Quarterly Bulletin
Kwartaalblad

March 2000

South African Reserve Bank
Suid-Afrikaanse Reserwebank

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Article: Quarterly Bulletin

March 2000

South African Reserve Bank

A note on cash holdings in South Africa during the transition to the year 2000

by VV Mamba and JP van den Heever

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Quarterly Economic Review

Introduction

The international financial crisis, which started in Southeast Asia around the middle of 1997 and then spread to other countries, had a damaging effect on the world demand for primary commodities. As demand faltered, the average prices in United States dollars of important commodities produced in South Africa fell by about 17 per cent from the middle of 1997 to the end of 1998.

The problems that producers of primary commodities encountered were compounded when the Russian Federation unilaterally restructured its rouble-denominated debt and declared a moratorium on the servicing of debt in August 1998. The effects of these measures were felt throughout the mature and emerging financial markets of the world. Conditions in the global financial markets generally tightened and governments and other public-sector borrowers in emerging-market economies faced sharply higher borrowing costs.

Despite these setbacks, the South African economy has fared better than anticipated over the past year. Although the economy has not yet experienced boom conditions, the potential economic impact of the Asian crisis on South Africa was moderated by the relative strength of the United States economy, which acted as a locomotive for global recovery, and the prompt response of a number of central banks in the main financial centres of the world by lowering official interest rates and stabilising financial markets.

To this must be added the efforts made by the Asian economies affected by the crisis to deal with the weaknesses in their economic and regulatory structures. These efforts helped to restore confidence and generally improved international economic conditions. The impact of these stabilisation measures was partly diluted by the steep rise in crude oil prices in 1999, but so far the higher oil prices have not seriously disrupted the international economic recovery that is currently under way outside the United States.

The success that South Africa achieved in coping with the international crisis was also influenced by the fact that the economy was operating from a base stronger than in many years. This was reflected in a number of improvements in domestic economic fundamentals, of which the more important ones were

- the decline in inflation during the 1990s and the strong commitment of the Reserve Bank to keeping inflation at low levels;
- the reduction of government financial deficits and the curbing of the rising level of government debt relative to the size of the economy (as measured by the ratio of public debt to gross domestic product);
- the major restructuring of South African businesses during the 1990s in reaction to stronger international competition as the country became more open to world trade and investment;
- the ongoing liberalisation and modernisation of the South African financial architecture; and
- the implementation in recent years of new technologies, especially in the area of information capturing, processing and dissemination.

Because of these structural adjustments, the economy has performed well over the past year or so. At the height of the international problems in the third quarter of 1998, real gross domestic product contracted. The economy nevertheless quickly recovered from this setback and positive growth in output had already been restored in the last quarter of 1998. Assisted by repeated relaxations in domestic monetary policy, and a recovery in agricultural production, output growth gathered momentum. By the second half of 1999 the real gross domestic product was growing at annualised rates of more than 3 per cent from quarter to quarter. For 1999 as a whole, growth in real gross domestic product was approximately 1 per cent.

A particularly promising development in the last months of 1999 was the strong showing of production activity in the secondary sectors of the economy. Output in the manufacturing sector took off, growth in the supply of electricity picked up and the decline in construction activity levelled out. Provided that there are no major setbacks in the global economy, the outlook is positive that economic growth in 2000 could at least match that of the second half of 1999.

The quarter-to-quarter growth in real gross domestic expenditure vacillated during 1999, but there was a firm rise in the fourth quarter. Consumers became more confident and stepped up their current expenditure, without resorting to debt for financing their rising consumption standards. Real final consumption expenditure by general government declined from quarter to quarter throughout 1999, steadily reducing general government's contribution to overall gross domestic expenditure. This should be seen as a deliberate step taken by government to lower the inflation potential of the economy and to pave the way for meaningful tax reform which will ultimately strengthen the supply side of the South African economy.

Total gross fixed capital formation still declined in the fourth quarter of 1999, but there was a healthy increase in fixed investment by private-sector companies. The creation of additional production capacity, in the midst of ample unutilised production capacity seems to reflect producers' positive assessment of the prospects for demand growth in the near to medium term. At the same time, manufacturers and traders were prepared to make significant additions to their holdings of inventories in anticipation of rising demand over the short term.

Gross saving relative to gross domestic product strengthened somewhat in the fourth quarter of 1999. Net dissaving by general government was reduced further and companies improved on their overall saving performance. There was no further deterioration in the household saving ratio. Nonetheless, the low saving ratio of South African society remains a structural impediment to enduringly faster economic growth.

There has been virtually no indication that the recent strengthening of economic growth is leading to a pick-up in the demand for labour. Official estimates indicate continuing declines in the level of formal-sector employment in the private and the public sectors during the first three quarters of 1999. In his address at the opening of Parliament in February 2000, the President recognised that certain aspects of the legislative instruments aimed at giving effect to government's labour market policies have had unintended consequences. The President indicated that certain amendments to elements of the legislative framework would be introduced during the current Parliamentary year.

During the first three quarters of 1999, the growth in earnings per worker slowed down more than the average settlement rate in collective bargaining agreements. This compression of "wage drift" indicates that regular pay is accounting for a growing proportion of overall worker compensation. Performance-related compensation and other types of bonuses are apparently becoming a smaller portion of worker compensation. Labour productivity remained buoyant in 1999, reducing the growth in unit labour costs to a rate of about 5 per cent per year.

Production prices have risen sharply in recent months, mainly on account of the rise in international crude oil prices, but there was also evidence of some widening of producers' operating margins. By contrast, overall consumer price inflation slowed down noticeably over the past year to rates approximately on a par with those of the country's major trading partners. This fall in inflation was largely a reflection of declining mortgage-bond interest rates. Core inflation, which does not capture the fall in mortgage bond interest rates, remained at a level of about 8 per cent during 1999. Core inflation is expected to slow down somewhat in the coming year, but as the economy begins to produce at higher rates of capacity utilisation, policy will have to be mindful of the potential for price pressures.

The recovery in economic activity and the greater aggregate demand resulted in an increase in the importation of intermediate goods, final consumer goods and capital goods during the fourth quarter of 1999. Furthermore, the strong inflows of investment capital into the economy in recent years and the subsequent increase in interest and dividend payments to non-resident investors led to a widening of the deficit on the services account of the balance of payments during 1999.

The combined value of merchandise and net gold exports also increased in 1999, but not enough to prevent the balance on the current account of the balance of payments from changing from a healthy surplus in the first quarter of 1999 to growing deficits in the last three quarters of the year. Although steadily deteriorating, the deficit on the current account of the balance of payments was still within ½ per cent of the gross domestic product in the fourth quarter of 1999.

South African residents continued to accumulate assets in other parts of the world, but these outward movements of capital were more than fully counteracted by a strong inflow of international capital into the economy. Portfolio investments, which have proved to be easily reversible in times of market uncertainty, dominated the inflows but foreign direct investment strengthened appreciably in the second half of the year. For 1999 as a whole, however, foreign direct investment amounted to about 1 per cent of gross domestic product, which is considered inadequate to boost meaningfully the long-run growth and labour absorption capacity of the South African economy.

The surplus on the financial account of the balance of payments was more than ample to finance the deficit on the current account, and led to a substantial increase in the country's international reserves in the fourth quarter of 1999. Gross international reserves have now risen from the equivalent of 10 weeks' worth of imports of goods and services at the end of 1998 to 15½ weeks' worth at the end of 1999.

The rising international reserves of the country helped to calm down the currency market after the excessive turbulence of 1998. Movements of the rand against the United States dollar were mostly offset by movements in the opposite direction against other currencies. The nominal effective exchange rate of the rand accordingly rose only marginally from the end of 1998 to the end of 1999. Significant progress was also made in removing another perceived source of rand vulnerability: the net open position in foreign currency of the Reserve Bank was reduced from US$22,5 billion at the end of 1998 to US$11,1 billion at the end of February 2000.

The year-on-year growth in money supply in 1999 remained mostly within the medium-term guideline range of 6 to 10 per cent that was still applicable at that time, but there was a rapid acceleration in the quarter-to-quarter money growth in the second half of 1999. Although this was a response to increased activity and higher growth in the economy, the rate of growth in the money supply exceeded by a wide margin the growth in real aggregate demand and output. This indicates that the threat of inflation and expectations of rising inflation were still prevalent and that caution should be exercised in the conduct of counter-inflationary policies.

A large part of the recent rise in the broad money supply was concentrated in the narrower monetary aggregates. This increased preference for more liquid assets was partly influenced by concerns about date-related problems with computer systems at the millennium changeover, as well as the bunching of public holidays over the year-end. But it could also have been signalling future growth in real aggregate spending, giving justification for persevering with a conservative monetary policy stance.

Fairly liquid conditions prevailed in the financial markets in the last quarter of 1999. The money market, which had already eased somewhat towards the end of the third quarter of 1999, became more flush with funds in the fourth quarter. The Reserve Bank had deliberately injected liquidity into the market in order to ward off any difficulties arising as a consequence of the millennium date-change. As the millennium changeover had been virtually uneventful, the Reserve Bank almost immediately thereafter began to increase the private banks' dependency on central bank funds.

In such liquid market conditions, and guided by the Reserve Bank's signals, money-market interest rates continued their declines of the first nine months of the year into the fourth quarter. In January 2000 the securities repurchase rate of the Bank was reduced further. The private banks followed the lead given by the repurchase rate and lowered their retail lending rates in October 1999 and again in January 2000 by 100 basis points.

Most of the fears concerning instability in emerging markets had faded by the third quarter of 1999. This, together with the downward trend in short-term interest rates and a steady stream of news confirming the improvement in the economy and the reduction of external vulnerability, caused long-term bond yields to move strongly downwards from the end of October 1999 and into January 2000. The share market also took off and the all-share price index recorded impressive gains from September 1999. The losses suffered at the time of the emerging-markets crisis of 1998 had been recovered in full by mid-December 1999. The real-estate market also bounced back from its depressed levels in late 1998 and early 1999 and returned to pre-crisis levels of activity.

In the primary capital markets, the public sector's mobilisation of funds declined sharply in the fiscal year 1999/2000. This development was the result of continued sound financial management practices as well as the proceeds derived from the sale of certain public-sector assets. However, an increase in the demand for capital from the private corporate sector did not compensate for the decline in the demand for funds by the public sector. Bond financing by the private corporate sector was almost non-existent and there was a sharp decline in capital raised by companies listed on the Johannesburg Stock Exchange in the fourth quarter of 1999.

Greater progress was made with the consolidation of public finances in the first three quarters of fiscal 1999/2000 than had been envisaged in national government's Budget of February 1999. National government receipts rose at a higher rate than budgeted, while expenditure growth remained well contained. The steady reduction in the national government's budget deficit is beginning to bear fruit: the slow growth in government debt over the past five years or so, together with the decline in capital-market interest rates, has kept growth in government interest payments to a fairly modest percentage.

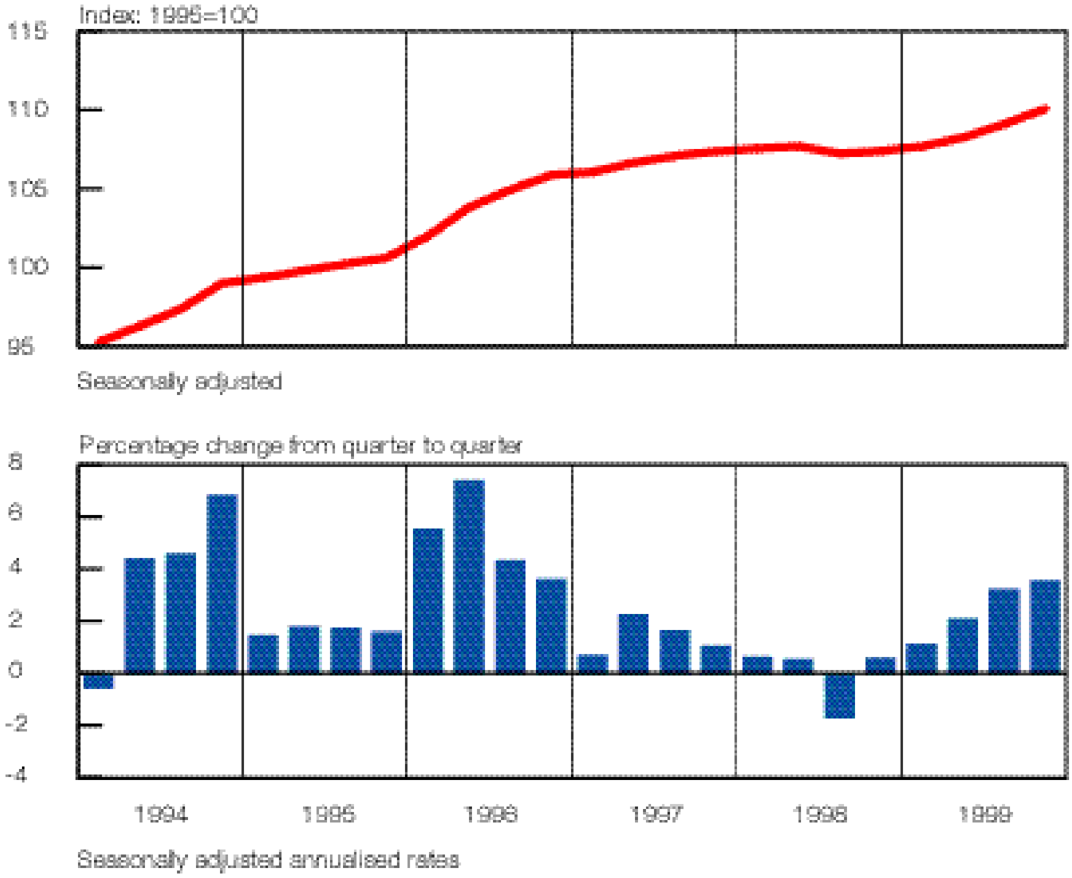
The improvement in the management of provincial governments ensured that their consolidated financial balances remained in surplus. The proceeds from the restructuring of government assets derived from the selling of the South African Special Risk Insurance Association (Sasria) assets and an equity interest in the Airports Company of South Africa (ACSA), have reduced the borrowing requirement of the public sector by almost a half in the current fiscal year so far. In this manner, scope is being created for the private corporate sector to satisfy its funding needs at increasingly affordable costs in the domestic primary capital market.

Domestic economic developments

Domestic output

Economic activity recovered somewhat in 1999, reflecting the improvement in global economic conditions after the financial market shocks of 1997 and 1998. Real gross domestic product, which had risen by only ½ per cent in 1998, increased by about 1 per cent in 1999. The recovery was especially noticeable in the second half of 1999 when quarter-to-quarter annualised growth of 3 per cent or more was recorded. Increases in primary-sector output, particularly in the agricultural sector where the real value of output rose by 4½ per cent, and in real output by the tertiary sectors were primarily responsible for the recovery in economic growth in 1999.

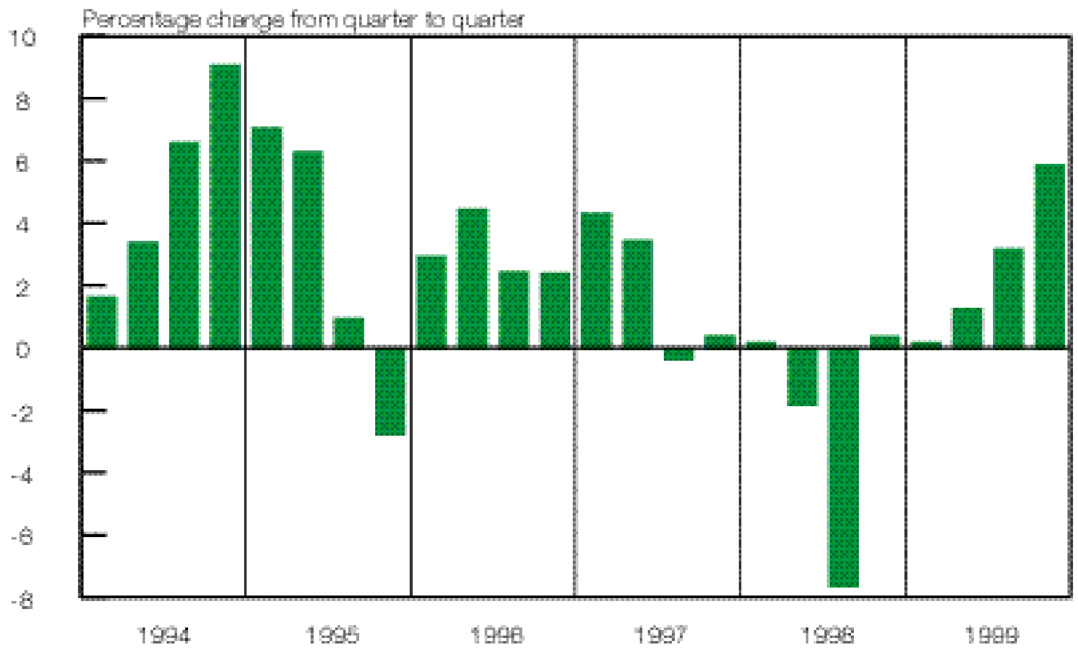
Real gross domestic product



The solid rise of 4½ per cent in the real value added by the *agricultural sector* in 1999 followed a decline of 3 per cent in 1998. Quarterly production in the agricultural sector escalated in the first three quarters of 1999. Although agricultural production growth slowed down in the fourth quarter of 1999, it maintained a sturdy pace. The growth in the fourth quarter of 1999 was mostly concentrated in the livestock and horticultural sectors, while field crop production was lower on account of a somewhat disappointing wheat crop.

Outside the agricultural sector, real output growth accelerated from an annualised rate of 2 per cent in the third quarter of 1999 to more than 3 per cent in the fourth quarter. Manufacturing production grew strongly in the fourth quarter of 1999, and real value added by the financial services sector also made a solid contribution to the output expansion in the second half of that year.

Real value added by the secondary sectors



Seasonally adjusted annualised rates

Real gross domestic product

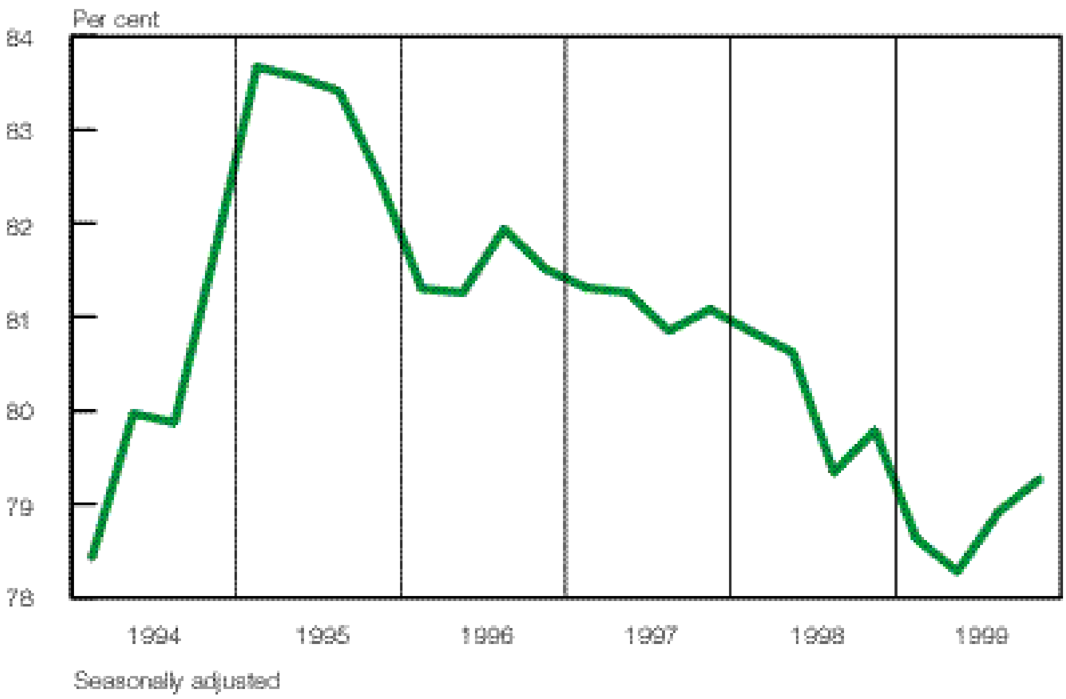
Percentage change at seasonally adjusted and annualised rates

Sector	1998					1999				
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Primary sectors................	-6½	-8	-6½	-5½	-1½	2½	6	13	5	1
Agriculture..................	-11	-15	-12	-12½	-3	7	16	38½	12½	4½
Mining........................	-2½	-2½	-2½	-½	-½	-½	-½	-2	0	-1
Secondary sectors...........	0	-2	-7½	½	-1	0	1½	3	6	0
Manufacturing............	-½	-3	-9½	½	-2	1	2	4	7	0
Tertiary sectors................	2½	3½	2	2	2	1½	2	2	2½	2
Non-agricultural sectors......	1½	1½	-1	1	1	1	1½	2	3½	1
Total...............................	**½**	**½**	**-1½**	**½**	**½**	**1**	**2**	**3**	**3½**	**1**

Mining output declined at annualised rates of between ½ and 2 per cent in the first three quarters of 1999. The shrinking of mining output appears to have levelled out in the fourth quarter of 1999 when the continued decline in gold production was counteracted by a strong output increase in other subsectors of the mining industry. Mining in general, and the platinum group metals in particular, benefited greatly from a recovery in international commodity prices in the fourth quarter of 1999.

Real value added by the *manufacturing sector* increased at annualised rates of between 1 and 4 per cent in the first three quarters of 1999, but then took off at a rate of 7 per cent in the fourth quarter. The initial upturn in production was led by the industries producing food, clothing, chemicals and machinery and transport equipment. The strong rise in the fourth quarter ensured that the overall level of real value added by the manufacturing sector in 1999 broadly maintained the overall output level attained in 1998. Another consequence of the accelerated growth in manufacturing production was that the utilisation of manufacturing production capacity moved from a low of 78½ per cent in the second quarter of 1999 to 79½ per cent in the fourth quarter.

Utilisation of production capacity in manufacturing



Growth in output by the sector supplying *electricity, gas and water* accelerated from an annualised rate of 1½ per cent in the second quarter of 1999 to 5 per cent in the fourth quarter. Moreover, the fall in real value added by the construction sector in the first three quarters of 1999 ended as the level of output in the third quarter was broadly maintained in the fourth quarter. The weak state of the construction industry, which had been caused largely by the sharp rise in bank lending rates in 1998, was probably the single most important reason why the real value of output in the secondary sectors of the economy in 1999 could not fully match the output volumes of 1998.

Growth in the real value added by the *tertiary sectors* remained buoyant throughout 1999, increasing the contribution of these sectors to overall value added from 64½ per cent in 1998 to 65½ per cent in 1999. In the fourth quarter of 1999, the growth in output by the tertiary sectors accelerated to an annualised rate of 2½ per cent from an average rate of 2 per cent in the first three quarters. This acceleration occurred despite a slowdown in the *commercial sector* where a decline in motor vehicle sales held back output growth somewhat. Wholesale and retail trade, excluding the motor trade, raised their activity levels in the fourth quarter of 1999 as consumers became more confident when asset prices rose and prospects for future income growth brightened.

The *transport, storage and communication* sector benefited from the further expansion of the telecommunication network in the fourth quarter of 1999. Activity in the equity and other financial markets expanded strongly in the fourth quarter of 1999 and, together with the strong recovery in the real-estate market, fuelled the growth in output by the *finance, insurance, real-estate and business services sectors.*

The growth in the real value of output available for disbursement in the domestic economy was strengthened somewhat by a decline in net primary income payments to the rest of the world. The impact of these on the growth in real gross national income was, however, somewhat diluted by a deterioration in the international terms of trade from 1998 to 1999. In the end, the real gross national income grew at a rate of 1 per cent in 1999, i.e. roughly on a par with growth in the real gross domestic product. Although this signalled an improvement on 1998 when real gross national income increased by only ½ per cent, it still meant a decline in the real gross national income *per capita* of the South African population.

Domestic expenditure

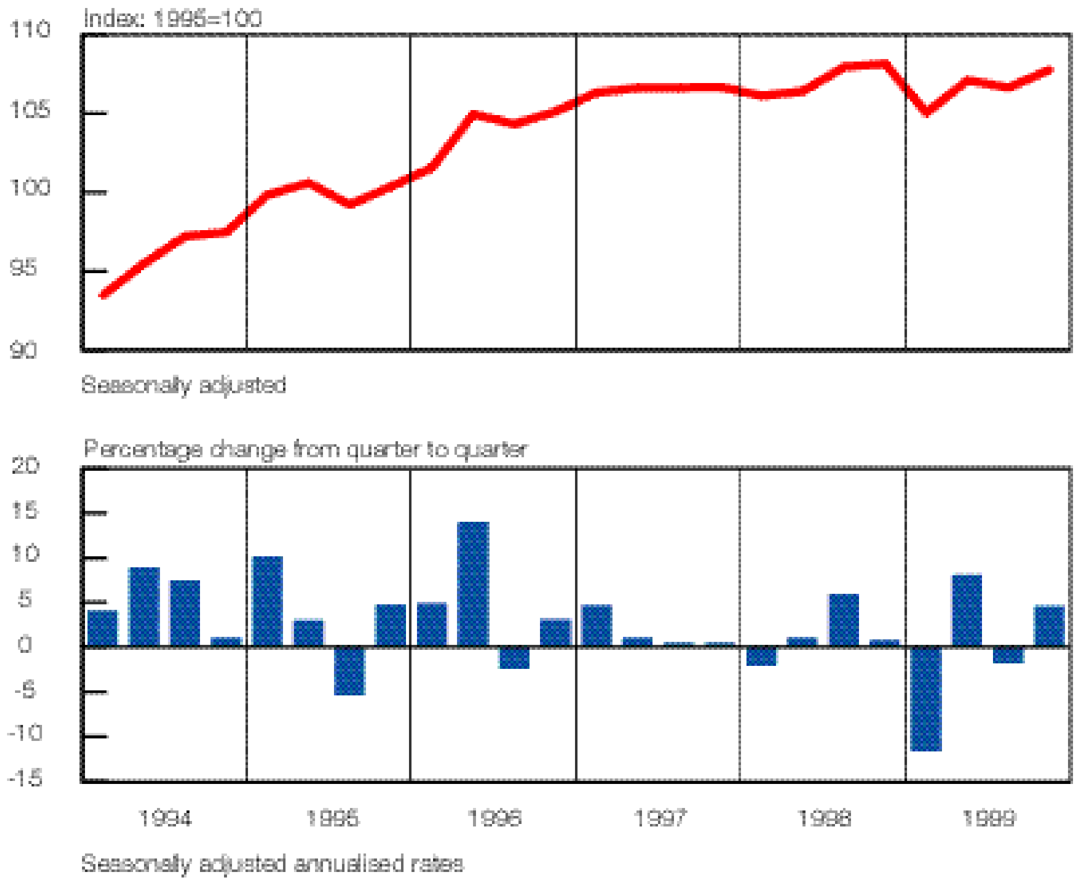
Growth from quarter to quarter in real gross domestic expenditure during 1999 vacillated between strong increases and almost equally strong declines – the change in each quarter was followed by a change in the opposite direction in the following quarter. For 1999 as a whole, real gross domestic expenditure declined by about ½ per cent – a decline that in absolute size was broadly equal to its growth in 1998, implying that real gross domestic expenditure in 1999 had almost returned to the level of 1997.

Real gross domestic expenditure

Percentage change at seasonally adjusted and annualised rates

Components	1998					1999				
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Final consumption expenditure by households	2	1	½	0	1½	-1	1	3	3	½
Final consumption expenditure by general government................	6½	-3½	-½	-2½	-½	-1½	-1½	-2	-3	-2
Gross fixed capital formation...................	3½	8½	9½	5½	5	-25½	-9	-5	0	-7
Domestic final demand.....	3	1½	2	½	1½	-6	-1	1	1½	-1
Change in inventories (R billions)..................	-7,5	-4,6	-3,3	-1,6	-4,2	-9,7	3,8	0,2	4,2	-0,4
Gross domestic expenditure	**-2**	**1**	**6**	**1**	**½**	**-11**	**8**	**-1½**	**4½**	**-½**

Real gross domestic expenditure



There was strong growth of about 4½ per cent (seasonally adjusted and annualised) in real gross domestic expenditure in the fourth quarter of 1999, following a decline of 1½ per cent in the third quarter. The return to positive growth was led by final consumption expenditure by households and a strong accumulation of inventories. Final consumption expenditure by general government declined in the fourth quarter of 1999, whereas gross fixed capital formation remained virtually unchanged at the level recorded in the third quarter.

Final consumption expenditure by households was severely affected by the high interest rates and declined at an annualised rate of 1 per cent in the first quarter of 1999. Since then, consumer confidence has been greatly restored as bank lending rates tumbled, asset prices escalated and nominal remuneration settlements continued to exceed overall consumer price inflation. To these factors should be added the higher gross income of the farming community and the windfall gains of those households whose interest in a mutual insurance company was converted into an equity interest or cash.

Real final consumption expenditure by households

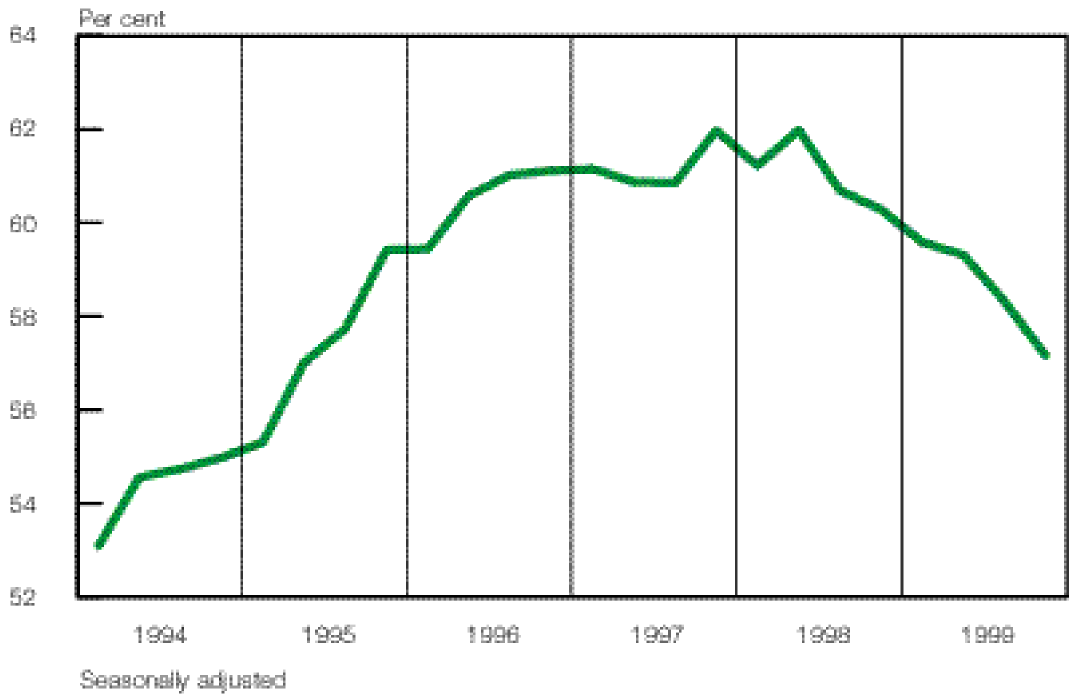
Percentage change at seasonally adjusted and annualised rates

Components	1998					1999				
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Durable goods..................	6	-4	-9½	-23½	-6	-11	9½	11½	-2	-6½
Semi-durable goods.........	4½	4	½	½	2½	-9½	½	6	9	-1
Non-durable goods...........	0	½	1	0	1	0	0	½	1½	½
Services............................	3	2½	3	5	3	2½	1	4	3½	3
Total.................................	**2**	**1**	**½**	**0**	**1½**	**-1**	**1**	**3**	**3**	**½**

Households responded to the improvement in their income and perceived wealth by increasing their real final consumption expenditure at annualised rates of 3 per cent in the last two quarters of 1999. Real outlays on *durable goods* fell back somewhat in the fourth quarter of 1999 as many prospective buyers postponed their purchases of new motorcars until after the end of the year, but spending on semi-durable goods rose briskly. Strong increases in real spending on non-durable goods and on services also contributed noticeably to the buoyancy of household spending in the fourth quarter of 1999.

