Quarterly Economic Review

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South African Reserve Bank

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Introduction

The sudden depreciation of the rand in 1996 and the various policy responses to that event had a powerful influence on economic developments in 1997. While the depreciation lasted, it created uncertainties among foreign and domestic investors and fostered expectations of rising inflation. The currency weakness emphasised the need to secure a better balance in the economy between aggregate demand and supply in order to restore investors' confidence and prepare the way for sustainable strong economic growth in the longer run.

By the end of 1997 the process of macroeconomic consolidation had largely been completed and the economy was in a much healthier state for the resumption of higher growth than at the beginning of 1996. This was evident from:

- better equilibrium between aggregate real gross domestic expenditure and real gross domestic product;
- the stabilisation of the annual deficit on the current account of the balance of payments relative to gross domestic product;
- the growing recognition of the need for fiscal discipline and the determination to reduce the size of the Budget deficit relative to gross domestic product;
- the increase of net inflows of capital into the country in amounts exceeding the large inflows of 1995;
- a substantial surplus on the overall balance of payments which allowed for a strong further accumulation of gold and other foreign reserves to a level which was significantly higher than at any time during 1996;
- a gradual reduction of the growth in bank credit extension to private-sector entities from inordinately high rates in 1996;
- a significant decline in inflation to quarter-to-quarter movements at the end of 1997 that became more in step with those of the country's major trading partners;
- signs by the third quarter of 1997 that the growth in aggregate unit labour cost was abating; and
- the behaviour of the rand against a basket of currencies - it was much more stable and devoid of the erratic movements that occurred during 1996.

The adjustment process of the past two years, on the other hand, also had negative short-term effects which were unavoidable if the long-run growth capacity of the economy was to be strengthened. These included:

- the short-term slowdown in the rate of real income growth; and
- declines in domestic employment levels as producers became increasingly cost-conscious and raised efficiency in their businesses to become internationally more competitive.

These short-term adjustment problems were aggravated by the uncertainties created by the economic and financial problems that some East Asian economies encountered during the past year and by the sharp decline in the price of gold. Economic activity consequently slackened and the growth in the real gross domestic product declined from slightly more than 3 per cent in 1996 to only 1½ per cent in

1997. In the second half of 1997 output growth slowed down even more and annualised output growth in the last six months was below 1 per cent.

The slowdown in output growth in the second half of 1997 occurred over the broad spectrum of economic activities, but was more conspicuous in the manufacturing and commercial sectors. The manufacturing sector had to contend with stronger competition in an increasingly open economy. Coupled with domestic cost pressures, subdued increases in output prices and weak demand growth, this compressed operating margins to such an extent that the real value added in the manufacturing sector declined in the second and third quarters of 1997. The downward pressure on real household incomes and the weakening of consumer confidence contributed to declines in the real value added by the commercial sector. Though still positive, growth in the mining sector - which was affected by falling international commodity prices - and in the services sectors also slowed down towards the end of 1997.

The slowdown in private consumption expenditure, which had already become apparent in the second half of 1996, continued into 1997. Falling employment levels and heightened job insecurity have weakened consumer confidence. Although the growth in consumer spending was curtailed in 1997, households still preferred to maintain certain minimum spending levels by activating their accumulated savings. Together with a further rise in household indebtedness, this caused the household savings rate and the national savings rate to decline to a level that is inadequate for the financing of fixed investment at a pace compatible with rapid job creation.

Real government consumption expenditure grew at an exceptionally rapid rate in 1997, thereby increasing the rate of dissaving of general government and reducing the already very low national savings rate even further. Real gross domestic fixed investment still increased in the second half of 1997, but at a much lower rate than in the preceding three years. Public-sector fixed investment was mostly responsible for this slowdown in real fixed investment activity, while private-sector companies modestly increased their rate of capital formation towards the end of 1997.

As already mentioned, the measures taken in response to the apparent weakness in the overall balance of payments during 1996 had the desired effect of restoring better balance between aggregate demand and supply. The deficit on the current account of the balance of payments in 1997 as a whole, however, changed little from that of 1996. In the course of 1997, an acceleration in total domestic demand in the fourth quarter, a decline in the gold price and international commodity prices and a decline in the ratio of import prices to the prices of domestically produced goods, however, resulted in a widening of the quarterly seasonally-adjusted current-account deficit. Although the deficit also widened relative to gross domestic product, it was still within the limits of sustainability during the fourth quarter of 1997. Aggregate output responded weakly to the strengthening of domestic demand towards the end of 1997. This caused the import-penetration ratio to rise steeply.

The current account deficit in 1997 was accompanied by a strong rise in net inflows of capital which helped to rebuild international reserves. Import cover improved to about two-and-a-half months' worth of imports of goods and services. The net inflows of international capital were mostly in the form of portfolio-type investments, which nevertheless need not be of a speculative nature. A sizeable part of the inflows was related to Eurorand bond issues with a fairly long maturity and asset swap arrangements between resident and non-resident investors, thereby assuming the character of longer-term investment. Foreign direct investors, however, still seemed somewhat hesitant to commit large amounts of long-term capital, probably due to uncertainty over prospective exchange rate movements, a mismatch between productivity and remuneration levels and concerns over violent crime.

The accumulation of international reserves during 1997 helped to steady the rand after the sharp loss in value of the previous year. The rand also recovered rather quickly after the effects of the problems in Asia had spilt over into the South African securities markets in October 1997, leaving the impression that the contagion from the currency crisis in Asia had been short-lived. This stabilisation of the rand was attained without official attempts to defend the rand at any particular level.

Consumer-price inflation is now firmly on a downward trend, having risen sharply in 1996 as a result of the depreciation of the rand. Production-price inflation declined equally impressively and the most recent quarter-to-quarter inflation rates were not completely out of step with trend inflation in South Africa's major trading-partner countries. Prospects for lower inflation also appeared to have improved, given the new-found stability of the exchange rate of the rand and the easing in the growth of private-sector credit. Furthermore, the opening up of the economy increasingly discouraged producers from raising prices in order to remain competitive with foreign suppliers.

Employee remuneration remained at a relatively high level. Any increase in the current growth of nominal remuneration per worker would be difficult to reconcile with the monetary-policy objective of enhanced price stability. Employment in the non-agricultural sector continued to fall in the first three quarters of 1997. This still reflected the restructuring and rationalisation of work practices by producers facing domestic cost pressures, aggressive foreign competition and weak international commodity prices. In addition, the elimination of export subsidies also forced domestic exporters to adjust and reduce the size of their workforce.

The Reserve Bank's guidelines for M3 growth were kept unchanged at 6 to 10 per cent for 1997. The upper limit of this guideline range continued to be substantially overshot. This coincided until recently with the persistently strong growth in credit extended to the private sector by monetary institutions. By the third quarter of 1997 it had become abundantly clear that private-sector credit growth had slowed down. A "revised" or "purified" definition of private-sector credit, which excludes, among others, credit extended by banks to local governments, indicated that the slowdown in private-sector credit growth was even more impressive than that indicated by the conventional definition. This slowdown in private-sector credit growth generally reflected subdued economic activity, falling inflation and weaker household expenditure.

The decline in private-sector credit growth, the improvement in the overall balance of payments, rising gold and other foreign exchange reserves and the easing of inflationary pressures paved the way for a one percentage point reduction in Bank rate in October 1997. Bank lending rates responded with little delay to the lowering of Bank rate, but the response of money market interest rates was rather muted. This was mainly owing to two reasons: firstly, the lowering of Bank rate had already been discounted in the prevailing market-determined rates and, secondly, the decline in the net foreign assets of the Reserve Bank following the financial problems in Asia, widened the liquidity shortage in the domestic money market and put upward pressure on short-term interest rates. Money market rates nevertheless began to subside in January 1998 as the impact of the Asian problems faded and trading conditions in the money and foreign-exchange markets steadied.

The main features of financial market developments in 1997 were the bullish sentiment which prevailed in the bond market, strongly rising turnovers in the securities markets, the heightened volatility in the share market and the increased non-resident participation in the South African markets. Bond yields fell nearly 250 basis points from the end of 1996 to the beginning of 1998, reflecting growing anticipation of an easing of monetary policy, steadily declining inflation and heavy non-resident buying. Share prices, which had risen firmly since the beginning of 1997 on the back of solid earnings growth and in anticipation of a decline in official interest rates, became highly volatile in late October 1997 when they fell back sharply as a result of the spill-over effects of the loss of international investor confidence in emerging markets. Non-residents were much more active in the South African securities markets than before. High yields, the easing of inflationary pressures, which strengthened prospects for a downward movement of the yield curve, and the perception that exchange risks had diminished lured non-resident investors back into the domestic securities markets.

Activity in the domestic primary bond market was overwhelmingly dominated by issues of entities in the public sector. As a result of the high level of liquidity in the corporate sector and the high cost of borrowed funds, private-sector companies preferred to raise capital through the issuance of shares. Private-sector companies also abstained from raising substantial amounts in international capital markets, but a number of public-sector bodies opted to issue bonds in the Eurorand market.

The overall public-sector borrowing requirement relative to gross domestic product in the first three quarters of fiscal 1997/1998 increased in comparison with its counterpart of the previous fiscal year. In contrast, the deficit before borrowing and debt repayment on the Exchequer account as a ratio of gross domestic product, was reduced from the first three quarters of fiscal 1996/1997 to the first three quarters of 1997/1998. The portion of the budgeted deficit absorbed in the first ten months of the current fiscal year was nevertheless significantly higher than during any of the previous five fiscal years. This was mainly the result of some provincial governments exceeding their budget allocations which also caused substantial increases in their indebtedness to the banking sector.

The first "Medium Term Budget Policy Statement" was released on 2 December 1997 and set out broad-based expenditure and revenue plans for the next three fiscal years. A key element of this Statement is the "Medium Term Expenditure Framework" which initiated a process of three-year rolling budgets. Government departments will in future be expected to frame their policy proposals within their three-year budgetary allocations. The Statement retained the budget deficit reduction targets indicated by the *Macroeconomic Strategy for Growth, Employment and Redistribution*. The Statement also pledged to restrain the growth in nominal government expenditure. If future economic growth does not meet current expectations, then spending growth will be contained below the projected expenditure levels.

Domestic economic developments

Domestic output

Economic activity slackened in 1997, reflecting weaker growth in aggregate domestic demand. *Real gross domestic product*, which had risen by more than 3 per cent in 1996, increased by only 1½ per cent in 1997. This slowdown in activity was especially noticeable in the second half of 1997 when quarter-to-quarter annualised rates of growth of only ½ per cent were recorded. Declines in manufacturing production and in the real output of the commercial sector during the second half of 1997, were primarily responsible for this slowdown of economic growth.

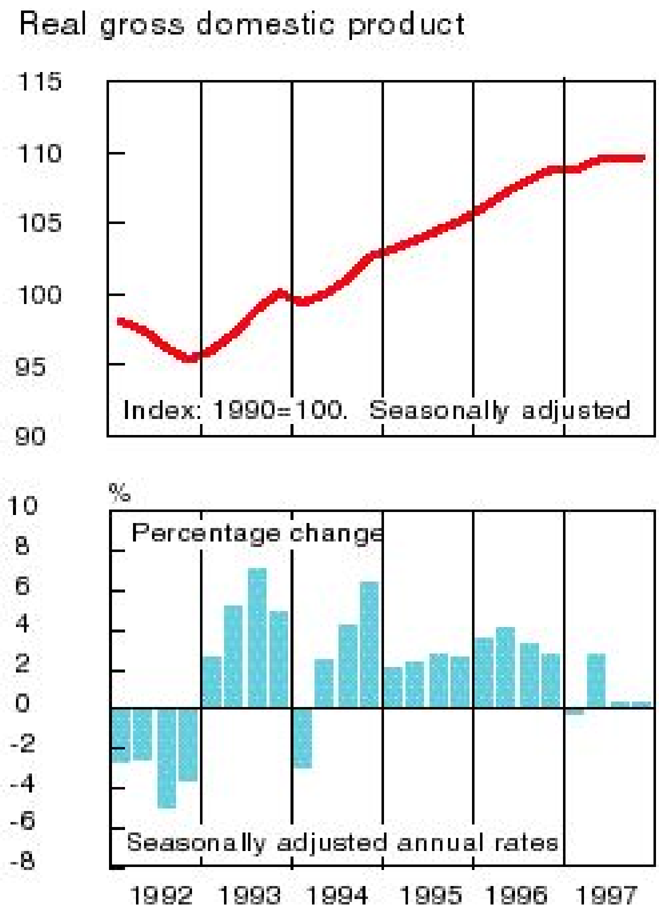


Table 1. Real gross domestic product

Percentage change at seasonally adjusted and annualised rates

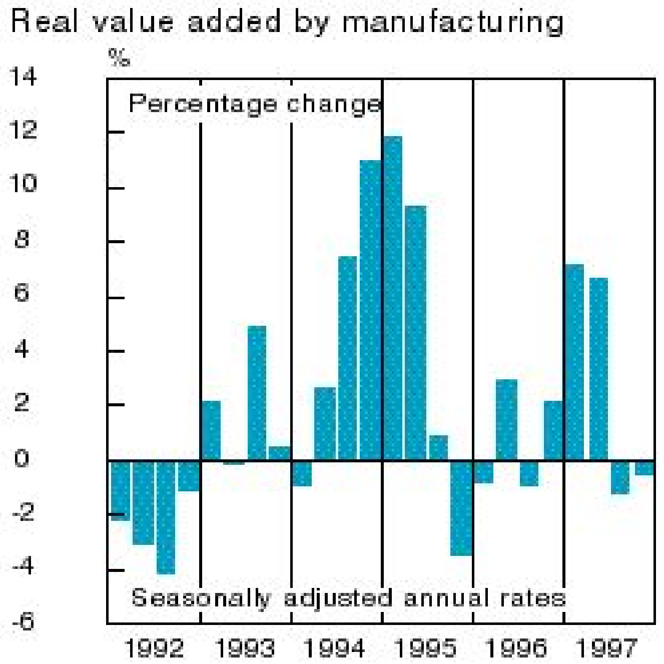
	1996	1997

Sector	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Primary sectors	26	16½	15½	2½	9	-13½	2	3	1	½
Agriculture	99	65	59½	4	29	-31	-5	-½	0	-1
Mining	-½	-5	-7½	1	-1½	1½	7	5	1½	1
Secondary sectors	½	3	½	2½	1	6	6	-½	0	3
Manufacturing	-1	3	-1	2	½	7	6½	-1	-½	3½
Tertiary sectors	1	3	2	3	3	-½	1	0	½	1
Commerce	-2½	5½	0	3	3½	-2	2	-1½	-½	½
Transport, storage and communication	1	2	3	2½	3	½	4½	3	2½	2½
Financial and other services	3½	3	4	4	3½	2	2	1	1½	2½
Total	**3½**	**4**	**3**	**3**	**3**	**-½**	**2½**	½	½	**1½**
Non-agricultural sectors	½	2	½	2½	2	2	3½	½	½	2

Real value added by the agricultural sector declined by 1 per cent in 1997 with the return to a more normal season following the bumper harvests in 1996. Agricultural output also declined marginally in the fourth quarter of 1997 owing to a decline in wheat production which offset the increases in real income of livestock and horticultural producers.

Outside the agricultural sector, real output growth slowed down from an average quarter-to-quarter annualised rate of about 2½ per cent in the first half of 1997 to approximately ½ per cent in the second half of the year. *Mining output* increased at an annualised rate of only 1½ per cent in the fourth quarter of 1997, down from a high rate of 5 per cent in the third quarter, mainly owing to the continued fall in the price of gold and international commodity prices which dampened the prospects for this sector.

Real value added by the *manufacturing sector* declined at rates of 1 per cent in the third quarter of 1997 and ½ per cent in the fourth quarter. These declines were related to a tapering off in the growth of foreign demand for South African manufactured goods, stiff competition faced by import-competing industries, the general slack in domestic final demand and the forward linkage effects of lower agricultural production. A spurt in manufactured output growth to annualised rates of 7 per cent in the first quarter of 1997 and 6½ per cent in the second quarter nevertheless ensured that the real value added by the manufacturing sector in 1997 as a whole was about 3½ per cent higher than in 1996.

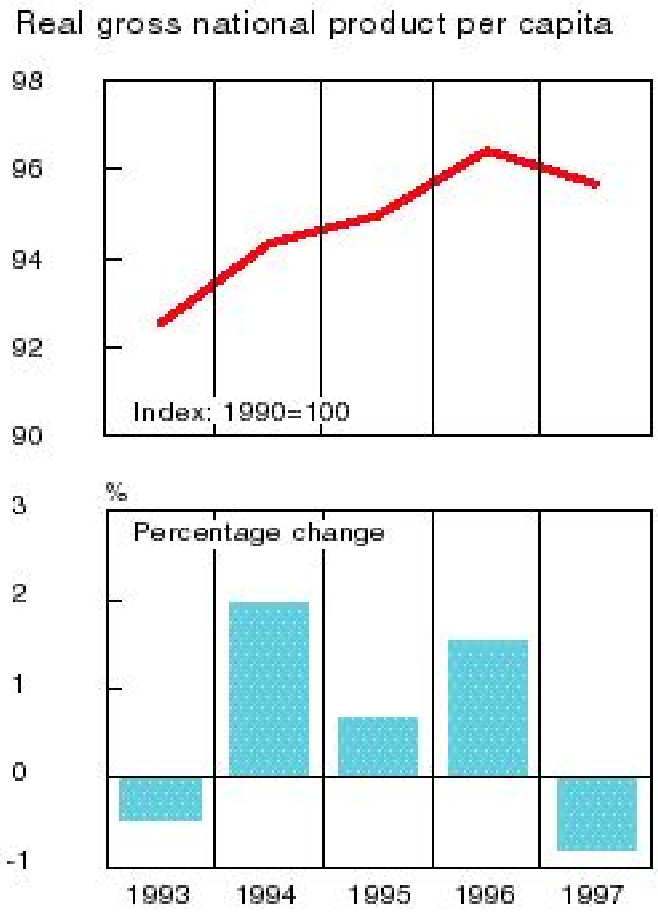


Growth in output by the sector supplying *electricity, gas and water* slowed down from 4 per cent and 6 per cent in the first two quarters of 1997 to ½ per cent in the third quarter and 1 per cent in the fourth quarter. At the same time, real value added by the *construction sector* slowed down too as the demand in the housing market weakened and business investment in new buildings tapered off. Together, these slowdowns contributed to falling output at an annualised rate of about ½ per cent in the combined *secondary sectors* of the economy in the last two quarters of 1997.

