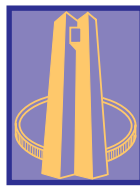


Quarterly Bulletin

December 2000

No. 218



South African Reserve Bank

Quarterly Economic Review

[Introduction](#)

[Domestic economic developments](#)

- Domestic output
- Domestic expenditure
- Factor income
- Gross saving
- Employment
- Labour costs and productivity
- Prices

[Foreign trade and payments](#)

- Current account
- Financial account
- Foreign debt
- Foreign reserves
- Exchange rates

[Monetary developments, interest rates and financial markets](#)

- Money supply
- Credit extension
- Yields and interest rates
- Money market
- Bond market
- Share market
- Market for derivatives
- Real-estate market
- Non-bank financial intermediaries

[Public finance](#)

- Non-financial public-sector borrowing requirement
- National government finance
- Adjustments Budget for fiscal 2000/01
- The Medium Term Budget Policy Statement

[List of tables](#)

[List of graphs](#)

List of tables

- Real gross domestic product
- Real gross domestic expenditure
- Real final consumption expenditure by households
- Consumer and production price indices
- Quarter-to-quarter changes in consumer and production prices
- Balance of payments on current account
- Net financial transactions not related to reserves
- Foreign debt of South Africa
- Exchange rates of the rand
- Twelve-month growth rates in monetary aggregates
- Increase in credit extension to the private sector by type of credit
- Credit categories as percentage of total claims on the domestic private sector
- National government revenue
- Financing of national government deficit
- Adjustments Budget estimates for fiscal 2000/01
- Fiscal projections

List of graphs

- Growth in real gross domestic product
- Real gross domestic expenditure
- Real gross domestic final demand
- Household debt as percentage of disposable income
- Real gross fixed capital formation by the private sector
- Gross operating surplus as percentage of total factor income
- Gross saving as percentage of gross domestic product
- Non-agricultural employment in the formal sectors
- Non-agricultural unit labour costs
- Non-agricultural labour productivity
- CPIX inflation
- Production price inflation
- Consumer price inflation
- Current-account balance as percentage of gross domestic product
- Balance of payments: Current account
- Real merchandise trade
- Total net capital movements not related to reserves
- Changes in portfolio investment liabilities of South Africa
- Change in net gold and other foreign reserves
- Effective exchange rates of the rand
- M3 money supply
- Income velocity of M3
- Credit extended by monetary institutions
- Credit extended to households and corporations
- Yield on long-term government bonds
- Sovereign risk premium on South African government bonds
- Currency risk premium on South African government bonds
- Money-market interest rates
- Annual cumulative net purchases of shares and bonds by non-residents
- Price earnings ratio: All shares
- Derivatives market
- Unit trust price movements
- Non-financial public-sector borrowing requirement
- National government expenditure as a ratio of gross domestic product
- Financing of national government deficit
- National government debt as a ratio of gross domestic product
- National government deficit as a ratio of gross domestic product

Quarterly Economic Review

Introduction

The world economy continued to expand at a lively pace in the first half of 2000. Early indications are that the expansion is more than likely to have spilled over into the second half of the year, but with some loss of momentum.

The industrialised economies of the world succeeded in maintaining relatively firm output growth. The United States economy is in its longest expansion phase in a century and widely held expectations are that any imminent slowdown will be more of a "soft" landing than an abrupt end to a period of prosperity. The world economy was further helped by the continued recovery in the east Asian economies, an improvement in some Latin American countries and exceptionally favourable conditions in certain of the transitional east European economies.

The sharp increase in international petroleum prices has had a negative impact on the prospects for containing global inflation. But, quite paradoxically, the transfer of real income from oil-importing countries to oil-exporting countries contributed in great measure to the stabilisation of the economies in some countries, particularly in the Russian Federation where the economy is booming because of oil export earnings. Although there is a risk of higher inflation everywhere, there are still no signs of any sustained price and cost increases in the oil-importing industrial countries. However, the longer the price pressures from petroleum prices persist, the greater the danger of second-round price and wage increases and a pick-up in endogenously generated inflation.

The South African economy gathered considerable momentum in the third quarter of 2000. The strong growth in the second half of 1999, which slowed down somewhat in the first half of 2000, was largely restored in the third quarter. Stronger growth in manufacturing production resumed and real income in the agricultural sector rose vigorously as the bulk of a bumper maize crop was harvested in the third quarter. Growth in real gross domestic product approached 4 per cent in the third quarter of 2000 – about the same as where it had been in the fourth quarter of 1999 and considerably firmer than the average annualised growth of about 2½ per cent in the first half of 2000.

In the third quarter of 2000 the composition of growth in expenditure shifted. A decline in the pace of export growth was offset by an increase in the growth in real gross domestic expenditure. The depreciation of the rand has not yet resulted in sustainably higher export volumes.

The national accounts showed continued growth in real final household spending in the third quarter. Increased spending on new motor cars and other durable goods more than offset the slower increases in spending on semi-durable goods.

Growth in household disposable income has supported personal consumption expenditure. Incomes were boosted by the tax reductions earlier in the year, a solid increase in farm and other property income which was buoyed by higher dividend payments. Asset price increases, especially that of real-estate and equities also encouraged consumer sentiment and added momentum to household spending.

On the other side of the household balance sheet, the debt of the household sector grew faster than its income, shifting the debt-income ratio slightly higher over the past quarter. The decline in bank lending rates over the past two years or so encouraged households to start borrowing again. The interest payment burden is now substantially lower than in 1998, allowing households some extra latitude for raising their discretionary spending.

A favourable external environment, continued growth in domestic final demand, rising profitability and the availability of investable funds provided the incentives for the business sector to raise its capital expenditure further in the third quarter. The improved outlook for the business sector was also reflected in firms' willingness to accumulate inventories ahead of an expected demand expansion.

Despite the recovery in income generation and aggregate spending, the formal labour market recorded further declines in employment numbers in the first half of 2000. Labour paring in the private sector was swelled by job losses at all levels of the public sector. Unemployment remained high, and may have contributed to some moderation in the growth of wages and salaries. The potential effect of rising labour costs on input costs was further checked by significant increases in productivity. For example, in the manufacturing sector the growth in nominal unit labour costs was flat when comparing the first half of 2000 with the first half of 1999.

The rates of increase in the broader measures of prices moved up in the course of 2000, despite the slow growth in unit labour costs. The pass-through of the steep rise in the cost of imported petroleum and the decline in the exchange rate of the rand since the beginning of the year, were the principal factors in the acceleration of production price increases. In the first half of the year, higher food prices added to the upward pressure on consumer prices. Apart from the effects of rising petrol and food prices, little indication of endogenously generated inflation could be seen in the changes in consumer prices. However, the recent rise in production prices, excluding exogenous cost-push pressures, gives evidence of some second-round price pressures and may be seen more fully in the consumer price index in coming months.

Reflecting the rise in final household expenditure and gross investment by firms, imports increased sharply in the third quarter. Although the value of gold exports rose impressively, the rise in merchandise exports failed to match the rise in merchandise imports, partly an indication of the long time delays between depreciations of the rand and their impact on export volumes. These developments were aggravated by a high level of dividend and interest payments to the rest of the world whereas income received from foreign sources actually declined. As a consequence, the surplus on the current account of the balance of payments was transformed into a deficit in the third quarter equal to about 0,6 per cent of gross domestic product.

The deterioration of the current account of the balance of payments in the third quarter of 2000 coincided with a reversal of international capital flows to the country: net outflows of capital in the second quarter were followed by a strong inward movement in the third quarter. This flow reversal emanated mostly from the changing pattern of securities purchases by non-resident investors. Equities, in particular, became quite popular among non-resident investors in the third quarter and net sales of fixed-income assets diminished. Foreign direct investment in real-sector job-creating projects remained low.

The surplus on the financial account of the balance of payments exceeded by a considerable margin the absolute value of the deficit on the current account, raising the country's international reserve holdings to their highest level ever. In the first two months of the third quarter, the excess supply of liquidity in the domestic foreign exchange market moved the external value of the rand higher, but from September the exchange rate of the rand came under downward pressure again when the inflows of portfolio capital subsided noticeably. From the end of 1999 the rand has depreciated on a weighted basis by some 10½ per cent to the middle of November 2000. The implicit real depreciation of the rand over this period is, of course, an approximate indication of the improved competitiveness of South African producers in export markets.

By the third quarter there were signs of a rebound in aggregate monetary growth and a return of stronger growth in banks' claims on the domestic private sector. Considering that inflation is ultimately determined by excessive monetary growth, the recent acceleration in the growth in M3 has the potential of fuelling inflation expectations and eventually the momentum of increase in the overall price level. These changes in the conditions underlying future inflation prompted the Reserve Bank to shift to a slightly more cautious policy stance in the fourth quarter of 2000.

Money market conditions tightened in the early months of 2000, but from about the beginning of the second quarter the daily liquidity requirements of the private banks fluctuated within a relatively narrow range. The Reserve Bank actively intervened in the money market to ensure such an outcome, in the process keeping the interest rate on repurchase transactions unchanged from January to October. Concerns about possible second-round price responses to the high crude oil prices and the depreciation of the rand, led to steps being taken by the Bank to raise the repurchase rate on 17 October by some 25 basis points. This was an unambiguous signal that the monetary policy stance has shifted towards greater caution. The private banks correctly interpreted the Bank's monetary policy statement as a precautionary measure and did not raise their prevailing lending rates as a result.

As the year began with concerns about the millennium date change out of the way, participants in the fixed-income market turned their attention to signs of possible changes in the domestic monetary policy stance and heightened uncertainty about future inflation movements in South Africa. At the international level there was also some increased aversion to risk taking in emerging markets. The investment mood changed quite dramatically and yields on long-term government bonds retraced part of their declines in 1999 over the period from January to May 2000.

Sentiment once again changed for the better in the second quarter. It became clear by then that developments in other parts of Africa would only have a limited impact on economic stability in South Africa. Non-resident investors returned as net buyers of fixed-income securities, contributing to a downward movement of bond yields up to August. Since about the end of August the bond market has been without clear direction, fluctuating around a fairly flat trend with an upward bias. Movements in equity prices almost perfectly mirrored developments in the fixed-income market, but non-residents maintained a presence as net buyers of shares throughout most of the first ten months of the year.

Activity was subdued in the primary market for long-term capital in the first nine months of 2000. The relatively small public-sector borrowing requirement, together with national government's preference for funding through the issuance of short-

term Treasury bills, led to a decline in the net issuance of bonds. Companies listed on the Johannesburg Securities Exchange partly filled this void and stepped up their capital-raising activities. This was predominantly done for purposes of mergers and acquisitions, and less so for the financing of new investment projects.

Trading in the derivatives markets continued to grow strongly as these financial instruments are increasingly being used to hedge the positions taken in the underlying securities markets. Activity in the real-estate market remained at a high level from about the first quarter of the year, following a period of strong recovery in the wake of the interest-rate declines of late 1998 and 1999.

The declining budget deficit of national government in recent years has been an important factor in containing the decline in domestic saving. The decline in dissaving by general government was sufficient to offset the decline in personal saving. A deeper pool of national saving, along with the willingness of foreign investors to augment domestic saving, will make a major contribution to containing increases in the cost of capital and for financing the expansion of real fixed capital formation. The future involvement of multilateral financial institutions in providing project finance is expected to make a significant contribution towards accelerating the development of infrastructure in the country.

Domestic economic developments

Domestic output¹

The growth in *real gross domestic product* picked up in the third quarter of 2000. After increasing at seasonally adjusted and annualised growth rates of 2 per cent in the first quarter of 2000 and 3 per cent in the second quarter, real gross domestic product (seasonally adjusted and annualised) grew by 4 per cent in the third quarter. The level of real gross domestic product was about 3 per cent higher in the first three quarters of 2000 than in the corresponding quarters of 1999.

Real output in the *primary sectors* increased at a seasonally adjusted and annualised rate of 8 per cent in the third quarter of 2000, following a decline of 5 per cent in the first quarter and an increase of just 1 per cent in the second quarter. The recent strong output growth was particularly evident in the *agricultural sector*. Field crop production was pushed to new heights by the delayed harvesting of the bumper maize crop, but solid contributions to output growth were also made by livestock and horticultural farming. The outbreak of foot-and-mouth disease in KwaZulu-Natal apparently had only a minor impact on agricultural output growth at national level. By contrast, maize output in the current season is estimated to exceed 10 million tons, about one-fourth more than the 8 million tons harvested in 1999.

Total real output in the *mining sector*, which had fallen at seasonally adjusted and annualised rates of 3 per cent in the first quarter of 2000 and 3½ per cent in the second quarter, declined by 2½ per cent in the third quarter. The downward movement of mining output was the outcome of shrinking gold production which offset increases in the other sectors of the mining industry. Among the non-gold mining sectors, real output in platinum mining was buoyed by an improvement in the international price of this commodity.

Real gross domestic product

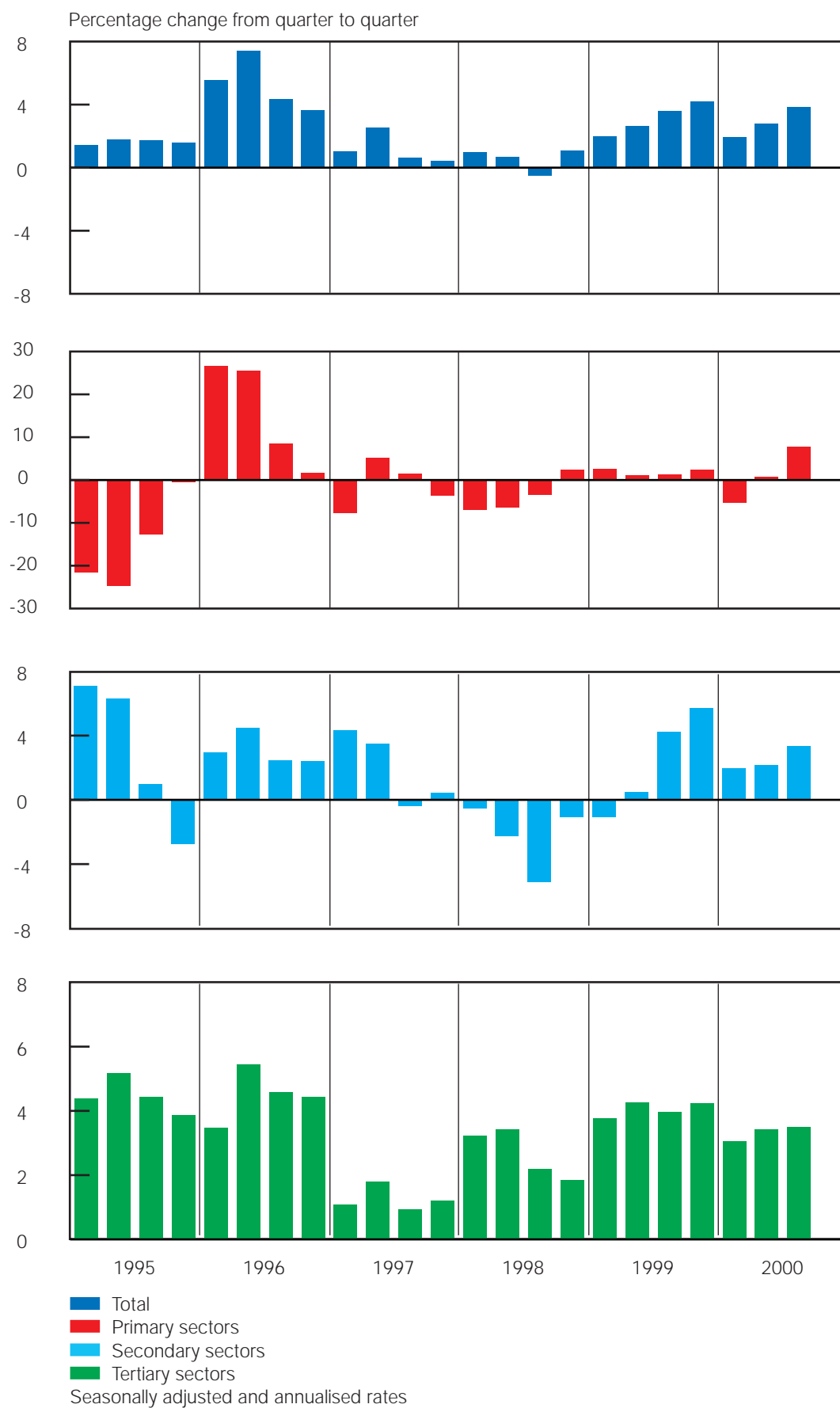
Percentage change at seasonally adjusted and annualised rates

Sectors	1999					2000		
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Primary sectors	2½	1	1½	2½	½	-5	1	8
Agriculture	6½	2½	4½	6½	3½	-8½	7½	24
Non-agricultural sectors	2	3	3½	4½	2	2½	2½	3
Mining	0	0	-1	0	-1	-3	-3½	-2½
Secondary sectors	-1	½	4	5½	-½	2	2	3½
Manufacturing	0	½	4½	6	0	2½	2	3½
Tertiary sectors	4	4½	4	4	3½	3	3½	3½
Total	2	2½	3½	4	2	2	3	4

Output growth in the *manufacturing* sector firmed in the third quarter of 2000 after a slowdown in growth during the first half of the year. Growth of 2½ per cent in the first quarter of 2000 was followed by 2 per cent growth in the second quarter and 3½ per cent in the third quarter. The acceleration in manufacturing output growth is explained by the rise in real domestic final demand and stronger export demand for certain subcategories of manufactured goods. Some inventory building, probably in anticipation of the continued

¹ In accordance with normal practice during the third quarter of every year, revisions have been made to national accounts data and are incorporated in this issue of the Quarterly Bulletin. These revisions are based on more detailed or more appropriate data that became available. In addition, seasonal factors have been updated.

Growth in real gross domestic product



strengthening of demand, also contributed to the firmer growth in manufacturing output. A broad spectrum of manufacturing subsectors responded to the improvement in demand conditions. Noteworthy among these were the producers of food, beverages and tobacco products, chemicals and chemical products, base metal products and transport equipment.

In the other secondary sectors, the real value added by the sector supplying *electricity, gas and water* increased at an annualised rate of 2 per cent in the third quarter of 2000 with the strengthening of economic activity generally and the expansion of these services to the rural areas of the country. The real value added by the *construction sector* also increased in the third quarter of 2000 as flood repairs got under way and the development of housing infrastructure continued. The growth in output by the secondary sectors accelerated from 2 per cent in the second quarter of 2000 to 3½ per cent in the third quarter.

Despite a decline in the real value added by the general government sector, growth in the tertiary sectors continued at a rate of 3½ per cent in the third quarter of 2000. In the *commercial sector*, activity remained brisk as consumers adopted a more positive attitude and became more prepared to incur debt for financing their purchases of consumer goods. Sales of new motor vehicles rose strongly in the third quarter of 2000, giving a fillip to value added in the *motor trade*. The subsector *catering and accommodation* also experienced lively conditions as tourist activities continued at a brisk rate.

The real value added by the *transport, storage and communication services* sector grew at a seasonally adjusted and annualised rate of 6 per cent in the third quarter of 2000, following on the heels of growth of 5 per cent in the first quarter and 6½ per cent in the second quarter. These high growth rates were largely driven by the ongoing buoyancy of the telecommunication subsector where the expansion in the cellular network and Internet activity continued, along with the expansion of telephone services to previously under-served areas. Growth in the real value added by the transport sector was underpinned by the need to move the maize crop and the rising volumes of foreign trade. The recovery of the real-estate market after the setback of 1998 contributed to another increase in the output volumes of the *financial intermediation, insurance, real-estate and business services sector*.

Domestic expenditure

After a steep decline of 2½ per cent in the second quarter of 2000, real gross domestic expenditure (seasonally adjusted and annualised) rebounded and increased by 6½ per cent in the third quarter. This took the accumulated total of real gross domestic

Real gross domestic expenditure

Percentage change at seasonally adjusted and annualised rates

Components	1999					2000		
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Final consumption expenditure by households	-½	2½	4	3	1	3½	3	3½
Final consumption expenditure by general government.....	-1½	-1½	-2	-3	-2	-7½	1	1
Gross fixed capital formation.....	-23	-9½	-3	-½	-6	3½	4	6
Change in inventories (R billions).....	-8,4	5,3	-4,2	1,8	-1,4	6,9	0,1	3,8
Gross domestic expenditure	-11½	9½	-3½	4½	0	5	-2½	6½

expenditure in the first three quarters of 2000 to a level that was 2½ per cent higher than in the first three quarters of 1999. All the main components of aggregate spending contributed to the higher spending level, but inventory accumulation was particularly vigorous.

Real outlays on *final consumption by households* grew from quarter to quarter at an annualised rate of 3 per cent or more during the first two quarters of 2000. During the third quarter, this growth accelerated to 3½ per cent as households stepped up their spending in all the major expenditure categories.

