Quarterly Economic Review

September 1999

No. 213

South African Reserve Bank

CONTENTS

List of tables

List of graphs

Quarterly Economic Review

Introduction

The domestic economic and financial situation in South Africa was highly volatile and uncertain in the second half of 1998. Like many other emerging-market economies, South Africa was seriously affected by the adverse economic situation in Asia and the Russian debt moratorium in August 1998. Strong capital inflows into the economy in the early months of 1998 were abruptly reversed into outflows in the second half of that year. As international investors sought less risky investment opportunities in the mature financial centres of the world, interest rate differentials between South Africa and the advanced economies widened perceptibly. Domestic demand and output in South Africa could not escape the short-term effects of a sharp rise in domestic interest rates – the downturn in economic activity since November 1996 was exacerbated and real gross domestic product fell sharply in the third quarter of 1998.

Since the fourth quarter of 1998 the situation in global financial markets has improved substantially. Interest rate reductions in the United States, the United Kingdom and in the euro area have helped to improve investor confidence and in most of the crisis-affected countries, financial markets have stabilised. There are good prospects of a strengthening in the current global economic recovery in the remainder of 1999 and in 2000.

In South Africa, the economy has regained some growth momentum over the past three quarters, supported by the recovery in the Asian economies, the continued strength of the United States economy and the general easing of domestic monetary conditions. Over this period the outlook for inflation deteriorated slightly as the rising cost of imported intermediate goods – following the depreciation of the rand around the middle of last year – and higher domestic production cost impacted on output prices. The inflationary effects of these cost pressures more than offset the deflationary influence of weak domestic activity. “Core” consumer price inflation and inflation in the prices of domestically produced goods have accelerated persistently since the second quarter of 1998.

The growth in real gross domestic product accelerated progressively from the fourth quarter of 1998 and reached an annualised rate of 1½ per cent in the second quarter of 1999 when it was boosted by a healthy increase in agricultural output. Among the main non-agricultural sectors of the economy it was the service-providing sectors, more particularly the telecommunications industry, that set the pace for output expansion. Despite the growth spurt in the second quarter, aggregate output in the first half of 1999 was about the same as in the first half of 1998, indicating negligible year-on-year growth in the first half of 1999. Considering the low levels of production in the second half of 1998, continuation of the current output recovery would take real gross domestic product in 1999 as a whole to a level higher than that in 1998.

Aggregate final demand (i.e. the total of household consumption expenditure, consumption expenditure by general government and fixed capital formation) declined in the second quarter of 1999. Despite gains in the real income of households and lower borrowing costs, consumer confidence was weak as memories of the asset price decline in 1998 lingered on and employment prospects remained poor. Household spending accordingly remained sluggish. General government consumption expenditure declined in real terms, once again reflecting the resolve of the authorities to contain the growth in their recurrent expenditures. The weakness of the economy and some uncertainties about medium-term prospects effectively dampened the demand for new production capacity in the business sector. Capital outlays were probably also reduced by the unfavourable prices at which many types of capital equipment could be imported and the relatively high cost of finance.

The decline in final demand and the slight acceleration in domestic production contributed to a fairly significant increase in inventory levels. Industrial and commercial inventories declined slightly in proportion to the increase in output outside the agricultural sector, but elsewhere inventories were accumulated, giving the impression that stockbuilding might have been largely unplanned or involuntary. The net investment in inventories in the second quarter of 1999 – the first of its kind in ten quarters – was sufficient to turn the decline in total final demand into a strong rise in gross domestic expenditure.

A positive development in the first half of 1999 was an improvement in the gross saving ratio of the South African economy. If the steady rise in domestic saving could be sustained in the quarters ahead, this might strengthen overall fixed capital formation and economic performance in general. The corporate sector is nevertheless struggling to sustain historical saving ratios as growth in operating surpluses per unit of output has been gradually slowing since about 1995.

The slow growth in output during 1998 and the first half of 1999 was associated with weak demand for labour and declining employment levels in the formal sectors of the economy. The unemployment rate, judged by changes in the official employment statistics for the formal sectors of the economy, has probably increased in line with the weaker than expected growth in the economy. Productivity growth lost some of its capacity to contain inflationary pressures.

The value of merchandise and net gold exports declined in the second quarter of 1999 as some hesitancy occurred in the external demand for metals and minerals produced in South Africa. At the same time, the strengthening of aggregate domestic expenditure, particularly the accumulation of inventories, created a demand for imported goods, causing the value of merchandise imports to rise slightly. The consequent weakening of the trade account was countered somewhat by a slight improvement in net payments for services (including income of production factors and current transfers), but the current-account balance was still turned around from a surplus in the first quarter of 1999 to a small deficit in the second quarter.

The consolidation in the international financial markets led to an improvement in the financial account of South Africa with the rest of the world in the first half of 1999. Foreign direct investment into South Africa, which had briefly turned into net disinvestment in the fourth quarter of 1998, increased further in the second quarter of 1999. Attractive yields in the domestic bond market, the relative strength of the rand in the first half of 1999, and the need to diversify emerging-market portfolios continued to encourage strong inflows of portfolio capital into the economy.

Despite continued foreign asset accumulation by South African companies and individuals, a sizeable surplus was recorded on the financial account with the rest of the world, which also translated into an overall surplus on the balance of payments during the second quarter of 1999. The net international reserve holdings of the country accordingly improved further. Under these favourable conditions the exchange value of the rand held up well and even appreciated somewhat over the second quarter.

The economy's vulnerability to exchange rate shocks was further diminished by a substantial reduction in the net open position in foreign currency of the Reserve Bank.

The broad monetary aggregate (M3) expanded relatively slowly during the first seven months of 1999. Year-on-year growth in the M3 money supply remained in the lower half of the 6 to 10 per cent guideline range indicated by the Reserve Bank as acceptable monetary growth in the medium term. The growth in M3 was partly held back by a rise in the income velocity of circulation of the broad money supply. Private households and businesses seemed to have allocated an increased share of their saving flows to equities and non-depository type interest-bearing assets, and reduced their net bank indebtedness.

The growth in the private banking sector's assets slowed down too, mainly due to a deceleration in the growth in their claims on the domestic non-bank private sector. The growth in the demand for credit by the private sector decelerated because of households' weak spending on durable consumer goods, and declines in the business sector's fixed capital formation. Weakness in the demand for working capital by the corporate sector and the shifting of trade financing from domestic to offshore sources of credit when the rand strengthened against the US dollar in the second quarter, could also have contributed to the slowdown in the banks' claims on the domestic private sector. In the aggregate, the growth in credit demand by the private household sector slowed down considerably more than the growth in the corporate sector's demand for credit.

Liquidity conditions in the money market tightened considerably in the second quarter of 1999 as the Reserve Bank drained liquidity from the market in order to raise the private banks' dependency on central bank money. Declining overall consumer price inflation and a greater sense of stability in the financial markets nevertheless created circumstances conducive to declining money market rates. The Reserve Bank endorsed the downward movement of short-term interest rates and at times even encouraged an acceleration in the speed of decline in the rate on repurchase agreements. The yield curve consequently assumed a fairly steep positive inclination over shorter maturities, but remained rather flat over maturities beyond three years. The positive slope of the curve inside the five-year interval could indicate expectations of an imminent decline in inflation, whereas the horizontal slope in the area beyond five years may indicate some scepticism about a sustained move towards lower inflation in the long term.

Bond yields generally moved in a narrow range around a steadily rising trend from the beginning of the second quarter of 1999. Yields responded, among other things, to the market's perceptions of the likely impact of foreign economic difficulties on the domestic financial markets, changes in interest rates in the United States, the fall in the gold price and the gradual accumulation of domestic inflationary pressures. Investor sentiment was more positive in the share market where prices rose over the first seven months of 1999. The prices of gold-mining shares, by contrast, remained under downward pressure as central banks and international organisations indicated their intentions to sell gold from their international reserve holdings.

The primary bond market was still dominated by public-sector organisations. Virtually all capital raised in the first half of 1999 through issues of fixed-interest securities was intended for the financing of public-sector organisations. When private-sector companies wished to raise capital in the primary markets, their activities were almost exclusively confined to the equity market.

The high levels of activity in the securities markets extended to the formal derivatives markets and the turnover of options and futures contracts in the formal markets remained lively. Activity in the real estate market, which had been severely affected by the financial turbulence of 1998, recovered slightly from the low levels of the first quarter of 1999, but was still much more subdued than activity in 1997 and the early months of 1998.

The increase in national government expenditure in the first four months of fiscal 1999/2000 was about on a par with the increase envisaged in the Budget for the full fiscal year. At the same time, national government revenue ran well ahead of budgetary projections. At this early stage of the fiscal year, prospects are good that government will meet, or be well within, the declared deficit objective for the full fiscal year. At the level of provincial governments, surpluses on the financial accounts are being maintained, albeit at a somewhat lower level than in the first three months of the 1998/99 fiscal year. Furthermore, the consolidation of fiscal discipline at national and provincial government levels would be extended to include local authorities.

Sound fiscal and monetary policies have contributed to the relatively rapid improvement in overall economic performance after the financial turbulence of 1998. Budgetary restraint at national and provincial government levels has helped to improve domestic saving and permitted the monetary authorities to reduce interest rates to lower levels than would otherwise have been possible. This policy mix, and sustained progress towards lower inflation, will in due course foster clear price signals, more efficient utilisation of productive resources, strong business investment and significant advances in employment, productivity and real compensation of employees.

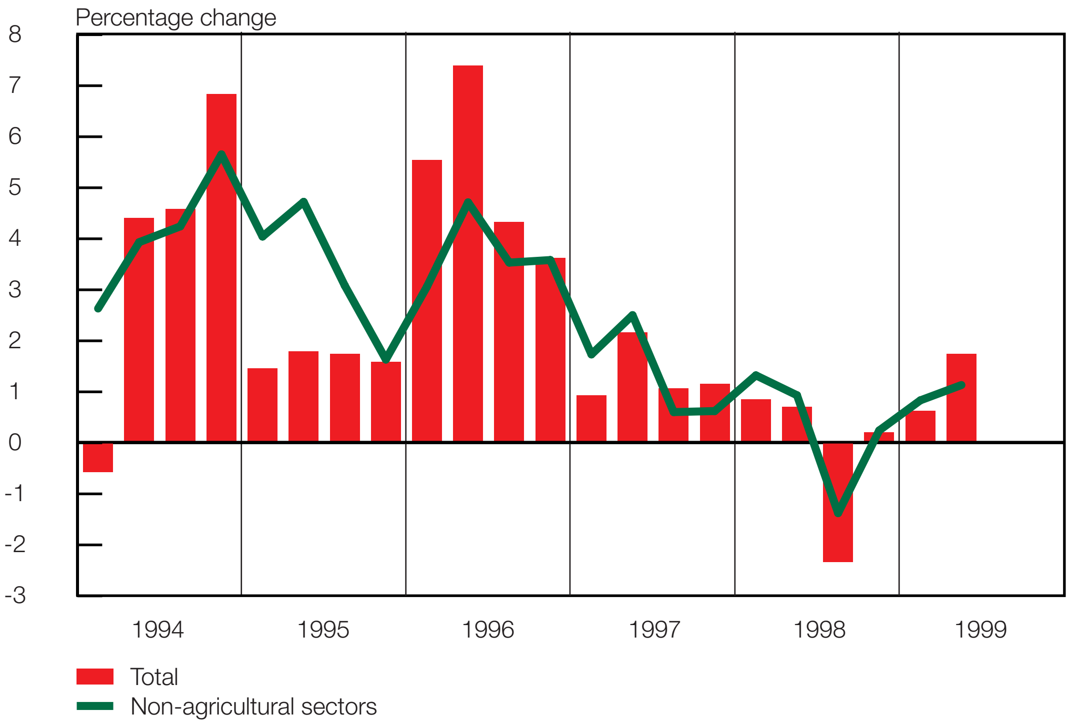
Domestic economic developments

Domestic output

After having declined at a seasonally adjusted and annualised rate of 2½ per cent in the third quarter of 1998, *real gross domestic product* is estimated to have increased at progressively accelerating rates over the past three calendar quarters – economic growth accelerated from ½ per cent in the first quarter of 1999 to 1½ per cent in the second quarter. Despite this growth, the level of domestic production in the first half of 1999 did not differ much from that in the first half of 1998.

The more favourable circumstances in the second quarter of 1999 could be ascribed to an improvement in agricultural conditions and continued growth in the tertiary sectors. Increases in the production of these sectors neutralised the decreases in real value added by the mining and secondary sectors.

Real gross domestic product



Seasonally adjusted annualised rates

Agricultural production, which had declined in all four quarters of 1998, recovered modestly in the first quarter of 1999 but rose sharply in the second quarter. This increase could be attributed to a return to more normal output levels of field crops, notably of sunflowers and maize, which were considerably higher than initially expected. Real value added in the livestock and horticultural subsectors also rose strongly from the first quarter of 1999 to the second quarter.

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

	1998					1999	
Sectors	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Primary sectors............	-3	-2½	-12	-½	-½	-1	7
Agriculture..............	-4	-3½	-24	-½	-1	1½	19½
Mining....................	-2	-1½	-2½	-1	-½	-2½	-1
Non-agricultural sectors	1½	1	-1½	0	½	1	1
Secondary sectors........	0	-2½	-6	½	-1	0	-½
Manufacturing.........	-½	-4	-8	½	-2	½	½
Tertiary sectors.............	2	2½	1	½	1½	1½	2
Total............................	1	½	-2½	0	½	½	1½

Real output in the *mining sector* declined at an annualised rate of 1 per cent in the second quarter of 1999, compared with a decline of 2½ per cent in the first quarter. The further decline in real value added by mining enterprises was due to declines in some of the main subsectors of the industry, which totally offset the growth in the constant-price value of coal and platinum production. Real value added by the gold-mining industry was reduced by rising production costs and a decline in the dollar price of gold.

The real output of the *manufacturing sector*, which had expanded at a seasonally adjusted and annualised rate of about ½ per cent in the first quarter of 1999, rose at about the same pace in the second quarter. The manufacturing sector could maintain its slight growth momentum as a result of some improvement in the external demand for South African manufactured goods and the replenishment of inventories in certain sectors of the economy.

A sizeable decline in the real output of the *other secondary sectors* was the result of declines in real value added by the sector supplying electricity, gas and water and by the construction sector. Electricity generation declined from the first quarter of 1999 to the second quarter as the economic recovery failed to gather significant momentum. The demand for electricity for heating purposes was further constrained by relatively mild winter temperatures during the second quarter. Real value added by the *construction sector* declined in the first and second quarters of 1999 as building contractors struggled to overcome the negative consequences of high mortgage bond rates and public-sector budgetary constraints slowed down the pace of infrastructural development.

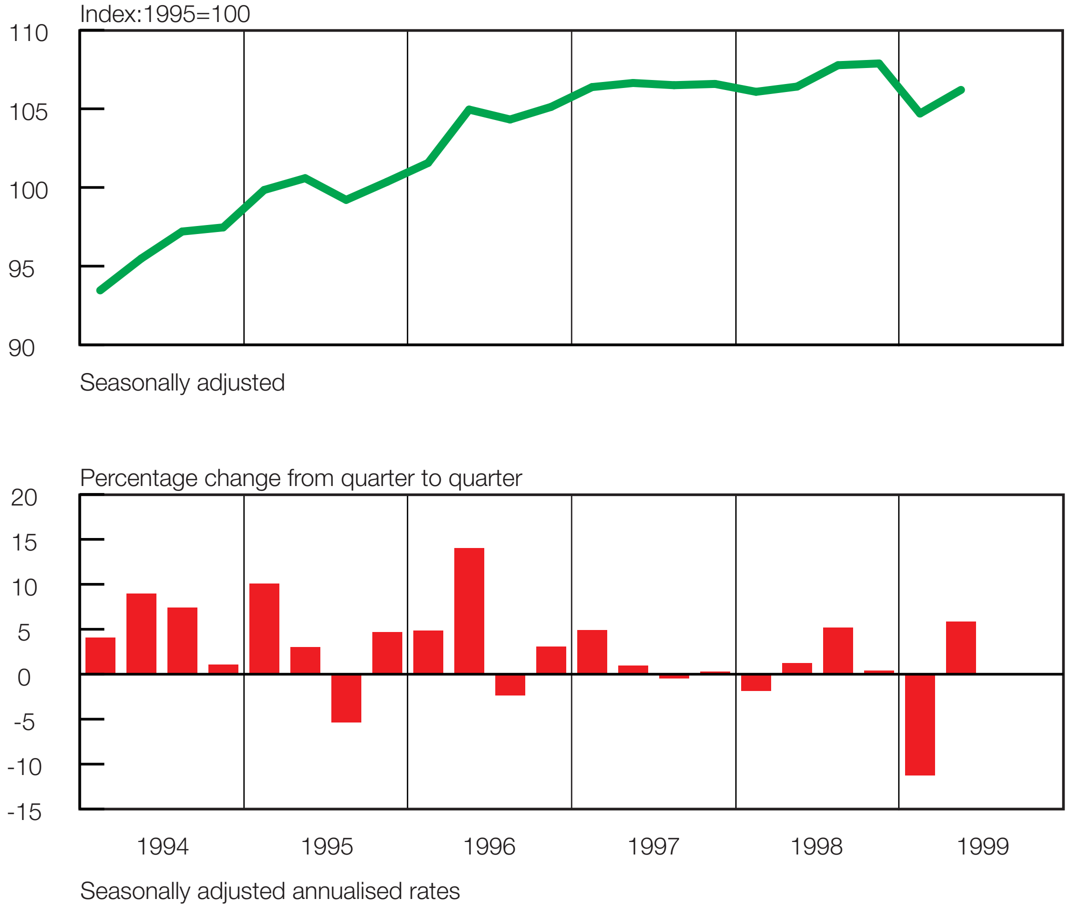
The real value added by the *tertiary sectors* increased at an annualised rate of about 2 per cent in the second quarter of 1999; in the first quarter these sectors recorded an increase of 1½ per cent. The faster growth in real value added by the tertiary sectors occurred mainly in the *commercial sector* and in the *transport*, *storage and communication sector.* Activity in the wholesale and retail sectors picked up as consumer confidence improved, allowing households some leeway to accumulate debt once again. By contrast, motor trading activity declined further in the second quarter of 1999.

Solid growth in the real value added by the *transport*, *storage and communication sector* was mainly the result of the further expansion of telecommunication networks. The growth in this sector was sustained at an average annualised rate of about 4 per cent in the first two quarters of 1999. Growth in the *financial services sector* strengthened in the second quarter of 1999, but this was fully counteracted by a further decline in activity in the *real-estate* sector.

Domestic expenditure

A largely unforeseen and probably involuntary accumulation of inventories reversed the change in real gross domestic expenditure from a sharp decline in the first quarter of 1999 to a sizeable increase in the second quarter. Apart from stockpiling, all the other main components of real gross domestic expenditure either declined or remained unchanged at levels recorded in the first quarter of 1999.

Real gross domestic expenditure



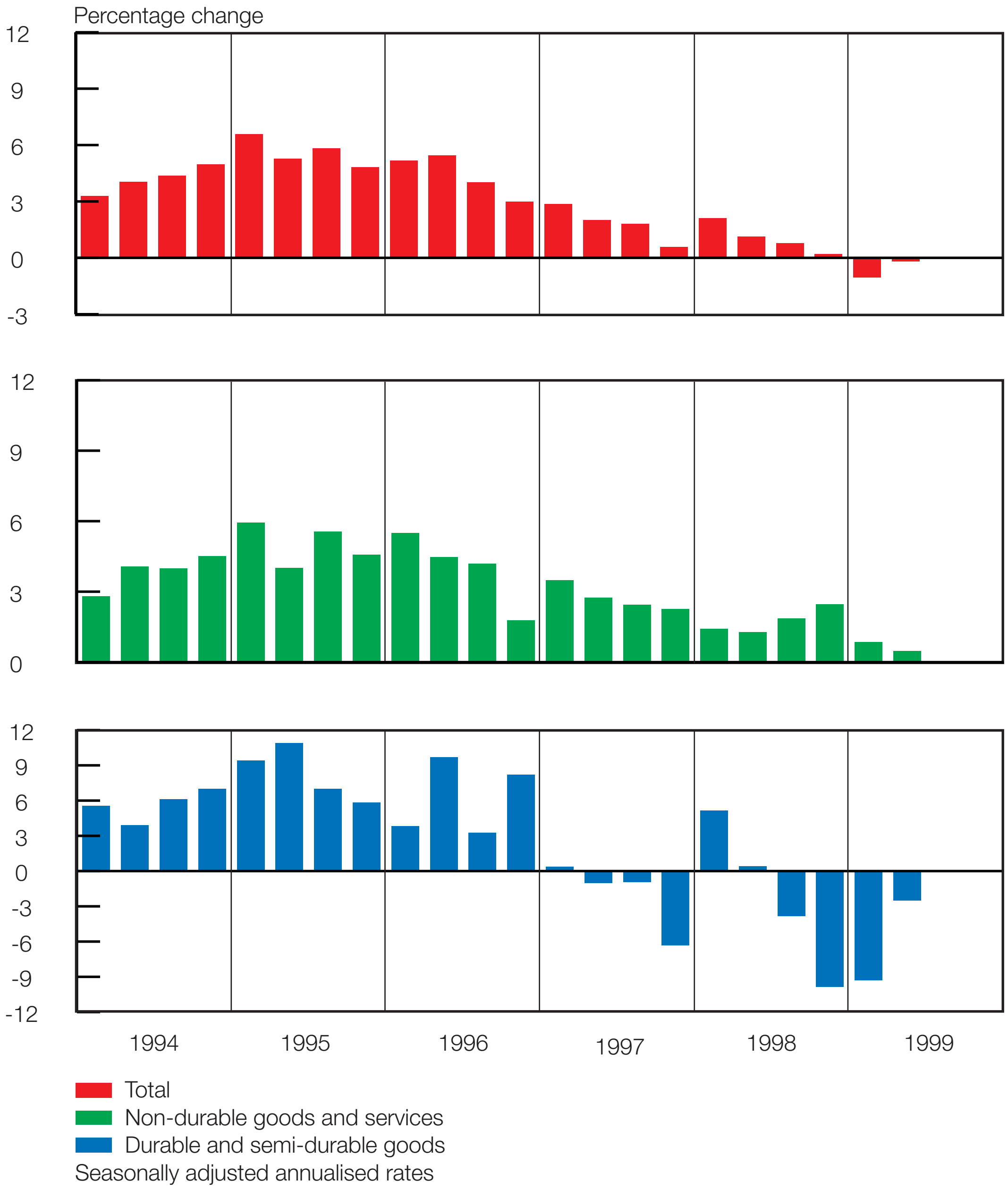
Real gross domestic expenditure
Percentage change at seasonally adjusted and annualised rates

Components	1998 1st qr	1998 2nd qr	1998 3rd qr	1998 4th qr	1998 Year	1999 1st qr	1999 2nd qr
Private consumption expenditure............	2	1	1	0	1½	-1	0
Government consumption expenditure......	4	3½	3	2	½	-1	-1
Gross fixed capital formation................	3	8½	10	4½	5	-24½	-9½
Domestic final demand	2½	3	3	1½	2	-5½	-2
Change in inventories (R billions)*	-4,3	-7,6	-4,2	-4,2	-5,1	-7,5	3,6
Gross domestic expenditure...........	**-2**	**1½**	**5**	**½**	**½**	**-11½**	**6**

* Constant 1995 prices

Real final consumption expenditure by households, which had declined in the first quarter of 1999, showed virtually no growth in the second quarter. Real outlays on durable goods and semi-durable goods declined further, albeit at somewhat lower rates than in the first quarter, whereas expenditure on non-durable goods and services posted modest increases in the second quarter of 1999.

