Quarterly Economic Review

December 1997

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South African Reserve Bank

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Introduction

The growth momentum of the economy, which had generally been slackening from the second half of 1996, weakened further in the third quarter of 1997. However, mainly owing to firm growth in two major sectors, namely mining and transportation and communication, output growth still proceeded at a positive, though only modest, rate of ½ per cent in the third quarter of 1997 - well down from the comparatively firm growth of 2½ per cent registered in the second quarter.

Output growth outside the primary sectors of the economy slowed down noticeably. In particular, manufacturing output, which was envisaged to provide the impetus to economic development and employment growth, declined in absolute terms from the second to the third quarter of 1997.

The average level of total real gross domestic product in the first three quarters of 1997 nevertheless was some 2 per cent higher than in the first three quarters of 1996. Current projections point to a growth rate of the South African economy in the calendar year 1997 of between 1½ per cent and 2 per cent, which is considerably lower than had generally been expected at the beginning of the year and is also lower than the average growth rate experienced over the past three calendar years. Although a technical analysis could not provide conclusive evidence that South Africa had entered a downward phase of the business cycle, the economy was definitely not producing at full capacity in the third quarter of 1997 and output growth clearly did not match the economic growth potential of South Africa.

Real gross domestic expenditure in the third quarter of 1997 has declined for the fourth time in the five quarters completed since the third quarter of 1996. As output was still increasing over this period, the decline in aggregate spending facilitated a much better balance between aggregate supply and demand in the South African economy. The proximate causes of the general decline in aggregate expenditure were the persistent expectations of weaker future demand growth and the high carrying cost of inventories, which induced manufacturers and merchants to economise on inventory holdings. Further, whilst still maintaining a relatively high rate of expansion, the growth in real consumption expenditure by general government abated somewhat in the third quarter, thereby also making some contribution to the strengthening of macro balance in the economy.

Consumer sentiment also turned slightly negative in the third quarter and household spending grew weaker. By contrast, real fixed investment expenditure persistently grew at rates higher than aggregate output growth in the first three quarters of 1997. Of particular significance was the gathering strength of private-sector real gross fixed capital formation which has increased at progressively higher growth rates since the first quarter of 1997. These growth rates were, admittedly, rather modest, but the trend movement augured well for future income growth.

The aggregate saving ratio in South Africa deteriorated further in the first three quarters of 1997. The low saving rate of the country remained a structural impediment to sustained, investment-driven, income and employment growth. Intentions to move the economy onto a steeper growth path without an increase in the saving ratio will imply increased reliance on net inflows of capital from outside the country. Excessive reliance on foreign borrowed capital, however, could eventually develop into unsustainable growth in foreign debt, which at some later stage would elicit stern corrective policy steps.

Partly owing to the improvement of macroeconomic balance in South Africa, significant progress was made with the lowering of inflation in recent months. Quarter-to-quarter changes in all the prominent indicators of price inflation moved into the single-digit area in the third quarter of 1997. The downward movement of inflation was, of course, strongly assisted by the relative strength of the rand in the early part of the year. By the same token, the gradual depreciation of the rand against other currencies from about the middle of March 1997 could, therefore, have been a portend of slower progress with the lowering of inflation.

In contrast to the benign counter-inflationary environment created by the relative stability of the rand in the first half of 1997, macroeconomic labour remuneration developments were less supportive of the policy objective of general price stability. The increase over four quarters in total employment costs rose again beyond the ten per cent mark in the second quarter of 1997. Although inflation-dampening productivity growth in the second quarter was procured through retrenchments in the formal sectors of the economy, the rate of increase in nominal unit labour costs also accelerated. As a consequence, employment in the formal non-agricultural sectors of the economy declined further and the recorded level of formal-sector employment receded to the levels which had been recorded in 1981.

The decline in formal-sector employment occurred in the face of continued, albeit moderate, growth in aggregate output and investment. For employment levels to rise parallel with output growth, it is important that an appropriate configuration of output price changes, productivity growth and macroeconomic wage developments be established. This would ensure a solid platform for investment-driven output and employment growth.

As could be expected, the decline in real gross domestic expenditure in the third quarter of 1997 coexisted with a slight decline in the physical quantity of imported goods. Simultaneously, the physical quantity of merchandise exports declined too, mainly on account of smaller quantities of minerals and agricultural products exported. In the end the deficit on the current account of the balance of payments widened against the backdrop of a slowing economy in the third quarter. Significantly, however, the value of manufactured goods exported continued to increase, most likely because of the strengthened competitiveness of domestic manufacturers in export markets.

The widening of the deficit on the current account of the balance of payments, in conjunction with a sharply reduced net inflow of capital from abroad, resulted in a reduction in South Africa's net holdings of gold and other foreign exchange reserves in the third quarter of 1997. The inward movement of long-term capital in the third quarter was well down from the inflows witnessed in the second quarter when Government was actively mobilising funds in the international capital markets and when the partial privatisation of a parastatal corporation elicited a large inflow of equity capital into the economy. Moreover, outflows of short-term capital accelerated in the third quarter as private banks chose to reduce their foreign short-term liabilities at a time when the exchange rate of the rand

and the money market shortage had been declining steadily. The Reserve Bank increased its foreign short-term obligations over the same period in order to bolster the overall level of gross gold and foreign exchange reserves.

Developments in the international exchange markets during the third quarter of 1997 were profoundly influenced by events in Asia, which had a contagion effect on other financial markets around the world. Structural weaknesses in the economies of a number of Southeast Asian countries which had been simmering for a long time, surfaced towards the end of the second quarter of 1997 and caused most Asian currencies to depreciate sharply against the United States dollar. The rand was not insulated from these events, but owing to the value correction it underwent in 1996 and the healthier state of macroeconomic management in South Africa, it depreciated considerably less against the dollar than the Asian currencies.

The growth in the broadly defined money supply slowed down appreciably in the third quarter of 1997, but was still at a level that exceeded the margin set for acceptable monetary growth over the year as a whole. Guided by expectations of declining long-term interest rates and some relaxation of a relatively tight monetary policy posture, deposit holders increasingly exhibited a preference for longer-term deposits during the first eight months of 1997. This process came to an end in September when a major shift back to short-term deposits took place. It is still too early to judge whether this recent apparent change in liquidity preference should be viewed as a one-time event or whether it formed part of a more permanent realignment of the preferred portfolio composition of the general public.

The credit market witnessed a general slowdown in credit extension and more decisively in credit extension to the non-bank private sector in the third quarter of 1997. This slowdown, along with the slower expansion of M3 and the progress made in reducing inflation, prompted a decision by the Reserve Bank to lower Bank rate on 20 October 1997. Unlike bank credit extension to the non-bank private sector, net credit extension to the government sector increased strongly in the third quarter.

Easy conditions continued to prevail in the money market in the third quarter of 1997. Short-term interest rates were mostly declining to levels well below the prevailing Bank rate. Under these circumstances the Reserve Bank was willing to permit easier liquidity conditions to develop and refrained from influencing the market shortage in any systematic way, apart from specific smoothing operations to prevent unduly large fluctuations in liquidity. In October when the Reserve Bank intervened in order to stabilise the foreign-exchange market, conditions in the money market tightened considerably for a short while. Somewhat tighter conditions than during the third quarter continued to prevail in November.

The mood in the bond market was predominantly bullish in the first nine months of 1997 as yields on long-term government bonds and other long-term fixed interest-bearing stock gradually drifted downwards. Significantly, non-residents' net buying of South African securities shifted during this period from emphasising bond buying in the first quarter of the year to an emphasis on share purchases in the second and third quarters of 1997. In October 1997, non-residents became net sellers of bonds. Thus, during the course of the year South African shares increasingly offered better value than bonds, according to the judgement of non-resident investors.

The positive sentiment in the securities markets was brought to an abrupt end when the poor macroeconomic management of Southeast Asian economies triggered a downward re-rating of bond and share values in financial markets around the world. Share prices declined sharply on the Johannesburg Stock Exchange in October 1997, but in terms of percentages by much less than during the sharp decline of October 1987. In 1987 it took a full twenty-two months for the all-share price index to recover to pre-"crash" heights; in 1997 more than 40 per cent of the initial loss in the value of the index was recovered in a matter of two weeks. In a pattern resembling the movement of share prices, the prices of long-term government bonds also responded to the turbulence in the financial markets and bond yields rose by 131 basis points, but then fell back again to register a net gain of 77 basis points from the low levels recorded immediately prior to the sharp fall in bond prices on 22 October 1997.

The decline in bond and share values in 1987 followed on the heels of a series of reductions in Bank rate and caused the fall in asset values to have little detrimental effect on subsequent domestic private-sector propensities to consume and invest. The eventual impact of the recent decline in asset values on domestic economic developments would also, therefore, depend to an important degree on the policy responses of the financial authorities, domestically and in the world's advanced economies.

The public-sector borrowing requirement relative to gross domestic product in the first half of fiscal 1997/1998 increased in comparison with its counterpart in the first half of the previous fiscal year. However, the deficit before borrowing and debt repayment on the Exchequer Account relative to gross domestic product shrank from the first half of fiscal 1996/1997 to the first half of fiscal 1997/1998. Ominously, a substantial portion of the budgeted deficit of the National Government for fiscal 1997/1998 as a whole has been absorbed in the first half of the fiscal year. This overshoot of the projected deficit was particularly acute at provincial government level.

Domestic economic developments

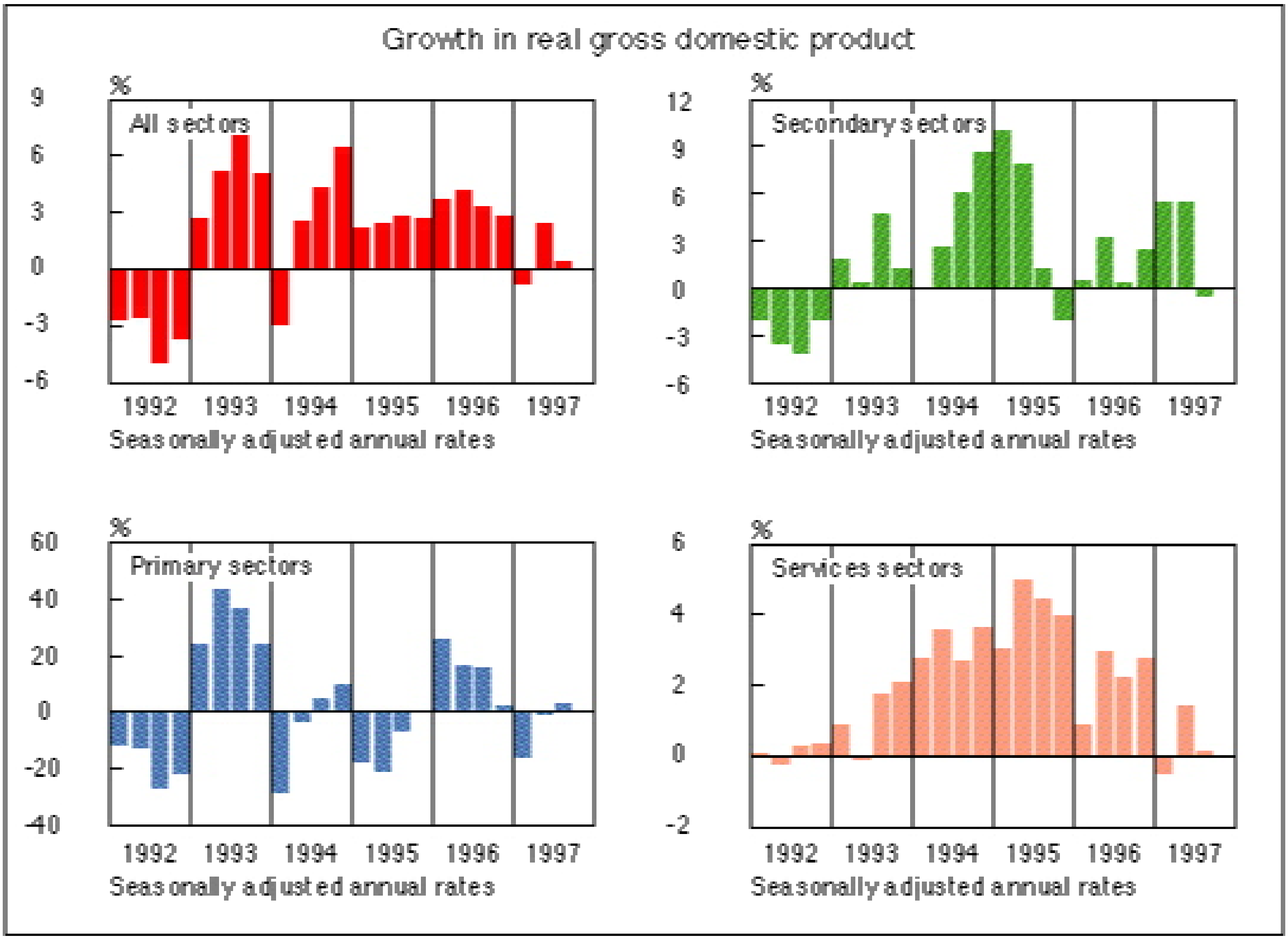
Domestic output[1]

The growth in aggregate *real gross domestic product* amounted to a seasonally adjusted and annualised rate of ½ per cent in the third quarter of 1997. This compared with a decline in aggregate output at an annualised rate of ½ per cent in the first quarter of 1997 and an increase at an annualised rate of 2½ per cent in the second quarter. The average level of real domestic output in the first three quarters of 1997 was about 2 per cent above the level in the first three quarters of 1996, thereby signalling that an economic growth rate of between 1½ and 2 per cent may be forecast with a fair degree of certainty for calendar year 1997 as a whole.

Table 1. Real gross domestic product

Percentage change at seasonally adjusted and annualised rates

Sectors	**1996**					**1997**		
	1st qr	**2nd qr**	**3rd qr**	**4th qr**	**Year**	**1st qr**	**2nd qr**	**3rd qr**
Primary sectors	26	16½	15½	2½	9	-15½	0	3
Agriculture	99	65	59½	4	29	-34½	-9	-½
Mining	-½	-5	-7½	1	-1½	½	6	5
Secondary sectors	½	3	½	2½	1	5½	5½	-½
Manufacturing	-1	3	-1	2	½	6	5½	-1
Tertiary sectors	1	3	2	3	3	-½	1½	0
Commerce	-2½	5½	0	3	3½	-2	2	-1½
Transport, storage and communication	1	2	3	2½	3	½	4	2½
Financial and other services	3½	3	4	4	3½	2	2	1
Total	**3½**	**4**	**3**	**3**	**3**	**-½**	**2½**	½
Non-agricultural sectors	½	2	½	2½	2	1½	3	½



The growth slowdown in the third quarter of 1997 came mainly from unchanged output in the non-primary sectors of the economy - output growth accelerated in the primary sectors. *Agricultural output* declined further in the third quarter, but at a much lower rate than in the previous two quarters. The real value added by the agricultural sector was detrimentally affected by adverse climatic conditions during the past growing season, which decimated the maize crop in certain production areas.

After showing little growth in the first quarter of 1997, output in the *mining sector* recovered strongly and rose at sturdy annualised growth rates in the middle quarters of the year. This improvement was brought about by an increase in gold and non-gold mining production. Real value added by coal mines was bolstered by a sustained high level of export demand, while platinum production benefited from higher prices occasioned by uncertain Russian supplies of platinum group metals. Gold-mining output rose in the third quarter of 1997 as the newly introduced productivity measures apparently are beginning to filter through to the operational levels of the gold-mining sector.

Real value added by the *secondary sectors* declined at an annualised rate of ½ per cent in the third quarter of 1997 after it had increased at brisk rates of 5½ per cent in both the first and second quarters. Output in the manufacturing sector declined at an annualised rate of 1 per cent as slack aggregate domestic demand and slower growth in export demand for manufactured goods left their mark. The rate of increase in domestic manufacturing sales and order volumes slowed down in the third quarter of 1997, the ratio of unfilled orders to sales shrank and the utilisation of production capacity declined from 82 per cent in the second quarter to 81 per cent in the third quarter. Output declines occurred in industries producing food, paper products and machinery and transport equipment, while small increases could be seen in the real value added by subsectors such as clothing manufacturing, chemicals and non-metallic mineral production.

Real value added by the sector supplying *electricity, gas and water* continued to expand in the third quarter of 1997, but only at a rate of ½ per cent, which was well down from the growth rates of 4 per cent in the first quarter and 6 per cent in the second quarter. This slowdown mirrored the slower pace of domestic economic activity and some slack in the export demand for electricity. Real output in the *construction sector* also increased in the third quarter of 1997, but only slightly.

Growth in the combined *tertiary sectors* also slowed down from an annualised rate of 1½ per cent in the second quarter of 1997 to less than ½ per cent in the third quarter. The *commercial sector*, especially wholesale trade, was adversely affected by slowdowns in private consumption demand, investment demand and the acquisition of goods and services by general government departments. In the motor trade, sales of new vehicles could also have been curtailed by the introduction of more stringent fringe-benefit taxation on company cars and car allowances in the middle of 1997.