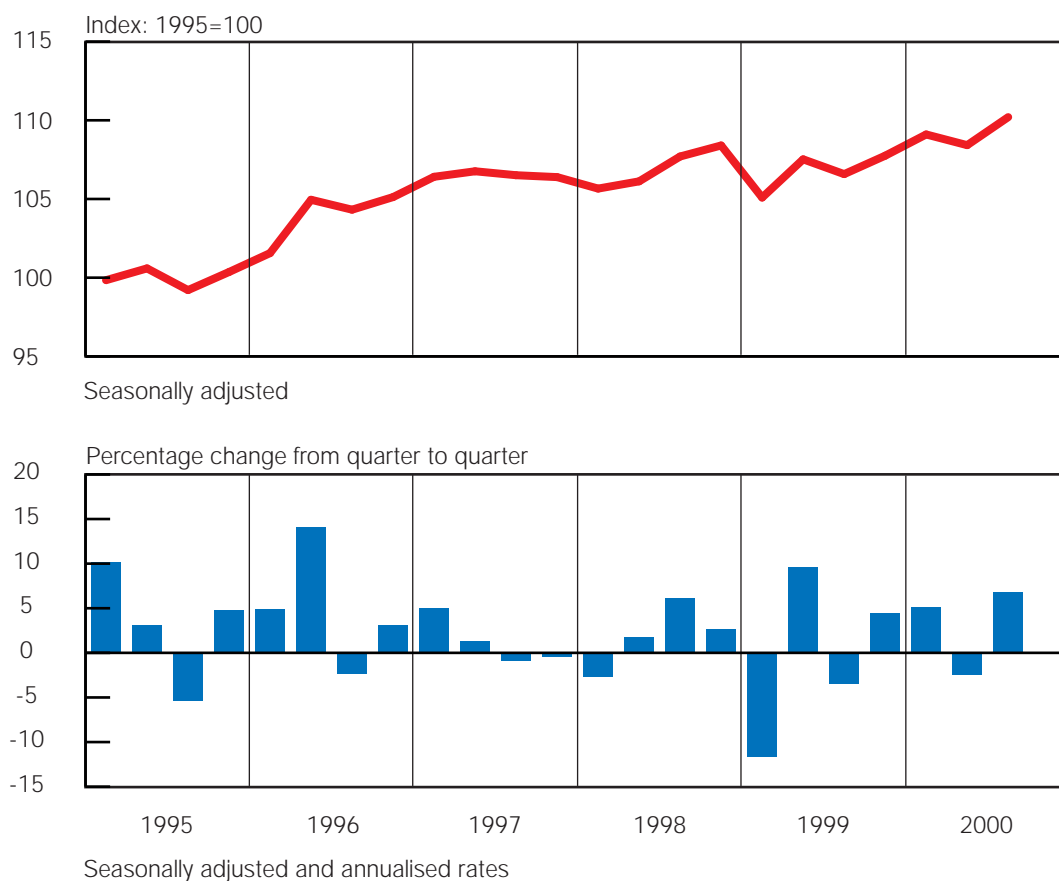
Real final consumption expenditure by households

Percentage change at seasonally adjusted and annualised rates

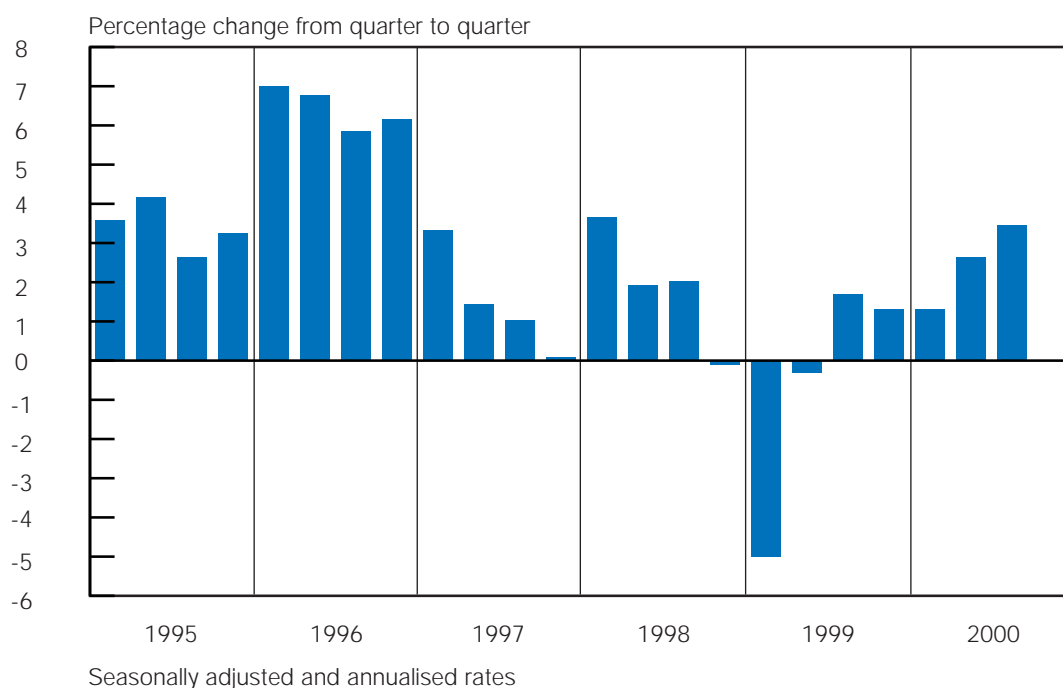
Components	1999					2000		
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Durable goods.....	-14½	12	14½	-3	-6	9	7	10
Semi-durable goods.....	-10½	3	6	9½	-½	6½	5	4
Non-durable goods.....	0	-½	½	1½	0	1½	1	2
Services.....	5	4½	5½	4	4	3	3½	4
Total.....	-½	2½	4	3	1	3½	3	3½

The acceleration of growth in real final consumption expenditure was realised despite a slowdown in the growth of spending on semi-durable goods. Real expenditure on clothing and footwear, an important component of semi-durable goods, was rather flat in the third quarter. By contrast, real expenditure on durable goods

Real gross domestic expenditure



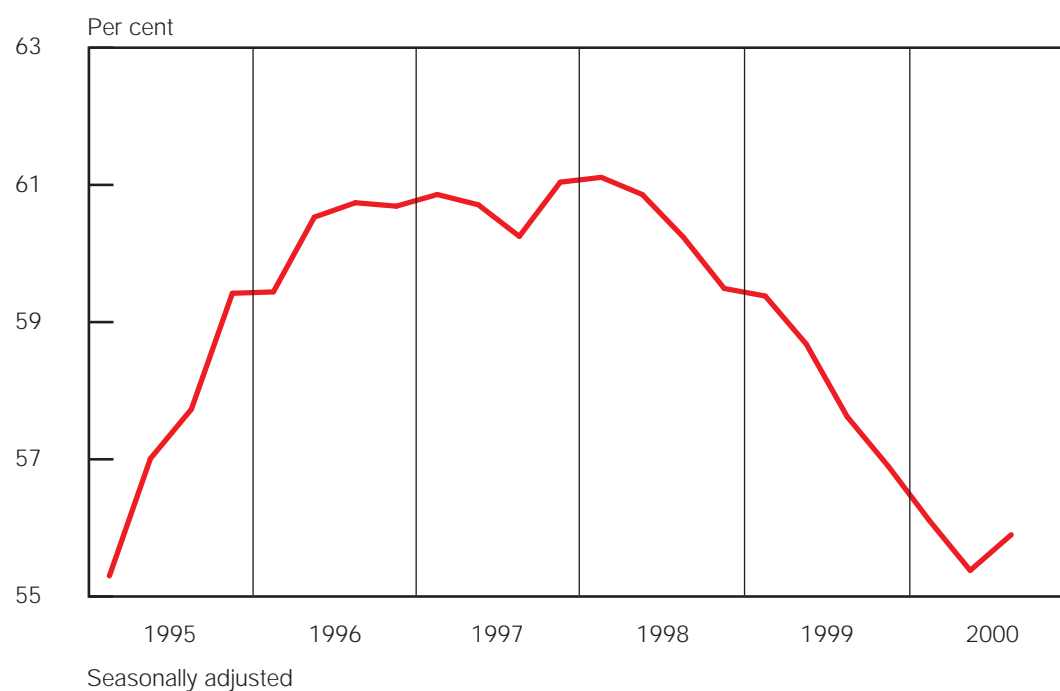
Real gross domestic final demand



accelerated from growth of 7 per cent in the second quarter to 10 per cent in the third quarter. Spending on new motorcars and furniture and household appliances was particularly strong in the third quarter.

Apart from the contributions made by higher real household income and the reduced personal tax burden, the rise in spending by consumers was also aided by the willingness of individuals to incur additional debt. In the aggregate, households have raised their debt at a rate that exceeded the growth in their disposable income. As a con-

Household debt as percentage of disposable income



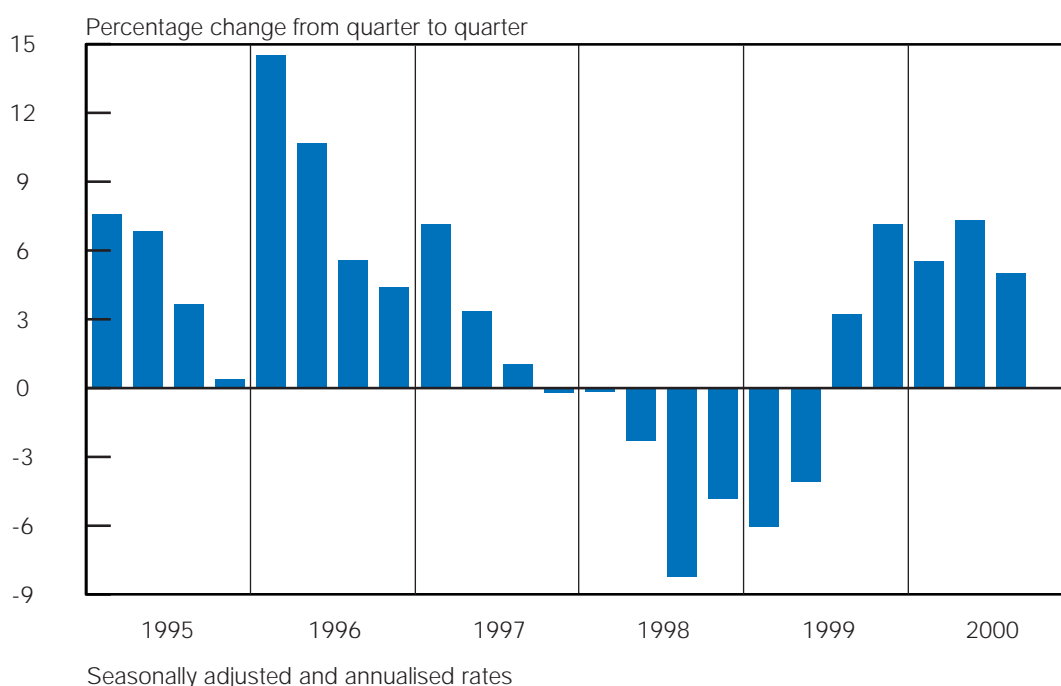
sequence, the ratio of household debt to personal disposable income increased from 55½ per cent in the second quarter of 2000 to 56 per cent in the third quarter. Household income, in turn, was strengthened by an increase in property income, mainly originating from a healthy increase in gross farm income. The aggregate compensation of employees increased at a rate that barely kept pace with the concurrent consumer price inflation, thus contributing little or nothing to the growth in real household income.

The rate of increase in real *final consumption expenditure by general government* remained at an annualised rate of 1 per cent in the third quarter of 2000. Measured over one year, real final consumption expenditure by general government in the first three quarters of 2000 was still about 3 per cent lower than in the corresponding period of the previous year. As a percentage of gross domestic product, general government's final consumption expenditure has now declined from nearly 20 per cent in 1998 to an average of 18½ per cent in the first three quarters of 2000. These developments were consistent with government's resolve to rein in government spending as part of a broader strategy that will create an environment conducive to enhanced economic growth and job creation.

The upward momentum in real gross fixed capital formation since the first quarter of 2000 was maintained in the third quarter. Current estimates indicate that increases in total real gross fixed investment, at an annualised rate of 3½ per cent in the first quarter of 2000 and 4 per cent in the second quarter, were followed by a further rise of 6 per cent in the third quarter. Despite this improvement in investment spending, real gross fixed capital formation in the first three quarters of 2000 was only about ½ per cent higher than the level in the corresponding period of 1999. The private and public business-sectors were entirely responsible for the further improvement in capital formation in the third quarter. Real fixed capital expenditure by the general-government sector declined in the third quarter of 2000.

Real gross fixed capital formation by the private sector increased at a seasonally adjusted and annualised rate of 5 per cent in the third quarter of 2000, taking the overall

Real gross fixed capital formation by the private sector



increase in the first three quarters of 2000 relative to the first three quarters of 1999 to 4½ per cent. A classification of capital spending in the private sector by kind of economic activity shows that the whole sector, apart from agriculture, participated in the expansion of capital formation in the third quarter of 2000. Prominent increases were recorded in the commercial sector, with the development of entertainment centres and shopping complexes, and in transport and communication where the telecommunications networks kept on expanding.

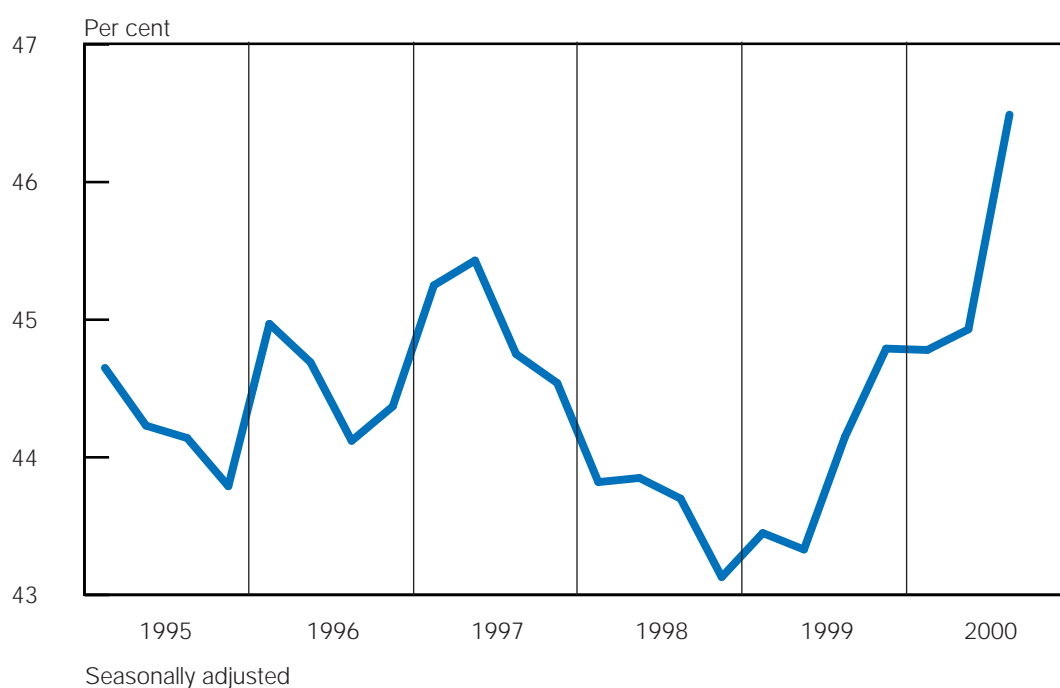
In the public sector, public corporations increased their capital spending as part of modernising strategies ahead of the expected increase in private-sector participation in these businesses. The business enterprises of general government are likewise being restructured, but with declining capital expenditure. General government increased its capital outlays somewhat, mainly in the form of higher spending on roads infrastructure.

The substantially larger *build-up in inventories* in the third quarter of 2000 than in the second quarter was the result of increases in industrial and commercial inventories, and in agricultural stocks-in-trade. The rise in industrial and commercial stocks probably reflected an optimistic assessment among firms regarding future demand growth, whereas the bulk of agricultural inventories consisted of maize stockpiles. Stock building added some 2½ percentage points to the growth in gross domestic product, quite a sizeable swing from the second quarter when the small accumulation of inventories had compressed growth by as much as 4½ percentage points. As a ratio of gross domestic product, the overall level of commercial and industrial inventories remained unchanged at a level of 14 per cent in the third quarter of 2000, despite the absolute increase in inventory holdings.

Factor income

The growth over four quarters in total *nominal factor income* accelerated from an average rate of 8½ per cent in the first half of 2000 to 11½ per cent in the third quarter. Growth in gross operating surpluses continued to outstrip growth in the aggregate compensation of employees.

Gross operating surplus as percentage of total factor income



A favourable external environment, continued growth in domestic final demand and the ready availability of financial resources at considerably lower cost than before, have underpinned a positive environment for the business sector. Profits continued to grow firmly with the gross operating surpluses of the corporate sector expanding by 17 per cent in the year to the third quarter of 2000. Cost containment, especially of labour costs, and much higher productivity levels added to the greater profitability of the corporate sectors. Strong growth in operating surpluses was obtained in most of the major sectors of the economy, but was quite profound in the telecommunication sector, the manufacturing sector and, for special reasons related to the bunching of the maize harvest, also in the agricultural sector.

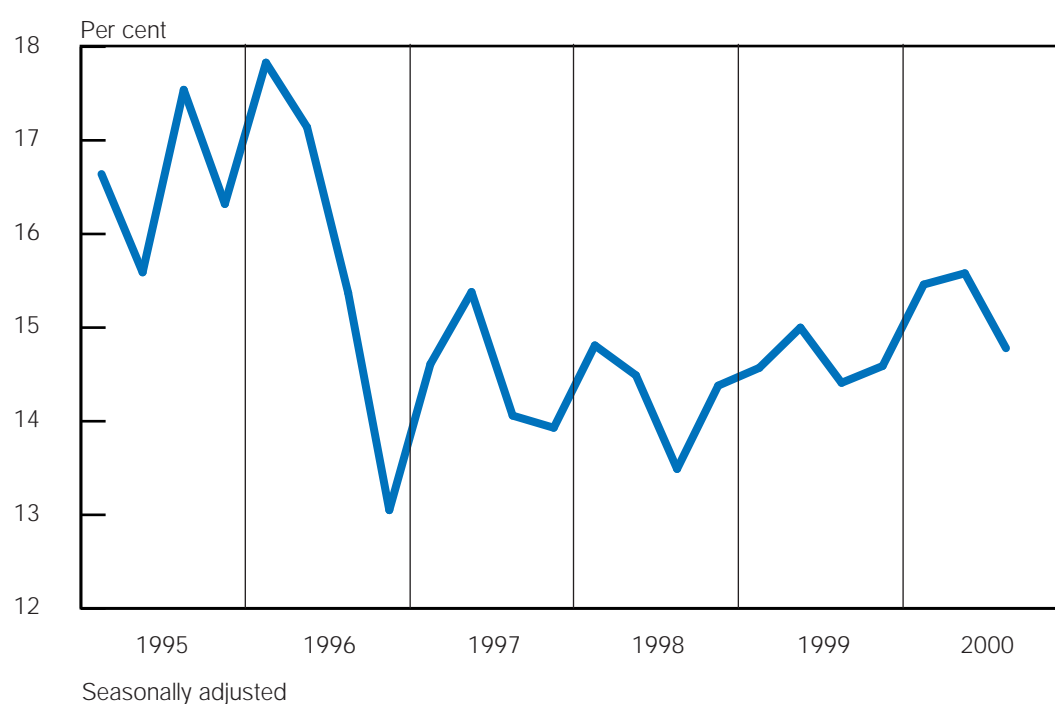
The rate of increase over four quarters in total *compensation of employees* slowed down from an average of 7½ per cent in the first three quarters of 1999 to an average of 6 per cent in the first three quarters of 2000 as nominal wage growth moderated and labour paring continued unabatedly. The compensation of employees as a percentage of total factor income accordingly declined from 56 per cent in the third quarter of 1999 to 53½ per cent in the third quarter of 2000.

Gross saving

Gross saving as a ratio of gross domestic product improved from 14½ per cent in the third quarter of 1999 to 15½ per cent in the second quarter of 2000, but weakened again to 15 per cent in the third quarter of 2000. This lower saving ratio, which is not nearly sufficient in view of the country's investment and growth requirements, was the result of a weakening in the savings effort of the corporate sector.

Gross saving by general government, which turned from dissaving to positive saving for the first time in almost a decade in the second quarter of 2000, remained positive in the third quarter at a level that was equal to approximately ½ per cent. The gross saving by private households remained equal to about 3 per cent of gross domestic

Gross saving as percentage of gross domestic product



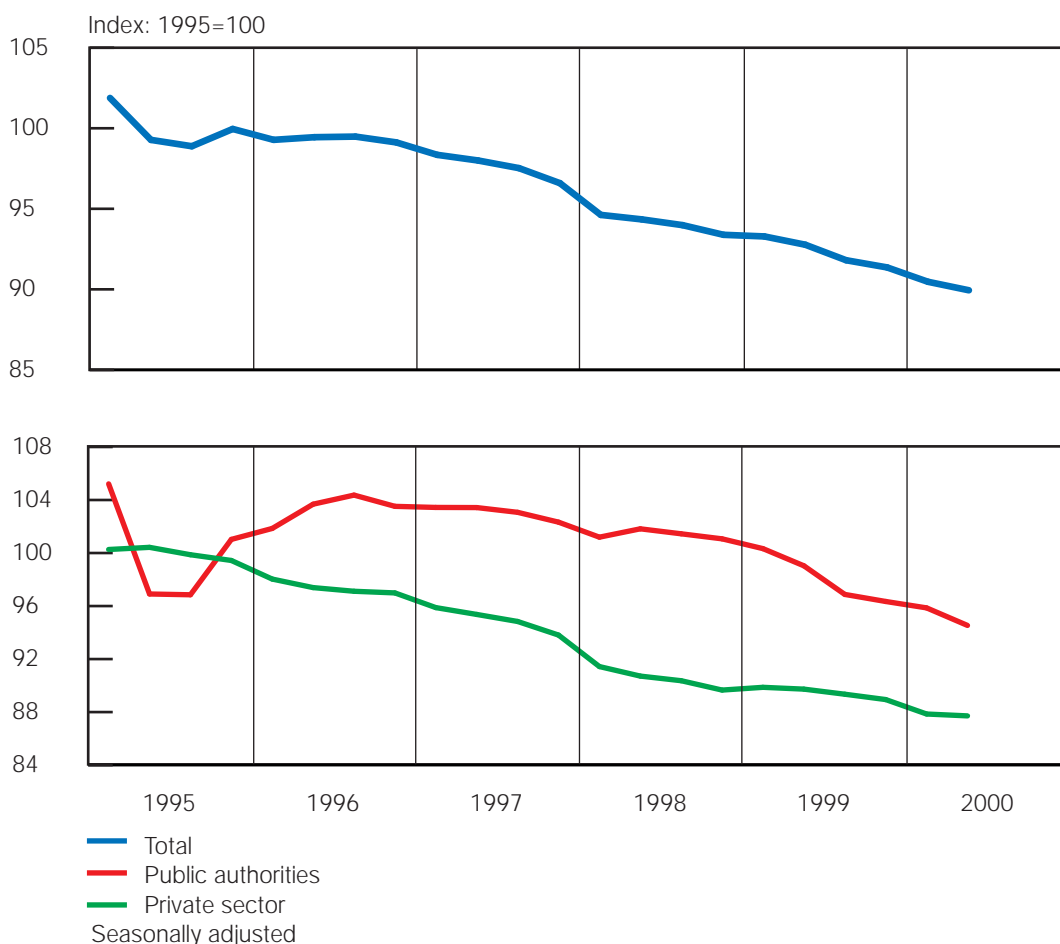
product despite households' increased appetite for consumption spending and debt accumulation.

Notwithstanding stronger profit growth in the corporate sector, gross saving by this sector relative to gross domestic product declined from 13 per cent in the first quarter of 2000 to 11½ per cent in the third quarter. An increase in dividend payments, which strengthened households' disposable income and contributed to the weakening of the current-account balance, was the main cause of the lower corporate saving ratio in the third quarter of 2000. Nevertheless, a substantial amount of internal funds were mobilised by the corporate sector. This, together with the ready availability of external sources of finance, and the continued prospects for sustained growth in aggregate demand, provided the incentive for the business sector to lift its capital expenditure meaningfully over the past three quarters.

