Quarterly economic review

Introduction

The upturn in economic activity, which had started fairly vigorously towards the middle of 1993 and had faltered somewhat during the political transition in the first half of 1994, regained much of the lost momentum and strengthened at a brisk and accelerating rate in the second half of 1994. The growth in domestic output was widespread and positive growth rates were recorded in all the main economic sectors, with the exception of mining. The mining of lower-grade ore, unstable labour conditions, the closure of some mines and technical difficulties experienced in the production process restricted the production of gold and were largely responsible for a decrease in the real value added of mining.

Owing to the strong growth in real domestic production and an improvement in South Africa's terms of trade, the real gross national product of the country rose by 3½ per cent in 1994. This was the first year since 1988 that the growth in real gross national product exceeded the population growth rate. The real gross national product per capita therefore recouped some of its previous losses and rose by 1 per cent to a level of about R6 650 in 1994.

Although part of the rise in domestic output was related to an increase in exports, the stimulus for the rise in production originated mainly from a substantial increase in domestic demand. All the components of domestic expenditure rose sharply throughout 1994, contributing to an increase of 6 per cent in aggregate real gross domestic expenditure. While the increase in real personal disposable income was only moderate, real private consumption expenditure increased at a rising rate throughout 1994, with the main thrust coming from spending on durable and semi-durable goods. The higher propensity to consume was made possible only by the utilisation of savings and a sharp rise in consumer credit, indicating an unsustainable position should household income not begin to rise more strongly. Real consumption expenditure of general government also rose sharply in 1994, largely because of the political transition.

More encouraging was the increased impetus of the recovery of fixed capital formation during 1994, which boded well for future income growth. The rate of increase in real gross domestic fixed investment accelerated throughout 1994 and led to an increase of 7 per cent in this aggregate for the full calendar year. A considerable part of this increase was due to investment in a few large capital projects, but it was also evident in increased capitai outlays in other manufacturing enterprises, agriculture, mining and the financial services sectors. This increase in investment took place mainly in the private sector, but extensions to the electricity reticulation system led to an increase in investment by public corporations. The more positive sentiment in the business community was also reflected in a continued build-up of inventories.

The rapid rate of increase in domestic expenditure during 1994, particularly in the outlays on capital formation, led to a sharp rise in the quantity of goods imported; in fact, the volume of imports increased at a much more rapid rate than real gross domestic expenditure. This rise in the marginal propensity to import was, however, not abnormally high for this stage of the business cycle and was below the average ratio in the preceding ten years. The rise in imports was therefore mainly related to an increase and change in the composition of expenditure and does not seem to reflect a general price advantage of imported goods.

Because the rise in the value of imports and service payments exceeded the increase in the proceeds from merchandise exports and net gold exports, the surplus on the current account of the balance of payments began to shrink in the first half of 1994 and was transformed into a fairly large deficit in the second half of the year. Over the same period the balance on the capital account changed from a net outflow to a large net inflow of capital. This was a remarkable achievement if account is taken of the commitments that fell due for repayment in 1994. The larger part of the net inflow of capital was related to trade, but towards the end of the year South Africa's relatively favourable country credit rating and the further normalisation of international financial relations also led to a net inflow of long-term capital.

The inflow of capital was larger than the deficit on the current account, with the result that both the net and gross gold and other foreign reserves of the country rose quite sharply in the second half of 1994, which contributed to a more stable exchange rate of the rand. On balance, both the nominal and the real effective exchange rates of the rand nevertheless decreased sharply in 1994. At the end of that year the real effective exchange rate of the rand was no less than 6½ per cent lower than at the end of 1992.

The sharp depreciation of the external value of the rand, together with rising oil prices, disruptions in the supply of agricultural produce and a strong domestic demand, caused a temporary reversal of the downward movement of production and consumer price inflation. However, in the fourth quarter of 1994 some of these price-raising forces started to dissipate and the quarter-to-quarter rise in the production and consumer price index declined sharply.

The continued sharp rise in domestic credit extension and money supply were nevertheless clear signals of a building-up of inflationary pressures and the danger that the balance of payments could move into an untenable position. Credit extension advanced rapidly and at an increasing rate throughout 1994. Moreover, an analysis of the monetary institutions' claims on the private sector by type of credit indicates that credit was to a large extent undertaken to finance increased consumer demand. This rise in credit demand was also responsible for high rates of increase in all the monetary aggregates and for the fact that the rise in M3 remained markedly higher than the upper limit of the guideline range. The increase in the liquidity preference of the private sector also contributed to the higher demand for money.

Reflecting these conditions, interest rates, which had started to firm in February 1994, generally rose further during the remainder of 1994 and the first seven weeks of 1995. The strong upward movement in the yields on long-term bonds in the first half of 1994 led to a steepening of the yield curve, which later flattened somewhat as short-term yields continued to rise and long-term yields became more stable. The upward slope of the yield curve over the early part of the maturity spectrum clearly pointed to expectations of further increases in short-term interest rates.

In view of the continued acceleration of the growth in the money supply and domestic credit extension, the danger of escalating price inflation, the upward movement in market-related interest rates and developments on the balance of payments, the authorities decided to adopt a more restrictive monetary policy stance (see complete monetary policy statement published in this *Quarterly Bulletin*). On 20 February 1995 the Governor of the Reserve Bank therefore announced the following changes in monetary policy:

- An increase in Bank rate, i.e. the rate at which the Reserve Bank provides accommodation to banks against the collateral of Treasury bills, Government stock, Reserve Bank bills and Land Bank bills with an outstanding maturity of less than 92 days, from 13 to 14 per cent on 21 February 1995. At the same time the rate on overnight loans extended against collateral of the same financial assets with outstanding maturities of 92 days and longer but less than 3 years, was raised from 14 to 15½ per cent per annum.

- A guideline range for the acceptable rate of growth in the M3 money supply from the fourth quarter of 1994 to the fourth quarter of 1995 was set at 6 to 10 per cent, compared with the 6 to 9 per cent for the preceding year. The higher upper limit takes account of potentially higher real growth in gross domestic product in 1995, whereas the unchanged lower limit of 6 per cent reflects the Reserve Bank's resolve to reduce the rate of inflation.

- An increase in the basic minimum cash reserve requirement from 1 per cent of the banks' total liabilities (minus capital and reserves) to 2 per cent from 21 March 1995. The additional interest-bearing reserve requirement of 1 per cent of short-term liabilities was retained.

- Quantitative guidelines for the banks on the maximum amount of credit that should be extended to the private sector in 1995 to give effect to the monetary policy objectives of the authorities. These guidelines are not mandatory but rely on the support of the banks to contain inflation.

In the financial markets, the private sector's demand for funds in the primary capital markets declined in 1994, reflecting the strong financial positions of businesses and the fact that some companies raised capital by means of convertible Eurobond issues. The net borrowing of the public sector in the primary bond market in calendar 1994 also fell back significantly compared with the preceding year, because of the policy pursued by the government of spreading the financing of the Exchequer deficit more evenly over the year.

Money market conditions remained relatively tight in 1994, while the buoyant conditions in the secondary bond and equity market began to wane in the fourth quarter of 1994 and in the first month of 1995. After having reached a new record high in November 1994, which was 93 per cent above the lower turning-point in October 1992, share prices began to decline. Turnover in the derivative markets, mortgage market and real estate market, however, increased throughout 1994.

In the area of public finance it seems fairly certain from the information for the first ten months of the fiscal year 1994/95 that the government will be successful in achieving its objective of reducing the Exchequer deficit before borrowing and debt repayment as a ratio of gross domestic product. Both the year-on-year rates of increase in Exchequer issues and receipts over this period were, however, well above the rates of increase that had been foreseen in the Budget for the full fiscal year. The further sharp rise in government debt relative to gross domestic product in 1994 is nevertheless a clear warning signal that the level of the Exchequer deficit must be reduced as quickly as possible.

A recent important positive development in the finances of the government was the decline in the dissaving by general government relative to gross domestic product from a peak of 6½ per cent in the first quarter of 1993 to 3 per cent in the fourth quarter of 1994. However, this smaller ratio of dissaving was not achieved by reducing the ratio of government's current expenditure to gross domestic product, but was the result of a sharp rise in tax receipts. It therefore probably reflected a shift in savings from the private to the public sector, particularly a decline in the savings ratio of households. The ratio of aggregate domestic saving to gross domestic product accordingly remained unchanged in calendar 1994 as a whole, even though it increased slightly in the fourth quarter of the year.

Domestic economic development

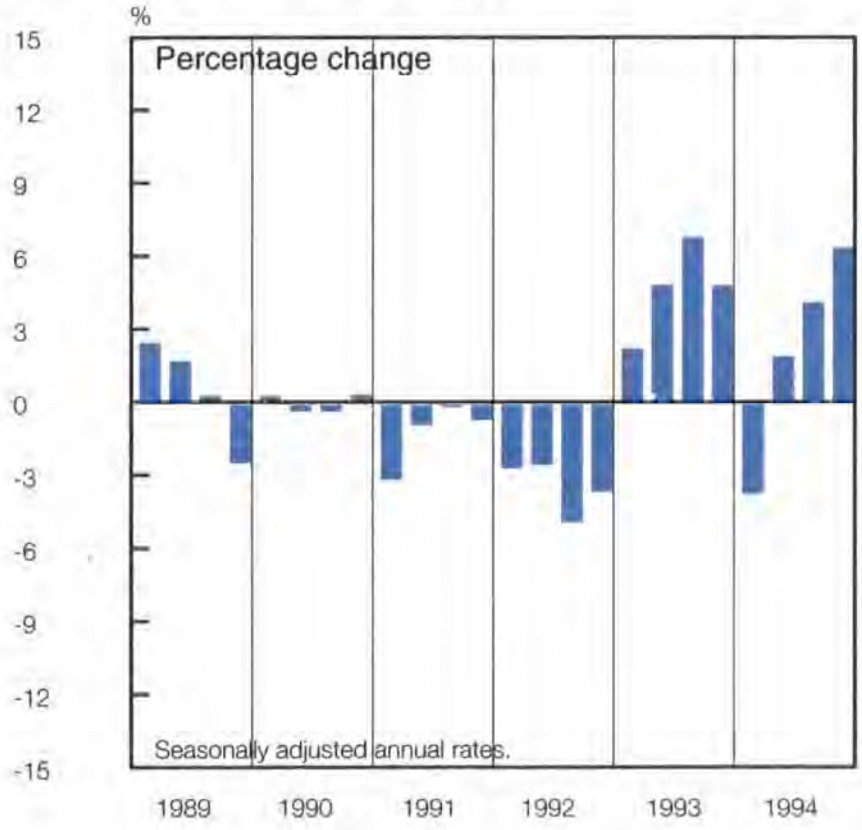
Domestic output

The seasonally adjusted and annualised rate of change in *total real gross domestic product* was reversed from a decrease of 3½ per cent in the first quarter of 1994 to upwardly revised increases of 2 per cent in the second quarter and 4 per cent in the third quarter. In the fourth quarter of 1994 the annualised growth in domestic product accelerated further to 6½ per cent; this took the seasonally adjusted real value of gross domestic product to about 1½ per cent above its previous peak in the third quarter of 1989.

After having registered negative growth in the period from 1990 to 1992, real gross domestic product rose by 1 per cent in 1993 and by 2½ per cent in 1994. Unfortunately, the growth in 1994 was disrupted by the political transition process as well as labour disputes and work stoppages which prevented the real gross domestic product from rising more strongly. However, the growth in domestic output was widespread and all the sectors, with the exception of the primary sectors, contributed to the acceleration in the growth of production.

Although the maize crop rose by more than one-third above the already high level of the preceding year, the growth in *agricultural* output slowed down significantly in 1994. Agricultural output was held back by the building-up of herds by livestock farmers when grazing conditions began to improve, extensive frost damage to vegetable output during the winter months, a serious disease which

Real gross domestic product



affected chicken production and a wheat crop that was considerably smaller than during the previous season.

Mining production recovered slightly in the second half of 1994 and rose at an annualised growth rate of ½ per cent in both the third and fourth quarter; this followed a substantial decrease in the first half of the year. A revival in international demand for base metals and minerals as well as continued strong growth in the output of coal mines were mainly responsible for the increase in the real value added by mining. However, real output by the mining sector still decreased by 2½ per cent in 1994 as a whole, largely because of a decline in gold production related to the mining of lower-grade ore and technical difficulties experienced in the production process.

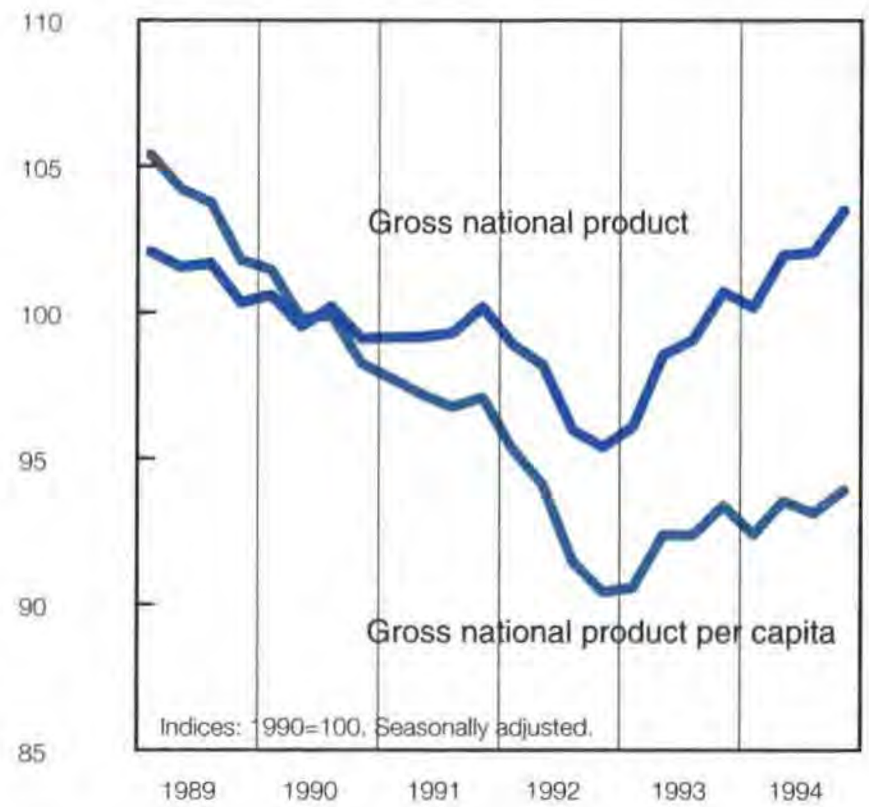
Output volumes in the *secondary sectors* rose strongly towards the end of 1994 and growth in the fourth quarter is currently estimated at an annualised rate of 8 per cent. The main impetus to this strong growth was provided by the manufacturing sector. Manufacturing output is estimated to have risen by about 2½ per cent in 1994; the growth in this sector in 1993 came to less than ½ per cent. The growth in demand for electricity and an extension of services led to a continued strong rate of increase in the output of the sector supplying electricity, gas and water, while the output of the construction sector increased at a steady but relatively modest rate throughout 1994.

All the *tertiary sectors* contributed to a much faster output expansion in 1994. The real value added by the tertiary sectors rose by 2 per cent in that year, compared with an increase of only ½ per cent in 1993. After having increased at annualised growth rates varying between 2 and 2½ per cent in the first three quarters of 1994, the real value added by the tertiary sector advanced at an annualised rate of 4 per cent in the fourth quarter.

The *wholesale and retail trade sectors* increased their output levels in the fourth quarter of 1994, with particularly strong growth occurring in the motor trade because dealers attempted to recoup the losses of the third quarter when the strike in the motor manufacturing industry disrupted normal trading. The trade and accommodation sector benefited from an increase in the number of domestic and foreign tourists. For 1994 as a whole the real value added by commerce therefore rose by 3 per cent, i.e. at a considerably higher rate than the ½ per cent recorded in 1993.