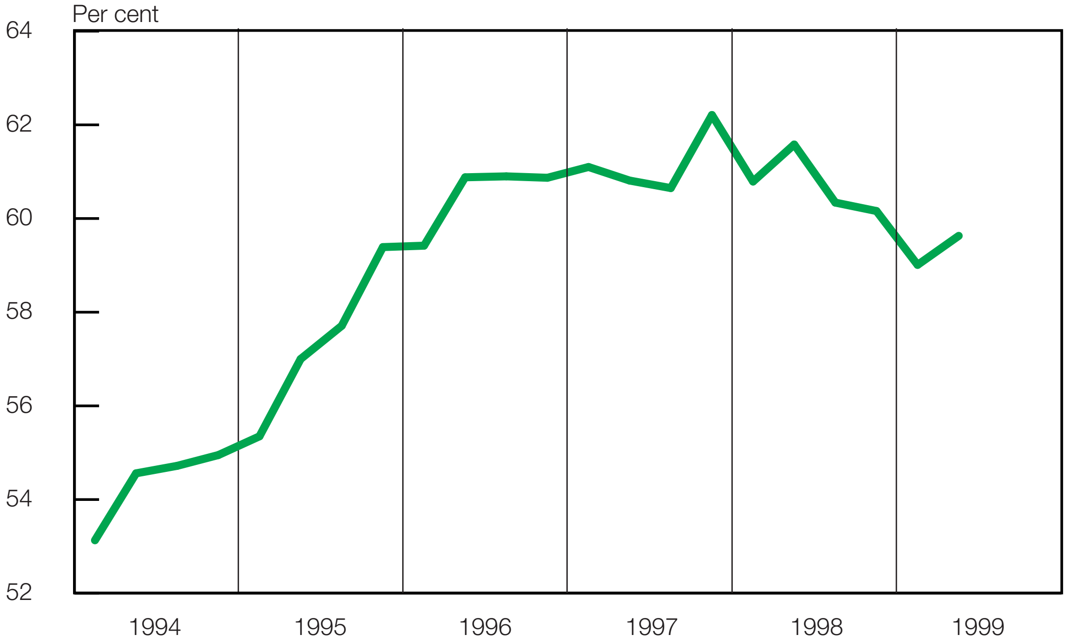
Real final consumption expenditure by households



Household spending remained weak because of a combination of circumstances that, on the whole, were detrimental to households' finances and spending attitudes. Declines in employment, despite advances in the real earnings of those in gainful employment, restrained the growth in real labour income and undermined consumer confidence. In 1998, the wealth of households shrank substantially, in large part due to the decline in equity and bond prices. These perceptions of declining real wealth lingered on into 1999 and were only partially reversed by rising asset prices in the first half of 1999.

The decline in households' net wealth probably accounted for a slight reduction in the household debt ratio over the past two years or so. Households usually tend to raise their debt ratios when they think that wealth is increasing, but they will generally refrain from accumulating debt and may even attempt to repay debt when they perceive that wealth is no longer increasing. The decline in the average household debt ratio is not so surprising when viewed against the sharp decline in the prices of financial assets in 1998.

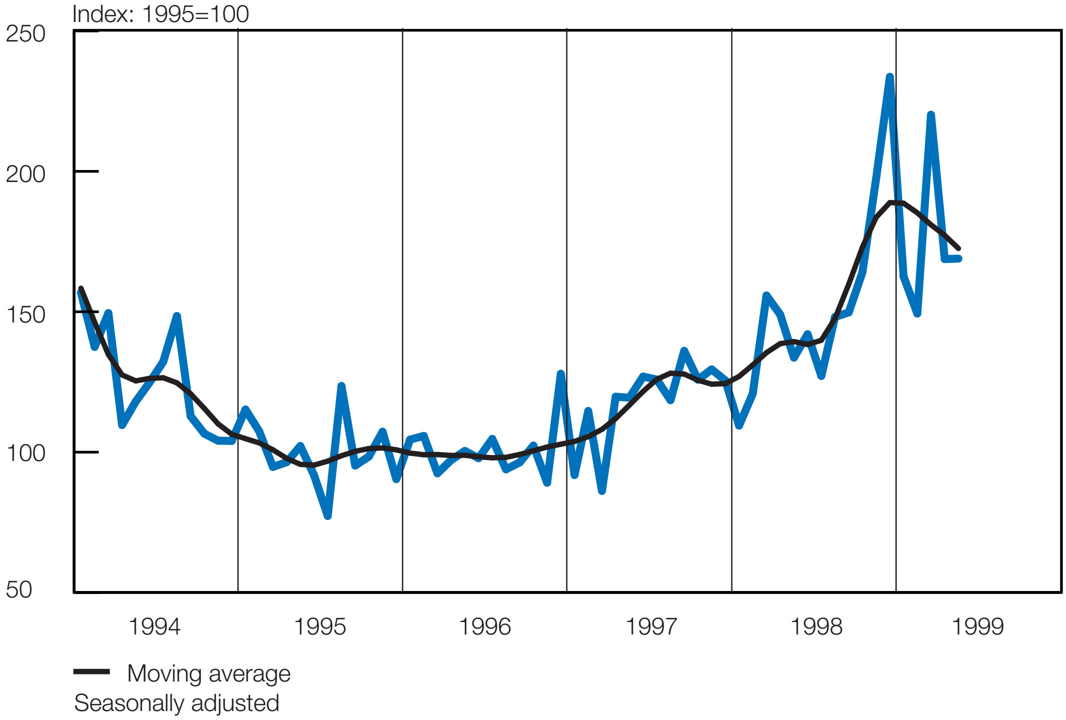
Household debt as percentage of disposable income



Seasonally adjusted

In addition to the decline in household debt, another measure of household financial stress also improved in the first half of 1999. Personal insolvencies declined from the end of 1998, although they have remained at a high level since then. Lower interest rates in the first half of 1999 have obviously helped to soften the effects of high debt levels on household debt-service burdens, leaving scope for a renewed accumulation of debt and a slight rise in households' debt ratio in the second quarter of 1999.

Insolvencies of individuals and partnerships



Real final consumption expenditure by general government declined at a seasonally adjusted and annualised rate of 1 per cent in the first and second quarters of 1999. As a ratio of gross domestic product, government consumption expenditure edged lower from 20½ per cent in the first quarter of 1999 to 20 per cent in the second quarter, reflecting government's resolve to contain recurrent government spending.

The weakness of the economy and concern about its medium-term prospects effectively dampened the demand for new production capacity in the business sector. Public-sector fixed capital formation also declined, resulting in declines in total real fixed capital formation of 24½ per cent (at a seasonally adjusted and annualised rate) in the first quarter of 1999 and 9½ per cent in the second quarter.

Real gross fixed capital formation in the private sector declined at an annualised rate of 3 per cent in the second quarter of 1999. The decline in private-sector fixed capital formation was concentrated in the mining, commercial and financial services sectors. By contrast, investment activity in the agricultural, manufacturing and telecommunication sectors increased in the second quarter of 1999. The increase in capital formation in the manufacturing sector was rather surprising as current surveys reveal a high level of unutilised production capacity in manufacturing. A sharp increase in capital spending on the development of infrastructural facilities for the cellular telephone network contributed to the higher capital outlays of the transport, storage and communication sector.

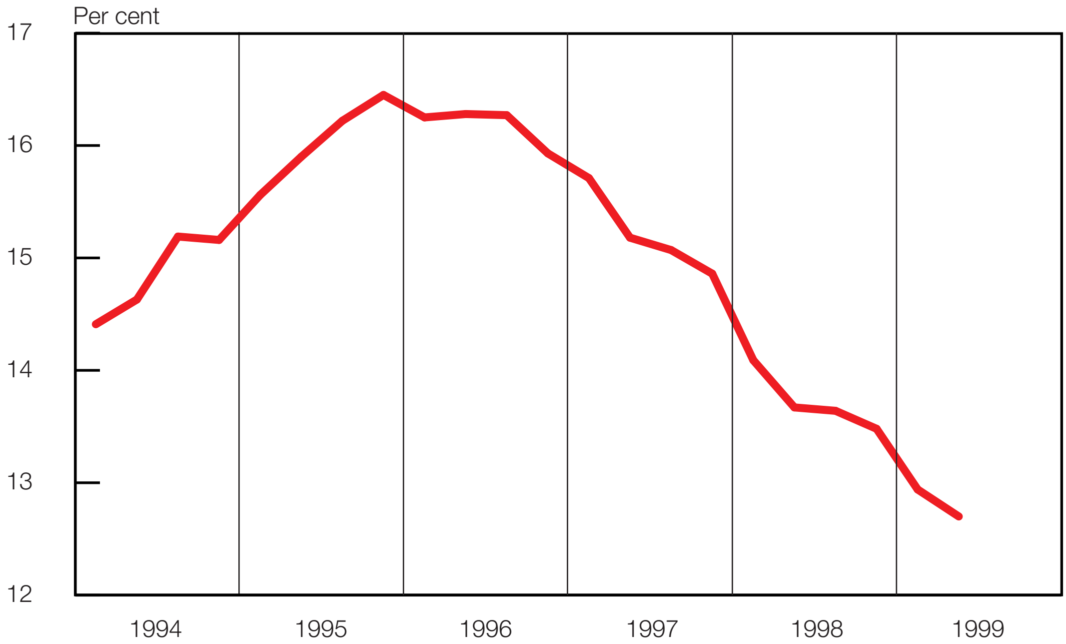
Real fixed capital formation by *public corporations* declined sharply in the first quarter of 1999 as the SAA completed its expansion programme and Telkom's capital spending was arrested at about the same high level as that of the fourth quarter of 1998. This was followed by a further substantial decline in the second quarter of 1999 when Telkom's expansion programme slowed down too. Fixed capital formation by *general government* declined for the third consecutive quarter as national, provincial and local governments cut back on investment programmes in the second quarter of 1999.

Real gross fixed capital formation
Percentage change at seasonally adjusted and annualised rates

	1998					1999	
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Private business enterprises	-5½	-3	-8	-5	-3	-4	-3
Public corporations.......	53½	87½	119	58	51½	-71	-30
General government.....	6	2	6½	-11½	2½	-5½	-10
Total.............................	**3**	**8½**	**10**	**4½**	**5**	**-24½**	**-9½**

The increase in real investment in *inventories* in the second quarter of 1999 followed an uninterrupted series of inventory reductions since the first quarter of 1997. Most of the inventory accumulation occurred in the mining and wholesale trade sectors of the

Industrial and commercial inventories as percentage of non-agricultural gross domestic product



Seasonally adjusted

economy. The accumulation of inventories in the second quarter of 1999 coincided with a sharp decline in domestic final demand, giving the impression that the accumulation had been largely unplanned or involuntary. Industrial and commercial inventories declined slightly, thus lowering the ratio of these inventories relative to the non-agricultural gross domestic product to 12½ per cent in the second quarter of 1999.

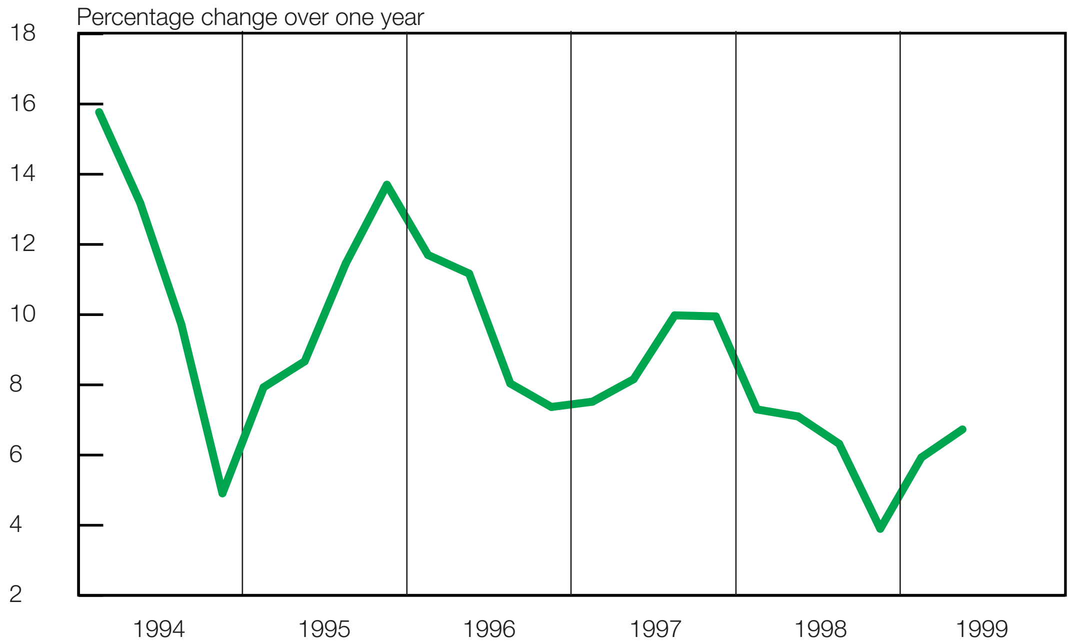
Factor income

Faster growth in the aggregate compensation of employees and in the operating surpluses of business enterprises accelerated the growth over four quarters in the total nominal value added, from 7½ per cent in the first quarter of 1999 to 8 per cent in the second quarter.

The rate of growth over one year in total salaries and wages increased from 8 per cent in the first quarter of 1999 to 9 per cent in the second quarter. A sectoral analysis shows that this faster growth in the total compensation of employees occurred in most of the main sectors of the economy. The notable exceptions were mining, construction and general government services. These developments took place against a background of rising industrial action and a decline in overall employment in the formal sectors of the economy. They led to an increase in the compensation of employees per unit of output. They also raised the ratio of employee compensation to gross domestic product (an indicator of real unit labour cost) from 55 per cent in the second quarter of 1998 to 55½ per cent in the second quarter of 1999.

Gross operating surpluses of businesses rose further in the year to the second quarter of 1999, but at a slower pace than in the years from 1995 to 1997. Growth in operating surpluses was constrained over the past year by the rising costs of imported intermediate goods and of labour. At the same time, companies had difficulty in raising output prices in line with cost increases in a competitive market environment and against the backdrop of the non-accommodating monetary policy stance by the Reserve Bank. The result was that economy-wide

Operating surpluses per unit of output



operating surpluses per unit of output rose by only 6½ per cent over the year to the second quarter of 1999, compared with an average growth of about 9 per cent a year from 1995 to 1998.

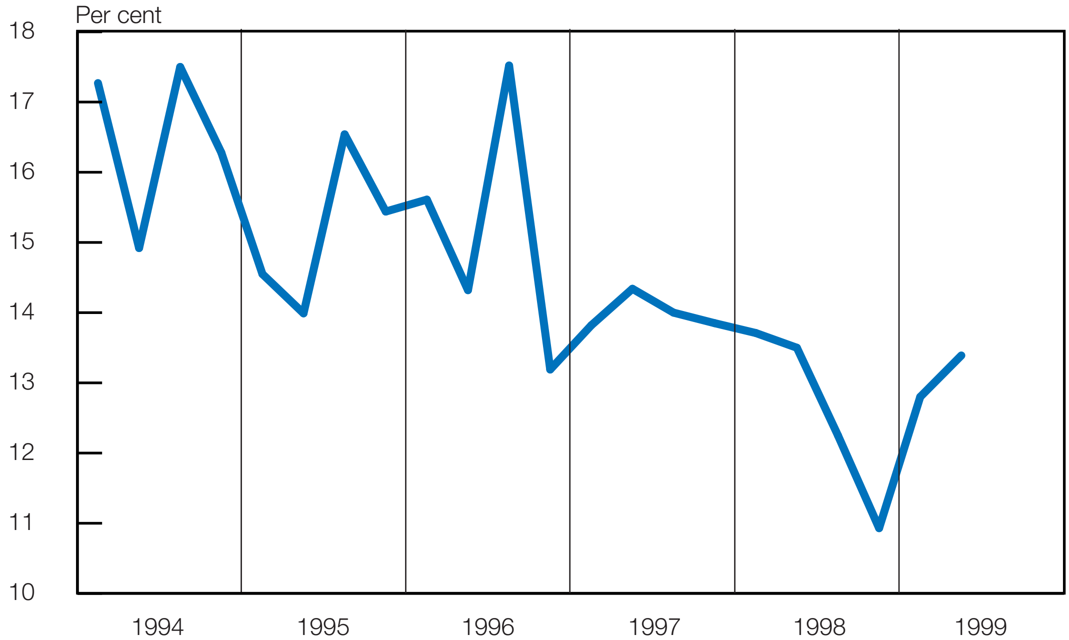
The growth over four quarters in total nominal gross operating surpluses increased from 6½ per cent in the first quarter of 1999 to 7 per cent in the second quarter. This acceleration was mainly the result of strong rises in the operating surpluses of the agricultural sector and some more ordinary improvements in commerce and in the transport and communication sector. In addition, a number of exporters in the mining industry also reported better financial results on account of the decline in the exchange rate of the rand.

Domestic saving

The ratio of *gross saving to gross domestic product* improved from 13 per cent in the fourth quarter of 1998 to 14½ per cent in the first quarter of 1999 and 15 per cent in the second quarter. These ratios can be compared with an average ratio of well in excess of 20 per cent in the second half of the 1980s. Despite the increase in the saving rate in the second quarter of 1999, gross saving still fell short of the capital needs of the economy and about 2½ per cent of gross capital formation in that quarter had to be financed by foreign saving through a net inflow of international capital into the economy.

An improved saving performance by all three institutional sectors, namely private households, general government and incorporated businesses, contributed to the higher national saving rate in the second quarter of 1999. With private households experiencing some improvement in real income, but at the same time holding back on consumption expenditure, *household saving* as a percentage of gross domestic product increased from ½ per cent in the fourth quarter of 1998 to 1 per cent in the second quarter of 1999. *Net dissaving by general government* (seasonally adjusted)

Gross corporate saving as percentage of gross domestic product



Seasonally adjusted

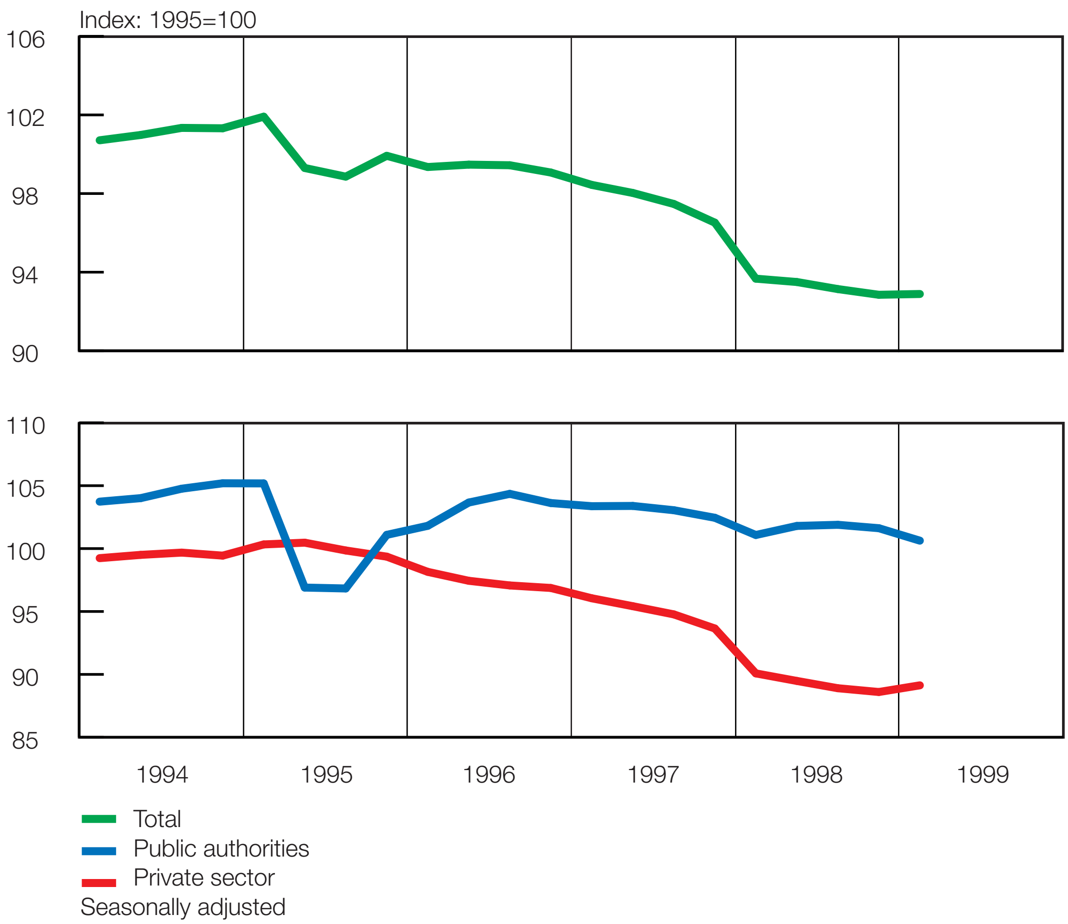
shrank from the first quarter of 1999 to the second quarter as government became even more frugal and interest payments on public debt became less burdensome.