Employment

The formal labour market continued to be characterised by employment declines in the first half of 2000. According to the *Survey of Total Employment and Earnings* by Statistics South Africa, employment in the formal non-agricultural sectors of the economy declined by 3,0 per cent or by about 149 000 jobs in the year to June 2000. Although this survey represents an understatement of about 27 per cent of total employment in the formal non-agricultural sectors of the economy, it should nevertheless be seen in terms of sample size as a representative sample of developments in the formal labour market in the country.

Non-agricultural employment in the formal sectors



Employment numbers in the *formal private non-agricultural sectors* fell on average by 2,2 per cent when comparing the first half of 2000 with the first half of 1999. Calculated in this way, employment gains were made in the trade, catering and accommodation services industry, washing and laundering services, and in the transport, storage and communication services sectors. These increases were, however, offset by strong declines in the gold-mining and in the manufacturing and construction sectors.

The decline in private-sector employment numbers was swelled by job losses at all levels of the *public sector*. On average, employment in the public sector fell by 4,5 per cent when comparing the first half of 2000 with the first half of 1999. The decline in employment numbers occurred at all levels of the public sector, but was most pronounced in the transport, storage and communication services sector, followed by provincial governments and national government departments.

Although the job-creating capacity of the economy is stronger than indicated by the regular establishment surveys, the inability of the formal economy to create jobs in sufficient numbers to reduce unemployment meaningfully remains a serious structural problem in the South African economy. The issue of structural unemployment was addressed by the Department of Labour in 1999 through reviewing certain provisions in existing labour laws that could have had unintended negative consequences for job creation.

A draft Code of Good Practice on HIV/Aids, an illness which has serious implications for the future evolution of the South African labour market, was gazetted in April 2000 as an annexure to the Employment Equity Act. The draft code provides guidelines for employers and employees on the handling of issues related to HIV/Aids. The code is based on the principle that no person, including job applicants, may be unfairly discriminated against in the workplace on the basis of that person's HIV status. In order to promote a non-discriminatory work environment, employers are also directed to adopt appropriate measures to ensure that HIV-affected employees are protected from discrimination and victimisation through measures such as recruitment practices, policies and awareness programmes.

Labour costs and productivity

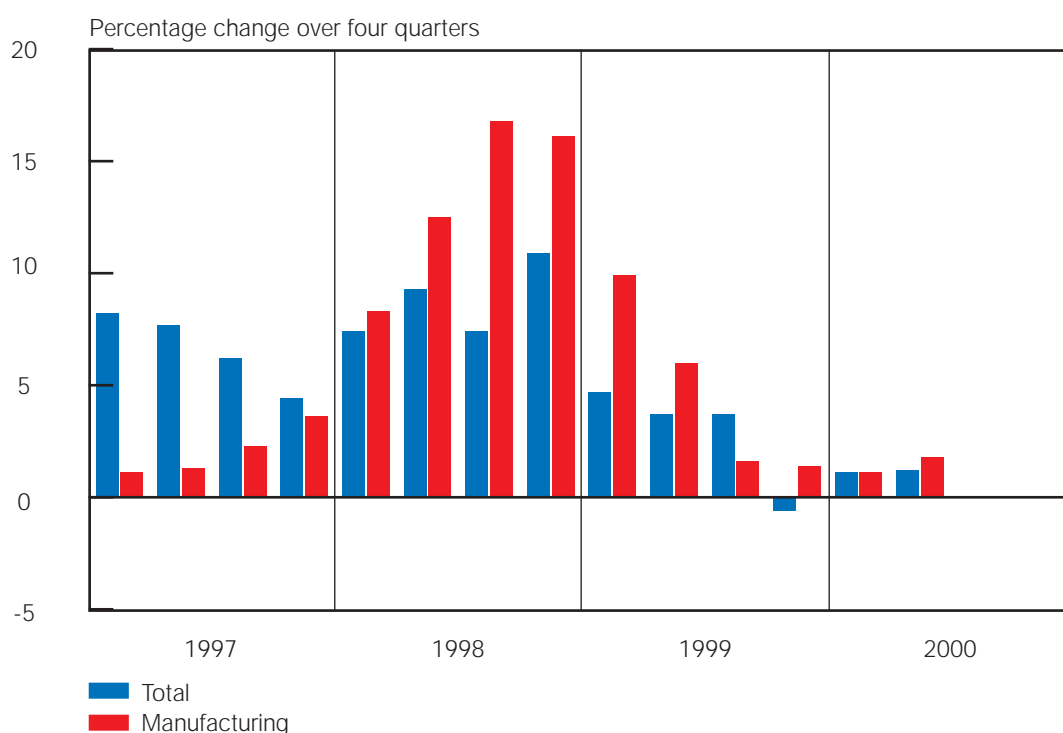
Nominal remuneration per worker in the non-agricultural sectors of the economy increased by 7,8 per cent in the year to the second quarter of 2000 – about the same increase as in the year to the first quarter. The absence of rising labour cost pressures in the economy is corroborated by the findings of surveys conducted by Andrew Levy and Associates, a private-sector labour consultancy firm. These surveys indicate that the average rate of wage settlements in collective bargaining agreements was 7,5 per cent in the first three quarters of 2000 – down from an overall average settlement rate of 8,3 per cent in 1999.

The growth in nominal worker compensation in the private sector slowed down from a year-on-year rate of 10,4 per cent in the first quarter of 2000 to 8,0 per cent in the second quarter. This slowdown was noted in almost all the various sectors of economic activity, but was more severe in the construction, electricity-generating, trade, catering and accommodation services sectors.

In contrast to wage developments in the private sector, the increase over one year in compensation per worker in the *public sector* accelerated from 4,5 per cent in the first quarter of 2000 to 7,9 per cent in the second quarter. The rise in nominal compensation growth in the public sector occurred mainly at the level of national government and in the transportation and communication services sectors.

The combined effect of continuing growth in aggregate real output and declining employment in the formal sectors of the economy was an acceleration in the growth in real output per worker in the formal non-agricultural sectors from a year-on-year rate of 2,4 per cent in the first quarter of 1999 to 6,5 per cent in the first and second quarters of 2000. Because of the sizeable gains in productivity, increases in worker compensation have not generated significant pressure on production costs in the domestic economy. Overall *nominal unit labour costs* rose only by 1,1 per cent when comparing the first half of 2000 with the first half of 1999. In the manufacturing sector, where output is measured more directly and probably also more accurately, the average increase over one year in nominal unit labour costs was only 1,5 per cent in the second quarter of 2000.

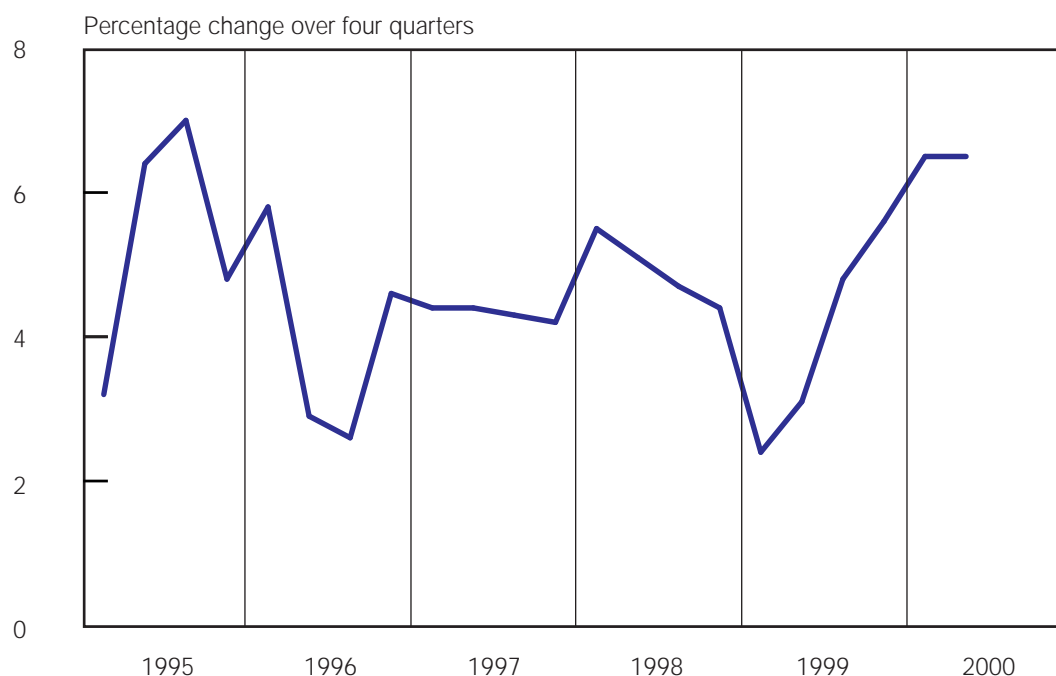
Non-agricultural unit labour costs



With the strong rise in labour productivity recently, the average yearly rise in output per worker since the early 1990s has accelerated significantly to 3,5 per cent from the 0,2 per cent pace of the 1980s. What has been particularly impressive is that the acceleration of productivity has exceeded the pick-up in output growth over the past decade, and fewer workers are now producing a far greater volume of output than in the 1980s. It appears from the experiences of the past decade that strong productivity growth has become a permanent feature of the domestic economy. Employers are therefore now realising lasting benefits from their expenses

on skills enhancement programmes and from their investments in equipment and processes that embody the advances made in information technologies over the past decade.

Non-agricultural labour productivity



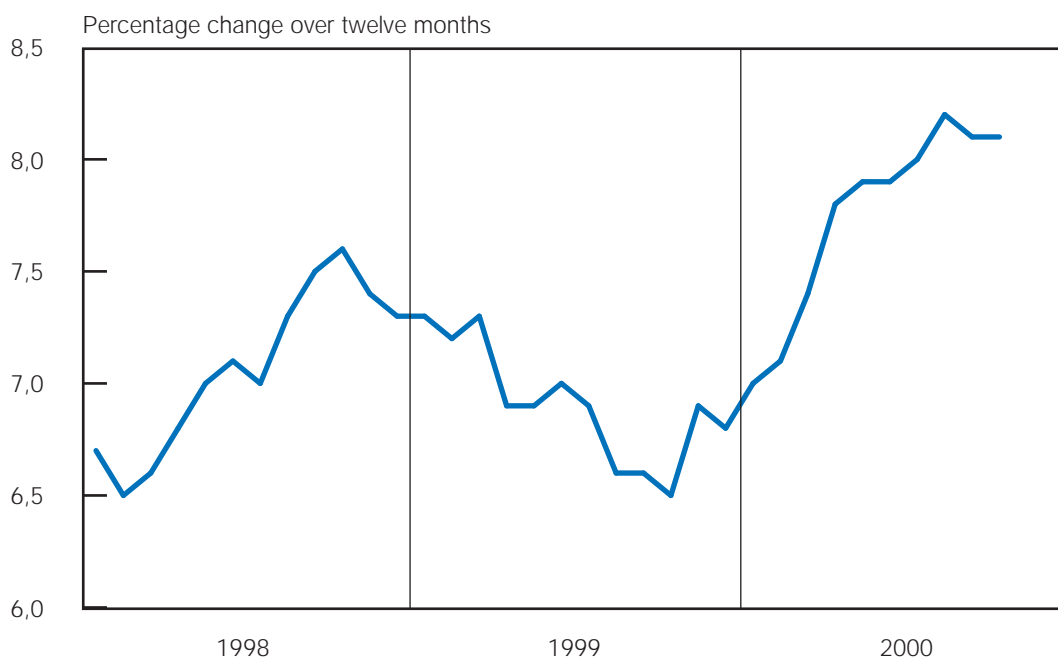
Prices

Despite the fairly benign trend in unit labour costs in the first half of 2000, measures of year-on-year inflation in consumer prices continued to increase in the third quarter. CPIX (i.e. the consumer price index for metropolitan and other urban areas, excluding mortgage interest costs) increased at annual rates of between 8,0 per cent and 8,2 per cent in the four months from July to October 2000; this inflation rate had been at 6,5 per cent in October 1999.

The steep rise in the cost of imported crude oil that began in early 1999 and continued into the first three quarters of 2000, and the upward shift in food prices following the damage to agricultural crops in the first quarter of 2000, have been the principal factors in the higher rates of increase in the prices of goods and services purchased by consumers. A measure of inflation that excludes fuel and food prices from CPIX actually slowed down marginally from a year-on-year rate of 6,8 per cent in the fourth quarter of 1999 to 6,7 per cent in the third quarter of 2000. This slowdown may be seen as indicating the absence of second-round price responses to the higher petrol and diesel prices.

Although the pass-through or second-round effects of the higher cost of imported crude oil are not clearly visible in the CPIX inflation indicator, these effects were much clearer in the rise in the index of prices paid at the production level during 2000. Measures of production price inflation over one year, excluding fuel and food prices, picked up strongly from 3,2 per cent in November 1999 to 6,2 per cent in October 2000.

CPIX inflation



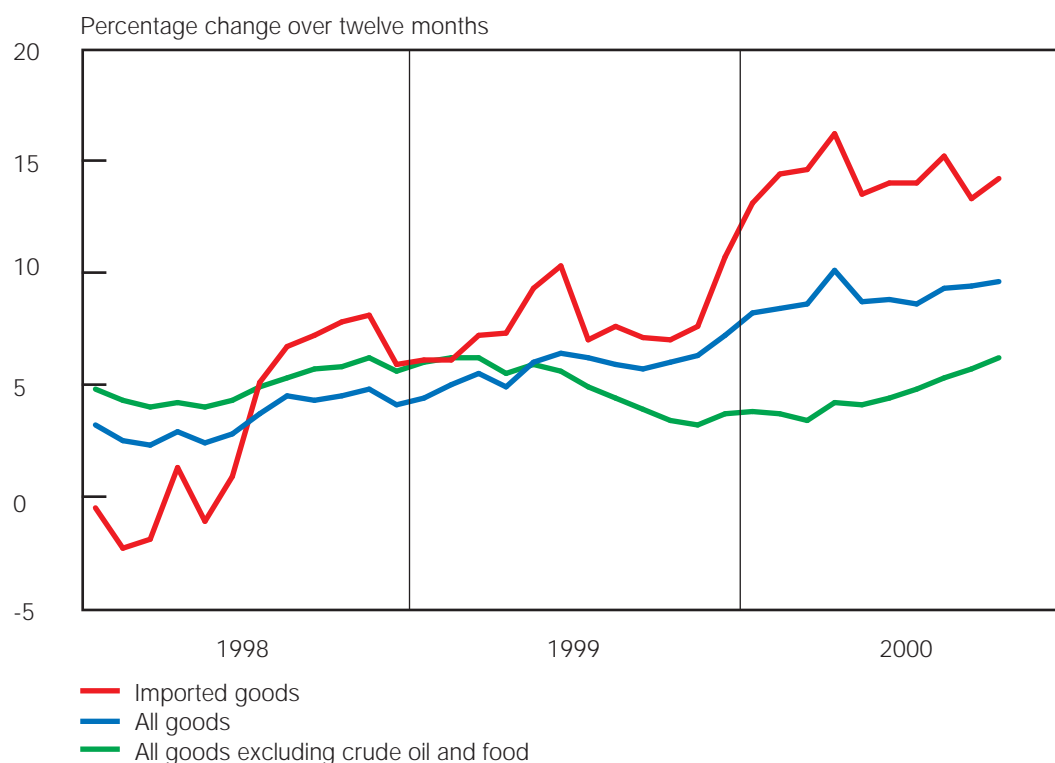
Though some of the rise in the all-goods production price index over the past year reflects the immediate effect of increases in the prices of imported crude oil and food, higher price increases have been registered quite broadly over the other components of the index. This could be interpreted as evidence of secondary price responses to the initial impact of the rising cost of imported crude oil. Even if commodity prices in sectors where import-parity prices apparently prevail, are excluded from the index, there remains evidence of second-round price effects.

Consumer and production price indices

Twelve-month percentage change

Period	CPIX		Production prices	
	All goods and services	Excluding fuel and food	All goods	Excluding fuel and food
1999: Oct.....	6,5	6,8	6,0	3,4
Nov.....	6,9	6,9	6,3	3,2
Dec.....	6,8	6,7	7,2	3,7
2000: Jan.....	7,0	6,8	8,2	3,8
Feb.....	7,1	6,7	8,4	3,7
Mar.....	7,4	6,6	8,6	3,4
Apr.....	7,8	6,6	10,1	4,2
May.....	7,9	6,8	8,7	4,1
Jun.....	7,9	6,9	8,8	4,4
Jul.....	8,0	6,7	8,6	4,8
Aug.....	8,2	6,6	9,3	5,3
Sep.....	8,1	6,7	9,4	5,7
Oct.....	8,1	7,0	9,6	6,2

Production price inflation



According to the long-established relationship in terms of which changes in production prices foreshadow changes in consumer prices by some two or three months, the higher increases in the production price index could be expected to spill over into higher increases in consumer prices. The faster pace of price increases at the production price level is therefore jeopardising the prospect of a steady downward drift in consumer price inflation.

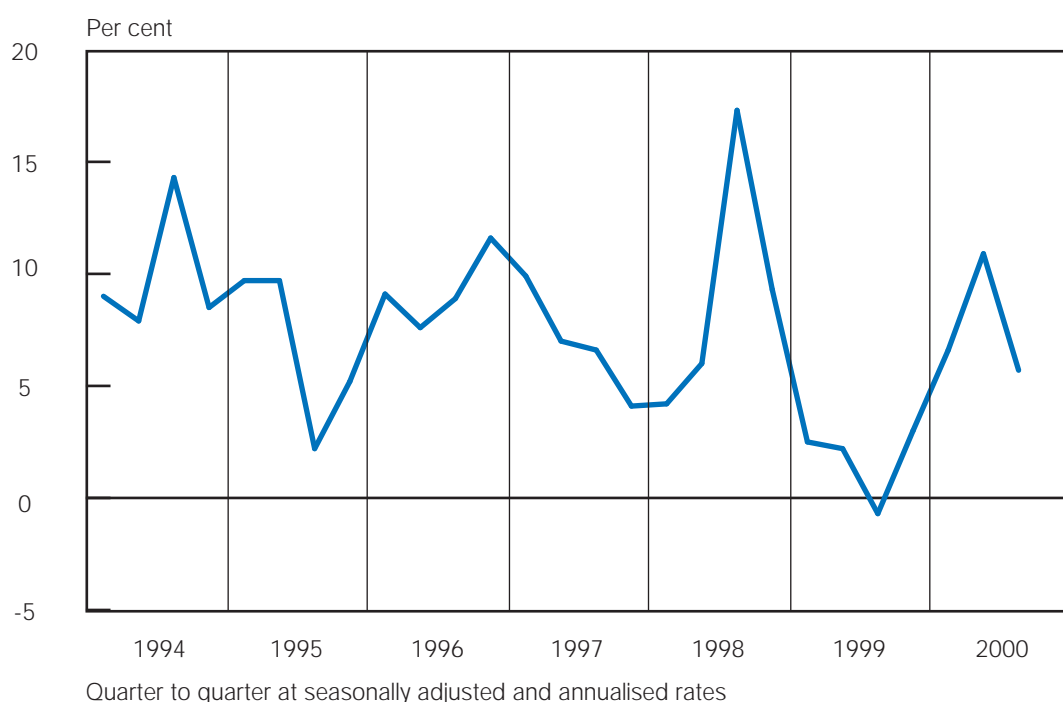
The rand has depreciated on a weighted basis by around 8 per cent since the beginning of the year to October 2000. The lower exchange rate contributed to sharp increases in the import component of the production price index. The year-on-year increase in the prices of imported goods rose from 10,7 per cent in December 1999 to 16,2 per cent in April 2000 and was still at 14,2 per cent in October. As indicated above, some secondary price responses to these increases were apparent in the first three quarters of 2000. However, the effect of the acceleration in production prices, excluding imported crude oil and food, is likely to be seen more fully in consumer prices in the months ahead.

Quarter-to-quarter changes in consumer and production prices

Annualised percentage change

Period	CPIX	All-goods production price index
1999: 1st qr	6,6	3,7
2nd qr	6,6	7,1
3rd qr	6,8	7,9
4th qr	6,9	6,9
2000: 1st qr	8,7	11,7
2nd qr	9,2	10,1
3rd qr	7,6	7,3

Consumer price inflation



While it is still unclear what the secondary price effects of the depreciation of the rand and the rise in the price of crude oil will be, the marginal change from quarter to quarter in consumer prices and in production prices has tapered off recently. CPIX inflation has fallen back from a seasonally adjusted and annualised rate of 9,2 per cent in the second quarter of 2000 to 7,6 per cent in the third quarter. Even more impressively, the annualised quarter-to-quarter change in the all-goods production price index shrank from 11,7 per cent in the first quarter of 2000 to 7,3 per cent in the third quarter.

Headline inflation, or changes in the overall consumer price index for metropolitan areas only, has also slowed down from a quarter-to-quarter seasonally adjusted and annualised rate of 10,9 per cent in the second quarter of 2000 to 5,7 per cent in the third quarter.

Foreign trade and payments

Current account

The surplus on the current account of the balance of payments (not seasonally adjusted and annualised), which had increased from less than R0,1 billion in the first quarter of 2000 to R1,4 billion in the second quarter, changed to a deficit of R3,9 billion in the third quarter. A cumulative deficit on the current account of R2,4 billion was therefore recorded in the first three quarters of 2000; in the first two quarters there had still been a surplus of R1,4 billion.

