Quarterly Economic Review

June 1999

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South African Reserve Bank

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Introduction

The business cycle in South Africa reached an upper turning point in November 1996. In the ensuing eighteen months or so business conditions gradually deteriorated as the downswing continued. Growth in aggregate output nevertheless proved fairly resilient. The real gross domestic product continued to expand throughout the six quarters from the beginning of 1997 to the middle of 1998.

In the early months of 1998 there was good reason to believe that the economy was heading for a "soft landing" and that the downswing would probably not degenerate into a fully-fledged recession with a prolonged period of declining output. During the first four months of 1998 fiscal policy was consolidated further and placed on a sound footing, the growth in credit extension and money supply was slowing down, international reserves were increasing, capital market interest rates were declining, inflation was on the wane and expectations were high that interest rates would generally decline further in the second half of the year.

From about May 1998 economic developments in South Africa were adversely affected by the financial crises in Southeast Asian countries and by those that unfolded later in Russia and Latin America. When after-effects of these crises spilled over into South Africa and international portfolio capital flowed out of the domestic bond market, monetary conditions tightened rapidly. Short-term interest rates rose to high levels and this helped to preserve overall financial stability and ward off the danger of repetitive rounds of exchange rate depreciations and domestic cost and price increases.

The aftershocks of the international crisis triggered sharp declines in the interest-rate sensitive components of domestic demand, such as inventory levels, household spending on durable goods and private-sector fixed capital formation. Furthermore, the steep decline in output in the countries of Southeast Asia affected by the crises effectively reduced the demand for exports from South Africa directly, and indirectly through the impact of the decline on business conditions in the advanced economies of the world. Domestically, the downswing intensified and the real gross domestic product contracted in the third quarter of 1998 – for the first time since the first quarter of 1994.

The setback in the third quarter was nevertheless short-lived. Led by a return to positive output growth in the manufacturing sector and the continued expansion of the services sectors, overall economic growth recovered somewhat in the fourth quarter of 1998. This modest recovery was sustained in the first quarter of 1999 when aggregate gross domestic production expanded at an annualised rate of ½ per cent. Although the rate of growth was still rather muted, more of the main production sectors began to record increases in real value added.

During most of 1998, the high levels of capital spending by parastatals increased real gross domestic expenditure at a pace that exceeded overall economic growth, raising concern about the increase in external deficits. By the first quarter of 1999, however, some of the expansion programmes of the parastatals had apparently run their course and aggregate real gross capital formation declined sharply. Real consumption expenditure by private households and general government also declined and inventory levels were reduced once again.

The combined effect of the decline in real domestic spending and the small increase in output was an improvement in the domestic saving ratio in the first quarter of 1999. Gross domestic saving as a percentage of gross domestic product reached 15 per cent in the first quarter of 1999 – the highest ratio since the third quarter of 1995. This domestic saving ratio was still considered too low for sustained high rates of economic growth and employment creation.

Aggregate remuneration of labour continued to grow faster than the operating surpluses of business enterprises during 1998 and in the first quarter of 1999. In an increasingly competitive environment, businesses experienced difficulties in recovering these additional costs through increases in their output prices. The reduction in the pricing power of businesses helped to contain production price inflation over the past three calendar quarters, but at the same time operating surpluses and therefore rates of return on invested capital came under greater pressure. However, it is not uncommon for operating surpluses to be compressed during downward phases of the business cycle when demand usually tends to be weak.

Employment in the formal sectors of the economy has been declining since 1989. This long-term decline in overall employment was aggravated by the current cyclical downswing in economic activity. In addition, government generally was committed to higher cost efficiency in public-service delivery and to this end, reduced the size of its workforce in the second half of 1998.

Nominal salaries and wages per worker in the non-agricultural sectors continued to increase in the second half of 1998. Although labour productivity increased at a fairly robust rate, this was not sufficient to prevent a more rapid rise in nominal unit labour costs during 1998. The impact of these and other cost-raising factors, such as higher agricultural prices and electricity tariffs, became discernible in a modest acceleration in the production prices of domestically produced goods in the first quarter of 1999. Overall consumer price inflation and core inflation nevertheless continued to slow down in the first quarter, signalling that the inflationary potential of the 1998 decline in the exchange value of the rand had been well contained so far.

Largely reflecting the sharp decline in gross domestic expenditure and the higher cost of imported goods, imports declined sharply in the first quarter of 1999. At the same time, exports rose strongly as the Southeast Asian economies began to recover and domestic producers expanded into export markets. These developments led to a quick transformation of the deficit on the current account into a surplus that was equivalent to about 1 per cent of gross domestic product in the first quarter of 1999.

Although net international capital flows into South Africa declined strongly during 1998, there was still a net inflow of capital into the economy for the year as a whole. A further inflow occurred in the first quarter of 1999. Net international capital inflows diminished in 1998 as inward foreign direct investment flows subsided and eventually developed into some disinvestment in the fourth quarter, while outward direct investment by South African organisations continued at a high level. Outward portfolio investment by resident institutions, mainly through the asset swap mechanism, also gathered momentum in 1998. In the first quarter of 1999, inward portfolio investment flows strengthened appreciably and there was a resumption of direct investment flows into the economy. As a consequence, there was a healthy surplus on the international capital transfer and financial account in the first quarter of 1999.

Together, the surpluses on the current and financial accounts of the balance of payments occasioned a sizeable increase in the country's international reserves. This contributed to a reduction in the net open position in foreign currency of the Reserve Bank, in this way lowering the exposure to risk that might arise from fluctuations in the exchange rate. Despite a strong increase in turnover in the market for foreign exchange, which often corresponds with exchange-rate weakness, the nominal effective exchange rate of the rand remained relatively stable during the first five months of 1999.

The growth in M3 slowed down quite perceptibly from the third quarter of 1998 as the general public reduced their liquidity preference and lengthened their expectations of a recovery in the economy. As a result the growth in M3 moved within the guideline range indicated by the Reserve Bank. The growth in bank credit extended to the private sector, particularly that to the private corporate sector, slowed down to levels far more compatible with expectations of low inflation. This positive development, from a perspective of inflation reduction, was probably a delayed response to the sharp rise in the cost of bank credit in the second and third quarters of 1998.

Money market conditions eased considerably during the first four months of 1999. Liquidity emanating from an increase in the Reserve Bank's net foreign assets and from transactions of the Bank in the forward foreign-exchange market, occasionally reduced the private banks' dependency on central bank funds to low levels. With an eye to managing changes in short-term interest rates, the Reserve Bank used various methods to drain liquidity from the market in April and May 1999.

In the second half of May 1999, the Bank also signalled that a pause in the decline of money market interest rates might be warranted as problems in Russia were once again threatening the financial stability in emerging markets and because of some nervousness in the markets ahead of the elections in South Africa. At the same time, the price of gold went into steep decline, threatening to revert the current account of the balance of payments to a deficit.

Bond yields moved decisively lower in the first three months of 1999. Pre-election nervousness, together with the weak gold price and events in other parts of the world, caused yields on long-term government bonds to move gradually higher towards the end of May 1999. Share prices strengthened, on balance, in the first four months of 1999, but fell back in May when adverse developments in the bond market echoed in the share market. Despite the price fluctuations in the bond and equity markets, non-resident investors maintained a strong presence as net buyers of bonds and shares in the domestic securities markets throughout the first five months of 1999.

Substantial progress has been made over the past fiscal year in strengthening fiscal policy by reducing the national government's budget deficit and the overall public-sector borrowing requirement. The outcome of the national government's actual deficit in fiscal 1998/99 was well below the targets indicated by the Minister of Finance when the Budget was presented to Parliament in March 1998. The public-sector borrowing requirement was reduced, equally impressively, from 9,4 per cent of gross domestic product in fiscal 1993/94 to 3,7 per cent in fiscal 1998/99, thus removing earlier concerns about unsustainable public-sector debt growth and the concomitant potential for crowding out of the private sector from the domestic capital markets. Government's commitment to sound fiscal policy was further demonstrated by the curbing of growth in public-sector expenditure in the face of a downswing in general economic activity.

Towards the middle of 1999 a substantially better balanced macroeconomic situation has been attained. Further positive factors are that the prospects for the global economy have improved since the second half of 1998. Strong growth has continued in the United States economy and the euro area is expected to respond in due course to the easing of monetary conditions and the depreciation of the euro. The implementation of reform measures in many emerging-market economies has also strengthened global economic performance. Trends in total economic activity have turned around or appear to have bottomed out in the Southeast Asian economies and in Japan. Economic growth on the African continent is also expected to be relatively strong in 1999.

Because investor sentiment towards emerging markets generally has improved, the South African economy is likely to continue to benefit from capital flows from the mature financial markets of the world. All these hold the promise of a stronger recovery in the second half of 1999. This will probably spill over into the new millennium, resulting in a rate of economic expansion which is likely to be stronger in 2000 than in 1999.

Domestic economic developments[1)]

Domestic output

Revised estimates of national accounts aggregates indicate that an uninterrupted series of 17 quarterly increases in the real gross domestic product (seasonally

1) The analysis in this section of the review is based on an extensively revised set of national accounts estimates. Estimates of the national accounts aggregates at constant prices are now based on 1995, instead of 1990 as before.

Growth in real gross domestic product

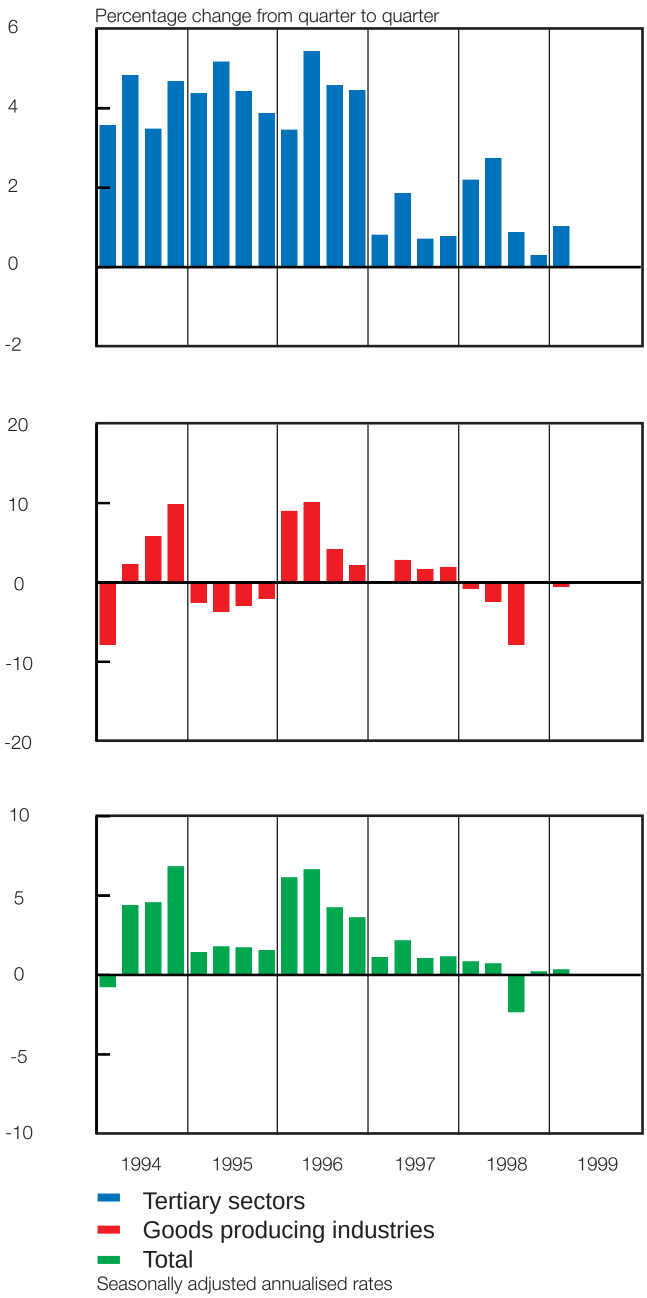


Table 1. Real gross domestic product
Percentage change at seasonally adjusted and annualised rates

	1997					1998					1999
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr
Primary sectors	-8½	1½	7	6½	2	-3	-2½	-12	-½	-½	-3
Agriculture	-21	-3	12½	15	2½	-4	-3½	-24	-½	-1	-4½
Mining	1	4½	3½	1	1½	-2	-1½	-2½	-1	-½	-2
Non-agricultural sectors	1½	2½	½	½	2½	1½	1	-1½	0	½	½
Secondary sectors	4	3½	-½	0	2½	0	-2½	-6	½	-1	½
Manufacturing	4½	3½	0	0	2½	-½	-4	-8	½	-2	½
Tertiary sectors	1	2	½	1	2½	2	2½	1	½	1½	1
Total	**1**	**2**	**1**	**1**	**2½**	**1**	**½**	**-2½**	**0**	**½**	**½**

adjusted and annualised) came to end in the third quarter of 1998 when total real value added in the economy declined at an annualised rate of 2½ per cent. This setback was nevertheless short-lived and aggregate output subsequently recovered slightly in the fourth quarter of 1998 and increased at an annualised rate of about ½ per cent in the first quarter of 1999. For 1998 as a whole, the growth in real gross domestic product is now estimated at ½ per cent – well below the growth of 2½ per cent in 1997.

The continuation of the moderate rise in aggregate output in the first quarter of 1999 was essentially a reflection of an increase in output originating in the secondary and tertiary sectors of the economy. Production volumes in the agricultural and mining sectors declined in the first quarter of 1999.

Total output in the *mining sector*, which had declined in each of the four quarters of 1998, declined further at an annualised rate of 2 per cent in the first quarter of 1999. Gold production, in particular, declined as producers reacted to sustained cost pressures and a relatively static gold price. Production volumes in the other branches of the mining sector, especially diamond, platinum and coal mining, rose slightly as these mines benefited from more stable international commodity prices and uncertain supplies of diamonds and platinum from the Russian Federation.

A decline in the real value added by the *secondary sectors* of the economy during the middle quarters of 1998 was followed by modest increases in the fourth quarter of 1998 and in the first quarter of 1999. The

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

Components	1997					1998					1999
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr
Private consumption expenditure	3	2	2	½	2½	2	1	1	0	1½	-½
Government consumption expenditure	-5	-5	-5	-3½	3½	4	3½	3	2	½	-1
Gross fixed capital formation	8½	5	3½	1½	5	3	8½	10	4½	5	-22½
Domestic final demand	2	1	1	0	3½	2½	3	3	1½	2	-5
Change in inventories (R billions)*	-0,9	-0,7	-1,4	-1,0	-1,0	-4,3	-7,6	-4,2	-4,2	-5,1	-7,9
Gross domestic expenditure	**5½**	**1**	**-½**	**½**	**2½**	**-2**	**1½**	**5**	**½**	**½**	**-12½**

* Constant 1995 prices

manufacturing sector roughly maintained its slight growth momentum of the fourth quarter of 1998, but output growth in the utilities sector (i.e. the sector supplying electricity, gas and water) accelerated somewhat in the first quarter of 1999. This small acceleration arose because domestic activity became slightly less subdued than before and because the demand for electricity from neighbouring countries picked up somewhat. Real value added by the *construction sector* responded in delayed fashion to the third-quarter rise in home mortgage rates and declined in the first quarter of 1999.

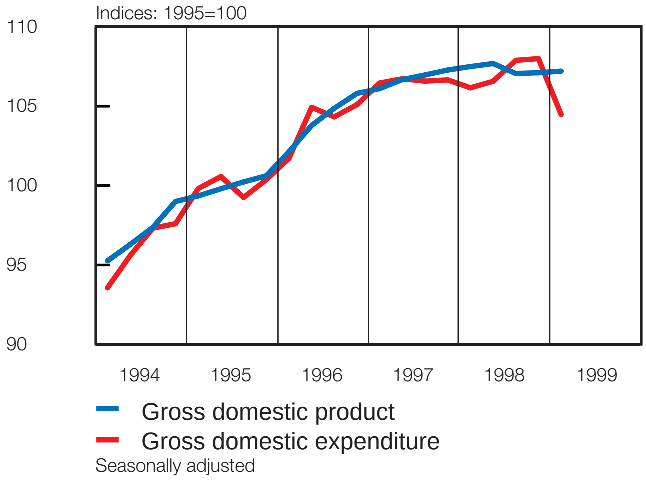
Activity in the *tertiary sectors* slowed down perceptibly from an annualised growth of 2½ per cent in the second quarter of 1998 to ½ per cent in the fourth quarter and 1 per cent in the first quarter of 1999. The growth in real value added by the sector *finance, insurance, real-estate and business services* slowed down from an annualised rate of 2 per cent in the fourth quarter of 1998 to 1½ per cent in the first quarter of 1999, most notably because of a decline in the number of real-estate transactions concluded. The rapid expansion of telecommunication services decelerated in the first quarter of 1999 and the real value added by the transportation and communication sector rose at an annualised rate of 3 per cent, compared with growth of 3½ per cent in the fourth quarter of 1998.

Business conditions in the *commercial sector* remained rather depressed in the first quarter of 1999. Real value added in this sector had contracted in all four quarters of 1998 at annualised rates of between ½ per cent and 3½ per cent; a further decline at an annualised rate of 1 per cent followed in the first quarter of 1999. Activity in the wholesale, retail and motor trade sectors was badly affected by a deterioration in consumer confidence and the high cost of bank credit. By contrast, the *catering and accommodation* sectors continued to experience lively conditions and the real value added by these sectors increased in the first quarter of 1999.

Domestic expenditure

Exceptionally strong flows of fixed capital expenditure by public corporations kept *real gross domestic expenditure* at high and rising levels in the last three quarters of 1998.