Despite the mood of growing optimism, households refrained from burdening themselves with additional debt. Greater conservatism among consumers is reflected in the slowdown in the year-on-year growth in household debt from 4½ per cent in the first quarter of 1999 to 2 per cent in the fourth quarter. As a result, household debt as a percentage of disposable income declined from 59½ per cent in the first quarter of 1999 to 57 per cent in the fourth quarter. Lower household debt burdens, along with the decline in bank lending rates, made debt-servicing charges far less onerous and increased the resources that households have available for discretionary spending.

Household debt as percentage of disposable income

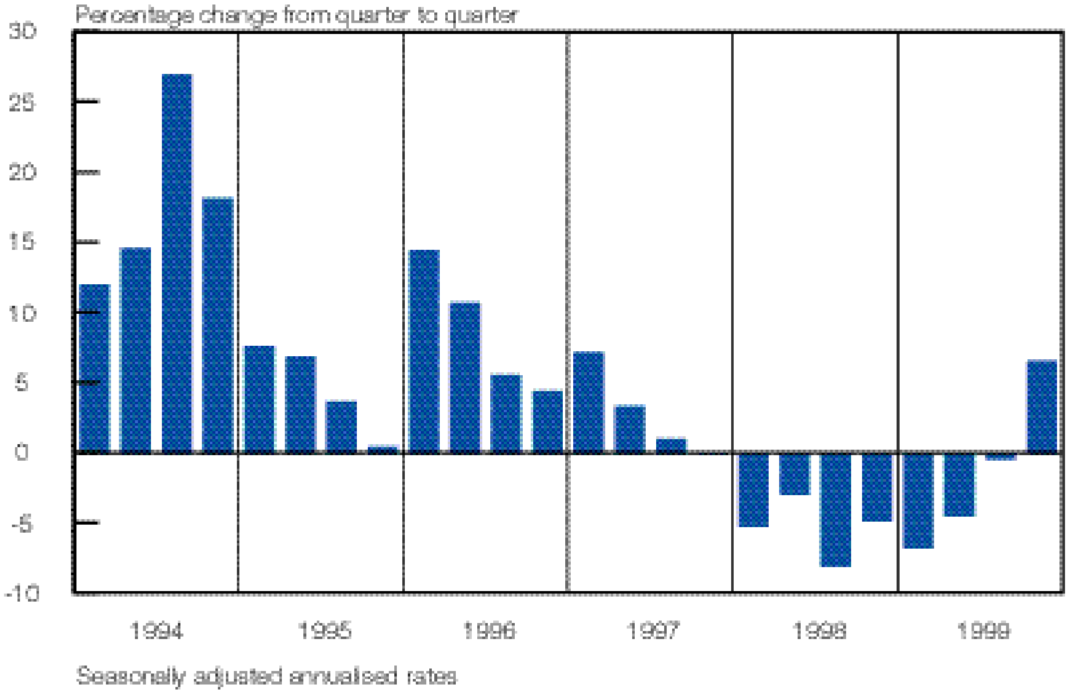


In the fourth quarter of 1999, *real final consumption expenditure by general government* (seasonally adjusted and annualised) declined for the seventh quarter in succession. The annualised rate of decline reached 3 per cent in the fourth quarter of 1999, up from 2 per cent in the third quarter. For the whole of 1999, real government consumption expenditure declined by 2 per cent, following a decline of ½ per cent in 1998. The persistent decline in government consumption expenditure reflects, in part, government's determination to apply fiscal discipline as part of a broader strategy that will create an environment in which economic growth and job creation can flourish. The ratio of final consumption expenditure by general government to gross domestic product consequently declined from 20 per cent in 1998 to 19 per cent in 1999.

The steep decline in *total real gross fixed capital formation* in the first three quarters of 1999 appeared to have been tapering off in the fourth quarter when real gross fixed capital formation showed almost no change from the level of the third quarter. Of importance was that an eight-quarter decline in private-sector fixed capital formation came to an end when private fixed capital outlays increased at an annualised rate of 6½ per cent in the fourth quarter of 1999. For the whole of 1999, total real gross fixed capital formation declined by 7 per cent, compared with an increase of 5 per cent in 1998.

The increase in *private-sector* real gross fixed capital formation in the fourth quarter of 1999 was apparent in all the main sectors of economic activity, except the mining industry. The increase in capacity utilisation in manufacturing, a relatively sharp decline in the user cost of capital and the prospects of continued strength in aggregate domestic and foreign demand could have contributed to the upturn in private-sector investment in the fourth quarter of 1999. The continuing expansion of the cellular telephone network also contributed materially to the growth of fixed capital spending by private-sector companies towards the end of 1999.

Real gross fixed capital formation by the private sector



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

Components	1998					1999				
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Private business enterprises................	-5½	-3	-8	-5	-3	-6½	-4½	-½	6½	-4½
Public corporations...........	53½	87½	118	61	51½	-70½	-19	-23½	-32	-17
General government.........	9	1	4½	-10½	2½	-4	-17	-2	9½	-5½
Total................................	**3½**	**8½**	**9½**	**5½**	**5**	**-25½**	**-9**	**-5**	**0**	**-7**

Following marked increases in 1998, real fixed capital formation by *public corporations* fell back during all four quarters of 1999. The cutbacks in the fourth quarter occurred largely in the communication sector. These declines took the overall decline in capital formation by public corporations to 32 per cent at an annualised rate in the fourth quarter of 1999 and to 17 per cent in 1999 as a whole. There had been an increase of 51½ per cent in 1998.

Real fixed *capital formation by general government* and the business enterprises of general government increased in the fourth quarter of 1999. Earlier declines from the fourth quarter of 1998 to the third quarter of 1999 nevertheless ensured that fixed capital formation by general government in 1999 was 5½ per cent lower than in 1998. In 1998 general government departments had increased their capital expenditure by 2½ per cent.

The real value of total *inventories* in the economy fell sharply in the first quarter of 1999, but was largely positive in the remaining quarters of that year as inventories were replenished. For the year 1999 as a whole, however, there was, on balance, still a relatively small drawing-down of inventories. The declining cost of holding inventories and prospects for future increases in final demand probably encouraged businesses to raise the level of inventories that they were prepared to hold.

Investment in inventories in the fourth quarter of 1999 occurred mainly in the area of *industrial and commercial inventories*. As a consequence, the value of these inventories as a percentage of gross domestic product increased to 13½ per cent in the fourth quarter of 1999 from a low point of 13 per cent in the second quarter. This turnaround may be an indication of business' confidence that an economic recovery is under way and that aggregate final demand is likely to strengthen in the short and medium term.

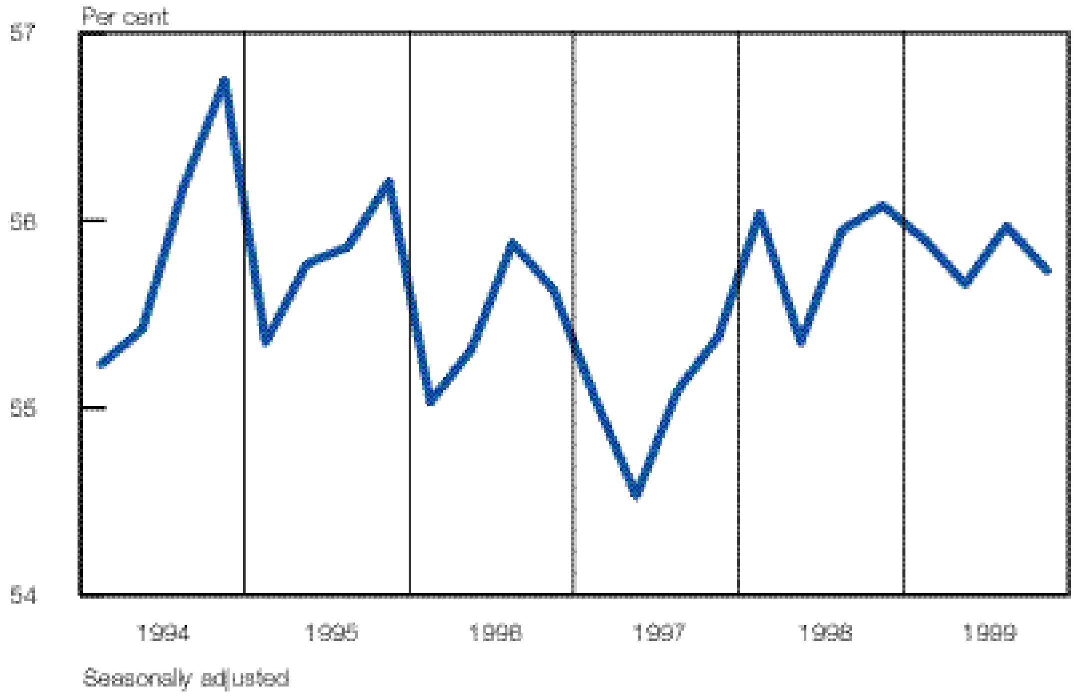
Factor income

The growth over four quarters in *total nominal factor income at factor prices* accelerated from an average rate of 7½ per cent in the second and third quarters of 1999 to 8 per cent in the fourth quarter. An analysis of the two principal components of factor income (namely compensation of employees and the gross operating surplus) shows that the rate of growth in employee compensation slowed down somewhat, whereas the growth in business operating surpluses accelerated. For 1999 as a whole, the growth in nominal factor income remained at a rate of 8 per cent that had also been recorded in 1998.

Growth in the nominal *gross operating surpluses* of business enterprises, measured over periods of four quarters, increased from an average rate of 7½ per cent in the first three quarters of 1999 to 8½ per cent in the fourth quarter. Increases were especially evident in the mining, manufacturing and financial services sectors. On an annual basis, the growth in total gross operating surpluses increased from 6 per cent in 1998 to 8 per cent in 1999.

The rate of growth over four quarters in the *total compensation of employees* slowed down from an average rate of 8 per cent in the first half of 1999 to 7½ per cent in the second half. This lower growth occurred in most of the major production sectors of the economy, except the commercial sector where compensation growth accelerated. Although the slowdown in the compensation of employees will ultimately reduce employees' share in the total value added, the recent changes have left employees' share in the total value added unchanged at 56 per cent from 1998.

Labour's share of total factor income



Domestic saving

Gross saving as a ratio of gross domestic product weakened from 15 per cent in the second quarter of 1999 to 14½ per cent in the third quarter, but recovered again when it rose to 15 per cent in the fourth quarter. This raised the average saving ratio for the whole of 1999 to 15 per cent from 14½ per cent in 1998.

The slight improvement in the saving behaviour of the economy was mainly due to a reduction in the net dissaving of general government. The improvement in gross saving, together with the decline in fixed capital formation, meant that only 2½ per cent of the economy's investment needs in 1999 had to be financed by inflows of foreign saving, compared with 11 per cent in 1998.

The *corporate sector's saving* came under pressure in the last half of 1998 as the growth in operating surpluses weakened. Following the recovery in business conditions during 1999, corporate saving as a percentage of gross domestic product rose slightly from 12½ per cent in the first quarter to 13 per cent in the fourth quarter. From 1998 to 1999 corporate saving relative to gross domestic product nevertheless deteriorated by ½ percentage point to 12½ per cent. *Household saving* as a percentage of gross domestic product remained unchanged at the level of 3 per cent attained in 1998. Although the reduction in household debt ratios would normally signal an improvement in the average household saving ratio, the recent decline in debt servicing cost has allowed households to step up consumption growth, instead of strengthening their retained current income.

Gross dissaving by general government as a percentage of gross domestic product improved marginally from the first quarter of 1999 to the fourth quarter. For 1999 as a whole, the gross dissaving ratio of general government improved from 1½ per cent in 1998 to ½ per cent. Higher tax collections and spending containment contributed most to the reduction in general-government dissaving. As a percentage of gross domestic product, the total tax income of government rose from 26 per cent in 1998 to 26½ per cent in 1999, whereas final consumption expenditure (excluding transfers to non-government parties and interest on public debt) declined from 20 per cent to 19 per cent over the same period.

Employment

There was no indication of a pick-up in the demand for labour by the end of the third quarter of 1999. According to the *Survey of Total Employment and Earnings* by Statistics South Africa, there was a decline of 81 000 jobs in the formal non-agricultural sectors of the economy from the end of December 1998 to the end of September 1999. This was preceded by persistent declines in the average level of formal-sector employment over the years from 1990 to 1998. As the accompanying graph shows, employment has rarely increased from one quarter to the next over the period since 1994. By the end of the third quarter of 1999 the official indicator of employment in the formal sectors of the economy was down to a level broadly similar to that of the late 1970s.

Officially measured employment in the *private sector* fell by 1,5 per cent when comparing the first three quarters of 1999 with the corresponding period in 1998. Decreases were recorded in six of the eight main production sectors. The rate of decline varied in intensity from 17,4 per cent in the construction sector to 1,4 per cent in the laundries and dry-cleaning services sector. Seemingly contradicting the

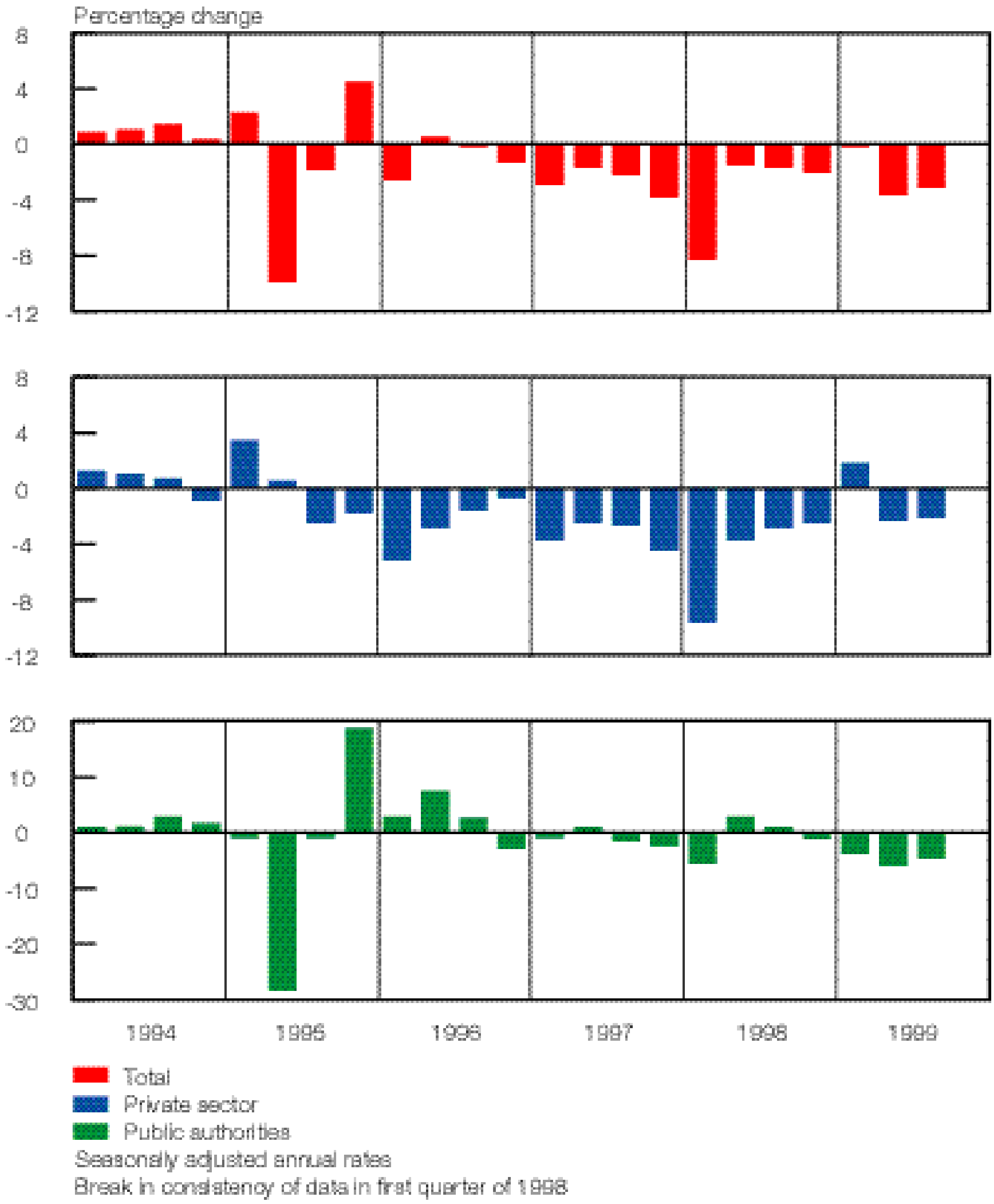
Year-on-year changes in non-agricultural private-sector employment in the first nine months of 1999

Sector	Per cent
Manufacturing	-2,6
Construction	-17,4
Electricity	-5,2
Gold mining	-9,4
Non-gold mining	-2,8
Trade, catering and accommodation services	9,0
Financial intermediation and insurance	-2,5
Laundries and dry-cleaning services	-1,4
Transport, storage and communication*	5,7
Total private sector	**-1,5**

* Non-governmental institutions only

evidence of large-scale job losses in the private sector, the number of jobs in the trade and allied services sectors and in the transport and communication sectors rose by 9,0 per cent and 5,7 per cent, respectively, in the first three quarters of 1999.

Non-agricultural employment



Employment in the *public sector* declined even more than in the private sector during 1999, as government bodies are continuously being encouraged to improve management, financial accountability and service delivery. There was a decline of 2,3 per cent in public-sector employment from the first three quarters of 1998 to the first three quarters of 1999. A decline of 7,8 per cent was recorded at the level of local government alone. In the third quarter of 1999 job losses in the public sector were exacerbated by the laying-off of casual and part-time workers involved in special projects of national and local government departments, the retrenchment of part-time employees of the health departments of provincial governments, and the departure of teachers and examiners whose employment contracts had expired.

There was a rise in industrial action in 1999. The number of *workdays lost* on account of strikes and other work stoppages rose from 2,3 million in 1998 to 3,1 million in 1999. Disputes over pay were the main reason for strike action – 97,2 per cent of all workdays lost and 80 per cent of the number of strikes were related to wage disputes.

Government's concern with the poor labour absorption capacity of the economy was expressed in a *Ministerial Determination* for small businesses that was published on 5 November 1999. Some of the conditions of the Basic Conditions of Employment Act (BCEA) were amended for employers who have fewer than 10 people in their employ. The publication of this Determination followed a period of in-depth research, consultation and deliberation and arose from the government's commitment to assessing the possible impact of the BCEA on small businesses. The Determination amended four conditions of the BCEA applicable to small businesses, as follows:

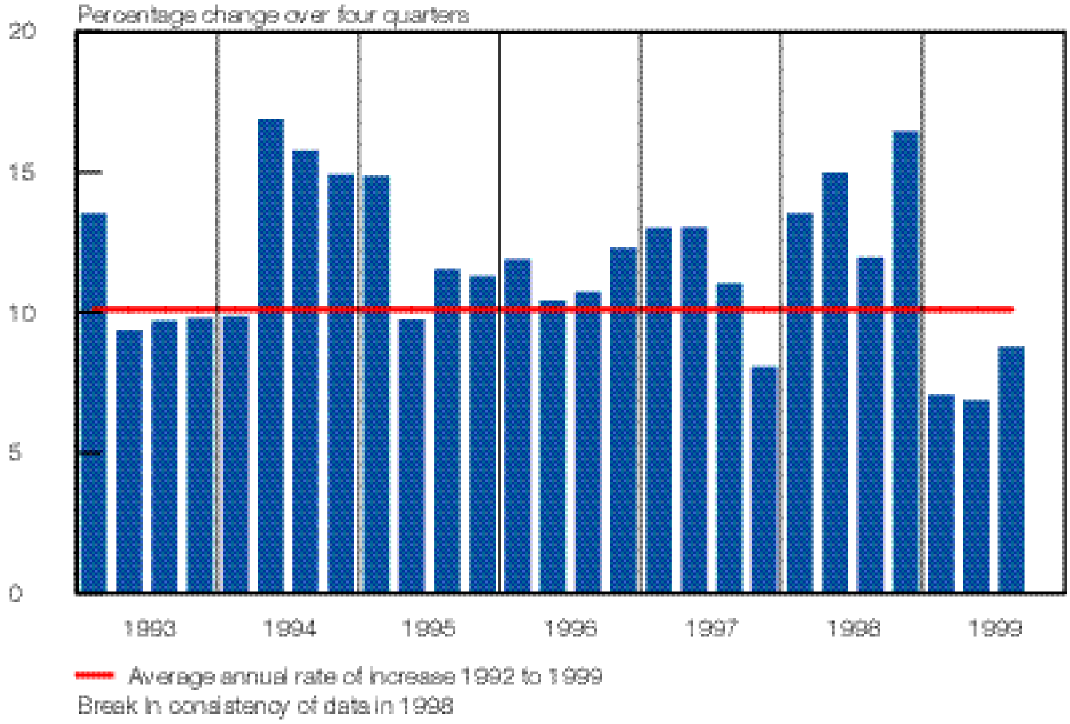
- it extended the maximum number of overtime hours that an employee may work from 10 to 15 hours in a week;
- it reduced the minimum rate of payment for overtime work from time-and-a-half to time-and-a-third;
- it allowed the averaging of working hours up to four months by written individual agreement, instead of collective agreement; and
- employees' entitlement to three days of family responsibility leave was included in their allocation of 21 days of annual leave. Under the conditions of the BCEA prior to amendment, employees are entitled to 3 days of family responsibility leave in addition to 21 days of annual leave.

In his address at the opening of Parliament on 4 February 2000, the President warned that illegal and unjustified strikes could not be tolerated and reiterated that government would continue to give priority to the creation of jobs. The President also indicated that after a review of the labour market legislative framework, government had reached the conclusion that certain aspects of this framework have had unintended consequences – hence the announcement that amendments to certain provisions of the Labour Relations Act, the BCEA and the Insolvency Act would be introduced during the current Parliamentary session.

Labour costs and productivity

Nominal remuneration per worker in the non-agricultural sectors of the economy increased by 7,6 per cent when comparing the first three quarters of 1999 with the corresponding period of 1998. The accompanying graph shows that this rate of nominal earnings growth was lower than at any time during the past seven years. Some of this slowdown may reflect statistical noise in the measurement of worker remuneration. But there was also a slowdown in the average settlement rate in collective bargaining agreements from 8,6 per cent in 1998 to 8,3 per cent in 1999. As a consequence, the gap between growth in average income per worker and settlements – often referred to as "wage drift" – narrowed during the past year. This is consistent with settlements accounting for an increasing share of overall income per worker, whereas overtime pay, performance-related rewards and other bonuses tended to constitute a smaller portion of the total compensation of workers.

Nominal remuneration per worker in the non-agricultural sectors



The average remuneration per worker in the *public sector* increased at a year-on-year rate of 2,7 per cent in the second quarter of 1999 and 9,1 per cent in the third quarter. This sharp acceleration was mainly due to the low base used in the calculation of the year-on-year percentage increase in the third quarter of 1999. When comparing the nominal remuneration of public-sector workers in the first three quarters of 1999 with that in the first three quarters of 1998, the average public-sector employee earned some 5,5 per cent more in 1999 than in 1998.

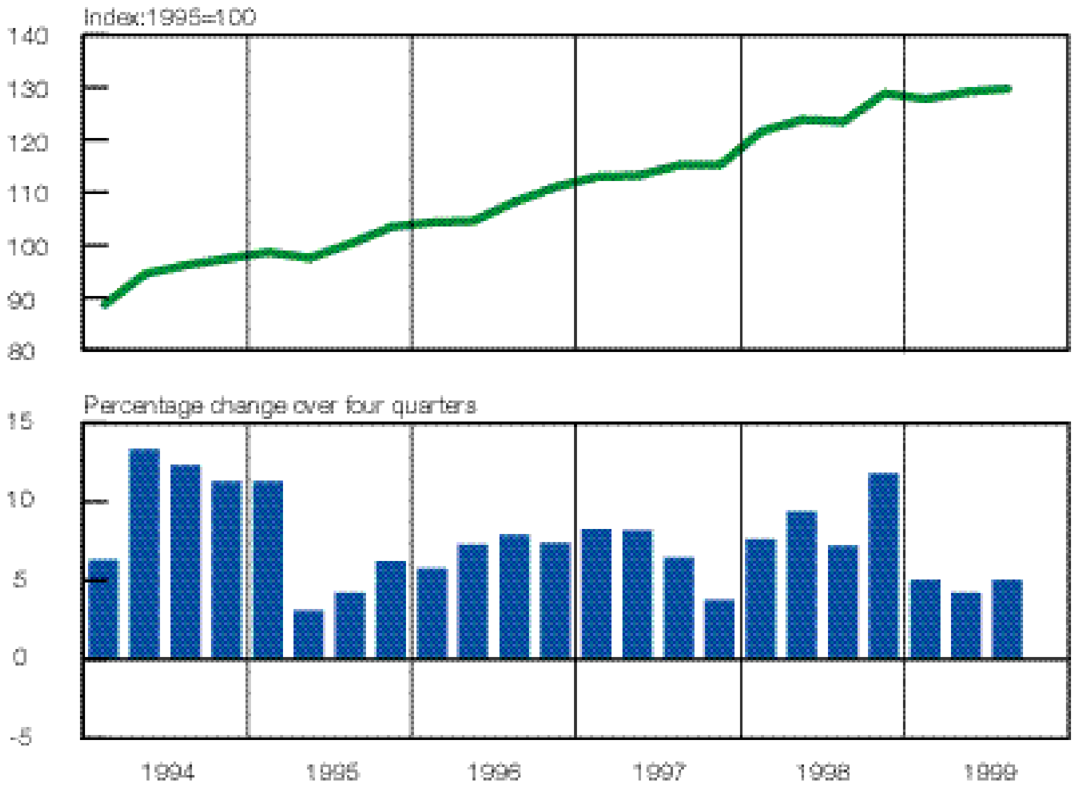
Salary and wage increases granted by *private-sector* employers were, on average, more generous than those granted by the public sector. When comparing the first three quarters of 1999 with the corresponding period of 1998, the growth in average nominal remuneration per worker in the private sector was 9,3 per cent. Average nominal remuneration growth over this period ranged from a low of 5,3 per cent in the gold-mining sector to 16,3 per cent in the electricity-generating sector.

During the first three quarters of 1999, nominal remuneration per worker in the non-agricultural sectors rose faster than output prices. This resulted in an increase of 0,9 per cent in the inflation-adjusted remuneration per worker or the *real product wage.* When the year-on-year growth in the real product wage is compared quarter by quarter, it accelerated from 0,2 per cent in the first quarter of 1999 to 2,2 per cent in the third quarter. This rise could conceivably have put upward pressure on output prices and contributed to the persistence of relatively high underlying inflationary pressures in the economy in the second half of 1999.

Despite the increase in industrial action, the growth in real *output per worker* in the formal non-agricultural sectors of the economy rose from a year-on-year rate of 1,9 per cent in the first quarter of 1999 to 3,6 per cent in the third quarter. Output per worker in the first three quarters of 1999 was 2,7 per cent higher than in the first three quarters of 1998. The growth in productivity was partly a consequence of declining employment totals, but there was also evidence of efficiency gains throughout the economy. Increased labour productivity should ideally be accompanied by rising employment totals in order to contribute meaningfully to solving the problem of unemployment.

The acceleration in productivity growth helped to contain the growth in *nominal unit labour costs* (i.e. the ratio between nominal remuneration per worker and output per worker) during 1999. Equal growth in remuneration per worker and output per worker will keep unit labour costs constant without adding to any upward pressure on output prices. The relatively strong productivity performance of the economy during 1999 reduced the year-on-year rate of growth in nominal unit labour cost to 4,7 per cent in the first three quarters of 1999 compared with the first three quarters of 1998. Continued moderate increases in nominal unit labour costs may alleviate upward pressure on the output prices of goods and services. Furthermore, a continuation of slower growth in nominal unit labour costs augers well for an improvement in the international price competitiveness of domestic producers.

Nominal unit labour costs in the non-agricultural sectors



Break in consistency of data in 1998

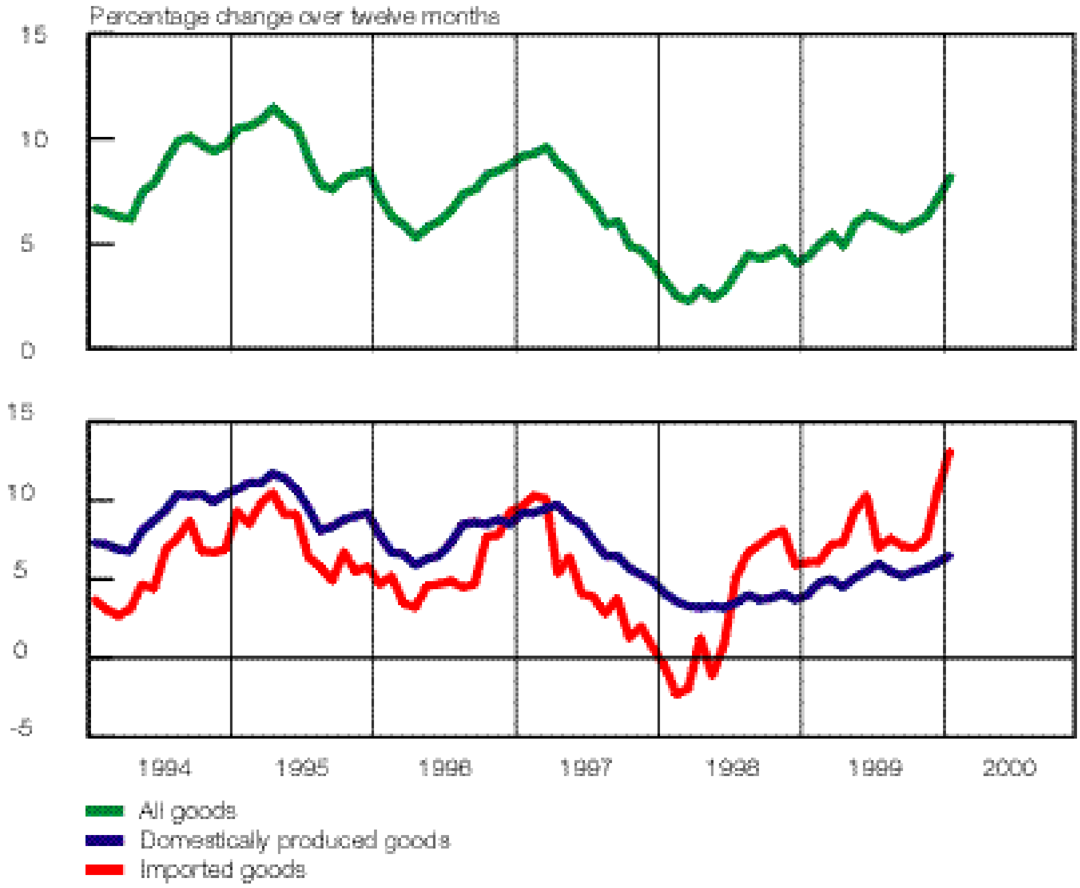
Inflation

Production prices have risen sharply in recent months. The annual increase in the *all-goods production price index* accelerated from 3,5 per cent in 1998 to 5,8 per cent in 1999, but still remained below the average rate of 8,8 per cent recorded over the period 1990 to 1997. The year-on-year increase in production prices rose to a thirty-one-month high of 8,2 per cent in January 2000, compared with 4,1 per cent in December 1998. This increase reflected in part the impact of the rise in international crude oil prices on domestic producers' output prices.