The high level of activity in the industrial and commercial sectors and the substantial increase in the volume of trade caused the real value added by the *transport, storage and communication* sector to continue growing at an annualised rate of approximately 2 per cent in all four quarters of 1994 and brought the growth in this sector to 3½ per cent for the year as a whole. The generally buoyant conditions in the financial markets and a revival in real estate transactions supported healthy quarterly annualised growth rates of more than 4 per cent throughout 1994 in the sector *finance, real estate and business services.*

Real gross national product



As a result of the strong growth in real domestic production and the improvement in South Africa's terms of trade, the *real gross national product* of the country rose by 3½ per cent in 1994. The real gross national product, which had started to rise from the beginning of 1993, therefore increased further in 1994. After having decreased by 14½ per cent from the beginning of 1989 to the end of 1992, the real gross national product per capita regained some of these losses and increased at an annualised rate of 3½ per cent to a level of about R6 700 in the fourth quarter of 1994.

Table 1. Growth in real gross domestic product by sector

Per cent

	1992	1993	1994
Primary sectors	-8½	6½	1
Agriculture	-27½	16½	9
Mining........................	1½	2½	-2½
Secondary sectors	-3	0	2½
Manufacturing............	-3	0	2½
Tertiary sectors	0	½	2
Trade	-2½	½	3
Transport	2	2½	3½
Finance......................	½	½	2½
Total..............................	**-2½**	**1**	**2½**

Table 2. Percentage changes in real private consumption expenditure, 1994
Quarter-to-quarter seasonally adjusted and annualised rates

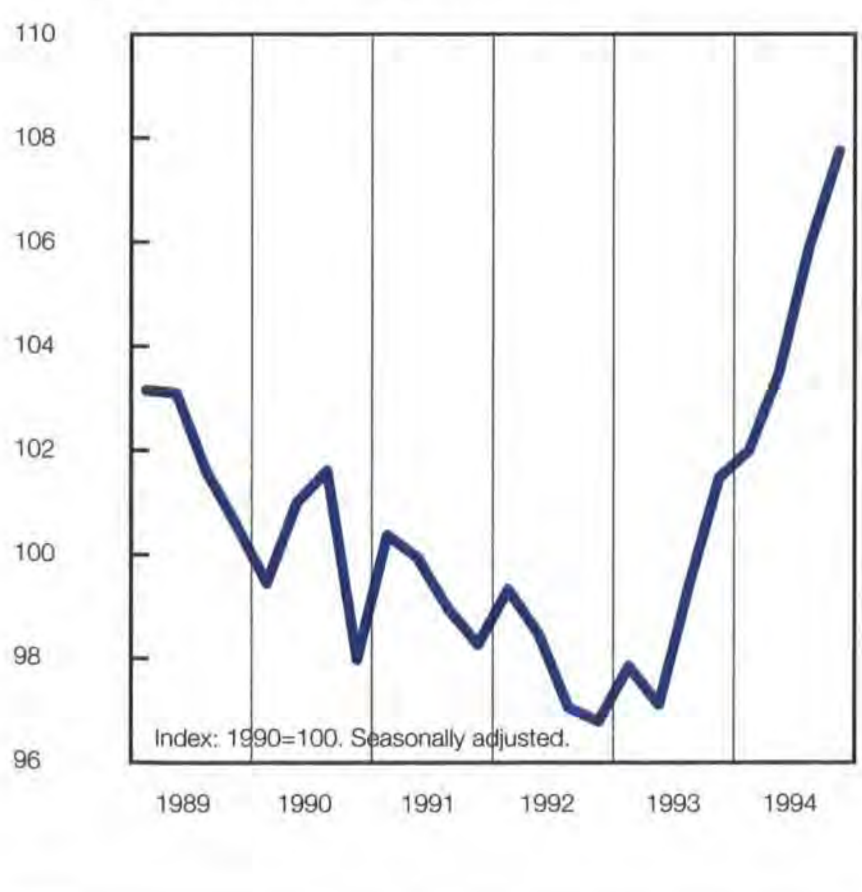
	1st qr	2nd qr	3rd qr	4th qr	1994
Durable goods	4	4	5	6	4
Semi-durable goods	3½	3½	4½	5½	3½
Non-durable goods	1½	3	3	3½	2½
Services	1	2	2	3½	1½
Total	**2**	**3**	**3½**	**4**	**2½**

Domestic expenditure

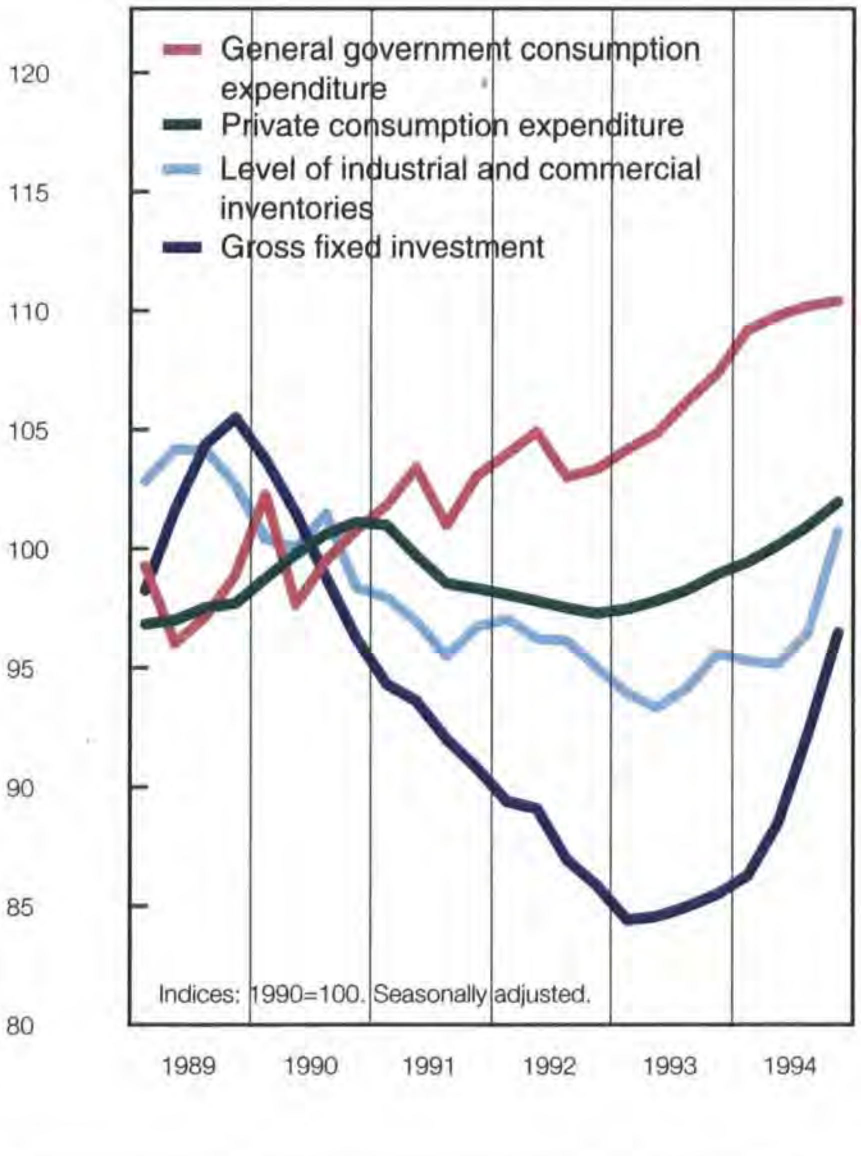
For the sixth consecutive quarter *aggregate real gross domestic expenditure* continued to advance at a rapid rate in the fourth quarter of 1994. Increases in all the main components of expenditure contributed to an increase at a seasonally adjusted and annualised rate of 7 per cent in the fourth quarter. For the full calendar year the growth in real domestic expenditure is estimated at 6 per cent; in 1993 it had increased by only 1 per cent. The continued sharp increase in all forms of expenditure caused aggregate real gross domestic expenditure to rise in the fourth quarter of 1994 to a level that was 11 per cent above its lower turning-point in the second quarter of 1993.

After having reached successively higher annualised rates of 2 per cent, 3 per cent and 3½ per cent in the first three quarters of 1994, the growth in *real private consumption expenditure* accelerated further to 4 per cent in the fourth quarter. This brought the increase in real private consumption expenditure to 2½ per cent in calendar 1994. Although all the main components contributed to this high growth, the main thrust came from spending on durable and semi-durable goods (see Table 2). The increase in real consumption expenditure by households exceeded the growth in real personal disposable income of 1½ per cent in 1994, indicating that the average propensity to consume had increased and

Real gross domestic expenditure



Main components of real gross domestic expenditure



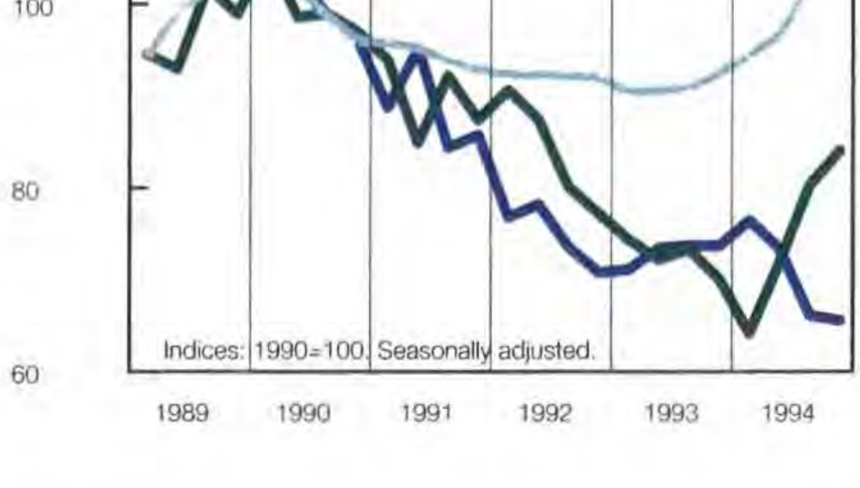
that a large part of this increase had been financed by means of consumer credit.

The growth in *real consumption expenditure by general government*, which had amounted to an annualised rate of 7 per cent in the first quarter of 1994, slowed down sharply in the next three quarters and reached a level of only 1 per cent in the fourth quarter of 1994. This deceleration in the growth of government consumption was, however, unable to prevent an increase in this aggregate of 4 per cent for calendar 1994; in 1993 it had risen by 2 per cent. The sharp increase in the real outlays of the government on consumer goods and services in 1994 was mainly due to the political transition process.

Upwardly revised estimates of *aggregate real gross domestic fixed investment* (seasonally adjusted) showed annualised growth rates of 3½, 10½ and 18 per cent in the first three quarters of 1994. This was followed by an increase of 19½ per cent in the fourth quarter. For the full year real gross fixed investment therefore rose at a high rate of 7 per cent – this was the first year-to-year increase since 1989. This increase in capital formation was the result of an expansion in real outlays on capital equipment by the private sector and public corporations, which more than offset a further decline in real gross domestic fixed investment by public authorities.

Real fixed capital formation by the *private sector* rose strongly throughout 1994. In the second half of the year real outlays on fixed capital formation accelerated to an annualised rate of 21 per cent from 8½ per cent in the first half. In the calendar year 1994 real fixed investment by private organisations and households rose by 10 per cent, compared with a decline of 1½ per cent in 1993. Strong growth rates were particularly evident in the investment expenditure by agriculture, mining, manufacturing and the financial services sectors. Although this was to a large extent due to a few major capital projects, the return to a more stable political environment undoubtedly played some part in a more general strengthening of the private sector's investment.

Real gross domestic fixed investment



The real fixed capital expenditure by *public corporations* increased sharply in the last three quarters of 1994. These increases followed sizable declines in the period 1991 to 1993 and were largely caused by the extension of Eskom's electric power network to high-density residential areas and to some rural areas. This outweighed declines in the fixed investment of other public corporations and led to an increase of 3½ per cent in the total fixed investment of these entities in 1994. The real capital outlays of *public authorities* continued to contract, with the result that a marginal decline was recorded in the real capital formation of the *public sector* as a whole in 1994.

The build-up in *inventories* from the second half of 1993 continued throughout 1994 and amounted to R5,7 billion at constant prices for the full year. The sharp increase in real investment in inventories was particularly evident in the mining, manufacturing and commercial sectors. This inventory accumulation could be ascribed to a more positive sentiment in the business community and a willingness among entrepreneurs to position themselves for a strengthening of final demand. The level of industrial and commercial inventories relative to gross domestic product accordingly rose from a low of less than 16 per cent in the third quarter of 1993 to about 17½ per cent in the fourth quarter of 1994.

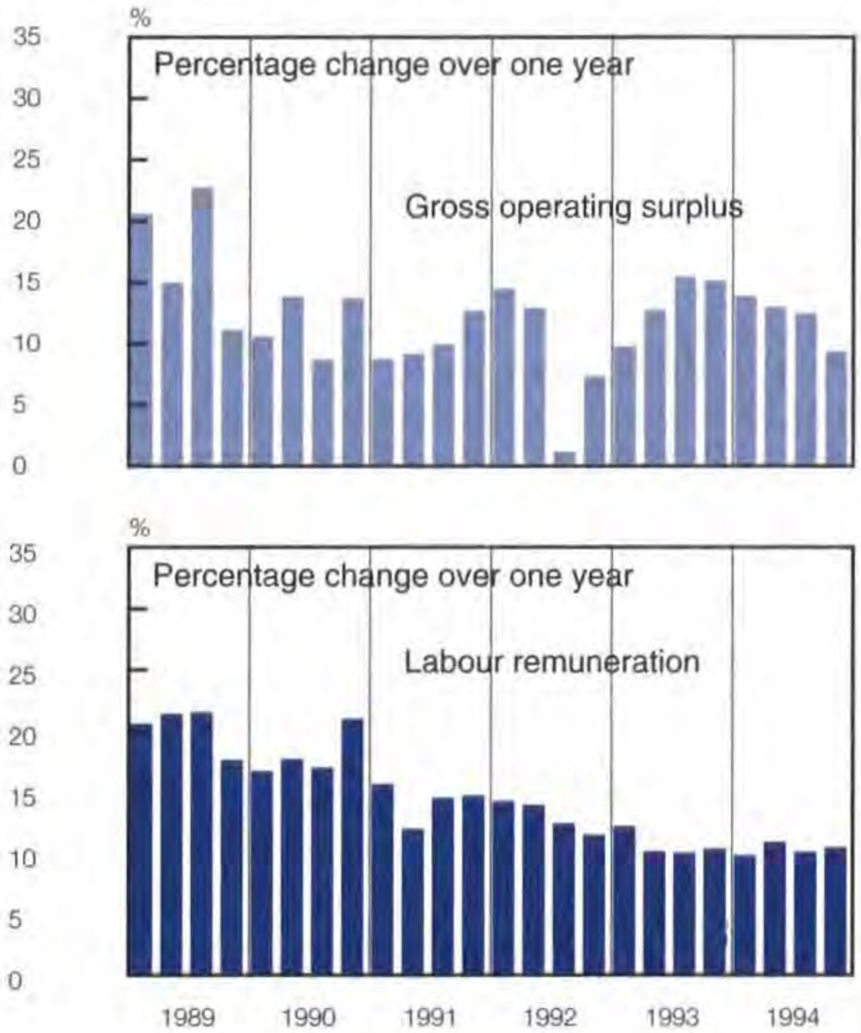
Factor income

The year-on-year increase in *total nominal factor income* slowed down from an average of 14 per cent in the last two quarters of 1993 to about 12½ per cent in the fourth quarter of 1994. This slowdown was the outcome of slightly lower growth in the year-on-year increase in the nominal gross operating surplus of business enterprises and a levelling-off in the year-on-year increase in the remuneration of employees.