Real gross domestic product and expenditure



This was followed by a sharp decline in capital spending by parastatal corporations in the first quarter of 1999, aggravating the already existing weaker undertone in the other main components of gross domestic expenditure. Following successive increases in the last three quarters of 1998, real gross domestic expenditure declined at an annualised rate of 12½ per cent in the first quarter of 1999.

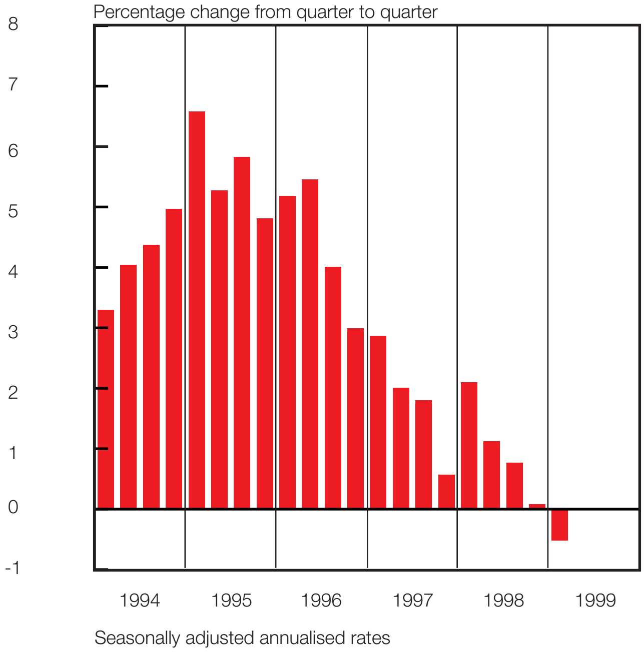
Real *private consumption expenditure*, which had experienced weak growth from the second quarter of 1998, declined at an annualised rate of ½ per cent in the first quarter of 1999. The decline in the first quarter of 1999 was mostly concentrated in interest-rate sensitive household spending on durable goods, especially motor vehicles and furniture. The other components of private consumption expenditure still increased in the first quarter of 1999, albeit at rates generally lower than in the preceding quarter.

The weakening and eventual decline of the growth in private consumption expenditure can be attributed to a set of circumstances which impacted directly on consumer attitudes and behaviour. These were:

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

	1998					1999
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr
Durable goods..................................	6	-4	-9½	-23	½	-19½
Semi-durable goods..........................	4½	4	½	½	2½	-1
Non-durable goods...........................	0	0	1	0	1	1
Services..	3	2½	3	5	3	2
Total	**2**	**1**	**1**	**0**	**1½**	**-½**

Growth in real private consumption expenditure



- low levels of consumer confidence as job prospects turned bleaker and job security diminished;
- smaller increases in the real income of households as overall economic growth remained at low levels and no net additions were made to the total number of gainfully employed people;
- the high cost of obtaining consumer credit and home mortgage loans;
- the deterioration of household perceptions of wealth as real-estate values declined in many parts of the country and bond and share prices performed poorly from the second quarter of 1998; and
- the desire among most households to strengthen balance sheets by working down outstanding household debt. Aggregate household debt as a percentage of the disposable income of households accordingly declined from 61½ per cent in the first quarter of 1998 to 59 per cent in the first quarter of 1999.

Real consumption expenditure by general government also contributed to the decline in gross domestic expenditure in the first quarter of 1999. During 1998 real consumption expenditure by general government had still added to growth in overall spending, although at a consistently declining rate from one quarter to the next. The first quarter of 1999 then saw a decline at an annualised rate of 1 per cent in the level of general government consumption expenditure. Spending by government departments on intermediate goods and services was kept in check and the growth in employment numbers in the civil service was curbed so as to stay within budgetary constraints.

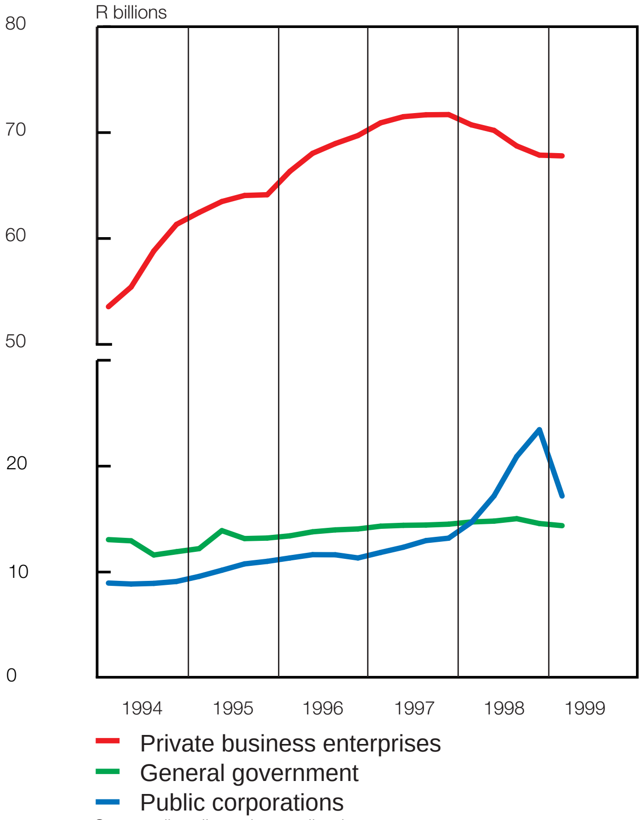
Total *real gross fixed capital formation* shrank at an annualised rate of 22½ per cent in the first quarter of 1999, following strong expansions of between 4½ and 10 per cent per quarter during the last three quarters of 1998. The high level of fixed capital spending in 1998 was essentially due to the acquisition of new aircraft by South African Airways and to accelerated spending by Telkom on the expansion of the telecommunications network to previously under-serviced areas. As South African Airways discontinued their expansion programme and Telkom did not raise capital spending levels beyond those of the second half of 1998, gross fixed capital formation by public corporations declined sharply in the first quarter of 1999, thus reinforcing the already existing declining tendencies in the private sector and in general government.

Gross fixed capital formation in the *private sector* has now declined for five quarters in succession. A decline at an annualised rate of about ½ per cent was registered in the first quarter of 1999, giving some indication that the pace of decline might have been slowing down from 1998 when declines of 8 per cent in the third and 5 per cent in the fourth quarter had been recorded. Apart from the mining and manufacturing sectors where investment activity expanded somewhat, real gross fixed capital formation in the other major sectors of the private economy declined in the first quarter of 1999. Cuts in fixed investment spending were particularly severe in the

Table 4. Real gross fixed capital formation
Percentage change at seasonally adjusted and annualised rates

Institutional sectors	1998					1999
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr
Private sector	-5½	-3	-8	-5	-3	-½
Public corporations............................	53½	87½	119	58	51½	-71
General government...........................	6	2	6½	-11½	2½	-5½
Total	**3**	**8½**	**10**	**4½**	**5**	**-22½**

Components of real gross fixed capital formation



Seasonally adjusted annualised rates

Gross operating surplus and compensation of employees

private agricultural sector. The installation of cost-saving capital equipment in some areas of the mining industry and an expansion of mining operations elsewhere contributed to a relatively firm expansion in mining-sector fixed investment spending in the early months of 1999.

During 1998 *inventory levels* were reduced sharply as businesses economised on their inventory holdings. Faced by the high costs of carrying inventories, rising prices of imported goods and limited prospects of an imminent recovery in domestic demand, firms found it necessary to reduce inventory levels further in the first quarter of 1999. In fact, the rate of inventory cutbacks accelerated noticeably from the fourth quarter of 1998, compressing domestic economic growth by about 2½ percentage points in the first quarter of 1999.

Factor income

The growth over four quarters in aggregate *nominal factor income* slowed down from 7 per cent in the fourth quarter of 1998 to 6 per cent in the first quarter of 1999. This slowdown was due to slower growth in the operating surpluses of business enterprises and in total labour remuneration.

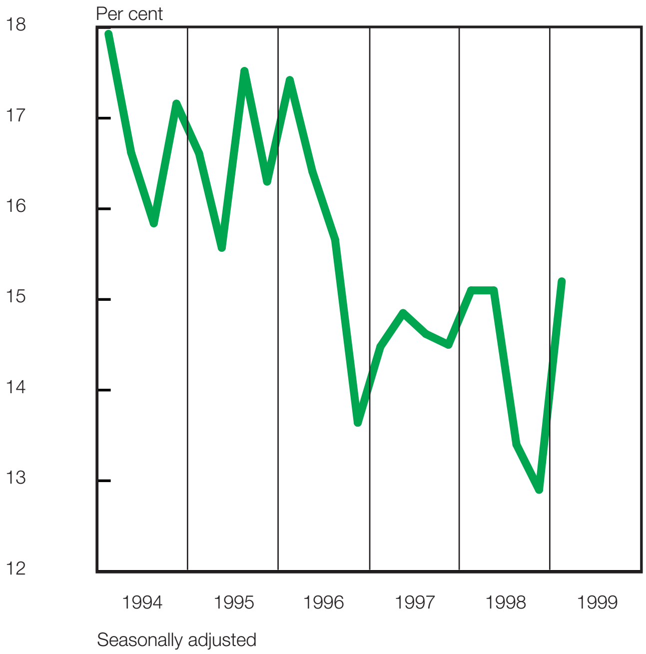
Growth in the nominal gross operating surpluses of business enterprises, measured over periods of four quarters, slowed down from 6 per cent in the fourth quarter of 1998 to 5½ per cent in the first quarter of 1999. The growth in total compensation of employees also slowed down, but at 9 per cent in the fourth quarter of 1998 and 8½ per cent in the first quarter of 1999, it still exceeded the growth in gross operating surpluses by a fair margin. Faster growth in labour remuneration than in operating surpluses implies a shift in the distribution of factor rewards away from employers and in favour of workers. Such a development is not uncommon during times of economic slack when corporate income is usually more flexible in adapting to changes in business conditions than is labour compensation.

Gross saving

The ratio of gross saving to gross domestic product improved substantially from 13 per cent in the fourth quarter of 1998 to 15 per cent in the first quarter of 1999. With aggregate investment demand falling from the fourth quarter of 1998 to the first quarter of 1999, the newly found strength of gross saving meant that the South African economy had an excess of saving over capital formation for the first time since the second quarter of 1994. Inflows of capital from the rest of the world augmented the supply of domestic savings, thus allowing for a significant accumulation of international reserves during the first quarter of 1999.

The saving ratio improved in all three of the institutional sectors usually identified as the principal contributors to gross saving, namely the private household and corporate

Gross saving as percentage of gross domestic product



sectors and general government. Despite relatively weak growth in real household income, the overall reduction in spending and the efforts made to reduce accumulated debt resulted in a marginal improvement in household savings relative to gross domestic product. Similarly, and in spite of mounting cost pressures and a slowdown in the growth of business operating surpluses, the corporate sector managed to lift its retained earnings and other forms of saving by more than the growth in nominal gross domestic product. Government's resolve to adhere to sound public-finance policies was also reflected in a decline in the net dissaving by general government as a percentage of gross domestic product from 4 per cent in the fourth quarter of 1998 to 3 per cent in the first quarter of 1999.

Employment

The slowdown in global economic activity following the adverse developments in international financial markets, the constant pressure on domestic producers to be competitive in an increasingly integrated world economic system and the cyclical downswing in domestic economic activity, combined to reduce the aggregate level of employment during 1998. Employment in the regularly surveyed *formal non-agricultural sectors of the economy* accordingly declined by 189 000 workers in the year to December 1998, or by 3,7 per cent.

Despite the deterioration of growth in domestic production, the decline from quarter to quarter in *private-sector employment* slowed down perceptibly in the course of 1998. This slowdown was also reflected in a decline in the number of applications for assistance from the Unemployment Insurance Fund (UIF) from more than 300 000 applications per month by the middle of 1998 to 250 000 per month in the early part of 1999. The year-on-year rate of growth in the number of beneficiaries of the UIF consequently declined from 25,5 per cent in the second quarter of 1998 to 17,2 per cent in the third quarter.

The pace of employment declines in the *private sector* generally slowed down in most of the major economic sectors during the fourth quarter of 1998. Slowdowns in labour paring were observed, especially in the gold-mining and the financial intermediation and insurance sectors, whereas employment actually increased in the trade, catering and accommodation sectors and in laundries and dry-cleaning services. By contrast, the rate of job declines in the construction industry accelerated from an annualised 9,6 per cent in the third quarter of 1998 to 20,5 per cent in the fourth quarter. Activity, and therefore also employment in the construction sector, are known to be more sensitive to changes in financing costs than in most of the other major economic sectors.

Total employment by the *public sector* increased in the first half of 1998, but then started to decline towards the end of that year. The decline in the second half of 1998 occurred almost throughout the public sector, apart from the national government departments where employment numbers expanded somewhat. Declines in employment by public-sector bodies during times of economic slowdowns are, however, not typical; employment by the public sector tended to increase during most of the cyclical downward phases of the economy in the 1970s and 1980s. The current decline in public-sector employment in a period of slackness in the economy should therefore be seen as evidence of the government's resolve to improve efficiency in public-service delivery and reduce the overall size of the public sector.

The *Employment Equity Act* which became law on 16 October 1998 will be given effect in four different phases. The Commission for Employment Equity was, firstly, established on 14 May 1999, to be followed by the promulgation of the prohibition of unfair discrimination at work on 9 August 1999. Parts of the Act which relate to the preparation of employment equity plans and the submission of reports to the Department of Labour by employers of more than 50 people or those with an annual turnover of more than a certain amount will follow in December 1999. Such employers are required to report on their equity plans to the Department of Labour in December 2000 as well as to submit a statement on the remuneration and benefits received in each occupational category of the workforce. Employers who employ more than 150 people are expected to report on their equity plans in June 2000. Regulations in the Act which pertain to government tenders will be implemented between September 2000 and April 2001. The Act requires that companies employing more than 150 people and intending to submit government tenders will have to present confirmation of compliance with the specifications of the Act.

The *Skills Development Act* of 1998 will endeavour to strengthen education and training efforts in order to meet the skills shortages in different sectors of the economy and to increase investment in training. The Act will establish institutions such as the National Skills Authority, various sectoral and training authorities and the National Skills Fund to be financed through a training levy on payrolls. Accordingly, the budget of the national government for 2000/2001 will include as revenue a Skills Development Levy of 0,5 per cent of the total payroll of private-sector employers and a levy of 1 per cent in the following year. Furthermore, to address the difficulties facing new entrants to the labour market, the Act will introduce a new learnership system which combines learning with work experience in areas where there is a clear demand. Those already employed will also be afforded more extensive training to improve productivity and efficiency.

Table 5. Labour costs and productivity
Percentage change over four quarters

Period	Remuneration per worker		Productivity	Nominal unit labour costs
	Nominal	Real		
1998: 1st qr* ...	14,3	5,3	6,2	7,6
2nd qr	15,8	7,3	5,5	9,8
3rd qr	13,3	5,4	4,8	8,1
4th qr.....	19,2	11,6	4,1	14,5
Year........	**15,7**	**7,4**	**5,1**	**10,0**

* Introduction of new labour market survey methodology

Labour costs and productivity

The downswing in economic activity from the end of 1996 and the decline in total employment in the formal sector of the economy apparently had a limited effect on restraining the rate of growth in nominal remuneration per worker during 1998. According to the latest information available, *nominal remuneration per worker* in the formal non-agricultural sectors increased at a higher rate in 1998 than the 10,7 per cent recorded in 1997. Admittedly, part of the rise in 1998 was the result of a change in survey methodology which could have imparted some upward bias to the estimates of remuneration growth. There was also a distinct acceleration in the year-on-year growth in nominal labour remuneration per worker from the third quarter of 1998 to the fourth quarter.

The sharp rise in average remuneration per worker in the fourth quarter of 1998 can primarily be attributed to an increase in the payment of annual bonuses and for overtime worked, and payments to some public-service officials who received their annual salary and wage increases only in the fourth quarter whereas in previous years these pay adjustments had mostly been made in the third quarter. For 1998 as a whole, the growth in average nominal *remuneration per worker in the public sector* accelerated from 10,9 per cent in 1997 to 11,7 per cent. The corresponding acceleration in the remuneration of *private-sector employees* was more substantial, but there were signs that the pace of remuneration growth in the private sector was tapering off in the early part of 1999. A private-sector labour-market consultancy recently indicated that the average settlement rate in collective bargaining agreements declined from an average of 8,6 per cent in 1998 to 8,0 per cent in the first quarter of 1999.

