Annual Economic Report

1998

South African Reserve Bank

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Introduction

South Africa has experienced a period of slowdown in economic activity and consolidation of the external current account from the third quarter of 1996. Economic growth has been weak and the current indicator of employment in the formal sectors of the economy has declined to its lowest level in nearly twenty years.

By the middle of 1997, macroeconomic balance had been strengthened materially and earlier concerns of non-resident investors had been adequately addressed. The economies in Europe and the Americas generally appeared to be moving into a renewed growth phase, brightening the prospects for export and income growth in South Africa. In the second half of 1997, however, severe financial strains surfaced in a number of emerging market economies in Asia. Initially it seemed as if these pressures would have little effect on the growth prospects of the South African economy.

In the second quarter of 1998, despite the existence of a relatively small shortfall between aggregate supply and demand, the South African economy was adversely affected by the financial turbulence in Asia. The domestic financial markets came under intense pressure in May 1998 and monetary conditions tightened considerably - after they had eased somewhat in October 1997 and March 1998. These events have delayed for a while the anticipated recovery in overall real economic activity.

Nonetheless, impressive gains were made in certain important respects over the past year or so: as indicated above, overall macroeconomic balance was restored to an important extent; the budget deficit of the national government was reduced much faster than most observers had anticipated; the deficit on the current account of the balance of payments was reduced in terms of absolute values and as a ratio of gross domestic product; inflation fell and inflation expectations diminished; productivity improved impressively in the formal sectors of the economy; and fixed investment in the productive business sectors of the economy has begun increasing in recent quarters. Overall, the economy was in a much healthier state at the beginning of 1998 than at the beginning of 1996.

Economic growth, as measured by year-to-year changes in real gross domestic product, decelerated from 1996 to 1997, reflecting mainly the consolidation of real gross domestic expenditure and a decline in agricultural output from the exceptionally high level of 1996. In the first half of 1998, quarter-to-quarter growth in real gross domestic product continued to be sluggish. This brought the real gross domestic product to a level in the first half of 1998 that was about ½ per cent above the level in the first half of 1997.

Apart from the agricultural sector, where production volumes have increased as weather conditions assumed a more "normal" pattern, all the major sectors of economic activity experienced slowdowns in output growth in the first half of 1998. The manufacturing and trade sectors were probably affected more by the slowdown in aggregate expenditure than most of the other sectors. Furthermore, increased external competition, which reduced the pricing power of domestic producers, and rising domestic cost pressures, compressed the operating margins of the manufacturing sector. Declining employment and slow growth in private households' disposable income were manifested in slow growth in the real value added by the trade sectors.

Growth in real gross domestic expenditure declined from 1996 to 1997 as the rate of increase in private consumption expenditure slowed down and inventories were reduced sharply. The growth rate of real fixed investment spending was more than halved from 1996 to 1997, but was showing signs of recovery in the first half of 1998. By contrast, general government consumption expenditure increased firmly in 1997 and continued to do so in the first half of 1998, albeit at a decidedly slower pace.

The slowdown in economic growth brought in its wake a further decline in total employment in the non-agricultural sectors of the economy from the middle of 1996 to the end of 1997. This decline probably also reflected the further substitution of capital for labour in the processes of production. Average remuneration per worker in the formal non-agricultural sectors of the economy rose in 1997 at a rate that was slower than in 1996, but which still exceeded the growth in average labour productivity. The growth in nominal unit labour costs accordingly slowed down to a rate which approximated the observed "core" or "underlying" inflation in 1997. At this level, inflation was still considerably higher than in South Africa's principal trading-partner countries.

Overall consumer-price inflation decelerated markedly from the first half of 1997 to the first half of 1998. Production-price inflation slowed down even more than consumer-price inflation, mainly owing to slowly rising and at times even declining prices of imported goods. However, underlying or core inflation - which excludes from the consumer price index potentially volatile food prices, mortgage rates and indirect taxes - declined by less than overall or "headline" consumer-price inflation. From August 1997, underlying inflation consistently exceeded overall consumer-price inflation, vindicating a policy of continuous vigilance to avert the build-up of underlying inflationary pressures.

The external current account deficit relative to gross domestic product widened fractionally from 1996 to 1997, but then narrowed appreciably in the first half of 1998 as the slowdown in aggregate domestic spending took effect and export earnings were boosted by a slight improvement in international commodity prices and the depreciation of the rand. The net services balance deteriorated further in 1997 and the first half of 1998 because of higher interest and dividend payments associated with the large increase in non-resident net purchases of South African shares and bonds. This, however, did not prevent the deficit on the current account from shrinking substantially in the first half of 1998.

Net capital inflows rose strongly in 1997 and the first half of 1998 and were more than ample for the financing of the deficit on the current account of the balance of payments. As a result, the surpluses on the external capital account contributed to an increase in the gross international reserves of the country to a level which covered about four months' worth of imports of goods and services. This improvement in international reserves was an important consideration when further relaxations of the restrictions on foreign investments by residents were announced in March 1998.

A large component of the capital inflows in 1997 and early 1998 comprised non-resident purchases of bonds and shares. When the financial crisis in the emerging markets again spilled over into South Africa in the second quarter of 1998, non-residents reduced their acquisitions of domestic securities and ultimately became net sellers of bonds. Despite this reduction, the net inflows of capital in the second quarter of 1998 still exceeded the absolute value of the current-account deficit, resulting in a further increase in non-borrowed international reserves.

The turbulence in emerging markets in the second quarter of 1998 and the sharp decline in the surplus on the external capital account brought downward pressure to bear on the exchange rate of the rand. Despite the tightening of liquidity conditions in the money market, and the increased supply of foreign currency by the Reserve Bank in the spot and forward foreign-exchange markets, the nominal effective exchange rate of the rand fell by about 20 per cent in the first seven months of 1998. Such a depreciation of the foreign exchange value of the rand invariably benefits industries with an orientation towards export markets. Whether these benefits would be lasting, would ultimately be determined by the extent to which domestic cost pressures, including the cost of labour, can be contained.

The expansion of the broadly defined M3 money supply accelerated from the middle of 1997. Over the same period, growth in credit extended to the private sector also proceeded at a brisk pace, apparently oblivious to the relatively high level of interest rates and responding, to a significant extent, to high levels of activity in the financial markets. Despite this rapid expansion of monetary conditions, the Reserve Bank found sufficient justification in the generally declining short-term and long-term interest rates and in the downward trend of consumer and production-price inflation to lower its lending rates by one percentage point in

October 1997.

When the new monetary accommodation arrangements between the Reserve Bank and the private banks were implemented in March 1998, the Bank initially set the repurchase rate at a level that was one percentage point below the former Bank rate, again signalling a slight easing of the monetary policy stance. The modest relaxations of monetary policy in October 1997 and March 1998 were fully in accordance with the Bank's eclectic approach which allows for greater discretion in judgement when taking policy decisions. Within this framework, the importance of aggregate monetary growth was de-emphasised somewhat, while still acknowledging that growth in the money supply is a vital element in propagating inflation.

Before the second round of Asian financial market turbulence erupted in May 1998, domestic monetary conditions appeared to be relatively placid. The assessment of most commentators was that the country had withstood the global financial turmoil of the last months of 1997 and that economic prospects were fairly sanguine. However, contrary to general expectations, South Africa was then also affected by the unsettled financial conditions in Indonesia and elsewhere, which had ripple effects throughout the international financial network in the second quarter of 1998.

The Reserve Bank responded by allowing liquidity conditions to tighten. This was achieved by selling foreign currency against rand and reducing the supply of liquidity relative to the private banks' daily needs, prompting a higher repurchase rate and forcing the banks to access the Marginal Lending Facility at rates which contained a severe penalty. Following the tightening of liquidity conditions, the private banks raised their prime overdraft rates by almost 6 percentage points from 18,25 per cent on 10 June 1998 to 24 per cent on 13 July.

The securities markets in South Africa have also been strongly affected by the financial crises in Southeast Asia. Emerging markets problems led to abrupt reversals of non-resident investor sentiment towards the country and heightened the volatility in interest rates, bond yields and asset-price movements. In addition, steps taken over the past eighteen months to modernise the financial infrastructure have made it easier for non-resident and domestic investors to gain access to and egress from South Africa's financial markets.

Non-resident investor participation in the domestic markets accordingly vacillated between strong net inflows of portfolio capital during times of relative calm in the markets, and heavy selling of fixed-interest securities when the rand was seen to be vulnerable. By contrast, expectations of firmer future economic growth inspired some consistency in non-resident buying interest in the share market.

Long-term bond yields showed a downward trend from December 1996 as macroeconomic balance was consolidated and inflation gradually abated. When the Asian financial problems affected the South African securities markets in the second half of October 1997, bond yields rose sharply but soon afterwards resumed their downward movement when it became clear that macroeconomic management would remain on its set course. However, the impression which had been created of relatively short-lived Asian contagion was changed completely when South Africa was once again afflicted by financial problems emanating from Asia in May 1998.

From May 1998 market sentiment abruptly turned bearish and yields on long-term government bonds moved sharply higher as monetary conditions were tightened. Short-term money market interest rates increased even more than long-term interest rates, steepening the inverted slope of the yield curve in the range of medium-term maturities, and maintaining an essentially horizontal slope over maturities of longer than three years. This particular shape of the yield curve appeared to reflect the general expectation that the current cautious monetary policy posture would lead to subdued inflation in the long term.

The deficit on the Budget of the national government in fiscal 1997/98 as a percentage of gross domestic product was lowered appreciably from the level of the previous fiscal year. The realised outcome was also closely in line with the budget target, thereby strengthening fiscal policy credibility. A primary surplus was attained and was also budgeted for the current fiscal year, effectively allaying any lingering concerns about unsustainable growth in government debt.

Although the growth in nominal gross domestic product in fiscal 1997/98 was lower than originally projected, greater efficiency in the administration of tax collection, among other things, resulted in government revenue exceeding the budget projection. Similarly, expenditure overruns at the national government level were limited to a minimum. At provincial government level, however, larger-than-budgeted expenditure equal to about 1 per cent of gross domestic product, made the improvement in the overall deficit of the broader general government sector less impressive when compared with the improvement in the deficit of the national government.

Gross domestic saving continued along its downward trend as private-sector saving declined relative to gross domestic product and dissaving by general government was not meaningfully lowered. Aggregate domestic saving also fell short of gross domestic fixed investment, leading to an increase in the reliance on foreign saving to finance domestic capital formation. To strengthen the long-run economic growth rate of South Africa, and to become more attractive for foreign direct investment in the economy, it is important that the savings rate should be increased significantly above its current inadequate level. If the propensity to save can be strengthened, and the inclination to borrow dampened, interest rates can be expected to decline to levels that would be justified by South Africa's current low inflation rate.

Domestic economic developments

Gross domestic production

The South African economy entered its sixth year of positive economic growth in 1998, albeit at a considerably slower pace than earlier in the upturn. In the early stages of the recovery, growth in real gross domestic product accelerated robustly to 3½ per cent in 1995 and 3 per cent in 1996, but later tapered off to about 1½ per cent in 1997. Growth diminished even further in the second half of 1997 and in the first two quarters of 1998 - on average, an annualised economic growth rate of only ½ per cent was realised over this period. As a result of these developments, the level of real gross domestic product in the first half of 1998 was only ½ per cent higher than in the first half of 1997. Output growth in the remainder of 1998 will have to accelerate strongly if growth for the calendar year as a whole is to match the population growth rate which is currently estimated at about 2 per cent per year.

The slow pace of production growth in the first half of 1998 can mainly be explained by a decline in the growth of output originating in the primary sectors of the economy and a decline in output volumes in the secondary sectors. The combined contribution of the primary and secondary sectors to overall gross domestic product, i.e. the contribution of the goods-producing industries, consequently declined to 42½ per cent, compared with a long-term average of 49½ per cent.

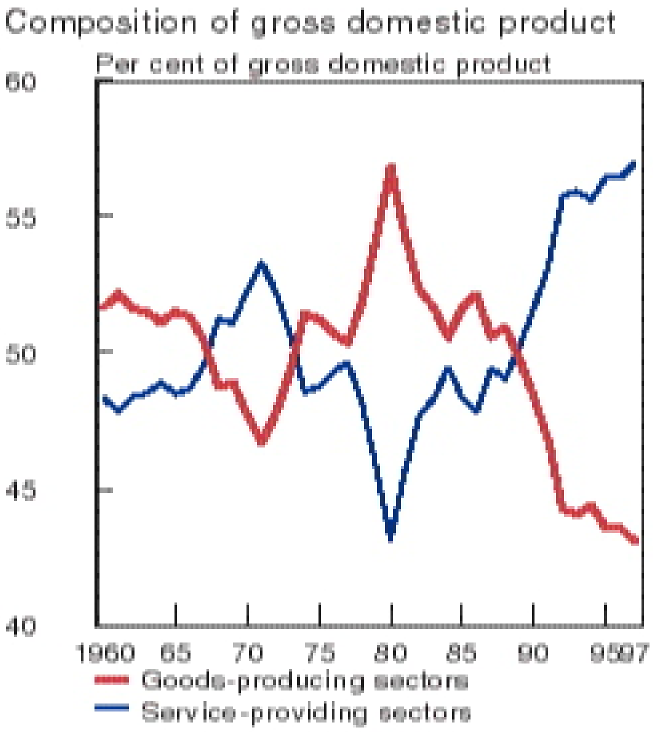
Table 1. Real gross domestic product

Percentage change at seasonally adjusted and annualised rates

Sectors	1996		1997		1998
	Year	1st half	2nd half	Year	1st half
Primary sectors	9	-6	2	½	-½
Agriculture	29	-17	-1½	-1	2½
Mining	-1½	2½	4½	1	-2
Secondary sectors	1	5	1	3	-1
Manufacturing	½	5½	1	3½	-1½
Electricity, gas and water	5	5	2	4½	½
Construction	2	1½	1½	1½	1
Tertiary sectors	3	½	½	1	1
Commerce	3½	0	-½	½	1
Transportation and communication	3	2	3½	2½	1½

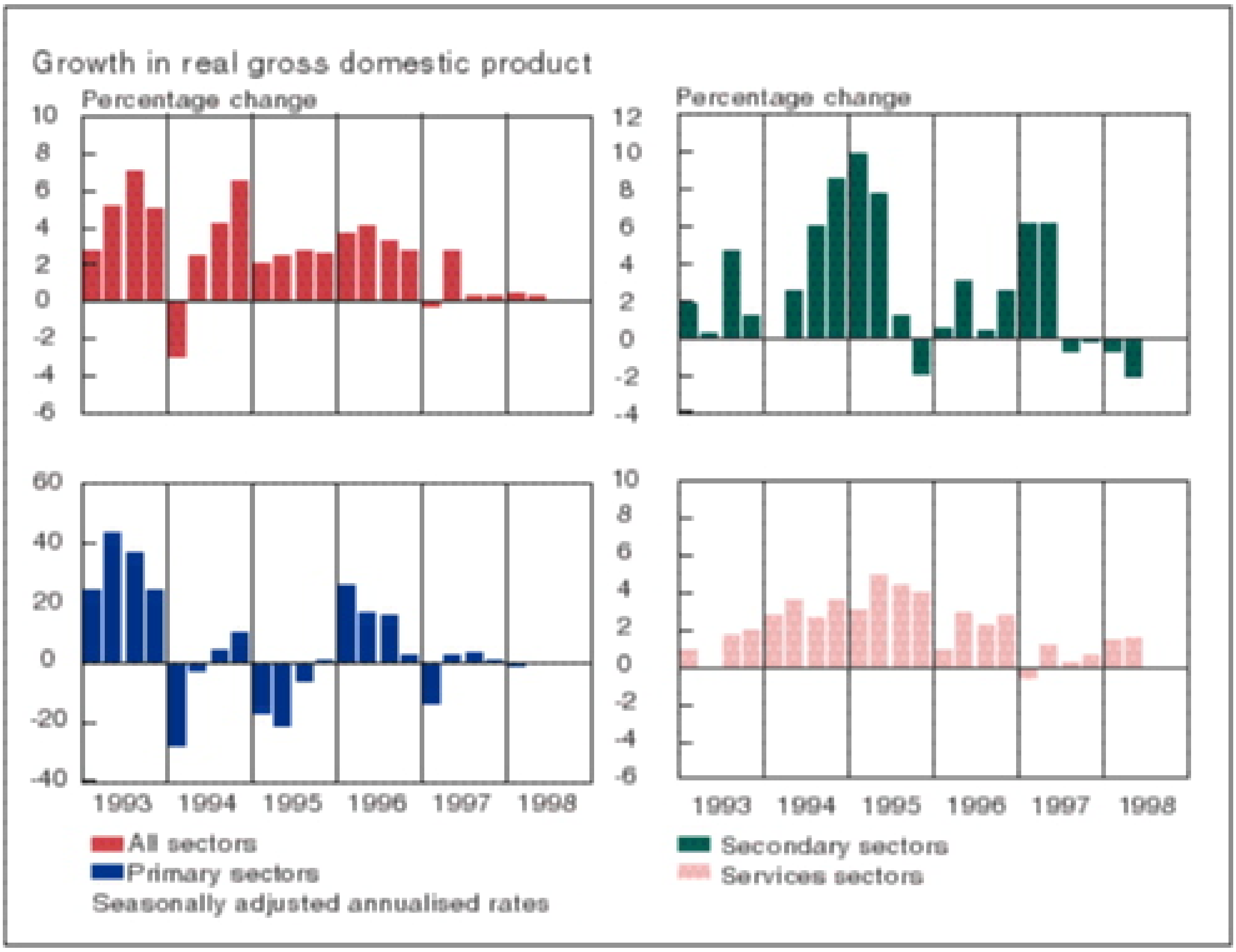
Financial and other services	3½	2½	1½	2½	3
Non-agricultural sectors	2	2½	1	2	0
Total	**3**	**1**	**1**	**1½**	**½**

The shift in emphasis in the production structure from goods-producing industries to the service-providing industries is a phenomenon not unique to South Africa. This trend has been observed elsewhere, in particular throughout the industrialised world. Furthermore, world trade in services is also growing much faster than trade in commodities as increases in the income and wealth of countries lead to a decline in the share of income being allocated to spending on basic needs.



The decline in the share of the goods-producing sector in the total economy and its corollary, the increasing importance of the service-providing sectors, tended to overshadow the volatility of output in the primary and secondary sectors, highlighting instead the more gradual changes in output that were occurring in the services sectors. In general, the demand for services is less sensitive to changes in income than the demand for output originating in the goods-producing industries. The service-providing sectors are therefore increasingly cushioning the impact on economic growth of potentially volatile changes in output in the primary and secondary sectors.

A sectoral analysis of production activity shows that real value added by the *agricultural sector*, which had declined by 1 per cent in 1997, held steady in the first half of 1998 when it increased at an average seasonally adjusted and annualised rate of about 2½ per cent. This modest improvement in agricultural output was especially noticeable in the increased incomes of livestock and horticultural farmers, who benefited from better-than-expected weather conditions in the early months of 1998. Field crop farmers suffered a slight decline in their gross incomes in the first six months of 1998.

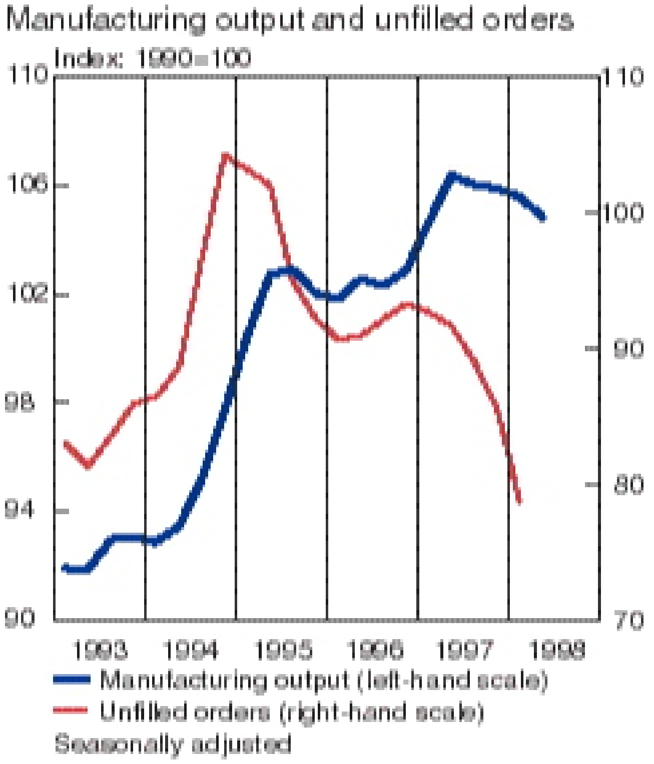


Output growth in the *non-agricultural sectors* of the economy slowed down from about 2 per cent in 1997 to virtually zero in the first half of 1998. The slackening in non-agricultural output growth was largely due to the mining and the manufacturing sectors, where declines in output occurred in the first half of 1998.

The real value added by the mining sector declined at an average annualised rate of 2 per cent in the first half of 1998. Despite the announcement of various strategies to lengthen the economic lifespan of marginal gold mines, gold production continued to fall as the dollar price of gold moved to lower levels and high-quality gold-bearing ore increasingly became exhausted. Output in the non-gold segments of the mining industry was affected by a decline in international demand following the economic slowdowns in Japan and other Asian economies, declining commodity prices and, as far as coal was concerned, congestion and increased handling costs at the point of exportation from the country.

The year-on-year growth in the real value added by the *manufacturing sector* accelerated from ½ per cent in 1996 to 3½ per cent in 1997. Growth in 1997 was concentrated in the first half of the year; in the second half growth slowed to a very modest rate, before output levels began to decline in the first half of 1998. The sluggishness of growth in manufacturing output over the past four quarters probably reflected:

- the slowdown in growth in real gross domestic demand over the past year and a half;
- the impact of falling output in the mining sector on manufacturing production activity;
- the removal of backlogs in supply as evidenced by the sharp decline in the ratio of unfilled orders to sales from the middle of 1997;
- the erosion of export demand emanating from the weakness of the Japanese economy and the problems experienced by a number of Southeast Asian economies;
- the enhanced competitiveness of the Southeast Asian economies in markets where they compete with South African producers;
- the delayed effects of the appreciation of the rand in the early part of 1997; and
- the termination of the General Export Incentive Scheme in the middle of 1997.



Output in the sector supplying *electricity, gas and water* was also adversely affected by slack production in the mining industry and declines in the demand for electricity from neighbouring states. The growth in real value added by this sector accordingly declined from
4½ per cent in 1997 to an annualised increase of ½ per cent in the first half of 1998. *Construction activity* remained rather subdued, interspersed with sporadic rounds of optimism when real interest rates appeared to begin declining; the real value added by enterprises in the construction sector increased by 1½ per cent in 1997 and at an annualised rate of 1 per cent in the first half of 1998.

Real output growth in the *tertiary sectors* fell back from almost 3 per cent in 1996 to 1 per cent in 1997 and then maintained this rather slow pace of expansion in the first half of 1998. In this broad sector of economic activity, the real value added by *financial institutions* and other *financial-service providers* increased steadily from the beginning of 1997 as bank intermediatory and financial market activity remained buoyant. Rising volumes of foreign trade and the expansion of the country's telecommunications network ensured a continued expansion in real value added by the sector *transport, storage and communication*. By contrast, real value added by general government and by the motor trade declined in the first half of 1998.

After an increase of 3½ per cent in 1996, the *real gross national product* rose by 1½ per cent in 1997 and at an annualised rate of 1 per cent in the first half of 1998. This slowdown was, to a significant extent, the net result of increased net factor payments to the rest of the world on account of the higher dividend and interest payments, which outweighed an improvement in the overall terms of trade. Because the rate of increase in real gross national product fell below the population growth rate, the real gross national product *per capita* declined, on balance, over the past six quarters. In the first half of 1998, real gross national product *per capita* was about 2 per cent lower than the most recent high point attained in the second quarter of 1996.

Gross domestic expenditure

The growth in real gross domestic expenditure decelerated from 2½ per cent in 1996 to 1½ per cent in 1997, followed by a decline at a seasonally adjusted and annualised rate of ½ per cent in the first half of 1998. As has been the case since the second half of 1995, the quarter-to-quarter change in aggregate real gross domestic expenditure remained erratic and a change in any one quarter was followed, almost without exception, by a change in the opposite direction during the subsequent quarter. Nevertheless, the general slowdown in the growth of aggregate domestic expenditure exceeded the slowdown in the growth of gross domestic output, thus relieving pressure on the current account of the balance of payments and on the overall level of prices.

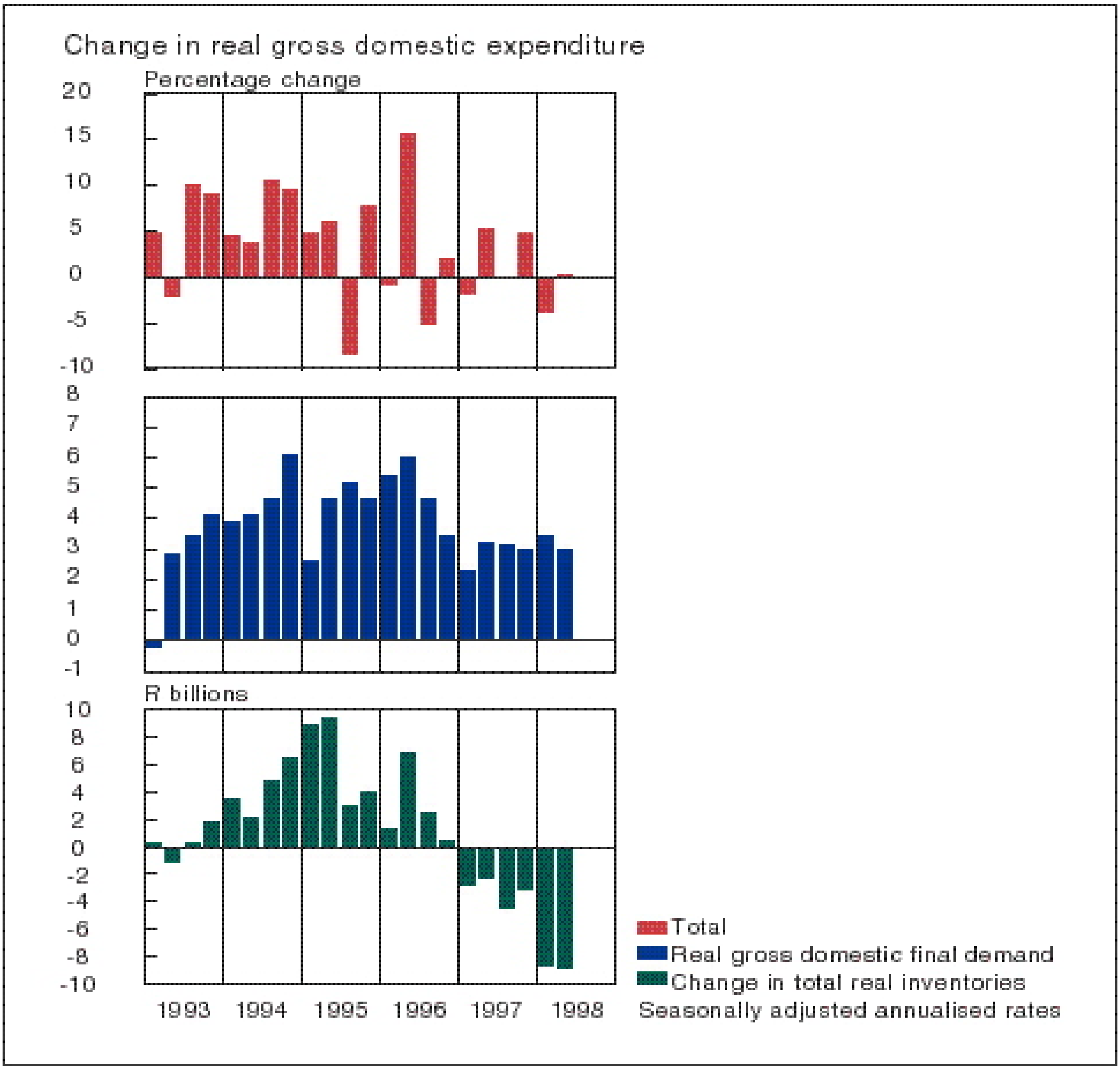
Table 2. Real gross domestic expenditure

Percentage change at seasonally adjusted and annualised rates

Components	**1996**		**1997**		**1998**
	Year	**1st half**	**2nd half**	**Year**	**1st half**
Private consumption expenditure	4	1½	1	2	1½
Government consumption expenditure	6	5½	9	7	5
Gross domestic fixed investment.	8	3	2½	3½	6
Inventory investment (R billions)*	2,7	-2,5	-3,7	-3,1	-8,7
Gross domestic expenditure	**2½**	**1**	**2½**	**1½**	**-½**

* 1990 prices, annualised

The slowdown in growth of aggregate demand in the first half of 1998 occurred despite a modest acceleration in the growth of real private consumption expenditure and a more significant acceleration in the growth of gross domestic fixed investment. The growth in real consumption expenditure by general government slowed down from uncommonly robust rates in 1997, but the growth in 1998 was still higher than the longer term growth in gross domestic production. Inventory levels continued to be reduced as the general slowdown in the growth of final domestic demand and the high carrying cost of inventories encouraged manufacturers and traders to economise on their inventory holdings.



Private consumption expenditure

The growth in real private consumption expenditure slowed down from 4 per cent in 1996 to 2 per cent in 1997. In the course of 1997, the quarter-to-quarter growth in real private consumption expenditure dwindled from an average seasonally adjusted and annualised rate of 1½ per cent in the first half of the year to 1 per cent in the second half. This slowdown was essentially a consequence of weak growth in the real disposable income of private households, which barely increased from the fourth quarter of 1996 to the fourth quarter of 1997. Growth in real personal disposable income was hamstrung by continued declines in employment in the formal sectors of the economy and an increase in the tax burden of households. The slowdown in private consumption expenditure was spread across all the major expenditure categories, but was more prominent in the durable-goods category, notably transport equipment and furniture, where the impact of high real interest rates was more intense.

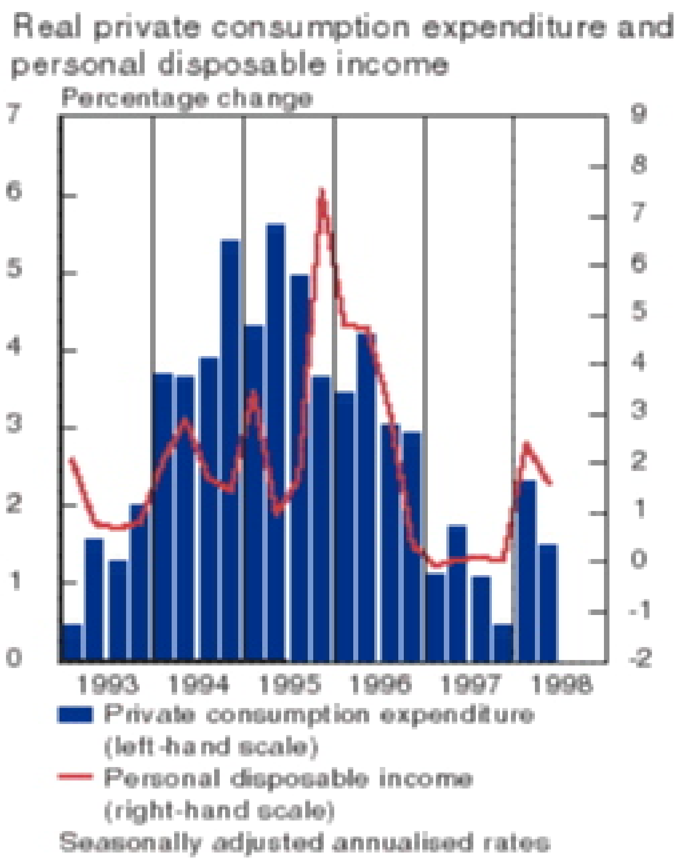


Table 3. Real private consumption expenditure

Percentage change at seasonally adjusted and annualised rates

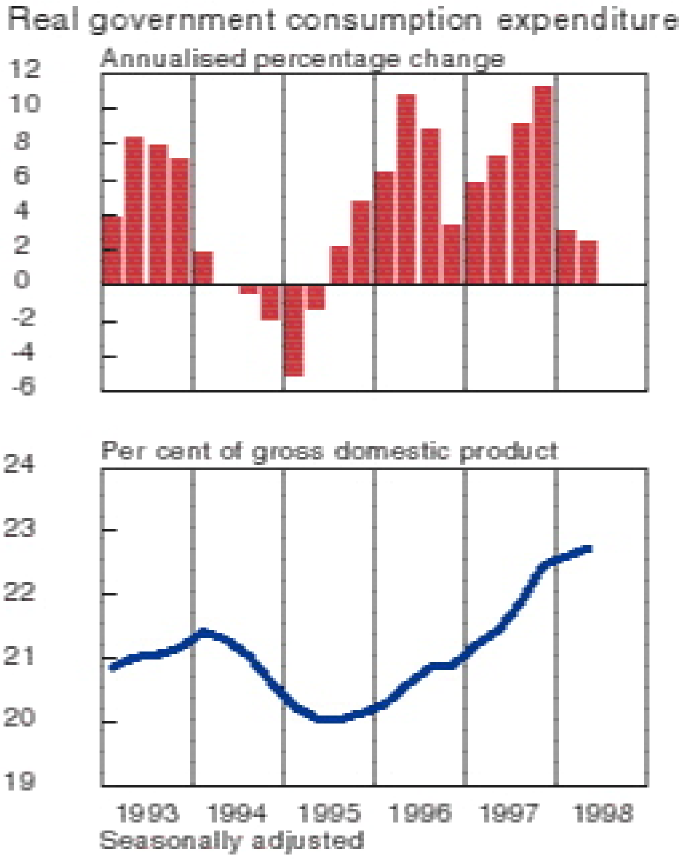
Components	1996		1997		1998
	Year	1st half	2nd half	Year	1st half
Durable goods	6½	1	-6	½	-3
Semi-durable goods	5	3½	½	3	2

Non-durable goods	3½	2½	1½	2½	1
Services	2½	0	3½	1	2½
Total	4	1½	1	2	1½

Relatively low consumer-price inflation, which boosted real personal disposable income, and an easing of the interest burden of households, created some leeway for households to accelerate their recurrent expenditure in the first half of 1998. Slower growth in outstanding household debt and downward adjustments in borrowing costs in the fourth quarter of 1997 and towards the end of the first quarter of 1998, led to a decline in the ratio of debt-servicing cost to personal disposable income from 13½ per cent in 1997 to 13 per cent in the first half of 1998. In addition, perceptions of increased wealth of households, inspired by the rise in share prices and a slight recovery in real-estate values, might have contributed to the strengthening of consumer confidence prior to the tumultuous events in the financial markets in the second quarter.

Consumption expenditure by general government

Real consumption expenditure by general government increased by 6 per cent in 1996 and 7 per cent in 1997, but then slowed down to an annualised rate of 5 per cent in the first half of 1998. Regardless of the recent slowdown, the level of consumption expenditure by general government in the first two quarters of 1998 was about 7 per cent higher than in the first two quarters of 1997. This was the net result of strong growth in real outlays on intermediate goods and services, which more than offset a slight decline in the aggregate real remuneration of employees.



The recent decline in real outlays on remuneration of employees was in keeping with programmes at the national government level to reduce the overall number of employees in the public service and to establish a more representative and efficient civil service. By contrast, strong growth in real expenditure on intermediate goods and services continued at all tiers of general government, namely local, provincial and, to a slightly lesser extent, central government. These spending programmes were mainly concerned with social infrastructural development and the upliftment of previously disadvantaged communities. As a consequence, the ratio of government consumption expenditure to gross domestic product rose from an average of 21 per cent in the first half of 1997 to 22 per cent in the corresponding period of 1998.

Gross domestic fixed investment

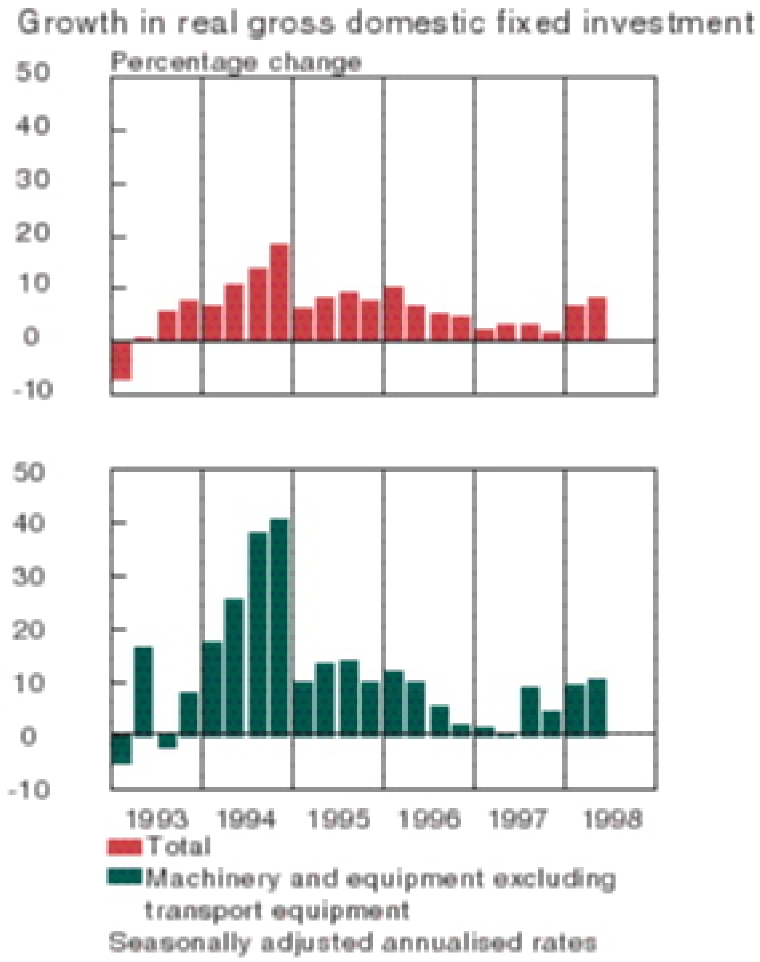
As has been the case since 1994, real gross domestic fixed investment grew at a faster rate than real gross domestic product in 1997 and the first half of 1998. Nonetheless, the growth rate in real gross domestic fixed investment fell back from 8 per cent in 1996 to 3½ per cent in 1997, before accelerating again to an average quarter-to-quarter annualised rate of 6 per cent in the first half of 1998. As a percentage of gross domestic product, fixed investment spending increased from 15½ per cent in 1993 to an average of 17½ per cent in 1997 and the first half of 1998, but was still substantially below the ratio of approximately 21½ per cent implied in the GEAR strategy for sustained higher economic growth.

Table 4. Real gross domestic fixed investment by type of organisation

Percentage change at seasonally adjusted and annualised rates

Components	**1996**		**1997**		**1998**
	Year	**1st half**	**2nd half**	**Year**	**1st half**
Private business enterprises	6	2½	2½	3	2½
Public corporations	10½	7½	5	5½	29
Public authorities	15	2½	½	4	1½
Total	**8**	**3**	**2½**	**3½**	**6**

The slowdown in real fixed investment in 1997 occurred in the private and the public sectors, whereas the acceleration in the first half of 1998 was largely confined to the public sector, especially public-sector business enterprises. Private fixed investment, which comprises about 72 per cent of total fixed investment, slowed down from 6 per cent in 1996 to 3 per cent in 1997 and 2½ per cent in the first half of 1998. In terms of a sectoral distribution of private-sector investment spending, real fixed investment continued to expand in all the major sectors of the economy, except for the agricultural sector. Strong fixed investment activity was sustained in manufacturing, especially in the export industries such as chemical and base metal processing and beneficiation.



Classified by type of asset, private-sector real fixed investment spending was concentrated in the category "machinery and equipment", including information technology and other office equipment. This trend was in all likelihood a reflection of the continuous process of substituting capital for labour. By contrast, residential construction grew modestly in 1997, prolonging the low level of construction activity that began in 1993. A slight recovery in residential building activity became discernible in the first half of 1998, probably in response to the lowering of nominal interest rates in October 1997 and in March 1998. Real capital outlays on transport equipment declined in 1997 and the first half of 1998, following very strong growth in the years from 1994 to 1996.

Real fixed capital formation by the public sector increased by 4½ per cent in 1997 and at an average seasonally adjusted and annualised rate of 15 per cent in the first half of 1998. The fastest growing component of public-sector fixed investment was the communications sector where the expansion of telecommunication services to previously under-serviced areas led to an increase in fixed investment expenditure at an annualised rate of 54 per cent in the first half of 1998. Fixed investment spending by all three tiers of general government increased steadily over the past six calendar quarters as backlogs in social-service delivery were removed and municipal infrastructure expanded.

Inventory investment

Inventory investment reached a high point in the second quarter of 1995. Subsequently, net additions to inventory levels declined progressively until the end of 1996. From the beginning of 1997 there was a large reduction in inventories, equivalent to about 2½ per cent of gross domestic product, as manufacturers as well as wholesalers and traders began to economise on their inventory holdings.

The decline in real inventory levels in 1997 and the first half of 1998 can be explained by the following factors:

- The general slowdown in the growth of final domestic demand, i.e. consumption plus fixed investment spending;
- deteriorating prospects for an acceleration in overall economic growth in the second half of 1998;
- unexpected spurts in domestic final demand, for example in the first quarter of 1998, which led to involuntary declines in inventory levels;
- the high level of real interest rates and the attendant high cost of carrying inventories; and
- the selling of strategic oil reserves in the first half of 1998.

The depletion of inventories was responsible for reducing the growth of real gross domestic product by 2½ percentage points in 1997 and the first half of 1998. The inventory-to-sales ratio of the commercial sector decreased from 7½ weeks worth of sales in 1996 to 6 weeks in the second quarter of 1998. The ratio of industrial and commercial inventories to gross domestic product in the non-agricultural sectors of the economy declined from a relative high point of 18½ per cent in the fourth quarter of 1996 to 15 per cent in the second quarter of 1998.

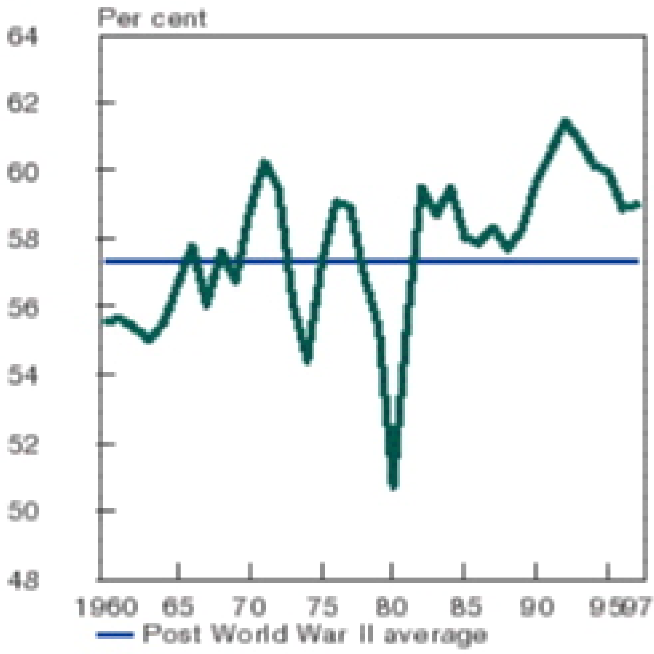
Factor income

The rate of increase in aggregate nominal factor income at market prices slowed down from 12 per cent in 1996 to 9½ per cent in 1997 and to a year-on-year rate of 8½ per cent in the first half of 1998. Growth in the two main components of factor income, i.e. operating surpluses and employee remuneration, has slowed down since 1996.

The growth in nominal operating surpluses weakened slightly from 9 per cent in 1997 to a year-on-year rate of 7 per cent in the first half of 1998. In the non-primary sectors of the economy, operating margins came under pressure as output price rises lagged behind the relatively firm increases in input costs, especially the overall cost of labour. Declining international commodity prices dampened growth in the operating surpluses of the primary sectors during 1997, but the depreciation of the rand in the first half of 1998 and the consequent improvement in nominal export earnings gave a fillip to profit growth in the primary sectors, notably in the mining industry.

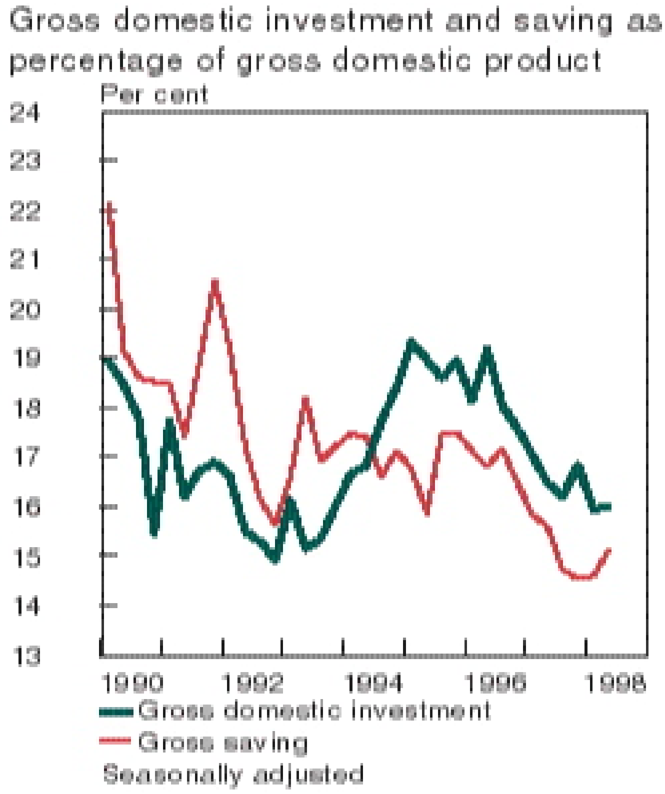
The rate of increase in total remuneration of employees declined from 9½ per cent in 1997 to a year-on-year rate of 8½ per cent in the first half of 1998 as employment levels in the formal sectors of the economy continued to decline and the growth in nominal salaries and wages moderated somewhat. On the whole, the share of employee remuneration in the total value of output was about 59½ per cent in the first half of 1998, compared with an average ratio of about 57 per cent over the period from 1960 to 1990.

