Quarterly Bulletin

September 2002

South African Reserve Bank

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No 225

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ISSN 0038-2620

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Quarterly Economic Review

Introduction

The latest estimates by the US Department of Commerce of the national accounts confirm that the United States economy was in a full-blown recession in 2001. Real gross domestic product in the United States declined in three successive quarters last year.

After the 2001 recession, the picture emerging in the second half of 2002 is that the global downturn has come to an end and that a relatively mild but broad-based recovery may already be under way. The easing of monetary policy and a more expansionary fiscal policy stance in many advanced economies have both helped support the current upturn.

Lower oil prices early in 2002 have reduced global inflation and helped sustain real disposable income. Inflation is expected to remain low but there are risks of a rise in some countries with rigid labour markets, especially in Europe. Nevertheless, the concerns about inflation are not expected to invite policy responses which could constrain the global recovery.

Deteriorating financial market conditions could dampen the global recovery. Falling stock market prices, through various wealth channels, are fully capable of slowing down the nascent recovery. Governments are still able to finance fiscal deficits at declining bond yields, but companies' ability to raise capital has become somewhat limited, given greater investor caution after a series of high-profile bankruptcies in the United States of America. In addition, the wider spread between corporate bond yields and government bond yields may slow down the speed of the global recovery.

Essentially because of the greater price competitiveness of exporting companies, the South African economy succeeded in outperforming the global economy in the second quarter of 2002. Whereas the growth momentum in the international economy is generally expected to have weakened in the second quarter, the seasonally adjusted annualised growth in real gross domestic product in South Africa accelerated from 2 per cent in the first quarter of 2002 to 3 per cent in the second quarter. Growth was well dispersed throughout all the productive sectors of the economy, but of special significance was the healthy performance of the increasingly export-oriented manufacturing sector.

Aggregate final demand rose robustly in the second quarter of 2002. Fixed capital formation led the way as firms added to their production capacity, apparently in anticipation of stronger future growth in demand. Final consumption spending by households and general government also contributed to the solid rise in domestic demand. However, inventory investment fell back, causing real gross domestic expenditure to decline below the level recorded in the first quarter of 2002. This decline in inventory investment dampened the demand for imported goods, thus contributing to the widening in the country's positive trade balance with the rest of the world.

The overall saving ratio deteriorated in the second quarter of 2002. Household saving held up well in the face of consumers' strong propensity for spending, and saving by general government improved as a ratio of gross domestic product. By contrast, corporate saving declined as a percentage of gross domestic product, mainly because of large-scale dividend distributions, a sizeable portion of which was paid to non-resident parent companies and other foreign shareholders.

The better performance of the economy during the past three years did not reverse the downward movement in formal-sector employment. Employment opportunities in the formal sectors of the economy continued to diminish in the first quarter of 2002. There were nevertheless signs that the pace of decline in employment was tapering off in both the private and public sectors. This slight improvement in labour market conditions was echoed in a rising number of vacancies in the first quarter of 2002 and an increase in the space occupied in the print media by job advertisements.

Industrial relations became far more harmonious in the early part of 2002. The number of workdays lost to strikes and other work stoppages in the first half of 2002 was much lower than in the corresponding period in 2001. Output per worker accordingly rose further, especially in the manufacturing sector where nominal unit labour cost was firmly curbed. Economy-wide productivity growth was less impressive and the year-on-year growth in unit labour cost for the entire economy exceeded the rate that could conceivably be associated with low inflation.

The acceleration in economy-wide unit labour cost, together with the depreciation in the value of the rand towards the end of 2001 and rapid increases in food prices, propelled production and consumer price inflation to considerably higher levels in the first half of 2002. These price increases started losing momentum for a while in the second quarter of 2002 but despite this, annual inflation remained at a high level, leaving little scope for complacency in the struggle against inflation.

The decline in real gross domestic expenditure in the second quarter of 2002 held back growth in merchandise import volumes. Simultaneously, export volumes benefited immensely from domestic producers' greater competitiveness in export markets. The surplus of merchandise and gold exports over goods imports accordingly widened. There was a sharp increase in net investment income payments to the rest of the world, but the overall current account of the balance of payments remained in surplus in the second quarter of 2002.

On the financial account of the balance of payments, the net inflows of capital into the economy in the second quarter of 2002 exceeded the net outflows by the widest margin ever recorded in a single quarter. The major portion of these net inflows consisted of portfolio capital flows, essentially the national government's borrowing in the international capital markets and non-resident investors' increases in their holdings of domestic debt and equity securities. Portfolio investment flows, especially the purchasing of bonds and shares on traded markets, are known for being fickle and subject to sudden reversals. Something of this kind occurred towards the end of May 2002 when non-resident investors began to sell their holdings of South African equity and debt securities on a net basis.

The excess of the net inflow of capital over the net outflow, together with a surplus on the current account of the balance of payments, led to a significant improvement in the country's net holdings of international reserves in the second quarter of 2002. Under circumstances such as these, a strengthening in the exchange value of the rand can normally be expected, and the rand appreciated accordingly in the first five months of 2002. Since the beginning of June 2002 the rand has again come under some downward pressure because of problems in other emerging markets and fears that problems in neighbouring countries may spill over into South Africa. The contents of a draft mining charter for South Africa also failed to instil confidence in the rand among participants in the foreign-exchange markets.

The rates of growth in the monetary aggregates have slowed somewhat from the beginning of the year, but they remained relatively strong. To the extent that the balances encapsulated by these aggregates are used to purchase goods and services, they are an indication of potential inflationary pressures. This assumption is strengthened by the greater concentration of deposits in the hands of non-financial companies whose spending plans are more likely to be directly related to aggregate nominal spending on goods and services than those of financial companies.

Part of the reason that growth in the monetary aggregates remained relatively strong in the second quarter of 2002 was the greater demand for money for precautionary purposes. In the face of heightened uncertainty about asset price movements and future income growth, companies and individuals chose to hold a higher level of deposits for precautionary purposes. This choice, and a shift towards more investment-oriented long-term deposits, partly countered the potential impact on inflation of the very high level of aggregate money holdings.

Credit extension to the private sector was flat in the second quarter of 2002. One of the principal reasons for this was the unwinding and eventual turnaround of leads and lags in payments for and receipts from foreign transactions. The appreciation of the rand in the first and second quarters of 2002 provided an incentive to exporters to repatriate their export proceeds as soon as possible. This generally dampened the demand for credit, especially the demand by companies for borrowing from the banking sector. By contrast, households' demand for mortgage bond lending remained firm.

On 14 June 2002 the Monetary Policy Committee of the Reserve Bank increased the rate on repurchase transactions by 100 basis points. This meant that the repurchase rate was increased by a total of 300 basis points in the first half of 2002. In reaching this decision, the Monetary Policy Committee indicated that the sharp decline in the exchange value of the rand in the last quarter of 2001 and higher international petroleum prices had fuelled inflationary expectations, prompting a tightening of the monetary policy stance in the quest to attain the inflation targets.

Short-term money market interest rates moved higher, following the Bank's cumulative increase in the repurchase rate. By contrast, the mood in the bond market turned positive by the end of March 2002 and the average monthly yield on long-term government bonds declined quite substantially as market participants held to the view that the acceleration in inflation would only be temporary.

The steady fall in bond yields was assisted by the limited supply of investable securities in the market, due to the national government's preference for offshore bond financing. At the same time, the outlook for the economy and corporate profits became slightly less certain, strengthening the demand for fixed-interest securities at the expense of the demand for equities. The divergent movements of short and long-term interest rates caused a flattening and eventually an inversion of the slope of the yield curve.

Share prices staged a strong comeback in the aftermath of the September 11 attacks on America. Most of the incoming information during the first five months of 2002 suggested that the economy had proven remarkably resilient and economic prospects were improving. The upward momentum in share prices was checked when many market participants in the United States became worried about the credibility of corporate financial statements and lowered their outlook for the economy. The JSE Securities Exchange SA followed the global trend downwards and the daily closing level of the all-share price index fell by 24 per cent from 22 May 2002 to 5 August.

Non-resident investor sentiment towards bonds improved noticeably in the second quarter of 2002 but then deteriorated abruptly in July. Since May 2002, non-residents have also been net sellers of shares listed on the stock exchange. Heightened aversion to risk taking in emerging markets and problems in some countries in the Southern African region led to a reduction in the exposure of international investors to South African shares and other financial assets.

The improving economic conditions and efficient tax administration have led to a smaller national government budget deficit than had been anticipated earlier. The national government budget deficit was reduced from 2,0 per cent of gross domestic product in fiscal 2000/01 to 1,5 per cent in fiscal 2001/02 – well below the original budgeted target of 2,5 per cent.

The budget for 2002/03 indicates an increase in the national government deficit to 2,1 per cent of gross domestic product, partly due to some tax relief for lower and middle-income taxpayers and higher spending in priority areas such as poverty reduction, social and economic infrastructure, HIV/Aids and crime. Despite these concessions, tax revenue growth continued to exceed expectations in the first four months of fiscal 2002/03, and the steps taken to improve expenditure monitoring and control ensured that growth in spending stayed broadly on target.

The funding of the relatively small national government budget deficit was mainly obtained in the international capital markets, releasing resources in the domestic fixed-interest market and assisting the bull market in bonds. The national government also used financial surpluses over the past year to pay down its outstanding domestic marketable debt. Overall, the public debt to gross domestic product ratio remained fairly modest, as did foreign debt as a portion of total public debt.

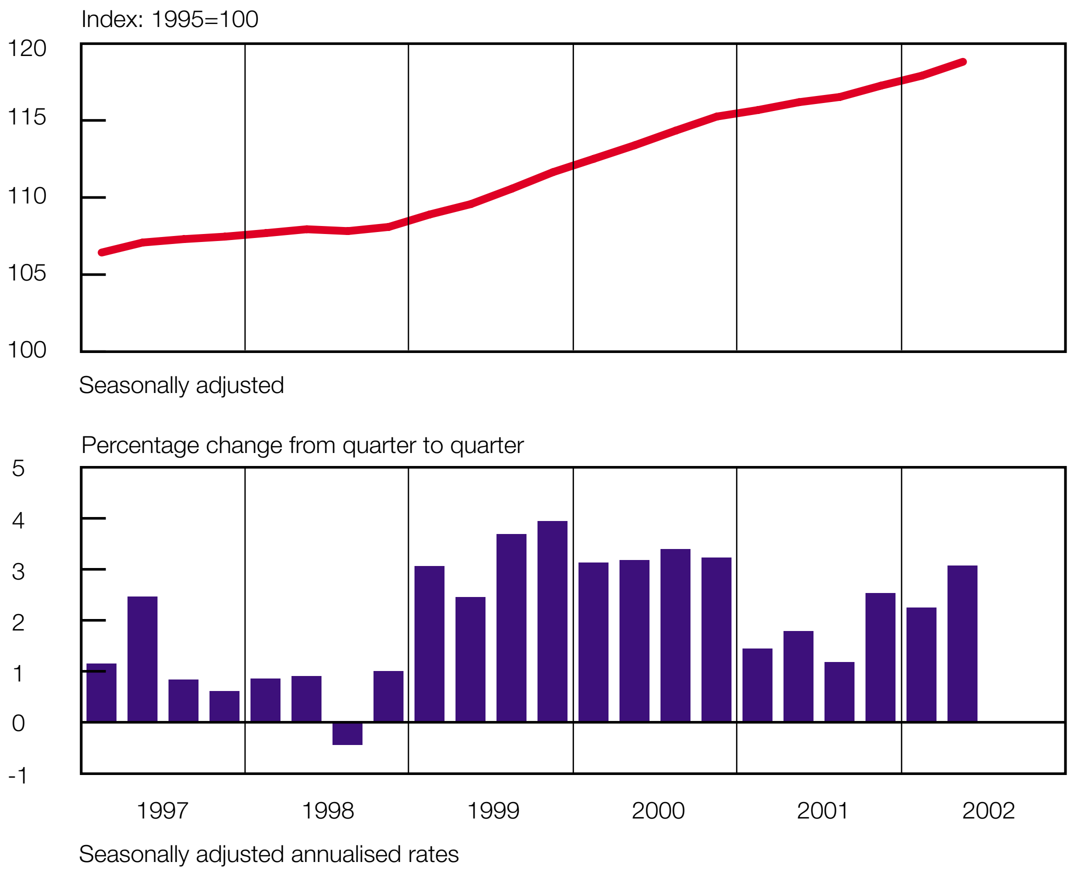
Domestic economic developments

Domestic output

Real economic growth firmed quite noticeably in South Africa during the second quarter of 2002 at a time when some analysts were concerned about the sustainability of the global economic recovery. Growth in *real gross domestic product* picked up from an annualised rate of 2 per cent in the first quarter of 2002 to 3 per cent in the second quarter. The growth in output was well distributed throughout the various sectors of the economy, and the export-oriented sectors clearly benefited from the depreciation in the exchange value of the rand.

The real value added by the *primary sectors* increased at an annualised rate of 3 per cent in the second quarter of 2002, following growth of 2 per cent in the first quarter. The real value added by the *agricultural sector* grew at a strong annualised rate of 6 per cent in the second quarter of 2002. Agricultural production benefited from a bumper maize crop of 8,8 million tonnes, predominantly harvested in the second quarter. Output originating in the *mining sector* also contributed somewhat to the higher output volumes in the primary sector. Mining output benefited from higher production of platinum and diamonds, and also from some bottoming-out in gold-mining production. The bottoming-out in gold output might have been temporary as the gold-mining industry has been in a state of decline for longer than thirty years.

Real gross domestic product



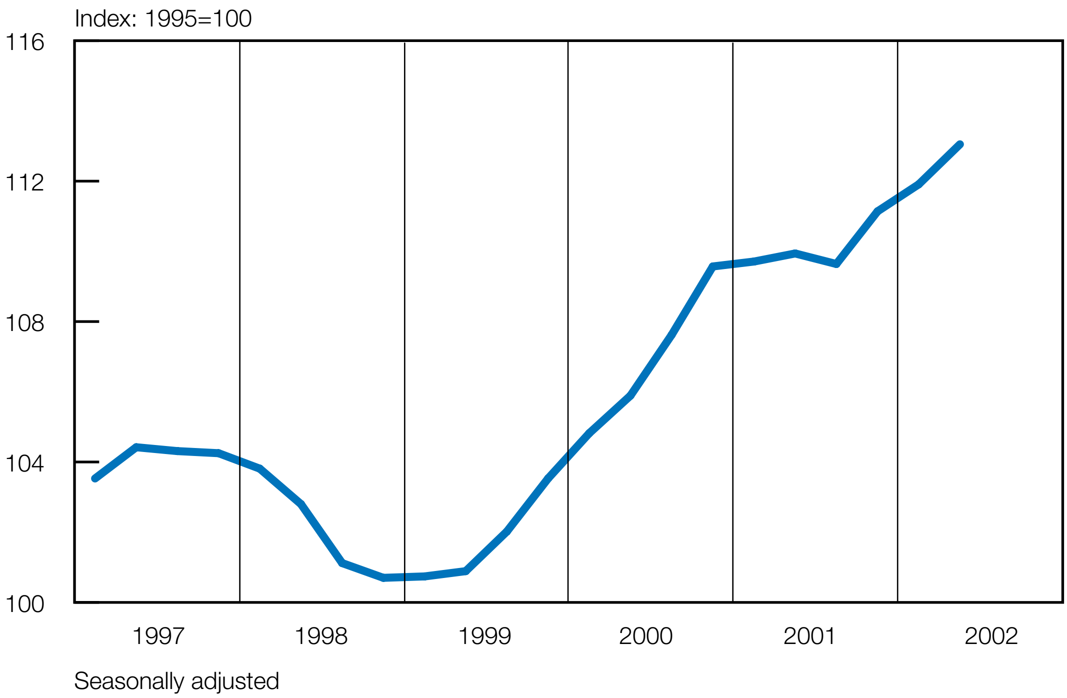
Real gross domestic product
Percentage change at seasonally adjusted annualised rates

	2001					2002	
Sectors	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Primary sectors	-4	-½	-1½	-2½	-1½	2	3
Agriculture	-10	-4	-1½	-2½	-3	4½	6
Mining	1½	2½	-1	-2½	0	0	½
Secondary sectors	½	1	-½	4	2½	2	3½
Manufacturing	½	1	-1	5½	3	3	4
Tertiary sectors	2½	2½	2½	2½	2½	2½	3
Non-agricultural sectors	2	2	1½	3	2½	2	3
Total	1½	2	1	2½	2	2	3

Output in the *secondary sectors* of the economy recovered fairly strongly in the second quarter of 2002 after a slowing down of growth in the first quarter of the year. Mainly because of a solid output effort in the *manufacturing sector*, the real value added in the secondary sectors expanded at an annualised rate of 3½ per cent in the second quarter of 2002, compared with 2 per cent in the first quarter. Modest increases in the real value added by the sector supplying *electricity, gas and water* and by the *construction sector* also contributed to the higher level of output in the secondary sectors.

Output in the *manufacturing sector* grew at an annualised rate of 4 per cent in the second quarter of 2002, significantly faster than in the first quarter but still slower than during the fourth quarter of 2001. Increased production activity was observed throughout the sector, but the industries that expanded fastest were the manufacturing of clothing and textile products, wood and wood products, non-

Real value added by manufacturing



metallic mineral products, and basic metal products. Most of these industries have a strong export orientation and they successfully capitalised on the lower exchange value of the rand by penetrating new export markets.

The real value added by the sector supplying *electricity, gas and water* increased at an annualised rate of 1½ per cent in the second quarter of 2002, broadly reflecting the stronger output performance of the goods-producing industries, an increase in the demand from neighbouring countries and the effects of a cold spell in May. New building construction, alterations to existing buildings and the start of new infrastructural projects by the government sector helped the *construction sector* to accelerate its output growth from ½ per cent in the first quarter of 2002 to 1½ per cent in the second quarter.

Output expansion continued at a relatively fast pace in the *services sectors* of the economy. Annualised output growth in the *commerce sector* accelerated from 2 per cent in the first quarter of 2002 to 3 per cent in the second quarter. The acceleration in growth in the second quarter of 2002 could be attributed to a strong expansion in the retail trade and in catering and accommodation services. Apart from continued strong demand by domestic consumers, the high number of international tourists visiting the country also contributed to the expansion of the hospitality industry.

The *transport, storage and communication sector* continued to grow at an annualised rate of 5 per cent in the second quarter of 2002. The expansion of the cellular telephone industry played a prominent role in the expansion of this sector, but the transport industry also benefited from the international tourist traffic in the country and the large freight volumes that had to be moved between the urban centres in the interior of the country and the coastal ports.

The real value added by the *financial intermediation, insurance, real-estate and business services sector* increased at a seasonally adjusted and annualised rate of 3½ per cent in the first and second quarters of 2002. Banks, other financial services and the real-estate sector benefited from high turnovers in the traded securities markets and in the real-estate market.

Domestic expenditure

Aggregate *real gross domestic expenditure* declined at a quarter-to-quarter seasonally adjusted annualised rate of 1 per cent in the second quarter of 2002, following an *increase* of 6 per cent in the first quarter. This abrupt turnaround in real gross domestic expenditure was entirely due to a sharp slowdown in the pace of inventory accumulation. Inventory levels still rose in the second quarter of 2002, but the increment was about a ninth of the size of the increment in the previous quarter. All the other main components of domestic expenditure increased at relatively solid rates in the second quarter of 2002. In particular, real gross fixed capital formation recorded a healthy increase.

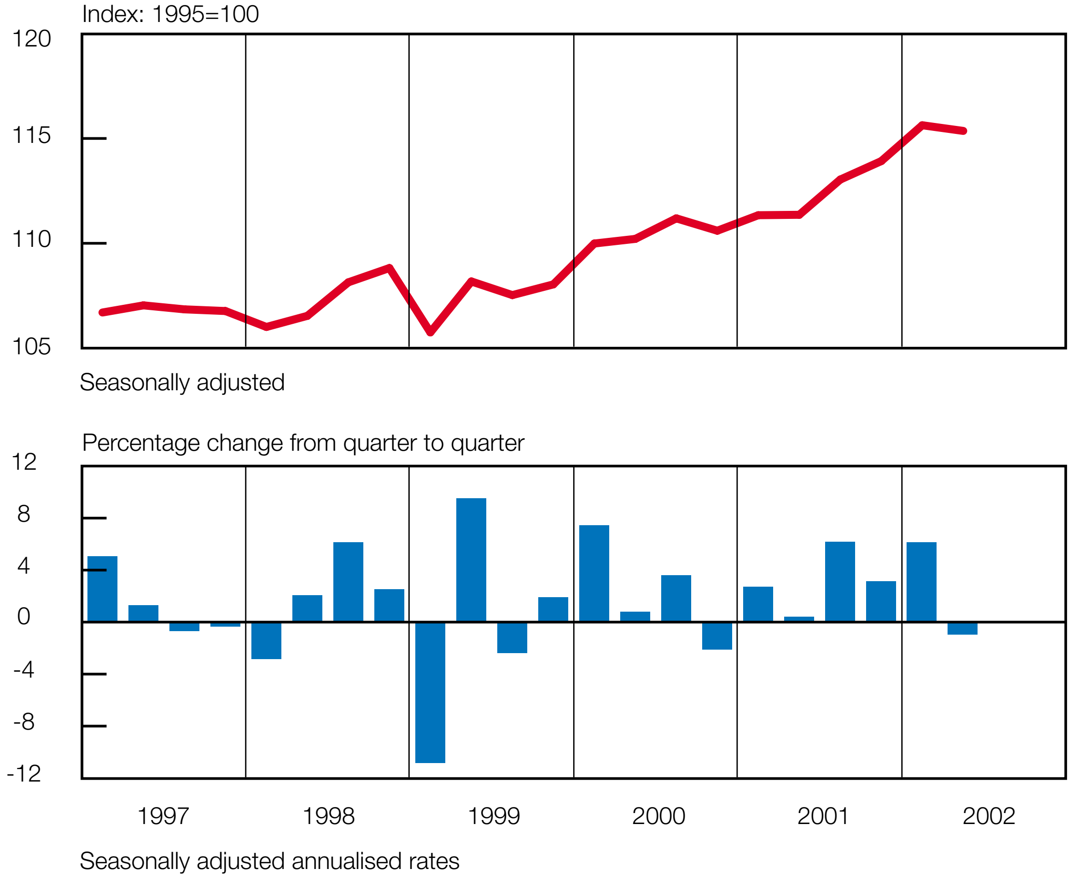
The growth in *real final consumption expenditure by households* continued steadily at a seasonally adjusted and annualised rate of 3 per cent in the first and second quarters of 2002. Especially semi-durable goods were in strong demand. All of the subcategories of semi-durable goods showed strong growth, but the higher spending on clothing and footwear was particularly prominent.

Real gross domestic expenditure

Percentage change at seasonally adjusted annualised rates

Components	2001					2002	
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Final consumption expenditure by households	2½	2½	2½	3½	3	3	3
Final consumption expenditure by general government	1½	2½	2½	3	1½	3	3
Gross fixed capital formation	5	3	3	5½	3½	6	7½
Change in inventories (R billions)	2,6	-2,3	5,3	6,2	3,0	8,8	1,0
Gross domestic expenditure	**2½**	**0**	**6**	**3**	**1½**	**6**	**-1**

Real gross domestic expenditure

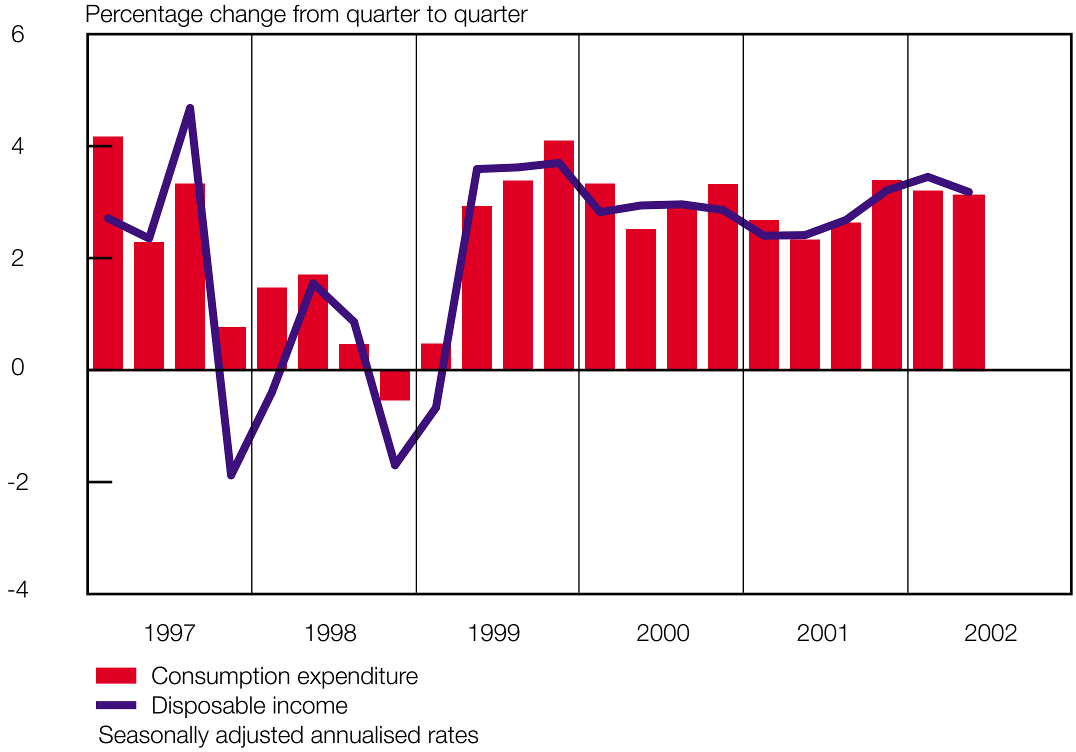


Expenditure on non-durable goods and services increased too, but real outlays on durable goods, mainly motorcars, declined. There was a rise in spending in most of the subcategories of non-durable goods and services, except for petroleum products where the higher price of petrol led to some economising on the use of fuel by private motorists.

Household spending on durable goods was influenced by the increase in the relative prices of these items. Durable goods typically have a high import content. The depreciation of the rand in the last quarter of 2001 raised the prices of durable goods relative to the prices of other consumer items, causing some substitution of non-durable goods for durable goods. The higher cost of bank financing could also have weighed on consumer demand for durable goods.

The fairly strong growth in real spending by households was underpinned by relatively strong growth in the *real disposable income of households*, which in turn was boosted by a solid increase in farm income, and by a reduction in personal income-tax rates. Households succeeded in sustaining spending at a high level without having to resort to additional bank funding. In fact, households managed to lower the ratio of their debt to their disposable income from 54 per cent at the end of the first quarter of 2002 to 53 per cent at the end of the second quarter.

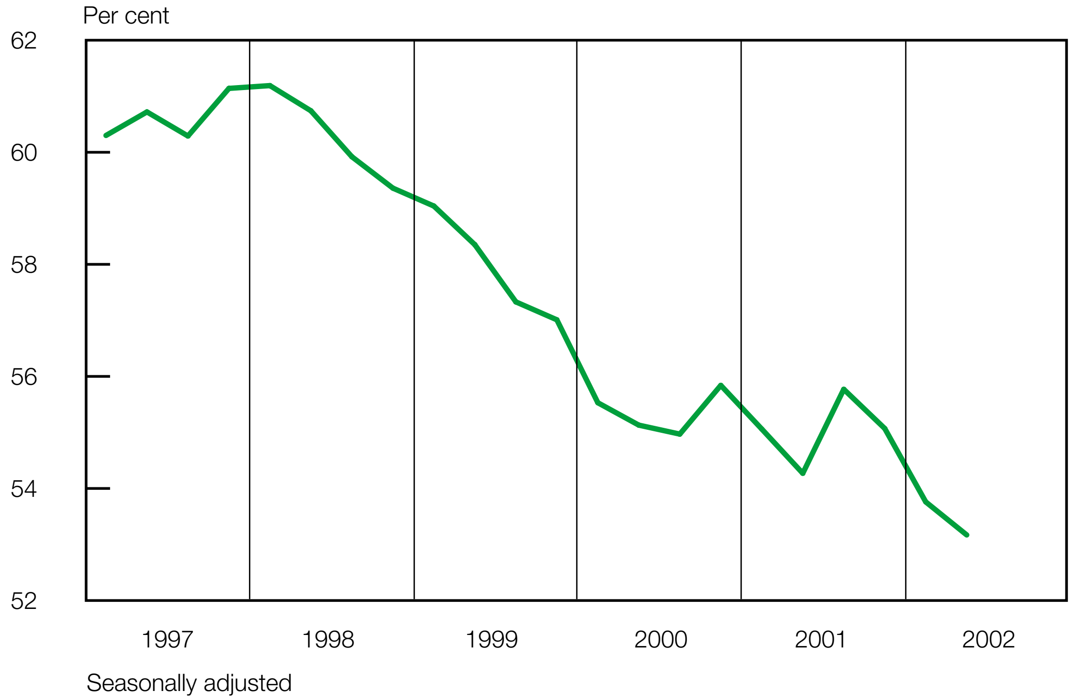
Real income and expenditure of households



Real final consumption expenditure by general government increased at a seasonally adjusted annualised rate of 3 per cent in both the first and second quarters of 2002. Spending on intermediate goods and services, on the one hand, and employee remuneration, on the other, increased in the second quarter of 2002. This increase is consistent with government's objective to accelerate the pace of activity in the domestic economy. Real outlays on the compensation of employees have risen for the first time since the fourth quarter of 1996. Despite the fairly strong growth in the latest two quarters, final consumption expenditure by general government as a percentage of gross domestic product has remained at a level of 18 per cent for ten quarters in succession.

Growth in *real gross fixed capital formation* accelerated from a seasonally adjusted annualised rate of 6 per cent in the first quarter of 2002 to 7½ per cent in the second quarter. All three institutional sectors, i.e. private business, public corporations and general government, contributed to the higher level of investment activity.