Production prices
Quarter-to-quarter percentage changes at annualised rates

Period		Domestically produced goods	Imported goods	Overall production prices
1998:	**Year............................**	**3,5**	**3,1**	**3,5**
1999:	1st qr	5,7	-2,8	3,7
	2nd qr.........................	5,7	11,5	7,1
	3rd qr..........................	6,7	13,4	7,9
	4th qr..........................	4,9	10,4	6,9
	Year............................	**5,3**	**7,8**	**5,8**

Production price inflation



Measured from quarter to quarter, inflation in production prices rose from a seasonally adjusted and annualised rate of 3,7 per cent in the first quarter of 1999 to 7,9 per cent in the third quarter, but then slowed down somewhat to 6,9 per cent in the fourth quarter. Lower rates of increase in the prices of both domestically produced goods and imported goods contributed to the slowdown in the fourth quarter of 1999.

The year-on-year inflation in the *prices of domestically produced goods* rose from 4,0 per cent in January 1999 to 6,5 per cent in January 2000. This reflected largely the pass-through to producers of the rise in imported crude oil prices. Price pressures also emanated from the agricultural sector where the prices of products not included in the food category rose by 33,2 per cent in the year to January 2000.

Mostly because of a slowdown in production price increases in the primary sectors and in the electricity-generating sector, quarter-to-quarter inflation in the seasonally adjusted prices of domestically produced goods declined from an annualised rate of 6,7 per cent in the third quarter of 1999 to 4,9 per cent in the fourth quarter. In the fourth quarter of 1998 this measure of inflation had still been as low as 3,8 per cent.

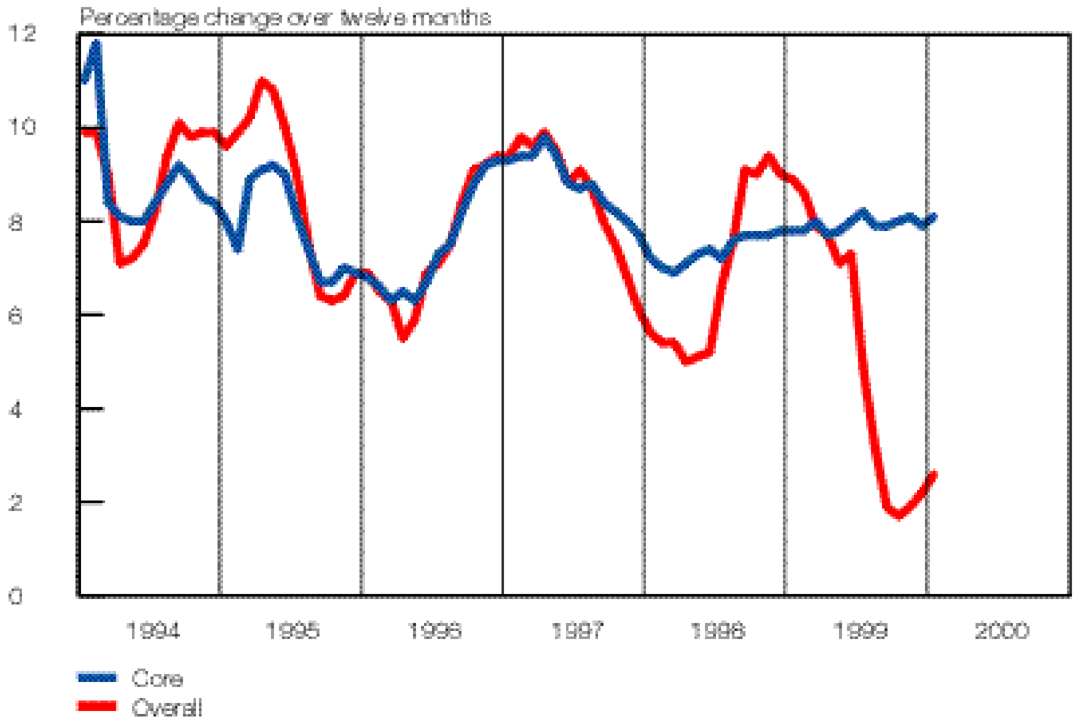
The year-on-year change in the prices of *imported goods* rose to 13,1 per cent in January 2000 – the highest such rate of increase since February 1991. In February 1998, negative inflation at a year-on-year rate of 2,3 per cent was recorded in the prices of imported goods. The annualised quarter-to-quarter change in the seasonally adjusted prices of imported goods peaked at 13,4 per cent in the third quarter of 1999, but showed signs of slowing down when it declined to 10,4 per cent in the fourth quarter. With inflation still relatively subdued in South Africa's main trading-partner countries and the small change in the effective exchange rate of the rand, steep increases in the prices of imported crude oil were the reason for the current high rate of imported price inflation.

The year-on-year rate of *overall consumer price inflation* declined from 9,4 per cent in November 1998 to 1,7 per cent in October 1999, before rising to 2,2 per cent in December and 2,6 per cent in January 2000. By contrast, year-on-year *core inflation* (i.e. the change in the overall consumer price index excluding the prices of certain food products, interest rates on mortgage bonds, overdrafts

Consumer prices
Twelve-month percentage changes

Period	Goods	Services	Overall consumer price inflation	Core inflation
1999: Jan.	6,4	11,8	8,9	7,8
Feb.	6,4	11,1	8,6	7,8
Mar.	6,1	10,1	7,9	8,0
Apr.	5,7	10,0	7,7	7,7
May	5,9	8,6	7,1	7,8
Jun.	6,1	8,6	7,3	8,0
Jul	6,1	3,6	4,9	8,2
Aug.	5,7	0,5	3,2	7,9
Sep.	5,7	-2,1	1,9	7,9
Oct.	6,0	-2,9	1,7	8,0
Nov.	6,6	-3,1	1,9	8,1
Dec.	6,4	-2,4	2,2	7,9
Year	6,1	4,2	5,2	7,9
2000: Jan.	6,9	-2,1	2,6	8,1

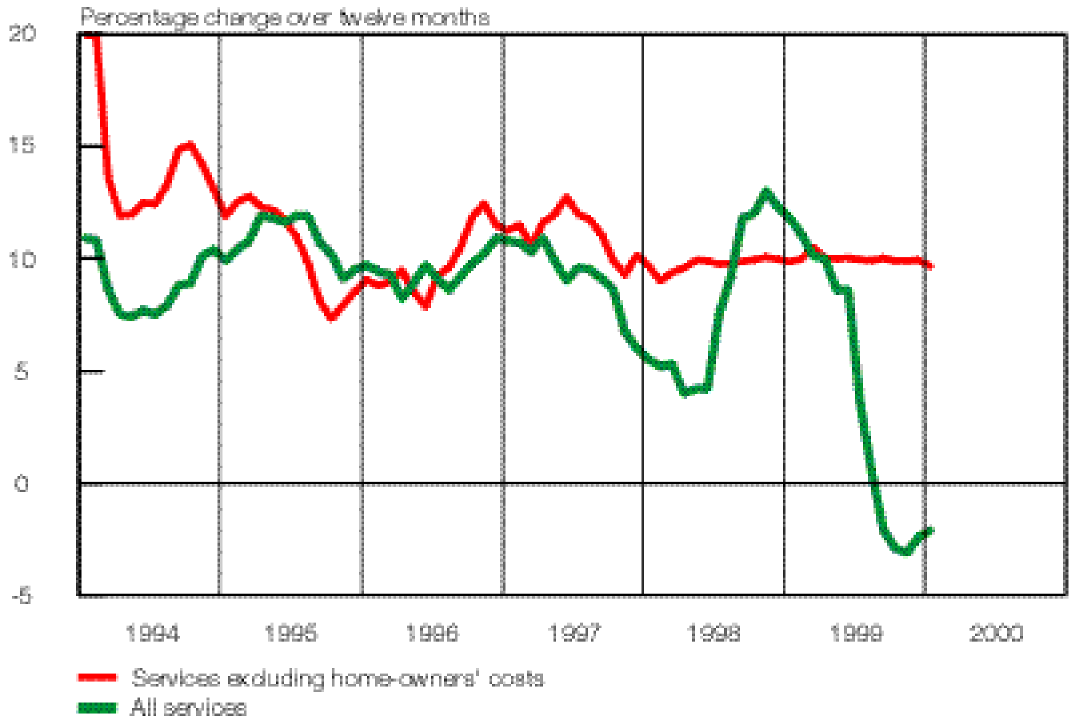
Consumer price inflation



and personal loans, value-added tax and property taxes) fluctuated within a narrow range between 7,8 per cent and 8,2 per cent; in January 2000 it was 8,1 per cent. The difference between consumer price inflation and core inflation reflected, among other things, declines in mortgage interest payments by households, which were affected mainly by declines in mortgage bond rates during the past year. However, the difference between consumer price inflation and core inflation will tend to narrow in coming months as the effects of the earlier declines in mortgage bond interest rates drop out of the calculation of year-on-year consumer price inflation.

The decline in mortgage-bond interest rates during 1999 brought inflation in the prices of consumer services down from a year-on-year rate of 13,0 per cent in November 1998 to negative inflation for the five months to January 2000. On average, inflation in the consumer prices of services fell from 7,9 per cent in 1998 to 4,2 per cent in 1999. However, when the effects of the decline in mortgage-bond interest rates and other home-owners' costs are excluded, the year-to-year increase in the prices of services still amounted to 10 per cent in 1999. The prices of consumer goods increased, on average, by 6,0 per cent in 1998 and 6,1 per cent in 1999.

Inflation in the prices of consumer services



Foreign trade and payments

Current account

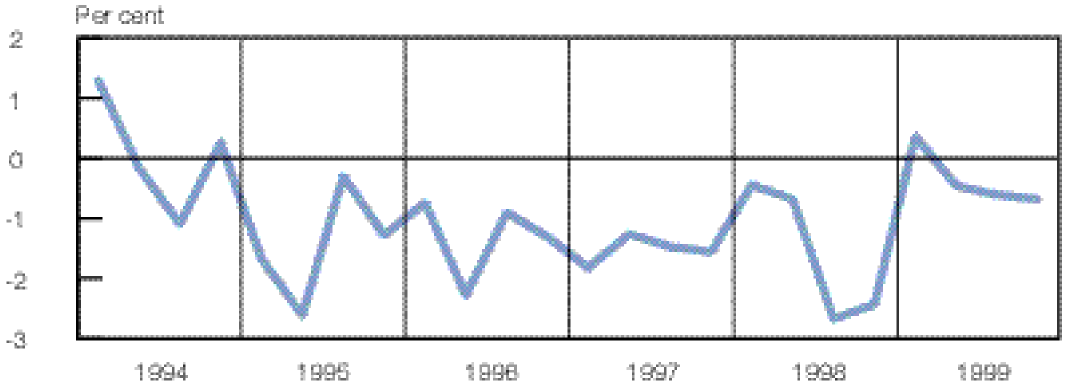
The deficit on the *current account* of the balance of payments narrowed considerably in 1999. Largely because of a strong improvement in the trade balance, the deficit on the current account declined from R11,6 billion in 1998 to R2,9 billion in 1999; as a percentage of gross domestic product the deficit fell from 1,6 per cent to 0,4 per cent. However, the improvement in the trade balance was partly offset by a deterioration in the services and transfer account of the balance of payments.

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

	1998	1999				
	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Merchandise exports.....................	135,1	147,2	139,6	148,2	161,0	149,0
Net gold exports	25,9	24,7	23,8	22,9	25,7	24,3
Merchandise imports.....................	-150,8	-142,6	-142,5	-149,7	-166,7	-150,4
Net service, income and current transfer payments.......................	-21,8	-26,5	-24,6	-26,3	-25,6	-25,8
Balance on current account..........	-11,6	2,8	-3,7	-4,9	-5,6	-2,9

Although the cumulated annual balance on the current account improved from 1998 to 1999, the quarterly estimates of balance-of-payments aggregates reveal a steady deterioration in the current-account balance from a surplus of R2,8 billion (seasonally adjusted and annualised) in the first quarter of 1999 to growing deficits in the last three quarters of the year. The upward trend in the deficit on the current account during 1999 was mainly related to the strengthening of the recovery in the South African economy, which led to an increase in the value of merchandise

Ratio of current-account balance to gross domestic product

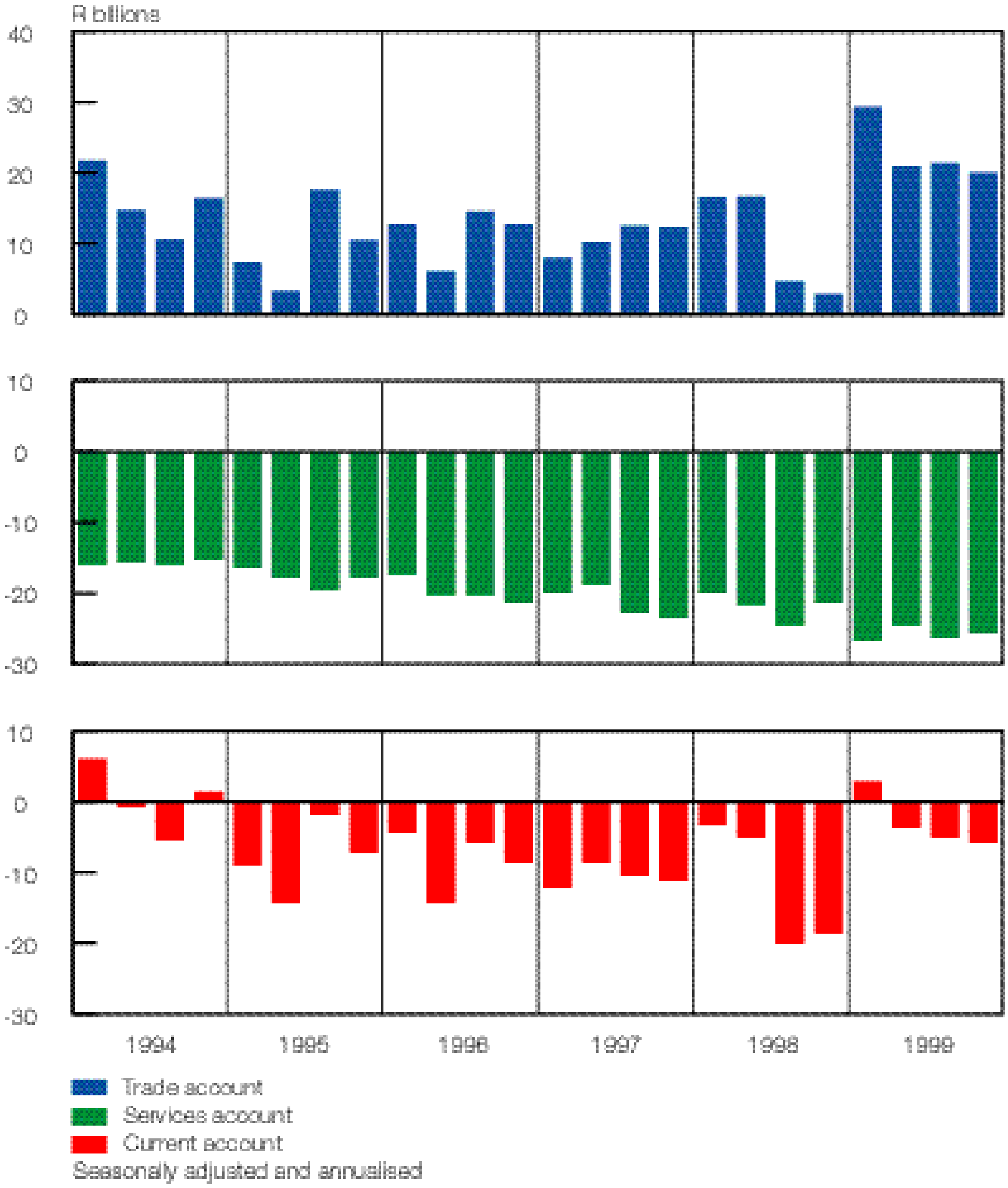


Seasonally adjusted and annualised

imports during the year, and higher crude oil prices. Export values of gold and other goods also increased during the year, but these gains were more than neutralised by the growth in import values from the first to the last quarter of 1999.

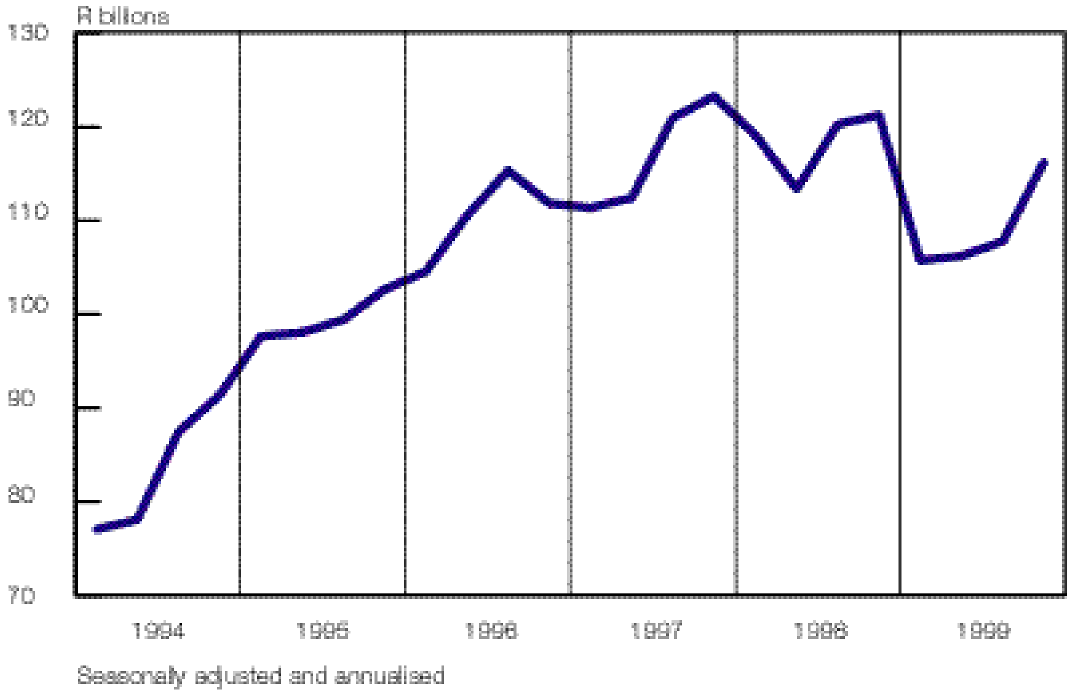
The *value of merchandise imports* (at a seasonally adjusted and annualised rate) had been flat in the first half of 1999, but rose substantially in the third and fourth quarters. The value of imported manufactured goods rose by about 9 per cent in the fourth quarter of 1999 as the growth in aggregate domestic demand led to a greater derived demand for imported intermediate, capital and other final goods. Of note were the sharply higher volumes of oil imports, together with steep rises in the international prices of crude oil, which increased the value of oil imports by more than 40 per cent in the fourth quarter of 1999. Consequently, imports of crude oil constituted 8,9 per cent of total merchandise imports in 1999 compared with 6,7 per cent in 1998.

Current account



The *physical quantity of merchandise imports,* having contracted in the first quarter of 1999, increased marginally in the second and third quarters and more substantially at a rate of 8 per cent when economic growth gained further momentum in the fourth quarter. The sharp increase in the fourth quarter could not prevent the volume of imports for the full calendar year 1999 from declining by 8 per cent compared with 1998. The *aggregate rand price level* increased by about 3½ per cent in the fourth quarter of 1999, mainly driven by the increase in the price of crude oil. On average, import prices in rand rose by 8½ per cent from 1998 to 1999. Some of these price increases still have to work their way through the price-formation system to the prices of domestically produced final goods.

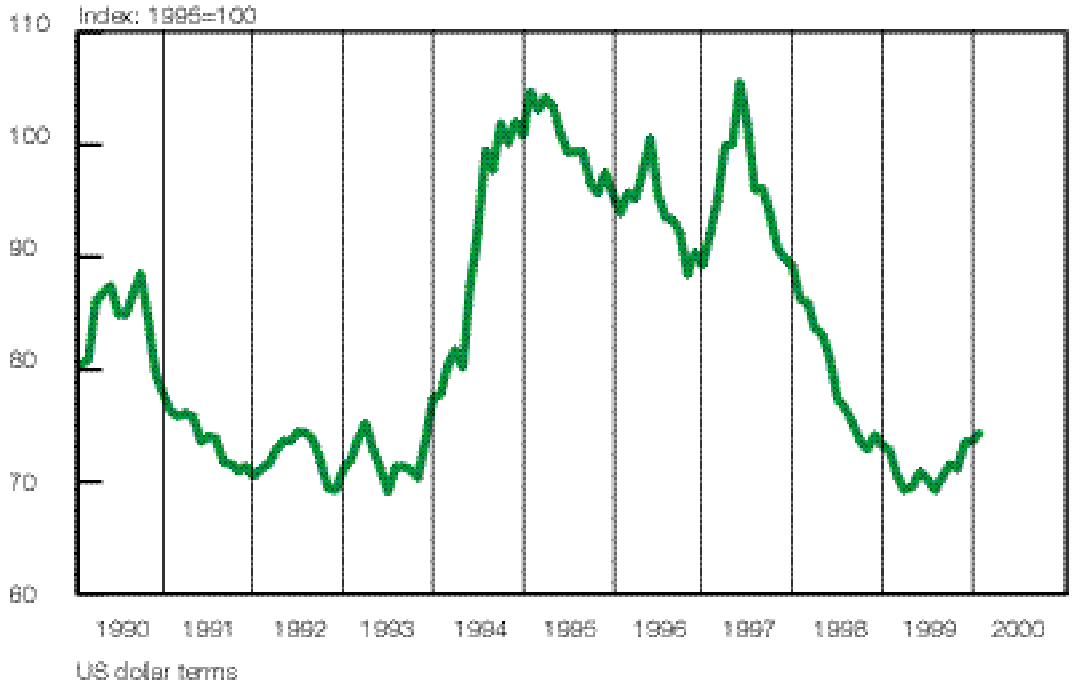
Merchandise imports at constant 1995 prices



The *value of merchandise exports*, which had declined to a seasonally adjusted and annualised value of R139,6 billion in the second quarter of 1999, rose to R148,2 billion in the third quarter and R161,0 billion in the fourth quarter. The increase in the fourth quarter of 1999 was caused by a sharp rise in the exports of mining products, mainly related to the better world prices for key commodities exported from South Africa. Export values of agricultural products and manufactured goods also increased in the fourth quarter of 1999, although far less impressively than those of mining products.

The *rand prices of goods exported* from South Africa remained more or less unchanged from the first to the third quarter of 1999 but increased by about 4 per cent in the fourth quarter. The increase in the fourth quarter of 1999 reflected a slight decline in the weighted effective exchange rate of the rand and, what was more important, the generally rising international commodity prices. A side-effect of the rise in export prices in the fourth quarter of 1999 was that the deterioration in South Africa's terms of trade (including gold) over the first three quarters of the year was arrested: the growth in export prices in the fourth quarter exceeded the growth in import prices.

Index of international commodity prices



Merchandise export volumes which have been growing at steadily declining rates since 1995, responded positively to the improvement in global economic conditions in the second half of 1999. Following a decline at a rate of approximately 5 per cent in the second quarter of 1999, the physical quantity of merchandise exports increased by about 5½ per cent in the third quarter and 4½ per cent in the fourth quarter. Mining products contributed most to the faster growth in export volumes, thus increasing the share of primary commodities in total merchandise exports. For 1999 as a whole, export volumes were 2½ per cent higher than in 1998.

The value of *net gold exports* (seasonally adjusted and annualised) declined from R28,2 billion in the fourth quarter of 1998 to R22,9 billion in the third quarter of 1999 but rose to R25,7 billion or by 12,2 per cent in the fourth quarter. The increase in the fourth quarter of 1999 was entirely due to a rise in the price of gold. Sentiment in the gold market was buoyed up when the European Central Bank announced that member countries had agreed to limit gold sales and gold lending. The average fixing price of gold on the London market responded by rising from US$259 per fine ounce in the third quarter of 1999 to US$296 per fine ounce in the fourth quarter. Expressed in rands, the average realised price moved from R1 612 per fine ounce to R1 834 per fine ounce over the same period.

The *physical quantity of gold exports* contracted by 1 per cent in the fourth quarter of 1999, following an increase of 6 per cent in the third quarter. For 1999 as a whole, the volume of net gold exports declined by about 8½ per cent. The gold content of ore milled declined from 5,1 grams per ton in 1998 to 4,6 grams in 1999, and was only partly offset by an increase in the quantity of ore milled. As a consequence, gold production fell by about 3 per cent to 449 tons in 1999.

Net *service, income and current transfer payments* increased from R24,6 billion in the second quarter of 1999 to R26,3 billion in the third quarter, but receded to R25,6 billion in the fourth quarter. This slight improvement occurred despite a decline in dividend and interest receipts from non-residents and higher payments for transportation and travel services. These changes were counteracted by a sizeable increase in receipts for tourist services rendered to foreign visitors, and a reduction in income payments made to non-residents. For the year as a whole the deficit on the services account deteriorated from R21,8 billion in 1998 to R25,8 billion in 1999, or, as a percentage of gross domestic product, from 2,9 per cent in 1998 to 3,2 per cent in 1999.

Financial account

The financial account of South Africa's balance of payments recorded positive inflows of capital at an increasing rate throughout 1999. Evidence of economic recovery in the crisis-hit Asian economies and an improved outlook for Russia encouraged foreign investors to re-evaluate their exposure to emerging markets with relatively sound macroeconomic fundamentals. The surplus on the financial account (including unrecorded transactions, but excluding reserve-related liabilities), which had increased from R2,6 billion in the first quarter of 1999 to R4,1 billion in the second quarter and R6,8 billion in the third quarter, increased sharply to R13,8 billion in the fourth quarter. For the calendar year 1999 as a whole, the net inflow of capital came to R27,3 billion, substantially higher than the net inflow of R8,0 billion in 1998 when the rand came under heavy speculative attack.

The surplus on the financial account in the fourth quarter of 1999 was mainly caused by a further strong inflow of portfolio capital. At the same time, net direct investment flows changed from an outflow in the third quarter of 1999 to an inflow in the fourth quarter.

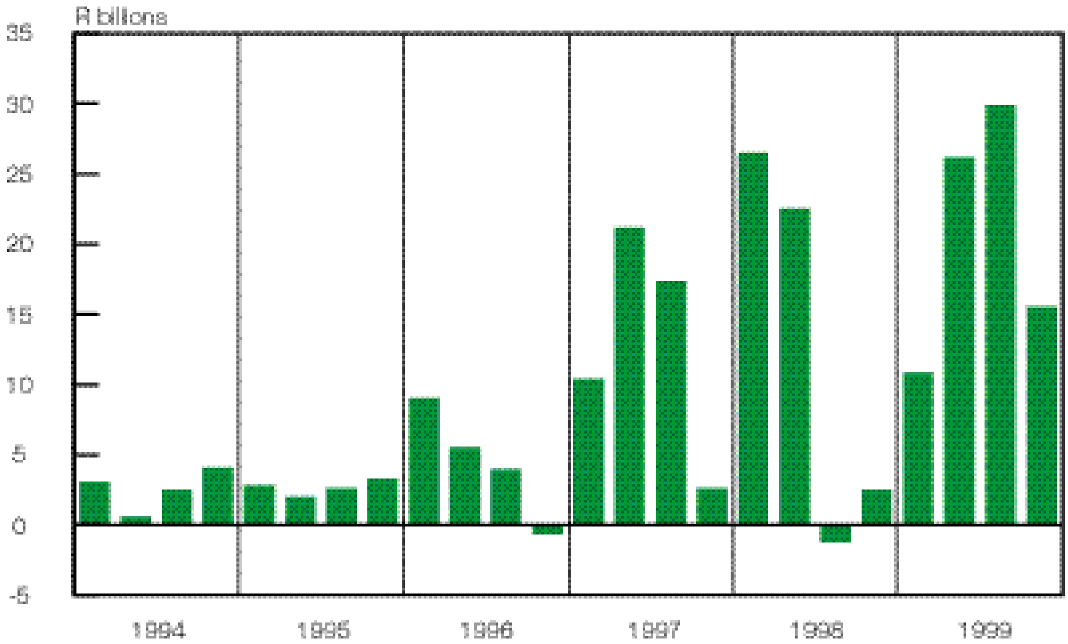
Net financial transactions not related to reserves
R billions

	1998	1999				
	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Liabilities						
Direct investment	3,1	2,0	1,5	1,7	3,2	8,4
Portfolio investment	50,4	10,8	26,2	29,9	15,5	82,4
Other investment	6,5	-2,2	-3,3	-9,1	-4,8	-19,4
Total liabilities	**60,0**	**10,6**	**24,4**	**22,5**	**13,9**	**71,4**
Assets						
Direct investment	-9,6	-4,5	-3,0	-2,0	2,7	-6,8
Portfolio investment	-30,1	-6,7	-10,9	-6,1	-7,6	-31,3
Other investment	-2,9	-1,5	-0,6	-3,7	-2,4	-8,2
Total assets	**-42,6**	**-12,7**	**-14,5**	**-11,8**	**-7,3**	**-46,3**
Total financial transactions*	**8,0**	**2,6**	**4,1**	**6,8**	**13,8**	**27,3**

* Including unrecorded transactions

Foreign direct investment flows into South Africa almost doubled from R1,7 billion in the third quarter of 1999 to R3,2 billion in the fourth quarter. The acquisition by Swissair of a 20 per cent equity interest in South African Airways contributed significantly towards this increase in foreign direct investment inflows. Direct outward investment changed from an outflow of R2,0 billion in the third quarter of 1999 to an inflow (i.e. a decrease in foreign assets) of R2,7 billion in the fourth quarter. The relatively large decline in directly held foreign assets resulted from the selling by resident shareholders to a non-resident party of a controlling interest in a UK-based listed company. For 1999 as a whole, net direct investment registered an inflow of R1,6 billion compared with an outflow of R6,5 billion in 1998.