Labour remuneration as percentage of total factor income



Domestic saving

Gross domestic saving continued to weaken, declining as a ratio of gross domestic product from 17 per cent in 1996 to 15 per cent in 1997 and the first half of 1998. In the 1980s, South Africa's gross domestic saving on average amounted to 24½ per cent of gross domestic product. Private-sector saving has declined since 1996, while general government dissaving remained at a high level with a slight bias towards further deterioration. From the middle of 1994 total gross domestic saving has fallen short of total gross domestic investment, hence the increasing reliance on foreign saving for the financing of gross domestic investment.



Since 1992, current expenditure by general government has been exceeding current government revenue, implying that saving from the private sector had to finance not only capital formation by the government sector, but also part of its recurrent expenditure. As a percentage of gross domestic product, net dissaving by general government amounted to 3½ per cent in 1997 and the first half of 1998. The sustained high level of dissaving by general government was primarily due to sharp increases in consumption expenditure by general government and higher interest payments on government debt, both of which increased faster than the growth in tax receipts. The level of general government dissaving was partly contained by an increase in tax revenues, which rose as a percentage of gross domestic product from 27 per cent in 1996 to 27½ per cent in 1997 and 29 per cent in the first half of 1998. As this tax ratio is well above the 25 per cent indicated as a long-term optimal ratio in the GEAR strategy, there is limited scope for further increases in tax rates to contain dissaving by general government.

Net corporate saving declined slightly as a percentage of gross domestic product to 4½ per cent in the first half of 1998. In agriculture, mining, and the manufacturing industries involved in the processing and beneficiation of mineral products, the declines were largely attributable to weak income growth associated with slowly growing or falling output volumes and lower international commodity prices. In the non-resource-based sectors of manufacturing, corporate operating surpluses and savings were also adversely affected by input costs rising faster than output prices.

With private consumption expenditure rising faster than household disposable income, net personal saving as a percentage of gross domestic product declined from 1½ per cent in 1996 to ½ per cent in 1997 and the first half of 1998. Households appeared to have been consolidating their outstanding debt in the first half of 1998, but reduced their contractual savings commitments from 1996 to 1997. The ratio of contractual saving of households to gross domestic product declined from 9 per cent in 1996 to 7 per cent in 1997, reflecting a substantial slowdown in the growth of contributions to pension and insurance funds, a sharp rise in surrenders of insurance policies and cessation of premium payments.

Employment

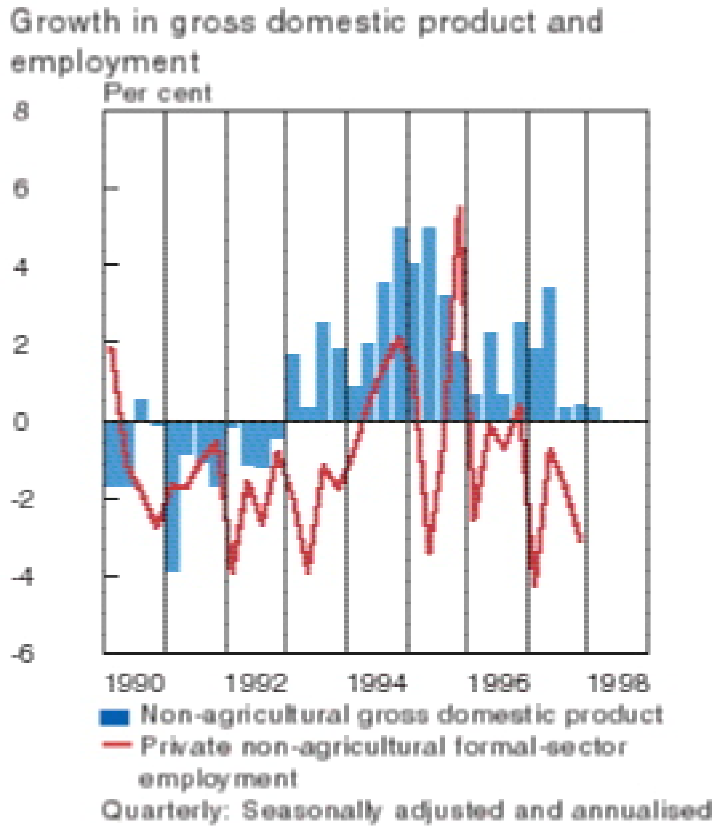
Several developments during the past year or so had an influence on industrial relations. In general, most of these measures contributed to more harmonious relations between employers and workers, resulting in a decline to the lowest level in a decade in the number of workdays lost through strikes and work stoppages. In 1997 only 650 000 workdays were lost, compared with 1,2 million in 1996 and as many as 9 million in 1987.

The labour policy framework created over the past two years will have an effect on the future employment-creating capacity of the economy. The following were the more important measures taken:

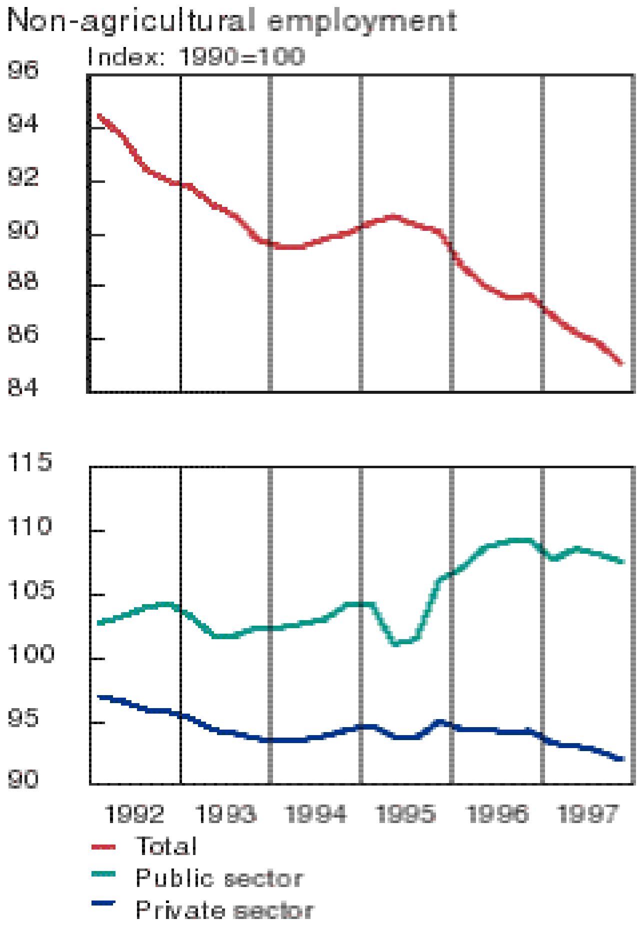
- New institutions, namely the Labour Court, Labour Appeal Court and Essential Services Committee, were established under the new Labour Relations Act;
- the new Basic Conditions of Employment Act was implemented with the aim of providing minimum working conditions for South African workers, particularly non-unionised workers;
- the Employment Equity Bill was tabled in Parliament; this proposed legislation is directed at eliminating unfair discrimination in employment practices and requires employers to submit employment equity plans within a specified number of months after the legislation has come into effect; and
- the Skills Development Bill, which was published for comment on 2 September 1997 provides for a skills development strategy based on a partnership between the public and private sectors.

Despite the greater clarity about labour market arrangements given in the newly introduced and proposed measures, total *formal-sector employment outside the agricultural sector* declined at a year-to-year rate of 1,6 per cent in 1997, following no material change in the average level of regularly measured employment in 1996 and only a marginal increase of 0,5 per cent in 1995. Cause for concern was the apparent acceleration in job losses which occurred from quarter to quarter during 1997: the second-quarter decline at an annualised rate of 0,7 per cent was followed by declines of 1,7 per cent in the third quarter and 3,0 per cent in the fourth quarter. From the high point in the employment cycle in 1989 to 1997, the average annual level of employment has now declined by 7,5 per cent, indicating a loss of about 422 000 formal-sector jobs.

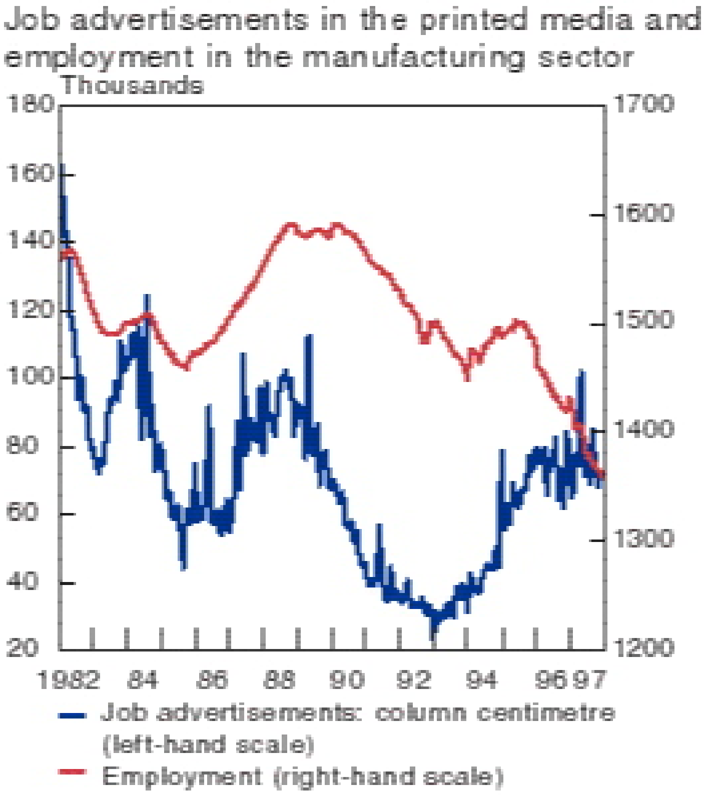
The reasons for the reduction in formal employment are diverse. They include the slow rate of economic growth, changing technologies which lead to the substitution of capital for labour, the need for domestic producers to contain cost increases so that they can remain internationally competitive, declining international commodity prices especially the price of gold, the objective of government to establish a smaller and more efficient public service, and continuing increases in nominal wage and non-wage costs. A further factor which may impact negatively on official employment figures is the process of reducing formal in-house payrolls in favour of outsourcing the non-core activities, some of which are currently not captured in official statistics. To address this shortcoming and further enhance the coverage and timeliness of official labour statistics, the Central Statistical Service is addressing the inadequacies related to labour statistics. This thorough and complex process is set to start yielding results during the second half of 1998.



Employment in the non-agricultural *private* sector of the economy, which accounted for about 70 per cent of total employment in the non-agricultural sectors in 1989, declined to 64 per cent of total employment in 1997. The estimated number of job losses over this period amounted to 572 000. The decline in employment opportunities was primarily concentrated in the mining, construction and manufacturing sectors. In 1997 the average level of employment in mining declined by 3,0 per cent, in construction by 4,7 per cent and in the manufacturing sector by 3,7 per cent. Employment in the public sector, which had been expanding at a year-to-year rate of 5,2 per cent in 1996, declined by 0,5 per cent in 1997. This decline in employment opportunities in the public sector occurred especially at the national government level, but was also affected by the closure of agricultural marketing boards which resulted in the termination of the services of about 1 000 employees during 1997.



An analysis of the volume of *job advertisements* in the printed media corroborated the observation that the demand for labour has been relatively weak in recent times. The volume of job advertisements placed in two prominent newspapers rose firmly from a lower cyclical turning point in December 1992, but levelled off in 1997. Over time, the volume of job advertisements has changed in harmony with overtime hours worked in the manufacturing sector, and ahead of job creation in manufacturing with a lead time of approximately one quarter. The recent levelling off in job advertisements in the printed media may, therefore, point to slow growth, or further declines, in the levels of manufacturing-sector employment.



Labour costs and productivity

The growth in the *nominal remuneration per worker in the non-agricultural sectors* of the economy slowed down somewhat from 11,2 per cent in 1996 to 10,7 per cent in 1997, but was nevertheless at a comparatively high level when judged in terms of the objective of reducing price inflation to rates comparable with those prevailing in trading-partner countries. The above-inflation increases in employee remuneration were, among other things, caused by the fact that workers at the lower end of the skills and wage scales were retrenched, the tightening of the skills shortages in certain specialist areas of the labour market some of it probably related to the net emigration of skilled people and the relatively healthy growth in corporate earnings.

The rate of change over four quarters in *nominal remuneration per worker* moderated significantly during the course of 1997 from an annualised level of 13,6 per cent in the first quarter of 1997 to 6,4 per cent in the fourth quarter. The continuation of such developments could make a major contribution towards the permanence of lower inflation. The benefits of permanently lower inflation should it materialise will become visible in lower nominal interest rates, stronger profit growth, higher levels of investment and a faster pace of job creation.

The potential impact of strong growth in employee remuneration on output price inflation was partly countered by robust growth in the physical quantity of output per worker. The growth in *labour productivity in the non-agricultural sectors of the economy* accelerated from 0,3 per cent in 1991 to an average of 2,9 per cent in the three years to 1997. Productivity growth was particularly conspicuous in the manufacturing sector at 7,2 per cent in 1997, compared with 3,5 per cent in the overall non-agricultural sectors. The main forces behind this development were:

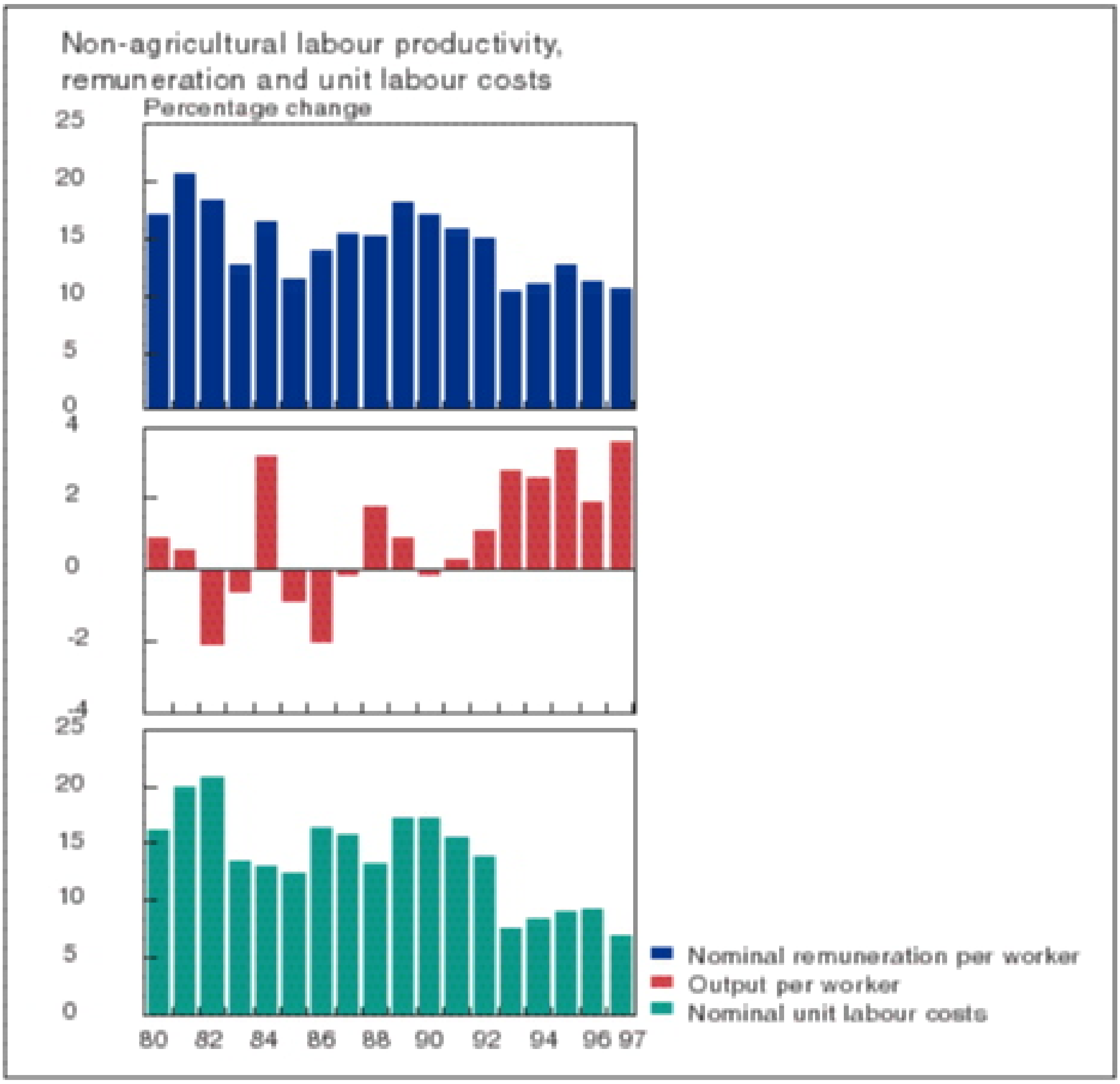
- the rationalisation of work practices, invariably leading to lower employment growth relative to output growth;

- tranquil industrial relations which prevailed in 1997 and the low number of workdays lost through strikes and work stoppages;
- emphasis on core activities and the higher degree of specialisation by domestic manufacturers, which was the result of increased international competition;
- increased investment in the development of human resources by means of in-work training schemes; and
- the replacement of labour-intensive production processes by technically improved equipment.

Table 5. Labour costs and productivity

Percentage change over four quarters

Period		Nominal remuneration per worker	Productivity	Nominal unit labour costs
1996:	1st qr	13,8	2,9	10,6
	2nd qr	8,7	1,4	7,1
	3rd qr	10,2	0,8	9,3
	4th qr	12,1	2,3	9,6
	Year	**11,2**	**1,9**	**9,1**
1997:	1st qr	13,6	3,0	10,3
	2nd qr	12,7	3,5	8,9
	3rd qr	10,2	3,7	6,3
	4th qr	6,4	4,0	2,3
	Year	**10,7**	**3,5**	**6,8**



Mainly because of the strong growth in labour productivity, and to a lesser extent because of nominal earnings moderation, the year-to-year rate of change in *nominal unit labour costs in the formal non-agricultural sectors of the economy* slowed down from 9,1 per cent in 1996 to 6,8 per cent in 1997. From quarter to quarter, the growth over one year in unit labour costs fell from 10,3 per cent in the first quarter of 1997 to 2,3 per cent in the fourth. These slowdowns contributed materially to the recent fall in domestic production-price inflation and in underlying consumer-price inflation.

Inflation

Considerable progress was made with the containment of inflation; the year-on-year rate of increase in the consumer-price index fell from 9,9 per cent in April 1997 to 5,0 per cent in April 1998 and 5,2 per cent in June 1998. A variety of forces contributed to this reduction in inflationary pressures. These forces include:

- the consistent application of a counter-inflationary monetary policy over a decade-long period;
- the recent moderation of growth in nominal unit labour costs;

- the lowering of import tariffs over the past two years;
- the reduced ability of domestic producers to raise prices in a relatively weak economy with growing competition from international suppliers;
- the importation of crude oil at reduced international prices;
- the highly competitive prices of products originating in a number of Southeast Asian economies which had experienced major currency depreciations in the second half of 1997;
- relative price stability in major trading-partner countries; and
- declines in home-ownership costs because of adjustments in mortgage rates following the lowering of official lending rates in October 1997 and March 1998.

The recent decline in inflation is a continuation of disinflationary forces which were set in motion towards the end of the 1980s and which occurred against the backdrop of declining world inflation. An indicator of world inflation, compiled by the International Monetary Fund, fell from 29,4 per cent in 1990 to 5,6 per cent in 1997. Consumer-price inflation in South Africa declined, on balance, over the same period from 14,4 per cent to 8,6 per cent. The counter-inflationary thrust of consistently applied conservative monetary policies during the past decade was, therefore, reinforced by the general opening of the South African economy to international economic developments and, more specifically, by a global trend towards increased price stability.

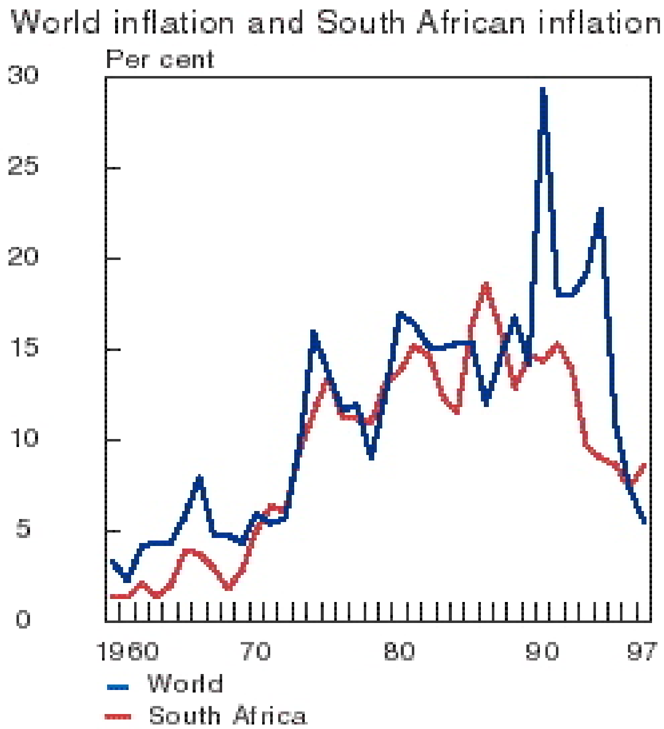


Table 6. Global and South African inflation

Year	World inflation	Inflation in South Africa
1990	29,4	14,4
1991	18,0	15,3

1992	18,0	13,9
1993	19,2	9,7
1994	22,7	9,0
1995	11,0	8,7
1996	7,4	7,4
1997	5,6	8,6

After eliminating the effects of one-off events from the consumer-price index, the core inflation rate (i.e. the change in the overall consumer-price index excluding the prices of fresh and frozen meat and fish, and of vegetables, fresh fruit and nuts, interest rates on mortgage bonds, overdrafts and personal loans, value-added tax and property taxes) recently appeared somewhat stickier than the overall or "headline" inflation. From August 1997 the twelve-month rates of core inflation have persistently been higher than those of overall inflation. On average, the core inflation rate exceeded the all-inclusive inflation rate by a margin of 1,4 percentage points from August 1997 to June 1998. The high rate of core inflation relative to price increases in trading-partner countries necessitates a strategy of constant vigil against inflationary pressures in South Africa, if inflation is to be brought on a *par* with that of competitor and trading-partner countries.

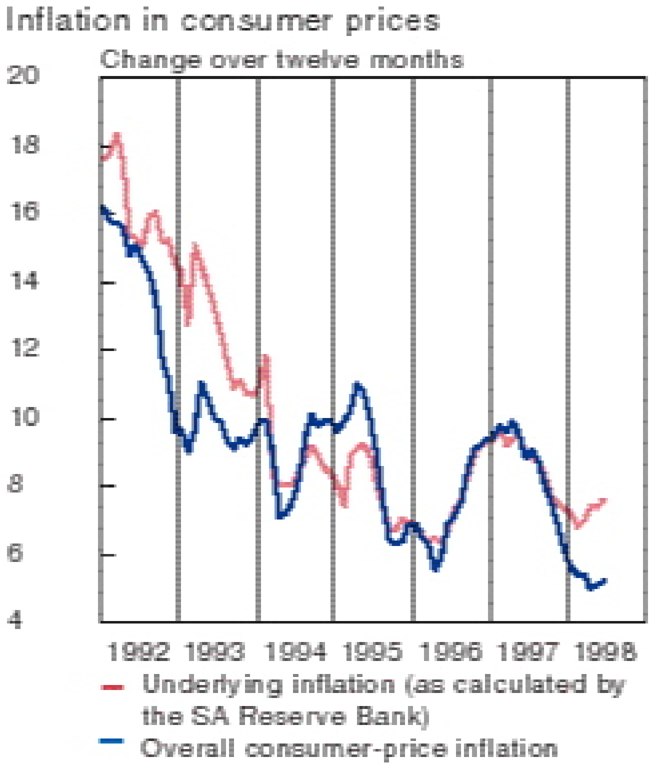
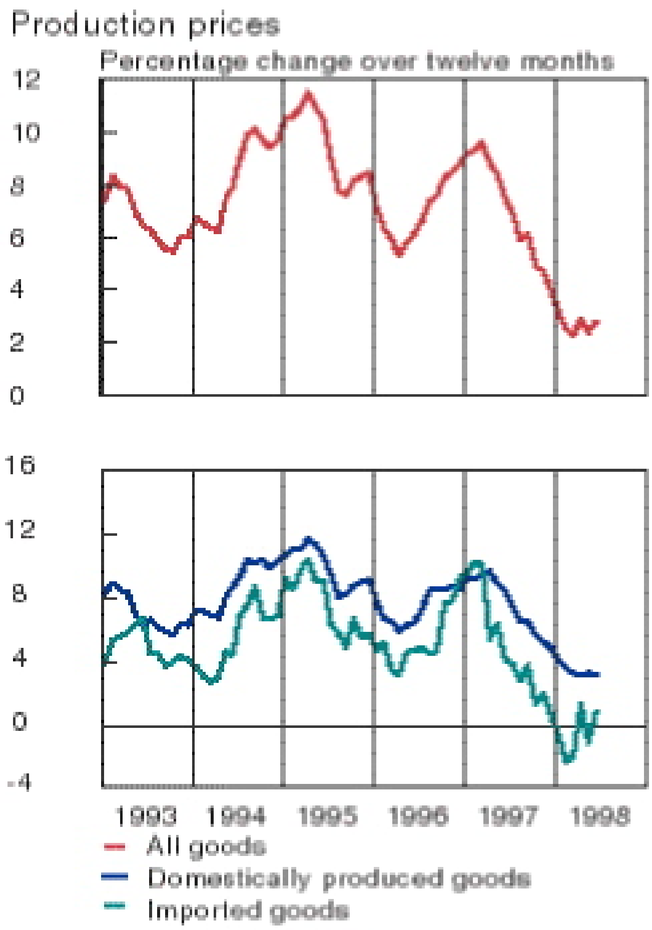


Table 7. Inflation

Percentage change over twelve-month periods

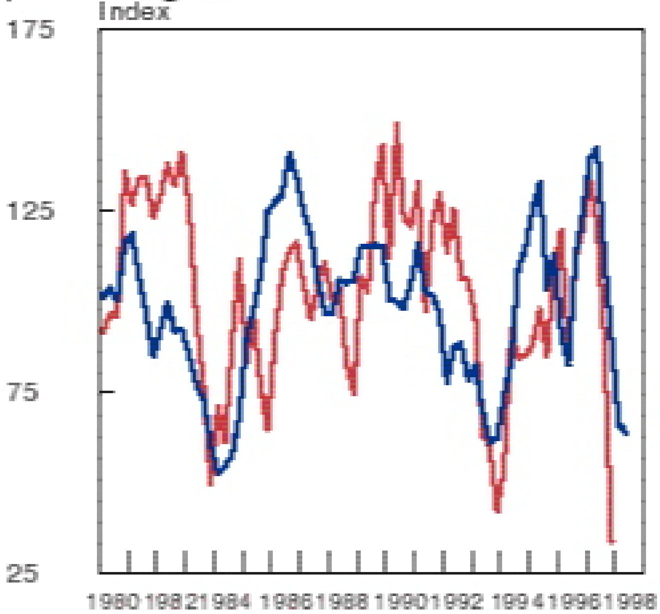
		Consumer- price inflation	Core inflation
1997:	Jun	8,8	8,8
	Jul	9,1	8,7
	Aug	8,7	8,8
	Sep	8,0	8,4
	Oct	7,5	8,2
	Nov	6,8	8,0
	Dec	6,1	7,7
1998:	Jan	5,6	7,2
	Feb	5,4	7,0
	Mar	5,4	6,9
	Apr	5,0	7,1
	May	5,1	7,3
	Jun	5,2	7,4

Indicators other than consumer-price inflation also declined more impressively than core inflation. All-goods production-price inflation fell from 9,6 per cent in March 1997 to 2,4 per cent in May 1998 and 2,8 per cent in June. The rate of change over twelve months in the prices of imported goods declined from 10,3 per cent in February 1997 to -1,1 per cent in May 1998 and 0,9 per cent in June, mainly owing to declines in the prices of imported crude oil. Over about the same period, the year-on-year rate of increase in the prices of domestically produced goods decelerated from 9,7 per cent in April 1997 to 3,2 per cent in June 1998.



The deceleration in the rate of increase in the prices of domestically produced goods reflected a reduction in cost-push factors emanating predominantly from the declining rate of increase in nominal unit labour costs during this period. The relationship between nominal unit labour costs and the prices of domestically produced goods suggested that changes in nominal unit labour costs have a direct bearing on the future rate of change in the prices of domestically produced goods. Upper and lower turning points in the cyclical movement of year-on-year changes in nominal unit labour costs are usually followed by corresponding changes in the rate of increase in the prices of domestically produced goods, with an average time delay of four quarters. Therefore factors that may contribute towards higher rates of increase in nominal unit labour costs have to be considered in terms of their contribution to the prices of domestically produced goods and, ultimately, to consumer-price inflation.

Cyclical relationship between non-agricultural unit labour costs and the prices of domestically produced goods



Changes in unit labour costs

Changes in the price of domestically produced goods

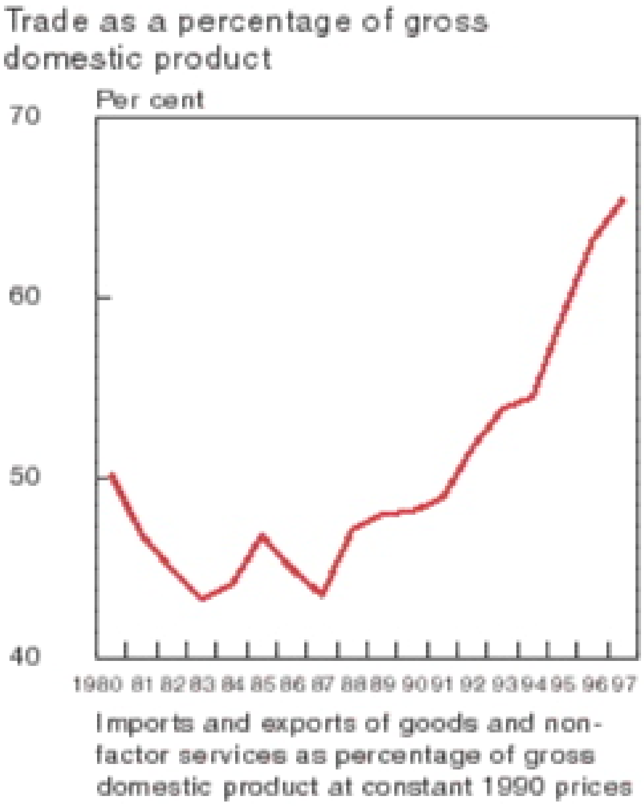
Foreign trade and payments

Policy issues and trade reforms

The process of financial liberalisation and the reintegration of the South African economy into the global economy, which had begun in earnest in 1994, gained further momentum from the beginning of 1997. Trade and industrial policy reforms, organisational and regulatory changes in the financial markets and further gradual relaxations of exchange control measures were collectively aimed at strengthening the competitiveness of South African producers and service providers and facilitating the country's gradual reintegration into the international markets.

The opening of the South African economy required many changes to the country's trade and industrial reform policies. In terms of the agreement concluded in 1994 with the World Trade Organisation (WTO), the South African Government committed itself to the reduction and restructuring of import tariffs, the removal of import surcharges and the phasing out of the General Export Incentive Scheme (GEIS). Since 1994, trade tariffs have been lowered by approximately 8 percentage points on a weighted average basis, i.e. at a more rapid rate than required by the WTO Agreement. GEIS was terminated on 11 July 1997 and replaced by a number of supply-side measures. The government introduced the "Export Marketing and Investment Assistance Scheme" (EMIA) on 15 August 1997 to assist exporters with meaningful international market research. Special emphasis is being placed on supporting small and medium-sized enterprises and business ventures in the previously disadvantaged communities.

As a result of the growing openness of the South African economy, the ratio of trade in goods and services to gross domestic product increased from 45,3 per cent in the period 1980-1985 to 53,9 per cent in the 1990s. This ratio has risen from 53,6 per cent in 1994, when the country held its first fully democratic elections, to 64,8 per cent in 1997.

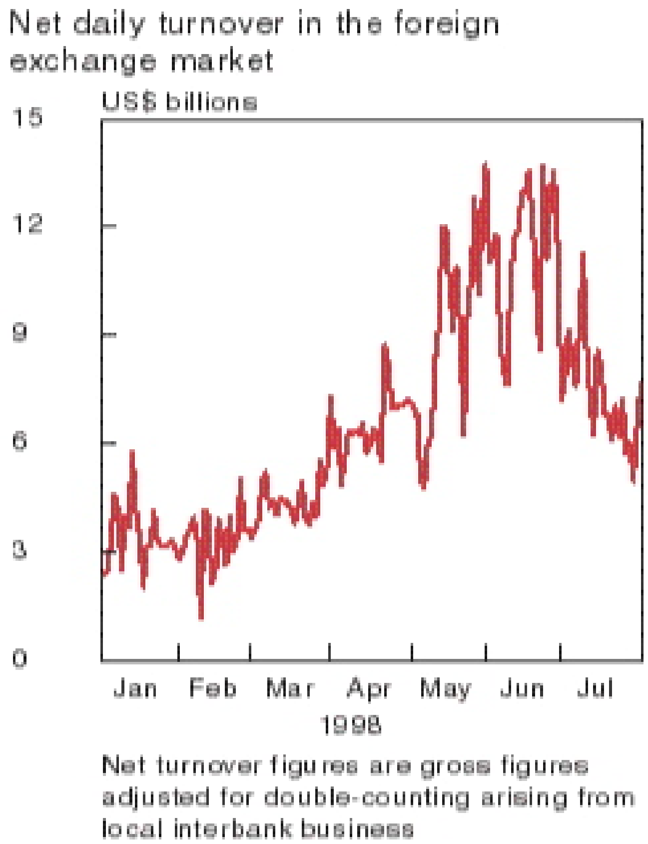


The sharp rise in the inflow of capital into the South African bond and share markets and the fundamentally sound overall balance of payments position in 1997 were important considerations when further exchange control liberalisations pertaining to capital-account transactions were announced by the Minister of Finance on 11 March 1998. Among the changes announced was the concession that South African institutional investors (i.e. insurance companies, pension funds and unit trusts) would thenceforth be permitted to invest up to 15 per cent of their total assets abroad. The limit had previously been 10 per cent. During 1998, offshore investments, in addition to those under the asset-swap mechanism, of up to 5 per cent of the net inflow of funds to institutional investors in 1997 would also be allowed; previously, 3 per cent of the net inflows during 1996 had been allowed.

South African companies are also allowed to retain foreign currency earnings abroad for up to 180 days from day of shipment or date of service rendition and to transfer up to R50 million from South Africa to finance approved investments outside the country. More generous liberalisations apply to outward investment into the SADC region. Private individuals, who are taxpayers in good standing, are permitted to invest up to R400 000 per person abroad, instead of the previous maximum of R200 000.

As exchange controls were phased out, the South African Reserve Bank's role in the foreign-exchange market was reduced. In order to better reflect normal market practice and in a step towards extricating the monetary authorities from their involvement in the forward foreign-exchange market, the Reserve Bank stopped providing long-term forward cover (cover beyond twelve months) in early 1997. Moreover, in an effort to promote the further development of the forward foreign-exchange market in South Africa, the limits on the total amount of foreign currency that authorised dealers in foreign exchange may hold offshore were abolished in January 1998. The Reserve Bank also announced in December 1997 that South Africa's gold production would increasingly be marketed by the Rand Refinery and the various mining houses - a function previously largely performed by the South African Reserve Bank.

The liberalisation of exchange control measures has resulted in rapid growth of turnover in the foreign-exchange market. The net daily turnover in this market in June 1998 exceeded US$11,1 billion, compared with $2,7 billion in 1994 and $3,9 billion in 1997. Of particular importance is the rapid growth in the share of non-residents in the spot, forward and swap markets. South African banks' commitments to sell foreign currency forward amounted to approximately US$170 billion at the end of May 1998 and were fully covered by forward purchases of similar magnitude.



A further development emanating from the globalisation process is the emergence of a eurorand bond market in which the outstanding amount of rand-denominated loans raised by foreign and South African borrowers from non-resident investors amounted to R36,4 billion by the end of June 1998. A significant part of these loan issues was hedged in the South African market through the purchase of bonds with a maturity broadly matching the maturity of the counterpart eurorand loan.

The integration of South Africa into the global financial markets had important implications for the South African banking sector. The official policy was not only to allow South African banks to participate in foreign markets, but also to expose the local banks to foreign competition. Consequently, 22 foreign banks had established themselves as operating institutions in South Africa by the end of June 1998, whereas more than 60 foreign banks do business in the country through representative offices.

Balance on current account

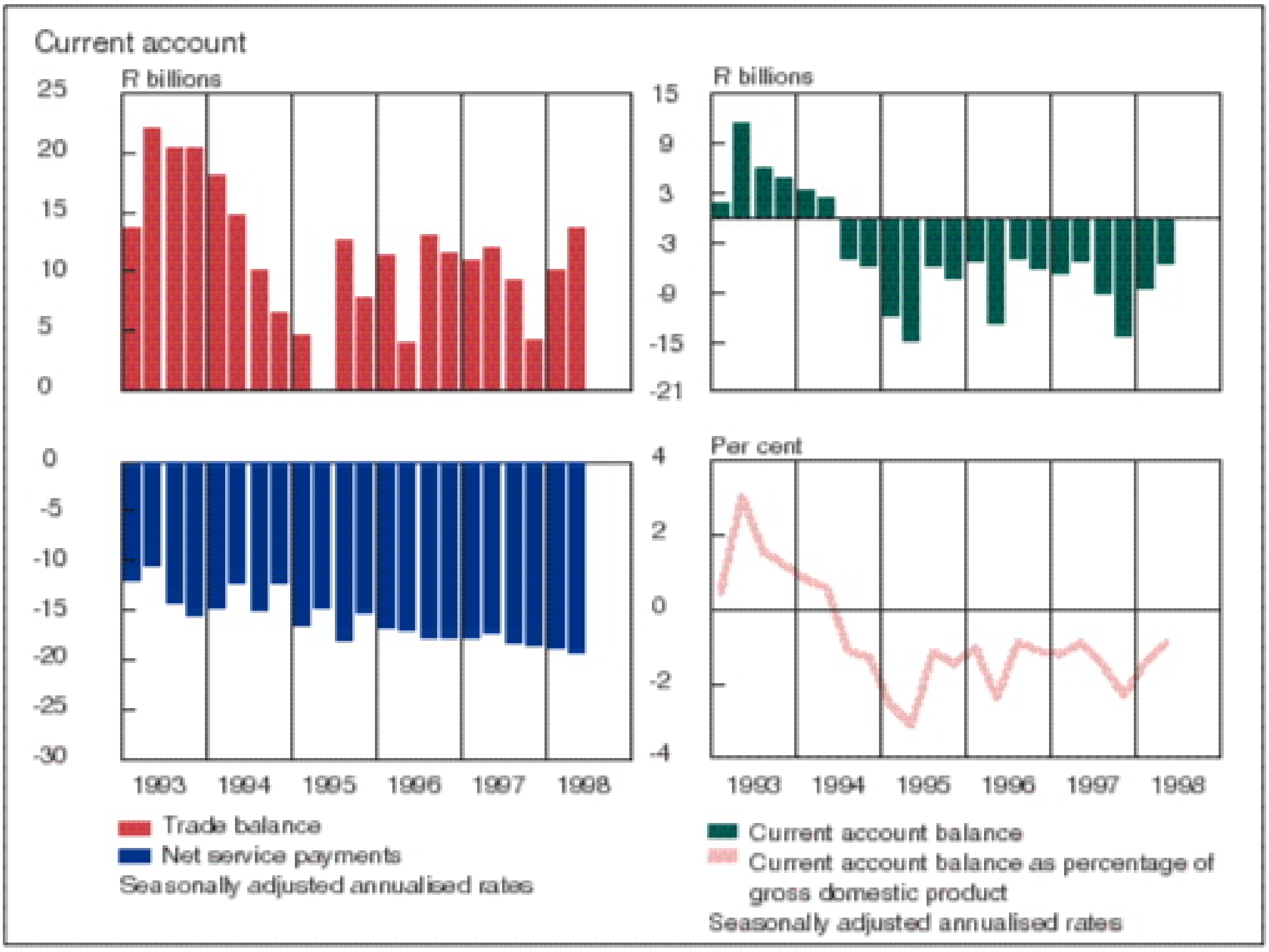
The balance of payments on the current account deteriorated in the course of 1997. Seasonally adjusted and annualised, the deficit on the external current account widened from R5,3 billion in the second quarter of 1997 to R14,1 billion in the fourth quarter; for the calendar year 1997 as a whole, the deficit came to R8,8 billion, compared with a current-account shortfall of R7,3 billion which had been registered in 1996. In the first half of 1998, however, the deficit on the current account narrowed appreciably to a seasonally adjusted and annualised average value of R7,1 billion, or about 1 per cent of gross domestic product.

Table 8. Balance of payments on current account

Seasonally adjusted and annualised

R billions

	1997				1998	
	1st qr	**2nd qr**	**3rd qr**	**4th qr**	**1st qr**	**2nd qr**
Merchandise exports	107,7	115,9	115,3	117,6	124,3	126,3
Net gold exports	26,8	24,7	26,0	25,7	24,9	22,1
Merchandise imports	-123,6	-128,6	-132,1	-139,0	-139,1	-134,7
Net service and transfer payments	-17,7	-17,3	-18,2	-18,4	-18,7	-19,2
Balance	-6,8	-5,3	-9,0	-14,1	-8,6	-5,5



Merchandise imports

The continued strong expansion in merchandise imports from 1994 to 1996 weakened in 1997 and then flattened out completely in the first half of 1998. The value of merchandise imports increased on average by 25,4 per cent per year from 1994 to 1996, but slowed down to a rate of 11,1 per cent in 1997. Measured from quarter to quarter the seasonally adjusted value of merchandise imports rose by 7,5 per cent from the first half of 1997 to the second half and by only 1,0 per cent from the second half of 1997 to the first half of 1998.

Mainly owing to a decline in the weighted external value of the rand, and in the face of declining international crude-oil prices and low inflation in trading-partner countries, the average level of *import prices* rose by 6,1 per cent in 1997; slightly less than the increase of 7,1 per cent in 1996. Continued growth in gross domestic expenditure and a relatively weak response in domestic production to this rise in aggregate demand counteracted the potential impact of higher import prices: the *physical quantity of imported goods* consequently continued to rise during 1997, but at a slower pace than during the period 1994-1996, and then declined in the first half of 1998.

The recent growth in imports occurred mainly in the categories of capital and intermediate goods. In particular, steep increases were recorded in the imports of machinery and electrical equipment and transport goods. Firm increases in these categories usually occur when domestic fixed-capital formation is expanding. With the physical quantity of imported goods growing faster than real gross domestic expenditure, the country's import penetration ratio (i.e. the ratio of imported goods at constant prices to real gross domestic expenditure) increased steadily from 26,8 per cent in the first quarter of 1997 to 28,2 per cent in the first quarter of 1998. The more important reasons for the continuous rise in the import penetration ratio were probably the declines in the prices of imported goods relative to the prices of domestically produced goods and the relatively high income elasticity of the demand for imported goods, coupled with firm growth in real aggregate domestic demand. In the second quarter of 1998 the import penetration ratio fell back to 261Ž2 per cent.

Net gold exports

The value of net gold exports contracted slightly in 1997. After having reached a relative high of R26,8 billion in the first quarter of 1997, the annualised value of net gold exports declined to R24,9 billion in the first quarter of 1998 and further to R22,1 billion in the second quarter. For calendar year 1997 as a whole, the net proceeds from gold exports amounted to R25,8 billion, compared with R26,3 billion in 1996.

This decline in the value of gold exports could essentially be attributed to a sharp decline in the London fixing price of gold which was only partly offset by a moderate increase in the physical quantity of net gold exports. After an extended period of decline, the volume of South Africa's net gold exports recovered somewhat when it rose by 5,6 per cent in 1997. However, in the first half of 1998 the volume of net gold exports once again declined to a level that was 13,6 per cent below the level of the second half of 1997.

The relative share of gold in South Africa's aggregate exports of goods and services has been contracting from the beginning of the 1980s. Gold, on average, had accounted for 37,2 per cent of the country's export of goods and services in the 1980s, but its relative contribution receded to 21,3 per cent in the 1990s. The declining contribution of gold exports to the country's overall export performance partly reflects a reduction in the volume of gold production because of factors such as the mining of ore with a lower gold content and the closure of some loss-making gold mines.