The slump in new motor vehicle sales in the fourth quarter caused real output in the motor trade to decline sharply in the fourth quarter of 1997. This was partly offset by small increases in the real value added by the retail and wholesale trade and catering and accommodation sectors, resulting in a decline in the output volumes of the *commercial* sector at an annualised rate of ½ per cent in the fourth quarter of 1997, compared with 1½ per cent in the third quarter.

Though slightly down from rates of 4½ per cent and 3 per cent in the preceding two quarters, real value added by the sector *transport, storage and communication* was boosted by the expansion of the domestic telecommunications network and the rising volumes of international trade entering the country and still increased sturdily at a rate of 2½ per cent in the fourth quarter of 1997. In the *financial services sector* output growth accelerated slightly from an annualised rate of 1 per cent in the third quarter of 1997 to 1½ per cent in the fourth quarter - turnovers in the foreign exchange and securities markets picked up strongly during the fourth quarter when the turmoil in the financial markets of a number of Asian economies impacted on the local markets.

The growth in real domestic production in 1997 was diluted somewhat by increased net factor payments to the rest of the world and a deterioration in the terms of trade. Net factor payments to non-residents increased on account of higher interest and dividend payments following the sharp rise in portfolio capital flows into South Africa, whereas the terms of trade deteriorated mainly because of the falling price of gold and weak international commodity prices. The real *gross national product* accordingly increased by nearly 1½ per cent in 1997, i.e. slightly less than the growth in real gross domestic product and significantly down from the rate of 3½ per cent that had been registered in 1996. Real gross national product per capita consequently declined by about 1 per cent in 1997, compared with an average annual growth of about 1½ per cent over the preceding three calendar years.



Domestic expenditure

Growth from quarter to quarter in aggregate real gross domestic expenditure during 1997 vacillated between a decline at an annualised rate of 2 per cent in the first quarter of the year and increases at annualised rates of 5½ per cent in the second quarter and 4½ per cent in the fourth quarter of the year. However, when calendar-year totals are compared, the growth in real gross domestic expenditure declined from 2½ per cent in 1996 to 1½ per cent in 1997. In the fourth quarter of 1997 expenditure growth accelerated strongly because of a sharp increase in real consumption expenditure by general government and a smaller decline in real inventory investment than in the third quarter.

Table 2. Real gross domestic expenditure

Percentage change at seasonally adjusted and annualised rates

Components	1996					1997				
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr	4th qr	Year

Private consumption expenditure	3½	4	3	3	4	1	1½	1	½	2
Government consumption expenditure	6½	11	9	3½	6	6	7½	9	11½	7
Gross domestic fixed investment	10½	6½	5	5	8	2	3	3	1½	3½
Final domestic demand	5½	6	4½	3½	5	2½	3	3	3	3½
Change in inventories (R billions)*	1,2	6,7	2,4	0,4	2,7	-2,7	-2,3	-4,4	-3,0	-3,1
Gross domestic expenditure	**-1**	**15½**	**-5**	**2**	**2½**	**-2**	**5½**	**0**	**4½**	**1½**
* Constant 1990 prices, annualised										

The growth in *real private consumption expenditure* slowed down from an annualised rate of 1½ per cent in the second quarter of 1997 to 1 per cent in the third quarter and ½ per cent in the fourth quarter. This reflected progressively declining growth from quarter to quarter in consumer spending on non-durable goods and larger actual declines in spending on durable goods. In 1997 as a whole, real private consumption increased at a rate of 2 per cent, compared with growth of 4 per cent in 1996.

Real outlays by households on *durable goods* declined at an annualised rate of 16½ per cent in the fourth quarter of 1997, thereby reducing this kind of household spending to a level that was 6 per cent lower than the previous year. Declines were particularly severe in two spending categories, namely transport equipment and furniture and household appliances. Spending on durable goods is generally easier to postpone and therefore has a more pronounced pro-cyclical pattern than spending on non-durable goods and services. In the current phase of economic consolidation, households also tend to withhold spending on durable goods to a larger extent than spending on non-durable and semi-durable goods and services.

Table 3. Real private consumption expenditure

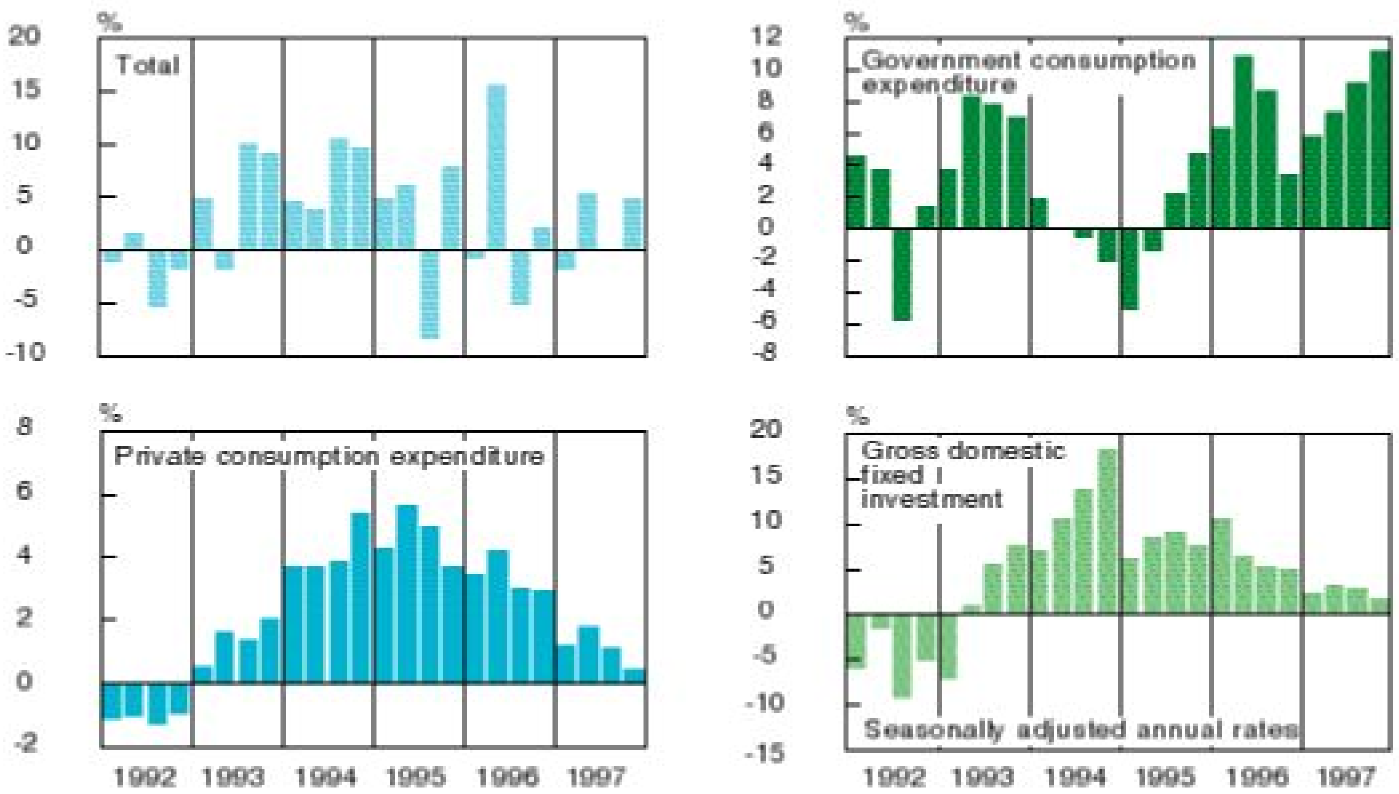
Percentage change at seasonally adjusted and annualised rates

Components	**1997**				
	1st qr	**2nd qr**	**3rd qr**	**4th qr**	**Year**
Durable goods	-3	-2	-2½	-16½	½

Semi-durable goods	4	1	-½	2½	3
Non-durable goods	3	2½	1½	1	2½
Services	-2	2½	3	5	1
Total	**1**	**1½**	**1**	½	**2**

The slowdown in household spending during 1997 can be attributed to, *inter alia,* slower growth in real personal disposable income. This was, in the main, a result of declining employment levels, a slowdown in the gross income of farmers, higher tax collections from households and an acceleration in the deflator for private consumption expenditure to a level that was roughly equal to the rate of remuneration settlements. Furthermore, consumer confidence might have wavered towards the end of 1997 as household debt ratios increased and property and equity values tended to stagnate or decline. This has ostensibly reduced the net worth of households and lowered the resources perceived by households to be at their disposal.

Change in real gross domestic final demand



Aggregate *real consumption expenditure by general government* accelerated from an annualised quarter-to-quarter growth rate of 9 per cent in the third quarter of 1997 to 11½ per cent in the fourth quarter, taking the year-to-year growth in 1997 to 7 per cent as against 6 per cent in 1996. The strong increase in real consumption expenditure by general government was the net result of a rapid increase in real outlays on intermediate goods and services other than employee services, and a small decline in the real remuneration of employees. All three tiers of government contributed to these high growth rates, but expenditure by provincial governments increased considerably more than that of the central government and local authorities. The ratio of general government consumption expenditure to gross domestic product accordingly increased from 20½ per cent in 1996 to 21½ per cent in 1997.

The year-to-year growth in *real gross domestic fixed investment* declined from 8 per cent in 1996 to 3½ per cent in 1997. This slowdown was evident in the capital outlays of all three institutional sectors: in the private sector it fell from 6 per cent in 1996 to 3 per cent in 1997, for public corporations from 10½ per cent to 5½ per cent and for public authorities from 15 per cent to 4 per cent.

Table 4. Real gross domestic fixed investment

Percentage change at seasonally adjusted and annualised rates

Institutional sectors	1997				
	1st qr	**2nd qr**	**3rd qr**	**4th qr**	**Year**
Private sector	1	2½	2½	3	3
Public sector	6	5	4½	-1½	4½
Public authorities	3	1½	2	-2	4
Public corporations	8½	8	6½	-1	5½
Total	**2**	**3**	**3**	**1½**	**3½**

The quarter-to-quarter growth in real gross domestic fixed investment decelerated from 3 per cent in the second and third quarter of 1997 to 1½ per cent in the fourth quarter. The low rate of increase in the fourth quarter of 1997 was essentially caused by a decline in *fixed capital formation by the public sector* (public authorities and public corporations combined) at a seasonally adjusted and annualised rate of 1½ per cent. Higher real capital outlays by Telkom, Eskom and general government were more than fully offset by declines in the fixed investment spending by Transnet and business enterprises of general government. In contrast to public-sector fixed investment, the growth in *real gross fixed investment by the private sector* accelerated slightly from rates varying between 1 and 2½ per cent in the first three quarters of 1997 to 3 per cent in the fourth quarter. Firm increases were evident in agriculture, mining and manufacturing.

After *investment in inventories* at constant 1990 prices had fallen from R6,3 billion in 1995 to R2,7 billion in 1996, it turned negative to an amount of R3,1 billion in 1997. The reduction of inventory levels in 1997 reduced gross domestic product growth by 2 percentage points. The negative investment in inventories was nevertheless reduced from the third quarter of 1997 to the fourth quarter, thereby adding some 2 percentage points to the annualised growth in gross domestic product in the fourth quarter.

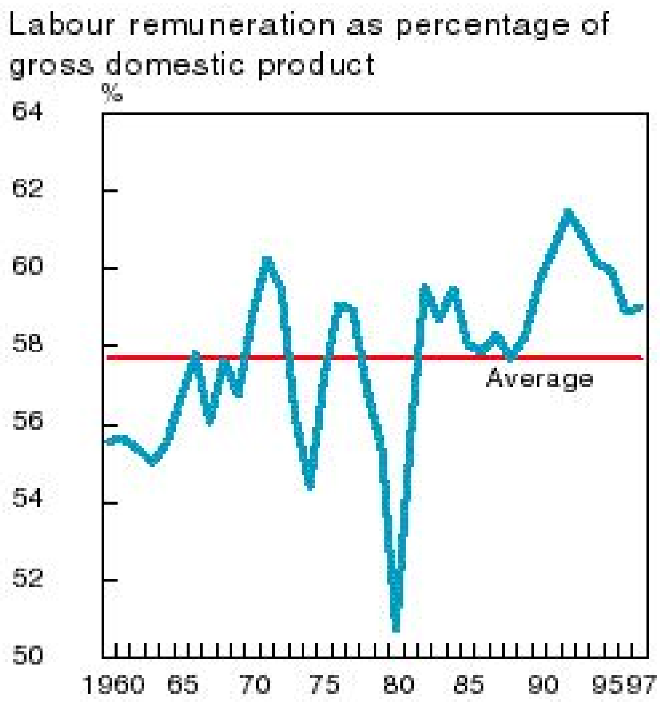
The continued negative net change in the real value of inventories in the fourth quarter of 1997 was largely confined to the mining sector and the wholesale and retail sectors. The slowdown in final domestic demand and the prevailing high cost of carrying inventories urged manufacturers as well as wholesale and retail enterprises to economise on their inventory holdings. As a consequence, the ratio of industrial and commercial inventories to the non-agricultural gross domestic product declined from 18½ per cent at the end of 1996 to 17½ per cent at the end of 1997.

Factor income

The year-on-year growth in *aggregate nominal factor income* at market prices slowed down from 10½ per cent in the first quarter of 1997 to 9½ per cent in the fourth quarter. Likewise, the growth in factor income for the calendar year slowed down from 12 per cent in 1996 to 9½ per cent in 1997. These slowdowns originated in lower growth of both the operating surpluses of business enterprises and the remuneration of employees.

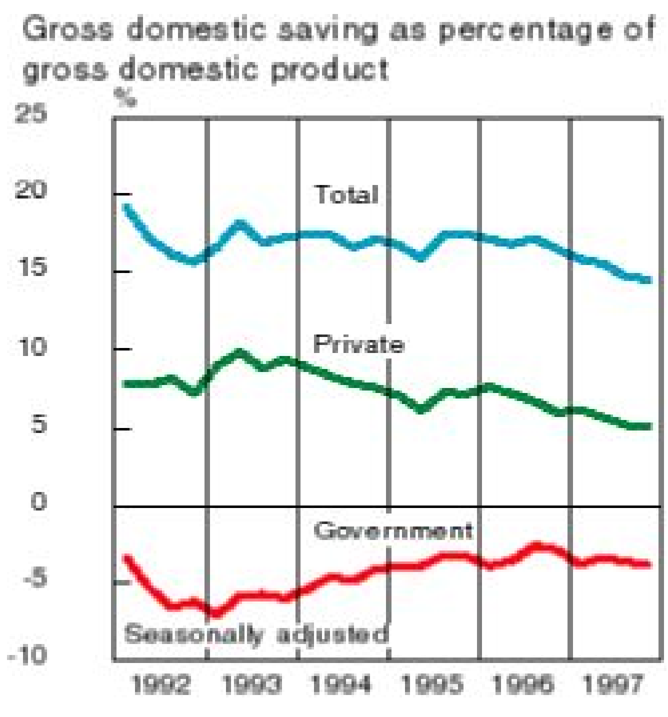
The growth over four quarters in aggregate nominal gross operating surpluses of business enterprises contracted from 10½ per cent in the first quarter of 1997 to 8½ per cent in the fourth quarter. This slowdown in the growth of operating surpluses was noticeable over a broad spectrum of sectors, ranging from agriculture to mining and commerce. In the agricultural sector the gross income of farmers was adversely affected by declines in the maize and wheat crops. The mining sector was affected by declining international commodity prices, which also impacted on the operating profits of the major resource-based manufacturing industries. In the manufacturing sector input costs generally also rose considerably faster than production prices, thereby putting downward pressure on total profit margins.

The rate of increase over four quarters in total remuneration of employees slowed down from 10 per cent in the first quarter of 1997 to 9 per cent in the fourth quarter, rather because of declining employment levels than the moderation of nominal employee remuneration growth. Despite the slower growth in aggregate employee remuneration, the share of labour in the value of aggregate output remained at 59 per cent in 1997 - the same share as in 1996. The long-run average of this ratio is calculated at 57½ per cent.



Domestic saving

The *ratio of gross domestic saving to gross domestic product* fluctuated around a level of approximately 15½ per cent in the first two quarters of 1997, but then declined sharply to 14½ per cent in the ensuing two quarters. This brought the domestic savings rate down from 17 per cent of gross domestic product in 1996 to 15 per cent in 1997.



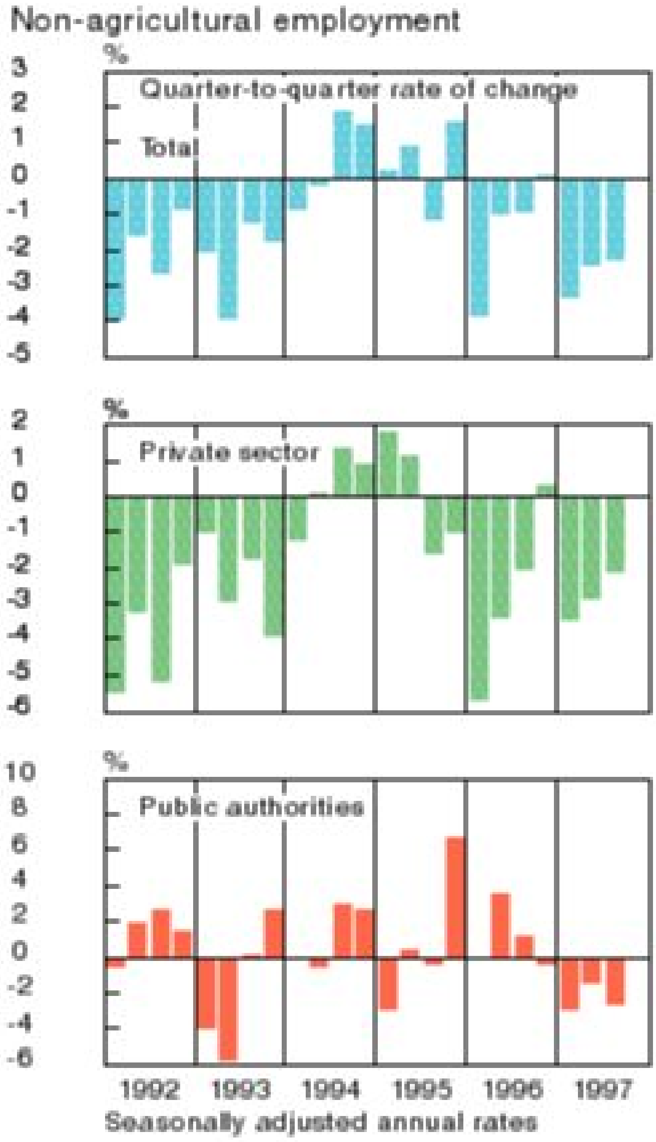
Net *dissaving by general government* as a percentage of gross domestic product increased from an average of 3½ per cent in the first three quarters of 1997 to nearly 4 per cent in the fourth quarter, reflecting the growing imbalance between the current income and expenditure of general government. A weakening in net saving by the corporate sector and a more pronounced decline in net saving by households lowered the private-sector net savings rate to 5½ per cent of gross domestic product in 1997 compared with 7 per cent in 1996. In fact, the private-household savings rate was barely positive in the fourth quarter of 1997.

