Quarterly economic review

Introduction

Economic events in South Africa during 1996 were dominated by the abrupt decline in the external value of the rand in February, which then developed into an almost continuous process of depreciation lasting until October. The effect of the weakening rand had its ramifications throughout the economy. While the depreciation continued, it created uncertainty, increased the risk premium associated with investment in South Africa, deterred potential foreign investment, raised the user cost of capital in the domestic economy and fuelled expectations of rising inflation.

When the rand's stability was ultimately restored in the foreign exchange market towards the end of the year, some of the more positive results of the process of currency depreciation became clearer. Especially the robust growth in merchandise export volumes, which is a prominent element of the government's growth and development strategy, raised prospects for growth and job creation in the domestic economy. Of course, the competitive gains made during 1996 still need to be consolidated by preventing secondary rounds of wage and price increases. If not, the benefits of the depreciation will be short-lived and the economy will be left in its structurally weak state, but with a considerably higher overall level of prices.

Aggregate output seemingly responded positively to the weakening of the rand and growth accelerated in the fourth quarter of 1996. Real value added in the non-agricultural sectors regained some of the momentum it had lost in the first three quarters of 1996. Of particular significance was the turn-around of production in the manufacturing sector; whereas manufacturing production shrank in the third quarter of 1996, it recovered quite strongly in the fourth quarter. The recovery in output levels in some of the non-agricultural sectors of the economy in the final quarter of 1996, together with a large increase in agricultural production, especially of field crops, resulted in an economic growth rate of 3 per cent in 1996 – moderately lower than the growth rate experienced in 1995.

Owing to the relatively strong growth in real domestic production and despite a sharp rise in the real value of net factor payments to the rest of the world, the real gross national product of South Africa increased by 3½ per cent in 1996. When population growth is taken into consideration, the real gross national product *per capita* rose by 1½ per cent in 1996. This was the third year in succession in which real national income *per capita* increased and the result is that the "average South African" was 4½ per cent better off in 1996 than in 1993.

Although part of the rise in real domestic production was related to a high level of domestic final demand, the major force behind non-agricultural output growth in 1996 came from the strong increase in the volume of exports. This was especially the case in the second half of the year. The strong build-up in fixed investment spending appeared to have lost momentum in the second half of last year. Similarly, the growth in private consumption expenditure also tended to decelerate in the last three quarters of 1996. Consumers have ostensibly become aware of the risks involved in their high debt-to-income ratios and began to hold back on spending growth. Government consumption expenditure, however, accelerated, thereby preventing a faster reversal in the high levels of dissaving by the general government. The country's overall saving ratio in 1996 was consequently still too low to adequately finance domestic investment demands.

The high level of economic activity was accompanied by an absolute decline in aggregate employment since the third quarter of 1995, largely because of determined efforts among private-sector producers to reduce costs and raise efficiency. The rate of increase in nominal wages and salaries per worker nevertheless remained downwardly inflexible. In fact, nominal and real wage growth began to accelerate in the second half of 1995 and rose at relatively high rates in the first three quarters of 1996. Although the inflationary impact of the rise in labour costs was partially countered by the strength of labour productivity, the increase in real remuneration per worker in an environment of rising unemployment was not in keeping with what could reasonably be expected under such circumstances.

The quickening of the growth in unit labour costs, along with the weaker rand and rising food prices, made themselves felt in an accelerating rate of production and consumer price inflation during the course of 1996. These price increases were accommodated by a strong expansion of the monetary aggregates. Steps taken during the year to curb the excessive monetary growth had the predictable but ironic short-term effect of increasing the measured rate of consumer-price inflation through their impact on home owners' cost. However, even when the temporary perverse effects of higher mortgage interest rates, and the effects of some other special factors are excluded from the consumer price index, it remains true that the underlying inflation rate accelerated in the second half of 1996. Domestic inflation, as measured by the increase in the production price index, was also higher than imported inflation, as measured by the rise in the prices of imported goods, despite the steep decline in the value of the rand. The build-up in real wage growth, the apparent long response lag in the prices of imported goods to the weakening in the value of the rand and the rise in underlying inflation, seem to indicate that latent inflationary forces are still present in the economy.

As could be expected with a decline in the overall level of aggregate domestic expenditure, the growth in the volume and value of imports showed signs of abating in the second half of 1996. Coupled with strong rises in the value of net gold exports and merchandise exports and a slowdown in net service payments to the rest of the world, the deficit on the current account of the balance of payments began to shrink in the second half of the year. At the same time, the net outflow of capital in the third quarter of the year changed in the fourth quarter to a net inflow of capital, although essentially in the form of financing facilities with a short maturity.

The inflow of capital in the fourth quarter of 1996 was larger than the deficit on the current account of the balance of payments and as a consequence the total gold and other foreign reserves of the country rose quite sharply. This contributed to a more positive sentiment in the financial markets and greater stability in the market for foreign exchange. The nominal exchange rate of the rand became more stable and strengthened moderately in the last two months of 1996, but then rose strongly in January 1997. At the end of 1996 the real effective exchange rate of the rand was about 16 per cent lower than at the end of 1995.

The continuation of relatively strong real income growth during 1996 and the accompanying high level of aggregate domestic demand for goods and services gave rise to rapid growth in the transactions need for money. The transactions demand for money was strengthened by a rise in the public's demand for more liquid monetary assets. This rise in the public's liquidity preference was probably motivated by the relatively attractive yields on deposit-type investments and by the many speculative opportunities presented by movements of financial asset prices during 1996. Firm growth in the broadly defined money supply and even stronger increases in the narrower monetary aggregates during 1996 were coincident with these portfolio preferences of the public.

During the second half of 1996 the growth rate in the broadly defined money supply slowed down, at first somewhat modestly in the third quarter, but then more evidently in the fourth quarter. Although this was a welcome development and a signal of a positive response to earlier policy steps which had been taken to curb excessive monetary expansion, the level of the M3 money supply in the fourth quarter of 1996 was still higher than the upper limit of acceptable money supply which had been indicated by the 1996 money growth guideline range. This indicates that the threat of inflation and expectations of rising inflation were still prevalent and that continuation with a conservative monetary policy posture is justified.

Credit extension advanced rapidly during 1996, albeit at a decelerating rate in the second half of the year. Moreover, the composition of the assets of the monetary institutions indicates that credit was a prominent source of funding for the growth in private consumption expenditure. This, of course, had serious implications for the already uncertain financial situation of the private household sector. High levels of household debt and the future servicing of such debt do not augur well for the national savings ratio, and thus for the output and employment-generating capacity of the economy in the long run. The rise in overall domestic credit extension was also the principal statistical counterpart of the rapid expansion of the monetary aggregates; the impact of credit growth was only partially undone by a decline in the net foreign assets of monetary institutions during 1996.

In the financial markets, the public sector's mobilisation of funds in the primary capital markets fell back from levels that prevailed in the previous fiscal year. This development was the result of substantial government stock redemptions, the run down of cash balances by the national government and extraordinary receipts in the current fiscal year. This may point to some alleviation of the crowding out of private-sector investment activity by the borrowing activities of public-sector organisations. Private-sector companies accordingly raised considerably more capital through rights issues of fixed-interest securities and equity issues in 1996 than in 1995.

The government raised more funds in the international primary bond market in 1996 than in 1995. Apart from the positive impact these borrowings had on pressures in the domestic capital market and on the country's level of gold and foreign reserves, it also established a benchmark for the pricing of future offshore borrowing by private-sector and parastatal entities.

Activity in the secondary bond and equity market was lively and turnovers in both markets increased substantially in 1996 compared with 1995. Non-resident participation in the domestic market was also boosted by the introduction of an electronic screen-trading system in the equities market and by the admission to membership of the Johannesburg Stock Exchange of foreign-owned banking institutions and broking firms. Nevertheless, price movements in both the secondary bond and equity markets were without clear upward or downward direction as from May 1996 until the year-end. Prices in both these markets rallied in the first six weeks of 1997.

Money market conditions remained relatively tight for the major part of 1996. The Reserve Bank occasionally injected liquidity into the market to relieve extremely tight conditions, but generally allowed the money market shortage to reflect the unbalanced position created by the excessive expansion of credit by monetary institutions against the background of a large decline in their net foreign assets. Since May 1996 the yields on short-term and long-term securities have moved broadly in tandem, leaving the general shape of the yield curve intact. In January 1997, the yield curve declined over the entire maturity spectrum and became somewhat more inverted in the less-than-three-year maturity spectrum, whilst maintaining its flat shape in the area beyond three years. This could be interpreted as an indication of expectations of imminent declines in short-term money market rates, whilst reflecting continued scepticism about the longer-term prospects for durably lower inflation.

The public-sector borrowing requirement, i.e. the deficit before borrowing and debt repayment of the national government and all other tiers of the public sector, declined as a percentage of gross domestic product in the first nine months of 1996/97 compared with the corresponding period in the previous fiscal year. This improvement in public finances occurred primarily at the level of the Central Government. The information for the first ten months of fiscal 1996/97 indicates that the government is likely to achieve success in its stated objective of reducing the Exchequer deficit relative to gross domestic product. Of some concern is that Exchequer issues were increasing well above the rate which had been foreseen in the Budget for 1996/97. Fortunately, the growth in Exchequer revenue exceeded the growth projected in the Budget by an almost similar margin. The stock redemptions during the fourth quarter of 1996 contributed to a small decline in the ratio of total government debt to gross domestic product from March to December 1996.

Domestic economic developments

Domestic output

The seasonally adjusted and annualised rate of change in *real gross domestic product* accelerated from 3 per cent in the third quarter of 1996 to 3½ per cent in the fourth quarter. The fourth-quarter growth was broadly on par with the growth rates recorded in the first two quarters of 1996 and took the year-to-year growth in real gross domestic product to about 3 per cent in calendar 1996, compared with 3½ per cent in 1995. Although the year-to-year growth rate declined somewhat in 1996, it was still significantly higher than the average growth of 1 per cent per year measured over the period since 1985.

Aggregate output growth in 1996 was boosted by a reversal in the fortunes of the agricultural sector. Total farm income was seriously hampered in 1995 by poor climatic conditions and the real value added by the agricultural sector declined by 15 per cent. In contrast, 1996 turned out to be an exceptionally good agricultural year with output levels of maize and wheat well above what could have been expected in an "average" year. The real value added by the agricultural sector accordingly increased by 26 per cent in 1996. Outside the agricultural

Real gross domestic product

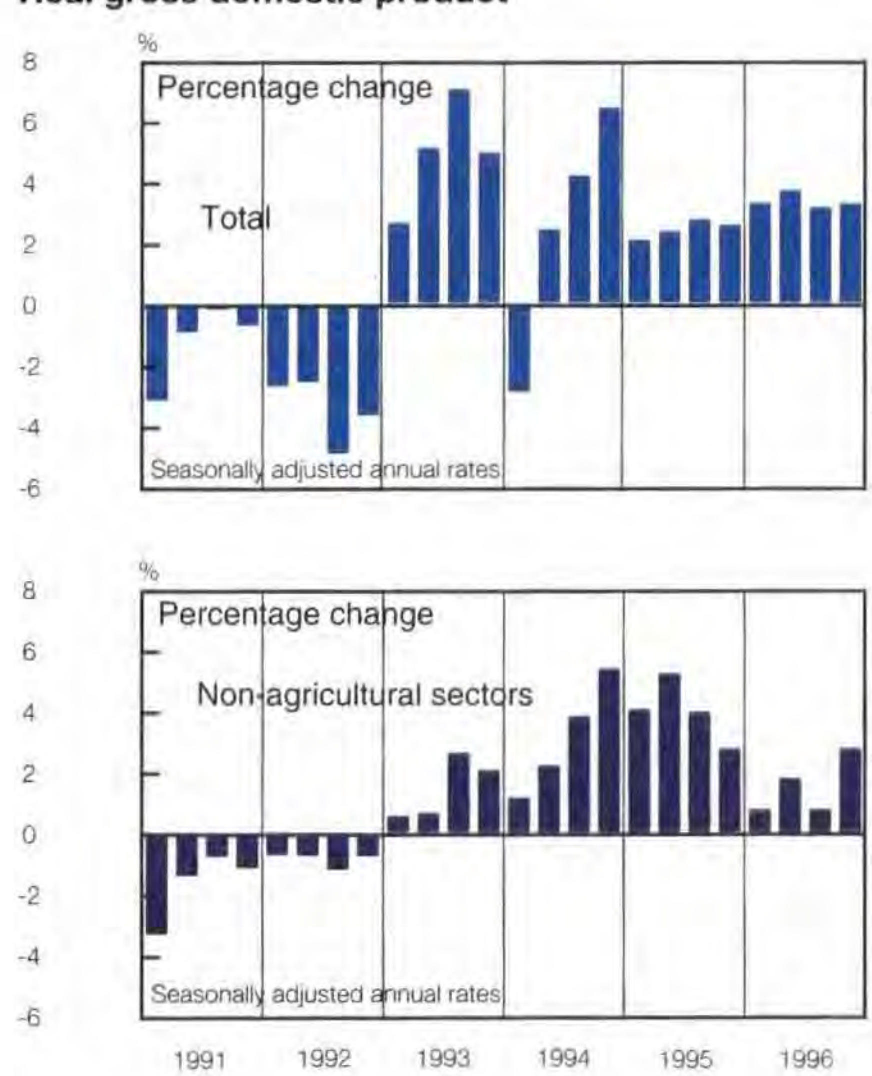


Table 1. Real gross domestic output
Percentage change at seasonally adjusted and annualised rates

Sectors	1995	1996				
	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Primary sectors	-7½	23	13	15	5½	8
Agriculture	-15	86½	53	60	12½	26
Mining	-3	-½	-5	-7½	1	-1½
Secondary sectors	6½	½	3	½	2½	1
Manufacturing	7½	-1	3	-1	2	½
Tertiary sectors	3½	1	3	2	3	3
Commerce	6½	-2½	5½	0	3	3½
Transport, storage and communication	5	1	2	3	2½	3
Financial services	3½	3½	3	4	4	3½
Total	**3½**	**3½**	**3½**	**3**	**3½**	**3**
Non-agricultural sectors	**4½**	**1**	**2**	**1**	**3**	**2**

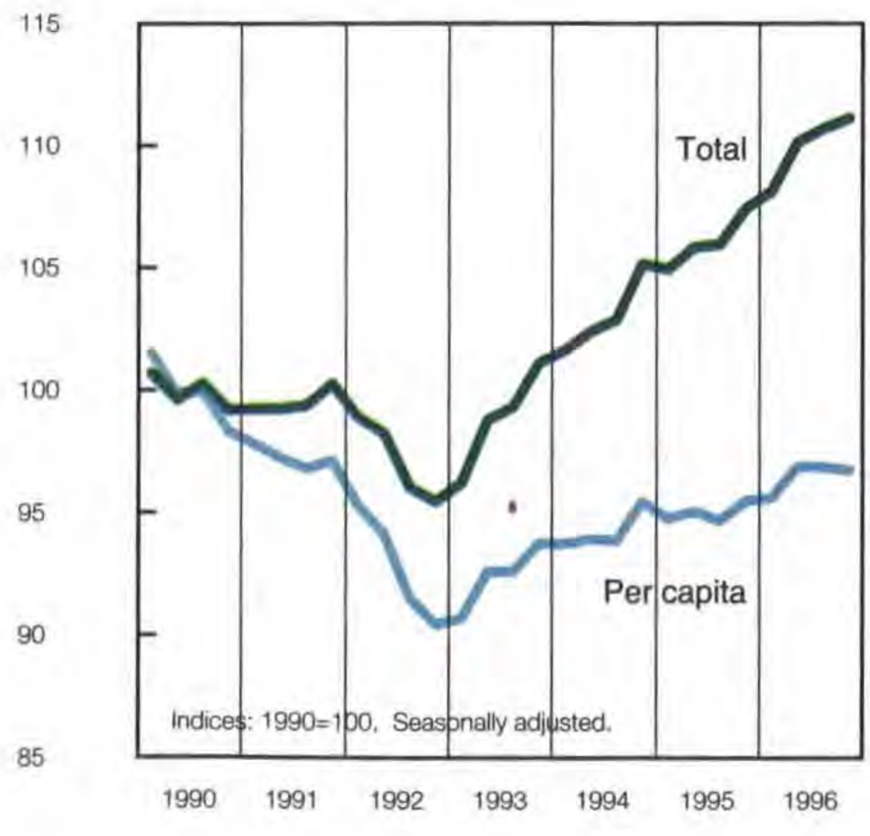
sector, the rate of growth in total real production fell back from 4½ per cent in 1995 to 2 per cent in 1996. Towards the end of 1996 the growth rate of non-agricultural output, however, accelerated noticeably from 1 per cent in the third quarter to 3 per cent in the fourth quarter.

The rate of decline in the real value added by the *mining industry* declined from 3 per cent in 1995 to 1½ per cent in 1996. In fact, the annualised change in mining production turned round from a decline of 7½ per cent in the third quarter of 1996 to an increase of 1 per cent in the fourth quarter. Gold-mining output, which had declined in 1996 to its lowest level in 40 years, recovered somewhat in the fourth quarter of last year. In contrast to the rise in gold-mining output in the fourth quarter of 1996, the real value added by the non-gold-mining sectors in that quarter showed a small decline.

The real value added by the *manufacturing sector* increased at an annualised rate of 2 per cent in the fourth quarter of 1996, after it had declined by 1 per cent in the third quarter. The output increase in the fourth quarter of 1996 was dispersed over all the main subsectors of industry and was, *inter alia*, a response to firm export demand for manufactured goods, most likely as a result of the improved price competitiveness of South African manufacturers in export markets. In 1996 as a whole the manufacturing sector succeeded in increasing its output level by ½ per cent, compared with growth of 7½ per cent in 1995.

The growth in real value added by the sector supplying *electricity, gas and water* slowed down from an average annualised rate of 6 per cent in the first three quarters of 1996 to an annualised rate of 5 per cent in the fourth quarter. For 1996 as a whole the real value added by this sector rose by 5 per cent, compared with 3½ per cent in 1995. The supply of electricity responded to the strong demand coming from energy-intensive minerals beneficiation plants, increased exports of electricity to neighbouring countries, a harsh winter and growing numbers of consumers being connected to the country-wide electricity network.

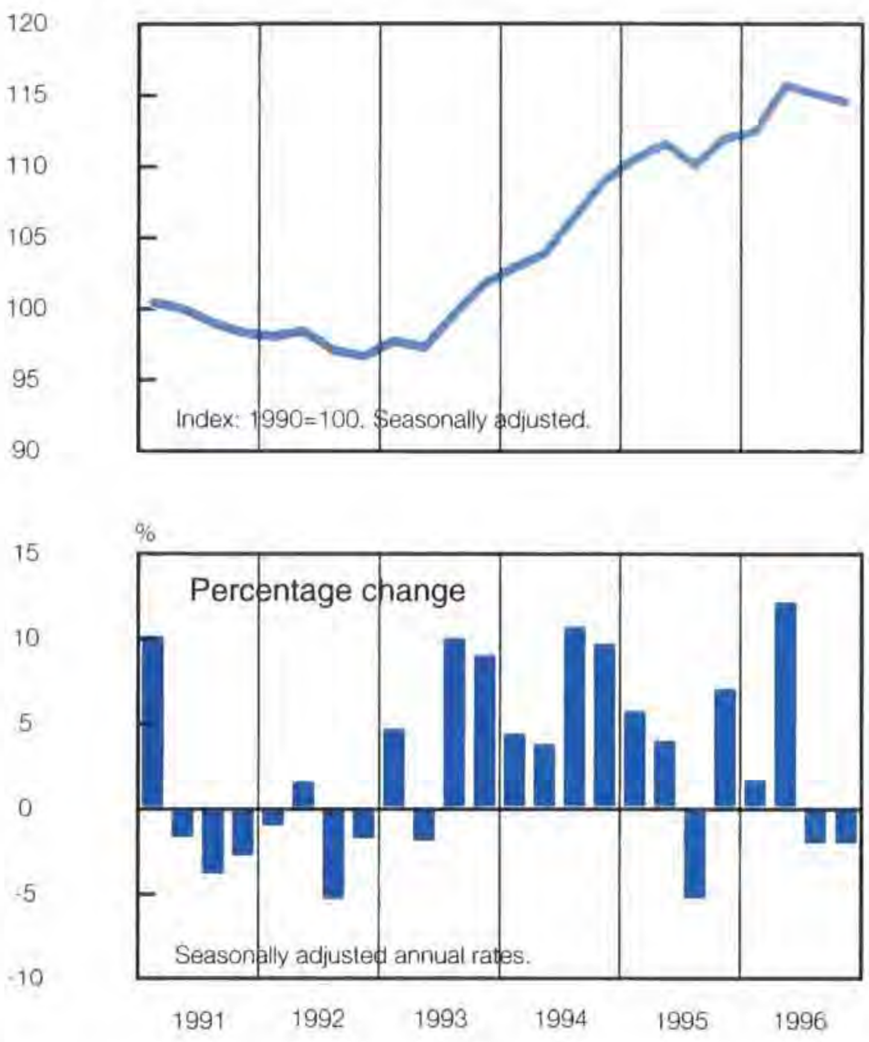
Real gross national product



All the major subsectors contributed to the relatively strong growth in the real value added by the *tertiary sectors* in 1996. Activity in the retail, wholesale and motor trade was helped by the positive sentiment among consumers, the overall high level of final demand, the rise in agricultural incomes and the large number of foreign tourists visiting the country. The positive impact of these forces was counteracted by the high and rising cost of credit, with the result that the growth in the real value added by the commercial sector slowed down from 6½ per cent in 1995 to 3½ per cent in 1996. Output growth in the *transport and communication sector* was buoyed by the high levels of final demand and the exceptionally large volumes of agricultural commodities which had to be transported. Nevertheless, output growth in the transportation and communication sector slowed down from 5 per cent in 1995 to 3 per cent in 1996. The strong increase in activity on the major financial markets brought about an increase in the real value of output of the financial services sector of 3½ per cent in 1996 – the same rate of growth as registered in 1995.

