Quarterly economic review

Introduction

The brisk and accelerating rate of economic growth that South Africa had experienced in the second half of 1994 slackened considerably in the first quarter of 1995. Adverse weather conditions, the mining of lower-grade gold-bearing ore and labour unrest on gold mines led to a sharp contraction in the real value added by the primary sectors. These developments, together with a lower rate of increase in consumer demand for goods and services, were also responsible for slower growth in the secondary and tertiary sectors of the economy. The seasonally adjusted and annualised growth rate of 3 per cent in the real output of the non-primary sectors in the first quarter of 1995 was nevertheless still relatively high.

Anticipated further decreases in the production by farms and gold mines could curb the economic recovery during the rest of 1995. The economic recovery could also be held back by uncertainties regarding negotiations with labour unions, pressures for substantial wage increases, capacity constraints in certain sectors and further increases in imports, which could force the authorities to adopt a more restrictive policy stance. Other developments which could have a negative impact on the strength of the economic recovery, are the high incidence of crime and the fact that a large part of the growth in domestic production has been based on rising consumption expenditure, financed not so much from higher personal disposable income as by an increase in consumer credit extension.

On balance, however, there are still a large number of favourable factors at work that should ensure the continuation of relatively strong economic growth for a fairly long period of time. The following are the main positive factors for further growth:

- Economic growth in many of the industrialised countries is expected to be relatively high in 1995 and 1996 and world demand and trade may carry on rising for a long period of time, which should benefit South African exports.
- Consumer and business confidence have improved substantially in South Africa in view of the relatively stable political conditions in the country.
- Real fixed investment has risen by no less than 15½ per cent since the start of the upturn in the business cycle up to the first quarter of 1995. This has brought about an expansion of the production capacity of private business enterprises producing goods for the export market in particular.
- Labour productivity has continued to increase relatively sharply over the past six years and private business undertakings are steadfastly attempting to improve the effective utilisation of their labour and capital resources.
- The low level of South Africa's foreign debt, at least in the short to medium term, allows foreign borrowing to finance the imports of capital goods.

The slackening of economic growth in the first quarter of 1995 was accompanied by a lower rate of increase in real gross domestic expenditure. The quarter-to-quarter rate of growth in investment and private consumption expenditure at constant prices slowed down in the first quarter of 1995, while real consumption expenditure by general government actually contracted. Despite the slower rate of increase in real domestic expenditure, the volume of imports continued to increase rapidly. The increase in imports in the first quarter of 1995 was to a large extent due to the imports of oil, chemical products, transport equipment and paper products, in other words intermediate as well as capital goods.

Fortunately the volume of merchandise exports also increased substantially in the first quarter of 1995, while the terms of trade improved marginally. These factors were, however, unable to prevent a further widening of the deficit on the current account of the balance of payments. At the same time, a large capital inflow in excess of the current account deficit was recorded, with the result that the net gold and other foreign reserves of South Africa rose further. By far the largest part of the capital inflow consisted of short-term capital to finance foreign trade. Much greater volatility also became apparent in South Africa's financial flows with the rest of the world during the first five months of 1995. In order to manage such periodic fluctuations in capital movements effectively, it has now become even more important to maintain a high level of foreign exchange reserves or to have sufficient unutilised credit facilities at hand.

The greater volatility in capital movements mainly reflected expected changes in exchange rates and arbitrage transactions. In view of the low discount of the financial *vis-à-vis* the commercial exchange rate of the rand immediately prior to the removal of exchange control on non-residents, the abolition of the dual exchange rate system on 13 March 1995 had little effect on the weighted exchange value of the rand. As a consequence of the sharp depreciation of the external value of the rand earlier, the real effective exchange rate receded in any event by 3,3 per cent from December 1994 to March 1995.

The depreciation of the rand was an important contributing factor to the upward movement in the rates of increase in both the production and the consumer price index from about the middle of 1994. Price inflation was also fostered by a rise in unit labour costs, the impact of adverse weather conditions on food prices, the increasing pressure of domestic demand on the production capacity of the economy, a sharp rise in oil prices, two increases in Bank rate, and the high growth in money supply and bank credit extension.

The quarter-to-quarter rate of increase in the broadly and narrowly defined money supply aggregates, however, showed a distinct downward movement in the first quarter of 1995. This slower growth in money supply reflected the lower rate of increase in domestic expenditure, despite the fact that a larger portion of expenditure by the private sector was financed by means of bank credit extension. The twelve-month growth rate in the credit extension of the monetary institutions to the private sector rose from approximately 10 per cent in December 1993 to no less than 17,5 per cent in March 1995. At first this increase in credit extension was divided fairly equally between households and business enterprises. However, in the first quarter of 1995 it was dominated by credit extension for the direct financing of consumption expenditure.

After having moved sharply upwards during 1994, the yield curve in the first five months of 1995 remained more or less on the level reached at the end of the preceding year. However, the shape of the curve flattened somewhat because the yields on securities which mature in the next five years edged up, whereas yields on longer-term securities remained virtually unchanged. Towards the end of April the yield on long-term stock also tended upwards because of an accelerating inflation rate, only small net purchases of domestic loan stock by non-residents and an expected rise in Bank rate.

The relatively tight money market conditions that prevailed in the fourth quarter of 1994 eased markedly in the first quarter of 1995, but the money market tightened substantially in April before easing again in May 1995. In the primary and secondary bond market activity declined sharply, mainly because of uncertainties regarding prospective movements in long-term yields and the relatively liquid position of the private sector. The value of shares traded on the Johannesburg Stock Exchange also contracted further in the first quarter of 1995. In contrast to these developments, new share issues in the primary equity market increased sharply as a result of the fact that many listed companies had embarked on a programme of increasing inventory levels, replacing ageing capital stock and initiating new capital projects.

Despite the generally lower level of activity on the stock exchange, the net purchases of shares by non-residents came to the exceptionally high amount of R2,0 billion in the first five months of 1995. In April and May 1995 non-residents once again became net purchasers of bonds on the stock exchange. The improvement in non-resident investor sentiment was probably boosted by the inclusion of the Johannesburg Stock Exchange in the International Finance Corporation's Emerging Market Index. The authorities also continued their efforts to normalise international financial relations by means of a stock issue in the Samurai market, while a number of private companies raised capital in foreign markets by means of convertible bonds.

In the domain of public finance, considerable success was achieved in restricting the government deficit for fiscal 1994/95 to below the deficit projected in the Budget. This relatively favourable result was achieved due to the fact that income received on income tax and customs and excise duties was considerably higher than the Budget estimates. At a ratio of 5,8 per cent of gross domestic product, the deficit of the government before borrowing and debt repayment nonetheless remained uncomfortably high and led to a further sharp increase in government debt.

Domestic economic developments

Domestic output

The pace of economic recovery slackened considerably in the first quarter of 1995. After having accelerated throughout the last nine months of 1994 from a seasonally adjusted and annualised rate of 2 per cent in the second quarter to 4 and 6½ per cent in the next two quarters, a comparatively subdued annualised rate of increase of 1½ per cent in *gross domestic product* was registered in the first quarter of 1995. The level of domestic output in the first quarter of 1995 was nevertheless still 3½ per cent higher than in the first quarter of 1994.

The weaker but still positive performance of the domestic economy in the first quarter of 1995 was predominantly brought about by developments in the primary sector. As is clearly illustrated in Table 1, the real value added in the primary sectors contracted substantially in the first quarter of 1995, while output growth in the secondary and tertiary sectors slowed down but remained positive. The slower growth in the real value added by the secondary and tertiary sectors probably reflected to a large extent the indirect impact of the contraction in the primary sector. However, at an annualised growth rate of 3 per cent in real value added, economic activity in the non-primary sectors was still rising quite rapidly.

Both agricultural and mining production contributed to the decline in the real value added by the primary sectors. The real output of the *agricultural sector* contracted at an annualised rate of 12½ per cent in the first quarter of 1995; in the last nine months of 1994 substantial increases had still been recorded in agricultural production. The lower real output of agriculture was the combined result of the lower gross income of field-crop farmers in the summer rainfall area, reflecting adverse weather conditions and rising intermediate input costs.

The real value added by the *mining sector* decreased at an annualised rate of 8 per cent in the first quarter of 1995, following small rates of increase in the last half of 1994 and a decline of 2½ per cent for the year as a whole. This was caused by a substantial contraction in the output of gold mines, which more than offset increases in the real value added by the rest of the mining sector. The results of the gold mines were affected adversely by a reduction in the quantity and quality of ore milled. As a result of these factors, the real value added by gold mining has now contracted by 12 per cent from its most recent peak in the second quarter of 1993 to the first quarter of 1995. In contrast to these developments,

Real gross domestic product

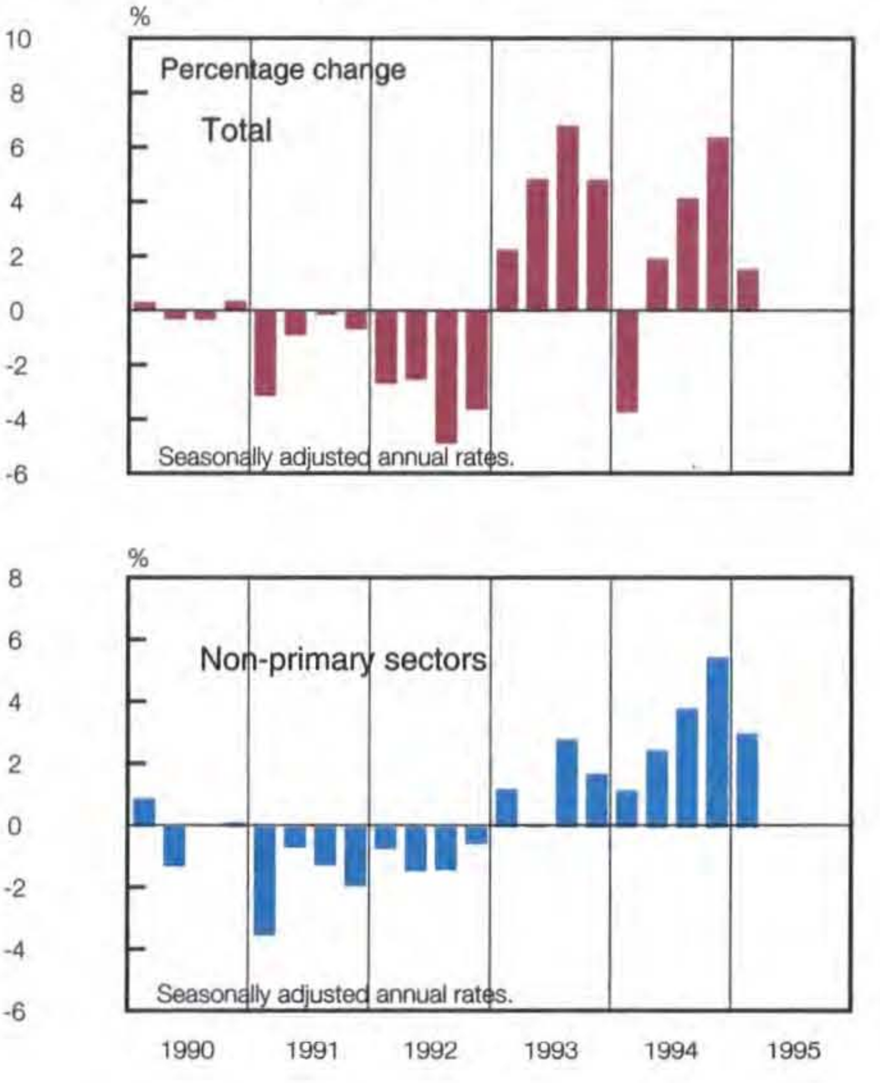


Table 1. Real gross domestic product
Percentage change at seasonally adjusted and annualised rates

Sector	1994				1995
	1st qr	2nd qr	3rd qr	4th qr	1st qr
Primary sector	-30	-3	4	9½	-10
Secondary sector	0	2½	6	8	3½
Tertiary sector	2	2½	2½	4	2½
Gross domestic product	**-3½**	**2**	**4**	**6½**	**1½**

the mining of coal and some base metals benefited considerably from a strong international demand, improved labour relations and increased productivity in the first quarter of 1995.

In the *secondary sectors* the growth in the real output of the manufacturing sector slowed down from a sturdy average annualised rate of about 9 per cent in the second half of 1994 to 4 per cent in the first quarter of 1995. This slower growth could mainly be attributed to a return to a more normal level of the output of industries producing transport equipment, after activity in these industries had increased exceptionally rapidly in the preceding quarter in an attempt to catch up on production losses that had been caused by strikes in the third quarter of 1994. The rate of increase in the real value added by the sector supplying electricity, gas and water, as well as the construction sector, accelerated in the first quarter of 1995 owing to the ongoing expansion of electricity services and an expansion in building and construction activities.

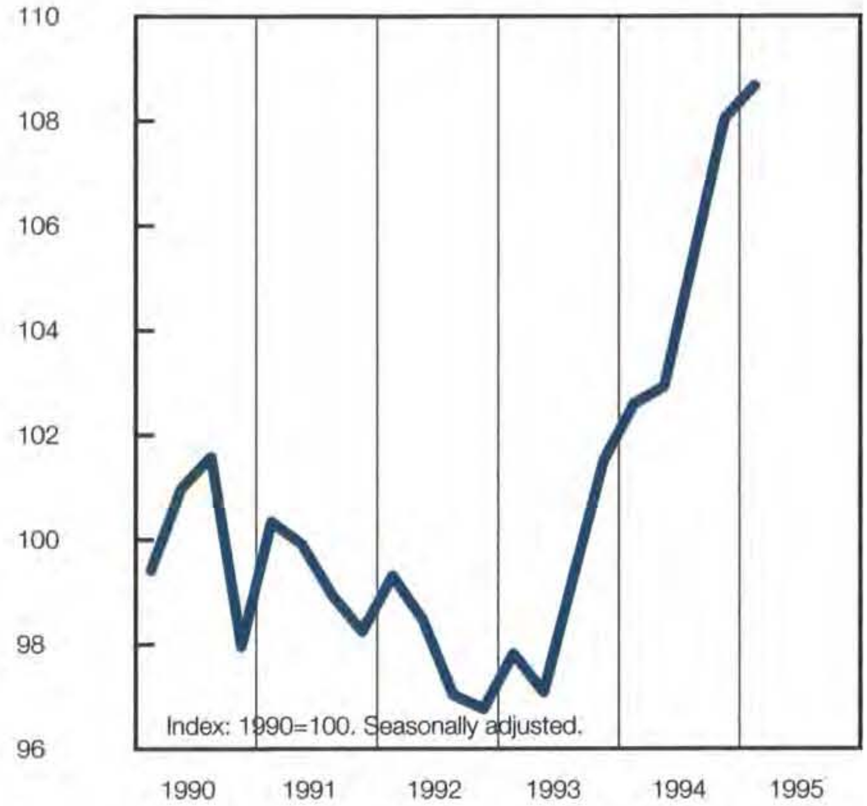
The real value added by the *tertiary sectors* rose further at an annualised rate of about 2½ per cent in the first quarter of 1995; this was somewhat lower than the average annualised rate of increase of 3½ per cent in these sectors in the second half of 1994. Slower growth in real value added by the tertiary sectors was the result of weaker growth in the volume of wholesale and retail trade. The growth in the other tertiary sectors accelerated further or remained at a high level. In particular, the real value added by the motor trade was boosted by additions to the fleets of car rental firms in anticipation of the Rugby World Cup Tournament and by business replacement demand. A further acceleration in the rate of increase in the real value added by the transport, storage and communication sector in the first quarter of 1995 in the main reflected the rise in international trade, while the demand for financial services remained high.

Domestic expenditure

Aggregate real gross domestic expenditure rose uninterruptedly during the current cyclical upward phase up to the first quarter of 1995, to a level that was almost 12 per cent higher than the lower turning-point in the second quarter of 1993. However, the strong growth in domestic expenditure at seasonally adjusted and annualised rates of 10½ and 10 per cent in the third and fourth quarter of 1994 dropped to 2½ per cent in the first quarter of 1995. The quarter-to-quarter rate of growth in investment and private consumption expenditure (at constant prices) slowed down in the first quarter of 1995, while real consumption expenditure by general government actually declined.

