Annual Economic Report 2000

South African Reserve Bank

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Introduction

World economic activity expanded at a faster pace than expected in 1999 and the first half of 2000. As a consequence, recovery from the setbacks suffered domestically in 1998 was considerably quicker than initially anticipated. In addition, the outlook for future export-led growth in developing countries strengthened further during 1999, prompting both the International Monetary Fund and the Organisation for Economic Co-operation and Development to revise upwards their forecasts of world economic activity over the next two years. The outlook for demand, especially in the euro area, South Africa's most important export market, has improved substantially since 1998. The pace of economic activity in Southeast Asia, another prominent destination for South African exports, is also accelerating.

While economic activity picked up on a worldwide scale, inflation remained low in most industrial and emerging-market economies. The evidence of strong growth in most countries focused the attention of monetary policy-makers on the possible overheating of economies. Due to official monetary policy intervention, interest rates generally rose throughout 1999 and the first half of 2000, keeping inflation pressures at bay. Technological progress and disciplined fiscal policies helped to contain consumer price inflation in most of the countries that have established trade links with South Africa. Global inflationary pressures remained muted, even in the face of strongly rising international prices for crude oil.

The South African economy responded quickly to the recovery in the international economy – growth accelerated progressively from quarter to quarter during 1999. Contrary to general expectations, the synchronisation of the domestic economy with the international economy broke down in the first half of 2000. At an annualised average rate of just more than 1½ per cent in the first half of 2000, South Africa's economic growth fell behind that of the international economy. For 2000 as a whole, global economic growth is expected to be in the region of 4 per cent and in developing countries it may go as high as 5½ per cent.

The slowdown in the domestic economy in the first half of 2000 was mostly concentrated in the goods-producing sectors of the economy. It was not caused by weak aggregate domestic demand or a fall-off in foreign demand for exports from South Africa. In fact, strong aggregate domestic demand caused import volumes to rise from the first quarter of 1999 and export volumes also grew vigorously over the same period. The slowdown should rather be blamed on a phenomenon that has become typical of the modern South African economy: aggregate supply is invariably lethargic in its response to demand stimuli.

Prospects for longer-term high production growth have also waned because of a steep decline in the fixed investment ratio. Fixed capital formation of about 14½ per cent of gross domestic product is not enough to sustain a high rate of output growth and job creation. Since capital formation adds to the stock of productive capital and therefore determines the rate at which aggregate demand can grow without inducing inflation, the low investment ratio is effectively constraining the growth capacity of the economy and increasing the underlying inflationary potential. However, over the past eighteen months or so, real gross domestic expenditure grew broadly in tandem with gross domestic product so that there is little reason to expect any additional pressure on end-product prices from this source.

Although capital formation fell to a low level during 1999 and the first half of 2000, the share of total factor rewards allocated to capital increased somewhat at the expense of labour's share. With output volumes growing at a fairly modest pace, the growing share of the value of output accruing to employers may seem to indicate that end-product prices were rising faster than unit labour costs and that producers were widening their operating margins.

The improvement in gross operating surpluses nevertheless enabled the corporate sector to step up their saving. At the same time, the consistent application of prudent fiscal policy is reaping rewards and general government's dissaving has declined to a low level. It may not be too long before general government will start making a positive contribution to the national saving effort.

The greater thriftiness of companies and general government lifted the gross saving ratio to about 15½ per cent in the first half of 2000, even though household saving remained weak. Households allowed their consumption to increase faster than their rate of income growth. This strong preference for current consumption may, paradoxically, result in lower consumption in future since weaker income growth is the inevitable result of a poor saving ratio.

The recovery in economic activity from the end of 1998 could not bolster the job-creating capacity of the formal sectors of the economy – the quarterly measure of employment in the formal sectors of the economy continued to decline throughout 1999 and the early months of 2000. Part of the poor labour absorption capacity should be attributed to the persistent decline in the user cost of capital relative to wage costs, which has led to the substitution of capital for labour in the production factor mix over most of the past decade. Capital intensity grew steadily, accompanied by a growing volume of real output per employed worker. However, as new fixed investment was dedicated more to the replacement of labour, rather than expanding the productive base of the economy, the combined productivity of labour and capital, or multifactor productivity, grew far less impressively than labour productivity alone.

The relative decline in fixed capital formation, together with the substitution of capital for labour, counteracted the employment of more people in the formal sectors of the economy, but there are signs that the informal economy and other sectors of the formal economy not covered by regular surveys are absorbing more and more job-seekers. Formal and informal sector employment together increased in the three years to October 1999. Nevertheless, the total supply of labour still exceeds the demand for labour, leaving about one out of every four members of the economically active population among the ranks of the jobless.

From a global perspective, and despite the presence of domestic disinflationary forces, South Africa could not expect to escape the inflationary consequences of rising international prices of crude oil and of the depreciation of the rand. Oil prices, which had declined in 1998 and then helped to contain domestic inflation, began to rise sharply from the beginning of 1999 in response to efforts by oil-producing countries to reduce their output. This caused some acceleration in wholesale price inflation in South Africa's trading-partner countries, lifted the prices of goods imported by South Africa and was reflected in higher inflation at the production and consumer levels during the adjustment phase. From the beginning of 2000 inflation has also been exacerbated by higher food prices, following flood damage to crops and harvests, and by the weakness of the rand. Nevertheless, the outlook for inflation containment appears positive. Once the price effects of external shocks have permeated the economy, the overall thrust of counter-inflationary forces, such as slowdowns in the growth in aggregate monetary demand and unit labour cost, is expected to take hold again.

South Africa's balance of payments was profoundly influenced by developments in other emerging-market economies during the past three years. The deficit on the current account of the balance of payments widened to unsustainable proportions when the weak demand from the Southeast Asian economies impacted negatively on merchandise exports from South Africa. The tightening of monetary conditions around the middle of 1998 contributed to the containment of growth in import volumes in 1999 and, together with the recovery in the global economy, helped to improve overall macroeconomic balance. The deficit on the current account was reduced to levels that presented no serious financing problems and surpluses were recorded in three of the past six completed calendar quarters.

Net international capital inflows into South Africa recovered and strengthened from quarter to quarter in 1999, but weakened abruptly in the first half of 2000. Portfolio investments, which can easily be reversed in times of market uncertainty, dominated the inflows during 1999 and contributed to the eventual net outflow of capital in the second quarter of 2000. The sudden reversal from inflows to outflows of portfolio capital through the bond market in the first half of 2000 once again gives the impression that these capital flows are more sensitive to exogenous and non-economic events than to the changing underlying economic situation in South Africa.

Foreign direct investment into South Africa remained low relative to gross domestic product in 1999 and the first half of 2000. For 1999 as a whole, foreign direct investment amounted to about 1 per cent of gross domestic product and is widely regarded as too low to improve the long-run growth and labour absorption capacity of the economy. However, outward direct investment from the economy continued during the past six quarters as South African companies sought to diversify their operations and expand into other parts of the world. On a net basis, the accumulated movement of direct investment capital from South Africa totalled R7 billion from the beginning of 1994 to the middle of 2000. During 1999, foreign direct investment flows to emerging-market economies were almost exclusively the result of major privatisations in those economies.

There was a surplus on the overall balance of payments from the beginning of 1999 to the middle of 2000, resulting in a solid improvement in the net international reserves of the country. Only in the second quarter of 2000 did the international reserves position deteriorate marginally. The accumulation of international reserves over the past six quarters made possible a substantial improvement in the net open position in foreign currency of the Reserve Bank. In this way, the Bank has gradually been eliminating an element of the perceived vulnerability of the South African financial system. The stronger financial situation in the country was also reflected in an improvement in import cover from about 10½ weeks at the end of 1998 to 14½ weeks in the second quarter of 2000.

The surplus on the overall balance of payments reduced pressures in the foreign exchange market during 1999 and the nominal effective exchange rate of the rand appreciated slightly from the end of 1998 to the end of 1999. Fluctuations nevertheless occurred as news, often of a non-economic nature, was factored into the decisions of market participants. This was particularly evident in the first half of 2000 when the rand weakened in response to renewed concerns about emerging markets and political stability in a small number of sub-Saharan countries. In real terms, i.e. taking into consideration the inflation differential between South Africa and its main trading partners, the rand has depreciated over the past year and a half, putting South African producers in a far better price-competitive position in export markets.

Despite the easing of monetary policy, the expansion of money and bank credit aggregates slowed down during most of 1999 and early 2000. Part of this can be explained as the usual slowdown following a decline in bank lending rates. There was a sudden spurt in monetary growth in the second half of 1999 when the recovery in the economy gathered momentum, but this was short-lived and the expansion of money and credit totals slowed down once more in the first half of 2000. There are signs that the threat of higher inflation may have been curbed and that the external price shocks that pushed inflation higher in the short run may not translate via second-round effects into higher inflation in the medium term.

The income velocity of money has generally declined over the years since 1993. This stemmed partly from the success of monetary policy in ensuring a relatively balanced macroeconomic situation. With inflation on the wane, money as a store of value is steadily being re-established. The recent introduction of an inflation-targeting monetary policy framework may help to lower inflation expectations, and so raise the demand for money and reduce the velocity of circulation even further.

The expansion of the narrower monetary aggregates over the past eighteen months or so was stronger than the growth in M3. The accumulation of short-dated deposits by companies and households may point to some unwillingness to commit funds to the expansion of production capacity and consumption expenditure respectively. This mood of weak confidence was probably a reaction to the same circumstances that caused the rand to depreciate in the first half of 2000. Once sentiment improves and confidence is restored, companies seem to have the wherewithal to step up their investment in productive assets. Households, however, still appear to be cautious about deploying cash holdings and using debt for financing current expenditure.

The past year saw many steps being taken to ensure that the domestic securities markets stay abreast of the latest innovations in the global financial markets. Exchange controls were relaxed, regulatory and supervisory practices continued to be harmonised with international best practice, the electronic infrastructure of markets was strengthened and new financial products were introduced. These measures raised the stature and the efficiency of the domestic markets and contributed to financial market behaviour that was not nearly as disruptive as in 1998.

Bond yields, which had declined quite markedly during 1999 following the turmoil of 1998, rose noticeably in the first four and a half months of 2000 when investor sentiment turned negative towards South Africa. It was only from the middle of May 2000 that confidence was gradually restored and some of the earlier losses were regained. The share market also rebounded from September 1999, but faltered along with the bond market in the first four to five months of 2000. Indications of a slowdown in the pace of economic activity, and market talk of possible increases in money-market interest rates, dampened confidence and led to a decline in share prices. Most of the factors that turned sentiment against share investment, including those emanating from other parts of the continent, appeared to have subsided by about the end of May 2000 and share prices rose in June and July.

Along with prudent fiscal management and a reduction in the borrowing requirement of the public sector, there was a steep decline in the amount of capital raised in the primary debt market during the past year. The public sector's reduced demand for loanable funds then left ample available resources to be taken up by private-sector borrowers. Low investment activity prevented this from occurring, but there were indications that private-sector companies were beginning to fill the void in the debt market left by the shrinking of the public-sector borrowing requirement.

The national government continued to consolidate the fiscal position and improve the management of public finances. The deficit before borrowing and debt repayment of national government has now been lowered to 2,6 per cent of gross domestic product. More impressive was the decline in the overall public-sector borrowing requirement which fell to just more than 1 per cent of gross domestic product – in fiscal 1993/94 the public-sector borrowing requirement was still equal to 10 per cent of gross domestic product. The healthier state of public finances was also reflected in a decline in the ratio of national government debt to gross domestic product and a decline in the share of overall national government spending devoted to interest payments. Overall, government's funding strategy is considered to be on a sound basis, judging by the successful issuance of bonds in international capital markets in the past eighteen months.

Over the past decade South Africa's gross domestic product grew at an average annual rate of only 1½ per cent while the unemployment rate is currently running at 23 per cent of the economically active population. Several years of high and stable growth would be necessary to reduce unemployment, and with it poverty. For higher growth, it is important to raise the ratio of fixed capital formation to gross domestic product from its current depressed level. Equally important is that the prices of production factors should be realigned so that producers could introduce more labour-intensive production technologies.

While the pursuit of sound macroeconomic policies undoubtedly helps to reduce inflation and inflation uncertainty, this is apparently not sufficient to raise the investment ratio, and further structural adjustments are necessary to attract higher levels of foreign direct investment. Greater diversification of production, preferably aimed at broadening the export base of the economy, would make the country more attractive for foreign direct investment. Above all, such structural diversification would make the country less vulnerable to changes in the global demand for primary commodities and shifts in the international terms of trade.

Domestic economic developments

Gross domestic production

Growth in real gross domestic product accelerated from ½ per cent in 1998 to 1 per cent in 1999. This recovery was particularly noticeable in the second half of 1999 when real gross domestic product grew at an annualised rate of 3 per cent. In the first half of 2000 economic growth slowed down again to an annualised rate of about 1½ per cent. Despite the slowdown, the total value of real gross domestic product in the first half of 2000 was still about 2½ per cent higher than in the first half of 1999.

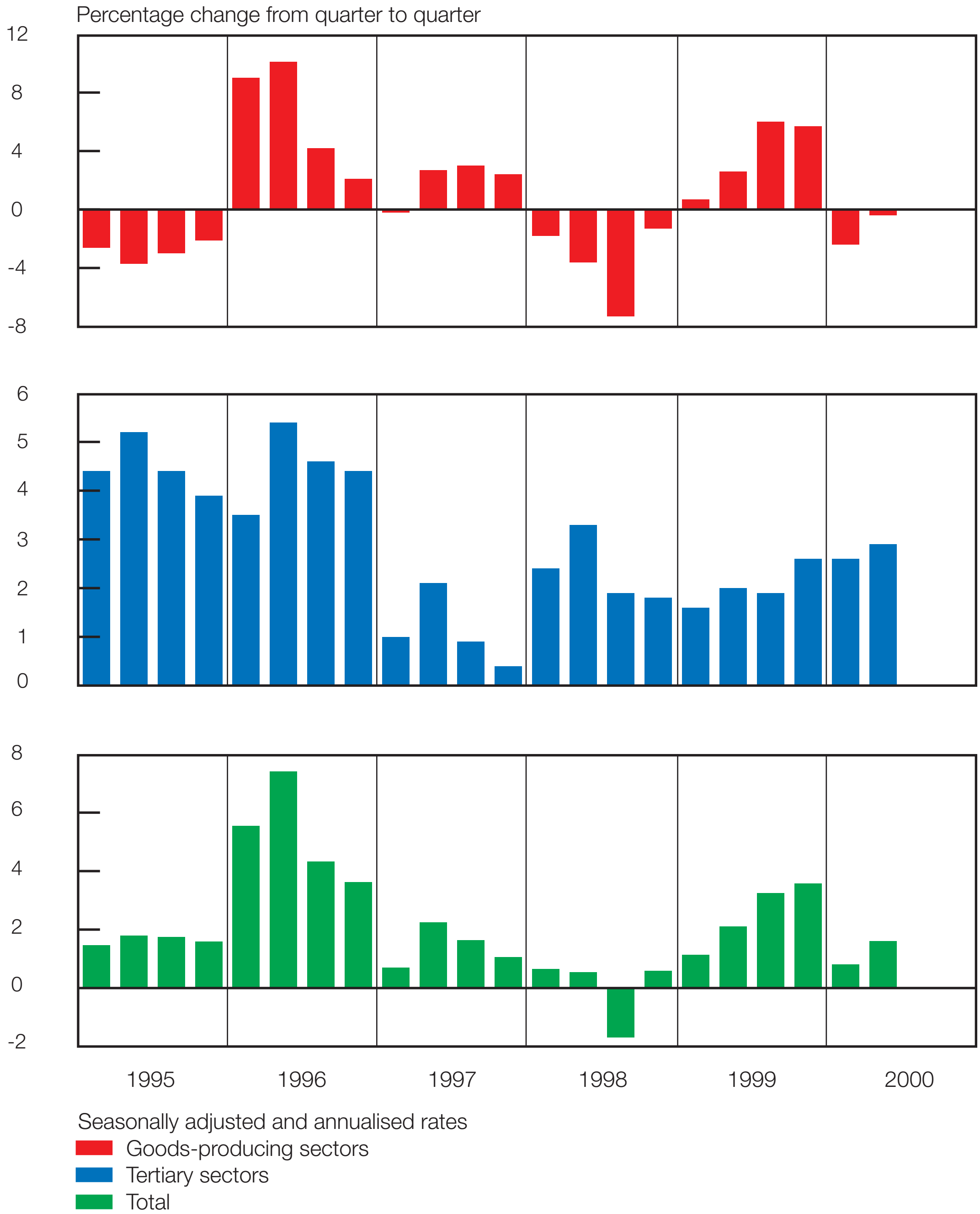
Real gross domestic product
Percentage change at seasonally adjusted and annualised rates

Sectors	1998	1999			2000
	Year	1st half	2nd half	Year	1st half
Primary sectors	-1½	1	9½	1	-4½
Agriculture	-3	3½	25½	4½	-7
Mining	-½	-½	-1	-1	-2
Secondary sectors	-1	½	3½	0	2
Manufacturing	-2	1	4	0	2
Electricity, gas and water	1	-1½	3	0	2½
Construction	1	-2	-1½	-1½	½
Tertiary sectors	2	1½	2	2	2½
Commerce	-1½	½	2	0	3½
Transportation and communication	8	5½	4	6½	4½
Financial and other services	3½	2	4	3	4
Non-agricultural sectors	1	1	2	1	2
Total	**½**	**1**	**3**	**1**	**1½**

The slow pace of economic expansion in the first half of 2000 was caused by slower growth in the secondary sectors of the economy and a decline in the real value added by the primary sectors. As a consequence, the share of the goods-producing industries in total gross value added declined further from 35 per cent in the first half of 1999 to 34½ per cent in the first half of 2000. The average ratio for the 1990s was calculated at 39 per cent. The changing production structure of the economy, shifting away from goods-producing industries towards service-providing industries, is similar to developments normally associated with economic development.

Following a decline of 3 per cent in 1998, the real value added by the *agricultural sector* increased by 4½ per cent in 1999 as field crop production returned to more normal levels after the poor harvests of 1998. In the first quarter of 2000, agricultural output in the northern and eastern parts of the country was adversely affected by torrential rain and flooding, whereas in the south-western wine and deciduous fruit producing areas extensive damage to crops was caused by high temperatures and veld fires. In addition, the bulk of the maize crop is expected to be harvested in the third quarter of 2000. Total agricultural output consequently declined in the first half of 2000.

Growth in real gross domestic product



The real value added by the *mining sector*, which had declined from quarter to quarter since the beginning of 1998, levelled out in the fourth quarter of 1999, essentially on account of increased output volumes in the non-gold segment of the industry. In the first half of 2000, mining output fell back again to levels that were lower than in the second half of 1999. Gold output continued to fall, whereas coal mines, facing oversupply on the international markets, had to cut back on output volumes. The platinum group of metals has benefited from firmer international commodity prices since the end of 1999, but output responses in this subsector were overshadowed by production cuts elsewhere in the mining industry.

The quarter-to-quarter growth in total *real manufacturing production* accelerated from a seasonally adjusted and annualised rate of 1 per cent in the first quarter of 1999 to 7 per cent in the fourth quarter. This large increase in manufacturing production was spurred by the firming of export demand for certain types of manufactured goods, including locally manufactured motor vehicles, and the greater price competitiveness of domestic producers in export markets. In addition, there was a need among producers and traders to replenish inventories ahead of an expected pick-up in aggregate demand.

Demand growth in the first half of 2000 turned out to be considerably weaker than anticipated, causing manufacturing output growth to become far more subdued and the underutilisation of production capacity to worsen somewhat. Apart from the potential impact of weaker-than-expected demand growth and perhaps some unplanned inventory accumulation, manufacturing production in the first half of 2000 was held back by a spate of strikes and work stoppages, and also by supply delays caused by the disruption of agricultural production in the first few months of the year. The statistical carry-over effect of the high production volumes of the fourth quarter of 1999 nevertheless ensured a year-on-year growth of 3 per cent in the real value added by the manufacturing sector in the first half of 2000.

After the real value added by the sector supplying *electricity, gas and water* had declined in the first quarter of 1999, it recovered somewhat and increased at annualised rates of 1½ per cent, 3 per cent and 5 per cent in the ensuing three quarters. During the first half of 2000 output growth in the electricity-generating sector slowed down somewhat along with the weakening of overall economic activity. In addition, the real output in the subsector responsible for water supply was negatively affected by the abundant rain and cooler weather conditions in the first half of 2000.

The level of the real value added by the construction sector showed little change in the first half of 2000, following a decline in 1999 as a whole. Building and construction activities were hampered by, *inter alia*, the prolonged effects of the high interest rates in the second half of 1998, the lower demand from government for infrastructural development and the slow delivery of low-cost housing. Furthermore, the building and construction industry was slow in its efforts to improve productivity by minimising the cost of labour through the reduction of direct employment and subcontracting.

The growth in the real value added by the *tertiary sectors* continued unabated during 1999 and the first half of 2000. The growing competition in global markets, coupled with productivity growth and advances in technology, accounted for structural developments which benefited the service-delivery industries of the economy. These developments contributed to the sustained growth in the real value added by the tertiary sectors and increased their combined share in total value added from 65 per cent in the first half of 1999 to 65½ per cent in the first half of 2000.

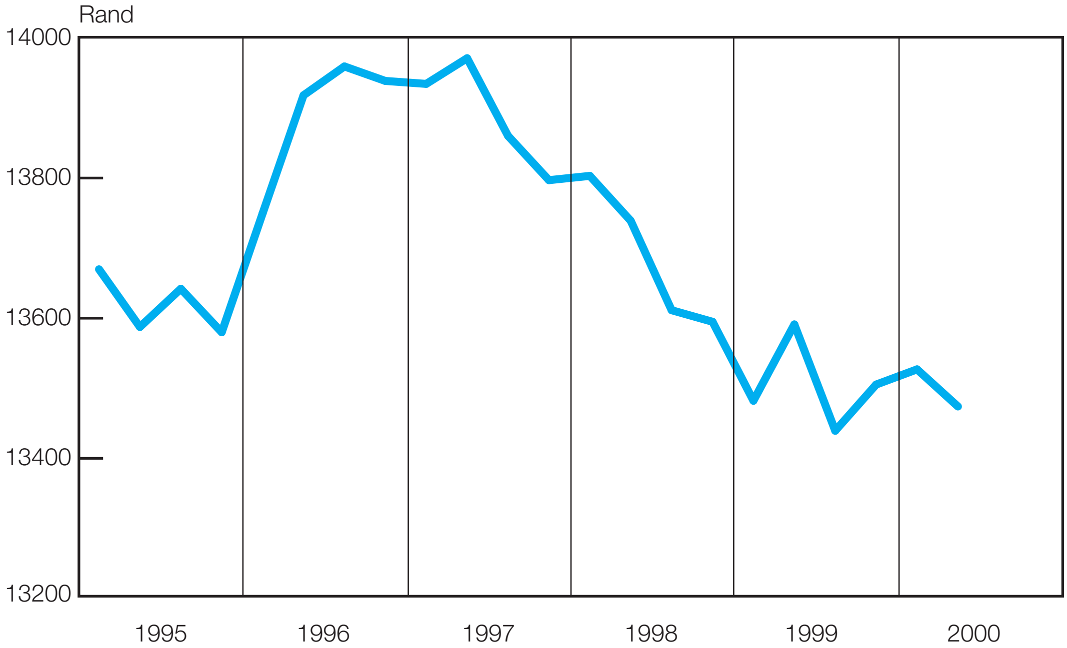
In *commerce,* the real value added increased at modest quarter-to-quarter and annualised rates of between 1½ and 2 per cent throughout 1999. In the first half of

2000 growth in the real value added by this sector accelerated to an annualised rate of about 3½ per cent, boosted mainly by lively activity in the retail and motor trade subsectors. Catering and accommodation services also benefited from relatively buoyant tourism activity.

The continued expansion of the country's telecommunications network ensured steady growth in the real value added by the sector *transport, storage and communication* throughout 1999 and into the first half of 2000. The real value added by the *finance, insurance, real-estate and business services sector* increased in the first half of 2000 at about the same rate as during the second half of 1999. Growth in the first half of 2000 was sustained essentially by the strong pick-up in transaction volumes in the real-estate market. By contrast, real value added by the government sector declined in the first half of 2000.

After increases of ½ per cent in 1998 and 1 per cent in 1999, *real gross national income* increased at an annualised rate of about 2½ per cent in the first half of 2000. The stronger growth in the first half of 2000 was due to continued growth in real gross domestic production, coupled with lower net primary income payments to the rest of the world. Net primary income payments to the rest of the world shrank mainly because of lower interest payments to non-resident holders of South African fixed-interest securities, following the reversal of portfolio capital flows into South Africa in the first six months of 2000. Real national income was further strengthened by an improvement in the terms of trade, which permitted the importation of an increased quantity of goods and services from the rest of the world in exchange for an unchanged quantity of goods and services exported. Despite the slight improvement in growth of aggregate national income, *national income per capita* in the first half of 2000 was still about 3½ per cent lower than the most recent high point attained in the second quarter of 1997.

Gross national income per capita at 1995 prices

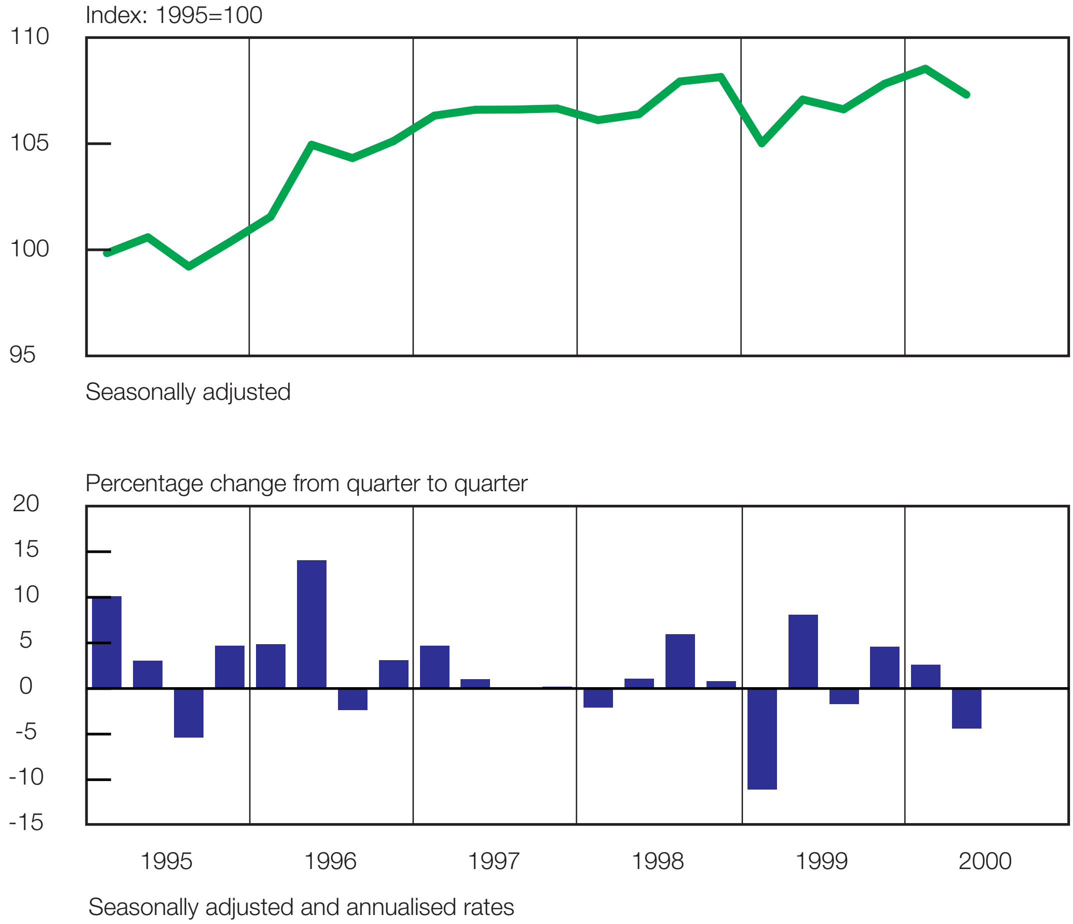


Seasonally adjusted and annualised rates

Gross domestic expenditure

The quarter-to-quarter change in aggregate *real gross domestic expenditure* was erratic in 1999 and a change in any one quarter was followed by a change in the opposite direction in the subsequent quarter. For the year 1999 as a whole, real gross domestic expenditure declined by ½ per cent. There was an increase of ½ per cent in 1998, implying that the level of aggregate real domestic expenditure in 1999 was about equal to that of 1997. A modest recovery followed in the first half of 2000 when real gross domestic expenditure expanded at an annualised rate of some 1½ per cent.

Real gross domestic expenditure



Measured over one year, real gross domestic *expenditure* increased by almost 2 per cent in the first half of 2000. Over the same period, real gross domestic *product* grew at a rate of about 2½ per cent. Considering that the growth over one year in gross domestic expenditure in the first half of 2000 was relatively slower than the growth in real gross domestic product, there is little reason to expect additional upward pressure from domestic demand on the average level of prices.

The increase in real gross domestic expenditure in the first half of 2000 was brought about by an accumulation of inventories and a further increase in domestic final demand. Growth in real final consumption expenditure by households and real fixed capital formation accelerated in the first half of 2000. Real final consumption expenditure by general government continued to decline.

Final consumption expenditure by households

Real final consumption expenditure by households, which accounted for about 63 per cent of aggregate gross domestic product, grew at progressively faster rates in the four quarters of 1999 and continued to grow at an average year-on-year rate of 3 per cent in the first half of 2000. In the first half of 1999, household spending was still held back by weak consumer confidence following the high interest rate levels during the second half of 1998. Because of this slow growth in the first half of the year, real final household consumption expenditure increased by only ½ per cent in 1999 as a whole.

Real final consumption expenditure by households
Percentage change at seasonally adjusted and annualised rates

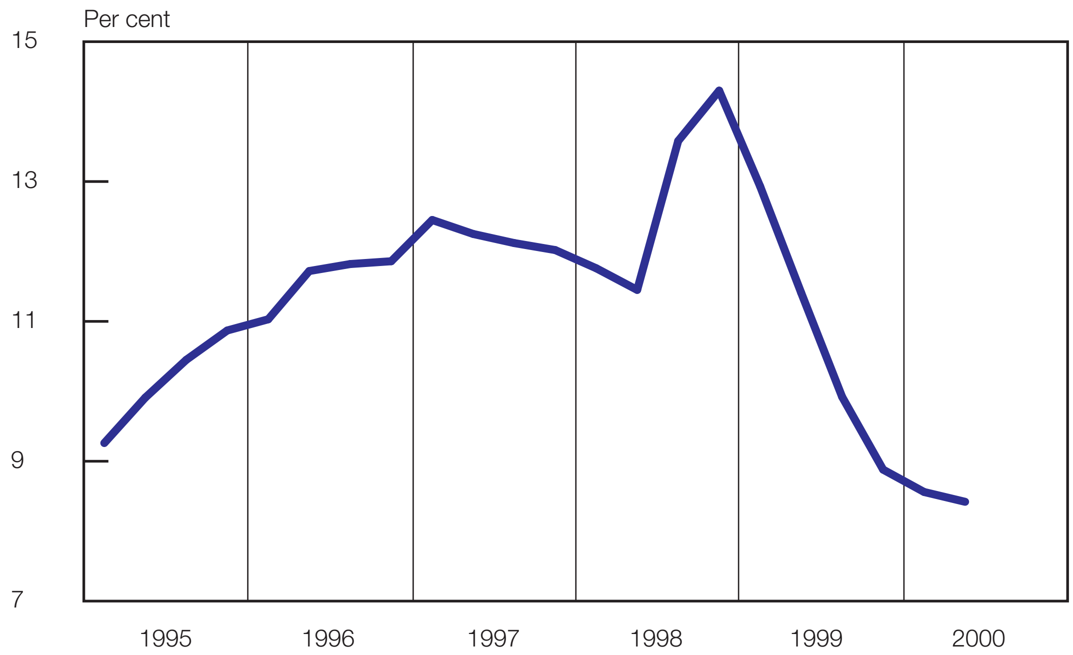
Components	1998	1999			2000
	Year	1st half	2nd half	Year	1st half
Durable goods	-6	-9½	7½	-6½	5½
Semi-durable goods	2½	-4½	5	-1	7
Non-durable goods	1	0	½	½	2
Services	3	2½	3	3	3
Total	**1½**	**0**	**2½**	**½**	**3**

From about the middle of 1999 consumers became far more confident and stepped up their recurrent expenditure. Sharp increases were then registered in expenditure on durable goods, especially furniture and transport equipment, and semi-durable goods and services, and spending on non-durable goods also started to rise faster.

The more positive attitude of households could, among other things, be ascribed to
- the easing of monetary conditions from October 1998 and the decline in bank lending rates;
- the improvement in the balance sheets of households as equity and residential property values recovered from their very depressed levels in the second half of 1998;
- moderate real wage increases during 1999 and the first half of 2000;
- higher property income resulting from dividends paid out and the recovery in farm incomes; and
- the lowering of effective income-tax rates on individuals, which generally took effect from the second quarter of 2000.

The growing optimism among consumers encouraged them to become somewhat less averse to debt financing than before. Whereas the growth over one year in household debt had fallen to a meagre 2 per cent in the fourth quarter of 1999, it picked up to about 4½ per cent in the first half of 2000. Nevertheless, the growth in outstanding household debt was still below the growth in household disposable income, thus lowering the household debt-to-income ratio from 59½ per cent at the beginning of 1999 to 57 per cent in the first half of 2000. This, together with the general decline in interest rates from the end of 1998, reduced the debt service costs of households from 14½ per cent of their disposable income in the fourth quarter of 1998 to an average of 8½ per cent in the first half of 2000. This meant that households had more capacity to spend on consumables, or to accumulate assets.

Debt-servicing cost of households as percentage of households' disposable income



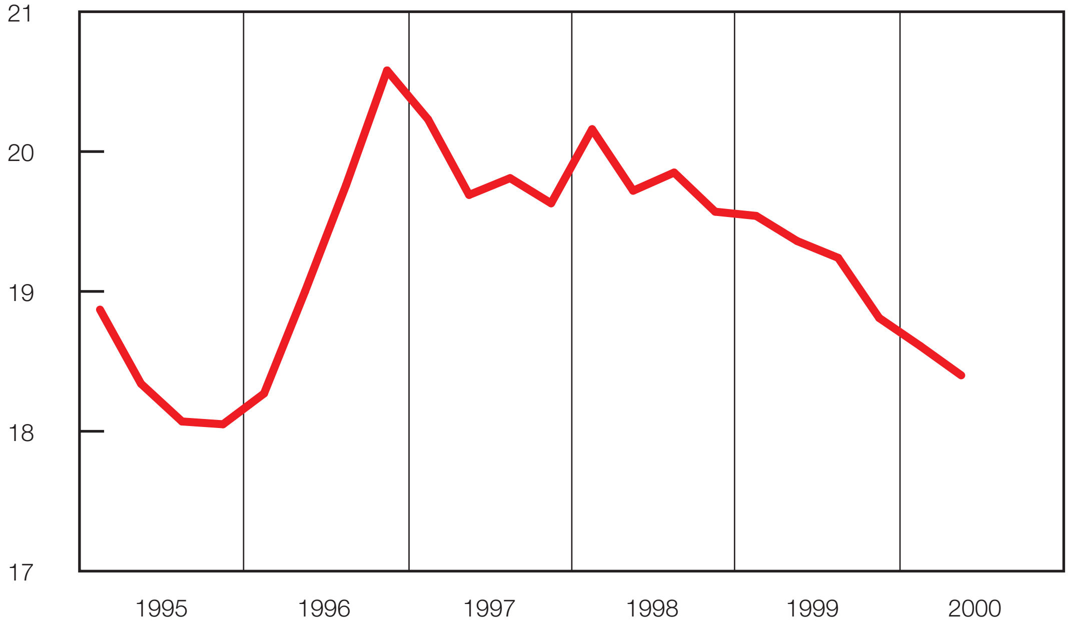
Seasonally adjusted

Final consumption expenditure by general government

Real final consumption expenditure by general government, which had declined by ½ per cent in 1998 and 2 per cent in 1999, declined further at an annualised rate of 3½ per cent in the first half of 2000. Declines in inflation-adjusted spending on intermediate goods and services, and reductions in employment levels, contributed to the fall in real recurrent spending by general government. A consequence of this rationalisation process was that the ratio of final consumption expenditure by general government to gross domestic product declined from close to 20 per cent in 1998 to 18½ per cent in the first half of 2000.

