Quarterly economic review

Introduction

The major development on the economic front in South Africa during the first five months of 1996 was the turmoil in the foreign exchange market and the impact this had on the rest of the economy. Based largely on unfounded rumours and speculative transactions, the external value of the rand began to depreciate from mid-February 1996. Initially, this depreciation brought the exchange rate of the rand, which had increased from the middle of 1995, to more realistic and competitive levels. This sharp decline in the value of the rand, however, also brought about certain fundamental changes in an environment characterised by uncertainties regarding future political, social and economic circumstances. After having remained relatively firm in March, the external value of the rand accordingly fell sharply in April and then stabilised to some extent in May 1996.

As could be expected, the disturbances in the foreign exchange market had serious consequences for South Africa's transactions with the rest of the world. The large net inflows of capital which had been recorded from the second half of 1994, were affected by leads and lags in foreign payments and receipts which led to a substantial outflow of short-term capital. At first this was largely offset by inflows of long-term capital. From the beginning of March these inflows began to subside and later turned into net outflows of long-term capital in April 1996. These speculative capital outflows could, however, easily switch around again should the exchange rate of the rand stabilise.

Although the deficit on the current account shrank significantly in the first quarter of 1996 owing to a substantial increase in merchandise and net gold exports, this could not prevent a decrease in the gross and net gold and other foreign reserves in the first four months of 1996. Both volume and price increases contributed to a further rise in merchandise imports and net service and transfer payments to non-residents. In view of the relatively high price elasticity for imported goods and manufactured exports of South Africa, the foreign reserves should in future benefit from the depreciation of the rand provided that this advantage is not wiped out by increases in production costs.

The depreciation of the rand also led to a substantial increase in the turnover in the South African foreign exchange market and forced the Reserve Bank to change its intervention policy in this market. From the middle of February 1996 the Bank became a net seller of foreign exchange to the market in order to ensure that the adjustment of the rand to a lower level would be as smooth as possible. In undertaking these transactions, the Bank did not attempt to defend a particular level of the exchange rate, but rather endeavoured to support an orderly correction in the market. In addition, the Reserve Bank had to increase its participation in the forward exchange market in an attempt to restore orderly conditions, which resulted in an increase in the Bank's net oversold foreign currency open position.

The depreciation of the rand furthermore arrested the downward movement in interest rates which had taken place in the eight months up to January 1996. Long-term rates reacted quickly to the uncertain conditions in the foreign exchange market, while the response of short-term rates was delayed. The slope of the yield curve accordingly steepened considerably during February and March 1996. The increase in Bank rate on 29 April 1996 by one percentage point led to corresponding increases in short-term yields, while having comparatively little effect on long-term yields. At the end of April 1996 the yield curve was therefore not only substantially higher than in January 1996, but also much flatter.

The increased volatility in the bond and derivative markets arising from the weakening in the exchange rate of the rand and fluctuations in interest rates, caused the activity in these markets to rise to new heights. The depreciation of the rand also benefited the prices of commodity and rand-hedged shares. In May 1996, however, the prices of listed industrial shares declined sharply, while the prices of gold-mining shares remained relatively stable. The decrease in the net foreign assets of the Reserve Bank contributed to a tightening in the money market.

The depreciation of the rand will inevitably also influence the rate of inflation of the country. Although current available information on consumer and production prices in 1996 still do not reflect the effects of the depreciation of the rand, prices of many imported goods can be expected to rise in due course, while prices of locally produced goods and services will, with some time lags, be affected. Indeed, there is a real danger that inflation resulting from the depreciation could eventually destroy more wealth and job opportunities than the initial gains arising from the lower value of the rand if appropriate policy measures are not pursued.

The upward pressures on price inflation will be assisted by the recent reacceleration in the growth of money supply. After having shown a distinct downward movement in the second half of 1995, the rate of increase in nearly all the various monetary aggregates (with the exception of M1A) started to rise relatively rapidly towards the end of 1995. Expected changes in interest rates and major adjustments in the share and bond markets at that time, encouraged private-sector entities to shift their funds to call, other short- and medium-term deposits. Although the private sector's preference for depository type investments intensified during the first quarter of 1996, the more rapid growth in money supply was nonetheless primarily demand driven.

The main counterpart of the increase in money supply continued to be credit extension to the private sector. Moreover, in the first quarter of 1996 the rate of increase in credit extended to private enterprises and households accelerated sharply, *inter alia* because of the depreciation of the rand. The uncertainty in the foreign exchange market resulted in a switching from foreign to domestic financing of trade transactions to avoid the risk of the vagaries of the external value of the rand. A persistently strong demand for machinery and equipment and consumer durables was also financed by means of instalment-sales credit, leasing finance, mortgages and other loans and advances. In addition, affirmative action and the easy availability of credit, promoted the extension of bank credit at a stage when interest rates were already high.

Despite the sustained strong demand for bank credit, real gross domestic expenditure actually declined in the first quarter of 1996, largely because of a substantial decrease in inventory accumulation. The net addition to stocks at constant prices in the first quarter of 1996 was nearly half of the level in the preceding quarter. The slower build-up of inventories was particularly evident in the mining, manufacturing and commercial sectors.

After having increased at relatively high rates, the growth in real private consumption expenditure in the first quarter of 1996 slowed down. This lower rate of increase was brought about by more modest growth in durable consumption expenditure and a slowdown in the growth of non-durable consumption expenditure at constant prices. Real household outlays on semi-durable goods and real consumption expenditure by general government were relatively buoyant in the first quarter of 1996. The growth in the consumption expenditure by general government at constant prices nevertheless came to less than 1 per cent in the fiscal year 1995/96 and contributed to a further fall in the public-sector borrowing requirement if extraordinary transfers are not taken into account.

The increase in total real gross domestic fixed investment, which had shown signs of slowing down in the fourth quarter of 1995, increased again at a high annualised rate of 7 per cent in the first quarter of 1996. Large capital outlays by public corporations on infrastructural developments were mainly responsible for the more rapid expansion in capital formation. The growth in investment expenditure by the private sector, however, continued to slacken with the completion of some of the major capital projects. A classification of the real fixed investment by the private sector according to economic sector nevertheless shows that capital outlays were fairly widespread in the first quarter: all the production sectors, apart from financial services, reported higher real capital formation figures.

Even with the decline in domestic demand, the rate of growth in domestic output rose strongly in the first quarter. A firm external demand for South African goods and services and favourable agricultural conditions led to a sharp rise in the growth of real gross domestic product from the fourth quarter of 1995 to the first quarter of 1996. From the beginning of the upturn in economic activity in the second quarter of 1993, the growth in real domestic output has averaged 3 per cent per annum, which is somewhat higher than the rate of increase in the population.

Employment growth continued to respond very slowly to the upturn in economic activity, mainly because of the rationalisation of labour by many employers who attempted to reduce unit labour costs and to improve competitiveness. The employment cycle, however, seemed to have reached a lower turning point in the second quarter of 1994, but employment growth was weak and could still not prevent a further increase in unemployment. The upturn in the employment cycle was also accompanied by moderately lower wage growth and further high increases in labour productivity. This resulted in a decline in real unit labour costs during 1995.

Domestic economic developments

Domestic output

The growth in *total real gross domestic product*, seasonally adjusted and annualised, which had accelerated from 1½ per cent in the first quarter of 1995 to 3 per cent in the third quarter before slowing down to 2½ per cent in the fourth quarter, rose to 3½ per cent in the first quarter of 1996. This took the value of total real gross domestic product to a level that was nearly 3 per cent higher than in the first quarter of 1995 and 11 per cent higher than the most recent lower turning-point that had been reached in the fourth quarter of 1992. From the beginning of the upturn in economic activity in the second quarter of 1993 the quarterly growth in real domestic output has averaged 3 per cent at an annualised rate, which is somewhat higher than the rate of increase in the population.

The more rapid growth in real gross domestic product in the first quarter of 1996 reflected a rebound in *agricultural production* after the poor climatic conditions which had prevailed during most of 1995. The growth in the real output of the *non-agricultural sectors*, on the other hand, slowed down further from an annualised rate of 6 per cent in the third quarter of 1995 to 3 per cent in the fourth quarter and 1 per cent in the first quarter of 1996. This low expansion in the output of the non-agricultural sectors was noticeable in nearly all the main sectors of the economy, with the exception of non-gold-mining, electricity generation and financial services.

A firm foreign demand for diamonds, base metals and minerals led to a sharp rise in the real value added by the non-gold-mining industry in the first quarter of

Real gross domestic product

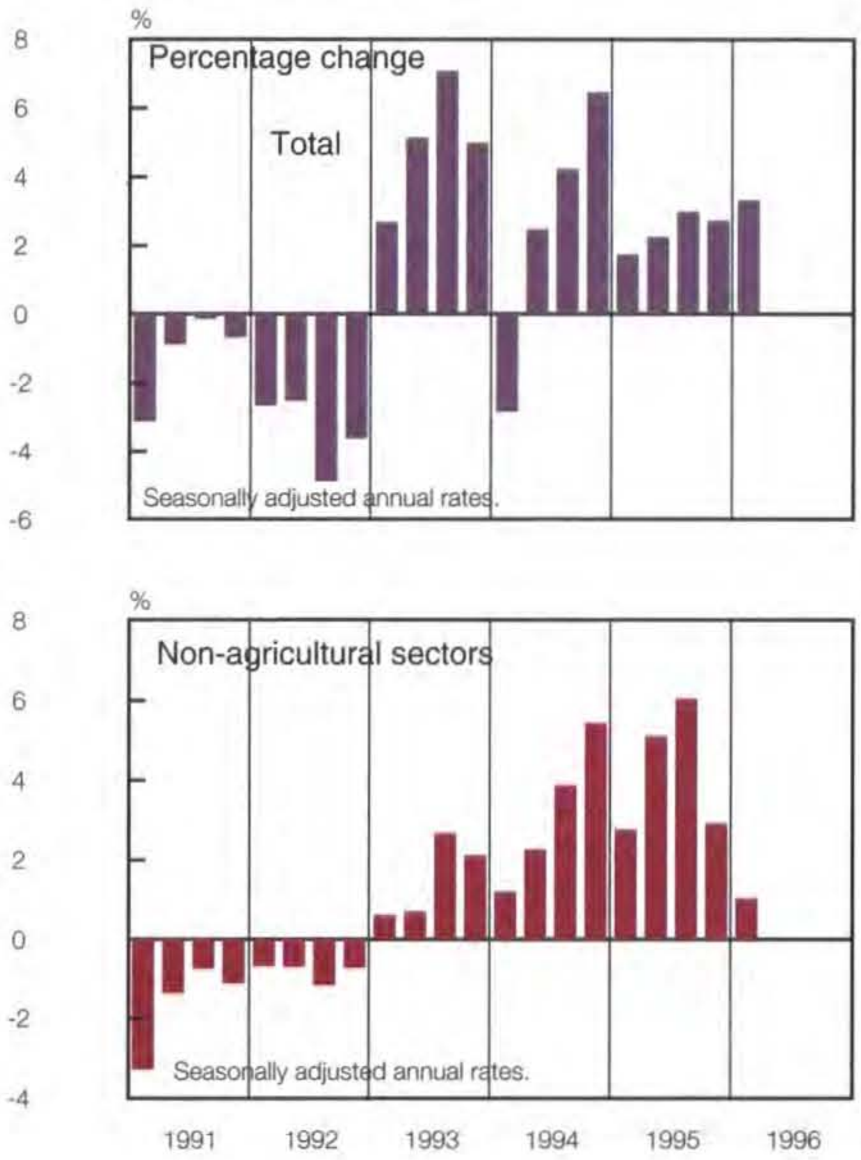


Table 1. Real gross domestic product
Percentage change at seasonally adjusted and annualised rates

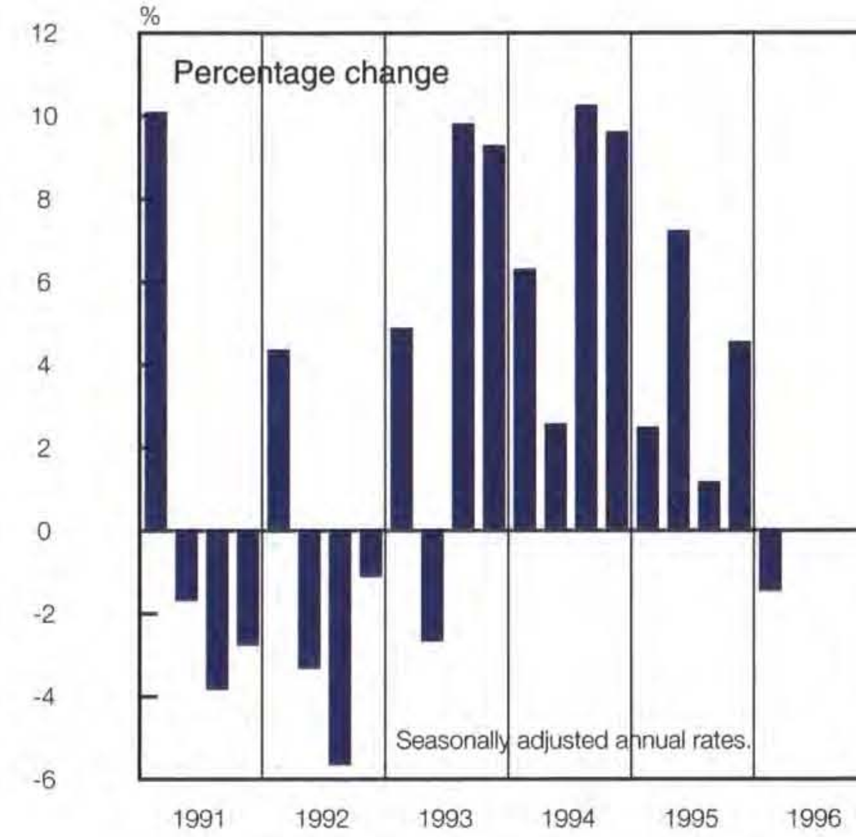
Sectors	1995					1996
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr
Primary sectors	-12½	-22	-17	1	-8	22
Agriculture	-15½	-42	-50	-2½	-15	82½
Mining	-10½	-7½	6	2½	-3½	½
Secondary sectors	6½	8½	7	-1½	6½	1
Manufacturing	7	10	8½	-3	7½	-
Tertiary sectors	2½	5	4½	4	3½	½
Commerce	2½	9	8½	9	6	-2
Transport and communication	6½	7½	6	3½	4½	1
Financial services	3	4	4	2½	4	3
Non-agricultural sectors	3	5	6	3	4	1
Total	**1½**	**2**	**3**	**2½**	**3½**	**3½**

1996. This increase was to a large extent neutralised by a decline in gold production related to a lower throughput of ore. As a result, the real output of the *mining sector* as a whole moved upward at an annualised rate of only ½ per cent; this followed fairly high growth rates of 6 and 2½ per cent in the last two quarters of 1995.

The output volume in the *secondary sectors* also rose moderately at an annualised rate of 1 per cent in the first quarter of 1996. This was, however, an improvement compared with the decline at an annualised rate of 1½ per cent in the real value added by the secondary sectors in the fourth quarter of 1995. The increase in the real value added by the secondary sectors was supported by continued growth in the output of the construction industry and the sector supplying electricity, gas and water, while manufacturing production remained at the lower level that had been reached in the preceding quarter. The lower level of the output of manufactured goods in the past two quarters, together with continued sharp increases in fixed investment, led to a decrease in the utilisation of production capacity in manufacturing from 83,7 per cent in the second quarter of 1995 to 80,2 per cent in the first quarter of 1996.

The real value added by the *tertiary sectors* rose at an annualised rate of only ½ per cent in the first quarter of 1996, after strong growth rates of between 2½ an 5 per cent had been recorded in the four quarters of 1995. A decline in the real value added by commercial services at an annualised rate of 2 per cent was mainly responsible for the weak performance of the services sector. More in particular, the real value added by the retail and motor trade contracted sharply, while output volumes of the wholesale trade increased. The real value added by transport, storage and communication rose at a more subdued pace in the first quarter of 1996 than in the preceding quarters, but buoyant conditions in the financial markets continued to boost output growth in the sector finance, insurance, real estate and business services.

Real gross domestic expenditure



Domestic expenditure

The acceleration in domestic production in the first quarter of 1996 was accompanied by a decline in domestic demand, indicating that output growth was largely based on the external demand for South African goods and services and favourable agricultural conditions. Total *real gross domestic expenditure* declined at an annualised rate of 1½ per cent in the first quarter of 1996 because of a substantial decrease in inventory accumulation and slower growth in real outlays on private consumption expenditure. Contrary to these developments, real consumption expenditure by general government and real gross domestic fixed investment increased strongly.

