Quarterly economic review

Introduction

The promising recovery in aggregate domestic output growth in the last quarter of 1996 seems to have lost momentum as real gross domestic product declined at an annualised rate of 1 per cent in the first quarter of 1997. Although this decline was primarily caused by a steep decline in agricultural output from the exceptionally high levels attained in 1996, growth in the non-agricultural sectors also slowed down noticeably in the first quarter of 1997. Notwithstanding this weakness in quarter-to-quarter output growth, the growth in aggregate output over one year still amounted to 2½ per cent in the first quarter of 1997, and came to 1½ per cent in the non-agricultural sectors of the economy.

The slowdown in output growth suggested that the upturn in the economy, which has been in progress since 1993, could have been drawing to a close, or that the upper turning-point of the business cycle might already have been passed. The composite coincident business cycle indicator has been showing a gradually downward tendency since the middle of 1995. Contradicting these signs of an imminent downturn of the business cycle, was the relative strength of output growth in the secondary sectors of the economy during the first quarter of 1997. Manufacturing output, especially, not only maintained the upward momentum that had developed since the final quarter of 1996, but even accelerated quite substantially in the first quarter of 1997. What is more, the recent generally upward trend in the backlog of unfilled orders might have been pointing towards a continuation of manufacturing output growth in the remainder of 1997. It is conceivable that the resilience of manufacturing output growth might be a stabilising factor in 1997.

The decline in the level of total real domestic production in the first quarter of 1997 coincided with a continuation of the actual decline in real gross domestic expenditure which has been evident since the third quarter of 1996. Inventory levels were reduced in the first quarter of 1997 and the growth in real private consumption expenditure continued to decelerate. A decline in aggregate personal disposable income began to restrain the recurrent spending of private households. Real fixed investment expenditure still increased in the first quarter of 1997, but like private consumption expenditure, at a much reduced rate. In this instance too, the behaviour of the manufacturing sector was at variance with the general trend: whereas growth in real fixed investment in most sectors of the economy slowed down, that in the manufacturing sector exhibited a sturdy increase, although these capital outlays were not necessarily employment-enhancing.

Real government consumption expenditure increased at a rapid rate in the first quarter of 1997, thereby contributing to a decline in the already very low savings ratio of the economy. With little incentive being provided to private-sector entities to strengthen their saving propensities, the low national savings ratio is likely to prevail for some time to come. As the savings ratio is evidently inadequate to finance a higher rate of productive investment, the South African economy is becoming more and more dependent on inward flows of foreign investment capital to bolster its output and employment-creating capacity.

The strengthening of output growth in the non-agricultural sectors of the economy in the second half of 1996 had a positive influence on the overall level of formal-sector employment. Total employment accordingly increased in the fourth quarter of 1996. Although this rise in employment was not nearly sufficient to make any inroads on the total level of unemployment in the economy, it was the first such increase since a series of quarterly increases in total employment had come to an end in the fourth quarter of 1995. Significantly, the rise in employment in the fourth quarter of 1996 occurred entirely in the private sector of the economy. Equally significant was that this rise in employment, like the previous increases recorded from the end of 1994 to the end of 1995, generally coincided with slowdowns in the rate of growth of nominal unit labour costs.

Price inflation accelerated in the second half of 1996 in response to the depreciation of the rand from the middle of February 1996 and the stronger growth in the cost of labour per unit of output from the third quarter of 1995. Some moderation in quarter-to-quarter production price and consumer price inflation then became evident in the first quarter of 1997 as the rand started to appreciate against other currencies and the growth in nominal unit labour costs slowed down in the fourth quarter of 1996. It is, however, still unclear whether this pause in the upward movement of prices will be sustained in the forthcoming quarters and whether the general downward trend in inflation, which had been evident since the early 1990s, will be resumed. The outcome of the round of wage negotiations currently in progress will be important for the near-term evolution of price inflation.

The decline in the level of overall domestic economic activity resulted in a decline in the value and the volume of imports in the first quarter of 1997. Unfortunately, the value and the volume of exports of merchandise goods declined even more, mostly because of an unexpected decrease in the quantity of relatively price-insensitive goods exported. The decline in total export earnings was exacerbated by a decline in the dollar and the rand price of gold, with the result that the deficit on the current account of the balance of payments, which had been declining steadily since the second quarter of 1996, widened again in the first quarter of 1997.

The net inflow of capital, which became positive in the fourth quarter of 1996, gained further momentum and became considerably larger than the absolute value of the deficit on the current account of the balance of payments in the first quarter of 1997. Unlike the fourth quarter of 1996, when the inflow of capital consisted overwhelmingly of financing facilities with a short maturity, the inflow of capital in the first quarter of 1997 was mostly classified as long-term capital.

Keen buying interest was displayed by non-resident investors in the domestic bond and share markets during the first quarter of 1997. Although these "portfolio investments" are classified as long-term capital on grounds of their maturities, they do not always represent a permanent investment in an economy. However, there is good reason to believe that a significant portion of the non-resident purchases of South African bonds in the first quarter of 1997 formed the hedge counterpart of Eurorand bond issues which were made in that quarter. As these Eurorand bonds mostly had a maturity of one year or longer, their hedge counterparts were likely to have a similar duration. Another significant feature of Eurorand bond issues is that they give rise to forward purchases of rand, alternatively forward sales of dollars, thereby improving the balance between sales and purchases in the domestic forward foreign-exchange market. Equally significant, however, was that part of the inflow of funds via the bond and share markets was neutralised by outflows of funds which were related to asset swap transactions.

The surplus on the overall balance of payments in the first quarter of 1997 had as a consequence a sizeable improvement in the gold and foreign reserves of the country for the second calendar quarter in succession. This created a more positive sentiment in the foreign-exchange market and the rand strengthened rather robustly from the end of October 1996 to the end of April 1997. The appreciation of the rand was therefore partly caused by the surplus on the overall balance of payments, but was also causal to the inflow of international capital into the economy. Despite the rise in the foreign exchange value of the rand in the first quarter of 1997, the rand still depreciated in real terms by about 8½ per cent from December 1995 to March 1997, thereby indicating a meaningful gain in the international competitiveness of South African producers over this period.

As is often the case shortly after a rise in Bank rate and in the banks' lending rates, bank credit extension to the private sector accelerated in the first quarter of 1997. The firming of the growth in credit to the private sector was underpinned by the need to finance transactions in an economy where the nominal value of domestic expenditure and activity in financial markets were expanding rapidly. Certain structural factors, such as the absorption of many South Africans into the mainstream of the modern sector of the economy and the further integration of South Africa into the international financial markets, also caused the demand for credit to remain robust. Credit growth was strengthened further by a strong increase in the monetary sector's claims on the government sector, which were not nearly counteracted by the relatively small increase of government deposits with the banking sector. All this contributed to an acceleration in the M3 money supply in the first quarter of 1997 at a rate of increase that was substantially higher than the potential real growth rate of the economy. Such monetary expansion, if left unchecked, would inevitably have serious repercussions on inflation expectations and ultimately on inflation itself.

Conditions in the money market remained tight in the first three months of 1997. Additional liquidity was supplied to the market by a decline in the value of notes and coin in circulation outside the Reserve Bank and through an increase in the net foreign assets of the Reserve Bank, but these were largely neutralised by the liquidity-reducing effect of surpluses stemming from the Bank's forward foreign-exchange transactions. The Reserve Bank generally allowed the market to reflect the tight underlying demand and supply conditions, but was at times prepared to provide assistance when liquidity was perceived to be in short supply. In April and May 1997 money market conditions became considerably less tight, owing mainly to a further improvement in the net foreign assets of the Reserve Bank. In May a strong injection of liquidity arising from the acquisition of an equity interest in Telkom by foreign companies had to be drained from the market by means of open-market and other operations with a similar effect.

As a reflection of the more positive sentiment created by the strengthening of the rand and the improvement in the net foreign assets of the Reserve Bank, market interest rates started to move downwards during the first three months of 1997. The yields on gilts and semi-gilts declined fairly substantially, whereas share prices generally rallied in the first quarter of 1997 and recovered most of the losses incurred in the last months of 1996. Trading in the secondary bond and share markets rose impressively, while non-resident participation relative to overall turnover in these markets showed major advances at the same time. Non-resident participation obviously added to liquidity in these markets, but the presence of non-residents also added some *potential* extra volatility to price movements in these markets.

The fiscal policy stance of the national government is becoming more supportive of the overall policy objective of maintaining overall financial stability. The deficit on the current revenue and expenditure account of the Central Government, relative to gross domestic product, was further reduced in the fiscal year ended March 1997 and is projected to decline even further in the current fiscal year. A primary surplus, i.e. an excess of current revenue over expenditure when interest charges are not taken into consideration, is forecast for the fiscal year to March 1998. The danger of a persistent rise in the ratio of government debt to gross domestic product and the threat of such a development for overall financial stability, have apparently been put to rest. Nonetheless, the upward trend in tax revenues and total government expenditure relative to gross domestic product is yet to be arrested.

Domestic economic developments

Domestic output

The seasonally adjusted *real gross domestic product* declined at an annualised rate of 1 per cent in the first quarter of 1997. This contraction followed an uninterrupted series of 11 quarterly increases in the real gross domestic product and quarter-to-quarter growth of 3 per cent or more throughout 1996. The total value of the real gross domestic product in the first quarter of 1997 was, nevertheless, still about 2½ per cent higher than in the first quarter of 1996.

The decline in the real gross domestic product in the first quarter of 1997 was essentially a reflection of a steep decline in the *real value added by the agricultural sector.* Excellent climatic conditions during the previous growing season raised output levels in the agricultural sector to unprecedented heights in 1996. In the first quarter of 1997, when production levels became more aligned with conditions that could be termed "normal", agricultural output declined at a seasonally adjusted annualised rate of 34 per cent.

Real output in the *sectors outside the agricultural sector* continued to increase in the first quarter of 1997,

Real gross domestic product

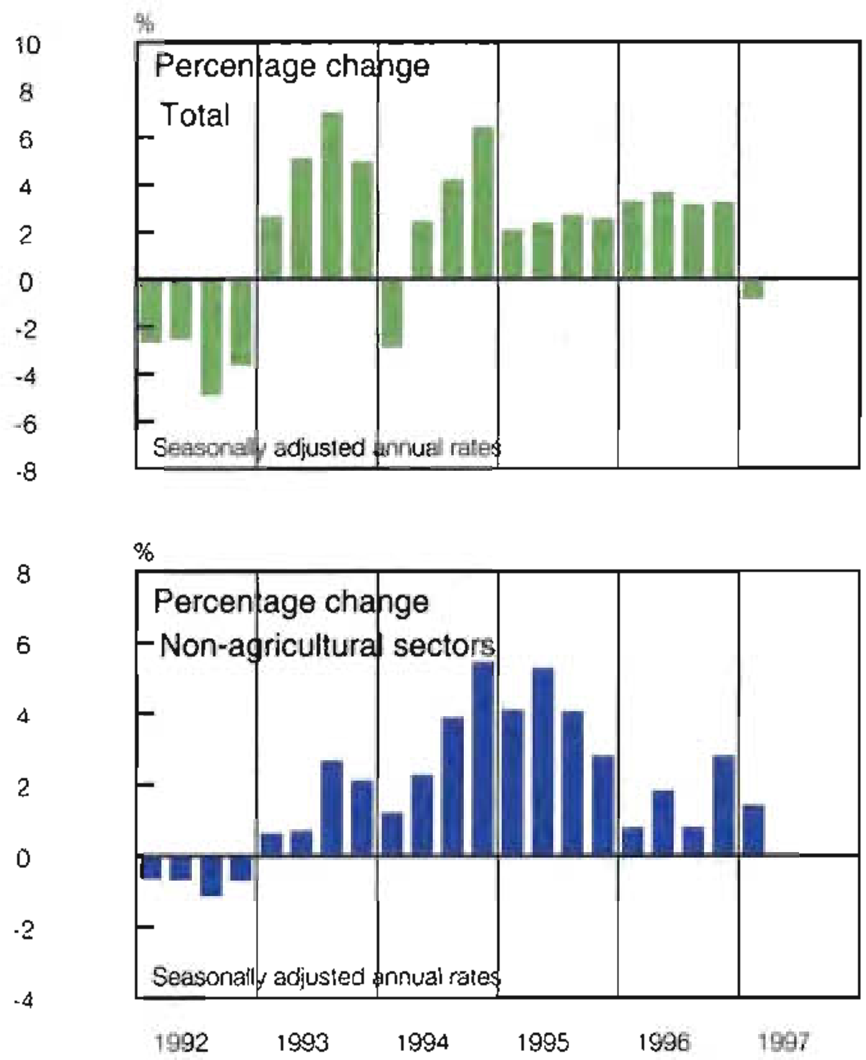


Table 1. Real gross domestic product
Percentage change at seasonally adjusted and annualised rates

Sectors	1996					1997
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr
Primary sectors	23	13	15	5½	8	-16
Non-agricultural sectors	1	2	1	3	2	1½
Non-primary sectors	½	3	1½	2½	2	1½
Secondary sectors	½	3	½	2½	1	3½
Manufacturing	-1	3	-1	2	½	3½
Tertiary sectors	1	3	2	3	3	½
Total	**3½**	**3½**	**3**	**3½**	**3**	**-1**

but at an annualised rate of 1½ per cent which was considerably slower than the 3 per cent recorded in the fourth quarter of 1996. This slower expansion of output in the non-agricultural sectors was noticeable in all the main sectors of the economy, with the exception of the secondary sectors where growth was maintained at a rate of 3½ per cent in the first quarter of 1997.

Total output in the *mining sector*, which declined in each of the first three quarters of 1996, but increased at an annualised rate of about 1 per cent in the fourth quarter, resumed its downward tendency in the first quarter of 1997 at a rate of ½ per cent. Gold production, in particular, declined because of a reduction in the quantity and the quality of ore milled. Production volumes in the diamond- and coal-mining sectors also declined slightly, but the real value added by the subcategory "other mining" apparently responded positively to the weaker rand and the improvement in the international prices of certain base metals and minerals.

Output growth in the *secondary sectors* strengthened from an annualised growth rate of 2½ per cent in the fourth quarter of 1996 to 3½ per cent in the first quarter of 1997. This was the strongest quarter-to-quarter growth in seven quarters and was particularly evident in the manufacturing sector and in the sector supplying electricity, gas and water. The growth in real output of the *manufacturing sector* accelerated from 2 per cent in the fourth quarter of 1996 to 3½ per cent in the first quarter of 1997. Most of the main subsectors of manufacturing participated in the output expansion, but notable contributions came from the subsectors clothing, chemical products, and machinery and transport equipment. The real value added by the sector supplying *electricity, gas and water* increased in the first quarter of 1997, albeit at a growth rate of 4½ per cent that was somewhat lower than the high quarter-to-quarter growth rates of between 5 and 6½ per cent which had been registered during 1996.

Activity in the *tertiary sectors* slowed down perceptibly in the first quarter of 1997 and the growth in the real value added by these sectors declined from a seasonally adjusted and annualised rate of 3 per cent in the fourth quarter of 1996 to ½ per cent in the first quarter of 1997. Business conditions in the motor and retail trade were badly affected by declining sales volumes. High levels of household debt, the high interest cost associated with this debt and the fact that the stock of durable consumer goods had largely been replenished during the strong sales recovery of 1995 and 1996, militated against the continuation of strong value-added growth in the retail sector. The real value added by the entire sector *commerce*, which had risen at an annualised rate of 3 per cent in the fourth quarter of 1996, accordingly declined by 1 per cent in the first quarter of 1997. Real output in the *transport and communication sector* showed little change from the fourth quarter of 1996 to the first quarter of 1997 as activity levels in this sector were constrained by a decline in the volume of internationally traded goods that had to be transported. The growth in the real value added by the sector *finance, insurance, real estate and business services* slowed down from an annualised rate of 4 per cent in the fourth quarter of 1996 to 2 per cent in the first quarter of 1997, owing mainly to a deceleration in the growth of the real value added by the banking sector.

Domestic expenditure

The gradual decline in aggregate real *gross domestic expenditure*, which had been evident since the third quarter of 1996, continued in the first quarter of 1997. Current estimates suggest that this decline amounted to a seasonally adjusted and annualised rate of ½ per cent; in the third and fourth quarters of 1996 annualised declines of 2 per cent were recorded in real gross domestic expenditure. However, the level of real gross domestic expenditure in the first quarter of 1997 was still 1½ per cent higher than in the first quarter of 1996.

The decline in aggregate real gross domestic expenditure in the first quarter of 1997 was mainly caused by a decline in the real value of inventories. In

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
Private consumption expenditure	3½	4	3	2½	4	½
Government consumption expenditure	6½	9	5½	4½	5	5½
Gross domestic fixed investment	8	6	4½	2½	7	2
Change in inventories (R billions)	1,4	6,7	3,0	0,2	2,8	-1,8
Gross domestic expenditure	**1½**	**12**	**-2**	**-2**	**3**	**-½**

addition, the growth in real outlays on private consumption expenditure slowed down, whereas real gross domestic fixed investment continued to increase at a rate slightly down from that of the fourth quarter of 1996. In contrast, real consumption expenditure by general government increased strongly in the first quarter of 1997.

The growth in *real private consumption expenditure*, which had already slowed down from an annualised rate of 4 per cent in the second quarter of 1996 to 2½ per cent in the fourth quarter, declined even further to only ½ per cent in the first quarter of 1997. This slowdown in real private consumption expenditure in the first quarter of 1997 was a consequence of a decline in real outlays on durable consumer goods and a weakening in the growth of real outlays on semi-durable and non-durable goods.

The seasonally adjusted real value of *household expenditure on durable consumer goods* declined at an annualised rate of 2½ per cent in the first quarter of 1997. This was caused by a steep reduction in real outlays on private transport equipment and on other durable goods such as furniture and household appliances. The rate of increase in real expenditure on *semi-durable goods*, particularly clothing and footwear, as well as expenditure on non-durable goods, slackened during the first three months of 1997. However, real household spending on *services* increased at an annualised rate of about 1 per cent in the first quarter of 1997, which was more or less equal to the growth rate registered in the third and fourth quarters of 1996.

