Quarterly economic review

Introduction

The economic upturn in South Africa, which had started in May 1993, was still characterised by relatively strong but fluctuating economic growth in 1995. After having reached a high level in the fourth quarter of 1994, the rate of increase in real gross domestic product slowed down considerably in the first six months of 1995 owing to a decrease in the real value added by the primary sectors. A severe drought at the time had an adverse impact on agricultural production, while the output of gold and diamond mines contracted *inter alia* because of mine closures, labour unrest and lower grades of ore milled.

A rise in mining output, together with further strong increases in the real value added by the non-primary sectors, caused economic growth to pick up again in the third quarter of 1995. Growth then slackened in the fourth quarter primarily because of a decrease in manufacturing output. Production cut-backs in the manufacturing sector were probably motivated by the elimination of delivery backlogs, while the domestic demand remained strong. Export orders for manufactured goods also moved to a lower level.

Despite these fluctuations, real output growth in 1995 came to 3½ per cent – the highest rate since 1988. This increase in production was generally boosted by a robust demand for goods and services. High consumer confidence and a pent-up demand for durable and semi-durable goods led to an increase in real private consumption expenditure, which exceeded the growth in real personal disposable income. Private consumption expenditure was partly financed by means of credit extension, i.e. at the cost of domestic saving. This made the country more dependent on foreign funds to finance domestic investment, although dissaving by the government improved and the saving of the corporate sector increased.

Real gross domestic fixed investment increased by no less than 10½ per cent in 1995, but investment outlays slowed down in the fourth quarter with the completion of some major capital projects. Fixed investment became fairly widespread during the course of the economic recovery, with the manufacturing industry showing the strongest growth. The building-up of inventories also continued throughout 1995, but the rate of inventory accumulation slackened slightly in the second half of 1995.

The upturn in economic activity was accompanied by weak employment growth, probably largely due to attempts to contain cost increases and to raise production efficiency. The rate of increase in the nominal wages and salaries per worker was nevertheless relatively inflexible and exceeded the rate of increase in output prices. Fortunately, the inflationary consequences of the increase in labour remuneration were absorbed partially by a strengthening of labour productivity, which brought about lower rates of increase in nominal and real unit labour costs.

The lower labour cost per unit of production was an important contributing factor to a decline in inflation rates in 1995 to levels last experienced in the early 1970s. The pursuance of a monetary policy stance consistently countering inflation was aided further by lower increases and at times even decreases in food prices in the second half of 1995. Developments such as an increase in the supply of livestock for slaughtering, the lowering of import tariffs on agricultural goods, a mild winter and reforms in the marketing of agricultural products, quelled the rise in food prices. In addition, an appreciation in the external value of the rand from May 1995, relatively low price increases in major trading partner countries, a general reduction in import tariffs and the removal of the surcharge on imported goods in October 1995 supported the lower inflation rates. Even excluding food and other special factors, the underlying inflation rate therefore also receded.

As could be expected with the strength in domestic demand, the value and volume of merchandise imports rose steeply in 1995, but showed signs of levelling off in the last quarter of 1995. Net service and transfer payments also continued to escalate, while the proceeds from international gold sales contracted. Despite a still good performance of merchandise exports, the deficit on the current account of the balance of payments deteriorated substantially in 1995. Moreover, towards the end of the year the demand for South African manufactured products from other countries began to abate.

The large deficit on the current account in 1995 was financed by an even larger net inflow of capital. The cumulative net inflow of capital not related to reserves came to nearly R31 billion from the middle of 1994 to the end of 1995. The bulk of this inflow consisted of foreign loan capital and portfolio equity investments. Foreign direct investment remained relatively small and consisted mainly of investments to buy existing operations, to form joint ventures or to take over South African companies.

These inflows of capital were responsible for a substantial increase in the gold and other foreign reserves and enabled the Reserve Bank to fully redeem all loans that had been entered into previously to supplement the level of the foreign exchange holdings. Under these circumstances, the nominal and real effective exchange rate of the rand increased in the last seven months of 1995. After rising further in January, the external value of the rand depreciated substantially in February 1996.

The high levels of economic activity and domestic expenditure were also responsible for a rapid growth in money supply, which for the second consecutive year exceeded the upper limits of the money supply guidelines in 1995. The private sector's liquidity preference rose over the same period on account of expected interest rate changes and in anticipation of major adjustments in share and bond markets. In a statistical or accounting sense, the main counterpart of the growth in money supply was a substantial increase in bank credit extension to the private sector. However, in the second half of 1995 both the growth in money supply and credit extension to the private sector began to taper off. The quarter-to-quarter growth rates in these two aggregates, in particular, reached lower and more acceptable levels.

The financial markets were characterised by sharp increases in equity prices, which rose to new record levels in January 1996 buoyed by strong corporate profits and increased foreign interest after the dual exchange rate system had been terminated. The upward movement in share prices was led by industrial and financial shares, but in January 1996 the relatively depressed prices of gold-mining shares also reacted vigorously to the rise in the gold price to above $400 per fine ounce on international markets. The value of shares traded on the Johannesburg Stock Exchange continued to recover throughout 1995 from the low level reached at the beginning of the year.

Activity in the domestic primary bond market was dominated by issues of entities in the public sector. As a result of the liquidity of the corporate sector, the relatively high cost of borrowing funds and the availability of capital from abroad, the funds mobilised by private-sector companies through new issues of fixed-interest securities stayed low. Private-sector companies were also reluctant to raise funds in the primary equity market, despite the high level of interest rates and increasing share prices. The number of shares issued as scrip dividends, however, increased substantially because of the high statutory rate of the Secondary Tax on Companies. Activity in the secondary bond market increased markedly in the second half of 1995 as long-term yields began to drop.

Long-term yields were fairly stable in the first six months of 1995, while short-term yields rose further. The yield curve accordingly flattened during this period, but still had a positive slope over the first five years of the maturity spectrum. It subsequently moved rapidly downwards, with long-term rates declining more than shorter-term yields. In January 1996 the yield curve was therefore not only markedly lower than at the beginning of 1995, but also had a slightly inverted though generally horizontal shape.

Money market conditions tightened considerably in the second half of 1995, owing largely to a substantial increase in government deposits with the Reserve Bank. At times increases in the net foreign assets of the Reserve Bank related to an inflow of foreign capital caused these tight conditions to ease somewhat. The Reserve Bank's operations in the money market were concentrated mainly on measures to drain sporadic increases in liquidity and generally to maintain tight conditions. The Bank engaged in open-market sales from its own portfolio of securities to attain these objectives. In the short term, large fluctuations in the money market shortage were countered by means of adjustments in the asset portfolio of the Corporation for Public Deposits and management of the government's deposits with the Reserve Bank.

The public-sector borrowing requirement, i.e. the deficit before borrowing and debt repayment of the central government and all other levels of the public sector, amounted to only 4,6 per cent of gross domestic product in the first nine months of fiscal 1995/96. This considerably lower level of the public-sector borrowing requirement than in the preceding year was the net result of a large increase in the revenue of the public sector with only a moderate rise in public-sector expenditure. Problems encountered by some provincial governments in the re-organisation of functions and in the administration of activities prevented them from carrying out expenditure plans. The expected expenditure on reconstruction and development programmes was also not met in the first ten months of fiscal 1995/96. These results, however, do not include any overspending provided for in the Adjustment Budget.

Domestic economic developments

Domestic output

The growth in *real gross domestic product*, which had moved sharply downwards from an annualised rate of 6½ per cent in the fourth quarter of 1994 to 1½ and 2 per cent in the first two quarters of 1995, recovered somewhat to 3 and 2½ per cent in the last two quarters of the year. This brought real output growth to nearly 3½ per cent for the full calendar year 1995 – the highest rate since 1988. In 1994 domestic output had expanded by 2½ per cent. The higher growth in 1995 was achieved despite output being severely hampered by steep declines in the real value added by the primary sectors of the economy; the real output growth in the non-primary sectors came to 4½ per cent in 1995.

The drought in the summer rainfall areas during the previous season had a grave impact on the gross income of farmers. Farm profits also came under pressure from the low-priced importation of agricultural products following deregulation. The real value added by the *agricultural sector* accordingly contracted by about 15 per cent in 1995. Towards the end of the year the rate of decline flattened out when farm income was supported by a better-than-expected wheat crop.

A recovery in the real value added by the *mining industry* in the second half of 1995 was unable to prevent a decrease of 3½ per cent in the real output of the mining sector for the year as a whole. Declines occurred mainly in the output volumes of gold and diamond mines as both these activities were plagued by labour problems. Diamond mining was constrained further by diamond sales of non-resident organisations on the international market in disregard of existing

Real gross domestic product

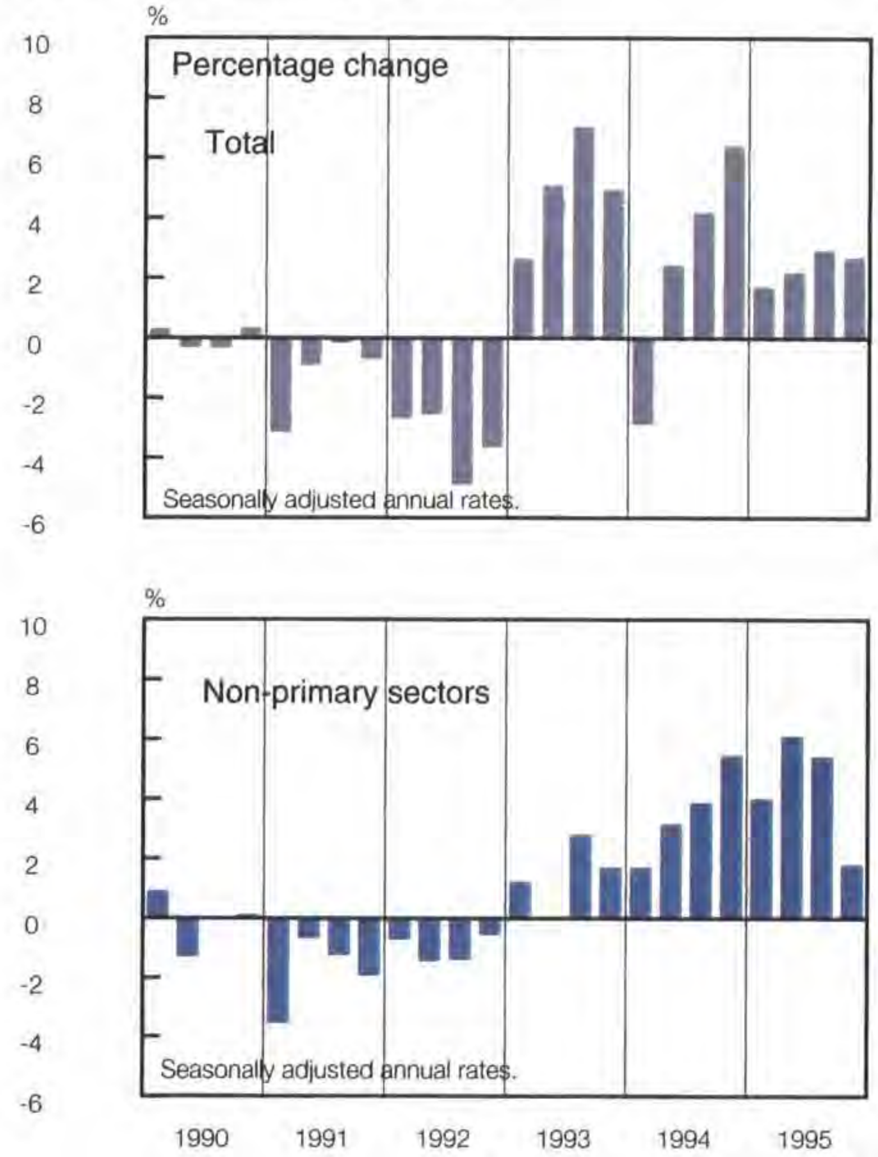


Table 1. Real gross domestic product
Percentage change at seasonally adjusted and annualised rates

Sectors	1994	1995				
	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Primary sector	2½	-12½	-22	-17	1	-8
Agriculture	12	-15½	-42	-50	-2½	-15
Mining	-2½	-10½	-7½	6	2½	-3½
Secondary sector	2½	6½	8½	7	-1½	6½
Manufacturing	2½	7	10	8½	-3	7½
Tertiary sector	2½	2½	5	4½	4	3½
Commerce	4	2½	9	8½	9	6
Transport and communication	3½	6½	7½	6	3½	4½
Financial services	3	3	4	4	2½	4
Non-primary sector	2½	4	6	5½	2	4½
Total	**2½**	**1½**	**2**	**3**	**2½**	**3½**

arrangements. The output of gold mines was also adversely affected by falling grades of ore milled because of a decline in the availability of ore with a high gold content, the milling of poor-quality surface material in order to supplement falling underground production and the difficulties encountered in raising grades without increasing working costs.

Real output growth in the *non-primary sectors* of the economy slowed from 6 per cent in the second quarter of 1995 and 5½ per cent in the third quarter to a relatively low 2 per cent in the fourth quarter. A decline at an annualised rate of 1½ per cent in the output of the secondary sectors was mainly responsible for this lower growth, but the rate of increase in the real value added by the tertiary sectors also slackened off.

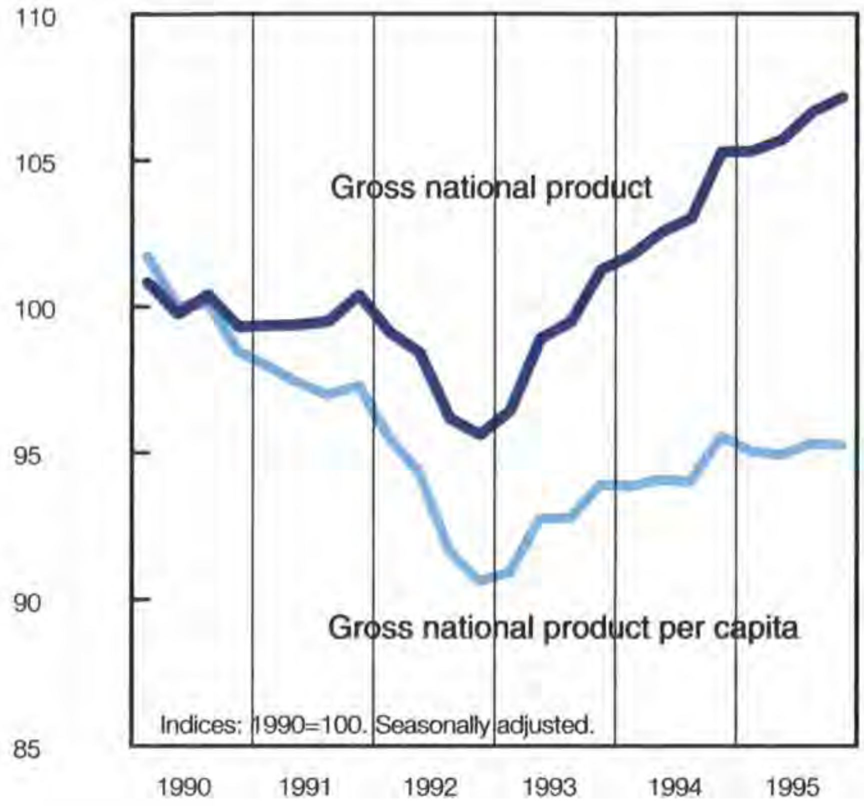
The real value added by the *manufacturing sectors* declined at a rate of 3 per cent in the fourth quarter of 1995, following high rates of increase in the preceding three quarters. The production cut-backs in manufacturing in this quarter probably stemmed from the elimination of delivery backlogs, as substantiated by a decrease in the real value of unfilled orders while the underlying demand apparently remained firm. Manufacturing output in 1995 was, however, still 7½ per cent higher than in 1994. The increase in manufacturing production in 1995 was assisted by much calmer industrial relations than in the preceding year.

The real value added by the sector supplying *electricity, gas and water* rose strongly throughout 1995 and came to 3½ per cent for the year as a whole; in 1994 the same growth rate was achieved. This strong growth could be attributed to the additional demand created by the expansion of the electricity network in less-developed regions of the country as well as the increase in real activity.

In the *construction industry* the positive growth that became apparent towards the end of 1993 advanced further throughout 1994 and 1995. This happened after a long period of declining output levels in the recent recession. The growth in real value added by the construction enterprises amounted to nearly 2 per cent in 1995; in the preceding year it was slightly lower at just above 1 per cent. The rise was mainly caused by the strengthening in the demand for residential building construction, which countered the mediocre performance of civil contractors.

All the major subsectors contributed to the relatively strong growth in the real value added by the *tertiary sectors* in 1995. Activity in the retail, wholesale and motor trade was boosted by the positive sentiment of consumers, rising personal disposable income, the availability of credit, the higher level of fixed investment in transport equipment, the containment of price increases and the successful introduction of new, low-priced motor cars. The high growth in transport, communication and financial services, was supported by the general buoyancy in aggregate domestic demand, increased international trade, the sharp increase in foreign tourism and the growing integration of South Africa's financial markets into the global financial network.

Real gross national product



The growth in real domestic production was countered to some extent by an increase in South Africa's net factor payments to the rest of the world and a deterioration in the terms of trade; the growth in the real *gross national product* was accordingly lower than in real gross domestic product. Moreover, the growth in real gross national product fell from 4 per cent in 1994 to 3 per cent in 1995. The real gross national product per capita rose accordingly by less than 1 per cent, bringing the accumulated increase in the real income per capita of South African nationals to only 2½ per cent in the current economic upturn. In the recession of 1989-93 the real income per capita had decreased by no less than 12 per cent.

Domestic expenditure

The quarter-to-quarter growth in real *gross domestic expenditure* remained positive in 1995, but fluctuated considerably during the year (see Table 2). For the full calendar year 1995 the growth in real domestic expenditure is estimated at 5½ per cent; growth at 6½ per cent in 1994 was somewhat higher. Domestic investment and private consumption made the major contribution to the high domestic demand, and only a modest increase in real consumption outlays by general government was registered.