After having accelerated throughout 1994 to an annualised level of 4 per cent in the fourth quarter of 1994, the growth rate in *real private consumption expenditure* declined somewhat to a still high 3 per cent in the first quarter of 1995. The lower rate of increase in consumption expenditure was mainly brought about by more moderate rates of increase in the real outlays on non-durable goods and services. In real terms, expenditure on durable and semi-durable goods rose at

Real gross domestic expenditure



Real consumer credit

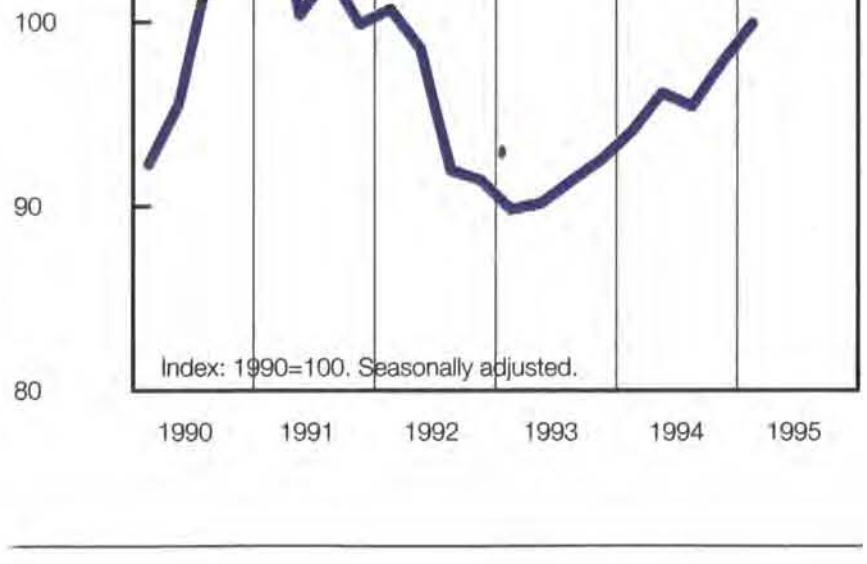


Table 2. Real gross domestic expenditure
Percentage change at seasonally adjusted and annualised rates

Components	1994				1995
	1st qr	2nd qr	3rd qr	4th qr	1st qr
Private consumption expenditure	2	3	3½	4	3
Consumption expenditure by general government	7	2	1½	1	-1½
Gross domestic fixed investment	3½	10½	18	19½	5
Change in inventories (R millions)	5 069	3 267	5 882	8 710	8 686
Gross domestic expenditure	**4½**	**1½**	**10½**	**10**	**2½**

annualised rates of 7 and 5 per cent in the first quarter of 1995; these rates on average being slightly higher than the 6 and 5½ per cent measured in the previous quarter. The sustained high gains in real outlays on durable and semi-durable goods that became evident from the second half of 1994 could be ascribed to growing consumer confidence, reduced violence in most townships and increased recourse to consumer credit. Consumer credit became more readily available to a wider spectrum of consumers through, among others, the proliferation of private-label credit cards that were introduced recently by a number of retail outlets. The use of consumer credit allowed households to extend their real outlays on goods and services at a more rapid rate than the growth in real personal disposable income.

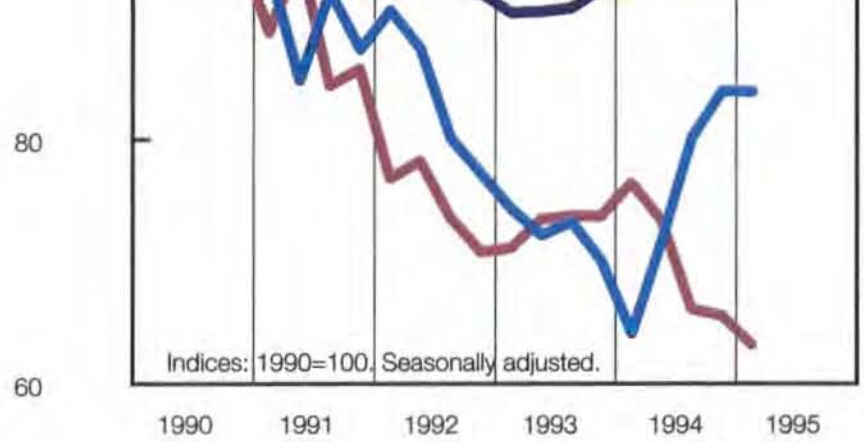
A decrease in the real outlays on intermediate goods and services was primarily responsible for the fact that the *real consumption expenditure by general government* contracted at an annualised rate of about 1½ per cent in the first quarter of 1995. The rate of increase in this aggregate had receded during 1994 from 7 per cent in the first quarter to less than 1 per cent in the fourth quarter. These changes brought the growth in real government consumption expenditure to 3 per cent in the full fiscal year 1994/95; this was about equal to the growth rate in fiscal 1993/94.

For the eighth consecutive quarter an increase was registered in aggregate *real gross domestic fixed investment* in the first quarter of 1995. Real fixed investment was therefore 15½ per cent above its lower turning-point in the first quarter of 1993. However, the rate of growth in real fixed capital formation dropped from 18 and 19½ per cent in the last two quarters of 1994 to 5 per cent in the first quarter of 1995. Significant further increases in real fixed investment by the private sector more than neutralised the continuing reductions in the real expenditure by public authorities on capital goods, while the real outlay on fixed investment by public corporations edged downwards from the high level reached in the preceding quarter.

Increases in real domestic *fixed investment by the private sector* took place in mining, manufacturing, transport and communication, commerce and finance. The fact that investment rose in most sub-sectors seems to confirm the existence of a more positive sentiment in the business community. Spending on some new mining ventures and expansion programmes on existing mines bolstered capital formation in the mining sector. Fixed capital formation in other private organisations was encouraged by the strengthening of aggregate demand, leading to capacity constraints in certain areas and the replacement of technically outdated machinery and equipment.

Real *fixed investment by public corporations* receded slightly in the first quarter of 1995. This followed substantial increases throughout 1994 as a result of the

Real gross domestic fixed investment

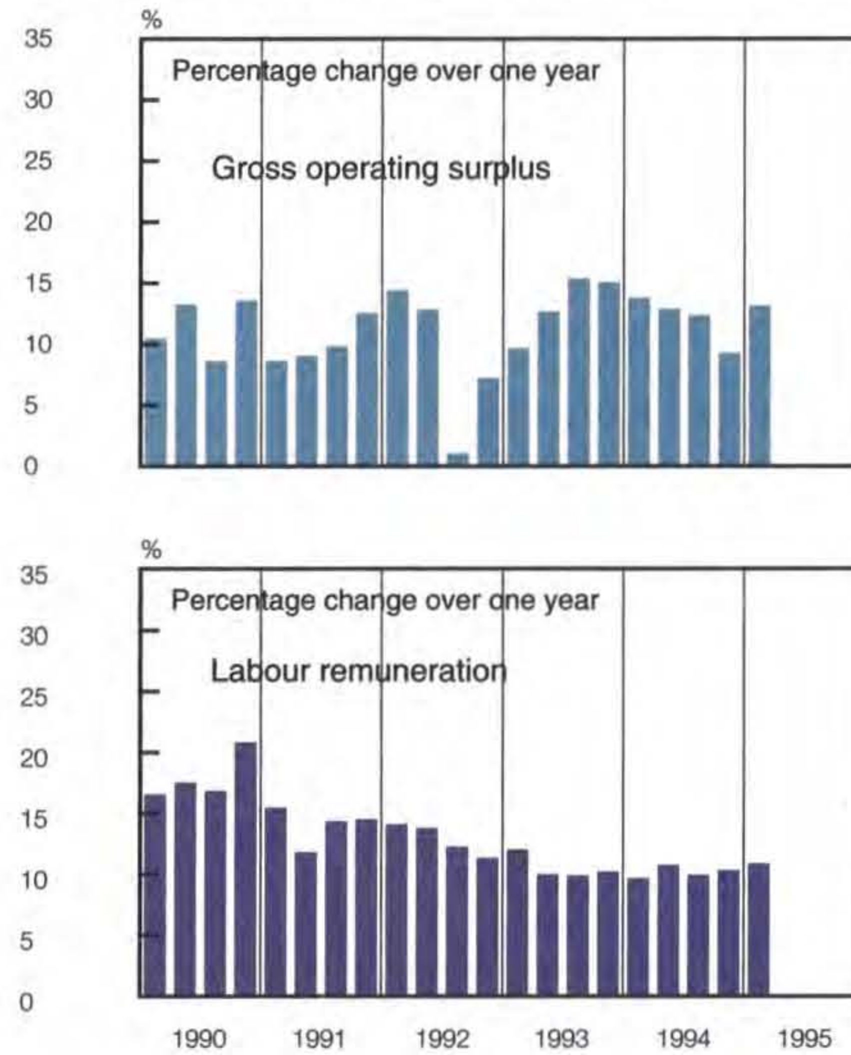


extensive electrification programme of Eskom. In the first quarter of 1995 the momentum of the spending on electricity provision moderated considerably, but fixed investment by other public corporations rose substantially. As a result of these changes, the level of real fixed investment by public corporations in the first quarter of 1995 was still more than 30 per cent higher than in the first quarter of 1994.

The *real fixed investment by public authorities* continued to decline in the first quarter of 1995, mainly owing to a further decrease in the funds allocated for capital extensions by the government. The level of fixed investment by public authorities has now declined by no less than 46½ per cent from its peak in the second quarter of 1989.

A further build-up of *inventories* was recorded in the first quarter of 1995. This inventory accumulation (measured at constant prices) was broadly based, but was particularly evident in wholesale and motor trade. As a consequence, the ratio of industrial and commercial inventories to gross domestic product was equal to 18 per cent in the first quarter of 1995, compared with the record low of 16 per cent in the fourth quarter of 1993.

Gross operating surplus and labour remuneration



Factor income

The year-on-year rate of increase in *total nominal factor income* increased from an average of 12 per cent in the last two quarters of 1994 to about 12½ per cent in the first quarter of 1995. This acceleration in factor income was the result of higher growth in the gross operating surpluses of business enterprises and in the aggregate remuneration of employees.

The rate of increase over four quarters in the *total remuneration of employees* rose from 10½ per cent in the fourth quarter of 1994 to 11 per cent in the first quarter of 1995. This slightly faster rise in total salaries and wages was evident in all the main sectors of the economy and reflected a moderate increase in the aggregate level of employment and some acceleration in the growth of the average remuneration per employee.

The growth in the total nominal *gross operating surplus* rose from an average of 11 per cent in the second half of 1994 to 13 per cent in the first quarter of 1995. However, quarter-to-quarter growth in the gross operating surplus of the primary sector declined in the first quarter of 1995 because of the lower profits of gold mines. In the secondary and tertiary sectors the rate of increase in the gross operating surpluses was boosted by the strengthening of domestic economic activity and higher turnovers.

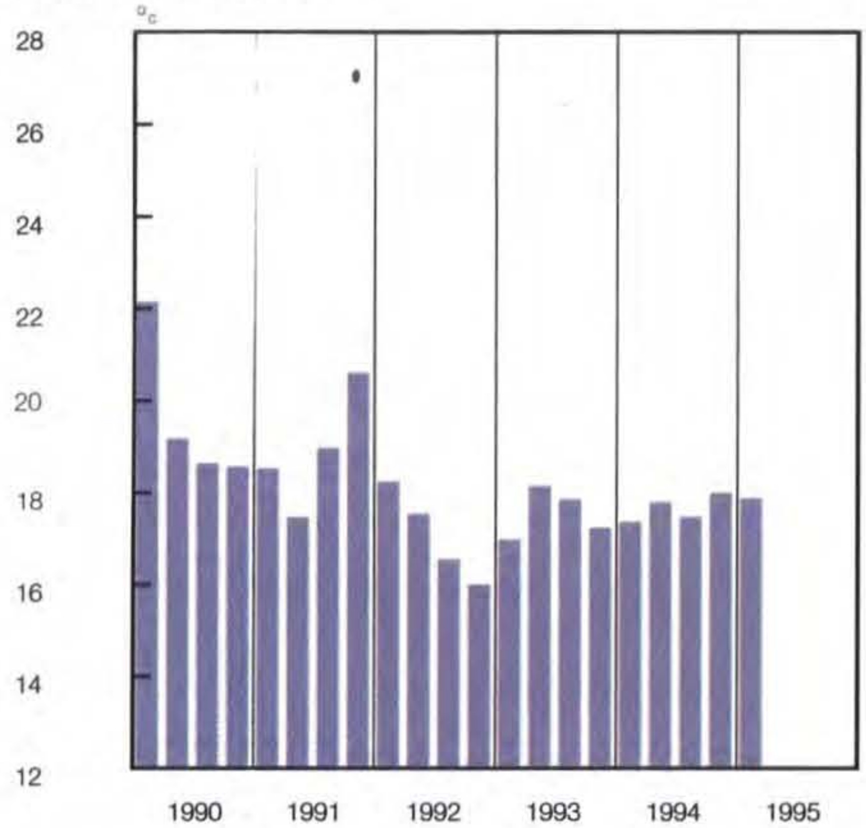
Domestic saving

Gross domestic saving relative to gross domestic product showed virtually no change in the first quarter of 1995 from the level of 18 per cent that had been reached in the fourth quarter of 1994. The relative stability in the domestic savings ratio could mostly be attributed to a further strong rise in corporate saving, which neutralised an increase in net dissaving by general government and a decline in net personal saving.

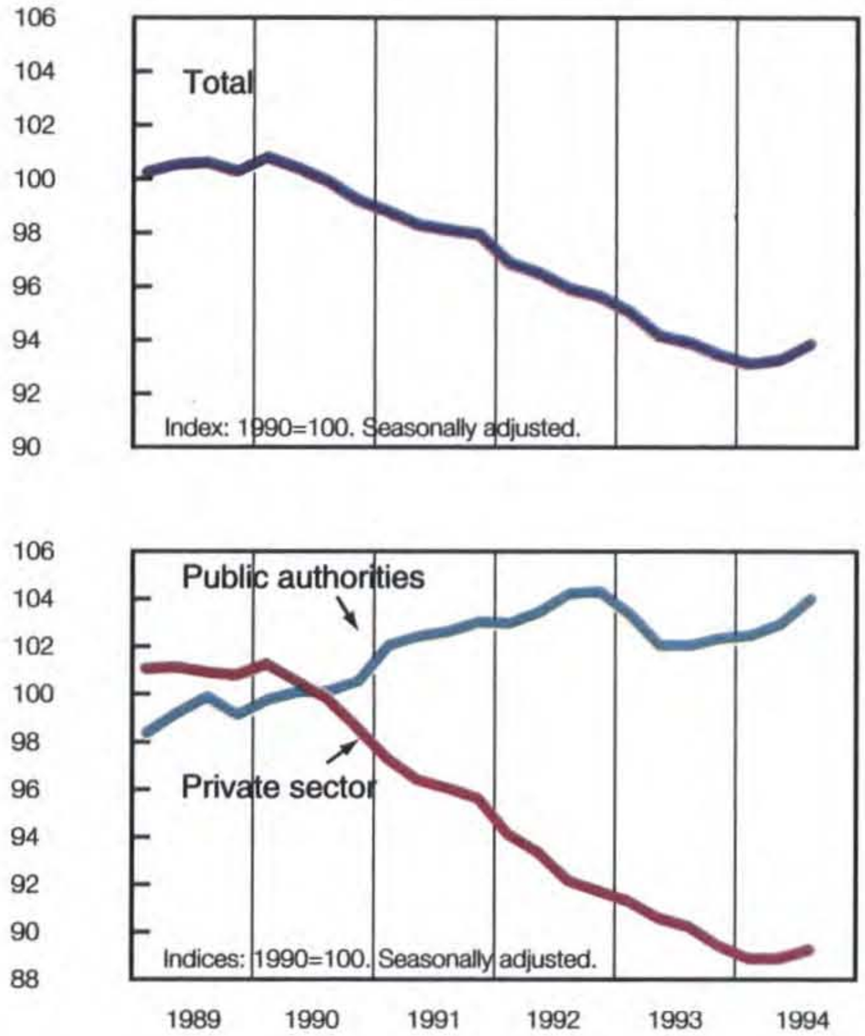
Increases in the gross operating surplus of business enterprises caused net corporate saving to rise substantially in the first quarter of 1995 to a level that was some 20½ per cent higher than in the first quarter of 1994. In contrast to this development, personal saving was nearly halved over the same period, with the result that the absolute amount of *private savings* was slightly higher, while the private sector's savings ratio remained about unchanged.

The downward movement in the ratio of *government dissaving* to gross domestic product from 6½ per cent in the first quarter of 1993 to 3 per cent in the fourth quarter of 1994, was reversed to 3½ per cent in the first quarter of 1995. This reversal occurred despite steady growth in government revenue from taxation and income from property, together with an actual decrease in real government consumption expenditure. The increased dissaving by general government in the first quarter of 1995 largely reflected a sharp rise in current transfers to households and interest payments on government debt.

