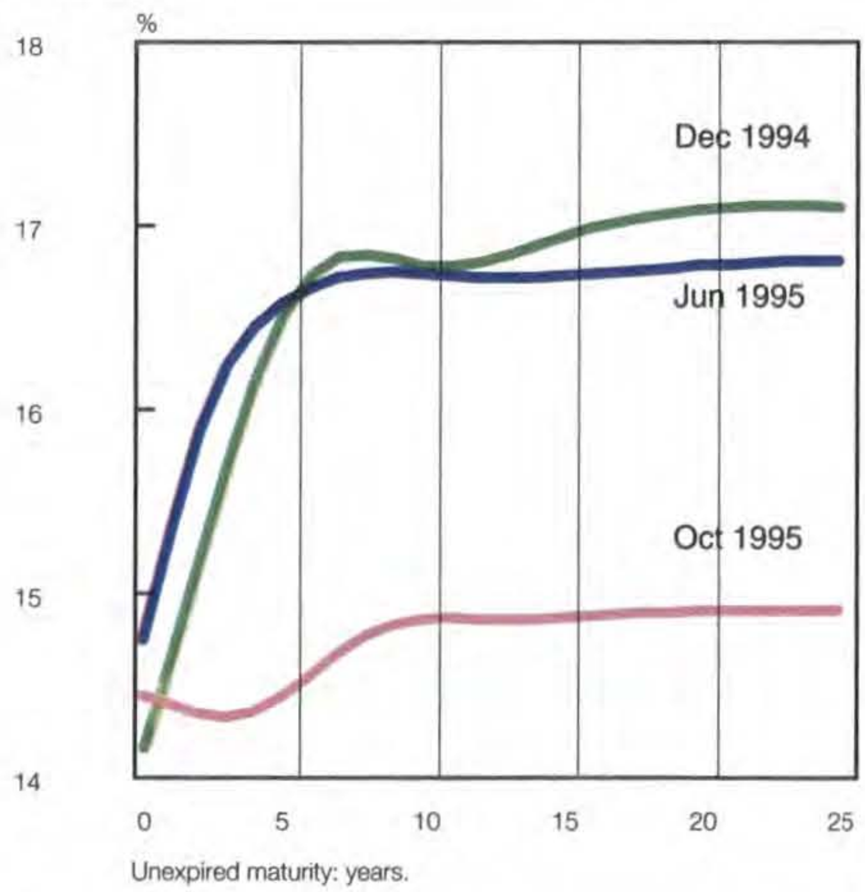
The interest rate structure, as embodied in the *yield curve,* changed considerably during the course of 1995. Long-term yields remained fairly stable in the first six months of 1995, while short-term yields firmed further. The yield curve accordingly remained on a high level, and although the curve flattened somewhat, it was still fairly steep over the first five years of the maturity spectrum. In the next four months long-term yields moved downwards more rapidly than short-term rates; the yield curve at the end of October 1995 was therefore not only altogether markedly lower than at the beginning of the year, but also relatively flat. This clearly reflected changed expectations of investors regarding the future stance of monetary policy and the rate of inflation. Bond yields across the maturity spectrum moved even lower at the beginning of November 1995, with declines in longer yields once again exceeding those in shorter yields.

The yield on short-term *government stock* fluctuated upwards from 15,78 per cent at the end of December 1994 to 15,98 per cent at the end of June 1995 before softening to 14,24 per cent at the end of October. In contrast to these changes, the yield on long-term government stock declined somewhat from 17,0 per cent at the end of December 1994 to 16,74 per cent at the end of June and then dropped to 14,90 per cent at the end of October 1995. *On balance*, the yield on short-term stock declined by 154 basis points in the first ten months of 1995, while the yield on long-term government stock declined by 210 basis points.

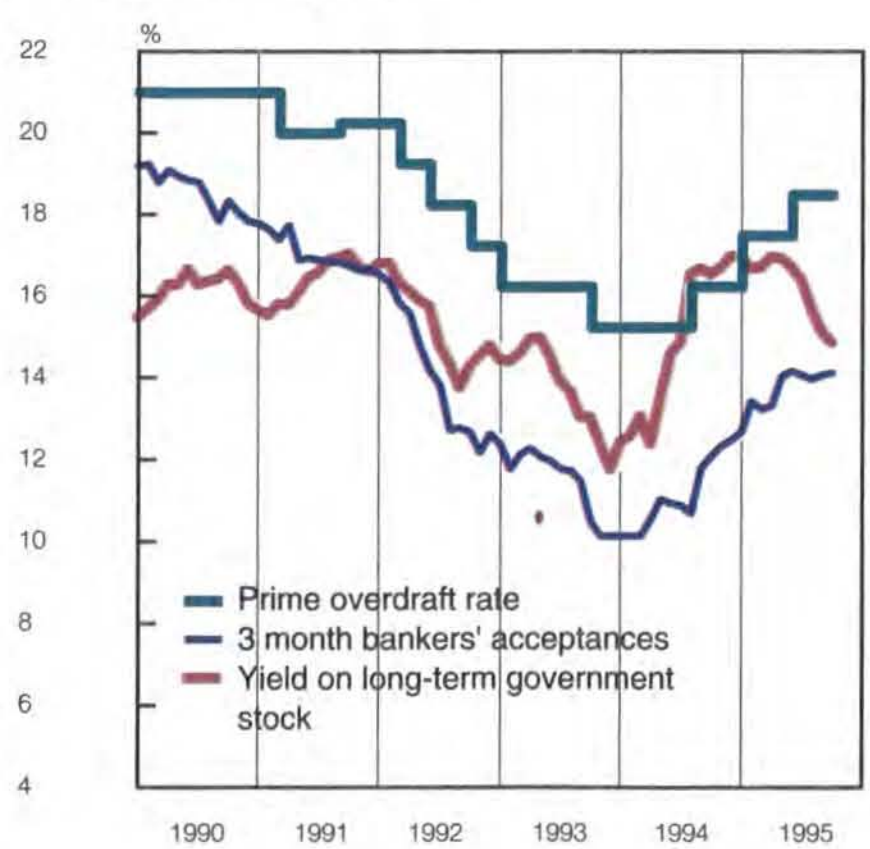
Money market interest rates, which had firmed substantially during the first half of 1995, remained more or less on these higher levels until the end of October 1995. The rate on bankers' acceptances with a maturity of three months, for instance, increased from 12,50 per cent at the end of December 1994 to 14,20 per cent at the end of June 1995, and then declined marginally to 14,15 per cent at the end of October 1995. The tender rate on Treasury bills of three months also rose sharply from 12,69 per cent to 14,07 per cent in the first six months of 1995, but then declined more distinctly to 13,68 per cent at the end of October 1995.