The decline in real consumption expenditure by general government departments is a clear reflection of government's determination to apply fiscal discipline as part of a broader strategy for creating an environment conducive to faster economic growth and job creation. Over the past four years or so, spending has been more severely reduced on purchases of intermediate goods and services than on salaries and wages. The compensation of employees as a percentage of final consumption expenditure by general government accordingly increased from 69 per cent in the first quarter of 1997 to an average of about 72½ per cent in the first half of 2000. This increase also reflects a gradual shift of expenditure away from providing collective services (such as defence, public order and safety) and general services, towards providing individual goods and services (such as healthcare, education and other social services). Almost 90 per cent of general government's expenditure for individual service-delivery is on employee compensation.

Final consumption expenditure by general government as percentage of gross domestic product



Gross fixed capital formation

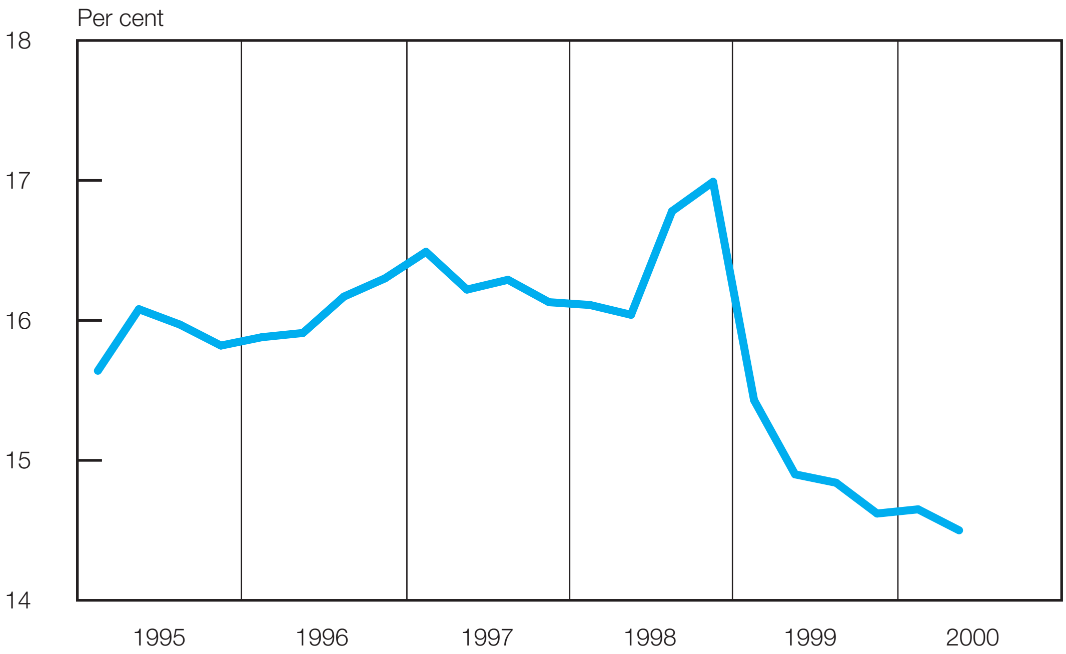
Real gross fixed capital formation, which had declined steeply in the first three quarters of 1999, appeared to have levelled out in the fourth quarter before increasing modestly in the first half of 2000. The increase in the first half of 2000 was concentrated in private-sector investment activity. Gross fixed capital formation in the public sector continued to decline, essentially because of further cuts in investment by public corporations.

Real gross fixed capital formation by type of organisation
Percentage change at seasonally adjusted and annualised rates

Components	1998	1999			2000
	Year	1st half	2nd half	Year	1st half
Private business enterprises	-3	-5½	0	-4½	5
Public corporations	51½	-42	-24½	-17	-15
General government	2½	-9	-3½	-5½	1½
Total	**5**	**-14½**	**-5**	**-7**	**1½**

The reduction in fixed investment in 1999 and the small increase in the first half of 2000 meant that gross fixed capital formation as a percentage of gross domestic product fell from 17 per cent in the fourth quarter of 1998 to an average of 14½ per cent in the first half of 2000. As capital formation adds to the stock of productive capital and therefore to the supply potential of the economy, which in turn determines the rate at which aggregate demand can grow on a sustainable basis without inducing inflationary pressures, the declining trend in the investment ratio is effectively putting a lid on the long-term growth capacity of the economy and adding to the underlying inflation potential.

Gross fixed capital formation as percentage of gross domestic product



Seasonally adjusted

After eight quarters of successive declines in private-sector real fixed capital formation, there were indications of some recovery when increases were recorded in the fourth quarter of 1999 and the first half of 2000. Apart from the mining and construction sectors, all the main sectors of economic activity contributed to the expansion of private fixed investment in the first half of 2000. Companies apparently started to increase capital spending in anticipation of stronger growth in domestic and export demand. Declines in the costs of borrowed capital, and some tentative indications that the level of capacity utilisation in manufacturing was unlikely to deteriorate further, might also have added to the expansion of private-sector investment activity in the first half of 2000.

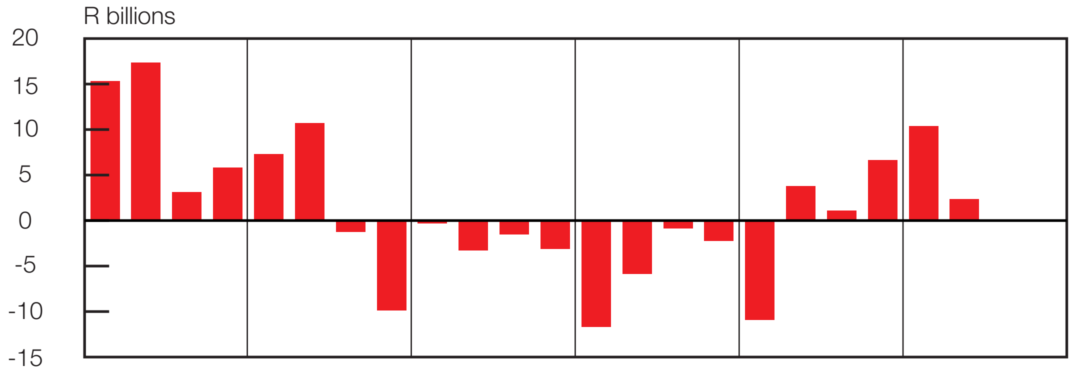
There was a sharp decline in real outlays on fixed capital goods by the public sector throughout 1999 and in the first half of 2000. Admittedly, this came from a very high base in 1998 when Telkom and South African Airways were rapidly adding to productive capacity. Largely because of the completion of these expansion programmes, the average annualised level of total real gross fixed capital formation by public corporations was about 29 per cent lower in the first half of 2000 than in 1998.

Real fixed capital formation by general government declined by 5½ per cent in 1999. There were signs of a slight recovery in the fourth quarter of 1999, which appeared to have spilled over into the first half of 2000, but general government fixed capital formation in the second quarter of 2000 was still some 3½ per cent lower than in the first quarter of 1999. Over time, general government capital expenditure as a percentage of total government expenditure has declined from roughly 40 per cent in the 1970s to about 10½ per cent in the first half of 2000. Part of this decline should be attributed to the transfer of certain functions from the general government sector to either the private sector or public corporations.

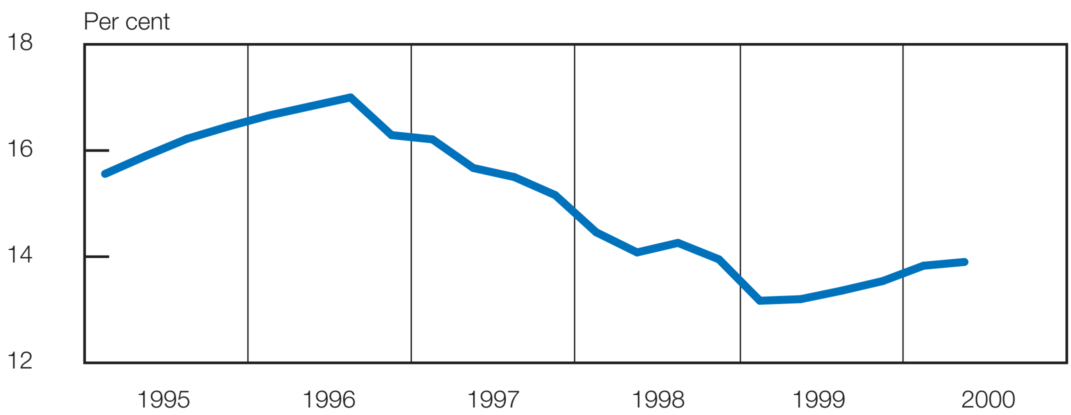
Change in inventories

The inventory cycle reached a lower turning point in the first quarter of 1999 when the inflation-adjusted value of real inventories was reduced at an annualised rate of R9,7 billion. Over the ensuing five quarters, inventory levels were steadily replenished in the industrial and commercial sectors of the economy as businesses positioned themselves in anticipation of a strengthening of aggregate demand and in response to the declining cost of holding inventories. When the strengthening of demand turned out to be somewhat below expectations, some involuntary stockpiling could reasonably be expected to have occurred in the first half of 2000.

Industrial and commercial inventories



Changes at seasonally adjusted and annualised rates



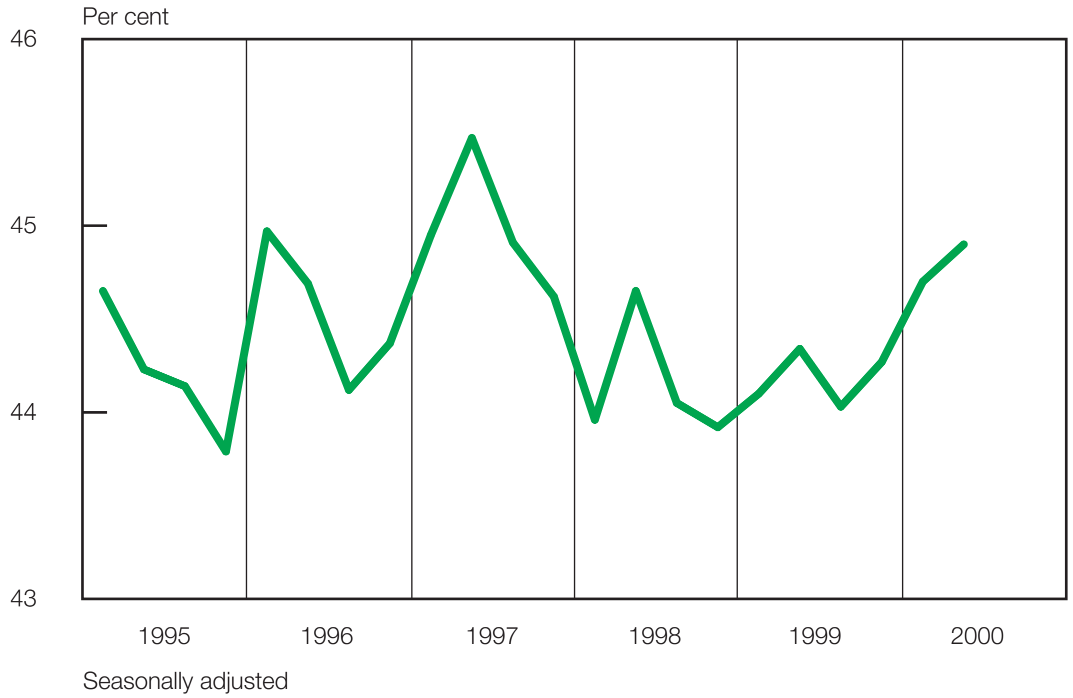
Inventories as percentage of non-agricultural gross domestic product
Seasonally adjusted

The level of industrial and commercial inventories relative to non-agricultural gross domestic product traced the inventory cycle closely and reached a lower turning point of 13 per cent in the first quarter of 1999. Along with the inventory build-up in the subsequent five quarters, the inventory to gross domestic product ratio increased to an average of 14 per cent in the first half of 2000. Inventory accumulation added a ½ percentage point to overall economic growth in 1999 as a whole and in the first half of 2000, compared with the situation in 1998 when the draw-down of inventories lowered the growth in real gross domestic product by a ½ percentage point.

Factor income

The growth over four quarters in total nominal factor income accelerated from 7½ per cent in the third quarter of 1999 to 8 per cent in the fourth quarter and the first half of 2000. The growth in operating surpluses accelerated from 1999 to 2000, and more than compensated for slower growth in employee remuneration. These movements indicate that businesses might have widened their operating margins somewhat, thus contributing to existing upward pressures on end-product prices.

Gross operating surplus as percentage of total factor income



The year-on-year rate of increase in total compensation of employees decelerated from 9½ per cent in 1998 to 7½ per cent in 1999 and 6½ per cent in the first half of 2000. Apart from the mining and trade sectors, remuneration growth slowed down in all the main sectors of the economy, but the slowdown was somewhat more pronounced in the manufacturing and finance sectors. The growth in employee remuneration nevertheless continued to exceed overall consumer price inflation, resulting in continuous increases in real employee remuneration and the real disposable income of households.

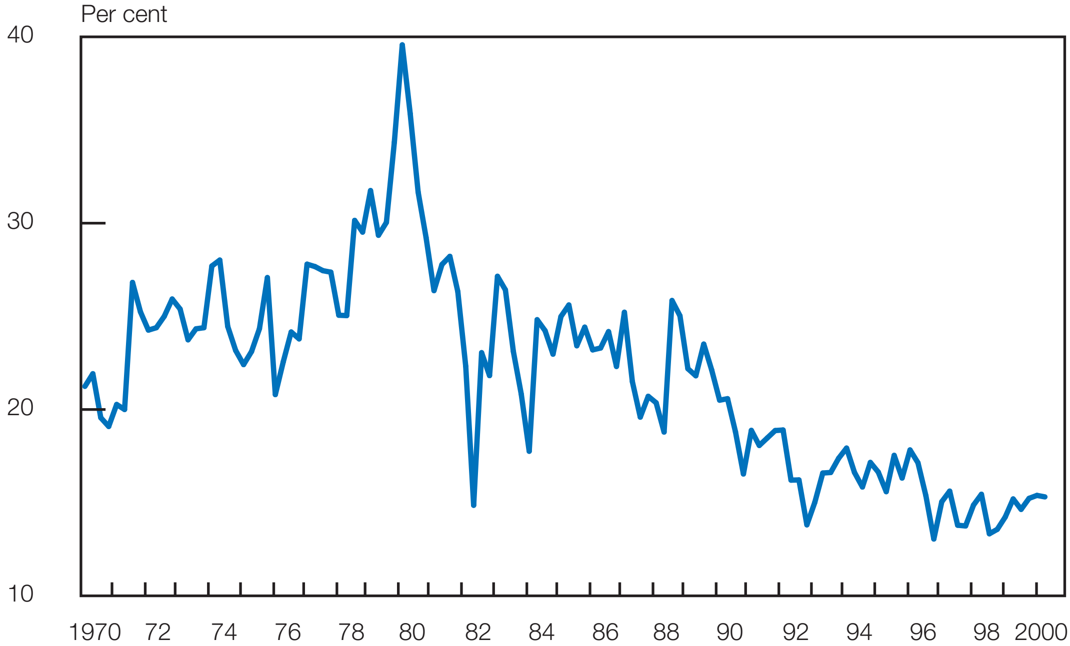
The slowdown in the growth in the compensation of employees was, among other things, occasioned by the response of domestic producers to labour cost pressures. By rationalising their employment of labour, businesses managed to contain cost pressures and remain competitive compared with producers in other parts of the world. In this process, the share of workers in the total value of factor income declined from 56 per cent in the first quarter of 1999 to 55 per cent in the first half of 2000. In the long run, the overall share of employees in the total value of output was calculated to be just below 57 per cent.

Growth over one year in aggregate nominal operating surpluses accelerated from 6 per cent in 1998 to 8 per cent in 1999 and to 10 per cent in the first half of 2000. All the major sectors of the economy shared in the faster growth in operating surpluses, with the mining and manufacturing sectors perhaps slightly ahead of the others. The pick-up in economic activity, rising productivity per employed worker and the slowdown in the growth in employee compensation all contributed to higher profitability and faster growth in gross operating surpluses. In addition, operating surpluses in the mining industry benefited from the higher commodity prices in the first half of 2000.

Gross saving

South Africa's gross saving as a percentage of gross domestic product deteriorated consistently from the middle of the 1980s, reaching a historic low of 14½ per cent in 1998. The saving ratio vacillated somewhat during 1999 but rose to 15½ per cent in the first half of 2000. This improvement was mainly due to a smaller net dissaving by general government and, to a lesser extent, a strong saving performance of the corporate sector.

Gross saving as percentage of gross domestic product



Seasonally adjusted

Gross saving by the corporate sector as a percentage of gross domestic product increased from 12 per cent in the fourth quarter of 1998 to an average of 12½ per cent in 1999 and the first half of 2000 as dividend growth tended to fall behind the growth in operating surpluses. Gross dissaving by general government declined even more markedly: from the equivalent of 2½ per cent of gross domestic product in the third quarter of 1998 to less than ½ per cent in the first half of 2000. The consistent application of disciplined fiscal policies is steadily reaping rewards and it may not be too long before the general government sector will again be making a positive contribution to the national saving effort.

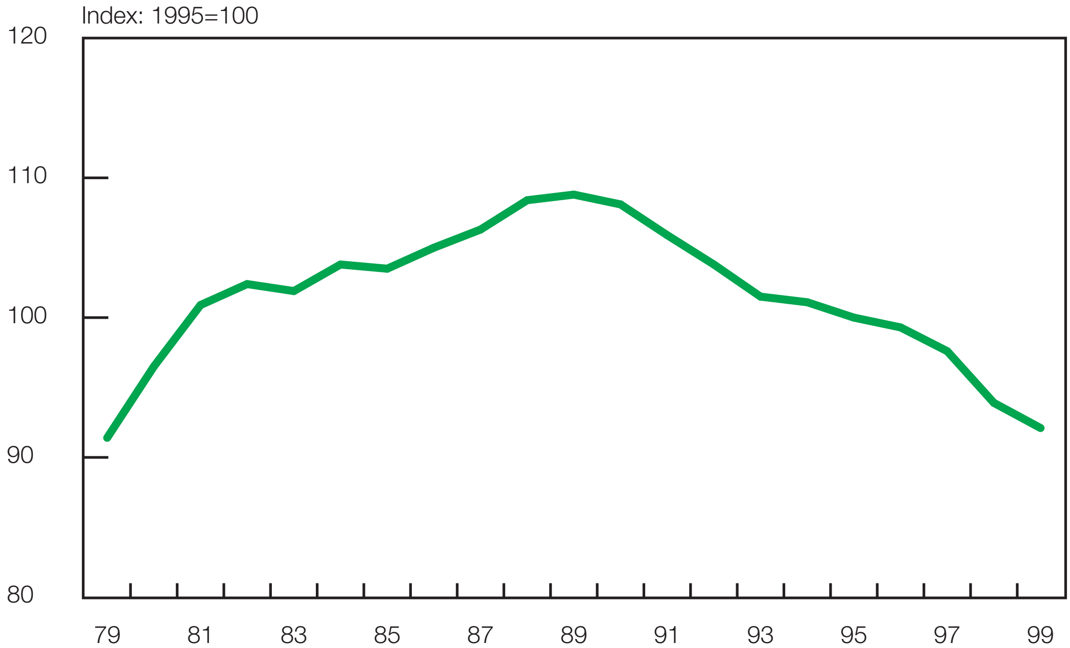
Household saving remained weak. As a percentage of gross domestic product, household saving declined to about ½ per cent in 1999 and the first half of 2000. Over this period, households allowed their consumption to increase faster than the rate at which their income grew. This strong preference for current consumption may result in lower consumption. This is an inevitable consequence of the weaker income growth derived from a poor saving ratio.

Employment

The formal sectors of the economy continued to shed jobs in 1999 and the first quarter of 2000. Regularly surveyed *formal non-agricultural employment* declined by an estimated 162 000 workers or 3,3 per cent in the year to March 2000. Consistent estimates of employment levels indicate that formal non-agricultural employment has declined to a level equivalent to that existing at the end of 1978. Almost one million employment opportunities have been lost since the height of the employment cycle in 1989.

Final results published in the *1999 October Household Survey* by Statistics South Africa indicate that the official unemployment rate decreased from 25,2 per cent in October 1998 to 23,4 per cent in October 1999. Overall employment in the economy

Non-agricultural employment



Regularly surveyed formal-sector employment increased from 9,4 million in October 1998 to 10,4 million in October 1999. The gains in *overall* employment were, however, not in the formal non-agricultural business sectors of the economy. These sectors reduced their employment numbers from 5,2 million in September 1996 to 4,8 million in September 1999. Overall employment growth should therefore be attributed largely to increased activity in the informal sector of the economy and to out-sourcing, consultancies and other forms of self-employment.

The reduction in employment in the formal economy during 1999 and early 2000 can be attributed to a combination of factors. These include the persistent pressure on domestic producers to be competitive in an increasingly globalised market, increasing capital intensity and concerted efforts by the government to reduce the size of the public sector. The employment-creating capacity of the economy was furthermore inhibited by the negative consequences of the acceleration in industrial action which resulted in the loss of 3,1 million workdays in 1999 – the highest in six years. When socio-economic stayaway action is included in strike statistics, Andrew Levy and Associates, a private-sector labour consultancy, reported that about one million workdays were lost during the first half of 2000. A factor which also negatively affected the official employment statistics was the reduction in formal in-house payrolls in favour of the out-sourcing of non-core activities, some of which are currently not captured by official employment surveys.

Employment in the non-agricultural *private* sector of the economy accounted for about 70 per cent of total employment in the formal non-agricultural sectors in 1989. This rate declined to about 65 per cent in 1999. This means that the non-agricultural private sector has effectively shrunk by almost 20 per cent or about 780 000 employment opportunities over the past decade. This decline in employment opportunities was primarily the result of jobs shed in the mining, construction and manufacturing sectors where 45,6 per cent, 43,9 per cent and 18,3 per cent, respectively, of the personnel complements have been lost over the past decade. The only two sectors showing a rise in employment over the ten-year period to 1999 were in the services sector, namely the trade, catering and accommodation services sector, and the financial intermediation and insurance sector. These two sectors grew by approximately 10 per cent and 14 per cent, respectively.

Employment in the formal non-agricultural private sector – 1989 to 1999
Number of workers (thousands)

Sectors	1989	1999	Employment loss (-) or gain (+)	Employment loss or gain as percentage of employment in 1989
Mining	796	433	-363	-45,6
Manufacturing	1 594	1 303	-291	-18,3
Construction	416	233	-182	-43,9
Electricity	52	42	-9	-18,9
Trade, catering and accommodation	805	881	+76	+9,5
Transport, storage and communication	91	60	-31	-34,3
Financial intermediation and insurance	179	204	+24	+13,5
Laundries and dry-cleaning services	13	10	-2	-21,4
Total private sector	**3 949**	**3 169**	**-780**	**-19,8**

Employment levels in the gold-mining sector declined by almost 9 per cent in 1999. Employment losses in the gold-mining sector can be attributed directly to cost-cutting practices occasioned mainly by a lower gold price. Manufacturing employment declined by 2,4 per cent in 1999. Employment opportunities in the construction sector fell by almost 17 per cent in 1999 as the high financing costs of 1998 still impacted negatively on construction sector activities.

Employment gains in the trade and catering and accommodation services sectors during 1999 were somewhat overshadowed by the job losses in other sectors of the economy. When the employment gains of these two services sectors are aggregated for the period 1995 to 1999, a total number of 124 000 new jobs were created. However, the rate of increase in employment in these sectors decelerated markedly in the course of 1999 and the first months of 2000.

The *public sector* has lost its role as an ever-expanding job provider over the past decade – about 102 000 fewer jobs were available in the public sector in 1999 than ten years earlier. The pace of decline in public-sector employment gained momentum in 1999 when almost 62 000 jobs were shed. This increase in the rate of job-shedding in the public sector resulted primarily from the implementation of a process of right-sizing which was aimed at raising the quality of public-service delivery. When measured over periods of one year, the pace of employment loss accelerated from 0,9 per cent in the first quarter of 1999 to 5,1 per cent in the first quarter of 2000. This acceleration in employment losses in the public sector was especially evident in national government departments and in provincial governments.

Notwithstanding the progress made towards greater efficiency in the South African economy, the *African Competitiveness Report*, published in June 2000 by the Harvard University's Centre for International Development, ranked South African competitiveness seventh out of 24 African economies. Furthermore, the 1999 World Competitiveness Yearbook puts South Africa in the 42nd place, out of a total of 47 international countries in terms of its competitiveness. In terms of labour productivity South Africa was placed in the 28th position. Other less favourable outcomes include those for the skilled nature of the workforce, the high rate of skills loss in the economy and the nature of labour regulations.

In June 1999, government announced that it will re-evaluate key aspects of labour legislation which could have a negative effect on job creation. Aspects of labour legislation which had been identified as warranting re-evaluation in terms of their effects on job creation, included probationary periods; unfair dismissal procedures and compensation in respect of procedurally unfair dismissals; retrenchments; and conditions of employment when companies change hands. Other areas to be investigated were provisions in the Basic Conditions of Employment Act dealing with work on Sundays and notice procedures; the role of the Minister of Labour in varying core rights in the Act; and improving the efficiency of institutions established to regulate the labour market, such as the Commission for Conciliation, Mediation and Arbitration (CCMA). A 15-point programme of action was outlined for the next five years which included the need to review the labour market in order to achieve worker welfare and economic efficiency. Furthermore, the government appointed a team of legal experts to draft amendments to current labour legislation in order to balance more appropriately the constitutional rights of employers, the employed and those not gainfully employed.

To address the acute shortage of appropriate skills in the labour market, government enacted a skills levy which came into effect on 1 April 2000. Employers are required to pay this levy at a rate of 0,5 per cent of total payrolls, to be increased to 1 per cent from 1 April 2001. The high priority assigned to the continued implementation of the Skills Development Act by the Department of Labour in its strategic plan for 2000-2004 shows great promise for the further enhancement of the skills base of the country.

Further developments in the labour market were related to the approval of equality legislation which outlaws unfair discrimination on the grounds of race, gender, disability or religion. The Promotion of Equality and Prevention of Unfair Discrimination Bill gives effect to constitutional principles and seeks to remove the discriminatory practices of the past. Though the Bill of Rights grants protection against unfair discrimination, the new law makes it an offence and simplifies the process of redress.

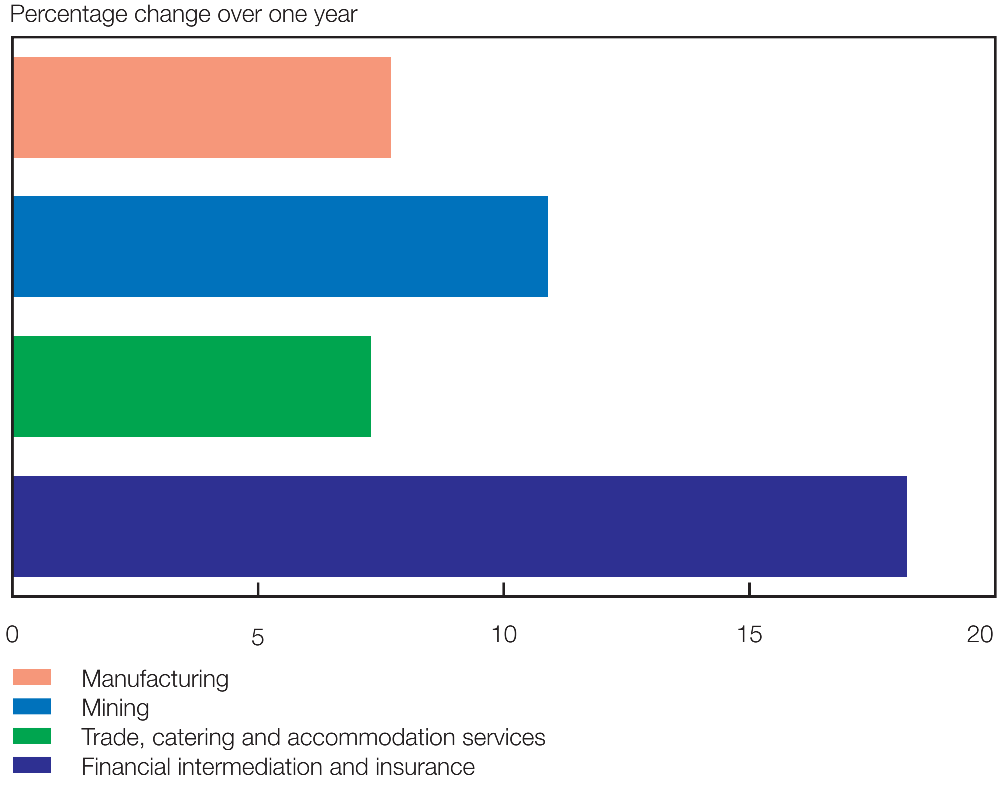
Labour costs and productivity

The growth in the *nominal remuneration per worker in the non-agricultural sectors of the economy* slowed down markedly to 6,6 per cent in 1999. A significant contribution to this slowdown came from public-sector remuneration growth which slowed down to a year-to-year rate of increase of 3,7 per cent. Remuneration growth in the private sector also slowed down to 9,1 per cent in 1999 from higher rates of increase in preceding years. Remuneration growth in both the private and public sectors, however, advanced at a faster pace in the early months of 2000. Private-sector remuneration growth accelerated from a year-on-year rate of increase of 8,0 per cent in the fourth quarter of 1999 to 9,6 per cent in the first quarter of 2000, while public sector remuneration growth rose from an increase of 0,1 per cent to 2,1 per cent over the same period.

Remuneration growth in the private sector in the recent past has varied considerably among the various sectors of economic activity. Whereas average nominal remuneration per worker in the trade, catering and accommodation services sector advanced at year-on-year rates of around 5 per cent during most of 1999 and the first months of 2000, workers in the financial intermediation and insurance sector, on average, received remuneration increases in excess of 20 per cent. The financial services sector, which is far more skills-intensive than some of the other sectors, competed aggressively to satisfy the demand for highly skilled employees. Structural changes in the economy have also put a higher premium on skilled labour and reduced the demand for unskilled labour. These changes include a shift away from goods-producing industries towards service-delivery industries. Computerisation and the modernisation of production processes using information technologies have also changed the demand patterns for labour.

The general deceleration in wage growth is further corroborated by statistics from Andrew Levy and Associates which indicate that the average settlement rate in collective bargaining agreements declined from 8,3 per cent in 1999 to 8 per cent in the first half of 2000. The increase in the average minimum monthly wage in the year to June 2000 amounted to 7,2 per cent. Wage-related issues were again rated as a contributing factor to almost 80 per cent of the workdays lost to industrial action in the first half of 2000. The dominance of wages as the major strike trigger reflects the tensions associated with the downward adjustment of wage growth in an inflation environment.

Remuneration growth in selected private non-agricultural sectors in 1999



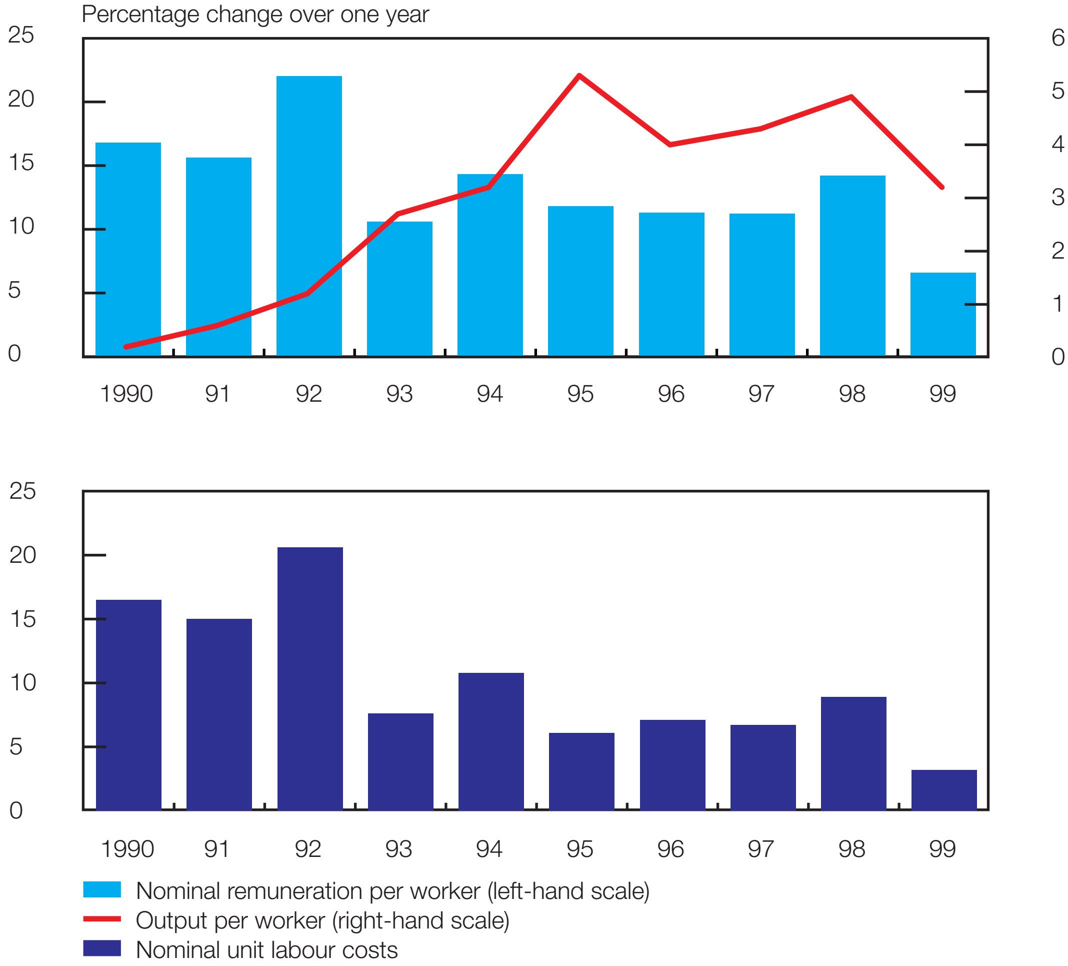
Broadly similar growth rates in nominal remuneration per worker and output prices were recorded in 1999. Consequently, the ratio of remuneration per worker to output prices (indicated by the price deflator for the non-agricultural gross domestic product) in 1999 remained on a par with that of 1998. However, when measured over periods of one year, real remuneration per worker grew marginally by 0,8 per cent in the first quarter of 2000, after remaining essentially unchanged from 1998 to 1999.

The consequences for inflation of nominal wage growth depend on productivity growth, which could allow the same number of workers to produce a larger output of goods and services. The growth in *output per worker* in the formal non-agricultural sectors of the economy amounted to 3,2 per cent in 1999. This compares with rates of increase of 4,9 per cent in 1998 and 4,3 per cent in 1997. Following the continued declines in employment, labour productivity rose at year-on-year rates of 4,5 per cent in the fourth quarter of 1999 and 5,7 per cent in the first quarter of 2000.

Several factors may have contributed to the higher growth in productivity over the past three years. Changes in labour productivity reflect anything that changes real output except a change in the number of workers employed. For example, improvements in the work performance of machinery and electronic equipment used by workers could increase labour productivity. Such technological advances might raise average output per worker by improving the efficiency of the production process so that a given amount of capital and labour can produce a greater output.

Because several aspects of the production process are involved, labour productivity is not a “pure” measure of how technological innovations are changing output levels. A better measure of technological change is multifactor productivity, which measures the average output produced by a fixed combination of capital and labour.