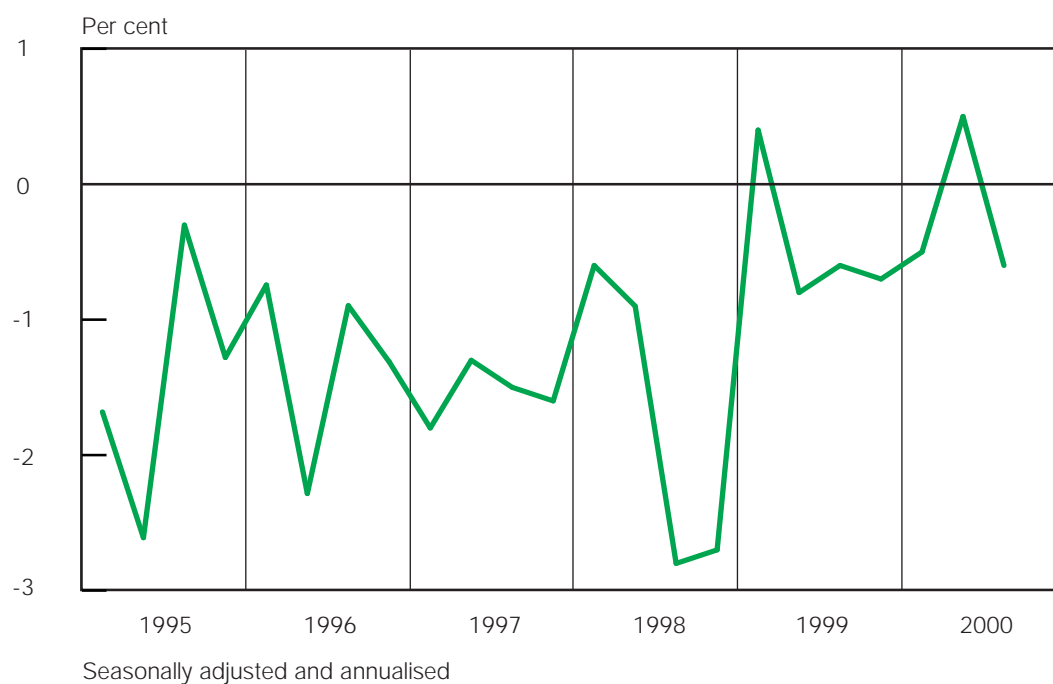
Balance of payments on current account

Seasonally adjusted and annualised
R billions

	1999				2000		
	1st qr	2nd qr	3rd qr	4th qr	1st qr	2nd qr	3rd qr
Merchandise exports.....	148,3	139,5	150,6	164,0	173,4	185,2	187,5
Net gold exports	24,7	23,8	22,9	25,7	27,0	26,0	28,4
Merchandise imports.....	-142,3	-142,2	-149,1	-164,6	-177,5	-178,7	-190,7
Net service, income and current transfer payments ...	-27,5	-27,1	-29,1	-31,2	-26,9	-27,8	-30,4
Balance on current account..	3,2	-6,0	-4,7	-6,1	-4,0	4,7	-5,2

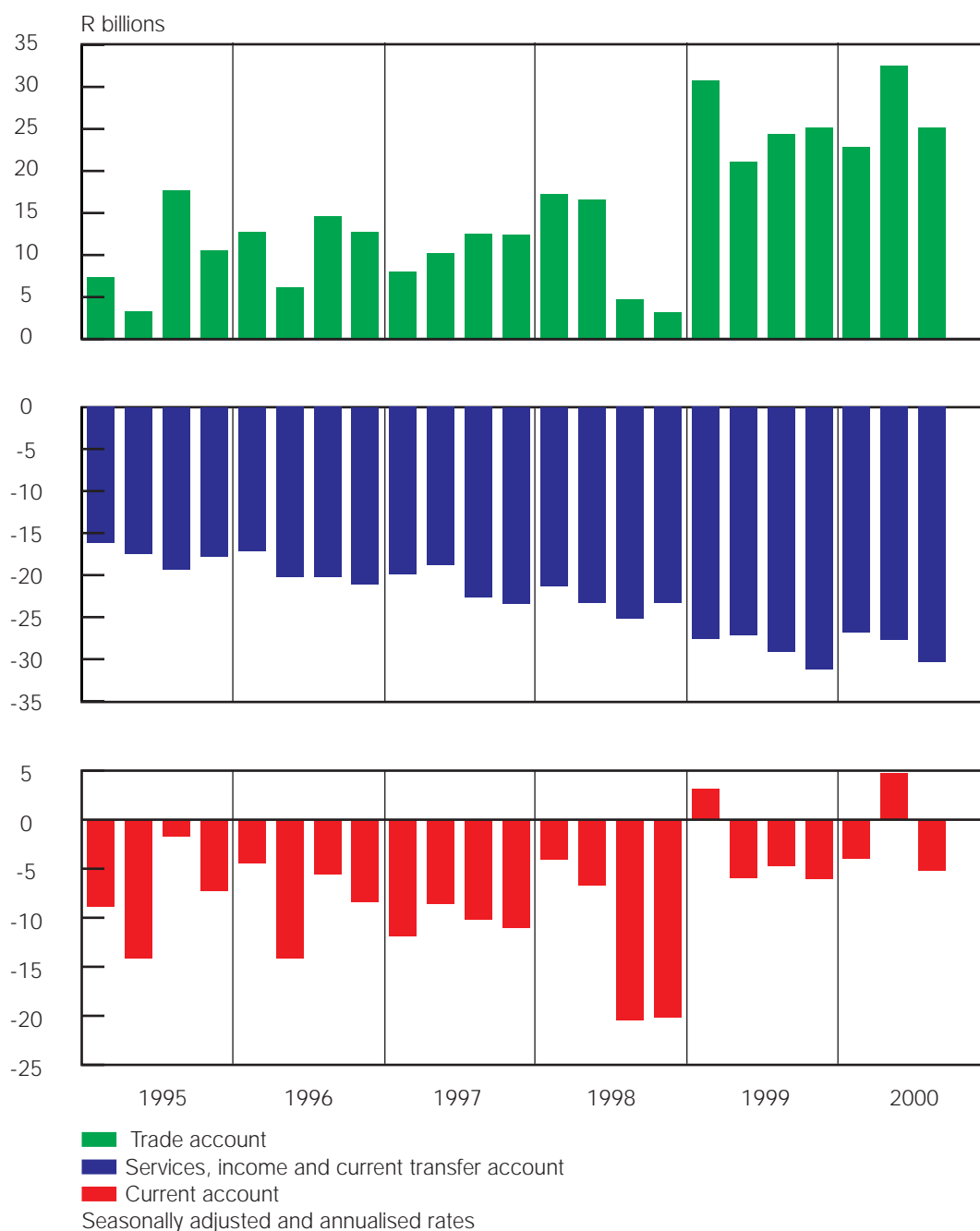
After adjustment for seasonal factors and measured at an annualised rate, the balance on the current account changed from a sizeable surplus of R4,7 billion in the second quarter of 2000 to a deficit of R5,2 billion in the third quarter. Expressed as

Current-account balance as percentage of gross domestic product



a percentage of gross domestic product the deficit was 0,6 per cent in the third quarter. This deterioration in the current-account balance was mainly caused by a noticeable rise in the value of merchandise imports and a decline in income receipts from non-residents. The shortfall of receipts from non-residents for services rendered and income earned, relative to payments to non-residents for such services, therefore widened from the second to the third quarter of 2000.

Balance of payments: Current account



The higher level of domestic expenditure in the third quarter of 2000 raised the value of merchandise imports from a seasonally adjusted and annualised R178,7 billion in the second quarter to R190,7 billion in the third quarter. Imports were also influenced by the

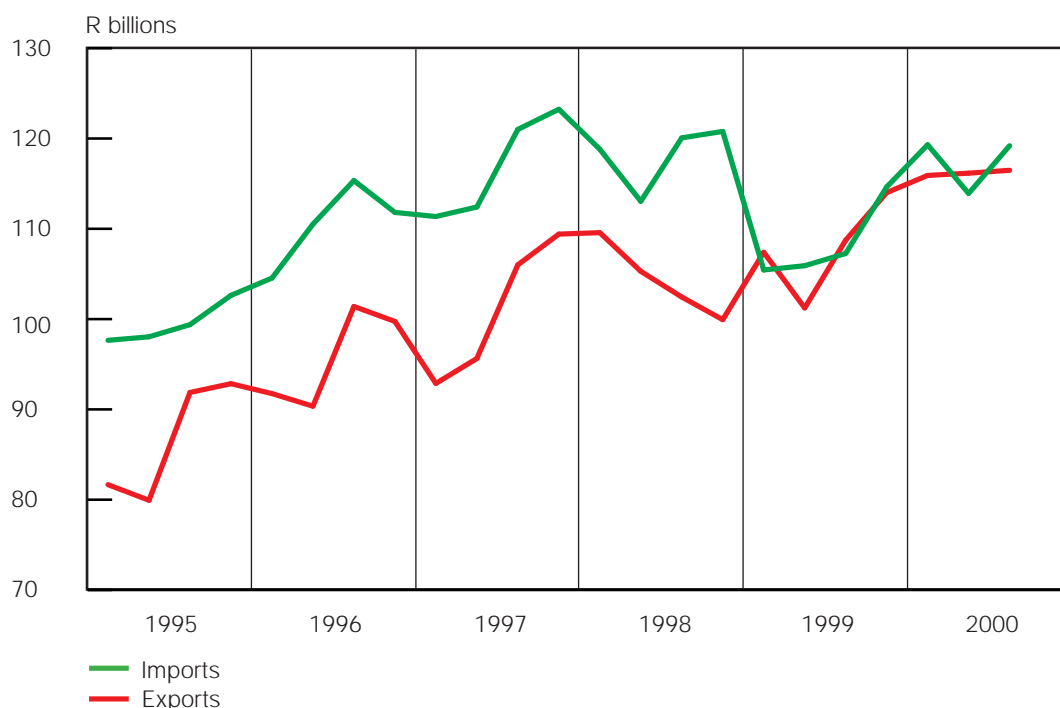
decline in the exchange rate of the rand and the expectations of further rises in import prices which encouraged the early importation of intermediate goods and capital equipment in order to avoid paying higher prices later. The physical quantity of merchandise imports consequently rose by 4½ per cent in the third quarter of 2000, raising the import penetration ratio (i.e. the portion of real gross domestic expenditure allocated to imported goods) from 19½ per cent in the second quarter of 2000 to 20 per cent in the third quarter.

The depreciation of the rand, rising international oil prices and modest production price increases in trading-partner countries lifted the overall price level of imported goods by about 2 per cent in the third quarter.

The overall rise in the value of merchandise imports was observed in all the main sub-categories, namely agriculture, mining and manufactured products. In the mining category, import values were boosted by a sharp increase in the value of petroleum imports, following the recent rises in the international prices of crude oil.

Unlike the merchandise import volumes that increased strongly, the physical quantity of exported goods increased by only ½ per cent from the second quarter of 2000 to the third quarter. Exports of mining products and of manufactured goods increased in the third quarter, the latter probably boosted by the greater competitiveness of domestic producers in export markets.

Real merchandise trade



Although international commodity prices showed little variation from the second to the third quarter of 2000, the average price level of merchandise exports still rose by about 1 per cent owing to some acceleration of production-price inflation in South Africa and in trading-partner countries. These price increases combined with marginally higher export volumes, increased the value of merchandise exports (seasonally adjusted and annualised) from R185,2 billion in the second quarter of 2000 to R187,5 billion in the third quarter.

The annualised value of net gold exports increased from R26,0 billion in the second quarter of 2000 to R28,4 billion in the third quarter. This was primarily the result of an increased quantity of gold exported, which was reinforced by a modest increase in the average realised price of exported gold from R1 939 per fine ounce in the second quarter of 2000 to R1 978 in the third quarter.

Net payments to non-residents for services rendered and income earned, together with current transfers to the rest of the world, increased on a seasonally adjusted and annualised basis from R27,8 billion in the second quarter of 2000 to R30,4 billion in the third quarter. Investment income payments, including dividend payments, increased strongly in the second quarter of 2000 and remained high in the third quarter, whereas the amount of income received from the rest of the world actually declined.

Financial account

A deficit on the current account of the balance of payments arises when domestic economic agents in the public and private sectors spend more than their current income by raising funds in the rest of the world or by reducing foreign assets. The counterpart to a current-account deficit is a surplus on the financial account. Many resident borrowers are likely to borrow through the domestic banking system, causing domestic borrowing from South African banks to exceed domestic deposits placed with banks. The gap then has to be closed by non-resident deposits with domestic banks, or by loans extended by non-resident entities to domestic banks. These transactions are normally recorded as "other capital movements" in the financial account of the balance of payments.

These *other capital movements* into South Africa (i.e. changes in foreign liabilities such as loans, trade finance or bank deposits) registered an inflow of R2,6 billion in the third quarter of 2000. There was a sizeable increase in the deposits of non-resident depositors with South African banks and in short-term borrowing by non-bank financial institutions. The inflows were partly offset by the scheduled repayment of debt in terms of existing arrangements with foreign creditor banks and of other debt guaranteed by foreign governments.

Net financial transactions not related to reserves

R billions

	1999					2000		
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr
Liabilities								
Direct investment.....	2,5	2,0	2,0	2,6	9,1	4,9	0,7	0,7
Portfolio investment.....	9,1	26,2	29,9	18,7	83,9	4,6	-2,7	9,1
Other investment.....	0,1	-3,2	-9,0	-4,8	-16,9	1,8	6,1	2,6
Total liabilities.....	11,7	25,0	22,9	16,5	76,1	11,3	4,1	12,4
Assets								
Direct investment.....	-5,8	-3,0	-3,1	0,1	-11,8	-1,0	-5,8	4,1
Portfolio investment.....	-6,8	-11,0	-6,1	-7,6	-31,5	-11,2	-4,3	-7,0
Other investment.....	-2,6	-1,3	-3,9	-2,5	-10,3	-3,1	2,4	-1,6
Total assets.....	-15,2	-15,3	-13,1	-10,0	-53,6	-15,3	-7,7	-4,5
Total financial transactions*	3,4	5,1	6,0	15,0	29,5	2,9	-8,8	11,9

* Including unrecorded transactions

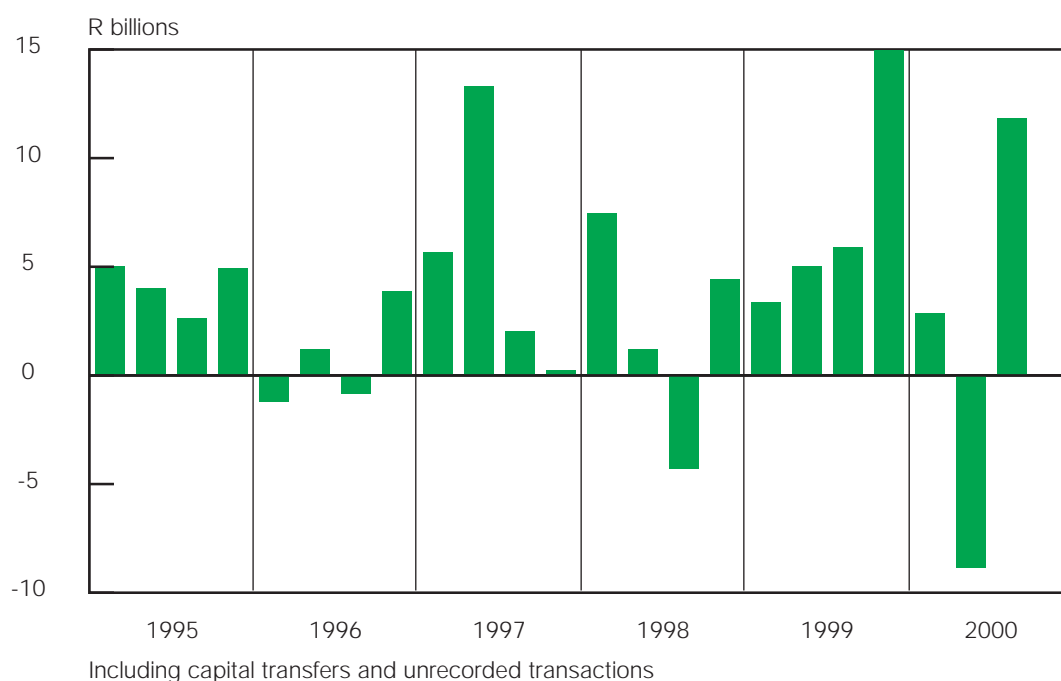
The accumulation of foreign assets by resident organisations through the granting of loans and trade finance to non-resident parties and deposits placed with non-resident financial institutions, totalled R1,6 billion in the third quarter. On a net basis, the *other investment* category registered an inward movement of capital of R1,0 billion in the third quarter of 2000, a significant reduction from the inflow of R8,5 billion in the second quarter.

Cross-border capital flows also include direct investment and portfolio investment, which can either offset or augment the flows through the banking system and other conduits. In the third quarter of 2000, foreign direct investment and portfolio investment clearly strengthened the inflow of other foreign investment.

Foreign direct investment into South Africa recorded an inflow of R0,7 billion in the third quarter of 2000. Prominent among these transactions was the acquisition of a significant additional interest in a domestic insurance company by the non-resident controlling shareholder. At the same time, equity held by South African companies in a United Kingdom property company was sold to a non-resident party, contributing to a decline in the asset values of South African investors in the rest of the world. Such transactions are recorded as inward movements of capital on the financial account: the aggregate inflow in the third quarter of 2000 through this avenue is estimated at R4,1 billion. On a net basis, i.e. offsetting changes in foreign direct investment liabilities against foreign direct investment assets, there was an inflow of *foreign direct investment* capital of R4,8 billion in the third quarter of 2000, reversing completely the outward movement of this class of capital during the second quarter.

Portfolio investment flows over international boundaries are renowned for their volatility. The third quarter of 2000 was no exception to this general pattern when non-resident investors acquired shares of companies listed on the Johannesburg Securities Exchange on a large scale, causing an inflow of portfolio capital into the economy of R9,1 billion, after an outflow of R2,7 billion had been recorded in the second quarter. The listing of an information technology company on the London Stock Exchange during the third quarter of 2000 contributed to the greater interest shown in the domestic equity market by non-resident investors.

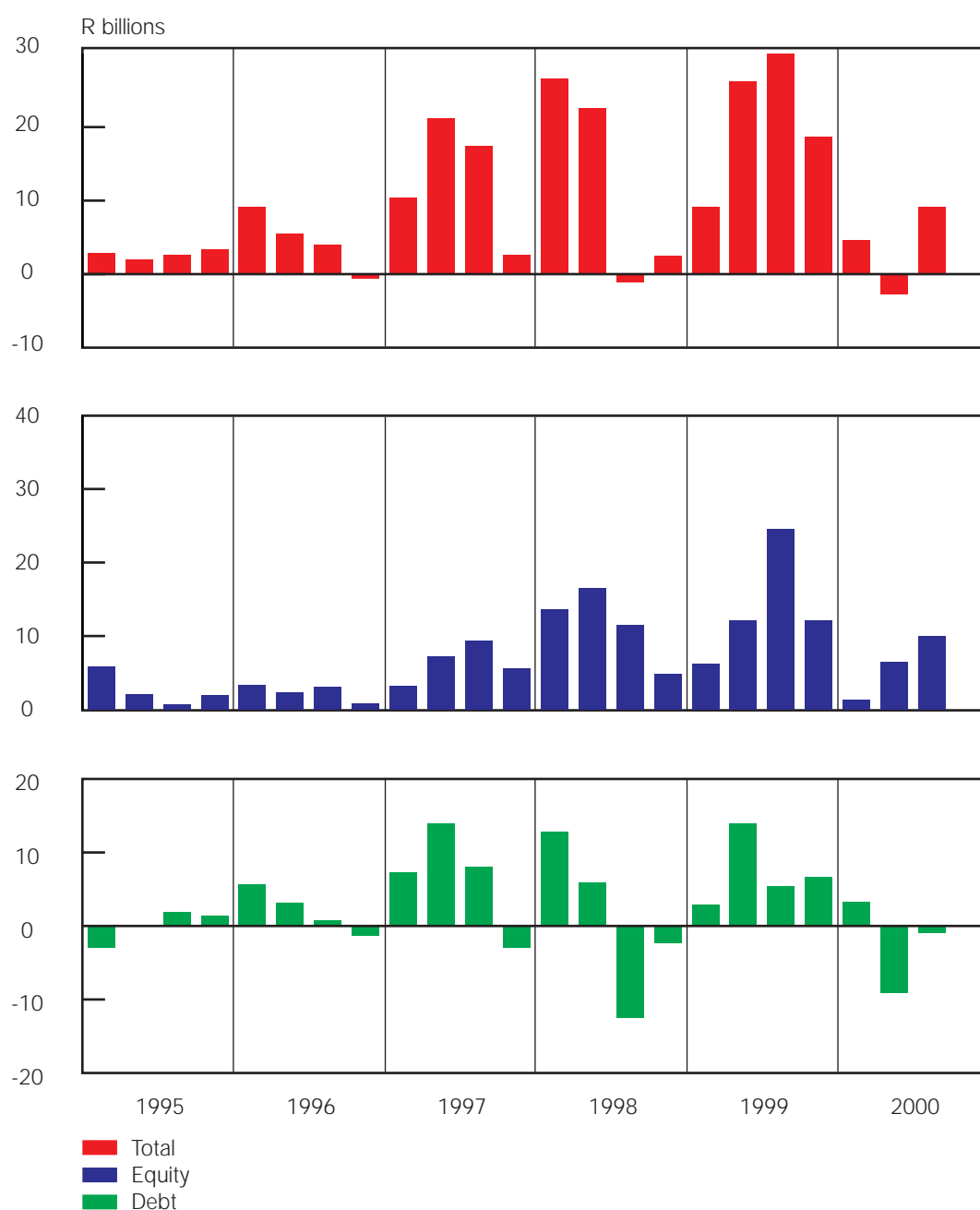
Total net capital movements not related to reserves



On balance, non-residents were net purchasers of bonds and shares totalling R0,6 billion in the first ten months of 2000. This is well down from the net purchases of R55 billion in 1999, indicating a sharp change in foreign investor sentiment towards South Africa during most of 2000.

Outward portfolio investment by South African residents, mainly through the acquisition of foreign equity and debt securities in terms of the asset swap mechanism, continued unabatedly in the third quarter of 2000 at a rate of R7,0 billion, up from R4,3 billion in the second quarter. Nevertheless, the strong inward movement of portfolio investment in the third quarter of 2000 was sufficient to reverse the *net movement of portfolio capital* from an outflow of R7,0 billion in the second quarter to an inflow of R2,1 billion in the third quarter.

Changes in portfolio investment liabilities of South Africa



The strong inward movement of portfolio capital was also instrumental in transforming a deficit of R8,9 billion on the overall financial account into a surplus of R11,8 billion in the third quarter.

Foreign debt

South Africa's total outstanding foreign debt declined by US\$1,2 billion in the first half of 2000, from US\$38,8 billion at the end of December 1999 to US\$37,6 billion at the end of June 2000. This decline in the country's foreign debt can mainly be attributed to a decline in *rand denominated debt* from US\$14,9 billion to US\$12,8 billion.

