Quarterly economic review

Introduction

Poor weather conditions and the lower production of gold were responsible for a further slackening of economic growth in the second quarter of 1995. However, this slower growth in domestic production in the first six months of 1995 came after a period of brisk and accelerating growth. The level of economic activity was therefore relatively high as clearly reflected by the rate of capacity utilisation in manufacturing, which was only slightly lower than at its peak in the cyclical upturn of 1986-89.

Although the contraction in the output of agriculture and the gold mines had an adverse effect on the economy, activity in the non-primary sectors continued to expand strongly. In fact, the growth in the real value added by the secondary and tertiary sectors accelerated from an annualised rate of 3½ per cent in the first quarter of 1995 to 4½ per cent in the second quarter. This more robust economic growth was fairly widespread, but was particularly evident in manufacturing, commerce, transport and communication and financial services.

The higher level of activity in the non-primary sectors was accompanied by an acceleration in the growth of real gross domestic expenditure. The sharp increase in domestic expenditure was the result of further increases in inventories, gross domestic fixed investment and private consumption expenditure, while consumption expenditure of general government remained on the lower level reached in the first quarter of 1995. Inventory investment, which had increased throughout the current cyclical upswing, gained considerable momentum in the first half of 1995, probably reflecting business confidence in the continuation of the economic recovery phase. A broadening of investment activity in the private sector also seems to confirm that production capacity is being created in anticipation of further strong growth in aggregate demand.

A somewhat stronger growth in real personal disposable income in the second quarter of 1995 owing largely to an increase in dividend receipts, employment growth since the middle of 1994 and an improvement in the real wage per worker, supported further strong growth in consumer demand. The largest part of households' higher outlays on appliances, transport equipment, clothing and footwear and other durable and non-durable goods was, however, financed by means of consumer credit. Households made considerable use of direct credit facilities from retailers, mortgage advances, instalment sales credit and overdrafts to finance these purchases. Economic expansion based to an important extent on higher consumer demand financed by means of increased household indebtedness is not a sound basis for sustainable economic development.

Reflecting the South African economy's high marginal propensity to import, the relatively limited excess production capacity in many economic sectors and the rise in capital formation, imports continued to respond to the rise in aggregate domestic demand in the second quarter of 1995. At the same time, the volume and value of net gold exports shrank further and a weaker export performance led to a decline in merchandise exports. Although these developments were partly offset by lower net payments for services and transfers to non-residents, the deficit on the current account of the balance of payments increased sharply to a ratio of approximately 2½ per cent of gross domestic product in the second quarter of 1995.

These developments clearly illustrate that the traditional balance of payments constraint on economic growth in South Africa has not yet been removed. With a relatively modest growth rate which averaged about 3 per cent per year in the current economic recovery, the surplus on the current account of the balance of payments was quickly transformed into a large negative balance. The structure of the South African economy therefore still leads to the emergence of large current account deficits at relatively low rates of economic growth. The only permanent solution to this problem is an effective and competitive production structure.

Fortunately, the low level of foreign debt of South Africa made it possible for the country to finance the shortfall on the current account of the balance of payments by means of a net inflow of capital from abroad. In the second quarter of 1995 more than 80 per cent of this net inflow of capital consisted of long-term capital. Indeed, over the past 2½ years South Africa has improved the maturity structure of its commitments to non-residents because of a sharp switch from short- to long-term net indebtedness. A large part of this long-term capital inflow could, however, in the end prove to be very volatile inasmuch as it embraced investments in securities on the Johannesburg Stock Exchange. Borrowing from foreign sources and non-direct investments by non-residents will in any case not solve the problem of achieving sustainable higher economic growth.

The large net inflow of capital outweighed the deficit on current account, with the result that the overall balance of payments position of the country improved further in the second quarter of 1995. However, the gross gold and other foreign reserves declined due to redemptions made on reserve-related liabilities. The healthy overall conditions on the balance of payments brought about a relatively stable nominal effective exchange rate of the rand. In July and August 1995 the weighted average value of the rand actually increased.

In a statistical sense, the net foreign assets of the monetary institutions did not exert any pressure on the growth of the money supply in the second quarter of 1995. The growth in nearly all the monetary aggregates nevertheless accelerated and the broadly defined money supply moved sharply above the upper limit of the guideline range for 1995. This rapid rate of growth in the money supply reflected the sharp growth in gross domestic expenditure and reintermediation. The fact that an increasing proportion of domestic expenditure was financed by means of bank credit, also led to an almost uninterrupted rise in the credit extension of monetary institutions to the private sector.

In view of the rapid rise in the money supply and bank credit extension and after taking other economic developments into consideration, a much more conservative monetary policy stance was adopted by the monetary authorities from the beginning of 1995. In response to the tighter monetary measures, short-term interest rates moved higher while long-term yields declined somewhat. The yield curve accordingly flattened further in the five-month period ended August 1995. Most of the lending and deposit rates of financial institutions also moved to higher levels after the increase in Bank rate at the end of June 1995.

The money market was generally characterised by sharp fluctuations arising from changes in the net foreign assets of the Reserve Bank and in government deposits with the central bank in the period March to August 1995. The Reserve Bank's operations in the money market during this period were accordingly aimed mainly at neutralising liquidity in order to keep its refinancing facilities effective. Activity in the bond and equity market subsided further, while the stable environment in the foreign exchange market, a decline in non-resident participation, the increase in real estate prices and the high level of and expected further increases in interest rates, had a negative impact on the volume of transactions in other financial markets.

The public-sector borrowing requirement amounted to 7,8 per cent of gross domestic product in the first quarter of fiscal 1995/96, which, although still high, was considerably lower than in the corresponding period of the preceding year. A part of this lower level of the public-sector borrowing requirement in the first quarter of the fiscal year may have been due to special circumstances that were related to the constitutional changes in South Africa. The establishment of the nine new provinces and administrative problems encountered in this regard probably delayed some expenditure, with the result that the revenue and grants of the provincial governments exceeded their total expenditure. The transfer of certain powers from the central government to the provincial administrations also had a marked effect on the expenditure pattern of the Main Budget: transfer payments rose substantially while expenditure on goods and services contracted.

On the inflation front, lower prices of fresh meat, vegetables and fruit were responsible for slower rates of increase in both the production and consumer price indices from April 1995. If the effect of the price changes of processed and unprocessed food is excluded from the production price index, the twelve-month rate of increase in other prices has shown a persistent upward movement since April 1994. Although the rate of increase in the underlying consumer price index (which measures changes in the overall consumer price index excluding food and non-alcoholic beverages, the costs of home-ownership and value-added tax) recently slackened somewhat, factors such as the strong domestic demand, increases in labour costs and the attempts of business organisations to maintain profit margins are preventing a lasting decline in the rate of inflation. Important structural features, including an inflexible labour market, an uncompetitive production structure and large budget deficits, also still stand in the way of a sustainable abatement of the inflation rate. Against this background, excessive increases in the money supply accommodate and lead to a persistent rise in production and consumer prices.

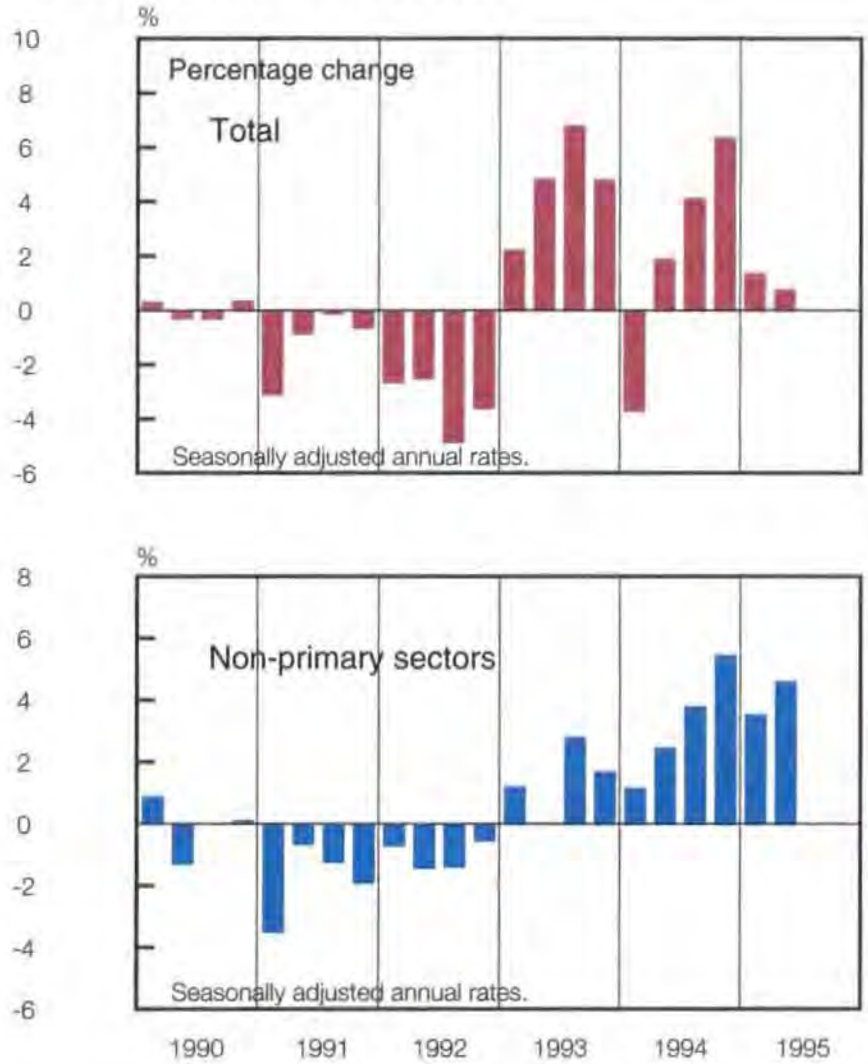
Domestic economic developments

Domestic output

First estimates indicate that *aggregate real gross domestic product* rose at an annualised rate of approximately 1 per cent in the second quarter of 1995, after having increased at an annualised rate of 1½ per cent in the first quarter. Such growth was well below the average annualised growth rate of 5½ per cent attained in the second half of 1994. Despite the slower growth of economic activity in the first half of 1995, total output was still nearly 3 per cent higher in this period than in the first half of 1994.

The slowdown in economic growth during the first six months of 1995 could be attributed mainly to a marked decline in agricultural output on account of adverse weather conditions in the summer rainfall areas, and lower gold production. Although the lower output in the primary sectors had a detrimental effect on production in the other sectors of the economy through backward and forward linkages, the non-primary sectors grew strongly and cushioned the slowdown in the economic recovery. The growth of aggregate real value added by the secondary and tertiary sectors actually accelerated from an annualised rate of 3½ per cent in the first quarter of 1995 to 4½ per cent in the second quarter. In the case of the primary sectors, the total output in the first half of 1995 fell at an annualised rate of 10½ per cent from the second half of 1994.

Real gross domestic product



Agricultural production, which had made a major contribution to economic growth in 1994, contracted sharply in the first six months of 1995. In particular, the poor grain harvests in the Highveld in the second quarter of 1995 brought about a negative year-on-year growth rate of 9 per cent in agriculture. It is generally expected that the maize crop in 1995 will only be about one-third of the production in the preceding year.

Total output in the *mining sector* decreased at annualised rates of 10 and 11 per cent in the first two quarters of 1995; this followed a decline of 2½ per cent in calendar 1994. More specifically, gold production contracted sharply owing to an increase in the number of special and public holidays and labour disruptions, industrial action, sit-ins, go-slows and strikes. The gold content of ore milled also decreased further, *inter alia* because of the mining of lower quality ore and the milling of surface material to supplement underground production. All these factors compounded the problems

Table 1. Real gross domestic product

Percentage change at seasonally adjusted and annualised rates

Sectors	1994				1995	
	1st qr	2nd qr	3rd qr	4th qr	1st qr	2nd qr
Primary sectors	-30	-3	4	9½	-13	-23
Non-primary sectors	1	2½	4	5½	3½	4½
Secondary sectors	0	2½	6	8	4½	6
Tertiary sectors	2	2½	2½	4	3	4
Total	**-3½**	**2**	**4**	**6½**	**1½**	1

of the industry, with the result that current production equals output levels of 1957 and 1958 and is about half of the record output of 1 000 tons in 1970. In contrast, the mining of coal and some base metals benefited from a strong revival in international demand and the concomitant surge in export prices, improved labour relations and increased productivity in the first two quarters of 1995.

The growth in the output of the *secondary sectors* accelerated from an annualised rate of 4½ per cent in the first quarter of 1995 to 6 per cent in the second quarter. This stemmed mainly from the buoyancy of manufacturing output, while real value added by the sector supplying electricity, gas and water and the construction industry continued to grow steadily. In the manufacturing sector, the growth in real value added amounted to an annualised rate of 7 per cent in the second quarter of 1995. Over the first two years of the current economic upswing, the output of the manufacturing sector expanded at an average annualised rate of 4½ per cent. Manufacturers in both the domestic and export-oriented industries experienced strong growth. This was related to a strong export demand, a supply response to the higher international prices of manufactured goods, buoyant private consumption expenditure and the widespread improvement of investors' sentiment in the private sector.

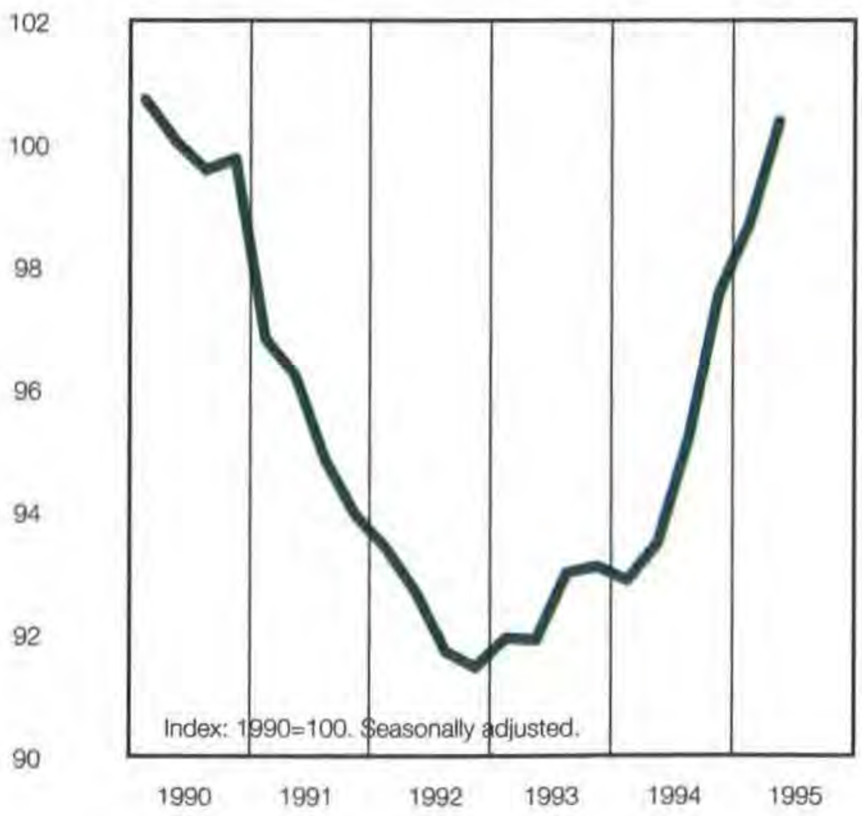
An analysis of the performance of the *tertiary sectors* in the second quarter of 1995 shows that:

- The real value added by the commercial sector rose at an annualised rate of 4½ per cent, largely because of a more positive sentiment among consumers after the relatively peaceful transition to a new political dispensation. The motor trade also grew strongly, underpinned by the significantly higher levels of fixed capital formation, a strong demand from car rental companies, more peaceful labour conditions with a concomitant improvement in productivity, and an expansion in the industry's export business.
- The real value added by transport and communication services rose strongly at an annualised rate of 6½ per cent. This could be attributed to a rise in international trade, increased tourism and the successful establishment of the cellular telephone network.
- The real output of the financial sector increased at an annualised rate of 5 per cent. This sector benefited from the growth in the securities and derivative markets and the generally sound financial conditions in the country.