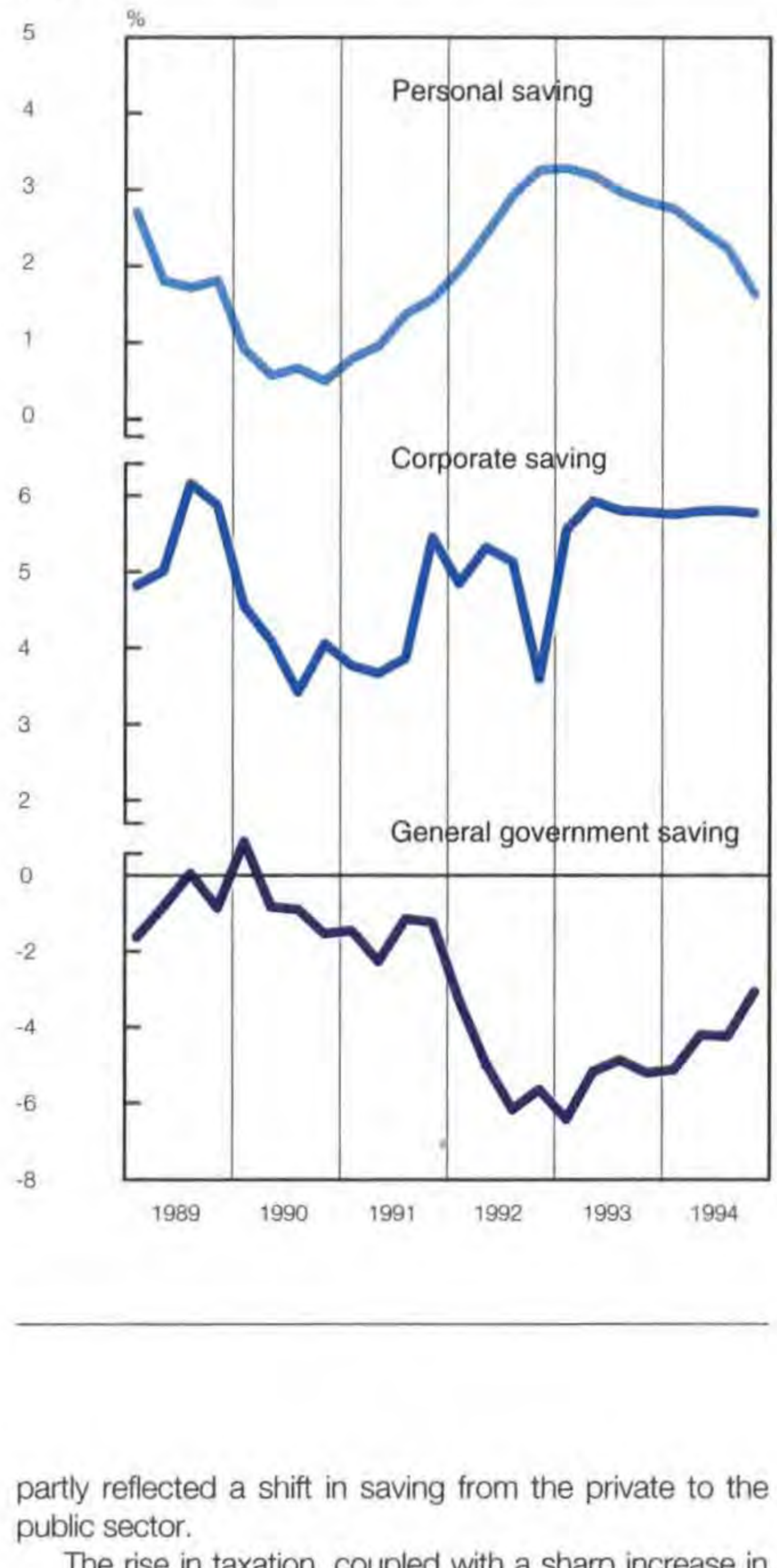
The rate of increase over four quarters in the nominal *gross operating surplus* declined from an average of 14½ per cent in the second half of 1993 to 11½ per cent in the second half of 1994. In 1994 as a whole the increase in the gross operating surplus totalled 12 per cent, against an increase of approximately 13½ per cent in 1993. Smaller increases were recorded particularly in the operating surpluses of enterprises engaged in mining, commerce and finance.

Measured over four quarters, the increase in aggregate *employee remuneration* continued to fluctuate downwards from 12 per cent in the first quarter of 1993

Gross operating surplus and labour remuneration



Net saving as percentage of gross domestic product



and reached 10½ per cent in the fourth quarter of 1994. On a calendar year basis the increase in total salaries and wages declined marginally from 10½ per cent in 1993 to slightly more than 10 per cent in 1994. These increases, however, exceeded the prevailing inflation rate, with the result that the real wage bill of the country rose despite a substantial rise in unemployment.

Domestic saving

The ratio of *gross domestic saving* to gross domestic product, which had decreased gradually from 18 per cent in the second quarter of 1993 to 17½ per cent in the third quarter of 1994, edged up to 18 per cent in the fourth quarter. On average, however, the total savings ratio in 1994 remained at the level of 17½ per cent reached in the preceding year.

The improvement in the savings ratio in the fourth quarter of 1994 could mainly be ascribed to a further lowering in the *dissaving by general government*. Dissaving by general government relative to gross domestic product has contracted fairly persistently from a level of 6½ per cent in the first quarter of 1993 to just above 4 per cent in the third quarter of 1994 and 3 per cent in the fourth quarter. This considerable improvement in government dissaving could be attributed to a sharp increase in tax receipts and therefore probably partly reflected a shift in saving from the private to the public sector.

The rise in taxation, coupled with a sharp increase in private consumption expenditure and only moderate growth in current income, led to a further decline in the savings ratio of households. The net *saving by households* as a ratio of gross domestic product, contracted sharply from over 3 per cent in the first quarter of 1993 to 1½ per cent in the fourth quarter of 1994. For 1994 as a whole the ratio of household saving to gross domestic product amounted to about 2 per cent, against 3 per cent in the preceding year.

The net *corporate savings ratio* of approximately 6 per cent of gross domestic product in 1993 remained unchanged in 1994. This ratio compares favourably with the average level of 5 per cent attained over the previous ten years. A relatively high turnover and a sustained focus on cost control and tight asset management enabled many companies to maintain healthy savings rates. The cash holdings of companies have strengthened further in 1994 and the corporate sector in general appears to be well placed to finance a higher level of investment.

Employment

Total employment in the formal non-agricultural sectors of the economy, which had declined throughout the recession and into the early stages of the current upswing in overall economic activity, increased at a seasonally adjusted and annualised rate of 0,6 per cent in the second quarter of 1994 (the most recent information released by the Central Statistical Service). This turn of events was largely due to an increase in the number of workers employed by public authorities. The workforce of the private sector still contracted in the second quarter of 1994, albeit at a much lower rate than during any of the preceding sixteen quarters.

Until the second quarter of 1994 employment in the *non-agricultural private sector* was slow to respond to the strengthening in overall economic activity. The total number of people employed by private entities continued to decline in the second quarter of 1994, but the rate of decline slowed down to a seasonally adjusted and annualised level of only 0,1 per cent from 2,0 per cent in the preceding quarter. This low rate of decline could be attributed mainly to increases in employment in the construction industry, the non-gold-mining sector, insurance companies and agricultural marketing control boards, while further reductions, albeit at lower rates, were recorded in the electricity-generating sector, retail trade, motor trade and private road transportation.

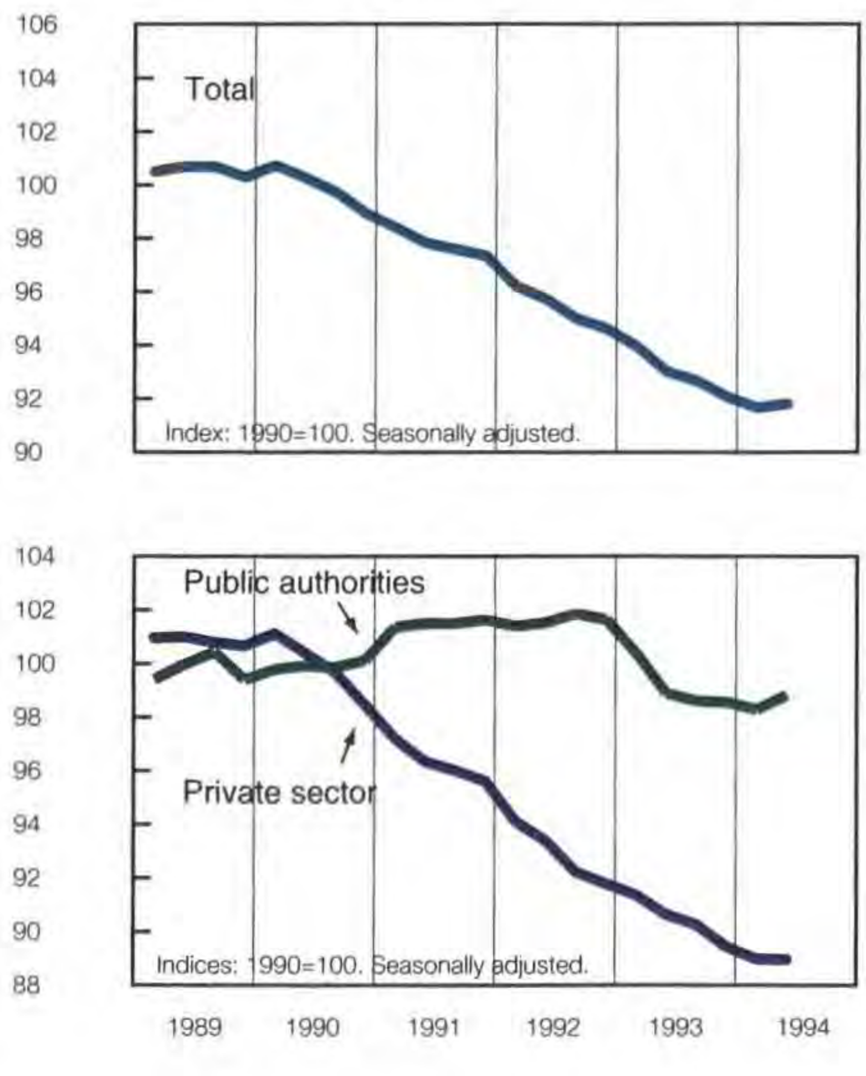
The overall employment level by *public authorities* increased at a seasonally adjusted and annualised rate of 2,3 per cent in the second quarter of 1994. This was the first increase in employment by public authorities since the third quarter of 1992. Increases in employment by the Central Government and provincial administrations, related partly to the employment of temporary workers over the election period in April 1994, were responsible for the rise in the number of workers employed by public authorities.

The small rise in the number of people employed in the formal non-agricultural sectors of the economy must be viewed against the loss of almost 500 000 job opportunities between the third quarter of 1989 and the first quarter of 1994 and the current high level of unemployment in the country. In fact, the number of *registered unemployed* workers has edged higher since the second quarter of 1994 to 292 000 in November 1994.

Labour costs and productivity

The year-on-year rate of increase in *nominal salaries and wages* per worker in the formal sectors of the economy fell from 16,0 per cent in the second quarter of 1992 to

Non-agricultural employment



Nominal remuneration per worker in non-agricultural sectors

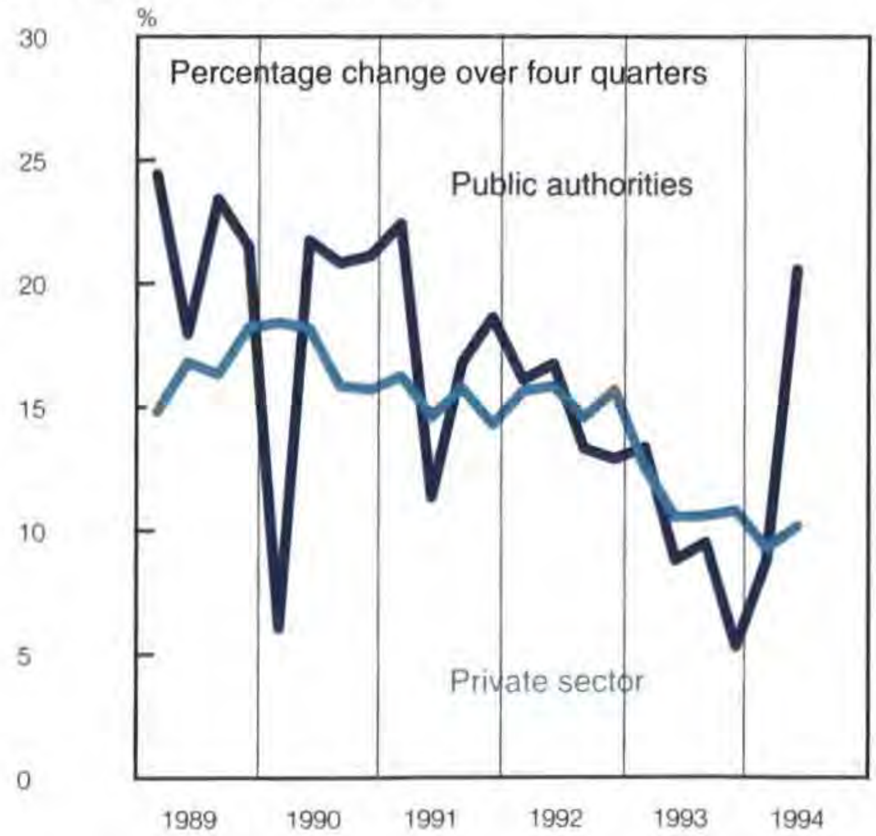


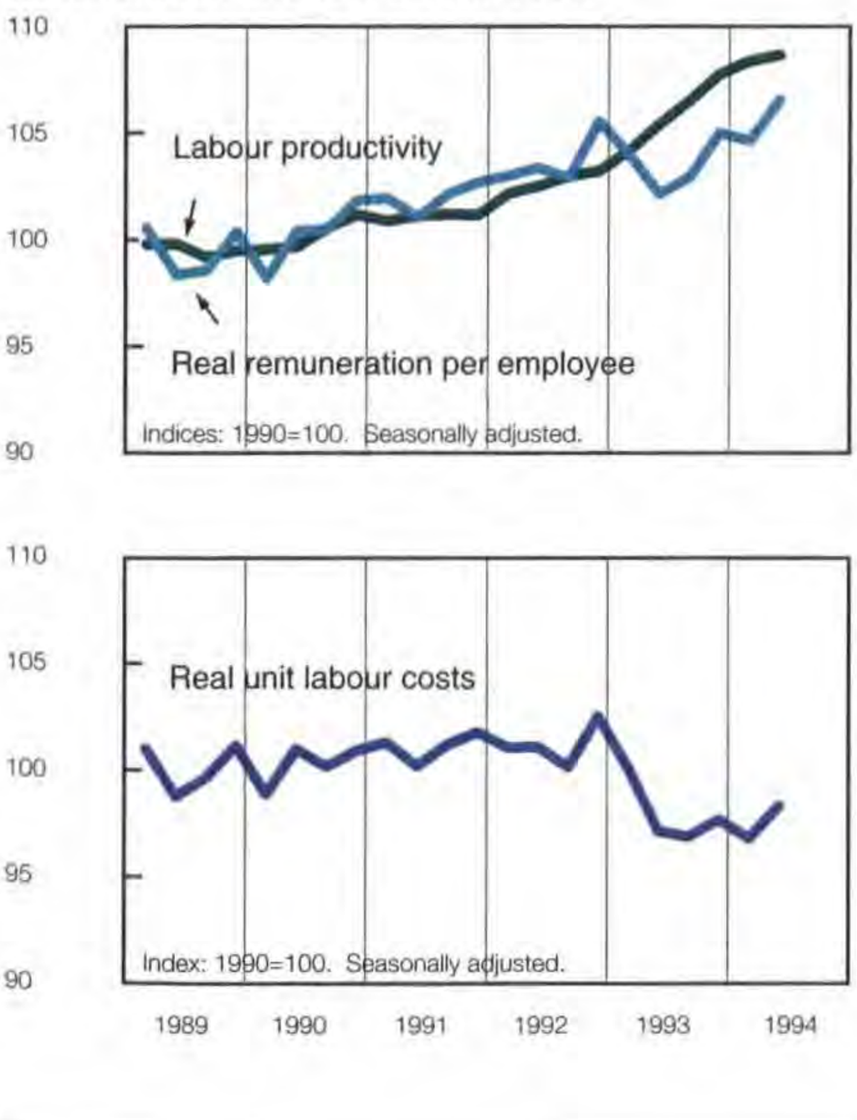
Table 3. The year-on-year rate of increase in nominal remuneration per worker

Percent

Period	Public authorities	Private sector	Total
1993: 1st qr	13,6	12,6	13,0
2nd qr	8,8	10,7	10,1
3rd qr	9,6	10,7	10,3
4th qr	5,5	10,9	9,1
1994: 1st qr	8,9	9,4	9,2
2nd qr	20,5	10,3	13,8

9,1 per cent in the fourth quarter of 1993 and to 9,2 per cent in the first quarter of 1994, before it accelerated again to 13,8 per cent in the second quarter of 1994. As shown in Table 3, the higher rate of increase in the second quarter of 1994 was essentially caused by adjustments in public-sector remuneration per worker. In the second quarter of 1994 annual and special bonuses were granted to certain categories of workers in the public sector and special allowances were paid to some workers during the election period. Nominal remuneration per worker in the non-agricultural private sector also rose more rapidly, but not nearly to the same extent as that of workers in the public sector: the year-on-year increase in the remuneration of workers in the private sector rose from 9,4 per cent in the first quarter of 1994 to 10,3 per cent in the second quarter.