Corporate saving as a percentage of gross domestic product rose slightly from 3 per cent in the second half of 1998 to 4½ per cent in the first half of 1999. However, over the medium term corporate saving came under almost continuous downward pressure. With the slower expansion of operating surpluses since 1995, and the desire to increase dividend payments or to maintain them at prevailing levels, corporate saving as a percentage of gross domestic product fell from 6½ per cent in 1995 to 3 per cent in the second half of 1998. Internally generated resources available for capital formation dwindled precariously, resulting in a steady rise in corporate borrowing for the financing of expansion programmes. Bank lending to the corporate sector, for example, has more than doubled in value since the end of 1994 and, as a percentage of gross domestic product, has increased from 23 per cent in 1994 to 31½ per cent at the end of the second quarter of 1999.

Employment

The slow growth of aggregate output during 1998 and the first months of 1999 was accompanied by weak demand for labour and continued declines in *employment numbers* in *the formal non-agricultural sectors* of the economy. By the end of the first quarter of 1999 the number of workers employed in the regularly surveyed formal sectors of the economy outside agriculture had declined by 42 000 or 0,8 per cent from a year before.

Non-agricultural employment



Apart from the weakness of aggregate output growth, employment was also constrained by constant pressures on domestic producers to be more competitive in an increasingly integrated international economy, continued increases in the cost of employing labour and the progress made by government with containing the growth of the public service and at the same time raising the quality of public service delivery.

The impact of these employment-constraining factors moderated somewhat over the past year and a half and job losses in the *private sector* slowed down from 2,6 per cent (seasonally adjusted and annualised) in the third quarter of 1998 to 1,4 per cent in the fourth quarter. Private-sector jobs then rose by 2,4 per cent (at a seasonally adjusted and annualised rate) from the fourth quarter of 1998 to the first quarter of 1999. The non-gold mining and the trade, catering and accommodation services sectors substantially increased their employment numbers in the first quarter of 1999, but the demand for labour continued to decline in other parts of the economy. The two sectors hardest hit by job losses in the first quarter of 1999 were the gold mining and the construction sectors.

Changes in private-sector non-agricultural employment in the first quarter of 1999

Quarter-to-quarter changes at seasonally adjusted and annualised rates

Sector	Per cent
Non-gold mining	24,0
Trade, catering and accommodation services	17,5
Manufacturing	-0,2
Transport, storage and communication*	-1,5
Electricity generation	-2,5
Laundries and dry-cleaning services	-2,9
Financial intermediation and insurance	-8,6
Gold mining	-14,6
Construction	-15,3
Total	2,4

* Non-governmental institutions only

The *public sector* reduced employment by 0,4 per cent in the year to March 1999. This decline occurred mostly in the period from October 1998 to March 1999 and was observed throughout the public sector, except for tertiary education institutions and some public corporations which expanded employment.

A programme of action was announced by government on 29 June 1999 to review labour legislation. Aspects of labour legislation which had been identified as warranting a re-evaluation included probation periods, unfair dismissal procedures and compensation in respect of procedurally unfair dismissals, retrenchments and conditions of employment when companies are taken over by new management.

Other areas to be investigated are certain provisions in the Basic Conditions of Employment Act dealing with work on Sundays and notice periods, the role of the Minister of Labour in varying the core rights in the Act, and improving the efficiency of institutions created to regulate the labour market, such as the Commission for Conciliation, Mediation and Arbitration.

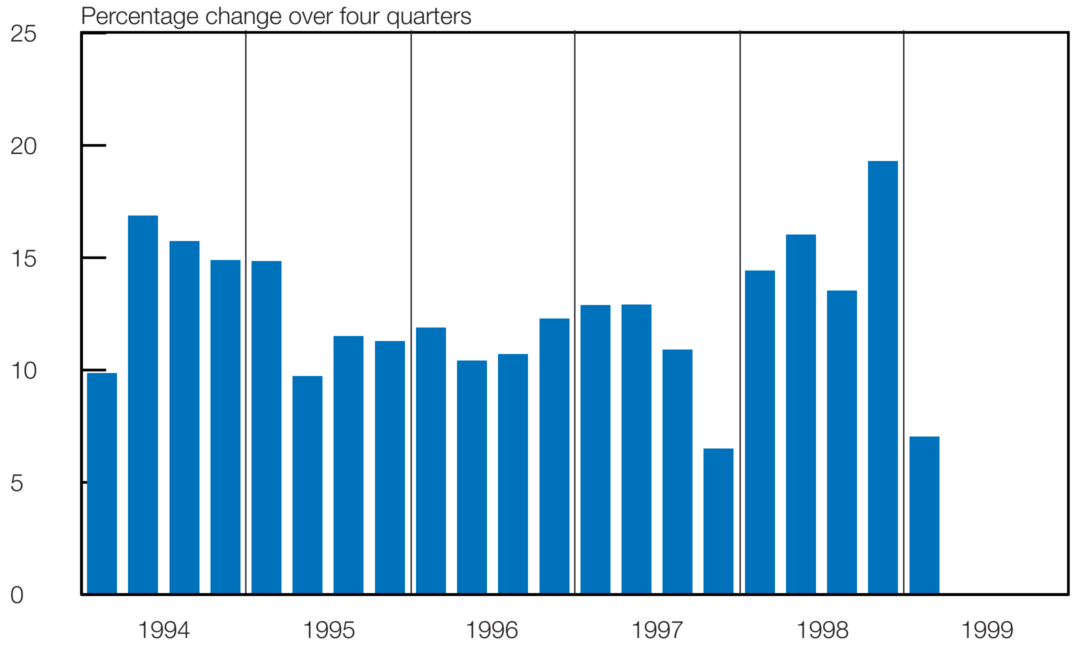
Labour costs and productivity

Nominal compensation per worker in the non-agricultural sectors of the economy rose by 7,0 per cent in the year to March 1999 after having increased by about 13 per cent per year, on average, over the two preceding calendar years. This slowdown was discernible in both the private and public sectors. A similar deceleration was observed in the average settlement rate in collective bargaining agreements, which tapered off to 8,1 per cent in the first half of 1999, significantly below the growth of 9,7 per cent in 1997 and 8,6 per cent in 1998.

Despite the decline in employment over the past year, and rising unemployment as its corollary, together with confirmation of expectations that inflation was on the wane, nominal wage demands remained firm. Employers, however, confronted by dwindling growth in profits, strongly resisted extreme wage demands. In such a situation, industrial action flared up and the number of workdays lost through strikes and work stoppages increased by about 32 per cent from the first half of 1998 to the first half of 1999. As noted above, the average settlement rate nevertheless fell back quite noticeably in the first half of 1999, raising prospects for further moderation of nominal compensation growth and lower future inflation.

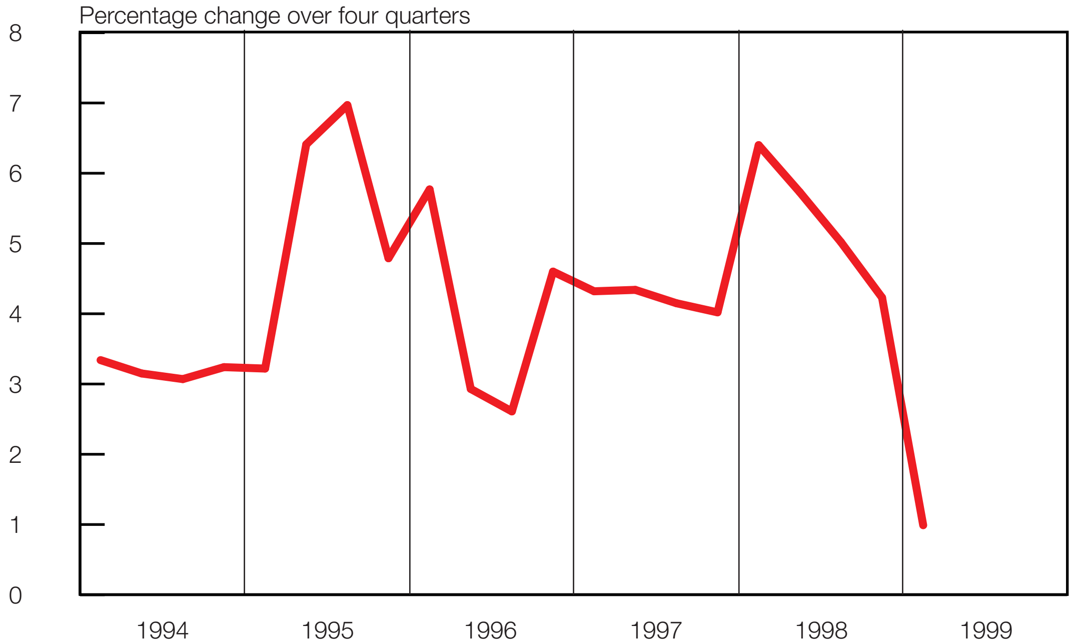
The ratio of compensation per worker to output prices – the *inflation-adjusted remuneration per worker* – rose by 0,9 per cent in the year to March 1999, compared with average growth of 5,0 per cent over the two previous calendar years, i.e. 1997 and 1998. This indicated that the growth in labour costs in excess of the growth in output prices was being diminished and that the prospects for profit growth were improving. A rising index value of the inflation-adjusted remuneration per worker indicates that businesses were unable to raise output prices sufficiently to recover increases in labour costs.

Nominal compensation per worker in non-agricultural sectors



Output per worker in the non-agricultural sectors of the economy rose by 0,9 per cent in the year to March 1999, following average growth of 4,8 per cent per year in 1997 and 1998. Because productivity growth often falls below its long-term trend when economic growth slows down, the recent relatively weak growth in productivity might well be understating the rate of efficiency gain that can be maintained in coming years. An acceleration of gross capital formation is likely to raise the amount of capital per worker, and workers can be expected to become more efficient in employing the new technologies during the imminent economic recovery. Employers are not only increasing their capital stock and input but are also making changes in their organisational structures and work procedures that might improve efficiency and bolster profit margins. Productivity and employment growth can therefore be expected to accelerate during the nascent recovery.

Growth in labour productivity



Change in output per worker in non-agricultural sectors

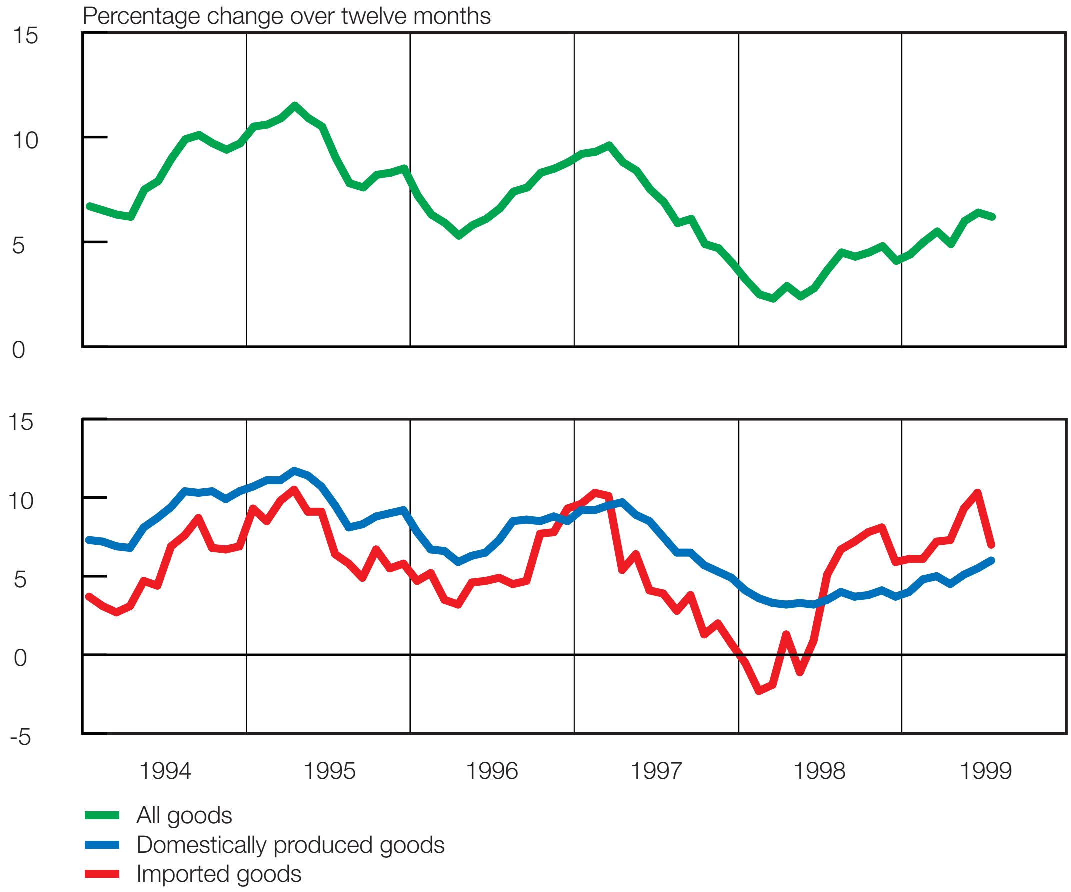
Because of the continued growth in labour productivity, *unit labour costs* have been rising far more slowly than compensation per worker in recent years. Unit labour costs in the non-agricultural sector increased by 6,0 per cent in the year to March 1999, compared with 8,1 per cent per year on average in 1997 and 1998. A continuation of the slowdown in the growth in nominal unit labour costs, through both a decline in the growth in nominal compensation per worker and faster productivity growth, will alleviate upward pressure on end-product prices, reduce inflation, improve the rate of return on invested capital, strengthen capital formation and ultimately lead to stronger economic growth and employment creation.

Inflation

Most of the broad measures of aggregate price change showed that inflation over one year had been accelerating from the first half of 1998. The accumulation of inflationary pressures was, however, partly disguised by the decline in home mortgage bond rates from the fourth quarter of 1998, which occasioned a steep decline in the year-on-year rate of increase in the overall consumer price index.

At the level of *production prices,* inflation over one year accelerated from 2,3 per cent in March 1998 to 6,4 per cent in June 1999 and 6,2 per cent in July. The *prices of imported goods,* which had declined by 2,3 per cent in the year to February 1998, rose by 10,3 per cent in the year to June 1999 and 7,0 per cent in the year to July, contributing to the accumulation of inflationary pressures. The rise in the prices of imported goods, in turn, was strongly affected by an increase of almost 40 per cent in the price of imported crude oil from the first quarter of 1999 to the second quarter.

Production price inflation



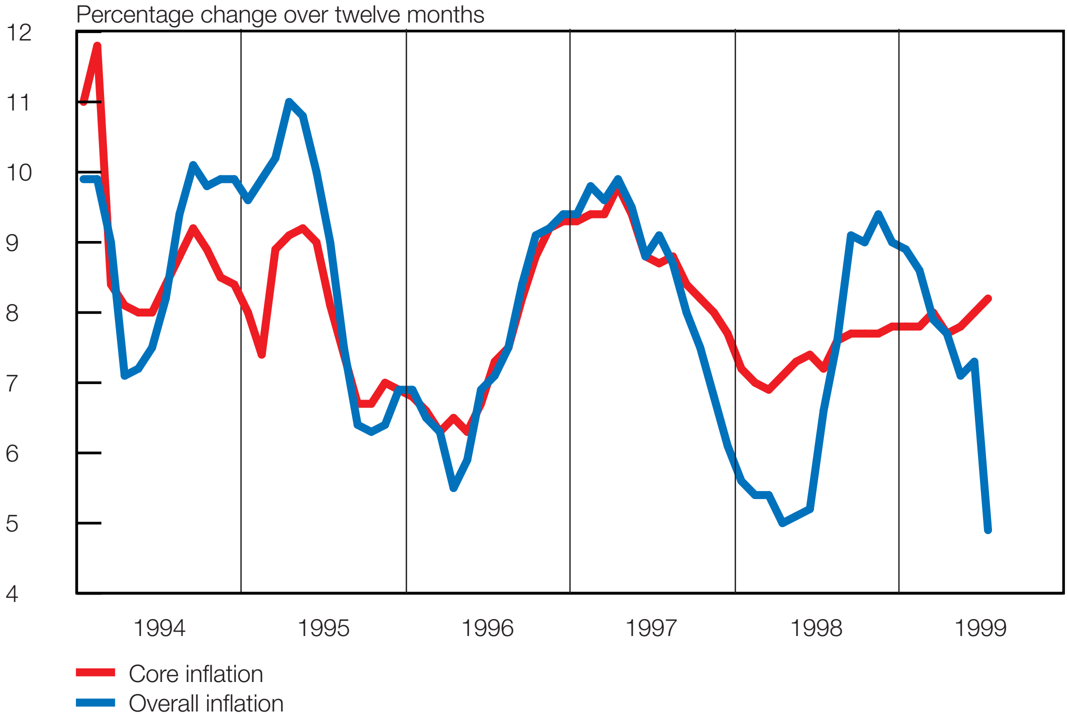
The year-on-year rate of increase in the *prices of domestically produced goods* rose from 3,2 per cent in June 1998 to 6,0 per cent in July 1999. This acceleration of production price inflation occurred despite the low levels of inflation in South Africa's main trading-partner countries and the relative strength of the rand since the third quarter of 1998. Evidently not all cost increases, either imported or domestically generated, could have been absorbed in the operating margins of domestic producers.

Consumer price inflation, measured year on year, slowed down from 9,4 per cent in November 1998 to 4,9 per cent in July 1999. As indicated earlier, the slowdown in the growth in consumer prices was first and foremost a consequence of the decline in mortgage bond rates since November 1998. Year-on-year inflation in the prices of consumer goods, (i.e., not taking into consideration the prices of consumer services of which the mortgage bond rate charged by banks is an important component) accelerated from 5,5 per cent in February and March 1998 to 6,1 per cent in July 1999. The prices of "other" services (other than home-owners' costs which contain mortgage bond rates) also accelerated from 9,0 per cent in February 1998 to 9,9 per cent in July 1999.

Consumer price inflation
Year-on-year percentage change

		Goods	Services	Overall
1998:	Apr	5,8	4,0	5,0
	May	5,9	4,2	5,1
	Jun	5,9	4,2	5,2
	Jul	6,0	7,5	6,6
	Aug	6,3	9,2	7,6
	Sep	6,6	11,8	9,1
	Oct	6,4	12,0	9,0
	Nov	6,2	13,0	9,4
	Dec	6,2	12,3	9,0
1999:	Jan	6,4	11,8	8,9
	Feb	6,4	11,1	8,6
	Mar	6,1	10,1	7,9
	Apr	5,7	10,0	7,7
	May	5,9	8,6	7,1
	Jun	6,1	8,6	7,3
	Jul	6,1	3,6	4,9

Consumer price inflation



Mainly due to the exclusion of changes in mortgage bond rates from *core inflation*, this measure of inflation, which is seen as more responsive to changes in the stance of monetary policy, accelerated from 7,1 per cent in April 1998 to 8,2 per cent in July 1999. What is more, since March 1999 the core inflation rate has exceeded the inflation rate in overall consumer prices by an increasing margin.

The outcome of inflation in 1999 will be decided by future changes in the rand price of imported crude oil and the effect this has on vehicle running costs, and the extent to which inflation expectations are accounted for in nominal wage settlements. Both measures, however, seem to suggest that the underlying trend of consumer price inflation is likely to be sustained in the near term. A similar indication is given by the steady rise in year-on-year inflation in the prices of domestically produced goods.

Foreign trade and payments

Current account balance

The *balance on the current account* of the balance of payments (seasonally adjusted and annualised), which had changed from sizeable deficits in the last two quarters of 1998 to a *surplus* of R4,9 billion in the first quarter of 1999, reverted to a deficit of R3,4 billion in the second quarter. With the exception of net service, income and other current transfer payments to the rest of the world, which shrank from the first to the second quarter of 1999, all the other main components of the current account contributed to the deterioration in the balance on the current account. The major part of the deterioration – approximately four-fifths of the absolute change in the current-account balance – was due to a decline in merchandise exports.

Balance of payments on current account
Seasonally adjusted and annualised
R billions

	1998				1999	
	1st qr	2nd qr	3rd qr	4th qr	1st qr	2nd qr
Merchandise exports	132,1	131,3	143,6	133,2	148,4	141,5
Net gold exports	25,5	23,0	26,9	28,2	24,7	23,8
Merchandise imports	-141,0	-137,7	-165,9	-158,5	-142,9	-143,7
Net service, income and current transfer payments	-19,8	-21,6	-24,4	-21,4	-25,3	-25,0
Balance on current account	**-3,2**	**-5,0**	**-19,8**	**-18,5**	**4,9**	**-3,4**

A substantial decline of 4½ per cent in the *physical quantity of merchandise exports* was responsible for a decrease of about 5 per cent in the value of merchandise exports in the second quarter of 1999. This contraction could mainly be attributed to a decline in the value of exports of mining products, other than gold. The exports of agricultural products and of manufactured goods still increased from the first quarter of 1999 to the second quarter.