The *other borrowing and lending rates* of banks have remained relatively stable since June 1995. The prime overdraft rate of banks, which had been increased in two steps in close adherence to Bank rate changes from 16,25 per cent at the beginning of 1995 to 18,50 per cent on 3 July 1995, remained at this level in the ensuing period. Similarly, the rate on mortgage loans has been maintained at 18,25 per cent since July 1995 and the predominant rate on twelve-month fixed deposits with banks at 14,50 per cent since June 1995. In view of the decline in the inflation rate, real interest rate levels, however, moved sharply upwards. For example, the real prime lending rate (i.e. the nominal prime rate adjusted by

Yield curves



Interest rates and yields



the increase in the consumer price index over twelve months) rose from 6,8 per cent in June 1995 to 11,4 per cent in September.

The maximum rates laid down in terms of the Usury Act were increased by three percentage points during the first ten months of 1995 and at the end of October 1995 stood at 31,0 per cent in respect of money lending, credit and leasing transactions for amounts of less than R6 000, and at 28 per cent for amounts of more than R6 000 but not exceeding R500 000.

Money market

Money market conditions, which had eased during the three months up to the end of July 1995, tightened considerably in the ensuing three months. This was clearly reflected in the amount of accommodation that the Reserve Bank provided to banks, which increased from R3,2 billion at the end of July 1995 to R7,4 billion at the end of October. These tighter conditions forced banks into the second tier of accommodation with the Reserve Bank towards the end of October and at the beginning of November, with a concomitant effect on interest rates because of the higher costs of such accommodation.

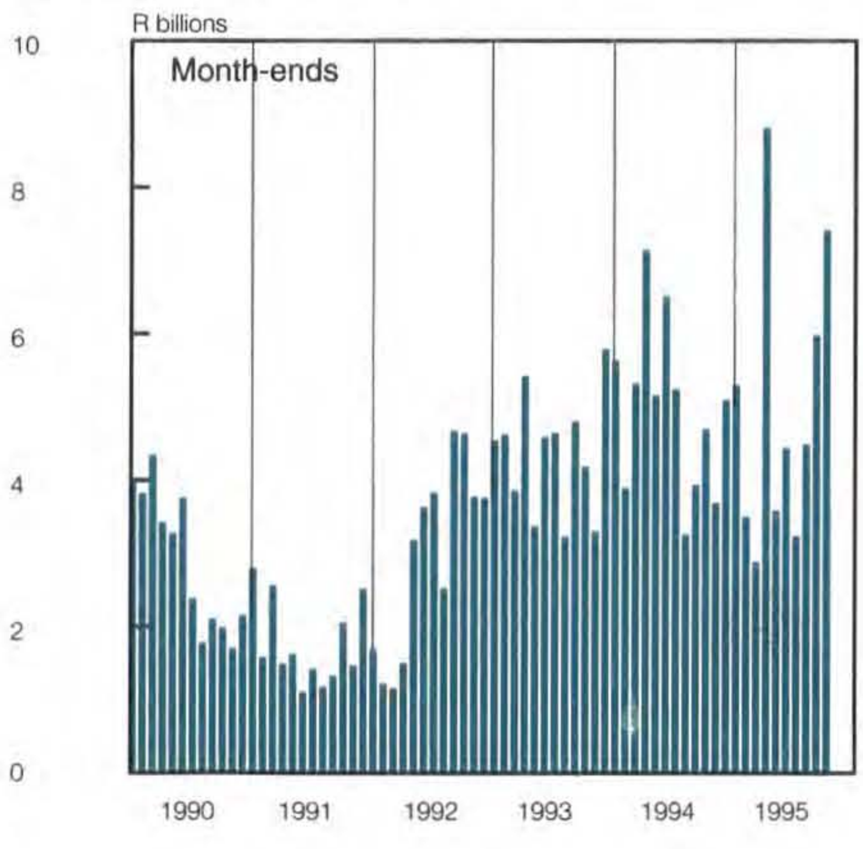
These tight money market conditions could be attributed mainly to a substantial increase in government deposits with the Reserve Bank, which rose from R3,9 billion at the end of July 1995 to R4,5 billion at the end of September and more sharply to R5,8 billion at the end of October. The tightening effect of these changes was supported by an increase in notes and coin in circulation outside the Reserve Bank and a decrease in the net foreign assets of the Reserve Bank during August and September. However, in October 1995 the net foreign assets of the Reserve Bank increased sharply again and contributed to money market liquidity.

