Quarterly Bulletin

March 2003

South African Reserve Bank

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Quarterly Economic Review

Introduction

After a decade of economic expansion, growth in the United States economy slowed down in 2001. Soon after this slowdown started, the growth rates of gross domestic product began faltering in most of the other industrialised countries. Overall, growth in the advanced economies of the world fell from close to 4 per cent in 2000 to less than 1 per cent in 2001.

Some improvement in economic conditions began to emerge in the United States of America in the fourth quarter of 2001. Recovery in other parts of the world economy also set in and global economic activity strengthened considerably in the first half of 2002. However, the rapid growth experienced in the early part of that year wavered in the second half as consumer and business confidence was negatively affected by revelations of corporate accounting malpractices, declining equity values and the threat of war against Iraq. By the end of 2002 the recovery in the world economy was still fragile and not evenly distributed across all regions.

The South African economy weathered the turbulent global economic conditions of the past two years well. Until the end of 2002 domestic economic growth outpaced the rate of expansion in many parts of the world, despite losing some momentum from the first to the second half of last year. The exchange value of the rand recovered appreciably from the setbacks suffered in 2001. In a drastic reversal of events in 2001 when the weighted external value of the rand fell by 24 per cent from the end of September to the end of December, the nominal effective exchange rate of the rand jumped by 18 per cent from the end of September 2002 to the end of December 2002.

The appreciation of the exchange value of the rand in 2002 has undoubtedly helped to reduce the cost of imported intermediate and final goods, thereby helping to improve the prospects for the successful attainment of the inflation target ranges set for 2004 and 2005.

The fairly impressive performance of the South African economy is also reflected in the duration of the current upward movement of the business cycle. In December 2002 the cyclical upward movement, which had started in September 1999, has been in progress for 40 months, making this expansion the fourth longest on record in the Post World War II period. Unfortunately, the economy lost some of its lustre when growth slowed down from annualised rates of 4 per cent and 3 per cent in the second quarter and third quarter to 2½ per cent in the fourth quarter – still a fairly healthy rate compared with growth in the past.

The slowdown in growth in the second half of 2002 was mainly due to slower growth in the real value added by the secondary sectors of the economy. Activity in the tertiary sectors remained lively, while virtually no growth was registered in the primary sectors of the economy. Despite the slowdown in quarter-to-quarter growth in the last two quarters of 2002, year-to-year economic growth was 3 per cent in 2002 as a whole – still slightly higher than the growth rate recorded in 2001.

Growth in aggregate real gross domestic expenditure slowed down considerably in the fourth quarter of 2002. Despite rising real income levels of the household sector, the growth in final consumption expenditure by households decelerated. Because of the more prudent spending habits of households, their debt-to-income ratio improved further in 2002. Inventory investment was scaled down as firms aligned their inventory levels to lower expected sales volumes, thereby contributing to the slowdown in aggregate domestic spending. The growth in fixed capital formation picked up in the fourth quarter of 2002, boosted by a strong increase in capital spending by public corporations, and growth in government consumption expenditure also proceeded at a lively pace. However, the stronger growth in capital formation and government consumption spending could not prevent a general slowdown in aggregate domestic expenditure from occurring in the fourth quarter of 2002.

Overall rates of inflation were noticeably higher during 2002, largely as a result of the depreciation of the exchange value of the rand towards the end of 2001 and steep increases in food and fuel prices. These price increases fully offset the counter-inflationary effects of greater efficiency in the South African economy. Nevertheless, the expansion and modernisation of production structures in recent years and the associated improvement in efficiency have continued to boost aggregate supply and productivity, thus helping to keep in check the gathering inflationary forces. During the final quarter of 2002 and in January 2003 there were signs – especially at the level of production prices – that inflation might be abating.

The productivity growth of the first three quarters of 2002 helped to expand aggregate supply while tighter monetary conditions contributed to slower growth in aggregate demand. For 2002 as a whole, the increase in nominal aggregate supply exceeded the increase in nominal aggregate demand. The counterpart to this was that a surplus developed on the current account of the balance of payments for the first time since 1994. The overall improvement of the current-account balance also had some help from a smaller deficit on the services and income account in 2002, among other things due to lower dividend and interest payments to non-resident investors.

An expansion of aggregate supply in excess of the growth in aggregate demand is likely to ease upward pressure on the aggregate level of prices and lower overall inflation. However, productivity growth slowed down in the second half of 2002, raising concerns that faster growth in unit labour cost may spill over with some time delay into higher final-product prices in 2003.

The current-account surplus in the fourth quarter of 2002, as well as in the calendar year 2002 as a whole, was accompanied by an inflow of capital from the rest of the world. The capital inflow in the fourth quarter of 2002 consisted mainly of a net accumulation of “other” foreign investment liabilities such as loans and advances by non-resident creditors, trade finance and bank deposits. Foreign direct investment capital – which is widely regarded as a vehicle for promoting sustainable growth and rising standards of living – was still leaving the economy in the fourth quarter of 2002, while non-residents were net sellers of portfolio capital. In fact, these outflows offset in large measure the net inflow of capital classified in the “other foreign investment” category in the fourth quarter of 2002.

With surpluses on both the current and the financial accounts of the balance of payments in the fourth quarter of 2002, an increase was recorded in the country’s net gold and other foreign reserves owing to balance-of-payments transactions. In such a situation, there is a strong likelihood for an appreciation of the exchange value of the rand. The positive change in net international reserves certainly contributed to the relative strength of the rand in the fourth quarter of 2002, but a host of other factors co-determined the extent and speed of this appreciation. Among these were great confidence in economic developments arising from the sound underlying macroeconomic fundamentals of the country and relatively high gross domestic product growth. Rising international commodity prices and the wide interest rate differential between South Africa and other economies also contributed to the strengthening of the rand.

Although the amount of the country's gross international reserves valued in US dollars increased in the fourth quarter of 2002, there was a sizeable decrease in these reserves when measured in rand, virtually entirely due to revaluation losses arising from the stronger exchange value of the rand against the US dollar. Import cover accordingly fell from 20½ weeks' worth of imports of goods and services at the end of September 2002 to 17½ weeks' worth at the end of December.

The growth rates of the monetary aggregates – measured over twelve months as well as from one quarter to the next – decreased appreciably from the beginning to the end of 2002. This was in part a repetition of the monetary and credit growth cycle usually encountered after monetary policy had been tightened in the past. When bank lending rates were increased in January 2002, overall monetary growth and bank credit extension temporarily accelerated in the first quarter. This provided the monetary accommodation for a rapid increase in the general price level.

In the last three quarters of 2002, growth in M3 was reined in by the Reserve Bank's progressive tightening of its monetary policy stance. From January to September 2002 the Reserve Bank increased its interest rate on short-term repurchase transactions on four occasions by 100 basis points at a time. The growth in the broad money supply slowed down to relatively low rates in the second half of 2002, signalling a possible reduction in inflation during 2003. In the long run, and with a stable velocity of circulation of money, an increase in the money supply which is broadly consistent with the growth in real aggregate output must be associated with a relatively stable price level.

Another positive development from a counter-inflationary viewpoint was that narrow money holdings (M1A) – usually accumulated to finance spending – actually declined in the fourth quarter of 2002.

Aggregate credit growth decelerated in the first three quarters of 2002 but bounced back in the fourth quarter when the banking regulatory authority reiterated that all banks must fully report on their balance sheets those assets and liabilities arising from their involvement in repurchase and other similar transactions. Because a sizeable portion of repurchase transactions involves government securities, the implementation of these accounting procedures by delinquent banks led to a sharp increase in banks' claims on the government sector. Credit demand by private-sector businesses and households continued to grow at a modest rate in the fourth quarter of 2002.

Short-term money-market interest rates generally moved higher during 2002, either following increases in the Reserve Bank's repurchase rate or in anticipation of future increases of this rate. By contrast, a bull market in bonds took shape from about the end of March 2002, lasting well into 2003 and taking long-term bond yields to their lowest level since 1980.

Because of these divergent movements of short-term interest rates and long-term bond yields, the yield curve had assumed an inverse shape towards the end of April 2002. Since then, short-term interest rates have been consistently higher than long-term rates, causing the yield curve to slope downwards as maturities lengthen. Market participants interpret this as indicating a fairly tight monetary policy stance that will ultimately succeed in lowering price inflation.

Emulating the movement of share prices in the international financial markets, the South African all-share price index fell by 29 per cent from May 2002 to February 2003. The share prices of companies listed in the resources sector of the market were particularly hard hit by the appreciation of the exchange value of the rand. Since about the middle of 2002 this weakness in share prices probably influenced non-resident investors to reduce their equity holdings in the domestic market on a net basis.

Trading conditions in the real-estate market maintained a lively pace throughout 2002 and in the early part of 2003, apparently oblivious of the steep increase in the cost of mortgage financing over this period. Increases in house prices nevertheless tapered off in the second half of 2002 and the early part of 2003.

The management of the country's fiscal affairs continues to be sound. The national government's budget imbalance was a surplus equal to 0,2 per cent of gross domestic product in the first three quarters of fiscal 2002/03, compared with a deficit ratio of 0,6 per cent in the corresponding period of the previous fiscal year. This outturn can be attributed to strong revenue growth and steps taken to strengthen expenditure monitoring and control. Improving economic conditions, higher inflation and efficient tax administration assured that the growth in national government revenue exceeded by a sizeable margin the original budget projections for the full fiscal year, whereas the growth in expenditure was considerably closer to the budget targets. This further consolidation of the public finances during the current fiscal year helped to maintain an approximate macroeconomic balance in the South African economy, thereby making an indispensable contribution to the eventual realisation of the national policy objective of general price stability and low inflation.

Unlike the finances of the national government, the accounts of the non-financial public sector (i.e. the entire public sector, including national government, provincial governments, local governments and non-financial public-sector businesses) turned from a surplus in the first nine months of fiscal 2001/02 to a deficit in the first nine months of fiscal 2002/03. There was a deterioration in the financial imbalances of provincial governments, local governments and non-financial public-sector business enterprises. As a percentage of gross domestic product the overall non-financial public-sector deficit was still quite small: merely 0,8 per cent in the first nine months of fiscal 2002/03.

The fiscal rectitude of the past eight years or so afforded the Minister of Finance the opportunity to introduce a growth supportive budget to Parliament for fiscal 2003/04 on 26 February 2003. The Budget for fiscal 2003/04 indicates an increase in the national government deficit from 1,4 per cent of gross domestic product in fiscal 2002/03 to 2,4 per cent in fiscal 2003/04, partly due to some tax relief for lower and middle-income taxpayers and higher spending in priority areas such as health, welfare, education, economic infrastructure, HIV/Aids, and combatting and prevention of crime. The government stated further that it remains committed to a gradual approach to exchange control relaxation and demonstrated confidence by announcing further changes in exchange control in the Budget speech.

The paucity of employment growth remains an intractable problem facing policy makers in South Africa. Employment opportunities in the major formal sectors of the economy have been declining since 1989, relegating growing numbers of workers to low-quality jobs in the informal economy or into unemployment and poverty. Some improvement set in during 2002 when employment totals in the formal sectors of the economy increased for two consecutive quarters.

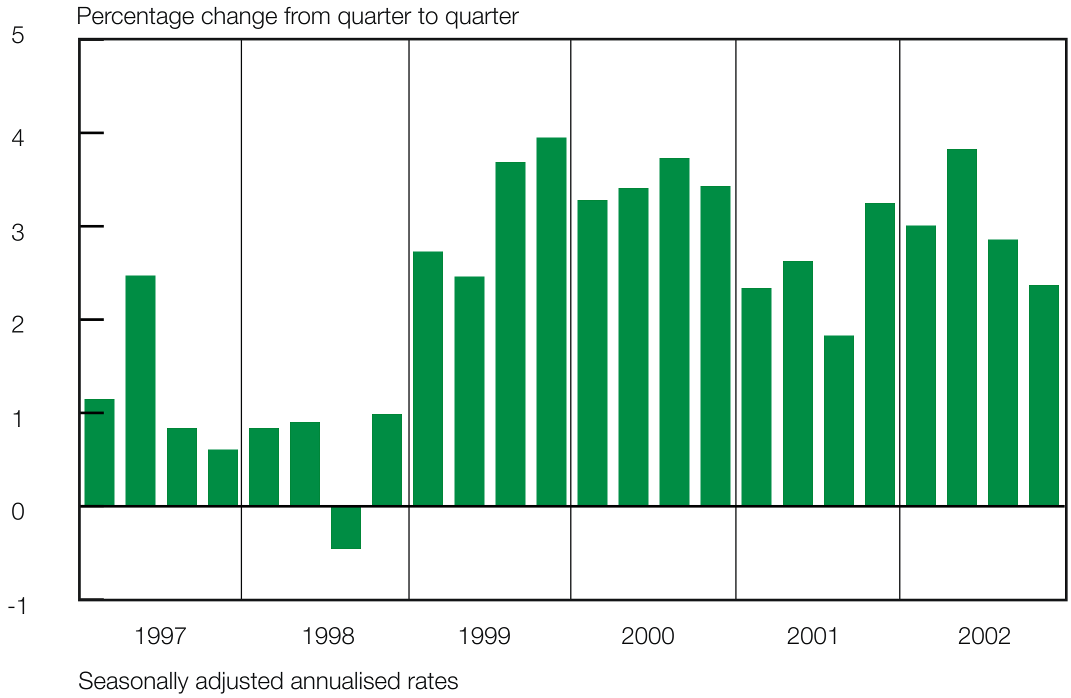
As part of a broad strategy to add impetus to the improvement in employment prospects, government has announced a Growth and Development Summit to be held in May 2003, involving the government, the organised business sector and the labour movement. The summit will seek to establish binding commitments between the three entities in order to boost growth and employment creation in a sustainable way without compromising macroeconomic stability.

Domestic economic developments

Domestic output

South Africa's *real gross domestic product* increased further in the fourth quarter of 2002 albeit at a slower pace than in the third quarter. After increasing at a quarter-to-quarter seasonally adjusted and annualised growth rate of 4 per cent in the second quarter of 2002 and 3 per cent in the third quarter, real economic growth slowed down further to 2½ per cent in the fourth quarter. This was mainly due to slower growth in the real value added by the secondary sectors of the economy. Activity in the tertiary sectors remained lively, while virtually no growth was registered in the primary sectors.

Real gross domestic product



Notwithstanding the somewhat slower growth in the fourth quarter, the South African economy grew by 3 per cent in 2002 as a whole, a growth rate that was marginally higher than that of nearly 3 per cent attained in 2001. Even though the economy lost some growth momentum in the second half of 2002, economic growth still outpaced the rate of expansion in many other parts of the world.

Following a seasonally adjusted and annualised increase of 2½ per cent in the third quarter of 2002, almost no growth was registered in the real value added by the *primary sectors* in the fourth quarter. Growth in output originating in the agricultural sector slowed down sharply and almost no growth was recorded by the mining sector. However, on an annual basis, real value added by the primary sectors improved from a decline of 1½ per cent in 2001 to growth of 1½ per cent in 2002.

Growth in the real value added by the *agricultural sector* slowed down from a seasonally adjusted and annualised rate of 5 per cent in the third quarter of 2002 to ½ a per cent in the fourth quarter. Nevertheless, following a decline of 1½ per cent in 2001, the real value added by the agricultural sector increased at a year-on-year rate of 4 per cent in 2002 as a whole. This can largely be attributed to an increase in field crop production. In particular, the maize crop increased from 7,5 million tonnes in 2001 to 9,1 million tonnes in 2002. In addition, the wheat and sugar crops have also shown some increases from 2001 to 2002.

Real gross domestic product
Percentage change at seasonally adjusted annualised rates

	2001					2002				
Sectors	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Primary sectors	-4	-1	-2	-2	-1½	3½	4½	2½	0	1½
Agriculture	-7	-2	-1	½	-1½	7½	9	5	½	4
Mining	-1½	0	-3	-4½	-1½	½	1½	1	0	-½
Secondary sectors	2	2	0	5½	3½	3½	5	3	2	3½
Manufacturing	1½	2	0	7	3½	4	6	3½	1½	4
Tertiary sectors	4	3½	3½	3½	3½	2½	3½	3	3	3
Non-primary sectors	3½	3	2½	4	3½	3	4	3	2½	3
Total	2½	2½	2	3	3	3	4	3	2½	3

Following an increase at a seasonally adjusted and annualised rate of 1 per cent in the third quarter, real value added by the *mining sector* declined marginally in the fourth quarter of 2002. This was the net result of a decline in the real value added by the gold, diamond and platinum mining sectors, which outweighed an increase in real output by coal and other mining sectors. Subdued global demand for metals and minerals, and the dampening effect of the stronger rand on export earnings might also have constrained mining production somewhat.

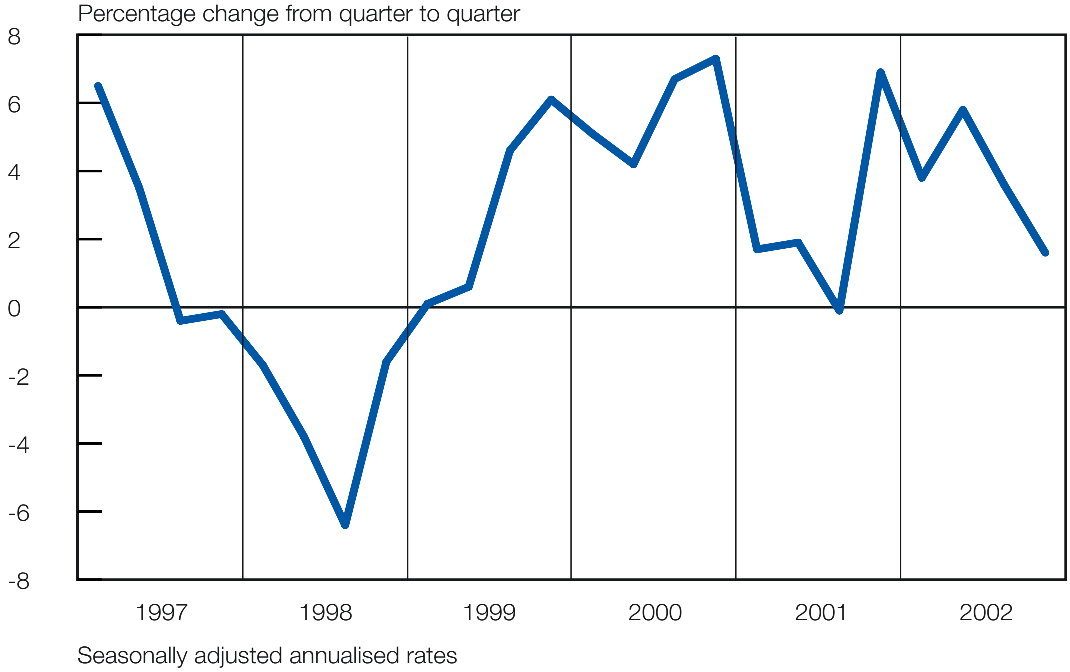
In 2002 as a whole real value added by the *mining sector* declined by ½ a per cent, somewhat less than the contraction of 1½ per cent in 2001. Production volumes of diamond mining fell as a result of weak demand, whereas global demand for platinum was also sluggish. This weakness in the non-gold mining sector was partly counteracted by an improvement in the real output originating in the gold-mining sector; 2002 was the first year since 1993 that the volume of gold output actually increased.

Growth in the real value added by the *secondary sectors* slowed down from a seasonally adjusted and annualised rate of 3 per cent in the third quarter of 2002 to 2 per cent in the fourth quarter. This was mainly due to a sharp slowdown in the growth of manufacturing output. Although robust growth was recorded in the sector supplying electricity, gas and water as well as in the construction sector, this pick-up was not sufficiently strong to offset the slowdown in manufacturing production. The year-on-year growth in the real value added by the secondary sectors maintained a growth rate of 3½ per cent in both 2001 and 2002. Despite the slowdown in manufacturing output in the second half of 2002, this sector was the major contributor to growth in the secondary sectors during 2001 and 2002.

Growth in the real value added by the *manufacturing sector* slowed down from a seasonally adjusted and annualised rate of 3½ per cent in the third quarter of 2002 to 1½ per cent in the fourth quarter. Quarter-to-quarter growth rates ranging between

1½ and 6 per cent lifted the growth in real manufacturing output for 2002 as a whole to 4 per cent, a slight acceleration from the 3½ per cent growth in 2001. This was due to the improved price competitiveness which South African producers enjoyed in export markets as a result of the lower exchange value of the rand for the greater part of 2002. In addition, there were also increased opportunities for import substitution. Final domestic demand was also relatively strong.

Real value added by manufacturing



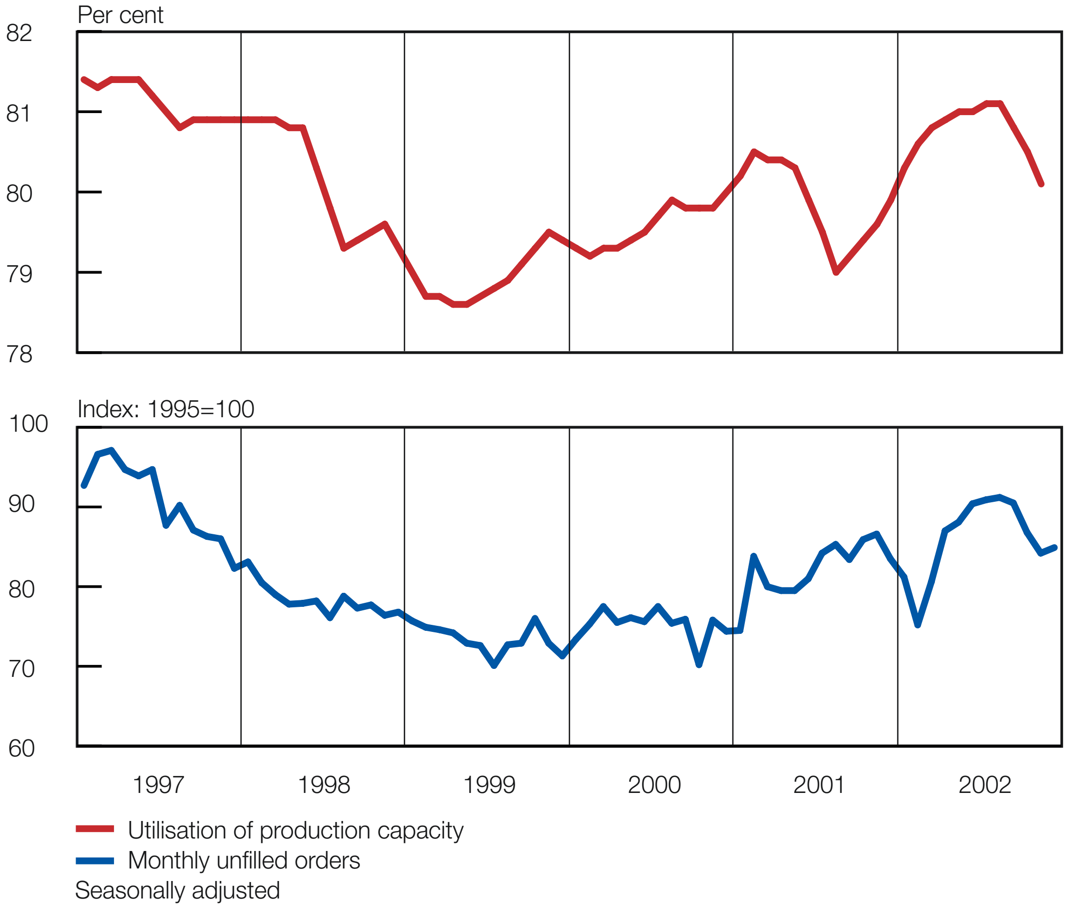
The slowdown in manufacturing production in the fourth quarter of 2002 was evident in quite a few subsectors. This includes, among others, manufacturers of paper products, basic chemicals, fabricated metal products, machinery and equipment, as well as transport equipment. The decline in the production of transport equipment is consistent with a decline in the demand for new motor vehicles.

Alongside the slack in manufacturing production in the fourth quarter of 2002, the utilisation of production capacity declined from 81,1 per cent in the third quarter to 80,1 per cent in the fourth quarter. In addition, there was a sharp decline in unfilled orders and in the number of new manufacturing orders. These may be signalling a weakening in demand for manufactured goods and possibly also some future weakness in manufacturing output volumes.

The slowdown in manufacturing production in the fourth quarter of 2002 can probably be attributed to:

- a slowdown in the domestic demand for durable consumer goods which apparently responded to the 400 basis points increase in bank lending rates;
- weaker international demand for South African manufactured products in a somewhat hesitant global economy; and
- a decline in the price competitiveness of local exporters and import-competing industries due to the strengthening of the exchange value of the rand towards the end of 2002.

Manufacturing production



In contrast to manufacturing production, the real value added by the *sector supplying electricity, gas and water* increased substantially in the fourth quarter of 2002. Following zero growth in this sector in the third quarter of 2002, growth accelerated to a seasonally adjusted and annualised rate of 4 per cent in the fourth quarter. This was mainly due to a decrease in imports of electricity from Mozambique which necessitated higher domestic production in order to compensate for the lower-than-usual supply. In addition, the steady increase in private residential construction and ongoing expansion of electrification in the rural areas of the country contributed to increased production.

Growth in the real value added by the *construction sector* accelerated from a seasonally adjusted and annualised rate of 2½ per cent in the third quarter of 2002 to 4 per cent in the fourth quarter. This can be attributed, among other things, to the sustained expansion of residential areas, especially high security developments which remain in high demand. The relatively robust quarter-to-quarter performance during 2002 lifted the real value added by the construction sector by 2 per cent for the year as a whole, following a sturdy increase of 5 per cent in 2001.

The real value added by the *tertiary sectors* grew at a seasonally adjusted and annualised rate of 3 per cent in the fourth quarter of 2002, broadly maintaining the growth rate of the second and third quarters. A slowdown in the growth of the real value added by the *financial intermediation, insurance, real-estate and business services sector* more than neutralised robust growth in the *commerce and transport sectors*.

As a result of these developments, the year-on-year growth in the real value added by the tertiary sectors slowed down slightly from 3½ per cent in 2001 to 3 per cent in 2002.

Growth in the real value added by the *commerce sector* accelerated from a seasonally adjusted and annualised rate of 2 per cent in the third quarter of 2002 to 3 per cent in the fourth quarter. This stronger growth was mainly concentrated in the *wholesale sector* and in the *catering and accommodation subsector.* The *catering and accommodation sector* has continued to benefit from the growing number of foreign tourists visiting the country. The increased activity in these sectors was partially offset by a decline in the real value added by the *motor trade* as the demand for new motor vehicles slackened. Growth in the *retail subsector* was also rather lacklustre as a result of the subdued growth in consumer demand.

For the year 2002 as a whole, the real value added by the commerce sector increased by 2½ per cent, compared with 3½ per cent in 2001. This was mainly due to a solid performance by the retail sector, which posted a growth rate of 4½ per cent in both 2001 and 2002.

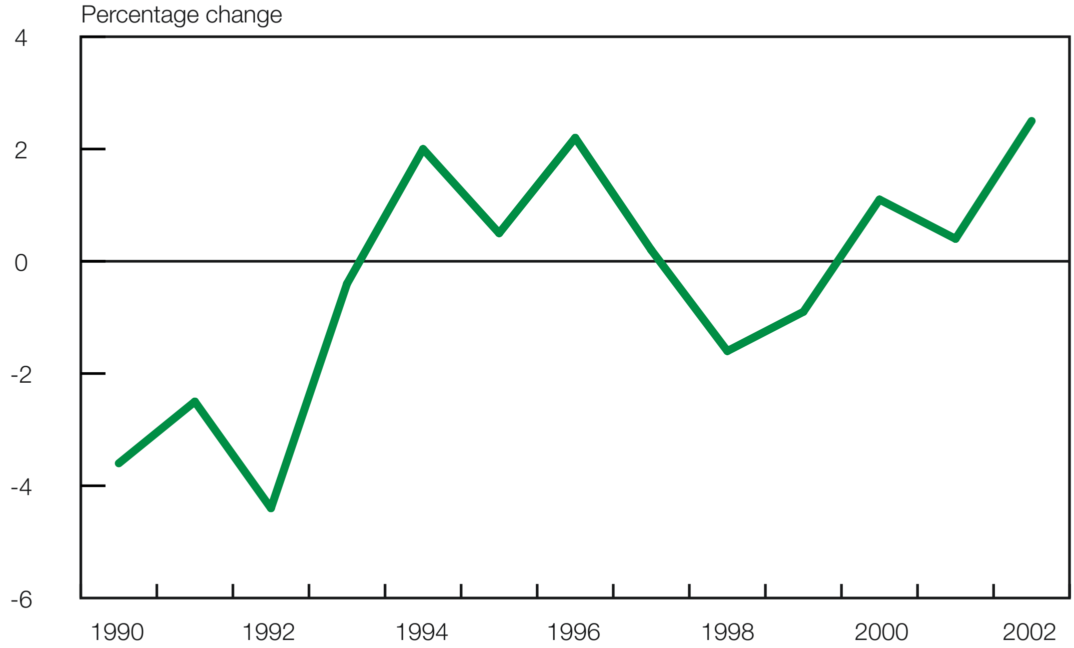
Growth in the real value added by the *transport, storage and communication sector* accelerated from 6 per cent in the third quarter of 2002 to a seasonally adjusted and annualised rate of 6½ per cent in the fourth quarter. This was largely a result of lively growth in the transport sector, particularly air transport which was boosted by the growing number of foreign tourists and increased volumes of merchandise imports. In addition, value added by the communication subsector benefited from continued expansion in the cellular telephone industry. Despite its strong expansion towards the end of 2002, the growth in the real value added by the transport, storage and communication sector slowed down from 7 per cent in 2001 to 6 per cent in 2002.

There was a marked slowdown in the growth of real value added by the *financial intermediation, insurance, real-estate and business services sector.* After recording an increase of 3 per cent in the third quarter, growth slowed down to a seasonally adjusted and annualised rate of 2 per cent in the fourth quarter of 2002. This slowdown was mostly confined to output originating in commercial banks and securities dealers. Real output by commercial banks was adversely affected by lower growth in deposit holdings and credit extension to private-sector organisations during 2002. The real value added by securities dealers was also negatively affected by a decline in the volume of transactions on the securities and derivatives markets. Overall growth in real value added by the financial intermediation, insurance, real-estate and business services sector was down from 4½ per cent in 2001 to 3½ per cent in 2002.

The growth in the real value added by *general government* also slowed down noticeably in the fourth quarter of 2002 as part of the drive by general government to contain the growth in employee remuneration. However, with quarter-to-quarter growth rates of between ½ a per cent and 2½ per cent recorded during the year, annual growth in real value added by general government accelerated to 1 per cent in 2002 following a decline of ½ a per cent in 2001.

The growth in real gross national income accelerated from 2½ per cent in 2001 to 4½ per cent in 2002. This acceleration in growth was underpinned by sustained growth in real gross domestic product and a smaller amount of net primary income transferred to the rest of the world. In addition, the international terms of trade improved in 2002 indicating that the same volume of exports is able to pay for a larger volume of imports. Real national income *per capita* has accordingly benefited, taking the growth in this aggregate to 2½ per cent in 2002, up from just ½ a per cent in 2001.

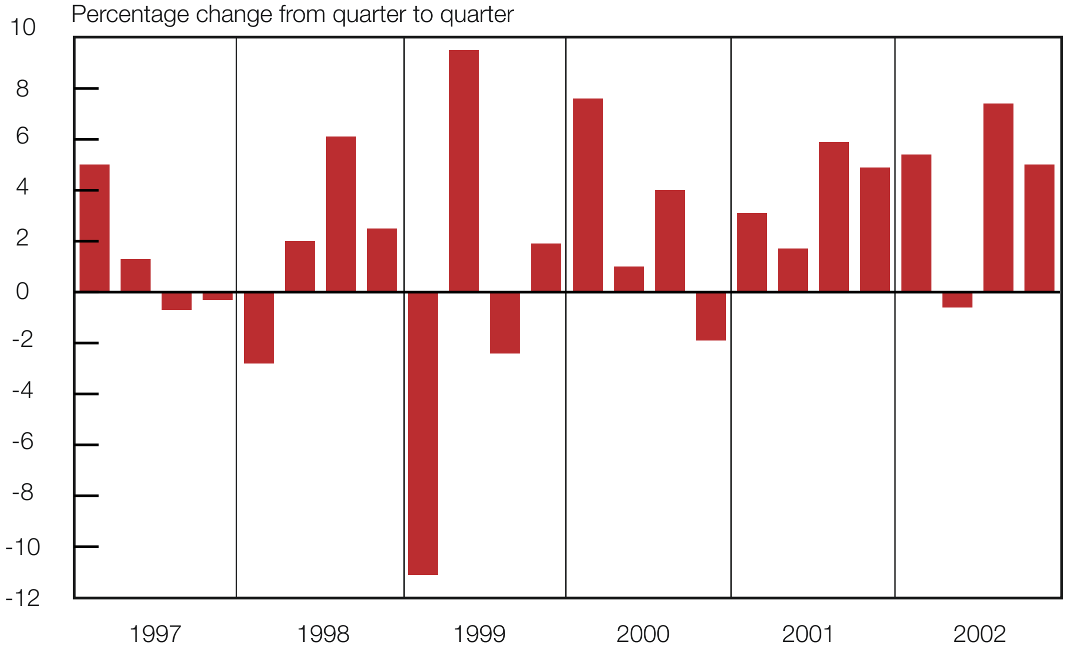
Real gross national income *per capita*



Domestic expenditure

The growth in *aggregate real gross domestic expenditure* slowed down considerably in the fourth quarter of 2002. Following an increase of 7½ per cent in the third quarter of 2002, the rate of increase in domestic expenditure slowed down to a seasonally adjusted and annualised rate of 5 per cent in the fourth quarter. This can be attributed to a slowdown in net inventory accumulation as well as somewhat lower growth in real final consumption expenditure by households. Notwithstanding these developments,

Real gross domestic expenditure



Seasonally adjusted annualised rates

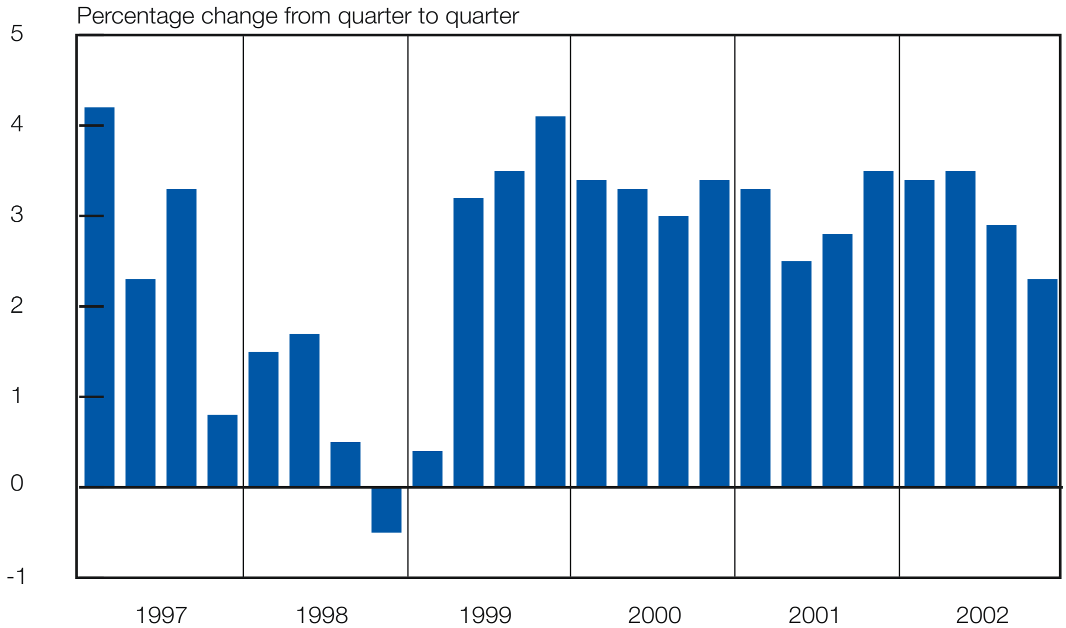
growth in real gross domestic expenditure for 2002 as a whole amounted to 4 per cent, compared with growth of 2½ per cent in 2001. Heightened investment activity contributed substantially to the acceleration of expenditure growth in 2002.

Real gross domestic expenditure
Percentage change at seasonally adjusted annualised rates

Components	2001					2002				
	1st qr	2nd qr	3rd qr	4th qr	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Final consumption expenditure by households	3½	2½	3	3½	3	3½	3½	3	2½	3
Final consumption expenditure by general government	3½	3½	3½	4	3½	3½	3½	3½	4	3½
Gross fixed capital formation	4	3	2	5½	3	7	8	8½	11½	6½
Change in inventories (R billions)	0,4	-2,3	4,0	4,7	1,7	6,4	0,4	4,5	6,2	4,4
Gross domestic expenditure	3	1½	6	5	2½	5½	- ½	7½	5	4

The growth in *real final consumption expenditure by households* slowed down from a seasonally adjusted and annualised rate of 3 per cent in the third quarter of 2002 to 2½ per cent in the fourth quarter. This was mainly due to a decline in real outlays on durable goods. In addition, slower growth was recorded in real expenditure on semi-durable as well as non-durable goods.

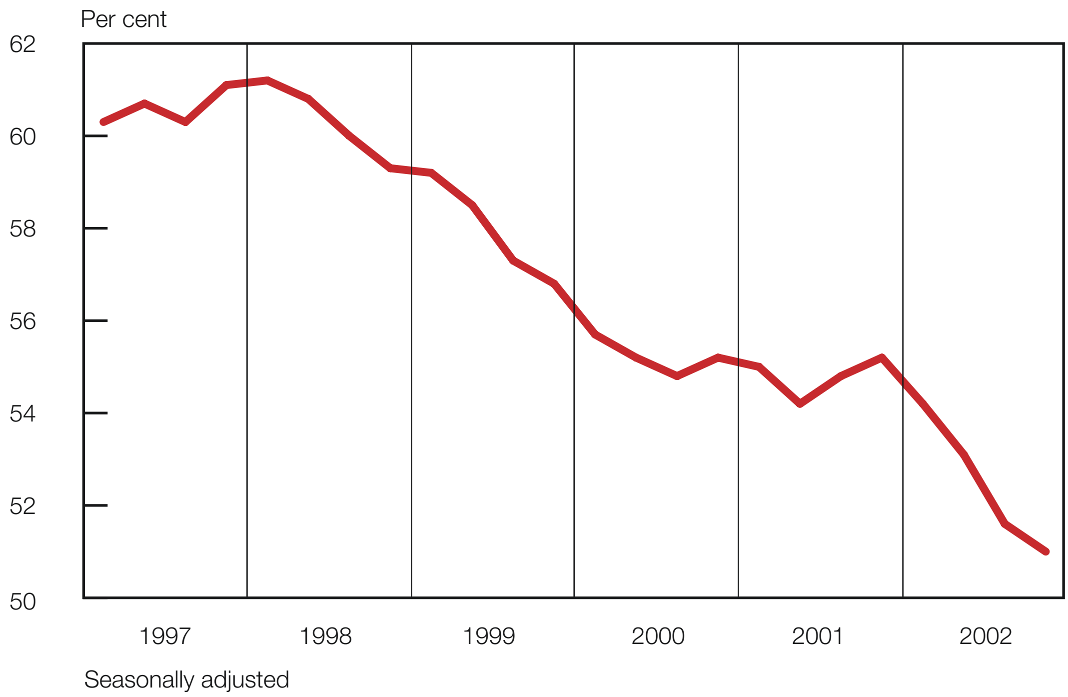
Real final consumption expenditure by households



Seasonally adjusted annualised rates

The quarter-to-quarter growth recorded in final consumption expenditure by households ranged between 2½ per cent and 3½ per cent during 2002, similar to the quarterly rates in 2001. Accordingly, growth in real outlays by households increased by 3 per cent in 2002, broadly maintaining the growth rate of 2001. The growth in final consumption expenditure by households was underpinned by the relatively strong growth of 3 per cent and 3½ per cent recorded in the real disposable income of households in 2001 and 2002 respectively. Households could therefore spend more on consumer goods without incurring debt excessively. As a result, household debt as percentage of disposable income declined from 55 per cent in 2001 to 52½ per cent in 2002.