Inward portfolio investment



Foreign portfolio investment into South Africa increased by R15,5 billion in the fourth quarter of 1999 compared with R29,9 billion in the third quarter. Non-resident investors added primarily to their holdings of South African equity securities in the fourth quarter of 1999. Foreign investment in domestic debt securities also increased somewhat in the fourth quarter of 1999, despite the redemption of a foreign loan of US$750 million by national government and foreign obligations of 737 million Netherlands guilder by a private-sector company. Inflows of portfolio capital were supplemented by international bond issues of €200 million by Eskom and €300 million by national government in the fourth quarter.

Investment in foreign financial assets by domestic institutional investors, through the asset swap mechanism, increased in the fourth quarter of 1999. As a consequence, portfolio investment *outflows* accelerated from R6,1 billion in the third quarter of 1999 to R7,6 billion in the fourth quarter. Despite these outflows, *net portfolio inflows* amounted to R51,1 billion in 1999 as a whole compared with R20,3 billion in 1998.

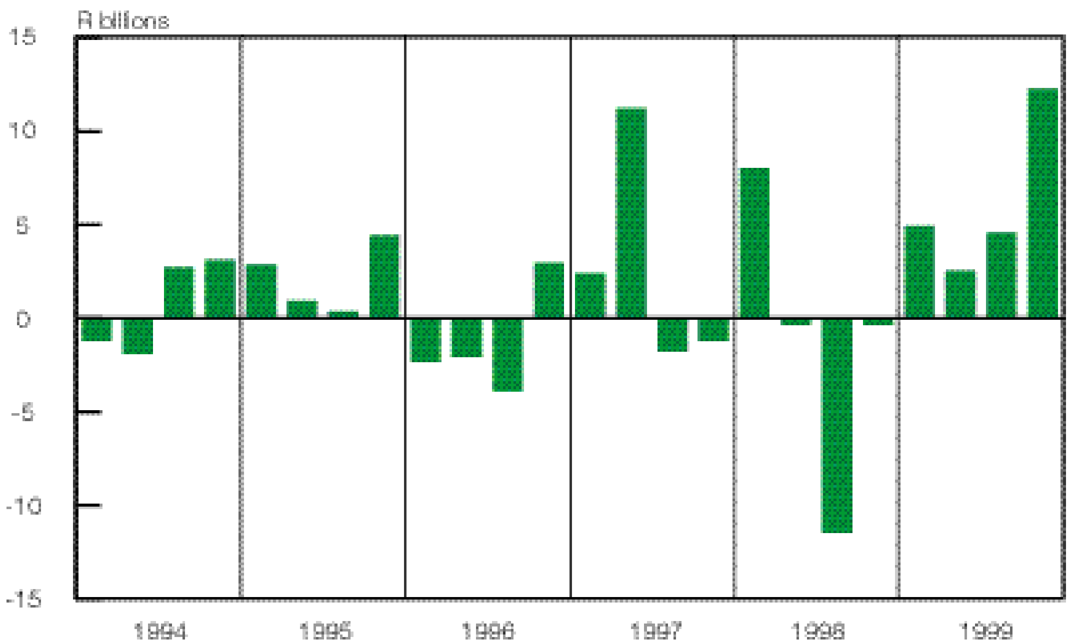
Other foreign investment into South Africa (i.e. changes in foreign liabilities incurred by South African businesses in the form of loans, trade finance or bank deposits) recorded an outflow of R4,8 billion in the fourth quarter of 1999, compared with an outflow of R9,1 billion in the third quarter. Non-resident investors reduced their foreign-currency denominated deposits with South African banks in the fourth quarter of 1999. Other foreign investment out of South Africa (i.e. foreign assets originating from loans to, trade finance to, or deposits with non-resident banks, and others) declined from R3,7 billion in the third quarter of 1999 to R2,4 billion in the fourth quarter. On a net basis, other foreign investment outflows from South Africa declined from R12,8 billion in the third quarter of 1999 to R7,2 billion in the fourth quarter. The decline in domestic borrowing costs, along with the relative stability of the rand, encouraged the substitution of domestic trade financing for foreign trade financing. This could have contributed to the net outflow of other, mainly short-term, foreign capital in the fourth quarter of 1999.

Foreign reserves

The surplus on South Africa's overall balance of payments of R4,6 billion in the third quarter of 1999 improved to R12,3 billion in the fourth quarter. The substantial net inflow of capital, particularly in the second half of 1999, increased the country's *net international reserves* by R24,3 billion in 1999 as a whole, compared with a decline of R4,0 billion in 1998.

Total *gross gold and other foreign exchange reserves* rose from R53,9 billion at the end of September 1999 to R67,5 billion at the end of December. The reduction in foreign reserves, which would otherwise have arisen from the redemption of the government's outstanding liabilities, was avoided by being partly financed from the proceeds of the eurobond issue. On balance, the country's gross international reserves increased by R25,4 billion or by 60 per cent in 1999 as a whole, compared with an increase of R6,7 billion in 1998.

Changes in net foreign reserves*



* Owing to balance of payments transactions

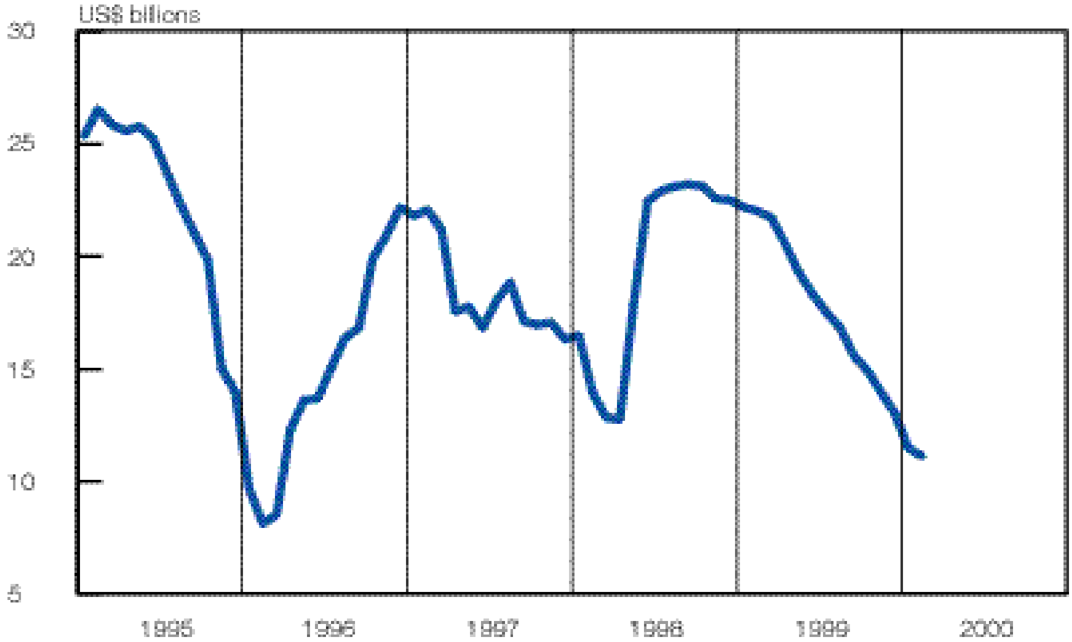
Measured in US dollars, South Africa's gross gold and other foreign exchange reserves rose from US$7,2 billion at the end of 1998 to US$11,0 billion at the end of 1999. Import cover, i.e. the value of gross international reserves expressed as a ratio of the value of imports of goods and services, improved from 10 weeks at the end of 1998 to 15½ weeks at the end of 1999.

The gross international reserves of the Reserve Bank increased from R31,6 billion at the end of 1998 to R45,4 billion at the end of 1999 and further to R47,0 billion at the end of February 2000. The Reserve Bank's short-term foreign commitments, which had declined persistently from R18,1 billion at the end of 1998 to R15,2 billion at the end of July 1999, rose to R19,8 billion at the end of November 1999. This was mainly a precautionary measure to avoid possible disruptions in the domestic market for foreign exchange during the millennium changeover. Since the end of November 1999, the Bank's short-term foreign loans have been reduced to R16,4 billion at the end of February 2000.

International reserves and net open position of the Reserve Bank
US$ billions

Period	Amount as at end of period		
	Net reserves	Gross reserves	Net open position
1999: 1st qr	2,4	5,3	-21,7
2nd qr..........................	3,1	5,8	-18,3
3rd qr..........................	3,6	6,5	-15,6
4th qr..........................	4,3	7,4	-13,0

Net open position in foreign currency*



* Oversold position of the Reserve Bank

The Reserve Bank reduced its oversold forward position in foreign currency from US$24,9 billion at the end of 1998 to US$17,4 billion at the end of 1999 and US$16,0 billion at the end of February 2000. The combined result of the strong increase in the Bank's gross international reserves and the much-reduced forward position in foreign currency was a sharp decline in the net open position in foreign currency. The net open position in foreign currency declined from US$22,5 billion at the end of 1998 to US$13,0 billion at the end of 1999 and US$11,1 billion at the end of February 2000.

Exchange rates

The relatively steady performance of the rand during the first nine months of 1999 came to an end during October 1999 when foreign investors repositioned their asset portfolios ahead of the millennium changeover in order to curb their exposure to the potential volatility of emerging-market asset prices. The nominal effective exchange rate of the rand subsequently declined by 1,4 per cent from the end of September 1999 to the end of October before increasing again by 1,5 per cent from the end of October to the end of December, leaving the weighted average exchange rate broadly unchanged from the end of the third quarter to the end of the fourth quarter. On balance, the nominal effective exchange rate of the rand increased marginally by 0,6 per cent from the end of 1998 to the end of 1999, compared with a decline of 18,6 per cent during 1998.

Exchange rates of the rand
Percentage change

	31 Dec 1998 to 30 Sep 1999	30 Sep 1999 to 30 Dec 1999	31 Dec 1998 to 30 Dec 1999	30 Dec 1999 to 31 Jan 2000
Weighted average*...........................	0,5	0,1	0,6	-0,8
Euro...	6,5	4,1	10,8	-0,1
US dollar	-2,7	-2,2	-4,7	-2,5
British pound....................................	-1,9	-0,4	-2,3	-2,8
Japanese yen...................................	-9,4	-5,5	-14,4	1,8

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

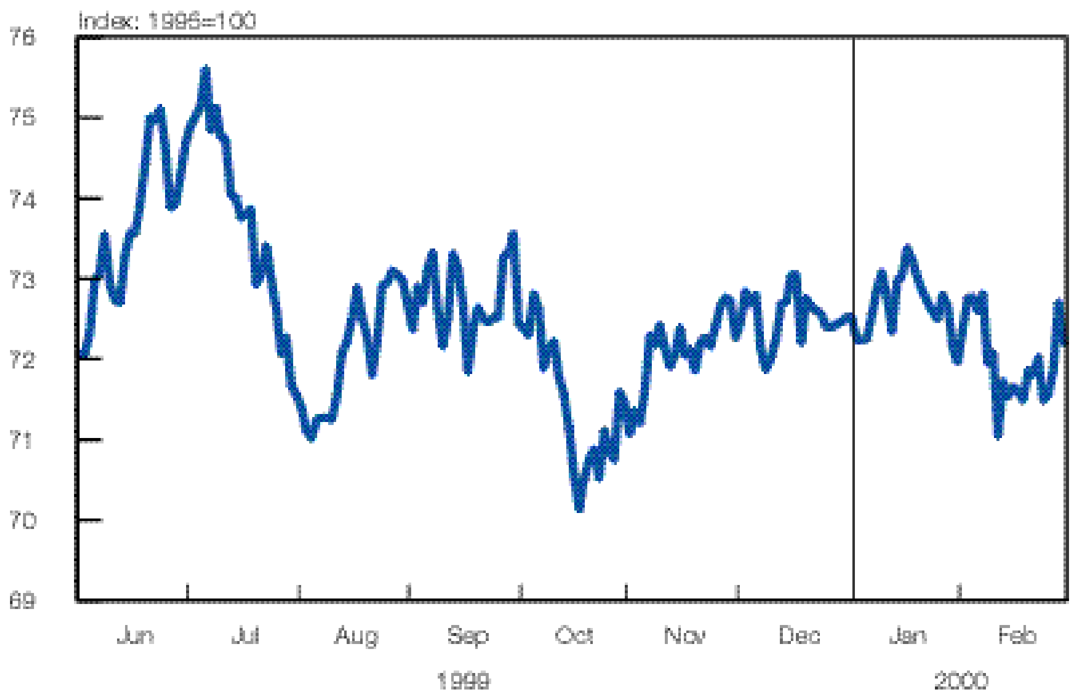
From the end of 1998 to the end of 1999, the external value of the rand appreciated by 10,8 per cent against the euro, but weakened against other major currencies, most notably by 14,4 per cent against the Japanese yen.

Short-term volatility in the exchange rate of the rand continued into 2000 as the nominal effective exchange rate of the rand initially increased by 1,2 per cent in the first half of January 2000 before declining again by 1,9 per cent in the second half of January. The narrowing of the interest rate differential between South Africa and its most important trading partners, as well as rumours about the possible outcome of South Africa's pending credit rating, contributed towards increased volatility in the domestic foreign exchange market in January. Much of the perceived volatility was due to the strength of the US dollar; the rand was far more stable against the basket of currencies than against the US dollar.

Owing mainly to the relatively stable conditions in the South African market for foreign exchange, the total net average daily turnover in the domestic market for foreign exchange declined from US$10,2 billion in the second quarter of 1999 to US$9,9 billion in the third quarter and US$8,3 billion in the fourth quarter.

The effective exchange rate of the rand, adjusted for the inflation differential between South Africa and its most important trading partners, increased by 2 per cent from December 1998 to August 1999. Preliminary estimates point to an increase of 2,9 per cent in the real effective rate of the rand by the end of 1999.

Nominal effective exchange rate of the rand



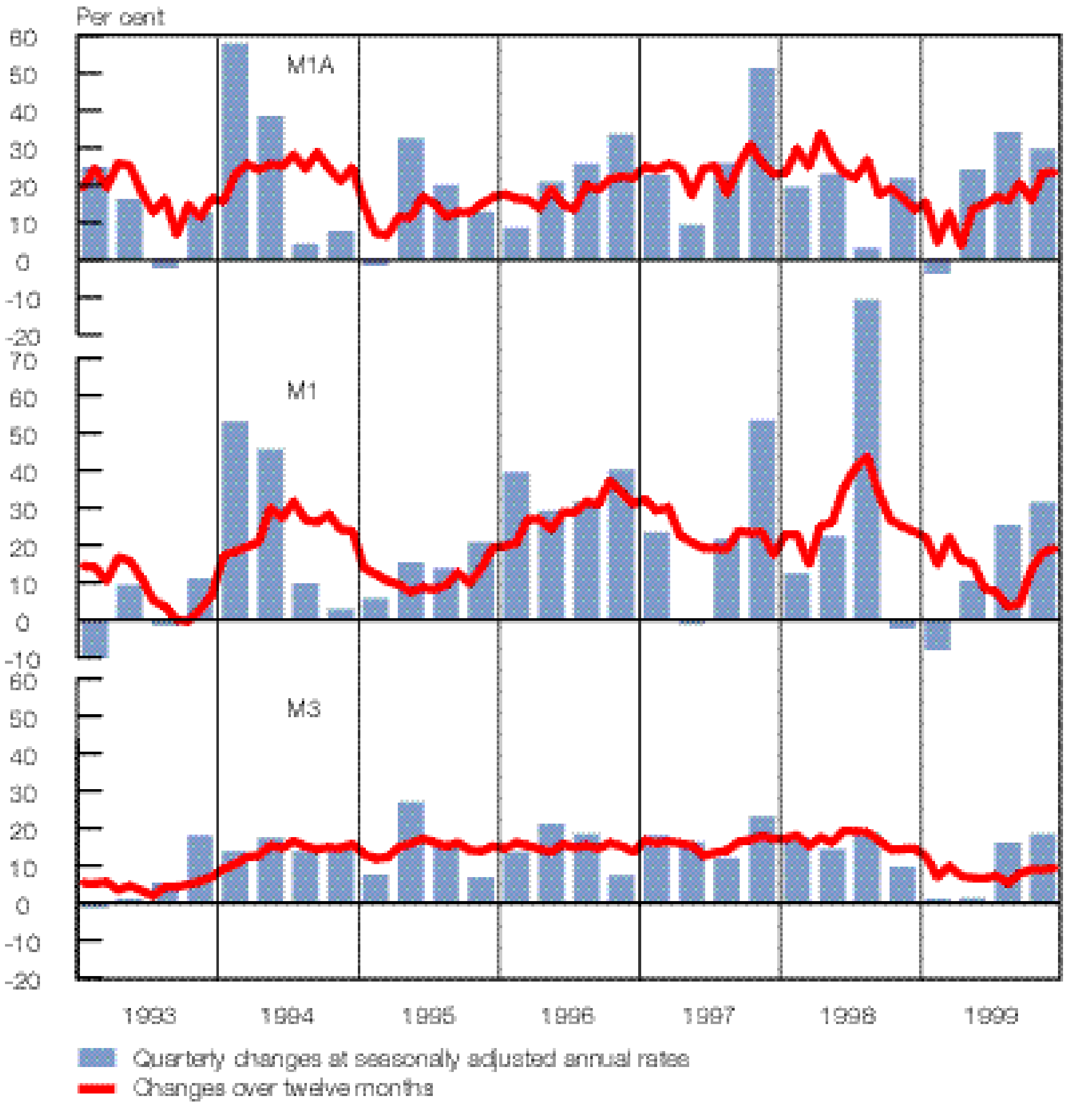
Monetary developments, interest rates and financial markets

Money supply

The growth in money supply accelerated strongly in the second half of 1999. The rate of increase over twelve-month periods in the broadly defined money supply (M3) increased from a low of 5,5 per cent in August 1999 to 9,3 per cent in December and 10,2 per cent in January 2000. On a quarterly basis, the quarter-to-quarter rate of increase in the average value of M3 (seasonally adjusted and annualised) picked up from around 1 per cent in the first and second quarters of 1999 to 16,2 per cent in the third quarter and 18,5 per cent in the fourth quarter.

The acceleration in money growth was primarily a reflection of the growing volume of activity in the domestic economy, leading to a greater demand for money for

Monetary aggregates



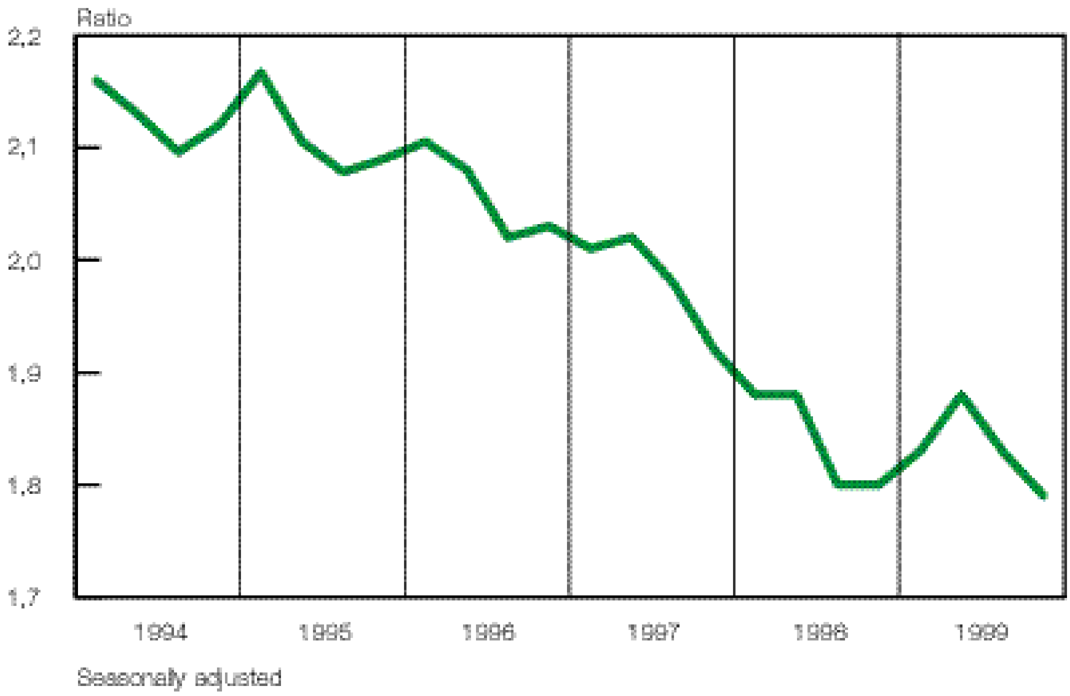
transactions purposes. At the same time, the continued buoyancy of the financial markets added to the demand for money for speculative purposes and for capitalising on sudden movements in asset prices. The demand for money was further strengthened by fairly attractive real interest rates on most types of bank deposits.

Growth in the *narrower monetary aggregates* was mostly higher than growth in M3 during the second half of 1999. The growth over twelve months in M1A accelerated from 14,7 per cent in June 1999 to 26,0 per cent in January 2000. M1 grew in the year to August 1999 at a rate of 3,6 per cent, but at 19,0 per cent in the year to December and 17,3 per cent in the year to January 2000.

Some of the recent rise in narrow money holdings was a reflection of households' and companies' increased preference for more liquid assets, partly influenced by concerns about possible date-related problems with computer systems at the beginning of 2000, as well as a spate of public holidays over the year-end. Growth in the narrow monetary aggregates may also signal future growth in real aggregate demand, which is consistent with projections of stronger output growth over the near term. In order to position themselves for higher spending, depositors – especially corporate depositors – could have transferred funds into cheque, transmission and other demand deposit accounts.

The growth rate of M3 reached annualised levels that were 12,4 percentage points higher than growth in the nominal gross domestic product in the third quarter of 1999 and 8,3 percentage points higher in the fourth quarter. The income velocity of circulation of M3 accordingly declined further from 1,83 in the third quarter of 1999 to 1,79 in the fourth quarter – its lowest level in the past twenty years. Income velocity typically declines during periods when existing off-balance-sheet items are converted to the balance sheets of banks.

Income velocity of M3

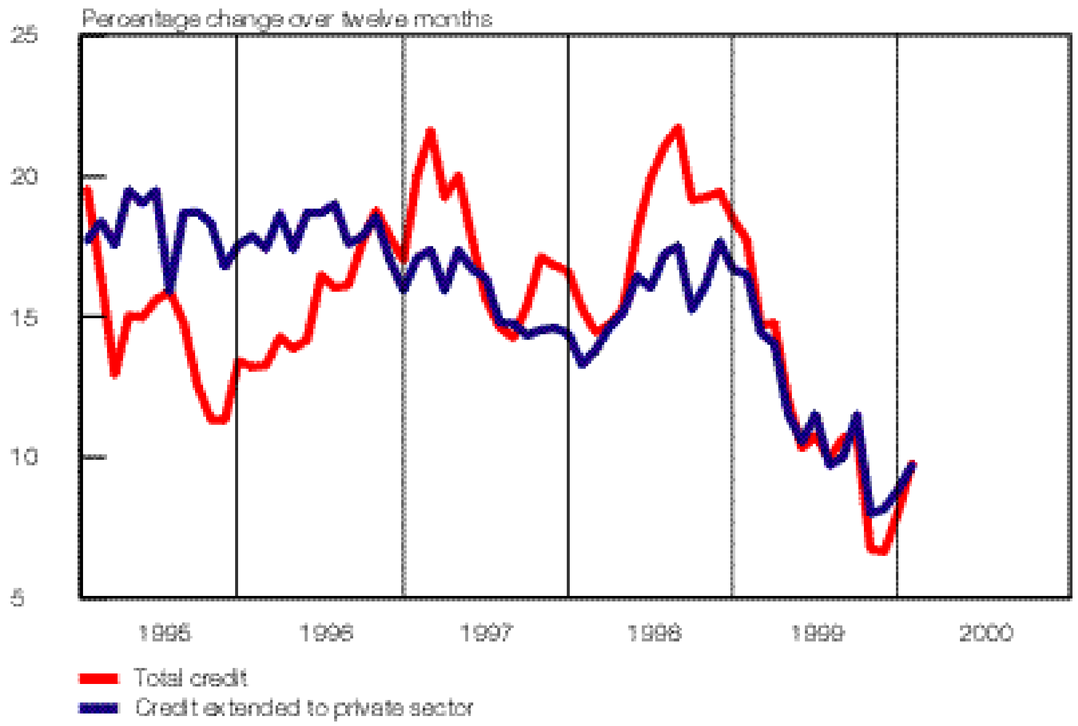


The main *counterparts* (from an accounting point of view) of the R17,7 billion increase in M3 during the fourth quarter of 1999 were increases of R16,2 billion in the monetary system's holdings of net foreign assets and R11,1 billion in the domestic monetary institutions' claims on the domestic private sector. In contrast to these positive contributions to money growth, the monetary institutions' net claims on the government sector decreased by R4,7 billion and their "net other assets" by R4,9 billion.

Credit extension by banks

The underlying growth in *total credit extended by banks* decelerated gradually over the first half of 1999 as private-sector credit demand slowed down along with the improvement in cash flows following the successive reductions in bank lending rates. Total credit growth over twelve months was still at 17,7 per cent in January 1999, partly the legacy of the spurt in credit demand during the emerging-market crisis around the middle of 1998. Credit growth over twelve months tapered off to 6,9 per cent in both October and November 1999 – the lowest growth rate since May 1993. Economic activity began to strengthen towards the end of 1999 and total credit growth accelerated to 8,4 per cent in the year to December and 9,8 per cent in the year to January 2000.

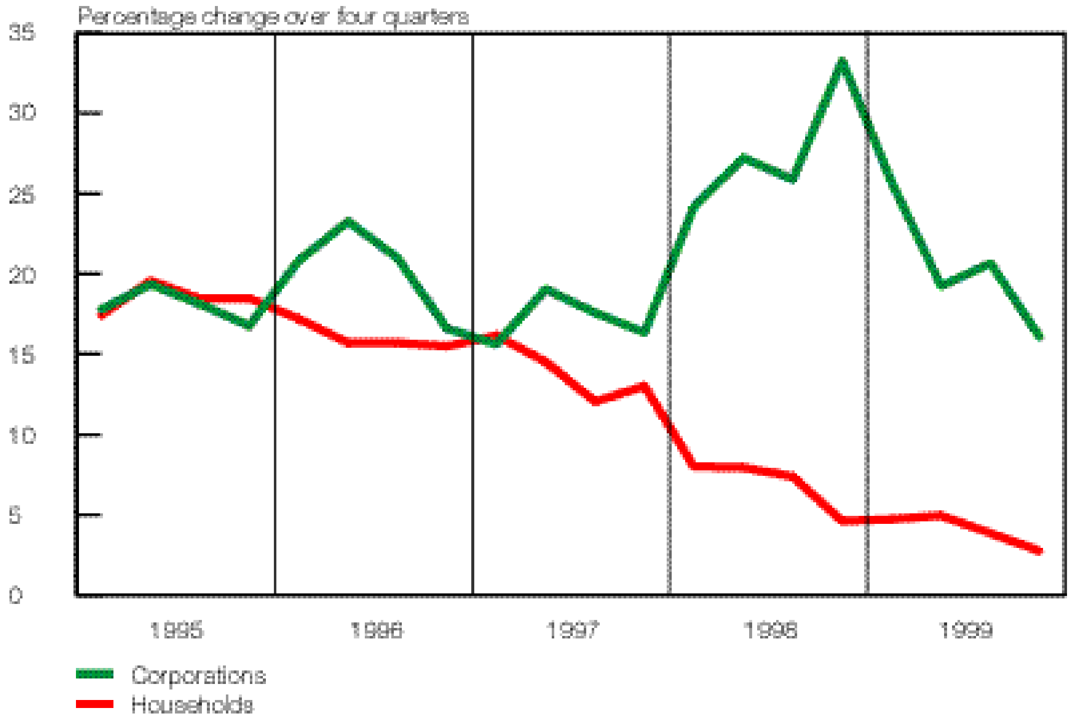
Credit extended by monetary institutions



The growth in *credit extended to the private sector* by banks slowed down too as stability returned to financial markets and cash flows strengthened. The twelve-month growth in credit extended to the private sector decelerated from its peak of 17,6 per cent in November 1998, reaching a six-year low of 8,1 per cent in October 1999. Private-sector credit growth subsequently firmed to 9,1 per cent in December 1999 and 9,7 per cent in January 2000. Measured from quarter to quarter (seasonally adjusted and annualised), the growth in credit extension to the private sector slowed down from 11,0 per cent in the third quarter of 1999 to 7,3 per cent in the fourth quarter. The actual increase in the seasonally adjusted value of bank credit extension to the private sector nevertheless rose from R9,7 billion in the third quarter of 1999 to R10,6 billion in the fourth quarter.

The general easing of growth in credit extension by banks during 1999 was largely related to lower demand for credit by households, reflecting the effect of high real interest rates in the second half of 1998. Households generally became less inclined to utilise consumer credit instruments to finance their purchases of consumer durables. At the same time, some banks also became less accommodating in extending credit to certain clients, as part of their credit risk assessment strategies. Bank credit to the corporate sector still grew appreciably during 1999.

Credit extended to households and corporations



An analysis of the banks' claims on the domestic private sector by *type of credit extension* revealed that the lower growth in credit extension during 1999 occurred mainly in the area of *mortgage advances*. The twelve-month rate of increase in mortgage advances sagged from 9,1 per cent in January 1999 to 3,8 per cent in October and November as activity dwindled in the real-estate market and the construction industry. Around the end of the year a recovery in the real-estate market helped to boost the twelve-month growth in banks' mortgage advances to 4,1 per cent in December 1999 and 4,0 per cent in January 2000.

Instalment sale credit and leasing finance also showed signs of stronger growth towards the end of 1999. Partly reflecting the weak demand for consumer durables, the growth over twelve months in instalment sales and leasing finance turned negative in July and August 1999 and fluctuated around an average rate of 0,4 per cent from September to November, but accelerated somewhat to 1,3 per cent in

December. In January 2000 the growth over one year in instalment sale credit and leasing finance fell back to 0,9 per cent. New business pay-outs of such credit rose from less than R9 billion in the first quarter of 1999 to R11,8 billion in the fourth quarter as purchases of durables firmed and business investment in machinery and equipment began to pick up.

The main thrust for growth in credit extension during 1999 was the *"other loans and advances"* extended by banks. Although well down from year-on-year growth of 31,4 per cent in January 1999, this credit category was still growing at a twelve-month rate of 16,6 per cent in December and 19,5 per cent in January 2000, exceeding all of the conventional measures of inflation by a substantial margin. Most of the increase during 1999 constituted credit extension to the corporate sector. The relative stability of the exchange rate of the rand and declining cost of credit encouraged the corporate sector to substitute domestic debt for foreign credit. Businesses also developed a strong demand for credit to replenish inventories that had fallen to exceptionally low levels by the end of the first quarter of 1999.