The *Reserve Bank's operations* in the money market concentrated mainly on measures to drain liquidity and to maintain relatively tight conditions. The Bank accordingly not only sold government stock on tap to the public in amounts that exceeded the immediate funding needs of the government sector and led to a rise in government deposits, but also undertook open-market sales from its own policy portfolio with a net tightening effect on money market conditions to an amount of R1,9 billion from September to November 1995. Short-term adjustments were also made in the asset portfolio of the Corporation for Public Deposits, and government deposits with the Reserve Bank were managed in such a way as to counter large fluctuations in the money market shortage.

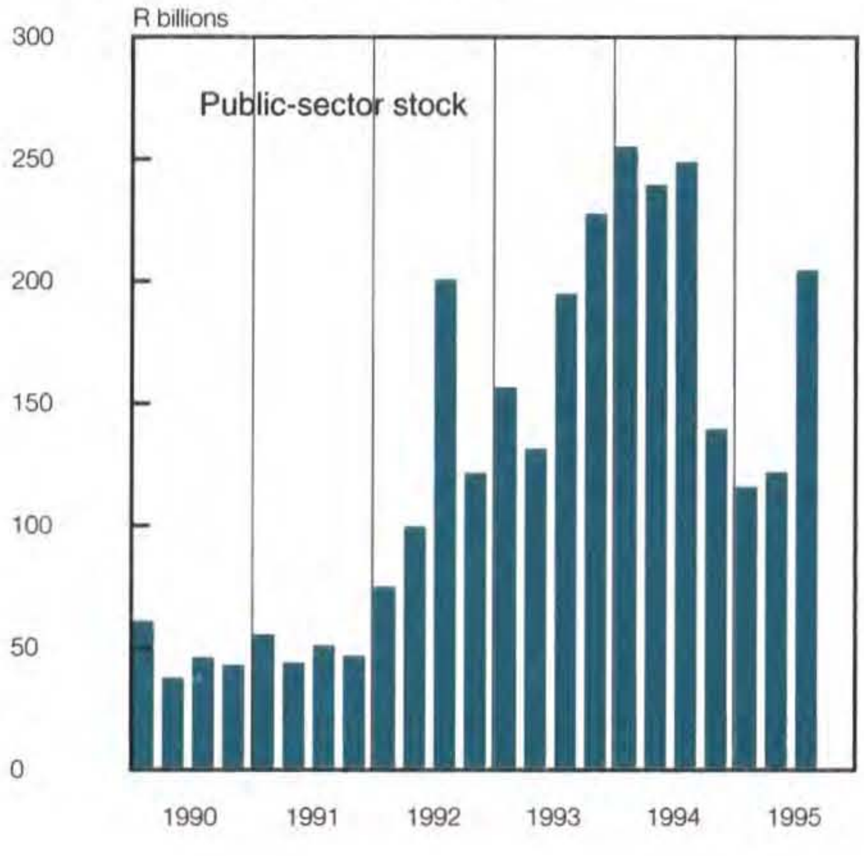
Bond market

Activity in the *domestic primary bond market* in the third quarter of 1995 was dominated by issues of borrowers in the *public sector*. As interest rates softened and conditions became more conducive to the marketing of such instruments, net new issues of fixed-interest securities by the public sector rose from R9,5 billion in the second quarter of 1995 to R10,0 billion in the third quarter. These issues accordingly amounted to R19,5 billion in the first six months of fiscal 1995/96; in the

Accommodation at the discount window



Stock exchange transactions



corresponding period of the preceding year R11,2 billion was raised in this manner.

In the light of the high liquidity of the corporate sector, the relatively high cost of domestic borrowing and the availability of funds from abroad, the funds raised by listed *private-sector* companies through new issues of fixed-interest securities (including convertible preference shares, debentures and corporate bonds) remained low. In the first nine months of 1995 the value of such issues by companies on the stock exchange nevertheless amounted to R972 million, which was significantly higher than the R76 million in the corresponding period of 1994.

Issues in the domestic market were supplemented by issues in the *international bond market*. The government made an issue of R1,3 billion (¥30 billion) in the so-called Samurai market in May 1995, and a number of companies in the private sector raised a total of R1,5 billion in foreign markets by means of convertible bonds in the first nine months of 1995. As already indicated, the asset swap scheme introduced by the Reserve Bank in July 1995 was also very popular and opened up international investment opportunities for South African institutional investors.

Activity in the *secondary bond market* increased markedly in the third quarter of 1995 as yields began to drop after ten months of little movement in long-term rates. The value of stock traded on the Johannesburg Stock Exchange rose from a relatively low R122 billion in the second quarter of 1995 to R205 billion in the third quarter. However, the value of these securities transactions receded to R442 billion in the first nine months of 1995, which was much lower than the R743 billion in the corresponding period of the preceding year.

Non-residents were actively involved in the secondary bond market and became relatively large net purchasers of stock from April 1995 after it had become clear that the abolition of the dual exchange rate system was reconcilable with a stable external value of the rand. The net purchases of bonds by non-residents reached R1,7 billion in the seven months up to October 1995.