Having remained fairly stable at a level of around US$385 per fine ounce from 1994 to 1996, the average London fixing price of gold fell by $57 per fine ounce, or by 14,6 per cent, to a 12-year low of $331 per fine ounce in 1997 - the largest downward year-on-year movement ever recorded. The average monthly price of gold declined almost uninterruptedly from $369 per fine ounce in December 1996 to $289 per fine ounce in December 1997. Subsequently, the gold price strengthened temporarily to $308 per fine ounce in April 1998 before it once again declined to an average of $296 per fine ounce in May and June 1998. In the first half of 1998 the average fixing price of gold amounted to $297 per fine ounce. The substantial decline in the price of gold over the past eighteen months could be attributed to:

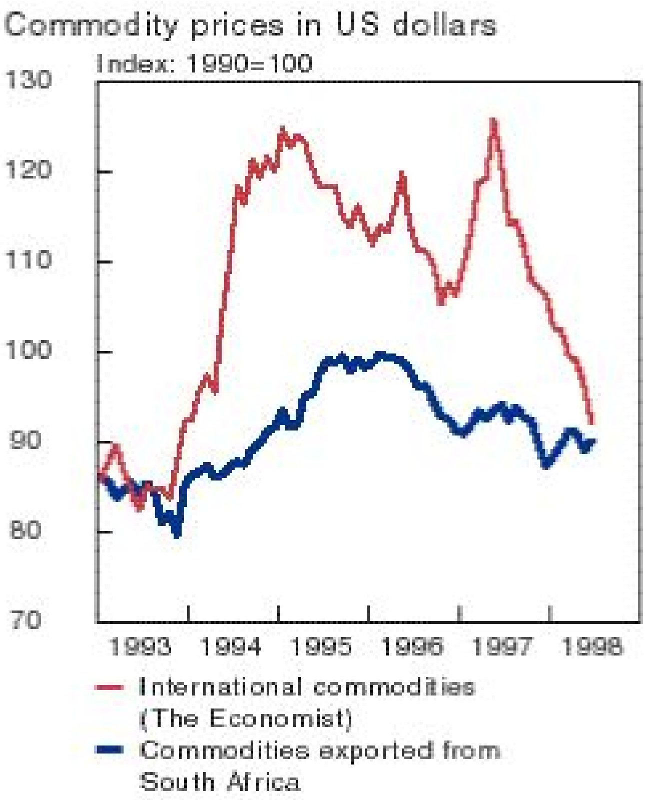
- bearish sentiment towards gold which was reinforced by the relative strength of the dollar, low world inflation and buoyant international stock markets;
- rumours of imminent outright sales of gold by central banks prior to the establishment of the European Monetary Union and concerns about the future role of gold as a reserve asset in the Monetary Union;
- the increased physical supply of bullion to the market through sales by central banks;
- hedging practices of gold producers, such as forward selling and taking of option positions;
- the short-selling of gold by investment funds; and - a subdued demand for gold, especially from countries in Asia.

Owing to the weakening of the external value of the rand, the price of gold in rand declined considerably less than the dollar price. It receded from R1 664 per fine ounce in 1996 to only R1 523 per fine ounce in 1997, or by 8,5 per cent. During the first half of 1998 the average price of gold in rand amounted to R1 504 per fine ounce. In June 1998, when the exchange rate of the rand against the dollar declined sharply, the average price of gold rose to R1 575. The price of gold then rose even further to R1 822 in July 1998.

Merchandise exports

The value of merchandise exports, which had increased robustly at an average annual rate of 20 per cent during the period from 1993 to 1996, rose by 12,5 per cent in 1997 and by 12,0 per cent in the first half of 1998 compared with the corresponding period in the preceding year. The recent slowdown in the growth of export values could be ascribed mainly to the lower growth in merchandise export volumes from the fourth quarter of 1996 to the end of 1997.

The average level of export prices rose by almost 8 per cent in 1997 and by 61Ž2 per cent from the first half of 1997 to the first half of 1998. These increases, which more or less equalled the price rises of 1995 and 1996, could be explained by the depreciation of the rand which counteracted the fall in international commodity prices. South African commodity exporters were, however, partly shielded from the full impact of the fall in world prices as the decline in the dollar prices of commodities exported from South Africa appeared to have been less severe than the general slump in international commodity prices. In fact, the price index for commodities exported from South Africa began to rise from the beginning of 1998. The relatively firm rate of increase in South Africa's export prices in 1997 could also be related to the fact that some of the country's goods are exported at contract prices which are likely to react with a time delay to changes in international prices.

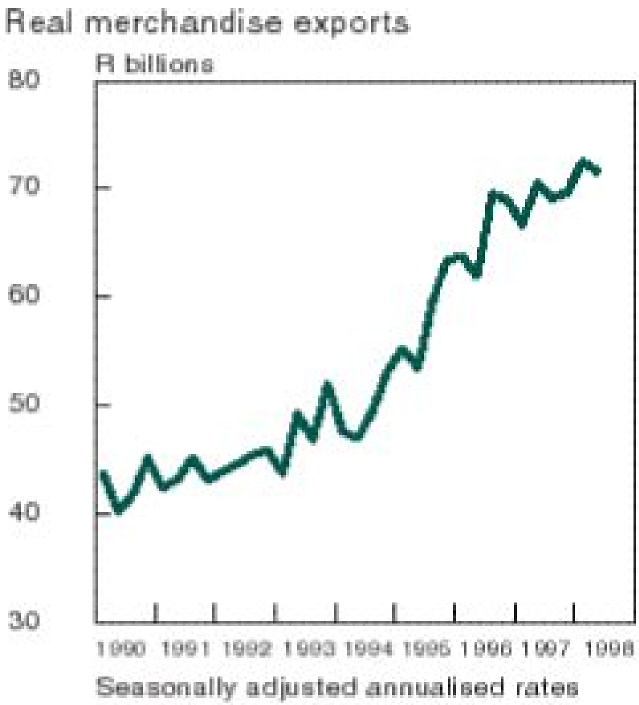


The physical quantity of merchandise exports expanded by 4,5 per cent in 1997, and by 5,0 per cent in the first half of 1998 compared with the corresponding period in 1997. As a percentage of gross domestic product, real merchandise exports increased from 22,2 per cent in the first quarter of 1997 to 23,7 per cent in the first half of 1998. World trade nonetheless expanded faster than merchandise trade from South Africa, causing a decline in the country's share in world trade.

Table 9. Real value of merchandise trade

Percentage change from previous quarter

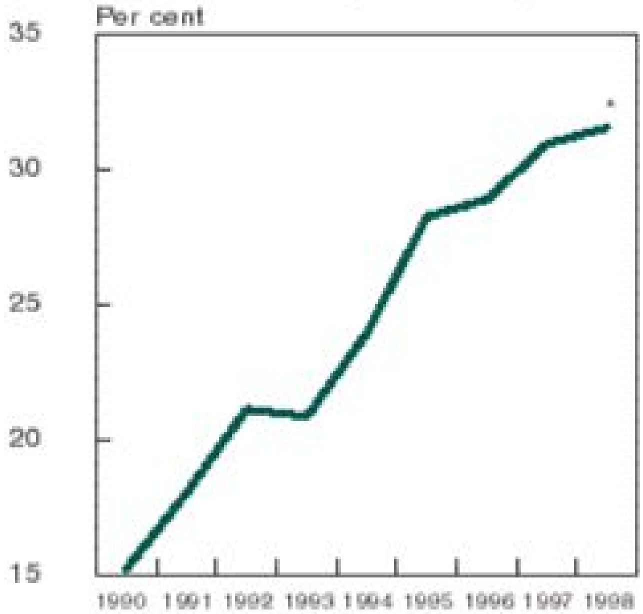
	1997				1998	
	1st qr	**2nd qr**	**3rd qr**	**4th qr**	**1st qr**	**2nd qr**
Merchandise exports	-3,2	5,7	-2,0	0,8	4,1	-1,4
Net gold exports	15,1	-6,4	7,8	-3,1	-9,1	-7,0
Merchandise imports	-0,4	4,4	0,4	3,1	-1,2	-5,6



An analysis of exports by sector of economic activity shows that the relatively weak growth in export volumes since the second quarter of 1997 was fairly evenly distributed among the various main sectors. Good seasonal rains during the first half of 1996 led to strong growth in the exports of agricultural products during the second half of 1996 and the first half of 1997. The high level of agricultural exports was then more or less maintained with limited growth occurring during the remainder of 1997 and the first half of 1998. The growth in the exports of mining products, which accounted for 57,3 per cent of South Africa's exports in 1997, levelled off in the course of 1997. Similarly, the exports of base metals tapered off from the second quarter of 1997. More in particular, constrained growth in the export value of mining products in 1997 could be attributed to the slowdown in world demand for mining commodities and an oversupply of certain commodities on international markets.

The growth in the value of exports of manufactured goods faltered and quarter-to-quarter declines were recorded in the last three quarters of 1997, following strong growth in 1996. Apart from the effect of a weaker undertone in the demand for South African manufactured goods in export markets, a slight loss in competitiveness during the last quarter of 1996 and the first quarter of 1997 could also have contributed to this somewhat lacklustre export performance of the manufacturing sector. Certain sectors of manufacturing, namely chemical products, machinery, transport equipment and paper and paper-related products, nonetheless, managed to sustain growth in export markets. The growth in exports of manufactured goods, however, appeared to have regained some of its earlier vigour when it turned positive once again in the first half of 1998. As a proportion of total merchandise exports, manufactured exports increased from 28,8 per cent in 1996 to 30,9 per cent in 1997 and 31,5 per cent in the first half of 1998.

Exports of manufactured goods as percentage of total export earnings



* First half

Net service and transfer payments

Net service and transfer payments to non-residents, which had increased steadily from a low of R10,7 billion in 1991 to R17,3 billion in 1996, rose further to R17,9 billion in 1997. On a quarterly basis, the seasonally adjusted and annualised value of net service and transfer payments to the rest of the world increased rapidly from R17,3 billion in the second quarter of 1997 to R18,4 billion in the fourth quarter and to R19,2 billion in the second quarter of 1998. As a ratio of gross domestic product, the deficit on the services account of the balance of payments amounted to 3,0 per cent in 1997 and in the first half of 1998.

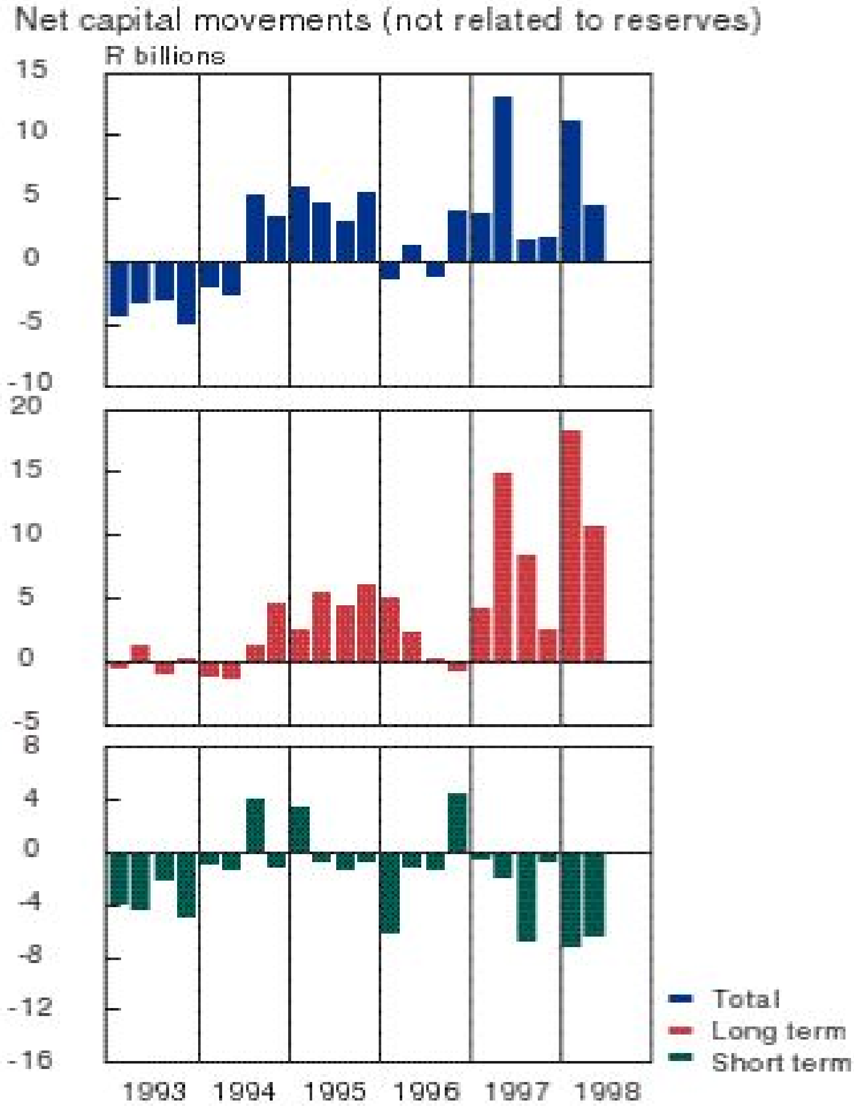
The higher deficit on the services account with the rest of the world could be ascribed mainly to a strong rise in *service payments* to non-residents. In particular, interest and dividend payments increased sharply, following the strong non-resident investment in South African securities during 1997. In addition, freight and merchandise insurance continued to rise owing to the higher value of merchandise imports, whereas an increase in the number of South Africans travelling abroad was responsible for a rise in tourist expenditure.

Receipts from services rendered to non-residents continued to increase to a seasonally adjusted and annualised value of R34,6 billion in the first half of 1998. Higher spending by foreigners travelling in South Africa and increased receipts from freight and merchandise insurance were mainly responsible for this increase in service receipts. Dividend receipts from other countries also rose fairly sharply following the relaxation of exchange control measures which allowed institutional investors to accumulate foreign assets which are now yielding returns.

Capital account

The reintegration of South Africa into the global financial network and the gradual liberalisation of capital-account transactions made the domestic economy susceptible to the capricious behaviour of the international financial markets. Involvement in these markets has made South Africa vulnerable to large movements of capital to and from the country. These capital flows are often associated with portfolio investments and are therefore highly sensitive to changes in the mood of global investors. For example, capital flows to an economy classified as an emerging market can easily be reversed simply because investors' sentiment towards emerging markets assets, as a group, has turned negative, and not necessarily in response to policy failure in that economy. An abrupt reversal of capital flows, even when it is of short duration, may be detrimental to macroeconomic equilibrium and pose serious challenges to the management of international reserves and overall liquidity in the economy.

Investors' sentiment towards South Africa has changed from time to time over the past five years. After having suffered a non-reserve-related net capital outflow of R15,2 billion in 1993, the balance on the capital account of the balance of payments turned into a surplus of R4,3 billion in 1994. This was followed by fluctuating net inflows which never switched into outflows in any calendar year, but which varied from R19,0 billion in 1995 to R2,7 billion in 1996 and back to R20,2 billion in 1997.



Net capital flows to and from South Africa over the past twelve months, in particular, have been profoundly influenced by events in a number of Southeast Asian economies. Over a period of years these economies had experienced various combinations of excessive money and credit growth, unsustainable deficits on the current accounts of their balance of payments, considerable net open forward positions in foreign exchange, nominal exchange rates pegged against the dollar and, consequently, inappropriate appreciations in real exchange rates. Concerns about the sustainability of macroeconomic balance in these economies led to capital withdrawals, which developed into major currency crises and the subsequent implementation of stern policy steps to correct structurally weak economic systems, in most instances with the involvement of the International Monetary Fund.

Because the South African economy is classified with the Southeast Asian economies as an emerging market, it was afflicted by these confidence crises. A net inflow of capital (not related to reserves) of R16,8 billion in the first half of 1997 was abruptly reduced to only R3,4 billion in the second half of that year. When it began to transpire that the events leading up to the crisis could perhaps be confined to Asia, investor sentiment towards South Africa turned positive again and a strong net inflow of R11,2 billion occurred in the first quarter of 1998. However, the crisis deepened in the second quarter with the realization that the Japanese economy could be on the verge of its poorest economic performance in twenty years. The attractiveness of emerging markets as an investment destination was dimmed even more by news of a deteriorating Russian economy. Once again the South African economy could not escape the consequences of the financial problems in other parts of the world and the net inflow of capital shrank from R11,2 billion in the first quarter to R4,3 billion in the second quarter of 1998.

The changed capital account situation in the first half of 1998 was evident in a large net outflow of *short-term capital*. The outflow of short-term capital amounted to R13,3 billion in the first half of 1998, compared with R9,8 billion in the whole of 1997. As was the case in 1997, the outflows of short-term capital originated mainly in the non-monetary private sector. The direct cause of this outflow was the almost continuous decline in the external value of the rand from the second quarter of 1997, which prompted a preference for the financing of external trade in the domestic credit market. The large outflow of short-term capital (including errors and unrecorded transactions) in the first half of 1998 also reflected to a significant extent adverse movements in leads and lags in foreign payments and receipts.

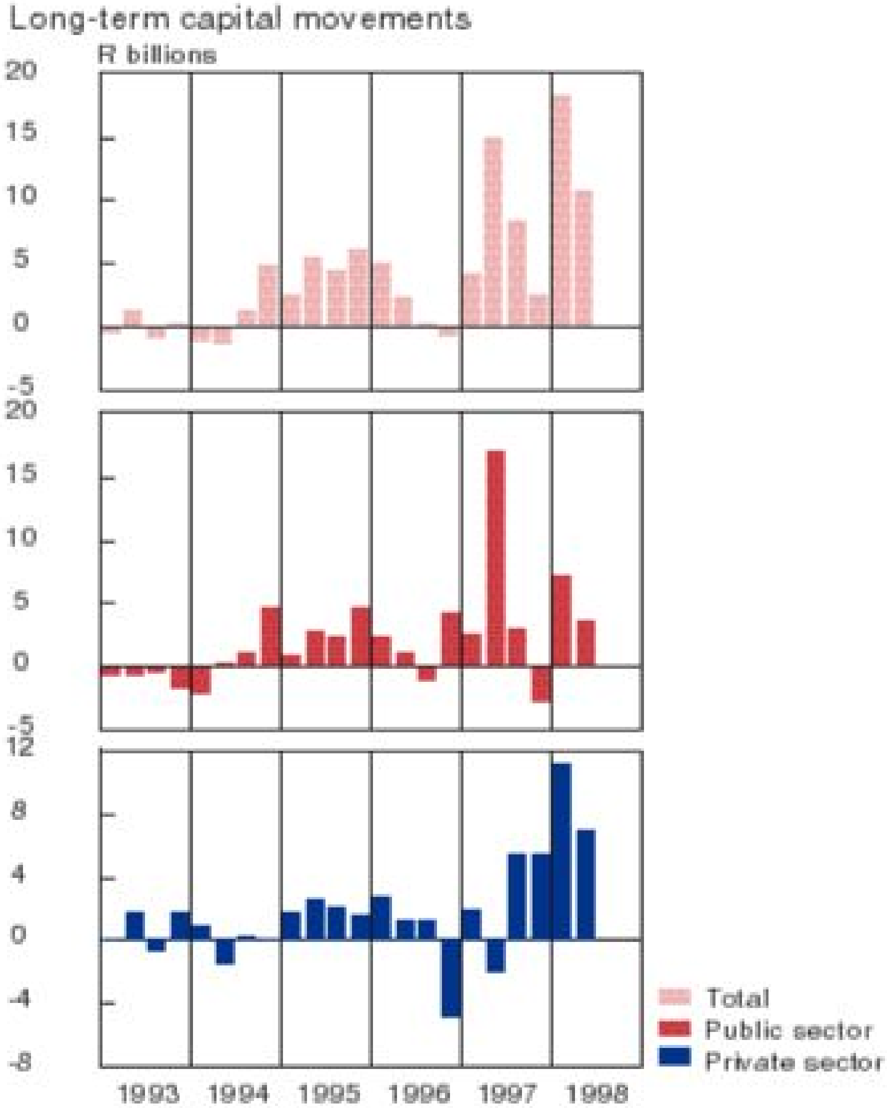
Table 10. Net capital movements not related to reserves

R billions

	1997				**1998**	
	1st qr	**2nd qr**	**3rd qr**	**4th qr**	**1st qr**	**2nd qr**
Long-term capital						
Public authorities	1,0	12,2	2,1	-2,5	6,2	1,9
Public corporations	1,4	4,8	0,8	-0,2	1,0	1,8
Monetary sector	-0,2	-0,1	-0,3	-0,2	-0,6	-0,2
Private sector	2,0	-2,0	5,7	5,5	11,6	7,1
Total long-term capital	**4,2**	**14,9**	**8,3**	**2,6**	**18,2**	**10,6**
Short-term capital						
Monetary sector	2,3	3,3	-4,5	0,0	-0,1	7,0
Other, including unrecorded transactions	-2,7	-5,2	-2,3	-0,7	-6,9	-13,3
Total short-term capital	**-0,4**	**-1,9**	**-6,8**	**-0,7**	**-7,0**	**-6,3**
Total capital	**3,8**	**13,0**	**1,5**	**1,9**	**11,2**	**4,3**

The monetary sector experienced a small inflow of capital from the first quarter of 1997 to the first quarter of 1998: during this period the non-resident deposit liabilities of South African banking institutions increased by more than the absolute value of the decline in their outstanding foreign loan liabilities. In the second quarter of 1998, the monetary sector increased their foreign short-term liabilities by R7,0 billion.

The *net inflow of long-term capital,* i.e. capital with an original maturity of longer than one year or with an indefinite maturity, was valued at R30,0 billion in 1997 and R28,8 billion in the first half of 1998. The aggregate inflow of long-term capital over the six-quarter period from the beginning of 1997 was roughly divided equally between the public sector and the private non-monetary sector. By contrast, the monetary sector experienced a persistent, but comparatively small net outflow of long-term capital over the same period.



Strong inflows of long-term capital to the *public sector* were recorded during the first half of 1997. These flows reflected the proceeds of the sale of a 30 per cent equity interest in Telkom to a consortium of non-resident companies and two major foreign-currency-denominated bonds issued in the international capital markets by the South African Government. At the same time, non-residents increased their holdings of public-sector bonds listed on the Bond Exchange of South Africa by an amount of R13,5 billion. In the second half of 1997, when the initial impact of the Southeast Asian financial troubles was felt, net purchases of public-sector bonds by non-residents fell to R1,3 billion. In fact, non-residents became net sellers of public-sector bonds to the amount of R2,7 billion in the fourth quarter of 1997. Inflows of long-term capital were also strengthened in 1997 by the issuance of rand-denominated bonds in European markets by Transnet, Eskom and the Development Bank of Southern Africa, totalling R0,9 billion.

The inflow of long-term capital to the public sector in the first half of 1998 is largely explained by a further increase of R8,9 billion in non-resident holdings of public-sector bonds and eurorand bonds issued on behalf of South African parastatals which raised an amount of R3,1 billion. The volatile nature of non-resident purchases of public-sector securities was once again demonstrated when the net value of these transactions fell from R6,8 billion in the first quarter of 1998 to only R2,1 billion in the second quarter.

The net inflow of long-term capital to the *private non-monetary sector* rose from a small amount of R19 million in the first half of 1997 to R11,2 billion in the second half and R18,8 billion in the first half of 1998. This was by and large the result of non-resident investors increasing their holdings of shares listed on the Johannesburg Stock Exchange by R26,2 billion in 1997 and R26,9 billion in the first half of 1998.

Net equity purchases by non-resident investors were largely left unaffected by the second wave of the Asian financial crisis as these transactions amounted to R14,1 billion in the second quarter of 1998, compared with R12,8 billion in the first quarter. The inflows through the Johannesburg Stock Exchange were partially offset by outflows arising from the acquisition of foreign assets by South African institutional investors through the asset-swap mechanism. The nominal value of asset-swap transactions amounted to R21,2 billion in 1997 and R13,7 billion in the first half of 1998. By the end of 1997 the value of foreign assets held by institutional investors represented some 5,8 per cent of the total value of their assets. Other sizeable outflows during the past six quarters arose from the repayment of fixed capital redemption commitments amounting to R13,7 billion in 1997 and R8,2 billion in the first half of 1998.

Foreign debt [(1)]

South Africa's total outstanding foreign debt increased from US$34,5 billion at the end of 1996 to $39,2 billion at the end of 1997, mainly as a result of the unprecedented foreign interest shown in rand-denomi nated public-sector bonds over this period. Foreign-currency-denominated debt declined from $26,0 billion at the end of 1996 to $25,2 billion at the end of 1997. Rand-denominated debt held by non-residents expressed in terms of US dollars increased from $8,5 billion to $14,0 billion over the same period.

Table 11. Foreign debt of South Africa

US$ billions at end of year

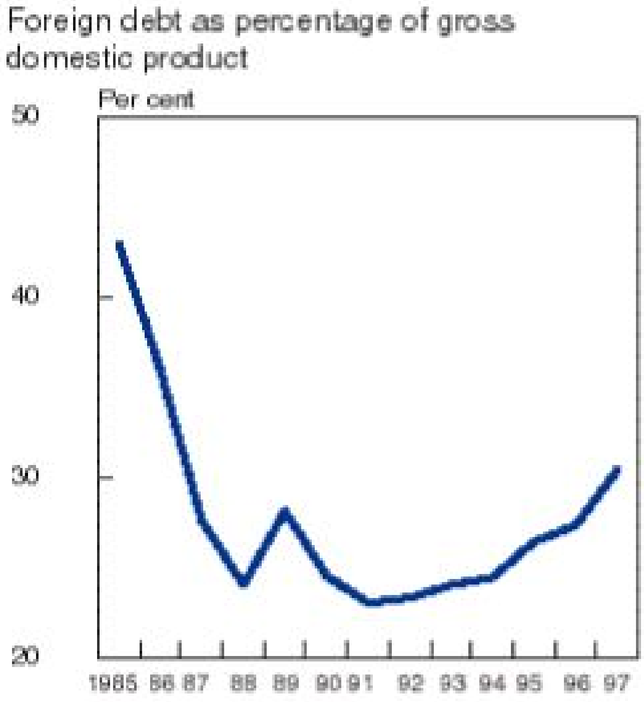
	1993	1994	1995	1996	1997
Renegotiated debt	**4,4**	**3,4**	**3,0**	**2,7**	**2,5**
Public sector	1,3	0,8	1,1	1,3	1,2
Monetary sector	1,6	1,0	0,7	0,3	0,2
Non-monetary private sector	1,5	1,6	1,2	1,1	1,1
Other foreign-currency-denominated debt	**15,0**	**18,3**	**22,4**	**23,3**	**22,7**

Public sector	3,3	3,4	4,5	4,7	4,2
Monetary sector	1,8	3,9	4,9	6,6	7,5
Non-monetary private sector	4,0	4,5	6,3	5,9	5,7
Bearer bonds	1,4	2,7	3,8	4,0	4,0
Converted long-term loans	4,5	3,8	2,9	2,1	1,3
Total foreign-currency-denominated debt	**19,4**	**21,7**	**25,4**	**26,0**	**25,2**
Rand-denominated debt	**7,6**	**8,0**	**9,9**	**8,5**	**14,0**
Bonds	5,0	5,3	7,3	6,3	10,4
Other	2,6	2,7	2,6	2,2	3,6
Total foreign debt	**27,0**	**29,7**	**35,3**	**34,5**	**39,2**

South Africa's renegotiated debt (i.e. debt negotiated in terms of successive standstill arrangements with foreign creditors) declined by US$0,2 billion to US$2,5 billion at the end of 1997. Valued at exchange rates prevailing at 31 August 1985, the outstanding amount of renegotiated debt has been reduced by $11,2 billion since the end of August 1985. Apart from actual repayments made to foreign creditors, the reduction in renegotiated debt was also influenced by conversions to longer-term loans and equity in terms of the standstill agreements.

Other foreign-currency-denominated debt declined from $23,3 billion at the end of 1996 to $22,7 billion at the end of 1997. Debt arising from international bond issues by the national government in the Japanese and North American markets was more than offset by the redemption of other longer-term loans.

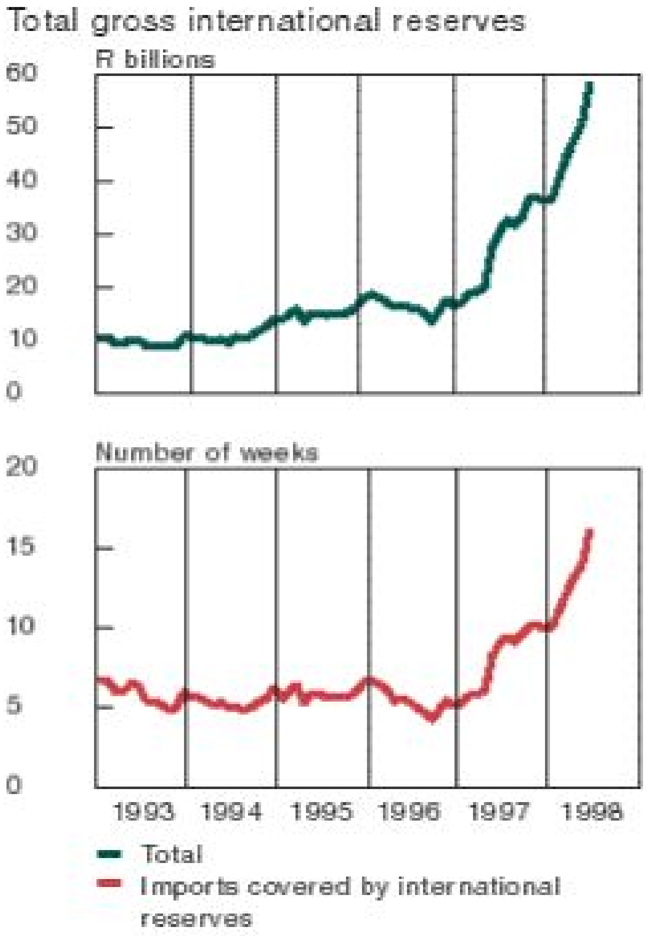
Measured in rand, the country's total foreign debt increased from R161,8 billion at the end of 1996 to R190,8 billion at the end of 1997. As a ratio of gross domestic product, total debt rose from 27,3 per cent in 1996 to 30,4 per cent in 1997; as a percentage of total export proceeds it increased from 96,3 per cent to 105,4 per cent over the same period. South Africa's short-term foreign-currency-denominated debt (i.e. debt with an original maturity of less than one year and other foreign-currency-denominated debt maturing within the next twelve months) amounted to 56 per cent of total foreign-currency-denominated debt at the end of 1997. At the end of 1997 gross foreign reserves covered 53,2 per cent of total short-term foreign-currency-denominated debt, compared with 25,3 per cent at the end of 1996.



Foreign reserves

After having declined by R4,6 billion in 1996, South Africa's *net gold and other foreign reserves* increased by R11,4 billion in 1997. The accumulation of reserves in 1997 could largely be attributed to a significant increase of R12,1 billion in the second quarter, resulting mainly from the partial privatisation of Telkom and the bond issues by the government in the international markets. Owing to a strong inflow of foreign capital through the securities markets, the country's net gold and other foreign reserves again increased by R8,7 billion in the first quarter of 1998. Negative sentiment towards emerging markets subsequently triggered a speculative attack on the rand in mid-May 1998 and in the process contributed to a decline of R10,1 billion in the net reserves of the Reserve Bank in the second quarter. However, including the short-term foreign assets of the private banks, the net international reserves of the country as a whole increased further by R2,2 billion in the same period.

The country's *gross gold and other foreign reserves* increased by R19,8 billion from a level of R16,8 billion (US$3,6 billion) at the end of December 1996 to R36,6 billion (US$7,5 billion) at the end of December 1997. During the first quarter of 1998 South Africa's gross gold and other foreign reserves continued to rise by a further R8,4 billion to an amount of R45,0 billion (US$9,0 billion) at the end of March. In the second quarter of 1998 total gross foreign reserves increased further to a level of R58,3 billion (US$9,9 billion) at the end of June. Relative to the value of imports of goods and services, the country's total gross reserves were equivalent to more than 12 weeks' worth of imports of goods and services at the end of March 1998 - a level widely regarded as an "acceptable level" of foreign reserves. In June the import-cover ratio increased to 16 weeks' worth of imports.



Despite an increase in the South African Reserve Bank's gold holdings from 3,8 million fine ounces at the end of December 1996 to 4,0 million fine ounces at the end of December 1997, the value of the Bank's gold reserves declined from R5,9 billion to R5,1 billion over this period. This occurred despite the depreciation of the rand and was the result of a fall in the price of gold from US$369 at the end of December 1996 to US$289 at the end of December 1997.

The *net open forward position of the South African* Reserve Bank (i.e. the Bank's net oversold forward position in foreign currency reduced by its net holdings of spot gold and foreign-exchange reserves) declined from US$22,2 billion at the end of December 1996 to US$16,3 billion at the end of 1997. The net open forward position improved further during the first four months of 1998 and amounted to US$12,8 billion at the end of April. In May and June 1998 the Reserve Bank supplied spot and forward dollars in the foreign-currency market to meet an unexpected increase in demand and to ensure orderly trading conditions. As a consequence the net open forward position of the Bank increased to US$17,9 billion at the end of May 1998 and US$22,5 billion at the end of June.

From February 1997 the Reserve Bank has increasingly utilised short-term foreign credit facilities and by the end of December 1997 the outstanding amount was R9,8 billion. This amount rose to R17,1 billion in May 1998. Six instalments totalling R2,9 billion were repaid to the International Monetary Fund in terms of the Compensatory and Contingency Financing Facility during 1997 and the first half of 1998. The final two instalments will be paid in the second half of 1998.

Exchange rates

After having fallen by 22,7 per cent during the first ten months of 1996, the nominal effective exchange rate of the rand stabilised and then strengthened by 10,9 per cent from the end of October 1996 to the middle of March 1997. The general downward revision of the credit risks associated with emerging market economies by some international portfolio investors, along with the strength of the US dollar on the international foreign-exchange markets, then brought new downward pressure to bear on the external value of the rand.

The downward drift of the rand gathered some momentum in the third quarter of 1997 and in October when the Asian financial crisis threatened to disrupt the South African foreign-exchange market. However, the spill-over effects of the Asian crisis were relatively moderate and appeared to be of short duration - the rand, in fact, appreciated against the basket of currencies in the last two months of 1997. On balance, the rand depreciated against a basket of currencies by only 0,3 per cent from the end of 1996 to the end of 1997, compared with a depreciation of 21,9 per cent from the end of 1995 to the end of 1996.

Conditions in the South African foreign-exchange market were relatively tranquil during the first four and a half months of 1998 and the exchange rate movements were not nearly as volatile as in some of the other emerging markets. The nominal effective exchange rate of the rand declined by 4,0 per cent over this period, being heavily dominated by movements against the US dollar and the German mark.

Table 12. Exchange rates of the rand

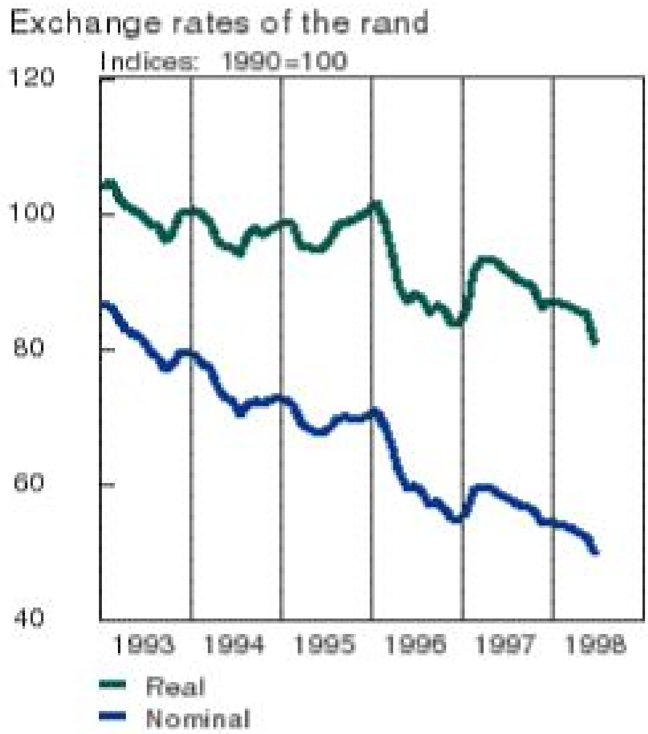
Per cent

	31 Oct 1996 to 13 Mar 1997	31 Dec 1996 to 31 Oct 1997	31 Dec 1997 to 22 May 1998	22 May 1998 to 31 Jul 1998
Weighted average	10,9	0,5	-4,0	-16,1
US dollar	7,7	-1,1	-4,3	-16,7
British pound	9,7	-0,2	-2,8	-16,8
German mark	20,6	2,5	-5,8	-15,7
Japanese yen	16,2	7,0	-	-11,7
Netherlands guilder	20,9	2,5	-5,7	-15,7
Italian lira	20,1	2,6	-5,4	-15,7

Being classified as an emerging market by most international investors, South Africa was also afflicted by the uncertain socio-political situation in Indonesia, which had ramifications for many other emerging market economies. In addition to news of a deteriorating Russian economy, which put downward pressure on the rouble and impacted negatively on other emerging markets, the South African rand came under a renewed wave of speculative attacks after the middle of May 1998. Partly fuelled by unfounded rumours and speculation, the nominal effective exchange rate of the rand declined by 13,5 per cent from 22 May 1998 to the end of June 1998. The rand depreciated from R5,0852 to the US dollar on 22 May 1998 to R5,8945 to the dollar at the end of June 1998.

The announcement of the Reserve Bank's foreign reserve position at the end of June 1998 and the increase in the Bank's net open forward position inspired another round of speculation against the rand. The nominal effective exchange rate of the rand subsequently declined further by 10,6 per cent during the first six days of July 1998: the rand fell to new record lows of R6,62 and R10,85 against the US dollar and the British pound respectively on 6 July 1998, before it recovered somewhat in July. From the end of 1997 to 31 July 1998 the average weighted value of the rand declined by 20 per cent.

The *real effective exchange rate* of the rand, which had increased on average by 0,7 per cent in 1997, declined by 6,8 per cent from December 1997 to June 1998 as the *nominal effective exchange rate* declined by more than the narrowing inflation differential between South Africa and its main trading partners. Provided that domestic cost pressures can be contained, the fall in the *real effective exchange rate* indicates a strengthening in the competitive ability of South African producers in export markets and the possibility of stronger export-led growth in the future.



FOOTNOTE :

[1] Estimates of foreign debt have been revised in view of results obtained from a comprehensive census survey of foreign transactions, liabilities and assets. Certain categories of debt were also reclassified to align the presentation of foreign debt with internationally accepted practices. Estimates of short-term foreign-currency-denominated debt have been revised upward from 1992.

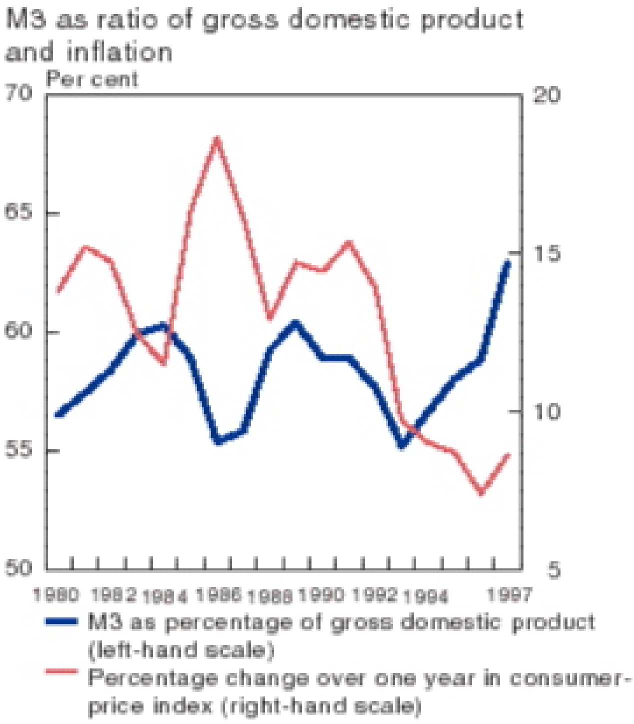
Monetary developments and interest rates

Monetary policy developments

Low inflation is almost universally accepted as the ultimate objective of monetary policy - not as an end in itself, but as the means whereby monetary policy can contribute to solid economic performance. To achieve this objective, the Reserve Bank designed a monetary policy framework which was anchored by the setting of guidelines for growth in the broad money supply (M3). This approach was based on the presumption that there was a stable relationship between changes in the money supply, aggregate nominal income and inflation. Considerable success has been achieved with this monetary policy framework as inflation has been brought down to more acceptable levels.

In recent years, however, the M3 money supply has increased at rates consistently higher than the indicated guideline ranges for growth in M3, but inflation nevertheless declined, contradicting previous expectations. Considerable uncertainties have arisen about the behaviour of the velocities of circulation of the various monetary aggregates and there were difficulties with forecasting the relationship between money growth, nominal income growth and inflation.

These problems, which are associated with an unstable relationship between the money supply and aggregate nominal income, are not unique to South Africa. Like other countries which moved through periods of stabilisation from high to low inflation, the relationship between money growth and nominal income growth observed during periods of high inflation, changed with declining inflation. Lower inflation and positive real returns on deposit-type investments contributed in restoring money's property as a store of value, thereby encouraging the community to hold an increased portion of their overall wealth in the form of bank deposits. In South Africa, in recent years, this process was reinforced by the growing integration of the global financial markets and the attendant increase in non-resident participation in the domestic financial markets. The accompanying graph illustrates the inverse relation over time between inflation and the ratio of M3 to gross domestic product.



Central banks in several countries, which have encountered similar problems with the instability of money-to-aggregate-income ratios since the 1980s, decided to abandon the use of monetary "targets" or "guidelines" as part of their overall macroeconomic policy strategies and introduced direct inflation-targeting as the principal indicator for taking monetary policy decisions.

The Reserve Bank is not convinced that South Africa has reached the stage where an explicit inflation target could be incorporated into its overall macroeconomic strategy. The adoption of an inflation target implies greater reliance on forward indicators of inflation and a continuous assessment of the relationship between the instruments of monetary policy and the inflation target. The lack of reliable inflation forecasting models together with the volatility in the financial flows convinced the Reserve Bank that it was not a convenient time to adopt an explicit inflation target. Policy credibility, hard won in the stabilisation process, could only be impaired by the premature adoption of direct inflation-targeting.

Instead of adopting a formal inflation target as the principal indicator for taking monetary policy decisions, the Bank preferred following a more eclectic approach to monetary policy. This meant that the money supply and bank credit extension would not be over-emphasised and that other financial indicators would also be observed closely during deliberations on policy issues. These indicators include other price indices, such as the index for production prices, the level of interest rates and the shape of the yield curve, money market conditions, the gross gold and other foreign exchange reserves, changes in the exchange rate and the public-sector borrowing requirement. It is also recognised that inflationary pressures in the economy will be affected by certain non-financial developments such as changes in nominal labour remuneration and nominal unit labour costs and the gap between potential and actual domestic output.

Although the Reserve Bank refrained from setting a formal inflation target for monetary policy purposes, it nevertheless indicated a range of between 1 and 5 per cent per year as an inflation objective that would be taken into consideration when formulating monetary policy. Guidelines for the growth in M3 were also announced on 9 March 1998. However, the guidelines for M3 growth of between 6 and 10 per cent were no longer defined over a time horizon of only one year, but for three years instead. Such an average growth rate in M3 was expected to contain inflation without inhibiting stronger economic growth.

The Reserve Bank also sought to improve the efficiency of its monetary policy measures by changing the procedures for providing liquidity to the banking system. With the introduction of the new arrangements on 9 March 1998, the Reserve Bank changed the operational procedures from a virtual automatic accommodation of banks' daily liquidity needs, to a repurchase-based auction system whereby banks tender on a daily basis for a given amount of liquidity determined by the Reserve Bank.

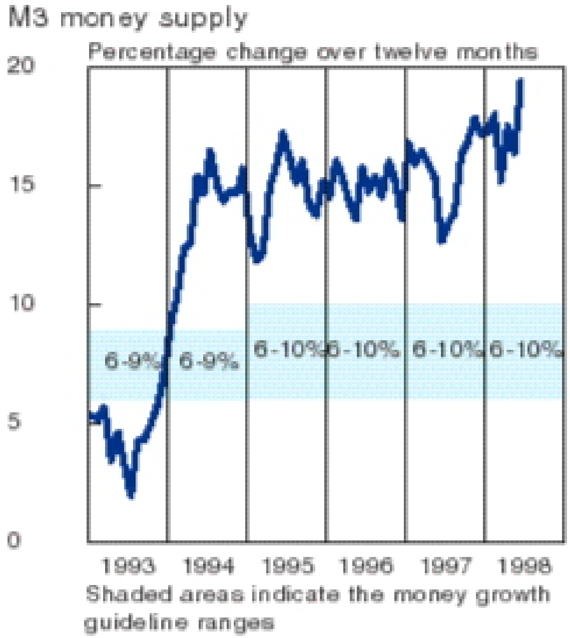
The fiscal policy posture over the past eighteen months supported the objective of price stability and relieved the burden on monetary policy by reducing some of the upward pressure on interest rates. The working relationship between the Reserve Bank and the Department of Finance was rationalised by the appointment of a panel of market-makers in government bonds. These market-makers, which are registered banking institutions, enjoy exclusive dealing rights with the government in respect of all domestic government bond issues. The appointment of the market-makers (or primary dealers) relieved the Reserve Bank of the obligation to act as a broker for the government. The potential conflict between the Bank's monetary policy responsibilities, which at times would require high interest rates, and its duties to fund the government deficit at the lowest possible cost, was effectively removed.