Household debt as percentage of disposable income



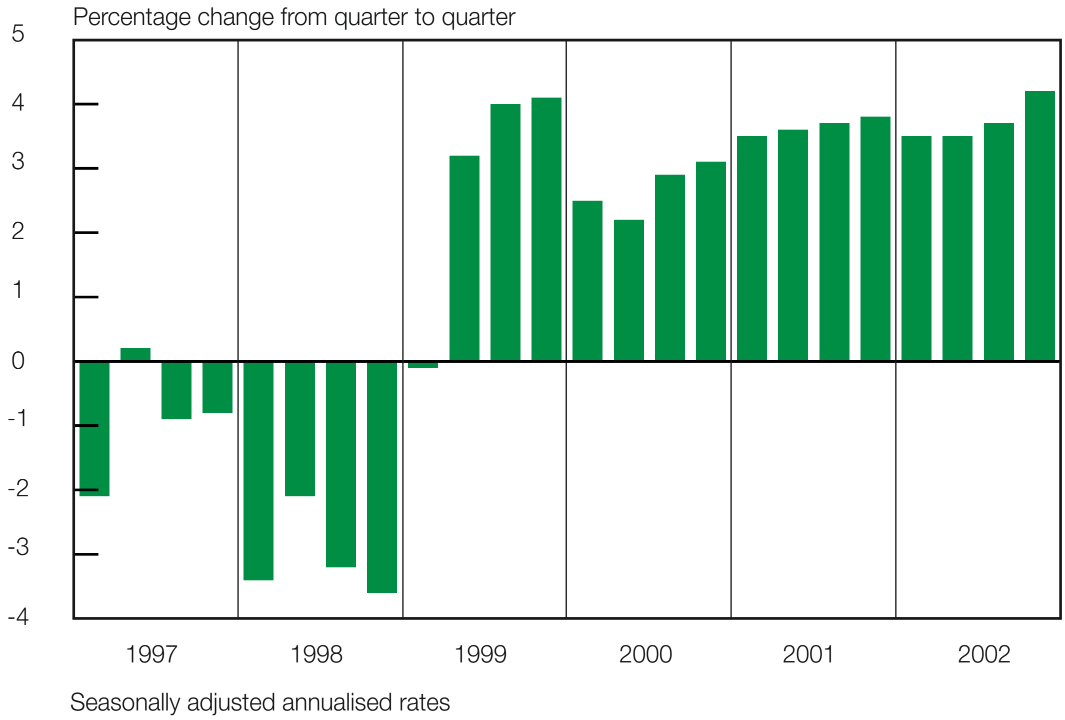
The decline in real expenditure on *durable goods* was evident in spending on furniture, household appliances and transport equipment, especially new motorcars. Higher prices and the higher cost of credit made new cars far less affordable. Since most expenditure in this category is of a discretionary nature, consumers tend to reduce their expenditure more readily when prices and interest rates are higher. Unlike the end of 2001 when consumers were engaged in pre-emptive buying following the steep decline in the exchange value of the rand, the situation was somewhat reversed in 2002. The strengthening of the rand towards the end of 2002 might have induced consumers to delay purchases in order to pay lower prices later.

Growth in real outlays on *semi-durable goods* slowed down from a seasonally adjusted and annualised rate of 4 per cent in the third quarter of 2002 to 2 per cent in the fourth quarter. This was mainly due to lower growth in expenditure on clothing and footwear, household textiles and motorcar parts and accessories.

Growth in real expenditure on *non-durable goods* weakened in the fourth quarter of 2002. This could mainly be attributed to a slowdown in the growth of real outlays on food and beverages and a decline in real outlays on petroleum products. Households economised on their petrol consumption as a result of high price increases during the year. The high food price increases throughout the year weighed on the demand for food in the third and fourth quarters of 2002, but spending on services continued to increase at a lively pace. This was primarily due to accelerated growth in expenditure on recreational, entertainment and educational goods.

Real final consumption expenditure by general government accelerated from a seasonally adjusted and annualised growth rate of 3½ per cent in the third quarter of 2002 to 4 per cent in the fourth quarter. This was the net result of a marked increase in expenditure on goods and services, other than labour services. Real compensation of employees increased only moderately and in line with the government's intention to contain the growth in its wage bill. For 2002 as a whole, final consumption expenditure by general government increased by 3½ per cent, maintaining the growth rate of 2001. The ratio of final consumption expenditure by general government to gross domestic product remained at 19 per cent in the calender year 2002, similar to that of 2001.

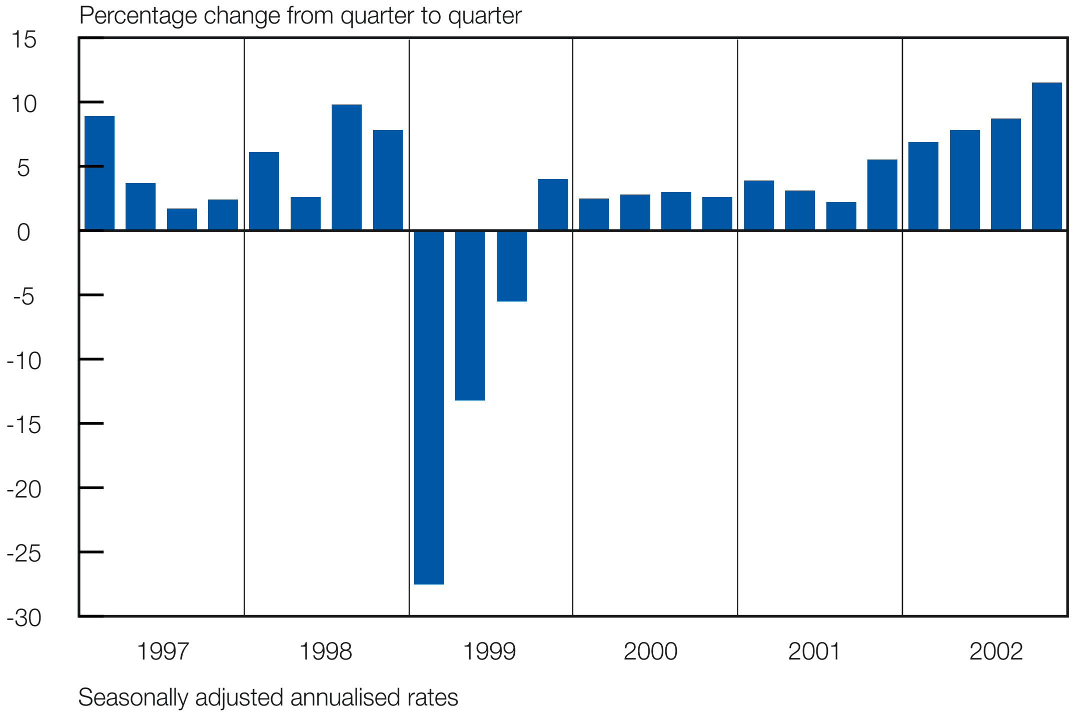
Real final consumption expenditure by general government



The expansion in *real gross fixed capital formation* accelerated in the fourth quarter of 2002. Following a quarter-to-quarter seasonally adjusted and annualised growth rate of 8½ per cent in the third quarter of 2002, growth picked up further to 11½ per cent in the fourth quarter – the strongest growth rate recorded since the second quarter of 1996 – largely due to a substantial increase in real capital expenditure by public corporations. The growth in real capital outlays by private business enterprises remained strong in the fourth quarter of 2002, albeit at a slightly lower rate than in the third quarter. With quarterly annualised growth rates ranging between 7 per cent and 11½ per cent in 2002, the year-to-year growth rate in total real gross fixed capital formation accelerated from 3 per cent in 2001 to 6½ per cent in 2002.

The increase in real gross fixed capital formation by *public corporations* was mostly centred around real capital expenditure by Transnet. The arrival of the first two of South African Airways fleet of new Airbuses boosted real capital expenditure by public corporations. The ongoing expansion of the Coega harbour project in the Eastern Cape was also a major contributor to real capital outlays in the fourth quarter of 2002.

Real gross fixed capital formation

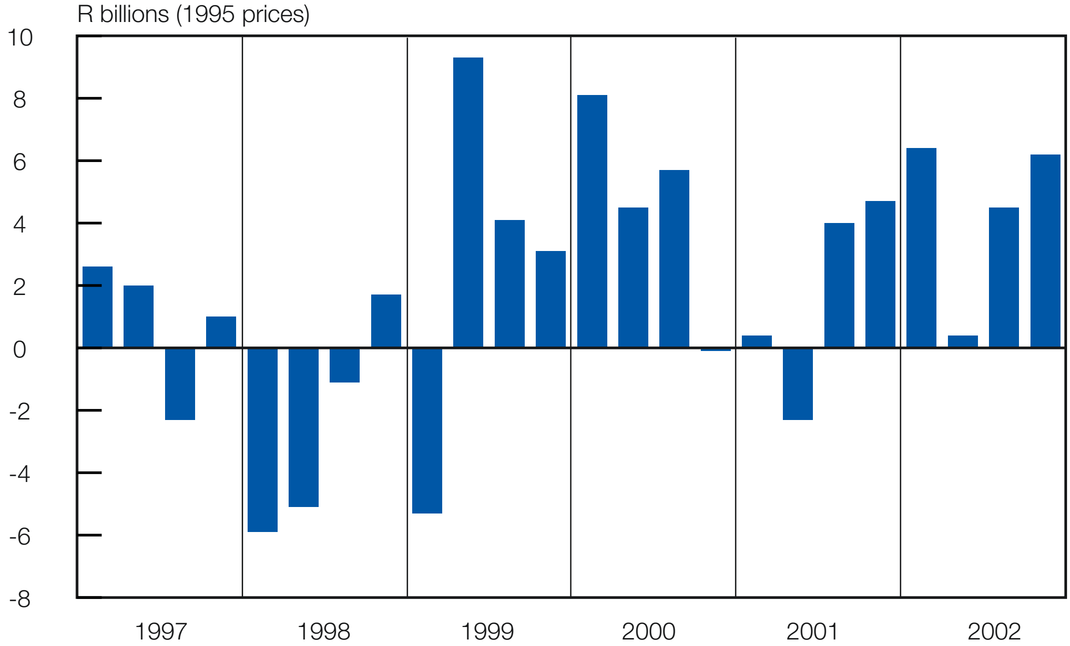


Growth in real fixed capital formation by *general government* increased in the fourth quarter of 2002. This growth in capital formation was spread throughout all tiers of government, which might be an indication of the improved capacity of government departments to undertake expenditure on service-delivery projects.

Growth in real capital outlays by *private business enterprises* remained strong, but nevertheless slowed down from 8 per cent in the third quarter of 2002 to 7 per cent in the fourth quarter. The increase in real capital expenditure by business enterprises was evident in all the sectors of the economy; it was especially noticeable in the mining sector, and more so in the platinum sector than in the other subsectors of mining. Farmers apparently are taking advantage of the stronger rand to replace ageing machinery and equipment which traditionally have a high import content.

Real *inventory investment* increased in the fourth quarter of 2002, but at a lower rate than in the third quarter. Inventory accumulation slowed down in virtually all sectors of the economy, but was particularly pronounced in the commerce sector. Consequently, net inventory investment contributed just 1 percentage point to growth in real gross domestic product in the fourth quarter of 2002, in contrast to 2½ percentage points in the third quarter. In addition, the ratio of industrial and commercial inventories to gross domestic product outside of agriculture fell back somewhat from 16 per cent in the third quarter of 2002 to 15½ per cent in the fourth quarter. However, for the year as a whole this ratio increased from 15 per cent in 2001 to 15½ per cent in 2002.

Change in inventories



Seasonally adjusted annualised rates

Factor income

The growth over four quarters in total *nominal factor income* accelerated to 13 per cent in the fourth quarter of 2002 after reaching a level of 12 per cent in the third quarter. The increase in total nominal factor income was based on solid growth in both gross operating surpluses of business enterprises and compensation of employees. For 2002 as a whole, the growth in nominal factor income advanced by 11½ per cent, following a growth rate of 10½ per cent in 2001. The acceleration in the growth of nominal gross operating surpluses can be attributed to higher prices, especially of agricultural products and exported goods.

The growth in total gross operating surpluses, measured over four quarters, has accelerated slightly to 16½ per cent in the fourth quarter of 2002 from 15½ per cent in the third quarter. An analysis of the increase in gross operating surplus by sector of economic activity in the fourth quarter of 2002 indicates that higher operating surpluses were evident in most sectors of the economy. It was particularly pronounced in the sector supplying electricity, gas and water as well as in the transport, storage and communication sector. Solid growth was recorded in the operating surpluses of resource-based industries such as mining which benefited from rising international commodity prices. The appreciation of the exchange value of the rand occurred late in 2002 with only limited impact on corporate operating surpluses as yet.

Operating surpluses generally remained at high levels throughout 2002, benefiting from the depreciation of the exchange rate of the rand which increased the pricing power of businesses and widened operating margins. This had the effect of bringing the share of operating surpluses to total factor income in 2002 to 48½ per cent compared with 47½ per cent in 2001. Apart from the special circumstances that prevailed during 1980 when the price of gold rose to extremely high levels, the current share of operating surpluses in total factor income has not been matched before.

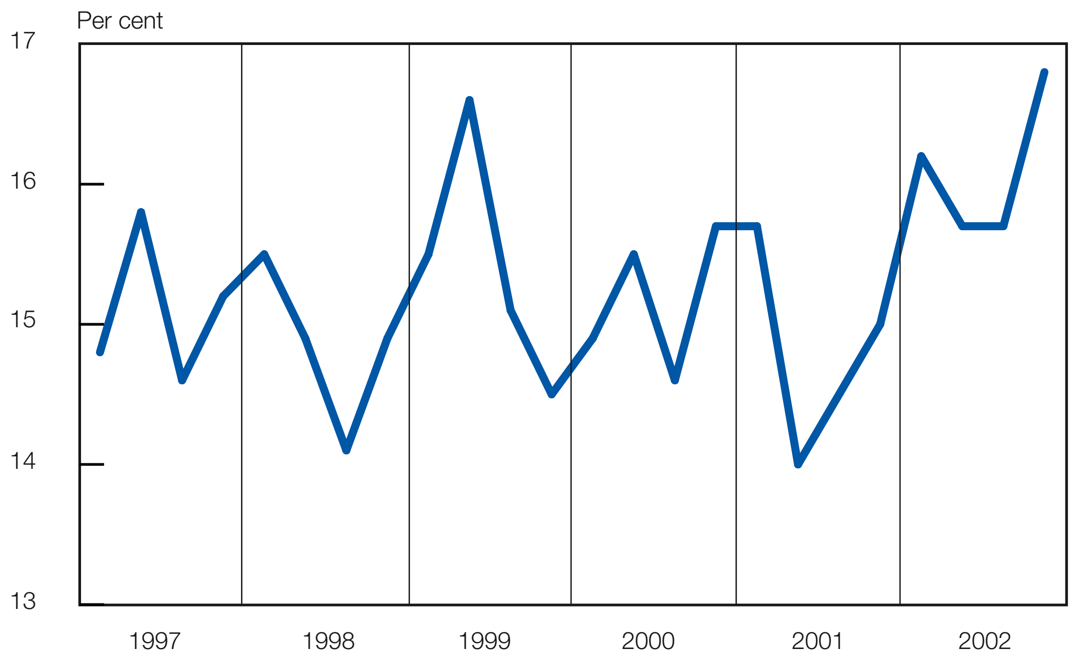
The growth over four quarters in total *compensation of employees* accelerated to 9½ per cent in the fourth quarter, following an increase of 9 per cent in the third quarter. This acceleration was evident in all sectors of the economy, except for the financial intermediation, insurance, real-estate and business services sector where compensation growth slowed down.

In 2002 as a whole, the growth in total compensation of employees accelerated from 8 per cent in 2001 to 8½ per cent. This was partly due to wage settlements which were higher in 2002 than in 2001. Notwithstanding these developments, the ratio of compensation of employees to total factor income has declined from 52½ per cent in 2001 to 51½ per cent in 2002.

Gross saving

The saving ratio, i.e. *the ratio of gross saving to gross domestic product,* improved from 15 per cent in 2001 to 16 per cent in 2002. Although South Africa's saving is far lower than in the 1980s, it was more than adequate for the financing of gross domestic capital formation in 2002, leaving some R3,3 billion of financial resources to be exported.

Gross saving as percentage of gross domestic product



Seasonally adjusted

The rise in the saving ratio was mainly brought about through higher saving by corporate businesses whose saving increased from 10 per cent of gross domestic product in 2001 to 11 per cent in 2002. This was supported by an increase in the gross saving by households and general government.

The gross saving of corporate businesses was boosted by higher operating surpluses, which in turn benefited from the solid economic expansion and windfalls still reaped from the depreciation of the exchange value of the rand in 2001. This was particularly evident in the agricultural and manufacturing sectors. Gross saving by the corporate sector was further boosted by the preference of companies to finance expansions from internally generated funds rather than accessing credit and capital markets at high interest rates.

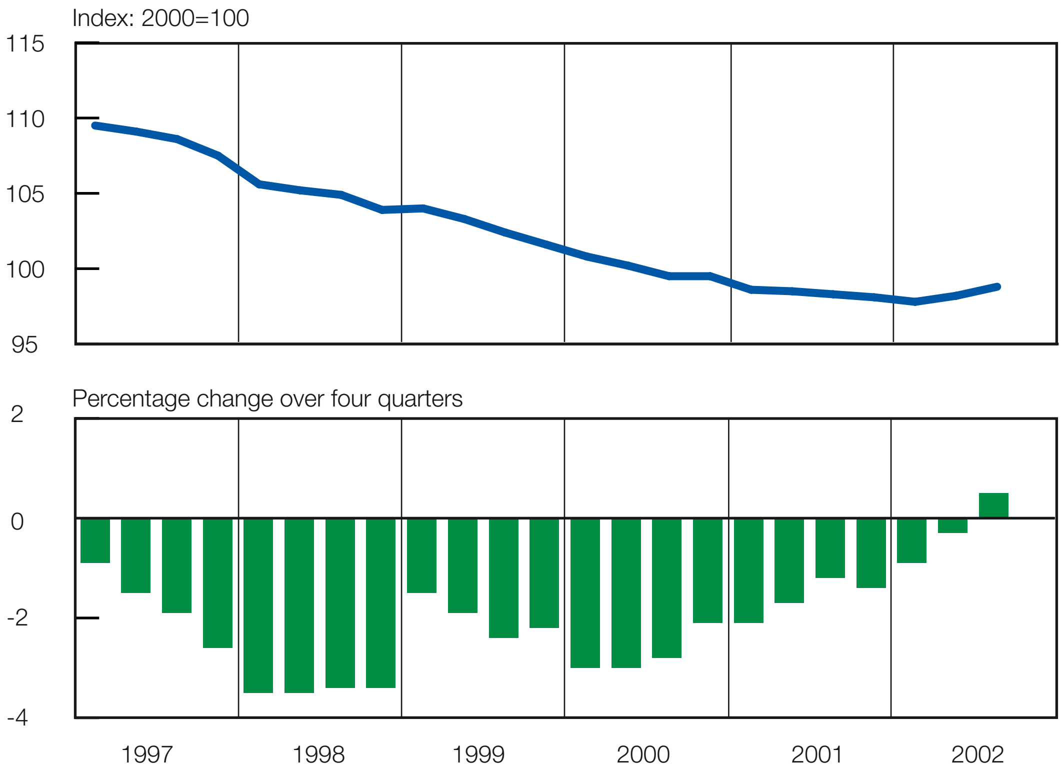
Notwithstanding the stronger growth in the nominal gross domestic product, the ratio of household saving to gross domestic product remained at 3 per cent in 2002, similar to that of 2001. Household saving was underpinned by an increase in real disposable income in 2002, arising mainly from higher income from property and mixed income of entrepreneurial households. In addition, household disposable income benefited from a lower tax burden and prudent household debt management. Household-sector debt increased by only 7½ per cent in 2002 following an increase of 8½ per cent in 2001.

The ratio of general government saving to gross domestic product remained broadly unchanged at 2 per cent from 2001 to 2002. Steps taken to strengthen the monitoring and control of government expenditure and better-than-budgeted tax revenues underpinned the gross saving of government.

Employment

According to the *Survey of Employment and Earnings in Selected Industries* (SEE) by Statistics South Africa, employment in the *regularly surveyed formal non-agricultural sectors of the economy* increased at an annualised rate of 2,4 per cent in the third quarter of 2002. Employment numbers have increased for two consecutive quarters following three years of continuous decline, suggesting that the formal economy may have entered an era of steadily rising employment levels, but it is still far too early to conclude that the tide has finally turned.

Non-agricultural employment



Measured employment in the third quarter of 2002 was assisted by the inclusion of about 11 000 National Defence Force reserve members who were not previously covered by the survey. Overall, formal-sector non-agricultural employment increased by 0,5 per cent in the year to the third quarter of 2002 – the first year-on-year rate of increase in the past six years. Even without the one-off rise in the aggregate level of employment, year-on-year employment growth would have been 0,2 per cent in the third quarter of 2002.

Employment in the *private sector* rose at an annualised rate of 3,3 per cent from the second to the third quarter of 2002. Employment gains were recorded in almost all the subsectors of the economy, apart from construction, electricity supply and gold mining. The largest increases were recorded in the sectors for washing and dry-cleaning services, transport, storage and communication, and non-gold mining.

Change in non-agricultural private-sector employment in the third quarter of 2002
Quarter to quarter and annualised

Sector	Percentage change
Gold mining	-0,6
Non-gold mining	16,9
Manufacturing	4,2
Electricity supply	-1,2
Construction	-2,0
Trade, catering and accommodation services	0,4
Transport, storage and communication	18,6
Financial intermediation and insurance	0,7
Washing and dry-cleaning services	34,8
Total private sector	3,3

Early indications are that employment growth in the fourth quarter of 2002 could have been somewhat weaker than in the two preceding quarters. For example, indicators of job advertisements fell back in both the third and fourth quarters. Also, results obtained from the *Investec Purchasing Managers Index* show that job growth in the manufacturing sector fell back in the fourth quarter of 2002. Furthermore, the number of electronically paid salaries, wages and pensions processed by the Automated Clearing Bureau of South Africa decreased in the fourth quarter of 2002.

Following the rise of private-sector employment, *public-sector employment* increased at an annualised rate of 0,6 per cent in the third quarter of 2002. Employment gains were noted in the national government departments where the numbers were boosted by the inclusion of the National Defence Force reserve members. The hiring of temporary employees, such as examiners and moderators, by some universities and technikons, further added to public-sector employment in the third quarter of 2002.

As part of a broad strategy to add further impetus to the improvement in employment prospects, government has announced a *Growth and Development Summit* to be held in May 2003 between the government, the business sector and the labour movement. This summit will seek to find strategies for the economy to grow sustainably and to reduce unemployment. As a preamble to the summit, the government stated its intention to continue building on economic successes born of fiscal discipline and macroeconomic stability, but added that the country has now progressed to a stage where the focus ought to be shifted more directly to growth and employment creation.

To further enhance the coverage of labour legislation, government has introduced a sectoral determination for agricultural workers taking effect on 1 March 2003. Accordingly, a minimum wage of R800 per month in wealthier areas and R650 a month in other areas will apply. The minimum wage will also be subject to an annual increase while payments in kind, such as accommodation and food, are limited to 20 per cent of the total remuneration package. A maximum working week of 45 hours will apply and a four-week notice period will have to be adhered to in the event of the termination of service of employees being employed for longer than six months.

According to *Andrew Levy Employment Publications*, a private-sector publication, the cumulative number of workdays lost due to strikes and work stoppages fell from 1,25 million in 2001 to 945 000 in 2002. The lower incidence of strike activity is attributed to a number of long-term agreements concluded in 2001 which reduced the inclination for strike action. These agreements, which included the automobile, mining, metal and engineering, and public service sectors, covered approximately 48 per cent of the workforce and brought a degree of stability to the labour market while setting an example of good conduct for other segments of the market.

Labour cost and productivity

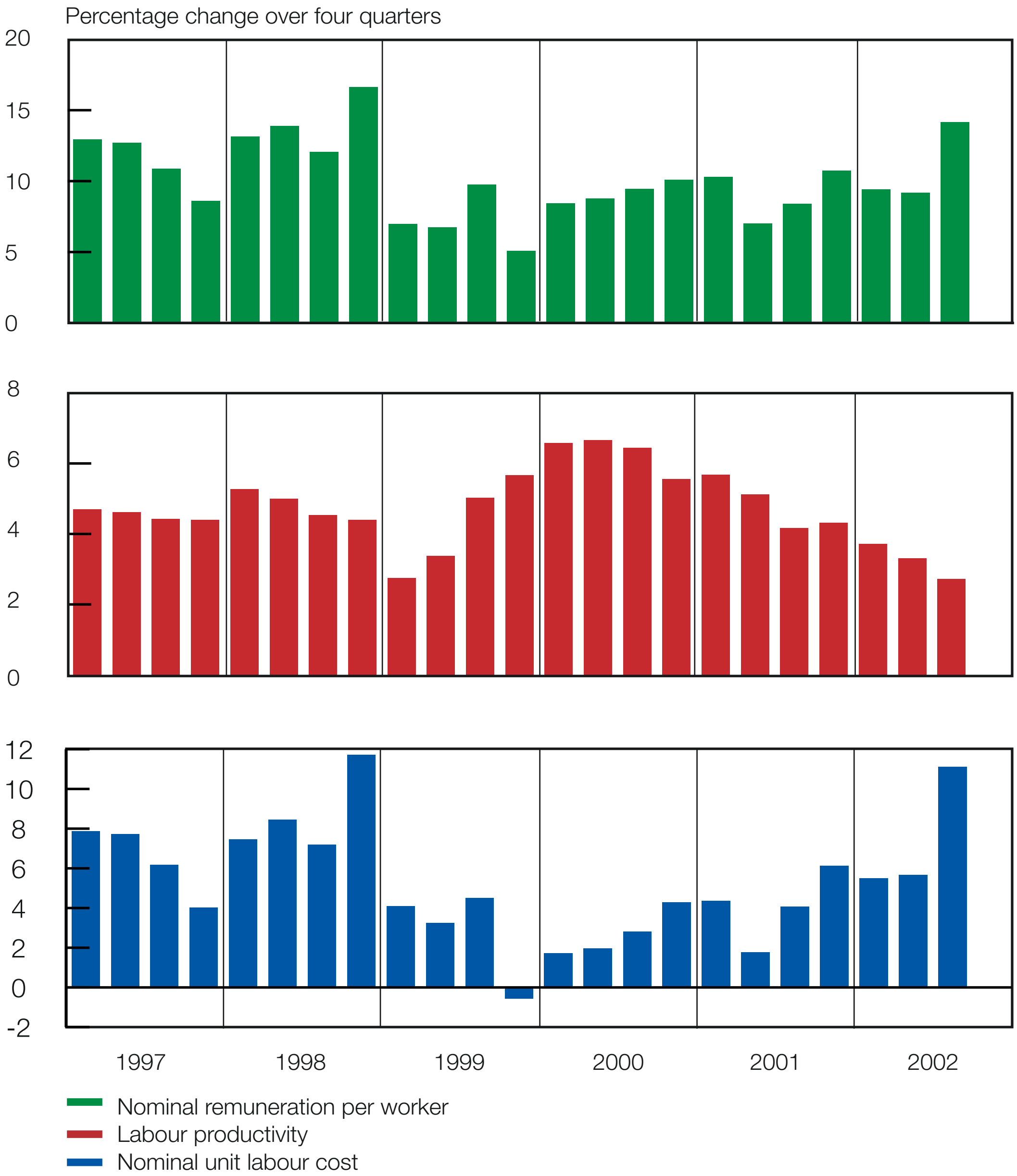
The year-on-year growth in *average nominal remuneration per worker* in the formal non-agricultural sectors of the economy accelerated rapidly from 9,2 per cent in the second quarter of 2002 to 14,1 per cent in the third quarter. Average year-on-year growth at 11,0 per cent in the first three quarters of 2002 was the highest in the past four years. With overall year-on-year consumer price inflation averaging 8,6 per cent in the first three quarters of 2002, gainfully employed workers, on average, enjoyed an improvement of 2,4 per cent in their "real consumption wage", i.e. in the real buying power of their remuneration during this period.

Information obtained from the *Automated Clearing Bureau* about the average salaries, wages and pensions deposited into the bank accounts of almost 5 million salaried and retired workers suggests that the faster pace of increase in nominal wage growth in the third quarter of 2002 might have been sustained in the fourth quarter. The amount of these deposits increased at a year-on-year rate of 14,4 per cent in the fourth quarter of 2002. Survey results obtained from *Andrew Levy Employment Publications* show that the average rate of wage settlements in collective bargaining agreements also picked up from 7,4 per cent in 2001 to 8,0 per cent in 2002 – the first acceleration in the settlement level since 1999. At the entry level, remuneration increases were far more generous as the average *minimum* monthly wage per worker rose by 12,3 per cent to R2 558 in the year to December 2002.

Growth in the average nominal compensation per worker in the *private sector* accelerated from a year-on-year rate of 9,6 per cent in the second quarter of 2002 to 10,7 per cent in the third quarter. Increased wage pressures were pervasive throughout the private sector in the third quarter of 2002. Remuneration growth in excess of 20 per cent was recorded in the financial intermediation and insurance industry. Fairly sizeable remuneration increases, i.e. in excess of 15 per cent, were also granted in the construction sector. Remuneration growth rates in the other private subsectors during the third quarter of 2002 were far more modest, generally below 10 per cent, even though some still accelerated from the second to the third quarter.

Growth in the nominal remuneration per worker in the *public sector* accelerated from a year-on-year rate of 6,5 per cent in the first quarter of 2002 and 8,6 per cent in the second quarter to 19,4 per cent in the third quarter. Remuneration growth in the third quarter of 2002 was bolstered by annual salary increases that took effect in July 2002, as well as by the payment of performance bonuses. Increased wage pressures were quite pronounced in the national government departments and in the public transport, storage and communication sector. Average year-on-year wage growth in the public sector amounted to 11,5 per cent in the first three quarters of 2002, exceeding the wage growth in the private sector during this period by about a full percentage point.

Remuneration, labour productivity and unit labour cost in non-agricultural sector



Partly as a consequence of increased international competitiveness following the sharp depreciation of the exchange value of the rand in the closing months of 2001, growth in manufacturing production picked up to a year-on-year rate of 7,8 per cent in the third quarter of 2002. As a result, growth in manufacturing labour productivity (measured as real output per worker) rose from 4,5 per cent in the first quarter of 2002 to 6,7 per cent in the third quarter. By contrast, economy-wide labour productivity growth was far more sedate, amounting to a year-on-year rate of just 2,7 per cent in the third quarter of 2002. This rate of increase is considerably lower than at any stage in the past seven years when annual productivity growth regularly exceeded 4 per cent and was as high as 6,3 per cent in 2000.

The rapid pace of increase in manufacturing labour productivity, together with a slowdown in nominal remuneration growth, jointly held back the growth in *nominal unit labour cost in the manufacturing sector.* When measured over periods of four quarters, the growth in the cost of labour per unit of manufacturing output fell back substantially from 6,0 per cent in the first quarter of 2002 to 0,8 per cent in the second quarter and 1,2 per cent in the third quarter. This benign development contributed to the containment of *production* price inflation which is expected to influence *consumer* price inflation too.

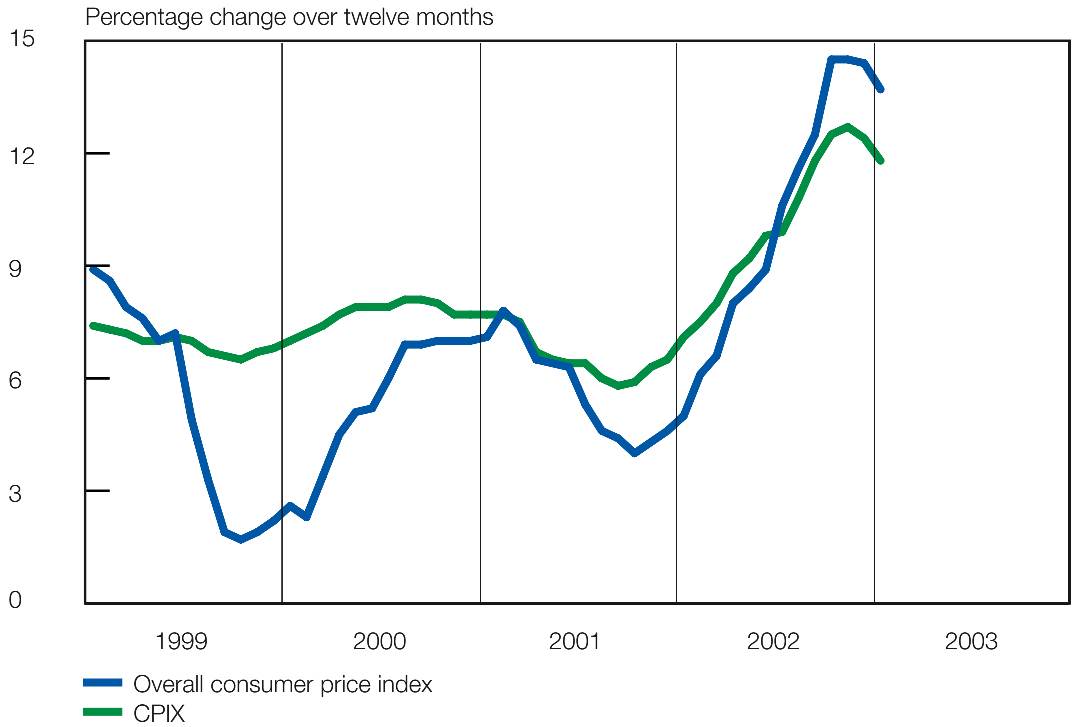
Contrary to the slowdown in nominal unit labour cost in the manufacturing sector, nominal unit labour cost in the other sectors of the economy grew considerably faster. A slowdown in economy-wide labour productivity and rising nominal wage growth resulted in *nominal unit labour cost in the formal non-agricultural sector of the economy* accelerating from 5,5 per cent in the first quarter of 2002 and 5,7 per cent in the second quarter to 11,1 per cent in the third quarter. Average year-on-year growth in nominal unit labour cost amounted to 7,5 per cent in the first three quarters of 2002, more than twice as high as in the first three quarters of 2001, signalling potential upward pressure on price inflation in coming months.

Non-agricultural nominal unit labour cost and consumer prices

Prices

Price inflation accelerated rapidly in 2002, mainly on account of a sharp depreciation of the exchange rate of the rand in the closing months of 2001. Rising food prices and an increase in energy costs also added to increased inflationary pressures in the domestic economy. CPIX inflation (i.e. changes in the overall consumer price index for metropolitan and other urban areas, excluding the interest cost of mortgage bonds) accordingly rose from a most recent low of 5,8 per cent in September 2001 to 12,7 per cent in November 2002. Following some moderation in food price inflation and a temporary decline in the cost of petrol and diesel, CPIX inflation slowed down to a year-on-year rate of 11,8 per cent in January 2003. If these two moderating effects are omitted from the index, year-on-year CPIX inflation amounted to 10,1 per cent in January 2003.

Consumer prices

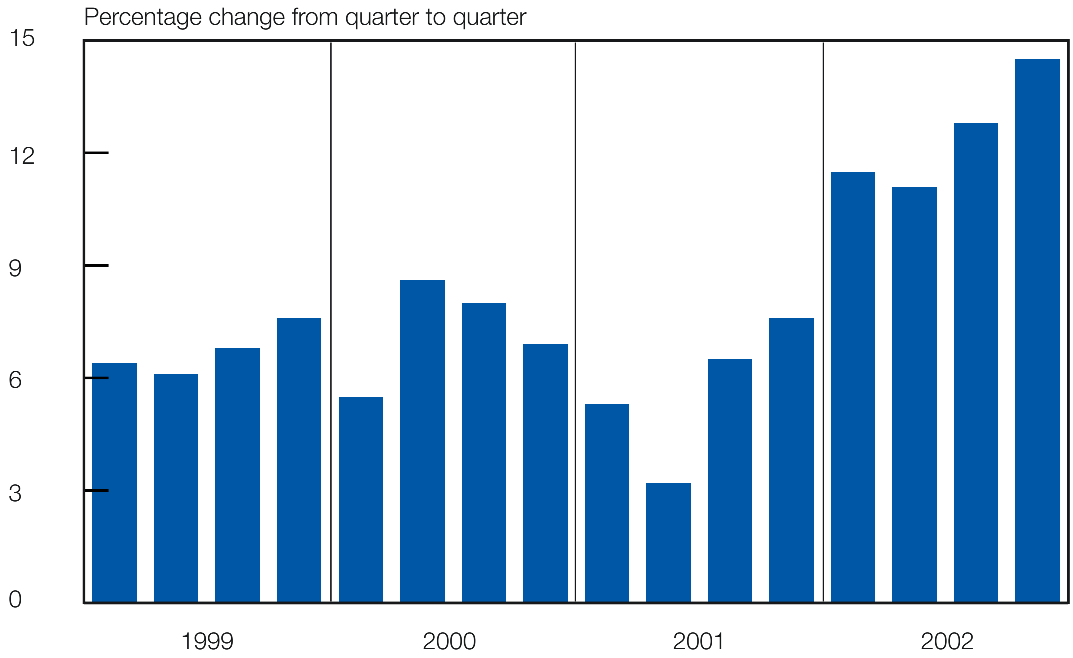


The quarter-to-quarter pace of CPIX inflation accelerated in the fourth quarter of 2002, amounting to an annualised rate of 14,5 per cent compared with a rate of 11,1 per cent in the second quarter. Besides food prices, CPIX inflation was pushed higher by rapid increases in transport running costs (including the cost of petrol and diesel), housing, medical care and health expenses. The average annual rate of CPIX inflation was 10,0 per cent in 2002 – its highest for the past eight years and exceeding by a fair margin the official inflation-target range of between 3 and 6 per cent set for that year.

Production price inflation, which is one of the main drivers of increases in consumer prices, rose strongly in the period following the fall in the exchange rate of the rand, and was further pushed higher by rising food prices and energy costs. As a result, the year-on-year rate of increase in the *all-goods production price index* rose from 8,3 per cent in December 2001 to 15,4 per cent in both August and September

2002 – the highest rate of increase since August 1989. Since October 2002 the recovery of the rand has curbed the rises in the prices of imported goods, slowing the year-on-year measure of all-goods production price inflation to 8,1 per cent in January 2003. The average annual rate of increase in the all-goods production price index was 14,2 per cent in 2002 which is 5,8 percentage points higher than the corresponding rate of 8,4 per cent in 2001.