Non-agricultural labour productivity, remuneration and unit labour costs



After having declined during the course of 1993, the year-on-year rate of change in *real remuneration* per worker rose again to 0,7 per cent and 4,6 per cent in the first two quarters of 1994. At the same time, the growth in *labour productivity* slowed down from a year-on-year rate of 4,4 per cent in the fourth quarter of 1993 to 3,1 per cent in the second quarter of 1994. As a result, *real unit labour costs* in the non-agricultural sectors (nominal costs deflated by the price deflator for the non-agricultural gross domestic product) increased again at a rate of 1,5 per cent in the second quarter of 1994 compared with the corresponding period in the preceding year. This was the first increase in real unit labour costs since the fourth quarter of 1992. The year-on-year rate of increase in *nominal unit labour costs* also rose sharply from 4,9 per cent in the first quarter of 1994 to 10,4 per cent in the second quarter.

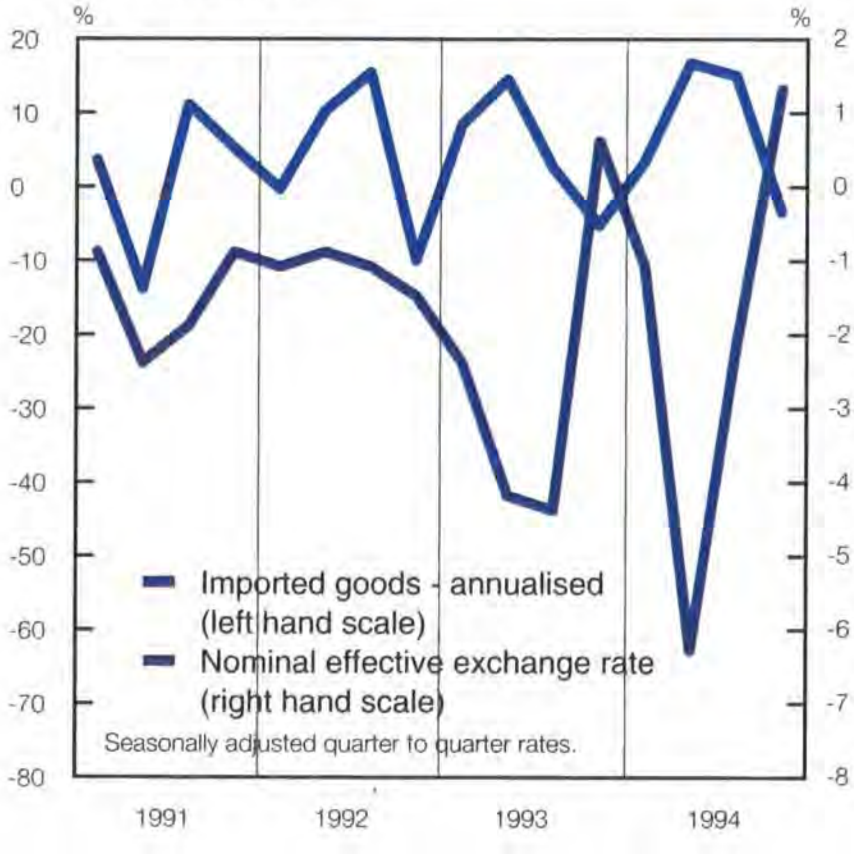
Prices

The strong progress made in lowering *production price inflation* were temporarily reversed during the first three quarters of 1994. The weakening exchange rate of the rand, rising international oil prices, disruptions in the supply of agricultural produce and a strong demand in the domestic market caused the quarter-to-quarter rate of increase in the production price index to accelerate from a seasonally adjusted and annualised level of 3,0 per cent in the fourth quarter of 1993 to 14,6 per cent in the third quarter of 1994. In the fourth quarter of 1994 some of these price-raising forces started to dissipate and the quarter-to-quarter rise in the all-goods production price index declined to a seasonally adjusted and annualised rate of 5,1 per cent.

Measured over a period of twelve months, the increase in the all-goods production price index also rose from a low point of 5,4 per cent in October 1993 to 10,1 per cent in September 1994 before falling back to 9,4 per cent in November and 9,7 per cent in December. As a result of these changes, the year-to-year rate of increase in production prices also rose from 6,6 per cent in 1993 – the lowest rate of increase in this price index since 1971 – to 8,2 per cent in 1994.

The effect of the depreciation of the rand on production prices is clearly illustrated in the quarter-to-quarter changes in the *price index of imported goods*. Under relatively stable international price conditions these quarterly changes accelerated from a seasonally adjusted and annualised decline of 5,4 per cent in the fourth quarter of 1993 to increases of 16,6 per cent in the second quarter of 1994 and to 14,8 per cent in the third quarter. The prices of imports therefore reacted with a

Production prices



lag to the depreciation of the rand and higher international oil prices in the first half of 1994. The strengthening of the nominal effective exchange rate of the rand during the second half of 1994, and a decline in international oil prices in the last three months of the year, then led to an actual decrease in the price index of imported goods amounting to 3,6 per cent at a seasonally adjusted and annualised rate in the fourth quarter of 1994.

Higher increases in the *price index of domestically produced goods* added to the acceleration in production price inflation. The quarter-to-quarter annualised rise in the seasonally adjusted production prices of domestically produced goods accelerated from 5,1 per cent in the fourth quarter of 1993 to 11,1 per cent in the first quarter of 1994, 9,0 per cent in the second quarter and 14,4 per cent in the third quarter. This increase was essentially caused by shortages in the supply of meat (on account of the rebuilding of livestock herds when grazing conditions improved) and vegetables (on account of frost damage to crops). When food supplies returned to more normal levels in the fourth quarter of 1994, the quarter-to-quarter increase in the production price index of domestically produced goods declined to a seasonally adjusted and annualised rate of 6,9 per cent.

As illustrated in Table 4, the quarter-to-quarter rate of change in the overall *consumer price index* followed a pattern fairly similar to that of the all-goods production price index: it also tended to accelerate during the first three quarters of 1994 before slowing down somewhat in

Table 4. Quarter-to-quarter rates of change in consumer prices at seasonally adjusted and annualised rates

Per cent

Period	Goods	Services	Total
1993: 4th qr	6,2	1,2	5,3
1994: 1st qr	8,3	6,8	9,2
2nd qr	8,0	8,3	6,7
3rd qr	19,4	16,0	15,7
4th qr	6,7	9,1	8,4

the fourth quarter. This acceleration in the rate of increase in the overall consumer price index came about because of more rapid increases in the prices of consumer goods as well as in the prices of consumer services.

On a year-to-year basis the rate of increase in the overall consumer price index nevertheless continued to fall back from 15,3 per cent in 1991 to 9,7 per cent in 1993 and further to 9,0 per cent in 1994 – the lowest such rate of increase since 1972 when an increase of 6,1 per cent was registered. Measured over periods of twelve months, consumer price inflation quickened from 7,1 per cent in April 1994 to 10,1 per cent in September and then slowed down marginally to 9,9 per cent in November and December 1994. The price of food and non-alcoholic beverages can be singled out as the most

Consumer prices

important explanation for the acceleration in consumer price inflation in 1994. If these spending categories are excluded, the rise over twelve months in the prices of other consumer goods and services was less impressive but more consistent; it rose from 6,6 per cent in April 1994 to 7,9 per cent in December.

Foreign trade and payments

Balance of payments on current account

As could be expected with the rapid rate of increase in gross domestic expenditure, the *balance on the current account* of the balance of payments (seasonally adjusted and annualised) turned about from an average quarterly surplus of R2,0 billion in the first half of 1994 to a deficit of R5,4 billion in the third quarter and R7,0 billion in the fourth quarter. In 1994 as a whole a current account deficit of R2,1 billion was registered; this was the first deficit since 1984 and a significant change compared with the surplus of R5,8 billion in 1993. Such sharp swings in the current account balance are not, however, uncommon near the lower and upper turning points of the business cycle.

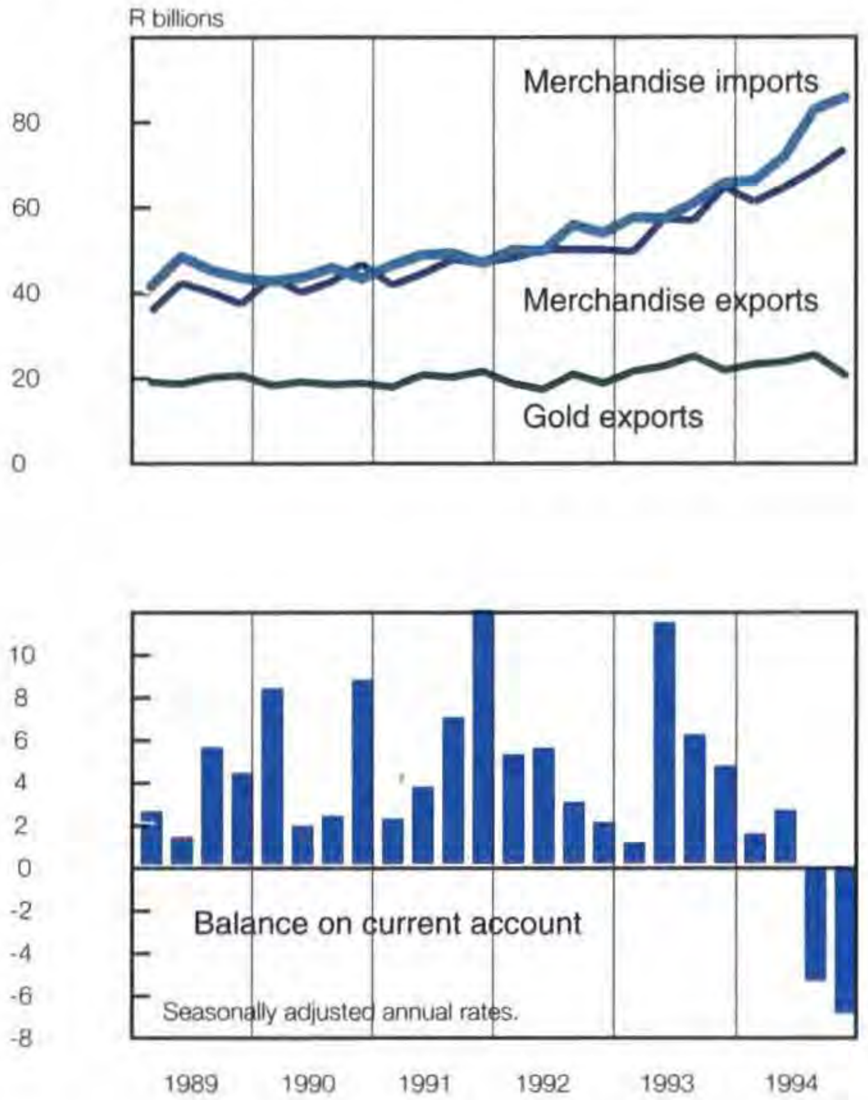
The marked deterioration in the balance on current account during the course of 1994 was primarily brought about by a substantial increase in the volume of *merchandise imports*. The physical quantity of goods imported in 1994 rose by 17½ per cent, or by 2,9 percentage points for every one percentage point increase in real gross domestic expenditure. This ratio is not abnormally high; it is, in fact, lower than the average ratio of 3,6 in the preceding ten years. The rise in merchandise imports was therefore mainly related to increased expenditure and does not seem to reflect a general price advantage of imported goods. At the same time, a decline in the exchange rate of the rand, combined with only moderate increases in the producer prices of trading partner countries, caused the prices of imported goods to increase by 8½ per cent and brought the rise in the value of imports to 27 per cent.

Pronounced increases occurred in the imports of machinery and electrical equipment, chemical products, textiles and transport goods. More important, a classification of imported goods according to stage of consumption shows that a substantial increase in the imports of capital goods was mainly responsible for the acceleration in the

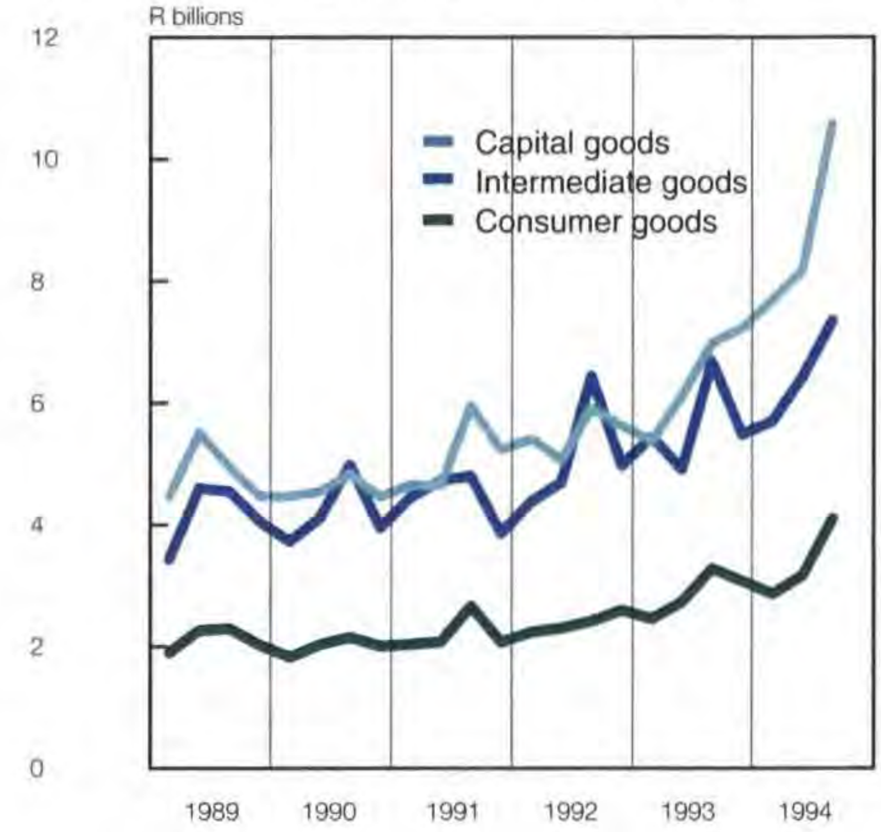
Table 5. Balance of payments on current account, 1994
Seasonally adjusted and annualised rates
R billions

	1st qr	2nd qr	3rd qr	4th qr	1994
Merchandise exports	60,6	64,0	67,9	73,0	66,4
Net gold exports	22,6	23,2	24,8	20,1	22,7
Merchandise imports	-65,6	-71,3	-82,3	-85,1	-76,1
Net service and transfer payments	-16,1	-13,3	-15,8	-15,0	-15,1
Balance on current account	**1,5**	**2,6**	**-5,4**	**-7,0**	**-2,1**

Current account



Imports according to stage of consumption



growth of imports. As large capital projects and other investment programmes gained momentum, the imports of capital goods also accelerated. More moderate increases were registered in the imports of intermediate and consumer goods.

The total value of *merchandise exports* rose by 17½ per cent in calendar 1994. An increase in international commodity prices and a decline in the nominal effective exchange rate of the rand led to an increase of close to 12 per cent in export prices. The volume of exports rose by 5 per cent in an environment of more rapid international economic recovery. Although this increase was lower than the estimated increase in the volume of world trade, it was nevertheless a remarkable performance if the effect on domestic production of the process of political transition and labour unrest are taken into consideration. These factors had a particularly strong impact on the exports of manufactured goods and metals and minerals.

The turnabout in the current account balance was also affected significantly by a decrease of 11 per cent in the volume of *net gold exports* in 1994, which largely arose from a further reduction in the average grade of ore mined. Not only the quality, but also the quantity of gold-bearing ore milled decreased sharply. Technical difficulties relating to seismic incidents, the closing of some mines and unstable labour conditions, contributed to a sharp decline in production. Fortunately, the average price of gold per fine ounce rose from $360 (R1 177) in 1993 to $384 (R1 363) in 1994, with the result that the value of net gold exports advanced by 2 per cent in 1994. The gold price, however, reached an upper turning-point in the third quarter of 1994. After having increased persistently in the first part of 1994, the value of net gold exports (seasonally adjusted and annualised) receded accordingly from R24,8 billion in the third quarter of the year to R20,1 billion in the fourth quarter.