Gross domestic saving as percentage of gross domestic product



Non-agricultural employment

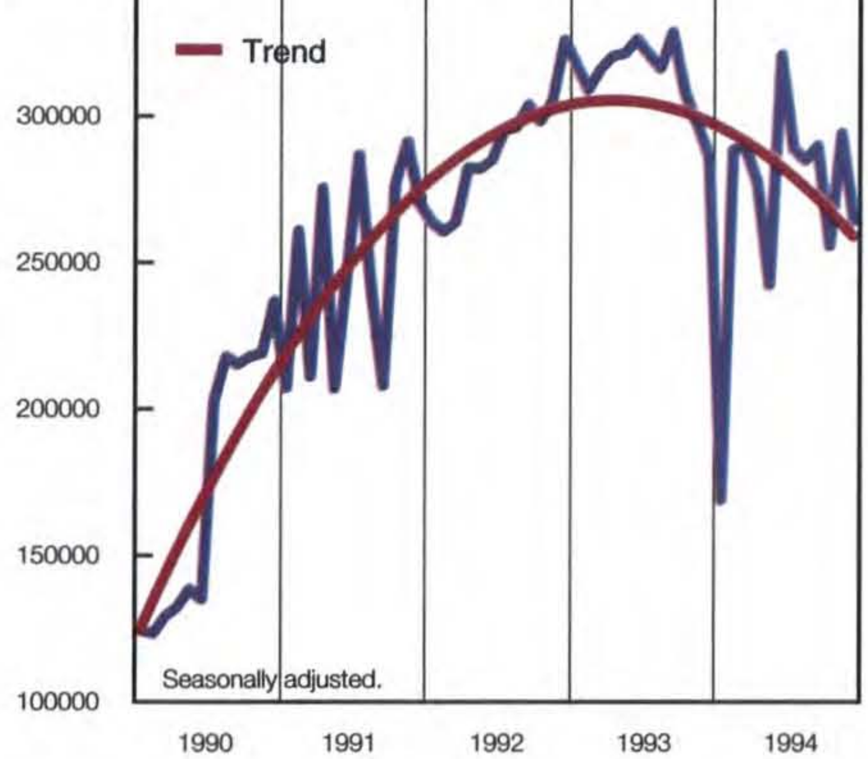


Employment

More or less in keeping with its normal cyclical pattern, *total employment* in the formal non-agricultural sectors of the economy at first continued to decline in the early stages of the upswing in overall economic activity. However, the rate of decline in total employment slowed down from a seasonally adjusted and annualised level of 3,7 per cent in the second quarter of 1993 (i.e. the quarter in which a trough in the business cycle was reached) to 1,4 per cent in the first quarter of 1994. In the second quarter of 1994 total employment increased for the first time, after having contracted persistently for four years. Total employment then increased more solidly at a rate of 2,5 per cent in the third quarter of 1994 (the latest information made available by the Central Statistical Service).

Employment in the non-agricultural *private sector* was, in particular, slow to respond to the strengthening in overall economic activity. The tempo of the decline in total employment in the private sector became more moderate only from the fourth quarter of 1993, when it slowed down from a seasonally adjusted and annualised rate of 3,6 per cent in the fourth quarter of 1993 to close to zero in the second quarter of 1994. The quarter-to-quarter increase in total employment by the private sector then accelerated to a seasonally adjusted and annualised rate of 1,7 per cent in the third quarter of 1994. This increase could be attributed to employment gains in a number of sectors, such as manufacturing, construction, wholesale and motor

Total number of registered unemployed workers



trade, banking, accommodation services and road transportation.

Employment by *public authorities* already started to increase from the fourth quarter of 1993 and, on balance, the quarter-to-quarter rate of increase advanced sharply from a seasonally adjusted annualised level of 1,1 per cent in the fourth quarter of 1993 to 4,2 per cent in the third quarter of 1994. This increase was, however, related to constitutional changes in South Africa rather than to the upturn in economic activity. Employment of temporary workers during the election in April 1994 was primarily responsible for the increase in employment by the public authorities.

The recent improved conditions in the domestic labour market were confirmed by a decrease of 13,4 per cent in the total number of *registered unemployed* workers during 1994. The seasonally adjusted total number of registered unemployed workers declined from 320 000 in June 1994 to 264 000 in December.

Labour costs and productivity

The economic recovery was also accompanied by a rise in labour costs. After having declined from a recent peak of 19,5 per cent in the second quarter of 1990 to 9,0 per cent in the fourth quarter of 1993, the year-on-year rate of increase in *nominal remuneration per worker* picked up again sharply to 14,4 per cent in the second quarter of 1994. The rate of increase in nominal remuneration per worker then subsided somewhat to 12,6 per cent in the third quarter of 1994. As shown in Table 3, the rise in total salaries and wages per worker was mainly due to sharply higher labour costs per worker employed by public authorities. This, in turn, reflected the payment of annual bonuses to certain categories of workers, special allowances to some workers during the election period and the relatively high average remuneration of temporary workers employed to ensure a smooth transition to a government of national unity.

As a result of the rising nominal labour costs, the *real remuneration per worker* (deflated by the price deflator for the non-agricultural gross domestic product) began to rise rapidly in 1994. A year-on-year rate of increase of only 0,5 per cent in real salaries and wages per worker in the first quarter of 1994 was followed by increases of 4,7 and 3,7 per cent in the next two quarters.

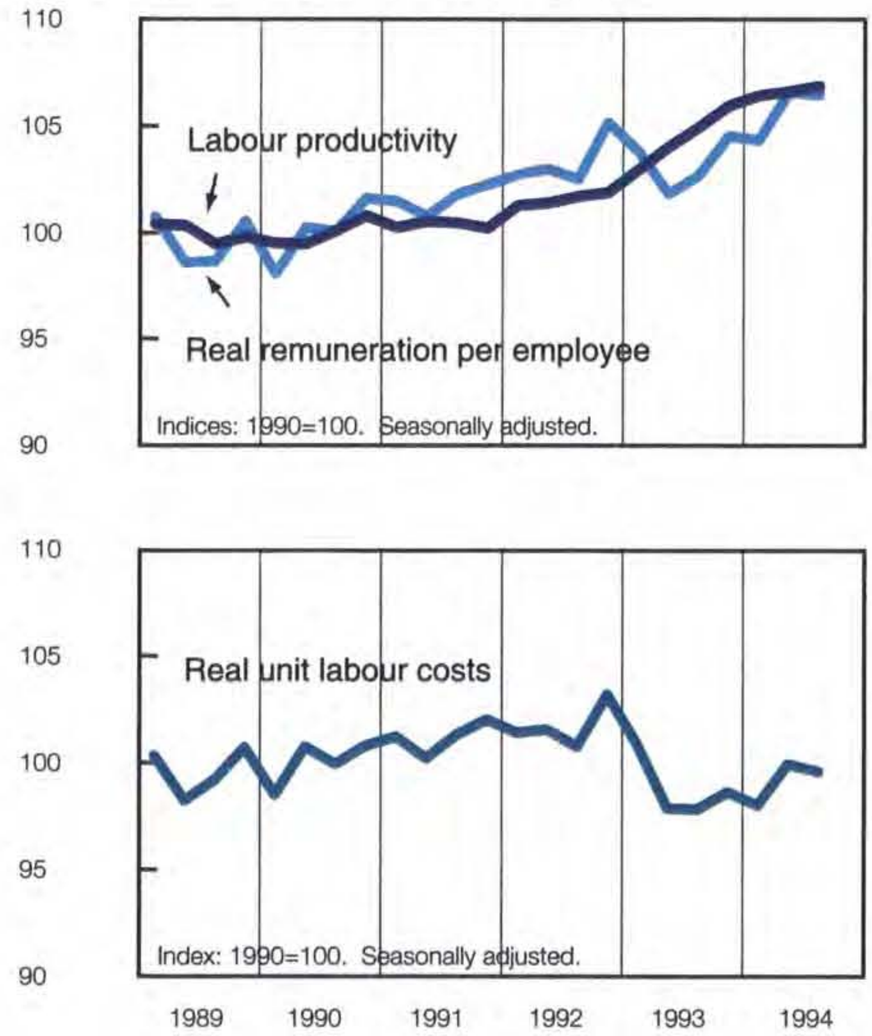
At the same time, the growth in *labour productivity* tapered off sharply from a year-on-year rate of increase of 4,0 per cent in the fourth quarter of 1993 to 1,8 per cent in the third quarter of 1994, when widespread labour unrest resulted in a significant increase in the number of man-days lost because of strikes and other work stoppages. This lower growth in productivity, coupled with the rise in real remuneration per worker, led to a reversal in the downward movement of *real unit labour costs*. Initially, the year-on-year rate of decline in real unit labour costs slowed down from a high of 4,4 per cent in the fourth quarter of 1993 to 2,8 per cent in the first quarter of 1994. Subsequently, in the second and third quarter of 1994, positive growth rates (measured over four quarters) of 2,1 and 1,8 per cent, respectively, were reported in real unit labour costs.

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

Per cent

Period	Public authorities	Private sector	Total
1993: 1st qr	13,3	12,6	13,0
2nd qr	8,6	10,7	10,0
3rd qr	9,6	10,8	10,3
4th qr	5,6	10,9	9,0
1994: 1st qr	8,9	9,5	9,4
2nd qr	20,8	10,4	14,4
3rd qr	14,0	11,5	12,6

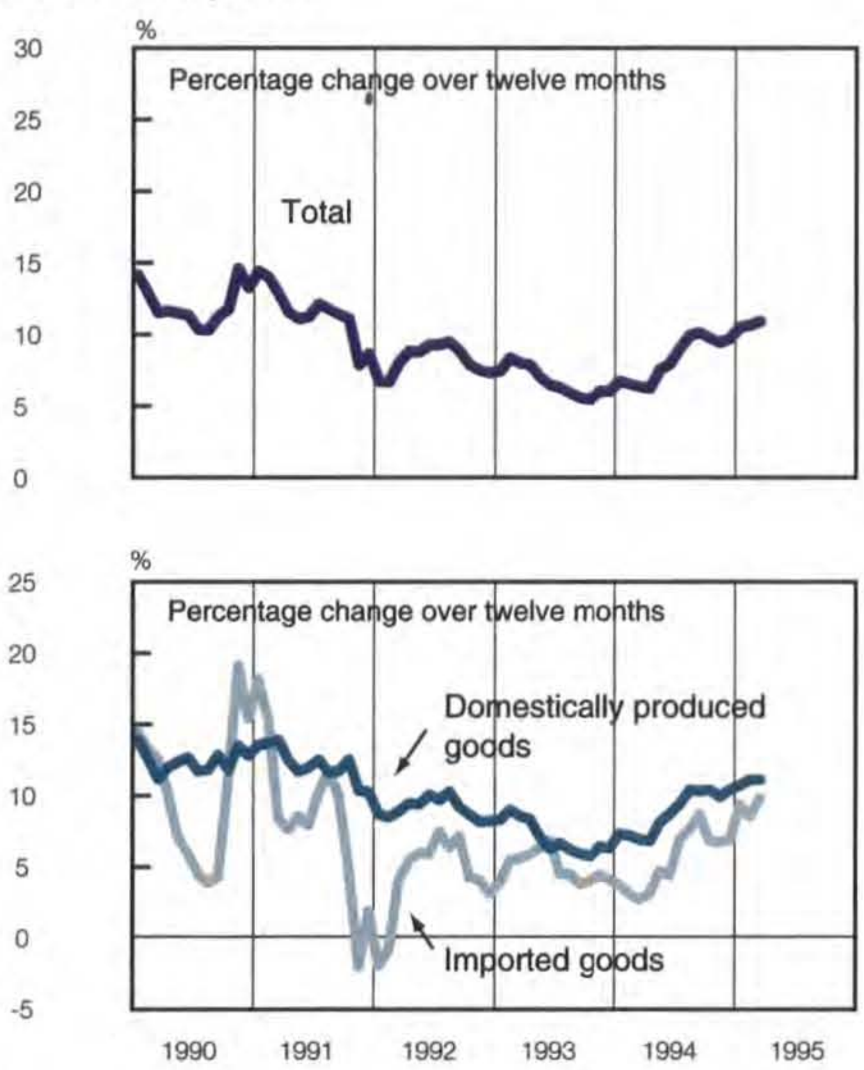
Non-agricultural labour productivity, remuneration and unit labour costs



Prices

The rise in unit labour costs was an important contributing factor in the recent upward movement in the

Production prices



rates of increase in both the production and consumer price indices. Other factors contributing to higher price inflation included the impact of adverse weather conditions on food prices, the increasing pressure of domestic demand on the production capacity of the economy, the high growth of money supply and bank credit extension, the depreciation of the external value of the rand, a sharp rise in oil prices on international markets, and increases in Bank rate.

Table 4. The quarter-to-quarter rate of change in production prices

Seasonally adjusted and annualised percentage

Period	Imported goods	Domestically produced goods	All goods
1993: 4th qr........	-5,4	5,1	3,0
1994: 1st qr........	5,0	11,0	10,0
2nd qr.......	14,1	9,7	10,2
3rd qr........	13,9	13,8	14,0
4th qr........	-2,1	7,3	5,6
1995: 1st qr........	12,7	13,4	13,2

Firmer international crude oil prices and the weaker exchange rate of the rand were the two main forces driving *import prices* higher. The rate of increase over periods of twelve months in the prices of imported goods advanced from a low 2,7 per cent in March 1994 to 8,7 per cent in September; it then declined to 6,7 per cent in November 1994 before rising again to 9,8 per cent in March 1995. The quarter-to-quarter rate of change in the prices of imported goods also rose sharply in the second and third quarter of 1994 and in the first quarter of 1995 (see Table 4).

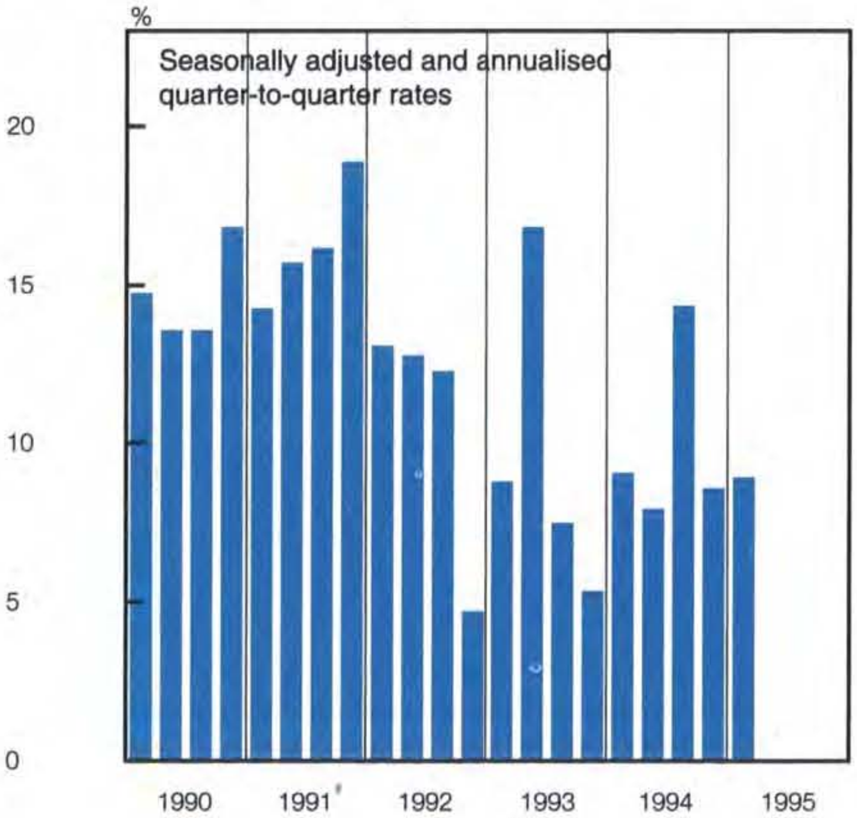
A distinct sharp upward movement was also discernible in the quarter-to-quarter rate of increase in the prices of *domestically produced goods* from the beginning of 1994. Measured over periods of twelve months the rate of these price increases reached a lower turning-point of only 5,7 per cent in October 1993. From November 1993 the rate of increase over twelve months in the prices of domestically produced goods rose steadily to a level of 10,4 per cent in August and October 1994; it then declined somewhat to 9,9 per cent in November 1994 before rising again to 11,1 per cent in February and March 1995. During this period exceptionally high increases in the prices of fresh meat (close to 50 per cent) made a major contribution to the higher rates of increase in the prices of domestically produced goods.

As a result of the observed movements in its two main components, the quarter-to-quarter rate of increase in the *all-goods production price index* accelerated, on balance, from a seasonally adjusted and annualised rate of 3,0 per cent in the fourth quarter of 1993 to 13,2 per cent in the first quarter of 1995. The rate of increase over periods of twelve months in the all-goods production price index also moved up from a lower turning-point of 5,4 per cent in October 1993 to 10,1 per cent in September 1994; it then declined to 9,4 per cent in November before rising again to 10,9 per cent in March 1995. This was the highest rate of increase in production prices since October 1991.

The quarter-to-quarter rate of increase in the overall *consumer price index* started to increase from the first quarter of 1994: it rose from 5,3 per cent in the fourth quarter of 1993 to 14,3 per cent in the third quarter of 1994 and then contracted to 8,5 per cent in the fourth quarter of 1994 and 8,9 per cent in the first quarter of 1995. The seasonally adjusted and annualised rate of inflation therefore stayed well below the ten per cent level in the period from September 1994 to March 1995.