CPIX



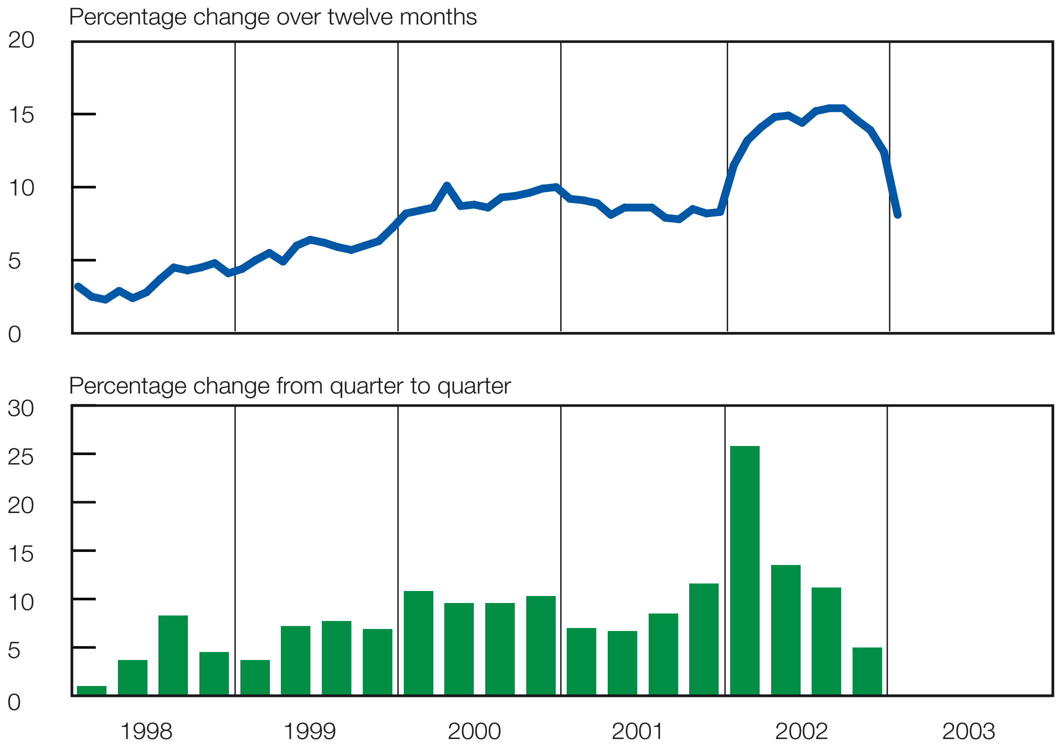
Seasonally adjusted and annualised

There was an impressive reduction in *quarter-to-quarter production price inflation* from an annualised rate of 25,8 per cent in the first quarter of 2002 to 5,0 per cent in the fourth quarter. Lower increases in the prices of imported goods and in the prices of a wide range of domestically produced goods contributed to this slow-down in production price inflation.

After it had been at around the 8 per cent level in the closing months of 2001, inflation in the prices of *domestically produced goods* rose strongly to 15,3 per cent in August 2002 as higher import prices started to impact on the cost of domestic production. The prices of domestically produced goods were also pushed higher by a rise in energy costs following higher international crude oil prices, and steep increases in the prices of processed and unprocessed food products. Production prices of food increased by 30,4 per cent in the year to September 2002 and domestic petrol and diesel prices by 14,5 per cent in the year to December 2002. Until the second quarter of 2002, production prices were mainly driven higher by prices of imported goods, food and fuel, but later price increases spread to a far wider array of goods.

Following declines in the price of electricity, occasioned by the introduction of a new pricing structure by Eskom, and a fall in the rise of food prices, domestically produced goods inflation receded to a year-on-year rate of 9,5 per cent in January 2003 and to a quarter-to-quarter annualised rate of 6,6 per cent in the fourth quarter of 2002. For comparison purposes, the quarter-to-quarter rate had been as high as 21,4 per cent in the first quarter of 2002. Fairly modest rates of increase in manufacturing nominal unit labour cost in the first three quarters of 2002 probably contributed to this reduction in domestically generated inflationary pressures.

Production prices



Seasonally adjusted and annualised

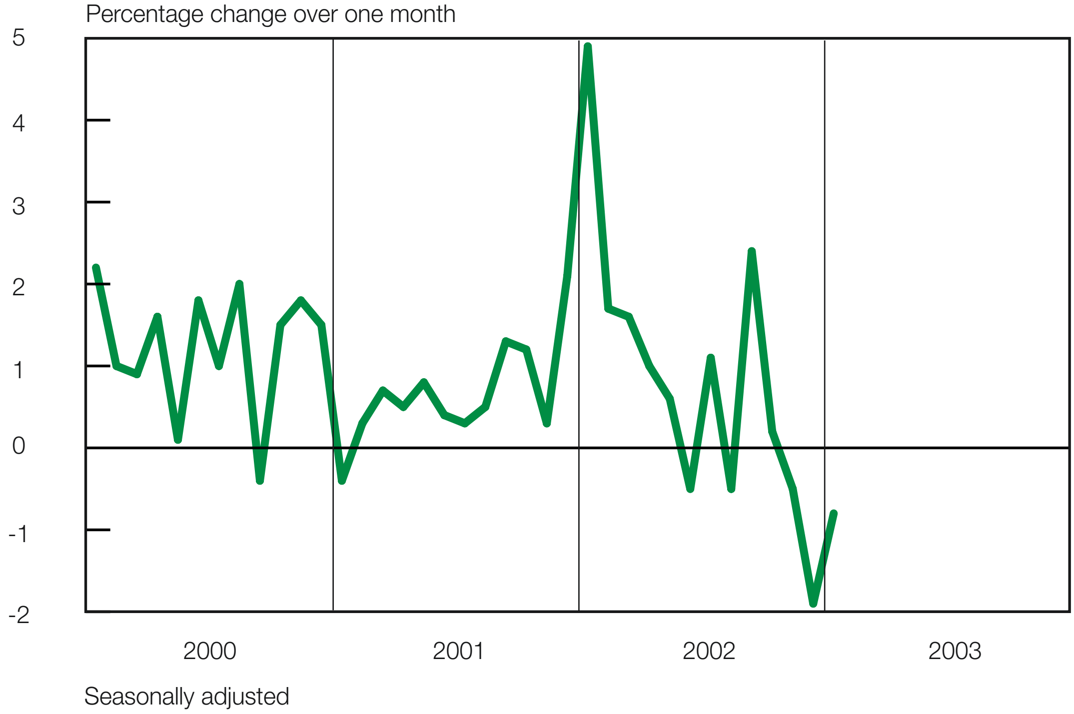
Production prices

Quarter-to-quarter percentage changes at seasonally adjusted annualised rates

Period		Domestically produced goods	Imported goods	Overall production prices
2001:	1st qr	6,5	6,7	7,0
	2nd qr	7,2	6,9	6,7
	3rd qr	8,4	6,3	8,5
	4th qr	11,5	12,9	11,6
	Year	**7,8**	**10,0**	**8,4**
2002:	1st qr	21,4	37,6	25,8
	2nd qr	14,6	12,3	13,5
	3rd qr	12,5	5,6	11,2
	4th qr	6,6	2,6	5,0
	Year	**13,5**	**15,5**	**14,2**

Imported goods inflation, when measured over periods of twelve months, rose from 7,4 per cent in November 2001 to 17,4 per cent in April 2002, substantially inflating prices at both the production and consumer price levels. In the months following April 2002, imported goods inflation petered out and the year-on-year rate fell back sharply to 4,6 per cent in January 2003. Even more impressive, the quarter-to-quarter annualised rate of increase in the prices of imported goods fell from 37,6 per cent in the first quarter of 2002 to 2,6 per cent in the fourth quarter. This slowdown in imported goods inflation resulted primarily from the recovery of the exchange rate of the rand during the second half of 2002.

Production prices of imported goods

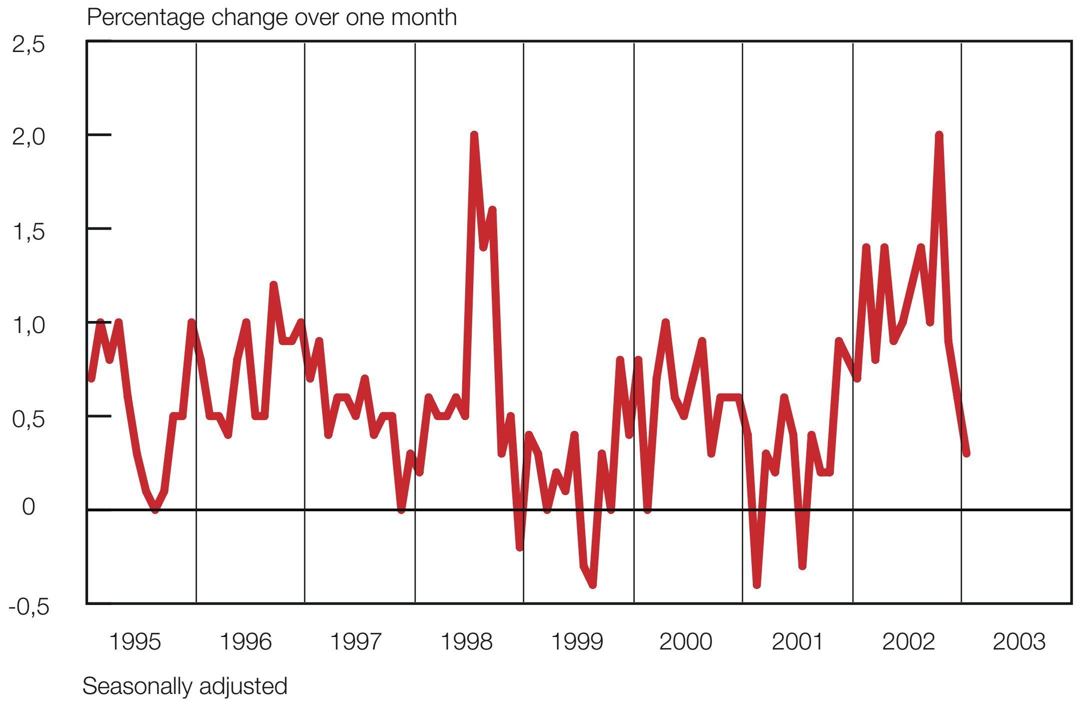


As price pressures moved from the production level to end-product prices, *headline inflation*, i.e. the year-on-year changes in the overall consumer price index for metropolitan areas, increased almost fourfold from 4,0 per cent in October 2001 to 14,5 per cent in October and November 2002, falling back slightly to 14,4 per cent in December and more significantly to 13,7 per cent in January 2003. Since July 2002, headline inflation has outpaced CPIX inflation as mortgage bond interest rates moved higher, but for 2002 as a whole, headline inflation at 10,1 per cent was about equal to the 10,0 per cent rise in CPIX.

Quarter-to-quarter consumer price inflation rose progressively from 1,9 per cent in the third quarter of 2001 to 17,1 per cent in the fourth quarter of 2002. Inflation in the prices of both consumer goods and services was still accelerating in the fourth quarter of 2002. A more positive development, seen from the perspective of disinflation, was that seasonally-adjusted annualised month-to-month inflation fell from around 25 per cent in October 2002 to 4,0 per cent in January 2003.

Inflation in the prices of *consumer goods* rose from a year-on-year rate of 7,2 per cent in January 2002 to 13,0 per cent in October. The prices of especially food, transport, and furniture and equipment rose strongly. Food price inflation then moderated somewhat, contributing to a slowdown in goods price inflation to 11,9 per cent in December 2002. Even though food price increases became slightly milder towards the end of 2002, the annualised quarter-to-quarter growth in consumer goods price inflation accelerated from 11,4 per cent in the third quarter of 2002 to 13,7 per cent in the fourth quarter, signalling that inflationary pressures were still quite pervasive in the closing months of that year.

Overall consumer price index



Consumer prices

Quarter-to-quarter changes at seasonally adjusted annualised rates

Period		Goods	Services	Headline inflation	CPIX inflation
2001:	1st qr..................................	3,2	3,9	3,3	5,3
	2nd qr.................................	5,4	-0,1	3,1	3,2
	3rd qr	4,7	-1,4	1,9	6,5
	4th qr..................................	8,0	2,9	5,6	7,6
	Year	**5,6**	**5,5**	**5,7**	**6,6**
2002:	1st qr..................................	12,5	11,4	11,9	11,5
	2nd qr.................................	12,4	15,3	14,0	11,1
	3rd qr	11,4	20,2	14,7	12,8
	4th qr..................................	13,7	21,5	17,1	14,5
	Year	**10,2**	**10,0**	**10,1**	**10,0**

Consumer services price inflation is somewhat unattached from changes in the prices of traded goods and only accelerated once higher goods prices began to influence the cost of service delivery. The year-on-year rate of increase in the prices of consumer services remained relatively low at around the 7 per cent level up to June 2002, but rose steeply thereafter to 17,6 per cent in January 2003. The acceleration in services price inflation not only resulted from increases in home mortgage interest rates, but was also pushed higher by stronger increases in the prices of other non-housing related services. When measured from quarter to quarter and annualised, services price inflation rose further from 20,2 per cent in the third quarter of 2002 to 21,5 per cent in the fourth quarter. However, omitting housing services from the consumer services price index, inflation in the prices of other services moderated slightly in the fourth quarter of 2002.

Although the prospects for inflation have improved as the exchange value of the rand strengthened and food price increases slowed down, there were other factors militating against a slowdown in inflation. Prominent among these were

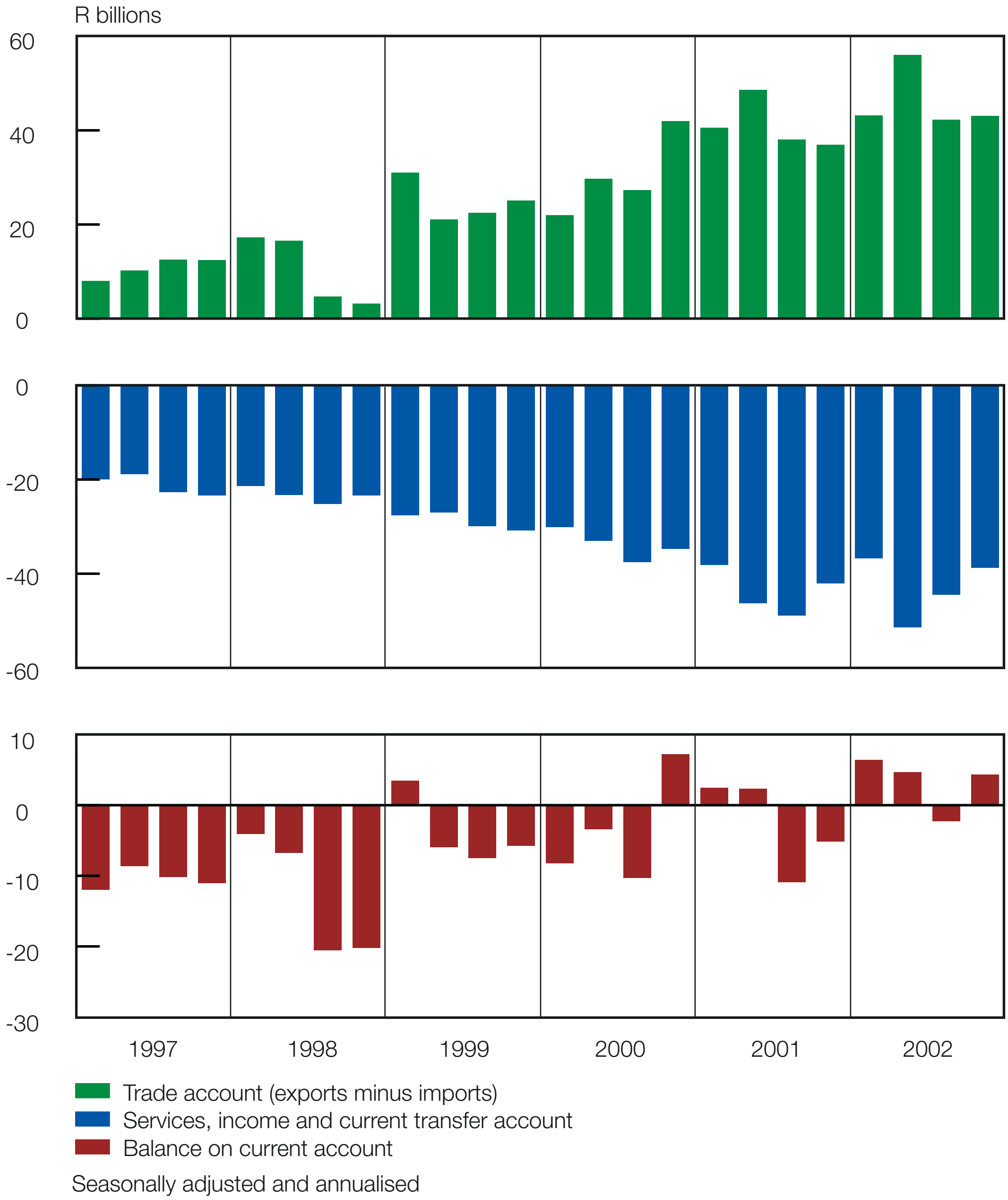
- an increase in the international price of crude oil associated with the prevailing geopolitical tensions and the threat of war against Iraq;
- accelerating unit labour cost throughout most of the non-agricultural sectors of the economy; and
- strong rises in the prices of most items where government agencies still have an important say in determining prices.

Foreign trade and payments

Current account

The current account of the balance of payments (seasonally adjusted and annualised) was transformed from a deficit of R2,2 billion in the third quarter of 2002 into a surplus of R4,3 billion in the fourth quarter. In 2002 as a whole, the current account was in surplus to the amount of R3,3 billion – the first such surplus since 1994. As a ratio of gross domestic product, this *surplus* was equal to 0,3 per cent compared with a *deficit* ratio of 0,3 per cent in 2001.

Balance of payments: Current account



The improvement in the current-account balance in 2002 occurred mainly in the first half of the year when the value of merchandise exports and net gold exports rose sharply. The value of merchandise exports levelled off in the second half of 2002 in response to weaker international demand for domestically produced goods, whereas an expansion in gross domestic expenditure contributed towards an increase in the value of merchandise imports. This compressed the surplus on the trade account quite noticeably. However, a decline in net income and service payments to the rest of the world ensured that the surplus on the current account of the balance of payments was maintained in the second half of 2002.

Balance of payments on current account

Seasonally adjusted and annualised
R billions

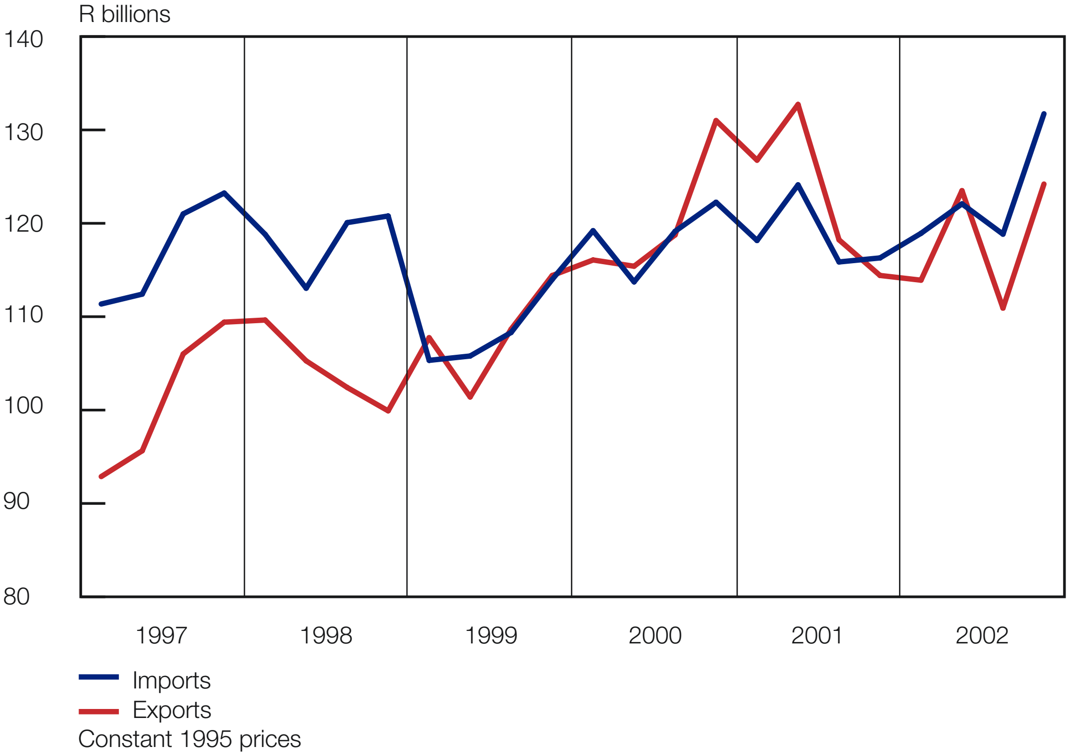
	2001	2002				
	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Merchandise exports	233,2	277,1	288,5	272,1	295,9	283,4
Net gold exports	29,4	39,6	43,5	46,9	40,2	42,6
Merchandise imports	-221,6	-273,5	-276,0	-276,8	-293,0	-279,8
Trade account	**41,0**	**43,2**	**56,0**	**42,2**	**43,1**	**46,2**
Net service, income and current transfer payments	-43,9	-36,8	-51,4	-44,4	-38,8	-42,9
Balance on current account	**-2,9**	**6,4**	**4,6**	**-2,2**	**4,3**	**3,3**

In the fourth quarter of 2002 an increase in the nominal value of merchandise export earnings was almost fully neutralised by a decline in the value of net gold exports and by an increase in the value of merchandise imports. As a consequence, the surplus on the trade account (seasonally adjusted and annualised) remained broadly unchanged from the third quarter of 2002 to the fourth quarter. However, a substantial contraction in the shortfall on the services and income account of the balance of payments caused an improvement in the current-account balance from a deficit of R2,2 billion in the third quarter of 2002 to a surplus of R4,3 billion in the fourth quarter.

After having declined by 5,7 per cent to a seasonally adjusted and annualised value of R272,1 billion in the third quarter of 2002, the value of merchandise exports rose to R295,9 billion in the fourth quarter of 2002 or by 8,7 per cent. The value of mining products exported increased strongly, especially in the subcategories base metals, and precious and semi-precious stones. The value of exports of agricultural and manufactured goods also increased, but not nearly as impressively as the export value of mining products.

The fall in the volume of merchandise exports in the third quarter of 2002 was reversed in the fourth quarter when the physical quantity of exports increased by 12,0 per cent. This increase in the physical quantity of merchandise exports was partly offset by a decline in the unit price of South Africa’s merchandise exports. Although international commodity prices strengthened, the appreciation of the exchange value of the rand against the major international currencies caused the rand prices of merchandise exports to fall by some 3 per cent from the third quarter of 2002 to the fourth quarter.

Real merchandise imports and exports



The annualised value of South Africa's net gold exports fell from R46,9 billion in the third quarter of 2002 to R40,2 billion in the fourth quarter. Owing mainly to the stronger external value of the rand, the average realised price of gold per fine ounce fell by 11,8 per cent over this period despite an increase in the dollar price of gold. At the same time, the volume of gold exports fell by 3,0 per cent.

The value of net gold exports rose to R42,6 billion in 2002, or by 44,9 per cent, raising the share of gold exports in the total value of goods exported to 13,1 per cent from 11,2 per cent in 2001. This increase in the value of net gold exports could be attributed to an increase in the average realised price of gold from R2 277 per fine ounce in 2001 to R3 307 per fine ounce in 2002. The physical quantity of gold exports fell by 0,9 per cent in 2002.

On the London market the average fixing price of gold, which had increased consistently since the second quarter of 2001, rose from US$271 per fine ounce in 2001 to US$310 per fine ounce in 2002. Uncertainty in global financial markets and concerns about the possibility of war in Iraq caused the average fixing price of gold on the London market to reach a level of US$357 per fine ounce in January 2003 – its highest level since March 1997.

The seasonally adjusted and annualised value of merchandise imports rose from R276,8 billion in the third quarter of 2002 to R293,0 billion, or by 5,9 per cent, in the fourth quarter. The value of imports of mining products and manufactured goods, especially in the subcategories mineral products and vehicles and transport equipment, increased sizeably in the fourth quarter of 2002.

Mainly due to the strengthening in the external value of the rand, the rand prices of imported goods fell by 4,5 per cent from the third quarter of 2002 to the fourth quarter. The nominal effective exchange rate of the rand appreciated on balance by 17,8 per cent from the end of September 2002 to the end of December. The demand for imported goods is evidently fairly sensitive to changes in import prices. Reflecting this sensitivity, the physical quantity of merchandise imports increased by about 10,9 per cent from the third quarter of 2002 to the fourth quarter. The demand for imported goods was further underpinned by an increase in gross domestic expenditure during the fourth quarter of 2002.

The deficit on the services and income account of the balance of payments (seasonally adjusted and annualised) contracted considerably from R44,4 billion in the third quarter of 2002 to R38,8 billion in the fourth quarter. A sharp decline in dividends declared on foreign direct investment in the economy caused a contraction in net investment-income payments to non-residents. Following non-residents' disinvestment from shares listed on the JSE Securities Exchange SA during 2002, dividend payments on foreign portfolio investment in the economy also contracted in the fourth quarter of 2002. The decline in dividend payments to the rest of the world was only partly countered by an increase in interest payments on foreign loan liabilities.

Relative to total income and service payments to the rest of the world, income payments declined from 49,0 per cent in the second quarter of 2002 to 42,3 per cent in the fourth quarter. For 2002 as a whole, the shortfall on the services and income account amounted to R42,9 billion compared with a deficit of R43,9 billion in 2001.

Financial account

Strong net capital flows into South Africa during the first half of 2002 were whittled away in the second half of the year when international investors' sentiment turned negative. Net financial inflows amounted to R33,1 billion in the first half of 2002 but these fell away almost completely in the second half. Net direct and net "other" investment capital flows into South Africa contracted substantially in the second half of 2002 and net portfolio investment turned around from considerable net purchases by non-residents in the first half of 2002 to large net sales in the second half.

Rising domestic interest rates relative to those in international markets and expectations of a stronger domestic currency probably encouraged net financial inflows into the economy during the first half of 2002. However, these factors were

Net financial transactions not related to reserves
R billions

	2001	2002				
	Year	1st qr	2nd qr	3rd qr	4th qr	Year
Change in liabilities						
Direct investment	58,4	1,7	4,8	2,1	-0,7	7,9
Portfolio investment	-24,1	4,4	15,7	-12,9	-1,8	5,4
Other investment	-10,2	14,1	-3,6	-3,9	-7,7	-1,1
Change in assets						
Direct investment	27,4	-1,2	5,3	2,3	-2,2	4,2
Portfolio investment	-43,6	-6,1	-1,6	-0,8	-1,2	-9,7
Other investment	-12,3	-0,5	-1,0	3,2	10,3	12,0
Total financial transactions*	**10,3**	**11,6**	**21,5**	**-0,2**	**0,6**	**33,5**

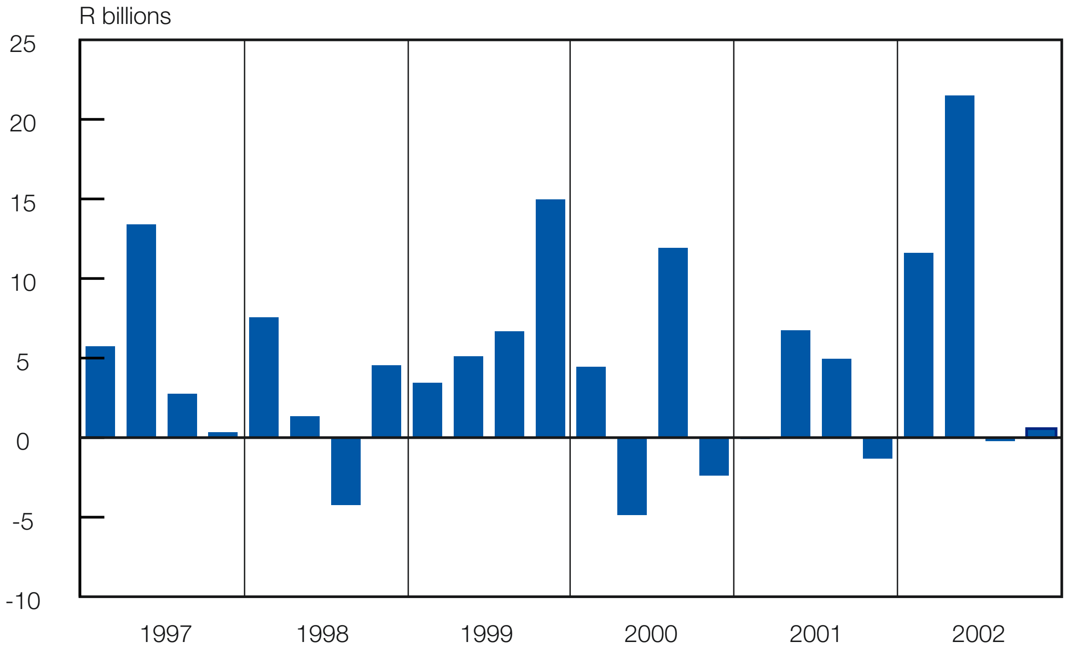
* Including unrecorded transactions

outweighed in the second half of 2002 by the heightened aversion to risk-taking by foreign investors when developments in international financial markets became quite volatile. In addition, foreign investors were able to realise healthy profits, valued in foreign currency, on their investments in South African assets following the appreciation of the exchange value of the rand.

After an inflow of *foreign direct investment* capital in the first three quarters of 2002, there was an outflow of R0,7 billion in the fourth quarter. The country's foreign direct investment liabilities rose in the fourth quarter of 2002 when a non-resident investor increased its direct investment in a domestic car manufacturing company, but this inflow was more than offset when dividends declared during the third quarter were actually remitted in the fourth quarter.

Outward direct investment changed from inflows of R5,3 billion in the second quarter and R2,3 billion in the third quarter to an outflow (i.e. an increase in foreign direct investment assets) of R2,2 billion in the fourth quarter of 2002. South African companies with foreign direct investment interests increased the amount of offshore open account balances and also acquired a dominant interest in the equity capital of certain foreign companies in the fourth quarter of 2002.

Balance of payments: Financial account

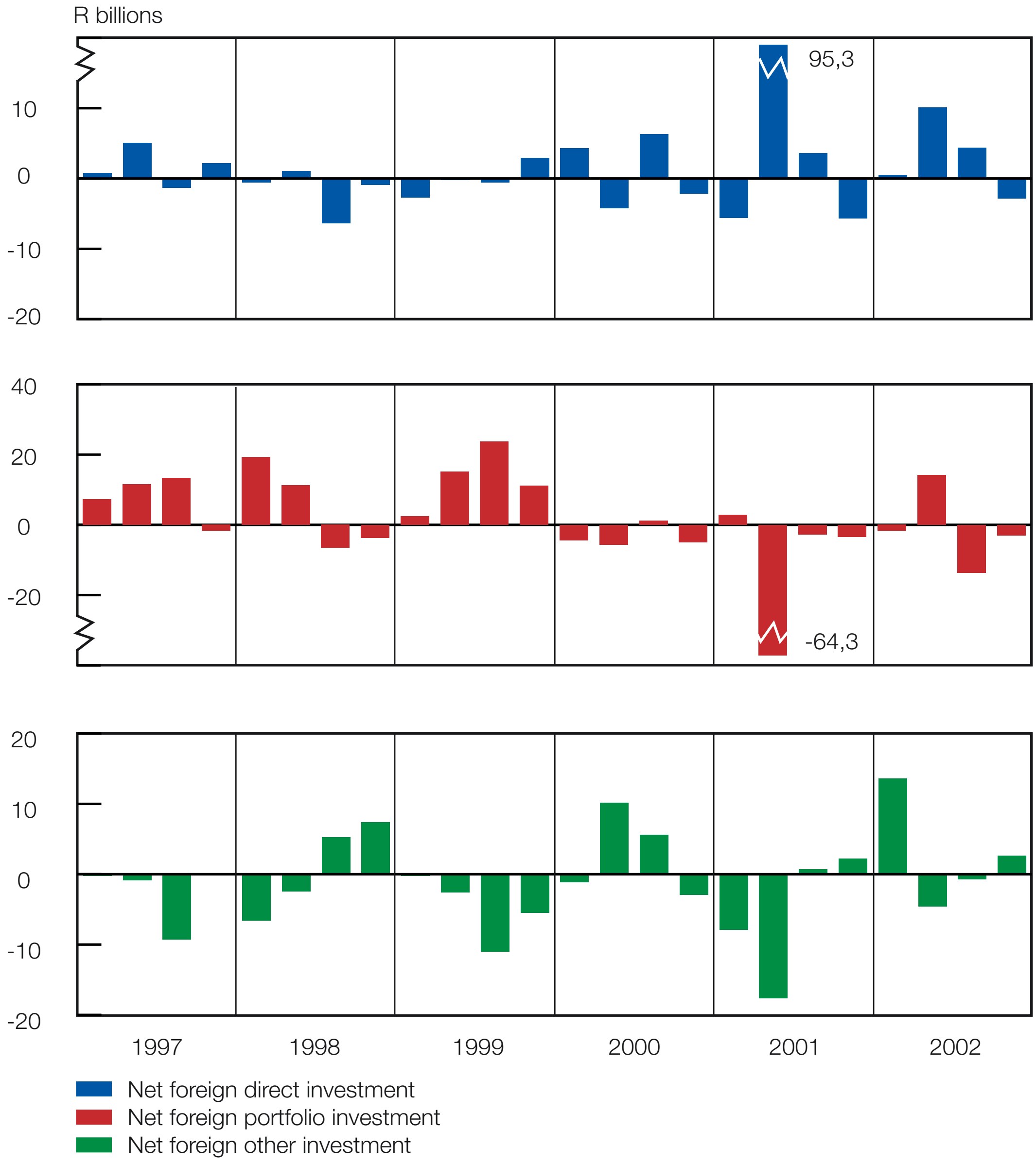


In the whole of 2002 there was a *net inflow of direct investment capital* of R12,1 billion. These inflows were mainly related to foreign investment in the equity capital of South African companies. South African companies also reduced their foreign direct investment assets during 2002, thereby contributing to the inward movement of direct investment capital.

Non-resident portfolio investors who sold South African equity securities on a net basis in the third quarter of 2002 continued to reduce their equity holdings in the fourth quarter, albeit less aggressively. Also, the redemption of a domestic bond by the national government contributed towards outflows of portfolio investment capital in the fourth quarter of 2002. These outflows were offset by inflows arising from non-resident investors adding to their holdings of fixed-interest securities during the fourth quarter of 2002; they were still net sellers of these types of securities in the third quarter. Portfolio investment outflows consequently declined from R12,9 billion in the third quarter of 2002 to R1,8 billion in the fourth quarter.

Portfolio investment abroad by South African investors, including individuals, increased somewhat from R0,8 billion in the third quarter of 2002 to R1,2 billion in the fourth quarter. The net outward movement of portfolio capital (i.e. outflows of portfolio capital offset against inflows) amounted to R3,0 billion in the fourth quarter compared with R13,7 billion in the third quarter. A net outflow of R4,3 billion was recorded in 2002 as a whole.

Financial account



Other foreign investment liabilities of South Africa, consisting mainly of loans, trade finance and bank deposits, declined by R7,7 billion in the fourth quarter of 2002.

The bulk of this outflow was in the form of repayments of short-term foreign loans by domestic banks. Non-resident deposit holders also reduced their rand-denominated deposits at domestic banks during the fourth quarter of 2002. Other foreign investment assets declined by R10,3 billion in the fourth quarter of 2002. South African companies reduced their short-term trade-related assets whereas dividends declared during the third quarter of 2002 by a foreign-listed company were actually paid to South African shareholders during the fourth quarter. These inflows lifted the *net inflow of other foreign investment capital* (i.e. changes in “other” foreign liabilities offset against changes in “other” foreign assets) to R10,9 billion in 2002.

In his 2003/04 Budget Speech the Minister of Finance reiterated the government’s commitment to a gradual approach to exchange control liberalisation. The Minister also announced significant changes to the exchange control regime. The concessions announced by the Minister will have an effect on flows through both the financial and current accounts of the balance of payments. Prominent among the concessions were the following:

- Consistent with the government’s policy of moving towards prudential regulations, institutional investors are allowed to invest, on approval, up to existing foreign asset limits of 15 per cent of total assets for long-term insurers, pension funds and fund managers, and 20 per cent for unit trust companies.

- With regard to corporates, their allowance of R500 million for the financing of new approved investments outside of Africa was increased to R1 billion.

- Dividend repatriation from foreign subsidiaries will be eligible for an exchange control credit, which will allow such funds to be re-exported for approved foreign direct investment.

- Blocked rand accounts are to be released to emigrated individuals. Emigrants will now receive an allowance of R750 000 per individual.

Various other concessions, having a greater impact on the services and current account of the balance of payments than on the financial account, were also announced. These include higher exchange control allowances for travel, study, gifts, maintenance and alimony.

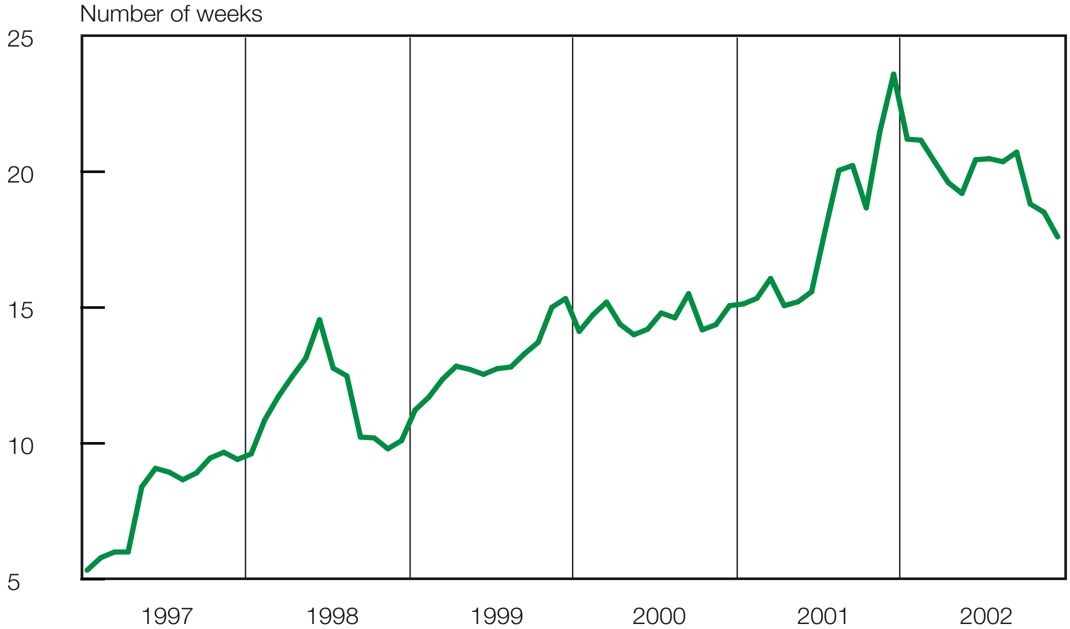
Amnesty was announced for individuals with funds held illegally offshore. Individuals filing for exchange control amnesty will be subject to a 5 per cent charge on funds repatriated, or a 10 per cent charge on any foreign assets remaining offshore.

