# 2

# Economic Policy and Outlook

*Growth has strengthened over the past year and the economy is adjusting well to the challenges of the global environment and domestic restructuring. Foundations are being laid for improved long-term economic growth – sound and consistent policies, stronger infrastructure investment, reinforcement of skills and steady progress in trade performance.*

*The realignment of the exchange rate in recent years has contributed to the competitiveness of South African industry. However, uncertainty in international financial markets impacted negatively on the rand in 2000. The currency is expected to stabilise in the period ahead.*

*Social development and improved economic performance depend on gains in public sector delivery, restructuring of state enterprises and more vigorous capital formation. Investment in communications, transport and education are especially critical for sustained, accelerated growth.*

*This chapter takes a closer look at the foundations of improved growth and outlines macroeconomic prospects for the next three years.*

## Introduction

### Steady growth recovery

*Steady growth and declining inflation projected*

Following two years of disappointing growth, the economy expanded by about 3,0 per cent in 2000. The marked increase in oil costs and weakening of the rand during the year contributed to rising prices, but underlying inflation remained muted and interest rates have declined in recent months. Growth of between 3 and 4 per cent is expected to be sustained over the medium term, and average inflation should fall to between 4 and 6 per cent by the end of 2001.

*Strong growth in agriculture and services…*

Last year's economic recovery was bolstered by a large increase in agricultural production, but also reflects the rapid advances of specialised manufacturing industries, telecommunication and financial services. Tourism-related services continue to exhibit strong growth potential.

*…due to efficiency gains and investment*

Progress has been particularly rapid where steady productivity advances, product diversification and integration with growing sectors or product lines have contributed to strong investment and output increases.

*Growth of exports supported by low inflation and the real exchange rate*

While export performance has benefited from the buoyancy of platinum group prices, there has also been rapid growth of exports in new and diverse manufacturing sectors. A competitive exchange rate and low inflation contribute to sustained improvements in international trade.

*Growth-oriented fiscal policy…*

After several years of consolidation, bringing the budget deficit down to 2,0 per cent of GDP in 1999/00, fiscal policy is now decidedly growth-oriented. Increased expenditure on infrastructure investment and maintenance, recapitalisation of the transport and communications sectors and steady advances in social service delivery will contribute both to expansion in the medium-term and stronger foundations for long-term growth.

*…supported by restructuring in communications, transport and energy sectors…*

Accelerated investment in infrastructure is one of several broad policy commitments aimed at strengthening sustainable growth and development. Regulatory reforms and restructuring in the telecommunciations, transport and energy sectors will also contribute to building a competitive environment and attracting greater private investment.

*…and sustained by human capital development*

Alongside the urgent social challenges of overcoming poverty and responding to HIV/Aids, Government recognises that progress in the quality of schooling, promotion of early learning opportunities and deepening the further education and higher education sectors are critical investments in future prosperity. Skills development receives a further boost this year as the financing of new learnerships gets underway.

*Broadening employment and informal economic activity*

The employment trends in formal sectors of the economy have been disappointing in recent years. However, informal economic participation appears to have expanded and there is evidence of considerable mobility and rising incomes outside of the formal economy.

Several policy initiatives aim to reinforce the broadening of economic opportunity. Land reform, investment in rural development and support for small businesses will in due course contribute to employment growth and income redistribution. The overhaul of local government and increased investment in municipal infrastructure in the years ahead will also broaden access to services and income-earning opportunities.

## Rising investment, saving and consumption

*Private and public investment accelerating*

Stronger private sector investment in 2000 (5 per cent higher in real terms in the first three quarters than in the same period of 1999) and planned increases in Government's capital outlays will result in expanded production capacity.

*Higher income leads to more saving and consumption*

Nominal household disposable income rose by 10,6 per cent in 2000, enabling an increase in both saving and consumption. Reduced government dissaving also contributed to the improved saving performance.

Fiscal policy has contributed to a downward trend in interest rates, which should reinforce confidence and investment further in 2001 and beyond. Developments in the telecommunications and transport sectors are expected to attract significant foreign investment, contributing to stronger capital formation in these sectors in the years ahead.

## Current account and price stability

*Current account deficit low*

The current account deficit remained low (about -0,1 per cent of GDP) in 2000 – primarily as a result of improved export performance due to the positive competitiveness effects of trade liberalisation and a moderation of import demand.

*Oil prices temporary threat to monetary stability*

The 58 per cent increase in international oil prices (in US dollar terms) in 2000 led to a modest rise in inflation. While the domestic component of producer price inflation increased last year, structural inflation pressures, particularly unit labour costs and the pricing power of firms, continue to moderate – suggesting a decline in the rate of producer price increases in 2001.