In the sector *transport, storage and communication* real value added rose at an annualised rate of 2½ per cent in the third quarter and in the *finance, real-estate and business services* sector at a rate of 1 per cent. Output growth in the transportation and communication sector maintained a relatively firm pace owing to the transportation of the bulk of the maize crop that was harvested in the third quarter and the high volume of tourist traffic. The modest growth in real value added by the financial services sector to some extent reflected the slack aggregate domestic demand in the third quarter of 1997.

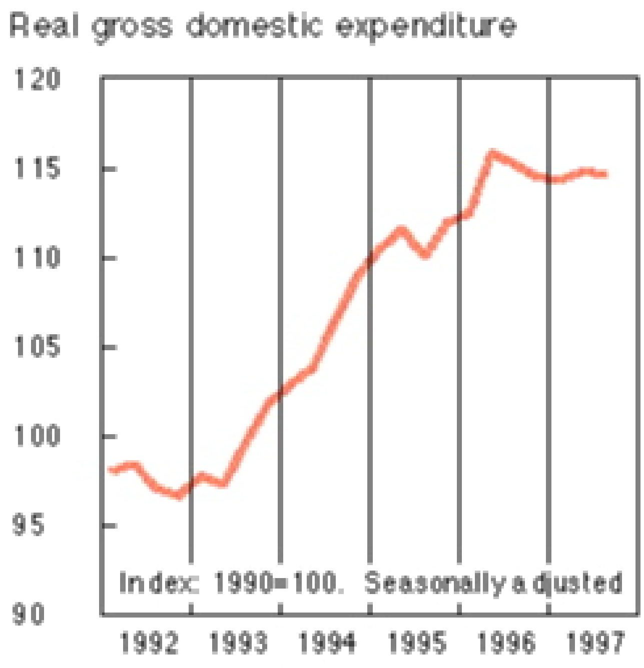
Domestic expenditure

Aggregate *real gross domestic expenditure* declined at a seasonally adjusted and annualised rate of ½ per cent in the first quarter of 1997, grew at a rate of 1½ per cent in the second quarter, but declined again by about ½ per cent in the third quarter. This took the accumulated total of real gross domestic expenditure in the first three quarters of 1997 to a level roughly equal to that of the first three quarters of 1996. The decline in gross domestic expenditure in the third quarter of 1997 was brought about by a sharp decline in real inventory levels, which more than offset the positive but somewhat sedate growth of real domestic final demand.

Table 2. Real gross domestic expenditure

Percentage change at seasonally adjusted and annualised rates

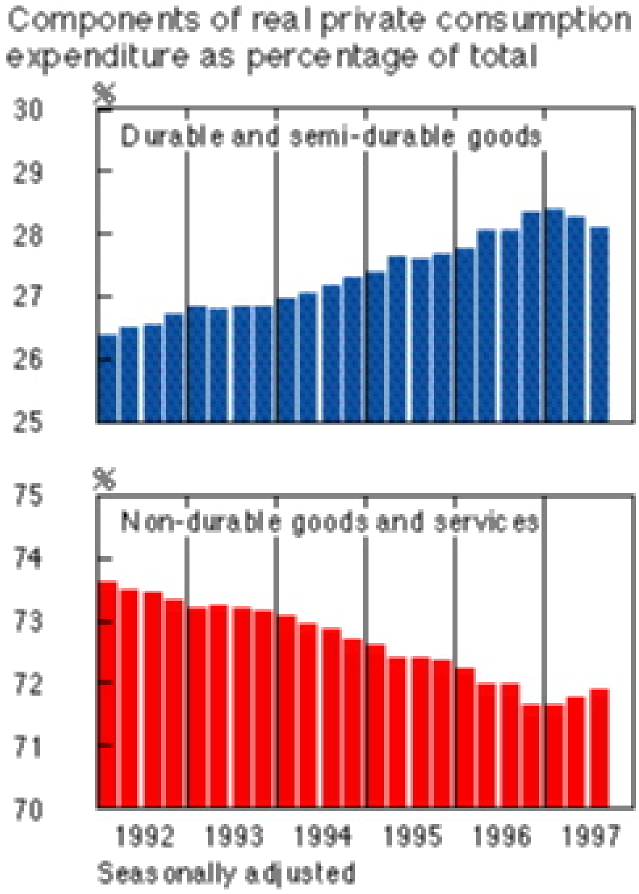
Components	1996					1997		
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Private consumption expenditure	3½	4	3	3	4	1	1½	1
Government consumption expenditure	6½	11	9	3½	6	4	4	2½
Gross domestic fixed investment.	10½	6½	5	5	8	2½	3	3
Final domestic demand	5½	6	4½	3½	5	2	2½	1½
Change in inventories (R billions)*	1,2	6,8	2,4	0,4	2,7	-2,4	-3,3	-4,8
Gross domestic expenditure	**2**	**12½**	**-2**	**-2½**	**3**	**-½**	**1½**	**-½**
* Constant 1990 prices								



The growth rate in *real private consumption expenditure* accelerated slightly from a seasonally adjusted and annualised 1 per cent in the first quarter of 1997 to 1½ per cent in the second quarter, but receded again to 1 per cent in the third quarter. This further rise in real private consumption expenditure was brought about by sustained growth in real expenditure on non-durable goods and services, while real outlays on durable goods and semi-durable goods declined.

Total real private consumption expenditure on durable goods declined at a seasonally adjusted and annualised rate of 2½ per cent in the third quarter, after declines of 2½ and 2 per cent had been recorded in the preceding two quarters of 1997. This was mainly the result of lower expenditure by households on furniture and household appliances and personal transport equipment.

Quarter-to-quarter growth in real outlays on semi-durable goods at first slowed down from an annualised rate of 3½ per cent in the first quarter of 1997 to 1 per cent in the second quarter, but then turned negative at a rate of ½ per cent in the third quarter of 1997. Declines in real outlays by households on textiles and furnishings, motor car tyres, parts and accessories and other semi-durable goods more than offset an increase in expenditure on clothing and footwear. In contrast, real outlays by households on non-durable goods and services increased further in the third quarter of 1997 at seasonally adjusted and annualised growth rates of 1½ per cent and 3 per cent respectively.



The emphasis in household spending patterns during recent quarters shifted clearly towards spending on non-durable goods and services and away from generally higher-priced categories. This kind of spending behaviour is not indicative of a confident consumer society expecting continued firm income growth and with an appetite for luxury and other durable goods. It rather reflected low growth in real personal disposable income and weak consumer confidence that might have emanated from:

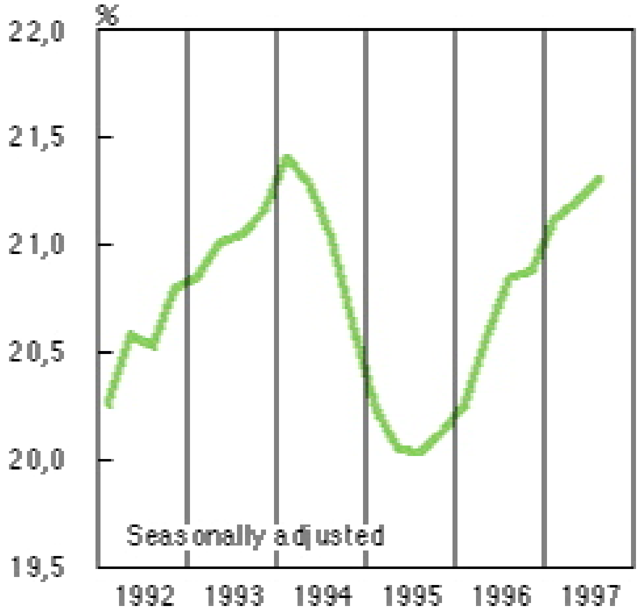
- the sustained high levels of unemployment;
- declining employment in the formal sector of the economy and general concern about job security;
- low levels of accumulated saving;
- high levels of household debt;
- the high cost of servicing debt;

- high levels of taxation on current income; and
- relatively poor short-term prospects for real income growth.

Under such circumstances households could reasonably be expected to be conservative in the deployment of their disposable income. Concerns about the strength of balance sheets are likely to encourage cutbacks on aggregate household spending and a sharper focus on essential non-discretionary consumer spending.

Aggregate real consumption expenditure by general government continued to increase in the third quarter of 1997, albeit at a slower pace than before. After *real consumption expenditure by general government* had risen at seasonally adjusted and annualised rates of 4 per cent in both the first and second quarters of 1997, it slowed down to 2½ per cent growth in the third quarter. This brought real expenditure on the consumption of goods and services by general government in the first nine months of 1997 to a level that was 5½ per cent higher than in the corresponding period of 1996. Lower growth in real outlays on intermediate goods and services and a decline in employment numbers were mainly responsible for the reported slowdown. The recent slowdown notwithstanding, the ratio of government consumption expenditure to gross domestic product rose from 20½ per cent in 1996 as a whole to an average of 21 per cent in the first three quarters of 1997.

Real government consumption expenditure as percentage of real gross domestic product



The strong growth in *real gross domestic fixed investment*, at quarter-to-quarter annualised rates that varied between 5 and 10½ per cent during 1996, tapered off to an increase of 2½ per cent in the first quarter and 3 per cent in both the second and third quarters of 1997. Real fixed investment in the first three quarters of 1997 came to a level that was about 3 per cent higher than in the corresponding period of 1996. The growth in total real fixed investment in the third quarter of 1997 was brought about by increases in capital formation by all three institutional sectors, namely private business enterprises, public corporations and public authorities.

Table 3. Real gross domestic fixed investment

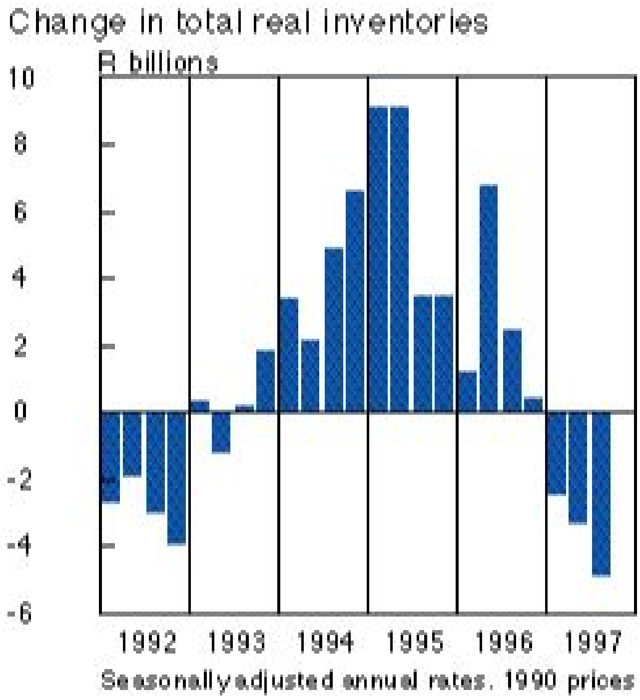
Percentage change at seasonally adjusted and annualised rates

Institutional sectors	1996					1997		
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Private business enterprises	6	3½	6	5½	6	1	2	2½
Public corporations	19½	-½	1½	4	10½	9	9	6
Public authorities	27½	34½	3½	3	15	2½	1½	1
Total	**10½**	**6½**	**5**	**5**	**8**	**2½**	**3**	**3**

The growth in *real gross fixed investment by private-sector organisations* accelerated from 1 per cent in the first quarter of 1997 to 2 per cent in the second quarter and 2½ per cent in the third quarter. Production capacity in all the main sectors of economic activity benefited from the higher level of capital formation by private-sector entities. In the agricultural sector, capital investment, especially in the field-crop producing areas, responded to better than expected crops in the second half of 1997. The manufacturing sector stepped up investment activity as a result of supply-side tax concessions introduced by government and from the need to maintain profitability in increasingly competitive and globalised markets. In the commercial sector, investment spending increased for a variety of reasons such as the development of specialty stores which need special premises, the need to resuscitate ailing shopping centres in central business districts around the country, the expansion of smaller retail centres in suburban areas and the development of retail centres in some of the less-developed areas of the country.

As had been the case in 1996, the growth in real *fixed capital formation by the public sector* (public corporations and public authorities) remained relatively strong in the first three quarters of 1997 and public-sector real fixed investment advanced at a robust rate of 3½ per cent in the third quarter of 1997. Higher real fixed capital formation by public-sector bodies resulted from infrastructure-related investments by organisations such as Transnet, Telkom and by the subsector supplying electricity, gas and water.

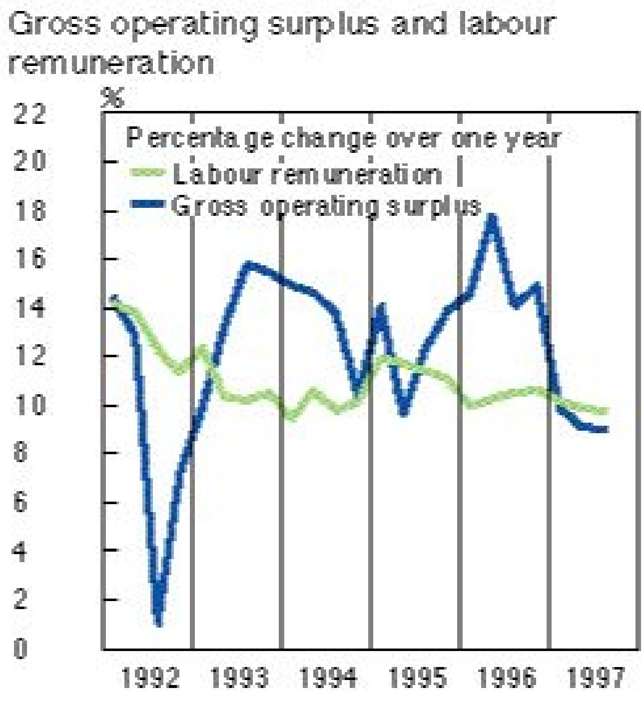
Whereas the inventory cycle merely lost momentum when the accumulation of *inventories* slowed down during 1996, inventory levels were actually reduced in the first three quarters of 1997. The declines in inventory levels in the third quarter of 1997 occurred mainly in the manufacturing, wholesale and retail trade sectors. The general slowdown in final domestic demand and the relatively high carrying cost of inventories urged manufacturers and other producers to economise on inventory holdings. As a consequence, the ratio of industrial and commercial inventories to gross domestic product in the non-agricultural sectors of the economy declined from an average of 18 per cent in the first two quarters of 1997 to 16½ per cent in the third quarter.



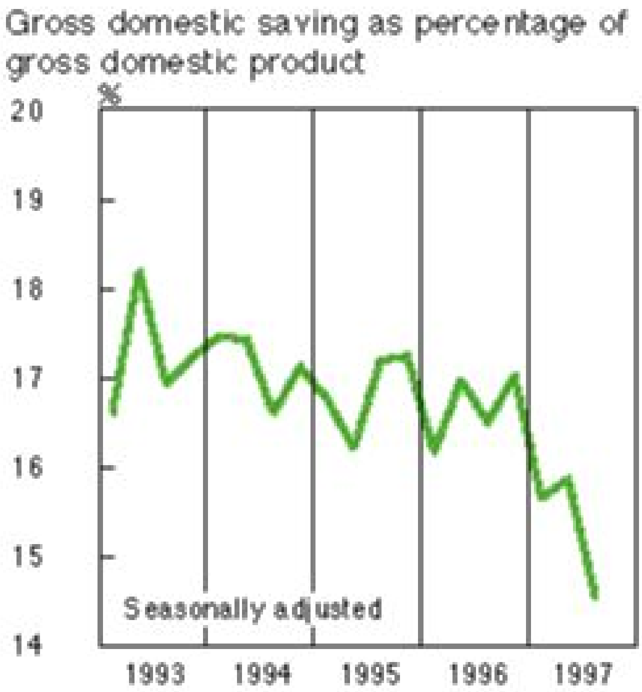
Factor income and saving

The year-on-year growth in aggregate *nominal factor income* at market prices slowed down from 10½ per cent in the first quarter of 1997 to an average of 10 per cent in the second and third quarters. This slowdown in factor-income growth was due to lower growth of both operating surpluses of business enterprises and the remuneration of employees.

The growth over four quarters in aggregate nominal *gross operating surpluses* declined from 10 per cent in the first quarter of 1997 to an average of 9 per cent in the ensuing two quarters. Operating surpluses declined in the agricultural sector and increased at slower rates in some of the other major sectors such as manufacturing, commerce and financial services. Similarly, the rate of growth over one year in total *remuneration of employees* slowed down from 10 per cent in the second quarter of 1997 to 9½ per cent in the third quarter.