Non-agricultural remuneration, labour productivity and unit labour costs

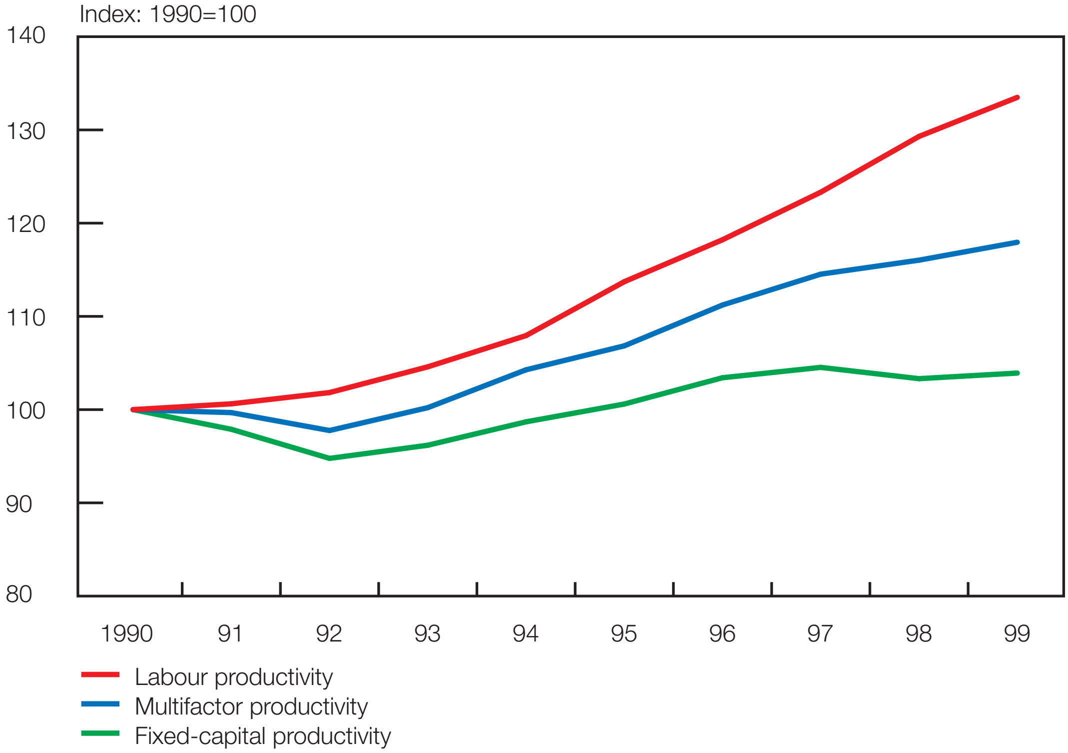


An analysis of the productivity index of the fixed capital stock in the domestic economy indicates that the growth in the productivity of capital fell short of the growth in labour productivity. From 1990 to 1999 output per unit of real capital employed in the non-agricultural sectors grew at an average rate of only 0,4 per cent per year, compared with growth of 3,4 per cent in labour productivity. As a consequence, the average annual rate of increase in multifactor productivity was estimated at 1,8 per cent over the period from 1990 to 1999 – significantly lower than the estimated productivity growth when only labour input is taken into account.

Profit-maximising firms, when deciding on the optimal allocation of production factors, will be influenced by the cost-effectiveness of employing one production factor over another. Due consideration will be given to the fact that a choice between different production factors, once implemented, may be irreversible for a long period of time. The user cost of capital can be calculated from information about the initial outlay price of capital goods, the rate of interest paid, the depreciation of capital and other information. Valuable insights are obtained into the outcome of the process of production factor allocation, when expressing the user cost of capital relative to wage rates.

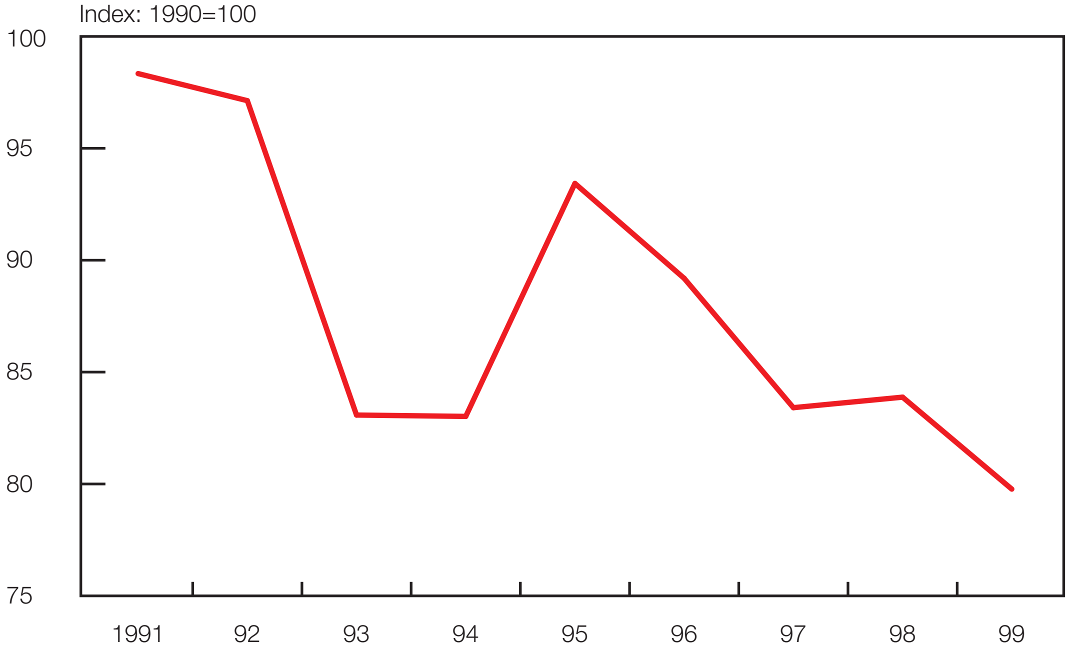
The ratio of the user cost of capital relative to the wage rate in the manufacturing sector has shown a downward trend during most of the 1990s. The decline in this ratio amounted to almost 20 per cent from 1991 to 1999, and resulted from higher

Productivity in private non-agricultural sector



growth in the cost of labour than in the cost of capital. The decline in the ratio of the user cost of capital relative to the cost of labour could have contributed to the substitution of capital for labour in the processes of production. The increased usage of capital is reflected in a rise of about 60 per cent in the capital-labour ratio over the past decade. Producers therefore preferred to employ capital rather than labour,

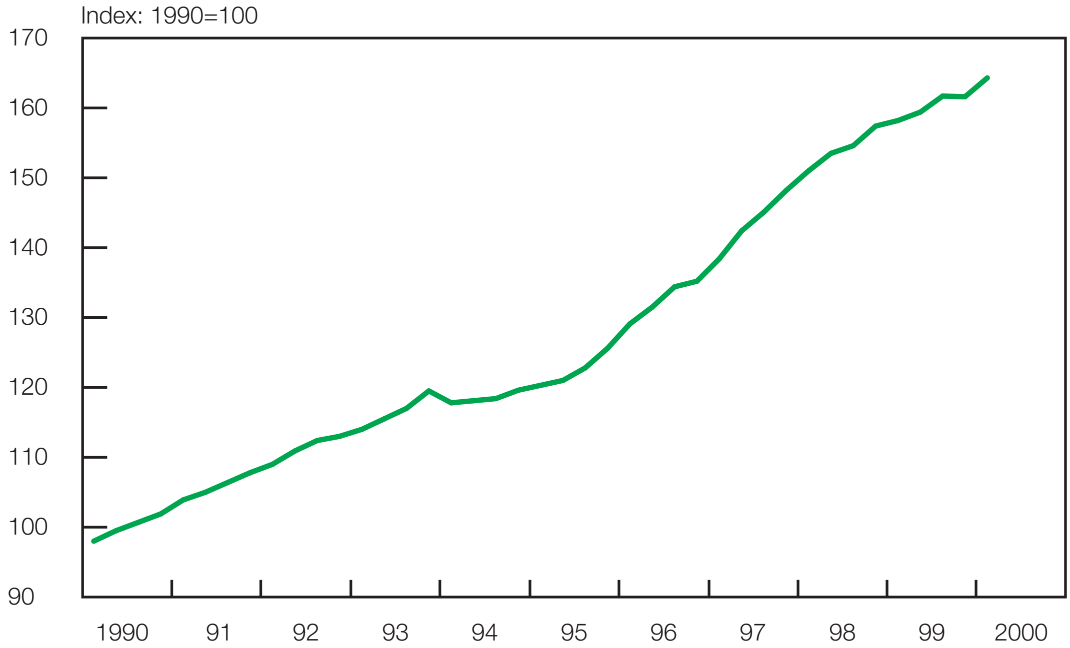
User cost of capital relative to cost of labour in manufacturing



contributing to a situation where one in every four members of the economically active population failed to become gainfully employed.

Economising on the utilisation of labour resources during the 1990s was in part a result of the decline in the relative user cost of capital, but was also a consequence of other issues such as a declining gold price and greater international competition in the domestic economy which raised the urgency of implementing cost-saving production methodologies. Furthermore, the slowdown in nominal wage growth, together with the increased utilisation of capital per employed worker, improved productivity to such an extent that the growth in the cost of labour per unit of real output fell from 16,5 per cent in 1990 to 3,2 per cent in 1999 and to a year-on-year rate of only 0,5 per cent in the first quarter of 2000.

Capital-labour ratio in manufacturing

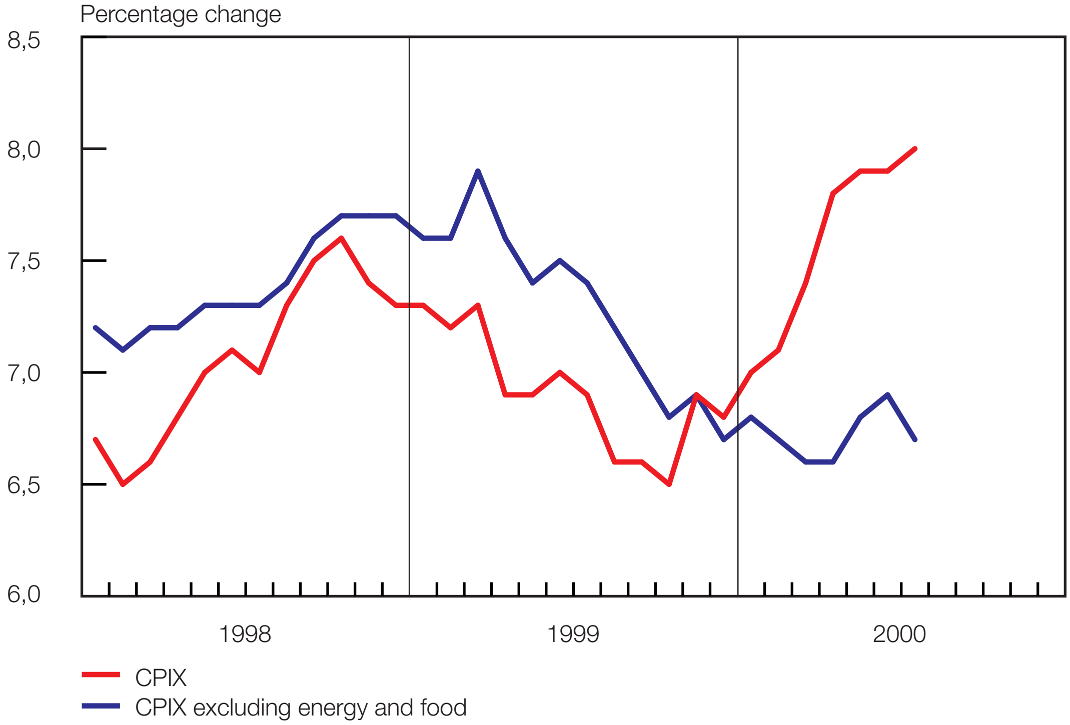


Inflation

Significant success has been achieved in combating inflation in recent years. Inflation in the prices of consumer goods and services declined from 6,9 per cent in 1998 to 5,2 per cent in 1999 – the lowest rate of increase in consumer prices since 1970. By contrast, production price inflation accelerated from 3,5 per cent in 1998 to 5,8 per cent in 1999. However, the year-to-year rate of increase in the all-goods production price index in 1999 was still well below the average rate of 8,0 per cent in the three-year period prior to 1998. The need for disinflation was prominent in the decision to introduce inflation targeting as a new monetary policy framework in the early months of 2000. Financial stability, which involves a low level of inflation, is a necessary prerequisite for sustained growth and development, and in most countries where inflation targeting was introduced, inflation has been contained more successfully.

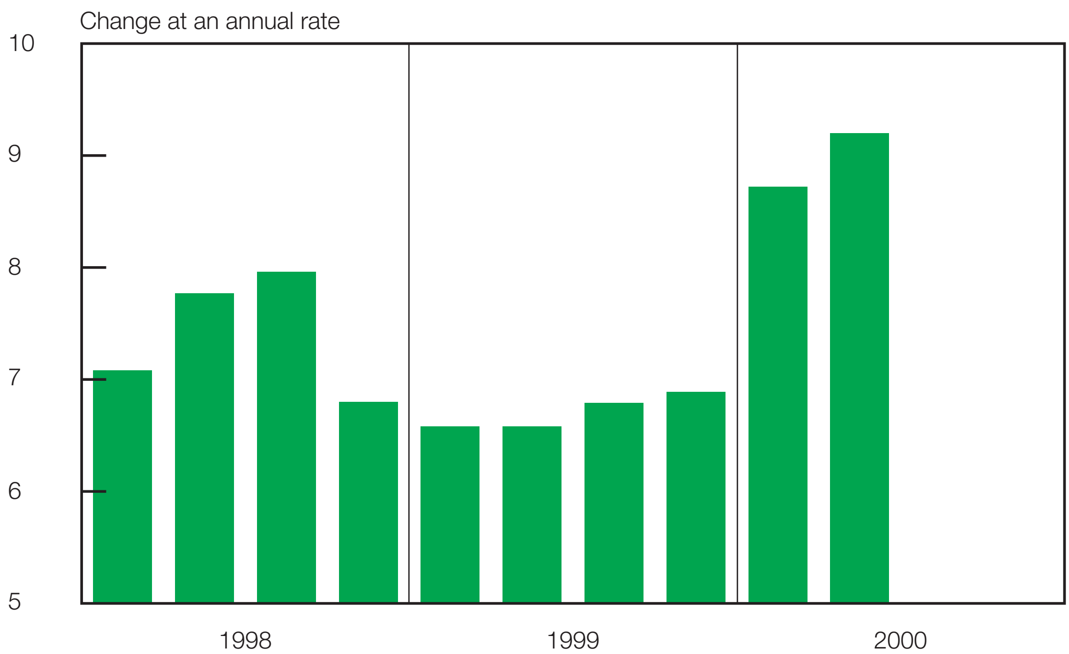
The new benchmark used for inflation-targeting purposes, CPIX as it became known, slowed down from 7,3 per cent in March 1999 to 6,5 per cent in October.

CPIX inflation over twelve months



CPIX inflation then accelerated to 8,0 per cent in July 2000. When omitting the effects of the rise in the domestic price of petrol and diesel due to the higher rand price of imported crude oil and higher food prices related to flood damage in the early months of 2000, the increase in CPIX in the year to June 2000 would amount to 6,7 per cent, the same as at the lower turning point in December 1999. However, the short-term acceleration in consumer price inflation in the early months of 2000

CPIX inflation from quarter to quarter



is more prominently revealed when the growth in CPIX is expressed at a seasonally adjusted and annualised rate. This rate of increase rose from 6,8 per cent in the third quarter of 1999 to 9,2 per cent in the second quarter of 2000 – the highest rate of increase in more than three years.

Consumer price inflation, as measured by the year-on-year changes in the *overall consumer price index,* declined impressively from 9,4 per cent in November 1998 to 1,7 per cent in October 1999. This decline arose mainly from the reduction in mortgage bond rates in the course of 1999. Subsequently, overall consumer price inflation accelerated to 5,9 per cent in July 2000 as the reduction in mortgage bond rates during 1999 entered the calculation of year-on-year inflation, and the prices of consumer *goods* rose at an accelerating pace. The rise in consumer price inflation can also be attributed to the higher rates of increase in the prices of *services not related to homeowners' costs*, which rose by 10 per cent in the year to July 2000.

Measured from quarter to quarter and expressed at an annualised rate, overall consumer price inflation more than trebled from 3,0 per cent in the fourth quarter of 1999 to 10,9 per cent in the second quarter of 2000. Prominent among the reasons for the acceleration in overall inflation was the reversal from a deflation rate of 0,9 per cent in the fourth quarter of 1999 in the prices of *consumer services* to an increase of 9,9 per cent in the second quarter of 2000. This reversal was essentially related to the waning impact that declines in mortgage bond rates had on overall price changes.

Consumer prices
Quarter-to-quarter changes at annualised rates

Period		Goods	Services	Overall	CPIX*
1998:	**Year**	**6,0**	**7,9**	**6,9**	**7,1**
1999:	1st qr	5,0	0,1	2,5	6,6
	2nd qr	5,8	-3,2	2,2	6,6
	3rd qr	6,8	-8,8	-0,7	6,8
	4th qr	7,3	-0,9	3,0	6,9
	Year	**6,1**	**4,2**	**5,2**	**6,9**
2000:	1st qr	8,4	5,3	6,6	8,7
	2nd qr	10,5	9,9	10,9	9,2

* For metropolitan and other urban areas

The year-on-year rate of increase in the *prices of consumer goods* remained in the proximity of 6 per cent throughout 1999, but then accelerated from 6,4 per cent in December 1999 to 8,6 per cent in July 2000. The quarter-to-quarter and annualised rate of increase in the prices of consumer goods accelerated from 5,0 per cent in the first quarter of 1999 to 7,3 per cent in the fourth quarter and further to 10,5 per cent in the second quarter of 2000. The rise in the prices of consumer goods during the early months of 2000 was mainly caused by the rising cost of imported goods associated with the depreciation of the rand, the rising price of crude oil, higher prices of food due to flood damage, and higher prices for alcoholic beverages and tobacco following the higher excise duties announced in the 2000/2001 National Budget. Furthermore, inflation in the prices of clothing and footwear accelerated to an annualised rate of 7,6 per cent in the first quarter of 2000, compared with quarterly rates of increase of around 1,5 per cent in the preceding year and a half. However, there was only a small rise at an annualised rate of 0,1 per cent in the prices of clothing and footwear in the second quarter of 2000.

Inflation in production prices, which usually precedes inflation rate changes in consumer prices, had been rising uninterruptedly for a two-year period to April 2000. The year-on-year increase in the *all-goods production price index* rose from a historically low rate of 2,3 per cent in March 1998 to 10,1 per cent in April 2000. This rate of increase then moderated to 8,7 per cent in May 2000 when the price of imported crude oil fell back temporarily, and 8,8 per cent in June. When measured from quarter to quarter and expressed at an annualised rate, inflation in production prices rose from an average quarterly rate of 6,4 per cent during the four quarters of 1999 to 11,7 per cent in the first quarter of 2000 and 10,1 per cent in the second quarter.

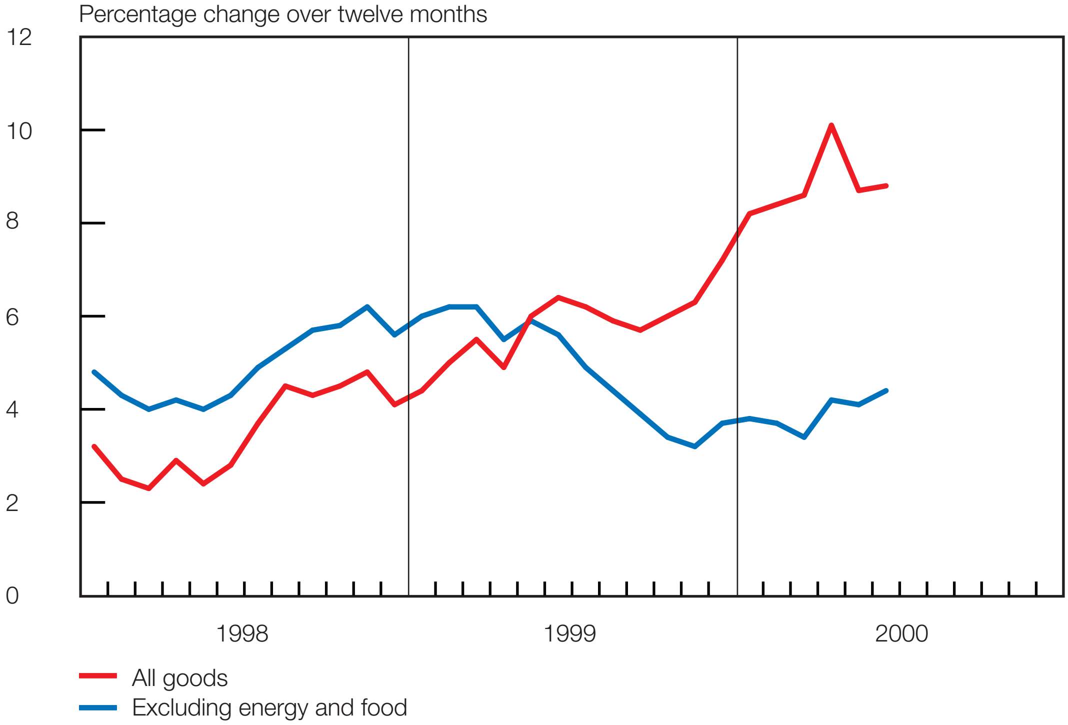
The main reasons for the acceleration in production price inflation in the last year or so, are the rise in the international price of crude oil, higher food prices, the depreciation of the rand in the early part of 2000 and somewhat faster increases than previously in the production prices of South Africa's main trading-partner countries. In fact, the year-on-year rate of increase in the composite foreign wholesale price index of South Africa's main trading-partner countries rose, on balance, from 0,2 per cent in March 1999 to 6,0 per cent in May 2000. It is estimated that the all-goods production price index, when stripped of rising energy and food prices, would have increased by only 4,4 per cent in the year to June 2000 as opposed to the actual increase of 8,8 per cent.

Foreign wholesale price inflation

Same 14 main countries as included in nominal effective exchange rate of the rand

The year-to-year rate of increase in the prices of *domestically produced goods* accelerated from 3,5 per cent in 1998 to 5,3 per cent in 1999, still considerably slower than the average annual rate of increase of 9,3 per cent in the eight-year period to 1998.

Production price inflation



The seasonally adjusted and annualised quarter-to-quarter rate of increase in the prices of domestically produced goods, after being fairly stable around a 5 per cent level during most of 1999, accelerated to 8,7 per cent in the first quarter of 2000 and 8,8 per cent in the second quarter. The year-on-year rate of inflation in the prices of domestically produced goods rose from 4,0 per cent in January 1999 to 8,0 per cent in April 2000, mainly as a result of an annual increase of about 60 per cent in the average price of products of petroleum and coal in the year to April 2000. Other categories of goods where prices started to rise faster were those for food, especially fruit and vegetables following flood damage to harvests, alcoholic beverages and tobacco, textiles, clothing and footwear, electricity, gas, water and mining products. Subsequently, year-on-year inflation in the prices of domestically produced goods receded somewhat to 7,1 per cent in May 2000 and 7,0 per cent in June as widespread declines in agricultural food prices were reported.

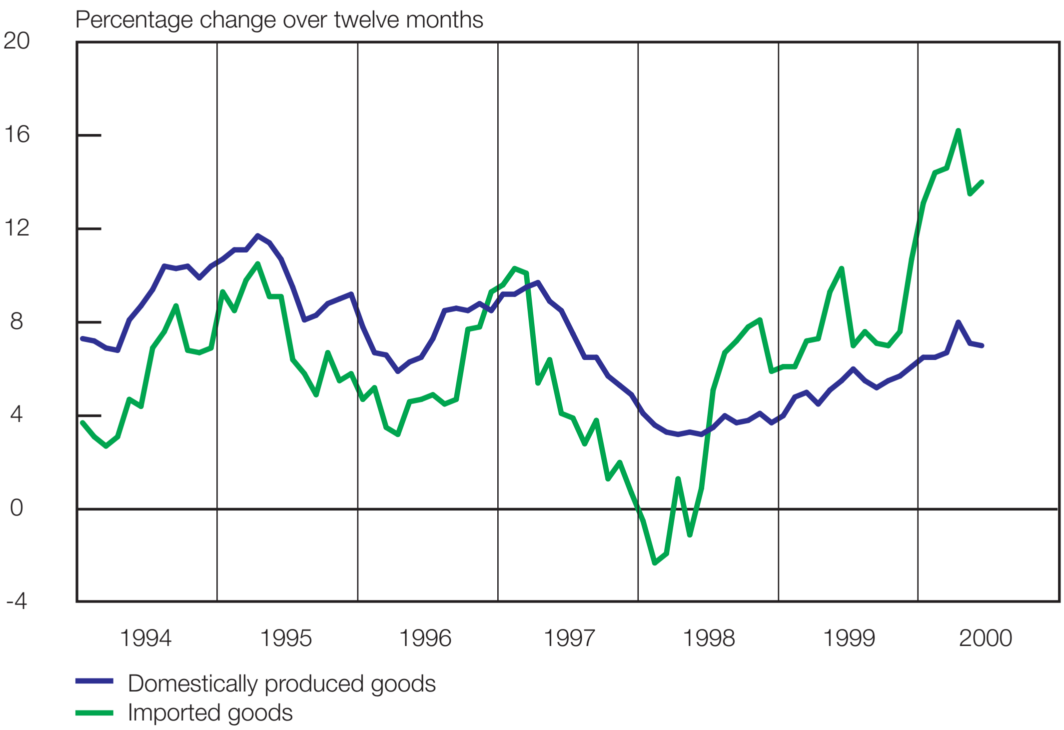
Production prices

Quarter-to-quarter changes at annualised rates

Period		All-goods production prices	Domestically produced goods	Imported goods
1998:	**Year**	**3,5**	**3,5**	**3,1**
1999:	1st qr	3,7	5,7	-2,8
	2nd qr	7,1	5,7	11,5
	3rd qr	7,9	6,7	13,4
	4th qr	6,9	4,9	10,4
	Year	**5,8**	**5,3**	**7,8**
2000:	1st qr	11,7	8,7	21,7
	2nd qr	10,1	8,8	14,4

The year-to-year rate of increase in the prices of *imported goods* more than doubled from 3,1 per cent in 1998 to 7,8 per cent in 1999 – the highest rate of increase since 1991. Measured over periods of twelve months, the rate of inflation in the prices of imported goods rose, on balance, from 6,1 per cent in January 1999 to 7,6 per cent in November. Inflation in the prices of imported goods then started to accelerate rapidly to 16,2 per cent in the year to April 2000, of which 13,7 percentage points were directly attributable to increases in the price of mining and quarrying products, mainly caused by an annual increase of 195,3 per cent in the average price of imported crude petroleum. Subsequently, year-on-year inflation in the prices of imported goods receded somewhat to 13,5 per cent in May 2000 and 14,0 per cent in June. Over and above the strong increase in the prices of imported crude oil as a primary cause of imported inflation since the closing months of 1999, other compounding factors were the higher rates of increase in the prices of basic metals, chemicals and chemical products, wearing apparel and non-food agricultural products. Inflation in the prices of imported goods, measured at year-on-year rates, had been consistently higher than in the prices of domestically produced goods since July 1998, following the depreciation of the rand in 1998 and the slight acceleration of inflation in trading-partner countries.

Production price inflation: Imported and domestically produced goods



The annualised quarter-to-quarter rate of change in the seasonally adjusted prices of imported goods turned around from a *decrease* of 2,8 per cent in the first quarter of 1999 to increases of 13,4 per cent in the third quarter and 10,4 per cent in the fourth quarter. The annualised rate of increase in the prices of imported goods rose strongly to 21,7 per cent in the first quarter of 2000, but slowed to 14,4 per cent in the second quarter when the international price of crude oil began to stabilise.

Foreign trade and payments

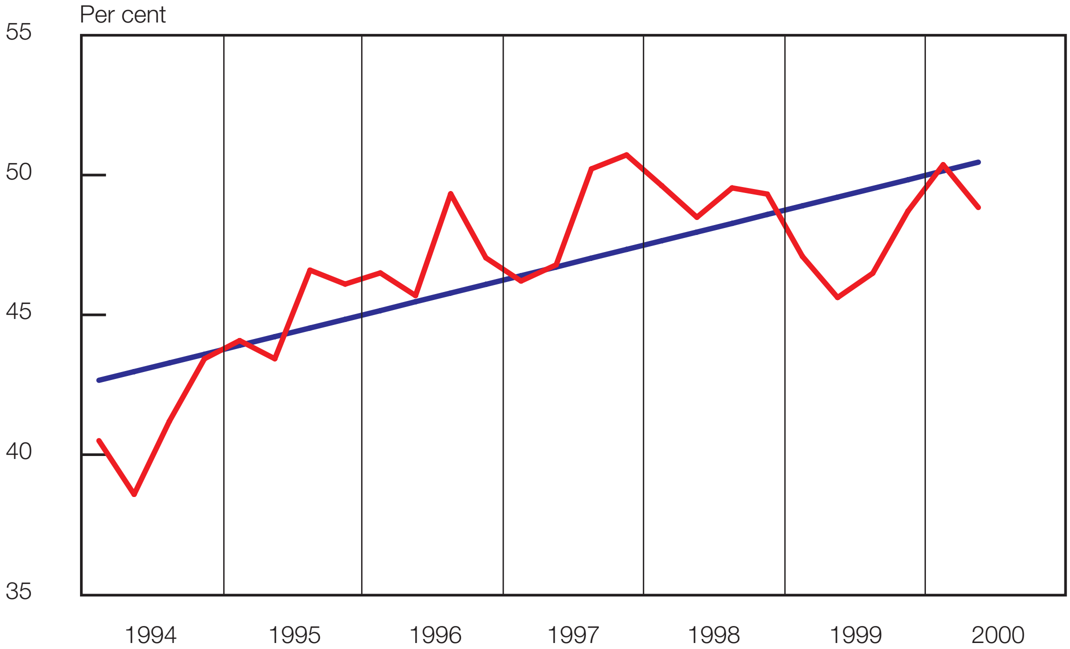
Policy issues and trade reforms

Further progress was made with the expansion of South Africa's participation in international trade while the gradual relaxation of exchange controls on residents continued during 1999 and the first half of 2000. New external trade relations were established, not only with traditional trading-partner countries, but also with markets which had been officially closed to South African importers and exporters prior to 1994. This was mainly achieved by means of various treaties, trade agreements and membership of international institutions.

Concessions made by the Minister of Finance to further the dismantling of exchange controls on residents in the 2000/01 fiscal year included the following:

- Companies would be allowed to use local cash holdings to finance up to 10 per cent of new foreign investments;
- companies would be allowed to use local cash holdings to repay up to 10 per cent of the foreign debt they raise for financing foreign investment;
- companies wishing to establish or acquire new companies abroad would be allowed to make use of corporate asset swaps to finance these investments;
- unit trusts would be permitted to invest up to 20 per cent of their total assets under management by way of asset swaps;
- pension funds, long-term insurers and unit trusts would be allowed to make foreign currency transfers in 2000 of up to 10 per cent of the net inflow of funds during the 1999 calendar year, subject to overall limits of 15 per cent of

Openness of the South African economy



Imports and exports of goods and services as percentage of gross domestic product at constant 1995 prices

assets under management for pension funds and long-term insurers, and 20 per cent for unit trusts;
- travel allowances were raised to R130 000 per adult and R40 000 per child under the age of twelve years, per calendar year; and
- the limit on private individuals who qualify to invest abroad was increased to R750 000 per person.

The Minister of Finance gave new impetus towards the liberalisation of exchange controls on residents when he announced on 23 February 2000 that subject to certain guidelines, major South African corporates would be allowed to obtain primary listings on foreign stock exchanges. Consideration would be given to cases where
- foreign expansion was necessary and integral to the company, given its size and the nature of its business;
- a significant proportion of revenue was generated outside South Africa, making the company in effect an international concern;
- there would be distinct balance of payments benefits for South Africa;
- a substantial advantage could be demonstrated over alternative approaches to raising the required capital;
- the direct and indirect South African assets would not be encumbered;
- South Africa's reserves would not be adversely affected by an outflow of dividends or any other funds;
- the company involved would have to undertake to match any dividends declared to a foreign holding company with dividends paid out to South African shareholders; and
- all the South African operations and assets of the South African company or the proceeds thereof, as well as any other cash holdings, would have to remain in South Africa and could only be exported from South Africa with Exchange Control approval.

Negotiations aimed at establishing a Free Trade Agreement between the member states of the Southern African Development Community continued in 1999 and 2000. The purpose of such an agreement will be to strengthen trade, investment and industrial linkages within the region.

The Trade, Development and Co-operation Agreement between South Africa and the country's largest trade and investment partner, the European Union (EU), was signed on 11 October 1999 and provisionally implemented with effect from 1 January 2000. In terms of the agreement, a free trade area came into existence between South Africa and the EU. The EU is committed to the full liberalisation of 95 per cent of its imports from South Africa within a 10-year transitional period, whereas South Africa will liberalise 86 per cent of its imports from the EU by the end of a 12-year transitional period.

The openness of the South African economy is expected to increase as a result of the abovementioned developments. Trade in goods and services as a ratio of gross domestic product, which had increased from 41 per cent in 1994 to 47 per cent in 1999, increased further to 49½ per cent in the first half of 2000.

Balance on current account

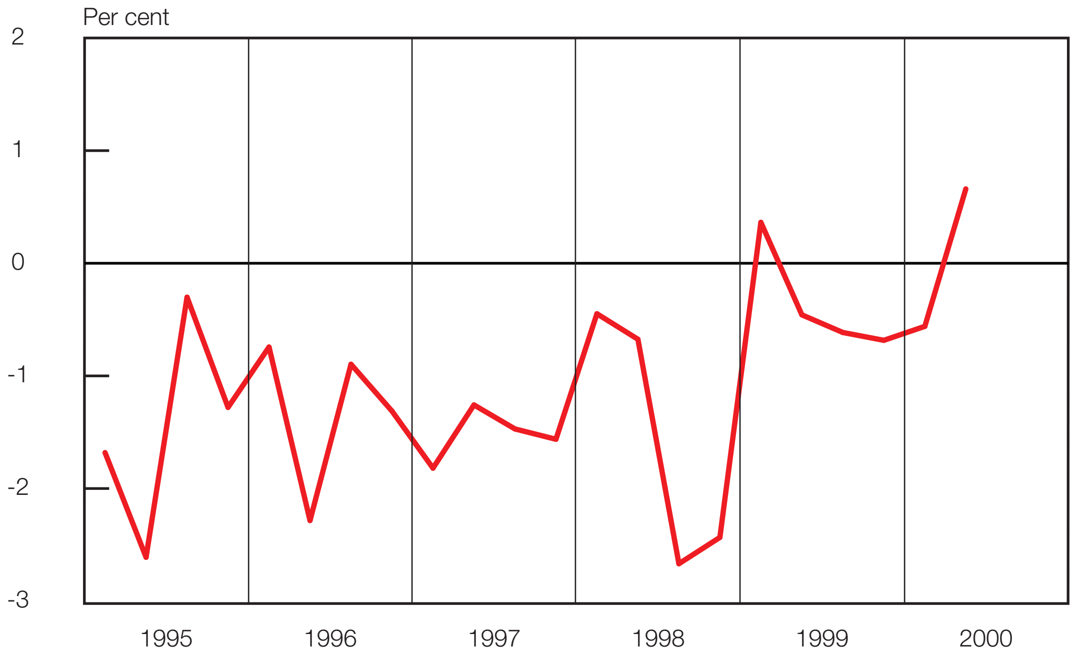
The deficit on the *current account of the balance of payments* (seasonally adjusted and annualised) narrowed from R19,1 billion in the second half of 1998 to only R0,4 billion in the first half of 1999. This improvement in the current-account balance resulted mainly from a contraction in the value of merchandise imports whereas the value of goods exported increased only marginally over the same period. Relatively subdued aggregate demand in the economy contributed towards this decline in the value of merchandise imports. In the second half of 1999, growth in the value of merchandise imports outpaced an acceleration in the value of merchandise exports. The deficit on the current account (seasonally adjusted and annualised) consequently widened to R5,3 billion in the second half of 1999. For the calendar year 1999 as a whole, the current-account balance came to a deficit of R2,9 billion, compared with a deficit of R11,6 billion in 1998.