The growth in *real gross national product* was held back by a relatively sharp increase in the real value of net factor payments to non-residents, but still accelerated from 3 per cent in 1995 to 3½ per cent in 1996. When the growth in the total population is allowed for, the real gross national income *per capita* increased by 1½ per cent in 1996. This was the third consecutive rise in the real gross national income *per capita*, which means that real income *per capita* in 1996 was roughly 4½ per cent higher than in 1993. By contrast, real income *per capita* fell by about 12 per cent between 1988 and 1993.

Real gross domestic expenditure



Domestic expenditure

Real gross domestic expenditure (seasonally adjusted and annualised) increased at a very high rate of 12 per cent in the second quarter of 1996, but thereafter declined by 2 per cent in both of the last two quarters of that year. For the full calendar year 1996 the growth in real gross domestic expenditure is estimated at 3 per cent; growth of 5 per cent was recorded in 1995. Domestic fixed investment and government consumption outlays were the main contributors to the growth in domestic demand in 1996. Private consumption also increased firmly, although at a lower rate than in 1995. A substantially smaller accumulation of inventories was by and large responsible for the lower growth in real gross domestic expenditure in 1996, especially in the second half of that year.

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

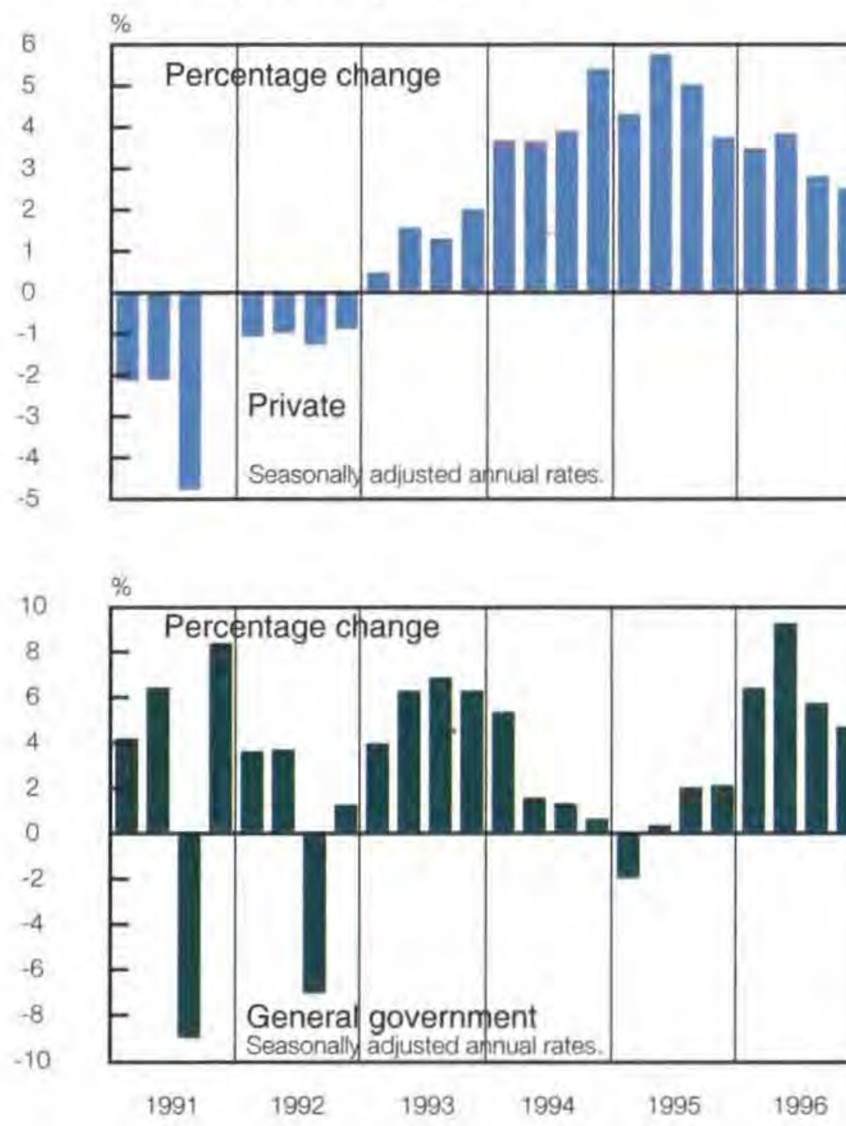
Components	1995	1996				
	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Private consumption expenditure........	4½	3½	4	3	2½	4
Government consumption expenditure	½	6½	9	5½	4½	5
Gross domestic fixed investment........	10½	8	6	4½	2½	7
Change in inventories (R billions).........	6,3	1,4	6,7	3,0	0,2	2,8
Gross domestic expenditure	**5**	**1½**	**12**	**-2**	**-2**	**3**

Real *private consumption expenditure* increased at seasonally adjusted and annualised rates of between 3 and 4 per cent during the first three quarters of 1996. The growth in real private consumption expenditure then slowed down to 2½ per cent in the fourth quarter. This slackening of the growth in real household outlays on consumption expenditure, which had generally been brisk in 1995 and in the first three quarters of 1996, was accounted for by slowdowns in consumer spending on semi-durable goods, non-durable goods and services. In contrast, a sharp rise in expenditure on motor cars caused total household spending on durable consumer goods to increase at a very high rate in the fourth quarter of 1996 (see Table 3).

The growth in real private consumption expenditure for the full calendar year 1996 is estimated at 4 per cent compared, with 4½ per cent in 1995. An increased awareness among private households of the rise in their debt-to-income ratios, the high cost of debt servicing and a rise in the portion of household incomes paid out as direct taxes were, among others, determinants of the slightly more cautious attitude of consumers in 1996. Direct taxes as a percentage of current household income rose from 14 per cent in 1995 to 14½ per cent in 1996.

The growth in *real consumption expenditure by general government* accelerated sharply in the first half of 1996, but then slowed down in the second half, albeit to a level that was still high in relation to the growth in real gross domestic product (see Table 2). For the calendar year 1996 as a whole, the growth in real consumption expenditure by the general government was estimated at 5 per cent, compared with an increase of ½ per cent in 1995. The strong growth in consumption expenditure by general government was at variance with one of the aims of government's macroeconomic strategy for growth and development, which called for a reduction in the ratio of government consumption expenditure to gross domestic product to 20 per cent in 1996 and 18 per cent in the year 2000. The ratio of government consumption expenditure to gross domestic product actually increased from 20½ per cent in 1995 to 21 per cent in 1996.

Real consumption expenditure



Estimates of *aggregate real gross domestic fixed investment* (seasonally adjusted and annualised) show progressively declining growth rates in the four quarters of 1996; growth in the fourth quarter of 1996 was down to 2½ per cent, compared with 8 per cent in the first quarter. For the full calendar year 1996 real gross fixed investment rose by 7 per cent. Although still high compared with the average annual growth in real fixed investment in the

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

Components	1995	1996				
	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Durable goods	7½	1½	11½	-1½	11½	6
Semi-durable goods	6	3	3	4	3½	3½
Non-durable goods	4	4½	3½	4	1	4
Services	4½	3	2	1	1	3
Total	**4½**	**3½**	**4**	**3**	**2½**	**4**

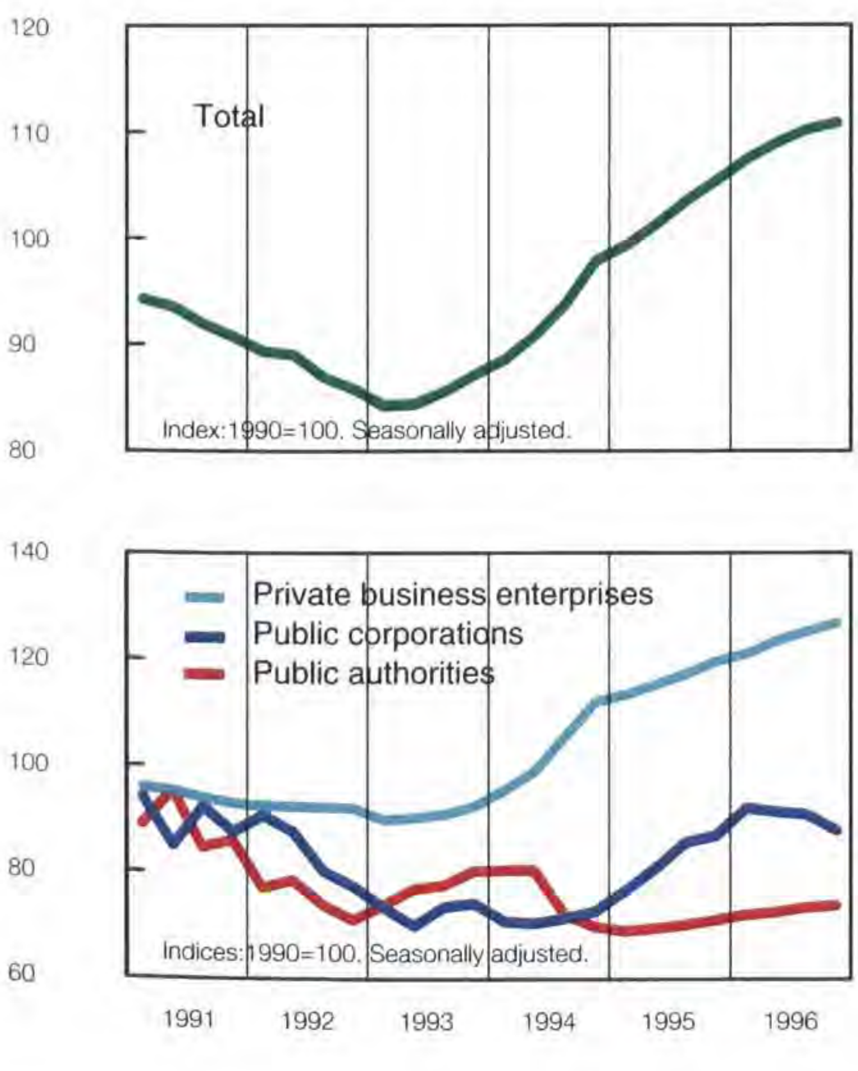
1990s, the 1996 growth rate was significantly lower than the growth of 10½ per cent estimated for 1995.

The growth in real gross fixed capital formation by the *private sector* rose firmly throughout 1996, but at a somewhat lower rate than during 1995. The year-to-year rate of growth in private-sector real fixed capital formation accordingly declined from 13 per cent in 1995 to 6½ per cent in 1996. All the major sectors of economic activity participated in the expansion of private-sector fixed investment. Firm growth rates were particularly evident in agriculture, manufacturing, commerce and the construction of private residential buildings.

Fixed investment in private manufacturing is expected to benefit from the government's Manufacturing Development Programme, which forms part of the government's package of supply-side measures in the macroeconomic strategy for growth and development. Among the more prominent elements of the programme are:

- an accelerated depreciation allowance for income tax purposes on plant and equipment and on buildings intended for manufacturing activities as from 1 July 1996, and
- a tax holiday of up to 6 years for new projects with assets in excess of R3 million.

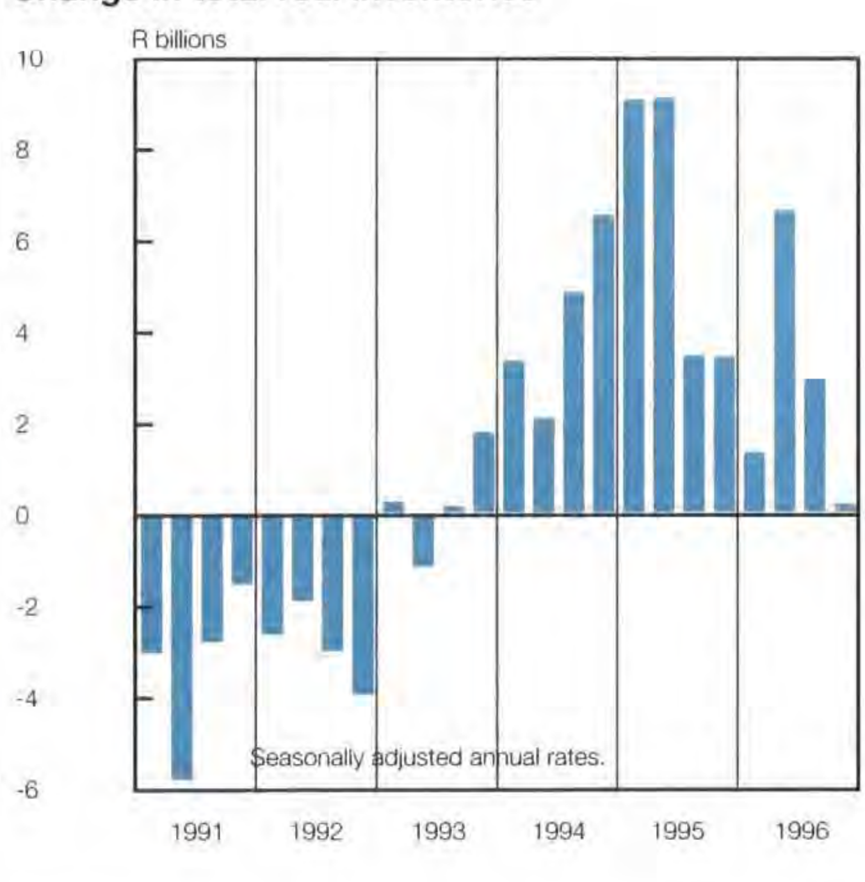
Real gross domestic fixed investment



Although the real fixed capital expenditure by *public corporations* declined in the last three quarters of 1996, the year-on-year growth rate in calendar 1996 still amounted to 10 per cent, compared with 15½ per cent in 1995. The public corporations involved in manufacturing, electricity generation, water supply and transportation slowed down their expansion programmes during 1996. Telkom persisted with a strong expansion of investment activities, but this could not fully offset the slower growth in investment activity by other public corporations. The real fixed capital outlays by *public authorities* turned around from a year-to-year decline of 7½ per cent in 1995 to an increase of 4½ per cent in 1996 on account of increased public service delivery by general government departments.

The build-up of *inventories*, that had commenced in the second half of 1993, continued into 1996, but the rate of inventory accumulation subsided noticeably in the second half of the year. The slowdown in inventory accumulation in the second half of 1996 was evident in all the major subsectors of economic activity, with the exception of agricultural marketing organisations where inventories accumulated simply because of the size of the maize and wheat crops and physical constraints on the ability to move large volumes. The slower build-up of inventories in the second half of 1996 was primarily caused by the slowdown in aggregate domestic final demand and expectations of further slowdowns. These were reinforced by the increase in the prices of imported goods and the high cost of carrying inventories during a

Change in total real inventories



period of high real interest rates. The level of industrial and commercial inventories relative to the non-agricultural gross domestic product came to 18½ per cent in the fourth quarter of 1996.

Factor income

The year-on-year growth in *aggregate nominal factor income* at market prices rose from 11 per cent in the first quarter of 1996 to 12 per cent in the third and fourth quarter. For 1996 as a whole the year-to-year rate of increase in factor income amounted to 12 per cent as against 12½ per cent in 1995. This slowdown was the outcome of slightly lower year-to-year growth in total labour remuneration, whereas the growth in aggregate gross operating surpluses accelerated somewhat.

The year-to-year rate of increase in the nominal *gross operating surplus* rose from 12½ per cent in 1995 to 15 per cent in 1996. Sharp increases in the operating surpluses of agriculture and mining, especially gold-mining, were essentially responsible for this faster growth. If the agricultural sector were to be excluded, the year-to-year growth in the gross operating surpluses of the non-agricultural sectors would have contracted from 15 per cent in 1995 to 14 per cent in 1996.

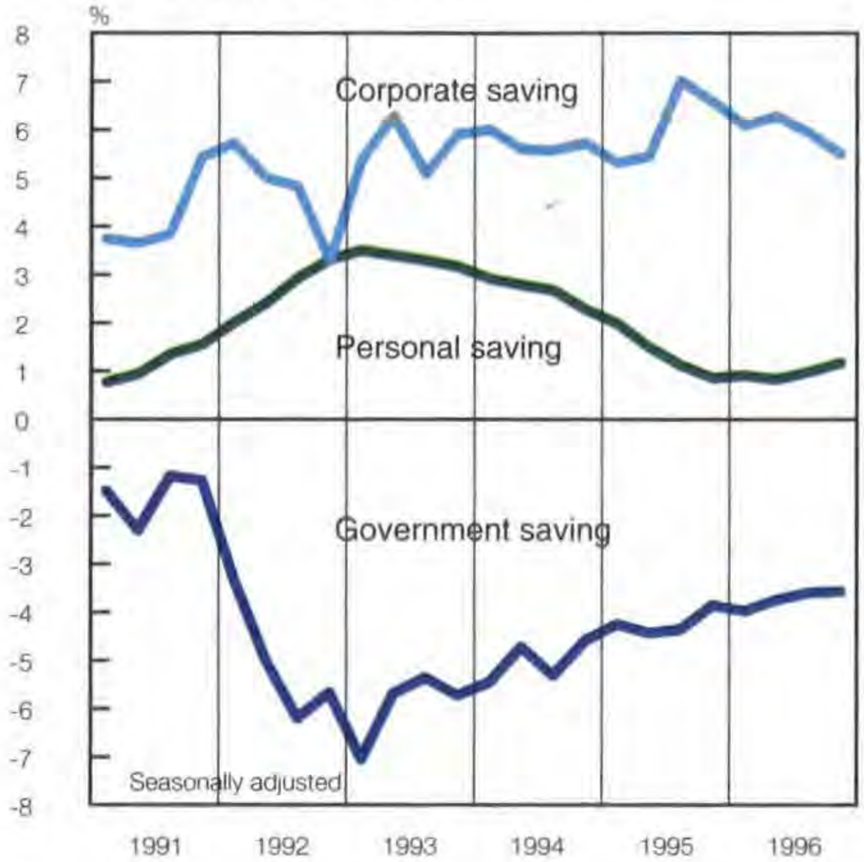
The rate of increase over four quarters in the aggregate *remuneration of employees* accelerated from 10 per cent in the first two quarters of 1996 to 10½ per cent in the two final quarters of the year. For calendar 1996, the year-to-year growth in total salaries and wages came to 10½ per cent, which was slightly lower than the 11½ per cent in 1995. The increase in 1996 was still higher than the then prevailing inflation rate, with the result that the real wage bill of the country still rose, despite a substantial increase in unemployment. As a percentage of gross domestic product, total remuneration of employees declined from 60 per cent in 1995 to 59 per cent in 1996. During the 1970s and 1980s the average of this ratio was 57½ per cent.

Domestic saving

The ratio of *gross domestic saving* to gross domestic product declined from 17 per cent in 1995 to 16½ per cent in 1996. The deterioration in the domestic savings ratio and the further rise in domestic investment meant that some 8½ per cent of total gross domestic investment had to be financed either through the running down of the gold and other foreign reserves of the country, or through a net inward movement of capital into the economy.

The net *dissaving by general government* relative to gross domestic product contracted from 4 per cent in 1995 to 3½ per cent in 1996. This reduction in government dissaving was mainly due to sharp increases in tax receipts which rose proportionately more than the current expenditure of general government in 1996. As a consequence of the rise in tax receipts, the ratio of total tax income of general government to gross domestic product rose to 27½ per cent in 1996 from an average ratio of 26 per cent in the first half of the 1990s and 22½ per cent in the 1980s.

Components of domestic saving as percentage of gross domestic product



The rise in direct taxes paid by individuals, together with the rapid rise in credit-financed private consumption expenditure, precluded the possibility of any meaningful rise in *private household saving* in 1996. The net saving by households as a ratio of gross domestic product accordingly receded from 1½ per cent in 1995 to 1 per cent in 1996. The very low savings ratio of the household sector is not only inadequate relative to the economy's investment and growth requirements, but also reveals the short time horizon over which consumers make their spending and saving decisions. It also implies a lack of concern among individuals for the need to provide for their old age. This may in years to come have serious implications for public-sector spending. The bulk of private-sector saving flows is currently still concentrated in the corporate sector.

