Quarterly Bulletin

June 2002

South African Reserve Bank

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Quarterly Economic Review

Introduction

Activity in the global economy slowed down substantially in 2001. High international oil prices, the slump in the high-tech sector in the United States and its spillover to other countries and regions weighed heavily on economic activity around the world. The September 2001 attacks on America further heightened economic uncertainty. On average, the growth in global economic activity is estimated to be just a fraction of that of 2000.

In response to the weakness in economic activity, monetary authorities in the United States and the other major industrial countries eased policy throughout the year. In some countries, fiscal measures were also taken to add to the stimulatory impact of an easier monetary policy.

Evidence of an improvement in global economic conditions began to surface in the fourth quarter of 2001. Since then the signs that a worldwide recovery was under way have steadily increased. Confidence in the United States economy, the traditional locomotive of the world economy, is returning more rapidly than expected and growth of close to 6 per cent was measured in the first quarter of 2002.

The synchronisation of the recovery in various parts of the world will probably strengthen the global expansion, in the same way as the downturn of 2001 was aggravated by its wide dispersion. Through various linkages, the South African economy stands to benefit from the world economic recovery, provided no major setbacks occur later in the year.

The South African economy could not escape the slowing down of the global economy but still succeeded in maintaining growth at a year-to-year rate of just more than 2 per cent in 2001. Growth at this level was broadly sustained in the first quarter of 2002, making this the fourteenth consecutive quarter of economic growth, starting in the fourth quarter of 1998.

A slight slowdown in economic growth from the fourth quarter of 2001 to the first quarter of 2002 was mainly concentrated in the manufacturing sector where growth merely returned to more normal levels after a period of frenetic growth in the final months of 2001. Overall, production structures are apparently still adjusting to a new set of relative prices so that the full impact on manufacturing output growth of the vastly more competitive exchange rate is yet to be seen.

Domestic spending was high in the first quarter of 2002. Final consumption expenditure by private households and general government contributed to the pick-up in spending, but the strongest contribution came from investment, especially the accumulation of inventories. Inventory investment contributed as much as 1½ percentage points to overall economic growth in the first quarter of 2002. In this respect the South African economy resembled the United States economy where growth also originated largely from a strong build-up of inventories in the first quarter of 2002.

A higher rate of gross fixed capital formation throughout all the main sectors of the economy also added to the strength of gross domestic expenditure in the first quarter of 2002. Fixed capital formation is widely acknowledged as the fountainhead of economic growth. However, in so far as it is of the efficiency-enhancing and labour-saving kind, it may not necessarily contribute to the creation of new employment opportunities.

Aggregate domestic expenditure rose considerably faster than domestic production in the first quarter of 2002 but this did not worsen the imbalance between spending and disposable income in the domestic economy. In fact, this imbalance improved appreciably because there was a sharp decline in dividend payments to the rest of the world, leaving a much higher portion of domestically generated income for spending in the South African economy.

Although there has been a persistent increase in the nominal compensation per worker in the formal sectors of the economy over the past five years, the share of employee compensation in the overall value of output kept on shrinking. This had much to do with the continuous reduction in employment opportunities in the formal sector of the economy, but rapid increases in operating surpluses, especially in mining and other export-oriented sectors of the economy, have also played a prominent role over the past year or so. The high level of operating surpluses led to higher corporate saving, providing some of the wherewithal for more investment in the economy.

The weakening in economic activity during 2001 took its toll on the labour market. Employment in the formal non-agricultural sectors of the economy edged down and there were signs that the pace of labour attrition might have accelerated in the fourth quarter of 2001. Job cuts accelerated in the construction sector as well as in the financial intermediation and insurance industry towards the end of last year. The officially measured unemployment rate moved up in the second half of 2001.

Given the prevailing economic conditions, growth in labour productivity was impressive in 2001, but it was nevertheless slower than in 2000. It should be remembered that productivity growth typically declines when the economy slows down, partly because employers tend not to shed workers in proportion to reduced demand.

Economy-wide nominal labour remuneration per worker during 2001 increased more or less at the same rate as in 2000. However, with productivity growth somewhat more sedate than in the previous year, growth in nominal unit labour cost picked up by almost 2 percentage points in 2001. This, of course, could impact negatively on overall price inflation but need not spill over into expectations of higher future inflation. Just as the increase in unit labour cost in 2001 was supported by the smaller productivity gains that accompanied weak economic activity, future increases in unit labour cost would be held down if output per worker began to increase more rapidly when the economy strengthens.

Higher unit labour cost growth contributed to a pick-up in domestically generated inflation in the second half of 2001, but the main factor responsible for the steep rise in inflation was the decline in the exchange value of the rand. This, alongside higher international crude oil prices, was responsible for an abrupt upward adjustment in the level of the production price index in the first four months of 2002. These price increases spilled over into higher consumer prices where the inflation situation was further aggravated by sharp increases in food prices, also partly related to the depreciation in the value of the rand. More recently there have been indications that the pace of food price growth is slowing down. Together with the price effects of the recent appreciation of the rand, the slowdown in food prices may in due course contribute to a better outlook for inflation than suggested by some current projections of inflation.

Export earnings rose strongly in the first quarter of 2002 as export prices improved, the global economy recovered and domestic producers expanded their sales into export markets. Gold exports, benefiting from the depreciation of the rand and the rising US dollar price of gold, bolstered export earnings even further. At the same time, imports remained lively in order to satisfy the fairly robust aggregate demand in the economy. More capital goods were imported, reflecting the high level of investment activity in the economy.

These developments led to the positive balance on the trade account with the rest of the world remaining broadly unchanged from the fourth quarter of 2001 to the first quarter of 2002. But there was a sharp decline in the deficit on the “services account”, causing the overall balance on the current account of the balance of payments to turn from a deficit in the fourth quarter of 2001 to a fairly sizeable surplus in the first quarter of 2002. A steep decline in dividend payments by the domestic subsidiaries of former South African companies that now have head offices in London, was primarily responsible for the quick turnaround in the balance on the current account.

A substantial surplus on the financial account of the balance of payments was recorded in the first quarter of 2002, following an outflow of capital from the economy in the fourth quarter of 2001. Central to this improvement was the conversion of part of the reserve-related external liabilities of the Reserve Bank into a long-term foreign liability of the National Treasury. The financial account also benefited from the reversal of the leads and lags in foreign-trade payments and receipts experienced in the fourth quarter of 2001.

Together, the surpluses on the current and financial accounts of the balance of payments occasioned a strong increase in the country’s holdings of gold and foreign-exchange reserves. This reduced the net open position in foreign currency of the Reserve Bank. Valued in rands, the stronger exchange rate of the rand, however, reduced the value of gross international reserves in the first quarter of 2002, contributing to a decline in import cover from 24 weeks’ worth of imports of goods and services to 20 weeks’ worth.

The excess supply of foreign currency in the domestic foreign-exchange market changed the fortunes of the rand quite drastically in the first quarter of 2002. Notwithstanding a decline in turnover in the market for foreign exchange – claimed by some analysts as a potential cause for rand weakness – the greater supply of foreign currency in the market caused the rand to strengthen. From a low point on 20 December 2001 to 31 May 2002 the nominal effective exchange rate of the rand strengthened by as much as 30,1 per cent.

The broad monetary aggregates grew rapidly towards the end of 2001 and in the first quarter of 2002. Measured from quarter to quarter, M3 increased at an annualised rate of over 30 per cent in the first quarter of 2002 – significantly above the rate of the past several years and well above the growth in nominal gross domestic product.

Part of the rapid growth in the broad money supply might have been a consequence of investors' portfolio restructuring. Because the rates of return provided by many components of M3 change sluggishly, the decline in market interest rates lowered the opportunity cost of money holdings up to the end of 2001, specifically of the narrow asset classes M1 and M2. Moreover, uncertain returns and heightened volatility in the equity market raised the demand for money assets as a safe investment haven throughout the second half of 2001 and into the first quarter of 2002.

In so far as the rapid accumulation of money was a consequence of investors' portfolio adjustments, there is no need to fear an increase in the inflationary potential of the economy. But part of the money accumulation could have been for transaction purposes with a view to increasing future spending, potentially to a level exceeding current disposable income. If such a situation is sustained over the medium to longer term, higher inflation would be the almost inevitable result. All prolonged periods of rapid monetary expansion in history have been accompanied by high price inflation.

The expansion of the banks' deposit liabilities at a faster rate than domestic credit extension facilitated the accumulation of foreign assets on a net basis by the consolidated banking sector in the first quarter of 2002. But assets in the form of claims on the domestic private sector also continued to rise steadily. The greater part of this was extended to the corporate sector where fixed capital formation, an important driver of future economic growth, has been growing solidly over the past year. The smaller part of credit extension to the private sector reflected a still reasonably buoyant demand for consumer goods and services.

Money-market conditions eased considerably during the first five months of 2002. Strong liquidity injections emanated from the deficits incurred by the Reserve Bank on transactions in the forward foreign-exchange market, and from an increase in the Bank's net foreign assets. At times the money market became awash with funds when the Bank had to provide liquidity assistance to smaller banks confronted by large-scale deposit withdrawals. To ensure the efficiency of the Bank's interest-rate policy, these liquidity injections had to be mopped up. The Bank employed various liquidity mopping-up techniques, including foreign-exchange swap transactions linked to foreign-currency deposits with the Bank and the issuing of Reserve Bank debentures.

Money-market interest rates generally moved higher during the first five months of 2002, reacting to the changes, or in anticipation of likely changes, in the Reserve Bank's repurchase rate. Bond yields, which changed inversely to the price of bonds, moved in tandem with the rise in money-market interest rates from the end of November 2001, also following the widely-held expectation of an acceleration in inflation. From the end of March 2002 bond yields began to decline, partly because of the relatively small supply of long-term fixed-interest bearing securities in the market.

Non-resident investors returned to the domestic bond market as net buyers in the first five months of the year, following a two-year period when they had consistently reduced their exposure to South African fixed-interest securities. The presence of non-resident investors as buyers in the bond market has also helped to lift the prices of bonds since the beginning of April 2002.

Share prices strengthened remarkably after the tragic events of 11 September 2001, driven higher by particularly strong interest in gold-mining stock and the resources sector of the JSE Securities Exchange SA. Prices of companies listed in the industrial and financial sections of the Exchange also showed some improvement, but this was far less impressive than in the gold and resources sectors. Non-resident holders of equity in South African companies added to these holdings over the first five months of 2002.

A strong improvement in overall tax administration and firm control over outlays led to a smaller national government deficit than had been anticipated earlier. The fiscal 2001/02 deficit was R15,1 billion, or about 1½ per cent of gross domestic product – well below the record deficit of R31,5 billion recorded in fiscal 1996/97 and the deficit of 2½ per cent of gross domestic product projected by the Minister of Finance when he presented his budget proposals to Parliament in February 2001. Given the overall healthy state of public finances, the Minister could announce sizeable tax concessions for the current fiscal year – a measure that is expected to assist the economic recovery and help to put the economy on a faster growth path in the years ahead.

Domestic economic developments

Domestic output

The economy continued to grow at a fairly sturdy pace in the first quarter of 2002, albeit at a rate slightly below that of the fourth quarter of 2001. The growth in *real gross domestic product* moderated somewhat from a seasonally adjusted and annualised rate of 2½ per cent in the fourth quarter of 2001 to 2 per cent in the first quarter of 2002. This was the fourteenth successive quarter of output expansion in the South African economy, starting in the fourth quarter of 1998.

The first-quarter slowdown was mostly confined to slower growth in the secondary sectors of the economy. By contrast, growth in the real value added by the primary sectors gained some momentum, though growth in the tertiary sectors continued at about the same pace as in the fourth quarter of 2001.

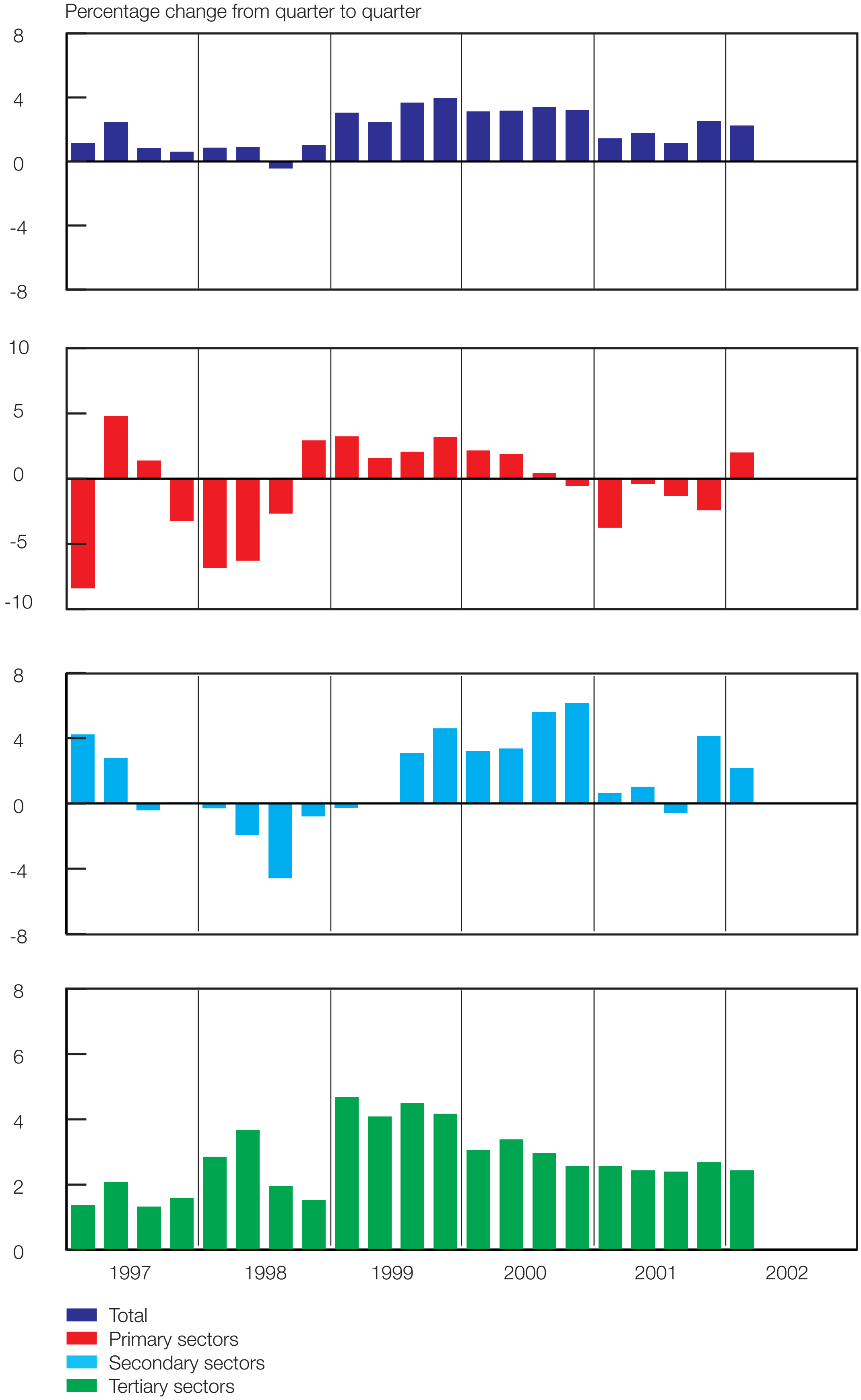
Real gross domestic product
Percentage change at seasonally adjusted annualised rates

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

Despite the slower growth from quarter to quarter, the total real value added in the first quarter of 2002 was still about 2 per cent higher than in the first quarter of 2001, placing year-on-year growth roughly on a par with economic growth in 2001 as a whole. The domestic economy apparently was more robust in the first quarter of 2002 than generally expected, given the uncertainties emanating from the steep fall in the exchange value of the rand and the unsettled situation in Zimbabwe prior to the election held in that country in March 2002. Activity in South Africa was probably supported by the recovery in the global economy, the bright prospects for exporters and a pick-up in the demand for goods produced by import-competing industries.

The real value added by the *primary sectors* increased in the first quarter of 2002 after declining for five consecutive quarters. The *agricultural sector* was entirely responsible for this output expansion, partly because of the harvesting of a large part of the wheat crop in the first quarter of 2002. Wheat is normally harvested in the fourth quarter of the year. The real value added by the *mining sector* showed virtually no change from the fourth quarter of 2001. Increased output by diamond and iron ore mines was almost completely offset by a decline in platinum output. Platinum output was held back by a weaker platinum price and the re-entry of Russian producers to the market.

Growth in real gross domestic product



Seasonally adjusted annualised rates

In the *secondary sectors* of the economy, the manufacturing subsector did not maintain the brisk growth rate of the fourth quarter of 2001: growth in the real value added by *manufacturing* fell back from 5½ per cent in the fourth quarter of 2001 to 3 per cent in the first quarter of 2002. The weakness in manufacturing output growth was particularly noticeable in the sectors producing transport equipment and basic iron and steel. This was largely due to a sudden fall in the demand for new cars and other motor vehicles, following the bunching of demand in the fourth quarter of 2001 to avoid paying higher prices later. Overall, the demand for manufactured goods remained firm, as reflected by year-on-year growth of 9 per cent in new orders during the first quarter of 2002.

The slowdown in the growth of manufacturing output also affected the demand for electricity, keeping output in the sector supplying *electricity, gas and water* at about the same level as in the fourth quarter of 2001. The growing demand for residential and non-residential buildings underpinned an expansion in the real value added by the *construction sector* of approximately ½ a per cent in the first quarter of 2002, roughly similar to the growth in the fourth quarter of 2001.

The real value added by the *tertiary sectors* grew at a seasonally adjusted and annualised rate of 2½ per cent in both the fourth quarter of 2001 and the first quarter of 2002. Slower growth in the commercial and financial services sectors was largely offset by stronger growth in the transport, storage and communication sector in the first quarter of 2002.

The growth in the real value added by the *transport, storage and communication sector* strengthened from 4½ per cent in the fourth quarter of 2001 to 5 per cent in the first quarter of 2002. The main contributors to this acceleration in growth were the cellular telephone industry, an increase in harbour and dock traffic, and lively foreign tourism.

Growth in the *commercial sector* fell from an annualised rate of 4 per cent in the fourth quarter of 2001 to 2 per cent in the first quarter of 2002. The subcategory catering and accommodation services experienced solid demand, and the growth actually accelerated in the first quarter of 2002. However, these were completely neutralised by a fall in the real value added by the wholesale and the motor trade.

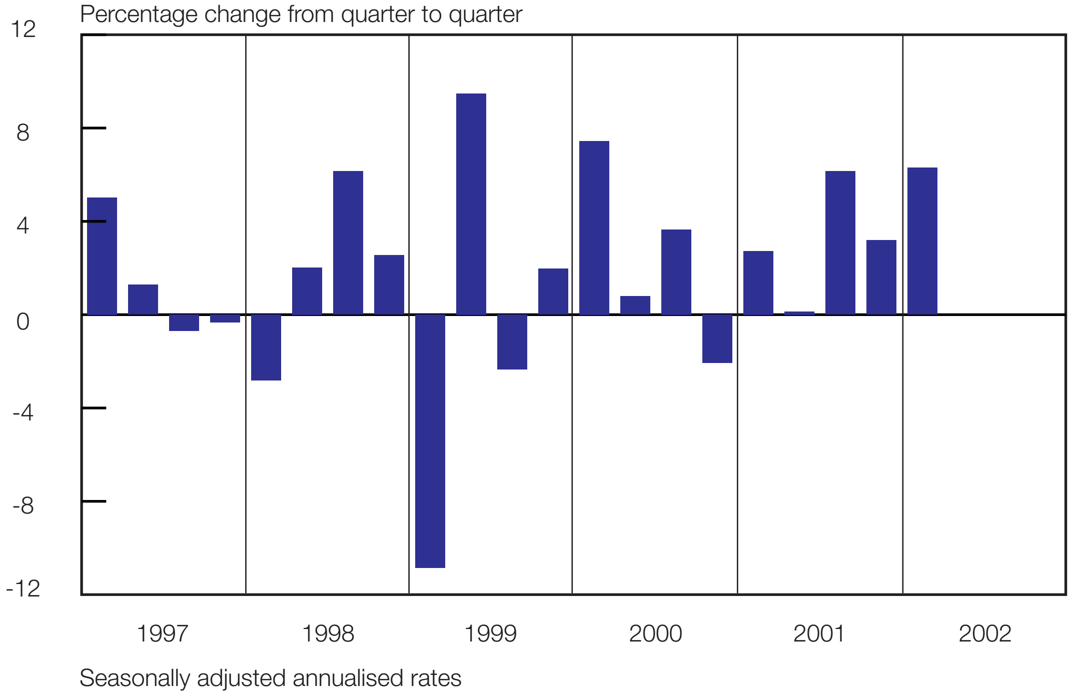
The real value added by the sector *financial intermediation, insurance, real-estate and business services* grew at a seasonally adjusted and annualised rate of 3½ per cent in the first quarter of 2002, following an increase of 4 per cent in the fourth quarter of 2001. This slowdown can mainly be attributed to slower growth in the real value added by the financial services subsector. By contrast, the real value added by the real-estate subsector improved markedly in the first quarter of 2002.

Domestic expenditure

Aggregate *real gross domestic expenditure* demonstrated strong growth in the first quarter of 2002 by accelerating to 6½ per cent at a seasonally adjusted annualised rate from 3 per cent in the fourth quarter of 2001. This was supported by faster growth in real outlays on gross capital formation and a relatively strong increase in consumption demand.

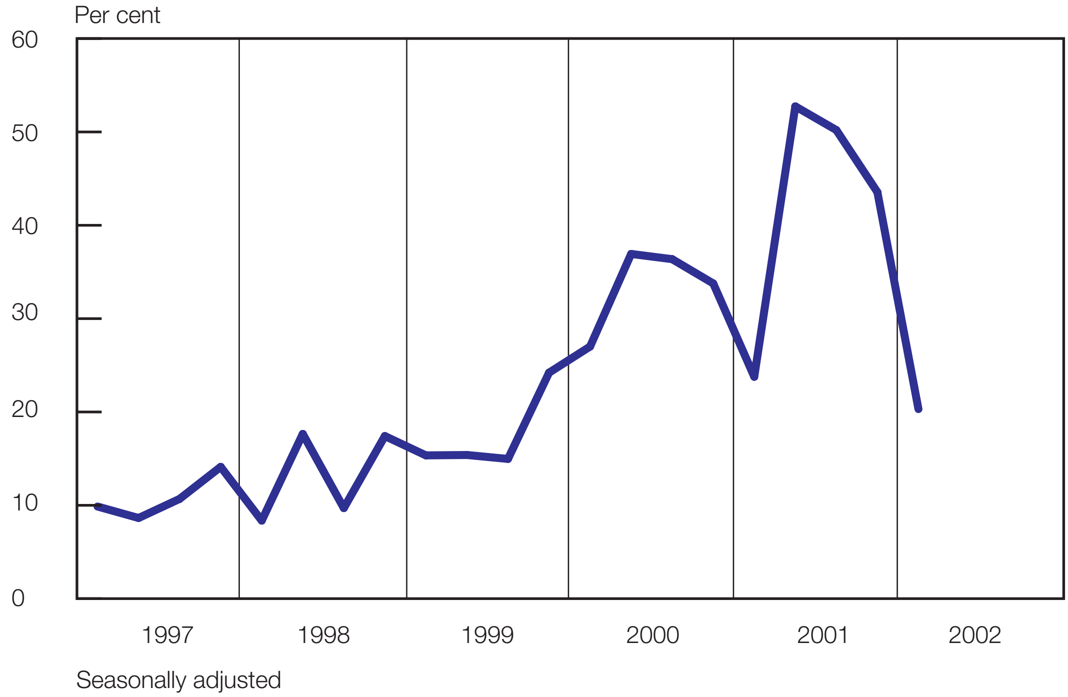
An analysis of the growth measured over four quarters shows that aggregate real gross domestic expenditure increased in the first quarter of 2002 by about 3½ per cent, well above the growth of 2 per cent recorded in total gross domestic product

Real gross domestic expenditure



over the same period. Fortunately, a smaller portion of domestically generated income was transferred as rewards to non-resident owners of production factors. This alleviated the upward pressure on prices that relatively high domestic spending might have exerted during the first quarter of 2002.

Dividends paid to the rest of the world as percentage of total dividends paid



Real gross domestic expenditure

Percentage change at seasonally adjusted annualised rates

	2001					2002
Components	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr
Final consumption expenditure by households	2½	2½	2½	3½	3	3
Final consumption expenditure by general government	1½	2½	2½	3	1½	3
Gross fixed capital formation	5	3	3	5½	3½	6
Change in inventories (R billions)	2,6	-2,3	5,3	6,2	3,0	8,8
Gross domestic expenditure	**2½**	**0**	**6**	**3**	**2**	**6½**

The growth in real *final consumption expenditure* by households waned from a seasonally adjusted and annualised rate of 3½ per cent in the fourth quarter of 2001 to just more than 3 per cent in the first quarter of 2002. This resulted mainly from substantially slower growth in real outlays on durable goods. Real expenditure on the other major spending categories showed healthy increases.

Real final consumption expenditure by households

Percentage change at seasonally adjusted annualised rates

	2001					2002
Components	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr
Durable goods	3½	-4½	3½	10½	3½	1
Semi-durable goods	6½	4	4	8½	6	11
Non-durable goods	1½	2½	2	½	1½	1½
Services	3	3	3	3½	3½	3
Total	**2½**	**2½**	**2½**	**3½**	**3**	**3**

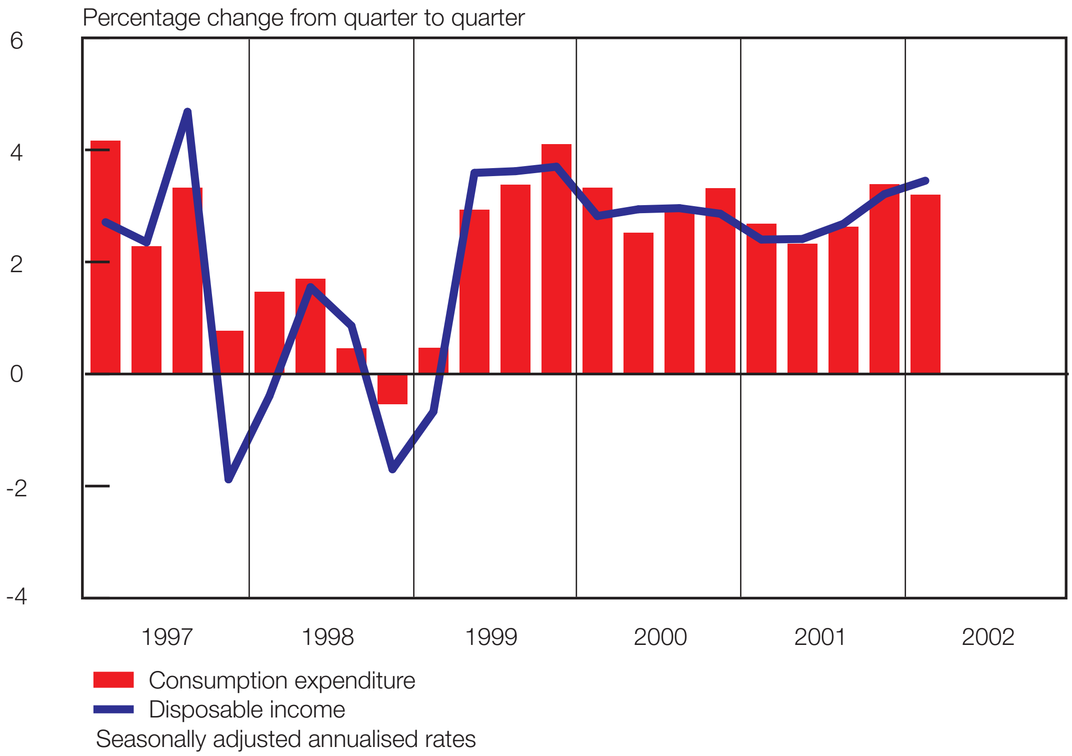
The loss of momentum in the growth of real outlays on *durable goods* was the result of a decline in expenditure on personal transport equipment, in particular on new motorcars. The decline in real outlays on motorcars came after a steep increase was reported in the fourth quarter of 2001. This increase was mainly in the form of pre-emptive buying, to avoid future price rises, but petered out in the first quarter of 2002 as motorcar prices and interest rates began rising. By contrast, real expenditure by households on furniture, household appliances and recreational goods still increased sufficiently in the first quarter of 2002 to neutralise the decline in expenditure on personal transport equipment.

Growth in real household expenditure on *semi-durable goods* accelerated in the first quarter of 2002. This development was mainly the result of robust growth in expenditure on clothing and footwear. Households were enticed to increase their real spending on clothing, footwear and household goods by retailers who actually lowered prices in an effort to attract customers. Sustained growth was also reported in the real outlays on the other categories of semi-durable goods, especially household textiles and recreational goods.

Real consumption expenditure by households on *non-durable goods and services* continued to increase in the first quarter of 2002. Higher levels of expenditure were reported for almost all the major spending categories, offsetting declines in the outlays on petroleum products and medical services. Exceptional increases in the prices of petrol and medical services compelled many households to avoid unnecessary spending on these items.

Households' demand for goods and services apparently was firmer and more stable in the first quarter of 2002 than initially expected. This can mainly be attributed to a relatively strong increase in the real disposable income of households, which was boosted by an increase in the income of farmers and higher dividend receipts from the corporate sector. Furthermore, a reduction in personal tax rates in the 2001/02 Budget impacted positively on the disposable income of households, and further substantial tax relief in the 2002/03 Budget also strengthened consumer confidence and underpinned households' demand for consumer goods and services.