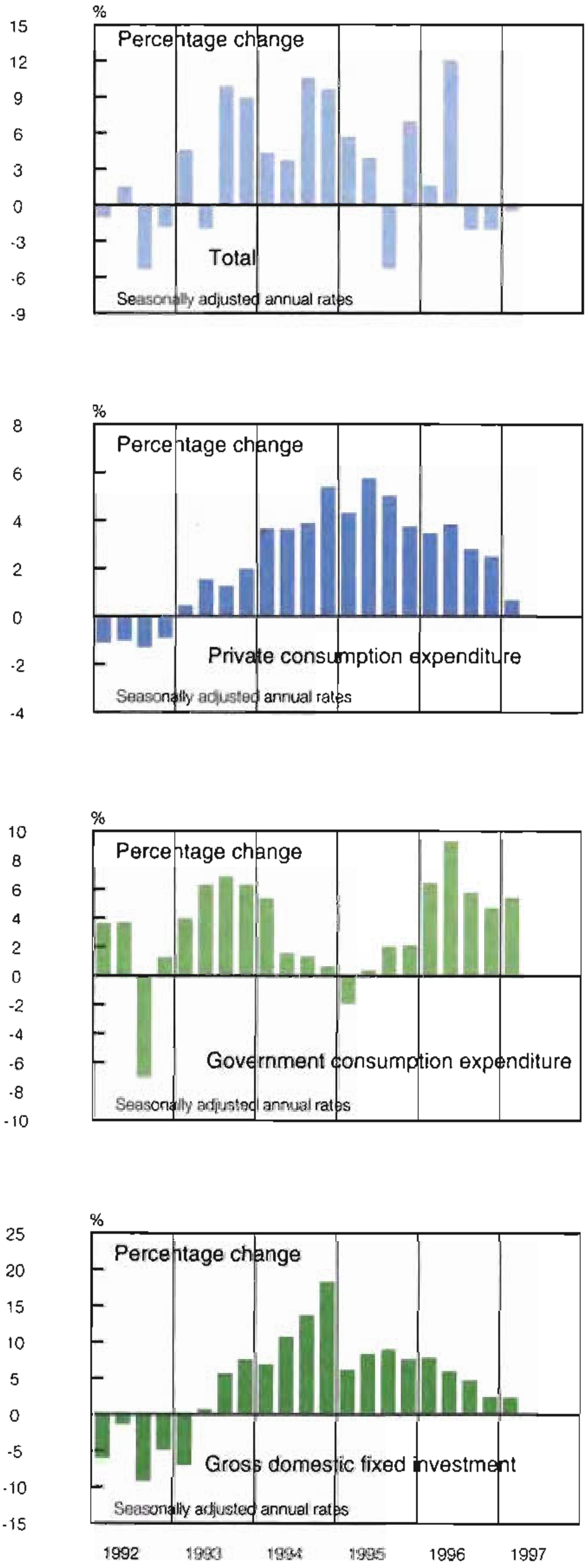
The weakening in the growth in private consumption expenditure towards the end of 1996 and in the first quarter of 1997 was a reflection of consumer responses to a set of circumstances that has developed over time, but which has until recently failed to contain the strong expansion of real spending by households. These circumstances include:

- the consistently applied, tight monetary policy and the resultant high level of interest rates;
- the high level of household debt in relation to personal disposable income: the ratio of household debt to personal disposable income reached a new high of 68 per cent in the first quarter of 1997;
- the cost of servicing household debt, which absorbed about 14 per cent of personal disposable income in the first quarter of 1997;
- caution among major retail stores regarding the issuing of private label credit cards which caused consumer credit facilities to become less freely available;
- smaller increases in salaries and wages and the rising level of unemployment;
- a decline in real income from property of households;

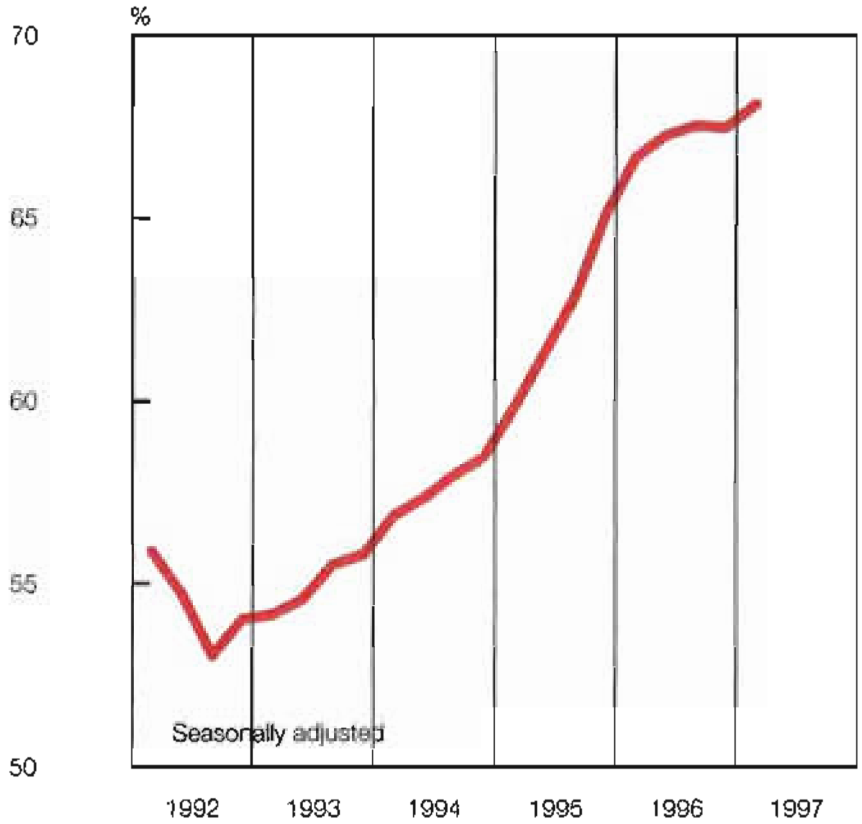
Table 3. Real private consumption expenditure
Percentage change at seasonally adjusted and annualised rates

Components	1996					1997
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr
Durable goods	1½	11½	-1½	11½	6	-2½
Semi-durable goods	3	3	4	3½	3½	2½
Non-durable goods	4½	3½	4	1	4	½
Services	3	2	1	1	3	1
Total	**3½**	**4**	**3**	**2½**	**4**	**½**

Real gross domestic expenditure



Household debt as percentage of personal disposable income



and

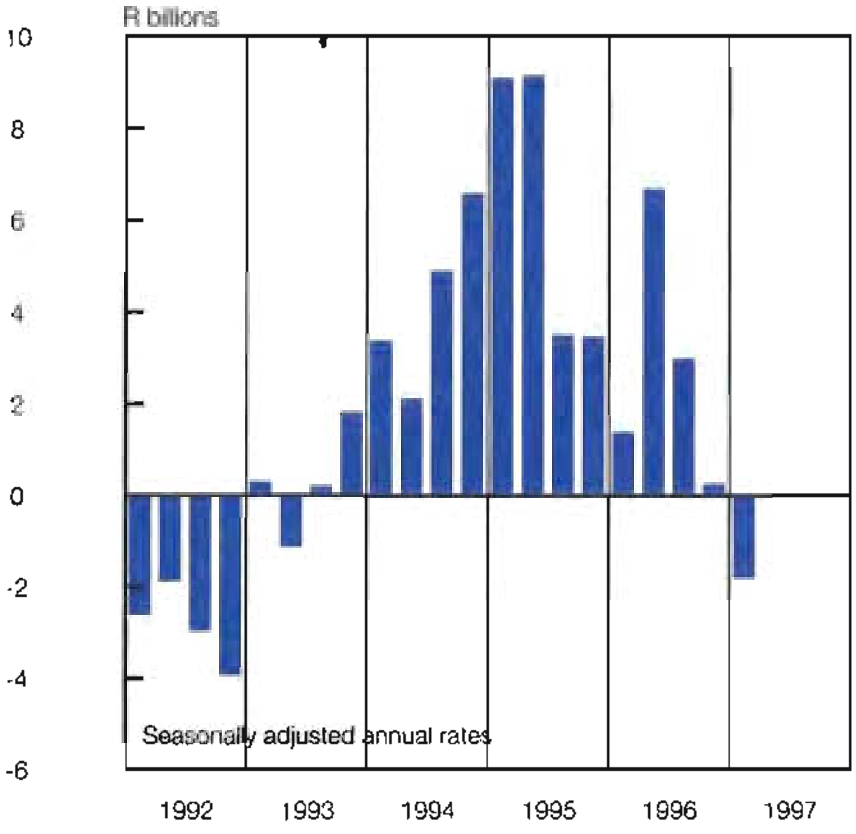
- the deterioration of the perceived wealth of households as real estate and share prices failed to maintain their strong upward thrust during 1996.

According to current estimates *real consumption expenditure by general government* increased at an annualised rate of 5½ per cent in the first quarter of 1997, compared with 4½ per cent in the last quarter of 1996. For the fiscal year 1996/97, real government consumption expenditure rose by nearly 6 per cent, whereas the increase in the previous fiscal year amounted to only 1 per cent. Expenditure on goods and services by the general government in the first quarter of 1997 was about 6½ per cent higher than in the corresponding quarter of the previous year; as a percentage of gross domestic product it increased from 20½ per cent in the first quarter of 1996 to 21½ per cent in the first quarter of 1997.

After the growth in aggregate *real gross domestic fixed investment* had subsided from an annualised increase of 8 per cent in the first quarter of 1996 to 2½ per cent in the fourth quarter, it slowed down further to about 2 per cent in the first quarter of 1997. This resulted in the level of real gross domestic fixed investment being 3½ per cent higher in the first quarter of 1997 than in the corresponding quarter of 1996.

Total real gross domestic fixed investment in the *private sector* increased at an annualised rate of 2 per cent in the first quarter of 1997, which was decidedly lower than the average rate of increase of 6 per cent per quarter registered during 1996. This was, nevertheless,

Change in total real inventories



the sixteenth consecutive quarterly rise in real fixed investment in the private sector. The level of private-sector fixed capital formation in the first quarter of 1997 was consequently about 38 per cent higher than what it had been at the lower turning-point of the private-sector investment cycle in the first quarter of 1993.

Apart from the mining industry, all the major sectors of economic activity participated in the growth in real fixed investment by private business enterprises during the first quarter of 1997. Firm increases were particularly evident in the manufacturing sector (at an estimated rate of about 4½ per cent) and in the agricultural sector. Private-sector fixed investment was boosted further by the development of new retail shopping complexes and hotels, while investment in residential buildings remained relatively buoyant, particularly that in high-density units with strong security features.

Real fixed investment by *public corporations*, which had been declining at seasonally adjusted and annualised rates ranging between 2 and 12½ per cent in the last three quarters of 1996, increased by 1½ per cent in the first quarter of 1997. Those public corporations involved in the supply of electricity and communication services were principally responsible for this higher level of investment activity because they continued with the provision of essential services to the underdeveloped regions of the country.

In the first quarter of 1997, the real gross domestic fixed investment by *public authorities* increased at an annualised rate of about 4 per cent, following quarter-to-quarter increases of between 2 and 6 per cent during 1996. This increase in the first quarter of 1997, as well as the preceding ones, occurred at the levels of central, provincial and local government and reflected progress made with infrastructural development in accordance with the reconstruction and development objectives of the government.

The gradual slowdown in the pace at which *inventories* had been accumulated in the second half of 1996 was followed by a decline in the level of inventories in the first quarter of 1997. This decline in the level of inventories, and the consequent negative change in inventory investment in the first quarter of 1997, were primarily evident in a sharp decline in strategic oil reserves, in the mining and manufacturing sectors and in retail and motor trade. Positive inventory investment still occurred in the wholesale trade and in agricultural stocks-in-trade, but these were relatively insignificant compared with the depletion of inventories in the other sectors of the economy. The level of industrial and commercial inventories as a percentage of gross domestic product decreased from 18½ per cent in the fourth quarter of 1996 to 18 per cent in the first quarter of 1997.

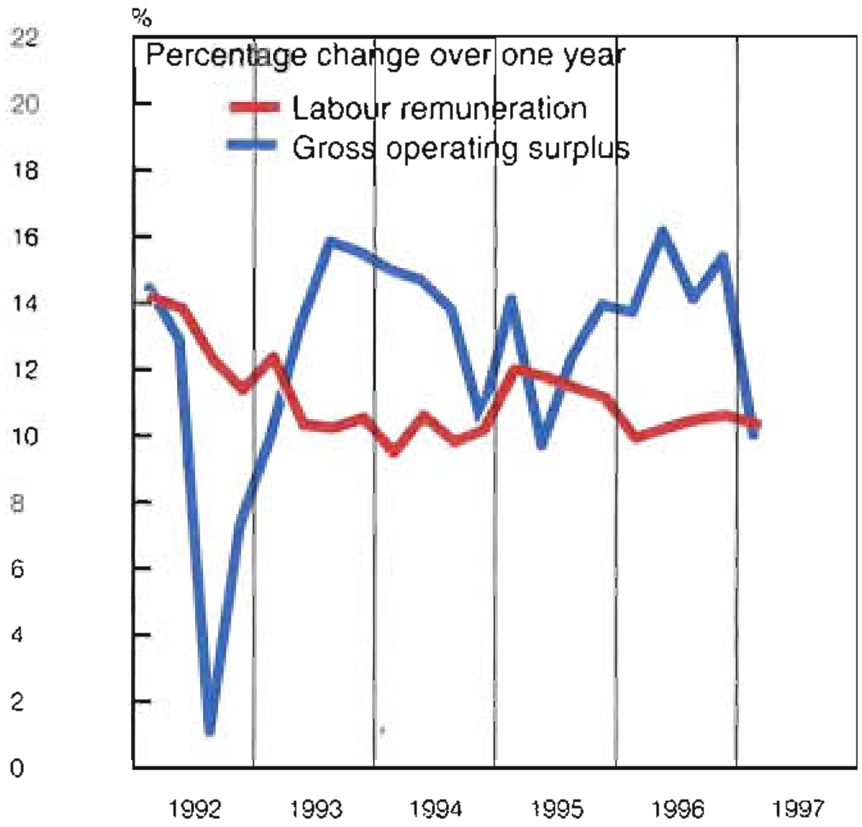
Factor income

The growth over four quarters in aggregate *nominal factor income* at market prices declined from 12 per cent in the fourth quarter of 1996 to 10½ per cent in the first quarter of 1997. This slowdown in nominal income growth was due to substantially lower increases in the operating surpluses of business enterprises and unchanged year-on-year growth in total labour remuneration.

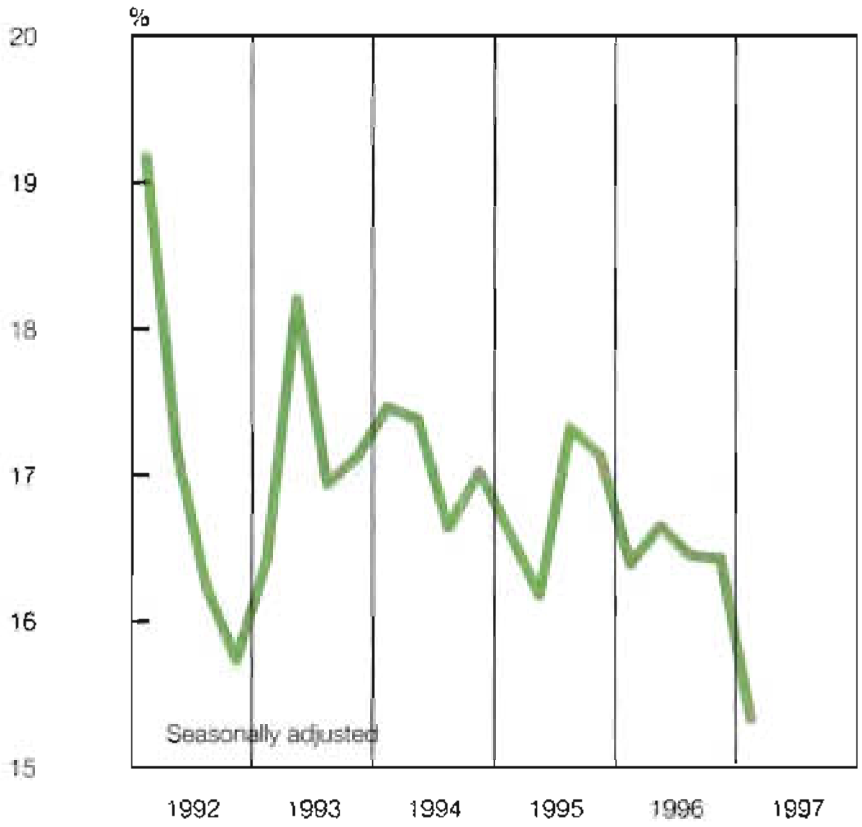
Growth in the *nominal gross operating surpluses* of business enterprises, measured over periods of four quarters, contracted from 15½ per cent in the fourth quarter of 1996 to 10 per cent in the first quarter of 1997. This weaker growth was a consequence of steep declines in the gross incomes of farmers and in the gross operating surplus of the mining sector. The gold-mining industry was adversely affected by the appreciation of the external value of the rand and the simultaneous decline in the dollar price of gold, which inevitably impacted negatively on the profitability of the industry. The growth over four quarters in the nominal gross operating surplus of the secondary and the tertiary sectors declined from 15 per cent in 1996 to 11 per cent in the first quarter of 1997. This decline was in keeping with the general slackening in the pace of economic activity in the first three months of 1997.

The year-on-year rate of increase in total *remuneration of employees* in the first quarter of 1997 remained unaltered at a rate of 10½ per cent recorded in the fourth quarter of 1996. This relative inflexibility in the growth of remuneration over four quarters was evident in almost all the sectors of the economy and was the result of small declines in the level of employment in the non-agricultural sectors of the economy and fairly moderate salary and

Gross operating surplus and labour remuneration



Gross domestic saving as percentage of gross domestic product



wage increases generally up to the first quarter of 1997. The increase in employee remuneration, however, still exceeded the rise in the aggregate gross operating surplus, causing the ratio of employee remuneration to total factor income to increase marginally from 59 per cent in the fourth quarter of 1996 to 59½ per cent in the first quarter of 1997.

Domestic saving

The ratio of total *gross domestic saving* to gross domestic product declined from 16½ per cent in the fourth quarter of 1996 to 15½ per cent in the first quarter of 1997. This extremely low savings ratio, which was the result of a continuing high level of dissaving by general government and a deterioration in the saving propensity of the private sector, warrants urgent attention in view of the need to bolster employment-enhancing fixed investment in the economy.

Net *dissaving by general government* as a percentage of gross domestic product deteriorated from 3½ per cent in the fourth quarter of 1996 to 4 per cent in the first quarter of 1997. This deterioration arose from an acceleration in expenditure by general government, mainly on goods and services and the servicing of government debt, which was not fully compensated for by a rise in direct and indirect tax revenue. The slowdown in the growth of operating surpluses and the consequent weakening of net saving in the corporate sector resulted in a decline in private-sector saving from 6½ per cent of gross domestic product in the fourth quarter of 1996 to 6 per cent in the first quarter of 1997.

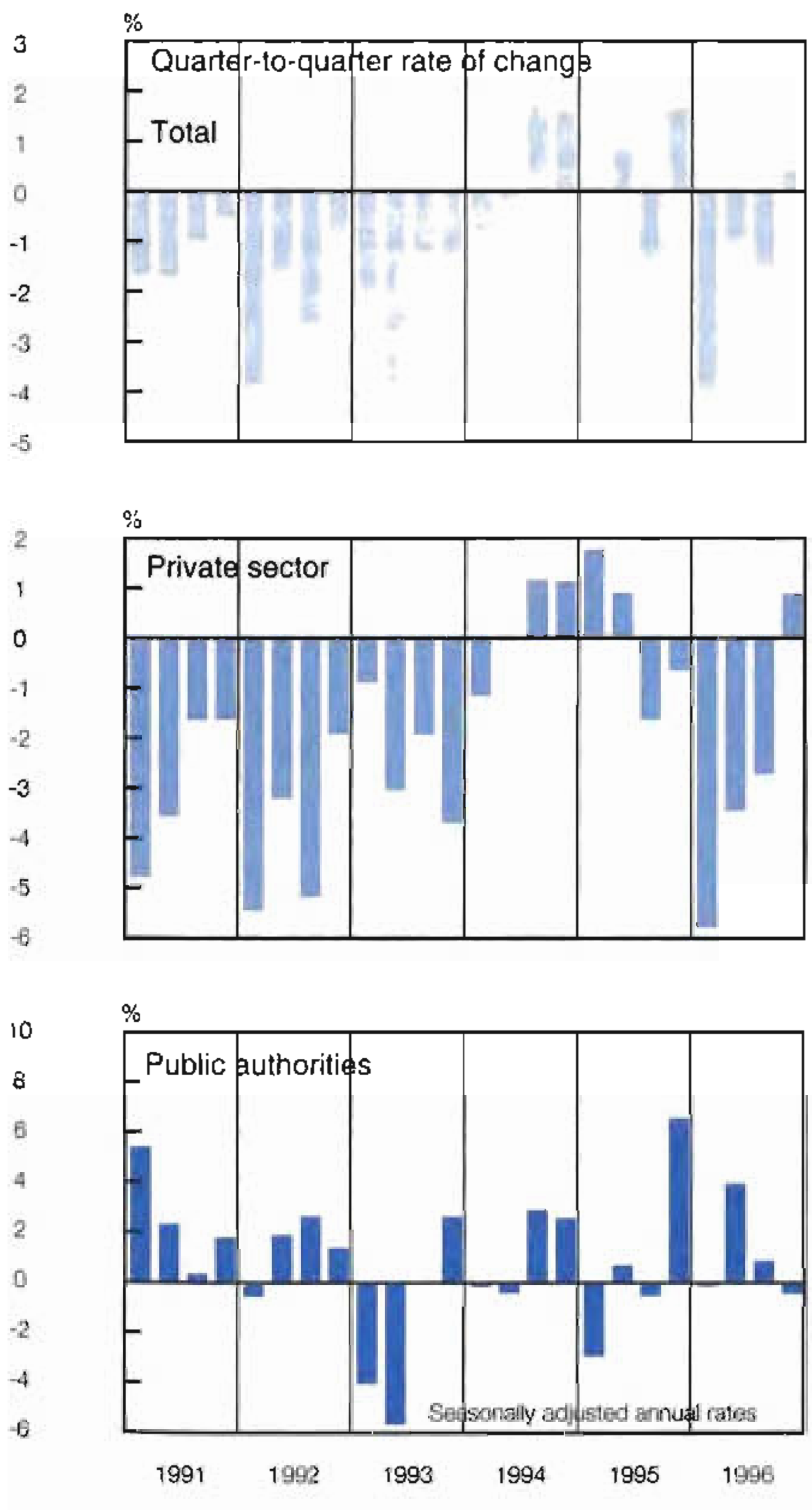
Employment

Total employment in the formal non-agricultural sectors of the economy increased at a seasonally adjusted and annualised rate of 0,4 per cent in the fourth quarter of 1996. This has been the first quarterly increase in aggregate formal-sector employment since the fourth quarter of 1995. Declines from quarter to quarter at seasonally adjusted and annualised rates of 3,9 per cent in the first quarter of 1996, 1,0 per cent in the second quarter and 1,5 per cent in the third quarter preceded the fourth-quarter increase in total employment. The average level of employment in the formal sectors of the economy outside agriculture was consequently still 1,1 per cent lower in 1996 than the average level recorded in 1995. This decline in 1996 took the overall decline in employment opportunities in the formal sectors of the economy to 7,0 per cent over the period 1989 to 1996. In other words, about one out of every fourteen employment opportunities which had existed in 1989, became redundant in the ensuing seven years.

Employment in the *private sector* had declined for five consecutive quarters up to the third quarter of 1996 at seasonally adjusted and annualised rates varying between 0,6 per cent and 5,8 per cent, but then increased by 0,9 per cent in the fourth quarter. The increase in private-sector employment in the fourth quarter of 1996 occurred in the mining sector, the construction industry, retail trade and the insurance industry, whereas job-shedding continued in the manufacturing, electricity generation, banking and the private road transportation sectors. Despite the increase in total private-sector employment during the last quarter of the year, the average level of employment in this sector still declined at a year-to-year rate of 2,7 per cent in 1996.