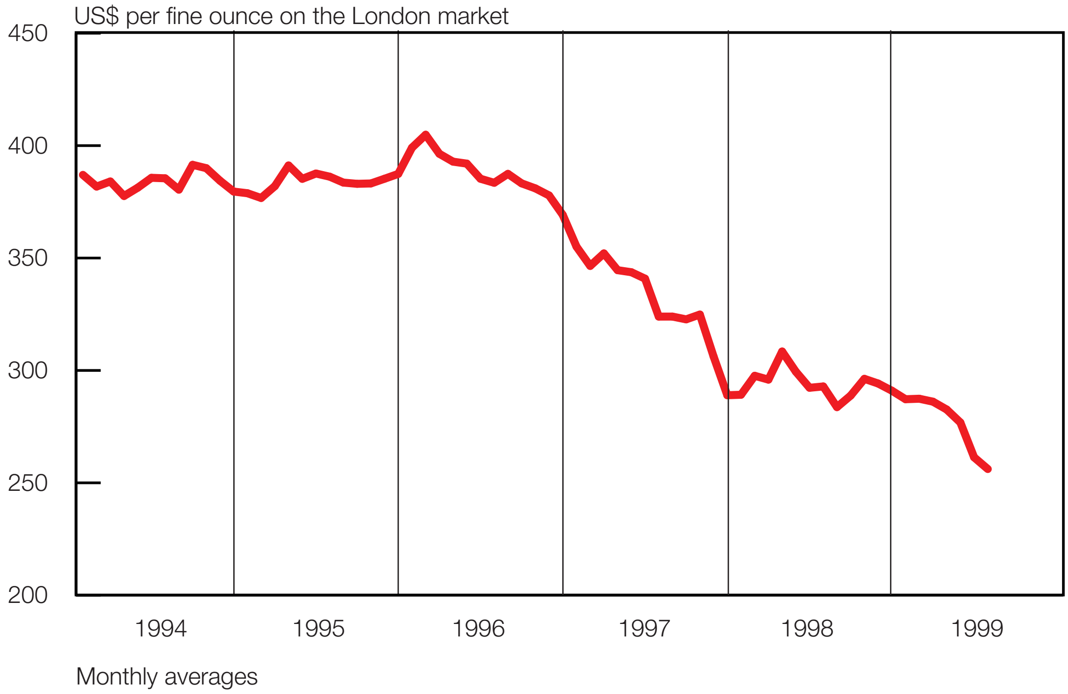
The average *price level of merchandise exports* declined marginally in the second quarter of 1999. This was partly a result of rather subdued international commodity prices. More importantly, the change in export prices was biased downwards by an increase in the nominal effective exchange rate of the rand of about 3 per cent in the second quarter of 1999.

Although the value of merchandise exports fell back in the second quarter of 1999, the nominal value in the first half of 1999 was still about 10 per cent higher than the average value in the corresponding period of 1998. As a ratio of gross domestic product, the value of merchandise exports amounted to 18½ per cent in the first half of 1999, still somewhat higher than the 18 per cent recorded in the first half of 1998. The slightly weaker export performance in the second quarter of 1999 was probably related to some faltering in the global economic recovery and the oversupply of many metals and minerals on international markets.

The value of South Africa's *net gold exports* which had declined from R28,2 billion in the fourth quarter of 1998 to R24,7 billion in the first quarter of 1999, declined further to R23,8 billion in the second quarter. The latest decline was the combined result of lower prices and smaller volumes.

The decline in the *physical quantity of gold* exported was due largely to a decline in the gold content of ore milled which caused less-viable mining operations to reduce output in an attempt to prolong the productive lives of mine shafts. The average realised *price of gold exports* decreased from R1 788 per fine ounce in the first quarter of 1999 to R1 780 per fine ounce in the second quarter. The average fixing price of gold fell from US$287 per fine ounce to US$274 per fine ounce over the same period.

Gold price



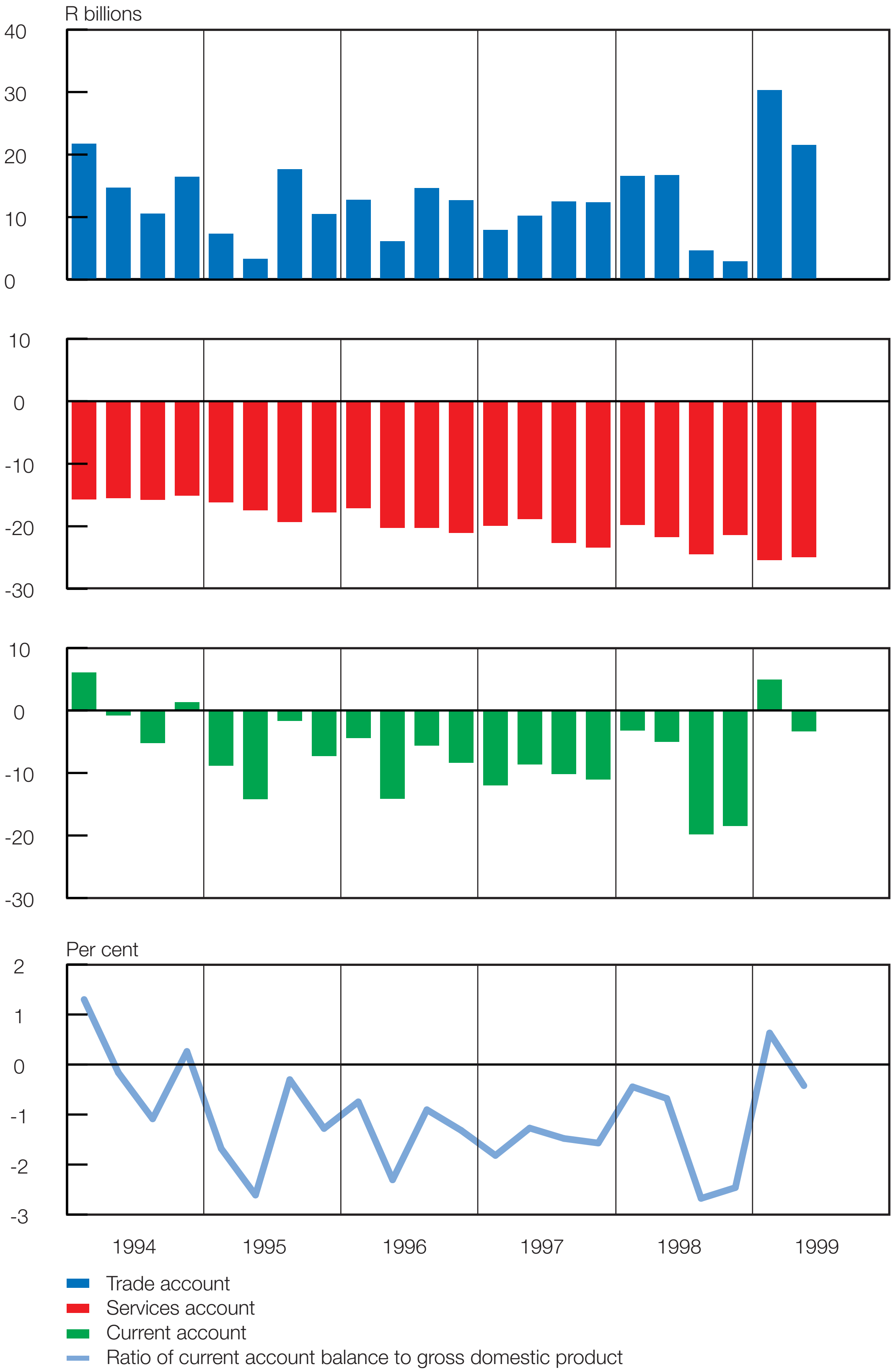
The gold market was adversely affected during the second quarter of 1999 by gold sales by central banks and a public debate about possible gold sales by the International Monetary Fund. The Bank of England announced plans to sell, on behalf of the British Treasury, 125 tons of gold in the 1999/2000 financial year and a further 290 tons over the medium term. The decision to sell part of the gold holdings of the Bank of England, in addition to possible sales by the Swiss National Bank and the International Monetary Fund, contributed to a fall in the average fixing price of gold on the London market from US$283 per fine ounce in April 1999 to US$261 per fine ounce in June 1999.

Taken at a seasonally adjusted and annualised rate, the *value of merchandise imports* decreased from R158,5 billion in the fourth quarter of 1998 to R142,9 billion in the first quarter of 1999, but then increased marginally to R143,7 billion in the second quarter. In response to a slight strengthening in manufacturing fixed capital formation and some accumulation of inventories, the volume of merchandise imports increased by about 1 per cent in the second quarter. The bulk of the increase in import volumes was in the category of *manufacturing equipment,* reflecting the demand for more productive capacity as domestic producers began to position themselves in anticipation of faster domestic demand growth. At the same time, an increase in the volume of crude oil imports added to the value and the volume of *mining products* imported.

Import prices declined slightly by about ½ per cent from the first quarter of 1999 to the second quarter. By then, the impact that the depreciation of the rand in 1998 had on the prices of imported goods had run its course. Instead, the slight appreciation of the rand in the second quarter of 1999 began to curb import price rises. Oil prices tended to aggravate imported inflation tendencies, but these were softened by marginal increases in production and wholesale prices in the countries supplying merchandise to South Africa and the stronger effective exchange rate of the rand.

Net services, income and current transfer payments to non-residents, which had increased strongly from a seasonally adjusted and annualised value of R21,4 billion in the fourth quarter of 1998 to R25,3 billion in the first quarter of 1999, fell to R25,0 billion in the second quarter. This improvement resulted mainly from a decline in net service and income payments, which more than offset an increase in current transfer payments to the rest of the world. More particularly, the improvement was due to lower investment income payments. The increase in current transfer payments emanated from higher payments made to neighbouring countries in terms of the Southern African Customs Union agreement. Net cross-border factor rewards (i.e. payments for labour compensation and interest and dividend payments) declined as payments to the rest of the world declined and receivables increased during the second quarter of 1999.

Current account



Seasonally adjusted and annualised

Capital transfer and financial account

The financial account of the balance of payments, which had deteriorated substantially in the middle quarters of 1998, showed a significant inflow of capital in the second quarter of 1999. This was the third consecutive quarterly inflow of capital into the economy and was again largely the result of foreign purchases of South African securities.

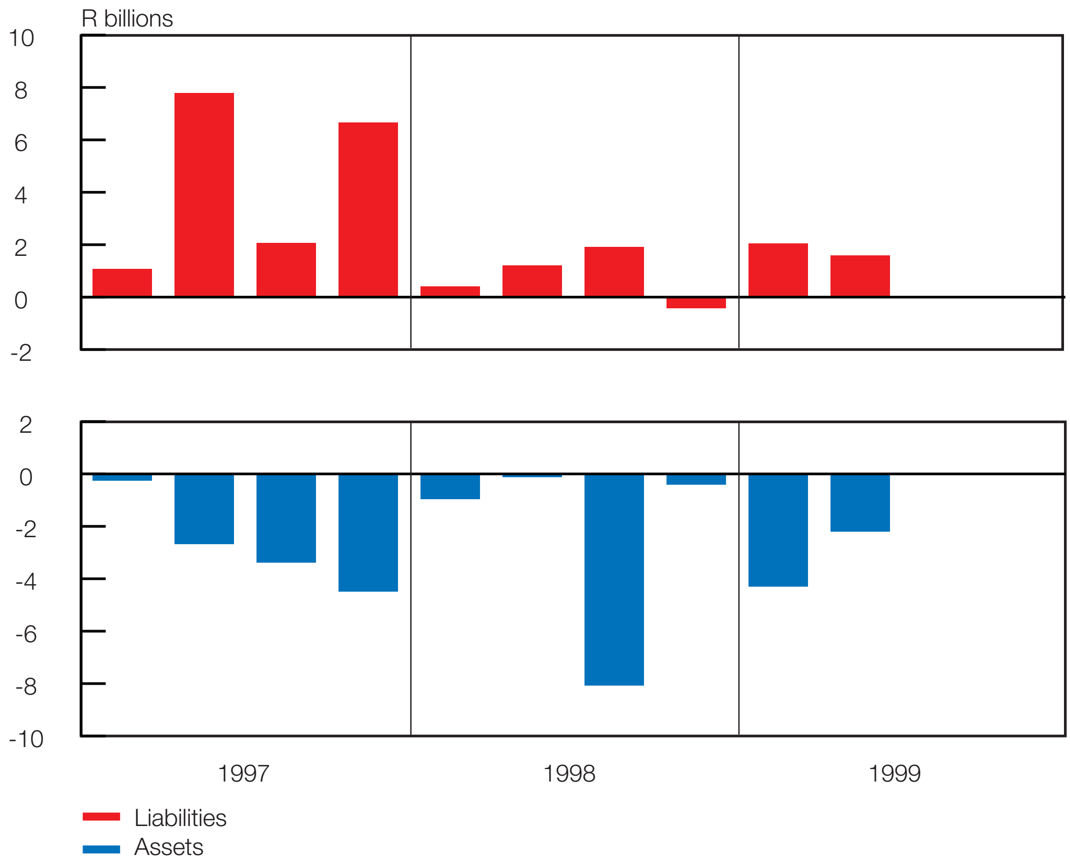
Net financial transactions not related to reserves

R billions

	1998					1999	
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Liabilities							
Direct investment	0,4	1,2	1,9	-0,4	3,1	2,0	1,6
Portfolio investment	26,5	22,5	-1,1	2,5	50,4	10,9	26,1
Other investment	-1,4	-2,3	1,4	8,8	6,5	-1,1	-3,0
Total liabilities	**25,5**	**21,4**	**2,2**	**10,9**	**60,0**	**11,8**	**24,7**
Assets							
Direct investment	-1,0	-0,1	-8,1	-0,4	-9,6	-4,3	-2,1
Portfolio investment	-7,1	-11,3	-5,5	-6,2	-30,1	-5,8	-9,4
Other investment	-5,1	-0,1	3,8	-1,5	-2,9	-2,1	-2,3
Total assets	**-13,2**	**-11,5**	**-9,8**	**-8,1**	**-42,6**	**-12,2**	**-13,8**
Total financial transactions*	**7,6**	**0,8**	**-4,4**	**4,0**	**8,0**	**3,0**	**3,8**

* Including unrecorded transactions

Direct investment



The net inflow of capital through the financial account (including unrecorded transactions, but excluding reserve-related liabilities) amounted to R3,8 billion in the second quarter of 1999; in the two preceding quarters the accumulated net inflow amounted to R7,0 billion, but in the middle quarters of 1998 there was an outflow of R3,6 billion.

Foreign direct investment into South Africa changed from an outflow of R0,4 billion in the fourth quarter of 1998 to inflows of R2,0 billion in the first quarter of 1999 and R1,6 billion in the second quarter. South African companies, in turn, also continued to expand their operations in the rest of the world, albeit at a slower pace than in the first quarter of 1999. Direct investment capital amounting to R2,1 billion left the country in the second quarter of 1999, down from R4,3 billion in the first quarter. These outward investments went mainly on the acquisition of equity interests in foreign enterprises. Therefore, on a net basis, foreign direct investment amounting to R2,8 billion flowed out of the domestic economy in the first half of 1999.

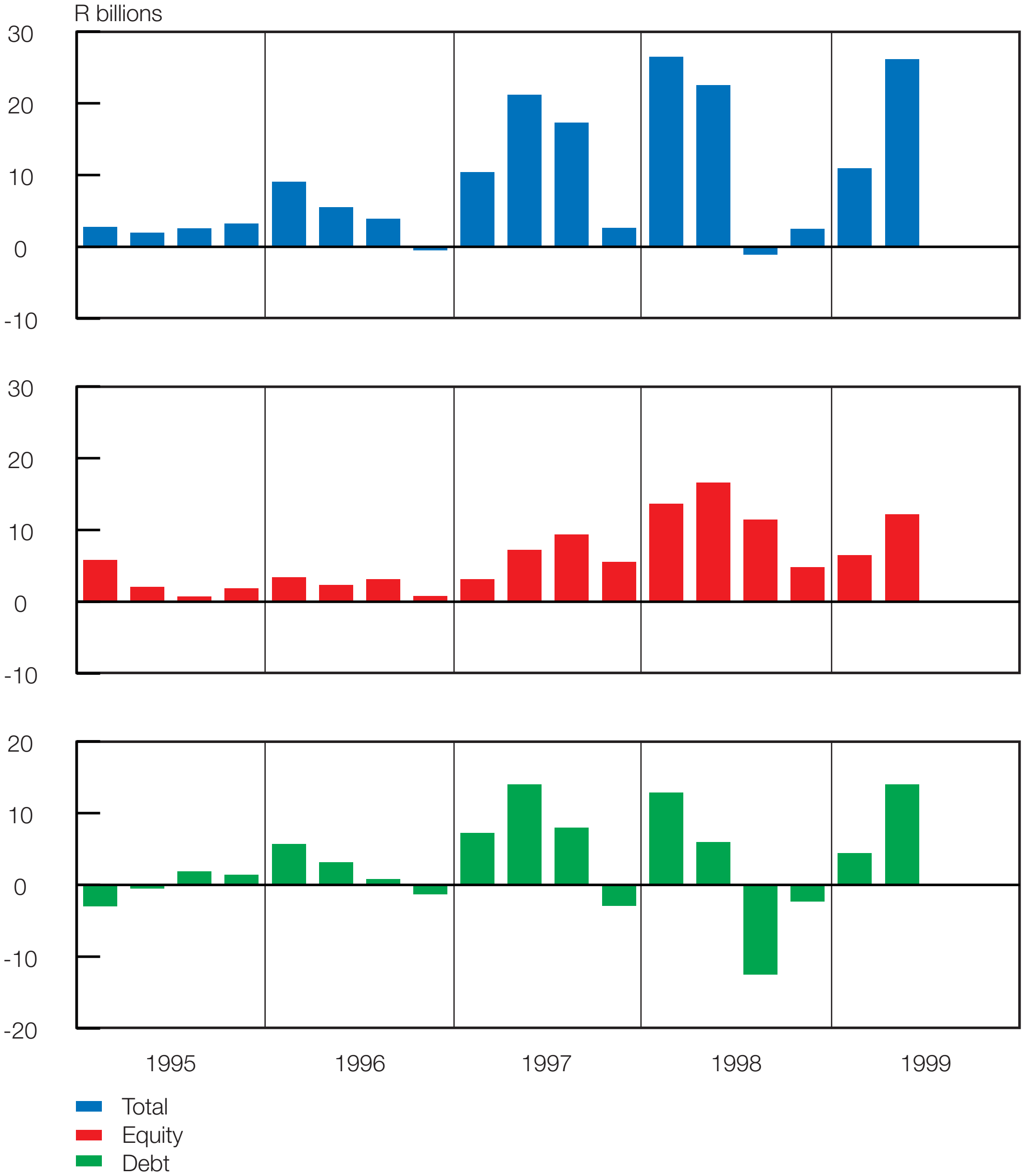
An improvement in investor sentiment towards South African assets and far more stable conditions in the foreign-exchange market over the past twelve months led to a resurgence of interest in the domestic securities markets shown by *foreign portfolio investors*. The inward flow of international portfolio capital strengthened from a meagre R1,4 billion in the second half of 1998 to R10,9 billion in the first quarter of 1999 and R26,1 billion in the second quarter. The second-quarter inflow was the second-highest inflow of portfolio capital ever recorded in any quarter – it was exceeded only by the inflows in the first quarter of 1998.

The large inflow of portfolio capital was by and large the result of purchases by non-resident investors of shares and bonds listed on South Africa's securities markets. The need to diversify portfolios, attractive yields in the domestic bond market, prospects of rising bond prices and the anticipated relative stability of the rand encouraged international fund managers to increase their exposure to South African fixed-interest securities. Equity purchases were boosted by the inclusion of listed South African companies in the prominent price indices of international markets. Managers of investment funds with a portfolio composition replicating the weighting structure of the share price indices then became active buyers of shares in the domestic market.

Large *portfolio capital inflows* also resulted from the transfer of the proceeds of the national government's euro and dollar denominated bond issues during the second quarter of 1999. A total of R6,3 billion was involved in these transfers. Non-residents also continued to diversify their international investment portfolios through asset swap arrangements with South African institutional investors.

Outward portfolio capital flows increased from R5,8 billion in the first quarter of 1999 to R9,4 billion in the second quarter as South African institutional investors activated the asset swap mechanism to broaden their holdings of predominantly foreign equity. On a net basis, the South African economy was a recipient of R16,7 billion of portfolio capital in the second quarter of 1999, in comparison with R5,1 billion in the first quarter.

Portfolio investment: Liabilities



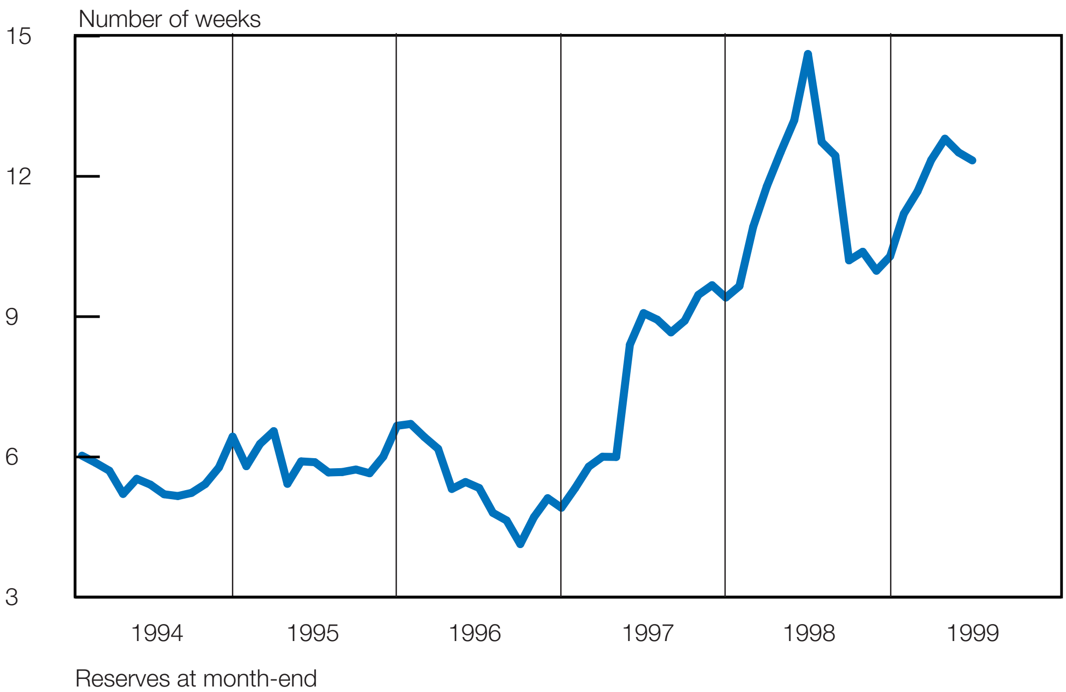
An outflow of capital from South Africa was recorded in the category *other investment* during the second quarter of 1999. Mainly due to a reduction in outstanding foreign loan liabilities, total other liabilities declined by R3,0 billion in the second quarter of 1999, following a decline of R1,1 billion in the first quarter. At the same time, South African resident individuals accumulated assets abroad in terms of existing exchange controls. This contributed to an increase of foreign assets in the category "other investment" of R2,1 billion in the first quarter of 1999 and R2,3 billion in the second quarter. In total, the net outflow of other investment capital accelerated from R3,2 billion in the first quarter of 1999 to R5,3 billion in the second quarter.