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

	1999		2000
	1st half	2nd half	1st half
Merchandise exports	143,4	154,6	180,5
Net gold exports	24,3	24,3	26,5
Merchandise imports	-142,6	-158,2	-179,6
Net service, income and current transfer payments	-25,5	-26,0	-26,9
Balance on current account	-0,4	-5,3	0,5

Sharp increases in the value of merchandise and net gold exports, which more than countered the higher value of merchandise imports, caused the balance on the current account (seasonally adjusted and annualised) to turn into a surplus of R0,5 billion in the first half of 2000. As a ratio of gross domestic product, the deficit on the current account declined from an average of about 1½ per cent in the period 1995-1998 to below 1 per cent in 1999. The surplus on the current account equalled 0,1 per cent of gross domestic product in the first half of 2000.

Ratio of current-account balance to gross domestic product



Seasonally adjusted and annualised

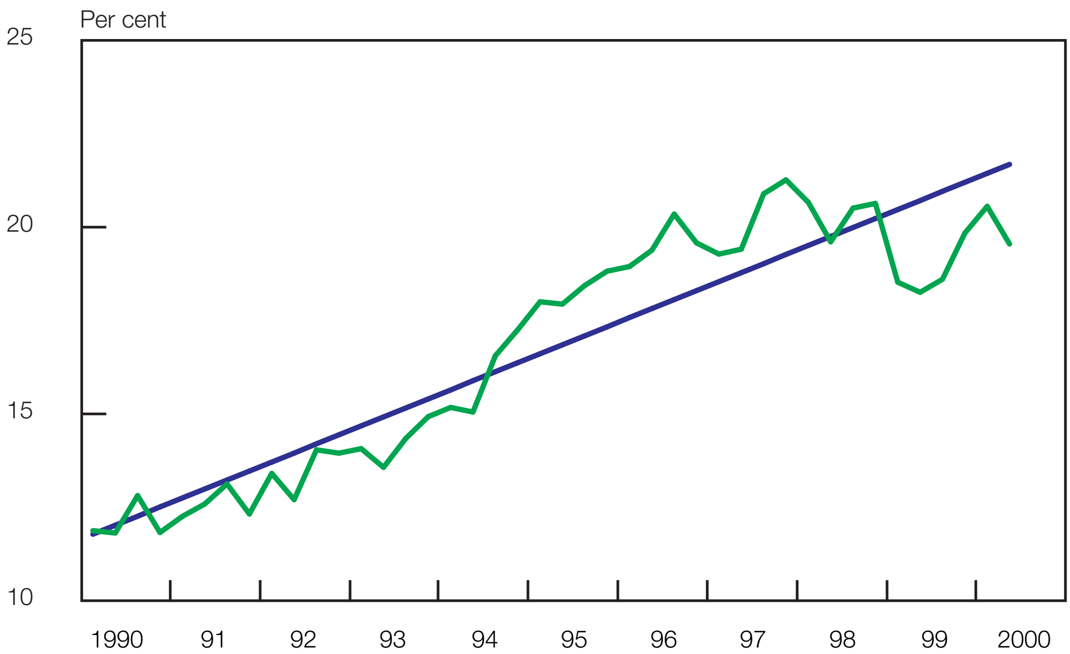
Merchandise imports

The seasonally adjusted and annualised *value of merchandise imports* declined in the first half of 1999 as domestic demand growth and overall economic activity remained rather subdued in the aftermath of the shocks of 1998. In the second half of 1999 improved prospects for demand-led growth and a steep rise in the international price of crude oil contributed to an increase in the value of imports, especially of mining and manufactured products. The value of merchandise imports (seasonally adjusted and annualised) consequently increased from R142,6 billion in the first half of 1999 to R158,2 billion in the second half.

Mainly as a result of higher imports of manufactured products, the value of merchandise imports (seasonally adjusted and annualised) increased to R179,6 billion in the first six months of 2000. Particularly large increases were recorded in the sub-categories for machinery and electrical equipment and vehicles and transport equipment. The volume of merchandise imports and the rand prices of goods imported into South Africa increased throughout 1999 and the first half of 2000.

After having declined by about 12½ per cent in the first half of 1999, the *volume of merchandise imports* increased again by about 5½ per cent in response to stronger economic growth in the second half. Import volumes increased by 5 per cent in the first six months of 2000, despite lower oil imports. The import penetration ratio (i.e. the ratio of real merchandise imports to real gross domestic expenditure) increased from 18½ per cent in the second quarter of 1999 to 19½ per cent in the second quarter of 2000, signalling that a growing portion of aggregate domestic demand was satisfied by foreign suppliers, rather than through supply responses in the domestic economy.

Import penetration ratio



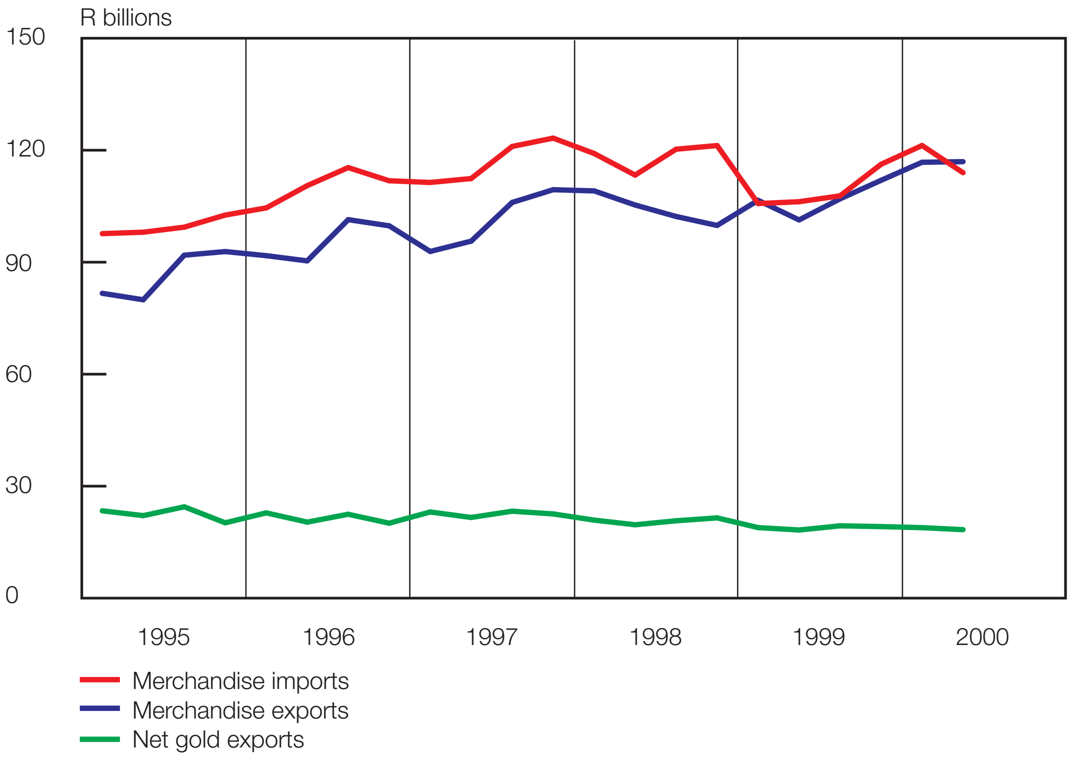
The *prices in rand* of merchandise imports were mainly driven by rising international oil prices in 1999. This increase in import prices was partly countered by a slight increase in the external value of the rand. The aggregate rand price level of imported goods consequently increased by about 8½ per cent in 1999. A weakening in the exchange value of the rand, further increases in the oil price and a slight acceleration in foreign wholesale price inflation then caused the prices in rand of imported goods to rise by 8½ per cent in the first half of 2000.

The share of mining imports relative to total merchandise imports, which had increased from the first half of 1999 to the second half, declined in the first six months of 2000 when the growth in the value of crude oil imports slowed down markedly. As a percentage of total merchandise imports, oil imports increased from 6,2 per cent in the first half of 1999 to 11,3 per cent in the second half, but declined to 10,6 per cent in the first half of 2000. Manufactured imports as a percentage of total merchandise imports increased marginally in the first half of 2000 as investment activity in the private sector got under way. The value of manufactured imports accounted for 74 per cent of total merchandise imports in the first half of 2000.

Merchandise exports

The *value of merchandise exports* (seasonally adjusted and annualised) rose consistently from R143,4 billion in the first half of 1999 to R154,6 billion in the second half and to R180,5 billion in the first half of 2000. Increases in the prices and physical quantities of goods exported contributed to the growth in export values.

Merchandise exports and imports at constant 1995 prices



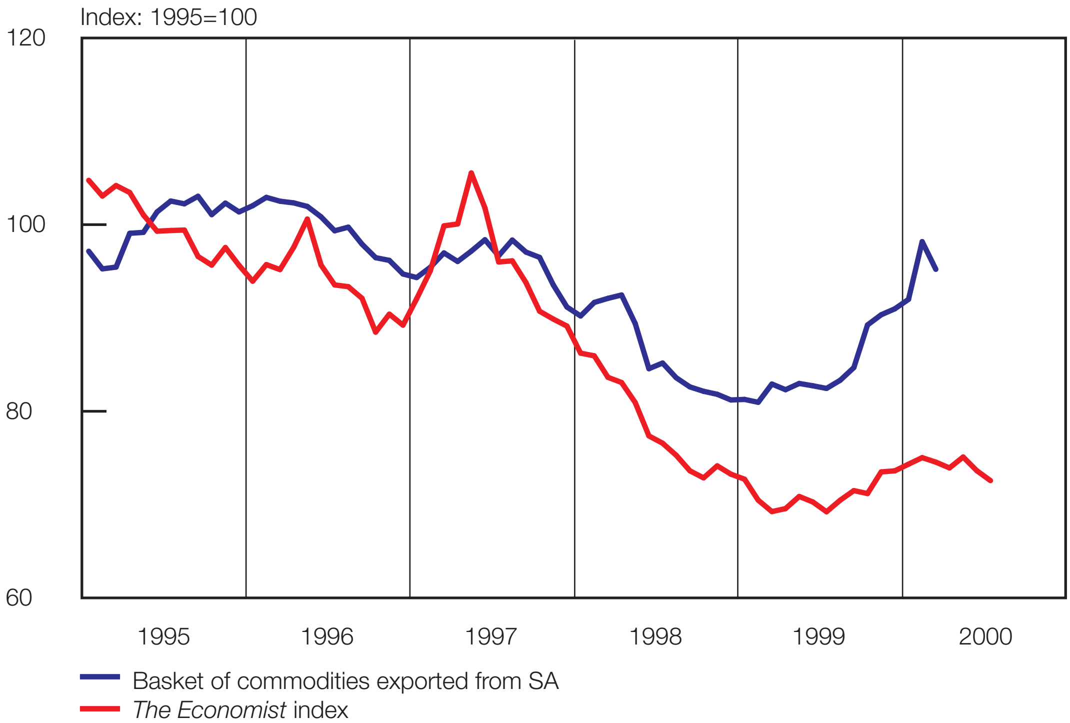
A decline in the value of agricultural exports from the first to the second half of 1999 was more than countered by increases in the export values of mining and manufactured products. The value of exported mining products responded positively to an improvement in international commodity prices during the latter part of 1999. Further increases were registered in the first half of 2000, owing to the greater competitiveness of South African exporters following the depreciation of the rand, and a further increase in international commodity prices.

The recovery in global economic conditions contributed to increases in *merchandise export volumes* in 1999 and the first half of 2000. The physical quantity of merchandise exports increased by 2,9 per cent in the first half of 1999, by 5,3 per cent in the second half and 6,8 per cent in the first half of 2000. As a ratio of real gross domestic product, merchandise export volumes improved from 17,7 per cent in 1998 to 17,9 per cent in 1999 before rising more impressively to 19,3 per cent in the first half of 2000.

After having increased by only ½ per cent in the first half of 1999, the *rand prices of goods exported* from South Africa rose by about 2½ per cent in the second half in response to generally rising international commodity prices. Prices for South Africa's main export commodities declined less than commodity prices in general during 1997 and 1998, and they apparently recovered more swiftly during the turnaround in the commodity price cycle (see accompanying graph). The rise in commodity prices, together with the weakening of the exchange rate of the rand, helped to lift the average price level of merchandise exports by 9½ per cent from the second half of 1999 to the first half of 2000. South Africa's terms of trade, which had deteriorated sharply in the second half of 1999, turned around in the first half of 2000 to a level that was about 1½ per cent higher than in the second half of 1999.

The share of mining exports in the total value of merchandise exports increased from 45 per cent in the first half of 1999 to 48 per cent in the second half and 50 per cent in the first half of 2000. This improvement in the export values of mining products could in part be explained by the recovery in international commodity prices. Over the same period, the value of manufactured goods relative to the total value of merchandise exports remained at about 39 per cent.

International commodity prices in US dollars



Net gold exports

The gold price was adversely affected by a number of events, mainly related to official sales of gold during 1999. On 7 May 1999, the Bank of England announced plans to sell 125 tons of gold reserves in the 1999/2000 financial year and a further 290 tons over the medium term. Planned sales by other central banks, in particular that of Switzerland, and the proposed sales by the International Monetary Fund also created a significant measure of uncertainty in the market.

These developments in the gold market adversely affected the *average fixing price of gold* on the London market by causing a decline from US$294 per fine ounce in the fourth quarter of 1998 to US$259 per fine ounce in the third quarter of 1999. Sentiment in the gold market improved somewhat in the fourth quarter after the announcement by the European Central Bank that member countries had agreed to limit gold sales and lending activities. The average fixing price of gold responded by rising to US$296 per fine ounce in the fourth quarter. However, sentiment in the gold market turned gloomy once again in the first half of 2000 as official gold sales gathered momentum. The London fixing price of gold subsequently declined to US$290 per fine ounce in the first quarter of 2000 and US$280 in the second quarter.

Almost 50 per cent of the world's official gold holdings are held by the fifteen European central banks which signed the Washington Agreement on 26 September 1999. In terms of the agreement, which is to be reviewed after five years, the joint gold sales of the member countries will not exceed approximately 400 tons per annum and total sales will be limited to 2 000 tons. In addition, gold leasing and the use of futures and options contracts will not be expanded over the five-year period. The International Monetary Fund (IMF) completed its off-market gold sales between 14 December 1999 and 5 April 2000. The proceeds from these transactions were allocated towards the financing of the IMF's contribution towards debt relief and financial support for the world's poorest nations.

The annualised *value of net gold exports* declined from R27,6 billion in the second half of 1998 to R24,3 billion in the first half of 1999. The decline in the first half of 1999 resulted entirely from a decline in the volume of gold exports. In the second half of 1999 a slight increase in the volume of gold exports was completely offset by a decline in the average realised price of gold, expressed in rands. The annualised value of net gold exports consequently showed no growth from the first half of 1999 to the second half. The depreciation of the rand against the US dollar caused the average realised rand price of gold to rise from R1 723 per fine ounce in the second half of 1999 to R1 946 per fine ounce in the first half of 2000. A decline in the volume of gold exports was outweighed by the higher rand price. Net gold export proceeds therefore increased again to R26,5 billion in the first six months of 2000.

The gold content of ore milled declined from 5,1 grams per ton in 1998 to 4,6 grams in 1999. This decline in the quality of ore milled was partly offset by an increase in the quantity of ore milled. Gold production consequently fell by about 3 per cent to 449 tons in 1999. Gold production contracted to an annualised 426 tons in the first half of 2000, probably as a result of higher mine-operating costs and the lower quality of ore milled.

Net service, income and current transfer payments

Net service, income and current transfer payments to non-residents rose from a seasonally adjusted and annualised level of R22,9 billion in the second half of 1998 to R25,5 billion in the first half of 1999. This deterioration was mainly due to an increase in payments to non-residents for transportation services rendered and higher current transfers to the rest of the world.

In the second half of 1999 an increase in service and income receipts was more than countered by higher service, income and current transfer payments to non-residents. The deficit on the services account consequently deteriorated from R25,5 billion in the first half of 1999 to R26,0 billion in the second half. The return of strong inflows of portfolio investment capital in 1999 contributed to an increase in investment income payments in the second half of the year. Payments to non-residents for transportation services also continued to expand, led by the higher nominal levels of international trade in the second half of 1999. South Africans also increased their spending on travel to other parts of the world in the second half of 1999.

The deficit on the services account of the balance of payments widened to R26,9 billion in the first half of 2000. This deterioration resulted mainly from the payment of more investment income to non-resident investors. Total interest and dividend payments to non-residents as a percentage of total export proceeds, increased from 10,9 per cent in 1998 to 11,3 per cent in the first half of 2000.

Financial account

Limited access to international financing by South African institutions since the foreign debt standstill in 1985 and the obligation to repay outstanding foreign debt had contributed towards net outflows of capital from the country during the early parts of the 1990s. However, since 1994 South Africa has experienced net inflows of capital in every completed calendar year. The international financial crisis of 1998 triggered a net outflow of capital in the second half of that year, but the quick recovery in the crisis-hit Asian economies and an improved outlook for emerging-market economies in general contributed towards a resumption of net capital flows into South Africa during 1999.

The *balance on the financial account* (including unrecorded transactions, but excluding reserve-related liabilities) changed from an outflow of R0,4 billion in the second half of 1998 to inflows of R6,8 billion in the first half of 1999 and R20,6 billion in the

Net financial transactions not related to reserves
R billions

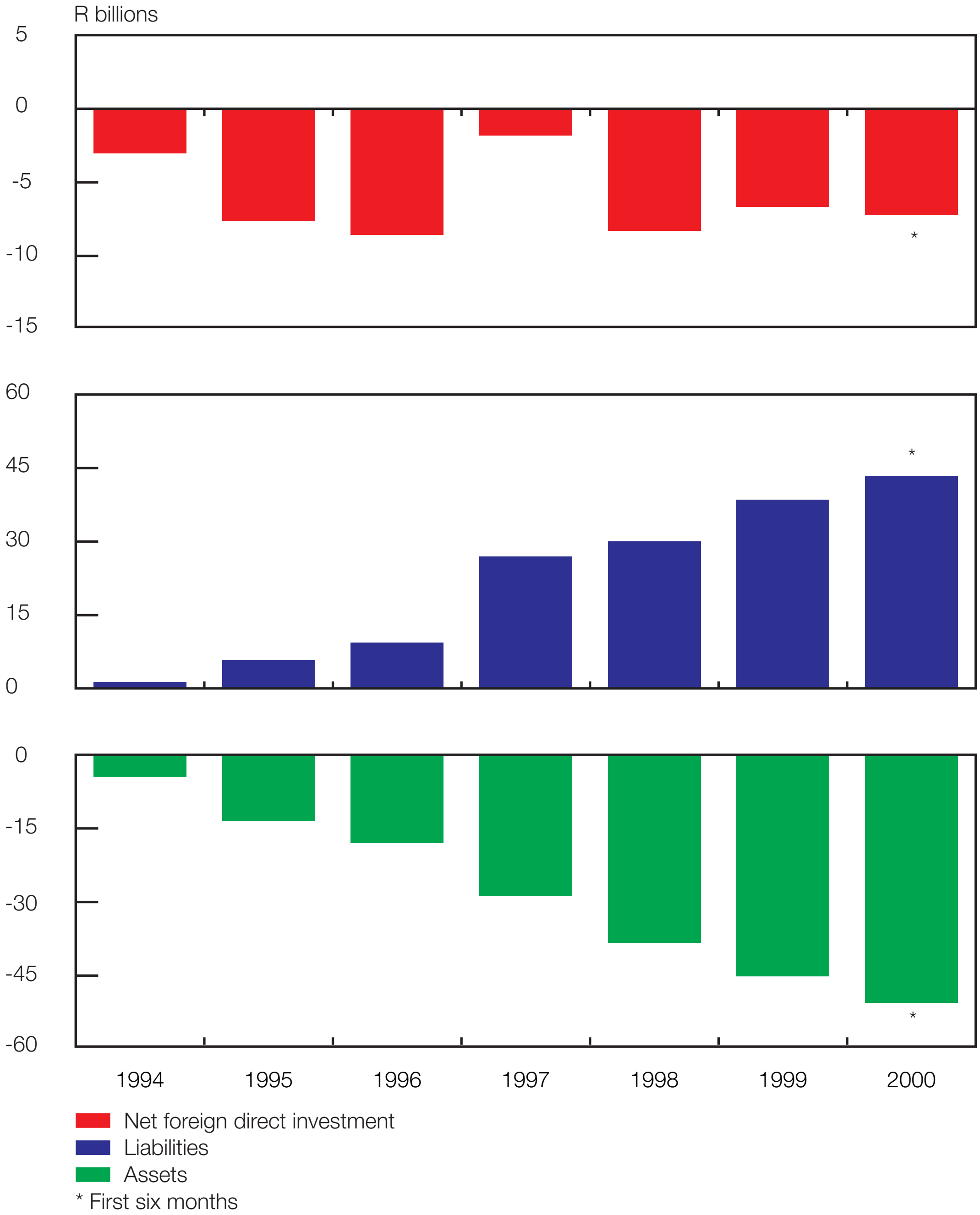
	1999		2000
	1st half	2nd half	1st half
Liabilities			
Direct investment	3,5	4,9	4,8
Portfolio investment	37,0	45,4	1,9
Other investment	-5,4	-13,9	7,4
Total liabilities	**35,1**	**36,4**	**14,1**
Assets			
Direct investment	-7,5	0,7	-5,4
Portfolio investment	-17,6	-13,7	-16,2
Other investment	-2,1	-6,1	0,6
Total assets	**-27,2**	**-19,1**	**-21,0**
Total financial transactions*	**6,8**	**20,6**	**-2,6**

* Including unrecorded transactions

second half. These inflows were mainly caused by strong inflows of portfolio capital which were only partly countered by outflows of other investment capital. In the first half of 2000 a global reassessment of risk-taking by international investors in emerging markets and heightened volatility in asset prices resulted in a deterioration in investor sentiment towards South Africa, causing the balance on the financial account to turn into an outflow of R2,6 billion as non-resident investors became large net sellers of bonds.

Foreign direct investment flows into South Africa increased to R3,5 billion in the first half of 1999 and R4,9 billion in the second half. The majority of these inflows resulted from the acquisition of private-sector companies by non-resident

Accumulated foreign direct investment since 1994



investors but the restructuring of government assets, more specifically the selling of a 20 per cent equity interest in South African Airways to Swissair, also made a significant contribution. In the first half of 2000 foreign direct investment flows into South Africa accelerated to R4,8 billion, mainly because of the acquisition of a domestic information technology company by a United States corporation.

Owing mainly to an expansion in the activities of South African companies in other parts of the world, their holdings of foreign direct investment assets increased by R7,5 billion in the first half of 1999. This outflow of investment capital was followed by an inflow of R0,7 billion in the second quarter of 1999, mainly as a result of the decision of resident shareholders to sell a controlling interest in a UK-based listed company. Such a transaction is recorded in the financial account of the balance of payments as a decline in foreign assets, in other words an inflow of capital.

In the first half of 2000, South African residents seeking to expand their businesses increased their investments in foreign firms by R5,4 billion. On a net basis, direct investment capital flows accordingly changed from an outflow of R4,0 billion in the first half of 1999 to an inflow of R5,6 billion in the second half. There was a further outflow of R0,6 billion in the first half of 2000. The accumulated net outflow of direct investment capital since the beginning of 1994 came to R7,2 billion by the middle of 2000.

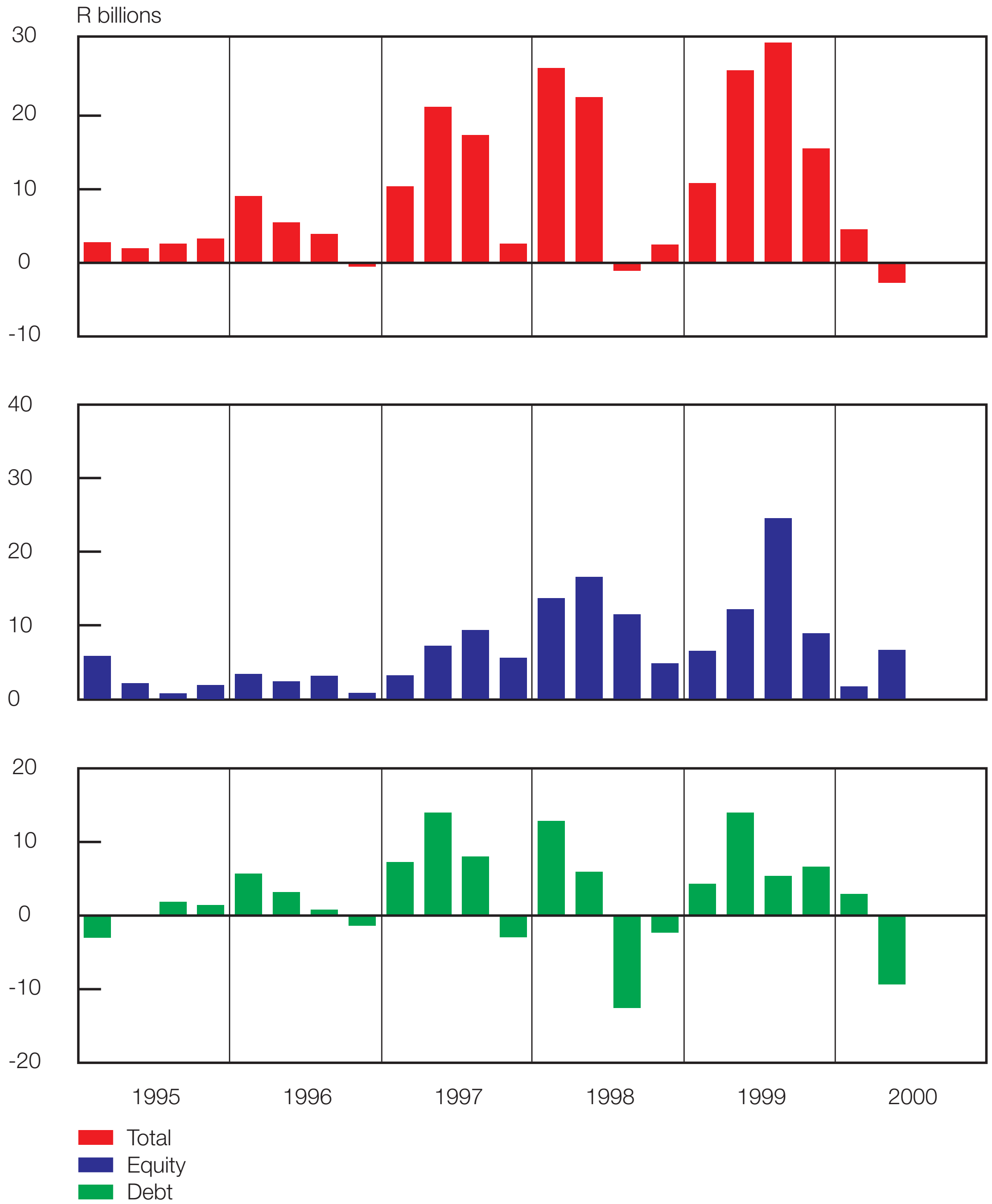
After having contracted sharply in the second half of 1998, *foreign portfolio investment flows* into South Africa increased to R37,0 billion in the first half of 1999. Attractive yields in the domestic bond market and the prospects of rising bond prices encouraged foreign investors to increase their holdings of rand-denominated fixed-interest securities. Non-resident investors consequently changed from being net sellers of domestic fixed-interest securities in the second half of 1998 to being net buyers of these securities during the first half of 1999. Foreign investment in shares of listed South African companies was boosted by the listing of South African companies on international stock markets in the first half of 1999. Foreign investors also increased their holdings of domestic debt and equity securities by conducting swap transactions with South African institutional investors over the same period. The government's international euro and dollar denominated bond issues also contributed towards the strong inflow of portfolio capital in the first half of 1999.

Portfolio flows into South Africa increased to R45,4 billion in the second half of 1999 – of this, R29,9 billion was recorded in the third quarter of 1999. The primary listing of the Old Mutual life assurance company on the London Stock Exchange in July 1999 resulted in significant inflows of portfolio capital. As in the first half of 1999, inflows of portfolio capital were supplemented by international bond issues by Eskom and National Government in the fourth quarter. These inflows were partly offset by the redemption of a dollar-denominated loan by National Government and a Netherlands guilder loan by a private-sector company.

Inflows of portfolio investment capital declined steeply from R45,4 billion in the second half of 1999 to R1,9 billion in the first half of 2000. This sudden contraction in inward portfolio investment flows was recorded despite the fact that South Africa had been assessed as an investment-grade country by the Standard and Poor's rating agency. The re-emergence of asset price volatility in emerging and some other markets, and developments in other economies on the African continent, resulted in negative investor sentiment towards South Africa, prompting non-resident investors to become net sellers of fixed-interest securities during the first half of 2000.

Outward portfolio investment flows declined from R17,6 billion in the first half of 1999 to R13,7 billion in the second half, before increasing again to R16,2 billion in the first half of 2000. South African institutional investors and individuals, who continued to broaden and diversify their holdings of foreign assets as exchange controls were gradually relaxed, were mainly responsible for this outflow of portfolio capital. On a net basis, net portfolio investment inflows increased from R19,4 billion in the first half of 1999 to R31,7 billion in the second half. Due to the large-scale selling of fixed-interest securities by non-residents and the allocation of a sizeable amount of shares in a United States company to a South African entity in compensation for the acquisition of the domestic information technology company referred to previously, net portfolio investment changed to an outflow of R14,3 billion in the first half of 2000.

Changes in portfolio investment liabilities of South Africa



Other foreign investment into South Africa (i.e. changes in foreign liabilities incurred by South African businesses in the form of loans, trade finance or bank deposits) recorded outflows of R5,4 billion in the first half of 1999 and R13,9 billion in the second half. Long-term foreign loan liabilities were accumulated in the first half of 1999, but these liabilities were reduced again in the second half of that year as part of the loans was repaid. An increase in rand-denominated deposits of non-resident investors with South African banks, was more than neutralised by a large outflow of foreign-currency denominated deposits of non-residents in the second half of 1999.

Other foreign investment into South Africa turned from an outflow in the second half of 1999 to an inflow of R7,4 billion in the first half of 2000. Non-resident investors continued their withdrawal of foreign-currency denominated deposits with South African banks in the first half of 2000, but these outflows were more than countered by an increase in short-term foreign loan liabilities of the private non-banking sector.

Other outward investment from South Africa (i.e. foreign assets originating from loans and trade finance to non-residents and deposits with non-resident banks) turned from outflows of R2,1 billion in the first half of 1999 and R6,1 billion in the second half to an inflow of R0,6 billion in the first half of 2000. On a net basis (i.e. changes in liabilities offset against changes in assets) other foreign investment outflows increased from R7,5 billion in the first half of 1999 to R20,0 billion in the second half of 1999, but an inflow of R8,0 billion was recorded in the first half of 2000.

Foreign debt

South Africa's total outstanding foreign debt increased from US$37,2 billion at the end of 1998 to US$38,9 billion at the end of 1999. Foreign-currency denominated debt declined marginally from US$24,7 billion at the end of 1998 to US$24,2 billion at the end of 1999, whereas rand-denominated debt increased from US$12,5 billion to US$14,7 billion over the same period.

Foreign debt of South Africa
US$ billions at end of year

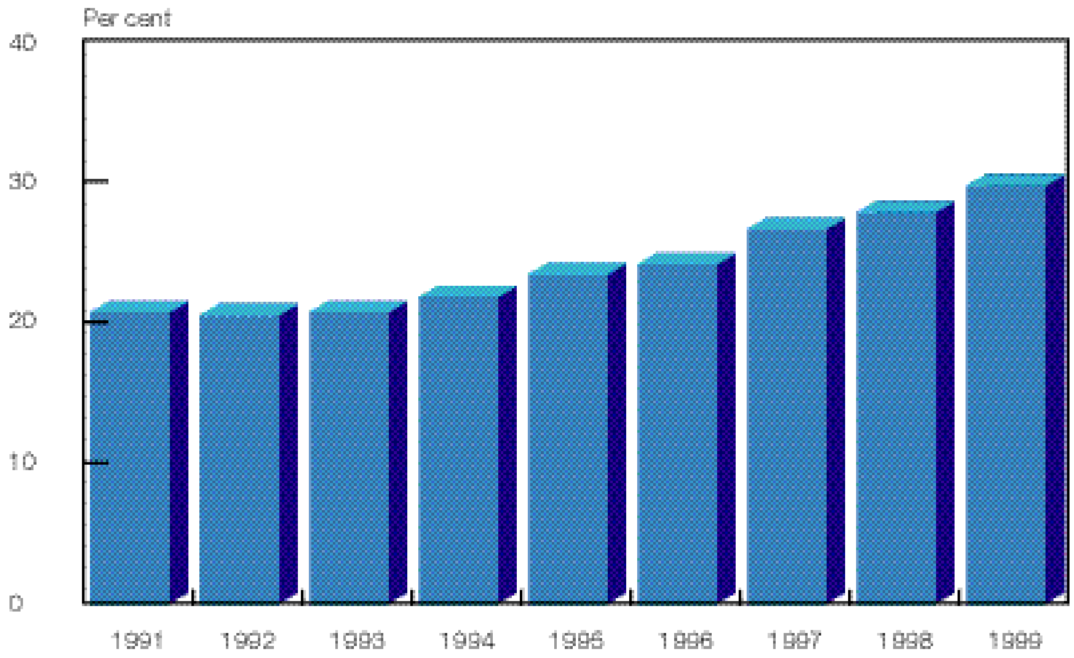
	1995	1996	1997	1998	1999
Renegotiated debt	**3,0**	**2,7**	**2,5**	**2,3**	**1,5**
Public sector	1,1	1,3	1,2	1,2	0,8
Monetary sector	0,7	0,3	0,2	0,1	0,1
Non-monetary private sector	1,2	1,1	1,1	1,0	0,6
Other foreign-currency denominated debt	**22,4**	**23,3**	**22,7**	**22,4**	**22,7**
Bearer bonds	3,8	4,0	4,0	4,4	4,8
Converted long-term loans	2,9	2,1	1,3	0,8	0,4
Public sector	4,5	4,7	4,2	3,3	3,5
Monetary sector	4,9	6,6	7,5	8,8	8,2
Non-monetary private sector	6,3	5,9	5,7	5,1	5,8
Total foreign-currency denominated debt	**25,4**	**26,0**	**25,2**	**24,7**	**24,2**
Rand-denominated debt	**9,9**	**8,5**	**14,0**	**12,5**	**14,7**
Bonds	7,3	6,3	10,4	7,6	9,8
Other	2,6	2,2	3,6	4,9	4,9
Total foreign debt	**35,3**	**34,5**	**39,2**	**37,2**	**38,9**

South Africa's *renegotiated debt* (i.e. debt negotiated in terms of successive stand-still arrangements with foreign creditors) declined to US$1,5 billion at the end of 1999. In terms of the Final Debt Arrangements with foreign creditors, the last instalment of South Africa's renegotiated debt is scheduled for payment in August 2001. Valued at the exchange rates of 31 August 1985, the outstanding amount of renegotiated debt at the time of the special arrangements in September 1985, has been reduced by $12,1 billion.

Other foreign-currency denominated debt increased only marginally from $22,4 billion at the end of 1998 to $22,7 billion at the end of 1999. A decline in the other foreign-currency denominated debt of the monetary sector and repayments on longer-term loans that had previously been converted from the category of renegotiated debt were more than counteracted by an increase in the other foreign-currency denominated debt of the public sector and the non-monetary private sector. National Government floated new loans in the international capital markets to the value of €0,8 billion and US$0,5 billion during 1999, whereas the non-monetary private sector increased the utilisation of foreign long-term loan facilities by $0,7 billion.

Partly as a result of the decline in the external value of the rand, the country's total foreign debt, measured in rand, increased from R218,1 billion at the end of 1998 to R239,5 billion at the end of 1999. As a ratio of gross domestic product, total debt rose from 27,8 per cent in 1998 to 29,7 per cent in 1999. The maturity structure of foreign-currency denominated debt improved slightly in 1999; debt maturing within twelve months as a percentage of total outstanding foreign-currency denominated debt declined from 57,5 per cent at the end of 1998 to 57,0 per cent at the end of 1999.