Foreign debt of South Africa US\$ billions at end of year

	1996	1997	1998	1999	2000*
Renegotiated debt	2,7	2,5	2,3	1,5	1,1
Public sector.....	1,3	1,2	1,2	0,8	0,5
Monetary sector	0,3	0,2	0,1	0,1	0,1
Non-monetary private sector.....	1,1	1,1	1,0	0,6	0,5
Other foreign-currency denominated debt	23,3	22,7	22,6	22,4	23,7
Bearer bonds.....	4,0	4,0	4,4	4,8	5,9
Converted long-term loans.....	2,1	1,3	0,8	0,4	0,3
Public sector.....	4,7	4,2	3,5	3,2	3,7
Monetary sector	6,6	7,5	8,8	8,2	7,3
Non-monetary private sector.....	5,9	5,7	5,1	5,8	6,5
Total foreign-currency denominated debt	26,0	25,2	24,9	23,9	24,8
Rand-denominated debt	8,5	14,0	12,5	14,9	12,8
Bonds.....	6,3	10,4	7,6	9,8	8,0
Other.....	2,2	3,6	4,9	5,1	4,8
Total foreign debt	34,5	39,2	37,4	38,8	37,6

* End of June 2000

Debt renegotiated in terms of successive standstill arrangements with foreign creditors had been reduced from US\$1,5 billion at the end of December 1999 to US\$1,1 billion at the end of June 2000. This debt is expected to be redeemed in full by August 2001.

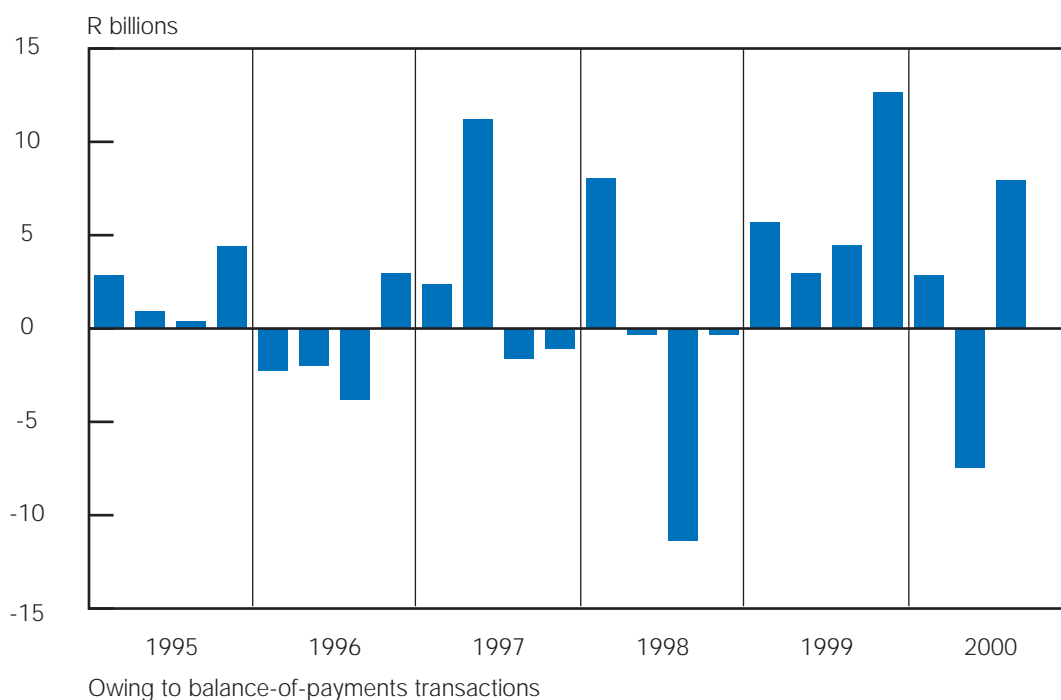
South Africa's *other foreign-currency denominated debt* (i.e. debt that had never been affected by the rescheduling arrangements) increased from US\$22,4 billion at the end of December 1999 to US\$23,7 billion at the end of June 2000, mainly as a result of net borrowing in foreign capital markets by public-sector entities. The national government issued bonds of US\$750 million and ¥30 billion, whereas Telkom issued a €500 million bond in the first half of 2000.

Measured in rands, the country's total foreign debt rose from R239,2 billion at the end of December 1999 to R256,8 billion at the end of June 2000. As a ratio of gross domestic product, total debt rose from 29,9 per cent to 30,3 per cent over the same period.

Foreign reserves

The deficit on the current account of the balance of payments was more than countered by the surplus on the financial account in the third quarter of 2000. South Africa's overall balance of payments position (i.e. the change in the country's international reserves owing to balance of payments transactions) was therefore in surplus to the value of R8,0 billion in the third quarter of 2000, indicating a substantial improvement from the second quarter when a deficit of R7,5 billion had been registered.

Change in net gold and other foreign reserves



Measured in US dollars, the country's gross international reserves improved from US\$10,2 billion at the end of June 2000 to US\$11,1 billion at the end of September. Expressed in rands, these reserves increased from R69,8 billion to R80,8 billion. A depreciation in the exchange rate of the rand during the third quarter of 2000 contributed meaningfully towards this increase in the rand value of the country's gross international reserves. Import cover (i.e. the value of gross international reserves relative to the value of imports of goods and services) increased from about 14½ weeks' worth of imports at the end of the second quarter of 2000 to 16 weeks at the end of the third quarter.

The gross gold and other foreign reserves of the Reserve Bank increased from R51,1 billion at the end of June 2000 to R54,7 billion at the end of September. In October, these reserves increased further to R56,8 billion. Short-term credit facilities utilised by the Bank increased from R17,8 billion at the end of June 2000 to R18,9 billion at the end of September and R19,6 billion at the end of October. The Bank's non-borrowed reserves accordingly rose from R33,2 billion at the end of June 2000 to R35,8 billion at the end of September and R37,1 billion at the end of October. The depreciation of the rand against the US dollar played a significant part in the recent increase in the value in rand of the Bank's foreign-currency holdings.

The Reserve Bank reduced its net oversold forward position in foreign currency from US\$15,1 billion at the end of June 2000 to US\$14,6 billion at the end of October. Similarly, the Bank's net open position in foreign currency declined from US\$10,1 billion to US\$9,6 billion over the same period.

Exchange rates

The exchange rate of the rand came under renewed downward pressure towards the end of the third quarter of 2000. Concern about the possible impact of rising petroleum prices on global growth prospects contributed to the increased volatility in international currency and securities markets as investors became increasingly risk-averse. The rand consequently depreciated by about 6½ per cent against the US dollar from the end of the second quarter of 2000 to the end of the third quarter. On balance, the rand weakened by more than 17 per cent against the US dollar from the end of December 1999 to the end of September 2000.

Exchange rates of the rand

Percentage change

	31 Mar 2000 to 30 June 2000	30 June 2000 to 29 Sep 2000	29 Sep 2000 to 31 Oct 2000	30 Dec 1999 to 31 Oct 2000
Weighted average*.....	-2,7	-1,1	-1,2	-8,7
Euro.....	-3,7	2,0	0,9	-2,7
US dollar.....	-3,4	-6,3	-3,7	-18,6
British pound.....	1,7	-3,1	-2,7	-9,1
Japanese yen.....	-3,2	-4,2	-2,7	-13,2

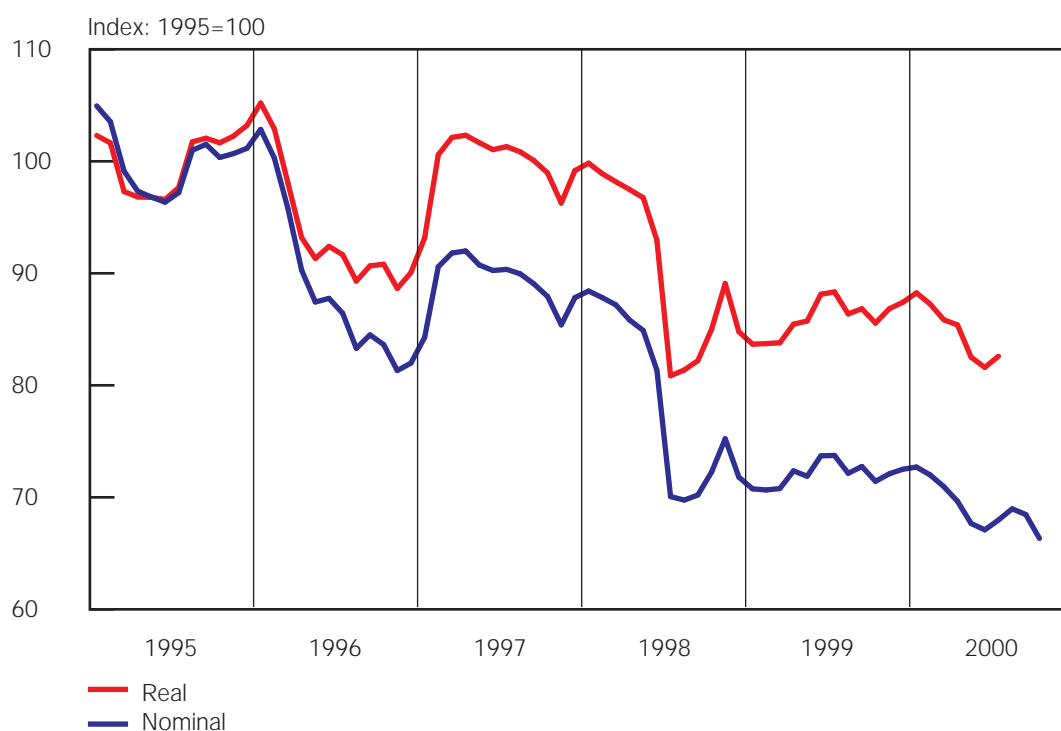
* The weighted exchange-rate index consists of a basket of 14 currencies

Despite having depreciated sharply against the US dollar, the exchange rate of the rand held up well against a basket of currencies of South Africa's major trading-partner countries. Following a decline of 6,6 per cent in the first half of 2000, the *nominal effective exchange rate* of the rand declined by only 1,1 per cent from the end of the second quarter to the end of the third quarter. From the end of June 2000 to the end of September the external value of the rand depreciated by 3,1 per cent against the British pound and by 4,2 per cent against the Japanese yen, but appreciated by 2 per cent against the euro.

Political tension in the Middle East and continued increases in international petroleum prices led to a further deterioration in investor sentiment and increased volatility in currency markets during October 2000. Amid this heightened turbulence, the exchange rate of the rand declined by 1,2 per cent on a weighted basis from the end of September 2000 to the end of October and by 3,7 per cent against the US dollar.

Turnover in the domestic market for foreign currency increased from a daily average of US\$8,3 billion in the fourth quarter of 1999 to US\$9,8 billion in both the second and third quarters of 2000. Participation by residents in the market subsided from US\$4,0 billion in the second quarter of 2000 to US\$3,8 billion in the third quarter, whereas transactions by non-resident participants increased from US\$5,8 billion to US\$6,0 billion.

Effective exchange rates of the rand



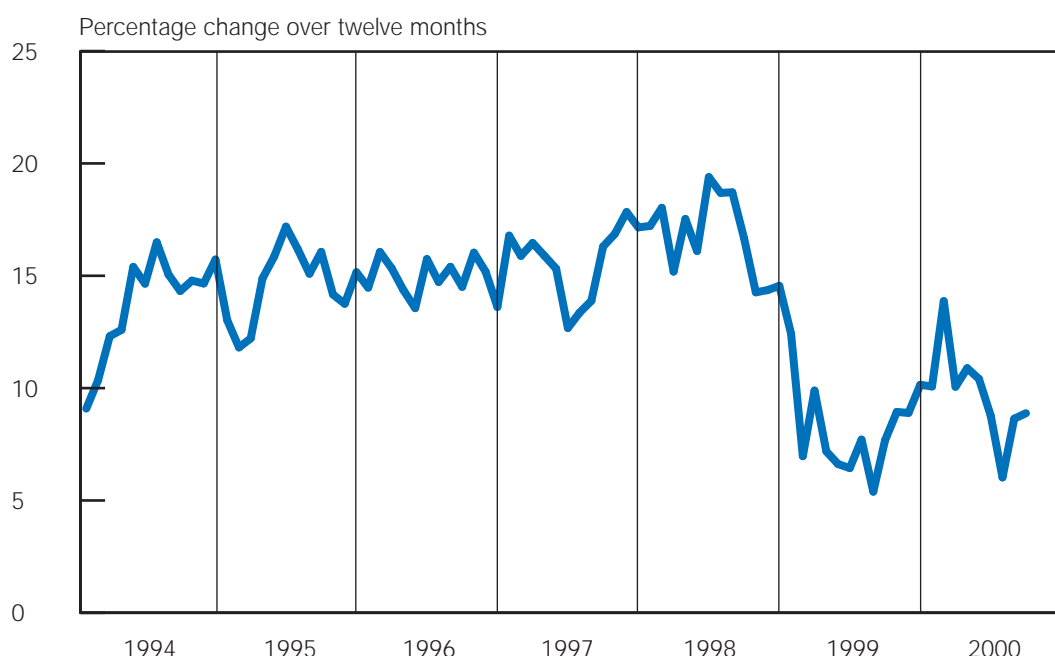
The effective exchange rate of the rand, adjusted for inflation differentials between South Africa and its main trading partners, declined by about 5½ per cent from December 1999 to July 2000. This decline is a fair approximation of the extent of the improved competitiveness of South African producers in foreign markets since the end of 1999.

Monetary developments, interest rates and financial markets

Money supply

Growth in the monetary aggregates over the first half of 2000 was held back by a number of factors. The demand for money for transaction purposes was relatively weak, owing to subdued economic conditions and slow growth in nominal gross domestic production and expenditure. A special factor which further compressed the demand for money in the early months of 2000 was the unwinding of build-ups of notes and coin and demand deposits in the final months of 1999 before the millennium date change.

M3 money supply



A third factor which could have depressed growth in the broad money supply (M3) was that interest rates on bank deposits were well below the interest rates on substitute assets, raising the opportunity cost of holding bank deposits. In response, deposit-holders could have reallocated a greater part of their funds to money-market unit trusts and direct holdings of money and capital-market instruments. The increased activity in the primary capital market where private-sector borrowers and lenders establish contracts directly without the intermediation of the banking system might also have contributed to the relatively slow growth in the consolidated balance sheet of the banking sector.

M3 expanded at year-on-year rates of more than 10 per cent in the first five months of 2000, but slowed down to 6,0 per cent in July 2000. The growth in M3 accelerated quite noticeably to 8,9 per cent in September. Measured from quarter to quarter and calculated at an annualised rate, the average value of M3 grew by 10,3 per cent

in the first quarter, but declined by 1,6 per cent in the second quarter. Quarter-to-quarter growth in M3 then rebounded to 4,8 per cent in the third quarter.

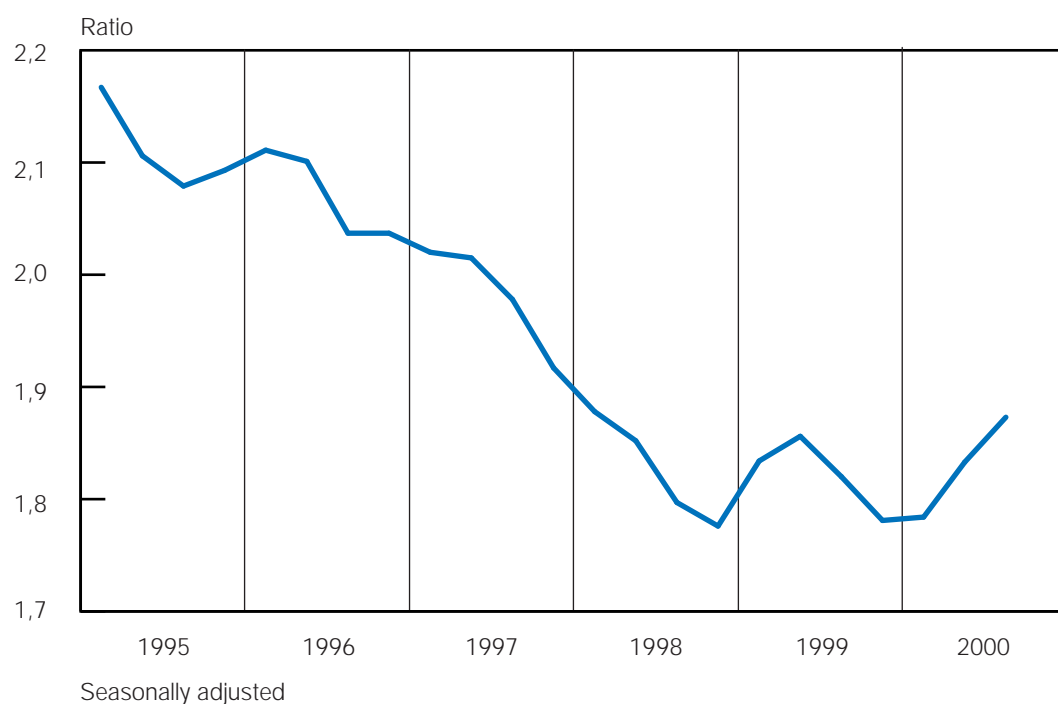
Twelve-month growth rates in monetary aggregates

Per cent

Period	M1A	M1	M2	M3
2000: Jan.....	26,0	17,3	13,6	10,1
Feb	29,4	25,3	18,3	13,9
Mar	18,3	17,0	13,8	10,1
Apr.....	20,8	20,6	13,2	10,9
May.....	17,6	17,9	12,2	10,4
Jun.....	12,2	16,9	9,9	8,6
Jul.....	6,1	11,0	6,5	6,0
Aug.....	2,0	8,4	7,1	8,6
Sep.....	7,0	14,1	7,2	8,9

M3 velocity – the ratio of nominal gross domestic product to M3 – increased over the second and third quarter of 2000, consistent with the presumption that a rise in the opportunity cost of holding money deposits would reduce the importance of money holdings in portfolios. Investors evidently restrained flows of funds into M3 deposits in favour of other more attractively priced assets such as interest-bearing debt securities.

Income velocity of M3



Growth in the narrower monetary aggregates has also subsided noticeably since the beginning of 2000, but there are signs that growth in these aggregates has also been picking up from September. For example, the increase over twelve months in M1 slowed from 25,3 per cent in February 2000 to 8,4 per cent in August, before strengthening to 14,1 per cent in September.

The main counterparts in an accounting sense of the increase in M3 in the third quarter of 2000 were increases in the monetary institutions' claims on the private sector and in their net claims on the government sector. The net foreign assets of the banks rose marginally, but there was a sharp decline in their "net other assets". The decline in "net other assets" was caused by a sharp increase in the banks' derivative liabilities.

The increase in banks' derivative liabilities which had previously been netted off against "other assets", may be netted off against claims on the private sector, without fear of sacrificing any accuracy in the measurement of the M3 money supply. Such a rearrangement of the statistical analysis will, of course, leave unaltered the absolute level of the M3 money supply and changes in this monetary aggregate.

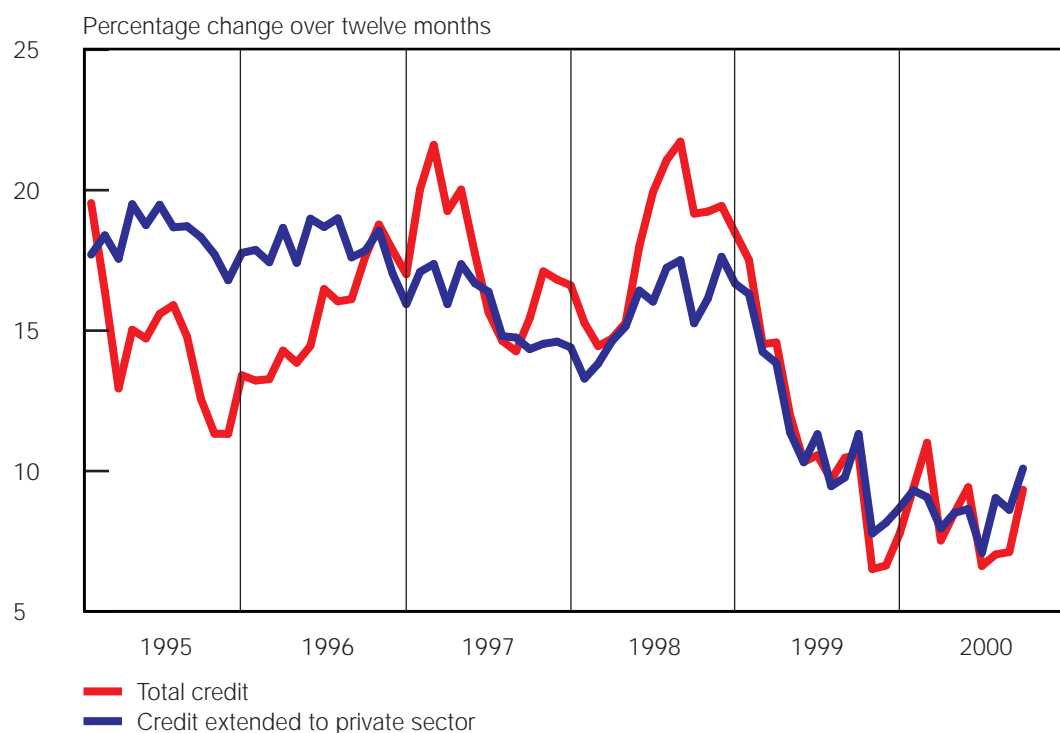
Credit extension

The total indebtedness of the non-bank private business sector, households and the government sector to the banking sector is estimated to have increased by 9,4 per cent from September 1999 to September 2000. In June 2000 the year-on-year growth in total bank credit extension was only 6,6 per cent and in July and August it was close to 7 per cent.

Outside the government sector, indebtedness to banks expanded at a year-on-year rate of 10,2 per cent in September 2000, buoyed by an unusually strong expansion in banks' investments in the non-bank private business sector. In June 2000 the year-on-year growth in bank credit extension was as low as 7,1 per cent.

As mentioned in the previous paragraph, banks' claims on the private sector were swelled by a large expansion in their investments in non-bank private-sector firms.

Credit extended by monetary institutions



Growth in this type of investment accelerated from a rate over twelve months of 11,0 per cent in June 2000 to 63,2 per cent in September. This extraordinary acceleration was almost completely due to a change in the reporting practices of banks.

Prior to the third quarter, the gross values of the banks' asset positions in derivative instruments were netted off against "liabilities in respect of derivative instruments" and were therefore not reported on the banks' consolidated balance sheet. Since July these transactions have been reported on the balance sheet of banks as part of "investments" assets and as "other liabilities in respect of derivative instruments" among the liabilities items.

Derivatives positions are now consolidated with "investments" whereas "liabilities in respect of derivative instruments" are lumped together with "other liabilities", reducing "net other assets" by a corresponding amount. If the increase in "liabilities in respect of derivative instruments" were still to be netted off against credit extension to the private sector, the year-on-year growth rate in bank credit extension to the private sector in September 2000 would be reduced to close to 8,6 per cent, the same as growth in August. In real or inflation-adjusted terms, credit extension to the non-bank private sector rose only marginally in the twelve months to September, after having vacillated between positive and negative growth rates in the course of 2000.