Household debt as percentage of disposable income



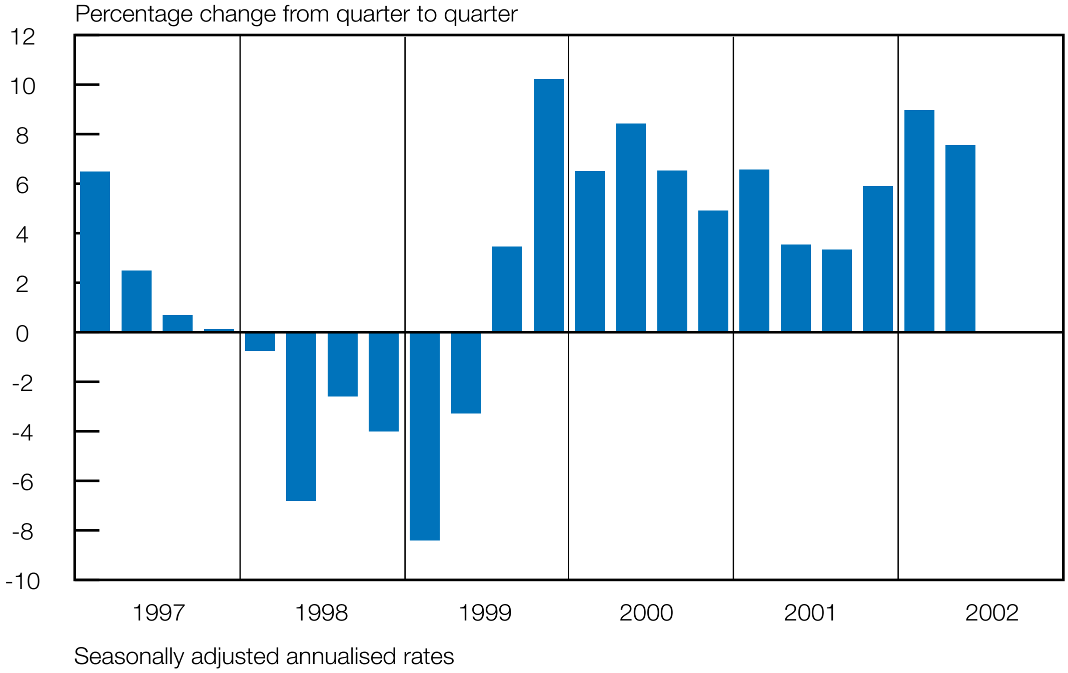
Real fixed capital expenditure by *public corporations,* which had been declining almost uninterruptedly for thirteen quarters, rebounded at a seasonally adjusted annualised rate of 6½ per cent in the second quarter. The Coega harbour project witnessed the start of the development of port infrastructure and Transnet expanded its communications capacity. Capital outlays by the other public corporations still declined.

Real gross fixed capital formation by general government grew at an annualised rate of 6 per cent in the first quarter of 2002 and 6½ per cent in the second quarter. The higher level of spending occurred mainly among local governments and was directed at improving the road network and at urban renewal. Included in this category was the capital spending on the improvement of infrastructure for the organising of the World Summit on Sustainable Development held in Gauteng Province.

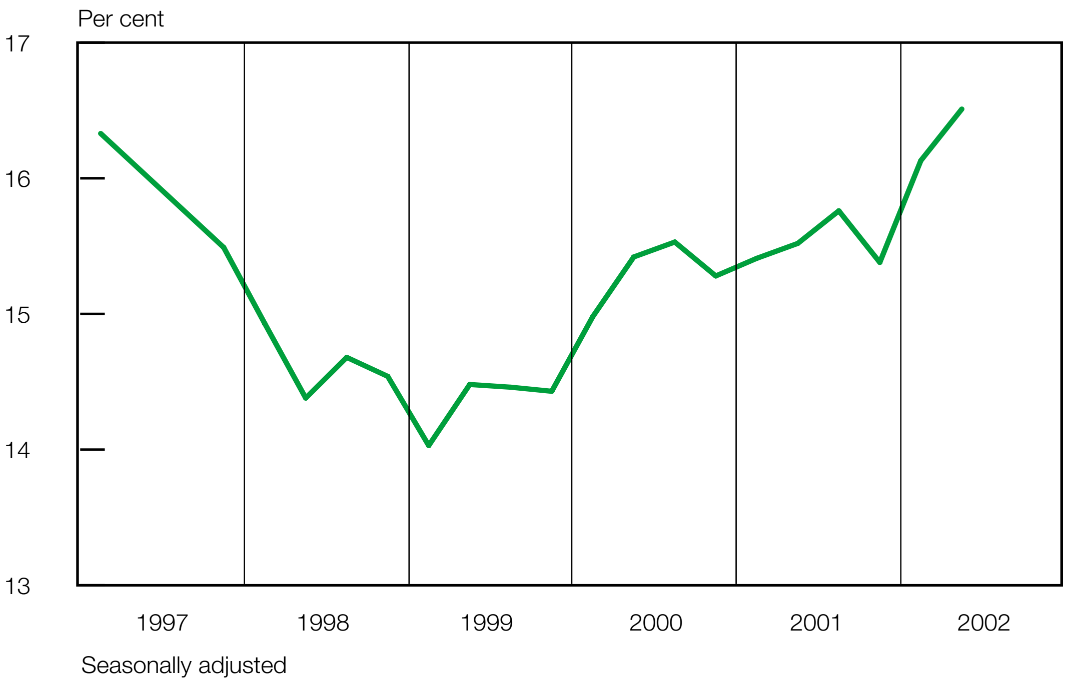
Real fixed capital formation by *private-sector* companies continued to grow in the second quarter of 2002, although at a slightly lower rate than in the first quarter; the seasonally adjusted annualised growth slowed from 9 per cent in the first quarter of 2002 to 7½ per cent in the second quarter. Increased capital formation occurred throughout all the productive sectors of the economy, except for agriculture. The strongest growth was in platinum mining, followed by commerce where entertainment centres and accommodation space were developed to cater for the growing tourist market.

The strong expansion in manufacturing output volumes contributed to a substantial increase in manufacturing inventory levels in the second quarter of 2002. As a consequence, the ratio of industrial and commercial inventories to non-agricultural gross domestic product increased from 16 per cent in the first quarter of 2002 to 16½ per cent in the second quarter.

Real gross fixed capital formation by private sector



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

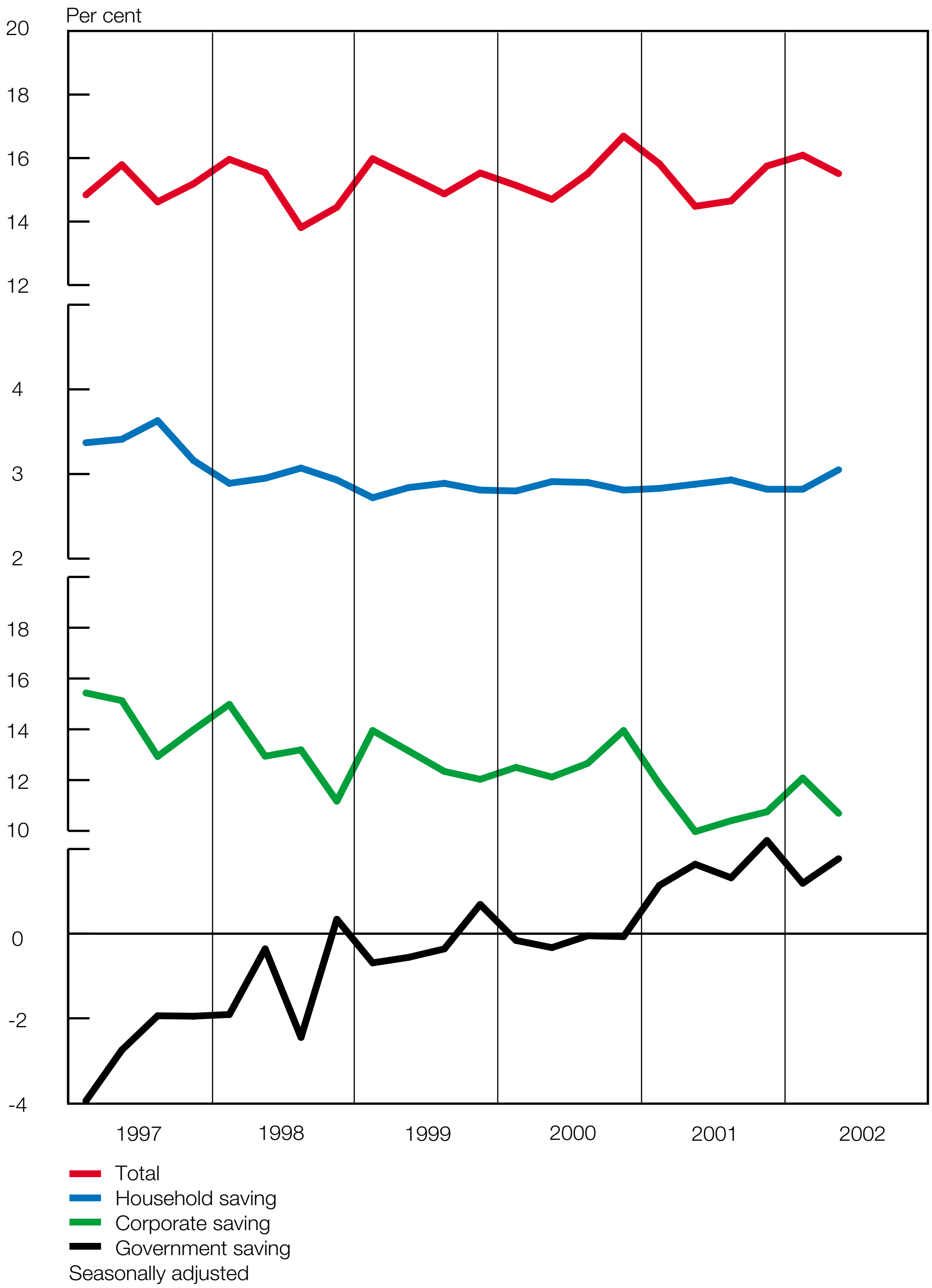


In sharp contrast to manufacturing inventories, mining and commercial inventories were reduced substantially during the second quarter of 2002, almost fully neutralising the increase in manufacturing inventories. On a net basis, total inventory levels still increased in the second quarter of 2002, but at a far slower pace than in the first quarter. The impact of the change in inventories on the growth in gross domestic expenditure was substantial: where inventory investment added some 1½ percentage points to overall expenditure growth in the first quarter of 2002, it subtracted 5 percentage points in the second quarter.

Factor income and saving

Total nominal factor income increased by 10 per cent in the first and second quarters of 2002. The operating surpluses of business enterprises grew slightly

Gross saving as percentage of gross domestic product



faster, while the growth in compensation of employees held steady at the 8 per cent rate of the previous quarter. But there was an increase in the overall remuneration bill from the first to the second quarter of 2002. As a result, the compensation of employees as a percentage of total factor income edged higher to 52 per cent in the second quarter of 2002, compared with 51½ per cent in the first quarter.

Nominal gross operating surpluses increased by 12 per cent in the year to the second quarter of 2002, about at the same rate as in the year to the first quarter. Strong profit growth in the export-oriented mining and manufacturing sectors contributed most to the solid growth in operating surpluses. These sectors benefited from the latest depreciation in the exchange rate of the rand and have also improved productivity levels (measured as output per worker employed) substantially over time.

The country's *saving ratio* (gross saving as a percentage of gross domestic product) weakened from 16 per cent in the first quarter of 2002 to 15½ per cent in the second quarter. Saving by general government improved and that of private households remained broadly unchanged relative to gross domestic product. Saving by the corporate sector as a percentage of gross domestic product, however, fell back from 12 per cent in the first quarter of 2002 to 10½ per cent in the second quarter. The retained earnings of companies were slightly diluted as corporates stepped up their distribution of profits. In particular, the distribution of dividends to non-resident shareholders increased sharply. This is evident from the higher dividend payments to the rest of the world as a percentage of total declared dividends, which rose from 20½ per cent in the first quarter of 2002 to about 45 per cent in the second quarter. It is not yet clear whether this increase is a passing occurrence, or a regular seasonal phenomenon, or an indication of a structurally higher ratio.

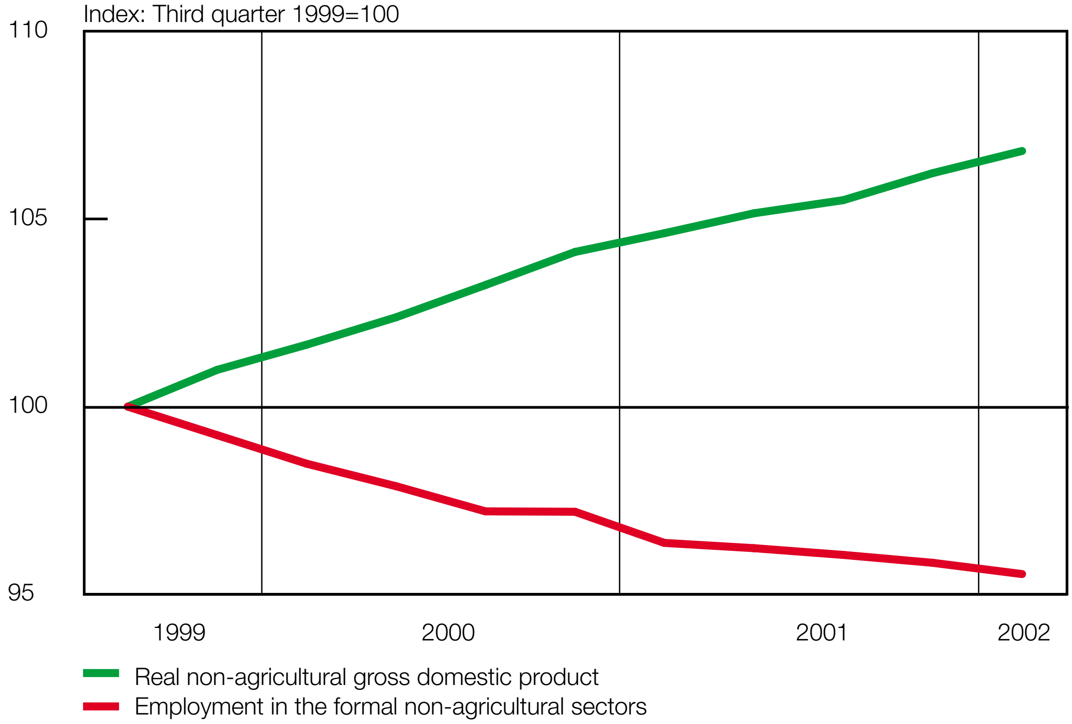
Employment

Employment numbers in the *formal non-agricultural sector* of the economy declined at a slower pace than previously. According to the *Survey of Employment and Earnings in Selected Industries (SEE)* by Statistics South Africa, employment in the regularly surveyed formal non-agricultural sectors of the economy declined at a rate of 0,9 per cent in the year to March 2002, significantly less than the decline of 1,4 per cent in the year to December 2001. The slower pace of job shedding in the first quarter of 2002 was evident in both the private and public sectors of the economy.

Employment in the formal sector responded poorly to the recovery in overall economic activity that commenced in the fourth quarter of 1999. In fact, employment totals reacted perversely to the improvement in economic conditions. Though the real gross domestic product has increased by 6,8 per cent since the third quarter of 1999, the number of workers employed in the formal non-agricultural sectors of the economy has declined by 4,5 per cent over the same period. According to the official statistics, about 216 000 employment opportunities were destroyed between the third quarter of 1999 and the first quarter of 2002. There are signs, however, that the pace of employment decline has been tapering off lately.

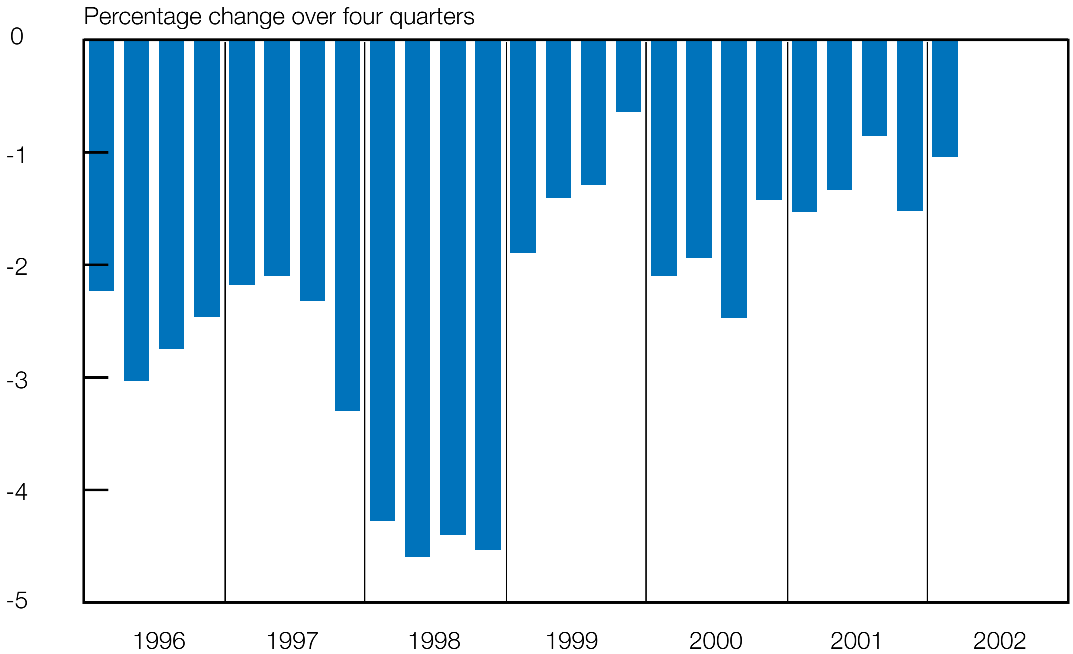
Private-sector employment losses slowed down from a year-on-year rate of 1,5 per cent in the fourth quarter of 2001 to 1,0 per cent in the first quarter of 2002. This was the third-lowest rate of job shedding in the past five years, surpassed only by the small declines in the fourth quarter of 1999 and the third quarter of 2001.

Domestic output and employment



Annual decreases in *private-sector* employment in the first quarter of 2002 occurred in five of the eight identified subsectors. The financial intermediation and insurance industry recorded the largest annual decrease of 4,0 per cent, followed by the mining sector where employment numbers decreased by 3,3 per cent. The contraction in overall mining employment was primarily due to the loss of job

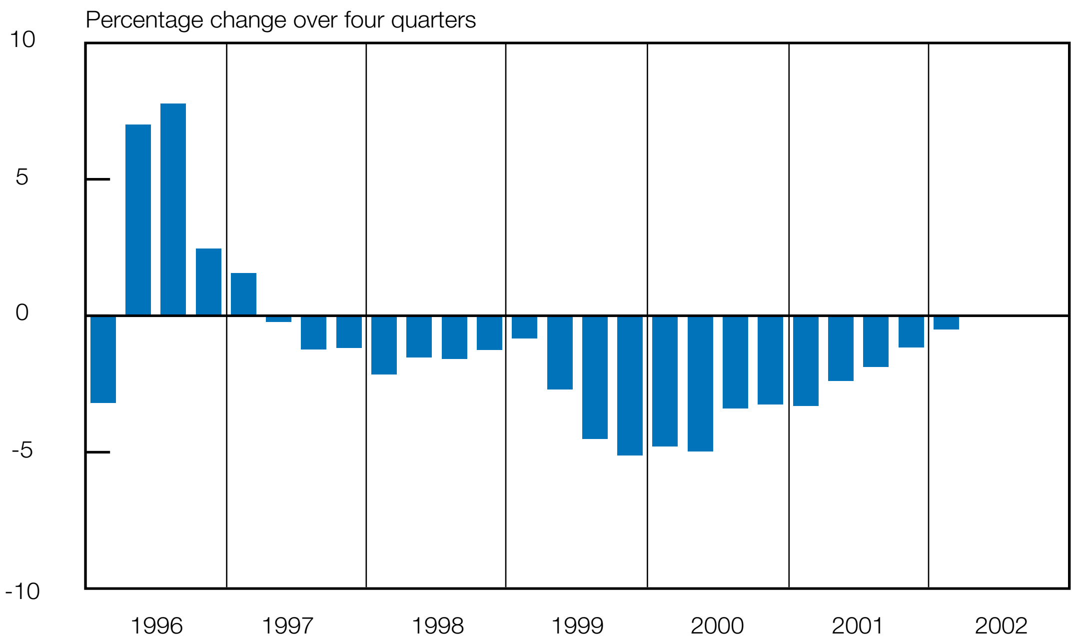
Non-agricultural private-sector employment



opportunities in the gold-mining sector. Non-gold mining establishments, however, expanded their employment numbers in the first quarter of 2002. This was their seventh consecutive quarterly increase. An expansion in private-sector employment in the opening months of 2002 was noted in the trade, catering and accommodation services sector, washing and laundering services, and in the transport, storage and communication sector.

The year-on-year rate of decline in *public-sector* employment slowed down to 0,5 per cent in the first quarter of 2002 – the lowest rate of decline in four and a half years. Furthermore, when measured from quarter to quarter and expressed at an annualised rate, public-sector employment totals actually *increased* at a rate of 1,3 per cent in the first quarter of 2002. This increase was quite broadly based. It was only in the transport, storage and communication sector that employment numbers contracted.

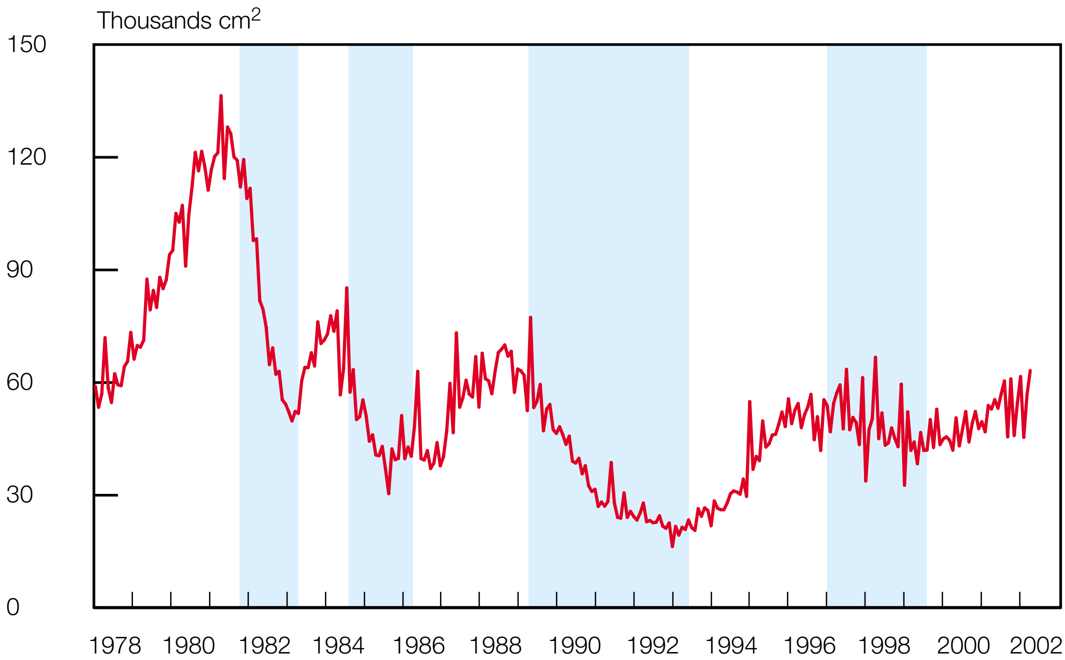
Public-sector employment



The *Survey of Average Monthly Earnings* by Statistics South Africa indicates that the total number of vacancies in all industry groups increased by 9,8 per cent in 2001 and at a year-on-year rate of 3,7 per cent in February 2002. The number of vacancies in the opening months of 2002 picked up noticeably in the transport, storage and communication industry and in the local government sector.

The improvement in employment prospects at the beginning of 2002 was also reflected in changes in job advertisement statistics. Historically, the quantum of job advertisements in the media has closely followed movements in the business cycle. Reflecting the improvement in the demand for labour, job advertisements in a major Sunday newspaper rose significantly during the current recovery phase of the business cycle. When measured over periods of four quarters, the space occupied by job advertisements rose by 7,5 per cent in the first quarter of 2002.

Job advertisements



Advertising space purchased in *The Sunday Times*
Shaded areas indicate downward phases of business cycle

Industrial relations were far more harmonious in the early months of 2002 than during 2001. There was a sharp drop in the number of workdays lost to strikes and other forms of work stoppage in the first quarter of 2002. According to NMG-Levy Consultants and Actuaries, a private-sector labour consultancy, the number of workdays lost was at an eight-year low of 10 000 in the first quarter of 2002. This compares with 85 000 workdays lost in the first quarter of 2001.

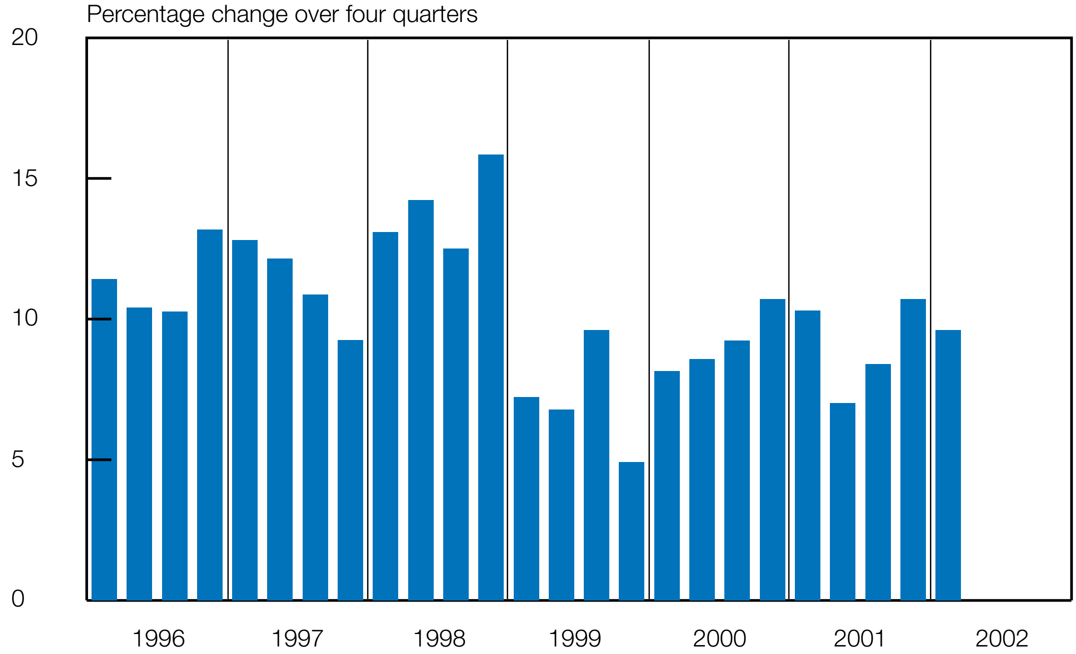
In an effort to improve the efficiency of the labour market, amendments to the Labour Relations Act and the Basic Conditions of Employment Act were enacted on 1 August 2002. The principal features of the amendments to the Labour Relations Act and the Basic Conditions of Employment Act, include:
- improved monitoring and enforcement procedures for collective agreements concluded by bargaining councils;
- facilitating mechanisms for the creation of workplace forums;
- amendments to trade union registration procedures;
- measures to streamline procedures as applied by the Commission for Conciliation, Mediation and Arbitration (CCMA);
- changed procedures relating to the length of the workday and overtime allowed; and
- measures to ensure adherence to fair procedures in the event of dismissals.

On 15 August 2002 the Department of Labour announced minimum wages and conditions of employment for domestic workers. The minimum monthly rate in urban areas for persons working more than 27 hours per week was set at R800.

Labour cost and productivity

Although remuneration growth in the private sector continued at a high rate, the year-on-year increases in *average nominal remuneration per worker* in the formal non-agricultural sectors of the economy tapered off somewhat from 10,7 per cent in the fourth quarter of 2001 to 9,6 per cent in the first quarter of 2002. The rates of increase in the average salaries and wages of public-sector workers slowed down, while those of workers in the private sector advanced at a faster pace.

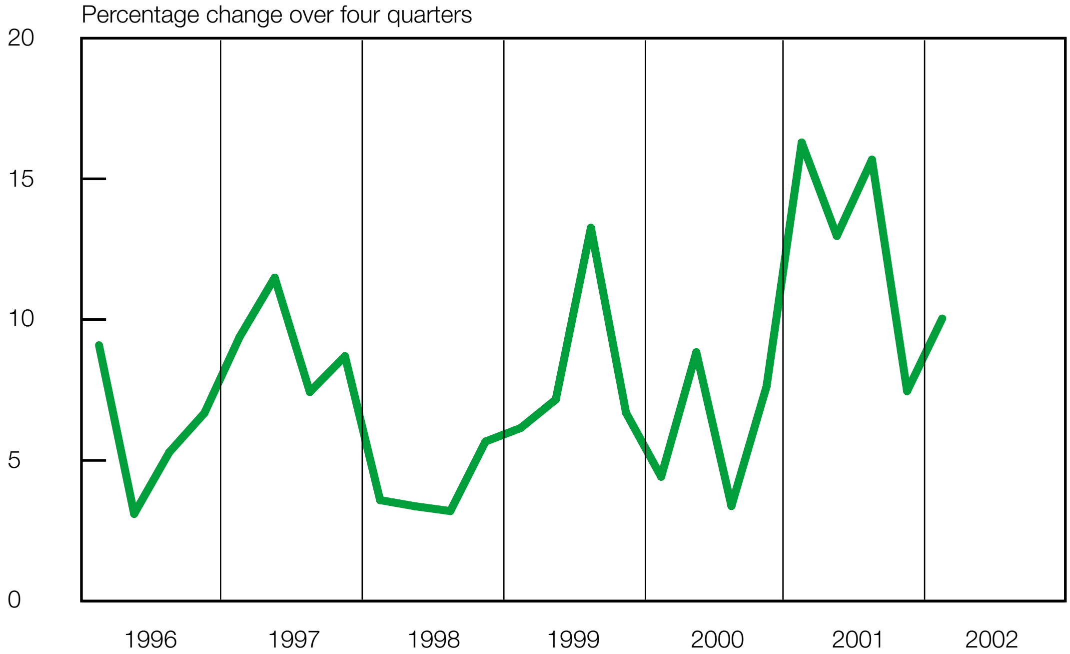
Nominal remuneration per worker in non-agricultural sectors



Survey results obtained from NMG-Levy Consultants and Actuaries show that the downward movement in the average annual *rate of wage settlements* in collective bargaining agreements levelled off at about 7,5 per cent in 2001 and the first half of 2002, virtually unchanged from the settlement rate of 7,4 per cent in 2000.