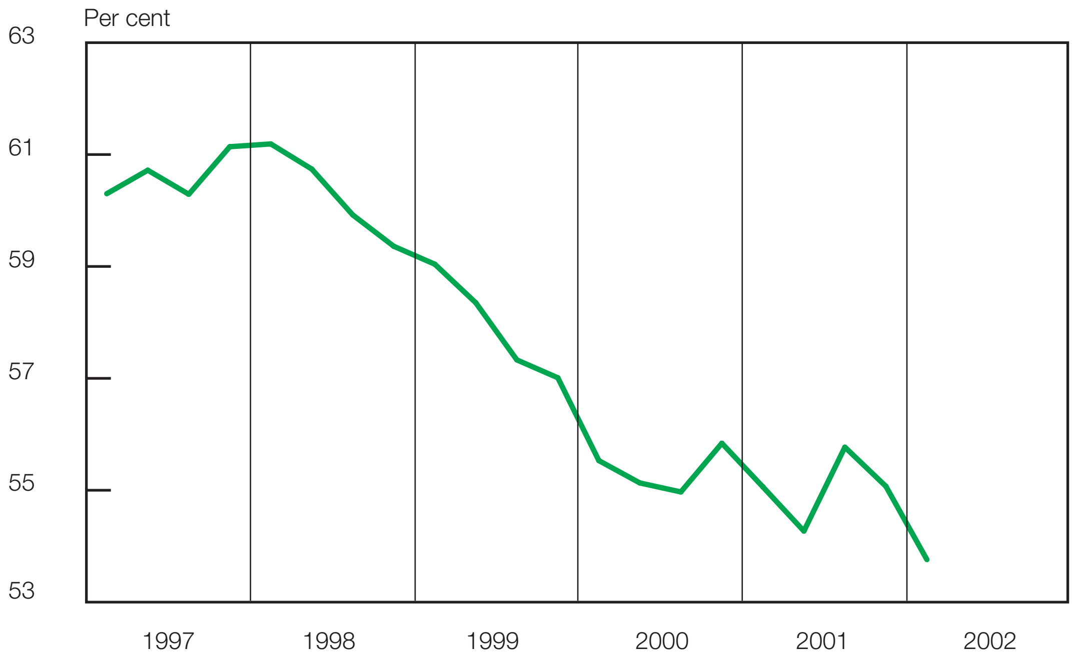
Real income and expenditure of households



Despite their willingness to spend, consumers refrained from using debt excessively. As a result, the ratio of household debt to disposable income declined from 55 per cent in the fourth quarter of 2001 to 54 per cent in the first quarter of 2002. Furthermore, in the first quarter of 2002 the purchasing pattern of households shifted away from items sensitive to changes in interest rates. The resilience of expenditure on non-discretionary items revealed some strength in the underlying demand of those consumers who were less affected by mortgage and other interest rates.

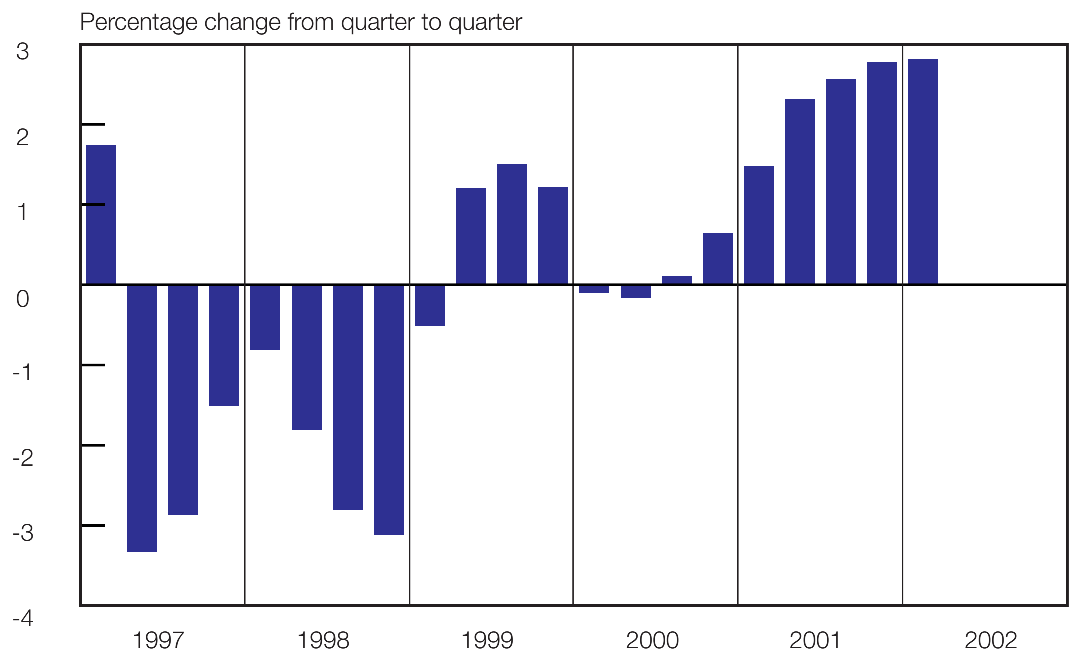
The real *final consumption expenditure by general government* increased at a seasonally adjusted and annualised rate of 3 per cent in the first quarter of 2002, following a roughly similar rate of increase in the fourth quarter of 2001. This increase in the recurrent expenditure by general government resulted mainly from a higher level of real outlays on intermediate goods and services which more than offset a further decline in the real compensation of employees. An analysis of government expenditure shows that the strongest increases were concentrated in the expenditure by local authorities. In addition, there were signs that the medium-term decline in real expenditure on the remuneration of employees was easing.

Household debt as percentage of disposable income



Seasonally adjusted

Real final consumption expenditure by general government

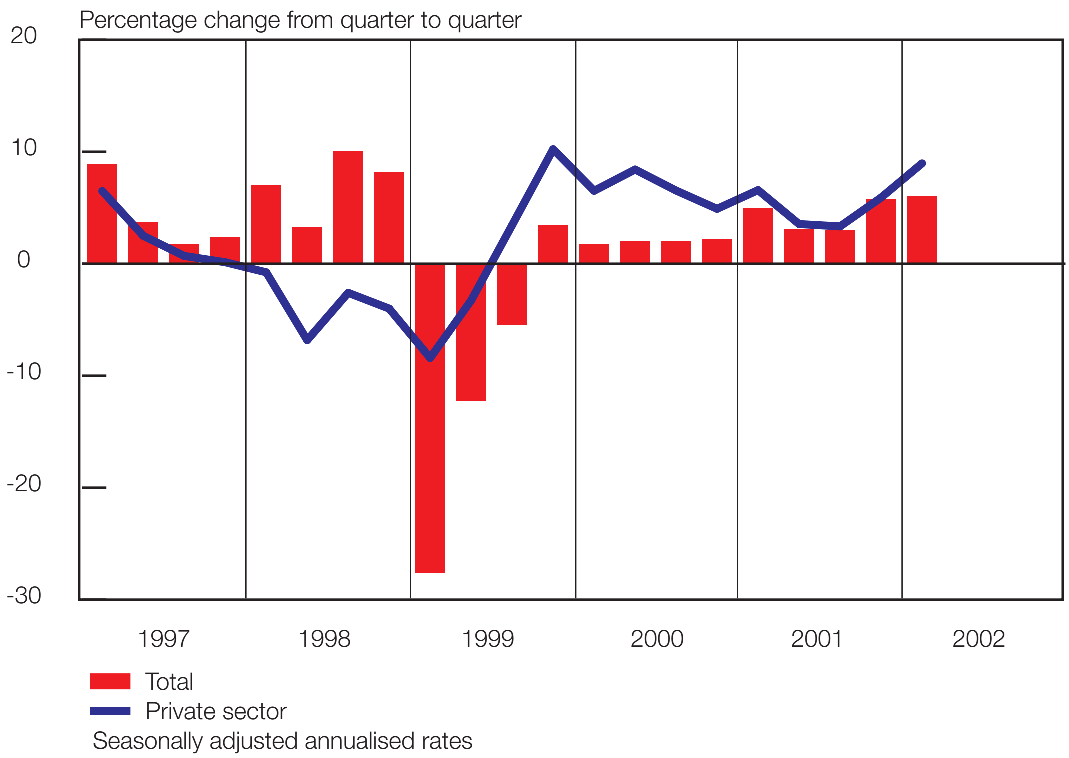


Seasonally adjusted annualised rates

Real *gross fixed capital formation* increased at a seasonally adjusted and annualised rate of 6 per cent in the first quarter of 2002, slightly higher than the rate of 5½ per cent recorded in the fourth quarter of 2001. Increases in real fixed capital outlays were recorded by private business enterprises and general government, but real fixed capital expenditure by public corporations declined.

The *general government* stepped up real fixed capital outlays in accordance with earlier plans to expand and rehabilitate infrastructure such as roads, water supply and sanitation in rural and urban areas. The decline in real fixed capital outlays by *public corporations* resulted mainly from cutbacks in the communications subsector. This can probably be attributed to preparations for possible privatisation later this year. However, real capital expenditure by the other major public corporations increased in the first quarter of 2002, notably the expenditure by Transnet on the renewal of its rolling stock and for the expansion of communication capacity.

Real gross fixed capital formation



The growth in real fixed capital formation by *private business enterprises* continued robustly at a seasonally adjusted and annualised rate of almost 9 per cent in the first quarter of 2002, following an increase of 6 per cent in the fourth quarter of 2001. This was the eleventh consecutive quarterly increase in real capital spending by private businesses and the highest since the fourth quarter of 1999. An analysis of real outlays on fixed capital by the private sector according to type of economic activity shows that the increase in the first quarter of 2002 was spread over all the major sectors of the economy.

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

	2001					2002
Components	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr
General government	8	7½	5	3½	0	6
Public corporations	-10	-6	-2	8	-6	-15
Private business enterprises	6½	3½	3½	6	5½	9
Total	**5**	**3**	**3**	**5½**	**3½**	**6**

The agricultural sector expanded capacity to accommodate the harvesting of the expected larger field crops. Real expenditure on capital goods in the mining sector was boosted by the addition of infrastructure in the coal and platinum mining industry. The expected benefits from export markets encouraged many companies in the manufacturing sector to renew their production capacity. In the commerce sector the expansion of retail outlets, hotels and entertainment areas boosted real capital spending. The communication sector continued to improve its existing network and expanded capacity in a more competitive environment.

Following the increase in *inventory levels* in the fourth quarter of 2001, real inventory accumulation continued in the first quarter of 2002. This increase was particularly evident in the manufacturing sector, which more than neutralised the decline in inventories in commerce. Producers were building inventories mainly in anticipation of improved demand conditions and to avoid paying higher prices later. Consequently, the ratio of industrial and commercial inventories to non-agricultural gross domestic production increased from 15½ per cent in the fourth quarter of 2001 to 16 per cent in the first quarter of 2002. The contribution of inventory investment to the growth in real gross domestic product increased from only ½ a percentage point in the fourth quarter of 2001 to 1½ percentage points in the first quarter of 2002. This partly resembles the dynamics of the United States economy where the largest part of economic growth in the first quarter of 2002 also had its roots in the demand for building up stock.

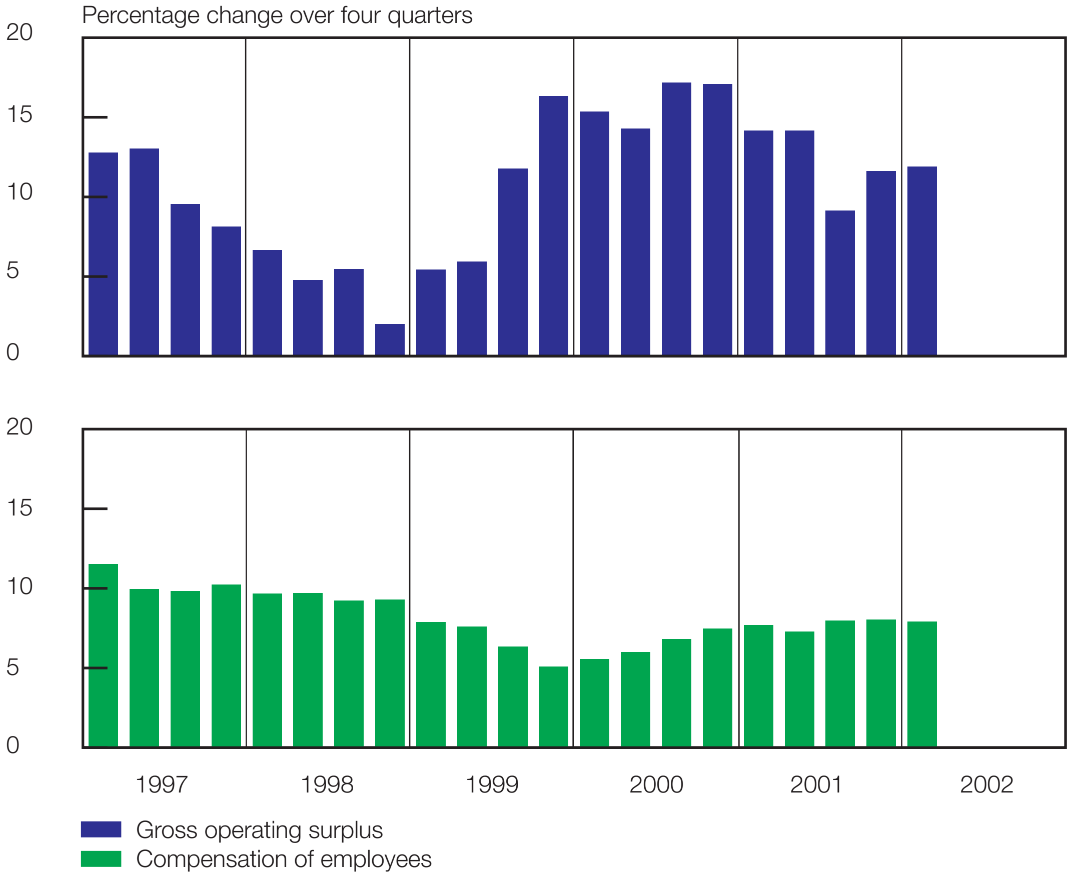
Factor income

Measured over four quarters, total *nominal factor income* increased by 10 per cent in the first quarter of 2002, broadly similar to the rate of increase recorded in the fourth quarter of 2001. This was the net result of steady growth in the total compensation of employees and slightly faster growth in the gross operating surplus of business enterprises.

The rate of increase over four quarters in the *total compensation of employees* remained steady at about 8 per cent in the fourth quarter of 2001 and the first quarter of 2002, reflecting moderate wage settlements which still provided for some real wage growth over the past year. This development was the net result of faster growth in salaries and wages in the electricity, gas and water, and general government services sectors, which outweighed slower growth in aggregate remuneration in the mining industry and financial services sector. Growth in the total compensation of employees in the other main sectors remained broadly unchanged.

The rate of increase over four quarters in the total *nominal gross operating surpluses* accelerated somewhat from 11½ per cent in the fourth quarter of 2001 to 12 per cent in the first quarter of 2002. Stronger increases were recorded in most of the subsectors, but they were most pronounced in the mining sector which benefited most from higher export prices. Overall, the gross operating surpluses as a percentage of total factor income increased from 48 per cent in the fourth quarter of 2001 to 48½ per cent in the first quarter of 2002. The relative strengthening of operating surpluses was also reflected in the rate of growth in output prices which exceeded by a growing margin the rate of increase in unit labour costs.

Gross operating surplus and compensation of employees



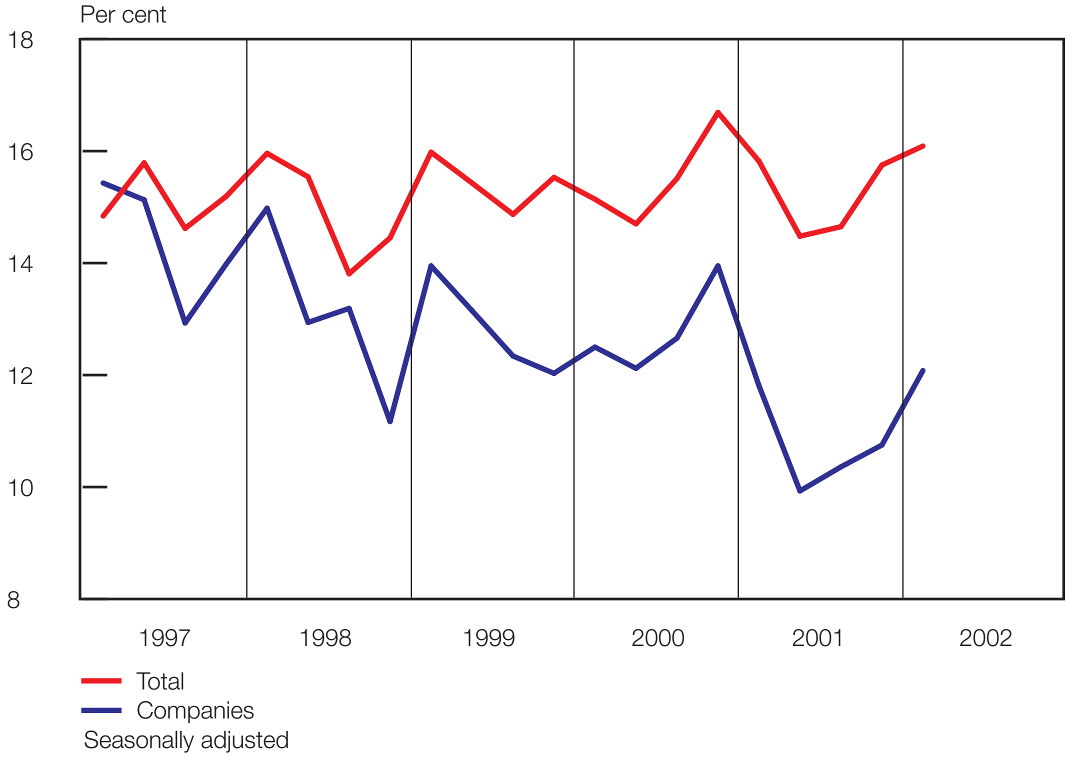
Gross saving

Gross saving as a percentage of gross domestic product strengthened from 15½ per cent in the fourth quarter of 2001 to 16 per cent in the first quarter of 2002. The higher saving ratio in the first quarter of 2002 was particularly evident in higher corporate saving, which more than neutralised a sharp decrease in government saving. Gross saving by households remained weak.

Gross saving by the corporate sector as a percentage of gross domestic product increased from 10½ per cent in the fourth quarter of 2001 to 12 per cent in the first quarter of 2002. The improvement in corporate saving in the first quarter was particularly evident in the mining, manufacturing, transport and financial services sectors of the economy where operating surpluses grew the strongest.

Gross saving by households as a percentage of gross domestic product remained at a level of about 3 per cent in the first quarter of 2002. The potential positive effect of faster growth in disposable household income was almost matched by the joint effect of higher growth in household spending and debt-servicing costs. The ratio of net household saving to disposable income also remained broadly unchanged at a level of ½ a per cent in the first quarter of 2002.

Gross saving as percentage of gross domestic product



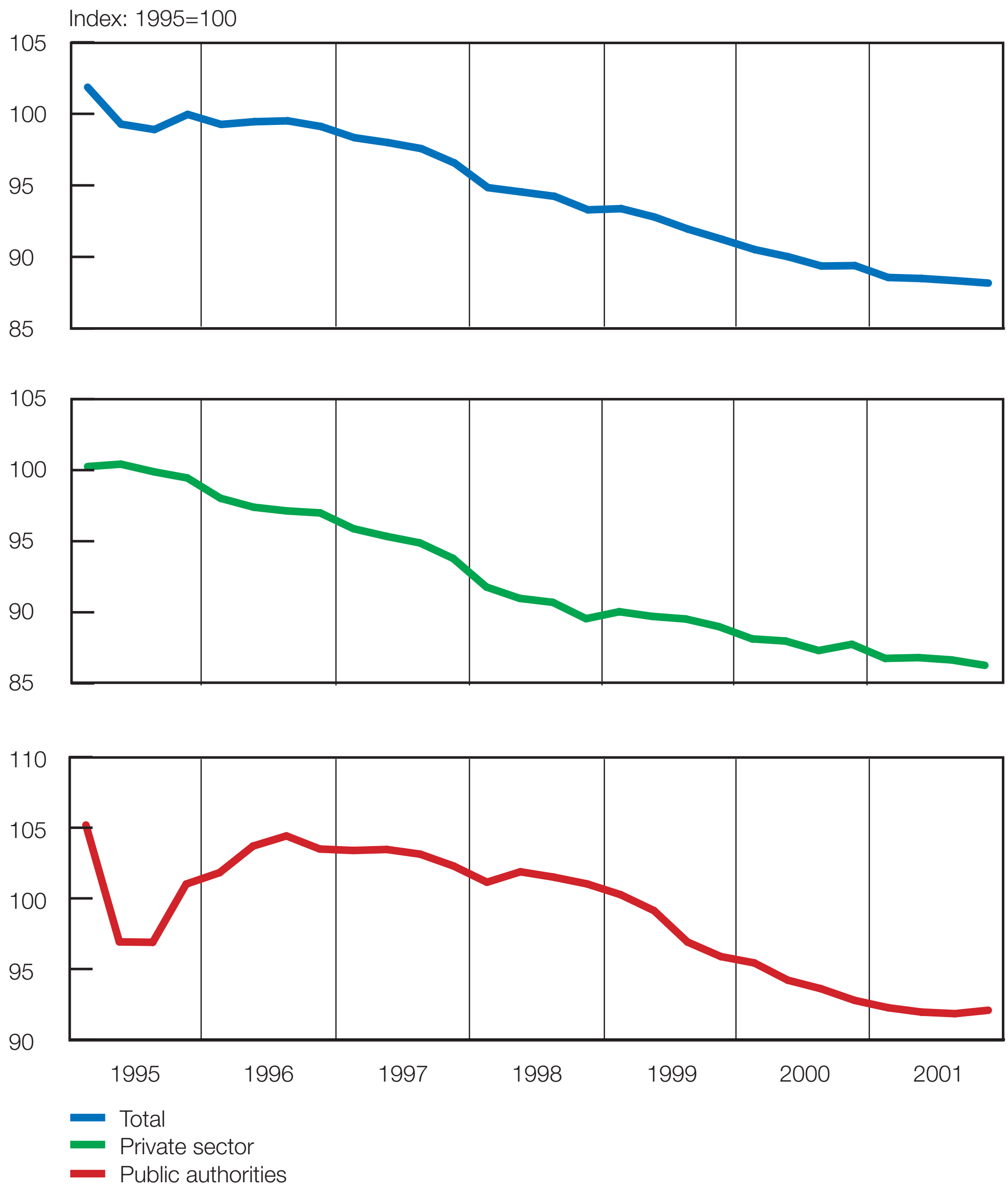
The saving ratio of general government declined in the first quarter of 2002. This deterioration resulted mainly from increases in nominal final consumption expenditure and debt-servicing costs, which offset a steady increase in government income.

Employment

Regularly surveyed formal non-agricultural employment contracted further at an accelerated pace in the fourth quarter of 2001. According to the *Survey of Employment and Earnings in Selected Industries* (SEE) by Statistics South Africa, formal non-agricultural employment decreased at a rate of 1,4 per cent in the year to December 2001, or by about 65 000 workers, compared with a rate of decrease of 1,1 per cent in the year to September. The increased pace of job shedding reversed a two-year slowdown in the rate of job losses.

Employment losses in the fourth quarter of 2001 occurred mainly in the private sector. The pace of decline in employment slowed down in the public sector. Despite the acceleration in the pace of private-sector employment losses in the closing months of 2001, the average level of private-sector employment contracted by just 1,3 per cent in 2001 – the lowest rate of decrease in the past five years. Public-sector employment decreased too, but at a year-to-year rate of 2,1 per cent in 2001, compared with a decrease of 4,1 per cent in 2000.

Non-agricultural employment



The most recent changes in the *Renwick index* confirm the observation that private-sector employment losses have intensified lately while the pace of public-sector employment losses slowed down. The Renwick index is based on an analysis of recruitment advertisements in the careers section of the *Business Times,* one of South Africa's largest job advertisers. This index serves as an informal barometer of recruitment trends in both the private and public sectors. According to this index, demand for managers from the private sector is plateauing as a consequence of the global economic slowdown, though that from the public sector is still growing.

Year-to-year change in non-agricultural private-sector employment in 2001

Sector	Percentage change
Gold mining	-5,9
Non-gold mining	2,3
Manufacturing	-2,8
Electricity supply	-1,2
Construction	-1,6
Trade, catering and accommodation services	1,2
Transport, storage and communication	0,4
Financial intermediation and insurance	-1,5
Washing and dry-cleaning services	-10,6
Total private sector	-1,3

Accordingly, the index shows that at the end of the first quarter of 2002, labour demand from the public sector was growing quite rapidly while private-sector appointments were levelling off from a peak in October 2001.

According to the most recent *Labour Force Survey* (LFS) by Statistics South Africa, the official unemployment rate rose to 29,5 per cent in September 2001 and overall employment in the economy fell between February and September 2001. The drop in employment was accounted for mainly by a decrease in the number of people employed in subsistence and small-scale agriculture, and a contraction in informal-sector employment. The LFS results furthermore indicate that *formal-sector* employment, incorporating agriculture, has remained largely stable over the past two years.

As mentioned previously, the pace of employment losses in the *private sector,* when measured over periods of four quarters, accelerated in the fourth quarter of 2001. Also, the annualised rate of decrease over one quarter in private-sector employment rose from 0,7 per cent in the third quarter of 2001 to 1,7 per cent in the fourth quarter. Quarterly decreases occurred in four of the eight industries identified and were most pronounced in the manufacturing and construction sectors, followed by electricity generation and trade, catering and accommodation services. The quarterly decrease in employment in the manufacturing sector, accounting for 13 700 job losses, was mainly due to the retrenchment of seasonal employees, especially in the food, beverages and tobacco subsectors. In the construction industry, where a quarterly decrease of 5 500 employees was reported, the decrease was mainly due to the retrenchment of contract workers at the expiry of their contracts.

Despite the decrease in overall private-sector employment in the closing months of 2001, a number of sectors recorded employment gains during this period. Following the depreciation of the rand, employment in the mining sector rose at an annualised rate of 4,6 per cent in the fourth quarter of 2001. This export-oriented sector stands to benefit substantially from the depreciation of the rand in terms of revenue earned and the potential for increased future employment creation. Furthermore, the financial intermediation and insurance industry, the washing and laundry services sector and the transport, storage and communication sector also added to their personnel complements in the fourth quarter of 2001.

In contrast to private-sector employment trends, the pace of employment losses in the *public sector* shrank to a year-on-year rate of 0,8 per cent in the fourth quarter of 2001 – the lowest rate of decline in the past four and a half years. When measured over a period of one quarter and expressed at an annualised rate, public-sector employment totals actually increased at a rate of 1,0 per cent in the fourth quarter of 2001. This increase in public-sector employment opportunities was made possible by employment gains at local government level, and no further lay-offs at the level of national government departments.

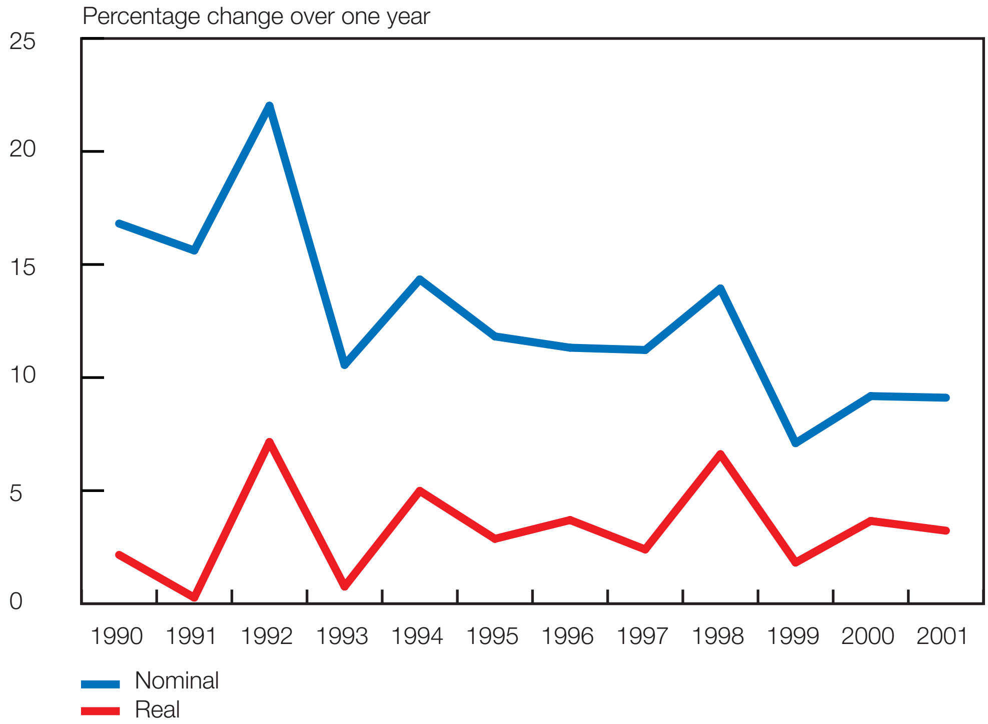
Although economy-wide job creation is progressing at a very modest pace, the number of workdays lost to strikes and other forms of work stoppages rose from about 0,5 million in 2000 to 1,25 million in 2001. According to NMG-Levy Consultants and Actuaries, the rise in the number of workdays lost in 2001 can mainly be attributed to the renegotiation of a number of long-term remuneration agreements which heightened the potential for industrial action across large sections of the economy. These long-term agreements were based on the assumption that CPIX inflation would remain within the target range of between 3 and 6 per cent set for 2002. Long-term wage agreements covering almost 48 per cent of the unionised workforce were negotiated in the automobile, tyre, mining, metal and engineering, and public service sectors in 2001.

An important development in the labour market was the enactment of the new Unemployment Insurance Fund Act on 1 April 2002. All employees are now liable for contributions to the Fund, except those in public and domestic service and in agricultural industries. Previously, only employees earning up to R8 099 per month were liable for a contribution of one per cent of their gross salaries, with the employer contributing the same percentage. In terms of the new Act, unemployment insurance benefits will be payable for a period of 238 days following the commencement of unemployment and will vary from 58 per cent of the person's normal salary to 38 per cent for higher income earners. The beneficiaries of the Fund have been broadened to include those on unpaid maternity leave or unpaid leave due to the adoption of a child, and the dependants of a deceased who was a contributing member. Further advantages resulting from the introduction of the new Unemployment Insurance Fund Act relate to the electronic processing procedures that will expedite the allocation of benefits. It is envisaged that the integration of the new Unemployment Insurance Fund database with that of the South African Revenue Service will, in due course, produce a system which will provide timeous, accurate sectoral information on employment and unemployment in the country.

Labour cost and productivity

The rate of increase over one year in the *nominal compensation per worker* in the formal non-agricultural sectors of the economy picked up from 7,3 per cent in the second quarter of 2001 to 8,2 per cent in the third quarter and even further to 10,4 per cent in the fourth quarter. Remuneration grew rapidly in both the private and public sectors of the economy but growth was more pronounced in the public sector. On average, economy-wide nominal remuneration per worker outside the agricultural sector increased by 9,1 per cent in 2001, almost on a par with the increase of 9,2 per cent in 2000. With overall consumer price inflation averaging 5,7 per cent, employed workers enjoyed a fairly generous improvement of 3,4 per cent in their “real consumption wage”, i.e. in the real spending power of their remuneration in 2001.

Nominal and real consumption wage



The pick-up in nominal wage growth in the fourth quarter of 2001 is consistent with the survey results obtained by NMG-Levy Consultants and Actuaries, which show that the downward movement in the average annual *rate of wage settlements* in collective bargaining agreements levelled off at 7,4 per cent in 2001, unchanged from the rate in 2000. Furthermore, the average settlement rate amounted to 7,5 per cent in the first quarter of 2002.