Domestic expenditure

The growth in aggregate *real gross domestic expenditure* amounted to a seasonally adjusted and annualised rate of 5½ per cent in the second quarter of 1995; in the first quarter of 1995 the increase in domestic expenditure had slowed down to a rate of 2 per cent from 10 per cent in the second half of 1994. The sharp increase in domestic

Real gross domestic product of manufacturing



Main components of real gross domestic expenditure

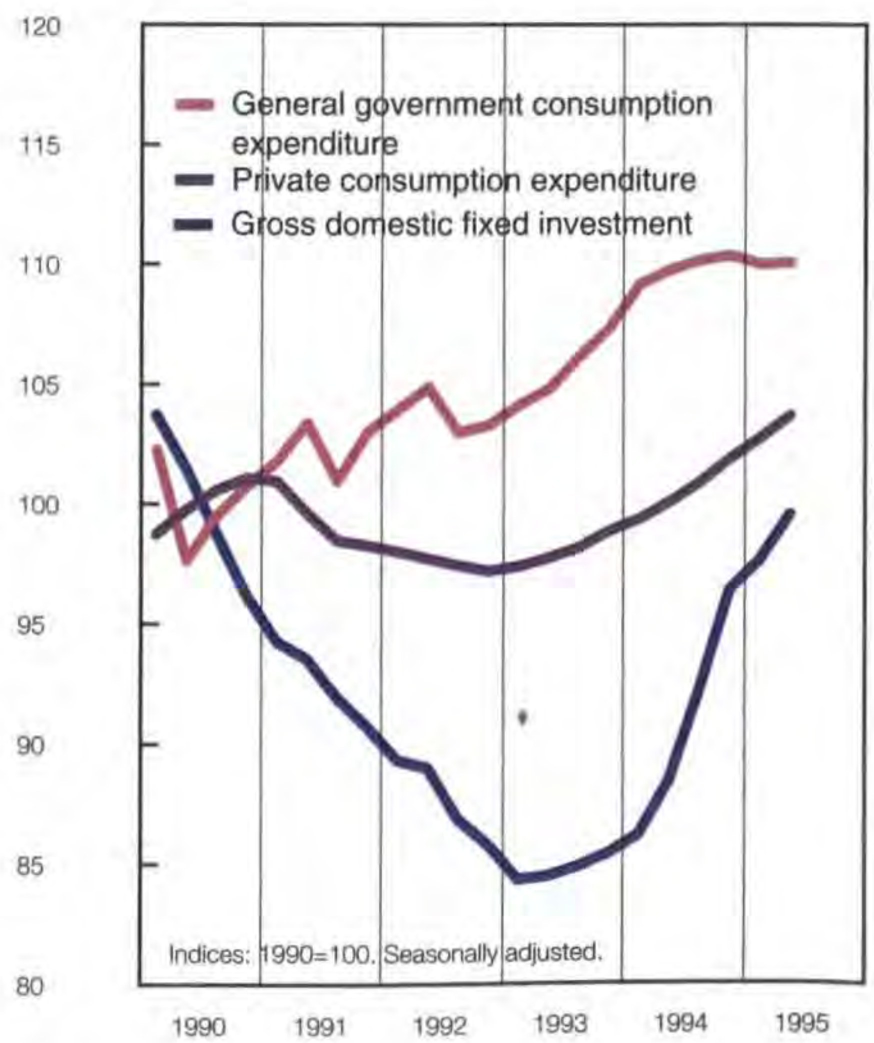


Table 2. Real gross domestic expenditure
Percentage change at seasonally adjusted and annualised rates

Components	1994				1995	
	1st qr	2nd qr	3rd qr	4th qr	1st qr	2nd qr
Private consumption expenditure	2	3	3½	4	3½	3½
Consumption expenditure by general government	7	2	1½	1	-1½	0
Gross domestic fixed investment	3½	10½	18	19½	5½	8
Change in inventories (R billions)	5,1	3,3	5,9	8,7	8,7	10,7
Gross domestic expenditure	**4½**	**1½**	**10½**	**10**	**2**	**5½**

expenditure was the result of further increases in private consumption expenditure, gross domestic fixed investment and inventories, while consumption expenditure by general government remained more or less on the level of the first quarter of 1995.

Real *private consumption expenditure* rose strongly in the first half of 1995, increasing in both the first and second quarter at an annualised rate of 3½ per cent. The sturdy growth in real outlays on consumer goods and services by households largely reflected increased expenditure on durable and semi-durable goods such as household appliances, transport equipment and clothing and footwear. Real household spending on non-durable goods edged slightly higher in the second quarter of 1995, while the growth in real spending on services moderated significantly on account of lower tourist spending abroad.

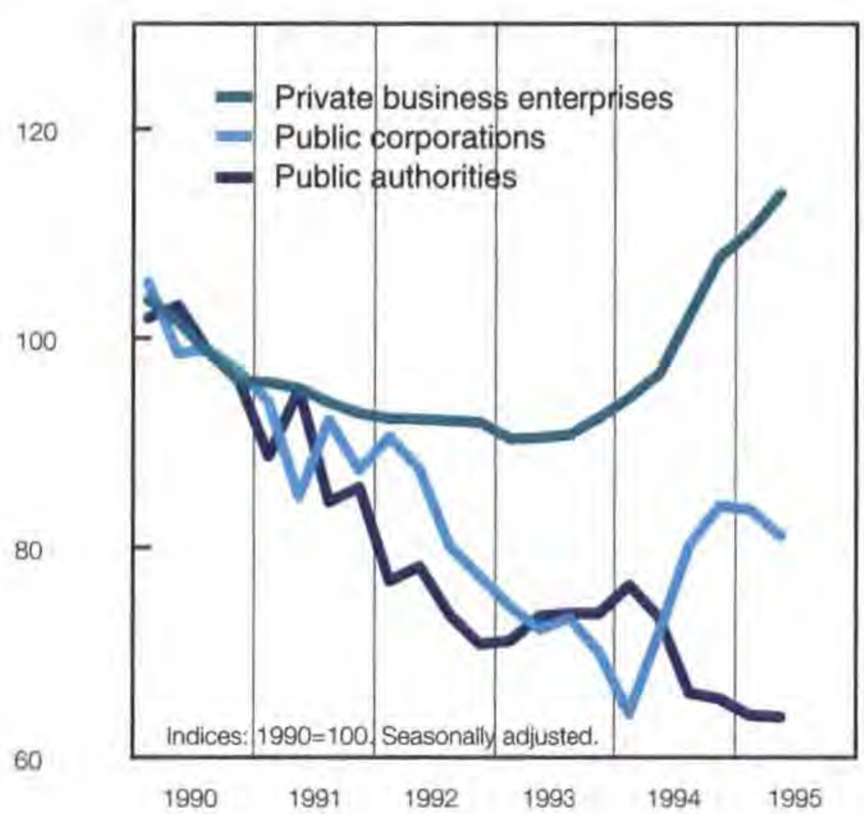
The sustained high rate of increase in the real outlays by households on consumer goods and services was supported by a somewhat stronger growth in real personal disposable income, owing, among other things, to an increase in dividend receipts from the corporate sector, some employment growth since the middle of 1994 and an improvement in the real wage per worker. The wider availability of consumer credit also encouraged household spending on goods and services.

After having contracted at an annualised rate of 1½ per cent in the first quarter of 1995, real *consumption expenditure by general government* remained on this lower level in the second quarter of 1995. Measured over a period of twelve months, real consumption expenditure by general government in the first half of 1995 was only ½ per cent higher than in the corresponding period of the previous year; in calendar 1994 this expenditure still rose by 4 per cent.

Total real *gross domestic fixed investment* is estimated to have increased at an annualised rate of 8 per cent in the second quarter of 1995; this growth rate was higher than the 5½ per cent in the first quarter, but considerably lower than the 19 per cent in the second half of 1994. As a ratio of gross domestic product, fixed capital formation has now increased from a lower turning-point of 15 per cent in the fourth quarter of 1993 to nearly 17 per cent in the second quarter of 1995. This additional increase in fixed investment was brought about by a significant expansion in the real outlays on capital goods by the private sector, while the capital expenditure by the public sector contracted.

The rate of increase in real *private-sector fixed investment* rose from an annualised level of 9½ per cent in the first quarter of 1995 to approximately 13½ per cent in the second quarter. In the initial stages of the current upswing of the fixed-investment cycle capital expenditure was mainly limited to a number of major projects, spurred by tax concessions relating to depreciation allowances.

Real gross domestic fixed investment



In the second quarter of 1995 increased capital outlays were evident in nearly all sectors of the economy. The expansion of investment activity seems to indicate that production capacity is being created in anticipation of continued growth in aggregate demand.

The ongoing increases in capital formation by the private sector could also be attributed to the direct and indirect effects of the major capital projects, a strong replacement demand and capacity expansions to capitalise on the relatively strong domestic and foreign demand for certain base metals, minerals and manufactured goods. Real fixed investment in the financial sector was boosted by the further increase in real outlays on private residential buildings, while capital expenditure on machinery and transport equipment, financed through instalment sale agreements and leasing contracts, remained brisk.

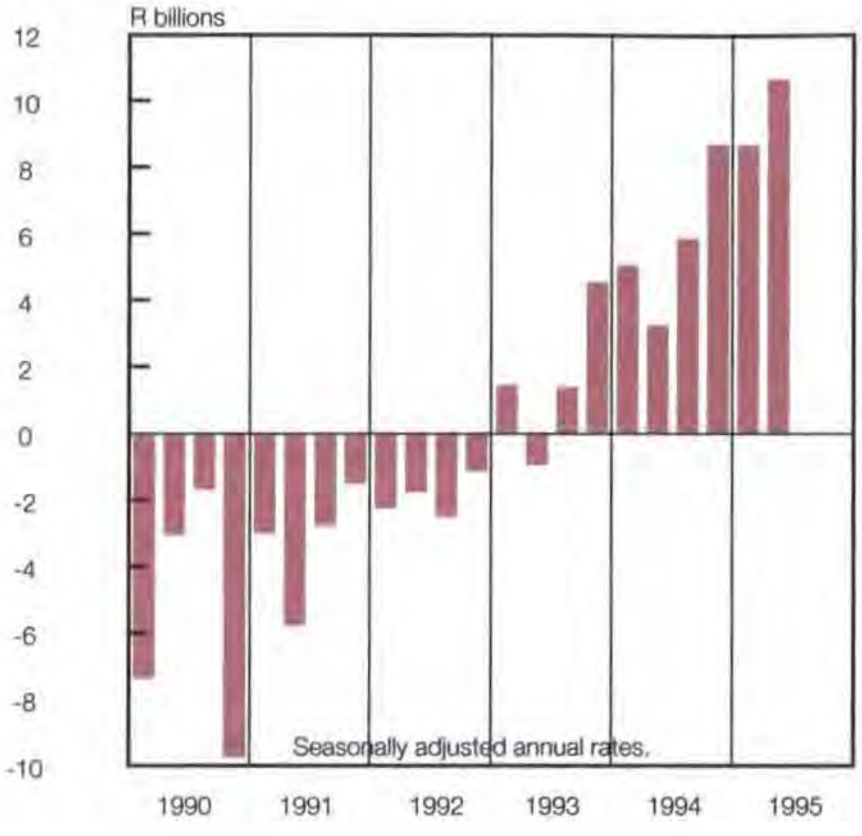
Real fixed investment by *public corporations* decreased at an annualised rate of 11½ per cent in the second quarter of 1995. A decline in the fixed investment by Eskom more than neutralised increases in investment expenditure by corporations involved in transportation and telecommunication services. Increases in real fixed investment by the central and provincial governments could not fully match the decline in investment expenditure by local authorities, but succeeded in slowing down the decline in total real fixed investment by all *public authorities* from an annualised rate of 9 per cent in the first quarter of 1995 to 1 per cent in the second quarter.

After having turned positive in the third quarter of 1993, inventory investment rose persistently throughout the current cyclical upswing of the economy. In the first two quarters of 1995 the real value of inventories rose very strongly mainly due to the accumulation of stocks in the mining sector, private manufacturing and wholesale, retail and motor trade. Agricultural stocks-in-trade, however, declined owing to the poor maize harvest. As a result of the further increase in industrial and commercial inventories, the level of these stocks relative to gross domestic product rose from a record low of 16 per cent in the fourth quarter of 1993 to more than 18½ per cent in the second quarter of 1995.

Factor income and saving

The growth in aggregate *nominal factor income* at market prices over a period of twelve months slowed down from 13 per cent in the first quarter to 11 per cent in the second quarter of 1995. This decline was due to lower growth in the total gross operating surplus; the year-on-year rate of increase in this aggregate contracted from 13½ per cent in the first quarter of 1995 to 10½ per cent in the second quarter owing to a deterioration in the profitability of the agricultural and mining sectors. In addition, the growth in total nominal labour remuneration over twelve months rose only slightly from 11½ per cent to not quite 12 per cent over the same period.

Change in real inventories



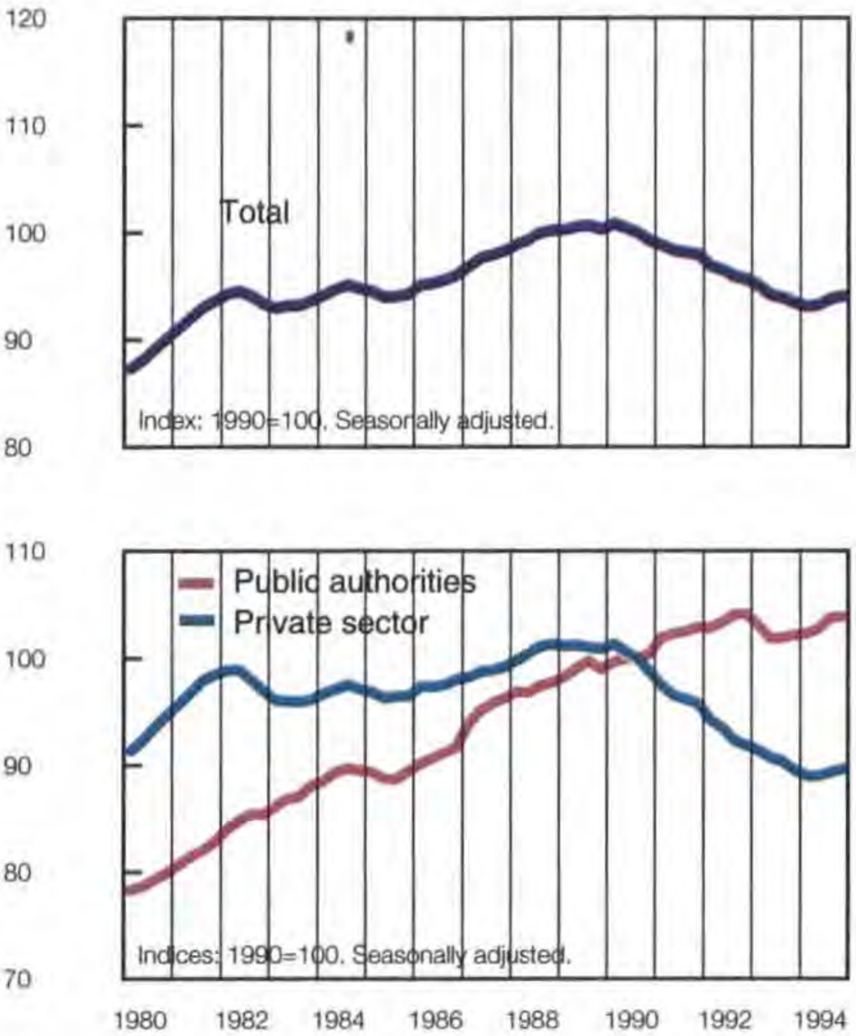
Despite the decline in factor-income growth, the ratio of *gross domestic saving* to gross domestic product in the second quarter of 1995 remained unchanged at 18 per cent for the third consecutive quarter. This compares favourably with an average ratio of 17½ per cent in 1994, but is still substantially lower than the long-term average of 23 per cent.