The *Reserve Bank's* role in the secondary market for government stock was reduced further during 1995, mainly because of the Bank's declared intention to withdraw from small or "retail" transactions. Gross sales of government stock by the Bank amounted to only R82 billion in the first ten months of 1995, compared with R147 billion in the corresponding period of 1994. The Reserve Bank's trading in government stock options also contracted from a monthly average of R7,5 billion in the first ten months of 1994 to R5,5 billion in the first ten months of 1995.

Non-residents' net transactions on the stock exchange

Equity market

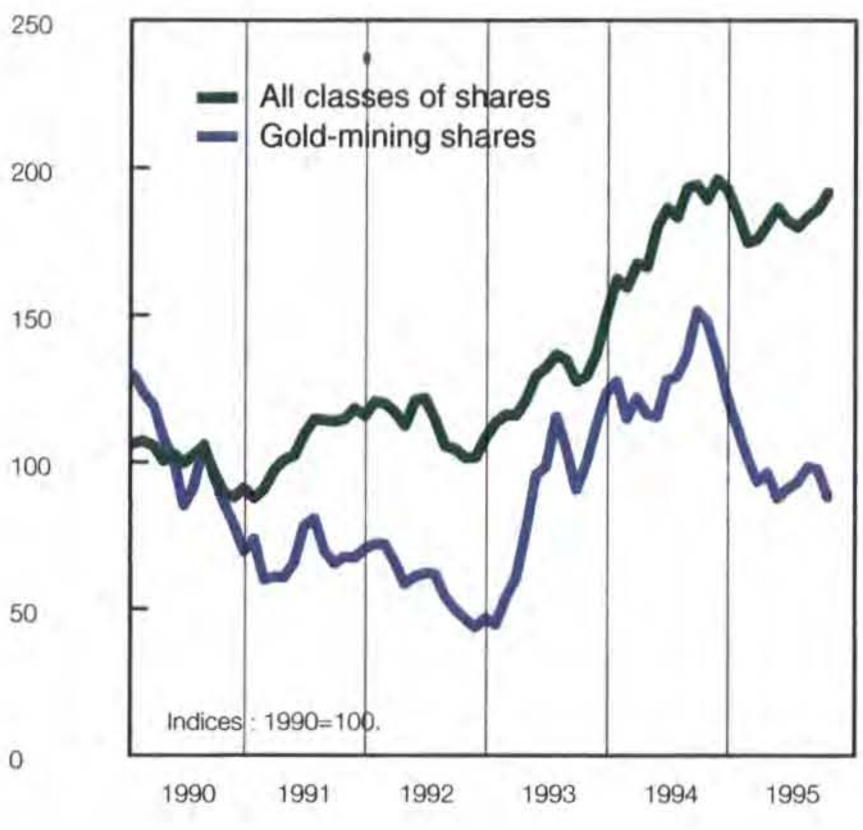
The demand for funds in the *primary equity market* showed a distinct downward tendency in the first nine months of 1995. The value of rights issues of ordinary shares decreased from R2,3 billion in the first quarter of 1995 to R1,6 billion in the second quarter and R1,2 billion in the third quarter. However, in the first nine months of 1995 the value of these issues nevertheless was R5,1 billion; in the corresponding period of the preceding year the rights issues of ordinary shares came to only R2,4 billion.

In the *secondary equity market,* the value of shares traded on the Johannesburg Stock Exchange rose from a lower turning-point of R13,3 billion in the first quarter of 1995 to R14,7 billion and R15,8 billion in the next two quarters. The value of shares traded increased further from a monthly average of R5,3 billion in the third quarter of 1995 to R6,1 billion in October. In spite of this upward movement, the value of these transactions in the first ten months of 1995 was 18,2 per cent below the level in the same period of the preceding year.

Non-residents were active participants in the secondary equity market as net buyers of shares from January 1995. Their net purchases of equities totalled R4,2 billion in the first ten months of 1995. As a ratio of the total value of shares traded on the Johannesburg Stock Exchange, non-residents' gross purchases of shares increased from 31,3 per cent in 1994 to 39,7 per cent in the first ten months of 1995.

The average *price level of all classes of shares* rose gradually from a lower turning-point in February 1995 up to October. This upward correction of 9,7 per cent was led by industrial shares and was supported by continued strength on the main international bourses. After having contracted sharply from September 1994 to May 1995, the prices of gold-mining shares recovered somewhat in the next four months, but

Share prices



declined again in October. The level of the prices of gold-mining shares in October 1995 was nevertheless 41,7 per cent below the high of September 1994, while the average price level of all classes of shares was only 2,3 per cent lower than the upper turning-point in November 1994.

Mirroring these share price changes, the average *dividend and earnings yield* on shares fluctuated upwards from January 1995. Share prices (excluding gold-mining shares) rose less rapidly than earnings in the first ten months of 1995, with the result that the *price-earnings ratio* declined. Owing to the marked decline in long-term yields, the *yield gap* (long-term bond yield less the dividend yield on all classes of shares) contracted sharply in the first ten months of 1995.

Other financial markets

The relatively stable conditions in the equity, bond and foreign-exchange markets and a greater wariness of futures transactions in the wake of the Barings incident continued to dampen the activity on the *South African Futures Exchange*. After having reached an all-time high of 1,4 million contracts in the first quarter of 1995, turnover in the derivative market for equity futures fell back to 0,7 million and 0,6 million contracts in the next two quarters. Trade in options on equity futures contracts followed a similar pattern and declined from 1,5 million contracts in the first quarter of 1995 to 0,5 million contracts in the third quarter. In October 1995 the trade in both these kinds of instruments began to pick up again.