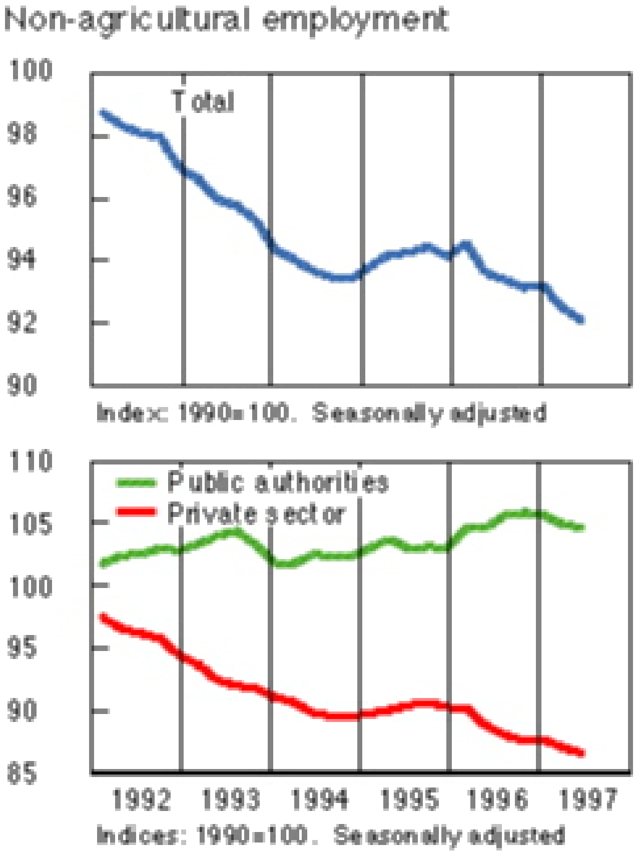


Gross domestic saving as a ratio of gross domestic product declined from 16½ per cent in 1996 to approximately 15½ per cent in the first three quarters of 1997. *Net dissaving by general government* remained at the level of 3½ per cent of gross domestic product throughout the first three quarters of 1997. *Net corporate saving* as a ratio of gross domestic product declined from an average of 5 per cent in the first half of 1997 to 4½ per cent in the third quarter. Over the same period, net saving by private households remained extremely low and, relative to gross domestic product, amounted to about 1 per cent in the first three quarters of 1997. In view of the development needs of the South African economy the dearth of saving as a means to finance strong investment-driven growth is evidently a serious structural shortcoming.



Employment

Despite the continuation of positive economic growth, *total employment in the formal non-agricultural sectors* of the economy declined in the first half of 1997 at annualised rates of 3,0 per cent in the first quarter and 1,7 per cent in the second quarter. From the end of 1996 to the end of the second quarter of 1997, the level of measured aggregate employment in the formal sectors declined by 62 000 jobs. This brought total employment back to a level which was roughly equal to that of 1981. However, the recording of employment levels must be seen in the context of official statistics which currently do not account for jobs created by subcontractors and omit other forms of labour market restructuring, which might have enhanced job-creation in the insufficiently surveyed services sectors.



Employment in the *formal private non-agricultural sectors* declined at a seasonally adjusted and annualised rate of 3,0 per cent in the first quarter of 1997 and 2,0 per cent in the second quarter. This translated into a loss of about 43 000 jobs which occurred primarily in the manufacturing, mining and construction sectors, with lesser declines in the electricity generating sector, motor trade and the financial services sectors.

The decline in employment was partly a consequence of the growing integration of world markets. This "globalisation" of markets, along with rapid technological advances, is emphasising the need for South African manufacturers and other producers to be competitive in world markets and to maintain competitiveness in the tradable goods and services markets. This problem was addressed in South Africa essentially by the substitution of capital for labour in the processes of production, which has resulted in declining employment levels in the formal sectors of the economy since the beginning of the 1990s.

A minimal requirement, at present, would be for employment growth to move roughly in parallel with the growth in capital formation. Such a development would have to have as an antecedent an improvement in the return on investment for it to create the necessary circumstances for sustained investment-driven economic growth. To achieve such a benign investment environment would require that production cost increases be contained. Because labour costs constitute a significant component of aggregate production costs, an appropriate configuration of macroeconomic wage developments, output price changes and productivity growth would be important for increasing employment levels and reducing unemployment.

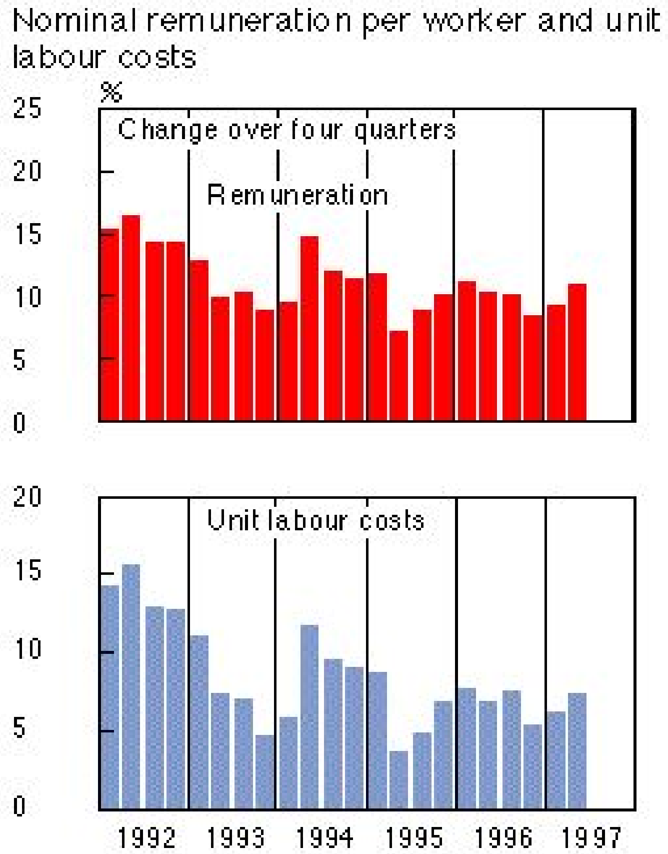
In order to ensure higher income on investment in the mining industry and to forestall the possible closure of gold mines, long-term agreements have been negotiated between mine management and trade unions at certain mines. Capital will be utilised more intensively by introducing additional shifts at certain mines and steps will be taken jointly by management and workers to increase production. These agreements are expected to ensure the viability and profitability of the gold-mining sector, while at the same time addressing workers' concerns about job security.

Unlike the years 1989 to 1996 when *public-sector employment* expanded simultaneously with the curtailment of private-sector employment, some progress appeared to have been made recently with efforts to reduce the number of jobs in the public sector. The size of the personnel corps in the public sector declined in three consecutive quarters at seasonally adjusted and annualised quarter-to-quarter rates of 0,5 per cent in the fourth quarter of 1996, 3,0 per cent in the first quarter of 1997 and 1,1 per cent in the second quarter. The decreases in employment opportunities seemingly occurred at the levels of both the national and the provincial governments.

The recorded decline in the number of formal-sector employment opportunities was corroborated by an increase of 0,4 per cent in the *total number of registered unemployed workers* in the first six months of 1997 compared with the first six months of 1996. Finally, in this regard, from 1 September 1997 the upper annual income limit for coverage by the Unemployment Insurance Fund (UIF) was raised by 8,3 per cent to an amount of R82 982. This increase will ensure that a greater number of the unemployed are assisted in future, but it will also cause an escalation in monetary contributions to the UIF.

Labour costs and productivity

The excess supply of mostly unskilled labour in South Africa exerted little downward pressure on the growth of labour remuneration over the past year. Despite declining levels of formal-sector employment and rising levels of unemployment, the rate of increase over four quarters in *nominal remuneration per worker in the non-agricultural sectors* of the economy accelerated from 8,4 per cent in the fourth quarter of 1996 to 11,0 per cent in the second quarter of 1997. Indications were that especially those employees covered by collective bargaining agreements had on average received salary and wage increments which were higher than year-on-year consumer price inflation in the first half of 1997.



The rate of increase over four quarters in nominal remuneration per worker in the *private non-agricultural sectors* of the economy, which had slowed down quite significantly to 7,7 per cent in the first quarter of 1997, increased again to a rate of 10,5 per cent in the second quarter. The year-on-year rate of increase in nominal remuneration of *public-sector workers* accelerated even more strongly from 7,5 per cent in the fourth quarter of 1996 to 11,8 per cent in the second quarter of 1997. Comparatively large remuneration increases were granted to employees of national government departments, Transnet and universities.

The year-on-year increase in nominal remuneration per worker continued to exceed the increase in output prices which was reflected by the price deflator for the non-agricultural gross domestic product in the second quarter of 1997. In fact, the increase over one year in the real remuneration per worker in the non-agricultural sectors (i.e. the ratio of nominal remuneration per worker to the deflator of output in the non-agricultural sectors as an indicator of output prices) accelerated from 0,9 per cent in the first quarter of 1997 to 3,0 per cent in the second quarter.

The growth in nominal remuneration per worker was accompanied by increases in *labour productivity*, albeit at a somewhat lower rate. Output per worker in the non-agricultural sectors increased over four quarters by 3,0 per cent in the fourth quarter of 1996 and in the first quarter of 1997 and then accelerated to 3,4 per cent in the second quarter. As a consequence of productivity growth not fully matching the growth in the remuneration per worker, *nominal unit labour costs* kept on rising. Indeed, the growth over four quarters in nominal unit labour costs accelerated from 5,3 per cent in the fourth quarter of 1996 to 6,1 per cent in the first quarter of 1997 and 7,3 per cent in the second quarter.

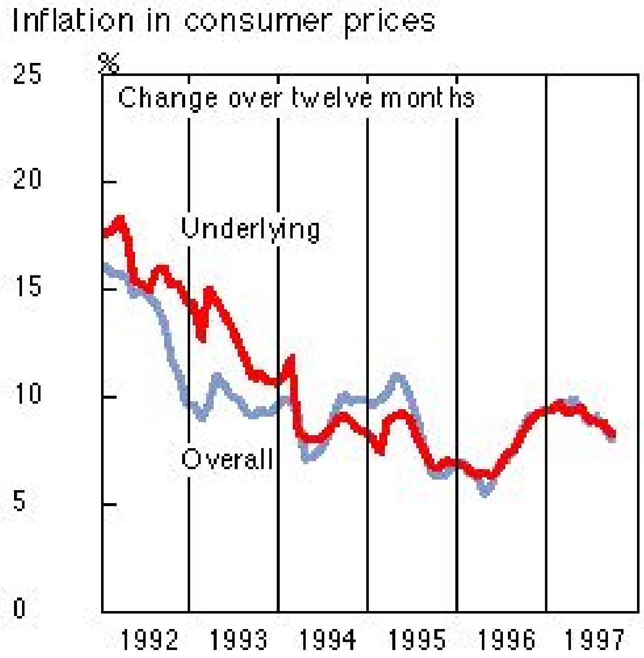
Table 4. Labour cost and productivity

Percentage change over four quarters

Period		Remuneration per worker		Labour productivity	Nominal unit labour costs
		Nominal	Adjusted for inflation		
1996:	1st qr	11,2	2,1	3,3	7,6
	2nd qr	10,2	0,5	3,1	6,9
	3rd qr	10,1	0,2	2,4	7,5
	4th qr	8,4	-1,7	3,0	5,3
1997:	1st qr	9,3	0,9	3,0	6,1
	2nd qr	11,0	3,0	3,4	7,3

Inflation

Inflation, as measured by the seasonally adjusted and annualised change from quarter to quarter in the *overall consumer price index,* declined further in the third quarter of 1997, falling below 7 per cent for the first time since the fourth quarter of 1995. *Underlying inflation,* measured as the quarter-to-quarter change in the seasonally adjusted consumer price index excluding the prices of food and non-alcoholic beverages, the costs of home-ownership and value-added tax, also declined to below 7 per cent in the third quarter of 1997. This was well below the recent peak of 12,6 per cent in the fourth quarter of 1996.



Measured over twelve months, overall consumer price inflation and underlying inflation have been moving in tandem since May 1996. Both these indicators of inflation have moved sharply downwards in recent months. The rise over one year in the overall consumer price index peaked at 9,9 per cent in April 1997, but subsequently declined to 8,0 per cent in September. Underlying inflation had peaked two months earlier at 9,7 per cent in February 1997, but then fell to 8,3 per cent in September.

Table 5. Indicators of inflation

Quarter-to-quarter change at annualised rates

	1996	1997		
	4th qr	**1st qr**	**2nd qr**	**3rd qr**
Consumer prices				
Overall index	11,6	9,5	7,1	6,6
Underlying inflation*	12,6	7,4	8,1	6,7
Production prices				
All goods	12,7	8,4	2,7	2,1
Domestically produced goods	11,4	7,2	6,3	2,9

Imported goods	18,1	12,4	-10,7	-2,2
* Change in consumer price index excluding the prices of food and non-alcoholic beverages, the costs of home-ownership and value-added tax.				

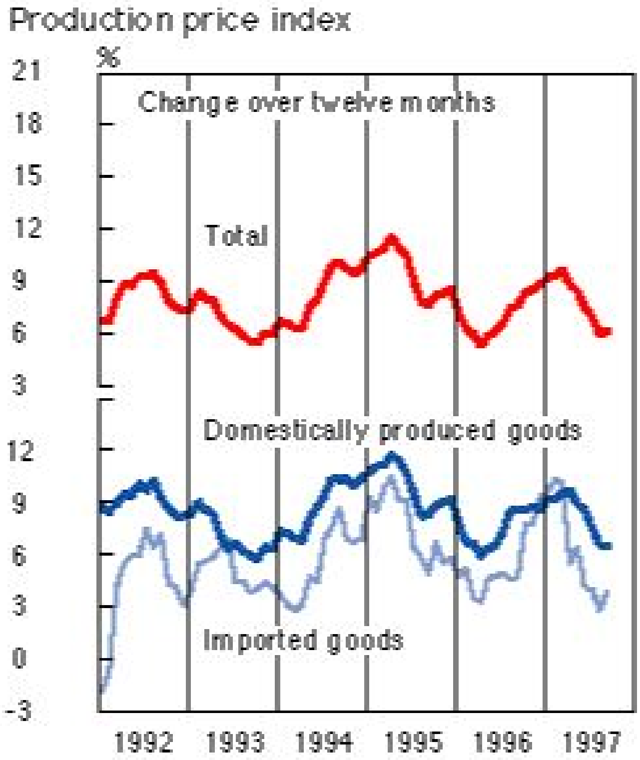
The prices of *consumer goods*, which usually tend to be more responsive to changes in productivity and nominal unit labour costs than the prices of *consumer services*, rose from the beginning of 1995 at rates well below the rate of increase in the prices of *consumer services*. From the beginning of 1997, the differential between the rates of increase over one year in the prices of consumer goods and that of consumer services narrowed from 2,2 percentage points in January to 0,3 percentage points in June. In July 1997 the increase in the prices of consumer services accelerated sharply as a result of the steep increase in municipal tariffs, with the result that the differential between goods price inflation and services price inflation widened once again to 1,7 percentage points in September.

Table 6. Prices of consumer goods and services

Percentage change over twelve months

Period		Consumer goods	Consumer services	Overall
1996:	Nov	8,7	10,2	9,2
	Dec	8,6	10,9	9,4
1997:	Jan	8,6	10,8	9,4
	Feb	9,0	10,7	9,8
	Mar	9,1	10,3	9,6
	Apr	9,2	10,9	9,9
	May	9,2	9,9	9,5
	Jun	8,7	9,0	8,8
	Jul	8,6	9,6	9,1
	Aug	8,0	9,5	8,7
	Sep	7,4	9,1	8,0

Other indicators of price inflation were even more subdued than the changes in consumer prices in the third quarter of 1997. The quarter-to-quarter annualised change in the seasonally adjusted *all-goods production price index* at 2,1 per cent in the third quarter of 1997 was no less than 10,6 percentage points lower than the recent peak in the fourth quarter of 1996. Over the same period, the quarter-to-quarter change in the *prices of domestically produced goods* fell to 2,9 per cent in the third quarter of 1997. This continued slowdown in the price increases of domestically produced goods was mainly due to lower rates of increase in the prices of electricity, gas, water, textiles, clothing and footwear. Measured over periods of twelve months, the increase in the all-goods production price index fell to 6,1 per cent in September 1997 - 3,5 percentage points down from the recent peak in March 1997 - and the increase over twelve months in the prices of domestically produced goods fell to 6,5 per cent - 3,2 percentage points lower than the recent peak in May 1997.



The strengthening in the exchange value of the rand from the end of October 1996 to the middle of March 1997 made a significant contribution to inflation reduction in recent months. One measure of this is that the *prices of imported goods* included in the all-goods production price index *declined* from quarter to quarter at a seasonally adjusted annualised rate of 10,7 per cent in the second quarter of 1997, after having *increased* at an annualised rate of 18,1 per cent as recently as the fourth quarter of 1996. The decline in the prices of imported goods in the second quarter of 1997 was particularly noticeable in the prices of crude oil which declined by 13,7 per cent from the first quarter and in the prices of paper and paper products which declined by 8,2 per cent from the first quarter. In the third quarter of 1997 the prices of imported goods declined further at a seasonally adjusted and annualised rate of 2,2 per cent. Measured over periods of twelve months, the prices of imported goods have increased by only 3,8 per cent in September 1997.