Credit extended to the private sector by type of credit
Percentage change over twelve months

	1999				2000
	Sep	Oct	Nov	Dec	Jan
Mortgage advances................	4,4	3,8	3,8	4,1	4,0
Instalment sale and leasing finance	0,5	0,3	0,5	1,3	0,9
Investments.............................	47,6	24,5	12,2	22,9	15,3
Bills discounted.......................	-19,3	-20,8	-28,2	-14,2	-27,7
Other loans and advances	22,1	15,2	17,2	16,6	19,5
Total...	**11,7**	**8,1**	**8,4**	**9,1**	**9,7**

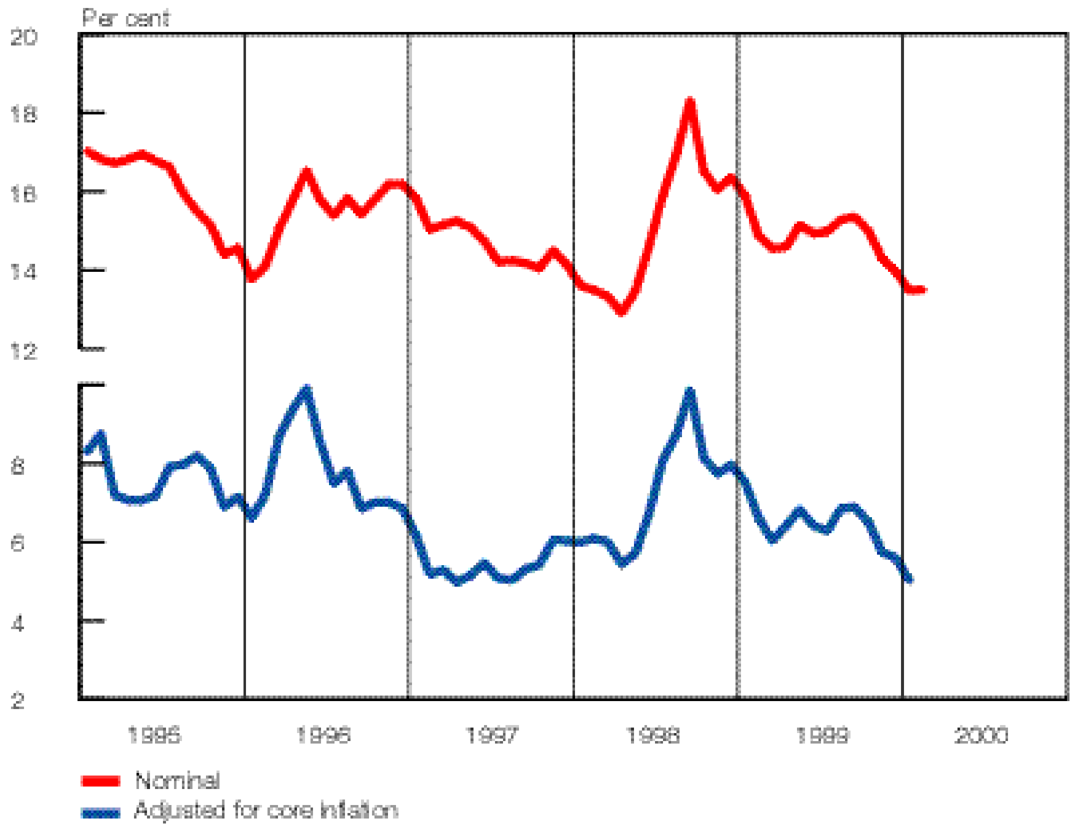
Interest rates and yields

Bond yields moved along a steady upward trend from March to September 1999, mainly driven by lingering concerns about financial stability in emerging markets generally and rising yields in the main financial centres of the world. Domestic market sentiment changed rather abruptly, and from about mid-September 1999 bond yields started to decline. A number of factors could have contributed to the fairly rapid decline in bond yields in the fourth quarter of 1999. These include

- the decline in the securities repurchase rate of the Reserve Bank and other short-term interest rates;
- fiscal consolidation as reflected by the shrinking public-sector borrowing requirement, and prospects for a reduced supply of public-sector securities in the domestic capital market;
- the relative strength of the rand;
- progress made with the reduction of the net oversold position in foreign currency of the Reserve Bank;
- the high level of the country's readiness for the millennium changeover;
- prominent foreign fund managers voicing their preference for South Africa as an investment destination; and
- expectations of a more favourable country rating by international credit rating agencies.

The bull market in bonds took the *monthly average yield on long-term government bonds* from 15,3 per cent in September 1999 to 13,5 per cent in February 2000, approaching the pre-crisis low of 12,9 per cent recorded in April 1998. Despite an occasional upward spike, the downward movement in rates progressed relatively smoothly. The *daily average yield on long-term government bonds* moved downwards from 15,58 per cent on 16 September 1999 to below the 15 per cent mark in October and dipped briefly below 14 per cent in November. After a brief upward correction in November 1999, bond yields resumed their downward trend and moved from 14,32 per cent on 30 November to 13,65 per cent at the end of December, taking the decline in bond yields from the beginning to the end of 1999 to almost 300 basis points.

Yield on long-term government bonds

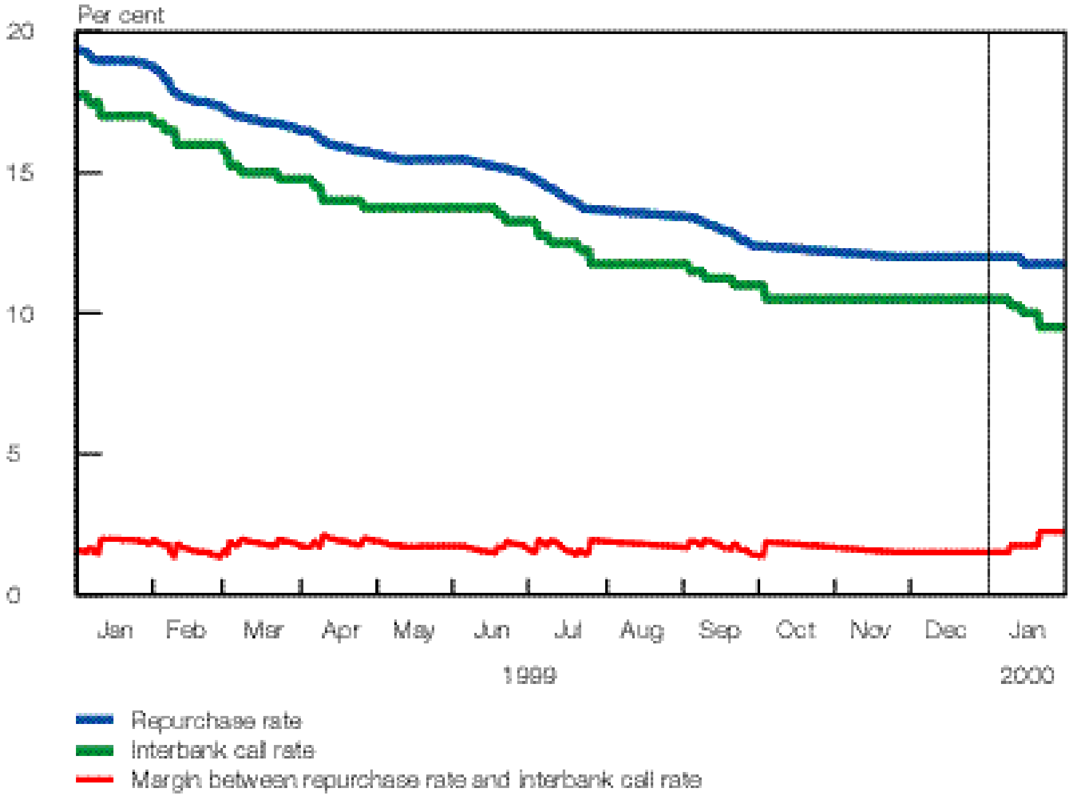


Some nervousness and profit taking in the international and domestic financial markets caused long-term yields to rise briefly in the first week of January 2000, but the bull market resumed soon afterwards and the yield on long-term government bonds declined to 13,12 per cent on 18 January 2000. In the ensuing period the heightened volatility in the exchange rate of the rand contributed to bond yields rising to 13,73 per cent at the end of January 2000 before receding to 13,68 per cent on 29 February.

Money market interest rates eased considerably during 1999. The pace of decline, however, slowed down from the fourth quarter of 1999. The *repurchase rate* of the Reserve Bank, which had been declining by one basis point a day from 30 September 1999, was fixed at 12,00 per cent on 25 November 1999 when the Monetary Policy Committee of the Reserve Bank suspended the variable-rate auction system. This was a temporary measure to allay fears of disruption in the money and securities markets at the turn of the millennium. Simultaneously with the decision to fix the repurchase rate, the *marginal lending rate* was lowered from 15 percentage points to 5 percentage points above the repurchase rate.

With the repurchase rate fixed over the year-end period, the money market rates displayed little variation. For instance, the tender rate on 91-day Treasury bills, which had declined from 10,93 per cent at the end of September 1999 to 10,70 per cent immediately before the meeting of the Monetary Policy Committee in November, remained within a narrow range of between 10,69 per cent and 10,71 per cent in the six weeks following the meeting. It was only on 7 January 2000, when expectations were rife that official interest rates would move down, that the tender rate on 91-day Treasury bills declined to 10,56 per cent. The publicly indicated *interbank call money rate,* after having stayed unchanged at 10,50 per cent from early October 1999, was also adjusted downwards to 10,25 per cent on 10 January 2000.

Money market interest rates



At the meeting of the Monetary Policy Committee held on 13 and 14 January 2000 it was decided that the repurchase rate of the Reserve Bank should be determined at the daily auction through the system of tendering in accordance with the agreed signalling procedures. The Committee concluded that a reduction of 25 basis points in the repurchase rate from 12,00 per cent to 11,75 per cent was appropriate and indicated that the daily liquidity requirement of the banks would be managed in a way which would ensure that the repurchase rate would remain at or around that level. This has resulted in the stabilisation of the repurchase rate at 11,75 per cent from 14 January 2000.

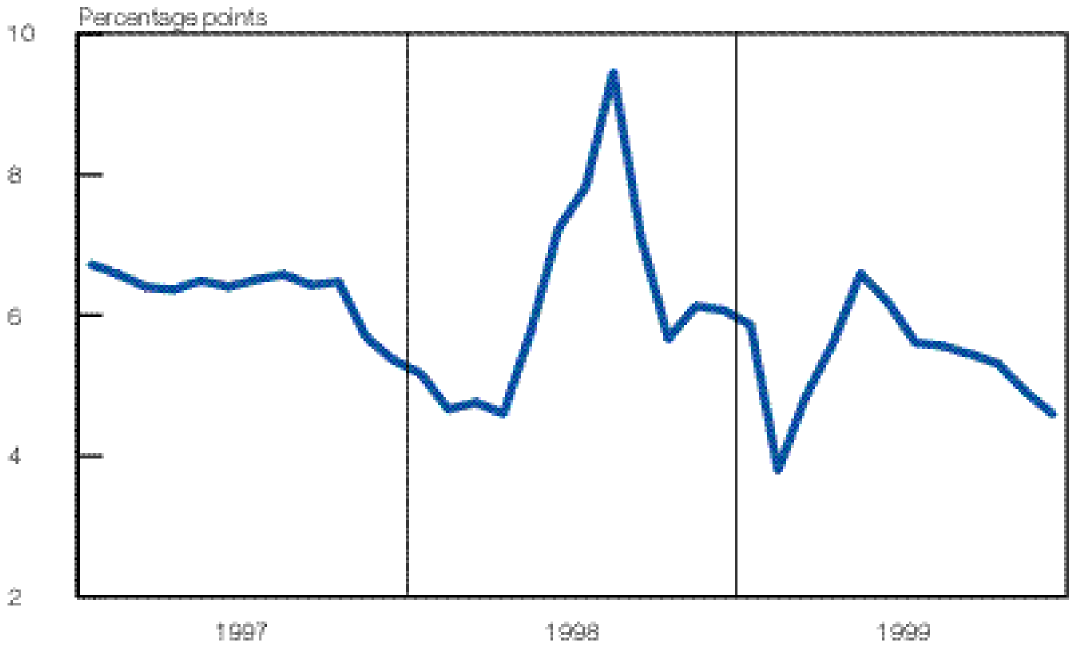
Following the resumption of the variable-rate auctions and the decline of 25 basis points in the repurchase rate on 14 January 2000, private banks lowered their *prime overdraft rates* by 100 basis points from 15,50 per cent to 14,50 per cent, effective on dates ranging from 19 to 26 January. The publicly disclosed interbank call money rate also moved down to 10 per cent on 14 January 2000 and 9,50 per cent on 21 January, restoring the margin of 5 percentage points between the prime overdraft rate and the interbank call money rate. Thus, the margin was restored to the one that had prevailed prior to 10 January 2000.

The changes in other money market rates were more in sympathy with the movement of 100 basis points in the prime overdraft rate in January 2000, than with the decline of 25 basis points in the Reserve Bank's repurchase rate. For example, the 91-day Treasury bill rate, which had stood at 10,71 per cent at the end of December 1999, declined to 9,78 per cent at the end of January 2000. Similarly, throughout November 1999 the rate on *bankers' acceptances* with a maturity of three months remained at 10,99 per cent, declining slightly to 10,93 per cent at the year-end. This rate then fell to single-digit levels from 21 January 2000, reaching a level of 9,84 per cent on 29 February 2000.

The *yield curve* drifted lower over its entire maturity spectrum from September 1999 and flattened somewhat as yields on bonds with long unexpired maturities declined more than yields on short-dated securities. The flattening of the yield curve during the fourth quarter was the result of rallies at the longer end of the maturity spectrum. These movements followed the sharp reduction in short-term interest rates earlier in the year, which apparently had no adverse effects on inflation expectations. The yield curve steepened briefly when short-term interest rates responded to the decline in the repurchase rate of the Reserve Bank, but flattened somewhat when long-term yields resumed their downward movement.

The general downward movement of long-term yields signalled a relatively sanguine outlook for inflation over the longer term. The currency risk premiums (measured as the difference between the nominal yield on government bonds with an outstanding maturity of five years in the domestic market and in the United States market) built into the prices of South African bonds also declined. Inflation expectations according to this measure were, on average, slightly lower in the last half of 1999 than the pre-crisis level in the first half of 1998.

Currency premium on government bonds

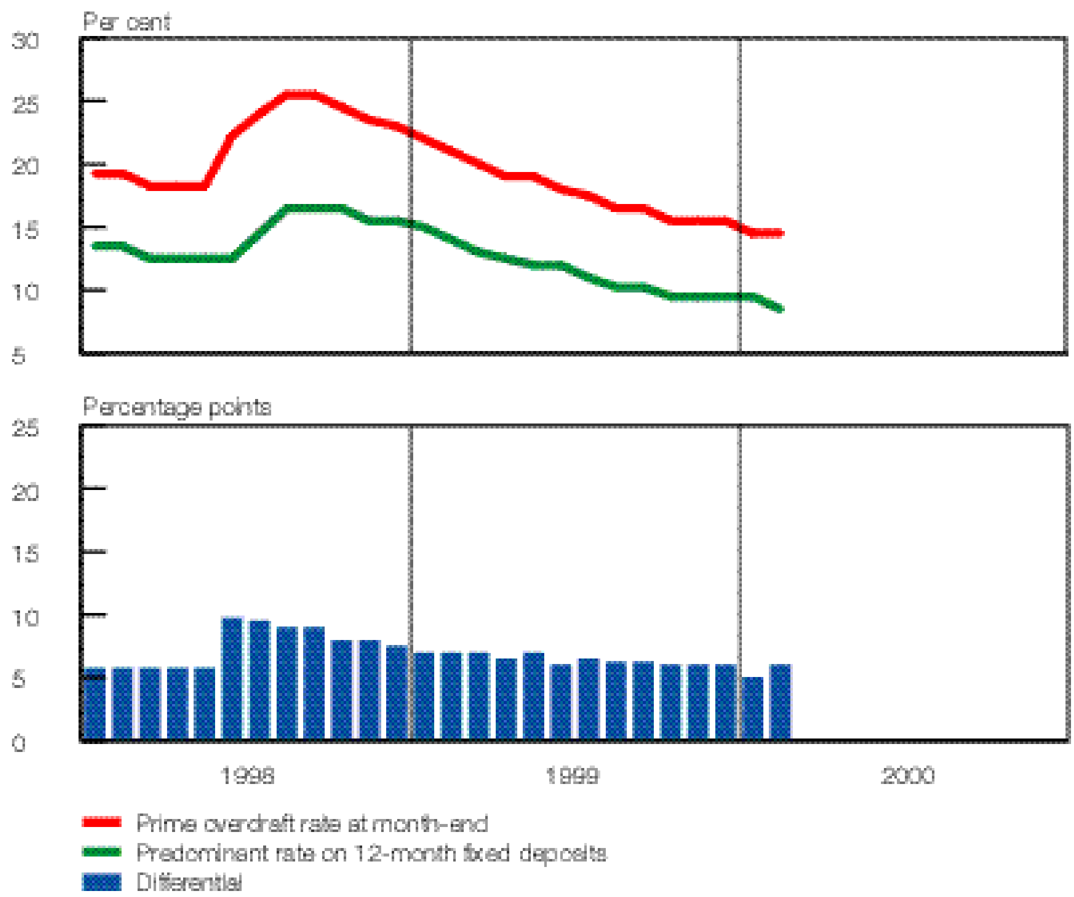


The *inflation-adjusted yield* on long-term government bonds declined from 6,9 per cent in September 1999 to 5,0 per cent in January 2000 when core inflation is used to measure the rise in the general level of prices. The *real bond yield* receded to a level last recorded in August 1997 while the real prime overdraft rate declined even more substantially to levels last observed in 1994.

The private banks kept the *predominant rate on mortgage loans* unchanged at 15,5 per cent from October 1999 to January 2000. With the resumption of the variable-rate auction for central bank funds on 14 January, the banks announced a reduction of 100 basis points in the mortgage loan rate to 14,5 per cent from February 2000.

The changes in the *predominant rate on twelve-month fixed deposits* with banks displayed a pattern broadly similar to that of mortgage rates. The twelve-month deposit rate remained broadly unchanged at 9,5 per cent from October 1999 to January 2000, before dropping to 8,5 per cent in February 2000. The difference between this deposit rate and the month-end prime overdraft rate narrowed from 600 basis points in October 1999 to 500 basis points in January 2000, i.e. to a level that was lower than the pre-crisis differential of 575 basis points in the first five months of 1998. In February 2000 the differential widened to 600 basis points.

Lending and deposit rates



Money market

Relatively easy money market conditions during the early months of 1999 made way for a considerable tightening of liquidity conditions from May to August, but in the last four months of 1999 the Reserve Bank deliberately eased conditions in order to allay fears of a severely tight market situation at the end of that year. The average daily liquidity requirement of the banks consequently decreased from R13,5 billion in August 1999 to a low of R4,9 billion in December.

The Reserve Bank's actions in adding liquidity to the money market in the fourth quarter of 1999 consisted, first and foremost, of working down the special foreign exchange intervention swaps with major banking institutions. These measures were essentially the reversal of the earlier steps for draining liquidity from the money market by means of appropriately structured foreign currency swaps. The result was that the value of the outstanding special swap transactions declined from R12,0 billion at the end of July 1999 to R4,3 billion at the end of December.

Other measures taken by the Reserve Bank to inject liquidity into the market during the fourth quarter of 1999 included a reduction in the amount of its own outstanding debentures from R4,96 billion at the end of September 1999 to R1,0 billion at the end of December. The Bank also refrained from rolling over all of its reverse repurchase transactions in government securities with private-sector parties. Outstanding reverse repurchase transactions accordingly fell from R2,0 billion at the end of October 1999 to R1,0 billion at the end of December.

The Reserve Bank's liquidity injection operations were further augmented by an increase of R5,1 billion in its net foreign assets in the fourth quarter of 1999 when non-resident investors were aggressively buying South African shares and government bonds. The easing of these factors was neutralised to some extent by a sharp increase in the value of notes and coin in circulation outside the Reserve Bank, which rose by an unseasonally high R6,3 billion during November and December 1999. Furthermore, surpluses arising from the Reserve Bank's involvement in forward foreign exchange transactions drained some liquidity from the money market in the last six months of 1999. The Bank provided liquidity to the full extent of the private banks' needs throughout the last four months of 1999, except on 7 September when more liquidity than the required amount was provided as a signal that the decline in the repurchase rate should be accelerated.

After the year-end and the smooth transition to the new millennium, the Reserve Bank once more began to raise the private banks' reserve dependency on central bank funding. The Bank entered into special foreign exchange intervention swaps with banks to drain liquidity from the market and also increased the amount of reverse repurchase transactions with private-sector parties from R1 billion to R2 billion. These liquidity-draining operations were partly counteracted by a net reduction in the amount of notes and coin in circulation outside the Reserve Bank and by an increase by the Bank in its holdings of net foreign assets. Despite these liquidity injections, the daily liquidity requirement rose to an average value of R5,7 billion in January 2000.

The liquidity-draining operations of the Reserve Bank were given further impetus when the Bank increased the weekly issuance of its own debentures from R250 million to R500 million on 9 February 2000.

Bond market

Concerted efforts to put public finances on a sound footing paid off further in the first three quarters of fiscal 1999/2000 when the public-sector borrowing requirement declined decisively. Total *net issues of fixed-interest securities* in the domestic primary bond market accordingly declined from R5,3 billion in the second quarter of 1999 to R3,1 billion in the third quarter, followed by the net retirement of public-sector debt to the value of R5,2 billion in the fourth quarter. In the nine months from April to December 1999, total net issues of fixed-interest securities amounted to R3,2 billion – well below the net amount of R7,3 billion issued in the corresponding period of 1998.

The improved sentiment of international investors towards emerging markets allowed public-sector borrowers to access the *international primary bond markets.* Public-sector borrowers raised R9,5 billion through *foreign-currency denominated bonds issued* from April to December 1999 – national government raised R8,2 billion and public corporations R1,3 billion. They refrained, however, from issuing any *rand-denominated bonds* in the euro market.

The decline in bank lending rates and in short-term interest rates generally stifled the demand for bond financing by private-sector companies and no *rights issues of preference shares and debentures* were made from January 1999 to January 2000 by companies listed on the Johannesburg Stock Exchange. The *nominal value of listed fixed-interest securities* of private-sector companies on the Bond Exchange of South Africa increased by a net amount of R1 billion in 1999.

Trading activity on the Bond Exchange of South Africa was boosted by price volatility in the market. Turnover in the *secondary bond market* increased from an already high R8,5 trillion in 1998 to an annual turnover of R8,8 trillion in 1999. The quarterly value of bonds traded increased from R1,7 trillion in the fourth quarter of 1998 to R2,5 trillion in the third quarter of 1999, but then receded to R2,2 trillion in the fourth quarter. With the subsequent heightened volatility in bond yields, turnover increased to an estimated quarterly rate of R2,7 trillion in January and February 2000.

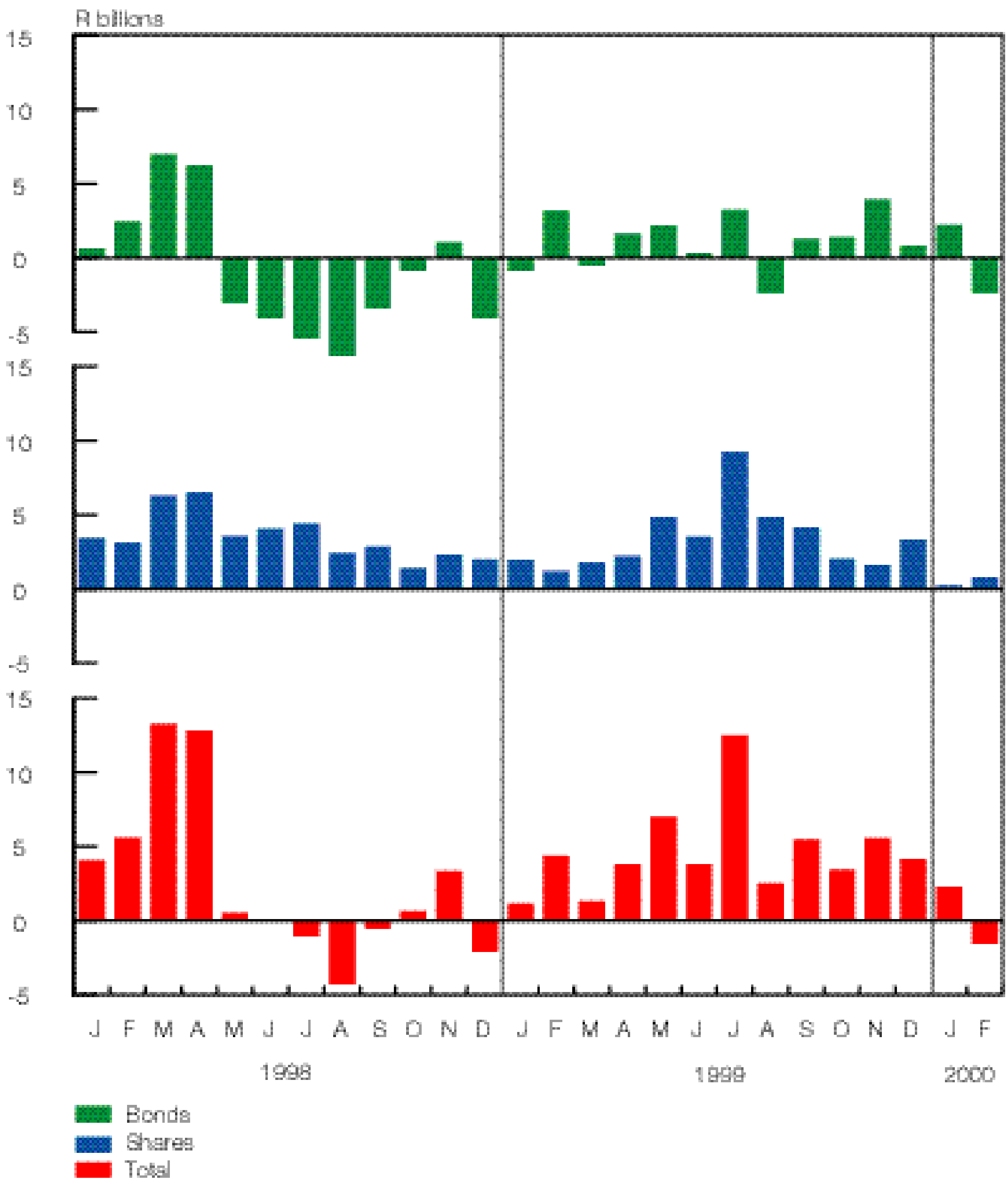
Foreign participation did not keep pace with the level of turnover in the domestic secondary bond market in 1999: the *gross* transactions value of non-residents' purchases and sales as a percentage of total purchases and sales declined from 16,2 per cent in 1998 to 12,7 per cent in 1999. On a *net* basis, non-residents bought bonds to the value of R14,3 billion in 1999 as a whole. The quarterly value of net purchases of bonds by non-resident investors fell back somewhat from R4,1 billion in the second quarter of 1999 to R2,2 billion in the third quarter. However, as millennium concerns about emerging markets abated, non-residents acquired bonds to the value of R3,9 billion in November. The total increase in non-residents' holdings of bonds in the fourth quarter amounted to R6,1 billion. In 2000 to the end of February, non-resident holdings of South African debt securities have decreased by a small amount of R35 million.

Share market

The total value of capital raised in the *primary share market* by companies listed on the Johannesburg Stock Exchange fell by more than 55 per cent from a record amount of R88 billion in 1998 to R39 billion in 1999. New listings declined from 101 in 1998 to 74 in 1999. The quarterly value of capital raised declined from R14,8 billion in the second quarter of 1999 to R9,2 billion in the third quarter and R7,3 billion in the fourth quarter. This decline also reflected uncertainties about the sustainability of the current upturn in economic activity. Subsequently, the value of capital raised decreased further from a monthly average of R2,4 billion in the fourth quarter of 1999 to R1,9 billion in January 2000.

The strong recovery in share prices throughout 1999 boosted trading activity in the *secondary share market.* The value of shares traded on the Johannesburg Stock Exchange rose to R448 billion in 1999 which was 40 per cent more than in 1998. The quarterly value of shares traded receded somewhat from R128 billion in the third quarter of 1999 to R119 billion in the fourth quarter, but volatility in share prices fuelled trading activity in the first two months of 2000. The value of shares traded increased from a monthly average of R39,5 billion in the fourth quarter of 1999 to R49 billion in January and R50 billion in February 2000.

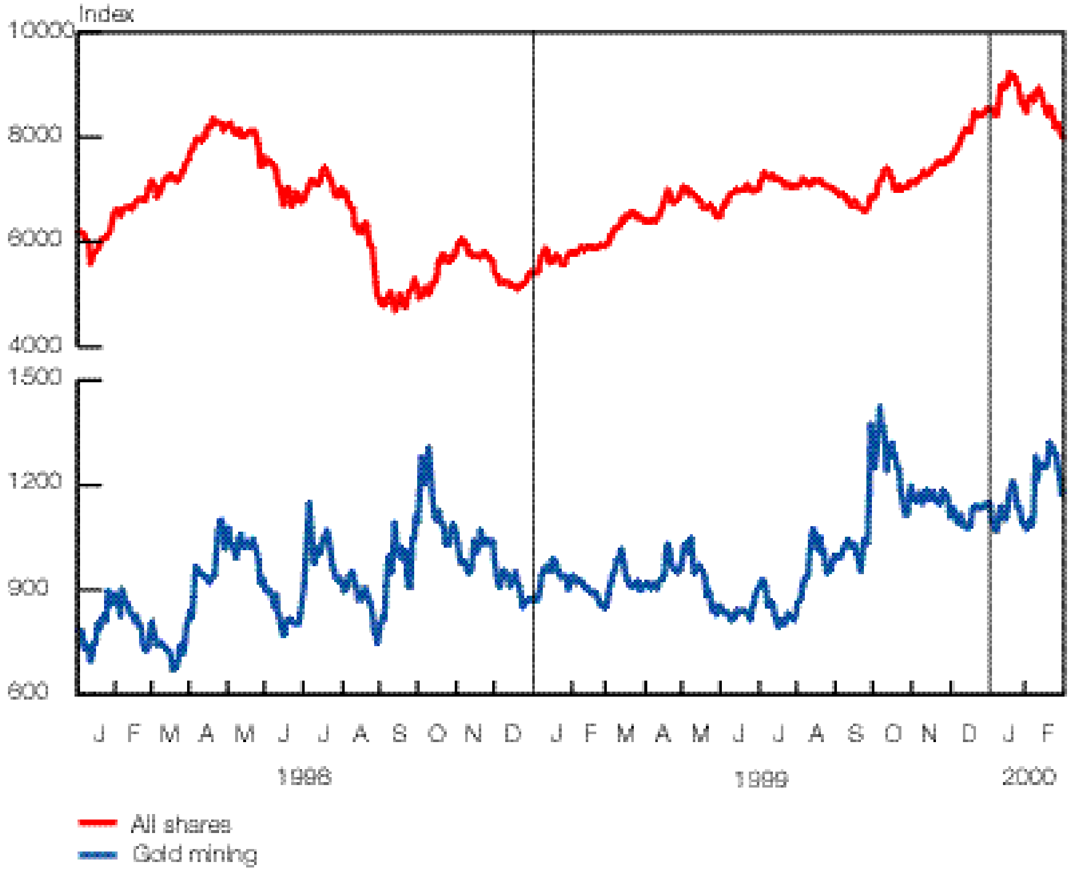
Non-residents' net transactions in the secondary capital markets



The decline in *non-residents'* net acquisitions of shares on the Johannesburg Stock Exchange in the months from August to November 1999, reflected foreign investor nervousness ahead of the millennium changeover. The value of net purchases of shares by non-residents fell back from a quarterly high of R18,2 billion in the third quarter of 1999 to R6,9 billion in the fourth quarter. On a net basis, non-residents increased their holdings of South African listed shares by R40,6 billion in 1999, slightly less than the annual record of R42,3 billion set in 1998. The value of non-resident investors' purchases and sales also broadly kept pace with the growth in total turnover on the Johannesburg Stock Exchange and maintained an average level of 27 per cent in 1999. Non-residents' net purchases of listed shares dwindled to R93 million in January 2000 and R772 million in February when the strong rally in share prices over the year-end lost some momentum.