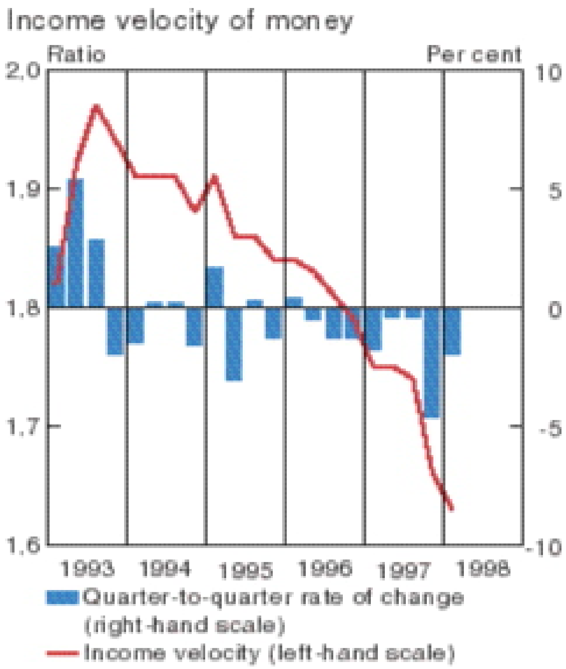
Monetary policy, as indicated by the nominal lending rates of the Reserve Bank, was eased in October 1997 and again in March 1998. The first step in easing monetary policy from the restrictive stance that had been adopted in the second half of 1994 was taken by the Reserve Bank on 17 October 1997, when it was announced that Bank rate would be lowered from 17 per cent to 16 per cent. The slowdown in the quarter-to-quarter growth in the money supply and bank credit extension to the private sector during the third quarter of 1997 and the resumption of a downward trend in consumer and production price inflation, permitted the Reserve Bank to relax the monetary policy stance on that occasion. The official lending rates of the Reserve Bank were lowered again on 9 March 1998 on the introduction of the new procedures for providing liquidity to the banks. On this occasion, the surplus on the overall balance of payments, the rise in the international reserves of the country and the waning of inflation were some of the factors taken into consideration.

Notwithstanding the progress made with stabilising the economy and lowering inflation, monetary policy had to remain relatively conservative. Inflation was still too high and the deficit on the current account of the balance of payments was essentially financed by inflows of international portfolio capital, which potentially could be reversed unexpectedly. Even though the policy posture of the Reserve Bank was regarded as rather restrictive, monetary policy was tightened further without much delay when the exchange rate of the rand came under pressure from about the middle of April 1998. The estimated liquidity requirements of the money market were not met in full and the market-determined lending rates of the Reserve Bank were permitted to rise sharply in an attempt to calm down the foreign-exchange market. The marginal lending rate was raised to a level that for most of the time was 20 percentage points above the Bank's repurchase rate.

Money supply

The growth in M3 from the fourth quarter of 1996 to the fourth quarter of 1997 amounted to 17,2 per cent, exceeding by a substantial margin the guidelines set for growth in the broadly defined money supply. The twelve-month growth rate of M3 during the first six months of 1998, on average, exceeded the upper limit of the guideline range of 10 per cent by about 7 percentage points. The growth in the money supply has now exceeded the growth in the gross domestic product for five years and caused the income velocity of M3 to decline by 17,8 per cent from its most recent peak of 1,97 in the third quarter of 1993 to 1,62 in the second quarter of 1998.





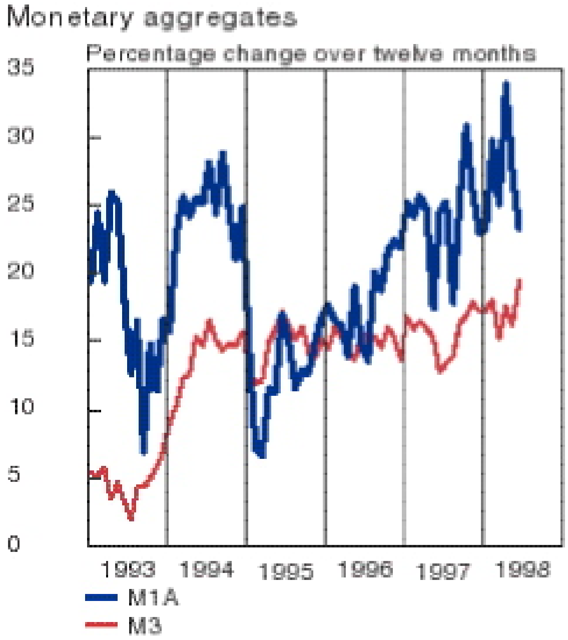
The quarter-to-quarter change in the income velocity of M3 during the period from 1993 to 1998 fluctuated between an increase of 1,6 per cent recorded in the first quarter of 1995 and a decline of 4,6 per cent recorded in the fourth quarter of 1997. These erratic changes in the income velocity of M3 serve as proof of the relative instability and unpredictability of the relationship between money and aggregate nominal income. For this reason, the Reserve Bank de-emphasised the significance of aggregate money growth in the new eclectic approach to monetary policy, while still acknowledging that growth in the money supply was vital to the process of inflation propagation.

The high growth in M3 from the second half of 1993 stemmed partly from the relative success attained with macroeconomic stabilisation and the decline in inflation during this period, which helped to re-establish money as a store of wealth. The stronger demand for bank deposits was also boosted by relatively strong final demand for goods and services, which increased the need to hold more money for transaction purposes. The increased trading activity on the bond and share markets added to the demand for money for speculative purposes. Large inflows of predominantly portfolio capital from outside the country also increased the growth in money supply to a level higher than what it would otherwise have been.

The process of financial deepening as the South African society increasingly gained access to the banking sector was reflected, among other things, by the increase in the number of current accounts with banks which rose from 3,28 million on 1 January 1995 to 4,18 million on 1 January 1998. Total bank deposits per head of the population increased from R5 300 in June 1993 to R10 000 in June 1998. The number of registered banks increased from 43 in January 1995 to 56 in January 1998, although the number of banking offices decreased from 4 049 in January 1995 to 3 197 in January 1998 as a result of branch mergers and bank rationalisation programmes. Foreign banks entered the domestic market and 11 branches and 10 subsidiaries of foreign banks were actively involved as banks in South Africa in early 1998 compared with 6 branches and 9 subsidiaries in early 1997. The number of approved local representative offices of foreign banks increased from 40 in December 1994 to 60 in December 1997. The number of automated teller machines dispensing cash increased from 5 157 in December 1994 to 5 930 in December 1997. The more intensive use of banking services probably contributed to the changes that have been observed recently in the relationship between the money supply and aggregate nominal income and expenditure.

Despite the sophistication of the domestic banking sector and the high level of financial penetration, the banks still find it difficult to supply full banking services to all sections of the community. A growing micro-lending industry is therefore still conducting a thriving business. The regulatory authorities are also considering an amendment to the Banks Act to allow village co-operatives to operate within the existing regulatory framework.

The continued strong growth in the money supply was characterised by a clear *preference for liquidity* and deposits with short maturities increased at substantially faster rates than those with longer ones. Notes and coin in circulation outside the monetary sector, however, increased more or less in line with gross domestic product. The income velocity of notes and coin consequently decreased only marginally from 37,8 in the second quarter of 1997 to 37,0 in the second quarter of 1998. This is in sharp contrast to the income velocity of M1A which decreased from 7,20 in the second quarter of 1997 to 6,05 in the second quarter of 1998 and that of M1 which decreased from 4,06 to 3,48 over the same period.



As indicated in Table 13, the rise in notes and coin in circulation outside the monetary sector constituted only a small percentage of the overall increase in M3 from July 1995 to June 1998. By contrast, the increases in "cheque and transmission deposits" and in "other demand deposits" constituted on average about 70 per cent of the overall increase in M3 over the same three-year period. Cheque and transmission deposits accordingly increased as a portion of M3 from 18,4 per cent in June 1995 to 22,2 per cent in June 1998 and other demand deposits from 14,0 per cent to 23,2 per cent. These increases came mainly at the expense of other short-term and medium-term deposits, which declined from 49,3 per cent of M3 in June 1995 to 40,4 per cent in June 1998, and long-term deposits, whose proportionate share declined from 13,4 per cent to 10,0 per cent.

Table 13. M3 and its components

	June 1995		June 1996				June 1997				June 1998			
					Change over 12 months				Change over 12 months				Change over 12 months	
	Actual R billion	% of M3	Actual R billion	% of M3	%	% of total change in M3	Actual R billion	% of M3	%	% of total change in M3	Actual R billion	% of M3	%	% of total change in M3
Notes and coin	13,0	4,9	15,1	5,0	16,3	5,0	15,5	4,5	2,8	1,0	17,1	4,2	10,2	2,4
Cheque and transmission	48,4	18,4	55,4	18,2	14,3	16,7	72,2	21,0	30,4	43,8	91,0	22,2	26,1	28,3
M1A	61,4	23,3	70,5	23,2	14,7	21,7	87,7	25,6	24,5	44,8	108,1	26,4	23,3	30,7
Other demand	36,7	14,0	55,7	18,3	52,0	46,1	62,5	18,2	12,2	17,6	95,2	23,2	52,2	49,2
M1	98,1	37,3	126,2	41,5	28,7	67,8	150,2	43,8	19,1	62,4	203,3	49,6	35,3	79,9
Other short and medium term	129,6	49,3	142,3	46,7	9,8	30,7	153,3	44,7	7,7	28,3	165,3	40,4	7,8	18,0
M2	227,7	86,6	268,5	88,2	17,9	98,5	303,5	88,5	13,0	90,7	368,6	90,0	21,4	97,9
Long term	35,3	13,4	35,9	11,8	1,7	1,5	39,5	11,5	9,9	9,3	40,9	10,0	3,7	2,1
M3	263,0	100,0	304,4	100,0	15,7	100,0	343,0	100,0	12,7	100,0	409,5	100,0	19,4	100,0

As was the case during previous periods, the main counterpart of the change in M3 in a statistical or accounting sense during the twelve months up to June 1998 was once again a substantial increase in the banks' claims on the domestic non-bank private sector. In contrast to the two previous years, net foreign assets and net claims on the government sector also showed increases during the twelve-month period up to June 1998.

Table 14. Accounting couterparts of change in M3

R billions

	1995/96	1996/97	1997/98

Net foreign assets	-6,1	-4,1	0,8
Net claims on government sector	-3,7	-0,6	17,8
Claims on the private sector	53,7	55,9	63,6
Net other assets	-2,5	-12,6	-15,7
Total change in M3	**41,4**	**38,6**	**66,5**

Credit extension

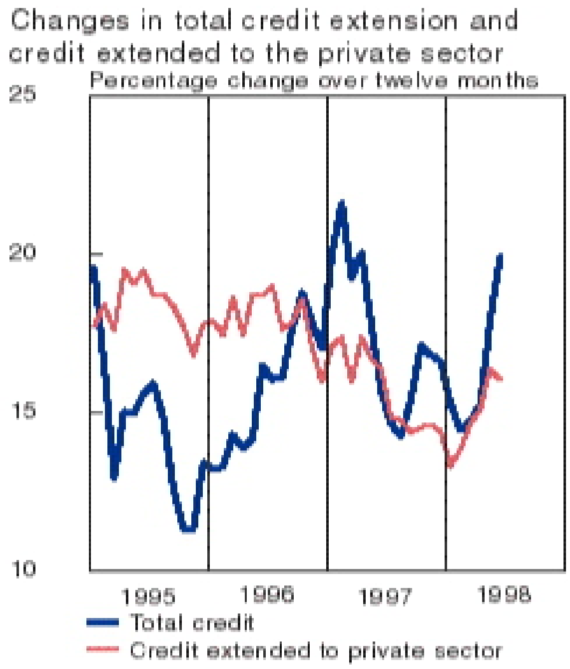
Total domestic credit extension (i.e. credit extended to the domestic private sector and net claims on the government sector) increased by R55,3 billion during the twelve months to June 1997 and by R81,4 billion during the subsequent twelve months. Unlike the year to June 1997 when the net claims of the monetary sector on the government sector shrank by R0,6 billion, net credit extension to the government sector added R17,8 billion to the banks' overall credit extension in the year to June 1998. The increase in credit extension to the government sector in the year to June 1998 was accounted for by an increase of R8,2 billion in the monetary sector's gross claims on the government sector and a decrease of R9,6 billion in government deposits with banks.

Table 15. Change in total credit extension by monetary institutions over twelve months

R billions

	1994/95	**1995/96**	**1996/97**	**1997/98**
Claims on the government				
Gross claims	0,6	2,8	2,6	8,2
Less: deposits	6,6	6,6	3,2	-9,6
Net claims	-6,0	-3,8	-0,6	17,8
Claims on the private sector	46,9	53,8	55,9	63,6
Total	**40,9**	**50,0**	**55,3**	**81,4**

In April 1998 government appointed six domestic banks and six foreign banks as primary dealers in government bonds. The primary dealers, in addition to ensuring a minimum level of demand in the primary bond market, were also responsible for maintaining liquidity in the secondary market and their appointment contributed to an increase in the monetary sector's holdings of government bonds. In addition, provincial governments used bank credit more extensively and the implementation of a more efficient cash management system allowed the national government to minimise its deposits with banks.



As a result of the increase in the monetary sector's net claims on the government sector during the twelve months to June 1998, the growth rate of total domestic credit extension over twelve months at 19,9 per cent exceeded that of credit extension to the private sector, which was recorded at 16,0 per cent in June 1998. The growth in credit extension to the private sector, however, was substantially higher than the growth in expenditure on gross domestic product. The total amount of outstanding credit extended to the private sector as a ratio of gross domestic product, consequently, increased from 66,3 per cent in the second quarter of 1997 to 70,4 per cent in the second quarter of 1998. This indication of financial deepening is corroborated by an increase in the number of debtor accounts in the books of the banks (see Table 16).

Table 16. Number of debtor accounts with banks*

Millions

	1995	1996	1997	1998
Mortgage loan accounts	1,39	1,57	1,71	1,82
Instalment sale accounts	1,12	1,27	1,21	1,23
Leasing finance accounts	0,38	0,51	0,40	0,40
Credit card accounts	2,74	3,19	4,41	5,10
Revolving credit accounts	0,23	0,22	0,26	0,30
Overdraft accounts	1,83	2,01	2,24	2,31
Total	**7,69**	**8,77**	**10,23**	**11,16**
* Number of accounts on 1 January				

The rate of increase over twelve months in credit extension to the private sector fluctuated along a declining trend from 16,4 per cent in June 1997 to 13,3 per cent in January 1998, but then rose to above 15 per cent in April and further to above 16 per cent in May and June 1998. A switch from offshore to domestic sources of finance as a result of the weakness of the rand and the highly attractive yields on the bond and share markets boosted the use of bank credit during the first four months of 1998. The sharp decline in the exchange rate of the rand towards the end of May and in June 1998 further encouraged the use of domestic credit sources to finance trade.

The twelve-month growth rate in all main types of credit extended to the private sector, with the notable exception of "bills discounted and investments" and "other loans and advances" (including overdrafts) slowed down, on balance, during the twelve months to June 1998. The growth rate of "bills discounted and investments" was affected by accounting practices such as marked-to-market and other valuation adjustments, whereas the growth in "other loans and advances" came mainly from a strong demand for operating capital by the corporate sector. Instalment sale credit, which is mainly used to finance motor vehicle purchases, increased at much lower rates than before as sales growth weakened in the automobile industry. Growth over twelve months in instalment sale credit declined from a recent peak of 30,7 per cent in January 1996 to 9,1 per cent in June 1998. Leasing finance, also closely related to the motorcar trade, declined over twelve months by 4,6 per cent in June 1998, compared with an increase of 19,8 per cent less than two years ago in September 1996.

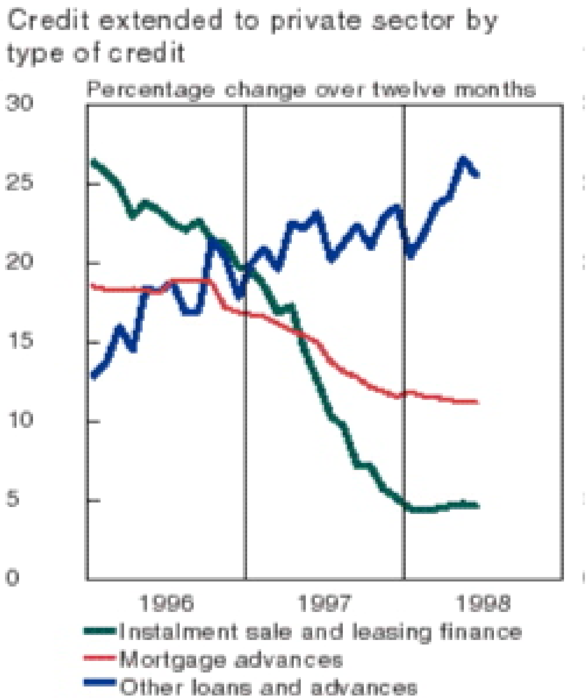


Table 17. Twelve-month growth rates in main types of credit extended to the private sector

Per cent

Period		Bills discounted and investments	Instalment sale credit	Leasing finance	Mortgage advances	Other loans and advances	Total
1996:	Dec	-8,9	21,2	16,8	16,9	17,8	15,9
1997	Mar	-6,2	18,1	14,3	16,1	19,6	15,9
	Jun	0,7	14,3	8,9	15,0	23,2	16,4
	Jul	6,1	12,2	6,6	13,7	20,2	14,8
	Aug	6,3	11,6	5,6	13,1	21,2	14,8
	Sep	3,0	10,6	0,5	12,7	22,4	14,3
	Oct	19,1	11,6	-1,4	12,2	21,0	14,5
	Nov	18,4	9,7	-2,3	11,8	22,8	14,6
	Dec	13,4	9,2	-3,0	11,5	23,6	14,4

1998	Jan	11,2	8,6	-3,9	11,9	20,4	13,3
	Feb	13,6	8,5	-3,8	11,6	21,8	13,8
	Mar	17,5	9,7	-6,1	11,5	23,6	14,6
	Apr	22,4	9,1	-4,5	11,3	24,2	15,1
	May	33,1	9,3	-4,5	11,2	26,6	16,4
	Jun	30,8	9,1	-4,6	11,2	25,5	16,0

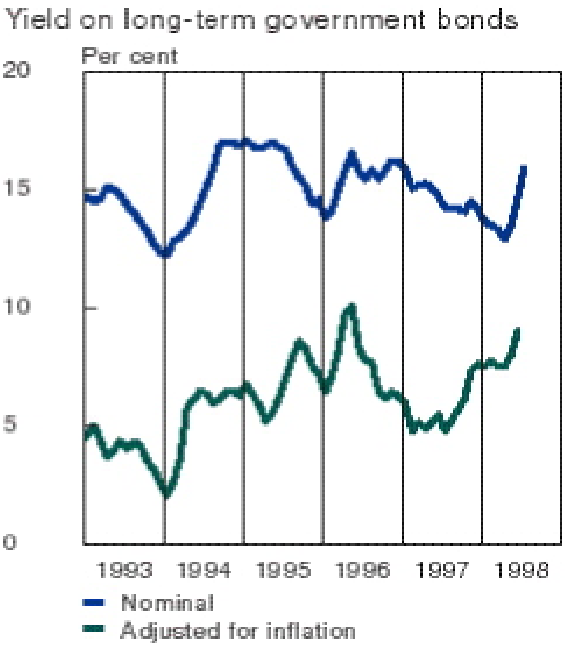
The growth rate in mortgage advances, which had almost consistently exceeded the increase in total bank credit extension to the domestic non-bank private sector during the five-year period to the end of 1996, fell below the growth in total credit to the private sector from January 1997. This development reflected not only slack conditions in the property market and the high cost of mortgage financing, but later also the regulatory authority's stated intention to increase the capital-adequacy risk-weighting of such loans. The increase in the capital risk-weighting of residential mortgage loans for advances in excess of 80 per cent of the value of the property is to be implemented because of a sharp increase in overdue payments on such loans. Payment arrears raised the risk and the cost of such loans and made this type of credit extension less attractive for banks.

Credit growth to the private household sector dwindled in recent months, whereas the corporate sector absorbed bank credit at an accelerating rate. The twelve-month growth rate of credit extended to the household sector declined from 14,5 per cent in June 1997 to only 7,9 per cent in June 1998. The twelve-month rate of increase in credit extended to the corporate sector, however, accelerated from an already high 19,1 per cent in June 1997 to as much as 27,2 per cent in June 1998. The increase in mortgage loans to the household sector constituted 73,2 per cent of the increase in bank credit extended to households between June 1997 and June 1998. In the case of the corporate sector, "other loans and advances" (including overdrafts) accounted for 69,7 per cent of the increase in credit extended to this sector during the same period and mortgage advances accounted for only 12,3 per cent. Credit extended by the monetary sector to the corporate sector as a ratio of total credit extension to the domestic private sector increased from 42,0 per cent in June 1997 to 46,0 per cent in June 1998.

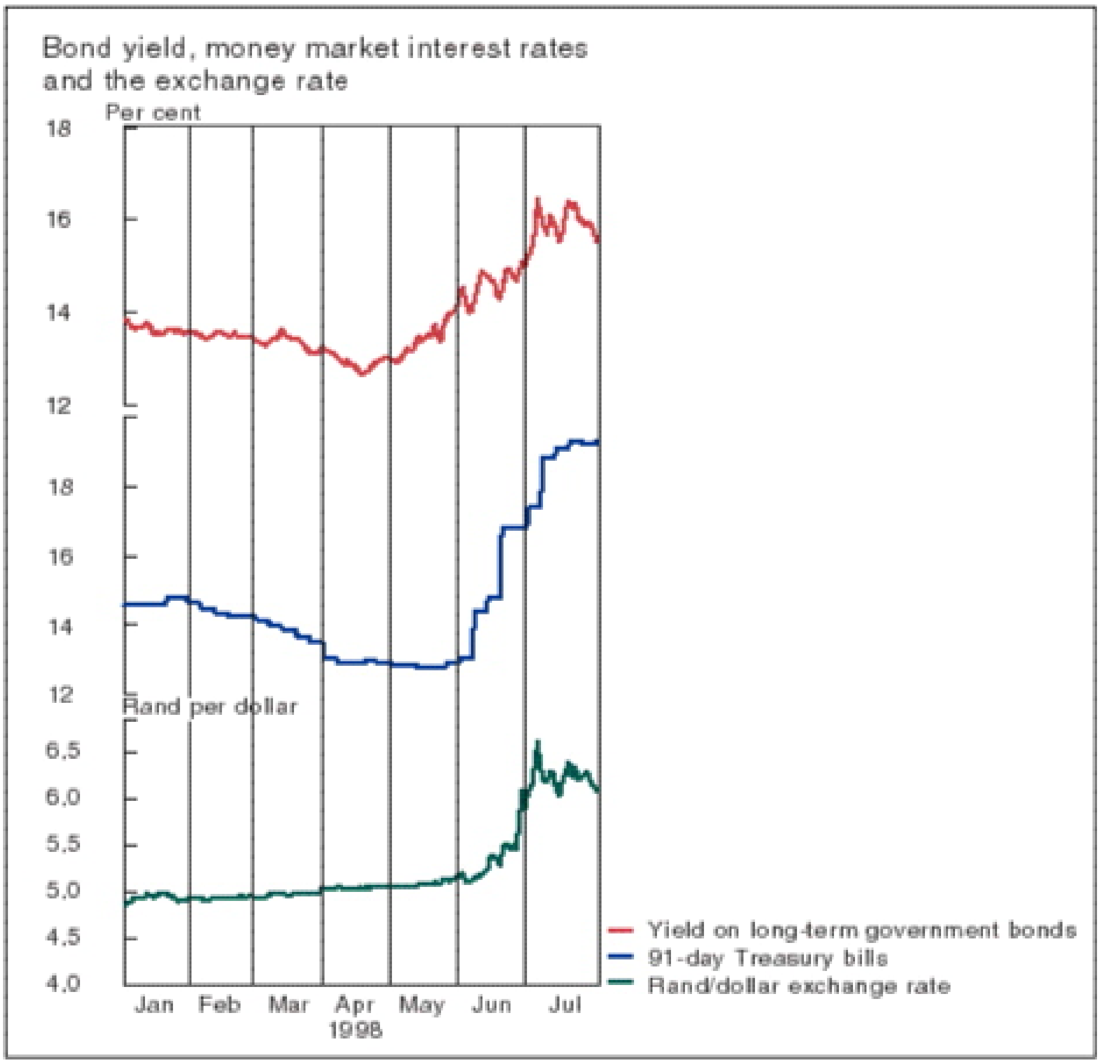
The growth in credit extension to the non-bank private sector consistently exceeded the inflation rate that is measured by changes in the consumer price index over twelve months. Consequently, the twelve-month growth rate in credit extended to the private sector, adjusted for inflation, increased from 5,3 per cent in July 1997 to 10,3 per cent in June 1998.

Interest rates and yields

The movement of bond yields during 1996 was strongly influenced by the sharp depreciation in the external value of the rand from February of that year. When the rand began to stabilise again in the last quarter of 1996, and it became clear that macroeconomic balance had been largely restored, bond yields peaked and shortly after that, began to decline for most of the period until April 1998. This general downward movement of bond yields was interrupted on two occasions: in March and April 1997 when uncertainties about the likely impact of the relaxation of exchange controls on residents made yields move higher, and again towards the end of October when the Asian financial crisis spilled over into the South African financial markets. Over the longer term, however, the monthly average yield on government bonds with a maturity of more than 10 years declined from 16,2 per cent in December 1996 to 12,9 per cent in April 1998. The daily average bond yield went as low as 12,67 per cent on 17 April 1998.



Because most international investors classify South Africa as an emerging market, the country is invariably affected when financial stability appears to be under threat in any of the other economies included in the emerging-markets category. As indicated, the rand came under speculative attack and monetary policy had to be tightened from the middle of May 1998. The resultant rise in short-term interest rates, the continued weakness of the rand and net sales by non-resident investors in the domestic bond market then caused the yields on long-term government bonds to rise sharply from an average level of 12,67 per cent on 17 April 1998 to 16,44 per cent on 6 July. The monthly average yield rose from 12,9 per cent in April 1998 to 13,5 per cent in May and 15,9 per cent in July.



With consumer-price inflation declining more than the monthly average nominal bond yield, the inflation-adjusted yield on long-term government bonds increased from an average level of about 5 per cent in the period from February to August 1997 to 7,5 per cent in April 1998 and 9 per cent in June. As a consequence, the differential between inflation-adjusted yields on long-term bonds of the United States Federal Government and those on long-term bonds of the South African Government widened from 0,6 percentage points in April 1997 to an average of 3,8 percentage points in the months from November 1997 to June 1998. The widening of the margin between the two inflation-adjusted yields arguably reflected a more accurate assessment of the differences in the country and currency risks of these two economies.

Whereas inflation-adjusted yields on long-term bonds in South Africa were higher than those on similar quality bonds in the North American capital markets, inflation-adjusted short-term interest rates were on average lower in South Africa than in a number of emerging markets. Only in September and October 1997 and in April and June 1998 were inflation-adjusted interest rates in South Africa marginally higher than an estimated average rate for 19 emerging market economies. On these occasions, short-term interest rates in South Africa moved higher in reaction to the financial problems of the Asian economies.

Table 18. Inflation-adjusted interest rates

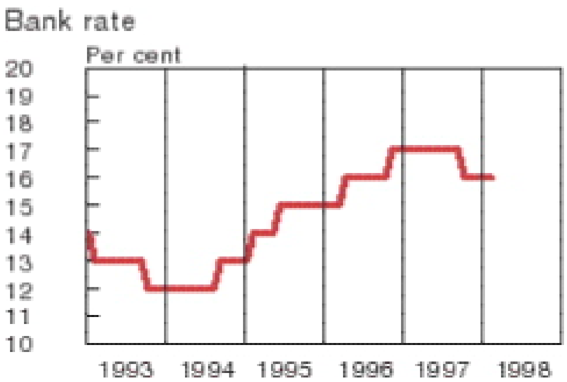
Per cent

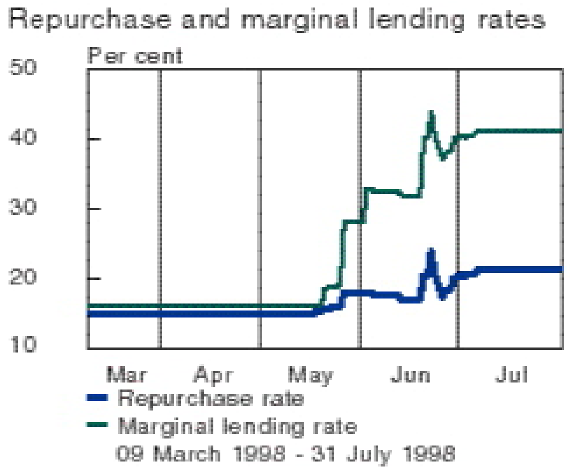
	Rate on long-term government bonds			Rate on short-term money market instruments		
	SA	USA	SA minus USA	SA	Emerging markets[1)]	SA minus emerging markets

1997:	Apr	4,9	4,3	0,6	5,6	5,7	-0,1
	May	5,1	4,4	0,7	5,8	6,1	-0,3
	Jun	5,5	4,1	1,4	6,2	6,5	-0,3
	Jul	4,8	3,9	0,9	5,6	6,1	-0,5
	Aug	5,2	4,0	1,2	5,8	6,1	-0,3
	Sep	5,7	4,0	1,7	6,4	6,2	0,2
	Oct	6,2	3,9	2,3	6,7	6,0	0,7
	Nov	7,3	4,0	3,3	7,5	7,9	-0,4
	Dec	7,6	4,0	3,6	8,2	8,3	-0,1
1998:	Jan	7,5	3,9	3,6	8,5	9,0	-0,5
	Feb	7,7	4,1	3,6	8,2	8,9	-0,7
	Mar	7,5	4,2	3,3	7,4	8,0	-0,6
	Apr	7,5	4,1	3,4	7,5	7,4	0,1
	May	8,0	3,9	4,1	7,7	8,6	-0,9
	Jun	9,0	3,7	5,3	10,7	10,3	0,4

1) Average rate of 19 emerging markets

Positive financial developments were taken into consideration when the Reserve Bank lowered *Bank rate* by one percentage point from 17 per cent to 16 per cent on 20 October 1997. These included the slower growth in financial aggregates in the third quarter of 1997, especially the M3 money supply and credit extension to the private sector, declining inflation, a much more stable evolution over time of the nominal effective exchange rate of the rand, rising gold and foreign exchange reserves and the narrowing of the net open position in foreign exchange of the Reserve Bank.





The *official lending rates of the Reserve Bank* were again lowered on 9 March 1998 on the introduction of the new procedures for providing liquidity to the banks. The rate at which the Bank was prepared to enter into repurchase transactions was set at 15 per cent and the marginal lending rate was introduced at the level of the former Bank rate, namely 16 per cent. These steps effectively reduced the cost of borrowing from the Reserve Bank by approximately one percentage point.

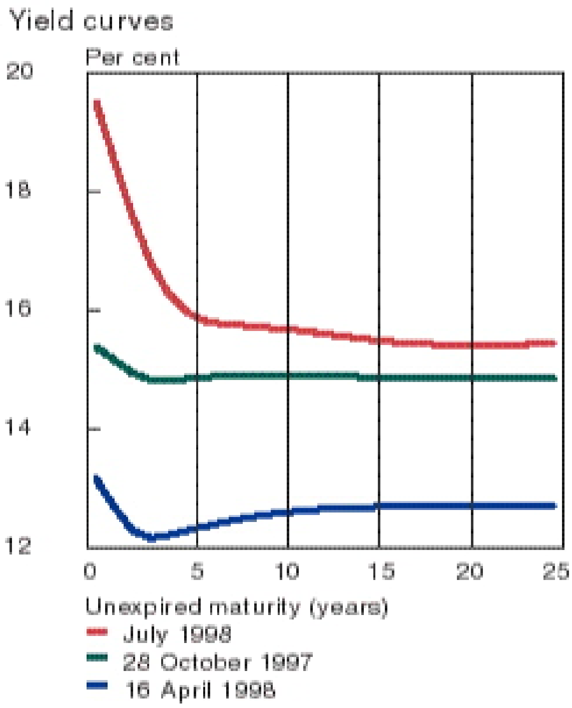
The average daily *repurchase rate* of the Reserve Bank remained unchanged after the introduction of the new procedures until the end of March. From the beginning of April the repurchase rate became sensitive to changes in the views held in the money market regarding the appropriate level of interest rates and moved downwards, on balance, to a level of 14,79 per cent on 11 May 1998. In response to strains which developed in the foreign exchange market, the Reserve Bank acquiesced in the upward pressures on money market rates by providing less than the daily estimated liquidity requirement through the repurchase facility. This signalling mechanism of the Bank ultimately caused an upward adjustment of interest rates, and the repurchase rate rose to 16,09 per cent on 25 May 1998. This upward movement of the repurchase rate was assisted by an increase in the marginal lending rate from 20 May 1998 to a level that was allowed to fluctuate in accordance with movements in the repurchase rate, but that was 3 percentage points above the daily average repurchase rate.

On 26 May 1998 the Reserve Bank suspended the variable-rate auction system and announced a fixed repurchase rate at the higher level of 18 per cent. Simultaneously, the marginal lending rate was raised to 10 percentage points above the repurchase rate. From the outset, this step was intended to be temporary and was meant to be maintained only until conditions in the financial markets had calmed down. On 2 June 1998 the spread between the fixed repurchase rate and the marginal lending rate was widened to 15 percentage points.

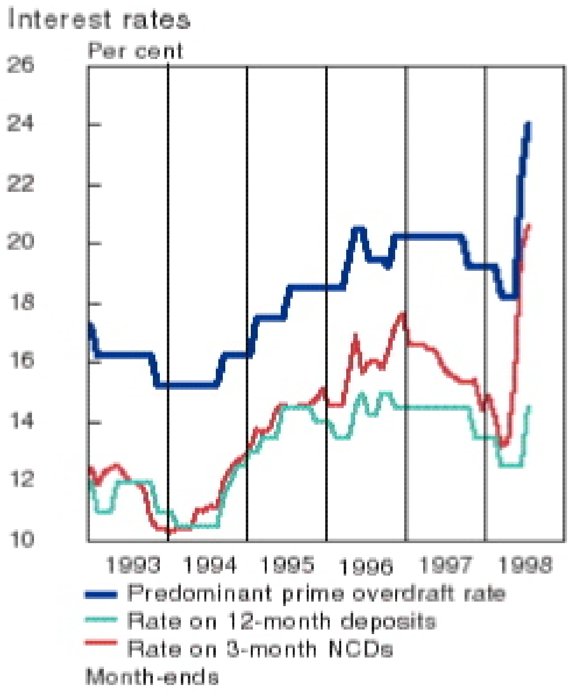
The fixed repurchase rate of the Reserve Bank was lowered by half a percentage point on each occasion on 4 June and 12 June 1998. These steps brought the fixed repurchase rate down to 17 per cent and the marginal lending rate to 32 per cent. When it became apparent that the rand would remain under attack for a longer period than originally envisaged, the Reserve Bank reinstated the variable-rate auction system on 19 June 1998 and widened the spread between the marginal lending rate and the repurchase rate to 20 percentage points. As a result, the average repurchase rate increased to 20,38 per cent, i.e. 3,38 percentage points above the fixed rate of the previous day, and the marginal lending rate was adjusted to 40,38 per cent. In subsequent auctions until the end of June 1998, the variable repurchase rate fluctuated widely between a high of 23,99 per cent on 22 June and 17,34 per cent on 25 June. Over this period, the daily average cost of Reserve Bank money (i.e. a weighted average of the cost of liquidity through the repurchase auction and at the marginal lending facility) ranged between 26,59 per cent on 22 June 1998 and 17,34 per cent on 25 June. Conditions in the money market calmed down fairly significantly in July 1998 and the repurchase rate gradually crept higher from 21,12 per cent on 6 July to 21,35 per cent on 31 July.

Money market interest rates, as reflected by the rate on three-month bankers' acceptances declined for fifteen consecutive months from January 1997 to April 1998, but then increased strongly from a relatively low point of 12,75 per cent on 14 April in the case of three-month bankers' acceptances to 14,95 per cent at the end of May and 19,00 per cent at the end of June. The interbank call rate initially remained steady at 13 per cent during the recent turbulence in the financial markets, and a small response of a quarter percentage point was delayed until 18 May 1998. Because of the ripple effect of changes in the interbank rate on banks' overall funding costs and consequently on their lending rates, banks are usually inclined to postpone changes in this rate for as long as they possibly can. The tightening of money market conditions and the subsequent upward adjustment of short-term interest rates caused the interbank call rate to adjust rapidly to levels that at times were higher than the repurchase rate of the Reserve Bank.

From January 1997 the downward movement of rates over the full range of maturities shifted the yield curve lower. With the exception of the relatively short-lived upward movement in the fourth quarter of 1997 when the Asian contagion was severe, this downward drift of the yield curve lasted until 16 April 1998. From the second half of April 1998 to early in July the yield curve once again shifted higher across the full maturity spectrum to a level approximately equal to that at the end of December 1996. The yields on bonds with maturities of three years and longer rose less than the yields on short-dated maturities, thus causing a steep inversion in the slope of the curve over the segment of less than three years. This was typical of tight liquidity conditions, which are most forcefully reflected in interest rates at the short end of the maturity spectrum.



The *prime overdraft rate of banks* was lowered by a full percentage point in October 1997. This was a reaction to the general downward movement of interest rates from the beginning of 1997 which prompted the Reserve Bank to lower the cost of central bank accommodation on 20 October 1997. After the introduction of the new operational procedures on 9 March 1998 the prime overdraft rate of banks was lowered again by one percentage point. With the sharp rises in the repurchase rate of the Reserve Bank in May and June 1998 and the concomitant compression of banks' operating margins, the prime overdraft rate was raised by two percentage points from the middle of June and by another two percentage points towards the end of that month. In July this rate was increased to 24,00 per cent.



The *predominant rate on mortgage loans* of banks closely followed the changes in the prime overdraft rate of banks and was lowered by one percentage point to 19 per cent in November 1997 and further to 18 per cent in March 1998. The tightening of money market conditions in May and June 1998 then caused a reversal in the downward movement of the mortgage rate when this rate was raised by two percentage points to 20 per cent from 1 July 1998. Against the backdrop of falling inflation, the *inflation-adjusted rate on mortgage loans* rose from 9,2 per cent in April 1997 to 12,2 per cent in June 1998.

The *predominant retail rate on twelve-month fixed deposits with banks* displayed a pattern similar to that of mortgage rates. After having remained unchanged at 14,50 per cent from November 1996, this rate was lowered to 13,50 per cent in November 1997 and further to 12,50 per cent in March 1998. When the turmoil erupted in the financial markets in May and June 1998, banks were compelled to raise the rates offered on twelve-month deposits by two percentage points in July 1998.

The cost of *wholesale funds* for banks, as represented by the rate on three-month negotiable certificates of deposits, was determined at a level about halfway between the rate on retail deposits (approximated by the rate on twelve-month fixed deposits) and the prime overdraft rate of banks in January 1997. During the ensuing period to September 1997 the cost of wholesale funds declined in sympathy with the general downward movement in market-determined interest rates, whereas retail deposit rates and bank lending rates remained unchanged. The banks' margin between their lending rates and the cost of wholesale funds accordingly widened, as is typical during periods when expectations of a reduction in Reserve Bank funding rates run high. This margin narrowed in the fourth quarter of 1997 when banks' lending rates were lowered by one percentage point in October. From then on, banks' operating margins at first widened until March 1998, but narrowed again as money market interest rates were pushed upwards by the turbulence in the markets from the middle of April 1998. Banks' margins were restored, however, when the prime overdraft rate was adjusted upwards in June and July. In the eighteen months to June 1998 an average margin of 4,2 percentage points was maintained between banks' lending rates and the rate on wholesale funds.

Other *interest rates* and *yields* generally displayed patterns similar to those described above. The *standard interest rate* applicable to loans granted by the State Revenue Fund was adjusted twelve times as it fluctuated from a high of 16,50 per cent in December 1996 to a low of 13,00 per cent in May 1998, before being raised to 13,75 per cent from 1 June 1998. The *maximum permissible finance charges rates*, as laid down in terms of the Usury Act, were last raised by one percentage point in March 1997. These rates are now fixed at 29 per cent in respect of money lending, credit and leasing transactions for amounts of more than R6 000 but less than R500 000 and 32 per cent for amounts up to R6 000.

Financial markets

Structural changes in the financial markets

The South African financial markets are more advanced than those of most other "emerging economies". Nevertheless, steps are continuously being taken to ensure that the country maintains a competitive advantage in the quality and sophistication of its financial infrastructural arrangements. These steps are aimed at:

- furthering the process of integration into the global financial network;
- modernising existing systems and procedures according to the standards specified by the advanced economies of the world;
- strengthening the regulatory and supervisory frameworks; and
- facilitating the introduction of new instruments and products.

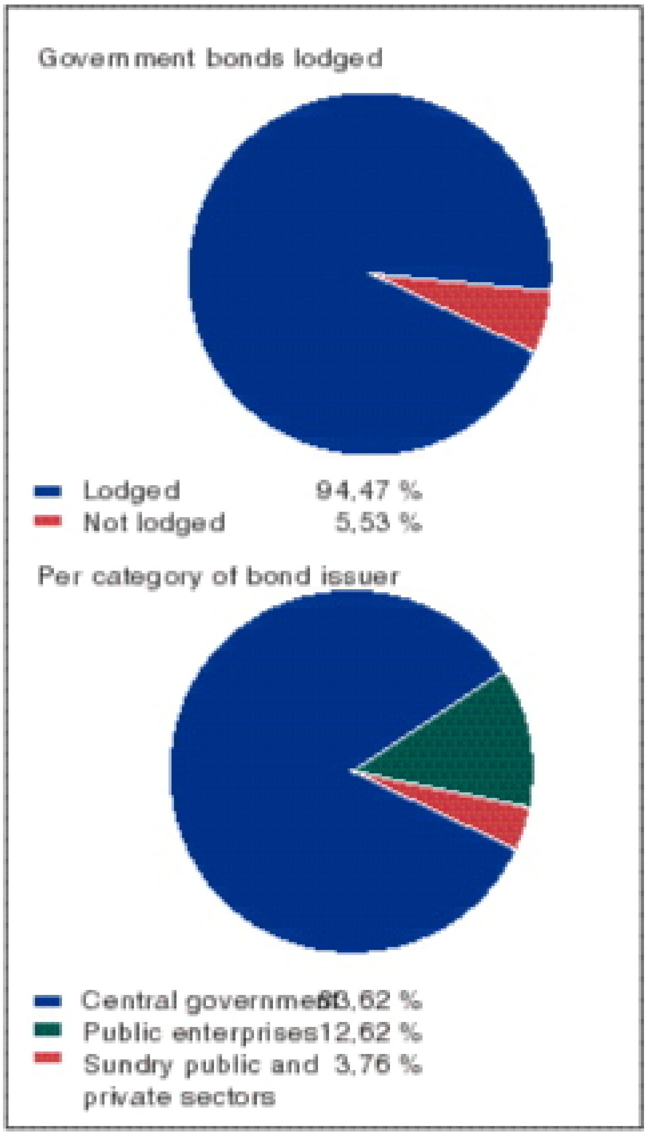
Important changes recently introduced to reinforce integration into the international financial network involved the further liberalisation of exchange control measures and an offer to the World Trade Organisation (WTO) regarding the liberalisation of trade in financial and other services. The offer to the WTO *inter alia* addressed access to the South African insurance, banking and other financial services markets and the equal treatment of domestic and foreign service providers. The member countries of the Southern African Development Community are also co-operating with one another to harmonise their financial infrastructural frameworks as a first step towards integrating the capital markets in the region.

The modernisation of the financial infrastructure was taken a step further with the introduction of the first phase of the South African Multiple Option Settlement system (SAMOS) on 9 March 1998. This system provides for end-of-day settlement in the national payment and clearing structures.

Modernisation of the financial markets is primarily focused on risk reduction through improving the clearing and settlement infrastructure. *The Johannesburg Stock Exchange* is currently developing an electronic settlement system which will replace weekly account settlement and a central security depository to enable the dematerialisation of equity certification. These systems changes will align South Africa with international best practice and conform to the G-30 recommendations for electronic settlement. A news service was introduced on 15 October 1997 to ensure that price-sensitive company information and announcements are disseminated to the market on a real-time basis. This step was aimed at curbing insider trading and improving communication between listed companies and the investor community.

The *Bond Exchange of South Africa* introduced a new settlement system on 17 November 1997 whereby transactions in bonds are settled within three days after concluding the transaction. This system conforms to the specifications of the G-30 recommendations for a low-risk clearing and settlement system. The Bond Exchange is also developing a risk management and margining system and is conducting research into the establishment of an automated bond-trading system.

Central Depository: June 1998



Rapid progress has been made with the immobilisation of security certification in the *Central Depository Limited,* which will eventually lead to full dematerialisation of certification. At the end of June 1998, 94 per cent of the domestic marketable government bonds had been lodged with the Central Depository. Of the total Central Depository holdings of bonds, government bonds comprised 84 per cent and the bonds of public-sector enterprises 13 per cent.

In the field of regulation and supervision an independent evaluation of the degree of compliance of the bank supervisory authority with the 25 core principles issued by the Basle Committee on Banking Supervision was commissioned by the Registrar of Banks. Deficiencies that were identified will be addressed, and improvements will be implemented once the necessary changes to legislation have been effected. The Commission of Enquiry into the Affairs of the Masterbond Group and Investor Protection in South Africa (generally known as the Nel Commission) highlighted certain weaknesses in the mechanisms for investor protection. Also receiving attention is the Final Report of the task group into Insider Trading Legislation, the framework for the regulation of investment service providers in the field of retail investment services and the Interim Report of an Inquiry into the Regulation and Supervision of Financial Conglomerates. The Bank Supervision Department of the Reserve Bank, in conjunction with the Financial Services Board, is working towards the supervision of conglomerates on a consolidated basis.

During 1997 and the first half of 1998 the introduction of *new financial instruments* broadened the variety of alternatives and aligned the financial product range in South Africa more closely with that of international financial markets. The new financial instruments originated mostly in the market for derivatives. *Foreign-exchange rand-dollar futures contracts* were introduced on the South African Futures Exchange (Safex) on 7 May 1997 and *equity options* contracts on 2 September. The *interest rate futures contracts* on Safex were expanded to include futures contracts and options on futures contracts for more government bonds in order to extend the coverage of the yield curve.