Private-household indebtedness crept higher from 66 per cent of disposable income in 1996 to 68 per cent in 1997, thereby adding to the decline in the ratio of household saving to personal disposable income from 2 per cent to 1 per cent over the same period. As consumers tend to smooth consumption over time, volatile changes in the savings ratio often relate to transitory movements in income. The recent fall in the household savings rate might therefore reflect an unanticipated slowdown in the growth of personal disposable income, rather than a lasting increase in the propensity to consume.

Employment

Total *employment in the non-agricultural formal sector* of the economy continued to fall in the first three quarters of 1997, due to further retrenchments in the private sector and attempts at "right-sizing" the public sector. Regularly surveyed employment in the non-agricultural sectors of the economy declined at seasonally adjusted and annualised rates of 3,3 per cent in the first quarter of 1997, 2,4 per cent in the second quarter and 2,2 per cent in the third quarter. From the end of 1996 to the end of the third quarter of 1997 employment in the formal sectors outside agriculture had been reduced by 104 000 jobs.

The private and public sector experienced job losses in each of the first three quarters of 1997. Employment losses in the private sector during the third quarter occurred almost over the full spectrum of activity, but were most evident in manufacturing, construction, electricity generation, motor trade, the insurance industry and gold mining. The declines in public-sector employment during the third quarter of 1997 occurred at both national and provincial government levels and among the ranks of agricultural marketing boards that were in the process of being wound down. The decline in recorded employment in the formal non-agricultural sectors of the economy was also reflected in an increase of 3,1 per cent in the total number of registered unemployed workers, comparing the first eight months of 1997 with those of 1996.



The lack of sufficient job creation in South Africa partly reflects the results of opening up an internationally less-than-fully competitive economy to full-blown international competition. The elimination of export incentive schemes and the reduction of import tariffs have left companies with high production cost structures vulnerable to an increasingly competitive environment, resulting in the rationalisation of work practices and a reduction of the workforce in lieu of other cost-containing measures. These and other relevant issues are likely to be discussed during 1998 at a Presidential Jobs Summit with the objective of finding ways to increase the labour absorption capacity of the economy.

Table 5. Employment in the non-agricultural sectors of the economy

Percentage change over one quarter at seasonally adjusted annualised rates

	Private sector	Public sector	Total

1996:	1st qr	-5,7	-0,1	-3,8
	2nd qr	-3,3	3,6	-1,0
	3rd qr	-2,0	1,1	-0,9
	4th qr	0,3	-0,4	0,0
1997:	1st qr	-3,5	-2,9	-3,3
	2nd qr	-2,9	-1,4	-2,4
	3rd qr	-2,1	-2,5	-2,2

The *Basic Conditions of Employment Act* was passed by Parliament early in November 1997. The intention with this act is to protect workers in sectors where no bargaining mechanisms exist, to avoid excessive working hours, to prohibit child labour and to address issues of gender discrimination. The main provisions of the act include the following:

- a 45-hour working week with the objective of progressively reducing it to 40 hours;
- an increase in the overtime rate from time-and-a-third to time-and-a-half;
- a minimum of four months maternity leave;
- three weeks annual leave and six weeks paid sick leave every 36 months; and
- a minimum working age of 15 years, or, if the work is inappropriate to a child of that age, 18 years.

The act allows for a certain degree of flexibility in that the conditions can be varied through collective bargaining, provided that "core rights" are not infringed.

Labour costs and productivity

Although there appears to be a growing awareness that remuneration increases need to be linked to productivity growth, there is little evidence of a decisive slowdown in the growth in nominal labour remuneration. Despite the falling levels of *employment in the formal non-agricultural sectors of the economy*, nominal remuneration per worker in these sectors increased at a rate of 10,0 per cent in 1996 and at year-on-year rates varying between 9,3 per cent and 10,9 per cent in the first three quarters of 1997. Consistently strong nominal remuneration growth was experienced in both the private and the public sectors of the economy (see Table 6). Wage settlements in the first three quarters of 1997 were slightly higher than the contemporaneous consumer-price inflation, indicating an increase over that period in the real spending power of those who were gainfully employed.

The year-on-year increase in nominal remuneration per worker continued to exceed the growth in output prices as reflected by the price deflator for the non-agricultural gross domestic product. The ratio of remuneration per worker to output prices, i.e. the *"inflation-adjusted remuneration per* *worker"*, rose by 0,8 per cent in 1995 and 0,2 per cent in 1996, but then accelerated to year-on-year rates of increase of 0,9 per cent in the first quarter of 1997, 2,8 per cent in the second quarter and 1,3 per cent in the third quarter.

Table 6. Nominal remuneration per worker

Percentage change over one year

		Private sector	Public sector	All employees
1996:	1st qr	12,7	8,5	11,3
	2nd qr	10,2	9,7	10,2
	3rd qr	11,0	8,3	10,2
	4th qr	8,7	7,4	8,4
	Year	10,6	8,5	10,0
1997:	1st qr	7,9	11,7	9,4
	2nd qr	10,3	11,8	10,9
	3rd qr	9,4	9,1	9,3

The excess of growth in nominal worker remuneration over growth in output prices was prevented from developing into a squeeze on the operating surpluses of employers by robust *productivity growth*. Rationalisation of work practices, which invariably led to declines in employment numbers and a reduction of 64 per cent in the number of man-days lost due to strikes and work stoppages in 1997, helped boost productivity (measured as output per worker in the non-agricultural sectors of the economy) by 3,0 per cent in 1996 and by an average rate of 3,6 per cent in the first three quarters of 1997 compared with the corresponding period of the previous year.

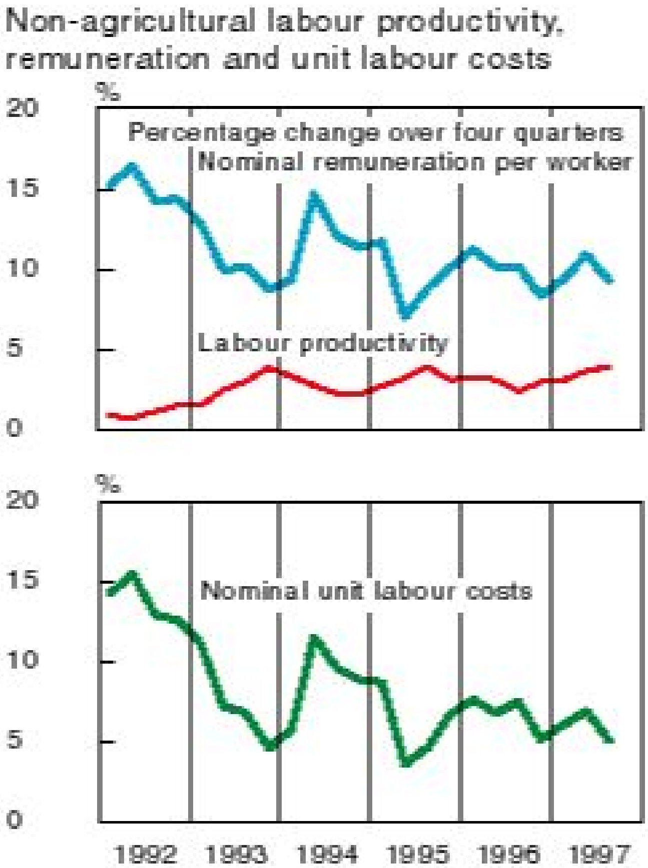
Table 7. Labour cost and productivity

Percentage change over one year

		Inflation-adjusted remuneration per worker	Labour productivity	Nominal unit labour costs
1996:	1st qr	2,1	3,3	7,7

	2nd qr	0,5	3,1	6,8
	3rd qr	0,2	2,4	7,6
	4th qr	-1,8	3,0	5,2
Year	Year	0,2	3,0	6,8
1997:	1st qr	0,9	3,1	6,1
	2nd qr	2,8	3,7	7,0
	3rd qr	1,3	3,9	5,1

As a consequence of productivity increases not fully keeping pace with the rises in the average remuneration per worker, *nominal unit labour costs* kept on growing, thereby putting upward pressure on the output prices of domestically produced goods and services. It would appear, however, as if these pressures moderated somewhat during 1997 - the increase over one year in nominal unit labour costs declined from 6,8 per cent in 1996 to 6,1 per cent in the first three quarters of 1997.



Any increase in the current growth rate of nominal remuneration per worker would be difficult to reconcile with the overriding monetary-policy objective of further reductions in the rate of production and consumer price inflation. Although higher remuneration growth might be absorbed by falling profit margins and weaker operating surpluses, such a process cannot continue indefinitely. The major part of the cost absorption process over the past number of years was the paring of the workforce in order to achieve higher productivity levels. Unemployment accordingly increased as employment fell and the population of working age continued to grow.

Inflation

Inflation in consumer prices as measured by the year-to-year rate of increase in the overall *consumer price index* rose from 7,4 per cent in 1996 to 8,6 per cent in 1997. This apparently higher rate of inflation in 1997 is somewhat misleading as it was more the result of a statistical carry-over of rising inflation in the second half of 1996, following the weakening of the exchange rate of the rand in that year, than of a resurgence of strong inflationary pressures.

Measured over periods of twelve months, the overall consumer-price inflation rate declined from 9,9 per cent in April 1997 to 6,1 per cent in December. The firm downward trend in consumer price increases in 1997 was assisted by once-off events such as a much slower rate of increase in food prices and the reduction in mortgage rates and instalments following the lowering of Bank rate in October.

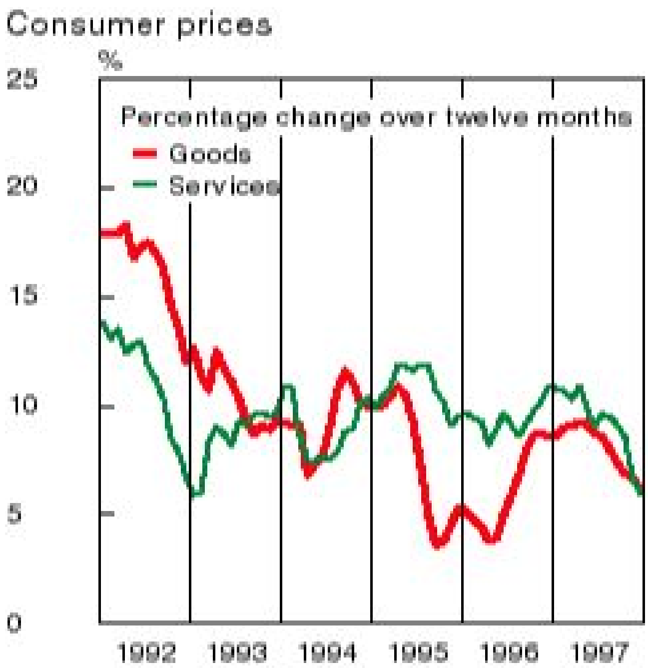
After the elimination of the effects of these once-off events from the consumer price index, the decline in *underlying inflation* (i.e. the change in the overall consumer price index excluding the prices of food and non-alcoholic beverages, the costs of home-ownership and value-added tax) was somewhat less impressive than the decline in overall consumer price inflation. Underlying inflation fell from 9,7 per cent in February 1997 to 7,3 per cent in December, i.e. a decline of more than one percentage point less than the decline in the overall consumer price inflation rate. Indeed, underlying inflation measured from quarter to quarter at an annualised rate accelerated from 6,7 per cent in the third quarter of 1997 to 8,1 per cent in the fourth quarter.

Table 8. Consumer price inflation

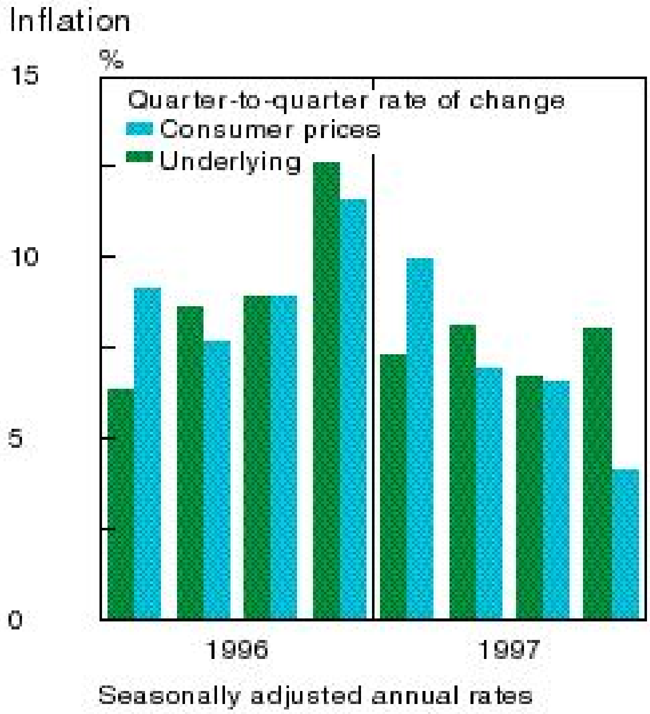
Quarter-to-quarter changes at annualised rates

		Underlying inflation	Overall index
1996:	1st qr	6,4	9,1
	2nd qr	8,6	7,6
	3rd qr	9,0	8,9

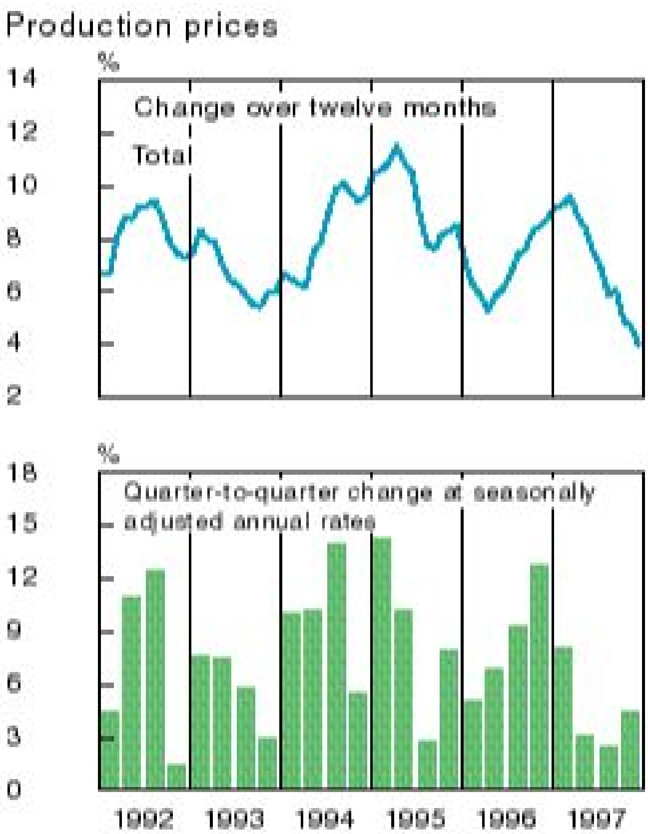
	4th qr	12,6	11,6
1997:	1st qr	7,3	9,9
	2nd qr	8,1	7,0
	3rd qr	6,7	6,6
	4th qr	8,1	4,1



The change in the prices of *consumer services*, which usually appear to respond much more slowly to changes in productivity and monetary conditions than the prices of consumer goods, declined considerably more than the change in the prices of consumer goods owing partly to the lowering of mortgage bond rates. The twelve-month increase in the prices of consumer services fell by 4,9 percentage points from April 1997 to December compared with a decline of 3,0 percentage points in inflation in consumer goods prices. In fact, the twelve-month increase in the prices of consumer services in December 1997 fell below the corresponding increase in the prices of consumer goods for the first time since November 1994.



Other measures of price inflation corroborated the view that inflation is firmly trending downwards. The year-to-year change in the *all-goods production price index* declined from 9,6 per cent in 1995 to 6,9 per cent in 1996 and 7,1 per cent in 1997. Measured over periods of twelve months, overall production price inflation fell from 9,6 per cent in March 1997 to 4,0 per cent in December - the lowest rate of increase since September 1971. The prices of domestically produced goods rose, in turn, by only 4,9 per cent in December 1997, compared with 9,7 per cent as recently as April 1997. The substantial gains made in reducing domestic production price inflation during 1997 can be attributed to modest increases, and in certain instances even declines, in the prices of processed food, agricultural, forestry and fishing products, electricity, gas and water, alcoholic beverages and tobacco, and textiles and clothing.



The relative strength and stability of the rand during 1997 made a significant contribution to inflation reduction in the second half of last year. The twelve-month *change in the prices of imported goods* fell from 10,3 per cent in February 1997 to 0,7 per cent in December as the price-raising effect of the rand-depreciation in 1996 abated. This downward movement in imported price inflation was assisted by a decline in the international price of crude oil, which resulted in the rand price of imported oil falling from R110 per barrel in December 1996 to R86 per barrel in December 1997.