Measured over a period of twelve months the rate of increase in the overall consumer price index rose from a lower turning-point of 7,1 per cent in April 1994 to 10,1 per cent in September; it then declined again to a single-digit level of 9,8 per cent in October and drifted sideways in the ensuing months. In March and April 1995 the twelve-month rate of increase in consumer prices reached double-digit levels of 10,2 and 11,0 per cent. This upward trend in consumer prices was to a large

Consumer price index



Foreign trade and payments

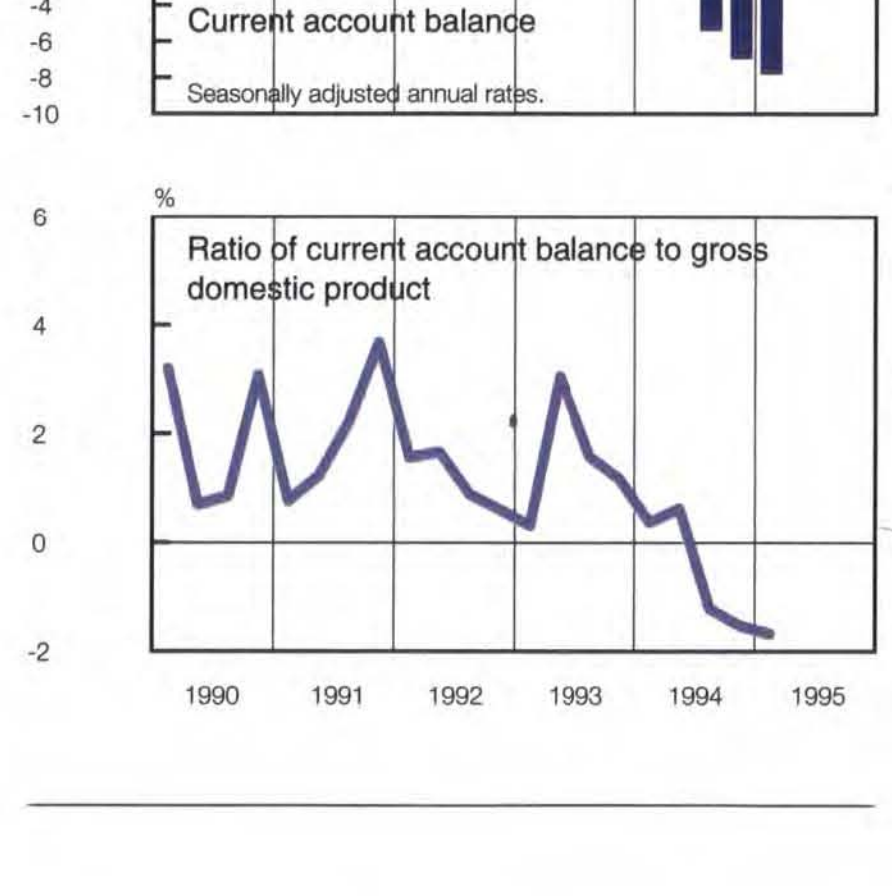
Current account

The *deficit on the current account* of the balance of payments increased significantly from R0,3 billion in the fourth quarter of 1994 to R2,2 billion in the first quarter of 1995. However, this deterioration was mainly due to seasonal factors. Taken at a seasonally adjusted and annualised rate, the deficit on the current account increased fairly modestly from R7,0 billion to R7,8 billion over the same period. As a ratio of gross domestic product, the deficit on current account was equal to 1,7 per cent in the first quarter of 1995, which is not exceptionally large for this stage of the upswing in economic activity.

The further weakening in the current account balance in a period in which the growth in economic activity slowed down considerably was mainly the result of a persistent rapid increase in merchandise imports which was only partly offset by higher merchandise exports. Both the value of net gold exports and net service and transfer payments to non-residents remained more or less on the levels that had been attained in the preceding quarter. In April 1995 both imports and exports declined

extent due to the effect of poor weather conditions on food prices. Excluding food and non-alcoholic beverages, the price increases of other consumer goods and services accelerated much more moderately from a year-on-year rate of 6,6 per cent in April 1994 to 9,4 per cent in April 1995. The rate of increase over twelve months in the prices of services, however, also accelerated from 7,5 per cent in April 1994 to 11,9 per cent in April 1995. This upward trend was mainly due to an increase in home ownership costs because of adjustments in mortgage rates following the increases in Bank rate in September 1994 and February 1995.

Balance of payments: Current account



sharply, leading to a significant improvement in the current account deficit.

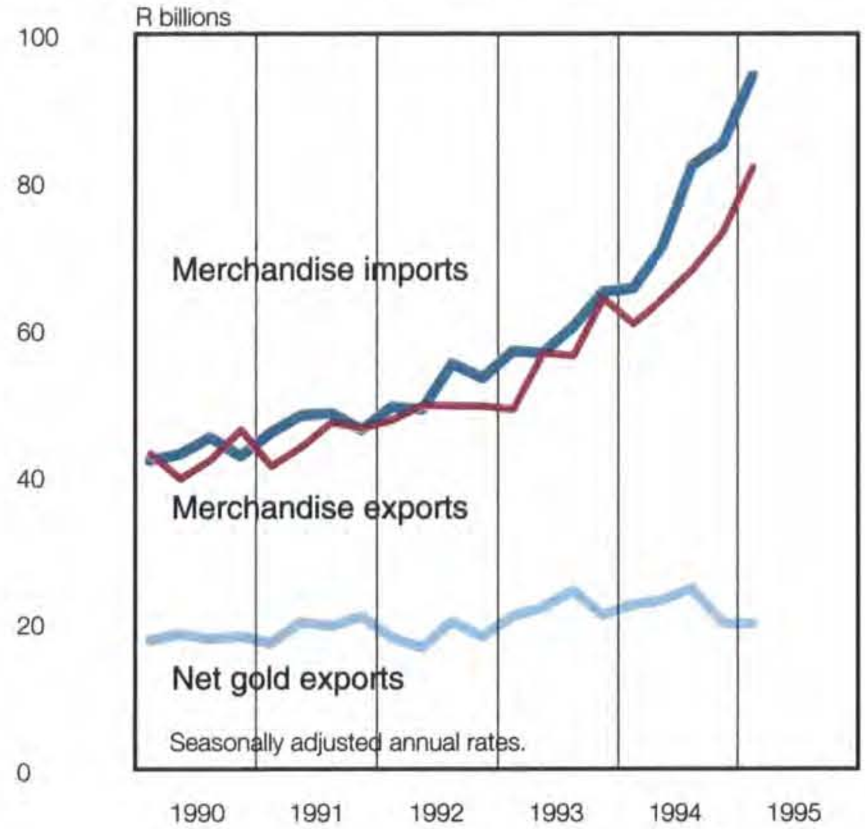
The value of *merchandise imports* increased sharply further from R85,1 billion in the fourth quarter of 1994 to R94,4 billion in the first quarter of 1995, or by almost 11 per cent. Despite the markedly slower rate of increase in domestic expenditure, the volume of imports rose by some 7½ per cent in the first quarter of 1995. This increase was to a large extent due to oil imports. Sharp increases were also recorded in the imports of manufactured goods, such as chemical products, transport equipment and paper products. The rise in imports in the first quarter of 1995 therefore occurred largely in intermediate goods used in the production process and, to a lesser extent, in the imports of capital goods for investment purposes.

Higher international oil prices, moderate rises in the prices of other imported goods, and a decline of 1½ per cent in the average nominal effective exchange rate of the rand from the fourth quarter of 1994 to the first quarter of 1995, were responsible for an increase of just more than 3 per cent in the prices of imported goods over the same period.

A substantial increase of almost 9½ per cent in the volume of exports was mainly responsible for the fact that the value of *merchandise exports* in the first quarter of 1995 was 12 per cent higher than in the fourth quarter of 1994. Increases were recorded in nearly all the major export categories, with the notable exception of agricultural, chemical and textile products. The exports of mineral products (coal), machinery and electrical equipment, transport equipment, paper and paper products and diamonds showed large increases.

The price of exported goods advanced by only 3 per cent in the first quarter of 1995. This can be ascribed to the fact that international commodity prices rose only moderately in this period, that South Africa's exports are primarily priced in US dollars and that the rand depreciated only slightly against the dollar. The average value of the rand against the dollar contracted by 0,7 per cent from the fourth quarter of 1994 to the first quarter of 1995.

Balance of payments: Trade account



The value of South Africa's *net gold exports* (seasonally adjusted and annualised), which had contracted sharply from R24,8 billion in the third quarter of 1994 to R20,1 billion in the fourth quarter, remained more or less on this lower level in the first quarter of 1995. This disappointing performance was caused predominantly by a further decrease in the volume of net gold exports: having contracted by almost 16 per cent in the fourth quarter of 1994, the volume of net gold exports decreased by a further 3½ per cent in the first quarter of

Table 5. 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
Merchandise exports	60,6	64,0	67,9	73,0	81,8
Net gold exports	22,6	23,2	24,8	20,1	20,0
Merchandise imports	-65,6	-71,3	-82,3	-85,1	-94,4
Net service and transfer payments	-16,1	-13,3	-15,8	-15,0	-15,2
Balance on current account	**1,5**	**2,6**	**-5,4**	**-7,0**	**-7,8**

1995. In addition to a further marked reduction in the average grade of ore milled, production was adversely affected by the large number of public holidays as well as continuing labour unrest.

Despite an increase in the average price of gold realised in the first quarter of 1995, the average fixing price of gold on the London market receded from US$385 to $379 per fine ounce from the fourth quarter of 1994 to the first quarter of 1995. Owing to the depreciation of the rand against the dollar, the fixing price in rand terms declined somewhat less, viz. from R1 362 to R1 352 per fine ounce over the same period. The monthly average fixing price of gold then rose to $391 and R1 410 per fine ounce in April 1995, before declining again to $385 and R1 409 per fine ounce in May.

Net service and transfer payments to non-residents increased only marginally from a seasonally adjusted and annualised value of R15,0 billion in the fourth quarter of 1994 to R15,2 billion in the first quarter of 1995. This was the net result of increases in payments for freight and merchandise insurance and dividends to foreigners, which were nearly completely neutralised by receipts for transportation services rendered to non-residents.

Capital account

The capital account of the balance of payments, which had turned around from a net outflow to a net inflow of capital in the second half of 1994, showed a further substantial total *net inflow of capital* not related to reserves of R5,4 billion in the first quarter of 1995. This brought the total net inflow of capital in the nine months ending March 1995 to no less than R14,2 billion. Unfortunately, direct investment in equity capital represented only a small portion of this capital inflow. South Africa's outstanding foreign debt therefore increased sharply over this period. The level of the debt is, however, still relatively low, as is clearly reflected by the ratio of 6 per cent of interest payments on foreign debt to export proceeds in the first quarter of 1995.

As shown in Table 6, the largest part of this inflow consisted of *short-term capital*, i.e. capital with a maturity of less than one year. The banks, in particular, were large net borrowers of short-term capital to the amount of R1,8 billion in the first quarter of 1995 – a pattern which had also been discernible in the first nine months of 1994. In addition, the private-sector entities increased their short-term foreign liabilities because of the availability of foreign trade financing at relatively favourable costs.

This large inflow of short-term capital implies that the maturity structure of South Africa's foreign debt obligations has probably shortened considerably since the end of 1993. It also resulted in greater volatility in South Africa's financial flows with the rest of the world, as is clearly illustrated by the quarterly fluctuations in these short-term capital movements in 1994. This is substantiated further by the considerable decline in the net foreign reserves in April 1995, followed by an equally marked increase in May 1995.

Notwithstanding the fact that fixed capital commitments of R2,2 billion fell due for repayment in the first quarter of 1995, a net inflow of R0,6 billion in *long-term capital* was recorded. Public authorities and public corporations made net repayments on long-term capital to non-residents, but a net inflow of capital of R1,0 billion to the private sector was registered. This is in sharp contrast with the last three quarters of 1994 when the private sector kept on reducing its net long-term foreign liabilities. Included in the inflow of long-term capital to the private sector were private placements on international capital markets to the value of R0,8 billion and net purchases of securities of R0,3 billion on the Johannesburg Stock Exchange by non-residents.

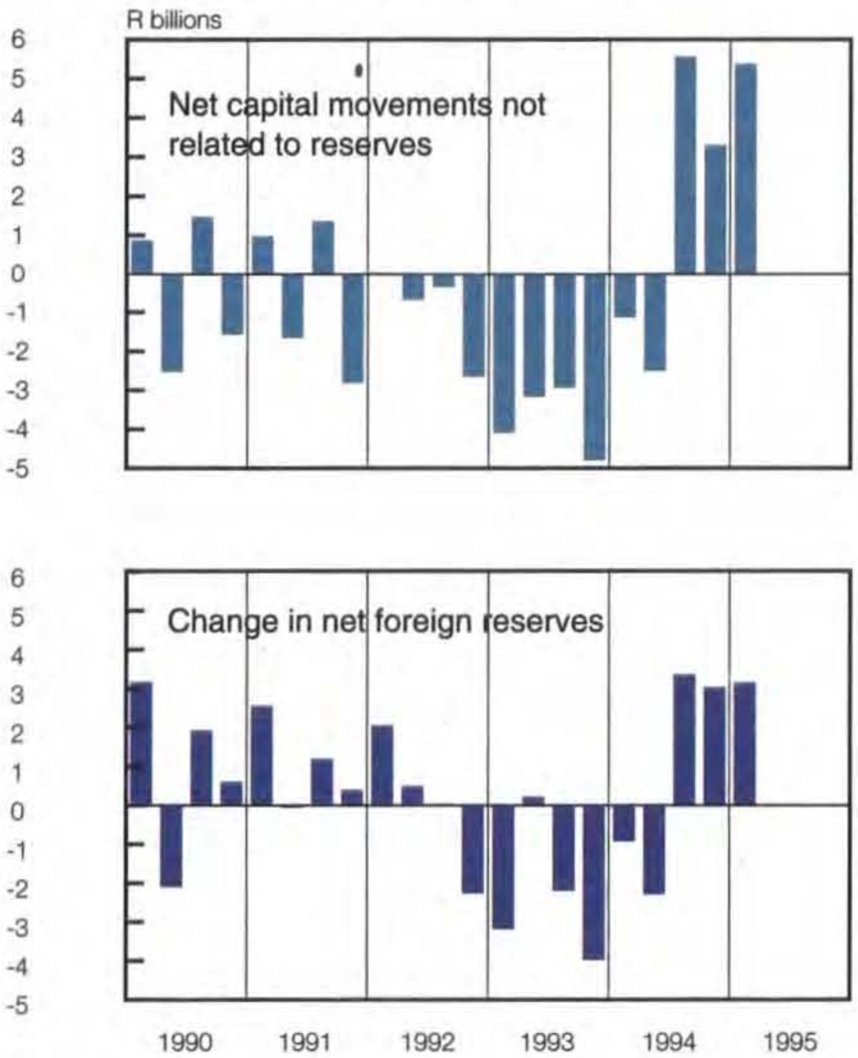
Foreign reserves

The considerable further improvement in the overall balance of payments position resulted in an increase of R3,1 billion in the country's *net gold and other foreign reserves* in the first quarter of 1995; in the second half of

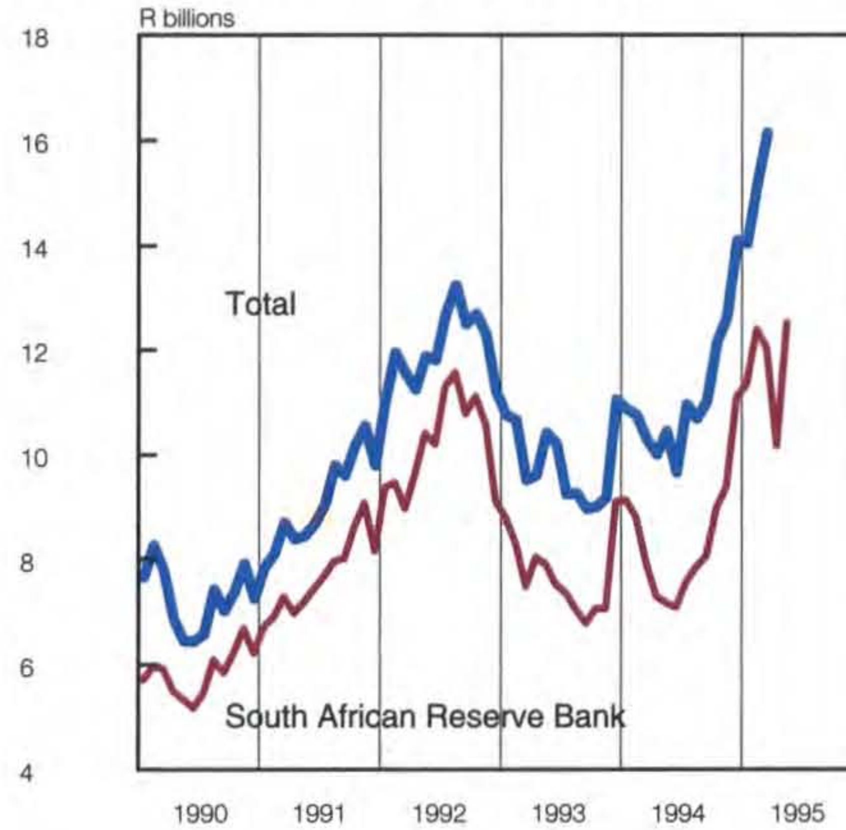
Table 6. Net capital movements not related to reserves
R billions

	1994				1995
	1st qr	2nd qr	3rd qr	4th qr	1st qr
Long-term capital					
Public authorities	-1,1	-0,1	0,5	3,7	-0,2
Public corporations	-1,4	-0,2	0,3	0,7	-0,2
Private sector	0,8	-1,3	-0,4	-0,1	1,0
Total long-term capital	-1,7	-1,6	0,4	4,3	0,6
Short-term capital	0,6	-0,9	5,1	-1,0	4,8
Total capital not related to reserves	**-1,1**	**-2,5**	**5,5**	**3,3**	**5,4**

Balance of payments: Overall balance



Gross gold and other foreign reserves



1994 the total net reserves had risen by R6,4 billion. In April 1995 the net gold and other foreign reserves of the Reserve Bank decreased substantially by R4,1 billion, before showing an equally dramatic improvement again of R5,8 billion in May 1995.