Foreign reserves

The overall surplus on South Africa's balance of payments with the rest of the world that had been recorded in the second quarter of 1999, led to a further increase in the country's net international reserves. The dollar value of the country's gross international reserves also rose marginally from the end of the first quarter of 1999 to the end of the second quarter. The strengthening of the rand against the dollar during the quarter resulted in a slight decline in the rand value of gross international reserves.

Total gross international reserves rose from US$7,7 billion at the end of March 1999 to US$7,8 billion at the end of June. In rand terms, the value of the reserves nevertheless declined on account of the strength of the rand by R0,6 billion to R47,2 billion at the end of June 1999. Import cover, i.e. the value of gross international reserves relative to the value of imports of goods and services, remained at about 12 weeks' worth of imports of goods and services at the end of June 1999.

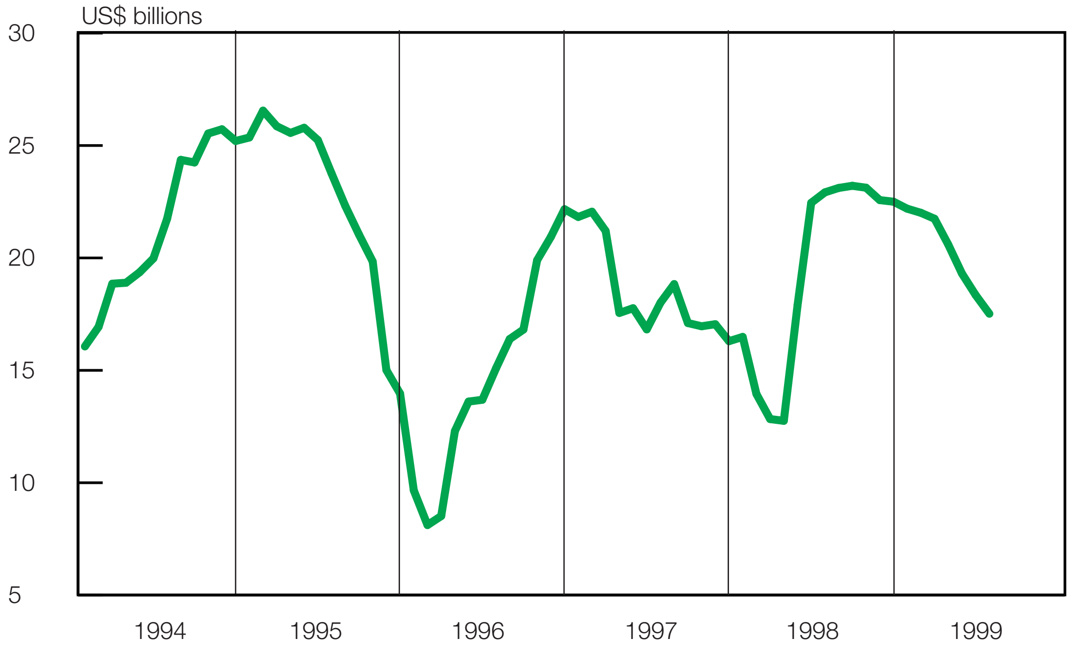
Imports covered by international reserves



The Reserve Bank's gross holdings of international reserves increased from R32,9 billion at the end of March 1999 to R35,1 billion at the end of June and R35,7 billion at the end of July. Utilised short-term credit facilities decreased from R17,9 billion to R15,2 billion, thus increasing the value of non-borrowed reserves from R14,9 billion at the end of March 1999 to R19,0 billion at the end of June and R20,4 billion at the end of July.

The Reserve Bank's *net oversold forward position in foreign currency* declined from US$24,2 billion at the end of March 1999 to US$21,5 billion at the end of June 1999. Together with the strengthening of net international reserves, this resulted in a decline of the Bank's *net open position in foreign currency* from US$21,7 billion at the end of March 1999 to US$16,9 billion at the end of August.

Net oversold open position in foreign currency of the Reserve Bank



End of period

Exchange rates

The *nominal effective exchange rate of the rand* which had declined, on balance, by about 1 per cent from the end of December 1998 to the end of March 1999, was subjected to increased volatility in the ensuing months.

Exchange rates of the rand
Percentage change

	31 Dec '98 to 31 Mar '99	31 Mar '99 to 30 Apr '99	30 Apr '99 to 31 May '99	31 May '99 to 23 Jun '99	23 Jun '99 to 30 Jul '99	30 Jul '99 to 13 Aug '99
Weighted average*	-0,9	2,5	-1,6	4,3	-4,7	0,9
US Dollar	-5,4	2,2	-2,4	3,6	-2,5	0,7
British pound	-2,3	2,0	-2,0	4,7	-4,6	1,2
Euro	2,9	3,4	-1,0	5,0	-6,1	1,1
Japanese yen	-0,3	2,0	-1,0	4,3	-8,0	0,4

* The weighted average has consisted of a basket of 14 currencies since 1 January 1999. Prior to the introduction to the euro, the basket consisted of 24 currencies

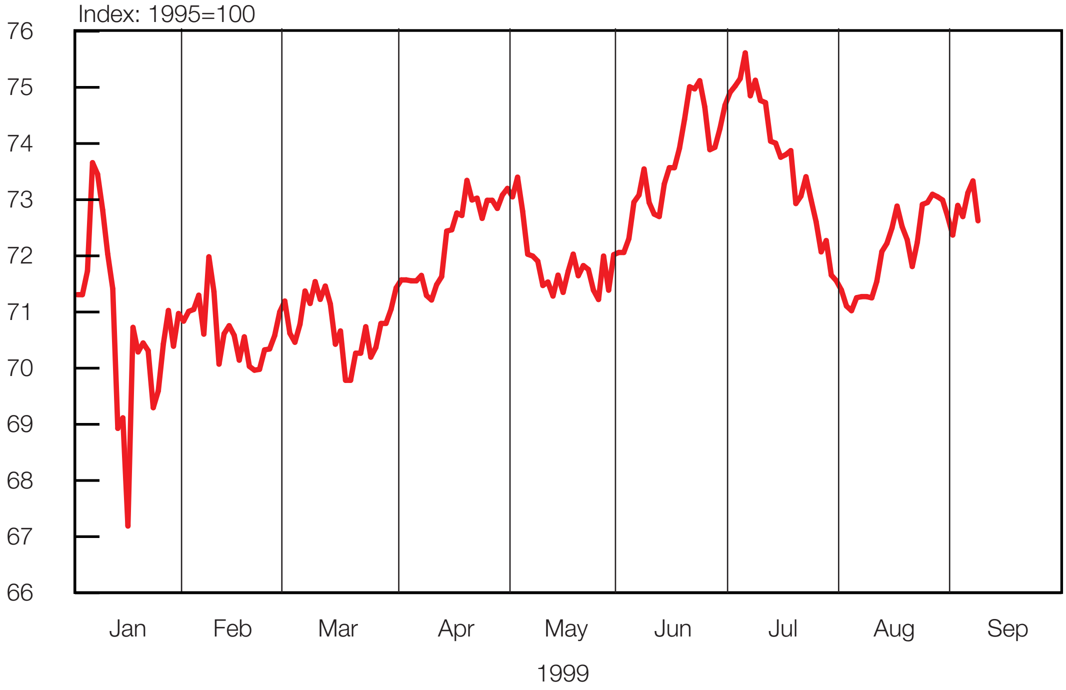
At first, an improvement in international investor sentiment towards emerging markets resulted in an appreciation of the rand of 2,5 per cent against a four-currency basket from the end of March 1999 to the end of April. A confluence of the effects of a number of external events then caused a decline in the weighted nominal value of the exchange rate in May 1999. The impact that the sudden fall in the gold price had on the exchange rate was exacerbated by fears of political instability in Russia and economic difficulties in South American economies. The downward pressure that these events exerted on the domestic currency was partially mitigated by the simultaneous listing of a large South African company on the London and

Johannesburg stock exchanges. The pending inclusion of these shares in a prominent London market price index (the FTSE100) encouraged foreign buying demand on the Johannesburg Stock Exchange ahead of the international listing of the company. This helped to limit the decline in the nominal effective exchange rate of the rand to only 1,6 per cent between the end of April and the end of May 1999.

The underlying strength of the rand that had been evident since the beginning of 1999 was boosted in June when the short rand positions that had been taken prior to South Africa's general elections were closed. The exchange rate was also supported by expectations of an overall surplus on the balance of payments during the second quarter of 1999. In response, the weighted value of the rand strengthened by about 4,3 per cent from the end of May 1999 to 23 June.

The reappearance of economic difficulties in Latin America in July weakened emerging-market currencies. The nominal effective exchange rate of the rand consequently declined by 4,7 per cent from 23 June 1999 to 30 July as the weak gold price also continued to depress the exchange rate of the rand. However, from 30 July 1999 to 13 August, the rand appreciated once again as prospects for the gold market improved and emerging markets appeared to be relatively tranquil. On balance, the inflation-adjusted effective exchange rate of the rand appreciated by 1,1 per cent from December 1998 to May 1999.

Nominal effective exchange rate of the rand



Daily average

The turnover in the foreign-exchange market was also affected by the heightened volatility in the second quarter of 1999. The total net average daily turnover in the market for foreign exchange accordingly increased from US$9,4 billion in the first quarter of 1999 to US$10,1 billion in the second quarter. Non-resident and resident participation in the market increased almost proportionately from the first to the second quarter of 1999.

Monetary developments, interest rates and financial markets

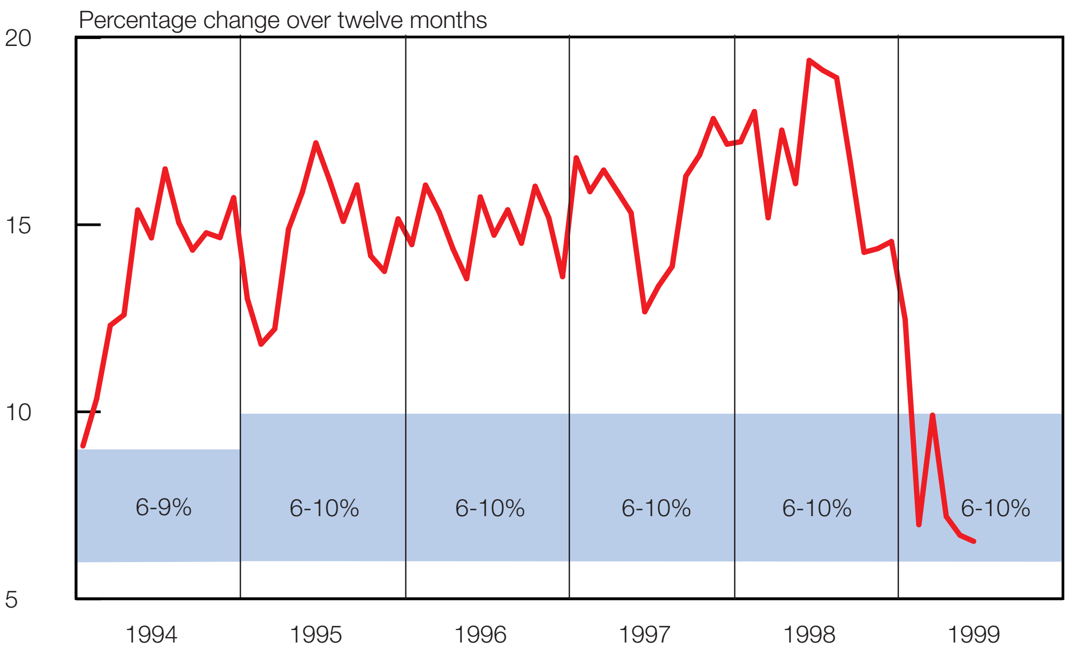
Money supply

Compared with average growth over the past five years, money supply expanded slowly in the first seven months of 1999.

From December 1997 to December 1998, M3 increased by 14,6 per cent, placing it well above the upper boundary of its 6 to 10 per cent medium-term desired growth range. This range was intended as a benchmark for money growth under conditions of firm long-term economic expansion, price changes broadly commensurate with inflation in trading-partner countries and a relatively stable long-term velocity relationship.

From December 1998, the growth over twelve months in M3 has fallen back to 9,9 per cent in March 1999, to 6,5 per cent in June and 7,4 per cent in July. Growth in M3 from one quarter to the next fell to very low levels, thus signalling the potential for further declines in year-on-year growth rates. The quarter-to-quarter growth in the seasonally adjusted average value of M3 slowed down significantly from 9,7 per cent in the fourth quarter of 1998 to 0,5 per cent in the first quarter of 1999 and 1,4 per cent in the second quarter.

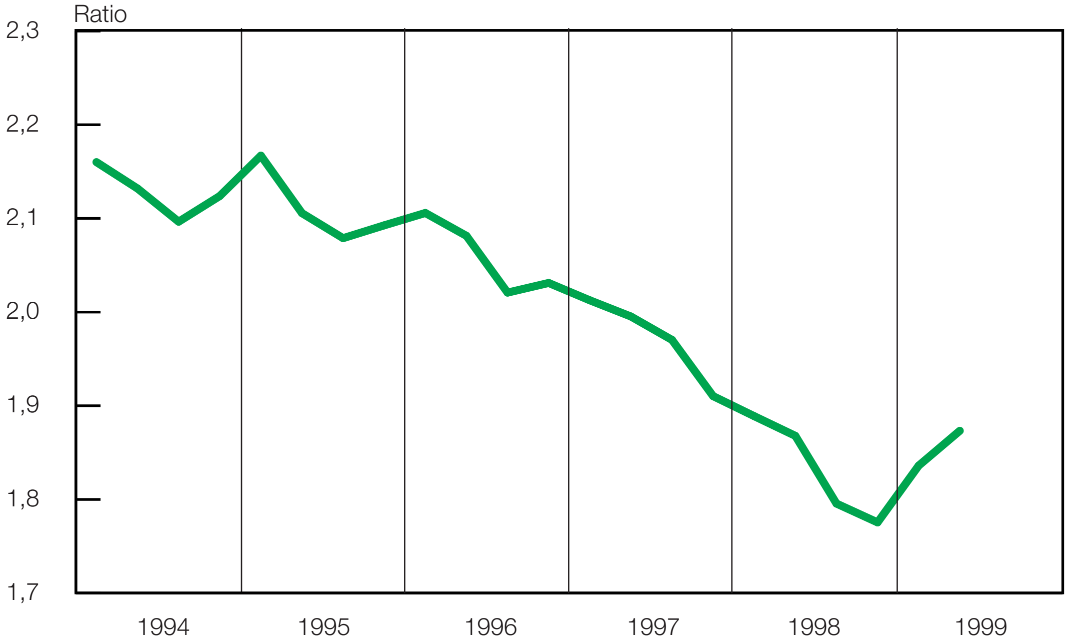
M3 money supply



Shaded areas indicate the money growth guideline ranges

Part of the slowdown in M3 growth was the result of slower growth in domestic spending that could conceivably be consistent with lower inflation and a greater degree of overall price stability. In addition, the income velocity of M3 (defined as the ratio of nominal gross domestic product to M3) increased by 5,1 per cent from the fourth quarter of 1998 to the second quarter of 1999. A rise in income velocity – which could have been

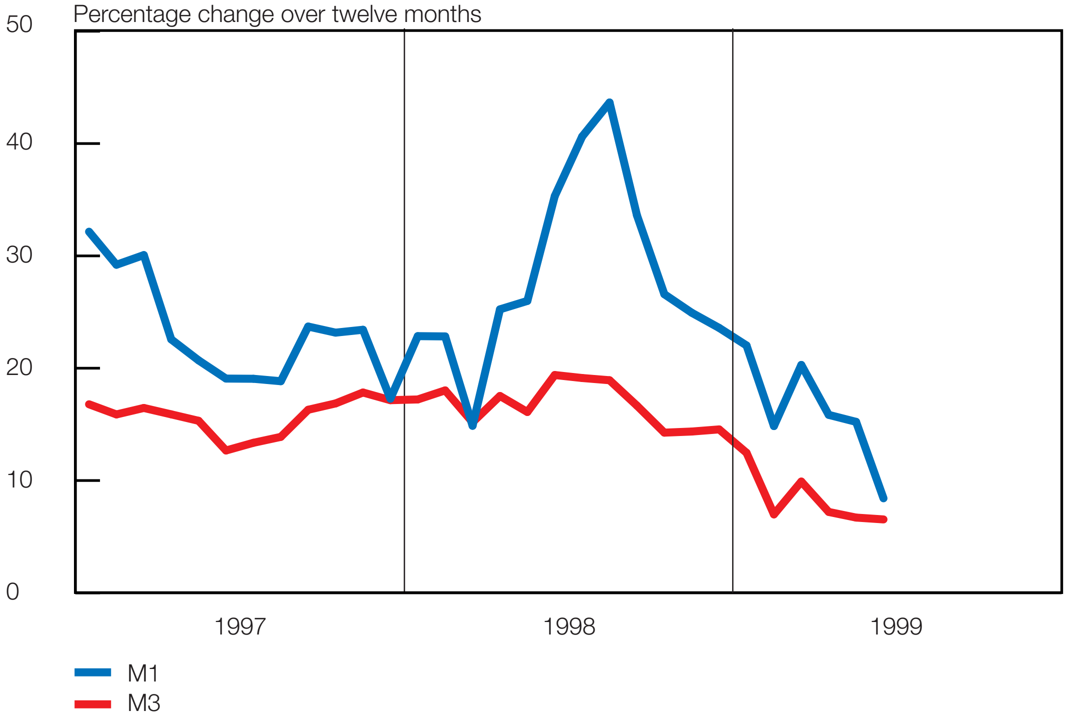
Income velocity of M3



Seasonally adjusted

triggered by interest rates on M3 deposits declining more than yields on other interest-bearing assets, thus reducing the attractiveness of M3 deposits – usually restrains growth in the broad monetary aggregate. The increase in velocity seems to indicate that the general public allocated more of their saving flows to equities and interest-bearing securities, and reduced their net bank indebtedness. This followed the steep decline in asset prices in 1998 and is consistent with widely held expectations of a strong recovery in the equity and bond markets in the first half of 1999.

Monetary aggregates



M1 (a narrower monetary aggregate than M3, consisting of cash, cheque, transmission and other demand deposits) increased faster than M3, but the growth differential between these two aggregates narrowed from 10,4 percentage points in March 1999 to only 0,1 percentage points in July. This is further evidence of a reduction in the general public's preference for easily accessible depository-type investments. The increase in cheque, transmission and other demand deposits accounted for 94 per cent of the increase in M3 during the first seven months of 1998 but contributed only 57 per cent in the same period in 1999. Of the latter increase in M3, 34 per cent came from the business sector, i.e. companies, insurance companies, pension funds, provident funds, close corporations and unincorporated businesses. Deposits held by individuals contributed 66 per cent to the increase in the non-bank private sector's deposit holdings with banks in the first seven months of 1999.

The statistical or *accounting counterparts* of the increase in M3 in the second quarter of 1999 were mainly concentrated in the monetary sectors' claims on the private sector. In fact, the increase in banks' claims on the private sector was greater than the increase in M3. The main accounting counterparts of M3 in the second quarter were as follows:

Statistical counterparts of changes in M3

R billions

	2nd qr of 1999	
Net foreign assets		0,7
Net gold and foreign exchange reserves	2,5	
Net other foreign assets	-1,8	
Net claims on the government sector		5,9
Gross claims	8,7	
Increase in government deposits*	-2,8	
Claims on the private sector		12,8
Net other assets		-9,5
Total change in M3		**9,9**

* Increase is indicated by a negative sign

Credit extension

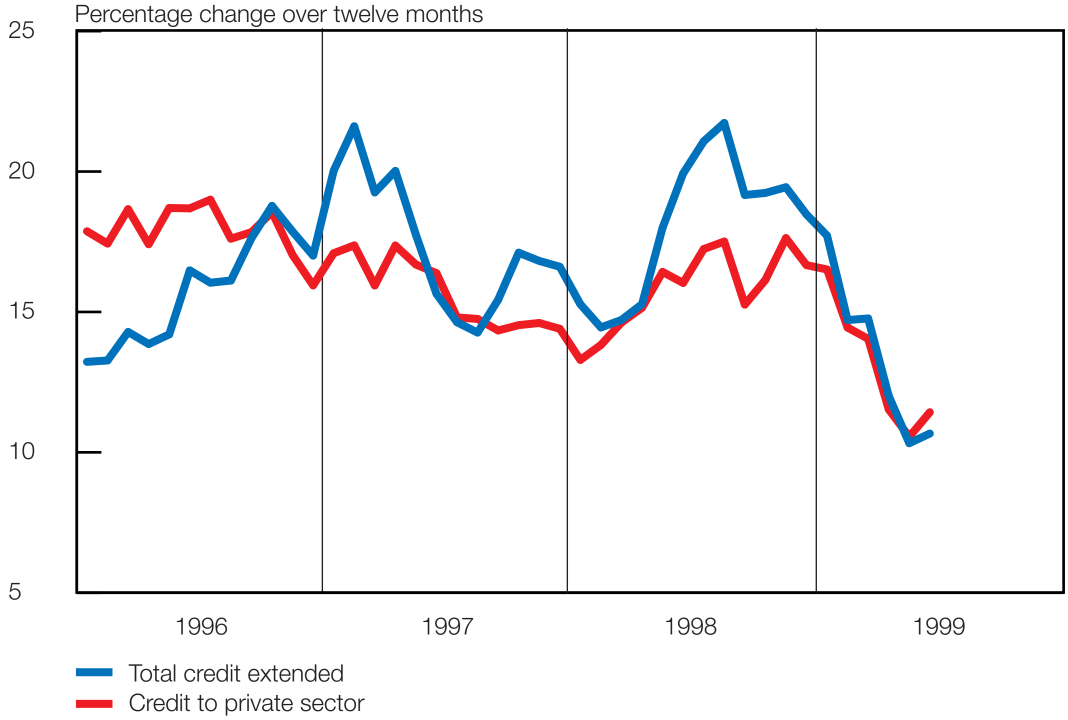
The growth over twelve months in *total domestic credit extended* by the monetary sector slowed down from a recent peak of 21,7 per cent in August 1998 to 14,8 per cent in March 1999 and even further to 10,7 per cent in June and 9,7 per cent in July. The low growth in credit demand in the second quarter of 1999 could be attributed to weaker growth in the demand for credit by the private sector.