Higher spending by foreign tourists in South Africa and an increase in dividend receipts on investments in other countries contributed to a decline in *net service and transfer payments* to non-residents from the third to the fourth quarter of 1994. For 1994 as a whole, however, these payments amounted to R15,1 billion, i.e. 16 per cent higher than the R13,0 billion in 1993. Sharp increases were noticeable in the payments for freight and merchandise insurance and interest on foreign loans.

Capital account

A further *total net capital inflow* took place in the fourth quarter of 1994. Having switched from a net outflow of R3,6 billion in the first half of 1994 to a net inflow of R5,5 billion in the third quarter, the net inflow of capital not related to reserves amounted to R3,3 billion in the fourth quarter of the year. In 1994 as a whole the net inflow of

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

	1993	1994				
	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Long-term capital						
Public authorities	-1,3	-1,1	-0,1	0,5	3,7	3,0
Public corporations	-1,6	-1,4	-0,2	0,3	0,7	-0,6
Private sector	2,6	0,8	-1,3	-0,4	-0,1	-1,0
Total long-term capital	-0,3	-1,7	-1,6	0,4	4,3	1,4
Short-term capital	-14,7	0,6	-0,9	5,1	-1,0	3,8
Total capital not related to reserves	**-15,0**	**-1,1**	**-2,5**	**5,5**	**3,3**	**5,2**

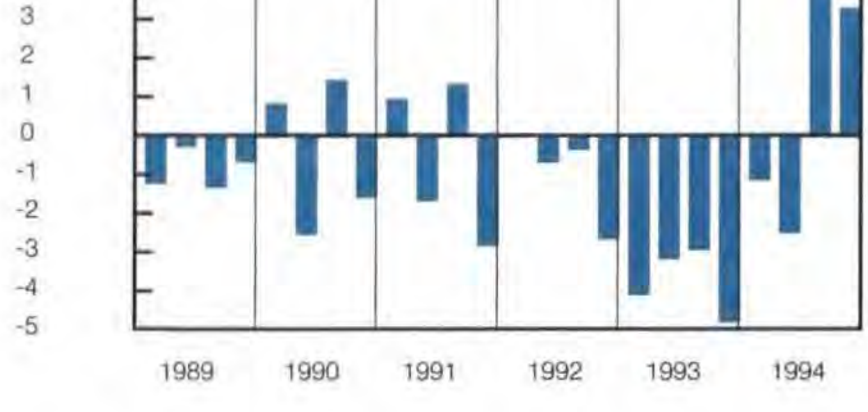
capital therefore totalled R5,2 billion, compared with a net outflow of capital of R15,0 billion in 1993. This was even more remarkable if account is taken of the fact that repayment obligations of R5,9 billion fell due for repayment on foreign long-term loans and affected debt during the year.

Despite these maturing loans, a net inflow of *long-term capital* amounting to R1,4 billion was recorded in 1994. This inflow of long-term capital occurred in the second half of the year, particularly in the fourth quarter: the long-term capital movements to and from South Africa changed from a net outflow of R3,3 billion in the first half of 1994 to a net inflow of R4,7 billion in the second half. The improvement in long-term capital flows was to a large extent due to the further normalisation of international financial relations and the relatively favourable formal credit ratings South Africa received in October. In view of these changes, private placements to the amount of R630 million and an issue of government stock to the amount of US$750 million (R2,7 billion) were made on international capital markets.

The public corporations also became net borrowers of foreign funds in the second half of 1994, while non-residents made major contributions to the large capital projects in progress. In addition, non-residents were net purchasers of securities to the amount of R1,2 billion on the Johannesburg Stock Exchange in 1994. These purchases were made through the financial-rand mechanism and therefore did not affect the foreign reserves of the country.

The largest part of the capital inflow consisted of *short-term capital* movements not related to reserves, but including unrecorded transactions. The short-term capital movements were reversed from a net outflow of R14,7 billion in 1993 to a net inflow of R3,8 billion in 1994. This inflow of short-term capital was mainly concentrated in the third quarter of 1994 and reflected factors such as the favourable costs and availability of foreign-trade finance, relatively tight money market conditions and the rise in the value of merchandise imports. In the fourth quarter of 1994 the practice followed by some foreign banks of reducing their outstanding claims on South Africa at the end of their financial years offset non-residents' net purchases of three-month South African Treasury bills of R1,7 billion and led to a net outflow of R1,0 billion in the form of short-term capital. This outflow of capital was also affected by the crisis in Mexico towards the end of the year.

Total net capital movements not related to reserves



Foreign reserves

As a result of the net inflow of total capital, the total *net gold and other foreign reserves* of South Africa rose by R3,0 billion in the fourth quarter of 1994. This brought the increase in the net foreign reserves since June 1994

Change in net gold and other foreign reserves

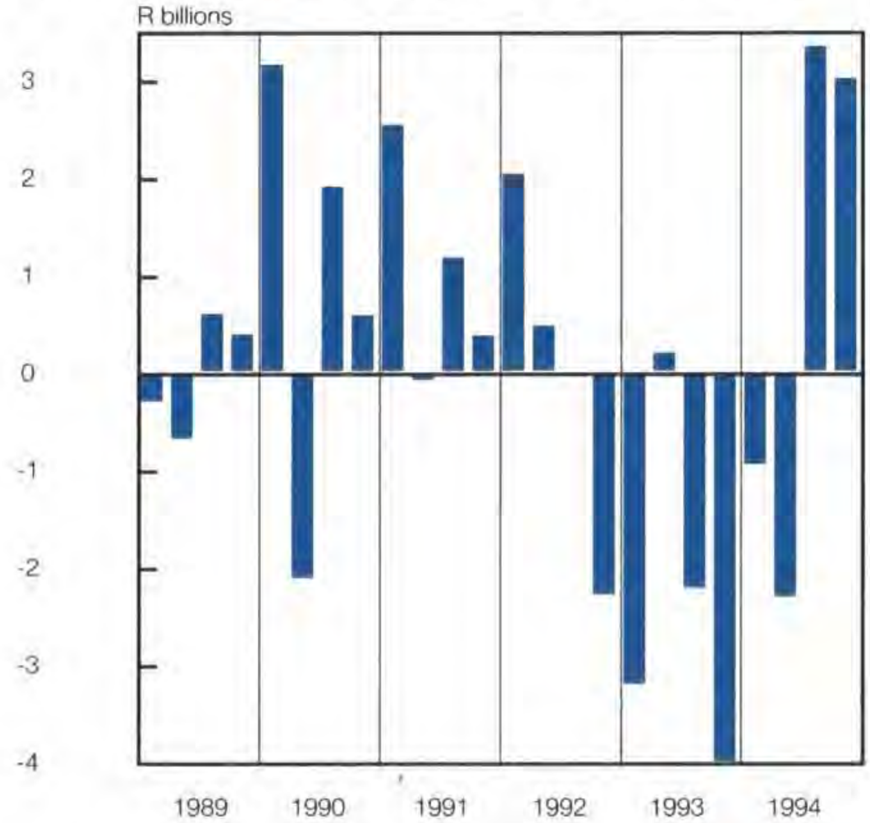


Table 7. Gold and other foreign reserves, 1994
R billions

Period	Changes in		Gross holdings*	
	Net reserves	Gross reserves	Reserve Bank	Total
1st qr.......	-0,9	-0,7	7,9	10,3
2nd qr	-2,3	-0,6	7,1	9,7
3rd qr	3,3	1,3	8,1	11,0
4th qr	3,0	3,1	11,1	14,1

* End of period.

to R6,3 billion. In January 1995 the net gold and other foreign reserves of the Reserve Bank increased by a further R0,7 billion. The improvement in the overall balance of payments position allowed the Reserve Bank to make considerable repayments on its reserve-related loan commitments: the outstanding balance on the foreign loans of the Bank decreased from R8,5 billion at the end of April 1994 to R4,7 billion at the end of January 1995.

South Africa's *gross gold and other foreign reserves* increased by R3,1 billion from the end of September 1994 to R14,1 billion at the end of December 1994. This level of reserves was equivalent to more or less 6½ weeks' imports of goods and services. In January 1995 the gross foreign reserves of the Reserve Bank increased by a further R0,2 billion to a level of R11,3 billion.

Exchange rates of the rand

Having declined sharply by more than 12 per cent from the end of 1993 to the middle of July 1994, the *nominal effective exchange rate* of the rand recovered significantly during the remainder of 1994. The nominal effective exchange rate of the rand nevertheless decreased, on balance, by 8,5 per cent during 1994. In the first seven weeks of 1995 the weighted index of the rand contracted moderately further, but then began to decrease sharply in anticipation of an expected abolition of the financial rand. The nominal effective exchange rate of the rand consequently decreased by 3,5 per cent from the end of 1994 to 23 February 1995.

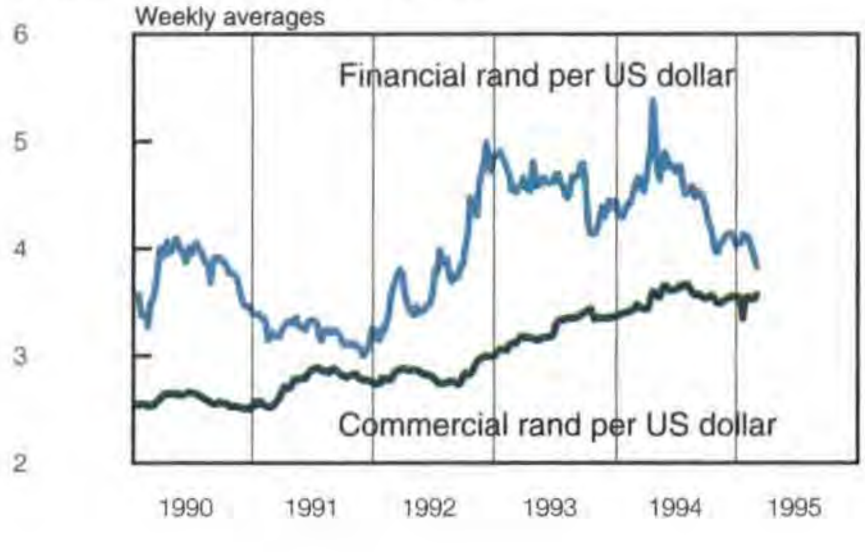
The *real effective exchange rate* of the rand declined on average by 3,0 per cent during 1994; in calendar 1993 it had declined at a much more rapid rate of 4,7 per cent. From the end of 1992 to the end of December 1994 the real effective exchange rate of the rand therefore decreased by 6,6 per cent.

Speculation about the possible abolition of the dual exchange rate system in South Africa and relatively stable internal conditions led to an appreciation of the *financial rand* from an all-time low of R5,58 per dollar

Table 8. Changes in exchange rates of the rand
Per cent

	31 Dec 1993 to 13 Jul 1994	13 Jul 1994 to 30 Sep 1994	30 Sep 1994 to 31 Dec 1994	31 Dec 1993 to 31 Dec 1994	31 Dec 1994 to 23 Feb 1995
Weighted average	-12,1	2,6	1,5	-8,5	-3,5
US dollar	-7,0	2,3	0,8	-4,1	-1,8
British pound	-12,3	1,4	2,2	-9,2	-3,7
German mark	-17,8	3,1	1,1	-14,3	-6,6
Japanese yen	-18,9	3,4	2,2	-14,5	-4,4
Netherlands guilder	-17,6	3,1	1,0	-14,2	-6,6
Italian lira	-17,5	4,8	5,4	-8,8	-2,2

Exchange rates of the rand



shortly before the April election to R3,92 per dollar on 21 October 1994. This caused the financial-rand discount to narrow from 35,7 per cent on 11 April 1994 to only 10,2 per cent on 21 October 1994. The turmoil in Mexico was subsequently mainly responsible for the depreciation of the financial rand to R4,10 per US dollar and a widening of the financial-rand discount to 13,9 per cent on 31 January 1995. Renewed speculation about the possible abolition of the financial rand in the second half of February caused an appreciation of the currency to R3,83 per dollar on 23 February 1995. The discount narrowed to only 5,7 per cent on the same day, as the commercial rand began to move sharply to the lower level of the financial rand.

Monetary developments, interest rates and financial markets

Money supply

The growth rates in M3 (seasonally adjusted and annualised) fluctuated considerably during 1994, but from March they remained markedly above the upper limit of the *guideline range* of 6 to 9 per cent for the 1994 guideline year. In the fourth quarter of 1994 the seasonally adjusted average value of M3 amounted to R237,7 billion; this was 14,6 per cent higher than the corresponding value of M3 in the fourth quarter of 1993. The actual increase in the quarterly average value of M3, as measured for money supply guideline purposes, was therefore R11,6 billion or 5,1 per cent above the upper limit of the guideline for 1994.

The twelve-month growth rates in the money supply, which had accelerated sharply during the first seven months of 1994, receded slightly in the following months before rising again in December 1994. The rate of increase over twelve months in the *broadly defined money supply* (M3) accelerated from 7,0 per cent in December 1993 to 16,9 per cent in July 1994; it then decreased somewhat to 14,7 per cent in November, but rose again to 15,7 per cent in December 1994. As shown in Table 9, the more *narrowly defined money supply aggregates* increased at much more rapid rates

Guidelines for growth in M3

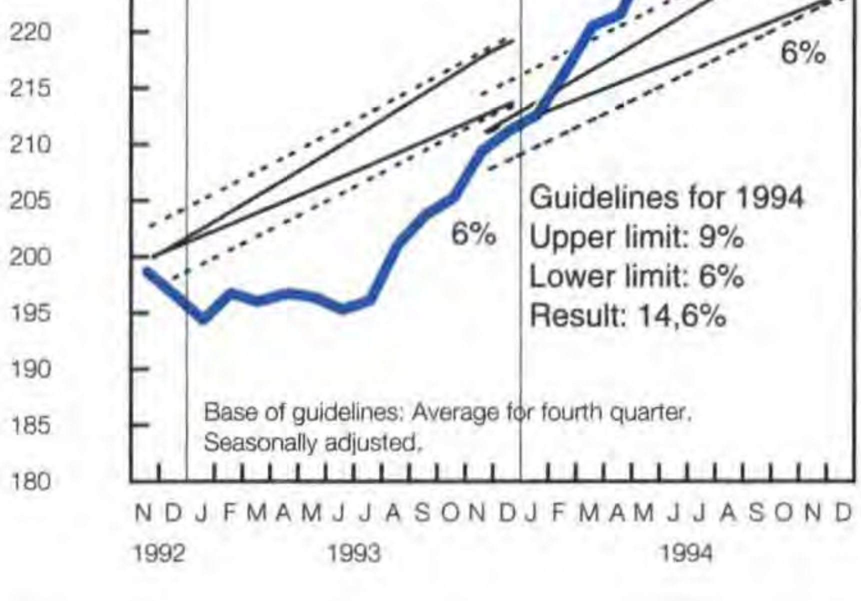


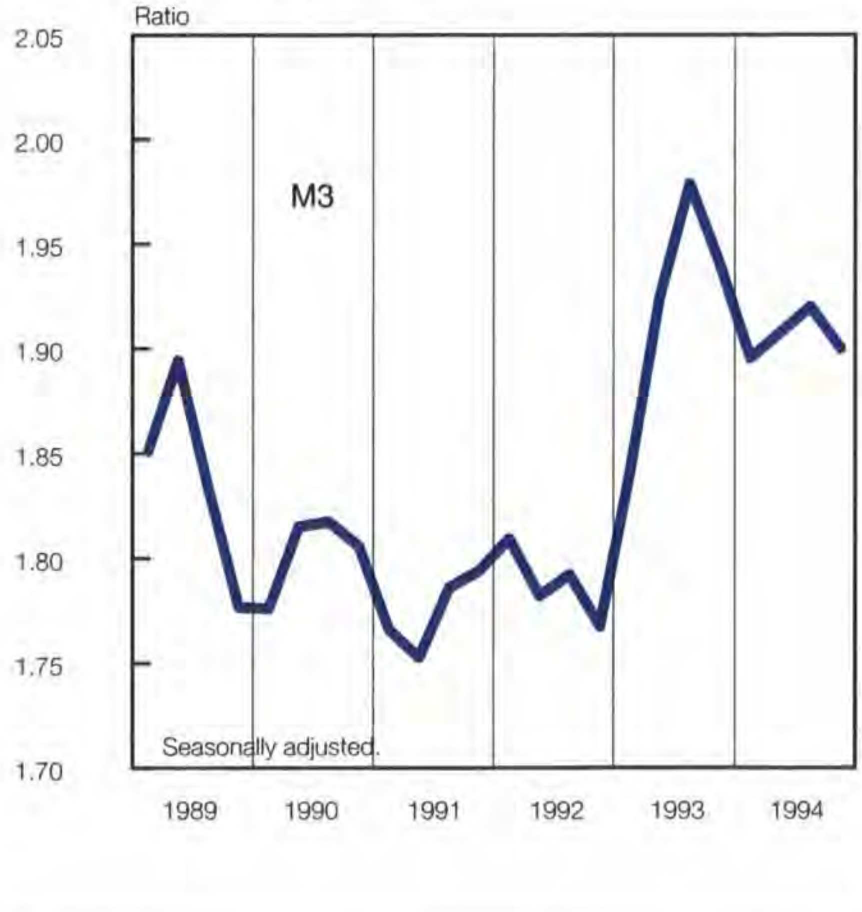
Table 9. Percentage change in money supply over twelve months

Period		M1A	M1	M2	M3
1993:	Dec	16,6	6,7	3,9	7,0
1994:	July	28,2	32,7	19,5	16,9
	Aug	24,4	26,7	19,6	15,1
	Sept	28,8	26,1	18,5	14,3
	Oct	24,6	28,2	19,4	14,8
	Nov	21,0	24,1	19,9	14,7
	Dec	24,8	23,7	20,6	15,7

than M3, clearly reflecting a high liquidity preference. The public's higher demand for monetary assets was confirmed by a decline in the income velocity of M3 from a recent peak of 1,97 in the third quarter of 1993 to 1,90 in the fourth quarter of 1994, or by about 4 per cent.