*CPIX and structural inflation remain moderate*

The rise in producer prices fed into consumer prices, with CPIX ending the year at 7,6 per cent, after having reached 8,1 per cent in October. The annualised growth in CPIX (seasonally adjusted) from June to December 2000 fell to 6,2 per cent from 9,3 per cent in the first half of the year.

## Falling interest rates and exchange rate adjustment

*Interest rates remain moderate and bond yields falling to new lows*

Interest rates remained stable in 2000, with yields on medium-term government bonds reaching a 7-year low of about 11,9 per cent by January 2001. Progress in reducing the net forward position of the SA Reserve Bank and the muted response of domestic prices to oil price rises contributed to an easing of inflation expectations, which in due course may lead to further declines in interest rates.

*Rampant dollar growth*

Along with many other currencies, the rand has depreciated markedly against the US dollar. The momentum of the US economy has now slowed, however, which should retard the large flows of capital to the US that have bolstered the value of the dollar.

## Macroeconomic forecast

*More broadly-based growth*

Economic growth is expected to continue strengthening across most sectors this year. The more competitive real exchange rate should sustain prospects for manufactured exports, while steady growth in household spending will impact broadly on demand.

*Price stability at lower interest rates*

Inflation will continue to decline, with CPIX inflation rate expected to average about 6,6 per cent in 2001 and 5,3 per cent in 2002. Interest rate cuts in the US and, later in the forecast period, in Europe, should allow some easing of interest rates in South Africa.

*Manageable current account deficit*

Higher imports in response to more rapid growth over the next three years will raise the current account deficit, but it is not expected to exceed 1,3 per cent of GDP. Capital inflows encouraged by a favourable exchange rate outlook, lower inflation, faster growth, state asset restructuring, and improving investor sentiment should more than cover the current account deficit.

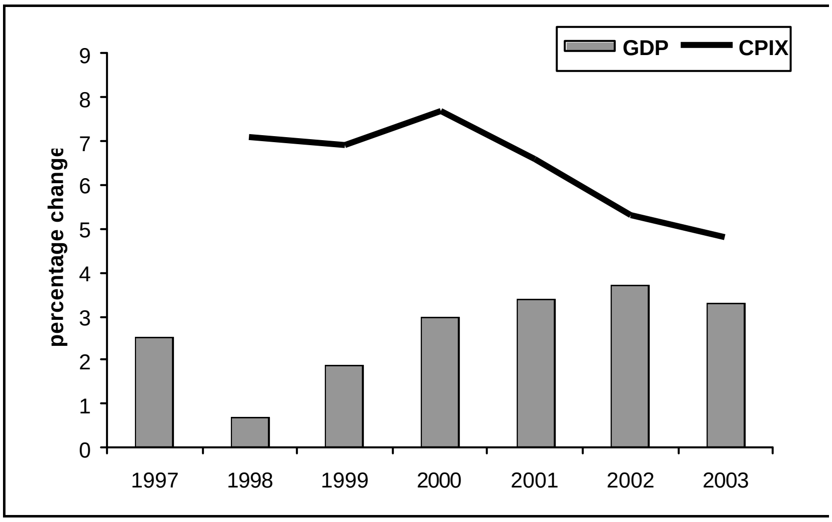
*Deficit targets of 2,1 per cent in 2003*

Despite the increases in spending, new issues of Government debt will remain moderate and the budget deficit is expected to decline to 2,1 per cent of GDP in 2003/04.

*Investment and consumption to grow*

GDP growth is expected to average about 3,5 per cent over the next three years as private and public sector investment and household consumption continue to strengthen.

**Figure 2.1 GDP growth and CPIX inflation**




## International developments and prospects

### Trade performance

*Exports continue to improve…*

The rapid integration of South Africa into the world economy is reflected in the increase in real merchandise exports and imports relative to GDP. Real merchandise exports increased from 11,5 per cent in 1990 to 18,8 per cent in 2000, while real merchandise imports increased from 12 per cent to 19,8 per cent over the same period.

*…especially in niche industries*

Some of the fastest growing exporters have been in smaller manufacturing industries (such as organic solvents, acyclic hydrocarbons, building plastics, catalytic converters), which prior to the 1990s, were unable to develop export markets.

*Trade deals facilitate growth*

Export performance is set to improve over the next decade as South African exporters increasingly take advantage of the opportunities presented by the US Africa Growth and Opportunity Act, the free trade agreement with the European Union, and expanding trade links with Latin America and within SADC.