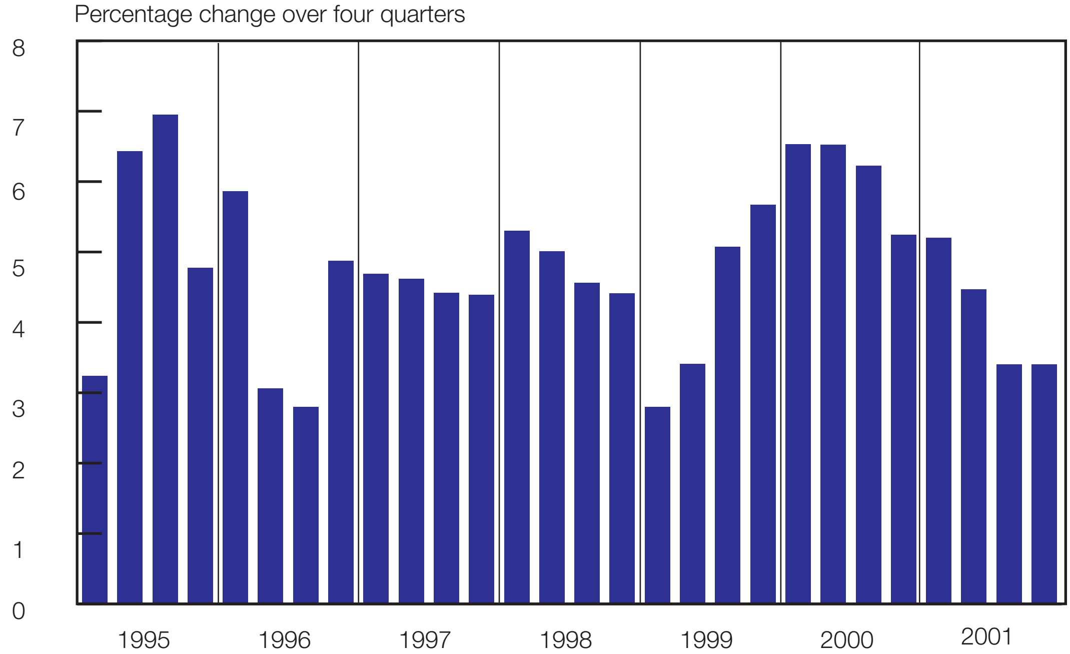
The pick-up in nominal wage growth in the formal non-agricultural sectors of the economy in recent months is corroborated by the information collected by the Automated Clearing Bureau on the average salaries, wages and pensions deposited into the bank accounts of almost 5 million salaried and retired workers. According to this information, average salaries and wages increased at a rate of 10,0 per cent in the year to the first quarter of 2002, significantly higher than the 7,5 per cent increase in the year to the fourth quarter of 2001.

When measured over periods of four quarters, the growth in nominal remuneration per worker in the *public sector* accelerated from 4,5 per cent in the second quarter of 2001 to 10,5 per cent in the fourth quarter. Despite this acceleration, the average annual rate of increase amounted to 9,5 per cent in 2001, approximately the same as in 2000, but workers in the national government's general departments fared considerably better than their counterparts at local government level in terms of salary increments for 2001 as a whole.

Unlike the acceleration in the year-on-year measure of nominal wage growth in the public sector in the course of 2001, *private-sector* nominal wage growth remained at more or less 9 per cent throughout 2001, accelerating to 10,2 per cent in the fourth quarter. This fourth-quarter acceleration was especially noticeable in the gold-mining sector where increased export earnings, following the depreciation of the rand, underpinned high levels of remuneration growth. Remuneration growth in the fourth quarter of 2001 also picked up in construction, trade, catering and accommodation services, and in the transport, storage and communication sectors.

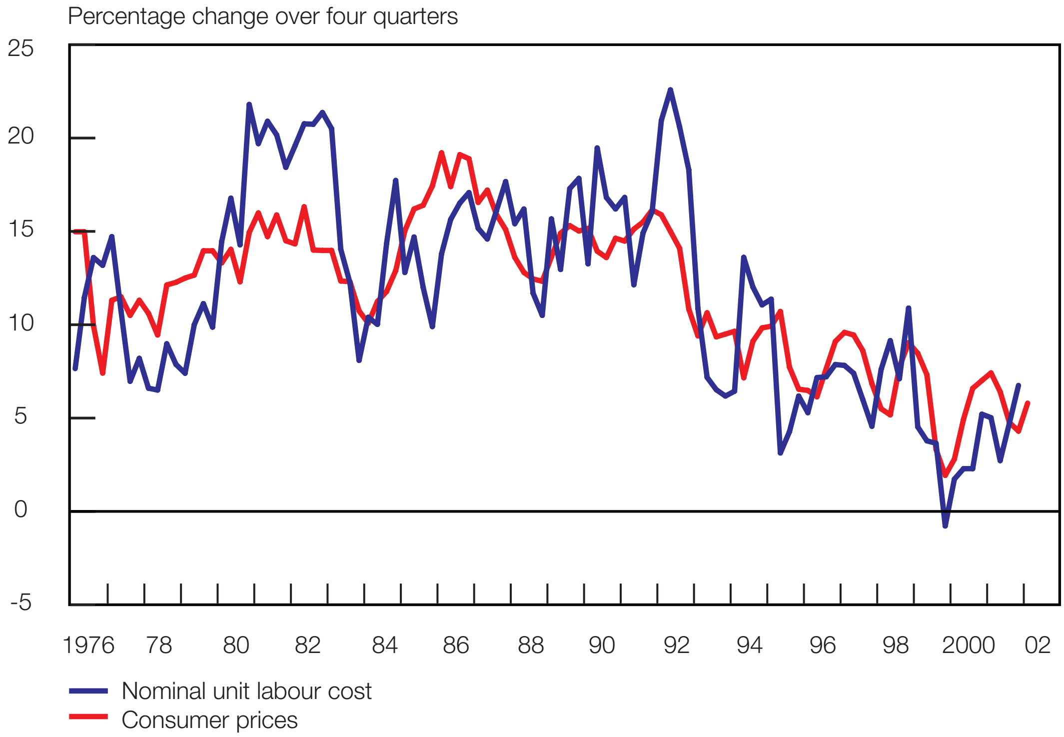
Partly as a result of the heightened industrial action during 2001, the growth in *productivity* (measured as real output per worker in the non-agricultural sectors of the economy) fell back from a year-on-year rate of 6,5 per cent in the second quarter of 2000 to 3,4 per cent in the third and fourth quarters of 2001. Slower output growth, partly a consequence of the global economic slowdown, weighed down on productivity growth in the course of 2001. Nevertheless, year-to-year growth in labour productivity in 2001 was still at a relatively high level of 4,1 per cent, although down from the growth of 6,1 per cent recorded in 2000. In the manufacturing sector in particular, labour productivity growth remained at a level of around 6 per cent throughout 2000 and 2001.

Non-agricultural labour productivity

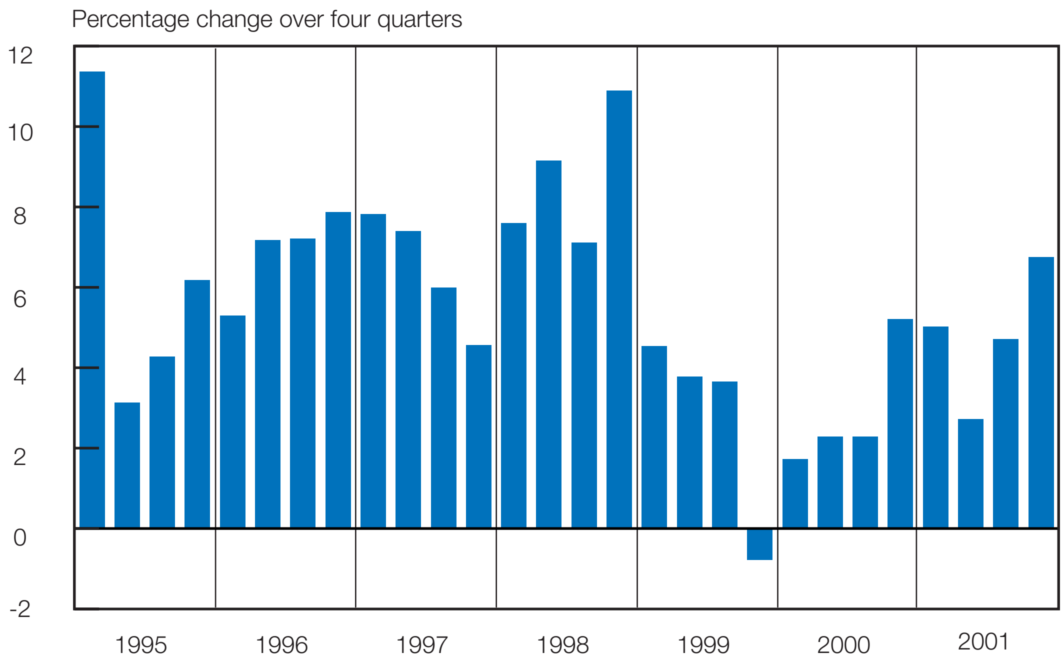


The rate of change in *nominal unit labour* cost in the formal non-agricultural sectors of the economy, which is one of the main determinants of the inflationary process, picked up from a year-on-year rate of 2,7 per cent in the second quarter of 2001 to 6,8 per cent in the fourth quarter. The growth in nominal unit labour cost, i.e. the ratio of nominal compensation per worker to output per worker, accelerated from an average annual rate of 2,9 per cent in 2000 to 4,8 per cent in 2001. The recent slowdown in labour productivity growth and the pick-up in nominal remuneration growth, if it continues, can be expected to add upward pressure to future consumer price changes (see the accompanying graph showing the fairly close correspondence over time between consumer price inflation and changes in unit labour cost). In the manufacturing sector, growth in nominal unit labour cost, albeit at a low level, doubled from 1,5 per cent in 2000 to 3,0 per cent in 2001.

Nominal unit labour cost and consumer prices



Non-agricultural nominal unit labour cost



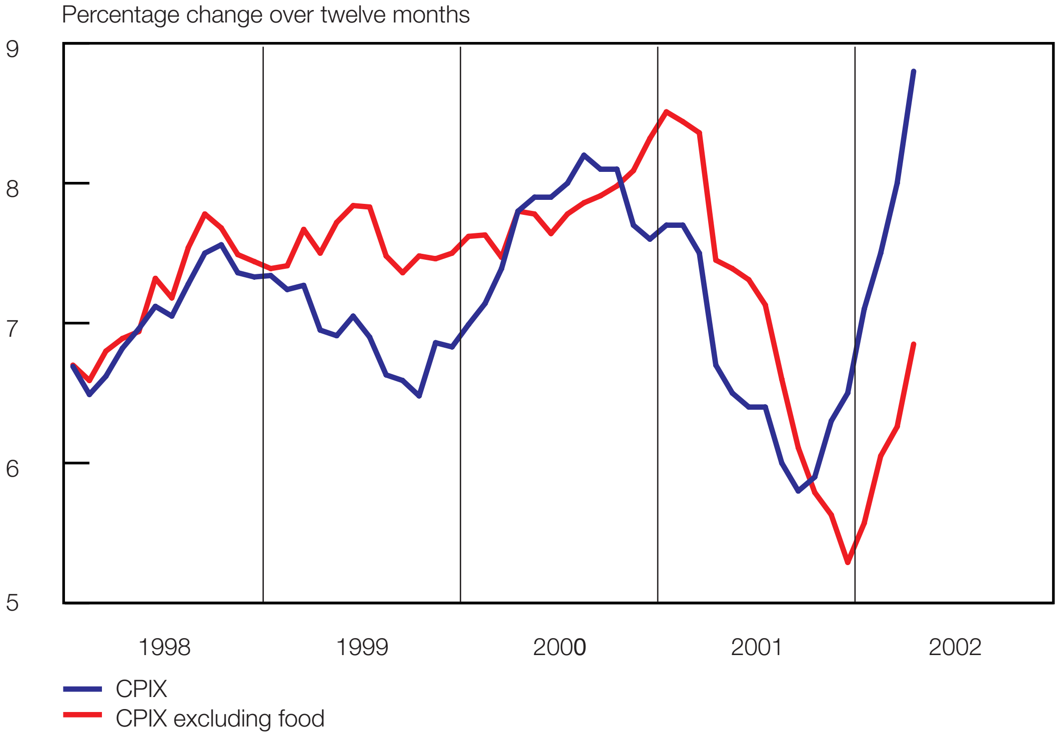
Prices

Inflationary pressures mounted in the wake of the depreciation of the rand during the closing months of 2001. Prior to this, all indicators showed that the economy was steadily progressing towards lower inflation. In fact, CPIX inflation over twelve months (i.e. year-on-year increases in consumer prices in metropolitan and other urban areas, excluding interest cost of mortgage bonds) fell to 5,8 per cent in September 2001, within the target range of 3 to 6 per cent set for 2002. As the depreciated rand impacted on prices, CPIX inflation rose to a year-on-year rate of 8,8 per cent in April 2002. The acceleration in the short-term pace of CPIX inflation was even more pronounced: from an annualised rate of 6,8 per cent in the fourth quarter of 2001 to 11,6 per cent in the first quarter of 2002 – the highest rate of increase in the past seven years.

The acceleration in CPIX inflation was first and foremost a consequence of the rapid increase in food prices from an annualised rate of 8,2 per cent in the third quarter of 2001 to 17,6 per cent in the fourth quarter and 18,2 per cent in the first quarter of 2002. Higher food price inflation is closely linked to the depreciation of the rand. Shortfalls in certain areas of domestic food production necessitate imports, prompting domestic producers to raise their product prices to bring them on a par with the landed cost of imported substitutes. Furthermore, growing export opportunities for domestic food producers, have led to domestic prices being charged at levels approximating those determined in export markets. These price-formation practices have resulted in a sharp rise in domestic prices, especially those of food products.

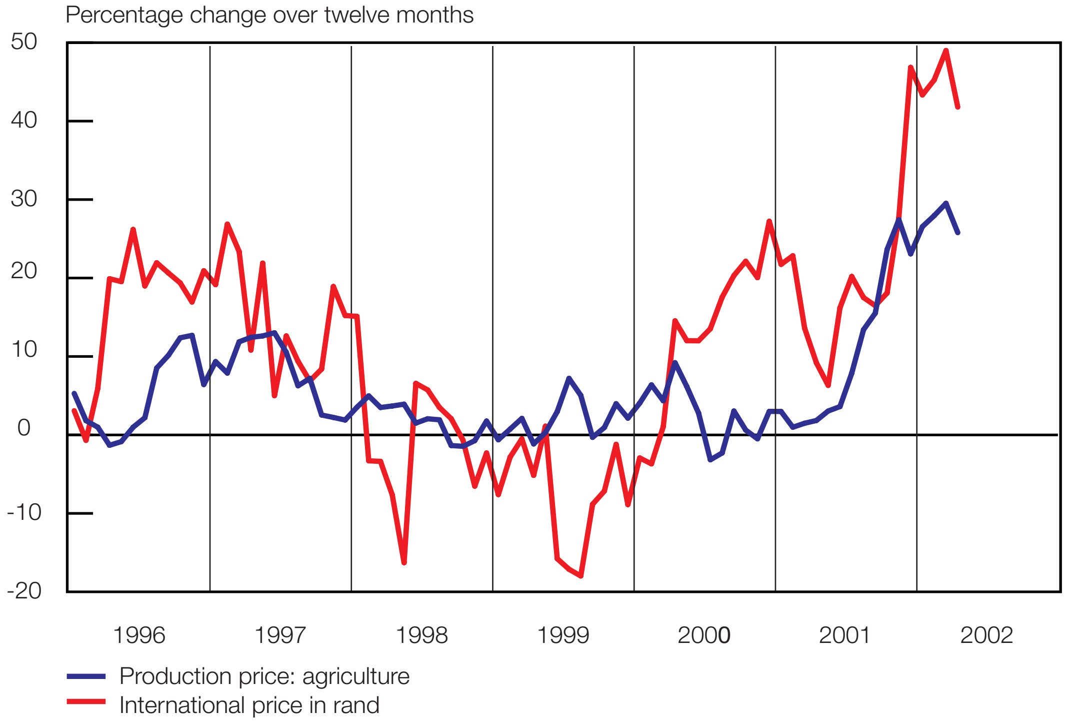
The rise in CPIX inflation was not just a consequence of higher food prices, but was more broadly based. When omitting food price changes, CPIX inflation still picked up from a year-on-year rate of 5,3 per cent in December 2001 to 6,9 per cent in April 2002. Also, the quarter-to-quarter annualised inflation rate of the non-food components rose from 3,9 per cent in the fourth quarter of 2001 to 9,0 per cent in the first quarter of 2002. This rise in non-food CPIX inflation was mainly a consequence of higher rates of increase in the prices of alcoholic drinks and tobacco (partly due to the excise duty increases announced in the national Budget), furniture and equipment, new and used vehicles, petrol and services not related to housing or transport.

CPIX



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, especially as imported inflation picked up. 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. Part of the impetus for production price inflation came from food prices, but non-food related production prices also rose at a year-on-year rate of 11,7 per cent in the year to April 2002. This rate of inflation was more than double the 5,1 per cent increase in the year to November 2001.

Food prices



The quarter-to-quarter rate of change in the prices of *domestically produced goods* accelerated from an annualised rate of 11,1 per cent in the fourth quarter of 2001 to 21,8 per cent in the first quarter of 2002. The rapid food price increases were the prominent factor behind this acceleration. There are signs, however, that food price inflation is moderating somewhat, e.g. the short-term pace of inflation in the category for agriculture, forestry and fishing (including agricultural food prices) slowed down from an annualised rate of 37,9 per cent in the fourth quarter of 2001 to 21,6 per cent in the first quarter of 2002. Recently, the lower rates of increase in maize prices have also begun to assist the slowdown in agricultural food-price inflation.

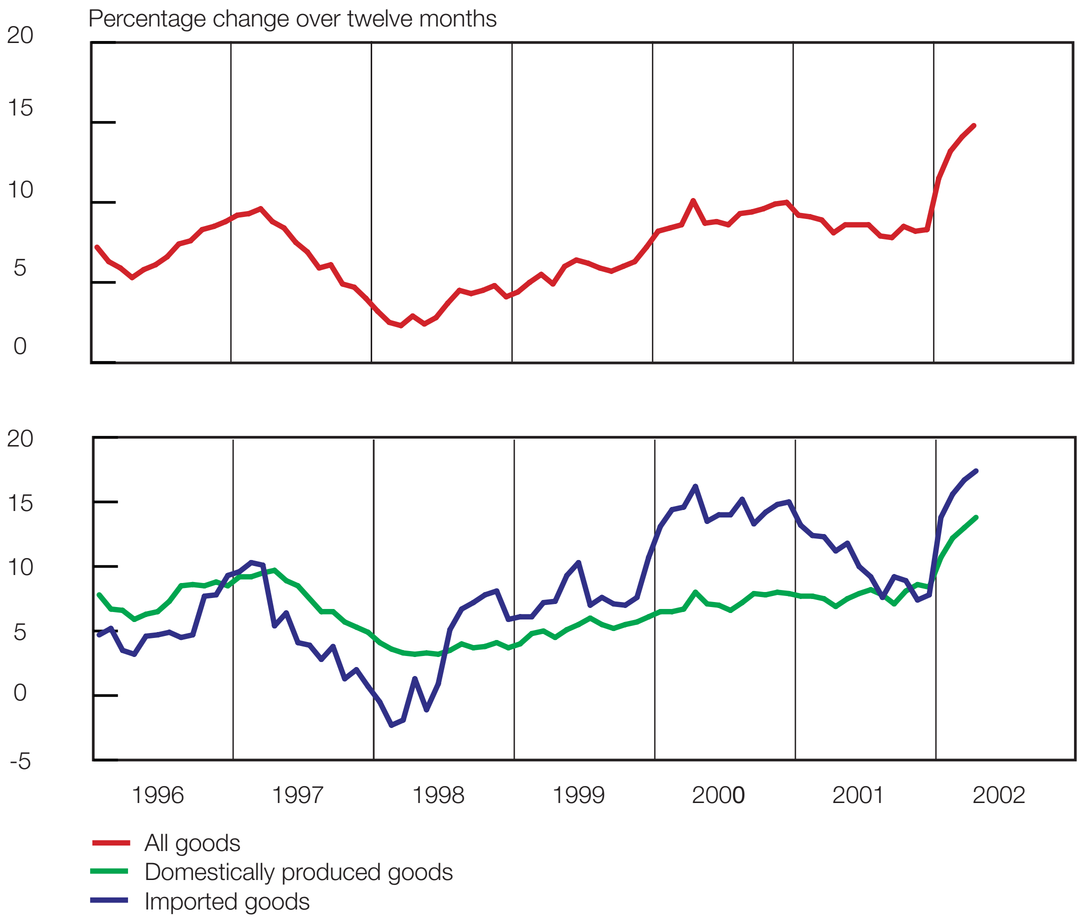
The lagged response of changes in agricultural food prices was noticeable in the acceleration in manufactured food price inflation from an annualised rate of 22,2 per cent in the fourth quarter of 2001 to 38,2 per cent in the first quarter of 2002. The input costs of other domestic producers were evidently also affected by the depreciation of the rand, since the year-on-year rate of increase in the prices of domestically produced goods accelerated to 13,8 per cent in April 2002 – the highest rate of increase since October 1989. Furthermore, non-food related domestically produced goods inflation picked up from an annualised rate of 1,2 per cent in the fourth quarter of 2001 to 17,0 per cent in the first quarter of 2002.

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

Period		Domestically produced goods	Imported goods	Overall production prices
2000:	1st qr	8,5	21,9	11,8
	2nd qr	8,8	14,4	10,0
	3rd qr	6,3	8,3	7,3
	4th qr	8,6	14,0	10,6
	Year	**7,3**	**14,4**	**9,2**
2001:	1st qr	7,2	12,8	8,2
	2nd qr	7,6	7,1	7,3
	3rd qr	7,6	2,3	6,4
	4th qr	11,1	11,5	11,3
	Year	**7,8**	**10,0**	**8,4**
2002:	1st qr	21,8	43,4	27,3

Growth in the prices of *imported goods* quadrupled from an annualised rate of 11,5 per cent in the fourth quarter of 2001 to 43,4 per cent in the first quarter of 2002. When measured over periods of twelve months, imported inflation amounted to 17,4 per cent in April 2002 compared with 7,4 per cent five months earlier.

Production prices

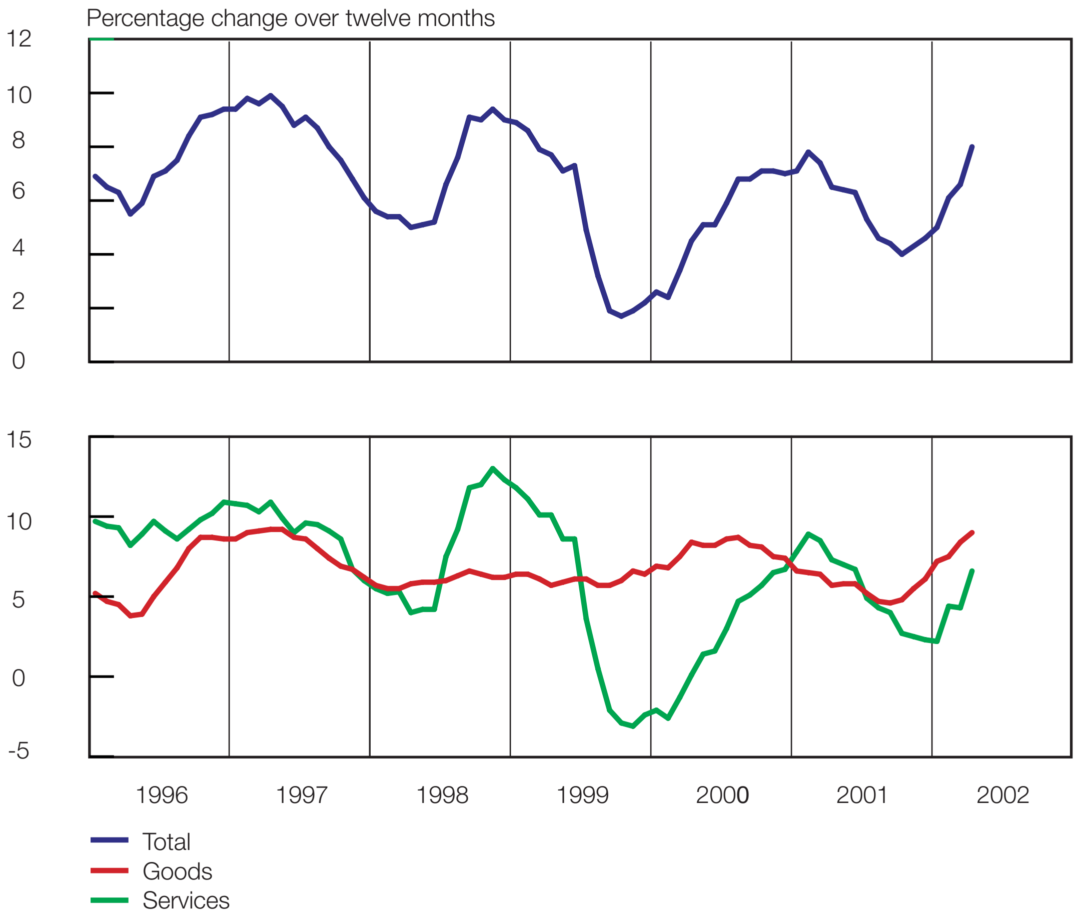


The acceleration in the pace of imported inflation in recent months reflects not only the depreciated value of the rand, but also the higher international oil prices. In April 2002, the mining and quarrying category which includes crude petroleum, increased at a month-on-month rate of 8,4 per cent. The international price of crude oil has lately retraced some of its previous increases due to reduced concerns about potential disruptions to Middle East supplies. Further mitigating against higher imported inflation in the coming months is the recent improvement in the exchange value of the rand. This will result in less imported inflation being fed into the domestic price formation process. If these developments were to be sustained, they could potentially brake the speed of inflation in the prices of domestically produced goods.

As price pressures moved from the production level to end-product prices, *headline inflation,* i.e. the year-on-year changes in the overall consumer price index for metropolitan areas, accelerated from 4,0 per cent in October 2001 to 8,0 per cent in April 2002. When measured over one quarter and expressed at an annualised rate, headline inflation picked up from 4,1 per cent in the fourth quarter of 2001 to 12,9 per cent in the first quarter of 2002. Higher rates of increase in the prices of consumer goods and services contributed to the acceleration in overall consumer price inflation.

Driven higher by price increases in food products and transport goods, year-on-year inflation in the prices of *overall consumer goods* rose steeply from the latest low of 4,6 per cent in September 2001 to 9,0 per cent in April 2002. Measured from quarter to quarter, the pace of increase in the prices of consumer goods picked up from an

Overall consumer prices



annualised rate of 3,7 per cent in the third quarter of 2001 to 12,5 per cent in the first quarter of 2002. The acceleration in the short-term pace of inflation in the prices of consumer goods was underpinned by exceptionally high rates of increase of 18,2 per cent in the prices of food, 16,5 per cent in the prices of new and used vehicles and 23,3 per cent in petrol and other transport running cost. Furthermore, inflation in the prices of furniture and equipment, which had registered almost no changes in the second half of 2001, rose to an annualised rate of 10,8 per cent in the first quarter of 2002.

The year-on-year rate of increase in the prices of *consumer services* was fairly moderate at 4,3 per cent in March 2002. This rate of increase was still broadly on a par with the rates of increase in the five months prior to the sharp fall in the exchange rate of the rand. In April 2002 the increase in home mortgage interest pushed year-on-year inflation in the prices of consumer services higher to 6,6 per cent.

Consumer prices

Quarter-to-quarter percentage changes at annualised rates

Period		Goods	Services	Overall CPI	CPIX inflation
2000:	1st qr	8,5	5,5	6,6	8,2
	2nd qr	10,6	9,3	10,7	8,7
	3rd qr	7,6	4,1	6,0	7,7
	4th qr	4,1	6,5	5,0	6,6
	Year	**7,9**	**2,4**	**5,4**	**7,8**
2001:	1st qr	5,2	15,0	8,9	5,9
	2nd qr	6,2	1,8	4,7	3,6
	3rd qr	3,7	-3,6	0,0	5,9
	4th qr	7,2	-0,1	4,1	6,8
	Year	**5,6**	**5,5**	**5,7**	**6,6**
2002:	1st qr	12,5	14,0	12,9	11,6

Measured from quarter to quarter, pressures in the price inflation of services were already visible in the first quarter of 2002 when these prices rose at an annualised rate of 14,0 per cent, following price declines at an annualised rate of 0,1 per cent in the fourth quarter of 2001. The pick-up of inflation in the prices of consumer services was not only confined to housing-related services, which include home mortgage interest cost, but was far more broadly based. In fact, inflation in the prices of other services not related to housing and transport accelerated from 6,3 per cent in the fourth quarter of 2001 to 11,2 per cent in the first quarter of 2002.

Foreign trade and payments

Balance of payments on current account

There was a sizeable decline in net factor payments to the rest of the world, turning the balance on the current account of the balance of payments from a deficit in the fourth quarter of 2001 to a surplus in the first quarter of 2002. The trade surplus of the last quarter of 2001 was broadly sustained in the first quarter of 2002. Expressed in terms of a seasonally adjusted and annualised rate, the current-account balance accordingly turned 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. As a ratio of gross domestic product, the current-account balance changed from a deficit of 0,3 per cent in the fourth quarter of 2001 to a surplus of 0,4 per cent in the first quarter of 2002.