Employment

Total employment in the formal non-agricultural sectors of the economy, which had increased only once during any calendar year since 1989 when it rose by 0,7 per cent in 1995, declined at a quarter-to-quarter seasonally adjusted and annualised rate of 3,9 per cent in the first quarter of 1996, 1,1 per cent in the second quarter and 1,4 per cent in the third quarter. This turn of events was mainly caused by a decline in the number of people employed by private-sector organisations. The workforce of the public sector increased in the second and third quarters of 1996, albeit at a more subdued rate than during the final quarter of 1995.

The total number of people employed in the *non-agricultural private sector* started to decline in the third quarter of 1995, after a short interlude of rising employment from the third quarter of 1994 to the second quarter of 1995. Consecutive declines in private-sector employment, at quarter-to-quarter seasonally adjusted and annualised rates of 5,8 per cent, 3,6 per cent and 2,8 per cent, were recorded in the first three quarters of 1996. The most prominent declines occurred in the mining, manufacturing and construction sectors. In the third quarter of 1996, reductions in workforce totals took place in mining, manufacturing, construction, electricity generation, banks and private transportation. The accumulated loss of measured private-sector employment opportunities since the second quarter of 1995 stood at 128 000 in the third quarter of 1996.

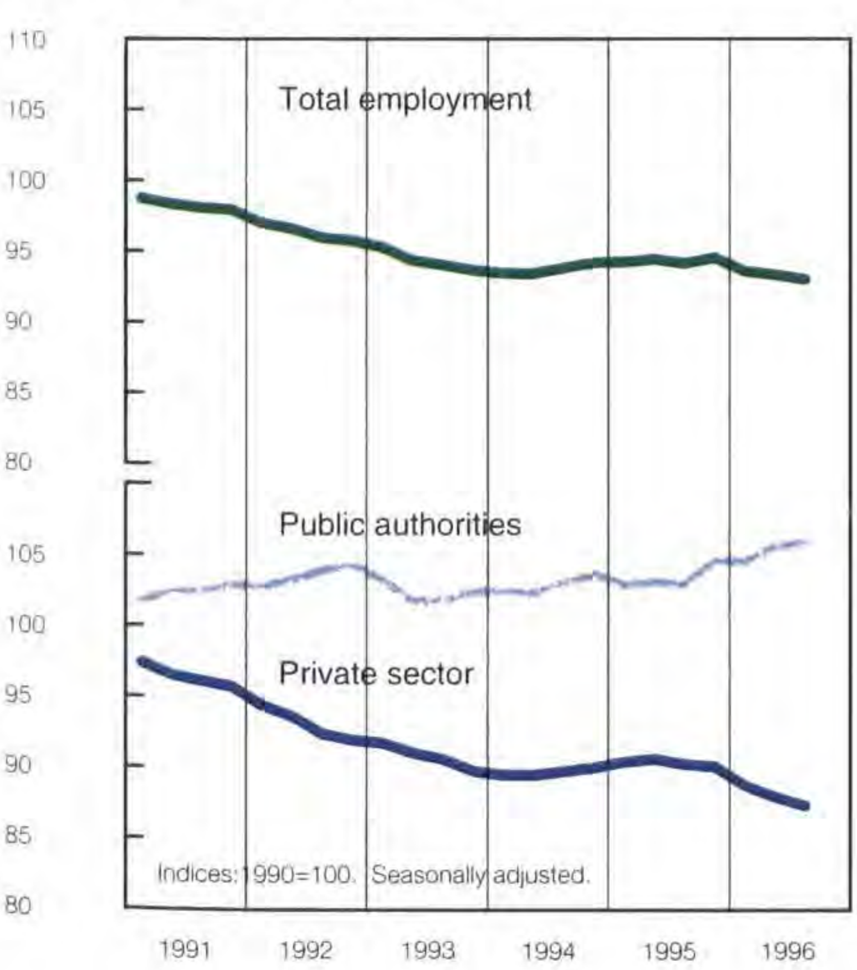
Total employment by *public authorities* increased by 0,5 per cent in 1995. A decrease at a seasonally adjusted and annualised rate of 0,2 per cent was recorded in the first quarter of 1996, followed by increases at rates of 4,0 per cent in the second quarter and 1,1 per cent in the third quarter. This growth in employment occurred mainly in public administration at the central and local government level and is at variance with government's recently adopted growth and development strategy "Growth, Employment and Redistribution" which targeted a reduction of 100 000 public-sector employment opportunities by June 1997. As a percentage of total formal-sector non-agricultural employment, the workforce of public authorities has increased from 30,3 per cent in the first quarter of 1990 to 34,8 per cent in the third quarter of 1996.

Table 4. Changes in employment in the non-agricultural sectors of the economy.
Quarter-to-quarter change at seasonally adjusted annual rates

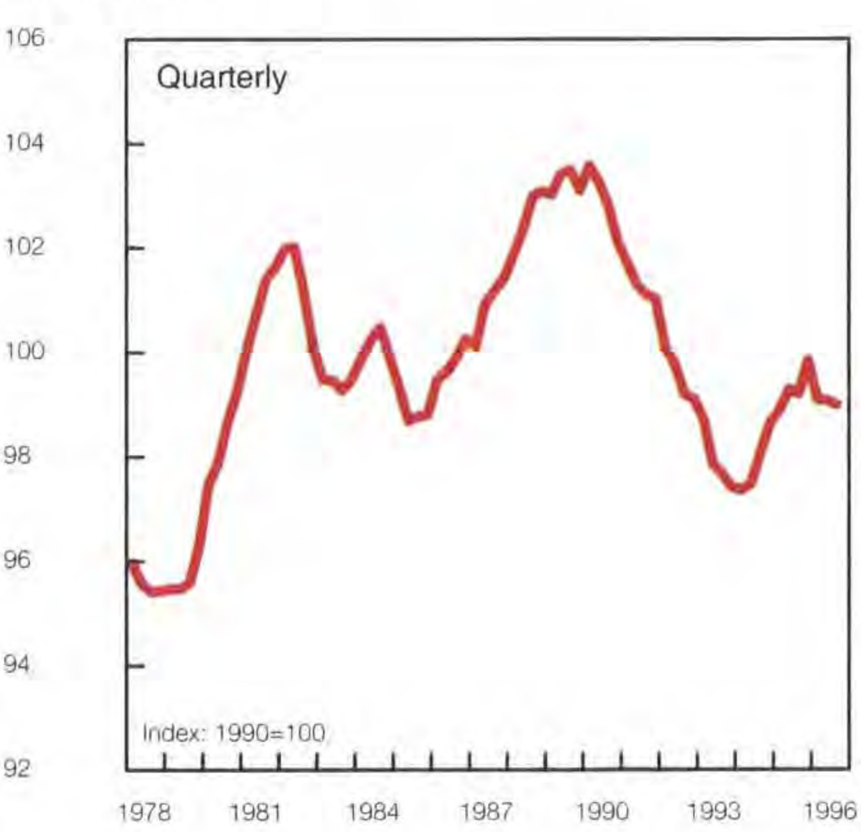
	Public authorities	Private sector	Total
1995: 1st qr	-2,9	1,8	0,2
2nd qr	0,7	0,9	0,8
3rd qr	-0,5	-1,6	-1,3
4th qr	6,6	-0,6	1,7
1996: 1st qr	-0,2	-5,8	-3,9
2nd qr	4,0	-3,6	-1,1
3rd qr	1,1	-2,8	-1,4

A somewhat disquieting aspect of longer-term employment trends in the South African economy is that the number of employment opportunities created during an economic recovery is getting smaller with each successive recovery (see the accompanying graph). In view of the rapid growth of the country's economically active population, this evidence emphasises the need for the speedy implementation of the government's macro-

Non-agricultural employment



Cyclical movement of non-agricultural employment



economic strategy for growth and employment creation.

The decline in total employment in the formal non-agricultural sectors of the economy further manifested in an increase of 7,3 per cent in the total number of registered unemployed workers, comparing the first nine months of 1996 with that of 1995. In September 1996 the total number of registered unemployed workers stood at 276 000, compared with 256 000 a year earlier.

According to the October Household Survey of the Central Statistical Service for 1995 some 29,3 per cent of South Africa's economically active population was unemployed. This estimate provides a dismal picture and places South Africa broadly on par with world unemployment rates: according to the International Labour Organisation (ILO) some 30 per cent of the world's workforce is either unemployed or underemployed when both the industrial and the developing countries are taken into consideration.

A major development during 1996 was the implementation of the new Labour Relations Act. The new Act is meant to facilitate greater employment creation in the South African economy, reinforce domestic companies' competitiveness in international markets and, more generally, contribute to the implementation of government's macroeconomic strategy. The Act provided for the establishment of the Commission for Conciliation, Mediation and Arbitration (CCMA), which aims to bring about the speedier resolution of disputes. In the first few weeks after its establishment, the CCMA was successful in settling all of the 355 disputes referred to it. The new institutional framework created by the Act aims to develop and nurture a more co-operative form of labour relations as opposed to the adversarialism that prevailed in the past.

Labour costs and productivity

The rate of increase in the *average nominal remuneration per worker* in the formal sectors of the economy outside the agricultural sector slowed down from a year-to-year rate of 11,9 per cent in 1994 to 9,4 per cent in 1995. The downward movement in the growth of nominal salaries and wages came to an end in the second quarter of 1995 and since the third quarter of that year the percentage change over four quarters in the average nominal remuneration per worker has increased generally. As shown in Table 5, the higher rate of remuneration increase was caused by rises in the average salaries and wages of workers in both the private sector and public authorities.

The year-to-year rate of increase in the *real remuneration per worker* in the non-agricultural sectors of the economy (defined as the nominal remuneration per worker divided by the price deflator for the non-agricultural gross domestic product) decelerated from 3,2 per cent in 1994 to 0,8 per cent in 1995. The year-on-year rate of increase in real remuneration nevertheless began to accelerate in the third quarter of 1995. A year-on-year rate of increase of 0,6 per cent in the third quarter of 1995 was followed by a rate of 0,8 per cent in the fourth quarter, 2,6 per cent in the first quarter of 1996, 1,3 per cent in the second quarter and 0,8 per cent in the third quarter. The realised growth in real wages is considerably higher than the 0,5 per cent *decline* in real wages envisaged for 1996 by the government's macroeconomic growth and development strategy.

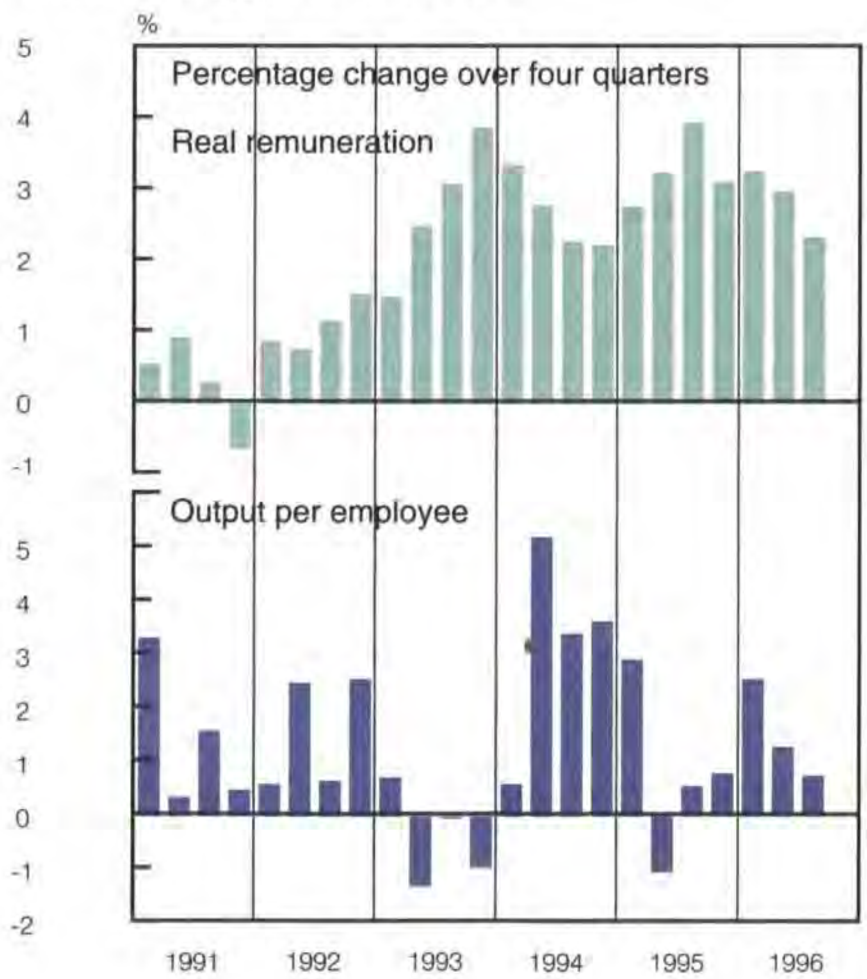
Table 5. The year-on-year rate of increase in nominal remuneration per worker

Per cent

	Public authorities	Private sector	Total
1995: 1st qr..........	14,1	10,3	11,7
2nd qr	-1,4	12,7	7,1
3rd qr	5,8	10,8	8,9
4th qr	8,5	11,0	10,1
1996: 1st qr..........	10,1	12,5	11,8
2nd qr	11,1	10,5	10,9
3rd qr	8,9	11,0	10,5

The impact of the high rates of increase in real remuneration per worker on product prices was partially counteracted by relatively strong productivity growth. *Real output per worker* increased by 2,7 per cent in both

Real remuneration and labour productivity in the non-agricultural sectors



1993 and 1994 and then further by 3,3 per cent in 1995 – the strongest productivity growth experienced in a calendar year since 1970. Productivity growth remained firm in 1996 and growth over four quarters of 3,3 per cent, 3,0 per cent and 2,3 per cent consecutively was recorded in the first three quarters of the year.

The rate of increase in nominal unit labour costs (i.e. the change in the ratio between nominal remuneration per employee and real output per employee) fell from 17,2 per cent in 1990 to 9,0 per cent in 1994 and 5,9 per cent in 1995. This slowdown contributed substantially to the waning of price inflation in the first half of the 1990s. Unfortunately, the downward trend in the year-on-year growth of nominal unit labour costs appeared to have come to an end in the second quarter of 1995 when a lower turning point of 3,7 per cent was registered. Since then the year-on-year increase in nominal unit labour costs has accelerated to 8,2 per cent in the first quarter of 1996, 7,7 per cent in the second quarter and 7,9 per cent in the third quarter. This acceleration is perhaps the single most important production cost determinant and is partly responsible for the acceleration in production and consumer prices in the second half of 1996.

Prices

The slower growth in nominal labour cost per unit of production made an important contribution to the decline in consumer-price inflation from 9,0 per cent in 1994 to 8,7 per cent in 1995 and 7,4 per cent in 1996. Consumer-price inflation in 1996 was at its lowest level since 1972. The decline in overall price inflation was, of course, not caused solely by slower rates of increase in nominal unit labour cost. Other factors that exerted downward pressure on price increases were the consistent application of a counter-inflationary monetary policy, reductions in tariffs on imported goods, month-to-month declines in food prices during the second half of 1995 and a relatively stable exchange value of the rand until the middle of February 1996.

Since March 1996 many of the counter-inflationary tendencies have been reversed – the rise in unit labour cost remained high, monetary aggregates and credit extension expanded rapidly, import tariffs remained more or less unchanged, food prices have resumed an upward tendency and, most significantly, the rand depreciated sharply. Furthermore, the tightening of monetary policy through increases in Bank rate had the temporary perverse effect of raising the measured level of consumer-price inflation. The return of an upward bias in measured inflation since the second quarter of 1996 poses a challenge for policy-makers to prevent second-round effects in wages and prices from occurring.

The prices of *imported goods* rose by 7,6 per cent in 1995 and 5,3 per cent in 1996. In the first quarter of 1996 the increase in the prices of imported goods, at a seasonally adjusted and annualised rate, amounted to 6,0 per cent. The depreciation of the rand which began in February 1996 then contributed to an increase in the quarter-to-quarter change in the prices of imported goods to 7,3 per cent in the second quarter. In the third quarter of 1996 the quarter-to-quarter rise in the prices of imported goods was held back by declines in the prices of imported mining and quarrying products, notably crude oil, and an annualised increase of only 2,9 per cent was recorded. The quarter-to-quarter increase in the prices of imported goods subsequently rebounded to 18,1 per cent in the final quarter of 1996. 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 9,3 per cent in December when the depreciation of the rand began to make itself felt. In December 1996 the twelve-month rate of increase in the prices of imported goods exceeded the corresponding increase in the prices of domestically produced goods.

The increase in the prices of *domestically produced goods* declined from 9,9 per cent in 1995 to 7,5 per cent in 1996. As mentioned earlier, the lower rate of increase in unit labour costs in 1995 contributed materially to this deceleration in the rate of price inflation. The return of renewed inflationary momentum in 1996, particularly the acceleration in the rate at which unit labour costs had been rising, led to an increase in the quarter-to-quarter annualised rate of inflation in the prices of domestically produced goods from 4,8 per cent in the first quarter of 1996 to 6,8 per cent in the second quarter and 11,4 per

Production price index

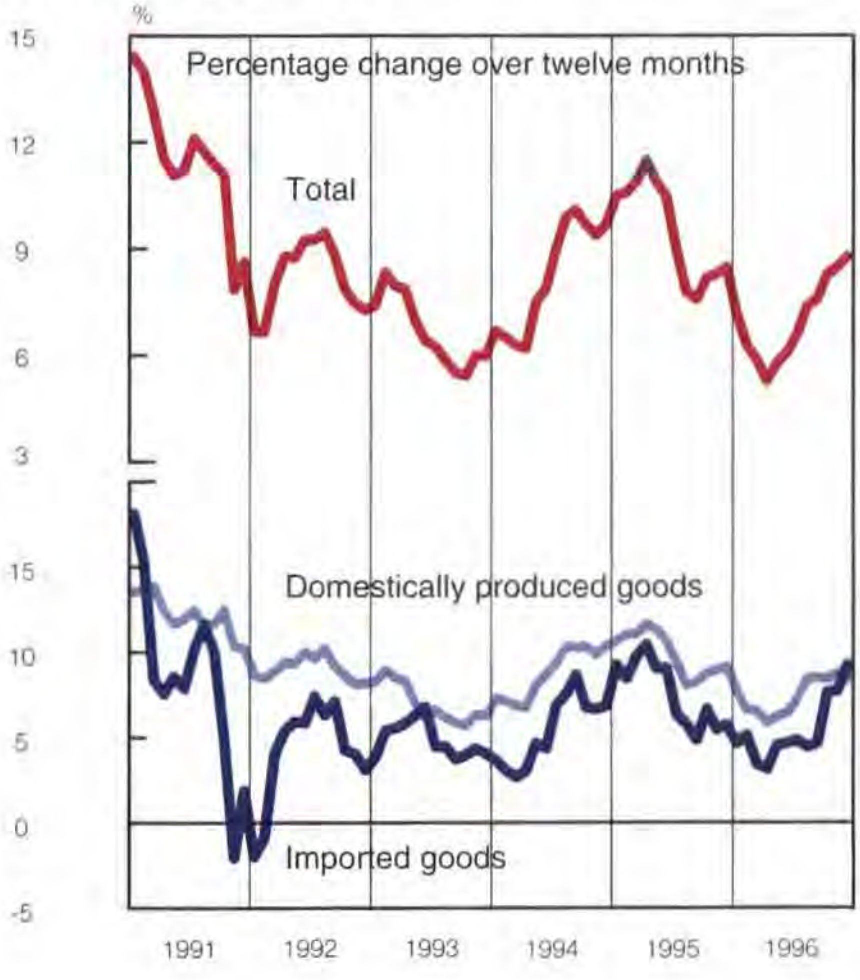


Table 6. Price increases over twelve months
Per cent

Period		Production prices		Consumer prices	
		Domestically produced goods	Imported goods	Overall	Underlying inflation*
1996:	Apr........	5,9	3,2	5,5	6,5
	May.......	6,3	4,6	5,9	6,3
	Jun........	6,5	4,7	6,9	6,7
	Jul..........	7,3	4,9	7,1	7,3
	Aug........	8,5	4,5	7,5	7,5
	Sep........	8,6	4,7	8,4	8,2
	Oct........	8,5	7,7	9,1	8,8
	Nov........	8,8	7,8	9,2	9,2
	Dec........	8,5	9,3	9,4	9,2

* Change over twelve months in the overall consumer price index, excluding the prices of food and non-alcoholic beverages, the cost of home ownership and value-added tax.

cent in the third and fourth quarters. Measured over a period of twelve months, the prices of domestically produced goods increased by 5,9 per cent in the year to April 1996. This rate of increase then accelerated to 8,5 per cent in the year to December 1996. Prices of domestically produced goods were therefore rising faster over periods of twelve months than the prices of imported goods until November 1996.