Foreign debt as percentage of gross domestic product



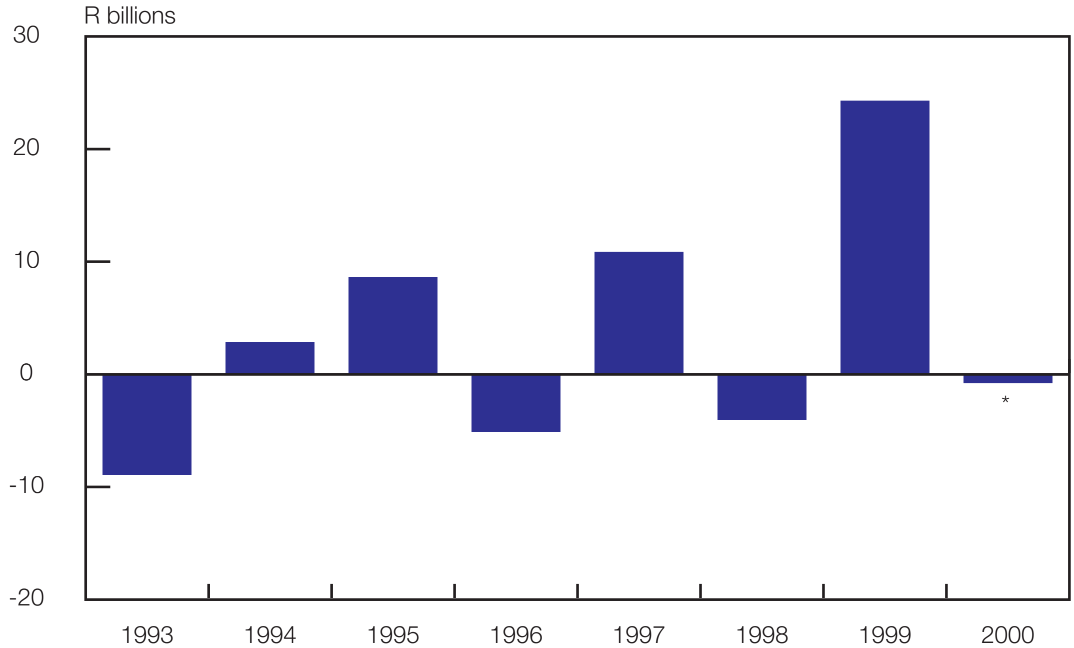
Foreign reserves

The return of stability to Southeast Asian financial markets and an international rescue package which had been arranged for Brazil in January 1999 helped to improve investor sentiment towards emerging markets generally and South Africa, in particular, during 1999. A record inflow of capital which was only partly countered by a small deficit on the current account, resulted in a strong increase in the surplus on the *overall balance of payments*. South Africa's net international reserves accordingly increased by R24,3 billion in 1999 – the highest increase ever recorded in any calendar year.

The consistent accumulation of net international reserves came to an end in the second quarter of 2000. Non-resident portfolio investors sold fixed-interest securities in the first half of 2000 and together with other outflows through the financial market, this caused a reversal in the overall balance of international payments from a surplus of R3,6 billion in the first quarter of 2000 to a deficit of R4,4 billion in the second quarter.

Total gross gold and other foreign reserves increased by R25,3 billion from the end of December 1998 to R67,5 billion at the end of December 1999 and by a further R3,9 billion in the first quarter of 2000 to R71,4 billion at the end of March 2000. There was a decline in total gross international reserves to R69,8 billion at the end of June 2000. Valued in terms of US dollars, the country's gross international reserves declined somewhat from US$11,0 billion at the end of December 1999 to US$10,2 billion at the end of June 2000.

Change in net gold and other foreign reserves



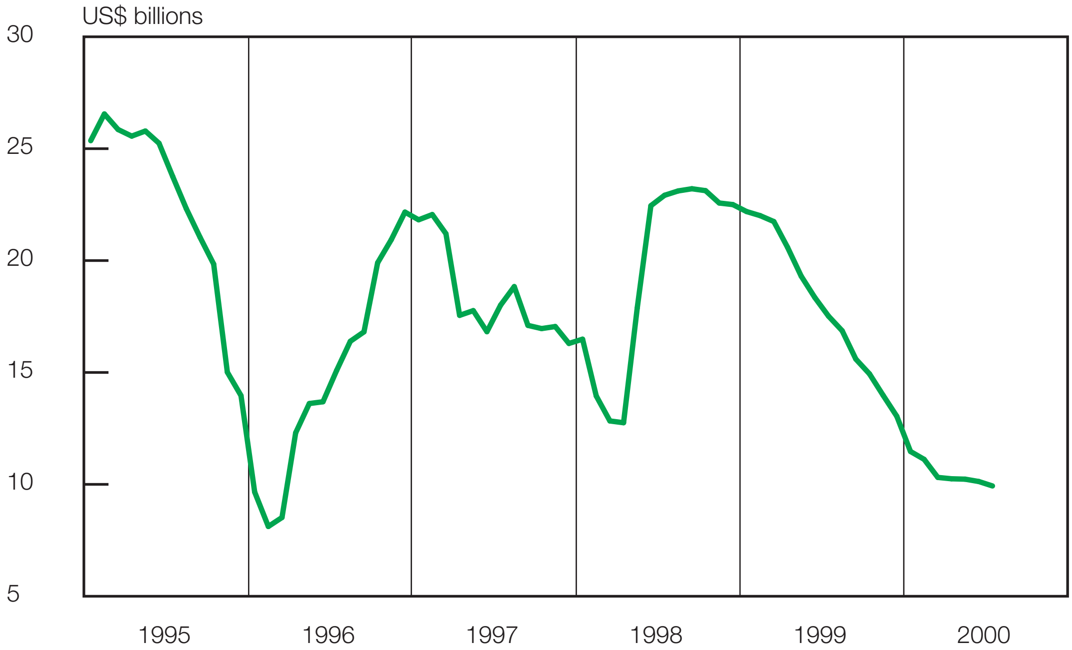
Owing to balance-of-payments transactions
* First six months

Relative to the value of imports of goods and services, the country's gross international reserves increased consistently throughout 1999. After having deteriorated from the end of the second quarter of 1998 to the end of the fourth quarter of 1998, the level of import cover improved again to 14½ weeks' worth of imports at the end of the second quarter of 2000.

The gross international reserves of the Reserve Bank rose from R31,6 billion at the end of December 1998 to R45,4 billion at the end of December 1999 and R51,1 billion at the end of June 2000. The non-borrowed international reserves of the Reserve Bank increased from R13,5 billion at the end of 1998 to R26,6 billion at the end of 1999 and R33,2 billion at the end of June 2000.

As a result of calmer trading conditions in the market for foreign exchange and the offset of the proceeds of foreign borrowing by National Government against the Bank's forward book, the Reserve Bank's oversold forward position in foreign currency declined from US$24,9 billion at the end of 1998 to US$17,4 billion at the end of 1999. The Bank's *net open position in foreign currency,* i.e. the net position obtained by offsetting the Bank's net international reserves against the oversold forward foreign-exchange balances, declined from US$22,5 billion at the end of 1998 to US$13,0 billion at the end of 1999. An increase in the net reserves of the Reserve Bank following the repayment of outstanding foreign credit facilities and a further reduction in the oversold forward book contributed towards a decline in the net open position in foreign currency to a level of US$10,1 billion at the end of June 2000.

Net open position in foreign currency



Oversold position of the Reserve Bank

The Reserve Bank announced on 28 June 2000 that a three-year loan facility for a total amount of US$1,0 billion had been concluded with a group of foreign banks. This new loan facility replaced the existing facility which matured in July 2000, consolidated existing bilateral credit lines and extended the maturity profile of the Bank's foreign loans. A new gold-denominated three-year loan facility of US$500 million was simultaneously negotiated by the Bank. Both these facilities will eventually contribute towards the strengthening of South Africa's gross international reserve position.

Exchange rates

As a result of South Africa's reintegration into the global financial markets since 1994, the exchange rate of the rand has become far more susceptible to international economic conditions. Successive deficits on the current account of the balance of payments since 1995 and volatile capital inflows, have limited the scope for a continued strong improvement in the country's overall balance of payments position. The gradual decline in the value of the rand against the currencies of South Africa's major trading-partner countries usually accelerated during periods of overall balance of payments weakness, and then regained only part of its lost value when the overall balance of payments improved. Following the emerging-market currency crises of 1998, when the *nominal effective exchange rate* had declined by 18½ per cent from the end of 1997 to the end of 1998, the rand strengthened, on balance, by about ½ per cent in 1999.

Although the exchange value of the rand appeared to have been relatively stable from the end of 1998 to the end of 1999, there was a fair measure of exchange rate volatility in the course of 1999. At first, the nominal effective exchange rate of the rand fell by 6,8 per cent from the end of December 1998 to 15 January 1999, but then strengthened by 11,8 per cent to 23 June. Problems in Latin America and a decline in the gold price to its lowest level since 1979 interrupted the strengthening of the rand and caused the rand to weaken by 4,7 per cent from 23 June 1999 to 30 July. In the remainder of the year the rand appreciated, on balance, by 1,3 per cent.

Exchange rates of the rand
Percentage change

	29 Dec 1995 to 31 Dec 1996	31 Dec 1996 to 31 Dec 1997	31 Dec 1997 to 31 Dec 1998	31 Dec 1998 to 30 Dec 1999	30 Dec 1999 to 30 June 2000
Weighted average*...........	-19,1	7,9	-18,6	0,6	-6,6
Euro................................	-19,7	8,1	-21,5	10,8	-5,5
US dollar..........................	-22,1	-3,7	-17,0	-4,7	-9,8
British pound	-28,9	-1,6	-17,1	-2,3	-3,6
Japanese yen	-12,1	7,7	-27,4	-14,4	-6,9

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

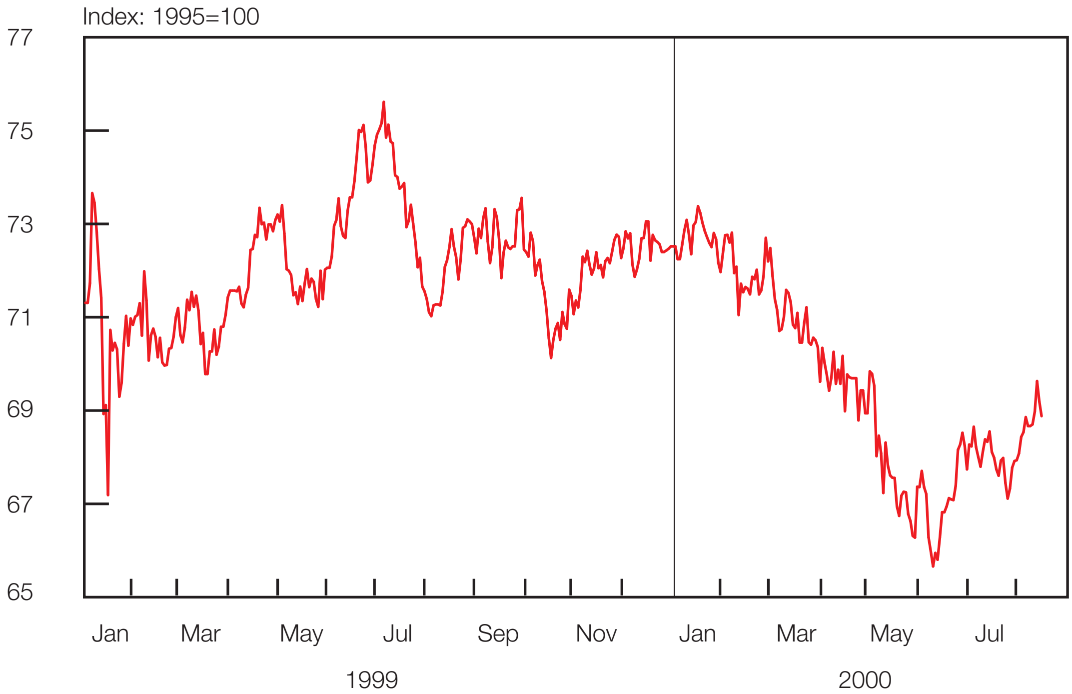
The relative strength in the value of the rand in the first half of 1999 could probably be attributed to

- the surplus on the overall balance of payments and expectations that the rand would strengthen, which encouraged a strong inflow of portfolio capital back into the economy;
- the listing of prominent South African companies on the London stock market which encouraged non-resident buying on the JSE; and
- oversold rand positions that had been taken ahead of South Africa's general elections in June and which were closed in the remainder of that month.

In the last five months of 1999 the relative firmness of the rand was partly due to improved prospects for the gold market and the return of relatively stable conditions in emerging markets. Concerns about the possible impact that the millennium changeover might have on emerging market asset prices, marginally increased volatility in the foreign exchange market during the second half of 1999.

In the first half of 2000 the value of the rand was subjected to renewed downward pressure. Events in other parts of sub-Saharan Africa and a substitution by international investors of commodity-related assets in favour of other assets resulted in a decline of 6,6 per cent in the weighted exchange rate of the rand from the end of December 1999 to the end of June 2000. The rand depreciated to R7,20 against the US dollar on 25 May 2000 – its lowest level ever against the dollar.

Nominal effective exchange rate of the rand



The average daily *turnover in the domestic market for foreign exchange,* which had increased from US$9,4 billion in the first quarter of 1999 to US$10,2 billion in the second quarter, declined during the remainder of 1999 to US$8,3 billion in the fourth quarter. This decline in turnover could be attributed to the return of relatively stable conditions in the South African market for foreign exchange. Heightened volatility in the foreign currency market led to an increase in the daily average turnover in the market for foreign exchange to US$9,2 billion in the first quarter of 2000 and US$9,7 billion in the second quarter. More than 70 per cent of all transactions in the spot market for foreign exchange are denominated in US dollars.

Non-resident participation in the domestic market for foreign exchange as a percentage of total turnover, which had increased sharply from 44 per cent in the first quarter of 1998 to 59 per cent in the third quarter, declined somewhat to 56 per cent in the first quarter of 1999. Transactions by non-residents accounted for more than 55 per cent of total turnover throughout 1999 and the first half of 2000.

South African exporters of goods and services continued to gain a competitive advantage as measured by changes in the *inflation-adjusted effective exchange rate* of the rand during 1999 and the first half of 2000. The average real effective exchange rate of the rand which had declined by 9½ per cent in 1998, fell by 5 per cent in 1999 and 1,8 per cent in the first half of 2000 compared to the second half of the preceding year.

Monetary developments and interest rates

New monetary policy framework

In February 2000 the previous "eclectic" approach to monetary policy-making was replaced by an inflation-targeting monetary policy framework.

The "eclectic" approach involved the public announcement of guidelines for the growth in the broad money supply, augmented by regular broad-based assessments of economic conditions and the outlook for inflation. In presenting the "eclectic" approach, the Reserve Bank had emphasised that it would not react automatically when monetary growth deviated from the guideline values. Policy would rather be based on an in-depth analysis of factors that could affect price stability.

Inflation targeting is a monetary policy framework characterised by an announcement of a numerical target for the inflation rate that is to be achieved over a specified period of time. It is also a broad-based strategy for achieving price stability, centred on an analysis of price developments and not on some reference value for monetary growth. The Bank will monitor a wide range of economic indicators – such as growth in money supply and credit extension, international interest rate movements, the shape and position of the yield curve, changes in nominal and real salaries and wages, nominal unit labour costs, the exchange rate, and other factors – before coming to final decisions about the optimal future evolution of official intervention interest rates.

The introduction of inflation targeting was partly influenced by structural changes in the financial system in recent years which altered the transmission mechanism in the economy and weakened the more stable relationships that had previously existed between changes in the money supply and in bank credit extension on the one hand, and in nominal spending on goods and services and prices on the other hand. Accordingly, changes in the monetary aggregates lost some of their usefulness as the most important indicators of possible future trends in inflation, and therefore also as an anchor for monetary policy decisions.

Given the need for disinflation and the weakening of the relationship between money growth and nominal income growth, the authorities decided that monetary policy decisions would in future be guided by the deviation of expected consumer price inflation from a predetermined inflation target. The inflation target had been specified as an average rate of increase in CPIX (i.e. the overall consumer price index for metropolitan and other urban areas, excluding the influence of mortgage interest costs) of between 3 and 6 per cent in 2002.

The following advantages of inflation targeting as a monetary policy framework were also considered before deciding to adopt the new approach:

- the importance of a nominal anchor for monetary policy and inflation expectations;
- the formal co-ordination of macroeconomic policies to contain inflation in pursuit of the broader economic objectives of sustainable high economic growth and employment creation;

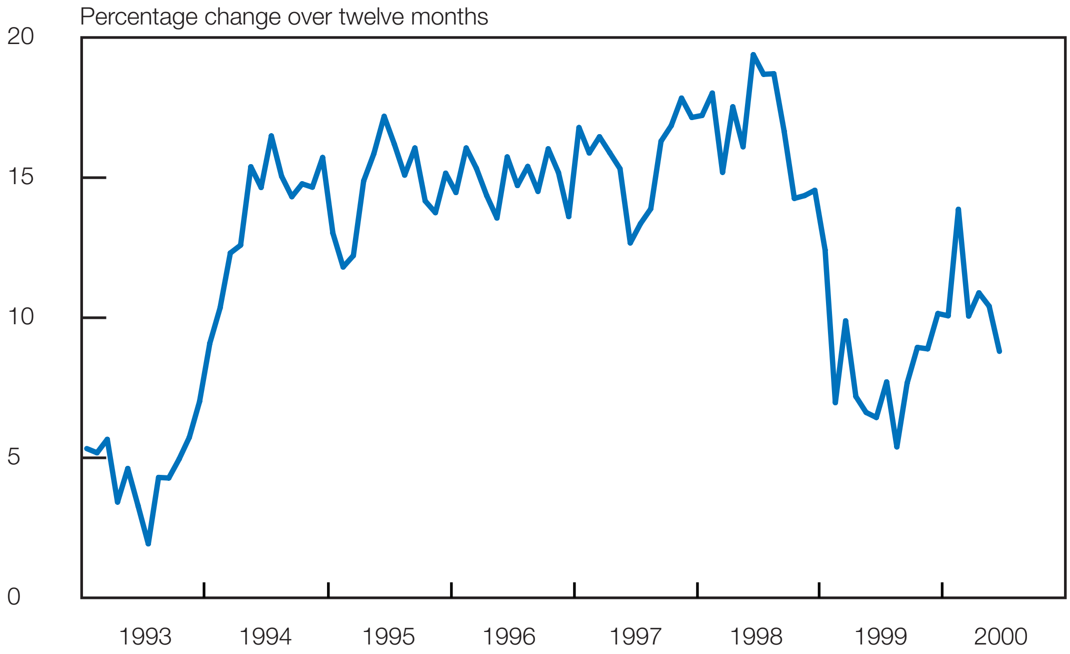
- the focusing of monetary policy on a single objective; and
- the enhanced transparency and credibility of monetary policy.

In the application of inflation targeting as a monetary policy framework, allowance will be made for the price effects of serious supply shocks. Examples of such unsustainable occurrences over which the Bank has little or no influence are changes in the international price of crude oil, higher food prices due to unfavourable weather conditions and inordinate changes in the international exchange value of the rand.

Money supply

Apart from a relatively short period in the second half of 1999, growth in the broadly defined money supply (M3) remained well contained during most of 1999 and in the first half of 2000. The restrictive monetary policy stance adopted in the second and third quarters of 1998 to quell financial-market turbulence played a major role in slowing down the growth in M3 from a year-on-year rate of 19,4 per cent in June 1998 to a low of 5,4 per cent in August 1999. Growth over twelve months of less than 10 per cent was consistently recorded from February to November 1999.

M3 money supply



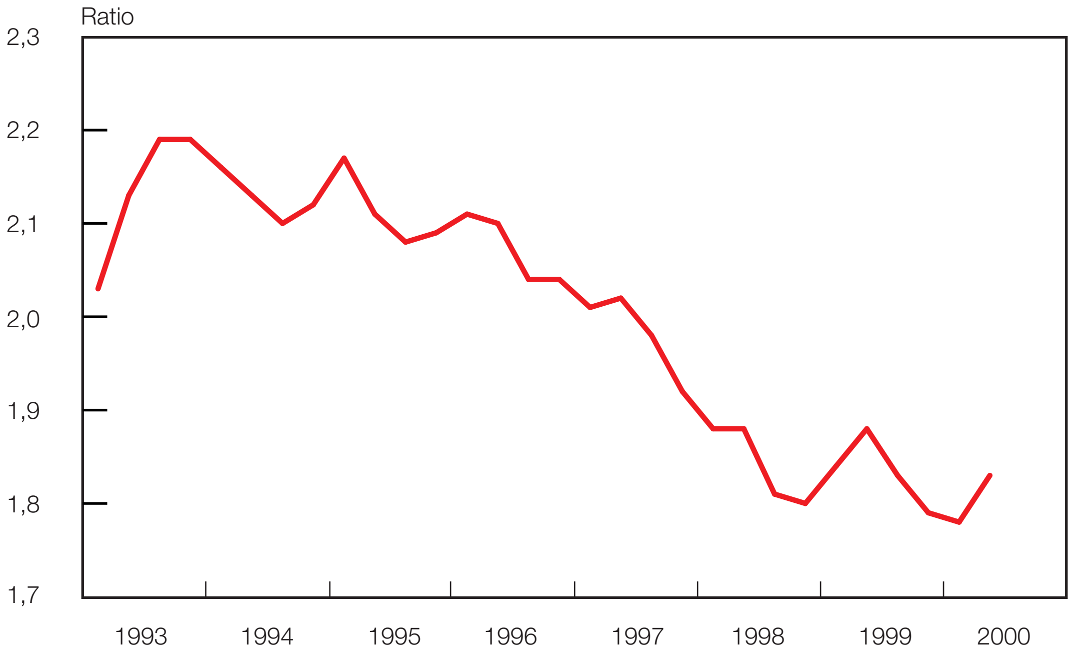
Some acceleration of broad money growth nevertheless occurred in the second half of 1999 as the economy recovered from the setbacks of 1998. Rising levels of economic activity in the second half of 1999 resulted in an increased demand for money for transaction purposes. The buoyancy of the financial markets added to the demand for money for speculative purposes and for capitalising on movements in asset prices. Fairly attractive real yields on most types of bank deposits also encouraged a movement of funds onto banks' balance sheets. Concerns about possible date-related problems with computer systems at the beginning of 2000, as well as a spate of public holidays over the year-end, also bolstered the demand for money.

The firming of the demand for money in the second half of 1999 caused the twelve-month growth in M3 to accelerate from 5,4 per cent in August 1999 to 10,1 per cent in December. On a quarterly basis, the quarter-to-quarter rate of increase in the average value of M3 (seasonally adjusted and annualised) accelerated from around 1 per cent in the first and second quarters of 1999 to 16,0 per cent in the third quarter and 19,3 per cent in the fourth quarter.

In the first six months of 2000, M3 growth over one year was fairly stable at around 10 per cent, except for February when growth of 13,9 per cent was recorded. The high growth in February 2000 was partly explained by the low base in 1999 for year-on-year growth calculations. In February 1999 the growth in M3 was slowed down by a substantial build-up of government deposits in advance of large interest payments on government debt over the month-end. The quarter-to-quarter annualised growth in M3 fell back to 10,3 per cent in the first quarter of 2000, but in the second quarter M3 actually declined at an annualised rate of 1,5 per cent. The slower growth in real aggregate output and expenditure, and lower returns on monetary deposits with banks, both in absolute terms and relative to those on substitute asset classes, probably contributed most to the less buoyant demand for money and the slower growth in M3.

The quarter-to-quarter annualised growth rates of M3 reached levels that were respectively 12,2 and 9,1 percentage points higher than those of the nominal gross domestic product in the third and fourth quarters of 1999. The margin between the two growth rates narrowed to 0,7 percentage points in the first quarter of 2000 and turned into an inverse gap of 12,2 percentage points when the quarterly average value of M3 declined in the second quarter. The income velocity of circulation of M3 accordingly declined by 5,1 per cent from the second quarter of 1999 to the first quarter of 2000, but rose by 3,0 per cent from the first to the second quarter of 2000.

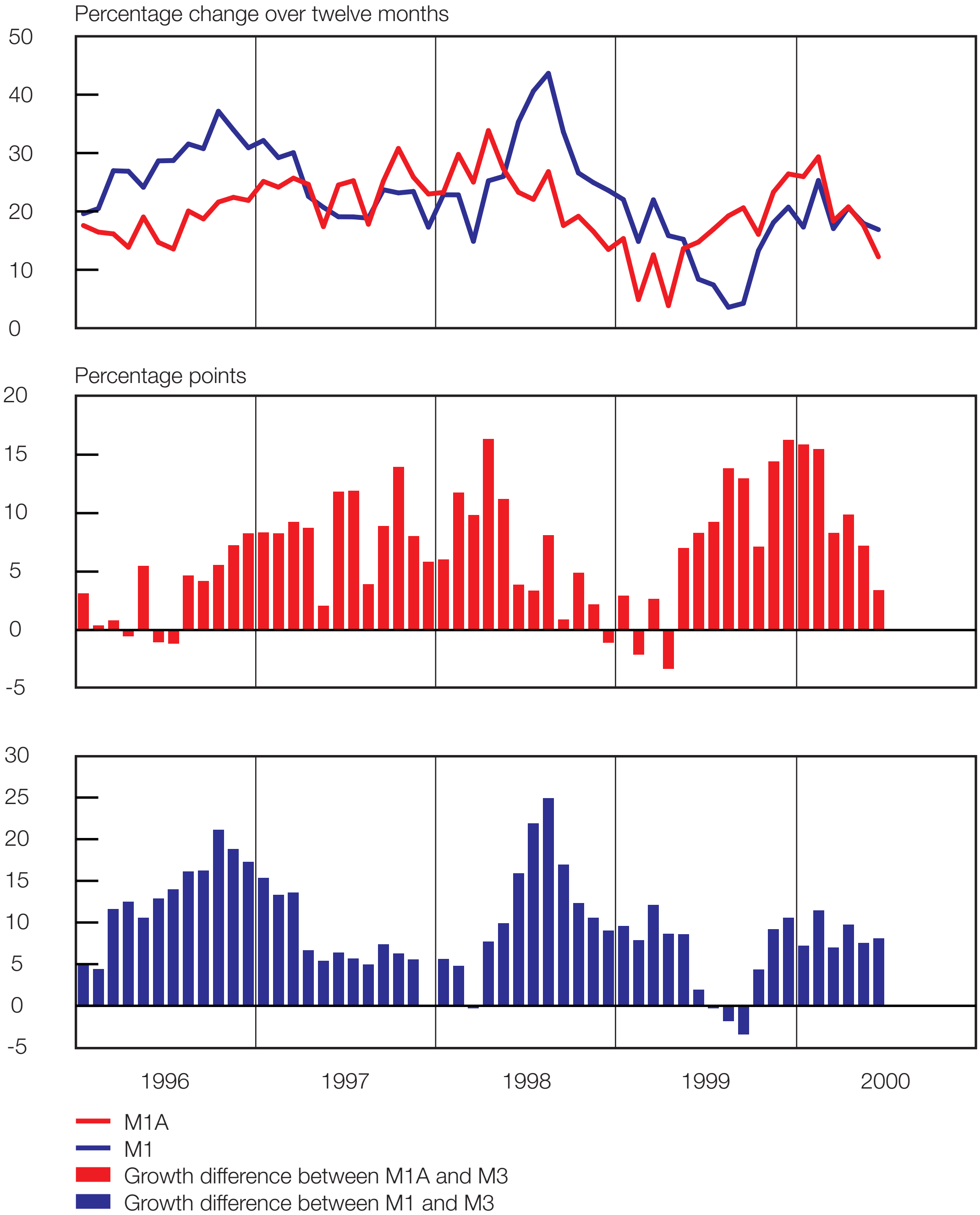
Income velocity of circulation of M3



Seasonally adjusted

The general decline in the income velocity of M3, or conversely, the stronger demand for money since about the second half of 1993, stemmed partly from the relative success achieved with macroeconomic stabilisation and the general slowdown in inflation during this period. This helped to re-establish money as a store of wealth. The implementation of inflation-targeting as a new policy regime may over time lower private-sector inflation expectations, and so eventually raise the demand for money and reduce the velocity of circulation even further from its current level.

Monetary aggregates



Growth in the narrower monetary aggregate M1A consistently outpaced growth in M3 during the second half of 1999 as well as during the first six months of 2000, but the growth differential narrowed considerably towards the middle of 2000. By the end of 1999, growth in M1A was boosted by a strong rise in notes and coin in circulation outside the monetary sector, partly because of Y2K concerns and partly because of the greater number of public holidays intended to ensure a smooth transition of computer systems over the millennium change. Similarly, the growth in M1, which includes other demand deposits, also outpaced the growth in M3 from October 1999. The faster increases in deposits with short maturities were an indication of a strong preference for more liquid types of deposits and came at the expense of other short, medium and long-term deposits. The relative share of these kinds of deposits in M3 declined from June 1999 to June 2000.

M3 and its components

	June 1999		June 2000		Change over 12 months	
	Actual R billion	Percentage of M3	Actual R billion	Percentage of M3	Percentage	Percentage of total change in M3
Notes and coin	18,5	4,3	21,7	4,6	17,2	8,3
Cheque and transmission deposits	105,6	24,2	117,6	24,8	11,4	31,3
M1A	124,1	28,5	139,3	29,4	12,2	39,6
Other demand deposits	96,3	22,1	118,3	24,9	22,9	57,4
M1	220,4	50,6	257,6	54,3	16,9	97,0
Other short-term and medium-term deposits	172,3	39,5	174,8	36,9	1,5	6,5
M2	392,7	90,1	432,4	91,2	10,1	103,5
Long-term deposits	43,2	9,9	41,8	8,8	-3,2	-3,5
M3	435,9	100,0	474,2	100,0	8,8	100,0

The main counterpart of the change in M3 in the twelve months up to June 2000 was a substantial increase in bank credit extended to the private sector. A decline in the net other domestic assets of the monetary sector partly countered the expansionary effect of domestic credit extension. This decline in net other domestic assets

Accounting counterparts of change in M3

R billions

	Year to June		
	1998	1999	2000
Net foreign assets	0,8	-14,7	21,6
Net claims on government sector	17,8	-0,4	-0,5
Gross claims	8,2	10,1	0,6
Deposits (increase-, decrease+)	9,6	-10,5	-1,1
Claims on the private sector	63,7	53,9	34,6
Net other assets	-15,8	-12,4	-17,4
Total change in M3	**66,5**	**26,4**	**38,3**

was brought about by the net surpluses originating from the Reserve Bank's forward foreign exchange transactions and an expansion of the capital and reserves of private banks. Aggregate imbalances between income and spending in the domestic economy have to be financed, in an accounting sense, either by the acquisition of foreign assets or liabilities, either directly with non-residents, or by intermediation via the banking system. As growth in the net domestic assets of the monetary sector fell short of the growth in its domestic liabilities, foreign assets to the net amount of R21,6 billion were acquired in the twelve months to June 2000.

Credit extension

Total domestic credit extension (i.e credit extended to the non-bank private sector and net claims on the government sector) increased by R34,1 billion in the twelve months to June 2000, compared with an increase of R53,5 billion in the twelve months to June 1999. The smaller increase in overall domestic credit extension was mainly related to a slowdown in the growth in private-sector credit demand: the growth in bank credit extension to the private sector decelerated from R53,9 billion in the twelve months to June 1999 to R34,6 billion in the twelve months to June 2000. Credit extension to the government sector changed only slightly over the two years to June 2000.

Measured as a percentage change over twelve months, the growth in total domestic credit extension slowed down sharply from a recent peak of 21,7 per cent in August 1998 to 6,9 per cent in October 1999. As economic activity began to strengthen towards the end of 1999, credit growth accelerated moderately but the year-on-year growth rates remained below 10 per cent; it was 6,3 per cent in June 2000 – the lowest growth since March 1987.

The growth in credit extension to the domestic non-bank private sector over periods of twelve months has been consistently below 10 per cent since October 1999. From June 1999 to June 2000 bank credit to the private sector grew by 6,7 per cent. This modest growth in the private sector's use of bank credit was mainly attributable to households' restraint in using bank credit for financing their acquisitions of consumer durables and fixed property, but was also the result of tighter risk assessment of potential borrowers by monetary institutions. Although it is still too early to draw firm conclusions, there is good reason to believe that the very high levels of interest rates in 1998 could have weakened the appetite for bank credit of private economic agents. The demand for credit by households and firms may also have been temporarily reduced by improved cash flows following the declines in interest rates after the fourth quarter of 1998 as well as the lowering of personal income tax rates in the 2000/2001 National Budget.

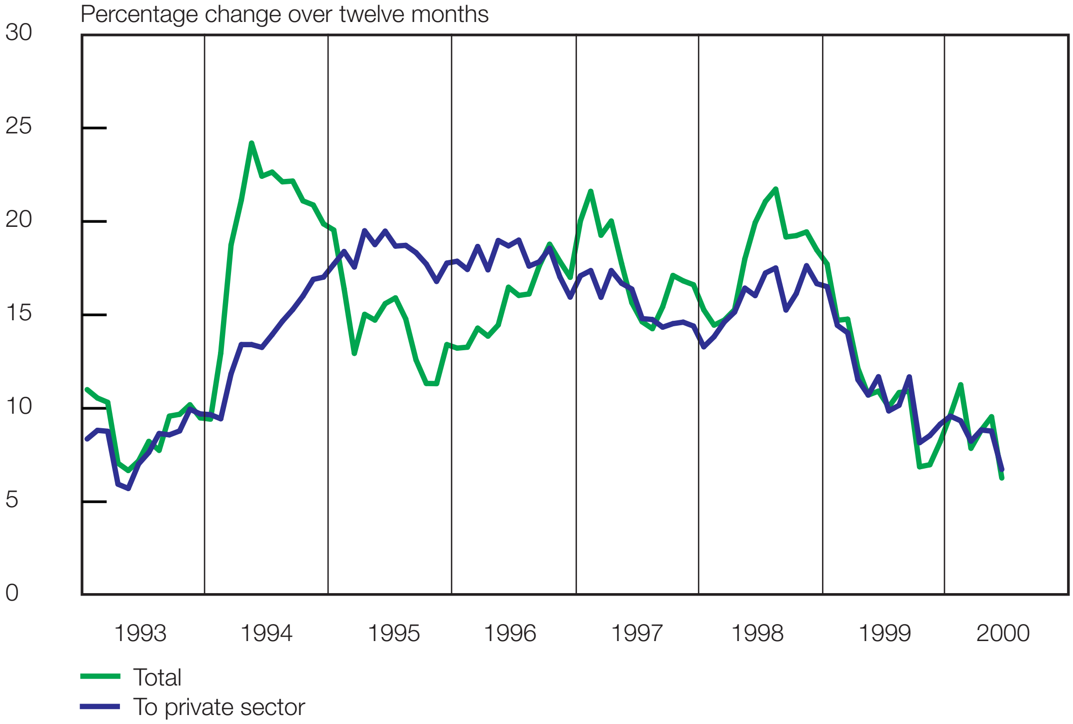
The growth in credit extension to the private sector over the past twelve months kept pace with the growth in nominal expenditure on gross domestic product. The amount of outstanding credit to the private sector as a ratio of gross domestic product accordingly showed little change, on balance, from the second quarter of 1999 to the second quarter of 2000; it amounted to 63,1 per cent in the second quarter of 2000. If this ratio is interpreted as a measure of the depth of the financial system and of financial intermediation in general, South Africa may be classified as an economy with a fairly well-developed financial system compared with most other countries on the continent (see accompanying table). Countries with broadly comparable financial systems are Algeria, Kenya, Mauritius, Morocco and Tunisia. It seems that South Africa has the necessary financial depth to mobilise the domestic saving resources

Monetary indicators for Africa
Average for 1995-1998: percentages

Region	Credit to private sector as percentage of GDP
Central	9
Eastern	22
Northern	29
Southern	53
Western	12

Source: Bank for International Settlements

Credit extended by monetary institutions



and foreign capital that are necessary to accelerate the overall pace of economic expansion and development. In fact, the indicator of financial depth is almost on a par with the ratio of 69 per cent that was calculated for the United States economy.

An analysis of banks' claims on the private sector shows that the rate of growth in *mortgage advances* has picked up somewhat in recent months; the twelve-month growth rate has accelerated, on balance, from 3,8 per cent in November 1999 to 7,5 per cent in June 2000. Although these growth rates are still rather modest, their recent strengthening is consistent with a recovery in the real-estate market and rising property values. The share of mortgage advances in the overall stock of outstanding private-sector credit stabilised around a still relatively high level of 38½ per cent in the year to June 2000.

The main thrust of growth in credit extension continued to be *other loans and advances* (including overdraft facilities and other advances), which have become the largest component of bank credit to the private sector since March 1999. The share of other loans and advances in the overall stock of outstanding private-sector credit increased to a peak of 43,2 per cent in January 2000 and settled down at an average level of 42,3 per cent in the first half of 2000.