Net credit extended to the government sector increased sharply in the second quarter of 1999. This was indicated by an increase of R8,7 billion in the banks' gross claims on the government sector, which was counteracted somewhat by an increase of R2,8 billion in government deposits with banks. On balance, net bank credit extended to the government sector rose by R5,9 billion in the second quarter of 1999.

The growth over twelve months in credit extended to the *private sector* slowed down from 17,6 per cent in November 1998 to 9,4 per cent in July 1999 – the first year-on-year growth rate below 10 per cent since February 1994. This slowdown can be attributed to weak spending on durable goods and residential construction by households, and declines in business investment, particularly investment in inventories.

The weaker undertone in the demand for bank credit by the private sector could have been aggravated when foreign trade financing reverted to external sources as the rand strengthened against most other currencies. By contrast, corporate restructuring activities, including mergers and acquisitions that substituted debt for equity, appeared to have remained buoyant for the time being, thereby supporting the private sector's demand for bank credit during the four months to July 1999.

Credit extended by monetary institutions



Among the components of bank credit extended to the domestic private sector, the main contributions during the first seven months of 1999 were made by *"other loans and advances"* which added 78,4 per cent to the increase in overall bank credit extended to the private sector. Measured over periods of twelve months, the growth in "other loans and advances" in the first seven months of 1999 fluctuated between 31,4 per cent and 18,8 per cent, consistently exceeding the growth in total credit extended to the private sector. As a result, "other loans and advances" as a percentage of total credit extended to the private sector increased from 39,9 per cent in December 1998 to 41,5 per cent in July 1999.

Increase in credit extension to the private sector by type of credit
Year-on-year percentage change

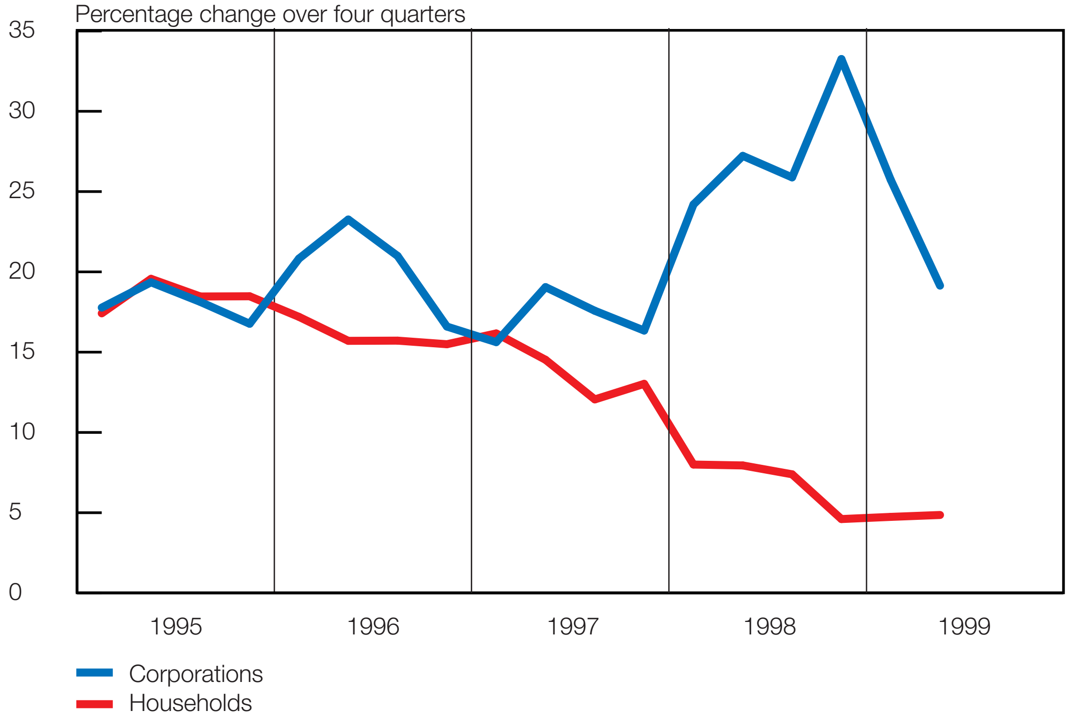
	1998	1999		
	Dec	Mar	Jun	Jul
Mortgage advances	10,0	7,2	4,8	4,1
Instalment sales................................	4,1	2,7	0,2	-0,6
Leasing finance	-0,2	1,0	0,9	0,4
Investments	20,8	29,4	28,8	21,7
Bills discounted	5,1	20,2	-11,5	-10,8
Other loans and advances	31,4	25,4	22,5	18,8
Total	**16,7**	**14,0**	**11,4**	**9,4**

The twelve-month rate of increase in *mortgage advances*, in contrast to that of "other loans and advances", remained below the growth in total bank credit extension to the private non-bank sector during the first seven months of 1999, reflecting the weak state of the real-estate market and the home-building industry. Measured over periods of twelve months, the growth in mortgage advances fluctuated between 9,1 per cent in January 1999 and 4,1 per cent in July. Since the growth over periods of twelve months in total private-sector credit extension consistently exceeded 9 per cent, the share of mortgage advances in the total outstanding claims of the banks on the private sector declined from 39,9 per cent in December 1998 to 38,7 per cent in July 1999.

As was the case with mortgage advances, the growth in other types of credit mostly used by households slowed down over the first seven months of 1999. The growth over twelve months in *instalment sale credit,* for example, fell from 4,9 per cent in January 1999 to -0,6 per cent in July, mainly reflecting the declining spending by private households on durable goods. *Leasing finance*, which had recorded negative annual growth rates in the eighteen months to February 1999, increased by only 0,4 per cent in the year to July.

The corporate sector absorbed the greater part of the increase in credit to the private sector. The share of the corporate sector in total credit extension to the private sector accordingly increased from 46 per cent in June 1998 to 49 per cent in June 1999. Conversely, the share of households decreased from 54 per cent to 51 per cent over the same period.

Credit extended to households and corporations



Interest rates and yields

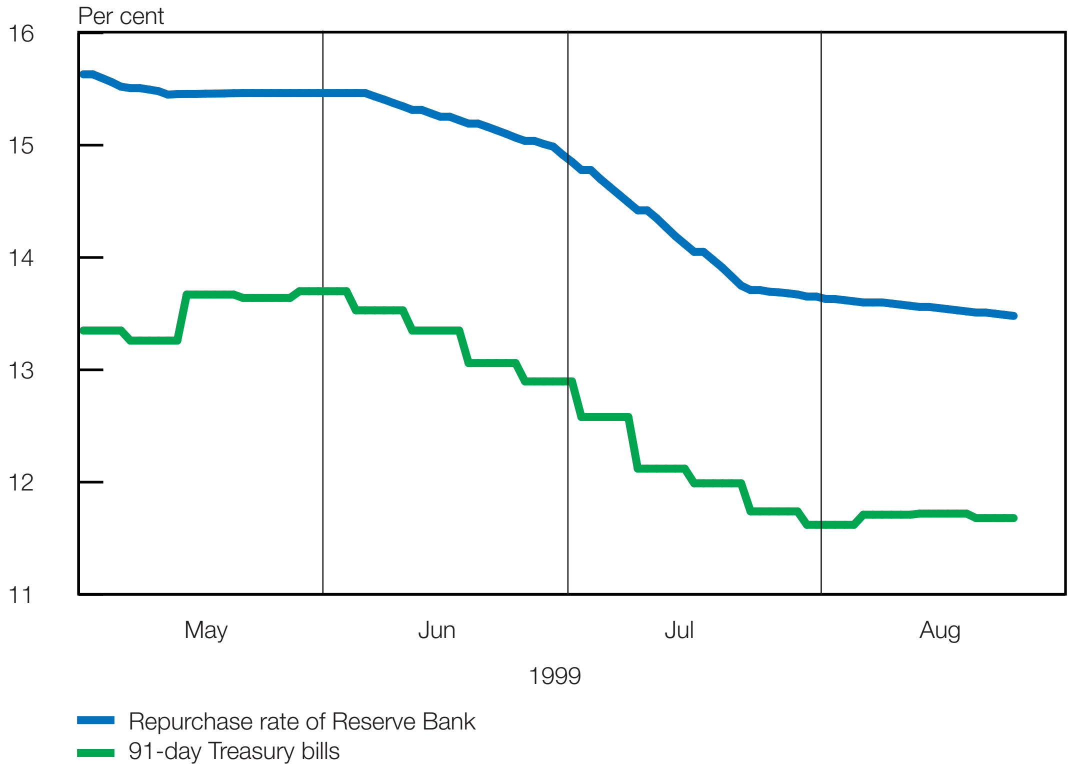
Over the fourth quarter of 1998 and the first quarter of 1999 the *yield on long-term government bonds* moved lower from a monthly average rate of 18,3 per cent in September 1998 to 14,5 per cent in March 1999 as stability returned to the international financial markets and domestic monetary conditions eased gradually.

Since the beginning of the second quarter of 1999 yields on long-term government bonds have moved in a relatively narrow range around a steadily rising trend. Yields responded, among other things, to the market's changing assessment of the likely impact of foreign economic difficulties on the domestic financial markets, movements in bond rates in the US securities markets, the fall in the gold price, steadily rising underlying inflationary tendencies and the intensification of industrial action. The average monthly yield on long-term government debt, on balance, edged higher to 15,1 per cent in May 1999 and 15,3 per cent in August.

The monthly *inflation-adjusted yield* on long-term government bonds averaged 6,1 per cent in the first quarter of 1999, compared with values in excess of 8,5 per cent at the peak of the financial turmoil around the middle of 1998. From the second quarter of 1999, the inflation-adjusted average bond yield moved higher as overall consumer price inflation drifted downwards from month to month and bond yields continued their gradually rising trend. The inflation-adjusted or real bond yield eventually moved to 9,6 per cent in July 1999.

Money market interest rates reached their zenith in September 1998. For example, the tender rate on three-month *Treasury bills* peaked at 22,30 per cent on 17 September 1998 and then declined to 11,62 per cent on 5 August 1999, some

Short-term interest rates



113 basis points below the pre-crisis low point of 12,78 per cent on 8 May 1998. This decline was not a smooth process, but was interrupted on more than one occasion by a temporary rise in the Treasury bill rate. At the time of the problems in Brazil in January 1999, the Treasury bill rate increased by 25 basis points. In May 1999 it rose against the medium-term trend by some 44 basis points. The rise in May was a consequence of weakness in the gold price and fears that the political situation in Russia could impact on financial stability in emerging markets generally. The tender rate on three-month Treasury bills gained some 10 basis points once again between 5 and 13 August when expectations of rising interest rates in the US market affected the interest rate structure in South Africa.

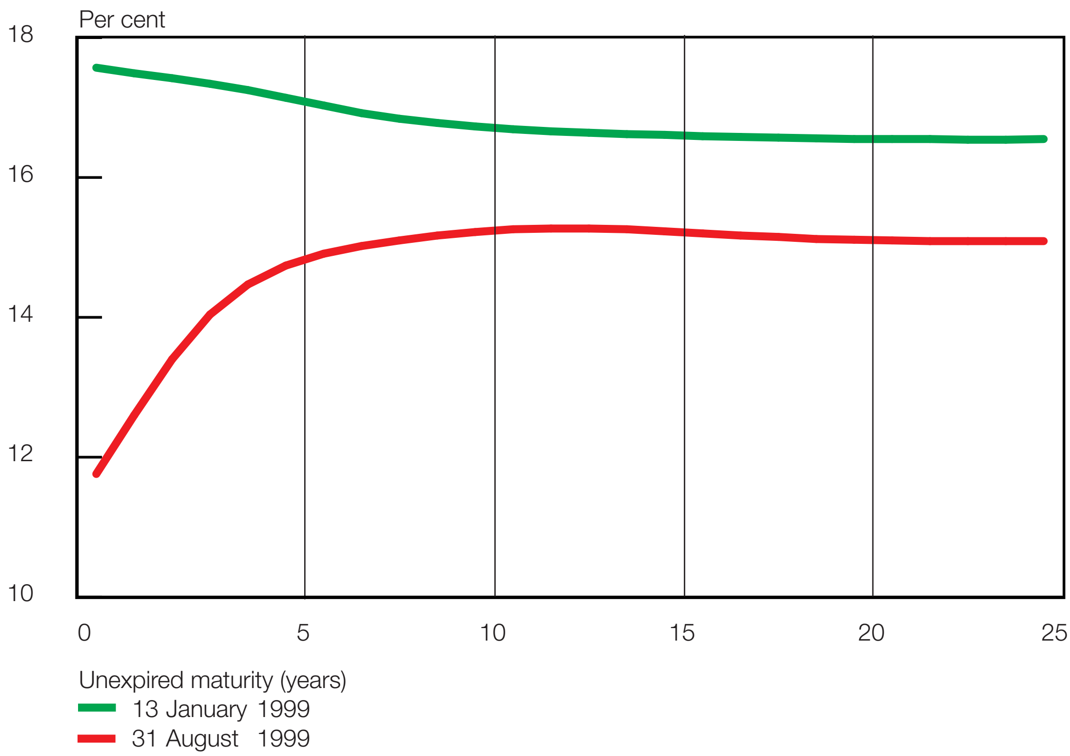
Evidence that the worst of the emerging-market crisis was over created circumstances in the domestic money market which allowed a persistent decline in the *repurchase rate of the Reserve Bank* from October 1998. This decline started about a month later than the decline in the rate on three-month Treasury bills, but was more gradual and smoother – on balance, the repurchase rate declined by 828 basis points from its peak to its latest low point, compared with 1068 basis points in the case of the peak-to-trough movement of the Treasury bill rate. The pace of change of the repurchase rate was on occasion accelerated or restrained by the Reserve Bank through its signalling mechanism. The Bank underprovided the market with liquidity at the daily auction from 13 May 1999 to 21 May, thus halting the downward movement in the repurchase rate and accepting a marginal increment of just more than one basis point over this period. Then the Bank returned to full provision, but had to overprovide in the daily liquidity needs of the banks before the repurchase rate resumed its downward movement again.

From the end of June 1999 the Reserve Bank signalled to the banks that it would be willing to accept a slightly faster decline in the repurchase rate. The market responded and the repurchase rate declined by 7 basis points a day, from the end of June to 22 July 1999. On 26 July 1999, the Reserve Bank once again signalled that the pace of decline in the repurchase rate should slow down. The provision of liquidity was restricted for one day to R10 million below the estimated requirement, leading to a steady decline of one basis point a day in the repurchase rate over the ensuing period.

With short-term yields declining faster than long-term yields, the downward sloping *yield curve* flattened out in the first four months of 1999. But when short-term yields fell below long-term rates in April 1999, the yield curve assumed an upward slope that was maintained until the end of August. Beyond the five-year interval the yield on long-term government bonds remained range-bound at a level of about 15 per cent, lending a fairly horizontal shape to the yield curve over longer maturities.

Changes in nominal interest rates reflect revisions to expectations about inflation, real interest rates and risk premiums. The rigidity of rates at the long end of the maturity spectrum and the greater flexibility at the shorter end may be indicative of higher uncertainty over the longer term than over the short to medium term. It is also conceivable that the risk premiums associated with investment in South Africa have been raised in line with those of all other emerging-market economies since the crisis of mid-1998. This could have imparted an additional risk bias to long-term yields in South Africa. The recent increases in nominal bond yields and the stability of yields over all maturities longer than five years could have been driven by such an additional emerging-market risk premium, and by government’s preference for issuing debt with longer maturities.

Yield curves



Closely following the downward movement in the repurchase rate of the Reserve Bank, the *predominant prime overdraft rate* on current accounts with banks was lowered in ten consecutive steps by a total of 9 percentage points from 25,5 per cent in mid-October 1998 to 16,5 per cent in August 1999. In tandem with the prime overdraft rate the *predominant rate on mortgage loans* was lowered from an all-time high of 24 per cent in October 1998 to 16,5 per cent in August 1999 – its lowest level since February 1995.

The *predominant retail rate on twelve-month fixed deposits* with banks, which is regarded as indicative of changes in deposit rates in general, similarly declined from 16,5 per cent in October 1998 to 10,25 per cent in August 1999 – its lowest level since August 1994. In July 1999 these deposits gave savers a pre-tax inflation-adjusted yield of 5,8 per cent. Coinciding with the downward trend in market-determined rates, the *standard interest rate* applicable to loans granted from the State Revenue Fund was lowered from 18,50 per cent in October 1998 to 15,25 per cent in July 1999.

In June 1999, money-lending transactions were exempted from the Usury Act, subject to certain provisos aimed at, among other things, the promotion of sound microlending practices. The *maximum permissible finance charges rates* laid down in terms of the Usury Act, which had remained unchanged from August 1998 at 33 per cent in respect of money lending, credit and leasing transactions of more than R6 000 but less than R500 000 and 36 per cent for amounts up to R6 000, were lowered to 28 per cent and 31 per cent, respectively, in July 1999.

Money market

Money market conditions eased considerably from the fourth quarter of 1998 to the first quarter of 1999 but then tightened in the second quarter. The average daily liquidity requirement of private banks declined from R8,2 billion in December 1998 to a lower turning point of R4,8 billion in March 1999, after which it increased steeply to R8,2 billion in May and R12,2 billion in July.

The easing of money market conditions up to the first quarter of 1999 was a reflection of

- an increase in the net foreign assets of the Reserve Bank,
- deficits which originated from the Reserve Bank's involvement in the market for forward foreign exchange, and
- a decline in the value of notes and coin in circulation outside the Reserve Bank as the demand for currency returned to normal levels after the festive season and the summer school holidays.

The tightening in money market conditions during the second quarter of 1999 could mainly be attributed to liquidity-draining operations by the Reserve Bank. There were two distinct motives which led to the Bank's decision to drain liquidity from the market. Firstly, there was the view that a higher dependency of private banks on central bank funding would increase their participation at the daily auction of repurchase contracts. This was expected to allow for a more competitive tender, make the market more sensitive to signalling by the Reserve Bank and remove distortions in the spreads of money market interest rates. Secondly, there was concern during May 1999 that money market rates could decline sharply following further injections of liquidity into the market at a time when the political situation in Russia threatened to destabilise other emerging markets and the gold price was being subjected to serious downward pressures.

As part of its liquidity management operations, the Reserve Bank increased the amount of its debentures to R5,0 billion at the end of July 1999. Another measure that the Bank used to contain liquidity was the introduction of reverse repurchase transactions with a maturity of 28 days on 29 April 1999, initially to an amount of R0,5 billion which was later increased to R1,0 billion.

The Reserve Bank also entered into special foreign currency swap transactions with banks. These transactions were designed to drain liquidity from the money market without affecting the foreign exchange market. The special arrangements are foreign exchange neutral in that the private banks temporarily acquire foreign currency from the Reserve Bank against payment in rand, thus draining liquidity from the money market, but are then required to deposit such foreign currency in a special foreign currency account with the Reserve Bank. At the end of July 1999 the value of the special outstanding swap arrangements amounted to R12,0 billion. In July and August 1999 surpluses arising from the Reserve Bank's forward foreign exchange transactions also drained liquidity from the money market.

At a meeting with representatives of private banks on 23 June 1999, the Governor explained the signalling mechanism of the Bank to money market participants. It was indicated to the banks that the size of the daily liquidity requirement should no longer be regarded as an important indicator of the Reserve Bank's interest rate intentions. Instead, the Bank's intentions would be signalled through the amount of liquidity provided at the daily auction of repurchase transactions relative to the needs of the market.

To improve the transparency of the Reserve Bank's signals, the signalling procedures were explained as follows:

- Full provision of the estimated daily liquidity requirement indicates a neutral monetary policy.
- Marginal underprovision has a tightening and overprovision an easing monetary policy bias.
- Significant overprovision would indicate that an acceleration is warranted in the speed of the decline in the repurchase rate.
- Conversely, significant underprovision would indicate that an acceleration is warranted in the speed of the increase in the repurchase rate.
- Auctions with a predetermined fixed interest rate would be used to achieve an immediate and substantial change in money market rates.

In May 1999 the political situation in Russia, the announcement of the resignation of the US Treasury Secretary and a sharp decline in the gold price prompted the Reserve Bank to signal its discomfort with the continuous decline in the repurchase rate. The Bank underprovided in the daily liquidity needs of the private banks from 13 to 21 May 1999, but reverted to full provision on 24 May. On 30 June 1999, the Bank overprovided at the daily tender by R15 million, mainly to signal that an acceleration in the daily speed of decline of the repurchase rate would be acceptable. After the major banks had announced a one percentage point reduction in their prime lending rates on 20 July 1999, the Bank underprovided in the market's liquidity needs by R10 million. This was correctly interpreted as a signal from the Bank that the pace of decline in the repurchase rate should slow down, for a while at least.