Table 2. Real gross domestic expenditure

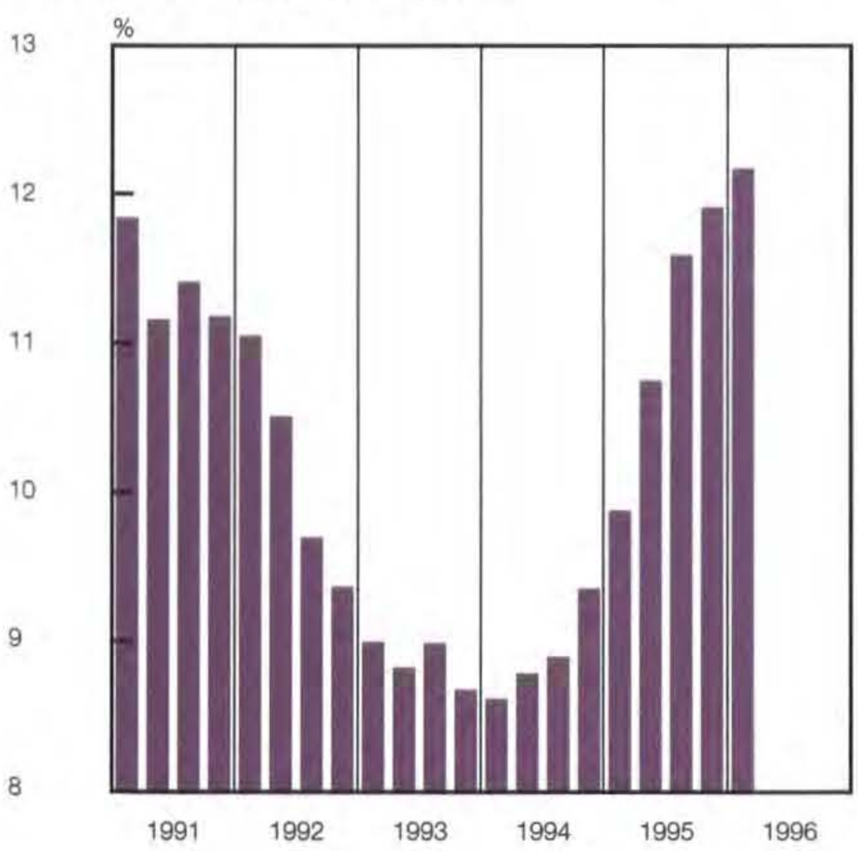
Percentage change at seasonally adjusted and annualised rates

Components	1995					1996
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr
Private consumption expenditure	4	5½	6½	5	5	2½
Consumption expenditure by general government	-2	½	2	2	½	3
Gross domestic fixed investment	8	8	7½	4	10½	7
Change in inventories (R billions)	8	9,6	6,9	6,3	7,7	2,7
Gross domestic expenditure	**2½**	**7**	**1**	**4½**	**5½**	-2

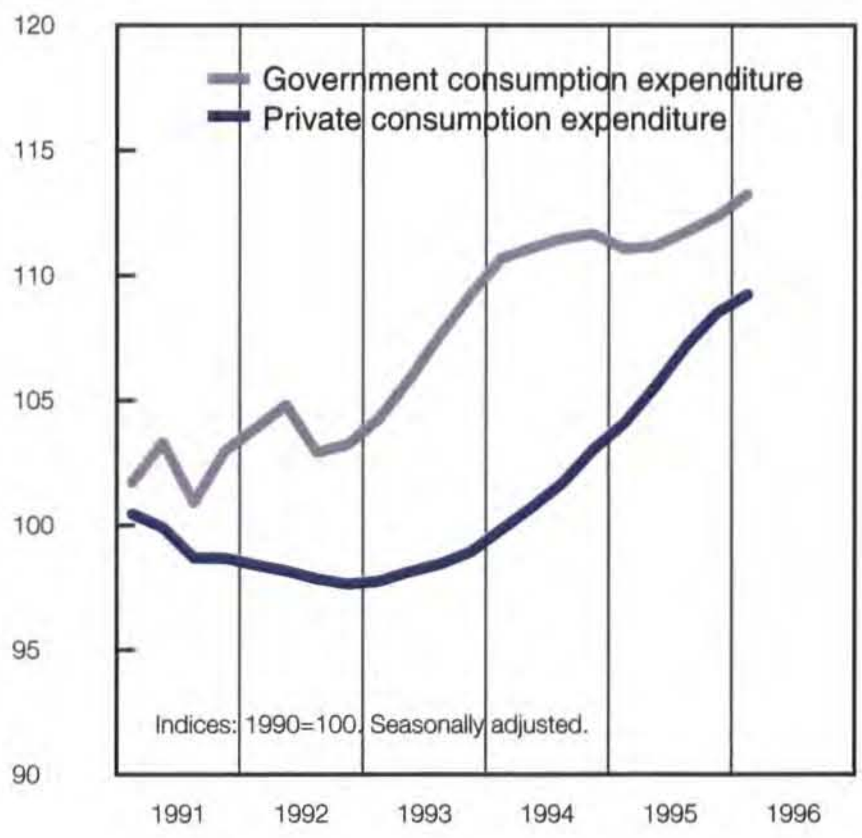
After having increased throughout 1995 at relatively high annualised quarter-to-quarter rates that varied between 4 and 6½ per cent, the growth in real *private consumption expenditure* rose by only 2½ per cent in the first quarter of 1996. This lower rate of increase in the real outlays by households on consumer goods and services was brought about by modest growth in durable consumption expenditure and slower growth in non-durable consumption expenditure at constant prices. The high interest rates in the country began to affect the outlays on durable goods because the cost of servicing household debt as a ratio of personal disposable income rose from an average level of 9 per cent in 1994 to nearly 12 per cent in the first quarter of 1996. Real household outlays on semi-durable goods, however, remained reasonably buoyant in the first quarter of 1996, especially in the clothing and footwear categories.

The growth in real *consumption expenditure by general government* turned positive in the second half of 1995 and quarter-to-quarter increases at annualised rates of about 2 per cent were recorded in the third and fourth quarter. In the first quarter of 1996 the real expenditure by general government on final goods and services for consumption purposes increased further at a higher annualised rate of 3 per cent. Despite these developments, the growth in real consumption expenditure by general government came to less than 1 per cent in the fiscal year 1995/96, compared with 1½ per cent in fiscal 1994/95.

Financing costs of household debt as percentage of personal disposable income



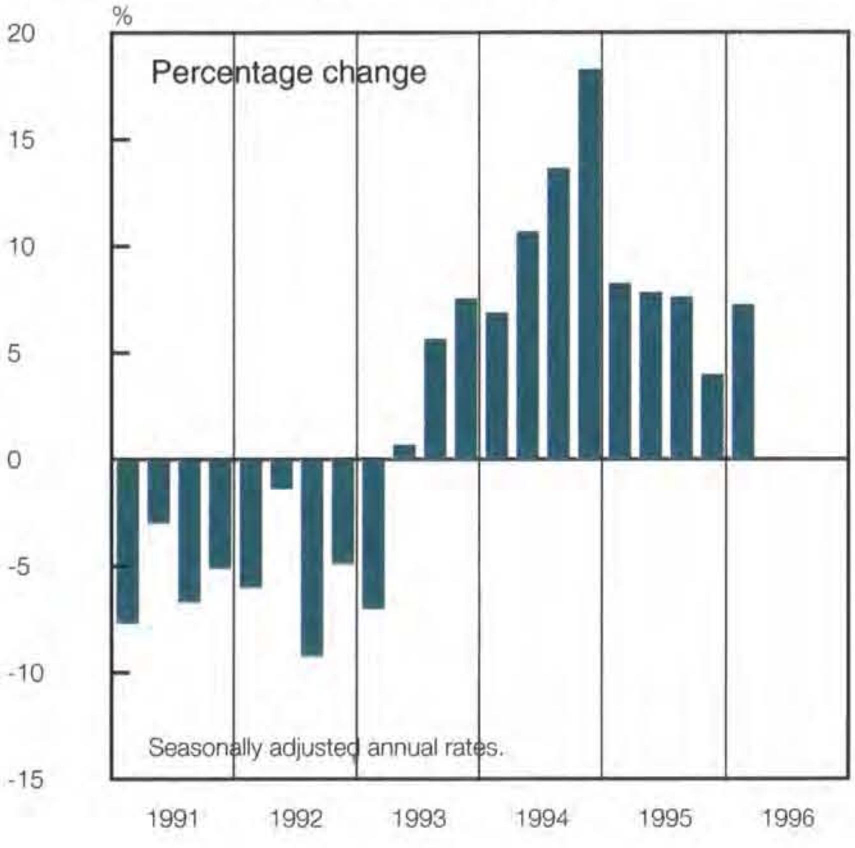
Expenditure on consumption of goods and services



The increase in total *real gross domestic fixed investment,* which had shown signs of slowing down from an annualised rate of 7½ per cent in the third quarter of 1995 to 4 per cent in the fourth quarter, accelerated again to 7 per cent in the first quarter of 1996. This higher increase was mainly due to strong growth in the real fixed capital formation by *public corporations* at an annualised rate of 40½ per cent. Large capital outlays were made by Transnet and Eskom on infrastructural developments, including the purchase of a new aircraft by the South African Airways.

The growth in investment expenditure by the *private sector* continued to slacken from a peak at an annualised rate of 8½ per cent in the third quarter of 1995 to 4 per cent in the fourth quarter and 3 per cent in the first quarter of 1996 with the completion of some of the major capital projects. A classification of the real fixed investment by the private sector nevertheless shows that the capital outlays were fairly widespread throughout the economy in the first quarter: all the main production sectors, apart from financial services, contributed to the increase. Higher investment spending in the agricultural sector was encouraged by the prospective improvement in agricultural incomes, while investment in the mining sector benefited from the upgrading of existing facilities and the expansion of several mining operations. The production capacity in the manufacturing sector was expanded further from the already high level reached in 1995, while new retail

Real gross domestic fixed investment



outlets as well as the further development of existing ones led to a rise in the fixed investment of commerce.

After having started to increase from the second quarter of 1995, the real gross domestic fixed investment by *public authorities* rose further at an annualised rate of 2 per cent in the first quarter of 1996. This mainly reflected increases in investment expenditure by central and provincial governments, among other things, on the Reconstruction and Development Programme.

The slowdown in real *inventory accumulation*, that had been evident since the second quarter of 1995, gained considerable momentum in the first quarter of 1996. The net addition to stocks at constant prices in the first quarter of 1996 was nearly half of the level in the fourth quarter of 1995. The slower build-up of inventories was particularly evident in the mining, manufacturing and commercial sectors. However, the level of industrial and commercial inventories relative to gross domestic product declined from the most recent high of 18½ per cent registered in the fourth quarter of 1995 to 18 per cent in the first quarter of 1996.

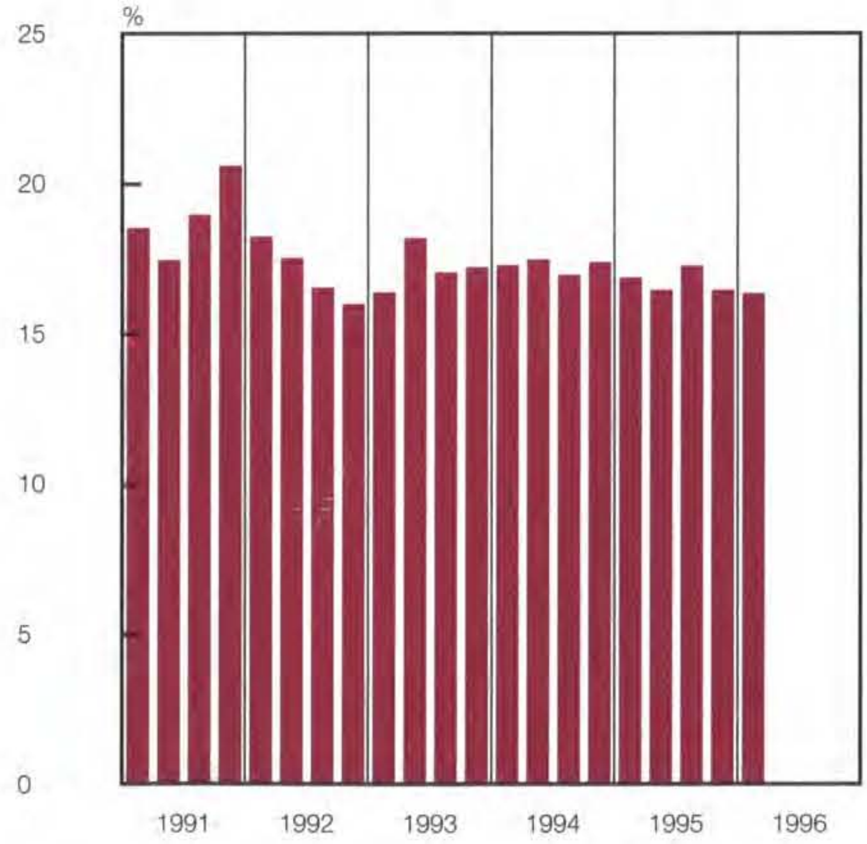
Factor income and domestic saving

The year-on-year rate of increase in *total nominal factor income* at market prices receded from an average of 13 per cent in the first two quarters of 1995 to 11½ per cent in the second half of the year and to approximately 10½ per cent in the first quarter of 1996. The further decline in the growth of nominal factor income in the first quarter of 1996 was the result of a lower increase in the total remuneration of employees, which outweighed a higher increase in the gross operating surpluses of business enterprises. A combination of lower nominal wage settlements throughout the economy and only moderate increases in employment levels, caused the rate of increase over four quarters in total remuneration of employees to decline from 11 per cent in the fourth quarter of 1995 to 10 per cent in the first quarter of 1996. Measured over four quarters, the increase in the total nominal gross operating surplus rose from 13½ per cent in the fourth quarter of 1995 to 14 per cent in the first quarter of 1996.

The ratio of *gross domestic saving* to gross domestic product remained on the low average level of 16½ per cent that had been recorded in 1995. In view of the increase in capital formation, the country therefore had to rely on foreign funds in order to finance the gap of 11 per cent between domestic saving and investment. The poor overall savings level of the economy was mainly due to low personal saving and dissaving by the government.

The seasonally adjusted level of net *saving by households* improved in the first quarter of 1996 owing to an increase of approximately 3 per cent in personal disposable income reflecting mainly an increase in the income of farmers. Despite this increase in income, the ratio of personal saving to personal disposable income remained virtually unchanged at the low level of

Gross domestic saving as percentage of gross domestic product



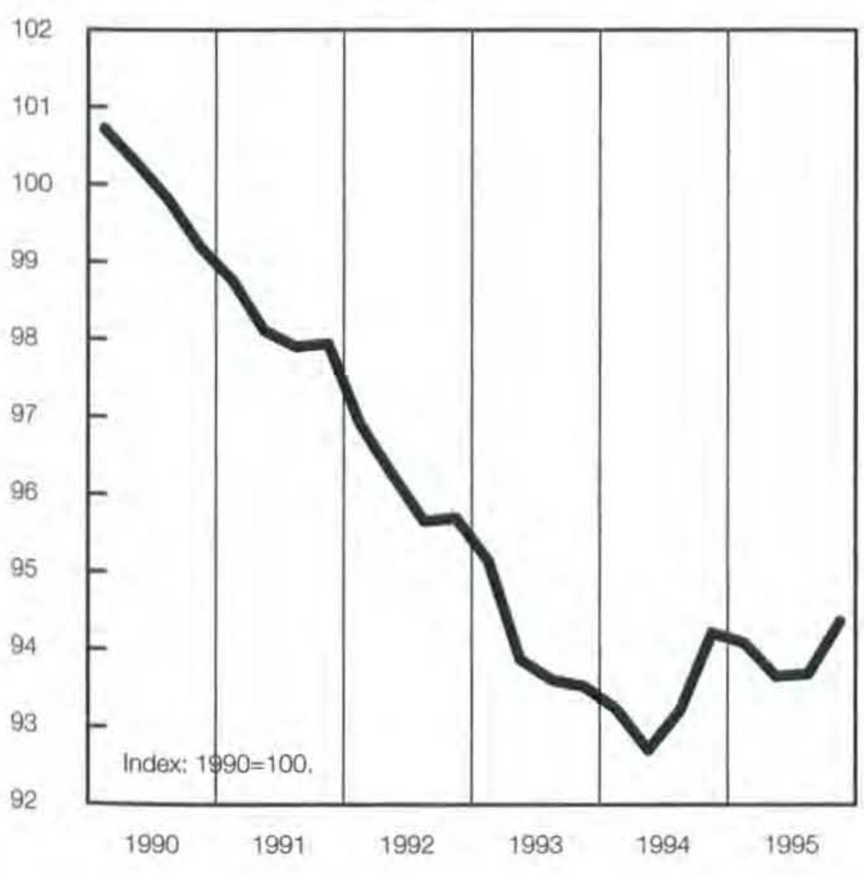
1 per cent which had been recorded in the fourth quarter of 1995. The high marginal propensity to consume of households therefore continued to absorb increases in income.

The ratio of net *dissaving by general government* to gross domestic product in the first quarter of 1996 also remained virtually unchanged at the level of 3½ per cent attained in the fourth quarter of 1995, because of a rapid rise in current expenditure. The *corporate sector's net saving*, however, continued to rise as a result of the higher profits of companies and the inducement to retain profits for investment purposes related to the high tax of 25 per cent on distributed profits of companies that still existed during the first quarter of 1996.

Employment

Employment growth continued to respond very slowly to the upturn in economic activity mainly because of the ongoing rationalisation of labour in many economic sectors in an effort to reduce unit labour costs and improve competitiveness. The employment cycle nonetheless seems to have reached a lower turning-point in the second quarter of 1994, although employment growth faltered to some extent in the first half of 1995. Decreases in *total employment in the formal non-agricultural sectors* of the economy at seasonally adjusted and annualised rates of 0,6 and 1,8 per cent in the first and second quarter of 1995 were followed by a marginal increase in the third quarter and more robust growth of 3,0 per cent in the fourth quarter (latest information made available by the Central Statistical Service). The average level of total employment in 1995 was therefore 0,6 per cent higher than in 1994. This was the first year since 1989 that an increase had been recorded in employment, but the rate of increase in employment was still well below the growth in the labour force. Despite the turnaround in the employment cycle, it is estimated that nearly 280 000 people joined the ranks of the unemployed in the eighteen months up to the end of December 1995.

Total non-agricultural employment



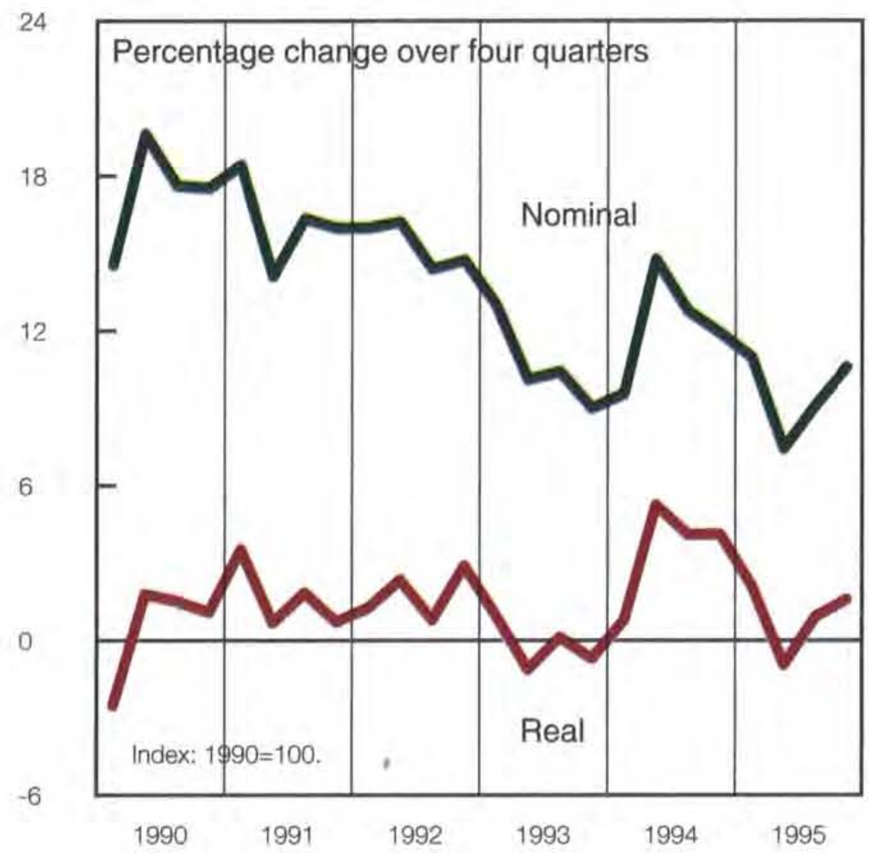
The sharp increase in employment in the fourth quarter of 1995 was primarily due to a rise in employment by *public authorities*. After having receded sharply in the first half of 1995 because of the reduction in the number of employees at the time of the incorporation of the former self-governing and independent territories into the South African public service, total employment by public authorities rose at seasonally adjusted and annualised quarter-to-quarter rates of 3,9 and 10,0 per cent in the last two quarters of the year. This increase could mainly be attributed to a rise in the number of staff members of the provincial governments, and was responsible for a rise of 0,6 per cent in the average level of employment by public authorities in 1995.

In sharp contrast to the changes in the employment by public authorities, employment in the non-agricultural *private sector* increased in the first half of 1995 and then contracted in the second half of the year. The decrease in employment by private-sector entities at seasonally adjusted and annualised rates of 1,7 and 0,5 per cent in the third and fourth quarter of 1995 was largely discernible in construction, gold mining and manufacturing. The average level of employment in the private sector in 1995 was nonetheless 0,7 per cent higher than in 1994.