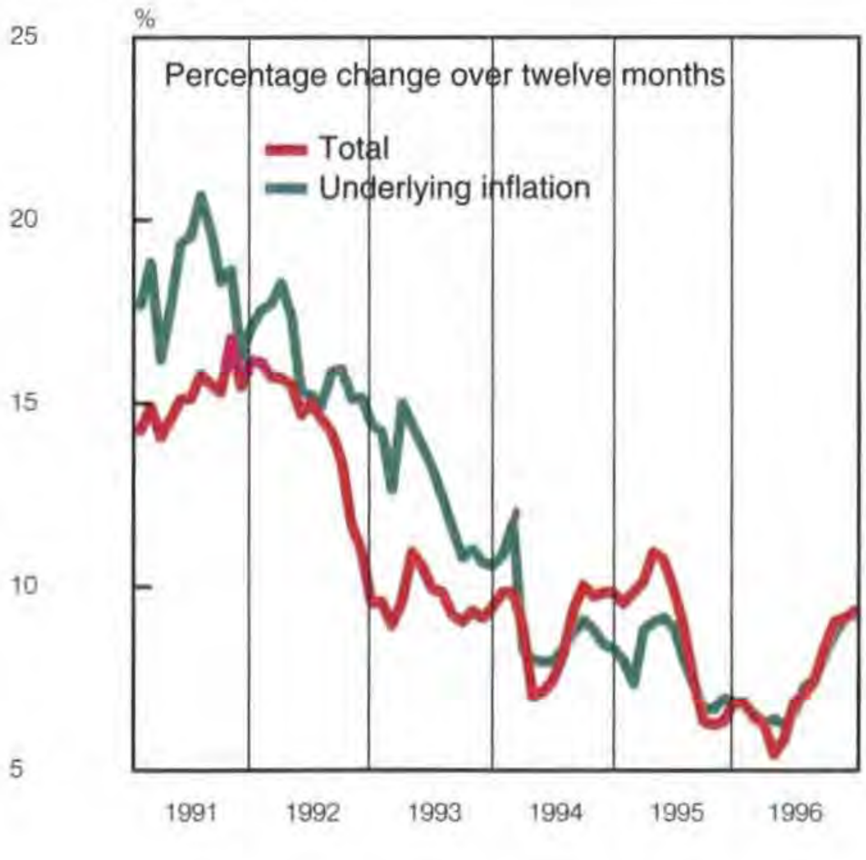
Inflation, as measured by changes in the *all-goods production price index*, declined from 9,6 per cent in 1995 to 6,9 per cent in 1996. On a seasonally adjusted and annualised quarter-to-quarter basis the increase in the all-goods production price index accelerated progressively from 5,1 per cent in the first quarter of 1996 to 6,9 per cent in the second quarter, 9,3 per cent in the third quarter and 12,7 per cent in the fourth quarter. Measured over periods of twelve months, the rise in the all-goods production price index fell to a low point of 5,3 per cent in April 1996, but thereafter increased at an accelerating rate to reach 8,8 per cent in December.

The rise in the *overall consumer price index* was somewhat subdued in the second half of 1995 owing to declines in the prices of food and a slowdown in the price increase of new motor vehicles. During 1996 the downward trend in consumer price inflation was reversed and the quarter-to-quarter rate of price growth (at seasonally adjusted and annualised rates) accelerated to 7,8 per cent in the second quarter, 8,8 per cent in the third quarter and 11,6 per cent in the fourth quarter. Measured over periods of twelve months, the overall consumer-price inflation declined to only 5,5 per cent in April 1996, its lowest level since June 1972. This rate of increase in consumer prices subsequently accelerated to 9,2 per cent in November 1996 and 9,4 per cent in December.

The rate of increase in the overall consumer price index accelerated following more rapid increases in the prices of *consumer goods* as well as in the prices of *consumer services*. In the year to December 1996 the prices of consumer services rose by 10,9 per cent, which was significantly more than the rise of 8,6 per cent in the prices of consumer goods. However, during 1996 the acceleration in the prices of consumer goods was appreciably faster than the acceleration in the prices of consumer services: the rate of increase over twelve months in the prices of consumer goods accelerated by 4,8 percentage points from April 1996 to December, whereas the rate of increase in the prices of consumer services accelerated by 2,7 percentage points over the same period.

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), which is more susceptible to change in aggregate monetary conditions in the economy, averaged 7,9 per cent in 1995 and 7,5 per cent in 1996. The quarter-to-quarter seasonally adjusted and annualised underlying inflation rate rose from 6,4 per cent in the first quarter of 1996 to 8,5 per cent in the second quarter, 9,0 per cent in the third quarter and 12,4 per cent in the fourth quarter. Measured over periods of twelve months, underlying inflation rose from a relatively low rate of 6,3 per cent in May 1996 to 9,2 per cent in November and in December. These tendencies seem to warrant continued vigilance in the campaign to contain inflation.

Consumer price index



Foreign trade and payments

Balance of payments on current account

As is usually the case with a slackening in the domestic expenditure, the *balance on the current account* of the balance of payments improved, in this instance from an annualised deficit of R12,9 billion in the second quarter of 1996 to R8,6 billion in the third quarter and R4,7 billion in the fourth quarter. In 1996 as a whole, the current account deficit came to R8,5 billion, compared with a deficit of R10,2 billion in 1995. As a ratio of gross domestic product, the deficit declined from 2,1 per cent in 1995 to 1,6 per cent in 1996.

The marked improvement in the current account deficit in the second half of 1996 was mainly brought about by a substantial increase in the physical quantity of exported goods and in the value of South Africa's net exports of gold. The rise in the quantity and prices of goods exported and the rise in the value of net gold exports were, of course, strongly influenced by the depreciation of the rand which began in the middle of the first quarter of 1996. The growth in the volume and value of merchandise imports also slowed down considerably in the fourth quarter of 1996, partly in reaction to declines in real gross domestic expenditure in the second half of the year and partly as a delayed response to the price-raising effects of the weakening rand. The time delay of the anticipated J-curve response, which presupposes that the current account balance deteriorates at first in response to a currency depreciation before it improves, was therefore relatively short: a healthy improvement in the current account balance was in progress within approximately six months after the start of the rand depreciation. In the fourth quarter of 1996, the improvement in the current account balance was assisted further by a decline in the net service and transfer payments to the rest of the world.

The total *value of merchandise exports* rose by 21½ per cent in calendar 1996. The weakness of international commodity prices and relatively modest domestic price rises restricted the increase in the average rand price of goods exported to only 8½ per cent in 1996, notwithstanding the fairly substantial fall in the exchange value of the rand. The volume of exports rose by a sound 12 per cent in 1996, greatly assisted by the increased competitiveness of South African manufacturers in export markets owing to the weaker rand. Some of the recently completed "mega investment projects" with a strong export-orientation reached the production stage during 1996 and began to contribute

Current account

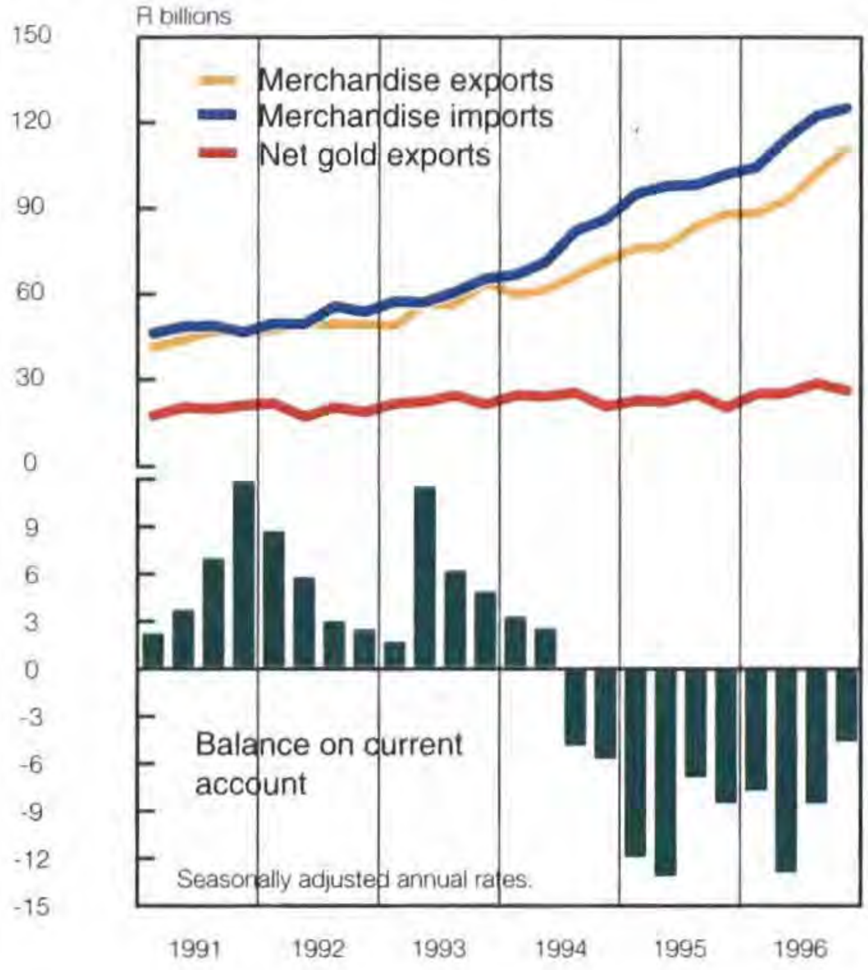


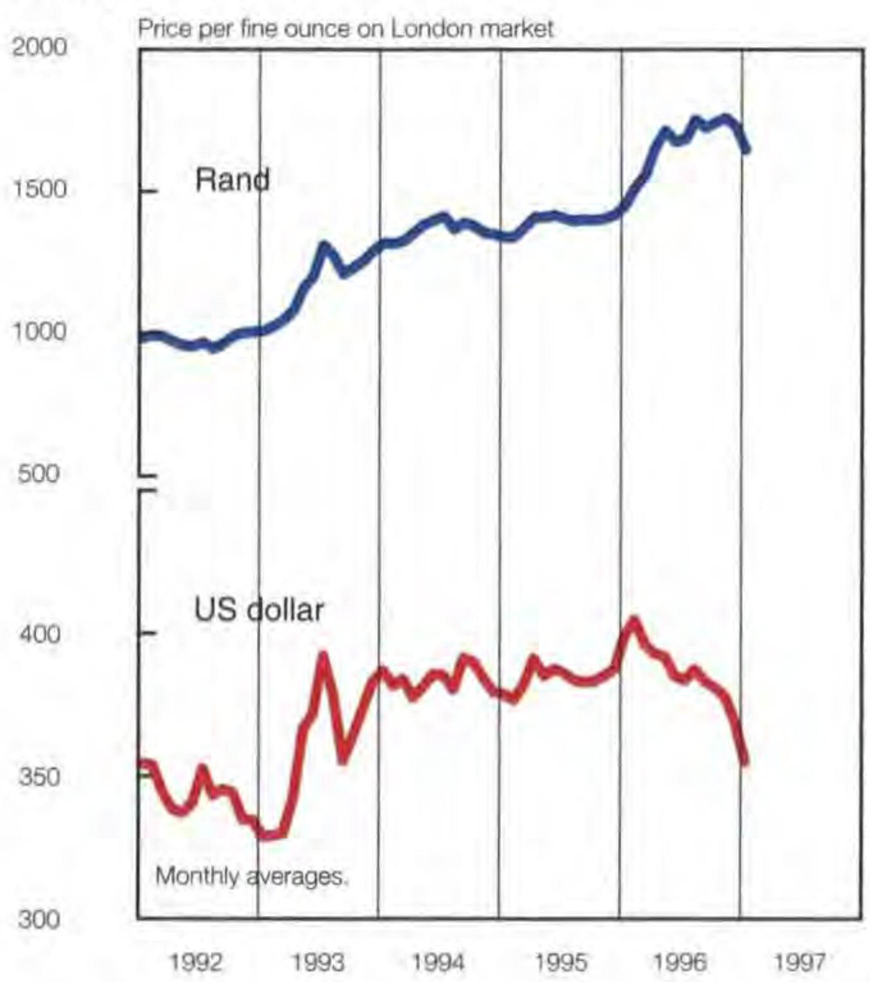
Table 7. Balance of payments on current account
Seasonally adjusted and annualised rates
R billions

	1995	1996				
	Year	1st qr	2nd qr	3rd qr	4rd qr	Year
Merchandise exports	81,3	88,5	93,1	102,6	111,0	98,8
Net gold exports	22,5	24,9	25,3	28,7	26,2	26,3
Merchandise imports	-98,0	-104,1	-114,1	-122,2	-124,8	-116,3
Net service and transfer payments	-16,0	-17,1	-17,2	-17,7	-17,1	-17,3
Balance on current account	**-10,2**	**-7,8**	**-12,9**	**-8,6**	**-4,7**	**-8,5**

meaningfully to the growth in export volumes. The exports of manufactured goods accordingly performed better than the other export categories over the past two years; the value of exports of manufactured goods as a percentage of the total value of merchandise exports rose to 29½ per cent in 1996, compared with a ratio of 26 per cent in 1994. All the other main export categories increased during 1996, being led by exports of mining and agricultural products. The improvement in export volumes of mining products could also have been influenced by the increasing price competitiveness of South African producers, albeit to a much lesser extent than in the case of the manufacturing sector.

The shrinking deficit on the current account was also affected significantly by an increase of 16,7 per cent in the value of net gold exports in 1996, which arose essentially from the decline in the value of the rand against the United States dollar. The average dollar price of gold per fine ounce increased marginally by 1 per cent from US$384 in 1995 to US$388 in 1996. In contrast, the average rand price of gold per fine ounce moved from R1 393 in 1995 to R1 664 in 1996, i.e. an increase of 19½ per cent. The value of net gold exports in 1996 was, however, held back by a decline in the physical production of the gold-mining industry. According to industry sources, the physical quantity of gold produced by South African mines declined by 5,3 per cent in 1996.

Gold price



The average *fixing price of gold* on the London market weakened from US$385 per fine ounce in the third quarter of 1996 to US$376 per fine ounce in the fourth quarter. In January 1997 the dollar price of gold retreated even further to an average of US$355 per fine ounce on account of expectations of lower world-wide inflation and growing concern about future gold sales by European central banks. The gold price was also subject to increasing pressure by highly attractive yields in the United States bond market. On 12 February 1997, the London fixing price was set at US$366,90 – the lowest fixing since April 1993.

The *value of merchandise imports* (seasonally adjusted and annualised) rose at a higher rate in the second quarter of 1996 than in the first quarter, owing mainly to a spurt in aggregate domestic expenditure and some pre-emptive importation of goods motivated by expectations of higher prices later in the year. Thereafter, the growth in the nominal value of merchandise imports slowed down from the 9½ per cent recorded in the second quarter of 1996 to 7 per cent in the third quarter and 2 per cent in the fourth quarter. For 1996 as a whole, the value of merchandise imports increased by 18½ per cent, compared with 28½ per cent in 1995. The rise in import volumes steadily lost momentum in the course of 1996 and by the fourth quarter the physical quantity of merchandise imports had declined by almost 2 per cent. The prices of imported goods rose by 7 per cent in 1996, but by the fourth quarter of that year the rate of increase in import prices at a seasonally adjusted and annualised rate had risen to 17½ per cent in a somewhat delayed response to the weakening of the rand. In tandem with the slowdown in aggregate real gross domestic expenditure in 1996, the growth in the physical quantity of merchandise imports declined from 19½ per cent in 1995 to 10½ per cent in 1996.

Net *service and transfer payments to non-residents,* which had increased gradually from R17,1 billion in the first quarter of 1996 to R17,7 billion in the third quarter, declined to R17,1 billion in the fourth quarter. The smaller deficit on the services account in the fourth quarter of 1996 was due to an increase in the value of services rendered to non-residents, which was only partially countered by an increase in service payments to them. Higher foreign tourist expenditure in South Africa and an increase in dividend receipts were largely responsible for the increase in service receipts, whereas higher interest and freight and insurance payments added to the level of payments for services rendered. For 1996 as a whole, net service and transfer payments to non-residents amounted to R17,3 billion, i.e. 8 per cent more than the R16 billion recorded in 1995.

Capital account

The surplus on the capital account of the balance of payments contracted drastically from 1995 to 1996. With the increased uncertainty concerning the value of the rand, the *net inflow of capital* (not related to reserves)

Table 8. Net capital movements not related to reserves
R billions

	1995	1996				
	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Long-term capital						
Public authorities	4,6	1,3	0,1	-0,2	2,1	3,3
Public corporations	2,3	0,9	1,0	-0,8	2,5	3,6
Banking sector	1,8	-0,2	-0,4	-0,2	-0,4	-1,2
Private sector	6,4	2,3	1,2	1,1	-5,4	-0,8
Total	**15,1**	**4,3**	**1,9**	**-0,1**	**-1,2**	**4,9**
Short-term capital	4,1	-4,4	-0,4	-0,7	4,5	-1,0
Total capital	**19,2**	**-0,1**	**1,5**	**-0,8**	**3,3**	**3,9**

shrank from R19,2 billion in 1995 to only R3,9 billion in 1996. The fact that a net inflow of capital occurred is quite remarkable in view of the frequent speculative attacks on the rand during 1996. These attacks were largely responsible for total net capital movements oscillating between net outflows of R0,1 billion in the first quarter and R0,8 billion in the third quarter and net inflows of R1,5 billion in the second quarter and R3,3 billion in the fourth quarter.

The net inflow of *long-term capital* declined from R15,1 billion in 1995 to R4,9 billion in 1996. The inflow of long-term capital in 1996 occurred in the first half of the year: a total inflow of capital of R6,2 billion in the first half of the year was followed by outflows of R0,1 billion in the third quarter and R1,2 billion in the fourth quarter. The net outflow of long-term capital in the fourth quarter occurred notwithstanding two bond issues that were successfully launched on behalf of the South African government in the international bond markets. One new issue was placed in the Eurobond market for an amount of DM500 million (R1,5 billion) in order to redeem a bearer bond issue of DM400 million maturing in October. The other issue was made in the United States market for an amount of US$300 million (R1,4 billion) and the proceeds were repatriated to South Africa.

Public corporations were also net borrowers of foreign funds in the fourth quarter of 1996, either in the form of new loans raised in offshore markets or in the form of net purchases of loan stock in the domestic securities markets by non-residents. The net inflow of capital to public corporations amounted to R2,5 billion in the fourth quarter, in contrast to a net outward movement of R0,8 billion in the third quarter.

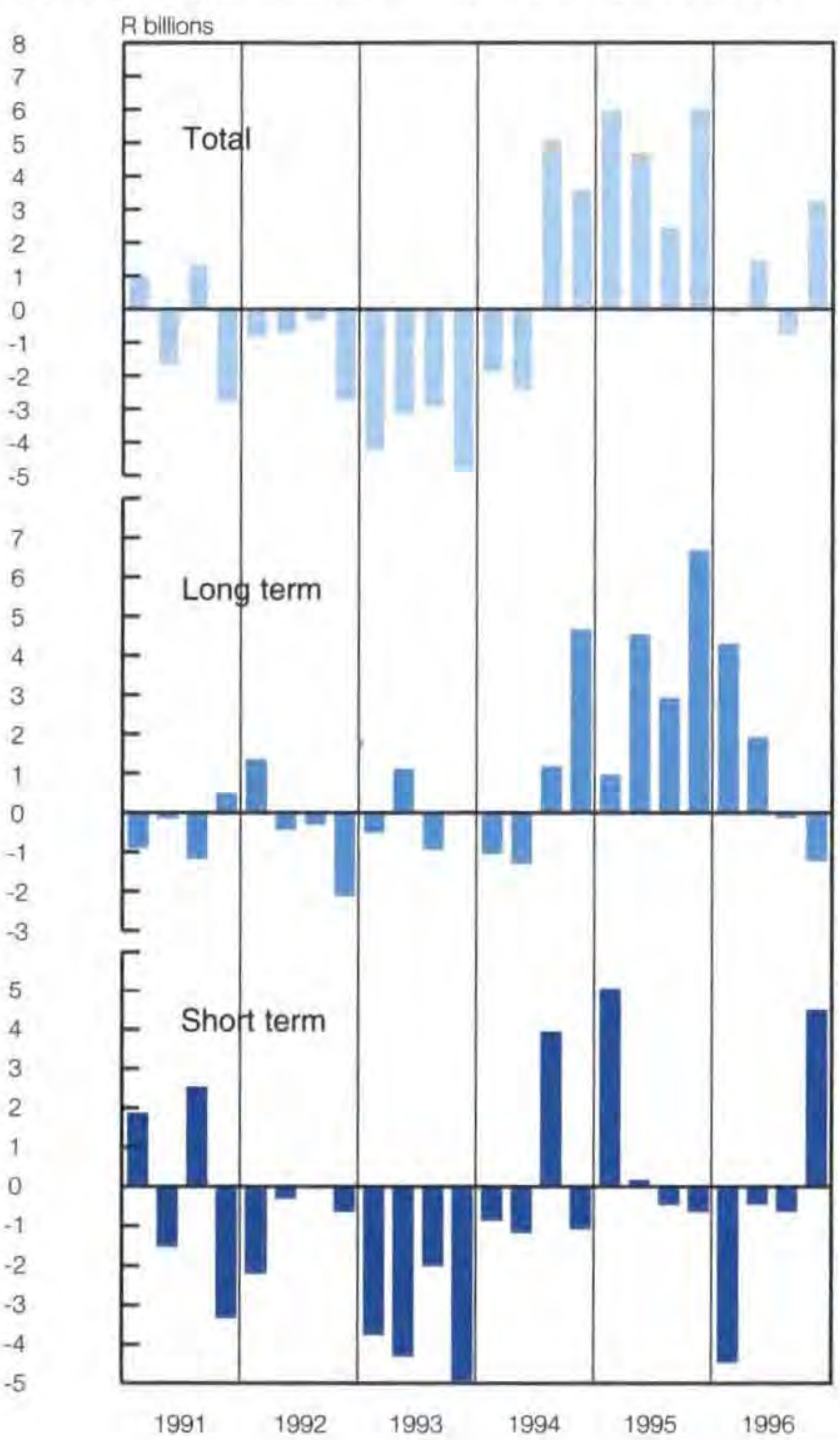
The movement of international long-term capital to the domestic private sector turned around from a net inflow of R1,1 billion in the third quarter of 1996 to a net outflow of R5,4 billion in the fourth quarter. Three factors contributed to the relatively strong outflow of long-term capital from the private sector in the fourth quarter of 1996, namely:

- foreign debt obligations, amounting to R3,2 billion, which fell due for repayment in the fourth quarter of 1996 and were apparently not rolled over or reinvested in the South African economy;
- net sales of more than R0,5 billion by non-residents of equity on the Johannesburg Stock Exchange; and
- a substantial increase in the acquisition of foreign assets by South African companies and non-bank financial institutions.