The improved foreign reserve position in the first three months of 1995 enabled the monetary authority to reduce its outstanding short-term *liabilities related to reserves* by R1,4 billion during this period. The Reserve Bank then drew on its foreign credit facilities to the amount of R2,1 billion in April 1995 before making repayments of R3,5 billion in May 1995. The outstanding balance of the Bank's short-term liabilities related to reserves was R2,4 billion on 31 May 1995, i.e. significantly lower than the peak of R8,5 billion at the end of April 1994.

Because a part of the overall balance of payments surplus was used for the repayment of reserve-related liabilities, the *gross gold and other foreign reserves* only increased from R14,1 billion at the end of December 1994 to R16,1 billion at the end of March 1995. This increase was reflected in higher foreign exchange holdings, but the gold reserves of the country also rose from 4,2 million to 4,4 million fine ounces over the same period. In the next two months the gross foreign reserves of the Reserve Bank increased, on balance, by a further R0,5 billion.

Exchange rates

After having contracted only moderately in the first seven weeks of 1995, the weighted index of the exchange rate of the rand began to decrease sharply in anticipation of the expected abolition of the dual exchange rate system. The *nominal effective exchange rate* of the rand receded by 5,8 per cent from the end of December 1994 up to 10 March 1995. On the same day, i.e. just prior to the lifting of exchange control on non-residents, the discount between the financial rand and commercial rand rates of exchange narrowed to 3,6 per cent. As could be expected with this low discount, the dismantling of the financial rand mechanism with effect from 13 March 1995 had very little effect on the exchange rate of the rand. From 10 March up to the end of May 1995 the nominal effective exchange rate of the rand contracted by only 2,0 per cent, which brought the decline in the first five months of 1995 to 7,6 per cent.

The relative stability of the rand after the abolition of the dual exchange rate system also reflected the relative weakness of the US dollar on international exchange markets. Towards the middle of May 1995 the dollar regained some strength and the rand began to depreciate fairly sharply against the dollar. From the end of December 1994 to the end of May 1995 the rand nevertheless receded by only 3,3 per cent against the dollar. Fairly moderate rates of decline were also

Table 7. Changes in exchange rates of the rand
Per cent

	31 Dec 1993 to 31 Dec 1994	31 Dec 1994 to 10 Mar 1995	10 Mar 1995 to 31 May 1995	31 Dec 1994 to 31 May 1995
Weighted average....	-8,5	-5,8	-2,0	-7,6
US dollar..................	-4,1	-2,4	-1,0	-3,3
British pound............	-9,2	-5,3	-0,7	-6,0
German mark...........	-14,3	-11,7	-1,8	-13,3
Japanese yen...........	-14,5	-10,7	-9,7	-19,4
Netherlands guilder..	-14,2	-11,6	-2,0	-13,3
Italian lira..................	-8,8	-0,1	-3,9	-4,0

recorded against the British pound and the Italian lira over the same period, while the rand depreciated substantially against the Japanese yen, German mark and Netherlands guilder.

The decline in the nominal effective exchange rate of the rand during the first quarter of 1995 exceeded the inflation differential between South Africa and its main trading partner countries. The *real effective exchange rate* of the rand therefore decreased by 3,3 per cent from December 1994 to March 1995. From its peak value in July 1992 up to March 1995 the real effective exchange rate of the rand has therefore contracted by nearly 10 per cent.

Monetary developments, interest rates and financial markets

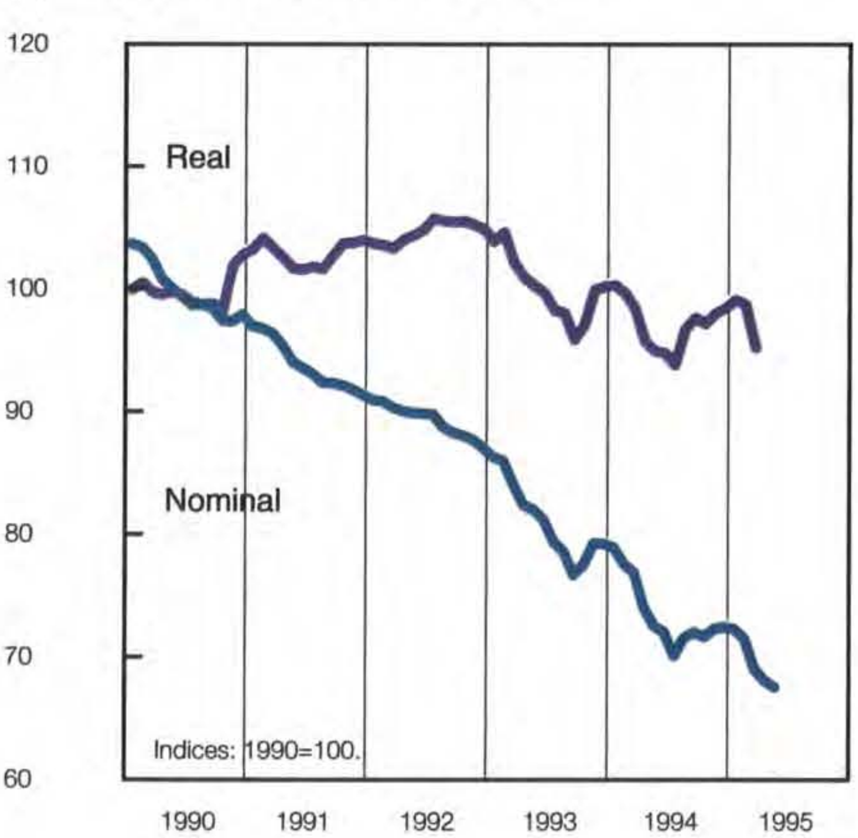
Money supply

The growth rate in the broadly defined money supply (M3), which had reached a peak in July 1994, showed a distinct downward movement in the following seven months but moved upwards again in March 1995. The twelve-month rate of increase in M3 contracted moderately from 16,9 per cent in July 1994 to 15,7 per cent in December and more rapidly to 11,9 per cent in February 1995; it then picked up slightly, reaching 12,3 per cent in March and a provisionally estimated 14,7 per cent in April 1995.

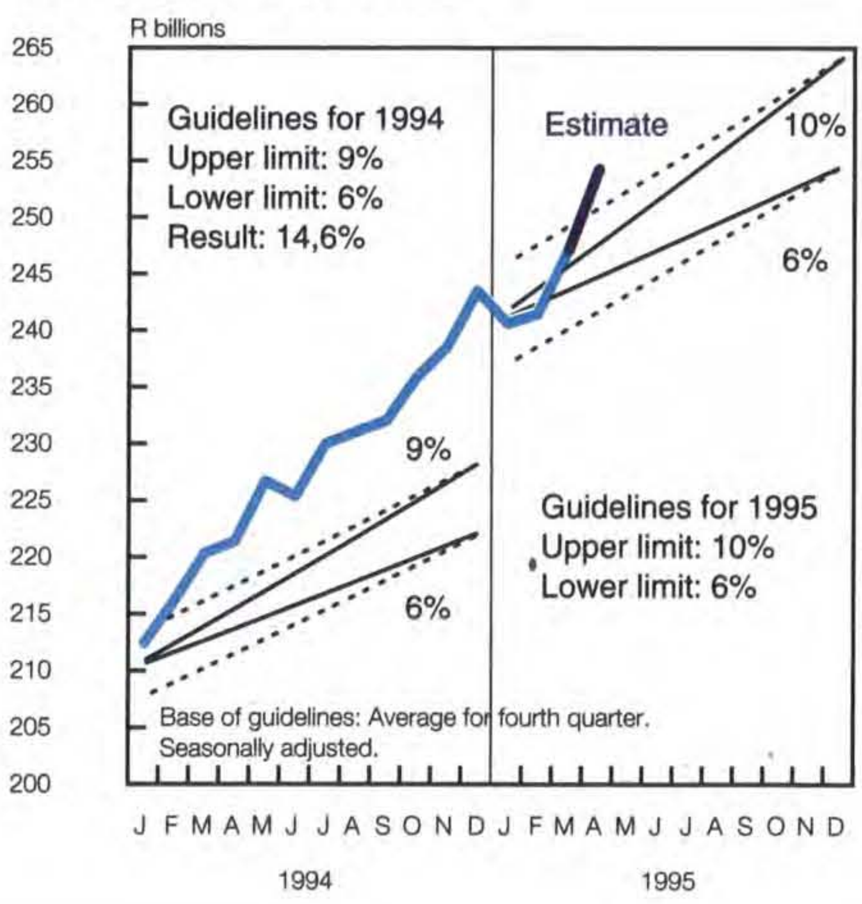
As a result of the slower growth in money supply and the raising of the money supply guidelines from 6-9 per cent in the 1994 guideline year to 6-10 per cent in the 1995 guideline year, the money supply moved within the guideline range in January and February 1995. However, in March 1995 the seasonally adjusted value of M3 again exceeded the upper limit of these guidelines by about R1,0 billion. The somewhat more favourable results in the first three months of 1995 may be short-lived if the rate of increase in bank credit extension does not subside.

The quarter-to-quarter rate of increase in M3 (seasonally adjusted and annualised) decreased from 13,6 per cent in the fourth quarter of 1994 to 8,8 per cent in the first quarter of 1995. This slower growth in money

Effective exchange rates of the rand



Guidelines for growth in M3



supply was primarily related to the lower rate of increase in the expenditure on consumption, investment and inventory accumulation and occurred despite a larger proportion of domestic expenditure being financed by means of bank credit extension to the private sector. What made this development even more remarkable was the existence of a number of factors that favoured an acceleration in money supply growth, such as:

- a narrowing of the margin between banks' lending and deposit rates in the greater part of the first quarter of 1995, which is normally conducive to reintermediation practices;
- a fairly high liquidity preference of the private sector due to expected interest rate changes and asset price adjustments; and
- a decline in investors' demand for securities on the equity and bond markets.

The lower quarter-to-quarter rate of increase in M3 in the first quarter of 1995 was therefore predominantly due to a slower growth in domestic expenditure. This seems to be substantiated by the income velocity of M3, which moved virtually horizontally in the first quarter of 1995.

In a statistical or accounting sense the main reason for the slowdown in the increase in the money supply from R12,0 billion in the fourth quarter of 1994 to R6,7 billion in the first quarter of 1995, was a substantial increase in government deposits with banks, which led to a decline of R2,0 billion in the net claims of the banks on the government sector. The net other assets of the monetary sector also declined by R2,4 billion. All the other *main counterparts* contributed to an increase in M3: increases of R1,6 billion in net foreign assets and R9,5 billion in claims on the private sector were recorded.

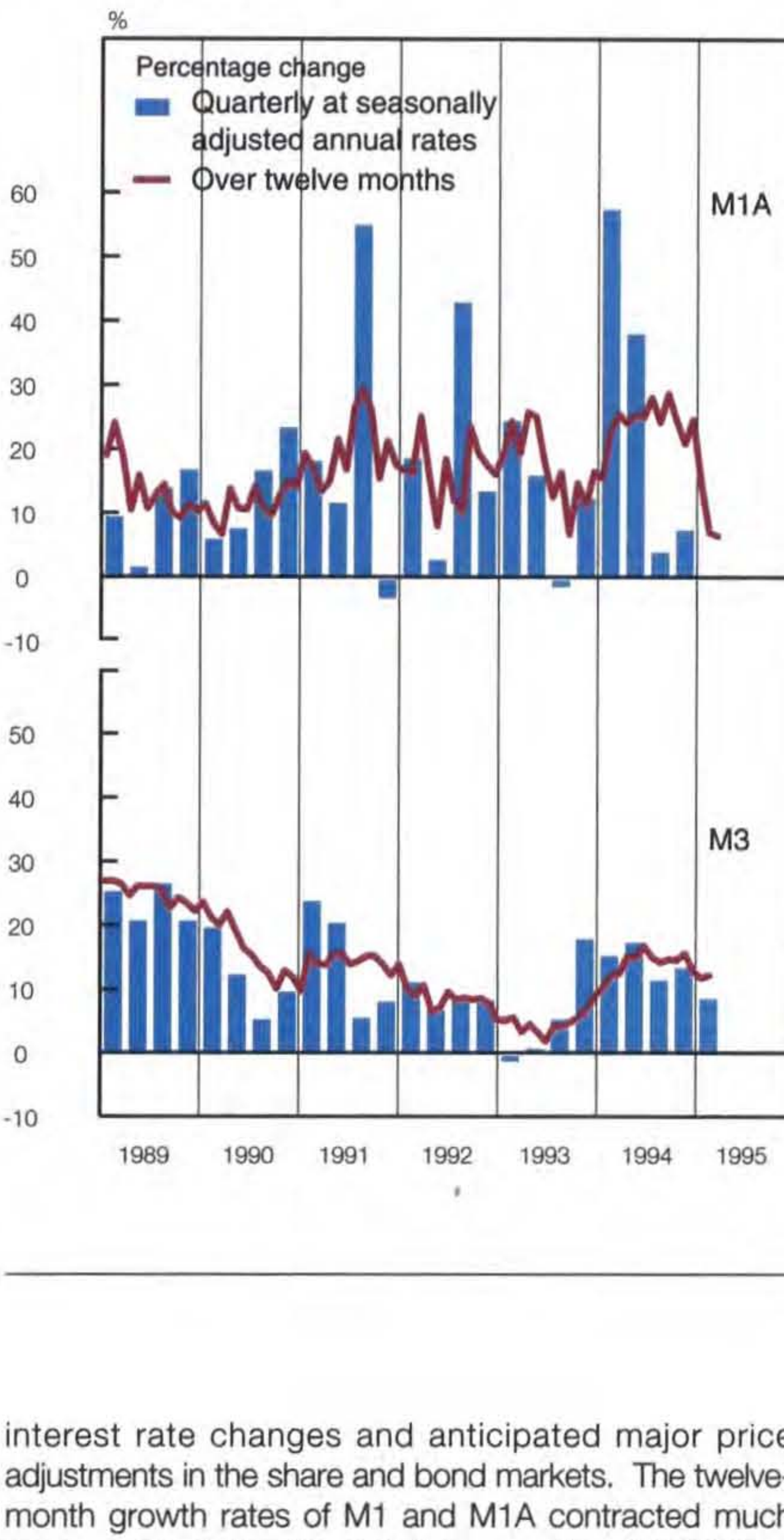
The twelve-month growth rates in the *narrower defined monetary aggregates* broadly displayed the same pattern as the corresponding rates of increase in M3 (see Table 8). However, considerably higher growth rates (measured over twelve months) were recorded in these aggregates in 1994 than in the broadly defined money supply. These high growth rates probably reflected the liquidity preference of the private sector due mainly to uncertainties regarding political developments, expected interest rate changes and anticipated major price adjustments in the share and bond markets. The twelve-month growth rates of M1 and M1A contracted much more rapidly during the first three months of 1995 than the broader monetary aggregates because of a shift out of cheque and transmission deposits.