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

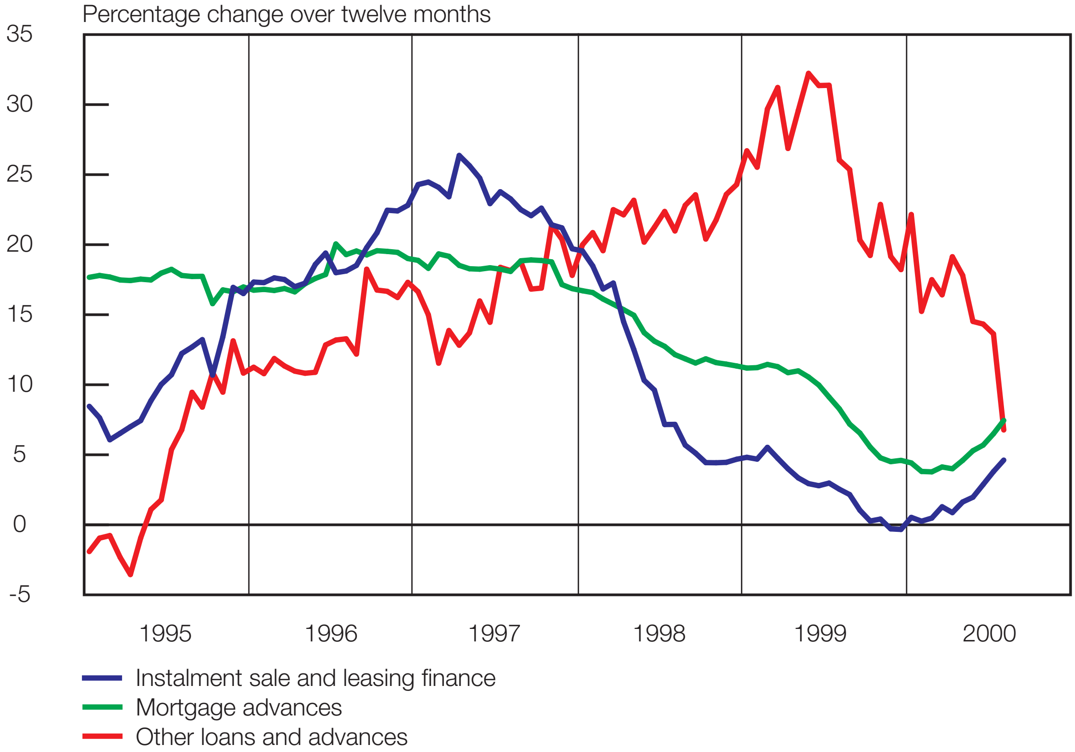
		Mortgages	Overdrafts	Instal-ment sale and leasing finance	Bills discoun-ted and invest-ments	General advances	Total
1999:	Jun	4,8	10,7	0,4	18,9	30,8	11,7
	Jul	4,5	-0,8	-0,3	14,0	32,1	9,9
	Aug	4,6	3,3	-0,3	25,2	27,2	10,2
	Sep	4,4	12,1	0,5	25,8	28,0	11,7
	Oct	3,8	2,6	0,3	12,1	22,3	8,2
	Nov	3,8	3,1	0,5	1,2	25,6	8,5
	Dec	4,1	-1,2	1,3	14,5	26,3	9,2
2000:	Jan	4,0	5,5	0,9	4,6	26,9	9,6
	Feb	4,6	7,6	1,6	3,2	23,8	9,3
	Mar	5,3	9,0	1,9	-0,1	17,7	8,2
	Apr	5,7	8,4	2,9	7,6	17,7	8,8
	May	6,5	10,9	3,8	3,5	15,1	8,8
	Jun	7,5	1,7	4,6	6,8	9,6	6,7

Even though the year-on-year growth in *other loans and advances* slowed down from 22,9 per cent in June 1999 to 13,6 per cent in May 2000, the rate of growth was still proceeding at rates considerably higher than all of the conventional measures of inflation. Other advances, i.e. the non-overdraft component of “other loans and advances” was particularly buoyant in the year to January 2000 when it grew by 26,9 per cent. Most of this credit was destined for the corporate sector, which replenished inventories that had fallen to low levels in the first half of 1999. From February 2000 the private-sector’s demand for funds was increasingly satisfied through issues of share capital and fixed-interest securities. This contributed to the growth in credit intermediated via banks slowing down. Other loans and advances, including overdrafts, grew by just 6,8 per cent in the year to June 2000.

Composition of credit extended to the private sector by type of credit
Per cent of total

Type of credit	June 1999	June 2000
Instalment sale credit and leasing finance	14,3	14,0
Mortgage advances	38,3	38,5
Overdrafts	14,8	14,1
General advances	24,4	25,2
Credit cards	2,1	2,1
Investments and bills	6,1	6,1
Total	100,0	100,0

Credit extended to private sector by type of credit

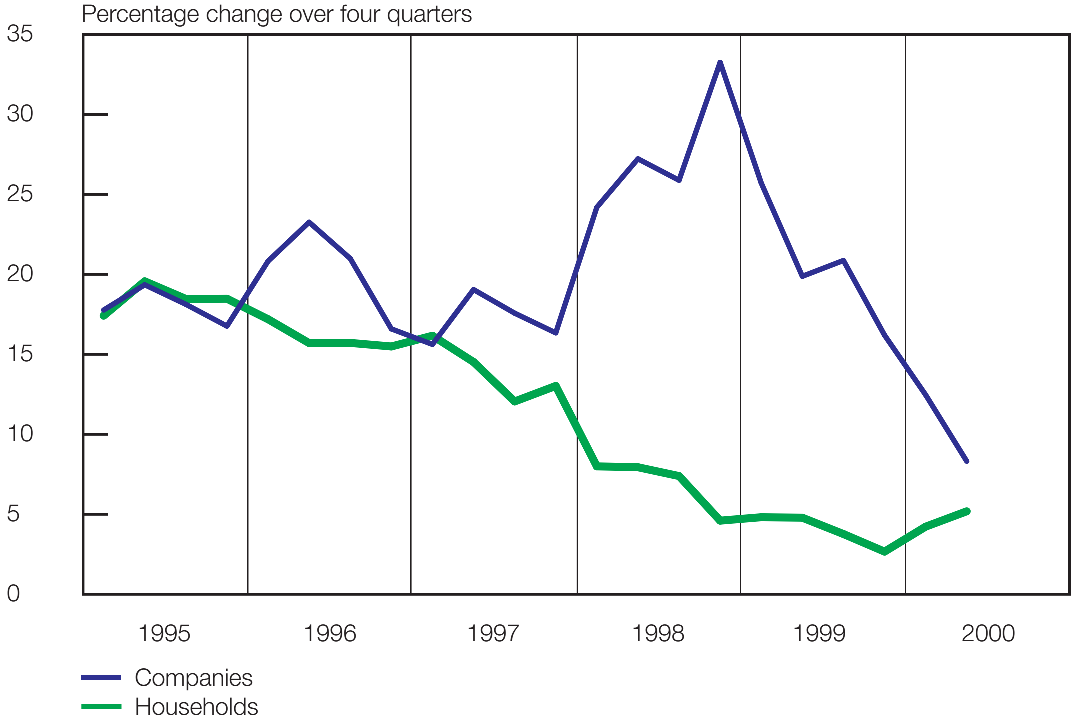


Instalment sale credit and leasing finance, which are used mainly for the financing of purchases of vehicles and other durable goods, declined from July 1998 to August 1999. Some recovery then set in, but by December 1999 credit extended through instalment sale and leasing finance agreements had risen by just 1,3 per cent, followed by growth of 1,9 per cent in the year to March 2000 and 4,6 per cent in the year to June. Despite the recent decline in bank lending rates, households are still reluctant to burden themselves with additional debt.

From mid-1999 to December of that year the growth in credit extended to the corporate sector exceeded the growth in credit extended to the household sector, but the relative growth rates were reversed in the first half of 2000. As a result, the share of the corporate sector in total private-sector credit extension by banks increased from 49,1 per cent in June 1999 to 51,0 per cent in December before receding to 49,8 per cent in June 2000. At the end of June 2000 credit extended to the household sector accounted for 50,2 per cent of total bank credit extended to the private sector.

The composition of credit extended to the various sectors of economic activity changed somewhat over the year to June 2000. The relative share of the finance, real-estate and other services sectors advanced strongly, mainly at the expense of a decline in the relative share of unallocated credit and credit to individuals. The relative importance of the trade and accommodation sector as a client of the monetary sector has increased slightly over the past twelve months.

Credit extended to households and companies



Bank credit extension to different sectors of the economy

Sector	June 1999	June 2000	Change
	Per cent of total		Percentage points
Agriculture	2,0	2,0	0,0
Mining	1,1	1,0	-0,1
Manufacturing	6,2	6,5	0,3
Construction	1,3	1,3	0,0
Electricity and water	0,4	0,5	0,1
Trade and accommodation	3,3	3,7	0,4
Transport and communication	1,6	1,5	-0,1
Finance and real-estate	24,2	25,5	1,3
Other services	6,4	9,4	3,0
Individuals	36,9	35,8	-1,1
Other	16,6	12,8	-3,8
Total	**100,0**	**100,0**	-

Interest rates and yields

In the aftermath of the international financial crises of 1998, the *monthly average yield on long-term government bonds* fell by almost 380 basis points from 18,3 per cent in September 1998 to 14,5 per cent in March 1999 as market sentiment improved and domestic monetary conditions eased. Bond yields then changed direction in March 1999 and moved steadily along a slightly upward trend during the second and third quarters of 1999. The monthly average yield increased to 15,3 per cent in September 1999 in response to, among other things, the tendency for interest rates and yields to rise in the main financial centres of the world, the fall in the gold price and lingering concerns about financial stability in emerging markets in general.

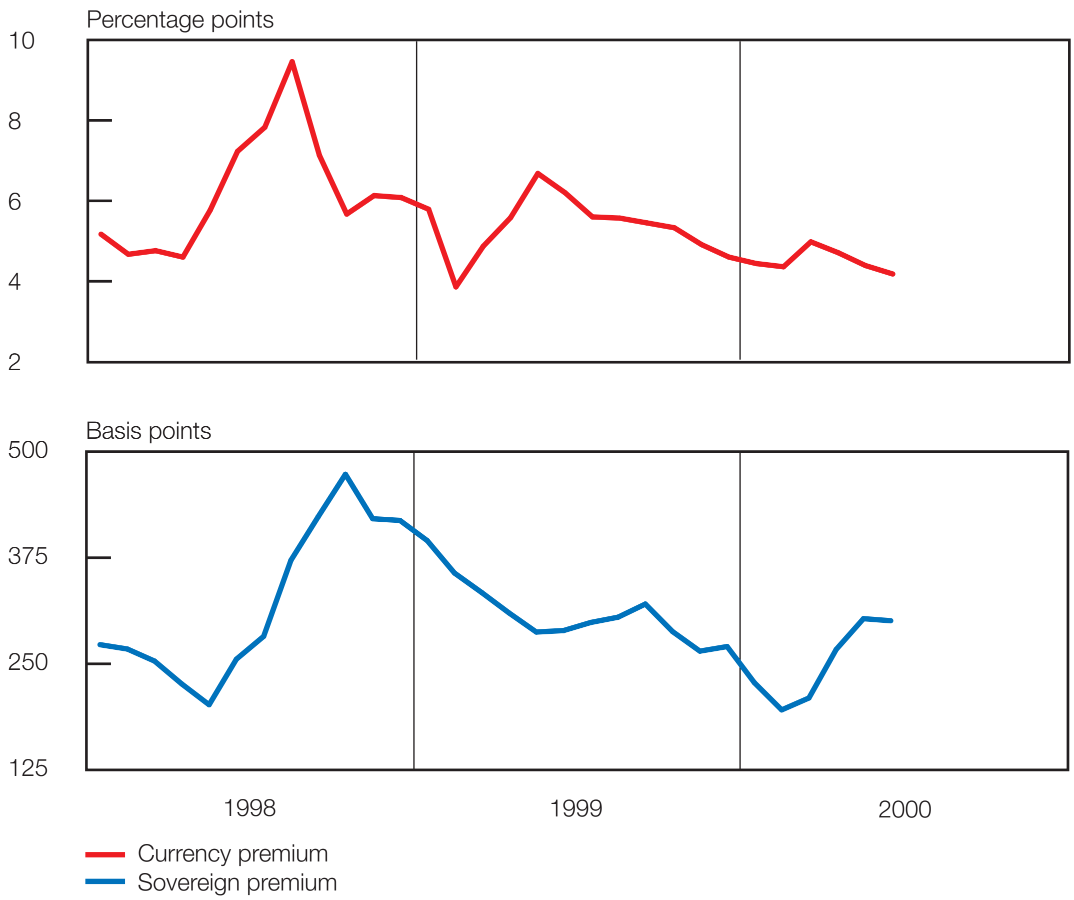
In the fourth quarter of 1999 the downward movement in bond yields resumed when market sentiment improved again. The daily average yield on long-term government bonds accordingly declined from a high of 15,6 per cent in mid-September 1999 to the most recent low of 13,1 per cent in mid-January 2000. This fairly rapid decline in bond yields followed the considerable reduction in short-term interest rates earlier in 1999 and could further be attributed to factors such as the relative strength of the rand, a shrinking of the public-sector borrowing requirement, South Africa's readiness for the Y2K changeover and a positive assessment by international investors of South Africa as an investment destination.

In the first half of 2000 bond yields at first traded in a tight range around a monthly average level of 13,5 per cent in January and February as the bond market consolidated in the face of heightened volatility in the exchange rate of the rand. The bull market in bonds ended in March 2000 when market sentiment deteriorated because of inflation fears in the international and domestic markets, rising official interest rates in the major international financial centres, the weakness of the rand against the dollar, uncertainties about the future direction of domestic short-term interest rates, turmoil in some parts of sub-Saharan Africa and the outflow of foreign portfolio investment capital from the economy. The monthly average yield on long-term government bonds increased to 14,8 per cent in May and the daily average yield peaked at 15,2 per cent on 10 May. Bond yields responded favourably to the subsequent firming of the rand and the monthly average yield declined to 14,3 per cent in June.

The *monthly average inflation-adjusted yield on long-term government bonds* declined steeply from 10,0 per cent in September 1998 to 6,8 per cent in March 1999, along with the decline in nominal bond yields. The inflation-adjusted bond yield then moved higher to an average of 8,2 per cent in September 1999 as bond yields increased and year-on-year CPIX inflation decreased gradually. The real yield fell back again to 5,9 per cent in February 2000 as nominal yields continued to decline but inflation picked up. In the first half of 2000, bond yields and consumer price inflation increased broadly in tandem and the inflation-adjusted yield levelled out at an average rate of 6,1 per cent, i.e. slightly lower than its pre-crisis level in the first half of 1998.

Changes in nominal yields reflect not only revised expectations about inflation, but also the continuous reassessment of *currency* and *sovereign* risk associated with investment in South Africa. The *currency risk premium* embedded in South African bond yields (measured as the difference between the nominal yield on government bonds with an outstanding maturity of five years in the domestic market and in the United States market) declined quite impressively from May 1999 to February 2000 but increased somewhat in March and April when the exchange rate of the rand weakened and inflationary pressures began to accumulate. South Africa's *sovereign risk premium* (measured as the spread between long-dated South African bonds listed on the North American capital market and comparable bonds issued by the US Federal Government) increased sharply during the period of international financial turmoil in 1998, but then declined steadily to February 2000 as bond yields in the United States drifted higher and as a series of credit-rating upgrades improved sentiment towards South African assets. From March 2000 concerns about continued political stability were triggered by events in a number of other sub-Saharan countries and South Africa's sovereign risk premium increased noticeably, but was still well below the spreads seen at the time of the 1998 financial crises.

Risk premiums on South African government bonds



During 1999 the Reserve Bank actively applied its signalling mechanism to guide the movements of money market interest rates. The Bank overprovided the private banks' liquidity needs on 30 June 1999, thereby accelerating the daily decline in the repurchase rate from 2 basis points on 29 June to 7 basis points from 30 June to 22 July 1999. On 26 July the Bank underprovided the market as a way of signalling to banks that a slower pace of decline was warranted in the repurchase rate. The result was a daily decline of 1 basis point until 7 September when the Bank overprovided again, thus accelerating the decline in the repurchase rate to 6 basis points daily.

In preparing for a decline in their prime overdraft rates, private banks bid the repurchase rate down by 15 basis points on 23 September 1999, but after this event the pace of decline decelerated. For September as a whole, the repurchase rate declined by 104 basis points. From 30 September 1999 to 24 November the decline in the repurchase rate settled down at 1 basis point a day.

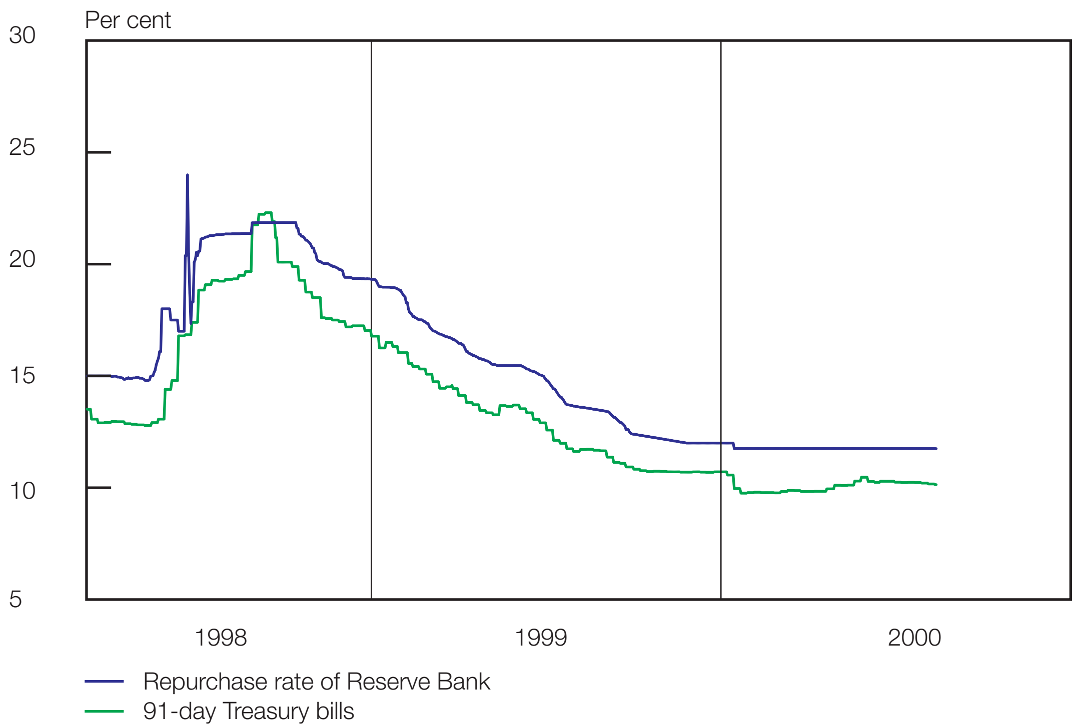
The Reserve Bank fixed the repurchase rate at 12 per cent on 25 November 1999 when it was decided that the variable-rate auction system would be temporarily suspended. This was a measure intended to allay fears of possible disruptions in the money and securities markets, that could have been caused by the failure of computer systems at the 2000 date change.

After the smooth transition to the year 2000, the Monetary Policy Committee of the Reserve Bank at its January meeting decided that the repurchase rate should be determined at the daily auction through a bidding process in accordance with the agreed signalling procedures. The Monetary Policy Committee concluded that a reduction of 25 basis points in the repurchase rate from 12,00 per cent to 11,75 per cent was appropriate under the prevailing circumstances, and indicated that the daily liquidity requirement would be managed in a way that would ensure a repurchase rate at or around 11,75 per cent. The repurchase rate has been stable at that level since then.

The *marginal lending rate* of the Reserve Bank was lowered from 20 to 15 percentage points above the repurchase rate on 20 April 1999. The margin over the repurchase rate was reduced further to 5 percentage points when it was decided that the repurchase rate would become fixed on 25 November 1999. This step was also aimed at allaying market fears in the period leading up to the millennium change.

Other money-market interest rates generally followed the movement in the repurchase rate during 1999. However, there were occasional disruptions in the international financial markets which temporarily distorted in domestic short-term interest rate spreads. When the repurchase rate was fixed at 12 per cent over the year-end, there was minimal variation in money-market interest rates. All in all, the tender rate on 91-day Treasury bills, as representative of all other money market rates, declined from 16,25 per cent on 8 January 1999 to 10,71 per cent on 24 December.

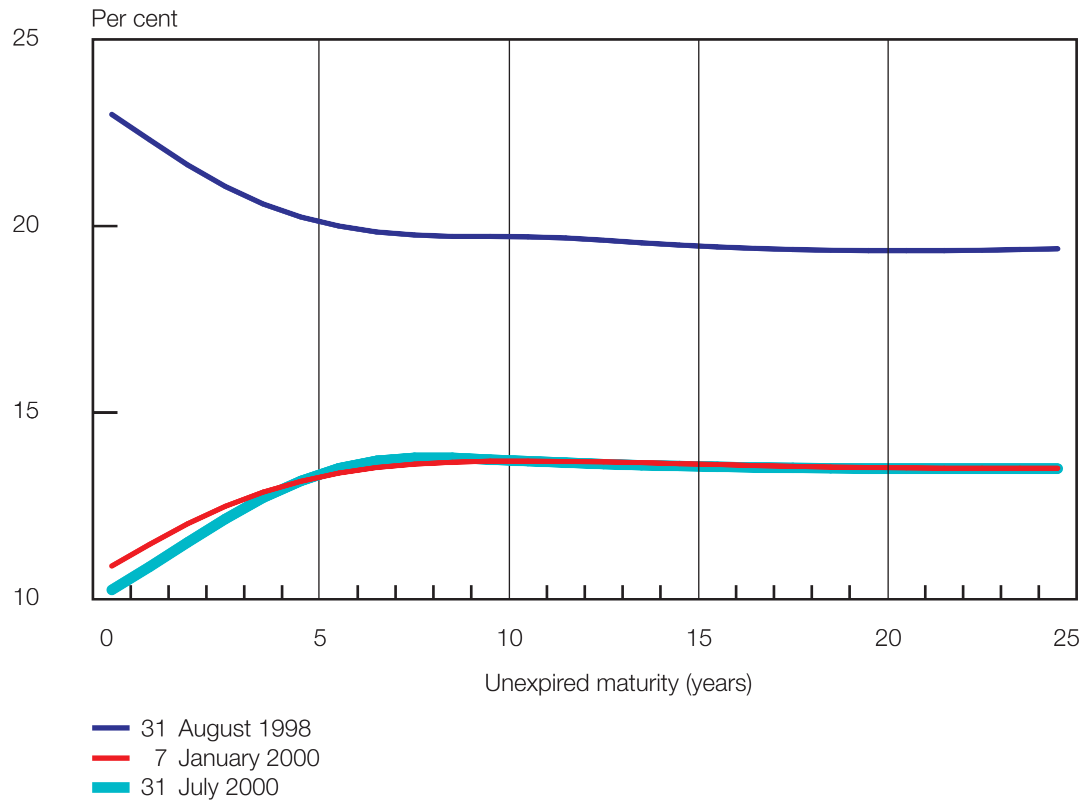
Short-term interest rates



Money-market interest rates followed the downward movement in the repurchase rate in January 2000 and then remained steady at the lower levels until they started to increase towards the end of April. The latest strengthening of rates can be attributed to, among other things, the weakening of the rand, rising short-term interest rates in most of the advanced economies of the world and expectations that official short-term interest rates might be raised in the near future. Representing the general movement in money-market interest rates, the rate on 91-day Treasury bills declined by 80 basis points from 10,56 per cent on 7 January 2000 to 9,76 per cent on 21 January and then stabilised around 9,84 per cent until 19 April. With renewed uncertainties creeping in, this rate increased by 27 basis points to 10,11 per cent on 28 April 2000. This rise was partly assisted by an increase in the weekly amount of the tender from R1,2 billion to R2,0 billion on 20 April 1999. Since the end of April 1999 the rate on 91-day Treasury bills has generally moved higher, reaching 10,25 per cent by the end of June. Other money-market rates followed a broadly similar time path.

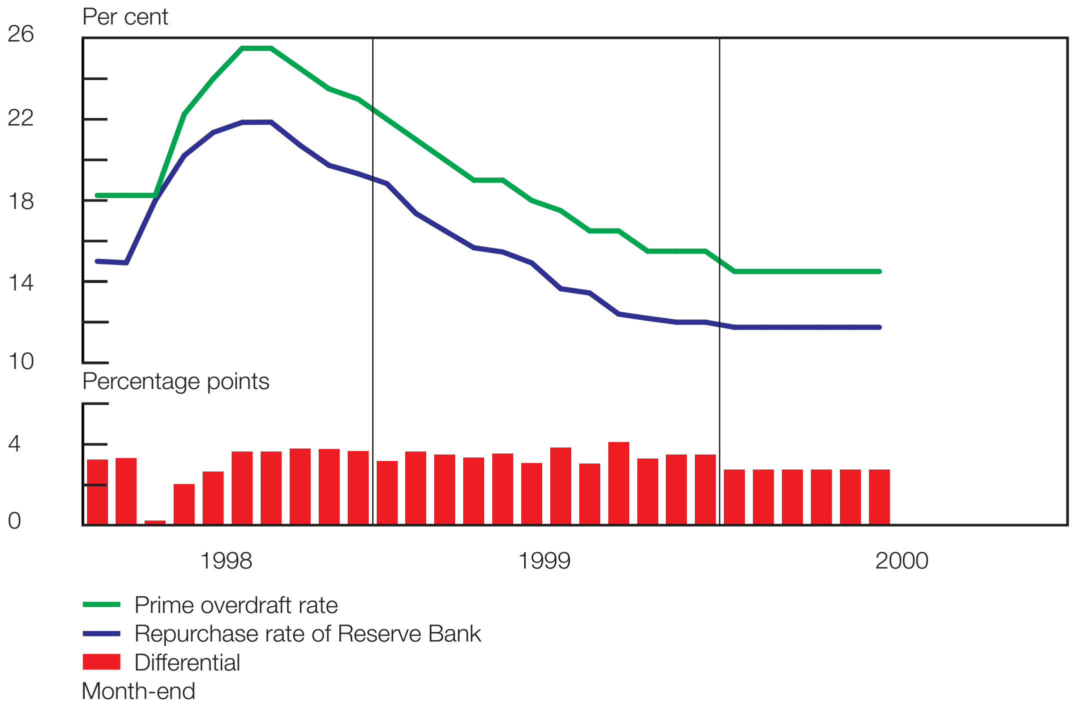
The tightening of monetary conditions in the midst of the international financial crisis of 1998 was reflected in the steep downward slope of the *yield curve* at the short end of the maturity spectrum. As monetary conditions improved, short-term interest rates declined faster than long-term interest rates, resulting in a flattening of the yield curve as it drifted lower. When short-term yields fell below long-term yields the slope of the *yield curve* tilted from downward-sloping to upward-sloping in April 1999. From then on, the slope of the yield curve became steeper as yields generally drifted lower on the back of a rather sanguine inflation outlook, but with short-term yields declining more than long-term yields. From about the third week of January 2000 sentiment in the market changed: there was some uncertainty about the direction of future changes in the repurchase rate of the Reserve Bank and random price shocks were interpreted as signs of renewed inflationary pressures. The slope of the yield curve consequently became steeper at the short end of the maturity spectrum as long-term yields moved higher.

Yield curves



Guided by the movements in the repurchase rate of the Reserve Bank during 1999, the private banks lowered their prime overdraft rates on current accounts in seven steps from 22 per cent on 11 January to 15,50 per cent on 4 October. Following the January 2000 meeting of the Monetary Policy Committee, the private banks reduced their prime overdraft rates further by 1 percentage point to 14,50 per cent. With the repurchase rate of the Reserve Bank declining by only 25 basis points, the January decline in the prime overdraft rate slightly compressed the margin between these two rates after an unusually wide margin had opened in the second half of 1999. The prime overdraft rate is now at its lowest level since 1988, having fallen below the low point of mid-1994 when it briefly levelled out at 15,25 per cent. The inflation-adjusted prime overdraft rate of 6,1 per cent in June 2000 was, however, still more than 4,7 percentage points higher than its average level in 1988.

Interest-rate differential



Other lending and deposit rates also followed the changes in the Reserve Bank's repurchase rate. The *predominant rate on mortgage loans* more than fully retraced its upward movement of 1998 and was lowered in seven steps from an all-time high of 24 per cent in October 1998 to 17,5 per cent in July 1999. Three further reductions in the following seven months brought the mortgage rate to 14,5 per cent in February 2000 – its lowest level since June 1988. Keen competition among banks, some of it based on mortgage loan securitisation, led to a substantial proportion of loans being priced below the predominant rate.

The *predominant rate on twelve-month fixed deposits* fell back from a peak value of 16,5 per cent in October 1998 to 12,5 per cent in April 1999. Broadly following the changes in the prime overdraft rate, this deposit rate declined further to 8,5 per cent in February 2000 – its lowest level since March 1981. The predominant rate on twelve-month fixed deposits rose to 9 per cent in June 2000, but still left savers in the higher income brackets with a substantial negative real return after tax.

Financial markets

Financial market globalisation and structural change

South Africa's financial markets demonstrated remarkable resilience during the various bouts of turbulence affecting international financial markets during the 1990s. Further steps were taken after the most recent crises of 1998 to strengthen institutional arrangements and to ensure that domestic markets remain integrated with the global financial system. These steps were aimed at increasing the depth, breadth and stature of the domestic markets through, *inter alia*, measures likely to

- advance integration into the main financial markets of the world;
- liberalise capital flows;
- harmonise regulation and supervision with international best practice;
- improve the electronic infrastructure of markets; and
- introduce new financial instruments.

Integration into the international financial network was reinforced by South Africa's participation in various international forums. The Interim Committee of the IMF was transformed into the International Monetary and Financial Committee with the objective, among other things, of addressing the weaknesses exposed in the architecture of the international financial system by the various crises of the 1990s. International financial stability will also be promoted by the Group of Twenty (G-20) created on 25 September 1999 in Washington, D.C. South Africa is a member of this forum which has broadened representation at the international financial level by including emerging markets of systemic importance. South Africa is also represented on the International Organisation of Securities Commissions, an organisation promoting the development of efficient securities and futures markets. In the area of bank supervision, the South African Registrar of Banks is a member of the Core Principles Liaison Group which was established by the Basel Committee on Banking Supervision.

Government initiatives to integrate South Africa into the international financial markets focused on foreign investment and the liberalisation of capital flows. The President announced in his State of the Nation Address on 4 February 2000 that an International Investment Council of eminent international business leaders had been constituted to help position South Africa as an attractive destination for foreign investment.

Legislation governing the financial services sector to be tabled in Parliament in 2000 for the strengthening of regulation and supervision include the following:

- The Collective Investment Schemes Control Bill which regulates all types of collective investment schemes where assets are pooled on behalf of investors.
- The Financial Advisory and Intermediary Services Bill which provides for the licensing of intermediaries in the financial services industry, compliance with codes of conduct and other enforcement measures.
- The Financial Institutions (Protection of Funds) Bill which provides for improved curatorship provisions, civil remedies and general enforcement.
- The Pension Funds Amendment Bill which provides for the conditional repatriation of surpluses in pension funds.

- The Investment Services Bill which provides for the consolidation of the Stock Exchanges Control Act, 1985, the Financial Markets Control Act, 1989, the Custody and Administration of Securities Act, 1992, the Insider Trading Act, 1998 and certain provisions of the Companies Act, 1973, into a single Act that will regulate all exchanges and related matters.

South Africa's *exchanges* for financial instruments improved their standing in international financial markets through the implementation of advanced electronic trading, clearing and settlement systems. The *Johannesburg Stock Exchange* (JSE) entered a new era when STRATE (Share Transactions Totally Electronic) commenced the first phase of electronic clearing and rolling contractual settlement. The shares of the first listed company to be phased in were dematerialised in September 1999 and trading for settlement in an electronic environment began on 25 October, followed by electronic settlement on 1 November. The JSE upgraded its electronic trading system by implementing a system which enables members to develop their own front-end systems and also enables clients to place orders and confirm trades electronically. The trading hours of the JSE were extended and aligned with those of international bourses. The JSE intends to implement an Electronic Communications Bureau in a phased approach during 2000 to enhance communication between members and fund managers.

In an effort to conform to international best practice the JSE is investigating additional disclosure requirements regarding insider trading and in October 1999 initiated a project to amend its listing requirements. Moreover, as far as regional co-operation is concerned, the Southern African Development Community (SADC) is working towards common requirements for listings in order to attract foreign investment and to facilitate capital movements by encouraging cross-border investments through dual listings. In October 1999 a number of stock exchanges in the SADC harmonised 13 principles extracted from the JSE's listing requirements.

The *Bond Exchange of South Africa* implemented the Bond Automated Trading System in January 2000. This system introduced centralised price discovery through screen trading and price transparency through information dissemination. The *South African Futures Exchange* regularly upgraded its Automated Trading System to provide a cost-effective and efficient trading and clearing facility.

The diversity of South Africa's *financial instruments* was broadened and aligned more closely with those of the international financial markets. In the *corporate bond market* the first listings were made of subordinate unsecured callable bonds in the first half of 2000. This was followed in June by the listing of the first tranche of the first medium-term note programme by a private listed company. The range of investments available in the *government bond market* was broadened with the listing of South Africa's first inflation-linked bond in March 2000.

In the *share market*, companies listed on the JSE may now repurchase their own securities with effect from 30 June 1999. In the *market for warrants* listed on the JSE, the first warrant on bonds was introduced in October 1999, followed in April 2000 by a new variety of warrants with two price levels and an enhanced risk profile. In the formal *market for derivatives* the range of individual equity futures and options on futures introduced in February 1999 was extended and in the Agricultural Markets Division the range of agricultural products was broadened with the introduction of Cape wheat and sunflower seeds in 1999, and second-grade white and yellow maize in July 2000.

Money market

Following tight liquidity conditions in the money market at the time of the international financial crises of 1998, the situation eased considerably towards the end of 1998 and in the first quarter of 1999. Reflecting the easier market conditions, the private banks' average daily liquidity requirement fell back from R12,0 billion in June 1998 to R4,8 billion in March 1999. The easier market conditions came mainly from liquidity injections through the net acquisition of foreign assets by the Reserve Bank and deficits arising from the Reserve Bank's involvement in the market for forward foreign exchange.

Between April and October 1999, the Reserve Bank intervened in the money market by draining liquidity with the objective of increasing the dependency of the private banks on central bank funding. This was expected to allow for more competitive bidding at the daily auction of repurchase contracts, thus making the market more sensitive to signalling by the Bank and eliminating perennial distortions in the spreads of money-market interest rates. Moreover, there was concern about the potential for a steep decline in money-market interest rates in the event of further easing in the market at a time when the gold price was under downward pressure and developments in Russia threatened to destabilise other emerging markets. As a consequence, the average daily liquidity requirement of the private banks was allowed to increase from R8,3 billion in May 1999 to R13,5 billion in August.

The tightening in liquidity conditions in the money market during the second and third quarters of 1999 was achieved through, among other things, increased issues of Reserve Bank debentures. The tightening effect was intensified when the Reserve Bank also entered into reverse-repurchase transactions with private-sector parties and arranged foreign-currency swap transactions with authorised dealers in foreign exchange. The foreign-currency swap arrangements were designed in May 1999 and were designed to drain liquidity from the money market without influencing the international reserves of the country, by requiring the Bank's counterparties to deposit a corresponding amount of foreign currency with the Bank. By the end of July 1999 the outstanding amount of the foreign-currency swaps was R12,0 billion, the reverse-repurchase transactions amounted to R1,0 billion and Reserve Bank debentures of R5,0 billion were outstanding.

In the fourth quarter of 1999 the Bank deliberately eased liquidity conditions in the money market in order to allay the fears that a severely tight market at the end of the year might arise from the Y2K-related failure of computer systems. The average daily liquidity needs of the banks consequently decreased to R4,9 billion in December 1999.