A formal *warrants market* was introduced on the Johannesburg Stock Exchange on 24 October 1997. Warrants are transferable instruments issued by independent issuers, mainly banks, in respect of the shares of listed companies. They give the warrant holder the right, but not the obligation, to buy or sell a fixed number of underlying shares in a listed company at a predetermined price on or before a specified date.

Consolidations in the gold-mining sector and the lack of liquidity in the financial and industrial equity-index futures contracts and options on equity-index futures contracts led to a review of the range of *equity-index derivatives*. After the Wheat Board was terminated in November 1997, wheat *commodity futures contracts* were introduced in November 1997. Options on white and yellow maize commodity futures were introduced on Safex in March 1998. Beef futures, however, were terminated by Safex in January 1998.

Money market

The Reserve Bank implemented new procedures on 9 March 1998 to regulate liquidity in the money market. With the new arrangements, the Reserve Bank changed its operational procedures from a virtually automatic accommodation of banks' liquidity needs, to a repurchase-based auction system whereby banks tender on a daily basis for a given amount of liquidity determined by the Reserve Bank.

Under the previous system of accommodation, the Reserve Bank managed liquidity largely by creating shortages in the money market through open market transactions in government securities, spot and forward foreign exchange transactions and the transfer of government balances between the Exchequer Account with the Reserve Bank and Tax and Loan Accounts with the private banks. The liquidity shortages so created were accommodated, unconditionally and automatically, through borrowing against collateral from the Reserve Bank at rates determined by the Bank.

Money market interest rates tended to be unresponsive to changes in the amount borrowed from the Reserve Bank. Hence, in the absence of changes in Bank rate, the impact of tighter liquidity conditions did not occur through a change in borrowing costs along the money market yield curve. Because of the rigidity of money market interest rates with respect to changes in liquidity conditions, the Reserve Bank experienced difficulties when attempting to signal its views on interest rates to market participants through variations in the liquidity shortage. This essentially left the Bank with a somewhat blunt policy instrument, i.e. officially announced changes in Bank rate and other official lending rates.

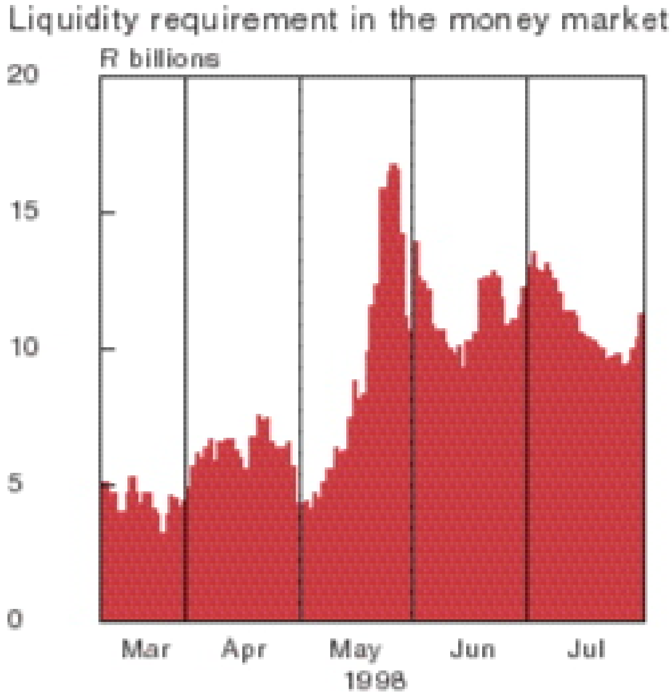
Under the new arrangements, the Reserve Bank provides liquidity to the money market through a daily auction where banks are allowed to tender for central bank funds through repurchase transactions. The Reserve Bank estimates the overall liquidity requirement of the market on a daily basis, allowing the Bank the opportunity to signal to the market its views on ruling interest rates by pre-announcing the extent to which it (the Bank) is prepared to meet the estimated liquidity requirement. The Reserve Bank also reserves the right to supply liquidity in the form of repurchase transactions at a fixed rate. The amount of liquidity provided at a fixed rate can also deviate from the estimated requirement for a specific day.

Another feature of the new money market operational procedures was the introduction of a marginal lending facility to provide liquidity needs in excess of that satisfied through the repurchase facility. Overnight loans or loans for a few days are provided to banks at a pre-announced marginal lending rate against the collateral of central government bonds, Treasury bills, Reserve Bank debentures and Land Bank bills. The marginal lending rate was initially intended to form an upper limit to the repurchase rate, but subsequently became linked to the repurchase rate with a pre-announced margin which is changed from time to time.

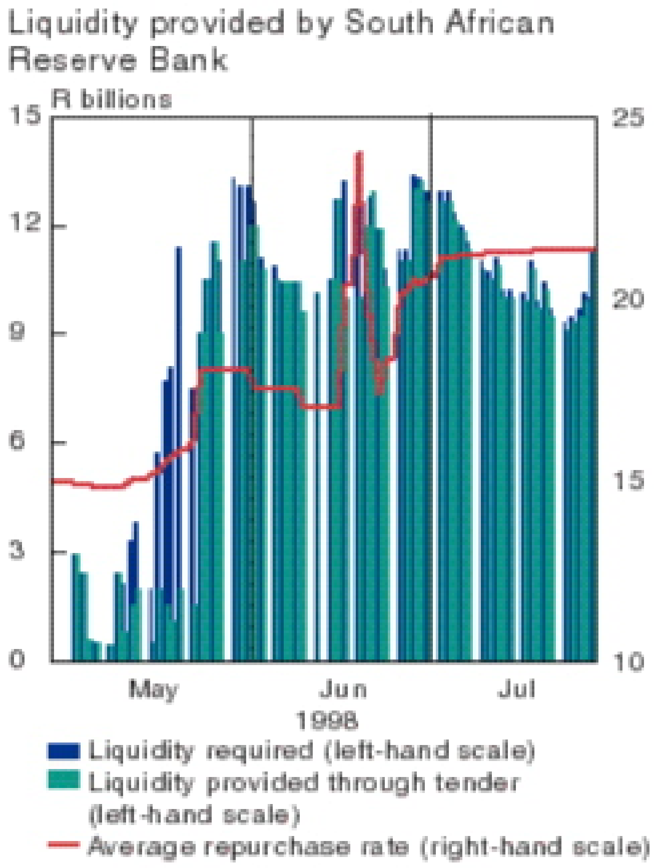
A new averaging procedure for calculating the minimum cash reserves that banks are required to maintain at the Reserve Bank, was introduced on 20 March 1998. Previously, banks were bound to maintain the required minimum cash reserves with the Reserve Bank on a daily basis. In terms of the new arrangements, banks are permitted to observe the cash reserve requirement on the basis of an average amount calculated over each maintenance period of approximately one month. This allows banks automatic recourse to their cash balances with the Reserve Bank on a daily basis, provided that the average level of reserves during the maintenance period equals or exceeds the minimum cash reserve requirement.

The minimum cash reserve requirement was also amended with effect from the maintenance period beginning on 23 April 1998. Previously the minimum cash reserve requirement for banks was a non-interest-bearing 2 per cent of the value of their *total* adjusted liabilities and an additional interest-bearing 1 per cent of their adjusted *short-term* liabilities. According to the new arrangements, only one reserve ratio of 2,5 per cent on total adjusted liabilities applies and no interest is earned on any part of the cash reserve balances.

Money market conditions tightened considerably during the last six months of 1997. This was reflected in the amount of accommodation which the Reserve Bank provided to the banks at month-ends, which increased, on balance, from R6,6 billion at the end of July 1997 to R10,2 billion at the end of December. The money market shortage, however, decreased sharply in the first four months of 1998 to R4,3 billion at the end of April, mainly due to a substantial increase, amounting to R4,8 billion, in the net foreign assets of the Reserve Bank. This was the result of sizeable surpluses on the overall balance of payments, which made the net foreign exchange reserves of the Reserve Bank increase appreciably. In May and June 1998 the Asian contagion resulted in speculative outflows of capital from South Africa, which led to a sharp decline in the net foreign assets of the Reserve Bank. The overall borrowing needs of the banks consequently increased to R10,7 billion at the end of May 1998 and R12,2 billion at the end of June.



The *Reserve Bank's operations* in the money market during most of the second half of 1997 and the first four months of 1998 were broadly neutral and directed at smoothing the changes in liquidity that were perceived to be temporary. The money market shortage was generally allowed to reflect the underlying supply of and demand for liquidity in the market. From the middle of April 1998, when strains began to surface in the foreign exchange market on account of the financial problems in other emerging market economies, the Reserve Bank acted to tighten monetary conditions by not providing in full the estimated liquidity requirements of the banks through the daily auction of repurchase contracts. Between 16 April and the end of that month, only about 76 per cent of the banks' estimated liquidity requirements were met through the repurchase-based auction system. In May 1998 the relatively tight monetary policy posture was also evident from the temporary suspension of the daily variable-rate auction system and the fixing of the repurchase rate by the Bank at a high level, and in the provision of about 60 per cent of the banks' estimated daily liquidity requirements through the repurchase facility. The Bank on occasion provided more than the estimated daily liquidity requirements of the banks during June 1998, but the overall policy posture remained biased towards tight monetary conditions and about 93 per cent of the estimated liquidity requirement was satisfied through the repurchase facility during that month and 98 per cent in July.

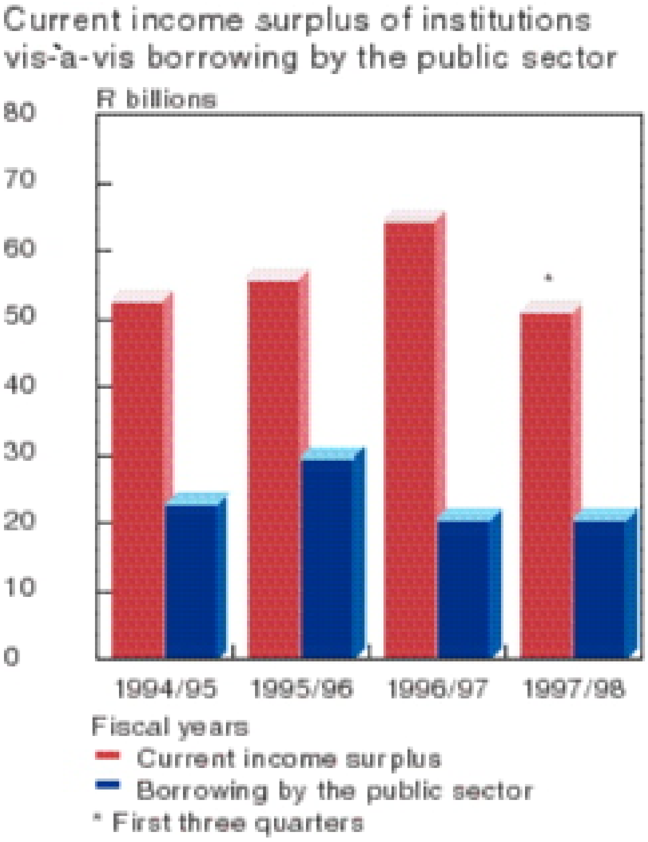


The tightening of monetary conditions during May and June 1998 often forced the banks to access the marginal lending facility at severely penal rates. At its highest, access to the marginal lending facility amounted to R7,3 billion on 22 May 1998 when this amount was accommodated at a rate of 18,80 per cent. During June 1998, the marginal lending rate once rose to 44 per cent when an amount of R1,5 billion had to be borrowed under this facility.

Bond market

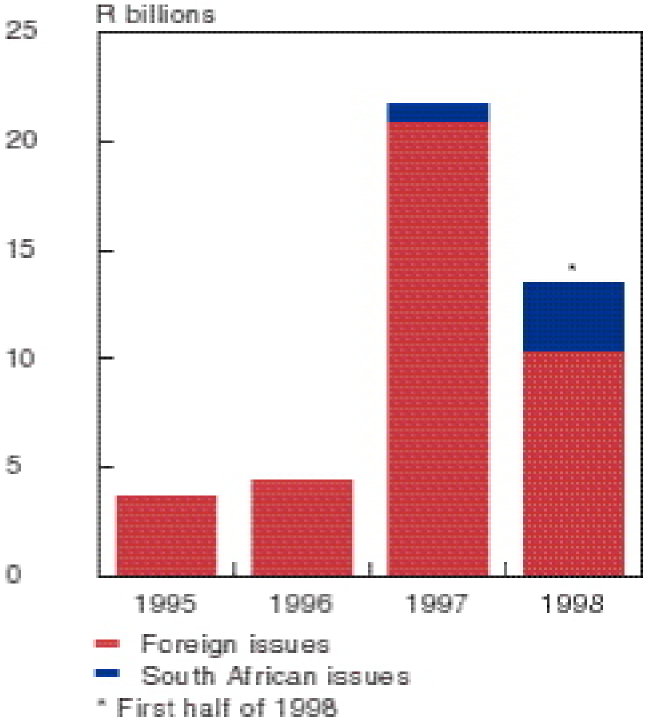
Central government and other public-sector borrowers dominated activity in the *domestic primary bond market* in fiscal 1997/98. By contrast, *private-sector borrowers* showed little interest in raising capital in the primary bond market. The value of rights issues of *fixed-interest securities* by private-sector companies actually fell from R2,2 billion in 1996 to only R32,8 million in the eighteen-month period from the beginning of 1997 to the middle of 1998. The private sector's lack of enthusiasm for debt financing could be attributed not only to the slowdown in fixed-investment spending from the high growth rates attained in 1996, but also to the high cost of bond financing relative to prospective returns which impelled companies to satisfy their financing needs elsewhere.

Net issues of fixed-interest securities in the domestic primary bond market by public-sector borrowers declined by almost a third from R29,5 billion in fiscal 1995/96 to R20,4 billion in each of fiscal 1996/97 and 1997/98, i.e. years to 31 March. The recent declines in the public sector's borrowing needs occurred despite a general decline in borrowing costs from January 1997 to mid-April 1998 and reflected, among others, the strong commitment of the national government to reducing its demands on the scare domestic savings resources. Government bonds with a nominal value of R8,4 billion were auctioned and allotted in the first three months of fiscal 1998/99, compared with issues of R8,6 billion in the corresponding period of fiscal 1997/98. As a percentage of gross domestic product this implied a decline from 5,9 per cent in April-June 1997 to 5,3 per cent in April-June 1998.

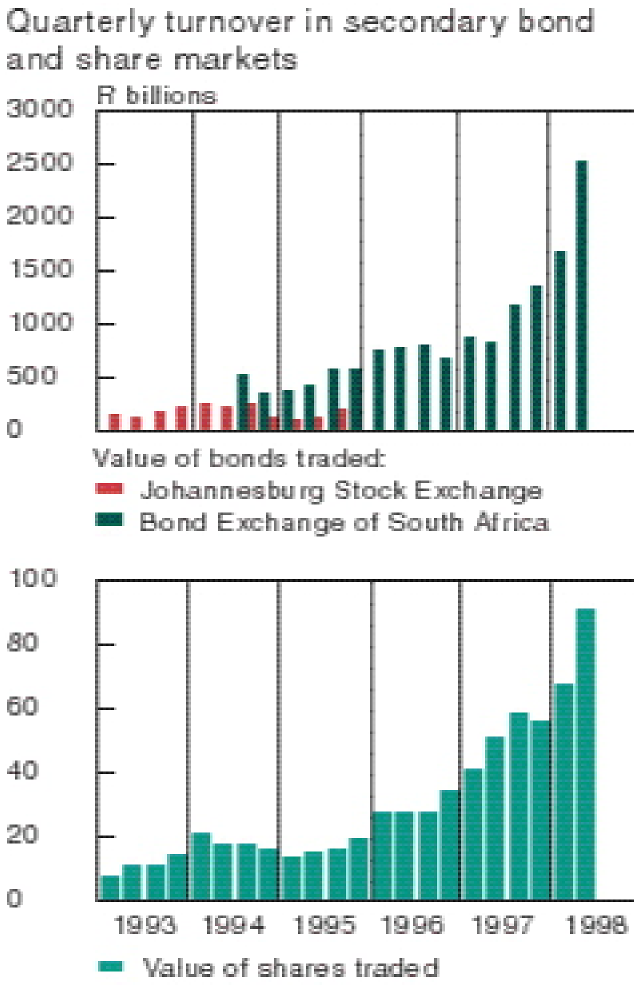


The aggregated domestic *current income surplus of long-term insurers* and *pension funds* and the net sales of units by *unit trusts* continued to exceed the financing needs of public-sector bodies by a significant margin. Furthermore, the domestic supply of investible funds was augmented by the issuance of foreign-currency and rand-denominated bonds in *international financial markets*. Government was the sole issuer of foreign-currency denominated bonds in 1997 - an amount of R3,8 billion having been raised in this manner in June 1997. Other domestic borrowers avoided foreign-currency denominated funding, presumably because of uncertainties about the future behaviour of the exchange rate of the rand. Instead, major parastatals (Eskom, Transnet and the Development Bank of Southern Africa) issued rand-denominated bonds in the eurobond market to the amount of R4,0 billion in the period from April 1997 to June 1998. These issues have long maturities, falling mostly in the range of thirty years and beyond, and were well received by retail investors in Europe.

Proceeds of eurorand bonds issued by foreign and domestic borrowers

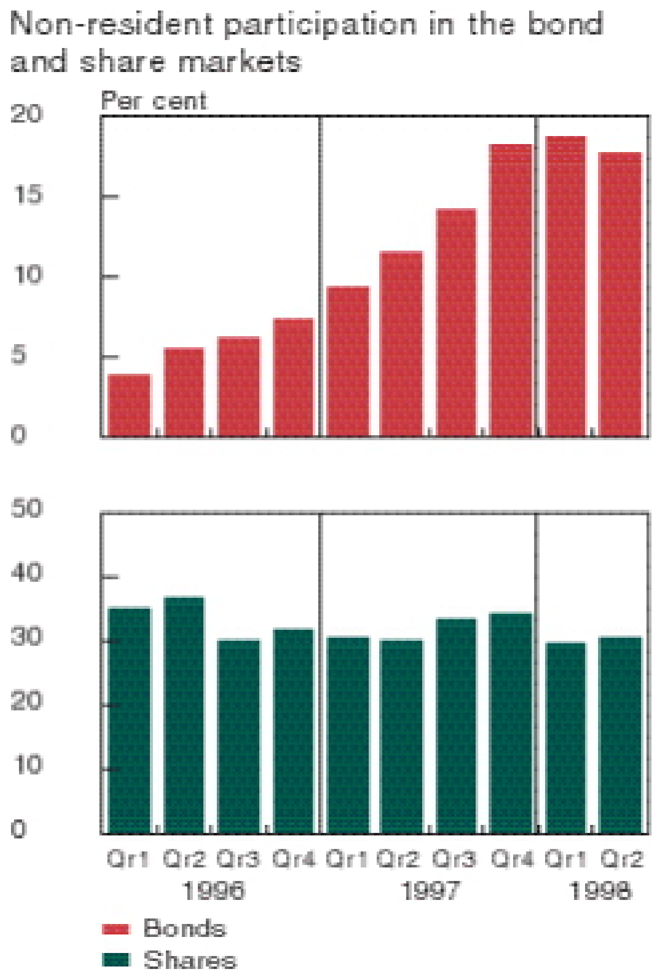


The value of bonds traded on the *Bond Exchange of South Africa* amounted to R4,2 trillion in the first six months of 1998 compared with R4,3 trillion in 1997 as a whole. From the second half of 1997 turnover in the secondary bond market was bolstered by the general downward movement of yields on long-term bonds which persisted despite recurrent bouts of Asian contagion and temporary declines in bond prices. Rising turnovers were also reflected in the annualised liquidity ratio (measured as the value of bonds traded relative to the value of bonds listed on the Bond Exchange) which rose from 9,9 in April 1997 to 32,7 in June 1998. *Purchases through repurchase transactions* gained in popularity and as a percentage of total purchases increased from 47 per cent in the first quarter of 1997 to 67 per cent in the first quarter of 1998, before subsiding to a still comparatively high level of 56 per cent in the second quarter. Apart from repurchase transactions, hedging of eurorand bond issues and non-resident transactions also contributed materially to increased turnover in the secondary bond market.



Bonds in the domestic bond market are frequently purchased outright as the hedge counterpart of *eurorand bond issues*. In the longer run the net proceeds of rand- denominated bonds issued by non-resident entities in the eurorand market recently tended to correspond closely with net purchases of bonds by non-residents in the domestic bond market. Non-residents' net purchases of bonds and net proceeds of eurorand bond issues amounted to aggregate amounts of approximately R24 billion and R33 billion in the period from September 1995 to July 1998 respectively.

Non-resident purchases and sales of bonds in the domestic secondary bond market as a percentage of total purchases and sales of bonds increased from 3,9 per cent in the first quarter of 1996 to an average of 18,2 per cent in the three quarters starting in the fourth quarter of 1997. Attractive yields in the domestic bond market and hedging-related transactions were the main forces behind non-resident bond purchases - on a net basis, non-residents bought bonds to the value of R14,8 billion in 1997 and R9,3 billion in the first half of 1998 alone. At times, especially when the Asian markets were in turmoil and the rand was perceived to be vulnerable, non-residents became net sellers of bonds. This happened in October 1997 when non-residents reduced their holdings of South African bonds by R5,2 billion and again in May, June and July 1998 when the value of net sales amounted to R12 billion. Non-resident interest in the domestic secondary bond market was also reflected in the rise in the nominal value of offshore transactions between non-residents, from R54 billion in the third quarter of 1996 to R608 billion in the second quarter of 1998.

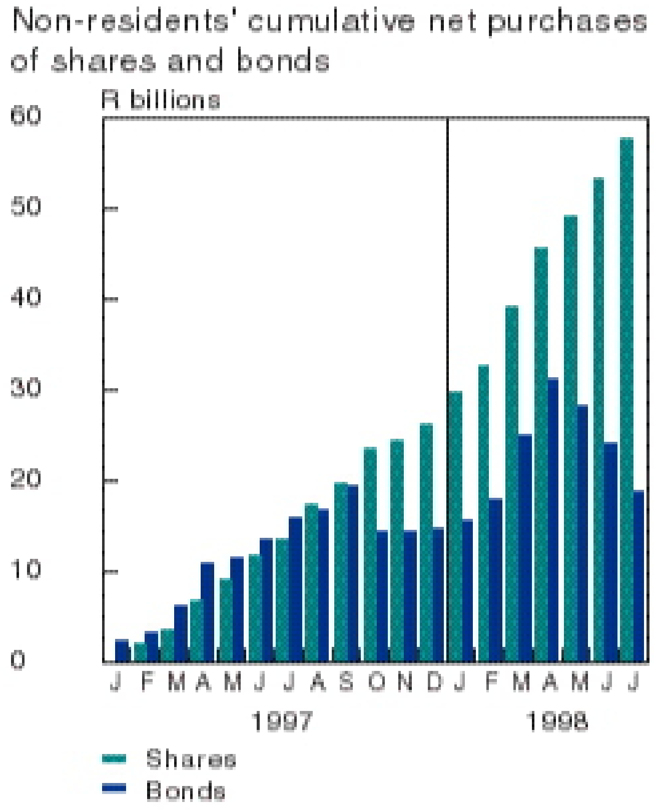


Share market

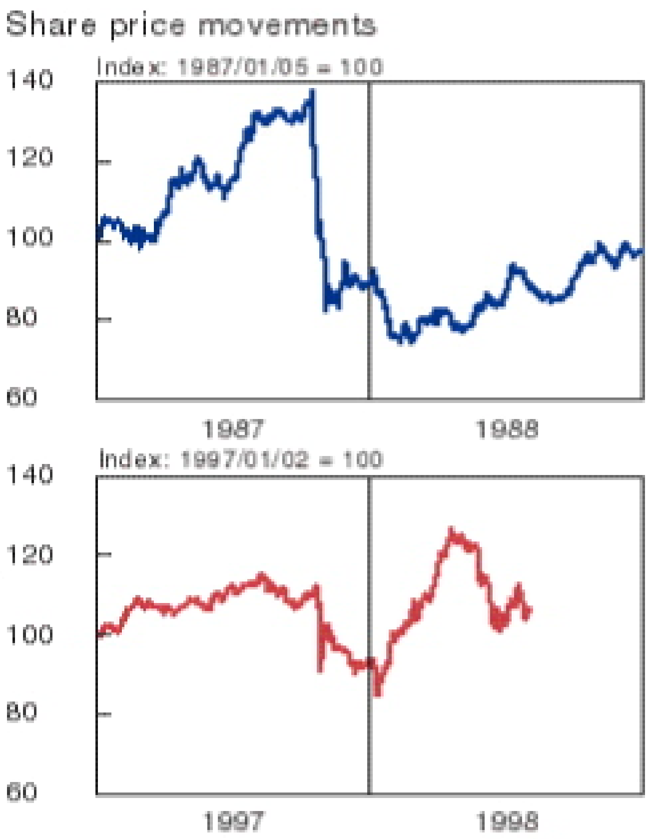
Private-sector companies increasingly turned to the *primary share market* as a major source of finance in 1997 and the first half of 1998. *New listings* rose from 28 in 1996 to 54 in 1997 and amounted to 31 in the first six months of 1998. Capital raised in the *primary share market* by companies listed on the Johannesburg Stock Exchange increased from R26,4 billion in 1996 to R50,3 billion in 1997 and reached R29,6 billion in the first half of 1998 (compared with R20 billion in the first half of 1997).

Lively trading conditions have prevailed in the *secondary share market* since 1996 and the value of shares traded increased from R117 billion in that year to R207 billion in 1997, and from R92 billion in the first half of 1997 to R159 billion in the first half of 1998. On account of this, share market liquidity (expressed as the annualised value of shares traded as a percentage of total market capitalisation at the end of the period) rose from 10,4 per cent in December 1996 to 18,3 per cent in December 1997 and 28 per cent in June 1998.

Non-resident investors traded actively in the secondary share market and the value of their purchases and sales of shares broadly kept pace with the growth in total turnover on the Johannesburg Stock Exchange. The high level of non-resident participation occurred in spite of the weakening of the rand over the past eighteen months, which eroded the foreign-currency prices of listed shares, and led to the weaker performance of domestic share prices relative to price movements in other major share markets. The value of *net purchases of shares by non-residents* increased from R5,2 billion in 1996 to R26,2 billion in 1997 and amounted to R26,9 billion in the first half of 1998 alone. As a consequence, the cumulative net purchases of shares by non-residents exceeded their net buying of bonds by an amount of R39 billion in the nineteen months to July 1998. Part of these inward investments in the domestic securities markets was related to asset swap transactions which, by symmetry, also involved an outward investment by a South African institutional investor.



Share-price movements followed a relatively flat trajectory during most of 1996 and in the first four months of 1997. The *average monthly price level of all classes of shares* consequently rose by only 1,9 per cent from February 1996 to April 1997. Since then, share-price movements have become much more volatile as forces external to the South African economy began having a disproportionate influence on the price determination of listed shares: the average monthly level of share prices at first increased by 6,7 per cent to a then all-time high in August 1997, declined by 16,5 per cent from August to December 1997, rose again by 32,3 per cent to a new all-time high in May 1998 and fell by 11 per cent in June. Nevertheless, viewed over the period from October 1997 to June 1998 the current volatility in share prices does not have nearly the same magnitude as the sharp decline of October 1987.



The share prices of *banks and insurers* increased in value by 67 per cent from February 1997 to June 1998, thereby imparting a general upward bias to the all-share price index. By contrast, the monthly average price of gold-mining shares fell, on balance, by 40 per cent over the same period. Between these two extreme price movements, the all-share price index increased on an average monthly basis by 5 per cent from February 1997 to June 1998.

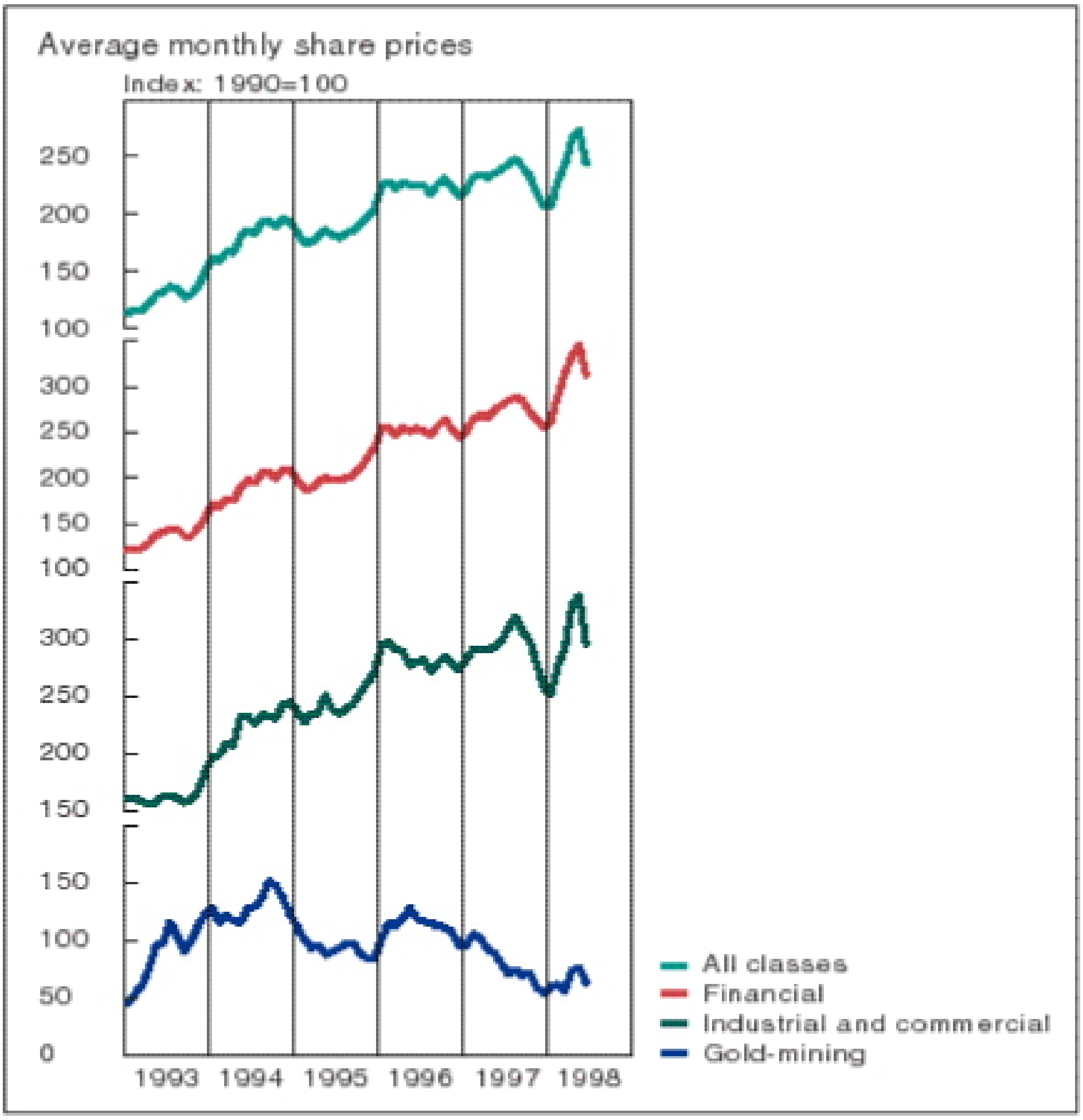


Table 19. Non-resident participation in South Africa's financial markets

Per cent

		Secondary bond market*	Secondary share market*	Market for derivatives**
1996:	1st qr	3,9	35,1	7,0
	2nd qr	5,6	36,5	7,1
	3rd qr	6,2	30,1	8,2
	4th qr	7,4	31,7	12,9
1997:	1st qr	9,3	30,4	17,7
	2nd qr	11,6	30,1	25,6

	3rd qr	14,3	33,4	25,5
	4th qr	18,3	33,9	27,7
1998:	1st qr	18,7	29,7	27,4
	2nd qr	17,7	30,4	25,7
*	Measured as gross transactions by non-residents as percentage of total turnover in the respective markets			
**	Measured as non-resident open interest as percentage of total open interest			

Mirroring the general trend in share prices, the average monthly *dividend yield* on all classes of shares and the *earnings yield* (for non-gold-mining shares) followed a flat trajectory in the first nine months of 1997, increased sharply in the last three months of the year, and then declined even more markedly in the first five months of 1998. The average dividend yield was 2,4 per cent in the first nine months of 1997, but rose to 2,7 per cent in December before falling to 2,1 per cent in May 1998. The earnings yield increased from an average of 6,7 per cent in the first nine months of 1997 to 7,6 per cent in January 1998, but then declined to 5,9 per cent in May.

The *price-earnings ratio* of all classes of non-gold-mining shares, after having fluctuated between 14,3 and 15,2 from December 1996 to July 1997, reversed its gentle upward-sloping trend and declined to 13,1 in January 1998 as earnings strengthened and share prices weakened. The sharp rise in share prices from January 1998 then took the price-earnings ratio to 16,9 in May. The direction of the price-earnings ratio, dividend yield and earnings yield observed during the first five months of 1998, changed course abruptly in June 1998 when non-resident investor sentiment towards the South African share market became less positive.

Market for derivatives

The high level of activity and price volatility in the underlying securities markets and the heightened uncertainties about future price movements ensured a high level of activity in the *formal market for derivatives*. The market also became more integrated into the global financial network as is evident from the sharply rising non-resident participation. Measured as a percentage of open interest, participation by non-residents increased from an average of 7,4 per cent in the first three quarters of 1996 to an average of 26,9 per cent in the three quarters up to the second quarter of 1998.

The combined number of trades in *futures contracts and options on futures contracts* rose from 9,3 million contracts in 1996 to 11,6 million contracts in 1997, whereas 8,4 million contracts were concluded in the first half of 1998 alone. This segment of the market was dominated by equity index futures contracts and options on equity index futures contracts which constituted more than 99 per cent of overall trading activity. Market trends further indicated a growing preference for trading in options on equity index futures contracts at the expense of trading in equity index futures contracts.

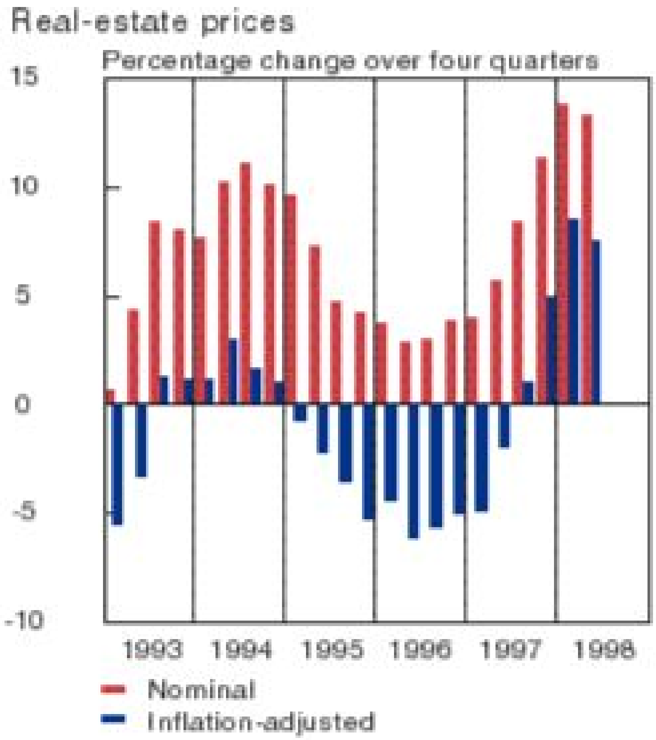
From their inception in September 1997 to the end of December, the average monthly number of *company equity options* traded totalled 18 840; then the number declined slightly to an average monthly total of 18 470 contracts in the first six months of 1998. By contrast, the number of trades conducted in *warrants*, a complementary product to equity options which was introduced in October 1997, increased from 39,7 million in the last three months of 1997 to 541,6 million in the first half of 1998. It seems that warrants are rapidly growing in popularity and that investor interest in equity options contracts has waned in the first six months of 1998.

Total trades in white and yellow *maize commodity futures* contracts increased from 2 704 contracts in 1996 to 20 338 in 1997 and from 4 987 in the first half of 1997 to 13 033 in the first half of 1998. Commodity futures contracts for wheat were only introduced in November 1997; 157 contracts were traded in the last two months of 1997 and 205 in the first six months of 1998. Options on commodity futures were introduced in March 1998 and 1 143 maize options were traded up to the end of June. The rapid growth in the market for commodity futures contracts and options on commodity futures contracts can be attributed to the termination of the centralised or single-channel marketing arrangements for agricultural commodities, the opportunities that this market presents for speculative activity and a growing awareness of the processes and procedures of this market.

Real-estate market

The high cost of mortgage finance, relatively subdued and declining economic growth and the high incidence of violent crime were, likely, the main factors behind the rather lacklustre performance of the real-estate market over the past two and a half years. The *value of real-estate transactions* increased moderately by 9,5 per cent in 1996 and 7,6 per cent in 1997, but then the average monthly value of real-estate transactions in the first five months of 1998 fell below the average monthly value recorded in 1997 as a whole.

The rate of increase in the number of real-estate transactions also slowed down from 6,4 per cent in 1996 to 2,7 per cent in 1997. The average value per transaction in the real-estate market consequently rose by less than the increase in the consumer-price index of 1996 and 1997. Notwithstanding the implicit year-to-year decline in the relative price of real estate, the rate of change over four quarters in the relative price of real estate turned positive in the third quarter of 1997 for the first time since the fourth quarter of 1994. Year-on-year increases in the relative price of real estate were then sustained in the first half of 1998 as consumer-price inflation over one year continued to subside.



The unattractiveness of real estate as an investment opportunity was also reflected in the movements of the prices of real-estate companies listed on the Johannesburg Stock Exchange. During the period March 1997 to June 1998 the value of the price index for the real-estate section of the Exchange fell by 14 per cent. Over the same period the consumer-price index rose by 6,7 per cent, implying an annualised decline of 4,1 per cent in the relative price of real-estate shares.

Public finance

Fiscal policy

In presenting his Budget to Parliament on 11 March 1998, the Minister of Finance emphasised that the *Reconstruction and Development Programme* (RDP) was the policy framework within which government pursued its objectives. The RDP embodies government's commitment to eliminating poverty and reducing inequalities in a rapidly growing economy in which fiscal policy supports economic growth. Government's fiscal policy was guided by three broad principles, namely:

- revenue raising, spending and borrowing must be consistent with increasing economic growth, maximising social development and eliminating the inequalities of the past;
- the allocation of expenditure across different parts of government must match the distribution of functions and their relative priorities; and
- each sphere of government must use resources in a manner which minimises costs, maximises delivery and avoids the duplication of services which the private sector can provide at a lower cost.

In order to attain these aims, government implemented the *Growth, Employment and Redistribution* (GEAR) strategy with the following objectives:

- To cut the overall budget deficit to 3,5 per cent of gross domestic product in fiscal 1998/99 and further to 3 per cent in fiscal 1999/2000;
- to eliminate government dissaving by fiscal 1999/2000;
- to avoid permanent increases in the overall tax burden beyond a ratio of 25 per cent of gross domestic product;
- to reduce consumption expenditure by general government to about 18 per cent of gross domestic product in the year 2000; and
- to strengthen the public sector's contribution to gross domestic fixed investment by increasing the real investment by general government and public corporations on average by between 2 per cent and 3 per cent per year.

In his speech the Minister indicated that the *Budget* for fiscal 1998/99 was the first to be compiled under the new Constitution and that it gave effect to the new framework of relations between national, provincial and local governments. The Minister also stated that the Budget reflected short-term and long-term objectives. To this end, a three-year *Medium Term Expenditure Framework* (MTEF) was designed to give effect to the policy objectives enunciated in previous policy documents. Some of the key objectives contained in the MTEF are to:

- adhere to the principles of sound public finances;
- reduce the share of debt service costs in total government expenditure in order to release resources for re-allocation to social-service delivery;
- improve domestic saving;
- ensure a fiscal policy position that is generally supportive of an overall counter-inflationary policy; and
- support an export-friendly trade and industrial strategy.

The publication of the Medium Term Budget Policy Statement 1997 and that of the first three-year budget projections, had a number of important advantages, namely:

- government departments and agencies were encouraged to evaluate their policy proposals

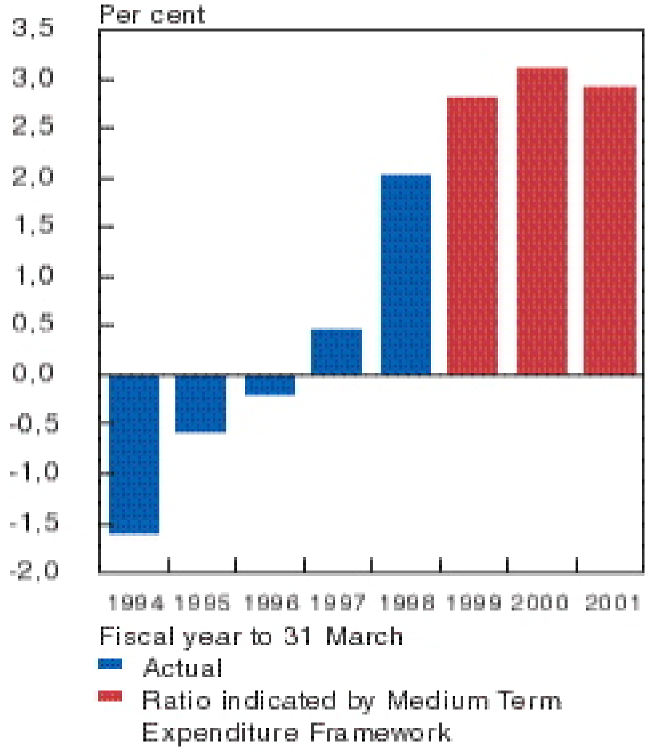
continuously within realistic budget projections;
- medium-term planning by departments and agencies was emphasised, in this way improving the efficiency of public-service delivery;
- the management of expenditure roll-overs from year to year was placed on a sound footing;
- a framework was created within which government could assess the financial implications of policy proposals; and
- the credibility of fiscal policy targets was strengthened.

As part of the implementation of *GEAR* and *the protocol on corporate governance of all state entities*, government continued during fiscal 1997/98 with its programme of asset restructuring that could lead to changes in the ownership of state entities. During fiscal 1997/98 government was successful in the partial privatisation of Telkom, and the full privatisation of six radio stations and Sun Air. In April 1998 an Italian company obtained an equity stake of 20 per cent in the Airports Company of South Africa.

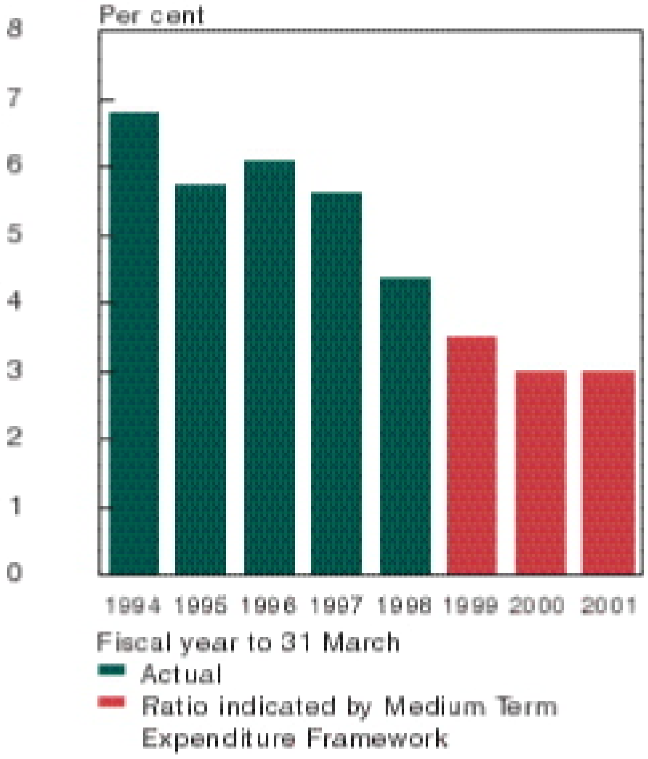
Taking the GEAR objectives into consideration, the Budget for fiscal 1998/99 provided for a *national government deficit* equivalent to 3,5 per cent of the expected gross domestic product. This deficit target of 3,5 per cent of gross domestic product represented a sharp decline in this ratio, as the actual outcome of the deficit for fiscal 1997/98 amounted to 4,4 per cent of gross domestic product. At the level of the *consolidated national government* (i.e. a consolidation of the finances of the national and provincial governments) the deficit was expected to decline even sharper from 5,0 per cent of gross domestic product in fiscal 1997/98 to 3,5 per cent in fiscal 1998/99 as provincial governments were expected to balance their accounts in fiscal 1998/99. The prudent fiscal policy stance of government is clearly illustrated in the accompanying graph by the overall deficit and also the so-called "primary" balance [(2)] of the national government, expressed as percentages of gross domestic product.

Both these balances have changed significantly from fiscal 1993/94. The overall *deficit* decreased from 8,5 per cent of gross domestic product in fiscal 1992/93 to 4,4 per cent in fiscal 1997/98, whereas the primary balance changed from a deficit of 3,7 per cent of gross domestic product in fiscal 1992/93 to a *surplus* of 2,1 per cent in fiscal 1997/98 and is budgeted to improve to 2,8 per cent of gross domestic product in fiscal 1998/99 and 2,9 per cent in fiscal 2000/01.