Total employment by *public authorities* increased by 0,5 per cent in both 1994 and 1995. A small decline in public-sector employment, at a seasonally adjusted and annualised rate of 0,2 per cent, was then recorded in the first quarter of 1996, followed by a strong increase at a rate of 3,9 per cent in the second quarter and 0,9 per cent in the third quarter. Although public-sector employment declined again at a rate of 0,5 per cent in the fourth quarter, the average level of employment in this sector was still 2,0 per cent higher in 1996 than in 1995. As a percentage of total employment in the formal non-agricultural sectors, public-sector employment has increased from 30,3 per cent in the first quarter of 1990 to 34,7 per cent in the fourth quarter of 1996.

Non-agricultural employment



The decline in the average level of formal-sector employment was also mirrored in an increase of 8,3 per cent in the average *number of registered unemployed workers* in 1996. In December of last year the total number of registered unemployed workers amounted to approximately 283 000.

A major recent development likely to change the regulatory environment within which the labour market functions is the publication of the draft Basic Conditions of Employment Bill in April 1997. The purpose of the draft Bill is to advance economic development and social justice by establishing and enforcing basic conditions of employment. The Bill applies to a wide range of employers and employees and proposes, *inter alia*, a shorter working week, increased leave arrangements and a higher premium on overtime worked. A business levy to fund a training and education strategy for the country was also proposed. To the extent that the implementation of these proposals could lead to an increase in the wage and non-wage costs of labour, it could have adverse implications for the overall level of formal-sector employment in the economy.

Labour costs and productivity

The increase in the average *nominal remuneration per worker* accelerated from a year-to-year rate of 10,4 per cent in 1993 to 11,9 per cent in 1994. It then fell back to 9,4 per cent in 1995, before strengthening to a rate of 10,2 per cent in 1996. The year-on-year rate of increase in nominal remuneration per worker accelerated continuously from the most recent low of 7,1 per cent in the second quarter of 1995 to 11,1 per cent in the first quarter of 1996. Nominal remuneration growth declined slightly in the second and the third quarter of 1996, but then slowed down quite significantly to 9,1 per cent in the fourth quarter.

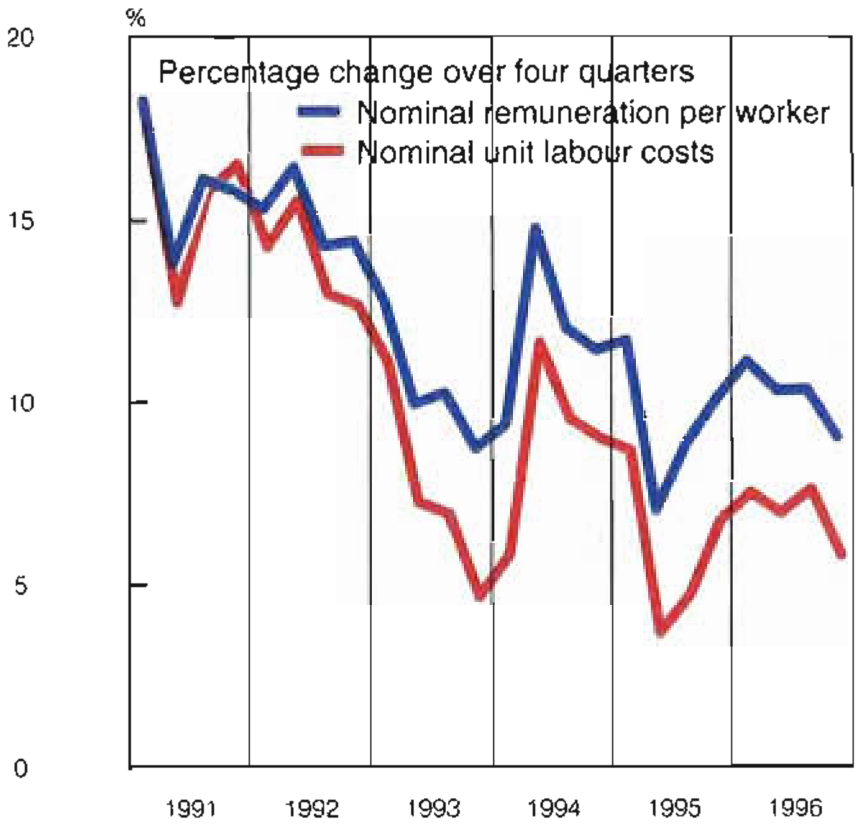
Nominal remuneration per worker in the *private sector* increased by 10,0 per cent in 1994, 11,2 per cent in 1995 and 10,7 per cent in 1996. The year-on-year rate of increase, when measured with a quarterly frequency, decelerated from 12,5 per cent in the first quarter of 1996 to 10,4 per cent in the second quarter and 11,2 per cent in the third quarter. A slowdown in nominal wage increases in the manufacturing sector and in wholesale, retail and motor trade then resulted in the year-on-year growth rate in private-sector remuneration per worker declining to 8,8 per cent in the fourth quarter of 1996.

The increase in remuneration per worker in the *public sector* slowed down from a rate of 14,9 per cent in 1994 to 6,5 per cent in 1995, but then accelerated to 8,9 per

Table 4. Labour costs and productivity
Percentage change over one year

Period	Remuneration per worker: Nominal	Remuneration per worker: Real	Productivity	Nominal unit labour costs
1995: 1st qr ...	11,7	2,9	2,8	8,7
2nd qr ..	7,1	-1,0	3,2	3,7
3rd qr ...	8,9	0,6	3,9	4,7
4th qr ...	10,1	0,8	3,1	6,8
Year......	9,4	0,8	3,3	5,9
1996: 1st qr....	11,1	2,0	3,3	7,5
2nd qr ..	10,3	0,6	3,1	7,0
3rd qr ...	10,4	0,4	2,5	7,6
4th qr ...	9,1	-1,1	3,1	5,8
Year......	10,2	0,5	3,0	7,0

Nominal remuneration per worker and nominal unit labour costs



cent in 1996. Contrary to remuneration movements in the private sector, the year-on-year rate of increase in public-sector remuneration per worker accelerated from 8,4 per cent in the third quarter of 1996 to 9,0 per cent in the fourth quarter – a rate of increase broadly similar to the remuneration increase of workers in the private sector in that quarter.

The year-to-year rate of increase in the *real remuneration per worker* in the non-agricultural sectors of the economy (as deflated by the price deflator for the non-agricultural gross domestic product) slowed down from 3,2 per cent in 1994 to 0,8 per cent in 1995 and 0,5 per cent in 1996. The government's Growth, Employment and Redistribution strategy projected real wages to decline by 0,5 per cent in 1996. Although real remuneration per worker increased in calendar 1996 as a whole, it nevertheless declined at a year-on-year rate of 1,1 per cent in the fourth quarter. This decline was, however, preceded by relatively firm year-on-year growth rates during the first three quarters of 1996.

Real output per worker in the non-agricultural sectors of the economy increased by 2,7 per cent in 1994, 3,3 per cent in 1995 and 3,0 per cent in 1996. The productivity increase in 1995 was the highest recorded since 1984. These high rates of productivity growth were a consequence of local producers' response to increased competition from foreign suppliers and domestic cost pressures emanating partly from workers' demands for higher nominal wages. The response of domestic producers also caused a further deepening of the capital intensity of production processes in the South African economy, thereby suppressing the demand for labour and employment growth.

The strong productivity growth in recent years led to relatively low rates of increase in *nominal unit labour costs*. The year-to-year rise in nominal unit labour costs declined to 5,9 per cent in 1995 – the lowest year-to-year rate of increase recorded since 1972. The acceleration in nominal wage growth and the slight decline in productivity growth then combined to accelerate the growth in nominal unit labour costs to 7,0 per cent in 1996. The year-on-year growth in *nominal unit labour costs*, however, slowed down from rates in excess of 7 per cent in the first three quarters of 1996 to 5,8 per cent in the fourth quarter.

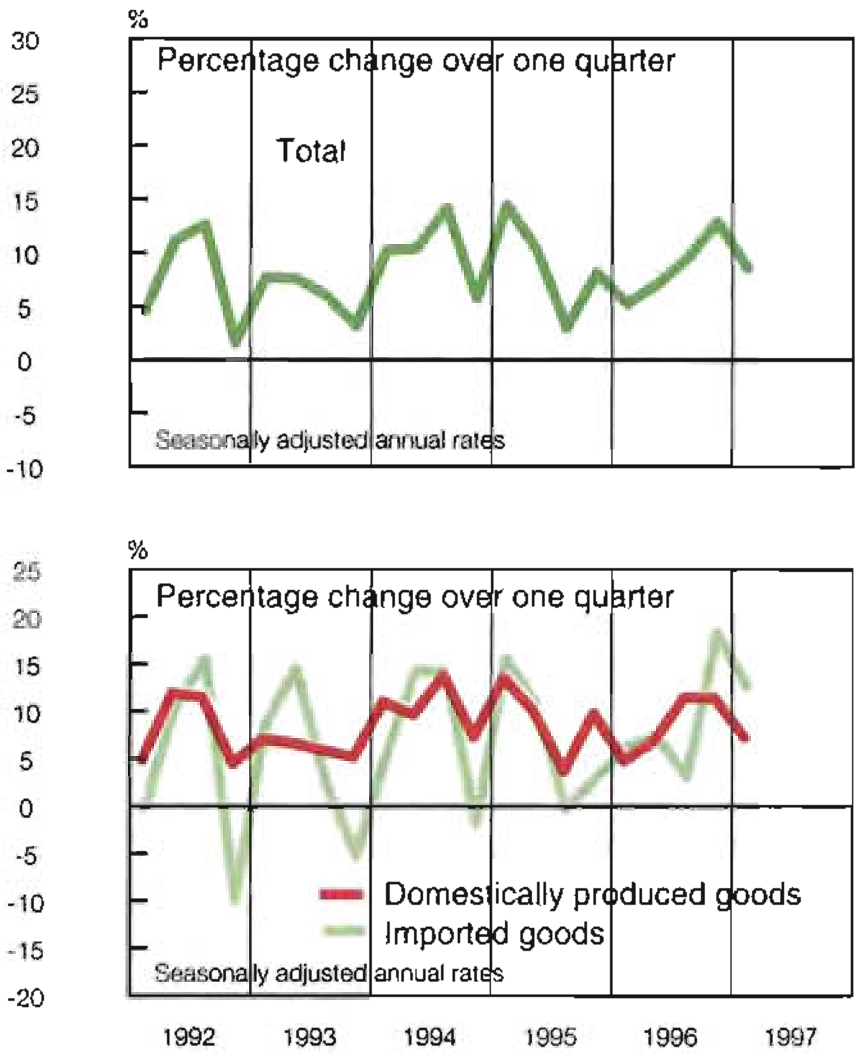
Prices

The lower growth in labour costs per unit of production was an important factor in slowing down the inflation rate in 1995 and the first quarter of 1996. The slower rise in labour costs in 1995 was assisted by the consistent application of a counter-inflationary monetary policy, the lowering of tariffs on imported goods, relatively low food price increases and the relative strength of the rand in the foreign exchange market until the middle of February 1996. The overall slowdown in inflation was reversed in the second quarter of 1996 when some of these inflation-containing forces changed direction and began to exert additional upward pressure on prices: the rand started to depreciate in February 1996, the rise in nominal unit labour costs began to accelerate from the fourth quarter of 1995, food price increases accelerated strongly and the rapid expansion of money and credit aggregates led to the persistence of high inflation expectations. In the first quarter of 1997, the pace of price inflation appeared to be decelerating once again.

Inflation as measured by changes in the *all-goods* *production price index,* declined from 9,6 per cent in 1995 to 6,9 per cent in 1996. The seasonally adjusted and annualised quarter-to-quarter rate of increase declined, on balance, from the most recent high point of 14,3 per cent in the first quarter of 1995 to 5,1 per cent in the first quarter of 1996, but then regained momentum and accelerated to 12,7 per cent in the fourth quarter of 1996 before slowing down again to 8,4 per cent in the first quarter of 1997. Measured over periods of twelve months, the overall production-price inflation fell to 5,3 per cent in April 1996, before re-accelerating to 9,3 per cent in February 1997 and a twenty-one-month high rate of 9,6 per cent in March.

The movements in the prices of *domestically produced goods* broadly mirrored that of the all-goods production price index. The year-on-year rise in the prices of domestically produced goods declined from 9,9 per cent in 1995 to 7,5 per cent in 1996. The quarter-to-quarter rate of increase in the prices of domestically produced goods decelerated on a seasonally adjusted and annualised basis from 13,6 per cent in the first quarter of 1995 to 4,8 per cent in the first quarter of 1996, only to accelerate again to 11,4 per cent in the fourth quarter. Agricultural food prices and rising unit labour costs contributed towards this acceleration in the prices of domestically produced goods. The quarter-to-quarter increase in the prices of domestically produced goods slowed down again to 7,2 per cent in the first quarter of 1997. The year-on-year increase in the prices of domestically produced goods accelerated recently from 5,9 per cent in April 1996 to 9,2 per cent in February 1997 and 9,5 per cent in March.

Production price index



Largely on account of the relative price stability in South Africa's main trading partners and the strength of the rand in the latter part of 1995, the year-to-year rate of increase in the *prices of imported goods* declined from 7,6 per cent in 1995 to 5,3 per cent in 1996. Seasonally adjusted and annualised, the prices of imported goods increased from quarter-to-quarter at rates that generally accelerated from 6,0 per cent in the first quarter of 1996 to 18,1 per cent in the fourth quarter. The acceleration in the prices of imported goods during 1996 was interrupted somewhat unexpectedly by a small quarter-to-quarter rise of only 2,9 per cent in the third quarter. This was a consequence, firstly, of a decline in the prices of imported mining and quarrying products, including that of crude oil, and secondly, of the fact that the prices of goods constituting about one third of the weighting of the import component of the production price index

Table 5. Quarter-to-quarter rate of change in prices
Seasonally adjusted and annualised percentage

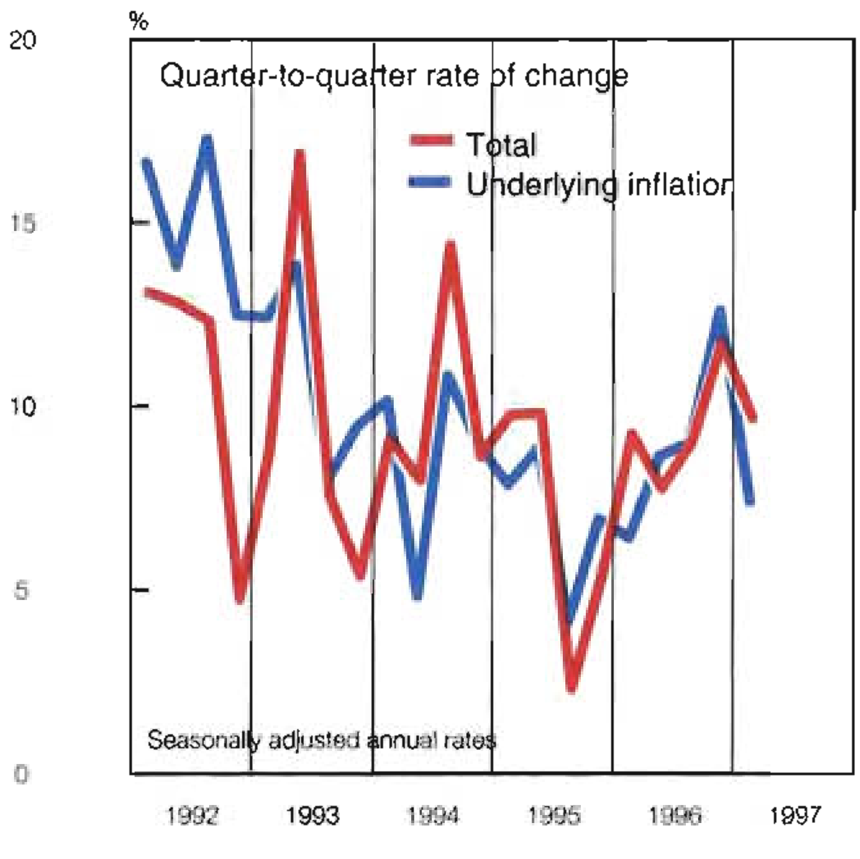
Quarter	Imported goods	Domestically produced goods	All-goods production prices	Consumer prices	Underlying inflation
1996: 1st qr	6,0	4,8	5,1	9,1	6,4
2nd qr	7,3	6,8	6,9	7,6	8,5
3rd qr	2,9	11,4	9,3	8,9	9,0
4th qr	18,1	11,4	12,7	11,6	12,6
1997: 1st qr	12,4	7,2	8,4	9,5	7,4

showed no change during the third quarter of 1996. The price level of this category of goods was not surveyed for a number of months during 1996. In the first quarter of 1997 the quarter-to-quarter increase in the prices of imported goods slowed down again to 12,4 per cent, mainly owing to the strengthening of the external value of the rand. Measured over periods of twelve months, the rate of increase in the prices of imported goods accelerated from 3,2 per cent in April 1996 to 10,3 per cent in February 1997 and 10,1 per cent in March.

The seasonally adjusted and annualised quarter-to-quarter rate of increase in the *overall consumer price index* declined from 14,3 per cent in the third quarter of 1994 to a low of 2,2 per cent in the third quarter of 1995. This rate of price increase has subsequently accelerated, on balance, to 11,6 per cent in the fourth quarter of 1996, before subsiding to 9,5 per cent in the first quarter of 1997. Measured over periods of twelve months, the increase in the overall consumer price index accelerated from 5,5 per cent in April 1996 (its lowest level since June 1972) to 9,8 per cent in February 1997, 9,6 per cent in March and 9,9 per cent in April.

Underlying inflation (i.e. the change in the overall consumer price index excluding the prices of food and non-alcoholic beverages, the cost of home ownership and value-added tax) measured from quarter to quarter, accelerated from a seasonally adjusted and annualised rate of 4,1 per cent in the third quarter of 1995 to 12,6 per cent in the fourth quarter of 1996, but then slowed down noticeably to 7,4 per cent in the first quarter of 1997. The year-on-year underlying inflation rate nevertheless accelerated from a low of 6,3 per cent in May 1996 to 9,7 per cent in February 1997, before slowing down somewhat to 9,2 per cent in March and 9,4 per cent in April.

Consumer price index



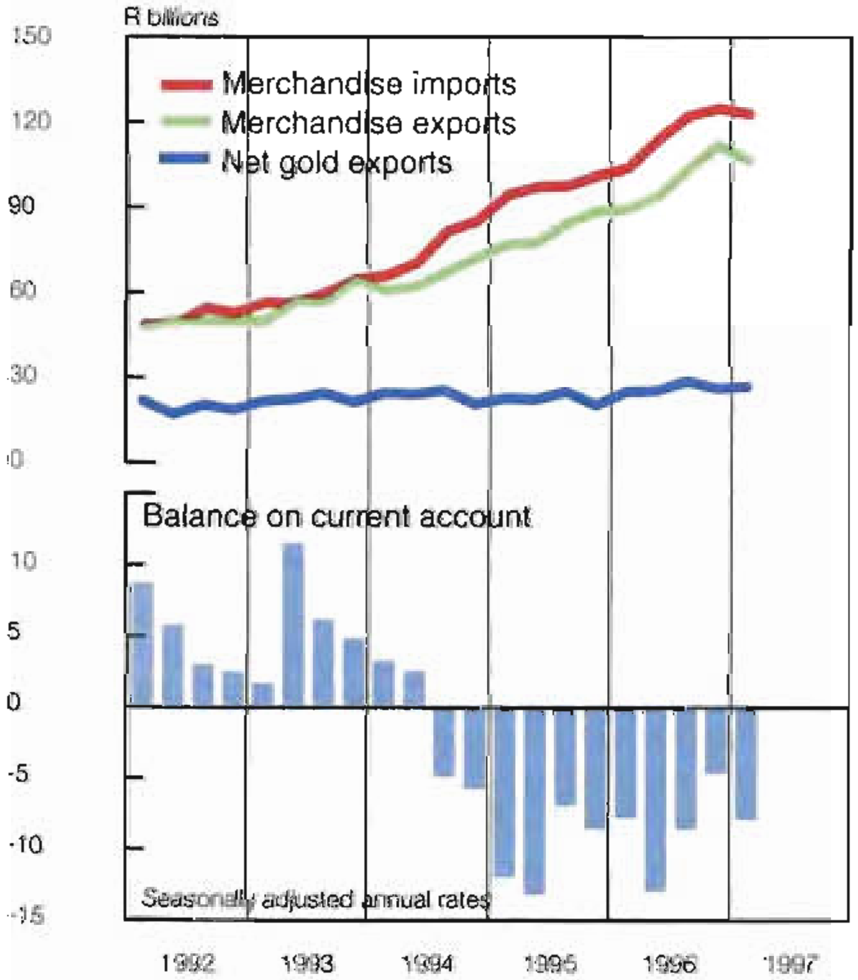
Foreign trade and payments

Current account

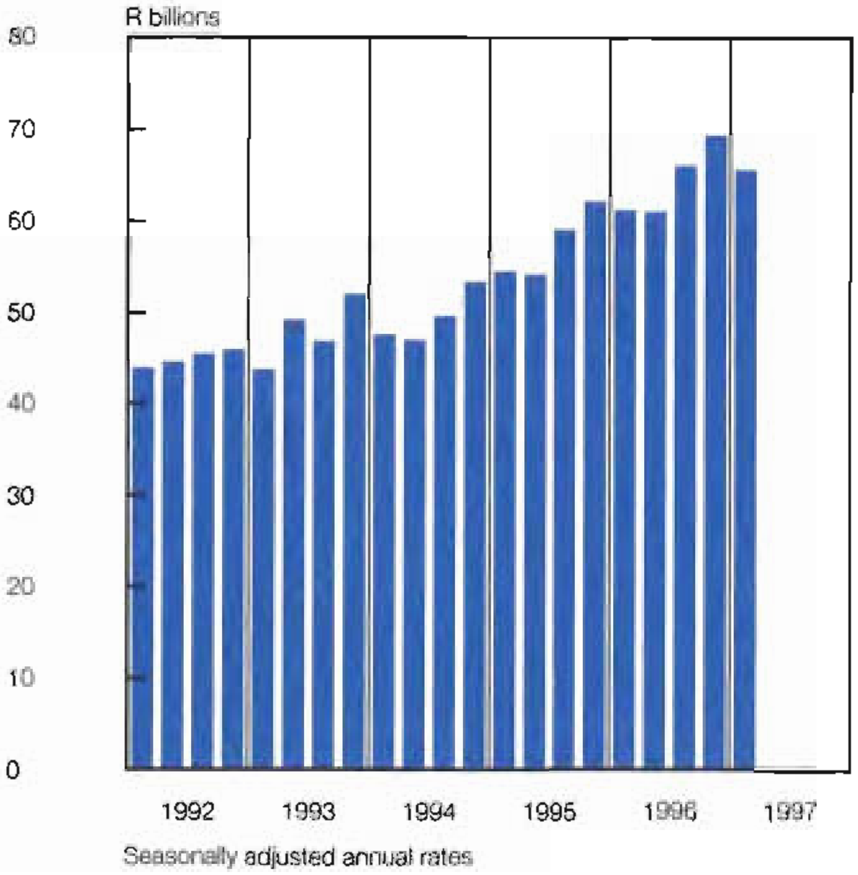
The *deficit on the current account* of the balance of payments widened from R0,1 billion in the fourth quarter of 1996 to R1,9 billion in the first quarter of 1997, largely because of a decline in the quantity of relatively price-insensitive goods exported. Calculated at a seasonally adjusted and annualised rate the deficit widened from R4,7 billion in the fourth quarter of 1996 to R7,9 billion in the first quarter of 1997. Prior to the fourth quarter of 1996, the deficit (seasonally adjusted and annualised) had narrowed from R12,9 billion in the second quarter of that year. As a ratio of gross domestic product, the current account deficit came to 1,4 per cent in the first quarter of 1997. In comparison, the average deficit ratio for 1996 was 1,6 per cent.