Table 9. Production price indices

Percentage change over twelve months

		Domestically produced goods	Imported goods	All goods
1997:	Jan	9,2	9,6	9,2
	Feb	9,2	10,3	9,3
	Mar	9,5	10,1	9,6
	Apr	9,7	5,4	8,8
	May	8,9	6,4	8,4

	Jun	8,5	4,1	7,5
	Jul	7,5	3,9	6,9
	Aug	6,5	2,8	5,9
	Sep	6,5	3,8	6,1
	Oct	5,7	1,3	4,9
	Nov	5,3	2,0	4,7
	Dec	4,9	0,7	4,0

Foreign trade and payments

Current account

The *deficit on the current account* of the balance of payments in 1997 as a whole differed only slightly from that of the previous year. The deficit increased from R7,3 billion in 1996 to R8,8 billion in 1997 and as a percentage of gross domestic product rose marginally from 1,3 per cent in 1996 to 1,5 per cent in 1997. This consolidation of the relative size of the current-account deficit was for the most part a consequence of the better equilibrium between aggregate demand and supply in the domestic economy.

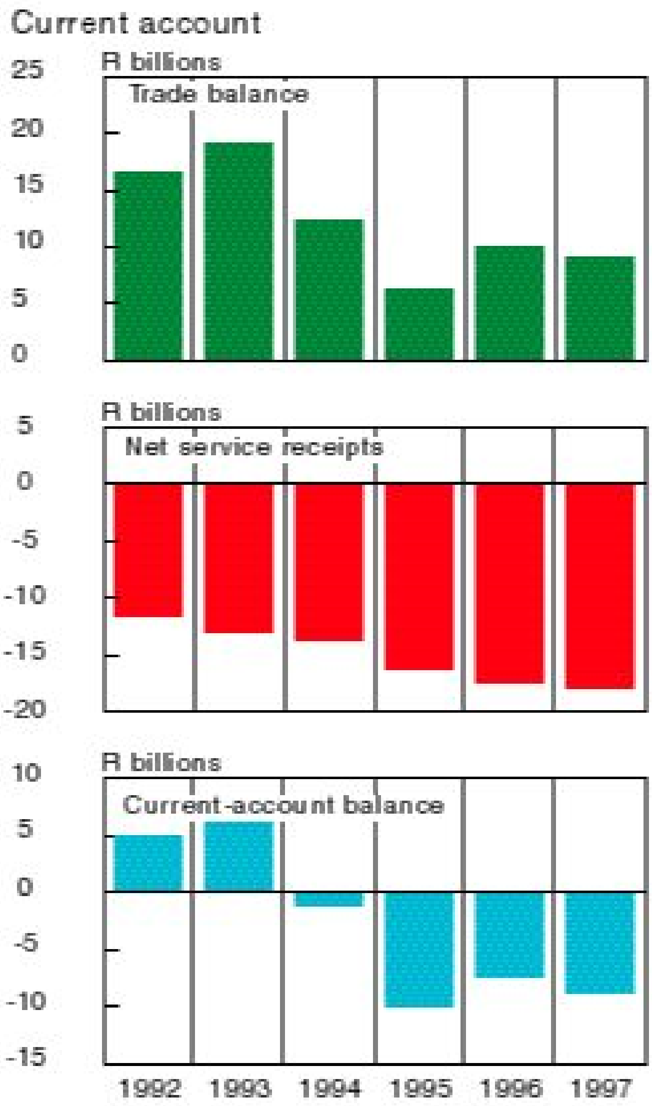
Table 10. Balance of payments on current account

Seasonally adjusted and annualised

R billions

	1996	1997				
	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Merchandise exports	101,4	107,7	115,9	115,3	117,6	114,1
Net gold exports	26,3	26,8	24,7	26,0	25,7	25,8
Merchandise imports	-117,7	-123,6	-128,6	-132,1	-139,0	-130,8
Net service and transfer payments	-17,3	-17,7	-17,3	-18,2	-18,4	-17,9
Balance on current account	**-7,3**	**-6,8**	**-5,3**	**-9,0**	**-14,1**	**-8,8**

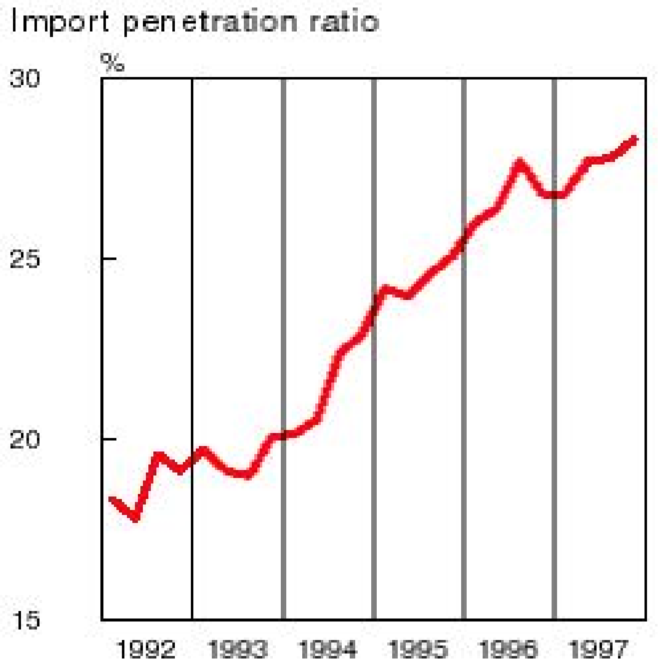
Within 1997 the *quarterly deficit* on the current account of the balance of payments (seasonally adjusted and annualised) deteriorated noticeably from the first to the second half of the year. On a quarter-to-quarter basis the current account deficit widened from R5,3 billion in the second quarter of 1997 to R9,0 billion in the third quarter and R14,1 billion in the fourth quarter. As a ratio to gross domestic product, the current-account deficit in the fourth quarter of 1997 was presumably still within the limits of sustainability, being equal to 2,3 per cent of gross domestic product.



The widening of the deficit on the current account in the fourth quarter of 1997 was largely caused by a sharp increase in the value of merchandise imports. This increase was only partially offset by a small increase in the total value of merchandise and net gold exports. Net payments for services and transfers to the rest of the world also increased in the fourth quarter of 1997, thereby aggravating the deterioration of the current account.

The sharp upward movement in the value of imports was closely related to the relatively high marginal propensity of the South African economy to import. Increases in real domestic expenditure normally result in more than proportionate increases in the volume of merchandise imports. This happened again in the fourth quarter of 1997 when the volume of merchandise imports rose by 3 per cent, implying an annualised growth rate of 13 per cent. This raised the value of merchandise imports in the fourth quarter of 1997 about 5 per cent higher than the value in the third quarter. Increases occurred in most of the import categories, except for agricultural products. Imports of especially vehicle and transport equipment, machinery and electrical equipment and crude oil increased strongly in the fourth quarter of 1997.

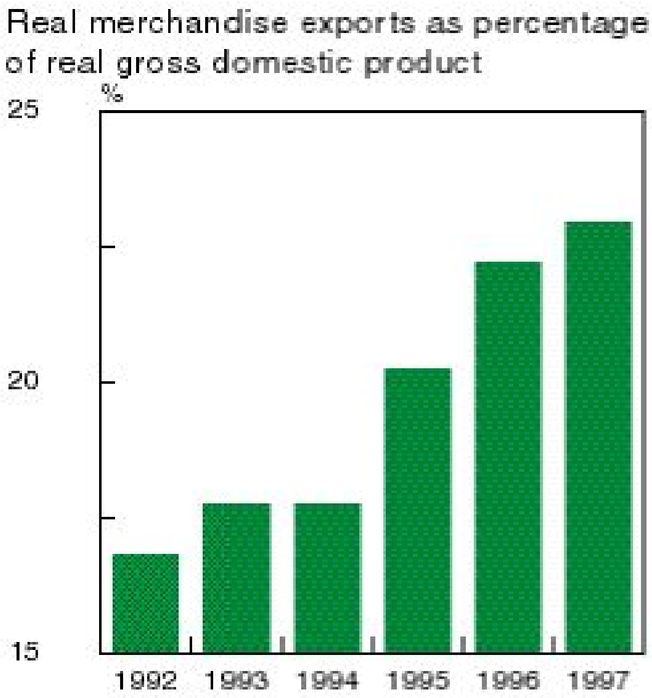
Apart from the influence of fairly robust domestic final demand in the fourth quarter of 1997, the volume of merchandise imports was also spurred on by a slowdown in the rate of increase of the prices of imported goods relative to the prices of domestically produced goods. The combined effect of these two forces raised the import penetration ratio of South Africa (i.e. the ratio of real merchandise imports to real gross domestic expenditure) from 27 per cent in the first quarter of 1997 to an all-time high of 28½ per cent in the fourth quarter. For the year as a whole, the volume of merchandise imports rose by 5 per cent, which increased the import penetration ratio from 26½ per cent in 1996 to 27½ per cent in 1997.



The value of *merchandise exports* (seasonally adjusted and annualised), which had receded somewhat in the third quarter of 1997, increased by 2 per cent to R117,6 billion in the fourth quarter of 1997. After having declined slightly in the third quarter of 1997, *merchandise export volumes* remained broadly unchanged in the fourth quarter. The volume of exports of manufactured goods, which had been growing consistently in recent years, remained broadly unchanged in the third quarter of 1997 and declined in the fourth quarter. Noticeable declines were recorded in the exportation of chemical and textile products in the fourth quarter of 1997.

The *prices in rand of South African export goods*, however, rose modestly by about 1 per cent in the fourth quarter of 1997, largely as a result of a decline in the nominal effective exchange value of the rand. International commodity prices, of relevance to South Africa's basket of export goods, were rather depressed in the fourth quarter of 1997 - on average they were about 6 per cent below the level of the second quarter.

In 1997 as a whole, merchandise export values increased by 12½ per cent compared with 23½ per cent in 1996. Merchandise export volumes rose to such an extent that the ratio of real merchandise exports to real gross domestic product increased from 20 per cent in 1995 to 22 per cent in 1996 and 23 per cent in 1997. The access to new markets since the early 1990s have ostensibly played a significant part in expanding the country's export base.



The value of *net gold exports (*seasonally adjusted and annualised) declined slightly from R26,0 billion in the third quarter of 1997 to R25,7 billion in the fourth quarter, essentially owing to a reduction of 3 per cent in the physical quantity of net gold exports. The export price realisation (in rand) by domestic gold producers rose by about 2 per cent in the fourth quarter, despite a decline in the fixing price of gold on the London market from US$324 per fine ounce in the third quarter of 1997 to US$307 per fine ounce in the fourth quarter. The disparity between the gold price realisation and the spot price in the London market was, of course, due mostly to forward sales of gold and other hedging practices that gold producers entered into. The potential price-raising effect of an increase in the physical demand for gold in January 1998 when some producers had to close short positions, was more than counteracted by rumours of substantial future gold sales by the South Korean central bank, leading to a decline in the monthly average fixing price of gold to US$289 per fine ounce in January 1998.

For the year 1997 as a whole, the average price of gold per fine ounce came to US$331; substantially below the average price level of US$388 per fine ounce recorded in 1996. Despite the physical quantity of gold produced having declined slightly from 497 tons in 1996 to an estimated 495 tons in 1997, the volume of net gold exports increased by about 5½ per cent in 1997 on account of sales from inventories which had been stockpiled earlier.

Net *service and transfer payments to non-residents* (seasonally adjusted and annualised) rose from R17,3 billion in the second quarter of 1997 to R18,2 billion in the third quarter and R18,4 billion in the fourth quarter. The deficit on the services account increased in 1997, in most part due to an increase in service payments, especially interest payments related to inward investment into South Africa, which exceeded the increases in the value of receipts arising from services rendered to non-residents. The rise in receipts for services stemmed largely from increased travel and accommodation expenditure by foreigners visiting the country and a significant rise in interest and dividend receipts resulting from the recent spate of outward investment by South African organisations.

Capital account

The *net inflow of capital not related to reserves*, which had amounted to R18,3 billion in the first three quarters of 1997, was sustained in the fourth quarter. In fact, the net inflow of capital increased from R1,5 billion in the third quarter of 1997 to R1,9 billion in the fourth quarter despite the problems in the East Asian economies. For the calendar year as a whole, the net inflow of capital came to R20,2 billion, substantially higher than the net inflow of R2,7 billion in 1996 when the rand came repeatedly under speculative attack.

Table 11. Net capital movements not related to reserves

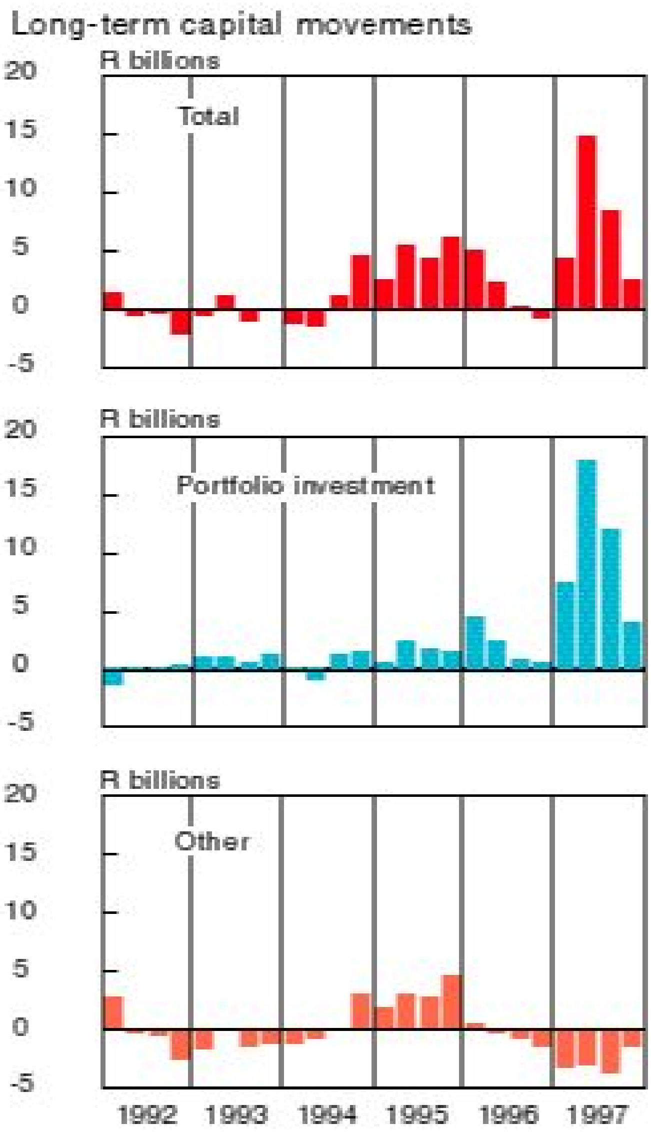
R billions

	1996	**1997**				
Long-term capital	**Year**	**1st qr**	**2nd qr**	**3rd qr**	**4th qr**	**Year**
Public authorities	8,0	1,0	12,2	2,1	-2,5	12,8
Public corporations	-1,3	1,4	4,8	0,8	-0,2	6,8
Monetary sector	-1,3	-0,2	-0,1	-0,3	-0,2	-0,8
Private sector	1,3	2,0	-2,0	5,7	5,5	11,2
Total long-term capital	**6,7**	**4,2**	**14,9**	**8,3**	**2,6**	**30,0**
Short-term capital						
Monetary sector	9,9	2,3	3,3	-4,5	0,0	1,1
Other, including unrecorded transactions	-13,9	-2,7	-5,2	-2,3	-0,7	-10,9
Total short-term capital	**-4,0**	**-0,4**	**-1,9**	**-6,8**	**-0,7**	**-9,8**
Total capital	**2,7**	**3,8**	**13,0**	**1,5**	**1,9**	**20,2**

The net inflow of long-term capital, however, declined from R8,3 billion in the third quarter of 1997 to R2,6 billion in the fourth quarter. Both the public sector and the private banking sector experienced net outflows of long-term capital to the rest of the world during the fourth quarter of 1997. These were, however, outweighed by a substantial cross-border inward movement of long-term capital to domestic non-bank entities in the private sector. The net outward movement of long-term capital from the public sector and from private banking institutions is explained by fairly large repayments of foreign fixed capital commitments and net sales by non-resident investors of securities listed on the Bond Exchange of South Africa.

The net inflow of long-term capital to the non-bank private sector declined slightly from R5,7 billion in the third quarter of 1997 to R5,5 billion in the fourth quarter. Net purchases by non-residents of shares listed on the Johannesburg Stock Exchange amounted to R6,6 billion in the fourth quarter, taking the total net inflow of capital through this conduit to R26,2 billion for 1997 as a whole. South African entities acquired R4,4 billion worth of assets by way of asset swaps with non-resident investors in the fourth quarter of 1997 and assets to the value of R3,7 billion by using offshore placings of shares for funding purposes. Excluding possible secondary operations, these transactions were neutral with respect to net capital movements and changes in foreign exchange reserves.

As indicated in the accompanying graph, long-term capital inflows into South Africa during 1997 were dominated by portfolio investment flows. This form of capital is generally seen as less stable than foreign direct investment and, in the event of abrupt flow reversals could have a potentially destabilising effect on general macroeconomic equilibrium. The potential for the disruption of the South African securities markets by a sudden reversal of portfolio funds is, however, mitigated by the unique nature of a sizeable portion of recent capital flows. Firstly, to the extent that these flows were related to Eurorand issues with a long maturity, they represented a relatively longer-term investment into the economy and, secondly, where these flows formed the counterpart of an asset-swap transaction between a resident and a non-resident investor, they also assumed the character of a longer-term investment.

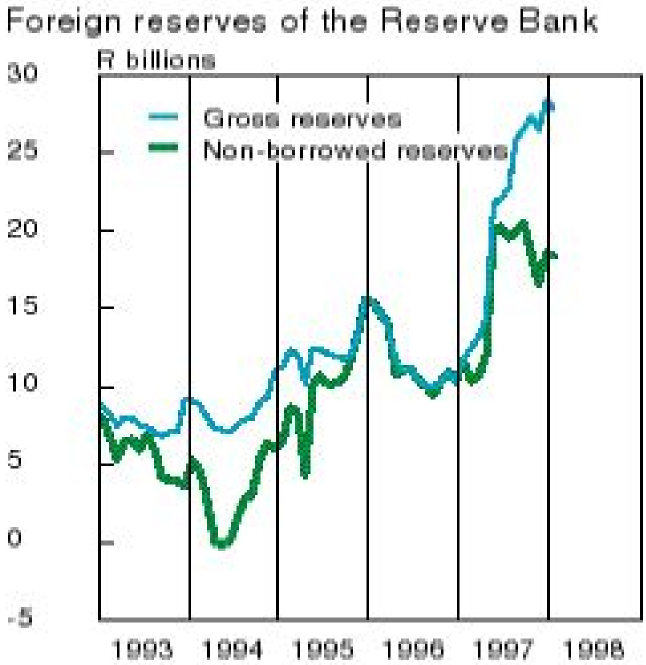


The net outflow of *short-term capital* not related to foreign reserves, but including measurement errors and unrecorded transactions, decreased from R6,8 billion in the third quarter of 1997 to R0,7 billion in the fourth quarter as non-bank private-sector organisations reduced their short-term foreign indebtedness. Although South African banks availed themselves of foreign short-term funds during a relatively tight period in the domestic money market, these flows were completely offset by a decrease in trade-related borrowing by other entities during the fourth quarter of 1997.