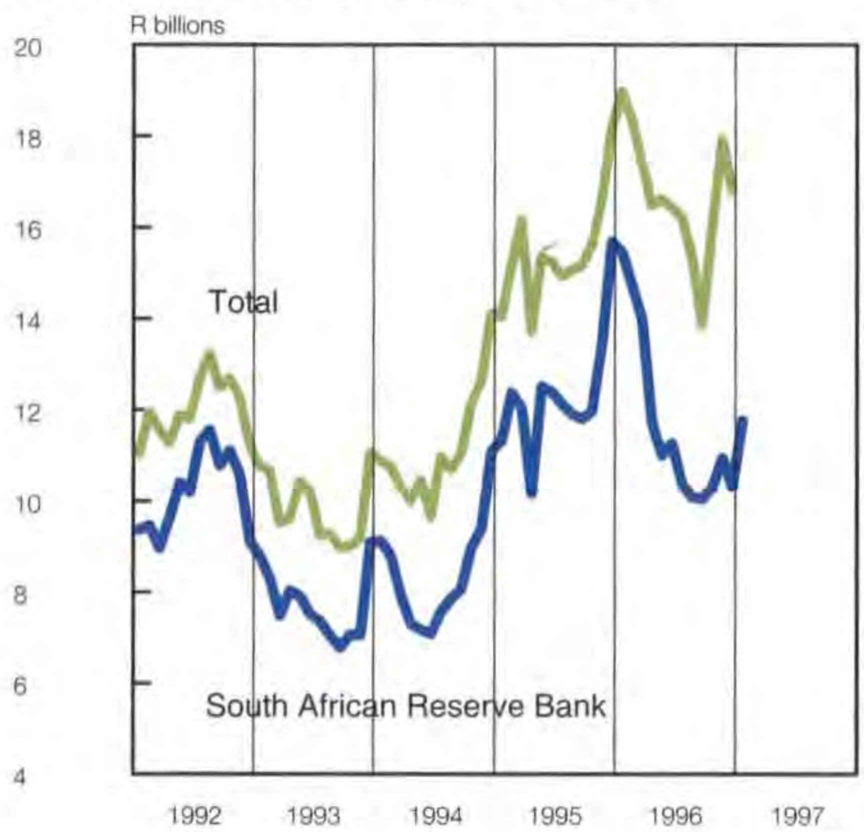
For the calendar year 1996 as a whole the total net outflow of long-term capital to the rest of the world from the domestic private sector came to R0,8 billion, in contrast with an inflow of R6,4 billion which had been registered in 1995.

Short-term capital movements (not related to reserves but including unrecorded transactions) to and from South Africa changed from a net inflow of R4,1 billion in 1995 to a net outflow of R1,0 billion in 1996. More recently, however, quarterly outflows of short-term capital which had prevailed since the second half of 1995 were transformed into an inflow in the fourth quarter of 1996; the inflow of short-term capital in the fourth quarter came to R4,5 billion compared with accumulated outflows amounting to R5,5 billion in the preceding three quarters. The principal contributing factor to the abrupt reversal of short-term capital flows in the fourth quarter was the offshore borrowing activity of private banking institutions. In the third quarter of 1996 the banks reduced their net short-term foreign liabilities by R0,4 billion, but then increased such liabilities by R8,6 billion in the fourth quarter, being motivated in their decision-making by the shortage of liquidity in the domestic money market and the perceived favourable cost of such foreign short-term credit facilities to South African banks. At the same time, the slowdown in the nominal value of merchandise imports in the fourth quarter of 1996 and

Net capital movements (not related to reserves)



Gross gold and other foreign reserves



the advancement of payment for imports gave rise to the reduced utilisation of foreign trade-financing facilities by the private non-bank sector.

Foreign reserves

The net inflow of capital in 1996 was not sufficient to finance the deficit on the current account of the balance of payments, with the result that the *net gold and other foreign reserves* of the country declined by R4,6 billion over the year. The shrinking of the deficit on the current account and the reversal of the net outflow of capital into a net inflow in the fourth quarter of 1996, however, caused the net gold and other foreign reserves to rise by R3,2 billion between the end of September and December 1996.

South Africa's *gross gold and other foreign reserves*, which had declined by R4,3 billion in the first three quarters of 1996, rose by R2,9 billion in the fourth quarter of 1996 to R16,8 billion at the end of the year; at the end of 1995 the gross gold and other reserves amounted to R18,2 billion. Some R2,6 billion of the overall increase in gross reserve holdings of R2,9 billion in the fourth quarter of 1996 was accumulated by the private banking sector. Without taking into consideration the availability of foreign credit facilities to the Reserve Bank, the total foreign reserves of the country were then equivalent to about 5½ weeks' worth of imports of goods and services. In January 1997 the gross gold and foreign reserves of the Reserve Bank rose by R1,5 billion to a level of R11,8 billion.

Exchange rates of the rand

The steadier performance of the rand in the market for foreign exchange in August and September 1996 was interrupted in the second half of October when the rand came under speculative attack again. The *nominal effective exchange rate of the rand* consequently declined by 5,5 per cent between the end of September and the end of October 1996. Some stability was restored in the foreign exchange market in November and December 1996 and in these more orderly trading conditions the nominal effective exchange value increased somewhat, thereby reducing the decline over the fourth quarter to 4,5 per cent. The overall decline in the nominal exchange value of the rand between the end of 1995 and the end

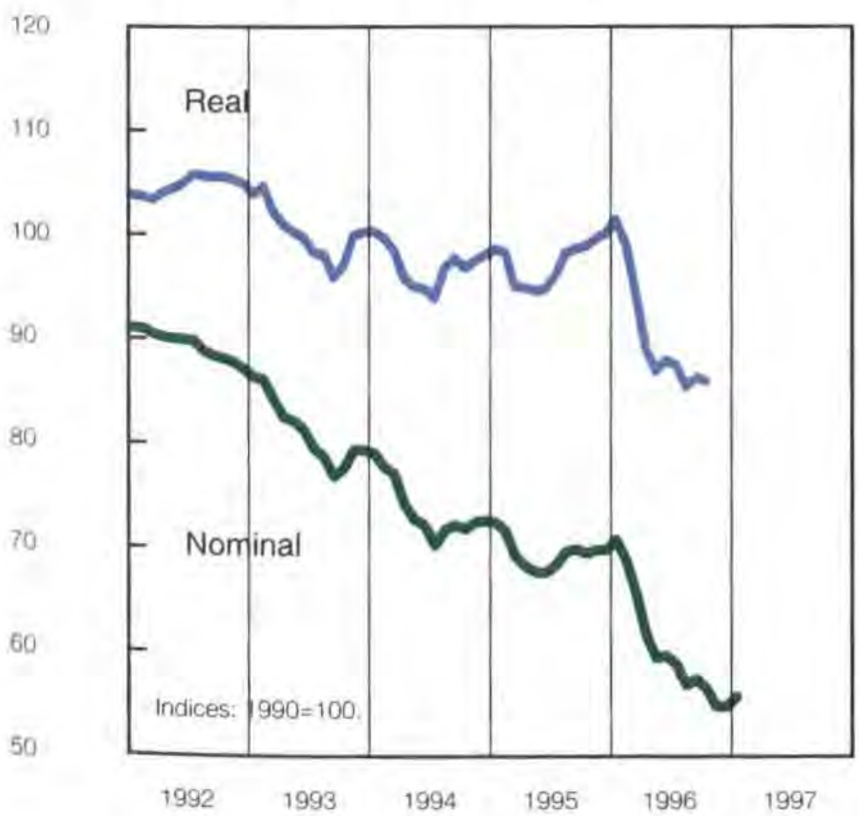
Table 9. Changes in the exchange rates of the rand
Per cent

	31 Dec 1995 to 31 Mar 1996	31 Mar 1996 to 30 Jun 1996	30 Jun 1996 to 30 Sep 1996	30 Sep 1996 to 31 Dec 1996	31 Dec 1995 to 31 Dec 1996	31 Dec 1996 to 11 Feb 1997
Weighted average	-8,0	-7,2	-4,3	-4,5	-21,9	9,5
US dollar	-8,9	-7,6	-4,1	-3,5	-22,1	6,8
British pound	-7,5	-8,9	-5,0	-11,1	-28,9	10,7
German mark	-6,4	-4,6	-3,8	-1,8	-15,7	14,2
Japanese yen	-5,8	-4,5	-2,8	-0,6	-12,1	13,2
Netherlands guilder	-6,5	-4,4	-3,8	-1,7	-15,4	14,3
Italian lira	-9,9	-9,6	-4,6	-3,4	-24,9	14,2

of 1996 was thus 21,9 per cent. In January 1997 the nominal effective exchange value of the rand strengthened by 5,3 per cent as sentiment in the market was positively influenced by the release of economic statistics indicating an improvement in the foreign trade balance and a slowdown in money and credit growth in the fourth quarter of 1996.

As indicated in the accompanying table, the rand weakened against all the *major currencies* in 1996. The combination of the rand's weakness and the strength of the British pound and US dollar resulted in a particularly steep decline of 28,9 and 22,1 per cent in the exchange value of the rand against these currencies, respectively. In January 1997 and in the first week of February the rand regained most of its losses against the main currencies, with the exception of these two strong currencies.

Effective exchange rates of the rand



The *real effective exchange rate of the rand* declined by 14,1 per cent in the first ten months of 1996 and by a provisionally estimated 16 per cent between December 1995 and December 1996. This, of course, strengthened the ability of South African producers to be competitive in export markets. The sustainability of these gains in competitiveness will ultimately be determined by the extent to which domestic cost pressures will be contained.

The slightly steadier behaviour of the rand in the foreign exchange market during the second half of 1996 coincided with a decline in the turnover in the market. The average daily net turnover, i.e. overall turnover values excluding local interbank transactions in order to avoid possible double counting, declined from US$6,6 billion in the first half of 1996 to US$5,5 billion in the second half. Preliminary estimates indicated that the average net daily turnover in January 1997 rose to US$6,5 billion. The increased involvement of non-resident banks in the South African currency market was primarily responsible for the higher turnover values in January 1997. It is conceivable that the higher activity levels of non-residents were linked to a spurt of activity in the Eurorand market in January 1997. Large-scale Eurorand issues to a value of R1,8 billion were made in January 1997. In the preceding nine months the total value of Eurorand issues amounted to R1,6 billion.

Monetary developments, interest rates and financial markets

Money supply

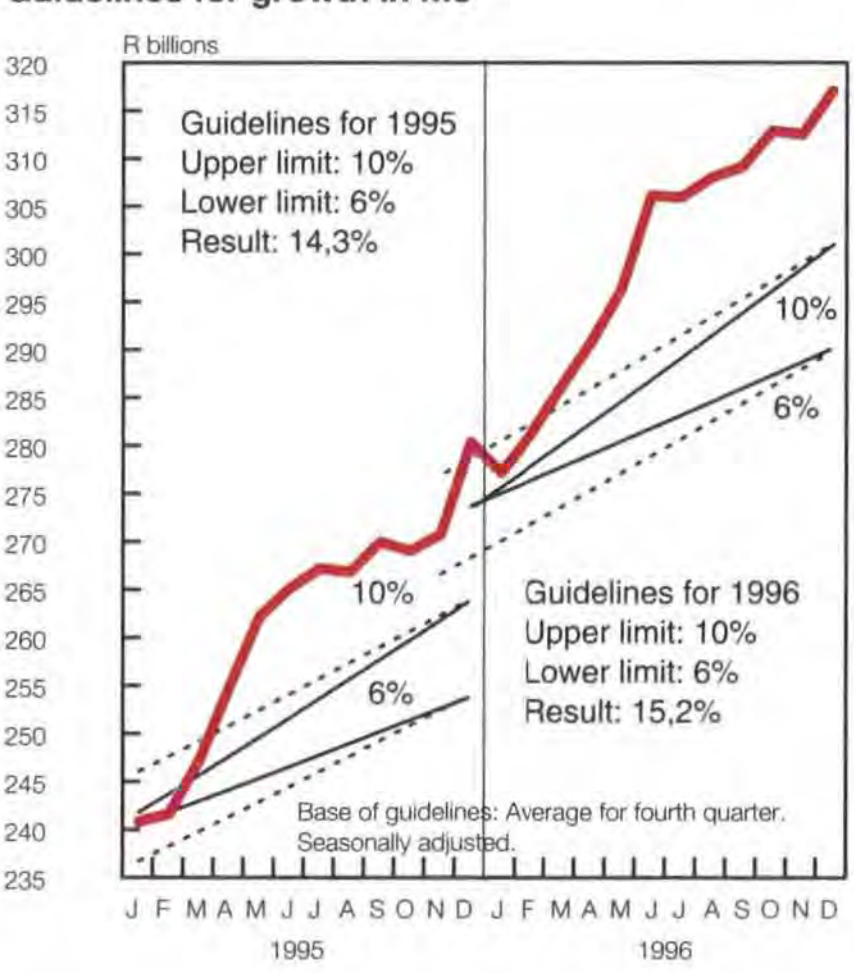
Growth in the monetary aggregates was very buoyant during the greater part of 1996. It was only in the final two months of the year that signs of a slowdown of the rapid monetary expansion began to emerge. The twelve-month growth rate in the *broadly defined money supply* (M3) reached 16,0 per cent in October, its second highest monthly level for 1996, but then decreased to 15,2 per cent in November and more meaningfully to 13,6 per cent in December. The quarter-to-quarter annualised growth in M3 slowed down even more noticeably from a peak of 21,2 per cent in the second quarter of 1996 to 18,6 per cent in the third quarter and then to 7,6 per cent in the fourth quarter.

Despite the slowdown in monetary growth in the second half of 1996, the quarterly average value of the M3 money supply in the fourth quarter still exceeded the upper limit of the *money supply guideline range* which was set at between 6 and 10 per cent at the beginning of the year. In fact, as in 1995, the upper limit of the guideline cone was exceeded throughout 1996. The quarterly average value of M3 in the fourth quarter of 1996 was 15,2 per cent higher than in the fourth quarter of 1995. Stated in absolute terms, this represented an actual increase of R41,2 billion over the year, compared with the guideline which provided for a maximum acceptable increase of R27,2 billion.

The rapid growth in the money supply during 1996 was primarily the result of an increase in the demand for money to finance high levels of domestic expenditure on household consumption, fixed capital formation and inventory accumulation. Another factor that contributed to the strong demand for money was a rise in the liquidity preference of individuals and private-sector organisations who positioned themselves in anticipation of major adjustments in the share and bond markets. Relatively attractive real yields on deposit-type investments reinforced the desire of private-sector participants in the economic process to increase their holdings of more liquid monetary assets. The slowdown in the growth of M3 in the second half of 1996 may be an indication that the monetary expansion has passed its peak and that it may stabilise at more acceptable rates of increase during 1997. The narrowing of the margin between the banks' deposit and lending rates in the second half of 1996, however, could have encouraged some re-intermediation of lending and borrowing activities and thus concealed an even more noticeable deceleration in monetary growth towards the end of that year.

The growth rates over twelve months of the *narrower monetary aggregates* fluctuated considerably, but

Guidelines for growth in M3



Monetary aggregates

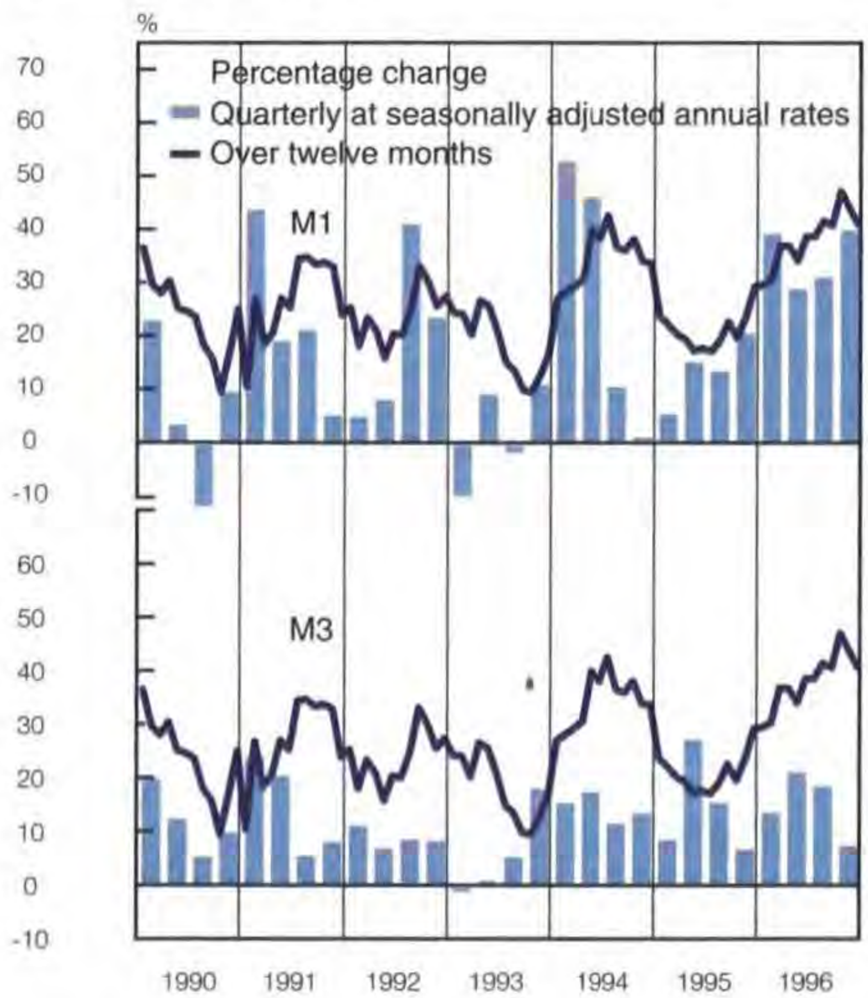


Table 10. Percentage change in monetary aggregates over twelve months

Period		M1A	M1	M2	M3
1995:	Dec	16,8	19,3	13,9	15,2
1996:	Mar	16,2	27,0	17,8	15,3
	Jun	14,7	28,5	17,9	15,7
	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

generally tended to increase during 1996 as the public's liquidity preference strengthened. The twelve-month growth rate of M1A accelerated from 16,8 per cent in December 1995 to 22,4 per cent in November 1996 and 21,9 per cent in December. The acceleration in the growth of M1 was even more pronounced: from 19,3 per cent in December 1995 to 34,0 per cent in November 1996 and 30,9 per cent in December. The "other demand deposits" component of the M1 monetary aggregate increased by R20,1 billion from the end of December 1995 to the end of December 1996; this represented more than 50 per cent of the overall increase in the month-end values of M3 over the same period and increased the portion of M3 consisting of "other demand deposits" from 16 per cent in December 1995 to about 20 per cent in December 1996.

The M3 money supply increased by R38,3 billion from the end of 1995 to the end of 1996. In a statistical or accounting sense the change in M3 in 1996 was more than fully explained by an increase of R50,9 billion in the monetary institutions' claims on the domestic private sector. The monetary sector's net claims on the government sector contributed a further R4,3 billion to the increase in the money supply. Contrary to these changes, monetary institutions' net foreign assets (including changes in the official holdings of gold and other foreign reserves) declined by R15,7 billion, mainly on account of increases in the foreign borrowing of monetary institutions. The full set of *accounting counterparts* of the growth in M3 during 1996 was as follows:

		R billions
Net foreign assets		-15,7
Net claims on government sector		4,3
Gross claims	7,8	
Less: increase in government deposits	3,5	
Claims on private sector		50,9
Net other assets and liabilities		-1,2
Increase in M3 (December 1995 to December 1996)		38,3

Credit extension

As already indicated, *credit extension to the domestic non-bank private sector* was the dominant statistical counterpart to growth in the money supply. The twelve-month rate of increase in credit extension by monetary institutions to the private sector advanced from an already high level of 17,6 per cent in December 1995 to 18,7 per cent in June 1996; it then, however, fell back to 17,1 per cent in November and 16,1 per cent in December. The quarter-to-quarter growth in credit extension to the private sector (at seasonally adjusted and annualised rates) decelerated even more substantially from 22,4 per cent in the second quarter of 1996 to 16,6 per cent in the third quarter and to 11,8 per cent in the fourth quarter.