The value of *merchandise exports* (seasonally adjusted and annualised), which had increased strongly in the second half of 1996, declined by about 5 per cent from R111,0 billion in the fourth quarter of 1996 to R105,6 billion in the first quarter of 1997, mainly as the result of a decline of 5½ per cent in the volume of goods exported in the first quarter of 1997. Despite this decline, the volume of merchandise exports in the first quarter of 1997 was still 7½ per cent higher than the average quarterly level in the first half of 1996.

Current account



Volume of merchandise exports



An analysis of the changes in the value of exports by product category shows that sharp declines were recorded in the categories vegetable products, particularly edible fruit and nuts, and precious and semi-precious stones. The value of exports in the categories vehicles and transport equipment and paper products also recorded sizeable declines, whereas increases were recorded in the categories machinery and electrical equipment and textile products, resulting in only a modest decline in the total value of exports of manufactured goods.

After having declined throughout 1995 and 1996, international commodity prices rebounded in the first quarter of 1997. The potentially beneficial effect of this rise in commodity prices on export earnings was partially negated by the appreciation of the rand during the early months of 1997.

The value of *net gold exports* rose marginally from a seasonally adjusted and annualised value of R26,2 billion in the fourth quarter of 1996 to R26,8 billion in the first quarter of 1997. *Export volumes of gold* rose strongly in the first quarter of 1997 because sales from accumulated inventories at the mines were added to the sale of current production. In contrast, the average fixing price of gold on the international market fell from US$376,00 per fine ounce in the fourth quarter of 1996 to $351,21 in the first quarter of 1997. Declining inflation and the consequent expectation of lower future inflation in industrial countries, rising interest rates in the United States and rumours about imminent central bank gold sales were among the

Table 6. 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
Merchandise exports	88,5	93,1	102,6	111,0	105,6
Net gold exports	24,9	25,3	28,7	26,2	26,8
Merchandise imports	-104,1	-114,1	-122,2	-124,8	-122,9
Net service and transfer payments	-17,1	-17,2	-17,7	-17,1	-17,4
Balance on current account	**-7,8**	**-12,9**	**-8,6**	**-4,7**	**-7,9**

factors which impacted negatively on gold price movements. The value of gold sales was also influenced by the relative strength of the rand against the dollar, which caused the rand equivalent of the gold price to fall from R1 743,85 per fine ounce in the fourth quarter of 1996 to R1 584,57 in the first quarter of 1997. In April 1997, the average price of gold per fine ounce fell even further to $344,59, or R1 532,18.

Normally, when the growth in gross domestic expenditure slows down, growth in the value of *merchandise imports* either slows down or turns negative. In this instance, the value of merchandise imports (seasonally adjusted and annualised) declined from R124,8 billion in the fourth quarter of 1996 to R122,9 billion in the first quarter of 1997. The volume of imports, which had declined by about 2 per cent from the third quarter of 1996 to the fourth quarter, declined further by ½ per cent in the first quarter of 1997. The downward movement in the value of merchandise imports during the first quarter of 1997 was slightly attenuated by a decline of 1 per cent in the domestic-currency value of the prices of imported goods, essentially as a consequence of the recent appreciation of the rand and low price inflation in trading-partner countries.

The decline in the value of merchandise imports was particularly prominent in the categories agricultural products and manufactured goods. These were partly countered by higher import values of mineral products, which include crude oil, and that of precious and semi-precious stones.

Net service and transfer payments to non-residents, which had declined from a high of R17,7 billion in the third quarter of 1996 to R17,1 billion in the fourth quarter, increased again to R17,4 billion in the first quarter of 1997. Although receipts for services increased on account of higher travel expenditure by foreign visitors to South Africa and higher investment income from the rest of the world, payment for services by South Africans travelling to other parts of the world, and dividend and interest pay-outs to non-resident investors rose even more.

Capital account

As could be expected in circumstances where the currency is strengthening, the large *net inward movement*

Table 7. Net capital movements not related to reserves
R billions

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

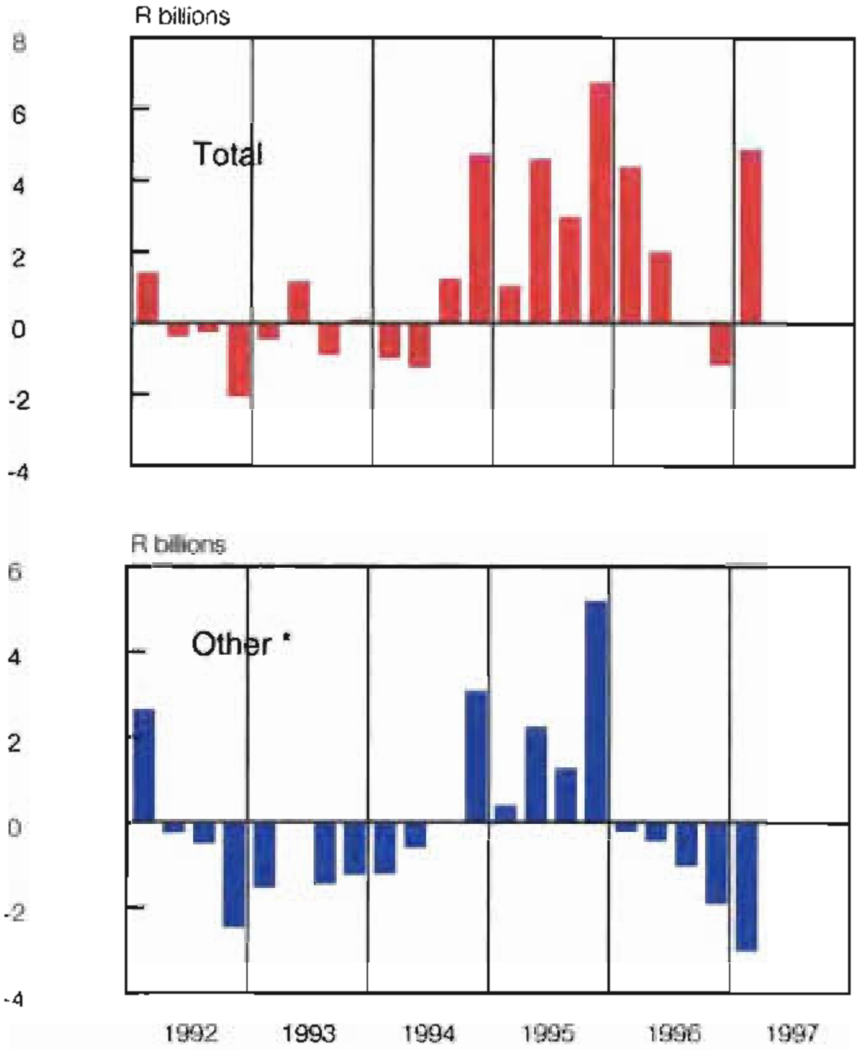
of capital (not related to reserves) which began in the fourth quarter of 1996, continued in the first quarter of 1997. In fact, the total net inward movement of capital not related to reserves increased from R3,3 billion in the fourth quarter of 1996 to R3,6 billion in the first quarter of 1997. By comparison, the total net inflow of capital unrelated to reserves in the calendar year 1996 as a whole amounted to some R3,9 billion. Unlike the fourth quarter of 1996 when capital movements were dominated by an inward movement of short-term capital, the inflows in the first quarter of 1997 were predominantly of a long-term nature.

Long-term capital movements changed from an outflow of R1,2 billion in the fourth quarter of 1996 to a net inflow of R4,8 billion in the first quarter of 1997. The inward flow of long-term capital in the first quarter of 1997 was primarily destined for non-bank private-sector entities and for the public sector, including public corporations. Contrary to these movements, the steady outflow of long-term capital from the banking sector, which had been observed in every quarter of 1996, continued in the first quarter of 1997.

By far the greatest part of the inflow of long-term capital during the first quarter of 1997 consisted of net purchases by non-residents of bonds in the domestic bond market and of shares listed on the Johannesburg Stock Exchange. The net payment for purchases of bonds by non-residents amounted to R3,9 billion in the first quarter of 1997. Net purchases to an amount of R2,2 billion were left unsettled at the end of the quarter, thereby holding the promise of further inflows of long-term capital in the remainder of the year. Shares listed on the Johannesburg Stock Exchange to the value of R3,5 billion were acquired by non-resident investors during the first quarter. The positive effect of these inflows of long-term capital through the bond and share market on the level of gold and other foreign reserves was partly negated by an outward flow of long-term capital to an amount of R3,4 billion, arising from the repayment of debt obligations which fell due in the first quarter of 1997, and by outflows of funds due to asset swap transactions.

It is generally assumed that portfolio investment flows could be highly volatile, and that they may have a destabilising effect on general macroeconomic equilibrium. The large portfolio investments from the beginning of 1997 could, therefore, impart some additional volatility to the South African securities markets and to the flows of capital into and out of the economy. This, however, may under current circumstances not necessarily be the case; to the extent that these investments were the hedging counterpart of some of the Eurorand bond issues which had been made in the first quarter of 1997, they represented a relatively longer-term investment into the economy. Indeed, some of the Eurorand bond issues of R7,1 billion issued in the first quarter of 1997 were hedged in the South African market through the purchase of bonds with a maturity of between one and five years. Another important

Long-term capital movements



* Excluding non-resident investment in South African securities

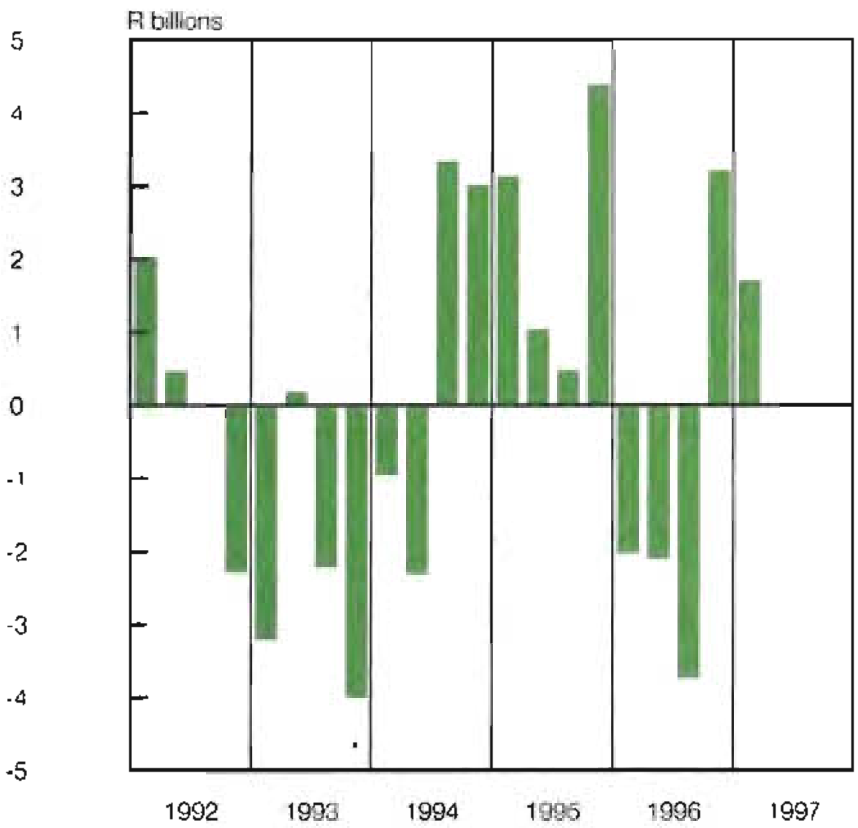
consequence of Eurorand bond issues is that they gave rise to increased forward purchases of rand, or forward sales of dollars, thereby contributing to a more balanced position between the purchases and sales in the domestic forward foreign-exchange market.

Short-term capital movements (not related to reserves, but including unrecorded transactions) changed from an inflow of R4,5 billion in the fourth quarter of 1996 to an outflow of R1,2 billion in the first quarter of 1997. The proximate cause of this reversal of short-term capital flows was the repayment of part of the outstanding external *loan* liabilities of the private banking sector in the first quarter of 1997. Non-resident short-term *deposits* with the domestic private banking sector increased strongly in the first quarter of 1997, but this inflow was completely offset by an outward movement of short-term capital from the non-bank private sector. Many private-sector companies capitalised on the higher external value of the rand and repaid part of their uncovered foreign short-term liabilities.

Foreign reserves

The net inflow of foreign capital exceeded the absolute value of the deficit on the current account of the balance of payments (not adjusted for seasonal variation) in the

Change in total net gold and other foreign reserves



first quarter of 1997, with the result that the country's *net gold and other foreign reserves* increased by R1,7 billion in that quarter. This was the second consecutive quarter in which the net gold and other foreign reserves showed an improvement – during the first three quarters of 1996 the net foreign reserves declined by R7,8 billion. Between the end of September 1996 and the end of March 1997, the net foreign reserves have increased by R4,9 billion.

The *gross gold and other foreign reserves* rose from R16,8 billion at the end of 1996 to R19,5 billion at the end of March 1997, notwithstanding a decline of R0,2 billion in the gross foreign reserves of the private banking sector. This level of gross reserves was equivalent to about six weeks' worth of imports of goods and services. In April 1997, the gross gold and other foreign reserves of the Reserve Bank increased by R1,3 billion, and in May by a substantial amount of R7,4 billion to reach a level of R21,8 billion. As a percentage of the total value of the Reserve Bank's foreign reserves, the value of gold holdings fell from 57 per cent at the end of December 1996 to 24 per cent at the end of May 1997.

Exchange rates of the rand

Frequent speculative attacks on the rand during the first ten months of 1996 caused the *nominal trade-weighted exchange rate* of the rand to decline by 22,7 per cent from the end of December 1995 to the end of October 1996. Stability returned to the foreign exchange market in the last two months of 1996, however, resulting in a slight appreciation of the rand of about 1 per cent from the end of October 1996 to the end of December.

As confidence was restored, the nominal effective exchange rate strengthened further by 8,9 per cent during the first quarter of 1997, taking the value of the rand against a basket of currencies of South Africa's most important trading partners to a level that was 10,0 per cent higher than the value that prevailed at the end of October 1996. In April 1997, the trade-weighted value of the rand against a basket of currencies remained broadly unchanged.

The recent strengthening of the rand occurred concurrently with a significant appreciation of the US dollar against all the other major currencies. The rand consequently also increased against these currencies. For example, from the end of October 1996 to the end of April 1997 the rand strengthened by 22,0 per cent against the Netherlands guilder, 21,7 per cent against the German mark, 20,5 per cent against the Italian lira and 19,1 per cent against the Japanese yen.

The strong showing of the rand since the end of October could be attributed to the effects of a range of factors which simultaneously influenced the foreign exchange market. Among these are:

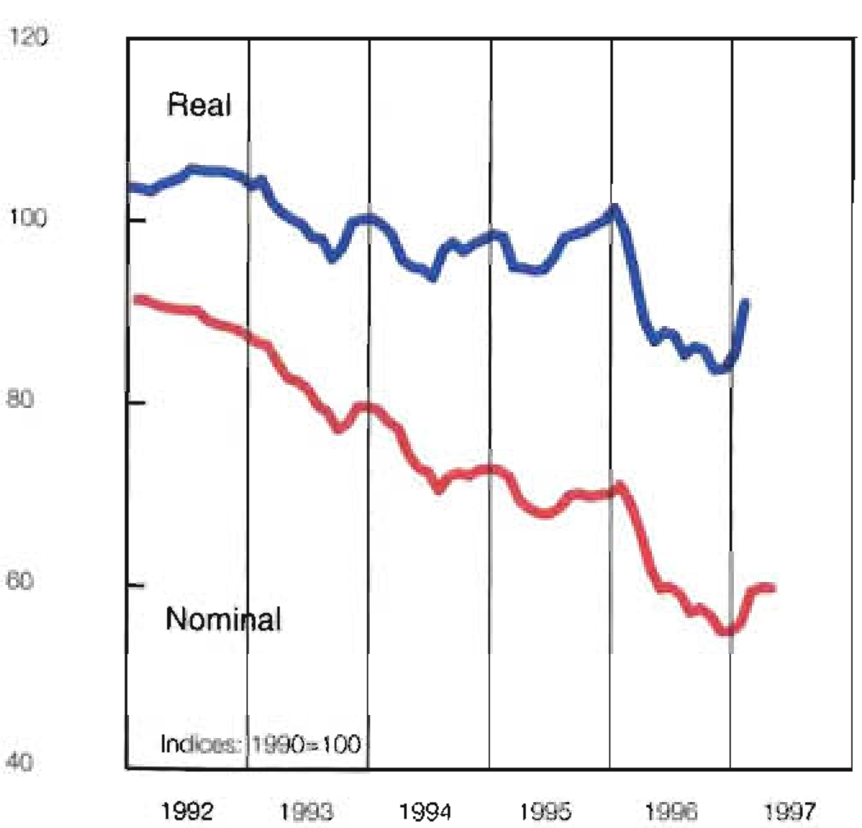
Table 8. Changes in the exchange rates of the rand
Per cent

	31 Dec 1995 to 31 Dec 1996	31 Dec 1996 to 27 Mar 1997	27 Mar 1997 to 30 Apr 1997*	31 Oct 1996 to 30 Apr 1997
Weighted average	-21,9	8,9	0,0	10,0
US dollar	-22,1	6,0	-0,6	6,6
British pound	-28,9	10,3	-0,7	6,4
German mark	-15,7	14,6	2,0	21,7
Japanese yen	-12,1	12,8	1,8	19,1
Netherlands guilder	-15,4	14,9	2,0	22,0
Italian lira	-24,9	16,5	1,4	20,5

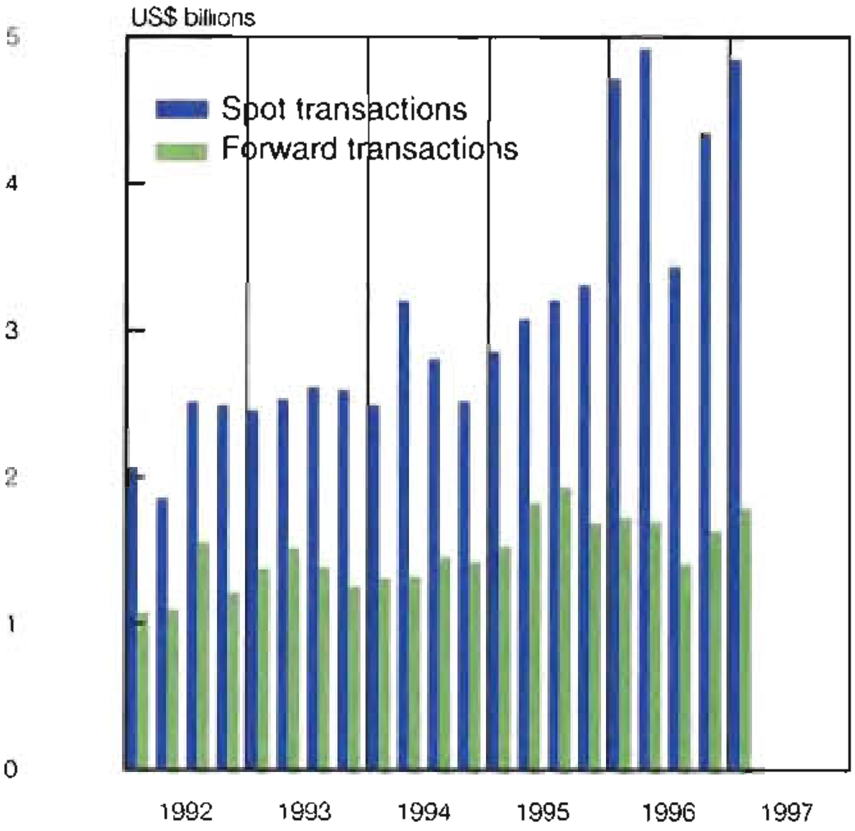
- the large-scale net purchases of securities by non-residents which were causal to, but also influenced by, the rising value of the rand;
- the sustained relatively high level of domestic interest rates;
- expectations of a substantially reduced current account deficit during the calendar year 1997;
- rises in the level of gross official foreign reserves and expectations of a continuing rise in the remainder of 1997;
- positive market sentiment following the announcement of a further liberalisation of foreign exchange control measures; and
- general satisfaction with the broad thrust of macroeconomic policies as indicated by the Minister of Finance when he presented the government's budget proposals for the 1997/98 fiscal year to Parliament.