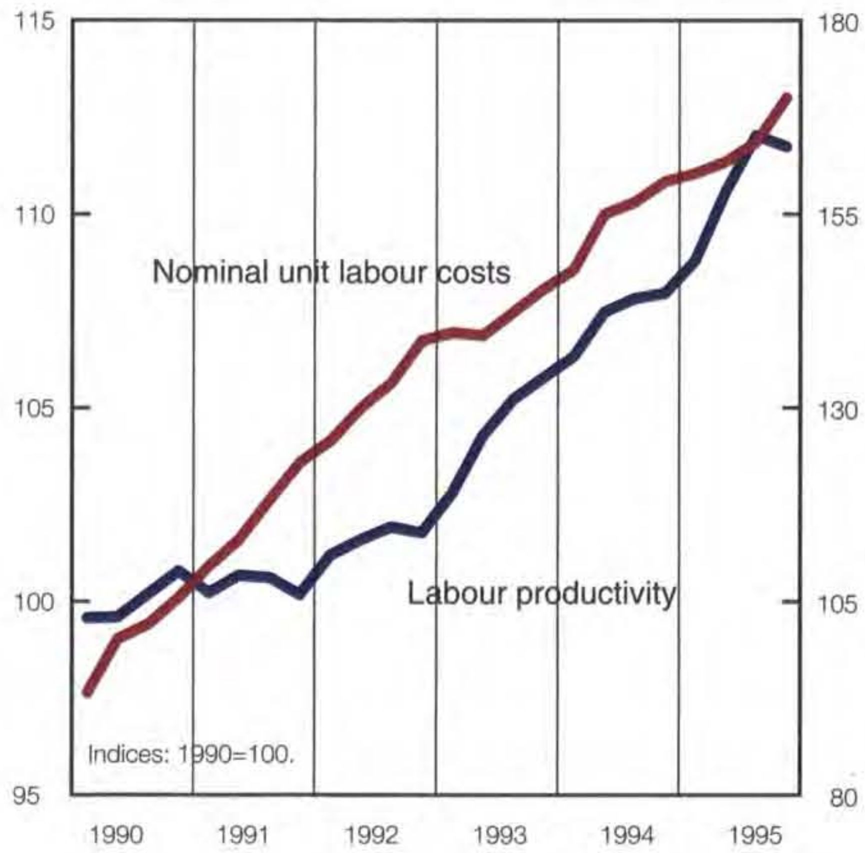
Labour costs and productivity

The upturn in the employment cycle has been accompanied by moderately lower wage growth. The rate of increase in the average *nominal remuneration per worker* in the non-agricultural sectors of the economy tapered off from 12,0 per cent in 1994 to 9,6 per cent in 1995. This slower growth was largely due to an increase of only 6,4 per cent in the salaries and wages per worker employed by public authorities in 1995 because of the retrenchment of a large number of well-remunerated officials employed by especially provincial governments, the employment of an increased number of lower-paid persons and only a modest general salary adjustments in the civil service during this year. As opposed to these developments, the rate of increase in the nominal remuneration per worker in the non-agricultural private sector rose from 10,2 per cent in 1994 to 11,6 per cent in 1995. The year-on-year rate of increase in the total remuneration per worker has also recently shown signs of an

Remuneration per employee



Labour productivity and nominal unit labour costs



acceleration from a low of 7,4 per cent in the second quarter of 1995 to 9,1 and 10,5 per cent in the third and fourth quarter, respectively.

As a result of the lower increases in nominal salaries and wages, the rate of increase in the *real remuneration* per worker in the non-agricultural sector fell from 3,3 per cent in 1994 to 1,0 per cent in 1995. However, in keeping with the rise in nominal wages and lower increases in prices, the growth in real wages per worker accelerated in the second half of 1995.

Labour productivity fortunately also kept on growing strongly. The year-on-year rate of increase in labour productivity rose from 2,3 per cent in the first quarter of 1995 to 3,9 and 3,5 per cent in the last two quarters of the year. For 1995 as a whole productivity increased by 3,2 per cent; in both the preceding years it had increased by 2,8 per cent. These high rates of increase were achieved at the cost of new employment in the formal sectors of the economy. This led to fairly low rates of increase in nominal *unit labour costs* and even declines in the year-on-year rates of increase in real unit labour costs from the first quarter of 1995.

Prices

The lower growth in labour cost per unit of production was an important factor in bringing the inflation rate down in 1995 and the first three months of 1996. This factor was supported by the persistent pursuance of a

Table 3. Percentage change in labour costs and productivity

	Remuneration per worker		Productivity	Unit labour costs	
	Nominal	Real		Nominal*	Real
1994: year	12,0	3,3	2,8	9,1	0,6
1995: 1st qr*	10,9	2,0	2,3	8,4	-0,3
2nd qr*	7,4	-1,0	2,9	4,4	-3,8
3rd qr*	9,1	0,9	3,9	4,9	-2,9
4th qr*	10,5	1,5	3,5	6,8	-1,9
year	9,6	1,0	3,2	6,2	-2,1

* Change over four quarters

conservative monetary policy stance, reforms to South Africa's foreign trade policy leading to a reduction in the effective taxation of imported goods, lower food price increases and a relatively stable external value of the rand until the middle of February 1996.

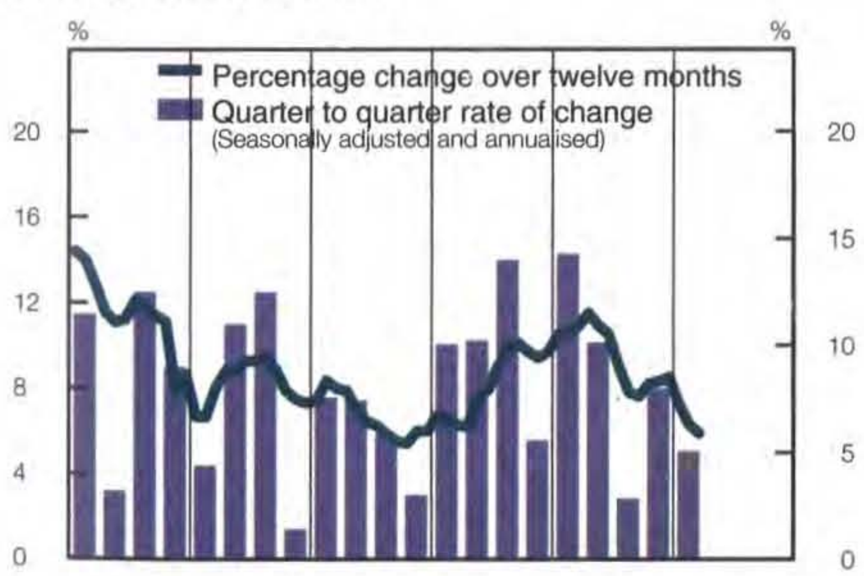
A slowdown in the price changes of domestically produced and imported goods contributed to a decrease in the quarter-to-quarter seasonally adjusted and annualised rate of increase in the all-goods *production price index* from 14,3 per cent in the first quarter of 1995 to 2,8 per cent in the third quarter; this rate then rose again to higher levels of 7,9 per cent in the fourth quarter and 5,1 per cent in the first quarter of 1996. Measured over a period of twelve months, the rate of increase in the all-goods production price index declined on balance from a high point of 11,5 per cent in April 1995 to 6,3 per cent in February 1996 and 5,9 per cent in March. The rate of increase over periods of twelve months in the prices of imported goods moved downwards from 10,5 per cent in April 1995 to 3,5 per cent in March 1996, while the corresponding increase in the prices of domestically produced goods decelerated from 11,7 to 6,6 per cent over the same period.

The quarter-to-quarter rate of increase in the overall *consumer price index* initially declined just as sharply from a seasonally adjusted and annualised rate of 9,7 per cent in the second quarter of 1995 to 2,2 per cent in the third quarter. Higher rates of increase in the prices of food, alcoholic beverages and tobacco and consumer services then caused this rate of increase in the overall consumer price index to accelerate again to 9,5 per cent in the first quarter of 1996.

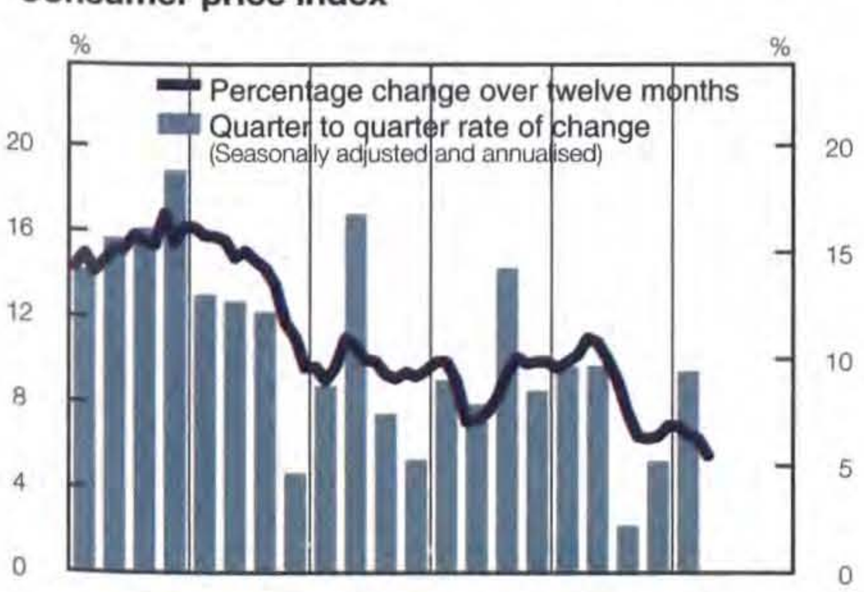
The rate of increase over twelve months in the consumer price index receded from a recent high point of 11,0 per cent in April 1995 to 6,3 per cent in October; it then rose somewhat to 6,9 per cent in December 1995 before declining further to 5,5 per cent in April 1996 – the lowest rate of increase that has been recorded since April 1972. The underlying inflation rate (i.e. the change over twelve months in the overall consumer price index excluding the prices of food and non-alcoholic beverages, home owners' costs and value-added tax) declined persistently from 9,2 per cent in May 1995 to 6,6 per cent in April 1996.

One interesting development recently in the composition of the consumer price index was the sharp divergence between the increases in the prices of consumer goods and the prices of consumer services. While the rates of increase over twelve

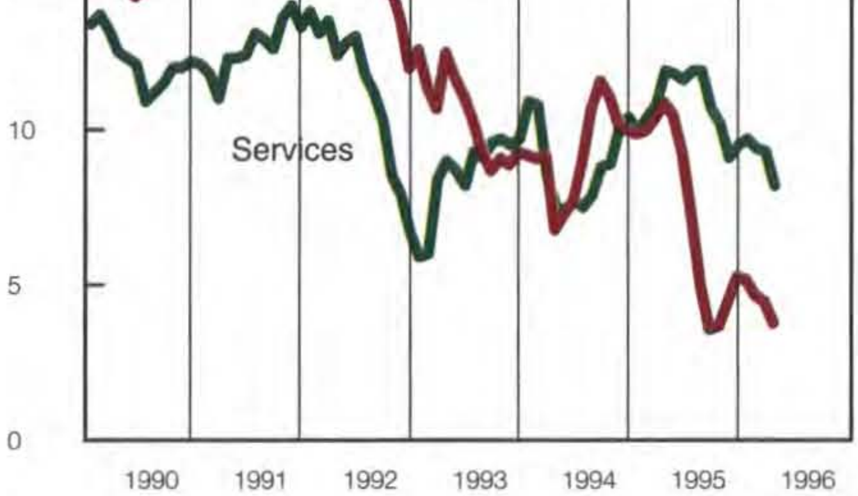
Production price index



Consumer price index



Consumer price index: Goods and services



months in the prices of consumer goods came down sharply from double-digit levels at the beginning of 1995 to 3,8 per cent in April 1996, the rate of increase in the prices of consumer services declined much more moderately over the same period to 8,2 per cent. More in particular, the cost of housing and the prices of transport services continued to increase at relatively high rates in the first four months of 1996. Nearly all the rates of increase in the prices of the main categories of consumer goods declined to the current relatively low levels. The depreciation in the external value of the rand from mid-February 1996 should, however, soon put some upward pressure on the prices of most of the categories of consumer goods and services.

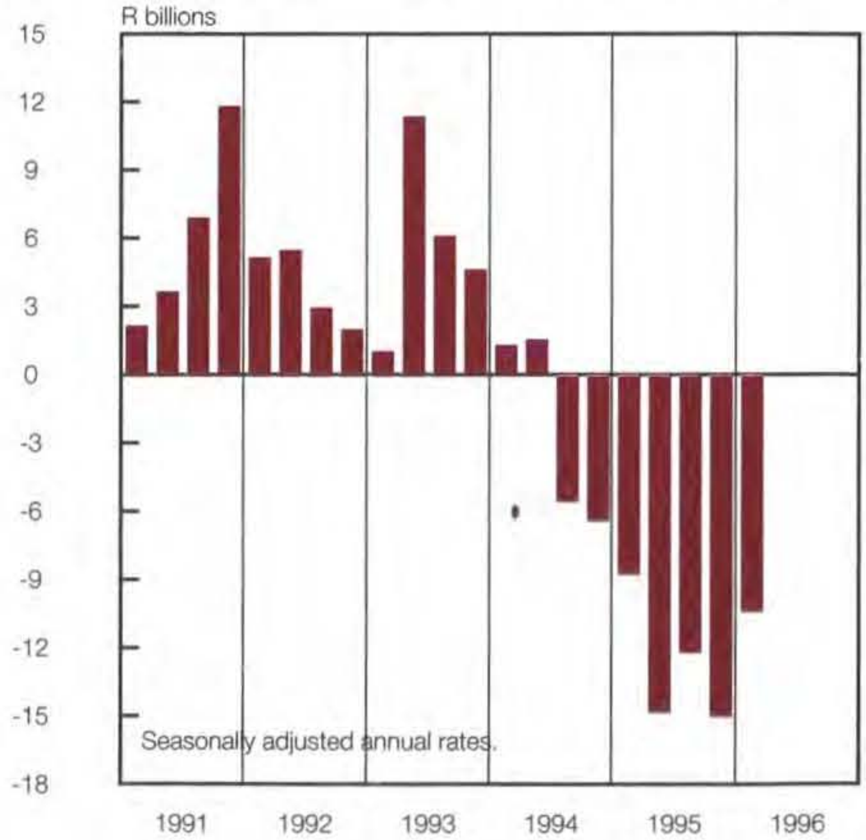
Foreign trade and payments

Current account

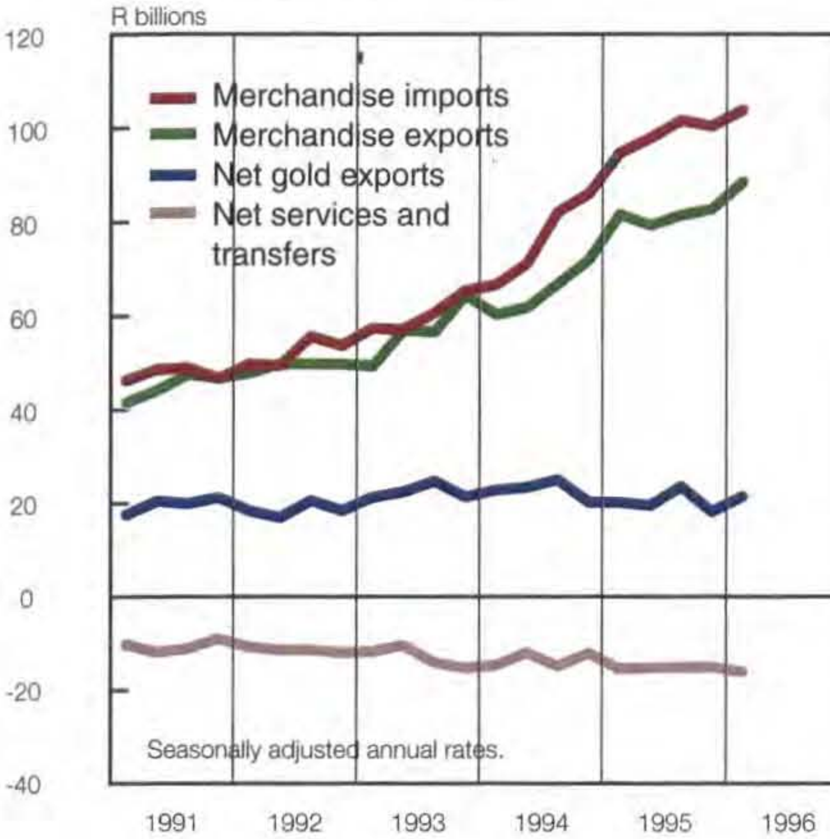
On account of the decrease in gross domestic expenditure, the *deficit on the current account* of the balance of payments receded from R3,0 billion in the fourth quarter of 1995 to R2,3 billion in the first quarter of 1996. Taken at a seasonally adjusted and annualised rate, the current account deficit shrank even more significantly from R15,0 billion to R10,4 billion over the same period, or to 2 per cent of gross domestic product. The lower current account deficit in the first three months of 1996 resulted mainly from a substantial increase in the value of goods and gold exported. This increase in export proceeds was partly offset by a rise in the value of merchandise imports and net service and transfer payments to the rest of the world.

The value of *merchandise exports* (seasonally adjusted and annualised), which had increased steadily from R79,0 billion in the second quarter of 1995 to R82,4 billion in the fourth quarter, rose much more sharply to R88,3 billion in the first quarter of 1996. The rise in exports was mainly due to higher export volumes, which increased by 5½ per cent in the first quarter of 1996. Sharp increases occurred in the exports of agricultural and mining products, particularly in the exports of chrome ore, manganese ore, copper and nickel. On the other hand, the exports of manufactured goods during the first quarter of 1996

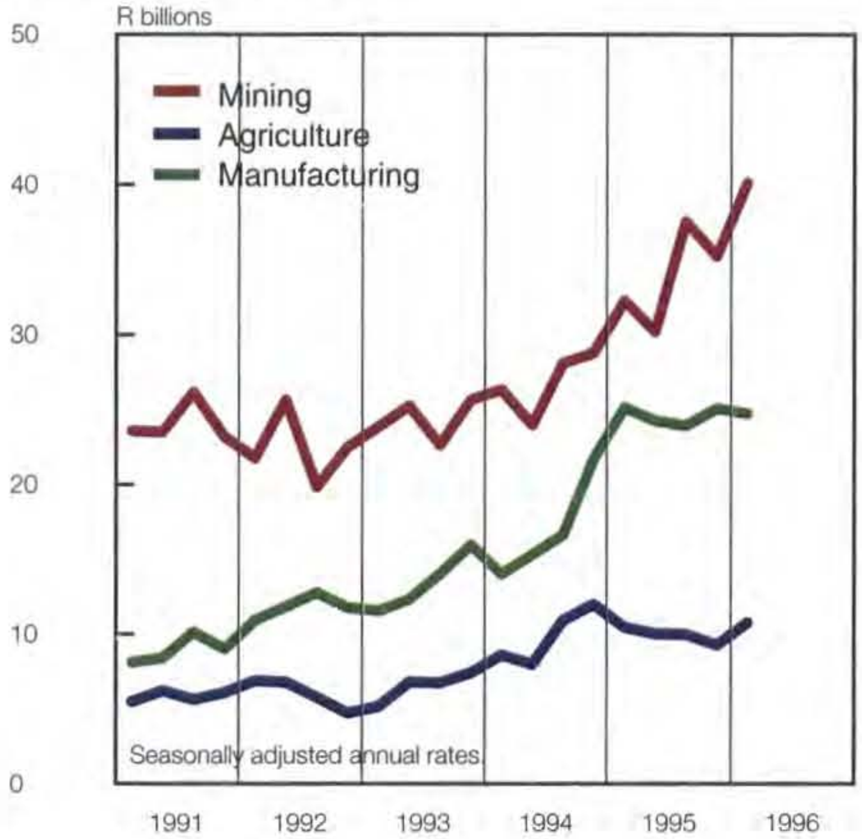
Balance of payments: Current account balance



Current account transactions



Merchandise exports



remained more or less on the level maintained throughout 1995; increases in the exports of machinery and electrical equipment were fully neutralised by declines in foreign sales of vehicle and transport equipment and paper and paper products. The sideways movement in manufactured exports probably reflected capacity constraints in certain sectors and shifts to the more lucrative domestic market.