**Table 2.1 Changing composition of merchandise exports**

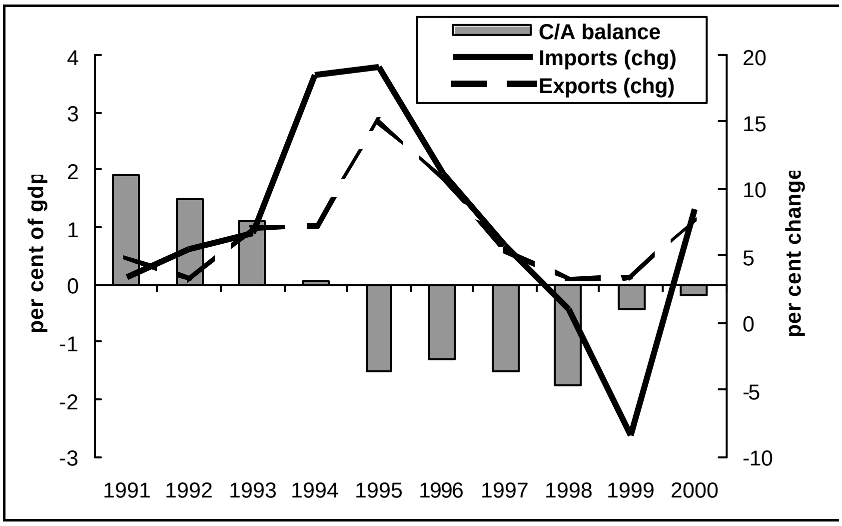
| | Share of total (%) | |
|---|---|---|
| | 1990 | 1999 |
| Primary Products | 58,5 | 36,7 |
| Beneficiated Primary Products | 26,2 | 31,8 |
| Material Intensive Products | 6,1 | 7,9 |
| Manufactured Products | 9,2 | 23,6 |

*Source: Industrial Development Corporation*

*Faster structural export growth…*

Real merchandise exports increased by 3,4 per cent in 1999 and by about 10 per cent in 2000. Growth in total world trade is expected to average 10 per cent a year over the next few years, and this, together with higher commodity prices and a more competitive rand, should contribute to an improved export performance over the medium and long run.

**Figure 2.2 Real import and export growth, 1990–2000**




*…supported by rising capital exports to regional mega-projects*

Manufactured goods comprise an increasing share of total merchandise exports. This is encouraged by export credit reinsurance and other export promotion programmes of the Department of Trade and Industry. One of the largest projects reinsured by Government is the MOZAL aluminium smelter in Mozambique, which absorbed more than R2 billion in capital exports from 192 South African contractors during its construction.

*Imports begin to recover*

Import volumes responded to higher economic growth, to grow by about 9 per cent in 2000. This is a marked reversal of the sharp fall in imports (-7,4 per cent) recorded from 1998 to 1999, and can be attributed to imports of intermediate goods and capital equipment in anticipation of better growth and export conditions.

### Sectoral export performance

Although the mining sector's contribution to GDP has declined over the last few decades, primary and beneficiated mineral exports continue to dominate South Africa's export profile. Gold and diamonds remain the country's most valuable export commodities, while the two fastest growing (major) export industries over the last five years have been aluminium and platinum. With platinum prices expected to remain above US$600 per ounce and export volumes set to increase, platinum could soon eclipse gold as South Africa's single largest foreign exchange earner.

The Government's Motor Industry Development Programme (MIDP) has been instrumental in supporting the strong rise in automotive exports evident in the table below.

In addition to the data provided in the table, a large number of smaller manufacturing industries have experienced rapid growth in exports (export growth rates averaging on an annual basis over 50 per cent), although their overall contribution to total exports remain small. Included in this group are organic solvents, acyclic hydrocarbons, building plastics, catalytic converters, vitamins, titanium, and beauty products.

**South Africa's leading export industries (% of total exports and by % change in value)**

| | As % of total exports | | Ave. annual growth (%) |
|---|---|---|---|
| | 1995 | 1999 | 1996-1999 |
| Gold | 20,7 | 14,0 | 2,2 |
| Diamonds | 7,8 | 10,2 | 21,5 |
| Motor vehicles and parts | 3,6 | 8,6 | 40,6 |
| Iron and steel | 9,1 | 8,1 | 9,0 |
| Mineral fuel | 7,4 | 7,9 | 15,3 |
| Platinum group metals | 2,1 | 7,7 | 68,4 |
| Primary agriculture | 5,4 | 5,7 | 14,2 |
| Ore | 3,1 | 3,8 | 18,5 |
| Machinery and boilers | 3,7 | 3,5 | 11,0 |
| Inorganic chemicals | 4,2 | 3,2 | 5,5 |
| Pulp and paper | 4,0 | 2,8 | 4,4 |
| Aluminium | 0,5 | 2,6 | 129,7 |
| Electrical machinery | 1,5 | 2,0 | 20,0 |
| Transport equipment | 1,3 | 1,7 | 26,0 |
| Furniture | 1,3 | 1,6 | 18,5 |
| Clothing, textiles and footwear | 1,4 | 1,6 | 17,9 |
| Processed food | 1,1 | 1,6 | 29,2 |
| **Sub-total** | **76,7** | **84,9** | **15,3** |

*Note: Diamonds exports may include stones mined in Namibia and Botswana.*
*Source: SARS, except for platinum group metals, for which estimates were obtained from the Chamber of Mines.*

*Economic diversification seen in services exports*

Diversification in the economy can also be seen in the development of services exports, which have been rising faster than merchandise exports over the last few years.