Foreign reserves

Surpluses on both the current and the financial accounts of the balance of payments caused an increase in South Africa’s net international reserves in the fourth quarter of 2002. This increase amounted to R1,9 billion compared with a decline of R2,2 billion in the third quarter of 2002. For the whole of 2002 there was an increase of R36,6 billion in the country’s net gold and other foreign exchange reserves, occasioned mainly by strong capital inflows in the first half of the year.

Valued in US dollars, South Africa’s gross gold and other foreign exchange reserves increased from US$14,5 billion at the end of September 2002 to US$15,4 billion at the end of December. Because of the stronger external value of the rand, total international reserves valued in rand declined from R153,6 billion at the end of September 2002 to R132,6 billion at the end of December. The level of import cover consequently fell from 20½ weeks' worth of imports of goods and services at the end of September 2002 to 17½ weeks' worth at the end of December.

Imports covered by reserves



The gross gold and other foreign exchange reserves of the Reserve Bank remained unchanged at US$7,6 billion from the end of September 2002 to the end of December, but increased somewhat to US$7,7 billion at the end of January 2003. Revaluing these reserves in rand caused a decline in the Bank's gross international reserves from R80,1 billion at the end of September 2002 to R66,0 billion at the end of December. In January 2003 the gross international reserves of the Bank rose somewhat to R66,2 billion. The short-term credit facilities utilised by the Reserve Bank declined from R26,3 billion at the end of September 2002 to R21,5 billion at the end of December and R21,4 billion at the end of January 2003. The Bank's non-borrowed reserves accordingly fell from R53,8 billion at the end of September 2002 to R44,5 billion at the end of December but increased again to R44,8 billion at the end of January 2003.

The Reserve Bank's net open position in foreign currency declined further from US$1,8 billion at the end of November 2002 to US$1,6 billion at the end of December and to US$1,4 billion at the end of February 2003.

Exchange rates

The weighted exchange rate of the rand, which had declined by 34,4 per cent from the end of December 2000 to the end of December 2001, bounced back by 26,0 per cent from the end of December 2001 to the end of December 2002. This strengthening of the external value of the rand coincided with surpluses on the current and financial accounts of the balance of payments of the country. The improvement of the external value of the rand occurred mainly in the fourth quarter of 2002 when, on balance, the nominal effective exchange rate of the rand strengthened by 17,8 per cent – the largest movement in any single quarter since the first quarter of 1986.

Factors that probably supported the improvement in the country's international reserves and the strengthening of the external value of the rand during 2002 and early 2003 were:

- sound macroeconomic policies by the South African monetary and fiscal authorities;
- positive statements about South Africa's credit outlook by international credit rating agencies and the International Monetary Fund;
- the interest rate differential between South Africa and other economies which had widened significantly during 2002 and invited capital flows into South Africa;
- a general reduction in risk aversion towards emerging-market asset classes;
- uncertainty about the health of the US economy and the associated weaker trend in the value of the US dollar;
- an improvement in South Africa's terms of trade;
- speculation against currency risk probably aided and abetted the strength of the rand (e.g. importers might have been induced not to cover forward their expected foreign exchange purchases and/or to sell back existing forward cover); and
- an improvement in perceptions regarding South Africa's status as a safe haven improved during 2002 following increased geopolitical tensions.

Exchange rates of the rand

Percentage change

	31 Dec 2001 to 28 Mar 2002	28 Mar 2002 to 28 Jun 2002	28 Jun 2002 to 30 Sep 2002	30 Sep 2002 to 31 Dec 2002	31 Dec 2002 to 31 Jan 2003
Weighted average*	6,9	1,4	-1,3	17,8	-1,0
Euro	7,3	-3,3	-0,9	14,7	-2,4
US dollar	6,0	9,9	-1,8	22,1	0,9
British pound	7,8	2,3	-3,8	18,8	-2,0
Japanese yen	7,0	-1,2	0,2	19,0	1,2

* The weighted exchange-rate index is calculated with reference to a basket of 14 currencies until the end of 2002 and a basket of 13 currencies in the ensuing period

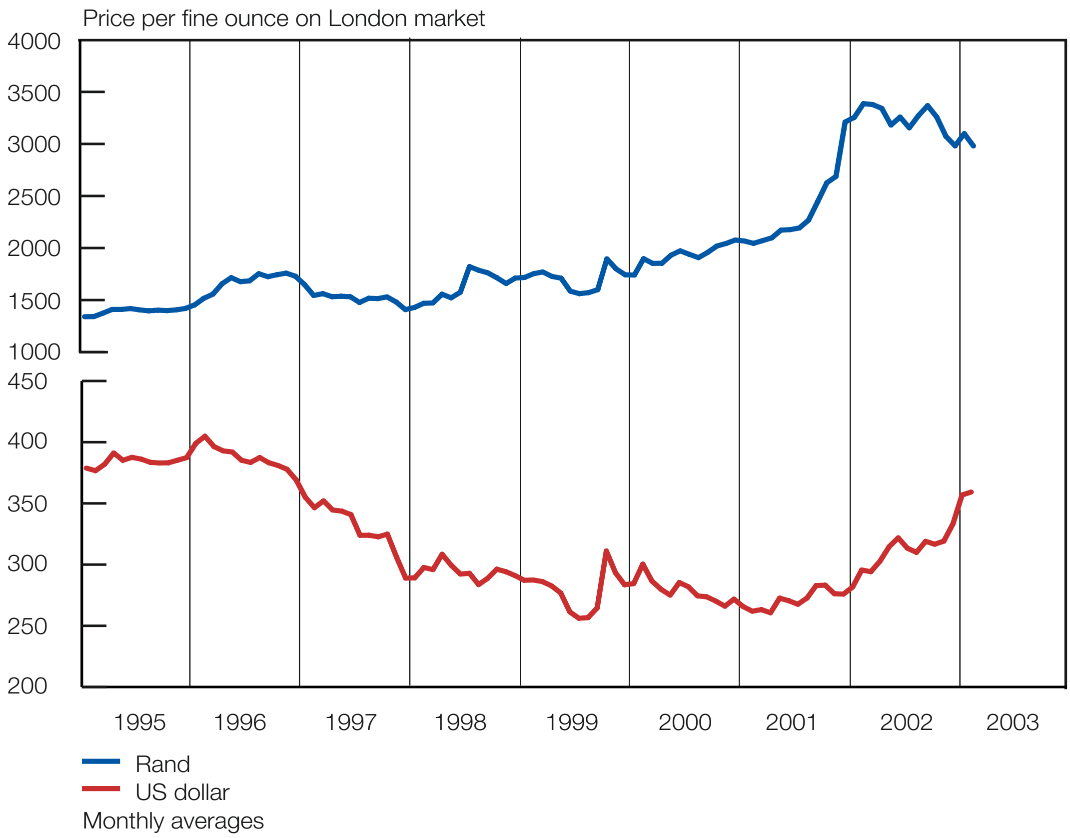
The external value of the rand weakened somewhat on a trade weighted basis during January 2003 despite the announcement of the date for the privatisation of the state-owned telecommunications company, Telkom. Heightened risk aversion amongst international investors in anticipation of a possible war in Iraq and a widespread decline in the value of financial asset prices caused non-resident investors to reduce their holdings of domestic fixed-interest and equity securities during January 2003. The weighted exchange rate of the rand declined by 1,0 per cent from the end of December 2002 to the end of January 2003. However, this was only a brief interlude and in February 2003 the rand strengthened again, taking the overall increase of the nominal effective value of the rand to 7,1 per cent from the end of December 2002 to the end of February 2003.

The net average daily turnover in the domestic market for foreign exchange, which had declined to US$7,3 billion in the third quarter of 2002, rose to US$8,2 billion in the fourth quarter of 2002 – its highest level since the fourth quarter of 2001. The value of transactions in which non-residents participated, increased from US$4,4 billion per day to US$5,0 billion over the same period. Participation by resident parties increased from US$2,9 billion per day in the third quarter of 2002 to US$3,3 billion in the fourth quarter.

Daily nominal effective exchange rate of the rand

Adjusted for the inflation differential between South Africa and its most important trading partners, the average monthly real effective exchange rate of the rand increased by 5,7 per cent from December 2001 to September 2002. However, the average real effective exchange rate of the rand was still 22,1 per cent lower in the first nine months of 2002 than in the corresponding period in 2001.

Gold price

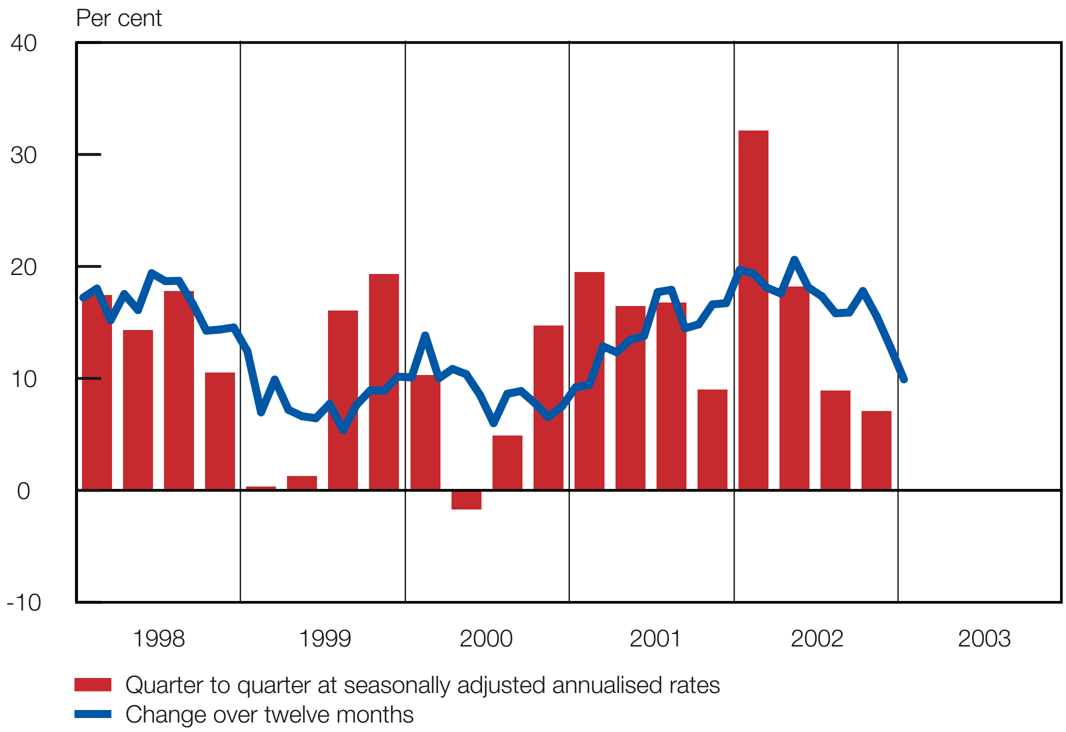


Monetary developments, interest rates and financial markets

Money supply

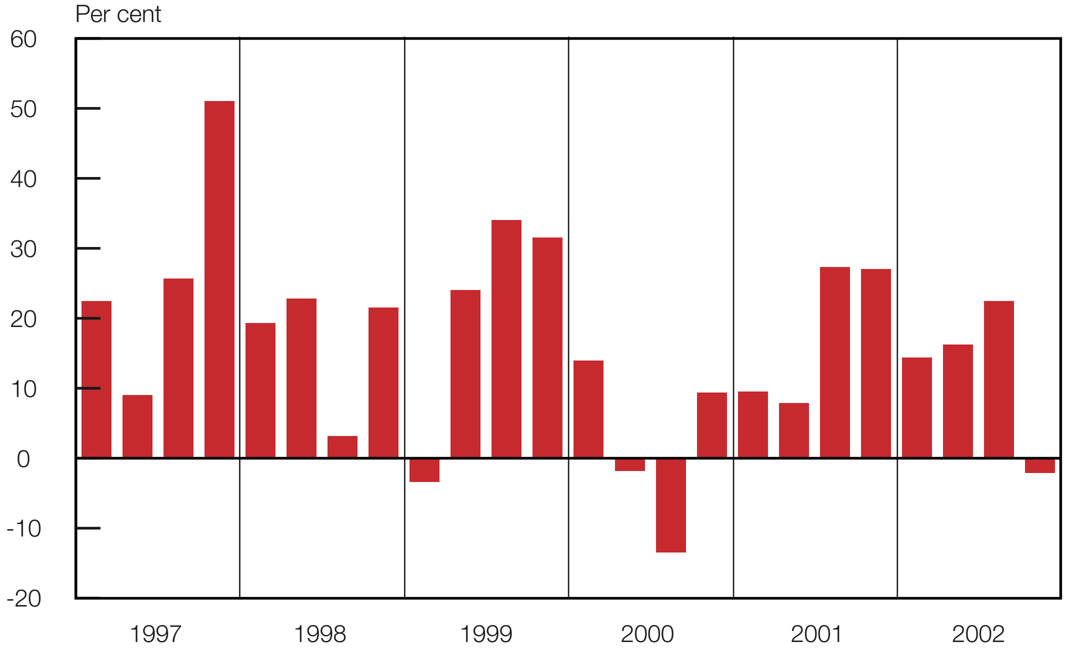
The rapid growth in the monetary aggregates in the first quarter of 2002 lost some momentum in the second quarter and decelerated considerably in the second half of the year. The seasonally adjusted and annualised quarter-to-quarter growth in the *broadly defined money supply, M3*, slowed down from 32,1 per cent in the first quarter of 2002 to 18,2 per cent in the second quarter, 8,9 per cent in the third quarter and 7,1 per cent in the fourth quarter. This slowdown was also evident in the growth over twelve months in M3 which decreased from 20,6 per cent in May 2002 to 12,8 per cent in December and 9,9 per cent in January 2003.

Growth in M3



While M1 and M2 displayed a broadly similar growth pattern to that of M3 during the year, rapid quarter-to-quarter growth in the narrowest monetary aggregate (M1A) was noticeable throughout the first three quarters of 2002. M1A (consisting of notes and coin in circulation plus cheque and transmission deposits of the domestic private sector with monetary institutions) increased at a rate of 14,4 per cent in the first quarter of 2002, 16,2 per cent in the second quarter, and 22,5 per cent in the third quarter but declined at an annualised rate of 2,1 per cent in the fourth quarter. Most of these deposits earn little or no interest and they are primarily held for transaction purposes rather than as an investment vehicle. During the first three quarters of 2002 the demand for M1A money might have been influenced by rapidly rising nominal income and expenditure. By the fourth quarter of 2002 the growth in household consumption expenditure eased somewhat, slowing the growth in the demand for money for transaction purposes. At the same time, the attractiveness of higher interest-bearing but less liquid deposits increased. This might have contributed to the decline in the demand for M1A in the fourth quarter of 2002.

Growth in M1A



Quarter to quarter at seasonally adjusted annualised rates

Percentage change in monetary aggregates
Quarterly at seasonally adjusted annualised rates

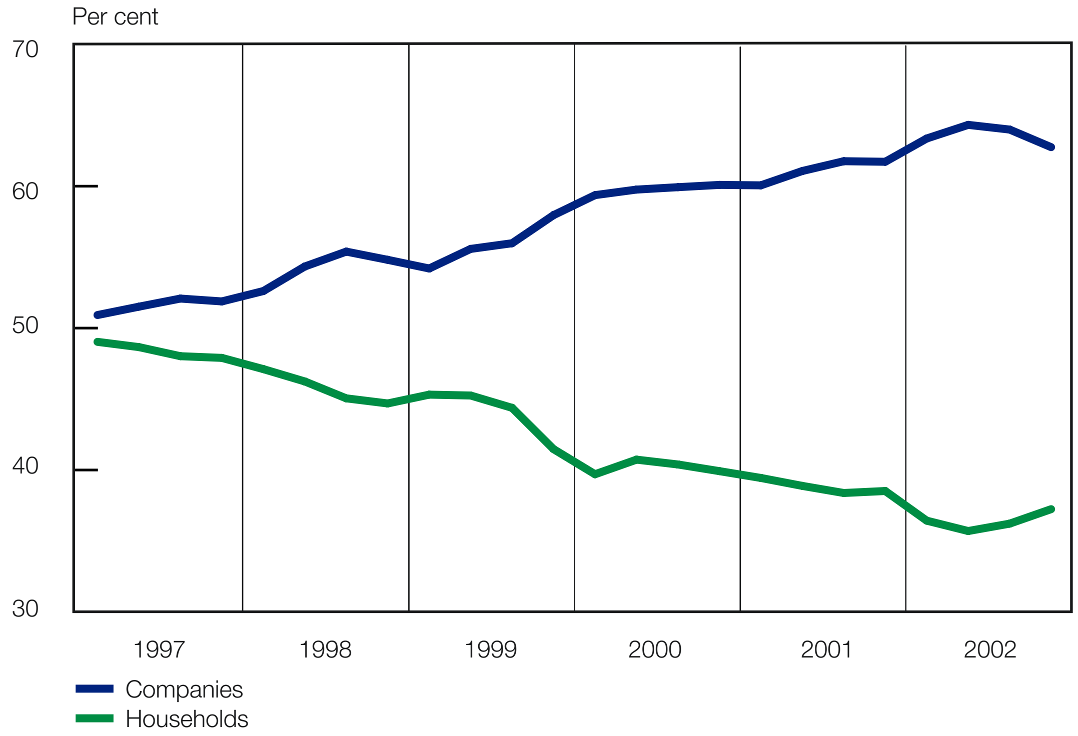
Period		M1A	M1	M2	M3
2001:	1st qr	9,5	18,8	21,0	19,5
	2nd qr	7,9	18,7	11,3	16,4
	3rd qr	27,3	10,5	9,8	16,8
	4th qr	27,0	8,2	9,0	9,0
2002:	1st qr	14,4	54,2	40,2	32,1
	2nd qr	16,2	21,8	15,3	18,2
	3rd qr	22,5	-1,0	0,2	8,9
	4th qr	-2,1	0,3	11,2	7,1

From early 2002 it was not only rising nominal expenditure and income that strengthened the demand for M3 money balances, but also heightened stock market uncertainty and concerns that the global economic weakness might spill over to South Africa. Around May, June and July 2002, exporters started to repatriate export earnings more rapidly than before, further adding to the demand for money balances. There was a recurrence of this in the fourth quarter of 2002.

Rising short-term interest rates, offering increasingly attractive yields on deposit-type investments, also contributed to the monetary expansion during 2002. In the fourth quarter of 2002 and the early months of 2003 expectations were rife that inflation had peaked and that real returns on deposits would continue to improve accordingly. This belief was strengthened when the exchange value of the rand appreciated beyond what was generally expected previously.

Growth in the broad monetary aggregates during 2002 was concentrated in the bank deposits of the private corporate sector. The corporate sector contributed 60 per cent of the total increase in M3 whereas the household sector contributed 40 per cent. Bank deposits by non-financial companies increased strongly but those of financial companies showed limited growth during 2002.

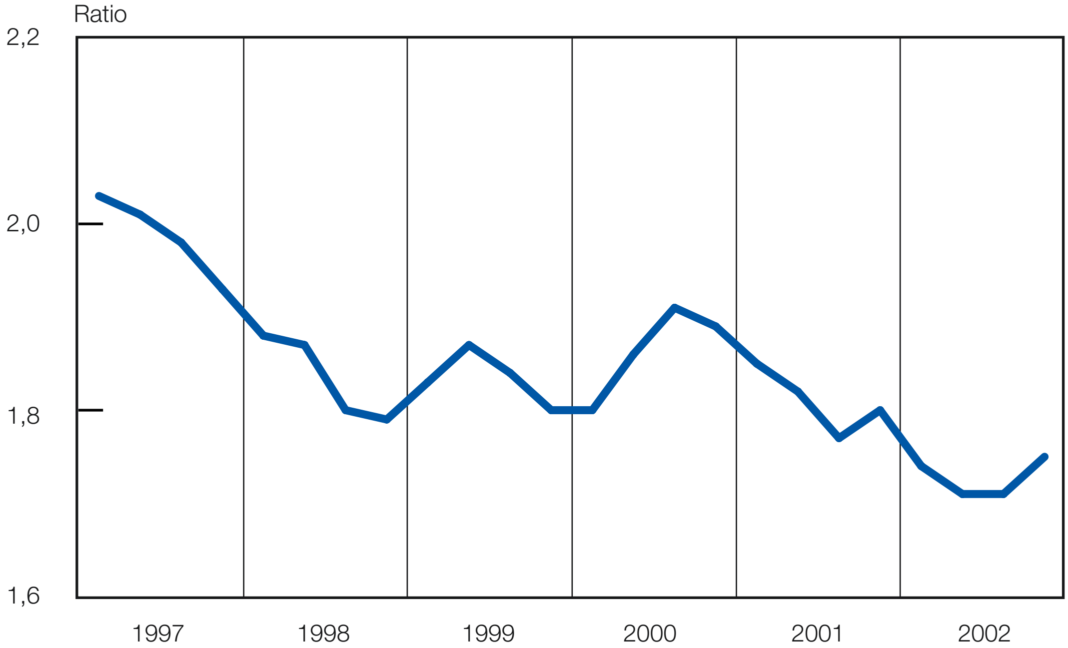
Deposits as percentage of M3



The quarter-to-quarter annualised growth in M3 exceeded the growth in nominal gross domestic product in the first two quarters of 2002. These relatively high growth rates were reversed in the remaining two quarters of 2002 when the growth in nominal gross domestic product exceeded growth in M3 by 0,2 percentage point in the third quarter and by 9,5 percentage points in the fourth quarter. The income velocity of circulation of M3 accordingly increased from 1,71 in the third quarter of 2002 to 1,75 in the fourth quarter.

The M3 money supply increased by R76,0 billion from the end of 2001 to the end of 2002. In a statistical or accounting sense the change in M3 in 2002 was explained by increases of R76,7 billion in net foreign assets, R24,3 billion in net claims on the government sector and R31,9 billion in claims on the private sector. These were partly offset by a contraction of R56,9 billion in “net other assets and liabilities” of the monetary sector. The indication towards the end of the year by the bank supervisory authority that all private-sector banks must report the full extent of their assets and liabilities arising from repurchase agreements on their balance sheets, made a significant contribution to the sharp decline in the banks' net other assets and liabilities in the final two months of 2002. Some 64 per cent of the total decline of R56,9 billion in net other assets and liabilities of the monetary sector during 2002 occurred in November and December.

Income velocity of M3



Seasonally adjusted

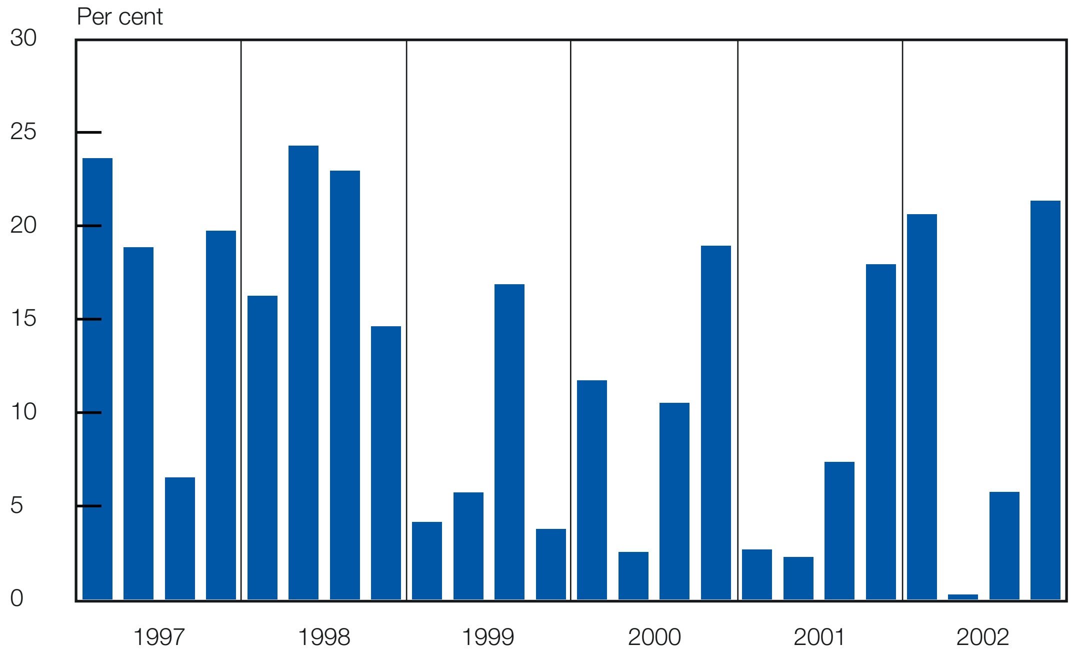
Accounting counterparts of M3
R billions

Counterparts	2002	
Net foreign assets		76,7
Net claims on government sector		24,3
Gross claims	17,4	
Government deposits (increase-, decrease+)	6,9	
Claims on the private sector		31,9
Net other assets and liabilities		-56,9
Total change in M3		**76,0**

Credit extension

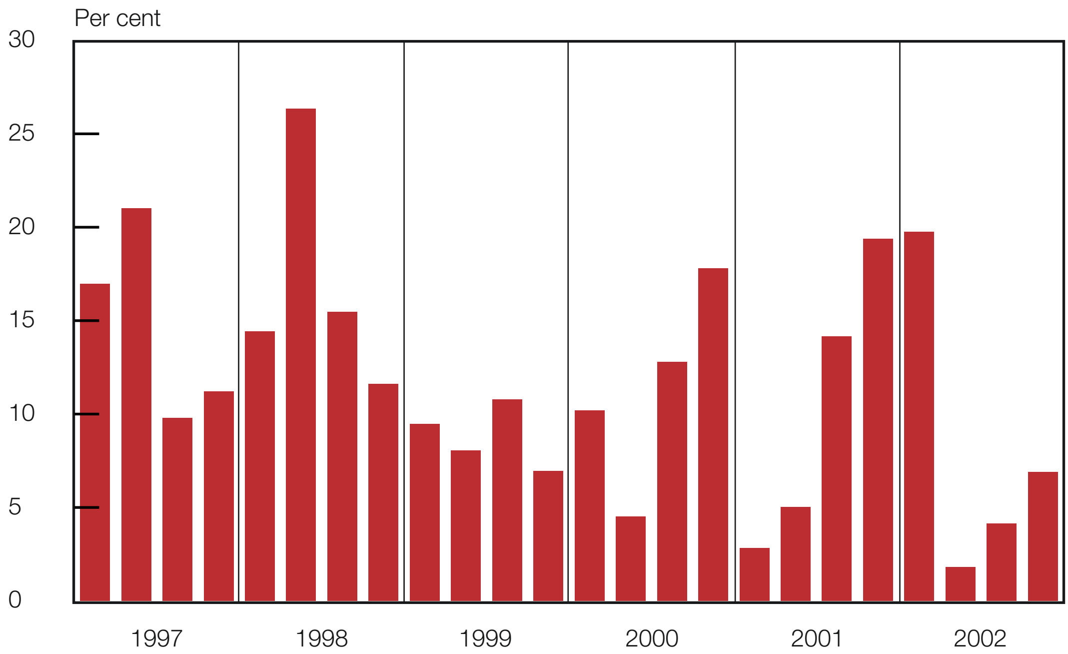
Growth in *total domestic credit extension* varied considerably during 2002. Measured from quarter to quarter and annualised, growth in total domestic bank credit extension (i.e. credit extended by monetary institutions to the domestic private sector and net claims of banks on the government sector) decelerated from 20,6 per cent in the first quarter of 2002 to a nine-year low of 0,2 per cent in the second quarter. Annualised credit growth was still quite low at 5,7 per cent in the third quarter of 2002, but bounced back to 21,3 per cent in the fourth quarter.

Total credit extended



Quarter to quarter at seasonally adjusted annualised rates

Credit extended to private sector



Quarter to quarter at seasonally adjusted annualised rates

The rapid acceleration in overall credit growth in the fourth quarter of 2002 was mainly caused by a steep increase in banks' net claims on the government sector. This increase in banks' net holdings of government securities was not a reflection of any rise in the funding needs of the government sector, but was essentially related to the bank regulatory authority reiterating that assets and liabilities arising from repurchase transactions must be reported on the balance sheet by all the banks. A sizeable portion of repurchase transactions involves government securities, i.e. claims on the government sector.

Measured over periods of twelve months, the growth in total bank credit extension slowed down from 13,5 per cent in January 2002 to 9,6 per cent in June. In the second half of the year total credit growth at first accelerated to 13,0 per cent in November 2002, but later fell back to 8,1 per cent in December when the high value of December 2001 entered the base for year-on-year growth calculations. Growth in total credit extension accelerated further to 15,4 per cent in January 2003.

The rising cost of credit during 2002 contributed to a slowdown in the quarter-to-quarter growth in *credit extension to the private sector* from 19,8 per cent in the first quarter of 2002 to just 1,8 per cent in the second quarter. Later, private-sector credit growth rose to still modest rates of 4,1 per cent in the third quarter of 2002 and 6,9 per cent in the fourth quarter. Growth over twelve months decelerated continuously from a recent peak of 15,6 per cent in January 2002 to 8,7 per cent in October but then picked up to 9,2 per cent in November before declining sharply to only 4,7 per cent in December.

The exceptionally low growth in December 2002 was mainly due to the high base value in 2001 which influenced year-on-year growth calculations one year later. Delays in the repatriation of export proceeds in December 2001 and January 2002 and advance payments for imports fuelled the demand for credit by the private sector and raised the base value for year-on-year growth calculations towards the end of 2002 and the beginning of 2003. These leads and lags in foreign payments and receipts were reversed in the second half of 2002, thereby contributing in itself to the slowdown in the growth in credit demand. Furthermore, the rising cost of credit probably braked the growth of aggregate nominal spending and the associated growth in the demand for credit. In January 2003, private-sector credit bounced back to a double-digit figure of 12,7 per cent. This can be ascribed to technical factors – notably the reporting of derivatives.

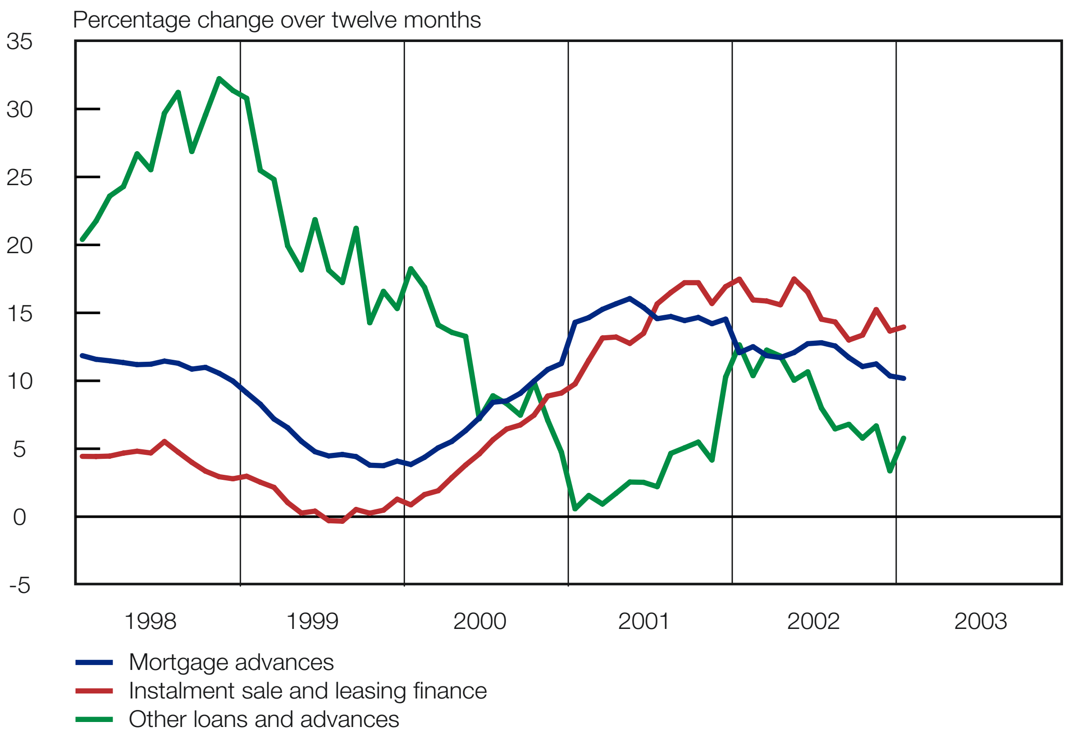
An analysis of banks' claims on the private sector by type of credit shows that the growth over twelve months in *mortgage advances* averaged 11,9 per cent in 2002 compared with an average of 14,9 per cent in 2001. The twelve-month growth rate fluctuated in a narrow range of between 11,0 per cent and 12,8 per cent from January 2002 to November. It broke out of that range to 10,4 per cent in December 2002 and grew at 10,2 per cent in January 2003. Although the percentage growth in this credit category generally slowed down during 2002, the absolute increase over the year was still considerable, amounting to R26,9 billion compared with the all-time high of R32,9 billion recorded in 2001. This firm growth in mortgage financing reflects the buoyant trading conditions in the real-estate market over the past two years.

The growth over twelve months in *instalment sale credit* accelerated from 12,3 per cent in February 2002 to a five-year high of 18,1 per cent in December, reflecting reasonably strong consumer demand. New motor vehicle finance contributed 28 per cent and used motor vehicle finance 30 per cent to the increase in instalment sale credit in the fourth quarter of 2002. As the number of vehicles sold declined in recent times, the higher demand for financing of motor vehicle purchases could probably be related more to increases in motor vehicle prices. The contribution of industrial, commercial and office equipment to the overall increase in instalment sale credit in the fourth quarter of 2002 amounted to 21,2 per cent. Growth over twelve months in *leasing finance* declined from 24,8 per cent in February 2002 to 5,7 per cent in September and 4,2 per cent in December. New business payouts of instalment sale credit and leasing finance declined from a record high of R18,5 billion in the third quarter of 2002 to R17,9 billion in the fourth quarter.

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

Period		Instalment sale credit	Leasing finance	Investments and bills discounted	Mortgage advances	Other loans and advances	Total
2002:	Jan................	14,5	24,5	55,0	12,1	12,6	15,6
	Feb	12,3	24,8	36,8	12,5	10,4	13,7
	Mar	13,0	22,8	28,3	11,8	12,3	13,6
	Apr................	12,5	23,3	32,4	11,7	11,8	13,5
	May..............	15,8	21,4	26,3	12,1	10,0	12,9
	Jun................	14,9	20,3	10,2	12,7	10,7	12,3
	Jul.................	15,5	12,3	7,3	12,8	8,0	10,9
	Aug	16,7	9,3	17,5	12,6	6,5	10,7
	Sep	16,4	5,7	8,2	11,7	6,8	9,7
	Oct................	17,3	5,1	1,9	11,0	5,8	8,7
	Nov	17,7	9,7	-1,5	11,2	6,7	9,2
	Dec	18,1	4,2	-28,5	10,4	3,4	4,7
2003:	Jan................	18,2	4,7	55,7	10,2	5,8	12,7

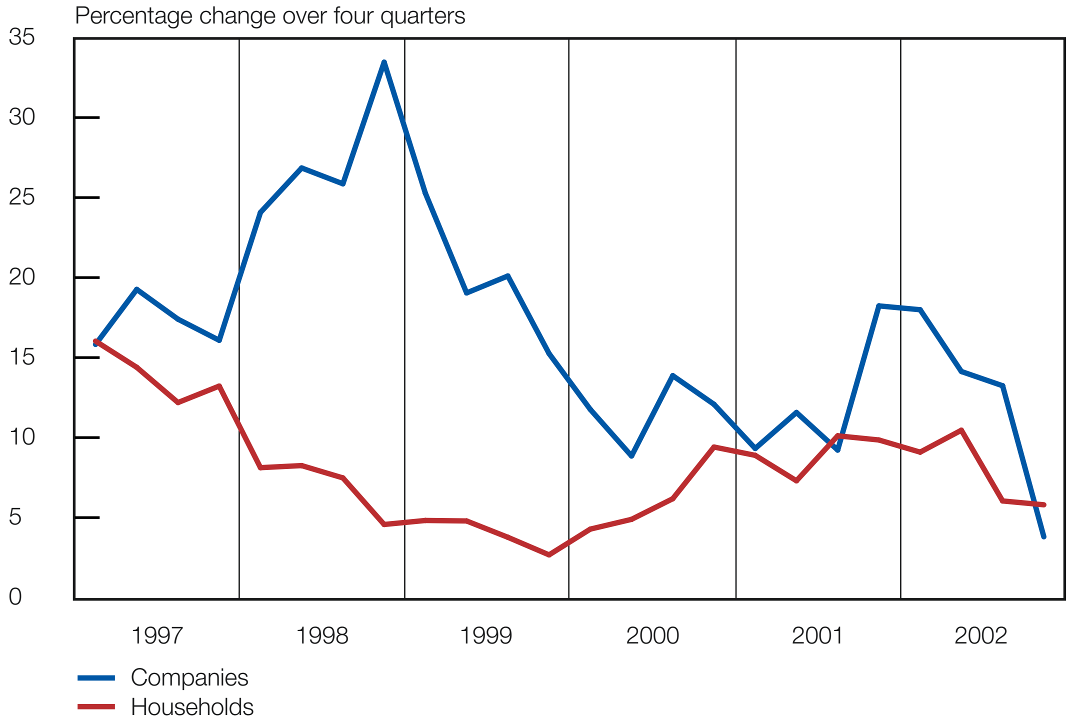
Credit extended to private sector by type of credit



The rate of increase over twelve months in *other loans and advances* slowed down from 12,6 per cent in January 2002 to 6,8 per cent in September and just 3,4 per cent in December. The changing direction of leads and lags in foreign payments and receipts over the past year clearly left its mark on the growth pattern of credit classified as “other loans and advances”.

The major part of the absolute increase of R9 billion in credit extended to the *household sector* in the fourth quarter of 2002 was associated with an increase in mortgage advances and instalment sale credit. *Other loans and advances* dominated the increase of R5 billion in credit extended to the corporate sector in the fourth quarter of 2002.