Owing to the depreciation in the external value of the rand and slightly higher international commodity prices, export prices rose by 2 per cent from the fourth quarter of 1995 to the first quarter of 1996. Future export earnings expressed in rand will probably be affected to a greater extent by the lower level of the exchange rate of the rand.

The seasonally adjusted and annualised value of South Africa's *net gold exports,* which had declined from R23,3 billion in the third quarter of 1995 to R18,0 billion in the fourth quarter, rose again to R21,2 billion in the first quarter of 1996. A higher volume of gold exports was mainly responsible for this increase. In addition, the gold price per fine ounce on the London market rose from an average of R1 408 in the fourth quarter of 1995 to R1 509 in the first quarter of 1996.

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

	1995				1996
	1st qr	2nd qr	3rd qr	4th qr	1st qr
Merchandise exports	81,4	79,0	81,2	82,4	88,3
Net gold exports	20,0	19,3	23,3	18,0	21,2
Merchandise imports	-94,5	-97,7	-101,4	-100,2	-103,6
Net service and transfer payments	-15,6	-15,4	-15,3	-15,2	-16,3
Balance on current account	**-8,7**	**-14,8**	**-12,2**	**-15,0**	**-10,4**

The price of gold advanced further to R1 715 per fine ounce in May 1996 owing to the depreciation of the rand against the dollar. In dollar terms, the average fixing price of gold per fine ounce rose from $385 in the fourth quarter of 1995 to $400 in the first quarter of 1996, before falling to $392 in May 1996.

Despite the decline in domestic final demand and the relatively high cost of carrying inventories, the volume of *merchandise imports* grew by 2½ per cent in the first quarter of 1996. At the same time, the prices of imported goods rose by only 1 per cent. The value of South Africa's merchandise imports in the first quarter of 1996 was therefore 3½ per cent higher than in the fourth quarter of 1995. Higher imports of manufactured goods (mainly machinery and electrical equipment) and agricultural products were offset to some extent by lower imports of mineral products.

Net *service and transfer payments* to non-residents increased from a seasonally adjusted and annualised value of R15,2 billion in the fourth quarter of 1995 to R16,3 billion in the first quarter of 1996. More in particular, dividend and interest receipts from investments in other countries contracted in the first quarter of 1996, while South African tourists and other travellers spent more money abroad.

Capital account

The large *net inflows of capital* not related to reserves, which have been a characteristic of South Africa's balance of payments since the second half of 1994, dropped from the high amount of R7,4 billion in the fourth quarter of 1995 to a negligibly small amount of only R0,1 billion in the first quarter of 1996. Preliminary indications are that the turbulence in the foreign exchange market in 1996 probably led to an outflow of capital in April and May 1996.

As could be expected with a significant weakening in the external value of the rand, the deterioration of the capital account in the first quarter of 1996 could largely be attributed to a net outflow of *short-term capital,*

Net capital movements (not related to reserves)

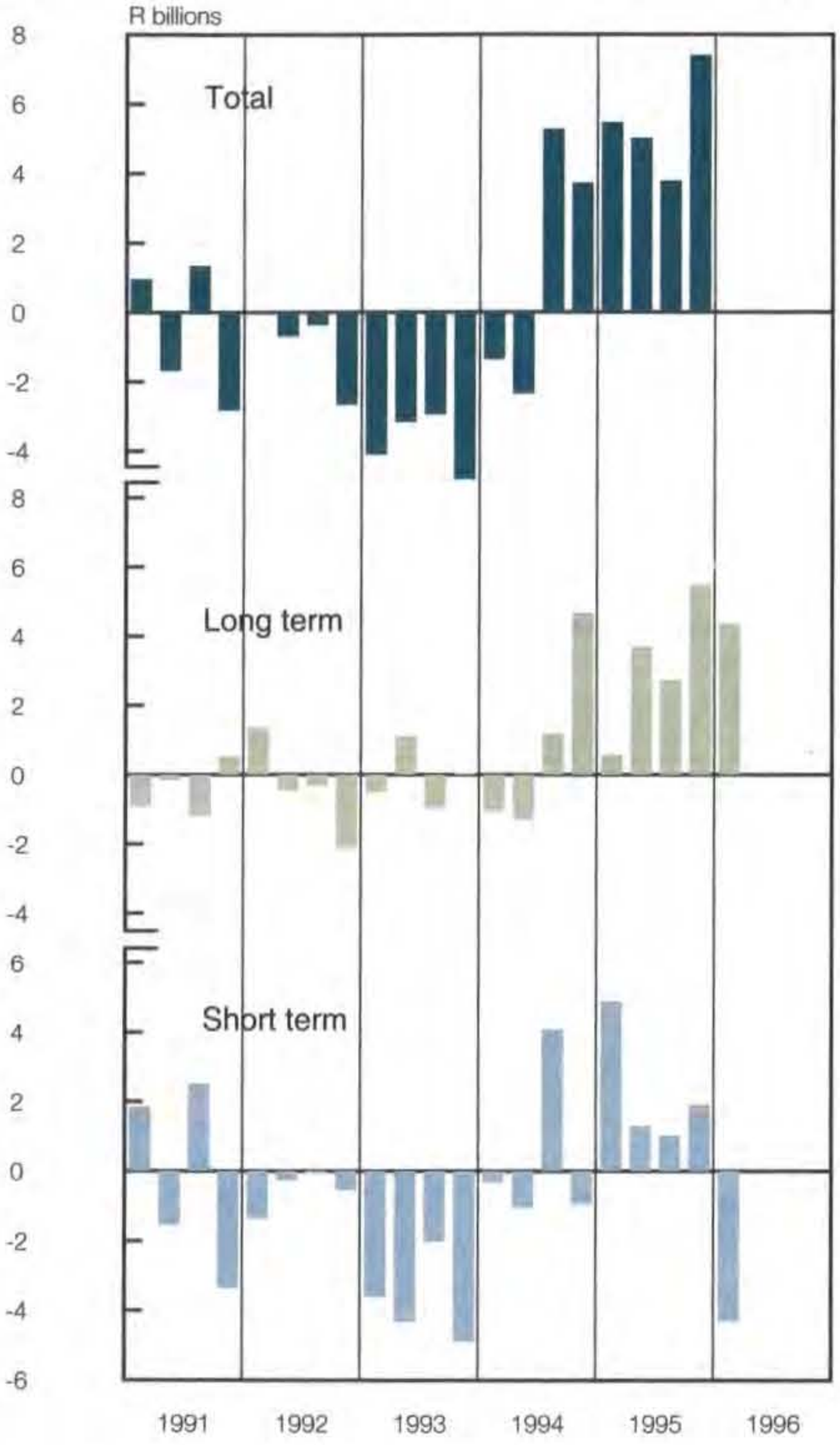


Table 5. Net capital movements not related to reserves
R billions

	1995				1996
	1st qr	2nd qr	3rd qr	4th qr	1st qr
Long-term capital					
Public authorities	-0,1	1,5	-	0,2	1,3
Public corporations	-0,4	-0,2	1,1	1,9	0,9
Private sector	1,0	2,4	1,7	3,4	2,2
Total	**0,5**	**3,7**	**2,8**	**5,5**	**4,4**
Short-term capital	5,0	1,3	1,0	1,9	-4,3
Total capital	**5,5**	**5,0**	**3,8**	**7,4**	**0,1**

including unrecorded transactions. The net outflow of R4,3 billion in short-term capital in the first quarter of 1996 included a decline in the foreign short-term liabilities of banks of R3,8 billion from the exceptionally high level that these liabilities had reached at the end of December 1995. Leads and lags in foreign payments and receipts were also responsible for a decline in trade-related liabilities and an increase in foreign short-term assets.

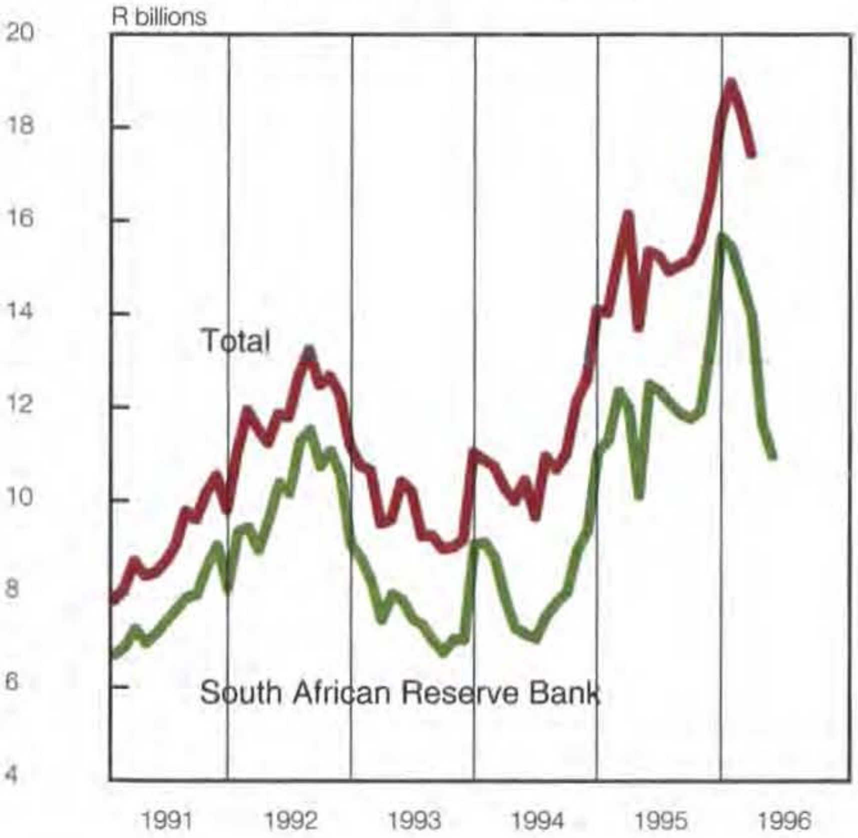
The net inflow of *long-term capital* receded from R5,5 billion in the fourth quarter of 1995 to a still high R4,4 billion in the first quarter of 1996. A decline in the foreign funds raised by international bond issues from R1,8 billion to R0,6 billion over the same period and net repayments on syndicated and other long-term loans of R1,0 billion, caused this decrease in long-term inflows from abroad. Contrary to these developments, the net purchases of South African securities by non-residents more than doubled from R2,2 billion in the fourth quarter of 1995 to R4,7 billion in the first quarter of 1996. During the course of the first quarter of 1996, however, these net purchases dropped from R4,5 billion in the first two months of 1996 to R0,2 billion in March. In April 1996 non-residents became net sellers of South African securities to the value of R1,9 billion, but these net sales soon turned around again and became net purchases to the amount of R1,6 billion in May.

Foreign reserves

South Africa's transactions with the rest of the world led to a large decrease in the country's *net gold and other foreign reserves*. After having increased by R15,4 billion from July 1994 to December 1995, the total net foreign reserves shrank by R2,2 billion in the first quarter of 1996. The net gold and other foreign reserves of the Reserve Bank decreased by a further R4,3 billion in April 1996, before the improvement in the overall balance of payments position resulted in an increase of R0,2 billion in May.

South Africa's total *gross gold and other foreign reserves* fell by R919 million from December 1995 to R17,3 billion at the end of March 1996. The Reserve Bank's gross gold and other foreign reserves declined by R1,7 billion over this period and by a further R3,0 billion in the ensuing two months to reach a level of R11,0 billion at the end of May 1996. Moreover, short-term funds to the value of R920 million were borrowed by the Bank in April 1996 in support of the ailing foreign exchange holdings of the country, and then repaid again in May.

Gross gold and other foreign reserves



Foreign exchange market

The general stability that had prevailed in the *market for foreign exchange* in South Africa during 1995 and the first six weeks of 1996, came to an abrupt end from the middle of February. Owing largely to unfounded rumours at that time, the exchange rates of the rand decreased sharply against all the major currencies. The external value of the rand then stabilised somewhat in March before more fundamental factors started to take effect and caused the rand to tumble once more against all the major currencies in April 1996. In May, conditions on the foreign exchange market became more orderly and the rand actually regained some of its losses of the preceding month.

Reflecting these uncertain conditions, the *net average daily turnover* in the South African foreign exchange market rose from $5,5 billion in January 1996 to $7,3 billion in February, before declining moderately to $6,6 billion in March; it then rose again to an all-time high of $8,2 billion in April and fell back to $6,6 billion in May 1996. The unpredictability of the foreign exchange market was also apparent in the large margins between foreign exchange selling and purchasing rates from the middle of February 1996 and the deviation between the minimum and maximum values of the exchange rate of the rand during the four months up to May 1996.

In view of these disturbances in the foreign exchange market, the Reserve Bank had to change its *intervention policy*. From the middle of February 1996 the Bank became a net seller of foreign exchange in order to ensure that the adjustment of the rand to a lower level would be as smooth as possible. The Reserve Bank's policy of supplying US dollars on a forward basis was also adjusted to take the new circumstances into consideration. In 1995 and the first few weeks of 1996 the Bank reduced its participation in the foreign exchange market fairly rapidly. The Reserve Bank's net foreign currency open position, which at one stage amounted to well over $20 billion,

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

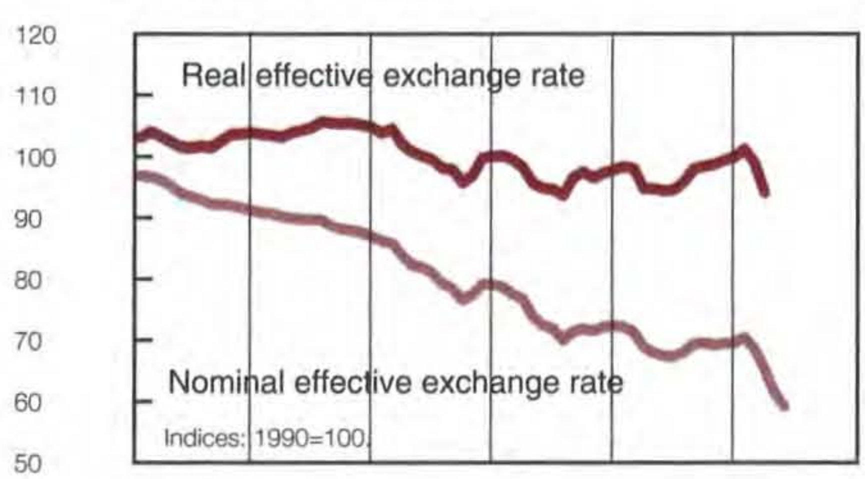
	31 May 1995 to 13 Feb 1996	13 Feb 1996 to 29 Feb 1996	29 Feb 1996 to 27 Mar 1996	27 Mar 1996 to 30 Apr 1996	30 Apr 1996 to 31 May 1996	31 Dec 1995 to 31 May 1996
Weighted average	5,5	-5,4	-2,4	-9,4	0,6	-15,1
US dollar	0,5	-5,2	-2,9	-9,7	0,5	-16,4
British pound	5,4	-5,3	-2,2	-8,9	-1,4	-15,8
German mark	6,5	-5,6	-1,9	-7,1	1,0	-10,7
Japanese yen	29,2	-7,2	-1,1	-11,6	4,5	-11,9
Netherlands guilder	6,5	-5,6	-2,0	-7,1	1,0	-10,7
Italian lira	-2,3	-6,5	-1,4	-10,1	-0,6	-18,3

was therefore reduced to $8,1 billion at the end of February 1996. It then rose again to $13,5 billion at the end of May 1996.

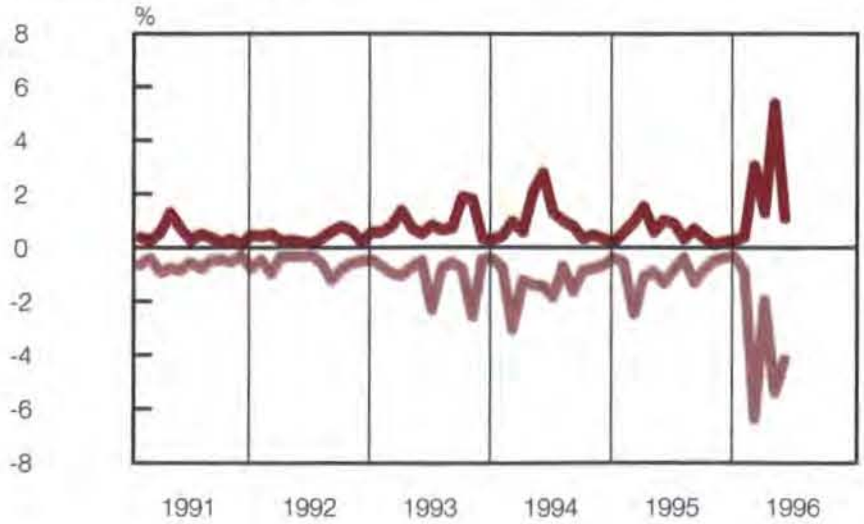
As a result of these conditions in the foreign exchange market, the increase of 5,5 per cent in the *nominal effective exchange rate* of the rand from the end of May 1995 to 13 February 1996 was followed by a nearly equal decline of 5,4 per cent in the last two weeks of February 1996. The weighted value of the rand then decreased by only 2,4 per cent in March, before it dropped by 9,4 per cent from late March to the end of April 1996. This brought the net decrease of the rand in nominal terms to 16,1 per cent from the middle of February 1996 to the end of April 1996. In May the somewhat calmer conditions led to an actual increase of 0,6 per cent in the weighted value of the rand up to the end of the month.

The *real effective exchange rate* of the rand, which had increased by 7,2 per cent from the end of May 1995 to the end of January 1996, contracted by 7,0 per cent in the next two months. The level of the real effective exchange rate at the end of March 1996 was accordingly already near the lower turning-point of the preceding year, i.e. before the sharp depreciation of the rand in April 1996.