Along with share price movements in the major international financial centres, the *monthly average price level of all classes of shares* on the Johannesburg Stock Exchange increased, on balance, by 73 per cent from September 1998 to February 2000. Converted into dollars, share prices rose by 69 per cent. The largest monthly increase during this period was recorded in December 1999 when share prices rose by just more than 10 per cent. More than half of the overall gains since September 1998 have occurred from September 1999 to January 2000.

Share price movements



The *daily* all-share price index increased strongly from 22 September 1999 and reached a new all-time high on 20 December 1999. The share market hesitated somewhat in the first days of January 2000 but then rallied to a new record level on 17 January 2000. In the ensuing period, share prices fell back by 13 per cent to the end of February 2000.

The strong gains in the overall index were motivated by the improvement in domestic economic activity and prospects for higher corporate earnings. The increase in the overall index was driven by the *financial sector* which gained from lower interest rates and consequent higher volumes of transactions, the *resources sector* which gained from rising commodity prices and the *industrial sector* which benefited from the improvement in overall economic conditions.

The prices of gold-mining shares fluctuated widely in the second half of 1999. The increase of almost 50 per cent in the *monthly average price level of gold-mining shares* from July 1999 to October was, by and large, based on an increase of almost $73 in the daily average price of gold per fine ounce. When the dollar price of gold fell, the average monthly value of the price index of gold-mining shares declined by 11,2 per cent from October 1999 to December. In January and February 2000 the average price level of gold-mining shares increased by 10 per cent.

The strong increase in share prices led to a decrease in the *monthly average dividend yield* on all classes of shares from 3,5 per cent in September 1998 to 1,9 per cent in January 2000 – i.e. slightly lower than the pre-crisis level in 1998. The *monthly average earnings yield* on all classes of shares, excluding gold-mining shares, declined from 10,2 per cent in September 1998 to 6,1 per cent in January 2000. The *price-earnings ratio* of all classes of shares, apart from gold shares, mirrored the movement in the earnings yield, and rose sharply from 9,8 in September 1998 to 16,4 in January 2000. The ratio in January 2000 was almost equal to the pre-crisis upper turning point of 16,9 in May 1998.

Market for derivatives

Price movements in securities spurred heightened activity in the formal derivatives market. Interaction between trading strategies in futures and options contracts and transactions in underlying securities, together with non-resident participation, further supported derivatives trading.

The combined number of *futures and options on futures contracts* traded on the South African Futures Exchange – almost exclusively *equity index contracts* – rose by 16 per cent from 16,1 million in 1998 to 18,7 million in 1999. The quarterly number of these contracts traded decreased from an all-time high of 5,7 million in the second quarter of 1999 to a still very high level of 4,3 million in the fourth quarter. The number of contracts traded increased somewhat from a monthly average of 1,4 million in the fourth quarter to 1,5 million in January 2000 and 1,7 million in February.

Trading in *commodity futures contracts and options* on such contracts on the South African Futures Exchange, mainly *maize contracts*, was lively in 1999 and more than trebled to 249 900 contracts. The increase in volume resulted from the introduction of more regular monthly contracts and broader participation in the market. This reflected greater understanding of the management of agricultural price risk. The quarterly number of contracts traded recorded an all-time high of 81 400 in the fourth quarter of 1999. Trading decreased from a monthly average of 27 100 contracts in the fourth quarter of 1999 to 24 000 contracts in January 2000.

The number of trades conducted in *warrants* on the Johannesburg Stock Exchange, mostly warrants on *individual listed shares*, more than doubled from 1,2 billion in 1998 to 2,8 billion in 1999. The market for warrants reached a quarterly all-time high of 1,5 billion trades in the fourth quarter of 1999 as participants became more familiar with this derivative instrument, and the underlying shares recorded impressive price increases. Trading increased further from a monthly average of 509 million trades in the fourth quarter of 1999 to 769 million trades in January 2000. The first warrant on bonds was introduced in October 1999; 3,4 million trades in these warrants were concluded before the end of 1999.

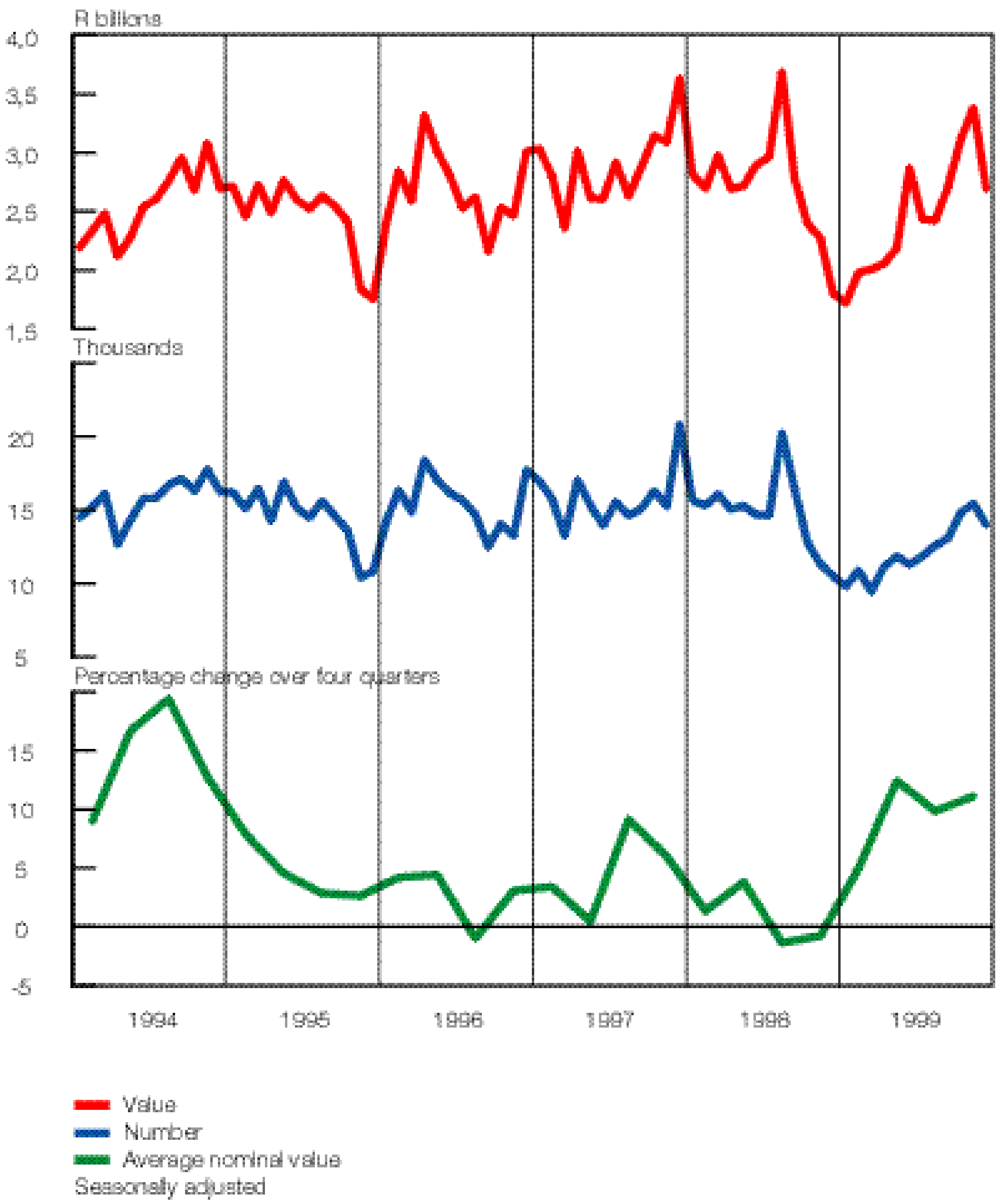
Real-estate market

Activity in the *real-estate market* bounced back from its depressed levels in late 1998 and early 1999 and has returned to higher levels in recent months as the reduction in mortgage bond rates found a response in rising turnovers.

The *value* of real-estate transactions increased from a low of R5,7 billion in the first quarter of 1999 – its lowest level since 1995 – to R9,2 billion in the fourth quarter. Real-estate transactions to the value of R3,4 billion were recorded in November, the highest monthly value since August 1998. The total value of transactions in 1999 was, however, still 9,5 per cent below that of 1998.

Despite the strong increase in the *number* of real-estate transactions from April 1999, the total number of such transactions in 1999 was still 17,9 per cent less than in 1998. The *average nominal value per real-estate transaction* increased by 9,6 per cent in 1999 relative to its level in 1998.

Real-estate transactions

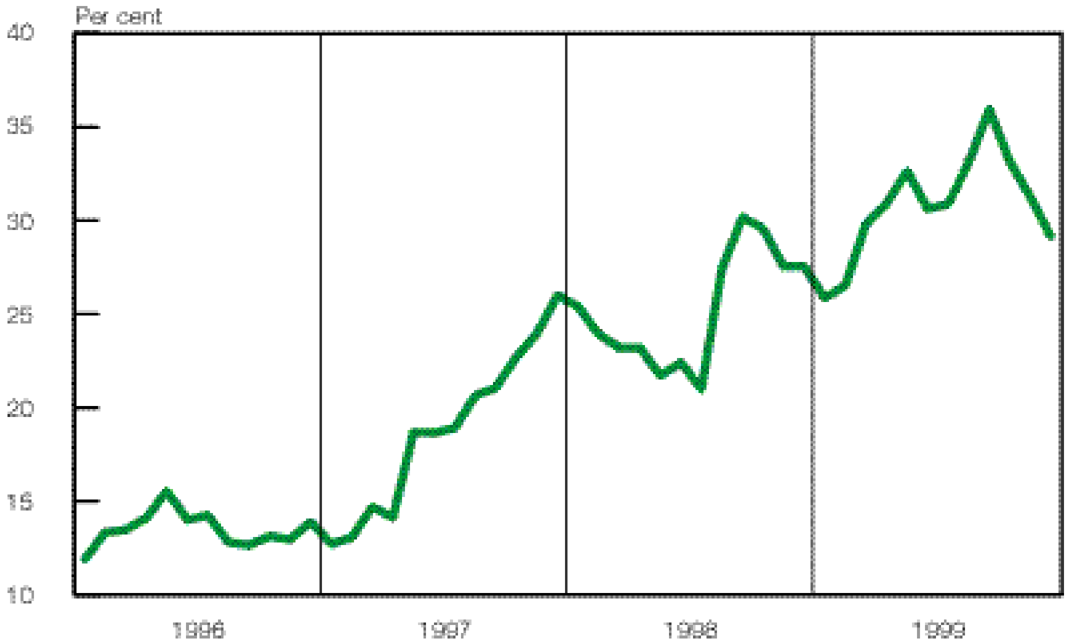


Non-bank financial intermediaries

Share price movements and changes in the overall level of interest rates and yields in 1998 and 1999 led to significant asset revaluations, shifts between asset classes and volatile net portfolio investment flows among non-bank financial intermediaries.

In the South African *unit trust industry*, for example, *asset revaluation* had a significant impact on balance sheet values during 1998 and 1999. The *market value of the net assets* of unit trusts (excluding those classified as "fund of funds") decreased from R85,2 billion in April 1998 to R61,7 billion in August 1998, causing the market value to decline below the corresponding book value. The market value of net assets once again exceeded the book value from October 1998 and increased markedly to R108 billion in December 1999.

Unit trusts: Cash and deposits as a percentage of net assets



Uncertainty in the financial markets led to a *shift in portfolio allocation* in favour of money market instruments. The decline in holdings of ordinary shares, at market value, was almost exactly mirrored by an increase in cash and deposits. The value of net assets of money market funds as a percentage of the market value of net assets of all unit trusts increased from 11 per cent in April 1998 to 24 per cent in December 1999.

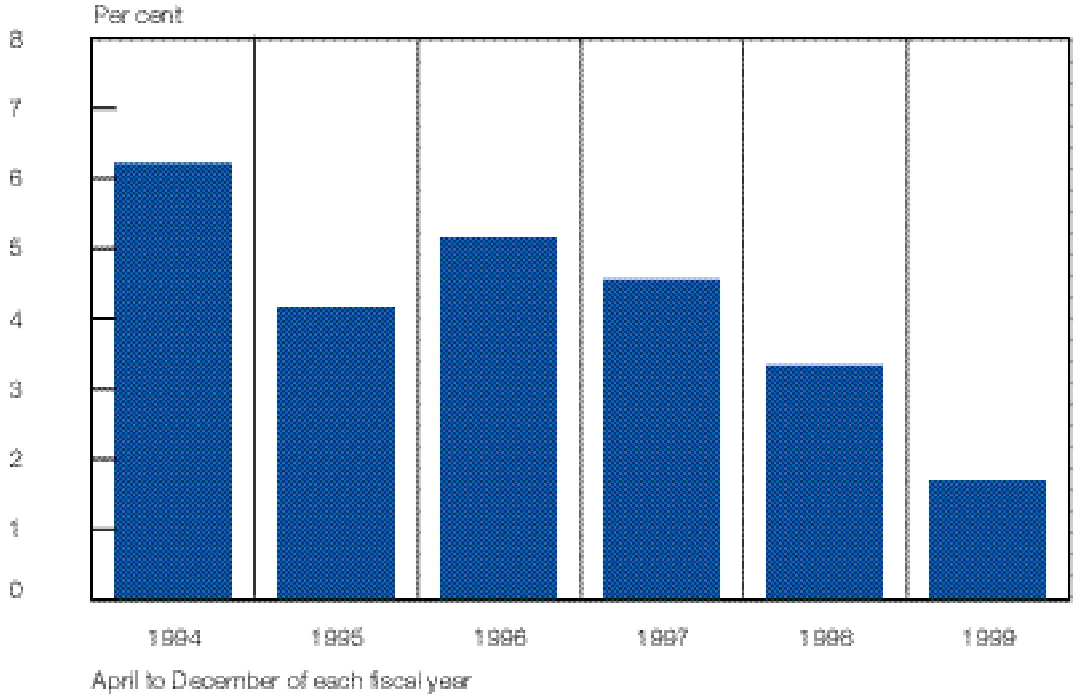
Asset price volatility and uncertainty also caused fluctuations in the *net acquisition of units in unit trusts.* The more cautious stance by investors led to a decline in the net sales of units by unit trusts from R4,9 billion in the first quarter of 1998 to R2,8 billion in the third quarter of 1998. However, as the general upward trend in asset prices gathered momentum, net sales of units increased to R27,7 billion in 1999 compared with R17,1 billion in 1998.

Public finance

Public-sector borrowing requirement

The financial activities of the *public sector* (i.e. the consolidated central government, provincial governments, local authorities and non-financial public enterprises and corporations), ended in a *surplus* of R7,6 billion in the October to December quarter of fiscal 1999/2000 – the first such surplus since quarterly estimates of the public-sector borrowing requirement were introduced in 1991. This reduced the public-sector borrowing requirement for the first nine months of fiscal 1999/2000 to R10,3 billion compared with R18,9 billion in the corresponding period of the previous fiscal year. As a ratio of gross domestic product, the public-sector borrowing requirement declined from 3,3 per cent in the first nine months of fiscal 1998/99 to 1,7 per cent in the first nine months of fiscal 1999/2000.

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



The improvement in the accounts of the public sector in the first nine months of fiscal 1999/2000 was caused by a reduction in the borrowing needs of the *non-financial public enterprises and corporations,* and of *general government.* The financial results of the non-financial public enterprises and corporations indicated a deficit of R1,5 billion in the first nine months of fiscal 1999/2000 compared with a deficit of R5,0 billion in the corresponding period of the previous fiscal year. The financial activities of *general government* resulted in a *surplus* of R8,0 billion in the October to December quarter of fiscal 1999/2000. The general government's borrowing requirement for the first nine months of the current fiscal year totalled R8,7 billion which was 37,0 per cent lower than its borrowing requirement in the corresponding period of the previous fiscal year.

The *consolidated central government* recorded a *surplus* of R7,2 billion in the October to December quarter of fiscal 1999/2000. There was a surplus of only R1,4 billion in the corresponding period of the previous fiscal year. The deficit on the accounts of the consolidated central government was R9,4 billion in the first nine months of fiscal 1999/2000 – 42,9 per cent lower than a year earlier. Better financial management, along with the proceeds derived from the restructuring of public assets, contributed most to the healthier financial position of government. Restructuring proceeds in the first nine months of fiscal 1999/2000 amounted to R4,5 billion, of which the restructuring of Sasria contributed R4,4 billion. The financial position of the social security funds and the extra-budgetary accounts also improved in the first nine months of fiscal 1999/2000.

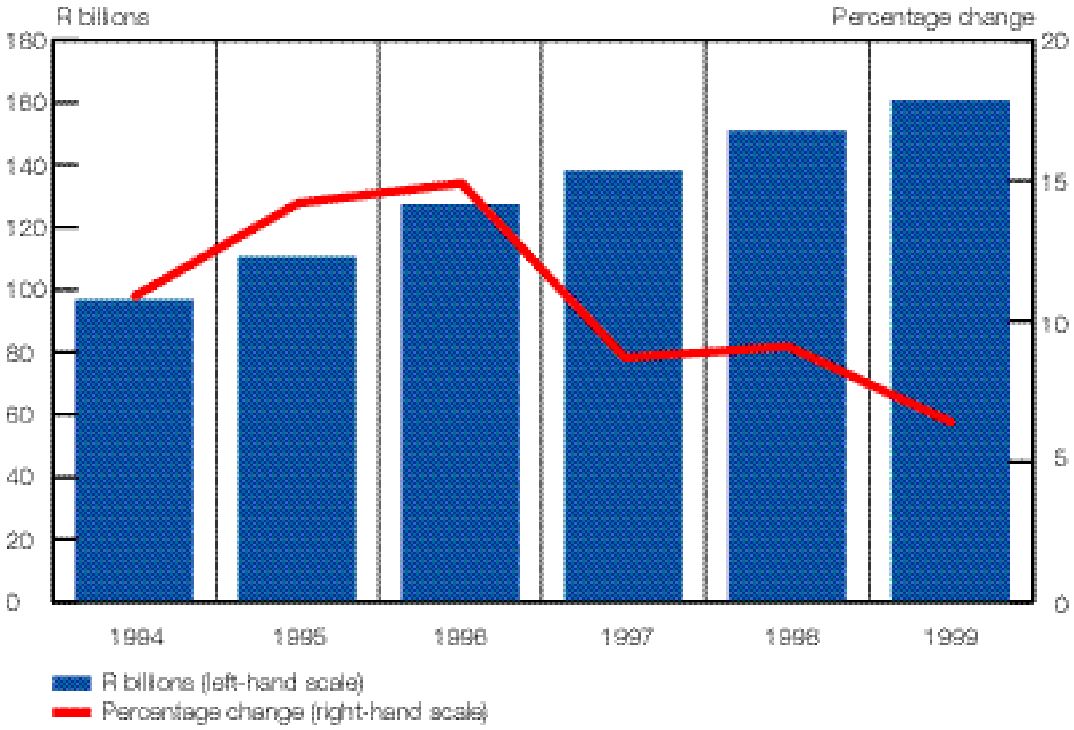
The consolidated balance of *provincial governments* improved from a surplus of R0,6 billion in the October to December quarter of fiscal 1998/99 to a surplus of R1,0 billion in the corresponding quarter of fiscal 1999/2000. This brought the fiscal balances of the provincial governments for the first nine months of fiscal 1999/2000 to a surplus of R1,0 billion, well down from the surplus of R3,3 billion in the corresponding period of the previous fiscal year. The main reason for the smaller surplus was a reduction in transfers from national government to provincial governments. The provincial governments' deposits with private banks increased from R2,7 billion at the end of March 1999 to R4,3 billion at the end of December 1999 and their combined indebtedness to commercial banks increased from R0,9 billion to R1,5 billion over the same period.

National government finance

National government expenditure amounted to R50,5 billion in the October to December quarter of fiscal 1999/2000, bringing this expenditure in the first nine months of fiscal 1999/2000 to R160,5 billion or 74,0 per cent of the budgeted expenditure for the year as a whole. The year-on-year rate of increase in government expenditure was 6,4 per cent in the first nine months of fiscal 1999/2000, slightly ahead of the budgeted rate of increase of 5,9 per cent for the fiscal year as a whole. National government expenditure increased at a lower rate in the current fiscal year than in the corresponding period of the previous fiscal year when it rose by 9,1 per cent, and was also lower than the average year-on-year rate of increase of 11,6 per cent in the first nine months of the preceding five fiscal years.

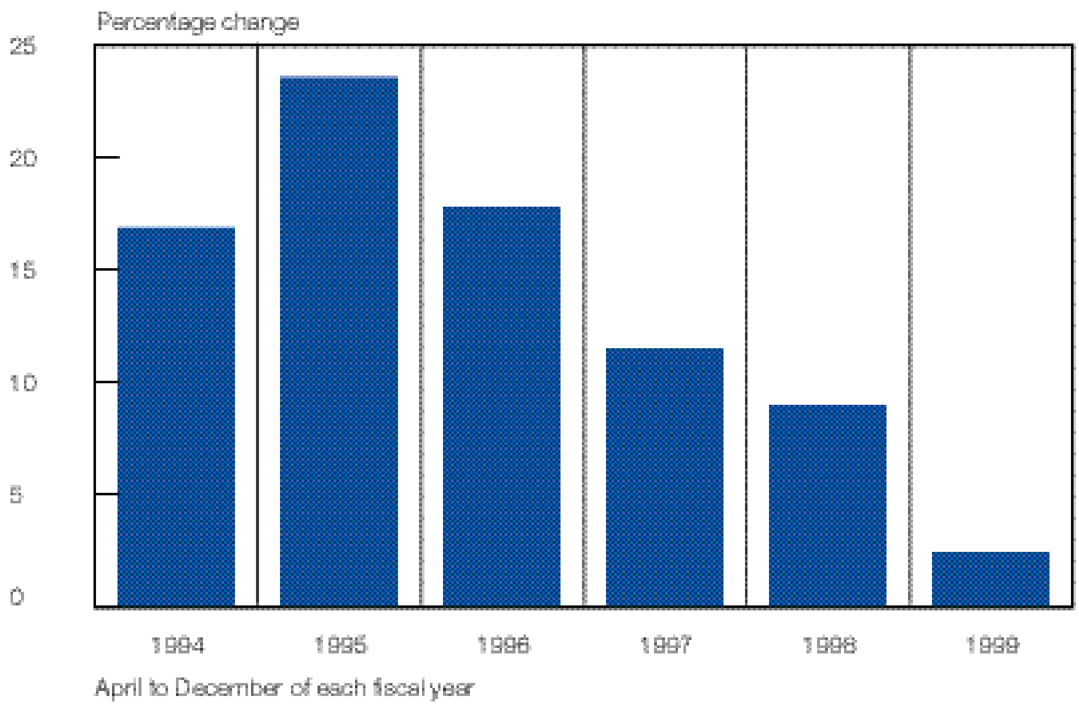
Included in the expenditure total for the current fiscal year is an amount of R2,0 billion which arose from the revaluation at the contemporaneous exchange rate of a foreign loan that fell due in December 1999. If this non-recurrent cost item is excluded, the increase in government expenditure would have been 5,1 per cent in the first three quarters of fiscal 1999/2000, not 6,4 per cent. In the Medium Term Budget Policy Statement presented to Parliament on 29 October 1999, the Minister of Finance announced that he intended to exclude such losses from expenditure in future.

National government expenditure for April to December



Interest payments on government debt amounted to R27,6 billion in the first nine months of fiscal 1999/2000, representing a year-on-year rate of increase of only 2,4 per cent, compared with an increase of 9,0 per cent in the first nine months of fiscal 1998/99. Fiscal consolidation, i.e. declining budget deficits and slower growth in government debt, along with the decline in money and capital market interest rates, were the main reasons for the relatively small increase in government interest payments.

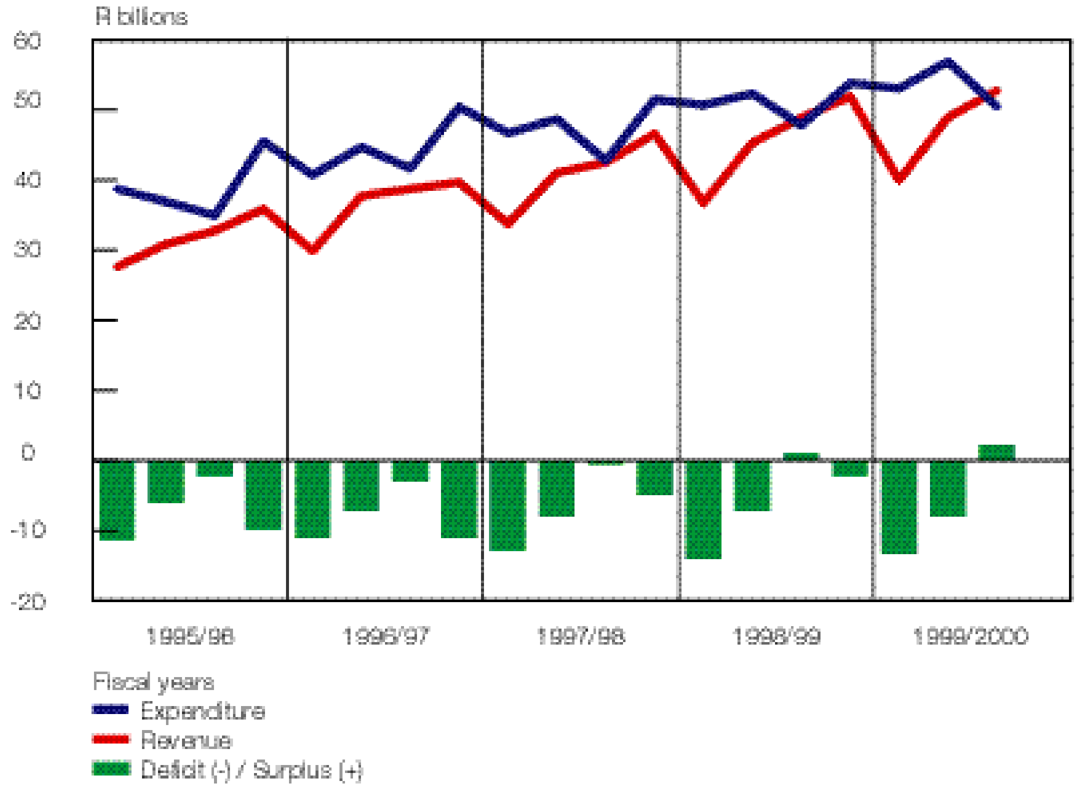
Interest on government debt



National government expenditure as a ratio of gross domestic product was 26,3 per cent in the first nine months of fiscal 1999/2000, slightly lower than the 26,7 per cent recorded in the corresponding period of the preceding fiscal year. After allowing for cash-flow adjustments associated with funds requested and allocated to the departments but not yet spent, government expenditure increased by 7,5 per cent in the first nine months of fiscal 1999/2000.

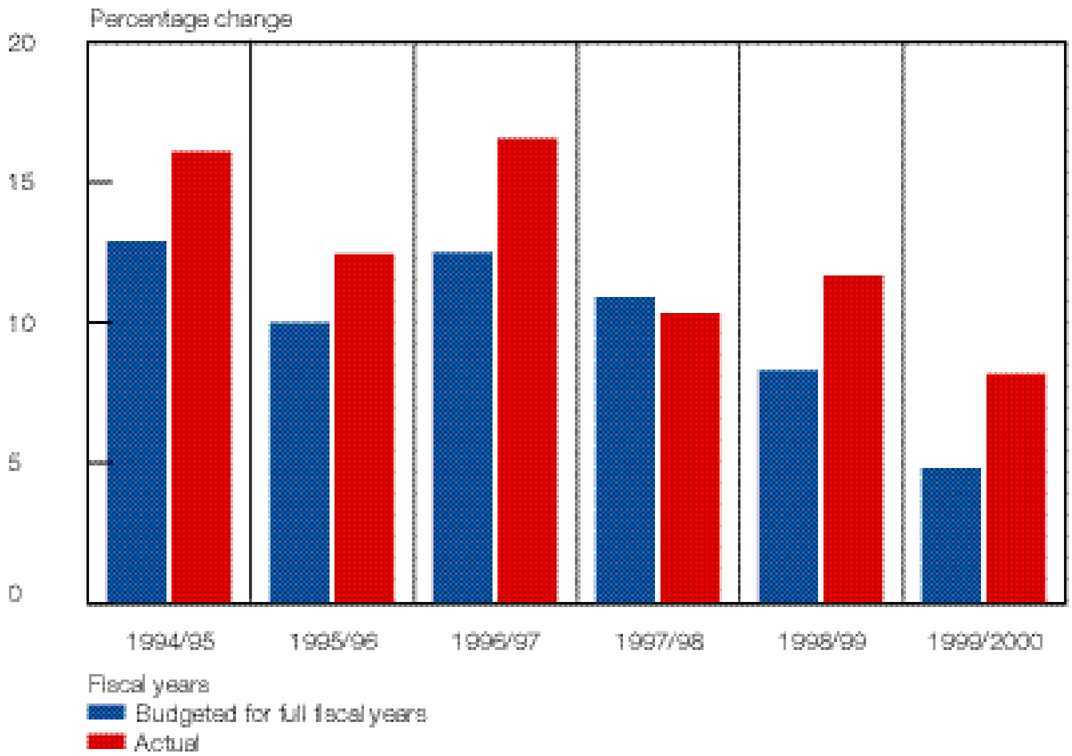
If national government expenditure in January 2000 is also taken into consideration, the year-on-year rate of increase in the first ten months of fiscal 1999/2000 came to 6,2 per cent. The cash-flow adjusted expenditure in the first ten months of fiscal 1999/2000 amounted to R175,0 billion, or was 6,5 per cent higher than the R164,3 billion recorded in the same period of the previous fiscal year.