Various new futures contracts were introduced recently. In the already dominant equity futures, the financial and industrial index futures contract (FNDI) started to trade on 9 October 1995. This contract is settled in cash and is based on the Johannesburg Stock Exchange Actuaries' top thirty financial and industrial index. In the commodity futures market, beef contracts based on physical delivery, have been traded since 31 July 1995. Potato (spud) cash-settled contracts started trading on 16 October 1995.

In the *real estate market* the value of transactions, which had increased from R7,8 billion in the first quarter of 1995 to R8,2 billion in the second quarter, receded to R7,7 billion in the third quarter. The value of real estate transactions in the first nine months of 1995 totalled R23,7 billion, which was 5,2 per cent higher than in the corresponding period of the preceding year. The number of transactions in real estate increased by only 0,3 per cent over this period.

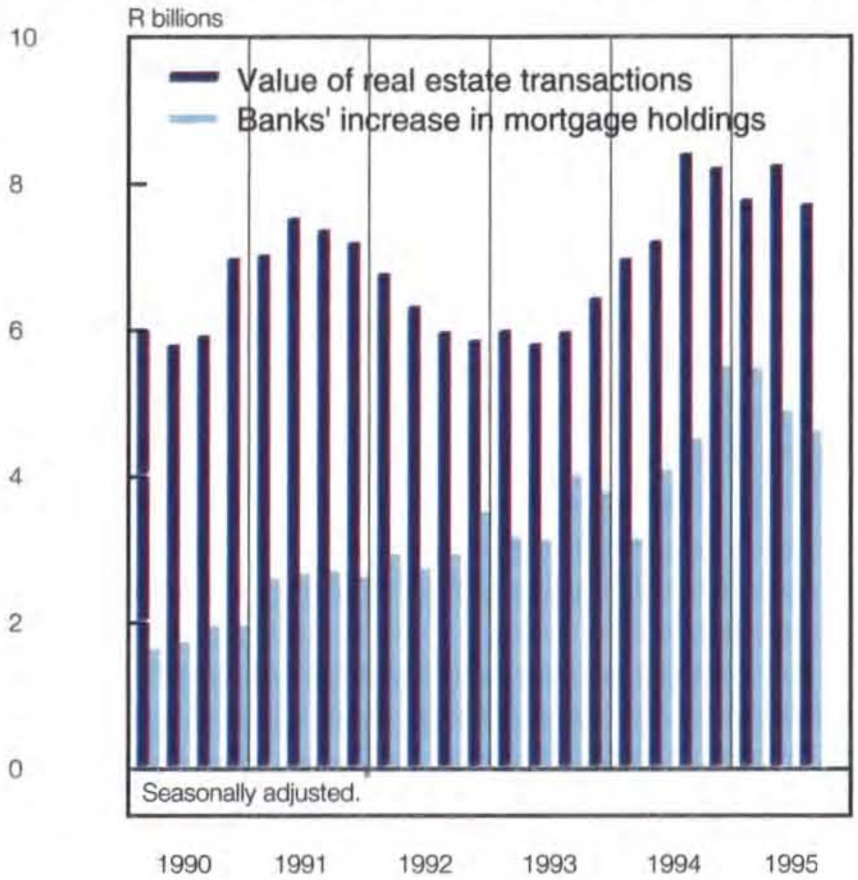
Financing in the *mortgage market* remained at high levels in the first nine months of 1995. The rate of increase over twelve months in mortgage advances

Table 8. Dividend yield, earnings yield, price-earnings ratio and yield gap on all classes of shares

Period	Dividend yield Per cent	Earnings yield* Per cent	Price-earnings ratio*	Yield gap Percentage points
1993: Dec	2,53	5,95	16,81	9,81
1994: Jun	2,14	5,08	19,69	12,32
Sept	2,12	5,09	19,65	14,77
Dec	2,19	5,27	18,97	14,61
1995: Mar	2,50	5,95	16,80	14,22
Jun	2,44	5,94	16,84	14,34
Sept	2,51	6,31	15,85	12,98
Oct	2,42	6,10	16,38	12,73

* Excluding gold-mining shares

Real estate transactions and mortgage holdings



continued to fluctuate around 19 per cent in this period. This exceptional activity in mortgage lending was to a large extent due to the active promotion by banks of this credit facility. The flexibility of some of the mortgage schemes and the comparatively low cost of mortgage advances, have caused these accounts to be used increasingly by many borrowers to finance purchases of durable and other consumer goods.