To ease money-market conditions in the last quarter of 1999, the Reserve Bank reduced the amount outstanding on special foreign-exchange intervention swaps to R4,3 billion at the end of December 1999. This measure was assisted by a reduction in the outstanding Reserve Bank debentures to R1,0 billion at the end of December 1999. The value of outstanding reverse-repurchase transactions was also reduced from R2,0 billion at the end of October 1999 to R1,0 billion at the end of December. The easing of the market was helped when the Reserve Bank added a net amount of R5,1 billion to its holdings of foreign assets and provided some lender-of-last-resort assistance to a small bank that had encountered liquidity problems. Part of the liquidity expansion in the money market was counteracted by a sharp rise in the value of notes and coin in circulation outside the Reserve Bank during November and December 1999 and by surpluses arising from the Bank's involvement in forward foreign exchange transactions.

After the transition to the new millennium had turned out to be rather uneventful, the Reserve Bank once again started draining liquidity so as to restore an adequate level of private bank dependency on central bank funding. The consequent tightening in the market was achieved through an increase in the amount of special foreign-currency swap arrangements, the issuance of Reserve Bank debentures and reverse repurchase transactions between the Bank and private-sector parties. Surpluses arising from the Bank's transactions in the forward foreign exchange market reinforced these actions of the Bank in the first quarter of 1999. Later, the depreciation of the rand during April and May turned these surpluses into deficits, thus adding liquidity to the market. A reduction in notes and coin in circulation outside the Reserve Bank and an increase in the net foreign assets of the Bank also added liquidity to the market in the first half of 2000.

From 8 September 1999 and during the first seven months of 2000 the Reserve Bank accommodated the liquidity requirements of the private banks in full, signalling that the interest rate on repurchase transactions of 12,00 per cent from 25 November 1999 to 13 January 2000 and later 11,75 per cent were appropriate. The Bank also seemed content with the liquidity requirement of banks remaining around R9 billion. A significant change in the underlying economic and financial conditions may prompt a shift in the range that is currently still seen as optimal.

Bond market

Over the past year, the credit-rating agencies Moody's, and Duff and Phelps reaffirmed South Africa's investment grade rating for rand and foreign-currency denominated debt, and readjusted the outlook from negative to stable. Moody's raised the rating outlook to positive on 7 February 2000 and Standard and Poor's upgraded South Africa's sovereign credit rating to investment grade with a stable outlook on 26 February. The sovereign ratings of key accredited rating agencies were aligned when Fitch upgraded South Africa from speculative to investment grade on 27 June. The reasons cited for the upgrades include a sophisticated, stable and well-regulated financial system, financial market liberalisation, liquid domestic financial markets, the independence of the central bank, the introduction of inflation targeting, prudent fiscal policies, a manageable external debt burden, and a credible economic policy framework.

The improved risk profile of South African debt and the reduced risk premiums made the international bond markets more accessible to domestic borrowers and opened the domestic market to global fund managers and institutional investors previously precluded from investing in South Africa.

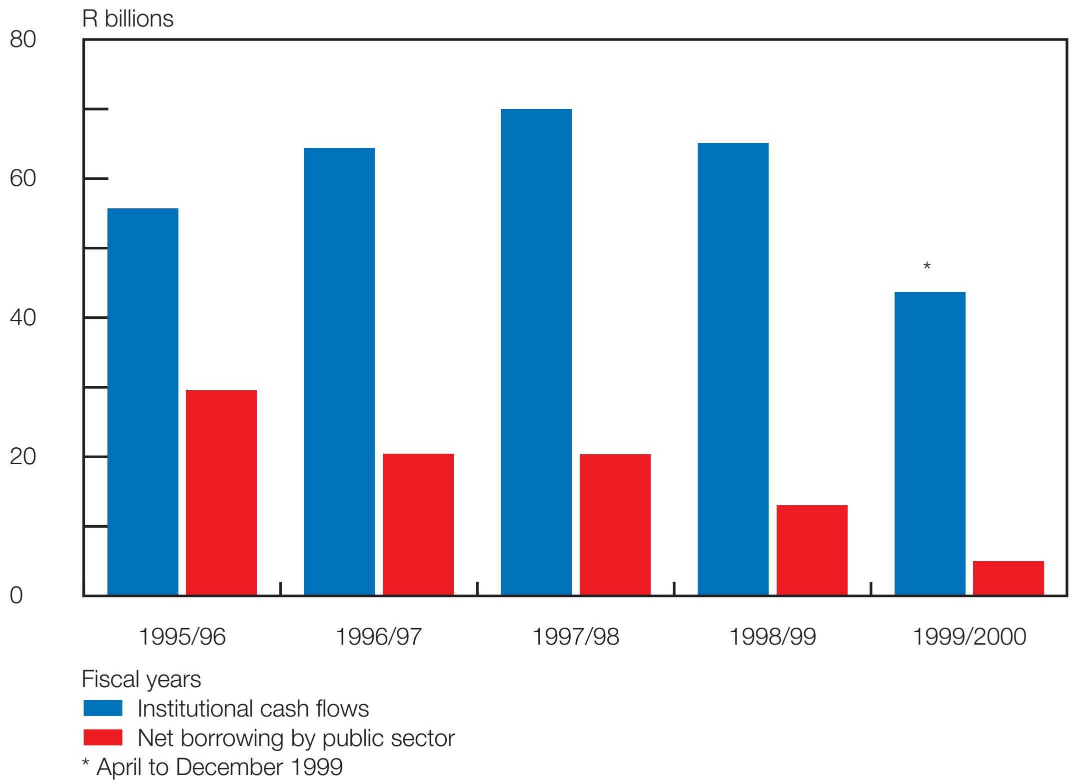
After an absence of almost two years, central government raised R13,1 billion in the *international financial markets* in fiscal 1999/2000. Government raised an amount of R6,3 billion in May 1999 through two *foreign-currency denominated bond* issues, one denominated in euro and the other in US dollar. Government also established liquid benchmarks in the major currencies, raising R1,9 billion denominated in euro in October 1999 and R4,9 billion denominated in dollar in March 2000. South African public corporations raised an amount of R4,5 billion in fiscal 1999/2000 through two euro-denominated bond issues, also in October 1999 and March 2000.

Funding through *rand-denominated bonds* in the *eurorand market* dwindled as a result of the lack of interest shown by foreign investors, presumably because of uncertainties about future movements in the exchange rate of the rand. South

African public-sector borrowers last issued rand-denominated bonds to the amount of R1 billion in March 1999. The *net proceeds* of rand-denominated bonds issued by non-resident entities fell back sharply from 1997 and reverted to net redemptions in the first half of 2000.

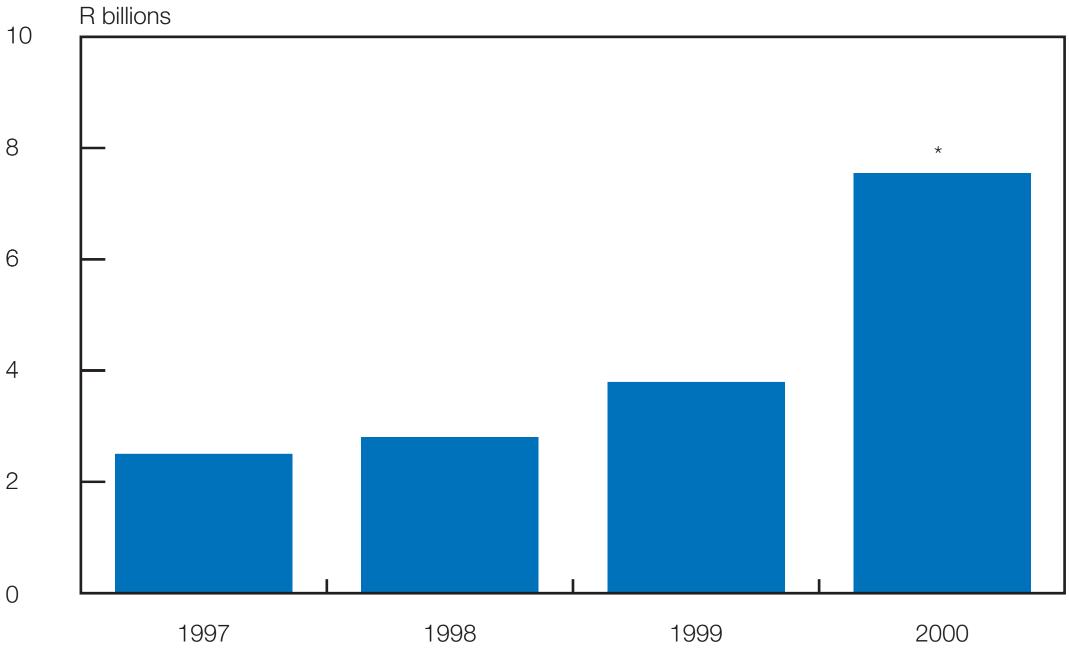
The decline in *net borrowing in the domestic primary bond market* by *public-sector organisations* largely reflected prudent fiscal management, increased recourse to offshore borrowing and a rise in once-only revenues from the restructuring of state assets. *Net issues of fixed-interest securities* declined by almost two-thirds to R4,9 billion in fiscal 1999/2000 from R13,1 billion in fiscal 1998/99. The public sector's reduced demand for loanable funds in the domestic bond market left ample resources for private-sector borrowers. This is evident from *contractual savings* (measured as the aggregate domestic current income surplus of long-term insurers and pension funds and the net sales of units by unit trusts) which have continued to exceed the financing needs of the public sector by a substantial margin, even though institutional cash flows have recently declined in nominal terms.

Institutional cash flows and public-sector borrowing



A livelier market in corporate debt securities emerged as funding by *private-sector companies* began to fill the void left by public-sector borrowers in the *domestic primary bond market.* The outstanding nominal value of private-sector loan stock listed on the Bond Exchange of South Africa increased, on balance, from R2,8 billion in December 1998 to R3,8 billion in December 1999 before three new listings doubled the amount to R7,6 billion in May 2000. Some debt was redeemed in June 2000, reducing the nominal value of outstanding debt to R7,5 billion.

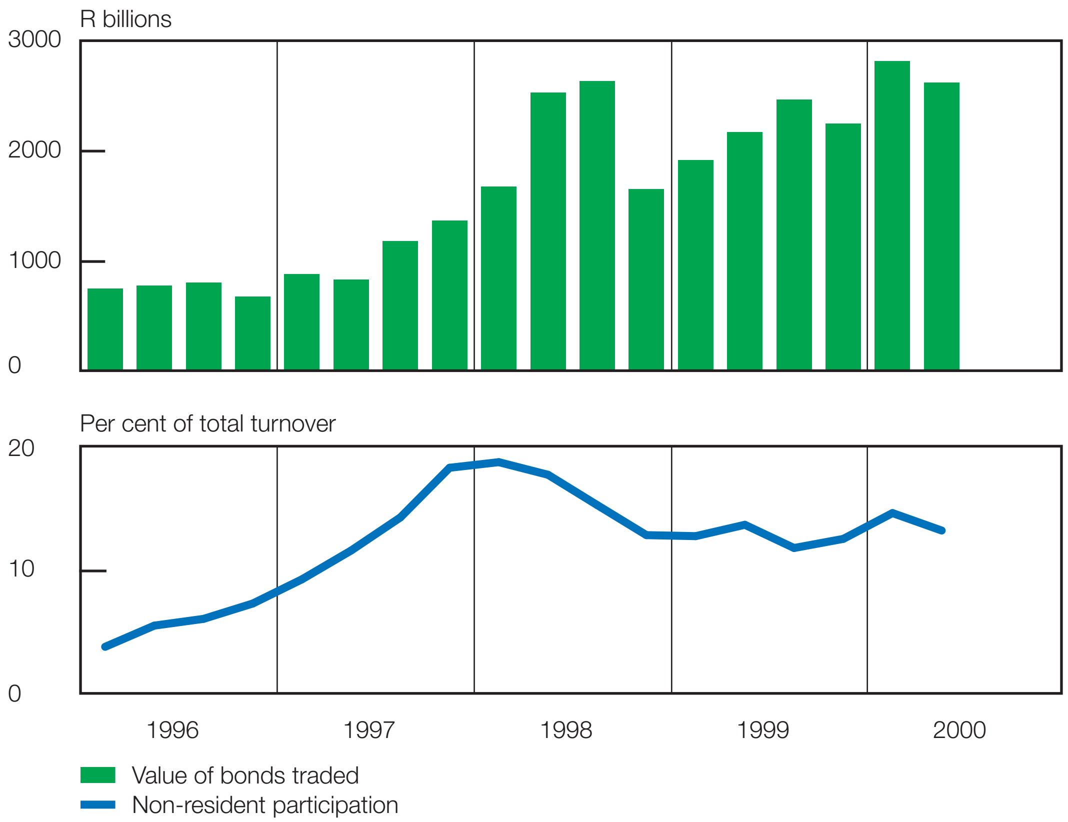
Outstanding nominal value of listed private-sector loan stock



As at December
* June 2000

Trading activity on the Bond Exchange of South Africa during 1999 and the first half of 2000 was spurred by heightened volatility in bond prices and sustained non-resident participation in the market. An unprecedentedly high annual turnover

Secondary bond market



of R8,8 trillion in the *domestic secondary bond market* was recorded in 1999 and the R5,4 trillion worth of assets traded in the first half of 2000 was 33 per cent more than in the corresponding period of 1999. The annualised *liquidity ratio* (measured as the nominal value of bonds traded relative to the nominal value of bonds listed on the Bond Exchange of South Africa) increased from 23,9 per cent in 1999 to 28,0 per cent in the first half of 2000.

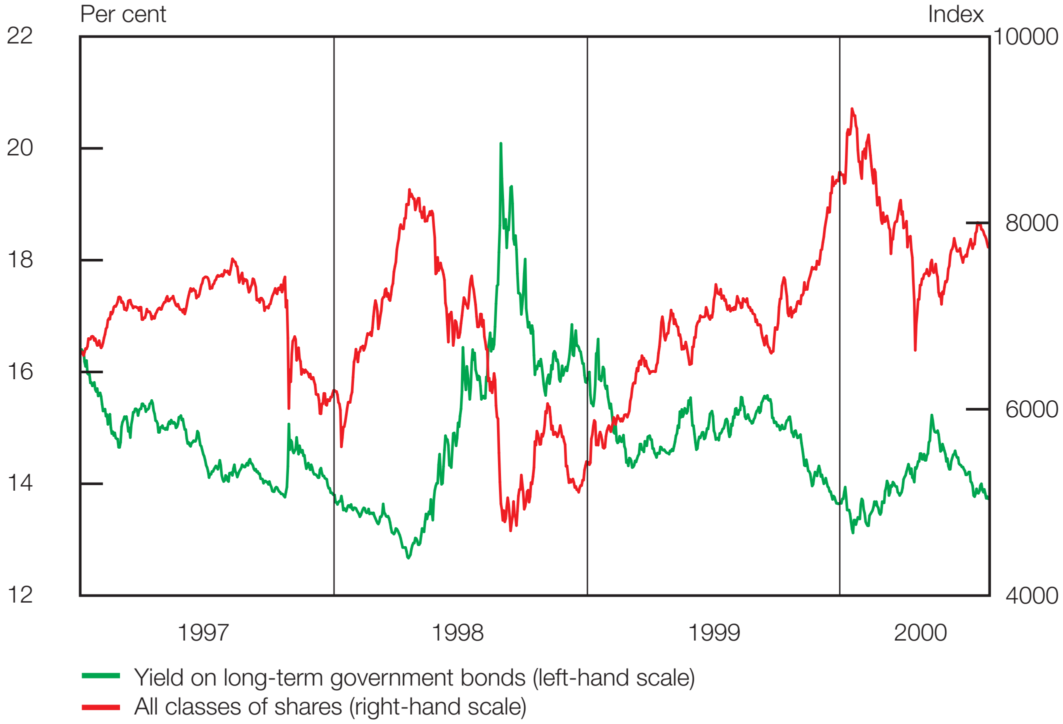
Non-resident participation in the *domestic secondary bond market* has fluctuated widely over the past two years or so. Non-resident investors increased their holdings of bonds by R14,2 billion in 1999 as part of the process of global rebalancing of portfolios after the crises in 1998. However, volatility in the global financial and currency markets resulted in nervousness about exchange rate risk and net purchases turned into net sales of R15,3 billion in the first half of 2000. This compares with net sales of R19,1 billion during the worst part of the emerging-markets financial crises in the second half of 1998. Demand for South African bonds as the hedge counterpart of eurorand bond issues largely fell away as the change in investor sentiment in the first half of 2000 was echoed in the eurorand bond market where the net proceeds of rand-denominated issues by non-resident entities reverted to net redemptions.

Share market

The South African share market recovered broadly in unison with the major international bourses after the crises in 1998. The *monthly average price level of all classes of shares* increased, on balance, by 79 per cent from September 1998 to a new all-time high in January 2000. There was a decline of 16 per cent from January to May 2000, but share prices rose again by 4 per cent in June.

The gains in share prices to January 2000 did not progress smoothly. Share prices faltered in December 1998 before increasing strongly to April 1999 as interest rates

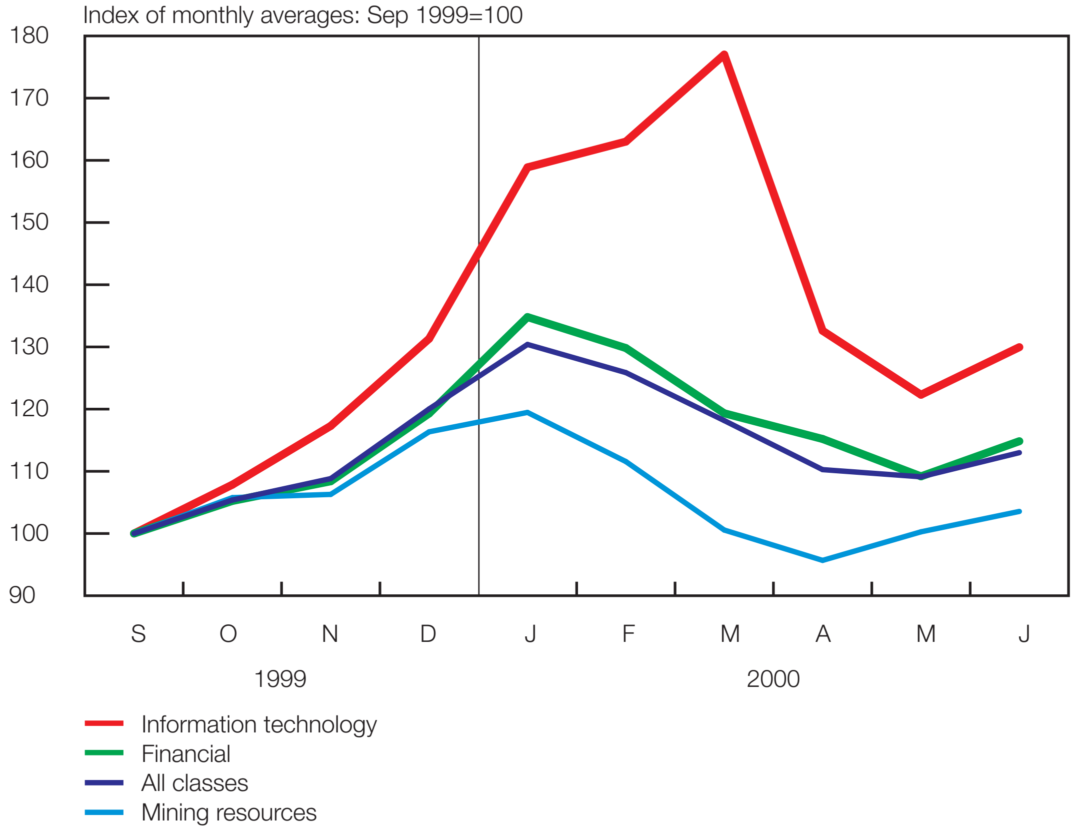
Bond yields and share prices



declined and investor confidence was restored. However, forces external to the South African economy impacted negatively on share prices when renewed concerns about emerging markets and declines in share prices on international markets slowed the pace of price growth on the JSE. From September 1999, buoyant domestic economic activity, the easing of monetary policy and prospects of higher corporate earnings, supported a strong upward movement in share prices. Conditions changed in 2000 when investor confidence was adversely affected by, among other things, increasing interest rates and yields, rand weakness and downward price corrections on the major international markets. Investor sentiment apparently became more bullish in June 2000 when share prices recovered quite strongly.

The sector with the most erratic price movements since September 1999 was the *information technology sector.* After a strong showing up to March 2000, share prices in this sector fell back sharply as global declines in the share prices of information technology companies took their toll. Share prices in the *financial sector* tracked the movements of the all-share index quite closely but declined somewhat more from the peak in January 2000 to June. The *mining-resources sector* broadly followed the trend of the all-share price index, but then outperformed the market by rising by more than 8 per cent from April 2000 to June.

Sectoral share prices



The heightened volatility in the dollar price of gold found a response in the share prices of gold-mining companies listed on the JSE. The *monthly average price of gold-mining shares* rose sharply by almost 50 per cent from June 1999 to October 1999 when the daily average price of gold per fine ounce increased by almost $73 from a 20-year low in July 1999. The monthly average value of the gold index then receded by 2,4 per cent to February 2000, but when the gold price fell below US$300 per fine ounce, gold shares declined, on average, by almost 20 per cent to May 2000. In June 2000, with the rand price of gold at an all-time high, the monthly average value of the gold index increased by 5,4 per cent.

The strong rise in share prices took the *price-earnings ratio* of all classes of non-gold-mining shares from 9,8 in September 1998 to 16,4 in January 2000. The upward movement was halted in January 2000 and the price-earnings ratio declined to 12,9 in May 2000 as *earnings* strengthened and share prices weakened; the ratio rose to 13,2 in June 2000. The direction of the *dividend yield* also changed course and increased from a low of 1,9 per cent in January 2000 to 2,6 per cent in May before receding slightly to 2,5 per cent in June.

The strong recovery in share prices throughout 1999 stimulated trading activity in the *secondary share market* and the value of shares traded increased by 40 per cent from R319 billion in 1998 to R448 billion in 1999. The value of shares traded in the first half of 2000 at R281 billion was 39 per cent more than in the first half of 1999. *Market liquidity*, measured as turnover as a percentage of market capitalisation, increased from 27 per cent in 1998 to 34 per cent in 1999 and 38 per cent in the first half of 2000.

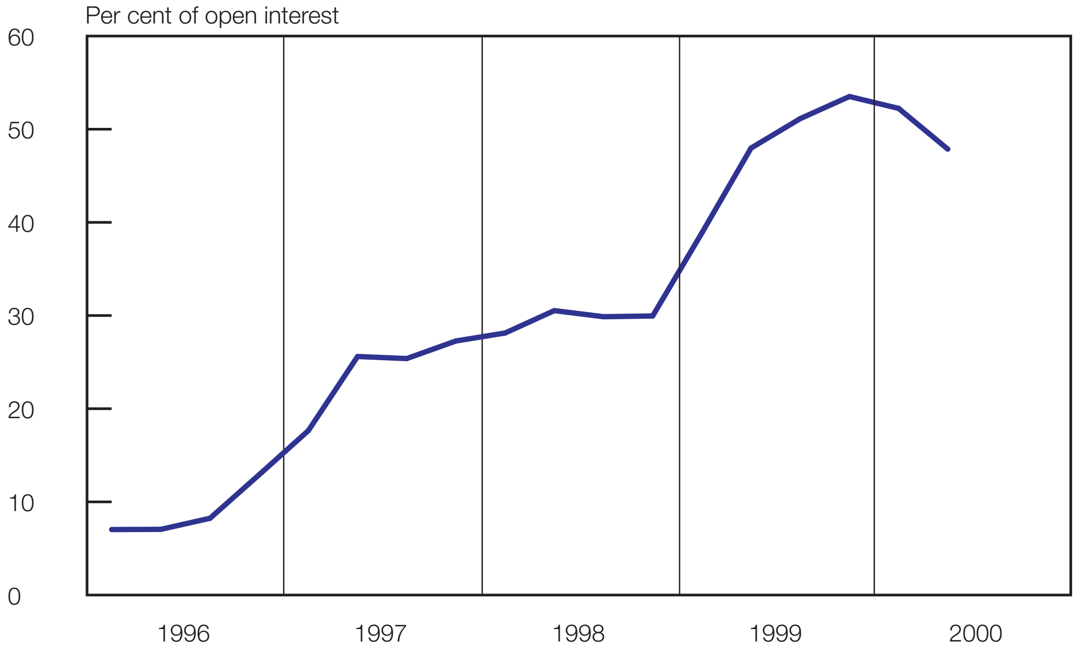
Non-residents traded actively in the *secondary share market* and the value of their purchases and sales broadly kept pace with the growth in total purchases and sales in listed shares. On average, non-residents were responsible for about 27 per cent of the value of all transactions on the JSE from 1999. On a *net basis,* the pace of non-residents' acquisitions of South African shares slowed somewhat from R42,3 billion in 1998 to R40,6 billion in 1999, but declined to only R0,6 billion in the first quarter of 2000 when rand weakness and the correction in share prices eroded the potential for further gains. Subsequently, foreign investor interest in South African shares strengthened again and the value of net purchases by non-residents increased to R5,3 billion in the second quarter of 2000. On the whole, non-resident holdings of listed shares increased by R5,9 billion in the first half of 2000.

The low level of fixed capital formation by *private-sector companies* was reflected in the amount of funding sourced in the *primary share market*. *New listings* declined from 101 in 1998 to 74 in 1999 and to only 7 in the first six months of 2000. The total value of *share capital raised* by companies listed on the JSE fell by more than 55 per cent from a record amount of R88 billion in 1998 to R39 billion in 1999. Subsequently, the value of shares issued increased and amounted to R31 billion in the first half of 2000 compared with R23 billion in the first half of 1999. The bulk of the capital raised since 1998 has been earmarked for expansions in the industrial and resources sectors.

Market for derivatives

Heightened price volatility in the domestic securities markets reinforced trading in the market for derivative products. The *formal derivatives market* also became more integrated into the global financial network as is evident from sharply rising non-resident participation. Measured as a percentage of open interest, participation by *non-residents* increased from 30 per cent in 1998 to 48 per cent in 1999 and 50 per cent in the first half of 2000.

Non-resident participation in derivatives market



Trade on the *South African Futures Exchange* is mainly concentrated in *equity index futures contracts and options on futures contracts* which, on average, account for more than 98 per cent of the value of overall trading activity. The value of trades in equity index futures contracts and options on futures contracts as a ratio of the value of turnover on the JSE came to 1,4 in 1999. Index contracts traded in the first quarter of 2000 rose to R256 billion compared with R155 billion worth of shares traded, giving a ratio of 1,65.

The *total number of futures and options on futures contracts* traded increased by 16 per cent from 16,1 million in 1998 to 18,7 million in 1999. In the first half of 2000 the number of contracts traded at 9,9 million equalled the number of contracts traded in the first half of 1999. Options remained the preferred instrument and the number of option contracts continued to exceed the number of futures contracts by a slight margin in the first half of 2000.

The number of *warrants* traded on the Johannesburg Stock Exchange more than doubled from 1,2 billion in 1998 to 2,8 billion in 1999 and reached a quarterly all-time high of 2,1 billion in the first quarter of 2000. The introduction of a more diverse spread of contracts and broader participation by investors contributed to the increase in the number of warrants traded. By the end of May 2000 the number of warrants traded from the beginning of the year had already surpassed the number traded in the whole of 1999.

The total number of *commodity futures and options on futures contracts* traded in the Agricultural Market Division of the South African Futures Exchange increased more than threefold from 80 600 in 1998 to 249 900 in 1999 and from 87 900 in the first half of 1999 to 196 900 in the first half of 2000. The rapid growth in the market for commodity futures can be attributed to a wider variety of and more regular contracts, as well as broader participation. *Maize* remained the dominant commodity on which contracts are based in the futures market.

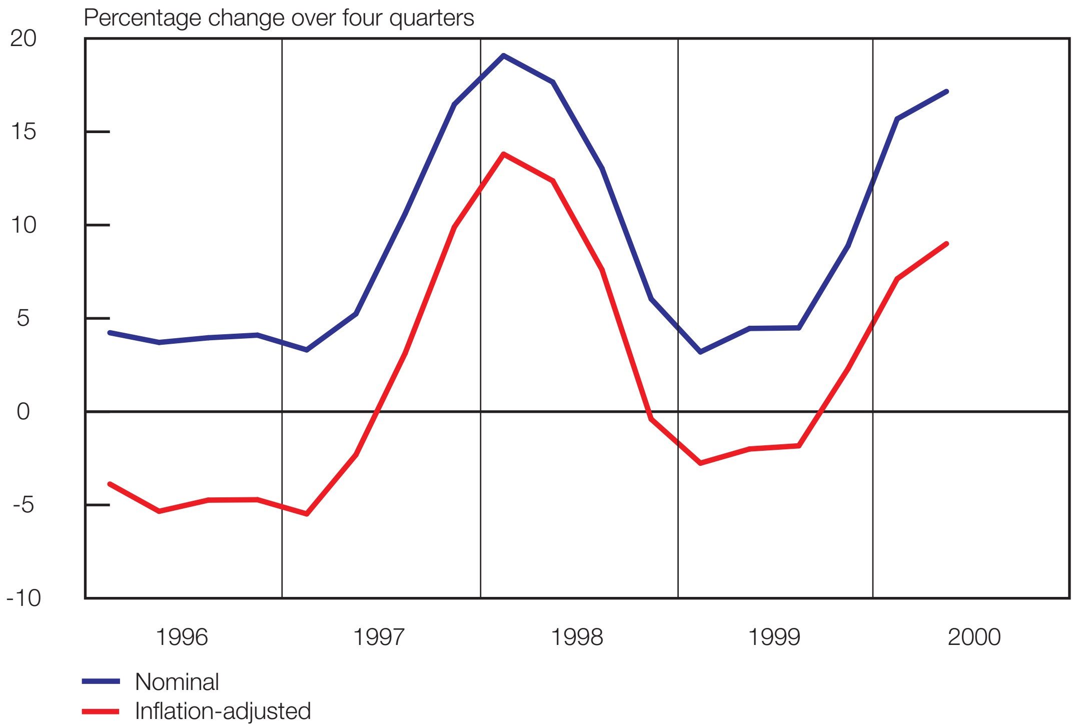
Real-estate market

The decline in home mortgage rates from October 1998 boosted the demand for housing and stimulated growth in the *home loan market* and real-estate transactions. The rate of increase over twelve months in banks' mortgage loans outstanding accelerated from a low of 3,8 per cent in November 1999 to 6,6 per cent in May 2000.

Activity in the *real-estate market* improved and the total *value* and *number* of transactions increased strongly from the recent lows in the first quarter of 1999. The value of real-estate transactions increased from a low of R5,9 billion in the first quarter of 1999 to a relatively high level of R9,9 billion in each of the first two quarters of 2000.

As the number of real-estate transactions increased more modestly than the value of such transactions, the *average nominal value per real-estate transaction* rose by 22 per cent from its average level in 1998 to the second quarter of 2000. The *rate of change over four quarters* in the average nominal price of real-estate accelerated from the first quarter of 1999, with the result that the changes in the *inflation-adjusted* price of real-estate turned positive in the fourth quarter of 1999 for the first time since the third quarter of 1998.

Real-estate prices



Non-bank financial intermediaries

The *asset allocation of non-bank financial institutions* (i.e. long-term and short-term insurers, private self-administered pension and provident funds, unit trusts, the Public Investment Commissioners and official pension funds) has shown a preference for shares rather than bonds over the past few years. The increased allocation in favour of *shares*, measured as total domestic and foreign share holding as a percentage of total holdings of shares and fixed-interest securities by these institutions, ought to benefit returns on investment as economic growth accelerates. However, recent bouts of volatility in share prices have exposed these portfolios to increased risk of *asset revaluations.*

Following further relaxations of exchange controls, these institutions have increasingly invested in foreign markets in an attempt to improve their risk-return profile. Consequently their holdings of foreign assets, measured as a percentage of their total holdings of shares and bonds, have increased noticeably. Their holdings of foreign shares and fixed-interest securities increased from less than 1 per cent per asset category in the first quarter of 1996 to 6,9 per cent in the case of bonds and 13,7 per cent in the case of shares in the final quarter of 1999.

Public finance

Fiscal policy

Government continued to consolidate the fiscal position and improve the management of public finances during the past financial year. In presenting the annual Budget to Parliament on 23 February 2000, the Minister of Finance reaffirmed government's commitment to a strategy for accelerated and sustainable economic growth and developing the potential of the South African economy, while taking advantage of the opportunities presented by globalisation. Employment creation, improved public service delivery and an equitable distribution of income remained serious challenges to strengthening the overall performance of the economy. These broad policy objectives and fiscal policy considerations created the framework within which the Minister presented government's Budget and policy statement.

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

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

The restructuring of government assets is expected to remain an essential component of government's drive for improved service delivery. To stimulate public-private partnerships, government adopted a policy framework and a set of regulatory principles. These were captured in a guideline document forming the basis for the Treasury Regulations in terms of the Public Finance Management Act. Public-private partnerships in appropriate cases will improve public service delivery by transferring to the private sector the responsibility for the redesign, construction, operation and revenue collection of parastatal organisations. Private partners will also be responsible for debt servicing.

Government departments are transforming from direct service providers to procuring and monitoring agencies for paid service delivery. This approach creates strong incentives for spending departments and helps to ensure that public money is efficiently spent. Current public-private partnership transactions include the construction of new prisons and the reconstruction and development of national highways.

Increased private-sector involvement through management contracts, the privatisation of non-core assets and strategic equity partners will be pursued, especially in utility sectors such as electricity generation and transmission, telecommunications and transport. This, together with the proceeds already received from the restructuring of state assets, will allow government to save on debt service costs and to free resources for spending on social services and infrastructure.

A policy framework was also developed for public-private partnerships at local government level. Current public-private partnership agreements in local governments include municipal services such as water provision and waste removal.

The Public Finance Management Act came into effect on 1 April 2000 after having been promulgated in 1999. The implementation of the Act will be phased in over a period of time. This phased process was necessitated by the need for financial training and systems reforms, both of which are of a long-term nature. The Act aims at improving financial management in the public sector by changing the emphasis from procedural compliance to improved standards for government accounting and output delivery. A committee of key directors-general will oversee the implementation process in selected national and provincial departments and will ensure that the best possible structures, systems and training are in place before these are introduced in other government departments.

Revised Treasury Regulations were issued in terms of the Public Finance Management Act with effect from 1 June 2000. These regulations created a framework of agreed principles and accounting requirements for financial and other managers. The Financial Management Bill for local government was published for public comment; the bill deals with aspects of financial management, focusing on the introduction of generally accepted principles in the accounting practices and procedures of local governments.

Government's funding strategy is considered to be on a sound basis, as is evident from the successful issuance of bonds in international capital markets during fiscal 1999/2000. The management of government debt is based on the principle of minimising debt service cost while maintaining a liquid and well-functioning market for government securities. In order to smooth the maturity profile of government debt and to maintain liquidity in the market, switch auctions and the consolidation of some smaller outstanding government bonds are undertaken when deemed appropriate. The Department of Finance is also exploring the options for managing the risk exposure of government's domestic and foreign liabilities to possible market shocks.