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

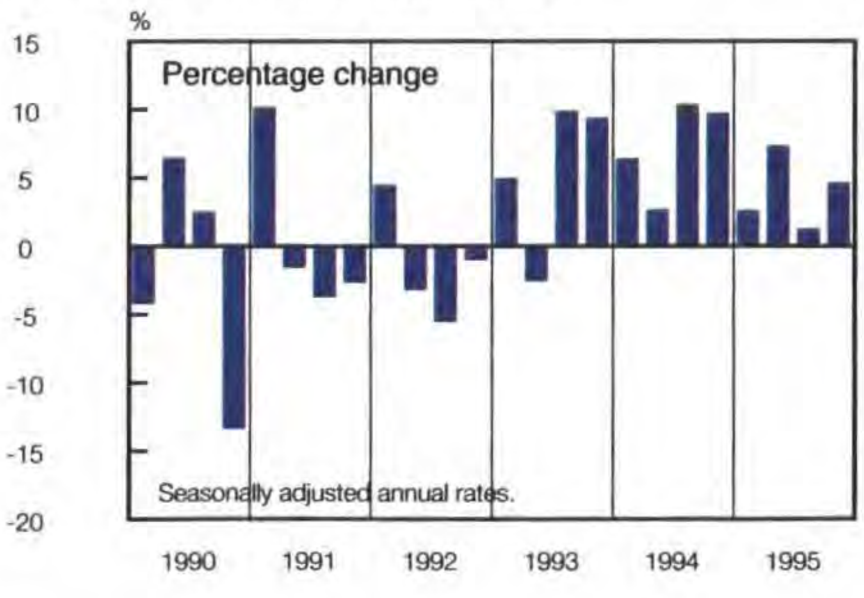
Components	1994	1995				
	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Private consumption expenditure	3	4	5½	6½	5	5
Consumption expenditure by general government	4	-2	½	2	2	½
Gross domestic fixed investment	8½	8	8	7½	4	10½
Change in inventories (R billions)	4,7	8,0	9,6	6,9	6,3	7,7
Gross domestic expenditure	**6½**	**2½**	**7**	**1**	**4½**	**5½**

After having reached a high annualised rate of increase of 5½ per cent in the fourth quarter of 1994, real *private consumption expenditure* continued to advance strongly in 1995. Owing to a high level of consumer optimism, households were willing to increase real current consumption outlays by 5 per cent in 1995, while the increase in real personal disposable income was only 2½ per cent. The resulting increase in the average propensity to consume was achieved at the cost of private household saving and led to a rapid accumulation of consumer debt.

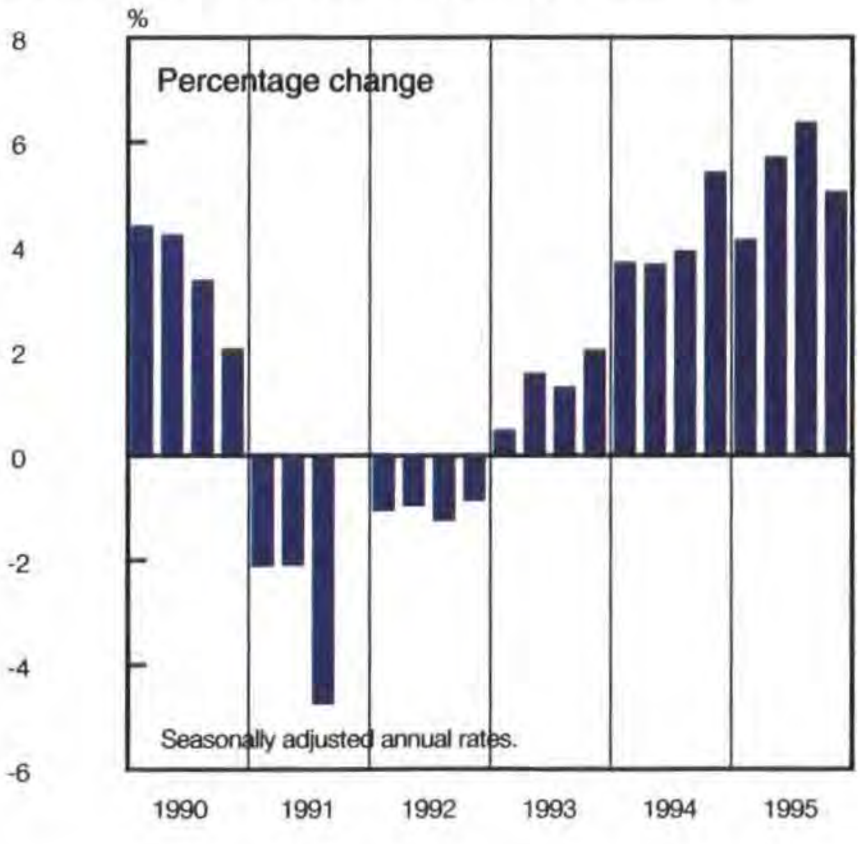
All the main components were instrumental to the rise in consumption expenditure, but the main thrust came from real outlays on durable goods which increased by 9 per cent in 1995. Personal transport equipment was especially in demand. Replacement demand for ageing vehicles and that arising from car theft, a decline in the relative prices of a number of new models and aggressive marketing strategies, bolstered the demand for new motor cars. Large gains were also registered in semi-durable goods, such as furniture and appliances, motor car parts and accessories, and clothing and footwear. The real outlays on these types of goods rose by 6 per cent in 1995.

Real *consumption expenditure by general government* in 1995 was ½ per cent above its level in 1994; this was considerably lower than the rate of increase of 4 per cent in the preceding year. The ratio of consumption expenditure by general government to gross domestic product accordingly edged down from 21 per cent in 1994 to 20½ per cent in 1995. During the course of 1995 there was, however, a slight

Real gross domestic expenditure



Total real private consumption expenditure



upward movement in the rate of increase of government consumption of goods and services in real terms to a still modest annualised level of 2 per cent in the fourth quarter.

One of the main features of the current economic upswing has been the strong growth in aggregate real *gross domestic fixed investment* of 8½ per cent in 1994 and 10½ per cent in 1995. In the fourth quarter of 1995, however, the rate of increase in real fixed capital formation slowed down to 4 per cent from an average annualised rate of 8 per cent of the growth in the first three quarters of the year. This slackening in investment expenditure was primarily the result of the completion of some of the major capital projects in the private sector and the levelling-off in capital outlays of public corporations.

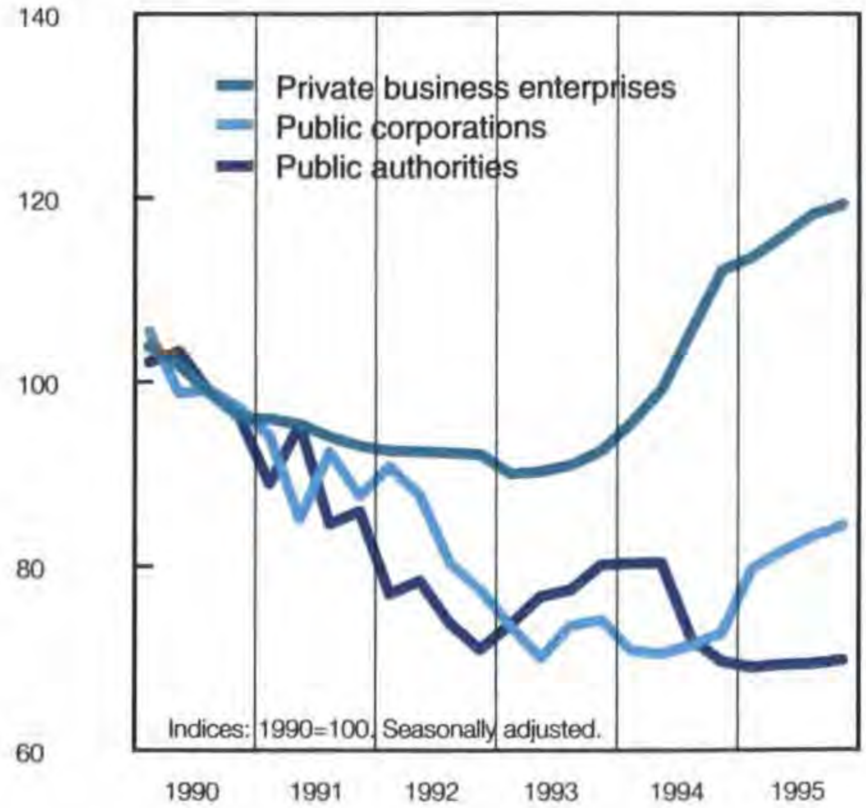
The real fixed investment in the *private sector* was initially restricted mainly to capital outlays on large new capital projects, but later became fairly widespread as the economic recovery gained momentum. Large expenditures were then incurred on transport and machinery and equipment to replace obsolete production equipment, the use of which had been extended beyond its normal economic lifespan in the years of sanctions against the country. In addition, the higher levels of demand and increased competition from the rest of the world raised the need for modernisation and additional production capacity.

Real fixed investment expenditure in the manufacturing sector was particularly strong: it rose by no less than 21 per cent in 1995. In the other sectors, the growth in real gross fixed investment varied between 5 per cent in the case of agriculture to about 12½ per cent in the commercial sector. As a result of this investment in manufacturing, the increase in the degree of capacity utilisation in this sector levelled off in the second half of 1995. At 83,4 per cent in the third quarter of 1995, capacity utilisation was nevertheless close to the utilisation rate of 84,1 per cent at the previous peak of the business cycle in 1989.

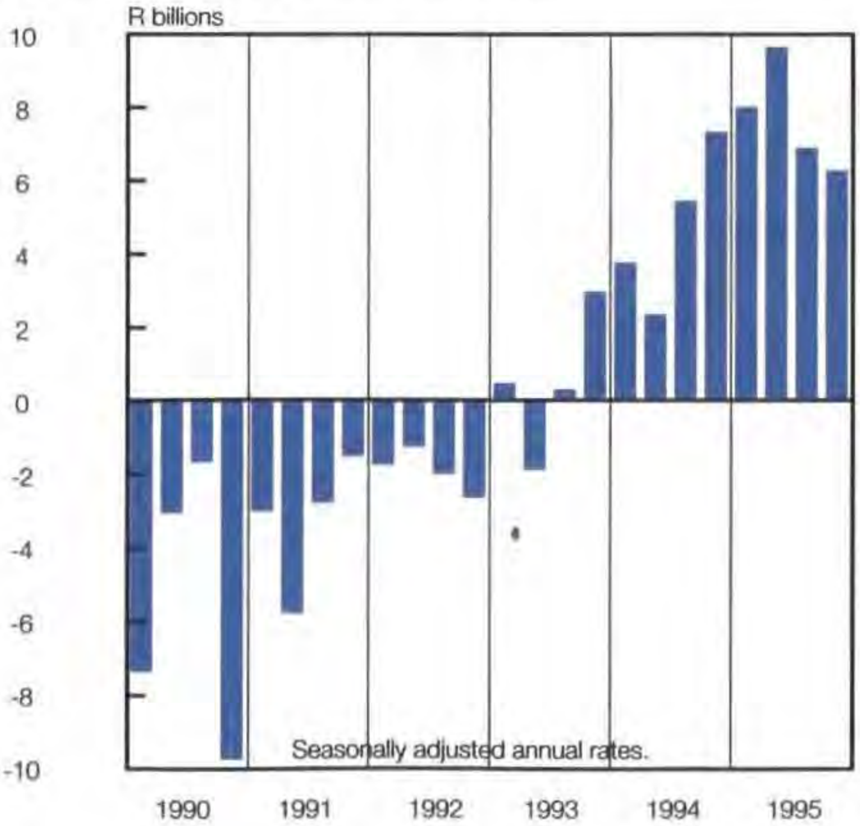
Following marked declines in the preceding four years, real fixed capital formation by the *public corporations* increased by 15 per cent in 1995. This stemmed largely from the expansion of the electricity network by Eskom and higher outlays on investment in machinery and transport equipment by Transnet. Real outlays on fixed investment by *public authorities* remained sluggish throughout 1995 and, apart from the local authorities, all subsectors of general government registered negative fixed-investment growth.

The build-up of *inventories* from the middle of 1993 continued throughout 1995, but the rate of inventory accumulation slackened somewhat in the second half of the year. For the calendar year 1995 the inventory accumulation contributed about 1 percentage point to the growth in real gross domestic product. The build-up of stock took place mainly in the mining, manufacturing and commercial sectors, and was presumably inspired by an expected strong rise in

Real gross domestic fixed investment



Change in total real inventories



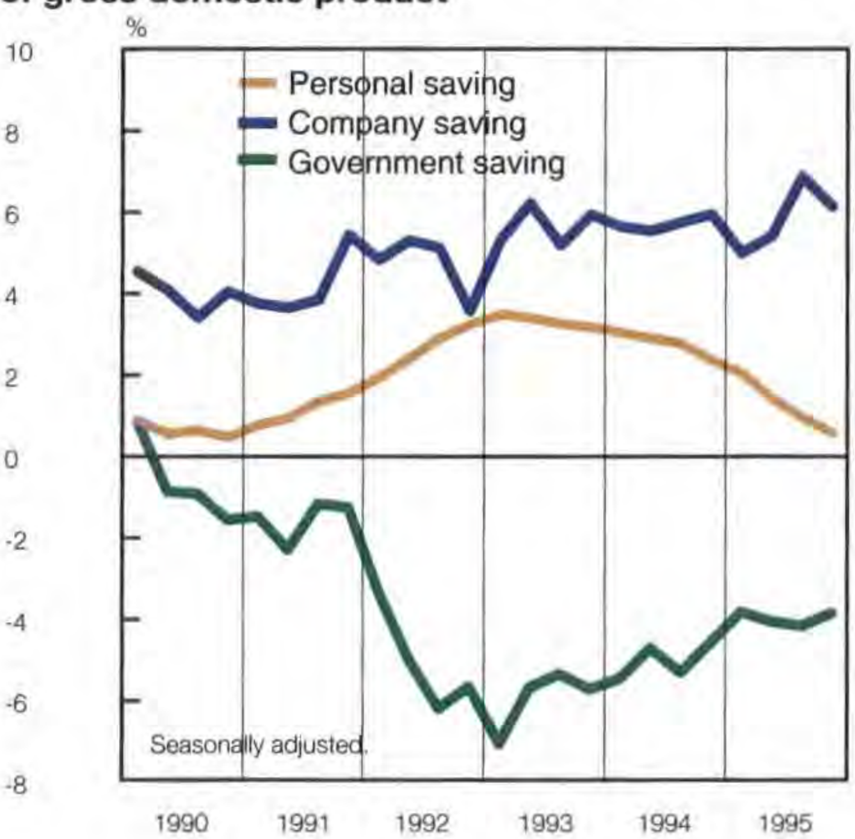
sales. As a result, the ratio of industrial and commercial inventories to non-agricultural gross domestic product rose to 18 per cent, compared with an all-time low of 16 per cent in 1993.

Factor income and saving

Aggregate *nominal factor income* at market prices, which had increased by 12½ per cent in both 1993 and 1994, increased again at this rate in 1995. This consistency in the growth of nominal factor income must be viewed against the backdrop of falling inflation and rising real output growth. Moreover, the relatively constant percentage increase in factor income was obtained while the rate of increase in the total nominal gross operating surplus slowed down from 13½ per cent in 1993 and 1994 to 12 per cent in 1995, because of declines in the operating surpluses of agriculture and mining. In contrast, the growth in the nominal operating surpluses of the non-primary sectors accelerated from about 11½ per cent in 1994 to 17½ per cent in 1995. The increase in the aggregate remuneration of employees amounted to 11½ per cent in 1995, compared with an average increase of 10½ per cent in the preceding two years.

Gross domestic saving as a ratio of gross domestic product declined from 17 per cent in 1994 to 16½ per cent in 1995, indicating that the country has become more dependent on foreign funds to finance domestic investment. This decline was registered regardless of a decrease in the net dissaving of the government

Components of domestic saving as percentage of gross domestic product



relative to gross domestic product from 5 per cent in 1994 to 4 per cent in 1995.

The net saving of the private sector weakened in 1995 and the saving of households and the corporate sector as a ratio of gross domestic product dropped from 8½ per cent in 1994 to 7 per cent in 1995. This result was realised even though the saving of the corporate sector rose from 5½ per cent of gross domestic product in 1994 to about 6 per cent in 1995. The corresponding savings ratio of households, however, contracted from 3 per cent to 1 per cent over the same period. Household income was badly affected in 1995 by the poor gross income of farmers, while the growth in household spending remained firm. A large part of the increase in spending was financed by means of credit, causing the savings rate to decline and the ratio of consumer credit to personal disposable income to rise from 23 per cent in 1994 to 25½ per cent in 1995.