[1)] In accordance with normal practice during the third quarter of every year, revisions were made to national accounts data and incorporated in this issue of the *Quarterly Bulletin*. These revisions are based on more detailed or more appropriate data which have become available. In addition, seasonal factors have been updated.

Foreign trade and payments

Balance of payments on current account

Despite the relatively mild expansion in economic activity, the *balance of payments on current account* deteriorated in the third quarter of 1997. The *deficit on the current account* (seasonally adjusted and annualised), which had narrowed from R10,4 billion in the first half of 1996 to R6,7 billion in the second half and R5,7 billion in the first half of 1997, widened in the third quarter. The seasonally adjusted and annualised deficit more than doubled from R3,4 billion in the second quarter to R7,0 billion in the third quarter. Nonetheless, as a percentage of gross domestic product the deficit on the current account of the balance of payments remained modest, being equal to 1,2 per cent in the third quarter of 1997.

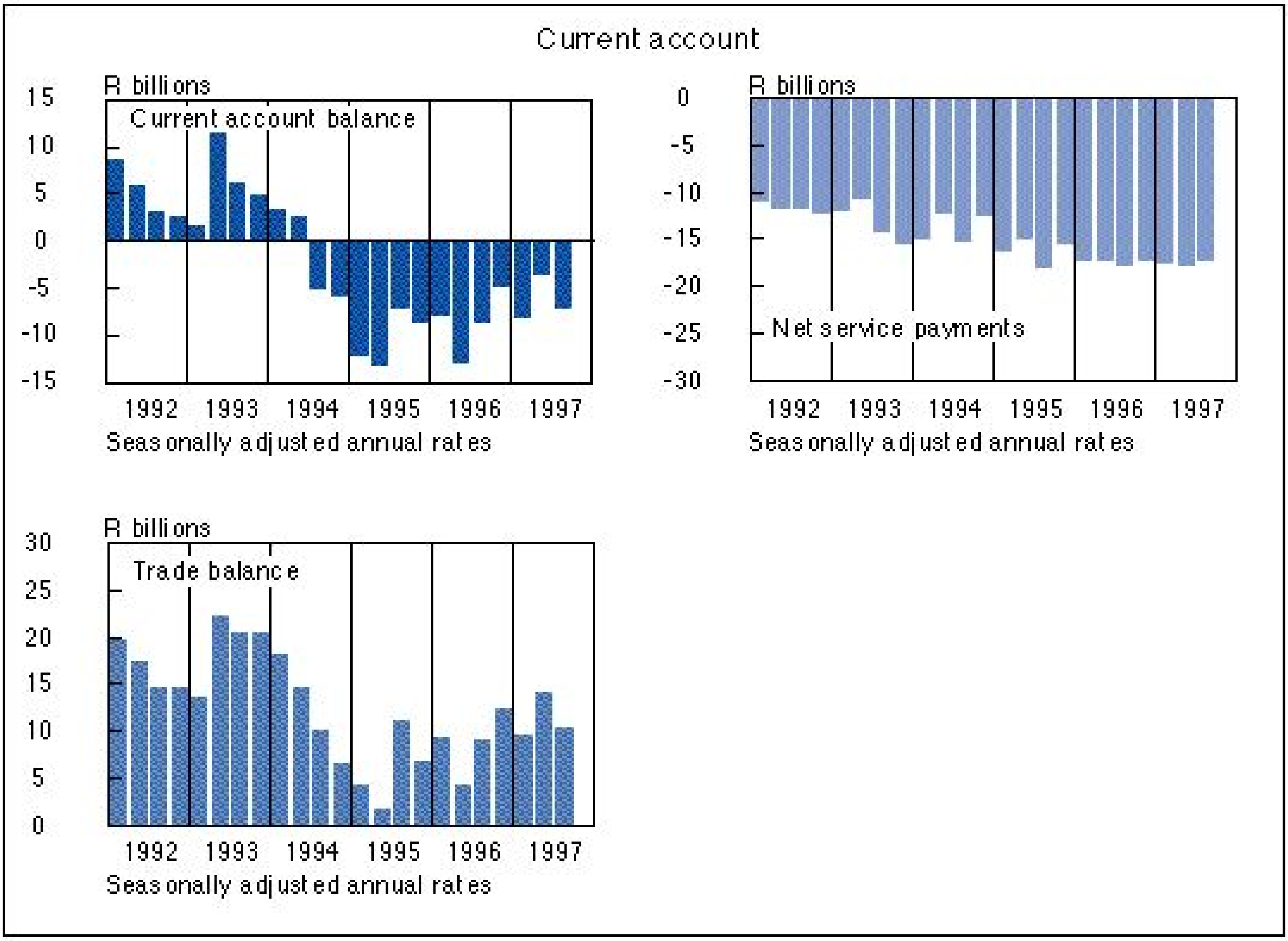
Table 7. Balance of payments on current account

Seasonally adjusted and annualised rates

R billions

	1996				**1997**		
	1st qr	**2nd qr**	**3rd qr**	**4th qr**	**1st qr**	**2nd qr**	**3rd qr**
Merchandise exports	88,5	93,1	102,6	111,0	105,6	116,9	113,0
Net gold exports	24,9	25,3	28,7	26,2	26,8	24,5	26,0
Merchandise imports	-104,1	-114,1	-122,2	-124,8	-122,9	-127,2	-128,7
Net service and transfer payments	-17,1	-17,2	-17,7	-17,1	-17,4	-17,6	-17,3
Balance on current account	**-7,8**	**-12,9**	**-8,6**	**-4,7**	**-7,9**	**-3,4**	**-7,0**

The widening of the deficit on the current account in the third quarter of 1997 was largely caused by a decline in the value of merchandise exports and a further, albeit small, increase in the value of merchandise imports. This was not fully neutralised by an increase in the value of net gold exports and a decrease in net services and transfer payments to non-residents.



The value of *merchandise exports* (seasonally adjusted and annualised), which had reached an all-time high of R116,9 billion in the second quarter of 1997, contracted to R113,0 billion or by 3½ per cent in the third quarter. This decrease was the combined result of a decline of almost 5 per cent in the physical quantity of goods exported and a small rise of 1½ per cent in export prices. The slight increase in the rand-denominated prices of goods exported was a reflection of a decline in the value of the average weighted exchange rate of the rand which counteracted a slight decline in the foreign-currency prices of internationally traded commodities. An analysis of the value of merchandise exports by product category showed that the decline during the third quarter resulted primarily from a decline in the value of mining products, mainly precious and semi-precious stones, and agricultural products, mainly vegetable products. Exports of manufactured goods, probably still benefiting from the increased competitiveness gained from the depreciation of the rand in 1996, continued to rise but at a somewhat lower rate than before.

Despite the decline in the physical quantity of goods exported in the third quarter of 1997, the constant-price value of merchandise exports was still about 5½ per cent higher than the quarterly average value achieved in 1996. As a ratio of real gross domestic product, the volume of exports rose from 21,8 per cent in the first quarter of 1997 to 22,4 per cent in the third quarter.

After having declined from R26,8 billion in the first quarter of 1997 to R24,5 billion in the second quarter, the seasonally adjusted and annualised value of *net gold exports* increased by 6 per cent to R26,0 billion in the third quarter of 1997. This improved performance could be attributed to an increase of 8½ per cent in the physical quantity of gold exported, largely owing to an increase in the production of gold and the delivery of gold previously sold forward. The average fixing price of gold on the London market fell from US$343 per fine ounce in the second quarter of 1997 to US$324 per fine ounce in the third quarter or by 5,5 per cent. Expressed in rand, the price of gold per fine ounce declined by only 2 per cent because of the stabilising effect of the decline in the external value of the rand on the rand price of gold. At the end of September 1997 the fixing price of gold briefly rose to US$337 per fine ounce before declining to $308 per fine ounce on 13 November 1997 - the lowest fixing on the London market since 2 July 1985. This sharp decline in the gold price occurred shortly after it became known that a Swiss group of experts suggested that the Swiss authorities sell a substantial portion of their gold holdings.

Along with the decline in real gross domestic expenditure, the *physical quantity of merchandise imports* (seasonally adjusted and annualised) declined slightly in the third quarter of 1997. The depreciation of the rand and small price increases in trading-partner countries caused the prices of imported goods to increase at a rate which exceeded the absolute size of the percentage decline in the volume of merchandise imports. Accordingly, the seasonally adjusted and annualised value of merchandise imports increased slightly from R127,2 billion in the second quarter of 1997 to R128,7 billion in the third quarter.

Table 8. Merchandise imports

Quarter-to-quarter percentage change of seasonally adjusted data

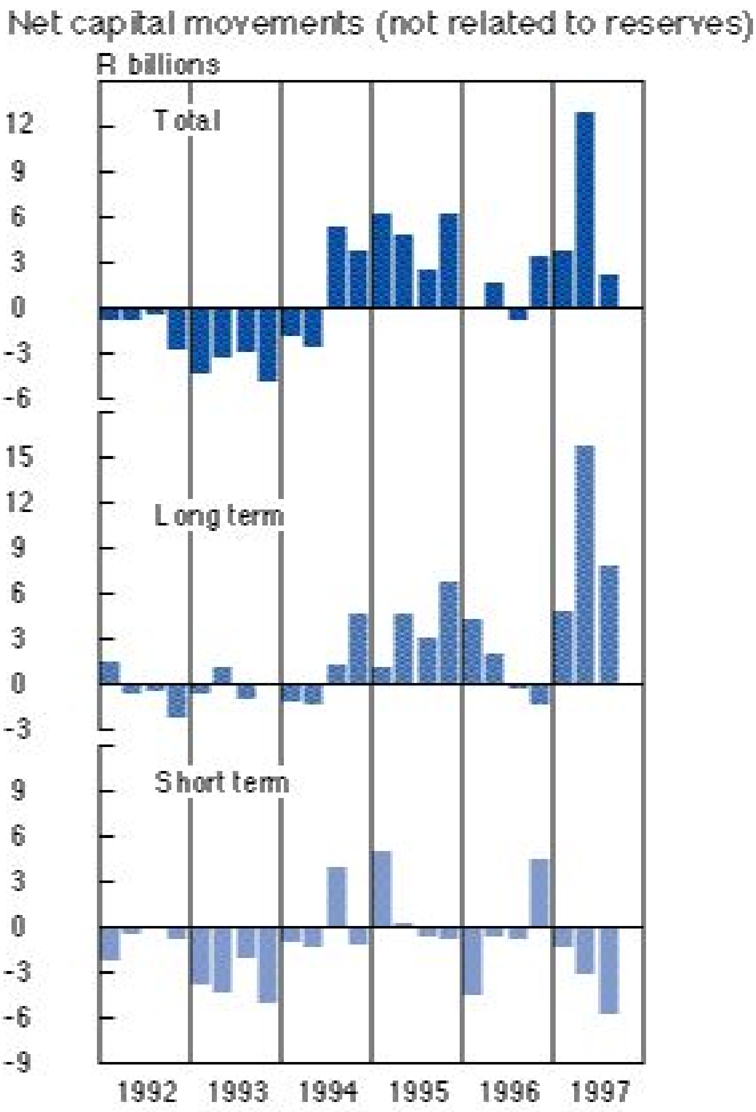
	1997		
	1st qr	2nd qr	3rd qr
Value	-1½	3½	1
Price	-1	-½	2½
Volume	-½	4	-1

Part of the decline in the physical quantity of merchandise imports was accounted for by a decline in the importation of agricultural products. By contrast, increased imports of mining products were recorded, especially in the categories base metals and precious and semi-precious stones.

Net *service and transfer payments* to non-residents (seasonally adjusted and annualised), which had increased from R17,4 billion in the first quarter of 1997 to R17,6 billion in the second quarter, decreased slightly to R17,3 billion in the third quarter. These marginally lower net payments were the result of higher services receipts, especially from travel expenditure by foreign visitors to the country and from transport services provided to non-resident entities. The value of payments for services received increased too, but to a lesser extent than the rise in the value of receipts for services rendered to non-residents. An increase in interest payments to non-residents flowing from the rise in South Africa's rand-denominated foreign debt commitments made the major contribution to the increase in service payments to the rest of the world.

Capital account

The total *net inward movement of capital not related to reserves* contracted from R12,7 billion in the second quarter of 1997 to R2,1 billion in the third quarter. This substantially reduced net inward movement of capital derived from a sharp decline in the net inflow of long-term capital and a fairly substantial increase in the outflow of short-term capital. Nevertheless, the cumulative net inflow of capital amounted to R18,4 billion in the first nine months of 1997, compared with only R0,6 billion in the corresponding period of 1996. In 1996 capital flows to South Africa were badly affected by negative investors' sentiment towards the country and the high volatility in the local foreign exchange market from February to October 1996.



The net inflow of *long-term capital* declined from R15,7 billion in the second quarter of 1997 to R7,7 billion in the third quarter. This decline was essentially caused by a sharp curtailment of cross-border capital movements to organisations in the public sector. Net long-term international capital movements to private-sector entities were reversed from a *net outflow* in the second quarter of 1997 to a sizeable *net inflow* in the third quarter.

The net inflow of long-term capital to the *public sector* was boosted to an unprecedented high in the second quarter of 1997 by two government bond issues in the international capital markets and by the proceeds of the sale to a consortium of non-resident investors of a strategic interest in Telkom. No such major events occurred in the third quarter and the net inflow of international capital to *public authorities* accordingly subsided from R11,2 billion in the second quarter of 1997 to R2,1 billion in the third quarter. In the case of public corporations, the net inflow of long-term capital declined from R6,1 billion in the second quarter to R0,9 billion in the third quarter.

Bonds of the Government and other public-sector corporations listed on the Bond Exchange of South Africa were acquired by non-resident investors to a net amount of R6,0 billion during the third quarter of 1997. However, by the end of September a net amount of approximately R2,0 billion had not yet been settled. Furthermore, fixed capital obligations of public-sector organisations to an amount of R2,5 billion became due for repayment to non-resident creditors during the third quarter of 1997.

International capital movements to *private-sector organisations* changed from net outflows in the second quarter of 1997 to fairly substantial inflows in the third quarter. The net inflow of foreign funds to the *non-bank private sector* amounted to R5,0 billion after a net outflow of R1,5 billion had been recorded in the second quarter. Included in the net inflows during the third quarter of 1997 were net purchases by non-residents of shares listed on the Johannesburg Stock Exchange to the value of R7,9 billion. During the same period South African institutional investors acquired foreign assets to the value of R4,1 billion through the mechanism of asset swaps with non-resident counterparties. Other foreign assets to the value of R2,7 billion were obtained through the offshore placement of shares by South African companies, which had a neutral effect on the value of the gold and foreign exchange reserves.

The net outflow of *short-term capital* not related to foreign reserves, but including errors and unrecorded transactions, increased from R3,0 billion in the second quarter of 1997 to R5,6 billion in the third quarter. The principal factor contributing to the increased net outward movement of short-term capital in the third quarter of 1997 was a sharp reduction in the outstanding foreign loan commitments of private banks. Unlike the second quarter of 1997, when the foreign-loan repayments of the private banks were more than fully counteracted by an accumulation of foreign liabilities in the form of non-resident foreign currency and rand-denominated deposits with domestic banks, such deposits rose by a much smaller amount in the third quarter. South African banks also increased their claims on non-residents by an amount of R0,8 billion during the third quarter.

Table 9. Net capital movements not related to reserves

R billions

	1996				**1997**		
	1st qr	**2nd qr**	**3rd qr**	**4th qr**	**1st qr**	**2nd qr**	**3rd qr**
Long-term capital							
Public authorities	1,3	0,1	-0,2	2,1	1,1	11,2	2,1
Public corporations	0,9	1,0	-0,8	2,5	1,4	6,1	0,9
Monetary sector	-0,2	-0,4	-0,2	-0,4	-0,2	-0,1	-0,3
Private sector	2,3	1,2	1,1	-5,4	2,5	-1,5	5,0
Total long-term capital	**4,3**	**1,9**	**-0,1**	**-1,2**	**4,8**	**15,7**	**7,7**
Short-term capital							
Monetary sector	-3,7	6,3	-0,4	8,6	2,6	5,3	-4,5

Other, including unrecorded transactions	-0,7	-6,7	-0,3	-4,1	-3,8	-8,3	-1,1
Total short-term capital	**-4,4**	**-0,4**	**-0,7**	**4,5**	**-1,2**	**-3,0**	**-5,6**
Total capital	**-0,1**	**1,5**	**-0,8**	**3,3**	**3,6**	**12,7**	**2,1**

The outflow of international short-term capital during the third quarter of 1997 was probably related to the steady decline in the external value of the rand, the high cost of forward cover against outstanding foreign financial commitments and the fairly easy access to domestic sources of credit. South African individuals also added to the net outflow of short-term capital during the third quarter of 1997 by depositing R274 million in offshore accounts. This was facilitated by the partial relaxation of exchange controls on individuals which came into force on 1 July 1997.