The recent more favourable development in domestic saving could be ascribed to a moderate improvement in net corporate saving and the lower level of net dissaving by general government. In contrast, the net saving by households declined somewhat from 2½ per cent of gross domestic product in the second quarter of 1994 to 1 per cent in the second quarter of 1995; as a ratio of personal disposable income, household saving contracted from 4 to 2 per cent over the same period. This could be attributed to the robust increase in households' real consumption expenditure, which exceeded the increase in total real personal disposable income.

Employment

The economic recovery took some time before it gathered sufficient momentum to reverse the downward movement in *total employment* in the non-agricultural sectors of the economy. Having reached a lower turning-point of the business cycle in the second quarter of 1993, it was only four quarters later that total employment showed any sign of responding to the improvement in overall economic activity. A modest increase in employment at a seasonally adjusted and annualised rate

Non-agricultural employment



of 0,6 per cent in the second quarter of 1994 was then followed by a stronger increase of 2,5 per cent in the third quarter and 0,9 per cent in the fourth quarter of 1994 (latest information made available by the Central Statistical Service). Despite these quarterly increases, the average level of employment in the calendar year was still 0,6 per cent lower than in 1993 – the fifth consecutive annual decline in aggregate employment.

During this period the economically active population advanced at a rate of 2,5 per cent per year. The number of *unemployed people* accordingly increased substantially, while the so-called informal sector became progressively larger. According to official statistics, no less than 43 out of every 100 economically active persons were either unemployed or involved in the informal sector in October 1994. These figures clearly illustrate the urgency of improving the labour-absorption capacity of the economy to maintain internal stability.

The sluggish reaction of total employment to the upturn in economic activity was caused by the unwillingness of *private-sector* employers to expand the size of their work-force. Increases in private-sector employment only took place in the second half of 1994; employment rose at seasonally adjusted and annualised rates of 1,6 and 1,2 per cent in the third and fourth

Table 3. Change in employment in the non-agricultural private sector from the second quarter of 1993 to the fourth quarter of 1994 by main economic sector

Sector	Employees (thousands)
Mining	-22,4
Manufacturing	10,4
Construction	-2,5
Electricity supply	-2,9
Wholesale trade	2,4
Retail trade	-31,5
Motor trade	3,1
Private road transport	-1,1
Banks	2,9
Other	0,9
Total	**-41,3**

quarter. The average level of employment in the private sector nevertheless still declined by 1,4 per cent in 1994 as a whole. As a result, total employment in the private sector was still some 41 300 persons less than at the end of the recession in the second quarter of 1993.

Table 3 clearly illustrates the reluctance of private business undertakings in many of the major *non-agricultural economic sectors* to increase employment. The levels of employment in the retail trade and the mining sector, in particular, were far below those at the end of the recent recession. No net gains in employment were registered in construction, electricity supply and private road transportation in the first six quarters of the economic recovery, while the number of people employed in manufacturing, wholesale and motor trade, banks and other services increased moderately.

In sharp contrast to these changes in private-sector employment, employment by *public authorities* advanced further by 34 400 net new jobs from the second quarter of 1993 to the fourth quarter of 1994. Employment by public authorities increased persistently throughout the recession of 1989-93, except in the first half of 1993. More recently, the quarter-to-quarter increase in total employment by public authorities accelerated from a seasonally adjusted and annualised rate of 0,4 per cent in the first quarter of 1994 to 4,2 per cent in the third quarter; this rate then declined slightly to 0,3 per cent in the fourth quarter of 1994. An increase of 0,9 per cent was recorded in calendar 1994 in the average level of employment by public authorities.

Labour costs and productivity

The many imperfections in South Africa's labour market kept on preventing wage demands and settlements from reflecting the growing excess supply of labour. This can be seen from the year-to-year rate of increase in *nominal remuneration per worker*, which rose from a lower turning-point of 10,5 per cent in 1993 to 11,9 per cent in 1994. Moreover, the year-on-year rate of increase in nominal remuneration per worker accelerated sharply from a low point of 9,0 per cent in the fourth quarter of 1993 (the first single-digit rate of increase since the fourth quarter of 1985) to 14,6 per cent in the second quarter of 1994; it then declined somewhat to 11,6 per cent in the fourth quarter of 1994.

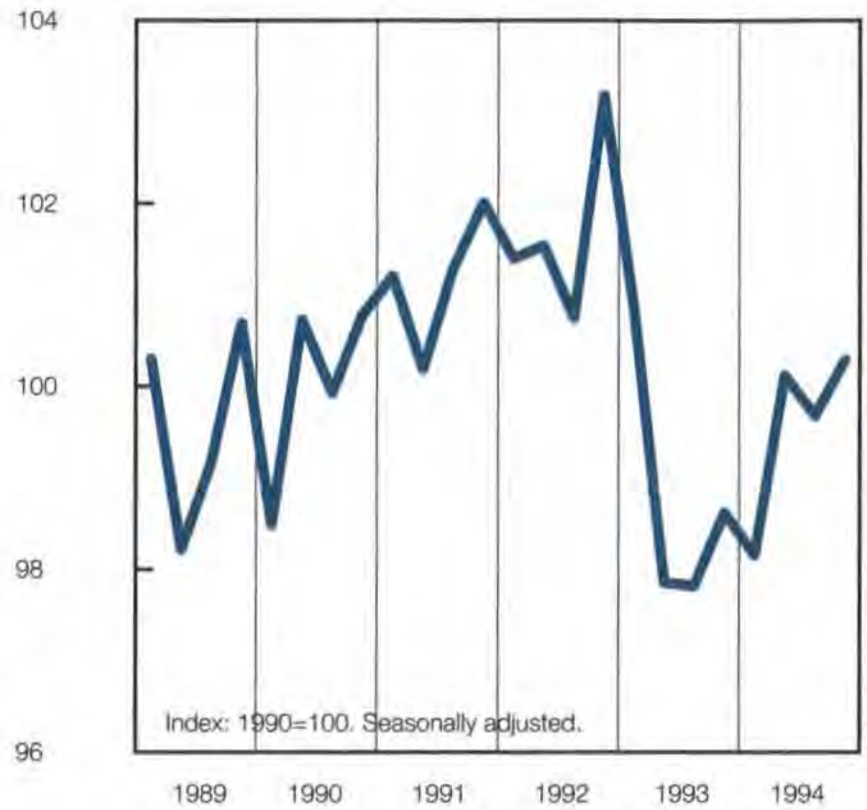
Wage increases in the *private sector* were driven to a significant extent by demands for a living wage. The year-to-year rate of increase in nominal remuneration per worker in the non-agricultural private sector nevertheless decreased from a high point of 17,0 per cent in 1990 to 10,2 per cent in 1994. Measured over a period of four quarters, the rate of increase in nominal remuneration per worker in the private sector declined uninterruptedly from 15,4 per cent in the fourth quarter of 1992 to 9,5 per cent in the first quarter of 1994; it then rose to 11,4 per cent in the third quarter of 1994 before slowing down to 9,5 per cent in the fourth quarter.

The nominal remuneration per worker employed by *public authorities,* which had contracted from 21,6 per cent in 1989 to only 9,2 per cent in 1993, advanced to 14,6 per cent in 1994. On a quarterly basis, the year-on-year rate of increase in nominal remuneration per worker employed by public authorities rose even more sharply from only 5,6 per cent in the fourth quarter of 1993 to 21,4 per cent in the second quarter of 1994. This exceptionally high rate of expansion was, however, caused by special circumstances at the time of the general election in April 1994. The rate of increase in the nominal wage per worker employed by public authorities then declined somewhat to 14,6 and 15,2 per cent in the last two quarters of 1994.

The inability of the domestic labour market to adapt meaningfully to underlying labour-market conditions is confirmed by the changes observed in *real remuneration per worker.* The real remuneration per worker increased by no less than 3,0 per cent in 1994. The year-on-year rate of change in real remuneration per worker also accelerated sharply from a negative 0,6 per cent in the fourth quarter of 1993 to positive figures of 4,9, 3,8 and 3,6 per cent in the last three quarters of 1994, respectively.

The rate of increase in *labour productivity* in the non-agricultural sectors of the economy moved ahead from 0,4 per cent in 1991 to 2,8 and 2,4 per cent in 1993 and 1994 largely owing to the reduction in the number of workers employed in the formal sectors of the economy. The average annual rate of increase of 1,7 per cent since 1991 was significantly higher than the 0,3 per cent per annum during the 1980s. However, the year-on-year rate of increase in the real production per worker declined from a high point of 4,0 per cent in the fourth quarter of 1993 to 1,9 per cent in the third and fourth quarter of 1994. These lower rates of increase in labour productivity were partly the result of a significant increase

Non-agricultural real unit labour costs



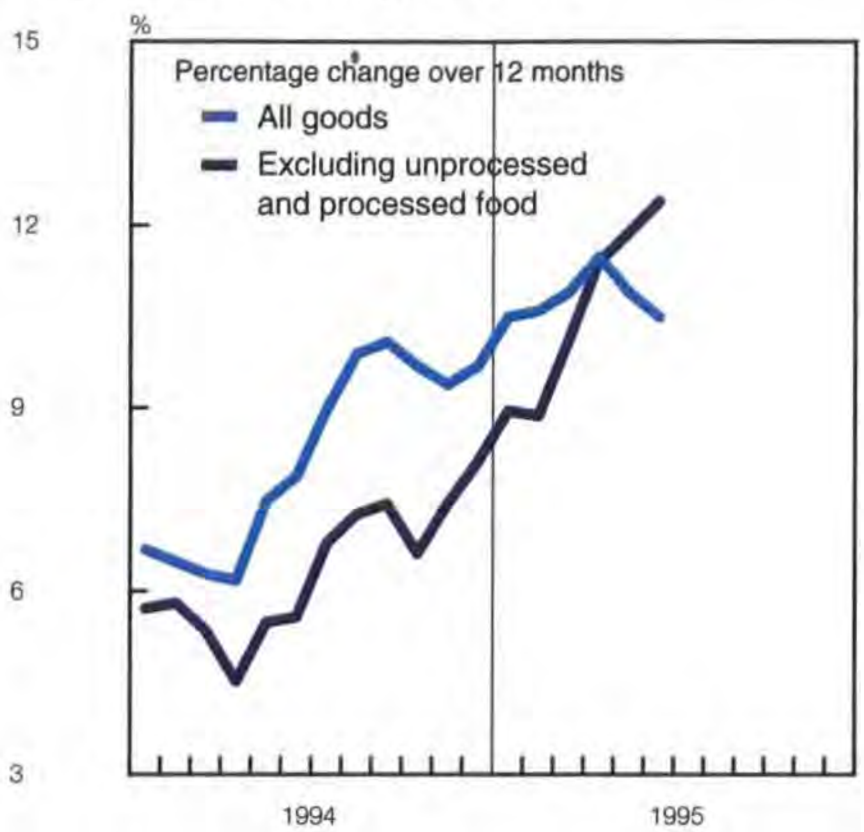
in the number of man-days lost on account of strikes and other work stoppages in the second half of 1994. These conditions improved significantly in the first half of 1995.

Seeing that the rise in labour productivity was lower than the increase in real remuneration per worker, *real unit labour costs* (measured over four quarters) began to increase again at rates of 2,3, 1,9 and 1,7 per cent in the last three quarters of 1994. For the year as a whole it rose by 0,7 per cent; in 1993 real unit labour costs had declined by 2,9 per cent. The rise in real unit labour costs, of course, has serious implications for inflation and the capacity of the economy to create jobs.

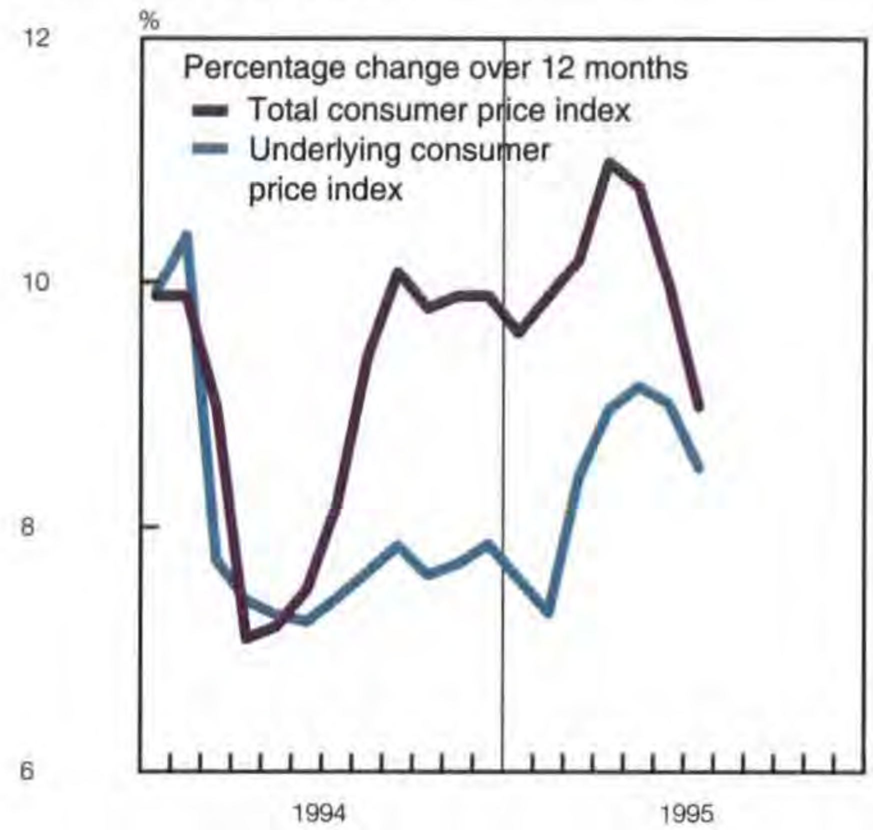
Prices

Despite the upward movement in real unit labour costs, the rate of increase in both the production and the consumer price index declined somewhat from the second quarter of 1995. The better performance of these price indices was, however, mainly brought about by a decline in food prices, more specifically in the prices of fresh meat, vegetables and fruit. The rise in the so-called underlying rate of inflation in the South African economy, which had started from the second quarter of 1994, recently also abated somewhat. A strong demand-pull on inflation still exists, as is evident from rapid rates of increase in credit extension and the money supply, as well as the high rate of capacity utilisation in manufacturing. In the first quarter of 1995 the utilisation of production capacity in manufacturing was only 1,9 percentage points below the level recorded at the end of the economic upswing of 1986-89.

All-goods production price index



Consumer price index



The quarter-to-quarter rate of increase in the all-goods *production price index*, which had accelerated from 5,6 per cent in the fourth quarter of 1994 to 13,2 per cent in the first quarter of 1995, declined again to 11,1 per cent in the second quarter. Similarly, the rate of increase in the all-goods production price index measured over periods of twelve months also declined somewhat from a high point of 11,5 per cent in April 1995 to 10,5 per cent in June. This downward movement was mainly discernible in the prices of domestically produced goods, although the greater stability in the external value of the rand caused the rise in the prices of imported goods to level off. More specifically, the decrease in production price inflation was brought about by changes in food prices. If the prices of processed and unprocessed food are excluded from the production price index, the twelve-month rate of increase in other prices accelerated from a lower turning-point of 4,5 per cent in April 1994 to 11,4 per cent in April 1995 and further to 12,4 per cent in June 1995.