When measured over periods of four quarters, nominal remuneration growth in the *private sector* rose from 10,5 per cent in the fourth quarter of 2001 to 11,8 per cent in the first quarter of 2002. This acceleration was especially noticeable in the trade, catering and accommodation services sector where employees earned some 16 per cent more in the first quarter of 2002 than in the same period of the previous year. Substantial increases were also recorded in the transport, storage and communication sector and the financial intermediation and insurance industry. Strong remuneration growth rates in the gold-mining sector in the closing months of 2001 were not sustained in the first quarter of 2002, but were still at a relatively high year-on-year rate of 13 per cent. The acceleration in nominal wage growth in the private sector during the opening months of 2002 is corroborated by information furnished by the Automated Clearing Bureau on the average salaries and wages deposited into the bank accounts of almost 5 million salaried and retired workers.

Average nominal salaries and wages per worker



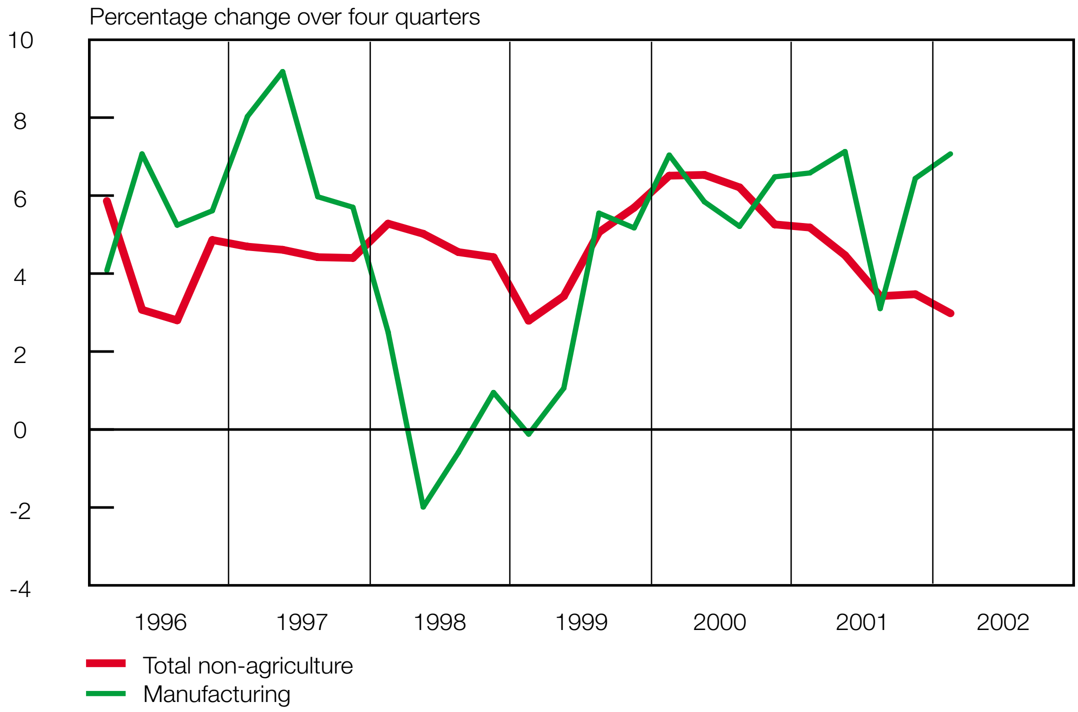
Source: Automated Clearing Bureau

The nominal remuneration per worker paid to the average *public-sector* employee increased at a more modest year-on-year rate of 6,5 per cent in the first quarter of 2002. This rate of increase is substantially lower than in the fourth quarter of 2001, when annual bonuses and back-dated salary increases were paid. Workers in the national government's general departments gained considerably higher salary increases than their counterparts at local government level in the first quarter of 2002. The annual wage increase in the public sector for the financial year 2002/03 was concluded at 9 per cent, a decision taken against a benchmark set by a rise of 9,2 per cent in consumer prices (excluding mortgage interest costs) in May 2002.

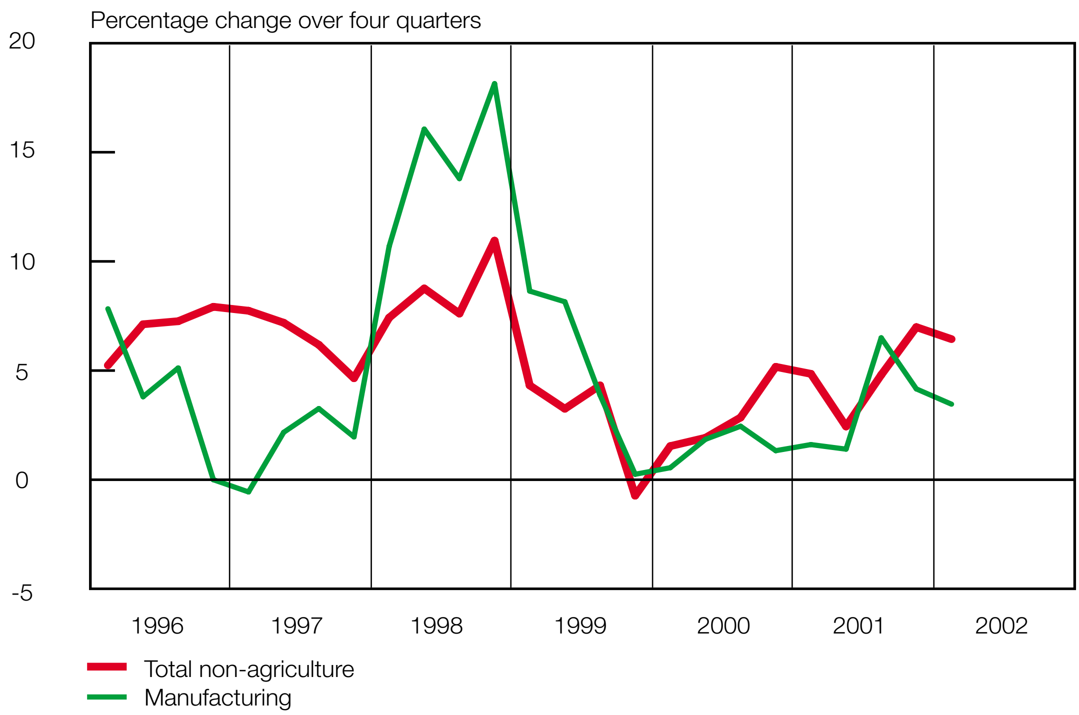
Partly as a consequence of the lower incidence of work disruptions in the first quarter of 2002, growth in labour productivity in the manufacturing sector (measured as real output per worker) accelerated from a year-on-year rate of 6,4 per cent in the fourth quarter of 2001 to an even higher rate of 7,1 per cent in the first quarter of 2002. Economy-wide productivity growth was far more sedate than in the manufacturing sector. Output per worker in the entire formal non-agricultural sector of the economy increased by 3,0 per cent in the year to the first quarter of 2002 – less than half of the growth in the manufacturing sector. Although still fairly high, the growth in economy-wide labour productivity is now at its lowest level in seven years.

The brisk pace of increase in labour productivity compressed the year-on-year growth in nominal unit labour cost in the manufacturing sector to just 3,6 per cent in the first quarter of 2002, about the same as in 2001. Economy-wide nominal unit labour cost rose by 6,4 per cent in the year to the first quarter of 2002, slightly below the year-on-year growth in the fourth quarter of 2001 but well above the average growth in nominal unit labour cost in the past three calendar years. Faster growth in nominal unit labour cost is usually associated with higher end-product inflation.

Labour productivity



Unit labour cost



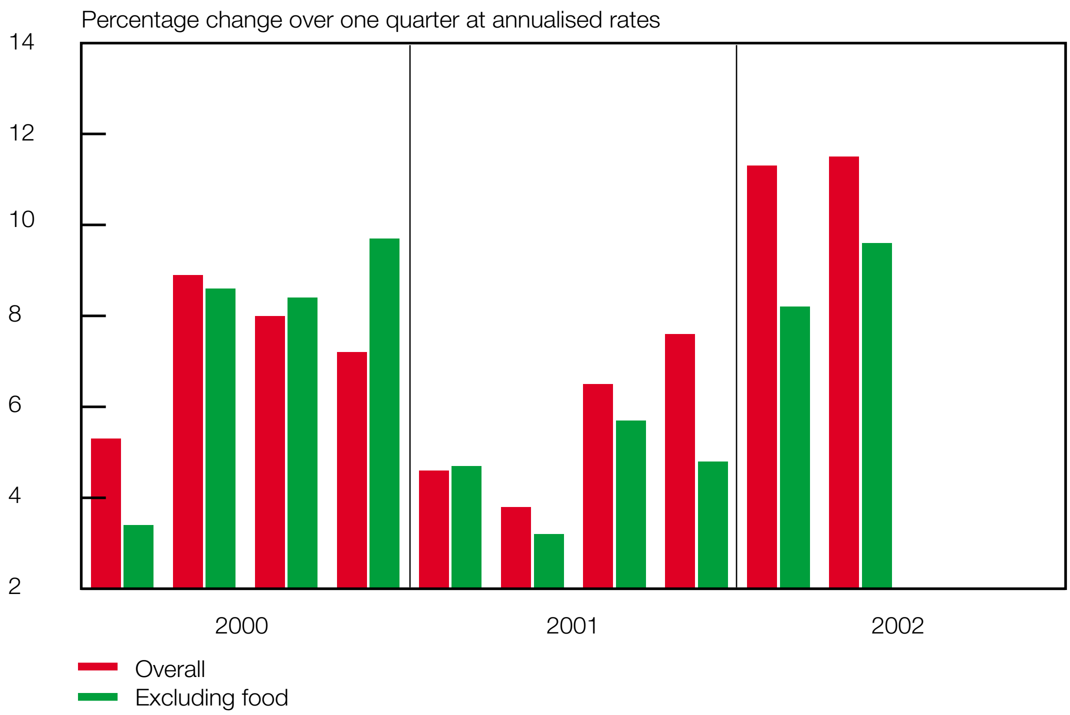
Prices

The gradual waning of price inflation in 2000 and 2001 was interrupted when inflationary pressures mounted in the wake of the sharp depreciation of the rand towards the end of 2001. Essentially driven higher by the cost-raising effects of the depreciated exchange value of the rand, CPIX inflation rose from year-on-year rates of approximately 6 per cent during the second half of 2001 to 9,8 per cent in June 2002 and 9,9 per cent in July. The acceleration in the pace of quarter-to-quarter CPIX inflation was even more pronounced, almost doubling from an annualised rate of 6,5 per cent in the third quarter of 2001 to 11,5 per cent in the second quarter of 2002.

Initially, CPIX inflation accelerated mainly on account of the sharp increases in the prices of food products which were in large measure related to the depreciation of the rand. When measured from quarter to quarter and expressed at an annualised rate, food price inflation picked up from 9,3 per cent in the third quarter of 2001 to 18,7 per cent in the first quarter of 2002. In the course of the second quarter of 2002, food price inflation at the producer level receded somewhat as outright declines have occurred in the prices of certain food categories, and the pace of increase fell back in others. This resulted in a slowdown in consumer food price inflation to an annualised rate of 16,7 per cent in the second quarter of 2002.

The rise in CPIX inflation was a consequence of not only higher food prices, but also of increases in the prices of other consumer goods and services. When omitting food price changes, CPIX inflation picked up from a year-on-year rate of 5,4 per cent in December 2001 to 7,8 per cent in July 2002. Also, the quarter-to-quarter rate of inflation in the prices of the non-food component of the CPIX consumer basket rose from an annualised rate of 4,8 per cent in the fourth quarter of 2001 to 8,2 per cent in the first quarter of 2002 and 9,6 per cent in the second quarter. The rise in non-food CPIX inflation was first and foremost a consequence of higher rates of increase in the prices of furniture and equipment, new and used vehicles and transport running cost, i.e. mostly petrol and diesel prices.

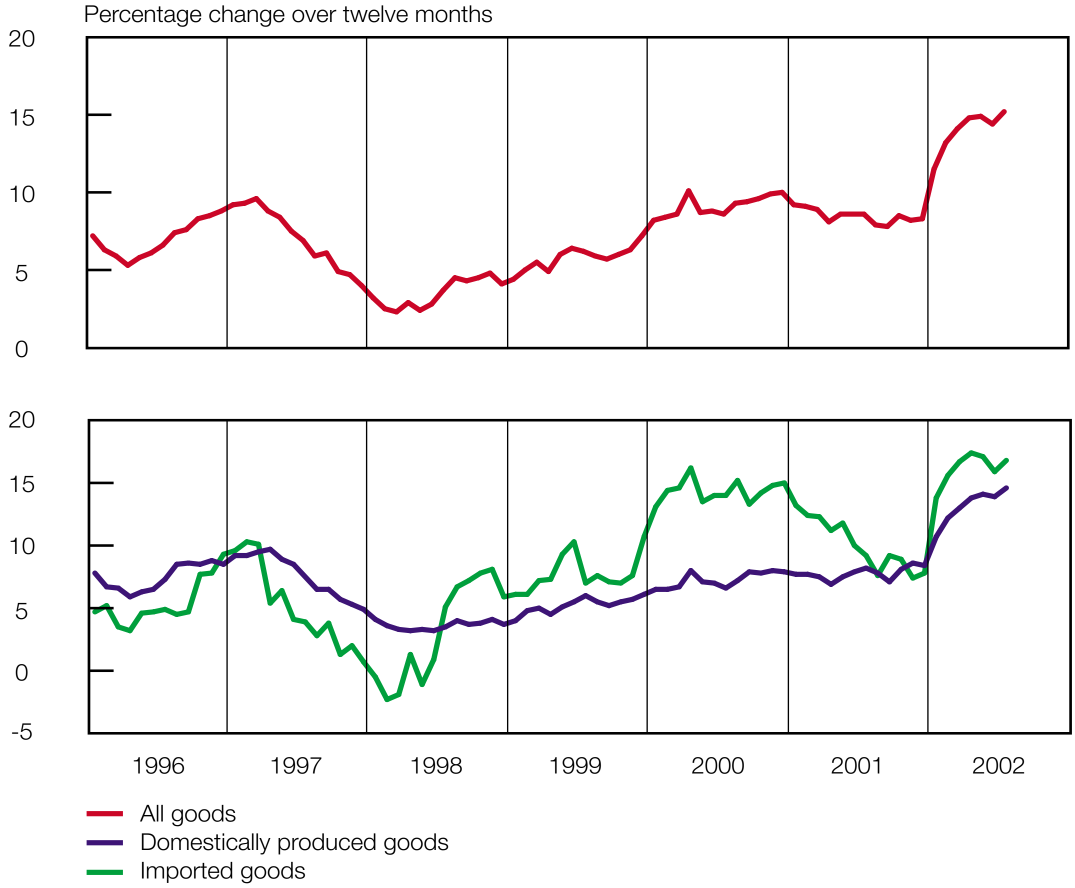
CPIX



Since the end of 2001, inflation in the production prices of goods has accelerated to a level significantly higher than that of consumer prices. Measured over periods of twelve months, the rate of increase in the *all-goods production price index* accelerated, on balance, from 7,8 per cent in September 2001 to 15,2 per cent in July 2002.

But there were signs emerging during the second quarter of 2002 that inflationary pressures were abating – the annualised rate of increase in the all-goods production price index has slowed down appreciably from 26,5 per cent in the first quarter of 2002 to 13,9 per cent in the second quarter. The slowdown in the short-term pace of production price inflation in the second quarter of 2002 resulted from the relative strength of the rand in that quarter and the greater stability in international petroleum prices. Later when the rand depreciated in July and August 2002 *vis-à-vis* most of the major international currencies, renewed inflationary pressures started gathering again.

Production prices



Inflation in the prices of *domestically produced goods*, after having risen from a quarter-to-quarter annualised rate of 11,4 per cent in the fourth quarter of 2001 to 21,2 per cent in the first quarter of 2002, abated to 15,1 per cent in the second quarter. This slowdown resulted mainly from outright declines in the prices of agricultural, forestry and fishing products. Lower rates of increase in the prices of basic metals and metal products, and of electricity, gas, water and mining products also helped to slow down the price increases of domestically produced goods. By contrast, the continued high rates of increase in the prices of manufactured food products prevented an even quicker decline in production price inflation. When measured from quarter to quarter and expressed at an annualised rate, manufactured food price inflation was still at

34,4 per cent in the second quarter of 2002. In addition, the short-term pace of increase in the prices of machinery and equipment, textiles, clothing and footwear and alcoholic beverages and tobacco also accelerated in the second quarter of 2002.

Measured over periods of twelve months, the price increases in domestically produced goods showed no sign of a consistent slowdown. Year-on-year inflation in the prices of domestically produced goods accelerated, on balance, from 7,1 per cent in September 2001 to 14,6 per cent in July 2002. Sharp increases in July 2002 were especially noticeable in the prices of agricultural products, paper, products of paper, printing and manufactured food.

Quarter-to-quarter *imported goods inflation* decelerated from an annualised rate of 40,9 per cent in the first quarter of 2002 to 12,5 per cent in the second quarter. But when measured over periods of twelve months, the decline in inflation in the prices of imported goods was far more muted – from the latest high of 17,4 per cent in April 2002 to 16,8 per cent in July. The downward rigidity in imported goods inflation was largely the result of increases in the prices of mining and quarrying products, and chemicals and chemical products in July 2002. Price behaviour in these product categories is strongly influenced by movements in international crude oil prices. The decline in the exchange rate of the rand in the three months to August 2002 kept the prices of imported goods higher than would otherwise have been the case.

Production prices

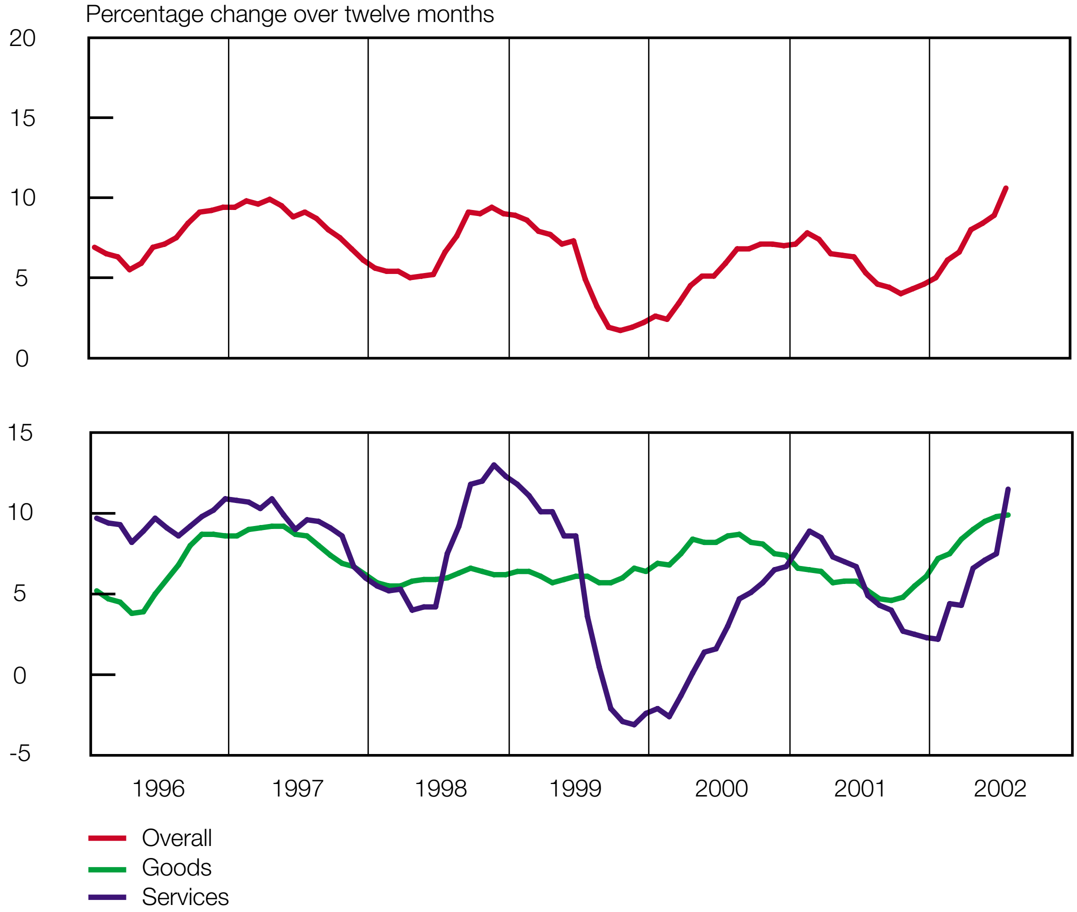
Quarter-to-quarter percentage changes at annualised rates

Period		Domestically produced goods	Imported goods	Overall production prices
2000:	**Year**	**7,3**	**14,4**	**9,2**
2001:	1st qr	6,8	11,4	7,6
	2nd qr	7,5	7,0	7,1
	3rd qr	8,4	4,6	7,8
	4th qr	11,4	12,3	11,6
	Year	**7,8**	**10,0**	**8,3**
2002:	1st qr	21,2	40,9	26,5
	2nd qr	15,1	12,5	13,9

Headline inflation, i.e. the year-on-year changes in the overall consumer price index for metropolitan areas, accelerated until July 2002. The overall consumer price index increased by 10,6 per cent in the year to July 2002, almost three times as high as the 4,0 per cent increase in the year to October 2001. Also, the quarter-to-quarter pace of inflation accelerated further from 12,3 per cent in the first quarter of 2002 to 14,8 per cent in the second quarter – the highest rate of increase in almost four years. Higher rates of increase in the prices of consumer goods and services contributed to the acceleration in overall consumer price inflation.

In the *consumer goods* category, prices rose over a broad front and reached a year-on-year rate of 9,8 per cent in June 2002 and 9,9 per cent in July. The increase in July 2002 was the highest in more than seven years and was more than twice as high as the increase of 4,6 per cent in September 2001. Measured from quarter to quarter, inflation in the prices of consumer goods accelerated progressively from an annualised rate of 4,5 per cent in the third quarter of 2001 to 13,2 per cent in the second quarter of 2002.

Consumer prices



Inflation in the prices of *consumer services* generally restrained overall consumer price inflation throughout most of 2001. Essentially reflecting falling home mortgage rates, the prices of consumer services fell at an annualised rate of 2,4 per cent in the third quarter of 2001, but later accelerated to 15,9 per cent in the second quarter of 2002 when interest rates generally moved higher. Measured over twelve-month periods, inflation in the prices of consumer services increased from 2,2 per cent in January 2002 to 7,5 per cent in June and 11,5 per cent in July.

Consumer prices

Quarter-to-quarter percentage changes at annualised rates

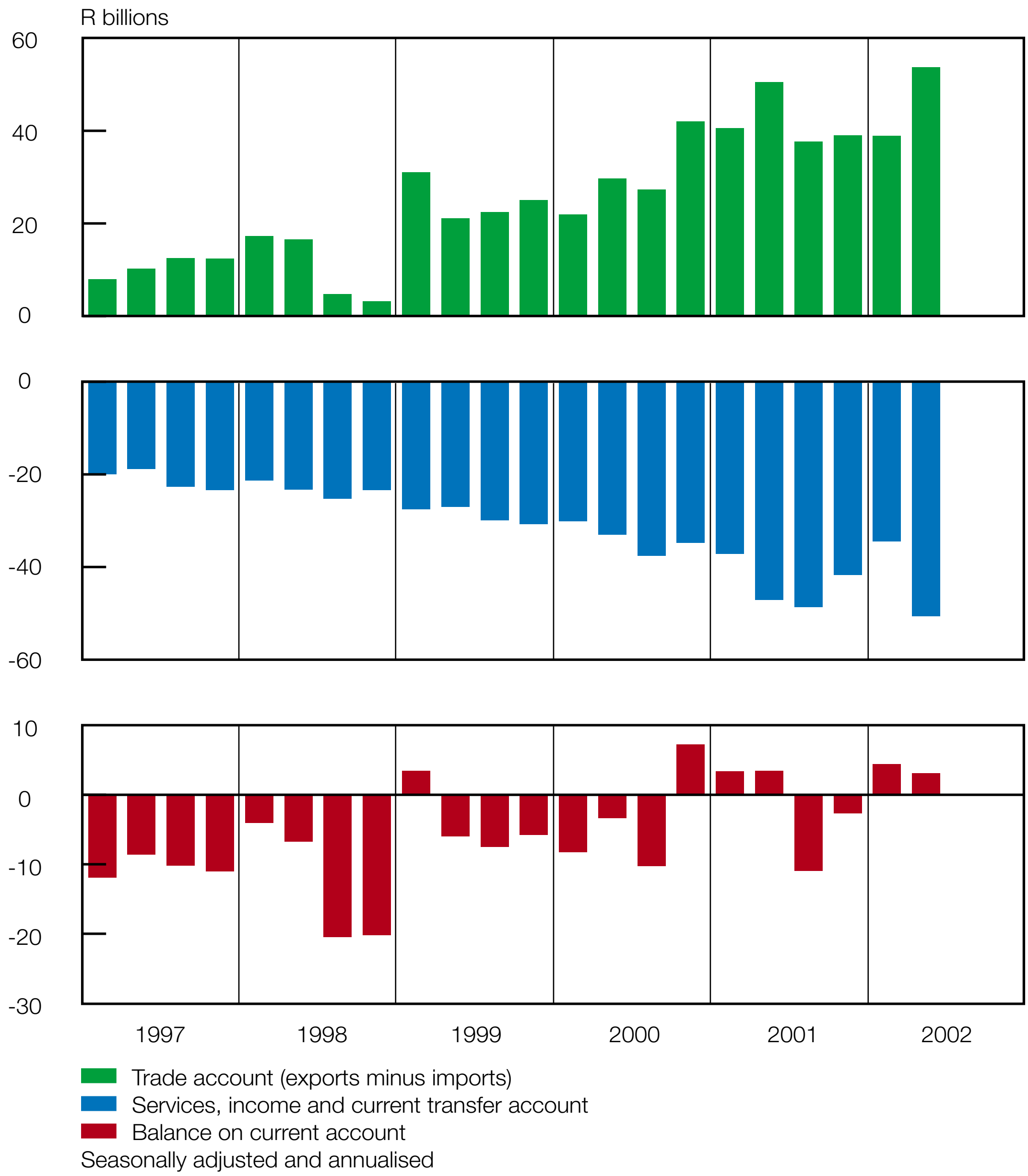
Period		Goods	Services	Overall CPI	CPIX inflation
2000:	**Year**	**7,9**	**2,4**	**5,4**	**7,8**
2001:	1st qr	3,6	7,8	5,2	4,6
	2nd qr	5,8	0,5	3,7	3,8
	3rd qr	4,5	-2,4	1,5	6,5
	4th qr	8,0	2,1	5,0	7,6
	Year	**5,6**	**5,5**	**5,7**	**6,6**
2002:	1st qr	12,3	13,0	12,3	11,3
	2nd qr	13,2	15,9	14,8	11,5

Foreign trade and payments

Current account

A decline in gross domestic expenditure is usually accompanied by slow growth or a slack in the demand for imported goods. Such a decline, accompanied also by strong growth in the international demand for domestically produced goods, widened South Africa's trade surplus with the rest of the world quite substantially in the second quarter of 2002 (see table on page 25). The perennial deficit on the services and income account of the country widened too, mainly because of an increase in the investment income payments made to the rest of the world.