Foreign reserves

South Africa's *net gold and other foreign reserves* declined for the second consecutive quarter when they fell by R1,2 billion in the fourth quarter of 1997. In 1997 as a whole, the country's net foreign reserves nevertheless rose by R11,4 billion, compared with a decline of R4,6 billion in 1996.

Partly owing to an increase of R3,9 billion in the foreign short-term indebtedness of the Reserve Bank, the country's gross gold and other foreign reserves rose by R3,0 billion from the end of September 1997 to R36,6 billion at the end of December. This represented an increase of R19,8 billion from the end of 1996, but cognisance should be taken of the Reserve Bank's usage of short-term foreign credit facilities to an amount of R9,8 billion in the course of 1997. Measured in terms of United States dollars, total gross foreign reserves increased from $3,6 billion at the end of 1996 to $7,5 billion at the end of 1997. Relative to the value of imports of goods and services, gross reserves at the end of 1997 were equivalent to about 10 weeks' worth of imports of goods and services - merely two weeks short of the level widely regarded as a "prudent level" of foreign reserves.



At the end of November 1997 the Reserve Bank's net open position in foreign currency (i.e. the Bank's net forward position in foreign currency reduced by its net holdings of spot gold and foreign exchange reserves) stood at US$17,1 billion, as against US$22,2 billion at the end of December 1996. The change in the net open position during 1997 gave evidence of meaningful progress with the attainment of the stated policy intention to gradually reduce the Bank's foreign currency exposure. The limits that used to apply to the holdings of spot foreign exchange by authorised dealers in foreign exchange amounting collectively to US$1,5 billion, were abolished with effect from 16 January 1998.

Exchange rates

Developments in the South African foreign exchange market were strongly influenced by events in the international financial markets during the fourth quarter of 1997. The problems in a number of East Asian economies heightened volatility in the local market for foreign exchange. As a consequence, the average daily turnover in this market rose from US$7,4 billion in the first nine months of 1997 to US$9,3 billion in October and US$9,5 billion in November. Trading conditions calmed down somewhat in December and the average daily turnover declined to US$7,5 billion in that month.

The nominal effective exchange rate of the rand, which had appreciated on balance by 0,4 per cent in September 1997, declined by 4,3 per cent in October when the problems in Asia began to spill over into South Africa. In the ensuing two-month period to the end of December 1997 the nominal effective exchange rate rose by 0,5 per cent and subsequently declined by 1,4 per cent in the first seven weeks of 1998. Taking the inflation differential between South Africa and its major trading partners into consideration it would appear as though the currency market had recovered from the disruption caused by the problems in Asia and that a fair measure of stability had returned to the market. Contagion from the currency problems in Asia appeared to have been limited.

Table 12. Changes in the exchange rates of the rand

Per cent

	30 Sep 1997 to 31 Oct 1997	31 Oct 1997 to 31 Dec 1997	31 Dec 1996 to 31 Dec 1997	31 Dec 1997 to 20 Feb 1998
Weighted average	-4,3	0,5	-0,3	-1,4
US dollar	-3,1	-1,1	-3,8	-1,5
British pound	-6,4	-0,2	-1,6	-0,3
German mark	-5,6	2,5	10,6	0,1
Japanese yen	-4,0	7,0	7,7	-4,0

Netherlands guilder	-5,5	2,5	11,1	0,0
Italian lira	-5,4	2,6	10,7	0,4

The stabilisation and eventual strengthening of the trade-weighted value of the rand in the aftermath of the currency problems in Asia occurred without official intervention to defend the exchange value of the rand at any particular level. During this episode, the Reserve Bank nevertheless entered the market from time to time to supply dollars, but this intervention was intended to provide liquidity when private market participants were reluctant to part with their foreign currency holdings and not so much to protect the external value of the rand.

The rand, which had lost 21,9 per cent of its value against a basket of currencies in 1996, was much steadier in 1997 when it depreciated by only 0,3 per cent, notwithstanding the strong downward pressures in the fourth quarter of 1997. From the end of 1996 the rand moved from R4,68 against the United States dollar to R4,87 at the end of 1997, a depreciation of only 3,8 per cent. Against the German mark, the Italian lira and the Netherlands guilder, however, the rand appreciated by 10,6 per cent, 10,7 per cent and 11,1 per cent respectively over the same period.

The decline in the average level of the nominal effective exchange rate of the rand in 1997 was less than the inflation differential between South Africa and its major trading partners. Accordingly, the average level of the *effective exchange rate adjusted for the inflation differential* in 1997 was 0,5 per cent above the average in 1996. Within 1997 the inflation-adjusted effective exchange rate appreciated by approximately 3 per cent from December 1996 to December 1997.

Monetary developments, interest rates and financial markets

Money supply

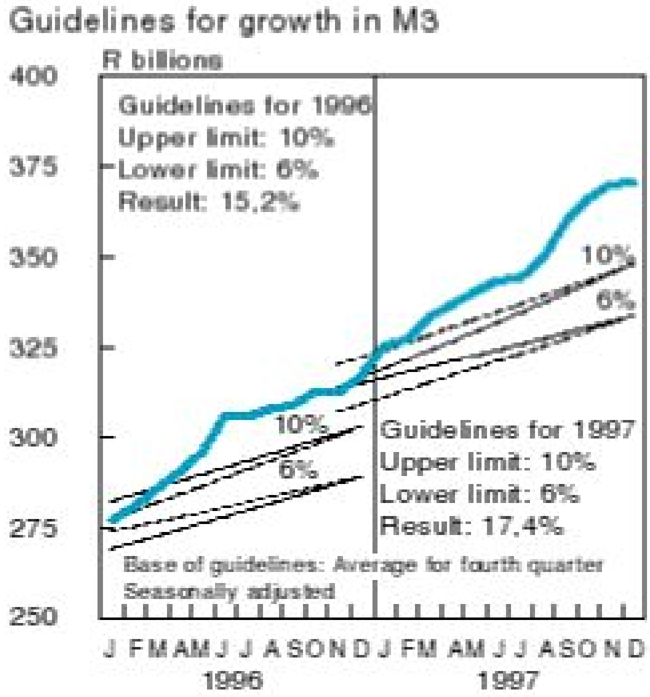
The *growth rates of M3* (seasonally adjusted and annualised) fluctuated within a wide range during 1997, initially moving downwards until the middle of the year only to accelerate rapidly towards the end of the year. The twelve-month growth rate of M3 decreased from 16,8 per cent in January 1997 to 12,7 per cent in June, but then accelerated to 17,8 per cent in November and 17,2 per cent in December. The annualised growth in the quarterly average value of M3 slowed down from 18,1 per cent in the first quarter of 1997 to 12,1 per cent in the third quarter, but then rose strongly to 23,1 per cent in the fourth quarter. The growth in the quarterly average value of M3 from the base of the 1997 guideline year to the fourth quarter of 1997 was 17,4 per cent; this was appreciably higher than the upper limit of the guideline range of 10 per cent.

Table 13. Quarter-to-quarter growth in monetary aggregates

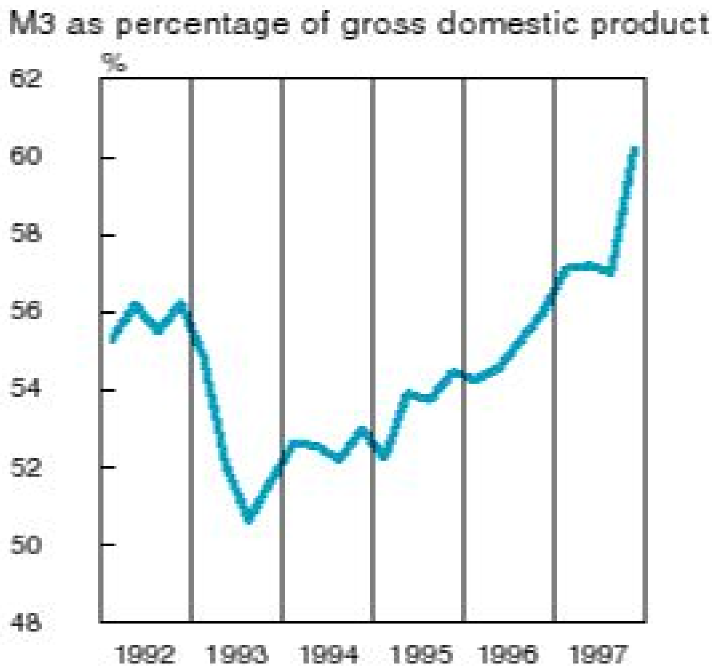
Per cent

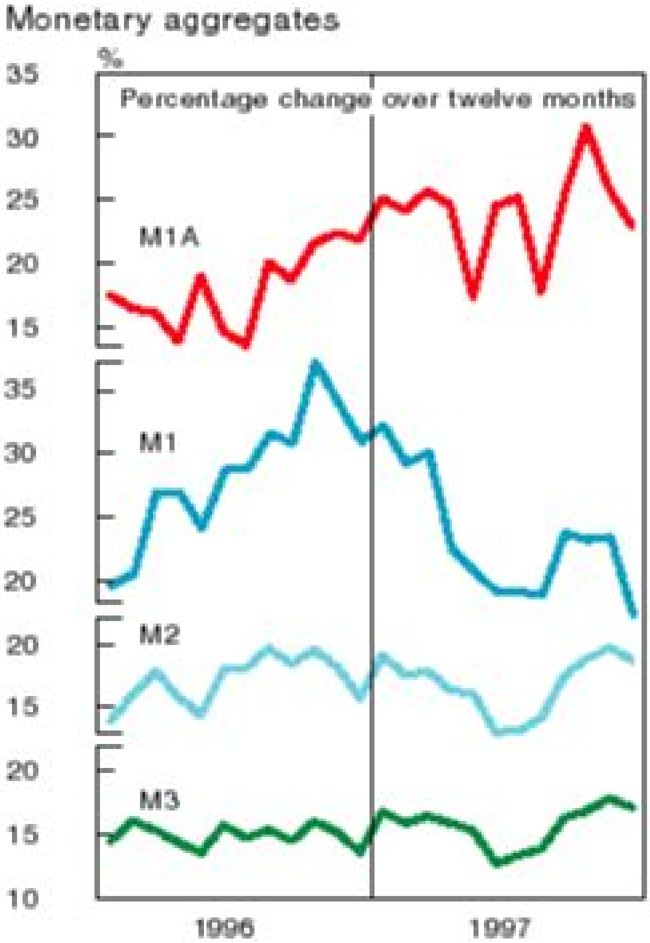
Period		M1A	M1	M2	M3
1997:	1st qr	22,5	23,3	24,2	18,1
	2nd qr	9,1	-1,3	13,5	16,4
	3rd qr	25,7	21,4	11,0	12,1
	4th qr	51,0	53,1	29,8	23,1

The rapid growth in the money supply was in part related to the growing demand for money for transactions purposes arising from continuing inflation (although this was lower than in previous years), and the demand arising from higher levels of overall economic activity as reflected in large increases in the turnover on the financial markets and by the growth in real domestic output and expenditure. Money also regained some significance as a store of value as inflation moved to lower levels, and real deposit rates rose. The uncertain outlook for financial markets following the financial problems in the Asian countries further strengthened the move towards deposit-type investments as an alternative to other financial assets.



As a consequence, the ratio of M3 to nominal gross domestic product (i.e. the inverse of the income velocity of circulation of M3) rose from 56,0 per cent in the fourth quarter of 1996 to 60,3 per cent in the fourth quarter of 1997. The rise in investors' preference for liquidity during 1997 is also reflected in the higher twelve-month growth rates of the narrower monetary aggregates (i.e. M1A, M1, M2) relative to the growth in M3 and the more rapid acceleration in the quarter-to-quarter growth rates of the narrower aggregates than the acceleration in the growth of M3.





The exchange control restrictions pertaining to the amount which a South African resident is allowed to hold in a deposit account denominated in foreign currency with a domestic bank were relaxed as from 1 July 1997. Such balances held by non-bank and non-government parties accordingly rose from R1,8 billion at the end of July 1997 to R2,1 billion at the end of December. In the case of individuals alone, the amounts deposited in foreign-currency denominated accounts rose from only R15,3 million to a still relatively insignificant R48,4 million over the same period.

Among the *statistical counterparts* of the increase of R54,8 billion in the M3 money supply during 1997, were the increases of R52,0 billion in the monetary sector's claims on the private sector and R9,8 billion on the government sector. The rise of R4,3 billion in the net foreign assets of the monetary sector also added to the growth in M3. These increases were partly offset by a decline in the "net other assets" of the monetary sector - the latter arising from, among others, surpluses accruing to the Reserve Bank as a result of its operations in the forward foreign exchange market. The complete set of accounting counterparts of the increase in M3 in 1997 was as follows:

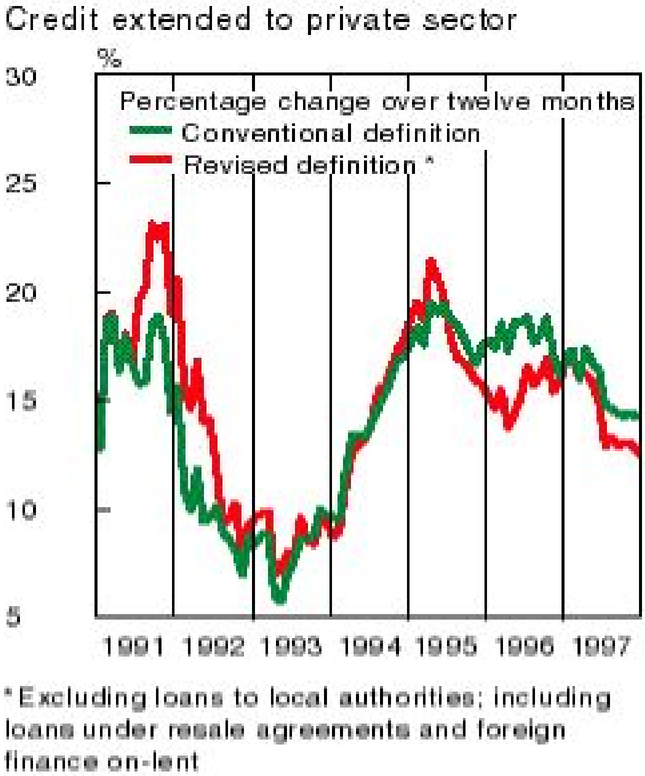
Table 14. Statistical counterparts of changes in M3

R billions

	1997				
	1st qr	**2nd qr**	**3rd qr**	**4th qr**	**Year**
Net foreign assets	-2,2	6,5	1,9	-1,9	4,3
Net claims on the government	4,6	-3,3	4,0	4,5	9,8
Claims on the private sector	16,1	14,2	9,5	12,3	52,0
Net other assets and liabilities	-1,2	-11,2	0,4	0,6	-11,3
Total change in M3	**17,4**	**6,2**	**15,8**	**15,4**	**54,8**

Credit extension

Credit extension to the private sector was the main factor responsible for the rapid growth in the money supply. Nonetheless, the twelve-month rate of increase in *credit extension by monetary institutions to the private sector* declined from 17,3 per cent in February 1997 to 14,2 per cent in December. A revised version of the definition of bank credit extension to the private sector (which excludes loans to local authorities but includes loans and advances under resale agreements to "other parties" and foreign finance in banks' own names and on-lent to "other clients") indicated twelve-month growth of only 12,4 per cent in December 1997. Measured from quarter to quarter the growth in the conventionally defined credit extension to the private sector decelerated from 21,2 per cent in the second quarter of 1997 to 9,5 per cent in the third quarter and 10,6 per cent in the fourth quarter.



An analysis of monetary institutions' claims on the private sector by *type of credit* shows that the twelve-month rate of increase in *mortgage advances* slowed down rapidly from 16,9 per cent in December 1996 to 11,5 per cent in December 1997 - its lowest level since February 1983. Lacklustre property market conditions and small increases in durable consumption expenditure contributed to the decline in the growth rate of mortgage advances. The high cost of mortgage borrowing naturally also cautioned households to exercise restraint in their recourse to mortgage financing facilities.