The sharp increase in the nominal effective exchange rate of the rand in the first quarter of 1997, together with the widening inflation differential between South Africa and its main trading partners, resulted in an increase of approximately 9½ per cent in the *real effective exchange rate* of the rand over the period December 1996 to March 1997. The real effective exchange rate nevertheless still declined, on balance, by 8,3 per cent between December 1995 and March 1997. If the relatively low value of the effective exchange rate of the rand in May 1995 were used as a benchmark, the depreciation of the rand in real terms from May 1995 to March 1997 would come to only 3,0 per cent.

Effective exchange rates of the rand



Net average daily turnover in the South African foreign exchange market



The large-scale interest shown by non-residents in South African securities in the first quarter of 1997 contributed, *inter alia*, to an increase in turnovers in the South African market for foreign exchange. The average net daily turnover, i.e. gross turnover adjusted for double counting arising from local interbank transactions, rose from US$6,0 billion in the fourth quarter of 1996 to $6,7 billion in the first quarter of 1997. Abrupt changes in the exchange rate of the rand against the US dollar during February 1997 probably contributed to the average net daily turnover rising to US$7,4 billion in that month. The appreciation in the external value of the rand during the first quarter of 1997 also contributed to a slowdown in the expansion of activity in the forward foreign exchange market and an improvement in the balance between sales and purchases in the forward foreign exchange market. It also resulted in substantial surpluses accruing to the Reserve Bank on account of transactions in the forward foreign-exchange market.

Monetary developments, interest rates and financial markets

Money supply

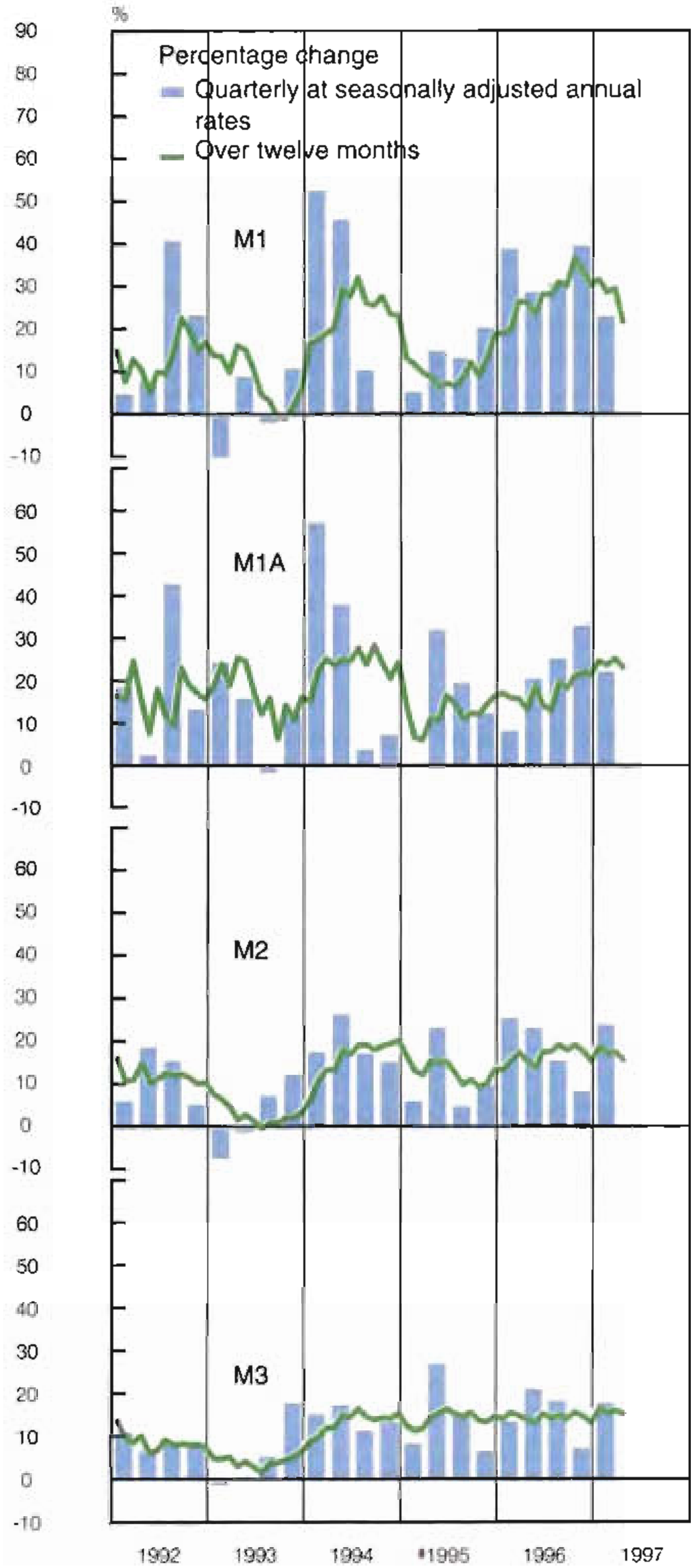
The slowdown in overall monetary expansion in the fourth quarter of 1996 appears to have been of a temporary nature as the growth in the more closely monitored monetary aggregates accelerated again in the first quarter of 1997. The quarter-to-quarter annualised growth rate in the seasonally adjusted, *broadly defined money supply* (M3), rebounded to 18,1 per cent in the first quarter of 1997, after having slowed down from 21,2 per cent in the second quarter of 1996 to 7,6 per cent in the fourth quarter. The growth over twelve months in M3 decelerated likewise from an upper turning-point of 16,1 per cent in February 1996 to 13,6 per cent in December, but then increased to 16,8 per cent in January 1997, 15,9 per cent in February and 16,5 per cent in March. These growth rates were followed by an increase of 15,7 per cent in April.

As was the case during 1996, the strong growth in the M3 money supply could be ascribed to a strong preference of individuals and other private-sector entities for call and other short- and medium-term deposits. The deposits of insurers and pension funds with banks, for example, increased by R5,2 billion in the first quarter of 1997. The increase in the deposit holdings of these institutions amounted to about 30 per cent of the increase in total M3 money supply in the first quarter of 1997. Furthermore, the non-bank private sector's investment in highly liquid negotiable certificates of deposit also increased sharply during the first three months of 1997.

As a reflection of strong investors' preference for liquidity, the *narrower monetary aggregates* rose more rapidly than the broad monetary aggregate, M3. The twelve-month growth rate of M1A accelerated during the second half of 1996 from a low point of 13,6 per cent in July to 21,9 per cent in December and then further to 25,7 per cent in March 1997. These were followed by growth over twelve months of 23,6 per cent in April 1997. The year-on-year growth of M1 fluctuated around a very high average level of 32,2 per cent during the second half of 1996, declining gradually from a peak of 37,2 per cent in October 1996 to 22,2 per cent in April 1997. Growth in M2 was sustained at relatively high year-on-year rates of between 15 per cent and 20 per cent in the second half of 1996. In the first quarter of 1997 these relatively high growth rates continued at 19,1 per cent in January, 17,5 per cent in February and 17,8 per cent in March. In April 1997 this growth rate fell back to 16,1 per cent.

The *main balance sheet counterparts* of the R17,4 billion increase in the M3 money supply during the first quarter of 1997 were increases in the banks' claims on the private non-bank sector and the government sector. Banks' claims on the non-bank private sector increased by R16,1 billion in the first quarter of 1997, whilst an increase of R5,2 billion in the banks' gross claims on the

Monetary aggregates



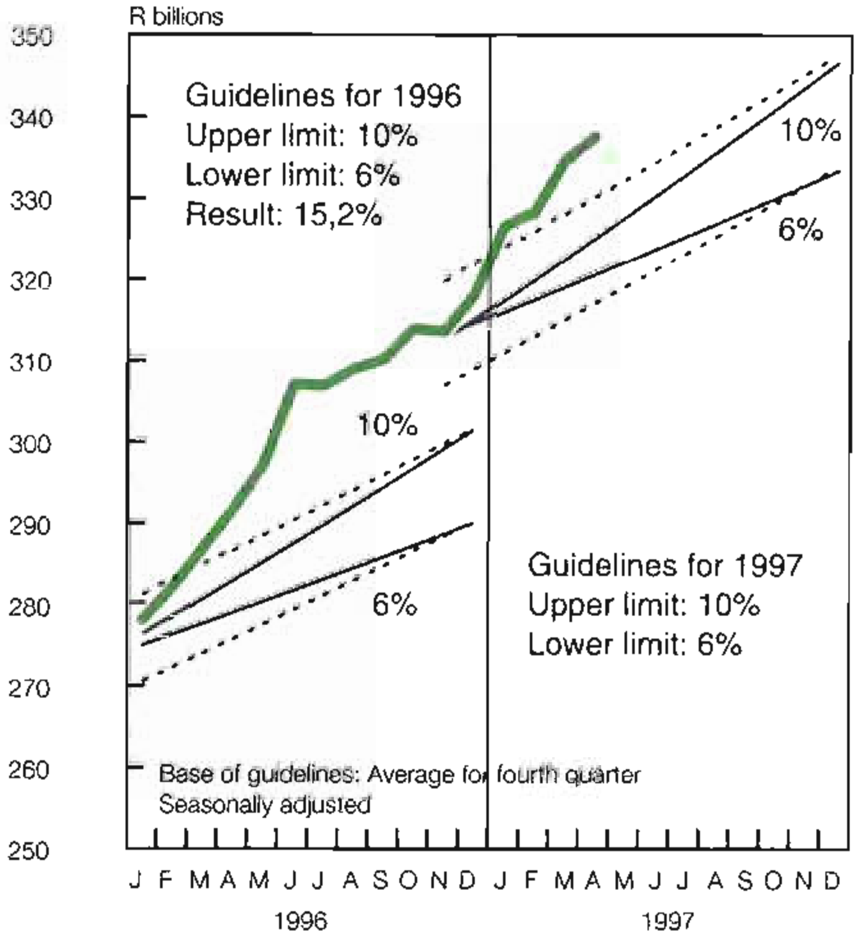
government sector during this period was only partially neutralised by an increase of R0,6 billion in government deposits with the banks, leaving a net amount of R4,6 billion of new bank credit extended to the government

Table 9. Growth over twelve months in monetary aggregates

Per cent

Period		M1A	M1	M2	M3
1996:	Apr	13,9	26,9	15,8	14,4
	May	19,0	24,1	14,3	13,6
	Jun	14,7	28,7	17,9	15,7
	Jul	13,6	28,7	18,1	14,7
	Aug	20,1	31,6	19,6	15,4
	Sep	18,7	30,7	18,4	14,5
	Oct	21,6	37,2	19,5	16,0
	Nov	22,4	34,0	18,2	15,2
	Dec	21,9	30,9	15,8	13,6
1997:	Jan	25,1	32,2	19,1	16,8
	Feb	24,1	29,2	17,5	15,9
	Mar	25,7	30,1	17,8	16,5
	Apr	23,6	22,2	16,1	15,7

Guidelines for growth in M3



sector. The remaining balance sheet counterparts of the increase in the M3 money supply reflected declines during the first quarter of 1997 – net foreign assets declined by R2,2 billion and "net other assets" by R1,1 billion.

Money supply guidelines

The Governor of the Reserve Bank announced on 14 March 1997 that the Bank had decided to set the guideline range for acceptable growth in the quarterly average value of the M3 money supply at between 6 and 10 per cent for the guideline year from the fourth quarter of 1996 to the fourth quarter of 1997. The range which had been set for the 1995 and 1996 guideline years was thus left unchanged.

In his announcement the Governor repeated that the mission of the Reserve Bank was the protection of the value of the rand. Financial stability and the containment of inflation would therefore remain the overriding objective of monetary policy in 1997. The Governor expressed his concern about the acceleration of consumer price inflation since the second quarter of 1996. The rise in the underlying inflation rate was of particular concern because it pointed to the fact that more fundamental inflationary forces were at work. The reappearance of inflationary pressures was apparently not caused by an overheated economy. The persistently high increases in nominal unit labour costs from the second quarter of 1995 to the third quarter of 1996 and the depreciation of the rand during 1996 were singled out as important factors contributing to the rise in inflation.

Under such circumstances it had become necessary to reduce the strong growth in money supply and bank credit extension to the private sector to prevent these from fuelling the emerging and existing inflationary pressures. Should a new cycle of continuous increases develop in the rate of inflation, it could jeopardise the achievement of the goals set by the government for reconstruction and development and delay the implementation of the *Growth, Employment and Redistribution* strategy.

The money supply guidelines of 6 to 10 per cent were decided upon with a view to accommodate possible growth in the real gross domestic product of between 2 and 3 per cent in the 1997 guideline year, whilst signalling the Reserve Bank's resolve to eventually reduce the rate of inflation to levels which are more compatible with the average rate of inflation in South Africa's main trading partners and competitors. The challenge for 1997 would be to contain the inflation rate at a level below 10 per cent.

The announcement of annual guidelines for an acceptable increase in the money supply is meant to contribute to greater transparency in the conduct of monetary policy. Deviations of actual money supply growth from these guidelines should signal pro-active policy responses by the Reserve Bank. Although the guidelines provide banks and the general public with a clear indication of the more important underlying forces that are likely to shape monetary policy steps, the guidelines are always applied with circumspection and discretion. The Reserve Bank has no intention of interpreting the guidelines as an inflexible money rule.

The rapid growth over twelve months in the money supply during the first quarter of 1997 raised the value of the seasonally adjusted, broad money supply to a level higher than the maximum acceptable level of M3 as indicated by the upper limit of the 6 to 10 per cent guideline range. At the end of March 1997 the seasonally adjusted value of M3 exceeded the upper limit of the guideline "cone" by R9,4 billion, or by 2,9 per cent.

Credit extension

The growth in *total credit extension* by banks, which appears to have slowed down in the fourth quarter of 1996, increased with renewed vigour in the first quarter of 1997. The year-on-year increase in total domestic credit extension slowed down initially from 19,1 per cent in October 1996 to 17,1 per cent in December, but then accelerated to 21,6 per cent in February 1997, 19,3 per cent in March and 20,0 per cent in April. The strong growth in total credit extension in the first quarter of 1997 could be ascribed to the rapid increase in credit extended to the private sector.

The twelve-month rate of increase in credit extension by banks to the *private sector* decelerated from 18,9 per cent in October 1996 to 16,1 per cent in December, and then fluctuated in a narrow range between 16,0 per cent and 17,3 per cent over the next four months. These monthly growth rates consistently exceeded the rate of inflation as measured by changes in the consumer price index. However, with inflation having accelerated perceptibly since April 1996, the inflation-adjusted growth in credit extension to the private sector fell from 11,6 per cent in March 1996 to 6,8 per cent in April 1997.

The quarter-to-quarter growth in credit extension to the private sector (seasonally adjusted and annualised) slowed down from 22,4 per cent in the second quarter of 1996 to 11,8 per cent in the fourth quarter, but then accelerated to 17,0 per cent in the first quarter of 1997. The most important contributing factor to the persistently high rates of increase in credit extension to the private sector was probably the need to finance transactions in an economy where the nominal value of domestic expenditure and activity in financial markets were expanding rapidly. Certain structural changes, such as the absorption of increasing numbers of potential borrowers into the modern sector of the South African economy and the further integration of South Africa into the international financial markets, also caused the growth in credit demand to be higher than what it would otherwise have been. Some conversion of trade finance

Credit extension by monetary institutions

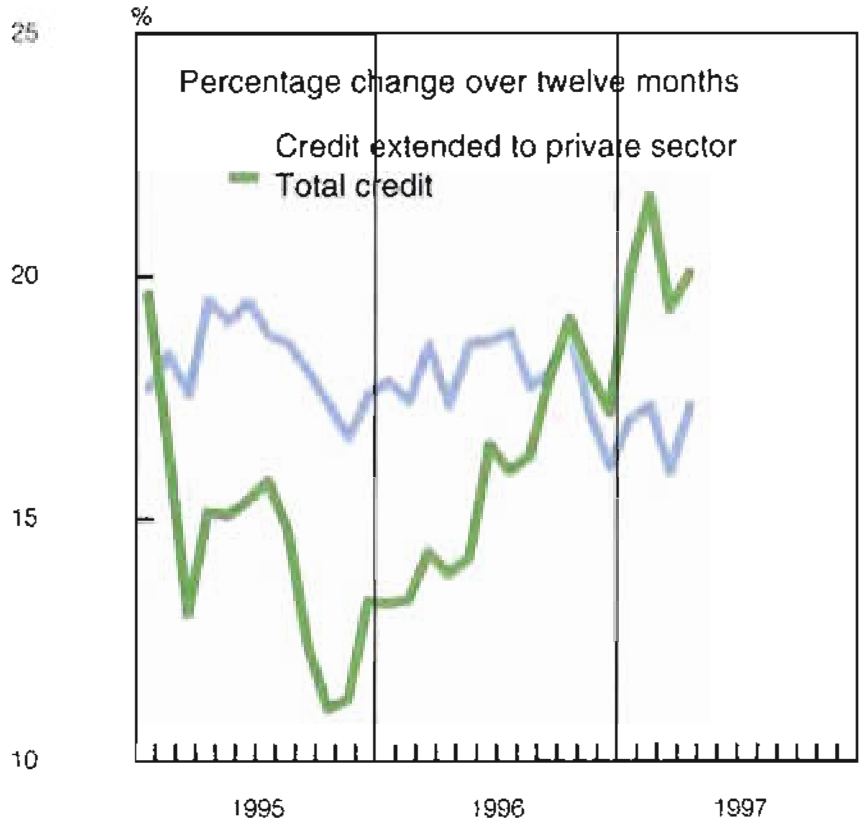


Table 10. Credit extension to the private sector by main type of credit
Percentage change over twelve months

Period		Investment and bills discounted	Instalment sales	Leasing finance	Mortgage advances	Other loans and advances	Total
1996:	Mar	18,4	28,8	17,5	16,7	18,0	18,6
	Jun	12,2	26,8	16,8	16,5	20,3	18,7
	Sep	5,2	24,1	19,8	17,1	19,2	18,1
	Dec	-7,5	21,2	16,8	16,5	18,2	16,1
1997:	Jan	-2,4	21,1	16,6	16,4	20,4	17,1
	Feb	0,4	20,2	15,1	16,3	21,2	17,3
	Mar	-6,1	18,1	14,3	15,8	19,9	16,0
	Apr	1,3	19,5	12,9	15,5	22,5	17,3

to domestic rather than foreign sources of credit could also have contributed to the firmer growth in credit extension.

An analysis of the banks' claims on the private sector by *type of credit* shows that the high rates of increase in credit extension to the private sector in the first quarter of 1997 were mainly caused by rapid growth in "other loans and advances" and in instalment sale credit. In both these credit categories the year-on-year growth rates exceeded 20 per cent in January as well as February 1997. Some slowdown appears to have taken place in the year-on-year growth in *"other loans and advances"* and *instalment sale credit* in March 1997. The growth in the year to the first quarter of 1997 in *leasing finance, instalment sale credit* as well as *mortgage advances* declined to rates below those recorded during 1996. Furthermore, new business pay-outs of instalment sale credit and leasing finance declined in the first quarter of 1997 relative to the final quarter of 1996, reflecting slower growth of consumer spending on durable goods and investment expenditure.