*Trade in services continues to strengthen*

Service exports grew by 6,6 per cent in 1999 after five years of rapid increases. With reference to figure 2.3, services exports have risen from 12 to 15 per cent of total exports over the last decade, while services imports have remained at around 16 per cent of total imports.

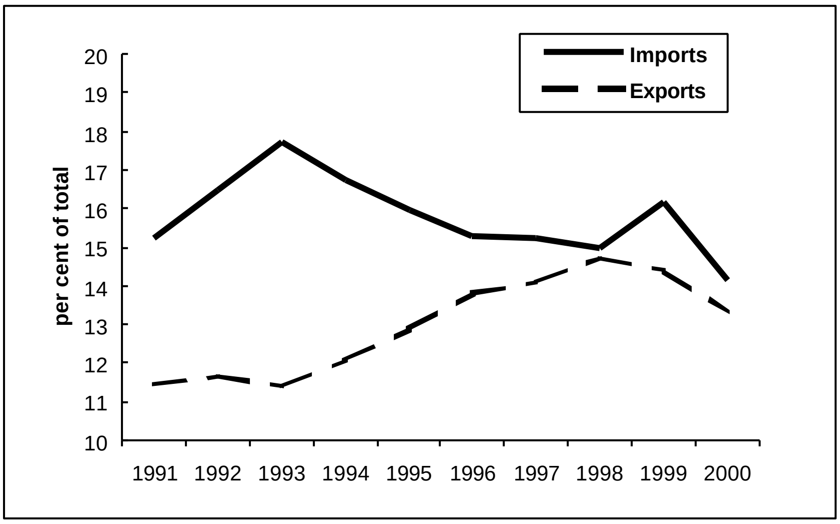
*Rapid advances in telecommunications, financial and information services*

Transport and travel services grew by an annual average rate of 16 per cent in nominal terms throughout the 1990's. The "other services" category (which includes telecommunication, financial and information services exports), has grown at an annual average rate of 28,9 per cent since 1994, almost 15 per cent faster than exports of goods over this period.

The current account deficit fell to 0,1 per cent of GDP in 2000, its lowest level since 1994. This deficit masks a substantial trade surplus, which was more than offset by income payments to foreign owners of South African assets. Based on preliminary figures, the trade surplus grew to R22 billion in 2000 from R16,2 billion in 1999.

*Current account deficit falls further*

**Figure 2.3 Exports and imports of services as a share of total exports and imports**




## Financial account

In what has proved to be a difficult year for emerging markets, the financial account of the balance of payments was relatively resilient, and there are positive signs of strong future inflows.

*Financial account at a turning point*

Caution on the part of foreign investors led to a strong flow of capital out of South African government bonds. However, holdings of equities by non-residents increased further, though at a more moderate pace.

The financial account deficit of R8,8 billion for the second quarter of last year was reversed with a significant net surplus of R11,8 billion in the third quarter. The financial account moved again into a deficit in the fourth quarter of 2000. However, a cumulative surplus of about R10 billion was registered on the financial account during the second half of 2000, compared with a deficit of nearly R6 billion in the first half.

In 2000, foreigners were net sellers of South African bonds to the value of R20,2 billion. Net foreign purchases of South African shares amounted to less than half of the R40,6 billion acquired in 1999.

Foreign direct investment slowed in the second and third quarters of 2000 from a large increase in the first quarter. Restructuring of state-owned assets will increase FDI and subsequent portfolio investment.

*FDI variable, but expected to increase*

**Dividend and income payments in the balance of payments**

The opening of the South African economy to world markets has entailed a number of adjustments to the economy, including a marked increase in flows of capital. Integration with the world economy has included firms listing on foreign stock exchanges in an effort to reduce the cost of raising capital by accessing wider and deeper pools of savings abroad.

Those capital flows lead in turn to current account flows, dividend payments to foreign shareholders (outflows) and payments to South African shareholders (inflows).