National government expenditure, revenue and deficit



National government revenue (excluding extraordinary revenue) amounted to R52,7 billion in the October to December quarter of fiscal 1999/2000, bringing revenue collections in the first nine months of fiscal 1999/2000 to R141,7 billion or 73,9 per cent of the budgeted revenue for the year as a whole. Year on year, national government revenue increased by 8,2 per cent in the first nine months of fiscal 1999/2000 compared with the previous year. The Budget for fiscal 1999/2000 envisaged an increase of 4,8 per cent on the actual collections of the previous fiscal year.

Budgeted and actual national government revenue for April to December



The higher-than-budgeted rate of increase in government revenue could mainly be attributed to sharp increases in the receipts of income tax and value-added tax. Income tax receipts increased at a year-on-year rate of 7,7 per cent in the first nine months of fiscal 1999/2000 compared with the 3,4 per cent envisaged in the Budget. The gains in income-tax collections were essentially the result of better management and the implementation of more efficient practices and procedures by the South African Revenue Service (SARS). The introduction of a new electronic administration and information system in December 1999 will further improve the ability of SARS to maximise revenue collections.

Percentage increase in national government revenue in fiscal 1999/2000

Revenue source	Budgeted	Actual
	Full Year	April - Dec
Inland revenue	**5,2**	**8,9**
Income tax	3,4	7,7
Value-added tax	7,7	11,2
Other inland revenue	5,6	21,6
Customs and excise duties	**1,8**	**2,8**
Customs duties	10,4	3,7
Fuel levy	5,9	3,8
Other excise duties	9,1	9,4
Total revenue	**4,8**	**8,2**

Receipts from *value-added tax* increased at a year-on-year rate of 11,2 per cent in the first nine months of fiscal 1999/2000 against a budgeted rate of increase of 7,7 per cent for the year as a whole. This higher-than-budgeted rate of increase could be attributed to the higher-than-expected increases in final consumption expenditure by households and fixed capital expenditure by businesses.

Receipts from customs and excise duties increased at a year-on-year rate of 2,8 per cent in the first nine months of fiscal 1999/2000 against a budgeted rate of increase of 1,8 per cent for the year as a whole.

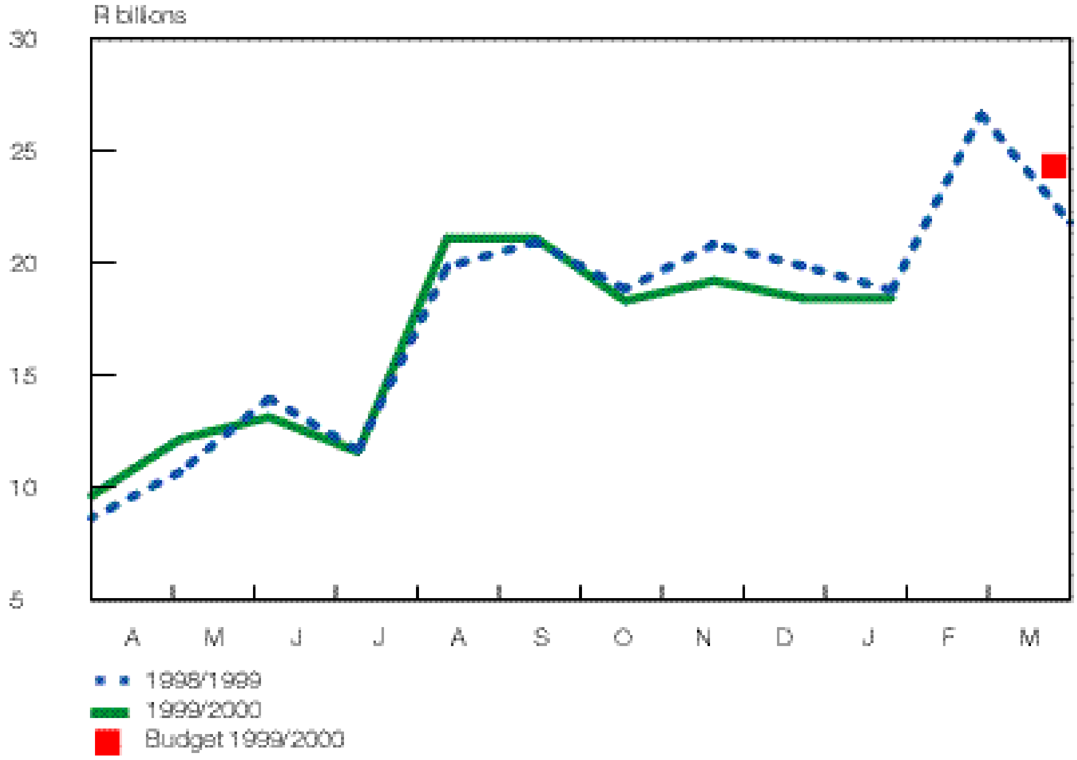
As a ratio of gross domestic product, national government revenue was 23,2 per cent in the first nine months of fiscal 1999/2000, which equaled the rate recorded in the corresponding period of the previous fiscal year.

After allowing for other receipts and cash-flow adjustments resulting from funds surrendered by government departments to the Exchequer, national government revenue amounted to R144,2 billion in the first nine months of fiscal 1999/2000. This represents a rate of increase of 9,4 per cent in the first nine months of fiscal 1999/2000 compared with the corresponding period of the previous fiscal year.

National government revenue in January 2000 amounted to R15,8 billion and brought the revenue for the first ten months of fiscal 1999/2000 to R157,4 billion or 7,3 per cent more than in the same period of fiscal 1998/1999. This rate of increase in national government revenue was once again due to sustained strong growth in income tax and value-added tax collections. National government revenue, adjusted for cash flows, amounted to R160,0 billion or was 8,3 per cent more than in the first ten months of fiscal 1998/99.

The net result of the higher-than-budgeted revenue and expenditure was a *national government deficit before borrowing and debt repayment* amounting to R18,8 billion in the first nine months of fiscal 1999/2000. As a ratio of gross domestic product, the deficit before borrowing and debt repayment amounted to 3,1 per cent in

Cumulative deficit of national government



the first nine months of fiscal 1999/2000. This can be compared with the 3,5 per cent realised in the corresponding period of the previous fiscal year. Given the seasonal pattern of the deficit in previous years, the containment of expenditure and the strong showing of revenue collections, it seems probable that the fiscal targets for the full fiscal year will be achieved.

The deficit in the first nine months of fiscal 1999/2000 came to 74,9 per cent of the deficit budgeted for the year as a whole. This was lower than the 83,8 per cent recorded in the corresponding period of the previous fiscal year. The deficit before borrowing and debt repayment, adjusted for cash flows, amounted to R17,0 billion in the first nine months of fiscal 1999/2000.

The net result of the national government's revenue and expenditure in January 2000 was a surplus of R0,4 billion, which brought the national government deficit before borrowing and debt repayment in the first ten months of fiscal 1999/2000 to R18,4 billion. The deficit before borrowing and debt repayment, adjusted for cash flows, amounted to R15,1 billion in the first ten months of fiscal 1999/2000. The deficit was financed as indicated in the accompanying table:

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

Financial instruments	R millions
Domestic capital market	
Government bonds (including discount)	6 394
Less: Discount on government bonds	2 772
Net receipts from government bonds issued	**3 622**
Treasury bills	2 704
Extraordinary receipts	
Demutualisation levy	577
Restructuring proceeds	4 478
International Monetary Fund	8
Strategic Fuel Fund	189
Extraordinary payments	-160
Foreign loans	5 634
Redemption of Section 239-debt*	-180
Redemption of Namibian debt	-272
Non-marketable securities	-5
Change in available cash balances (increase-,decrease+)	-1 519
Total net financing	**15 076**

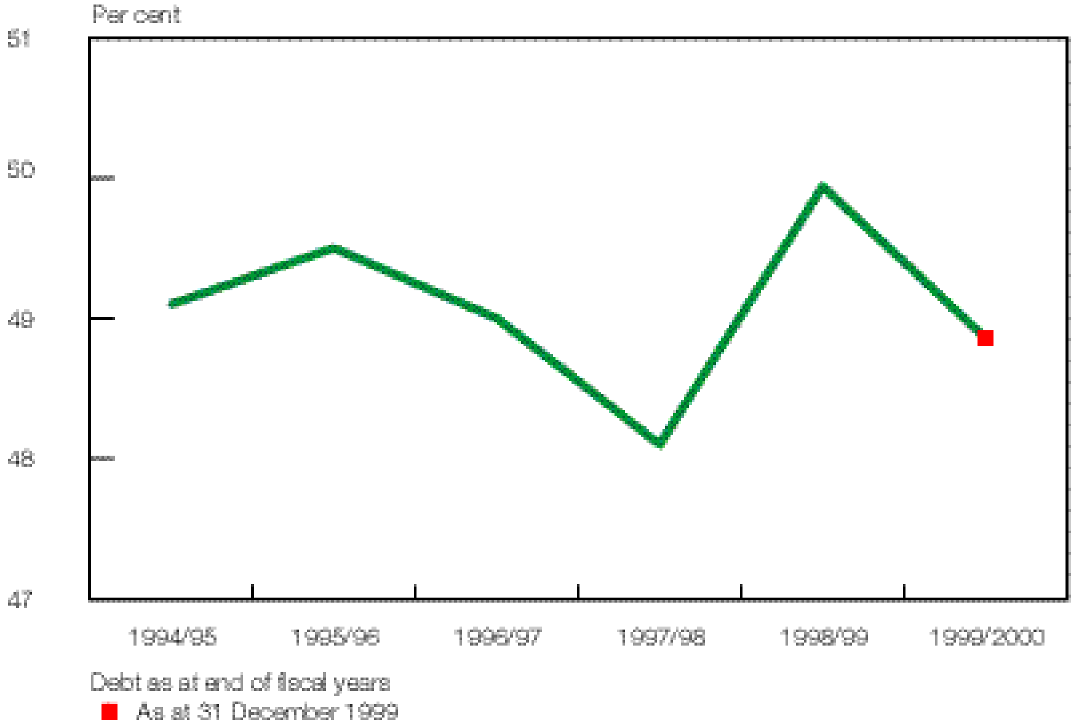
* Debt of the former Transkei, Bophuthatswana, Venda and Ciskei and self-governing states.

Long-term funding was obtained at an average rate of 14,1 per cent per annum and short-term instruments were sold at an average rate of 12,4 per cent per annum in the first ten months of fiscal 1999/2000. These rates can be compared with a Budget assumption of 14,0 per cent. Domestic loans of R10,8 billion and a foreign loan of $750 million were redeemed up to the end of December 1999. Extraordinary receipts include proceeds from the restructuring of Sasria and the selling of an equity interest in ACSA, which together amounted to R4,5 billion.

The borrowing requirement of national government plus the discount on new government stock issued and the revaluation of foreign debt, taking into account changes in the exchange rate, led to an increase in the *total debt of national gov -*

ernment from R377,7 billion at the end of March 1999 to R391,4 billion at the end of December 1999. As a ratio of gross domestic product, government debt decreased from 49,9 per cent at the end of March 1999 to 48,9 per cent at the end of December 1999. The debt of national government receded further to R390,3 billion at the end of January 2000.

National government debt as a ratio of gross domestic product



The Budget for the fiscal years 2000/01 to 2002/03

The Minister of Finance presented his Budget proposals for the 2000/2001 fiscal year to Parliament on 23 February 2000. In his address the Minister reaffirmed government's commitment to a strategy for accelerated and sustainable economic growth, employment creation and development, improved public-service delivery and an equitable distribution of income.

The Minister announced the introduction of inflation targeting as a new monetary policy framework. Inflation targeting is expected to increase the transparency of the Reserve Bank's policy intentions and improve the co-ordination of macroeconomic policies. The aim of the new framework is to curb the inflation expectations of producers, employers and workers, and to provide consistency in the conduct of monetary policy. The targeted price index is the current overall consumer price index, excluding mortgage interest rates (CPIX). The inflation target has been set at a range of between 3 per cent and 6 per cent and the objective is to bring the average annual inflation rate within this range by 2002.

Further steps in the gradual dismantling of exchange controls were announced. These measures include the following:

- Companies will be allowed to make use of local cash holdings to finance new foreign investments and repay foreign debt.
- Companies will be able to use corporate asset swaps to finance acquisitions abroad.
- Pension funds, long-term insurers and unit trusts will be allowed to make foreign currency transfers in 2000/01, subject to certain limitations.
- Travel allowances have been increased.
- Conditions have been set for companies wishing to establish primary listings offshore.
- Limits imposed on residents' investments abroad have been raised.

The Budget for 2000/01 was based on three fiscal policy considerations, namely

- reducing the overall burden of tax, so as to lower the cost of investment and job creation, and release household spending power;
- providing for government's social, development and infrastructural expenditure responsibilities; and
- lowering the budget deficit relative to the size of the economy in order to contribute to lower interest rates and fiscal sustainability.

It was estimated that total *government expenditure* would increase to R233,5 billion in fiscal 2000/01, or by 8,1 per cent over the revised estimates of expenditure in fiscal 1999/2000, and to R251,5 billion in fiscal 2001/02 and R266,7 billion in fiscal 2002/03. This represents an average rate of increase of 7,3 per cent in the three-year medium-term budget period. As a ratio of gross domestic product, total government expen-

Comparison of the revised estimates for 1999/2000 and the 2000/01 – 2002/03 Budget

	1999/2000		2000/01		2001/02		2002/03	
	Revised estimates		Budget		Budget		Budget	
		Annual change		Annual change		Annual change		Annual change
	R bn	Per cent	R bn	Per cent	R bn	Per cent	R bn	Per cent
Expenditure	**216,0***	**5,5**	**233,5**	**8,1**	**251,5**	**7,7**	**266,7**	**6,0**
Capital	8,8**	6,5	7,5	-14,8	8,2	9,3	8,6	4,9
Interest	44,5	4,2	46,5	4,5	49,5	6,5	51,0	3,0
Non-interest recurrent	162,7	8,1	179,5	10,3	193,8	8,0	207,1	6,9
Revenue	**196,3**	**7,3**	**210,4**	**7,2**	**227,4**	**8,1**	**243,6**	**7,1**
Deficit before borrowing and debt repayment	**19,7**		**23,1**		**24,1**		**23,1**	
Deficit as a ratio of gross domestic product	2,4		2,6		2,5		2,2	

* Excluding the revaluation of maturing foreign loans in 1999/2000. If included, total expenditure for 1999/2000 would amount to R218,0 billion, and the deficit would be 2,7 per cent of the estimated gross domestic product

** Including a transfer of R855 million to the Umsobomvu Fund diture is expected to amount to 26,4 per cent in fiscal 2000/01 compared with the revised estimate of 26,7 per cent in 1999/2000. The expectation is that this ratio will decrease to 26,2 per cent in fiscal 2001/02 and to 25,7 per cent in fiscal 2002/03.

The growth in interest payments on government debt is expected to increase from 4,2 per cent in fiscal 1999/2000 to 4,5 per cent in fiscal 2000/01 and 6,5 per cent in fiscal 2001/02 before declining to 3,0 per cent in fiscal 2002/03. As a ratio of total expenditure, interest payments are expected to decline from an estimated 20,6 per cent in fiscal 1999/2000 to 19,9 per cent in fiscal 2000/01. The non-interest current expenditure is expected to increase from R162,7 billion in fiscal 1999/2000 to R179,5 billion in fiscal 2000/01 or by 10,3 per cent. More than 59,1 per cent of non-interest current expenditure is to be transferred to provincial governments as conditional grants and as their equitable share of government revenues. The nine provinces will receive a total of R106,7 billion from national government in the coming financial year, R6,6 billion more than in fiscal 1999/2000.

Social-service expenditure remains the largest functional category of government spending, amounting to 44,7 per cent of the estimated total consolidated national government expenditure in 2000/01. Spending on social services is expected to increase at an average rate of 5,6 per cent from fiscal 1999/2000 to 2002/03.

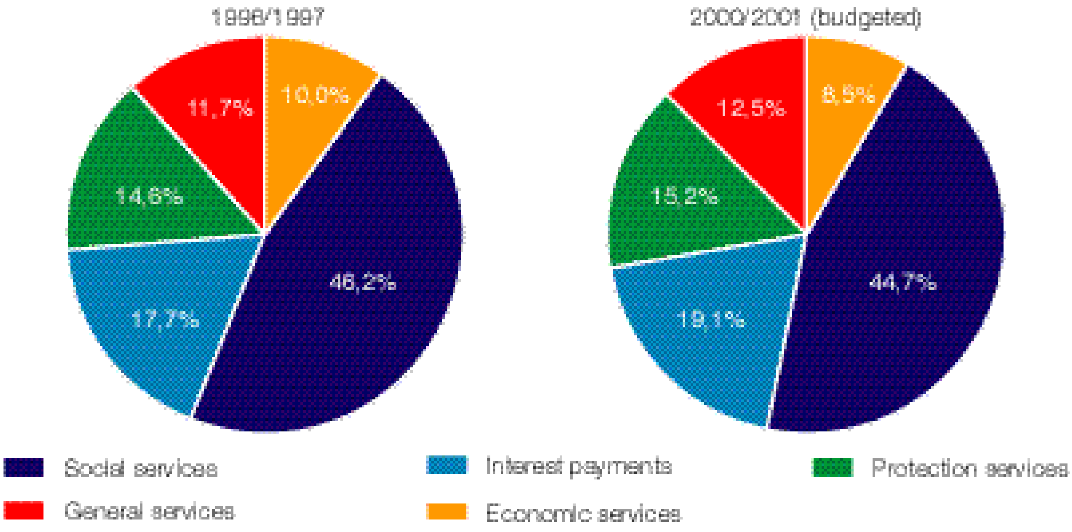
The share of government spending on defence was projected to grow at an annual average rate of 15,8 per cent from fiscal 1999/2000 to 2002/03, reflecting the cost of the strategic armaments procurement package.

Functional classification of the expenditure by consolidated national and provincial governments and social security funds

Per cent of total expenditure

	1999/2000	2000/01	2001/02	2002/03
General government services and unallocatable expenditure	11,5	12,5	13,1	14,4
Protection services	14,5	15,2	15,3	15,2
Defence	4,8	5,6	5,8	5,9
Police	6,6	6,5	6,4	6,3
Prisons	1,9	1,9	1,9	1,9
Justice	1,2	1,2	1,2	1,1
Social services	45,7	44,7	43,9	43,3
Education	21,3	20,8	20,5	20,3
Health	13,3	13,3	13,1	13,0
Social security and welfare	8,8	8,6	8,3	8,0
Housing and community development	1,9	1,7	1,7	1,7
Other	0,4	0,3	0,3	0,3
Economic services	8,5	8,5	8,8	8,8
Water schemes and related services	1,0	1,0	1,0	0,9
Fuel and energy	0,2	0,1	0,1	0,2
Agriculture, forestry and fishing	1,6	1,6	1,4	1,4
Mining, manufacturing and construction	0,1	0,1	0,1	0,1
Transport and communication	4,1	3,6	3,6	3,6
Other economic services	1,5	2,1	2,6	2,6
Interest	19,8	19,1	18,9	18,3
Total	100,0	100,0	100,0	100,0

Functional classification of the expenditure by national government, provincial governments and social security funds



Total government revenue (excluding extraordinary revenue) is estimated to increase to R210,4 billion or by 7,2 per cent in fiscal 2000/01. This would take total government revenue to 23,8 per cent of the projected gross domestic product compared with an estimate of 24,3 per cent in fiscal 1999/2000. It is estimated that total national government revenue will increase at an average rate of 7,5 per cent in the three-year medium-term budget period. The overall tax burden is expected to decrease from 24,7 per cent in fiscal 1999/2000 to 24,1 per cent in fiscal 2000/01 and to 23,9 per cent in fiscal 2002/03.

A skills development levy will be introduced on 1 April 2000 at a rate of 0,5 per cent of payroll payments, with a subsequent increase to 1,0 per cent in the following year. Income from this levy will be used to defray the cost of expenditure on training programmes. The strategy determines that 80 per cent of the levy collected should be used to fund the various sectors' education and training authorities and 20 per cent be allocated to the National Skills Fund. The levy will be deductible from income tax, resulting in a reduction in revenues from company tax.

Specific tax adjustments were announced, giving relief to a broad range of individual taxpayers. The tax proposals and other measures include the following:

- A single scale of rates was proposed for all individuals, reaching a maximum marginal rate of 42 per cent at a taxable income of R200 000 a year.
- The primary rebate was increased from R3 710 to R3 800.
- The secondary rebate for individuals of 65 years and older was increased from R2 775 to R2 900.
- A graduated rate structure was introduced for small and medium enterprises.
- The interest exemption was increased from R2 000 to R3 000 a year for all taxpayers and from R2 000 to R4 000 a year for those aged 65 and over. This exemption will also apply to taxable dividends.
- A tax on realised capital gains was proposed, with effect from 1 April 2001, and will apply to gains accruing and realised after that date. It will not apply to family homes, private vehicles or ordinary household possessions. Draft legislation on this matter is to be released later this year.

- A tax of R100 per departure on international air travel will be imposed from 1 August 2000. The tax will be payable by the airlines and recovered from travellers as an integral element of ticket prices.
- It is proposed that current practice will change to a residence-based income tax for South African residents for the years of assessment commencing on or after 1 January 2001. Foreign source dividends accruing to residents became taxable as ordinary income with immediate effect.
- Excise duties on alcoholic beverages and tobacco were increased with effect from 23 February 2000. Duties on soft drinks and mineral water were lowered.
- The levy on leaded and unleaded petrol was raised by 5 cents a litre and on diesel by 3 cents a litre with effect from 5 April 2000.

The net result of the budgeted expenditure of R233,5 billion and the estimated revenue of R210,4 billion in fiscal 2000/01 is an estimated *deficit before borrowing and debt repayment* of R23,1 billion, equal to 2,6 per cent of the projected gross domestic product. A primary deficit (i.e. the deficit recalculated by excluding interest payments from total expenditure) of 2,6 per cent of gross domestic product is foreseen for fiscal 2000/01. This can be compared with the revised estimated primary deficit of 3,1 per cent of gross domestic product in fiscal 1999/2000. Government dissaving as a ratio of gross domestic product is expected to deteriorate slightly from 1,6 per cent in fiscal 1999/2000 to 1,7 per cent in fiscal 2000/01 before improving to 0,7 per cent in fiscal 2002/03.

After taking the scheduled loan redemptions of R17,0 billion into consideration, the gross financing requirement for fiscal 2000/01 is projected to amount to R40,1 billion. This is expected to be financed as follows:

	R billions
Domestically registered stock	25,3
Extraordinary receipts	5,0
Treasury bills	3,5
Foreign loans	6,5
Other	-0,2
Total financing	40,1

Due to the low rate of increase in the borrowing requirement and the proposed partial funding of the deficit with the proceeds from the restructuring of state assets, the government's borrowing requirement is not expected to add to existing pressures in the domestic capital market. To smooth the maturity profile of government debt, funding will be obtained by issuing bonds with medium and long-term maturities. To ensure liquidity throughout the yield curve, switch auctions will be conducted to repurchase bonds before maturity. Of the US$1,0 billion in foreign borrowing, about US$300 million will finance the export credit agreement of the defence procurement programme. The restructuring of South Africa's government-owned assets will contribute R5 billion towards debt reduction in 2000/01, increasing to R10 billion in 2002/03. The government is committed to restructuring the four largest state-owned enterprises, namely Eskom, Telkom, Transnet and Denel, to maximise economic efficiency and encourage competition.

It is estimated that *government debt* will increase from R372,5 billion or 49,4 per cent of gross domestic product at the end of fiscal 1998/99 to R386,6 billion or 47,7 per cent of gross domestic product at the end of fiscal 1999/2000. Although government debt is budgeted to increase to R408,5 billion at the end of fiscal 2000/01, it is expected that as a ratio of gross domestic product it will decline further to 46,1 per cent. Further decreases to 45,0 per cent of gross domestic product are envisaged for fiscal 2001/02 and 43,0 per cent for fiscal 2002/03.

Statement of the Monetary Policy Committee

13 January 2000

Issued by Mr T T Mboweni, Governor of the South African Reserve Bank, at the third meeting of the Monetary Policy Committee (MPC) in Pretoria

The Monetary Policy Committee, meeting over two days on 12 and 13 January 2000, made a detailed assessment of changes in general economic conditions since its last meeting on 24 November 1999. The main conclusions of the Committee are summarised in this statement.

International economic developments

International economic indicators that have become available since the last meeting of the Monetary Policy Committee generally confirm the improved world economic conditions perceived at that time. The latest projections of the OECD have been revised sharply upward. In the OECD Economic Outlook for December 1999 the growth in world output is projected to accelerate from 3 per cent in 1999 to around 3½ per cent in both 2000 and 2001. Growth expectations for Africa, Asia and Latin America have also improved.

Although the higher global economic growth is expected to take place under relatively stable economic conditions, consumer price inflation has accelerated somewhat as a result of higher oil and other international commodity prices. Mainly because of supply-side constraints, oil prices increased to an average level of US$25,50 per barrel in December 1999, compared with just above US$10 a year ago. Concerns about inflationary pressures arising from this and other developments caused the monetary authorities of industrial countries to tighten monetary policy in the last half of 1999. However, rates in emerging markets have generally been flat or trended downwards.

Domestic real economic developments

Recently released economic data confirm the previously noted improvement in domestic economic activity. In particular, the composite coincident business cycle indicator (an index derived from a range of statistics showing the present state of the business cycle) displayed a sharp rise in the three-month period from June to August 1999. Other economic indicators showing improved conditions include an increase in mining production during September and October 1999, a rising trend in manufacturing output in the second half of 1999, an increase in electricity generated from June 1999, a sharp rise in the value of total unfilled orders from July to October 1999 and a distinctly increasing trend in retail and wholesale sales from the beginning of the year.

The recovery in economic activity took place from a relatively low level and has not yet brought about any improvement in reported formal-sector employment. In fact, the available data indicate that the number of people employed in the non-agricultural sectors of the economy declined by about 80 000 in the first nine months of 1999. Decreases in employment were recorded in the mining, manufacturing and construction sectors. Despite the rise in unemployment, the average year-on-year rate of increase in nominal salaries and wages per employee rose from 7,1 per cent in the first quarter of 1999 to 8,8 per cent in the third quarter. This acceleration was mainly due to wage increases in the public sector from a low base. Growth in the average nominal remuneration per worker in the private sector continued to rise at high levels of between 8 and 9 per cent during this period. The increase in wages per worker was countered to some extent by the acceleration in the growth of labour productivity from a year-on-year rate of 1,9 per cent in the first quarter of 1999 to 3,6 per cent in the third quarter. As a result, nominal unit labour costs rose by only 5,0 per cent from the third quarter of 1998 to the third quarter of 1999.

Domestic monetary developments

The relatively small increase in nominal unit labour costs was an important contributing factor to a moderation in consumer price inflation to a year-on-year rate of 1,7 per cent in October 1999. The downward movement in consumer price increases was, however, mainly the result of a fall in mortgage bond rates. The year-on-year rate of increase in the consumer price index rose marginally to 1,9 per cent in November 1999 because of increases in the prices of food, medical care and transport services.

Sharp increases in petrol and diesel prices kept core inflation at a level of 8,1 per cent in November and the year-on-year increase in the production price index at 6,3 per cent in the same month. Moreover, if the effects of reductions in interest rates are not taken into account, there was a moderate increasing trend in inflation during 1999.

The growth in broad money supply (M3) measured over a period of twelve months remained firmly below 10 per cent from February 1999 and amounted to 8,5 per cent in November. However, an annualised increase of 24 per cent was recorded in the seasonally adjusted value of M3 over the three months from the end of August to the end of November 1999. This sharp growth in M3 was concentrated in notes and coin, and cheque and call deposits.

The value of total credit extended by the monetary institutions contracted from approximately R558 billion at the end of September 1999 to R555 billion at the end of November, largely owing to a reduction in banks' claims on the government sector. The twelve-month growth rate in credit extended to the private sector receded from 11,5 per cent in September 1999 to 8,2 per cent in November.

Domestic money and capital markets

In order to alleviate possible Y2K problems, the Reserve Bank has actively engineered a sharp decline in the banks' liquidity requirement since the last meeting of the Monetary Policy Committee. The liquidity requirement of banks consequently declined by R3,8 billion from R6,2 billion on 25 November 1999 to R2,4 billion on 31 December, despite an increase of R6,7 billion in notes and coin in circulation. At R32,7 billion at the end of 1999 the level of notes and coin in circulation was well below the market's expectations.

Money market interest rates eased slightly further from 25 November to 31 December 1999, while yields on government bonds decreased by approximately ½ percentage point over this period. In the first week of the new year there was a rally in the bond market, which brought yields to a level below 13 per cent. Activity on the bond and share markets remained buoyant and the value of real-estate transactions rebounded from deeply depressed levels at the beginning of 1999 to more normal levels in August. From the beginning of October to the end of December 1999 share prices rose by no less than 23 per cent, bringing the total increase from their lower turning point in September 1998 to 65 per cent. The most recent increase in the all-share price index was mainly the result of gains recorded by financial and industrial shares.

Non-residents played an important part in these price developments, increasing their holdings of South African bonds and equities further by R3,3 billion and R0,8 billion, respectively, during December 1999. For the calendar year as a whole, non-residents increased their holdings of domestic bonds by R14,3 billion and their equity holdings by R40,6 billion. The corresponding figures for 1998 were net sales of bonds to the amount of R9,8 billion and net purchases of equities to the value of R42,3 billion.

Balance of payments and foreign exchange market

Trade figures for the first two months of the fourth quarter of 1999 indicate that the deficit on the current account of the balance of payments probably deteriorated further in the fourth quarter of 1999. The trade surplus declined from an average monthly value of R1,6 billion in the third quarter of 1999 to an average of only R0,4 billion in October and November 1999. The weaker trade surplus was the result of an increase in the value of merchandise imports, which outweighed increases in the value of the exports of gold and other goods.

The financial account of South Africa with the rest of the world was probably characterised by a substantial increase in the inflow of capital, as indicated by a rise of R6,2 billion in the gross foreign reserves of the Reserve Bank during the fourth quarter to a level of R45,4 billion at the end of December. From 25 November 1999 the net open position in foreign currency declined further to a level of US$13 billion at the end of the year, i.e. close to pre-crisis levels. This was consistent with the Bank's intention to continue reducing the net open position in foreign exchange.

During December 1999 the rand traded in a narrow range of R6,12 to R6,17 per dollar and remained strong against most major currencies. The nominal effective exchange rate of the rand increased by 0,3 per cent in this month. Over the year as a whole, the nominal effective exchange rate of the rand rose by 0,6 per cent. However, the average level of the rand decreased by 8½ per cent in 1999. In the first week of January 2000 the rand strengthened marginally.

Stability in the financial sector

The banking sector's thorough preparations to avoid the possible effects of the transition to the year 2000, proved to be very effective. With the exception of a few minor disruptions which generally were not Y2K related, normal operations were reported by the banks during the first week of the new millennium. The positive spin-offs of large-scale technology renewal, the systematic rationalisation of systems and processes, the improvement of human resources and closer co-operation in the sector, can significantly enhance efficiency.

The way that the banks and corporates managed the millennium date change has been commendable. The Monetary Policy Committee expresses its appreciation to the management of these institutions for their actions that ensured that South Africa coped well with the transition to the new millennium. In addition, the Committee commends the members of the public for their mature and responsible behaviour over the year-end.