The increase in private-sector credit in the first quarter of 1997 was predominantly utilised by households. Of the total increase of R16,1 billion in credit to the private sector in the first quarter of 1997, households utilised R11,8 billion, or 73,3 per cent, and companies only R4,3 billion, or 26,7 per cent. In terms of percentage change, the growth over twelve months in credit extension to both companies and households amounted to 16,0 per cent in the first quarter of 1997.

Interest rates and yields

The movement of *bond yields* in the first five months of 1997 has been strongly influenced by the strengthening of the rand until March 1997 and by the subsequent stability of the exchange rate in April. This gave rise to burgeoning net purchases of bonds by non-residents, which were reinforced by the need to hedge positions arising from Eurorand bond issues through purchases in the South African bond market. The monthly average yield on long-term government stock accordingly declined from 16,19 per cent in December 1996 to 15,82 per cent in January 1997 and 15,03 per cent in February. Subsequently, the monthly average yield on long-term government stock moved higher to 15,24 per cent in April 1997, but declined again to 15,08 per cent in May.

Yield movements were fairly volatile in the first four months of 1997. Market responses to changing expectations of inflation and the underlying real economic situation, as well as changes in interest rates and yields in the United States bond market, resulted in movements in the *daily average yield* on long-term government bonds ranging between extremes of 16,40 per cent at the beginning of January and 14,65 per cent on 26 February.

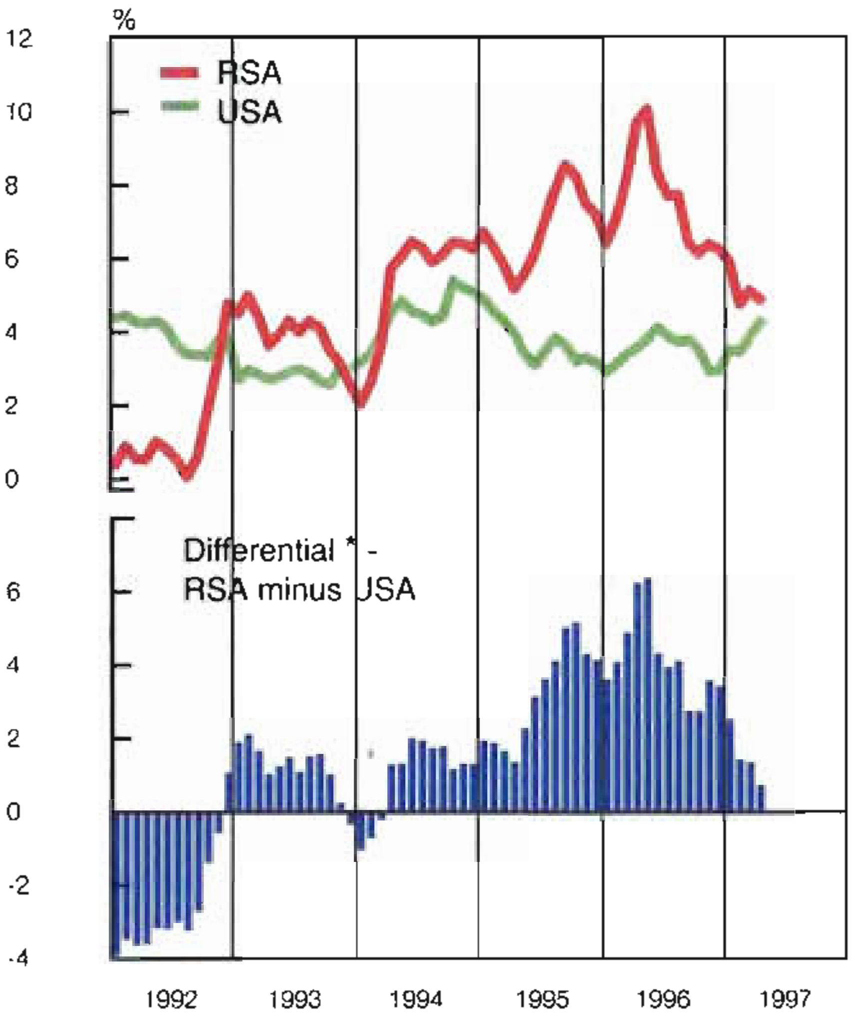
The *monthly average inflation-adjusted yield on long-term government bonds* declined steadily from 10,1 per cent in May 1996 to 4,8 per cent in February 1997 – its lowest level since March 1994. The inflation-adjusted yield on long-term South African government bonds increased slightly to 4,9 per cent in April 1997. If allowance were made for differences in country and

Table 11. Interest rates and yields
Per cent

Period		Monthly average yield on long-term government stock: Nominal	Real	3-month bankers' acceptances*	Prime overdraft rate*	Predominant rate on mortgage loans	Predominant rate on 12-month fixed deposits
1996:	Apr	15,78	9,7	15,20	19,50	18,25	13,50
	May	16,53	10,1	16,40	20,50	19,25	14,50
	Jun	15,78	8,3	15,20	20,50	20,25	15,00
	Jul	15,39	7,7	15,55	19,50	19,25	14,25
	Aug	15,82	7,7	15,95	19,50	19,25	14,25
	Sep	15,42	6,5	15,30	19,50	19,25	15,00
	Oct	15,80	6,1	15,80	19,25	19,00	15,00
	Nov	16,18	6,4	16,55	20,25	19,00	14,50
	Dec	16,19	6,3	17,00	20,25	20,00	14,50
1997	Jan	15,82	5,9	16,15	20,25	20,00	14,50
	Feb	15,03	4,8	16,00	20,25	20,00	14,50
	Mar	15,16	5,1	16,05	20,25	20,00	14,50
	Apr	15,24	4,9	15,95	20,25	20,00	14,50
	May	15,08	...	15,85	20,25	20,00	14,50

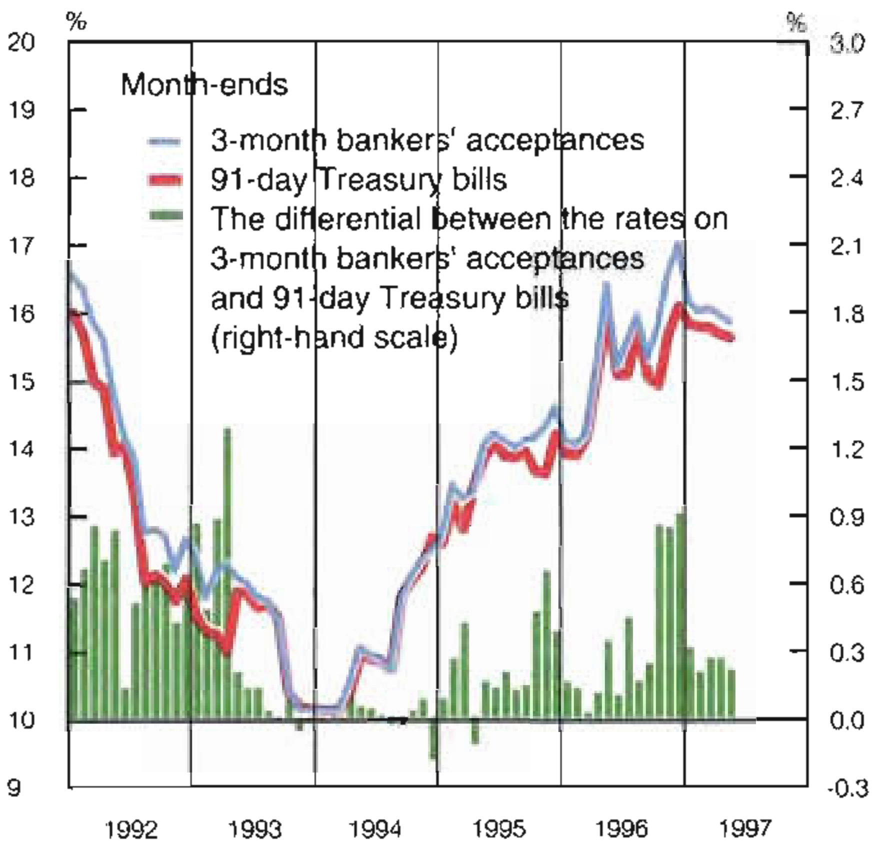
* As at end of month

Inflation-adjusted yields on long-term government stock



* Percentage points

Money market interest rates



currency risk premia, the inflation-adjusted yield in April was broadly in keeping with the similarly determined yield on long-term bonds of the United States Federal Government, which was calculated at 4,2 per cent for the same month.

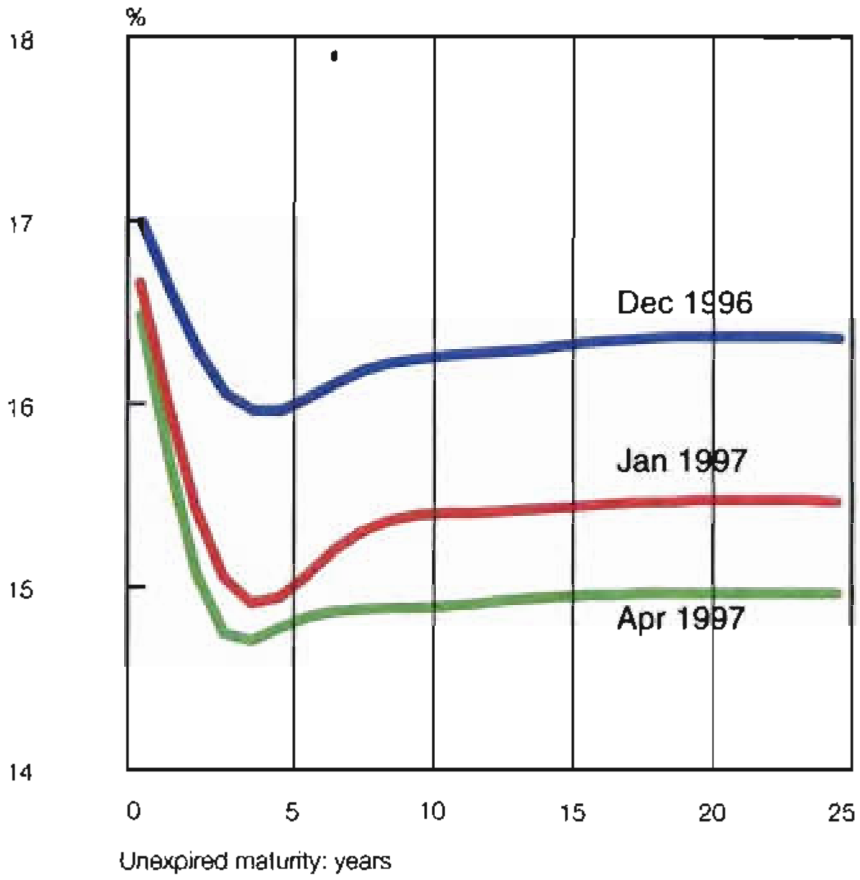
Money market interest rates rose steeply in the fourth quarter of 1996 and then softened during the first five months of 1997. The rate on *bankers' acceptances with a maturity of three months,* for example, increased from 15,30 per cent at the end of September 1996 to 16,55 per cent at the end of November, after Bank rate had been increased earlier that month. The rate on three-month bankers' acceptances then moved higher to 17,00 per cent at the end of December 1996, but started to drift downwards in the first five months of 1997 to 15,85 per cent at the end of May 1997.

The *tender rate on Treasury bills of three months* which had at times moved in an opposite direction to the general movement in money market rates during the fourth quarter of 1996, once again began to move in harmony with other money market rates during the first five months of 1997. The average month-end margin between the tender rate on Treasury bills of three months and the rate on bankers' acceptances with a maturity of three months, which had widened from 0,28 percentage points in the third quarter of 1996 to 0,86 percentage points in the fourth quarter, narrowed to 0,26 percentage points in the first quarter of 1997. This was a consequence of the more readily available supply of assets qualifying as first-tier collateral at the discount window. The Treasury bill rate accordingly declined from 16,10 per cent at the end of December 1996 to 15,64 per cent at the end of May 1997.

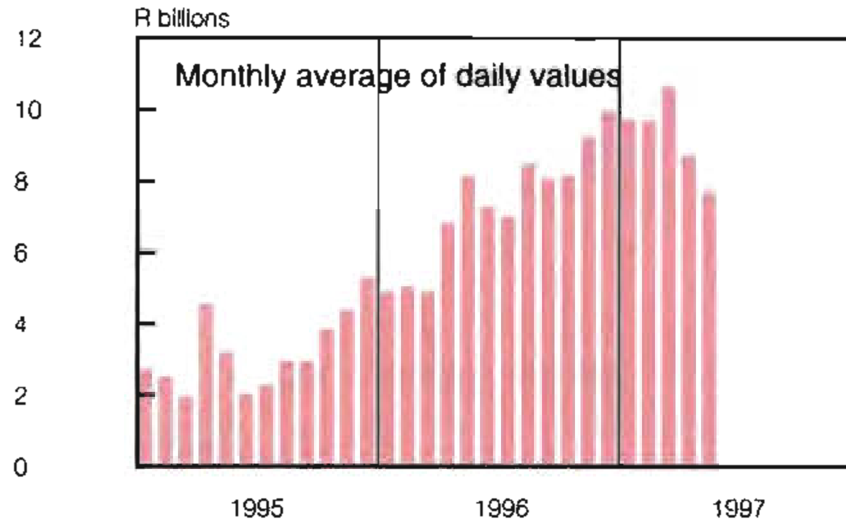
The level of the *yield curve* varied considerably in the course of 1996 on account of yield volatility across the maturity spectrum, but consistently maintained an inverted shape. The entire yield curve moved significantly upwards from January to December 1996, before declining slightly at the short end and more markedly at the long end in January 1997, thus becoming more inverted. It then settled more or less at this level in the next three months as the gradient changed marginally, with shorter-term yields being relatively stable amidst some volatility in longer term yields. The decline in the yield curve at the long end during the first four months of 1997 was indicative of expectations of lower inflation in the long run, the further consolidation of fiscal policy and the more positive sentiment in the foreign exchange market.

The *prime overdraft rate of banks* increased from 19,50 per cent at the end of the third quarter of 1996 to 20,25 per cent at the end of the fourth quarter. This was essentially a response to the abolition of the levy on financial services rendered by banks, which allowed a reduction in the prime overdraft rate of 0,25 percentage points on 1 October 1996, and an increase of one percentage point in Bank rate on 21 November 1996.

Yield curves



Total accommodation at the discount window



Since then, this rate has remained unaltered at 20,25 per cent. The *predominant rate on mortgage loans of banks*, which has followed the changes in the prime overdraft rate of banks closely, has also remained unchanged at 20,00 per cent since December 1996. This rate had been raised from 19,00 per cent to 20,00 per cent in December 1996, following the rise in the prime overdraft rate in November 1996.

The *predominant retail rate on twelve-month fixed deposits of banks* was lowered from 15,0 to 14,5 per cent in November 1996 and has remained unchanged since then. The *maximum permissible finance charges rates*, as laid down in terms of the Usury Act, were increased by one percentage point in March 1997, after having remained unchanged since September 1995. Since the increase, these rates have amounted to 29 per cent 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 conditions

Money market conditions remained tight in the last three quarters of 1996 and in the first quarter of 1997. Measured in terms of *average daily values*, the money market shortage exceeded R9 billion during each month over the period November 1996 to March 1997 and reached a record level of R10,6 billion in March 1997. Somewhat less tight conditions prevailed during April and May 1997, when the average amount of accommodation receded to R8,7 billion and R7,6 billion, respectively.

The accommodation which the Reserve Bank had to extend to banks at *month-ends* rose from R9,3 billion at the end of September 1996 to R10,4 billion at the end of December and R10,5 billion at the end of March 1997. On balance, the liquidity position in the money market therefore remained virtually unchanged in the first quarter of 1997. Increases in the net foreign assets of the Reserve Bank and a net decline in the value of notes and coin in circulation outside the Reserve Bank added liquidity to the market during the first quarter of 1997. These were, however, largely counteracted by the draining of liquidity from the market through surpluses recorded on account of the Reserve Bank's involvement in forward foreign-exchange transactions. The money market "shortage" declined towards the end of April and May 1997, mainly as a result of a further strengthening of the net foreign asset position of the Reserve Bank.

The *Reserve Bank's operations* in the money market during the first quarter of 1997 were primarily directed towards permitting the money market "shortage" to signal the underlying pressures prevailing in the market. Nevertheless, when the market appeared to become exceedingly tight, as at the end of March 1997, the Bank was prepared to provide assistance. To this end the Reserve Bank entered into a number of foreign currency swap arrangements with banks and also purchased assets for the portfolio of the Corporation for Public Deposits. Conversely, liquidity arising from the partial privatisation of Telkom in May 1997 was mostly sterilised by means of open-market sales of bonds and other short-term measures with a similar impact, such as foreign currency swaps.

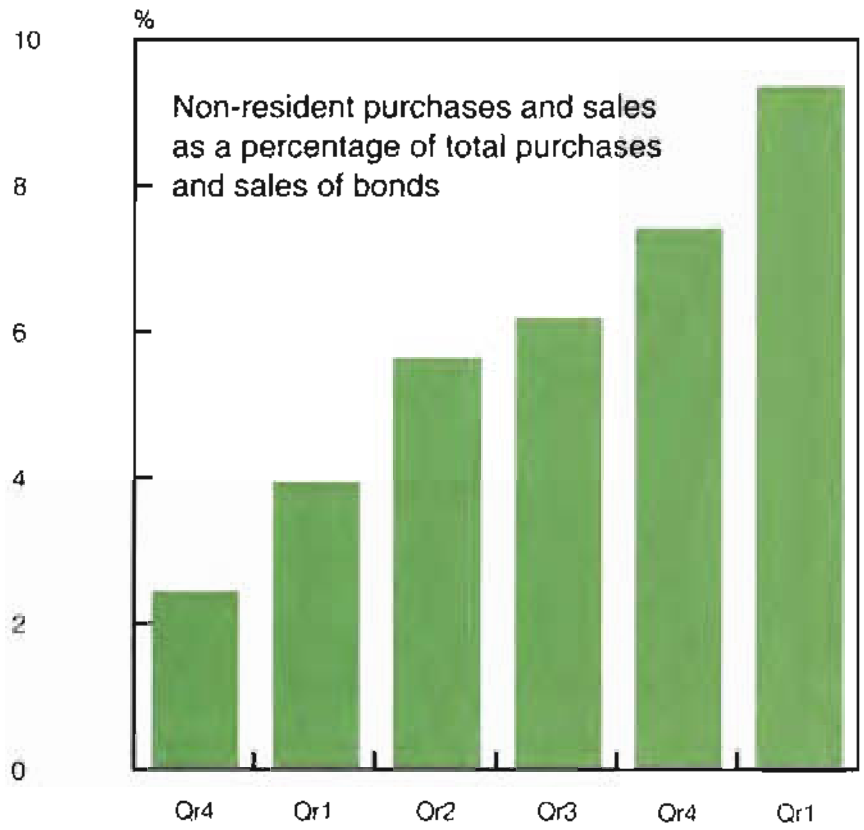
Bond market

Net issues of fixed-interest securities by the *public sector* in the *domestic primary bond market* decreased sharply from R9,8 billion in the third quarter of 1996 to R0,6 billion in the fourth quarter. This decline was a

Table 12. Bond market activity

Period	Primary market		Secondary market	
	Public-sector stock	Private-sector stock	Bonds traded on the Bond Exchange	Net purchases by non-residents on the Bond Exchange
	R billions	R billions	R billions	R billions
1996: 1st qr.....	8,5	-	753,2	2,4
2nd qr....	1,9	-	780,7	0,4
3rd qr.....	9,8	2,1	808,5	-0,6
4th qr.....	0,6	0,1	679,9	1,2
1997: 1st qr......	8,2	-	882,9	6,1

Non-resident participation in the secondary bond market



consequence of net stock redemptions, predominantly by the Central Government, amounting to R2,9 billion in November 1996. Net issues of public-sector stock subsequently increased to R8,2 billion in the first quarter of 1997, bringing the total amount raised by public-sector entities through issues of fixed-interest securities to R20,5 billion in fiscal 1996/97, as against a much larger amount of R29,5 billion in the previous fiscal year.

No *rights issues* of fixed-interest securities (including convertible preference shares and debentures) were made in the domestic primary capital market by *listed private-sector companies* during the first three months of 1997. An amount of R2,2 billion was raised by means of such issues in 1996. South African entities also abstained from issuing *foreign-currency denominated bonds* on the *international primary bond market* in the first quarter of 1997. During 1996 the government raised an amount of R3,4 billion in these markets and non-financial public-sector enterprises a total of R0,6 billion.

The value of transactions in the *secondary bond market* increased by 51 per cent during 1996. In the first quarter of 1997 the value of bonds traded on the Bond Exchange of South Africa increased even further to an all-time quarterly high of R882,9 billion; the average quarterly turnover amounted to R755,6 billion in 1996. Turnover in the secondary bond market was particularly lively in February 1997 when bonds to the value of R315,7 billion were traded. In April 1997 the value of bonds traded came to R249,9 billion, significantly down from the monthly average value of R294,3 billion in the first quarter of 1997.