Increase in credit extension to the private sector by type of credit

Year-on-year percentage change

Credit category	2000			
	Jun	Jul	Aug	Sep
Mortgage advances	7,4	8,3	8,6	9,2
Instalment sales	4,8	5,9	6,7	7,1
Leasing finance	4,2	5,1	5,8	5,8
Investment	11,0	37,0	22,3	63,2
Bills discounted	-7,4	-30,0	-15,1	-22,0
Other loans and advances	7,7	9,2	8,5	7,7
Total	7,1	9,0	8,6	10,2

The fairly slow growth in the private sector's bank indebtedness (excluding the banks' investments) resulted partly from the funding arrangements established by borrowers and lenders outside the banking system. Households were also hesitant about using bank credit for financing their purchases of durable goods. In addition, banks have tightened the terms and standards for loans and take particular care in assessing the credit-worthiness of potential clients. Nonetheless, quarter-to-quarter growth in nominal credit extension by banks to the private sector accelerated from an annualised rate of 4,4 per cent in the second quarter of 2000 to 12,9 per cent in the third quarter, reflecting stronger growth in overall economic activity in addition to the one-off effect of the change in reporting practices described in some detail earlier.

The rate of growth in "other loans and advances" declined from 14,0 per cent in March 2000 to 7,7 per cent in September. The slowdown was most noticeable in credit extended to companies. From about the beginning of 2000, private business demand for funds has increasingly been satisfied through the issuance of share capital and fixed-interest securities, and this could have contributed to the slowdown in credit intermediated through the banking sector. Despite the slower growth

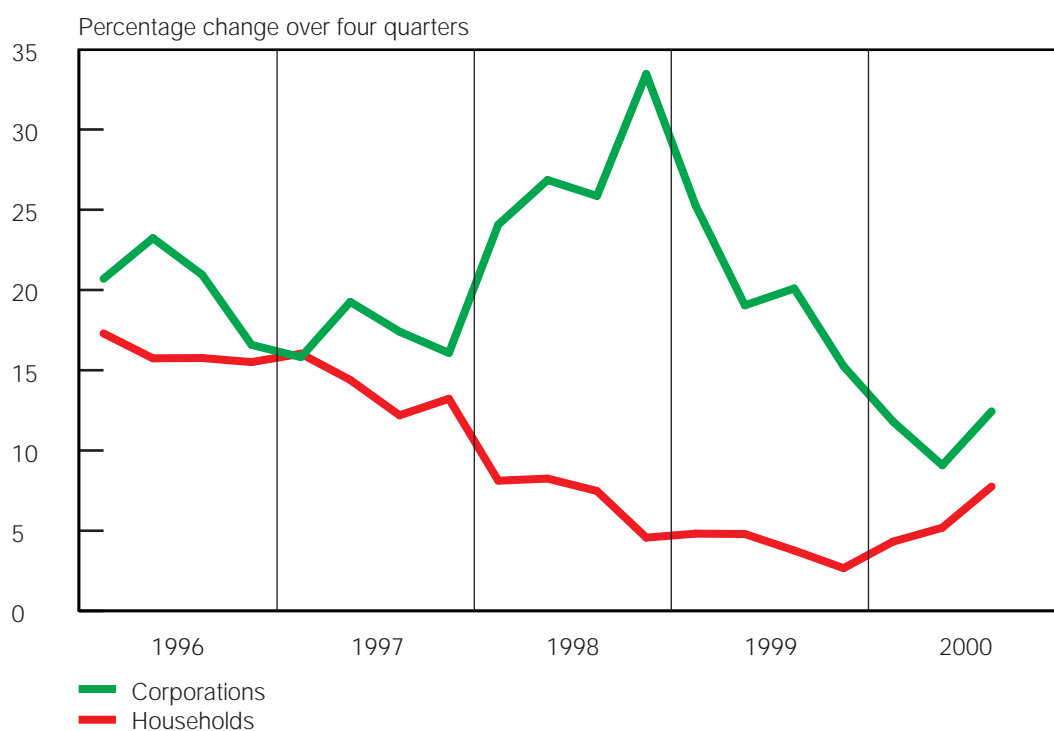
in "other loans and advances", this category remains the largest credit component on banks' balance sheets with a share in the overall stock of outstanding private-sector credit of 41,2 per cent in September 2000.

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
2000: Jan.....	5,3	13,8	38,0	42,9	100,0
Feb.....	5,3	13,9	38,2	42,6	100,0
Mar.....	5,5	13,9	38,4	42,2	100,0
Apr.....	5,8	14,0	38,5	41,7	100,0
May.....	5,9	14,0	38,5	41,6	100,0
Jun.....	6,1	14,0	38,5	41,4	100,0
Jul.....	6,2	13,9	38,5	41,4	100,0
Aug.....	6,3	13,7	38,7	41,1	100,0
Sep.....	7,0	13,7	38,1	41,2	100,0

During the second and third quarters of 2000, the largest contribution to the growth in bank credit extension to the private sector came from the category *mortgage advances*. The rate of increase over twelve months in mortgage advances picked up somewhat from 5,3 per cent in March 2000 to 9,2 per cent in September. Although these growth rates are still rather modest, their strengthening is consistent with the lower interest rate levels and the recovery in the real-estate market. The share of mortgage advances in the overall stock of outstanding private-sector credit accordingly increased slightly from 38,0 per cent in January 2000 to 38,1 per cent in September.

Credit extended to households and corporations



As was the case with mortgage advances, the types of credit regularly used for the financing of purchases of consumer durables and movable assets by firms, i.e. *instalment sale credit and leasing finance*, have also shown signs of stronger growth in recent months. The percentage change over twelve months in instalment sale credit and leasing finance accelerated from 1,9 per cent in March 2000 to 6,8 per cent in September. New business payouts in respect of instalment sale credit and leasing finance reached a record high of R12,7 billion in the third quarter of 2000.

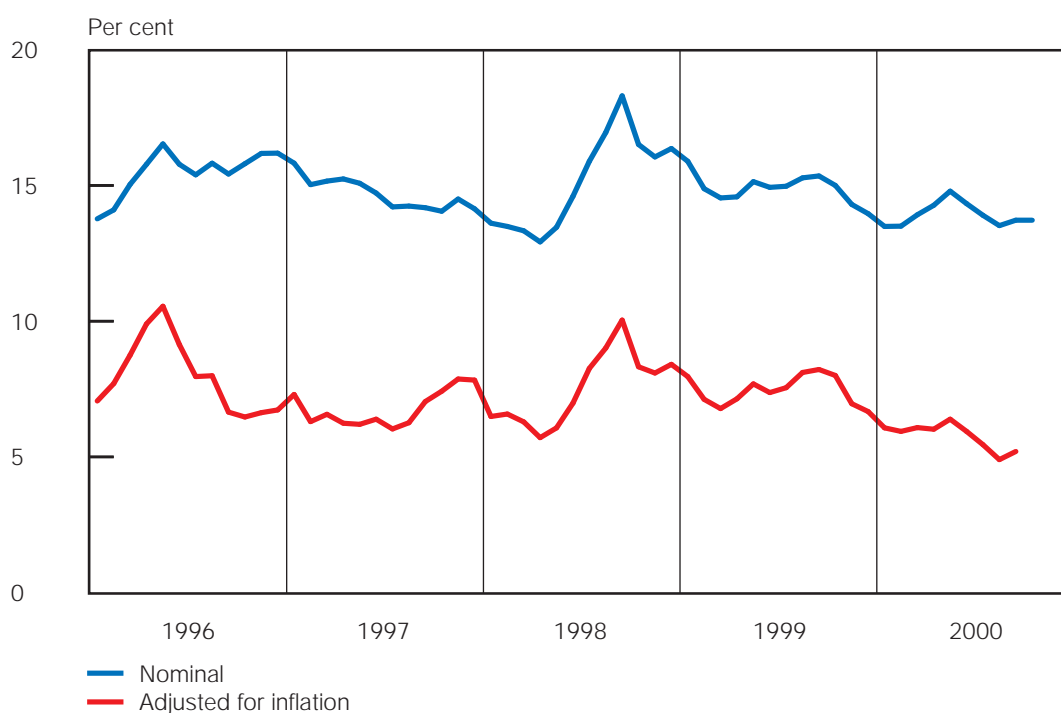
The corporate sector absorbed the greater part of the increase in credit extended to the private sector in the third quarter of 2000. The share of the corporate sector in total credit extension to the private sector consequently increased from 49,8 per cent in the second quarter of 2000 to 50,9 per cent at the end of the third quarter. Conversely, the share of the household sector decreased from 50,2 per cent to 49,1 per cent over the same period.

Yields and interest rates

Bond yields declined from May 2000 to August as the bond market responded positively to an apparent improvement in inflation expectations, some strengthening of the rand against the US dollar and the return of non-resident investors as net purchasers to the domestic bond market. Reflecting the positive sentiment in the market, the *monthly average yield* on long-term government bonds declined from 14,8 per cent in May 2000 to 13,5 per cent in August – i.e. similar to its level in January and February this year.

Perceptions changed again in September 2000 as sentiment in the bond market was affected by events in other parts of sub-Saharan Africa and by fears that second-round responses to rising crude oil prices and the depreciation of the rand would lead to enduringly higher inflation. Long-term bond yields retraced part of their earlier declines and the monthly average yield on long-term government bonds rose to 13,7 per cent in September and October 2000.

Yield on long-term government bonds



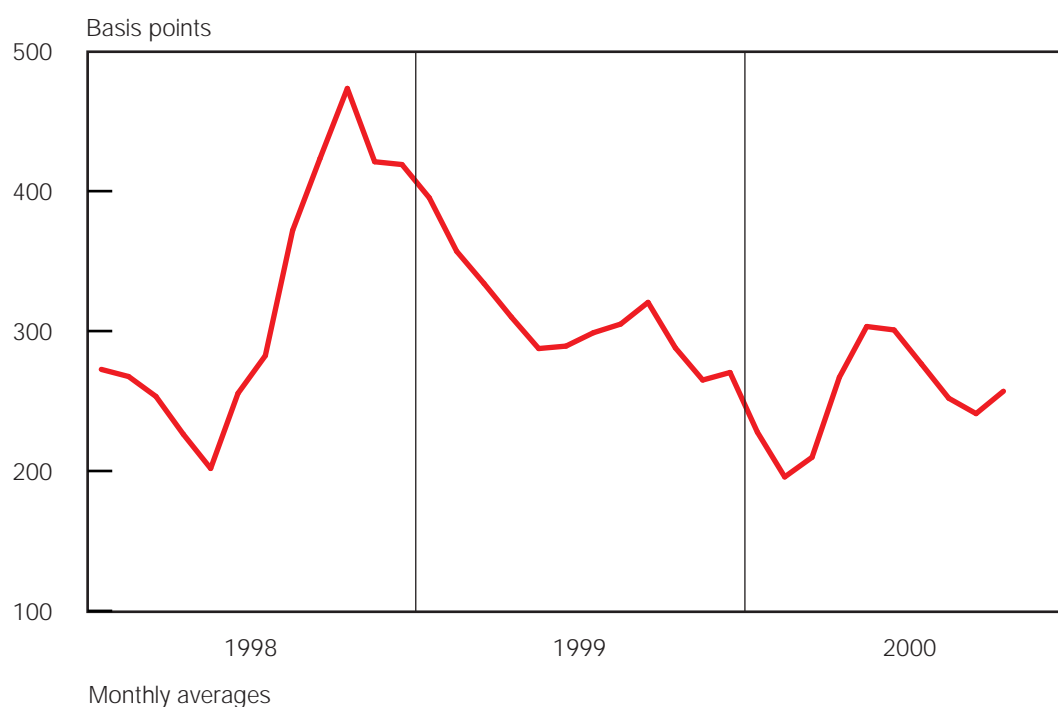
The *daily average yield* on long-term government bonds declined from a high of 15,21 per cent on 10 May 2000 to 13,31 per cent on 14 August – its lowest level since the second week of February. Bouts of profit-taking and the waxing and waning of non-resident interest in the domestic bond market subsequently caused long-term yields to vacillate around a slightly upwardly sloping trend, reaching a high point of 13,89 per cent on 18 October 2000.

The *inflation-adjusted yield on long-term government bonds*, along with the decline in nominal yields, fell from 6,4 per cent in May 2000 to 4,9 per cent in August, when using past price increases as an indicator of expected inflation. When nominal yields moved higher in September 2000 and year-on-year inflation levelled off, the real yield rose to 5,2 per cent.

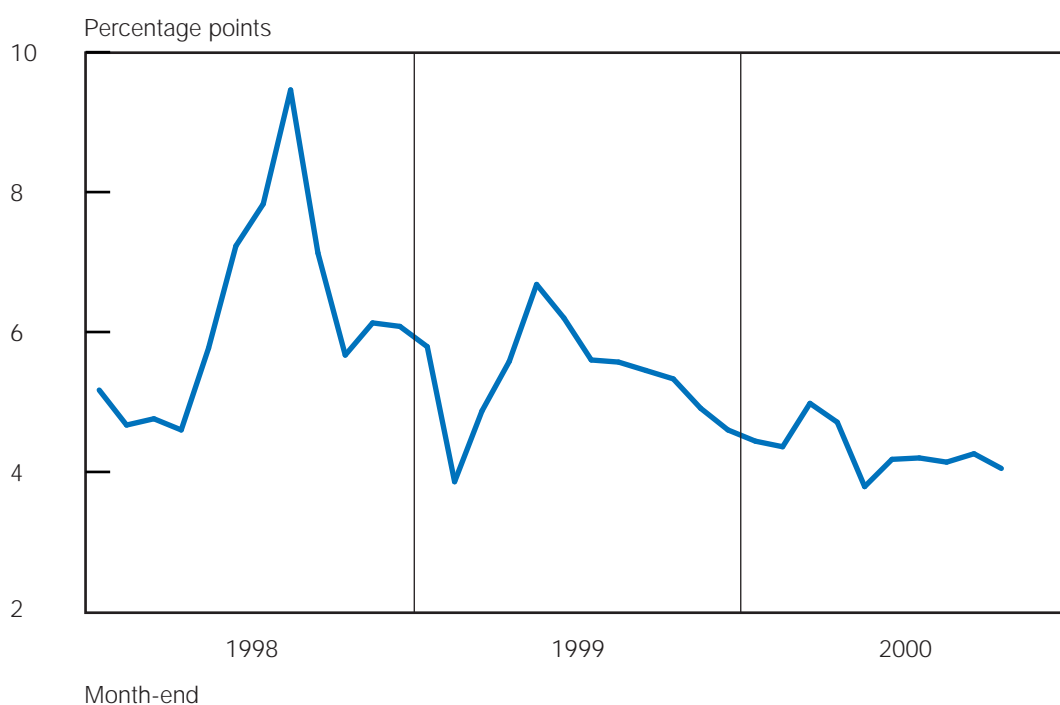
The *differential* between the *real yield* on South African Government bonds and bonds of the United States Federal Government has narrowed noticeably since 1998 when the international financial crisis widened the interest-rate spread on virtually all emerging-market debt. The current margin for South Africa is below the average differential calculated for the period since 1994. The recent narrowing might be seen as an indication of an improvement in South Africa's sovereign and currency risks.

Changes in risk premiums reflect foreign investor's perceptions of risk-reward opportunities in a country. The current level of the *sovereign risk premium*, although well down from its recent high in May 2000, still suggests a fair measure of negative sentiment towards South Africa when compared with the risk assessments of May 1998 and February 2000 (see accompanying graph). The *currency risk premium*, in turn, signalled a fairly sanguine outlook for inflation. According to this measure (calculated as the difference between the nominal yield on South African Government bonds with an outstanding maturity of five years in the domestic market and in the United States market), inflation expectations have levelled off at 4,3 per cent in the first ten months of 2000.

Sovereign risk premium on South African government bonds

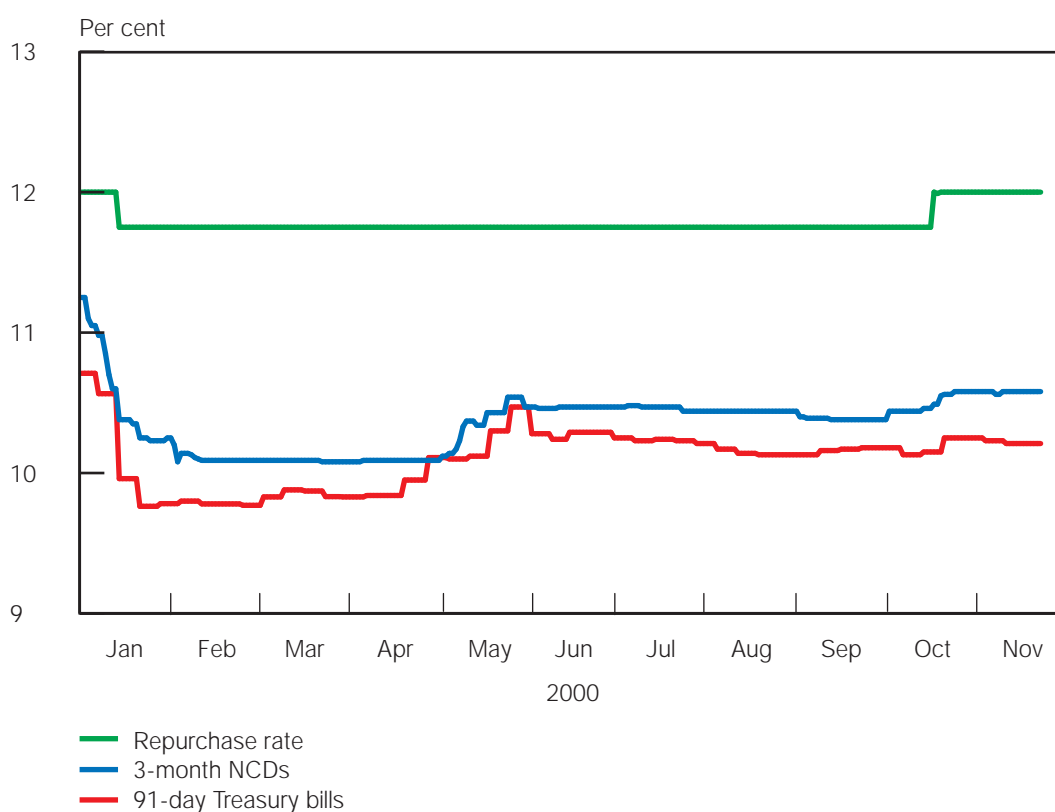


Currency risk premium on South African government bonds



The interest rate on repurchase transactions by the Reserve Bank remained unchanged at 11,75 per cent from 14 January 2000 to 16 October. A special meeting of the Reserve Bank's Monetary Policy Committee was convened on 16 October to review the potential second-round price effects of the depreciation in

Money-market interest rates



the exchange rate of the rand and the continued high international oil prices. The committee decided that a marginal tightening in the monetary policy stance would be appropriate as a signal that such second-round price effects would not be accommodated by a monetary easing. The Bank also indicated that it would intervene in the money market in a manner that would ensure a rise in the repurchase rate to 12 per cent on 17 October.

Money-market interest rates moved downwards towards the end of May 2000 when expectations of an increase in official short-term interest rates began to dissipate. Afterwards, money-market interest rates moved broadly parallel with the repurchase rate of the Reserve Bank until the beginning of October 2000 when concerns about the inflation consequences of rising oil prices and the depreciating rand contributed to an upward shift in these rates. When the repurchase rate of the Reserve Bank rose on 17 October most of the other money-market interest rates also moved slightly. Notable exceptions were the interbank call money rate and the prime lending rate, which have been unchanged since January 2000.

The rate on three-month Treasury bills declined from a high point of 10,47 per cent on 1 June 2000 and stood at 10,15 per cent on 13 October, immediately prior to the Reserve Bank's decision to increase the repurchase rate. The Treasury bill rate then increased to 10,25 per cent on 20 October and broadly maintained that level in the ensuing period. The rate on three-month bankers' acceptances rose from 10,16 per cent on 16 October to around 10,31 per cent after the effects of the repurchase rate increases had permeated the market.

The upward sloping *yield curve* has become flatter since May 2000 as bond yields at the short end of the curve have increased somewhat and long-term yields generally declined up to August. On balance, the overall level of the curve declined to a level on 29 August 2000 that was well below the level on 7 January 2000. From the end of August the yield curve, at first, moved higher, indicating among other things that there was still concern about the possibility of higher inflation. After reaching a peak on 18 October 2000, there has been a downward shift in the overall level of the curve.

The private banks have kept their *lending rates* unchanged since January 2000. The *prime lending rate* and the *predominant rate on mortgage loans* have accordingly remained unchanged at 14,5 per cent from February 2000 to October. This has been the lowest level of these rates since June 1988. The *predominant rate on twelve-month fixed deposits* was nevertheless raised in two steps from 8,50 per cent in May 2000 to 9,50 per cent in July, but was lowered to 9,25 per cent in September.

Money market

The relatively small liquidity requirement that prevailed towards the end of 1999 before the millennium date change, increased considerably in the first ten months of 2000, essentially through the liquidity-draining operations of the Reserve Bank. The private banks' daily liquidity requirement rose from a monthly average of R4,9 billion in December 1999 to R7,2 billion in March 2000, afterwards fluctuating between R8,4 billion and R9,4 billion in the months to October.

The relative stability in the daily cash requirements of the private banks during the second and third quarters of 2000 was also brought about mainly by Reserve Bank

interventions in the money market. Over this period, liquidity was injected into the money market through steady increases in the Bank's net foreign asset holdings and through the deficits realised by the Bank in its forward foreign-currency transactions.

In order to counter the continuous additions to money market liquidity, the Reserve Bank stepped up the outstanding amount of reverse-repurchase transactions in government securities (with private-sector parties) from R4 billion at the end of September 2000 to R5 billion at the end of October. More important, the outstanding amounts of foreign-currency swap arrangements with private-sector parties were increased from R9,3 billion at the end of April 2000 to R15,1 billion at the end of October. In addition, a relatively small increase in the amount of notes and coin in circulation outside the Reserve Bank, which tightened liquidity conditions in the market somewhat, aided the Bank in its efforts to counteract undue increases in the banks' liquidity position.

The Reserve Bank has continuously accommodated in full the liquidity needs of the private banks. In terms of the Bank's signalling mechanism, this was understood by market participants as an indication that the interest rate on repurchase transactions at the daily auction should remain unchanged.

On 16 October 2000 the Bank made known that in its view the repurchase rate should move higher by 25 basis points to 12 per cent as a clear indication that any future monetary accommodation of inflation pressures would not be tolerated. On 17 October 2000 this announcement was reinforced by an underprovision in the daily liquidity requirement to the amount of R50 million. The repurchase rate responded in the desired manner and full provision of the banks' daily liquidity needs resumed on 18 October.