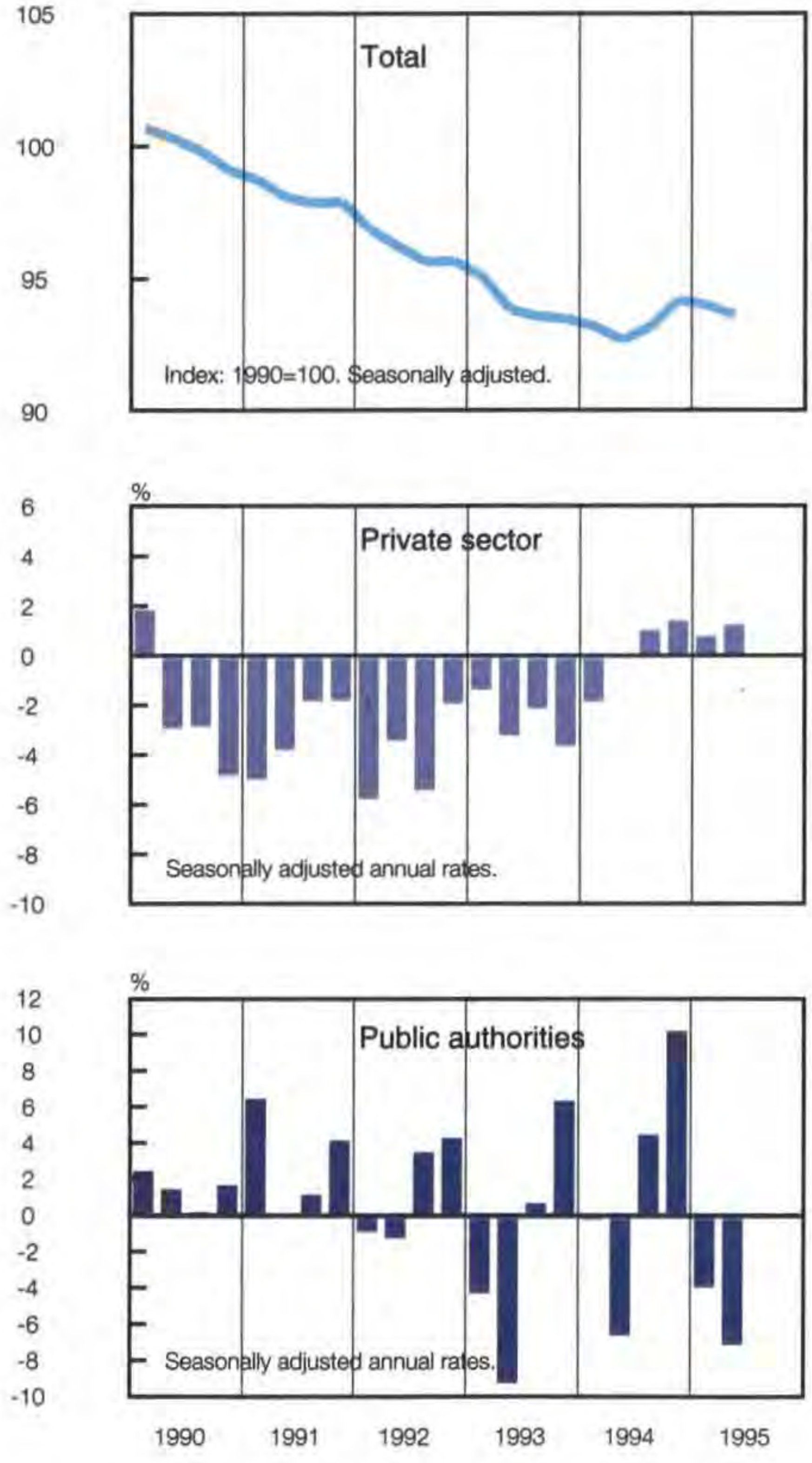
Employment

The upturn in economic activity was accompanied by weak employment growth, probably largely due to efforts by producers to contain cost increases and to raise production efficiency. The employment cycle only reached its lower turning-point in the second quarter of 1994, i.e. about a year after the start of the economic upswing. Even then the employment growth was unsteady. After having declined almost uninterruptedly for nineteen calendar quarters, *total employment* in the non-agricultural sectors increased fairly strongly at seasonally adjusted and annualised rates of 2,2 and 4,4 per cent in the last two quarters of 1994; it then declined again at seasonally adjusted and annualised rates of 0,8 and 1,6 per cent in the first and second quarter of 1995 (the latest quarter for which data have been made available by the Central Statistical Service). From the start of the economic upswing up to the second quarter of 1995 only 12 000 employment opportunities had been created.

The decline in employment in the first half of 1995 could be attributed entirely to a reduction in employment by *public authorities*. Unlike employment in the private sector, total employment by public authorities increased virtually throughout the recession. Efforts by the central government to curb increases in current expenditure then caused employment by public authorities to contract by 1,2 per cent in 1993. From the third quarter of 1993 public-sector employment tended to increase again, but sporadic declines occurred from time to time. In the first half of 1995 employment by public authorities decreased sharply on account of 32 000 jobs having been rationalised by provincial governments.

Total employment in the *non-agricultural private sector* declined during each of the calendar years from 1990 to 1994 and only showed signs of picking up from the second half of 1994. It then increased in the

Non-agricultural employment



four quarters up to the second quarter of 1995 at seasonally adjusted and annualised quarter-to-quarter rates that fluctuated between approximately 1 and 1½ per cent. In these four quarters a net gain of 40 000 employment opportunities was created in the private sector, against an increase of approximately 350 000 people in the economically active population.

Labour costs and productivity

The rate of increase in the average annual *nominal remuneration per worker* in the non-agricultural sectors of the economy declined from a recent high point of 18,4 per cent in 1989 to 10,5 per cent in 1993 and 12,0 per cent in 1994. In the first six months of 1995 the year-on-year rate of increase in nominal salaries and wages per worker amounted to 11,1 per cent. The lower wage increases were initially entirely the result of a decline in the rate of increase in the nominal remuneration per worker employed by the *public authorities* from 21,6 per cent in 1989 to 9,2 per cent in 1993; it then, however, rose again to 14,9 per cent in 1994, before falling to only 4,9 per cent in the first half of 1995 compared with the same period in the preceding year.

At around 15 per cent in the period 1989 to 1992, the rate of increase in the nominal remuneration per worker in the *private sector* was relatively inflexible during the major part of the recent recession. It was only in 1993 that private-sector wage increases began to respond to the increasing excess supply of labour. The rate of increase in the nominal remuneration per worker in the private sector dropped to 11,2 per cent in 1993 and to 10,2 per cent in 1994. The year-on-year rate of increase in the nominal remuneration per worker in the private sector then rose again to 11,7 per cent in the first half of 1995.

Since 1990 the rate of increase in the remuneration per worker had exceeded the rate of increase in output prices, except for a short interlude in 1993. In fact, the rate of increase in the *real remuneration* per worker (as deflated by the price deflator for non-agricultural gross domestic product) accelerated from 0,4 per cent in

Non-agricultural labour productivity and remuneration

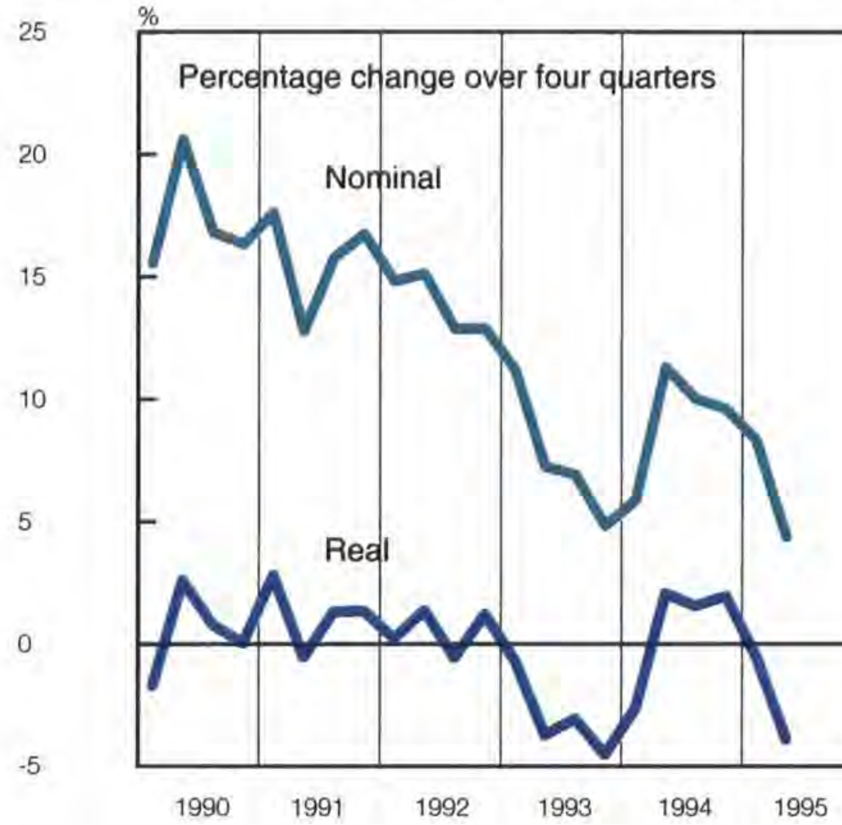
1990 to 1,7 per cent in 1992. After having declined marginally by 0,3 per cent in 1993, the real wage per worker increased again by a high 3,3 per cent in 1994. The real wages per worker in the first half of 1995 were 0,5 per cent higher than in the corresponding period of the preceding year.

The increase in real labour remuneration was backed to some extent by a strengthening in labour productivity. The rate of increase in *labour productivity* in the non-agricultural sectors of the economy rose from 0,4 per cent in 1991 to 2,8 per cent in 1993 and 1994; the year-on-year rate of increase then remained more or less at this level in the first half of 1995, amounting to 2,6 per cent. These productivity increases, however, were achieved at the cost of declining employment. An abatement in the number of man-days lost due to strikes and other work stoppages partly contributed to the productivity growth in 1995.

The rate of increase in *nominal unit labour costs* contracted from 17,3 per cent in 1990 to 7,4 per cent in 1993 – the lowest level since 1978. The sharp upward movement in nominal labour remuneration in 1994 then led to an acceleration of the increase in nominal labour costs per unit of physical output to 9,1 per cent in 1994. The year-on-year rate of increase then dropped again to 6,3 per cent in the first half of 1995. This slower growth, of course, contributed decisively to the waning of price inflation.

Real unit labour costs, which had remained positive throughout most of the recent recession and had declined by 3,1 per cent in 1993, increased again by 0,6 per cent in 1994. High wage increases caused real unit labour costs to increase immediately after the start of the upturn in economic activity from the third quarter of 1993. In previous upward phases of the business cycle there were normally a long lag between the rise in activity and the increase in real labour cost per unit of output. This change in the cyclical pattern is probably an important explanation of the weak response of formal employment to the recovery in business conditions. In the first half of 1995, however, real unit labour costs were 2,1 per cent lower than in the corresponding period of the preceding year.

Non-agricultural nominal and real unit labour costs



Prices

The lower increases in labour cost per unit of production were an important contributing factor to the decline in inflation since 1993. The pursuance of a consistent counter-inflation monetary policy started to pay dividends in the second half of 1995 when the rates of increase in both production and consumer prices began

Table 3. Year-on-year changes in non-agricultural labour remuneration, productivity and unit labour costs

Per cent

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

to subside. As a result, the inflation differential between South Africa and its major trading partner countries narrowed from 13,2 percentage points in January 1992 to 4,0 percentage points in October 1995.

The slowdown of inflation in the second half of 1995 was assisted by lower increases and at times even decreases in food prices. This behaviour of the prices of products such as fresh meat, vegetables, fruit, coffee and tea could, in turn, be attributed to developments such as:

- the drought in the country, which forced farmers to increase the supply of livestock for slaughtering;
- the lowering of import tariffs, which raised the supply of imported meat at competitive prices;
- a milder winter, which caused vegetable prices to increase more moderately, particularly in comparison with the preceding year's sharp increases under very cold weather conditions;
- reforms in the marketing of agricultural products, which allowed the prices of these products to reflect underlying supply and demand conditions more closely; and
- a restoration of the international supply of coffee, which caused the rate of increase in coffee prices to subside.

In addition, lower increases in the prices of imported goods made a major contribution to lower inflation rates. This factor not only contributed directly to the decline in inflation rates, but probably also had an important indirect effect because of the practice of import parity pricing followed by many domestic producers. The lower rate of increase in the prices of imported goods from April 1995 was related to an appreciation in the external value of the rand from May, a general reduction of import tariffs in accordance with the provisions of the multilateral trade negotiations and the final removal of the surcharge on imported goods in October 1995.

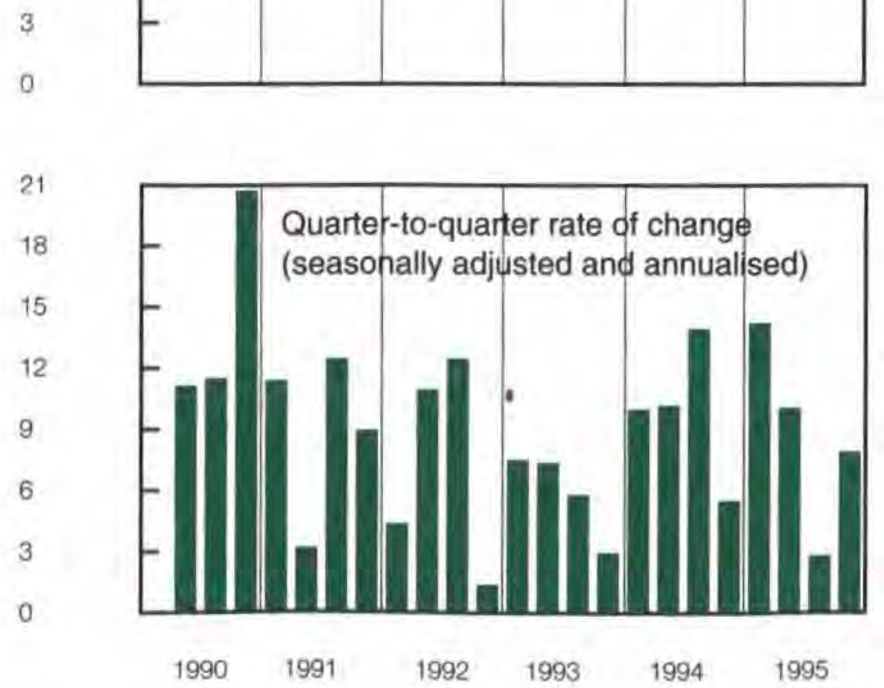
As a result of these developments, the average level of the *prices of imported goods* declined at a seasonally adjusted and annualised rate of 0,3 per cent from the second to the third quarter and then rose only moderately at a seasonally adjusted and annualised rate of 2,8 per cent in the fourth quarter of 1995. These changes can be compared with quarter-to-quarter rates of increase (seasonally adjusted and annualised) of 12,7 and 12,6 per cent in the first two quarters of 1995. The rate of increase over a period of twelve months in the prices of imported goods declined, on balance, from a high point of 10,5 per cent in April 1995 to 5,8 per cent in December.

The quarter-to-quarter increase in the prices of *domestically produced goods* declined from a seasonally adjusted and annualised rate of 13,4 per cent in the first quarter of 1995 to 2,8 per cent in the third quarter. In the ensuing quarter a fairly steep rise in food prices caused the quarter-to-quarter increase in the prices of domestically produced goods to accelerate once again to 9,8 per cent. The rate of increase over a period of twelve months in the prices of domestically produced goods also declined from a recent high point of 11,7 per cent in April 1995 to 8,1 per cent in August, but then rose again to 9,2 per cent in December 1995.

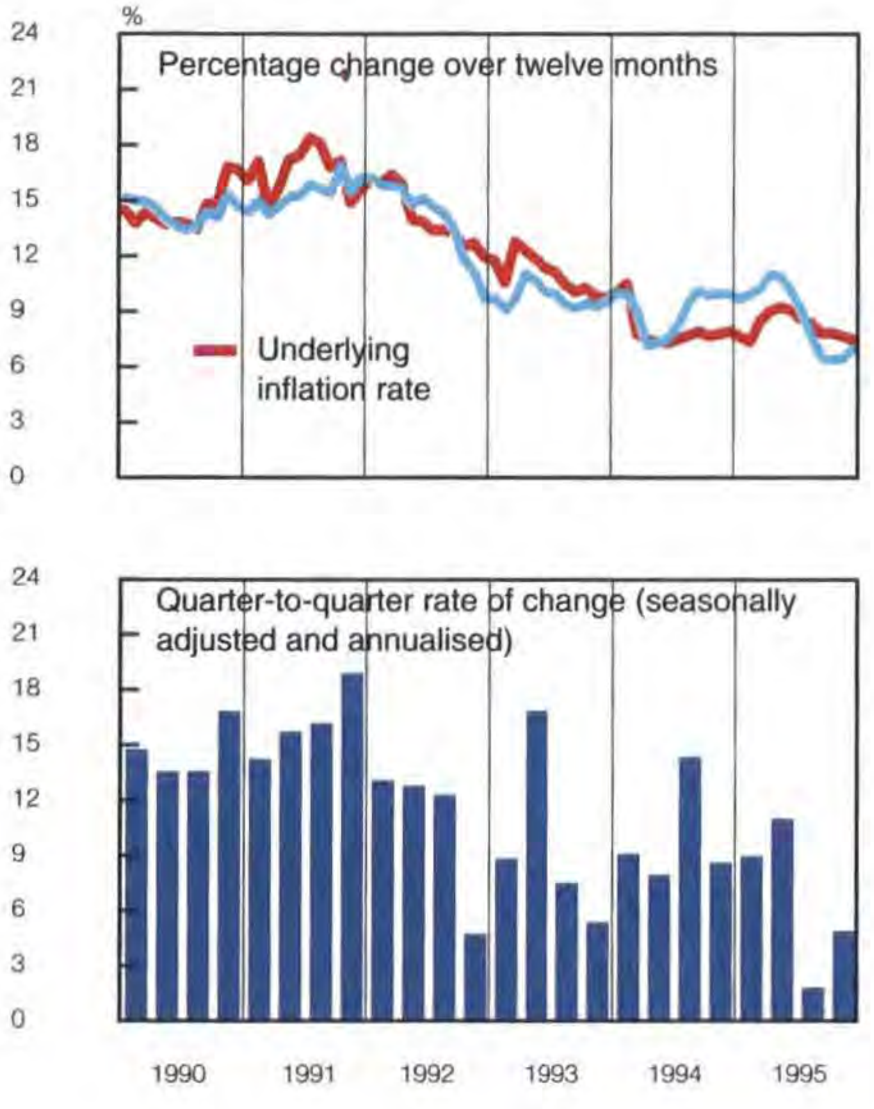
As a result of these changes in its two components, the quarter-to-quarter rate of increase in the *all-goods production price index* (seasonally adjusted and annualised), declined from 13,2 per cent in the first quarter of 1995 to 2,7 per cent in the third quarter and then rose somewhat to 7,9 per cent in the fourth quarter. The rate of increase over twelve months in the all-goods production price index also came down from 11,5 per cent in April 1995 to 7,6 per cent in September, before rising again to 8,5 per cent in December 1995. Despite these recent improvements in production prices, the increase in the average annual level of the all-goods production price index rose from 8,2 per cent in 1994 to 9,6 per cent in 1995.