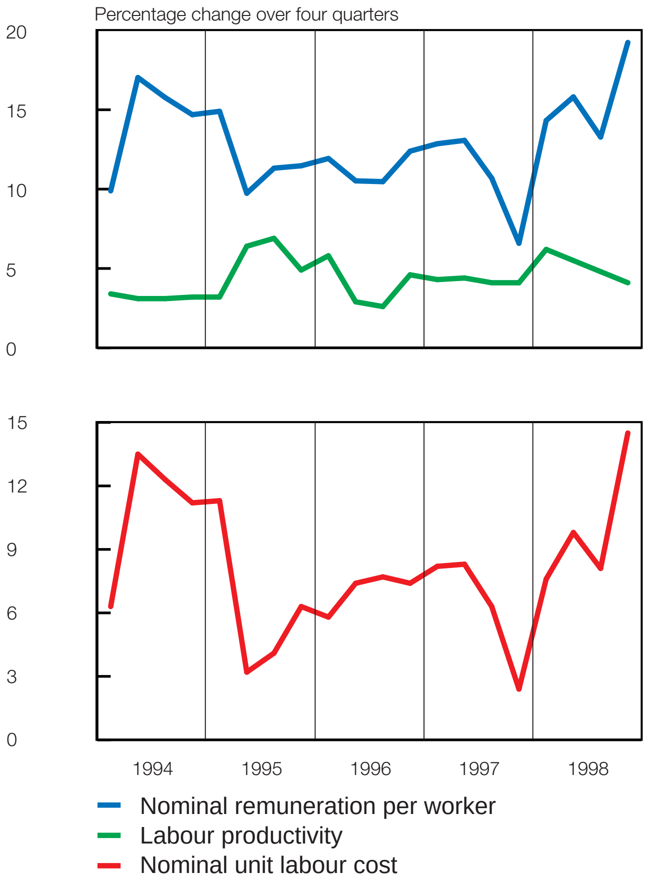
The growth in nominal remuneration per worker continued to exceed the growth in output prices in 1998. Consequently, the ratio of *remuneration per worker to output prices,* or the *real product wage*, rose by 7,4 per cent in 1998 – the third consecutive year of acceleration. Without an accompanying increase in output per worker, increases in the real product wage could compress the operating margins of producers, reduce the rate of return on invested capital and weaken the overall inducement to invest.

This somewhat less appealing outcome is more likely if producers realise that when they raise their output prices, they may lose market share as their competitors may not necessarily follow suit. In such an economic setting, businesses can be expected to be unwilling to raise wages faster than what is affordable at current price levels. That this is not happening in the South African economy may be an indication that most producers still believe there is a general inflationary tendency in the economy and their decisions to raise prices will eventually be validated.

Concerns that strong growth in the nominal remuneration of employees could lead to lower operating margins, or add to already existing inflationary pressures, were to a degree allayed by solid growth in *labour productivity* during 1998. The growth in output per worker in the formal sectors of the economy was 5,1 per cent in 1998. In the course of 1998, however, year-on-year productivity growth appeared to have slowed down, partly because of heightened strike activity in the second half of the year. The number of workdays lost to strikes and work stoppages rose sharply from 0,7 million in 1997 to 2,3 million in 1998.

Despite the rapid growth in labour productivity during 1998, the growth in *nominal unit labour costs* (i.e. the cost of labour per unit of output, or the ratio between nominal remuneration per worker and output per worker) accelerated from 1997 to 1998. As labour cost is still the single most important component of overall production cost in the economy, the acceleration in the growth of unit labour cost could potentially halt the decline in domestically generated production price and core inflation.

Non-agricultural labour productivity, remuneration and unit labour costs



Inflation

The sharp rise in the aggregate price level in the third quarter of 1998 was evidently a one-off event, triggered by the adverse developments in international capital markets over the past two years or so. The application of an orthodox monetary policy during the second half of 1998 restrained domestic cost pressures and helped prevent the depreciation of the rand from turning into a renewed spiral of domestic cost increases, output price increases and further depreciations. Consequently, a significant slowdown in inflation at the level of both production and consumer prices was observed from the fourth quarter of 1998. The rise in the *all-goods production price index* decelerated from a seasonally adjusted and annualised rate of 8,1 per cent in the third quarter of 1998 to 2,8 per cent in the first quarter of 1999. The quarter-to-quarter rise in the *overall consumer price index* fell from 17,3 per cent in the third quarter of 1998 to 2,0 per cent in the first quarter of 1999.

Measured over periods of twelve months, inflation in production and consumer prices in the first four months of 1999 appeared to be considerably higher than the rates indicated by the quarter-to-quarter changes in the respective price indices. There were increases in the overall production price index of 5,5 per cent in March 1999 and 4,9 per cent in April, and increases in the overall consumer price index of 7,7 per cent in April and 7,1 per cent in May. These seemingly high inflation rates were, however, more the result of the statistical carry-over of the strong price increases in the third quarter of 1998 than the emergence of some price-raising cost pressures towards the end of 1998.

The slower growth from quarter to quarter in the *all-goods production price index* resulted largely from a decline in the *prices of imported goods* from the fourth quarter of 1998 to the first quarter of 1999. Low inflation in trading-partner countries, the relative strength of the rand and, up to February, declining prices of imported crude oil contributed to a fall in the price index of imported goods at a seasonally adjusted and annualised rate of 5 per cent in the first quarter of 1999.

From March 1999 international crude oil prices began rising from one month to the next. Unless reversed in May and June 1999, the rise in the price of crude oil may conceivably bring to an end the steady decline in the quarter-to-quarter growth in production prices.

Unlike the prices of imported goods, the *prices of domestically produced goods* rose from the fourth quarter of 1998 to the first quarter of 1999. Moreover,

Production price index

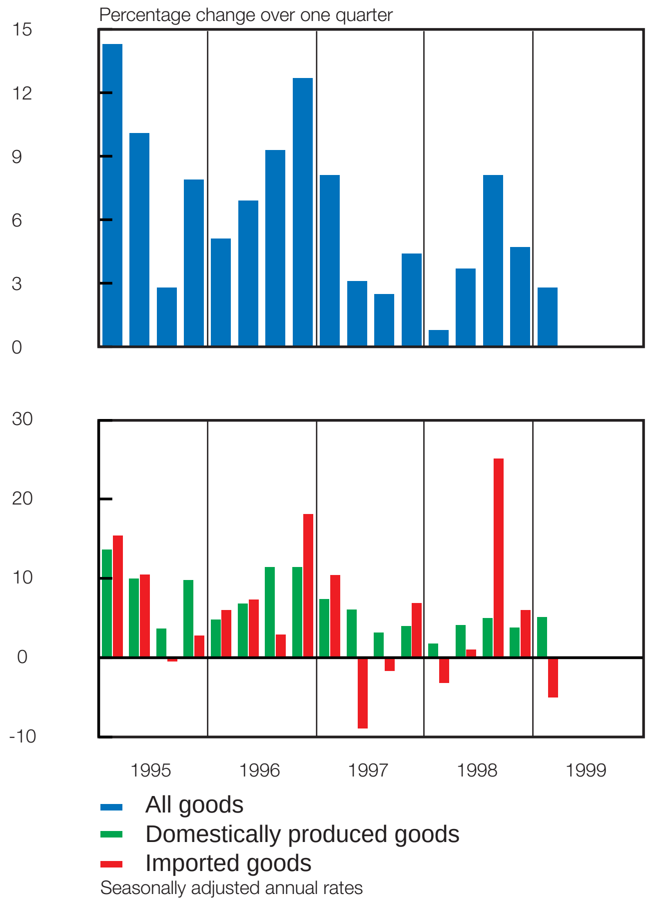
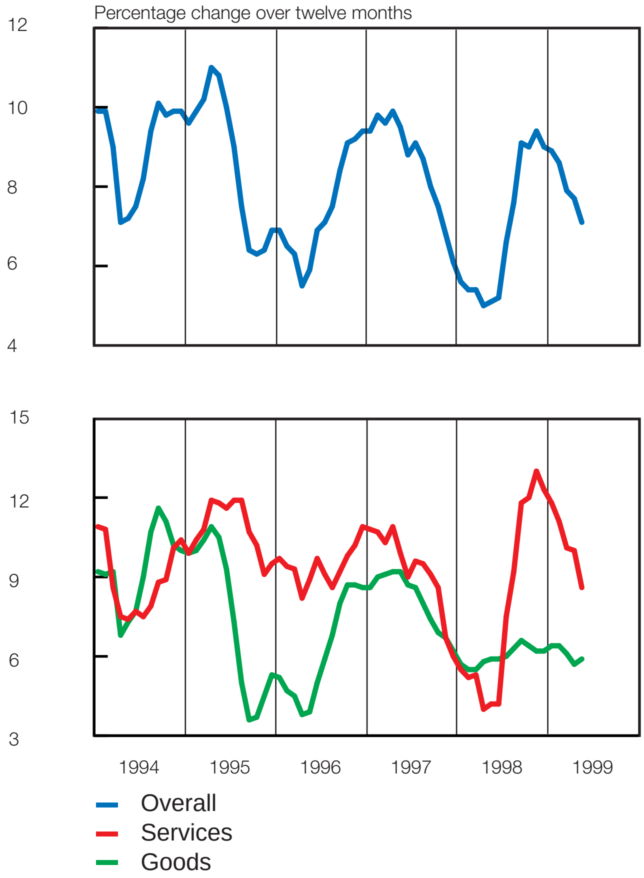


Table 6. Change in production prices
Quarter-to-quarter changes at annualised rates

	All goods	Imported goods	Domestically produced goods
1998: 1st qr........	0,8	-3,2	1,8
2nd qr	3,7	1,0	4,1
3rd qr	8,1	25,1	5,0
4th qr	4,7	6,0	3,8
1999: 1st qr........	2,8	-5,0	5,1

the seasonally adjusted annualised rate of increase accelerated somewhat from 3,8 per cent in the fourth quarter of 1998 to 5,1 per cent in the first quarter of 1999. Higher increases in the prices of electricity, gas and water, and of agricultural, forestry and fishing products, coupled with some acceleration in unit labour costs during 1998, were probably the main reasons for the slight acceleration in domestically generated increases in production prices.

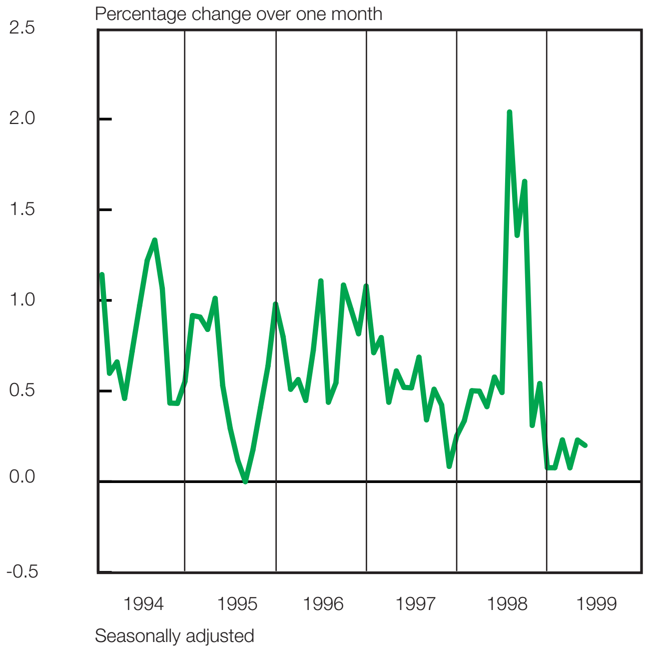
Consumer prices



The growth in *consumer prices* decelerated even more substantially than the growth in production prices over the past three completed quarters. This was particularly evident in the sharp decline in annualised quarter-to-quarter consumer price inflation – from 17,3 per cent in the third quarter of 1998 to 2,0 per cent in the first quarter of 1999. Although to a far lesser extent, quarter-to-quarter *core inflation* (which does not take into consideration changes in the prices of certain food products, the cost of mortgage bonds and consumer credit and certain indirect taxes) also slowed down, namely from 8,4 per cent in the third quarter of 1998 to 6,7 per cent in the first quarter of 1999. Month-on-month changes in the overall consumer price index in the early months of 1999 were also below those of the first half of 1998.

The disparity between overall consumer price inflation and core inflation arose from the sharp decline in home mortgage and other interest rates over the past two quarters. Mainly because of these declines, the quarter-to-quarter increase in the prices of *consumer services* fell from an annualised rate of 29,4 per cent in the third quarter of 1998 to an annualised rate of 0,5 per cent in the first quarter of 1999. The increase in the prices of *consumer goods* slowed down too – from an annualised rate of 7,8 per cent in the third quarter of 1998 to 4,5 per cent in the first quarter of 1999. Measured over periods of twelve months, the increase in the prices of both consumer goods and consumer services have also slowed down since the latter part of 1998.

Consumer prices



Foreign trade and payments[2)]

Current account

The compression of aggregate demand in the economy contributed to the reversal of the *deficit on the current account* of the balance of payments into a surplus – a deficit of R6,9 billion in the third quarter of 1998 became a surplus of R2,0 billion in the first quarter of 1999. Expressed in terms of a seasonally adjusted and annualised rate, the current account turned from a deficit of R19,8 billion in the third quarter of 1998, or 2,7 per cent of gross domestic product, to a surplus of R6,2 billion in the first quarter of 1999, equivalent to 0,8 per cent of gross domestic product. The improvement in the current-account balance in the first quarter of 1999 resulted mainly from a substantial decline in the value of merchandise goods imported and an equally impressive increase in the value of merchandise exports.

The value of *merchandise imports* (seasonally adjusted and annualised), which had declined from R165,9 billion in the third quarter of 1998 to R158,5 billion in the fourth quarter, contracted further by 10,2 per cent to R142,4 billion in the first quarter of 1999. This contraction was attributable mainly to reduced imports of manufactured goods and agricultural products. Declines were registered especially in the categories of machinery and electrical equipment, and vehicles and transport equipment, thus reflecting the decline in fixed investment activity and the weak demand for durable consumer goods.

The physical quantity of imported goods, having increased by 6,2 per cent in the third quarter of 1998 and by 0,8 per cent in the fourth quarter, declined by almost 13,0 per cent in the first quarter of 1999. The decline in the physical quantity of imported goods exceeded the decline in real gross domestic expenditure, causing the import penetration ratio (i.e. the ratio of real merchandise imports to real gross domestic expenditure) to decline from an average of about 20,4 per cent in 1998 to 18,6 per cent in the first quarter of 1999. A larger proportion of aggregate domestic demand was consequently satisfied by domestic suppliers. Owing essentially to the depreciation of the external value of the rand from the fourth quarter of 1998 to the first quarter of 1999, import prices in terms of rand rose by some 3 per cent over the same period.

After having declined from a seasonally adjusted and annualised value of R143,6 billion in the third quarter of 1998 to R133,2 billion in the fourth quarter, the value of *merchandise exports* increased to R149,1 billion or by 11,9 per cent in the first quarter of 1999. The export values of mining, agricultural and manufactured products all rose, with particularly large increases noted in the categories for mineral products, and base metals and articles of base metals. The physical quantity of total merchandise exports increased by about 8,1 per cent in the first quarter of 1999. The share of South African exports destined for Asian countries as a percentage of total merchandise exports, which had declined from 17,9 per cent in the third quarter of 1998 to 14,6 per cent in the fourth quarter, increased to 19,3 per cent in the first quarter of 1999 as the general recovery in economic activity in those countries got under way.

The decline in the exchange value of the rand also assisted an increase of approximately 3,5 per cent in the average rand *prices of exported merchandise goods* from the fourth quarter of 1998 to the first quarter of 1999. International commodity prices changed little during this period. Future export earnings expressed in rand are also likely to be affected by the relative stability of international commodity prices.

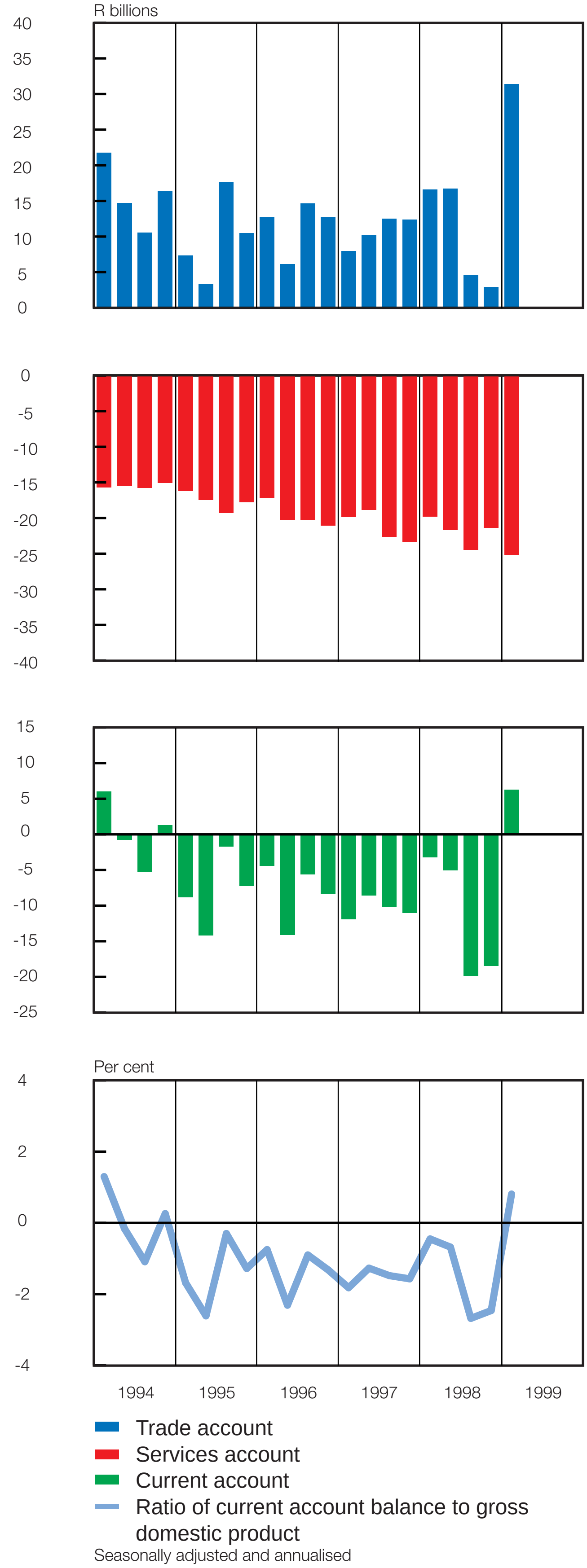
The seasonally adjusted and annualised value of South Africa's *net gold exports,* which had increased

2) The methodology for compiling the balance of payments statistics was changed to meet the specifications of the fifth edition of the *Balance of Payments Manual* of the International Monetary Fund.