The latest available statistical information suggests that conditions in the banking sector remained stable and profitability improved during October and November 1999. Although some of the smaller banks at times experienced a temporary liquidity squeeze due to the reduction of wholesale deposits, these problems were dealt with quickly and efficiently. A noticeable change was also reported in the anticipated short-term liquidity mismatch of banks which, measured as a percentage of their total funding, decreased from a level of approximately 12 per cent in the four months June to September 1999 to about 9 per cent in October and just slightly above 10 per cent in November.

Monetary policy

In accordance with the decisions taken at the Monetary Policy Committee Meeting on 24 November 1999, the rate on repurchase transactions was kept fixed at 12,00 per cent in the ensuing period and full liquidity was provided to banks at the daily auctions of the Reserve Bank. This resulted in relatively stable money market interest rates and yields over the past six weeks.

As already indicated, the inflation rate has started to increase somewhat, primarily due to the substantial rise in international oil prices. Wage increases could also contribute to a moderate increase in the inflation rate over the next few months if they are not neutralised by productivity gains. However, over the more medium to longer term the inflation outlook is still promising and this has been enhanced by the recent further restructuring of the trade regime. Most projections indicate that the average inflation rate is expected to decline over the next two years. The projections of the Reserve Bank show a similar trend provided that the exchange rate of the rand remains relatively stable, the growth in money supply and bank credit extension are contained and that positive real interest rates are maintained.

The Monetary Policy Committee in its deliberations expressed concern about the continued shedding of jobs in South Africa. Unemployment is a structural problem that requires significant supply-side adjustments in the economy.

After careful consideration of international and domestic economic developments and the successful transition to the new millennium, the Monetary Policy Committee of the Reserve Bank decided to discontinue the temporary measure of fixing the repo rate at 12 per cent. The Bank will again apply a variable-rate auction in accordance with the agreed signalling procedures from Friday, 14 January 2000. Although the repo rate will be determined at the daily auctions of the Bank, the Monetary Policy Committee believes that recent changes in short-term interest rates warrant an immediate reduction to 11,75 per cent in the rate at the first auction on Friday. This reduction should allow the banks to reduce their prime overdraft rate with immediate effect by 100 basis points. The Monetary Policy Committee is of the opinion that the daily liquidity requirement of the banks must then be managed in such a way that short-term money market rates remain at or around this level, as the Committee is of the considered view that current and projected conditions do not at present warrant a further reduction in interest rates.

Statement on exchange control

23 February 2000

Issued by Mr T T Mboweni, Governor of the South African Reserve Bank

In his 2000/2001 Budget Speech today, the Minister of Finance has announced further steps in the gradual process of exchange control liberalisation.

The new relaxations are:

South African corporates

In terms of existing policy, corporates wishing to invest in countries outside the Common Monetary Area are, on application, allowed to transfer up to R250 million from South Africa per new investment into member countries of the Southern African Development Community and up to R50 million per new investment elsewhere. Corporates will now, on application, be allowed to use part of their local cash holdings to finance up to 10 per cent of approved new foreign investments where the cost of these investments exceeds the current limits.

In addition to the aforegoing, corporates wishing to invest abroad may now also apply for permission to make use of corporate asset/share swaps to finance these investments.

South African corporates will now be allowed to utilise part of their local cash holdings to repay up to 10 per cent of outstanding foreign debt raised to finance foreign investments, provided the foreign debt has been in existence for a minimum period of two years.

Primary listings offshore

Consideration will be given to requests by major corporates to establish primary listings offshore. The following guidelines will, *inter alia*, be taken into account:

- Foreign expansion is necessary and integral to the company, given its size and the nature of its business;
- a significant proportion of revenue is derived from outside South Africa, making the company in effect an international concern;
- there are clear monetary and balance of payments benefits to South Africa;
- a substantial advantage can be demonstrated over alternative approaches to raising the required capital;
- the direct and indirect South African assets may not be encumbered;
- South Africa's reserves may not be negatively impacted by an outflow of dividends or any other funds;
- the corporate involved must commit itself to matching any dividends declared to the foreign holding company with dividends paid out to South African shareholders, to preserve balance of payments neutrality; and
- all the South African operations and assets of the South African corporate or the proceeds thereof, as well as any other cash holdings, must remain in South Africa and may only be exported from South Africa if payable pro rata to the non-resident shareholders of the listed holding company with Exchange Control approval.

South African institutional investors

It has been decided to retain the current asset swap dispensation available to qualifying institutions but to change the definition of the 15 per cent limit from total assets employed in South Africa to 15 per cent of total assets.

For unit trusts through unit trust management companies not only is the definition of assets changed but the limit is also increased to 20 per cent of total assets under management.

Furthermore, long-term insurers, pension funds and unit trusts through unit trust management companies may now also apply to avail themselves of foreign currency transfers in 2000 of up to 10 per cent of the net inflow of funds during the 1999 calendar year, to acquire foreign portfolio investments subject to the overall respective limits referred to.

South African resident private individuals

Private individuals who are over 18 and taxpayers in good standing have been permitted to invest abroad since 1 July 1997. A total amount of approximately R9,4 billion has been transferred from South Africa, to date. The current limit of R500 000 is now increased to R750 000 per person.

Miscellaneous

South African residents travelling abroad on holiday or business currently have the travel allowance endorsed in their passports. This requirement is, with immediate effect, dispensed with. Residents travelling abroad will now be permitted a travel allowance of a maximum of R130 000 per person of twelve years and older and R40 000 per child under the age of twelve years, per calendar year.

Companies and individuals will, where appropriate, need to continue to satisfy the authorities that their tax affairs are in good standing.

Various other limits will also be adjusted.

Statement of the Monetary Policy Committee

2 March 2000

Issued by Mr T T Mboweni, Governor of the South African Reserve Bank, at the fourth meeting of the Monetary Policy Committee (MPC) in Pretoria

The main conclusions made at the Monetary Policy Committee meeting of 1 and 2 March 2000 are summarised in this statement.

International ecomonic developments

The positive international economic outlook reported after the end of the last meeting of the Monetary Policy Committee continues to prevail. Global growth prospects remain favourable, although there are some signs of an acceleration of inflation in industrial countries. Since the beginning of 2000 most of the member countries of the OECD, with the notable exception of Japan, have increased their official interest rates as a precautionary measure to quell rising inflationary pressures exacerbated by higher commodity prices. In the emerging-market economies, by contrast, there was no dominant trend in the path of official interest rates.

In particular, international oil prices moved up further from just below US$23 per barrel on 11 January 2000 to above US$28 per barrel from the middle of February. This upward movement was mainly attributable to the product-cut accord of the main oil producers. The gold price also gained about US$25 per fine ounce early in February primarily because a number of producers bought gold back that had previously been sold forward. On 29 February 2000 the fixing price of gold had fallen back again to about US$294 per fine ounce.

Domestic real economic developments

The upturn in economic activity that was noted at the meeting of the Monetary Policy Committee at the beginning of January 2000, was confirmed by the recently released national accounts data. According to this information the real gross domestic product increased from quarter to quarter at rates in excess of 3 per cent in the second half of 1999. Moreover, the recovery in economic activity became more widespread and the real output of manufacturing enterprises rose at a rate of almost 7 per cent in the fourth quarter of 1999.

As could be expected under these circumstances, domestic final demand began to pick up. Consumers stepped up their current expenditure in line with lower interest payments on loans and increases in real personal disposable income, without resorting to a large increase in debt for the financing of their outlays. Total gross fixed capital formation still declined in the fourth quarter of 1999, but private-sector fixed investment rose. Real final consumption expenditure by general government continued to decline, while the growth in final demand was supplemented by an increase in total inventories at constant prices.

These production and expenditure patterns will, of course, be influenced by the recent floods that have devastated vast areas in South Africa and other parts of southern Africa.

Conditions in the labour market remained relatively depressed, with new jobs only being created in the trade, transport and communication sectors during the first nine months of 1999. Labour productivity increased by 2,7 per cent in the first three quarters of 1999 compared with the corresponding period in the preceding year, and helped to contain the growth in nominal unit labour cost to 4,7 per cent over the same period.

Domestic monetary developments

The low rate of increase in nominal unit labour costs helped to contain the rise in the consumer price index excluding the effect of mortgage rate changes (i.e. in the CPIX in metropolitan and urban areas, which is used to measure inflation in the targets pursued by the authorities). The twelve-month growth rate in CPIX amounted to 7,0 per cent in January 2000. Some inflationary pressures have recently become discernible in the economy due to increases in international oil prices, the prices of transport equipment and, more recently, also in the cost of food.

The growth in money supply accelerated strongly in the second half of 1999. The rate of increase over twelve-month periods in the broadly defined money supply (M3) increased from a low of 5,5 per cent in August 1999 to 10,2 per cent in January 2000. Although low growth in money supply is no longer an intermediate objective of monetary policy, it remains an important indicator of financial stability and will still be monitored closely by the central bank as one of the important variables in the determination of monetary policy.

The growth in total credit extended by banks measured over a period of twelve months, which had slowed down from 17,7 per cent in January 1999 to 6,9 per cent in October, increased to 9,8 per cent in January 2000. Reflecting the strengthening in domestic economic activity, this rise in bank credit extension can mainly be attributed to funds made available to private corporations. Households remained reluctant to utilise consumer credit instruments to finance the purchase of durable goods, and banks have become more cautious in the extension of credit.

Domestic money and capital markets

Following the decline in the repo rate of 25 basis points to 11,75 per cent on 14 January 2000, the prime overdraft rate of banks was reduced by one percentage point to 14,50 per cent. The interbank call rate also moved down from 10,25 per cent to 10 per cent on 14 January and 9,50 per cent on 21 January. The changes in other money market rates generally reflected the decline in the prime overdraft rate of the banks.

The yields on domestic bonds have moved to slightly higher levels since the last meeting of the Monetary Policy Committee, probably in response to higher short-term interest rates in the main international markets. Activity on the bond and share markets remained buoyant, but was lower in the fourth quarter of 1999 in comparison with the high figures of the preceding quarter. For the year 1999 as a whole, turnover in the secondary bond market increased to R8,8 trillion from the very high R8,5 trillion in 1998. The value of shares traded on the Johannesburg Stock Exchange came to R448 billion in 1999, or to 40 per cent more than in 1998. Share prices rallied to a new record level on 17 January 2000, before declining again by 13½ per cent until 29 February. The real-estate market continued to recover in the closing months of 1999.

Balance of payments and foreign exchange market

The balance of payments on the current account, which had moved into a deficit from the second quarter of 1999, recorded a further deficit in the fourth quarter. This amounted to an estimated seasonally adjusted and annualised amount of approximately R5½ billion, or about ½ per cent of gross domestic product. The appearance of a deficit on the current account at this early stage of a recovery in domestic economic activity was, to a large extent, due to a deterioration in South Africa's terms of trade, relating to the substantial increase in the price of oil. In the fourth quarter of 1999 the quantity of imports also rose sharply.

The financial account of South Africa's balance of payments recorded increasingly positive inflows of capital throughout 1999. In the fourth quarter of 1999 the net inflow of capital was provisionally estimated at R14 billion, which should bring the annual net inflow to about R27 billion. This large inflow of capital consisted mainly of portfolio investments in the form of equity investments. Non-residents' net purchases of shares on the Johannesburg Stock Exchange amounted to R40,6 billion and their net purchases of bonds to R14,3 billion in 1999. These inflows were offset to some extent by a repayment on foreign loans and investments in foreign financial assets by domestic institutional investors through the asset swap mechanism. In the first two months of 2000, non-residents' net purchases of securities declined to R0,8 billion.

The overall balance of payments surplus in the fourth quarter of 1999 led to a further increase in the total gross gold and other foreign reserves from R53,9 billion at the end of September 1999 to R67,5 billion at the end of December. This increased the import cover, i.e. the value of gross international reserves expressed as a ratio of the value of imports of goods and services, to about 15 weeks at the end of 1999. In the first two months of 2000 the gross foreign reserves of the Reserve Bank rose further by R1,6 billion. The net open foreign currency position of the Reserve Bank improved by US$1,9 billion over the same period to US$11,1 billion at the end of February 2000.

The exchange rate of the rand was relatively volatile against the US dollar during the first two months of 2000. After having reached a level of R6,06 to the US dollar on 13 January, the rand depreciated sharply to a low of R6,32 at the end of January. During February the rand traded between R6,20 and R6,40 against the US dollar. The depreciation of the rand against the dollar was due to the overall strength of the US currency, as demonstrated by an appreciation of 0,6 per cent in the value of the rand against the Euro in the first two months of 2000. As a consequence the nominal effective exchange rate of the rand declined by only 0,4 per cent from the end of December 1999 to the end of February 2000.

Stability in the financial sector

Conditions in the banking sector remained stable during the fourth quarter of 1999 and in the first two months of 2000. The gross overdues of the banking sector increased from R28,4 billion in the third quarter of 1999 to R29,4 billion in the fourth quarter. As a ratio of total loans and advances, gross overdues therefore increased slightly from 4,8 per cent to 4,9 per cent over the same period. However, total provisions as a ratio of gross overdues also improved from 53,7 per cent in the third quarter of 1999 to 57,5 per cent in the fourth quarter. This is much higher than the international norm of 40 per cent.

Monetary policy

The Reserve Bank had deliberately eased liquidity conditions in the money market during the last four months of 1999 to allay fears arising from the millennium change. From the beginning of the new year when it became apparent that no serious Y2K problems would be experienced, the Bank began to increase the reserve dependency of banks on central bank funding. In order to drain liquidity the Bank entered into foreign exchange swaps with banks, increased the number of reverse-repurchase transactions and also issued more Reserve Bank debentures.

Although these operations were partly offset by a decline in notes and coin in circulation, the liquidity requirement of the banks increased from R2,4 billion at the end of 1999 to R7,7 billion at the end of February 2000. The Reserve Bank provided liquidity to the full extent of the private banks' needs, with the result that only limited use was made of the marginal lending facility during the first two months of 2000.

The repo rate of the Reserve Bank at the daily auction remained at a level of 11,75 per cent from 14 January 2000. This constant repo rate probably resulted from the Monetary Policy Committee's conclusion on 13 January 2000 that such a level was regarded as appropriate for South Africa under the circumstances at that time, and that the banks' daily liquidity requirement would be managed in a way which would ensure that the repo rate would remain at or around that level.

Since the last meeting of the Monetary Policy Committee, clear signs of increased inflationary pressures have become apparent in the South African economy. Increases in the prices of petrol and diesel, transport equipment and more recently food products have led to accelerated inflation. For example, the imported component of the production price index increased from a twelve-month rate of 7,1 per cent in September 1999 to 13,1 per cent in January 2000, while the rate of increase in domestically produced goods accelerated from 5,2 per cent to 6,5 per cent over the same period. The Monetary Policy Committee will be closely monitoring any second-round effects of these inflationary pressures.

Over the medium to longer term, inflation in South Africa is expected to decline again because of monetary and fiscal discipline, international competition, the projected low growth of nominal unit labour costs and excess production capacity in the economy.

Given these circumstances, and consistent with the inflation target of 3 to 6 per cent as an average in 2002 as set by the government, the Monetary Policy Committee is of the opinion that the current level of the repo rate is appropriate. In accordance with the decision taken at the previous meeting, the Reserve Bank will therefore continue to manage the banks' daily liquidity requirement in a way that will result in a repo rate at or around 11,75 per cent.

A note on cash holdings in South Africa during the transition to the year 2000

by V V Mamba and J P van den Heever[1]

Introduction

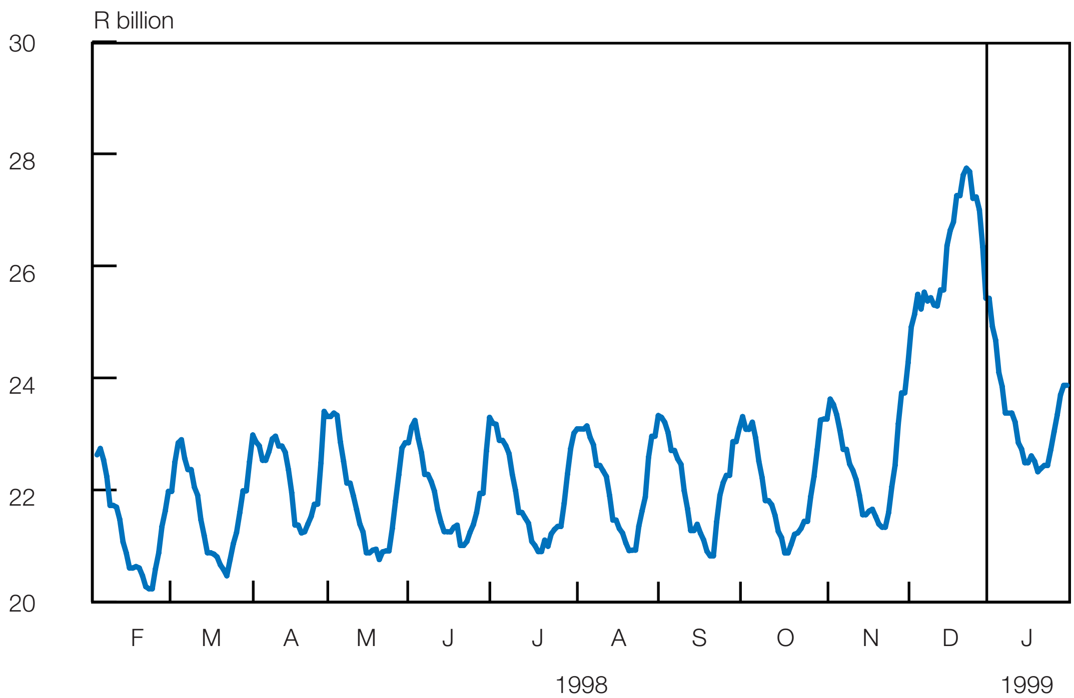
In many quarters predictions were made that the public's demand for cash would rise excessively towards the end of 1999. It was generally expected that people would withdraw money from banks in order to protect themselves against the possible failure of banks' computer systems at the time of the changeover to the Year 2000 (Y2K), and to have cash at hand during the many public holidays in the festive season. This note describes the actual changes in banknotes and coin in circulation in South Africa over the Y2K transition period.

The usual pattern of notes and coin in circulation outside the Reserve Bank

Notes and coin in circulation have a distinct behavioural pattern during the course of a month, as is seen in Graph 1. The amount in circulation usually has an upper turning point on the last day of the month, but from then on it tapers off until a lower turning point is reached on or around the 20th of the month. This pattern results from conventions and habits regarding wage and salary payments and household consumption expenditure. Many employers pay their employees at or close to the end of the month, and at that time convert deposits into cash. Though many other employees are paid by means of direct credits to their bank accounts, they invariably have a high transactions demand for notes and coin on payday and withdraw

1 *The authors are indebted to the major South African banks for providing data, and to colleagues in the Reserve Bank's Research Department for processing and graphically presenting data.*

Graph 1 Notes and coin in circulation outside the Reserve Bank, 1998/1999



cash from their bank accounts. Soon afterwards, the cash is spent on goods and services or is used to redeem outstanding debts. Businesses and other suppliers accumulate the notes and coin in their cash registers and then deposit the cash in their bank accounts. The banks, in turn, deposit the cash with the Reserve Bank, causing a decline in the amount of notes and coin in circulation.

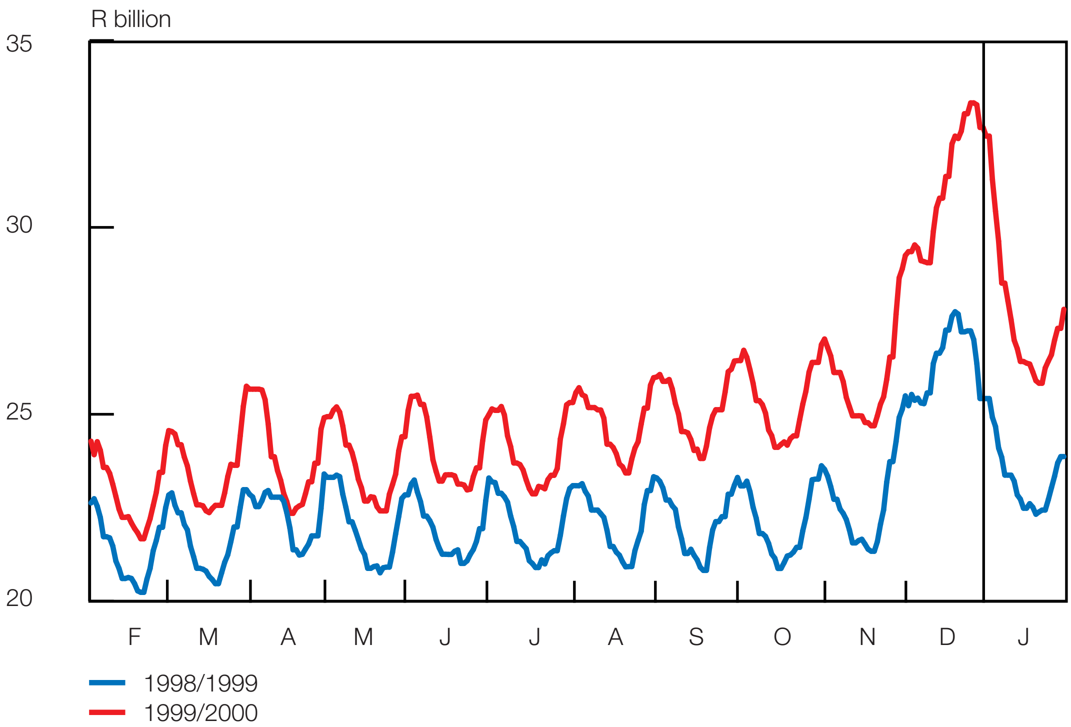
This general monthly scenario is somewhat different for the months of November, December and January. From early November in any year, the amount of notes and coin in circulation starts rising strongly on a daily basis, usually reaching a peak on one of the four days before Christmas. This trend is strengthened by the payment of annual wage and salary bonuses in November and December, when many people enjoy an extended holiday and migrant workers return home. People generally require more cash when travelling. Most important, the greater spending on gifts, recreation and other holiday goods during the festive season creates a strong demand for notes and coin. Conversely, during January the amount of notes and coin in circulation declines considerably as pay patterns return to normal.

The behaviour of notes and coin outside the Reserve Bank during the Y2K transition period

As shown in Graph 2, the level of notes and coin outside the Reserve Bank was consistently higher in 1999 than in 1998. This could be attributed to a higher level of nominal transactions in the economy resulting from inflation and some real growth, and the lower opportunity cost of holding interest-free cash, following the decline in interest rates from their high levels in the second half of 1998.

When comparing the level of notes and coin outside the Reserve Bank on a daily basis with the level on the same day of the previous year, year-on-year growth in both October and November 1999 averaged 15 per cent and thereafter fluctuated

Graph 2 Notes and coin in circulation outside the Reserve Bank, 1998/1999 and 1999/2000



between 13½ and 17 per cent up to 15 December. The year-on-year growth accelerated to 21½ per cent on 24 December, and to between 22 and 27½ per cent from 28 December 1999 to 8 January 2000. The highest rate recorded was 27,6 per cent on 3 January 2000. From 10 January the growth in notes and coin in circulation decelerated to below the 20 per cent mark, stabilising at between 14,4 and 16,9 per cent in the final two weeks of January 2000.

Notes and coin in circulation peaked a few days later than in a normal year. The highest total nominal value of notes and coin in circulation outside the Reserve Bank over the Y2K period was R33,33 billion on 28 December 1999. This implied that an amount of more than R750 was in circulation for every man, woman and child in South Africa. The Reserve Bank, of course, also held substantial additional amounts of notes in its vaults.

At the 1999 year-end the value of notes and coin stood at R32,67 billion. A year before, on 31 December 1998, the amount was R25,42 billion. Growth of 15 per cent (as had been the norm in October, November and the first half of December 1999) would have increased the amount of notes and coin in circulation to R29,23 billion on 31 December 1999. The difference of R3,44 billion or 11,8 per cent between the actual value of R32,67 billion and the hypothetical R29,23 billion may be attributed to the special circumstances surrounding the Y2K period.

As mentioned before, the value of notes and coin circulating outside the Reserve Bank amounted to R32,67 billion on 31 December 1999. As shown in the accompanying table, the increase in the value of cash outside the Reserve Bank over December 1999 was concentrated in the R100 denomination. More than 26 million R100 notes with a value of more than R2,6 billion were added to the quantity in circulation from the end of November to the end of December. R20 notes recorded the second-highest increase in terms of physical quantities in circulation; some 15 million R20 notes were added during December.

Notes and coin outside the Reserve Bank by denomination
R billions

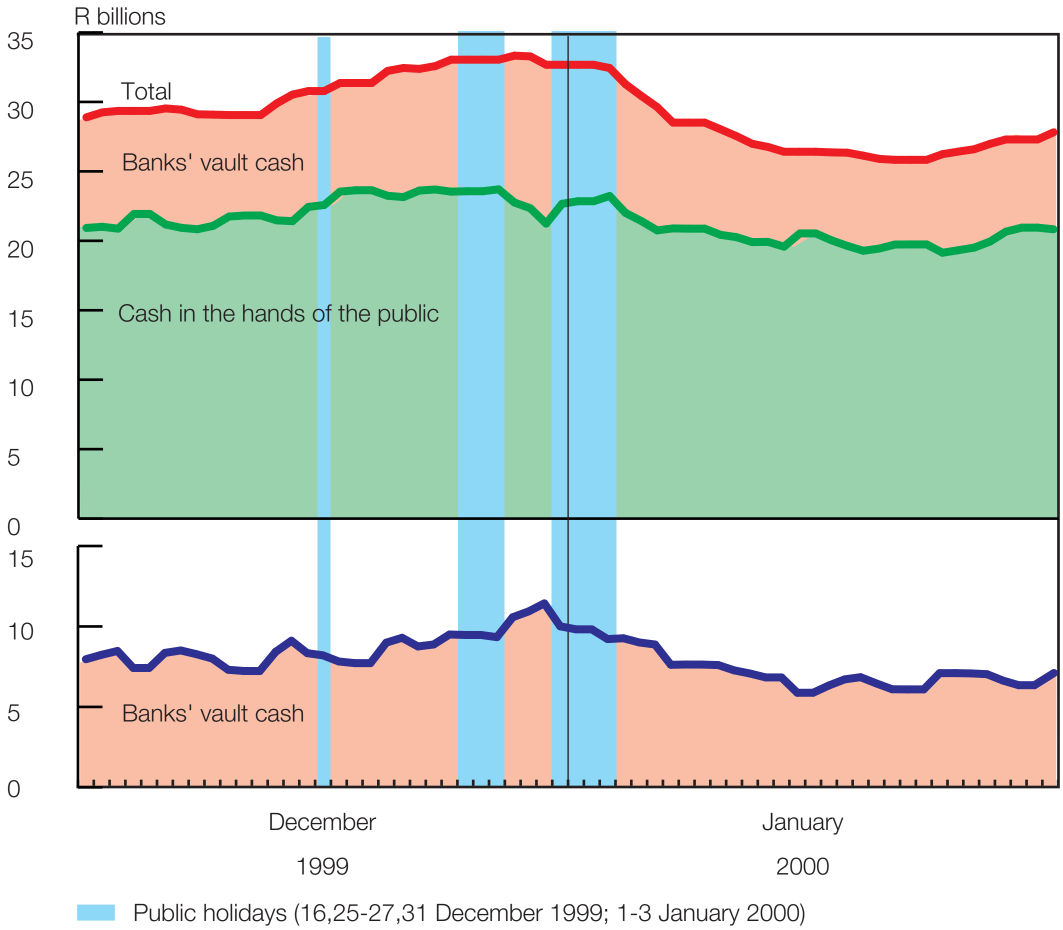
Denomination	30 Nov 1999	31 Dec 1999	31 Jan 2000
R200	4,78	5,33	4,83
R100	10,57	13,19	10,99
R50	8,00	8,44	6,93
R20	2,26	2,56	2,10
R10	1,15	1,23	1,05
Coin*	1,89	1,92	1,91
Total	**28,65**	**32,67**	**27,81**

* Including small amounts of “old” R5, R2 and R1 notes

Banks’ vault cash versus cash held by the non-bank public

Total notes and coin outside the Reserve Bank may be divided into the private banks’ holdings of notes and coin in bank vaults and automated teller machines (ATMs), on the one hand, and the non-bank public’s holdings, on the other. The separate movements in these two components during December 1999 and January 2000 are depicted in Graph 3.

Graph 3 The distribution of cash held in bank vaults and by the public, December 1999 - January 2000



The banks' vault cash rose from R7,70 billion on 30 November to around R9,5 billion over the Christmas long weekend, and to a maximum amount of R11,43 billion on 30 December, dropping sharply to R10,01 billion on 31 December. The non-bank public's holdings increased from R20,94 billion on 30 November to more than R22 billion from 15 December and to peak values of R23,70 billion on 23 December and R23,71 billion on 27 December, but declined to R22,66 billion on 31 December.

Judging by the increases from the end of November up to the respective maximum values in December, the build-up of cash clearly featured more prominently in the banks' vault cash. The non-bank public's cash holdings recorded a year-on-year increase of 22,4 per cent up to the end of December 1999, but the banks' vault cash rose by 44,8 per cent over the same period. It was probably because of the banks' ample holdings of cash in their vaults and ATMs that the public, finding that notes were available normally, tailored their demand for cash to the needs of an extended long weekend, but not to the calls of Y2K alarmists.

Once into the year 2000, banks' vault cash declined from the level of approximately R10 billion recorded on 31 December 1999 and 1 January 2000 to around R9,2 billion on 3 January as the public withdrew notes from ATMs. The Reserve Bank also accepted some cash deposits from the banks, opening its doors for such business from 3 January. Vault cash levels receded further, reaching a lower turning point of R5,88 billion on 15 January 2000.

The non-bank public, using ATMs over the long weekend, increased their cash holdings from R22,66 billion on 31 December to R23,23 billion on 3 January. Then they worked down their cash holdings to a low point of R19,14 billion on 24 January.

Conclusion

The unique circumstances surrounding the changeover to the Year 2000 led to a higher-than-usual amount of bank notes and coin being held in banks' vaults and ATMs and in the hands of the non-bank public. It is estimated that over the year-end note and coin holdings increased by an additional R3,44 billion, or by 11,8 per cent, on account of these unique circumstances.

The additional demand for cash fell far short of the huge amounts mentioned by alarmists. This favourable outcome was largely due to the programmes launched to get key systems Y2K compliant and to inform the public of the state of readiness of the banking system. Actions along these lines began long before the critical date-change; as early as 3 October 1996 the Registrar of Banks, in Banks Act Circular 12/96, highlighted to banking institutions the possibility of systemic risk that could result from the failure of computer systems to recognise or store more than two digits in the identification of a year after the end of 1999. Intensive preparations followed, not only in the technical area but also in communicating the true state of affairs to the public. These efforts involved key players, from the Governor of the Reserve Bank and the Registrar of Banks to banks' chief executive officers and information technology experts.[2] This was rewarded when there was little or none of the panic demand for cash that some observers had forecast.

2 See for example the booklet Year 2000 readiness status of the South African banking system, issued in November 1999 by the South African Reserve Bank and the Banking Council South Africa.