An analysis of monetary institutions' claims on the private sector by *type of credit* shows that *mortgage advances* continued to grow persistently at a twelve-month rate of increase of more or less 17 per cent throughout 1996. Considering the slowing of activity in the real estate market since April 1996, it is likely that a sizable portion of mortgage advances to the private sector was used for purposes other than the acquisition of real estate or the construction or improvement of residential buildings. *Instalment sale credit* was strengthened by the high activity levels in the market for new motor vehicles, but also showed signs of tapering off in the second half of the year. The growth over twelve months in instalment sale credit reached 26,8 per cent in June 1996, before subsiding to 24,1 per cent in

Credit extended by monetary institutions

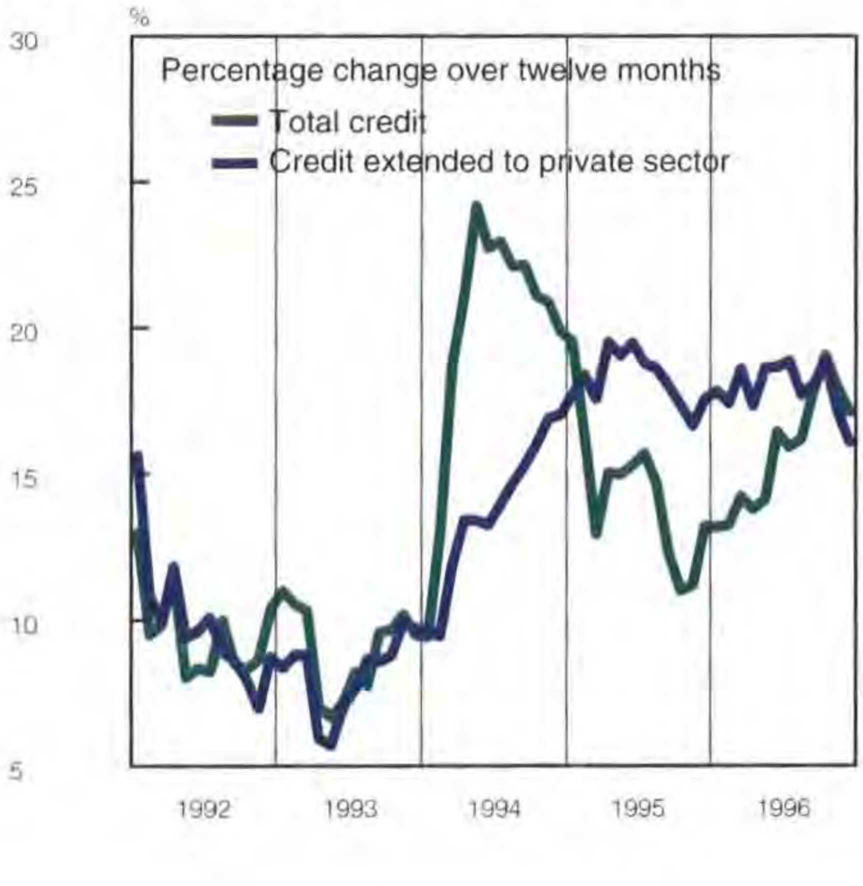


Table 11. Change in credit extended to households and companies during 1996

	Households		Companies	
Type of credit	R billions	Per cent	R billions	Per cent
Mortgage advances	14,8	13,6	3,9	34,6
Overdrafts	1,6	12,1	4,4	18,4
Other loans and advances	1,3	11,6	2,5	7,7
Credit cards	1,8	26,9	0,0	0,0
Instalment sale credit	3,1	17,6	4,6	23,9
Leasing finance	0,3	4,2	2,9	24,9
Total	**22,9**	**13,9**	**18,3**	**18,6**

September and 21,2 per cent in December. The growth over twelve months in *leasing finance* exhibited a pattern broadly similar to that of instalment sale credit: it accelerated rapidly to 19,8 per cent in September 1996, but then showed some signs of slackening when it receded to 16,8 per cent in December. The persistence of strong domestic demand in most categories of goods and services also lifted the twelve-month growth in "*other loans and advances*" (including overdrafts on current accounts) from 15,8 per cent in December 1995 to 23,8 per cent in October 1996. Subsequently, the growth over twelve months in "other loans and advances" decelerated to 18,3 per cent in December.

Overall credit extension by monetary institutions to the private sector was dominated during 1996 by the absolute size of the increase in "other loans and advances" and mortgage advances. Together, these two credit categories increased by R41,2 billion, which represents 81 per cent of the overall increase of R50,9 billion in credit extension to the private sector.

Credit extension to *private households* by monetary institutions increased by R4,4 billion in the fourth quarter of 1996 and by R22,9 billion for the year as a whole (see Table 11). The rate of increase over four quarters in credit extension to private households decelerated gradually from 18,7 per cent in the fourth quarter of 1995 to 16,0 per cent in the third quarter of 1996 and then more substantially to 13,9 per cent in the fourth quarter. Mortgage advances are still the largest component of credit used by households. At the end of 1996 outstanding mortgage advances constituted almost two thirds of total credit extended to households by monetary institutions.

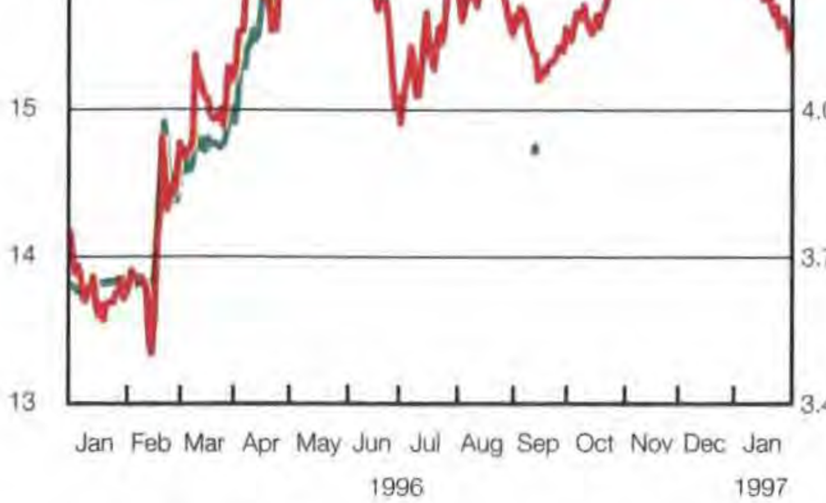
The increment in credit extended to the *private corporate sector* amounted to R2,4 billion in the fourth quarter of 1996 and R18,3 billion in the calendar year as a whole. Unlike the growth over four quarters in credit extended to private households, which decelerated steadily over the year, the four-quarter growth in credit to the corporate sector rose at first from 17,3 per cent in the fourth quarter of 1995 to 21,9 per cent in the second quarter of 1996, but then receded to 19,4 per cent in the third quarter and to 18,6 per cent in the fourth quarter. Overdrafts on current accounts remained the most popular source of credit utilised by the corporate sector in 1996.

Interest rates and yields

The trend and volatility of *bond yields* since the beginning of 1996 were influenced strongly by changes in the exchange rate of the rand, anticipated upward adjustments in Bank rate, expectations of rising inflation and the continuously tight liquidity situation in the money market. The *monthly average yield on long-term government stock* accordingly increased from 13,77 per cent in January 1996 to 16,53 per cent in May and then fell back to 15,78 per cent in June. It oscillated somewhat in subsequent months within a narrow range, reaching extremes of 15,39 per cent in July and 15,82 per cent in August. The trading range of long-term government stock then shifted to a higher level in November 1996 and monthly average yields were recorded at 16,18 per cent in November and 16,19 per cent in December.

Bond prices increased in January 1997 and the yield on long-term government stock fell from 16,40 per cent at the beginning of the month to 15,42 per cent at the

Bond yield and the exchange rate



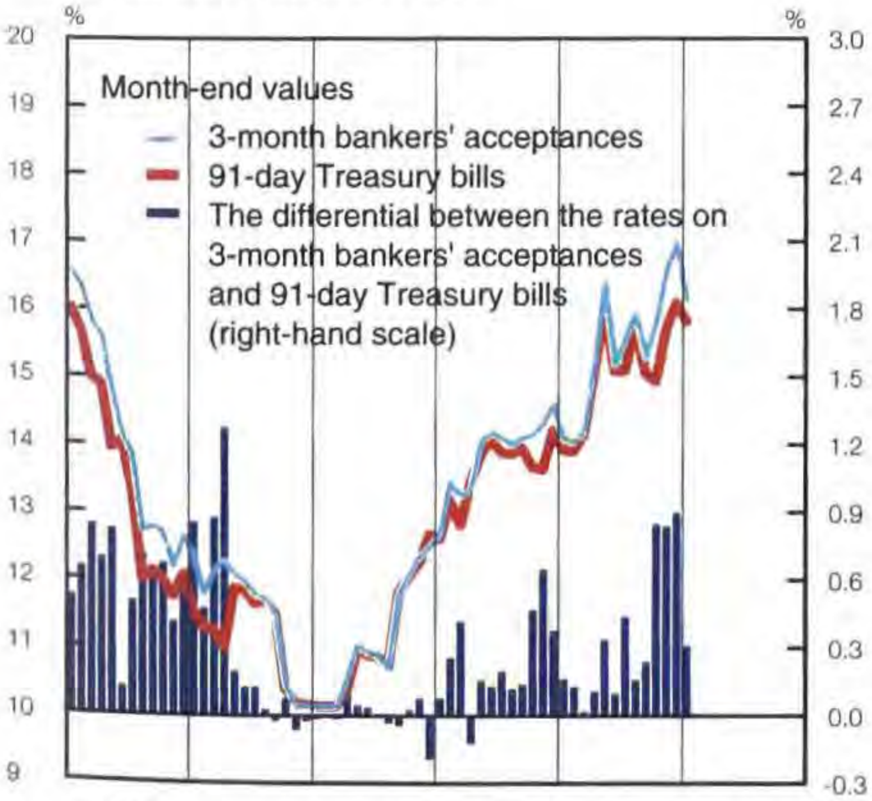
end of the month; the average yield for the month is calculated at 15,82 per cent. The market reacted positively to news of a healthy improvement in the country's trade balance in December, the announcement that inflation figures were lower than those which had been anticipated, the release of monetary statistics which indicated a welcome slowdown in monetary expansion and consequently a more sanguine outlook for inflation, and renewed expectations of an easing in the monetary policy stance. The monthly average *real* yield on long-term government stock declined steadily from 10,1 per cent in May 1996 to 6,2 per cent in December, but this was more the result of a rise in the actually observed inflation than a consequence of any risk reassessment or adjustment in required rates of return.

Money market interest rates rose throughout the first five months of 1996, declined sharply in June, moved along a relatively horizontal time path from July to September and then increased again in the fourth quarter of last year. The rate on *bankers' acceptances* with a maturity of three months, which usually is representative of the general movement of money market rates, increased from 14,10 per cent at the end of January 1996 to 16,40 per cent at the end of May, before it declined to 15,20 per cent at the end of June. During the third quarter of 1996 the rate on bankers' acceptances fluctuated around a level that was slightly higher than in June.

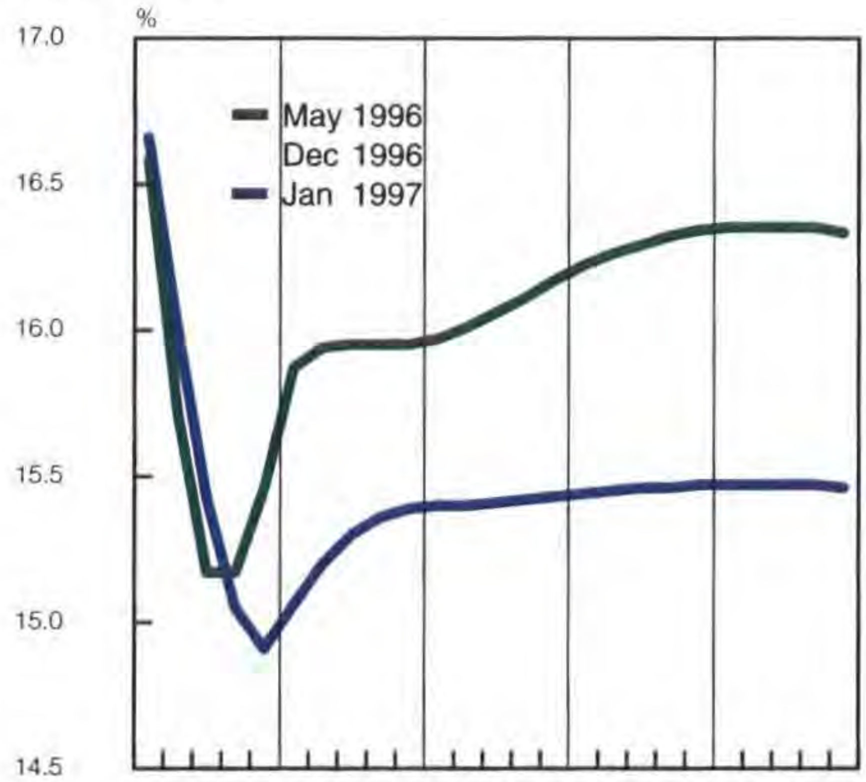
By the beginning of the fourth quarter of 1996 rumours about an imminent rise in Bank rate were rife, money market conditions tightened even further and inflation expectations were generally higher. The rate on bankers' acceptances reflected this change in market sentiment and moved higher to 16,55 per cent at the end of November 1996 and 17,00 per cent at the end of December. Part of this rise was reversed in January 1997 when the rate on bankers' acceptances fell back to 16,15 per cent at the end of the month.

The *tender rate on Treasury bills of three months* at times moved in an opposite direction to the general movement of money market rates. The Treasury-bill rate started out from a level of 13,93 per cent at the end of January 1996 and rose to 16,06 per cent at the end of May. It then declined to 15,10 per cent at the end of June 1996 and moved around this level during the third quarter. Contrary to the general upward movement in money market interest rates, the rate on Treasury bills of three months then drifted lower to 14,95 per cent at the end of October 1996. The limited availability of assets qualifying as first-tier collateral at the discount window at that time created a strong demand for Treasury bills among banks. This explained, on the one hand, the softening in the tender rate on Treasury bills which occurred in October and the first half of November 1996, and on the other hand, the increase in the volume of borrowing at the discount window against collateral of second-tier assets, at penal rates, at the end of November. From the middle of November 1996 tight conditions in the money market, expectations of an imminent rise in Bank rate, and later an actual increase in Bank rate pushed the tender rate of Treasury bills of three

Money market interest rates



Yield curves



months higher to 15,71 per cent at the end of November and 16,10 per cent at the end of December 1996; it then receded to 15,84 per cent at the end of January 1997.

The level and shape of the *yield curve* changed considerably during the first five months of 1996 in reaction to the unsettled conditions in the foreign exchange market. The yield curve shifted higher from January 1996 to May, becoming more inverted at the short end and steeper at the long end. From May 1996 to January 1997 the volatility in shorter-term rates led to frequent changes in the degree of invertedness in the shorter-than-three-year maturity range. Over this same period, the shape of the relatively flat, though marginally upward-sloping, yield curve for maturities in excess of three years remained essentially intact, but the level of the curve declined slightly.

Amidst turbulent conditions in the foreign exchange market as from the middle of February 1996, Bank rate was raised from 15 per cent to 16 per cent on 29 April with the overriding aim of restoring orderly trading conditions in that market. Despite further weakness of the rand and increasingly tight conditions in the money market, Bank rate remained unchanged until the third week of November 1996. Against the backdrop of very tight money market conditions, the rapid expansion of the money and credit aggregates, expectations of rising inflation and the further depreciation of the rand, Bank rate was increased for the second time in 1996 on 21 November. This increase of one percentage point in Bank rate from 16 per cent to 17 per cent was meant to dampen the inflation pressures arising from the depreciation of the rand and formed part of the Reserve Bank's overall counter-inflation strategy.

The *prime overdraft rate of banks* increased from 18,50 to 19,50 per cent on 29 April 1996 in response to the first Bank rate increase of 1996. To alleviate pressure on the margin between their lending and deposit rates, the banks increased their prime overdraft rate even further to 20,50 per cent in May, even though Bank rate was left unchanged in that instance. Only after the Reserve Bank had announced a reduction in the cost of discount-window accommodation against collateral of second-tier assets and conditions in the money market had become somewhat easier, did the banks lower their prime overdraft rates by one percentage point to 19,50 per cent in July 1996. When the financial services levy was abolished in October 1996, the banks announced another cut in their prime overdraft rates to 19,25 per cent. On 21 November, when Bank rate was increased for the second time in 1996, the prime overdraft rates of the banks increased once again by one percentage point to 20,25 per cent.

The *predominant rate on mortgage loans of banks* followed the changes in the prime overdraft rate of banks closely. The mortgage rate was lowered twice, first to 19,25 per cent in July and then to 19 per cent in October. The rise in the prime overdraft rate in November 1996 was followed by an increase in the mortgage rate to 20 per cent in December 1996.

The *predominant retail rate on twelve-month fixed deposits* with banks was increased from 13,50 per cent to 14,50 per cent in May 1996 and even further to 15,00 per cent in June. This rate was subsequently lowered to 14,25 per cent in July 1996 and increased to 15,00 per cent in September, only to be lowered again to 14,50 per cent in November.

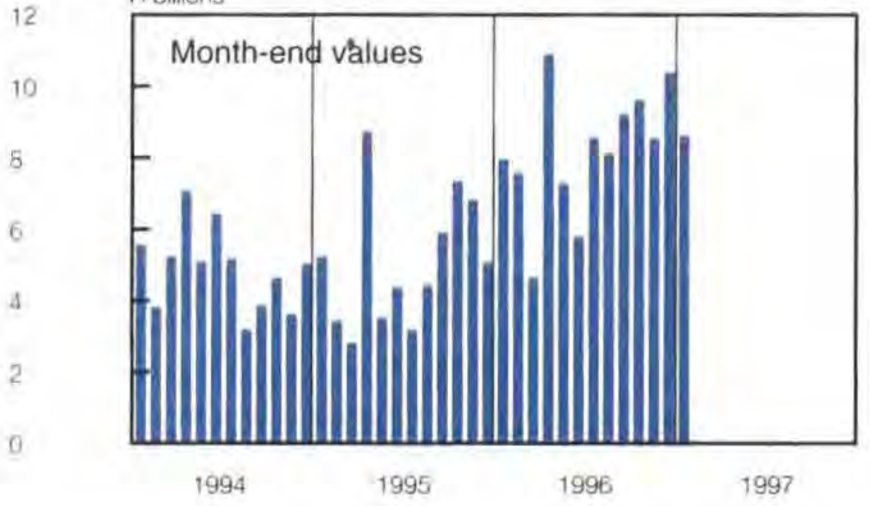
Money market conditions

Money market conditions were relatively tight throughout the first three quarters of 1996, but tightened even further

Table 12. Interest rates and yields
Per cent at month-end, unless otherwise indicated

Period	Monthly average yield on long-term government stock		3-month bankers' acceptances	Prime overdraft rate	Predominant rate on mortgage loans	Predominant rate on 12-month fixed deposits
	Nominal	Real				
1996: Jan	13,77	6,43	14,10	18,50	18,25	14,00
Apr	15,78	9,72	15,20	19,50	18,25	13,50
May	16,53	10,08	16,40	20,50	19,25	14,50
Jun	15,78	8,35	15,20	20,50	20,25	15,00
Jul	15,39	7,73	15,55	19,50	19,25	14,25
Aug	15,82	7,74	15,95	19,50	19,25	14,25
Sep	15,42	6,45	15,30	19,50	19,25	15,00
Oct	15,80	6,15	15,80	19,25	19,00	15,00
Nov	16,18	6,41	16,55	20,25	19,00	14,50
Dec	16,19	6,21	17,00	20,25	20,00	14,50
1997: Jan	15,82	5,90	16,15	20,25	20,00	14,50

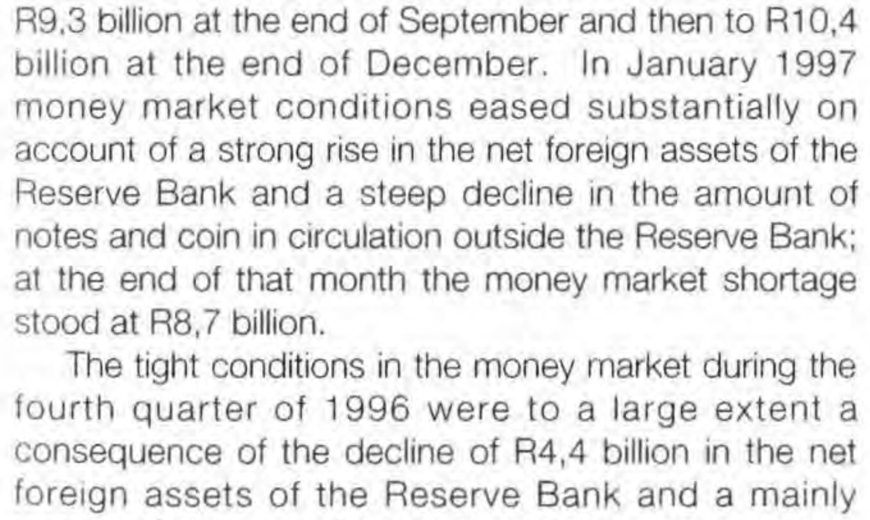
Total accommodation at the discount window



in the fourth quarter. The amount of accommodation which the Reserve Bank extended to banks rose sharply from R5,8 billion at the end of June 1996 to R9,3 billion at the end of September and then to R10,4 billion at the end of December. In January 1997 money market conditions eased substantially on account of a strong rise in the net foreign assets of the Reserve Bank and a steep decline in the amount of notes and coin in circulation outside the Reserve Bank; at the end of that month the money market shortage stood at R8,7 billion.