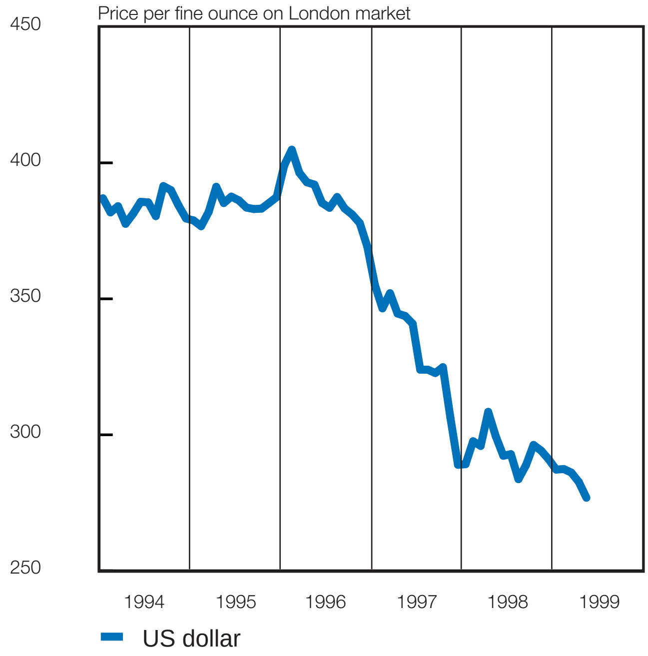
Table 7. Balance of payments on current account
Seasonally adjusted and annualised
R billions

	1998				1999
	1st qr	2nd qr	3rd qr	4th qr	1st qr
Merchandise exports	132,1	131,3	143,6	133,2	149,1
Net gold exports	25,5	23,0	26,9	28,2	24,7
Merchandise imports	-141,0	-137,7	-165,9	-158,5	-142,4
Net service, income and current transfer payments	-19,8	-21,6	-24,4	-21,4	-25,2
Balance on current account	**-3,2**	**-5,0**	**-19,8**	**-18,5**	**6,2**

Current account



Gold price



from R26,9 billion in the third quarter of 1998 to R28,2 billion in the fourth quarter, declined to R24,7 billion or by 12,4 per cent in the first quarter of 1999. A lower volume of gold exports was mainly responsible for this decrease. In addition, the realised price of gold per fine ounce also declined marginally from an average of R1 791 in the fourth quarter of 1998 to R1 789 in the first quarter of 1999.

Sentiment in the gold market was adversely affected in May 1999 when the Bank of England announced its intention to reduce its gold holdings from 715 tonnes to 300 tonnes over the next three years. The average fixing price of gold on the London market reacted and declined from US$287 per fine ounce in the first quarter of 1999 to $277 per fine ounce in May.

Net service, income and transfer payments to non-residents increased from a seasonally adjusted and annualised value of R18,5 billion in the fourth quarter of 1998 to R25,1 billion in the first quarter of 1999. In particular, interest payments on inward investment into South Africa and payments for transport services rose more than current inward transfers and receipts for services rendered to non-residents.

Capital transfer and financial account

The slowdown of financial flows to emerging-market economies, following the turbulence in many of these economies, was also echoed in a contraction of financial flows to South Africa during 1998. Statistics of global financial movements released by the International

Table 8. Net financial transactions not related to reserves
R billions

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

* Including unrecorded transactions

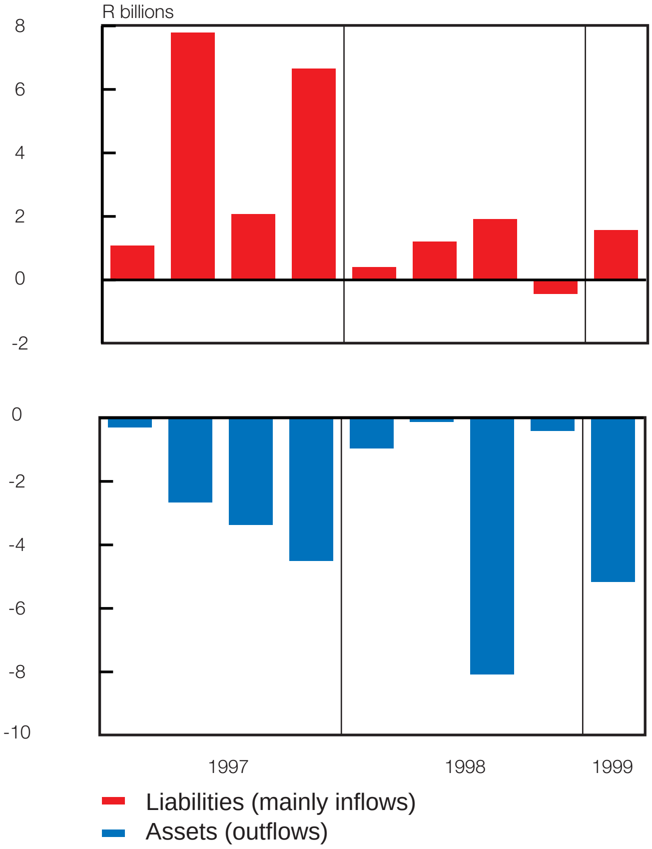
Monetary Fund show that foreign direct investment flows to emerging markets as a group declined suddenly in 1998, after a period of sustained growth dating back to the beginning of the 1990s. The net inward movement of portfolio investment into emerging markets also declined in 1998, but there was a strong increase in "other investment outflows" – including the withdrawal of short-term bank lending – from emerging-market economies in 1998.

As was the case in most emerging-market economies, *foreign direct investment in South African assets* declined sharply – from R17,6 billion in 1997 to R3,1 billion in 1998. There was some disinvestment in the fourth quarter of 1998 when direct investment by non-resident investors declined by R0,4 billion, but this was followed by inward investment of R2,0 billion in the first quarter of 1999.

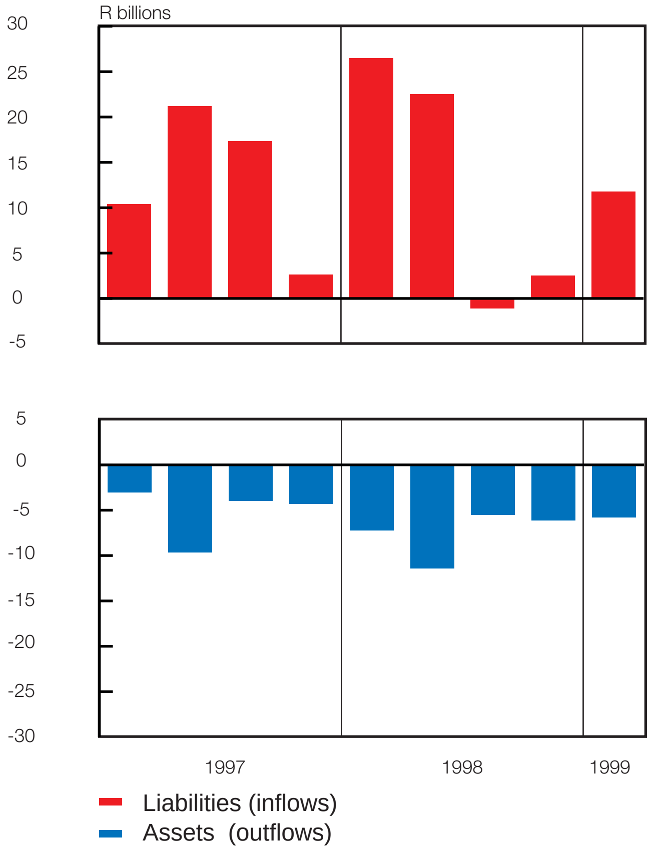
The outflow of capital arising from the *acquisition of foreign direct investment assets* by South African entities maintained a steady flow of R10,8 billion in 1997 and R9,6 billion in 1998. A further outward movement of R4,3 billion in direct investment capital occurred in the first quarter of 1999, largely driven by South African mining companies seeking to expand their activities abroad.

The inflow of capital resulting from *portfolio investment decisions by non-residents* has waxed and waned since the beginning of 1997. It shrank from an inflow of R26,5 billion in the first quarter of 1998 to an outflow of R1,1 billion in the third quarter, but then inflows resumed at R2,5 billion in the fourth quarter and R10,9 billion in the first quarter of

Direct investment



Portfolio investment



1999. These perturbations were essentially determined by non-resident investors intermittently changing from being net buyers of domestic fixed-interest securities to being net sellers of these securities. Non-residents maintained a steady presence as buyers of shares of listed South African companies and also acquired debt and equity securities by means of the asset swap mechanism during 1998 and in the first quarter of 1999.

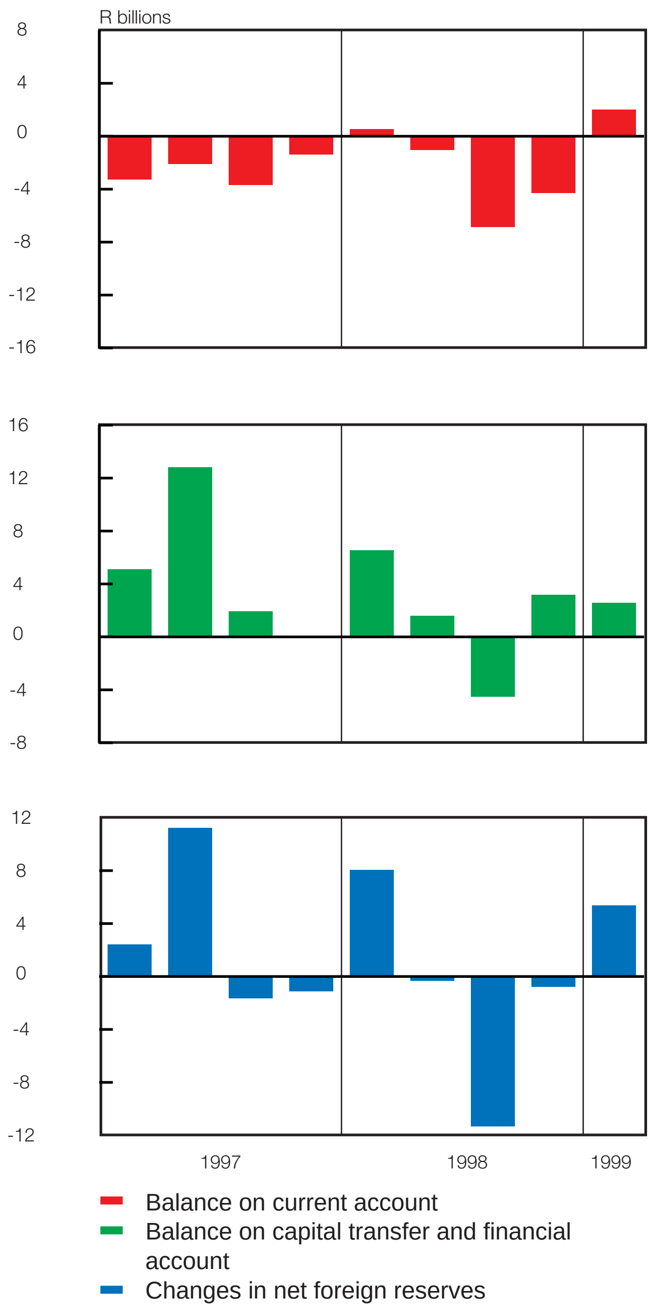
Portfolio investments in foreign assets by South African entities rose from R21,0 billion in 1997 to R30,1 billion in 1998 and amounted to R5,8 billion in the first quarter of 1999. The greater part of the outflows was arranged in terms of asset-swap agreements between resident and non-resident investors.

A strong inflow of capital into South Africa was recorded in the category *"other identified investments"* during the fourth quarter of 1998. This inflow, which was estimated at R8,8 billion, emanated mainly from an accumulation of claims by non-residents on residents on account of the delayed settlement of bond sales by foreign investors. The settlement of the outstanding amounts and the consequent reduction in foreign liabilities was the main reason for the outflow of R1,1 billion in the "other" category during the first quarter of 1999. This outward movement of "other identified foreign investments" was to some extent offset by long-term foreign borrowing by domestic private non-bank companies and the placing of non-resident deposits with the South African banking sector.

Foreign reserves

The positive balance on South Africa's transactions with the rest of the world in the first quarter of 1999 led to a sizeable increase in the international reserves of the country. The *gross gold and other foreign reserves* (mar-

Overall balance of payment position



ked to market) accordingly increased by R6,1 billion in the first quarter of 1999 to reach a level of R48,3 billion at the end of March 1999. Import cover, that is the value of gross international reserves relative to the value of imports of goods and services, improved from 10½ weeks at the end of 1998 to approximately 12½ weeks at the end of March 1999.

The non-borrowed reserves of the Reserve Bank amounted to R14,9 billion at the end of March 1999. In April and May 1999 the Bank's gross holdings of international reserves increased by R1,4 billion, whereas the outstanding amount of utilised foreign short-term credit facilities decreased by R1,5 billion, resulting in non-borrowed reserves rising to R17,8 billion at the end of May 1999.

The Reserve Bank's *net forward position in foreign currency* declined from US$24,9 billion at the end of December 1998 to US$23,3 billion at the end of April 1999. The subsequent delivery of the proceeds of the government's foreign borrowing activities against the Bank's forward book lowered the net forward position in foreign currency by another US$1,1 billion to US$22,2 billion at the end of May 1999. Congruent with the net forward position in foreign currency, the Reserve Bank's *net oversold position in foreign currency* (i.e. the Bank's net forward position in foreign currency reduced by its net holdings of spot gold and foreign exchange reserves) declined from US$22,5 billion at the end of December 1998 to US$20,6 billion at the end of April 1999 and US$19,3 billion at the end of May.

Exchange rates

The *nominal effective exchange rate of the rand* declined by 6,8 per cent between 31 December 1998 and 15 January 1999 when events in Brazil threatened to unsettle international financial markets. In the ensuing weeks the rand recovered as global markets settled down once again and by the end of April 1999 the nominal effective exchange rate had increased by 0,5 per cent on a net basis since the end of December 1998.

Renewed uncertainties, mainly related to concerns about political stability in Russia and the weakness of the gold market, then caused the nominal effective exchange rate to decline again, leaving a net depreciation of 1,3 per cent from the end of December 1998 to 31 May 1999. The relatively muted response of the rand to the Brazilian incident could probably be attributed to the comprehensive restructuring of international portfolio investments in 1998. Risk-averse international investors reassessed the risks associated with investment in emerging markets. They reacted during 1998 by reducing their exposure to emerging markets in favour of assets domiciled in the advanced economies of the world. In the first quarter of 1999, the surplus on the overall balance of payments and widely held expectations that the exchange value of the rand would become more stable, encouraged a return of strong portfolio capital flows into the economy. In a self-fulfilling way, this helped to stabilise the exchange rate of the rand against the US dollar: the rand traded within a relatively stable range of R5,97 to R6,26 from the end of December 1998 to the end of April 1999.

Continued instability in Russia and some South American economies resulted in a renewed crisis of confidence in emerging markets in May 1999. Negative sentiment towards emerging markets has also been influenced by the sudden decline in the gold price which followed the announcement of planned gold sales by the Bank of England. The nominal effective exchange rate of the rand subsequently declined to a level on 31 May 1999 that was 1,8 per cent lower than at the end of April 1999. The nominal effective exchange rate of the rand subsequently strengthened by 4,2 per cent from the end of May 1999 to 21 June 1999.

From the end of 1998 to the end of May 1999 the external value of the rand declined by 5,7 per cent against the US dollar and 2,3 per cent against the British pound. Over the same period, the rand appreciated by 5,3 per cent against the euro and 0,7 per cent against the Japanese yen. The rand also depreciated in general against the Southeast Asian currencies, in particular against the Philippine peso by 8,5 per cent.