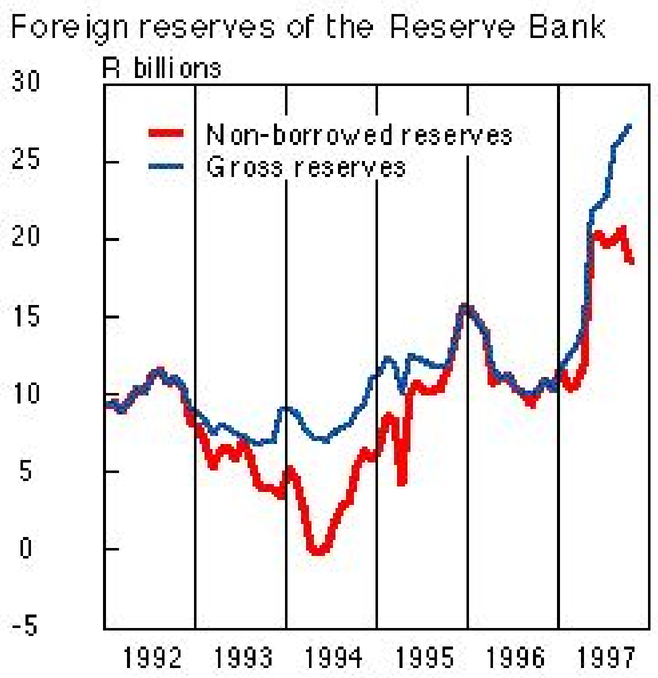
Foreign debt

As a result of the continued net repayment of South Africa's foreign-debt commitments, the country's total foreign-currency-denominated debt declined from US$23,6 billion at the end of 1996 to $23,4 billion at the end of June 1997. Foreign debt, which existed in 1985 and had been renegotiated in terms of successive special arrangements with foreign creditors, decreased from $2,7 billion at the end of 1996 to $2,6 billion at the end of June 1997, whereas other foreign-currency-denominated debt declined from $20,9 billion to $20,8 billion over the same period. Stated in rand at the exchange rate prevailing at the time of conversion, the ratio of foreign-currency-denominated debt to gross domestic product declined from 18,6 per cent at the end of December 1996 to 18,5 per cent at the end of June 1997 - substantially lower than the ratio of 43 per cent at the end of 1985 when the foreign debt standstill had been declared.

Foreign reserves

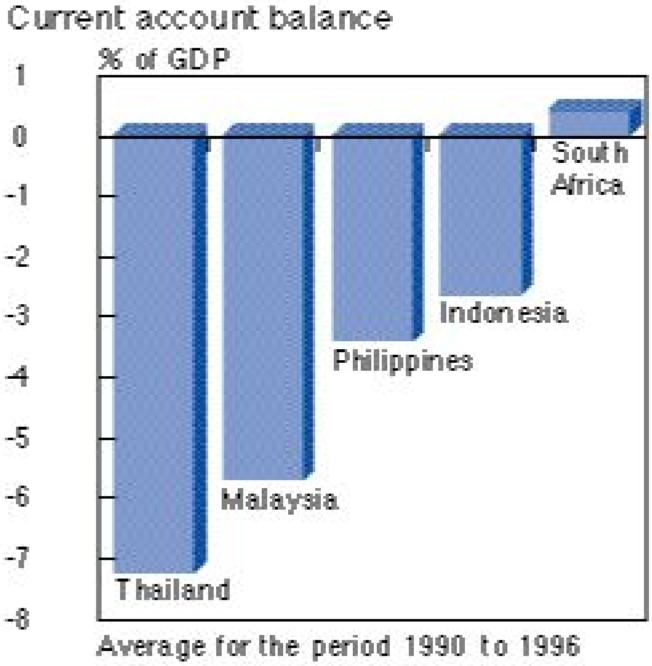
The reduced net inflow of capital and the larger deficit on the current account of the balance of payments caused South Africa's *net gold and other foreign reserves* to decline by R1,2 billion in the third quarter of 1997. During the first nine months of 1997, however, the total earned foreign reserves still increased, on balance, by R12,6 billion. In October 1997, the net gold and other foreign reserves of the Reserve Bank declined by another R2,5 billion. The value of *non-borrowed foreign reserves* held by the Reserve Bank at the end of October 1997 amounted to R18,6 billion, compared with an amount of R10,3 billion at the end of December 1996.

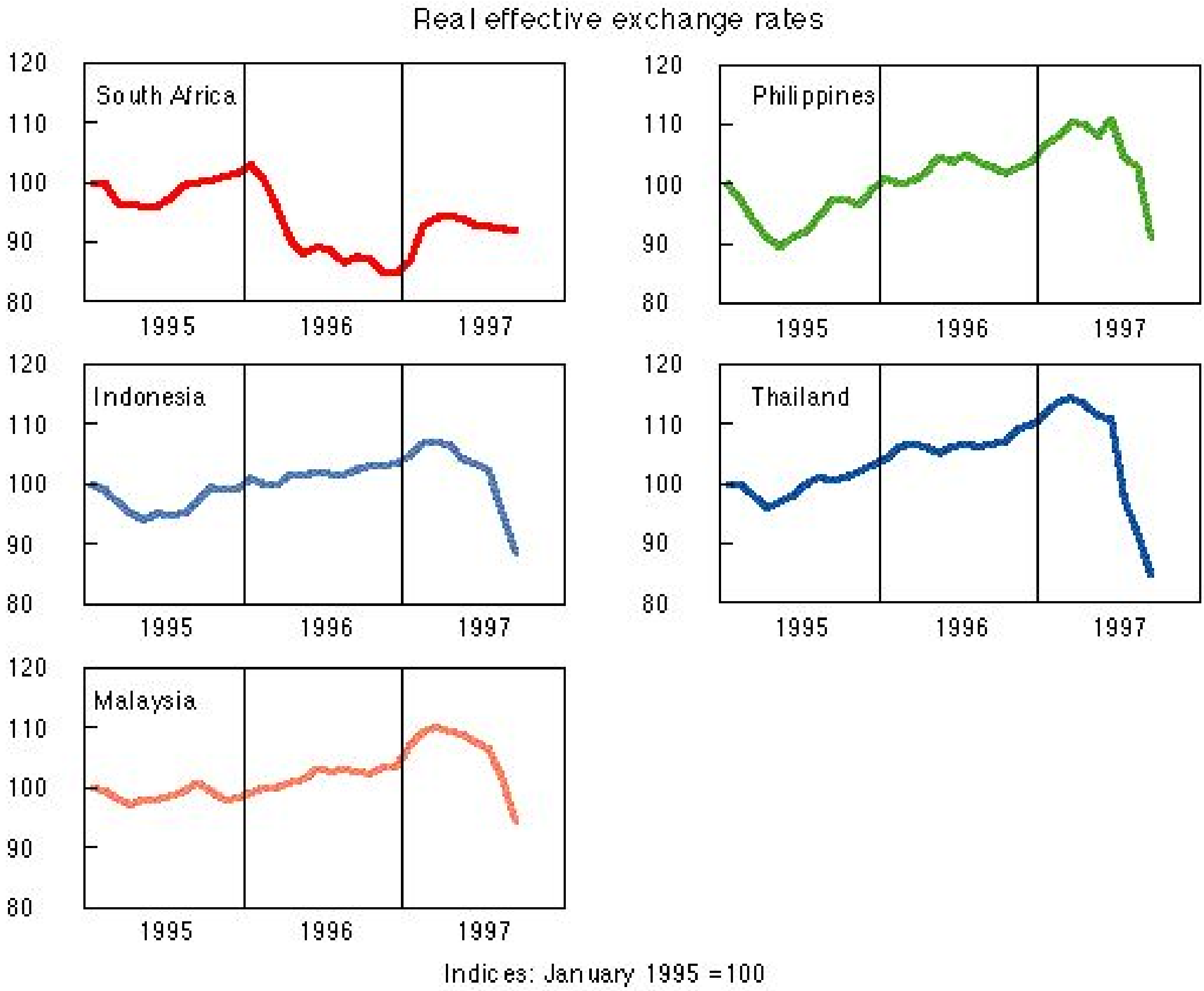
Partly as a result of increased foreign short-term borrowing by the Reserve Bank, the country's total gross gold and other foreign reserves increased from R30,7 billion at the end of June 1997 to R33,6 billion at the end of September. Measured in terms of the United States dollar, this increase was from $6,8 billion at the end of June 1997 to $7,2 billion at the end of September. Relative to the value of imports of goods and services, gross reserves increased from 9½ weeks' worth of imports at the end of the second quarter of 1997 to 10 weeks at the end of the third quarter - more than double the "import cover" of a year earlier. The gold reserves of the Reserve Bank increased from 3,8 million fine ounces at the end of June 1997 to 4,0 million ounces at the end of September. The gold component of total gross gold and other foreign reserves nevertheless declined from 16,9 per cent at the end of June 1997 to 16,1 per cent at the end of September.



Exchange rates

Developments in the international exchange markets from June to October 1997 were profoundly influenced by events in a number of Southeast Asian economies. Over a period of years these economies had experienced excessive money and credit growth, unsustainable deficits on the current accounts of their balance of payments, considerable net open forward positions in foreign exchange, nominal exchange rates pegged against the dollar and, consequently, inappropriate appreciations of real exchange rates. Concerns about the sustainability of macroeconomic balance in these economies led to capital withdrawals, which soon developed into major currency crises and the subsequent implementation of stern policy steps to correct structurally weak economic systems, in some instances with the involvement of the International Monetary Fund. From June to September 1997 the Thailand baht depreciated by 37,2 per cent against the US dollar, the Philippine peso by 24,4 per cent and the Indonesian rupiah by 22,6 per cent.


Current account balance
% of GDP
1
0
-1
-2
-3
-4
-5
-6
-7
-8
Thailand
Malaysia
Philippines
Indonesia
South Africa
Average for the period 1990 to 1996



Owing largely to the correction of the rand during 1996 and the fundamentally healthier state of macroeconomic management in South Africa, the depreciation of the rand against the US dollar from June to October was mild in comparison with the performance of the struggling Asian currencies. From the end of June to 31 October 1997 the rand depreciated by only 6,0 per cent against the dollar and by 5,9 per cent against a basket of currencies. At the height of the decline in global financial markets, the rand still held relatively firm and declined by 2,4 per cent on a nominal effective basis between 27 October and 31 October 1997.

Table 10. Changes in exchange rates of the rand

Per cent

	31 Oct 1996 to 13 Mar 1997	13 Mar 1997 to 30 Jun 1997	30 Jun 1997 to 31 Oct 1997	31 Dec 1996 to 25 Nov 1997

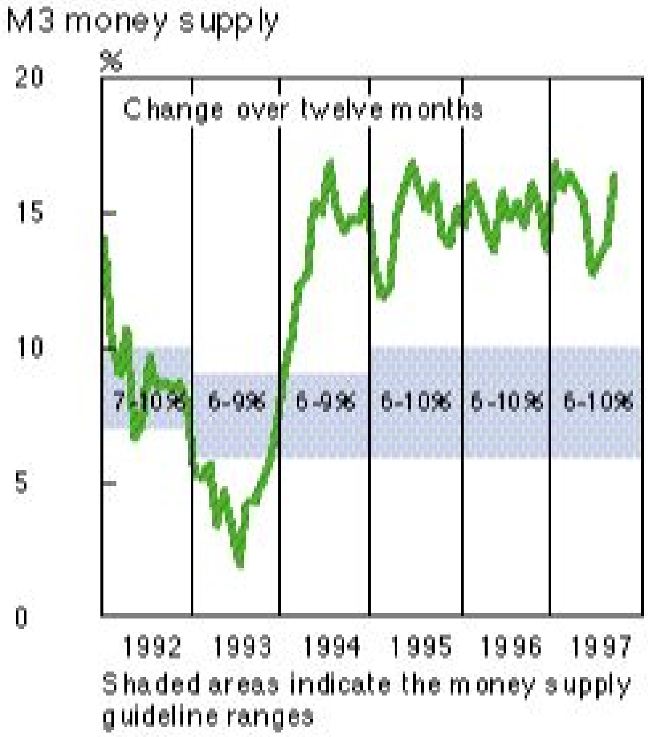
Weighted average	10,9	-3,9	-5,9	-0,9
US dollar	7,7	-2,8	-6,0	-3,4
British pound	9,7	-6,4	-6,6	-3,0
German mark	20,6	-0,1	-6,7	8,1
Japanese yen	16,2	-9,1	-1,2	6,3
Netherlands guilder	20,9	-0,1	-6,6	8,6
Italian lira	20,1	-2,3	-6,2	7,9

The decline in the nominal effective exchange rate of the rand during the third quarter of 1997 was slightly more than the inflation differential between South Africa and its major trading-partner countries. The *real effective exchange rate* of the rand accordingly declined by 1,9 per cent from June to August 1997. On average, the level of the real effective exchange rate of the rand in the first eight months of 1997 was approximately ½ per cent below the average for the corresponding period of 1996.

Monetary developments, interest rates and financial markets

Money supply

The quarter-to-quarter annualised growth in the average level of the *broadly defined money supply (M3)* slowed down from 18,1 per cent in the first quarter of 1997 to 16,4 per cent in the second quarter and 12,1 per cent in the third quarter. This brought the annualised growth in M3 closer to the guideline range for acceptable monetary growth which has been set at between 6 and 10 per cent for 1997. In contrast, the growth over periods of twelve months in M3 accelerated during the third quarter of 1997 from 12,7 per cent in June to 16,3 per cent in September. This acceleration in the twelve-month growth rate of M3 from June 1997 to September was not only the result of large increases from month to month, but also of a decline in the level of M3 in July 1996, which lowered the base of the twelve-month rate calculations. In September 1997 the seasonally adjusted value of M3 exceeded the upper limit of the guideline "tunnel" by R18,9 billion or 5,5 per cent. From the base of the guideline year in the fourth quarter of 1996 up to September 1997 M3 grew at an annualised rate of 17,3 per cent.



The continued rapid growth in the money supply was partly related to the growth in nominal domestic output and expenditure on consumption and fixed investment in the first nine months of 1997. Developments in the financial markets also seemingly had an impact on increased money holdings by the general public. An analysis of *banks' liabilities according to type of depositor* shows that the increase in bank deposits was mostly concentrated in deposits held by *companies and close corporations*. These deposits increased by R24,5 billion in the first three quarters of 1997, substantially more than the increase of R7,1 billion over the corresponding period in 1996. Deposits held by *private households* also increased further by R6,3 billion during the first three quarters of 1997, following an increase of R8,9 billion in the corresponding period in 1996. *Institutional investors* apparently preferred to increase their exposure in the securities markets rather than hold more deposits as was reflected by the increase in the holdings of bank deposits by insurance companies and pension funds of only R2,5 billion in the first three quarters of 1997, compared with R8,0 billion in the first three quarters of 1996.

Although the growth rates over twelve months in the *narrower monetary aggregates* generally exceeded those of M3 during the first nine months of 1997, the growth in the narrower aggregates over shorter periods of time tended to subside between the fourth quarter of 1996 and the second quarter of 1997, but then rebounded in the third quarter. For example, the annualised quarter-to-quarter growth in the average quarterly value of M1 fell from 39,9 per cent in the fourth quarter of 1996 to a negative rate of 1,3 per cent in the second quarter, but then bounced back to 21,4 per cent in the third quarter. From the fourth quarter of 1996 until August 1997 there was a shift in the public's liquidity preference from shorter-term deposits to longer-term deposits with banks. This was motivated largely by expectations of declining long-term interest rates and an anticipated reduction of official lending rates. These developments were suddenly reversed in September 1997 when a major shift back to shorter-term deposits occurred. This may turn out to have been a one-time event and did not necessarily signal a permanent rise in the preference of the general public for shorter-term deposits.

The behaviour of the main statistical or accounting counterparts of M3 varied considerably over the second and third quarters of 1997:

- increases in claims on the private sector dominated the overall change in M3 but declined nonetheless from an increase of R14,2 billion in the second quarter of 1997 to R9,1 billion in the third quarter;

Table 11. Accounting counterparts of change in M3

R billions

	1997	
	2nd qr	**3rd qr**
Net foreign assets	6,5	1,9

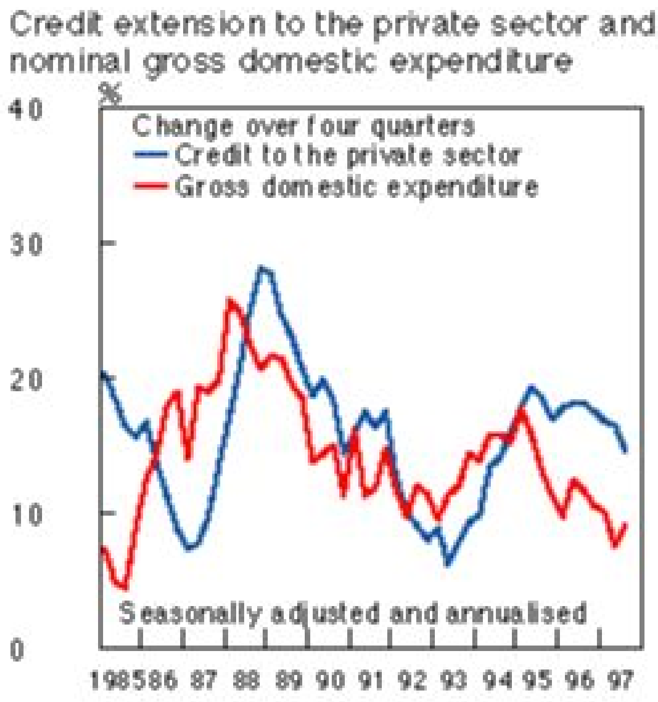
Net claims on government sector	-3,2	4,0
Claims on private sector	14,2	9,1
Net other assets	-11,3	0,9
Total change in M3	**6,2**	**15,8**

- net foreign assets of monetary institutions rose moderately in the third quarter of 1997 after they had risen much more substantially in the second quarter;
- the contribution of net claims of the banks on the government sector turned from a contraction of R3,2 billion in the second quarter of 1997 to an increase of R4,0 billion in the third quarter; and
- "net other assets" increased slightly by R0,9 billion in the third quarter after they had declined by R11,3 billion in the second quarter when surpluses on account of Reserve Bank involvement in the forward foreign-currency market and a reduction in loans granted under resale agreements had a contractionary impact on the monetary sector's net other assets.