Credit extended to households and companies



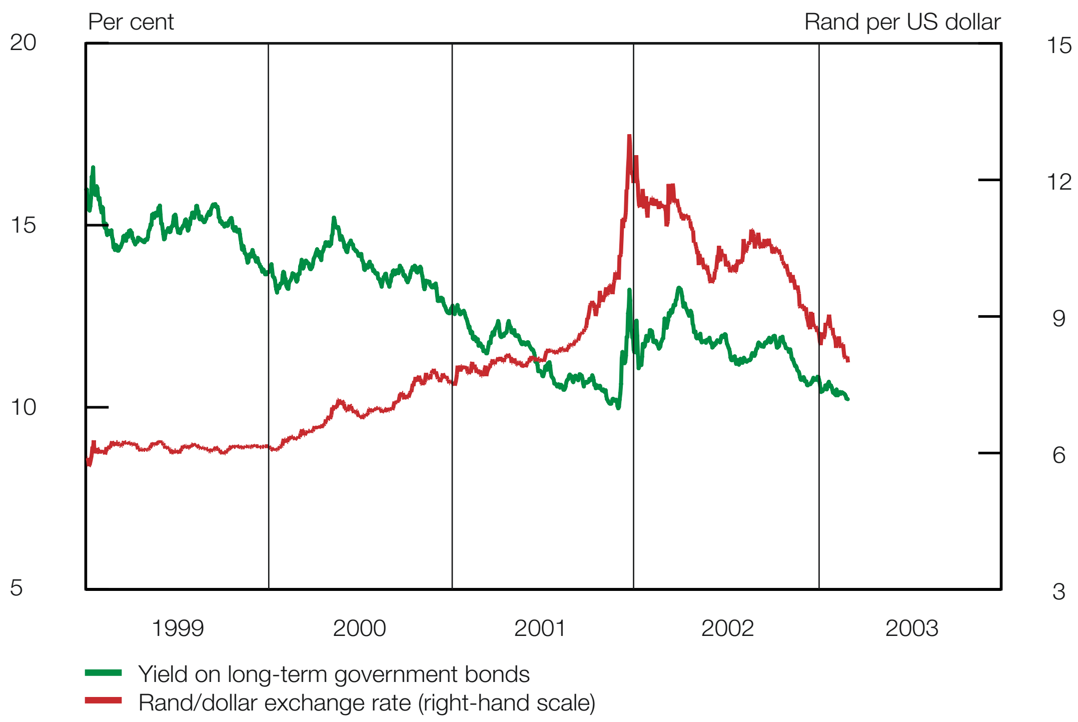
Reviewing the year 2002 as a whole, the household sector accounted for the bulk of the increase in credit extended to the private sector. The absolute increase, from the end of 2001 to the end of 2002, in overall credit extension to the private sector amounted to R31,9 billion of which the larger share of R18,3 billion was absorbed by credit to households. Credit extended to the corporate sector increased by R13,6 billion.

Interest rates and yields

The prices of fixed-interest securities broadly traced the changes in the exchange rate of the rand since November 2001. The steep fall in the exchange value of the rand in December 2001 caused yields in the market for fixed-interest securities to rise sharply up to March 2002. The mood in the market then turned positive when the exchange value of the rand began to show clear signs of strengthening.

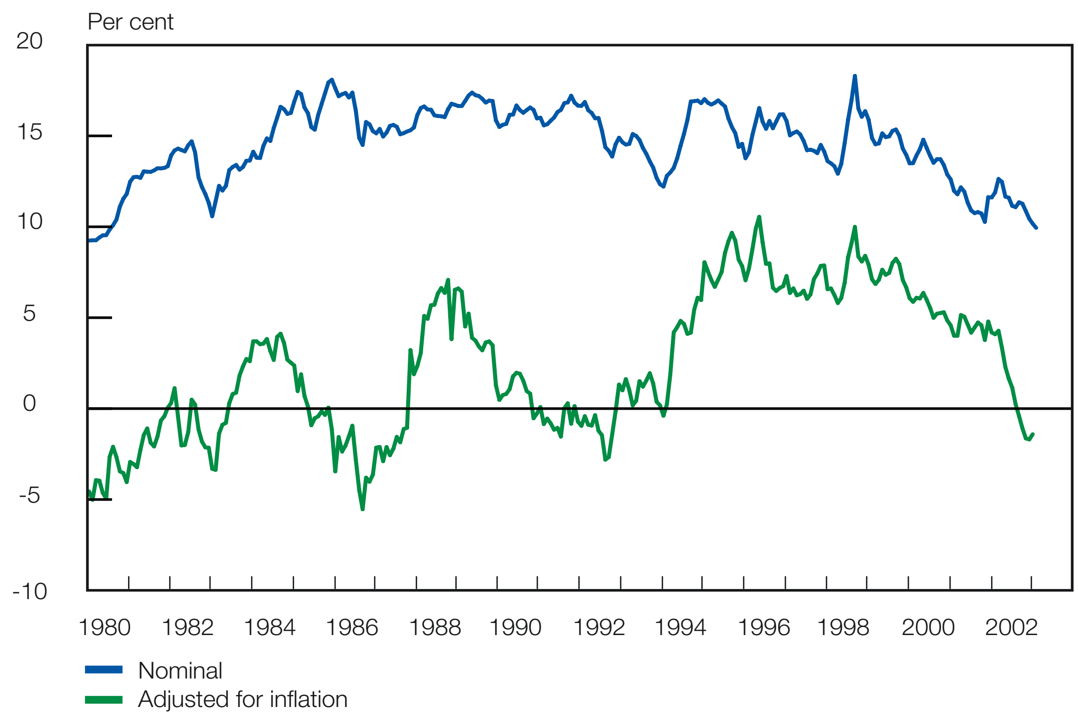
Since late March 2002, the yield on long-term fixed-interest securities generally declined almost in tandem with the appreciation of the exchange value of the rand. This downward movement of yields was further assisted by the absence of the public sector as a net borrower in the domestic capital market.

Bond yield and exchange rate



The *monthly average yield on long-term government bonds* in the eleven-to-thirteen years maturity range declined from 12,6 per cent in March 2002 to 9,9 per cent in February 2003 – below the level where they were in November 2001 when the rand fell dramatically. In fact, long-bond yields in February 2003 were at their lowest since 1980. Bearish sentiment interrupted the bond market rally in September and October 2002 but this turned out to be just a temporary occurrence.

Yield on long-term government bonds

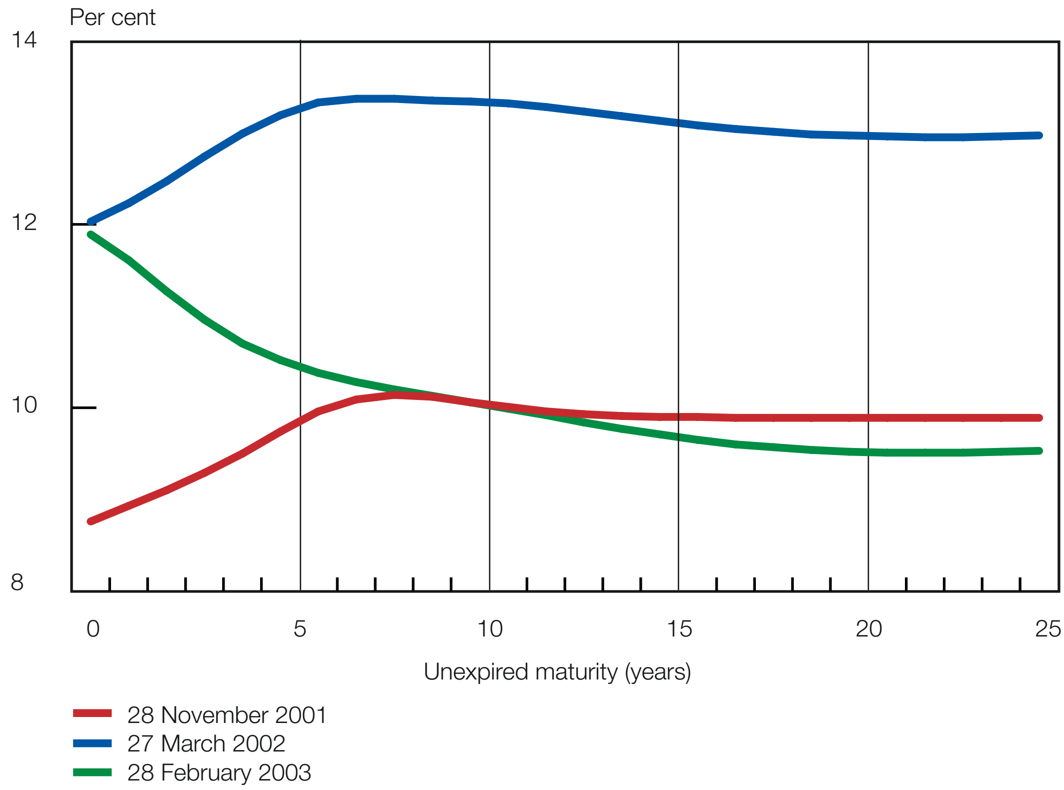


The *daily average yield* on R153 government bonds (with redemption dates ranging from 2009 to 2011) declined from 13,28 per cent on 28 March 2002 to 11,17 per cent on 26 July and from 11,96 per cent on 7 October 2002 to 10,22 per cent on 28 February 2003. Both these rallies coincided with bouts of strong rand appreciation.

Persistently high inflationary pressures motivated the Reserve Bank to tighten monetary policy during 2002. The repurchase rate of the Bank was increased on four occasions in 2002, each time by 100 basis points. The latest adjustment was on 13 September 2002 when the repurchase rate was raised to 13,50 per cent.

Other short-term interest rates anchored themselves to the repurchase rate. *Yields on short-dated bonds* accordingly rose by 327 basis points from 28 November 2001 to 27 March 2002. By the end of February 2003 the yield on short-dated bonds was 313 basis points higher than on 28 November 2001. As described above, *yields on long-dated bonds* fell, on balance, by 344 basis points from 27 March 2002 to the end of February 2003.

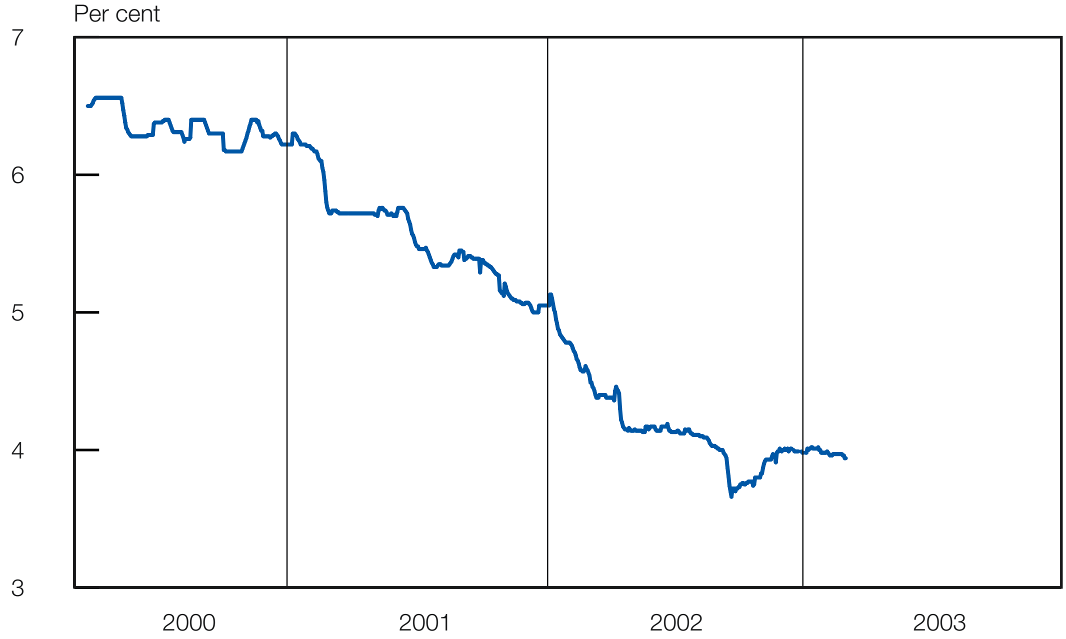
Yield curves



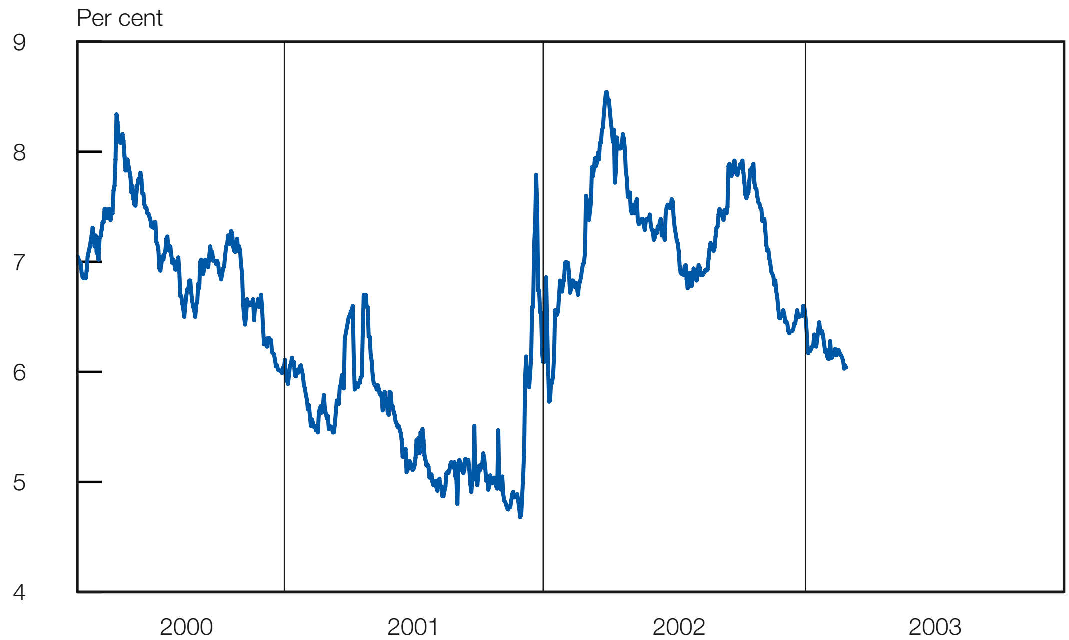
These divergent movements of long-bond yields and short-bond yields were reflected in quite a drastic change in the slope of the yield curve. During April 2002 the slope of the yield curve changed from upwards to downwards and persisted with this inverted shape throughout the rest of 2002 and into the early months of 2003. Market participants interpret this downward sloping yield curve as an indication of relatively tight monetary policy with the prospect that inflation will be enduringly reduced in the long term. Market commentators also agree that the limited demand for loanable funds by the public sector contributed to the decline in long-bond yields, thus playing a prominent role in the inversion of the slope of the yield curve. The *inverse yield gap*, i.e. the difference between bond yields at the extreme long and short ends of the curve, amounted to 236 basis points on 28 February 2003.

The *real yield on government's R189 inflation-linked bond* decreased from 4,4 per cent in March 2002 to 3,7 per cent in September but increased to 4,0 per cent in February 2003 in response to a general scaling down of inflation expectations.

Real yield on R189 inflation-linked government bond



Inflation expectations in the bond market



Difference between the nominal yield on conventional and real yield on inflation-linked bonds within the six-to-ten-year maturity range

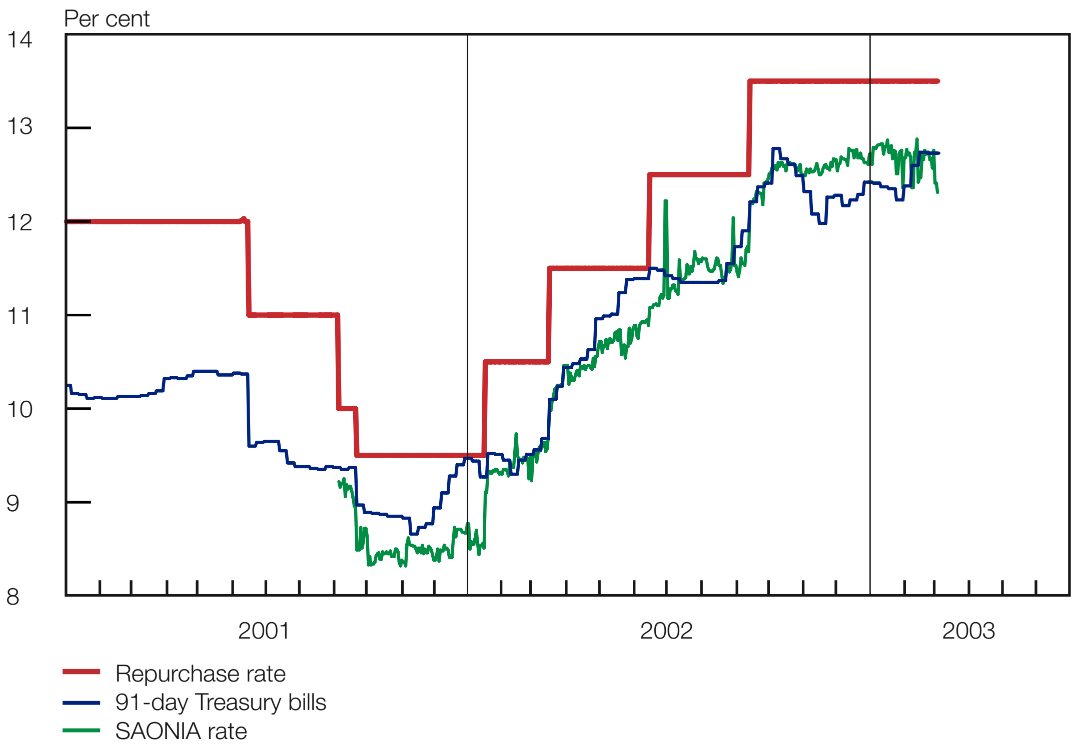
Expected long-term inflation is approximated by the break-even inflation rate, which is calculated as the difference between the nominal yield on conventional government bonds and the real yield on inflation-linked bonds in the six-to-ten-year maturity range. Expected longer-term inflation derived in this way decreased, on balance, from a monthly average of 8,0 per cent in April 2002 to 6,1 per cent in February 2003.

Long-bond yields below the contemporaneous inflation rate were last seen in South Africa in January 1994, but they reappeared in 2002 when inflation picked up strongly. Using historical year-on-year increases in CPIX, the real or *inflation-adjusted yield on long-term government bonds* declined to a negative value in September 2002. The real yield fell from 4,8 per cent in December 2001 to just 0,2 per cent in August 2002 and to a negative value of 1,7 per cent in December. With the subsequent slight deceleration of CPIX inflation the real rate of return on long-term government bonds improved slightly but was still negative to the value of 1,4 per cent in January 2003.

The *sovereign risk premium* on South African government bonds listed on the North American capital market shrank by 52 basis points from November 2001 to February 2003, whereas the yield spread of emerging markets' sovereign debt over United States Treasury Bonds decreased by 362 basis points. However, in absolute terms, the yield spread on South African government bonds is considerably less than that of emerging-market debt. In February 2003, Moody's, the international credit rating agency, revised their assessment of South Africa from a stable to a positive outlook. This brought the number of rating agency upgrades in the fifteen months to February 2003 to four.

The South African Overnight Interbank Average (SAONIA) rate moved higher during 2002 as money-market conditions tightened somewhat. The SAONIA rate rose from 8,44 per cent on 10 January 2002 and briefly breached 12 per cent on 28 June when

Money-market interest rates

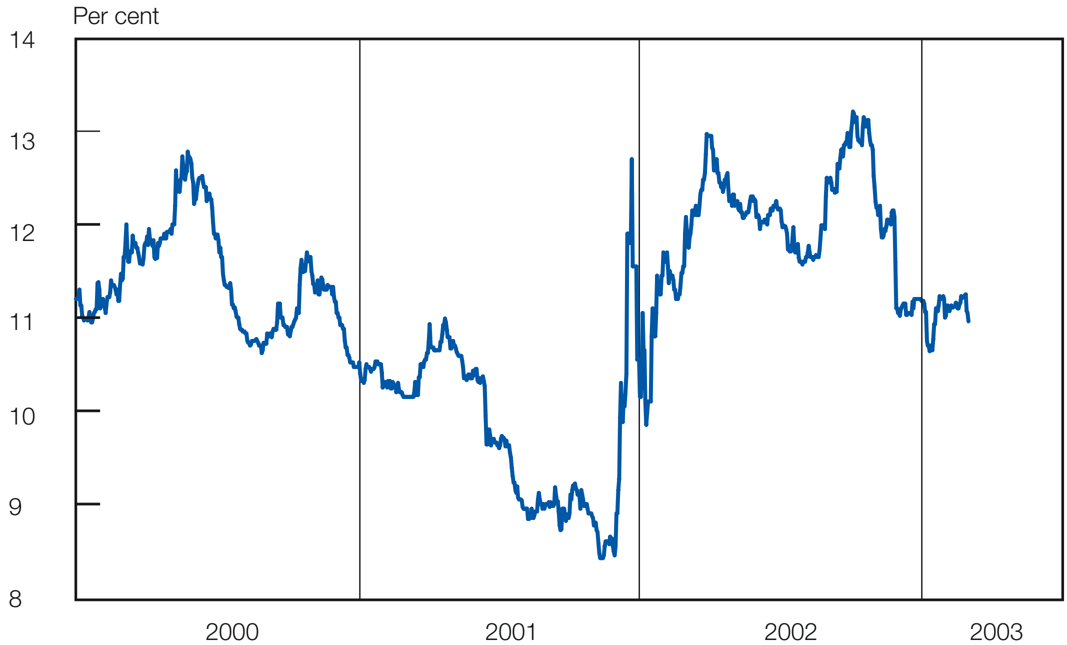


some private-sector banks had to access the accommodation facilities of the Reserve Bank through the final clearing mechanism. In the ensuing months the SAONIA rate moved even higher and reached 12,45 per cent on 30 September. In the fourth quarter of 2002, the SAONIA rate firmed even further to within a narrow range of between 12,48 per cent and 12,78 per cent, essentially emulating the steady behaviour of the Reserve Bank's repurchase rate. In early 2003 this rate moved slightly lower and reached 12,67 per cent on 12 March 2003.

Other money-market interest rates increased considerably in the first nine months of 2002. Broadly mirroring the increase in the repurchase rate, the rate on three-month bankers' acceptances increased by 365 basis points from a low of 9,50 per cent on 15 January 2002 to 13,15 per cent on 23 October. In similar fashion, the tender rate on 91-day Treasury bills increased from 9,27 per cent on 17 January 2002 and peaked at 12,78 per cent on 10 October.

Likewise, the rate on 9x12-month forward rate agreements (FRAs) rose, on balance, from a low point of 9,85 per cent on 8 January 2002 to a peak of 13,19 per cent on 3 October 2002. There were interruptions in the upward movement of forward rates as sentiment in the market occasionally turned bullish. The longest rally of the 9x12-month FRA rate lasted ninety-nine days and reduced the rate by 138 basis points from 12,95 per cent on 2 April 2002 to 11,57 per cent on 29 July.

Rate on 9x12-month forward rate agreements



October appeared to mark a turning point in the money-market rates as fears of higher inflation began to dissipate and the exchange value of the rand strengthened. The rate on three-month bankers' acceptances declined from 13,15 per cent on 23 October 2002 to 13,03 per cent on 8 November and remained at around this level in the ensuing period to 10 February 2003. The tender rate on 91-day Treasury bills moved lower from 12,78 per cent on 10 October 2002 and briefly fell below the 12 per cent mark in mid-November. During the second half of November the tender rate resumed its upward movement, rising from 12,28 per cent at the end of that month to 12,74 per cent on 14 February 2003. The weekly amount of 91-day Treasury bills offered on tender was increased by R500 million to R1,5 billion from 31 January 2003, contributing to upward pressure on this rate.

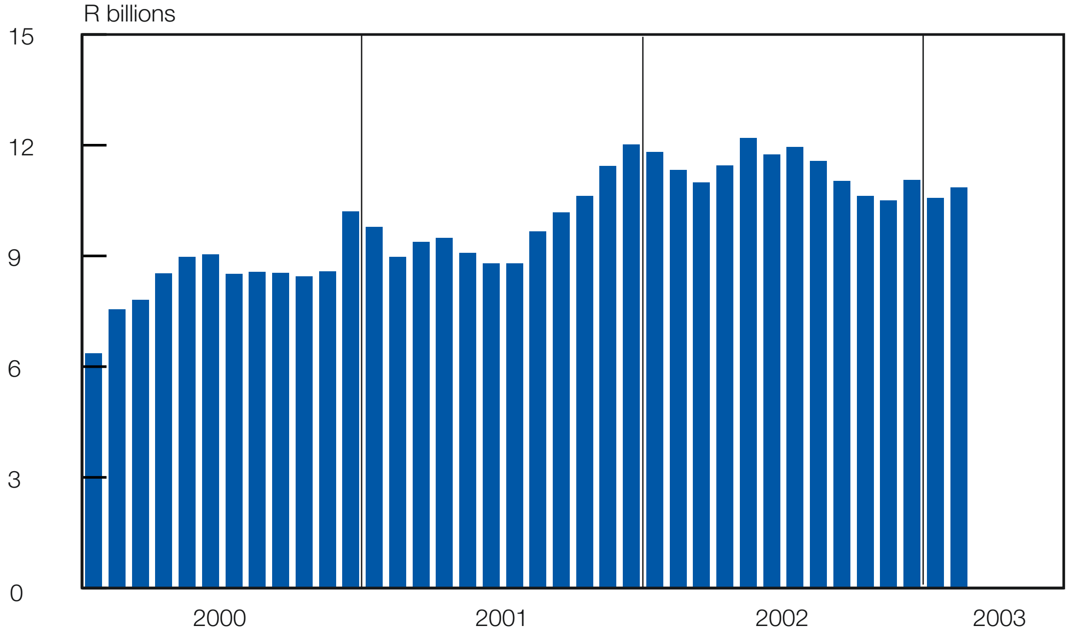
Similarly, the rate on 9x12-month FRAs declined, on balance, to a low of 10,64 per cent on 9 January 2003. This rate moved higher to 11,23 per cent on 27 January 2003 after the Governor of the Reserve Bank cautioned against premature speculation of an imminent reduction in the repurchase rate and geopolitical tensions heightened risks in financial markets around the world. In February this rate declined, on balance, to 10,96 per cent at the end of the month.

The prime overdraft rates and the predominant rate on mortgage loans of the private-sector banks closely followed the changes in the Reserve Bank's repurchase rate during 2002. When monetary conditions tightened in the first nine months of 2002, these rates increased from 13 per cent in early January 2002 to 17 per cent in September – their highest levels since July 1999.

Money market

The average daily liquidity requirement of the private-sector banks varied between R12,2 billion in January 2002 and R10,5 billion in November. In January 2003 the liquidity needs of the private-sector banks declined to R10,6 billion from R11,1 billion in December 2002, but increased again to R10,9 billion in February 2003.

Average monthly liquidity requirement of private-sector banks



The Reserve Bank maintained the daily liquidity requirement of the private-sector banks at a fairly steady level throughout the year by actively implementing various intervention techniques. These measures included foreign-currency swap transactions with private-sector parties. The outstanding amount of these transactions rose from R41,1 billion at the end of January 2002 to R54,8 billion at the end of August. Three major events, which added substantial amounts of liquidity to the money market, necessitated measures to mop up excessive liquidity. These were:

- the transfer of liability of a foreign loan of US$1,5 billion from the Reserve Bank to the national government in January 2002 (this transaction swelled liquidity in the money market when the *Tax and Loan Accounts* of the national government with the private-sector banks were credited with an amount of R17,5 billion);

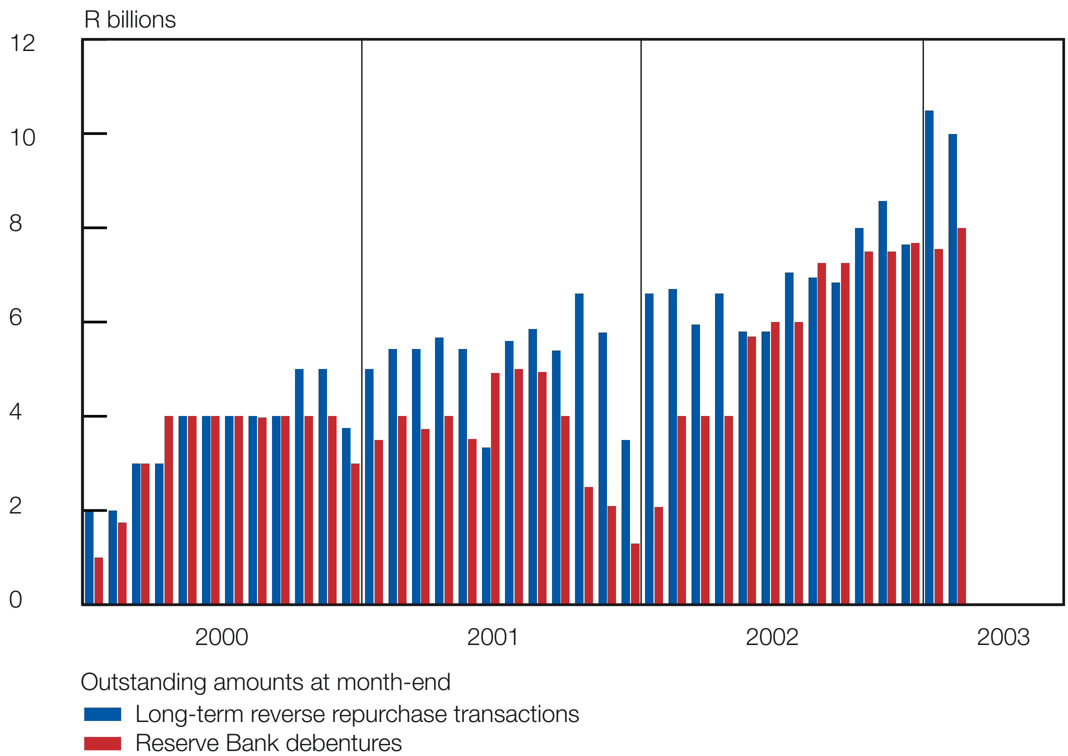
- the proceeds of a foreign loan to the value of US$1 billion which added R10,7 billion to money-market liquidity in April 2002; and

- the assistance provided to a few banks which experienced large withdrawals of deposits.

The liquidity effects of both these transactions were offset by the increase in the outstanding amount of foreign-currency swap transactions. During the second half of 2002, the Reserve Bank reduced the outstanding amount of foreign-currency swap transactions with private-sector parties from R54,8 billion at the end of August 2002 to R45,3 billion at the end of December and R44,7 billion at the end of January 2003. The potential liquidity effects of these reductions were counteracted through their synchronisation with liquidity-draining measures such as:

- an increase in the amount of notes and coin in circulation outside the Reserve Bank;
- the partial repayment of lender-of-last-resort assistance that had been granted by the Reserve Bank to private-sector banks in the early months of 2002;
- the further phasing out of that portion of banks' vault cash holdings that qualifies as a deduction when calculating their required reserve deposits with the Reserve Bank;
- an increase in the amount of outstanding reverse repurchase transactions in government securities between the Reserve Bank and private-sector banks; and
- an increase in the outstanding amount of Reserve Bank debentures.

Reserve Bank operations in the money market



The Reserve Bank increased the outstanding amount of its own *debentures* from R2,1 billion at the end of January 2002 to R7,7 billion at the end of December. Debentures with a maturity of three months were introduced in August and gradually increased to R3,0 billion by December 2002, reducing the amount of one-month debentures to R4,7 billion. Outstanding debentures amounted to R7,6 billion at the end of January 2003, divided between R3,9 billion with a one-month maturity and R3,7 billion with a maturity of three months.

The Reserve Bank also allowed the amount of *reverse repurchase transactions* in government securities to increase, on balance, from R5,8 billion in January 2002 to R8,6 billion in November. This was reduced to R7,6 billion at the end of December 2002 as the strong demand for notes and coin drained an additional amount of R2,2 billion in liquidity from the money market during that month. At the height of the festive season on 24 December 2002 notes and coin in circulation outside the Reserve Bank amounted to R42,1 billion or some R4,1 billion more than its corresponding peak in 2001.

When notes and coin began to flow back to the Reserve Bank, the reverse repurchase transactions were increased to R10,5 billion at the end of January 2003. Out of that total, R6,4 billion worth of reverse repurchase transactions had a maturity of 28 days and R4,1 billion had a maturity of 91 days. The longer maturity had been introduced in June 2002.

The amount of vault cash that qualifies as a deduction when calculating banks' required cash reserve deposits with the Reverse Bank was reduced further from 75 to 50 per cent in September 2002. This drained about R1,7 billion from the money market, bringing the cumulative money-market effect of the new vault cash dispensation to some R3,5 billion since September 2001.

Following the improvement in the exchange rate of the rand in the last quarter of 2002, a profit of R290 million was realised on forward foreign exchange transactions in December 2002, breaking a series of 32 months of uninterrupted losses. This profit also helped to drain some liquidity from the money market during December 2002.

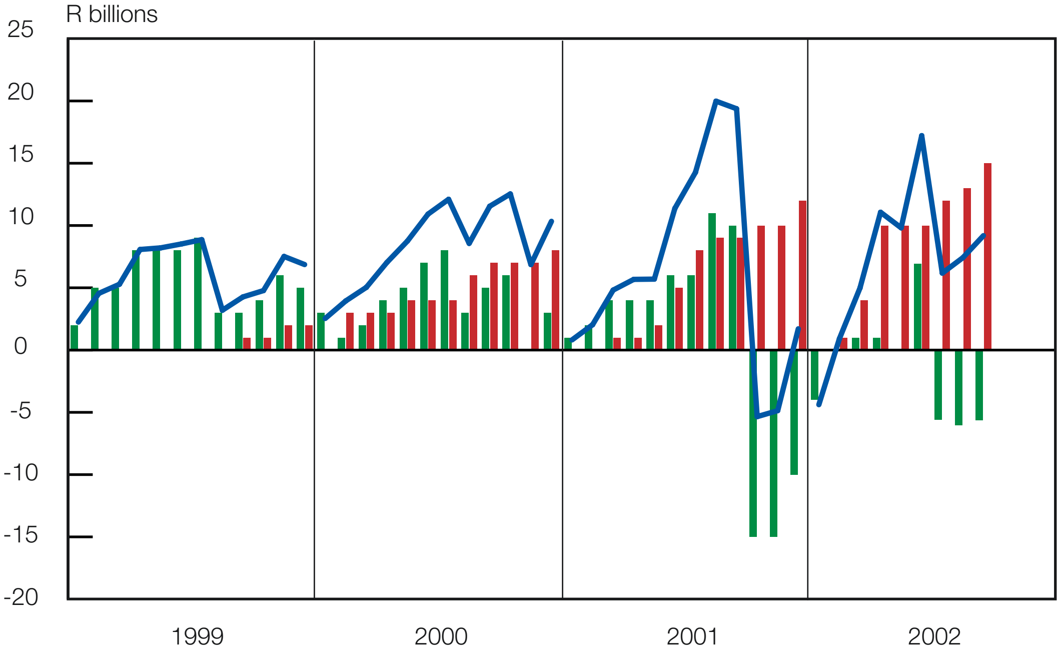
In February 2003 the Reserve Bank abolished the use of Cash Reserve Contra Accounts when recording banks' withdrawals against cash reserves and depositing of additional amounts. The averaging principle is now applied directly to the balances on the Cash Reserve Accounts. In essence, banks still have to comply with the statutory cash reserve requirements on an average basis over each maintenance period.

Bond market

Public-sector borrowers repaid fixed-interest securities to the net amount of R5,6 billion in the first nine months of fiscal 2002/03, compared with capital raised to a net value of R9,9 billion in the same period of the previous fiscal year. On a quarterly basis, a net amount of R0,6 billion was mobilised in the second quarter of 2002, followed by R6,4 billion in the third quarter. The latter amount included a R7 billion zero-coupon bond issued by the national government to the Reserve Bank. Public-sector borrowers later repaid fixed-interest securities to the net amount of R12,6 billion in the fourth quarter of 2002. Net redemptions amounted to R1,8 billion in January 2003.

In contrast to the public sector's reduced demand for loanable funds in the domestic primary bond market, demand for *private-sector funding* in the primary corporate bond market intensified. The *outstanding nominal value of private-sector loan stock* listed on the Bond Exchange of South Africa increased, on balance, from R21,9 billion in December 2001 to R39,2 billion in December 2002, i.e. by some 79 per cent. Overall the domestic pool of public and private-sector bonds increased by R1,7 billion in fiscal 2001/02 and by R8,9 billion in the first nine months of fiscal 2002/03.

Funding in the domestic primary bond market



Fiscal years
Annual cumulative net funding
Public sector
Private sector
Total

The *national government* raised R10,7 billion through foreign-currency denominated debt issues in the *international bond markets* so far in the current fiscal year, compared with R12,4 billion in the whole of fiscal 2001/02. The public utility company, Eskom, raised R2 billion in October 2002 by issuing a three-year eurobond to replace a maturing bond.

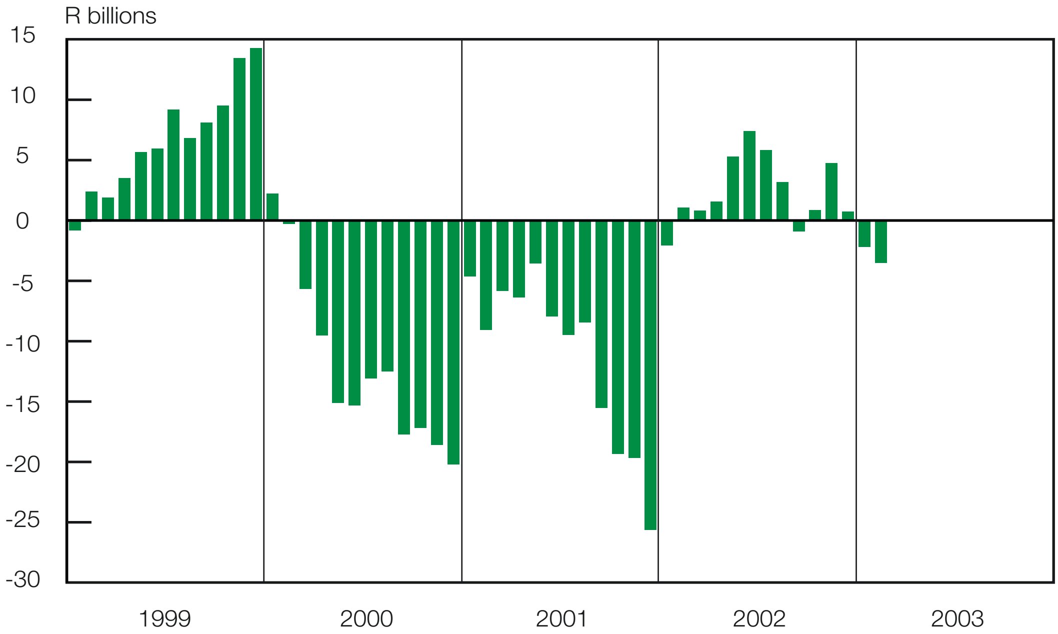
In 2002, the scheduled redemptions of rand-denominated bonds issued by non-residents in the *European bond markets* exceeded new issues by some R1,3 billion. Sentiment among potential borrowers towards rand-denominated bonds in the eurobond market apparently deteriorated in the course of 2002 and new issues declined from R3,6 billion in the first half of the year to only R0,6 billion in the second half. The strengthening of the exchange rate of the rand presumably discouraged unhedged issues. Net issues by non-residents amounted to just R0,2 billion in January 2003.

Despite heightened volatility in bond yields, trading activity on the Bond Exchange of South Africa declined by almost 2 per cent from a record R12,4 trillion in 2001 to

R12,2 trillion in 2002. The quarterly value of bonds traded in the *domestic secondary bond market* declined to R2,6 trillion in the fourth quarter of 2002 – the lowest quarterly turnover since the fourth quarter of 2000. In January 2003 turnover on the Bond Exchange of South Africa amounted to R0,9 trillion.

There was quite a noticeable ebb and flow in non-resident investor sentiment during 2002. Net outright purchases of bonds by *non-resident investors* of R6,3 billion in the first half of 2002 turned into net outright sales of R8,6 billion in the second half. In the first two months of 2003, sentiment remained weak and non-resident holdings of South African debt securities decreased by a further R3,5 billion up to the end of February. All along, offshore investor sentiment vacillated between episodes of net bond purchases and net bond sales depending to a large extent on the relative strength or weakness of the exchange rate of the rand.