Bond market

Funding by *public-sector borrowers* through the net issuance of fixed-interest securities in the *domestic primary bond market* declined by 15 per cent from R8,4 billion in the first six months of fiscal 1999/2000 to R7,1 billion in the first half of the current fiscal year. The *national government's* demand for loanable funds in the *domestic primary bond market* shrank by 50 per cent from the first half of fiscal 1999/2000 to the corresponding period of the current fiscal year. Government satisfied the major part of its borrowing needs through the issuance of short-term Treasury bills. In total, a net amount of R12,4 billion in Treasury bills was issued in the April-September 2000 period, compared with a net amount of R3,8 billion in the corresponding period of the previous year.

"Stripped bonds" were introduced by a private-sector issuer in September 2000. These involve the acquisition of government bonds and the separate listing of their interest and principal components as new financial instruments. The *outstanding nominal value of private-sector loan stock* listed on the Bond Exchange of South Africa (excluding "stripped" bonds) increased strongly from R3,8 billion in December 1999 to R8,5 billion in September 2000. By contrast, private-sector companies listed on the Johannesburg Securities Exchange (JSE) made no *rights issues of preference shares and debentures* in the first nine months of 2000.

National government and other domestic borrowers successfully accessed the *international primary bond markets* in the first ten months of 2000. South African *public-sector borrowers* raised R10,1 billion through the issuance of *foreign-currency*

denominated bonds in the first ten months of 2000, compared with R9,5 billion in the corresponding period of the previous year. The *national government* raised R4,9 billion in March and R2 billion in June. *Other domestic public-sector borrowers* raised R3,2 billion in March.

Exchange-rate concerns and the associated deterioration of foreign investor sentiment towards rand-denominated investments had a dampening effect on funding through *rand-denominated bonds* in the *eurobond market*. As a consequence South African public-sector borrowers have steered clear of this market since March 1999. Net redemptions of euro-rand bonds to the value of R1,6 billion were made by resident and non-resident borrowers in the first ten months of 2000 – net issues to the value of R3,6 billion had been made in 1999.

Trading activity on the Bond Exchange of South Africa in the first ten months of 2000 was boosted by the volatility in bond prices and by the market's susceptibility to exchange-rate volatility and non-economic events in sub-Saharan Africa. Turnover in the *secondary bond market* rose sharply and the value of bonds traded, at R8,9 trillion in the first ten months of 2000, surpassed the annual turnover of R8,8 trillion in 1999. However, the quarterly value of bonds traded decreased somewhat from a record high of R2,8 trillion in the first quarter of 2000 and levelled off at R2,6 trillion in each of the second and third quarters. Limited trading in the newly created stripped bonds started towards the end of September 2000.

The sudden deterioration in foreign investor sentiment early in 2000 led to substantial net sales of bonds in the domestic market by non-resident investors. *Non-residents'* net purchases of bonds in the *secondary bond market* of R14,3 billion in 1999 as a whole turned into net sales of R17,2 billion in the first ten months of 2000. Net outright sales by non-resident investors totalled R9,1 billion in the first ten months of 2000 and sales through repurchase transactions R8,1 billion. This indicated negative sentiment among speculative and longer-term investors alike.

Share market

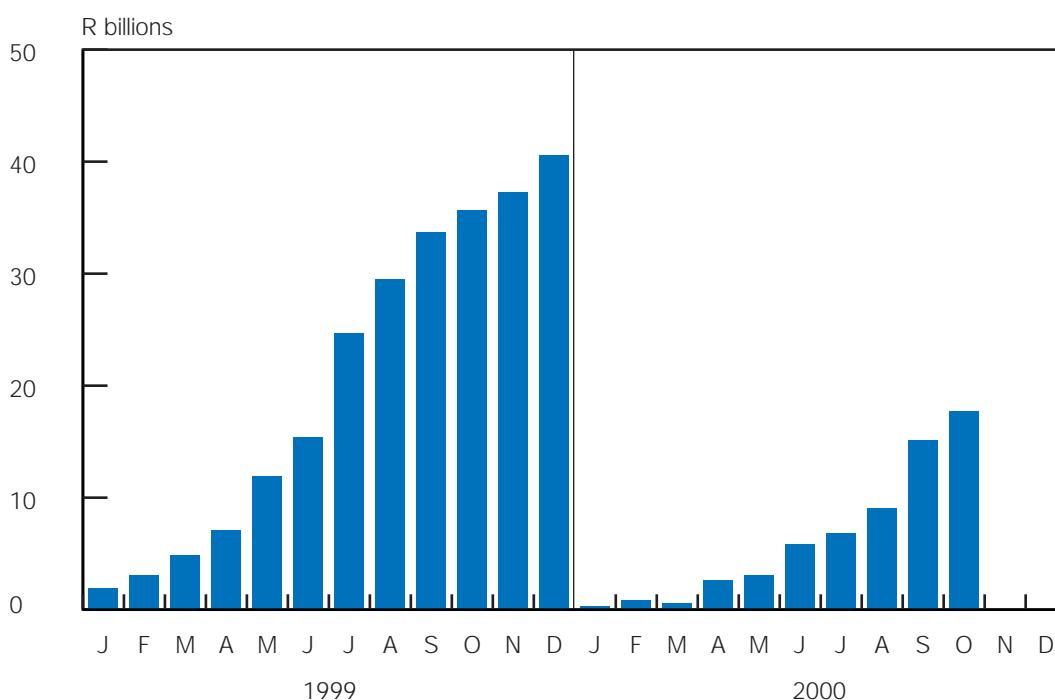
The *number of listed private-sector companies* on the JSE declined from 668 in December 1999 to 642 in September 2000, but the total value of *equity capital* raised in the *primary share market* by listed companies rose from R39,3 billion in the whole of 1999 to R61,6 billion in the first nine months of 2000. Included in the statistics for the first nine months of 2000 were shares issued for the *acquisition of unlisted assets* to the value of R36,8 billion; only R16,5 billion had been raised in this manner in the corresponding period of 1999.

Turnover in the *secondary share market* was brisk in the first ten months of 2000 as heightened price volatility fuelled trading activity. The value of shares traded in the first ten months of 2000, at R447 billion, was 21 per cent more than in the corresponding period of 1999. The quarterly value of shares traded rose to an all-time high of R155 billion in the first quarter of 2000 but receded to about R125 billion in each of the second and third quarters. *Market liquidity*, measured as annualised turnover relative to market capitalisation, accordingly peaked at 41 per cent in the first quarter of 2000 but fell back to 32 per cent in the third quarter.

Foreign investors maintained a bullish outlook on South African shares and domestic economic prospects, as reflected by their net purchases of R17,8 billion worth of shares in the first ten months of 2000. Nevertheless, foreign investor sentiment has

deteriorated since 1999 when net purchases of shares by non-resident investors totalled R40,6 billion. The quarterly value of net purchases by non-residents increased from just R0,6 billion in the first quarter of 2000 to R5,3 billion and R9,3 billion in the second and third quarters respectively as sentiment was buoyed by, *inter alia*, the rise in domestic share prices. In October 2000, non-residents lowered their net acquisition of shares to R2,6 billion along with the correction in share prices.

Annual cumulative net purchases of shares by non-residents



The *monthly average price level of all classes of shares* declined, on balance, by 8,6 per cent from an all-time high in January 2000 to October. During this period a decrease of 16,3 per cent in share prices from January to May was followed by an increase of 13,6 per cent from May to September, but share prices declined again by 3,8 per cent from September to October. The *daily closing level of the all-share price index* declined by 10 per cent from a most recent high on 4 September 2000 to 18 October before firming by about 4,1 per cent at the end of October.

A number of factors could be cited as potential contributors to the equity market weakness from early September 2000. These include

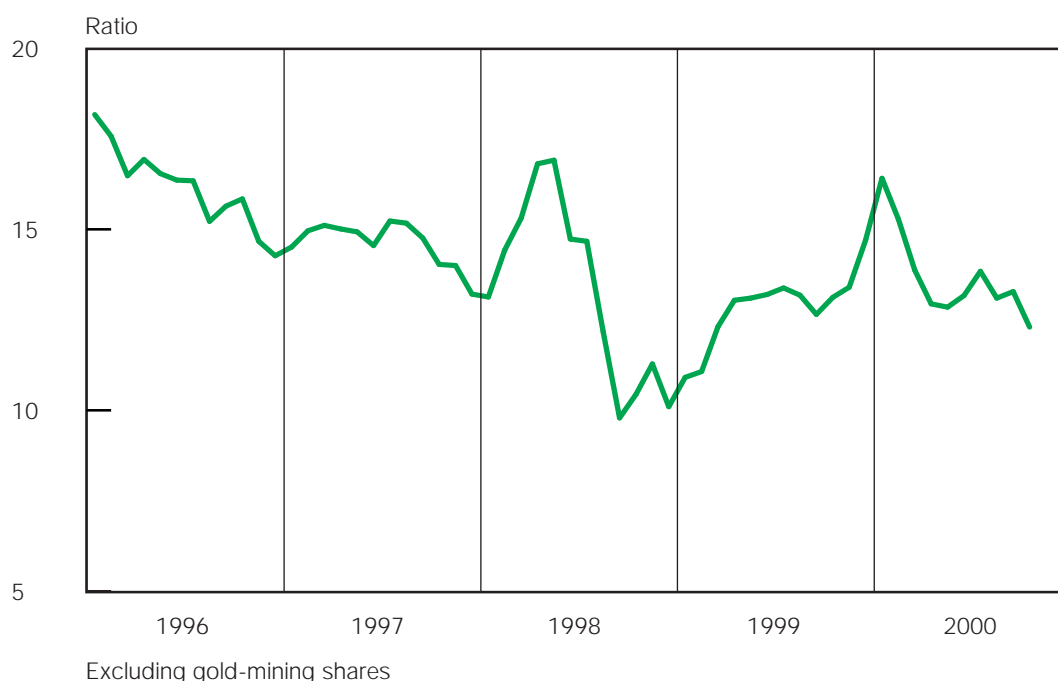
- the weakness of the rand against the United States dollar;
- the sustained high price of petroleum, giving rise to inflation concerns;
- the increase in domestic interest rates and yields which impacted negatively on earnings expectations and share valuations;
- the volatility of share prices in the major international markets; and
- escalating tension in the Middle East.

The *major indices* on the JSE moved broadly in unison over the past ten months. The broad advances from May to September were led by the rebound in the *information technology sector* and the *mining and non-mining resources sectors* which gained favour on account of the weaker rand and firmer commodity prices. The performance of the "blue chip" companies, included in the *Alsi Top 40 Index*, also

helped to push the market higher as these indices outperformed the all-share index. The smaller increases of share prices in the *financial and industrial sectors* reflected continued qualms about the future direction of interest rates and the sustainability of the domestic economic recovery.

The volatility in *price-earnings ratios* mostly reflected changes in corporate earnings expectations. The price-earnings ratio for all classes of shares, excluding gold-mining shares, fell from 16,4 in January 2000 to 12,9 in May and 12,3 in October. Mirroring the movements in the price-earnings ratio, the *earnings yield* of the non-gold sector in recent months rose from 7,2 per cent in July to 8,1 per cent in October. The *dividend yield* on all classes of shares increased from 1,9 per cent in January 2000 to 2,6 per cent in May along with the decline in share prices and then remained broadly unchanged at an average rate of 2,4 per cent from July 2000 to October.

Price-earnings ratio: All shares

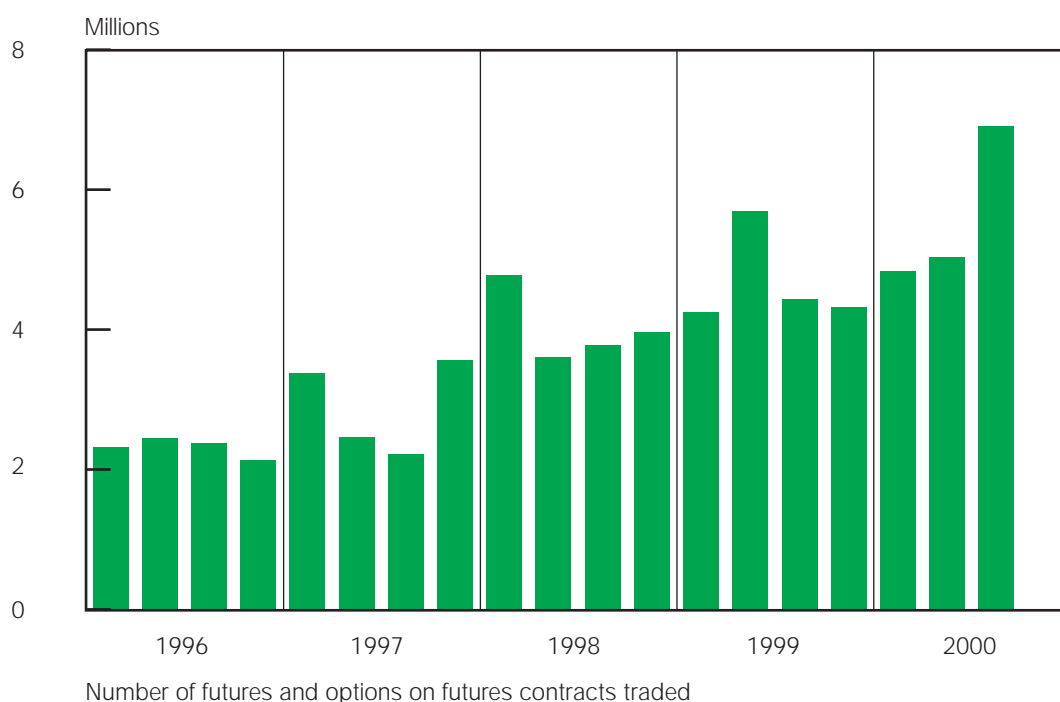


Market for derivatives

Heightened price volatility boosted trading in equity and commodity contracts in the *formal derivatives market* in the first ten months of 2000. Market participants are increasingly making use of derivatives to reduce their risk exposures in the underlying securities markets.

The combined number of *futures and options on futures contracts* traded on the *South African Futures Exchange* – almost exclusively equity-related contracts – rose by 20 per cent in the first ten months of 2000 compared with the corresponding period of 1999. The introduction of a further 34 *individual equity futures and options on futures contracts* in August 2000 expanded the range of equity-related derivative products to full coverage of all the underlying shares included in the Alsi 40 and Indi 25 indices of the JSE. This contributed to a quarterly all-time high of 6,9 million contracts traded in the third quarter of 2000.

Derivatives market



By May 2000, the number of *warrants* traded on the JSE since the beginning of the year had already surpassed the number of warrants traded in 1999 as a whole. Warrants of 2,77 times more than the whole of 1999 were traded up to October 2000. The number of warrants traded increased from a quarterly average of 1,9 billion in the first half of 2000 to an all-time high of 2,7 billion in the third quarter.

The number of *commodity futures contracts and options on such contracts* traded in the Agricultural Market Division of the South African Futures Exchange in the first ten months of 2000 was 48 per cent more than the number traded in the whole of 1999. These contracts increased from a quarterly average of 62 500 in 1999 to a quarterly all-time high of 124 600 in the third quarter of 2000, boosted by the volatility in the spot price of white maize.

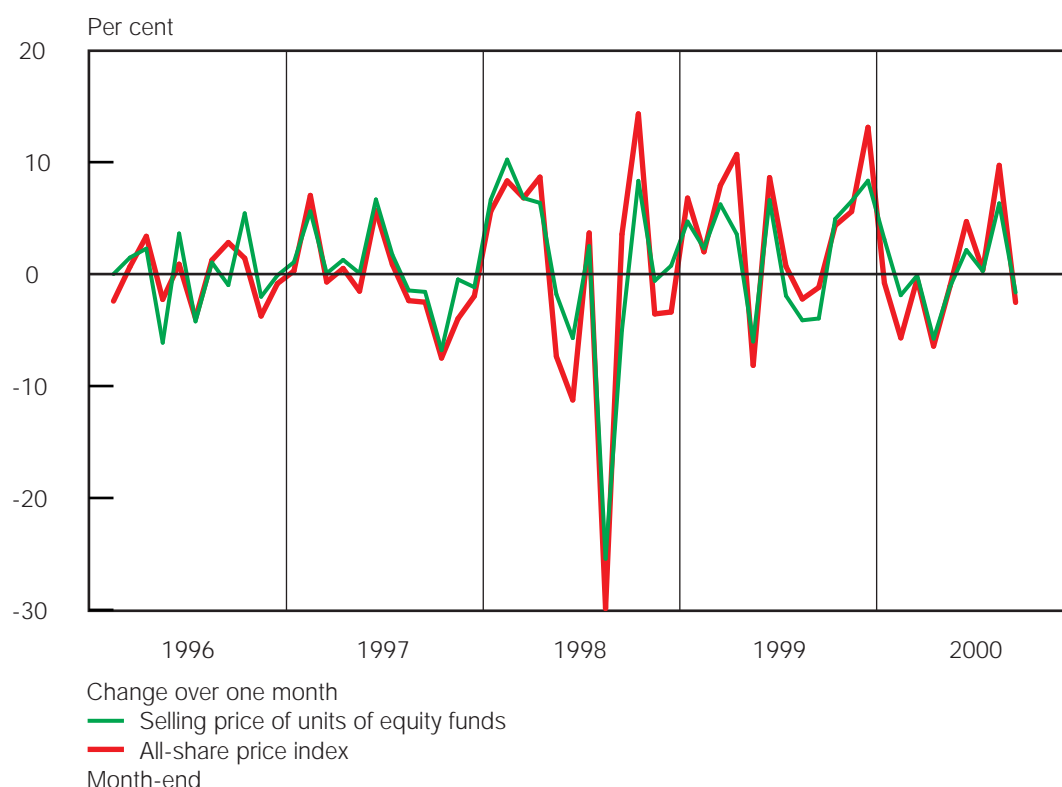
Real-estate market

The *value* of real-estate transactions increased from a low of R5,9 billion in the first quarter of 1999 to R9,9 billion in the first quarter of 2000, essentially in response to the sharp decline in mortgage bond rates from the very high levels of 1998. Turnover in the *real-estate market* then levelled off at this relatively high level. The value of real-estate transactions amounted to R9,8 billion in the second quarter of 2000 and R9,9 billion in the third quarter. The *average nominal value* per real-estate transaction increased by 8,4 per cent in the first nine months of 2000 relative to its level in the first nine months of 1999; i.e. an increase marginally higher than the current rate of CPIX inflation.

Non-bank financial intermediaries

Asset price volatility and uncertainty in the financial markets showed up in increased volatility in the *net acquisition of units in unit trusts* as investors closely matched their purchases and sales of units with the movements in share prices. The *net sales of units* by unit trusts amounted to a quarterly average of about R8,5 billion from the fourth quarter of 1998 to the second quarter of 1999. These net sales fell to R3,8 billion in the third quarter of 1999, but increased over three consecutive quarters to R4,9 billion in the second quarter of 2000 before falling back to net repurchases of R0,1 billion in the third quarter of 2000.

Unit trust price movements



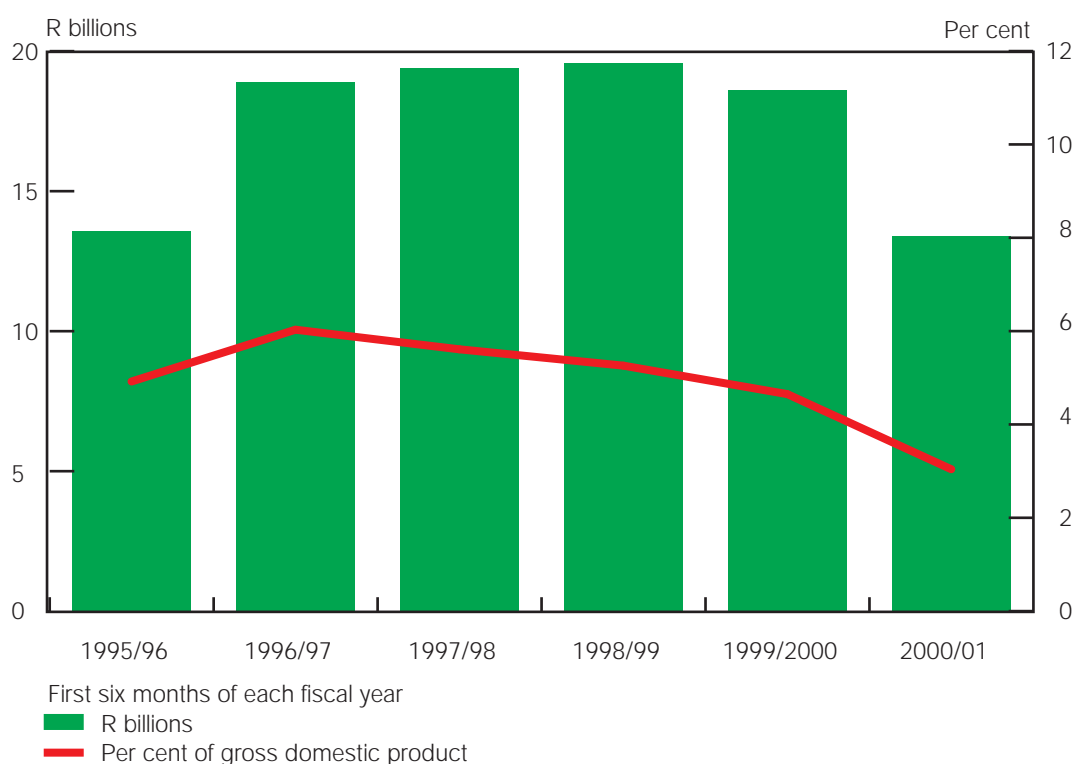
The index of the *selling price of units of equity funds* tracked the overall trend in the all-share price index of the JSE relatively closely, as indicated by the difference in the growth over one month in these indices. However, the differential tends to widen somewhat during periods of heightened market volatility.

Public finance

Non-financial public-sector borrowing requirement

The borrowing requirement of the non-financial public sector (i.e. the deficit before borrowing and debt repayment of the consolidated central government, provincial governments, local authorities and non-financial public enterprises and corporations) amounted to R5,6 billion in the July-September quarter of 2000 – R2,1 billion less than in the corresponding quarter of 1999. This brought the non-financial public-sector borrowing requirement for the first half of fiscal 2000/01 to R13,4 billion, which is R5,2 billion less than in the same period of the previous fiscal year. As a ratio of gross domestic product, the non-financial public-sector borrowing requirement declined from 4,7 per cent in the first half of fiscal 1999/2000 to 3,0 per cent in the first half of fiscal 2000/01. This ratio was substantially lower than the average ratio of 5,3 per cent observed in the first half of the preceding five fiscal years.