In contrast to these developments in production prices, the rate of increase in the *overall consumer price index* declined uninterruptedly from a peak of 15,3 per cent in 1991 to 8,7 per cent in 1995 – the

Production prices



Consumer prices



lowest rate of increase since the 6,1 per cent registered in 1972. The quarter-to-quarter rate of increase in the overall consumer price index reached its lowest level since the second quarter of 1968 when it shrank to a seasonally adjusted and annualised level of 1,7 per cent in the third quarter of 1995; it subsequently rose again to a still low 4,8 per cent in the fourth quarter.

The rate of increase over periods of twelve months in the overall consumer price index declined, on balance, from a peak of 11,0 per cent in April 1995 to a low point of 6,3 per cent in October. As already indicated, lower food prices were a strong force in reducing inflation. But the underlying inflation rate (i.e. the change in the total consumer price index excluding the prices of food and non-alcoholic beverages, home owners' costs and value-added tax) also declined from 9,2 per cent in May 1995 to 7,8 per cent in October. The underlying inflation rate then receded further to 7,4 per cent in December 1995, while the rate of increase in overall consumer prices reverted to 6,9 per cent.

Foreign trade and payments

Current account

The *deficit on the current account* of the balance of payments, which had appeared in the second half of 1994, increased rapidly from a seasonally adjusted and annualised rate of R6,4 billion in the fourth quarter of 1994 to R12,2 billion in the third quarter of 1995 and to no less than R15,0 billion in the fourth quarter. The deficit for 1995 as a whole amounted to R12,7 billion, or 2½ per cent of gross domestic product; this was significantly higher than the deficit of R2,2 billion or ½ per cent of gross domestic product in 1994.

A continued strong increase in the value of merchandise imports, which more than offset the rise in the level of merchandise exports, was primarily responsible for the increasingly large negative current account balance in 1995. In addition, the proceeds from net gold exports contracted and net service and transfer payments to non-residents continued to increase.

The value of *merchandise imports* (seasonally adjusted and annualised) moved sharply upwards from R85,8 billion in the fourth quarter of 1994 to R101,4

Current account

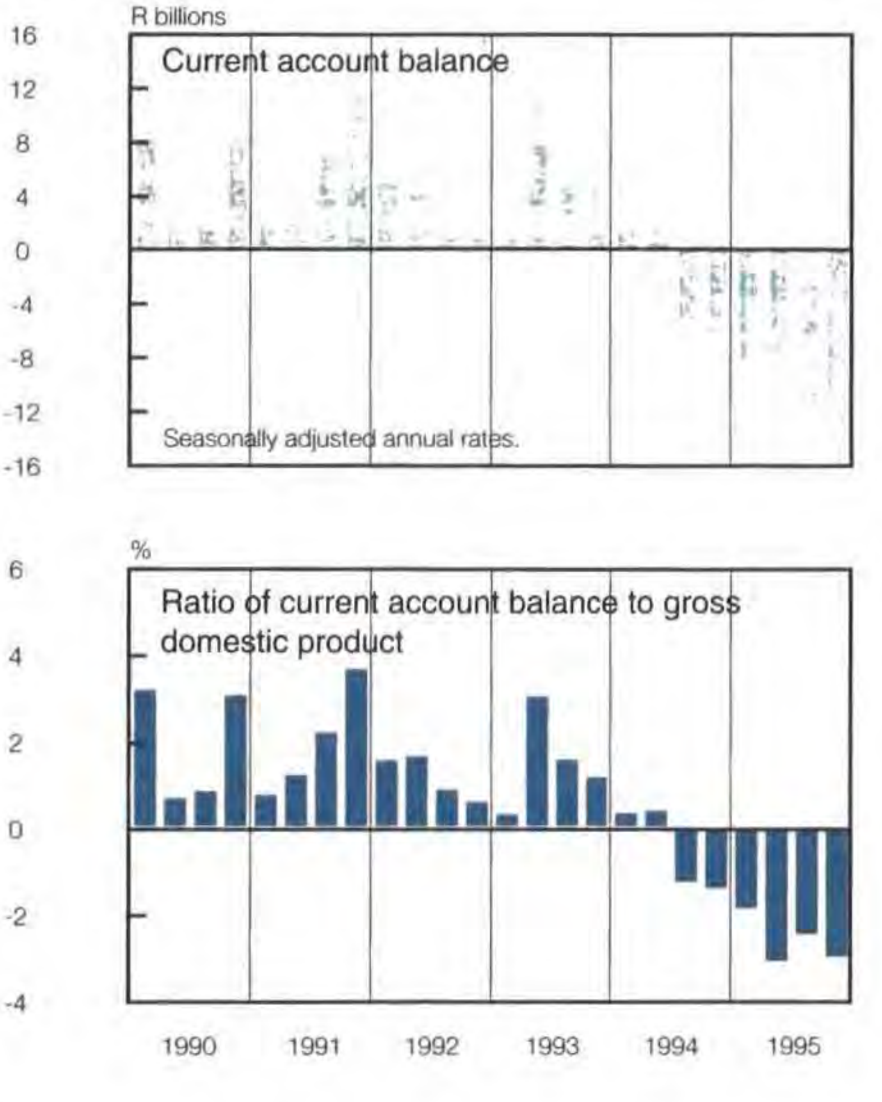


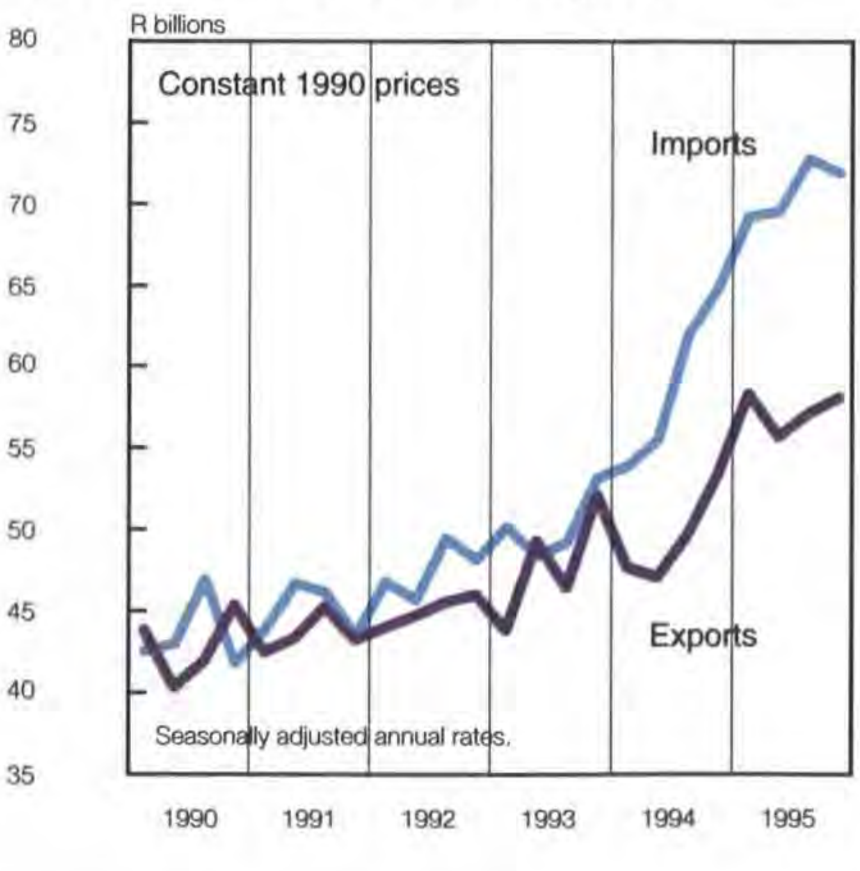
Table 4. Balance of payments on current account
Seasonally adjusted and annualised rates
R billions

	1994	1995				
	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Merchandise exports	65,0	81,4	79,0	81,2	82,4	81,0
Net gold exports	22,6	20,0	19,3	23,3	18,0	20,2
Merchandise imports	-76,3	-94,5	-97,7	-101,4	-100,2	-98,5
Net service and transfer payments	-13,5	-15,6	-15,4	-15,3	-15,2	-15,4
Balance on current account	**-2,2**	**-8,7**	**-14,8**	**-12,2**	**-15,0**	**-12,7**

billion in the third quarter of 1995 and then declined to R100,2 billion in the fourth quarter. In the full calendar year 1995 the value of imports was 29 per cent higher than in the preceding year. This substantial increase was mainly related to the volume of imports: the physical quantity of imports advanced very strongly in the first nine months of 1995, bringing the growth in 1995 to 20 per cent. Although increases were recorded in all the main categories of imports, pronounced increases were registered in machinery and electrical equipment, vehicle and transport equipment and mineral products.

Import prices continued to accelerate at a relatively rapid rate in the first half of 1995 and then declined slightly in the second half. The strong external value of the rand and the relatively low inflation rates in South Africa's major trading partner countries were the main factors responsible for this turnaround in import prices. The average level of import prices in 1995 was nevertheless 7½ per cent higher than in the preceding year, which was nearly equal to the rate of increase of 8 per cent in 1994.

Real merchandise imports and exports



After having increased briskly in 1994, the seasonally adjusted and annualised value of *merchandise exports* fluctuated throughout 1995 around a more or less horizontal level. The average value of merchandise exports was, however, still 24½ per cent above the export proceeds in 1994. In particular, the exports of manufactured goods (chemical products, machinery and electrical equipment, transport equipment and paper products) as well as mining products performed well, while the poor agricultural conditions at that time hampered the growth in the export of agricultural products.

Both volume and price increases contributed to the rise in the average value of merchandise exports in 1995. The volume of exports expanded by 16 per cent, which was substantially higher than the increase of 3 per cent in 1994. As a ratio of real gross domestic product, merchandise exports at constant prices rose from 17½ per cent in 1994 to 20 per cent in 1995; these ratios were considerably higher than the low of 10½ per cent in 1984. A decline in international commodity prices and the strong value of the rand internationally in the second half of 1995 gave rise to a levelling-off in the upward movement in export prices. In any event, export prices rose by 7½ per cent in 1995 on top of the increase of 11½ per cent in 1994.

The value of *net gold exports* generally remained depressed throughout 1995, with the result that gold earnings declined by 11 per cent in the year as a whole. The volume of net gold exports receded by 13½ per cent in 1995 on account of the poor performance in the domestic production of gold described in some detail above. The average fixing price of gold rose from R1 363 per fine ounce in 1994 to R1 393 per fine ounce in 1995. Expressed in US dollars, the average gold price remained unchanged at $384 per fine ounce in 1995. A sharp rise in the investment demand for gold brought about a surge in the gold price from the beginning of 1996 and caused the average monthly gold price to strengthen to $399 per fine ounce in January 1996.

Net *service and transfer payments* to non-residents rose from R13,5 billion in 1994 to R15,4 billion in 1995, or by 13 per cent. Higher payments on freight and merchandise insurance on imports and interest payments on sharply rising foreign debt were mainly responsible for this increase. These higher payments were only partly offset by an increase in tourist receipts arising from the greater number of foreigners who visited South Africa in 1995.

Capital account

A continued large *total net inflow of capital* not related to reserves was recorded on the capital account of South Africa's balance of payments in the fourth quarter of 1995. Moreover, the total net inflow of capital not related to reserves increased from R3,8 billion in the third quarter of 1995 to R7,4 billion in the fourth quarter – the highest quarterly inflow recorded since the turnaround in capital movements had taken place after the election of the Government of National Unity. For the calendar year 1995 as a whole, the total net inflow of capital accordingly amounted to R21,7 billion. This followed a net inflow of R5,4 billion in 1994. The cumulative net inflow of capital not related to reserves from the middle of 1994 to the end of 1995 came to R30,8 billion, compared with a net outflow of capital of R51,7 billion from the beginning of 1985 up to the second quarter of 1994.

The improvement in the capital account in 1995 was mainly due to a net inflow of *long-term capital*, i.e. capital with an original maturity of longer than one year or with an indefinite maturity. A large part of the inflow of long-term capital, however, consisted of portfolio investments which could be less permanent and more volatile. In 1995 non-residents were net purchasers of securities in the formal and informal markets to the amount of R6,0 billion, which represented nearly half of the total net inflow of long-term capital of R12,5 billion.

Various factors contributed to the remaining more permanent part of the inflow of long-term capital in 1995, such as:

Net service and transfer payments

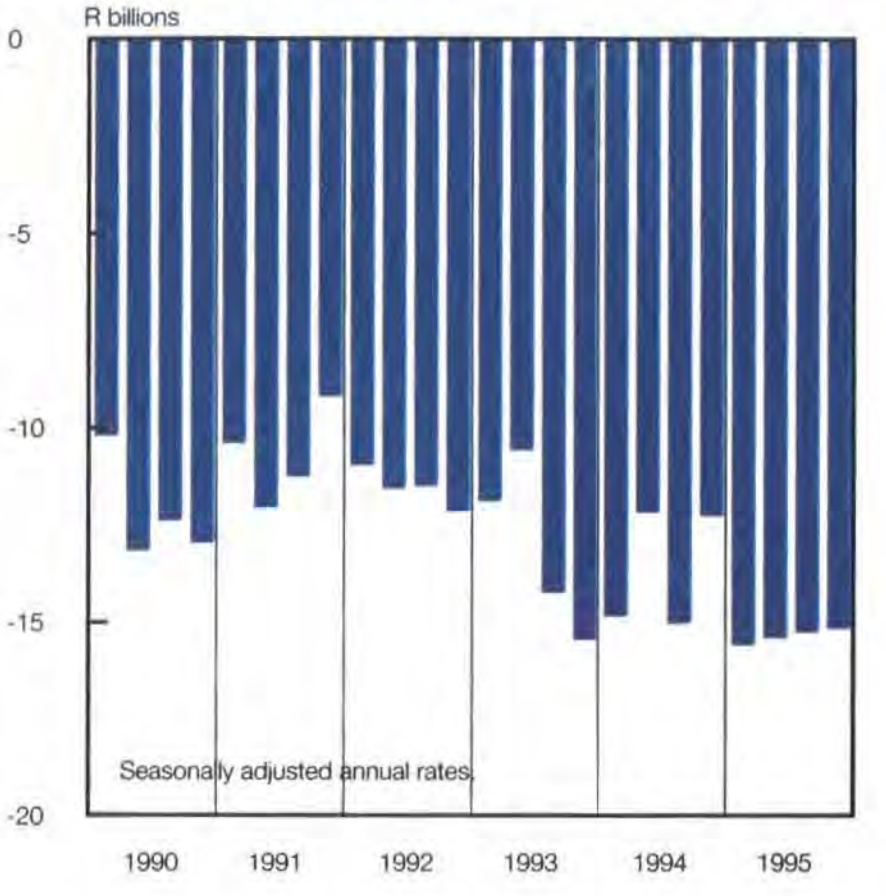


Table 5. Net capital movements not related to reserves
R billions

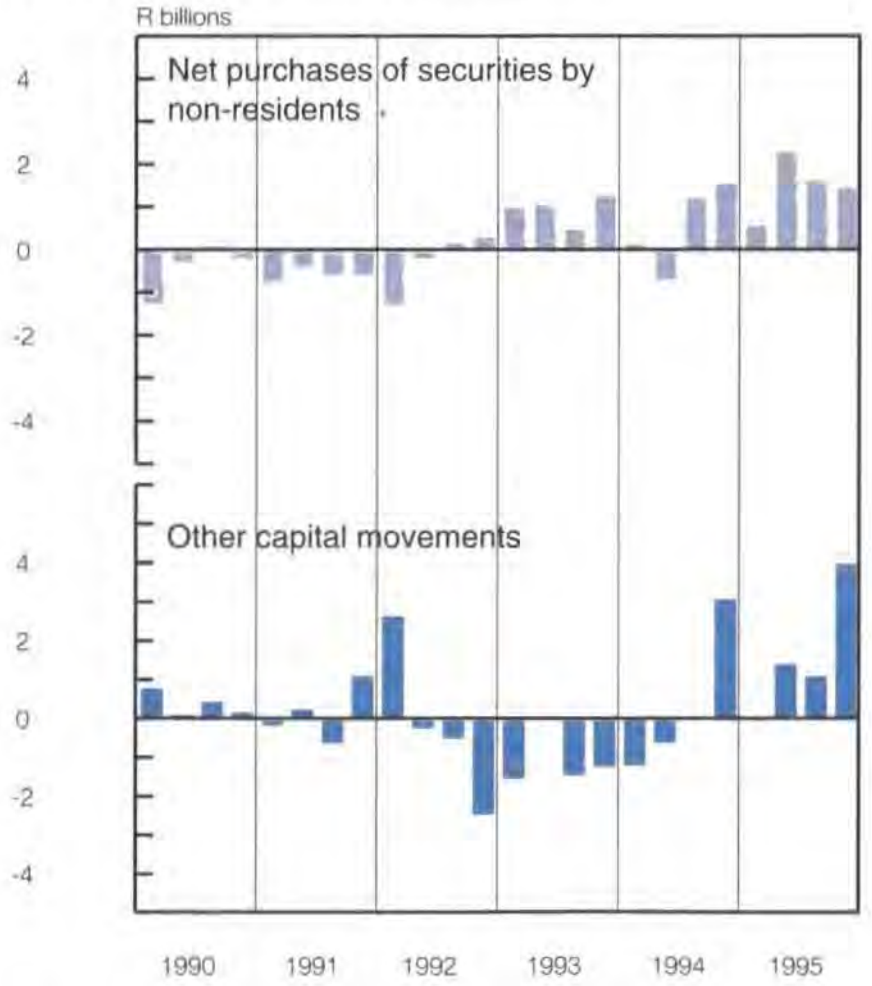
	1994	1995				
	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Long-term capital						
Public authorities	3,5	-0,1	1,5	-	0,2	1,6
Public corporations	0,6	-0,4	-0,2	1,1	1,9	2,4
Private sector	-0,6	1,0	2,4	1,7	3,4	8,5
Total	**3,5**	**0,5**	**3,7**	**2,8**	**5,5**	**12,5**
Short-term capital	1,9	5,0	1,3	1,0	1,9	9,2
Total capital	**5,4**	**5,5**	**5,0**	**3,8**	**7,4**	**21,7**

- The rolling over of some of the country's fixed repayment obligations on foreign debt in view of the relatively favourable credit ratings which the country had received. Debt obligations which fell due for repayment in 1995 amounted to no less than R7,9 billion.