Annual cumulative net purchases of bonds by non-residents



Share market

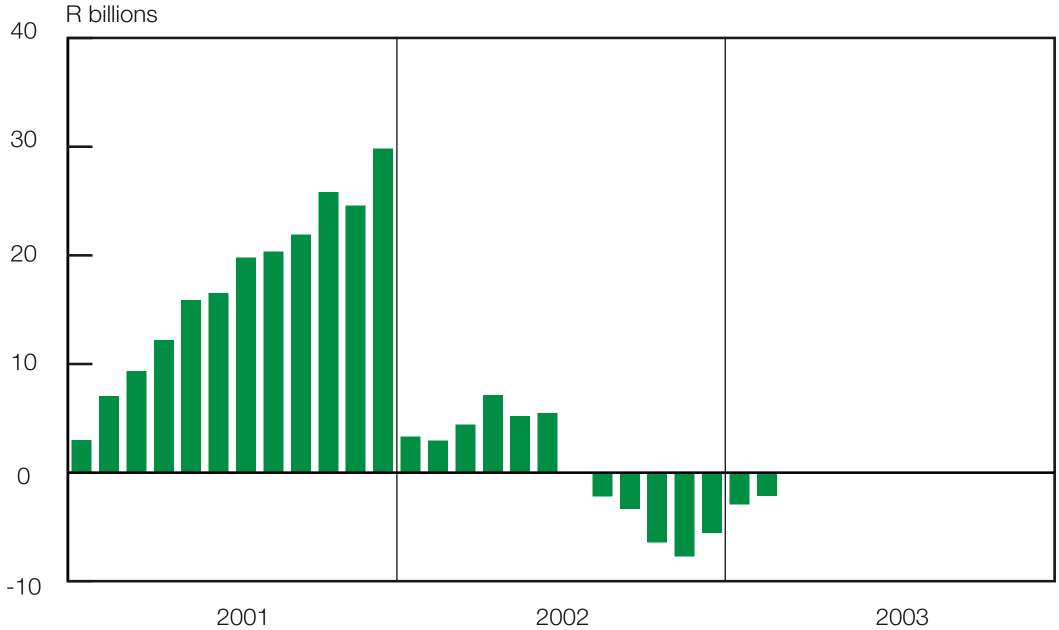
The total value of equity capital raised in the domestic and international *primary share market* by companies listed on the JSE Securities Exchange SA amounted to R59,9 billion in 2002 – 154 per cent more than the R23,6 billion raised in 2001. The quarterly value of capital raised, however, decreased from a high R28,1 billion in the third quarter of 2002 to R10,9 billion in the fourth quarter. Equity financing amounted to R1 billion in January 2003.

Trading activity in the *secondary share market* was buoyant in 2002, boosted by the heightened volatility of share prices. The value of shares traded on the JSE Securities Exchange SA rose by 33 per cent from R606 billion in 2001 to a record amount of R808 billion in 2002. However, the quarterly value of shares traded fell back from a record of R236 billion in the second quarter of 2002 to R178 billion in the fourth quarter. This could be attributed to a sharp decline in the value of shares traded since May 2002 and the 19 per cent decline in the number of shares traded from the second to the fourth quarter of 2002. Subsequently, turnover increased from a monthly average of R59,3 billion in the fourth quarter of 2002 to R61,8 billion in January 2003.

In the *secondary share market* a net *inflow* of foreign portfolio capital to the value of R29,8 billion in 2001 switched to a net *outflow* of R5,6 billion in 2002 – the first such outflow since 1992. In the first half of 2002 non-resident investors were still net purchasers of shares to the value of R5,4 billion, but they reduced their holdings of listed shares on a net basis by R8,8 billion in the third quarter and R2,2 billion in the fourth quarter. Among the developments that contributed to this change were:

- widespread disappointment with the contents of the unofficially leaked draft empowerment charter for the mining industry;
- the reduced attractiveness of rand-hedge shares following the improvement in the exchange value of the rand; and
- the general erosion of confidence in equities worldwide due to, *inter alia*, revelations of corporate malfeasance at a number of prominent American corporations.

Annual cumulative net purchases of shares by non-residents

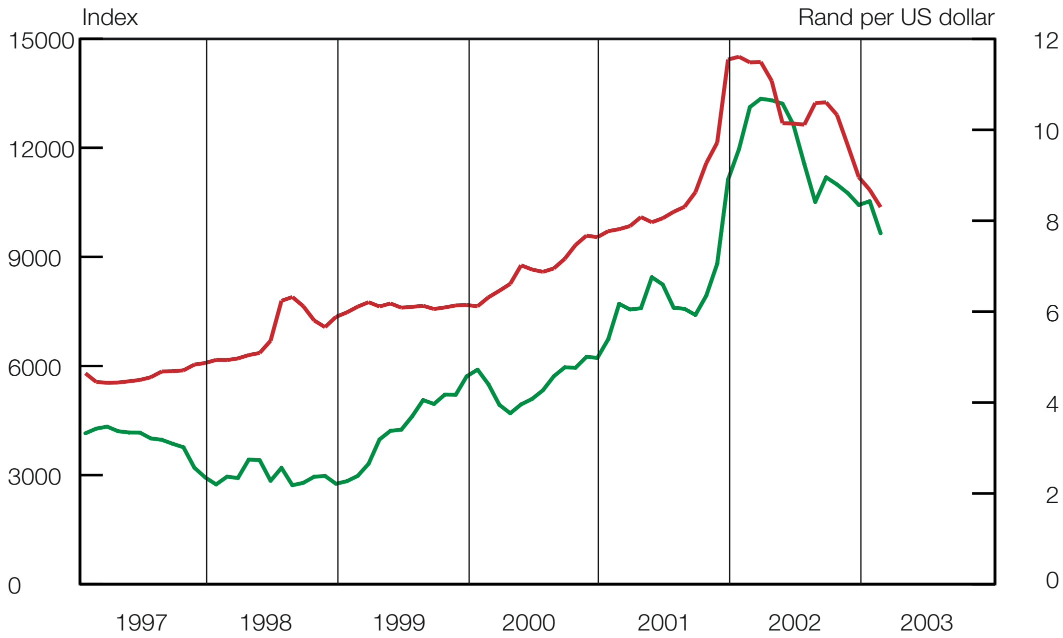


From the beginning of 2003 to the end of February, non-residents sold shares on a net basis in the domestic market to the value of R2,1 billion.

The popularity of rand-hedge shares, such as those of mining companies and other companies with substantial exposure to foreign earnings, waxed and waned quite considerably since November 2001. The monthly average price level of companies listed in the resources sector increased, at first, by 50 per cent from November 2001 to March 2002, but subsequently fell by 28 per cent to February 2003.

The fragile global economic recovery and the threat of war in Iraq underpinned a rise in the dollar price of gold to a daily average of $385 per fine ounce on 5 February 2003 – its highest level since October 1996. Despite this gold price increase, the *monthly average gold-mining share price index* fell by 22 per cent from May 2002 to February 2003. The steadily improving exchange rate of the rand effectively dampened the profit prospects for the gold-mining industry, just as it did for most other companies in the resources sector of the market.

Share prices and exchange rate



* Source: JSE Securities Exchange South Africa

The *daily closing level of the all-share price index* fell by 29 per cent from a record high on 22 May 2002 to its lowest level in sixteen months on 26 February 2003. On balance, the daily closing level of the all-share price index declined by 11 per cent

Share price indices

Source: JSE Securities Exchange South Africa from the end of 2001 to the end of 2002. By contrast, the daily closing level of the price index for middle-sized companies (mid-cap index) increased by 18 per cent in the year to 31 December 2002. The earnings of these companies predominantly originate in South Africa.

Share price movements were mirrored by changes in the dividend and earnings yields. The *dividend yield on all classes of shares* increased from 3 per cent in the April-June 2002 quarter to 4 per cent in February 2003. The *earnings yield on all classes of shares* similarly increased from 8,3 per cent in May 2002 to 12 per cent in February 2003. The *price-earnings ratio* of all classes of shares fell from 12 in May 2002 to 8 in February 2003 – its lowest level since 1990.

Market for derivatives

Trading activity in the formal derivatives market fell back in the fourth quarter of 2002 when the number of shares traded on the JSE Securities Exchange SA levelled off and the all-share price index fluctuated within a narrow range.

The combined number of *futures and options on futures contracts* traded on the Financial Derivatives Division of the JSE Securities Exchange SA declined by 18 per cent from 35,6 million in 2001 to 29,4 million in 2002. The quarterly number of these contracts traded fell back from 8,2 million in the third quarter of 2002 to 6,9 million in the fourth quarter. Trading of *index* derivatives declined by 21 per cent and of *individual equity* derivatives by 8 per cent over the same period. The number of these contracts traded decreased further from a monthly average of 2,3 million contracts in the fourth quarter of 2002 to 1,6 million contracts in January 2003.

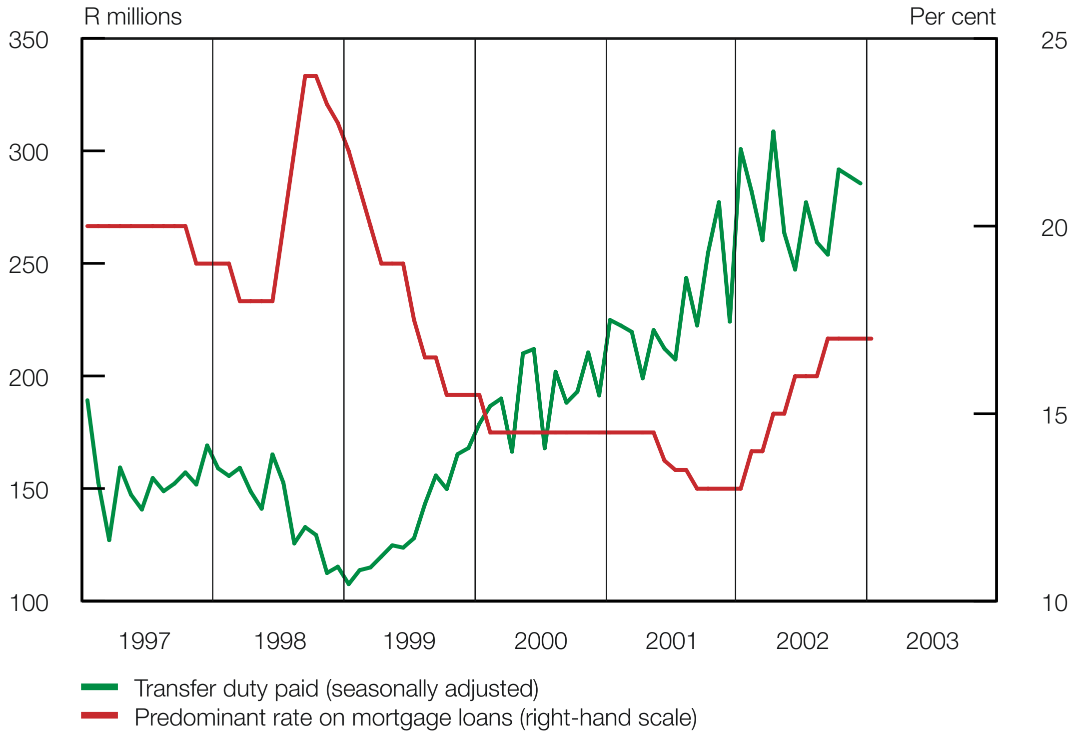
The number of *warrants* traded on the JSE Securities Exchange SA decreased by 23 per cent from 25,6 billion in 2001 to 19,6 billion in 2002. Trading decreased from a quarterly average of 5,5 billion warrants in the first three quarters of 2002 to 3,2 billion in the fourth quarter of 2002 and further from a monthly average of about 1,1 billion in the fourth quarter of 2002 to 0,9 billion contracts in January 2003.

Price movements of agricultural products caused by changes in the exchange value of the rand, together with supply and demand imbalances, fuelled trading in commodity derivative instruments on the Agricultural Products Division of the market. Trading in the number of *commodity futures contracts and options on such contracts* increased almost twofold from 1 million contracts in 2001 to nearly 2 million contracts in 2002. The quarterly number of these contracts traded recorded an all-time high of 0,6 million in the fourth quarter of 2002. Trading subsequently levelled off at a monthly average of about 0,2 million contracts in the fourth quarter of 2002 and in January 2003.

Real-estate market

Trading activity in the *real-estate market* remained buoyant in 2002 despite the increase in the cost of mortgage finance in the first nine months of the year. Overall, the seasonally adjusted turnover in the real-estate market, measured by *transfer duty paid,* rose by almost 21 per cent in 2002 compared with a year-on-year increase of 19 per cent in 2001. On a quarterly basis trading activity declined by almost 3 per cent from the first to the second quarter and 4 per cent from the second to the third quarter before increasing by almost 10 per cent in the fourth quarter.

Real-estate market activity



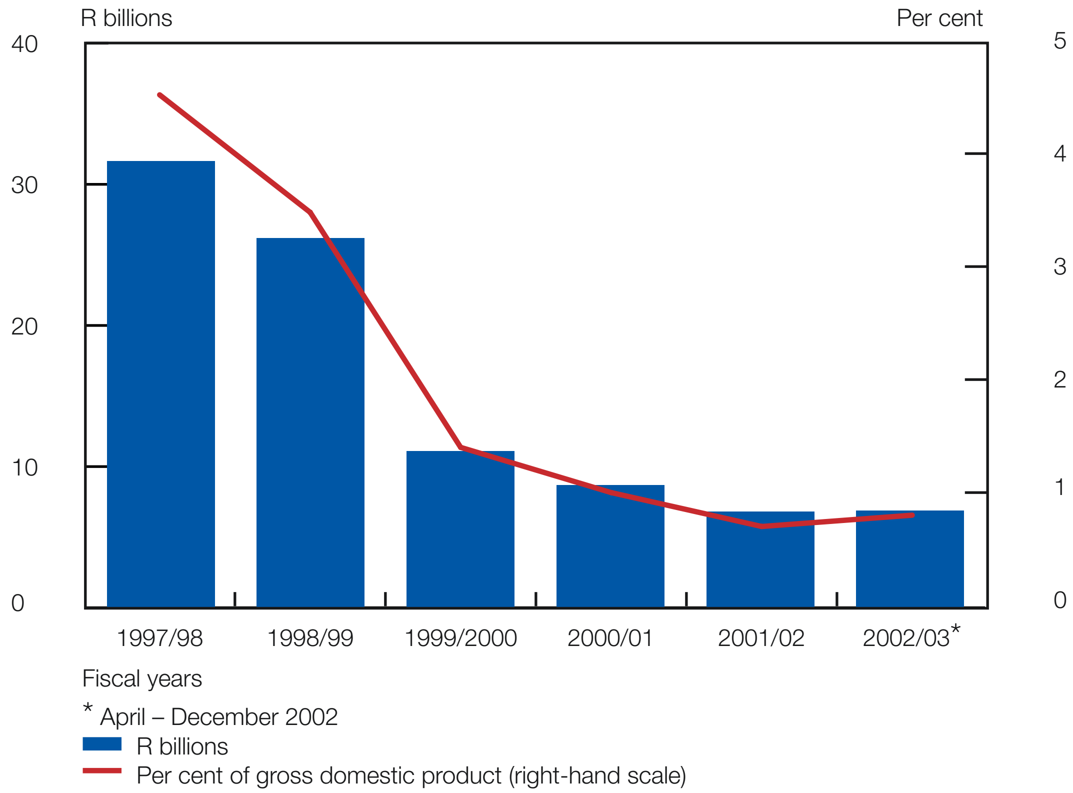
In contrast to the rapid growth in trading volumes, gains in *residential property prices* slowed down in 2002. The rate of increase in nominal house prices, as measured by Absa Bank, slowed from a month-to-month rate of 1,5 per cent in July 2002 to 0,7 per cent in January 2003. Less dramatically, the rate of increase over twelve months slowed down from a high of 14,8 per cent in July 2002 to 13,6 per cent in January 2003.

Public finance

Non-financial public-sector borrowing requirement

The activities of the non-financial public sector (i.e. the consolidated central government, provincial governments, local governments and non-financial public-sector business enterprises) resulted in a financial *surplus* of R9,0 billion in the October-December quarter of 2002 – R0,6 billion more than the surplus recorded in the corresponding quarter of 2001. This surplus partly offsets the deficits recorded in the earlier quarters of the fiscal year, resulting in a non-financial public-sector *deficit* of R7,0 billion in the first nine months of fiscal 2002/03. The outcome in the first nine months of fiscal 2002/03 can be compared with a *surplus* of R4,3 billion in the corresponding period of the previous fiscal year.

Non-financial public-sector borrowing requirement



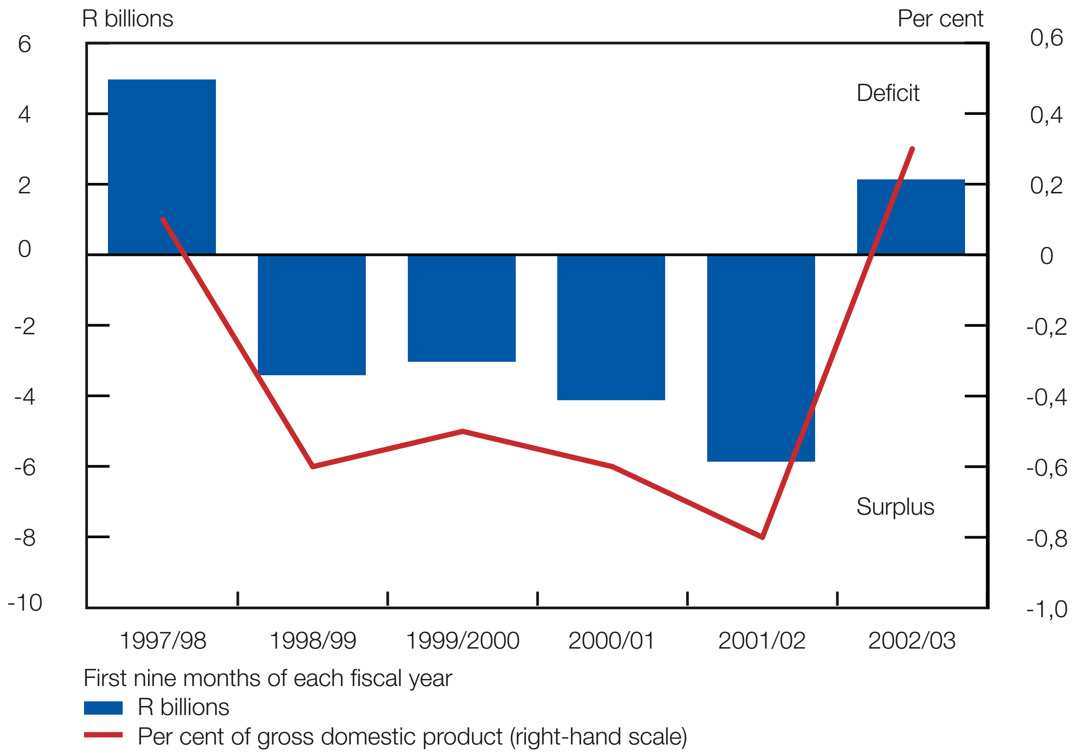
As a ratio of gross domestic product, the non-financial public-sector deficit amounted to 0,8 per cent in the first nine months of fiscal 2002/03 compared with a surplus of 0,6 per cent in the corresponding period of the previous fiscal year. These ratios may be compared with an average deficit ratio of 2,1 per cent in the first nine months of the preceding five fiscal years.

The borrowing requirement of the public sector can partly be attributed to a turnaround in the surplus financial position of provincial governments and an increase in the borrowing requirement of local governments. The inclusion of a capital transfer of R7 billion from national government to the Reserve Bank as part payment of the outstanding balance on the Gold and Foreign Exchange Contingency Reserve Account also contributed to the increased borrowing requirement of the public sector. The surpluses of non-financial public enterprises decreased from R2,8 billion in the first nine months of fiscal 2001/02 to R1,5 billion in the same period of the current fiscal year, essentially because of higher capital expenditure.

The activities of general government (i.e. public-sector entities other than non-financial public enterprises) in the October-December quarter of 2002 resulted in a financial surplus of R8,0 billion, bringing the general-government borrowing requirement to R8,5 billion in the first nine months of fiscal 2002/03 compared with a surplus of R1,5 billion recorded in the first nine months of the previous fiscal year.

An analysis of the *Statement of revenue, expenditure and borrowing of the provincial governments* indicated a collective financial deficit of R2,1 billion in the first nine months of fiscal 2002/03 compared with a surplus of R5,9 billion in the first nine months of fiscal 2001/02. The equitable share of national government revenue transferred to provincial governments amounted to R88,8 billion in the first nine months of fiscal 2002/03, reflecting a year-on-year increase of 11,1 per cent. Conditional grants, earmarked for specific purposes, amounting to R9,7 billion were transferred to provincial governments in the first nine months of fiscal 2002/03, representing a decrease of 9,0 per cent compared with the same period of the previous year. By contrast, provincial government expenditure increased by 19,4 per cent in the first nine months of fiscal 2002/03, outstripping by a sizeable margin the growth in provincial government revenue.

Provincial governments' surplus or deficit



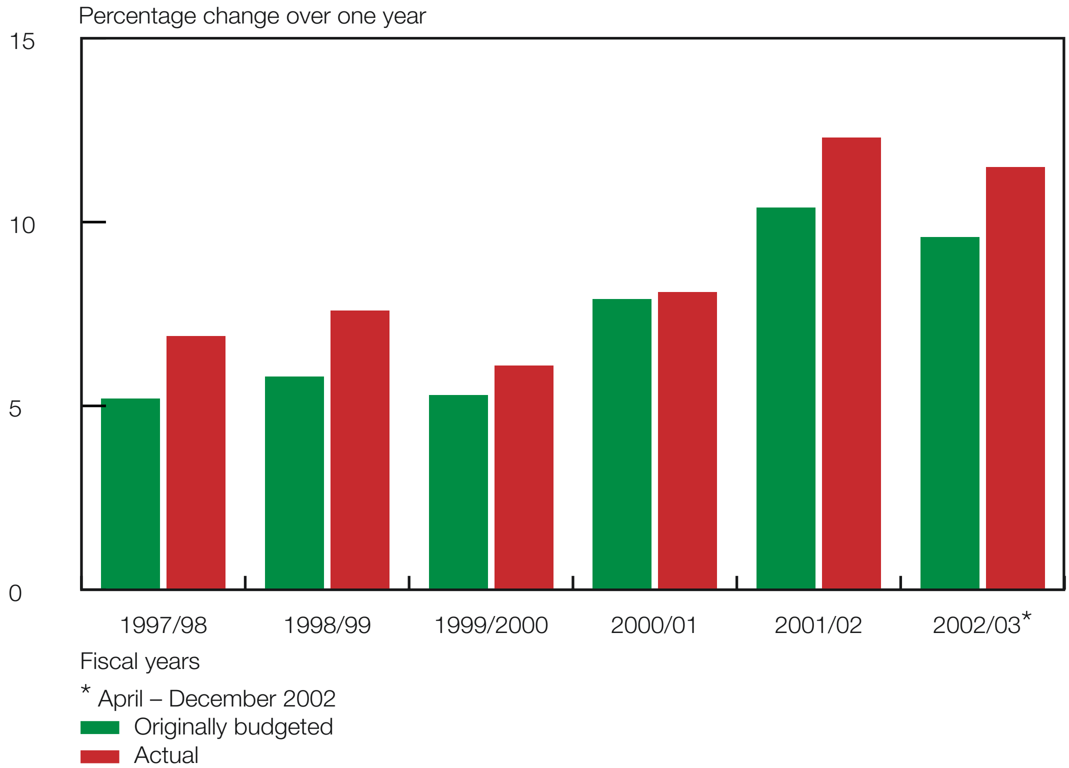
The financial activities of provincial governments resulted in a decrease in their deposits with private banks from R9,6 billion at the end of March 2002 to R6,4 billion at the end of December 2002. Over the same period the provincial governments' bank indebtedness fell from R0,5 billion to R0,3 billion.

Preliminary data on the financial position of local governments indicate an increase in their borrowing requirement. The estimated deficit of local governments amounted to R3,4 billion in the first nine months of fiscal 2002/03, compared with a deficit of R2,7 billion recorded in the same period of the previous fiscal year.

National government finance

National government expenditure in the first nine months of fiscal 2002/03 amounted to R206,9 billion. This represents a year-on-year rate of increase in government expenditure of 11,5 per cent in the first nine months of fiscal 2002/03, which is moderately higher than the originally budgeted increase of 9,6 per cent for the fiscal year as a whole. This rate of increase was also higher than the increase of 11,1 per cent projected in the Adjustments Budget. The revised projections indicate that total expenditure will amount to R291,8 billion for the full 2002/03 fiscal year.

Expenditure by national government



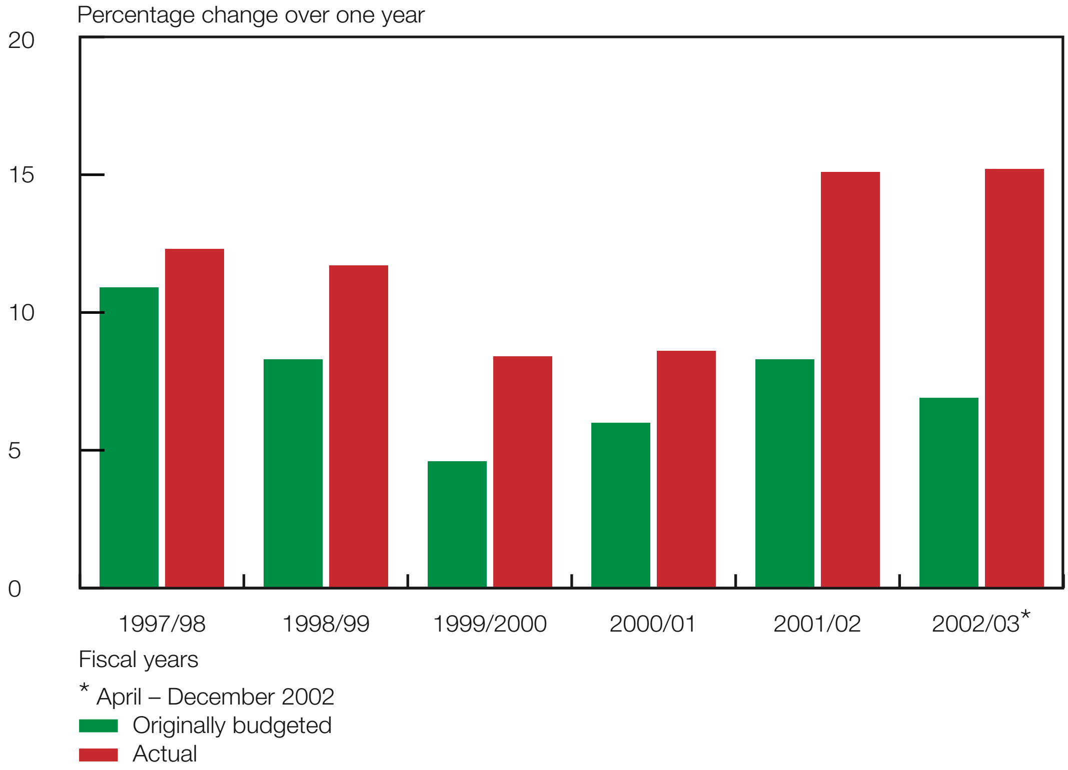
As a ratio of gross domestic product, national government expenditure in the first nine months of fiscal 2002/03 amounted to 24,6 per cent, which was about the same as the 24,8 per cent recorded in the corresponding period of the preceding fiscal year.

The redemption of domestic government bonds, together with the containment of the deficit, has led to a reduction in the interest paid on government debt from R28,4 billion in the first nine months of fiscal 2001/02 to R27,9 billion in the first nine months of fiscal 2002/03. Spending on capital projects amounted to R12,3 billion in the first three quarters of fiscal 2002/03, representing approximately 66 per cent of the budgeted amount of R18,7 billion.

After allowing for cash-flow adjustments (i.e. transactions recorded in government ledgers but not yet cleared by the banking system, and late departmental requests for funds), government's cash expenditure in the first nine months of fiscal 2002/03 amounted to R206,2 billion, representing a year-on-year rate of increase of 10,7 per cent.

National government revenue in the first nine months of fiscal 2002/03 amounted to R208,7 billion, equalling 78,7 per cent of the originally budgeted revenue of R265,2 billion for the fiscal year as a whole. Revenue increased at a year-on-year rate of 15,2 per cent in the first nine months of fiscal 2002/03, exceeding by far the originally budgeted increase of 6,9 per cent for the full fiscal year. The Adjustments Budget projected that total revenue collections would rise by 10,1 per cent in fiscal 2002/03 as a whole.

Revenue of national government



Taxes on income and profits, the principal source of revenue of the national government, increased at a year-on-year rate of 8,9 per cent in the first nine months of fiscal 2002/03 to R118,7 billion. This increase was higher than the originally budgeted increase of 5,7 per cent for the full fiscal year. Domestic taxes on goods and services contributed R70,1 billion to the National Revenue Fund. Value-added tax, which is a major component of this tax category, increased by 17,2 per cent, strongly outperforming budget expectations.

As a ratio of gross domestic product, national government revenue amounted to 24,8 per cent in the first nine months of fiscal 2002/03 compared with 24,2 per cent in the corresponding period of the previous fiscal year.

National government revenue

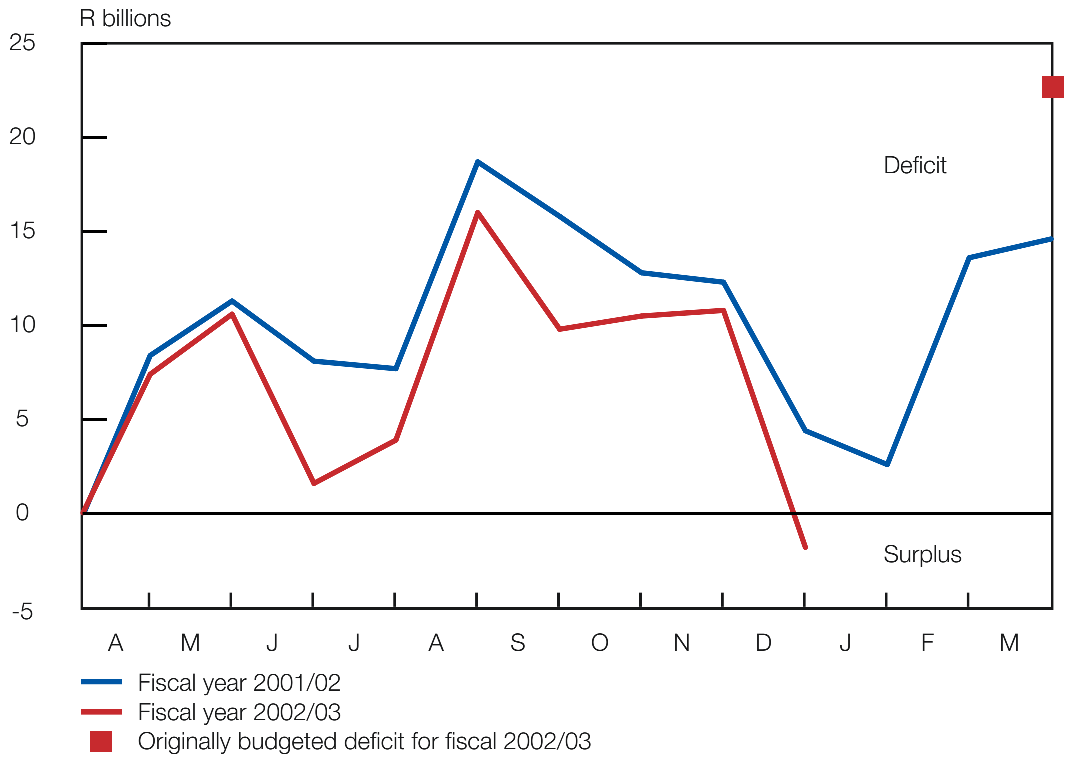
Revenue source	Fiscal 2002/03 Originally budgeted (R billions)	April – Dec 2002 Actual (R billions)	Percentage change*
Taxes on income and profits	155,7	118,7	8,9
Payroll taxes	3,0	2,4	19,7
Taxes on property	4,6	3,8	14,8
Domestic taxes on goods and services	92,8	70,1	13,7
Taxes on international trade and transactions	10,6	7,9	11,5
Other revenue	6,8	11,9**	181,5**
Less: SACU*** payments	8,3	6,2	0,7
Total revenue	**265,2**	**208,7**	**15,2**

* April – December 2001 to April – December 2002
** High values are partly due to unallocated revenue which is currently not allocated to a specific revenue source
*** Southern African Customs Union

National government's cash revenue (revenue adjusted for timing differences between the recording of transactions and bank clearances) in the first nine months of fiscal 2002/03 amounted to R208,3 billion, representing an increase of 16,3 per cent compared with the corresponding period of the previous fiscal year.

The net result of the revenue and expenditure recorded in the *Statement of national government revenue, expenditure and borrowing* was a national government surplus of R1,8 billion in the first nine months of fiscal 2002/03. This surplus will contribute towards meeting the expected funding requirements for the remainder of the fiscal

Cumulative balance of national government



year. The original *Budget Review 2002* projected a national government deficit of R22,7 billion, whereas the revised estimates contained in the Adjustments Budget projected a deficit of R18,5 billion in fiscal 2002/03 as a whole.

The surplus before borrowing and debt repayment as a ratio of gross domestic product amounted to 0,2 per cent in the first nine months of fiscal 2002/03. This can be compared with a deficit ratio of 0,6 per cent recorded in the corresponding period of the previous fiscal year.

The cash surplus (i.e. the surplus before borrowing and debt repayment, adjusted for cash flows) amounted to R2,1 billion in the first nine months of fiscal 2002/03. Government receipts were also bolstered by R1,3 billion being the profit on the revaluation of maturing foreign loans and the receipts from Transnet's disposal of its equity holding in M-Cell. National government had to make extraordinary payments in respect of a premium of R0,3 billion on the restructuring of its domestic debt portfolio and a payment of R7,0 billion to the South African Reserve Bank as referred to earlier in this review. These extraordinary transactions have resulted in a net borrowing requirement of national government of R3,9 billion in the first nine months of fiscal 2002/03.

The greater part of the borrowing requirement of national government in the first nine months of fiscal 2002/03 was financed through the issuance of bonds in the international capital market, as indicated in the accompanying table. On a net basis, the amount of funds raised in the long-term segment of the domestic market for fixed-interest securities was quite small. Furthermore, strong revenue flows allowed the national government to accumulate sizeable bank balances.

Financing of national government deficit

R billions

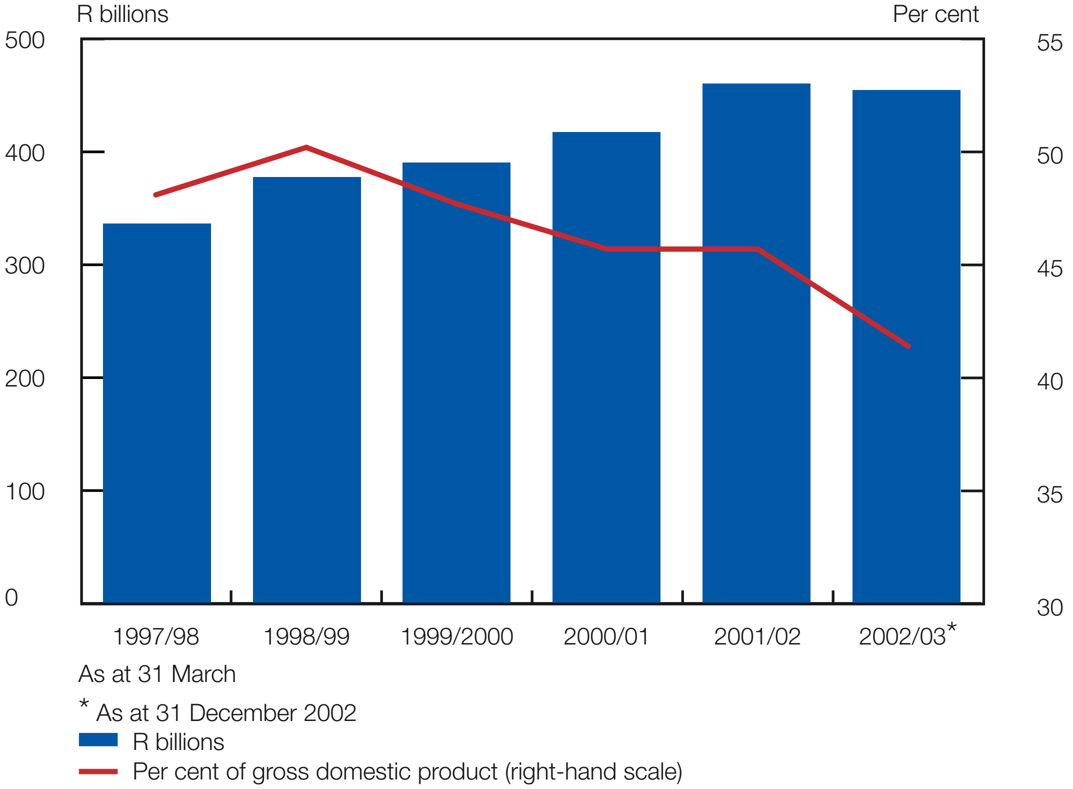
Instrument	Fiscal 2002/03 Originally budgeted	April – Dec 2002 Actual
Cash deficit/surplus*	**22,7**	**-2,1**
Plus: Extraordinary payments	1,6	7,3
Less: Extraordinary receipts	12,0	1,3
Net borrowing requirement	**12,3**	**3,9**
Domestic government bonds	-10,9	0,5
Treasury bills	4,0	1,3
Foreign loans	16,3	13,9
Change in available cash balances**	2,9	-11,8
Total net financing	**12,3**	**3,9**

* Deficit +, surplus -
** Increase -, decrease +

Domestic long-term funding in the first nine months of fiscal 2002/03 was obtained at an average rate of 11,3 per cent per annum, compared with a budget assumption of 11,4 per cent. This rate includes the revaluation cost of inflation-linked bonds. Domestic short-term instruments were sold at an average rate of 11,4 per cent per annum, compared with a budget assumption of 9,7 per cent.

Despite government's net borrowing activities, the total *debt of national government* decreased from R460,3 billion at the end of March 2002 to R454,4 billion at the end of December 2002. This decrease was mainly the result of the revaluation of foreign-currency denominated debt occasioned by the strengthening of the exchange value of the rand against most foreign currencies. As a ratio of gross domestic product, total national government debt decreased from 45,7 per cent at the end of March 2002 to 41,4 per cent at the end of December 2002.

Total national government debt



The Budget for the fiscal years 2003/04 to 2005/06

The Minister of Finance presented the *Budget Review 2003* to Parliament on 26 February 2003. Macroeconomic projections underlying the preparations of the Budget signalled a positive assessment of the recent performance of the economy and an optimistic view of its future course. It was reiterated that the 2003 Budget builds upon priorities laid down in previous years and will also focus on service delivery. For the first time the *Estimates of National Expenditure 2003* tabled in Parliament contained objectives to measure government departments' service-delivery performance.

Sound public finance management during years of fiscal rectitude brought about the opportunity to adopt a more expansionary fiscal stance since the 2001 Budget. The Minister stated that with a view to increasing the long-term growth capacity of the economy, this cautious expansionary fiscal stance will be maintained over the medium term.