Exchange rates of the rand



Nominal effective exchange rate of the rand (minimum and maximum deviation from the monthly average)

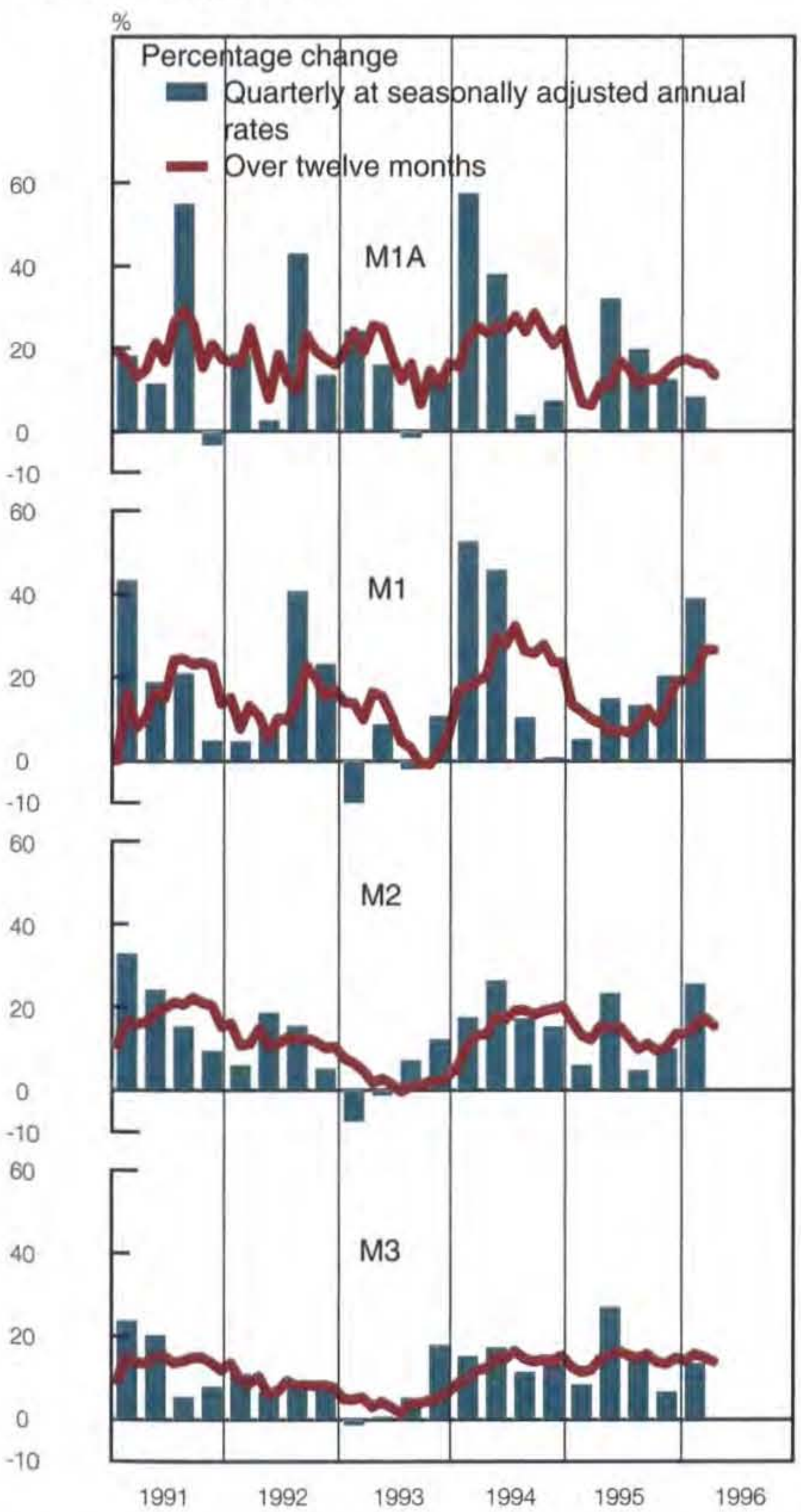


Monetary developments, interest rates and financial markets

Money supply

The firm expansion in economic activity in the first quarter of 1996 was accompanied by a reacceleration in the growth of money supply. The growth rate over twelve months in the broadly defined money supply (M3), which had shown a distinct downward movement from a peak of 16,8 per cent in June 1995 to 13,8 per cent in November, rose again to 15,2 per cent in December and fluctuated around this higher level in the first three months of 1996. Provisional estimates for April 1996, show a slight decline in this growth rate to 14,4 per cent. The vigorous growth in the money supply was reflected even more clearly in the quarterly growth rates of this monetary aggregate. After having receded sharply from 27,3 per cent in the second quarter of 1995 to only 6,9 per cent in the fourth quarter, the quarter-to-quarter rate of increase in M3, at a seasonally adjusted and annualised rate, rose again to 13,7 per cent in the first quarter of 1996.

Monetary aggregates



Although this more rapid growth in the money supply was primarily related to growth in domestic expenditure and income, the private sector's preference for depository-type investments intensified during the first quarter of 1996. Expected changes in interest rates and major adjustments in the share and bond markets encouraged private entities to shift their funds to overnight, other short- and medium-term deposits. The deposits of insurers and pension funds with banks, in particular, increased by R7,4 billion in the first quarter of 1996, indicating these institutions' high liquidity preference. Despite relatively attractive interest rates offered by banks on longer-term deposits, the amount of these deposits actually contracted during this quarter. Cheque and transmission deposits also declined.

In view of these changes in the structure of deposits, the rates of increase in the *narrower monetary aggregates,* with the exception of M1A, rose more rapidly from lower to higher levels than those in M3. The rate of increase in M1 and M2 had already begun to accelerate from the fourth quarter of 1995, i.e. before M3 reacted. The twelve-month growth rate of M1, in particular, rose steeply from only 9,7 per cent in October 1995 to 27,0 per cent in March 1996 because of the substantial increase in call deposits. In contrast to these developments, the rate of increase over twelve months in M1A showed a slight downward movement in the first three months of 1996, while the quarter-to-quarter growth in this aggregate, at seasonally adjusted and annualised rates, fell from 32,3 per cent in the second quarter of 1995 to 8,5 per cent in the first quarter of 1996.

The *main counterparts* (in a statistical or accounting sense) of the increase in the money supply were increases in monetary institutions' claims on the private sector and net foreign assets. Monetary institutions' net claims on the private sector rose by no less than R14,2 billion in the first quarter of 1996. A sharp increase in government deposits with banks, however, led to a decrease of R2,6 billion in the monetary institutions' net claims on the government sector.

Money supply guidelines for 1996

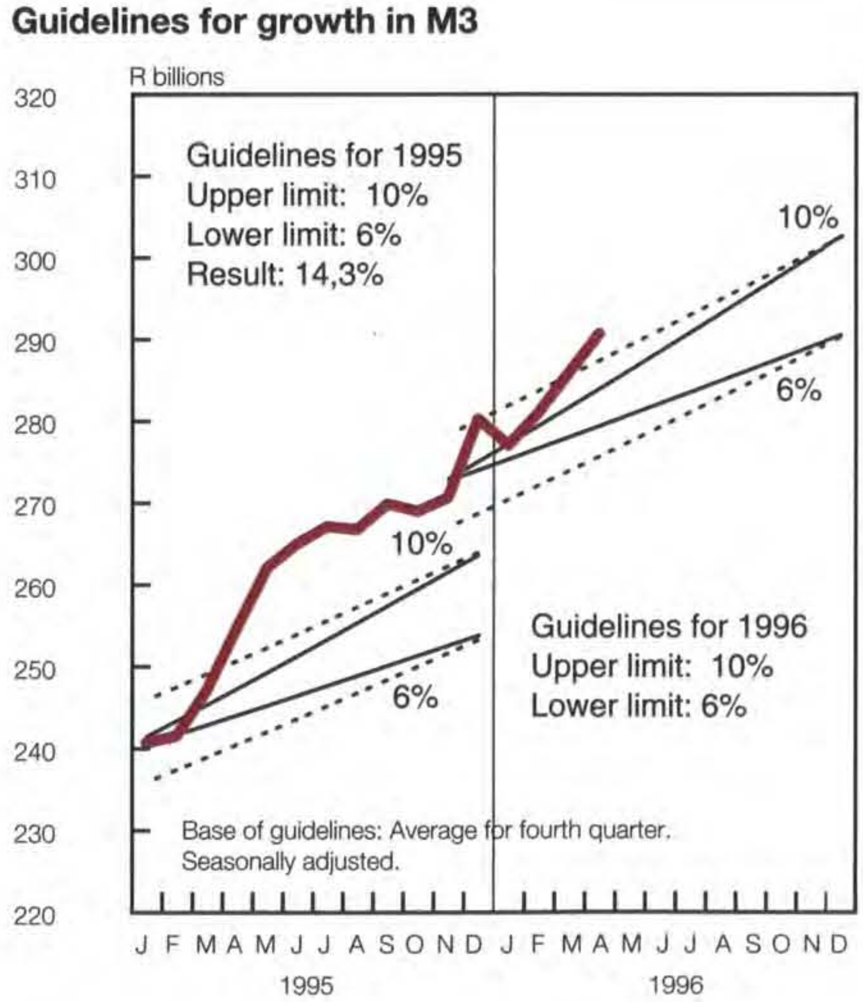
In accordance with the objective of monetary policy in South Africa to protect the value of the currency, the Governor of the Reserve Bank announced on 24 April

1996 that the monetary authority had decided to retain guidelines for an appropriate rate of growth in the M3 money supply at the level of 6 to 10 per cent from the fourth quarter of 1995 to the fourth quarter of 1996. This decision was taken after due consideration of the recent financial developments, the disturbing events in the foreign exchange market and the danger that prices might increase more rapidly because of the sharp depreciation of the rand from the middle of February to early May 1996.

In the statement issued by the Governor of the Reserve Bank on the money supply guidelines for 1996, it was reiterated that the guidelines should not be interpreted as a forecast for 1996 or as representing targets that must be achieved at all cost. The guidelines merely contribute to greater transparency in monetary policy and provide an indicator of the Reserve Bank's monetary policy stance. Persistent growth in excess of the upper limit will accordingly prompt a more restrictive monetary policy approach by the Bank.

The rapid growth in the money supply in the first three months of 1996 caused the seasonally adjusted values of M3 to exceed the upper limits of the new guideline "tunnel" in March 1996. At the end of this month the seasonally adjusted value of M3 was R1,2 billion, or 0,4 per cent above the upper limit of the so-called "tunnel".

Guidelines for growth in M3



Credit extension

Credit extension by monetary institutions kept on accelerating during the first quarter of 1996. After having receded from a peak of 24,2 per cent in May 1994 to a low of 11,0 per cent in October 1995, the rate of increase over twelve months in *total domestic credit extension* by monetary institutions rose to 14,2 per cent in March 1996. This more rapid growth could mainly be attributed to credit obtained by private entities. Net claims on the government sector, however, expanded sharply in March 1996 as a result of a decline in government deposits and the issue of stock to the Reserve Bank in settlement of the outstanding balance on the Gold and Foreign Exchange Contingency Reserve Account. The issue of this stock to the Bank did not, of course, lead to a rise in money supply because of an offsetting decline in so-called "net other assets" of the monetary institutions.

The twelve-month rate of increase in credit extension by the monetary institutions to the *private sector* abated from 19,5 per cent in June 1995 to 17,6 per cent in December, and then fluctuated around this still high level in the first four months of 1996. These monthly growth rates were considerably higher than the rate of inflation as measured by changes in the consumer price index, and the rate of increase in real credit extension to the private sector amounted to as much as 11,5 per cent over the twelve months to March 1996. Moreover, the quarter-to-quarter annualised growth in credit extension to the private

Credit extension to the private sector

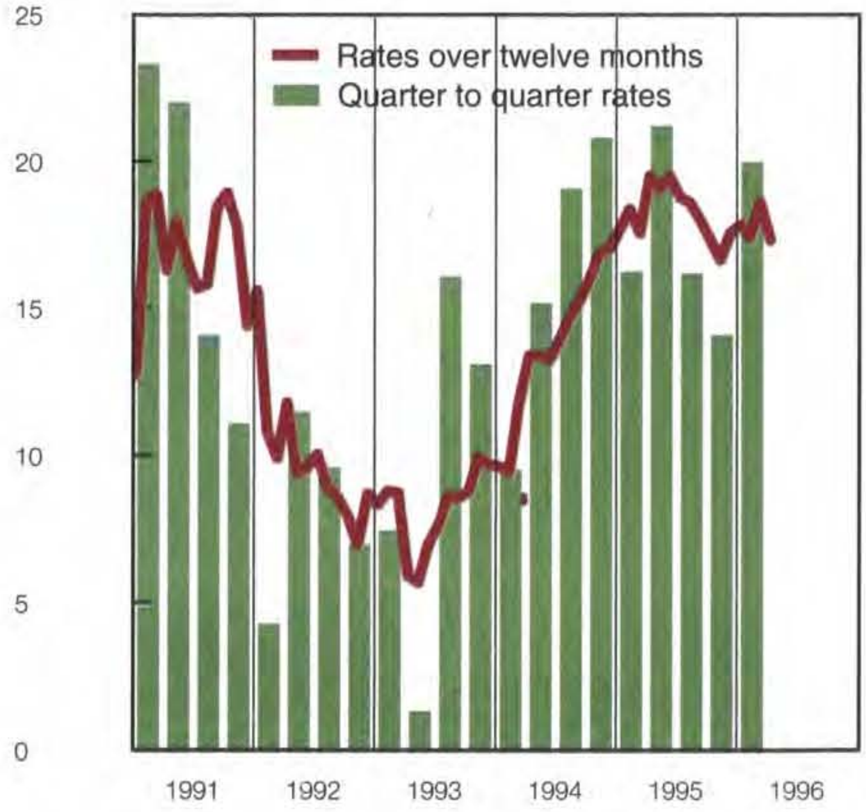


Table 7. Twelve-month rate of increase in domestic credit extension to the private sector by type of credit

Per cent

Period	Investments and bills discounted	Instalment sales	Leasing finance	Mortgages	Other loans and advances	Total
1995: June	27,0	27,8	13,8	19,5	16,7	19,5
Sep	4,1	28,1	17,8	18,9	16,6	18,0
Dec	11,3	27,3	16,6	17,7	15,8	17,6
1996: Jan	17,2	30,7	18,8	17,1	14,7	17,8
Feb	10,0	30,0	18,0	16,7	15,7	17,4
Mar	18,4	28,8	17,5	16,7	18,0	18,6

sector rose from 14,1 per cent in the fourth quarter of 1995 to 20,0 per cent in the first quarter of 1996.

An analysis of monetary institutions' claims on the private sector by *type of credit* shows that the higher rates of increase in credit extension to the private sector were mainly caused by a more rapid growth in instalment-sales credit and "other loans and advances" (including overdrafts). The growth in these forms of credit advanced rapidly because of a persistently strong demand for consumer durables and a switch from foreign to domestic financing of trade transactions in view of the unstable external value of the rand. In addition, leasing finance in the first quarter of 1996 increased at a higher rate than in the preceding year, despite the poor performance in the sales of new motor vehicles, while the growth in mortgage advances remained high.

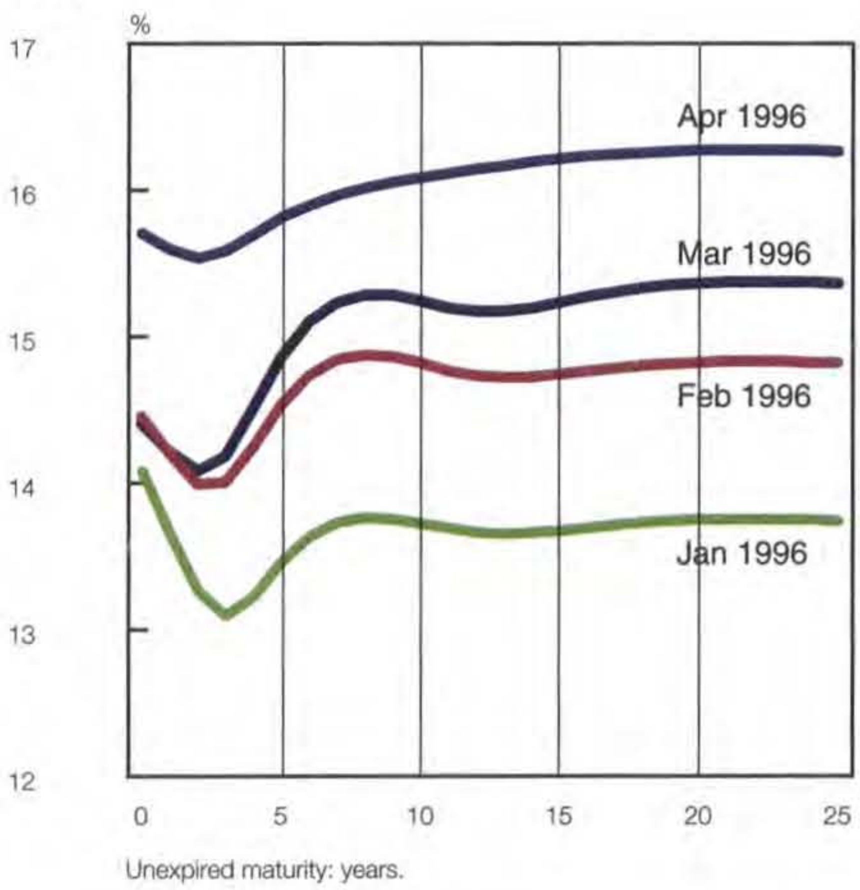
In absolute terms, credit extension by monetary institutions to the private sector during the first quarter of 1996 was dominated by mortgage advances and "other loans and advances". These two credit instruments contributed R11,5 billion, or approximately 81 per cent, to the total increase of R14,2 billion in credit extension to the private sector. By far the largest part of the credit was extended to households, indicating that it was utilised to finance consumption expenditure.

Interest rates and yields

Interest rates and yields moved sharply upwards from February 1996 and the shape of the *yield curve* changed considerably in reaction to the uncertain conditions in the foreign exchange market. After having moved downwards and becoming flat to slightly inverted in the eight months up to January 1996, the yield curve rose sharply when the rand started to depreciate from mid-February 1996. Owing to sharper increases in long-term yields than in shorter-term yields, the slope of the yield curve steepened considerably during February and March 1996. The increase in Bank rate on 29 April 1996 led to correspondingly sharp increases in short-term yields, while having comparatively little effect on long-term yields. At the end of April 1996 the yield curve was therefore not only substantially higher than in January 1996, but also flatter.

Besides the developments in the foreign exchange market, the upward adjustment in the yields on *domestic long-term government stock* was particularly influenced by the sharply higher bond yields in the United States. These two factors brought about a reversal in the downward movement in the monthly average yield on long-term government stock from a low of 13,77 per cent in January 1996 to 15,78 per

Yield curves



cent in April. The rate on these stocks then reached a high of 16,84 per cent on 9 May 1996, before declining to 16,29 per cent on 31 May 1996. The monthly average real yield on long-term government stock receded from 8,6 per cent in September 1995 to 6,4 per cent in January 1996, and then rose to 9,7 per cent in April.

Money market interest rates softened somewhat in January and February 1996 before picking up in March and rising in delayed reaction to the volatility in other financial markets in April and May 1996. *The rate on bankers' acceptances with a maturity of three months,* for instance, receded from 14,60 per cent at the end of December 1995 to 14,05 per cent at the end of February 1996; it then rose to 14,20 per cent at the end of March 1996 and much more sharply to 15,20 and 16,40 per cent at the end of the next two months.

In order to restore some stability in the foreign exchange market, the Reserve Bank raised *Bank rate* from 15,0 to 16,0 per cent on 29 April 1996. The *prime rate on overdrafts* and the predominant *rate on mortgage loans* of banks followed the increase in Bank rate and were both increased by one percentage point to 19,50 per cent on 29 April 1996 and to 19,25 per cent as from May 1996. Although Bank rate then remained unchanged, the prime rate on overdrafts and the predominant rate on mortgage loans were adjusted further to 20,50 per cent on 20 May 1996 and 20,25 per cent as from June 1996. In addition, the predominant retail *rate on twelve-month fixed deposits* of banks was adjusted upwards by 1,0 percentage point to 14,50 per cent from May 1996.