The tight conditions in the money market during the fourth quarter of 1996 were to a large extent a consequence of the decline of R4,4 billion in the net foreign assets of the Reserve Bank and a mainly seasonal increase of R2,8 billion in the notes and coin in circulation outside the Reserve Bank. This fully negated the minor easing effect on money market conditions

Second-tier accommodation at the discount window



that came from a decrease of R0,5 billion in government deposits with the Reserve Bank.

The prime objective of the *Reserve Bank's operations* in the money market during the fourth quarter of 1996 was to permit the money market shortage to signal clearly the underlying excess demand for funds in the market. Nevertheless, when the market appeared to become exceedingly tight, the Bank was occasionally prepared to inject liquidity. To this end the Bank entered into a number of foreign currency swap arrangements with the banks and also made liquidity available by adjusting the asset portfolio of the Corporation for Public Deposits.

Bond market

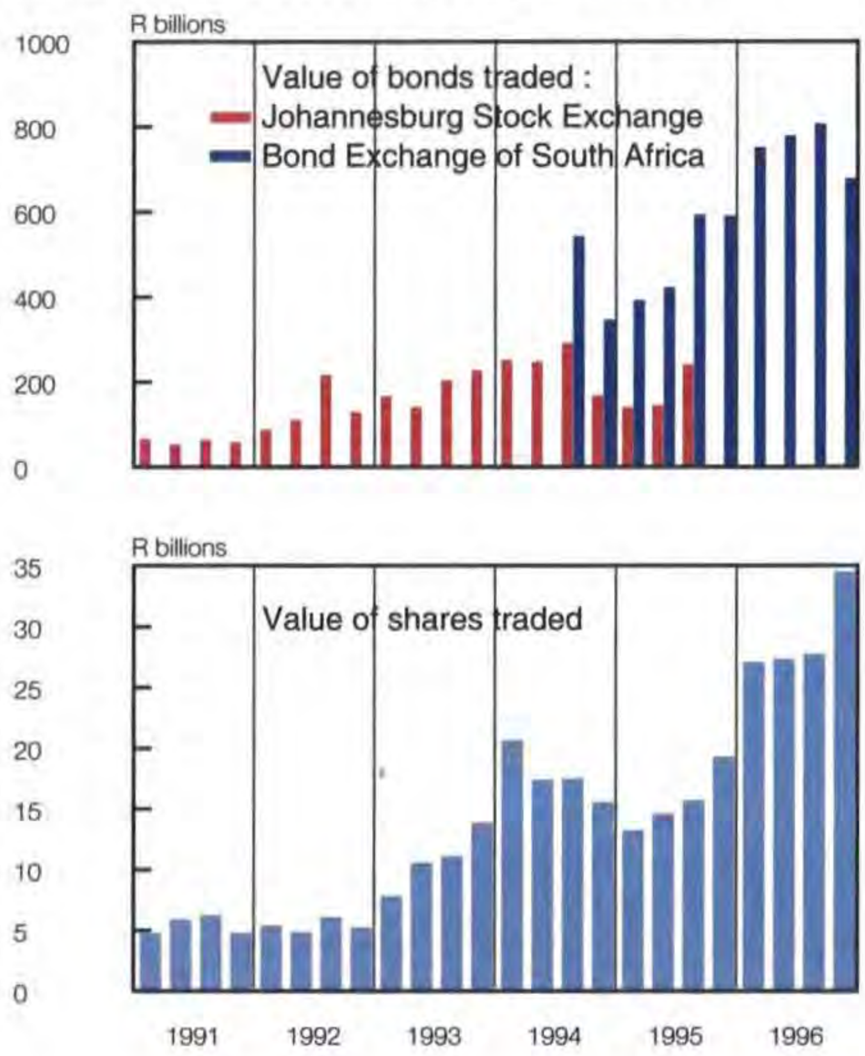
Net issues of fixed-interest securities by the *public sector* in the domestic primary bond market increased from R1,9 billion in the second quarter of 1996 to R9,8 billion in the third quarter. Redemptions, especially by the Central Government, then caused the net bond issues by public-sector entities to decline to R0,6 billion in the fourth quarter. The net amount raised by the public sector through issues of fixed-interest securities during the first nine months of fiscal 1996/97 (i.e. from April to December 1996) accordingly came to R12,3 billion, compared with an amount of R21,1 billion in the corresponding period of the previous year.

Listed private-sector companies acquired funds through rights issues of fixed-interest securities (including convertible preference shares and debentures) to an amount of R2,2 billion in 1996, compared with R0,9 billion in 1995. The opportunity offered to obtain funds at below prevailing lending rates of the banks by this means of finance was perhaps the single most important reason for the increased popularity of fixed-interest securities among private-sector companies in 1996.

The government raised R3,4 billion in the *international primary bond market* during 1996, compared with R1,3 billion in 1995. The amount raised in offshore markets by non-financial public-sector enterprises, however, fell from R1,4 billion in 1995 to R0,6 billion in 1996, most likely because of the downward trend in the exchange value of the rand. Private-sector companies raised no new funds in the international primary bond market in 1996, compared with R1,9 billion which had been raised in these markets in 1995.

The value of transactions in the *secondary bond market* increased by 51 per cent in 1996. The value of bonds traded on the Bond Exchange of South Africa increased from R753 billion in the first quarter of 1996 to R781 billion in the second quarter and R809 billion in the third quarter. The turnover then declined to R680 billion in the fourth quarter of 1996 as a result of a sharp decline in trading activity on the securities markets during the December festive season. As bond yields started to soften in January 1997, the value of bonds

Turnover in the secondary capital market



traded increased to R284 billion compared with a monthly average trade value of R227 billion in the fourth quarter of 1996.

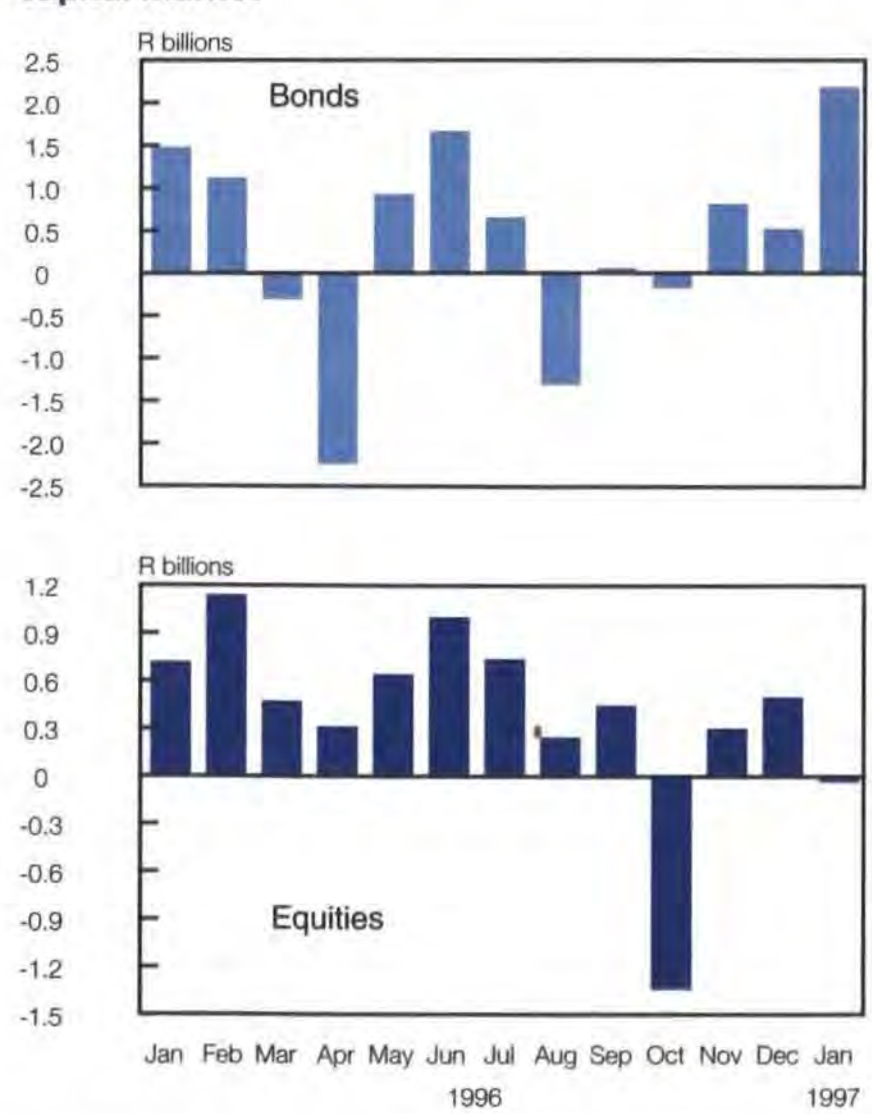
Non-residents were actively involved in the secondary bond market in 1996 and although they were occasionally net sellers, their net purchases on the Bond Exchange amounted to R3,4 billion for the year as a whole. The non-resident demand for rand-denominated assets increased towards the end of 1996 and in January 1997 due to expectations of greater stability in the value of the rand and attractive domestic yields relative to softening international interest rates. This not only contributed to net purchases of bonds of R3,8 billion up to mid-February 1997, but also led to a marked revival in rand-denominated Eurobond issues, which had abated in 1996 because of the depreciation of the rand.

Equity market

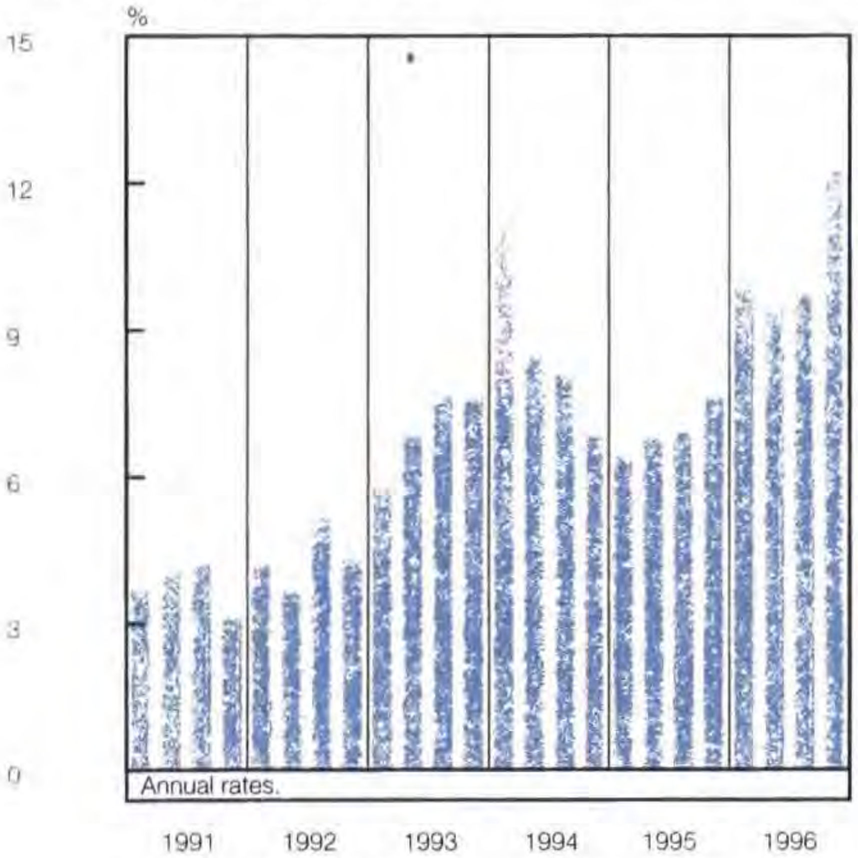
Total capital raised in the *primary equity market* by companies listed on the Johannesburg Stock Exchange increased by 39,9 per cent from R18,9 billion in 1995 to R26,4 billion in 1996, as the relatively high cost of borrowing favoured finance through equity rather than debt. Funds raised through *rights issues of ordinary shares* increased from an average of R1,5 billion during the first three quarters of 1996 to R3,0 billion in the fourth quarter. In the full calendar year 1996 the value of these issues amounted to R7,6 billion, compared with R5,9 billion in 1995. Apart from capital raised through rights issues, substantial amounts were raised by means of scrip dividends and the acquisition of assets, i.e. shares issued for the acquisition of assets not already listed. Together, these two means of financing accounted for about 50 per cent of total capital raised in the primary equity market in 1996 by companies listed on the Johannesburg Stock Exchange.

Turnover in the *secondary equity market* was extremely buoyant in 1996 at R117 billion or 85 per cent more than in 1995. Volatility in the securities and derivatives markets and mutual interaction among these markets as well as the operational and regulatory changes introduced in the equity market from the latter part of 1995 and in 1996, especially the introduction of the Johannesburg Equities Trading System and dual capacity trading, contributed to the huge increase in turnover and liquidity. The quarterly value of shares traded on the Johannesburg Stock Exchange increased consistently from a lower turning-point of R13,3 billion in the first quarter of 1995 to a new record level of R34,6 billion in the fourth quarter of 1996. Liquidity (measured as the value of equities traded as a percentage of total market capitalisation) increased from 6,9 per cent in December 1995 to 10,2 per cent in December 1996.

Non-residents' net transactions in the secondary capital market



Stock exchange liquidity *



* Measured as the value of equities traded as a percentage of total market capitalisation.

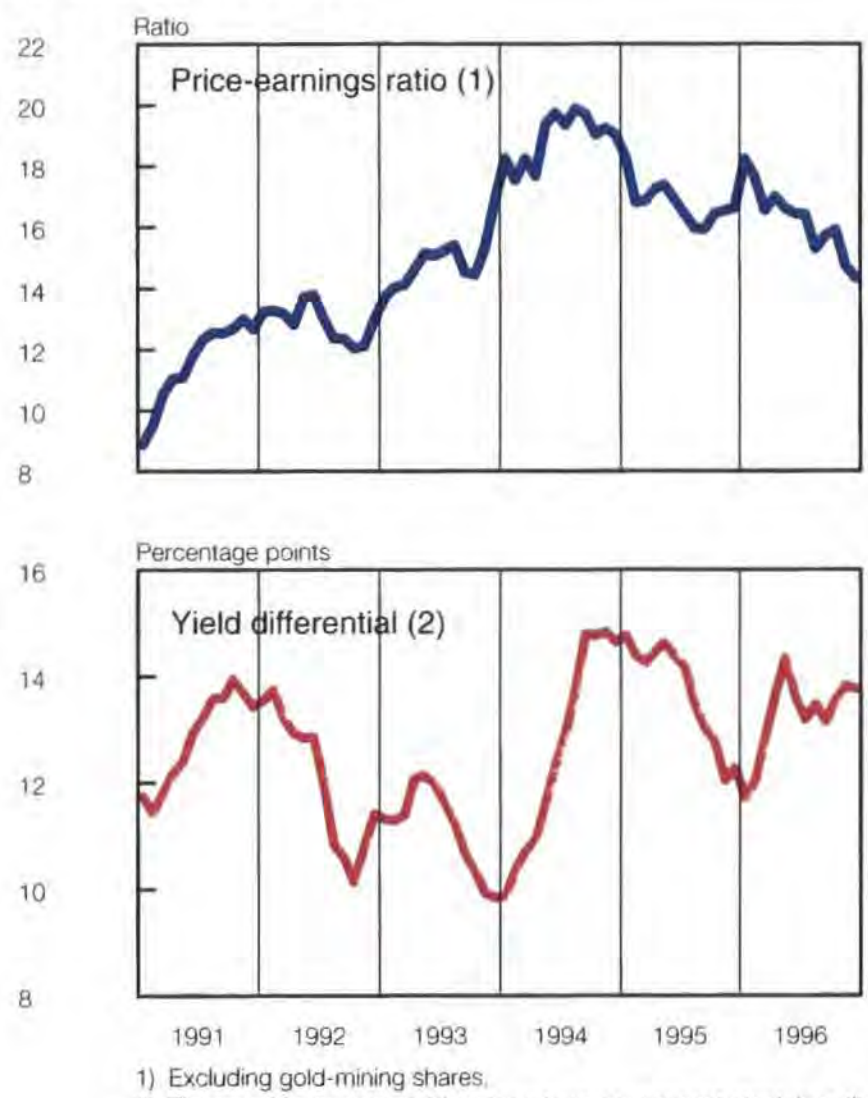
However, as market capitalisation only increased from R1 023 billion to R1 130 billion over the same period and taking into consideration the relatively flat time path of share prices in 1996, the improvement in liquidity may be attributed primarily to sharp increases in the number of shares traded and in the number of transactions in shares. The value of shares traded increased further from a monthly average of R11,5 billion in the fourth quarter of 1996 to R11,8 billion in January 1997.

Non-residents traded actively in the secondary equity market during 1996. The admission to the Johannesburg Stock Exchange of subsidiaries of foreign banks and securities firms probably contributed to non-residents doing more business locally. Non-resident net purchases of shares on the Johannesburg Stock Exchange amounted to R5,3 billion for the full year, 10 per cent more than the net amount purchased in 1995. The quarterly value of net purchases, however, declined from R2,4 billion in the first quarter of 1996 to R2,0 billion in the second quarter and R1,5 billion in the third quarter, followed by net sales of R0,5 billion in the fourth quarter. The net sales in the fourth quarter of 1996 were the first since the fourth quarter of 1994. In the first seven weeks of 1997, non-residents were net purchasers of shares to the amount of R1,0 billion.

Share price movements in 1996 were rather lustreless compared with 1995, despite the continued strength of international bourses. In the year to February 1996, the monthly *average price level of all classes of shares* increased by 30,3 per cent from a low in February 1995. The average level of share prices fluctuated thereafter within a relatively narrow range and increased, on balance, by only 1,2 per cent from February to a new all-time high in October 1996. Share prices then fell in November and December 1996 to a level that was 6,4 per cent below the level of October. However, there was a marked disparity in performance between different sectors; the decline in the overall index was mainly attributable to commercial and gold-mining shares. The monthly average price level of *gold-mining shares* declined by 25,4 per cent between May 1996 and January 1997 to a level that was only 13,7 per cent above its previous low in November 1995. Similarly, the monthly average price of commercial shares fell by 22,8 per cent from February 1996 to January 1997. The equity market steadied again in January 1997 as share prices increased slightly by 2,4 per cent as from December 1996 in reaction to renewed gains on international bourses.

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. The monthly average *earnings yield* of all classes of shares (excluding gold-mining shares) increased similarly from 5,50 per cent in January 1996 to 6,89 per cent in January 1997,

All classes of shares



1) Excluding gold-mining shares.
2) The monthly average yield on long-term government stock less the the dividend yield on all classes of shares.