Balance of payments: Current account

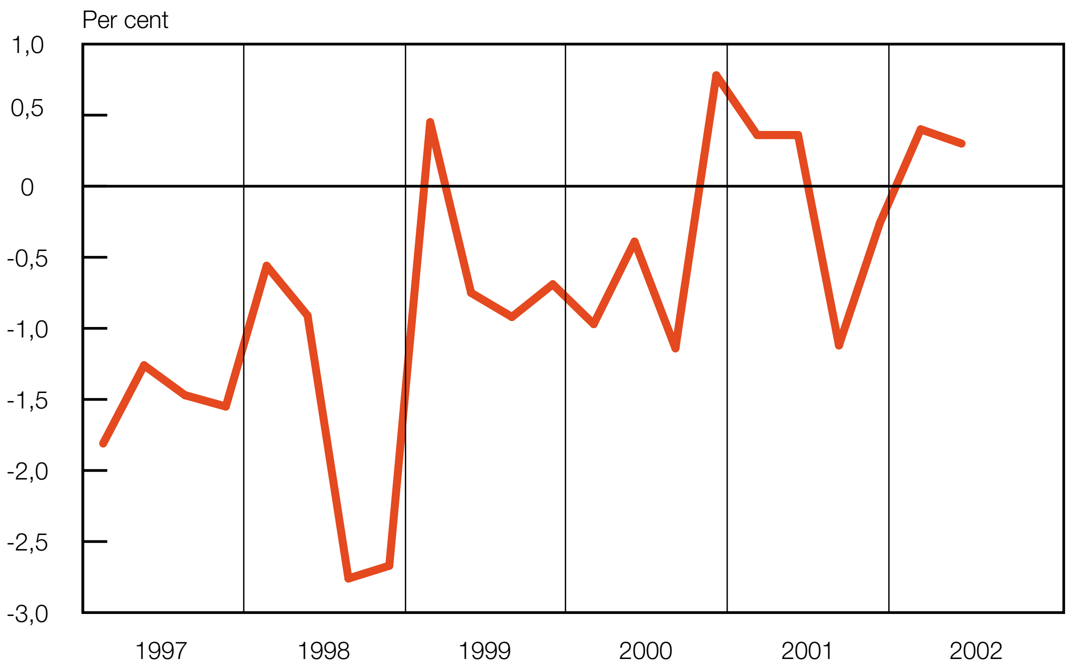


Balance of payments on current account

Seasonally adjusted and annualised
R billions

	2001					2002	
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Merchandise exports	226,0	241,4	221,5	240,9	232,5	275,3	288,0
Net gold exports	25,3	27,4	30,1	34,9	29,4	39,6	44,2
Merchandise imports	-210,7	-218,2	-214,0	-236,8	-219,9	-276,0	-278,5
Trade account	**40,6**	**50,6**	**37,6**	**39,0**	**42,0**	**38,9**	**53,7**
Net services, income and current transfer payments	-37,2	-47,1	-48,5	-41,7	-43,7	-34,7	-50,6
Balance on current account	**3,4**	**3,5**	**-10,9**	**-2,7**	**-1,7**	**4,2**	**3,1**

Current-account balance as percentage of gross domestic product

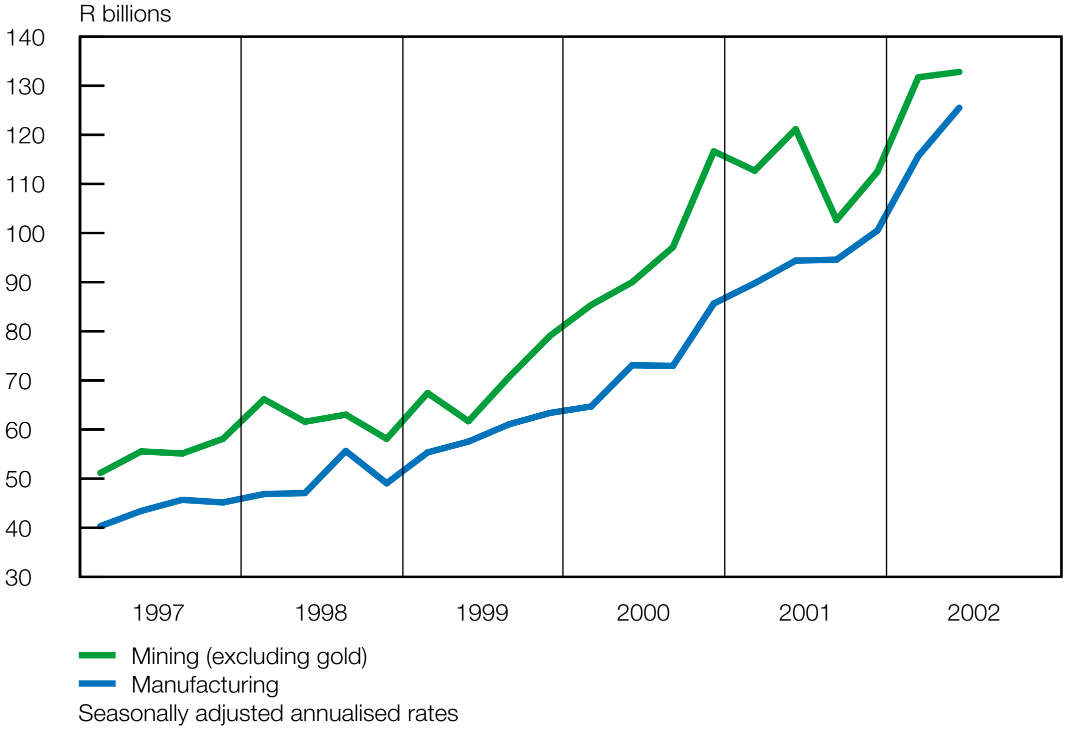


The widening of the negative balance on the services and income account exceeded the increase in the positive balance on the trade account, narrowing the surplus on the current account of the balance of payments somewhat. However, the current account balance still remained in surplus in the second quarter of 2002, equal to about 0,3 per cent of nominal gross domestic product. This surplus ratio was 0,4 per cent in the first quarter of 2002.

Export volumes rallied strongly in the first two quarters of 2002. The mild pick-up in global economic activity, alongside the greater price competitiveness of domestic producers, created an external demand for domestically produced goods which lifted the volume of merchandise exports by almost 2 per cent in the first quarter of 2002 and by 7½ per cent in the second quarter. Exporters of manufactured goods – especially of vehicles, transport equipment, machinery and electrical equipment – benefited most from the expansion in the international demand for South African-produced merchandise.

Overall, the volume of merchandise exports as a percentage of gross domestic product rose from 17,6 per cent in the fourth quarter of 2001 to 19,1 per cent in the second quarter of 2002. The lagged effect of the depreciation of the rand in the fourth quarter of 2001 contributed appreciably to this strong improvement in the overall export performance of domestic producers.

Exports of mining and manufactured products



The prices realised by exporters are also directly influenced by the gyrations of the exchange rate of the rand. Though the average rand price of exports increased steeply by about 12 per cent in the first quarter of 2002, the appreciation of the rand against most currencies since the beginning of the year has caused merchandise export prices to fall by 2½ per cent in the second quarter. This lowered the rate of increase in the value of merchandise exports (seasonally adjusted and annualised) from 14½ per cent in the first quarter of 2002 to 4½ per cent in the second quarter.

Gold exports have fared spectacularly well recently. From the first quarter of 2001 to the second quarter of 2002 the nominal value of net gold exports rose by almost 75 per cent. Gold exports were boosted in the second quarter of 2002 by a rise in the average price of gold from US$291 per fine ounce in the first quarter of 2002 to US$313 in the second quarter – the latter is the highest price realised since the third quarter of 1997. Simultaneously, gold producers increased their export volumes by about 17 per cent from the first quarter of 2002 to the second quarter. Gold stocks that had apparently been accumulated in the first quarter of 2002 came onto the market in the second quarter.

Merchandise import volumes were rather flat in the second quarter of 2002. The physical quantity of non-oil imports, reflecting the sudden decline in real gross domestic expenditure, showed virtually no change from the first quarter of 2002 to the second quarter. Declines occurred in the category for imported manufactured goods, especially machinery and electrical equipment. Oil imports rose solidly in the second quarter of 2002, raising the total physical quantity of all merchandise imports to a level that was 2½ per cent higher than in the first quarter.

The average nominal effective exchange rate of the rand strengthened by 7 per cent from the first quarter of 2002 to the second quarter. This compressed the growth in import prices quite severely. On average, the prices of imported goods actually fell by about 1½ per cent in the second quarter of 2002. This weighed on the value of merchandise imports which rose by just 1 per cent in the second quarter of 2002, following an increase of 16½ per cent in the first quarter.

There was a sharp increase in dividend payments by domestic subsidiary companies to their foreign parent or holding companies. The investment income earned on foreign assets increased too, but by a considerably smaller amount than the increase in dividend payments. Foreign tourists also spent less on travel-related services during the second quarter of 2002 than during the first quarter, even though the number of foreign visitors was still rather high. These factors jointly contributed to an increase in the negative imbalance on the country's services and income account from R34,7 billion (seasonally adjusted and annualised) in the first quarter of 2002 to R50,6 billion in the second quarter.

Financial account

The accompanying table shows that recorded net inflows for financial account transactions consistently exceeded recorded net outflows in the first half of 2002. There was even a marked acceleration in the net inflows of capital into the economy from the first quarter of 2002 to the second quarter. The positive imbalance on the financial account in the second quarter of 2002 was the largest surplus ever recorded in a single quarter. The major portion of this surplus on the financial account of the balance of payments is attributable to portfolio investments which in the past have proved fickle and subject to sudden reversals in flows.

Net financial transactions not related to reserves
R billions

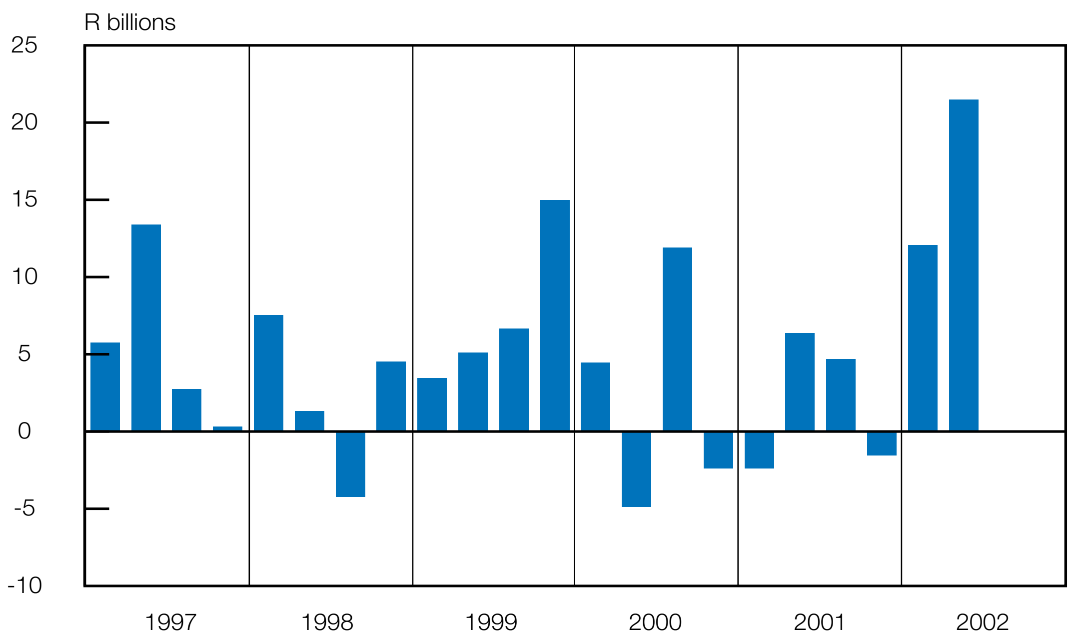
	2001					2002	
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr
Change in liabilities							
Direct investment	2,4	53,1	3,6	-1,9	57,2	1,6	2,3
Portfolio investment	3,5	-27,2	-0,2	-0,1	-24,0	4,4	15,7
Other investment.....................	-2,5	-9,0	-5,1	-1,5	-18,1	13,7	-4,8
Change in assets							
Direct investment	-8,1	42,2	0,0	-5,4	28,7	-1,0	5,4
Portfolio investment	-0,7	-37,1	-2,5	-3,3	-43,6	-5,7	-1,6
Other investment.....................	-6,0	-10,8	5,9	-0,3	-11,2	0,7	-0,9
Total financial transactions*.........	-2,4	6,4	4,7	-1,5	7,2	12,1	21,5

* Including unrecorded transactions

The positive imbalance for *direct investment* flows increased from R0,6 billion in the first quarter of 2002 to R7,7 billion in the second quarter. These inflows included a loan which a resident company obtained from an affiliated company abroad and a non-resident investor's acquisition of a dominant interest in a domestic steel company. Furthermore, a domestic mining company, having disposed of part of its foreign asset holdings, repatriated the proceeds during the second quarter of 2002.

The negative imbalance on *portfolio investment* of R1,3 billion in the first quarter of 2002 turned into a positive imbalance of R14,1 billion in the second quarter. International portfolio investors increased their holdings of South African fixed-interest securities and shares, and the national government raised the equivalent of US$1,0 billion in loan funding in the international capital markets. Individual investors boosted the excess of recorded net portfolio inflows over recorded net outflows by reducing their net acquisitions of offshore debt and equity securities during the second quarter of 2002. Preliminary information indicates that there was an abrupt reversal in the inflows of foreign portfolio capital into the economy in July and August 2002.

Balance on financial account



Other investment had a positive discrepancy of R14,4 billion in the first quarter of 2002, but this changed into a negative discrepancy of R5,7 billion in the second quarter. This net outflow of essentially short-term capital was mainly due to importers who reduced their foreign-currency denominated trade-related commitments following the rise in the foreign-exchange value of the rand. Non-residents also reduced their foreign-currency denominated deposits with South African banks. Contributing to the negative imbalance in other investments were the advance payments made to foreign suppliers in terms of the national government's arms procurement programme.

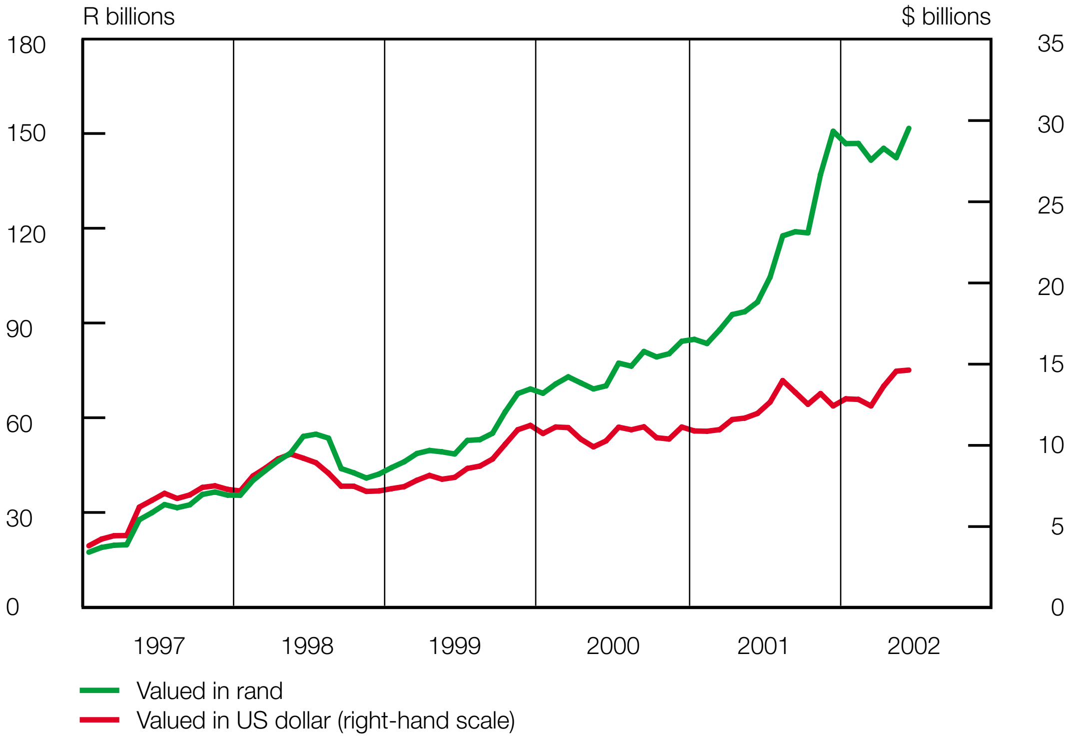
Foreign reserves

The positive imbalance in financial account transactions along with the surplus on the current account significantly improved the country's overall balance of payments (i.e.

the change in the country's net international reserves due to balance-of-payments transactions) during the second quarter of 2002. The country's net international reserves accordingly rose by R21,7 billion in the second quarter of 2002, following an increase of R15,8 billion in the first quarter.

The value of the country's gross gold and other foreign reserves (i.e. international reserves before adjusting for reserve-related liabilities and valuation changes) increased from R141,6 billion at the end of March 2002 to R151,6 billion at the end of June. The level of import cover (i.e. the value of gross international reserves expressed in relation to the value of imports of goods and services) remained unchanged at 20 weeks' worth of imports from the end of the first quarter of 2002 to the end of the second quarter.

Total gross gold and other foreign reserves



In July 2002, the Reserve Bank's holdings of international reserves declined from R78,3 billion at the end of June to R76,6 billion. This was mainly a consequence of the strengthening in the exchange value of the rand. Expressed in dollars, the Bank's gross international reserves remained broadly unchanged from the end of June 2002 to the end of July.

The Reserve Bank's net oversold position in foreign currency (i.e. the Bank's oversold forward position in foreign currency reduced by its net holdings of spot international reserves) declined from US$2,9 billion at the end of March 2002 to US$1,8 billion at the end of July. Many analysts regard this net oversold position of the Bank as a sign of vulnerability to exchange rate shocks.

Exchange rates

The nominal effective exchange rate of the rand (i.e. a weighted average of the exchange rate of the rand against a basket of currencies) strengthened by 6,9 per cent from the end of December 2001 to the end of March. During April and May 2002 the exchange value of the rand appreciated sharply, but most of these gains were wiped out in June, leaving the rand with a net gain on a weighted basis of just 1,4 per cent in the second quarter of 2002.

Exchange rates of the rand

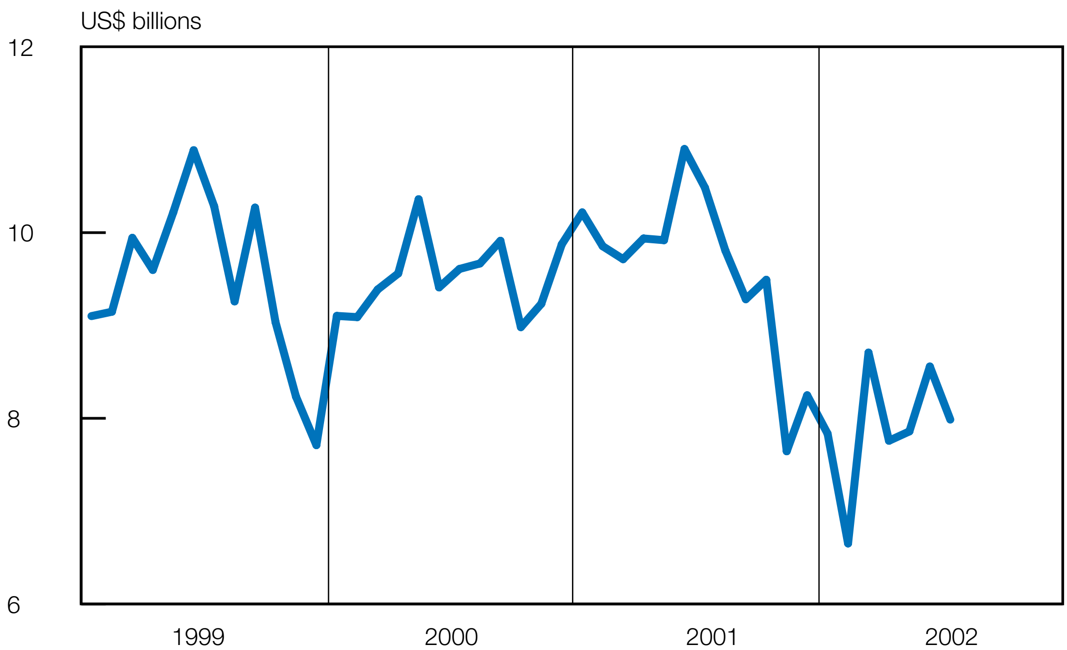
Percentage change

	31 Dec 2001 to 28 Mar 2002	28 Mar 2002 to 28 June 2002	28 June 2002 to 30 Aug 2002
Weighted average*	6,9	1,4	-2,3
Euro	7,3	-3,3	-1,6
US dollar	6,0	9,9	-2,4
British pound	7,8	2,3	-3,8
Japanese yen	7,0	-1,2	-3,4

* The weighted exchange rate index is calculated with reference to a basket of 14 currencies

The nominal effective exchange value of the rand depreciated by 9,4 per cent from the end of May 2002 to the end of June and further by 2,3 per cent from the end of June to the end of August. The weakness of the exchange rate coincided with an aggressive reduction by non-resident investors of their exposure to South African debt and equity securities. Analysts attributed this reduction to heightened risk aversion to emerging-market assets following the problems in Argentina and the fear of debt default in Brazil. More specific to the Southern African region, there were

Average daily net turnover in South African foreign-exchange market

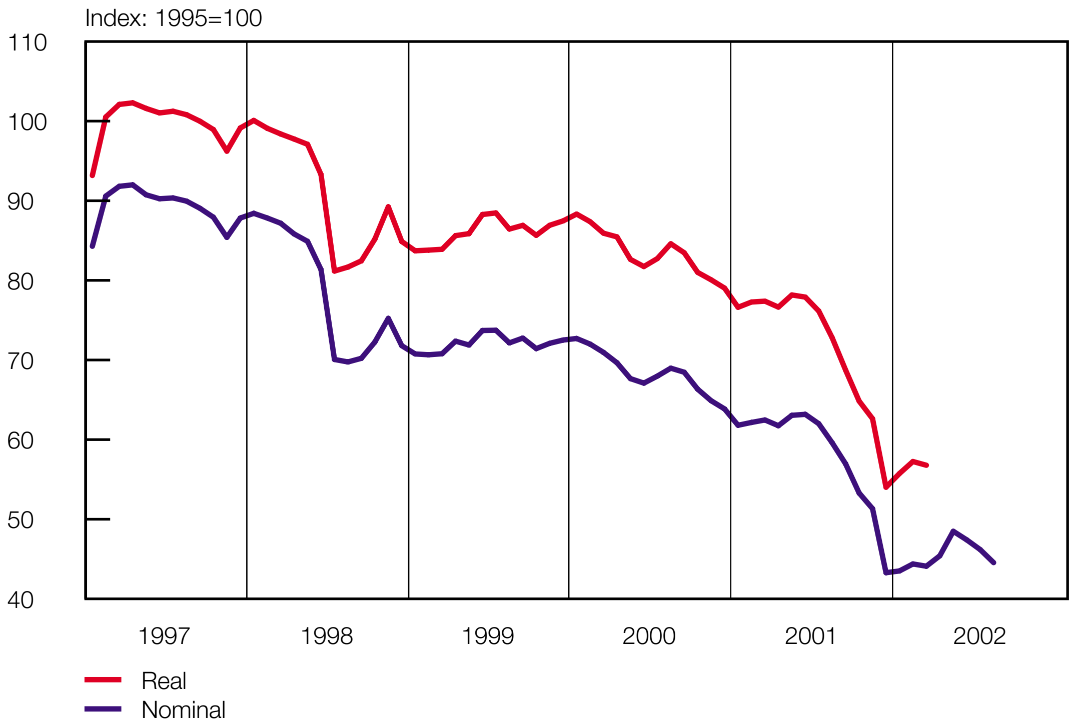


concerns that problems arising from the land reform programme in Zimbabwe might spill over into neighbouring countries, and some commentators feared that the draft mining charter in South Africa might eventually impact on the investment climate throughout the region.

The net average daily turnover in the domestic market for foreign exchange declined from US$10,3 billion in the second quarter of 2001 to US$7,7 billion in the first quarter of 2002, but rose to US$8,1 billion in the second quarter of 2002. Participation by non-residents in this market fell from US$6,3 billion in the second quarter of 2001 to US$4,3 billion in the first quarter of 2002, before increasing to US$4,6 billion in the second quarter. These movements confirm the inability of a variation in turnovers in the foreign-exchange market to explain satisfactorily the changes in the exchange value of the rand.

The real or inflation-adjusted effective exchange rate of the rand appreciated by some 5 per cent from December 2001 to March 2002. This followed a real depreciation of 31,6 per cent from December 2000 to December 2001, and implies that South African producers forfeited only a small fraction of the competitive gains they had made in 2001.

Effective exchange rates of the rand



The "Commission of Inquiry into the rapid depreciation of the exchange rate of the rand and related matters" completed its investigation during the second quarter of 2002. An interim report was released on 30 April 2002, merely summarising the evidence presented to the commission, but not making any findings or recommendations. A final majority report and a minority report were released on 1 August 2002. The commission could not link any single transaction in the foreign-exchange market to the rapid depreciation of the rand in 2001.

Monetary developments, interest rates and financial markets

Money supply

The rates of growth of all the monetary aggregates were unusually high in the first half of 2002. The seasonally adjusted and annualised quarter-to-quarter growth in the broad monetary aggregate M3 was 32,0 per cent at an annualised rate in the first quarter of 2002 and 18,2 per cent in the second quarter. To the extent that these balances are used to purchase goods and services, they are an indication of potential spending that may exceed the economy's production potential, and therefore of inflationary pressures.

The rapid growth in M3 in the seven months to July might have been influenced by
- the continued strength of nominal gross domestic income;
- the relatively more attractive yields on M3 deposits following the increases in short-term interest rates in the first half of 2002;
- the strong liquidity preference of companies and individuals in the face of heightened stock market uncertainty and concerns about future global economic growth; and
- the repatriation of export proceeds in May and June 2002 after exporters had been delaying such repatriation for quite some time.

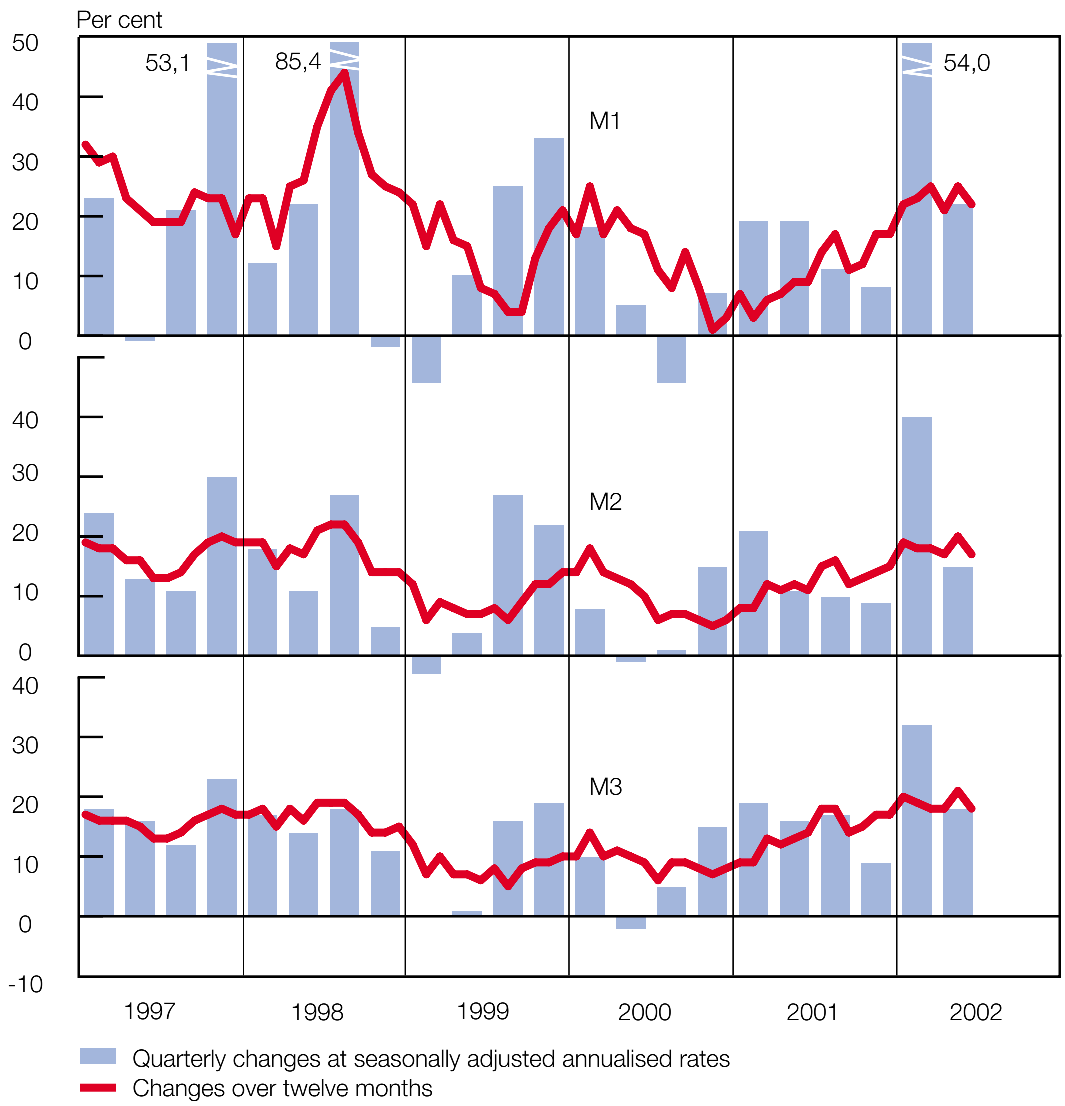
Percentage change in monetary aggregates
Quarterly at seasonally adjusted annualised rates

Period		M1A	M1	M2	M3
2001:	1st qr	9,5	18,8	21,0	19,4
	2nd qr	7,9	18,7	11,3	16,5
	3rd qr	27,3	10,5	9,8	16,9
	4th qr	27,0	8,2	9,0	8,9
2002:	1st qr	14,4	54,2	40,2	32,0
	2nd qr	16,2	21,8	15,4	18,2

There were signs that the growth in M3 might have been slowing down in the second quarter of 2002 and may continue to do so in the third quarter. Not only did the annualised growth rate fall from the first quarter of 2002 to the second quarter, but the growth over twelve months in M3 also decelerated from 20,6 per cent in May 2002 to 18,1 per cent in June and 17,3 per cent in July. Much of the decline in the growth in M3 during the second quarter was due to high tax collections which reduced the private sector's holdings of M3 deposits with the monetary sector while raising government's deposits. Government deposits with banks are not part of M3.

The rates of growth of the two narrower monetary aggregates, M1 and M2, have slowed down significantly from the first quarter of 2002 to the second quarter, but remained relatively strong at annualised rates of 21,8 per cent in the case of M1 and 15,4 per cent in the case of M2. Part of the reason that growth in the narrow aggregates remained so strong was the greater demand for money for precautionary purposes.