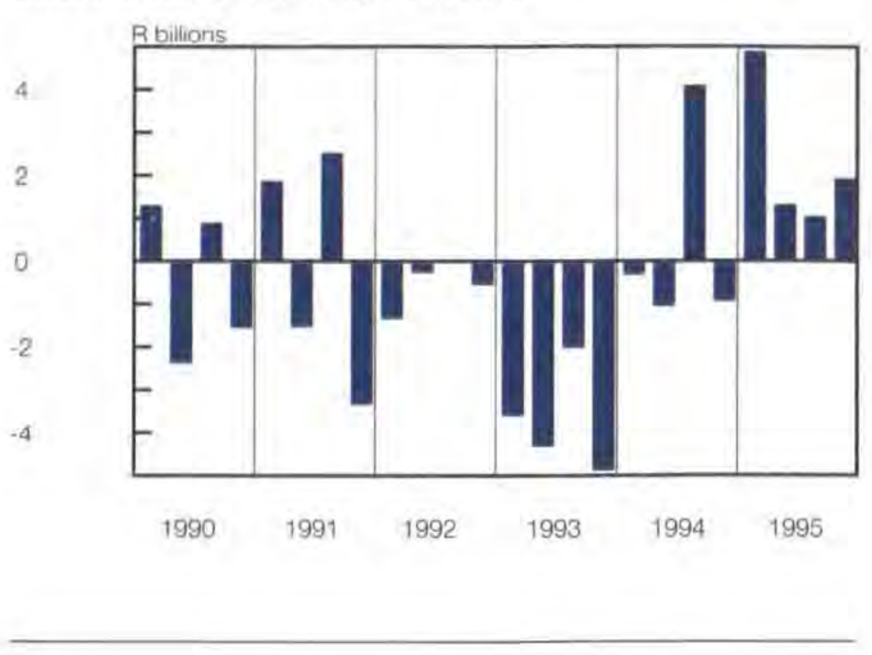
- The placement of various bond issues on the international capital markets by the public authorities, public corporations and the banking sector totalling R4,1 billion in 1995; in the fourth quarter of 1995 foreign funds raised by international bond issues came to R1,8 billion.

- Syndicated loans entered into first by the banking sector but later also by the public corporations to finance domestic operations. The maturity structure of these loans also lengthened considerably during 1995. Initially, only one-year syndicated loans were available; from the fourth quarter of 1995 South African banks successfully concluded negotiations for loans with a three-year redemption period.

Long-term capital movements



Short-term capital movements



Net *short-term capital* movements not related to reserves, but including unrecorded transactions, dropped from a high inflow of R5,0 billion in the first quarter of 1995 to an average net inflow of R1,4 billion in the next three quarters. This lower inflow could be attributed mainly to a decrease in trade-related liabilities. South African banks, however, continued to borrow considerably from abroad to finance their domestic credit extension. Besides their net long-term borrowing of R1,3 billion, the private banks raised short-term liabilities abroad amounting to R9,0 billion in 1995. These flows were primarily responsible for the total net inflow of short-term capital of R9,2 billion for calendar 1995, compared with R1,9 billion in the preceding year. In contrast to this borrowing of short-term funds by the banking sector, the public authorities and the private non-banking sector made net repayments on their foreign short-term debt.

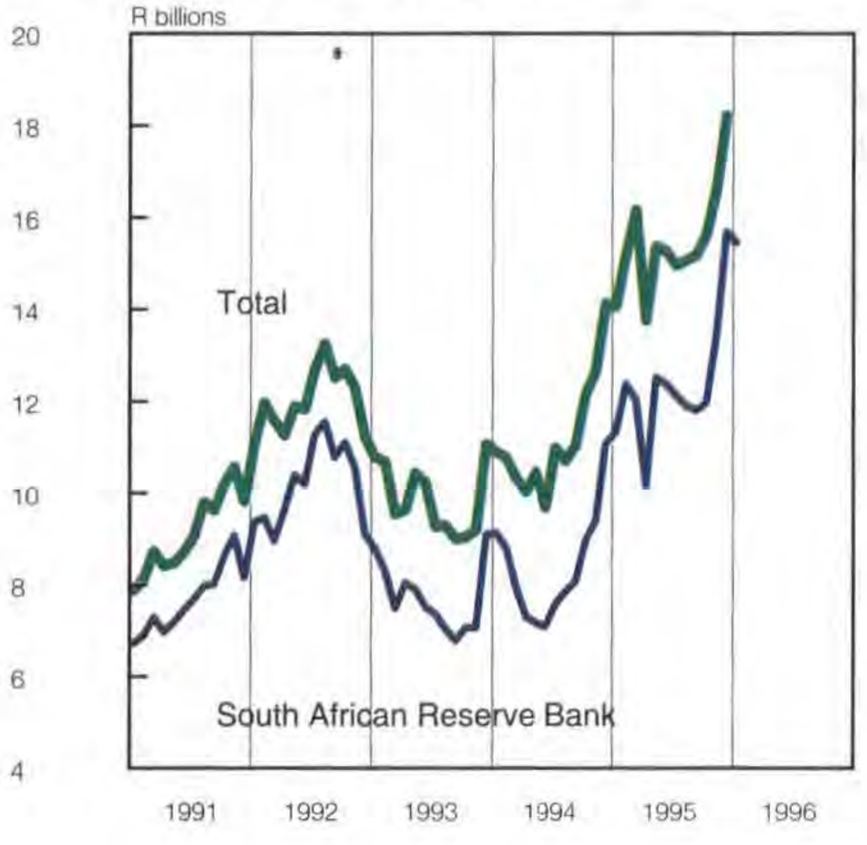
Foreign reserves

The substantial net inflow of capital in 1995 was more than sufficient to finance the shortfall on the current account of the balance of payments, with the result that the *net gold and other foreign reserves* rose by R9,1 billion in the year. By far the largest quarterly increase, viz. R4,4 billion, was registered in the fourth quarter of 1995. However, the net gold and other reserves of the South African Reserve Bank declined again by R0,5 billion in January 1996.

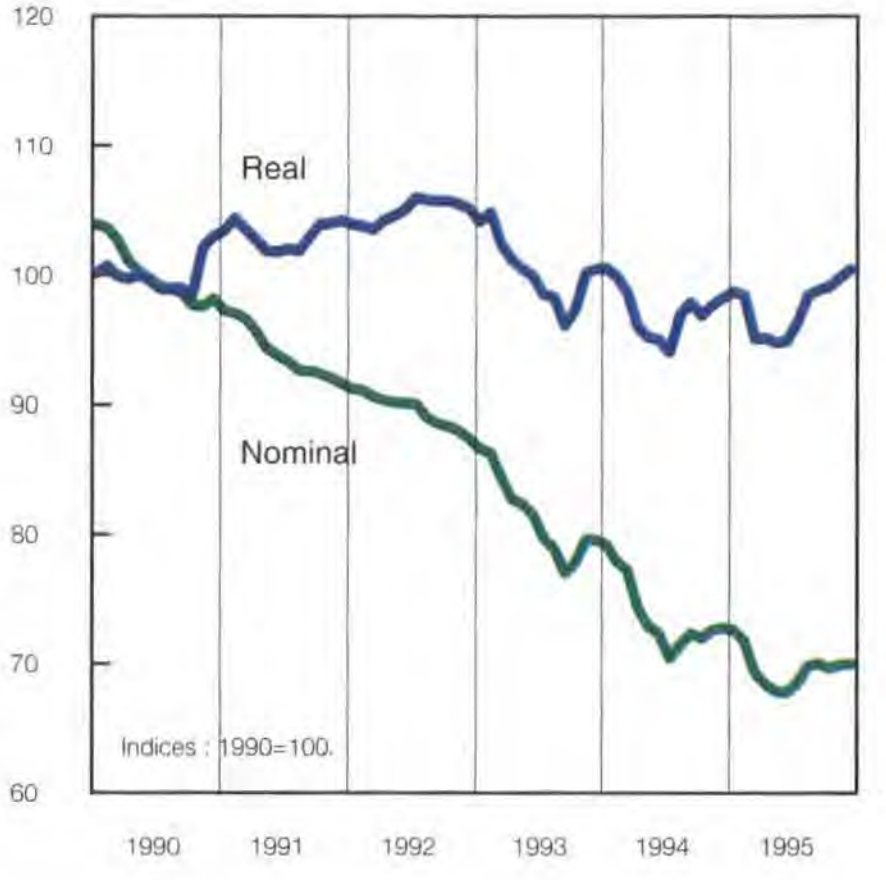
The significant improvement in the overall balance of payments position enabled the Reserve Bank to fully redeem its outstanding *reserve-related liabilities* in November 1995; the outstanding foreign loans of the Bank still amounted to R5,1 billion at the end of December 1994. From April 1994 the Reserve Bank has now repaid loans to the value of R8,5 billion undertaken to support the gross foreign exchange holdings of the country.

South Africa's total *gross gold and other foreign reserves* rose from R14,1 billion at the end of 1994 to R15,2 billion at the end of September 1995 and to R18,2 billion at the end of December 1995. After having increased by R2,2 billion in December 1995, the gross foreign reserves of the Reserve Bank decreased by R229 million in January 1996. Without taking into account the credit facilities of the monetary authority, the total foreign reserves of the country were equal to seven weeks' imports of goods and services at the end of December 1995.

Gross gold and other foreign reserves



Effective exchange rates of the rand



Foreign exchange market

The general stability in the international market in foreign exchange was probably mainly responsible for a small decline in the net daily *turnover* (gross figures adjusted for double-counting arising from domestic interbank business) in foreign exchange in South Africa from \$5,2 billion in the third quarter of 1995 to \$5,0 billion in the fourth quarter. More particularly, the turnover in forward cover contracted over this period, while the turnover in spot transactions rose moderately.

After having declined by 7,6 per cent in the first five months of 1995, the *nominal effective exchange rate* of the rand rose by 4,4 per cent up to the end of December 1995. This rise brought the decline in the average weighted value of the rand to 3,6 per cent in 1995; this was considerably smaller than the decline of 8,5 per cent during the calendar year 1994. In January 1996 the nominal effective exchange rate of the rand increased further by 1,4 per cent.

As shown in the accompanying table, the rand depreciated against all the *major currencies* in 1995, with the exception of the Japanese yen. Large depreciations were particularly registered against the German mark and the Netherlands guilder.

The increase in the nominal effective exchange rate of the rand and the smaller inflation differential between South Africa and its major trading partner countries brought about an increase of 5,3 per cent in the *real effective exchange rate* of the rand from May 1995 until December. At the end of December 1995 the real effective exchange rate of the rand was therefore 1,5 per cent above its level at the end of 1994.

Table 6. Changes in the exchange rates of the rand

Per cent

	31 Dec 1994 to 31 May 1995	31 May 1995 to 31 Dec 1995	31 Dec 1994 to 31 Dec 1995	31 Dec 1995 to 31 Jan 1996
Weighted average	-7,6	4,4	-3,6	1,4
US dollar	-3,3	0,5	-2,9	-0,1
British pound	-6,0	4,1	-2,1	2,6
German mark	-13,3	3,8	-10,0	3,5
Japanese yen	-19,4	24,4	0,2	3,7
Netherlands guilder	-13,3	3,8	-10,1	3,5
Italian lira	-4,0	-1,5	-5,4	0,7

Monetary developments, interest rates and financial markets

Money supply

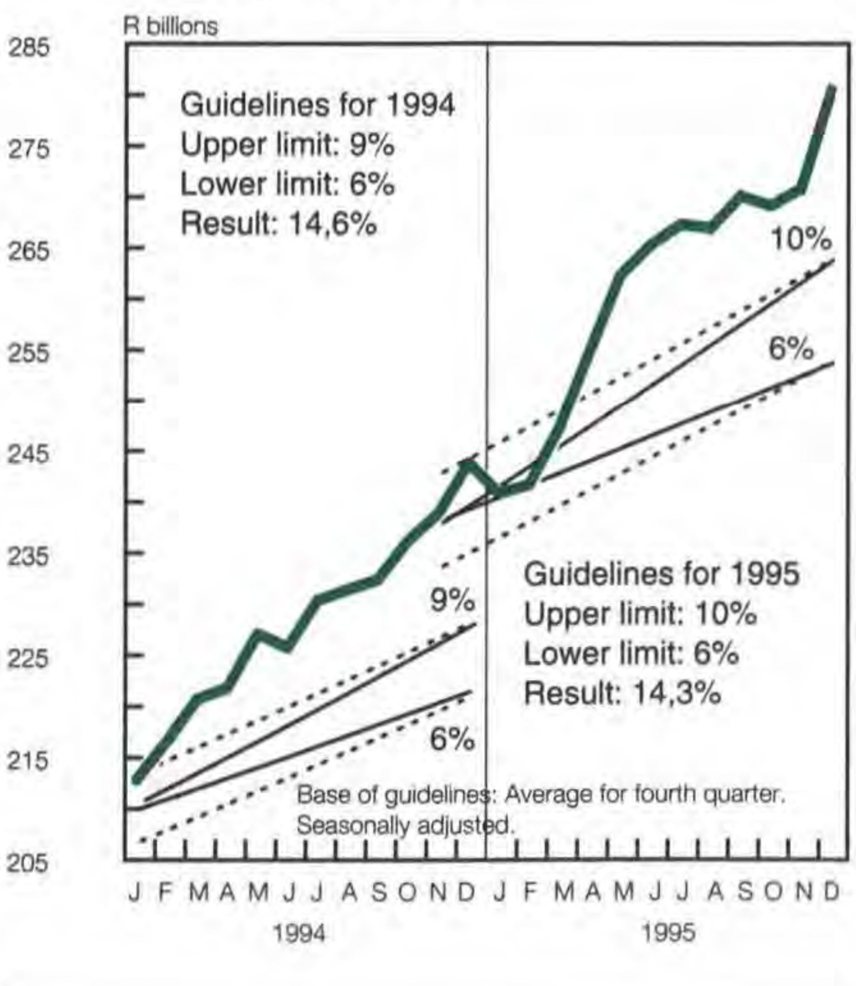
The growth rate over twelve months in the *broadly defined money supply* (M3), which had peaked at 16,9 per cent in July 1994, dropped to 11,8 per cent in February 1995 and then rose to 16,8 per cent in June before declining again to 13,8 per cent in November. In December 1995 it rose abruptedly to 15,1 per cent. The generally rapid growth in money supply during 1995 was primarily demand driven, reflecting the higher level of economic activity and increases in expenditure on consumption, investment and inventory accumulation. The private sector's liquidity preference rose at the same time, *inter alia* on account of expected interest rate changes and in anticipation of major adjustments in the share and bond markets.

The quarter-to-quarter growth in M3, at seasonally adjusted and annualised rates, peaked at 27,3 per cent in the second quarter of 1995 and then declined to 15,5 per cent in the third quarter and 6,9 per cent in the fourth quarter. This lower growth was recorded while economic activity accelerated somewhat and probably indicated a decrease in the liquidity preference proper in view of sharply increasing share and bond prices in the second half of 1995. The margin between the banks' deposit and lending rates also widened during this period which is conducive to disintermediation practices and a slowdown in monetary growth.

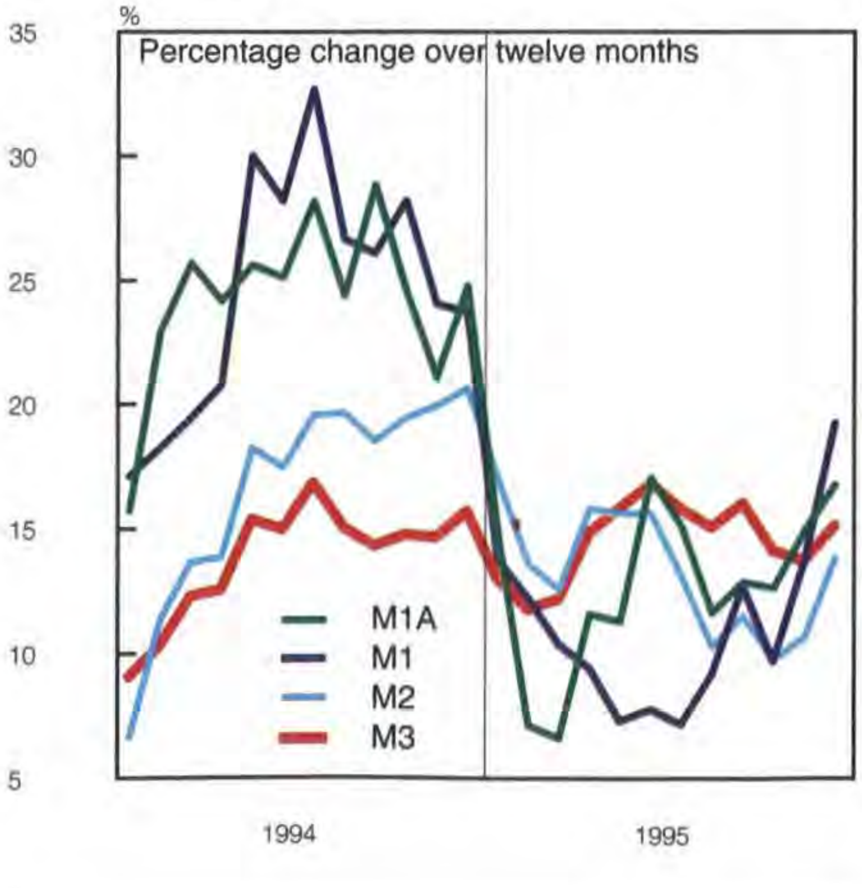
The money supply growth during 1995 nevertheless exceeded the *monetary guidelines* for the second consecutive year. During the 1994 guideline year the growth in M3 amounted to 14,6 per cent from the fourth quarter of 1993 to the fourth quarter of 1994, against the guideline range of only 6 to 9 per cent. After having stayed within the guideline range in the first two months of 1995, the monthly values of M3 exceeded the corresponding values of the upper limits of the money supply guideline range continuously from March 1995. The growth in the quarterly average value of the broadly defined money supply from the fourth quarter of 1994 to the fourth quarter of 1995 eventually came to 14,3 per cent; this was sizeably higher than the upper limit of the guideline range of 6 to 10 per cent.