Table 15. Credit extended to the private sector by type of credit

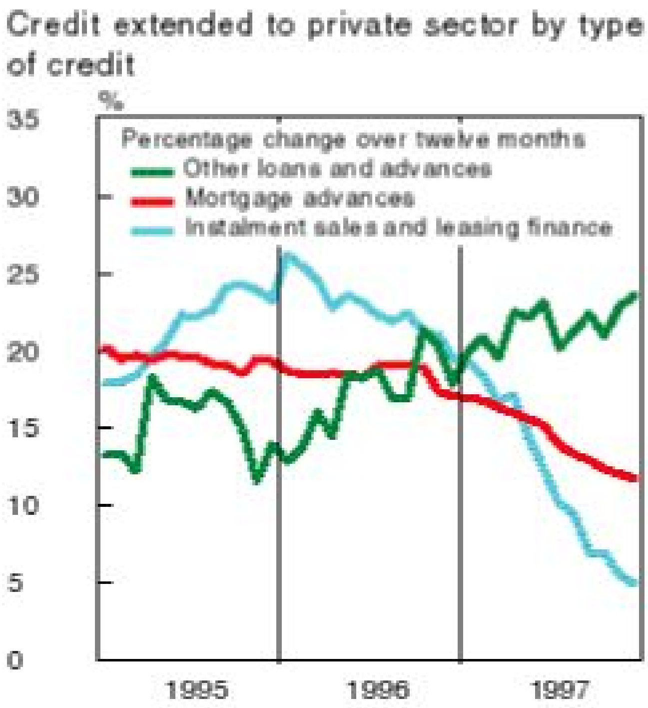
Percentage change over twelve months

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

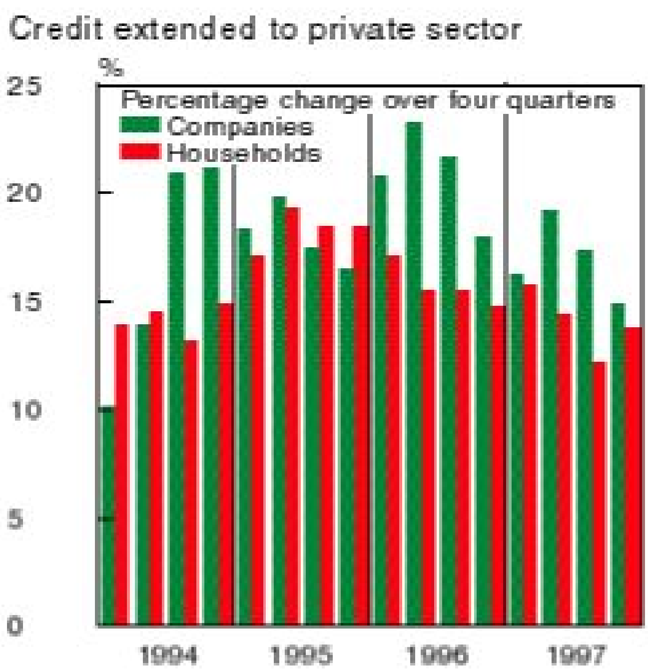
May	10,2	-10,9	15,8	11,9	15,4	22,1	16,7
Jun	9,9	-15,8	14,3	8,9	15,0	23,2	16,4
Jul	15,8	-14,9	12,2	6,6	13,7	20,2	14,7
Aug	5,6	-0,7	11,6	5,6	13,1	21,2	14,6
Sep	-1,0	13,0	10,6	0,5	12,7	22,4	14,4
Oct	10,8	21,9	11,6	-1,4	12,2	21,0	14,3
Nov	14,1	11,7	9,7	-2,3	11,8	22,8	14,4
Dec	9,5	8,2	9,2	-3,0	11,5	23,6	14,2

The percentage change over twelve months in total *instalment sale credit and leasing finance* declined from 19,6 per cent in January 1997 to 5,1 per cent in December. Reflecting the decline in motor vehicle sales in the fourth quarter of 1997, the outstanding amounts of credit extended by monetary institutions in terms of leasing agreements during the fourth quarter of 1997 fell below that of a year earlier. Total new business payouts in respect of instalment sale and leasing transactions receded from R41,5 billion in 1996 to R38,5 billion in 1997; in terms of inflation-adjusted totals this implies a decline of 14,5 per cent.

The strongest thrust for growth in credit extension to the private sector in the second half of 1997 was provided by increases in *overdrafts and other loans and advances*. The rate of increase over twelve months in this credit category has exceeded 20 per cent in each and every month since April 1997 and amounted to 22,8 per cent in November and 23,6 per cent in December. Strong demand for working capital by the corporate sector, some borrowing by businesses to keep afloat during a temporary slack in demand and the switching of foreign trade financing from offshore to domestic sources of credit were among the main forces behind the rise in the demand for overdrafts and other loans and advances.



The shift in the relative importance of credit extended by the monetary sector from households to the corporate sector continued in the fourth quarter of 1997. In terms of percentage changes, the growth rate over twelve months in credit extension to households amounted to 13,7 per cent in December 1997, i.e. still below the twelve-month growth of 14,8 per cent in credit extension to the corporate sector over the same period.

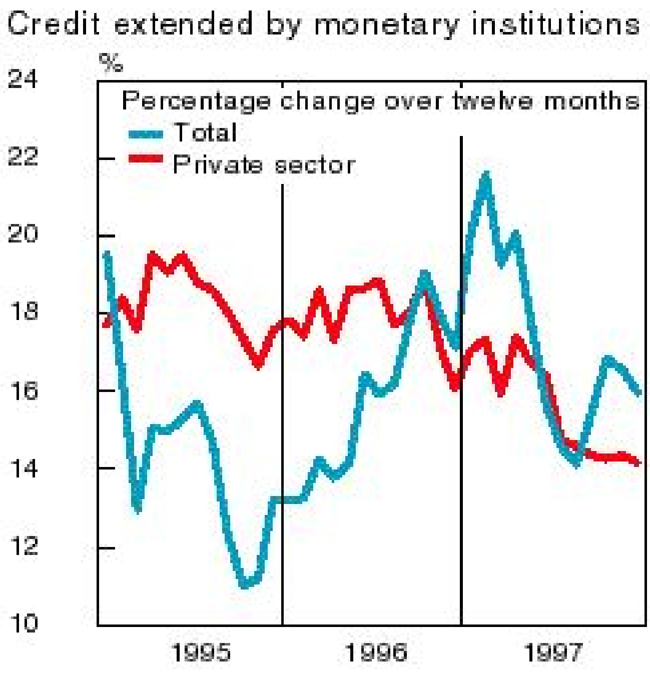


Local subsidiaries and branches of foreign banks increased their share of the consolidated balance sheet of the banking sector fairly rapidly during 1997, albeit from a very low base. At the end of 1997 these subsidiaries and branches had extended credit to private-sector entities to an amount equivalent to only 2,1 per cent of total bank credit extended to the private sector - this despite a three and half fold increase in their lending operations over the past three years.

Table 16. Credit extended by local subsidiaries and branches of foreign banks

End of	Percentage change over twelve months	Percentage of total bank credit to private sector
1992	9,7	0,7
1993	80,3	1,1
1994	-2,1	0,9
1995	19,3	0,9
1996	98,9	1,6
1997	49,3	2,1

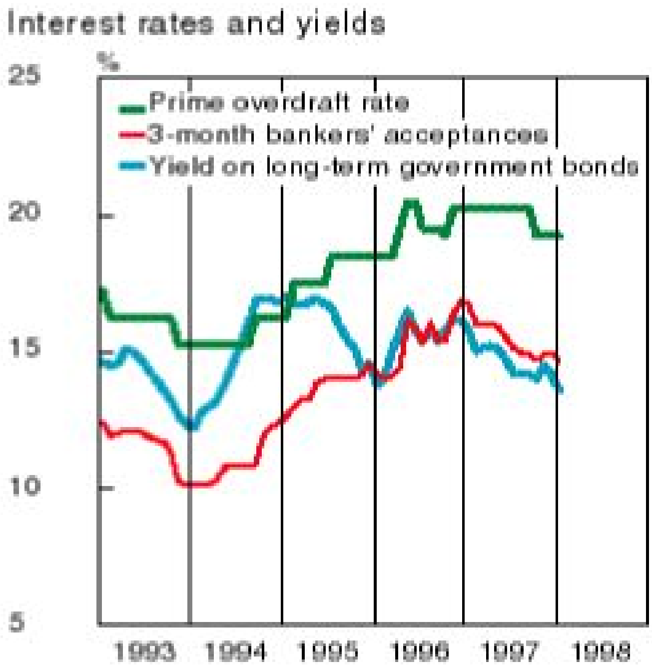
Net claims of monetary institutions on the government sector increased strongly during 1997, resulting in the twelve-month growth rate of total credit extension consistently exceeding the growth in credit extension to the private sector, except for the months from June to August. Aggregate credit growth measured over periods of twelve months nevertheless slowed down from 20,1 per cent in April 1997 to 14,1 per cent in August, but then accelerated, on balance, to 16,4 per cent in December. The increases in the banks' net claims on the government sector were more the result of increased holdings by banks of government securities than of a decline in government deposits with the monetary sector.



Interest rates and yields

Bond yields, which usually tend to decline during periods of gathering economic slack, eased during 1997 as expectations of inflation waned and the movements of the exchange rate of the rand became much more stable. The generally downward movement of bond yields was temporarily interrupted on two occasions: in March and April 1997 when uncertainty about the Budget proposals of the National Government and the likely impact of the partial relaxation of exchange controls on residents caused yields to move higher, and again towards the end of October when the effect of the turbulence in some Asian financial markets impacted on the South African securities markets.

The *monthly average yield on long-term government bonds* declined from 16,2 per cent in December 1996 to 14,0 per cent in October 1997, but then rose to 14,5 per cent in November as the contagion effect of the Asian financial problems spread to South Africa. Bond yields subsequently resumed their downward movement and the monthly average value retreated to 14,1 per cent in December 1997 and 13,6 per cent in January 1998. The movements of the *daily average yield on long-term government bonds* during the fourth quarter of 1997 exhibited, as could be expected, much more volatility than the monthly averages: the daily average rate declined to 13,76 per cent on 22 October - its lowest level in 1997 - but then rose rapidly to 15,07 per cent on 28 October. When the bond market became more tranquil and non-residents again became net buyers of bonds, the daily average value of bond yields receded to 13,57 per cent at the end of January 1998.



The monthly average *inflation-adjusted yield* on long-term government bonds, which had bottomed out at about 5 per cent over the period from February 1997 to August, increased to 6,2 per cent in October as consumer-price inflation over one year began to decline more decisively whilst the monthly average of nominal bond yields remained broadly unchanged. The fairly rapid decline in consumer-price inflation in the fourth quarter of 1997 then took the inflation-adjusted yield on long-term government bonds to 7,6 per cent in December.

Table 17. Interest rates and yields

Per cent

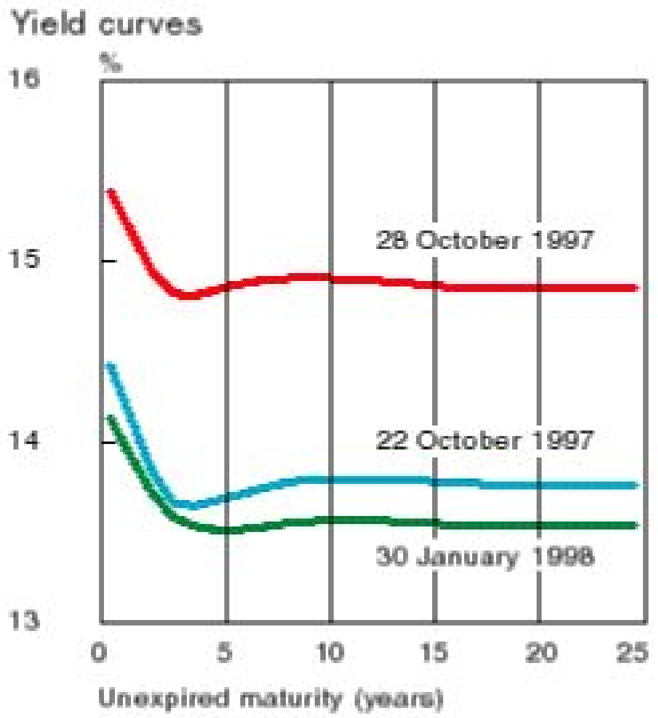
Period		Monthly average yield on long-term government bonds		Predominant rate on	
		Nominal	Inflation-adjusted	Mortgage loans	12-month fixed deposits
1997: Jan		15,8	5,9	20,0	14,5
	Feb	15,0	4,8	20,0	14,5
	Mar	15,2	5,1	20,0	14,5
	Apr	15,2	4,9	20,0	14,5
	May	15,1	5,1	20,0	14,5
	Jun	14,7	5,5	20,0	14,5

	Jul	14,2	4,8	20,0	14,5
	Aug	14,2	5,2	20,0	14,5
	Sep	14,2	5,7	20,0	14,5
	Oct	14,0	6,2	20,0	14,5
	Nov	14,5	7,3	19,0	13,5
	Dec	14,1	7,6	19,0	13,5
1998:	Jan	13,6	7,5	19,0	13,5

The *rate on bankers' acceptances with a maturity of three months*, which generally represents movements in money market rates fairly accurately, gradually drifted lower from 16,15 per cent at the end of January 1997 to a rate of 14,85 per cent at the end of September and 14,2 per cent on 23 October. Expectations of declining inflation and prospects of a reduction in official lending rates were among the main causes for the decline in money market rates during 1997. When the effects of the financial problems in the Asian economies spread to other emerging markets, the rate on bankers' acceptances of three months rose abruptly to 14,9 per cent at the end of October 1997 and 15,0 per cent at the end of November. With the return of more normal trading conditions, the rates declined somewhat to 14,9 per cent at the end of December 1997 and 14,45 per cent at the end of January 1998.

The downward trend in money market rates was also mirrored in a decline in the *tender rate on Treasury bills with a maturity of three months* from 15,84 per cent at the end of January 1997 to 14,49 per cent at the end of October. Despite the decrease of one percentage point in Bank rate on 20 October 1997, the tender rate on three-month Treasury bills rose to 14,59 per cent at the end of November and 14,79 per cent at the end of December. Upward pressure on the three-month Treasury bill rate was mainly caused by the large money market shortage which occasionally necessitated banks' use of collateral qualifying for second-tier Reserve Bank accommodation during November and December. The strong demand for Treasury bills with a maturity of three months to avoid accommodation against collateral of second-tier assets kept the rate on these bills from rising as strongly as other money-market rates and consequently caused the differential between the Treasury bill rate and the bankers' acceptances rate to widen quite substantially during November 1997. Towards the end of January 1998 the tender rate on Treasury bills with a maturity of three months declined to 14,25 per cent.

Along with the general downward movement in interest rates and yields, the *yield curve* shifted downwards during 1997 to assume a form on 22 October that was clearly inverted in the less-than-three-year maturity area and with a notably flat gradient over longer maturities. With the heightened uncertainties in the latter part of October, the yield curve shifted markedly upwards over the full spectrum of maturities, but broadly maintained the shape and gradient that prevailed before the upward correction had taken place. The yield curve subsequently moved downwards again, but, with money-market interest rates declining slightly more than the yields on bonds with a three-year maturity, the gradient of the inverted section of the curve on 30 January 1998 was slightly less steep than on 22 October 1997. Judging from the recent changes in the shape and slope of the yield curve, shorter-term interest rates and yields could have, maybe only temporarily, become somewhat more responsive than before to changes in underlying liquidity and general market conditions.



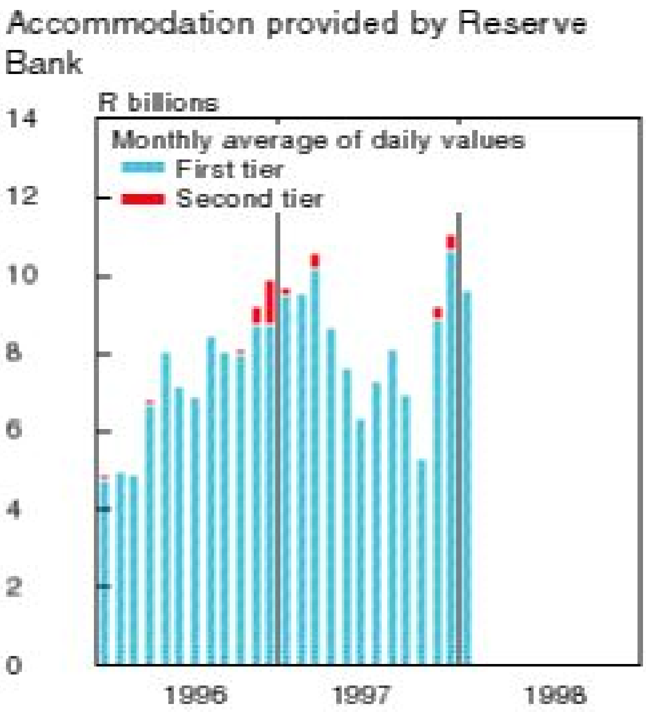
Positive financial developments were taken into consideration when the Reserve Bank lowered *Bank rate* by one percentage point from 17 per cent to 16 per cent on 20 October 1997. These included the slower growth in financial aggregates in the third quarter of 1997, especially the M3 money supply and credit extension to the private sector, falling inflation, a much more stable time path of the nominal effective exchange rate of the rand and rising gold and foreign exchange reserves. In response to this reduction in Bank rate, the banks lowered their *prime overdraft rate*, which had been unchanged at 20,25 per cent since 21 November 1996, by one percentage point to 19,25 per cent and their *predominant rate on mortgage loans* to 19 per cent. The inflation-adjusted rate on mortgage loans increased from 9,8 per cent in December 1996 to 12,2 per cent in December 1997 as the decline in consumer price inflation exceeded the decline in the nominal rate charged by banks on mortgage loans.

Other deposit and lending rates were also adjusted either in the fourth quarter of 1997 or early in 1998. The *predominant retail rate on twelve-month fixed deposits with banks* was lowered by one percentage point to 13,50 per cent in November 1997. The *standard interest rate* applicable to loans granted from the State Revenue Fund was raised from 14,0 per cent in November 1997 to 14,5 per cent in January 1998, but then lowered to 13,75 per cent in February 1998.

Money market

Money market conditions, which were relatively tight throughout the first quarter of 1997, eased during the second and third quarter, but then tightened again in the fourth quarter. This is reflected by the amount of *accommodation* extended to banks by the Reserve Bank *at month-ends*, which rose from R8,7 billion at the end of January 1997 to R10,5 billion at the end of March. The money market "shortage" then declined to R5,1 billion at the end of June 1997 and was still at a relatively low level of R6,5 billion by the end of September.

The decline in the net foreign assets of the Reserve Bank, following the turbulence in Asian financial markets, along with seasonal flows of banknotes caused the amount of accommodation provided by the Bank to rise sharply to R11,1 billion at the end of November 1997 and R10,2 billion at the end of December. The tightening of the market in November and December 1997 compelled banks to approach the Reserve Bank with collateral qualifying for "second-tier" accommodation at penal interest rates. The money market "shortage" subsequently subsided to R7,6 billion at the end of January 1998.



The relatively tight money market conditions that prevailed in the fourth quarter of 1997 were the result of the draining of liquidity from the market through an increase in notes and coin in circulation of R2,7 billion and a decrease of R2,3 billion in the net foreign assets of the Reserve Bank. The tightening effect of these developments was partially counteracted by losses incurred on account of the Reserve Bank's involvement in forward foreign exchange transactions during the fourth quarter which injected liquidity into the market.