Until 1999, the flow of dividend income from direct investment out of South Africa through the current account was moderate, although rising. These outflows grew rapidly from R 5,5 billion in 1999 to R 13,1 billion (seasonally-adjusted and annualised) in the third quarter of 2000. However, offsetting inflows of foreign dividend payments to South African residents are growing, and can be expected to rise with further exchange control liberalisation. In addition, more rapid economic growth will result in increased FDI into South Africa. Longer-term and more productive inflows through the financial account will thus compensate for the current account outflow. Increased outward direct investment by South African firms should also contribute to greater payments inflows.

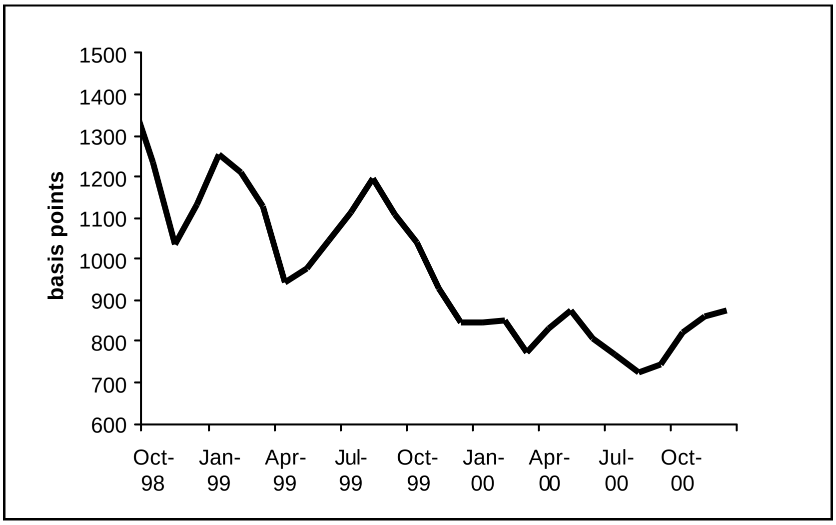
*Net reserves stable despite poor capital flows in 2000*

Gross reserves of the Reserve Bank increased by 25,6 per cent from R45,4 billion at the end of 1999 to R57,0 billion at the end of 2000, mainly as a result of rand depreciation. Net reserves increased by 40,5 per cent over the same period. In dollar terms net reserves increased by 14,3 per cent.

*Contrasting yields on financial assets between SA and other emerging markets*

Investor confidence in some emerging markets deteriorated in the latter half of 2000, after recovering from the uncertainty of 1998 and 1999. Figure 24 shows the difference between market yields on SA government debt and US treasuries, illustrating the weakening in investor perceptions towards the end of last year. Bond yields in South Africa have declined to historic lows in early 2001, however, signalling confidence in economic policies and inflation prospects.

**Figure 2.4 SA bond spread over US Treasuries (September 1998 to January 2001)**



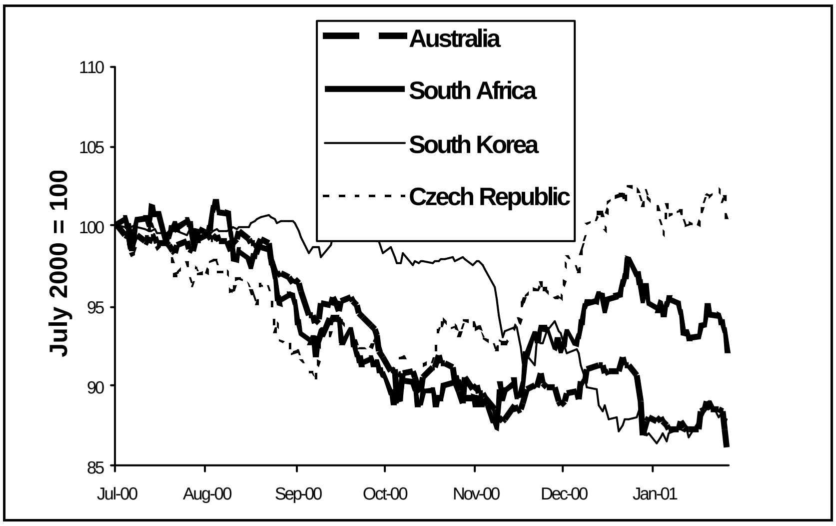

## Exchange rates

*Rand weakens due to uncertainty in major economic centers*

Having appreciated by 3,1 per cent from December 1998 to December 1999, the real effective exchange rate depreciated by 9,5 per cent between December 1999 and December 2000 based on preliminary estimates. The decline in the value of the rand in 2000 was caused primarily by a strengthening dollar as investors shifted away from holding emerging market assets.

Figure 2.5 gives a comparative view of the rand's nominal depreciation to the US dollar. Economies with floating exchange rates typically depreciated against the US dollar in 2000, while those pegged to the dollar have had considerable difficulty adjusting to the resulting real appreciation.