As shown in the accompanying graph, the twelve-month growth rates in the *narrowly defined monetary aggregates* generally displayed the same pattern as the corresponding rates of increase in M3. The growth rates in the narrowly defined aggregates were, however, more volatile and generally on higher levels than those of M3 in 1994 and the first three months of 1995. These high growth rates probably reflected the liquidity preference of private-sector depositors at that time due to expected interest rate increases. From the

Guidelines for growth in M3



Monetary aggregates



middle of 1995 the rates of increase over twelve months in the narrower monetary aggregates, with the exception of M1, broadly corresponded with that of M3, but were at considerably lower levels. The relatively faster growth in M3 than in the narrower monetary aggregates was the result of a shift from demand deposits to other short- and medium-term deposits and long-term deposits with the monetary sector, particularly when expectations of a decline in long-term interest rates arose.

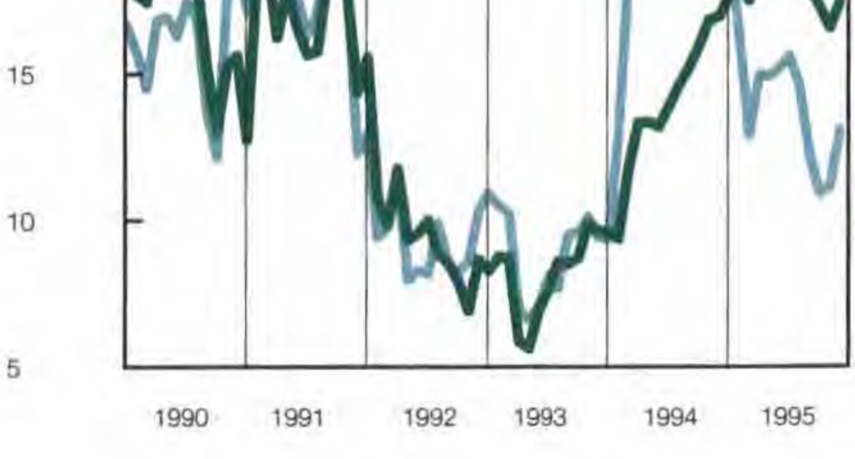
In an accounting or statistical sense, the *counterparts* of the increase of R37,0 billion in M3 during 1995 were as follows:

		R billions
Net foreign assets		-
Net gold and foreign exchange reserves	9,1	
Net other foreign assets	-9,1	
Net claims on government sector		-9,7
Gross claims	-0,1	
Government deposits	9,6	
Claims on private sector		47,1
Net other assets and liabilities		-0,4
Increase in M3		**37,0**

Credit extension

The growth over twelve months in *total domestic credit extension* by the monetary sector receded from 19,9 per cent in December 1994 to 11,0 per cent in October 1995, but increased again to 13,2 per cent in December.

Credit extended by monetary institutions



This lower rate of increase in credit extension was mainly the result of a contraction in the net claims on the government sector of monetary institutions owing to a sharp increase in government deposits with banks. Particularly in the second half of 1995 the net credit extended to the government sector declined sharply.

The twelve-month rate of increase in *credit extension to the private sector* by monetary institutions advanced from an already high 17,0 per cent in December 1994 to a peak of 19,5 per cent in June 1995; it then receded to 16,7 per cent and 17,5 per cent in November and December, respectively. These monthly growth rates have exceeded the rate of increase over twelve months in the consumer price index since March 1994, indicating that credit extension in real terms has been consistently positive. Recently, however, the twelve-month rate of increase in real credit extension to the private sector abated somewhat from 10,9 per cent in September 1995 to 9,9 per cent in December. The quarter-to-quarter growth (at seasonally adjusted and annualised rates) declined too, viz. from 21,3 per cent in the second quarter of 1995 to 14,1 per cent in the fourth quarter.

An analysis of the monetary institutions' claims on the private sector by *type of credit* shows that the growth rate over twelve months in the main categories of credit extension varied considerably in 1995. The following main tendencies were discernible:

- the growth in mortgage advances began to taper off in the second half of the year;
- instalment sales continued to increase at exceptionally high rates;
- leasing finance began to expand rapidly in the second half of the year owing to the buoyant sales of new motor vehicles;

Table 7. Percentage change over twelve months in credit extension to the private sector by main type of credit

	1994	1995			
	Dec	Mar	Jun	Sept	Dec
Mortgages	17,9	19,6	19,5	18,9	17,7
Instalment sales	27,6	25,4	27,8	28,1	27,2
Leasing finance	7,2	7,9	13,8	17,8	16,6
Investments and bills discounted	28,0	33,6	27,0	4,1	11,1
Other loans and advances	12,8	12,2	16,7	16,6	15,6
Total	**17,0**	**17,6**	**19,5**	**18,0**	**17,5**
Total real credit extension	6,5	6,7	8,6	10,9	9,9

- the growth in investments and bills discounted contracted to relatively insignificant rates; and
- the rate of increase in "other loans and advances", which had accelerated in the first half of the year, became more subdued in the last six months.

In absolute terms credit extension by monetary institutions to the private sector was dominated during 1995 by mortgage advances and "other loans and advances". These two credit instruments contributed R34,3 billion, or approximately 73 per cent, to the total increase of R47,1 billion in credit extension to the private sector.

Credit extension to *households* by monetary institutions increased by R26,0 billion, or 18,7 per cent, in 1995. The rate of increase over twelve months in the credit extension to households initially rose from 14,7 per cent in December 1994 to 18,7 per cent in December 1995. Mortgage advances remained the most important type of credit to households and 66 per cent of the outstanding household credit at the end of 1995 was secured by mortgages.

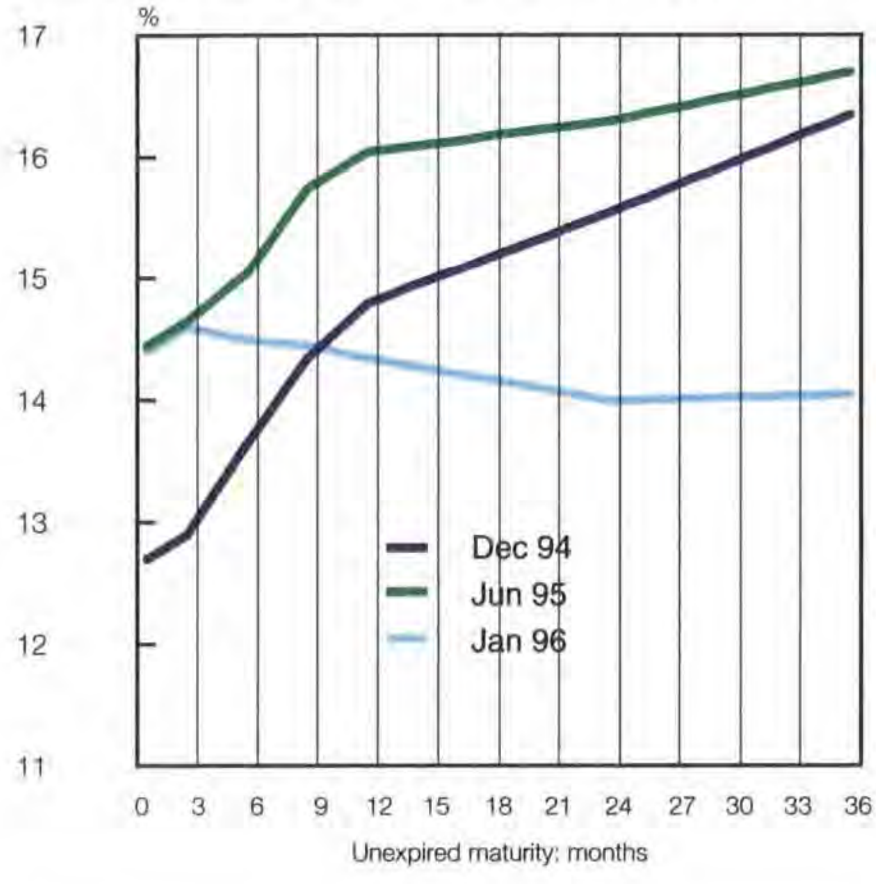
The twelve-month rate of increase in credit extended by monetary institutions to the *private business sector* declined from 17,1 per cent in December 1994 to 14,8 per cent in March 1995, before accelerating again to 17,1 per cent in December 1995. With the exception of overdrafts, all types of credit contributed to the more rapid growth of credit to private enterprises.

Interest rates and yields

Money market interest rates, which had started to rise during 1994, increased steeply in the first six months of 1995 and remained relatively firm in the last half of the year. In January 1996 these rates generally began to move downwards. The rate on bankers' acceptances with a maturity of three months, for instance, increased from 12,50 per cent at the end of December 1994 to 14,20 per cent at the end of June 1995 and 14,60 per cent at the end of December 1995; it then softened to 14,10 per cent at the end of January 1996. The tender rate on Treasury bills of three months similarly rose from 12,69 per cent at the end of 1994 to 14,07 per cent at the end of June 1995; it then fluctuated upwards to 14,22 per cent at the end of December 1995 and contracted to 13,93 per cent at the end of January 1996.

These movements in money market interest rates during 1995 were also reflected in the term structure on negotiable certificates of deposit (see graph). The yields on negotiable certificates of deposit with an outstanding maturity of up to six months moved steeply upwards during the course of 1995. In contrast to these movements, the yields on negotiable certificates of deposits with outstanding maturities of twelve months and longer softened in the second half of 1995. The yield curve of negotiable certificates of deposit consequently became inverted, which may be an indication of an expected decline in money market rates.

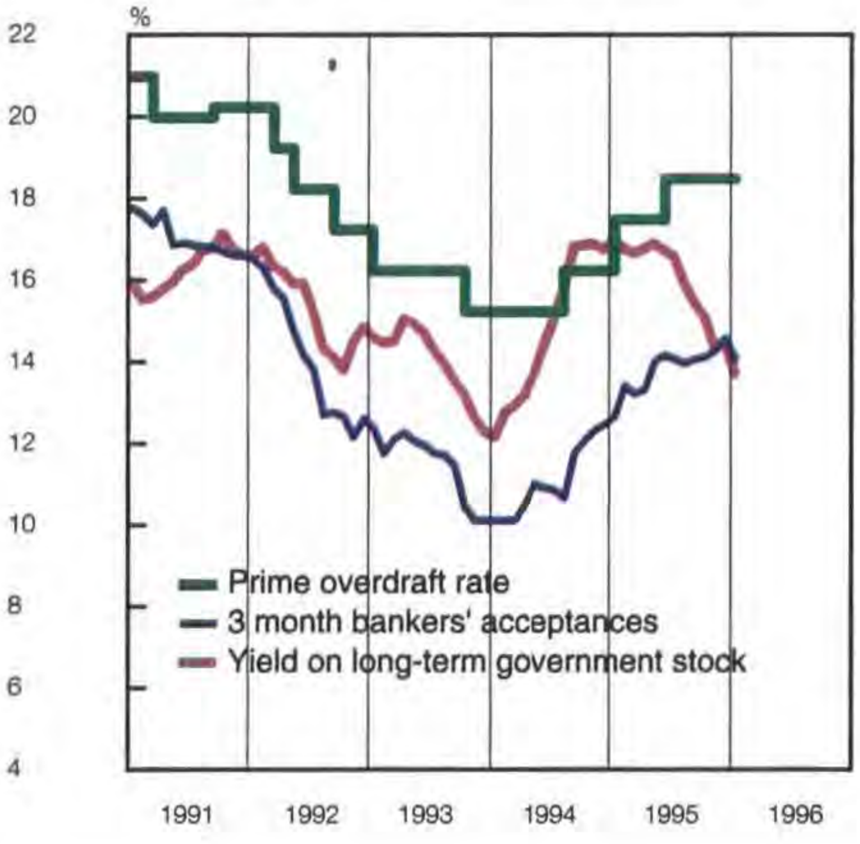
Yield curves for negotiable certificates of deposit



The *longer-term interest rate structure*, as embodied in the yield curve of government securities, also changed considerably during the course of 1995. In June 1995 long-term yields were substantially higher than shorter-term yields, but in the second half of the year long-term yields moved downwards more rapidly than shorter-term yields. The yield curve at the end of October 1995 was therefore not only markedly lower than in June 1995, but also relatively flat. From November 1995 bond yields across the maturity spectrum moved even lower.

The monthly average yield on long-term government stock initially receded hesitantly from a high of 17,02 per cent in January 1995 to 16,62 per cent in July 1995, and then declined rapidly to 13,77 per cent in January 1996. Various factors probably contributed to the fall in capital market yields during this period, including significant downward adjustments in inflation expectations; an increase in domestic liquidity due to large capital inflows from abroad; a relatively low demand for funds in the domestic capital market; and declines in international long-term yields. Despite this decline in nominal yields, the monthly average real yield on long-term government stock of 7,2 per cent in December 1995 was still comparatively high.

Interest rates and yields



The *other borrowing and lending rates* have remained relatively stable since July 1995. The prime overdraft rate and the predominant rate on mortgage loans of banks were maintained at their respective levels of 18,50 and 18,25 per cent. The predominant rate on twelve-month fixed deposits with banks was reduced by 0,5 percentage points to 14,0 per cent in November 1995 because of easier market conditions. This increased the margin between the prime lending and twelve-month deposit rates to 4,5 per cent. The pre-tax real yields (i.e. nominal rates adjusted by the increase in the consumer price index over twelve months) on twelve-month deposits and mortgage loans amounted to 6,6 and 10,6 per cent in December 1995.

The *maximum permissible finance charge rates,* as laid down in terms of the Usury Act, were increased by three percentage points during 1995. At the end of 1995 these rates stood at 31 per cent in respect of money lending, credit and leasing transactions for amounts of less than R6 000 and at 28 per cent for amounts higher than R6 000 but not exceeding R500 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 in six steps from 17,25 per cent in June 1995 to 14,50 per cent from 1 December 1995, and then increased again to 14,75 per cent from 1 January 1996. With effect from 1 February 1996 this rate was lowered to 14,00 per cent.

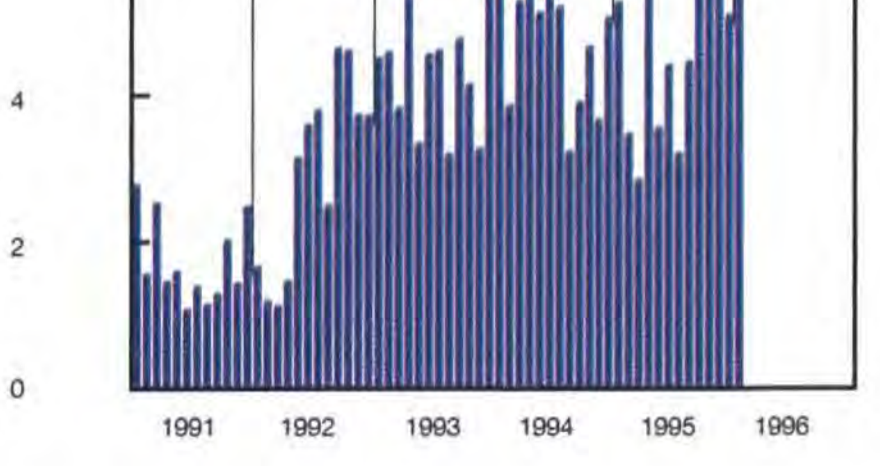
Money market

Money market conditions, which had generally been easy in the first seven months of 1995, tightened considerably during the rest of the year and in January 1996. This was clearly reflected in the amount of accommodation which the Reserve Bank provided to banks. This so-called money market shortage rose from R3,2 billion at the end of July 1995 to R7,4 billion at the end of October, contracted to R5,1 billion at the end of December 1995 and rose again sharply to R8,0 billion at the end of January 1996.

These tight conditions in the money market could to a large extent be attributed to an increase in government deposits with the Reserve Bank from R3,9 billion on 31 July 1995 to R5,8 billion on 31 October; it then contracted to R2,9 billion at the end of 1995 before rising to R7,9 billion on 31 January 1996. The tightening effect of these changes was supported by an increase in notes and coin in circulation outside the Reserve Bank in the second half of the year and a decrease in the net foreign assets of the Reserve Bank during August and September 1995. However, in the fourth quarter of 1995 the net foreign assets of the Reserve Bank increased by R5,5 billion.