The relatively rapid growth in money supply during 1994 was primarily the result of an increase in the demand for money to finance the high level of expenditure on consumption, investment and inventory accumulation. Another factor which contributed to the higher growth in money, was a rise in the liquidity preference of the private sector due to uncertainties prevailing during the political transition, expected interest rate changes and the perceived danger of major adjustments in the share and bond market.

Income velocity of money



The M3 money supply increased by R33,2 billion in 1994, compared with only R13,8 billion in 1993. The *main counterparts* (in a statistical or accounting sense) of the increase in M3 during 1994 were as follows:

		R billions
Net foreign assets		- 0,3
Government sector: net claims		8,0
Gross claims	5,0	
Government deposits (increase-, decrease+)	3,0	
Claims on the private sector		39,1
Net other assets and liabilities		-13,6
Total change in M3		**33,2**

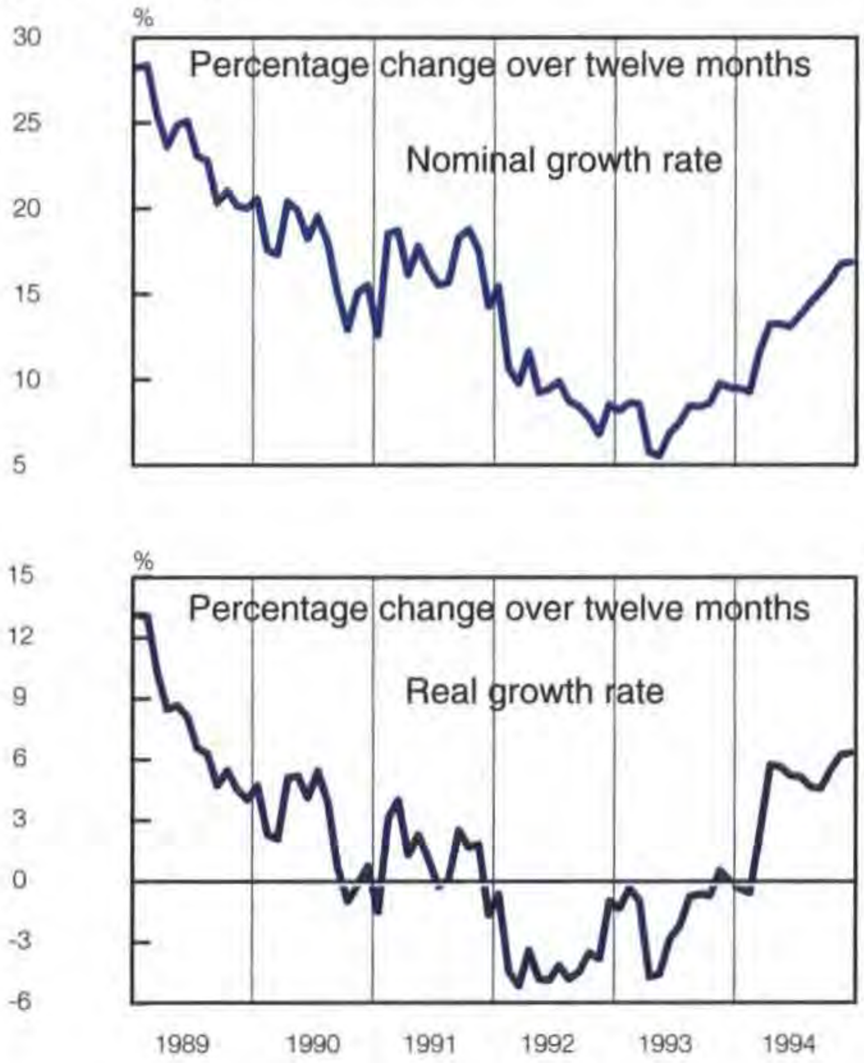
As has already been indicated in previous quarterly surveys, the issuing of special government stock to the value of R7,5 billion to the Reserve Bank caused a switch in these statistical counterparts from changes in "net other assets and liabilities" to changes in the gross and net claims on the government, without affecting the overall change in M3. If this stock issue is not taken into account, the monetary sector's net claims on the government increased by only R0,5 billion in 1994. This small increase was mainly due to a decline in government deposits with monetary institutions related to the funding practices of the government: a policy of spreading the financing of the Exchequer deficit more evenly over the year and using available balances was followed in fiscal 1994/95, which led to a sharp decrease in government deposits with monetary institutions.

Credit extension

Credit extension to the *private sector* was the statistical counterpart primarily responsible for the accelerated growth in money supply. The twelve-month rate of increase in credit extension to the private sector by monetary institutions advanced from 9,7 per cent in December 1993 to 17,0 per cent in December 1994. These monthly growth rates exceeded the rates of consumer price inflation since March 1994, indicating that credit extension in real terms has been positive since that time.

An analysis of the monetary institutions' claims on the private sector by *type of credit* shows that the twelve-month rate of growth in mortgage advances remained at a level of about 17 per cent during 1994 and amounted to 17,9 per cent in December. Reflecting a sharp increase in sales of new motor vehicles, the rate of increase over twelve months in instalment sale credit accelerated further from 18,0 per cent in December 1993 to 27,6 per cent in December 1994. The general rise in expenditure led to an increase in the twelve-month growth rates of "other loans and advances" (including overdrafts) from 8,4 per cent to 12,8 per cent over the same period. The twelve-month rate of increase in leasing finance, however, remained at a relatively low

Credit extended by monetary institutions to private sector



level during 1994 and reached only 7,2 per cent in December.

In absolute terms credit extension by monetary institutions to the private sector during 1994 was dominated by mortgage advances and "other loans and advances". Mortgage advances contributed R17,3 billion and other loans and advances R10,2 billion to the total increase of R39,1 billion in credit extension by monetary institutions to the private sector, or about 70 per cent.

Table 10 indicates that credit extension to *households* by monetary institutions increased by R17,9 billion in 1994, or by 14,7 per cent. Mortgage advances remained the most important type of credit used by households: at the end of 1994, 68 per cent of total credit extended by monetary institutions to individuals was in the form of mortgage advances. Instalment sale credit and so-called "other loans and advances" (excluding overdrafts) increased significantly in 1994, while overdrafts extended to households declined by 20 per cent, partly on account of a shift to flexible mortgage finance schemes from overdrafts.

Credit extended by monetary institutions to the *private business sector* rose by R12,4 billion, or 17,1 per cent, during 1994. This was mainly due to relatively sharp increases in overdrafts, mortgage advances and instalment sale credit. The rate of increase in "other loans and advances" (excluding overdrafts) amounted to only 8,5 per cent in 1994, but this remained the main type of credit used by the private business sector and comprised about 37 per cent of total credit utilised by private businesses at the end of 1994.

Interest rates and yields

Interest rates and bond yields, which had started to firm in February 1994, in general rose further in the fourth quarter of 1994 and the first two months of 1995. The strong upward movement in the yields on long-term bonds in the first half of 1994 led to a steepening in the *yield curve*, which later flattened somewhat as short-term yields continued to rise while long-term yields became more stable. This is clearly reflected in the margin between month-end yields on bonds with a maturity of one year and ten years: this margin widened from 2,0 percentage points in January 1994 to 3,0 percentage points in June 1994 as the yield curve steepened, and

Table 10. Changes in credit extended to households and private businesses during 1994

	Households		Private businesses	
	R billions	Percentage change	R billions	Percentage change
Mortgage advances	14,5	18,1	1,9	26,9
Instalment sale credit	1,8	15,3	4,5	39,9
Overdrafts	-2,5	-20,1	3,3	20,0
Leasing finance	1,1	17,4	0,1	1,6
Credit cards	1,1	30,1	0,2	–
Other loans and advances	1,9	25,0	2,4	8,5
Total	**17,9**	**14,7**	**12,4**	**17,1**

narrowed to 2,6 percentage points in January 1995 as the yield curve flattened. The upward slope of the yield curve still indicates expectations of further increases in short-term rates, while the flattening of the curve indicates an abatement of inflation expectations over the long term.

Money market interest rates, on balance, continued to show a distinct upward movement during 1994 and the first two months of 1995. The inter-bank call rate, for instance, rose from 9,75 per cent at the end of January 1994 to 11,00 per cent at the end of May 1994 before returning to levels reached at the beginning of the year. In reaction to the increase in Bank rate, this rate then rose by one percentage point to 10,75 per cent in September. In the subsequent months it increased further to 11,80 per cent at the end of January 1995 and softened somewhat to 11,50 per cent on 20 February. After the increase in the Bank rate, the inter-bank call rate rose to 11,75 per cent on 23 February 1995.

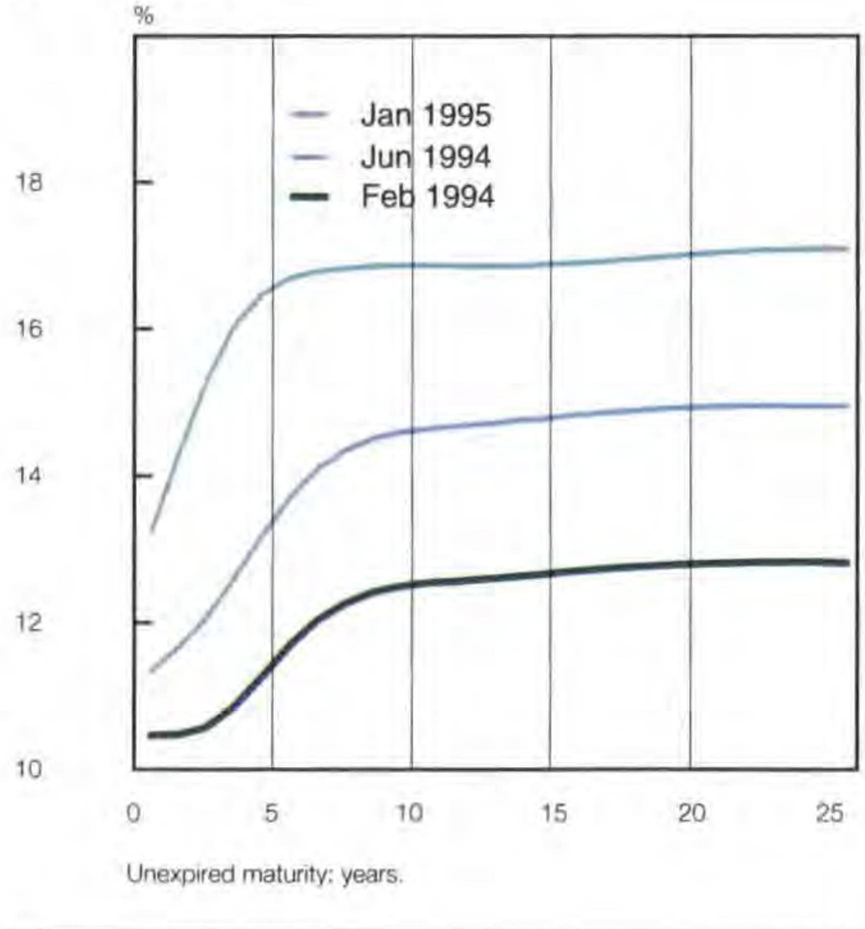
The increase in Bank rate from 12 to 13 per cent on 26 September 1994 led to a corresponding increase in both the banks' *prime lending rate* and the *predominant mortgage bond rate* to 16,25 per cent. The increase in the prime rate became effective on 26 September 1994 and the increase in the mortgage bond rate in October 1994 for new mortgage loans and between 28 October and 1 November 1994 for existing mortgage loans. The real or inflation-adjusted rate on both types of advances was 5,8 per cent in December 1994, compared with 5,2 per cent in December 1993. The measures announced to tighten monetary policy in February 1995 caused a further rise of 1,25 percentage points in the prime overdraft rate to 17,5 per cent from 22 February 1995 and of 1,0 percentage point in the mortgage rate to 17,25 per cent per annum from 22 February 1995 on new loans and from 23 March to 1 April 1995 on existing loans.

Capital market yields also hardened appreciably during 1994. The monthly average *yield on long-term government stock* increased from 12,21 per cent in January 1994 to 15,87 per cent in August and to 16,89 per cent in September. In the subsequent months it fluctuated around this level and reached 17,02 per cent in January 1995. The real yield on long-term government stock rose from 2,1 per cent in January 1994 to 6,3 per cent in December 1994. Capital market yields hardly reacted to the latest increase in Bank rate.

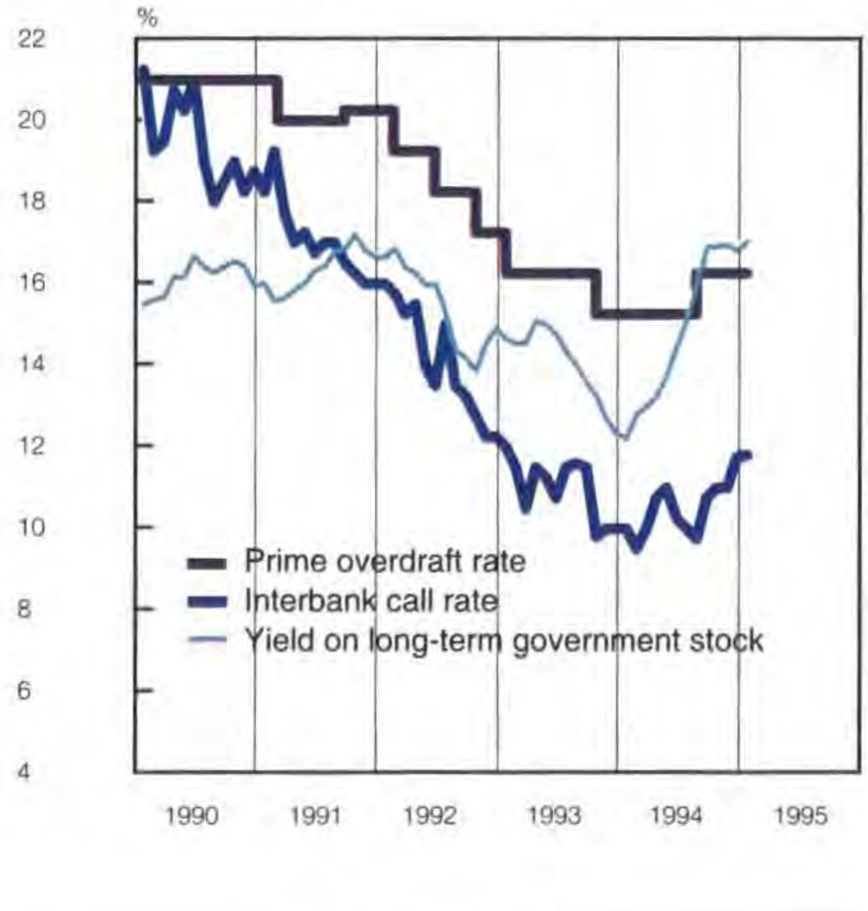
As a result of the increase in Bank rate in September 1994, the predominant *twelve-month retail deposit rate* of banks was adjusted upwards by one percentage point to 11,5 per cent in September 1994. In a bid by banks to attract longer-term deposits amid rising yields, this rate was increased further to between 12,0 and 12,25 per cent in October 1994, to 12,5 per cent in November and to 13,0 per cent in January 1995. At this level depositors earned a positive real yield before tax of 2,4 per cent in December 1994. At the end of February 1995 the twelve-month deposit rate was increased further to 13,5 per cent.