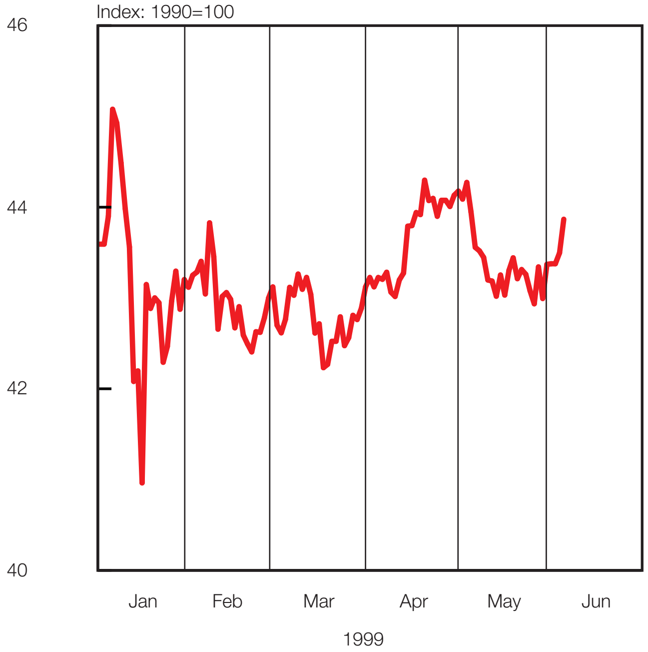
The nominal effective exchange rate of the rand adjusted for the inflation differentials between South Africa and its major trading partners appreciated by 0,2 per cent from December 1998 to April 1999. In the twelve months to April 1999 the real effective exchange rate of the rand

Table 9. Exchange rates of the rand
Percentage change

	30 Apr 1998 to 30 Apr 1999	31 Dec 1997 to 31 Dec 1998	31 Dec 1998 to 30 Apr 1999	31 Dec 1998 to 31 May 1999
Weighted average	-15,9	-19,5	0,5	-1,3
US dollar	-16,7	-17,0	-3,3	-5,7
British pound	-13,7	-17,2	-0,4	-2,3
Euro*	-13,5	-21,4	6,4	5,3
Japanese yen	-24,6	-27,4	1,7	0,7
Emerging markets				
Indonesian rupiah	-15,6	15,1	-1,2	-4,5
Malaysian ringgit	-15,1	-18,6	-3,4	-5,7
Philippine peso	-21,2	-19,8	-6,2	-8,5
Singaporean dollar	-10,5	-18,4	-0,3	-1,3
Taiwanese dollar	-17,4	-18,1	-1,9	-4,3

* The German mark was included in the four-currency basket prior to 1 January 1999

Nominal exchange rate of the rand

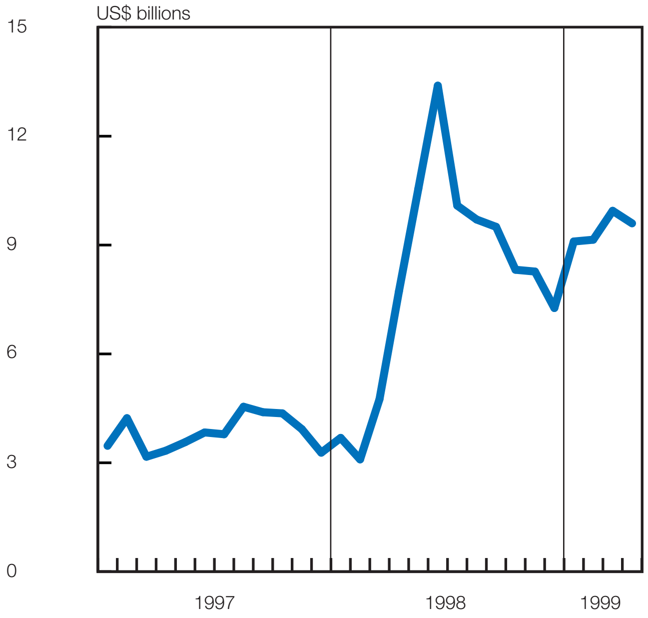


Daily average

nevertheless declined by 12,3 per cent, signalling a substantial improvement in the competitive ability of domestic producers in export markets.

The total *net average daily turnover* in the market for foreign exchange (including transactions in third currencies), which had declined from an average level of $9,8 billion in the third quarter of 1998 to $8,0 billion in the fourth quarter, increased again to $9,4 billion in the first quarter of 1999. Non-resident participation in this market declined from an average daily turnover of $5,8 billion in the third quarter of 1998 to $4,5 billion in the fourth quarter, before increasing again to a level of $5,3 billion in the first quarter of 1999. Transactions by residents in the domestic market for foreign exchange declined from $4,0 billion in the third quarter of 1998 to $3,5 billion in the fourth quarter before increasing again to $4,1 billion in the first quarter of 1999.

Average net daily turnover in the South African foreign exchange market



Monetary developments, interest rates and financial markets

Monetary policy approach

In a statement on monetary policy issued on 10 March 1999, the Governor of the Reserve Bank repeated the fact that the Bank is required in terms of the Constitution of the Republic of South Africa to protect the value of the currency in the interest of sustained economic development. Achieving this objective requires that inflation should be brought in line with the average rate of inflation in South Africa's major trading-partner countries and international competitors.

The Governor also indicated that in the application of monetary policy, changes in a number of important economic variables would continue to be monitored closely. In particular, the medium-term to longer-term adjustments sought included

- lowering the core inflation rate to within the range of 1 to 5 per cent during the next three years;
- restricting the average growth in the broad money supply (M3) over the next three years to between 6 and 10 per cent per year which would be deemed to be consistent with the stated inflation objective and supportive of sustained economic growth at a rate higher than that experienced in recent years;
- limiting growth in total bank credit extension, which should on average not increase by much more than 10 per cent per year over the next three years for it to be compatible with the objective for growth in M3.

The ultimate monetary policy objective of reducing inflation to sustainably low rates therefore leads to an intermediate objective of influencing the money supply and bank credit extension. In implementing this policy the Bank uses changes in the amount of liquidity provided to banks, relative to the banks' daily liquidity needs, as a mechanism to influence the level and direction of change in short-term interest rates.

It was made clear that the Bank has no predetermined goal for the exchange rate of the rand. The Bank nevertheless assumes that the attainment of the inflation objective will reduce the need for continuous downward adjustments to the exchange rate.

The Governor indicated that the Bank would continue to remain flexible in its policy implementation strategies. The intention is not to implement policy according to any strict policy rule. The Bank will, rather, exercise discretionary judgement in deciding what combination of money supply growth, changes in bank credit extension, amount of liquidity in the banking sector and levels of interest rates should be aimed at in any given set of circumstances in order to achieve the objective of low inflation. The Governor also indicated that external developments might at times compel the Reserve Bank to deviate temporarily from its stated guidelines for money supply growth and bank credit extension. Some intervention in the financial markets might occur from time to time.

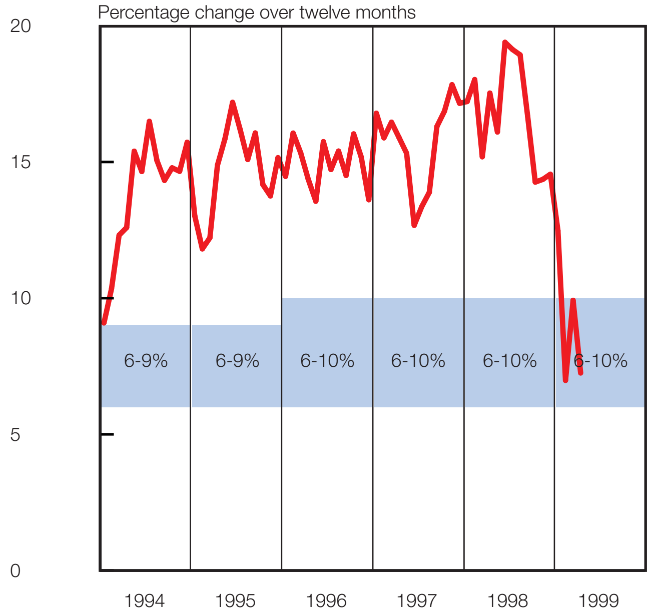
Money supply

The general downswing in economic activity, more specifically the decline in real gross domestic production from the third quarter of 1998, lower inflation and widely held expectations that inflation would continue to subside, together with a decline in general liquidity preference, contributed to a sharp deceleration in the rate of growth in the *broadly defined money supply* (M3). The seasonally adjusted and annualised quarter-to-quarter growth in M3 slowed down from 18,7 per cent in the third quarter of 1998 to 9,7 per cent in the fourth quarter and to a six-year low of 0,5 per cent in the first quarter of 1999.

The growth in M3 over twelve months decelerated from its most recent peak of 19,4 per cent in June 1998 to 14,6 per cent in December and 7,0 per cent in February 1999. The lower growth in February was jointly determined by some exceptional circumstances, including the high base in 1998 of the year-on-year growth calculation, and the build-up of government deposits ahead of large interest payments. These payments were due on the last day of February, which fell on a Sunday; hence the actual payment could only be effected in March.

In March and April 1999 the year-on-year growth rates in M3 were 9,9 per cent and 7,3 per cent

M3 money supply



Shaded areas indicate the money growth guideline ranges

Table 10. Twelve-month growth rates in monetary aggregates

Per cent

		M1A	M1	M2	M3
1998:	Apr	33,9	25,2	18,4	17,5
	May	27,3	26,0	16,6	16,1
	Jun	23,3	35,3	21,4	19,4
	Jul	22,1	40,6	22,3	19,1
	Aug	26,8	43,7	22,5	18,9
	Sep	17,6	33,6	18,8	16,7
	Oct	19,2	26,6	14,0	14,3
	Nov	16,6	24,9	13,8	14,4
	Dec	13,5	23,6	13,6	14,6
1999:	Jan	15,3	22,0	12,0	12,5
	Feb	4,9	14,8	5,8	7,0
	Mar	9,7	20,3	8,7	9,9
	Apr	3,9	16,0	7,8	7,3

Table 11. Accounting counterparts of changes in M3

R billions

Counterparts	2nd qr 1998	3rd qr 1998	4th qr 1998	1st qr 1999
Net foreign assets	-5,0	-15,9	-2,2	2,1
Net gold and foreign exchange reserves	-0,3	-11,4	-0,3	5,3
Net other assets	-4,7	-4,5	-1,9	-3,2
Net claims on the government sector	12,0	5,1	-3,1	-8,5
Gross claims	4,3	6,7	1,1	-6,6
Government deposits (+decrease; -increase)	7,7	-1,6	-4,2	-1,9
Claims on the private sector	21,7	8,2	20,9	10,7
Net other assets	-7,2	11,7	-5,5	-6,6
Total change in M3	**22,5**	**9,1**	**10,1**	**-2,3**

respectively. This was the first time in almost six years that the twelve-month growth rates of M3 had moved within the guideline growth range of between 6 and 10 per cent that the Reserve Bank had once again affirmed as being one of the set of medium-term to longer-term indicators to guide monetary policy decision-making.

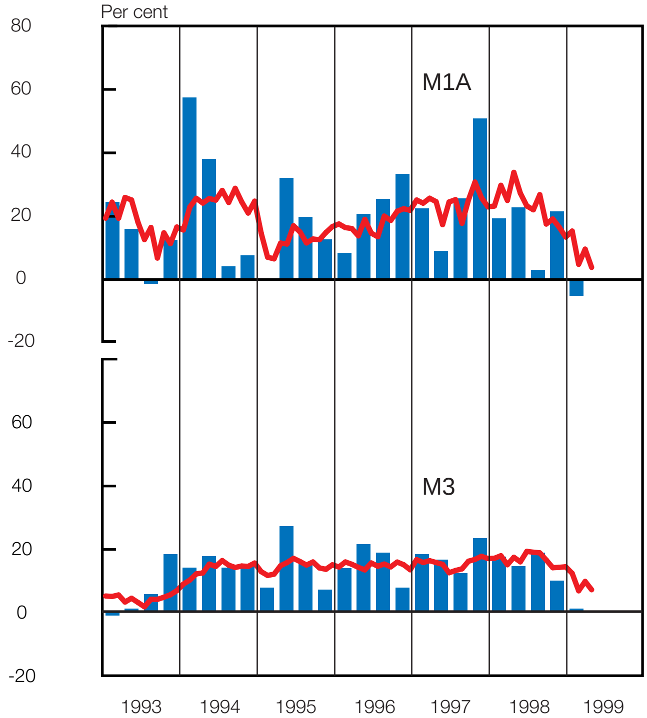
The moderation of the growth in M3 arose *inter alia* from a decline in the liquidity preference of the general public and a slowdown in the growth of the demand for transactions balances. More specifically, the decline in M3 money supply growth in the first quarter of 1999 could be attributed to a declining preference among private-sector entities for call deposits and other short-term and medium-term deposits.

The decline in liquidity preference is also reflected in the sharp deceleration in the twelve-month growth rate of M1A from the year's peak of 33,9 per cent in April 1998 to 19,2 per cent in October and 3,9 per cent in April 1999. Similarly, the growth in M1 declined from the peak rate for the year of 43,7 per cent in August 1998 to 26,6 per cent in October and 16,0 per cent in April 1999.

The year-on-year growth rates of M3 exceeded the growth in the nominal gross domestic product by 8,1 percentage points in the fourth quarter of 1998, but fell short of the growth in the nominal value of output by 4,4 percentage points in the first quarter of 1999. As a consequence, the income velocity of circulation of M3 declined to a twenty-year low of 1,78 in the fourth quarter of 1998 before increasing slightly to 1,81 in the first quarter of 1999.

The actual level of M3 before adjustment for seasonal influences declined by R2,3 billion in the first quarter of 1999. The main counterparts, in an accounting or statistical sense, of this contraction in M3 in the first quarter of 1999 were the decrease of R8,5 billion in the

Monetary aggregates



Percentage change
Quarterly at seasonally adjusted annual rates
Over twelve months

monetary sector's claims on the government sector and the sharp decline of R6,6 billion in the "net other assets" of the monetary institutions reflecting, among other things, a strengthening of the banks' capital and reserves. These decreases were only partly offset by an increase of R2,1 billion in the net foreign assets of the banking system and an increase of R10,7 billion in the monetary sector's claims on the private sector.

Credit extension

The growth in *total domestic credit extension* during the first quarter of 1999 returned to the rates last seen in the first quarter of 1998, the period prior to the turbulence in the international financial markets. The rate of increase over twelve months in *total domestic credit extension* by monetary institutions (i.e. credit extension to the private sector and net claims on the government sector) receded from a recent peak of 21,7 per cent in August to 18,5 per cent in December 1998 and 12,0 per cent in April 1999. This slowdown in the rate of credit growth was the result of a slowdown in credit extended by monetary institutions to the private sector and a decline in the banks' net claims on the government sector. Where claims by the monetary institutions to the private sector grew by R20,9 billion in the fourth quarter of 1998, the increase was only R10,7 billion in the first quarter of 1999 as companies and consumers curtailed the growth in their use of credit. Net claims of banks on the *government sector* decreased by R3,1 billion in the fourth quarter of 1998 and further by R8,5 billion in the first quarter of 1999. The fall in the net claims of the monetary sector on the government sector in the first quarter of 1999 was due to a decrease of R6,6 billion in gross claims by banks on the government sector which was reinforced by an increase of R1,9 billion in government deposits.

The twelve-month rate of growth in *credit extension to the private sector* slowed down from 17,6 per cent in November 1998 to 14,0 per cent in March 1999 and 11,5 per cent in April. Measured from quarter to quarter the annualised growth in bank credit to the private sector fell from 26,2 per cent in the second quarter of 1998 to 10,1 per cent in the first quarter of 1999. The growth in total credit extension by banks – to the government and the private sector – slowed down even more substantially from 24,2 per cent in the second quarter of 1998 to 4,7 per cent in the first quarter of 1999. The growth in the first quarter of 1999 was well within the guideline for growth in domestic credit extension indicated by the

Credit extended by monetary institutions

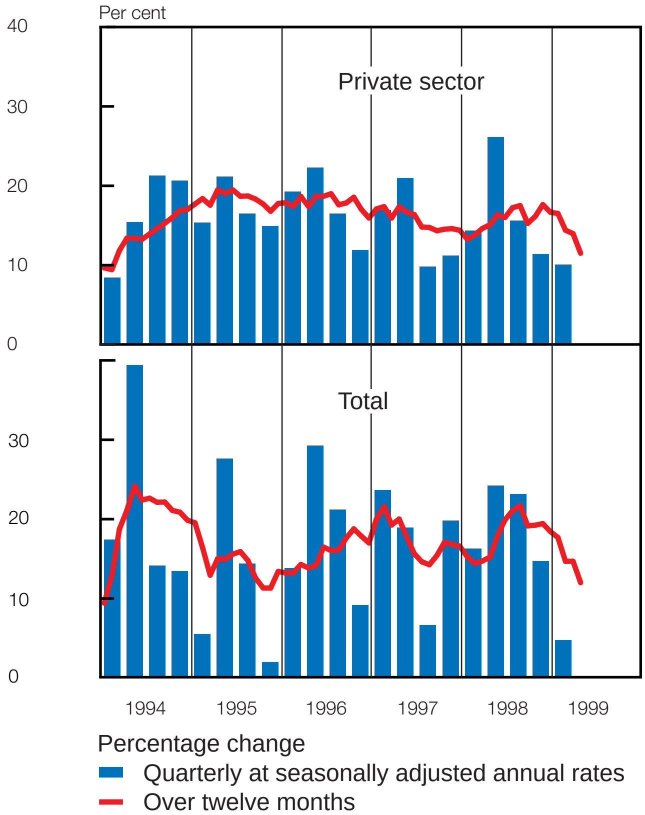


Table 12. Credit categories as percentage of total claims on the domestic private sector

	Investments and bills discounted	Instalment sale and leasing finance	Mortgage advances	Other loans and advances	Total
1998: Mar	5,3	16,4	41,8	36,5	100
Jun	5,7	15,9	40,8	37,6	100
Sep	4,7	15,6	41,0	38,7	100
Dec	5,2	15,0	39,9	39,9	100
1999: Jan	5,5	14,9	39,8	39,7	100
Feb	5,5	14,9	39,8	39,8	100
Mar	5,9	14,7	39,3	40,1	100
Apr.................	5,8	14,8	39,5	39,9	100

Reserve Bank as being consistent with monetary growth of less than 10 per cent per annum.

Credit growth has consistently outpaced the growth in nominal gross domestic expenditure by a considerable margin, thereby raising the ratio of outstanding private-sector credit to annualised gross domestic product to 64,4 per cent in the first quarter of 1999 – the highest ratio on record. Factors contributing to the growth in the demand for bank credit by the private sector in recent times were the buoyancy of financial market activity and the steady undercurrent of corporate restructurings. Some conversion of trade finance to domestic instead of foreign sources of credit, owing to the perceived risk of exchange rate depreciation could also have contributed to the growth in credit extension.