Non-resident participation in the secondary bond market (measured as non-resident purchases and sales as a percentage of the total purchases and sales of bonds) increased sharply from about 5,8 per cent in 1996 to 9,9 per cent in the first four months of 1997. The value of net purchases by non-residents on the Bond Exchange amounted to R6,1 billion in the first quarter of 1997, compared with total net purchases of R3,4 billion in the entire calendar year 1996. In April 1997 non-residents' purchases of bonds exceeded their sales by a further R4,7 billion, bringing total net purchases in the first four months of 1997 to R10,8 billion. Attractive yields on offer in the domestic market compared with those in other markets, the relative strength of the rand in the first quarter of 1997, expectations of a slowdown of inflation in the near future and general satisfaction with the policy direction indicated by the Minister of Finance when government's budget proposals were presented to Parliament, were among the more prominent factors responsible for the keen interest shown by foreigners in the domestic bond market. The changing perceptions of non-resident investors, however, could have imparted some additional volatility to the bond market.

Share market

Total capital raised in the *primary equity market* by companies listed on the Johannesburg Stock Exchange amounted to R7,8 billion in the first quarter of 1997, compared with R10,1 billion in the fourth quarter of 1996. Capital raised through *rights issues of ordinary shares* fell from R3,0 billion in the fourth quarter of 1996 to R1,6 billion in the first quarter of 1997.

Buoyant conditions prevailed in the *secondary share market* and the turnover on the Johannesburg Stock Exchange increased from R34,6 billion in the fourth quarter of 1996 to R41,2 billion in the first quarter of

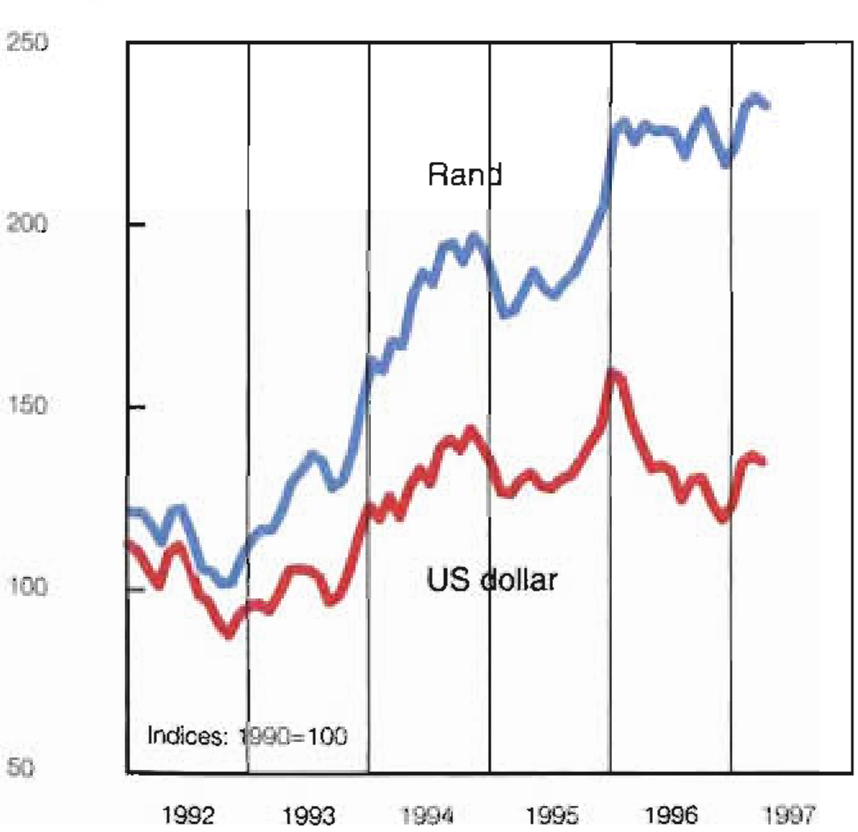
Table 13. Share market transactions

Period	Number of shares traded	Value of shares traded	Net purchases by non-residents
	billions	R billions	R billions
1996: 1st qr..........	1,9	27,2	2,3
2nd qr	1,9	27,4	1,9
3rd qr..........	2,4	27,8	1,4
4th qr	2,7	34,6	-0,5
1997: 1st qr...........	3,9	41,2	3,5

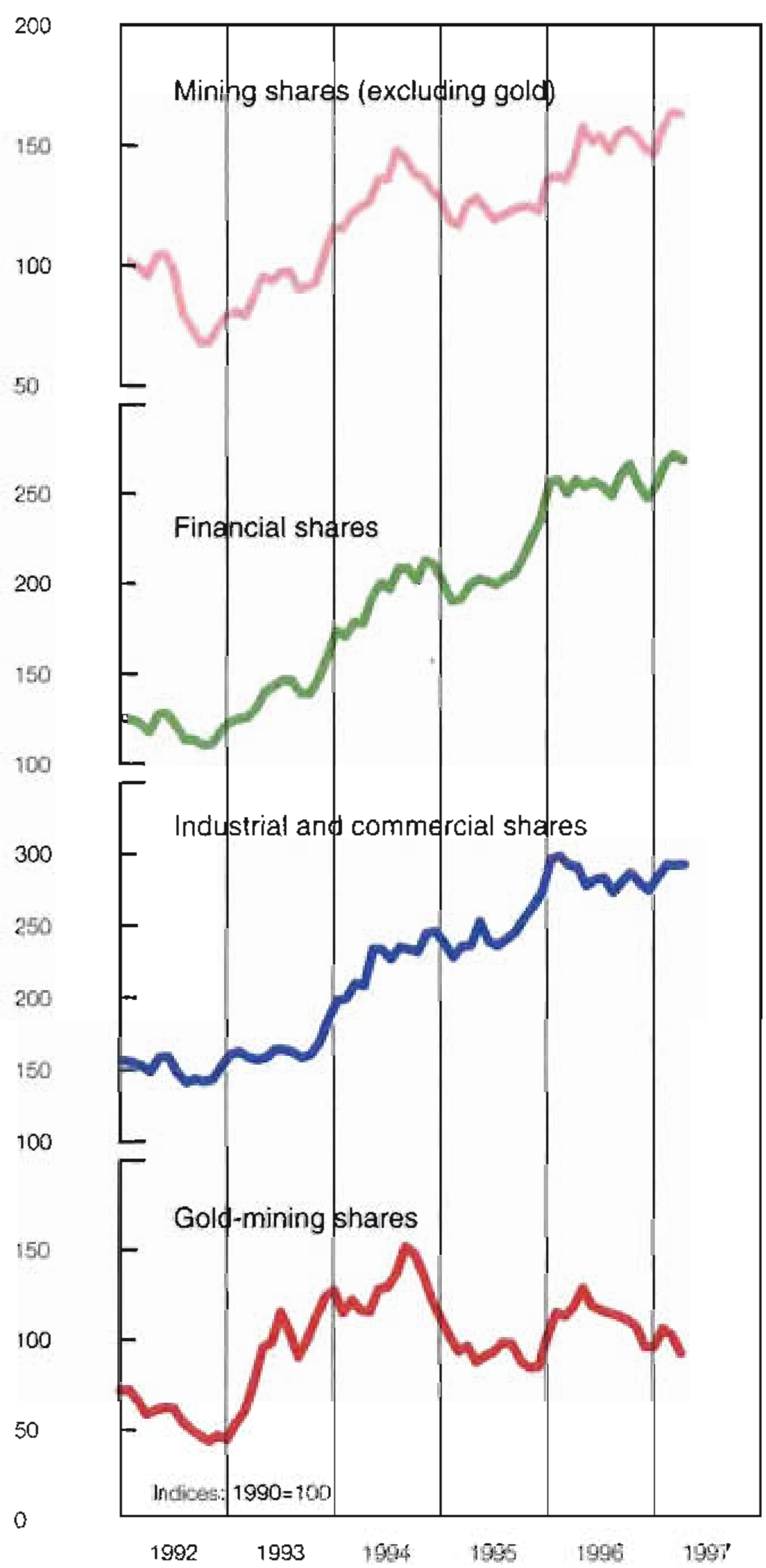
1997. Trading was particularly lively in February 1997 when the monthly turnover reached R17,1 billion. In April 1997 the value of shares traded increased even further to R17,4 billion, which was significantly higher than the monthly average of R13,7 billion recorded in the first quarter of 1997.

Non-residents traded actively in the secondary share market and accounted for about 33 per cent of turnover (measured as non-resident purchases and sales as a percentage of total purchases and sales of shares) on the Johannesburg Stock Exchange in 1996 and in the first four months of 1997. Buying interest of non-residents behaved as if it had been kindled by the strength of the rand which was the principal force behind an increase of 13,2 per cent in the dollar value of the monthly average price level of all classes of shares between December 1996 and April 1997. Non-residents' trading activity was reversed from net sales of shares totalling R0,5 billion in the fourth quarter of 1996 to net purchases of R3,5 billion in the first quarter of 1997. In April 1997 net purchases of shares by non-residents increased to R2,8 billion, taking total net

Share price indices of all classes of shares



Share prices



purchases in the first four months of the year to R6,3 billion. By comparison, net purchases of shares by non-residents amounted to R5,3 billion in the entire calendar year 1996.

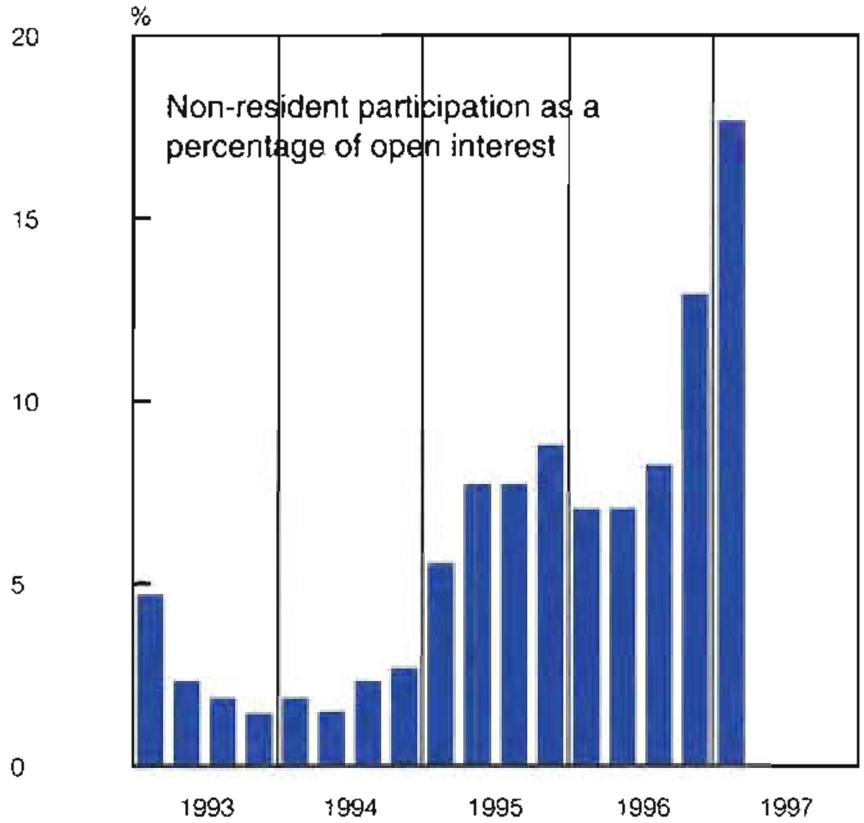
The *monthly average price level of all classes of shares* increased by 8,5 per cent from December 1996 to a new all-time high in March 1997. Share prices in the categories financial, industrial and commercial and non-gold-mining, in particular, rose firmly in the first quarter of 1997. This firming of share prices followed a period of relative weakness during which share prices initially rose by 1,3 per cent from February to October 1996 and then declined by 6,3 per cent from October to December. The monthly average price of *gold-mining shares*, which had fallen by 25,4 per cent from May 1996 to January 1997, rose by 10,8 per cent from January 1997 to February, but then shed these gains in March and April. The recent decline in gold-mining shares contributed to a decline in the monthly average price level of all classes of shares of 1,1 per cent in April 1997. The downward correction of share prices on Wall Street in the second half of March 1997 and in April probably also played a part in the decline of share prices on the Johannesburg Stock Exchange in April.

The monthly average *dividend yield* on all classes of shares increased steadily from 2,08 per cent in January 1996 to 2,46 per cent in January 1997, but then drifted downwards to 2,40 per cent in March when share prices strengthened. In April 1997, the dividend yield increased fractionally to 2,41 per cent. The monthly average *earnings yield* (excluding gold-mining shares) increased likewise from 5,50 per cent in January 1996 to 7,01 per cent in December, before falling back to 6,62 per cent in March 1997 and 6,66 per cent in April. The *yield differential* (the monthly average yield on long-term government stock less the dividend yield on all classes of shares) narrowed from 13,7 percentage points in December 1996 to 12,8 percentage points in April 1997 because the long-term yield on government bonds declined and the dividend yield remained essentially unchanged. The *price-earnings ratio* (excluding gold-mining shares) fell from 18,2 in January 1996 to 14,3 in December, but then rose to 15,0 in April 1997 as share prices strengthened more than earnings.

Other financial markets

Activity in the *formal derivatives market*, like that in the underlying share and bond markets was extremely brisk in the first quarter of 1997. Compared with the fourth quarter of 1996, the number of *options* on futures contracts traded increased by 92,8 per cent to 2,1 million contracts in the first quarter of 1997. The number of *futures* contracts traded increased, in turn, by 23,6 per cent to 1,3 million contracts during the first quarter of 1997. The increasing internationalisation of the South African capital market, and more specifically that of the derivatives market, is evident from *non-resident* participation as a percentage of *open interest* which increased from an average of 7,4 per cent in the first three quarters of 1996 to 12,9 per cent in the fourth quarter and even further to 17,7 per cent in the first quarter of 1997.

Non-resident participation in the derivatives market

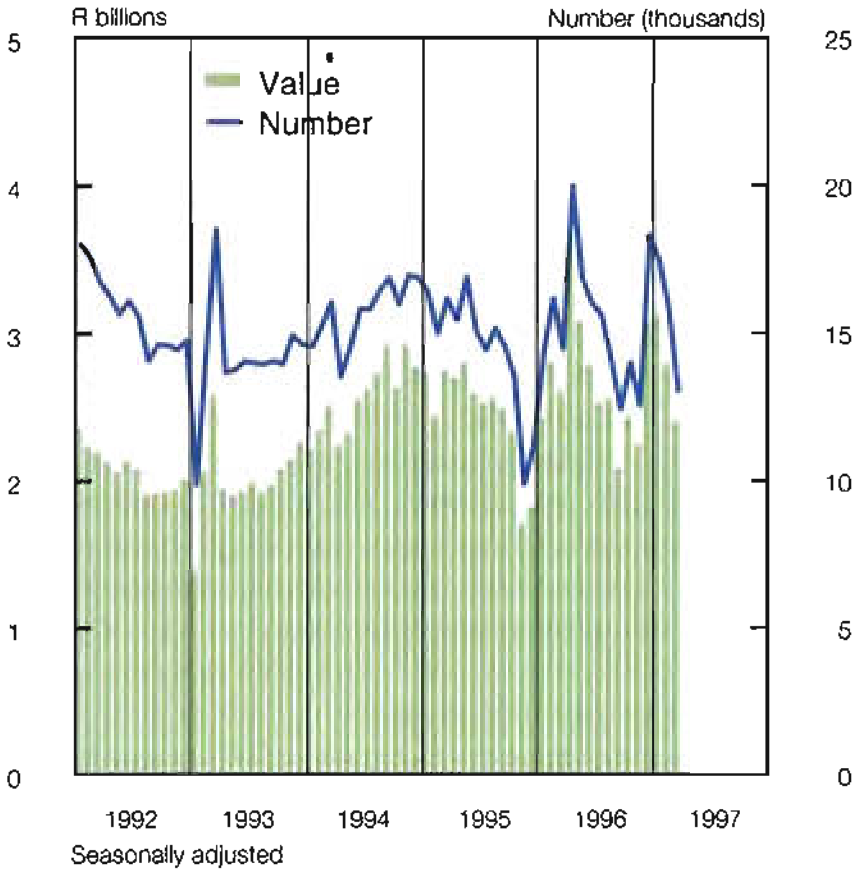


The Chicago Mercantile Exchange and the South African Futures Exchange both introduced *rand-dollar futures* contracts on 7 May 1997 as a further step in the gradual integration of South Africa into the world financial and foreign exchange markets. However, trading in rand-dollar futures on the South African Futures Exchange has been restricted to non-resident clients of members of the exchange and authorised foreign exchange dealers. Residents will, however, be able to hedge foreign exchange exposure in the rand-dollar forward market through authorised dealers, who will then be able to offset their risk in the forward cover market or through the futures market.

The need to manage price uncertainty in a deregulated market, arising from the termination of the marketing arrangements of the Maize Board on 30 April 1997, led to a sharp increase in the volume of *maize futures* traded as from the fourth quarter of 1996. This is also indicative of a greater acceptance and understanding of this market.

The *real estate market* became more buoyant as from the fourth quarter of 1996. The quarterly value of real estate transactions increased from R7,2 billion in the third quarter to R7,7 billion in the fourth quarter of 1996 and R8,3 billion in the first quarter of 1997. The value of real estate transactions in 1996 amounted to R32,3 billion, which was 9,5 per cent higher than in 1995. The number of transactions increased by 6,5 per cent over the same period.

Real-estate transactions



Financing in the *mortgage market* levelled off as from the fourth quarter of 1996. The rate of increase over twelve months in mortgage advances receded from an average of 17,4 per cent in the first three quarters of 1996 to an average of 17,2 per cent in the fourth quarter and 16,5 per cent in the first quarter of 1997. The total amount of mortgage loans outstanding to banks, however, still increased from R152,4 billion at the end of December 1996 to R157,6 billion in March 1997.

Public finance

Public-sector borrowing requirement

The *public-sector borrowing requirement* (i.e. the deficit before borrowing and debt repayment of the consolidated central government, provincial governments, local authorities and the non-financial public enterprises and public corporations) amounted to R32,6 billion in fiscal 1996/97; i.e. R2,4 billion more than the borrowing requirement in the preceding fiscal year. As a percentage of gross domestic product, the public-sector borrowing requirement declined from 6,1 per cent in fiscal 1995/96 to 5,9 per cent in fiscal 1996/97, in line with the government's stated objective of reducing the deficit on the Main Budget as a percentage of gross domestic product to a sustainable level before the year 2000.

The main reason for the increase in the rand value of the total public-sector borrowing requirement was the widening in the shortfall on the revenue and expenditure account of the consolidated central government from R28,8 billion in fiscal 1995/96 to R31,2 billion in 1996/97. A deficit of R1,3 billion was recorded by the provincial governments, which signalled a deterioration in their financial position from a small surplus of R24 million in fiscal 1995/96. The financial balance of non-financial public enterprises and public corporations was reversed from a deficit of R0,9 billion in fiscal 1995/96 to a surplus of R0,7 billion in fiscal 1996/97.

Exchequer account for 1996/97

Exchequer issues to government departments in fiscal 1996/97, which totalled R177,2 billion, were R3,5 billion higher than the original budgetary provision of R173,7 billion. This over-spending was mainly a consequence of higher-than-budgeted expenditure on debt servicing and substantial increases in expenditure on policing and transfers to provinces. The rate of increase in government spending accordingly amounted to 13,5 per cent in fiscal 1996/97, as opposed to an increase of 10,4 per cent envisaged in the Budget presented to Parliament in March 1996. The growth in Exchequer issues during the past fiscal year was nevertheless lower than the average growth in government spending of 14,5 per cent per year over the preceding five fiscal years. As a percentage of gross domestic product, government expenditure, nevertheless, rose further from the 31,3 per cent recorded in 1995/96 to 31,8 per cent in 1996/97.

Government receipts (excluding extraordinary revenue to an amount of R1,6 billion derived from the sale of strategic oil reserves) increased to R146,1 billion, or by 16,0 per cent in fiscal 1996/97, an increase which was considerably higher than the rate of increase of 13,6 per cent indicated in the initial budget proposals and also well above the rate of increase of 12,2 per cent recorded in the previous fiscal year.

The higher-than-budgeted rate of increase in government receipts in fiscal 1996/97 was mainly the result of higher-than-budgeted receipts from income tax, which increased by 20,7 per cent, and customs duties, which increased by 22,1 per cent. Receipts from value-added tax and excise duties, in contrast, fell short of the budgetary projections. This could possibly be explained by the slowdown in the growth of private consumption expenditure. Improved tax administration and relatively high nominal income growth contributed to the increase in income tax and customs duties in fiscal 1996/97. As a ratio of gross domestic product, government receipts amounted to 26,3 per cent in fiscal 1996/97. This is higher than the ratio of 25,3 per cent recorded in fiscal 1995/96 and also more than the government's stated objective of 25 per cent of gross domestic product.

The higher-than-expected expenditure and receipts for fiscal 1996/97 resulted in a *deficit before borrowing and debt repayment* of R31,1 billion, which was slightly more than the budgeted deficit of R30,7 billion. As a percentage of gross domestic product, the deficit was estimated at 5,6 per cent in fiscal 1996/97, compared with the initial budgetary indication of 5,5 per cent and the ratio of 6,1 per cent recorded in the preceding fiscal year. The generally declining ratio of the fiscal deficit to gross domestic product is consistent with the objectives of the government's Growth, Employment and Redistribution strategy, which calls for a reduction in the overall budget deficit to 3 per cent of the gross domestic product in fiscal 1999/2000.