After having adopted a much more conservative policy stance towards the end of the first quarter of 1995, the *Reserve Bank's operations* in the money market in the rest of the year concentrated mainly on measures to drain liquidity. In accordance with this approach, the Reserve Bank undertook open-market

Accommodation at the discount window



operations from its own portfolio with a net tightening effect on money market conditions. In addition, short-term adjustments were made in the asset portfolio of the Corporation for Public Deposits and government deposits with the Reserve Bank were managed in such a way as to counter large fluctuations in the money market shortage.

Bond market

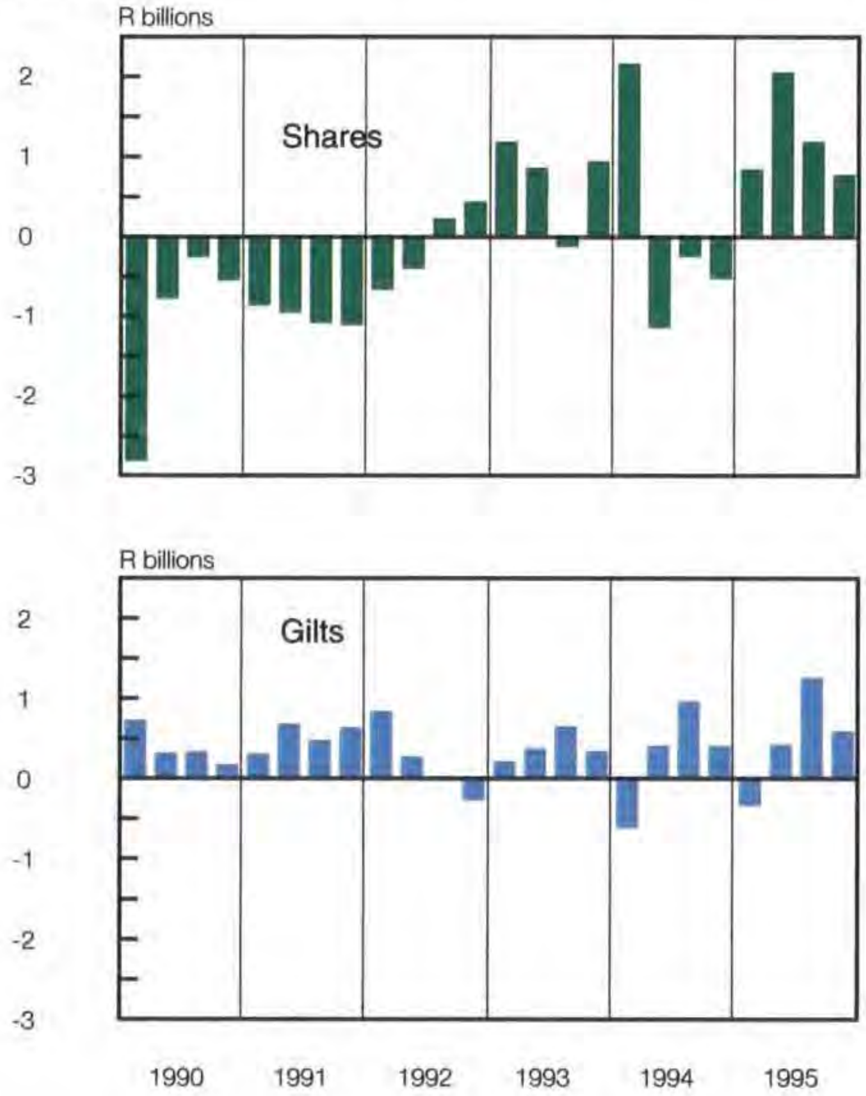
During 1995 net new issues of fixed-interest securities in the domestic *primary bond market* by the *public sector* increased significantly from R3,5 billion in the first quarter to levels of R9,5 billion and R10,0 billion in the next two quarters, before decreasing to R1,5 billion in the fourth quarter. The net issues of public-sector stock in the first nine months of fiscal 1995/96 (i.e. the period April 1995 to December 1995) therefore totalled R21,1 billion; in the corresponding period of the preceding year these issues amounted to R19,1 billion. The redemption dates of the new issues of stock were predominantly in the five-to-fifteen year range because these bonds were in great demand.

In addition to these domestic issues, the authorities continued their efforts to normalise *international financial relations* by reintroducing South Africa to the international investment community and expanding the investor base of the country. The government's issue of R1,3 billion (¥30 billion) in the Samurai market in May 1995 was followed by an issue of R560 million (£100 million) in the UK market in January 1996. The last-mentioned bond has a maturity of ten years and local institutions were allowed to buy up to 10 per cent of the issue. The tight spread at the time of issue of 190 basis points above the equivalent British government bonds illustrated the improved investor rating of South Africa. Other institutions in the public sector raised R1,4 billion in the Japanese bond market in the fourth quarter of 1995.

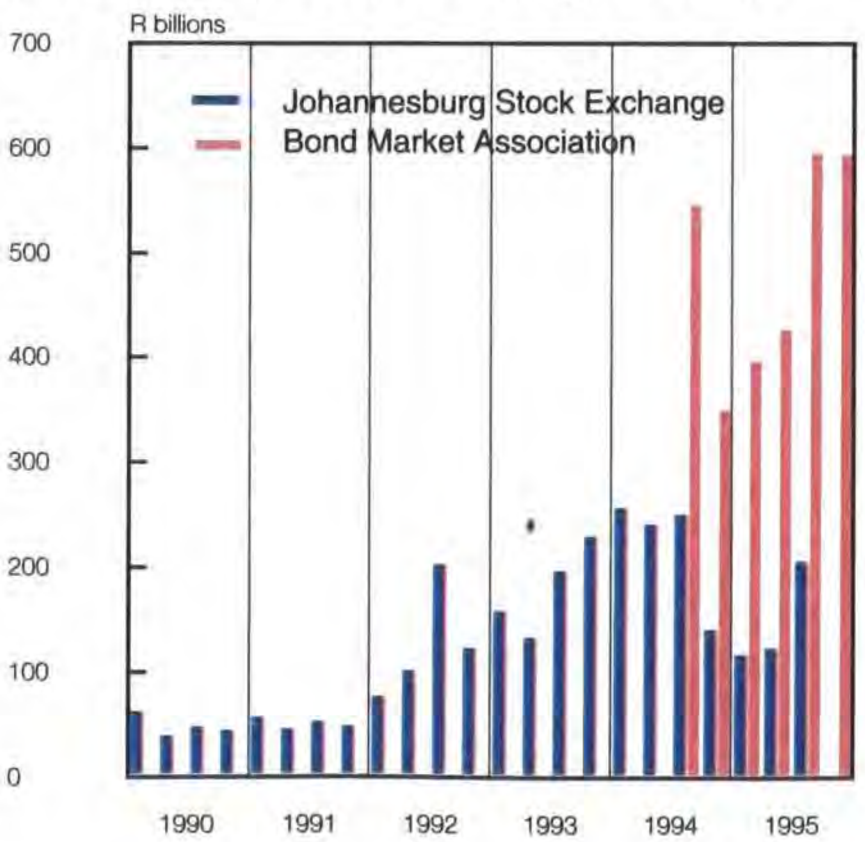
Funds acquired by listed *private-sector* companies through new issues of fixed-interest securities in the primary market remained low in 1995. This was most probably due to the liquid position of the corporate sector. In 1995 these issues by private-sector companies listed on the stock exchange amounted to R932 million. A number of companies, however, raised capital in foreign markets by means of convertible bonds to the amount of R1,9 billion during this period.

Activity in the *secondary bond market* was subdued at the beginning of 1995 due to uncertainty regarding prospective movements in long-term yields, but increased markedly from the third quarter as yields began to soften. The value of public-sector stock traded on the bond market, as published by the Bond Market Association, advanced from R394 billion in the first quarter of 1995 to R595 billion in the third quarter and R592 billion in the fourth quarter. In January 1996 the value of public-sector stock traded came to R227 billion; this was slightly higher than the monthly

Non-residents' net transactions on the stock exchange



Transactions in securities of the public sector



average of R197 billion in the fourth quarter of 1995.

Non-residents were actively involved in the secondary bond market and became large net purchasers of stock from April 1995. This could be attributed to the successful abolition of the dual exchange rate system, a stable external value of the rand, attractive domestic yields and declining rates abroad. In the nine months to December 1995 non-residents' net purchases on the Johannesburg Stock Exchange amounted to R2,2 billion, which brought their net purchases for the year as a whole to R1,9 billion. In 1994 non-residents' net purchases of bonds on the stock exchange amounted to R1,1 billion.

Equity market

Funds raised in the *primary equity market* on a quarterly basis showed a distinct downward movement in 1995. The value of rights issues of ordinary shares by listed private sector companies on the Johannesburg Stock Exchange decreased from R2,3 billion in the first quarter of 1995 to R1,3 billion in the third quarter and R1,0 billion in the fourth quarter. In the full calendar year 1995 the value of these issues nevertheless amounted to R6,2 billion, which was considerably in excess of the total of R2,7 billion raised in the preceding year.

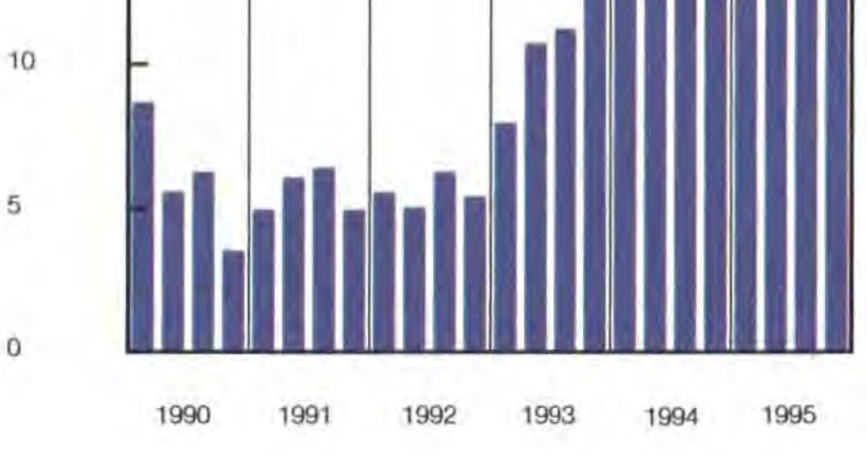
Turnover in the *secondary equity market* was affected positively by rising share prices, good company results and declining bond yields in the second half of the year. The value of shares traded on the Johannesburg Stock Exchange increased from a recent lower turning-point of R13,3 billion in the first quarter of 1995 to R19,4 billion in the fourth quarter, only 6,6 per cent below the record figure reached in the first quarter of 1994. Despite this upward movement, the value of these transactions in 1995 was, at R63,2 billion, still nearly 11,7 per cent lower than in 1994. The monthly average value of shares traded increased further from R6,5 billion in the fourth quarter of 1995 to R9,6 billion in January 1996.

Non-residents were active net buyers of shares on the Johannesburg Stock Exchange during 1995. Their total net purchases amounted to R4,8 billion in this year, compared with R0,2 billion in 1994. The monthly value of net purchases by non-residents grew further from an average of R254 million in the fourth quarter of 1995 to R726 million in January 1996.

The average *price level of all classes of shares* rose steadily from a low in February 1995 to a new all-time high in January 1996. The soaring share prices were led by industrial and financial shares, but in January 1996 the up to then relatively depressed prices of gold-mining shares also reacted vigorously to the higher gold price, which broke through the four hundred dollar resistance level for the first time since July 1993.

The increase in share prices up to September 1995 was less than the average rise in dividends and earnings, with the result that both the *dividend yield* and the *earnings yield* increased in the first nine months of the year. Both these indicators, however, then contracted sharply in the four months up to January when share prices rallied. Owing to the

Stock exchange transactions



Share prices

marked decline in long-term yields, the *yield gap* (the monthly average yield on long-term government stock less the dividend yield on all classes of shares) decreased sharply from 14,6 percentage points in May 1995 to 11,7 percentage points in January 1996.

Important *operational and regulatory changes* were introduced, or are envisaged in the near future, in the Stock Exchange Control Act passed by Parliament in September 1995 and in the new constitution of the Johannesburg Stock Exchange. The major changes included the introduction of:

- limited liability corporate membership and the ownership of broking firms by non-stockbrokers;
- the eligibility of foreign stockbrokers to form new stockbroking companies;
- dual capacity trading;
- fully negotiable brokerage commissions;
- an automated trading system; and
- an electronic scrip registry and rolling settlement.

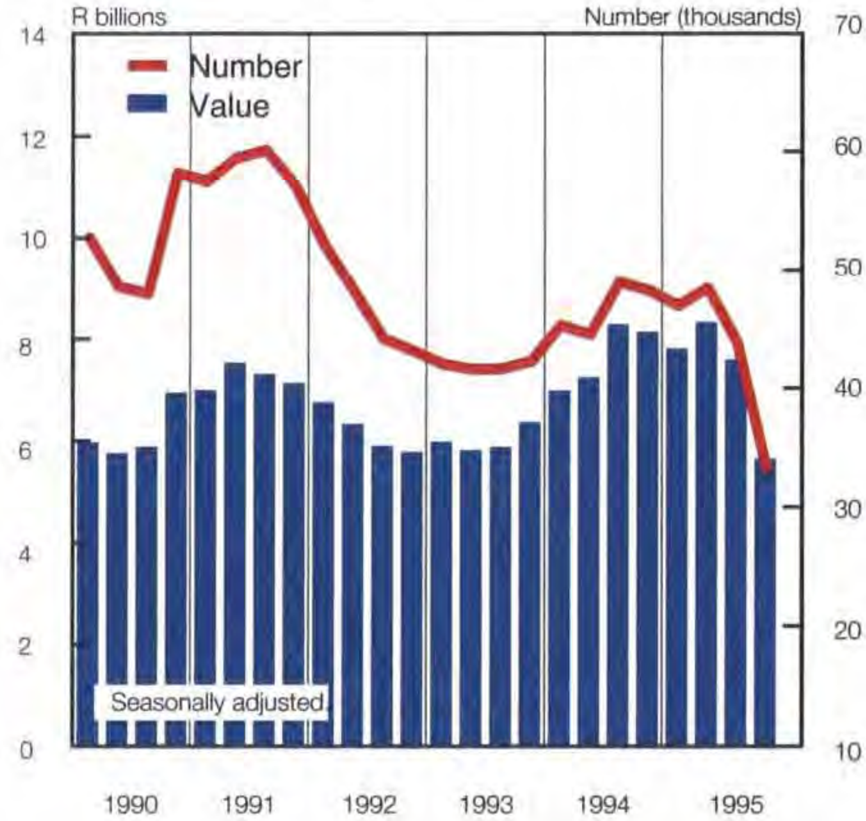
In accordance with the Johannesburg Stock Exchange's goal of contributing to the restructuring of the South African economy, the first company in the new Redevelopment Sector was also listed on the financial board in December 1995. In addition, a new sector known as the Development Stage was included on the industrial board in January 1996.

Other financial markets

In view of the fact that equity futures contracts, at 98,8 per cent of total turnover, dominated trading on the South African Futures Exchange in 1995, the activity in the *formal derivative market* more or less followed that in the equity market. The turnover in *futures contracts* fell back from an all-time high of 1,4 million contracts in the first quarter of 1995 to 0,7 million contracts in the fourth quarter. The total number of contracts traded in 1995 was 13,1 per cent less than in 1994. In January 1996, however, trade began to pick up again. Trade in *options* on futures contracts followed a similar pattern and declined from 1,5 million contracts in the first quarter of 1995 to 0,9 million contracts in the fourth quarter, before increasing sharply in January 1996. During 1995 as a whole trade in these options amounted to 3,6 million contracts, 9,5 per cent more than in 1994.

As indicated earlier, the *mortgage market* remained buoyant during 1995 owing to the active promotion of this comparatively low-cost credit facility. The total amount of mortgage loans outstanding to banks accordingly increased from R110 billion at the end of 1994 to R130 billion at the end of 1995. In the *real estate market,* the value and number of transactions declined from May 1995. The value of real estate transactions in 1995 therefore amounted to R29,5 billion – 4 per cent less than in the previous year. The number of transactions decreased by 7,7 per cent over this same period.

Real estate transactions



Public finance

Public-sector borrowing requirement

The *public-sector borrowing requirement* (i.e. the deficit before borrowing and debt repayment of the consolidated central government, provincial governments, local authorities and the non-financial public enterprises) decreased from R8,6 billion in the first quarter of fiscal 1995/96 (the second quarter of the calendar year 1995) to R5,3 billion in the second quarter and then even further to R3,2 billion in the third quarter. This brought the cumulative public-sector borrowing requirement to R17,1 billion in the first nine months of fiscal 1995/96, or to R5,8 billion below the level in the corresponding period of the preceding year. As a ratio of gross domestic product, the public-sector borrowing requirement amounted to 4,6 per cent in the first nine months of fiscal 1995/96, compared with 6,9 per cent in the first nine months of fiscal 1994/95.

The lower borrowing requirement of the public sector could be attributed to a small increase in the surplus of the non-financial public corporations and a substantial contraction in the borrowing requirement of *general government*. With the exception of the deficit on the income and expenditure accounts of local authorities and social security funds, the balances on the accounts of all other tiers of general government improved in the first nine months of fiscal 1995/96. The Main Budget borrowing requirement decreased slightly from R20,0 billion in the first nine months of fiscal 1994/95 to R19,1 billion in the first nine months of fiscal 1995/96, while the balance on the income and expenditure accounts of provincial governments turned around from a deficit of R2,2 billion to a surplus of R2,1 billion during the same period. The last-mentioned figure, however, includes a deficit of R864 million recorded in the books of the provincial governments during the third quarter of fiscal 1995/96. This could be an indication that some of the provincial governments have now mastered initial problems encountered in the re-organisation of functions and in the administration and management of their activities.

Owing largely to the inability of the government to adapt immediately to all the planned structural changes and reforms, general government expenditure increased at a year-on-year rate of only 6,3 per cent in the first nine months of fiscal 1995/96; in the corresponding period of the preceding year this increase amounted to 17,8 per cent. The Main Budget showed a marked decrease in expenditure on goods and services, and a sharp increase in transfer payments to lower levels of government. At the same time, expenditure on goods and services by the provincial governments increased because of the shift in functions.