Primary balance as a ratio of gross domestic product



Deficit before borrowing as a ratio of gross domestic product

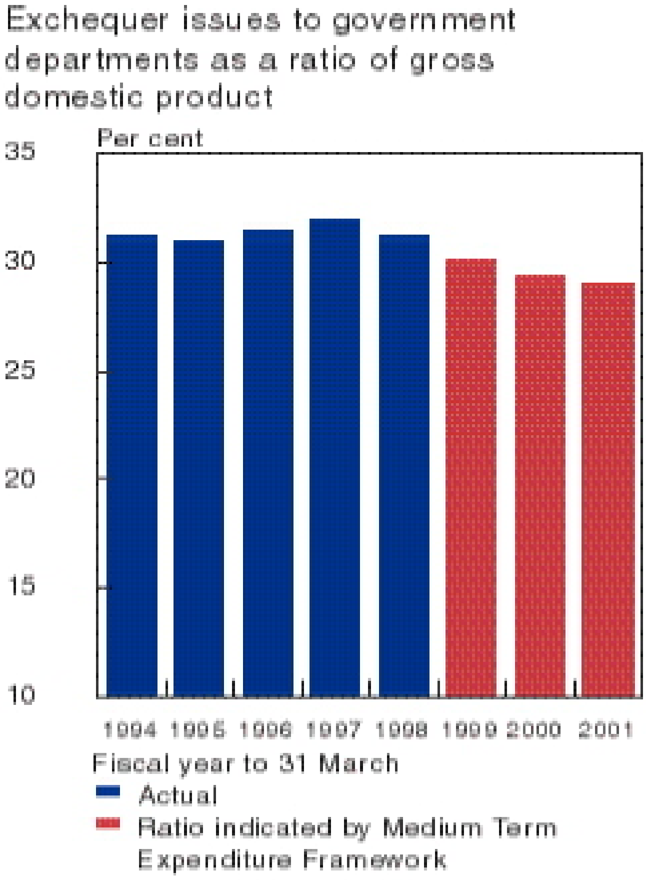


Government expenditure

Total expenditure (excluding net lending and extraordinary transfers) by the national government in fiscal 1997/98 amounted to R189,7 billion, which was 7,0 per cent higher than in fiscal 1996/97. Although the growth in government expenditure in fiscal 1997/98 was higher than the budgeted rate of increase of 6,1 per cent, it was considerably lower than the average rate of increase of 12,0 per cent recorded in the four years since June 1993.

The increase in total expenditure in fiscal 1997/98 was, in part, the result of an increase of 7,0 per cent in current expenditure compared with the level of this expenditure in fiscal 1996/97. A factor contributing to the rise in current expenditure was the increase of 15,6 per cent in interest payments in fiscal 1997/98, which followed an increase of 14,6 per cent in fiscal 1996/97. Expenditure on goods and services (including salaries and wages) increased by only 2,6 per cent in fiscal 1997/98.

Total government expenditure was estimated to increase to R201,3 billion in fiscal 1998/99 or by 6,1 per cent over actual expenditure in fiscal 1997/98. Further increases of 7,2 per cent in fiscal 1999/2000 and 9,0 per cent in fiscal 2000/01 were indicated by the MTEF. These were expected to lead to a slight decline in the ratio of government expenditure to gross domestic product from 31,2 per cent in fiscal 1997/98 to 29,0 per cent in fiscal 2000/01, giving credence to government's objective of reducing its share of total domestic spending.



Capital expenditure by government was projected to increase by 4,0 per cent in 1998/99, which is unlikely to increase the ratio of government capital formation to gross domestic product. This development appeared to be at variance with the stated objective of the GEAR strategy of an expansionary infrastructure programme for addressing service deficiencies and backlogs. However, it should be noted that public-private partnership projects and programmes of parastatals are increasingly replacing the direct spending on infrastructure in the Budget. The ratio of interest payments to total expenditure was expected to increase to 21,0 per cent in fiscal 1998/99 from 20,3 per cent in fiscal 1997/98; earlier expectations were that the interest-to-expenditure ratio would peak in 1998/99 and then subside in the ensuing years. The shift projected in government expenditure from general, economic and protection services to expenditure on social services at the level of the *consolidated national government* (i.e. the consolidated expenditure of the national and provincial governments) is indicated in Table 20.

Table 20. Functional classification of consolidated national government expenditure

Per cent of total expenditure

	1997/ 1998	1998/ 1999	1999/ 2000	2000/ 2001
General government services and unallocatable expenditure	7,6	4,9	6,3	7,8
Protection services	15,6	16,1	16,0	15,8
Defence	5,6	5,3	5,3	5,1
Police	6,9	6,9	6,9	6,7
Prisons	2,0	2,6	2,7	2,7
Court of law	1,0	1,2	1,2	1,3
Social services	46,6	49,8	48,7	47,8
Education	21,2	22,8	22,4	21,8
Health	10,6	12,2	12,0	11,7
Social security and welfare	9,7	9,6	9,4	9,3
Housing	2,2	1,9	2,0	1,8
Other	2,9	3,2	3,0	3,1
Economic services	10,0	8,3	8,4	8,6
Interest	20,3	21,0	20,6	20,1

Government revenue

Government revenue in fiscal 1997/98 amounted to R163,1 billion, an increase of 11,7 per cent over fiscal 1996/97. As a percentage of gross domestic product, government revenue amounted to 26,9 per cent in fiscal 1997/98 compared with 26,3 per cent recorded in fiscal 1996/97. This can be attributed to a sharp increase in the number of registered taxpayers and new registrations, as well as a general improvement in the revenue-collecting efficiency of the South African Revenue Service. Owing to the increase in government revenue, government was able to finance 86,0 per cent of its expenditure by means of tax and non-tax revenue. This was the highest level of own financing since fiscal 1990/91.

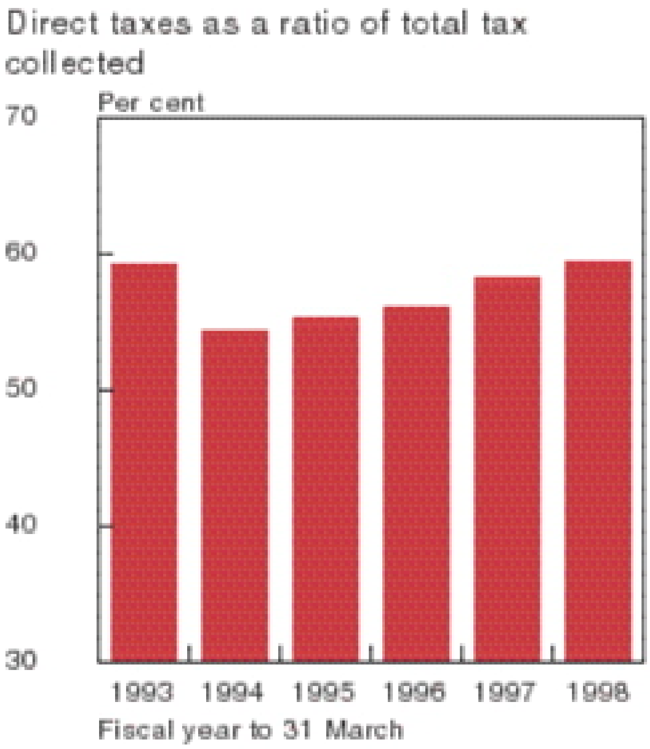
An analysis of changes in tax revenue according to type of tax shows that the rise in tax revenue over the past five fiscal years was mainly due to sharp increases in taxes on net income and profit. The growth in receipts from domestic taxes on goods and services fluctuated in accordance with the ebb and flow of the growth in private consumption expenditure. Taxes on international trade and transactions decreased sharply in fiscal 1997/98 because of the accelerated implementation of tariff reductions agreed to in the Final Act of the Uruguay Round of trade negotiations.

Table 21. Rate of increase in tax revenue according to type of tax

Per cent

Type of taxation	**1993/1994**	**1994/1995**	**1995/1996**	**1996/1997**	**1997/1998**	**Contribution to total tax revenue 1997/98**
Taxes on net income and profits	6,6	23,0	14,4	21,2	15,3	59,4
Taxes on property	22,9	32,3	11,0	3,7	1,0	1,7
Domestic taxes on goods and services	31,9	8,2	15,3	9,5	14,2	37,7
Taxes on international trade and transactions	22,5	5,5	12,8	6,2	-82,3	0,3
Other taxes	12,9	20,0	54,9	-23,3	22,7	0,9
Total tax revenue	**16,7**	**16,5**	**15,0**	**15,4**	**12,9**	**100,0**

Taxes on net income and profits remained the main source of revenue for government, contributing 59,4 per cent of tax revenue in fiscal 1997/98. Tax receipts from individuals accounted for no less than 68,7 per cent of the total receipts from taxes on income and profits in fiscal 1997/98. As indicated in the accompanying graph, direct taxes constituted a growing portion of total tax revenue, increasing from a level of 54,3 per cent in fiscal 1993/94 to 59,5 per cent in fiscal 1997/98.



Total government revenue (excluding extraordinary revenue) was estimated to increase to R177,6 billion or by 8,9 per cent in fiscal 1998/99, by a further 8,9 per cent in fiscal 1999/2000 and 8,8 per cent in fiscal 2000/01. These increases were expected to lead to a decline in the ratio of revenue to gross domestic product from 26,9 per cent in fiscal 1997/98 to 25,9 per cent in fiscal 2000/01.

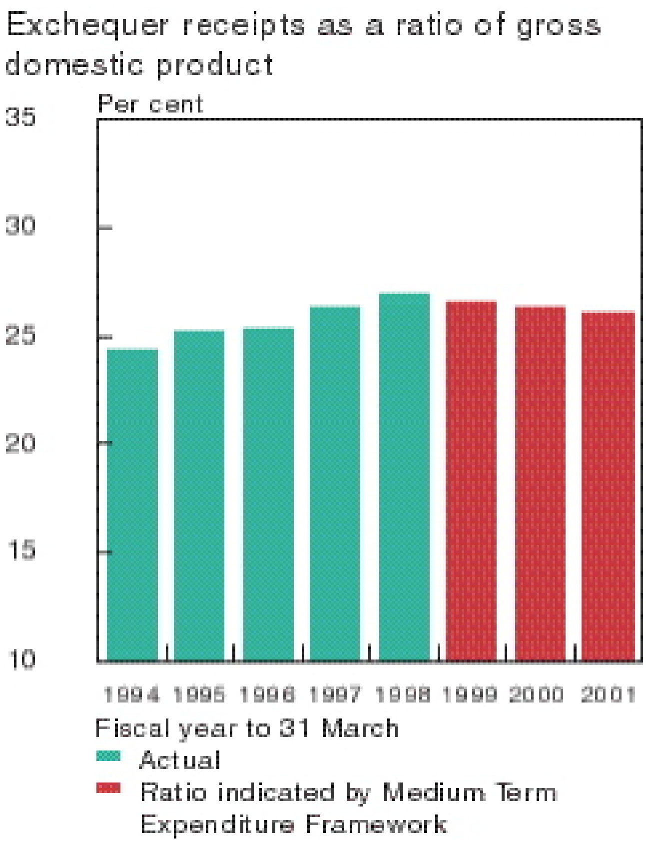
Table 22. Government revenue

Sources of	**1997/98** **R millions**	**1998/99 Budget** **R millions**	**% change revenue** **1997/98 to 1998/99**
Total customs and excise	**20 505**	**24 493**	**19,4**
Fuel levy	12 088	14 409	19,2
Customs and other excise	8 417	10 084	19,8
Total inland revenue	**142 622**	**153 107**	**7,4**
Income tax	95 023	100 450	5,7
Value-added tax	40 091	43 444	8,4

Other inland revenue	7 509	9 213	22,7
Total income	**163 127**	**177 600**	**8,9**

Specific tax adjustments and other measures were announced to spread the tax burden more equitably and raise additional revenue amounting to R3,3 billion in fiscal 1998/99. These included the following:

- A reduction in the number of income brackets for individuals and a reduction of the marginal tax rate applicable to taxpayers in the lower-income categories;
- the introduction of additional measures to eliminate that tax avoidance which occurs through aggressive structuring of salary packages;
- measures dealing with the tax treatment of trusts;
- an increase in the tax rate applicable to the interest and rental income of retirement funds;
- the exclusion of liquor and tobacco products from the existing export incentive scheme;
- an increase in the fuel levy;
- more uniform *ad valorem* duties; and
- changes to selected customs and excise duties.



Government also created the Umsobomvu Fund, which will be financed by means of a one-off levy of 2,5 per cent on the free reserves of mutual insurers who have decided to restructure themselves as companies. This Fund is intended to be a vehicle for financing development and job creation.

Borrowing requirement

Since the national government's current expenditure exceeded its current revenue by 11,9 per cent in fiscal 1997/98, government had to borrow R19,4 billion, equivalent to 3,2 per cent of gross domestic product, to finance its current expenditure. This, nevertheless, represented a smaller *dissaving* by the national government compared with the level of dissaving in fiscal 1996/97 - dissaving was reduced by R5,0 billion in fiscal 1997/98. Government's stated objective is to eliminate the general government's dissaving by the year 1999/2000.

Capital outlays amounted to R7,2 billion in 1997/98, taking the total deficit to be financed by means of loans and other non-recurrent revenue to R26,5 billion, equal to 4,4 per cent of the gross domestic product. The financing of this deficit is shown in Table 23.

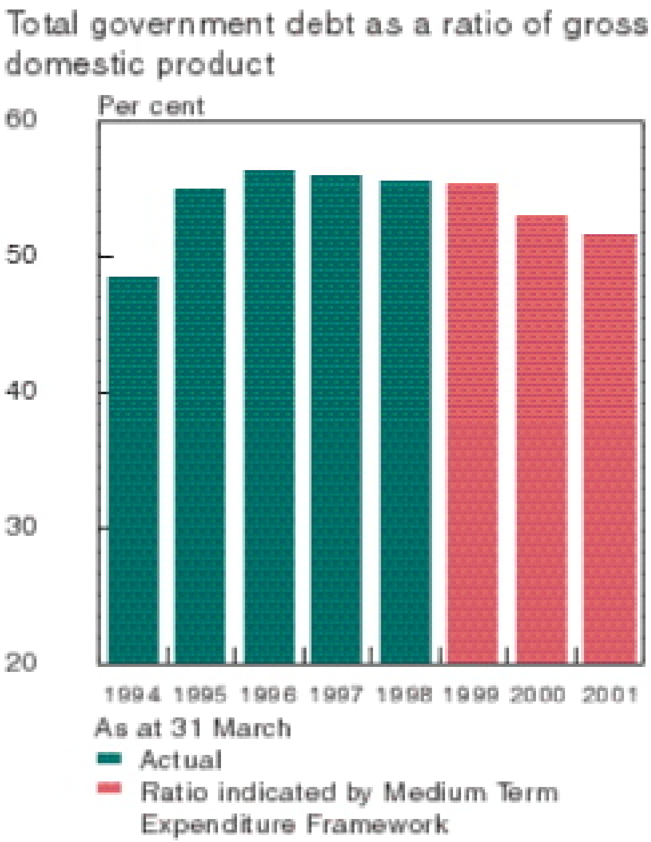
Table 23. Financing the government deficit in fiscal 1997/98

		R billions
Government stock (including discount on new issues)		25,6
	Public Investment Commissioners	*-1,6*
	Monetary institutions	*0,3*
	Non-monetary private sector	*26,9*
Less:	Discount on government stock	-4,0
Net receipts from government stock		**21,6**
Treasury bills		1,9
Foreign loans		2,4
Repayment of IMF loan		-1,4
Other		3,8
Non-marketable securities		-0,1
Extraordinary receipts		2,9
Redemption of Section 239 debt*		-3,8
Redemption of Namibian debt		-0,2
Transfer from IMF account		1,4
Decrease in available cash balances		0,4
Total net financing		**26,5**

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

As in previous years, long-term government stock issued in the domestic market remained the most important borrowing instrument used to finance government's shortfall. The national government also accessed the international primary bond market during fiscal 1997/98 by means of two foreign bond issues: one in the Samurai market amounting to ¥40 billion with a maturity of 7 years at an interest rate of 3,35 per cent, and one in the United States market for US$500 million with a maturity of 20 years at an interest rate of 8,5 per cent. Following the issuance of the protocol on corporate governance of all state assets that contains a programme of asset restructuring which could lead to changes in the ownership of state entities, government obtained an amount of R2,9 billion from the sale of state assets.

The large financing requirement of the national government, together with the discount on the issue of new government stock, resulted in an increase in *national government debt* from R310,6 billion at the end of March 1997 to R336,4 billion at the end of March 1998. Slightly faster growth in the nominal gross domestic product, however, resulted in a decline in the ratio of debt to gross domestic product from 55,8 per cent at the end of March 1997 to 55,4 per cent at the end of March 1998. Although the average maturity of the national government's domestic marketable stock declined slightly from 115 months at the end of March 1997 to 114 months at the end of March 1998, the average maturity of foreign debt increased from 61 months to 88 months over the same period because of the two foreign bond issues mentioned above.



The *deficit before borrowing and debt repayment* in fiscal 1998/99 was estimated at R23,7 billion, compared with the deficit of R26,5 billion in fiscal 1997/98. The overall strengthening of fiscal discipline was also expected to reduce government dissaving (current revenue less current expenditure) as a percentage of gross domestic product from 3,2 per cent in fiscal 1997/98 to 2,5 per cent in fiscal 1998/99.

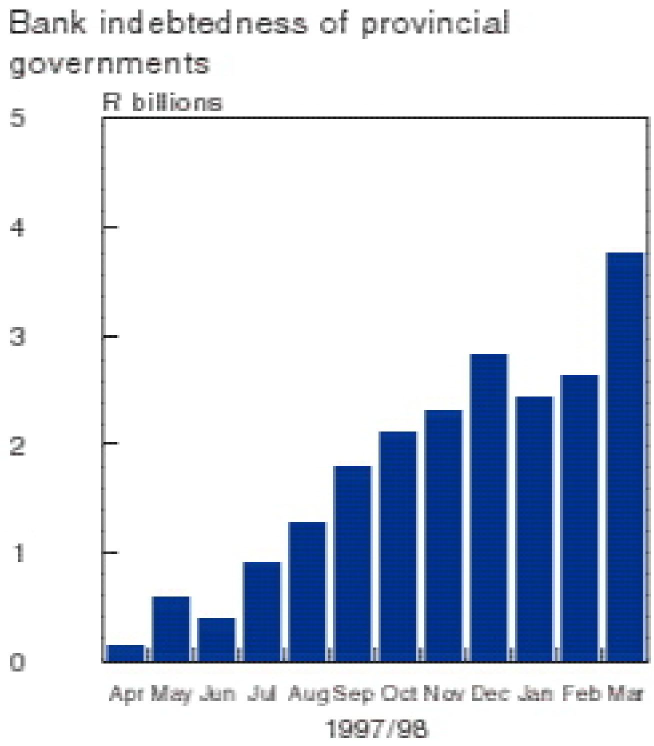
After taking the scheduled loan redemptions of R15,8 billion into consideration, the gross financing requirement for fiscal 1998/99 was projected to amount to R39,5 billion. This was expected to be financed as follows:

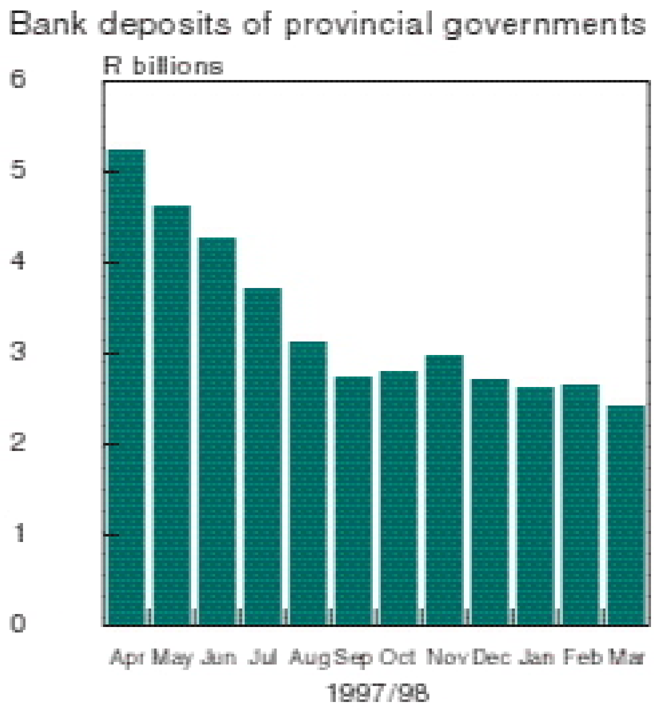
	R billions
Government stock	31,0
Extraordinary receipts	0,8
Transfer from IMF accounts	1,0
Treasury bills (net)	2,5
Foreign loans	5,0
Change in cash balances	-0,8
Total financing	**39,5**

The net addition to total government debt during fiscal 1998/99 is unlikely to increase the ratio of government debt to gross domestic product. It was estimated that this ratio could decline to 54,3 per cent by the end of fiscal 1998/99 from its level of 55,4 per cent at the end of 1997/98. A relatively small amount of debt owed by some of the former regional structures, that was uncovered subsequent to the closure of accounts on 31 March 1995, should still be added to total government debt. The amounts involved were sufficiently small so that their inclusion in total government debt were unlikely to raise government's debt ratio materially.

The *borrowing requirement of the consolidated central government* (i.e. the borrowing requirement of the national government, extra-budgetary institutions and social security funds) amounted to R22,7 billion in fiscal 1997/98, R8,6 billion lower than in fiscal 1996/97. This improvement in the borrowing requirement of the consolidated central government was mainly due to the narrowing of the financial shortfall of the national government. As a percentage of gross domestic product, the consolidated central government borrowing requirement declined from 5,6 per cent in fiscal 1996/97 to 3,7 per cent in fiscal 1997/98.

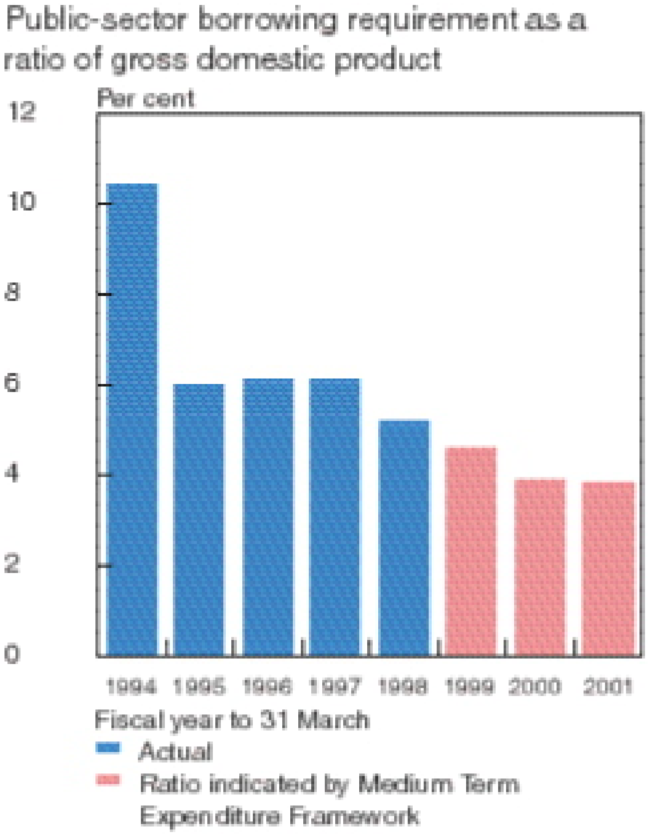
The decline in the borrowing requirement of the consolidated central government in fiscal 1997/98 was, however, partially negated by the deterioration in the financial position of the *provincial governments,* whose financial shortfall increased from R2,4 billion in fiscal 1996/97 to R6,2 billion in fiscal 1997/98. This shortfall was financed by drawing down provincial government deposits with private banks and increasing the bank indebtedness of provincial governments. Provincial government deposits with banks were drawn down from R5,2 billion at the end of March 1997 to R2,4 billion at the end of March 1998, whereas additional bank credit extended to the provincial governments amounted to R3,4 billion in fiscal 1997/98. The borrowing requirement of *local authorities* also increased somewhat from R0,8 billion in fiscal 1996/97 to R1,0 billion in fiscal 1997/98.





The *borrowing requirement of the general government* (i.e. the borrowing requirement of the consolidated central government, provincial governments and local authorities) decreased from R34,4 billion in fiscal 1996/97 to R29,9 billion in fiscal 1997/98 or by 13,1 per cent. As a percentage of gross domestic product, the borrowing requirement of general government amounted to 4,9 per cent in fiscal 1997/98 compared with 6,2 per cent in fiscal 1996/97. Dissaving by the general government amounted to R13,1 billion or 2,1 per cent of gross domestic product in fiscal 1997/98, compared with R17,7 billion or 3,2 per cent of gross domestic product in fiscal 1996/97. This improvement in the savings of general government conforms to the objective of eliminating the dissaving of the general government by the fiscal year 1999/2000 and was essentially the result of curtailing the growth in spending.

The *public-sector borrowing requirement* (i.e. the borrowing requirement of the consolidated general government and the non-financial public corporations and public enterprises) amounted to R31,3 billion in fiscal 1997/98; i.e. R2,3 billion less than in fiscal 1996/97. As a percentage of gross domestic product, the borrowing requirement of the public sector, having peaked at 10,4 per cent in fiscal 1993/94, declined to 5,2 per cent in fiscal 1997/98 - the lowest ratio since fiscal 1990/91 when this ratio amounted to 4,5 per cent of gross domestic product.



Exchequer account in the first quarter of fiscal 1998/99

The year-on-year rate of increase in *Exchequer issues* to national government departments (adjusted to reflect cash flows) amounted to 8,4 per cent in the first quarter of fiscal 1998/99. This rate of increase was below the average year-on-year rate of increase of 13,3 per cent in the corresponding period of the preceding five fiscal years, but it was somewhat higher than the 6,1 per cent that was provided for in the budget for fiscal 1998/99 as a whole. As a ratio of gross domestic product, Exchequer issues to government departments in the first quarter of fiscal 1998/99 amounted to 32,3 per cent, compared with 32,4 per cent in the corresponding period of the preceding fiscal year.

The level of *Exchequer receipts* (excluding extraordinary receipts) in the first quarter of fiscal 1998/99 amounted to R36,8 billion, which was 7,6 per cent above the level in the corresponding quarter of the preceding fiscal year, but lower than the budgeted increase of 8,9 per cent for the fiscal year 1998/99 as a whole. As a ratio of gross domestic product, Exchequer receipts declined from 23,5 per cent in the first quarter of fiscal 1997/98 to 23,2 per cent in the first quarter of fiscal 1998/99.

The net result of these increases in government revenue and expenditure was a *deficit before borrowing and debt repayment* of R14,4 billion in the first quarter of fiscal 1998/99, or 9,1 per cent of gross domestic product. The actual deficit in the first quarter of 1998/99 was equal to about 60,7 per cent of the deficit budgeted for fiscal year 1998/99 as a whole. In the previous year the comparable percentage was 52,5 per cent.

The financing of the deficit before borrowing and debt repayment in the first quarter of fiscal 1998/99 is indicated in Table 24.

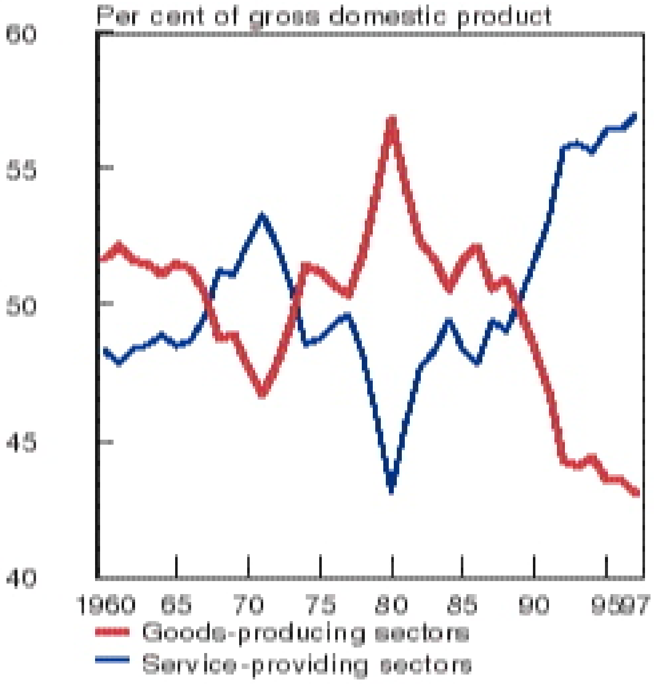
Table 24. Financing the government deficit

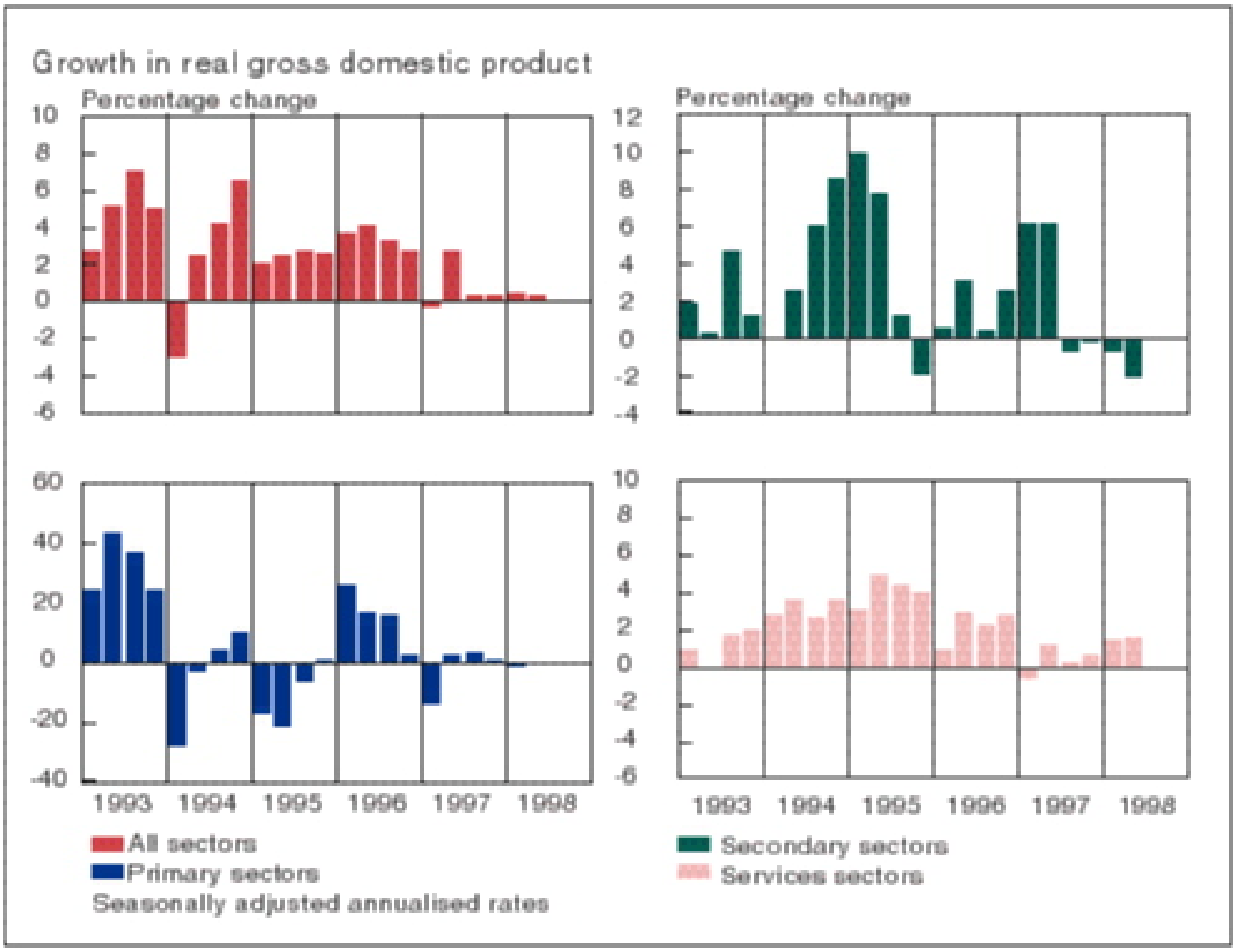
		R billions
Government stock (including discount)		8,0
Less:	Discount on new government stock	-0,8
Net receipts from government stock		7,2
Treasury bills		4,0
Extraordinary receipts		1,6
Foreign loans		-0,3
Redemption of Section 239 debt*		-0,1
Transfer from IMF accounts		0,3
Changes in available cash balances		1,7
Cash balances at the Reserve Bank		-0,2
Cash balances at banks		1,9
Total net financing		**14,4**
* Debt of the former Transkei, Bophuthatswana, Venda and Ciskei and self-governing territories		

FOOTNOTE :

(2) The "primary" balance is defined as government revenue less government expenditure, other than interest payments on government debt.

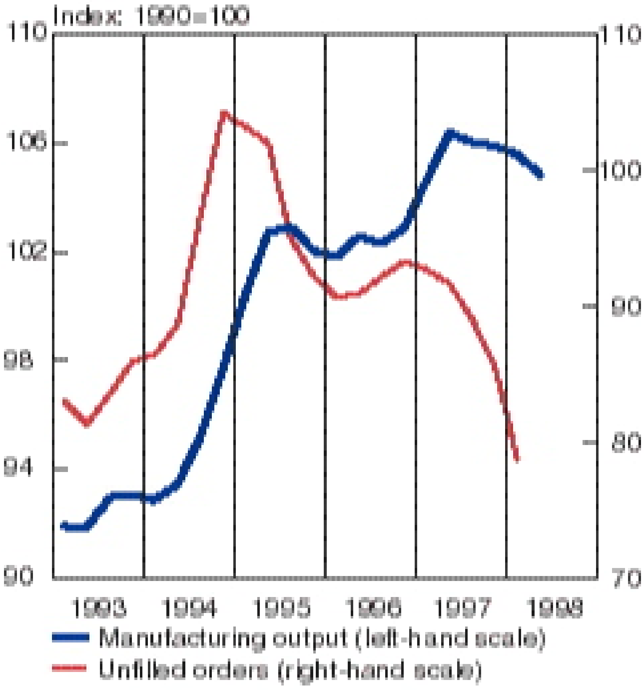
Composition of gross domestic product



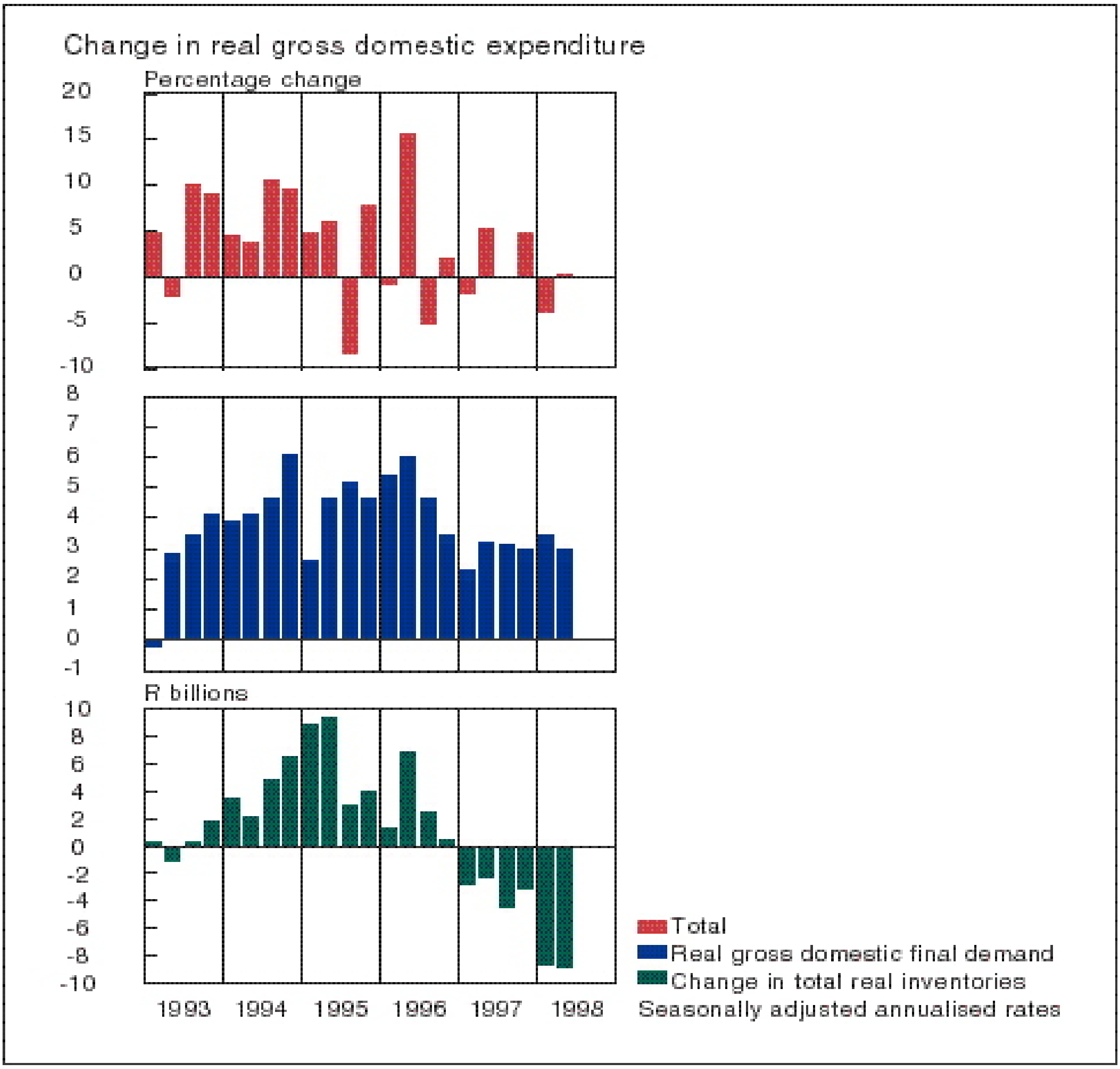


Growth in real gross domestic product
Percentage change
Percentage change
10
8
6
4
2
0
-2
-4
-6
12
10
8
6
4
2
0
-2
-4
60
40
20
0
-20
-40
10
8
6
4
2
0
-2
-4
-6
1993 1994 1995 1996 1997 1998
1993 1994 1995 1996 1997 1998
All sectors
Primary sectors
Seasonally adjusted annualised rates
Secondary sectors
Services sectors

Manufacturing output and unfilled orders

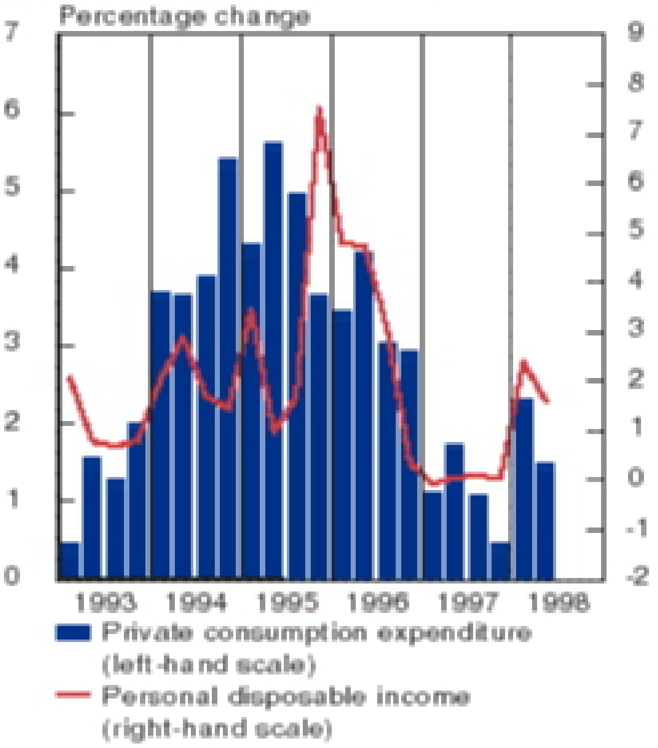


Seasonally adjusted



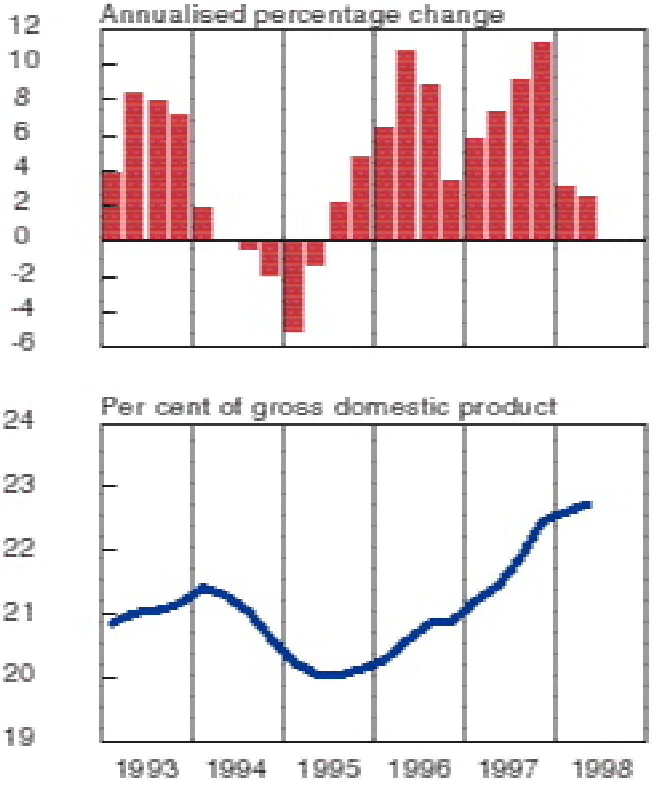
Change in real gross domestic expenditure
Percentage change
20
15
10
5
0
-5
-10
8
7
6
5
4
3
2
1
0
-1
R billions
10
8
6
4
2
0
-2
-4
-6
-8
-10
1993
1994
1995
1996
1997
1998
Total
Real gross domestic final demand
Change in total real inventories
Seasonally adjusted annualised rates

Real private consumption expenditure and personal disposable income



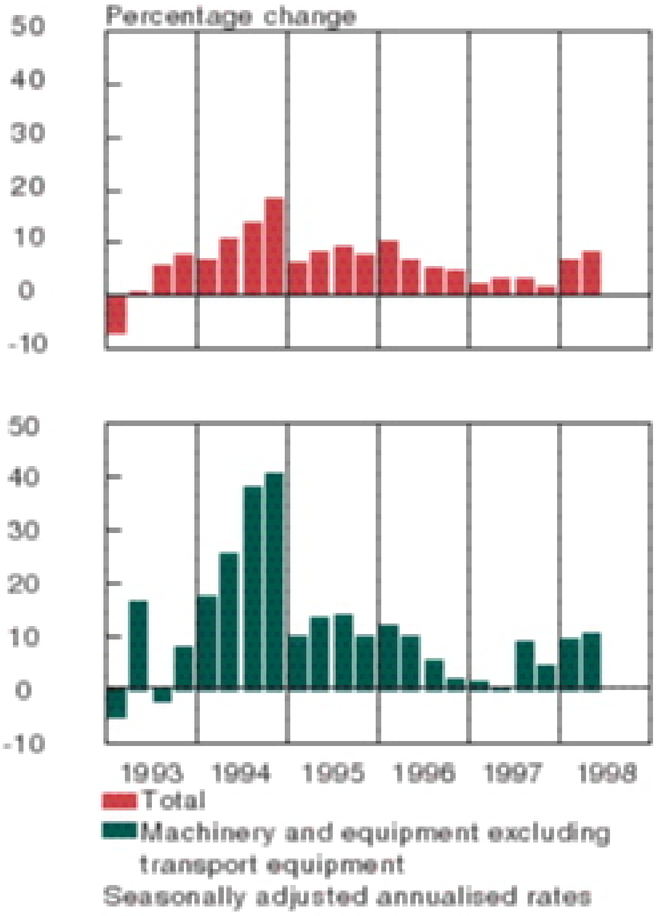
Seasonally adjusted annualised rates

Real government consumption expenditure



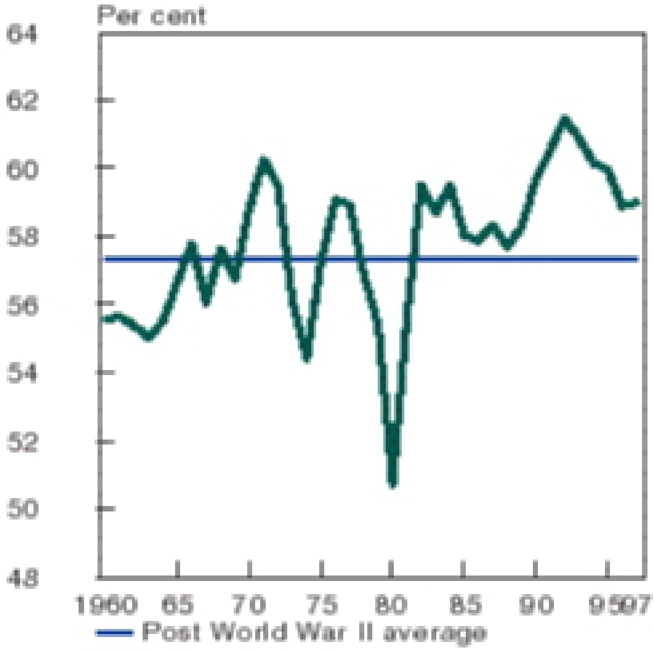
Seasonally adjusted

Growth in real gross domestic fixed investment

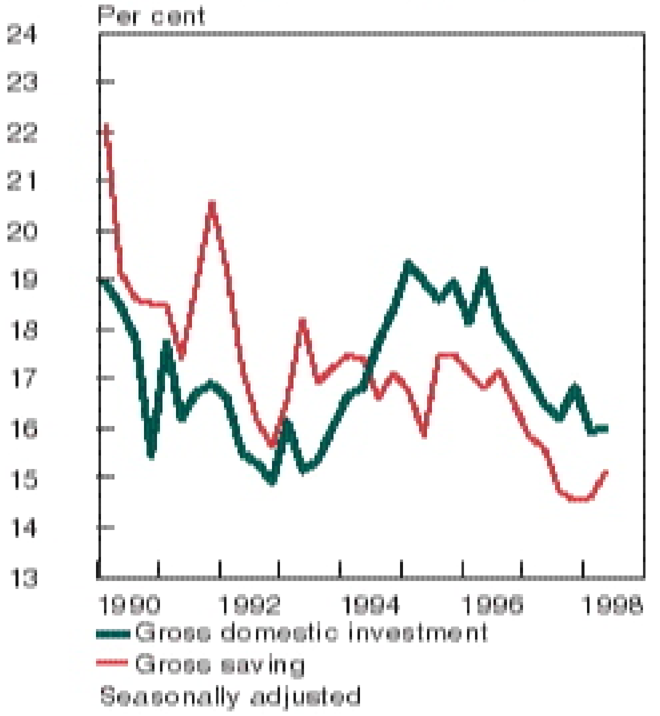


Commercial inventories to sales ratio

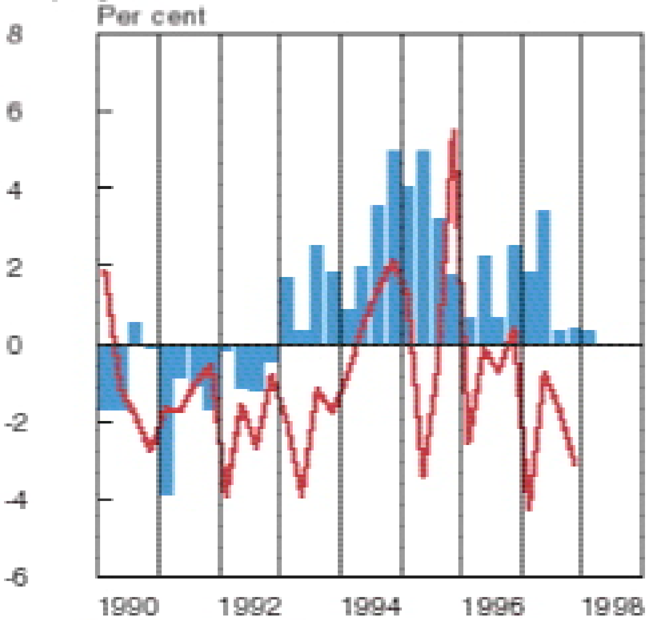
Labour remuneration as percentage of total factor income