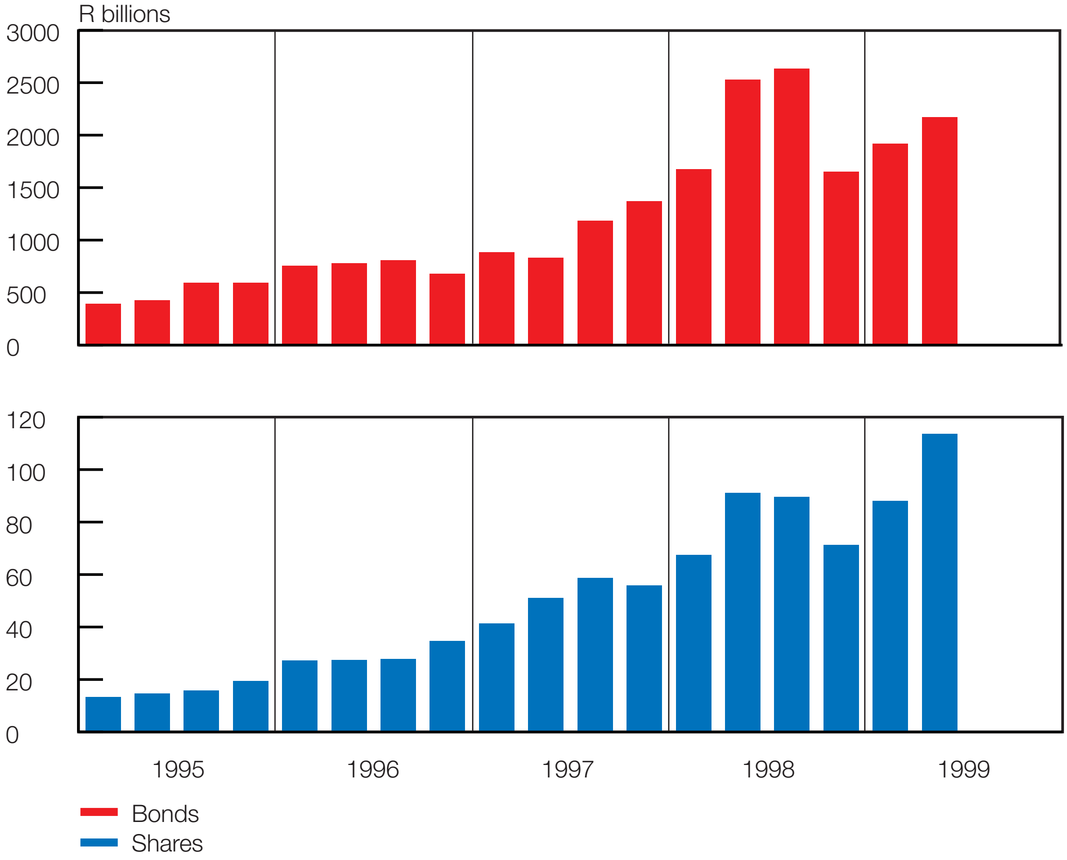
Bond market

Activity in the *domestic primary bond market* in the first half of 1999 was totally dominated by public-sector borrowers. Private-sector companies showed a clear preference for raising capital in the primary share market, and listed private-sector companies made no rights issues of fixed-interest securities (i.e. preference shares and debentures). In fact, private-sector borrowers reduced their amount of listed fixed-interest securities in issue on the Bond Exchange of South Africa by R15 million from the first to the second quarter of 1999. Borrowing by private-sector companies in the second quarter of 1999 was probably partly precluded by the availability of funding at relatively low short-term interest rates and an unwillingness to issue securitised debt at relatively high medium to long-term rates.

Public-sector organisations, by contrast, increased their net issuance of fixed-interest securities by about one-fifth from R9,2 billion in the first half of 1998 to R11,1 billion in the first half of 1999. The national government, however, reduced its demand for loanable funds from 1998 to 1999, leaving scope for borrowing by other public-sector and private-sector borrowers. Government bonds with a nominal value of R9,7 billion were *auctioned and allotted* in the first five months of the current fiscal year, compared with issues of R15,4 billion in the corresponding period of the fiscal year 1998/99.

Apart from an amount of R6,3 billion which was raised by the national government through two foreign-currency denominated bond issues in the *international primary bond markets*, other public-sector organisations refrained from issuing either foreign-currency denominated or rand-denominated bonds in the international markets in the second quarter of 1999. Rand-denominated bonds to the value of R1,0 billion were issued in the eurobond market during the first quarter of 1999.

Turnover in secondary capital markets



The general decline in interest rates and the volatility in bond yields in the first eight months of 1999 encouraged trading along a changing yield curve and the quarterly value of bonds traded in the *secondary bond market* increased from the fourth quarter of 1998 to the second quarter of 1999. Nonetheless, the value of bonds traded on the Bond Exchange of South Africa at R5,7 trillion in the first eight months of 1999 was still about 6,5 per cent lower than the R6,1 trillion worth of bonds traded in the corresponding period of 1998 when turnover increased to unprecedentedly high values in a time of inordinate instability in international financial markets.

Bond market activity
R billions

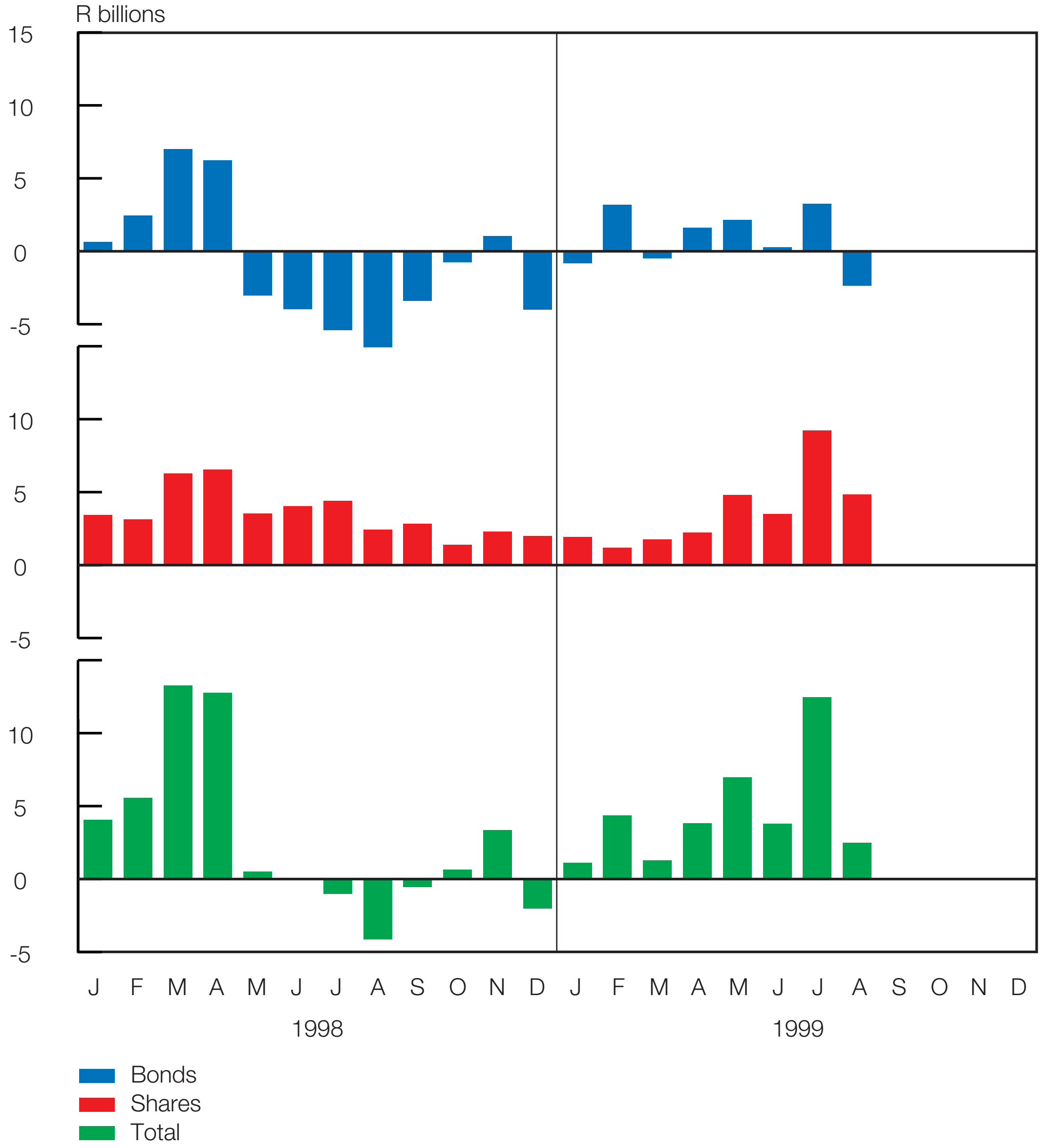
		Secondary market	
		Bonds traded	Net purchases by non-residents
1998:	4th qr	1 653	-3,7
	Year	8 489	-9,8
1999:	1st qr	1 919	1,9
	2nd qr	2 171	4,1
	Year to date*	**5 747**	**6,8**

* Including July and August

As investor sentiment towards South Africa improved, *non-resident investors* once again increased their exposure to South African bonds and increased their net holdings of these securities by R9,2 billion in the first seven months of 1999, compared with net sales to the value of R9,8 billion in 1998 as a whole. Non-residents' net purchases of South African bonds were a response to the attractive returns on these bonds and the relative stability of the exchange value of the rand. However, nervousness about domestic and international developments set in and net purchases were turned into net sales of R2,4 billion in August 1999.

Eurorand bond issues by non-resident entities dwindled in the first eight months of 1999 and the cumulative net proceeds of these issues fell short by R6,0 billion of non-resident net purchases of domestic bonds over the same period. The demand for South African bonds as a hedge counterpart for eurorand bond issues, therefore, declined substantially over the first eight months of 1999.

Non-residents' net transactions in secondary capital markets



Share market

Capital raised in the *primary share market* by companies listed on the Johannesburg Stock Exchange amounted to R28 billion in the first seven months of 1999 compared with R43 billion in the corresponding period of 1998. Funds obtained through *issues of share capital* by listed companies increased from R8,1 billion in the first quarter of 1999 to R14,8 billion in the second quarter, still reflecting a strong preference for equity financing over debt financing. A further amount of R5,3 billion was raised in July, of which the demutualisation and listing of Old Mutual accounted for R3,0 billion.

Trading activity in the *secondary share market* increased from a quarterly average value of R80 billion in 1998 to R88 billion in the first quarter of 1999 and reached an all-time high of R114 billion in the second quarter. The increases in turnover were caused by rising share prices that were boosted by increased trading in mining and other resource-related shares and new listings. In July 1999, turnover rose to a monthly all-time high of R52 billion, followed by R38 billion in August.

Non-residents were active participants in the *secondary share market* during the first eight months of 1999. Their net purchases of shares listed on the Johannesburg Stock Exchange amounted to R29,5 billion compared with R33,8 billion in the first eight months of the previous year. The monthly value of net purchases of listed shares rose steeply to R9,2 billion in July 1999. This was the largest acquisition of South African shares by non-resident investors in any single month and was mainly due to net purchases of R4,6 billion on 12 July, the day that the shares of Old Mutual were listed on the Johannesburg Stock Exchange.

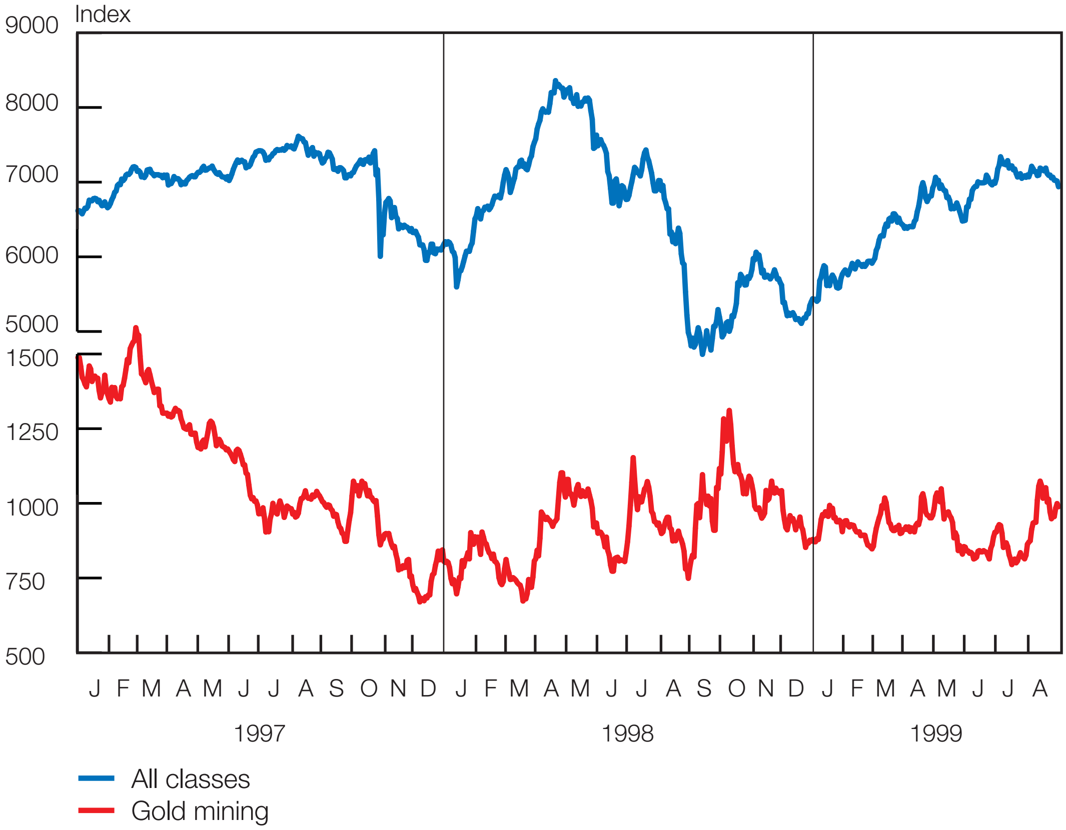
Share market activity
R billions

		Secondary market	
		Shares traded	Net purchases by non-residents
1998:	Year	319	42,3
1999:	1st qr	88	4,9
	2nd qr	114	10,5
	Year to date*	**292**	**29,5**

* Including July and August

The *monthly average price level of all classes of shares* increased, on balance, by 28 per cent from December 1998 to April 1999, but then the pace of increase slowed down to only 6 per cent over the months from April to July, followed by a decline of about 1 per cent in August. Share prices generally have now recovered by 45 per cent from September 1998 to August 1999, strongly driven by price increases in the mining sector (excluding gold mining) and the mining financial sector. In August 1999 the average monthly all-share price index was still 11 per cent below its peak value recorded in May 1998.

Share price movements



In stark contrast to the movement of the all-share price index, the *monthly average price level of gold-mining shares* declined by about 25 per cent from October 1998 to June 1999. This downward rating of the share prices of gold-mining companies was, by and large, based on a decline in the dollar price of gold, which was aggravated by the announcement of forthcoming gold sales by the Bank of England. As opposition mounted to the proposed selling of gold by the International Monetary Fund – an initiative to finance debt relief to a number of highly indebted poor countries – the prices of shares in gold-mining companies recovered somewhat from about mid-July. The average monthly value of the price index of gold-mining shares in August 1999 was about 20 per cent higher than in June.

Because share prices had generally risen by more than dividend payments, the monthly average *dividend yield* on all classes of shares declined from 3,2 per cent in January 1999 to 2,5 per cent in August. The monthly average *earnings yields* (gold-mining shares excluded) also declined from 9,2 per cent in January 1999 to 7,6 per cent in August. The *yield differential* (the difference between the monthly average yield on long-term government bonds and the dividend yield on all classes of shares) narrowed from 12,7 percentage points in January 1999 to 12,4 per cent in June, and this may have marginally increased the relative attractiveness of equity investments. In August the yield differential again widened to 12,8 percentage points. The steady increase in the *price-earnings ratio* (gold-mining shares excluded) from 10,9 in January 1999 to 13,4 in July broadly mirrored the upward movement in share prices during the first seven months of 1999.

Yields and price ratios

		Dividend yield Per cent	Earnings yield Per cent	Price-earnings ratio*
1999:	Jan	3,2	9,2	10,9
	Feb	3,2	9,0	11,1
	Mar	2,8	8,1	12,3
	Apr	2,7	7,7	13,0
	May	2,6	7,6	13,1
	Jun	2,5	7,6	13,2
	Jul	2,4	7,5	13,4
	Aug	2,5	7,6	13,2

* Excluding gold-mining shares

Market for derivatives

Buoyant activity in the underlying securities markets also extended to the formal *derivatives market* during the first eight months of 1999. The number of *equity index futures contracts* and *options on such futures contracts* traded, increased from a quarterly average of 4,0 million contracts in 1998 to 4,2 million in the first quarter of 1999. Trading in these contracts recorded an all-time high in June and reached its highest level ever of 5,7 million contracts in the second quarter of 1999. The average monthly turnover then receded slightly from 1,9 million contracts in the second quarter of 1999 to 1,4 million contracts in July and August.

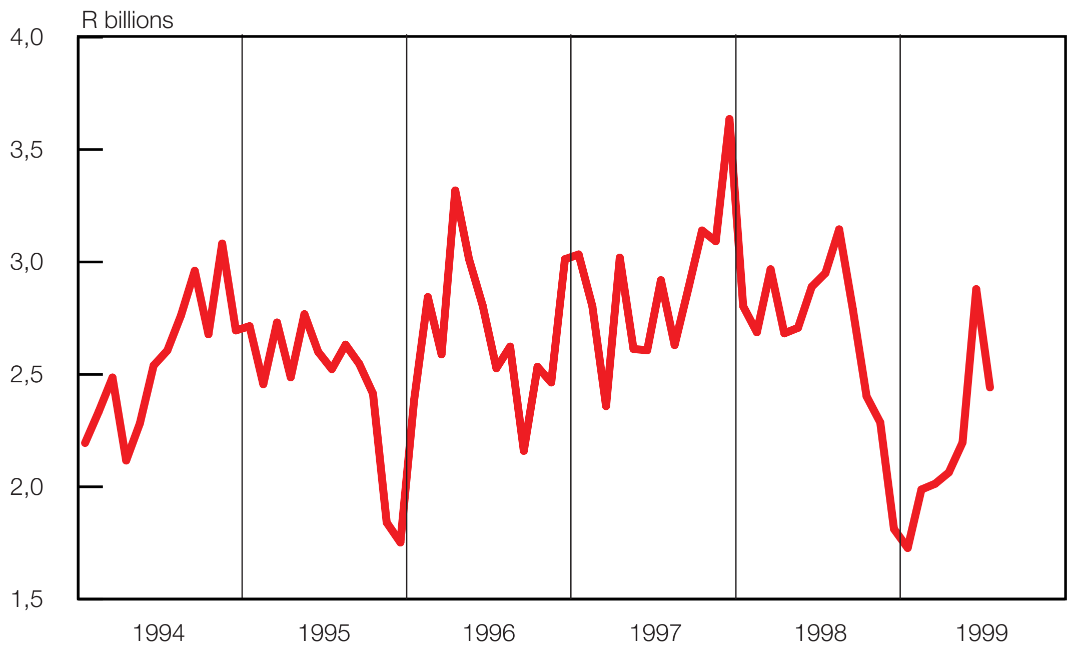
Trading in *individual equity futures contracts* declined from 82 396 contracts in the first quarter of 1999 to only 450 contracts in the second quarter. By contrast, the number of trades conducted in *warrants*, mostly on individual listed shares, increased from 230 million in the first quarter of 1999 to 276 million in the second quarter. Transactions in warrants numbered 455 million in July and August.

Trading in *commodity futures contracts and options on futures contracts* mainly consisted of maize contracts and were extremely buoyant in the first eight months of 1999. The number of contracts traded increased from a quarterly average of about 20 000 contracts in 1998 to successive quarterly all-time highs of 42 000 and 46 000 in the first and second quarters of 1999. In July and August a total of 55 000 contracts were traded.

Real-estate market

The real-estate market, which suffered a serious setback in 1998 when mortgage bond rates rose to unprecedented levels, showed signs of a modest recovery in the second quarter of 1999. The *value of real-estate transactions* declined from a quarterly average of R8,5 billion in the first three quarters of 1998 to R6,5 billion in the fourth quarter. The reductions in mortgage bond rates from October 1998 and somewhat brighter prospects for the domestic economy then led to an increase in the value of real-estate transactions to R7,1 billion in the second quarter of 1999 from a low of R5,7 billion in the first quarter. The average nominal value per real-estate transaction also increased modestly in the first two quarters of 1999. Together with the slowdown in consumer price inflation, the acceleration in the average nominal value per real-estate transaction also sparked a slight increase in the average inflation-adjusted value.

Real-estate transactions



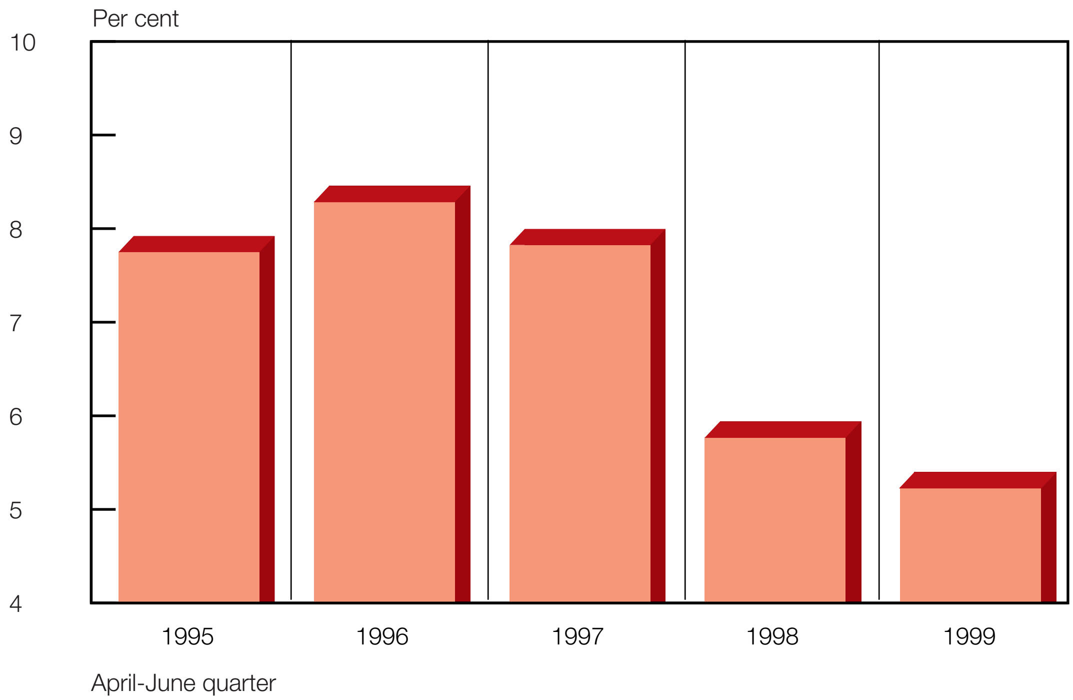
Seasonally adjusted

Public Finance

Public-sector borrowing requirement

The *public-sector borrowing requirement* (i.e. the deficit before borrowing and debt repayment of the consolidated central government, provincial governments, local authorities and non-financial public enterprises and corporations) amounted to R10,3 billion in the April-June quarter of 1999 or R0,3 billion less than in the corresponding period of the previous fiscal year. As a ratio of gross domestic product, the public-sector borrowing requirement decreased slightly from the 5,8 per cent recorded in the April-June quarter of 1998 to 5,2 per cent in the corresponding quarter of 1999. However, this ratio is substantially lower than the average ratio of 8,1 per cent observed in the first quarters of the preceding five fiscal years.