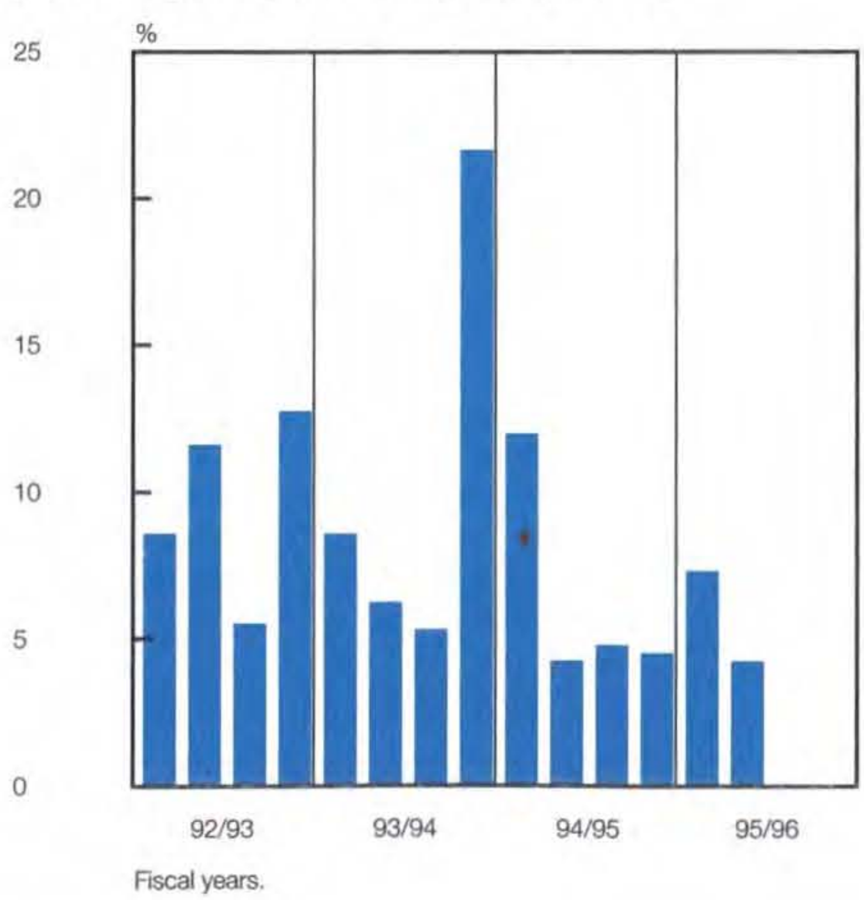
Public finance

Public-sector borrowing requirement

In accordance with its normal seasonal pattern, the *public-sector borrowing* requirement (i.e. the deficit before borrowing and debt repayment of the consolidated Central Government, provincial governments, local authorities and the non-financial public enterprises) narrowed from R8,6 billion in the first quarter of fiscal 1995/96 (April to June 1995) to R5,3 billion in the second quarter. This brought the public-sector borrowing requirement to R13,9 billion in the first six months of fiscal 1995/96, which was considerably lower than the deficit of R17,4 billion in the corresponding period of fiscal 1994/95. As a ratio of gross domestic product, the public-sector borrowing requirement receded from 8,0 per cent to 5,7 per cent over the same period.

The improvement in the borrowing requirement of the public sector in the first six months of fiscal 1995/96 could be attributed to a small increase in the surplus of the non-financial public corporations and a substantial decline in the borrowing requirement of general government. It was, in particular, related to a turnaround from a deficit to a surplus on the income and expenditure accounts of provincial governments, because of teething problems experienced by some of these governments in fulfilling all their functions in terms of the interim constitution. This restrained the growth in their expenditure, while their income (consisting mainly of

Public-sector borrowing requirement as percentage of gross domestic product

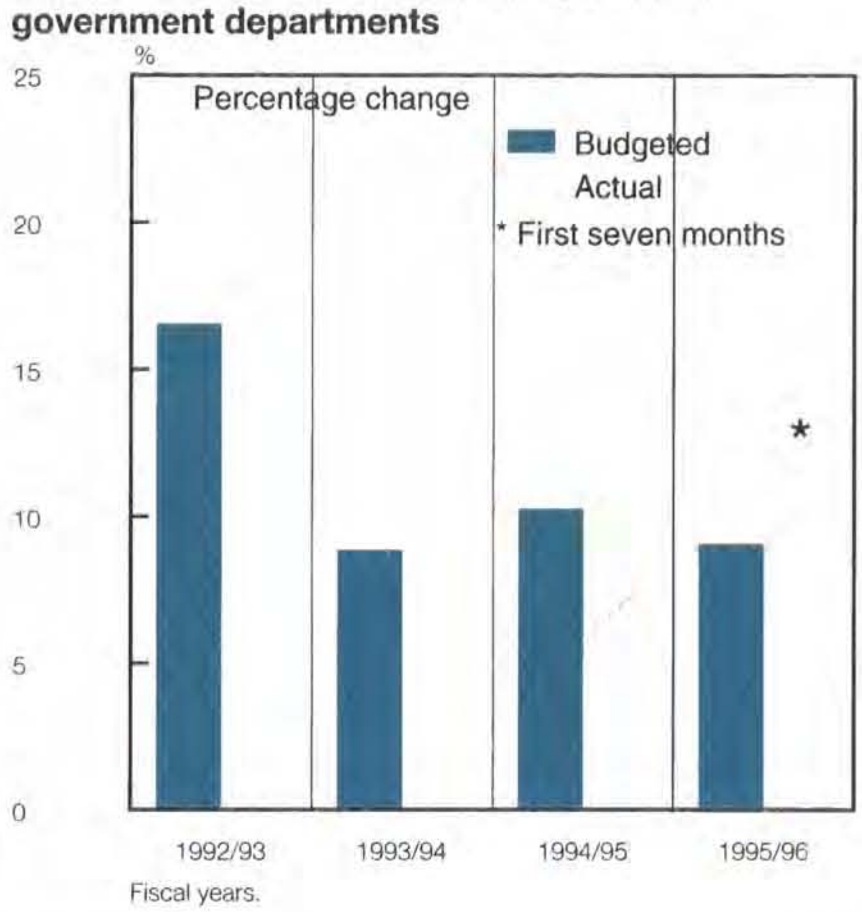


transfer payments from the Main Budget) rose sharply.