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

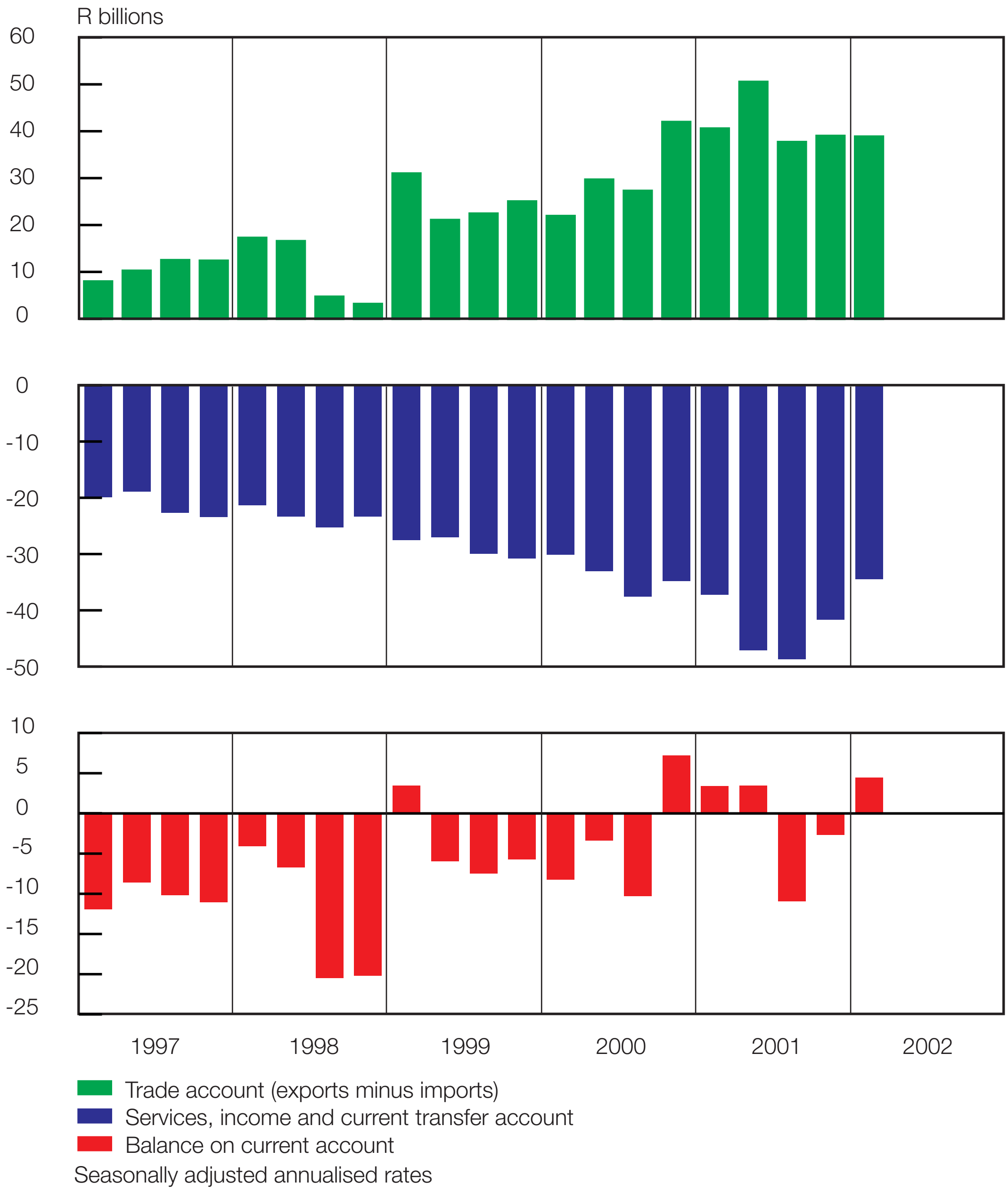
	2001					2002
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr
Merchandise exports	226,0	241,4	221,5	240,9	232,4	275,3
Net gold exports	25,3	27,4	30,1	34,9	29,4	39,6
Merchandise imports	-210,7	-218,2	-213,9	-236,8	-219,9	-276,0
Net service, income and current transfer payments	-37,2	-47,1	-48,6	-41,7	-43,6	-34,7
Balance on current account	**3,4**	**3,5**	**-10,9**	**-2,7**	**-1,7**	**4,2**

The *value of merchandise imports* (seasonally adjusted and annualised) rose by 16,6 per cent from the fourth quarter of 2001 to the first quarter of 2002. Strong increases were noted in the import values of manufactured goods and agricultural products. The rise in the imports of manufactured goods was spread over most of the manufacturing subcategories but, consistent with the lively pace of fixed investment expenditure in the economy, somewhat stronger growth was registered in the importation of machinery and electrical equipment, and vehicles and transport equipment. The value, as well as the volume, of imports of crude oil declined in the first quarter of 2002.

The *prices of imported goods* rose steeply in the first quarter of 2002. Owing mainly to the depreciation of the rand, the rand prices of imported goods jumped by 10½ per cent from the fourth quarter of 2001 to the first quarter of 2002. Inflation in countries exporting to South Africa was flat in the first quarter of 2002; the average weighted exchange rate of the rand depreciated by about 11 per cent in the first quarter of 2002, implying low inflation, or even declining production prices in countries exporting to South Africa.

The physical quantity of merchandise imports increased by 5½ per cent in the first quarter of 2002, following a decline of about 1 per cent in the fourth quarter of 2001. About 19½ per cent of real aggregate domestic expenditure was satisfied by foreign

Balance of payments: Current account



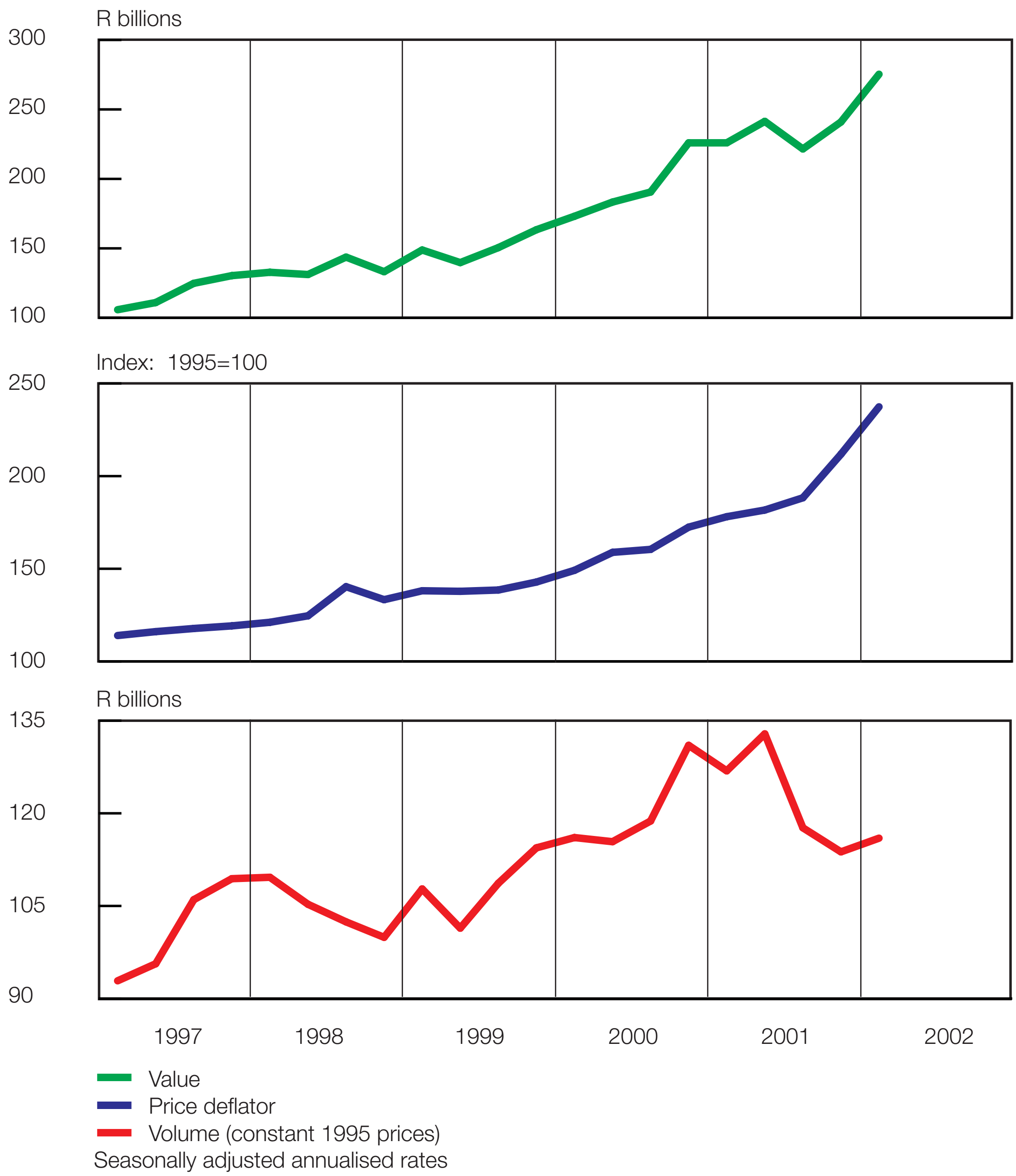
suppliers during the first quarter of 2002, slightly more than the 18½ per cent in the fourth quarter of 2001. Import-competing industries ought to benefit from the lower exchange value of the rand, raising the expectation that this ratio of merchandise imports to domestic expenditure could decline in the quarters ahead.

The *value of merchandise exports* (seasonally adjusted and annualised) rose by 14,3 per cent in the first quarter of 2002. Increases were recorded in all the main export subcategories, but the value of mining products exported, which are mostly priced in foreign currency, fared appreciably better than the others.

Driven firstly by the strengthening of activity in the global economy, and secondly by the improved competitiveness of domestic producers in export markets, the *physical quantity of merchandise exports* rose by 2 per cent in the first quarter of

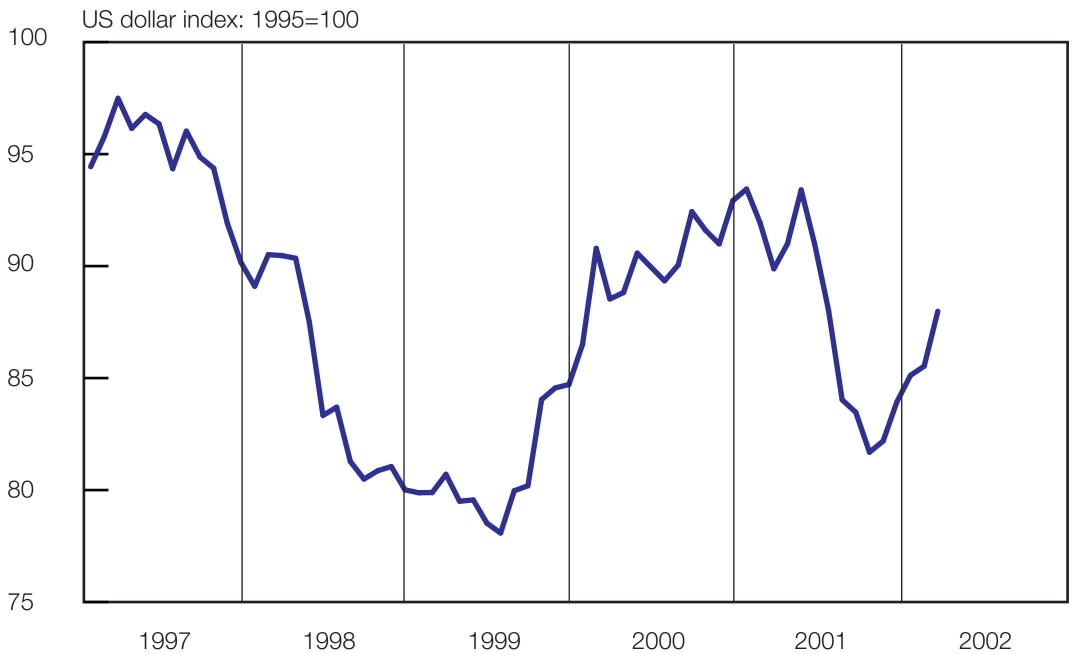
2002. This followed a decline of 3½ per cent in the fourth quarter of 2001. Export prices improved by some 12 per cent from the fourth quarter of 2001 to the first quarter of 2002. An increase in international commodity prices, alongside the depreciation of the rand, gave export prices a fillip in the first quarter of 2002.

Merchandise exports



The *gold price* benefited from uncertainties about the health of the United States economy and the exchange value of the US dollar, and also from political tension in certain parts of the world. In dollar terms the fixing price of gold on the London market rose from an average of US$278 per fine ounce in the fourth quarter of 2001 to US$291 per fine ounce in the first quarter of 2002 and reached US$327 on 31 May. Gold producers continued to cut output volumes, contributing to a drop of 6½ per cent in the volume of net gold exports between the fourth quarter of 2001 and the first quarter of 2002. But because of the improvement in the average realised price, the value of net gold exports rose by about 13½ per cent in the first quarter of 2002.

International commodity price index



Compiled by the South African Reserve Bank

Net primary income payments to non-resident investors, consisting among other things of dividend and interest payments, increased to unprecedentedly high levels in the second and third quarters of 2001. In the last quarter of 2001 these payments declined quite noticeably, taking the shortfall on the "services account" of the balance of payments down from R48,6 billion in the third quarter of 2001 to R41,7 billion in the fourth quarter. An even more pronounced decline occurred in the first quarter of 2002 when the deficit on the "services account" shrank further to R34,7 billion, well below its level in the first quarter of 2001.

There was a particularly strong decline in dividend payments to non-resident shareholders in the first quarter of 2002. Lower dividend payments by local subsidiary companies of former South African companies that had recently relocated their head offices to the United Kingdom, were mainly responsible for this sharp decline. Dividend payments to other shareholders who do not reside in South Africa, grew steadily as non-resident investors accumulated their holdings of listed South African shares in 2001.

The improvement in the balance on the "services account" was also helped by an increase in travel expenditure by foreign visitors to South Africa in the first quarter of 2002.

Financial account

An improvement in international investors' sentiment towards emerging markets and the relatively low prices of domestic financial assets following the depreciation in the external value of the rand during the fourth quarter of 2001, probably contributed to the renewed capital flows into South Africa during the first quarter of 2002. A surplus of R12,1 billion was recorded on the financial account of the balance of payments during the first quarter of 2002, compared with a shortfall of R1,5 billion in the fourth quarter of 2001.

Net financial transactions not related to reserves

R billions

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

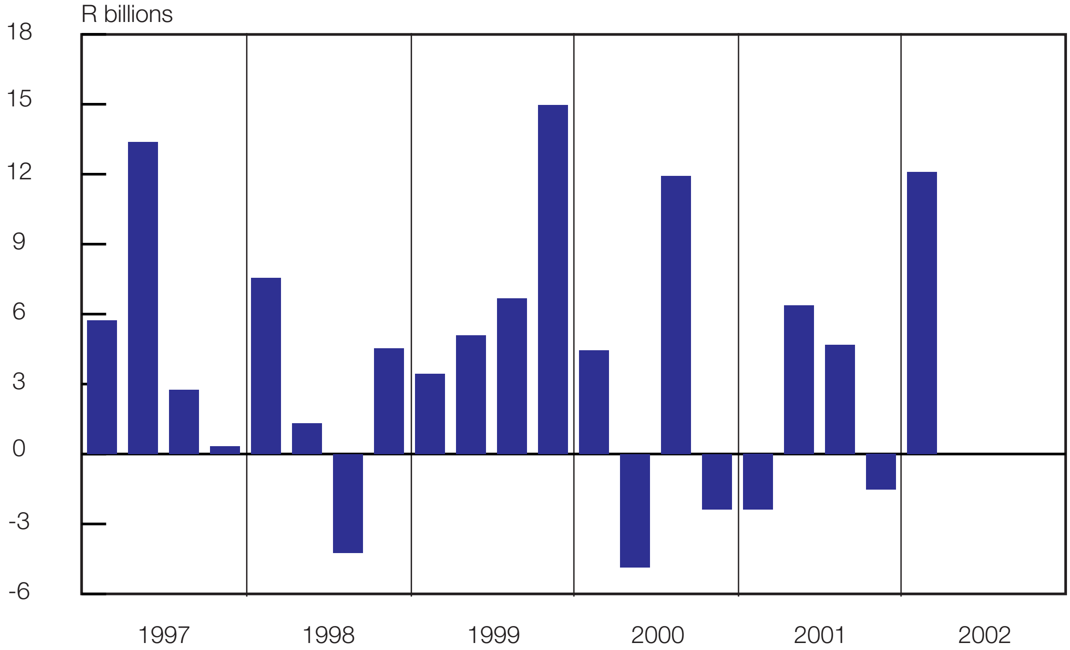
* Including unrecorded transactions

Foreign direct investment into South Africa changed from an outflow of R1,9 billion in the fourth quarter of 2001 to an inflow of R1,6 billion in the first quarter of 2002. The inflow of direct investment capital was mainly related to the acquisition by non-resident investors of a dominant interest in two South African steel companies. This inflow of international direct investment capital was partly countered by a decline in direct foreign liabilities when the dividends declared in 2001 were actually remitted in the first quarter of 2002, and the re-acquisition by Transnet of a 20 per cent interest in South African Airways, previously held by Swissair. Direct investment outflows from South Africa declined from R5,4 billion in the fourth quarter of 2001 to R1,0 billion in the first quarter of 2002. Overall net foreign direct investment changed from an outflow of R7,3 billion in the fourth quarter of 2001 to an inflow of R0,6 billion in the first quarter of 2002.

Non-resident investors apparently reassessed the risks associated with investment in domestic portfolio assets and increased their total holdings of South African bonds and shares by R4,4 billion in the first quarter of 2002. This improvement in international investor sentiment towards domestic bonds and shares could be attributed to the attractive returns provided by these assets and the general expectation that the exchange rate of the rand would hold steady during 2002. Further portfolio investment inflows of R2,8 billion occurred with the reopening of an existing US dollar loan by the National Treasury.

In the first quarter of 2002 private individuals continued to accumulate foreign assets in terms of the exchange control dispensation which allows taxpayers in good standing to transfer capital of up to R750 000 offshore. Furthermore, South African companies in the metals and steel sector of the economy were allocated a minority shareholding in a non-resident company as part compensation for disposing of their holdings in a domestic steel company. In total, there was an accumulation of foreign portfolio assets to the amount of R5,7 billion in the first quarter of 2002. When

Balance on financial account



changes in portfolio assets are offset against changes in portfolio liabilities, there was still a net outward movement of *portfolio capital* from South Africa to the amount of R1,3 billion in the first quarter of 2002. This was preceded by a larger outflow of R3,4 billion in the fourth quarter of 2001.

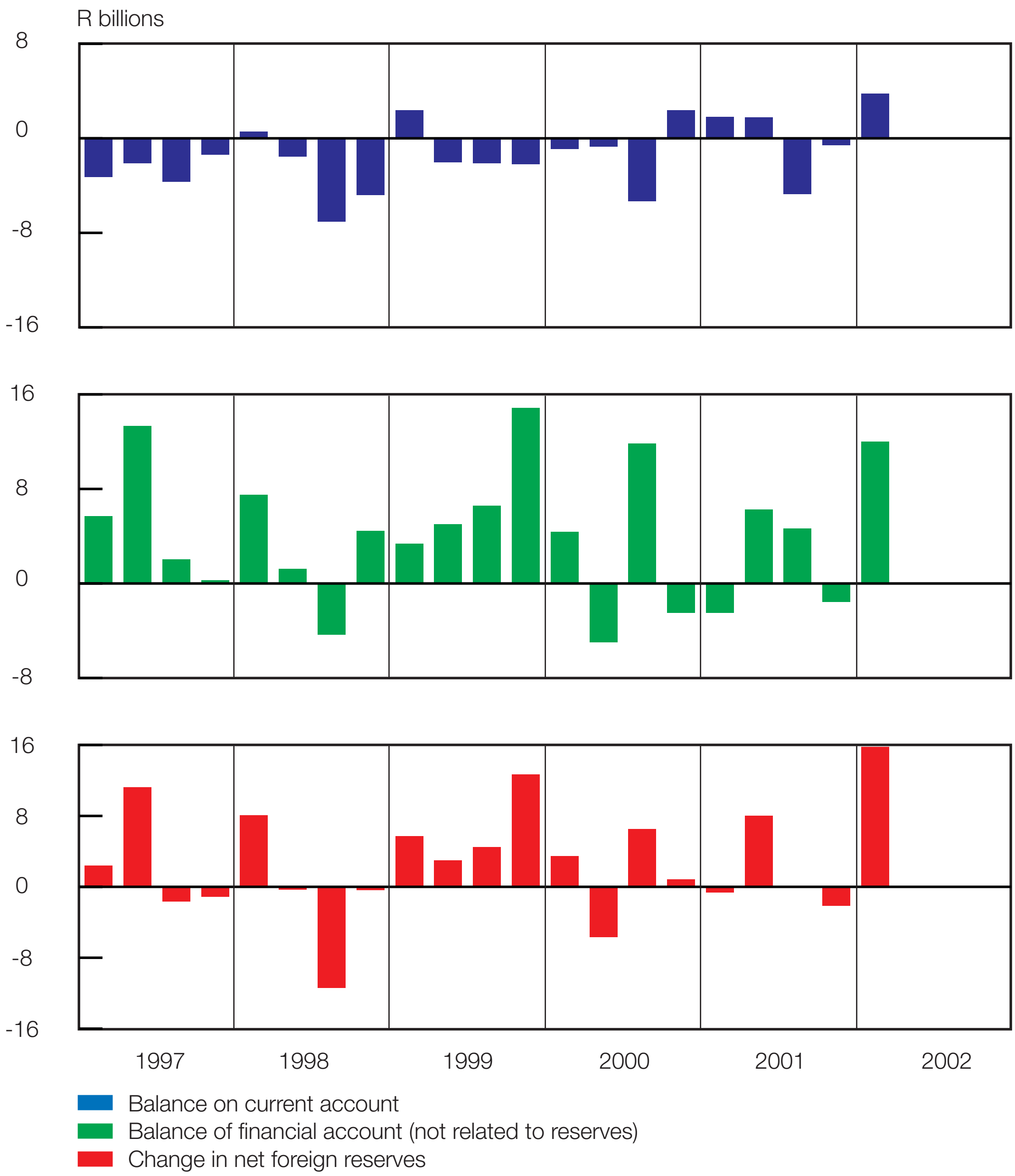
Other foreign investment liabilities of South Africa, consisting mainly of loans, trade finance and bank deposits, which had declined by R1,5 billion in the fourth quarter of 2001, increased by R13,7 billion in the first quarter of 2002. These inflows were mainly related to the transfer of liability for a syndicated foreign loan of US$1,5 billion from the Reserve Bank to the National Treasury.

Other investment assets (i.e. South African claims on non-residents) changed to an inflow of R0,7 billion in the first quarter of 2002 compared with an outflow of R0,3 billion in the fourth quarter of 2001. South African exporters repatriated accumulated foreign currency earnings to South Africa in the first quarter of 2002. By doing so they reduced the overall value of offshore assets. In the balance of payments accounting framework such a reduction in foreign assets is shown as an inflow of capital. On a net basis, other foreign investment changed from an outflow of R1,8 billion in the fourth quarter of 2001 to an inflow of R14,4 billion in the first quarter of 2002.

Foreign reserves

The analytical presentation of South Africa's balance of payments identifies changes in the country's net gold and other foreign reserves separately from changes in the gross gold and other foreign reserves. The objective is to exclude compensatory borrowing by the monetary authorities so as to obtain an external balance which reflects the influence that "pure" balance-of-payments transactions have on the country's gold and other foreign reserves. Changes in the net foreign reserves are determined by subtracting from changes in the gross gold and foreign reserves the changes in the reserve-related liabilities of the Reserve Bank and the central government, and valuation adjustments to foreign reserves.

Balance of payments: Overall balance



South Africa's *net gold and other foreign reserves* changed from a deficit of R2,1 billion in the fourth quarter of 2001 to a surplus of R15,8 billion in the first quarter of 2002. This improvement resulted from surpluses on both the current and financial account of the balance of payments.

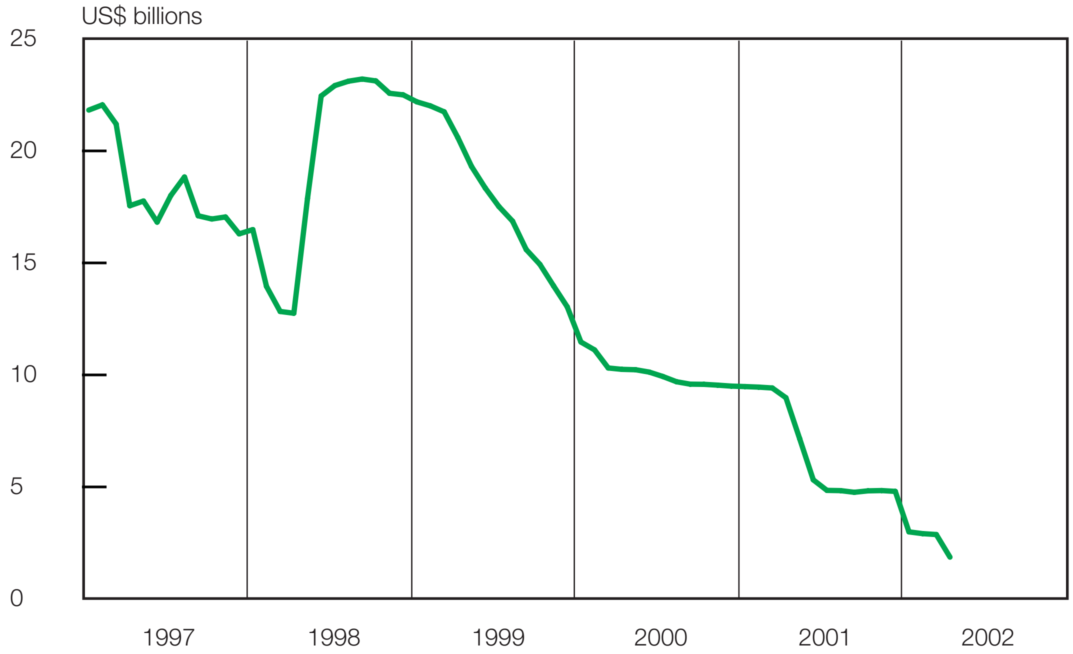
Owing to the appreciation of the rand, *gross* gold and other foreign reserves (i.e. international reserves before subtracting reserve-related loans and valuation adjustments) valued in rands declined from R150,7 billion at the end of December 2001 to R141,6 billion at the end of March 2002. The level of import cover (i.e. the value of gross international reserves relative to the value of imported goods and services) fell from 24 weeks' worth of imports of goods and services in December 2001 to 20 weeks' worth in March 2002. This deterioration in the level of import cover can be attributed to the decline in the rand value of the country's total international reserves as well as an increase in the value of imports of goods and services during the first quarter of 2002.

Measured in dollars, the country's gross gold and other foreign reserves were unchanged at US$12,4 billion from the end of December 2001 to the end of March 2002. The dollar value of the Reserve Bank's gross international reserves also remained unchanged at US$7,5 billion from the end of December 2001 to the end of March 2002 but, because of a decline in the Bank's short-term foreign liabilities, non-borrowed reserves improved from US$3,5 billion at the end of December 2001 to US$5,0 billion at the end of March 2002. The foreign liabilities of the Bank declined steeply in January 2002 when the National Treasury assumed responsibility for repaying some of the Bank's foreign liabilities.

The Bank's net open position in foreign currency declined from US$4,8 billion at the end of December 2001 to US$2,9 billion at the end of March 2002 and US$1,9 billion at the end of April 2002. This improvement can be attributed to

- the transfer of the syndicated loan liability from the Reserve Bank to the National Treasury, improving the Bank's net international reserve position by US$1,5 billion in January 2002;
- the reopening of an existing dollar bond by the South African government which raised US$274 million for delivery against the oversold forward book of the Reserve Bank; and
- the issuing of a new bond by the National Treasury in the international capital markets which mobilised US$1,0 billion for delivery against the forward book.

Net open position in foreign currency



Oversold position of the South African Reserve Bank

Exchange rates

The South African market for foreign exchange which had been characterised by turbulent conditions in the second half of 2001, consolidated in the first five months of 2002. After having declined by 24 per cent from the end of September 2001 to the end of December, the nominal effective exchange rate of the rand strengthened in the first quarter of 2002. A healthy overall surplus on the balance of payments led to a marked improvement in international sentiment towards South Africa, which bolstered the external value of the rand against a broad range of foreign currencies. On a trade-weighted basis the exchange rate of the rand increased by 6,9 per cent from the end of December 2001 to the end of March 2002.

Exchange rates of the rand
Percentage change

	28 Sep 2001 to 31 Dec 2001	31 Dec 2001 to 28 Mar 2002	31 Dec 2001 to 31 May 2002
Weighted average*.....	-24,0	6,9	19,7
Euro..........................	-23,5	7,3	17,2
US dollar...................	-26,0	6,0	24,1
British pound.............	-25,0	7,8	22,8
Japanese yen............	-18,5	7,0	17,0

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

The negative attitude of non-resident portfolio investors towards South African assets during the second half of 2001 turned quite positive in the first quarter of 2002 and continued into the second quarter as non-residents became keen buyers of South African bonds and equities on a net basis. This improvement in foreign investors' sentiment towards South Africa could probably be attributed to, among other things,

- their positive assessment of the macroeconomic policies pursued by the South African authorities;
- the continued reduction in the net oversold position in foreign currency of the Reserve Bank;
- the prospect that the net oversold position would be eliminated in due course;
- a rise in international commodity prices in the first quarter of 2002;
- the expectation that a synchronised global upswing in economic activity in the second half of 2002 could boost the country's export performance;
- an improvement in international investors' sentiment towards emerging markets in general, despite uncertainty about developments in some Latin American economies; and
- attractive yields on domestic fixed-interest securities and the prospect of a relatively strong and steady exchange rate of the rand.

All these factors contributed to a strengthening in the external value of the rand, following its unprecedented depreciation against all major currencies towards the end of 2001. The continued repatriation of export proceeds in anticipation of a further appreciation in the domestic currency, the closing of loss-making long dollar positions by investors and the weakness of the US dollar due to concerns about the strength of the US economic recovery, contributed to a further appreciation of the rand in the second quarter of 2002. From 28 March 2002 to 31 May 2002 the rand appreciated by 17,1 per cent against the US dollar, bringing the recovery in the external value of the rand against the dollar since the end of December 2001 to 24,1

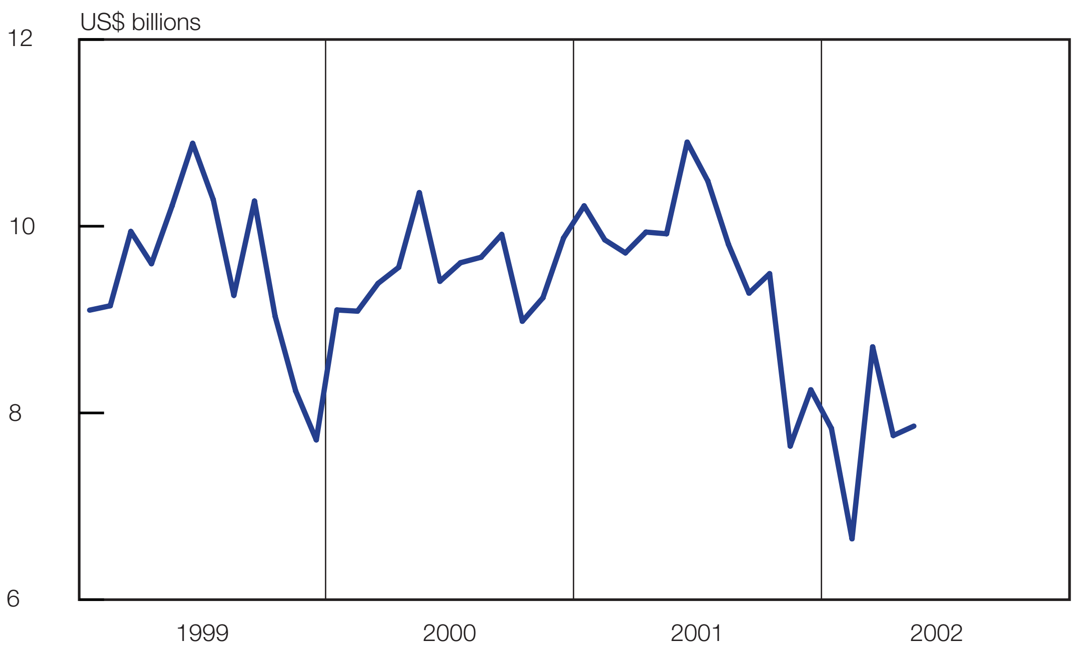
Nominal effective exchange rate of the rand

Daily averages

per cent. The weighted exchange rate of the rand strengthened by 19,7 per cent from the end of December 2001 to 31 May 2002, and by 30,1 per cent from its low point on 20 December 2001.