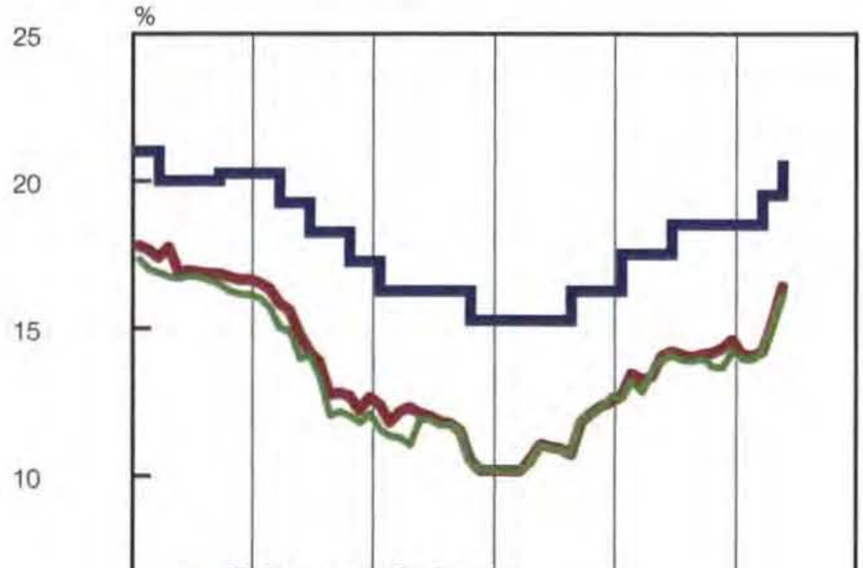
Other long-term rates were also affected by these developments. The standard interest rate applicable to loans granted by the State Revenue Fund (Exchequer Act, Act No. 66 of 1975), for example, was lowered in two steps from 14,75 per cent in January 1996 to 13,75 per cent from 1 March 1996; it was then increased again in three steps to 16,50 per cent with effect from 1 June 1996. In contrast to these developments, the maximum permissible finance charge rates, as laid down in terms of the Usury Act, have remained unchanged since September 1995 at 28 per cent in respect of money lending, credit and leasing transactions for amounts of more than R6 000 but less than R500 000, and at 31 per cent in respect of amounts up to R6 000.

Money market

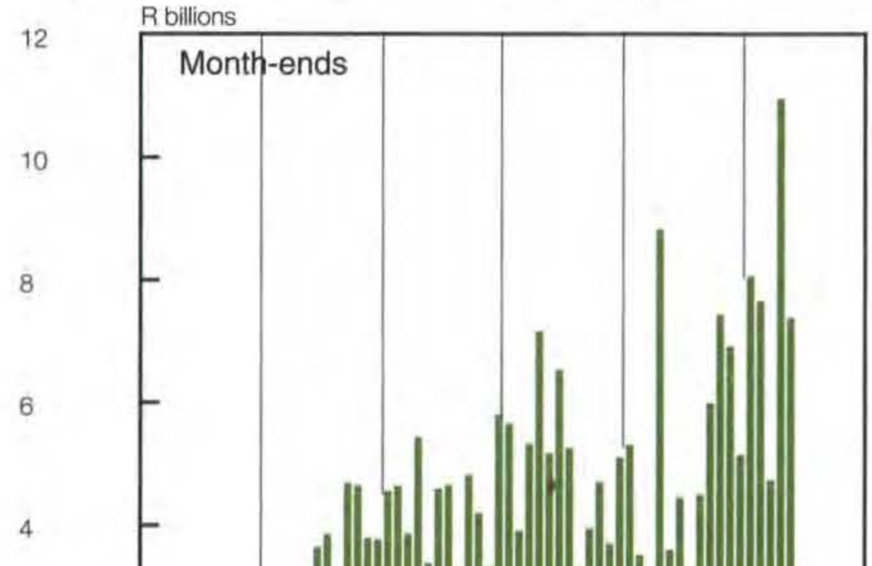
Money market conditions, which had generally tightened considerably in the last five months of 1995, became even tighter in the first five months of 1996. This was clearly reflected in the amount of accommodation which the Reserve Bank provided to banks. This so-called money market shortage increased from R5,1 billion at the end of December 1995 to R8,0 billion at the end of January 1996 and R7,6 billion at the end of February; it then contracted again to R4,7 billion at the end of March, before rising to a record level of R10,9 billion at the end of April 1996. In May 1996 the accommodation of the Reserve Bank to the banks subsided to a still high level of R7,4 billion at the end of that month.

These tight conditions in the money market were primarily related to a decrease in the net foreign assets

Short-term interest rates



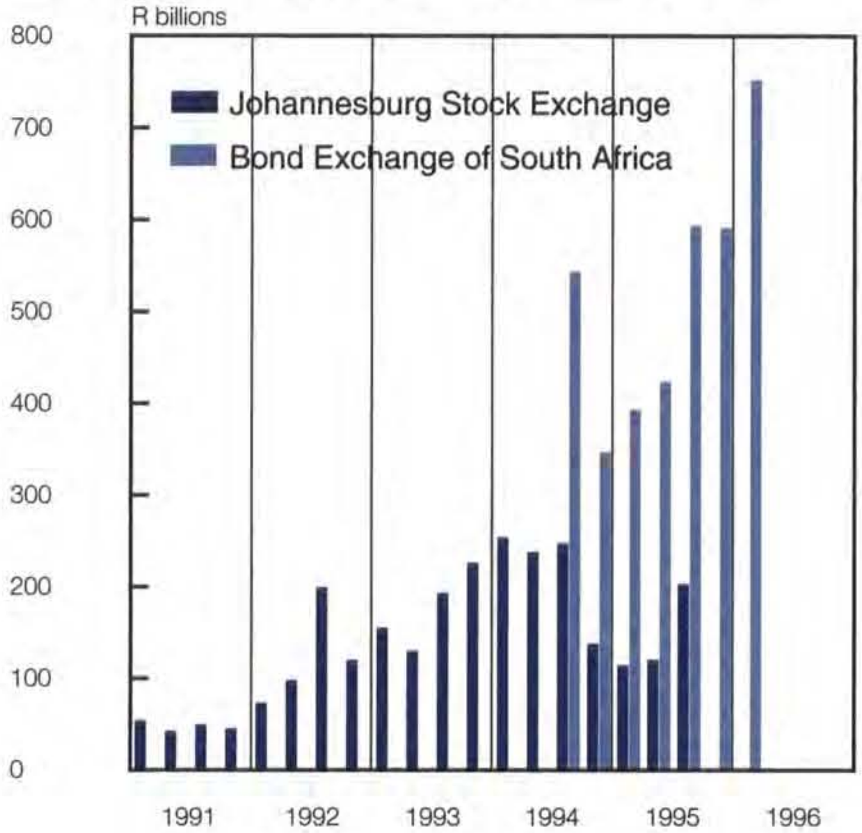
Accommodation at the discount window



of the Reserve Bank. In the first quarter of 1996 this tightening effect was partly countered by a decline in banknotes and coin in circulation outside the Reserve Bank, but in April the banknotes and coin in circulation increased again sharply. A rise of R2,9 billion in government deposits with the Reserve Bank contributed further to the very tight money market conditions in that month. In May both government deposits with the Reserve Bank and banknotes and coin in circulation outside the Bank declined somewhat.

The *Reserve Bank's operations* in the money market during the first three months of 1996 were generally neutral and aimed at maintaining liquidity. Transfers of government deposits between the Exchequer account with the Reserve Bank and the government's tax and loan accounts with banks were, however, used to regulate the money market shortage. With the subsequent sharp depreciation of the rand from the end of March 1996, the Bank at first drained liquidity through large net sales of government stock and by allowing government deposits with the Reserve Bank to increase with the proceeds of these sales. Later the Reserve Bank took up R640 million of the R1 000 million Treasury bills on offer at the tender of 10 May 1996 to inject some liquidity and provide more orderly conditions in a market characterised by great uncertainty.

Transactions in securities of the public sector



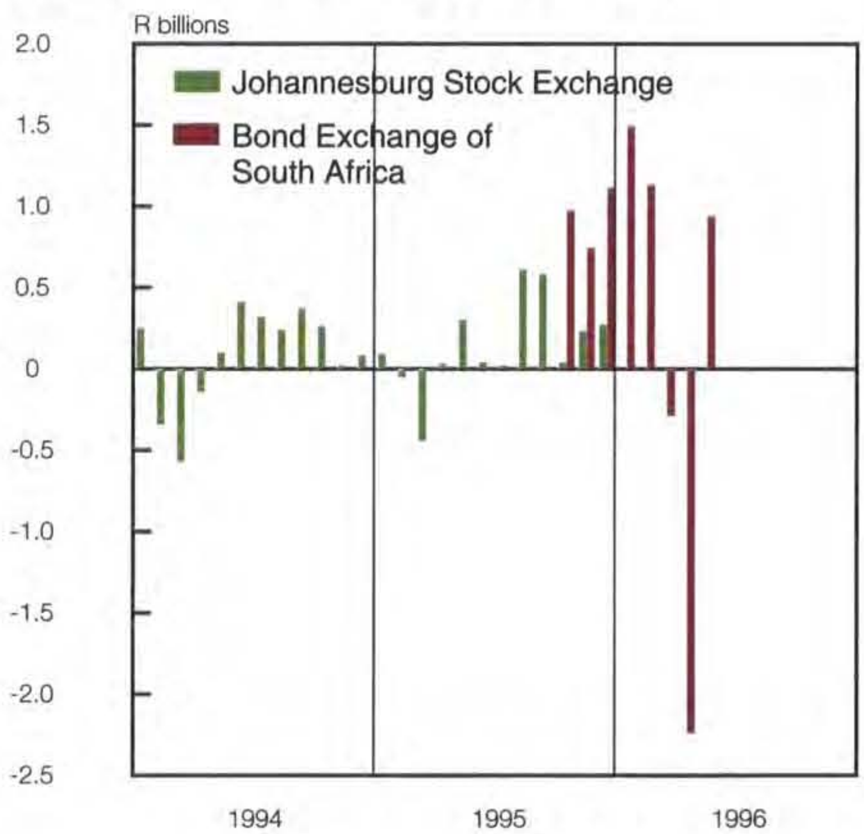
Bond market

Net new issues of fixed-interest securities in the domestic *primary bond market* by entities in the *public sector,* which had contracted from levels of R9,5 billion and R10,0 billion in the second and third quarter of 1995 to R1,5 billion in the fourth quarter, rose again to R8,4 billion in the first quarter of 1996. The net new issues of public-sector stock in fiscal 1995/96 therefore totalled R29,5 billion; in the preceding year these issues had amounted to R22,6 billion.

Funds acquired by listed companies in the private sector through new issues of fixed-interest securities in the primary market, remained low. These issues on the Johannesburg Stock Exchange came to R932 million in 1995, and no such issues were made during the first quarter of 1996. In contrast with 1995, no funds were raised by the private sector in foreign capital markets by means of convertible bonds in the first quarter of 1996.

Activity in the *secondary bond market* increased substantially in the first quarter of 1996 as yields fluctuated widely before ending at new heights in the aftermath of the weakening of the exchange rate of the rand. This was exacerbated by a marked shift in sentiment in international bond markets, uncertainty on the political front and unrest in the labour market. The value of public-sector stock traded on the bond market, as published by the Bond Exchange of South Africa, increased from R595 billion and R592 billion in the last two quarters of 1995 to no less than R753 billion in the first quarter of 1996 owing to a turnover of R301 billion in February 1996. In April 1996 the value of public-sector stock traded amounted to R247 billion; this was slightly lower than the monthly average of R251 billion in the first quarter of 1996.

Non-residents' net transactions in gilts



cent in April. The rate on these stocks then reached a high of 16,84 per cent on 9 May 1996, before declining to 16,29 per cent on 31 May 1996. The monthly average real yield on long-term government stock receded from 8,6 per cent in September 1995 to 6,4 per cent in January 1996, and then rose to 9,7 per cent in April.

Money market interest rates softened somewhat in January and February 1996 before picking up in March and rising in delayed reaction to the volatility in other financial markets in April and May 1996. *The rate on bankers' acceptances with a maturity of three months,* for instance, receded from 14,60 per cent at the end of December 1995 to 14,05 per cent at the end of February 1996; it then rose to 14,20 per cent at the end of March 1996 and much more sharply to 15,20 and 16,40 per cent at the end of the next two months.

In order to restore some stability in the foreign exchange market, the Reserve Bank raised *Bank rate* from 15,0 to 16,0 per cent on 29 April 1996. The *prime rate on overdrafts* and the predominant *rate on mortgage loans* of banks followed the increase in Bank rate and were both increased by one percentage point to 19,50 per cent on 29 April 1996 and to 19,25 per cent as from May 1996. Although Bank rate then remained unchanged, the prime rate on overdrafts and the predominant rate on mortgage loans were adjusted further to 20,50 per cent on 20 May 1996 and 20,25 per cent as from June 1996. In addition, the predominant retail *rate on twelve-month fixed deposits* of banks was adjusted upwards by 1,0 percentage point to 14,50 per cent from May 1996.

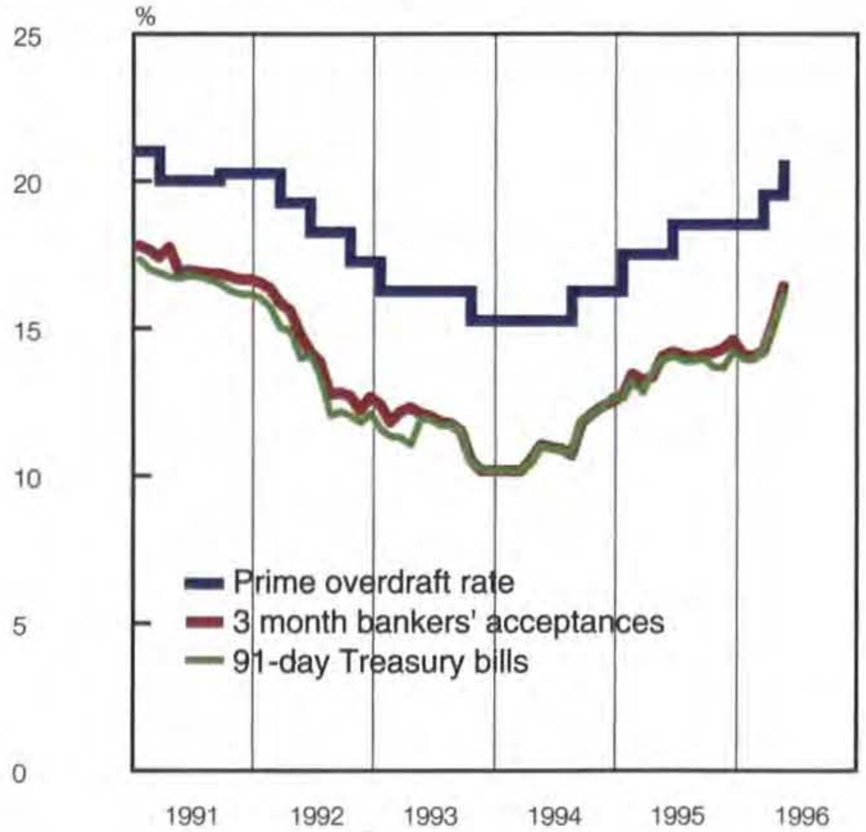
Other long-term rates were also affected by these developments. The standard interest rate applicable to loans granted by the State Revenue Fund (Exchequer Act, Act No. 66 of 1975), for example, was lowered in two steps from 14,75 per cent in January 1996 to 13,75 per cent from 1 March 1996; it was then increased again in three steps to 16,50 per cent with effect from 1 June 1996. In contrast to these developments, the maximum permissible finance charge rates, as laid down in terms of the Usury Act, have remained unchanged since September 1995 at 28 per cent in respect of money lending, credit and leasing transactions for amounts of more than R6 000 but less than R500 000, and at 31 per cent in respect of amounts up to R6 000.

Money market

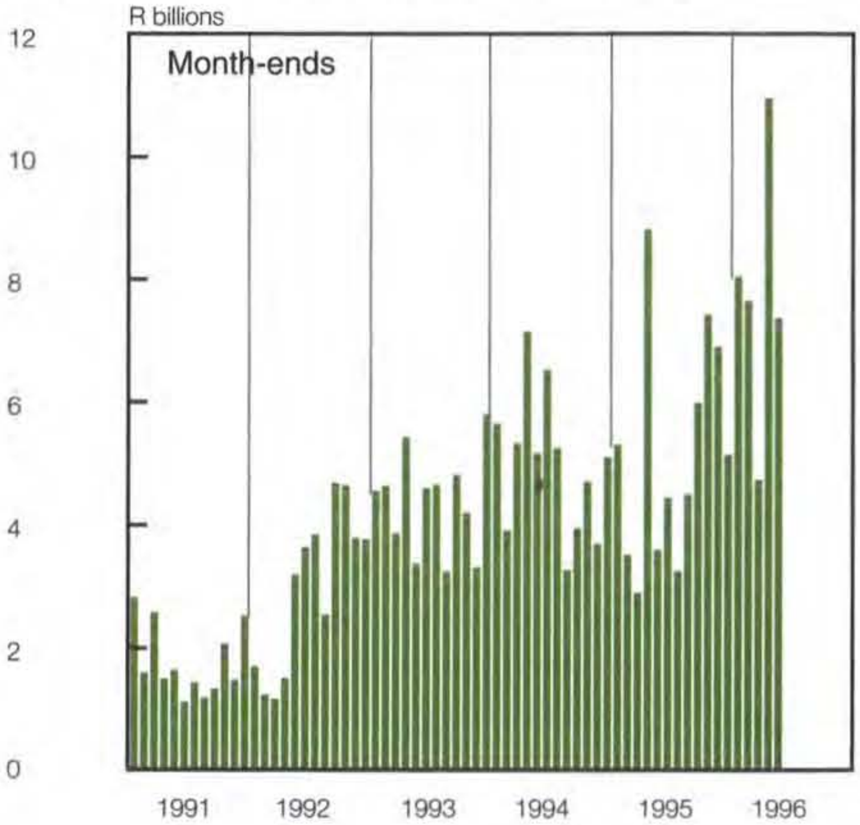
Money market conditions, which had generally tightened considerably in the last five months of 1995, became even tighter in the first five months of 1996. This was clearly reflected in the amount of accommodation which the Reserve Bank provided to banks. This so-called money market shortage increased from R5,1 billion at the end of December 1995 to R8,0 billion at the end of January 1996 and R7,6 billion at the end of February; it then contracted again to R4,7 billion at the end of March, before rising to a record level of R10,9 billion at the end of April 1996. In May 1996 the accommodation of the Reserve Bank to the banks subsided to a still high level of R7,4 billion at the end of that month.