Owing to these administrative problems, *general government expenditure* increased at a year-on-year rate of only 5,5 per cent in the first half of fiscal 1995/96. This lower rate of increase was especially evident in the expenditure on goods and services by general government and in subsidies. Interest payments by general government rose by no less than 21 per cent from the first half of fiscal 1994/95 to the first half of fiscal 1995/96 as a result of the rise in public debt and the relatively high borrowing costs. Capital expenditure by general government also rose by 4,5 per cent over this period.

In the first half of fiscal 1995/96 *general government revenue* was 11,8 per cent higher than in the first half of fiscal 1994/95. Since approximately 84 per cent of this income consists of tax revenue, the generally satisfactory increase in government income mainly arose from the growth in income, profits, domestic expenditure and imports, combined with some increases in the tax rates applicable in fiscal 1995/96. Non-tax revenue of general government in the form of property income, administration fees, fines and forfeitures, however, also rose sharply.

Budgeted and actual Exchequer issues to government departments



Exchequer account

Although the overall finances of general government were generally favourable in the first half of fiscal 1995/96, the deficit on the Exchequer Account was substantially higher than the target envisaged in the Budget. The relatively high deficit in the first half of the fiscal year, which seems to reflect the normal seasonal pattern, was the result of a higher-than-budgeted increase in Exchequer issues and a lower-than-budgeted increase in Exchequer receipts.

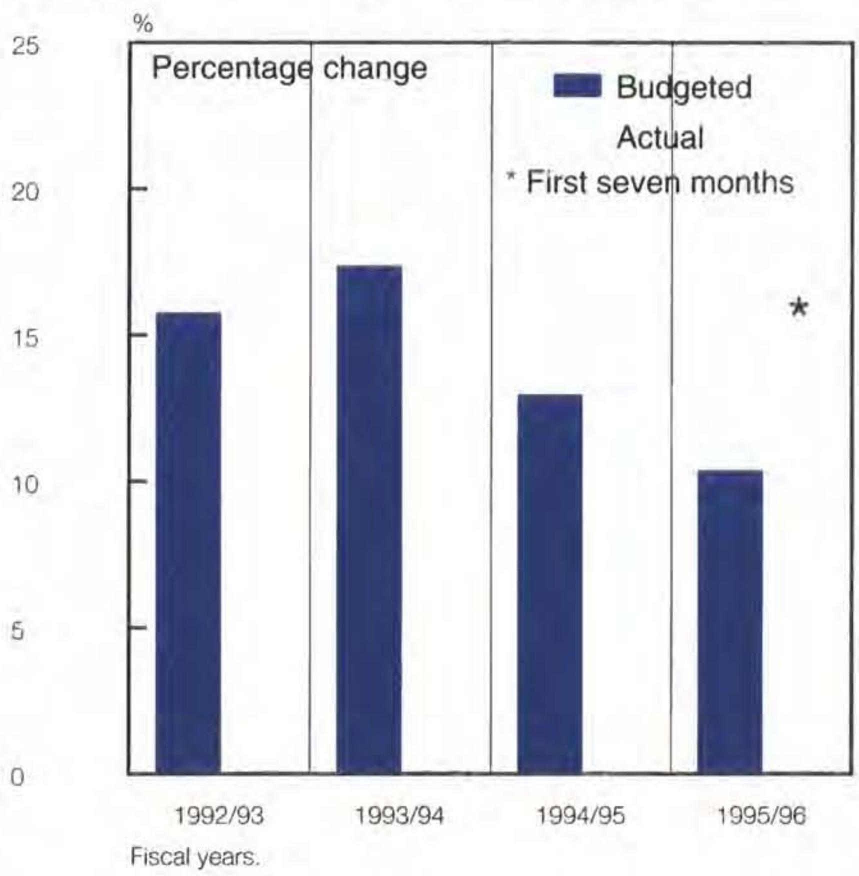
The rate of increase in *Exchequer issues* to government departments (adjusted to reflect cash flows) in the first half of fiscal 1995/96 was 10,8 per cent higher than in the corresponding period of the preceding year; provision had been made in the Budget for an increase of 9,0 per cent for the full fiscal year. This increase in Exchequer issues was, however, below the average rate of increase (measured over twelve months) of 16,0 per cent in the first half of the preceding five fiscal years. Expenditure in the first six months of fiscal 1995/96 included only R0,8 billion of the R4,8 billion (after taking account of the roll-over from the previous year) available to the Reconstruction and Development Fund.

In October 1995 Exchequer issues increased by 21,3 per cent compared with October 1994, which brought the year-on-year rate of increase in these issues to 12,0 per cent in the first seven months of fiscal 1995/96. Exchequer issues in the first seven months of fiscal 1995/96 therefore equalled 59,2 per cent of the total expenditure of R152,6 billion budgeted for the year as a whole.

From the first half of fiscal 1994/95 to the first half of fiscal 1995/96 the rate of increase in *Exchequer receipts* (excluding proceeds from privatisation) amounted to 9,1 per cent, compared with a budgeted increase of 10,3 per cent for the fiscal year as a whole and an average rate of increase of 12,4 per cent for the corresponding period in the preceding five fiscal years.

This relatively poor performance of Exchequer income

Budgeted and actual government revenue



in an upward phase of the business cycle took place despite the fact that the receipts from customs and excise duties performed considerably better than the Budget projections. Customs and Excise receipts rose by 13,2 per cent in the first six months of fiscal 1995/96 against a budgeted growth of only 4,3 per cent because of the relatively high level of domestic expenditure (particularly the sales of motor vehicles) and imports. The strong demand for goods and services also resulted in a sharp increase in value-added tax, but this increase was more or less in line with Budget expectations. Inland revenue, however, rose at a much lower rate than budgeted in the first six months of fiscal 1995/96 because of the extension of the payment date for provisional taxpayers by one month to 30 September, which resulted in an overflow of funds to October due to the fact that the last day of September fell on a Saturday.