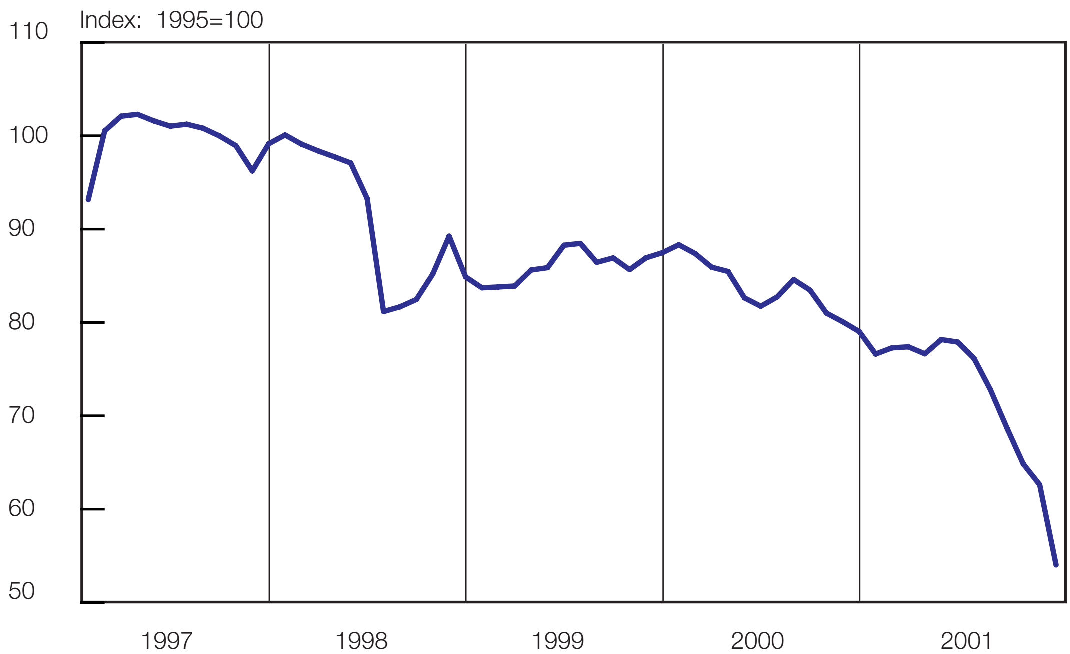
The exchange rate of the rand strengthened in the first quarter of 2002, despite a further contraction in turnover in the domestic market for foreign exchange. Market

Average daily turnover in the South African foreign exchange market



participants probably scaled down their activities in the domestic market for foreign exchange, owing to uncertainty about the impact of the Zimbabwean elections on the southern African region and in anticipation of the findings of the official enquiry into the reasons for the depreciation of the rand by the Myburgh Commission. The average daily turnover in the market for foreign exchange which had declined from US$10,3 billion in the second quarter of 2001 to US$9,9 billion in the third quarter and US$8,5 billion in the fourth quarter, contracted further to US$7,7 billion in the first quarter of 2002. The value of transactions in which non-residents participated, declined from US$5,2 billion per day in the fourth quarter of 2001 to US$4,3 billion in the first quarter of 2002. The proportionate share of non-resident participation therefore shrank from about 61 per cent to 56 per cent over the period.

Real effective exchange rate of the rand



Adjusted for the inflation differential between South Africa and its most important trading partners, the average monthly effective exchange rate of the rand declined by 31,6 per cent from December 2000 to December 2001, signalling a quite astounding improvement in the competitive ability of South African producers in export markets. The appreciation of the rand since the beginning of 2002 has obviously neutralised part of these gains.

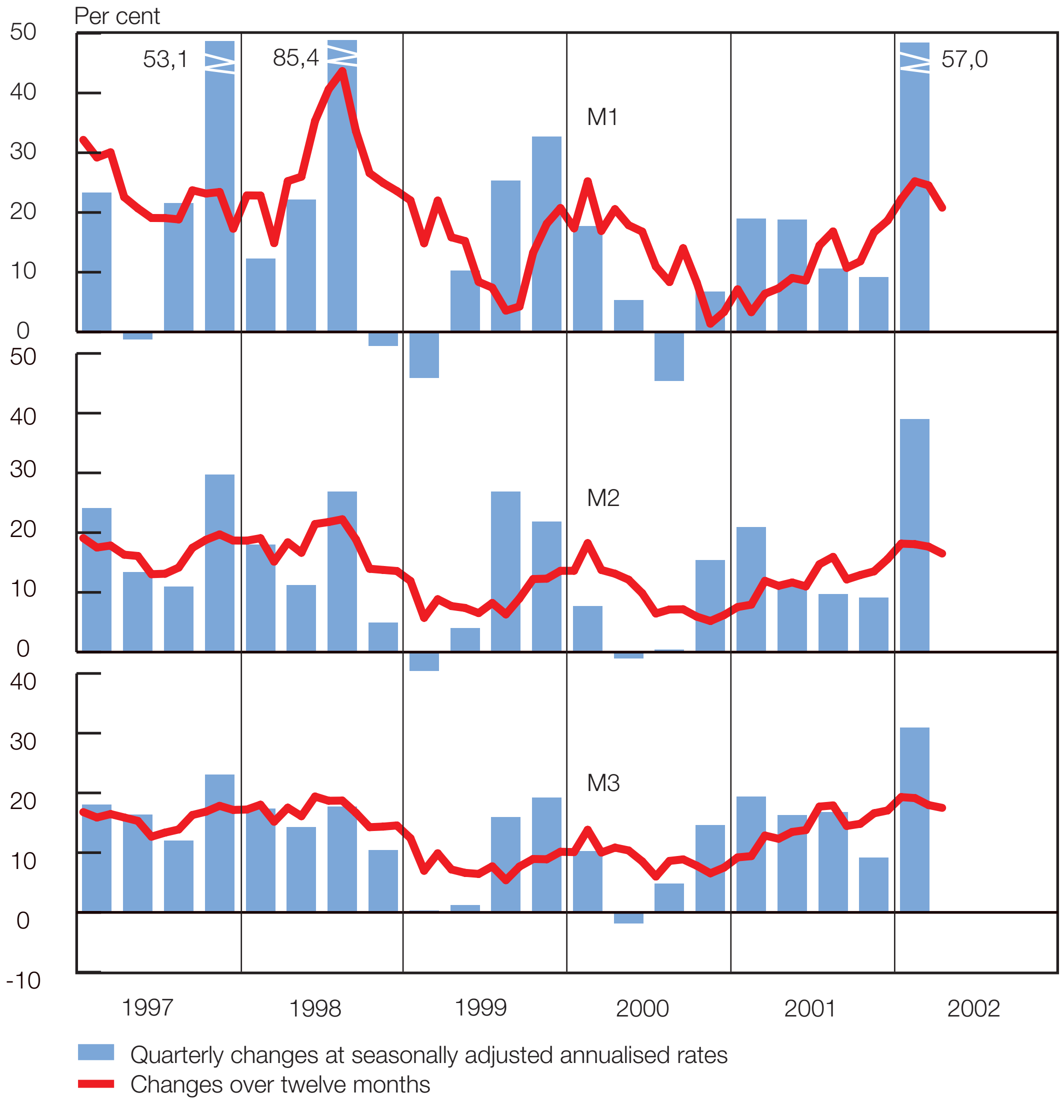
Monetary developments, interest rates and financial markets

Money supply

The seasonally adjusted and annualised quarter-to-quarter growth in the *broadly defined monetary aggregate* (M3) accelerated from 16,9 per cent in the third quarter of 2001 and 9,2 per cent in the fourth quarter to 31,9 per cent in the first quarter of 2002 – the highest average quarterly growth rate ever recorded. Measured over periods of twelve months, M3 increased at a rate of 19,7 per cent in January 2002 but, because a higher base for year-on-year growth calculations had been established in 2001, this growth rate declined somewhat to 18,0 per cent in March 2002 and 17,5 per cent in April.

The twelve-month growth in the narrower monetary aggregate *M1A* was close to 18 per cent in January and February 2002 before escalating to 28,1 per cent in March. In

Growth in monetary aggregates



April 2002 this growth rate returned to 18,5 per cent. The high growth rates in the first four months of 2002 were largely due to a low base for year-on-year growth comparisons in the early months of 2001. This is evident from a slowdown in the quarter-to-quarter growth in M1A from an annualised rate of 27,5 per cent in the fourth quarter of 2001 to 13,9 per cent in the first quarter of 2002. The slowdown in the growth in M1A during the first quarter of 2002 was essentially caused by the slower accumulation of low-interest-yielding cheque deposits by companies and individuals.

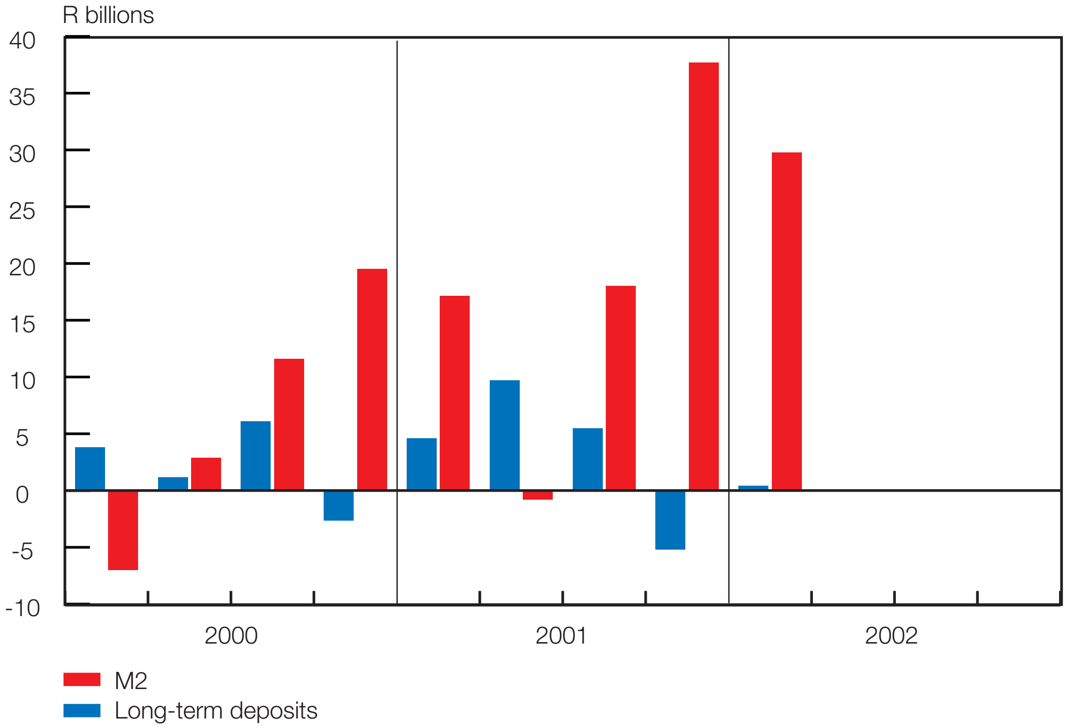
Percentage change in monetary aggregates
Quarterly at seasonally adjusted annualised rates

Period		M1A	M1	M2	M3
2001:	1st qr	9,5	18,8	21,0	19,5
	2nd qr	7,9	18,7	11,3	16,4
	3rd qr	27,3	10,5	9,8	16,9
	4th qr	27,5	9,1	9,2	9,2
2002:	1st qr	13,9	57,0	40,1	31,9

The twelve-month growth rates of *M1* also accelerated impressively, ranging between 21,9 per cent and 25,2 per cent in the first four months of 2002. Partly mirroring the slowdown in quarter-to-quarter growth in M1A, growth in M1 jumped from 9,1 per cent in the fourth quarter of 2001 to 57,0 per cent in the first quarter of 2002 as there was a portfolio shift into high-yielding call and overnight deposits.

M2 growth also accelerated from the fourth quarter of 2001 to the first quarter of 2002. Measured over periods of twelve months, M2 grew at rates of between 16 and 19 per cent in the first four months of 2002 but quarter-to-quarter growth

Quarterly changes in M2 and long-term deposits

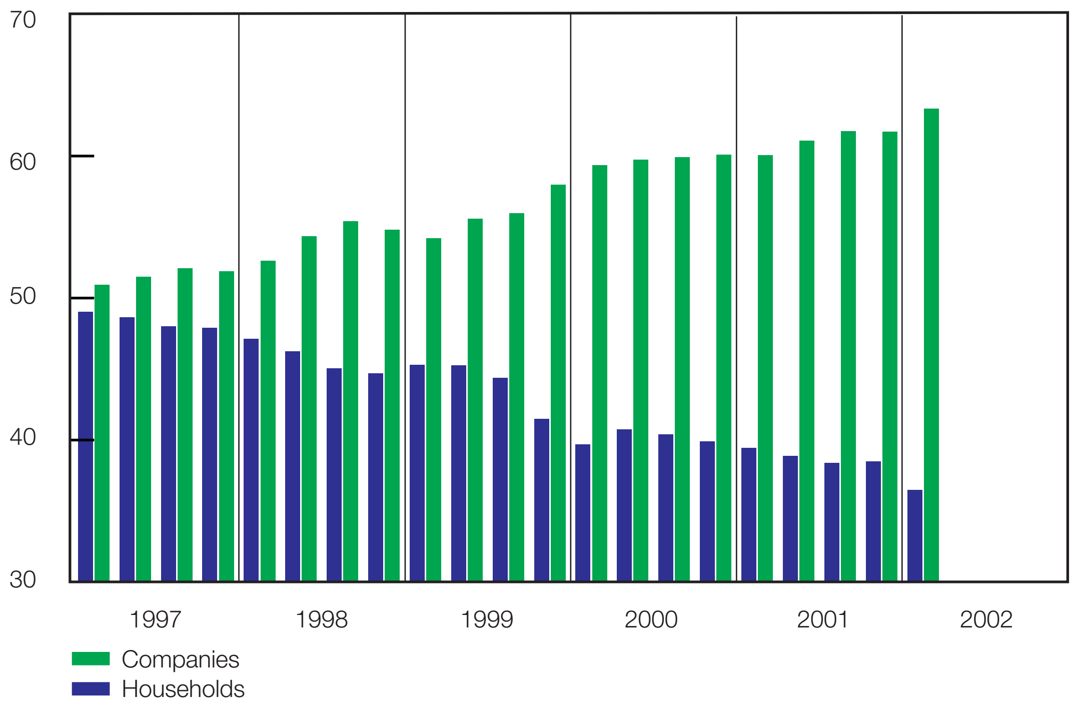


accelerated from 9,2 per cent in the fourth quarter of 2001 to 40,1 per cent in the first quarter of 2002. Some buoyancy in the demand for other short and medium-term deposits contributed to this stronger growth. By contrast, deposits with a maturity of six months and longer fell in absolute terms in the three months to December 2001 and remained rather flat in the first quarter of 2002. In April 2002 there was a strong increase in long-term deposits with the banking sector.

From the foregoing analysis it is clear that most of the growth in the M3 monetary aggregate was in the area of short and medium-term deposits. The corporate sector was the main contributor to this growth in the deposit liabilities of the banks. During the last three months of 2001 the increase in corporate bank deposits exceeded the overall increment in the M3 aggregate, implying a decline in households' deposits with the banks. In the first four months of 2002 companies still contributed more than 80 per cent to the overall growth in M3 deposits. The unusually high level of corporate bank deposits may be seen as evidence of a high degree of uncertainty about the outlook for the South African economy. Companies apparently preferred to keep their cash in the bank rather than invest it in medium to long-term business ventures.

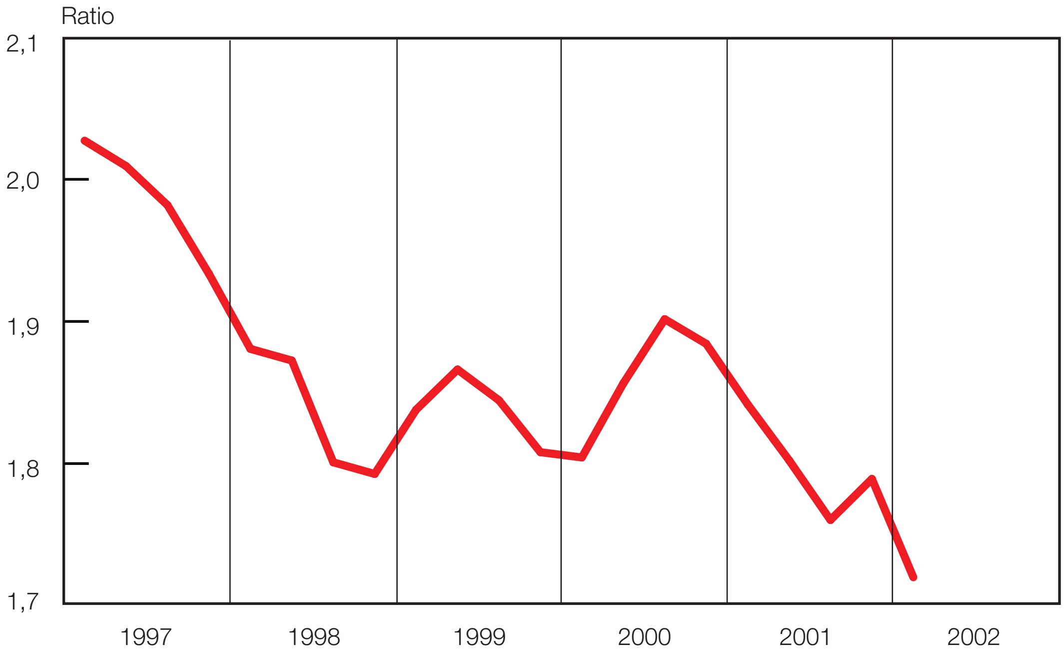
Part of the rapid growth in the broad money supply might have been a consequence of investors' portfolio restructuring. During most of 2001, short-term money-market interest rates declined steadily, whereas the returns on bank deposits changed more sluggishly. The opportunity cost of money holdings was reduced, strengthening demand in particular for the narrow asset classes, M1 and M2.

Deposits as percentage of M3



The demand for money holdings during the first quarter of 2002 was further strengthened by heightened uncertainty about the secondary bond and equity markets. This increased the demand for money assets as a safe investment haven throughout the last quarter of 2001 and the first quarter of 2002. Investors were inclined to take a wait-and-see attitude before committing funds to potentially higher earning assets in the bond and equity markets.

Income velocity of M3



Seasonally adjusted

Uncertainty was aggravated by depositors' experience with smaller banks during the first quarter of 2002. These problems strongly favoured a preference for deposits with the larger banking groups. Moreover, the robust monetary expansion in the first four months of 2002 occurred against the backdrop of an expanding economy in which inflation expectations were driven higher by the depreciation of the rand and other factors. This typically increases the demand for money for transaction purposes.

The M3 money supply increased by R32,5 billion in the fourth quarter of 2001 and by R30,2 billion in the first quarter of 2002. The accounting counterparts of these changes are summarised in the accompanying table. The substantial increase in the

Accounting counterparts of changes in M3
R billions

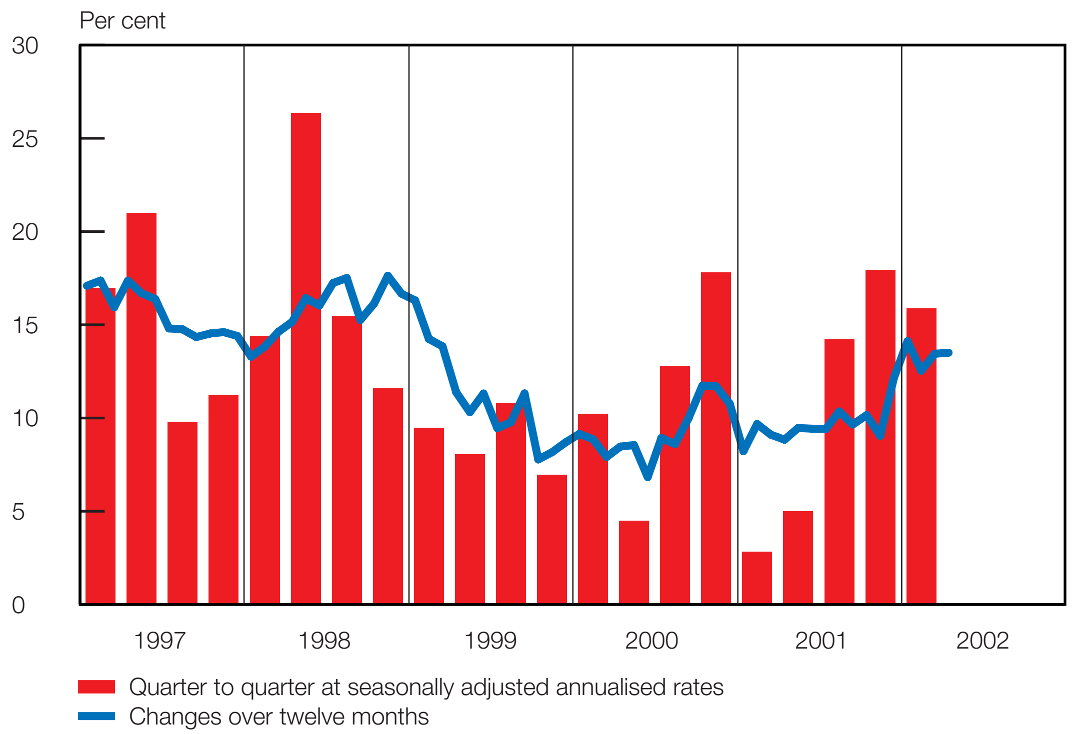
Counterparts	4th quarter 2001		1st quarter 2002	
Net foreign assets		-18,9		31,1
Net claims on the government sector		1,6		-3,5
Gross claims	1,1		-5,5	
Government deposits (+decrease; -increase)	0,4		2,0	
Claims on the private sector		31,8		6,0
Net other assets and liabilities		18,0		-3,4
Total change in M3		**32,5**		**30,2**

banks' net foreign assets in the first quarter of 2002 was a consequence of the liability the government assumed for a US dollar loan arranged earlier with the Reserve Bank as debtor. This transfer of liability from the Bank to the government reduced the Bank's foreign liabilities by R17,5 billion, increasing the Bank's net foreign assets by an equal amount. The increment in the banks' claims on the domestic private sector added some R6,0 billion to these banks' overall assets in the first quarter of 2002, following a substantial increase of R31,8 billion in the fourth quarter of 2001.

Credit extension

The quarter-to-quarter annualised growth in *total domestic bank credit extension* (i.e. credit extended to the private sector and net claims of banks on the government sector) accelerated from 2,2 per cent in the second quarter of 2001 to 16,4 per cent in the fourth quarter and 18,7 per cent in the first quarter of 2002. Measured over twelve months, the growth in total bank credit extension accelerated from 10,0 per cent in December 2001 to 13,5 per cent in January 2002, 11,1 per cent in March and 10,7 per cent in April. The generally strong growth in total domestic credit extension in the first quarter of 2002 was essentially caused by stronger demand for credit by private sector bodies. Net credit extended to the government sector declined by R3,5 billion over the same period.

Credit extended to private sector



Despite indications of a slight weakening in overall economic activity, bank *credit extension to the private sector* increased at a high quarter-to-quarter growth rate of 17,9 per cent in the fourth quarter of 2001 and 15,9 per cent in the first quarter of 2002. Among other things, the increase in the fourth quarter of 2001 could be explained by the impact of the depreciation of the rand, which encouraged exporters to borrow in the domestic credit market in order to meet their working capital requirements, while delaying the repatriation of their export proceeds for as long as possible. In the first quarter of 2002, rising inflation and pre-emptive buying by individuals and companies ahead of anticipated price increases contributed to the high levels of private-sector credit growth.

Growth over twelve months in the banks' claims on the domestic private sector accelerated from 12,2 per cent in December 2001 to 15,6 per cent in January 2002 and 13,4 per cent in March. Growth of 13,5 per cent was registered in April 2002. The sharp acceleration in January 2002 was mainly a consequence of the very low base value for year-on-year growth calculations as a result of changes in the reporting format of the banks in January 2001.

An analysis of banks' claims on the private sector by type of credit shows that the growth in *mortgage advances* posted high twelve-month rates ranging from 14,2 per cent to 16,1 per cent throughout 2001. It was only in the first four months of 2002 that the growth in mortgage advances started tapering off from 12,1 per cent in January to 11,5 per cent in March and 11,7 per cent in April. The firm growth in mortgage advances in recent years has reflected the more affordable cost of mortgage financing and the associated higher level of activity in the real-estate market over the past two years. Growth in mortgage advances contributed 40,2 per cent to the overall increase in the banks' claims on the private sector in the year to April 2002.

Selected categories of credit to the private sector by type of credit

Percentage change over twelve months

Period		Instalment sale credit and leasing finance	Mortgages	Other loans and advances
2001:	Mar	13,2	15,3	0,9
	Jun	13,5	15,4	2,5
	Sep	17,2	14,4	5,1
	Dec	16,9	14,5	10,4
2002:	Jan	17,5	12,1	12,6
	Feb	15,6	12,5	10,5
	Mar	15,6	11,5	12,3
	Apr	15,6	11,7	11,8

Fully consistent with the stronger consumer demand for durable consumer goods, growth in *instalment sale credit and leasing finance* gained momentum throughout 2001; it increased from 9,8 per cent in January 2001 to a five-year high of 17,5 per cent in January 2002. The twelve-month growth rate later declined to 15,6 per cent in February, March and April 2002. Instalment sale and leasing financing of used passenger cars, followed by the financing of new passenger cars and trucks, contributed most to the increase in credit from December 2001 to March 2002. New payouts of such credit declined from a record high of R18,2 billion in the fourth quarter of 2001 to a still high amount of R16,1 billion in the first quarter of 2002, as expenditure on durable goods moderated somewhat.

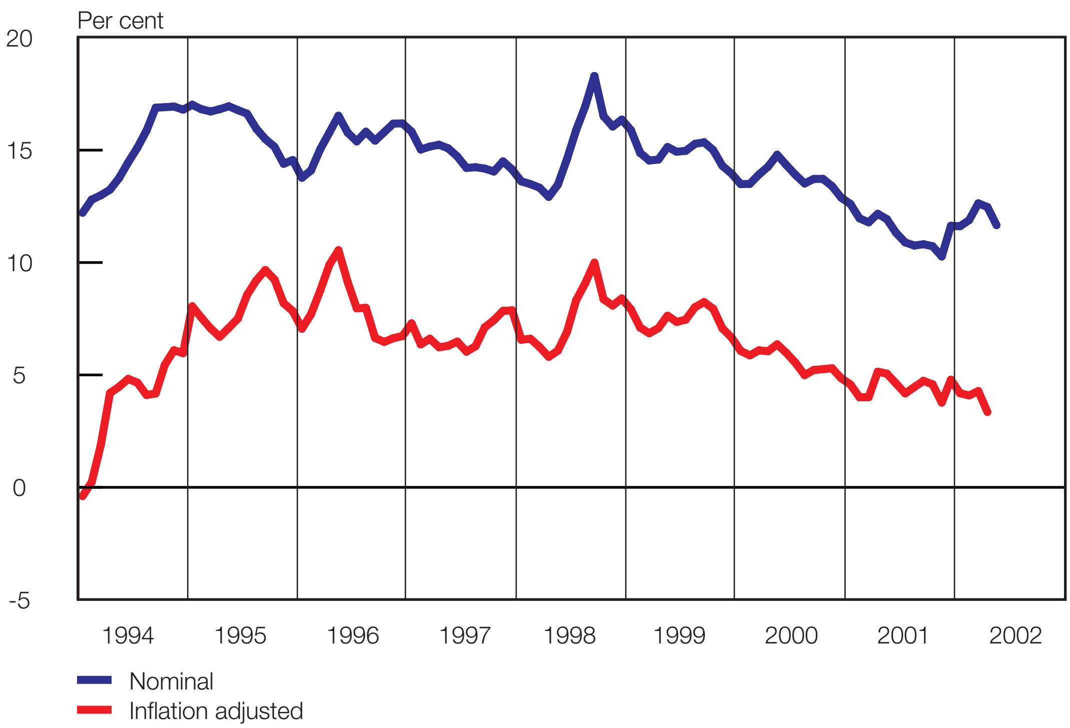
The rate of increase over twelve months in *other loans and advances*, which fluctuated within a range of 0,5 per cent to 5,5 per cent during most of 2001, accelerated to 10,4 per cent in December, 12,6 per cent in January 2002 and 12,3 per cent in March. This rate amounted to 11,8 per cent in April. However, viewed on a quarterly basis, other loans and advances extended by banks declined by R2,4 billion in the first quarter of 2002, compared with an increase of R12,7 billion in the fourth quarter of 2001, suggesting a sharp turnaround in the growth of this credit category shortly after the exchange rate started to strengthen. The demand for credit originating with companies rather than with individuals underpins the current high level of other loans and advances granted by banks. The other loans and advances category is still an important asset on banks' balance sheets, despite a decline in its contribution to total credit extended to the private sector by banks from 39,4 per cent in December 2001 to 38,5 per cent in April 2002.

The household sector absorbed the greater part of the increase in credit extension to the private sector in the first quarter of 2002, but households' total share of private-sector credit remained more or less unchanged at 47,7 per cent.

Interest rates and yields

Higher inflation was widely expected to result from the steep depreciation of the rand in December 2001. Partly in response to the changed outlook for inflation, the decline in long-term bond yields came to an end and the *monthly average yield on long-term government bonds* picked up from 10,3 per cent in November 2001 – its lowest level since August 1980 – to 12,6 per cent in March 2002 – its highest level since January 2001.