Reducing unemployment and ensuring that economic growth and development benefit all communities, remained government's policy challenge. It was stated that several key economic policy initiatives serve this aim. These initiatives include:

- the skills development programme;
- increases in infrastructure investment and tax incentives to stimulate industrial growth and employment;
- redistribution of land, supported by agricultural support programmes;
- widening the access to financial services and the integration of small businesses into the formal economy; and
- further easing of the tax burden on low and middle income households.

With the aim to broaden economic participation, it was recognised that black economic empowerment has an important role in sustaining South Africa's economic growth path and in improving the distribution of income in the economy. To this effect the Minister announced that R10 billion will be set aside over the next five years to support business initiatives that meet agreed empowerment criteria. The roles of the National Empowerment Fund and other development finance institutions will be reviewed by National Treasury and the Department of Trade and Industry in order to ensure that the use of resources is optimised.

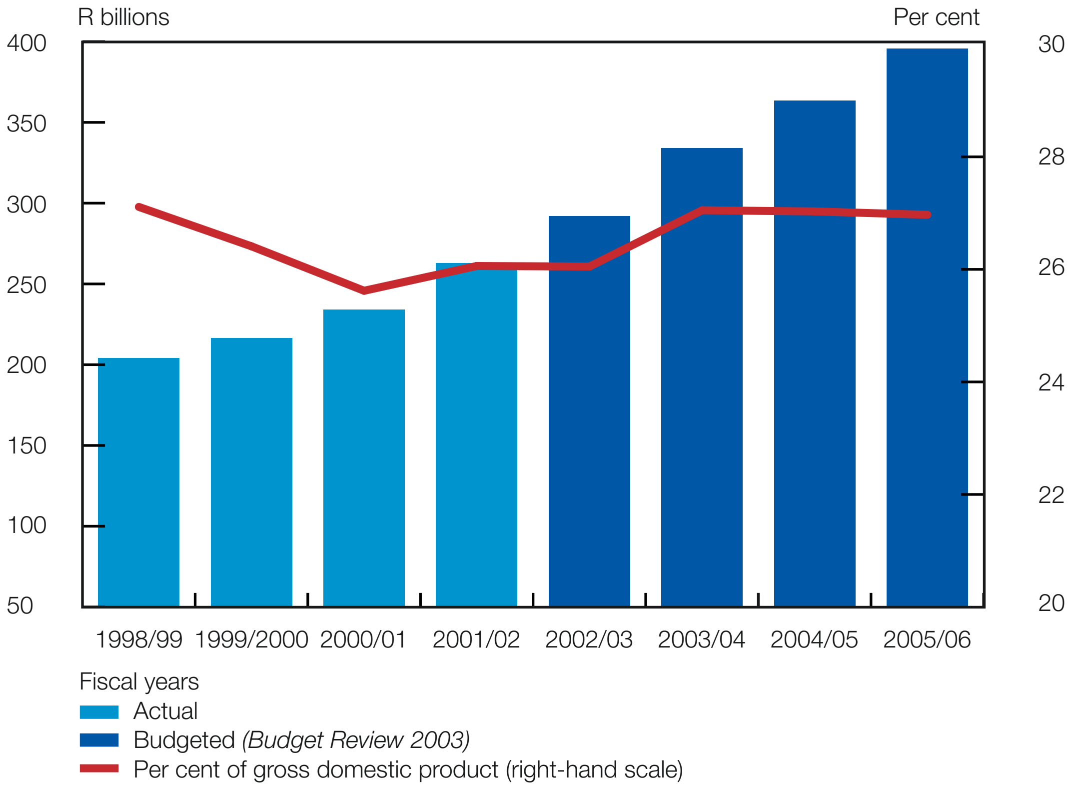
Fiscal projections

	2002/03		2003/04		2004/05		2005/06	
	Revised estimate		Budget		Budget		Budget	
	R bn	Annual change Per cent	R bn	Annual change Per cent	R bn	Annual change Per cent	R bn	Annual change Per cent
Expenditure	**291,8**	**11,0**	**334,0**	**14,4**	**363,3**	**8,8**	**395,6**	**8,9**
Capital	18,6	19,1	22,7	22,1	23,8	4,9	25,4	6,7
Interest	47,0	-0,8	50,7	7,9	52,8	4,1	55,0	4,1
Non-interest current	226,2	13,2	260,6	15,2	286,7	10,0	315,2	9,9
Revenue	**275,7**	**11,1**	**304,5**	**10,4**	**331,0**	**8,7**	**361,2**	**9,1**
Deficit before borrowing and debt repayment	**16,1**		**29,5**		**32,4**		**34,4**	
Deficit as ratio of GDP (per cent)	*1,4*		*2,4*		*2,4*		*2,3*	

National government expenditure was budgeted to increase by 14,4 per cent to amount to R334,0 billion in fiscal 2003/04. This is equivalent to 27,1 per cent of the estimated gross domestic product in fiscal 2003/04, compared with a revised estimate of R291,8 billion or 26,1 per cent of the estimated gross domestic product in fiscal 2002/03. It was estimated that national government expenditure would increase at an average rate of 10,7 per cent over the three-year budget period and, as a ratio to gross domestic product, it would be kept just above 27 per cent over the medium term.

Interest payments on government debt were budgeted to amount to R50,7 billion or 4,1 per cent of the estimated gross domestic product in fiscal 2003/04, and were projected to decrease to 3,9 per cent in fiscal 2004/05 and further to 3,7 per cent in fiscal 2005/06. This reduction can be attributed to the planned containment of the borrowing requirement of government, the contribution to funding to be made by the proceeds of the restructuring of state assets, and the effects that the restructuring of government's bond portfolio are likely to have. Non-interest current expenditure was expected to increase to R260,6 billion or by 15,2 per cent in fiscal 2003/04 and at an average annual rate of 11,7 per cent over the three-year budget period. Non-interest spending plans were also reprioritised in favour of social services such as health, education, welfare and housing.

National government expenditure



The division of revenue amongst the three spheres of government (national departments, provincial governments and local governments) once again reflected a marked shift in favour of provinces and local governments, being the centre of social service delivery. Provincial governments would receive more than half of the non-interest current expenditure in the form of transfers. It was envisaged that these transfers would grow at an average rate of 11,9 per cent over the next three years. Transfers to local governments were projected to increase at an average rate of 19,0 per cent over the medium term. It was stated that R23,7 billion will assist local governments to extend basic services to poor households and a further provision of R4,1 billion will provide free basic services, such as clean water and sanitation, over the next three years. Specific provision was also made for anchor projects with the aim of supporting rural development and urban renewal.

Substantial increases were announced in allocations for capital expenditure in support of a number of government functions. Capital expenditure of national government was expected to increase at a rate of 22,1 per cent in fiscal 2003/04. Far lower growth rates of 4,9 per cent in fiscal 2004/05 and 6,7 per cent in fiscal 2005/06 were envisaged. Infrastructure investment, in support of the growth strategy of government, included allocations for new office accommodation, upgrading of existing facilities and investment in technology.

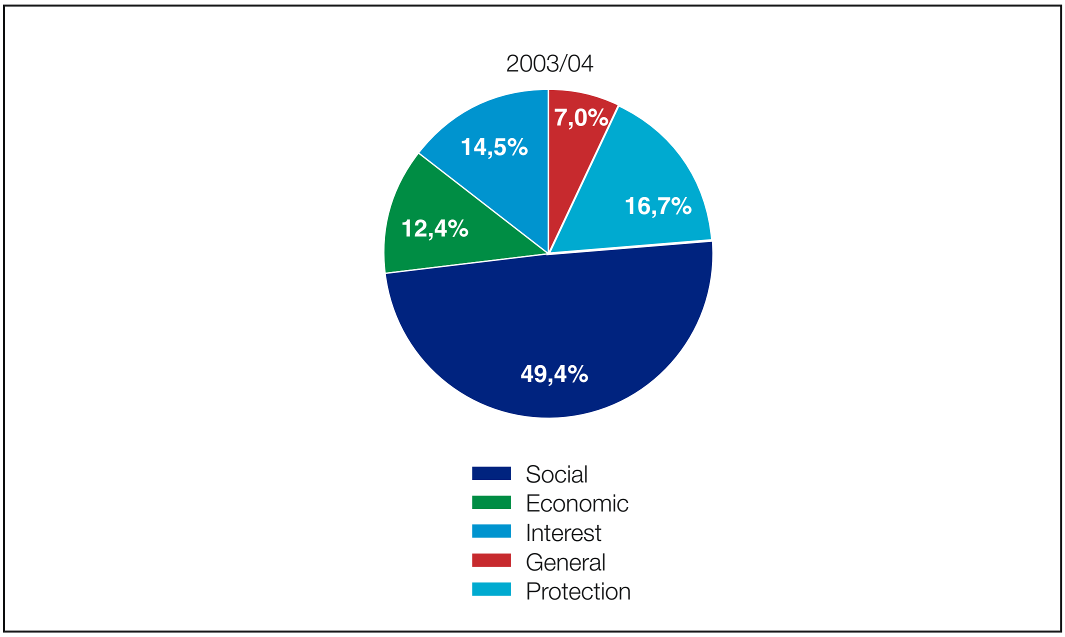
Functional classification of expenditure*
Per cent

Spending category	Percentage of total expenditure				Average growth 2002/03 to 2005/06
	2002/03	2003/04	2004/05	2005/06	
General government services and unallocatable expenditure	6,5	7,0	7,5	8,4	18,6
Protection services	17,2	16,7	16,5	16,3	9,5
Social services	49,4	49,4	50,1	50,0	12,5
Economic services	11,7	12,4	12,0	12,0	13,8
Interest	15,2	14,5	13,1	13,3	3,8
Total	100,0	100,0	100,0	100,0	13,0

* Consolidated national and provincial government and social security funds

As indicated in the accompanying graph, spending on *social services* remains the largest functional category of government spending, amounting to 49,4 per cent of the consolidated national and provincial government and social security funds' expenditure in fiscal 2003/04. Spending on these services is expected to increase at an average annual rate of 10,6 per cent over the three-year budget period. In the area of *protection services* provision was made for an average growth rate of 9,9 per cent for police services. Although the provision for general government services seems to be increasing, it is essentially due to the inclusion of a contingency reserve of R3,0 billion in fiscal 2003/04, R4,0 billion in fiscal 2004/05 and R8,0 billion in fiscal 2005/06. The contingency reserve provides for future unforeseen and unavoidable spending.

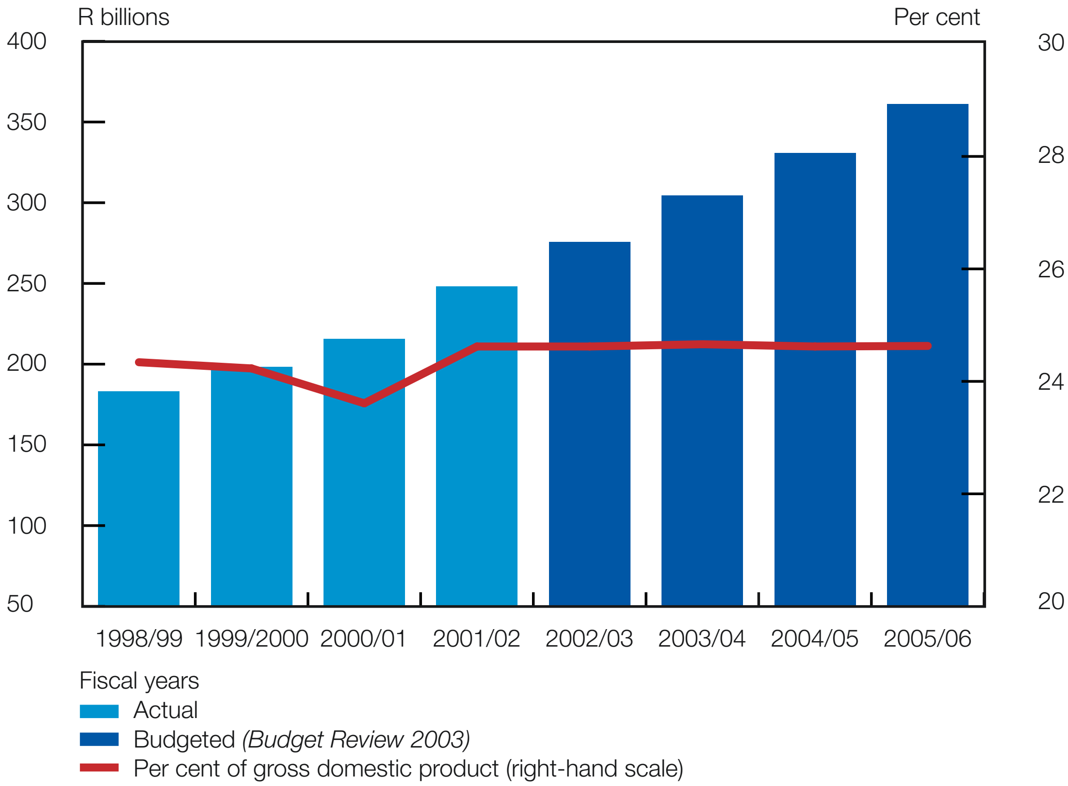
Functional classification of government expenditure*



* Consolidated national and provincial government and social security funds

The total *revenue of national government* was estimated to amount to R275,7 billion in the current fiscal year and R304,5 billion in fiscal 2003/04, representing a year-on-year rate of increase of 10,4 per cent. It was estimated that national government revenue would increase at an average rate of 9,4 per cent over the three-year budget period. National government revenue as a ratio of gross domestic product was projected to amount to 24,6 per cent in fiscal 2002/03 and to be maintained at approximately that level in the ensuing years.

National government revenue



National government tax revenue was estimated to amount to R280,1 billion in fiscal 2002/03 and R310,0 billion in fiscal 2003/04, representing a year-on-year rate of increase of 10,7 per cent. National government tax revenue was expected to increase at an average rate of 9,6 per cent over the medium term. It was estimated that the tax burden of 25,0 per cent of gross domestic product in fiscal 2002/03 would probably increase slightly to 25,1 per cent in fiscal 2003/04 and be maintained at that level over the medium term.

Specific tax adjustments were announced and are expected to reduce total tax revenue by R15,1 billion in fiscal 2003/04. The tax relief was primarily associated with adjustments in personal income tax rates at the lower and middle-income group rendering relief to the amount of R13,3 billion in fiscal 2003/04. The major tax proposals include the following:

- A single rate scale for individuals reaching a maximum marginal rate of 40 per cent at a taxable income of R255 001 (previously R240 001) a year was proposed.

- The primary rebate was increased from R4 860 to R5 400 per year, increasing the tax threshold by R3 000 to R30 000, or by 11,1 per cent.

- The secondary rebate for individuals 65 years and older was increased to R3 100 a year raising the tax threshold to R47 222, or by 10,7 per cent.

- Interest and dividend exemption was increased from the current R6 000 to R10 000 for taxpayers under the age of 65 and from R10 000 to R15 000 for senior citizens.

- Stamp duty on insurance policies and fixed deposit receipts was eliminated.

- The graduated rate structure for transfer duties was amended in order to stimulate investment in home ownership. The duty exempt level was increased from R100 000 to R140 000. Transfer duty rules were amended to prevent avoidance through “nominee transactions”.

- Losses from secondary trades (e.g. “weekend” businesses) will be ring-fenced in order to prevent losses from being claimed as an offset against other types of income.

- Tax on retirement funds was reduced from 25 per cent to 18 per cent.

A number of administrative reforms pertaining to the treatment of transactions of government agencies, an extension of the list of public benefit organisations and the tax exemption of securities on-lending was announced. Other miscellaneous proposals aimed at attaining consistency in the tax system and simplifying tax administration were amongst the announcements.

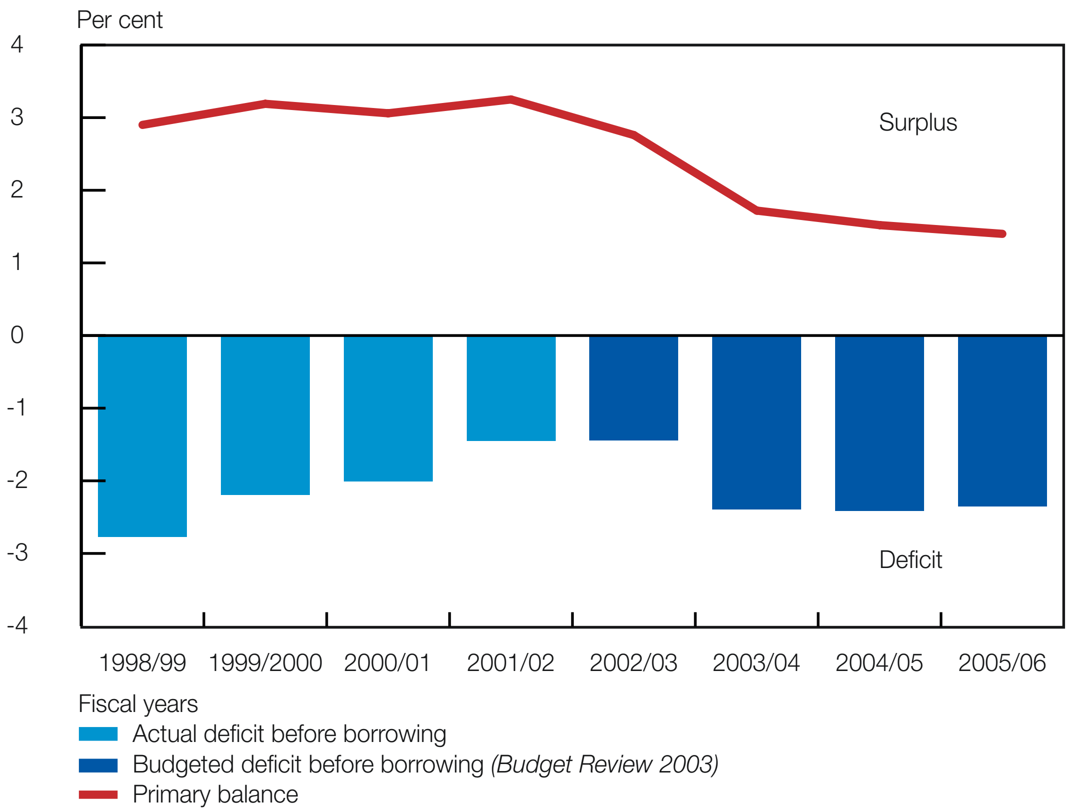
Several proposals set out in the *Budget Review 2003* are aimed at encouraging business investment and growth in the economy. An accelerated depreciation allowance for urban development was announced with the view of addressing urban decay. It was also announced that the accelerated depreciation arrangements for manufacturing assets, initially introduced as a temporary measure, will be retained in tax policy. This will be supplemented with an accelerated write-off period for capital expenditure related to research and development in the field of natural and applied science as well as a double deduction for the first R20 000 of costs incurred in the start-up of new businesses. Relief was provided for businesses reinvesting proceeds from the sale of assets within 18 months and an allowance to claim losses on the sale of depreciable assets was granted. The turnover limit for small businesses qualifying for a lower company tax rate was increased from R3 million to R5 million.

The tax treatment of foreign dividends had the unintended effect of discouraging dividend inflows. It was announced that the tax on foreign dividends will be removed where a South African taxpayer has a meaningful interest in the foreign subsidiary paying the dividend. The income and dividends of South African businesses earned abroad will earn exchange control credits which will facilitate future outflows of direct investment upon application. As discussed earlier, several other exchange-control concessions were also announced.

Increases in the excise duties payable on tobacco and alcoholic beverages were also announced, air passenger departure tax and the *ad valorem* excise duty on new motor vehicles were adjusted for inflation and the *ad valorem* excise duty on computer equipment was abolished. The fuel levy was raised and provision was made for an increase in the levy of the Road Accident Fund.

The net result of the revised estimates of the revenue and expenditure of national government in the fiscal year 2003/04 is an estimated deficit before borrowing and debt repayment of R29,5 billion, or 2,4 per cent of the projected gross domestic product. It was envisaged that this ratio will be maintained in fiscal 2004/05 with a slight decrease to 2,3 per cent of gross domestic product projected for fiscal 2005/06. The primary balance (i.e. the deficit recalculated by excluding interest payments from total expenditure) was estimated to record a surplus of 1,7 per cent of gross domestic product in fiscal 2003/04. A slight decrease to 1,5 per cent was envisaged for fiscal 2004/05 which would be maintained at approximately that level for the remainder of the three-year budget horizon.

National government balances as ratio of gross domestic product



As indicated in the accompanying table, the borrowing requirement of national government was determined after providing for certain extraordinary receipts and payments. Although extraordinary receipts of R12,0 billion were provided for in the original Budget for fiscal 2002/03, only R10,2 billion was expected to be paid into the National Revenue Fund. The restructuring of state assets would contribute R5,0 billion to the financing of national government in fiscal 2003/04 and 2004/05, with R3,0 billion provided for in fiscal 2005/06. Provision was also made for an annual payment of R7,0 billion in part payment of the outstanding balance on the Gold and Foreign Exchange Contingency Reserve Account.

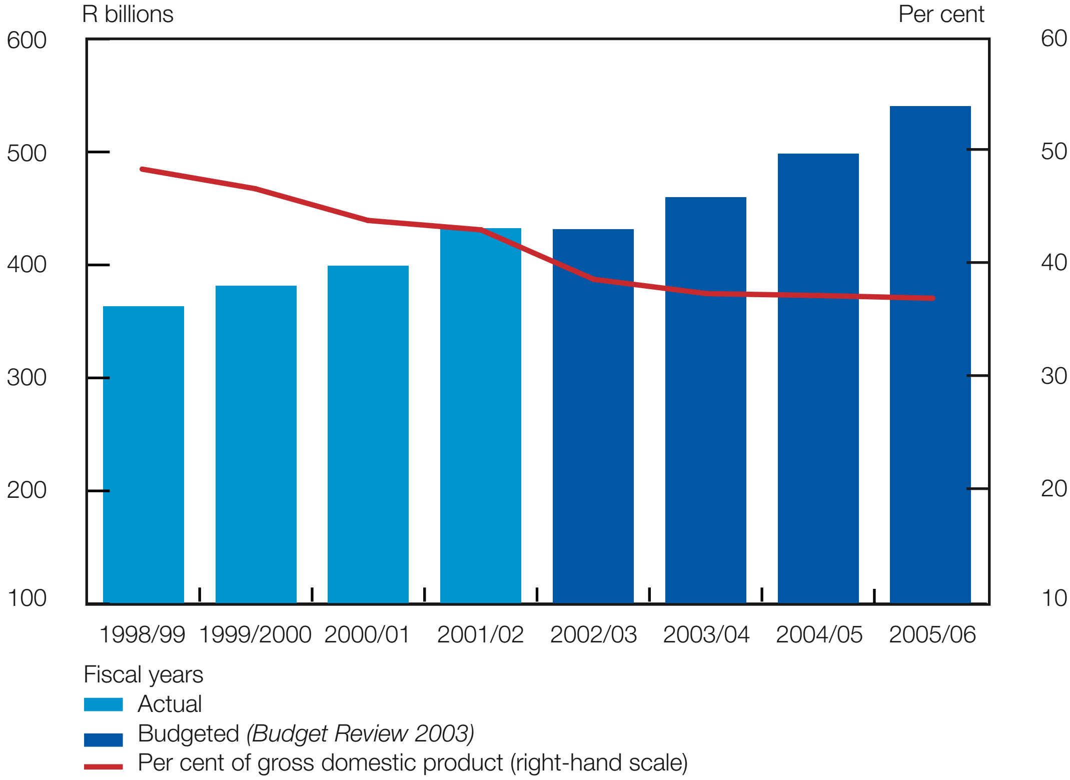
Financing of national government deficit
R billions

	Revised estimate	Medium-term estimates		
	2002/03	2003/04	2004/05	2005/06
Deficit	**16,1**	**29,5**	**32,4**	**34,4**
Plus: Extraordinary payments*	7,8	7,0	7,0	7,0
Revaluation of maturing foreign loans	0,0	1,9	2,5	1,7
Less: Extraordinary receipts**	10,2	6,3	6,3	4,6
Net borrowing requirement	**13,7**	**32,1**	**35,6**	**38,5**
Domestic government bonds	-3,1	9,3	14,4	21,5
Treasury bills	4,0	6,0	6,0	8,0
Foreign loans	14,5	13,7	15,2	9,0
Changes in available cash balances***	-1,7	3,1	-	-
Total net financing	**13,7**	**32,1**	**35,6**	**38,5**

* Including premiums paid on debt portfolio restructuring previously included in state debt cost expenditure
** Including premiums and book profits resulting from debt restructuring previously included in revenue
*** Increase -, decrease +

Although government's reliance on foreign funding is estimated to decrease in fiscal 2005/06, foreign bond issues will remain at significant levels. It was envisaged that the foreign funding strategy would contribute towards the reduction in the South African Reserve Bank's net open position in foreign currency. Funding plans for fiscal 2003/04 indicated an envisaged foreign bond issue to the value of US$1 billion and a further disbursement of approximately R5,3 billion on the arms procurement credit facility.

National government loan debt



It was estimated that national government loan debt would increase from R440,9 billion at the end of fiscal 2002/03 to R466,3 billion at the end of March 2004 and to R546,8 billion at the end of March 2006. As a ratio of gross domestic product, national government loan debt was expected to decrease from 39,4 per cent at the end of fiscal 2002/03 to 37,8 per cent at the end of fiscal 2003/04 and eventually to 37,3 per cent at the end of fiscal 2005/06. Medium-term estimates provided for a decrease of R7,0 billion a year in the outstanding balance on the Gold and Foreign Exchange Contingency Reserve Account. Guarantees issued to public-sector bodies with borrowing powers were increased from R70,3 billion at the end of March 2001 to R80,7 billion at the end of March 2002.

As indicated in the accompanying table, the public-sector borrowing requirement as a ratio of gross domestic product is projected to increase from 1,4 per cent in fiscal 2002/03 to 3,1 per cent in fiscal 2003/04. A decrease to 2,7 per cent is envisaged for 2005/06. The higher borrowing requirement of the public sector over the forecast horizon is also reflecting the expansionary fiscal policy stance adopted by the national government.

Public-sector borrowing requirement
R billions

	Revised estimate	Medium-term estimates		
	2002/03	2003/04	2004/05	2005/06
National government*	13,7	30,2	33,1	36,8
Reconstruction and development fund	-0,3	-0,2	-0,2	-0,2
Extra-budgetary institutions	-2,5	-3,4	-3,2	-2,5
Social security funds	-0,9	-1,3	-0,9	-0,8
Provincial governments	3,3	0,2	-0,8	0,0
Local authorities and local enterprises	5,5	4,7	5,0	5,1
Non-financial public enterprises	-2,9	7,8	5,4	1,5
Public-sector borrowing requirement	**15,9**	**38,1**	**38,5**	**39,9**
Per cent of GDP	*1,4*	*3,1*	*2,9*	*2,7*

* Excluding the cost associated with the revaluation of maturing foreign loans

Statement of the Monetary Policy Committee

28 November 2002

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

CPIX inflation, i.e. the increase in the consumer price index for metropolitan and other urban areas excluding mortgage interest cost, accelerated from 5,8 per cent in September 2001 to 12,5 per cent in October 2002 when measured over a period of twelve months. The increase in the quarter-to-quarter CPIX index was even more pronounced from an annualised rate of 3,8 per cent in the second quarter of 2001 to 12,7 per cent in the third quarter of 2002.

The acceleration in inflation from within to considerably above the inflation target range of 3 to 6 per cent was at first caused mainly by exogenous factors, such as the depreciation of the rand in the last half of 2001, rising food prices and an increase in oil prices during 2002. However, even if petrol, diesel and food prices are excluded from the CPIX index, the prices of other components rose from a quarter-to-quarter annualised rate of 1,1 per cent in the second quarter of 2001 to 5,8 per cent in the fourth quarter and 11,2 per cent in the third quarter of 2002. In October 2002 the year-on-year increase in the prices of these other components amounted to 9,5 per cent. The continued acceleration in consumer prices was mainly due to steep increases in the prices of services, whereas the rate of increase in the prices of non-food goods started to level off.

Although there is still no evidence that consumer price inflation is decreasing, a number of factors indicate that we may be close to the point where inflationary pressures could start to abate, namely:

- Inflation in the production prices of goods, which generally precedes changes in consumer price inflation, has slowed down significantly. The quarter-to-quarter rate of increase in the production prices of goods came down from 26,0 per cent in the first quarter of 2002 to 10,4 per cent in the third quarter. This appreciably slower growth in production prices was discernible in both domestically produced and imported goods in the third quarter of 2002. The year-on-year increase in the total production price index amounted to 14,6 per cent in October 2002, which was lower than the 15,4 per cent in the preceding month.

- A strengthening in the external value of the rand. The exchange rate of the rand showed a meaningful improvement from the beginning of October 2002. After a relatively weak performance during the third quarter of 2002, the rand has recovered most of its losses since the beginning of October. As a result, the weighted exchange rate of the rand on 27 November 2002 was about 22 per cent higher than at the end of last year.

- A decline in international oil prices. Crude oil prices dropped sharply by almost 12 per cent in dollar terms, and 23 per cent in rand terms, from the beginning of October 2002. This represents a reversal of the distinct upward trend in international oil prices that started towards the end of 2001.

- Slower growth in bank credit extension to households and business enterprises. The twelve-month growth rate in credit extended by the monetary sector to the private sector declined from a recent high of 15,6 per cent in January 2002 to 9,3 per cent in September 2002. This decline was not only due to a reversal in the leads and lags in foreign payments and receipts that were experienced in the last quarter of 2001, but was also evident in instalment sale and leasing finance, mortgage advances and other loans and advances to households.

- A deceleration in the pace of growth in the more broadly defined money supply aggregates. The quarter-to-quarter seasonally adjusted and annualised growth rate in M3 fell from 18,2 per cent in the second quarter of 2002 to 8,9 per cent in the third quarter. Moreover, hardly any growth was recorded in M1 and M2 during the third quarter of 2002, but M1A again increased at a high rate.

- Continued excess production capacity in the economy. The utilisation of production capacity in manufacturing amounted to about 81 per cent in both the second and the third quarter of 2002, which is still way below the level that is normally regarded as a reflection of full production capacity. The real capital outlays by private business enterprises, public corporations and general government also continued to grow rapidly during the first three quarters of 2002.

- No signs of excess spending in the economy. Although the current account on South Africa's balance of payments changed from a surplus in the second quarter of 2002 to a deficit in the third quarter, this deficit at less than ½ per cent of gross domestic product is small and clearly sustainable at present in view of the strong performance in the external value of the rand.

- Persistent fiscal discipline applied by the authorities. Further considerable increases in revenue collections from taxes on income and profits as well as from taxes on goods and services made it possible to absorb higher government expenditure and to increase the primary surplus of the government, i.e. the balance on the government's accounts excluding interest payments. The Minister of Finance accordingly indicated in the *Medium Term Budget Policy Statement* in October 2002 that the national government's deficit before borrowing is expected to amount to only 1,6 per cent of gross domestic product in the current fiscal year.

Despite these factors favouring a slowdown in inflation, there are still significant upside risks that could prevent the increase in the CPIX index from moving towards the inflation target. Of these, the high inflationary expectations, recent increases in some administered prices and the faster growth in nominal unit labour cost are probably the most serious. Wage settlements considerably higher than productivity increases could severely hamper the containment of inflation. In addition, high increases in administered prices are clearly not desirable if we are serious about combatting inflation. The public authorities need to place this matter high on their list of priorities. Discipline is necessary if we want to reach the inflation targets. At the same time, business should realise that the advantages of the still lower external value of the rand could quickly be eroded by excessive price increases.

Provided that this discipline is applied and that there are no further exogenous shocks, the CPIX inflation should start to move towards the inflation target. This is also confirmed by a number of forecasts of inflation generated by our econometric models.

After careful consideration of the recent and expected future economic developments and of the underlying factors that could impact on inflation, the Monetary Policy Committee came to the conclusion that the current level of short-term interest rates is appropriate to bring the rate of inflation within the target range. The Committee therefore decided to keep the repurchase rate of the Bank unchanged at 13,5 per cent per annum.

Note on the changing structure of the manufacturing sector

by H Smith

Introduction

Over the past two decades the South African economy experienced a fair amount of structural change. Prominent among these was the declining share of the goods-producing industries in the total economy, which is not dissimilar to trends observed in most of the industrialised economies of the world. The end to the political and economic isolation of the country in the early 1990s, together with factors such as continuous technological change, trade liberalisation and globalisation, contributed substantially to the steady transformation of the South African economy.

This note is a review of some of the key developments in South Africa's manufacturing sector. The discussion focuses on longer-term developments during the past two decades as well as on the cyclical behaviour of the manufacturing sector. In the second section the evolution over time of gross value added is reviewed. The third section deals with changes in gross fixed capital formation, followed by notes on the changes in the distribution of factor income and saving. This is followed by a discussion of employment trends, whereas the final section contains some concluding observations.

Changes in gross value added

After World War II the South African economy changed from a resources-based economy and became increasingly industrialised and services oriented. This is clear from the decline of the share of mining and agricultural production in total gross domestic product from an average of 25½ per cent in the 1950s to an average of

Components of gross value added as percentage of total gross value added
Per cent

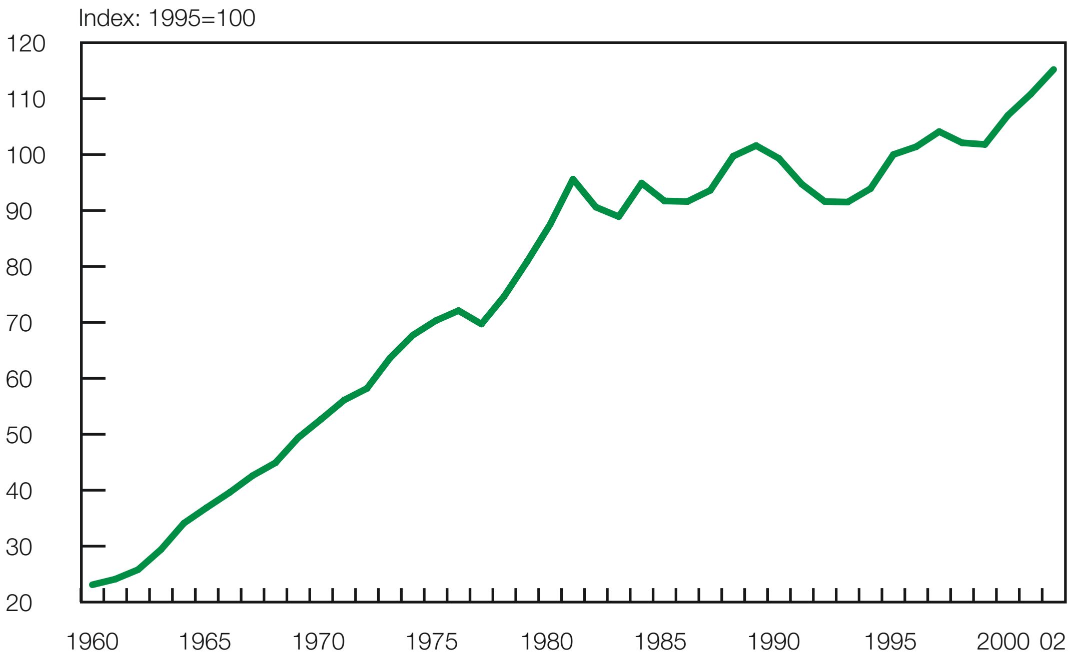
	Resources industries	Goods-producing industries	Manufacturing	Services-providing industries	Share of export-oriented industries in manufacturing value added
Decade averages					
1950s	25½	50½	20	49½	
1960s	21	48½	21½	51½	49
1970s	18½	47½	22	52½	47
1980s	19	49	23	51	46
1990s	11½	39	21	61	46
Years					
1995	11	38½	21	61½	45
1996	11	37½	20	62½	46
1997	10½	36½	20	63½	46½
1998	10	36	19	64	47
1999	10	34½	18½	65½	47
2000	10	34½	18½	65½	48½
2001	11	35	18½	65	49½
2002	12	36	19	64	50

19 per cent in the 1980s and 11½ per cent in the 1990s. By contrast, the share of manufacturing production in total gross domestic product increased from about 20 per cent in the 1950s to 23 per cent in the 1980s, before falling back from a peak of 24 per cent in 1981 to 18½ per cent in 1999 and 19 per cent in 2002.

There was a strong increase in the total real value of mining production during the 1960s, followed by a steep decline during most of the 1970s. The mining sector benefited temporarily from a spurt in base metal prices in the first half of the 1980s, but since about the middle of the 1980s the real value added by the mining sector has fallen persistently, especially in the gold-mining industry.

The real value added by the manufacturing sector expanded steadily from 1960 to 1981, except for a short period during the second half of the 1970s, recording an average annual growth rate of about 7 per cent during the entire period. However, from 1982 to 1993 real manufacturing production actually declined at an average rate of about ½ a per cent per year. This decline could be attributed to the slowdown in world economic growth, but also to the increasing effective application of economic and financial sanctions against South Africa by the international community.

Real value added by the manufacturing sector



With the repealing of most of the trade and investment sanctions in the early 1990s, activity in the manufacturing sector was boosted by South Africa's reintegration into the global economy. The average annual real manufacturing output growth rate picked up to 2½ per cent from 1994 to 2002. Viewed over the entire period since 1960, the contribution of all the goods-producing industries peaked at 54½ per cent in 1980, followed by a decline to 34½ per cent in 1999 and 36 per cent in 2002. The goods-producing industries encompass the agricultural, mining, manufacturing, construction, electricity, gas and water sectors. The declining share of the value added by the goods-producing industries in total value added is consistent with trends observed in most of the industrialised economies of the world.

The recent increase in the contribution of the goods-producing industries to the total gross domestic product between 2000 and 2002 can, in addition to stronger growth in manufacturing output, be attributed to an increase in the real value added by the mining sector. Real mining production gained from rising metal and mineral prices which, alongside the depreciation in the exchange value of the rand, lifted the contribution of the mining industry to total gross domestic product from 7 per cent in 1999 to 8 per cent in 2002. Over the same period, the contribution of the manufacturing sector increased from 18½ per cent in 1999 to about 19 per cent in 2002.

The manufacturing sector contributed materially to the faster growth in the real gross domestic product during the current recovery in the economy, which started in the fourth quarter of 1999. The real value added by the manufacturing sector grew at an average annualised rate of 4 per cent during the past 12 quarters. Stronger growth was particularly noticeable in the subsectors producing basic metals, transport equipment, chemical products and electrical equipment, which jointly have increased at an average annual rate of 7 per cent since 1999, contributing some 3½ percentage points to overall manufacturing output growth.

These sectors, known for the high export content of their output volumes, expanded output volumes faster than the other subsectors during the period 1994-2002. Consequently, the combined share in total manufacturing production of chemical products, basic metals and transport equipment increased from 44 per cent in 1993 to 47 per cent in 1999 and 50 per cent in 2002. These sectors count among the more prominent export-oriented subsectors of South Africa's manufacturing industry.