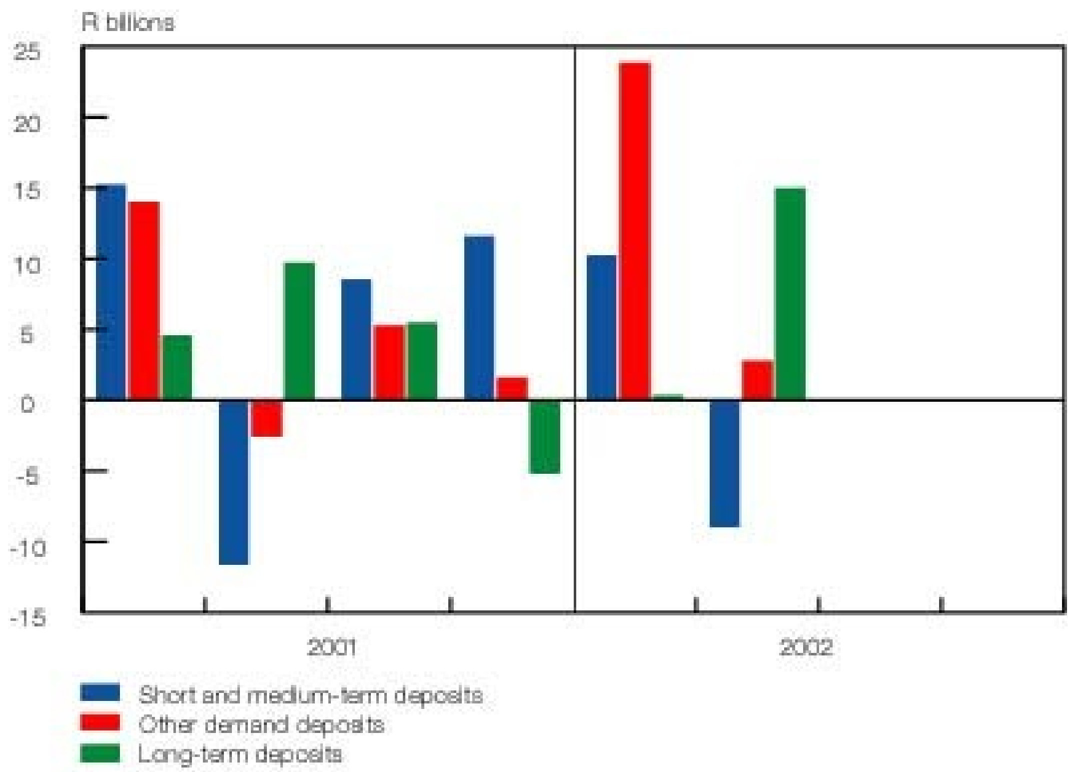
Growth in monetary aggregates



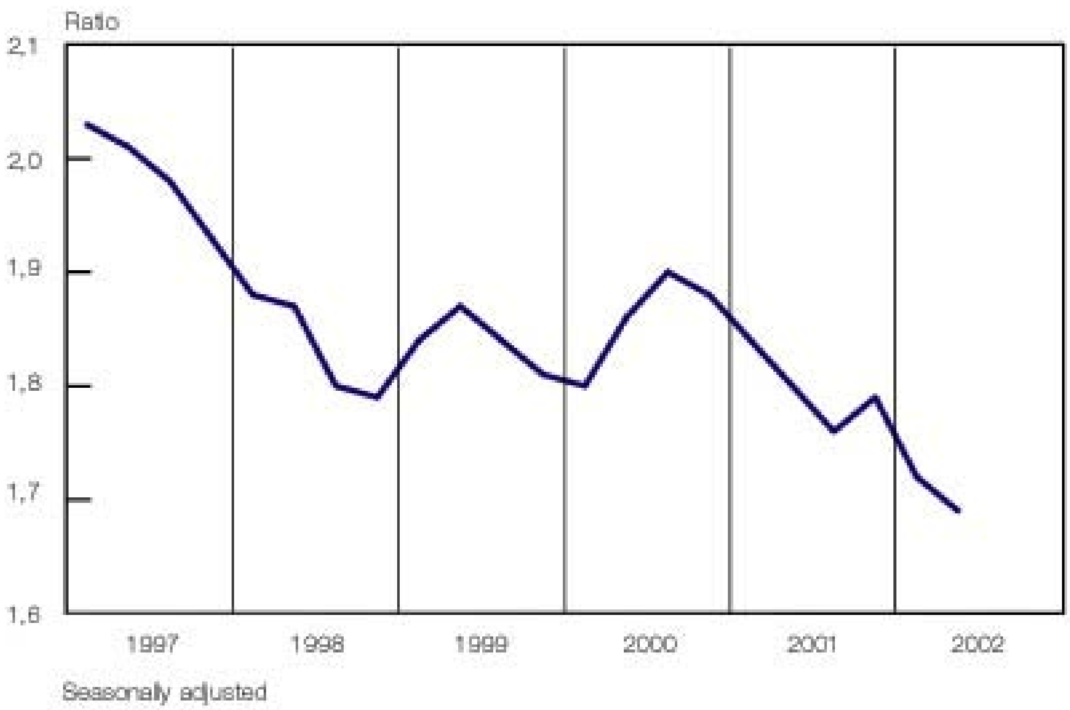
There was nevertheless a clear shift in deposit holders' preferences in the second quarter. Long-term deposits which are part of M3 but not of M1 and M2, rose by R15 billion from the end of the first quarter of 2002 to the end of the second quarter, mostly at the expense of other demand, short and medium-term deposits. This was probably a manifestation of the views held by deposit holders that interest rates were at or near an upper turning point, signalling that the time would be opportune to lock in relatively high deposit rates for a longer period. Long-term deposits rose further in July 2002.

The share of households in total M3 deposits was fairly stable at around 37 per cent in the first seven months of 2002. The share of non-financial companies picked up from 35 per cent in January 2002 to 39 per cent in July. By contrast, the share of financial companies fell from 29 per cent in January 2002 to 24 per cent in July. As the money holdings of financial companies (e.g. life assurers, pension funds, securities dealers, financial public-sector corporations) are less likely to be related directly to aggregate nominal spending on goods and services than money holdings by other sectors, their shrinking share in M3 may signal increased potential for future spending and greater inflationary pressures. These pressures have been partly counteracted by the overall shift into long-term deposits which are seen more as an investment vehicle rather than a temporary store of purchasing power.

Quarterly changes in deposits



Income velocity of M3



The quarter-to-quarter annualised growth in M3 exceeded the growth in nominal gross domestic product by 19,6 percentage points in the first quarter of 2002 and by 8,9 percentage points in the second quarter. The income velocity of M3 accordingly decreased from 1,72 in the first quarter to 1,69 in the second quarter – the lowest level in more than 22 years.

The main accounting counterparts of the increase of R10,9 billion in M3 in the second quarter of 2002 were increases of R29,1 billion in net foreign assets and R5,9 billion in claims on the private sector. These were partly offset by a contraction of R15,4 billion in net claims on the government sector and of R8,7 billion in net other assets of the monetary sector.

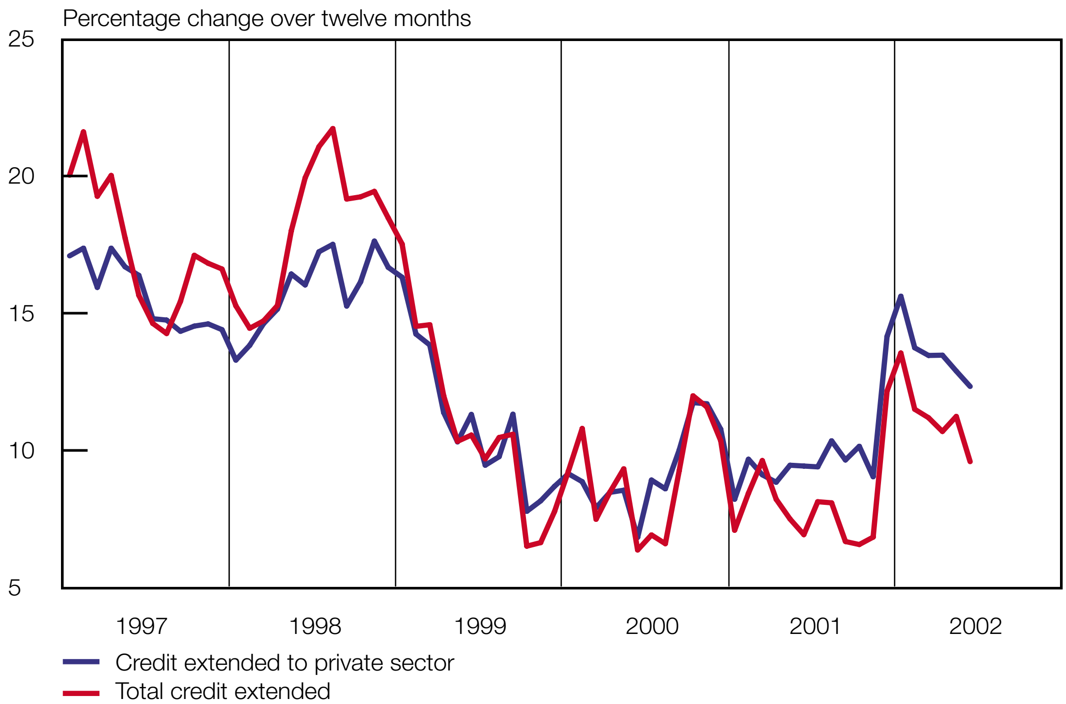
Credit extension

Growth in *total domestic credit extension* was fairly robust in both the last quarter of 2001 and the first quarter of 2002, but slowed down drastically in the second quarter. Measured from quarter to quarter and annualised, total domestic credit extended by banks increased at a rate of 20,4 per cent in the first quarter of 2002, but then slowed down to a rate of just 0,3 per cent in the second quarter.

The abrupt slowdown was essentially caused by a steep decline of R15,4 billion in banks' net claims on the government sector – the largest quarterly decline ever recorded. Government deposits amounting to R18,4 billion were accumulated during the second quarter. Tax revenues increased strongly in the quarter at the same time that government needed to hold more deposits in preparation for major interest payments on public debt to be made in August 2002.

The growth over twelve months in credit extended to the *private sector* slowed down from a three-year high of 15,6 per cent in January 2002 to 12,3 per cent in June and 11,6 per cent in July. Measured from quarter to quarter, growth in credit extension

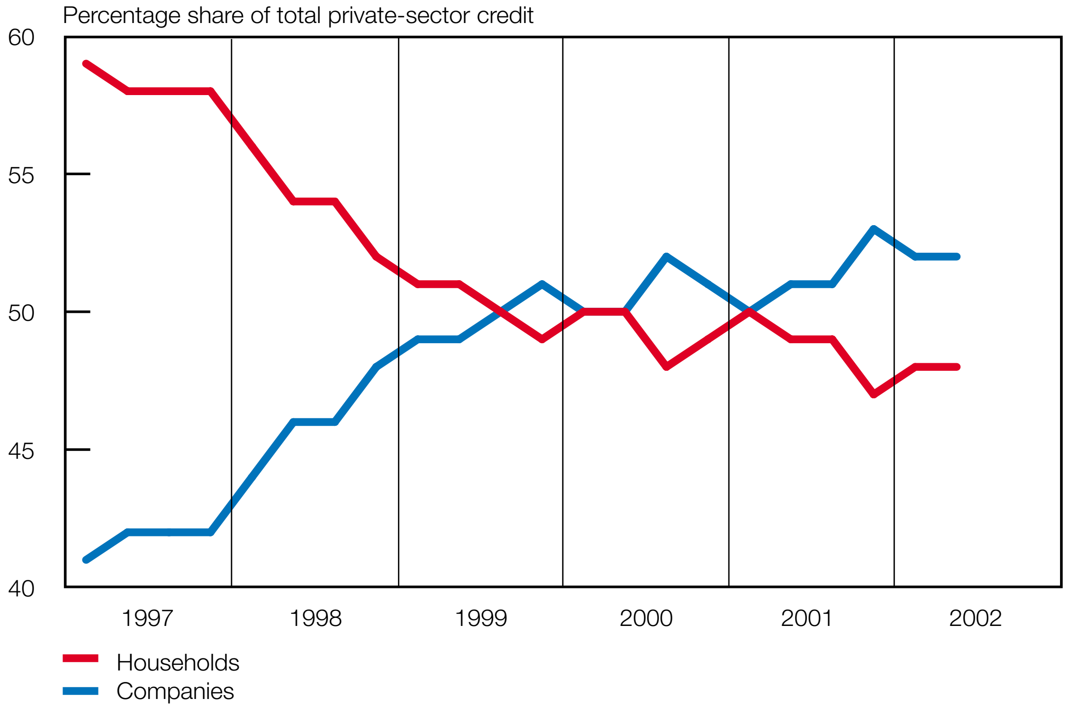
Domestic credit extension



to the private sector fell from 19,6 per cent in the first quarter of 2002 to 1,9 per cent in the second quarter. The ebb and flow in credit extension to the private sector were heavily influenced by reversals in the leads and lags in the payments for and receipts from foreign transactions. Indications are that the earlier borrowing associated with these leads and lags was mostly repaid in the second quarter of 2002 when the exchange rate of the rand generally strengthened.

The household sector absorbed the major portion of the increase in credit extended to the private sector during the second quarter of 2002; its share in total credit extension to the private sector increased from 47,7 per cent in the first quarter to 48,4 per cent in the second quarter. Mortgage advances constituted a sizeable portion of the increase in bank credit extension to the private sector.

Bank credit extended to households and companies



Mirroring the growing share of households in total credit extension to the private sector, the share of the corporate sector declined from 52,3 per cent in the first quarter of 2002 to 51,6 per cent in the second quarter. The slower rate of credit extension to the corporate sector was related to the turnaround in the leads and lags in foreign payments and receipts referred to previously.

An analysis of banks' claims on the private sector by type of credit shows that the year-on-year rate of growth in *mortgage advances*, which had averaged 14,9 per cent in 2001, on balance, tapered off to 12,7 per cent in June and 12,8 per cent in July. The declining cost of mortgage financing in recent years, together with lively conditions in the real-estate market, contributed appreciably to the strong demand for mortgage advances in the first half of 2002. The share of mortgage advances in the overall stock of outstanding private-sector credit accordingly increased from 38,5 per cent in December 2001 to 40,9 per cent in July 2002.

Change in credit extension to the private sector by type of credit
R billions per quarter

	2001	2002	
	Dec	Mar	Jun
Mortgage advances	8,6	6,5	9,3
Instalment sale credit	2,1	2,9	2,5
Leasing finance	0,7	0,4	1,1
Other loans and advances	12,4	-2,1	-1,6
Investments	19,7	-13,3	-4,9
Bills discounted	0,1	0,0	-0,5
Total	43,6	-5,6	5,9

Just like mortgage advances, the growth in the other types of credit used mainly by households accelerated during the second quarter of 2002. The growth in *instalment sale credit* and *leasing finance* accelerated from a year-on-year rate of 15,6 per cent in March 2002 to 17,5 per cent in May and 16,5 per cent in June. The financing of used passenger cars contributed most to the growth in this credit category in the second quarter of 2002, followed by the financing of trucks, buses and pick-up trucks. The year-on-year growth rate in this credit category slowed down to 14,5 per cent in July 2002.

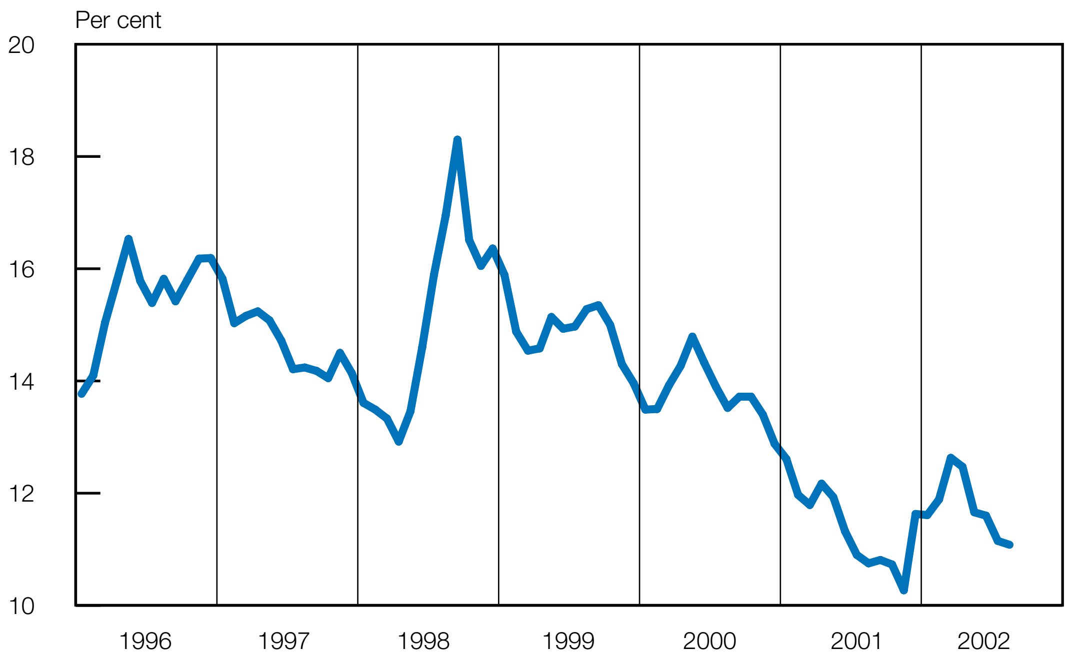
The banks' claims on the private sector in the asset categories *investments* and *bills discounted* declined substantially in the first quarter of 2002 and somewhat less in the second quarter. Banks reduced their equity holdings in unlisted private-sector companies and in derivative instruments issued by private-sector counterparties. In the overall scheme of things, these asset categories represent only a small fraction of banks' overall claims on the private sector. Sizeable increases in these small asset classes will therefore have only a minor impact on overall credit extension to the private sector.

The growth over twelve months in banks' *other loans and advances* – i.e. bank credit extension not linked to the acquisition of an asset by the debtor – declined from 12,3 per cent in March 2002 to 10,7 per cent in June and 8,0 percent in July. Viewed from quarter to quarter, other loans and advances declined by R1,5 billion in the second quarter of 2002. In addition to the turnaround of leads and lags in foreign payments and receipts, the demand for this type of credit was also affected by the rapid development of the market in corporate bonds, which enabled companies to satisfy part of their funding needs outside the banking sector. Other loans and advances still represented as much as 37,3 per cent of the overall stock of outstanding bank claims on the private sector in July 2002.

Interest rates and yields

The sharp increase in long-term bond yields that followed the steep decline in the exchange value of the rand in December 2001 was arrested towards the end of March 2002. With the return to bull market conditions, the *daily average long-term bond yield* fell back from 13,28 per cent on 28 March 2002 to 11,61 per cent at the end of August. The *monthly* average yield on long-term government bonds declined from 12,6 per cent in March 2002 to 11,1 per cent in August.

Nominal yield on long-term government bonds



The principal reasons for the change in the mood in the bond market were

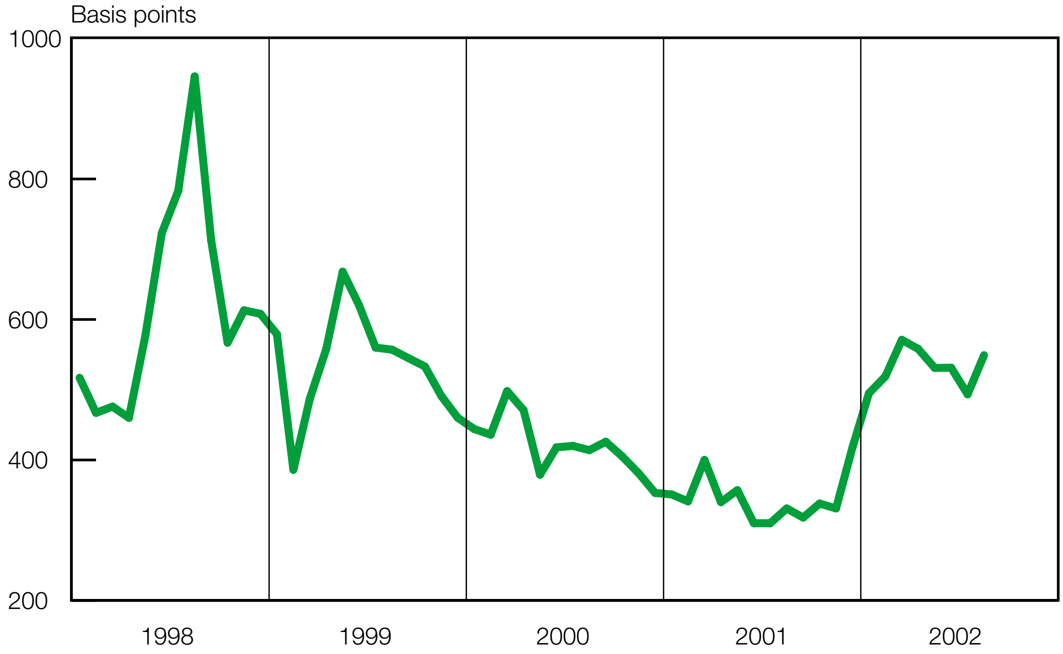
- the view held by many market participants that the rise in inflation in the first half of 2002 would be temporary and short-lived;
- the decisive tightening of the stance of monetary policy in response to the emergence of inflationary pressures;
- the firmer undertone in the foreign-exchange market and the greater stability in the exchange rate of the rand in the first five months of 2002;
- the reduced supply of investable securities by the national government in the face of relatively buoyant investor demand; and
- the general weakness of the equity market from about the last week of May 2002.

International market participants lowered the *currency risk premium* embedded in South African government bond yields. This probably also contributed to the buoyancy in the domestic bond market during the second quarter of 2002 and later. The improvement in the currency risk premium was reflected in a shrinking of 22 basis points from March to August 2002 in the difference between the nominal yield in the domestic market and the yield on dollar-denominated bonds of similar outstanding maturity issued by the South African government in the international market.

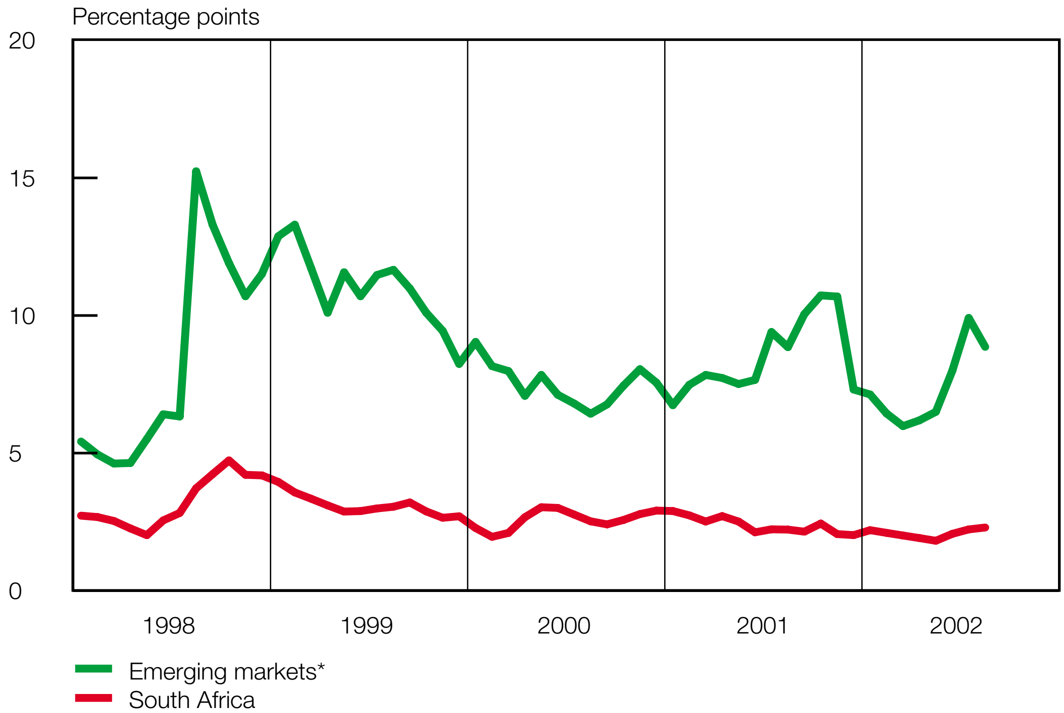
The *country risk premium* on South African government bonds also improved from March 2002 relative to the sovereign risk premium of most emerging-market economies. This was reflected by the decline in the yield on the 10-year Yankee bond issued by the South African government in October 1996, and the rise in the spread of the EMBI+ (i.e. the JP Morgan Emerging Markets Bond Index) relative to the yield on bonds issued by the United States Federal government.

The bond market is signalling a decline in inflation expectations. *Expected longer-term inflation*, measured as the difference between the nominal yield on conventional bonds and the real yield on inflation-linked bonds, declined from a monthly average of 8 per cent in April 2002 to 7 per cent in August. Along with the expectations of lower inflation, the real yield on government's inflation-linked R189 bond levelled off at a monthly average of 4,2 per cent during the months from April to August 2002, compared with 5,1 per cent in November 2001. The real or *inflation-adjusted* yield on long-term government bonds declined too, but this was more the result of the acceleration in year-on-year CPIX inflation than the decline in nominal bond yields.

Currency risk premium on South African government bonds



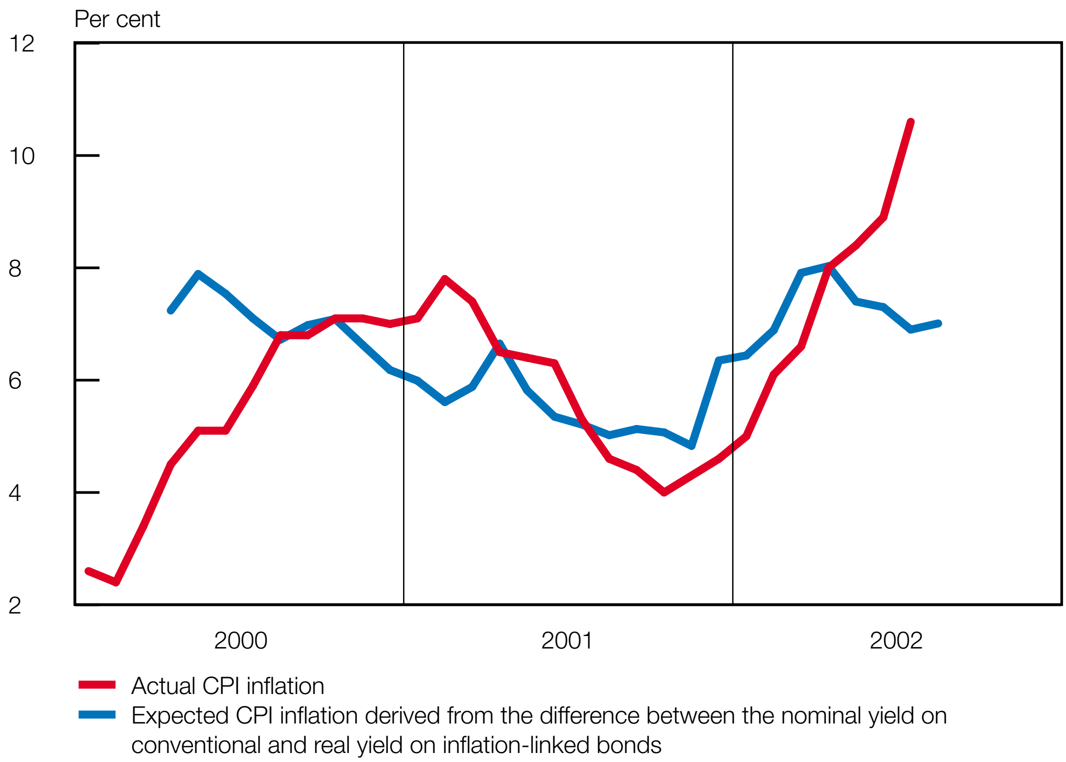
Sovereign risk premiums



* Source: JP Morgan EMBI+

This measure of the real yield (i.e. the nominal yield on government bonds adjusted for year-on-year inflation in CPIX) fell from 4,8 per cent in December 2001 to just 1,2 per cent in July 2002 – the lowest level since February 1994.

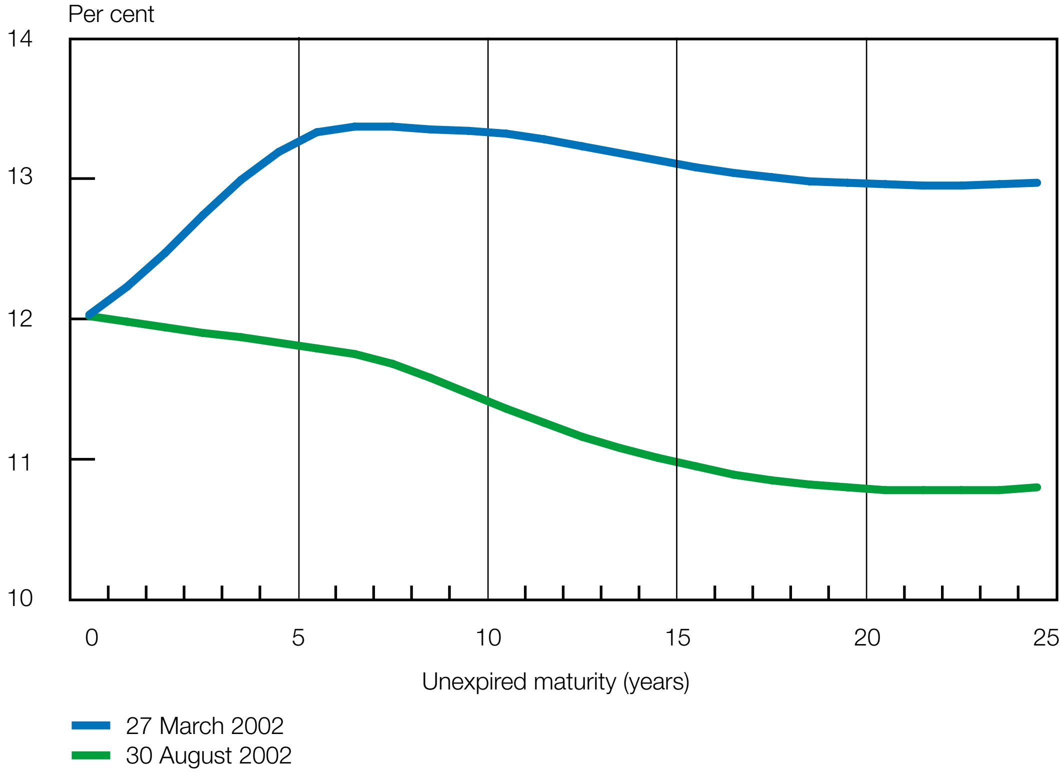
Observed and expected inflation



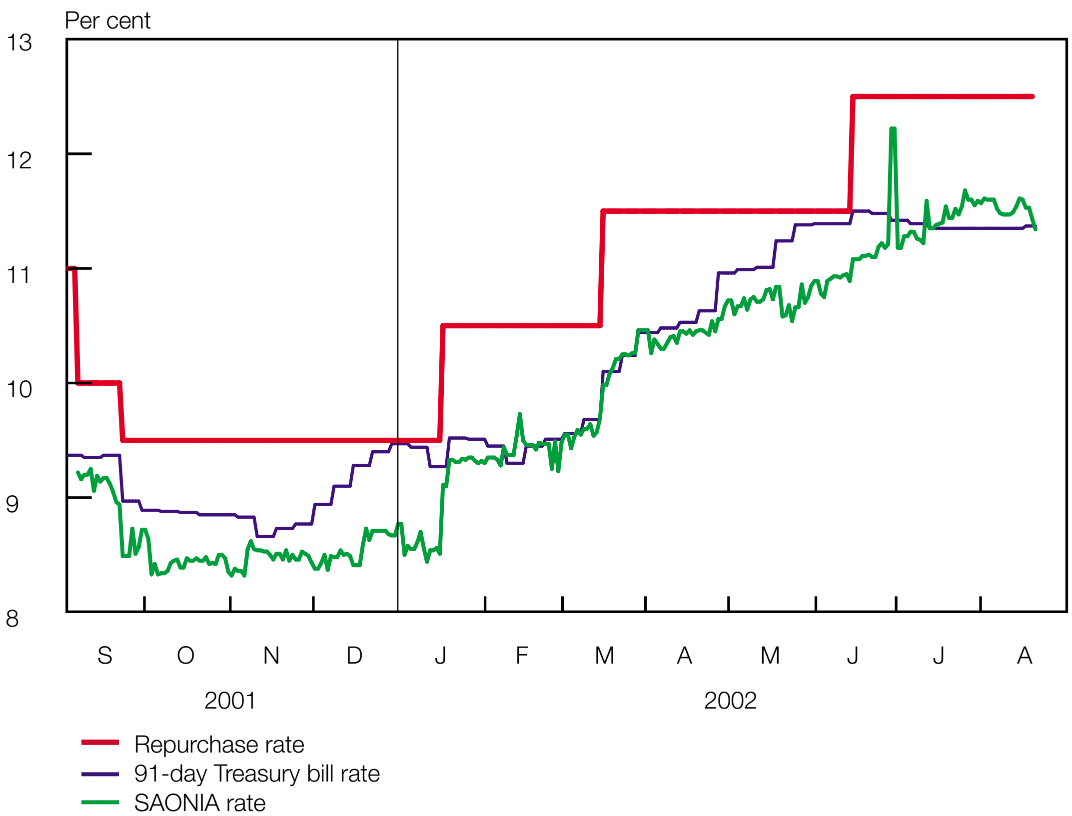
Short-term money market interest rates moved higher with the Reserve Bank's cumulative increase in the rate on repurchase transactions of 3 percentage points in the first half of 2002. For example, the yields on 91-day Treasury bills rose by about 2,75 percentage points from mid-November 2001 to early August 2002. As the Monetary Policy Committee of the Bank aggressively tightened the stance of monetary policy during the first half of 2002, investors' expectations of a strong revival in economic activity moderated somewhat. This delay in the anticipated recovery was manifested in a progressive flattening, and eventual inversion, of the shape of the *yield curve*. The inverse yield gap between bonds at the extreme long end of the yield curve and those at the very short end was 112 basis points by the end of August 2002.