An analysis of banks' claims on the private sector by *type of credit* shows that the rate of growth over twelve months in *mortgage advances* decreased from 10,0 per cent in December 1998 to only 6,5 per cent in April 1999 – a level last reached in 1967. The share of mortgage advances in the overall stock of bank credit extended to the private sector declined from 41,8 per cent in March 1998 to 39,3 per cent in March 1999, reflecting mainly the weak state of the real-estate market and the home-building industry.

Despite the interest rates on bank lending rising to an unprecedented level in the third quarter of 1998, growth in the *"other loans and advances"* category showed remarkable resilience throughout the second half of 1998 and in the first quarter of 1999. The rate of increase over twelve months in this category fluctuated at levels above 31 per cent in the three months to January 1999 and only started to decline in February when the rate was still at a relatively high level of 26,0 per cent. In March and April the growth in *"other loans and advances"* declined to 25,3 and 20,2 per cent. The greater part of *"other loans and advances"* was destined for the corporate sector, probably because of some distress borrowing by companies to help them through a period of relatively slack demand in the economy. Corporate restructurings, lively financial markets and high levels of external trade added to the demand for credit of the business sector. The twelve-month growth rate of *instalment sale credit* moderated to within a narrow range of between 4,1 and 4,9 per cent from October 1998 to February 1999. It decreased to low rates of 2,7 and 1,8 per cent in March and April 1999. *Leasing finance,* which had recorded negative annual growth rates for the eighteen months to February 1999 showed a positive growth rate of 1,0 per cent in March, but declined again in the year to April 1999.

The absolute increase in private-sector credit of R10,7 billion in the first quarter of 1999 could be attributed to an increase of R8,9 billion in *credit extended to the corporate sector* – credit extended to households increased by merely R1,8 billion. In terms of percentage changes, the growth over twelve months in credit extension to the corporate sector decelerated from 33,3 per cent in December 1998 to 25,7 per cent in March 1999. Mortgage advances accounted for 11,6 per cent of the increase in bank credit extension to the corporate sector in the first quarter of 1999, overdrafts for 39,4 per cent and investments for 34,7 per cent. *Credit extension to private households*, which had increased slowly at a rate of 4,6 per cent in the year to December 1998, rose by 4,7 per cent in the year to March 1999.

Interest rates and yields

Bond yields moved sharply lower from an all-time high in September 1998 when stability returned to the international financial markets during the last few months of 1998. The *monthly average yield on long-term government bonds* declined from 18,3 per cent in September 1998 to 15,9 per cent in January 1999.

In the first quarter of 1999 the general downward movement in bond yields gained further momentum as

Table 13. Credit extended to the private sector by main type of credit
Percentage change over twelve months

	Other loans and advances	Instalment sale finance	Leasing finance	Investments and bills discounted	Mortgages advances	Total
1998: Mar	23,6	9,7	-6,1	17,5	11,5	14,6
Jun	25,5	9,1	-4,6	30,8	11,2	16,0
Sep	26,9	7,9	-4,3	10,2	10,9	15,3
Dec	31,4	4,1	-0,2	16,3	10,0	16,7
1999: Jan	31,4	4,9	-1,3	20,2	9,1	16,5
Feb	26,0	4,6	-2,2	21,8	8,3	14,4
Mar	25,3	2,7	1,0	26,3	7,2	14,0
Apr	20,2	1,8	-0,4	21,0	6,5	11,5

bond prices discounted the prospect of an improvement in overall economic performance. Sentiment in the market for fixed-interest securities was positively influenced by a slowdown in consumer price inflation, an easing of money-market conditions and declining short-term interest rates, a conservative fiscal policy which reduced government's funding requirement for the new fiscal year, and positive credit-rating reviews by international rating agencies. The monthly average yield consequently declined to about 14,5 per cent in March and April 1999 before increasing to 15,1 per cent in May when money market conditions tightened somewhat and stability in some emerging markets became suspect again.

The *daily average yield on long-term government bonds* generally moved lower from 16,6 per cent on 15 January 1999 to the most recent low of 14,3 per cent on 5 March 1999. From mid-January to mid-March the close relationship between movements in the exchange rate and bond yields weakened considerably. While the rand traded higher against the dollar, non-residents returned to the domestic bond market as net purchasers, as they sensed profit opportunities in the relative strength of the rand, coupled with declining bond yields. An upward correction in bond yields followed in March when the rand came under downward pressure again. From 8 February 1999, when the daily average yield declined below the 15 per cent level for the first time since June 1998, bond yields fluctuated within the 14 to 15 per cent range. However, they increased to beyond the 15 per cent level in May following the deterioration in external factors and when the exchange rate of the rand was perceived to be vulnerable once again.

The *monthly average inflation-adjusted yield on long-term government bonds* decreased from values in excess of 8,5 per cent at the peak of the financial turmoil around the middle of 1998 to 5,8 per cent in February 1999, mainly owing to the decline in nominal bond yields which exceeded the decline in year-on-year consumer price inflation. The inflation-adjusted average bond yield subsequently increased to 6,4 per cent in April as inflation continued to recede and nominal bond yields rose.

The increasingly easier money market conditions since the second half of 1998 and in the first quarter of 1999 prompted a steady decline in money-market interest rates. The tender rate on three-month *Treasury bills,* for instance, declined from 22,30 per cent on 17 September 1998 to 13,26 per cent on 7 May 1999 – a decline of 904 basis points. When some nervousness crept back into the market, the rate on Treasury bills rose to 13,70 per cent on 29 May 1999, but subsequently declined to 13,35 on 11 June. Similarly, the rate on *bankers' acceptances* with a maturity of three months declined by 818 basis points from 21,60 per cent on 16 September 1998 to 13,42 per cent on 11 June 1999. At this level it was still some 67 basis points higher than its lower turning point of 12,75 per cent prior to the onset of the financial market crisis of 1998.

Bond yield and the exchange rate

— Yield on long-term government bonds (left-hand scale)
— Rand/dollar exchange rate (right-hand scale)

Table 14. Interest rates and yields
Per cent

	Monthly average yield on long-term government bonds		Predominant rate on	
	Nominal	Inflation-adjusted	Mortgage loans	Twelve-month fixed deposits
1998: Jun	14,6	9,0	18,00	12,5
Jul...........	15,9	8,7	20,00	14,5
Aug..........	16,9	8,6	22,00	16,5
Sep..........	18,3	8,5	24,00	16,5
Oct	16,5	6,9	24,00	16,5
Nov..........	16,0	6,1	23,25	15,5
Dec..........	16,4	6,7	22,75	15,5
1999: Jan	15,9	6,4	22,00	15,0
Feb	14,9	5,8	21,00	14,0
Mar..........	14,5	6,1	20,00	13,0
Apr	14,6	6,4	19,00	12,5
May	15,1	7,6	19,00	12,0

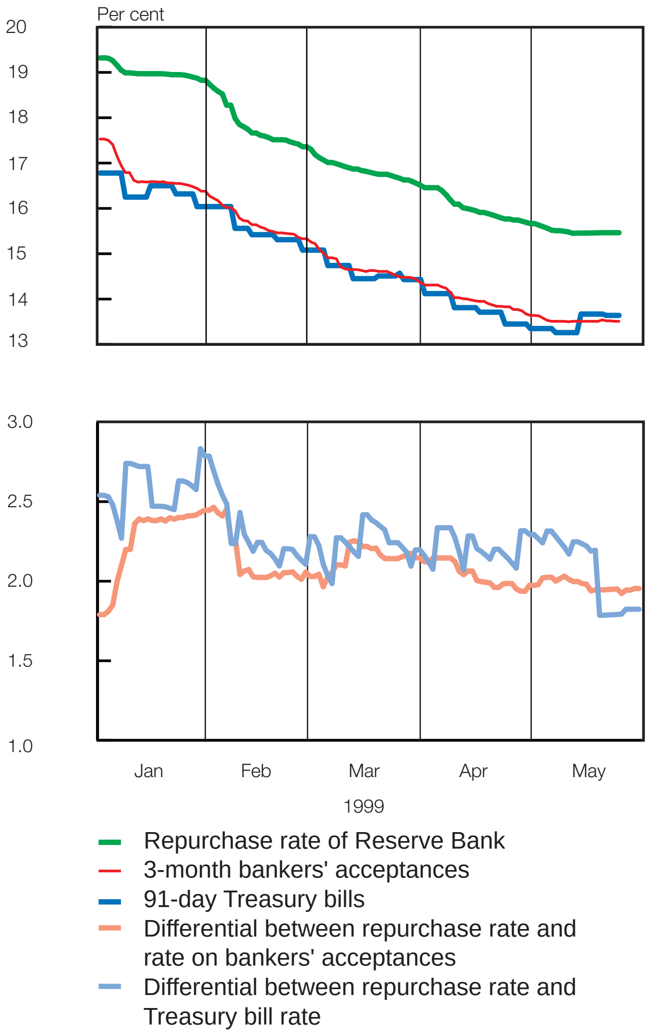
In comparison with the rates on Treasury bills and bankers' acceptances, the repurchase rate of the Reserve Bank declined more gradually by 655 basis points from 21,86 per cent on 13 October 1998 to 15,31 per cent on 11 June 1999. The subsequent heightening of uncertainty in financial markets, the decline in the gold price and the underprovision of liquidity by the Reserve Bank then created a lull in the downward movement of the repurchase rate. In fact, this rate increased from 13 May 1999, but not nearly to the same extent as the rise in the tender rate on Treasury bills over roughly the same period.

The auction-determined rate on new issues of Reserve Bank debentures declined by 722 basis points from 21,31 per cent on 16 September 1998 to 14,08 per cent on 5 May 1999. Since the rate on Reserve Bank debentures declined more than the repurchase rate, the differential between the two widened from 55 basis points on 16 September 1998 to 148 basis points on 5 May 1999. When liquidity in the money market tightened, the rate on Reserve Bank debentures rose by more than the repurchase rate, narrowing the margin between the two rates to 122 basis points on 11 June 1999.

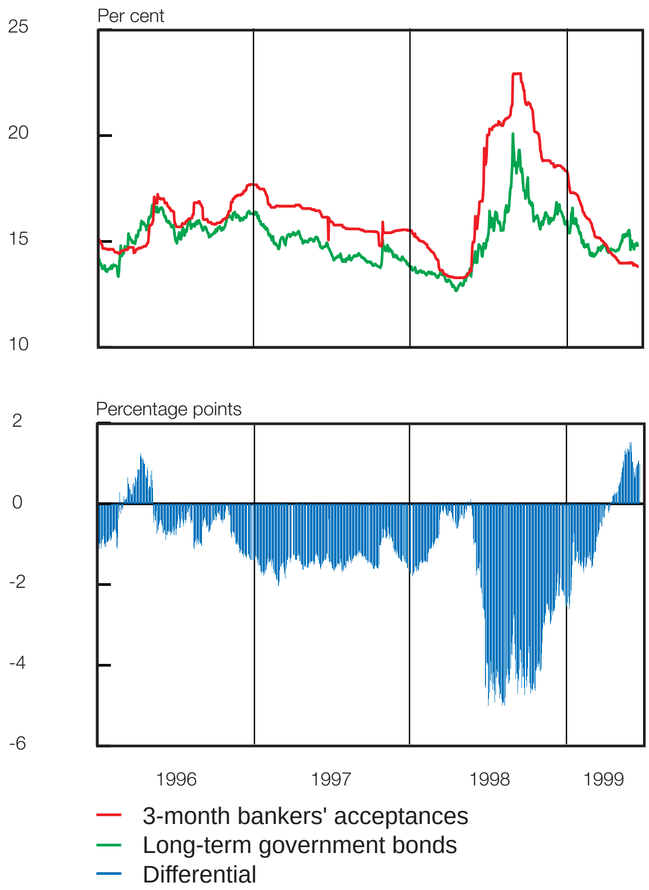
In a move that was widely interpreted as an endorsement of the downward trend in short-term interest rates, the Reserve Bank reduced the differential between its marginal lending rate and the repurchase rate from 20 percentage points to 15 percentage points on 19 April 1999.

The general downward movement of interest rates from the third quarter of 1998 shifted the *yield curve* lower over its full maturity spectrum. In the first four months of 1999 the decline in short-term yields exceeded that of long-term yields, resulting in a continuous flattening of the curve. In April 1999 short-term yields declined to levels below those of long-term yields and the yield curve assumed a slightly upward sloping shape for the first time since May 1996. The increase in long-term yields and further declines in short-term interest rates led to the further "normalisation" of the yield curve in May 1999. The upward slope at the short end of the curve probably indicated that market participants were not expecting an acceleration in inflation in the near term. Beyond the three year area, the yield curve was extreme-

Short-term interest rates



Long-term and short-term yields



ly flat, probably indicating generally neutral market expectations about consistently lower inflation in the medium to long term.

Largely led by the steady decline in the Reserve Bank's repurchase rate, the *predominant prime overdraft rate* on current accounts with banks was lowered in seven steps from a peak of 25,50 per cent in August 1998 to 19,00 per cent in April 1999. The banks also cut their *predominant rate on mortgage loans* by a total of five percentage points from September 1998 to April 1999. This decline broadly shadowed the downward movement in the prime overdraft rate and almost fully reversed the rise of 6 percentage points between June and September 1998.

The *predominant retail rate on twelve-month fixed deposits* with banks was lowered in five steps from 16,50 per cent in October 1998 to 12,50 per cent in April 1999. The *standard interest rate* applicable to loans granted from the State Revenue Fund followed the movements in market-determined rates and declined from 17,25 per cent in January 1999 to 14,75 per cent in April, but rose to 15 per cent in May.

Money market conditions

The mechanism for meeting the liquidity requirement of banks through daily auctions of repurchase contracts has now been in operation for about fifteen months. Over this period the system has allowed for the speedy transmission of changes in overall money market conditions to money market interest rates, and has enabled the Reserve Bank to signal its policy intentions to market participants. The repurchase system has indeed become central to the process of implementing monetary policy. The system allows the Reserve Bank to influence interest rates on money market instruments, and therefore the interest rate structure of the economy more generally, through a market-clearing process that gives due recognition to the collective views of all participants in the market for central bank funds.

Money market conditions eased considerably from the fourth quarter of 1998 to the first quarter of 1999. Accordingly, the average daily total liquidity requirement of private banks declined from R8,2 billion in December 1998 to R4,8 billion in March 1999 and R5,0 billion in April. Liquidity was added to the market through an increase in the net foreign assets of the Reserve Bank, deficits arising from earlier Reserve Bank involvement in the market for forward foreign exchange and a decline in the notes and coin in circulation outside the Reserve Bank when the demand for currency returned to normal levels after the end of the festive season and the summer school holidays.

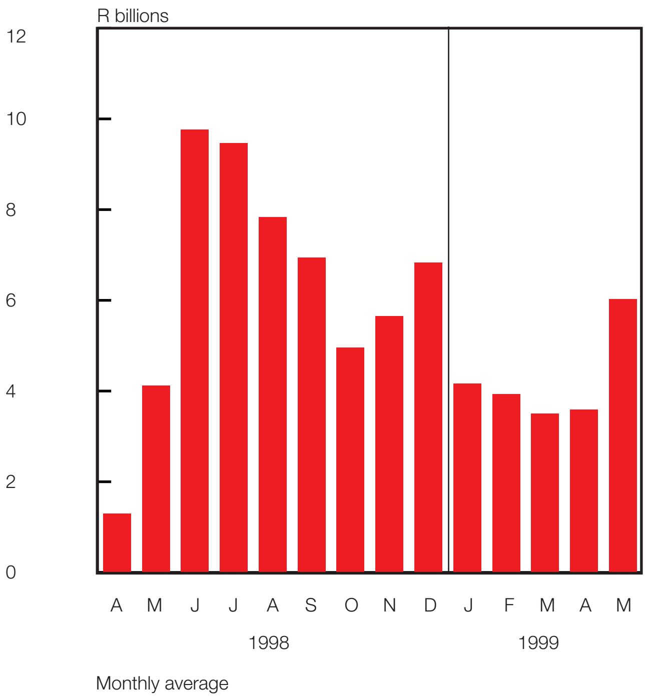
From the second half of April 1999 and into May the Reserve Bank intervened in the market to absorb excess liquidity and to avoid a too rapid descent in domestic money market interest rates when it appeared that international financial markets had yet to settle down properly. It was also not clear whether the growth in domestic aggregate demand had been contained to a sustainable rate. There was also concern that a sharp reduction in the banks' dependency on central bank funding would corrode Reserve Bank influence on short-term interest rates.

As a first defence against excessive liquidity injections into the money market, the Reserve Bank increased its own outstanding debentures to the net amount of R2,625 billion in the first five months of 1999, thus raising the amount of outstanding debentures to R4,5 billion at the end of May. The Bank also acted to mop up liquidity originating from the forward foreign exchange market by entering into foreign currency swap arrangements with private banks.

As a further measure to drain liquidity, the Reserve Bank on 29 April 1999 conducted a reverse-repurchase transaction with a maturity of 28 days with private-sector parties. In this way, the Bank increased the private banks' dependency on central bank funds, auctioning government stock worth R500 million from its own portfolio. Another auction of this kind was abandoned on 30 April 1999 when the rates tendered turned out to be unrelated to prevailing market-determined interest rates.