Public-sector borrowing requirement as a ratio of gross domestic product



The decrease in the public-sector borrowing requirement was mainly the result of a decrease in the borrowing requirement of the non-financial public-sector businesses. The borrowing requirement of these businesses turned around from a deficit of R1,2 billion in the April-June quarter of 1998 to a surplus of R0,3 billion in the same period of 1999. The *borrowing requirement of general government* (i.e. the deficit of the consolidated central government, provincial governments and local authorities) increased from R9,3 billion in the April-June quarter of 1998 to R10,6 billion in the corresponding quarter of 1999.

The financial position of general government has deteriorated, mainly because of a decrease in the surplus on the accounts of provincial governments. Total revenue and grants received by general government increased at a year-on-year rate of 8,1 per cent to reach R48,8 billion in the April-June quarter of 1999. This increase was brought about by buoyant increases in tax and non-tax revenues. Total expenditure and net lending of the general government increased at a rate of 9,1 per cent to amount to R59,4 billion in the April-June quarter of 1999 compared with R54,4 billion in the corresponding period of the previous fiscal year. This was essentially the result of an increase in current expenditure. Capital expenditure by general government, by contrast, declined from the April-June quarter of 1998 to the corresponding quarter in 1999.

Although the *provincial governments* recorded a surplus of R0,3 billion in the April-June quarter of 1999, this surplus was substantially lower than the surplus of R3,8 billion recorded in the same quarter a year earlier. This can be attributed to a combination of a decrease in the total revenue and grants received by provincial governments and a slight increase in their total expenditure and net lending. There was also a marked decrease in the non-tax revenue of provincial governments. Total expenditure and net lending of the provincial governments in the April-June quarter of 1999 increased by 3,3 per cent from the corresponding quarter a year earlier. Provincial governments increased their deposits with private banks from R2,7 billion at the end of March 1999 to R3,6 billion at the end of June, but simultaneously increased their combined bank indebtedness from R0,9 billion to R1,4 billion over the same period.

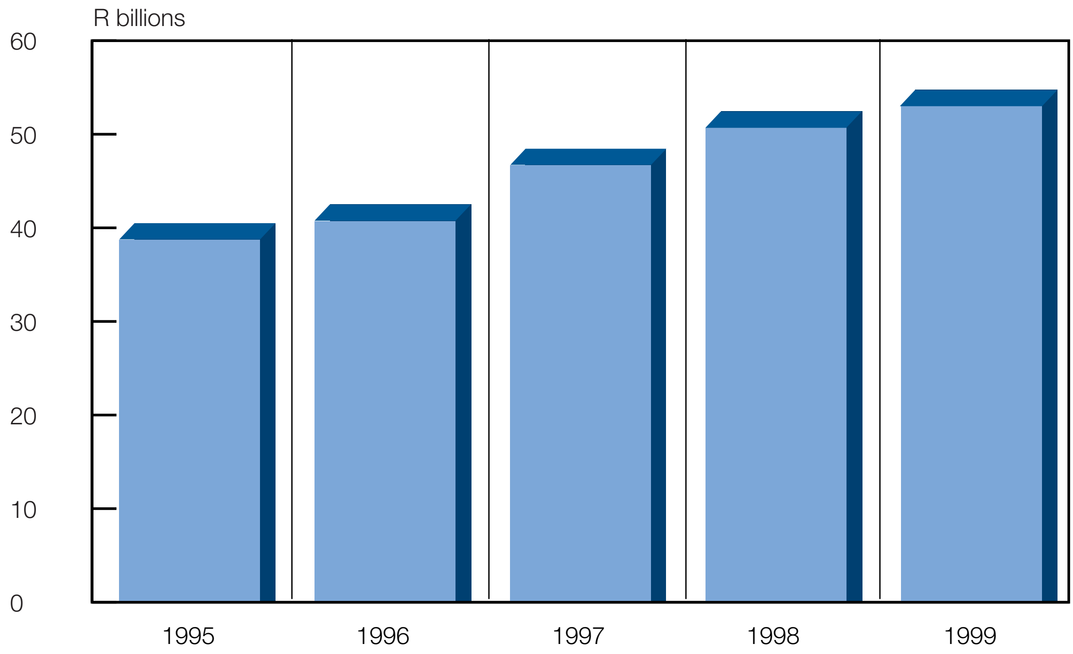
The borrowing requirement of *local authorities* decreased slightly from R0,4 billion in the April-June quarter of 1998 to R0,2 billion in the corresponding period of the current fiscal year. Widespread reports of financial crises at the level of local authorities were dismissed by the Minister of Provincial Affairs and Local Government, who indicated that although instructions for interventions in terms of the Local Government Transitional Act had been issued to municipalities facing financial problems, many municipalities have established excellent administrative and financial capacities to deal with their responsibilities. Management support programmes had been instituted in some municipalities and newly formed public-private partnerships should contribute to an improvement in the finances of local authorities. The consolidation of fiscal discipline at national and provincial government level would also be extended to include the local authorities.

The improvement in the borrowing requirement of the *consolidated central government* resulted essentially from a decrease in the borrowing requirement of the national government from R12,8 billion in the April-June quarter of 1998 to R11,1 billion in the corresponding period of 1999. The extra-budgetary accounts recorded a small surplus of R0,4 billion while the financial position of the social security funds remained broadly unchanged.

National government finance

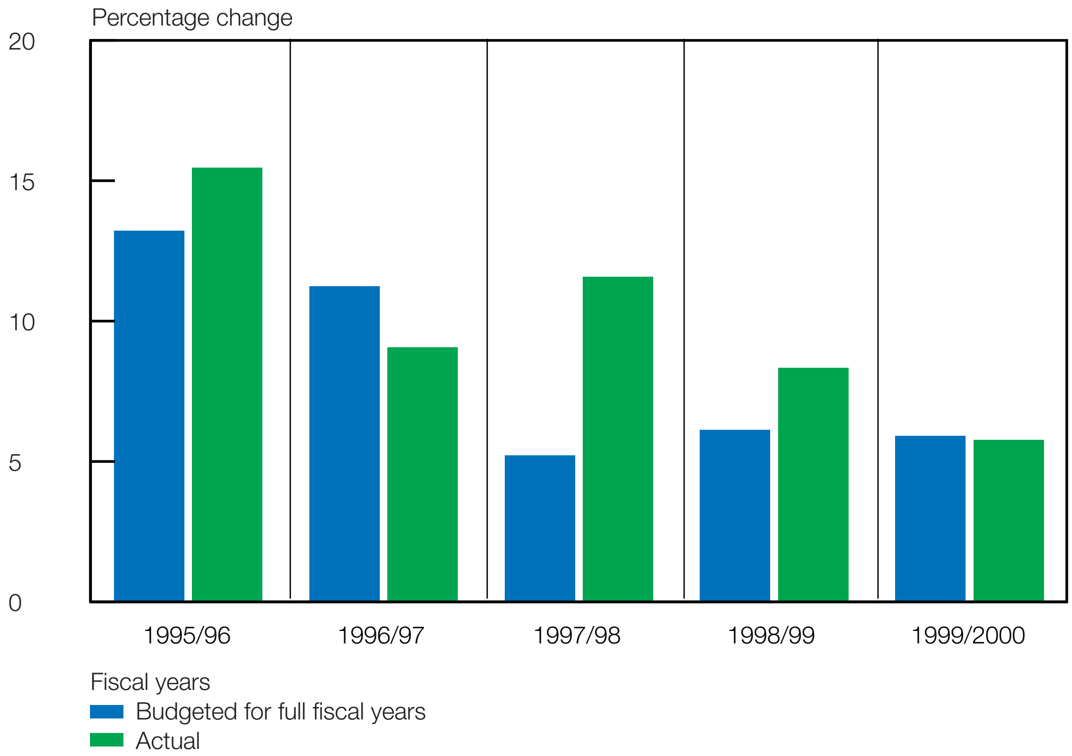
National government expenditure in the April-June quarter of 1999 amounted to R53,1 billion which was 4,6 per cent higher than in the corresponding quarter of 1998. This increase was significantly lower than the average year-on-year rate of increase of 11,9 per cent in the first quarters of the five preceding fiscal years and 1,3 percentage points lower than the increase of 5,9 per cent envisaged in the Budget of the national government for the full fiscal year. National government expenditure as a ratio of gross domestic product amounted to 27,0 per cent in the first quarter of fiscal 1999/2000 – lower than the ratio of 27,7 per cent recorded in the corresponding quarter of the previous fiscal year. After allowing for cash-flow adjustments, total expenditure increased by only 0,4 per cent to amount to R51,4 billion in the April-June quarter of 1999 compared with R51,2 billion in the corresponding period of the previous fiscal year.

National government expenditure in April-June quarter



If national government expenditure in July 1999 is also taken into consideration, the year-on-year rate of increase in the first four months of fiscal 1999/2000 came to 5,8 per cent. The cash-flow adjusted expenditure in the first four months of fiscal 1999/2000 amounted to R67,3 billion, compared with the amount of R65,9 billion recorded in the same period of the previous fiscal year. This low rate of increase in

Budgeted and actual national government expenditure for April-July



the first four months of fiscal 1999/2000 can be attributed to an increase in the outstanding transfers (i.e. requisitions from the Exchequer account not yet spent) at the end of July 1999, as the month-end fell on a Saturday.

Revenue received by national government amounted to R40,0 billion in the April-June quarter of 1999 which represents a year-on-year rate of increase of 8,7 per cent. The Budget for fiscal 1999/2000 envisaged an increase of 4,8 per cent on the actual collections of the previous year.

Percentage increase in national government revenue in fiscal 1999/2000*

Revenue source	Budgeted	Actual	
		April–June	April–July#
Inland revenue	**5,2**	**8,6**	**8,0**
Income tax	3,4	9,6	...
Value-added tax	7,7	-6,1	...
Other inland revenue	5,6	26,1	
Customs and excise duties	**1,8**	**9,0**	**1,5**
Customs duty	10,8	-5,0	...
Fuel levy	5,9	6,9	...
Other excise duties	9,5	7,1	...
Total revenue	**4,8**	**8,7**	**7,2**

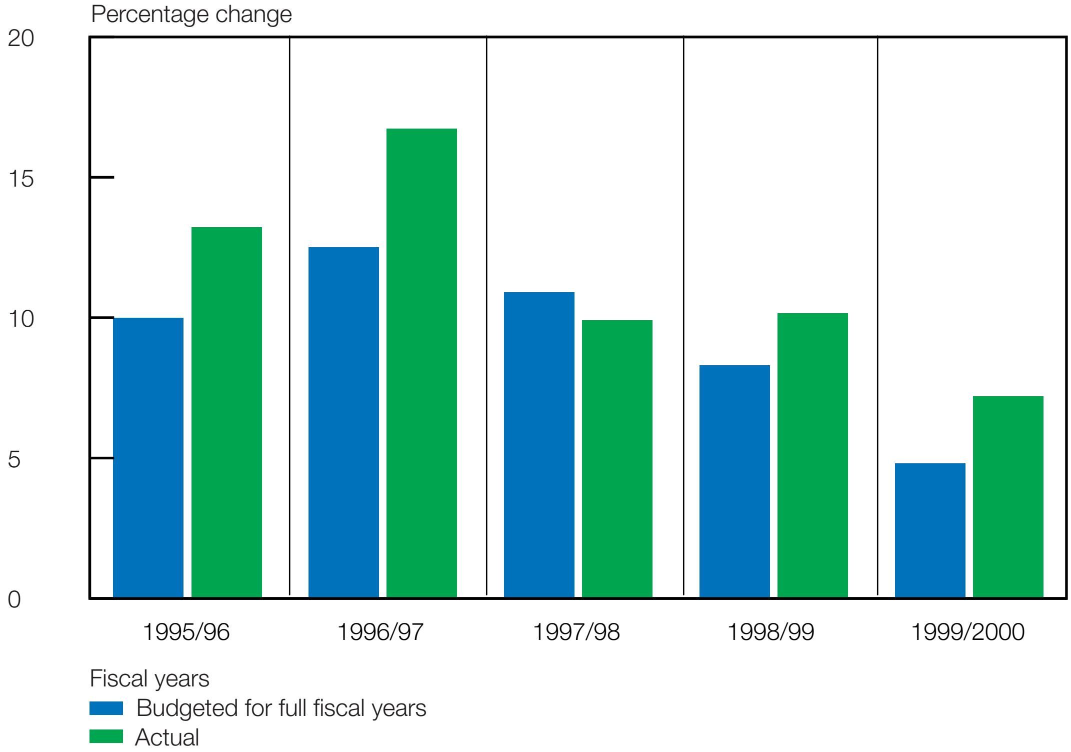
* Based on the actual outcome of previous fiscal years
\# Details for July 1999 not available at time of publication

The increase in the revenue of national government was mainly the result of a higher than budgeted increase in inland revenue. Inland revenue increased at a rate of 8,6 per cent in the April-June quarter of 1999 compared with a budgeted rate of increase of 5,2 per cent for the fiscal year as a whole. This increase was due to continued buoyancy in the receipts of income tax which counteracted the decline in the collection of value-added tax. The decline in value-added tax revenue was in part a consequence of slackness in private household expenditure, but was also affected by delays in electronic payments at the end of June 1999. Other inland revenue increased at a rate of 26,1 per cent, but this represents only a small component of national government revenue. Revenue from customs duties fell below its level in the corresponding period of the previous year, largely because of a decline in domestic expenditure which affected import values, and reductions in the tariffs imposed on imported merchandise.

National government revenue as a ratio of gross domestic product increased slightly from 20,1 per cent in the first quarter of fiscal 1998/99 to 20,3 per cent in the first quarter of 1999. After allowance had been made for cash-flow adjustments, national government revenue amounted to R40,3 billion in the April-June quarter of 1999. This represents an increase of 9,5 per cent over the same period in the previous fiscal year.

National government revenue in July 1999 amounted to R16,9 billion and brought the revenue for the first four months of fiscal 1999/2000 to R56,9 billion or 7,2 per cent more than in the same period of fiscal 1998/99. The relatively high rate of increase in national government revenue was once again the result of unexpectedly strong growth in inland revenue. Inland revenue increased at a rate of 8,0 per cent to reach R50,2 billion in the first four months of fiscal 1999/2000. The receipts from customs and excise duties increased at a year-on-year rate of 1,5 per cent in the first four months of fiscal 1999/2000 – approximately equal to the rate envisaged in the Budget. National government revenue adjusted for cash flows associated with surrenders by government departments and other receipts, amounted to R57,9 billion or 8,1 per cent more than in the first four months of fiscal 1998/99.

Budgeted and actual national government revenue for April-July



The net result of the revenue and the expenditure of national government in the April-June quarter of 1999 was a *deficit before borrowing and debt repayment* of R13,1 billion. As a ratio of gross domestic product, the deficit came to 6,7 per cent in the April-June quarter of 1999. This can be compared with the 7,6 per cent that was realised in the corresponding quarter of the previous fiscal year. After adjustments for cash flows, the deficit amounted to R11,1 billion in the April-June quarter of 1999.

The net result of the national government revenue and expenditure in July 1999 was a surplus of R1,5 billion which brought the *national government deficit before borrowing and debt repayment* down to R11,6 billion in the *first four months* of fiscal 1999/2000. The deficit before borrowing and debt repayment, adjusted for cash flows, amounted to R9,4 billion in the first four months of fiscal 1999/2000. The cash-flow deficit was financed as indicated in the accompanying table.

Financing of national government deficit in the first four months of fiscal 1999/2000

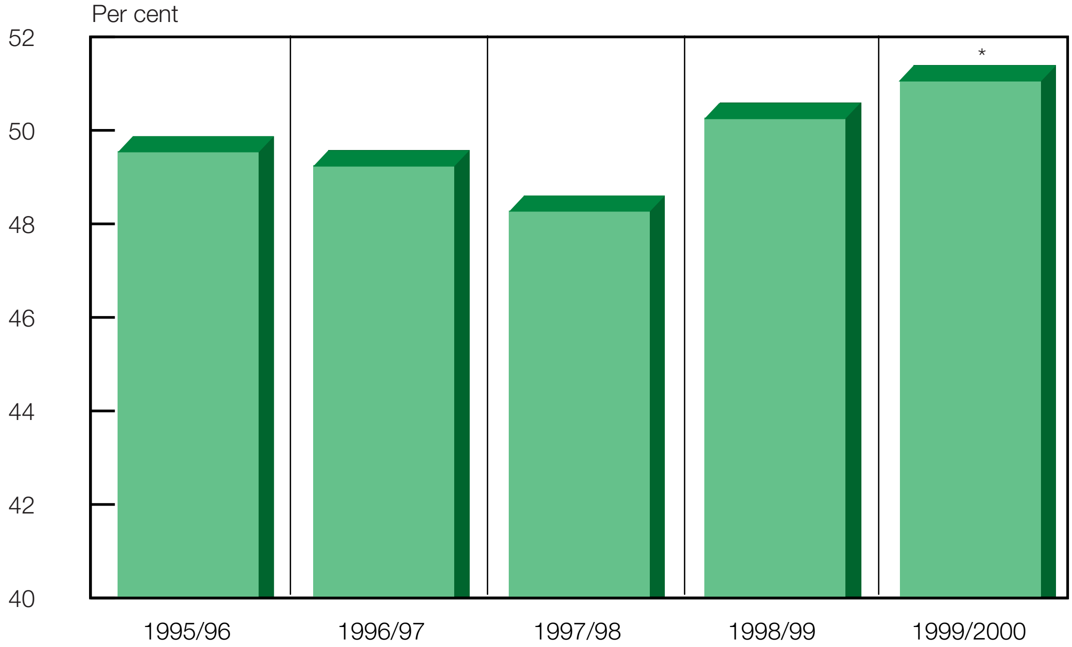
Financing instrument	R billions
Government bonds (including discount)	9,3
Less: Discount on new government bonds	1,4
Net receipts from government bonds	7,9
Treasury bills	0,9
Foreign loans	6,3
Other financing	-0,4
Change in available cash balances (increase -)	-5,3
Cash balances with the Reserve Bank	0,1
Cash balances with banks	-5,4
Total net financing	9,4

Long-term government bonds issued in the domestic capital market remained the principal means of financing the government's deficit and issues of government bonds to the nominal value of R9,3 billion were made in the first four months of fiscal 1999/2000. These funds were obtained at an average interest cost of 14,2 per cent per annum which can be compared with a budget assumption of an average of 14,0 per cent for fiscal 1999/2000 as a whole. Issues of Treasury bills contributed only R0,9 billion to the financing needs of government in the first four months of the current fiscal year. The domestic demand for financing was reduced by the proceeds from two foreign currency denominated bond issues. The 7-year eurobond issue to the value of euro500 million and the 10-year dollar bond issue to the value of US$500 yielded R6,3 billion for the Exchequer. These issues contributed to a lengthening of the average outstanding maturity of government's foreign debt from 76 months at the end of March 1999 to 80 months at the end of July 1999 and completed the foreign borrowing programme envisaged in the Budget for fiscal 1999/2000.

Total *national government debt* increased from R377,7 billion at the end of March 1999 to R390,5 billion at the end of June. Apart from the need to finance the deficit of national government, government debt was also expanded by the higher rand value of outstanding foreign-currency denominated debt and some early borrowing to accumulate cash balances ahead of the large interest payments due towards the end of August. At the end of June 1999 total national government debt was equivalent in value to 51,0 per cent of gross domestic product, compared with 49,1 per cent a year earlier and 50,3 per cent at the end of March 1999. The debt of national government increased further to amount to R393,9 billion at the end of July 1999.

With the aim of transforming state-owned enterprises from cost centres for government into commercial businesses, the Ministry of Public Enterprises announced that a legislative framework for the restructuring and privatisation programme is to be drawn up. This framework will reiterate government's commitment to the restructuring of state assets and will provide greater certainty about the rules and processes to be followed during the transfer of ownership of public enterprises to the private sector.

National government debt as a ratio of gross domestic product



As at 31 March
* As at 30 June

Progress with the sale and restructuring of state assets was also announced in recent months. After the announcement that Swissair had acquired a 20 per cent interest in South African Airways (SAA) for R1,4 billion, it was announced that the Swiss carrier has the option of buying a further 10 per cent of the issued share capital of the company in the next six months. Another 5 per cent equity interest has been earmarked for black economic empowerment, and it is expected that SAA employees will also benefit from the privatisation initiative. It was also announced that a further 10 per cent of the share capital of Telkom will be sold. Shares will be allotted to the National Empowerment Fund (5 per cent), black economic empowerment (3 per cent) and unions and Telkom staff (2 per cent). A preferred bidder for a strategic management partnership with the Post Office and the possible restructuring of Post Bank has been announced. In an effort to turn the state-owned resort group, Aventura, into a viable business concern, government awarded a five-year management contract to a hotel group in terms of which they will take full operational responsibility for the resorts. The deadline for bids on the South African Forestry Company was set at 31 August 1999. The commercial forestry assets with an approximate value of between R1,0 billion and R1,5 billion will be offered on a long-term lease.