Other long-term rates were also increased in the fourth quarter of 1994 and the first two months of 1995.

Yield curves

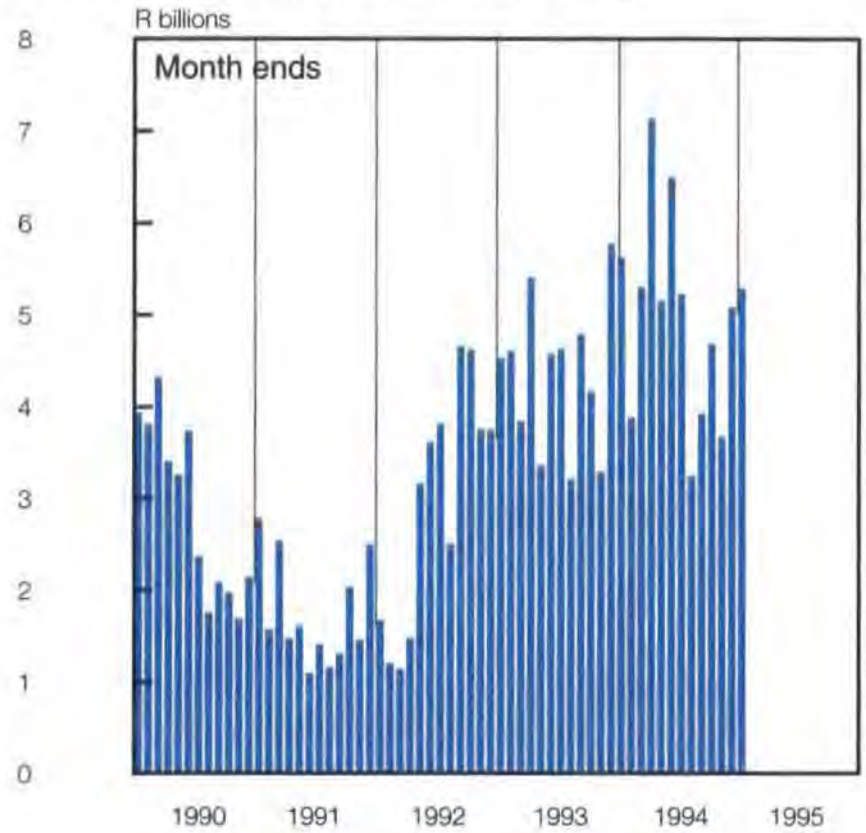


Interest rates and yields



The *standard interest rate* applicable to loans granted by the State Revenue Fund (Exchequer Act, Act No. 66 of 1975), which had been raised in three steps from 13,25 per cent on 1 June 1994 to 15,5 per cent from 1 September 1994, was increased further to 17,0 per cent with effect from 1 November 1994 and to 17,25 per cent from 1 December 1994. On 1 January 1995 it was reduced again to 17,0 per cent before being increased to 17,25 per cent on 1 February 1995. The maximum permissible *finance charges rates*, as laid down in terms of the Usury Act, were increased with effect from 11 November 1994 from 23 to 25 per cent in respect of money lending, credit and leasing transactions for amounts of more than R6 000 (but not exceeding R500 000), and from 26 to 28 per cent in respect of amounts up to R6 000.

Accommodation at discount window



Money market conditions

The relatively tight *money market conditions* that prevailed in the first six months of 1994 eased considerably in the third quarter, but the money market tightened again in the fourth quarter. This is clearly reflected by the accommodation at month ends, which contracted from R6,5 billion at the end of June 1994 to R3,9 billion at the end of September; it then increased again to R5,1 billion at the end of December. The tightening in money market conditions during the fourth quarter of 1994 could be attributed to an increase in notes and coin in circulation outside the Reserve Bank and the cash-draining effect of the decline in the Bank's net gold and foreign exchange reserves.

Although money market conditions eased somewhat during January 1995, the money market shortage rose further to R5,3 billion at the end of the month. These tighter conditions at the end of the month were mainly due to an increase in government deposits with the Reserve Bank, which more than offset a decrease in notes and coin in circulation outside the Reserve Bank and an increase in the net foreign assets of the Bank. In the first two weeks of February the shortage shrank to R2,6 billion, owing to a sharp rise in the net foreign assets of the Reserve Bank.

The *operations of the Reserve Bank* in the money market during the fourth quarter of 1994 and in January 1995 were fairly neutral and the Bank generally allowed the money market shortage to reflect underlying demand and supply conditions. Certain actions, such as the purchase of assets for the portfolio of the Corporation for Public Deposits and the redemption of the special Treasury bills that had been issued in August 1994, at times resulted in an easing of money market conditions. These operations were, however, offset by the Reserve Bank's management of the Tax and Loan Accounts.

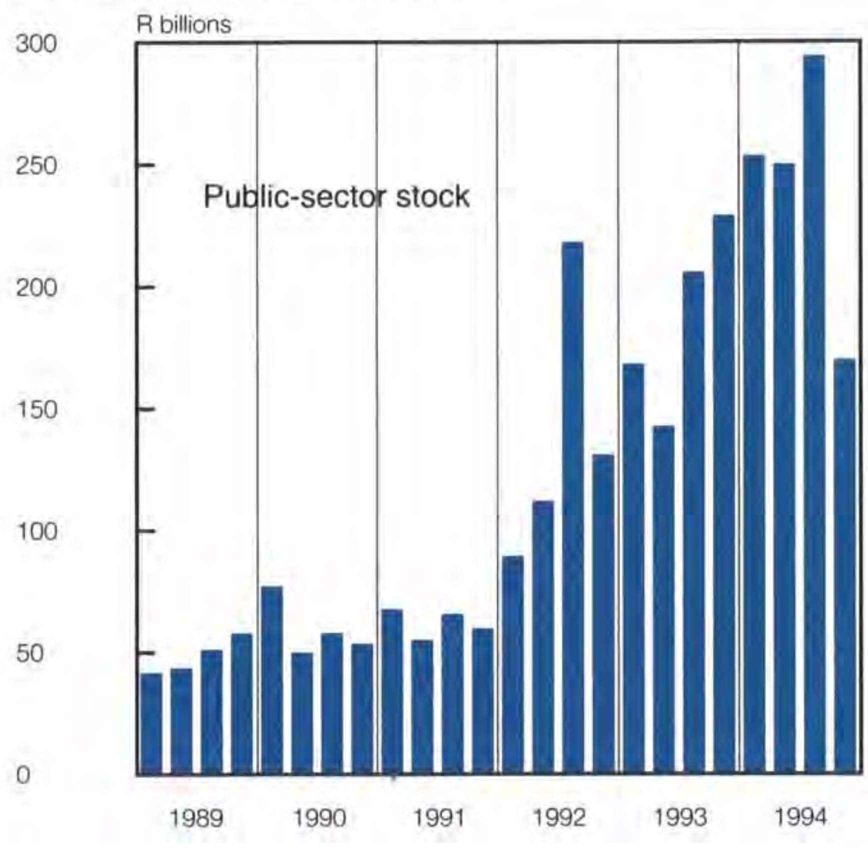
Towards the end of January and the beginning of February 1995 the Reserve Bank started to take actions to prevent unduly sharp downward movements in the money market shortage. These actions included an increase in government deposits at the Bank of R1 150 million during the first two weeks of February. As part of its more stringent monetary policy approach, the Bank positioned itself to mop up liquidity by increasing the basic minimum cash reserve requirement of the banks from 1 to 2 per cent of their total liabilities as adjusted with effect from 21 March 1995.[1]

Bond market

Net new borrowing in the *primary bond market* by the *public sector* fell back significantly from R7,2 billion in the second quarter of 1994 to R4,1 billion in the third quarter, and then increased to R7,8 billion in the fourth quarter. This brought the new issues of the public-sector stock to only R19,1 billion in the first nine months of fiscal 1994/95; in the corresponding period of the preceding year these issues had totalled R26,2 billion. The government also tapped the international capital market with a US dollar bond issue amounting to R2,7 billion in December 1994. This was the first international issue since 1991 and represented a further step in the normalisation of South Africa's international economic relations.

The *private sector's* demand for funds raised by means of primary fixed-interest securities abated in 1994 and new issues of such securities by listed companies in the private sector (against the backdrop of the firming in long-term interest rates and yields) declined by about 82 per cent to R138 million for the year 1994. A number of companies also raised capital by means of convertible Eurobond issues to the amount of $175 million, which lowered the demand for loanable funds in the domestic capital market.

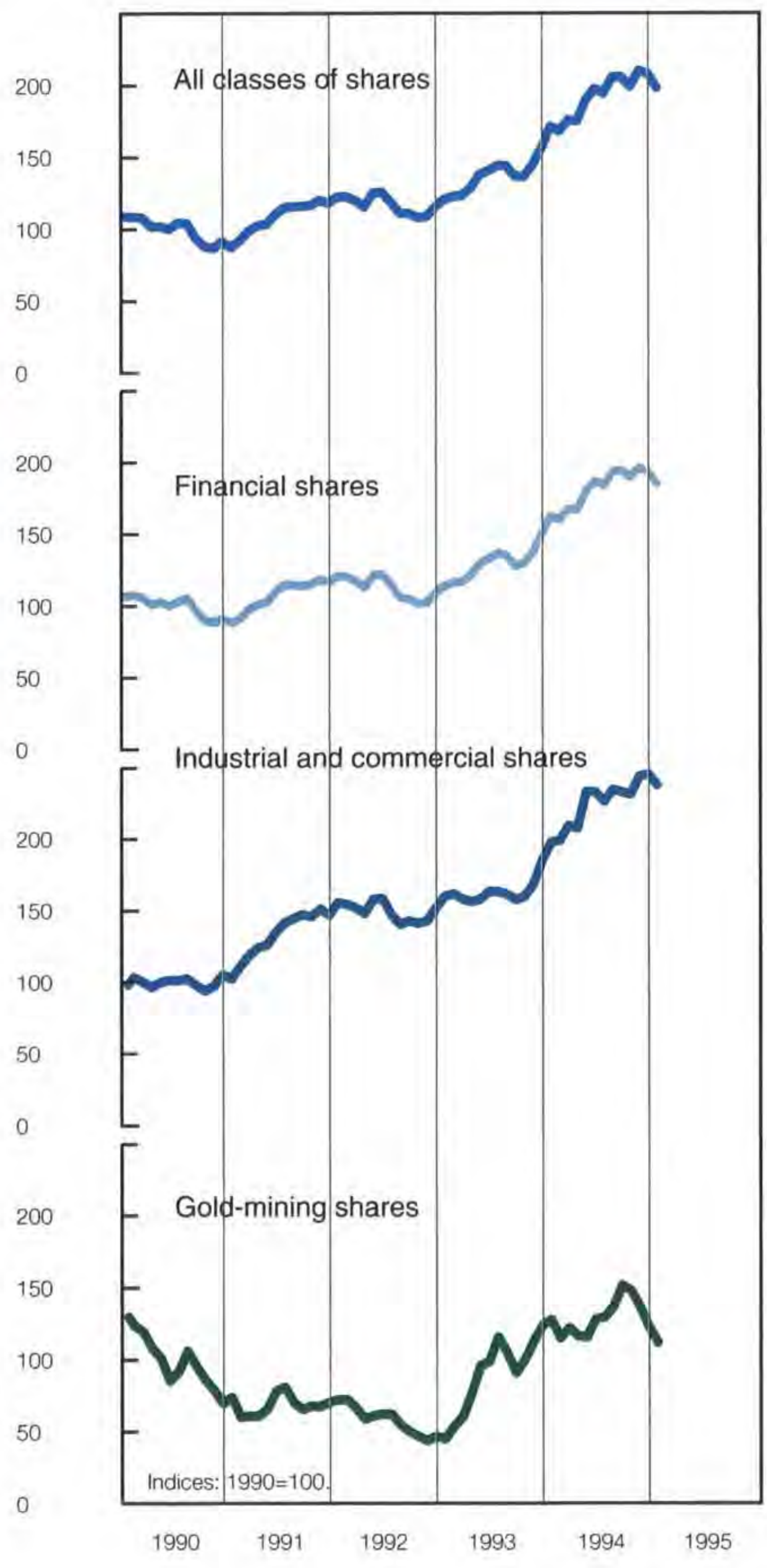
Stock exchange transactions



Activity in the *secondary bond market* remained very buoyant throughout the first three quarters of 1994, but then declined sharply from October onwards. The value of *public-sector stock* traded on the Johannesburg Stock Exchange increased from an already high R253,5 billion in the first quarter of 1994 to a new record level of R294,5 billion in the third quarter, but decreased sharply to R170,1 billion in the fourth quarter. At R968,3 billion in 1994, the annual turnover of these stocks was nearly 30 per cent higher than in 1993. In January 1995 the value of public-sector stock traded fell back further to R52,4 billion from a monthly average of R56,7 billion in the fourth quarter of 1994.

Non-residents remained net buyers of bonds in the fourth quarter of 1994. For 1994 as a whole their net purchases of gilts on the Johannesburg Stock Exchange amounted to R1,1 billion. In January 1995 further net purchases to the amount of R0,1 billion were made by non-residents. Although their share of total gross purchases came to only 1,2 per cent in 1994, they continued to serve as an important indicator for investors in this market.

Share prices



Equity market

The demand for funds in the *primary equity market* declined substantially in 1994, despite relatively favourable conditions for such issues. The value of rights issues of ordinary shares by companies listed on the stock exchange declined from R5,3 billion in 1993 to R2,7 billion in 1994, or by more than 50 per cent.

Activity in the *secondary equity market*, however, was brisk. The value of shares traded on the Johannesburg Stock Exchange increased from a quarterly average of R10,9 billion in 1993 to an all-time-high quarterly level of R20,7 billion in the first quarter of 1994, before decreasing to R15,7 billion in the fourth quarter. Total share transactions in 1994 amounted to R71,6 billion, almost 66 per cent more than the turnover in 1993. In January 1995 the value of shares traded contracted further from a monthly average of R5,2 billion in the fourth quarter of 1994 to R4,5 billion because of the volatility in the market and downward corrections in share prices.

Non-residents, who became net sellers of equities from the second quarter of 1994, made further net sales of R535 million in the fourth quarter. However, for the year as a whole they were still net buyers of equities totalling R185 million. In January 1995 non-residents made further net purchases of equities to the amount of R211 million. Non-residents continued to be important operators on the stock exchange and their gross purchases of shares amounted to approximately 31 per cent of the turnover of listed shares in 1994.

Supported by a strong performance in nearly all the share categories (with the exception of gold-mining shares), the monthly *average price of all classes of shares* fluctuated upwards and reached a new record high in November, which was 93 per cent above its lower turning-point in October 1992. In December 1994 and January 1995 the plunge in share prices on Wall Street, a lower gold price, the ripple effect of the Mexican crisis on emerging markets, the earthquake in Japan and pre-emptive action in anticipation of the possible abolition of the financial rand, led to a downward correction of 5,8 per cent in the average price level of all classes of shares.

Mirroring the increase in share prices, the average dividend and earnings yields decreased sharply throughout 1994, before rising somewhat in January 1995 (see Table 11). The price-earnings ratio reached a high in August 1994, but then declined during the next five months. The relative expensiveness of South African shares is also illustrated by the sharp rise in the yield gap (monthly average yield on long-term government stock minus the dividend yield) on all classes of shares, which rose from 9,8 percentage points in December 1993 to 14,7 percentage points in January 1995.