In the second half of May the Reserve Bank countered injections of liquidity into the money market by allowing banks to place foreign-exchange deposits with the Bank and by entering into special foreign-exchange swap arrangements to neutralise the potential liquidity effects of government's foreign loan programme. The proceeds of government's foreign borrowings were

Liquidity required



effectively delivered against the Bank's forward foreign-exchange book. The Bank also successfully conducted another reverse-repurchase auction. The maturity of the reverse-repurchase contracts was 28 days, the amount involved was R1 billion and payment by the banks had to be effected on 31 May 1999.

Apart from its liquidity management operations, the Reserve Bank also signalled to the market its discomfort with a too rapid decline in interest rates when the dismissal of the Russian Prime Minister threatened to unsettle international capital markets. The nervousness in the international markets was aggravated by the resignation of the Secretary of the Treasury of the United States on the same day and by the announcement that the United Kingdom government would be selling 400 tonnes of gold from international reserves over the next three years. In these uncertain circumstances, the Reserve Bank signalled that it would prefer a pause in the decline of interest rates by underproviding the banks' liquidity needs to an amount of R50 million on 13 May 1999. The amount of underprovision was reduced to R20 million on 14 May and R10 million on 17 May. Full provision of liquidity was resumed on 24 May 1999.

By adopting a policy of liquidity absorption, the Bank made it more difficult for domestic economic agents to substitute domestic liabilities for foreign liabilities and thus discouraged an outflow of capital from the country or, alternatively, encouraged an inflow of capital into the economy. These measures ensured a reduction in the potential for herd-like or panic-driven reactions in the domestic financial markets.

Bond market

Net issues of fixed-interest securities by the *public sector* in the *domestic primary bond market* amounted to R13,1 billion in the full 1998/99 fiscal year compared with R20,4 billion in fiscal 1997/98. This decline could be attributed to the fiscal discipline exercised by government, the aversion of public-sector borrowers to the high cost of bond financing and the amortisation of a large amount of government and public corporation debt. The quarterly amount of debt issued changed from net redemptions of R1 billion in the fourth quarter of 1998 to net issues of R5,8 billion in the first quarter of 1999.

In the *domestic primary capital market, private-sector listed companies* made no rights issues of *preference shares and debentures* in the first four months of 1999. The last time that capital was raised on the Johannesburg Stock Exchange through these debt instruments was in the second quarter of 1998, and then to the relatively small amount of only R30 million.

The greater stability in global financial markets and the firming of investor sentiment towards emerging-market economies, encouraged *South African borrowers* to return to the *international primary market for fixed-interest securities* after an absence of about a year. Transnet re-entered the *eurobond market* in March 1999, with the first *rand-denominated* issue by a South African issuer since March 1998. The proceeds of this issue amounted to R1 billion. After an absence of almost two years, the national government also returned to the offshore primary debt market and raised about R6,3 billion through the launching of *foreign-currency denominated bonds.* The first was a euro500 million 7-year eurobond in April 1999, and the second was a US$500 million 10-year global bond in May. Most of the proceeds of these two issues will be used to facilitate the redemption of a US$750 million global bond in December 1999. The 10-year global bond was priced at 370 basis points above 10-year United State Treasury bonds and the eurobond at 328 basis points higher than 7-year debt of the French government.

The value of bonds traded on the Bond Exchange of South Africa receded from a record high of R2,6 trillion in the third quarter of 1998, at the peak of the problems in the international financial markets, to R1,6 trillion in the fourth quarter as trading activity became less hectic during the holiday season. The further decline in bond yields encouraged trading, causing turnovers to increase to R1,9 trillion in the first quarter of 1999 and R0,6 trillion in April. With the subsequent increase in bond yields, the value of transactions amounted to R0,8 trillion in May 1999.

Non-residents reduced their exposure to South African bonds through *net sales* of these securities to the amount of R19,9 billion in the last three quarters of 1998. When the worst of the problems in international financial markets appeared to be over by January 1999, non-residents acquired bonds to the net value of R1,9 billion in the first quarter. Buying was mainly concentrated in February 1999 when non-residents increased their holdings of South African bonds on a net basis by R3,2 billion. As market sentiment improved, net purchases of R1,6 billion and R2,1 billion were recorded in April and May respectively.

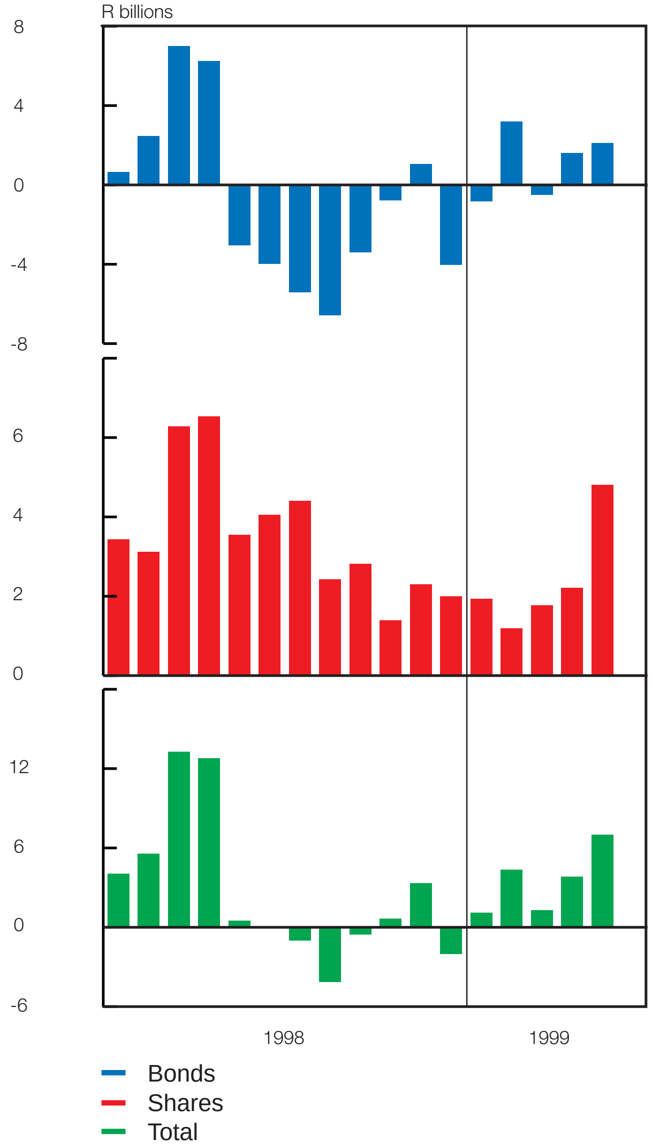
Share market

Total *share capital* raised on the Johannesburg Stock Exchange amounted to R13 billion in the first four months of 1999 compared with R20 billion in the corresponding period of 1998 as the volatility of share prices apparently impeded capital-raising activity. Equity financing in the *primary share market*, after having increased to a high of R25,9 billion in the third quarter of 1999, increased further to R32,9 billion in the fourth quarter. When leaving the demutualisation of Sanlam out of consideration, new equity financing would have been R16,9 billion. The total value of capital raised subsequently declined to R8 billion in the first quarter of 1999.

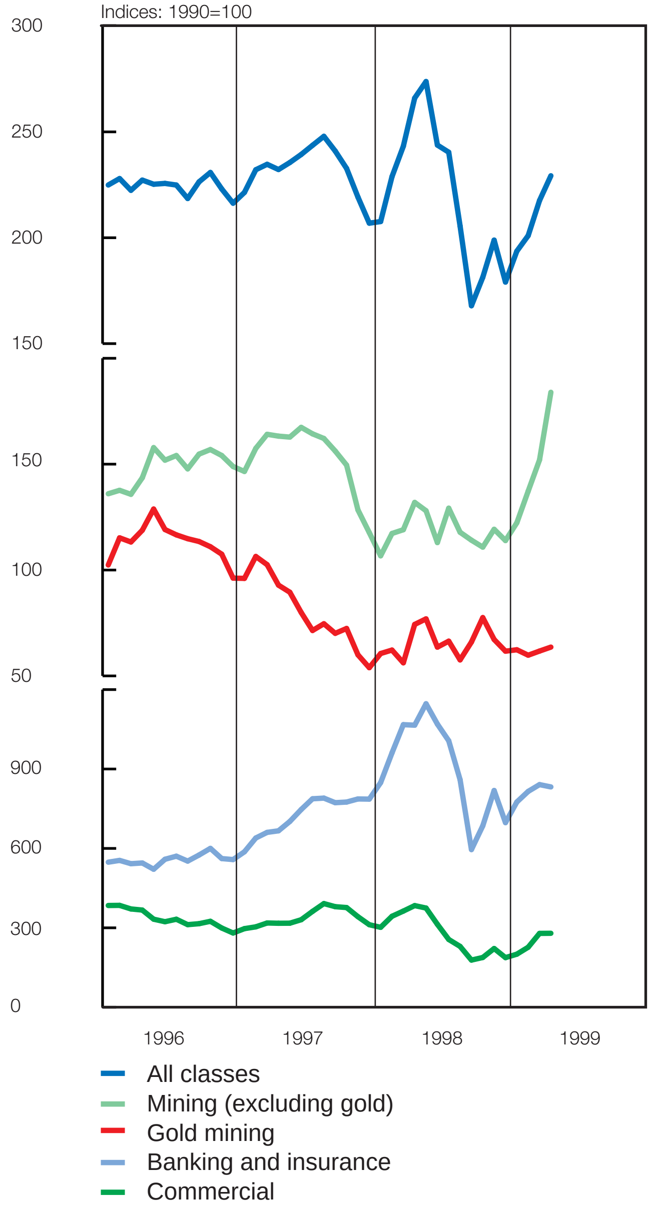
In the *secondary share market* the value of shares traded reached an all-time high of R91 billion in the second quarter of 1998, but then declined slightly to R90 billion in the third quarter and R71 billion in the fourth quarter. Turnover rebounded to R88 billion with the surge of share prices in the first quarter of 1999. In March 1999, turnovers reached a monthly all-time high of R40 billion, followed by turnovers of R37 billion in April and R36 billion in May.

The reassessment of risk associated with investment in emerging markets instigated the slower accumulation of

Net transactions in the secondary capital markets by non-residents



Average monthly share prices



non-resident holdings of equity in South African companies. Non-residents' net purchases of shares on the Johannesburg Stock Exchange accordingly decreased from a quarterly all-time high of R14,1 billion in the second quarter of 1998 to R4,9 billion in the first quarter of 1999 – but they remained net buyers of shares throughout the period of turmoil in the global financial markets. Sentiment improved in the first five months of 1999 and non-residents bought shares on the Johannesburg Stock Exchange to the total net amount of R7,0 billion in April and May.

The sharp decline of 39 per cent in the *monthly average price level of all classes of shares* from May 1998 to early September, was followed by a gradual upturn of 7 per cent to December 1998. In the first four months of 1999 investor confidence was greatly restored as interest rates moved lower, inflation decelerated, prospects for the domestic economy improved somewhat, and the corporate tax rate was cut. The monthly average value of the all-share price index increased by 29 per cent from December 1998 to April 1999 and, on balance, by 38 per cent from September 1998 to April 1999. When converted to US dollars, there was an increase of 23 per cent from December 1998 to April 1999. Concerns about political stability in Russia and about continued financial stability in Latin America subsequently contributed to an increase of almost 1 per cent in the all-share price index in May 1999.

Table 15. Monthly average share prices
Indices: May 1998 = 100

	All classes	Mining			Banking and insurance	Commercial
		Excluding gold	Financial	Gold		
1998: May	100	100	100	100	100	100
Sep	61	89	75	86	52	48
Dec	65	89	75	80	61	50
1999: Jan	71	96	74	81	68	53
Feb	73	107	79	78	71	60
Mar	79	119	89	80	73	74
Apr	84	144	113	83	73	75
May	84	155	124	82	74	73

The rise in the all-share price index from December 1998 to April 1999 was led by an increase of 62 per cent in the prices of *mining shares* (excluding gold) and an increase of 51 per cent in the prices of *mining financial shares.* The prices of gold-mining shares faltered and increased by only about 4 per cent, partly as a result of the expected impact on the gold price of planned gold sales by central banks.

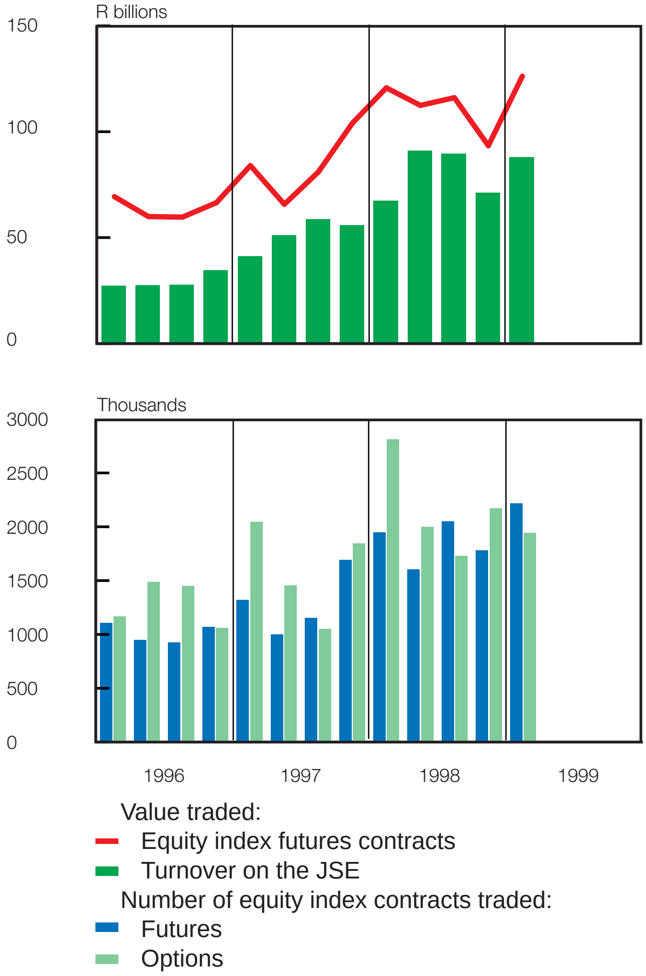
The prices of commercial shares strengthened by 48 per cent from December 1998 to March 1999 as consumer-related shares seemingly benefited substantially from the decline in bank lending rates. The prices of shares in banking and insurance companies increased by 20 per cent from December 1998 to March 1999. Then they levelled off along with commercial company shares from March to May 1999.

The rise in share prices from September 1998, and the weaker earnings growth, reduced the *dividend and earnings yields* on shares in the first four months of 1999. The monthly average *dividend yield* on all classes of shares declined from 3,5 per cent in September – its highest level in 1998 – to 3,2 per cent in January 1999, and further to 2,7 per cent in April. Similarly, the monthly average *earnings yield* (gold-mining shares excluded) declined from 10,2 per cent in September 1998 to 7,7 per cent in April 1999. The *price-earnings ratio* of all classes of shares, apart from gold-mining shares, mirrored the trend in earnings and increased strongly from 9,8 in September 1998 - its lowest level in that year – to 13,0 in April 1999. At this level it was still markedly lower than the upper turning point of 16,9 in May 1998.

Market for derivatives

Uncertainties about the financial stability in emerging markets and heightened price volatility in domestic financial markets fostered an *environment* for hedging, arbitrage and speculation in the formal market for derivatives. The *value of equity index futures contracts* traded on the South African Futures Exchange changed in tandem with, but exceeded by a substantial margin, the turnover on the Johannesburg Stock Exchange. Heightened trading activity also spilled over to options on equity index futures contracts (see accompanying graph).

Trading in derivative products and turnover on the Johannesburg Stock Exchange



Trading in equity index futures contracts recorded an all-time high in March 1999, while trading in options on equity index futures contracts also reached its highest level ever in April 1999. The quarterly *number of equity index futures and options on futures contracts* traded, increased from 3,9 million in the fourth quarter of 1998 to 4,2 million in the first quarter of 1999. The number of these contracts traded declined from an all-time high of 2 million in April 1999 to 1,6 million in May. Equity option contracts were replaced by *individual equity futures contracts* in February 1999. In the four months to May, 82 686 futures contracts on individual listed shares were traded.

Trading in *warrants*, measured in terms of the number of underlying shares as a percentage of the total number of shares traded on the Johannesburg Stock Exchange, averaged about 0,6 per cent in 1998 and in the first four months of 1999. *Warrants on equity indices,* including index tracking certificates, were introduced in September 1998. Trading activity in warrants continued to be dominated by warrants on individual listed shares, which accounted for 94 per cent of the total number of trades.

Trading in *interest rate futures and options on futures contracts,* increased from an all-time low of 880 contracts in the fourth quarter of 1998 to 2 950 contracts in the first quarter of 1999. The number of these contracts traded subsequently decreased from a monthly average of 983 in the first quarter of 1999 to a monthly average of 620 in April and May 1999.