Like the rate on 91-day Treasury bills, other money market interest rates also followed an upward trend in the second quarter of 2002. The SAONIA rate, i.e. a weighted average of the rates at which banks obtain unsecured overnight funding in the interbank market, rose from 10,26 per cent at the beginning of April 2002 to 11,53 per cent at the end of August. At the end of June 2002 the SAONIA rate rose briefly to 12,21 per cent as frictions in the money market temporarily forced some private-sector banks to access the accommodation facilities of the Reserve Bank through the final clearing mechanism at 150 basis points above the repurchase rate.

Yield curves



Money-market interest rates



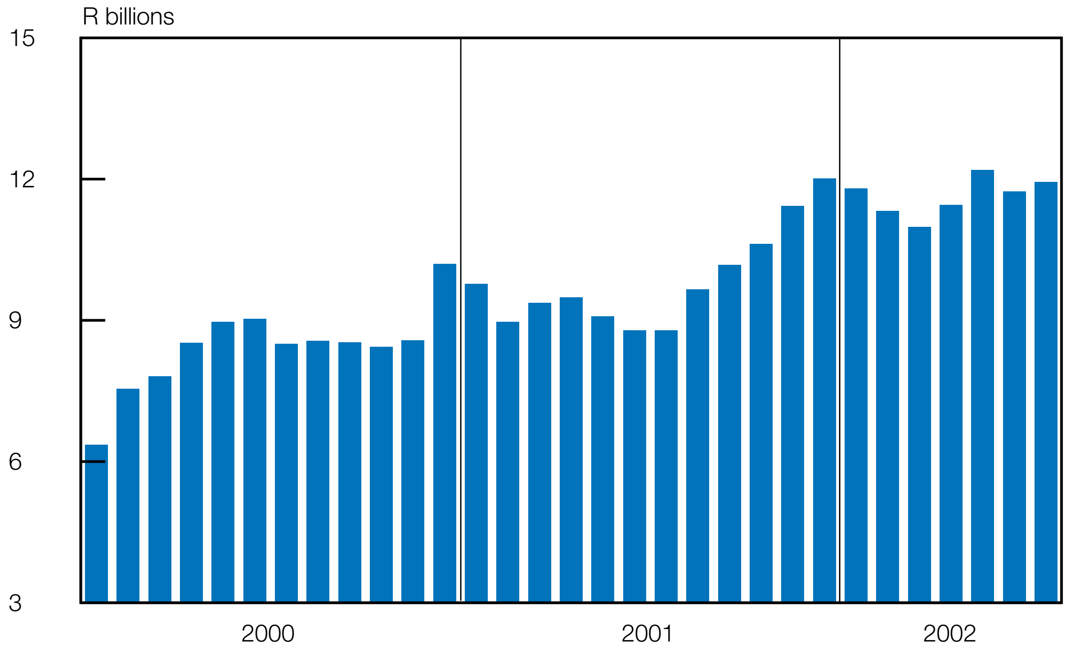
Once the 2001 decline in the exchange value of the rand had largely run its course, rates on forward agreements (FRAs) started to decline towards the end of June 2002. The increase in the Reserve Bank's repurchase rate in June had apparently been fully discounted prior to its announcement. The FRA rates showed little variation in the aftermath of the increase in the repurchase rate on 14 June 2002. The rate on 9x12-month FRAs increased from 11,95 per cent on 4 June to 12,25 per cent on 25 June but declined after that to 11,57 per cent on 29 July. The decline in the exchange value of the rand in August and mounting expectations of higher inflation caused the rate on 9x12-month FRAs to rise to 12,47 per cent on 30 August.

Other *retail lending and deposit rates* of private-sector banks broadly followed the increases in the Reserve Bank's repurchase rate. These banks increased their prime overdraft rate and predominant rate on mortgage loans in three steps from 13 per cent in January 2002 to 16 per cent in June 2002. The predominant rate on twelve-month fixed deposits was raised from 8 per cent in January 2002 to 11 per cent in June.

Money market

The average daily liquidity requirement of the private-sector banks increased from R11,0 billion in March 2002 to R12,2 billion in May, but decreased, on balance, in the ensuing months to R11,6 billion in August.

Average monthly liquidity requirements of private-sector banks



The Reserve Bank maintained the daily liquidity requirement within a fairly narrow range in the first seven months of 2002 by actively implementing various intervention techniques. These were aimed at offsetting the liquidity injections arising from the losses realised on the Bank's forward foreign-exchange transactions, increases in the Bank's net foreign assets, as well as the liquidity assistance provided to certain banks.

In order to drain liquidity from the market, the Reserve Bank increased the amount of its own debentures from R4,0 billion at the end of April 2002 to R6,0 billion at the end of July and R7,25 billion at the end of August. Outstanding reverse repurchase transactions were stepped up from R5,8 billion at the end of May 2002 to R7,1 billion at the end of July. Of the latter total, R5,7 billion worth of reverse repurchase transactions had a maturity of 28 days and R1,4 billion worth had a maturity of 91 days. The remainder of the overall excess liquidity was mopped up by means of foreign-currency swap transactions with parties in the private sector.

On balance, changes in the amount of notes and coin in circulation outside the Reserve Bank caused money market liquidity to ease by R0,9 billion in the second quarter of 2002, and to tighten by R1,0 billion in July and August. The further phasing in of the new vault cash dispensation, which will eventually bar the vault cash of the banks from qualifying as part of their cash reserve balances, is set to drain R1,8 billion from the money market in the second half of September 2002.

Bond market

The supply of new debt in the domestic *primary bond market* by public-sector borrowers declined in the year to March 2002. This is reflected by a decline of R10,7 billion in the nominal value of public-sector fixed-interest securities listed on the Bond Exchange of South Africa in the year to March 2002. Public-sector debt was paid down on a net basis to the value of R10,2 billion over the same period. Net new issues of bonds in the domestic market amounted to only R0,6 billion in April – June 2002.

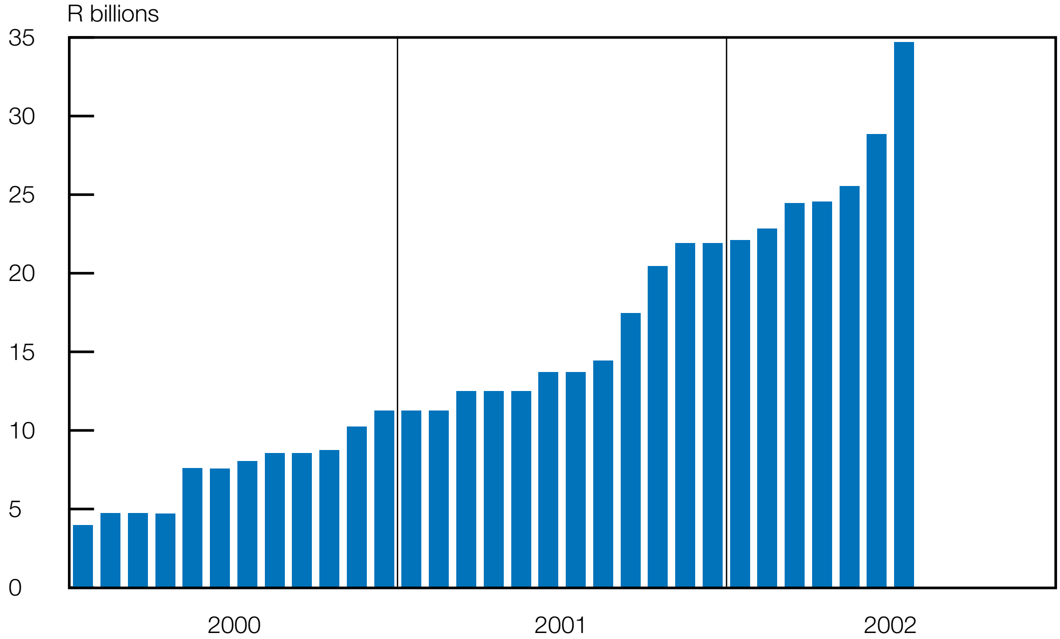
The supply of fixed-interest securities in the domestic bond market was constrained by the national government's preference for borrowing in the *international markets*. Several foreign-currency denominated debt issues were successfully concluded and the national government raised R12,3 billion in fiscal 2001/02 and R10,7 billion in April 2002 in the international markets.

Despite a deterioration in sentiment towards emerging markets generally, confidence in the *eurobond market* for rand-denominated bonds responded positively to the improvement in the exchange value of the rand in 2002. The net proceeds of issues by foreigners changed from net redemptions in 2000 and 2001 to net issues of R0,4 billion in the first eight months of 2002. By contrast, South African issuers redeemed eurorand bonds to the amount of R0,1 billion in the first eight months of 2002.

The issuance of fixed-interest securities in the *primary corporate bond market* gained in popularity as companies sought to satisfy part of their capital requirements outside the banking sector. Private-sector banks were also keen on raising part of their secondary capital in the bond market. The outstanding nominal value of private-sector loan stock listed on the Bond Exchange of South Africa accordingly increased from R21,9 billion in December 2001 to R34,8 billion in July 2002.

Trading activity in the *secondary bond market* was unprecedentedly high at R12,4 trillion in 2001. Quarterly turnover peaked at R3,5 trillion in the fourth quarter of 2001 when the depreciation of the rand dramatically changed expectations about inflation and interest rates. Despite heightened volatility in bond yields in 2002, quarterly turnover fell back somewhat to a still high R3,3 trillion in the first quarter and R3,4 trillion in the second quarter. The value of bonds traded amounted to R1,2 trillion in July and R0,9 trillion in August 2002.

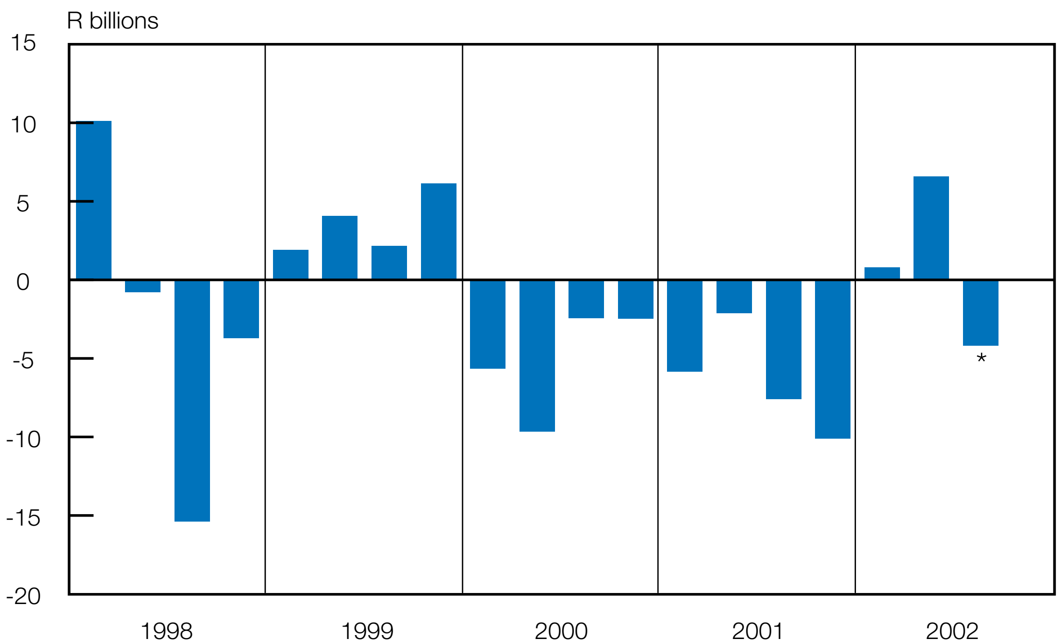
Private-sector funding in corporate bond market



Nominal value of listed private-sector bonds

Non-resident investor sentiment improved quite noticeably in the second quarter of 2002. The potential profit opportunities brought about by the strengthening of the rand together with the decline in longer-term bond yields since March 2002 contributed to an increase in net purchases of bonds by non-resident investors from R0,8 billion in the first quarter of 2002 to R6,6 billion in the second quarter. Subsequently, problems in parts of Latin America and events in neighbouring

Net purchases by non-residents in secondary bond market



* July and August 2002

countries affected sentiment adversely. Non-residents accordingly sold bonds, on a net basis, to the value of R4,2 billion in July and August 2002. On balance, non-resident holdings of South African bonds still increased by R3,2 billion in the first eight months of 2002 compared with net sales of R25,6 billion in 2001.

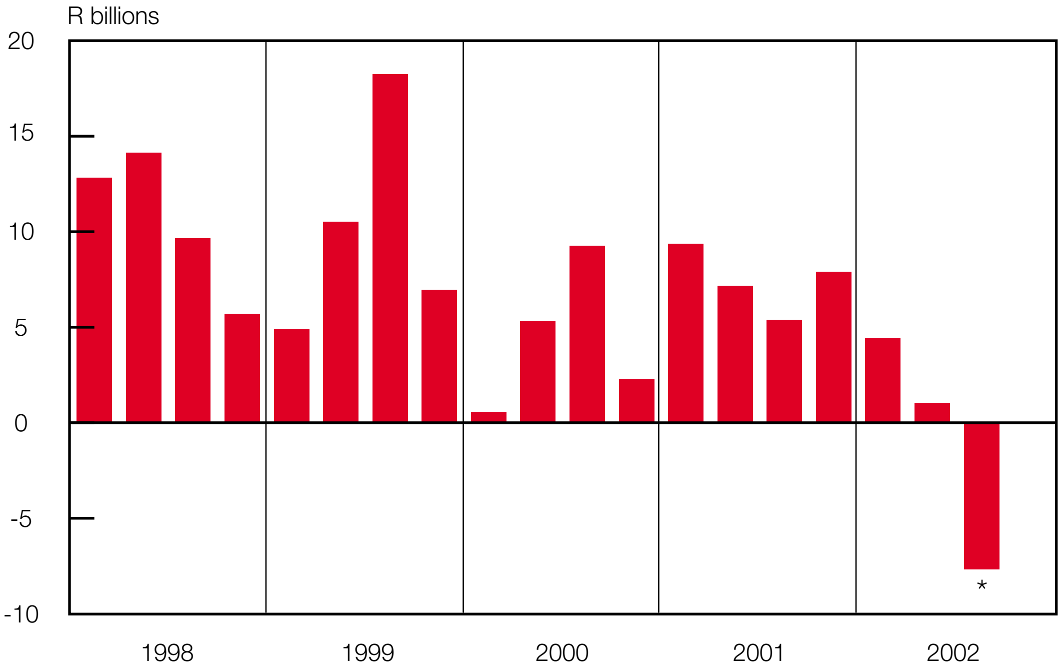
Share market

Funding in the *primary share market* by companies listed on the JSE Securities Exchange SA increased more than threefold from a quarterly average of R3,6 billion in the first three quarters of 2001 to R12,9 billion in the fourth quarter and R12,6 billion in the first quarter of 2002. Owing to the subsequent decline in share prices, the value of capital raised fell back to R8,3 billion in the second quarter of 2002. However, capital raised in the first seven months of 2002 still amounted to R26,2 billion, compared with R23,6 billion in 2001 as a whole.

Trading in the *secondary share market* remained buoyant. Consecutive quarterly turnovers attained record levels as the value of shares traded increased from R161 billion in the fourth quarter of 2001 to R236 billion in the second quarter of 2002. Subsequently, monthly turnover receded somewhat from a high of R89 billion in May 2002 to a monthly average value of R76 billion in July and August 2002.

After May 2002, non-resident investor sentiment towards shares listed on the JSE Securities Exchange SA deteriorated markedly. A more pessimistic evaluation of the near-term global economic outlook caused share prices to decline worldwide and ushered in a movement of funds towards the higher quality assets of mature economies. The quarterly value of net purchases of shares by non-residents accordingly declined from R4,4 billion in the first quarter of 2002 to R1,0 billion in the second quarter. In fact, *non-resident* investors *sold* shares to the value of R1,9 billion in May. This was followed by non-residents' net sales worth R7,7 billion in July and

Net purchases by non-residents in secondary share market

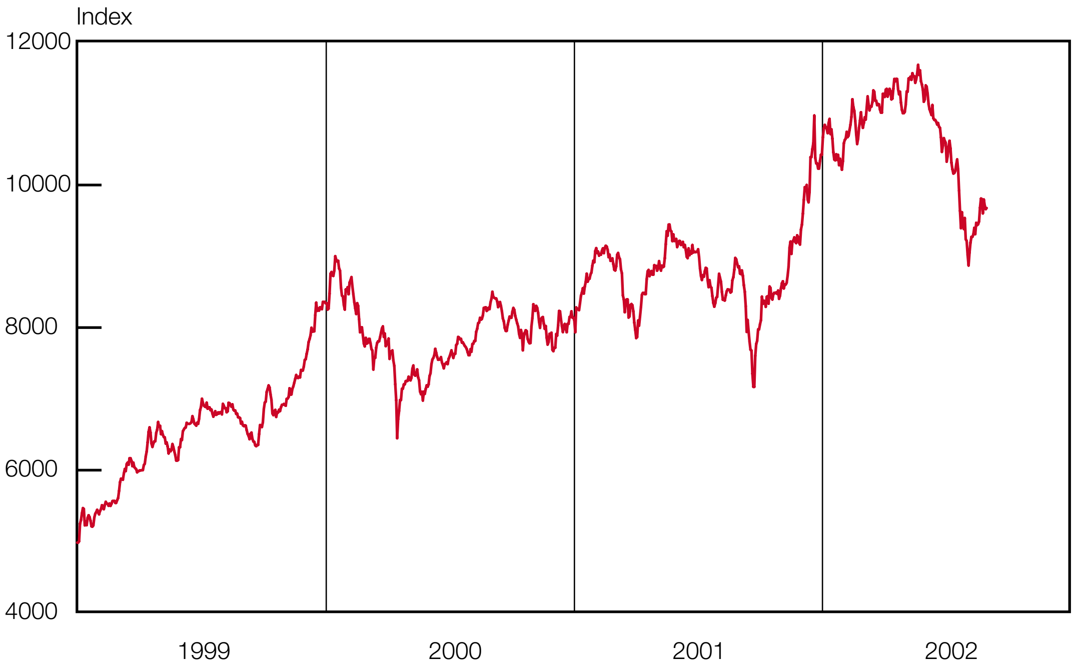


* July and August 2002

August 2002. On a net basis, non-residents sold shares to the amount of R2,2 billion in the first eight months of 2002 compared with net purchases of R29,8 billion in 2001.

Share market participants worldwide changed their outlook on the economy and corporate earnings and became less optimistic during the first eight months of 2002. The resulting weakness in share prices was aggravated when investors also became disillusioned as wrongful disclosures and doubtful accounting practices came to light. The JSE Securities Exchange SA followed the global trend downwards and the daily closing level of the *all-share price index* fell by 24 per cent from a record high on 22 May 2002 to its lowest level in nine months on 5 August, before increasing by 9 per cent to the end of August. At the end of August 2002, domestic share prices were still 35 per cent higher than the low point recorded on 21 September 2001.

All-share price index



Source: FTSE/JSE

The price level of the *resources sector* declined by 21 per cent from its peak on 2 April 2002 to the end of August, in part because of the stronger exchange value of the rand which negatively influenced the earnings of mining companies. Investors also downrated resources shares in response to the empowerment proposals contained in the draft Mining Charter of the Minerals and Petroleum Resources Development Bill. The market capitalisation of the resources sector fell by R50 billion immediately after the contents of the draft charter had become public. Later, some of these losses were recouped when consultation between government officials and mining representatives clarified the preliminary status of the draft charter. The sharp downward correction in the price level of the *gold-mining index* of 23 per cent from a high point on 22 May 2002 to the end of August 2002 was also influenced by the fall in the dollar price of gold. The monthly average prices of shares in the financial sector declined by 15 per cent from May to August 2002 and those in the industrial sector by 13 per cent.

The declines in share prices and increases in earnings per share lowered the *price-earnings ratio* of all classes of shares from 11,4 in May 2002 to 9,7 in August – the lowest level since November 2001. The monthly average *dividend yield* on all classes of shares increased from 3,0 per cent in June 2002 to 3,9 per cent in August.

Market for derivatives

The relative strength of the exchange rate of the rand and the downward movement of share prices in the underlying market introduced uncertainty in the formal market for equity derivative products. Trading in equity-related derivative products (i.e. index and individual equity futures, options on such futures contracts and warrants) accordingly fell back from the high levels recorded in the second half of 2001.

The combined number of *futures contracts and options on futures contracts* traded on the JSE Financial Derivatives Division declined from a record 10,9 million in the fourth quarter of 2001 to 7,9 million in the first quarter of 2002 and 6,2 million in the second quarter. Subsequently, the number of these contracts traded increased from a monthly average of 2,1 million in the second quarter of 2002 to 2,8 million in July and 3,4 million in August.

The number of *warrants* traded on the JSE Securities Exchange SA similarly decreased from a quarterly record of 7,9 billion in the third quarter of 2001 to a quarterly average of 5,5 billion in the first half of 2002. Trading later increased from a monthly average of 1,8 billion contracts in the second quarter to 2,2 billion in July and 1,7 billion in August.

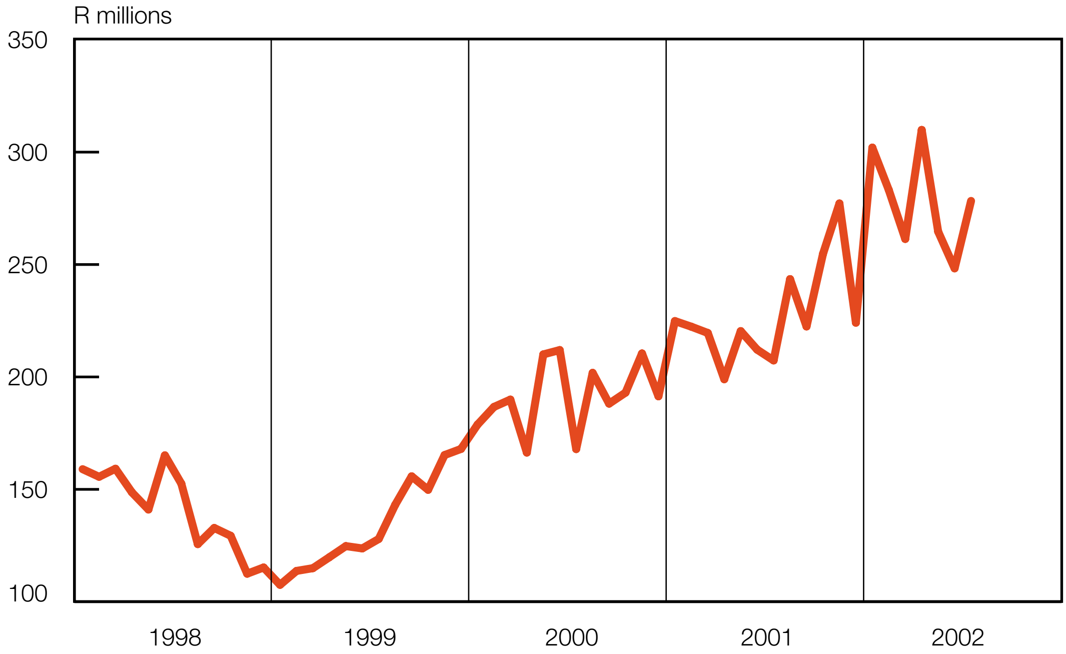
By contrast, the fluctuating prices of agricultural products underpinned the lively trading in commodity derivative instruments on the JSE Agricultural Division. The *number of commodity futures contracts and options on such contracts* (mainly white maize contracts) increased by 47 per cent from the second half of 2001 to the first half of 2002. Later, the monthly average number of 168 000 contracts in the second quarter of 2002 increased to 174 000 contracts in August.

Real-estate market

Changes in the cost of mortgage finance are a prominent factor in determining trading activity and pricing behaviour in the real-estate market. Trading activity in the *real-estate market* remained buoyant in the first seven months of 2002 despite the rising cost of mortgage financing. The overall seasonally adjusted turnover in the real-estate market, indicated by *transfer duty paid,* increased by 17 per cent from the last half of 2001 to the first half of 2002. However, the value of transfer duty collected decreased by almost 3 per cent from the first to the second quarter of 2002, partly because of the lowering of the duty in March 2002, and the dampening effect of the increase in the cost of mortgage finance.

When mortgage rates increased in the first half of 2002, quarter-to-quarter increases in *house prices* slowed from 3,3 per cent in the third quarter of 2001 and 3,1 per cent in the fourth quarter to 2,6 per cent and 2,7 per cent in the first and second quarters of 2002 respectively. The strong acceleration in inflation lowered the rate of increase from quarter to quarter in the *inflation-adjusted* or relative price of houses from more than 2 per cent per quarter in the last two quarters of 2001 to 0,6 per cent and 1,8 per cent in the first and second quarters of 2002.

Activity in real-estate market



Seasonally adjusted transfer duty paid

Non-bank financial intermediaries

The worldwide fall in share prices and the decline in the all-share price index from a high point on 22 May 2002 to the end of August caused a reduction of R256 billion in the market capitalisation of the JSE Securities Exchange SA. The wealth destroyed was equal to 26 per cent of nominal gross domestic product in 2001.

The fall in share prices has not only lowered the overall market value of the share capital of listed companies, but is also expected to reduce the market value of the domestic share holdings of non-bank financial intermediaries (i.e. unit trusts, long-term insurers and pension funds) and as such the accumulated contractual savings of all South Africans. The holdings of domestic shares by non-bank financial intermediaries account for about 40 per cent of the market capitalisation on the JSE Securities Exchange SA. The loss of wealth on the balance sheets of these intermediaries is estimated at approximately R102 billion. However, the overall negative effect of the decline in share prices on the total asset value of these intermediaries could have been diluted somewhat as more than half of their total portfolio was invested in other securities whose prices might have risen over the period in question.

Public finance

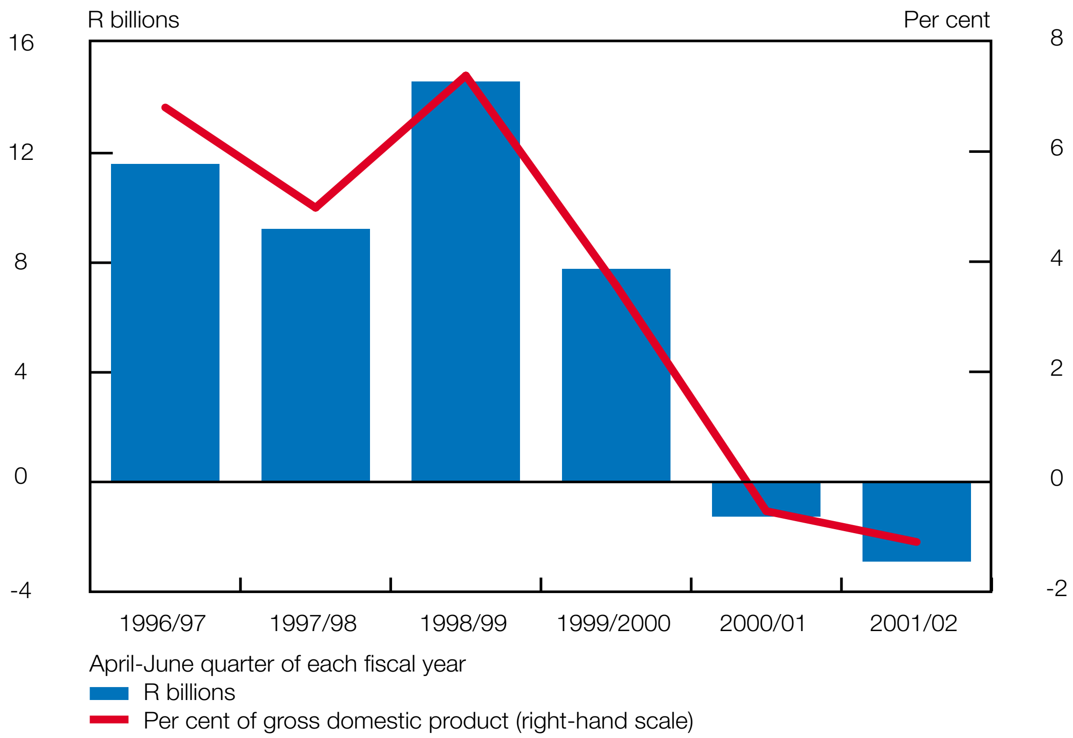
Non-financial public-sector borrowing requirement

The surplus of revenue over expenditure of the non-financial public-sector (i.e. the consolidated central government, provincial governments, local governments and non-financial public enterprises and corporations) amounted to R2,9 billion in the April-June quarter of 2002 – R1,6 billion more than in the corresponding quarter of 2001. As a ratio of gross domestic product, the non-financial public-sector surplus in the April-June quarter of 2002 amounted to 1,1 per cent compared with 0,5 per cent in the same quarter of the previous year.