The deficit on the revenue and expenditure account of the national government in 1996/97 was financed mainly by means of government stock issues and, to a lesser extent, by a reduction in cash balances, the issuing of Treasury bills, the sale of strategic oil reserves and foreign loans. New funds obtained by issuing government stock amounted to R21,2 billion, whereas Treasury bills to an amount of R5,6 billion were issued. The government also accessed the international primary bond market by means of two foreign bond issues: one in the Eurobond market amounting to DM500 million (R1,5 billion) and with a maturity of seven years, and the other in the United States market to an amount of $300 million (R1,4 billion) with a maturity of ten years. Part of these proceeds was used to redeem foreign debt of the government which fell due in the fiscal year.

The borrowing activity of the government, together with the substantial discount at which new stock was issued, resulted in an increase in government debt from R278,9 billion at the end of March 1996 to R310,0 billion at the end of March 1997. Slightly faster growth in the nominal gross domestic product, mainly on account of increases in the general price level, led to a marginal decline in the ratio of government debt to gross domestic product from 56,0 per cent at the end of March 1996 to 55,7 per cent at the end of March 1997.

The Budget for fiscal 1997/98

In presenting his Budget to Parliament in March, the Minister of Finance emphasised that the fiscal year 1997/98 would be one of consolidation and that the government's financial policy would be guided by the need for accelerated social service delivery, the promotion of economic growth and job creation, and the containment of inflation. The Minister reiterated the objectives of the government's macroeconomic strategy and described it as a reform programme directed towards:

- creating a competitive, fast-growing economy which will ensure sufficient jobs for all job seekers;
- redistributing income and opportunities in favour of the poor;
- establishing a society capable of ensuring that sound health, education and other services are available to all; and
- creating an environment in which safety and security prevail and places of work are conducive to productivity.

Table 14. Government receipts by type of income in fiscal 1996/97

Percentage increase

Revenue category	Budgeted	Actual
Customs and excise	9,7	11,5
Customs duty	15,4	22,1
Excise duty	5,2	3,5
Other	9,5	10,8
Inland revenue	14,2	16,7
Income tax	17,5	20,7
Value-added tax	13,3	9,6
Other	-12,8	10,9
Total receipts	**13,6**	**16,0**

Table 15. Financing the government deficit in fiscal 1996/97

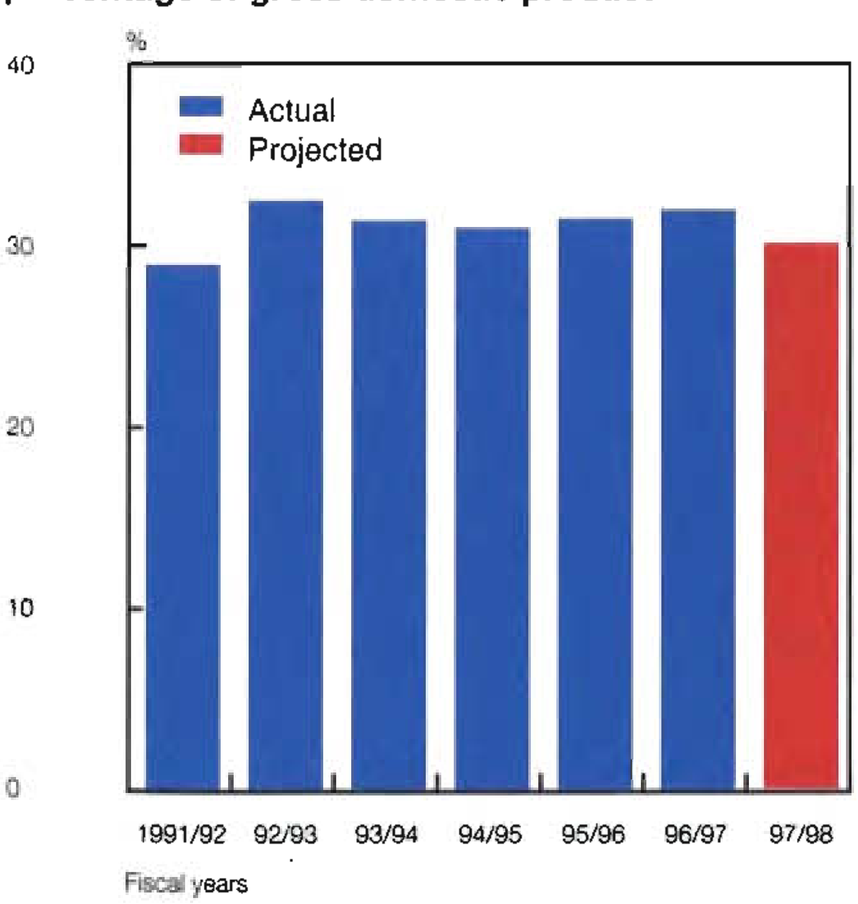
	R millions
Government stock (including discount)	27 360
Less: Discount on government stock	-6 169
Net receipts from government stock	**21 191**
Treasury bills	5 567
Extraordinary receipts	1 603
Foreign loans	1 277
Non-marketable securities	-216
Money market instruments	-3 827
TBVC debt	-294
Decrease in available cash balances	5 836
Total net financing	**31 140**

The Budget was in line with the commitments made by the government when the macroeconomic strategy was presented to Parliament in June 1996.

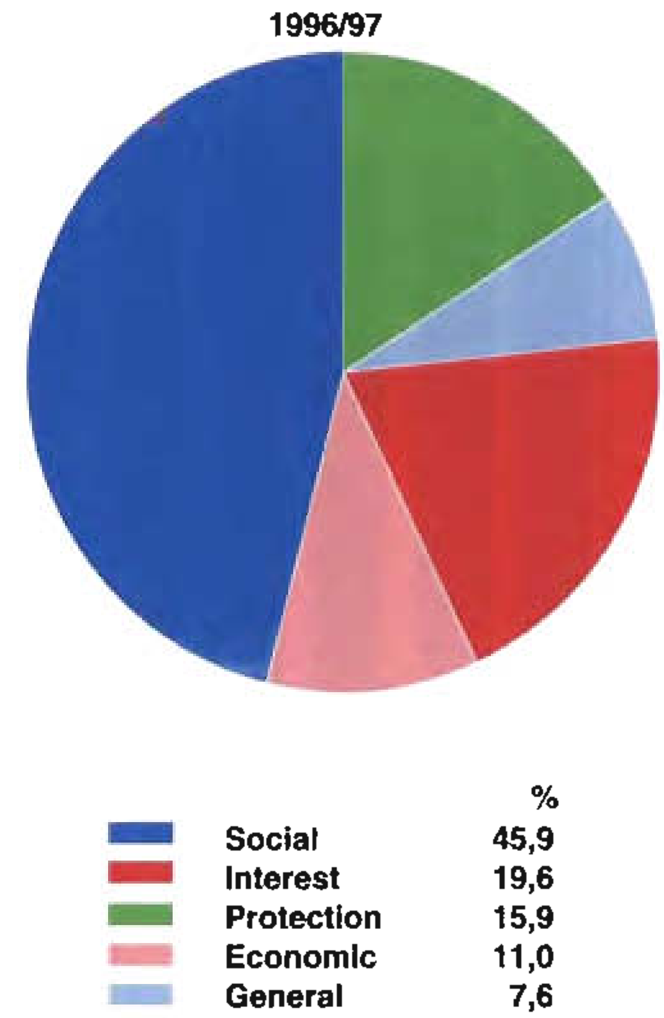
It was estimated that total *government expenditure* would increase by 6,1 per cent to R186,7 billion in fiscal 1997/98. As a percentage of gross domestic product, total government expenditure was expected to decrease from 31,8 per cent in fiscal 1996/97 to 30,0 per cent in fiscal 1997/98. Interest to be paid on government debt was estimated at R38,5 billion in fiscal 1997/98, leaving an amount of R148,2 billion for non-interest recurrent and capital expenditure. This amount was only 5,3 per cent more than the revised estimate for such expenditure in 1996/97. Capital expenditure in fiscal 1997/98 was estimated at R13,2 billion, which in nominal terms was lower than the revised amount of capital expenditure of R14,6 billion in fiscal 1996/97. According to a functional classification of government expenditure, the proportion of total spending allocated to the provision of social services and debt servicing was expected to increase in fiscal 1997/98 at the expense of the respective shares of protection, economic and general administration services.

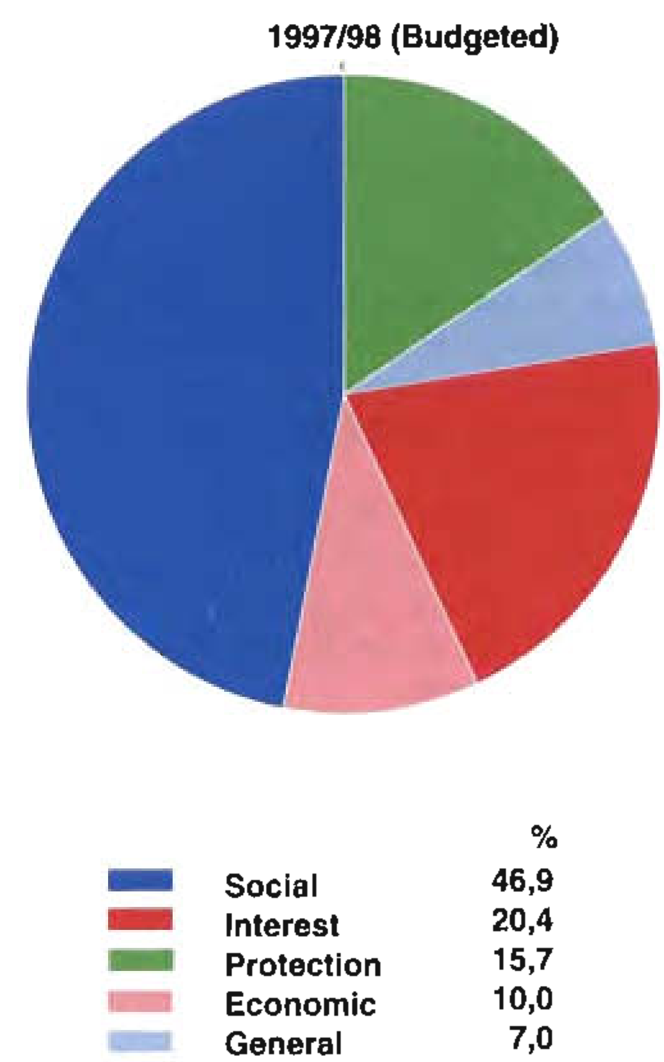
Total revenue was projected to increase by 11,2 per cent to R162,0 billion in fiscal 1997/98, equivalent to 26,0 per cent of gross domestic product. Although the ratio of government revenue to gross domestic product was expected to decline fractionally from 26,3 per cent in fiscal 1996/97, it would still be notably higher than the government's stated objective of 25 per cent. The government anticipated that an improvement in the

Exchequer issues to government departments as percentage of gross domestic product

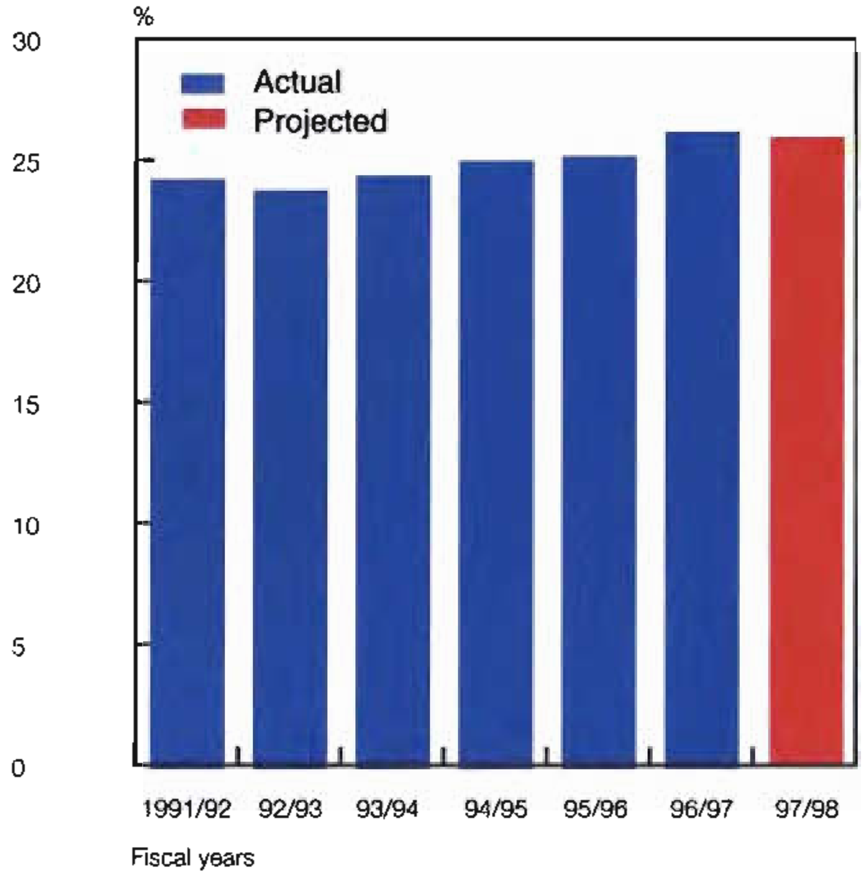


Functional classification of government expenditure as percentage of total government expenditure

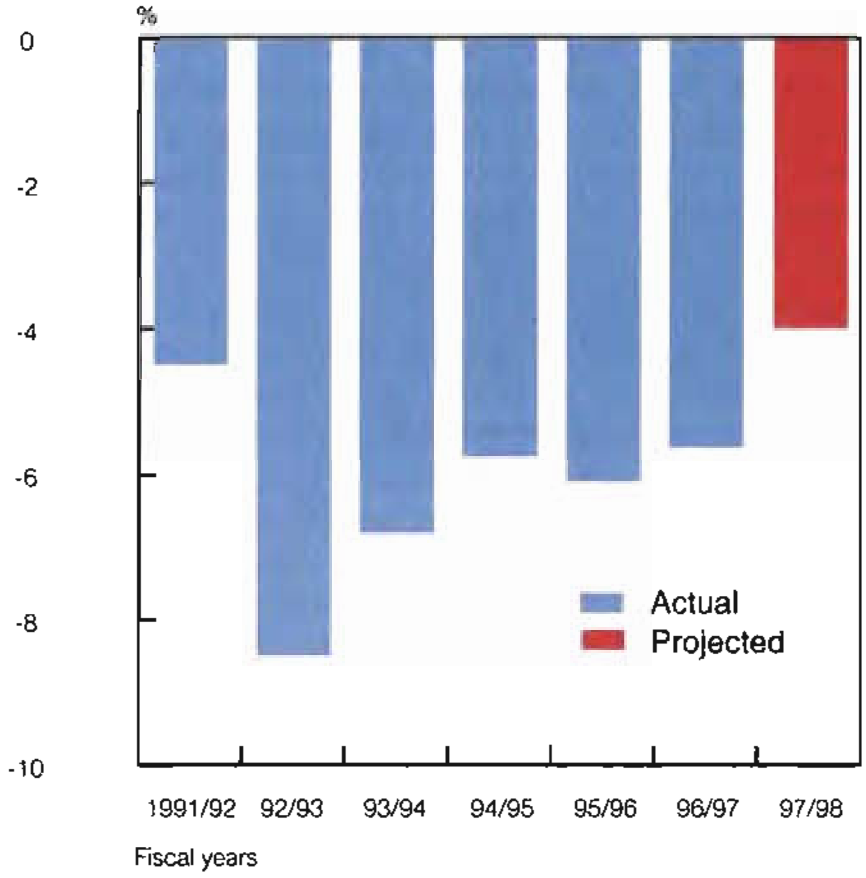




Exchequer receipts as percentage of gross domestic product



Deficit before borrowing as percentage of gross domestic product



efficiency of tax administration and the collection of outstanding taxes was likely to contribute to the increase in government revenue. Furthermore, specific tax adjustments were announced to raise an additional amount of revenue of R1,6 billion. These tax proposals and other measures included the following:

- Amendments to income tax on individuals to alleviate the burden of taxation and compliance on those in lower-income categories. Among others, the marginal tax rate applicable to taxpayers with taxable incomes ranging from R40 000 to R45 000 was reduced from 41 per cent to 32 per cent, and the threshold at which an individual does not have to submit a tax return was increased from R50 000 to R60 000.
- Measures dealing with the tax treatment of company cars, travelling allowances and holiday accommodation provided by employers to employees. Steps would be taken to curb the abuse of such fringe benefits as tax avoidance instruments.
- Dividends received by retirement funds from property unit trust schemes would henceforth be subject to tax on retirement funds.
- Excise duties on tobacco products and alcoholic and certain other beverages were increased.
- The rate of marketable securities tax was lowered and the remaining levy on financial services would be abolished.

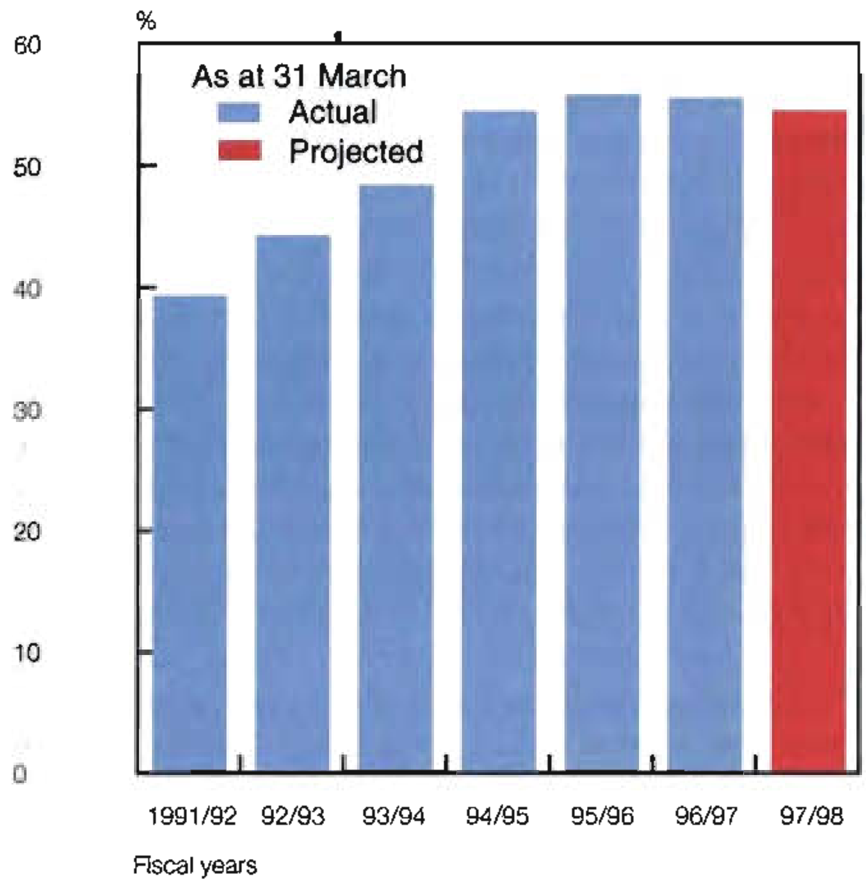
The net result of the budgeted expenditure of R186,7 billion and the estimated revenue of R162,0 billion (excluding extraordinary revenue of R3,1 billion) was a deficit *before borrowing and debt repayment* of R24,8 billion, or 4 per cent of the estimated gross domestic product. This should be compared with a much larger deficit of R31,1 billion or 5,6 per cent of the gross domestic product for fiscal 1996/97.

After taking the scheduled loan redemptions of R12,1 billion into consideration, the gross financing requirement for fiscal 1997/98 is projected to amount to R36,9 billion. This was expected to be financed as follows:

	R billions
Government stock (excluding discount)	27,7
Short-term loans	2,0
Foreign loans	4,0
Transfer from IMF Deposit Account at SARB	1,4
Transfer from Strategic Fuel Fund	1,3
Proceeds from the sale of state assets	0,5
Total financing	**36,9**

The net addition to total government debt during fiscal 1997/98, also taking into account the added responsibility for repaying part of Namibia's public debt, is unlikely to increase the ratio of government debt to gross domestic product. It is estimated that this ratio could decline to 54,8 per cent by the end of fiscal

Total government debt as percentage of gross domestic product



1997/98 from its level of 55,7 per cent at the end of 1996/97.

Exchequer account in April 1997

In April 1997 Exchequer issues to government departments (adjusted to reflect cash flows) were 9,5 per cent higher than in April 1996. This year-on-year increase was higher than the rate of 6,1 per cent anticipated in the Budget for fiscal 1997/98 as a whole. Exchequer receipts (excluding extraordinary receipts), on the other hand, increased at a year-on-year rate of 3,2 per cent, a rate which is substantially lower than the 11,2 per cent envisaged in the Budget. The net result of the lower-than-budgeted receipts and higher-than-budgeted expenditure was a deficit on the Exchequer account before borrowing and debt repayment of R6,2 billion, or 25,1 per cent of the budgeted deficit for the fiscal year 1997/98 as a whole. In April 1996 the deficit was equivalent to 17,8 per cent of the eventual deficit for fiscal 1996/97 as a whole.