Table 8. Twelve-months growth rates in monetary aggregates

Per cent

Period		M1A	M1	M2	M3
1994:	July	28,2	32,7	19,5	16,9
	Sept	28,8	26,1	18,5	14,3
	Dec	24,8	23,7	20,6	15,7
1995:	Jan	14,8	13,8	17,0	13,1
	Feb	7,1	12,2	13,6	11,9
	Mar	6,6	10,4	12,6	12,3

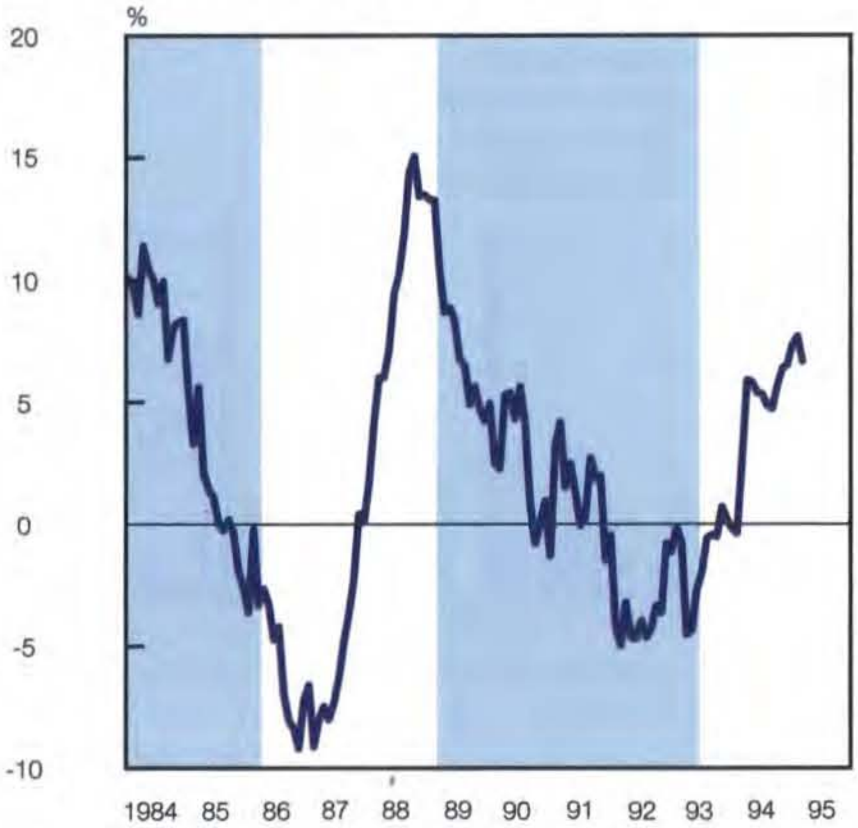
Monetary aggregates



Credit extension

The rate of increase over twelve months in *total domestic credit extension* by monetary institutions (i.e. credit extension to the private sector and net claims on the government sector) receded from a recent peak of 24,2 per cent in May 1994 to 19,9 per cent in December and further to 16,3 per cent in February 1995. This sharp fall in credit extension was essentially the result of a significant decrease in the net claims of the monetary institutions on the government sector during the three months up to February 1995. However, in March 1995 the net claims on the government sector increased substantially, largely because of a sharp decrease in

Real credit extension to the private sector



government deposits with the monetary sector. Despite this development and a continued rapid advance in credit extended to the private sector, the rate of increase over twelve months in total credit extended by the monetary sector in that month slowed down to 12,9 per cent, largely owing to its high level in the same month of 1994.

The twelve-month growth rate in the credit extension of the monetary institutions to the *private sector* rose from 9,7 per cent in December 1993 to 17,0 per cent in December 1994 and 17,5 per cent in March 1995. These monthly growth rates exceeded the rate of inflation as measured by changes in the consumer price index from March 1994, and the twelve-month rate of increase in real credit extension to the private sector amounted to as much as 6,6 per cent in March 1995.

An analysis of the monetary institutions' claims on the private sector by *type of credit* shows that the rate of increase over twelve months in mortgage advances remained at a level of about 17 per cent in 1994 and then advanced to 19,4 per cent in March 1995. The rate of increase in instalment sales credit was even higher and accelerated throughout 1994, before stabilising somewhat in the first quarter of 1995. The substantial rise in this type of credit was by and large due to the sharp increase in the sales of new and used motor vehicles. Reflecting the general rise in domestic expenditure, the twelve-month growth rate of other loans and advances levelled off somewhat in the first quarter of 1995. In contrast to these developments, the rate of increase over twelve months in leasing finance remained relatively low throughout 1994 and the first quarter of 1995.

A disturbing aspect of the increase in credit extension to the private sector by monetary institutions during the first quarter of 1995 was that it was dominated by *credit extension to households*. Credit provided by banks to households was responsible for no less than 63 per cent of the increase in total credit extended to the private sector in the first quarter of 1995; this may be compared with ratios of 59 per cent in the calendar year 1993 and 46 per cent in 1994. A considerably larger proportion of bank credit extended to the private sector was therefore provided directly for the financing of private consumption expenditure.

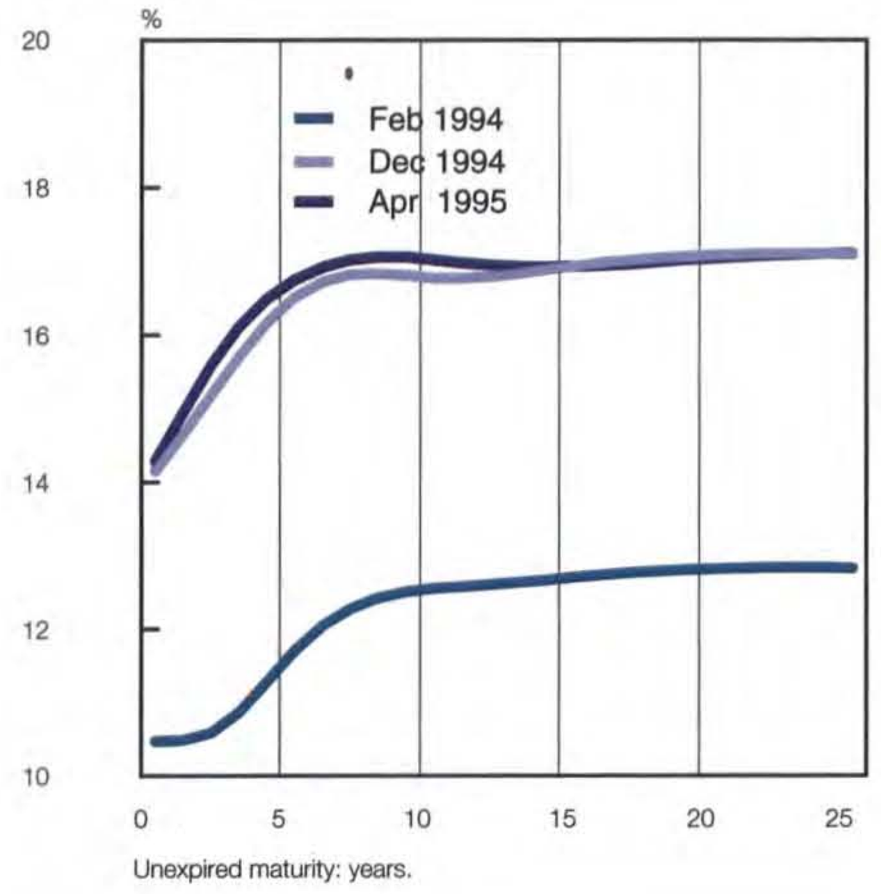
Interest rates and yields

After having moved upwards during 1994, the *yield curve* basically remained at the same level during the first five months of 1995. However, the shape of the curve flattened somewhat more as the yields on shorter-term maturities edged up, whereas yields on longer-term maturities remained more or less unchanged. The sharp

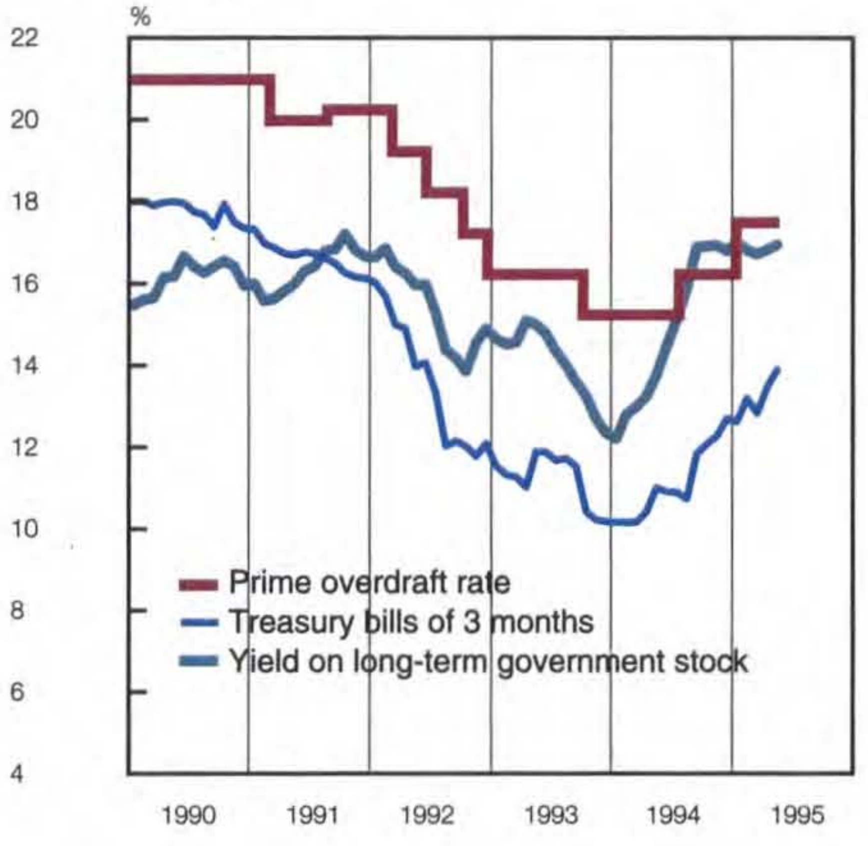
Table 9. Percentage change over twelve months in credit extension to the private sector by main type of credit

Period		Investments and bills	Instalment sales	Leasing finance	Mortgages	Other loans and advances	Total
1993:	Dec	-25,5	18,0	6,8	17,7	8,4	9,7
1994:	Mar	-25,9	23,9	7,7	16,6	13,1	11,8
	June	-11,5	23,5	8,4	16,8	12,3	13,3
	Sept	17,2	24,7	5,9	16,6	12,4	15,3
	Dec	28,0	27,6	7,2	17,9	12,8	17,0
1995:	Jan	26,8	27,6	4,2	19,9	13,2	17,6
	Feb	46,4	26,2	6,2	19,1	13,3	18,3
	Mar	33,5	25,4	7,9	19,4	12,2	17,5

Yield curves



Interest rates and yields



upward slope of the yield curve over the first five years of the maturity spectrum continues to point to expected increases in short-term interest rates.

Money market interest rates, which had started to firm in February 1994, fluctuated around their December 1994 levels during the first quarter of 1995 but hardened further, on balance, in April and May 1995. The tender rate on three-month Treasury bills, for instance, rose only slightly from 12,69 per cent at the end of December 1994 to 12,83 per cent at the end of March 1995, before rising more vigorously to 13,47 per cent at the end of April and 13,89 per cent at the end of May 1995. Most of the other money market rates showed similar changes during these five months, with the inter-bank call rate displaying the most volatility. Spurred by a record money supply shortage, the inter-bank call rate also hardened considerably from 11,75 per cent at the end of March 1995 to 13,75 per cent at the end of April; it then eased marginally to 13,25 per cent at the end of May 1995.

The increase in Bank rate from 13 to 14 per cent on 21 February 1995 and the increase in the banks' minimum cash reserve requirement from 1 to 2 per cent of total liabilities (other than capital and reserves) effective from 21 March 1995 led to an increase of 1,25 percentage points to 17,50 per cent in the *prime lending rate* of the banks from 22 February 1995. The real or inflation-adjusted prime lending rate of the banks also increased from 5,8 per cent at the end of 1994 to 6,6 per cent at the end of March 1995 as an indication of the more restrictive policy stance of the monetary authorities.

The measures announced to tighten monetary policy in February 1995 also instigated a rise 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. The banks also increased their predominant *rate on fixed deposits* of twelve months from 13,0 per cent to 13,50 per cent in March 1995. This brought the increase in deposit rates to 3,0 percentage points from August 1994 to March 1995, while the prime rate was raised by 2,25 percentage points. The margin between lending and deposit rates therefore narrowed.

As already indicated, long-term bond yields fluctuated around their year-end levels in the first four months of 1995, while *short-term yields* hardened somewhat. Although short-term interest rates were affected by the rise in Bank rate, these rates generally rose by substantially less than the increase in Bank rate as a result of the fact that a large part of this increase had already been discounted earlier. The significant increase in the domestic demand for credit, the expected growing deficit on the current account of the balance of payments and the upward trend in international short-term interest rates also placed pressure on domestic short-term bond rates to rise.

Long-term bond rates remained fairly stable in the first four months of 1995 because the actual borrowing requirement of the government in the 1994/95 fiscal year could be accommodated relatively easily by the domestic capital market and the estimated borrowing requirement in the fiscal year 1995/96 is not regarded as unduly large. However, certain political developments, clear signs of an accelerating inflation rate and only small net purchases of domestic loan stock by non-residents then caused the yield on long-term government stock to tend upwards towards the end of April 1995. The average monthly yield on long-term government stock therefore decreased gradually at first from 17,02 per cent in January 1995 to 16,72 per cent in March 1995 before firming again to 16,82 per cent in April and 16,95 per cent in May 1995. The *real* yield on long-term government stock decreased from 6,8 per cent in January 1995 to 5,2 per cent in April as a result of the upward movement in the inflation rate, while long-term yields moved sideways.

The maximum permissible *finance charges rates*, as laid down in terms of the Usury Act, remained unchanged in the first five months of 1995. These rates were last 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.

The *standard interest rate* applicable to loans granted by the State out of the State Revenue Fund (Exchequer Act, Act No 66 of 1975) was lowered by 0,25 percentage points to 16,75 per cent with effect from 1 April 1995 and then increased again to 17,0 per cent with effect from 1 May 1995.

Money market

The relatively tight *money market conditions* that prevailed in the fourth quarter of 1994 eased considerably in the first quarter of 1995, but the money market tightened substantially again in April. This was clearly reflected in the level of accommodation at the discount window, which contracted from R5,1 billion at the end of December 1994 to R2,9 billion at the end of March 1995; it then increased to a record level of R8,8 billion at the end of April. From the first week of May 1995 the money market eased sharply again to a shortage of R3,6 billion at the end of that month.

The easier money market conditions during the first quarter of 1995 could mainly be attributed to a sharp increase in the net foreign assets of the Reserve Bank, especially in February 1995, as well as a substantial reduction in government deposits with the Bank in March 1995. The notes and coin in circulation outside the Reserve Bank also declined somewhat during the first quarter of 1995, which had an easing effect on money market conditions. In April 1995 all these factors turned around and brought about the substantial tightening of the money market. From the beginning of May the net foreign assets of the Reserve Bank rose again to a considerably higher level and government deposits with the Bank declined sharply, causing the easier conditions in the money market in this month.

The *Reserve Bank's operations* in the money market during the first quarter of 1995 were fairly mild at first, but nevertheless moderately restrictive. The Bank tempered money market conditions by managing the Tax and Loan Accounts and in purchasing assets for the portfolio of the Corporation for Public Deposits. Towards the end of February a much more restrictive monetary policy stance was adopted by the central bank, and the Bank positioned itself to mop up excess 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. This proved to be a prudent measure in the light of the substantial decline in government deposits with the Reserve Bank in March. In the first week of April the Reserve Bank was also forced to conclude foreign exchange swap transactions to counter autonomous factors leading to an easing of the market. In the rest of April the Reserve Bank's operations on the whole alleviated the substantially tighter money market conditions. This was followed by restrictive measures in May when the liquidity in the money market increased again.

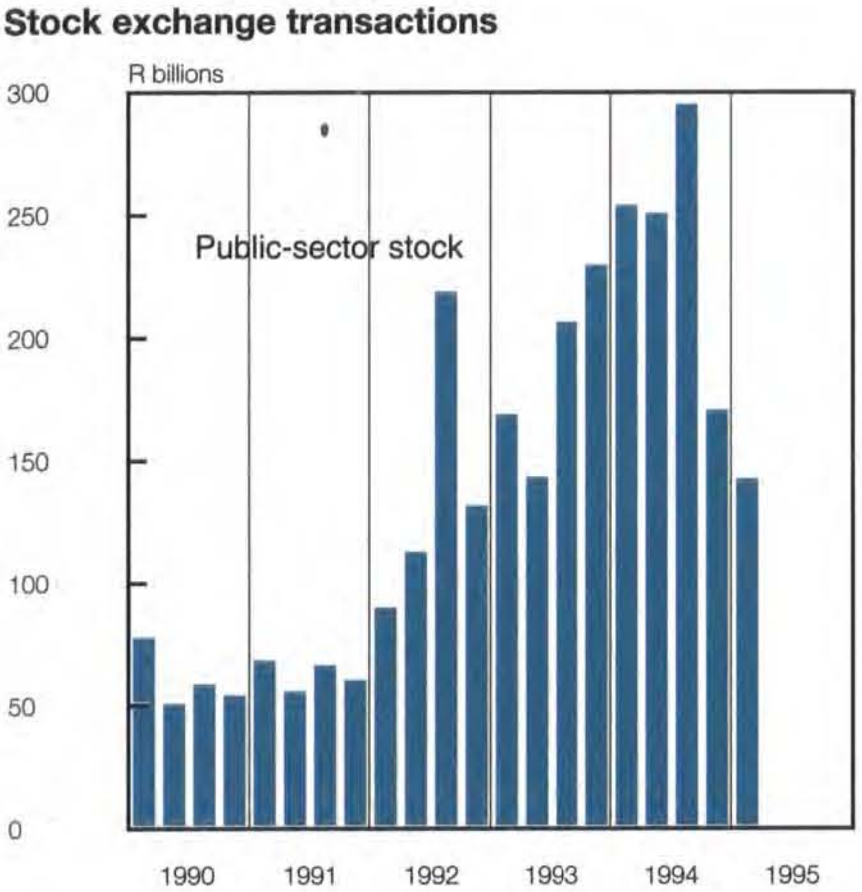
Bond market

New issues in the *primary bond market* by entities in the *public sector* declined to a relatively low level in the first quarter of 1995 because of the public sector's lower borrowing requirement in fiscal 1994/95 and the authorities' endeavour to fund the deficit more evenly during the year. The amount of funds raised by borrowers in the public sector through new issues of fixed-interest securities decreased from R7,8 billion in the fourth quarter of 1994 to R3,5 billion in the first quarter of 1995. This brought the new issues of domestic public-sector stock to R22,6 billion in the fiscal year 1994/95; in the previous year these issues had amounted to R33,7 billion.