Credit extension

The rate of increase over twelve months in *total domestic credit extension* (i.e., the monetary sector's credit extended to the private sector and net claims on the government sector) decreased from 17,1 per cent in December 1996 to 15,3 per cent in September 1997. The quarter-to-quarter annualised growth rate in the average level of total credit extension decelerated even more impressively from 23,6 per cent in the first quarter of 1997 to 6,1 per cent in the third quarter.

The slower rate of increase in total domestic credit extension in the third quarter of 1997 was mainly the result of a decline in the growth of credit extension to the *private sector*. The twelve-month growth rate in credit extension to the private sector fell back from 17,4 per cent in April 1997 to 14,3 per cent in September as private-sector organisations economised on the use of bank credit. Nonetheless, these monthly growth rates still exceeded the inflation rate as measured by changes over twelve months in the consumer price index. Furthermore, despite the slowdown in credit extension to the non-bank private sector, credit growth has consistently outpaced the growth in nominal gross domestic expenditure by a considerable margin since early 1995. The rapid expansion of credit extended by the monetary sector to the private sector is also evident from the high level of the ratio of private-sector credit to gross domestic product which amounted to 65,6 per cent in the third quarter of 1997 - the second highest ratio ever recorded.



An analysis of monetary institutions' claims on the private sector by *type of credit* shows that the growth in credit extension to the private sector in the third quarter of 1997 consisted mainly of *overdrafts and other loans and advances*. The rate of increase over twelve months in this credit category has exceeded 20 per cent in each and every month since April 1997. Strong demand for working capital by the corporate sector, some borrowing by companies struggling to keep afloat during a temporary slack in demand and the switching of foreign trade financing from offshore to domestic sources of credit were among the main forces behind the rise in corporate demand for bank credit.

Table 12. Twelve-month growth rates in main types of credit extended to the private sector

Per cent

Period		Investments	Bills discounted	Instalment sales	Leasing finance	Mortgage advances	Other loans and advances	Total
1997:	Jan	2,6	-13,2	21,1	16,6	16,4	20,4	17,1
	Feb	1,4	-2,2	20,2	15,1	16,3	21,2	17,3
	Mar	-1,5	-16,0	18,1	14,3	15,8	19,9	16,0
	Apr	4,7	-6,2	19,5	12,9	15,5	22,7	17,4
	May	10,2	-10,9	15,8	11,9	15,1	22,4	16,7
	Jun	9,9	-15,8	14,3	8,9	14,7	23,3	16,4
	Jul	15,8	-14,9	12,2	6,6	13,4	20,5	14,7
	Aug	5,6	-0,7	11,6	5,6	12,8	21,5	14,6
	Sep	-1,0	13,0	10,8	0,2	12,5	22,2	14,3

The growth over twelve months in *mortgage advances* slowed down perceptibly from 14,7 per cent in June 1997 to 12,5 per cent in September. The growth over twelve months in *instalment sale credit* also subsided from rates higher than 20 per cent at the beginning of 1997 to 14,3 per cent in June and 10,8 per cent in September. Similarly, the twelve-month growth in *leasing finance* declined from rates higher than 15 per cent at the beginning of 1997 to only 0,2 per cent in September.

The shift in the relative importance of credit extended by the monetary sector from *households* to the *corporate sector* continued in the third quarter of 1997. Credit extended to households increased by R4,6 billion in the second quarter of 1997 and by R3,7 billion in the third quarter, whereas credit extended to the corporate sector rose by R9,5 billion in the second quarter and R5,4 billion in the third quarter. In terms of percentage changes, the growth rate over twelve months in credit extension to households amounted to 12,4 per cent in September 1997 - well below the twelve-month growth of 16,9 per cent in credit extension to the corporate sector during the same period.

Interest rates and yields

For the major part of the first nine months of 1997, sentiment in the South African bond market turned out to be mostly bullish as market participants traded on the expectation that inflation was likely to subside, the exchange rate was likely to remain firm and that official lending rates were likely to be lowered soon. Apart from a relatively short interlude from March to April 1997 when uncertainties about government's fiscal policy intentions and later also uncertainties surrounding the possible effect of the partial relaxation of exchange controls on residents caused bond yields to rise for a while, the overall mood in the bond market was predominantly optimistic. This positive sentiment came to an end towards the end of October 1997 when the turbulence in Southeast Asian financial markets reverberated throughout the global financial network, including the South African financial markets.

The *monthly average yield on long-term government bonds* declined from 15,2 per cent in April 1997 to 14,2 per cent in July, a level that was maintained in August and September. The *daily average yield on long-term government bonds* subsequently fell below 14 per cent for the first time since February 1996 and reached a low of 13,8 per cent on 22 October 1997. The sharp decline in bond prices in the Southeast Asian markets then followed and the daily average yield on long-term government bonds rebounded to 15,1 per cent on 28 October 1997 as non-resident investors became net sellers of bonds on a vast scale. Despite the sharp rise in bond yields in the last week of October, the monthly average yield in October 1997 nonetheless declined to 14,0 per cent from 14,2 per cent in the preceding month.

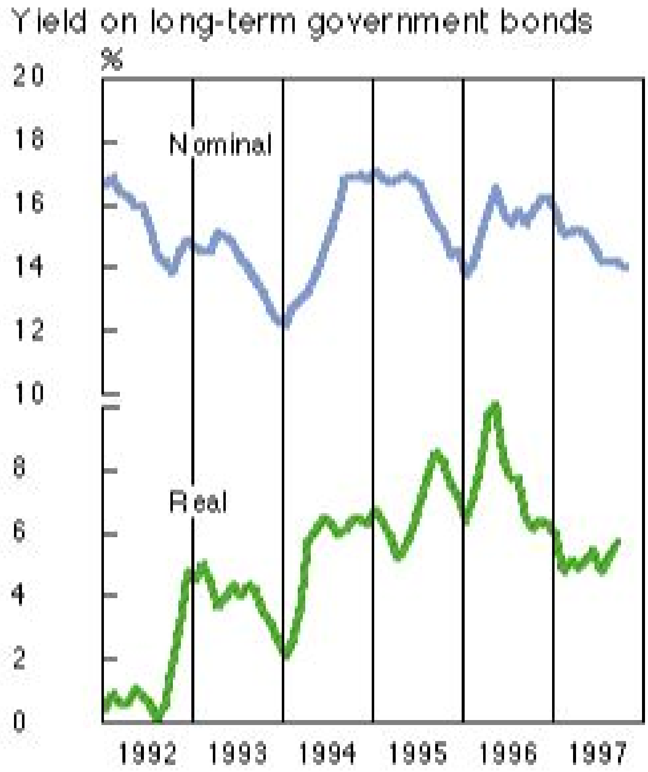


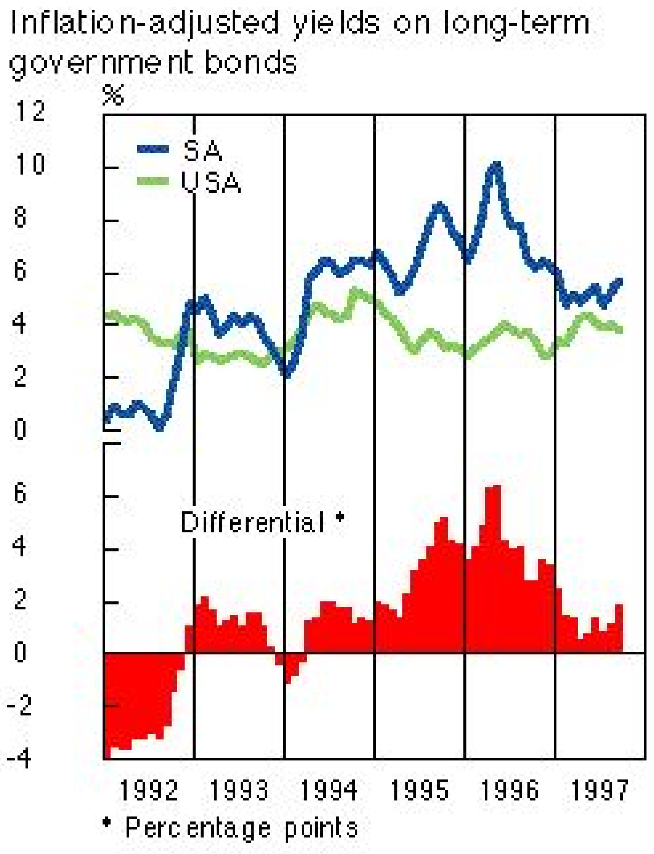
Table 13. Interest rates and yields

Per cent

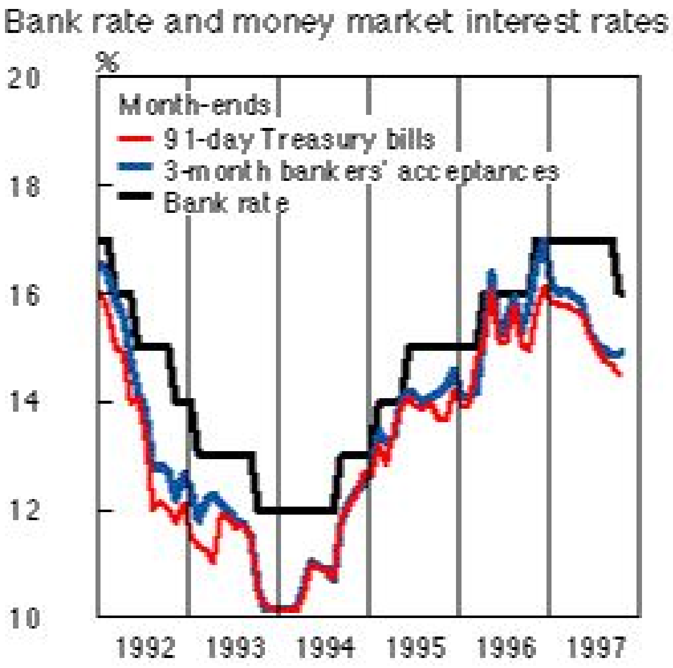
Period		3-month bankers' acceptances*	Monthly average yield on long-term government bonds				Predominant rate on	
			South Africa		United States of America			
			Nominal	Real	Nominal	Real	Mortgage loans	12-month fixed deposits
1996:	Nov	16,55	16,2	6,4	6,2	2,8	19,00	14,50
	Dec	17,00	16,2	6,3	6,4	2,9	20,00	14,50
1997:	Jan	16,15	15,8	5,9	6,5	3,4	20,00	14,50
	Feb	16,00	15,0	4,8	6,5	3,3	20,00	14,50
	Mar	16,05	15,2	5,1	6,7	3,8	20,00	14,50
	Apr	15,95	15,2	4,9	6,8	4,3	20,00	14,50
	May	15,85	15,1	5,1	6,7	4,4	20,00	14,50
	Jun	15,30	14,7	5,5	6,4	4,1	20,00	14,50
	Jul	15,05	14,2	4,8	6,2	3,9	20,00	14,50
	Aug	14,95	14,2	5,2	6,3	4,0	20,00	14,50
	Sep	14,85	14,2	5,7	6,1	3,8	20,00	14,50
	Oct	14,90	14,0	6,2	6,0	3,8	20,00	14,50
	Nov	...	...	...	...	...	19,00	13,50

* As at end of month

The *monthly average inflation-adjusted yield on long-term government bonds*, which had bottomed out at about 5,0 per cent over the period from February 1997 to July, increased to 6,2 per cent in October as the monthly average of nominal bond yields remained approximately unchanged and consumer price inflation over one year declined fairly decisively. This movement widened the differential between inflation-adjusted government bond yields in South Africa and the USA to margins that might have been a more accurate reflection of the differences in the country and currency risks of these two economies.

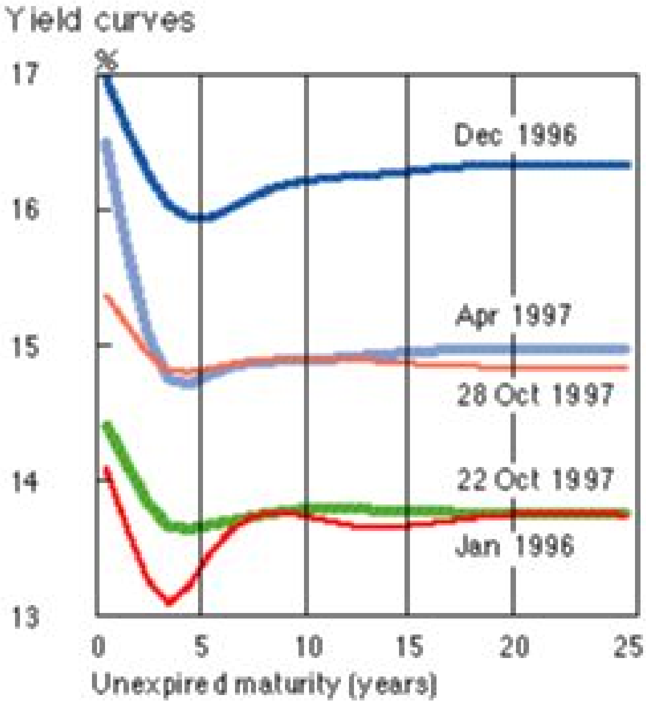


Money market interest rates generally moved downwards from April 1997 up to September 1997. The *rate on bankers' acceptances with a maturity of three months*, which represents the overall movement in money market rates fairly closely, declined from 16,05 per cent at the end of March 1997 to 14,85 per cent at the end of September. This downward movement was mainly a result of easier money market conditions in the second and third quarters of 1997 and widespread expectations of a reduction in Bank rate. When Bank rate was lowered on 20 October, the rate on bankers' acceptances of three months declined further to 14,20 per cent on 23 October, but bounced back to 15,20 per cent on 28 October when money market conditions tightened considerably in the wake of the turmoil in the financial markets. By the end of October the bankers' acceptances rate had fallen back to 14,90 per cent and then remained more or less at this level during the first three weeks of November.



The *tender rate on Treasury bills of three months* moved in harmony with other money market rates from the first quarter of 1997. This rate declined from 15,79 per cent at the end of March 1997 to 14,69 per cent at the end of September. It then fell to 14,10 per cent on 24 October before being overtaken by the events in global markets in the last days of October when it rose again to 14,49 per cent. Strong demand by banks for assets qualifying as first-tier collateral kept the increase in the tender rate on Treasury bills at bay in the last days of October and in November.

A sizeable downward movement in bond yields across the full maturity spectrum from April 1997 to 22 October moved the *yield curve* lower to a level broadly similar to that which prevailed shortly before the rand started to depreciate in February 1996. The ensuing turbulence in financial markets increased short-term yields by 96 basis points to 28 October, whereas long-term yields increased by 108 basis points. The yield curve was thus restored to its level of April 1997, but still maintained its inverted gradient while becoming even flatter than before. The yield curve subsequently drifted downwards over the full maturity spectrum towards the end of October. Judging from the general level and shape of the yield curve, the flight away from emerging markets was clearly reflected in the re-rating of bond prices in South Africa.