The rate of increase over periods of twelve months in the overall *consumer price index* also retreated significantly from a recent high of 11,0 per cent in April 1995 to 10,0 per cent in June and 9,0 per cent in July. However, the so-called underlying inflation rate (as measured by the overall consumer price index, excluding food and non-alcoholic beverages, the costs of home-ownership and value-added tax) did not decline to the same extent. Measured over a period of twelve months, the underlying rate of inflation rose sharply from a low of 7,3 per cent in February 1995 to 9,2 per cent in May and then receded to 8,5 per cent in July. This implies, of course, that other factors, such as strong aggregate domestic demand, increases in labour costs and the efforts by the private business community to restore their profit margins after the drawn-out recession, are preventing a prolonged decline in the rate of inflation. The quarter-to-quarter rate of increase in the overall consumer price index also rose from a seasonally adjusted and annualised rate of 8,5 per cent in the fourth quarter of 1994 to 10,9 per cent in the second quarter of 1995.

Foreign trade and payments

Current account

The *balance on current account* of the balance of payments (seasonally adjusted and annualised), which had moved into a deficit at a quarterly average of R6,2 billion in the second half of 1994, displayed further deficits of R7,8 billion in the first quarter of 1995 and R12,5 billion in the second quarter. As a percentage of gross domestic product, the deficit on current account rose from 1,7 per cent in the first quarter of 1995 to 2,6 per cent in the second quarter; during 1994 as a whole this ratio had averaged 0,5 per cent. The weaker current account balance in the second quarter of 1995 was the combined result of a strong increase in the value of merchandise imports and a decline in the value of merchandise exports and net gold exports. Net service and transfer payments to non-residents contracted in this quarter.

The value of *merchandise imports* advanced further from the already high seasonally adjusted and annualised rate of R94,4 billion in the first quarter of 1995 to R97,7 billion in the second quarter, or by 3½ per cent. Pronounced increases were recorded in the imports of manufactured goods, particularly in the categories machinery and electrical equipment, transport equipment and textiles. In addition, the imports of maize led to a significant increase in the import category vegetable products over this period. The value of mineral imports (mainly crude oil), on the other hand, declined marginally in the second quarter of 1995; the exceptionally high level of the preceding quarter was therefore more or less maintained.

The higher value of merchandise imports in the second quarter of 1995 was mainly the result of an increase in import prices together with a small increase in import volumes; the physical quantity of imported goods rose by about ½ per cent. Owing to moderately higher oil prices and other foreign production prices and a decline in the average effective exchange rate of the rand, import prices rose by almost 3 per cent in the second quarter of 1995.

The value of *merchandise exports* (seasonally adjusted and annualised) contracted from R81,8 billion in the first quarter of 1995 to R79,4 billion in the second quarter. This decline was more than fully accounted for

Current account

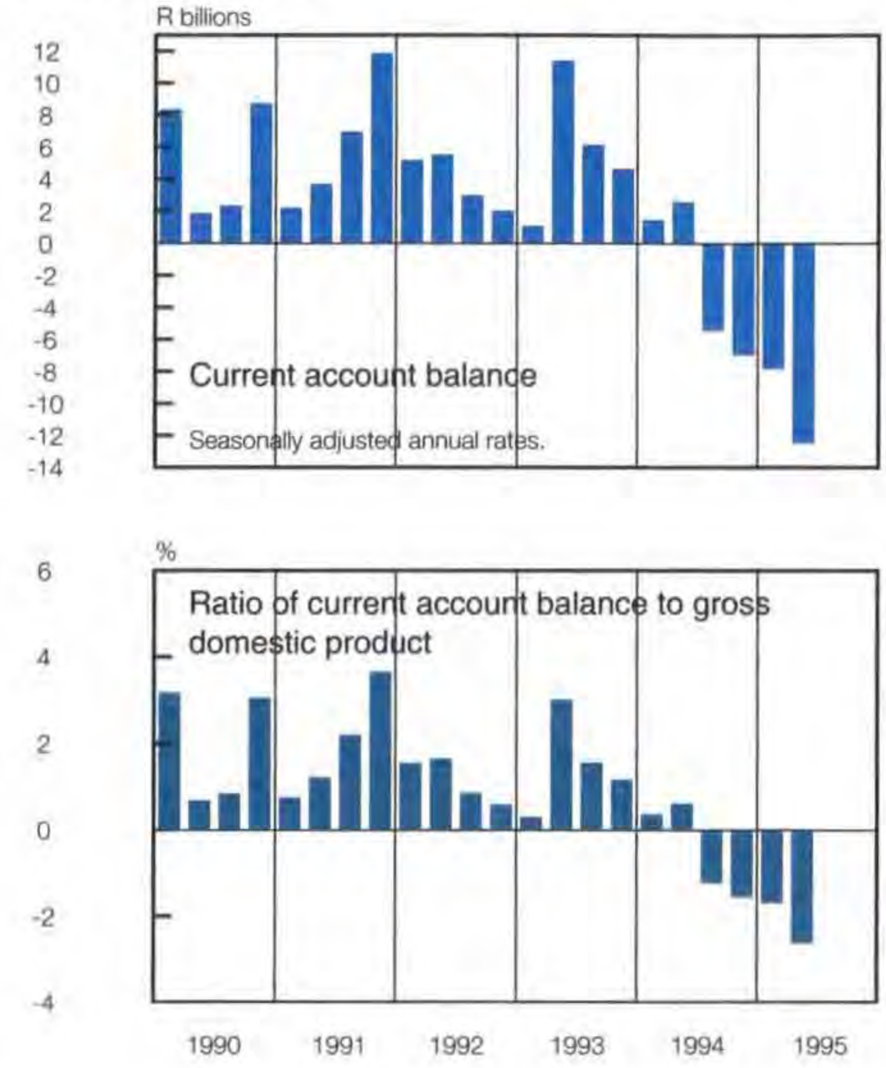
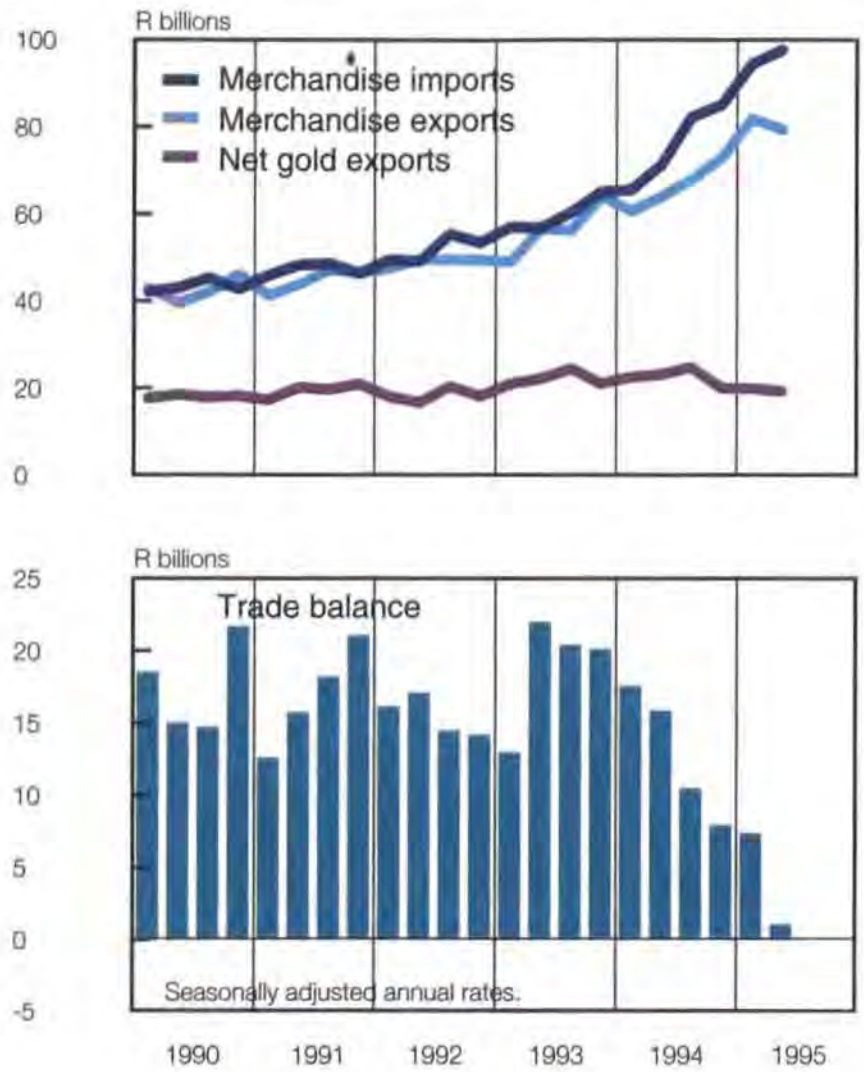


Table 4. Balance of payments on current account
Seasonally adjusted and annualised rates
R billions

	1994				1995	
	1st qr	2nd qr	3rd qr	4th qr	1st qr	2nd qr
Merchandise exports	60,6	64,0	67,9	73,0	81,8	79,4
Net gold exports	22,6	23,2	24,8	20,1	20,0	19,3
Merchandise imports	-65,6	-71,3	-82,3	-85,1	-94,4	-97,7
Net service and transfer payments	-16,1	-13,3	-15,8	-15,0	-15,2	-13,5
Balance on current account	**1,5**	**2,6**	**-5,4**	**-7,0**	**-7,8**	**-12,5**

Trade account



by a decrease of 5 per cent in the volume of goods exported, reflecting the weaker export performance of mining and manufactured exports. The exports of agricultural goods also receded somewhat because of the drought experienced in the course of 1994. The depreciation of the rand against the dollar caused export prices to advance by 2 per cent from the first to the second quarter.

After having declined persistently from a seasonally adjusted and annualised value of R24,8 billion in the third quarter of 1994 to R20,0 billion in the first quarter of 1995, the value of *net gold exports* shrank further to R19,3 billion in the second quarter. As in the previous two quarters, this decrease could mainly be attributed to a decline in the volume of net gold exports; the physical quantity of net gold exports dropped by a further 8½ per cent in the second quarter because of continued labour disruptions. The average fixing price of gold rose from $379 per fine ounce in the first quarter of 1995 to $388 in the second quarter, or from R1 352 to R1 413 per fine ounce. However, it then retreated to $386 (R1 406) per fine ounce in July.

Net *service and transfer payments* to non-residents declined from a seasonally adjusted and annualised value of R15,2 billion in the first quarter of 1995 to R13,5 billion in the second quarter. This relatively sharp decline was caused by a drop of R1,9 billion in service payments, which was well in excess of the decline of R0,2 billion in receipts for services rendered to non-residents. A decline in interest and dividend payments to non-resident investors and lower tourist spending by South Africans travelling abroad, were mainly responsible for the decrease in service payments.

Capital account

The *total net inflow of capital* not related to reserves declined from R5,4 billion in the first quarter of 1995 to R4,4 billion in the second quarter; in the first half of 1995 the net inflow of capital nevertheless amounted to R9,8 billion, which was somewhat higher than the inflow of R8,8 billion in the second half of 1994.

The inflow of capital in the second quarter of 1995 consisted largely of *long-term funds*: a net inflow of long-term capital of R3,7 billion was registered. The proceeds of the government debt issue on the Samurai market to the amount of R1,3 billion were responsible for the further net inflow of long-term funds to public authorities; in total, a net amount of R1,1 billion flowed to the public authorities in the second quarter. In addition, public corporations and the banking sector became small net borrowers to the amounts of R0,2 billion and R0,6 billion, respectively. At the same time, the net inflow of long-term capital to the private sector increased from R1,1 billion in the first quarter of 1995 to R1,9 billion in the second quarter. Included in the last-mentioned amount were net purchases by non-residents of securities listed on the Johannesburg Stock Exchange, as well as over-the-counter transactions, of R2,3 billion.

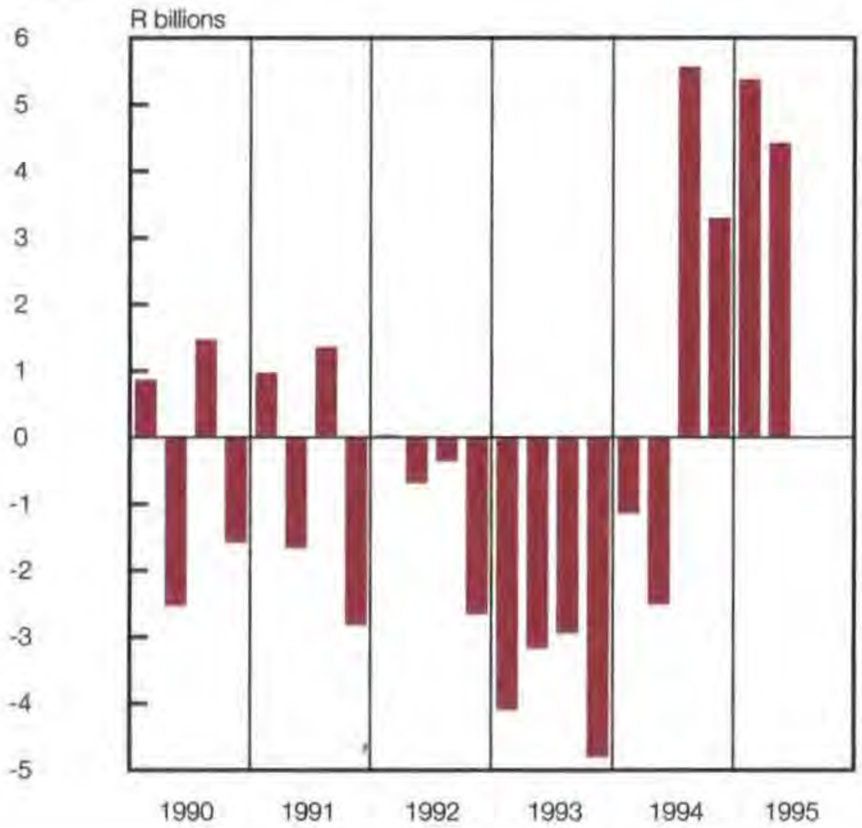
Short-term capital movements (excluding reserve-related liabilities, but including unrecorded transactions) decreased sharply from a net inflow of R4,8 billion in the first quarter of 1995 to an inflow of R0,7 billion in the second quarter. The full outstanding amount of R1,9