Gross domestic investment and saving as percentage of gross domestic product



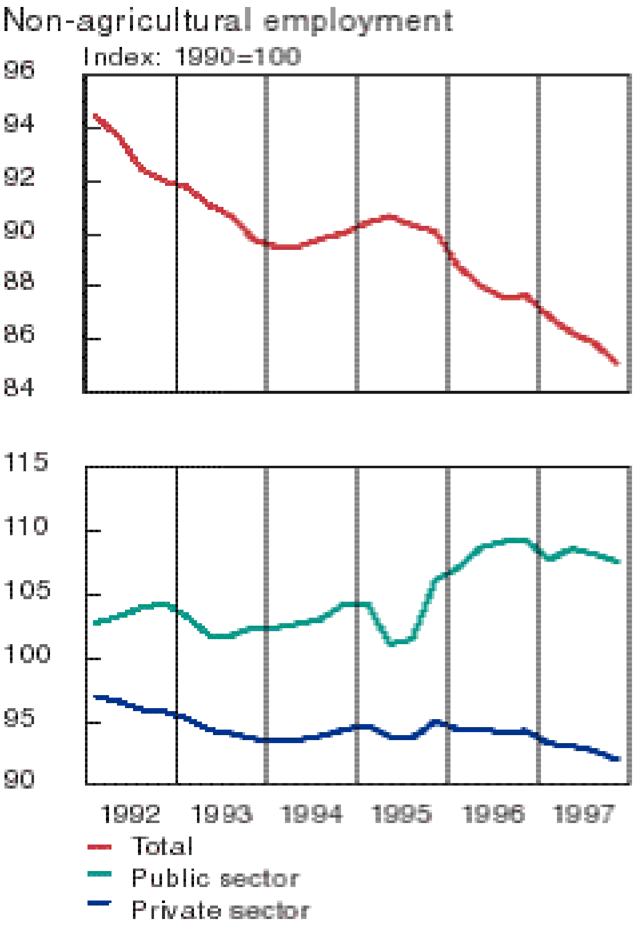
Growth in gross domestic product and employment



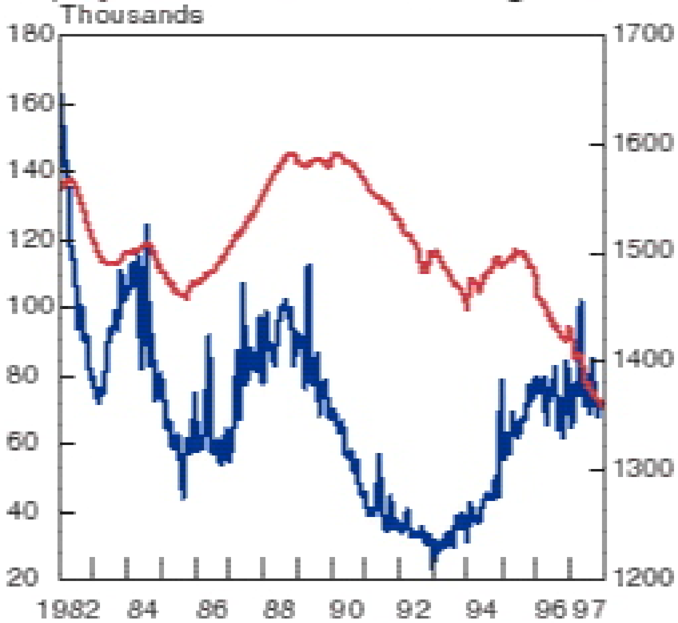
Non-agricultural gross domestic product

Private non-agricultural formal-sector employment

Quarterly: Seasonally adjusted and annualised

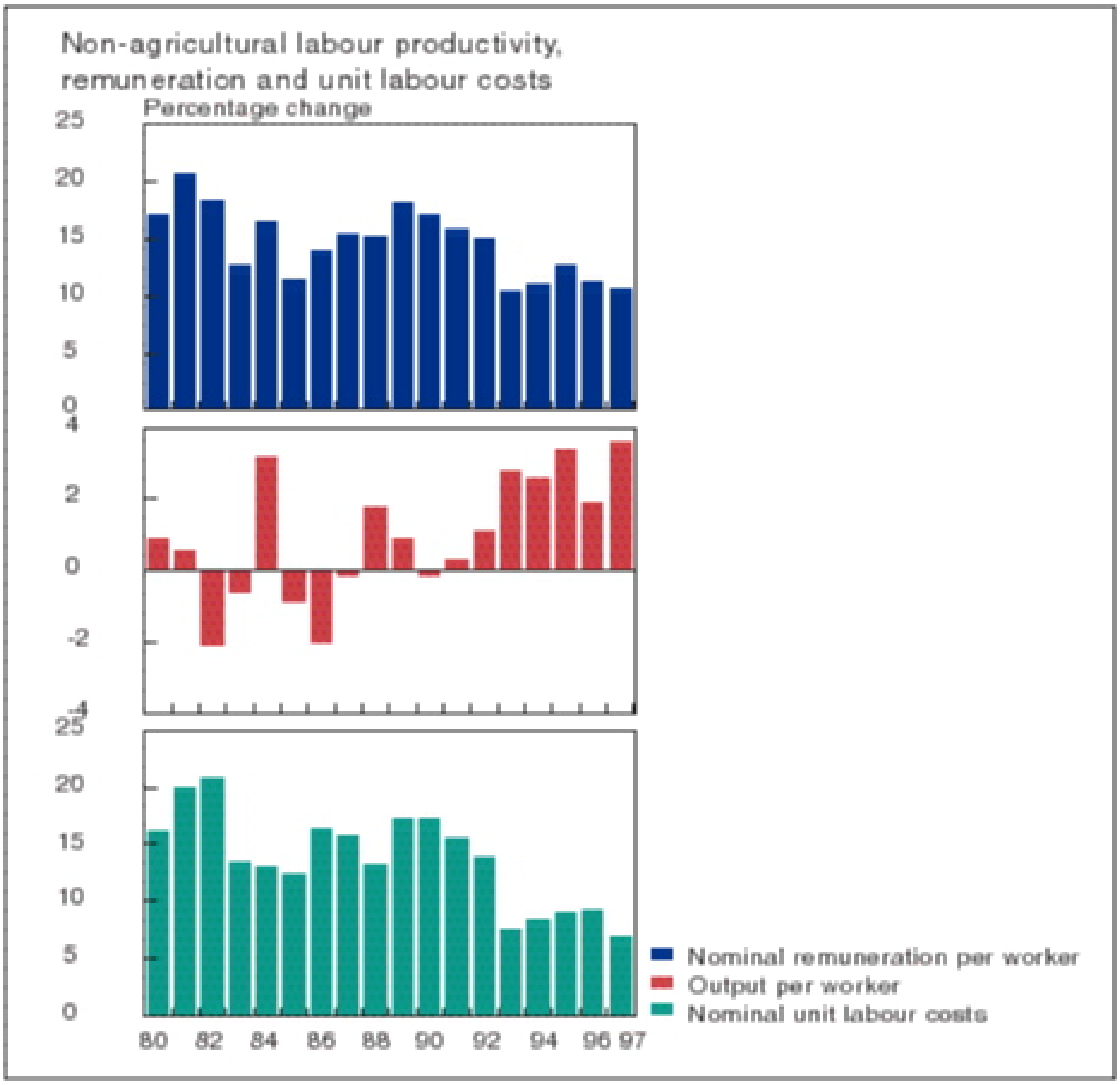

Non-agricultural employment
Index: 1990=100
96
94
92
90
88
86
84
115
110
105
100
95
90
1992
1993
1994
1995
1996
1997
Total
Public sector
Private sector

Job advertisements in the printed media and employment in the manufacturing sector



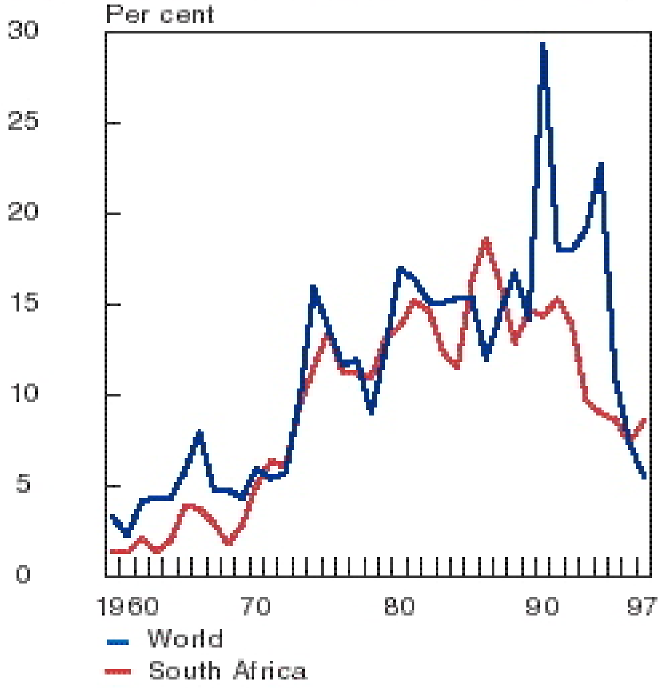
Job advertisements: column centimetre (left-hand scale)

Employment (right-hand scale)

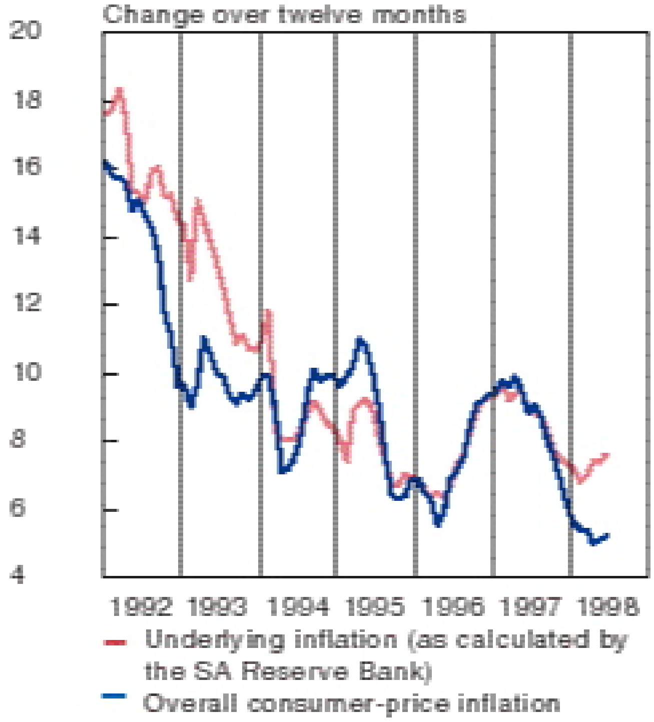


Non-agricultural labour productivity, remuneration and unit labour costs
Percentage change
25
20
15
10
5
0
4
2
0
-2
-4
25
20
15
10
5
0
80
82
84
86
88
90
92
94
96
97
Nominal remuneration per worker
Output per worker
Nominal unit labour costs

World inflation and South African inflation

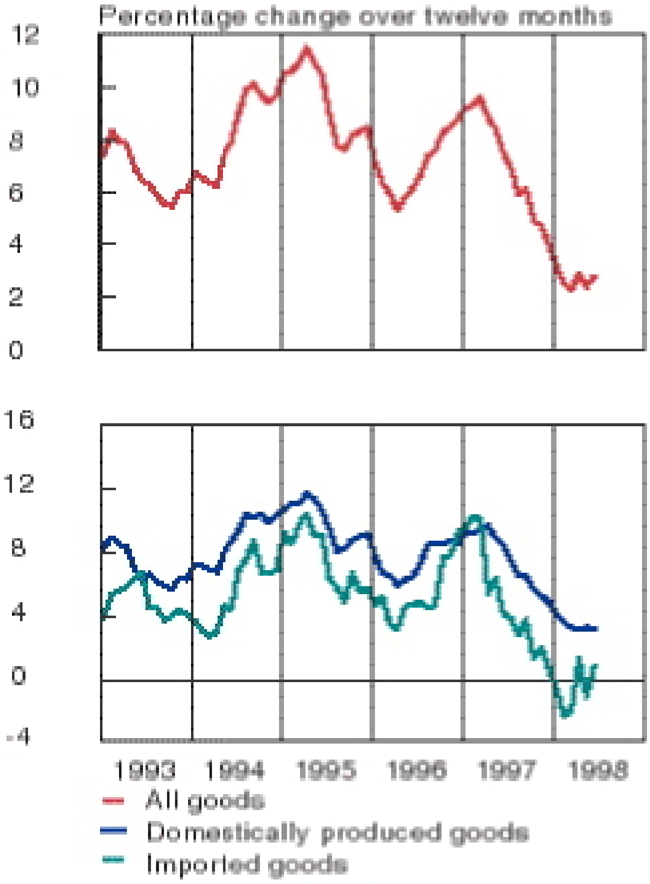


Inflation in consumer prices

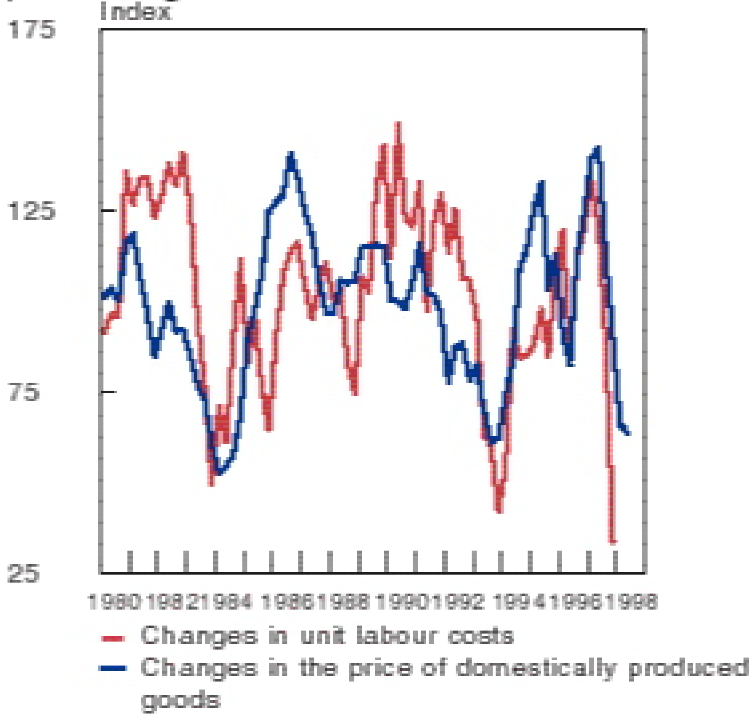


Production prices

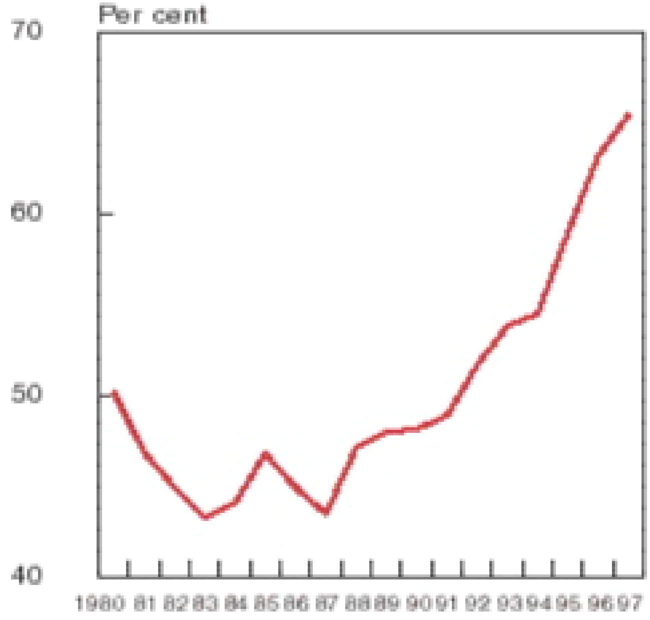
Percentage change over twelve months



Cyclical relationship between non-agricultural unit labour costs and the prices of domestically produced goods

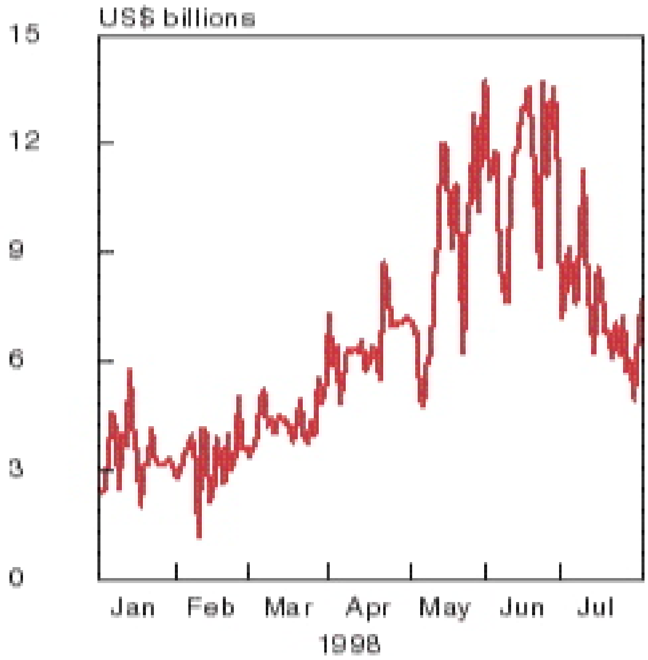


Trade as a percentage of gross domestic product

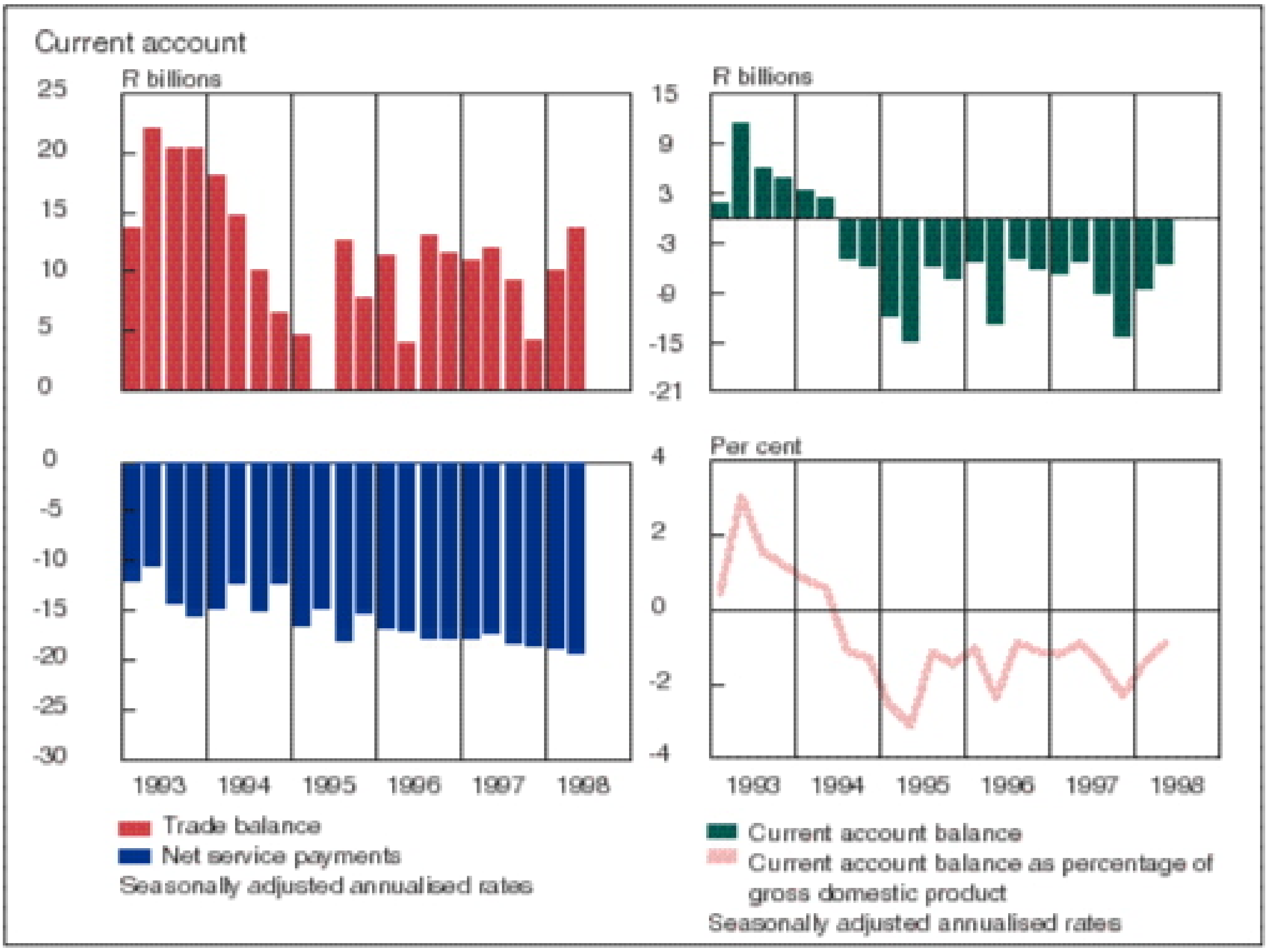


Imports and exports of goods and non-factor services as percentage of gross domestic product at constant 1990 prices

Net daily turnover in the foreign exchange market

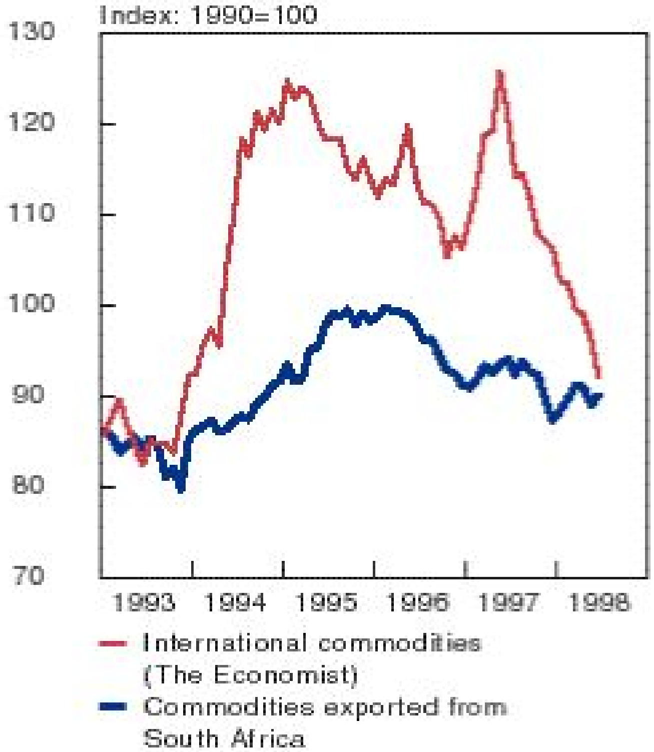


Net turnover figures are gross figures adjusted for double-counting arising from local interbank business

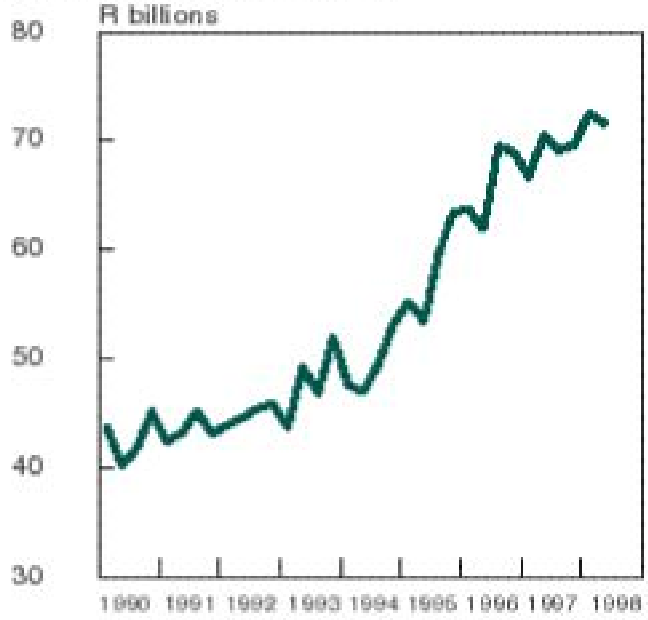


Current account
R billions
25
20
15
10
5
0
15
9
3
-3
-9
-15
-21
0
-5
-10
-15
-20
-25
-30
4
2
0
-2
-4
Per cent
1993
1994
1995
1996
1997
1998
Trade balance
Net service payments
Seasonally adjusted annualised rates
Current account balance
Current account balance as percentage of gross domestic product
Seasonally adjusted annualised rates

Commodity prices in US dollars

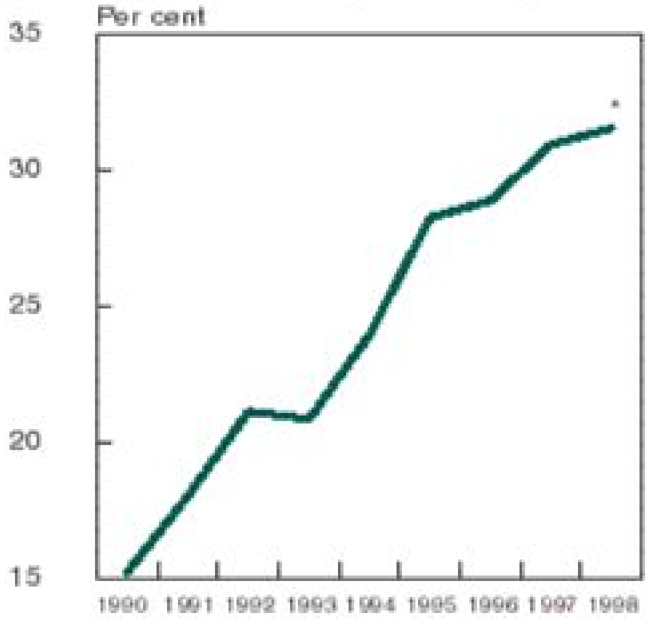


Real merchandise exports



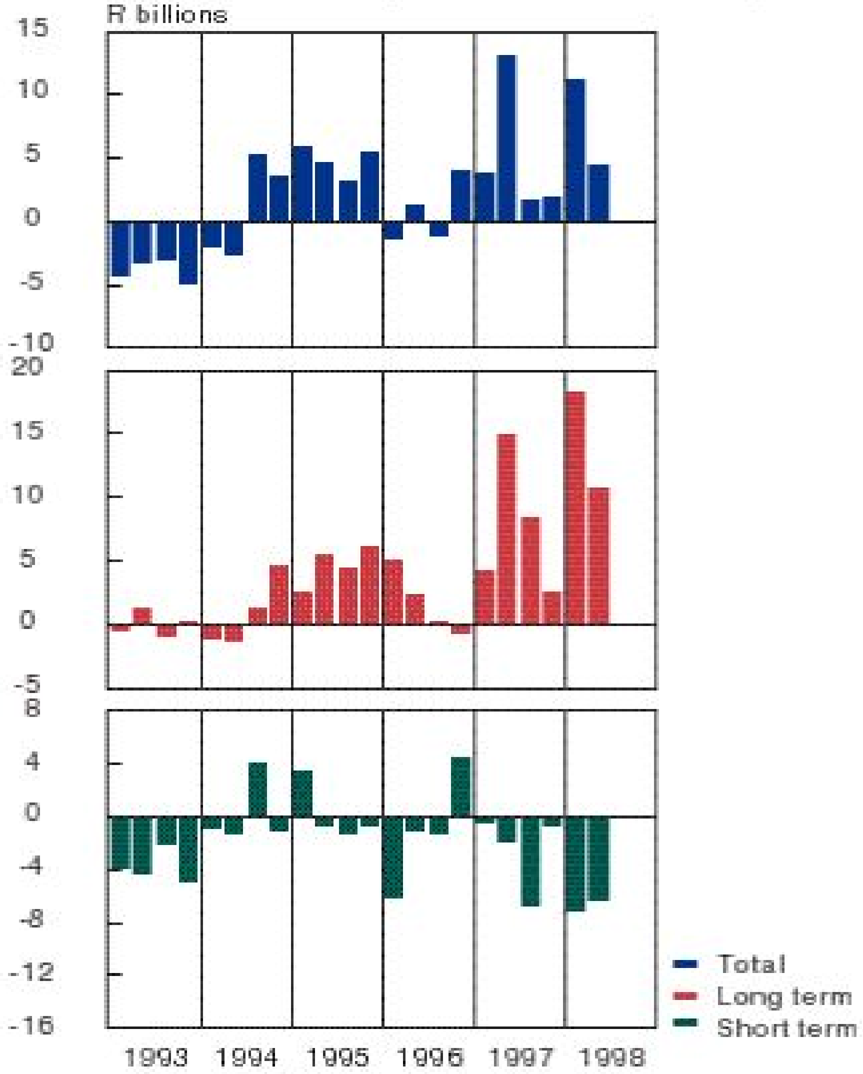
Seasonally adjusted annualised rates

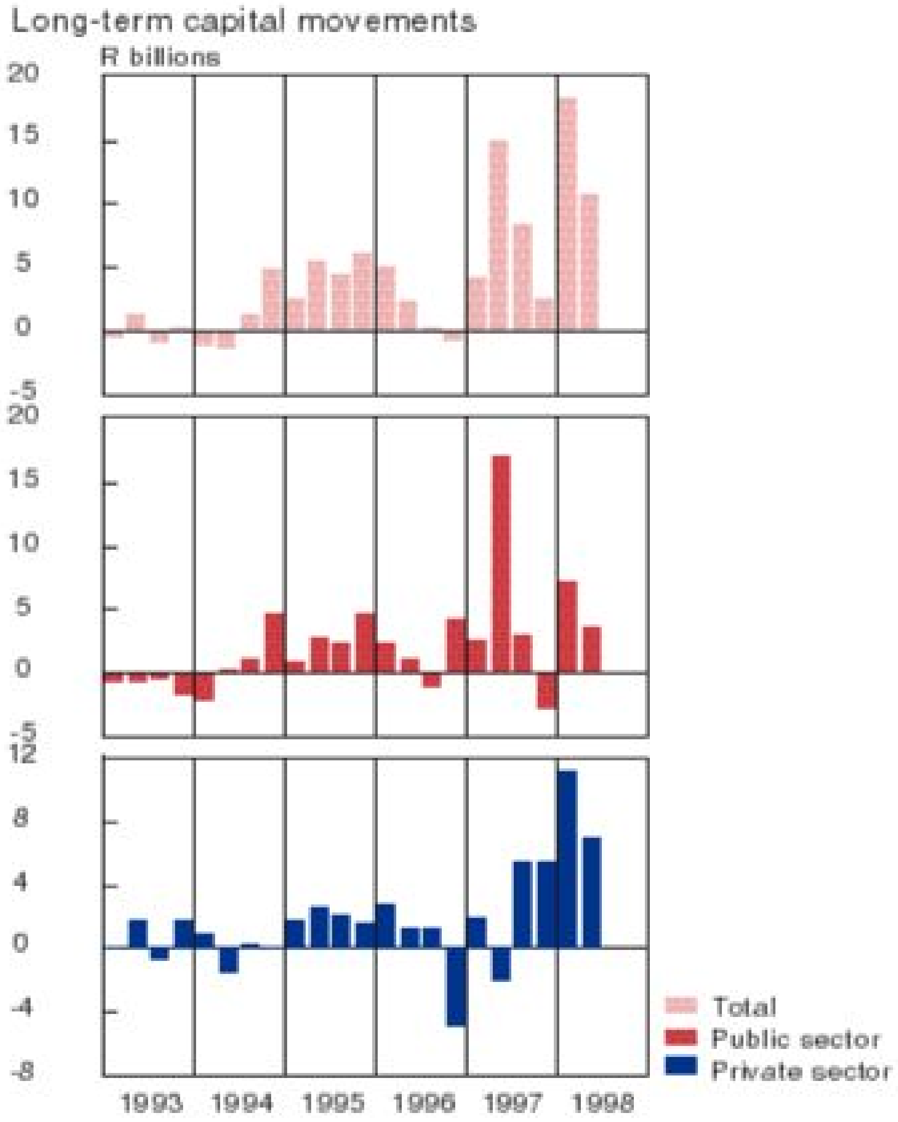
Exports of manufactured goods as percentage of total export earnings



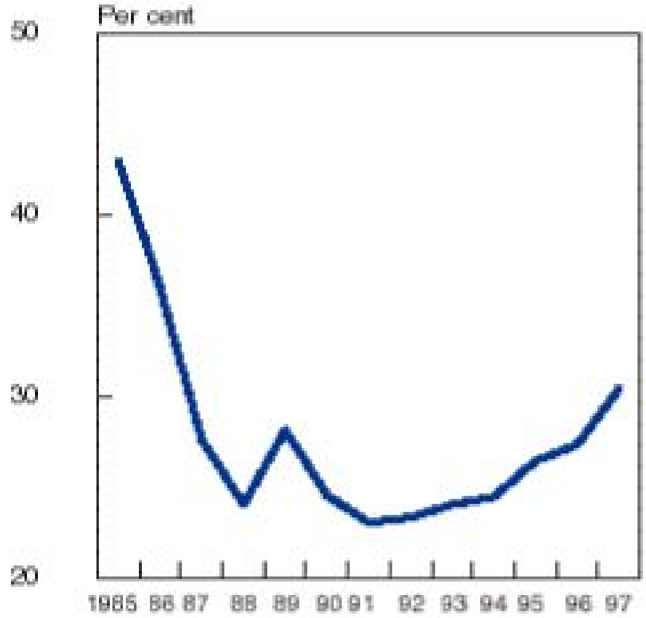
* First half

Net capital movements (not related to reserves)



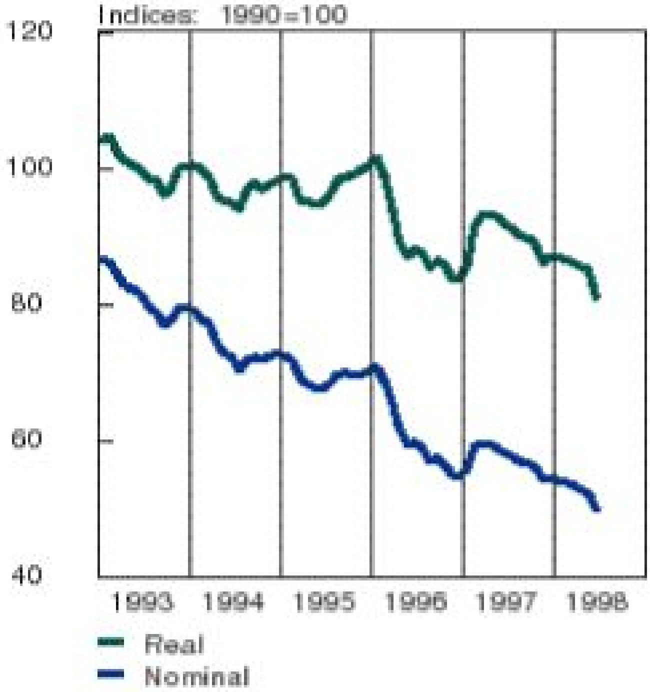

Long-term capital movements
R billions
20
15
10
5
0
-5
20
15
10
5
0
-5
12
8
4
0
-4
-8
1993
1994
1995
1996
1997
1998
Total
Public sector
Private sector

Foreign debt as percentage of gross domestic product

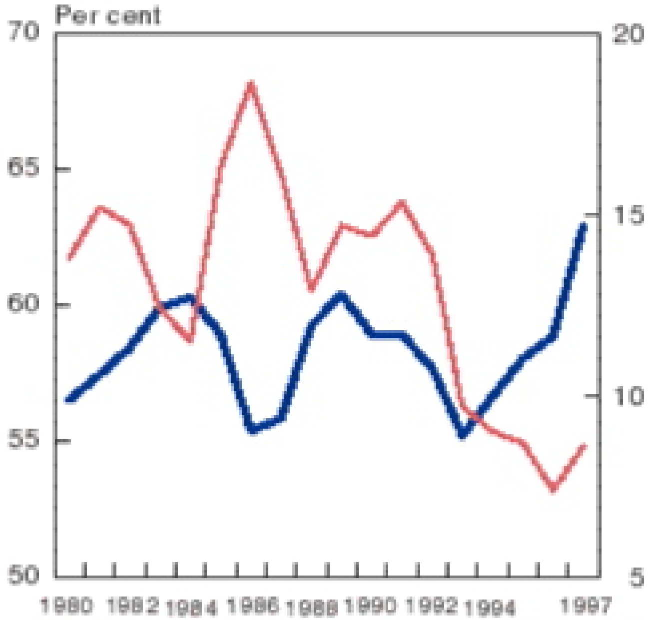


Total gross international reserves

Exchange rates of the rand



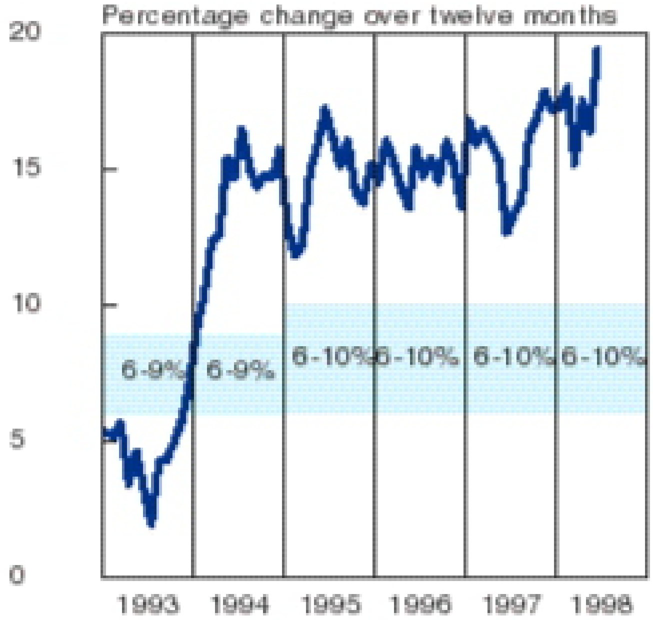
M3 as ratio of gross domestic product and inflation



M3 as percentage of gross domestic product (left-hand scale)

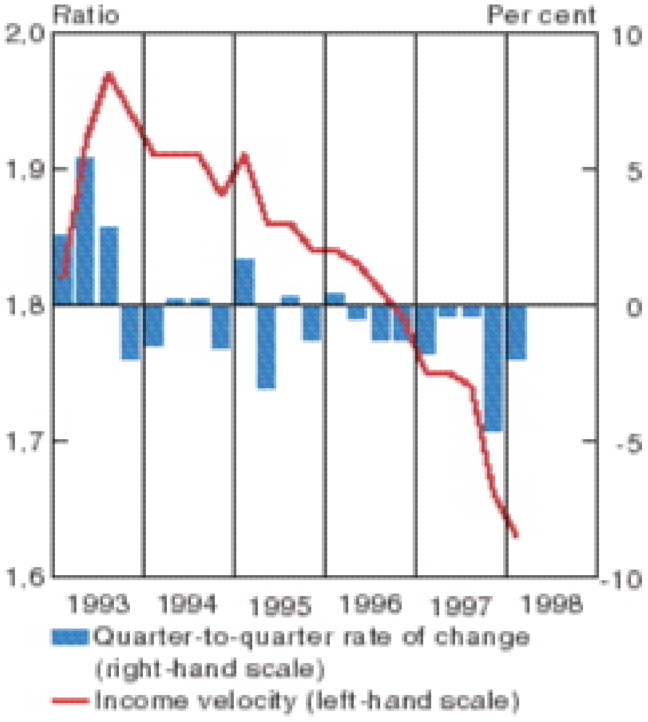
Percentage change over one year in consumer-price index (right-hand scale)

M3 money supply

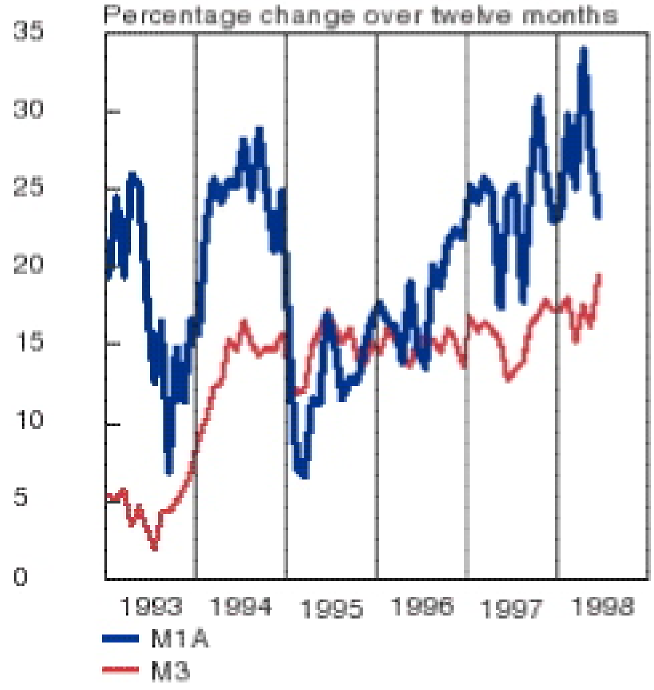


Shaded areas indicate the money growth guideline ranges

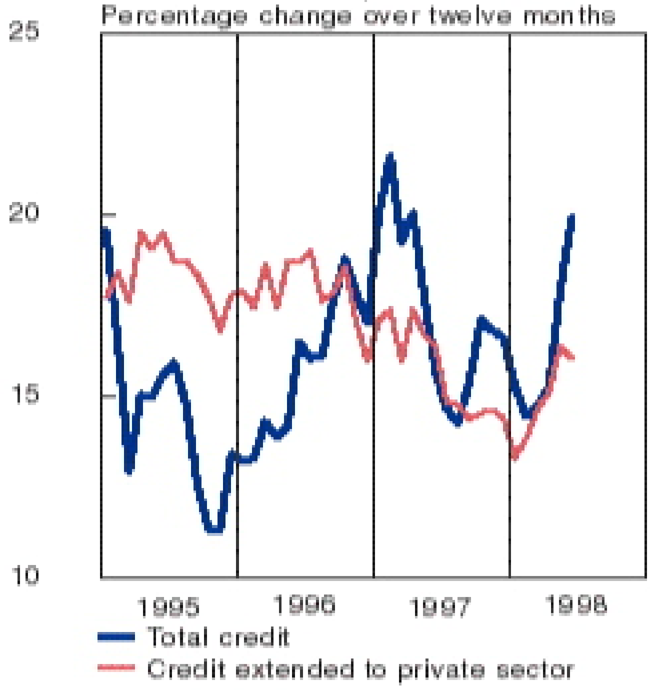
Income velocity of money



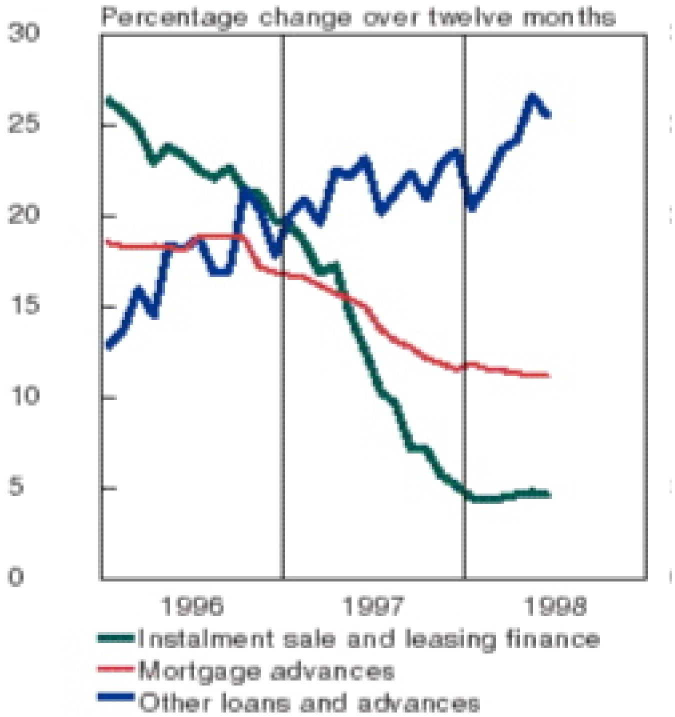
Monetary aggregates



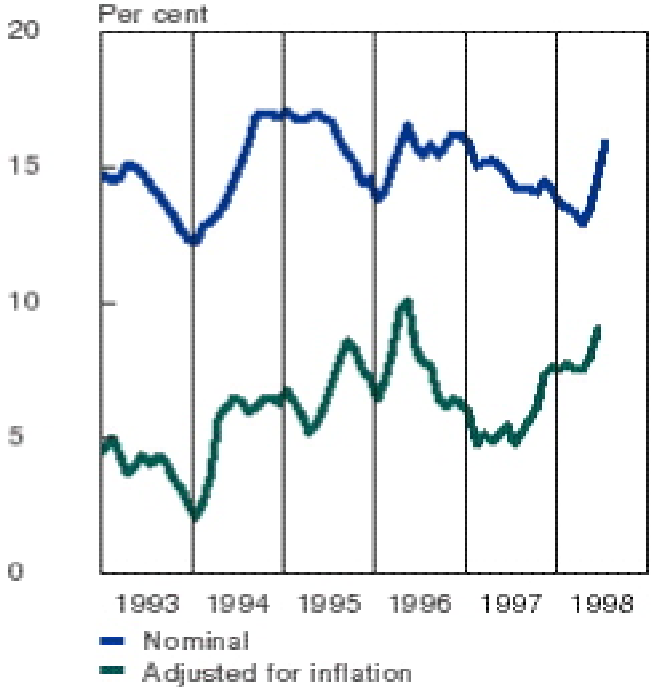
Changes in total credit extension and credit extended to the private sector