In January 1998 money market conditions eased considerably as notes and coin moved back to the Reserve Bank after the festive season. Government deposits with the Reserve Bank were also reduced in January 1998, while bank liquidity was further strengthened through the losses incurred on account of the Reserve Bank's transactions in the forward foreign exchange market.

The *Reserve Bank's operations* in the money market during the fourth quarter of 1997 were intended to permit the money market shortage to reflect the underlying demand and supply situation in the market. Short-term adjustments were made to the asset portfolio of the Corporation for Public Deposits and foreign currency swap arrangements were entered into with banks in such a way as to counter large fluctuations in the money market shortage.

Bond market

Private-sector listed companies focused their capital-raising activities in 1997 on the primary share market and almost completely abstained from making *issues of fixed-interest securities*, i.e. convertible preference shares and debentures. An amount of only R2,8 million was raised through the issuance of convertible preference shares and debentures in 1997 as a whole, compared with R2,2 billion in 1996. However, an amount of R1,2 billion was mobilised by private-sector companies through issuing *bonds* listed on the Bond Exchange of South Africa during 1997.

As a consequence of private-sector companies' lack of interest in the issuance of *fixed-interest securities*, activity in the domestic primary market for fixed-interest securities was dominated by *public-sector entities*. The net amount raised by public-sector bodies through issues of fixed-interest securities in the first nine months of fiscal 1997/98 (i.e. from April to December 1997) came to R16,8 billion, compared with R12,3 billion in the corresponding period of the previous year. Wide fluctuations occurred from quarter to quarter in the net access of public-sector bodies to capital-market resources; net issues by public-sector bodies fell from R7,2 billion in the April-June quarter to R2,1 billion in the July-September quarter when net stock redemptions amounting to R6,9 billion were made, but then rose again to R7,5 billion in the October-December quarter.

The *National Government* supplemented its funding requirements to an amount of R3,8 billion through issues of foreign-currency denominated bonds in the international primary bond market in 1997, compared with R3,4 billion in 1996. In June 1997, a ¥40 billion seven-year Samurai bond was issued. The spread of 93 basis points between the yield on these bonds and their Japanese counterpart was significantly narrower than the previous Samurai issue in 1995, which was priced at 215 basis points above the yield on comparable bonds of the Japanese government. The South African government followed shortly after the Samurai with a US$500 million twenty-year Yankee bond, priced at a spread of 183 basis points above the yield of comparable bonds of the US Federal Government. This was the international loan issue with the longest maturity that has been issued by South Africa, clearly reflecting improved investors' confidence in the country. It also enabled the Government to extend and improve the maturity profile of external debt.

Non-financial public-sector and *private-sector corporations* abstained from issuing foreign-currency-denominated bonds in the international capital markets. Eskom, Transnet and the Development Bank of Southern Africa opted instead to raise R870 million through rand-denominated bonds in the Eurobond market during 1997. In January 1998 Eskom raised a further amount of R137 million in Eurorands and the Development Bank of Southern Africa R1 billion in February.

Turnover in the *secondary bond market* increased by 41 per cent in 1997 to an aggregate amount of R4 269 billion. An all-time quarterly high turnover value of R1 370 billion was recorded in the fourth quarter of 1997. Trading activity remained buoyant at R465 billion in January 1998. Among the more prominent explanations behind the sharp rise in turnover were:

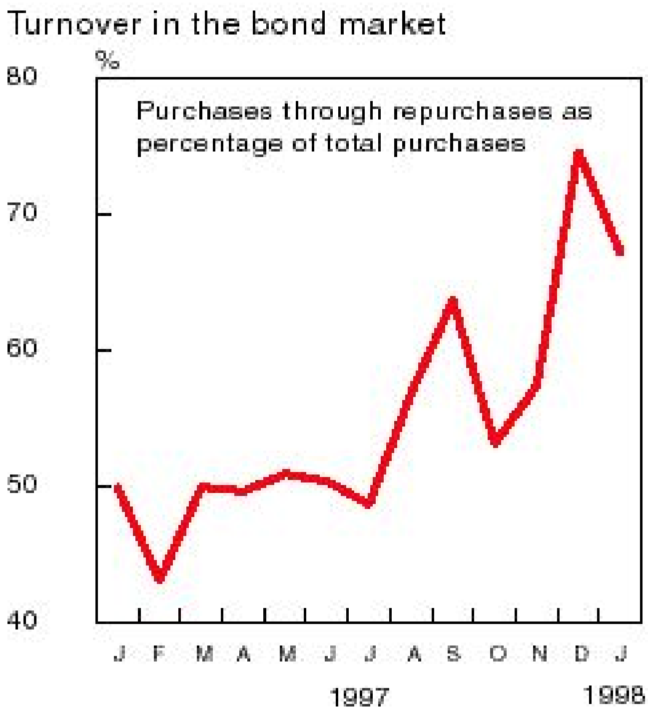
- the relatively high yields which attracted the interest of non-resident investors;
- the prospects for continued stability of the rand;
- the need to hedge positions arising from Eurorand bond issues through purchases in the South African bond market;
- the turmoil in the Southeast Asian financial markets and the resilience of the domestic bond market amidst unsettled conditions in a number of emerging markets;
- the improved efficiency of bond trading in South Africa brought about by, among others, the shortening of the bond settlement period; and
- the availability of repurchase transactions whereby market participants can use sale and buyback trades to "carry" their positions from day to day and over settlement dates.

Table 18. Bond and share market activity

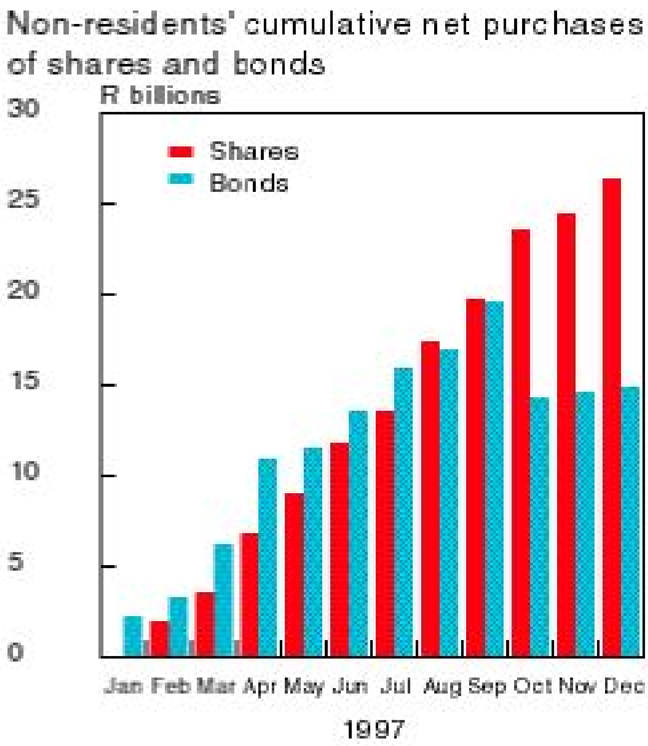
Period		Secondary market		
		Bonds traded	**Shares traded**	
		Value	**Number**	**Value**
		R billions	**billions**	**R billions**
1996:	1st qr	753	2,0	27,2
	2nd qr	781	1,9	27,4
	3rd qr	809	2,4	27,8
	4th qr	680	2,7	34,6
	Year	**3 023**	**9,0**	**117,0**
1997:	1st qr	883	3,9	41,2
	2nd qr	834	4,5	51,0
	3rd qr	1 182	4,9	58,7
	4th qr	1 370	4,6	55,8

	Year	**4 269**	**17,9**	**206,7**

Repurchase transactions, in particular, gained in popularity in the course of 1997. Purchases through repurchase transactions, increased as a percentage of total purchases from 49 per cent in the first half of 1997 to 56 per cent in the third quarter and 60 per cent in the fourth quarter. The highest percentage for any individual month was recorded in December 1997 at 75 per cent.

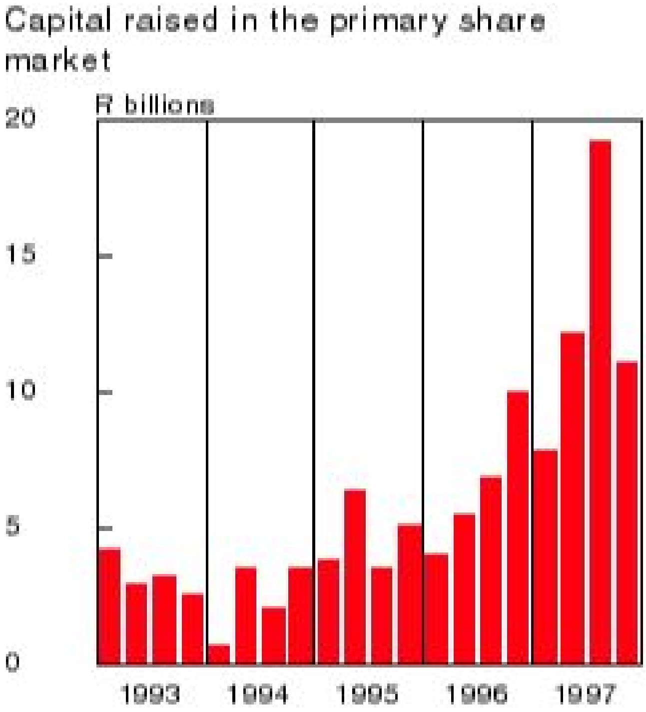


Despite net sales of bonds to the value of R4,2 billion in the fourth quarter of 1997, the *cumulative net purchases of bonds by non-residents* amounted to R14,8 billion in 1997 as a whole, compared with R3,4 billion in 1996. Settlement of an amount of R2,9 billion of these net purchases during 1997 was still outstanding at the end of that year. The further decline in bond yields early in 1998 to levels that were still attractive relative to yields in other markets and the prospects of further capital gains, continued to lure non-residents into the South African bond market and their net purchases amounted to R3,6 billion in the six weeks up to mid-February 1998.



Share market

Unlike the primary market for fixed-interest securities, the *primary share market* was extensively used by companies listed on the Johannesburg Stock Exchange and the *total value of capital* raised in this market increased from R26,4 billion in 1996 to R50,3 billion in 1997 or by 91 per cent. Shares issued for the *acquisition of assets* not already listed increased more than threefold from R6,4 billion in 1996 to R21,6 billion in 1997 and *rights issues of ordinary shares* increased from R7,6 billion to R9,7 billion over the same period. These two means of finance therefore accounted for 43 per cent and 19 per cent of total capital raised in the primary share market in 1997.



Turnover in the *secondary share market* rose strongly in 1997. The *number* of shares traded on the Johannesburg Stock Exchange almost doubled from 1996 to 1997, whereas the value of such shares increased by some 77 per cent to R207 billion. Monthly turnovers reached a peak of R21,8 billion in October 1997, but subsided in the ensuing months to R16,5 billion in December as investors' confidence in emerging markets weakened. Investors' sentiment improved appreciably in the early weeks of 1998 and turnover in the secondary share market rose to R18,6 billion in January.

The share market was underpinned by strong demand from *non-resident investors* in 1997. The cumulative net purchases of shares in the secondary share market by non-residents amounted to R26,2 billion in 1997, or almost five times as much as their net purchases of R5,3 billion in 1996. Although some re-assessment of the intrinsic value of South African securities took place in the aftermath of the Asian financial market problems, non-resident investors remained net buyers of shares to the value of R6,6 billion in the fourth quarter of 1997 and R4,3 billion in the first six weeks of 1998. The perception of reduced exchange rate risk, a positive outlook for price movements in the share market and the problems in Asia have apparently encouraged non-resident investors to increase the portion of their emerging market portfolios allocated to the shares of South African companies.

The *monthly average price level of all classes of shares,* which had risen steadily since the beginning of 1997, dropped sharply in the second half of October, reflecting the general turbulence in global equity markets. Supported by solid earnings growth and in anticipation of a decline in interest rates, the average level of all-share prices reached an all-time high in August 1997 - a rise of 14,6 per cent from December 1996. This happened despite a slump in the monthly average price level of *gold-mining shares,* which fell by 58,2 per cent from May 1996 to December 1997 in response to a decline in the price of gold. From August 1997 to December, the monthly average level of the all-share price index fell by 16,5 per cent. The monthly average value of gold-mining shares improved by 12 per cent in January 1998 when the price of gold steadied. This increase in the price of gold-mining shares notwithstanding, the all-share price index increased by only 0,4 per cent in January 1998.

The decline in share prices from August 1997 was essentially caused by the deterioration of investor confidence in emerging markets following the problems in Asia and introduced an additional element of volatility in share price movements on the Johannesburg Stock Exchange. The *all-share price index*, at first, declined slightly by 2,5 per cent from a peak on 7 August 1997 to 22 October. Within four trading days the all-share price index then fell by 19 per cent to 28 October. The index recovered briefly in the ensuing six trading days before weakening again, reaching a low point for the calendar year on 12 December 1997. It declined further by 6 per cent to a new low on 12 January 1998. Although the market recovered strongly in the second half of January 1998, the all-share price index was still 14 per cent lower at the end of that month than the peak value on 7 August 1997.

The monthly average *dividend yield* on all classes of shares declined from 2,46 per cent in January 1997 to 2,31 per cent in July as share prices increased firmly, but then increased to 2,70 per cent in January 1998 as share prices moved lower. The monthly average *earnings yield* (gold-mining shares excluded) declined likewise from 7,01 per cent in December 1996 to 6,56 per cent in July 1997, before increasing to 7,62 per cent in January 1998. The *price-earnings ratio* of all classes of shares, excluding gold-mining shares, averaged about 14,9 over the period January-September 1997, but then declined to 13,1 in January 1998 as earnings strengthened and share prices weakened. The weakening of share prices in the last quarter of 1997 caused the popularity of unit trust investments to wane fairly drastically. Transactions in units of unit trusts changed from monthly average net sales of R1,3 billion in the first ten months of 1997 to average net sales of R1,1 billion per month in November and

December.

Table 19. Yields and price ratios

Period		Dividend yield Per cent	Earnings yield* Per cent	Price- earnings ratio*
1996:	Dec	2,46	7,01	14,27
1997:	Jan	2,46	6,89	14,51
	Feb	2,37	6,68	14,96
	Mar	2,40	6,62	15,11
	Apr	2,41	6,66	15,01
	May	2,40	6,70	14,93
	Jun	2,37	6,87	14,55
	Jul	2,31	6,56	15,23
	Aug	2,33	6,59	15,17
	Sep	2,44	6,77	14,76
	Oct	2,53	7,13	14,03
	Nov	2,62	7,14	14,00
	Dec	2,74	7,57	13,21
1998:	Jan	2,70	7,62	13,13
* Excluding gold-mining shares				

The market liquidity of the Johannesburg Stock Exchange, measured by annual turnover as a percentage of market capitalisation, improved in 1997 to 18,3 per cent from 6,2 per cent in 1995 and 10,9 per cent in 1996. This improvement was partly a reflection of growing participation by non-residents, the increased efficiency of trading on the Johannesburg Stock Exchange and the partial relaxation of exchange control measures which allowed domestic institutional investors to enter into asset swap transactions with non-resident investors. Despite this improvement, market liquidity remained low by international standards, probably because of the remaining exchange controls which limit investment opportunities of domestic investors and thereby inhibit institutional investors from trading their portfolios actively.

Other financial markets

The exceptionally strong rise in the activity levels of the share market, the increased participation of non-residents in the domestic securities markets and the problems in Asian financial markets boosted trading in the *formal derivatives market* in 1997. Trading in *equity and interest rate futures and options contracts* accordingly increased by 25,1 per cent from the levels attained in 1996. Trade in equity contracts overwhelmingly dominated this kind of trading and accounted for 99,6 per cent of all trades concluded. The number of *futures contracts* traded increased by 26,8 per cent and the number of *options on futures contracts* traded by 23,8 per cent from 1996 to 1997. Non-resident participation in this market also increased strongly from an average of 8,8 per cent of open interest in 1996 to 28,3 per cent in December 1997.

From their introduction in May 1997 only 475 *rand-dollar futures contracts* had been traded by the end of January 1998. Until the end of January 1998 the number of *equity options contracts* traded since their introduction in September 1997 totalled 98 110. From the introduction of *warrants* on the Johannesburg Stock Exchange in October 1997, a total number of 117 million trades had been concluded by the end of January 1998.

Trade in *commodity futures* was dominated by *maize contracts* which had increased from 2 700 in 1996 to 20 200 in 1997 - 68 per cent of these were white maize contracts. Only 163 *wheat* commodity futures contracts had been traded since their introduction in November 1997 to the end of January 1998.

Trading conditions in the *real-estate market* as a whole, and especially in the residential property market, remained sluggish in 1997, mainly owing to the relatively high cost of mortgage financing. The value of transactions increased by 7,6 per cent from 1996 to 1997, whereas the number of transactions increased by only 2,7 per cent over the same period. The average value per transaction thus showed an increase of less than 5 per cent in 1997, which was well below the corresponding rate of consumer-price inflation.

Public finance

The Medium Term Budget Policy Statement

The Minister of Finance released the *Medium Term Budget Policy Statement 1997* on 2 December 1997. The Statement sets out the policy framework for the budget for fiscal 1998/1999, describes government's goals and objectives, explains the economic environment within which these objectives are addressed and projects the total level of resources that will be available.

The Statement should be seen as a further step in the development of an open, transparent and co-operative policy-making process. It does not constitute a new policy, but presents an operational plan in the sphere of the national budget, designed to give effect to policy objectives that were enunciated in previous policy documents. These were:

- to reduce the overall budget deficit and the level of government dissaving;
- to avoid permanent increases in the overall tax burden;
- to reduce consumption expenditure by general government relative to gross domestic product; and
- to strengthen the general government contribution to gross domestic fixed investment.

A key element of the Statement is the *Medium Term Expenditure Framework* (MTEF) which initiates a process of rolling three-year budgets. These are first steps in a wider overhaul of the budgetary process. The emphasis will be on transparency, output-driven programme budgeting and political prioritisation.

The acceptance and publication of a three-year expenditure framework by the national and provincial governments have important advantages. The more prominent among these are:

- departments and agencies will be encouraged to evaluate their policy proposals within realistic budget projections;
- a framework will be created within which government could assess the financial implications of policy proposals;
- medium-term planning by departments and spending agencies will be fostered, leading to improved efficiency;
- the management of rollovers will be facilitated as departments and agencies will be allowed to enter into contracts that will involve future payments; and
- the credibility of fiscal targets will improve.