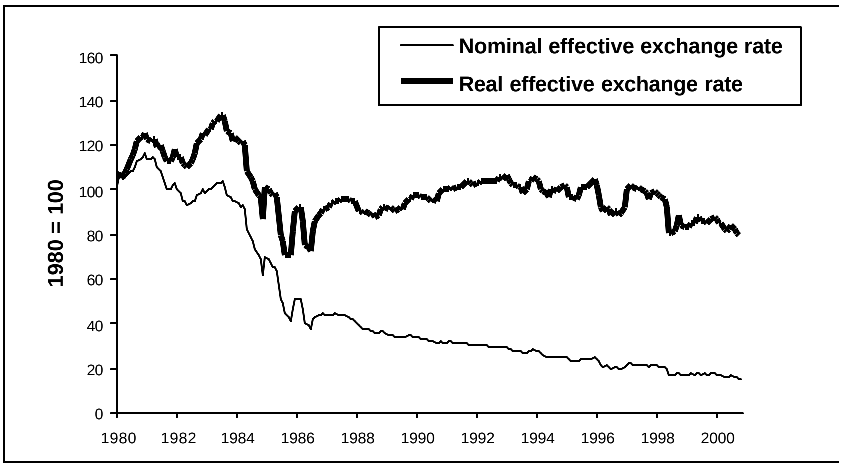
**Figure 2.5 Comparative nominal exchange rates, 2000**




*Long-term competitiveness of the currency*

Figure 2.6 shows the nominal and real effective exchange rate trend since 1980. The real effective exchange rate has fallen to levels last seen in the mid-1980s. A moderate strengthening of the rand in real terms is possible over the next few years, although flexibility of the currency will remain an important element in South Africa's trade competitiveness.

**Figure 2.6 Nominal and real effective exchange rates of the rand, 1980 to 2001**



**South Africa's foreign diversification profile**

Since 1995, South Africans have taken advantage of the benefits of diversifying their holdings of foreign and domestic assets. This has provided greater stability to the exposure of firms and individuals to risk, and thus indirectly increases the 'wealth effects' of holding assets.

In 1995, foreign exposure was almost exclusively obtained through holding equity in domestic companies with international links. By 1999, holdings of foreign assets by residents had more than doubled as a percentage of GDP, from 15,1 per cent in 1995 to 43,1 per cent in 1999.

Foreign portfolio investment has surged (from R1,7 billion in 1995 to R 167 billion in 1999) and the increasingly outward orientation of South African companies has meant that direct investment assets have shown a notable increase in nominal rand terms, from R81 billion in 1995 to R175 billion in 1999. The current structure of asset holdings better reflects South Africa's integration with the world economy.

The growth in diversification has been rapid despite continued exchange controls, and South Africa has achieved a comparatively high level of foreign assets as a percentage of GDP. By the end of 1998, South Africa had realised a level of diversification in line with Spain and Denmark but less than in Italy – and in line with trends in OECD diversification.

**Personal sector foreign assets (as a percentage of GDP)**

| | 1995 | 1996 | 1997 | 1998 | 1999 |
|---|---|---|---|---|---|
| Australia | 20,3 | 23,4 | 24,3 | 28,4 | … |
| Belgium | 106,5 | 113,3 | 115,2 | 129,1 | … |
| Denmark | 20,8 | 24,6 | 29,2 | 38,3 | … |
| Italy | 26,1 | 26,8 | 35,8 | 49,3 | … |
| Spain | 13,9 | 15,1 | 21,5 | 34,9 | … |
| South Africa | 15,1 | 19,3 | 24,0 | 33,4 | 43,1 |

## International financial relations

*Participation in international financial forums*

South Africa plays a prominent leadership role in advancing developing country positions in the major international financial institutions. South Africa is vocal in its calls for the democratisation of the International Monetary Fund and the World Bank; the reform of their facilities – particularly those catalysing private capital flows – to better suit the needs of African countries; the opening of developed country markets to African goods; debt cancellation and the reversal of the declining trend in aid flows.

*SA's role in the G20*

The depth and sophistication of the financial sector has earned South Africa a place in the major forums established to oversee the international financial architecture – the G22, the Financial Stability Forum, and most recently the G20 of "systemically significant" countries. The G20 focuses on exchange rate management, external liability management, the international implementation of codes and standards, and measures to ensure the participation of the private sector in avoiding and resolving financial crises.

South Africa's prominent participation confers a number of advantages and opportunities, among them, derived gains in knowledge and best practice, the opportunity to harness these in the further strengthening of the financial sector, and the improvement of South Africa's profile as an investment destination.