In addition to these domestic issues, the authorities continued their efforts to normalise international financial relations. After R2,6 billion had been raised in the global capital market in December 1994, a further stock issue of R1,3 billion was made in the Japanese bond market in May 1995.

The value of funds acquired by companies in the *private sector* through issues of fixed-interest securities (including convertible preference shares, debentures and corporate bonds) decreased sharply in 1994, and during the first quarter of 1995 no such issues were made by listed private-sector companies. A number of companies did, however, raise capital in foreign markets by means of convertible bonds to the amount of R0,8 billion in the first quarter of 1995, which lowered yet further the demand for loanable funds in the domestic capital market.

In the *secondary bond market* the value of public-sector stock traded on the Johannesburg Stock Exchange, which had decreased from a record level of R294,5 billion in the third quarter of 1994 to R170,1 billion in the fourth quarter, contracted further to R142,1 billion in the first quarter of 1995. The lower value of stock traded was strongly influenced by uncertainty



regarding prospective movements in long-term yields. The value of bonds traded moved even lower from an average monthly level of R47,3 billion in the first quarter of 1995 to R33,7 billion in April 1995 because of the smaller number of trading days.

Net sales of bonds by *non-residents*, probably in anticipation of the abolition of the dual exchange rate system, began in February 1995 and increased significantly in the week before and after the abolition of the financial rand. After having been net purchasers of bonds to the value of R1,7 billion on the Johannesburg Stock Exchange during the last three quarters of 1994, non-residents therefore became net sellers to the amount of R363 million in the first quarter of 1995. However, with the currency remaining relatively stable after the dismantling of the dual exchange rate system, the yields on long bonds became increasingly attractive to foreigners and in April and May 1995 non-residents were once again net purchasers of bonds to the amount of R42 million and R311 million, respectively.

Equity market

New share issues in the *primary equity market* increased sharply in the first quarter of 1995 as a result of the fact that many listed companies had embarked on a programme of increasing inventory levels, replacing ageing capital stock and initiating new projects. New issues of shares therefore shot up from R0,4 billion in the fourth quarter of 1994 to R2,3 billion in the first quarter of 1995.

The value of *shares traded on the Johannesburg Stock Exchange* contracted from R20,7 billion in the first quarter of 1994 to R15,7 billion in the fourth quarter of 1994, and even further to R13,3 billion in the first quarter of 1995. The significant decline in the turnover in the fourth quarter of 1994 and the first quarter of 1995 was affected by a lacklustre performance of share markets world-wide. In April the value of shares traded contracted further to R3,9 billion from an average monthly level of R4,4 billion in the preceding three months. This decline, however, was mainly related to the smaller number of trading days.

Domestic investors were by and large responsible for the lower turnover on the stock exchange. 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 38,3 per cent in the first quarter of 1995 and further to 46,7 per cent in the next two months. Despite a temporary drop in purchases by foreigners with the abolition of the dual exchange rate system, their net purchases of shares came to the exceptionally high amount of R2,0 billion in the first five months of 1995, compared with R185 million in 1994 as a whole. The marked improvement in non-resident investor sentiment was probably boosted by the inclusion of the Johannesburg Stock Exchange in the International Finance Corporation's Emerging Market Index.

After having increased almost uninterruptedly for two years by 92,2 per cent to reach an all-time high in November 1994, the average monthly total *share price*

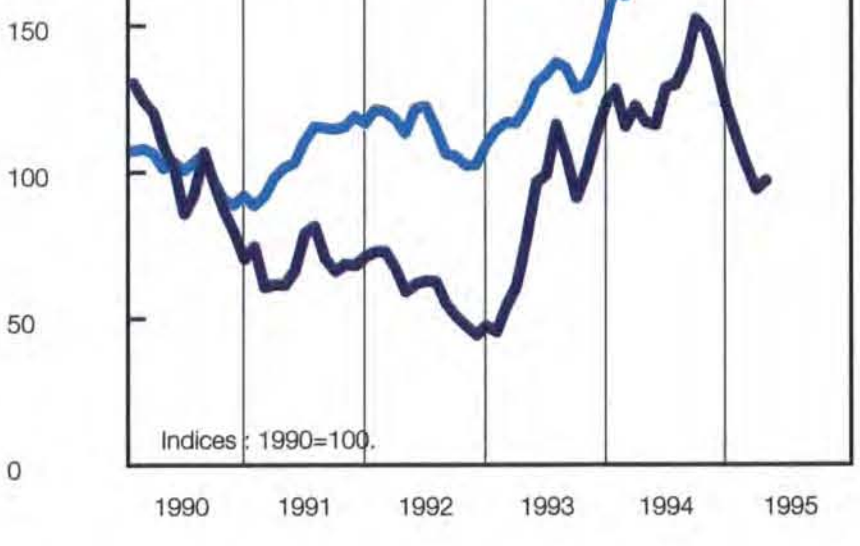


Table 10. Dividend yield, earnings yield, price-earnings ratio and yield gap on all classes of shares

Period	Dividend yield Per cent	Earnings yield* Per cent	Price-earnings Ratio	Yield gap Points
1994: Oct	2,18	5,27	18,98	14,73
Nov......	2,14	5,21	19,19	14,80
Dec......	2,19	5,27	18,97	14,61
1995: Jan	2,28	5,48	18,25	14,74
Feb......	2,46	5,97	16,75	14,36
Mar......	2,50	5,95	16,80	14,22
Apr	2,41	5,82	17,17	14,41

* Excluding gold-mining shares

index decreased quite sharply by 10,7 per cent up to February 1995 because of the slump in share prices on Wall Street, the ripple effects of the Mexican crisis on emerging markets and in anticipation of the possible abolition of the financial rand. The announcement of the termination of the dual exchange rate system and attempts in the Budget to encourage foreign investment in South Africa reversed the downward trend towards the end of March 1995 and was responsible for a recovery of 3,4 per cent in the average price level of all classes of shares from February to April; the average level of share prices in April 1995 was nevertheless still 7,7 per cent below the peak in November 1994.

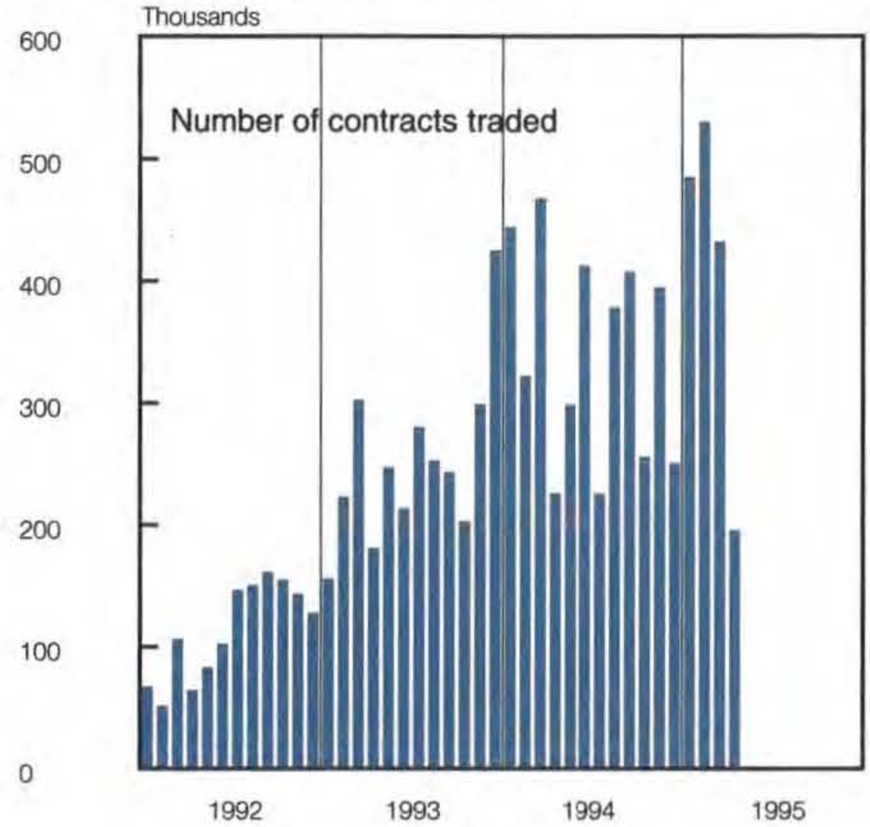
Lower gold-mining profits, labour unrest on certain mines and reduced production depressed gold-mining share prices from October 1994 to March 1995. In April the share prices of gold mines increased again on average by 3 per cent with the improvement in the gold price amidst uncertainty in global currency markets. This brought the average monthly level of gold-mining share prices to 36,2 per cent below the upper turning-point of September 1994. Industrial and commercial shares and financial shares performed better and their respective average share price levels in April 1995 were only 4,1 per cent and 6,2 per cent below their peaks in December and November 1994.

Mirroring the lower average level of share prices, the *dividend yield* on all classes of shares was somewhat higher in April 1995 than in November 1994. Although the *price-earnings ratio and the yield gap* (monthly average yield on long-term government stock less the dividend yield on all classes of shares) moved marginally downwards, they both remained on high levels, reflecting the fact that equities are relatively expensive.

Other financial markets

The turnover in the *derivative market for futures contracts* increased to a new record level of 1,4 million contracts in the first quarter of 1995, after having remained buoyant

Futures exchange transactions



throughout 1994. In April 1995 trading declined to 0,19 million contracts, mainly due to fewer trading days during this period. Trade in *options on futures* contracts in the formal derivative market also reached a new all-time high level of 1,5 million contracts in the first quarter of 1995 before slumping to 0,16 million contracts in April. As in the share market, non-resident participation in the derivative market rose significantly in the first four months of 1995.

The *mortgage market* remained buoyant throughout 1994 and recorded further significant growth in the first quarter of 1995. The average monthly value of mortgage advances paid out by banks increased from R3,9 billion in the fourth quarter of 1994 to R4,4 billion in the first quarter of 1995. However, the growth in flexible mortgage advances (which can also be used to finance the purchases of durable and other consumer goods) exceeded the growth in conventional mortgage advances.

In the *real estate market*, the value of real estate transactions contracted from a peak of R8,4 billion in the third quarter of 1994 to R8,2 billion in the fourth quarter and R7,8 billion in the first quarter of 1995. The increase in real estate prices, the continued high nominal and real mortgage interest rate and expectations of a further rise in interest rates were probably mainly responsible for the lower level of transactions in fixed property as well as a decline in the average property size of these transactions.

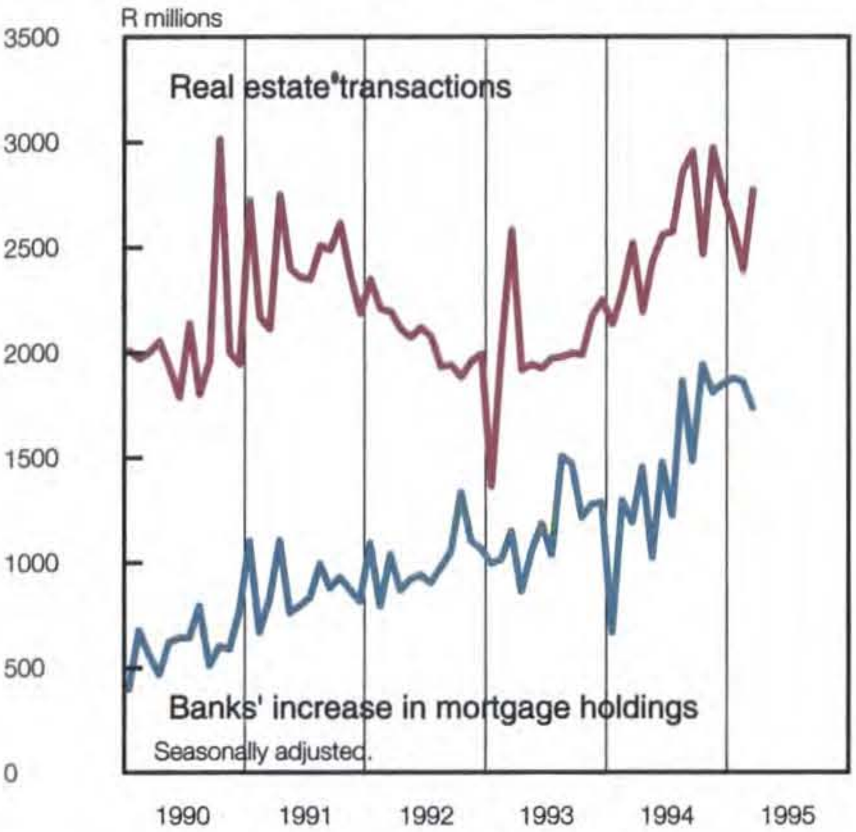
Public finance

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 R29,8 billion in fiscal 1994/95, or R11,2 billion less than in the preceding fiscal year. As a ratio of gross domestic product, the public-sector borrowing requirement decreased from 10,4 per cent in fiscal 1993/94 to 6,7 per cent in fiscal 1994/95. The exceptionally high borrowing requirement in fiscal 1993/94 was, however, to a large extent due to special non-recurrent transfers of R14,8 billion. If these transfer payments are excluded, the public-sector borrowing requirement in fiscal 1993/94 was equal to 6,6 per cent of gross domestic product, or slightly lower than the ratio in fiscal 1994/95.

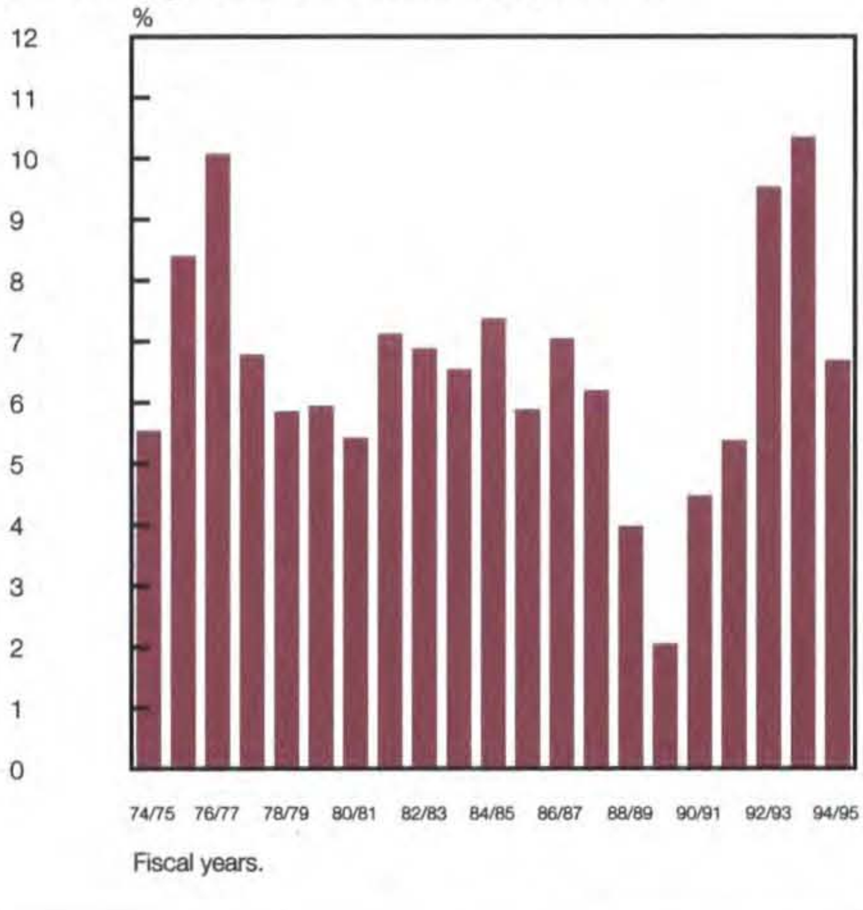
The comparatively large public-sector borrowing requirement in fiscal 1994/95 consisted primarily of a deficit of R26,0 billion on the Main Budget. The borrowing requirements of provincial governments and extra-budgetary institutions came to R2 386 million and R762 million, these amounts being considerably higher than their counterparts of R883 million and R331 million in the preceding year. In contrast to these developments, the borrowing requirement of local authorities shrank from R590 million in fiscal 1993/94 to R520 million in fiscal 1994/95.