The *Budget Review 2002* projects an outcome for the deficit ratio of 1,4 per cent for fiscal 2002/03 as a whole. Viewed against the background of an average deficit ratio of 4,4 per cent in the corresponding quarter of the previous five years, the ratio for the April-June quarter 2002 gives evidence of the progress made by government in consolidating the overall fiscal position in South Africa. This declining need for borrowing by the public sector can mainly be attributed to a reduction in the borrowing requirement of national government.

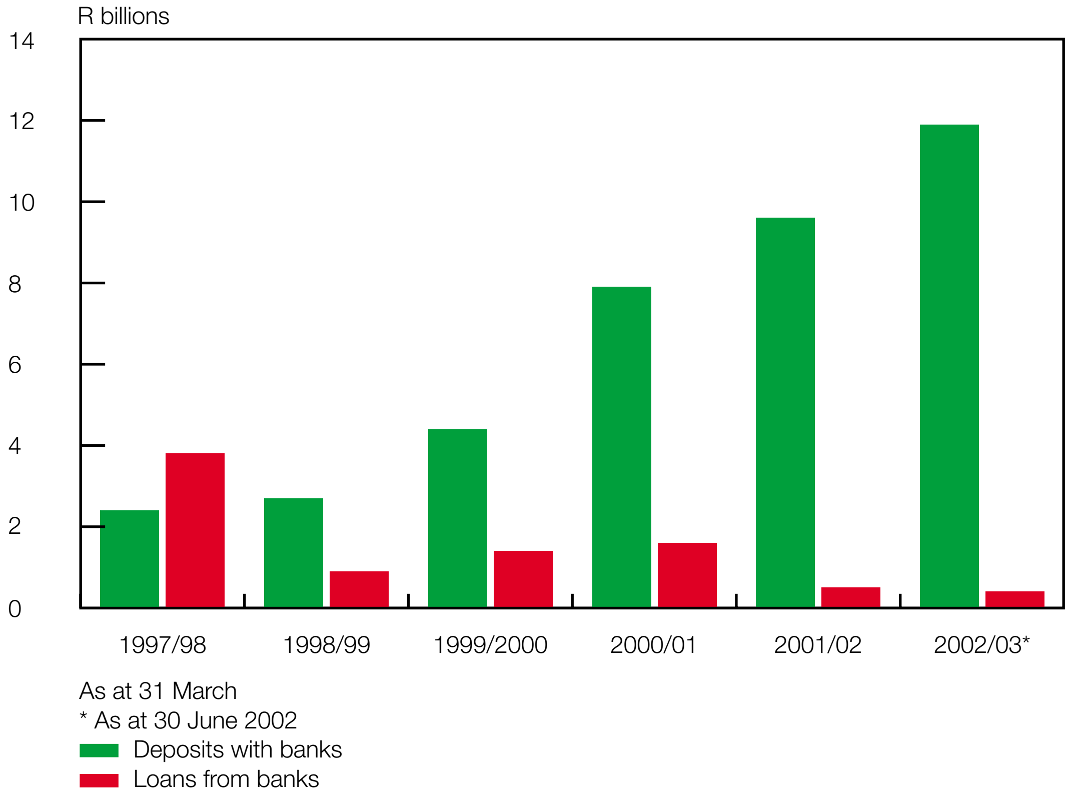
The *Statement of provincial government revenue, expenditure and borrowing* indicated a financial surplus of provincial governments to the amount of R6,2 billion in the April-June quarter of 2002 – slightly less than the surplus of R6,6 billion recorded in the same period of the previous year. The reduction in the surplus can mainly be attributed to an expansion of current and capital expenditure rather than to weak revenue increases.

Non-financial public-sector borrowing requirement



Conditional grants amounting to R3,1 billion were transferred to provincial governments in the April-June quarter of 2002, compared with R2,3 billion in the corresponding quarter of 2001. The equitable share of provincial governments in the national revenue pool amounted to R33,4 billion in the April-June quarter of 2002 compared with R29,5 billion in the same period of the previous year. Along with the revenue raised by the provincial governments themselves, this brought the total revenue and grants of provincial governments to R37,7 billion in the April-June 2002 quarter, up from R32,6 billion a year earlier. The healthier financial position of the provincial governments is also reflected in a decrease in their use of bank credit from R0,5 billion at the end of March 2002 to R0,4 billion at the end of June 2002 and an increase in their bank deposits from R9,6 billion to R11,9 billion over the same period.

Finances of provincial governments



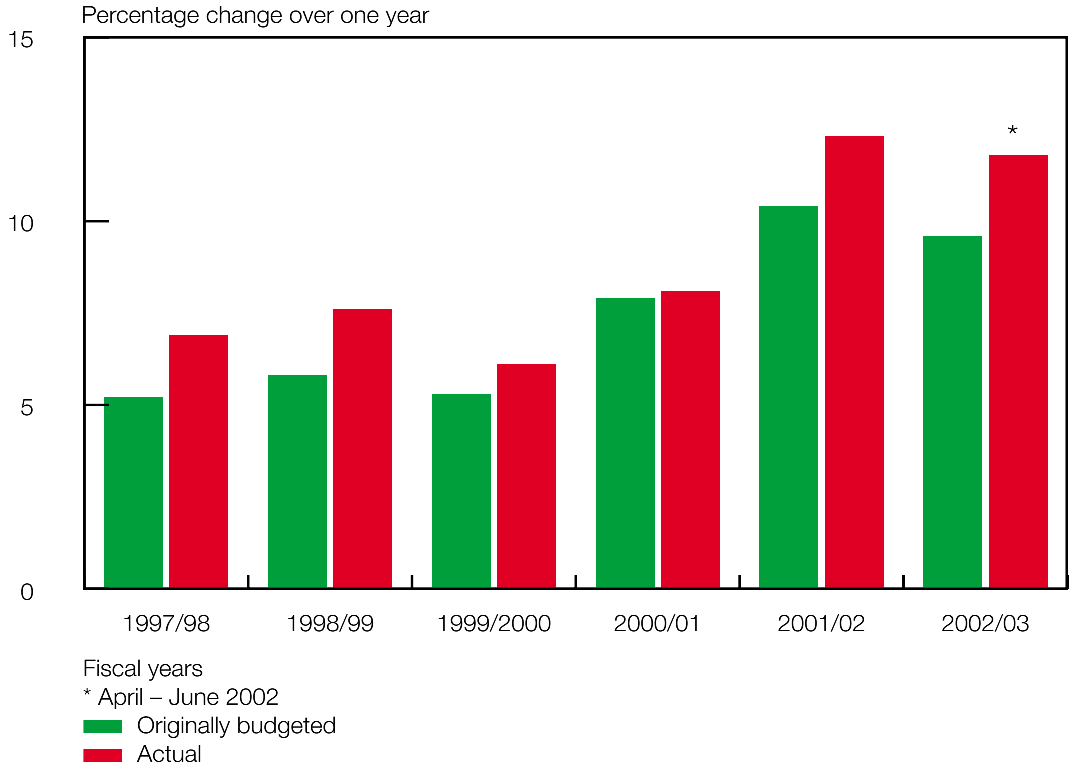
The borrowing requirement of local governments in the April-June quarter of 2002 was estimated at R3,6 billion, which was more than the R1,3 billion recorded in the previous year. The draft Municipal Finance Management Bill has been tabled in Parliament with the aim of modernising the principles of financial management at local government level.

The borrowing requirement of the consolidated central government decreased mainly because of a much-reduced borrowing requirement of national government, which is discussed in far more detail in the following section.

National government finance

National government expenditure in the April-June quarter of 2002 amounted to R68,3 billion which was 11,8 per cent more than in the corresponding quarter of 2001. Among the Budget proposals for fiscal 2002/03, national government expenditure was estimated to amount to R287,9 billion for the full fiscal year, representing an increase of 9,6 per cent on the actual expenditure in fiscal 2001/02.

Expenditure of national government

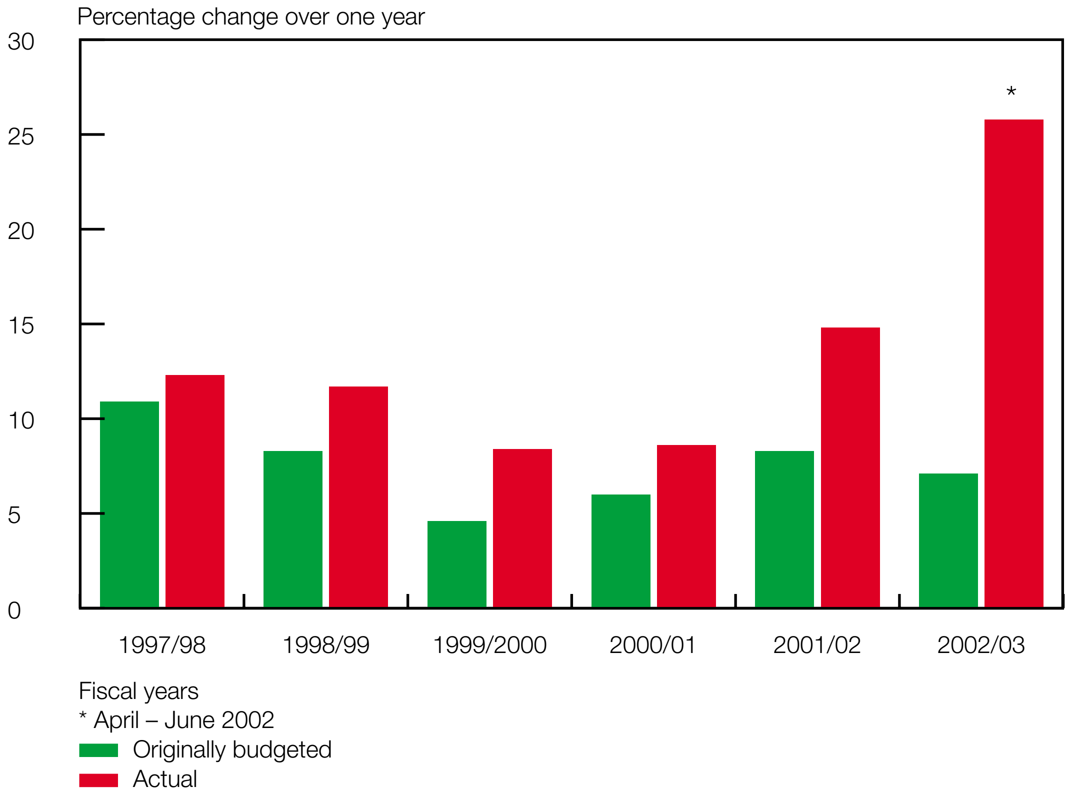


An amount of R3,4 billion in national government spending was recorded as capital outlays in the April-June quarter of 2002. This represents 18,4 per cent of the R18,7 billion envisaged in the original Budget for the current fiscal year as a whole. It was expected that capital expenditure would grow at a rate of 26,1 per cent in fiscal 2002/03 and that this would be supplemented by investment spending by partnerships formed between government and private-sector parties. Interest payments declined by 6,5 per cent compared with the same period in fiscal 2001/02, mainly due to the shrinking borrowing requirement and lower interest rates.

National government expenditure as a ratio of gross domestic product amounted to 25,6 per cent in the April-June quarter of 2002. This ratio was marginally higher than the 25,4 per cent recorded in the corresponding quarter of the previous fiscal year. After allowing for cash-flow adjustments (i.e. accounting adjustments for timing differences between the recording of transactions and bank clearances, and late departmental requests for funds), total expenditure increased by 10,9 per cent to amount to R69,3 billion in the April-June quarter of 2002 compared with R62,5 billion in the corresponding period of the previous year.

National government revenue amounted to R66,7 billion in the April-June quarter of 2002, representing a year-on-year rate of growth of 25,8 per cent. This growth rate significantly exceeded the initially estimated growth rate of 7,1 per cent for fiscal 2002/03 as a whole. All categories of revenue increased at higher-than-budgeted rates (see accompanying table). The high rate of increase in taxes on income and profits can mainly be ascribed to increases in corporate tax payments as company profits benefited, among other things, from the depreciation of the exchange value of the rand. Domestic taxes on goods and services increased appreciably, mainly because of higher collections of value-added tax. Although "other revenue" increased at a very high rate, it represented only a small portion of total revenue collections.

Revenue of national government



National government revenue in fiscal 2002/03

R billions

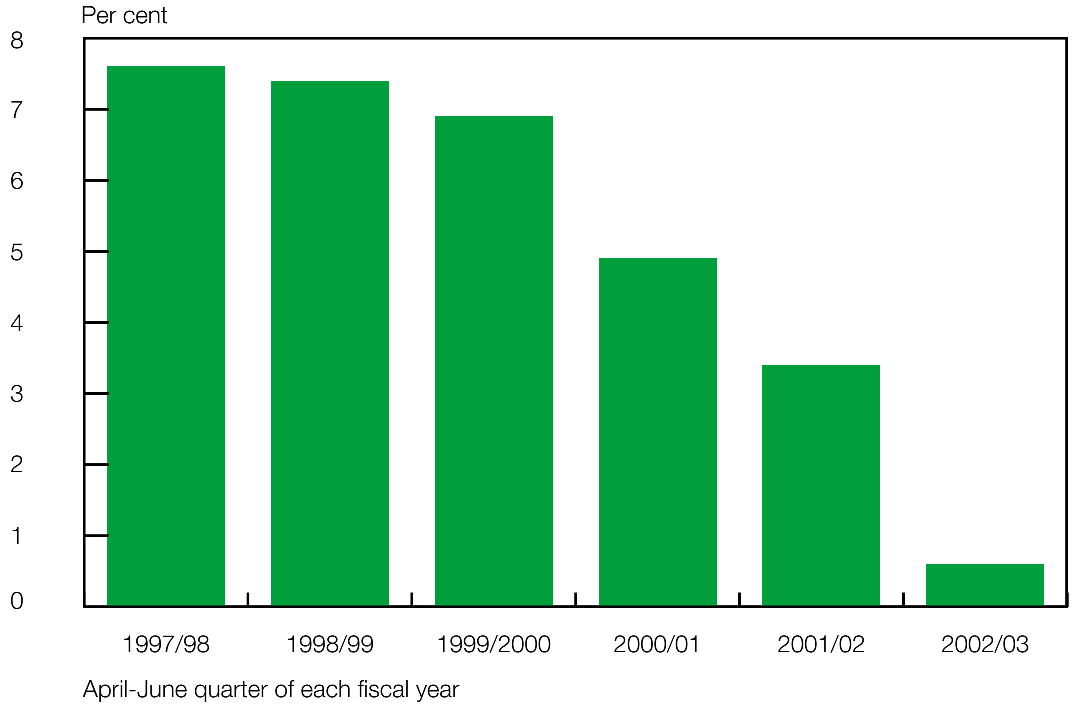
Revenue source	Budgeted full year	Actual April – June	Percentage change*
Taxes on income and profits	155,7	38,2	19,7
Payroll taxes	3,0	0,8	35,9
Taxes on property	4,6	1,4	30,0
Domestic taxes on goods and services	92,8	22,4	19,3
Taxes on international trade and transactions	10,6	2,5	18,4
Other revenue	6,8	3,5	466,6
Less: SACU** payments	8,3	2,1	0,7
Total revenue	**265,2**	**66,7**	**25,8**

* April – June 2001 to April – June 2002
** Southern African Customs Union

National government revenue as a ratio of gross domestic product increased from 22,1 per cent in the April-June quarter of 2001 to 25,0 per cent in the April-June quarter of the current year. After allowing for cash-flow adjustments due to timing differences between the recording of transactions and bank clearances, national government revenue amounted to R66,6 billion in the April-June quarter of 2002. This represents an increase of 30,9 per cent compared with the same period in the previous fiscal year.

The net result of the revenue and expenditure of national government in the April-June quarter of 2002 was a *deficit before borrowing and debt repayment* of R1,6 billion, which was markedly lower than the deficit of R8,1 billion recorded in the same period of the previous fiscal year. As a ratio of gross domestic product, the deficit amounted to 0,6 per cent in the April-June quarter of 2002 compared with a deficit ratio of 3,4 per cent in the corresponding quarter of the previous fiscal year. The cash-flow adjusted deficit amounted to R2,7 billion in the April-June quarter of 2002.

National government deficit as percentage of gross domestic product



No extraordinary revenues were received in the April-June quarter of 2002 by way of the restructuring of state assets. An amount of R12,0 billion was projected to be received from the restructuring of government assets in fiscal 2002/03. Extraordinary payments for premiums on debt portfolio restructuring amounted to R0,3 billion in the April-June quarter of 2002.

As indicated in the accompanying table, the net borrowing requirement in the April-June quarter of 2002 was financed mainly through the issuance of long-term bonds in the international capital markets. A ten-year dollar denominated bond was issued in the amount of US$1 billion, yielding R10,8 billion for the national government. This concluded government's budgeted funding programme in the international market for fiscal 2002/03 as envisaged in the *Budget Review 2002*. The average outstanding maturity of government's foreign bonds lengthened from 89 months at the end of March 2002 to 95 months at the end of June 2002. An amount of R1,9 billion was drawn on foreign export credit facilities for the financing of the strategic defence procurement programme.

National government finance
R billions

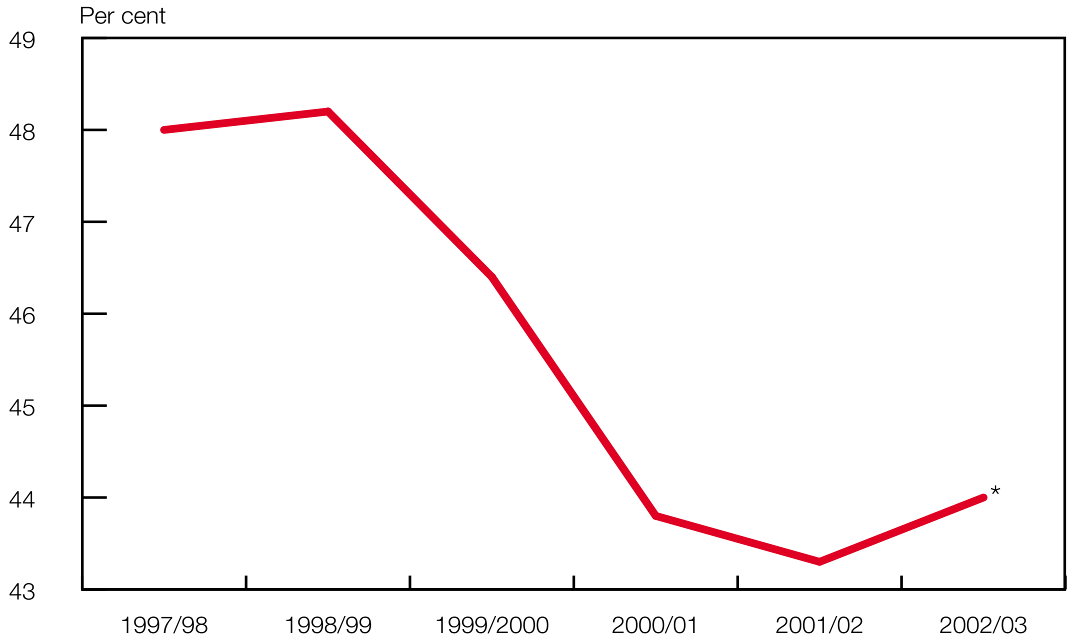
	Fiscal 2002/03 Originally budgeted	April – June 2002 Actual
Deficit	**22,7**	**2,7**
Plus: Extraordinary payments	1,6	0,3
Less: Extraordinary receipts	12,0	0,0
Net borrowing requirement	**12,3**	**3,0**
Domestic primary capital market		
Government bonds	...	5,0
Less: Discount on government bonds	...	0,6
Net receipts from government bonds issued	**-11,0**	**4,4**
Treasury bills	4,0	4,1
Foreign loans	16,3	12,7
Change in available cash balances*	3,0	-18,2
Total net financing	**12,3**	**3,0**

* Increase -, decrease +

Net receipts from domestic government bonds issued in the domestic market amounted to R4,4 billion during the April-June quarter of 2002. Long-term fixed-interest bonds were obtained at an average rate of 11,8 per cent, compared with the earlier assumption of 11,4 per cent. Net Treasury bills to the amount of R4,1 billion were issued at an average rate of 10,6 per cent compared with the budget assumption of 9,7 per cent. These funding activities resulted in an increase in government balances amounting to R18,2 billion in the April-June quarter of 2002. National government deposits reached an all-time high of R24,7 billion, accumulated in preparation for the large interest payments due at the end of August 2002.

National government loan debt rose from R432,3 billion at the end of March 2002 to R451,7 billion at the end of June 2002. Total foreign debt amounted to 20,4 per cent of the total national government loan debt at the end of June 2002 compared with 19,0 per cent at the end of March 2002 and 8,0 per cent at the end of the previous fiscal year. As a ratio of gross domestic product, national government loan debt amounted to 44,0 per cent at the end of June 2002 compared with 43,3 per cent at the end of March 2002.

National government loan debt as percentage of gross domestic product



As at 31 March
* As at 30 June 2002

National government finance in July 2002

National government expenditure in July 2002 amounted to R21,9 billion, bringing the cumulative expenditure in the first four months of fiscal 2002/03 to R90,2 billion which was 13,6 per cent more than in the same period of the previous fiscal year. The cash-flow adjusted expenditure for the first four months of fiscal 2002/03 amounted to R91,0 billion which was 13,2 per cent more than in the corresponding period of 2001.

National government finance
R billions

	Fiscal 2002/03 Originally budgeted	April – July 2002 Actual
Deficit	**22,7**	**4,6**
Plus: Extraordinary payments	1,6	0,3
Revaluation of maturing foreign loans	0,0	-0,3
Less: Extraordinary receipts	12,0	1,0
Net borrowing requirement	**12,3**	**3,6**
Domestic primary capital market		
Government bonds	...	6,2
Less: Discount on government bonds	...	0,8
Net receipts from government bonds issued	**-11,0**	**5,4**
Treasury bills	4,0	2,6
Foreign loans	16,3	13,4
Change in available cash balances*	3,0	-17,8
Total net financing	**12,3**	**3,6**

* Increase -, decrease +

National government revenue amounted to R19,6 billion in July 2002 and to R86,3 billion in the first four months of fiscal 2002/03, representing a year-on-year rate of increase of 20,4 per cent. After the usual adjustment for cash flows, revenue amounted to R86,4 billion in the first four months of fiscal 2002/03, which was 21,1 per cent more than in the corresponding period of 2001.

The net result of the national government's revenue and expenditure in the first four months of fiscal 2002/03 was a deficit of R3,9 billion compared with R7,7 billion in the same period of the previous fiscal year. The deficit before borrowing and debt repayment, adjusted for cash flows, amounted to R4,6 billion. Taking into consideration the proceeds from the restructuring of the information and telecommunications company, M-Cell, the net borrowing requirement of national government amounted to R3,6 billion. This deficit was mainly financed by loans in the international capital market as indicated in the accompanying table.

National government funding activities and the revaluation of foreign-currency denominated debt in July led to a decline in total national government debt to R478,1 billion at the end of that month.

Statement of the Monetary Policy Committee

13 June 2002

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

Inflationary pressures increased sharply in the first few months of 2002 largely as a result of the depreciation in the external value of the rand in the last half of 2001 and rising expectations of price increases. The change in price expectations was clearly reflected in a considerable increase in households' purchases of durable consumer goods in the last quarter of 2001. As the depreciated rand impacted on prices, the year-on-year increase in consumer prices excluding the interest cost on mortgage bonds (CPIX) rose from 5,8 per cent in September 2001 to 8,8 per cent in April 2002. The quarter-to-quarter rate of increase in CPIX inflation was even more pronounced, rising from a seasonally adjusted and annualised level of 6,8 per cent in the fourth quarter of 2001 to 11,6 per cent in the first quarter of 2002.

Apart from the weaker currency, food price increases were at first the main factor contributing to the acceleration in inflation. These food price increases were partly related to the depreciated value of the rand because domestic prices are charged at levels approximating those determined internationally. Shortages of certain types of food produced in the Southern African region also brought about higher food prices. Later the increases in consumer prices became more broadly based. The CPIX inflation excluding food prices rose from a year-on-year rate of 5,3 per cent in December 2001 to 6,9 per cent in April 2002. Moreover, the quarter-to-quarter seasonally adjusted and annualised inflation rate of non-food products increased from 3,9 per cent in the fourth quarter of 2001 to 9,0 per cent in the first quarter of 2002.

Higher international oil prices expressed in dollars and rand were a further important element in the acceleration in inflation. The average monthly price per barrel of Brent crude oil rose from US$18,60 in December 2001 to US$25,38 in May 2002, while the rand price per barrel increased from R217,40 to R257,83 over the same period.

All these factors also had a hand in an acceleration in production price inflation. The quarter-to-quarter and annualised rate of increase in the all-goods production price index rose strongly from 11,3 per cent in the fourth quarter of 2001 to 27,3 per cent in the first quarter of 2002. When measured over periods of twelve months, production price inflation accelerated from 8,2 per cent in November 2001 to 14,8 per cent in April 2002.

Consumer and production price inflation both accelerated during the first four months of 2002, and the risks of slightly exceeding the inflation target in 2003 are still rather high. Moreover, a number of recent developments could impact on the inflation outlook in the period ahead. These include:

- *Recent stronger rand.* The nominal effective exchange rate of the rand rose by nearly 15 per cent from the end of 2001 to 13 June 2002. The rand therefore recouped a significant part of the decline in its weighted value of just more than 34 per cent during 2001. This appreciation in the external value of the rand has already brought about and may in future result in actual price reductions of products such as fuel, or food where import or export parity pricing methods are applied. In addition, the stronger rand may also dampen price increases in other products. However, it is important to take account of the fact that the weighted exchange rate of the rand is still 19 per cent below its level at the beginning of 2001.

- *Improvement in balance of payments*. The current account of the balance of payments, seasonally adjusted and annualised, changed from a deficit of R2,7 billion in the fourth quarter of 2001 to a surplus of R4,2 billion in the first quarter of 2002. A steep decline in dividend payments to non-residents was primarily responsible for this change. The surplus trade balance in the first quarter of 2002 remained virtually unchanged from its level in the preceding quarter.

  In addition, a substantial surplus was recorded on the financial account of the balance of payments. The conversion of a reserve-related loan of US$1,5 billion of the Reserve Bank into a liability of the National Treasury was largely responsible for this favourable outcome in the financial account. A reversal of the leads and lags in payments and receipts arising from foreign trade, was also responsible for the net inflow of capital. This is substantiated by a reduction in the average remittance period of exporters' proceeds from customer foreign-currency accounts at authorised dealers from 116 days in the last two months of 2001 to 79 days in April 2002.

  The balance of payments outlook at present seems promising. The depreciated external value of the rand, the increase in gold and other international commodity prices and a recovery in the world economy should lead to higher export values and prevent excess demand conditions from recurring during 2002. A more positive sentiment by non-residents indicates a greater willingness to invest in South Africa. These developments could support the external value of the rand and dampen price increases, provided that they are not disrupted by international political and economic events or other exogeneous shocks.

- *Surplus production capacity.* There is considerable surplus production capacity in the South African economy. This is confirmed by the index of the utilisation of production capacity which amounted to 80,6 per cent in the first quarter of 2002. In addition, economic growth at just more than 2 per cent is clearly below the potential growth rate of the economy. At present there seems to be little danger that supply constraints could arise in the economy.

- *Fiscal discipline.* The government applies continued fiscal discipline which has led to an exceptionally low fiscal deficit before borrowing and net repayments on domestic debt. The medium-term projections of the government indicate that this fiscal discipline will be maintained in the coming years.

- *Slowdown in but still high rate of increase in monetary expansion.* The month-to-month rate of increase in both the broadly defined money supply and total bank credit extension slowed down considerably during 2002. In fact, bank credit extension declined somewhat in absolute terms from the high level that it had reached in January 2002. Towards the end of 2001 and the beginning of the current year the credit extended by banks was affected by the pre-emptive buying of durable consumer goods in anticipation of price increases. Despite the recent slower pace of growth in monetary expansion, the level of growth in both money supply and bank credit extension is still too high. Measured over a period of twelve months, the money supply increased by 17,5 per cent and total bank credit extension by 10,7 per cent in April 2002.

- *Rising nominal unit labour cost.* The year-on-year rate of increase in nominal unit labour cost picked up from 2,7 per cent in the second quarter of 2001 to 6,8 per cent in the fourth quarter (latest available information). This is a concerning development because there is a close relationship between consumer price inflation and changes in unit labour cost. Moreover, the recently announced increases in salaries and wages in the private and public sector do not bode well for inflation if they are not neutralised to some extent by a rise in productivity.

- *Continued high inflation expectations.* According to a survey undertaken by the Bureau for Economic Research of the University of Stellenbosch, the inflation expectations of the business sector, financial analysts, the trade union movement and households continued to increase in the second quarter of 2002. Higher inflation expectations were also reflected in a continued decline in the real yield on government's inflation-linked R189 bond from a monthly average of 5,1 per cent in November 2001 to 4,1 per cent in May 2002.

At present there are still considerable risks that may prevent the attainment of the inflation target for 2003. The risks that the Reserve Bank cannot disregard are in particular the high salary and wage increases, developments in the oil price and the exchange rate of the rand, the continued high level of growth in money supply and bank credit extension, high inflation expectations and the uncertainties about political and economic developments in some parts of the world. Econometric projections based on a number of different scenarios also show that the average inflation rate in CPIX in the year 2003 will be close to the upper level of the inflation target.

In view of these risks, the Monetary Policy Committee has decided to increase the repurchase rate of the South African Reserve Bank by a further 100 basis points to 12,5 per cent with effect from 14 June 2002.