**Address to the Board of Governors of the IMF and World Bank**

In September 2000 the Minister of Finance chaired the annual meeting of the boards of the IMF and World Bank in Prague. This provided South Africa with an opportunity to give prominence to key aspects of its international economic agenda: democratisation of the international financial institutions, developed country reforms to complement those of the developing world in attacking poverty, and measures to ensure a more equitable distribution of the benefits of globalisation.

The main points of his speech are summarised below:

Globalisation has had little impact on the tragedy of poverty. The latest *World Development Report* reminds us that some 2,8 billion people, almost half of the world's population, live on less than $2 a day and that 1,2 billion people live on less than $1 a day. Most of these people are located in South Asia and Africa.

Growing inequality poses the greatest risk to the future of the global economy. If the majority of the world's population is increasingly marginalised and economically disenfranchised, then globalisation will fail. Ensuring that the benefits of globalisation reach developing countries is the responsibility of both the developing and developed.

Africa faces a number of critical challenges. While Africa contributes resources critical to world growth, its capacity to process these, and its share of world trade and foreign direct investment are insignificant. Addressing these challenges means that Africa must remain focused on key priorities: sound and sustainable macroeconomic and development policies, increasing the level of savings and investment, bridging the digital divide, addressing HIV/AIDS and resolving conflict.

As long as developing countries remain debilitated by unsustainable debt burdens, adequate growth rates will not be achieved.

The integration of world trade requires equal access for all countries and for all products and services. Advanced country trade policies require urgent reform. OECD subsidies continue to reach record levels, in effect creating barriers to trade. It is imperative that we refocus our efforts on a comprehensive and equitable conclusion of a new round of multilateral trade negotiations.

Given the substantial savings gap in the poorest countries, debt relief is unlikely to be effective in helping our countries fight poverty without well-targeted aid. The recent decline in development assistance should not be tolerated by civilized and compassionate societies.

The World Bank and the IMF have a vital role to play in global economic processes. To do this effectively and credibly means that these institutions have to reflect the needs of those that they are designed to serve. This means not only a reconsideration of governance structures, to give a greater voice to developing countries in the direction of the institutions, but also a greater appreciation of what developing countries expect from the programmes and products of the Bretton Woods Institutions.

*SADC cooperation*

Through the SADC Finance and Investment Sector Unit (FISCU), the National Treasury has played a key role in coordinating sectoral work in Southern Africa on a Finance and Investment Protocol covering macroeconomic convergence, investment, development finance and central banking.

*Negotiations for a new SA Customs Union agreement continue*

Negotiations for a new customs union agreement between South Africa and its SACU partner countries (Botswana, Lesotho, Swaziland and Namibia) are expected to be concluded this year. Agreement has been reached on a new revenue sharing formula for the distribution of customs and excise revenues within the union, and is likely to be implemented after progress has been made towards the restructuring of SACU institutional and policy arrangements.

## The changing shape of the economy

*Structural shifts and trends in expenditure and production*

The progressive opening of the economy since the early 1990s has induced structural shifts in production and expenditure as South African markets become more competitive, and take advantage of access to technology. Greater consumption of services is developing alongside diversified manufacturing and services production, and more downstream processing of primary products.

## Domestic expenditure

*Changing consumption patterns*

Spending trends suggest a shift in favour of goods and services produced by the tertiary sector – providing a stimulus to the transport, entertainment and telecommunications industries. Final consumption of services amounted to over 40 per cent of total consumption in 2000, compared with 37 per cent in 1994/95. The shift toward greater consumption of services in part reflects broader access and the introduction of new services into the South African market. Spending patterns are likely to stabilise.

*Increased debt financing sustained by greater disposable income*

The aversion of households to debt financing may have passed its peak. The year-on-year growth in household debt increased from 2 per cent in the fourth quarter of 1999 to about 5,3 per cent in the first three quarters of 2000. This debt increase was sustainable as growth in disposable income outpaced growth in debt. The household debt-to-disposable income ratio declined from 59,4 percent at the first quarter of 1999 to 55,9 percent in the third quarter of 2000.

*Spending on durable goods strengthens…*

The bulk of the increase in disposable income fed into real expenditure (from quarter on quarter growth of 2,8 per cent in the second quarter of 2000 to 3,5 per cent in the third quarter), primarily on durable goods.