Non-financial public-sector borrowing requirement



The improvement in the borrowing requirement of the non-financial public sector can partly be ascribed to an improvement in the financial balances of public-sector business enterprises. The financial results of these businesses indicate a reduction in their consolidated financial deficits from R1,2 billion in the first half of fiscal 1999/2000 to R0,2 billion in the first half of fiscal 2000/01.

The borrowing requirement of *general government* amounted to R5,5 billion in the July-September quarter, bringing the borrowing requirement for the first six months of fiscal 2000/01 to R13,2 billion. The improvement in the borrowing requirement of general government is mainly due to improvements in the finances of provincial governments.

The finances of the provincial governments turned around from a deficit of R0,8 billion in the first six months of fiscal 1999/2000 to a surplus of R5,1 billion in the first six months of fiscal 2000/01. This surplus arose mainly as a result of an increase of 9,6 per cent in the equitable share of national government revenue transferred to provincial governments. This surplus was primarily used for the reduction of outstanding liabilities. As a consequence, the provincial governments could increase their deposits with private banks from R4,4 billion at the end of March 2000 to R5,7 billion at the end of September 2000. Their bank indebtedness nevertheless increased somewhat from R1,4 billion to R2,0 billion over the same period.

The financial position of local governments deteriorated slightly during the first half of fiscal 2000/01. The reduction in the balance of the consolidated central government occurred mainly at the level of national government.

National government finance

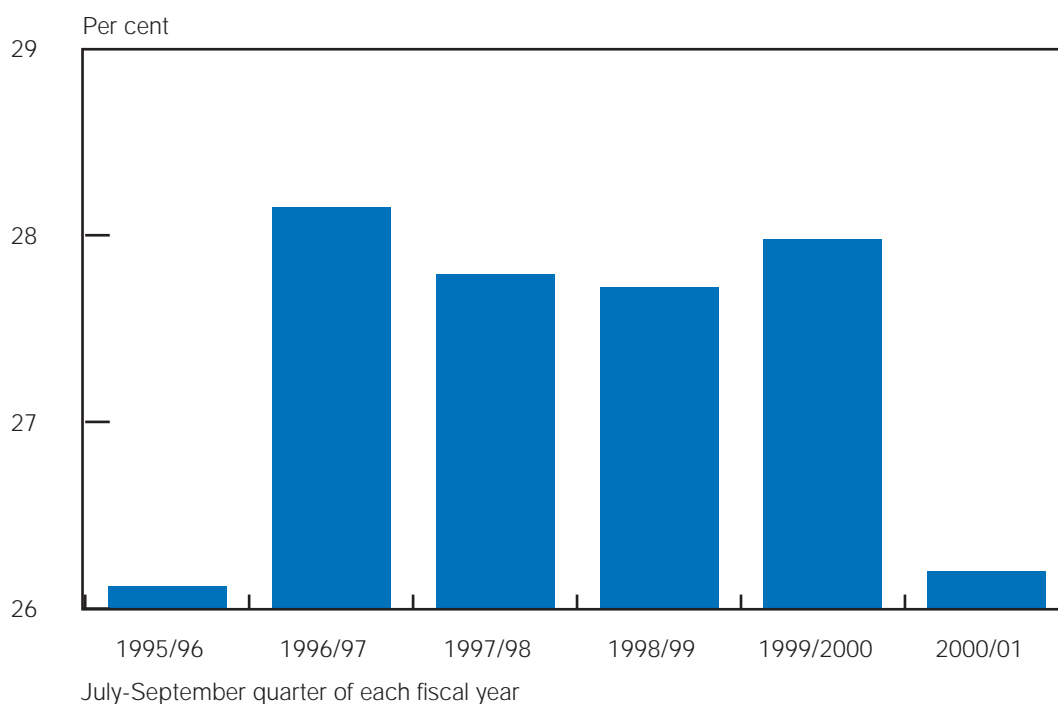
The Public Finance Management Act came into effect on 1 April 2000. In accordance with Section 32 of this Act, the National Treasury now publishes a Statement of National Revenue, Expenditure and Borrowing within 30 days after the end of each month. This statement replaces the monthly statement of Exchequer issues and receipts, previously published in the *Government Gazette*. A cash-flow statement is also provided as part of the new information set. Cash-book transactions recorded in the general ledgers of the National Government serve as the basis for the new reporting structure, whereas the previous structure relied on bank statement transactions. Data reflected in the Statement of National Revenue, Expenditure and Borrowing are therefore not strictly comparable with data for the period prior to June 2000. The historical data based on bank statement transactions were adjusted in accordance with the methodology followed in the compilation of the new cash-flow statement in order to obtain estimates of spending and revenue flows that are consistent over time.

National government expenditure in the July-September quarter of 2000 amounted to R59,2 billion, bringing accumulated expenditure to R114,8 billion in the first half of fiscal 2000/01. Expenditure in the first half of fiscal 2000/01 accounted for 49,2 per cent of the originally budgeted expenditure of R233,5 billion for the full year. National government expenditure as a ratio of gross domestic product amounted to 26,2 per cent in the July-September quarter of 2000, slightly lower than the ratio of 28,0 per cent in the corresponding quarter of the previous fiscal year.

During the first half of the fiscal year, the equitable share of national government revenue transferred to provincial governments amounted to R48,0 billion and interest paid on government debt to R22,8 billion. Only R2,0 billion of the R7,7 billion originally budgeted for capital projects for the full year was spent in the first six months of fiscal 2000/01.

After allowing for cash-flow adjustments (i.e. transactions recorded in the government ledgers but not yet cleared in the banking system, and late departmental requests) government expenditure amounted to R116,4 billion, representing an increase of 8,5 per cent in the first half of fiscal 2000/01 compared with the corresponding period of the previous fiscal year. This rate of increase was slightly lower

National government expenditure as a ratio of gross domestic product



than the average rate of increase of 9,1 per cent in the corresponding period of the preceding five fiscal years.

National government revenue in the July-September quarter of 2000 amounted to R51,7 billion which brought the revenue for the first half of fiscal 2000/01 to R96,4 billion or 45,8 per cent of the budgeted revenue of R210,4 billion for the fiscal year as a whole. Taxes on income and profits remained the principal source of revenue, contributing R54,4 billion to total revenue in this period. The domestic taxes collected on goods and services (including value-added tax and excise duties) contributed a further R36,8 billion to the Revenue Fund.

National government revenue, adjusted for cash flows stemming from time delays between the occurrence and the recording of transactions, amounted to R96,9 billion, representing an increase of 8,3 per cent in the first half of fiscal 2000/01 compared with the first half of fiscal 1999/2000.

National government revenue

R billions

Revenue source	Budgeted 2000/01	Actual: First six months of fiscal 2000/01
Taxes on income and profits	121,3	54,4
Payroll taxes.....	1,4	0,5
Taxes on property	3,3	2,0
Domestic taxes on goods and services.....	79,4	36,8
Taxes on international trade and transactions	6,5	4,4
Other revenue	6,9	2,8
Less: SACU payments*	8,4	4,5
Total revenue.....	210,4	96,4

* In terms of the Customs Union agreement

pared with the corresponding period of the previous fiscal year. This increase can be compared with an average rate of increase of 10,9 per cent in the corresponding period of the preceding five fiscal years.

The net result of revenue and expenditure recorded in the Statement of National Revenue, Expenditure and Borrowing, was a deficit before borrowing and debt repayment of R18,5 billion in the first half of fiscal 2000/01. This deficit amounts to 80,1 per cent of the deficit envisaged for the fiscal year as a whole. Although not strictly comparable, the corresponding ratio in the previous fiscal year was 86,0 per cent. No conclusions about the outcome of the finances for the full fiscal year should be drawn from the deficit for the April–September period, as a large deficit in the first months of the fiscal year is generally a regular seasonal occurrence.

The cash-flow adjusted deficit before borrowing and debt repayment amounted to R19,5 billion in the first half of fiscal 2000/01. Apart from financing this deficit, national government had to fund the cost of the revaluation of maturing foreign debt. After also taking into consideration the proceeds from the restructuring of state assets, the net borrowing requirement of national government amounted to R19,8 billion.

As indicated in the accompanying table, the greater part of the borrowing requirement in the first half of fiscal 2000/01 was financed by means of new issues of Treasury bills in the domestic market. These bills were sold at an average rate of 9,9 per cent per annum. Government bonds to the nominal value of R5,5 billion were issued during this period at an average cost of 12,6 per cent per annum which can be compared with a budget assumption of 13,6 per cent for fiscal 2000/01 as a whole. The foreign financing obtained during this period was mostly related to the export credit facility for defence procurement.

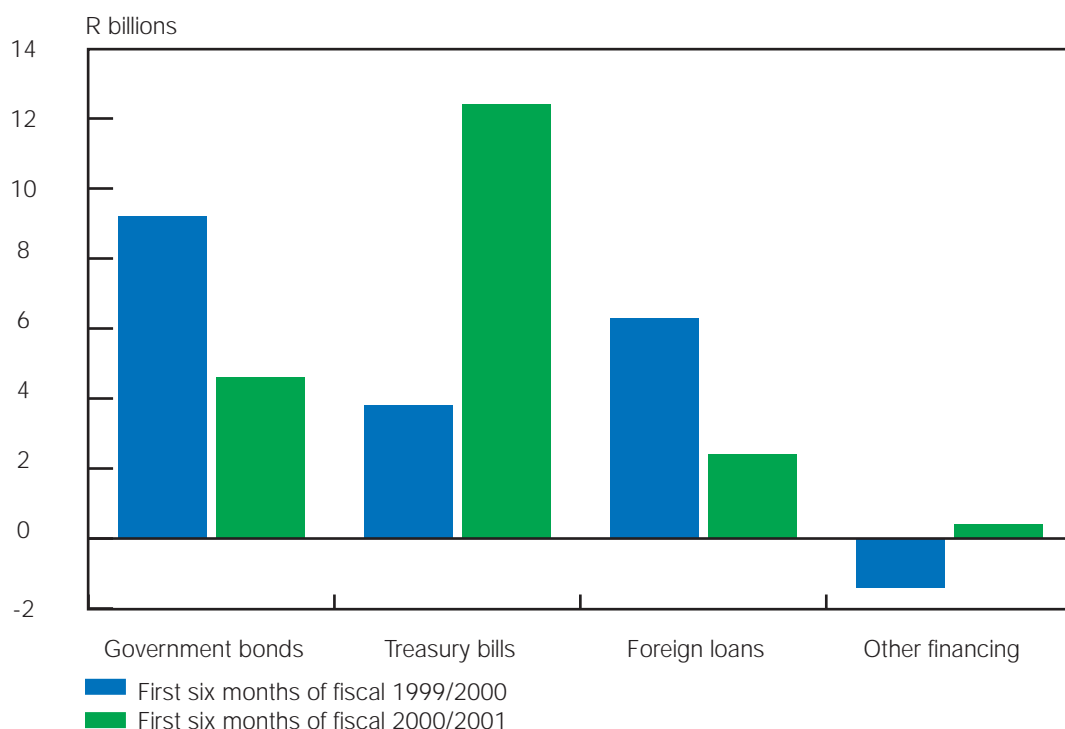
Financing of national government deficit

R billions

Instrument	Budgeted 2000/01	Actual: First six months of fiscal 2000/01
Deficit	23,1	19,5
Plus: Extraordinary payments	2,2	0,0
Revaluation of maturing foreign loans	0,6	0,7
Less: Extraordinary receipts	5,0	0,4
Borrowing requirement.....	20,8	19,8
Domestic primary capital market		
Government bonds.....	...	5,5
Less: Discount on government bonds	0,9
Net receipts from domestic government bonds issued ...	10,1	4,6
Treasury bills.....	3,5	12,4
Foreign loans.....	5,2	2,3
Changes in available cash balances*.....	2,0	0,5
Total net financing	20,8	19,8

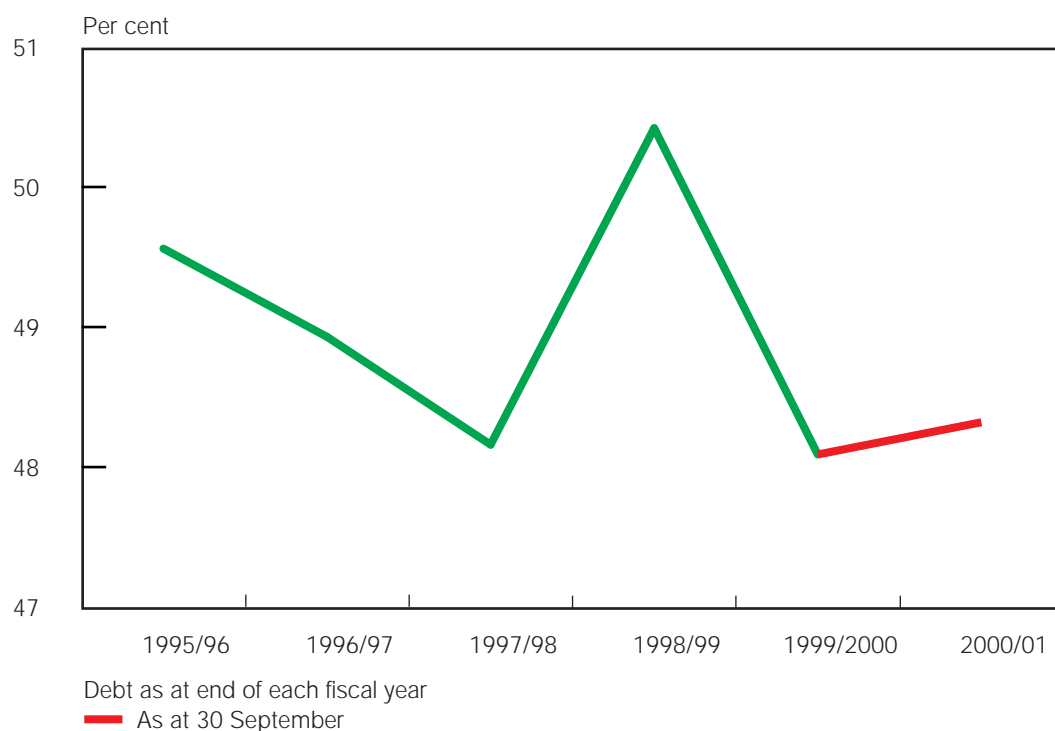
* Increase -, decrease +

Financing of national government deficit



The borrowing requirement of the national government and the discount on new issues of government bonds led to an increase in the total debt of national government from R390,4 billion at the end of March 2000 to R412,0 billion at the end of September. As a percentage of gross domestic product, national government debt increased from 48,1 per cent at the end of March 2000 to 48,3 per cent at the end of September.

National government debt as a ratio of gross domestic product



Adjustments Budget for fiscal 2000/01

In the Adjustments Budget tabled in Parliament on 12 October 2000, the Minister of Finance gave the assurance that national government finances would not add to existing pressures in the South African capital market. Although the Minister sought approval for additional government spending to the amount of R3,9 billion for fiscal 2000/01, a contingency reserve for unforeseen expenses to the amount of R2,0 billion had already been provided for in the main estimates presented to Parliament in February.

The increase in expenditure was mainly related to the higher-than-estimated salary increases for government employees, flood-related damage, expenses for the creation of new local government structures and for the forthcoming local government elections. Provision was also made for the costs associated with higher fuel prices and for the new arrangement for the payment of bonuses in the month of their birthdays to those public servants celebrating their birthdays in January, February and March. In the past these bonuses were paid in April.

Adjustments Budget estimates for fiscal 2000/01

	R billions
Original budgeted expenditure	233,5
<i>Plus:</i> Additional expenditure	3,9
<i>Less:</i> Roll-overs, savings and suspensions	2,2
Total adjusted expenditure	235,2
Total revenue	212,2
Adjusted deficit	23,0
Adjusted deficit as percentage of gross domestic product	2,6

The additional expenditure will be financed from an expected increase in the revenue of national government. Income tax is expected to yield R1,3 billion more than originally envisaged, mainly because of the higher revenue from taxes on companies and retirement funds. It is also expected that the greater consumption of imported goods will result in higher revenue from value-added tax.

The net result of the adjustments to national government revenue and expenditure is an unchanged estimate of the deficit before borrowing and debt repayment. This deficit is still expected to be equal to about 2,6 per cent of gross domestic product for the full fiscal year.

The Medium Term Budget Policy Statement

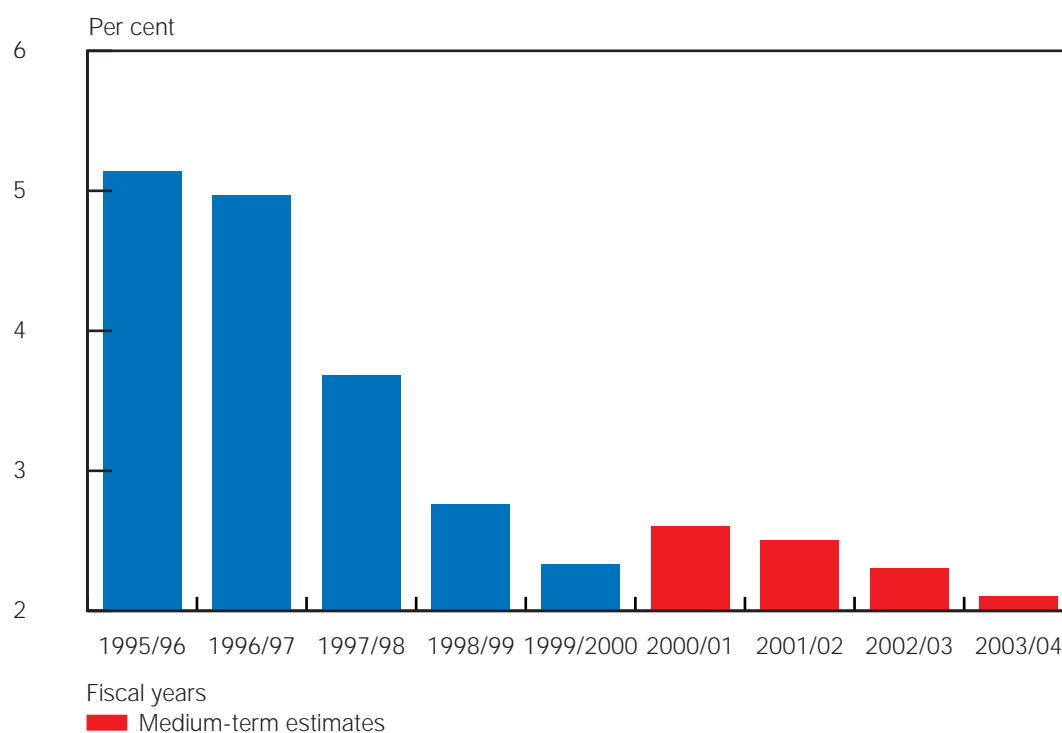
The Minister of Finance released the Medium Term Budget Policy Statement and Medium Term Expenditure Framework (MTEF) on 30 October 2000. This policy statement contains National Treasury's assessment of the economy, creates the policy framework within which government's spending plans are formulated and articulates government's medium-term vision for the economy. It was reiterated that government sought to balance the high priority of meeting the social needs of all South Africans with its sustained commitment to fiscal discipline. The Medium Term Budget Policy Statement focuses on the following two key policy themes:

- Public spending on programmes that promote human development and broaden economic opportunities; and
- additional expenditure on capital formation and the maintenance of infrastructure.

It was noted that a number of external factors adversely affected the growth performance of the economy. Although the current growth performance of the economy was less vigorous than expected, the economy has adjusted to serious external shocks and is expected to resume more rapid growth next year. Economic growth, mainly driven by a strong export performance and accelerated investment, is expected to average 3,5 per cent over the MTEF period. It is also envisaged that the higher priority assigned to capital formation in the public sector is likely to raise the rate of sustainable long-term growth and enhance service delivery.

The success attained in containing the national government deficit over the past five years has resulted in lower debt levels and lower debt-servicing costs. This has released significant amounts of funds for non-interest expenditure, which is expected to grow by more than 3 per cent a year in real terms. The success attained with tax reforms has broadened the tax base and resulted in buoyant tax collections, creating the opportunity for further income-tax rate reductions.

National government deficit as a ratio of gross domestic product



The MTEF clearly reflects a shift in the allocation of public resources towards provincial and local government. The increase in the allocation to provincial governments pertains to higher social benefit payments, poverty alleviation programmes, health services resulting from HIV/Aids and increased spending on infrastructure. Increased allocations to local governments are related to government's objective to provide basic services, including water, sanitation and municipal services, to all communities. It was also announced that guidelines for the possible introduction of selected provincial taxes were being developed with the aim of ensuring that such taxes would not have negative consequences for the overall fiscal position of government. It was also announced that the local government grant system would be rationalised and extended to a three-year time horizon in order to promote more effective planning at this level of government.

As indicated in the accompanying table, government envisages a steady decline in the borrowing requirement at all levels of the public sector relative to the gross domestic product. The national government deficit is projected to reach 2,1 per cent of gross domestic product in fiscal 2003/04 and general government's borrowing requirement is projected to reach a level of 1,6 per cent of gross domestic product at that time. Similarly, the public-sector borrowing requirement is projected to decline to a level of 2,0 per cent of gross domestic product in fiscal 2002/03.

Fiscal projections

Period	Medium-term estimates			
	2000/01 Revised estimates	2001/02	2002/03	2003/04
		R billions		
<hr/>				
National government				
Revenue.....	212,2	232,2	251,5	271,0
Expenditure	235,3	257,1	275,5	295,4
Deficit before borrowing	23,1	24,9	24,0	24,4
General government deficit	19,7	19,9	17,1	17,9
Public-sector deficit.....	21,8	23,4	21,1	22,6
		Ratio of gross domestic product		
National government				
Revenue.....	23,8	23,8	23,7	23,6
Expenditure	26,4	26,3	25,9	25,7
Deficit before borrowing	2,6	2,5	2,3	2,1
General government deficit	2,3	2,0	1,6	1,6
Public-sector deficit.....	2,4	2,4	2,0	2,0

It was also revealed that Cabinet had agreed to consider project loan proposals with multilateral financial institutions. These loans must comply with the following criteria:

- All project loans must form part of a broader partnership, including benefits such as technical expertise, additional grant funding and capacity building;
- the financial terms and conditions of a loan must be acceptable to, and must fit into the broader borrowing strategy of government; and
- expenditure to be financed through a loan must form part of the normal departmental budget plans.

Consideration is being given to a hospital rehabilitation programme. Local government development projects and municipal infrastructure development are also included among the projects qualifying for financial assistance by the multilateral lending agencies.