These tight conditions in the money market were primarily related to a decrease in the net foreign assets

Short-term interest rates



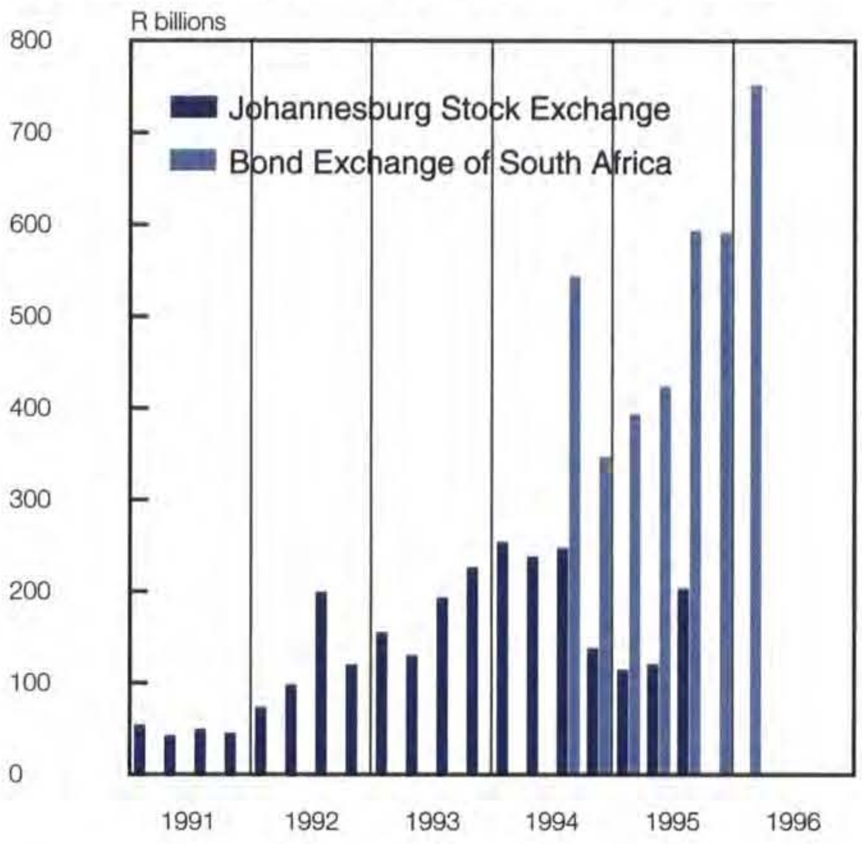
Accommodation at the discount window



of the Reserve Bank. In the first quarter of 1996 this tightening effect was partly countered by a decline in banknotes and coin in circulation outside the Reserve Bank, but in April the banknotes and coin in circulation increased again sharply. A rise of R2,9 billion in government deposits with the Reserve Bank contributed further to the very tight money market conditions in that month. In May both government deposits with the Reserve Bank and banknotes and coin in circulation outside the Bank declined somewhat.

The *Reserve Bank's operations* in the money market during the first three months of 1996 were generally neutral and aimed at maintaining liquidity. Transfers of government deposits between the Exchequer account with the Reserve Bank and the government's tax and loan accounts with banks were, however, used to regulate the money market shortage. With the subsequent sharp depreciation of the rand from the end of March 1996, the Bank at first drained liquidity through large net sales of government stock and by allowing government deposits with the Reserve Bank to increase with the proceeds of these sales. Later the Reserve Bank took up R640 million of the R1 000 million Treasury bills on offer at the tender of 10 May 1996 to inject some liquidity and provide more orderly conditions in a market characterised by great uncertainty.

Transactions in securities of the public sector



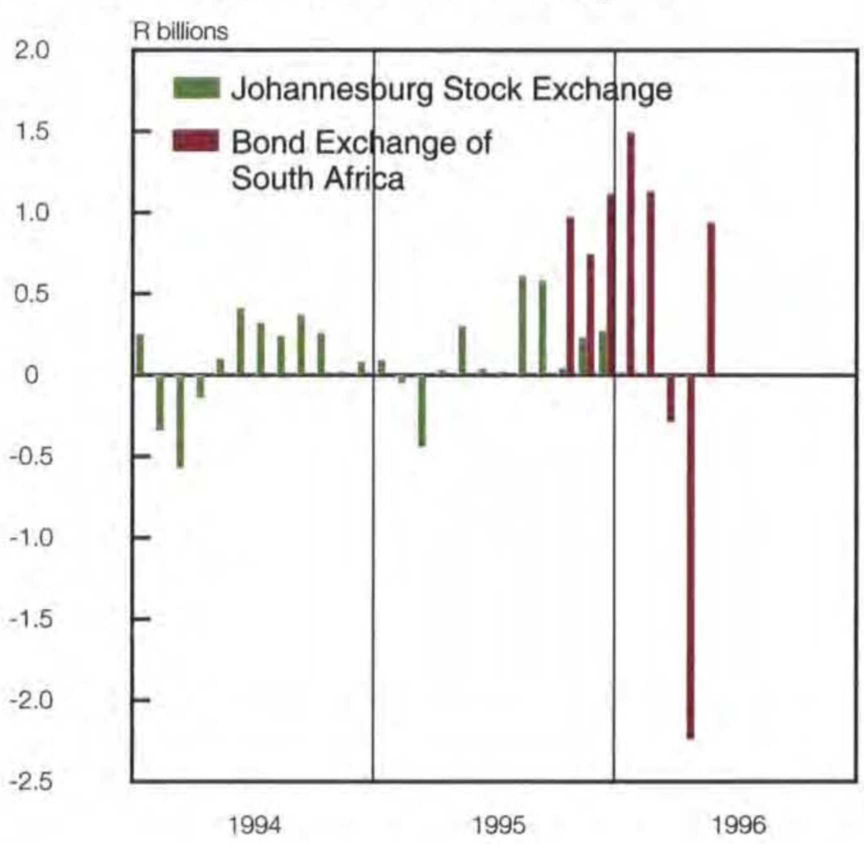
Bond market

Net new issues of fixed-interest securities in the domestic *primary bond market* by entities in the *public sector,* which had contracted from levels of R9,5 billion and R10,0 billion in the second and third quarter of 1995 to R1,5 billion in the fourth quarter, rose again to R8,4 billion in the first quarter of 1996. The net new issues of public-sector stock in fiscal 1995/96 therefore totalled R29,5 billion; in the preceding year these issues had amounted to R22,6 billion.

Funds acquired by listed companies in the private sector through new issues of fixed-interest securities in the primary market, remained low. These issues on the Johannesburg Stock Exchange came to R932 million in 1995, and no such issues were made during the first quarter of 1996. In contrast with 1995, no funds were raised by the private sector in foreign capital markets by means of convertible bonds in the first quarter of 1996.

Activity in the *secondary bond market* increased substantially in the first quarter of 1996 as yields fluctuated widely before ending at new heights in the aftermath of the weakening of the exchange rate of the rand. This was exacerbated by a marked shift in sentiment in international bond markets, uncertainty on the political front and unrest in the labour market. The value of public-sector stock traded on the bond market, as published by the Bond Exchange of South Africa, increased from R595 billion and R592 billion in the last two quarters of 1995 to no less than R753 billion in the first quarter of 1996 owing to a turnover of R301 billion in February 1996. In April 1996 the value of public-sector stock traded amounted to R247 billion; this was slightly lower than the monthly average of R251 billion in the first quarter of 1996.

Non-residents' net transactions in gilts



Non-residents were actively involved in the secondary bond market in the first two months of 1996 and their net purchases came to the exceptionally large amount of R2,6 billion. However, with the increased uncertainty about the future value of the rand, they then became net sellers in the next two months. These net sales amounted to R0,3 billion in March and R2,2 billion in April 1996. From early May 1996 they reverted again to net purchases when somewhat calmer conditions became apparent in the foreign exchange market.

Equity market

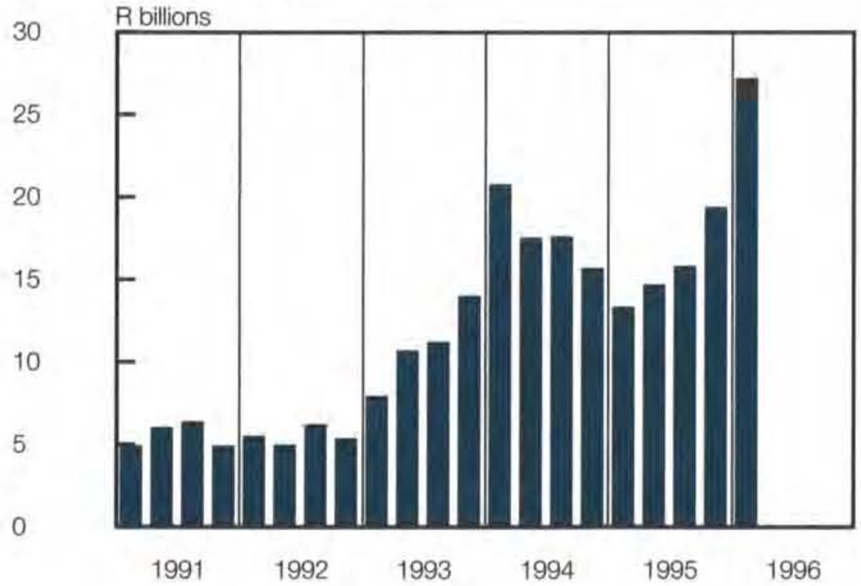
Funds raised in the *primary equity market* through rights issues of shares by listed companies increased from R1,0 billion in the fourth quarter of 1995 to R2,9 billion in the first quarter of 1996. New capital in the form of scrip dividends and other issues remained very popular and listed companies raised R4,1 billion in this way in the first quarter of 1996, compared with R5,1 billion in the last quarter of 1995.

Activity in the *secondary equity market* was also very brisk in the first four months of 1996. The turnover on the Johannesburg Stock Exchange increased from R19,4 billion in the fourth quarter of 1995 to R27,2 billion in the first quarter of 1996, surpassing the previous record of R20,7 billion in the first quarter of 1994 by 31,1 per cent. The value of shares traded advanced further from a monthly average of R9,1 billion in the first quarter of 1996 to R9,9 billion in April 1996, mainly as a result of an increase in the volume of shares traded. The increase in Bank rate near the end of April 1996 had, however, a negative impact on activity during May.

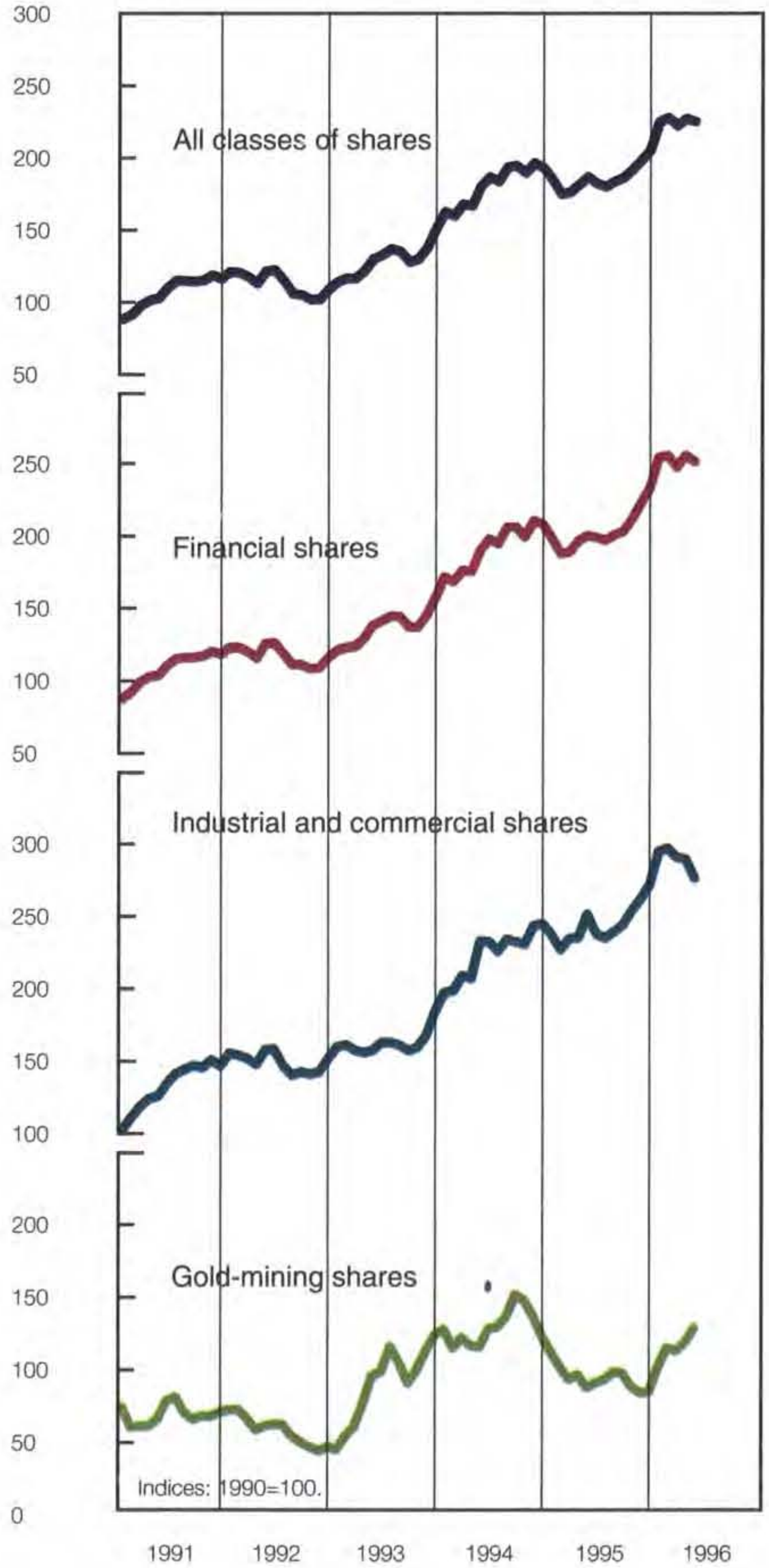
Non-residents were initially large net buyers of shares on the Johannesburg Stock Exchange, and their net purchases reached the high level of R1,1 billion in February 1996. The monthly value of their net purchases then declined sharply to R0,5 billion in March and R0,3 billion in April 1996 as expected returns on equities were overshadowed by potential currency losses. In total, however, a net inflow of R2,7 billion through equity purchases by non-residents was still recorded in the first four months of 1996.

The average *price level of all classes of shares* rose steadily by 30,3 per cent from a low in February 1995

Stock exchange transactions



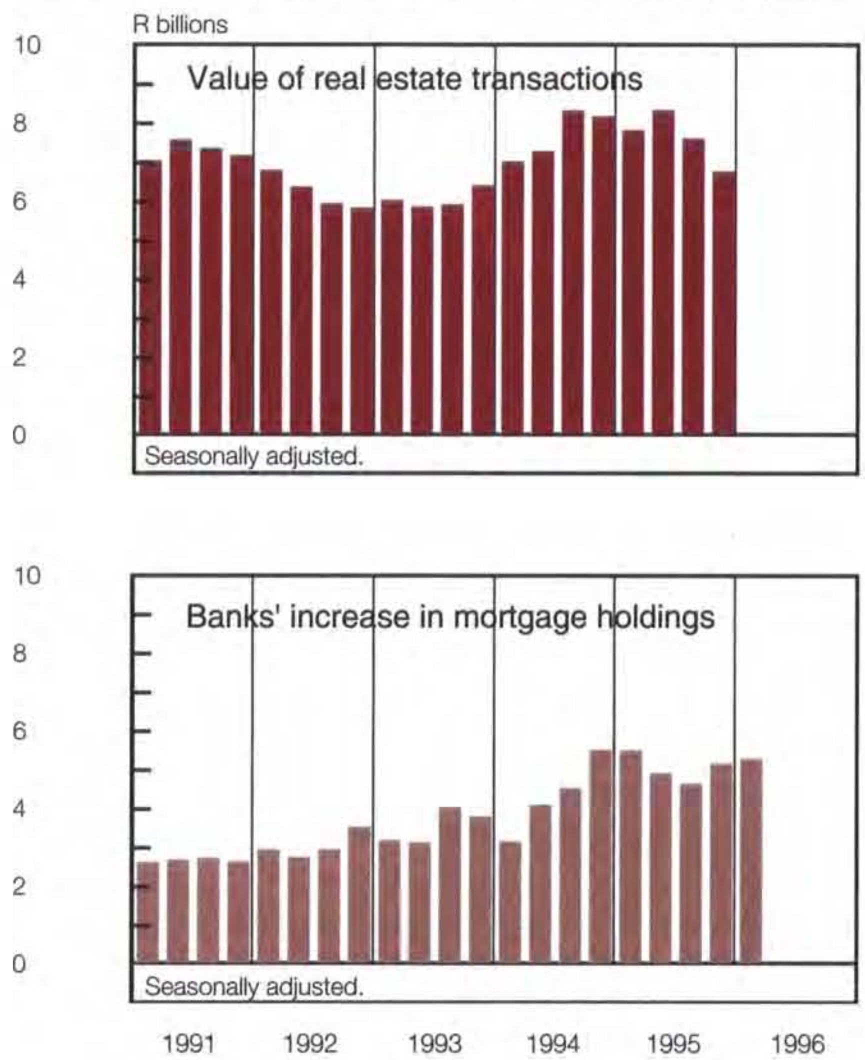
Share prices



to an all-time high in February 1996. Share prices then receded slightly by 2,4 per cent in March, before recovering again by 2,2 per cent in April 1996. This upward correction was led by industrial, commercial and financial shares and was supported by the continued strength of world bourses. The depreciation of the rand also benefited the commodity and rand-hedge shares. In May 1996, however, prices of industrial shares on the stock exchange declined sharply. The prices of gold-mining shares, which had been relatively depressed in 1995, surged ahead in the first five months of 1996.

As share prices declined, the average *dividend yield* and the average *earnings yield* (excluding gold-mining shares) on all classes of shares increased in the first five months of 1996. The increase in long-term yields on bonds from February 1996 caused the *yield gap* (the monthly average yield on long-term government stock less the dividend yield on all classes of shares) to increase from 11,7 percentage points in January 1996 to 14,3 percentage points in May 1996. The *price-earnings ratio* (excluding gold-mining shares) receded from 18,2 in January 1996 to 16,5 in May 1996 because of the decline in share prices.

Real estate transactions and mortgage holdings



Other financial markets

The volatility in the foreign exchange market also spilled over into the *derivative market*. Turnover in equity futures contracts, options on equity futures contracts and interest rate futures contracts accordingly increased sharply in the first five months of 1996. In the commodity futures market yellow and white maize contracts have been traded since 26 February 1996. These contracts are still very illiquid because of the remaining controls in the agricultural market and because investors are still not fully aware of their advantages.

Activity in the *real estate market* slowed down in the first two months of 1996, and the monthly average value of real estate transactions receded to R2,0 billion from R2,2 billion in the preceding quarter. The 17 per cent tax introduced with effect from 1 March 1996 on the gross interest and net rental income received by or accrued to all pension, provident and retirement annuity funds had a negative effect on property investments. This also contributed to a decrease of 10,2 per cent in the real estate share price index on the Johannesburg Stock Exchange from November 1995 up to April 1996.

Financing in the *mortgage market* also levelled off in the first three months of 1996. The average monthly value of mortgage advances decreased by 5,9 per cent from the fourth quarter of 1995 to the first quarter of 1996. Banks' total mortgage loans outstanding nevertheless increased from R130,3 billion in December 1995 to R135,7 billion in March 1996.