Table 5. Net capital movements not related to reserves

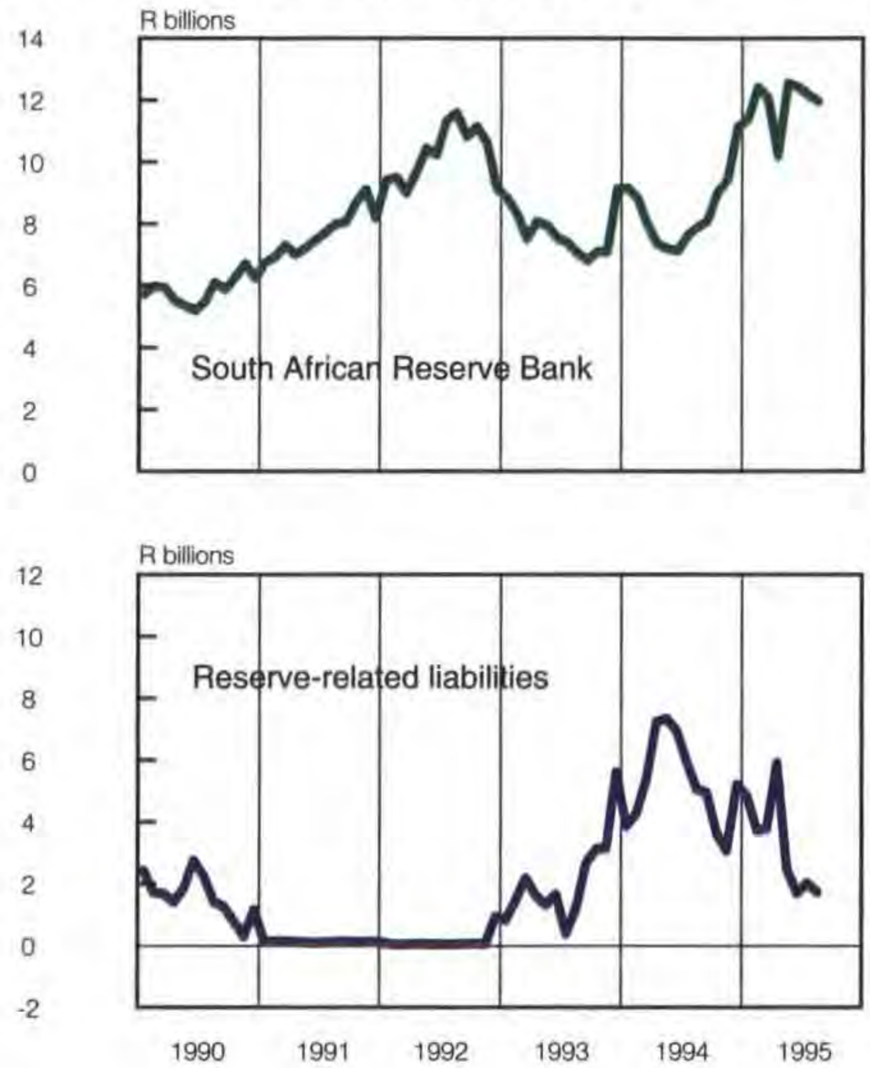
R billions

	1st qr 93 to 2nd qr 94	3rd qr 94 to 2nd qr 95	1st qr 93 to 2nd qr 95
Long-term capital			
Public authorities	-2,5	5,1	2,6
Public corporations..	-3,2	1,0	-2,2
Private sector	2,1	2,9	5,0
Total	-3,6	9,0	5,4
Short-term capital.......	-15,1	9,6	-5,5
Total capital	**-18,7**	**18,6**	**-0,1**

Total net capital movements not related to reserves



Gross gold and other foreign reserves



billion raised from sales of three-month Treasury bills to non-residents in the last quarter of 1994 and the first quarter of 1995 was repaid in the second quarter. Moreover, the somewhat more expensive cost of forward cover may possibly have encouraged importers to make less use of foreign trade financing. Banks, however, continued to borrow funds for the financing of their own activities to the amount of R2,3 billion during the second quarter of 1995.

The capital movements in the second quarter of 1995 brought the total net inflow of capital to R18,6 billion in the twelve months up to the end of June 1995. As shown in Table 5, this net inflow of capital was virtually equal to the net outflow of capital in the preceding eighteen months. However, over the whole period of 2½ years the maturity structure of South Africa's commitments to non-residents improved because of a sharp switch from short- to long-term net indebtedness. Furthermore, it is interesting to note from the table that public authorities and the private sector experienced a large net inflow of long-term capital over the whole period, while the net long-term indebtedness of public corporations was reduced.

Foreign reserves

The net result of the large deficit on the current account of the balance of payments and the even larger net inflow of capital not related to reserves was an increase of R1,1 billion in South Africa's *net gold and other foreign reserves* in the second quarter of 1995; in the twelve months to June 1995 the net foreign reserves have now increased by R10,6 billion. This improved overall balance of payments position enabled the Reserve Bank to reduce its reserve-related liabilities from R8,5 billion at the end of April 1994 to only R1,7 billion at the end of June 1995.

South Africa's *gross gold and other foreign reserves* decreased by R0,9 billion in the second quarter to R15,2 billion at the end of June 1995. Although this level of foreign reserves was equivalent to only six weeks' imports of goods and services, it was considerably higher than the gold and other foreign reserves of R9,7 billion at the end of June 1994. Moreover, the foreign reserves at the end of June 1995 consisted mainly of "non-borrowed" reserves instead of the overwhelmingly "borrowed" reserves at the end of June 1994.

In July and August 1995 the gross gold and other foreign reserves of the Reserve Bank decreased by R0,5 billion to a level of R11,9 billion at the end of August, while the Bank's net foreign reserves declined by R0,3 billion.

Exchange rates

After having weakened by almost 6 per cent from the end of December 1994 up to 10 March 1995 (i.e. the period prior to the abolition of the dual exchange rate system), the *nominal effective exchange rate* of the rand

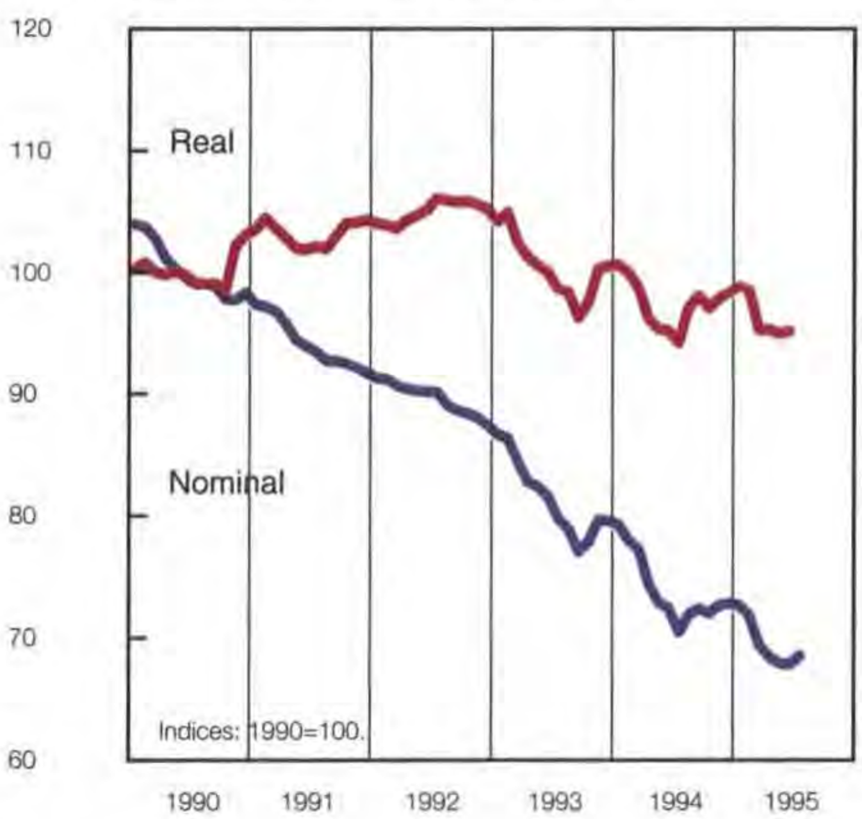
Table 6. Changes in the exchange rates of the rand
Per cent

	31 Dec 1994 to 10 Mar 1995	10 Mar 1995 to 30 Jun 1995	30 Jun 1995 to 31 Aug 1995	31 Dec 1994 to 31 Aug 1995
Weighted average....	-5,8	-0,5	2,5	-3,8
US dollar..................	-2,4	-0,2	-0,5	-3,2
British pound............	-5,3	0,7	2,3	-2,5
German mark...........	-11,7	-1,6	5,5	-8,3
Japanese yen...........	-10,7	-7,3	14,5	-5,3
Netherlands guilder..	-11,6	-1,7	5,6	-8,2
Italian lira..................	-0,1	-1,8	-1,6	-3,5

decreased by only 0,5 per cent in the ensuing period until 30 June 1995. This relatively steady performance of the average weighted exchange rate of the rand was the result of a marginal depreciation of the rand against all the main currencies, except the British pound. The rand, however, depreciated sharply against the Japanese yen over this period on account of the relative strength of this currency in the international foreign exchange markets.

In the period from the end of June 1995 to the end of August 1995, the rand appreciated again vis-à-vis all the major currencies, except the US dollar and the Italian lira.

Effective exchange rates of the rand



The strength of the US dollar against the Japanese yen, German mark and Netherlands guilder in the last half of August 1995 caused a marked appreciation of the rand against these currencies. As a result of these changes, the nominal effective exchange rate of the rand rose by about 2½ per cent in July and August 1995. In the first eight months of 1995 the nominal effective exchange rate of the rand declined, on balance, by nearly 4 per cent.

The *real effective exchange rate* of the rand declined by 3½ per cent from December 1994 to June 1995. This brought the real effective exchange rate of the rand to nearly 10 per cent below its peak in July 1992.

Monetary developments, interest rates and financial markets

Money supply

After having receded from a peak of 16,9 per cent in July 1994 to 11,8 per cent in February 1995, the twelve-month rate of increase in the *broadly defined money supply* (M3) accelerated again to 16,8 per cent in June 1995. The monthly values of M3 (seasonally adjusted), which had started the 1995 guideline year below the lower limits of the "cone" but within the "tunnel", accordingly moved above the upper limit of the cone in March 1995 and above the tunnel in April 1995. In fact, the preliminarily estimated seasonally adjusted monthly value of M3 in July 1995 was R12,8 billion, or 5,0 per cent, higher than the corresponding value of the upper limit of the guideline "cone". The growth rate in the seasonally adjusted value of M3 from the base of the guideline year amounted to an annualised rate of 17,9 per cent, compared with the upper limit of the guideline range of 10 per cent.

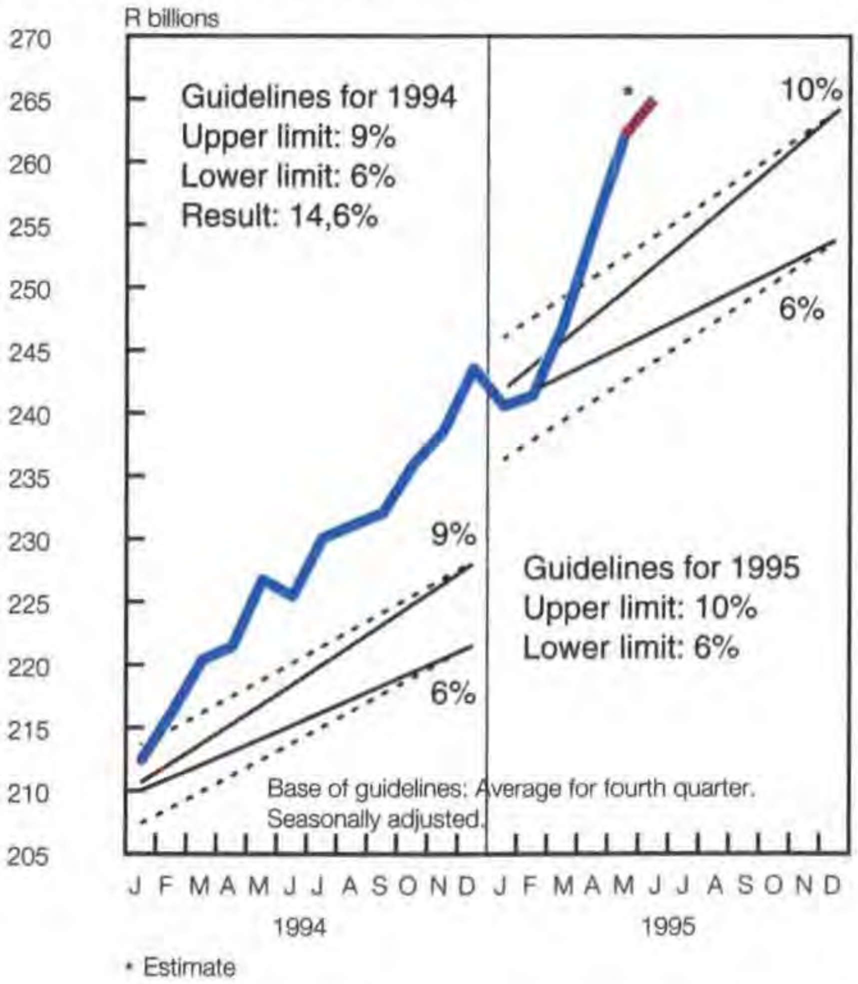
As shown in Table 7, the growth rates in the *narrower monetary aggregates,* with the notable exception of M1, broadly displayed the same growth pattern as M3. The twelve-month rate of increase in M1 continued to decline from a turning-point of as much as 32,7 per cent in July 1994 to 7,3 per cent in May 1995 and then rose only slightly to 7,8 per cent in June. This clearly reflected a shift from demand deposits (other than cheque and transmission deposits) to medium- and long-term deposits, probably based on expectations that longer-term interest rates and yields had reached a peak and would start declining.

The quarter-to-quarter rates of increase in all the monetary aggregates also accelerated sharply in the second quarter of 1995. Because the money stock is demand-determined under the present monetary control system, this more rapid rate of increase in the monetary aggregates probably reflected mainly the sharp growth in real gross domestic expenditure. Reintermediation was another factor which could have contributed to the high rates of increase in the money supply in the second quarter of 1995. A narrowing of the margin between

Table 7. Percentage change in money supply over twelve months

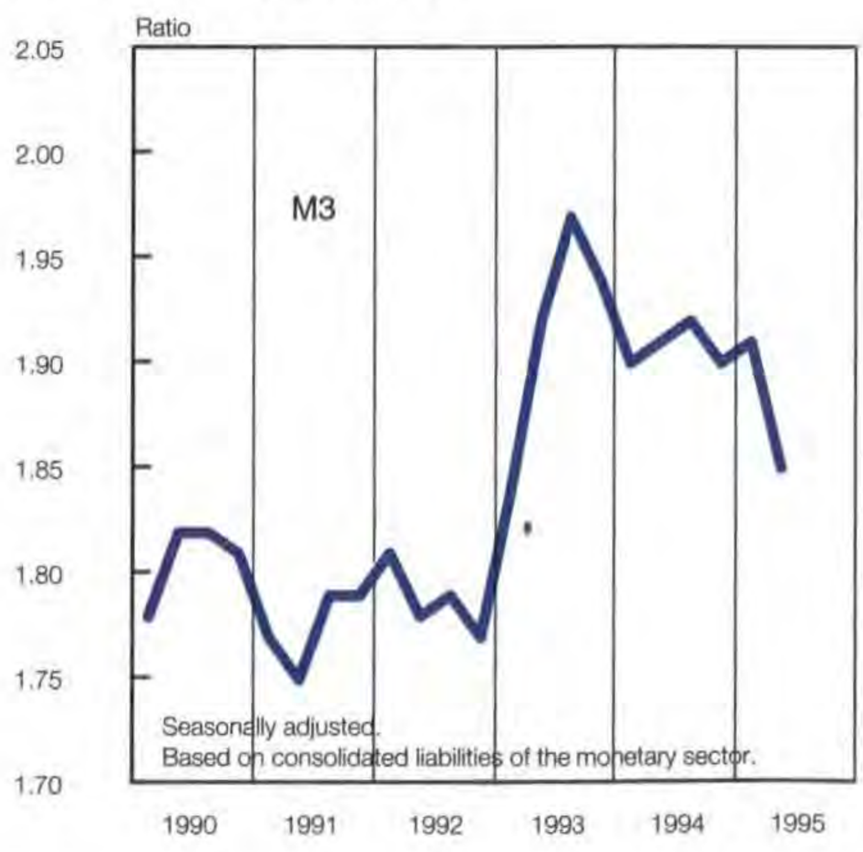
Period		M1A	M1	M2	M3
1994:	July	28,2	32,7	19,5	16,9
	December ...	24,8	23,7	20,6	15,7
1995:	March..........	6,6	10,4	12,6	12,2
	April.............	11,6	9,4	15,8	14,9
	May.............	11,3	7,3	15,6	15,9
	June............	17,0	7,8	15,6	16,8

Guidelines for growth in M3



• Estimate

Income velocity of money



banks' deposit and lending rates, as experienced in the first six months of 1995, normally favours the intermediation process. This is confirmed by developments in the *income velocity of circulation* of M3: after remaining fairly constant throughout 1994 and the first quarter of 1995, the income velocity of circulation declined by 3,0 per cent in the second quarter of 1995.