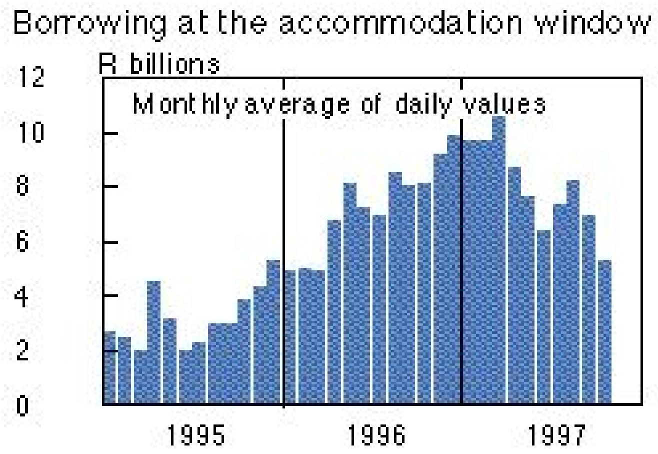
The lending rates of banks have remained relatively stable since November 1996. The *prime overdraft rate of banks* was raised to 20,25 per cent on 21 November 1996 and remained at this level until 20 October 1997. The slowdown in the quarter-to-quarter growth in the money supply and bank credit extension to the private sector during the third quarter and the resumption of a downward tendency in consumer and production price inflation permitted the Reserve Bank to announce a reduction in Bank rate from 17 per cent to 16 per cent with effect from 20 October. The banks followed this signal by lowering their prime overdraft rates from 20,25 per cent to 19,25 per cent in a series of reductions from 20 October to 1 November 1997. The *inflation-adjusted prime overdraft rate* (i.e. the nominal prime overdraft rate adjusted by the increase in the consumer price index over twelve months) declined from 11,3 per cent at the end of September 1997 to 10,9 per cent at the end of October owing to the twelve-month consumer price inflation rate declining sharply by 0,5 percentage points in October.

The *predominant rate on new mortgage loans by banks* was reduced by one percentage point to 19 per cent from 1 November 1997 in the aftermath of the reduction in Bank rate on 20 October. However, *fixed and maximum-rate home loan rates* were lowered by up to 1,5 percentage points between July and September 1997 as competition in the mortgage market intensified against the backdrop of subdued trading conditions and growing expectations of mortgage lending rate reductions.

The *predominant retail rate on twelve-month fixed deposits* was lowered by one percentage point to 13,5 per cent in November 1997. The *standard interest rate* applicable to loans granted from the State Revenue Fund was set at 14,0 per cent from 1 November 1997 - a net reduction of 2,5 percentage points since December 1996. The *maximum permissible finance charges rates* for most types of loans were raised by one percentage point in March 1997. These rates now stand at 29 per cent per annum in respect of money lending, credit and leasing transactions for amounts of more than R6 000 but less than R500 000, and 32 per cent in respect of amounts up to R6 000.

Money market

The exceedingly tight money market conditions in the first quarter of 1997, eased considerably during the second and third quarters. The amount of accommodation which the Reserve Bank extended to banks declined from a daily average level of R10,6 billion in March 1997 to R6,3 billion in June and R6,9 billion in September. The daily average amount of accommodation subsequently declined to R5,3 billion in October. However, wide fluctuations occurred during the course of that month. Prior to the reduction of Bank rate on 20 October 1997 and in the days immediately thereafter, the daily amount of accommodation provided by the Reserve Bank declined to below R4 billion. In the midst of the largely unforeseen and unsettling developments in the global financial markets, the amount of accommodation provided by the Bank increased to R10,0 billion on 29 October before declining somewhat to R8,5 billion on the last day of the month.



The easier money market conditions that prevailed in the second quarter of 1997 were mainly due to a strengthening of the net foreign assets of the Reserve Bank which were neutralised only partially by surpluses originating from the Bank's transactions in the forward foreign-currency market and an increase in government deposits with the Reserve Bank. The slightly tighter conditions in the third quarter of 1997 were primarily caused by a decline of R1,7 billion in the net foreign assets of the Reserve Bank. This decline in net foreign assets outweighed a decline of R0,5 billion in government deposits with the Bank which would otherwise have eased money market conditions, all else remaining unchanged.

A decrease in the net foreign assets of the Reserve Bank was mainly responsible for the tightening of money market conditions towards the end of October 1997. The potential for disorderly trading conditions to develop as a result of the global financial troubles forced the Reserve Bank to provide liquidity on a limited scale to the foreign exchange market. This had the desired effect of stabilising the foreign exchange market, but at the same time had a tightening effect on money market conditions.

The rise in the money market shortage compelled some banks to tender second-tier assets as collateral for overnight borrowing from the Reserve Bank in the last days of October 1997 and in November.

The *Reserve Bank's operations* in the money market during the first ten months of 1997 were generally neutral and aimed towards permitting the money market shortage to reflect the underlying pressures prevailing in the market and to avoiding undue fluctuations in the amount of accommodation supplied to banks. During July the Bank sold government stock from its portfolio of zero-coupon bonds to drain liquidity emanating from the repatriation of the proceeds of the sale of a minority interest in Telkom to a consortium of foreign companies.

Bond market

Capital raising activities by *private-sector companies* were focused exclusively on the primary share market in the first nine months of 1997 and companies listed on the Johannesburg Stock Exchange made *no rights issues of fixed-interest securities* during this period. An amount of R2,2 billion was raised through these instruments in 1996 as a whole. The only capital raised in the *domestic primary bond market* by private sector companies in 1997 occurred in February with three issues of bonds listed on the Bond Exchange of South Africa amounting in total to R1,2 billion. These were the first such listed bond issues since December 1992.

With private-sector companies abstaining from the domestic primary bond market, this market continued to be dominated by the activities of *public-sector borrowers.* Net issues of fixed-interest securities by public-sector bodies amounted to R9,3 billion in the first half of fiscal 1997/1998, compared with R11,7 billion in the corresponding period of the previous fiscal year. These net issues exhibited fairly volatile movements from month to month. For instance, net stock redemptions amounting to R6,9 billion were made in August 1997.

The National Government raised an additional amount of R3,8 billion by issuing foreign-currency denominated bonds in the *international primary bond markets* during the first seven months of fiscal 1997/1998. Eskom, Transnet and the Development Bank of Southern Africa also mobilised an amount of R813 million in the Eurobond market through the issuance of rand-denominated bonds in the period from April to October 1997.

Trading activity in the *secondary bond market* became extremely buoyant in the third quarter of 1997 as the generally downward movement in yields ostensibly became entrenched. The quarterly average value of bonds traded on the Bond Exchange of South Africa increased from R858 billion in the first half of 1997 to an all-time high of R1 182 billion in the third quarter. A steep rise in *total repurchase transactions* contributed materially to increased turnovers in the secondary bond market: repurchase transactions as a percentage of total turnover increased from 49 per cent in the first half of 1997 to 56 per cent in the third quarter. Total turnover increased further to an all-time monthly high of R555 billion in October 1997, compared with a monthly average of R394 billion in the third quarter of 1997. A further step was taken in the process of improving the efficiency of bond trading in South Africa when a new settlement system was introduced in the bond market in November 1997. The old system of settlement on the second Thursday following the conclusion of a transaction was replaced by a system of settlement on the third day after a transaction had been concluded.

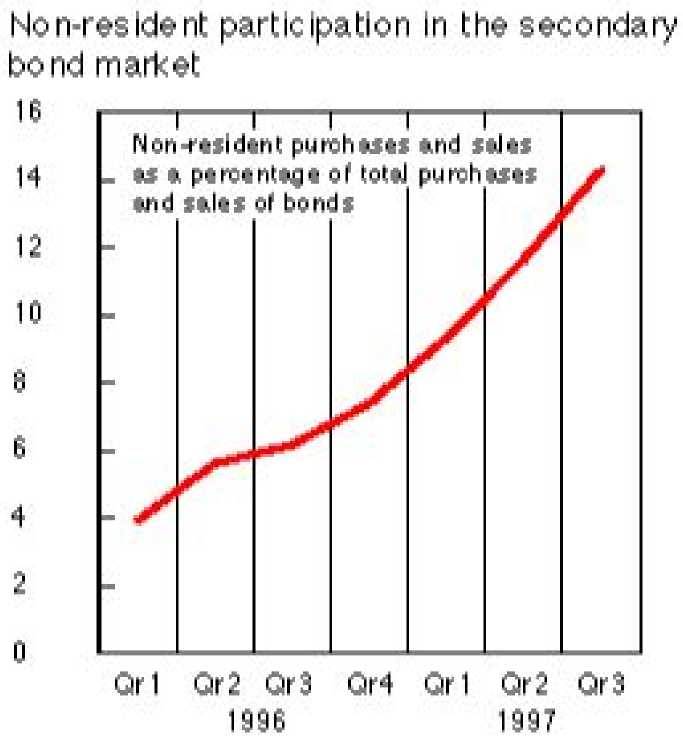
The value of transactions in the secondary bond market involving *non-resident investors* increased from R347 billion in 1996 to R887 billion in the first ten months of 1997. As a percentage of the total purchases and sales of bonds, purchases and sales by non-residents increased from 5,7 per cent in 1996 to 17,2 per cent in October 1997. *Repurchase transactions* also gained in popularity among non-resident investors; these type of transactions as a percentage of non-resident purchases of bonds increased from 41 per cent in the first half of 1997 to 54 per cent in the third quarter.

Table 14. Non-resident transactions in the bond and share markets

R billions

Period		**Bonds**			**Shares**		
		Purchases	**Sales**	**Net purchases**	**Purchases**	**Sales**	**Net purchases**
1996:	1st qr	30,7	28,3	2,4	10,7	8,4	2,3

	2nd qr	44,0	43,6	0,4	11,0	9,0	2,0
	3rd qr	49,5	50,1	-0,6	9,1	7,6	1,5
	4th qr	50,9	49,7	1,2	10,7	11,2	-0,5
1997:	1st qr	85,4	79,3	6,1	14,3	10,8	3,5
	2nd qr	100,7	93,3	7,4	19,4	11,2	8,2
	3rd qr	171,9	165,9	6,0	23,6	15,7	7,9



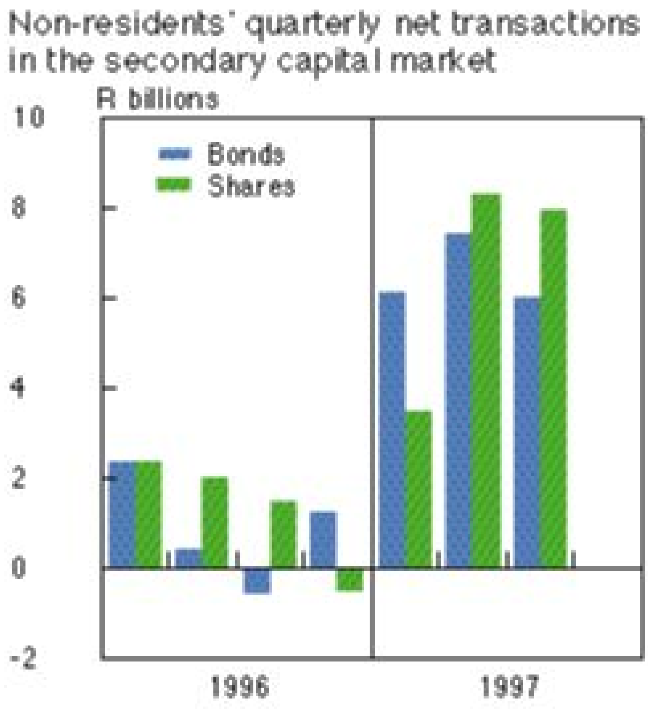
In view of the relatively attractive yields available in the domestic bond market and the prospects for continued rand stability, *non-residents* predominantly remained *net buyers* of bonds in the first nine months of 1997. The monthly value of these net purchases, however, declined from an all-time high of R4,7 billion in April 1997 to a monthly average of R1,7 billion from May to September. In October 1997 non-residents became net sellers of bonds to the amount of R5,2 billion. This change in behaviour was motivated by a desire to lock in profits when bond yields were declining sharply in the first three weeks of October, uncertainty about the continued stability of the exchange rate of the rand and the contagion effect on domestic financial markets of the turbulence in global markets.

Share market

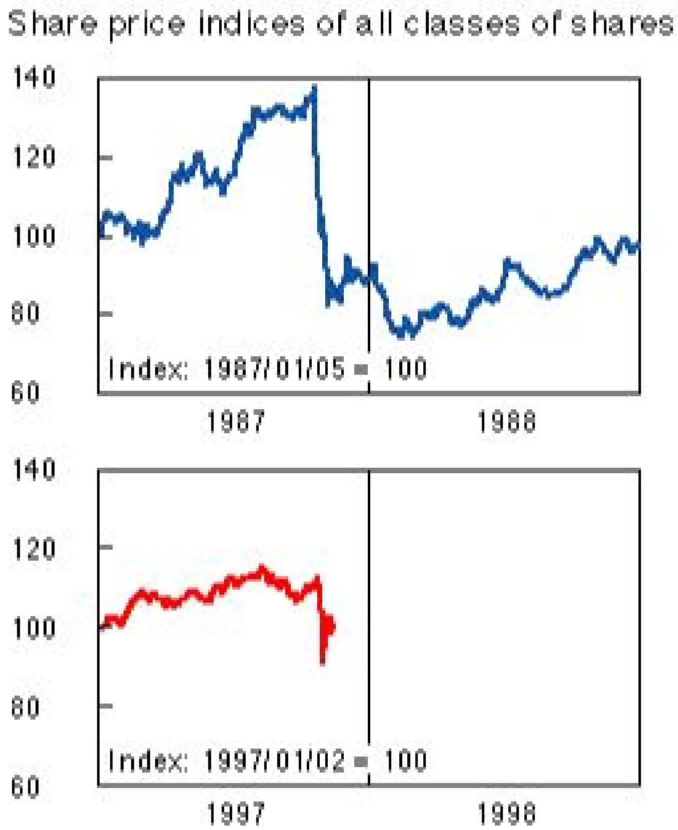
The demand for capital in the *primary share market* showed a distinct upward tendency in the first nine months of 1997. The value of *capital raised* increased from R7,9 billion in the first quarter of 1997 to R12,2 billion in the second quarter and R19,2 billion in the third quarter. Of the total amount of R39,3 billion mobilised in the primary share market during the first three quarters of 1997, some R17,2 billion or almost 44 per cent was in the form of shares issued for the acquisition of assets that were not already listed on the Johannesburg Stock Exchange.

In the *secondary share market* the value of shares traded on the Johannesburg Stock Exchange increased from R41,2 billion in the first quarter of 1997 to R51,0 billion in the second quarter and R58,7 billion in the third quarter. The sudden and sharp decline in share prices on 23 October 1997 caused a flurry of trading activity which swept the value of share market trading higher to R21,8 billion in October compared with average monthly turnovers of R19,6 billion in the previous three calendar months.

Non-residents participated actively in trading on the Johannesburg Stock Exchange and their purchases and sales of shares accounted for 31,7 per cent of total purchases and sales of shares in the first ten months of 1997. In fact, net purchases of shares by non-residents exceeded their net buying of bonds by an amount of R2,7 billion in the second and third quarters of 1997. This marked quite some change from the fourth quarter of 1996 and the first quarter of 1997 when net *purchases* of bonds by non-residents were R4,3 billion more than their net buying of shares. With the collapse of the global share markets in October 1997, the net purchases of shares by non-residents increased to R3,8 billion in that month compared with an amount of R2,3 billion in September and net *sales* of bonds amounting to R5,2 billion in October.



After a period of consolidation lasting almost a year, the *monthly average price level of all classes of shares* on the Johannesburg Stock Exchange increased, on balance, by 14,6 per cent from December 1996 to August 1997. Some nervousness then set in, which caused the monthly average level of the all-share price index to decline by 2,8 per cent in September 1997 before the sharp plunge of share prices in the last week of October took the monthly average index value down by 3,4 per cent in that month. Compared with the "crash" of 1987, the slump in share prices in October 1997 was relatively moderate - the all-share price index declined by as much as 45 per cent from 19 October 1987 to 12 February 1988, whereas the decline from the most recent daily high on 7 August 1997 to 28 October was 21 per cent. The monthly average prices of gold-mining shares, which were badly affected by a fall of about US$68 in the price of gold per fine ounce, declined by 44 per cent from May 1996 to October 1997.



The monthly average *dividend yield* on all classes of shares declined from 2,46 per cent in December 1996 to 2,31 per cent in July 1997, but then increased again to 2,53 per cent in October. The monthly *average earnings* yield (gold-mining shares excluded) declined likewise from 7,01 per cent in December 1996 to 6,56 per cent in July, before increasing to 7,13 per cent in October. The *yield differential* between long-term government bonds and all classes of shares narrowed from 13,7 percentage points in December 1996 to 11,5 percentage points in October 1997 as the yield on government bonds generally declined while the dividend yield on shares remained broadly unchanged.

The *price-earnings ratio* of all classes of shares, apart from gold-mining shares, averaged about 14,9 over the period from January to September 1997, but then declined to 14,0 in October.

Table 15. Yields and price ratios

Period		Dividend yield Per cent	Earnings yield* Per cent	Price-earnings ratio*	Yield differential Percentage points
1996:	Dec	2,46	7,01	14,27	13,73
1997:	Jan	2,46	6,89	14,51	13,36
	Feb	2,37	6,68	14,96	12,66
	Mar	2,40	6,62	15,11	12,76
	Apr	2,41	6,66	15,01	12,83
	May	2,40	6,70	14,93	12,68
	Jun	2,37	6,87	14,55	12,35
	Jul	2,31	6,56	15,23	11,90
	Aug	2,33	6,59	15,17	11,91
	Sep	2,44	6,77	14,76	11,74
	Oct	2,53	7,13	14,03	11,52

* Excluding gold-mining shares

Other financial markets

Activity in the *formal derivatives market* for equity and interest rate futures and options contracts receded from an all-time high of 3,4 million contracts in the first quarter of 1997 to 2,5 million in the second quarter and 2,2 million in the third quarter. Trading volumes in the first ten months were nevertheless still 21 per cent more than in the first ten months of 1996. However, non-resident participation in the derivatives market increased from 15,8 per cent of open interest in January 1997 to 26,9 per cent in October.