National government finance

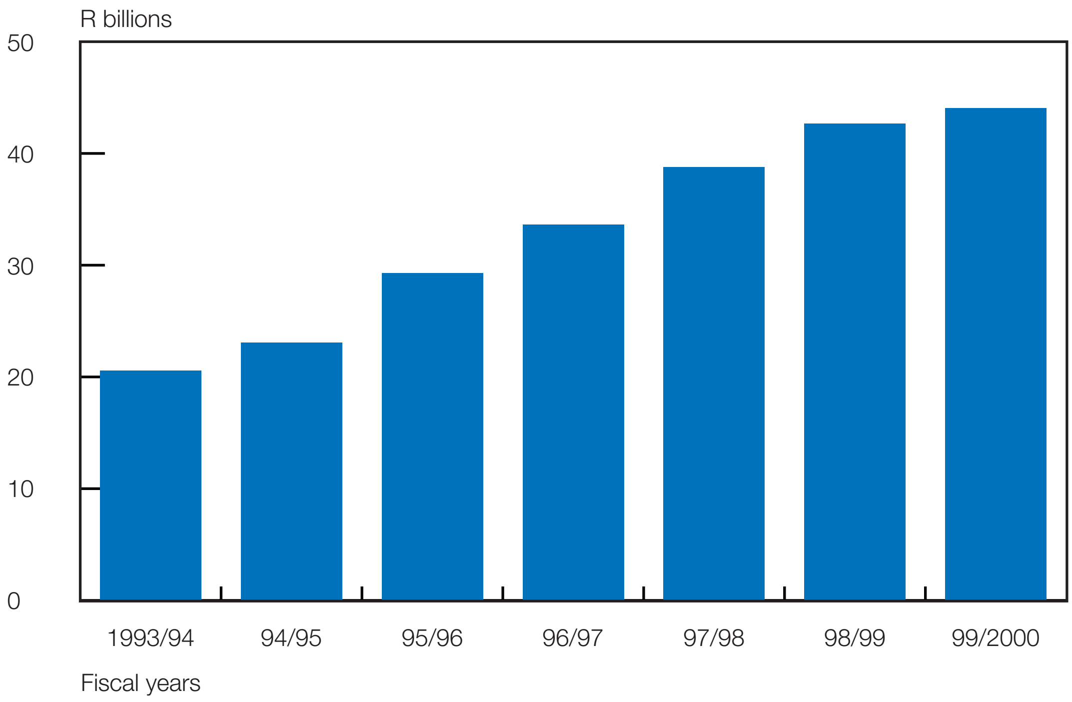
National government expenditure in fiscal 1999/2000 amounted to R218,4 billion, which was 6,7 per cent higher than in fiscal 1998/99. Although this rate of increase was higher than the growth of 5,9 per cent envisaged in the original Budget proposals, it was substantially lower than the average rate of increase of 11,0 per cent recorded for the preceding five fiscal years.

Expenditure in fiscal 1999/2000 included some non-recurrent cost items, such as an additional transfer of R1,4 billion to provincial governments, earmarked for the redemption of outstanding provincial debts, and R0,9 billion as a transfer to the Umsobomvu Fund. The establishment of this fund was announced in 1998 with the purpose of investing in skills enhancement and job creation. The fund was established as a non-profit company and came into operation in March 2000.

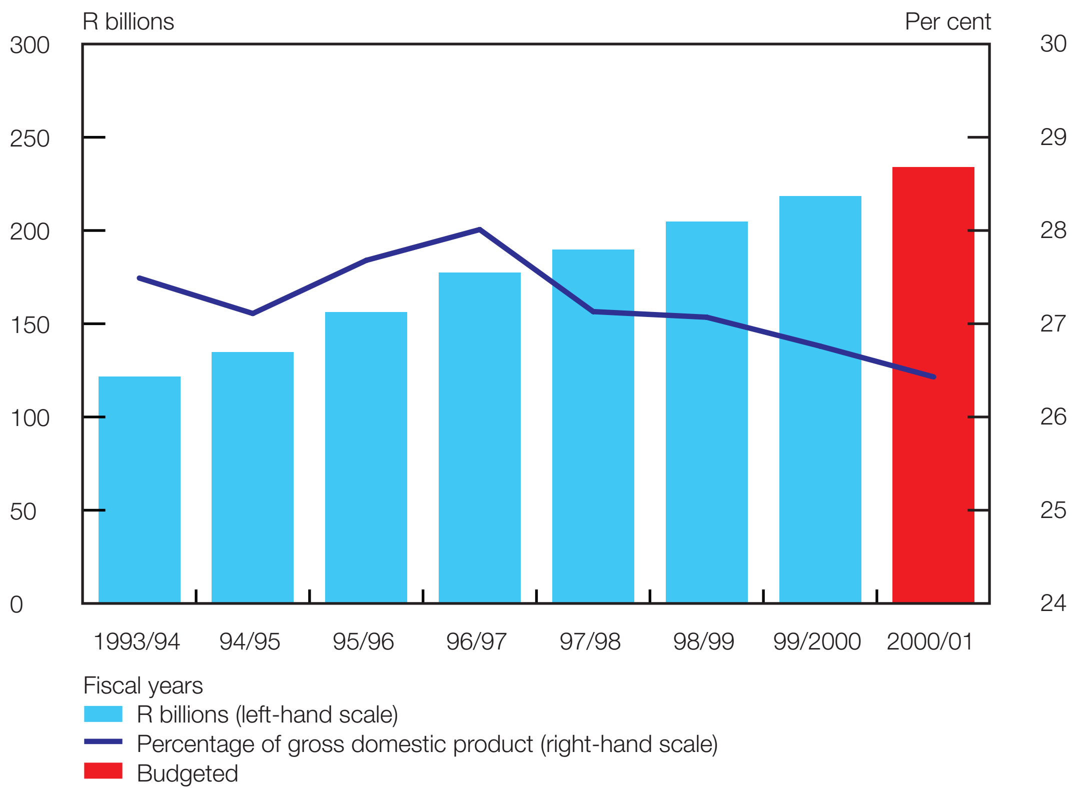
The expenditure in fiscal 1999/2000 also included an amount of R2,0 billion for the cost of the revaluation of a maturing foreign loan. In the Medium Term Budget Policy Statement presented to Parliament on 29 October 1999, the Minister of Finance announced that, in line with the accepted international practice, he intended to exclude in future such losses from headline expenditure.

Interest payments by national government increased to R44,0 billion in fiscal 1999/2000 compared with the R42,7 billion paid out in fiscal 1998/99. Fiscal consolidation, i.e. declining budget deficits and slower growth in government debt, along with the decline in money and capital market interest rates, were the main reasons for the relatively small increase in government interest payments. The slowdown in the growth in interest cost to more sustainable levels released scarce resources for the social economic reform plans of government.

Interest on government debt



National government expenditure



As a ratio of gross domestic product, national government expenditure amounted to 26,8 per cent in fiscal 1999/2000 – slightly lower than the 27,1 per cent recorded in the previous fiscal year. After allowing for cash-flow adjustments, such as funds requested and allocated to the departments but not yet spent and late departmental requests, national government expenditure amounted to R219,0 billion or 5,9 per cent more than in the previous fiscal year.

It was estimated that national government expenditure would increase to R234,0 billion in fiscal 2000/01 or by 7,2 per cent over actual expenditure in the previous fiscal year. Further increases to R251,5 billion in fiscal 2001/02 and R266,7 billion in fiscal 2002/03 were indicated in the Medium Term Expenditure Framework (MTEF). This represents an average annual rate of increase of 6,9 per cent in the three-year medium-term budget period. Interest payments were expected to increase at a rate of 5,4 per cent in fiscal 2000/01, 6,6 per cent in fiscal 2001/02 and 3,0 per cent in fiscal 2002/03. The non-interest recurrent expenditure was expected to increase by 8,3 per cent to R180,1 billion in fiscal 2000/01.

Government is encouraging overall moderation in remuneration growth through modest wage settlements in the public sector. Personnel expenditure as a percentage of total non-interest expenditure grew from 45,5 per cent in fiscal 1995/96 to 52,2 per cent in fiscal 1998/99 and declined to 51,2 per cent in fiscal 1999/2000. Over the medium term, government plans to reduce the proportion of non-interest expenditure on personnel to 46,8 per cent. Capital expenditure was expected to grow modestly but would be supplemented through investment spending by partnerships formed between government and the private sector.

The functional classification of expenditure by the consolidated national and provincial governments and social security funds clearly reflects a substantial reprioritisation of expenditure. Spending on social services reached the level of 45,7 per cent of total expenditure in fiscal 1999/2000 and was expected to increase at an average annual rate of 5,6 per cent over the ensuing three fiscal years. Due to the R30,0 billion expenditure project in modernising defence equipment from fiscal 2000/01 to 2002/03, government spending on defence was projected to grow at an annual average rate of 15,8 per cent. Increased government expenditure on economic services was largely the result of the introduction of the National Skills Fund which was expected to receive R1,4 billion in 2000/01.

Revenue received by national government in fiscal 1999/2000 amounted to R197,4 billion. This represented an increase of 7,8 per cent over fiscal 1998/99 compared with an originally budgeted increase of 4,6 per cent. Receipts include a one-off collection of an amount of R577 million from the demutualisation of the Old Mutual life assurance company. As a ratio of gross domestic product, national government revenue amounted to 24,2 per cent in fiscal 1999/2000 which equalled the ratio recorded in the previous fiscal year. This ratio is well within government's stated longer-term objective of 25,0 per cent of gross domestic product. After allowing for cash-flow adjustments resulting from funds surrendered by spending departments to the Exchequer and other receipts, national government revenue amounted to R200,2 billion or 7,7 per cent more than in the previous fiscal year.

The higher-than-budgeted rate of increase in national government revenue was brought about by relatively strong growth in the collection of income tax and value-added tax. By contrast, receipts from customs duty and the fuel levy fell short of the original Budget projections, but other excise duties comfortably exceeded the

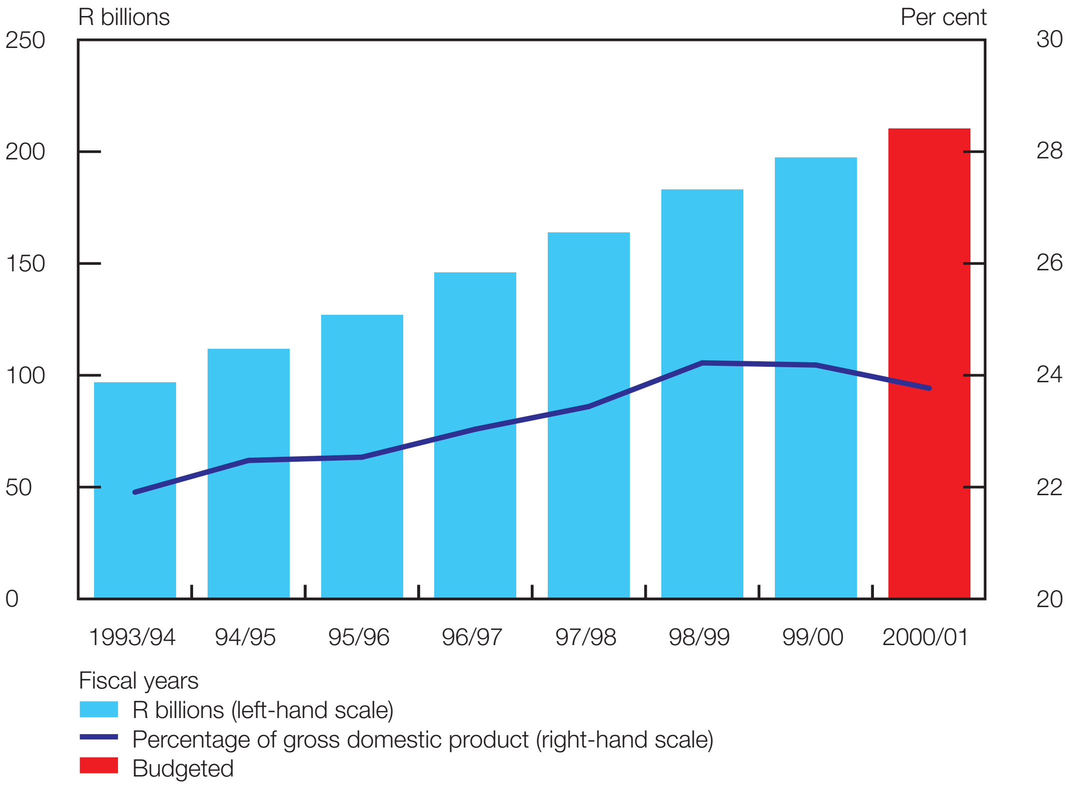
Functional classification of expenditure by consolidated national and provincial governments and social security funds

Per cent of total expenditure

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

Source: Department of Finance

National government revenue



budgeted targets. The gains in tax collection were essentially the result of better management and the implementation of more efficient practices and procedures by the South African Revenue Service (SARS). The introduction of a new electronic administration and information system in December 1999 further improved the capability of the SARS to maximise revenue collection and minimise all forms of tax evasion.

National government revenue by type of income in fiscal 1999/2000

Revenue category	Percentage change*	
	Budgeted	Actual
Income tax	3,1	7,3
Value-added tax	7,7	10,1
Customs duty	10,4	8,9
Fuel levy	5,9	4,8
Other excise duties	9,1	10,4
Total revenue	**4,6**	**7,8**

* Based on the actual outcome of the previous fiscal year

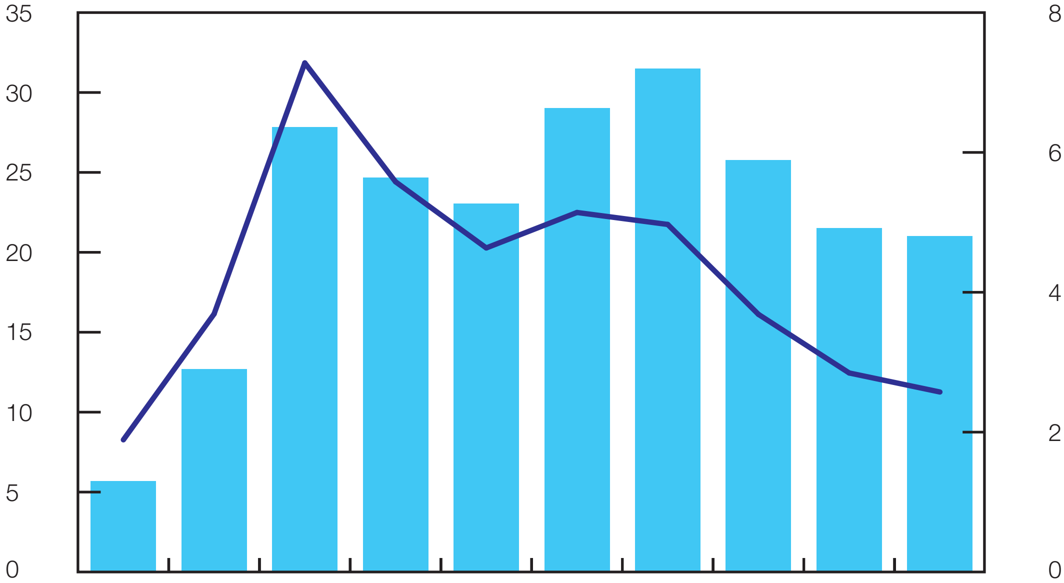
Total government revenue (excluding extraordinary revenue) was estimated to increase to R210,4 billion or by 6,6 per cent in fiscal 2000/01. Growth of 8,1 per cent is expected in fiscal 2001/02 and 7,1 per cent in fiscal 2002/03. Income tax was expected to remain the primary source of revenue for the national government. Due to efficiency gains it has been possible to introduce several measures of tax relief for individuals and small enterprises in the Budget for fiscal 2000/01. This will result in tax relief to the amount of R9,9 billion in fiscal 2000/01. In spite of this tax relief, it was expected that the total tax revenue as a ratio of gross domestic product would increase from 23,6 per cent in fiscal 1999/2000 to 24,1 per cent in fiscal 2000/01.

The unexpectedly strong growth in revenue and relatively tight expenditure controls in 1999/2000 resulted in a *national government deficit before borrowing and debt repayment* of R21,0 billion, which was considerably lower than the originally budgeted deficit of R25,1 billion. As a ratio of gross domestic product, the deficit amounted to 2,6 per cent in fiscal 1999/2000 compared with a ratio of 2,8 per cent recorded in the preceding fiscal year. This was the lowest ratio recorded since fiscal 1990/91. If the cost of the revaluation of maturing foreign loans is excluded in fiscal 1999/2000, the deficit would be R19,3 billion or 2,4 per cent of gross domestic product. The net result of the budgeted expenditure and revenue for fiscal 2000/01 was an estimated deficit before borrowing and debt repayment of R23,6 billion that should increase to R24,1 billion in fiscal 2001/02 before decreasing to R23,1 billion in fiscal 2002/03.

Government's primary surplus (i.e. the deficit recalculated by excluding interest payments from total expenditure) is also expected to be reduced further over the next three years. The primary surplus was 2,8 per cent of gross domestic product in fiscal 1999/2000. The general slowdown in debt accumulation should help to contain the primary surplus, which was expected to average 2,7 per cent of gross domestic product over the period of the Medium Term Expenditure Framework.

The deficit before borrowing in fiscal 1999/2000, when adjusted for the cash flows associated with late departmental transfers, surrendering of funds by spending

National government deficit before borrowing and debt repayment



departments and funds requested but not yet spent, amounted to R18,8 billion. This was financed by means of government securities issued in the domestic and foreign capital markets and from the proceeds of the restructuring of government assets, as shown in the accompanying table.

National government financing according to instruments
R millions

	Actual 1999/2000	Budget 2000/01
Domestic primary capital market		
Government bonds (including discount)	6 997	11 150
Less: Discount on government bonds	3 686	1 009
Net receipts from government bonds issued	3 311	10 141
Treasury bills	1 884	3 500
Extraordinary receipts		
Restructuring of government assets	7 145	5 000
International Monetary Fund	8	-
Extraordinary payments		
Transnet Pension Fund	-1 333	-
Closed Pension Fund	-152	-
South African Rail Commuter Corporation	-	-2 200
Other	-8	-
Foreign loans	10 496	4 612
Redemption of Namibian debt	-272	-
Redemption of Section 239 debt*	-181	-
Non-marketable securities	-5	-
Change in available cash balances	-2 120	2 560
Total net financing	18 773	23 613

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

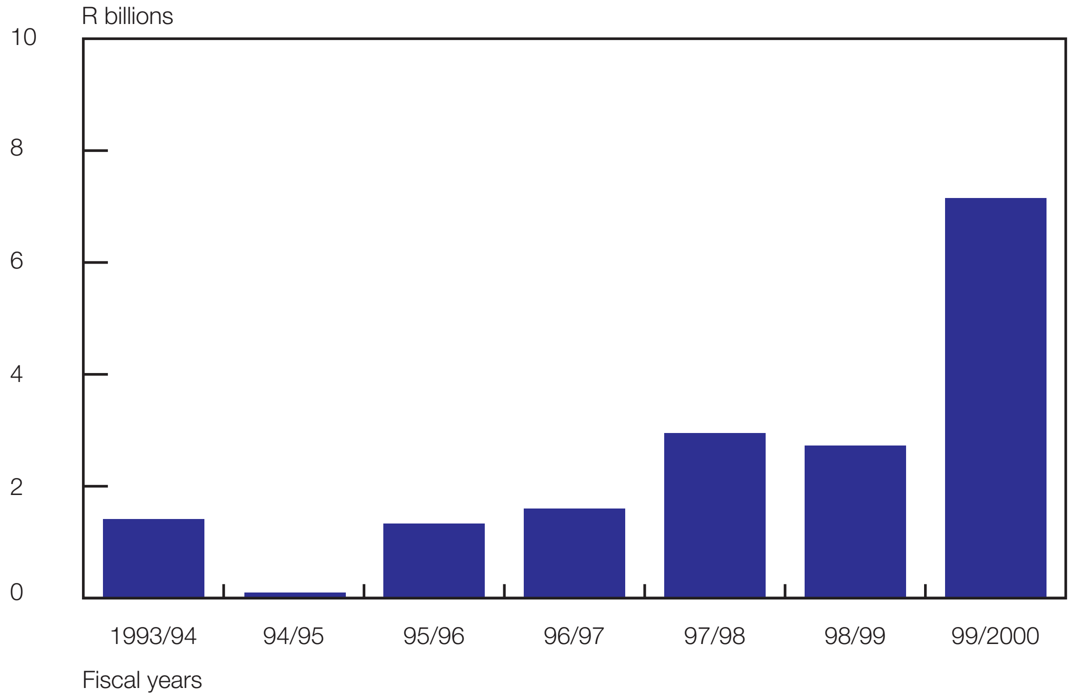
Foreign bond issues made a relatively large contribution to government funding in fiscal 1999/2000. The Global Bond of US$750 was redeemed in December 1999, but the amount of new loans arranged was significantly more than the foreign debt amortisations.

The average maturity of national government's domestic marketable bonds decreased slightly from 113 months at the end of March 1999 to 110 months at the end of March 2000. By contrast, the average maturity of foreign debt increased from 76 months at the end of March 1999 to 92 months at the end of March 2000.

Long-term funding was obtained at an average rate of 13,8 per cent per annum and short-term debt instruments were sold at an average rate of 11,1 per cent per annum during fiscal 1999/2000. These rates can be compared with an initial budget assumption of 14,0 per cent. The Budget for fiscal 2000/01 envisages average capital market yields of 13,5 per cent and an average short-term interest rate of 11,5 per cent over the three-year period.

The proceeds from the restructuring of government assets contributed significantly to the financing of the deficit of national government in fiscal 1999/2000. Receipts from this source included R6,3 billion from the conversion of the South African Special Risks Insurance Association (Sasria) into a public company with a reduced level of reserves, R44 million from the partial sale of the Airports Company of South Africa, R625 million from Transnet for the partial sale of South African Airways and R165 million from the outsourcing of the motorcar financing scheme for senior government officials.

Extraordinary revenue of national government

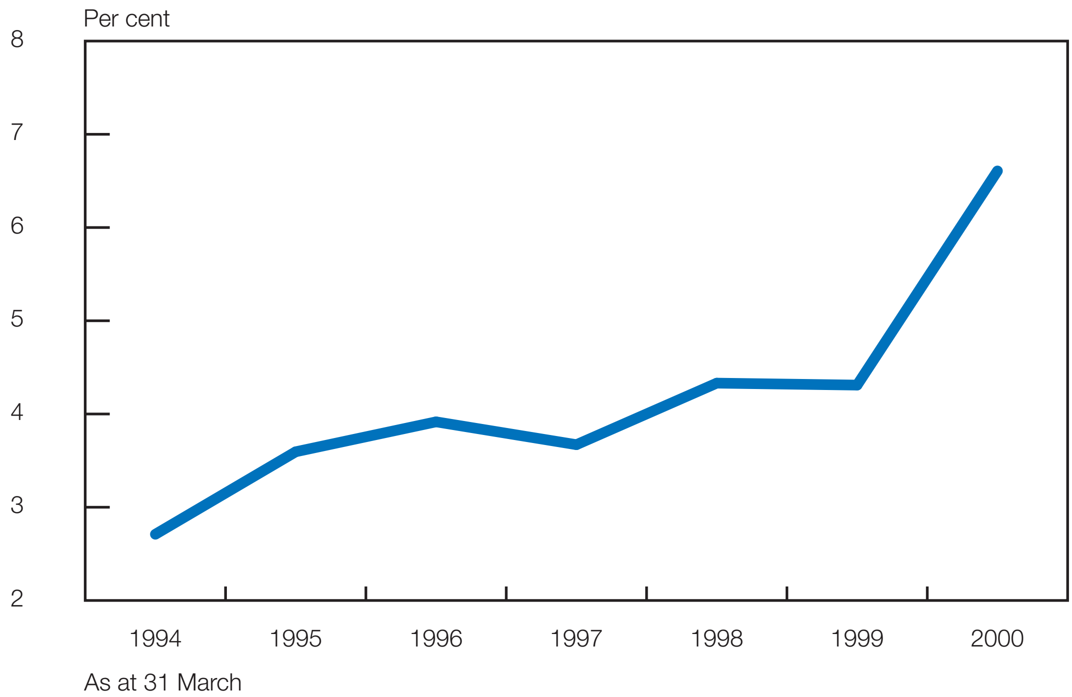


It was anticipated that privatisation proceeds would contribute R5,0 billion to debt reduction in 2000/01, increasing to R10,0 billion in fiscal 2002/03. Because of the decline in the borrowing requirement and the proposed partial funding of the deficit with the proceeds from the restructuring of state assets, the government's borrowing requirement in fiscal 2000/01 is not expected to exert additional pressure on the domestic capital market.

Government has sought to focus investment interest in South Africa's economic reform programmes with the release of the policy framework for the restructuring of state-owned enterprises on 10 August 2000. Government committed itself to complete the restructuring of the four major public corporations – Eskom, Transnet, Telkom and Denel – by 2004. This does not imply full privatisation by 2004, but private-sector participation will be introduced into electricity generation and transmission. Government is convinced that the impact of restructuring will be positive for employment growth, and that competition is more important for the delivery of social services than the perpetuation of public-sector monopolies.

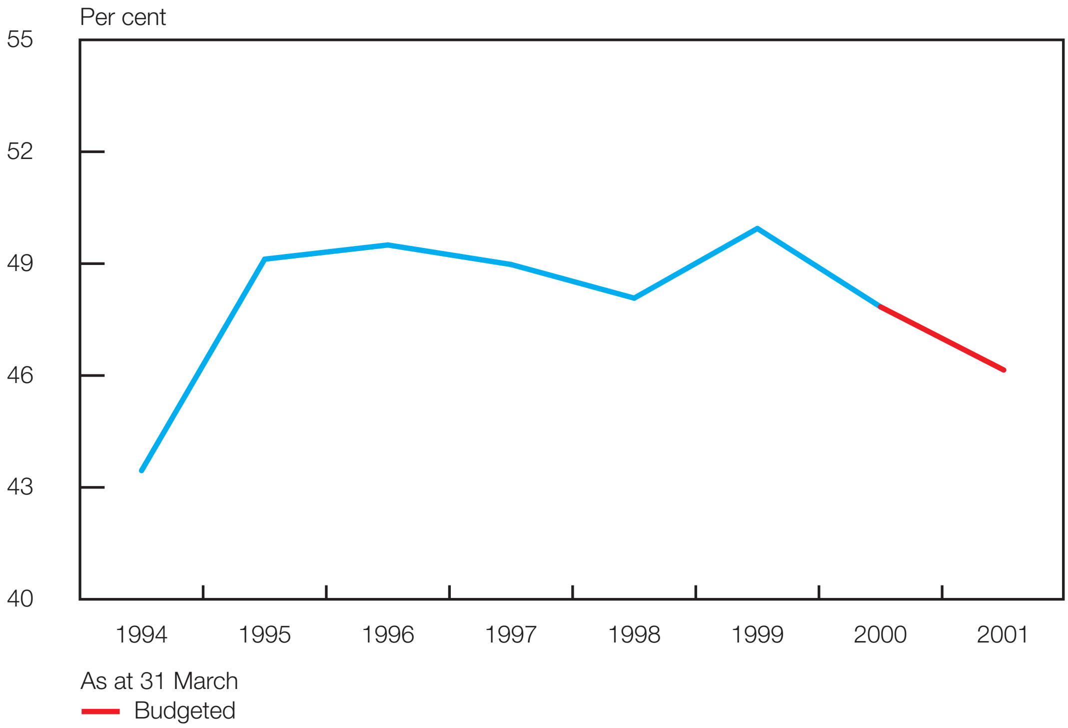
National government debt increased from R377,7 billion at the end of March 1999 to R390,5 billion at the end of March 2000. The increase in outstanding securities debt was offset to some extent by the lower balance on the Gold and Foreign Exchange Contingency Reserve Account, which fell from R14,4 billion at the end of March 1999 to R9,2 billion at the end of March 2000. Total foreign debt amounted to 6,6 per cent of total debt at the end of March 2000, up from 4,3 per cent at the end of March 1999. Taking into account the Reserve Bank's contingent net open position in foreign currency, the government's overall exposure to exchange rate movements came to around 11 per cent of gross domestic product at the end of fiscal 1999/2000 – down from 20 per cent a year earlier. As a ratio of gross domestic product, total national government debt declined from 49,9 per cent at the end of March 1999 to 47,8 per cent at the end of March 2000.

Foreign debt as a ratio of total government debt



Although the Budget for fiscal 2000/01 projects an increase in the nominal value of national government debt over the three-year budget period, debt as a ratio of gross domestic product is projected to decrease. Total government guaranteed debt on 31 March 1999 amounted to R85,8 billion compared with R76,3 billion on 31 March 1998. Foreign loans for which government guarantees were issued in 1999/2000 had an average maturity of 9,8 years. Some lengthening of the maturity was made possible largely by improved access to the eurobond market and various sources of concessionary finance. During 1999/2000 guarantees were mainly restricted to concessionary loans to public enterprises, project finance for infrastructural development schemes and facilities in support of public-enterprise restructuring.

National government debt as a ratio of gross domestic product



General government finance

The *borrowing requirement of general government* (i.e. the borrowing requirement of the consolidated central government, provincial governments and local authorities) decreased from R17,2 billion in fiscal 1998/99 to R8,6 billion in 1999/2000. As a ratio of gross domestic product, the borrowing requirement of general government amounted to 1,1 per cent in fiscal 1999/2000 compared with 2,3 per cent in fiscal 1998/99. Total revenue and grants received by general government increased at a rate of 11,0 per cent in fiscal 1999/2000. Tax revenue increased by 7,9 per cent and non-tax revenue by 34,8 per cent, owing mainly to the restructuring of Sasria.

Total expenditure and net lending by general government rose at a rate of 6,6 per cent in fiscal 1999/2000 compared with an increase of 5,4 per cent in fiscal 1998/99. Interest payments increased at a rate of 3,4 per cent, while spending on goods and services increased by 3,6 per cent in fiscal 1999/2000. The Budget Review for 2000/01 projected that the borrowing requirement of general government would average 1,9 per cent of gross domestic product over the next three years.

The strengthening in the financial position of general government occurred mainly at the level of consolidated central government. The accounts of the provincial governments indicated a smaller surplus in fiscal 1999/2000 than in the previous fiscal year: R3,0 billion in fiscal 1999/2000 compared with a surplus of R3,2 billion in the previous fiscal year. The surplus on the accounts of the provincial governments in fiscal 1999/2000 can partly be explained by the condition attached to an additional transfer of R1,4 billion from national government to provincial governments. This condition stipulated that these funds had to be used for debt reduction and that they should not be employed for recurrent expenditures. Total revenue and grants of provincial governments increased by 4,1 per cent as a result of an increase in revenue transfers from national government.

Total expenditure and net lending by *provincial governments* increased at a rate of 4,5 per cent in 1999/2000 compared with a decrease of 1,3 per cent in fiscal 1998/99. Provincial governments allocate, on average, approximately 95 per cent of total expenditure to current expenditure and 5 per cent to capital outlays. Social service delivery represents 85 per cent of overall spending by provincial governments, financed essentially by the equitable share of government revenue transferred by national government to provincial governments.

The equitable share formula for provinces comprises seven components:

- An education share based on the average school-age population and the number of learners in schools;
- a health share based on the proportion of the population without access to medical-aid funding;
- a social security component based on the estimated number of people entitled to social security grants – the elderly, disabled and children – weighted by using a poverty index derived from the 1995 income and expenditure survey conducted by Statistics South Africa;
- a basic share derived from each province's share of the total population of the country;
- a backlog component based on the distribution of capital needs as captured in the schools register of needs, the audit of hospital facilities and the proportion of the rural population to total population;
- an economic activity share based on the distribution of total remuneration in the country; and
- an institutional component equally divided among the provinces to reflect the costs of running a provincial government.

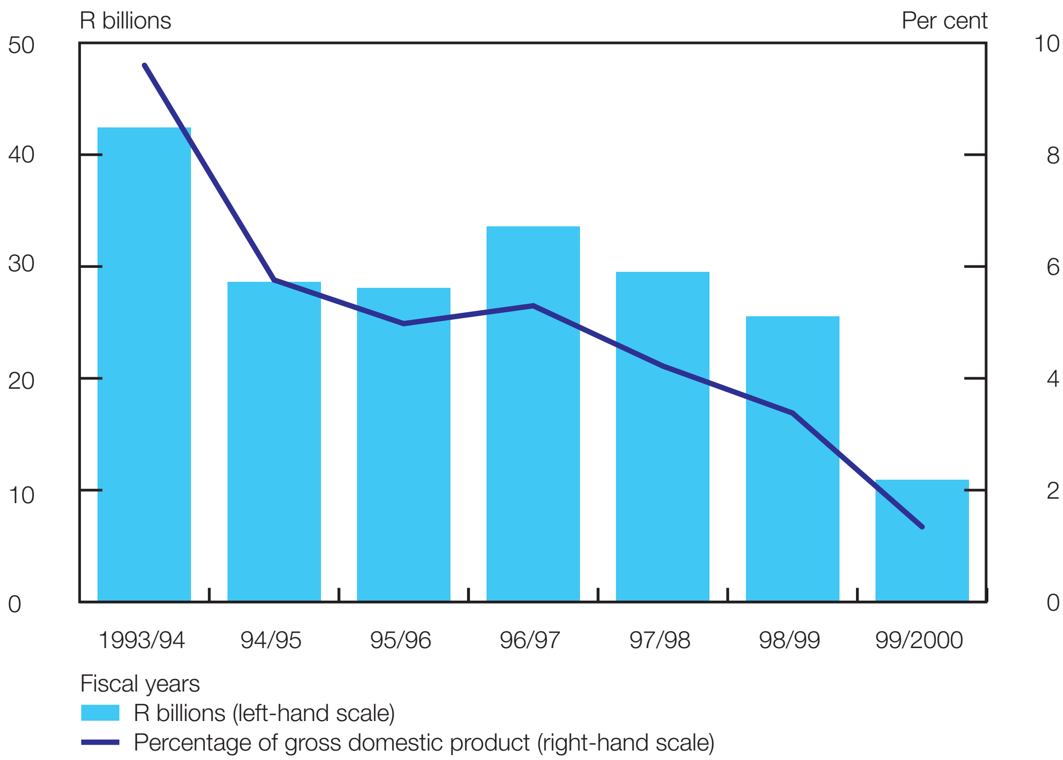
Bank credit extended to provincial governments increased from R0,9 billion at the end of March 1999 to R1,4 billion at the end of March 2000, while the bank deposits of provincial governments increased from R2,7 billion to R4,4 billion over the same period.

The borrowing requirement of local authorities in fiscal 1999/2000 amounted to R1,0 billion, which was virtually unchanged from the previous fiscal year.

Public-sector borrowing requirement

The *public-sector borrowing requirement* (PSBR), defined as the borrowing requirement of the consolidated general government and non-financial public business enterprises, broadly followed trends similar to those of the borrowing requirement of general government. The PSBR amounted to R10,9 billion or 1,3 per cent of gross domestic product in fiscal 1999/2000 compared with R25,6 billion or 3,4 per cent of gross domestic product in the previous fiscal year. This improvement can be ascribed to the substantially better financial position of the general government and the non-financial public business enterprises and corporations. The accounts of the non-financial public enterprises and corporations reflect a borrowing requirement of R2,4 billion in fiscal 1999/2000 compared with a borrowing requirement of R8,4 billion in the previous fiscal year. The decline in the borrowing requirement was due to a decline in investment spending in 1999/2000, following large investment spending by companies such as Eskom, Telkom and Transnet during 1998/99.

Public-sector borrowing requirement



National government finance in the first quarter of fiscal 2000/01

In the April-June quarter of fiscal 2000/01 national government expenditure amounted to R57,9 billion or 9,0 per cent more than in the same period of the previous fiscal year. The Budget provided for an increase in national government expenditure of 7,2 per cent for the fiscal year as a whole. After allowing for cash-flow adjustments, this expenditure amounted to R58,2 billion, which was 13,2 per cent higher than in the same quarter a year earlier.

Revenue received by national government amounted to R43,8 billion in the April-June quarter of fiscal 2000/01. This represents an increase of 9,6 per cent on the same period in the previous fiscal year. The Budget envisaged an increase of 6,6 per cent for the fiscal year as a whole. After allowing for cash-flow adjustments, national government revenue amounted to R44,7 billion in the April-June quarter of fiscal 2000/01.

The net result of the expenditure incurred and revenue receipts in the April-June quarter of fiscal 2000/01 was a deficit before borrowing and debt repayment of R14,1 billion, which was slightly higher than the deficit recorded in the same period of the previous fiscal year. After adjustments for cash flows, the deficit amounted to R13,5 billion. This appears to be consistent with budget projections when the usual seasonal patterns of revenue and expenditure are taken into consideration.

As indicated in the accompanying table, the deficit adjusted for cash flows in the April-June quarter of fiscal 2000/01 was financed mainly through the issuance of short-term Treasury bills. Receipts from the restructuring of Sasria amounted to R89 million. Government refinanced the 5 per cent yen loan which matured in June 2000 by issuing Japanese Notes, due for repayment on 1 June 2020. The loan amounted to R2,0 billion.

Financing the national government deficit in April to June 2000

Financing instrument	R millions
Government bonds (including discount)	1 013
Less: Discount on government bonds	533
Net receipts from government bonds issued	**480**
Treasury bills	8 824
Extraordinary receipts	89
Foreign loans	2 126
Redemption of Section 239-debt*	-14
Redemption of Namibian debt	-5
Change in available cash balances	1 968
Total net financing	**13 468**

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