Public finance

Public-sector borrowing requirement

The public-sector borrowing requirement (i.e. the deficit before borrowing and debt repayment of the consolidated central government, provincial governments, local authorities and non-financial public enterprises) amounted to R30,0 billion in fiscal 1995/96; in the preceding fiscal year the public-sector borrowing requirement had totalled R28,2 billion. As in the past, the largest part of this deficit (R28,2 billion or almost 94 per cent) was due to a shortfall in the income and expenditure accounts of the central government. A small surplus of R0,1 billion was recorded by provincial governments, while the local authorities had a deficit of R0,4 billion. This deficit of general government of R28,6 billion, was slightly lower than the R28,8 billion in fiscal 1994/95. Largely because of a sharp increase in investments by public corporations, the surplus of R0,6 billion on the income and expenditure accounts of these entities in fiscal 1994/95 turned around to a deficit of R1,4 billion in fiscal 1995/96.

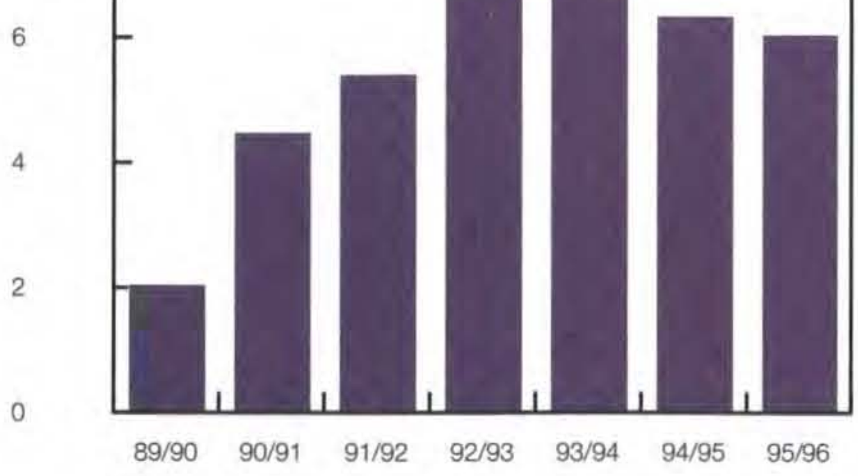
As a ratio of gross domestic product, the public-sector borrowing requirement has now declined from an all-time high of 10,4 per cent in fiscal 1993/94 to 6,3 per cent in fiscal 1994/95 and 6,0 per cent in fiscal 1995/96. However, large extraordinary transfers of R14,8 billion and R3,1 billion were included in the borrowing requirement of the public sector in fiscal 1993/94 and 1995/96. If these transfers are not taken into account, the borrowing needs of the public sector contracted from 6,7 per cent in fiscal 1993/94 to 5,4 per cent in fiscal 1995/96.

Exchequer account for fiscal 1995/96

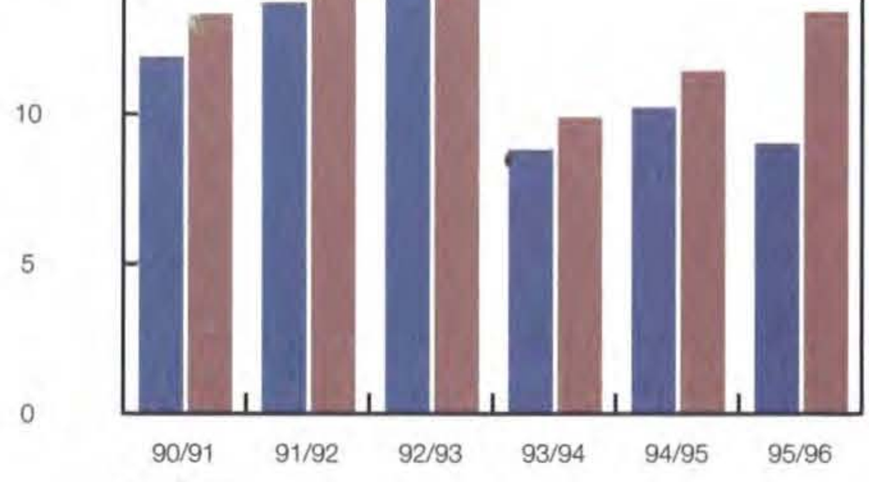
Exchequer issues to government departments in fiscal 1995/96 totalled R156,1 billion, which was R3,5 billion higher than the original Budget estimate of R152,6 billion. The higher-than-budgeted expenditure was mainly due to a rise in debt-servicing costs, a provision for revenue shortfalls among the provincial governments and a transitional reserve to provide for the provinces' spending on health and welfare. The rate of increase in government expenditure therefore amounted to 13,4 per cent in fiscal 1995/96, compared with a budgeted increase of only 9,0 per cent and an average annual rate of increase of 14,5 per cent in the past five fiscal years. Total government expenditure was equal to 31,4 per cent of gross domestic product in fiscal 1995/96, which was slightly higher than the 30,9 per cent in fiscal 1994/95.

Government receipts (excluding extraordinary revenue and in transit receipts to the State Revenue Account) increased by 11,8 per cent in fiscal 1995/96, which was considerably lower than the rate of increase of 15,9 per cent in the preceding fiscal year. The outcome for fiscal 1995/96 of R125,4 billion was, however, higher than the budgeted amount of R123,0

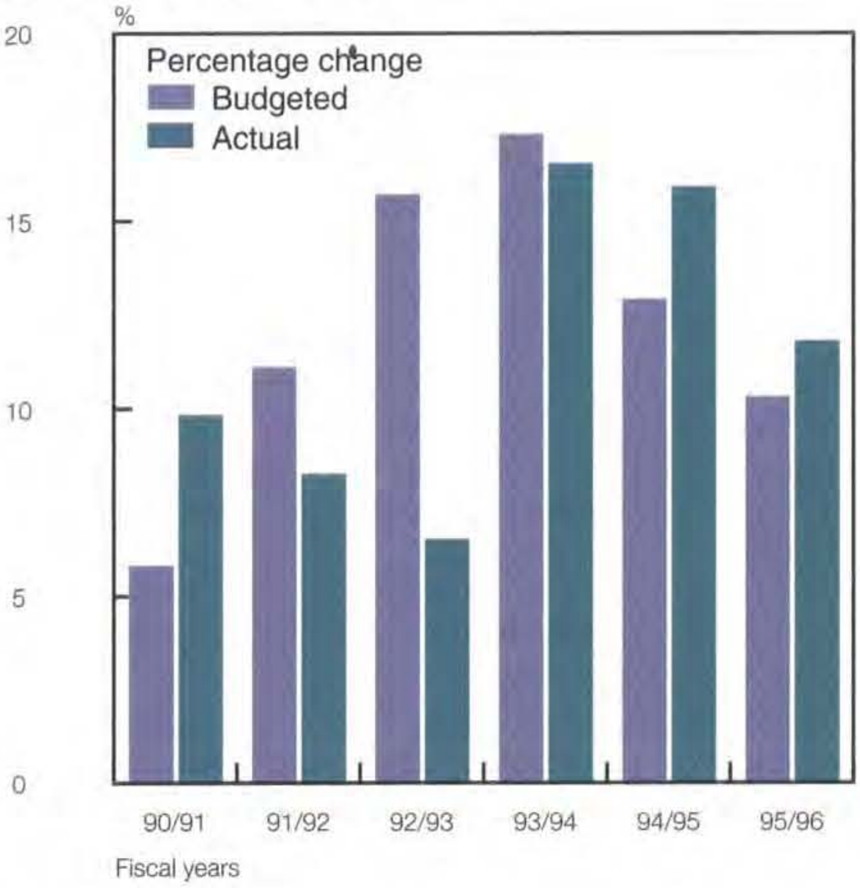
Public-sector borrowing requirement as percentage of gross domestic product



Budgeted and actual exchequer issues to government departments



Budgeted and actual revenue



billion. The rate of increase in Exchequer receipts was also higher than the average rate of increase of 11,4 per cent in the past five fiscal years. As a ratio of gross domestic product, Exchequer receipts rose marginally from 25,2 per cent in the fiscal year 1994/95 to 25,3 per cent in fiscal 1995/96. This is more or less in keeping with the objective of a ratio of 25 per cent stipulated in the medium-term fiscal programme that had been adopted by the authorities in 1994.

As shown in Table 8, the better-than-expected growth in government receipts was mainly the result of a substantial increase in the collection of funds from customs duties because of too low projections of the value of merchandise imports. Personal income tax collections also rose more sharply than had been foreseen, partly because of improvements in the administration of tax collection and partly because of conservative budget estimates.

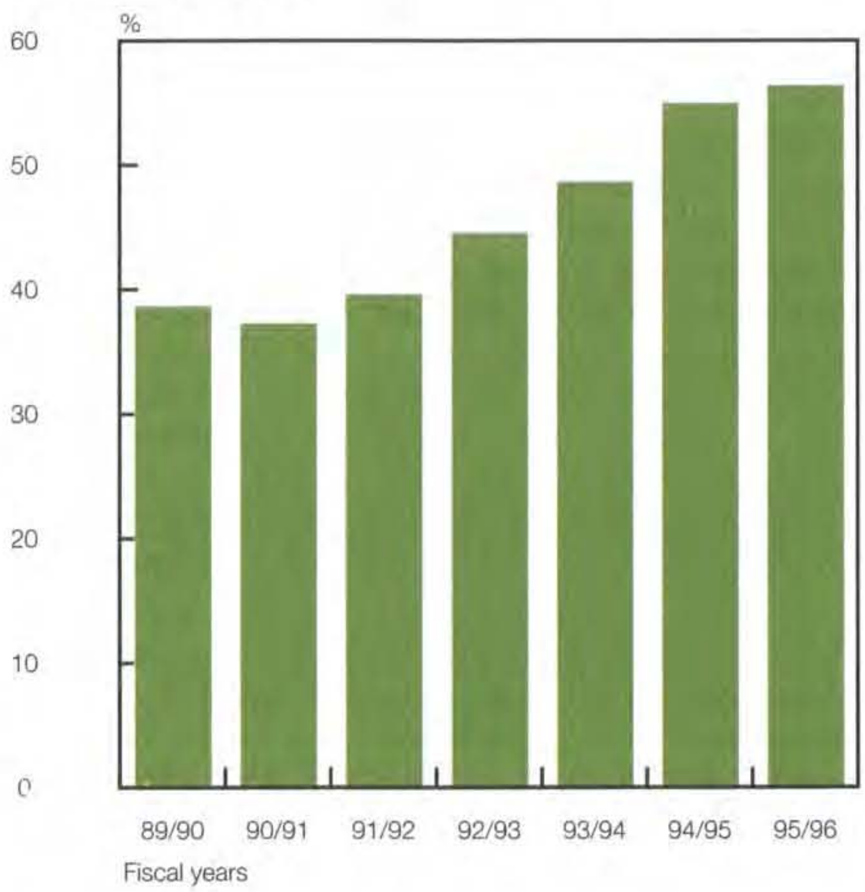
The higher-than-expected expenditure and income for fiscal 1995/96 led to a *deficit before borrowing and debt repayment* of R30,7 billion, which was also larger than the budgeted deficit of R29,7 billion. As a ratio of gross domestic product, the budget deficit came to 6,2 per cent if extraordinary receipts from the sale of strategic oil inventories are not regarded as income but as part of the financing of the government shortfall. This was slightly higher than the comparable ratio of 5,7 per cent in fiscal 1994/95, but considerably lower than the all-time high of 8,5 per cent in fiscal 1992/93.

Table 8. Government receipts by type of income in fiscal 1995/96
Percentage increase

	Budgeted	Actual
Customs and Excise	4,3	7,0
Customs duty	14,6	25,3
Excise duty.............	11,5	10,7
Other	0,9	-8,5
Inland revenue	11,2	12,6
Income tax	11,4	13,7
Value-added tax.....	13,0	10,4
Other	1,9	13,2
Total receipts....................	**10,3**	**11,8**

The deficit in fiscal 1995/96 was *financed* mainly by means of government stock issues, and to a lesser extent also by the issue of Treasury bills, foreign loans and oil sales. New funds obtained from government stock added up to R29,9 billion, including stripped-coupon stock to the amount of R3 073 million that was issued to the Reserve Bank to defray losses on the Gold and Foreign Exchange Contingency Reserve Account. Treasury bills to the value of R2,9 billion were issued, among other things, to replace the maturing debt of the former TBVC countries and self-governing states. In addition, the government expanded its

Total government debt as percentage of gross domestic product



investor base during fiscal 1995/96 through two foreign bond issues, i.e. a Samurai bond of ¥30 billion with a maturity of five years and a Eurosterling bond of £100 million with a maturity of ten years.

The borrowing requirement of the government plus the large discount on new government stock issues led to an increase in total *government debt* from R244,6 billion at the end of March 1995 to R279,8 billion at the end of March 1996. As a ratio of gross domestic product, government debt rose from 54,9 per cent to 56,3 per cent over the same period.

The Budget for fiscal 1996/97

In the Budget presented to Parliament on 13 March 1996, the Minister of Finance reiterated the *medium-term policy objectives* of government, i.e:

- to reduce the overall budget deficit and the general level of government dissaving;
- to avoid permanent increases in the overall tax burden;
- to decrease consumption expenditure by general government relative to gross domestic product;
- to keep overall wage and salary increases within inflation limits; and
- to strengthen the general government's contribution to gross domestic fixed investment.

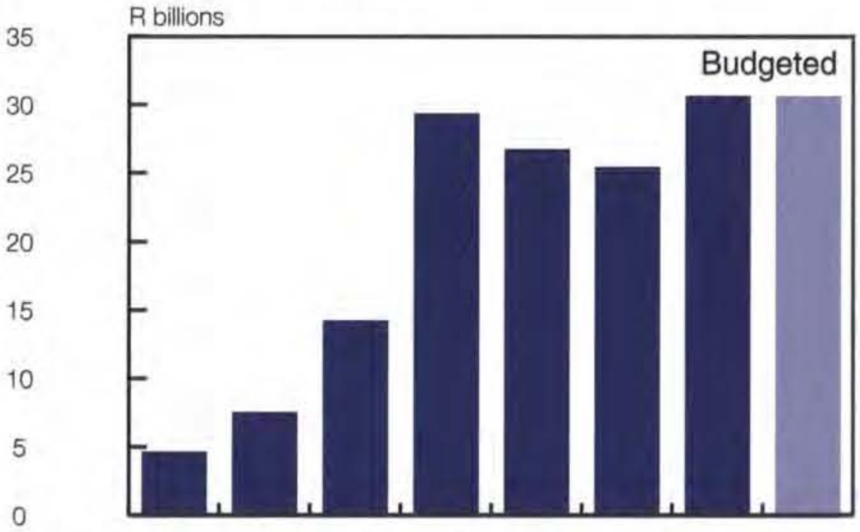
These objectives will be pursued as part of broader overall economic policy to promote economic growth with outward-oriented policies and increased international competitiveness, while addressing the problems of poverty, unemployment and low living standards.

Taking these broad objectives into consideration, total *government expenditure* was estimated to increase by 10,4 per cent to R173,7 billion. As a ratio of gross domestic product, total government expenditure is expected to decline from 31,4 per cent in fiscal 1995/96 to 31,0 per cent in fiscal 1996/97. These expenditure projections include an amount of R33,6 billion for the payment of interest on government debt, which left R140,1 billion for non-interest current and capital expenditure, i.e. 9,2 per cent more than the revised estimate for 1995/96. Although no detailed functional and economic classification of this expenditure was provided, the Minister of Finance gave the assurance that the allocation of funds would reflect and reinforce the priorities established in fiscal 1995/96.

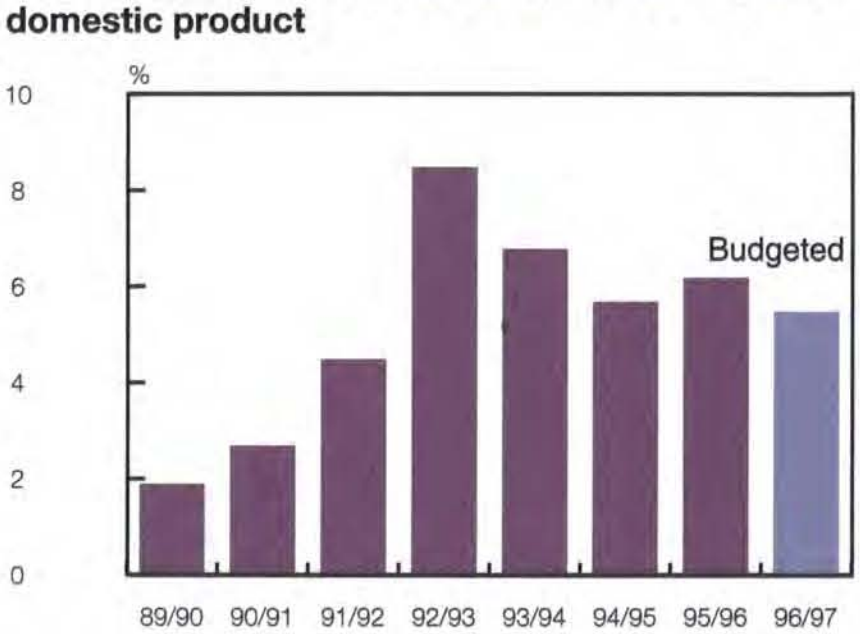
On the revenue side, an increase of 13,6 per cent to R143,0 billion was projected for fiscal 1996/97. This should take *government revenue* to 25,5 per cent of gross domestic product. Various measures were introduced and tax changes announced, including the following:

- The establishment of the South African Revenue Service by merging the sections Inland Revenue and Customs and Excise in order to increase the efficiency of tax administration.
- Modifications to value-added tax, consisting of the removal of exemptions on gambling and fee-based financial services, while abolishing the financial services levy. The value-added tax rate was, however, maintained at 14 per cent.
- Amendments to income taxation on individuals to adjust the tax structure for bracket creeping. The minimum taxable income threshold was raised, the number of tax brackets was reduced from ten to eight and the threshold from where a marginal rate of 45 per cent is applicable, was raised from R80 000 to R100 000.
- The reduction from 25 per cent to 12½ per cent in the secondary tax rate on companies' dividend payments, while retaining the corporate tax rate at 35 per cent.
- The introduction of a 17 per cent tax on the monthly gross interest and net rental income of pension, provident and other retirement funds.
- Increases in excise duties, the fuel levy and the rate of estate duty and donations tax.

Deficit before borrowing



Deficit before borrowing as percentage of gross domestic product



The net result of the budgeted expenditure and revenue was a projected *deficit before borrowing and debt repayment* in the government accounts of R30,7 billion, or 5,5 per cent of gross domestic product, in fiscal 1996/97. After taking the scheduled loan redemptions of R16,3 billion into account, the gross financing requirement was expected to amount to R47,0 billion. This shortfall will be financed as follows:

	R billions
Domestic registered stock, excluding the discount on government stock	39,6
Treasury bills...	3,0
Foreign loans...	2,5
Extraordinary receipts..............................	1,9
Total	**47,0**

Exchequer account in April 1996

In April 1996 Exchequer issues to government departments (adjusted to a cash-flow basis) were 5,4 per cent higher than in April 1995, i.e. expenditure increased at a substantially slower rate than anticipated in the Budget for the fiscal year as a whole. Exchequer receipts (excluding extraordinary receipts), on the other hand, increased at a year-on-year rate of 12,7 per cent in April 1996, which was only slightly below the rate envisaged in the Budget. The net result of these changes in government receipts and expenditure was a deficit on the Exchequer account before borrowing and debt repayment of R5,3 billion, or 17,4 per cent of the budgeted deficit for the full fiscal year.