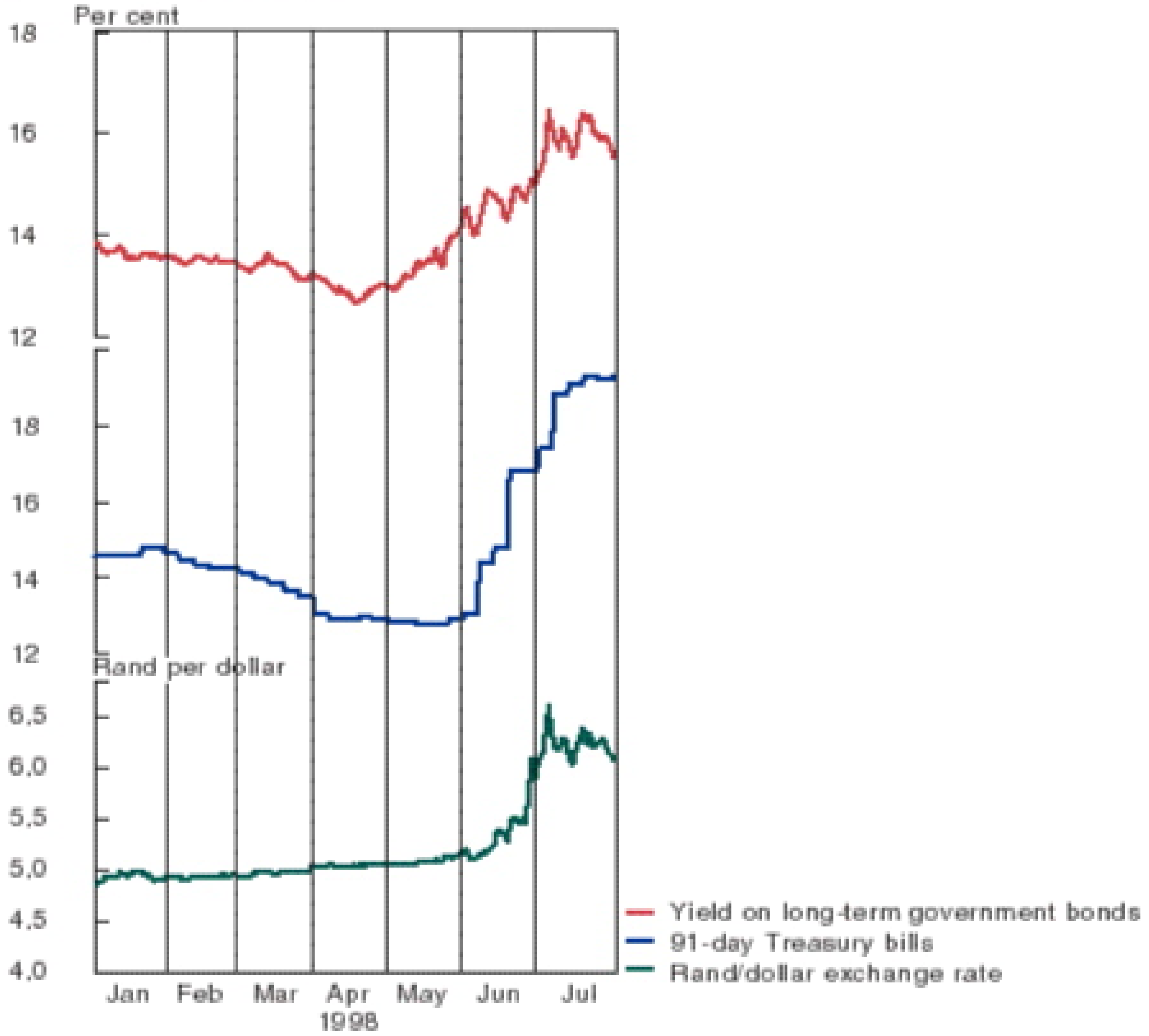
Credit extended to private sector by type of credit



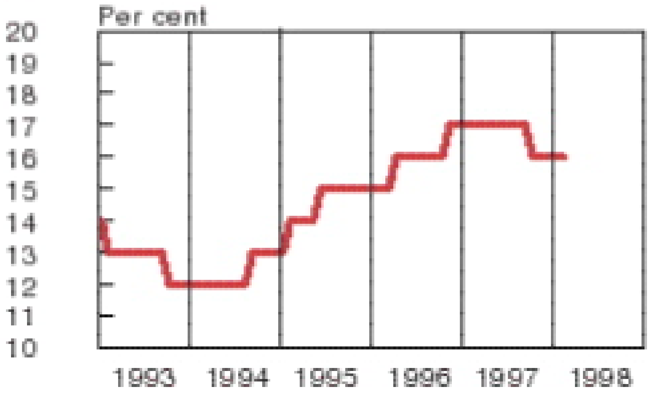
Yield on long-term government bonds



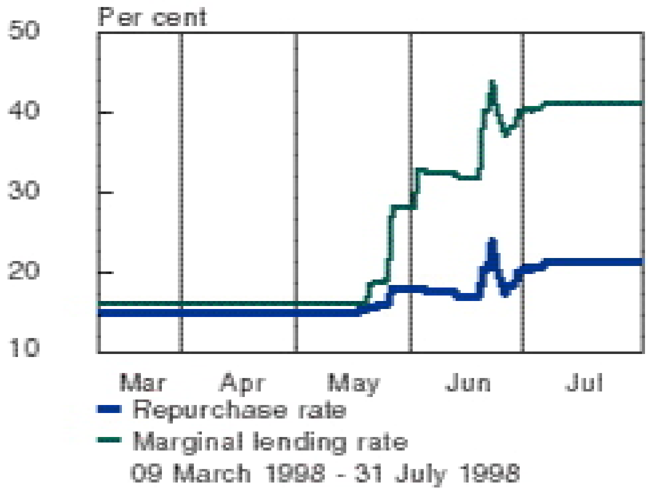
Bond yield, money market interest rates and the exchange rate



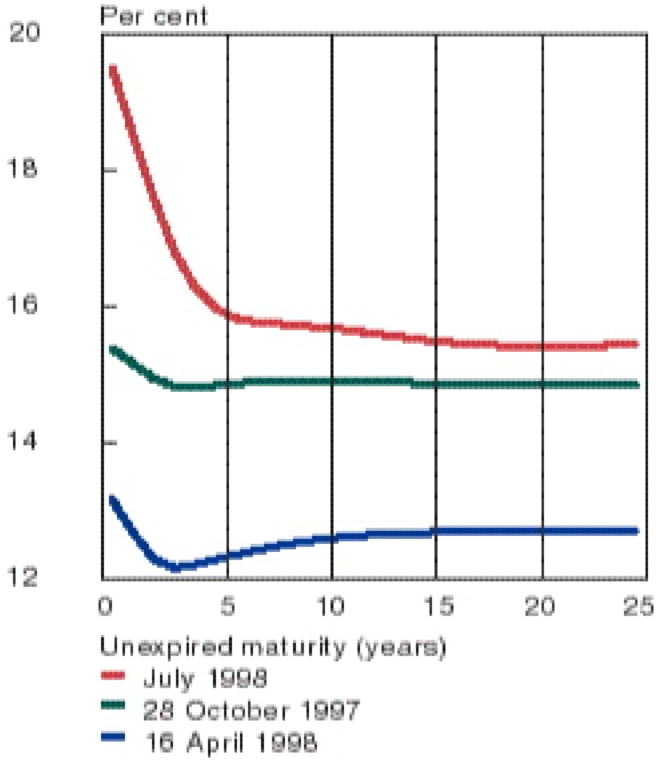
Bank rate


Per cent
20
19
18
17
16
15
14
13
12
11
10
1993
1994
1995
1996
1997
1998

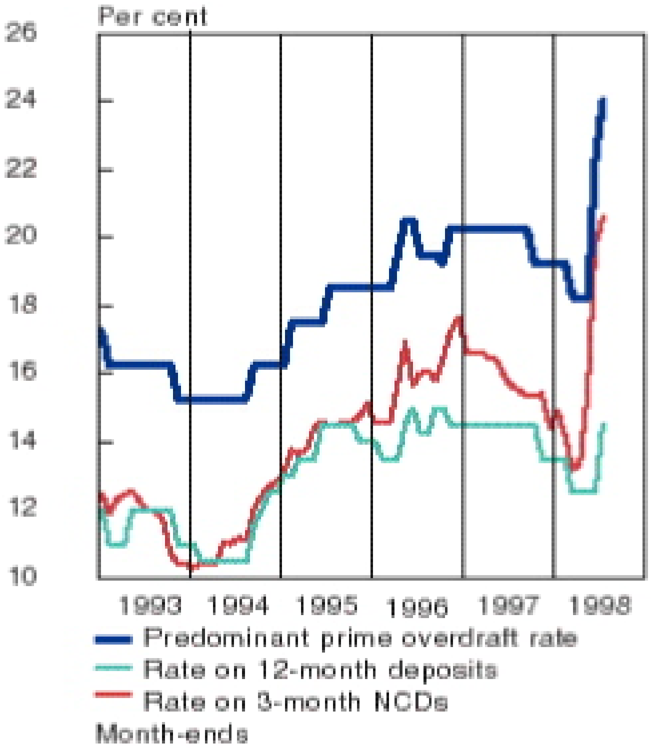
Repurchase and marginal lending rates



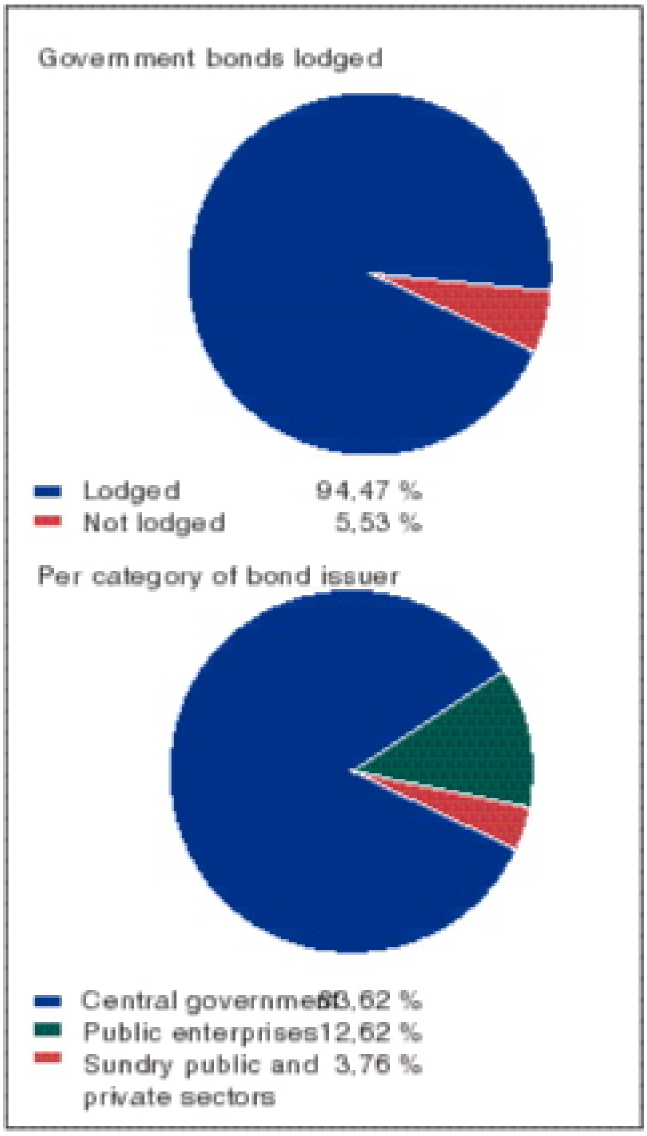
Yield curves



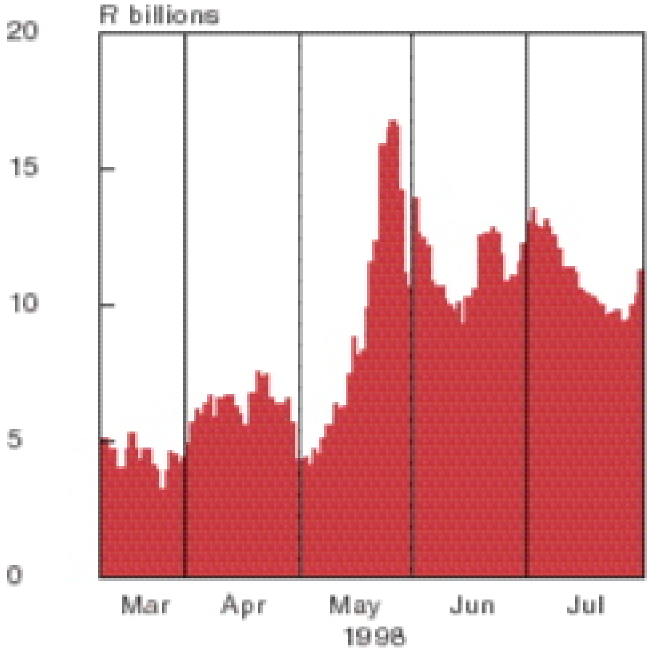
Interest rates



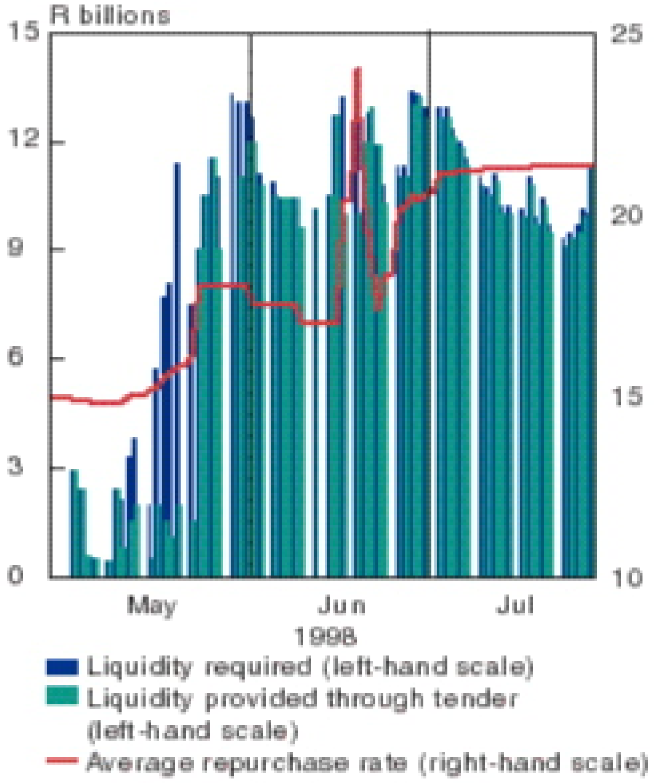
Central Depository: June 1998



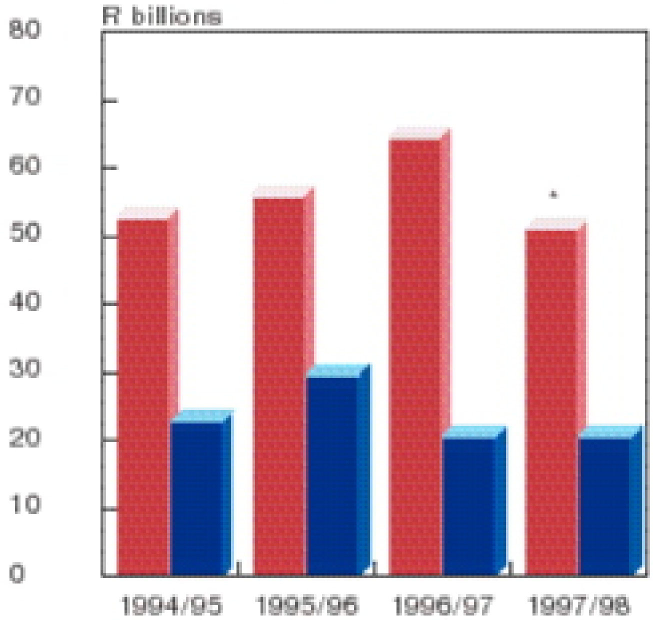
Liquidity requirement in the money market



Liquidity provided by South African Reserve Bank



Current income surplus of institutions vis-à-vis borrowing by the public sector



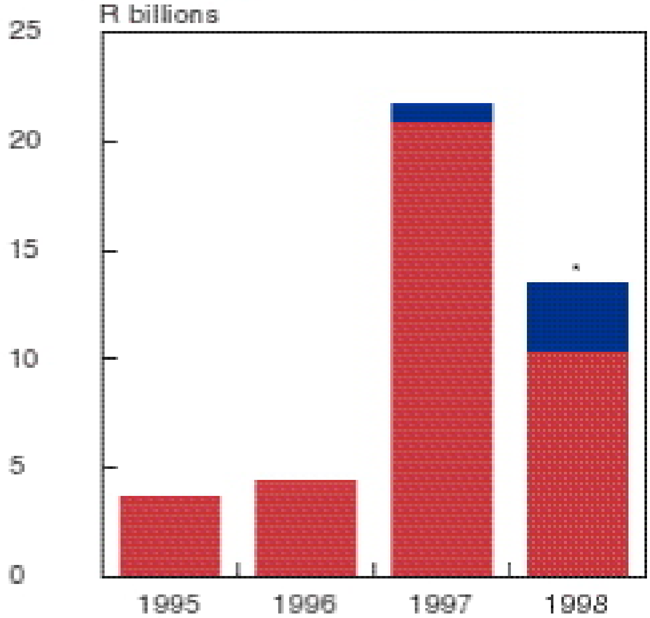
Fiscal years

Current income surplus

Borrowing by the public sector

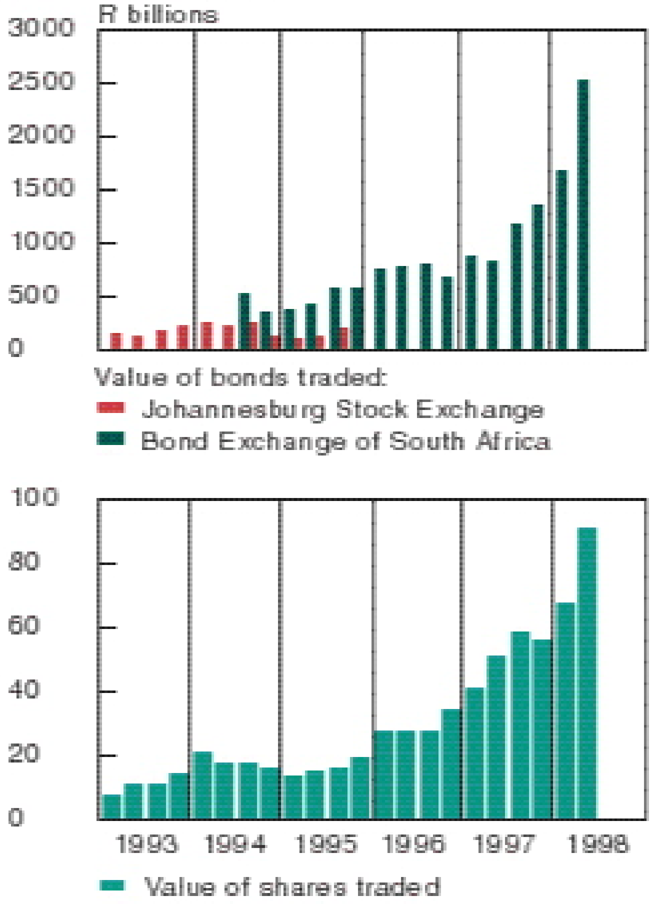
* First three quarters

Proceeds of eurorand bonds issued by foreign and domestic borrowers

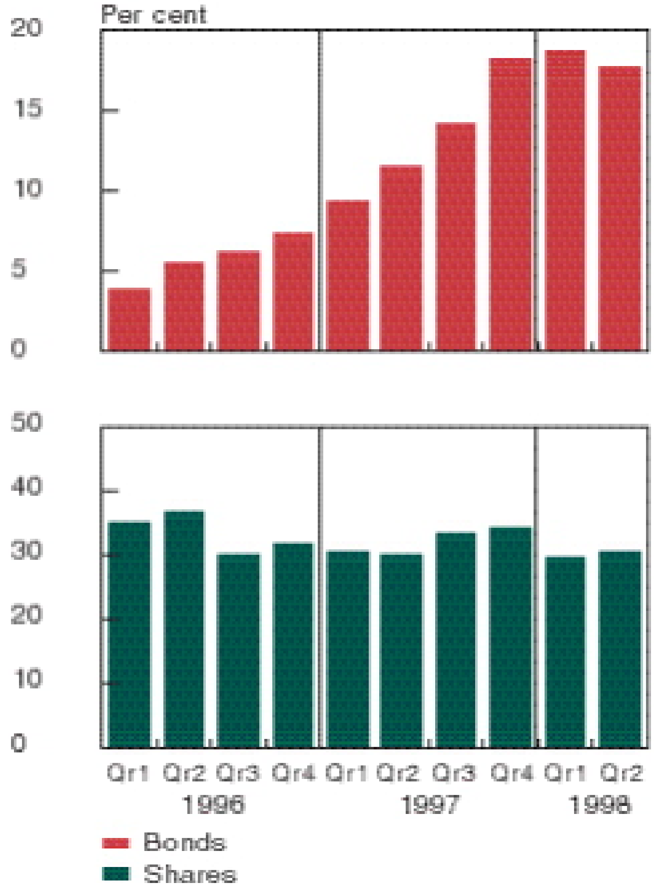


Foreign issues
South African issues
* First half of 1998

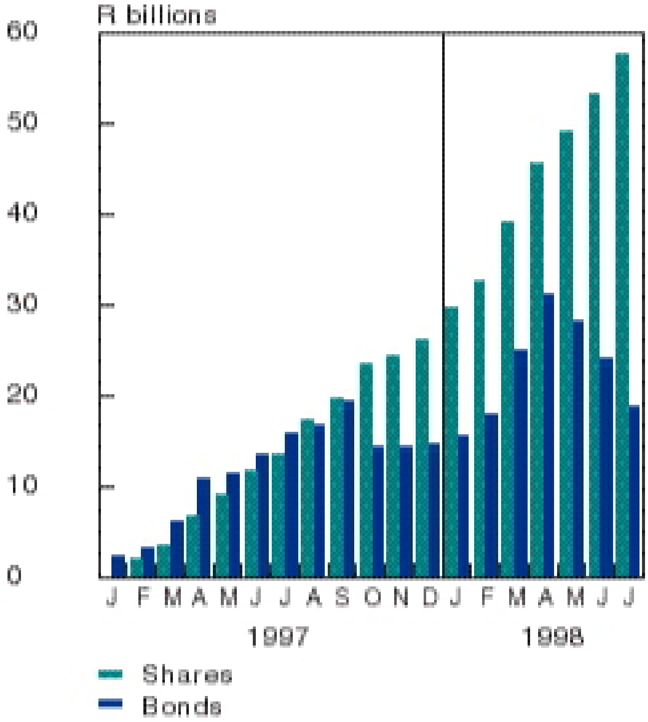
Quarterly turnover in secondary bond and share markets



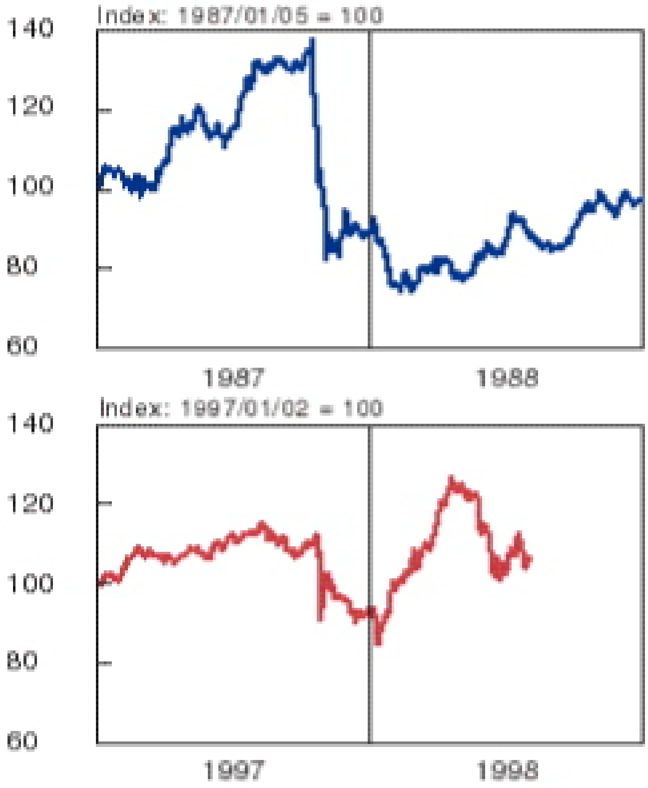
Non-resident participation in the bond and share markets

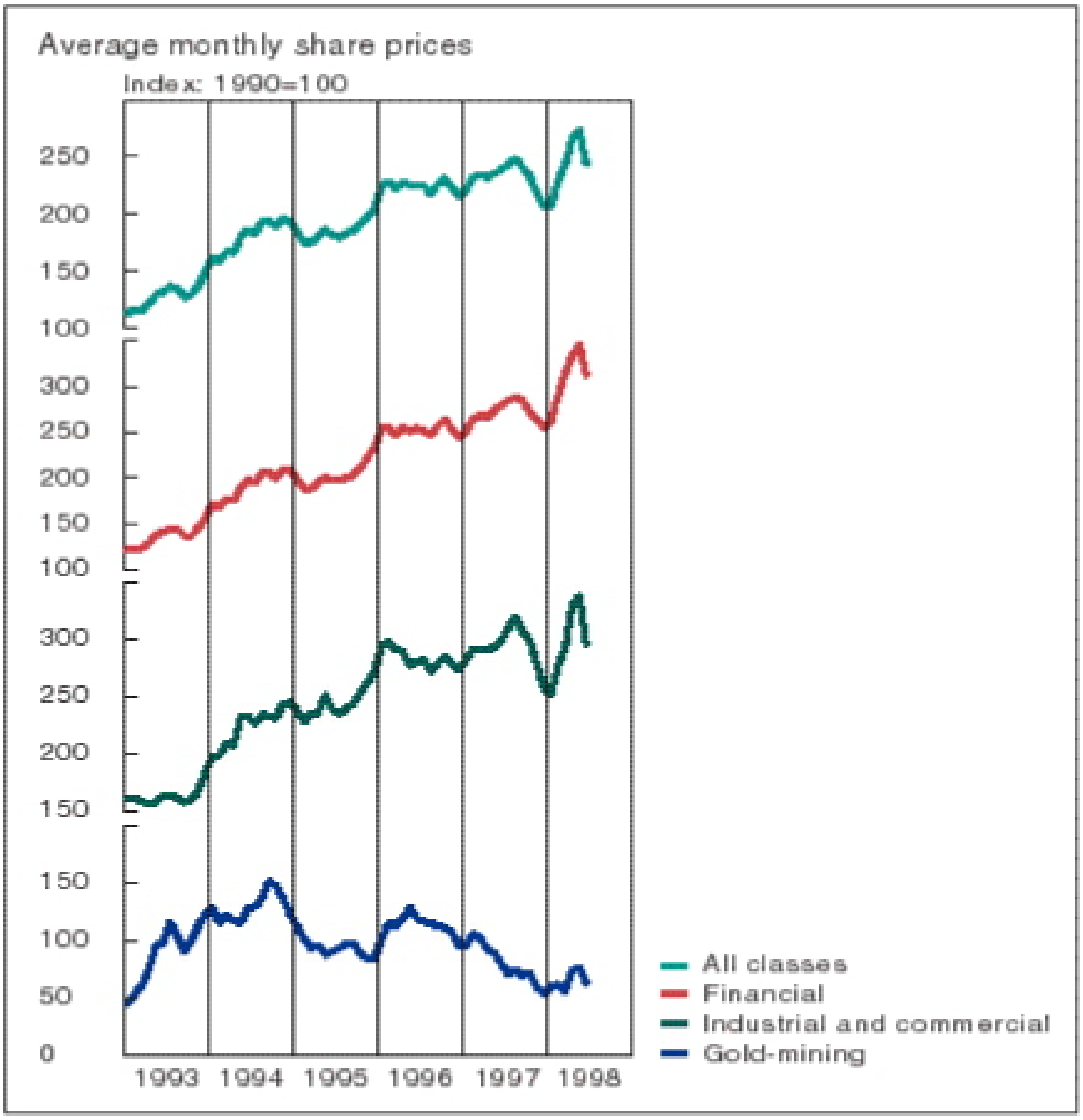


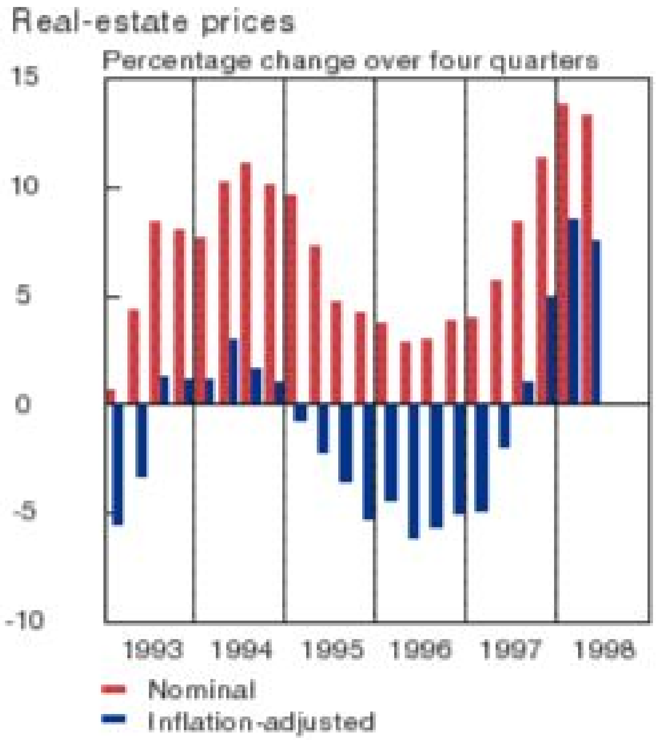
Non-residents' cumulative net purchases of shares and bonds



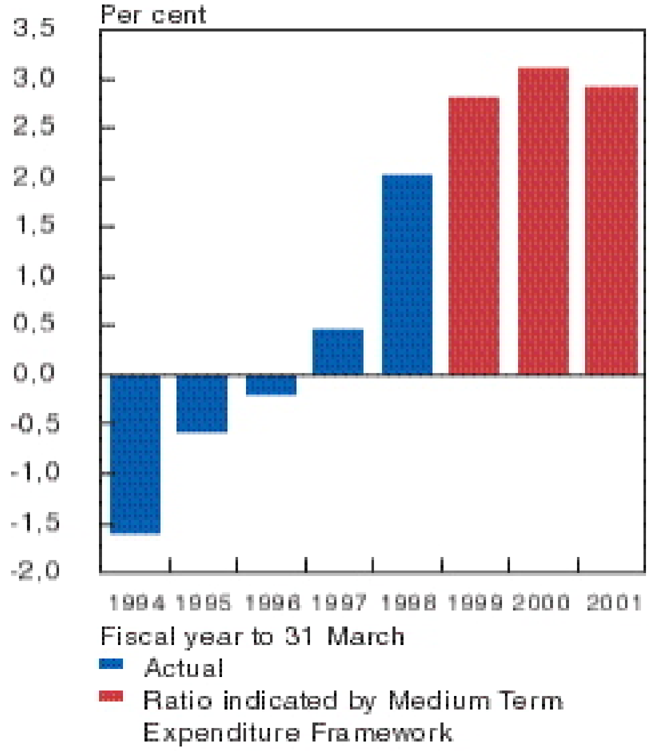
Share price movements



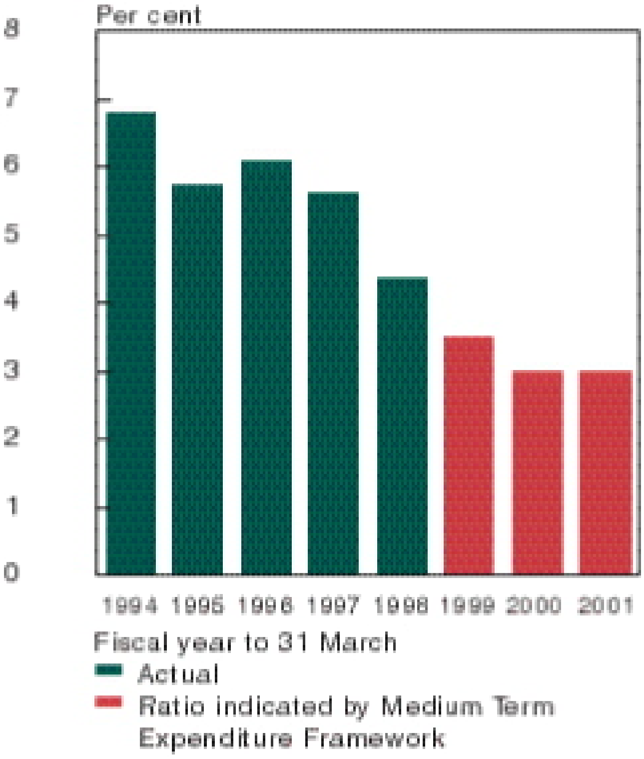

Average monthly share prices
Index: 1990=100
250
200
150
100
300
250
200
150
100
300
250
200
150
150
100
50
0
1993
1994
1995
1996
1997
1998
All classes
Financial
Industrial and commercial
Gold-mining


Real-estate prices
Percentage change over four quarters
15
10
5
0
-5
-10
1993
1994
1995
1996
1997
1998
Nominal
Inflation-adjusted

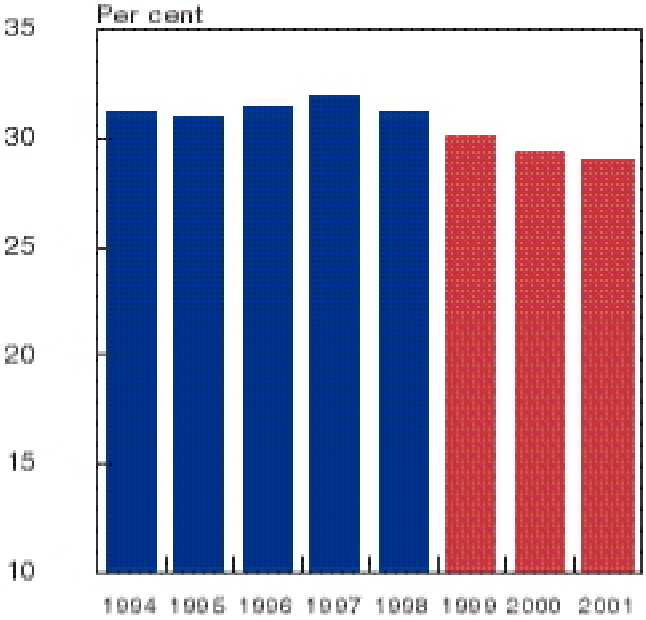
Primary balance as a ratio of gross domestic product



Deficit before borrowing as a ratio of gross domestic product

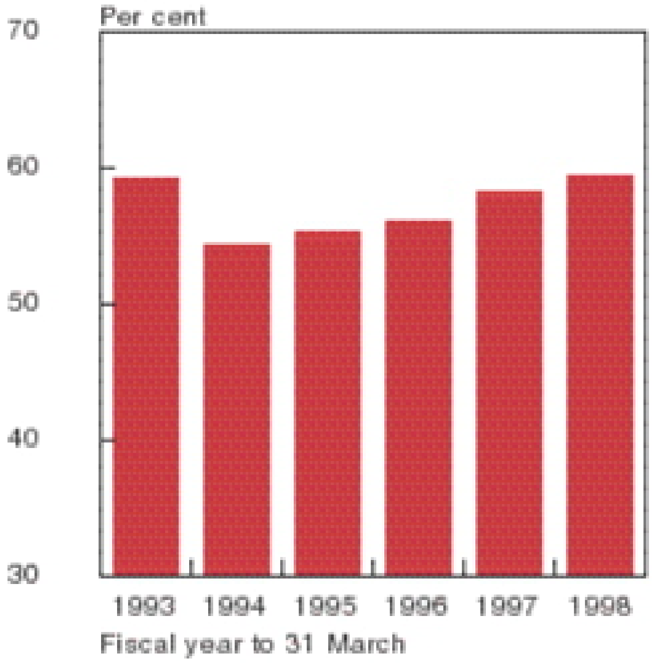


Exchequer issues to government departments as a ratio of gross domestic product

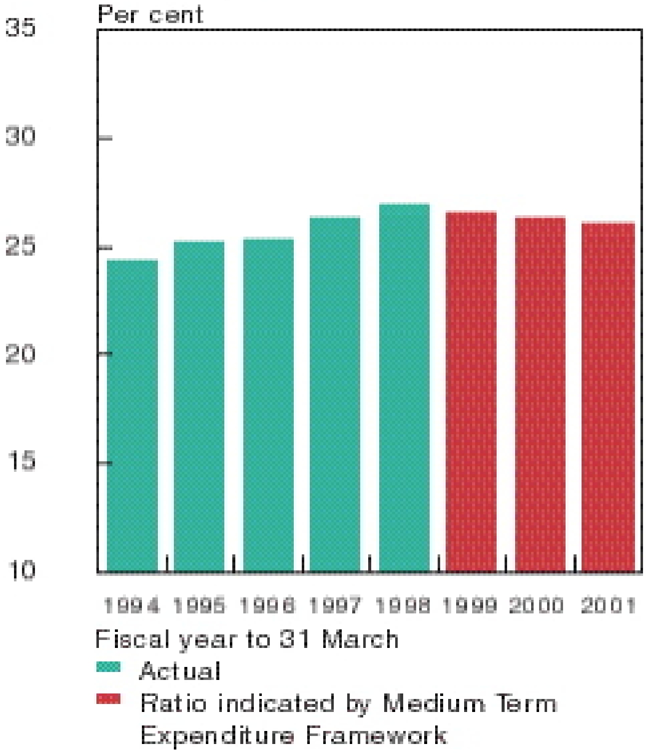


Actual
Ratio indicated by Medium Term Expenditure Framework

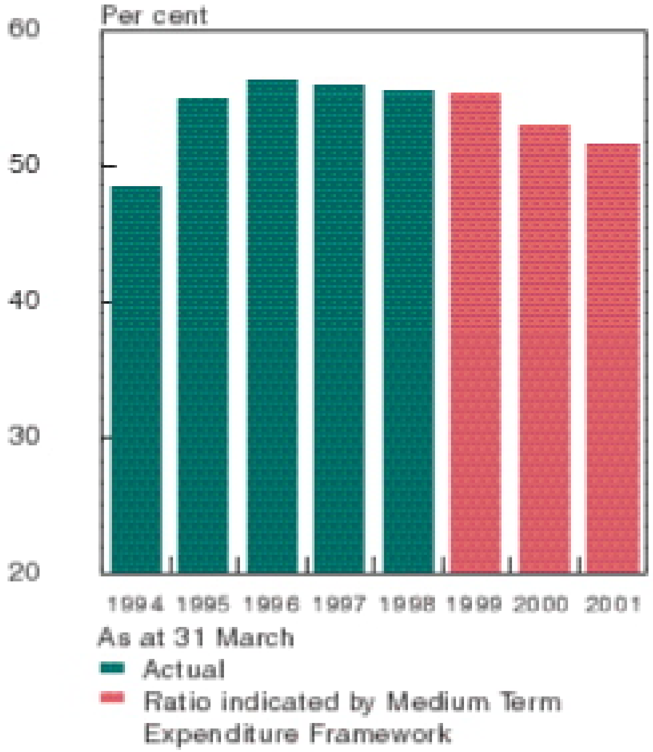
Direct taxes as a ratio of total tax collected



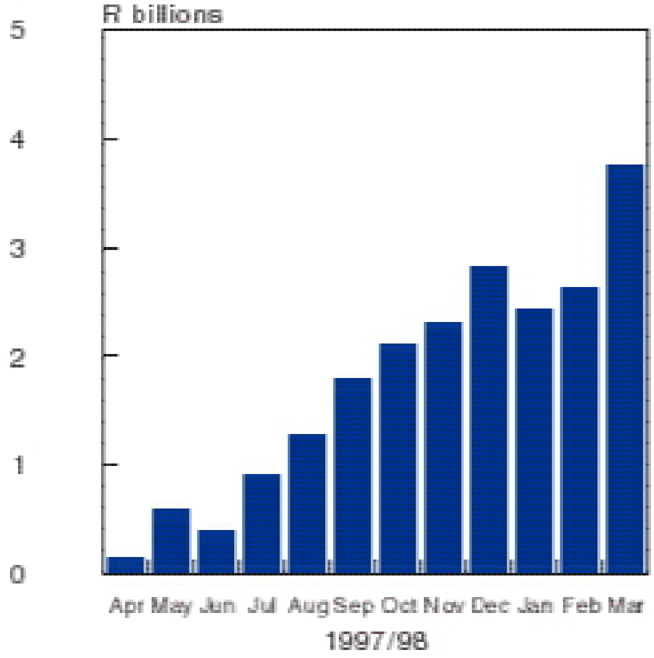
Exchequer receipts as a ratio of gross domestic product

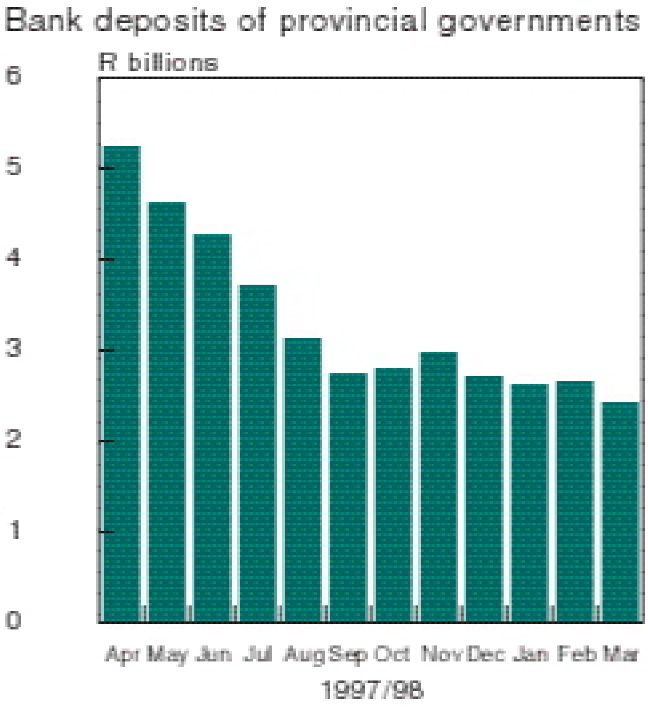


Total government debt as a ratio of gross domestic product



Bank indebtedness of provincial governments




Bank deposits of provincial governments
R billions
6
5
4
3
2
1
0
Apr May Jun Jul Aug Sep Oct Nov Dec Jan Feb Mar
1997/98

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