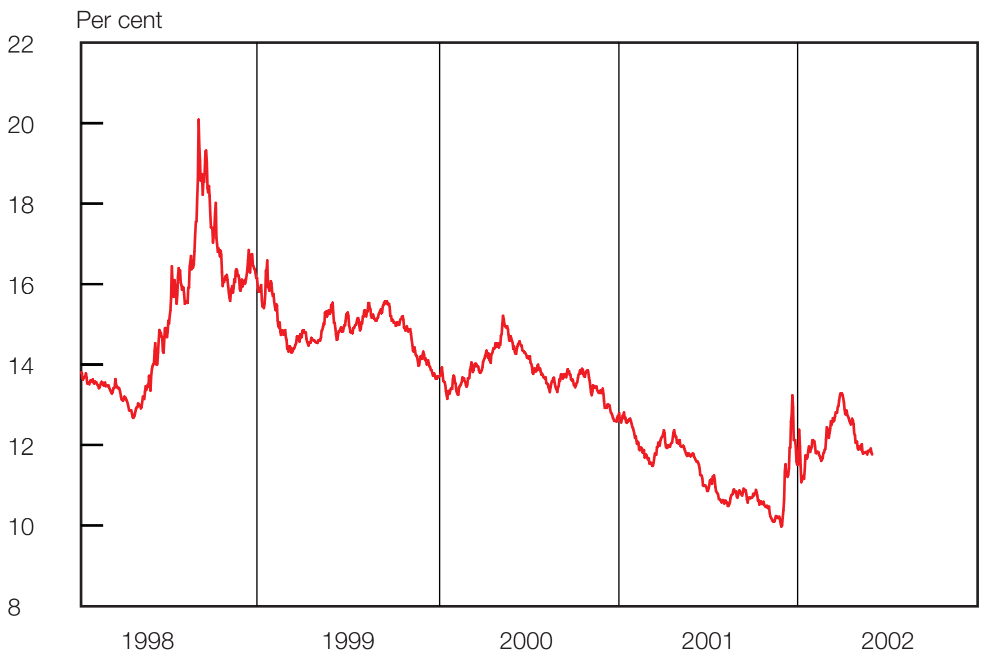
Monthly average yield on long-term government bonds



The prolonged decline in bond yields since the international financial crisis of 1998 was also underpinned by a dwindling supply of government securities. Despite widespread expectations that monetary policy would be tightened in order to contain inflation, and later the actual increases in the repurchase rate of the Reserve Bank, inflation fears drove bond yields higher from about the end of November 2001. Against this, the national government's funding proposals for the 2002/03 fiscal year continued to limit the domestic supply of bonds, for example by focusing on funding in foreign capital markets.

In an environment of heightened uncertainty, bond yield movements became increasingly sensitive to changes in the exchange rate of the rand. Along with the sharp weakening of the rand, the daily average yield on long-term government bonds rose rapidly from a low of 9,97 per cent on 28 November 2001 to 13,23 per cent on 20 December. When some stability returned to the foreign-exchange market, bond yields fell back to a daily average of 11,07 per cent on 8 January 2002. Concerns about rising inflation again took hold in early 2002, pushing the daily average yield on long-term government bonds to 13,28 per cent on 28 March 2002.

Yield on long-term government bonds



The mood in the bond market turned more positive from the beginning of April 2002. The daily average yield on long-term government bonds declined to 12,08 per cent at the end of April and 11,76 per cent at the end of May. The monthly average bond yield fell back to 12,5 per cent in April 2002 and 11,7 per cent in May.

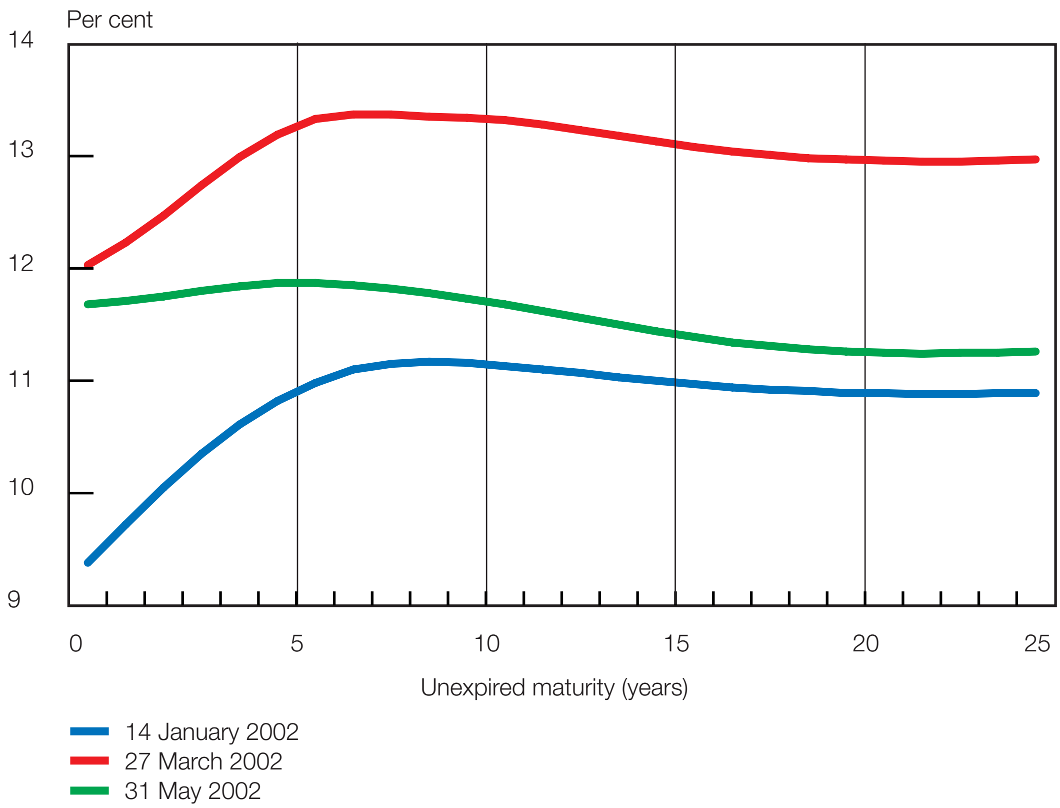
The main explanations for the decline in bond yields since the end of March 2002 include the following:

- The strong showing of the rand;
- the conservative monetary policy stance of the Reserve Bank; and
- the ongoing shortage of investable long-term securities in the fixed-interest market.

The yield curve moved higher over the entire maturity spectrum with broadly similar increases at the short and the long ends after the Reserve Bank increased the *repurchase rate* in January and in March 2002. The repurchase rate was increased by a cumulative total of 200 basis points in the first five months of 2002. The first upward adjustment of 100 basis points occurred on 16 January 2002 after a special meeting of the Monetary Policy Committee concluded that the sharp depreciation of the rand had negatively influenced inflation expectations and that the attainment of the inflation target in 2002 and 2003 was at risk. At its scheduled meeting on 13 and 14 March 2002 the Monetary Policy Committee increased the repurchase rate by a further 100 basis points to 11,50 per cent, effective from 15 March 2002. In reaching this decision the Monetary Policy Committee concluded that this tightening of the monetary policy stance was justified to reinforce the January increase, so as to prevent second-round price increases arising from the depreciation of the rand and to demonstrate the Reserve Bank's resolve to meet the inflation target.

The level of the *yield curve* on 27 March 2002 was, on average, 230 basis points above its level immediately before the increase in the repurchase rate in January – i.e. the curve shifted upwards by more than the overall increase of 200 basis points in the repurchase rate. Since 27 March 2002 the yield curve has become appreciably flatter and even assumed an inverted shape after 24 April, when the yields on bonds with outstanding maturities of more than 20 years declined to yield levels below those of bonds with short outstanding maturities. By the end of May 2002, yields at the short end of the curve were on average 23 basis points above their levels on 14 March, whereas the yields at the longer end of the curve were on average 97 points below the reference value of 14 March.

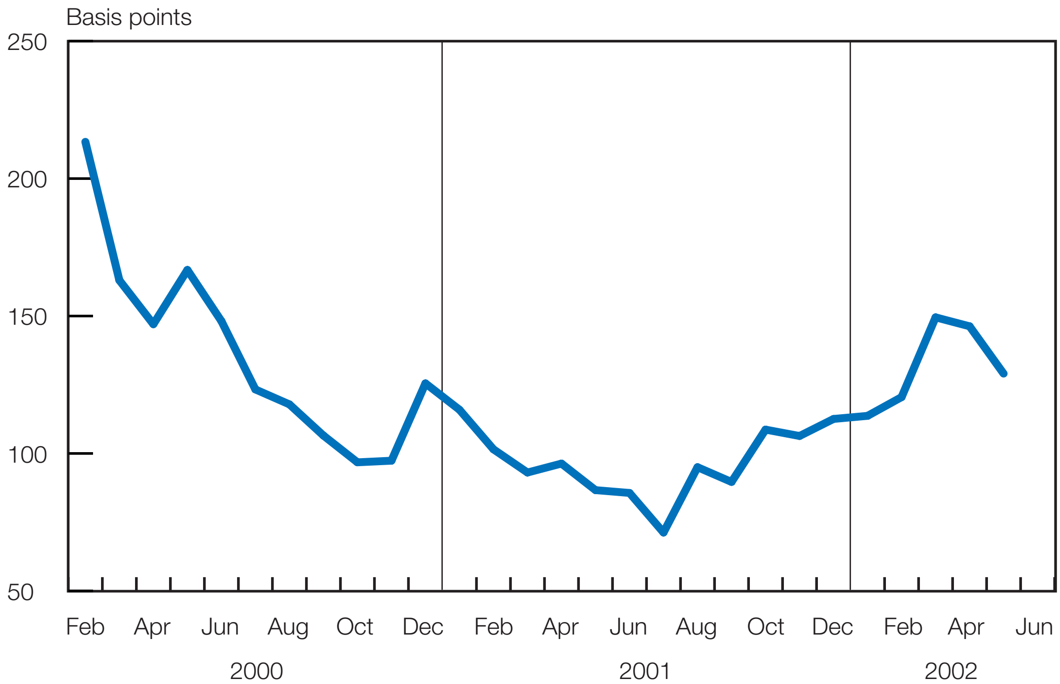
Yield curves



The *inflation-adjusted yield* or *real yield* on long-term government bonds, a key measure of bond values, increased from 3,8 per cent in November 2001 – its lowest level since March 1994 – to 4,8 per cent in December along with the sudden rise in nominal bond yields. The real yield subsequently fell back to 3,3 per cent in April 2002 as rising inflation outpaced the increase in nominal bond yields. The deterioration in inflation expectations was also reflected in a sharp 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.

The risks associated with the bonds issued by private-sector banks have been thoroughly reassessed in the past year or so. Whereas the average yield on bonds issued by banks exceeded the yield on government bonds of equal maturity by 70 basis points in July 2001, this margin widened to 150 basis points in March 2002 and 129 basis points in May. A general apathy towards investment in financial-sector stock and the recent problems experienced by some of the smaller banks probably contributed to this down-rating of tradable securities issued by banks.

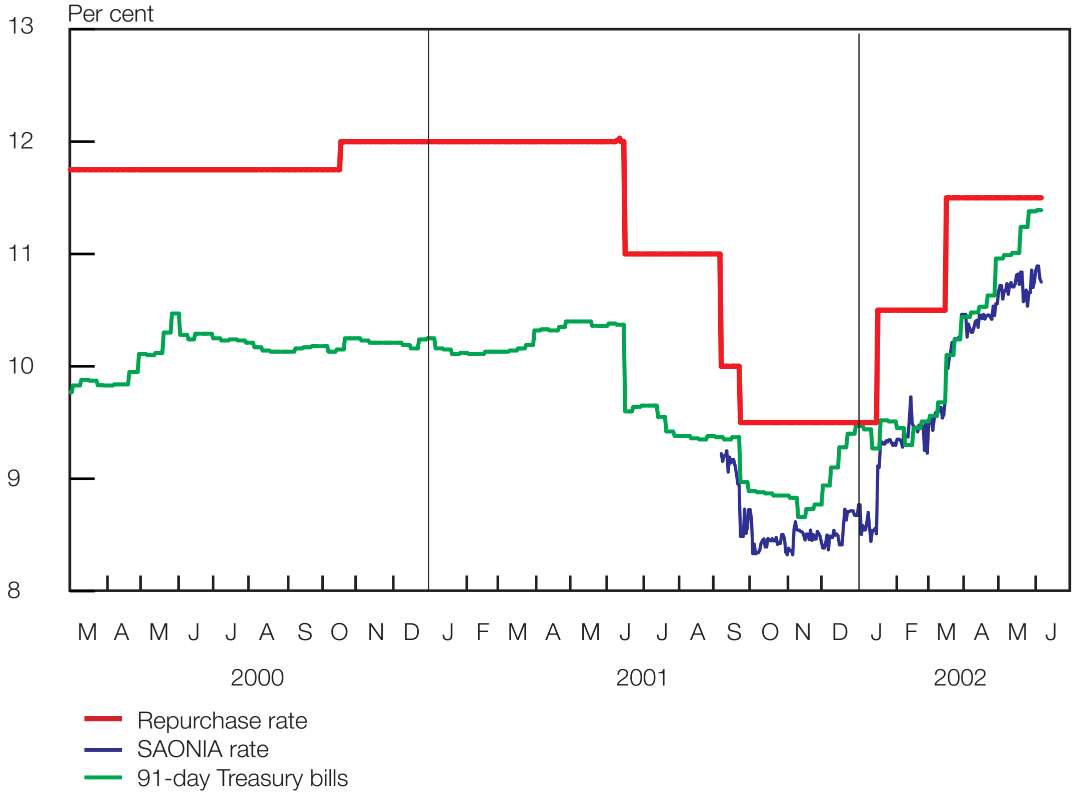
Yield spread on corporate bonds



Money-market interest rates, which had started to rise in the second half of November 2001, rose considerably in the first five months of 2002. Notable increases were concentrated in late February and March 2002 when, apart from the impact of the increase in the repurchase rate, market participants also became concerned about the potential for social instability in Zimbabwe and the inflationary consequences of rising international crude oil prices. Two consecutive releases of higher-than-expected production price inflation figures towards the end of February and March 2002 reinforced the bearish market sentiment at that time.

On 2 April 2002, some changes were made to the composition of the South African Overnight Interbank Average (SAONIA) rate which had been introduced by the South African Reserve Bank on 5 September 2001. The changes were implemented to improve the SAONIA rate as an indicator of money-market conditions. The revised SAONIA rate now comprises the average rate on unsecured interbank funding at market rates only, i.e. it excludes the interbank overnight funding raised in terms of special agreements among banks at the prevailing Reserve Bank repurchase rate. The previous SAONIA rate, now called the SAONIA+ rate, covers all unsecured interbank overnight funding, i.e. the weighted average of funding at the repurchase rate as well as the other overnight funding rates.

Money-market interest rates



Partly reflecting actual and anticipated changes in the repurchase rate, overnight interbank rates increased during the first five months of 2002. The SAONIA+ rate increased by a total of 132 basis points from 8,90 per cent on 2 January 2002 to 10,22 per cent on 15 March. As liquidity conditions became tighter closer to the Easter holiday at the end of March, the SAONIA+ rate increased by 90 basis points to 11,12 per cent on 27 March 2002 but subsequently fell to 10,50 per cent on 11 April when liquidity conditions eased somewhat. However, towards the end of April the SAONIA+ rate again increased, peaking at 11,25 per cent on 29 April, but declined steadily in the ensuing weeks to 11,13 per cent on 31 May 2002. The SAONIA rate was calculated at 10,26 per cent on 2 April 2002 but later rose to 10,89 per cent on 31 May 2002.

Along with increases in the repurchase rate, the rate on three-month bankers' acceptances increased from 9,56 per cent on 2 January 2002 to 10,75 per cent on 2 April but stabilised at this level in the following week. From the second half of April the rate on three-month bankers' acceptances began to move higher and reached 11,13 per cent on 6 May, as fears heightened that rising international crude oil prices would fuel inflation. The tender rate on 91-day Treasury bills increased from 9,27 per cent on 11 January 2002 to 9,52 per cent on 18 January 2002 and 10,10 per cent on 15 March. The weekly amount of 91-day Treasury bills offered on tender was increased by R400 million to R1,4 billion from 28 March 2002, contributing to upward pressure on this rate. A recent high of 11,39 per cent was reached on 31 May 2002.

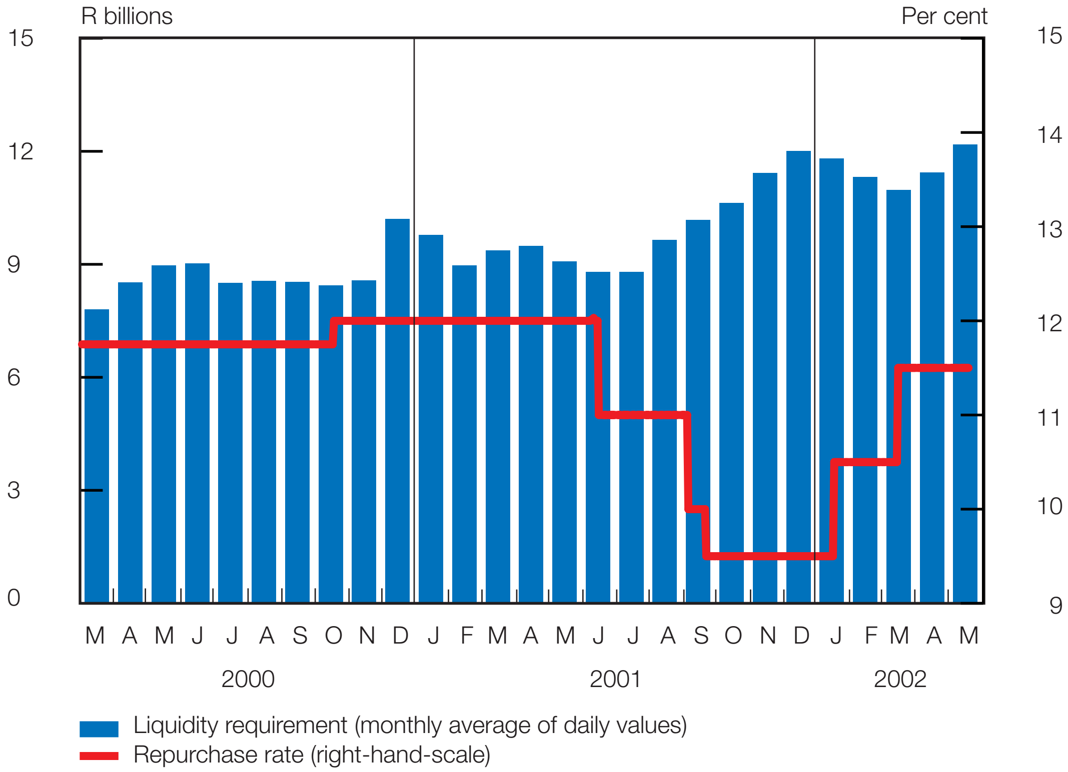
Expectations of increases in money-market interest rates, as portrayed by the rates on forward agreements (FRAs), generally prevailed in the first five months of 2002. For instance, the rate on 9x12-month FRAs rose, on balance, from a low point of 9,85 per cent on 8 January 2002 to 12,08 per cent on 28 February and peaked at 12,97 per cent on 27 March 2002. As the strengthening of the effective exchange rate of the rand gained some momentum during April and May, the rate on 9x12-month FRAs retraced part of its earlier increases to reach 12,10 per cent on 31 May 2002.

The private-sector banks responded to the increases in the repurchase rate in January and March 2002 by raising their prime overdraft rate. On 16 January 2002 the prime overdraft rate was increased by 100 basis points to 14 per cent and this was followed by a further increase of 100 basis points to 15 per cent on 18 March. At the level of 15 per cent, the prime overdraft rate was two percentage points higher than at the end of 2001 but half a percentage point lower than its level at the end of 2000.

Money market

Money-market conditions eased during the first three months of 2002, in part because of the liquidity assistance the Reserve Bank provided to certain banks when they encountered large-scale deposit withdrawals. The average daily liquidity requirement of the banks accordingly decreased from R12,0 billion in December 2001 to R11,0 billion in March 2002. This was contrary to the behaviour of money-market accommodation rates which rose by some 200 basis points over the first three months of the year. In the second quarter of 2002, liquidity conditions became

Total liquidity requirement



less accommodative as the banks' average daily liquidity requirement rose to R11,4 billion in April and R12,2 billion in May.

The Reserve Bank allowed fairly liquid conditions to prevail in the first five months of 2002 but occasionally intervened to offset undue liquidity injections arising from the deficits incurred on its forward foreign-exchange transactions. At times liquidity was fed into the market through the assistance provided to certain banks and changes in the Reserve Bank's holdings of net foreign assets.

Actions by the Reserve Bank to mop up excess liquidity in the money market included foreign-currency money-market swap transactions with parties in the private sector. The outstanding amount of these swap transactions rose sharply in January 2002 after government had replaced the Reserve Bank as debtor in respect of a US$1,5 billion syndicated loan in a transaction which swelled liquidity in the market by R17,5 billion.

On 25 April 2002, the proceeds of the government's US$1 billion foreign loan expanded liquidity by R10,7 billion but this amount was immediately neutralised through foreign-exchange swap transactions. These swaps are expected to be reversed gradually when the foreign exchange are repurchased by the Bank in the second leg of the swap transaction and is delivered against maturing forward foreign-exchange contracts.

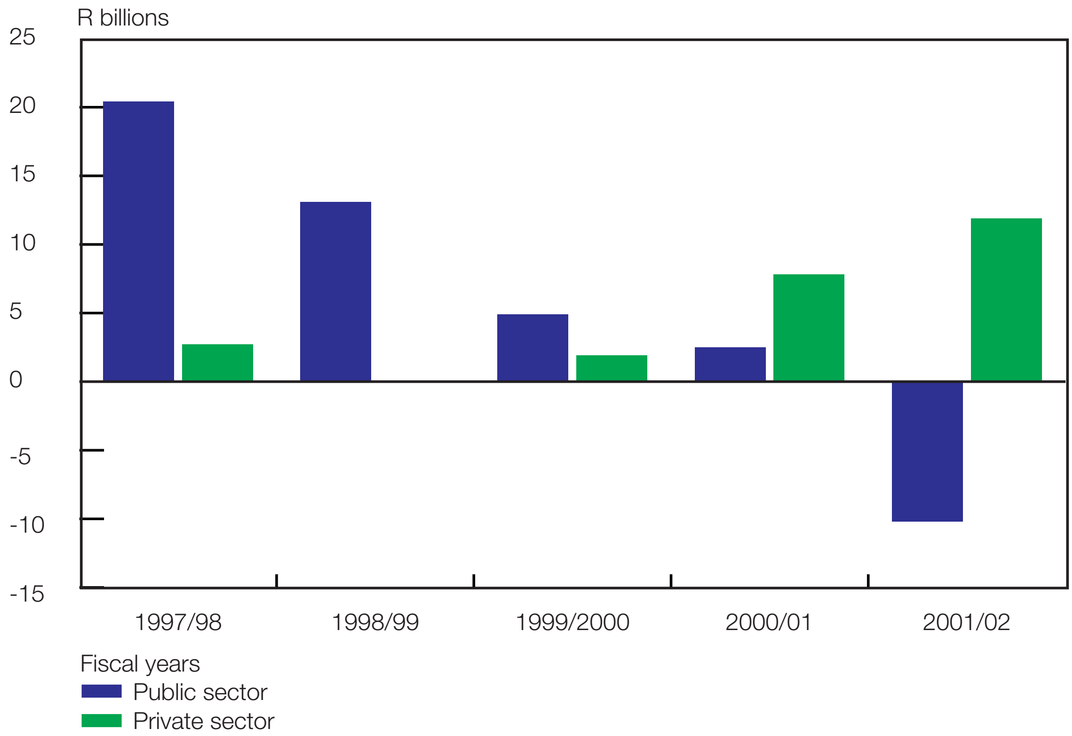
Another measure taken by the Bank to drain excess liquidity from the money market was an increase in the amount of outstanding Reserve Bank debentures. The issued value of the debentures rose from R1,3 billion at the end of December 2001 to R4,0 billion at the end of February 2002 and during May to R5,7 billion at the end of that month. The amount of outstanding reverse repurchase transactions in government securities with private-sector parties was also increased from R3,5 billion at the end of December 2001 to R6,7 billion at the end of February 2002. These transactions were reduced to R6,0 billion to alleviate a tightening in the market over the Easter weekend at the end of March 2002, but rose to R6,6 billion at the end of April and R5,8 billion at the end of May, as mopping-up operations were resumed at the former levels.

Following the usual seasonal pattern, notes and coin in circulation outside the Reserve Bank decreased by R3,4 billion in January and February 2002. In March 2002 notes and coin in circulation outside the Reserve Bank increased by R2,0 billion on account of the public's demand for cash over the Easter holidays, tightening the liquidity conditions in the money market. A reverse flow of notes and coin to the Reserve Bank in the amount of R0,4 billion eased the liquidity situation somewhat in April 2002. In May a decline of R0,5 billion in the value of notes and coin in circulation outside the Reserve Bank added liquidity to the market.

Bond market

There was a decline in the supply of new public-sector debt securities in the *domestic primary bond market* during fiscal 2001/02. In fact, public-sector borrowers retired debt to a net value of R10,2 billion in fiscal 2001/02. In fiscal 2000/01 there were still net issues of debt by public-sector bodies to the amount of R2,5 billion. Debt retirement by the public sector reached a zenith in January 2002 when the *national government* repaid maturing debt to the value of R21,7 billion and bought back debt to the value of R2,5 billion. Overall, the *public sector* retired debt to the amount of R25,1 billion in January and February 2002. In April 2002 the National Treasury returned to the market as a borrower, issuing a new inflation-linked bond maturing in March 2008 and a new variable-rate bond in May.

Funds raised in domestic bond market



The supply of fixed-interest securities in the domestic primary bond market was constrained by the national government's preference for meeting its financing requirements in the *international capital markets.* A total amount of R12,3 billion was raised by national government in the international market during fiscal 2001/02. In April 2002 the entire offshore borrowing programme for fiscal 2002/03 was completed with the placing of a 10-year global dollar bond to the value of US$1 billion. This bond was issued at an annual coupon rate of 7,375 per cent. At the time of placement the issue price implied a premium of 240 basis points over the yield on the equivalent loan stock of the United States Federal Government.

Bond issues by *private-sector entities* partly filled the void left by public-sector borrowers in the fixed-interest securities market. The outstanding nominal value of private-sector loan stock listed on the Bond Exchange of South Africa rose strongly from R11,2 billion in December 2000 to R21,9 billion in December 2001 and R24,4 billion in March 2002. Private-sector banks were fairly active in the market in the first quarter of 2002, raising R1,6 billion in borrowed funds to supplement their capital base in the wake of substantial write-offs of bad debts.

Trading activity on the Bond Exchange of South Africa was quite lively during 2001 and rose by 18 per cent to R12,4 trillion. In the early months of 2002 turnover values declined slightly from the record level of R3,5 trillion established in the fourth quarter of 2001 to R3,3 trillion in the first quarter of 2002 and R2,5 trillion in April and May.

Non-resident investors sold bonds to the value of R25,6 billion in the domestic market during 2001 as falling nominal yields and the persistent depreciation of the rand steadily wrung potential profit opportunities from the market. The sharp decline in bond prices in December 2001 and the new-found strength of the rand vis-à-vis other currencies from the beginning of 2002 enticed non-resident investors back to the South African bond market as net buyers. Though non-resident investors still sold bonds to the net value of R10,1 billion in the fourth quarter of 2001, they acquired bonds to the value of R5,3 billion on a net basis in the first five months of 2002. Since the beginning of 2002 an increasing proportion of net purchases by non-residents has been in the form of outright purchases, whereas repurchase transactions have lost some of their earlier popularity.

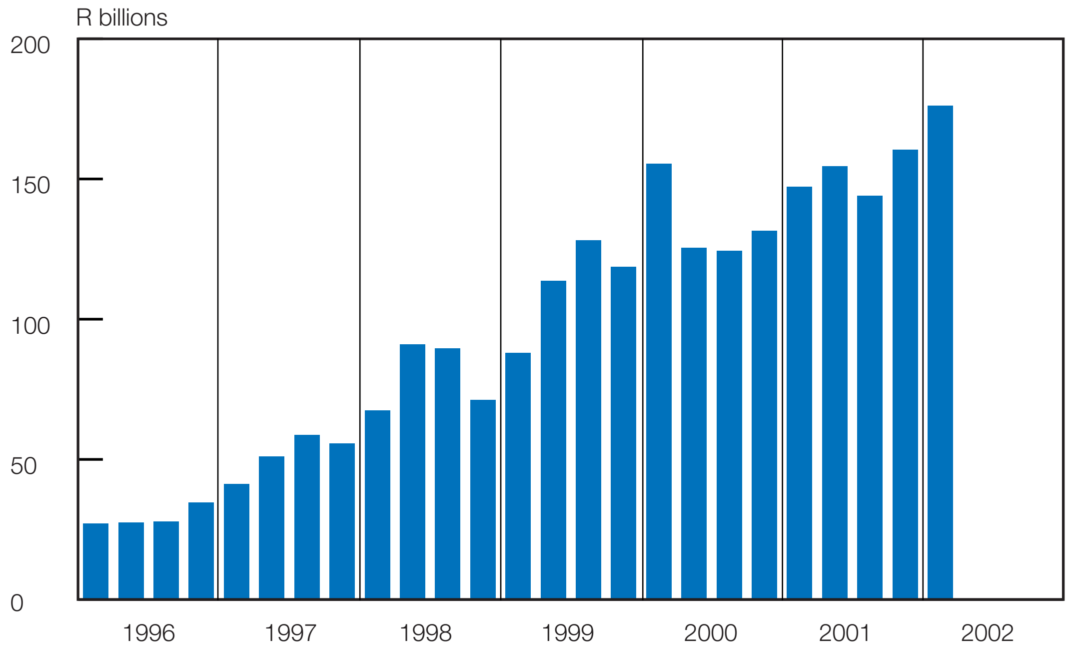
Share market

The strong rise in share prices since September 2001 has encouraged a number of companies with listings on the JSE Securities Exchange SA to satisfy part of their capital requirements in the *primary share market.* The quarterly value of share capital raised on the JSE Securities Exchange SA accordingly increased from R5,0 billion in the third quarter of 2001 to R12,9 billion in the fourth quarter and R12,6 billion in the first quarter of 2002. Companies listed in the financial and resources sectors of the Exchange actively mobilised funds.