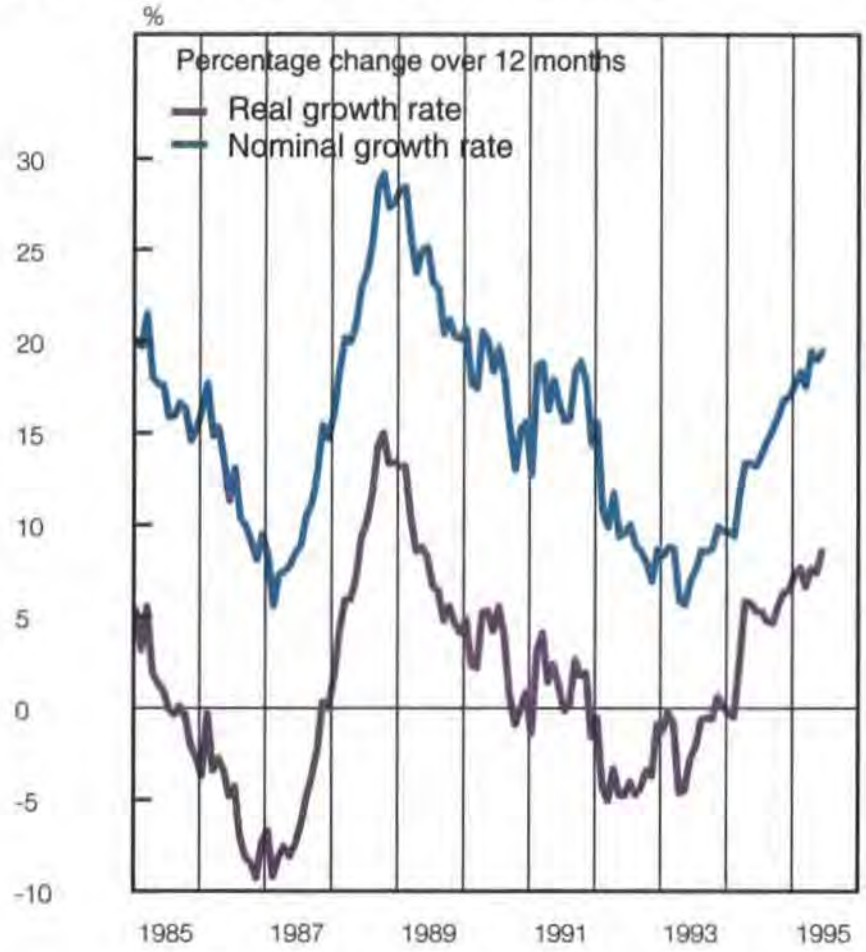
The *main counterparts* (in a statistical or accounting sense) of the R12,3 billion increase in M3 in the second quarter of 1995 were increases of R11,6 billion in total domestic credit extension and R4,2 billion in the so-called net other assets and liabilities of the monetary sector. In contrast to these developments, the net foreign assets of the monetary institutions decreased by R3,4 billion: a decline in the total gross gold and other foreign reserves and a substantial increase in the foreign loans of private banks more than offset the decline in the reserve-related liabilities of the Reserve Bank.

Credit extension

The growth in *total domestic credit extension* by the banking sector over twelve-month periods, which had receded from 19,9 per cent in December 1994 to 13,0 per cent in March 1995, rose again to 15,3 per cent in June 1995. This higher growth in credit extension by the monetary sector in the second quarter of 1995 was due to increases both in credit extension to the private sector and in the net claims on the government sector. The net credit extended to the *government sector* rose sharply, by R2,5 billion, as a result of an increase of R5,5 billion in the gross claims on the government, which was neutralised partly by a rise of R3,0 billion in government deposits with monetary institutions.

Credit extension to the *private sector* continued to grow at substantially higher twelve-month rates of increase than the broad money supply in the second quarter of 1995, largely because of a strengthening in consumer confidence following the successful outcome of the April 1994 elections and credit becoming available to individuals who did not previously qualify for bank loans. The fact that an increasing proportion of domestic expenditure was financed by means of bank credit led to an almost uninterrupted rise in the twelve-month growth rate in credit extended by monetary institutions to the private sector from a trough of 5,7 per cent in May 1993 to 19,5 per cent in April 1995; this rate then fluctuated around this high level in the next two months. These growth rates exceeded the rate of inflation as measured by changes in the consumer price index, with the result that real credit extension to the private sector increased by 8,6 per cent over the twelve months up to June 1995.

Credit extension to the private sector



An analysis of monetary institutions' claims on the private sector by *type of credit* shows that the R9,2 billion

Table 8. Percentage change over twelve months in credit extension to the private sector by main type of credit

Period	Investments and bills	Instalment sales	Leasing finance	Mortgages	Other loans and advances	Total
1994: December	28,0	27,6	7,2	17,9	12,8	17,0
1995: March	33,6	25,4	7,9	19,6	12,2	17,6
April	28,1	26,8	9,0	19,3	18,2	19,5
May	23,2	28,1	9,5	19,6	16,7	19,1
June	27,0	27,8	13,8	19,5	16,7	19,5

increase in credit extension to the private sector in the second quarter of 1995 could largely be ascribed to increases of R4,6 billion in mortgage advances, R2,3 billion in instalment sales credit and R1,5 billion in so-called "other loans and advances" (including current account overdrafts). These three types of credit extension therefore represented about 92 per cent of the increase in credit extension to the private sector during the three months ended June 1995.

The rate of increase over twelve months in mortgage advances fluctuated around a level of 19½ per cent in the second quarter of 1995, notwithstanding a lower rate of expansion of activity in the real estate market. These accounts have been used increasingly by borrowers to finance purchases of durable and other consumer goods in view of the flexibility of some of the mortgage schemes of banks and the comparatively low interest rates on mortgage advances. Banks promoted this credit facility on account of the low capital requirements applicable to it and the low credit risk of such loans.

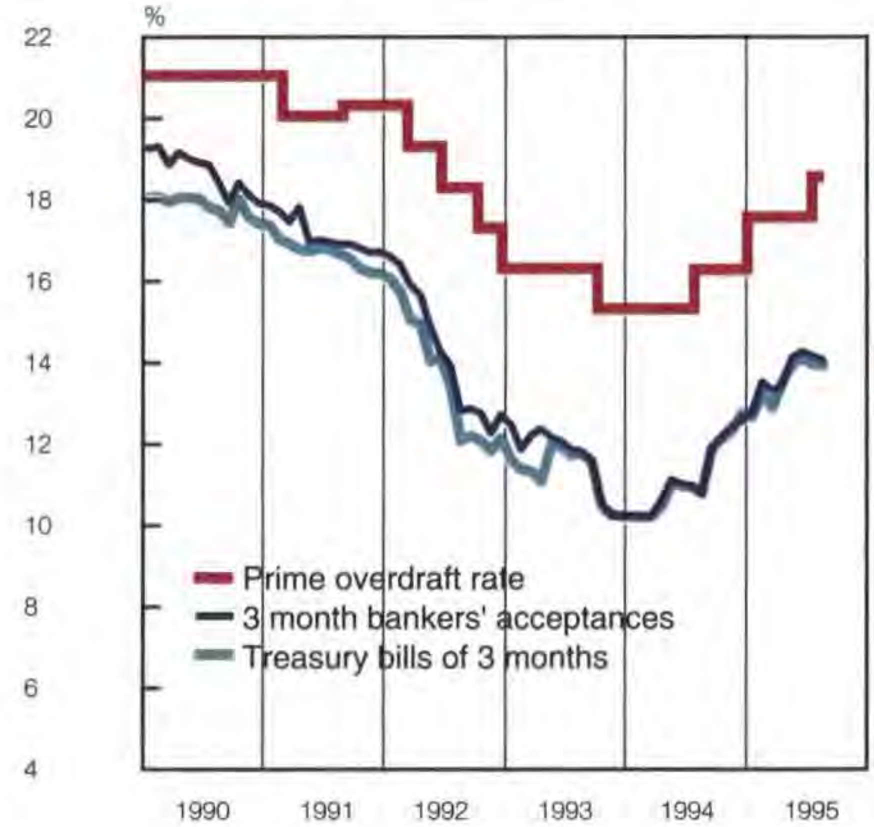
In contrast to the relative stability in the twelve-month growth rate of mortgage advances, the corresponding growth rates in instalment sales credit and "other loans and advances" rose in the second quarter of 1995. The buoyant demand for these types of credit was also due to the financing of outlays on consumer durables, particularly purchases of new and used motor vehicles. Leasing finance, which had remained subdued during 1994 and the first five months of 1995, rose sharply in June 1995 to a level above the rate of inflation recorded over a period of twelve months.

Interest rates and yields

The *yield curve* shifted to a slightly lower level during the first half of 1995 and flattened somewhat more as short-term rates moved higher in response to the tightening of the monetary policy stance while long-term yields declined slightly. The increase in Bank rate on 22 February 1995 by one percentage point from 13 to 14 per cent and by a further one percentage point on 30 June 1995 to 15 per cent did not have an immediate effect of the same magnitude on short-term interest rates, which had already firmed in anticipation of the tightening of monetary policy. On balance, the tender rate on Treasury bills with a maturity of three months firmed from 12,69 per cent at the end of December 1994 to 14,07 per cent on 1 July 1995, which represented an increase of 138 basis points against the 200 basis points increase in Bank rate over this period. The yield on long-term government bonds, on the other hand, declined by 21 basis points from the end of December 1994 to the end of July 1995.

Yields in the money as well as the capital market subsequently softened during July and August 1995. Yields on long-term government bonds decreased significantly in August 1995 when they fell back by 64 basis points; short-term yields decreased by 2 basis points over the same period. This softening in yields

Short-term interest rates



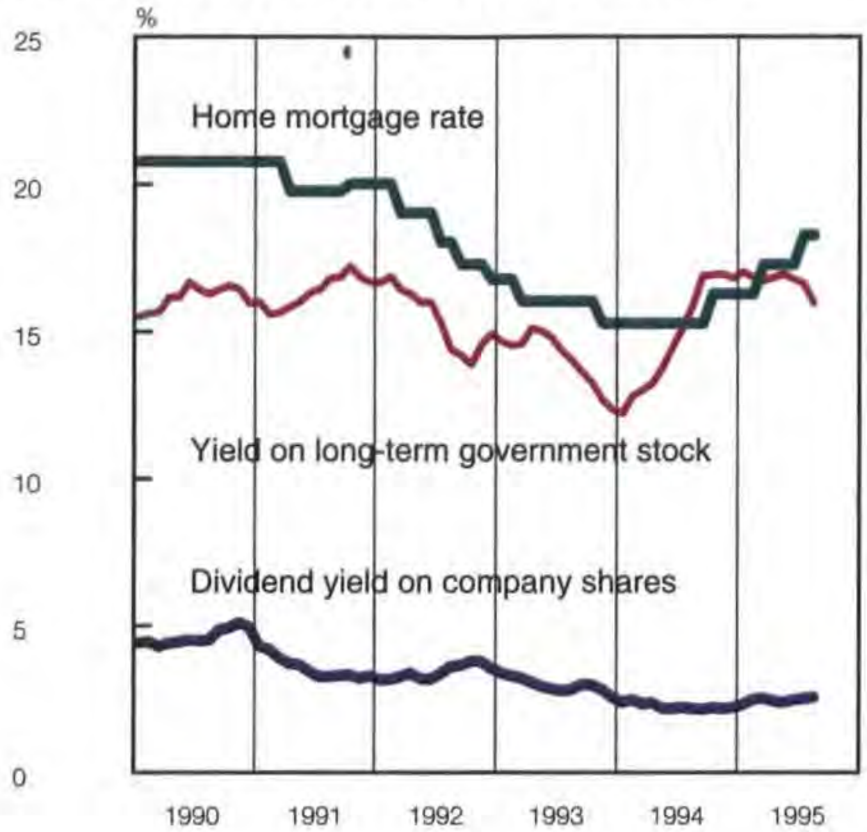
was brought about by renewed interest in South African bonds by non-residents, a decline in bond yields abroad and lower actual and expected domestic inflation. The tender rate on Treasury bills of three months declined to 13,88 per cent at the end of August 1995, while the yield on long-term bonds also fell from 16,69 per cent at the end of June 1995 to 15,76 per cent at the end of August.

Closely adhering to the Bank rate change at the end of June 1995, the *prime lending rates* of the banks were raised by one percentage point to 18,50 per cent on 3 July 1995. The banks also increased their predominant *rate on mortgage loans,* which had stood at 17,25 per cent from March 1995, to 18,25 per cent in August 1995 in reaction to the increase in Bank rate. The interest rates on the fixed rate mortgage bonds announced in June 1995 will, for instance, vary between 20 per cent in the case of loans of between R50 001 and R65 000 and 22,5 per cent in the case of loans between R10 000 and R25 000.

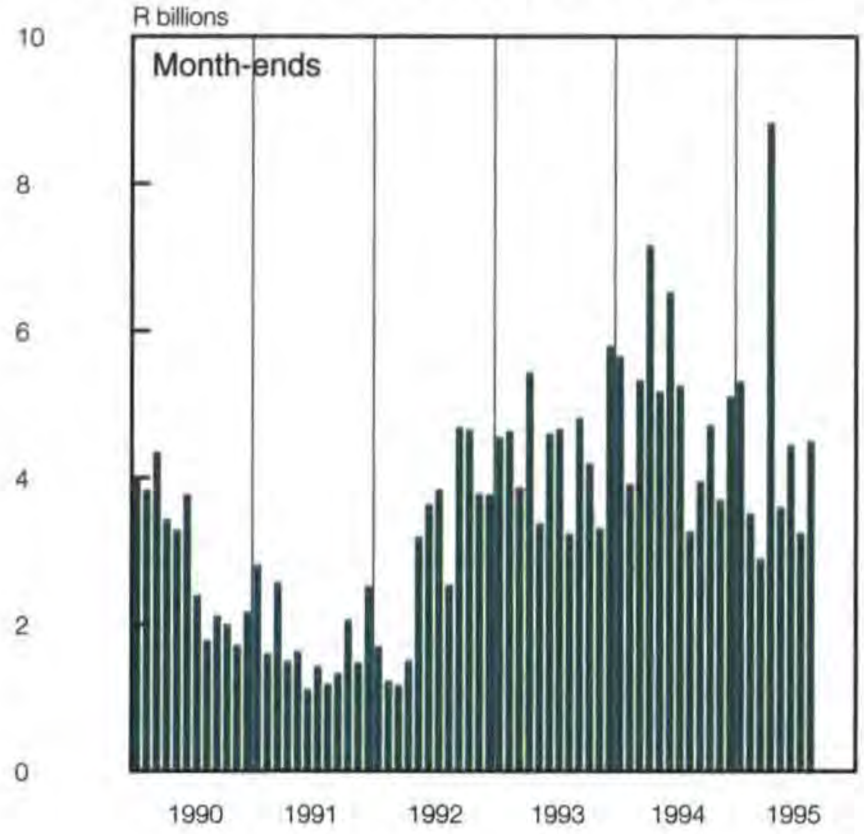
The predominant *rate on twelve-month fixed deposits* with banks was also raised by one percentage point to 14,5 per cent in June 1995. This brought the total increase in this rate since the middle of 1994 to 3 percentage points against an increase of 2,25 percentage points in prime lending rates. In July 1995 the twelve-month deposit rate provided investors with a real pre-tax yield of 5,0 per cent.