Total revenue receipts of general government recorded a year-on-year rate of increase of 13,4 per cent in the first nine months of fiscal 1995/96. Although this was considerably higher than the rate of increase in general government expenditure, it was somewhat lower than the corresponding rate of increase in revenue during the same period of the preceding year. From the information in Table 8, it is

Public-sector borrowing requirement as percentage of gross domestic product

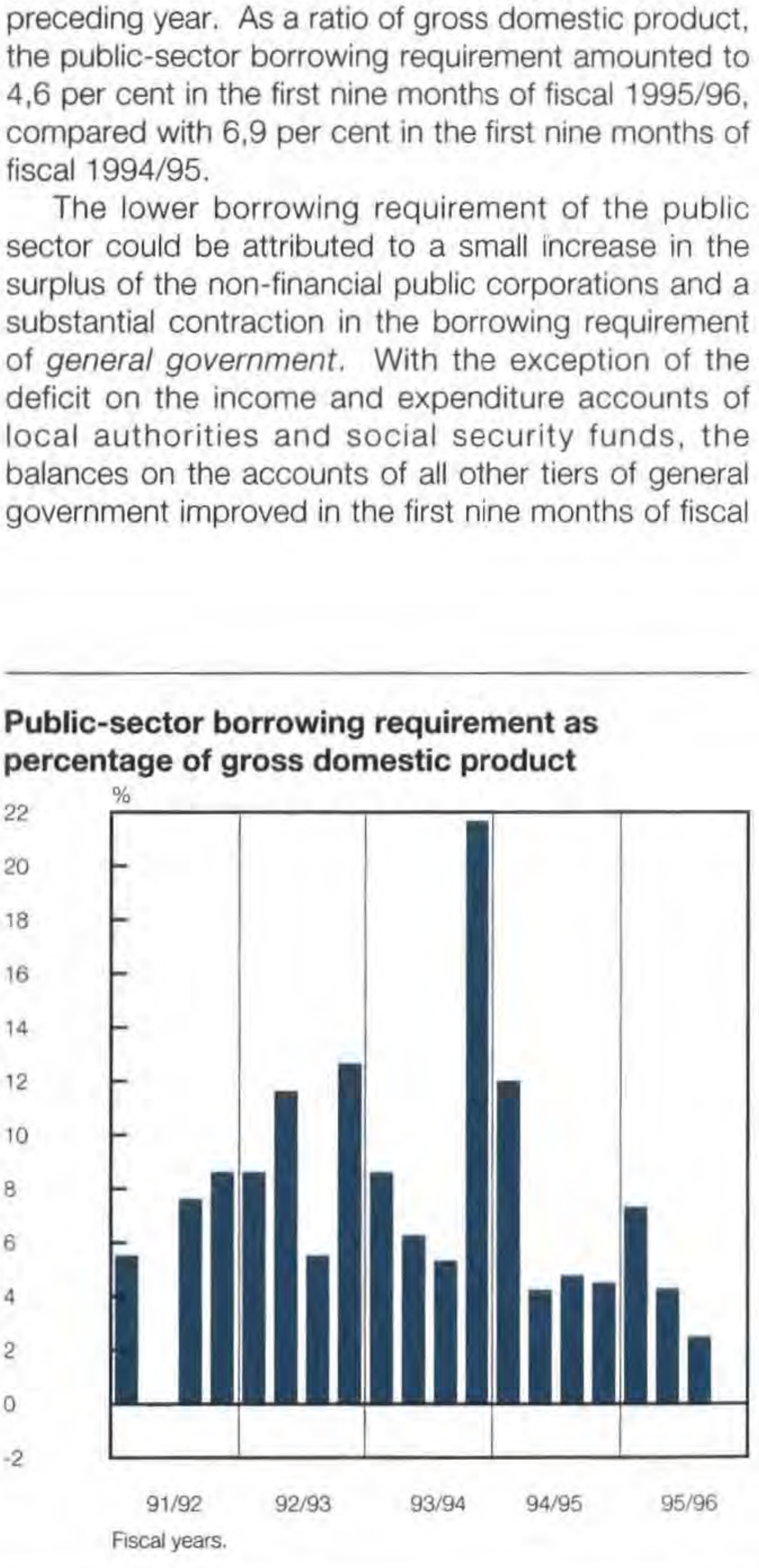


Table 8. Year-on-year rates of increase in general government revenue by type of income
Per cent

	First nine months of fiscal 1994/95	First nine months of fiscal 1995/96
Taxes on income and profits	22,4	12,2
Taxes on property	34,2	5,0
Taxes on goods and services	7,4	17,9
Taxes on international trade	-0,9	11,7
Other taxes	9,7	-21,1
Other revenue	21,9	18,7
Total revenue	**17,2**	**13,4**

apparent that only taxes on goods and services (value-added tax, the fuel levy and excise duties) and taxes on international trade (import duties) had higher rates of increase in the first nine months of fiscal 1995/96 than in the corresponding period of fiscal 1994/95.

Exchequer account

The deficit on the Exchequer account in the first ten months of fiscal 1995/96 conformed more or less with the projections of the Budget for the year. This was the net result of higher-than-budgeted increases in both Exchequer issues and receipts.

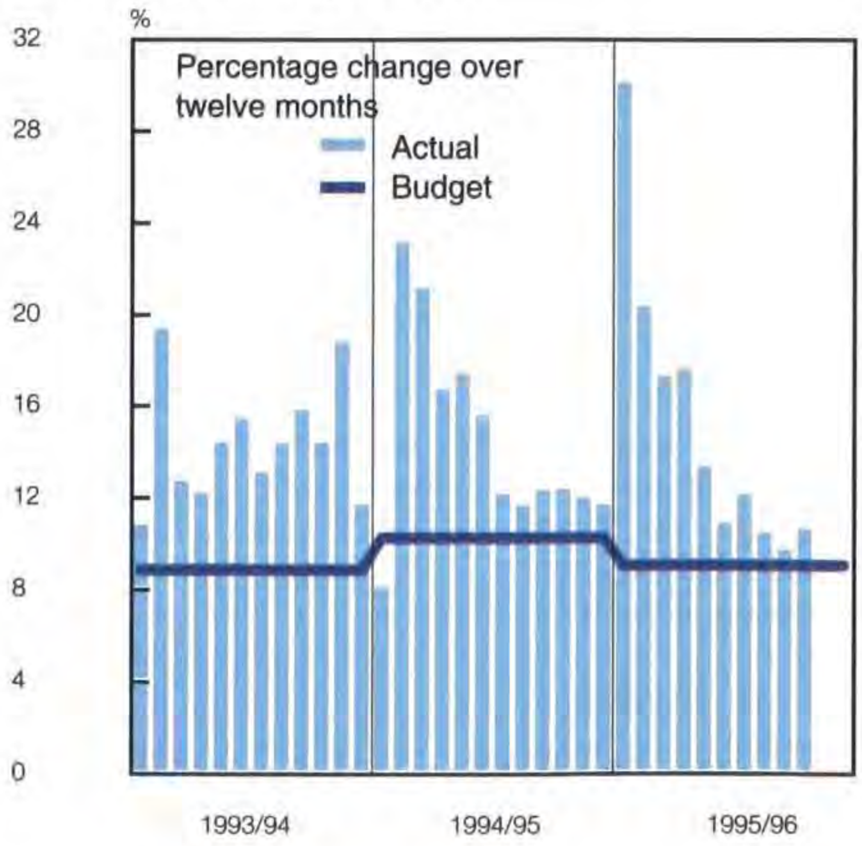
Exchequer issues to government departments (adjusted to a cash flow basis) in the first ten months of fiscal 1995/96 were 10,6 per cent higher than in the first ten months of the preceding year; the Budget provided for an increase of 9,0 per cent in government expenditure for the full fiscal year. This relatively favourable outcome does, however, not include any overspending that was addressed in the Adjustment Budget in February 1996. Such expenditure will only be taken into account in the Exchequer account of March 1996. Furthermore, the government expenditure in the first ten months of fiscal 1995/96 included only R1,7 billion of the R4,8 billion available for Reconstruction and Development programmes in the current fiscal year.

The year-on-year rate of increase in *Exchequer receipts* on a cash flow basis in the first ten months of fiscal 1995/96 amounted to 14,0 per cent; in the Budget it had been projected that revenue would rise by 10,3 per cent. Inland revenue continued to perform well with the rise in nominal salaries and wages, higher company profits, the effects of fiscal drag, the acceleration in the growth of domestic expenditure and greater efficiency in tax administration. Customs and excise receipts were also higher than anticipated in the Budget because of the substantial increase in merchandise imports and higher excise rates. Slower growth in excise duties can be expected in the last part of the year because excise duties on all motor vehicles had been abolished as from 1 September 1995 while an ad valorem tax came into force on motor vehicles on 22 December 1995. Excise duties in the form of an ad valorem tax are now levied on domestically produced motor vehicles, while customs duties include an ad valorem tax on imported motor vehicles.

The net result of these changes in Exchequer issues and receipts was a *deficit before borrowing and debt repayment* on the Exchequer account of R16,5 billion in the first ten months of fiscal 1995/96. As a ratio of gross domestic product, the deficit came to 5,5 per cent in the first nine months of fiscal 1995/96, against a budgeted deficit of 5,9 per cent for the fiscal year as a whole.

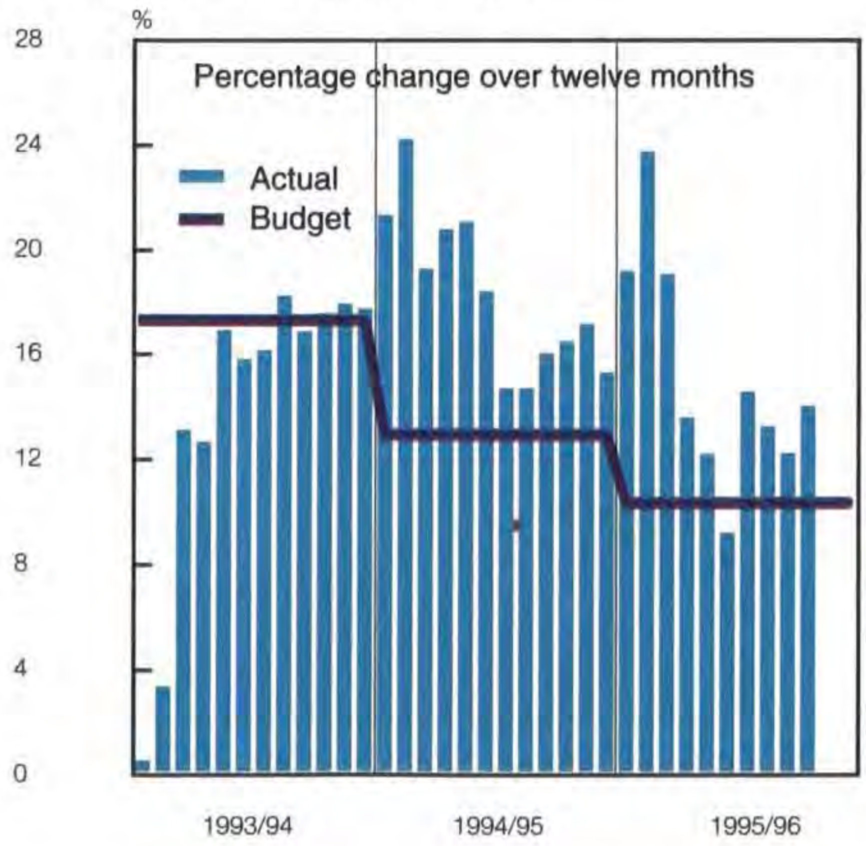
The deficit before borrowing and the discount on new government stock issues of R8,8 billion were *financed* by means of the following debt instruments:

Cumulative Exchequer issues



Fiscal years.

Cumulative Exchequer receipts



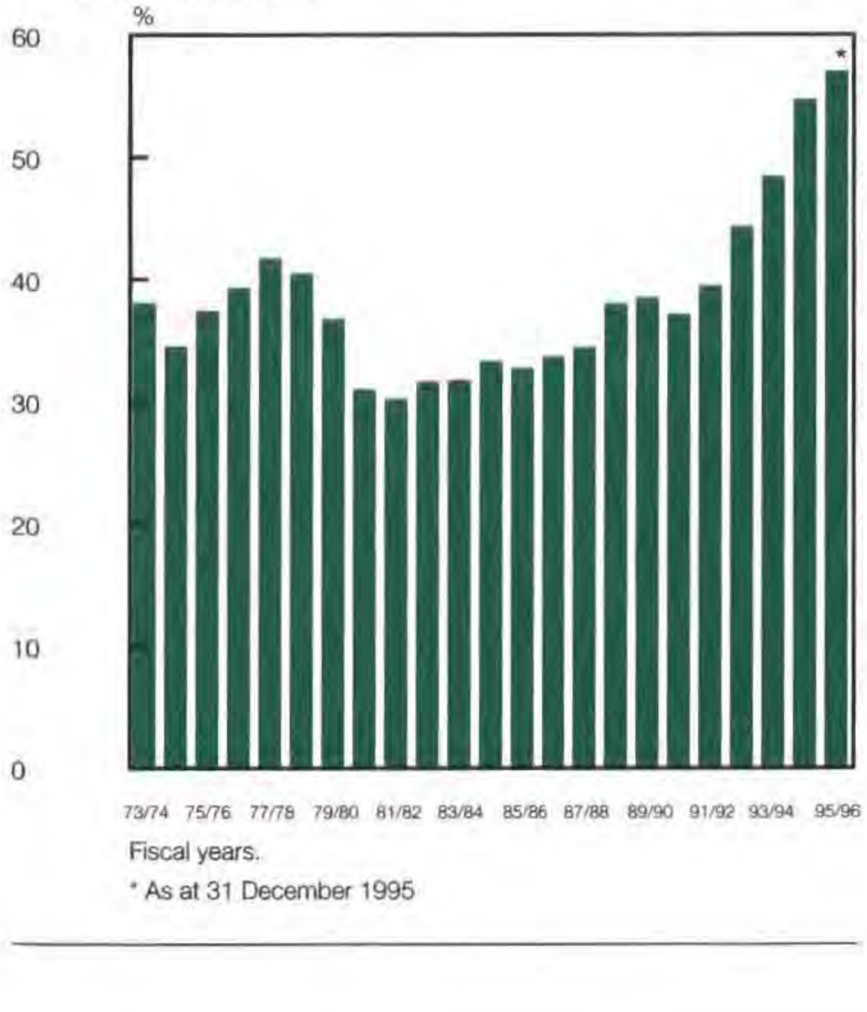
Fiscal years.

	R millions
Government stock	25 351
Treasury bills	836
Foreign loans	1 199
Non-marketable securities	-144
Money market instruments	-1 225
Extraordinary receipts	1 245
Increase in available cash balances	-10 760
Reserve Bank	-5 228
Banks	-5 532
Total	**16 504**

A large part of government stock was taken up by the non-monetary private sector, but monetary institutions' holdings of government stock also rose sharply in the first ten months of fiscal 1995/96. The net claims of monetary institutions on the government nevertheless declined because of the build-up of government deposits with banks. In contrast to preceding years, the Public Investment Commissioners took up only a relatively small proportion of the newly issued government stock. The change in the investment behaviour of the Public Investment Commissioners could mainly be attributed to their desire to obtain a more diversified investment portfolio, which in the past consisted mainly of government stock.

The financing of the Exchequer deficit resulted in an increase of outstanding *government debt* from R244,6 billion at the end of March 1995 to R276,2 billion at the end of December 1995. As a ratio of gross domestic product, government debt increased from 55,0 per cent to 57,0 per cent over the same period; at the end of fiscal 1990/91 it still amounted to only 37,2 per cent.

Total government debt as percentage of gross domestic product



Adjustment Budget

In the Adjustment Budget tabled in Parliament on 13 February 1996 *additional expenditure* of R15,1 billion was approved. However, if declared savings and suspension of funds, the shifting of functions, recoveries from the pension funds for the improvement of conditions for services, the roll-over of funds and the double counting in respect of the national budget's contribution to the Reconstruction and Development Program Fund are taken into consideration, the expenditure is estimated to increase by only R3,0 billion to R157,4 billion in fiscal 1995/96. This amount includes a provision for revenue shortfalls of R1,5 billion in the provinces and a so-called transitional reserve of R1,0 billion to cover the provinces' spending needs on health and welfare. As a ratio of gross domestic product, the revised government expenditure is expected to amount to 31,5 per cent, i.e. slightly higher than the ratio of 31,2 per cent in the preceding year.

In the Adjustment Budget provision was also made for a considerable increase in *government revenue* from an initially projected R124,2 billion to a revised estimate of R127,3 billion (including extraordinary revenue of R1,2 billion). This will bring government revenue to an estimated 25,5 per cent of gross domestic product; in the preceding year this ratio was marginally higher at 25,6 per cent.

Table 9. Revised Budget estimates for fiscal 1995/96

	R millions
Printed estimate of expenditure	154 374
Plus: Adjustments estimate	15 017
Plus: Standing appropriations	63
Subtotal	169 454
Less: Roll-over of unspent funds	6 440
Expected savings	908
Shifting of functions	129
Recovery from pension funds	1 060
Double counting in respect of RDP Fund	3 557
Estimated expenditure for 1995/96	157 360
Estimated revenue and grants (including extraordinary revenue of R1 231 million)	127 269
Estimated deficit	30 091
Estimated deficit as percentage of gross domestic product	6,0

In view of these estimated changes in government expenditure and revenue, the *deficit before borrowing and debt repayment* is now estimated at R30,1 billion in fiscal 1995/96, or 6,0 per cent of gross domestic product. This ratio is only slightly higher than the budgeted ratio of 5,8 per cent.