Trading in the *secondary share market* increased equally impressively from a quarterly average of R148 billion in the first three quarters of 2001 to R161 billion in the fourth quarter, and a record of R176 billion in the first quarter of 2002. Furthermore, in May 2002 the turnover in the secondary share market reached its highest monthly level ever, namely R97 billion.

Strongly rising share prices ensured that *non-resident investors* maintained a presence in the domestic share market as buyers of equity. Net purchases by non-resident investors, valued at R5,4 billion in the third quarter of 2001, were followed by net share purchases of R7,9 billion in the fourth quarter and R4,4 billion in the first quarter of 2002 and R0,8 billion in April and May. Net purchases occurred consistently, except in November 2001 when R1,3 billion worth of shares were sold on a net basis by non-resident investors, and in February and May 2002 when non-residents' net sales of shares amounted to R0,3 billion and R1,9 billion, respectively.

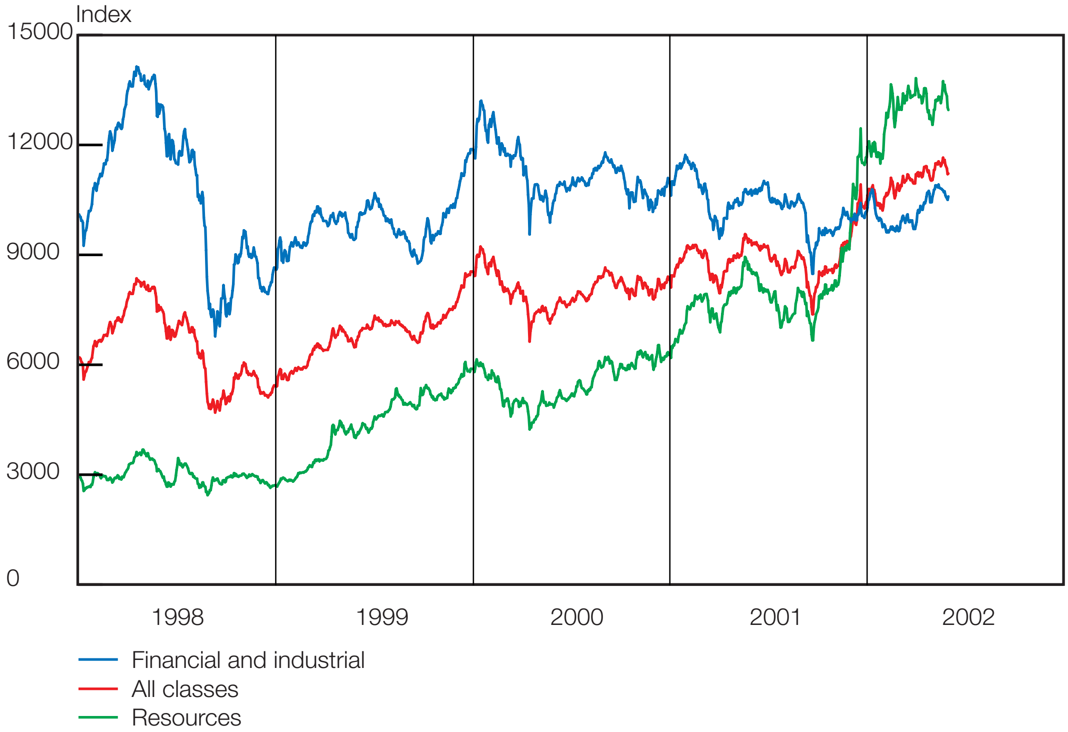
Turnover in secondary share market



Underpinned by solidly rising turnovers, the closing level of the *all-share price index* increased by 58 per cent from a sixteen-month low on 21 September 2001 to a record high on 22 May 2002. The monthly average of the all-share price index rose by 39 per cent from September 2001 to May 2002. Gains in share prices were particularly prominent in the resources sector of the Exchange where prices moved upwards by 79 per cent from September 2001 to May 2002. The average prices of counters in the gold section rose by 186 per cent over the period from September 2001 to May 2002 but far more modest increases of 19 per cent in the industrial sector and 4 per cent in the financial sector were reported.

The *price-earnings ratio of all classes of shares* increased from a low of 10,5 in September 2001 – its lowest level since the international financial crisis of 1998 – to 13,2 in February 2002, but declined slightly to 13,1 in May. Broadly mirroring these movements, the *dividend yield* on all classes of shares declined from 3,4 per cent in September 2001 when it was at its highest level since December 1998, to an average of 2,9 per cent in the first five months of 2002.

Share prices

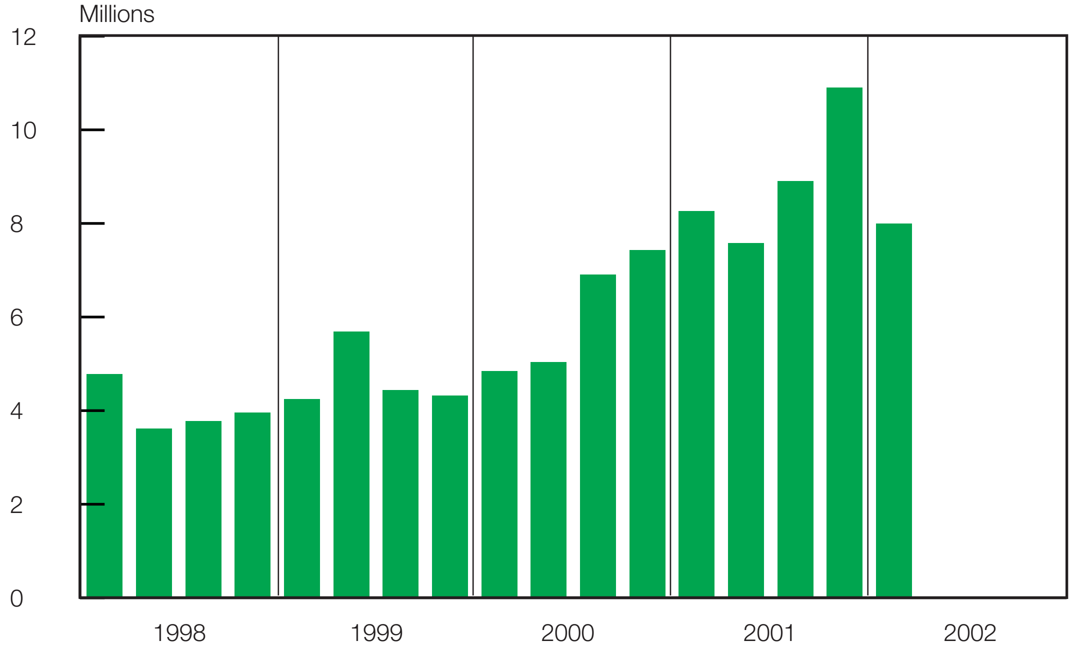


Market for derivatives

The high level of trading activity in the market for equity-related derivative contracts in the fourth quarter of 2001 subsided in the first five months of 2002 when stability returned to the foreign-exchange and financial markets. Index and individual equity derivative products, on average, accounted for almost 99 per cent of the overall number of trades in financial derivatives.

The combined number of *futures and options on futures contracts* traded in the JSE Financial Derivatives Division rose by 47 per cent to 35,6 million in 2001. The quarterly number of these contracts traded increased from a quarterly average of 8,2 million in the first three quarters of 2001 to a record 10,9 million in the fourth quarter of 2001, but declined to 7,9 million in the first quarter of 2002. The number of these contracts traded later decreased from a monthly average of 2,7 million in the first quarter of 2002 to 2,1 million in April and 1,8 million in May.

Number of futures and options on futures contracts traded



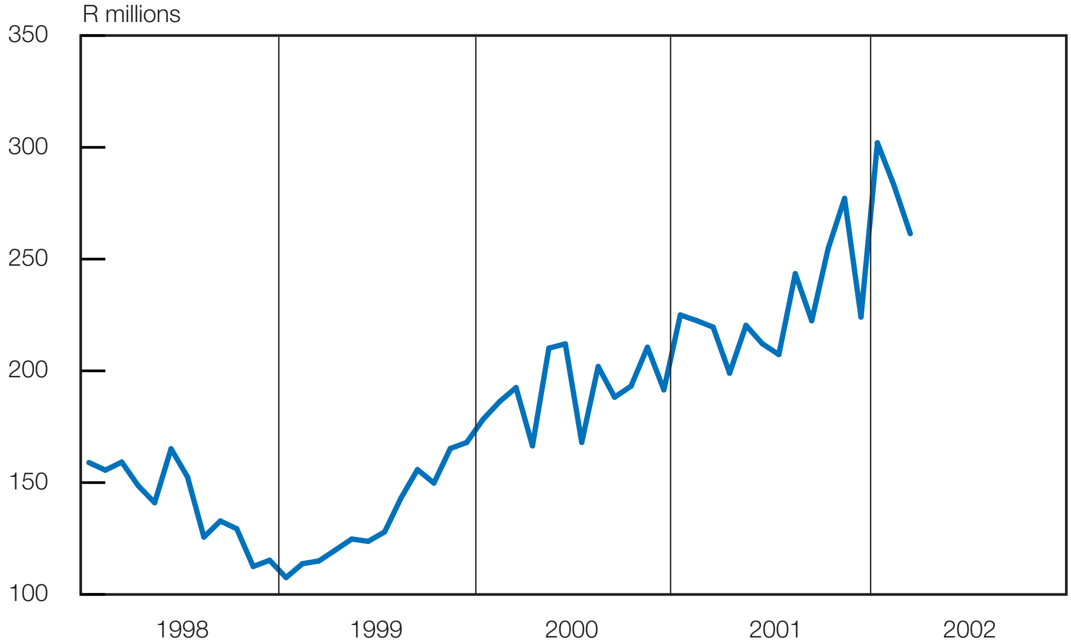
The number of *warrants* traded on the JSE Securities Exchange SA decreased from a quarterly record of 7,9 billion in the third quarter of 2001 to 6,8 billion in the fourth quarter and 5,5 billion in the first quarter of 2002. Trading later increased from a monthly average of 1,8 billion in the first quarter of 2002 to 2,1 billion in April, but returned to 1,8 billion in May.

Commodity futures contracts and options on such contracts traded in the JSE Agricultural Products Division mainly consisted of *white maize* contracts, which on average account for 79 per cent of all commodity-related trading and 82 per cent of all maize-related contracts. Heightened volatility in the spot price of white maize, in tandem with volatility in the exchange rate of the rand, boosted trading activity in commodity derivatives. The number of commodity futures contracts and options on such contracts increased from 329 000 in the fourth quarter of 2001 to a record 380 000 in the first quarter of 2002. The monthly number of such contracts traded peaked at 168 000 in February 2002. Trading increased further from a monthly average of about 127 000 contracts in the first quarter of 2002 to 150 000 in April and 144 000 in May.

Real-estate market

The *real-estate market* became increasingly buoyant as the overall seasonally adjusted *value of turnover,* measured by *transfer duty paid,* firmed from an average monthly level of R215 million in the first seven months of 2001 to R244 million in the remainder of 2001 and R282 million in the first quarter of 2002. However, the amount of transfer duty paid began to decline in February 2002. This was probably in response to a weakening of trading conditions in the real-estate market caused by the increase in the cost of mortgage financing in the second half of January.

Real-estate market: Transfer duty collected



Seasonally adjusted

Non-bank financial intermediaries

The decline in the yields on interest-bearing securities from May 2000 to November 2001 was, *inter alia,* driven by the shrinking *supply* of government and public-sector debt securities and the increased *demand for these securities by the non-bank financial intermediaries* (i.e. insurers, unit trusts and private and official pension funds). These institutions' holdings of domestic debt securities as a percentage of their total assets increased from 19 per cent in the fourth quarter of 1999 to 21 per cent in the fourth quarter of 2001.

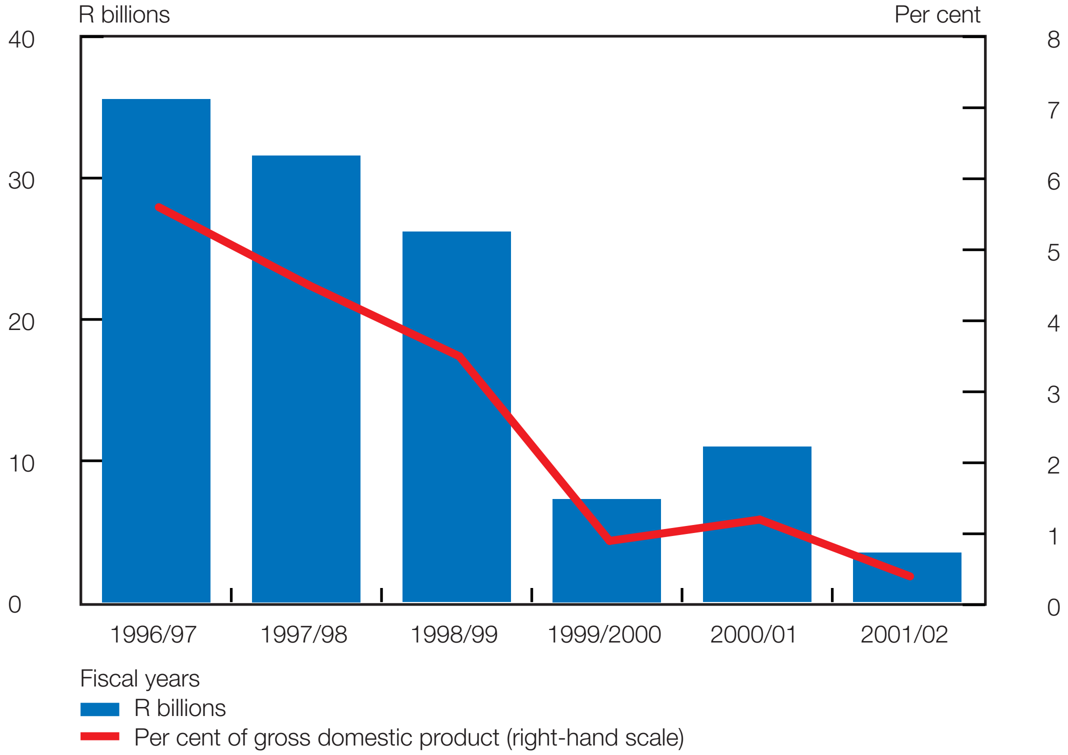
The constrained supply of new debt securities was eased somewhat by non-residents' net sales of fixed-interest securities in the secondary bond market and the increase in the outstanding nominal value of listed private-sector loan stock. The strong increase in the demand for fixed-interest securities was reflected in increases in institutional investors' holdings of this type of assets of R28,5 billion in 2000 and R57,4 billion in 2001.

Public finance

Non-financial public-sector borrowing requirement

The financial results of the non-financial public sector (i.e. the consolidated central government, provincial governments, local authorities and non-financial public enterprises and corporations) showed a deficit of R4,1 billion in fiscal 2001/02 which was R7,5 billion less than in the previous fiscal year. As a ratio of gross domestic product, this borrowing requirement amounted to 0,4 per cent in fiscal 2001/02 compared with 1,3 per cent in the previous fiscal year. This decline is evidence of government's resolve to contain the public sector's borrowing requirement.

Non-financial public-sector borrowing requirement



The decline in the overall borrowing requirement was largely due to prudent financial management by general government and non-financial public-sector businesses. Capital expenditure was at a relatively low level, contributing to the containment of public-sector borrowing. In addition, the financial surplus of the non-financial public-sector businesses worsened modestly from R5,6 billion recorded in fiscal 2000/01 to R5,5 billion in fiscal 2001/02, offsetting deficits elsewhere in the public sector.

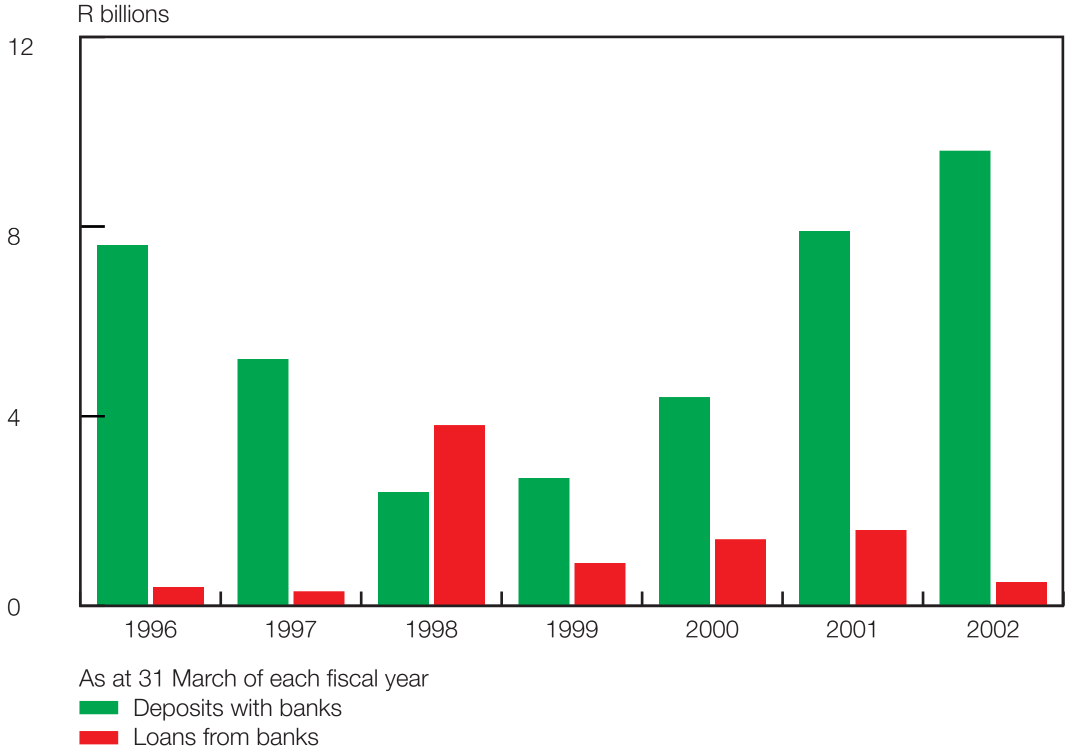
The borrowing requirement of the consolidated general government shrank from R17,2 billion in fiscal 2000/01 to R9,7 billion in fiscal 2001/02. The financial position of the national government and of the provincial governments improved impressively during the recently completed fiscal year, but that of the local governments deteriorated overall.

An analysis of the *Statement of revenue, expenditure and borrowing* of the provincial governments indicates that these administrations recorded a surplus of R4,1 billion in fiscal 2001/02. This surplus was slightly higher than the surplus of R3,6 billion recorded in the previous fiscal year. Total grants received by the provincial governments from the national government amounted to R121,7 billion during fiscal 2001/02 or 12,1 per cent more than in the preceding fiscal year. Conditional grants included under these transfers amounted to R16,4 billion in fiscal 2001/02 compared with R14,2 billion in the previous fiscal year. These transfers are earmarked to be spent on specific projects by the provincial governments.

Capital spending by provincial governments amounted to R10,0 billion during the 2001/02 fiscal year, representing an increase of 38,7 per cent over the rather low level of such spending in the previous fiscal year. Although capital expenditure increased quite substantially in the past fiscal year, it still represented only 8,1 per cent of the total expenditure by provincial governments.

The bank indebtedness of the provincial governments decreased from R1,6 billion at the end of March 2001 to R0,5 billion at the end of March 2002, whereas their deposits with the banking sector increased from R7,9 billion to R9,6 billion over the same period.

Finances of provincial governments



Local government financial statistics indicate a deterioration from a deficit of R1,5 billion recorded in fiscal 2000/01 to a deficit of R3,4 billion in fiscal 2001/02. The financial position of some local governments was adversely affected by the large-scale non-payment for services provided to certain communities.

The borrowing requirement of both the extra-budgetary and social security funds improved in fiscal 2001/02 compared with the financial results reported for the previous fiscal year. The small financial surplus of the social security funds was due to an additional transfer by national government to the Unemployment Insurance Fund (UIF). An amount of R605 million was transferred to enable the UIF to repay outstanding debt to the Department of Labour and to finance the restructuring of the fund. The restructuring was necessitated by the introduction of the new Unemployment Insurance Act which came into effect on 1 April 2002.

National government finance

The preliminary outcome of national government finances indicates that national government expenditure in fiscal 2001/02 amounted to R262,7 billion – R4,4 billion more than the originally budgeted provision, but close to the revised estimate presented to Parliament by the Minister of Finance in February 2002. This resulted in a year-on-year rate of increase in government expenditure of 12,3 per cent in fiscal 2001/02, which exceeded the original budget target of 10,4 per cent.

The year-on-year rate of increase in national government expenditure in fiscal 2001/02 was higher than the increase of 8,1 per cent recorded in the previous fiscal year and also exceeded the average year-on-year rate of increase of 8,5 per cent in the preceding five fiscal years.

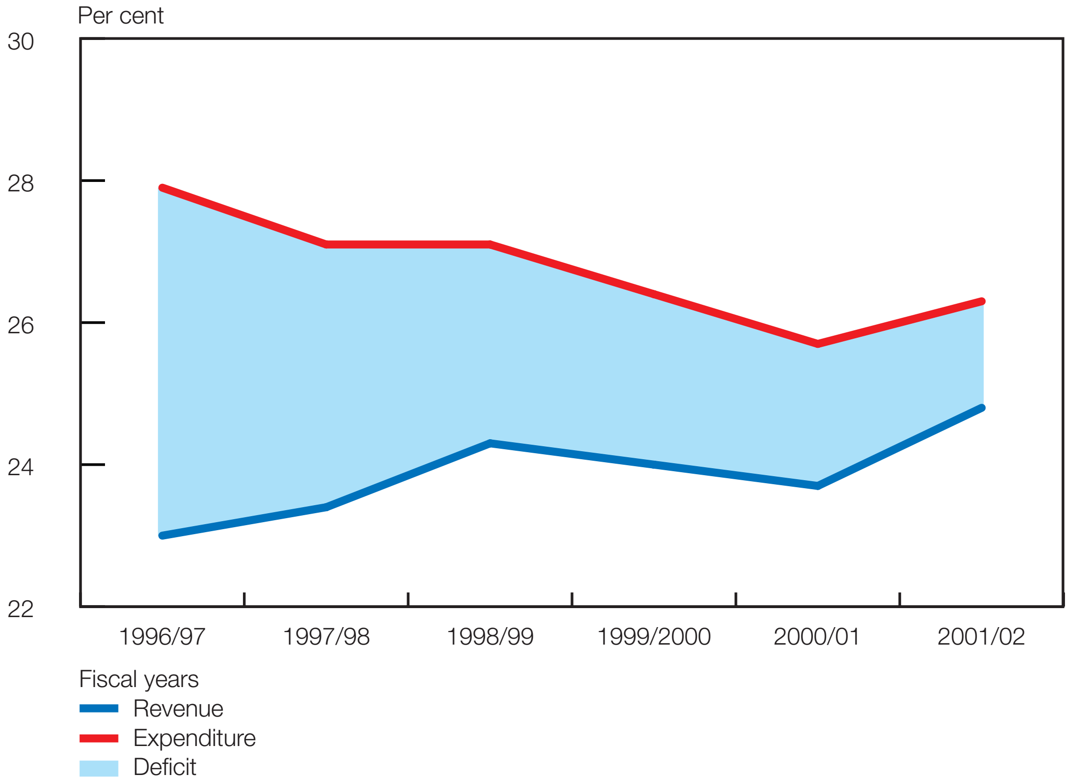
Growth in the interest paid by the national government was well contained and increased by just 2,3 per cent to R47,4 billion in fiscal 2001/02. This rate of increase was well below the 5,1 per cent increase recorded in the previous year, and was appreciably lower than the average rate of increase of 9,7 per cent in the preceding five fiscal years. Lower interest rates, appropriate borrowing strategies and the steady decline in the borrowing requirement of national government in recent years, jointly contributed to the slower growth in the interest burden. In his presentation to Parliament of the Budget for fiscal 2001/02, the Minister of Finance indicated that debt service cost would decrease from 5,5 per cent of gross domestic product in fiscal 1999/2000 to 4,9 per cent in fiscal 2001/02. In the end, interest payments as a ratio of gross domestic product in fiscal 2001/02 amounted to 4,7 per cent, outperforming the original estimate by a fair margin.

National government transferred R105,3 billion, equivalent to 40,1 per cent of its total expenditure, to provincial governments as their equitable share of the revenue pool. Although only 5,6 per cent of the spending by the national government was of a capital nature, the capital expenditure in fiscal 2001/02 represented an increase of almost 90 per cent from the previous fiscal year.

National government expenditure as a ratio of gross domestic product amounted to 26,3 per cent in fiscal 2001/02, slightly up from the 25,7 per cent recorded in the preceding fiscal year. After allowing for cash-flow adjustments (i.e. transactions recorded as a result of timing differences between the recording of transactions and bank clearances, and late departmental requests for funds), government's expenditure amounted to R258,8 billion in fiscal 2001/02, which was 10,5 per cent higher than in the previous fiscal year.

The *Statement of national revenue, expenditure and borrowing* indicates that unaudited national government revenue increased by 14,8 per cent to R247,6 billion in fiscal 2001/02 – R14,2 billion more than the original budget estimate, but slightly less than the revised estimate of R248,4 billion presented to Parliament in February 2002. The rate of increase was considerably higher than the rate of increase of 8,3 per cent originally envisaged in the Budget for fiscal 2001/02.

National government finances as percentage of gross domestic product



The rate of increase in national government revenue in fiscal 2001/02 was higher than the rate of increase of 9,2 per cent recorded in the previous fiscal year and also well above the average year-on-year rate of increase of 11,2 per cent in the preceding five fiscal years.

As shown in the accompanying table, the increase in national government revenue was primarily due to stronger-than-envisaged growth in taxes on income and profits, especially by companies, but the strong growth rate can also be attributed to continued improvements in the efficiency of tax collections. Collection of secondary tax on companies increased from R4,0 billion in fiscal 2000/01 to R7,2 billion in fiscal 2001/02 as a result of the step-up in the distribution of dividends by companies.

National government revenue as a ratio of gross domestic product amounted to 24,8 per cent in fiscal 2001/02, compared with 23,7 per cent in the previous fiscal year. National government's cash revenue (revenue adjusted for timing differences between the recording of transactions and bank clearances) amounted to R248,0 billion, representing an increase of 14,8 per cent in fiscal 2001/02 compared with the previous fiscal year.

The net result of the higher-than-budgeted revenue and expenditure was a national government deficit before borrowing and debt repayment of R15,1 billion in fiscal 2001/02. The actual deficit was much lower than the originally budgeted deficit of

National government revenue in fiscal 2001/02
R billions

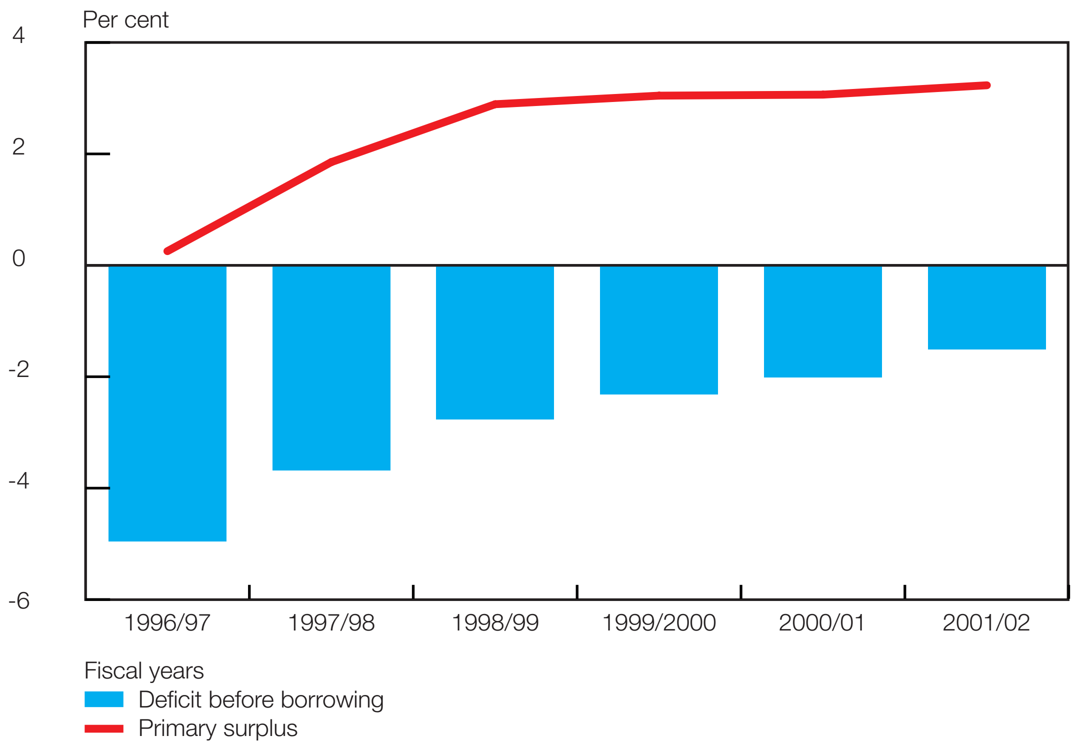
Revenue source	Originally budgeted	Actual
Taxes on income and profits	131,6	147,3
Payroll taxes	2,8	2,7
Taxes on property	4,7	4,6
Domestic taxes on goods and services	86,7	86,8
Taxes on international trade and transactions	9,4	9,0
Other revenue	6,4	5,4
Less: SACU* payments	8,2	8,2
Total revenue	**233,4**	**247,6**

* Southern African Customs Union

R24,9 billion, but slightly exceeded the revised estimate of R14,1 billion presented to Parliament in February 2002. The national government deficit before borrowing and debt repayment as a ratio of the gross domestic product amounted to 1,5 per cent in fiscal 2001/02 compared with a ratio of 2,0 per cent in the previous fiscal year.

The *primary balance* (i.e. the deficit recalculated by excluding interest payments from total expenditure) reached a surplus of 3,2 per cent of gross domestic product in fiscal 2001/02, slightly higher than the 3,1 per cent recorded in the previous fiscal year.

National government balances as percentage of gross domestic product



The cash deficit amounted to R10,8 billion in fiscal 2001/02. Apart from financing this deficit, national government also had to fund the cost of revaluing maturing foreign loans amounting to R47 million and a premium of R2,1 billion paid on debt portfolio restructuring.

Although the proceeds from the restructuring of state assets contributed less than originally anticipated, extraordinary revenue nevertheless made a significant contribution towards reducing the net borrowing requirement of national government in fiscal 2001/02. Receipts from the restructuring of government assets consisted of a special dividend of R2,2 billion received from the South African Special Risks Insurance Association (Sasria) and a dividend of R1,4 billion declared by the transport utility Transnet. This dividend followed from the monetisation of Transnet's interest of 20 per cent in M-Cell, an information and telecommunications company.