Mortgage lending and real estate transactions



Seasonally adjusted.

Public-sector borrowing requirement as percentage of gross domestic product

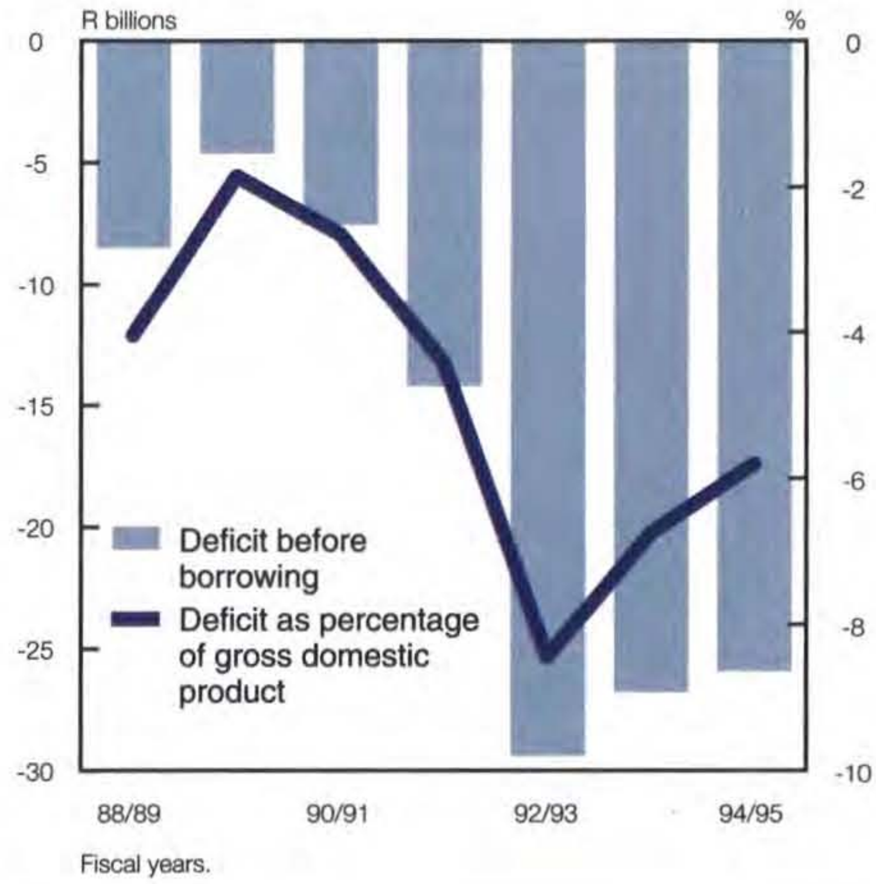


Fiscal years.

Table 11. Expenditure of general government as a ratio of gross domestic product
Per cent

	1993/94	1994/95
Goods and services	22,7	22,7
Interest	5,7	5,8
Subsidies and transfers	6,7	5,4
Current expenditure	35,1	33,9
Capital expenditure	2,5	2,2
Capital transfers	2,9	1,0
Toral expenditure	**40,5**	**37,1**

Budget deficit



The large transfer payments in fiscal 1993/94 were also mainly responsible for a reduction in total *general government expenditure* as a ratio of gross domestic product from 40,5 per cent in that year to 37,1 per cent in fiscal 1994/95. If these transfer payments are not taken into account, the total expenditure of general government amounted to 36,8 per cent of gross domestic product in fiscal 1993/94; there was, therefore, a more than proportionate increase in government expenditure in fiscal 1994/95. As shown in Table 11, most of the other main components of government expenditure as a ratio of gross domestic product changed only marginally in fiscal 1994/95.

Total *revenue and grants of general government* as a ratio of gross domestic product increased from 30,5 per cent in fiscal 1993/94 to 30,7 per cent in fiscal 1994/95. This increase could largely be attributed to the fact that tax revenue increased more rapidly than domestic product, signifying a rise in the overall tax burden. With the introduction of a transitional levy in fiscal 1994/95, the taxes on income and profits rose very rapidly. On the other hand, taxes on goods and services receded from 10,0 to 9,0 per cent of gross domestic product over the same period.

Fiscal year 1994/95

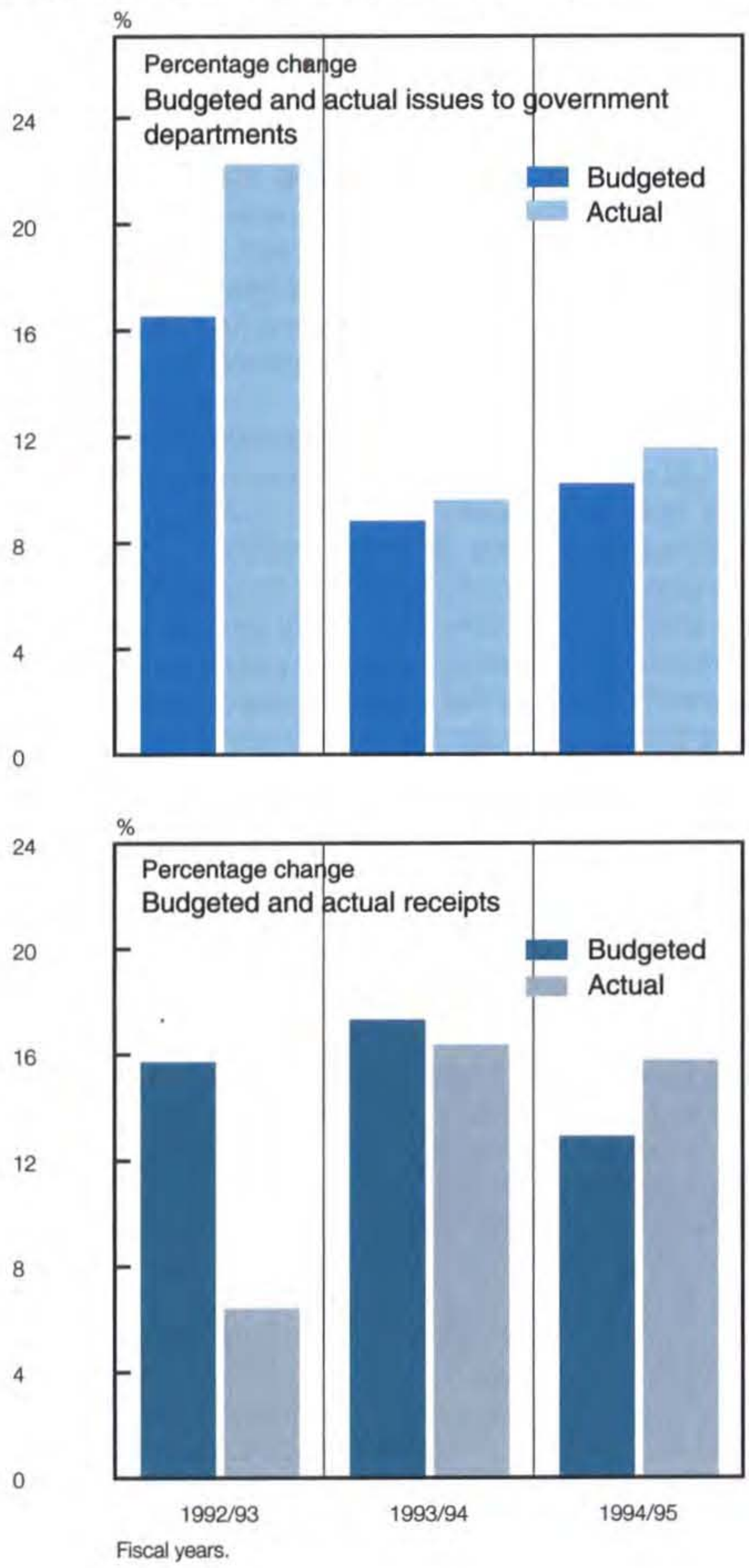
The *government's deficit* before borrowing and debt repayment of R26,0 billion in fiscal 1994/95 was considerably lower than the budgeted deficit of R29,5 billion. As a ratio of gross domestic product, the deficit was equal to 5,8 per cent, compared with 6,8 per cent in fiscal 1993/94 and 8,5 per cent in fiscal 1992/93. The lower value of the deficit in fiscal 1994/95 was the result of a higher rate of increase in government receipts than had been foreseen in the Budget in June 1994. The increase in issues to government departments also exceeded budgeted projections, but by a smaller margin.

The rate of increase in *issues to government departments* amounted to 11,5 per cent in fiscal 1994/95, which was moderately higher than the budgetary provision of 10,2 per cent. This rate of increase in government issues was also higher than the rate of increase of 9,6 per cent in fiscal 1993/94, but well below the average rate of increase of 15,6 per cent in the preceding five fiscal years. Expenditure in fiscal 1994/95 included an amount of R1,2 billion of the amount of R2,5 billion that had been allocated to the Reconstruction and Development Programme. Approximately one half of this amount was spent on nutrition programmes at primary schools and on free health services.

Government receipts increased by 15,8 per cent in fiscal 1994/95; revenue had been projected to rise by 12,9 per cent in the Budget. This considerably better-than-expected performance of government revenue largely reflected the improvement in general economic activity. The income received from income tax and customs and excise duties, in particular, was considerably higher than the Budget estimates. Receipts from value-added tax, however, performed below expectations.

As indicated in Table 12, the *deficit* was *financed* mainly by means of long-term government stock issues. Most of this government stock was taken up by the Public Investment Commissioners and the non-monetary private sector. Seeing that this stock was issued at substantially lower coupon rates than the ruling market interest rates, the discount on government stock increased from 6,5 per cent of the net increase in government stock in fiscal 1993/94 to 30,9 per cent in fiscal 1994/95. In fiscal 1994/95, however, a premium was also earned on the consolidation of some government stock issues. The net discount of R9,4 billion on government stock issues nevertheless added another 2,1 percentage points to the

Budgeted and actual issues and receipts



ratio of government debt to gross domestic product at the end of March 1995.

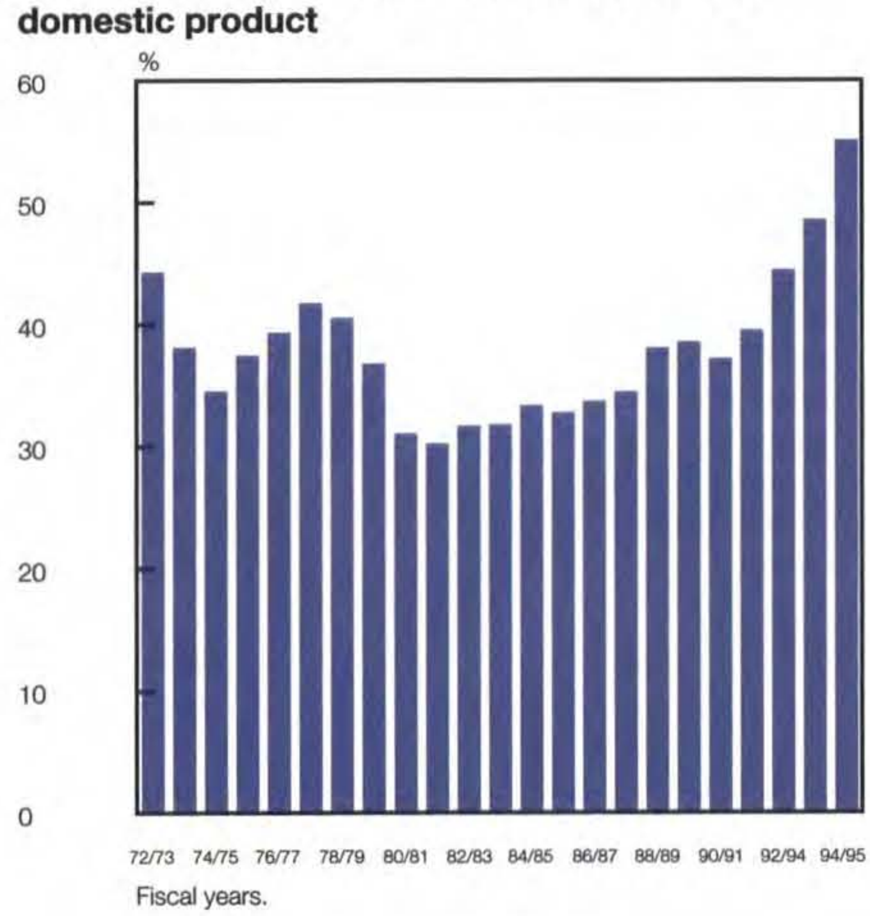
In financing the deficit, Treasury bills to the value of R1 880 million were sold to non-residents during fiscal 1994/95, which also contributed to the strengthening of the foreign reserves. In December 1994 the government succeeded for the first time since October 1991 in making a major issue of government stock in the global bond market. Stock amounting to US$750 million was issued, which contributed R2 672 million to the financing of the deficit.

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'

Table 12. Financing of the government deficit in fiscal 1994/95

	R millions
Government stock:	
Public Investment Commissioners	16 639
Monetary institutions	2 603
Non-monetary private sector	15 603
Total including discount	34 845
Less: Discount on government stock	10 764
Plus: Premium on consolidation of stock	1 321
Total	25 402
Treasury bills	-167
Foreign loans	2 604
Non-marketable securities	-265
Loan levy	-710
Money market instruments	1
Extraordinary receipts	31
Increase in available cash balances	-934
Total net financing	**25 962**

Total government debt as percentage of gross domestic product



preferences for a capital market instrument with money market qualities, a new variable-rate stock was introduced in October 1994. Although this stock was aimed at satisfying the preferences of the institutional investors, the main investors turned out to be the Public Investment Commissioners and the monetary sector, which held R2,0 billion and R1,3 billion, respectively, out of a total of R5,2 billion issued up to the end of March 1995.

The borrowing requirement of the government before debt repayment plus the large discount on new government stock issues led to an increase in government debt from R192,2 billion at the end of fiscal 1993/94 to R245,3 billion at the end of fiscal 1994/95. As a ratio of gross domestic product, government debt rose from 48,6 to 55,1 per cent over this period. The steep upward trend in this ratio increases the danger of the monetisation of government debt.

The Budget for fiscal 1995/96

In his Budget Speech on 15 March 1995 the Minister of Finance stated that the *theme of the Budget* for fiscal 1995/96 was to provide for the material well-being of all South Africans on a sustainable basis, with changes that must be politically feasible, economically affordable and managerially sound. With these objectives in mind, the following key benchmarks were set for the Budget:

- the avoidance of permanent increases in the overall tax burden;
- containing non-interest expenditure in real terms;
- keeping overall wage and salary adjustments within inflationary limits; and
- reducing the overall budget deficit and the level of government dissaving.

In accordance with these criteria, *government expenditure* was budgeted at R152,6 billion, which represents an increase of 9,0 per cent on the preceding year's level. At the same time, a reallocation of expenditure was provided for in the Budget to achieve the aims of the Reconstruction and Development Programme. This involved a marked move away from expenditure on general government administration, defence and economic services in favour of expenditure on education, health care, social security, welfare, housing and police.

Total *government revenue* was projected to rise by 10,3 per cent to R123,0 billion in fiscal 1995/96. Considerable emphasis was placed on the revenue side to bring the tax structure in line with the Interim Constitution's requirement of a unitary tax rate structure for all individuals. The Minister also emphasised the need for improved tax administration, the feasibility of a general tax amnesty and the maintenance of the *status quo* in respect of value-added tax and corporate income tax for the time being. More specifically, the tax proposals included the following major changes:

- a single scale of rates for all individuals, reaching a maximum marginal rate of 45 per cent at a taxable income of R80 000;
- an increase in certain excise duties and the fuel levy;
- the removal of the import surcharge on all capital and intermediate goods;
- the abolition of non-resident shareholders' tax;
- the harmonisation of taxes applicable in the former TBVC countries with the rest of South Africa; and
- the introduction of measures to prevent tax avoidance in respect of more than one company car, the accrual and incurring of interest on financial instruments, interest earned by emigrants, the taxation of lump sum payments and the writing-off of the cost of ships and aircraft.

The government expenditure and revenue projections should result in a deficit of R29,7 billion, or 5,9 per cent of the estimated gross domestic product. If loan redemptions of nearly R9 billion are taken into account, the *gross borrowing requirement* for fiscal 1995/96 would be R38,6 billion. The government intends to finance R35,5 billion of this borrowing requirement by issuing government stock. The rest of the shortfall will mainly be met through proceeds from foreign loans, Treasury bills and extraordinary income.