The maximum *rates laid down in terms of the Usury Act* were increased from 25,0 to 26,0 per cent in April 1995 in respect of money lending, credit and leasing

Capital market interest rates and yields



Accommodation at the discount window



transactions for amounts of more than R6 000 but not exceeding R500 000, and from 28,0 to 29,0 per cent in respect of amounts up to R6 000.

Money market

Money market conditions, which had tightened considerably in April 1995, eased significantly in the subsequent months up to the end of July 1995. This was clearly reflected in the amount of accommodation at month-ends, which initially increased from R2,9 billion at the end of March 1995 to R8,8 billion at the end of April before easing again to R3,2 billion at the end of July. This substantial decline in the money market shortage was mainly due to the sharp increase of nearly R7 billion in the net foreign assets of the Reserve Bank in May 1995. A sharp increase in government deposits with the Reserve Bank arising from the sales of government stock then caused the money market shortage to rise again to R4,5 billion at the end of August 1995.

Money market conditions since the second quarter of 1995 were characterised by very sharp fluctuations arising from changes in the net foreign assets of the Reserve Bank and in the government deposits with the Reserve Bank. Large capital flows between South Africa and the rest of the world led to more volatile changes in the net foreign assets of the Reserve Bank. This was aggravated by the transfer payments that are made at the beginning of each month by the central government to the nine provinces, which on certain occasions led to substantial changes in government deposits with the Reserve Bank.

The *Reserve Bank's operations* in the money market during this period were mainly aimed at neutralising liquidity in order to keep its refinancing facilities effective. The very large fluctuations in the money market shortages which occurred during the five months to August 1995 were counteracted by Reserve Bank transactions such as foreign exchange swaps, adjustments made in the asset portfolio of the Corporation for Public Deposits and the daily management of government deposits with the Reserve Bank.

Bond market

As in 1994 and in the first three months of 1995, activity in the domestic *primary bond market* was completely dominated by the public sector in the first four months of fiscal 1995/96 (i.e. the period April 1995 to March 1996). Net new issues of fixed-interest securities by the public sector came to R11,7 billion in this period; in the corresponding period of the preceding year the public sector raised R7,0 billion in this manner. The funds acquired by listed private-sector companies through new issues of fixed-interest securities (including convertible preference shares, debentures and corporate bonds) remained low. In the four months from April to July 1995 issues to the value of R0,9 billion were made by companies listed on the stock exchange.

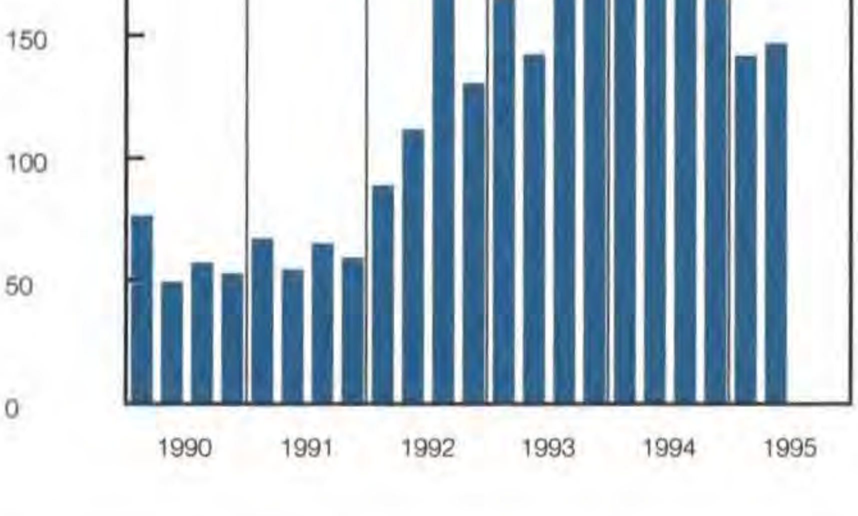
A number of companies, however, continued to raise capital in foreign markets by means of convertible bonds to the amount of R0,7 billion in the second quarter of

1995. In total R2,1 billion was obtained in this manner by private companies in the eighteen months from January 1994 to June 1995, because international investors were willing to take up positions with the view that South African corporate earnings offer attractive growth prospects. Capital-raising operations took advantage of this demand, and in some instances exchange control approval was given that a certain percentage of the proceeds be held offshore by South African companies in order to fund international expansion. In July 1995 the Reserve Bank also announced that approval would be given on a case-by-case basis for insurance companies, pension funds and unit trusts to negotiate international asset swaps.

Activity in the *secondary bond market* subsided further in the second quarter of 1995. After having reached a peak monthly average of R98,2 billion in the third quarter of 1994, the value of public-sector stock traded on the Johannesburg Stock Exchange halved to a monthly average of R49,0 billion in the second quarter of 1995. In July and August 1995 the value of such transactions amounted to R49,2 billion and R111,8 billion, respectively. The higher level of public-sector stock traded in August was to a large extent affected by the sharp fall in long-term yields during this month.

The high level of liquidity facilitated a reduction in the *Reserve Bank's role as market-maker* in the secondary market for government stock. Gross sales of government stock by the Reserve Bank accordingly receded somewhat from a monthly average of R13,7 billion in 1994 to R6,9 billion in the first seven months of 1995. The Bank also reduced its trading in government stock options from a monthly average of R7,4 billion to R5,5 billion over the same period.

Stock exchange transactions



Non-residents were actively involved in the secondary bond market. In February 1995 they became net sellers of public-sector stock, probably in anticipation of the abolition of the dual exchange rate system. These sales increased significantly in the week before and after the dismantling of the financial rand. All in all, non-residents were net sellers of stock to the amount of R363 million in the first quarter of 1995. With the external value of the rand having remained relatively stable, the yield on long-term bonds was attractive to foreign investors and led to net purchases of government bonds by non-residents totalling R1,1 billion in the five-month period from April to August 1995.

Equity market

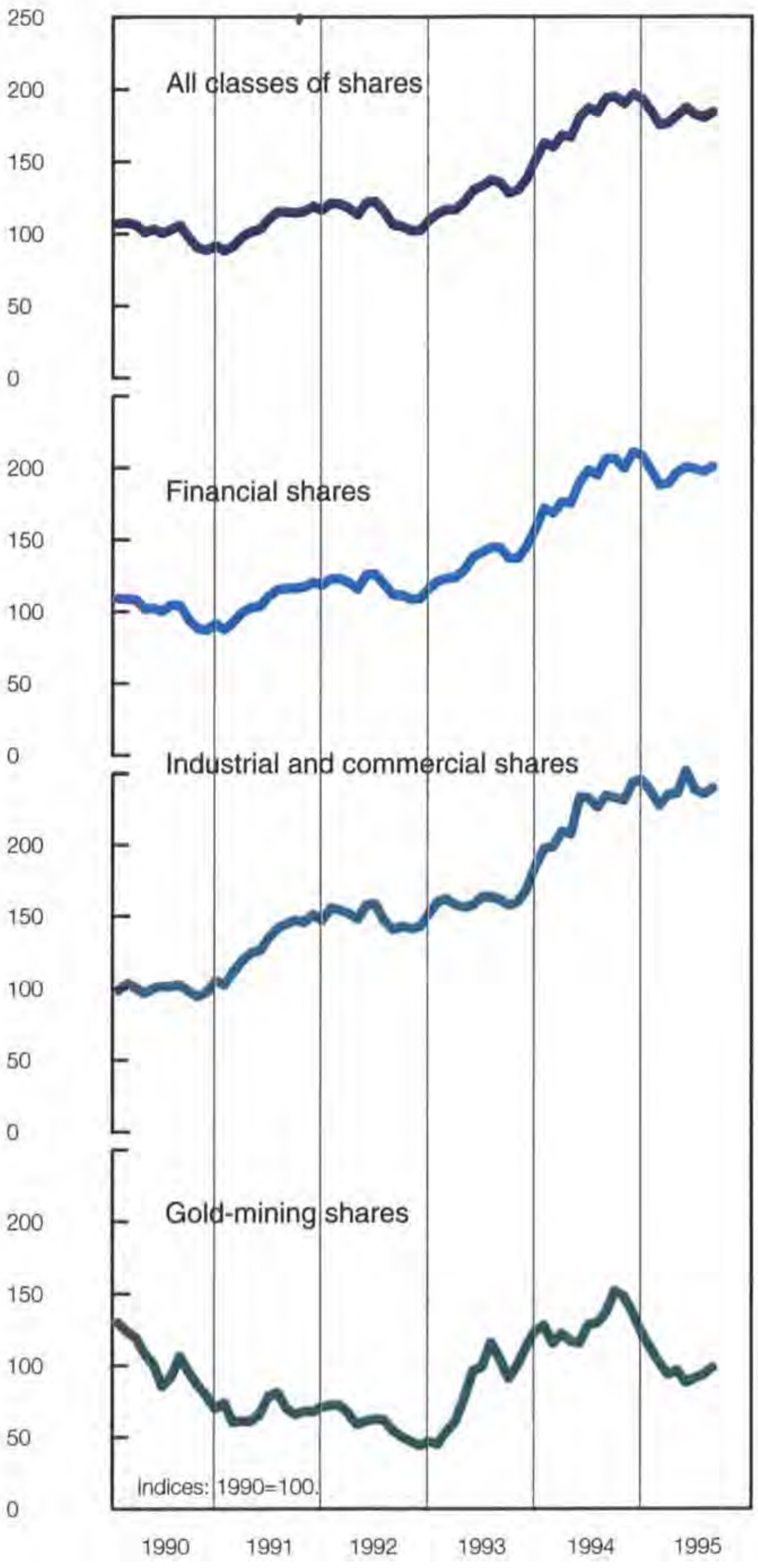
The demand for funds in the *primary equity market* remained firm in the first seven months of 1995 owing to high and increasing share prices and a shortage of scrip. After having raised R2,3 billion in the first quarter of 1995, the value of rights issues of ordinary shares came to R1,8 billion in the four months ended July 1995. The value of shares issued as scrip dividends also remained popular as a result of the Secondary Tax on Companies, which discouraged the declaration of cash dividends.

Turnover in the *secondary equity market* towards the end of 1994 and during most of the first seven months of 1995 was negatively affected by the high level of interest rates and a lacklustre performance of share markets world-wide. The monthly average value of shares traded on the Johannesburg Stock Exchange declined from R6,0 billion in 1994 to R4,3 billion from January to April 1995, but recovered somewhat in the ensuing four months to R5,4 billion, in response to recoveries on some of the major stock exchanges of the world.

Spurred by the removal of exchange control on *non-residents* and the inclusion of the Johannesburg Stock Exchange in the International Finance Corporation's Emerging Market Index, the net purchases of equities by non-residents on the Johannesburg Stock Exchange increased from R0,8 billion in the first quarter of 1995 to R2,0 billion in the second quarter. In July and August they made further net purchases of R1,0 billion, which brought their total net purchases of equities to R3,8 billion in the first eight months of 1995. As a consequence, gross purchases by non-residents as a ratio of the total value of shares traded increased from 31,4 per cent in 1994 as a whole to 41,9 per cent in the first eight months of 1995.

The downward movement in *share prices* from November 1994 until February 1995 was subsequently reversed by factors such as higher company profits and attempts to encourage foreign investment in South Africa. The average price level of all classes of shares accordingly recovered by 6,9 per cent from February to

Share prices



May 1995, but then fell back by 1,6 per cent in the next three months. In August 1995 the level of all classes of share prices was 6,1 per cent below the upper turning-point in November 1994.

After having reached a new record high in September 1994, lower gold-mining profits, labour unrest on certain mines and the mining of lower grade gold-bearing ore continued to depress the prices of gold-mining shares during 1995. Despite having recovered somewhat from April 1995, the level of gold-mining share prices in August was still 34,9 per cent below the high of September 1994.

Mirroring the changes in share prices, the average *dividend yield* on all classes of shares declined at first from 2,50 per cent in March 1995 to 2,35 per cent in May and then rose again to 2,54 per cent in August. The average *earnings yield* on all classes of shares (excluding gold-mining shares) increased from 5,95 per cent in March 1995 to 6,29 per cent in August.

Other financial markets

The stable environment in the foreign exchange market, a decline in non-resident participation and a greater wariness about futures transactions caused the level of activity on the South African Futures Exchange to decline in the second quarter of 1995. The turnover in *futures contracts* fell back from an all-time quarterly high of 1,4 million contracts in the first quarter of 1995 to 0,7 million contracts in the second quarter of 1995. An overwhelming part of these transactions consisted of equity futures contracts, while activity in interest rate contracts remained low and the volume of transactions in the Kruger Rand futures contract and a new Bank Bill futures contract were relatively insignificant. Trade in commodity futures contracts started in July 1995, with the beef future as the only contract being traded.

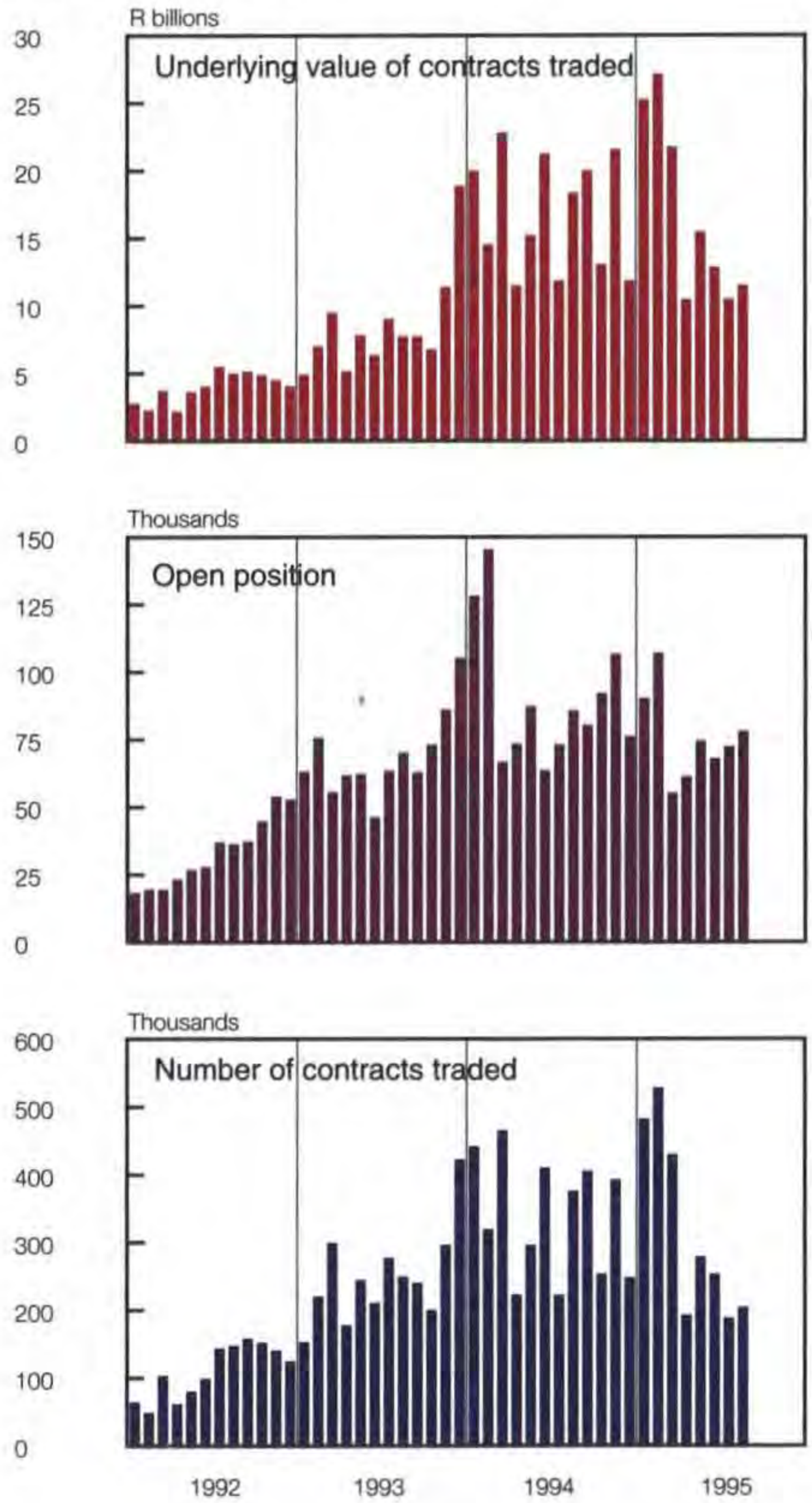
The number of options on equity futures receded from a record of 1,5 million contracts in the first quarter of 1995 to 0,6 million contracts in the second quarter. Equity options also dominated the total position in option contracts, with very little activity in interest-based options on futures contracts. Options on the new commodities futures contracts are not yet available in the formal market and are only traded in the over-the-counter market.