Table 13. Dividend yield, earnings yield, price-earnings ratio and yield differential on all classes of shares

Period		Dividend yield Per cent	Earnings yield* Per cent	Price earnings ratio*	Yield differential Percentage points
1996:	Jan	2,08	5,50	18,17	11,69
	May	2,21	6,05	16,54	14,32
	Dec.......	2,46	7,01	14,27	13,73
1997	Jan	2,46	6,89	14,51	13,36

* Excluding gold-mining shares

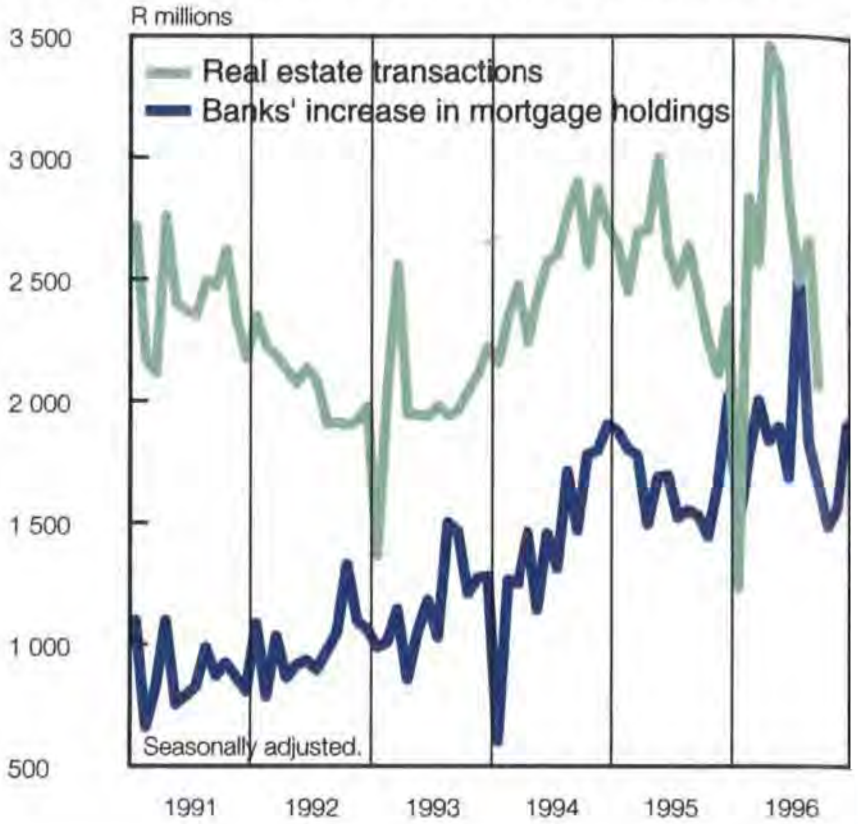
as share prices increased only slightly. The *yield differential* (the monthly average yield on long-term government stock less the dividend yield on all classes of shares), which closely followed the movements of long-term bond yields, narrowed from 14,3 percentage points in May 1996 to 13,4 percentage points in January 1997 as dividend yields increased and long-term bond yields declined. The *price-earnings ratio* (excluding that of gold-mining shares) fell from 18,2 in January 1996 to 14,5 in January 1997 as earnings increased and share prices lacked strong upward direction.

Other financial markets

During 1996 uncertainties in the foreign exchange market, the high level of activity in the securities markets and the implementation of the Automated Trading System by the South African Futures Exchange impacted positively on the *formal derivatives market.* The number of *options* on futures contracts traded was 43,2 per cent higher in 1996 than in 1995, although this fell back by 26,8 per cent from the third to the fourth quarter of 1996. In contrast, the number of *futures* contracts traded increased by only 15,3 per cent in 1996 relative to trades concluded in 1995. The number of futures contracts traded per quarter, however, increased by 15,4 per cent from the third to the fourth quarter of 1996. The combined turnover in options and futures contracts then increased from a monthly average of 0,7 million contracts in the fourth quarter of 1996 to 1,3 million contracts in January 1997. Non-resident participation in the formal derivatives market also increased from an average of 7,4 per cent of open interest in the first three quarters of 1996 to 12,9 per cent in the fourth quarter.

The high level of interest rates, especially the home mortgage rate, impacted negatively on the demand for housing and had a dampening effect on growth in the home loan market and thus on real estate transactions. Financing in the *mortgage market*, although levelling off in the course of the year, remained buoyant in 1996. Total capital repayments in 1996 increased by 22,7 per cent

Mortgage lending and real estate transactions



relative to the levels recorded in 1995. However, over the same period mortgage loans paid out increased by only 17,6 per cent. The total amount of mortgage loans outstanding to banks, nevertheless, increased from R130,3 billion at the end of December 1995 to R152 billion in December 1996. In the *real estate market*, the monthly value as well as the number of transactions declined from April 1996 onwards. The value of real estate transactions in the first three quarters of 1996 amounted to R23,5 billion – about 0,8 per cent lower than in the corresponding period of the previous year. The number of real estate transactions decreased by 2,6 per cent over this period.

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 R21,5 billion in the first nine months of fiscal 1996/97, or to R1,0 billion more than the borrowing requirement in the corresponding period of the preceding year. As a ratio of gross domestic product, the public-sector borrowing requirement came to 5,2 per cent in the first nine months of fiscal 1996/97, which was fractionally lower than the 5,5 per cent in the first nine months of fiscal 1995/96. In the December 1996 quarter, the public-sector borrowing requirement (not adjusted for seasonal variation) amounted to R3,2 billion, which was well down from R10,7 billion in the June 1996 quarter and R7,6 billion in the September 1996 quarter.

The absolute year-on-year increase of R1,0 billion in the public-sector borrowing requirement in the first nine months of fiscal 1996/97 is more than fully accounted for by a year-on-year increase of R2,3 billion in the *borrowing requirement of general government*. In contrast, the borrowing requirement of *non-financial public corporations and central-government business enterprises* was reversed from a deficit of R0,8 billion in the first nine months of fiscal 1995/96 to a surplus of R0,5 billion in the first nine months of fiscal 1996/97.

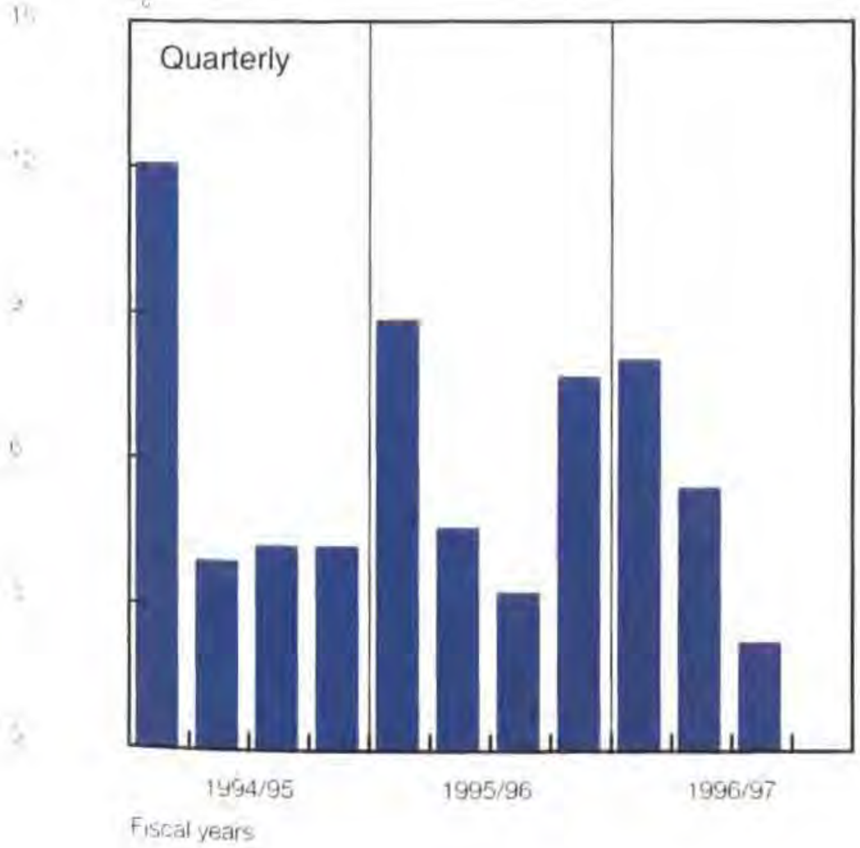
An analysis of the general-government borrowing requirement according to the various *tiers of government*, indicates that the Central Government was responsible for approximately 94 per cent of the overall borrowing required by general government. The borrowing requirement of the Central Government increased by R1,1 billion from R19,5 billion in the first nine months of fiscal 1995/96 to R20,6 billion in the first nine months of fiscal 1996/97. The deficit of *local authorities* rose from R0,3 billion to R0,4 billion over the same period, whereas a financial surplus of *provincial governments* of R0,2 billion in the first nine months of fiscal 1995/96 was turned into a deficit of R0,9 billion in the first nine months of fiscal 1996/97. The reversal in the financial balance of provincial governments from a surplus to a deficit partly reflects the increased social service delivery at the level of provincial governments.

Exchequer account

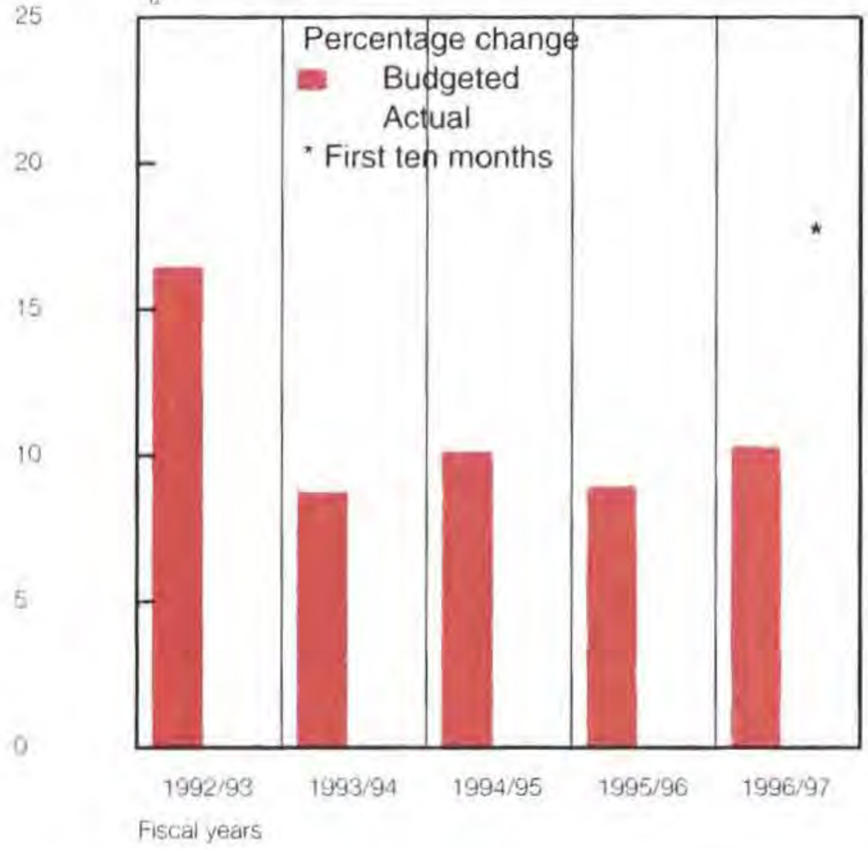
The deficit before borrowing and debt repayment on the Exchequer account in the first ten months of fiscal 1996/97 conformed more or less to the budgetary projections for the full fiscal year. The year-on-year rates of increase in both Exchequer issues and receipts over this period exceeded the increases which had been projected in the Budget for the full fiscal year.

Exchequer issues to government departments (adjusted to reflect cash flows) amounted to R145,5 billion in the first ten months of fiscal 1996/97. This brought the year-on-year rate of increase in adjusted

Public-sector borrowing requirement as percentage of gross domestic product



Budgeted and actual Exchequer issues to government departments



Exchequer issues to 16,9 per cent in the first ten months of fiscal 1996/97, which was substantially higher than the budgetary provision of 10,4 per cent for the year as a whole. The rate of increase in Exchequer issues in the first ten months of the current fiscal year was higher than the average year-on-year rate of increase of 14,2 per cent in the first ten months of the preceding five fiscal years. As a ratio of gross domestic product, Exchequer issues amounted to 31,4 per cent in the first *nine* months of fiscal 1996/97, compared with 30,6 per cent recorded in the corresponding period of the preceding fiscal year.

Exchequer receipts (with the exclusion of extraordinary revenue) in the first ten months of 1996/97 amounted to R124,6 billion, or 15,4 per cent above the level in the first ten months of the preceding year; the growth in government revenue had been budgeted at 13,6 per cent for the year as a whole. As a ratio of gross domestic product, Exchequer receipts amounted to 26,3 per cent in the first nine months of fiscal 1996/97 compared with 25,2 per cent in the first nine months of the previous fiscal year.

The higher-than-budgeted receipts were largely brought about by strong growth in inland revenue receipts which outperformed the budgetary projections. As shown in Table 14, the good performance of Exchequer receipts could mainly be attributed to strong growth in revenue from income tax and customs and excise duties. Value-added tax collections fell disappointingly below the budgetary projections owing to relatively high growth in the exempted categories of exports and fixed capital outlays. Inland revenue benefited from stronger than expected growth in corporate profits, the general overhaul of tax administration and the consequent improvement in tax efficiency. Customs and excise receipts turned out stronger than anticipated in the Budget on account of the sharp rise in the value of merchandise imports, partly related to the weakening of the rand. Customs controls have also been tightened at many points of entry into the country.

The net result of the higher-than-budgeted revenue and expenditure was a *deficit before borrowing and debt repayment* of R20,9 billion in the first ten months of fiscal 1996/97, which represents 68,2 per cent of the deficit budgeted for the year as a whole. This percentage is higher than the 54,7 per cent of the full-year deficit that was realised in the first ten months of the previous year, and also higher than the average of 65,3 per cent recorded in the first ten months of the preceding five fiscal years.

As a ratio of gross domestic product, the deficit before borrowing and debt repayment and excluding extraordinary receipts, amounted to 5,1 per cent in the first

Budgeted and actual Exchequer receipts

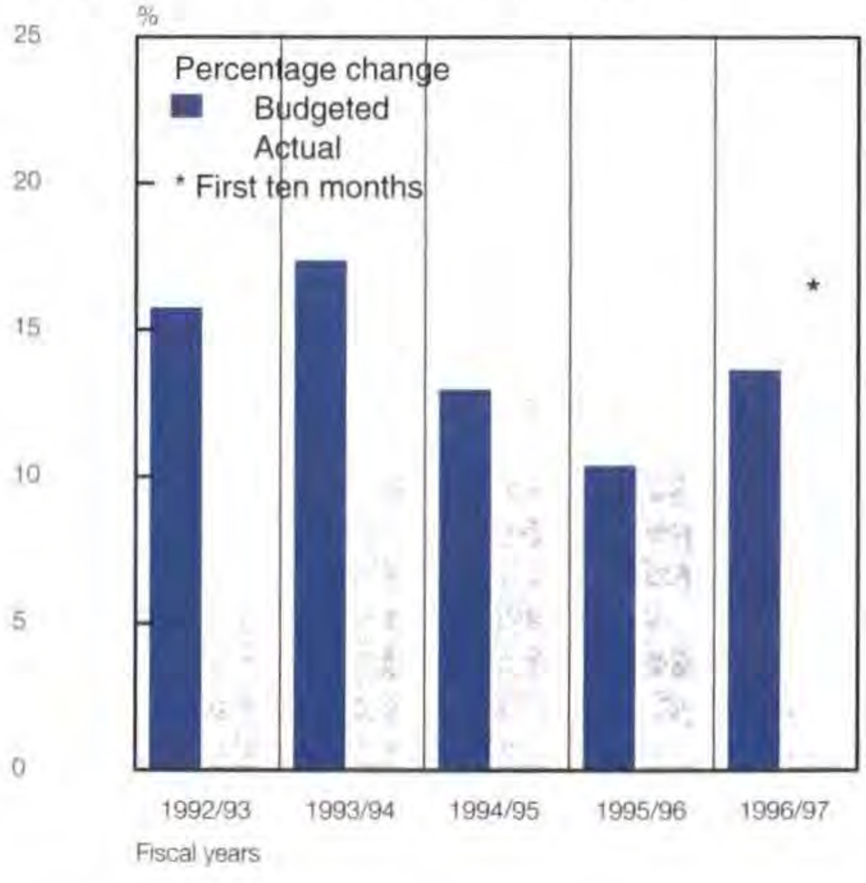


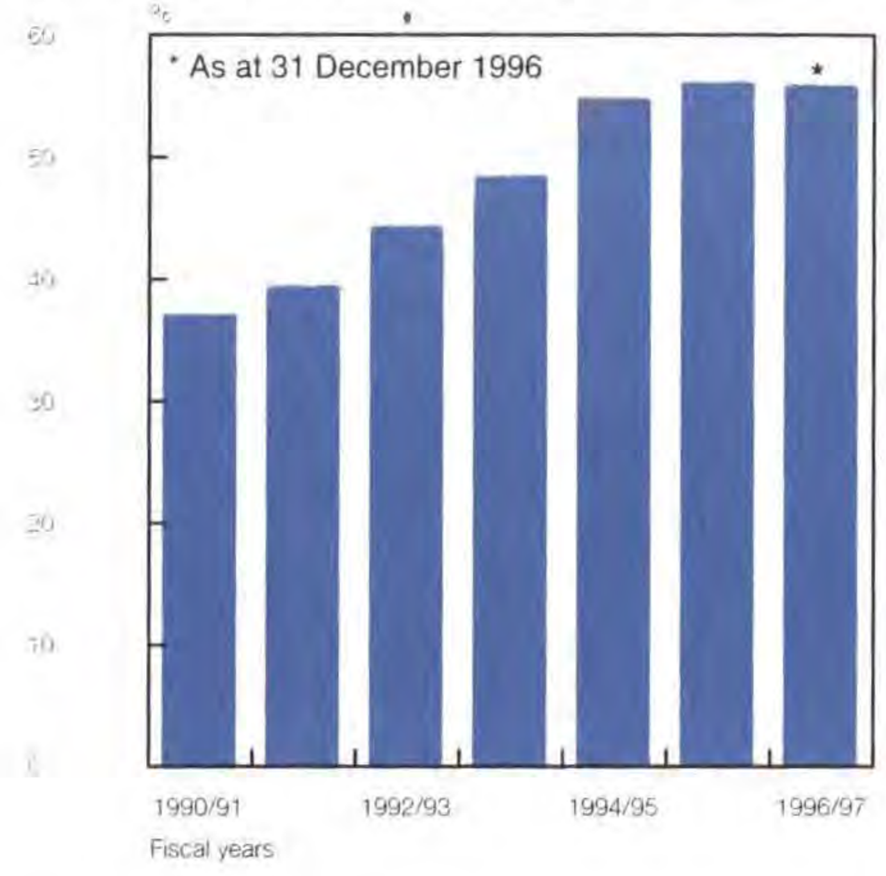
Table 14. Percentage increase in Exchequer receipts

Type of revenue	Budgeted increase for fiscal 1996/7	Actual increase in the first nine months of fiscal 1996/7
Customs and		
excise duties	9,7	16,2
Inland revenue	14,2	16,3
Income tax	17,5	22,8
Value-added tax	13,3	7,8
Total receipts	**13,6**	**17,1**

Table 15. Financing of Exchequer deficit in the first ten months of fiscal 1996/97

	R millions
Government stock (nominal value)	23 424
Less: Discount on government stock	5 652
Net receipts from government stock	**17 772**
Treasury bills	4 795
Extraordinary receipts	1 878
Foreign loans	2 081
Non-marketable securities	-178
Money market instruments	-3 827
Increase in available cash balances	-1 604
Total net financing	**20 917**

Total government debt as percentage of gross domestic product (end of fiscal year)



nine months of fiscal 1996/97 compared with 5,4 per cent in the corresponding period in the previous fiscal year, and the 5,5 per cent projected for the current fiscal year as a whole.

As shown in Table 15, the greater part of the deficit in the first ten months of fiscal 1996/97 was financed by means of new issues of government stock. The funding of the deficit by means of debt instruments caused total government debt to rise from R280,0 billion at the end of March 1996 to R304,1 billion at the end of December. As a percentage of gross domestic product, government debt declined fractionally from 56,2 per cent at the end of March 1996 to 56,0 per cent at the end of December.

Adjustments Budget for fiscal 1996/97

In the Adjustments Budget tabled in Parliament on 13 February 1997 additional expenditure of R13,1 billion was approved for fiscal 1996/97. However, if consideration is given to declared savings, the shifting of funds and functions between tiers of government and budgetary votes, amounts recovered from pension funds, unspent funds and the double counting in respect of the national government's contributions to the Reconstruction and Development Programme Fund, the Supplementary Budget estimates of expenditure for fiscal 1996/97 are lowered by R1 billion from R177,1 billion to R176,1 billion. As a ratio of gross domestic product, the revised government expenditure is expected to be 31,4 per cent in fiscal 1996/97 – similar to the ratio of the preceding fiscal year.

Table 16. Revised Budget estimates for fiscal 1996/97

	R millions
Printed estimate of expenditure	177 100
Plus: Adjustments estimate	13 105
Plus: Standing appropriations	295
Subtotal	**190 500**
Less: Unspent funds	9 000
Recovery from pension funds	300
Expected saving	485
Shifting of funds and functions	536
Double counting in respect of the RDP Fund	4 110
Estimated expenditure for 1996/97	176 069
Estimated revenue and grants (including extraordinary revenue)	147 411
Estimated deficit	**28 658**
Estimated deficit as percentage of gross domestic product	5,1

In the Adjustments Budget provision was also made for an upward revision of the initial estimate of revenue from R144,9 billion to R147,4 billion. The estimates include R1,9 billion as extraordinary revenue, being the proceeds from the sale of strategic oil reserves. Government revenue as a percentage of gross domestic product is expected to be 26,3 per cent, which exceeds by one percentage point the ratio of the preceding fiscal year.

In view of the adjustments to the expenditure and revenue estimates, the deficit before borrowing and debt repayment on the budget of the national government is expected to be R28,7 billion in fiscal 1996/97. This deficit is equivalent to 5,1 per cent of gross domestic product and corresponds with the ratio envisaged by the Minister of Finance when he submitted his initial budget proposals to Parliament in March 1996.