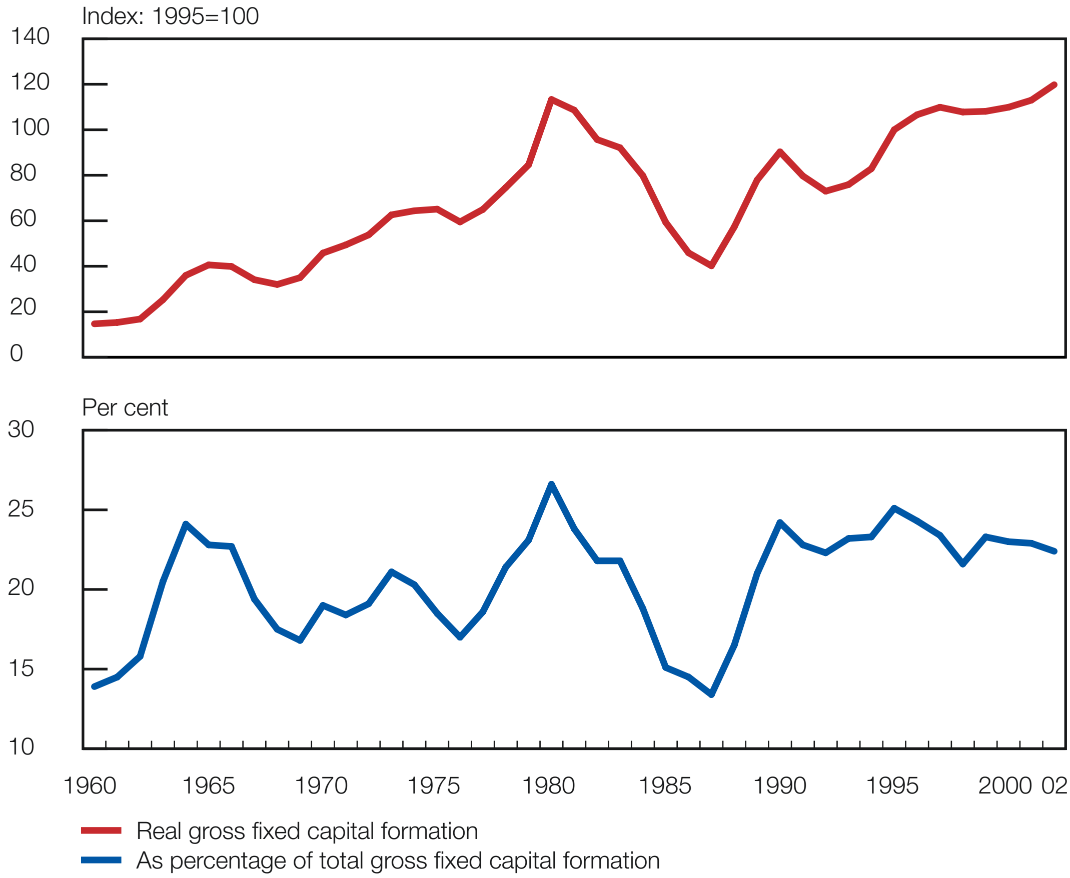
Apart from highly favourable global trading conditions during the 1990s, manufacturing exports also benefited from the conclusion of trade agreements and heightened price competitiveness brought about by the depreciation of the exchange value of the rand. The growth in the real value of exports of manufactured goods accelerated from an average annual rate of 3 per cent between 1975 and 1990, to 11 per cent from 1990 to 1998. Although the somewhat weaker global economic conditions hindered South Africa's exports from 1999 to 2002, export volumes still increased at an average annual rate of 10 per cent during the past three years.

Real manufacturing output since 1999 was boosted by a strong rise in inventory investment. Businesses needed to replenish inventories as they perceived inventory levels as too low to accommodate expected changes in demand during the upward phase of the business cycle. The level of manufacturing inventories relative to manufacturing output accordingly increased from a low turning point of 38½ per cent in the fourth quarter of 1993 to 45½ per cent in the first quarter of 1999, and an average of about 51 per cent in 2002. The long-term average of this ratio was 61½ per cent in the period 1960 to 2002.

Gross fixed capital formation

Gross fixed capital formation by the manufacturing sector increased at an average annual rate of 3½ per cent during the 1990s, compared with a decline of 1 per cent during the 1980s. As a percentage of total gross fixed capital formation, capital formation by the manufacturing sector showed an erratic pattern, ranging from 26½ per cent in 1980 to 13½ per cent in 1987. Strong rises in this ratio coincided with the expansion of Sasol towards the end of the 1970s and the development of Mossgas and expansions by Iscor in the second half of the 1980s. During the 1990s, when public corporations in the manufacturing sector were not expanding capacity on a vast scale, the ratio of manufacturing capital formation to total capital formation settled at a level of around 23 per cent.

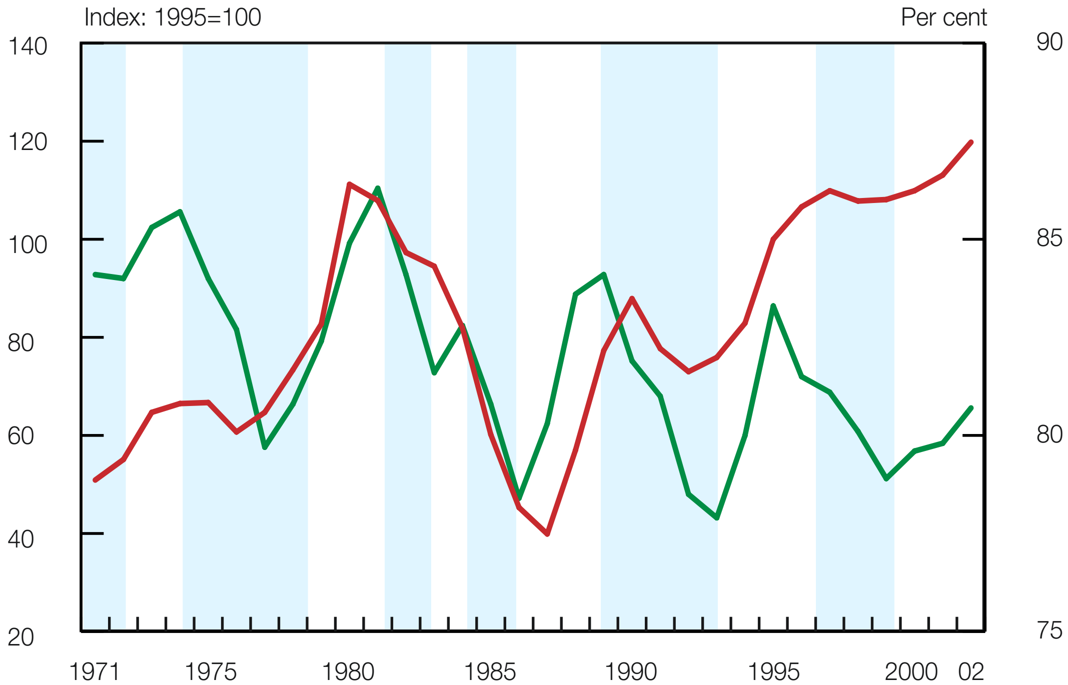
Gross fixed capital formation by the manufacturing sector



The need to be competitive in an increasingly open international economy and to compete in the domestic market prompted South African producers, particularly motor manufacturers, to expand capacity and to modernise production technology in the years after 1994. Real outlays on, especially, machinery and equipment were stepped up to meet the expected increase in demand and to implement newly developed information and computing technologies. The date change at the turn of the millennium also created demand for computing equipment.

Prior to about 1995, rising rates of capacity utilisation in the manufacturing sector usually coincided with heightened investment activity and, conversely, declining capacity utilisation rates with a slowdown in investment activity. This fairly well-established relationship broke down in the second half of the 1990s when low and falling rates of capacity utilisation in the manufacturing sector were accompanied by a fairly vigorous pick-up in investment spending. The reasons for this deviation from the established pattern are not entirely clear, but it is thought that the expenditure on new technology expanded the absolute capacity of the manufacturing sector by more than what was anticipated, resulting in an increased under-utilisation of capacity at the prevailing levels of output.

Gross fixed capital formation and capacity utilisation in the manufacturing sector



Real gross fixed capital formation
Capacity utilisation (right-hand scale)
The dark areas represent the downward phases of the business cycle

Other factors contributing to the rise in real fixed capital formation by the manufacturing sector since 1999 include:

- the ageing of transport equipment and other machinery and equipment;
- increased rates of return on invested capital; and
- the consistent decline in the cost of capital relative to labour.

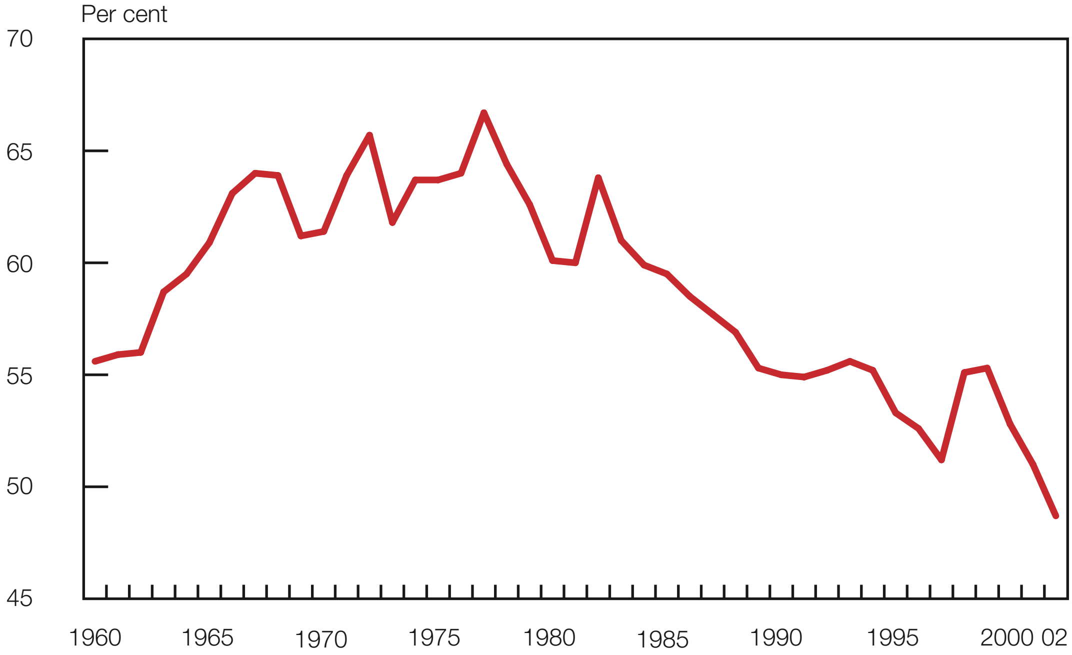
Factor income

An analysis of the distribution of factor income in the manufacturing sector shows the growing importance of operating surpluses from the second half of the 1970s and the associated decline in the share of salaries and wages.

The continued paring of labour resources, together with some moderation in nominal wage growth, helped to lift the share of operating surpluses in the overall value of output – a shift which is common in periods of economic expansion. In addition, the growth in operating surpluses generally benefited from the depreciation of the exchange value of the rand during the 1990s, especially in the export-oriented subsectors of the manufacturing industry.

The share of compensation of employees as a percentage of total factor income in the manufacturing sector declined from an average of about 61½ per cent in the period 1960 to 1985, to about 55 per cent in 1990 and remained more or less at this level until 1999, but then declined further to its lowest level ever of 49 per cent in 2002.

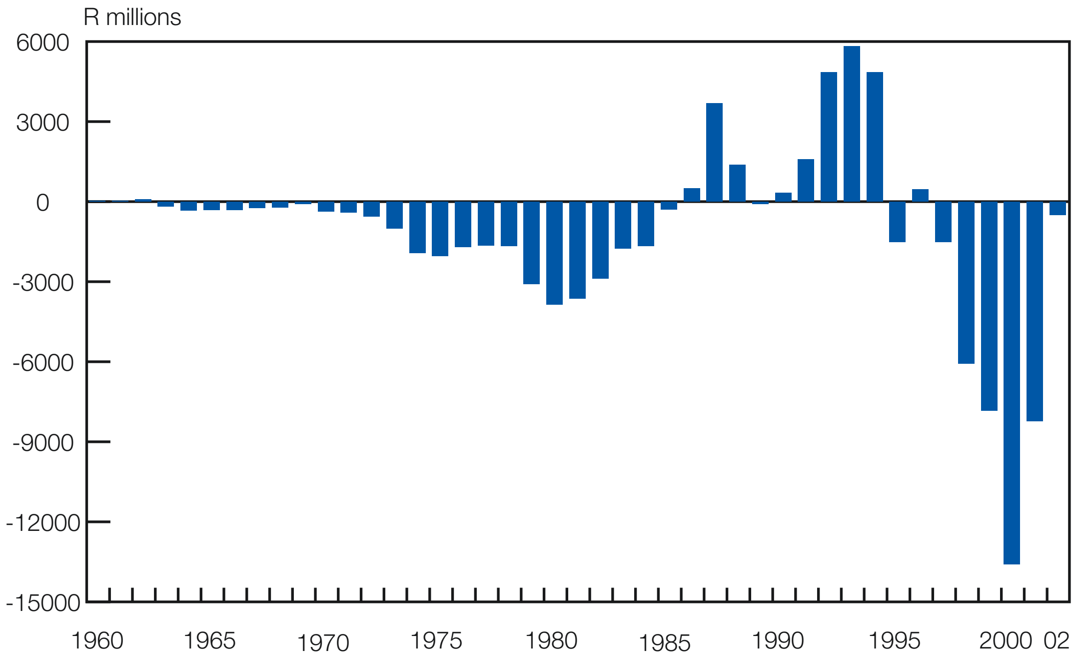
Compensation of employees as percentage of total factor income



Saving and net lending

The sharp rise in operating surpluses bolstered aggregate gross saving by the manufacturing sector during the 1990s. However, gross saving has fallen short, by a growing margin, of gross capital formation since 1995. Even with a stronger saving effort the manufacturing sector remains dependent on external sources for meeting its investment requirements.

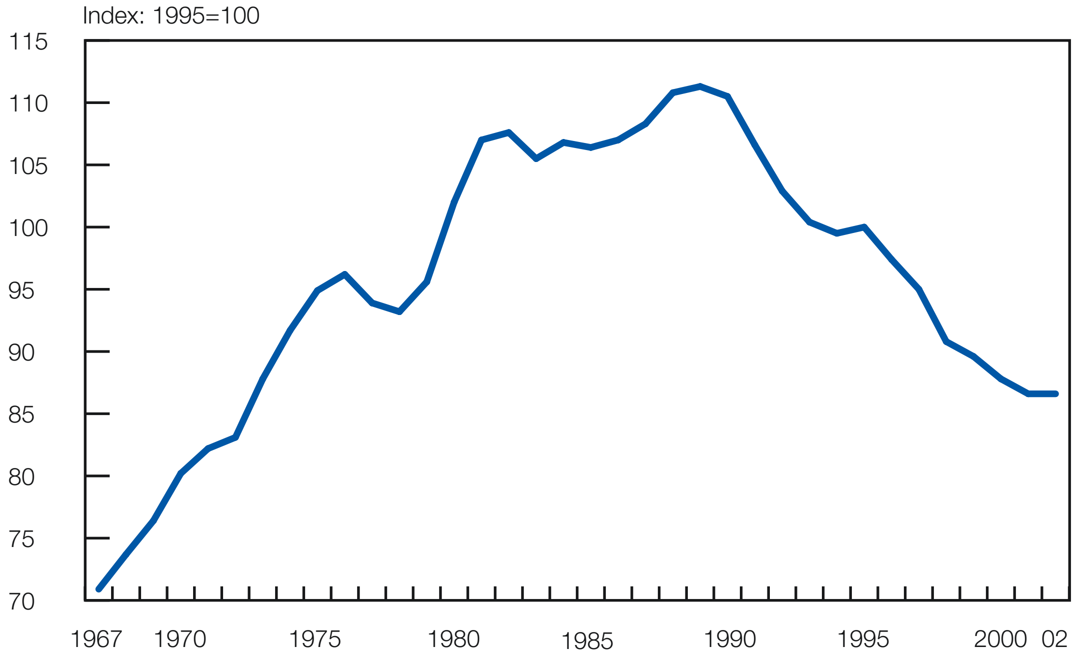
Excess of gross capital formation over gross saving in the manufacturing sector



Employment trends

Retrenchments in the manufacturing sector have continued almost unabatedly for more than a decade. Employment in the manufacturing sector declined by 21 per cent from 1990 to 2002. The decline in manufacturing employment and the associated declining share of employee compensation in the value of manufacturing output can be attributed to the continued rationalisation of labour resources, including the outsourcing of core activities by manufacturers in order to raise the efficiency of labour in a competitive environment, as well as to the implementation of technologically advanced and skills-intensive production methods.

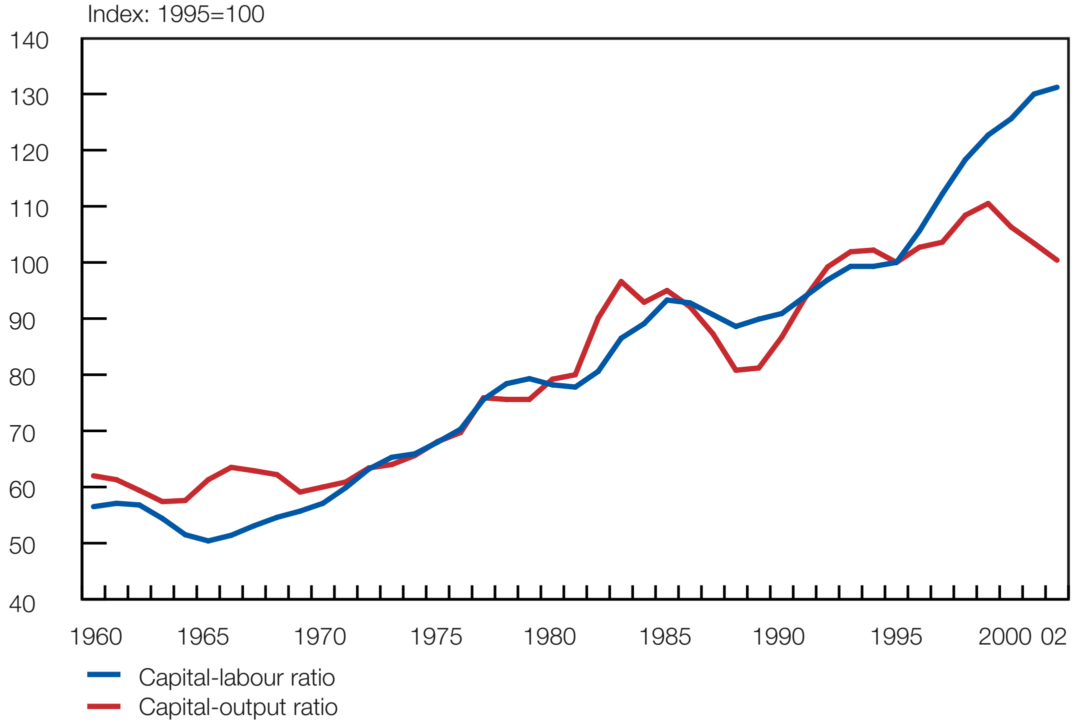
Employment in the manufacturing sector



There is a strong positive relationship between changes in manufacturing production and employment levels during the upward and downward phases of the business cycle. Rising output levels are usually associated with upward phases of the business cycle, whereas employment levels tend to fall back with shrinking output volumes during periods of subdued economic activity. However, during the current upward phase of the business cycle, higher rates of output growth were not accompanied by increases in employment numbers to the same extent as in previous recovery phases. This indicates that the growth in manufacturing production during the current economic recovery was essentially driven by increasing labour productivity.

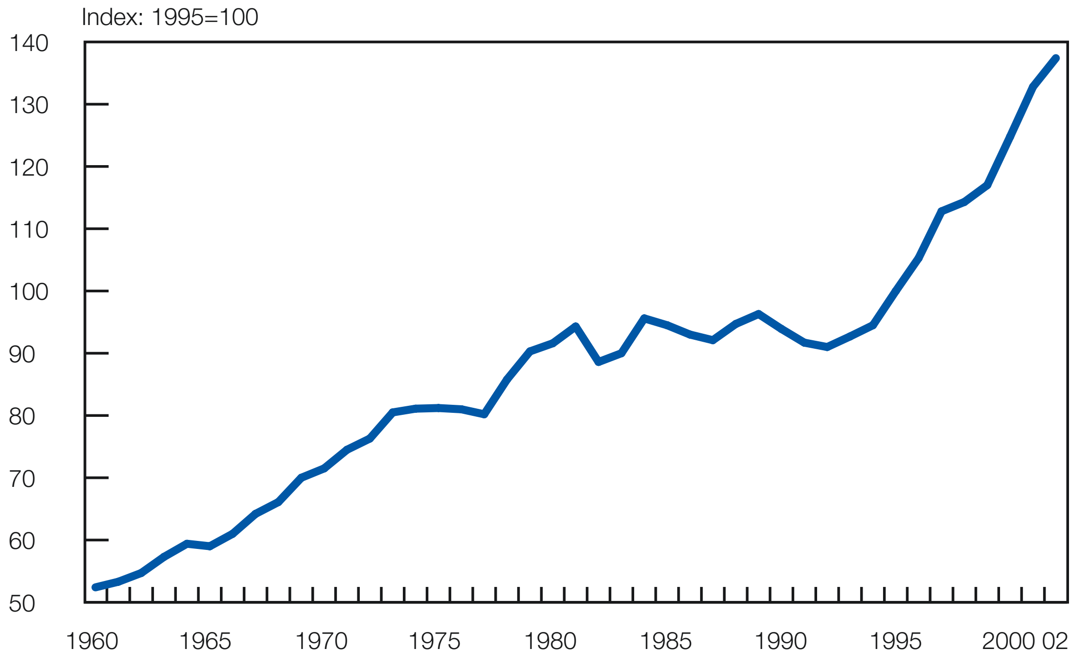
The introduction of more capital-intensive production processes is also evident in the increase in the capital-labour ratio and the capital-output ratio of the manufacturing sector. Against the background of rising real wages during the 1990s, employment numbers were continuously cut back. As a result, the productivity of labour – reflected in a strongly rising output-labour ratio – increased quite impressively from the middle of the 1990s. This strong growth in productivity compressed the growth in nominal unit labour cost to modest levels and contributed significantly to the overall containment of inflation in the South African economy during most of the 1990s.

Capital intensity in the manufacturing sector



The persistent decline in manufacturing employment since 1990 has apparently bottomed out in 2002. This may portend that the restructuring in the manufacturing sector might be drawing to a close and that this sector may be resuming its traditional role as a major employment creator in the South African economy.

Labour productivity in the manufacturing sector



Summary

The most significant development in South Africa's manufacturing industry during the 1990s was the resuscitation of output growth at around the middle of that decade. The institution of an all-inclusive democratic system of government, and the repeal of trade and financial sanctions against the country, undeniably played a major role in the revival of the manufacturing sector.

The opening up of export markets and the ferocity of competition in these markets compelled South African producers to become more cost conscious. This awareness brought

- an urgency to contain growth in labour cost;
- declining levels of employment in the industry;
- continuously strong growth in labour productivity;
- increased capital intensity in production processes;
- growing export-orientation of the sector; and
- a shift in the distribution of factor rewards in favour of operating surpluses.

There were signs during 2002 that the prolonged period of labour shedding might have run its course and that the manufacturing sector could once more become a major provider of new job opportunities in the South African economy.

A note on flows of funds in South Africa's national financial accounts for the year 2001

by D H Meyer and Z Nhleko[1]

Introduction

South Africa's sectoral flow-of-funds accounts for 2001 are presented in the national financial accounts on pages S-44 to S-53 of this issue of the *Quarterly Bulletin*. This note highlights some of the important observations which can be made on the basis of the information presented. The note's coverage is illustrative rather than comprehensive[2].

Total economic activity in the four quarters of 2001 is summarised by the flow-of-funds accounts of South Africa and indicates how the financial flows are linked to real economic activity by associating financial data with data on saving and capital formation. It is a record of all transactions between economic agents and integrates transactions in both real and financial assets. These interrelationships between the macroeconomic accounts facilitate a comprehensive analysis of economic developments.

Financing balance

Domestic saving and investment activity in South Africa are summarised in Table 1. For individual sectors these transactions may result in either a surplus or a deficit, i.e. these sectors either become net lenders or net borrowers.

Any individual sector may experience a surplus or deficit, but by definition for the domestic economy as a whole investment may not exceed saving, unless supplemented

1 The views expressed are those of the authors and do not necessarily reflect the views of the South African Reserve Bank. The Reserve Bank wishes to express its sincere appreciation for the co-operation of all the reporting organisations – government departments, financial market and other public and private-sector institutions – for furnishing the data used for the compilation of South Africa's financial accounts.

2 For a more comprehensive discussion on the technical aspects of South Africa's national financial accounts refer to: A note on flows of funds in South Africa's national financial accounts for the year 1999 *by M A Kock and D H Meyer.* Quarterly Bulletin, *No 219, March 2001.*

Table 1 Financing balances[1,2] 2000 and 2001
Surplus units (+) / deficit units (-)

R millions

	2000			2001		
	Gross saving	Gross capital formation	Net lending (+)/net borrowing (-)	Gross saving	Gross capital formation	Net lending (+)/net borrowing (-)
Foreign sector[3]	4 013	-	4 013	3 072	-	3 072
Financial intermediaries	21 903	2 483	19 420	15 625	3 097	12 528
Central and provincial governments	-13 181	10 687	-23 868	1 492	9 205	-7 713
Local authorities	6 746	10 324	-3 578	7 589	12 396	-4 807
Public business enterprises	24 556	13 583	10 973	23 433	14 450	8 983
Private business enterprises	68 445	84 326	-15 881	65 135	89 784	-24 649
Households[4]	25 785	16 864	8 921	32 078	19 492	12 586
Total	138 267	138 267	-	148 424	148 424	-

1 Gross saving plus net capital transfers less gross capital formation. Gross capital formation consists of total fixed-capital formation and total changes in inventories, before providing for consumption (depreciation) of fixed capital.
2 A positive amount reflects a net lending position and by implication a net acquisition of financial assets, whereas a negative amount reflects a net borrowing position and by implication a net incurrence of financial liabilities.
3 A positive amount reflects a surplus for the rest of the world and therefore a deficit on South Africa's balance on current account of the balance of payments. A negative amount represents a deficit for the rest of the world and a surplus on South Africa's balance on current account of the balance of payments.
4 Including unincorporated business enterprises and non-profit institutions serving households.

by transactions with the rest of the world. Domestic net savings had to be augmented by an inflow of foreign capital in 2001 in order to finance gross capital formation. The net domestic borrowing requirement is equal, but of opposite sign, to South Africa's balance on current account of the balance of payments, including net capital transfers from the rest of the world. A deficit was recorded on the current account of the balance of payments, even though it was smaller than that experienced in 2000. This means that the financing surpluses of the financial intermediaries, non-financial public business enterprises and households were insufficient for the financing of the deficits of the central and provincial governments, the local authorities and private business enterprises.

Lower saving by financial intermediaries and private business enterprises was primarily countered by the government's increased contribution to national savings. Prudent fiscal policy and consistently higher government revenue collections contributed to the lower net borrowing requirement of the central and provincial governments in 2001. Household saving also rose somewhat in 2001.

Sectoral analysis

Beyond the net lending and/or net borrowing requirements generated by the saving and investment behaviour discussed above, the national financial account focuses on the financial flows generated by the surplus units seeking appropriate investment outlets and thereby financing the insufficient savings of deficit units.

An analysis of inter-sectoral interaction through financial transactions indicates how transactions by one sector impacts on the system as a whole. Each sector is briefly analysed.

Foreign sector

The account of the foreign sector is compiled from the point of view of the rest of the world and is as such a mirror image of the balance of payments, which is drawn up from the point of view of the South African economy. The foreign sector refers to all non-resident units that enter into transactions with residents and, within the financial account framework, its primary function is to balance the domestic saving-investment gap – i.e. through imbalances on the current account of the balance of payments of South Africa.

The total net acquisition of financial assets equals the total net accumulation of liabilities, leaving transactions with the rest of the world as the balancing item. In 2001, as noted in Table 2, the net accrual of financial assets by the domestic institutional sectors amounted to R530,9 billion and the net increase in their financial liabilities amounted to R534,0 billion. The difference of R3,1 billion represents net borrowing from the rest of the world[3].

3 "Borrowing" in this context should be interpreted in the widest sense, including new share investment.

Table 2 Flow of funds: foreign sector and combined domestic sectors, 2001

R millions

	Domestic institutional sectors	Rest of the world	Total
Net incurrence of financial liabilities	533 952	49 121	583 073
Net lending (+)/net borrowing (-)	-3 072	3 072	-
Net acquisition of financial assets	530 880	52 193	583 073

The foreign sector's net contribution to saving in the South African economy was mainly effected through non-residents' increased holdings of ordinary shares, but trade credit and other short-term loans and monetary deposits also increased. The sustained purchases by international investors of shares listed on the JSE Securities Exchange SA reflected the country's favourable weighting in emerging-market equity indices. Total inflows from the rest of the world was, however, dampened by significant net sales of government bonds by offshore investors as volatility in the market for foreign exchange and protracted rand weakness, together with the decline in domestic bond yields during most of 2001, eroded returns relative to that offered elsewhere.

Financial intermediaries

Financial intermediaries are at the centre of the flow-of-funds system. These institutions transform funds received from surplus entities (lenders) into a variety of financial instruments structured to suit the requirements of deficit entities (borrowers). The financial intermediaries identified in South Africa's national financial accounts extend beyond monetary institutions and include non-bank financial institutions, which have played an increasingly important role in recent years. The financial intermediaries sector consists of five subsectors, namely the monetary authority, other monetary institutions, Public Investment Commissioners, insurers and retirement funds, and other financial institutions. Each of these will be discussed seperately.

Monetary authority

In exercising its functions of implementing monetary policy, issuing money, executing foreign exchange policy and holding international reserves the monetary authority, consisting of the South African Reserve Bank and the Corporation for Public Deposits, interacts mostly with other monetary institutions, the central government and the foreign sector. The monetary authority increased its gold and other foreign reserves somewhat during 2001 despite a substantially weaker rand towards the end of the year. Banks increased their deposits at the Reserve Bank in 2001, partly because of an effective tightening of the cash reserve requirements. The close interaction between the monetary authority and the banking sector is reflected by the loans and advances that were made to and received from other monetary institutions. Additional funds were also acquired from the foreign sector, mainly in the form of a syndicated loan.

Other monetary institutions

The other monetary institutions sector engages in financial intermediation mainly through accepting deposits and extending loans. This sector reflects the consolidated accounts of the banks, mutual banks, the Land Bank and Postbank. As reflected in the abbreviated flow of funds presented in Table 3, this sector experienced a substantial increase in financial intermediation in 2001.

Other monetary institutions recorded gross saving of R11,1 billion and gross capital formation of R2,8 billion in 2001. However, the value of non-financial transactions was small compared with the huge financial flows. An increased preference for more secure investments, due to volatility in financial markets, ensured that monetary deposits increased by R94,9 billion. Additional funds were also acquired through the issuance of bills and bonds as well as trade credit and other short-term loans. Intermediation to deficit sectors was effected through bank loans and advances amounting to R53,9 billion, mortgage loans of R32,7 billion and gold and foreign reserves to the value of R18,8 billion. The rise in other assets and other liabilities of this sector was mainly concentrated in derivatives instruments. In 2001, the other monetary institutions invested 98,3 per cent of their total resources in financial assets and this sector's asset flows accounted for 48,0 per cent of financial-intermediary asset flows and 22,2 per cent of total asset flows.

Table 3 Flow of funds: other monetary institutions, 2001

Transaction items	Sources/ liabilities R millions	Uses/ assets R millions
Gross saving	11 058	
Gross capital formation		2 813
Net lending (+)/net borrowing (-)	8 245	
Net financial investment (+/-)		8 245
Net incurrence of financial liabilities	153 945	
Net acquisition of financial assets		162 190
Gold and other foreign reserves	-	18 836
Monetary deposits	94 928	3 907
Bank loans and advances	2 334	53 949
Bills, bonds and loan stock	6 291	18 216
Mortgage loans	-	32 747
Other assets/liabilities	50 392	34 535
Total sources/liabilities and uses/assets	165 003	165 003
	Per cent	
Percentage of total sources used for gross capital formation	1,7	
Percentage of total sources used to acquire financial assets	98,3	
Percentage of total asset flows	22,2	
Percentage of total financial-intermediary asset flows	48,0	

Public Investment Commissioners

The main function of the Public Investment Commissioners is to act as asset manager for the government's official pension and provident funds and, to a lesser extent, social security funds, other government funds and trust accounts of households. Of the amount of R32,0 billion received by the Public Investment Commissioners in 2001 the bulk was channelled into fixed-interest securities. In a period when global risk aversion led to net sales of bonds by non-residents, the Public Investment Commissioners acted as counterweight by acquiring domestic government bonds. A small amount was also invested in shares while about a third of the funds was allocated to other external asset managers, mostly in the insurance industry, whereas deposits at other monetary institutions were reduced.

Insurers and retirement funds

Insurers and retirement funds accounted for 19,2 per cent of financial-intermediary asset flows, surpassed only by the other monetary institutions sector.

These contractual savings institutions were responsible for 8,9 per cent of total asset flows in 2001. As indicated in Table 4 this sector is usually a financing surplus sector. In 2001 this sector was able to supply funds, on a net basis, to the deficit sectors: transactions in financial assets exceeded transactions in financial liabilities by R2,8 billion. Member contributions accounted for the bulk of the amount available for investment in financial assets by insurers and retirement funds. The official pension and provident funds increased their investment portfolios at the Public Investment Commissioners by R31,4 billion. The rest of the insurer and retirement fund industry, on balance, increased their cash holdings at banks and decreased their exposure to bills, bonds and equities.

Table 4 Flow of funds: insurers and retirement funds, 2001

	R millions
Financing balance	2 845
Net incurrence of financial liabilities	62 860
Members' interest in the reserves of retirement and insurance funds	54 277
Other liabilities	8 583
Net acquisition of financial assets	65 705
Monetary deposits	12 468
Other deposits	43 714
Public Investment Commissioners	31 405
Foreign deposits	2 585
Other	9 724
Bills and bonds	-8 113
Short-term government bonds	11 317
Long-term government bonds	-17 199
Other	-2 231
Other loan stock and preference shares	2 032
Domestic	6 434
Foreign	-4 402
Shares	-1 669
Domestic	-5 510
Foreign	3 841
Other assets	17 273
	Per cent
Percentage of total asset flows	8,9
Percentage of total financial-intermediary asset flows	19,2

Other financial institutions

The other financial institutions sector includes all other non-bank financial intermediaries that acquires funds and carry out investments through sales of units, lending and similar activities. This sector includes, among others, unit trusts, participation mortgage bond schemes, finance companies and financial public enterprises. For 2001, financial activity in this sector resulted mainly from inflows to unit trusts. Inflows from institutional investors equalled those of individuals and thereby supported the financial activity of this sector. The spread of assets indicated a distinct preference for investment in shares, followed by an increase in deposits with monetary institutions and acquisition of bills and bonds.

General government: central government and provincial governments

Increased saving through fiscal rectitude and improved revenue collection enabled the central government and provincial governments to limit their financing deficit to R7,7 billion for the calendar year 2001. An amount of R42,7 billion was raised in the financial markets through the net incurrence of financial liabilities; however, of this amount R35,0 billion flowed through to the acquisition of financial assets – mainly an accumulation of bank deposits.

As shown in Table 5, a substantial portion of the financing needs for 2001 was funded through the issuance of short-term government bonds to the amount of R24,3 billion. Large redemptions of long-term government bonds during the first quarter of 2001 and a preference for foreign bond issues limited the availability of these instruments to domestic investors. However, net sales of bonds by non-residents in the domestic market ensured a steady supply of bonds to resident investors in the secondary market. Notwithstanding the foreign bond issues, the contribution of the foreign sector to the financing needs of the central and provincial governments decreased on a net basis – new capital raised in the international primary bond market was to a large extent offset by net sales of bonds by non-residents in the domestic secondary bond market – while that of the domestic sectors, with the exception of insurers and retirement funds, increased.

Table 5 Flow of funds: central government and provincial governments, 2001

	R millions
Financing balance	-7 713
Net acquisition of financial assets	35 036
Net incurrence of financial liabilities	42 749
Net incurrence of financial liabilities by financial instrument	42 749
Treasury bills	-7 548
Short-term government bonds	24 294
Long-term government bonds	1 258
Non-marketable government bonds	1 332
Other	23 413
Financing by sector	42 749
Foreign sector	-12 472
Public Investment Commissioners	25 729
Insurers and retirement funds	-5 533
Other financial institutions	9 963
Other domestic sectors	25 062

General government: local authorities

Local authorities recorded an overall financing deficit in 2001. The financing of this deficit was made possible through a reduction in financial assets, which exceeded a simultaneous reduction in financial liabilities. This was enabled by reducing short-term loans advanced and a decline in the outstanding balances of sundry debtors.

Non-financial public corporate business enterprises

The savings of non-financial public-sector enterprises exceeded their gross capital formation by a wide margin in 2001. This enabled these institutions to allow for a reduction in financial liabilities, such as bank loans and advances and long-term and mortgage loans. Excess funds were made available to other sectors through trade credit and short-term loans, purchases of bills, bonds and loan stock, as well as increased deposits with other financial institutions.

Non-financial private corporate business enterprises

As indicated in Table 6, non-financial private corporate business enterprises experienced a financing deficit in 2001. The financing deficit of R24,7 billion was funded in the financial markets through issuing equity capital on both domestic and international bourses, through bank loans and advances, as well as through other long and short-term loans and credit facilities. The funding arranged in this way exceeded the financing deficit of this sector and the excess was deposited with monetary institutions and channelled to shares, trade credit, short-term loans and other assets.

Table 6 Flow of funds: non-financial private corporate business enterprises, 2001

Transaction items	Sources/ liabilities R millions	Uses/ assets R millions
Gross saving	64 546	
Capital transfers	589	
Gross capital formation		89 784
Net lending (+)/net borrowing (-)	-24 649	
Net financial investment (+/-)		-24 649
Net incurrence of financial liabilities	129 592	
Net acquisition of financial assets		104 943
Monetary deposits	-	38 889
Other deposits	4 321	-3 857
Bank loans and advances	24 598	-
Trade credit and short-term loans	16 518	35 721
Bills, bonds and loan stock	18 386	5 780
Shares	51 557	10 958
Domestic	5 115	6 372
Foreign	46 442	4 586
Long-term and mortgage loans	14 012	-6 648
Other assets/liabilities	200	24 100
Total sources/liabilities and uses/assets	194 727	194 727
	Per cent	
Percentage of total sources used for gross capital formation	46,1	
Percentage of total sources used to acquire financial assets	66,6	
Percentage of total asset flows	26,2	

Households

Households continued to be net providers of funds to deficit sectors in 2001. A financing surplus, together with access to funding through bank loans and advances, mortgage loans and trade credit, enabled households to increase their interest in retirement and life funds and their deposits with banks and other financial institutions, such as unit trusts.

Summary and conclusion

The analysis of South Africa's national financial accounts for the year 2001 reveals the following:

- a lower net borrowing requirement of the central government;
- an increased borrowing requirement of private business enterprises;
- the foreign sector's net contribution to saving in the South African economy through sustained portfolio flows where net purchases of shares exceeded net sales of government bonds;
- the preference for monetary deposits, due to the volatility in financial markets, and the associated increase in the financial activity of the other monetary institutions;
- the growing importance of the other financial institutions sector in the portfolio diversification of institutional investors;
- the government's preference for funding through foreign bond issues which limited the domestic supply of long-term bonds;
- net sales of bonds by offshore investors helped to satisfy the domestic demand for fixed-interest securities;
- the continued strong financial position of non-financial public corporate business enterprises; and
- the continued importance of households as net providers of funds to deficit sectors.

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