Medium-term fiscal projections

Government's revenue and spending projections for the fiscal years 1998/99 to 2000/01 were based upon the following assumptions:

- growth of real gross domestic product would accelerate from 2 per cent in fiscal 1997/1998 to 3 per cent in fiscal 1998/1999, 4 per cent in fiscal 1999/2000 and 5 per cent in fiscal 2000/2001; and
- the inflation rate would fall from 9 per cent in fiscal 1997/1998 to 7,5 per cent in fiscal 1998/1999, 6,5 per cent in fiscal 1999/2000 and 6 per cent in fiscal 2000/2001.

These assumptions will, of course, be adjusted in future years in light of actual economic performance. The fiscal projections for the year 1998/1999 to 2000/2001 are presented in Table 20.

Table 20. Fiscal projections

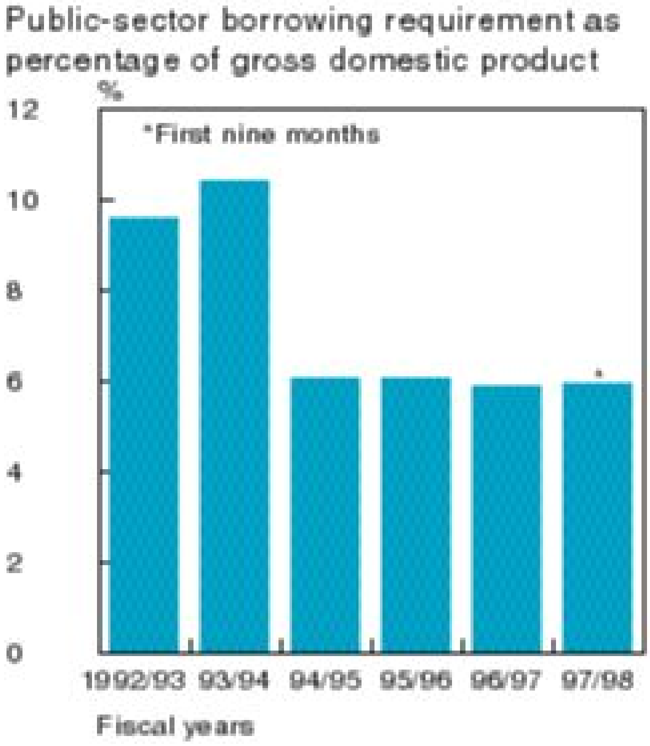
R billions

	1997/ 1998	1998/ 1999	1999/ 2000	2000/ 2001
National Budget revenue	162,0	178,1	195,7	216,2
National Budget expenditure	186,8	202,1	218,5	241,5
Deficit	24,8	24,0	22,8	25,3
Percentage of gross domestic product				
National Budget revenue	26,2	26,0	25,8	25,6
National Budget expenditure	30,2	29,5	28,8	28,6
Deficit	4,0	3,5	3,0	3,0

As far as public spending is concerned, government is committed to fiscal prudence. Should the economy fail to grow as fast as indicated by the macroeconomic projections, government expenditure growth will have to be lower than the projections.

Public-sector borrowing requirement

The *public-sector borrowing requirement* (i.e. the deficit before borrowing and debt repayment of the consolidated central government, provincial governments, local authorities and non-financial public enterprises and public corporations) increased from R21,9 billion in the first three quarters of fiscal 1996/1997 to R27,1 billion in the first three quarters of fiscal 1997/1998. As a ratio of gross domestic product, the public-sector borrowing requirement increased from 5,3 per cent in the first three quarters of fiscal 1996/1997 to 6,0 per cent in the corresponding period of fiscal 1997/1998.

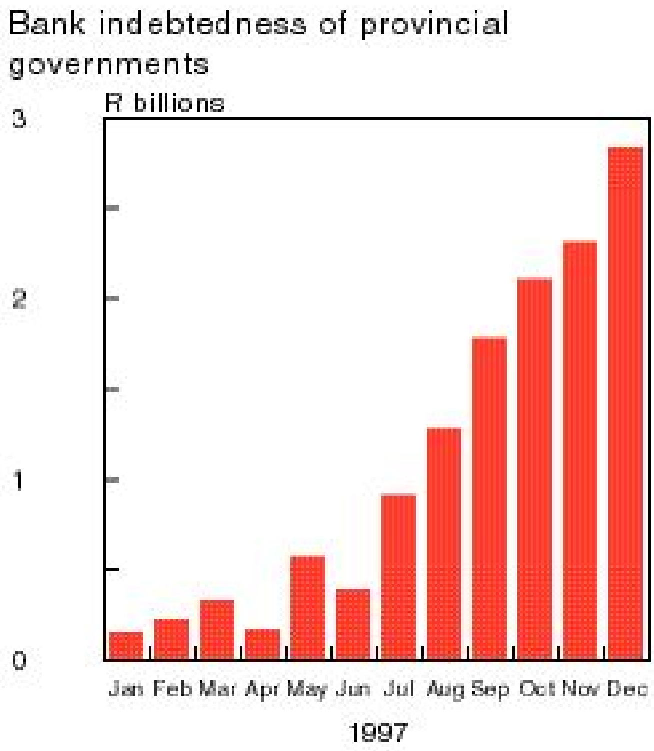


The larger borrowing requirement of the public sector could mainly be attributed to increased borrowing by *provincial governments* which increased from R0,9 billion in the first nine months of fiscal 1996/1997 to R5,6 billion in the first nine months of fiscal 1997/1998. This was mainly the result of higher levels of expenditure by a number of provincial governments on education, health care and welfare service delivery. Some of the provincial governments accessed bank credit resources for the funding of their revenue shortfalls, leading to an increase in bank indebtedness of provincial governments from R332 million at the end of March 1997 to R2 834 million at the end of December.

Table 21. Public-sector borrowing requirement

	April-December 1996		April-December 1997	
	R billions	**Per cent of gross domestic product**	**R billions**	**Per cent of gross domestic product**
Main Budget	19,5	4,7	18,0	3,9
Extra-budgetary institutions	1,4	0,3	1,6	0,3
Provincial governments	0,9	0,2	5,6	1,2
Local authorities	0,4	0,1	0,9	0,2

Non-financial public enterprises and public corporations	-0,5	-0,1	0,8	0,2
Total public sector	**21,9**	**5,3**	**27,1**	**6,0**



In contrast to the increase in the borrowing requirement of provincial governments, the *borrowing requirement of the Main Budget* decreased from R19,5 billion in the first nine months of fiscal 1996/1997 to R18,0 billion in the first nine months of fiscal 1997/1998. This decline in the borrowing requirement of the Main Budget occurred notwithstanding a year-on-year rate of increase of 6,8 per cent in the transfers to provincial governments in the first nine months of fiscal 1997/1998. Transfers to provincial governments were budgeted to be R80,4 billion in fiscal 1997/98, which indicates an increase of only 2 per cent over the actual transfers that were made in fiscal 1996/1997.

Expenditure by general government increased at a year-on-year rate of 10,9 per cent in the first nine months of fiscal 1997/1998 compared with 14,9 per cent in the first nine months of the previous fiscal year. Despite this slowdown in general government expenditure over twelve months, it still increased as a percentage of gross domestic product from 36,9 per cent in the first nine months of fiscal 1996/1997 to 37,5 per cent in the first nine months of fiscal 1997/1998.

Total revenue receipts of general government increased at a year-on-year rate of 8,9 per cent during the first nine months of fiscal 1997/1998, compared with 15,0 per cent in the corresponding period of the previous fiscal year. This led to a slight decrease in total revenue receipts as a percentage of gross domestic product from 31,4 per cent in the first nine months of fiscal 1996/1997 to 31,3 per cent in the first nine months of fiscal 1997/1998.

Exchequer account

Exchequer issues to government departments (adjusted to reflect cash flows) amounted to R139,8 billion in the first nine months of fiscal 1997/1998 or 74,8 per cent of total budgeted expenditure for the year as a whole. This brought the year-on-year rate of increase in Exchequer issues to 6,8 per cent in the first nine months of fiscal 1997/1998; the Budget provided for an increase of 6,1 percent for the full fiscal year. As a ratio of gross domestic product, Exchequer issues amounted to 30,7 per cent in the first nine months of fiscal 1997/1998 against 31,5 per cent recorded in the corresponding period of the preceding year.

Also taking Exchequer issues during January 1998 into account, these issues amounted to R152,3 billion in the first ten months of fiscal 1997/1998, or 4,7 per cent more than in the first ten months of the preceding year. Exchequer issues during this period equalled 81,5 per cent of the total expenditure budgeted for the year as a whole.

Exchequer receipts (not considering extraordinary revenue) amounted to R118,8 billion in the first nine months of fiscal 1997/1998 or 8,2 per cent more than in the corresponding period of the previous fiscal year. An increase of 11,2 per cent was envisaged in the Budget for the fiscal year as a whole.

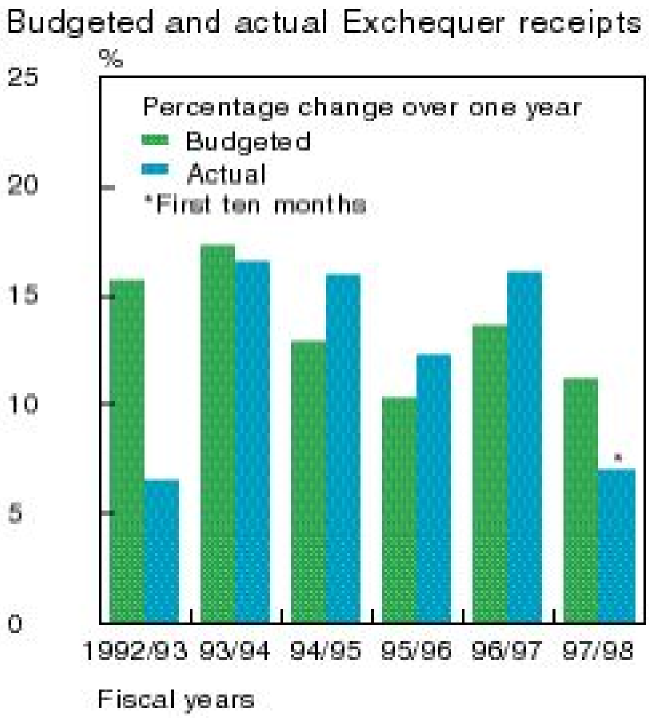


Table 22. Percentage increase in government revenue in fiscal year 1997/1998

Revenue categories	Budget projection for full year	Year-on-year increase in first nine months
Customs and excise	**8,0**	**1,3**
Customs	4,3	-5,2
Excise	15,9	16,7
Fuel levy	10,4	16,2
Payments to BLNS countries*	20,0	20,0
Inland revenue	**11,7**	**12,8**
Income tax	13,5	12,6
Value-added tax	11,4	13,8
Total Exchequer receipts	**11,2**	**8,2**

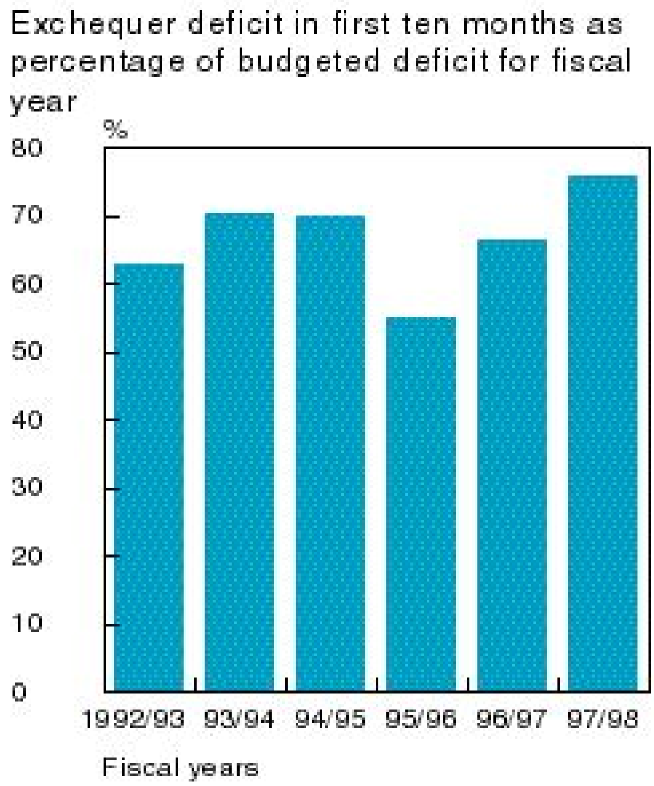
* Botswana, Lesotho, Namibia and Swaziland

Apart from income tax and customs duties, all the other broad categories of revenue have outperformed the budget expectations thus far. The weak growth in the collection of customs duties was partly due to the accelerated implementation of tariff reductions agreed to in the Final Act of the Uruguay Round of trade negotiations. Despite this shortfall in revenue growth, the contractual responsibilities in respect of transfers to members of the Southern African Customs Union, of course, remained unchanged.

In January 1998 Exchequer receipts decreased by 1,9 per cent compared with January 1997. This brought the year-on-year rate of increase in Exchequer receipts to 7,0 per cent in the first ten months of fiscal 1997/1998. Exchequer receipts during this period accounted for 82,4 per cent of total revenue of R162,0 billion envisaged in the Budget for the fiscal year as a whole.

The net result of the lower-than-budgeted revenue and higher-than-budgeted expenditure was a *deficit before borrowing and debt repayment* of R20,9 billion in the first nine months of fiscal 1997/1998. As a ratio of gross domestic product, the deficit before borrowing and debt repayment amounted to 4,6 per cent in the first nine months of fiscal 1997/1998, compared with 5,1 per cent in the corresponding period of the previous fiscal year and 4,0 per cent projected for the current fiscal year as a whole.

The realised deficit in the *first ten* months of fiscal 1997/1998 amounted to R18,7 billion, which represents 75,7 per cent of the deficit budgeted for the year as a whole. This percentage was substantially higher than the 67,3 per cent of the full-year deficit that was realised in the first ten months of the previous year and the average of 64,8 per cent recorded in the preceding five fiscal years.



The greater part of the deficit in the first ten months of fiscal 1997/1998 was *financed* by means of new issues of government stock as indicated in the following table:

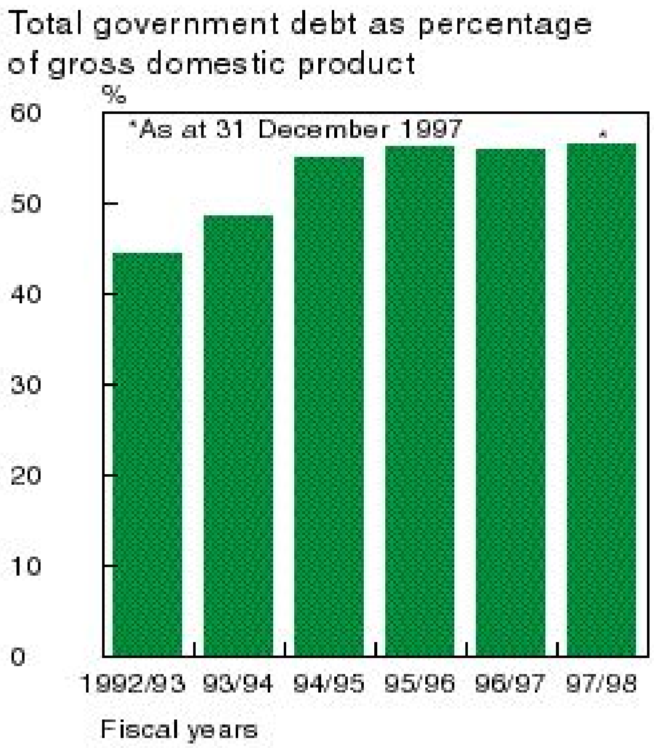
	R millions
Government stock (including discount)	20 714
Less: Discount on government stock	3 867
Net receipts from government stock issued	**16 847**
Treasury bills	3 733
Extraordinary receipts	2 937
Foreign loans	
Redemption of IMF loan**	-1 036

Other loans	3 758
Non-marketable securities	-99
Redemption of Namibian debt	-203
Redemption of Section 239 debt*	-3 551
Transfer from IMF accounts**	1 036
Increase in available cash balances	-4 679
Total net financing	**18 743**

* Debt of the former Transkei, Bophuthatswana, Venda and Ciskei and self-governing states.

** Contra entries.

Total government debt rose from R310,6 billion at the end of March 1997 to R336,1 billion at the end of December 1997. As a percentage of gross domestic product, government debt increased from 55,8 per cent at the end of March 1997 to 56,5 per cent at the end of December 1997. Government debt continued to increase in January 1998 and accumulated to R336,3 billion by the end of that month.



Adjustments Budget for fiscal 1997/1998

In the Adjustments Budget tabled in Parliament on
13 February 1998 additional expenditure of R9,1 billion was approved for fiscal 1997/1998. However, if consideration is given to the postponement of spending to subsequent fiscal years and other

adjustments, the revised estimates of expenditure for fiscal 1997/1998 are raised by R2,7 billion to R189,5 billion. As a ratio of gross domestic product, the revised expenditure estimate is expected to be 30,5 per cent in fiscal 1997/98, which is more than the original budget estimate of 30,0 per cent, but less than the 31,8 per cent realised in the previous fiscal year.

Table 23. Adjustments Budget estimates for 1997/1998

		R billions
Original budgeted expenditure*		186,7
Plus: Additional expenditure		7,0
		193,7
Less:	Roll-overs	3,6
	Savings and suspensions	0,6
Total adjusted expenditure		189,5
Total revenue		162,0
Adjusted deficit		27,5
Adjusted deficit as percentage of gross domestic product		4,5
* This amount includes an amount of R2,1 billion that was provided for but not approved in the March 1997 Budget.		

The initial estimate of revenue of R162 billion was left unchanged in the Adjustments Budget, leaving an upward revision of the Budget deficit from R24,8 billion to R27,5 billion. This is equivalent to 4,5 per cent of the revised estimate of the gross domestic product as against the expectation of a deficit of 4,0 per cent of gross domestic product that was held at the time when the Minister of Finance presented his initial budget proposals to Parliament in March 1997.