Open positions in futures contracts and options on futures contracts traded on the South African Futures Exchange increased significantly. Based on the mark-to-market prices of equity futures and options, the total open position was worth R4,8 billion at close of business on 31 August 1995.

As indicated before, the *mortgage market* was strong in the first six months of 1995 despite a somewhat less lively housing market and a lacklustre commercial and industrial letting market in the first quarter of 1995. Mortgage financing may in future be affected by the implementation of the government's mass housing programme, which got off the ground in June 1995.

Investors in property became more cautious towards the end of 1994 and the value of transactions in the *real estate market* receded from a peak of R8,4 billion in the third quarter of 1994 to R7,8 billion in the first quarter of 1995, before recovering somewhat to R8,2 billion in the second quarter. The increase in real estate prices, the

Futures exchange transactions: Futures contracts



continued high nominal and real mortgage rates and expectations of a further rise in interest rates were probably mainly responsible for the lower level of transactions in fixed property.

Public finance

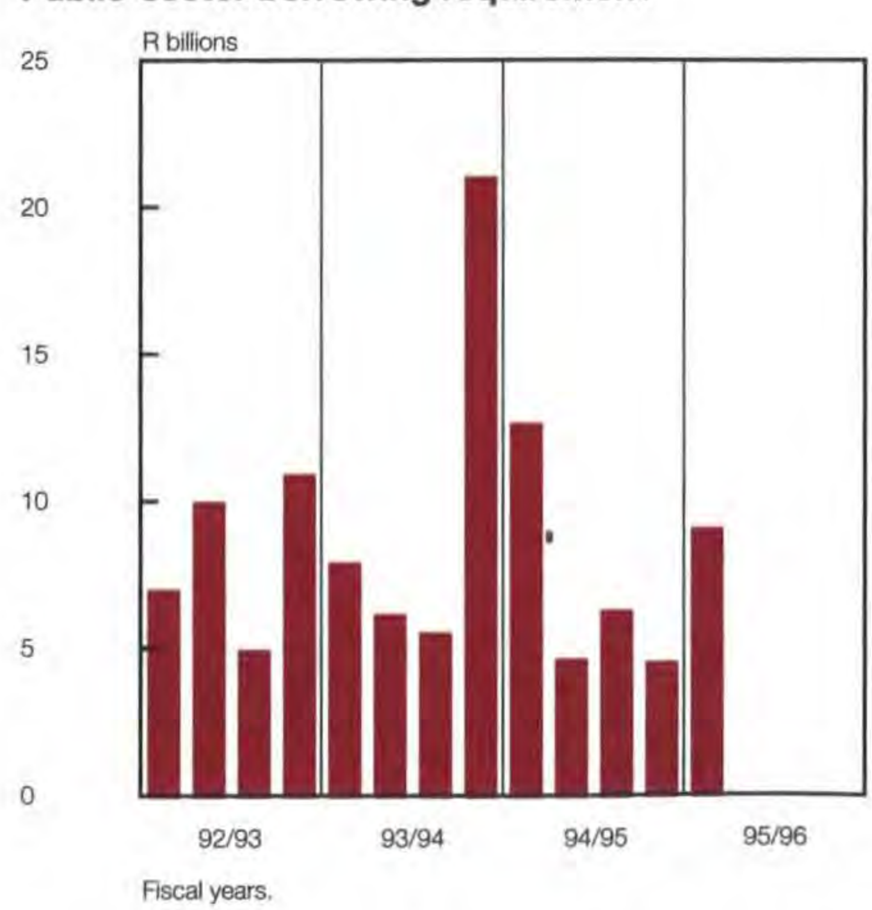
Public-sector borrowing requirement

The public-sector borrowing requirement (i.e. the deficit before borrowing and debt repayment of the consolidated central government, provincial governments, local authorities and non-financial public enterprises) amounted to R9,1 billion in the first quarter of fiscal 1995/96, or to 7,8 per cent of gross domestic product. This was considerably lower than the deficit of R12,7 billion, or 12,0 per cent of gross domestic product, recorded in the corresponding quarter of the preceding fiscal year. As illustrated in Table 9, this lower public-sector borrowing requirement may be due to special circumstances related to the constitutional changes in South Africa.

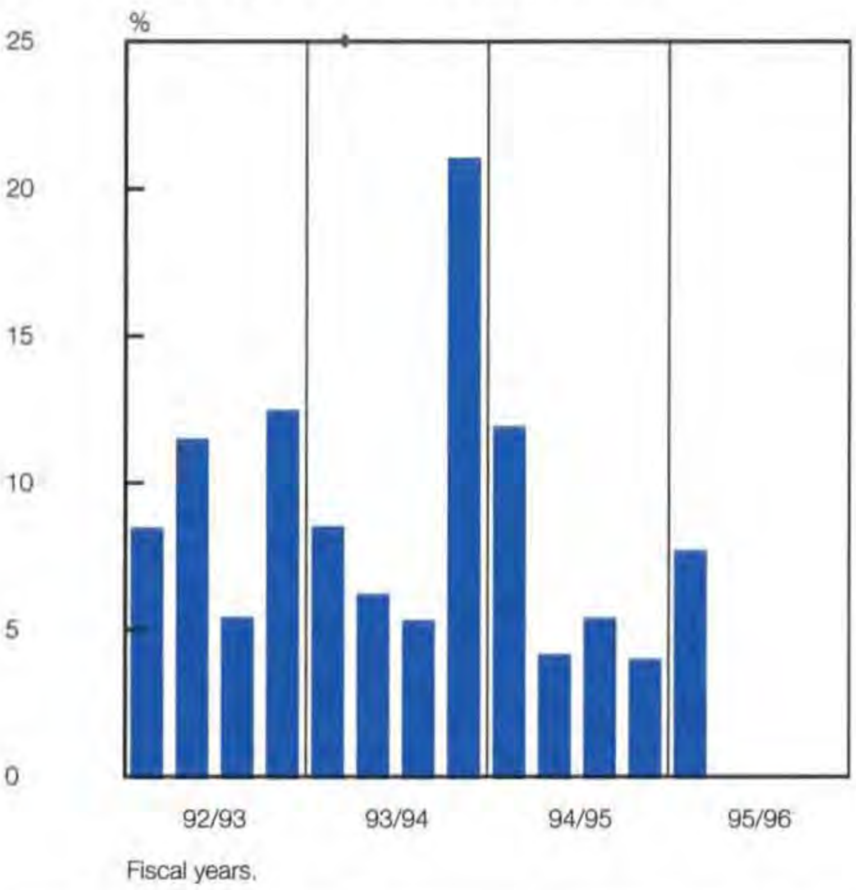
Administrative problems experienced by the newly established *provincial governments* restrained their expenditure. Whereas the total expenditure by provincial governments has normally exceeded their total revenue and grants, a surplus of R2,0 billion was registered in the first quarter of fiscal 1995/96. This surplus offset to a large extent the deterioration in the finances on the Main Budget, where the deficit came to R11,0 billion notwithstanding the additional proceeds of R1,2 billion from the sale of strategic oil reserves in April 1995.

The devolution of certain powers from the central government to the provincial governments also had a marked effect on the expenditure on the *Main Budget*.

Public-sector borrowing requirement



Public-sector borrowing requirement as percentage of gross domestic product



These constitutional changes in intergovernmental fiscal relations led to a sharp increase in the transfer payments from the Main Budget to the provincial governments. As a result, transfer payments in the Main Budget in the first quarter of fiscal 1995/96 were no less than 60,5 per cent higher than in the first quarter of fiscal 1994/95. On the other hand, the Main Budget expenditure on goods and services decreased by 32,3 per cent over the same period.

In comparison with the first quarter of fiscal 1994/95, the finances of local authorities and other public-sector entities improved in the first quarter of fiscal 1995/96. The *local authorities* continued to maintain relatively small borrowing requirements because of considerable increases in tariffs imposed on their inhabitants. The surplus on the income and expenditure accounts of the *other public-sector entities* was mainly due to a favourable outcome in the finances of extra-budgetary institutions and non-financial public corporations and central-government enterprises.

Exchequer account

Exchequer issues to government departments (adjusted to reflect cash flows) in the first four months of fiscal 1995/96 were 17,5 per cent higher than comparable figures in the first four months of the preceding year. This rate of increase was well above the average year-on-year rate of increase of 13,9 per cent over the corresponding

Exchequer receipts and issues

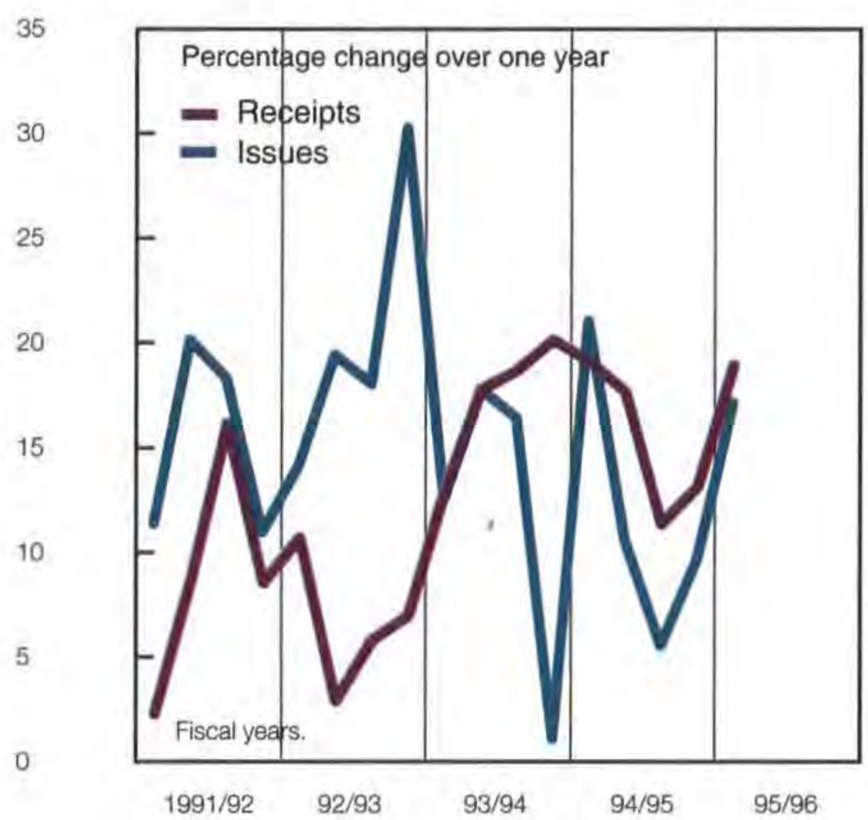


Table 9. Public-sector borrowing requirement

R billions

Fiscal years		Main Budget	Provincial governments	Local authorities	Other public sector	Total
1994/95	1st qr	10,9	1,1	0,8	0,0	12,7
	2nd qr	4,8	0,5	-0,6	-0,1	4,7
	3rd qr	4,3	0,6	0,1	1,5	6,4
	4th qr	4,7	0,2	0,3	-0,5	4,6
1995/96	1st qr	11,0	-2,0	0,7	-0,5	9,1

period of the preceding five fiscal years and was also substantially higher than the growth rate of 9,0 per cent provided for in the Budget for fiscal 1995/96. A large part of this increase was due to a shift in the interest payments pattern to the first four months of the fiscal year, which resulted from new interest payment dates on debt issued during the previous fiscal year. As a ratio of the total budgeted expenditure of R152,7 billion for the fiscal year 1995/96, Exchequer issues of R51,9 billion in the first four months of this year came to 34,0 per cent.

Exchequer receipts in the first four months of fiscal 1995/96 amounted to R39,0 billion, or 13,5 per cent more than the comparable level in the corresponding period of the preceding year. This increase in the first four months was substantially higher than the budgeted increase of 10,3 per cent in government revenue for the full fiscal 1995/96.

The receipts of Inland Revenue were mainly responsible for the higher-than-expected increase in government receipts during the first four months of fiscal 1995/96. Income tax receipts rose more rapidly than envisaged in the Budget on account of the high level of economic activity, fairly sharp increases in salary and wage adjustments and relatively large net profits of business undertakings. Income tax receipts could continue to perform well in the rest of the fiscal year because the transition levy introduced during the previous year was effectively incorporated in the individual income tax rates applicable in fiscal 1995/96, and the last part of the transition levy (1,67 per cent) is being collected throughout the fiscal year. The proceeds from value-added tax were also higher than foreseen in the Budget owing to the continued high growth in domestic expenditure.

Government revenue from customs and excise duties decreased by 6,0 per cent in the first four months of fiscal 1995/96 against the first four months of the preceding year. The Budget provided for an increase of 4,3 per cent in this source of revenue for fiscal 1995/96 as a whole. This relatively poor performance of the receipts from customs and excise duties was due to the partial abolition of the surcharge in the preceding year, which only began to have an impact on these receipts from August 1994. The income receipts from the surcharge therefore were reduced by over one half from the first four months of fiscal 1994/95 to the first four months of fiscal 1995/96.

Table 10. Percentage increase in Exchequer receipts, 1995/96

	Budgeted increase	Increase in first four months*
Exchequer receipts	10,3	13,5
Customs and excise duties	4,3	-6,0
Inland revenue	11,2	19,7
Income tax	11,4	12,7
Value-added tax	13,0	15,9

*Year-on-year rate

The higher-than-budgeted Exchequer issues and receipts resulted in an *Exchequer deficit* before borrowing and debt repayment of R12,9 billion for the first four months of fiscal 1995/96. This deficit was equal to 43,3 per cent of the budgeted deficit of R29,7 billion for the year as a whole. The deficit for the corresponding period of fiscal 1994/95 came to 37,7 per cent of the deficit budgeted for that year.

The deficit of R12,9 billion, plus the discount on new government stock issues of R3,6 billion, was financed by means of the following *borrowing instruments:*

	R millions
Government stock	16 746
Treasury bills	1 566
Foreign loans	1 301
Non-marketable securities	-38
Money market instruments	7
Extraordinary receipts	1 203
Change in available cash balances at the:	
Reserve Bank	-1 208
Banks	-2 081
Total financing	16 496
Less: discount on new government stock	3 621
Total net financing	**12 875**

As a result of this financing of the Exchequer deficit, outstanding *government debt* increased from R245,3 billion at the end of March 1995 to R264,0 billion at the end of July 1995. As a ratio of gross domestic product, government debt amounted to 57,8 per cent at the end of July 1995.