Table 11. Dividend yield, earnings yield, price-earnings ratio and yield gap on all classes of shares

		Dividend yield Per cent	Earnings yield* Per cent	Price-earnings ratio	Yield gap Points
1993:	Dec	2,53	5,95	16,81	9,81
1994:	Mar	2,30	5,50	18,18	10,69
	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:	Jan	2,28	5,48	18,25	14,74

* Excluding gold-mining shares.

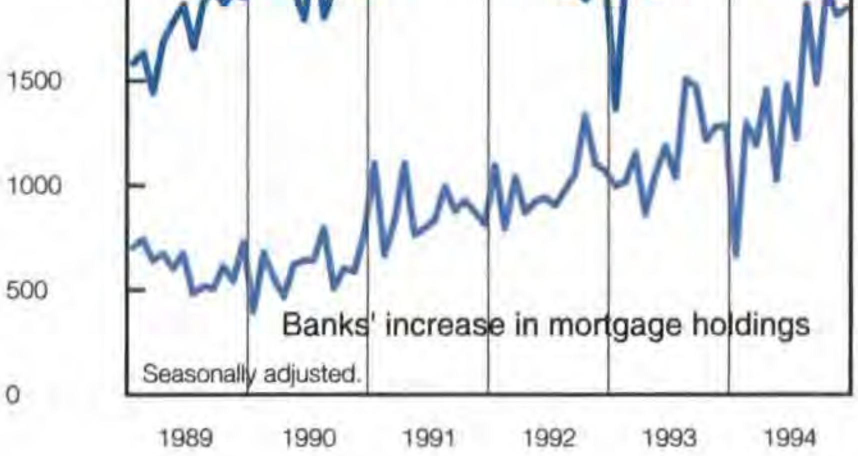
Other financial markets

Turnover in the formal *derivative market* for *equity futures* generally remained at a high level throughout 1994 and January 1995. The number of contracts traded in equity futures was accordingly nearly 34 per cent higher in 1994 than in 1993. Trade in *options* on equity futures, which had started in October 1992, also continued to increase sharply. Trade in these options amounted to 3,3 million contracts in 1994; this was about one and a half times the number of 2,1 million contracts traded in 1993. In January 1995 the trade in these options totalled 0,6 million contracts, compared with a monthly average of 0,3 million contracts in 1994.

Trading in a new *interest rate futures contract*, with the government stock R150 as the underlying instrument, commenced on 30 November 1994, and trading in *options* on 9 December 1994. Both these new instruments were fairly heavily traded in the next two months.

Growth in the *mortgage market* remained buoyant throughout the first eleven months of 1994, with the banks' total mortgage loans outstanding increasing from R92,9 billion in December 1993 to R108,7 billion in November 1994. The value and number of *real estate transactions* also increased throughout 1994 and the average price of all property transactions in November was 19,4 per cent above the corresponding month in the preceding year.

Mortgage lending and real estate transactions



Public finance

Public-sector borrowing requirement

The *public-sector borrowing requirement* (i.e. the deficit before borrowing and debt repayment of the consolidated Central Government, provincial governments, local authorities and the non-financial public enterprises) amounted to R20,7 billion in the first nine months of fiscal 1994/95, or to R0,7 billion more than the amount in the corresponding period of the preceding year. As a ratio of gross domestic product, the public-sector borrowing requirement came to 6,2 per cent in the first nine months of fiscal 1994/95, which was substantially lower than the 10,2 per cent for fiscal 1993/94 as a whole. The exceptionally high borrowing requirement in fiscal 1993/94 was, however, largely due to special non-recurrent transfers of R14,8 billion. If these transfers are excluded, the public-sector borrowing requirement in fiscal 1993/94 was equal to 6,4 per cent of gross domestic product, or only slightly higher than the deficit in the first nine months of fiscal 1994/95.

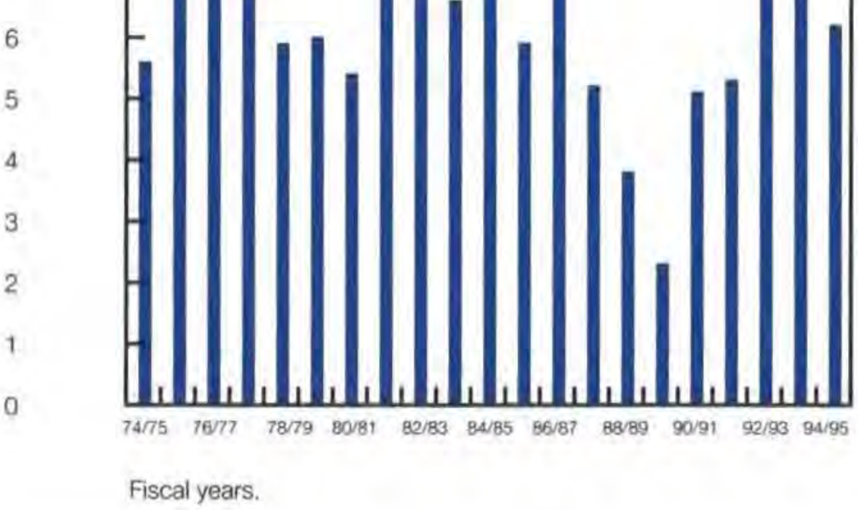
An analysis of the public-sector borrowing requirement by *level of government* shows that the Main Budget was responsible for approximately 96 per cent of the total borrowing requirement, and that the deficit on this account increased slightly (by R0,3 billion) from the first nine months of fiscal 1993/94 to the first nine months of fiscal 1994/95. The borrowing requirement of the non-financial public corporations and central government enterprises also increased from R0,1 billion to R0,4 billion over the same period, while the surplus of R10 million of the extra-budgetary institutions was transformed into a deficit of R860 million. In contrast to these developments, the borrowing requirement of the local authorities was reduced from R310 million to R220 million and the surplus on the income and expenditure accounts of provincial governments increased from R193 million in the first nine months of fiscal 1993/94 to R805 million in the first nine months of fiscal 1994/95.

Exchequer Account

The deficit on the Exchequer Account before borrowing and debt repayment in the first ten months of fiscal 1994/95 was more or less in line with projections in the June 1994 Budget. Both the year-on-year rates of increase in Exchequer issues and receipts over this period were, however, well above the rates of increase that had been foreseen in the Budget for the full fiscal year.

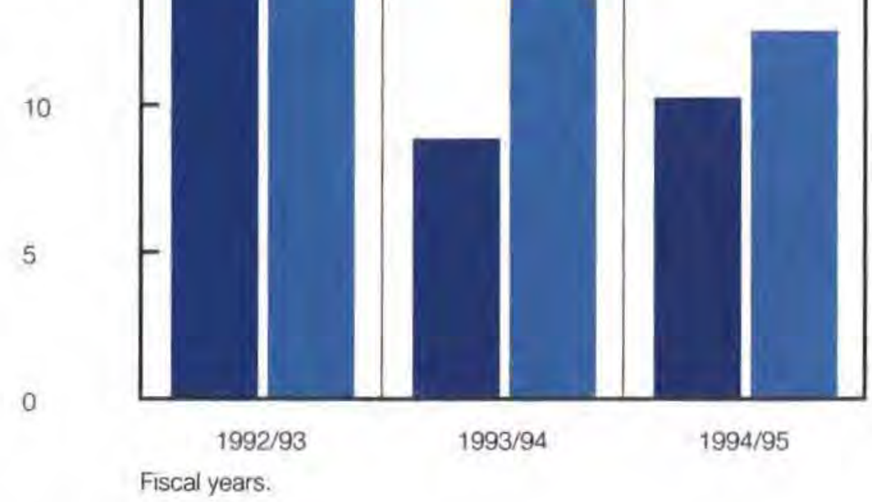
The year-on-year rate of increase in *Exchequer issues* to government departments (adjusted for cash flows) in the first ten months of fiscal 1994/95 amounted to 12,5 per cent, which was markedly higher than the budgetary provision of 10,2 per cent for the year as a whole. This rate of increase in Exchequer issues was, however, well below the rate of increase of 14,1 per cent in the corresponding period of the previous fiscal year and the average rate of increase of 16,6 per cent in the first ten months of the preceding five fiscal years. As a ratio of gross domestic product, Exchequer issues also remained at a level of approximately 30½ per cent of nominal gross

Public-sector borrowing requirement as percentage of gross domestic product



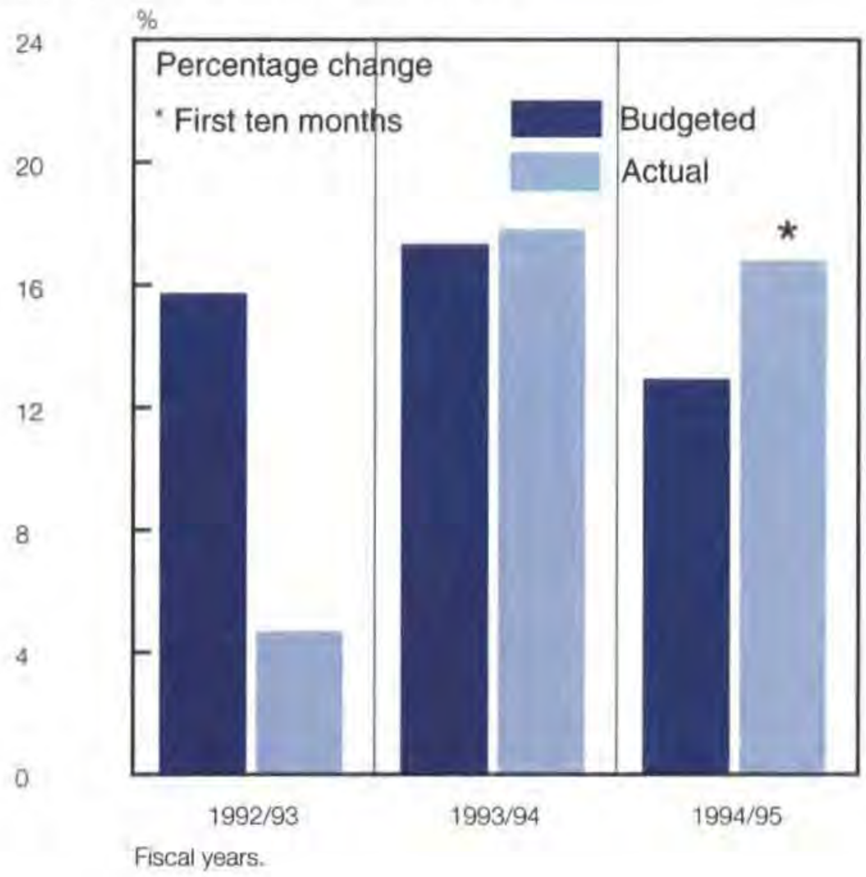
Fiscal years.

Budgeted and actual Exchequer issues to government departments



Fiscal years.

Budgeted and actual revenue



domestic product in the first nine months of fiscal 1994/95. These figures included certain planned government expenditure on reconstruction and development programmes. However, by the end of January 1995 no claims had been filed against the Reconstruction and Development Fund; these claims are likely to be made in the last two months of the fiscal year.

Exchequer receipts (adjusted to a cash flow basis and for capital profits[1]) in the first ten months of 1994/95 were 16,8 per cent above the level in the first ten months of the preceding year; the growth in government revenue had been budgeted at 12,9 per cent for the year as a whole. In the corresponding period of the previous year government revenue rose by 17,4 per cent, while the average rate of increase over this period in the preceding five fiscal years came to 14,0 per cent. The exceptionally good performance of Exchequer receipts in fiscal 1993/94 could be attributed mainly to a substantial increase in the rate of value-added tax.

Although the increase in Exchequer receipts in the first ten months of fiscal 1994/95 was markedly lower than in the preceding year, it was still comparatively high and exceeded budgeted projections. As shown in Table 12, the higher-than-budgeted rate of increase in government revenue could be attributed to sharp

Table 12. Percentage increase in Exchequer receipts

	Budgeted increase for fiscal 1994/95	Actual increase in first nine months of 1994/95
Customs and excise duties..	2,6	7,3
Inland revenue.....................	14,8	17,5
Income tax.....................	16,5	20,0
Value-added tax.............	15,3	15,8
Total receipts.....................	**12,9**	**16,3**

increases in inland revenue as well as in the receipts from customs and excise. Inland revenue performed better than envisaged in the Budget because of a better-than-expected increase in personal income. The higher-than-budgeted rate of increase in income from customs and excise duties was brought about by a substantial increase in the value of merchandise imports.

Despite the introduction of a temporary transition levy on persons and companies, the total tax burden showed no significant change. After having increased sharply from a lower turning-point of 23,5 per cent in fiscal 1992/93 to 24,4 per cent in fiscal 1993/94, Exchequer receipts as a ratio of gross domestic product amounted to 24,3 per cent in the first nine months of fiscal 1994/95.

The net result of the higher-than-budgeted revenue and expenditure was a *deficit on the Exchequer Account* before borrowing and debt repayment of R17,8 billion for the first ten months of fiscal 1994/95. This amount was equal to 60,4 per cent of the deficit budgeted for the year as a whole, which was considerably lower than the ratio of 74,2 per cent for the corresponding period of the previous fiscal year and the average ratio of 64,2 per cent in the preceding five fiscal years. Despite an expected acceleration in government expenditure towards the end of the year, it seems fairly certain that the deficit for the fiscal year as a whole will not exceed the budgeted deficit significantly and could even be lower than expected.

Information on the *financing* of the deficit by *type of lender*, which is available for the first nine months of fiscal 1994/95 only (see Table 13), clearly shows that the deficit was financed mainly by funds obtained from the Public Investment Commissioners and the non-monetary private sector, while the monetary institutions' net claims on the government were reduced sharply. Treasury bills to the amount of R1,7 billion were sold to foreigners during the third quarter of fiscal 1994/95, while the global stock issue of the government in December 1995 contributed R2,7 billion towards the financing of the deficit.

The issuing of domestic long-term government stock, however, continued to be the main *borrowing instrument*

1 Exchequer receipts were adjusted for capital profits arising from the consolidation of government stock, which did not present an actual cash flow or ordinary income.

Table 13. Financing of Exchequer deficit by type of lender in the first nine months of fiscal 1994/95

	R millions
Public Investment Commissioners	13 707
Non-monetary private sector	16 085
Monetary institutions:	-5 722
Corporation for Public Deposits	-2 383
Other monetary institutions	-3 339
Foreign sector	4 709
Extraordinary receipts	29
Total gross financing	28 808
Less: Discount on new government stock	9 615
Plus: Premium on consolidation	1 170
Total net financing	**20 363**

utilised in the financing of the deficit. Seeing that government stock was issued at a substantially lower coupon rate than the ruling market interest rate, the discount on government stock (capitalised interest) increased from 6,5 per cent of the net increase in government stock in fiscal 1993/94 to 31,1 per cent in the first nine months of fiscal 1994/95. As a result, the discount on government stock issues also made a major contribution to the rise in government debt during fiscal 1994/95.

In an attempt to avoid increasing the pressure of the high cost of debt servicing on the government's finances and at the same time satisfy institutional investors' preferences for a capital market instrument with money market qualities, a new variable-rate stock was introduced in October 1994. This stock has a maturity of four years and a coupon rate that is derived quarterly from the ruling Treasury bill tender rate through the addition of a premium. This stock was very popular with investors and an amount of R5,2 billion was raised in the fourth quarter of 1994 by means of this instrument. Although this stock was issued to satisfy the needs of institutional investors, the Public Investment Commissioners and the monetary sector took up R3,6 billion or nearly 70 per cent of the total issue over this period.

The borrowing requirement of the Exchequer before debt repayment, plus the large discount on new government stock issues, led to an increase in *government debt* from R192,1 billion at the end of fiscal 1993/94 to R239,9 billion at the end of December 1994. A substantial portion of this increase (R14,2 billion) could be attributed to the transfer of the debt of the former TBVC countries and self-governing states to the South African national government. As a ratio of gross domestic product, the total government debt has now increased sharply from 37,2 per cent at the end of fiscal 1990/91 to 48,7 per cent at the end of fiscal 1993/94 and further to 55,4 per cent at the end of December 1994. This is a clear warning signal that the present large deficits on the Exchequer Account are not sustainable and must be reduced as quickly as possible.

Total government debt as percentage of gross domestic product