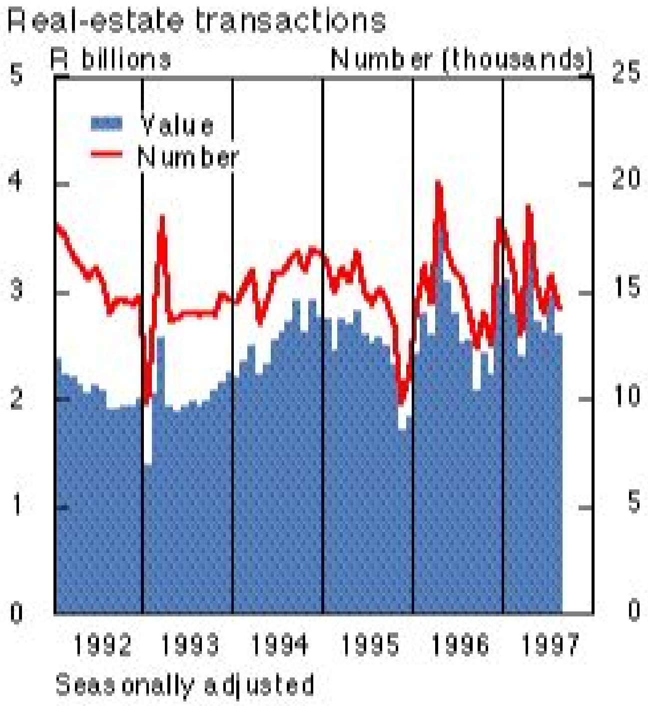
In contrast to the continued increases in the value of turnover in the share market, the aggregate quarterly number of *equity futures and options contracts* declined throughout the first three quarters of

1997, but increased strongly in October 1997 on account of heightened volatility in the share market. The high level of activity in the bond market, however, redounded to both *interest rate futures and options contracts*, which increased from an aggregate quarterly number of 6 500 contracts in the first quarter of 1997 to 9 200 contracts in the second quarter and 12 200 contracts in the third quarter.

Since their introduction in May 1997 a total of 365 *rand-dollar futures contracts* had been traded at the end of October 1997. The lack of interest in these contracts could probably be attributed to the high level of liquidity in the underlying spot and over-the-counter forward foreign-exchange markets.

Trade in *maize commodity futures* increased substantially from 2 700 contracts in 1996 to 11 900 contracts in the first ten months of 1997. Trading in *wheat* commodity futures contracts started in November 1997. In September 1997 *equity options contracts* were introduced, offering new hedging opportunities on six individual shares. Up to the end of October, 70 750 such contracts had been traded. The Johannesburg Stock Exchange furthermore introduced a *formal warrants market* in October 1997. These warrants are transferable securities applicable to specific individual shares and are issued by a securities house. They give the holder the right, but not the obligation, to buy or sell a fixed number of securities in a listed company at a fixed price on or before a specified date.

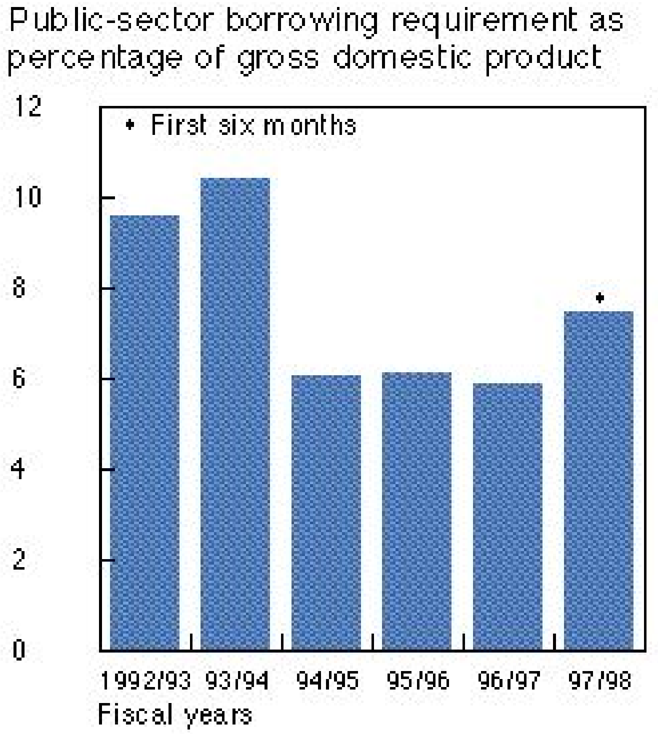
Trading conditions in the *real-estate market* remained rather sluggish as the value of transactions increased by only 1 per cent in the first eight months of 1997 over the corresponding period of the previous year, whereas the number of transactions decreased by about 2 per cent over the same period. It is expected that activity in the real-estate market might benefit somewhat from the recent reduction in mortgage rates.



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 corporations and public enterprises) declined in typical seasonal fashion from R12,5 billion in the period April to June 1997 to R9,7 billion in the period July to September. The accumulated deficit of R22,2 billion in the first half of fiscal 1997/1998 was nonetheless R3,9 billion more than its counterpart in the first half of fiscal 1996/1997. This increase took the ratio of the public-sector borrowing requirement to gross domestic product to 7,4 per cent in the first half of fiscal 1997/1998, compared with 6,7 per cent in the first half of fiscal 1996/1997.



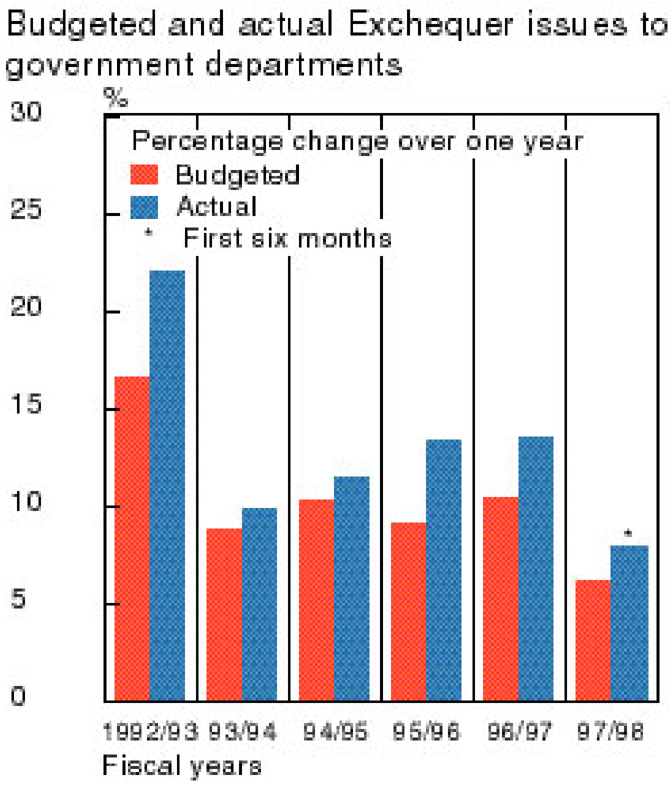
The increase in the public-sector borrowing requirement from fiscal 1996/1997 to fiscal 1997/1998 was mainly brought about by the deterioration of the finances of provincial governments: the financial shortfall of provincial governments deteriorated from R0,5 billion in the first half of fiscal 1996/1997 to R4,3 billion in the first half of 1997/1998. This widening of the deficit of provincial governments can be attributed to sustained high levels of expenditure on education, health care and welfare services and on salary and wage increases which took effect on 1 July 1997, without a concomitant transfer of funds from National Government.

A sizeable disparity developed between changes in *general government expenditure and revenue* during the first half of fiscal 1997/1998. Although the year-on-year growth in total expenditure declined from 14,6 per cent in the first half of fiscal 1996/1997 to 11,4 per cent in the first half of fiscal 1997/1998, the growth over one year in general government revenue declined even more from 14,2 per cent in the first half of fiscal 1996/1997 to 8,9 per cent in the first half of fiscal 1997/1998. The proximate cause of the disparate growth in revenue and expenditure was a decline in the year-on-year growth in tax revenue from 14,1 per cent in the first half of 1996/1997 to 10,1 per cent in the first half of 1997/1998.

Exchequer account

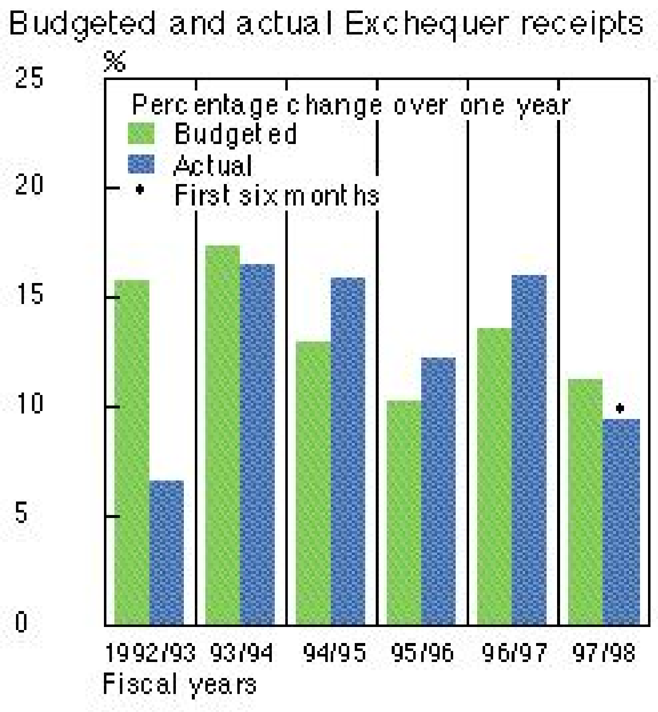
The deficit on the Exchequer account as a percentage of gross domestic product in the first half of fiscal 1997/1998 was substantially higher than the target envisaged in the Budget for the full fiscal year. The relatively large deficit in the first half of the year reflected expenditure growth in excess of the normal seasonal pattern and revenue growth which fell short of the Budget estimates.

The rate of increase over one year in *Exchequer issues* to government departments (adjusted to reflect cash flows) amounted to 7,9 per cent in the first half of 1997/1998, which was notably higher than the budgetary provision of 6,1 per cent for the year as a whole. When budgeted expenditure in fiscal 1997/1998 is compared with actual outcome of Exchequer issues in 1996/1997, government spending in 1997/1998 is supposed to grow by only 5,4 per cent in fiscal 1997/1998. The year-on-year rate of increase in Exchequer issues during the first half of fiscal 1997/1998 was, however, well below the average year-on-year rate of increase of 14,0 per cent recorded in the first half of the preceding five fiscal years. As a *ratio of gross domestic product*, Exchequer issues to government departments accordingly declined to 31,9 per cent in the first half of fiscal 1997/1998 from a ratio of 32,4 per cent in the first half of fiscal 1996/1997.



In October 1997 Exchequer issues decreased by 1,7 per cent compared with October 1996, which brought the year-on-year rate of increase in these issues to 6,5 per cent in the first seven months of fiscal 1997/1998. Exchequer issues during this period equalled 58,9 per cent of the total expenditure of R186,7 billion budgeted for the year as a whole.

From the first half of fiscal 1996/1997 to the first half of fiscal 1997/1998 the rate of increase in *Exchequer receipts* (excluding proceeds from privatisation and the sale of strategic oil reserves) amounted to 9,4 per cent, compared with a budgeted increase of 11,2 per cent for the fiscal year 1997/1998 as a whole and an average rate of increase of 13,0 per cent for the corresponding period of the preceding five fiscal years.



The year-on-year rate of increase in Inland revenue receipts in the first half of fiscal 1997/1998 was more or less on target with the Budget projections. Collections of customs and excise duties, in contrast, fell well short of the Budget objectives. The deviation between the actual and projected revenue from customs and excise duties was the result of the accelerated implementation of tariff reductions agreed to in the Final Act of the Uruguay Round of trade negotiations and in the Marrakesh Agreement which established the World Trade Organisation (WTO). Value-added tax collections also fell short of their budgeted rate of growth as private consumption expenditure failed to live up to the expectations which were held at the time of the Budget.

Table 16. Percentage increase in government revenue

	Budgeted increase: fiscal year 1997/1998	**Actual increase: first half 1997/1998**
Exchequer receipts	11,2	9,4
Customs and excise duties	8,0	-0,4
Inland revenue	11,7	11,6
Income tax	13,5	12,4
Value-added tax	11,4	9,8

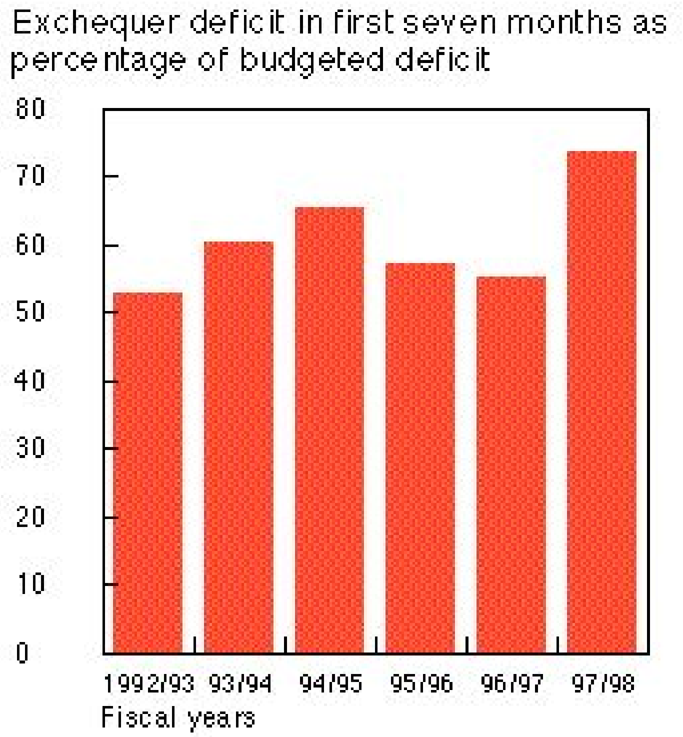
As a ratio of gross domestic product, Exchequer receipts amounted to 25,5 per cent in the first half of fiscal 1997/1998 - fractionally lower than a ratio of 25,6 per cent in the first half of fiscal 1996/1997. In October 1997 Exchequer receipts decreased by 5,4 per cent compared with October 1996. This brought the year-on-year rate of increase in Exchequer receipts to 6,6 per cent in the first seven months of fiscal 1997/1998, which accounted for 56,7 per cent of total revenue of R162 billion that was budgeted for the year as a whole.

The net result of the lower-than-budgeted revenue and higher-than-budgeted expenditure was a deficit before borrowing and debt repayment of R19 billion in the first half of fiscal 1997/1998. As a percentage of gross domestic product this deficit came to 6,4 per cent. This ratio compared with a ratio of 6,8 per cent in the corresponding period of fiscal 1996/1997 and a budgeted deficit of 4,0 per cent of gross domestic product for the fiscal year 1997/1998 as a whole. In the *first seven months* of fiscal 1997/1998 the deficit before borrowing and debt repayment amounted to R18,2 billion or 73,5 per cent of the deficit budgeted for the fiscal year as a whole.

Table 17. Financing the deficit - April to September 1997

Source of finance	**R billions**
Government stock (including discount)	12,6
Less: Discount on government stock	2,3
Net receipts from government stock issued	10,3
Treasury bills	**7,4**
Foreign loans	3,4
Non-marketables securities	-0,1
Redemption of Namibian debt	-0,2
Redemption of Section 239 debt*	-3,5
Transfer from IMF accounts	0,3
Extraordinary receipts	2,9
Increase in available cash balances**	-1,5
Total net financing	**19,0**

*	Former independent republics of Tanskei, Bophuthatswana, Venda and Ciskei and self-governing states.
**	Included in the increase in available cash balances is an amount of R345 million which was transferred to the IMF but had not yet fully been accounted for in the Exchequer Account.



The means of financing the deficit of R19,0 billion in the first half of fiscal 1997/1998 are indicated in Table 17. Long-term government stock continued to be the dominant debt-financing instrument. Treasury bills contributed R7,4 billion to overall financing, R3,6 billion of which was absorbed by the Corporation for Public Deposits and R2,9 billion by the private banks. Special Treasury bills with a maturity of three days were issued during the third quarter at times when the cash balances of Government were almost completely exhausted. An amount of R0,5 billion was raised in this manner on 1 September 1997 and a further amount of R1,0 billion on 22 September. The net outcome of Government's borrowing activities was an increase of government debt from R310,6 billion, or 55,9 per cent of gross domestic product, at the end of March 1997 to R334,7 billion, or 57,4 per cent of gross domestic product, at the end of September.

Total government debt as percentage of gross domestic product