The impact of offshore listings on the South African economy

by S S Walters and J W Prinsloo[1]

Introduction

1 The authors are grateful for the valuable assistance made by Mr B L de Jager in the preparation of this paper. However, the views represented here are those of the authors and do not necessarily reflect those of the South African Reserve Bank.

South Africa has had to face a number of globalisation issues and international developments over the past decade or so. These impacted directly and indirectly on the economic and financial affairs of the country. Part of this process was the gradual liberalisation of exchange controls which paved the way for large South African companies to transfer the primary listing of their stock to foreign bourses.

By the end of 2000, five companies had received permission to move their primary listings from the JSE Securities Exchange SA (JSE) to the London Stock Exchange (LSE). Although the government holds a positive view on international capital flows as a means to strengthen economic performance, several other stakeholders in the economy became increasingly negative about the ultimate benefits of offshore listings for the South African economy. This can be attributed to the perceived negative impact that offshore listings may have on domestic economic growth and investment. The objective of this study is to clarify some of these issues.

This analysis presents an overview of the main reasons for South African companies to seek listings abroad as well as the exchange control guidelines that such companies have to observe before an application for a primary offshore listing is approved. This is followed by a brief description of the companies that obtained offshore listings up to the end of 2001 and of the circumstances surrounding their applications. Further sections deal with the impact of offshore listings on the market capitalisation of the JSE and the effect on the country's international investment position and dividend flows. This is followed by a discussion of some developments in the modern theory of economic growth and the empirical impact of the offshore listing on South Africa's gross domestic product (GDP) and gross national income. The last section contains a summary and some concluding remarks.

Reasons for South African companies listing abroad

When the South African economy opened up in the second half of the 1990s and exchange controls were gradually relaxed, a number of domestically listed companies approached the exchange control authorities with requests to move the primary listing of their shares from Johannesburg to London.

Such a change in the listing of a company implies that the company has to be domiciled in London and that it has to comply fully with the listing standards of the LSE. This entails a change in the centre of interest of the head offices of the companies concerned from South Africa to London. They essentially become companies foreign to South Africa, or non-residents.

The companies wishing to change their primary listing argued that offshore listings offered certain advantages they would be denied if they maintained a primary listing on the JSE.

These advantages typically include the following:
- Easier access to capital resources at lower cost;
- opportunities to raise efficiencies by competing head-on with global competitors;
- the opportunity to escape from the volatility of financing costs in an emerging-market economy;
- the opportunity to promote foreign investment in South Africa;
- the opportunity to expand their core business into other countries and regions;
- the possibility of benefiting from divergent business cycle movements in different markets;
- the benefit of a diversified business approach which limits the impact of a severe contraction in the economic activity of a single market; and
- the opportunity to improve South Africa's profile internationally.

Exchange control guidelines for offshore primary listings

The exchange control authorities agreed that the global expansion of South African firms would hold significant benefits for the economy, such as greater market access, increased exports, stronger competitiveness and the other reasons listed above. In order to support this expansion from a South African base, the limit on the use of South African funds for new approved foreign investment was raised from R50 million to R500 million in February 2001. South African firms are also permitted to utilise up to R750 million of local cash holdings for approved foreign investment in Africa. In addition, firms are allowed to use local cash holdings to finance up to 10 per cent of the remaining investment outlay where the cost of such investments exceeds the stated limits.

With the same objectives in mind, the exchange control authorities considered the applications for offshore primary listings in a detached and open-minded manner. To make the process more transparent, the authorities set guidelines for companies to comply with, before considering an application for an offshore primary listing. Companies wishing to obtain approval for an offshore primary listing have to prove that:
- foreign expansion is necessary and integral to the firm, taking into account the size and nature of the business;
- a significant portion of the firm's revenue is derived from outside the borders of South Africa, making the business in effect an international concern;
- there will be definite balance-of-payments benefits for South Africa;
- there will be a substantial advantage over alternative approaches to raising the required capital;
- the direct and indirect assets of the South African company will not be encumbered;
- South Africa's gross international reserves will not be adversely affected by a net outflow of dividends or any other funds;
- the company involved will match the dividends declared to the foreign holding company with the dividends paid to South African shareholders in order to preserve balance-of-payments neutrality; and
- all the South African operations and assets of the company will remain in South Africa.

South African companies involved in primary offshore listings

Since the middle of 1997, five of South Africa's big business concerns have received approval from the exchange control authorities to move their primary listings from Johannesburg to London. These companies are:
- Billiton,
- South African Breweries,
- the Anglo American Corporation,
- the Old Mutual Life Assurance Company (SA) Limited, and
- Dimension Data.

The circumstances surrounding each of these offshore listings are discussed briefly below.

As part of a strategic restructuring initiative, Gencor Limited sold its non-precious metal assets to Billiton plc in July 1997. The sale of Gencor's non-precious metal assets comprised the shares of Billiton International, Samancor, Alusaf and Ingwe. At the same time, Billiton plc became the first South African company to obtain a primary listing on the LSE and a secondary listing on the then Johannesburg Stock Exchange. With effect from 1 July 1997, Gencor Limited was transformed into a precious metals company with interests mainly in gold and platinum.

South African Breweries (SAB), one of the world's major beer and beverage companies became, with effect from 8 March 1999, the second South African company to obtain a primary listing on the LSE. SAB believed that offshore listing would put the company in a better position to pursue a growth strategy based on greater access to world capital markets. The management furthermore believed that the step would enhance SAB's ability to take advantage of mergers and acquisitions in the international brewing industry and to compete with other international brewers for development opportunities throughout the world.

The boards of the Anglo American Corporation and Minorco announced in October 1998 that they had agreed in principle to combine their businesses to establish Anglo American as a United Kingdom company. The shares of Anglo American plc, a company with its primary listing on the LSE and with secondary listings on the Swiss Exchange, were traded for the first time on the LSE on 24 May 1999. The Anglo American Corporation and Minorco were merged by means of share exchange offers, and this provided the opportunity to develop a joint strategy focused almost exclusively on mining operations.

The merger made Anglo American plc one of the world's largest mining and natural resources companies. The forming of a single, more internationally based business entity has given it the opportunity to pursue corporate objectives and strategy through a simpler and more transparent organisational structure, and to compete more effectively worldwide for new opportunities for business and growth.

Old Mutual was demutualised in May 1999 and obtained a primary listing on the LSE in July 1999. Based in the United Kingdom, this financial services group with secondary listings on the Johannesburg, Malawian, Namibian and Zimbabwian stock exchanges, has substantial life assurance business in South Africa and other southern African countries and an integrated international portfolio of activities in asset management, banking and general insurance.

Dimension Data, a leading international network and interactive integration services group which operates in more than 30 countries and provides communication network services and e-commerce solutions, obtained its primary offshore listing on the LSE in July 2000. The company maintains a secondary listing on the JSE.

At the time of their listing, all five of the above-mentioned former South African companies had sufficient critical mass for inclusion in the FTSE 100 share price index of companies listed on the London stock market. The Anglo American Corporation entered the FTSE 100 in the 21st position but was subsequently rerated to the 16th position. The ranking of all five companies is indicated in Table 1.

Table 1 Ranking in the FTSE 100 of former South African companies

Companies	Ranking at time of listing	Current rating*
Billiton	54	27
South African Breweries	78	62
Anglo American	21	16
Old Mutual	71	68
Dimension Data **,***	42	...

* As on 19 April 2002
** The company was listed on the LSE on 19 July 2000 but included in the FTSE 100 from 19 September 2000
*** The company was moved to the FTSE 250 on 7 August 2001

The impact of offshore listings on the market capitalisation of the JSE Securities Exchange SA

All the South African companies that successfully obtained primary listings in London maintained secondary listings in Johannesburg, essentially leaving the market capitalisation of the JSE intact. In fact, their market capitalisation increased in most instances as some of the companies concerned took steps to strengthen their capital base. The increase in the market capitalisation of SAB, Anglo American and Dimension Data (see Table 2) can mainly be attributed to the issuance of additional shares by these companies.

Table 2 Market capitalisation of offshore listed companies on the JSE Securities Exchange SA
R billions at end of period

Companies	1997	1998	1999	2000	2001
Billiton	26,7	25,0	62,9	65,4	141,1
South African Breweries	41,9	35,5	48,4	41,2	66,4
Anglo American	46,0	36,2	161,8	166,7	268,8
Old Mutual	-	-	55,6	66,1	56,3
Dimension Data	11,6	16,3	27,6	60,7	18,7
Total market	1 129,4	1 001,6	1 616,2	1 551,5	1 770,7

Non-resident ownership of shares in the companies newly listed abroad increased appreciably along with the increase in market capitalisation. Table 3 indicates the change in the percentage of non-resident shareholding in the companies that recently obtained primary listings on the LSE. The increased exposure of these companies to international markets and their inclusion in the FTSE 100 share price index obviously encouraged international investors' interest in these companies and this led to further increases in non-resident shareholdings and a concomitant inflow of capital into the economy.

Table 3 Non-resident shareholding in companies listed on the London Stock Exchange

Per cent at end of year

Companies	1998	1999	2000	2001
Billiton	48,6	62,9	67,0	77,4
South African Breweries.............	19,7	45,1	43,8	59,8
Anglo American	16,9	44,1	46,5	77,5
Old Mutual.................................	-	38,7	38,1	43,9
Dimension Data	10,9	31,2	55,0	59,2

The capital inflows resulting from the offshore listings helped the South African Reserve Bank to reduce its net open position in foreign currency by purchasing foreign currency in the open market. The net open position of the Bank is perceived as a major source of vulnerability to external shocks to the South African economy. Reducing the net open position in foreign currency, with the ultimate objective of eradicating it completely, enhances the ability of the economy to withstand external shocks.

Through positive wealth effects, the rise in the market capitalisation of the JSE contributed to a higher level of spending in the South African economy during 1999. This helped to counteract the negative effects of the international financial crisis of 1998. Despite the disturbances in global financial markets during 1998, which unsettled economic conditions in many emerging-market economies in 1999, economic growth in South Africa accelerated from 0,8 per cent in 1998 to 2,1 per cent in 1999.

The effect on South Africa's international investment position

The relocation of the primary listing of South African companies from Johannesburg to London increased South Africa's foreign liabilities and foreign assets. Before the change in the primary listing, shareholdings by South African investors in the five companies had been classified as investment in domestic assets. After the change, these shareholdings became classified as investment in foreign assets, thus raising the overall foreign assets of the country.

All domestic subsidiary investments by the five companies had been classified as domestic assets of South African resident companies prior to the listings. After the relocation of the primary listings, these domestic subsidiaries became wholly or partly owned subsidiaries of foreign companies. In this manner, non-resident interest in the South African economy was stepped up and the country's liabilities to foreign shareholders increased commensurately.

The country's international investment position reflects the market value of total foreign assets and liabilities. The value of the foreign-listed companies' assets in South Africa is recorded as a *direct* inward investment into the country – a foreign liability – whereas the value of South African shareholding in the foreign-listed companies is recorded predominantly as outward *portfolio* investment into the United Kingdom – a foreign asset of South Africa.

It is estimated that the foreign liabilities of South Africa increased by R179 billion from the end of 1997 to the end of 2000 on account of the relocation of the primary listings of the five companies. For the same reason, the overall foreign assets of the country were estimated to have increased by R203 billion from the end of 1997 to the end of 2000. Although estimates of the country's foreign liabilities and assets were adjusted for the change in the primary listings, these changes in balance sheet totals were not recorded as capital movements in the international financial account of South Africa because they only represented a reclassification of existing assets.

The effect of foreign listings on dividend flows

The dividends that South African companies provided for and paid to non-resident shareholders and the dividends received and receivable from external equity investments influence the country's balance of payments. The net inflow and outflow of dividends to and from South Africa will depend on the dividend payments from South African subsidiary companies to their London-listed parent companies, as well as on the number of shares held by South African shareholders in the London-listed companies.

Dividends received by South African entities from offshore equity investments increased from R2,4 billion in 1998 to R4,3 billion in 1999, to R8,8 billion in 2000 and to R10,7 billion in 2001. The dividends paid to the rest of the world increased from R5,7 billion in 1998 to R8,1 billion in 1999, to R17,6 billion in 2000 and to R30,9 billion in 2001. As a consequence, the shortfall of cross-border dividends received relative to dividends paid, widened from R3,3 billion in 1998, to R3,8 billion in 1999, to R8,9 billion in 2000 and to R20,2 billion in 2001.

As shown in Table 4, a significant portion of the widened margin between the dividends received and dividends paid came from the activities of the companies that had recently been listed in London. The adverse effect on the net flow of dividends to the rest of the world, and consequently also on the services account of the balance of payments, could therefore be attributed to the fact that dividends previously distributed to a resident holding company, were now being distributed to a foreign head office. Simultaneously, resident shareholdings in the foreign-listed companies declined as foreign interest in these companies grew, resulting in a smaller return flow of dividend income than would otherwise have been the case.

Table 4 International dividend flows of South African companies listed in London
R millions

Period	Paid *	Received **
1998	592	139
1999	2 131	213
2000	9 849	4 992
2001	13 183	6 091

* Dividends declared by South African subsidiary companies to their London-listed parent companies
** Dividends declared by London-listed companies to their South African shareholders

The effect of offshore listings on South Africa's gross domestic product and gross national income

Modern theory of economic growth

The modern theory of economic growth that has developed since the 1950s is based on the work of the classical economists Adam Smith and David Ricardo. Many of Smith's economic growth factors are elements of modern growth theory: the division of labour, accumulation of capital and technological progress. To this may be added a working legal framework and an understanding of the importance of open trade.

David Ricardo conceived the notion that diminishing returns would impose a limit on economic growth. Additional investment tends to yield a lower return over time, implying that growth will dwindle and eventually cease. These diminishing returns apply to all capital investments, implicitly showing that eventually the economy will slow down.

These ideas of Smith and Ricardo, who wrote in the late 18th and early 19th centuries, form the basis of modern growth theory. In the 1950s Solow and Swan developed a growth model incorporating growing output in response to an increasing input of capital and labour in a world of perfect competition. Solow and Swan's model of the economy also obeyed Ricardo's "law of diminishing returns", with each new unit of capital (given a fixed supply of labour) producing a slightly lower return than the preceding unit.

The model developed by Solow and Swan soon became known as the neoclassical growth theory. The model can be used to describe how labour and capital combine to create output and how households allocate their income between consumption and saving. Accordingly, macroeconomic performance relies on how income (which is by definition equal to output) is allocated between consumption and investment, and on productivity, i.e. the amount of output per unit of input.

A key implication is that to keep growing, an economy would have to benefit from continual infusions of new technology, resulting in higher productivity. A high saving rate will result in higher income *per capita* than a low saving rate, but the rate of income growth does not depend on the saving rate. However, an economy-wide rise in saving relative to income will accelerate growth temporarily. Income *per capita* would be higher in economies with higher saving rates and lower in economies with lower saving rates.

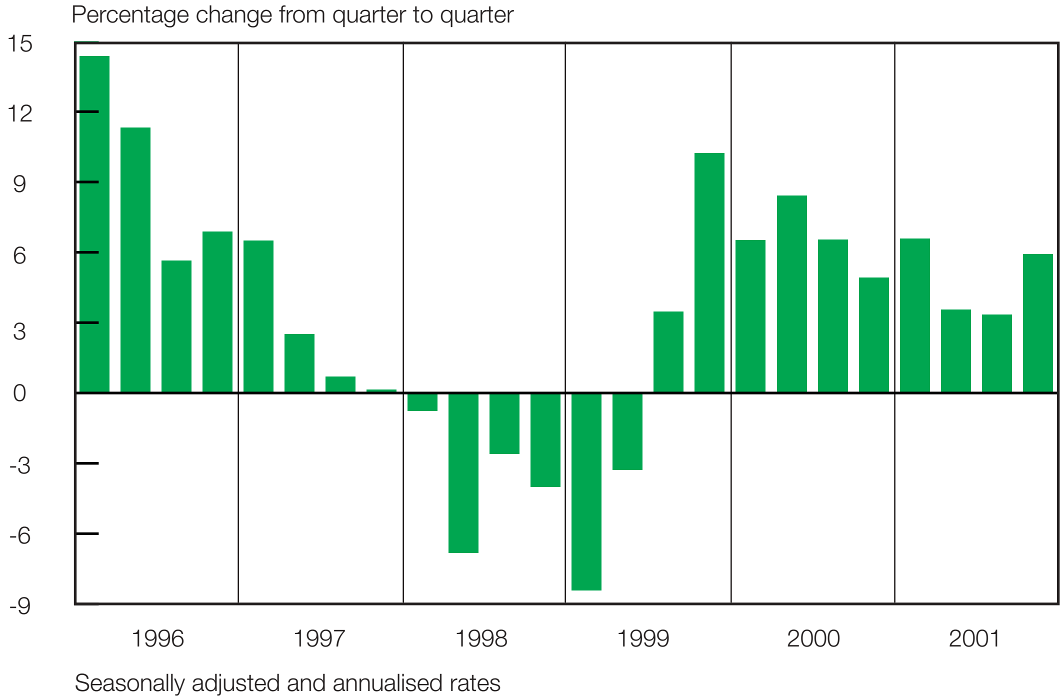
In the long term, growth could be expected to settle down at a steady rate as determined by the growth in labour supply and technological progress. Also, poorer economies with relatively small stocks of capital equipment should grow faster than rich ones because, according to the law of diminishing returns, investment in economies with small capital stocks brings higher returns.

As long as the South African companies that relocated their primary listings to London do not suspend their operations in the geographical area of South Africa, the overall size and growth of domestic output are expected to remain intact. Whether assets are owned by residents of the country or by foreigners is in no way decisive for domestic economic growth. If the offshore listings lead to greater investment activity in the domestic economy, growth would accelerate for a while.

Conversely, a reduction in investment activity in response to the offshore listings would slow down growth during the period of adjustment to the lower investment ratio.

In fact, real fixed capital formation picked up in 1999, giving the impression that the offshore listings could potentially lead to a phase of faster economic expansion (see Graph 1). However, it is not clear whether the pick-up in domestic capital formation by the private sector during 1999 was entirely related to the listing of South African-based companies on the LSE. Other factors might also have contributed to higher investment. For example, normal cyclical factors contributed to the strong showing of capital formation in the South African economy in 2000 and 2001.

Graph 1 Real gross fixed capital formation by private sector



The neoclassical growth theory was challenged after 1986 by Paul Romer's work on "endogenous growth theory". Romer formulated a theory that economic growth is driven by the accumulation of knowledge. He argues that knowledge is the basic form of capital and that investment in knowledge leads to increasing returns in marginal products.

The key factor in Romer's theory is an adequate stock of human capital. He believes that what is important for growth is not integration into an economy with a large number of people, but integration into an economy with a large amount of human capital. His conclusion is that, to promote growth, countries' economic policies should:

- encourage investment in new research, as opposed to encouraging investment in physical capital accumulation; or if this is not possible, at least to
- subsidise the accumulation of total capital.

If the offshore listings of major South African companies had been accompanied by the emigration of highly skilled and innovative people, this could have contributed to existing constraints on the potential growth rate of the economy. No evidence could be found that the offshore listings have been instrumental in accelerating the pace of skills exportation from the country.

Foreign direct investment in an economy is normally seen as beneficial to the host economy in the sense that such investment is mostly accompanied by the introduction of new technologies, leading to higher productivity levels and faster technological progress. New investment by the London-listed companies can therefore be expected to contribute meaningfully to long-term wealth and income creation in South Africa.

Defining residence and centre of economic interest

In an attempt to make a quantitative assessment of the impact of offshore listings on the South African economy, and more specifically on gross domestic product and gross national income, it is necessary to define the concepts "residence" and "centre of economic interest". These can be explained by the fact that total economic activity is defined in terms of resident units and that the activities of non-resident units *vis-à-vis* resident units have a direct impact on the magnitude of gross domestic product and gross national income. The residence status of producers determines the limits of domestic production and affects many important flows in the system for recording the national accounts.

The 1993 *System of National Accounts* (1993 SNA) defines residence as follows: "An institutional unit is then said to be a resident unit when it has a centre of economic interest in the economic territory of the country in question." The economic territory of a country can be described as the geographic territory administered by a government, within which people, goods and capital circulate freely. The 1993 SNA also defines the centre of economic interest as some location inside a country from which an institutional unit engages in economic activity and transactions on a significant scale. Against the background of these definitions, it is possible to evaluate the macroeconomic impact of the primary listing of South African companies on offshore bourses.

Although the centre of economic interest for the headquarters of the companies involved in the primary listing on foreign stock exchanges since 1997 has moved from South Africa to London, the *de facto* operational activities have remained in South Africa. Consequently, the "traditionally" South African-based subsidiaries' contribution to gross domestic product should not change. However, in terms of the calculation of gross national income, the impact of offshore listing could be more noticeable – depending of course on the dividend and interest policies of the foreign holding company and those of its subsidiaries resident in South Africa.

The difference between gross domestic product and national income

Conceptually the difference between gross domestic product and gross national income comprises the measurement of production versus income. Gross national income (at market prices) is calculated by adding to gross domestic product at market prices the primary income receivable by resident units from the rest of the world, minus the primary income payable by resident units to non-resident units. The concept of primary income refers to the factor payments and receipts (i.e. mainly dividends, interest and compensation paid to migrant workers) used in the national accounts of South Africa.

The impact of offshore listings on gross domestic product

Empirical estimates, as shown in Table 5, indicate that the value added by resident subsidiaries of the primary offshore-listed companies amounted to approximately 7½ per cent of South Africa's total gross domestic product in 2000. This is equal to the contribution of the entire mining sector and less than the contribution of 10 per cent registered by the transport, storage and communication sector. If the foreign activities of these enterprises, i.e. those originating outside the geographical boundaries of South Africa, are taken into account then the total output of these companies relative to South Africa's gross domestic product amounted to about 15½ per cent in 2000.

These estimates clearly indicate that a significant portion of the gross output generated by the London-listed companies came from their operational activities in South Africa. Currently there is no empirical evidence that the "local" activities of these companies (and therefore South Africa's gross domestic product) have been negatively affected by the offshore listings. On the contrary, the expansion of some of the formerly South African-owned companies in neighbouring countries, for example in the construction of the Mozal project in Mozambique, may have activated the exports of capital goods from South Africa, thus contributing to higher economic growth.

Table 5 Resident subsidiaries of offshore listed companies' contribution to South Africa's gross domestic product in 2000

Per cent

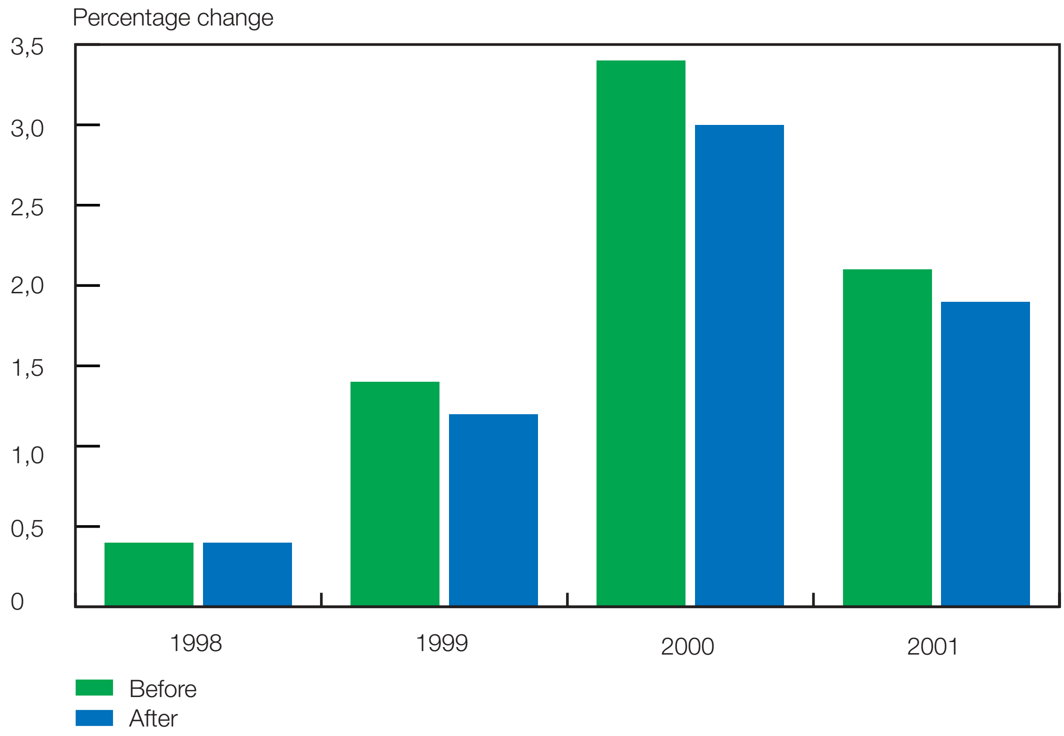
Companies	Contribution to GDP
Anglo American	4,2
Billiton	1,3
Dimension Data	0,2
Old Mutual	0,6
South African Breweries	1,1
Total	7,4

The impact of offshore listings on gross national income

The impact of offshore-listed companies on South Africa's gross national income at market prices can be partially estimated from the changes in the net flow of investment proceeds. In 2000 the net outflow of dividends related to the London-listed companies amounted to R4,9 billion or 21,3 per cent of the total net payment of investment income (i.e. mostly dividend and interest payments) to non-residents.

As indicated above, the margin between total dividend payments and total dividend receipts to and from the rest of the world widened from R3,8 billion in 1999 to R8,9 billion in 2000 and to R20,2 billion in 2001. Net dividend payments to the rest of the world by the London-listed companies widened from R1,9 billion in 1999 to R4,9 billion in 2000 and to R7,1 billion in 2001, indicating that a substantial part of the change in net dividend flows was a consequence of the dividend policies of these companies. The impact that this could have had on growth in the gross national income was nevertheless cushioned by the net selling of South African fixed-interest securities by non-resident investors, which resulted in a decline of R1,8 billion in interest payments to the rest of the world in 2000.

Graph 2 Estimates of change in real gross national income before and after offshore listings



If an assumption is made that there had been no offshore listings, so that the R4,9 billion net outflow of dividends in 2000 would not have taken place, the gross national income at market prices would have been higher by that amount. The level of gross national income at market prices would have increased from R866,1 billion to R871,0 billion in 2000, or by ½ per cent. The rate of increase in the nominal value of gross national income at market prices would have increased from 10½ per cent in 2000 to 11 per cent in 2001. In fact, the net outflow of dividends increased to R7,1 billion in 2001 but the change in net dividend outflows between 2000 and 2001 declined from R3,0 billion to R2,2 billion. Consequently, there was almost no change in the growth rate in the nominal value of gross national income at market prices before and after the adjustment of the net outflow of dividends – it amounted to 9 per cent in both instances.

In the case of the real gross national income at constant 1995 prices (assuming the derived deflator for 2000 and 2001 would have remained unchanged), the growth rate could have risen from 3 per cent to nearly 3½ per cent in 2000, implying an acceleration in real disposable income for the country as a whole of about ½ a percentage point. By contrast, the incremental growth in 2001 was reduced to only 0,2 percentage points (see Graph 2). Based on these assumptions, gross national income *per capita* for 2000 could have increased from R19 826 to R19 937, and at constant prices the *per capita* income could have increased by R77 from R13 785 to R13 862. In 2001, the real *per capita* income could have increased from R13 777 to R13 881, or by R104.

All in all, it can be said that the offshore listings had no noticeable impact on growth in gross domestic product in 2000 and 2001. However, growth in nominal gross national income could have been reduced by a margin of at most ½ a percentage point in 2000, though in 2001 the impact was almost negligible.

Although it is difficult to quantify precisely, it can be argued that the offshore listings might have contributed to stronger performance in the domestic economy. It stands to reason that the offshore listings encouraged an inward movement of capital into the economy as non-resident investors sought greater exposure to these companies. This undoubtedly raised the market capitalisation of the JSE and total wealth of South African residents, thus strengthening investment and consumption in the economy. Expansions by these companies in distant parts of the world further contributed to a stronger pace of economic activity because much of the construction of such projects was sourced from South Africa.

Summary

From a macroeconomic perspective it can be argued that the domestic economy was not excessively sensitive to the relocation of the primary listing of South African companies from Johannesburg to London. As all the South African companies that obtained primary listings on the LSE still have secondary listings on the JSE, the market capitalisation of the JSE has not been affected adversely by the listings on a foreign stock market. In addition, none of the companies that relocated have terminated any of their operations in the geographic area of South Africa, leaving the aggregate size and potential growth of the gross domestic product largely unaffected. The likely expansion of offshore-listed companies in future years in South Africa may give extra impetus to economic growth.

However, the growth in South Africa's gross national product was temporarily affected by a change in net dividend flows following the offshore listings. It was estimated that the growth in nominal gross national income could have been reduced by about ½ a percentage point in 2000 on account of the offshore listings. The impact on gross national product in 2000 was largely cushioned by a substantial fall in interest payments to the rest of the world, when non-resident investors reduced their holdings of South African fixed-interest securities on a large scale. But in 2001, the impact of offshore listings on the nominal gross national product became almost negligible, as the rate of increase in the net payments of dividends slowed down considerably.

Notes to tables

Banks: Credit cards, cheques and electronic transactions – S-13

Footnote 2 was added to Table S-13

Selected money market indicators – S-26

Column 1442M now includes data on reverse repurchase transactions with a maturity of 91 days.

Column 1443M now includes data on Reserve Bank debentures with a maturity of 91 days.

Footnotes 5 and 6 were added to Table S-26.

Money market and related interest rates – S-28

A column was added showing the average tender rate on Reserve Bank debentures with a maturity of 91 days.

Footnote 6 was added to the table and the sequencing of footnotes was amended accordingly.

Capital market activity – S-30

Rights issues of fixed-interest securities were omitted. This item was replaced by the value of other share capital raised which, together with the rights issues of ordinary shares, equal the total value of share capital raised.

Net purchases of bonds by non-residents were separated into repurchase and outright (spot) transactions.

The value and number of real-estate transactions were replaced by the seasonally adjusted value of transfer duties collected.

Derivative market activity – S-31

The number of commodity futures contracts was changed to include both futures and options on futures contracts, from March 1998.

Unit trusts – S-34

This table contains selected items and transactions of the unit trust industry. The frequency of the table was changed from monthly to quarterly, from June 2002.