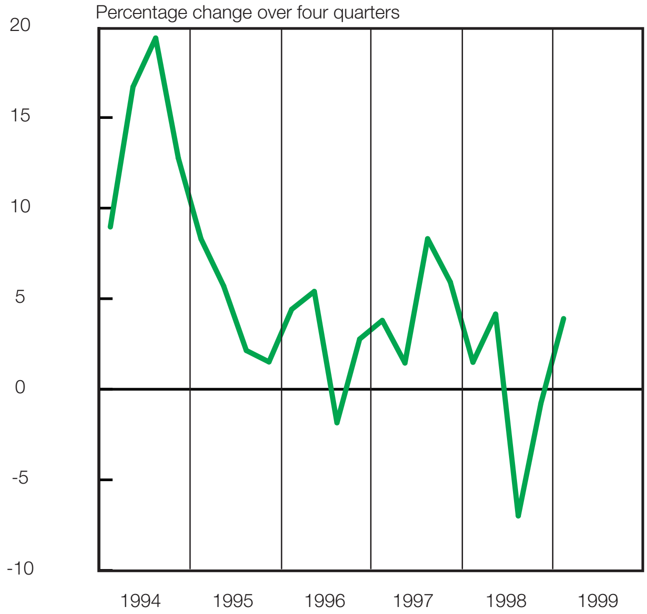
Trading in *commodity futures contracts* and *options* on such contracts was buoyant in the first quarter of 1999 as the impact of adverse weather conditions boosted the market for maize contracts. The number of contracts traded increased from 19 252 in the fourth quarter of 1998 to an all-time high of 41 538 in the first quarter of 1999. In April and May 1999 a total of 25 578 contracts were traded.

Real-estate market

Activity in the *home loan and real-estate markets* at the beginning of 1999 still reflected the impact of high financing costs. Depressed underlying conditions in the *home loan market* led to a slowdown in the rate of increase over twelve months in mortgage loans outstanding to banks from 16,7 per cent in January 1997 to 10 per cent in December 1998 and 6,5 per cent in April 1999. This rate of increase was marginally lower than the contemporaneous increase in the consumer price index.

The *real-estate market* became more subdued towards the end of 1998 when the total value of transactions in fixed property 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 value of transactions amounted to R5,7 billion in the first quarter of 1999 and R2,1 billion in April.

Average nominal value per real-estate transaction



The *average nominal value per real-estate transaction* declined in the third and fourth quarters of 1998 relative to its level in the corresponding quarters of 1997. As consumer prices kept on rising, the real value of fixed property declined even more than the nominal value – on average, the inflation-adjusted real-estate values declined by 5,6 per cent in 1998. From the beginning of 1999 they appeared to have strengthened slightly. This was also reflected in the movement in the share prices of real-estate companies listed on the Johannesburg Stock Exchange. During the period from December 1998 to April 1999 the value of the price index of the real-estate section of the Exchange increased by 20 per cent.

Public finance

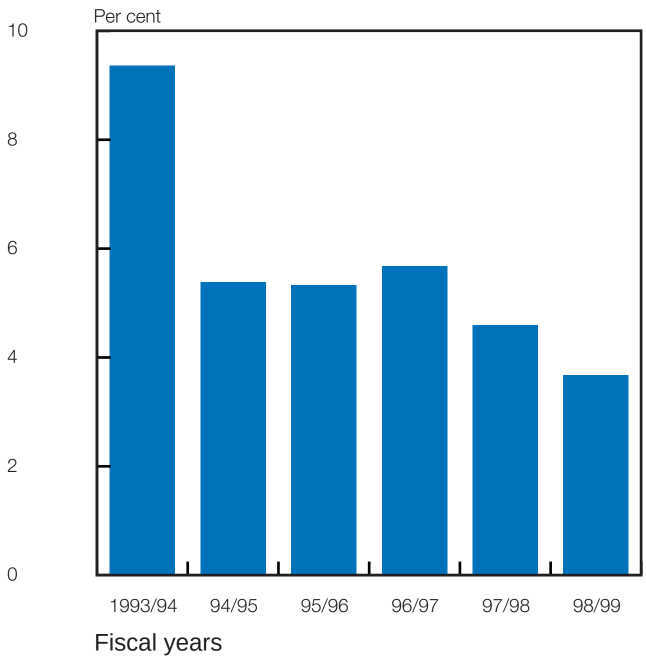
Public-sector borrowing requirement

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) declined from R10,6 billion in the April-June quarter of 1998 to R4,6 billion in the January-March quarter of 1999. This contributed to a decline in the public-sector borrowing requirement from R32,0 billion in fiscal 1997/98 to R27,6 billion in fiscal 1998/99. As a ratio of gross domestic product, the public-sector borrowing requirement declined from 4,6 per cent in fiscal 1997/98 to 3,7 per cent in fiscal 1998/99.

The decline in the borrowing requirement of the public sector in relation to gross domestic product can be attributed to an impressive improvement in the financial position of general government. However, this was partly offset by an increase in the borrowing requirement of *non-financial public enterprises and corporations* from R2,3 billion in fiscal 1997/98 to R8,6 billion in fiscal 1998/99, mainly consequent upon the intensification of capital expenditure programmes by public corporations, notably South African Airways and Telkom.

The deficit of *general government* amounted to R3,5 billion in the January-March quarter of 1999, bringing the deficit for the whole of fiscal 1998/99 to R19,0 billion.

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



This represented a decline of 35,9 per cent in the size of the deficit from the R29,7 billion recorded in the previous fiscal year.

Total revenue receipts of general government increased by 11,7 per cent in fiscal 1998/99 because of buoyant collections of current revenue. Tax revenue grew solidly by 11,0 per cent in fiscal 1998/99 and non-tax revenue even more strongly by 16,6 per cent.

Total expenditure by general government rose at a rate of 5,3 per cent in fiscal 1998/99. Although interest payments by general government increased at a rate of 10,1 per cent in fiscal 1998/99, general government successfully contained growth in current expenditure, mainly through a decisive slowdown in its spending on goods and services.

The financial position of general government improved mainly because of a significant strengthening of the finances of provincial governments, reinforced by a decline in the borrowing requirement of the consolidated central government. By contrast, a slight increase was recorded in the fiscal deficit of local governments.

Provincial governments recorded a surplus of R0,1 billion in the January-March quarter of 1999, which took their aggregated financial balances to a surplus of R3,2 billion in fiscal 1998/99. The improvement in the finances of the provincial governments resulted from the containment of expenditure, the late departmental transfer of R1,5 billion from national to provincial governments and a special capital transfer of R0,9 billion earmarked for the settlement of accumulated debts. Bank credit extended to provincial governments decreased from R3,8 billion at the end of March 1998 to R0,9 billion at the end of March 1999, while the bank deposits of provincial governments increased from R2,4 billion at the end of March 1998 to R2,7 billion at the end of March 1999.

The improvement in the financial position of the consolidated central government resulted essentially from a decrease in the borrowing requirement of the *main budget* from R21,0 billion in fiscal 1997/98 to R19,1 billion in fiscal 1998/99. This improvement outweighed a slight deterioration in the financial deficits of extra-budgetary institutions and social security funds.

National government finance

National government expenditure in fiscal 1998/99 amounted to R204,7 billion – R3,4 billion higher than the original budgetary provision of R201,3 billion, or 7,9 per cent higher than in the preceding fiscal year. The original budget proposals targeted an increase of 6,1 per cent in expenditure which was well down from an average growth rate of 11,4 per cent in the five preceding fiscal years. As a ratio of gross domestic product, national government expenditure amounted to 27,3 per cent in fiscal 1998/99, the same level as that which was recorded in fiscal 1997/98. After allowing for cash-flow adjustments, total expenditure increased by 8,8 per cent in fiscal 1998/99, compared with growth of 4,3 per cent in the previous fiscal year.

Revenue received by national government amounted to R182,9 billion in fiscal 1998/99. This represented an increase of 11,6 per cent for the fiscal year compared with a budgeted increase of 8,3 per cent. The higher-than-budgeted increase in government revenue was mainly the result of growth of 11,8 per cent in *receipts from inland revenue,* solidly in excess of the budgeted increase of 6,9 per cent. This increase in inland revenue was primarily due to an increase of 13,7 per cent in income tax collections, as against the budgeted rate of 6,3 per cent. In a somewhat subdued domestic economy this clearly illustrates the success that the South African Revenue Service has achieved in improving the efficiency of tax administration.

Receipts from customs and excise duties fell short of the budgetary provisions in fiscal 1998/99. This could be attributed to the decline in receipts from customs duties associated with the accelerated implementation of tariff reductions agreed to in the Final Act of the Uruguay Round of trade negotiations. Revenue receipts were still supported by positive, but lower than budgeted, increases in receipts from the fuel levy and other excise duties.

As a ratio of gross domestic product, national government revenue amounted to 24,4 per cent in fiscal 1998/99, compared with 23,6 per cent in the preceding fiscal year. After including the cash-flow adjustment for surrenders and other receipts, national government revenue amounted to R185,7 billion in fiscal 1998/99. This represented an increase of 11,9 per cent over the previous fiscal year.

The higher-than-expected expenditure and revenue for fiscal 1998/99 resulted in a *national government deficit before borrowing and debt repayment* of R21,8 billion, which was noticeably lower than the originally budgeted deficit of R23,7 billion. As a ratio of gross

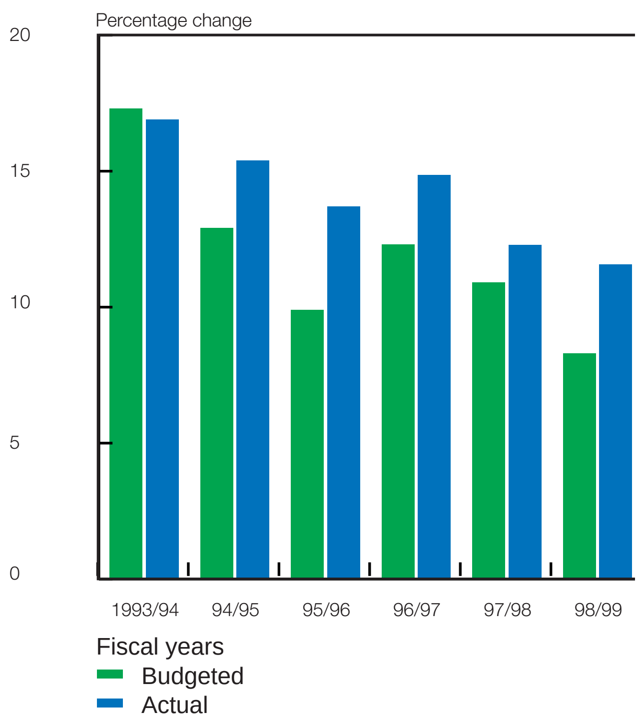
Table 16. National government revenue by type of income in fiscal 1998/99

Percentage change*

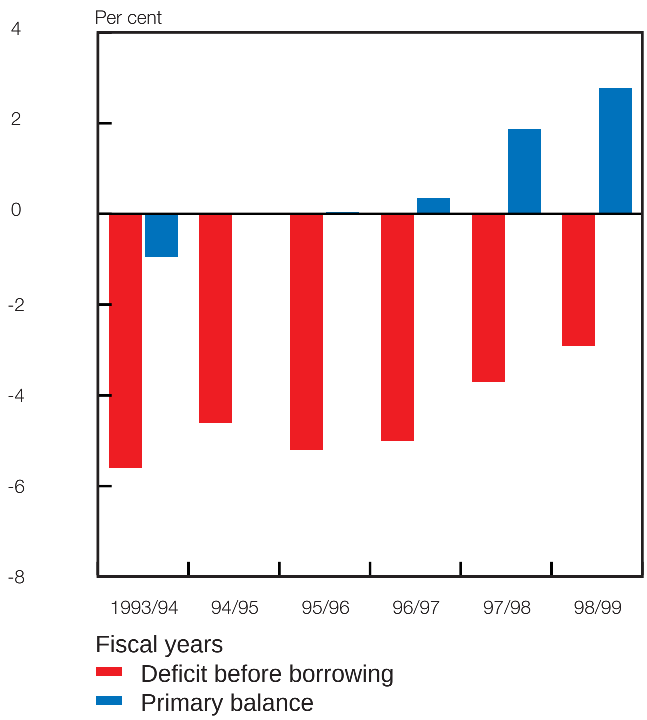
	Budgeted	Actual
Inland revenue	6,9	11,8
Income tax	6,3	13,7
Value-added tax	8,4	9,3
Customs and excise duties	18,4	10,2
Customs duty	10,6	-1,2
Fuel levy	19,2	12,8
Other excise duties	11,9	6,6
Total revenue	**8,3**	**11,6**

* Based on the actual outcome of the previous fiscal year

Budgeted and actual national government revenue



National government balances as a ratio of gross domestic product



domestic product, the deficit amounted to 2,9 per cent in fiscal 1998/99, compared with a ratio of 3,7 per cent recorded in the preceding fiscal year. The generally downward movement in the ratio of the deficit to gross domestic product is consistent with government's objectives as outlined in the Growth, Employment and Redistribution Strategy (GEAR). National government also succeeded in recording a primary surplus (i.e. the balances recalculated by excluding interest payments from total expenditure) of 2,8 per cent of gross domestic product in fiscal 1998/99.

The deficit before borrowing and debt repayment, adjusted for cash flows, amounted to R21,1 billion in fiscal 1998/99 or 2,8 per cent of the gross domestic product, well down from 3,5 per cent in fiscal 1997/98. This was financed mainly by means of government stock issues, and to a lesser extent by issues of treasury bills and receipts from the sale of government assets. As indicated in the accompanying table, new funds obtained through the issue of government stock amounted to R18,4 billion, whereas treasury bills were issued to the amount of R1,4 billion.

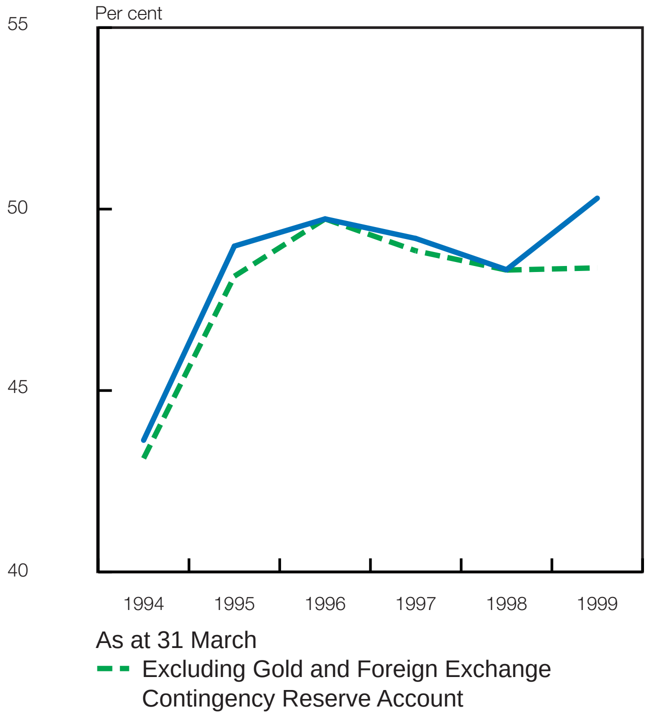
Long-term funding was obtained at an average rate of 16,4 per cent per annum and short-term debt instruments were sold at an average rate of 16,5 per cent per annum during fiscal 1998/99. These rates compare with an initial budget assumption averaging 13,0 per cent. The favourable outcome of national government finances in fiscal 1998/99 resulted in a positive cash balance on the Exchequer account, which made funds available for the financing of future deficits. The net financing requirement of national government in fiscal 1999/2000 was accordingly reduced to R12,0 billion from R14,9 billion, as indicated in the Budget presented to Parliament on 17 February 1999.

Table 17. Financing the national government deficit in fiscal 1998/99

Financing instrument	R millions
Government stock (including discount)	24 555
Less: Discount on government stock	6 194
Net receipts from government stock	**18 361**
Treasury bills	1 352
Extraordinary transfers	-936
Extraordinary receipts	3 001
Foreign loans	
Repayment of IMF loan	-1 036
Other	-20
Non-marketable securities	-13
Redemption of Section 239 debt*	-263
Redemption of Namibian debt	-46
Transfer from IMF account	1 036
Change in available cash balances	-340
Total net financing	**21 096**

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

National government debt as a ratio of gross domestic product



Total national government debt rose from R336,2 billion at the end of March 1998 to R377,7 billion at the end of March 1999. This increase resulted from the borrowing requirement of the government, the discount on new government stock issued and the inclusion of the deficit of R14,4 billion on the Gold and Foreign Exchange Contingency Reserve Account. As a ratio of gross domestic product, government debt increased from 48,3 per cent at the end of March 1998 to 50,3 per cent at the end of March 1999. The increase in the balance on the Gold and Foreign Exchange Contingency Reserve Account added 1,9 percentage points to the ratio of government debt to gross domestic product at the end of March 1999.

National government finance in April 1999

In April 1999 national government expenditure amounted to R20,3 billion or 6,4 per cent more than in April 1998. After allowing for cash-flow adjustments, this expenditure amounted to R18,9 billion, which was 5,8 per cent *lower* than the corresponding amount a year earlier. The Budget provided for an increase in national government expenditure of 5,9 per cent in fiscal 1999/2000. Revenue received by national government amounted to R10,7 billion in April 1999 or 2,3 per cent more than in April 1998. There was no need for any cash-flow adjustment to the revenue received in April 1999.

The net result of these changes in revenue and expenditure in April 1999, was a deficit before borrowing and debt repayment of R9,6 billion, which amounted to R8,2 billion after adjustment for cash flows. Although this deficit is equivalent to a high percentage of the budgeted deficit for fiscal 1999/2000, no firm conclusions regarding fiscal developments in the remainder of the year should be drawn from the April outcome. Spending is known to be relatively high in April whereas revenues in that month usually tend to fall short of targets for the full fiscal year.

National government successfully placed two foreign bond issues during April and May. The first was a 7-year Eurobond issue to the value of 500 million euro and the second a 10-year Dollarbond to the value of US$500 million. The proceeds of these new issues were delivered against the forward-exchange position of the Reserve Bank. These issues lengthened the average outstanding maturity of government debt and also completed the foreign funding programme envisaged in the Budget for fiscal 1999/2000.