National government financing in fiscal 2001/02
R billions

Instrument	Originally budgeted	Actual
Deficit	**24,9**	**10,8**
Plus: Extraordinary payments	0,6	2,1
Revaluation of maturing foreign loans	0,0	0,1
Less: Extraordinary receipts	18,0	4,0
Net borrowing requirement	**7,5**	**9,0**
Domestic primary capital market		
Government bonds	...	-9,1
Less: Discount on government bonds	...	3,2
Net receipts from government bonds issued	**-7,4**	**-12,3**
Treasury bills	3,5	-8,0
Foreign loans	11,4	33,2
Change in available cash balances*	-	-3,9
Total net financing	**7,5**	**9,0**

* Increase -, decrease +

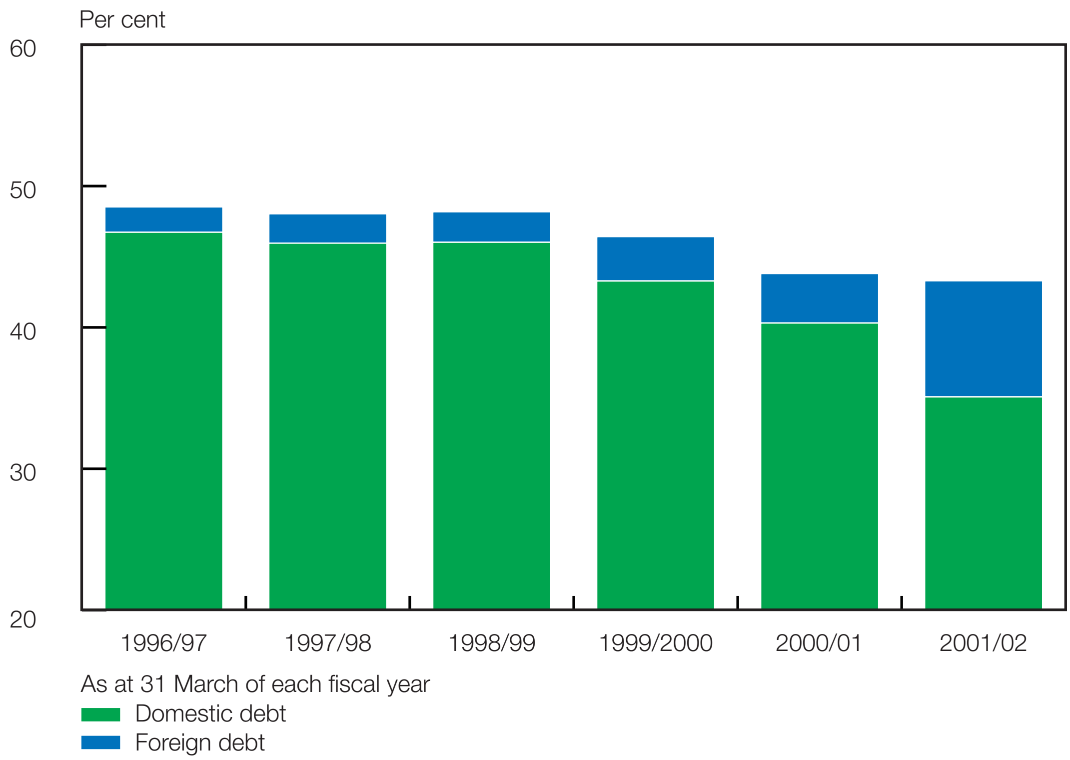
The greater part of national government's net borrowing requirement in fiscal 2001/02 was financed through the issuance of bonds in the foreign capital market. Total foreign loans arranged during fiscal 2001/02 amounted to R33,2 billion compared with the R11,4 billion originally envisaged in the Budget for 2001/02. Amounts drawn on the export credit facility which had been arranged specifically for the Special Defence Procurement Programme, amounted to R3,4 billion in fiscal 2001/02. National government also assumed liability for a syndicated loan denominated in US dollars, initially concluded with the Reserve Bank as debtor. The proceeds of this loan amounted to R17,5 billion. In addition, the reopening of an existing US dollar loan contributed R2,8 billion to the National Revenue Fund. Earlier in the financial year, the floating of a Eurobond yielded R3,6 billion while two Samurai issues yielded R5,9 billion.

In April 2002 the National Treasury announced the launch of a new 10-year US dollar bond, maturing in April 2012 with a coupon rate of 7,375 per cent. This transaction is the national government's largest new foreign loan issued in the capital market so far and reportedly attracted interest from a number of new investors. With this transaction government also concluded its planned funding in foreign markets for fiscal 2002/03.

The excess foreign funding allowed the National Treasury to redeem net amounts of Treasury bills and domestic government bonds during fiscal 2001/02. Gross funding by means of issuing long-term domestic bonds in fiscal 2001/02 was obtained at an average rate of 8,5 per cent per annum and short-term instruments were sold at an average rate of 9,4 per cent per annum. These rates can be compared with budgetary assumptions of 11,6 per cent and 10,0 per cent, respectively.

The issuance of debt instruments, the discount on new government bond issues and the revaluation of foreign debt at a depreciated exchange value of the rand, led to an increase in the loan debt of national government from R399,3 billion at the end of March 2001 to R432,3 billion at the end of March 2002. As a ratio of gross domestic product, the national government's loan debt decreased from 43,8 per cent at the end of March 2001 to 43,3 per cent at the end of March 2002. The contribution of foreign loans to this ratio increased from 3,5 per cent at the end of March 2001 to 8,2 per cent at the end of March 2002.

National government loan debt as percentage of gross domestic product



Statement of the Monetary Policy Committee

14 March 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 began to build up during the fourth quarter of 2001, activitated by the first-round effects of the depreciation in the value of the rand and steep increases in food prices. This became clearly reflected in the quarter-to-quarter change in the all-goods production price index (PPI) which rose from a seasonally adjusted and annualised rate of 6,4 per cent in the third quarter of 2001 to 11,3 per cent in the fourth quarter. The twelve-month rate of increase in this index also accelerated from 7,8 per cent in September 2001 to 8,3 per cent in December and 11,5 per cent in January 2002.

As could be expected, CPIX inflation was not immediately affected to the same extent because of the lag between producer and consumer price increases. The quarter-to-quarter increase in the CPIX index nevertheless rose from an annualised rate of 5,9 per cent in the third quarter of 2001 to 6,8 per cent in the fourth quarter. Measured over periods of twelve months, CPIX inflation accelerated from below the psychologically important level of 6 per cent in September 2001 to 6,5 per cent in December and 7,1 per cent in January 2002.

This increase in consumer price inflation was mainly due to changes in food prices. The CPIX inflation excluding food rose by only 5,6 per cent in January 2002 when compared with the same month in the preceding year. The steep increase in food prices, in turn, was largely the result of a depreciation in the external value of the rand. On a trade-weighted basis the exchange rate of the rand declined by more than 34 per cent in the last half of 2001. Import and export parity pricing have become common practice in the now largely deregulated agricultural sector. Despite relatively good crops in 2001, food prices accordingly increased substantially. In particular, a rise in the maize price was the main driver of food price inflation because of its effect on the prices of other agricultural produce.

The depreciated value of the rand also began to affect the prices of other commodities towards the end of 2001. The weakness of the rand was probably related to a number of factors, such as domestic spending in excess of national disposable income, unfounded expectations of an immediate abolition of exchange control, leads and lags in foreign payments and receipts and negative socio-political perceptions of the region. Although changes in monetary policy will have little impact on the first-round price effects of the depreciation of the rand, it is nevertheless important that measures be taken to prevent a continuation of upward price adjustments. The timely response of monetary policy is intended to help prevent second-round price increases, making the attainment of the inflation target far less onerous.

A tighter monetary policy stance is also indicated by other developments, including:

- A rise in inflation expectations. The survey conducted by the Bureau for Economic Research of the University of Stellenbosch, released today, clearly indicates that inflation expectations in South Africa have increased. This is confirmed by other indicators of inflation expectations such as the higher and steeper yield curve and the increase in the monthly average implied or break-even inflation rate since December 2001. (This rate equates the nominal return on government's conventional long-term bonds with the real yield on inflation-linked bonds.)

- Domestic spending in excess of national disposable income. Growth in domestic expenditure accelerated during the second half of 2001. This was the combined result of an increase in inventory investment and real domestic final demand. The consumption expenditure of households and government as well as gross fixed capital formation continued to increase at a steady pace. The higher rates of growth in domestic spending than in income were reflected in deficits on the current account of the balance of payments in the third and fourth quarters of 2001. These deficits, which were still relatively small, mainly reflected a strong demand for imports and a decline in the volume of exports which were neutralised somewhat by an improvement in the terms of trade. Projections show that the current account will remain in deficit during most of 2002. It is also disconcerting that the rise in domestic spending was accompanied by a substantial increase in credit growth. The quarter-to-quarter growth in the credit extension of banks to the private sector accelerated considerably from an annualised rate of 2,8 per cent in the first quarter of 2001 to 14,2 per cent in the third quarter and 17,9 per cent in the fourth quarter.

- A rising trend in nominal unit labour cost. Unit labour cost picked up from an average rate of 2,9 per cent in 2000 to a year-on-year rate of 4,3 per cent in the first nine months of 2001. The unit labour cost in the manufacturing industry rose even more sharply from a year-on-year rate of 1,6 per cent in the first quarter of 2001 to 7,1 per cent in the third quarter. This development reflects a slower pace of increase in productivity than in nominal compensation of labour.

- The high growth in money supply. Although the quarterly growth in the broadly defined money supply slowed down in the fourth quarter of 2001, growth over twelve months remained high at levels of 17,0 per cent in December 2001 and 19,3 per cent in January 2002. Moreover, the narrowest monetary aggregate (MIA) continued to increase at exceptionally high quarter-to-quarter rates in the second half of 2001. This may merely reflect a strong preference for liquid assets, but it could also indicate a positioning to step up future spending.

Although the effects of these developments can be neutralised to some extent by the excess production capacity in the economy and continued fiscal discipline, the Monetary Policy Committee is of the opinion that they warrant a more restrictive monetary policy stance. The committee has therefore decided to increase the repurchase rate by 100 basis points to 11,50 per cent per annum with effect from 15 March 2002. It is expected that this will lead to similar adjustments in deposit and lending rates in the domestic market.

The Monetary Policy Committee realises that this increase might have a negative effect on domestic economic growth over the short term in an international environment characterised by a hesitant and apparently slow economic recovery. Monetary discipline is, however, essential for price stability and sustainable high economic growth. The negative effect of higher interest rates on short-term growth may also be neutralised to a large extent by the very competitive external value of the rand, which will in all likelihood lead to substantially higher exports when the world economic recovery gathers momentum.

The modalities of International Monetary Fund conditionality – further considerations[1]

by B T Thoka

Introduction

The International Monetary Fund (IMF) has, since its establishment in 1944, evolved into a major actor in the international economic and financial arenas. This development can be attributed largely to the global economic shocks of the 1960s, 1970s and 1980s and more recently to the major financial crises of the 1990s. In tandem with these changes, the role and responsibilities of the IMF as an international financial institution have consequently expanded considerably and in so doing, inspired vigorous debate and discussion among policy makers, IMF member countries and academics.

A major issue of contention is the appropriate scope and intrusiveness of IMF conditionality. There are two prominent issues at the core of the debate and discussions: one is the issue of the ownership of Fund-supported programmes and the other, the issue of streamlining or simplifying IMF conditionality.

A recent IMF response was the publication of an IMF *Staff Paper*, titled "The modalities of conditionality – further considerations." The authors of the paper accept that conditionality should be simplified and greater ownership be assumed by member countries receiving IMF support. The paper proposes two approaches which would incorporate the aforementioned issues, namely outcomes-based conditionality and floating tranche conditionality. Both approaches are distinct, albeit related concepts.

This paper begins by giving a historical overview of the evolution of IMF conditionality from its simple origins to a complex set of instruments utilised for the purpose of monitoring compliance. Next it summarises outcomes-based conditionality and floating tranche conditionality. Then the relationship between programme ownership and conditionality and also the process of streamlining conditionality are reviewed. The paper ends with a broad overview of some unresolved issues and summarises South Africa's position in the ongoing debate.

Overview of conditionality

The formulators of the IMF's original Articles of Agreement concurred that the key function of the IMF would be to monitor and maintain the Bretton Woods's par value exchange rate system, and lend money on a revolving basis to member countries facing short-term payment imbalances.[2] The concept of conditionality was not mandated in these Articles of Agreement. The first "conditional" IMF loan, the Stand-by Arrangement, was introduced in 1952. A Stand-by Arrangement was initially conceived as an agreement between a member country and the IMF, allowing the member country access to a certain portion of its quota if it maintained certain policy targets within a relevant time period.[3] Peru became the first recipient of a Stand-by Arrangement in 1954.

The Stand-by Arrangement underwent several modifications up to 1957 when leading IMF theoretician, Jacques Polak, published an article titled "Monetary analysis of income formation and payments problems." This article significantly influenced the IMF to formally adopt policy-based conditionality as the basis for the IMF's lending

1 This paper originated as a briefing report submitted to the senior management of the Research Department of the South African Reserve Bank (SARB). The report emanated in part as a response to a request by Dr C D R Rustomjee, IMF Africa Group 1 Constituency Executive Director, that the SARB should submit comments on an IMF Staff Paper titled "The modalities of conditionality – further considerations". These comments were submitted and considered by the IMF's Executive Directors.

The author would like to thank his colleagues in the Research Department for their comments and contributions. The views expressed in this paper are those of the author and do not necessarily reflect those of the South African Reserve Bank.

2 Dell, S. 1981. *On being grandmotherly: the evolution of IMF conditionality.* Essays in International Finance, *No 144 (October). Schadler, S. et al. 1995. Experience under Stand-by and Extended Arrangements. Part 1: Key issues and findings.* Occasional Paper *No 128. International Monetary Fund, Washington, DC.*

3 *Spitzer, E. 1969. Stand-by Arrangements: purposes and form, in Margaret G de Vries and Keith Horsefield (eds.)* The International Monetary Fund 1945-1965: twenty years of international monetary cooperation. *Vol. II. Washington, DC, International Monetary Fund.*

The IMF defines the Stand-by Arrangement (SBA) as a non-concessional loan designed to address short-term balance-of-payments problems and is the most widely used facility of the IMF. The length of an SBA is typically 12-18 months. Repayment is normally expected within 27 months to 48 months, unless an extension is approved. Surcharges apply to high levels of access.

operations. Polak argues that the basis upon which an IMF loan should be granted ought to involve linking the restoration of balance-of-payments imbalances to monetary, fiscal and exchange rate policies. In other words, the IMF should not focus solely on the balance of payments to restore stability, but consider how other policies such as monetary, fiscal and exchange rate policies could be adjusted. Paraguay was allocated the first such loan arrangement in 1957.

Stand-by Arrangements were expanded subsequent to the Paraguay loan arrangement. Member countries were guaranteed access to larger portions of their quota and the Stand-by Arrangement remained active for a longer time. Dell observes that these larger loans required more "justification", meaning more conditionality.[4] As a result of this development, the IMF decided to incorporate the practice of conditionality explicitly into its Charter. The First Amendment to the Articles of Agreement on 28 July 1969 outlines the IMF's position with respect to conditionality.

4 *Dell, S. 1981. On being grandmotherly: the evolution of IMF conditionality.* Essays in International Finance, *No 144 (October).*

Initially, IMF loan programmes were stabilisation programmes which attempted to solve temporary balance-of-payments problems by focusing on monetary, fiscal and exchange rate policies. IMF programmes later turned into structural adjustment programmes which address chronic balance-of-payments shortfalls and low production growth. In addition, though economic growth and poverty alleviation were not explicit goals of the IMF at its inception, both have evolved into central goals in many of the IMF's recent lending facilities.[5] Stand-by Arrangements continued to be the dominant loan vehicle until the international economy experienced major shocks throughout the 1970s, 1980s and 1990s.

5 *Polak, J. 1991. The changing nature of IMF conditionality.* Essays in International Finance, *No 184 (September). Princeton, New Jersey. International Finance Section, Department of Economics, Princeton University.*

These shocks were the oil price increases of the 1970s, the ensuing Third World debt crisis of the 1980s and the financial crises in Mexico, Russia and Asia in the 1990s. All these events gave rise to the emergence of new loan programmes with different purposes and, of course, the expansion of the scope of conditionality. These included the Extended Fund Facility (EFF) established in 1974, and the Structural Adjustment Facility (SAF) established in 1986 to provide balance-of-payments assistance on concessional terms to low-income developing countries. The terms of the SAF constitute conditionality. The Enhanced Structural Adjustment Facility (ESAF) replaced the SAF and was established in 1987 to provide resources to low-income members undertaking strong three-year macroeconomic and structural adjustment programmes. These facilities are known as extended arrangements. All facilities focused on quantified targets such as ceilings for bank credit extensions, the budget deficits, foreign borrowing, external debt arrears and international reserves. The ESAF was reorganised in 1999 into the Poverty Reduction Growth Facility (PRGF) with the objective to foster durable growth, in this way raising standards of living and reducing poverty. The facilities introduced during the 1980s and 1990s reflected the IMF's commitment to fashioning these lending windows so that they would address both macroeconomic and structural reforms.

In 1978 the Second Amendment of the Articles of Agreement came into effect. This amendment includes two important changes: firstly, the establishment of the right of members to adopt exchange rate arrangements of their choice and secondly, with specific regard to conditionality, the expansion of the IMF's surveillance responsibilities. For example, IMF Article IV Consultation Country Mission teams were charged with expanding their evaluations of a country's economic and development prospects by including greater attention to structural problems. This focus led the IMF to consider structural issues and include structural policy conditions in its programmes.

The key components of structural policy conditions in IMF-supported programmes are the instruments used in monitoring compliance with such programmes. There are four such instruments:

- Performance Criteria (PC). The primary purpose of the PC is to provide a direct link between programme implementation and the disbursement of IMF resources. When a recipient country meets a specified criterion on a set date, the IMF disburses the necessary funds. However, if this does not occur, funds are not disbursed unless the IMF issues a waiver. Waivers are issued only when significant exogenous factors obstruct the programme.

- Prior actions. These are the policy measures a member country agrees to take before an IMF agreement is put into effect.

- Structural benchmarks (SBMs). SBMs serve as indicators that facilitate the evaluation of the progress of policy implementation.

- Programme reviews. These are similar to SBMs in that they also assess the implementation of policies. The difference is that they focus specifically on those policies that do not comply with performance criteria.

Efforts by member countries to achieve satisfactory compliance with IMF programmes have inadvertently led to the IMF placing greater reliance on prior actions. Goldstein states that the result has been the proliferation of "... more wide-ranging and detailed structural policy conditions." [6]

6 *Goldstein, M. 2000. IMF structural conditionality: how much is too much? Paper presented at the* NBER Conference on Economic and Financial Crisis in Emerging Market Economies. *Woodstock, Vermont: USA.*

Many of the less-developed member states, particularly those in sub-Saharan Africa, expressed strong concerns about the form and substance of conditionality. They argued that the IMF was overstepping its mandate and core area of expertise, using its financial leverage to promote an extensive policy agenda and short-circuiting national decision-making processes. A further concern was that IMF conditionality had evolved to become unduly pervasive and had consequently detracted from the implementation of desirable policies by undermining the recipient member country's ownership of programmes. These concerns were expressed internally in the IMF and externally, and have been incorporated into the Executive Board's ongoing discussions on conditionality. One of the IMF's responses has been to publish a *Staff Paper* which proposes two approaches to conditionality. At the core of these proposals are two central concepts: the streamlining of conditionality and programme ownership. These proposals are discussed in the following section.

Outcomes-based and floating tranche conditionality [7]

Outcomes-based conditionality

The first proposal is referred to as outcomes-based conditionality. As the name suggests, greater emphasis is placed on the required results or outcomes. The paper suggests that this approach would make the availability of IMF financing conditional on the achievement of specified outcomes, such as bank recapitalisation, improved tax enforcement and the liberalisation of foreign exchange markets. In this instance, less emphasis is placed on the *steps* toward outcomes. The main argument for this approach is that it would give the recipient country greater flexibility in choosing the appropriate method of achieving the agreed objectives and thus of enhancing ownership.

7 *The modalities of conditionality – further considerations. IMF* Staff Paper. *2002. IMF, Washington, DC.*

8 *The modalities of conditionality – futher considerations. IMF* Staff Paper. *2002:8. IMF, Washington, DC.*

Examples of financial institutions which have initiated outcomes-based conditionality are the Asian Development Bank (ADB) and the Inter-American Development Bank (IADB). The former introduced the Programme Cluster Approach (PCA) in 1999. The latter approved a pilot project for Guarantee Disbursement Loans in 2000.[8]

Outcomes-based conditionality has two main benefits. Firstly, the member country would be responsible for the design of policies to achieve desired goals. Hence the country would bear the risk of success or failure. As the design of policies would be the country's responsibility, this approach would enhance ownership by ensuring that the authorities and the IMF would agree only on the objectives of the programme. Secondly, IMF funds would only be disbursed when certain goals had been attained, and incentives would be provided for both the IMF and the country to formulate appropriate policies.

This approach has several risks. Firstly, it has the potential to create uncertainty about the availability of IMF funds, since the agreed policies may not necessarily lead to the envisaged results. Secondly, there may be significant lags in the reporting of data on outcomes, particularly for the real sector and the trade accounts. The data may also be subject to frequent revisions, making timely monitoring and disbursements problematic. Finally, programme objectives are influenced not only by policies under the control of the recipient country, but also by exogenous factors which might lead to the destabilisation of programmes or the non-attainment of goals.

Floating tranche conditionality

Current IMF-supported programmes have specific deadlines. The majority of member countries believe that these rigid schedules have placed severe constraints on their choices, as well as straining their implementation capacity. In response to this concern, the *Staff Paper* suggests floating tranche conditionality as the second alternative proposal. The authors claim that programmes could be designed to allow for greater flexibility in the timing of the implementation of structural reform measures, thus increasing the scope for greater ownership. This may be achieved through the use of floating tranche conditionality for structural measures. Under this approach, the availability of a loan disbursement would not be tied directly to any specific date. Instead, the disbursement would become available upon the completion of certain agreed structural reforms.

9 *Operations Evaluation Department. 1999.* Higher Impact Adjustment Lending (HIAL): initial evaluation. *World Bank, Washington, DC.*

For this proposal, the IMF has taken into account a review of the experience with a form of floating tranche conditionality, namely the Higher Impact Adjustment Lending (HIAL), which the World Bank introduced in the Africa region in 1995. This approach had two objectives. Firstly, it afforded governments more freedom in the timing of agreed reforms, thus increasing ownership. Secondly, the approach sought to reduce pressure on the World Bank to disburse funds when conditions were not met. These objectives were to be achieved through the disbursement of multiple tranches. The further benefits of this approach are highlighted in a study[9] conducted by the Operations Evaluation Department of the World Bank in 1999. This study found that the HIAL initiative was associated with positive policy outcomes in terms of fiscal adjustment and interest rate policy. In addition the HIAL participants had a clear edge over non-participants in achieving lower inflation, improved current-account balances, stabilised foreign exchange reserves, faster economic growth rates and a sustainable debt path.

Programme ownership and streamlining conditionality

Ownership and conditionality

The IMF has acknowledged in principle that programme ownership should feature as a major component in conditionality. A major problem, though, is that the relationship between programme ownership and conditionality remains complex. This is largely because of the difficulty in reaching consensus on the definition of ownership. This observation is supported by the presence of various definitions of programme ownership offered in the literature on IMF conditionality.

The IMF defines ownership as "... a willing assumption of responsibility for an agreed program of policies, by officials in a borrowing country who have the responsibility to formulate and carry out those policies, based on an understanding that the program is achievable and is in the country's own interest." [10]

Boughton proposes that one way of addressing this lack of conceptual consensus would be to provide a clear distinction between programme ownership by a member country and the policies imposed by the IMF. Such an exercise, he points out, poses three important challenges, particularly if the IMF's definition is accepted. Firstly, ownership is not directly observable. As a result, any efforts to discern ownership are reduced to highly subjective observations. Secondly, ownership must be understood as a dynamic process involving "... dialogue, negotiation, and signalling" that could strengthen ownership over time. Thirdly, ownership may include several potential owners. Therefore ascertaining the degree of ownership remains a difficult task, for ownership cannot be allocated solely, for example, to the Central Bank, Ministry of Finance or other key ministries.[11]

10 *International Monetary Fund, 2001.* Strengthening country ownership of Fund-supported programs *(5 December).*

http://www.imf.org/external/np/pdr/cond/2001/eng/strength/120501.htm (accessed 15 May 2002).

11 *Boughton, J. and Mourmouras, A. 2002. Is policy ownership an operational concept?* IMF Working Paper. *April 2002. IMF, Washington, DC.*

Streamlining conditionality

The principle of simplifying, or streamlining, IMF conditionality has been accepted by the IMF, member countries and other interested observers. After a meeting on 29 April 2001, the IMF's International Monetary and Financial Committee (IMFC) endorsed the need to implement a new approach to conditionality by reducing the often numerous conditionality requirements on a member country. The committee's communiqué states that streamlining conditionality shifts "... the presumption of coverage from one of comprehensiveness to one of parsimony". Goldstein has long urged the IMF to re-examine the issue of streamlining conditionality.[12] Goldstein and other observers agree that IMF funds should not be disbursed without conditions. Rather, their concern has been about the sharp rise in the number of conditions attached to programmes. Goldstein suggests eight approaches that may be applied to the streamlining of conditionality:

- Structural preconditions;
- collaterised IMF lending;
- the definition of conditionality in terms of outcomes instead of structural policies or benchmarks;
- placing restrictions or penalties on foreign-currency borrowing;
- greater recourse to international standards;
- leaner structural conditionality within present arrangements;
- allowing the IMF to borrow in the private capital market; and
- establishing a clear division of responsibility with the World Bank and more outsourcing of structural conditionality in non-core areas.[13]

12 *Goldstein, M. 2000. IMF structural conditionality: how much is too much? Paper presented at the* NBER Conference on Economic and Financial Crisis in Emerging Market Economies. *Woodstock, Vermont, USA.*

13 *For an elaboration of the eight approaches see Goldstein 2000, p. 20-23.*

Unresolved issues

On 17 April 2002, in the Managing Director's report to the IMFC, the IMF announced its commitment to addressing the issues of streamlining conditionality and enhancing ownership. With respect to the proposed approaches, namely outcomes-based conditionality and floating tranche conditionality, the Executive Directors were more inclined to shift towards outcomes-based conditionality. However, the Executive Directors cautioned that the scope of floating tranche conditionality "... was likely to be limited because most policy conditions in Fund-supported programs must be implemented in a timely manner to be effective".[14]

14 Managing Director's Report to the International Monetary and Financial Committee. *17 April 2002. IMF. Washington, DC.*

The IMF's decision to revisit the issue of conditionality has been applauded in most academic and non-governmental circles. Conditionality, irrespective of any proposed changes, will remain a dominant feature in future IMF lending programmes. Though the re-evaluation of streamlining conditionality and programme ownership is clearly an important starting point in this discussion, a great deal still has to be accomplished. Questions will continue to arise about both issues, particularly regarding the measurement of conditionality and a consensual conceptualisation of programme ownership. For instance, what instruments or methods are available to determine whether conditionality is in fact an obstacle to programme objectives? Or what is the appropriate degree of conditionality? Ownership, as stated earlier, poses various problems of its own.

In the ongoing discussions on conditionality there is consequential oversight, namely the role of external financiers in IMF-supported programmes. Little is mentioned in the IMF's reports or publications about the considerable influence these financiers may have in determining the adoption and implementation of any changes in the substance and form of conditionality.

External financiers include creditor states, multilateral organisations and private financial institutions. The IMF provides only a fraction of the necessary funds to support its lending programmes and depends on external financiers to supplement these programmes. The relationship between external financiers and the IMF is aptly summarised by Polak: "... a key component of any Fund arrangement was that the resources provided by the Fund together with those from the World Bank, aid donors, commercial banks, and other sources, would cover the country's projected balance-of-payments gap. In the absence of an integral financing package, the Fund could not be confident that the degree of adjustment negotiated with the country would be sufficient. To this end the Fund sought financing assurances from other suppliers of financial assistance. In the second half of the 1980s, however, commercial banks began to exploit this approach. No longer afraid of becoming victims of generalized debt crisis, the banks began to realize that they could insist on favourable terms for themselves by blocking a country's access to Fund credit (and to other credit linked to a Fund arrangement)."[15]

15 *Polak, J in Gould, E. 2001. Money talks: the role of external financiers in influencing International Monetary Fund conditionality. Paper presented at the 2001* Annual Meeting of the American Political Science Association, *San Francisco, 30 August – 2 September 2001, p. 29.*

Gould elaborates on this relationship by quoting a former IMF Executive Director who referred to the expansion of IMF conditionality as "mission push". In other words, external financiers have "pushed" the expansion of IMF conditionality.[16] She states that the IMF gauges the success or failure of its programmes by the volume of funds received from external financiers. Furthermore, to ensure access to supplementary funding, the IMF adopts revisions to policy programmes which in effect detract from its intended objectives.[17]

16 *Polak, J in Gould, E. 2001. Money talks: the role of external financiers in influencing International Monetary Fund conditionality. Paper presented at the 2001* Annual Meeting of the American Political Science Association, *San Francisco, 30 August – 2 September 2001, p. 29.*

17 *Moe, T. 1984. The New Economics of organization.* American Journal of Political Science, *28: 739-777.*

A further complication is the variety of external financiers, all with different interests, who provide financing and in this way make demands on the IMF to include individual specific terms in their IMF conditionality arrangements. Gould points out that "... creditor states finance for political ends" whereas "... private financial institutions finance for profit ..." and "... multilateral organisations finance for policy ends".[18]

Given the above description of the relationship between the IMF and external financiers, it seems prudent to encourage greater participation by these financiers in discussions on conditionality.

South Africa's position

South Africa is not engaged in any of the IMF's lending facilities. The country's position on the issue of conditionality is intimated through contributions to discussions and debates on the restructuring of the IMF and the International Financial Architecture (IFA). During these deliberations, key South African spokespersons have strongly advocated the need for structural changes within the IMF, changes which would promote the interests of what are called the less-developed countries. South Africa therefore clearly supports the position of reviewing the IMF's policies on conditionality.

18 *Gould, E. Money Talks: The role of external financiers in influencing International Monetary Fund conditionality. Paper presented at the 2001* Annual Meeting of the American Political Science Association, *San Francisco, 30 August – 2 September 2001, p. 32.*

Notes to tables

National government debt – S-58 and S-59

This table shows the nominal value and the ownership distribution of debt instruments issued by the national government. The table was revised to exclude debt instruments which are currently not in use and sectors that do not invest in government debt.

Public finance selected data – S-144

This table shows the percentage change over one year in the aggregates appearing in the National Revenue account. The table was revised to present the same subdivisions as shown in the national government finance table (S-54).