As could be expected, the revenue collected by the government in October 1995 duly increased sharply when the provisional taxes were paid. This brought the year-on-year rate of increase in Exchequer receipts to 14,5 per cent in the first seven months of fiscal 1995/96, or to 59,6 per cent of the total revenue of R123,0 billion budgeted for the year as a whole.

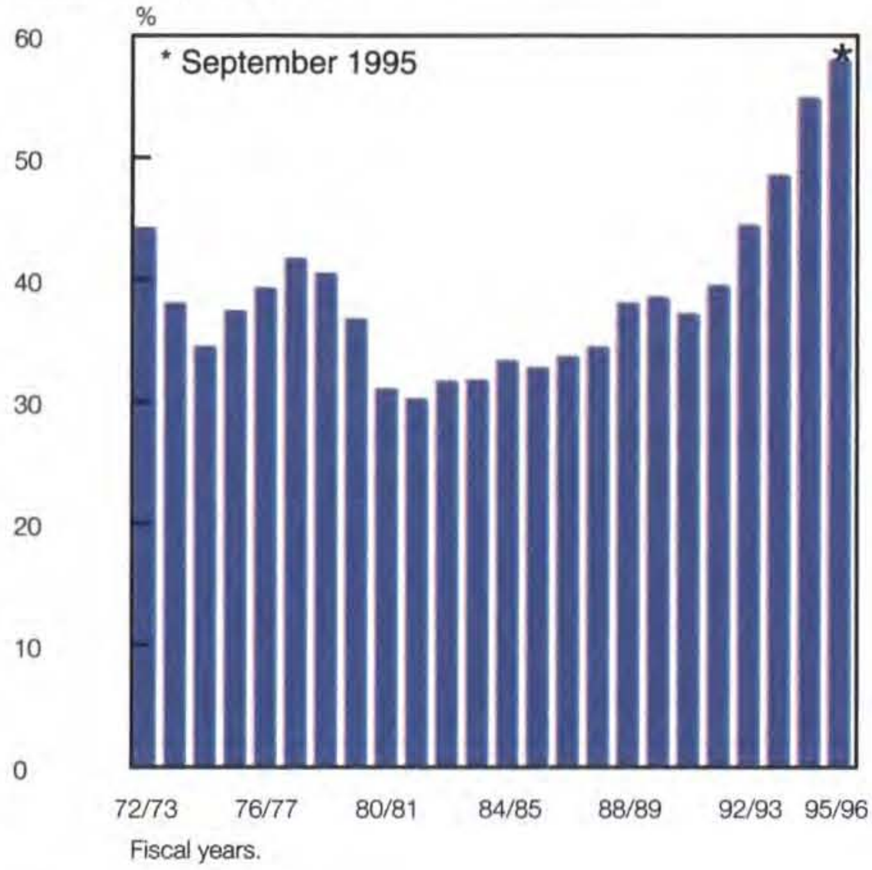
The net result of the lower-than-budgeted revenue and higher-than-budgeted expenditure was a *deficit* of R18,8 billion on the Exchequer Account before borrowing and debt repayment in the first half of fiscal 1995/96. As a ratio of gross domestic product, this deficit came to 7,7 per cent; this was close to the ratio of 7,5 per cent in the corresponding period of fiscal 1994/95, but considerably higher than the budgeted deficit of 5,9 per cent for fiscal 1995/96.

As shown in Table 9, the Exchequer deficit was mainly financed by the issue of domestic government

Table 9. Financing of the Exchequer deficit in the first six months of fiscal 1995/96

Type of instrument	R millions
Government stock:	
Public Investment Commissioners	1 097
Non-monetary private sector	13 293
Monetary institutions	13 647
Less net discount on government stock	-6 478
Total	**21 559**
Treasury bills	4
Foreign loans	1 295
Non-marketable securities	-84
Money market instruments	2
Extraordinary receipts	1 215
Increase in available cash balances	-5 175
Total net financing	**18 816**

Total government debt as percentage of gross domestic product



stock and to a lesser extent by means of foreign loan issues and the sales of strategic oil stocks (included under extraordinary receipts). A large part of the government stock was taken up by the non-monetary private sector, but monetary institutions' holding of government stock also rose sharply in the first six months of fiscal 1995/96. Despite this increase, the net claims of monetary institutions on the government declined. In sharp contrast to their practices in the past, the Public Investment Commissioners took up only a small proportion of the newly issued government stock. In fact, if investments of the Public Investment Commissioners in Treasury bills are also taken into account, the total holdings of government paper by this institution declined in the first six months of fiscal 1995/96. This change in the investment behaviour of the Public Investment Commissioners was due to the shift of funds of certain members of the associated pension fund away from the Public Investment Commissioners to private institutions, the suspension of banking services provided to the Public Investment Commissioners by the Reserve Bank and the Public Investment Commissioners' objective of obtaining a more diversified investment portfolio which, up to now is still consisting mainly of government stock.

The borrowing requirement of the Exchequer before debt repayment plus the large discount on new government stock issues led to an increase of R29,0 billion in government debt to R273,6 billion at the end of September 1995. As a ratio of gross domestic product, government debt came to 58,0 per cent, compared with 55,0 per cent at the beginning of the fiscal year.