**Table 2.2 Consumption categories as a proportion of total final consumption expenditure by households**

| Category of consumption | Share of total consumption (%) | | | Annual average real consumption growth (%) |
|---|---|---|---|---|
| | 1991 | 1995 | 2000[1] | 1995-2000[2] |
| Durable goods | 8,6 | 8,4 | 6,7 | 0,1 |
| Semi-durable goods | 11,5 | 10,6 | 9,1 | 3,6 |
| Non-durable goods | 42,5 | 43,3 | 43,2 | 1,6 |
| Services | 37,4 | 37,6 | 41,0 | 4,2 |
| *Rent* | *9,9* | *8,9* | *9,1* | *1,5* |
| *Household services* | *6,4* | *7,8* | *8,6* | *1,5* |
| *Transport & comm.* | *8,1* | *8,7* | *9,2* | *7,0* |

*1 Average for the first three quarters of 2000*
*2 To the third quarter of 2000.*

*…as does spending on lotteries, gambling and cellphones*

Spending on the new national lottery, cellphones and casinos has surged during the past year. This reflects a change in the household consumption spending patterns towards sectors of the economy. These changes have come at the expense of other more traditional areas of consumption.

Real final consumption expenditure by households grew by year-on-year rates of above 3 per cent in all four quarters of 2000.

The steady strengthening of consumer spending since the mire of 1998 is primarily due to a decline in interest rates, income growth, and a lower effective income tax rate on individuals.

*More disposable income from lower taxes and interest rates*

Government's consumption spending slowed in 2000. Improvements in spending capacity and a more growth-oriented fiscal stance will lead to a moderate expansion of government consumption expenditure over the next three years. Fiscal policy continues to reprioritise spending toward enhancing the delivery of services and appropriately targeting key drivers of long-run economic growth.

*Government expenditure weak in 2000*

In 2000/01, the budget deficit fell to 2,0 per cent of GDP. The public sector borrowing requirement also declined (from 5,7 to 1,3 per cent of GDP from 1994 to 1999), and despite the planned increases in spending is projected to average about 2,0 per cent of GDP over the next three years.

*Fiscal targets on track*

## Domestic production

Although much of the economy remains geared toward the production of resource-intensive goods, the sectors specialising in information, communication, technology and services have exhibited the strongest growth in investment and output – and will influence the future development path of the economy.

*ICT sectors strong…*

Output in the transport, storage and communication sector has been particularly vibrant, increasing by 5,8 per cent in the third quarter of 2000. From 1995 to the third quarter of 2000, this sector recorded an average annual real growth rate of 7,6 per cent.

*…led by transport and communications*

This growth can be ascribed to the continued buoyancy of the telecommunications sub-sector, especially the extension of telephone networks to under-serviced communities and growth in cellular services. Growth has also been consistent in the transport sub-sector supported by rising volumes of foreign trade.

*Buoyant telecommunications*

The tourism sector is expected to grow strongly in the medium-term, with positive implications for job creation and social development. Travel income reached R18,7 billion in 2000. Provincial development plans are in place to realise much greater gains from tourism in coming years.

*Tourism set for accelerated growth*

Overall manufacturing has grown at an average annual real rate of 1,0 per cent since 1995. Rapid export growth, however, is occurring in a wide selection of manufacturing sub-sectors.

*Mixed manufacturing growth*

The construction sector has been slow to recover from the 1998 interest rate highs, and contracted by an estimated 2,0 per cent in 2000. With lower interest rates and declining inflation, prospects for growth are improving.

*Construction sector still in decline*

**Knowledge, capital expenditure and productivity**

A major challenge to developing economies is to broaden and deepen the stock of skills and technological knowledge possessed by its workforce. Output per worker differs by a factor of 30 between the world's richest and poorest countries, partly because technology designed for developed economy production is not always appropriate for developing countries.

One measure of countries' progress toward higher skills levels is "innovative capacity," which shows how well a country produces and adopts new technology over the long term. Innovative capacity is measured by the quality of the innovative infrastructure (research universities, stock of patents), the policy environment (education spending, intellectual property rights enforcement, openness to trade), and the microeconomic environment (ability to market innovations).

Accessing pools of knowledge may require government support of various types. For instance, accessing information may require a combination of competition in telecommunications infrastructure and services provision (reducing costs) alongside adequate media in schools and universities (delivering points of access). Information dissemination by government may also play a key role in linking businesses and entrepreneurs to capital, markets or strategic partners.

Continued capital expenditure on knowledge infrastructure by the state (especially schools, tertiary education, and information as well as more conventional "highways") crowds-in private sector investment and leads to higher economic returns and more equitable growth in household income. Steps are being taken, notably by The National Research and Technology Foresight Project sponsored by the Department of Arts and Culture, to develop ways of enhancing knowledge and integrating it for economic development.

**Table 2.3 Sectoral contributions to GDP**

| | Sectoral contributions (%) | | | Annual average growth |
|---|---|---|---|---|
| | **1991** | **1995** | **2000[1]** | 1995-2000[2] |
| **Primary** | **13,0** | **10,8** | **9,9** | **1,4** |
| Agriculture | 4,6 | 3,9 | 3,4 | 4,6 |
| Mining & quarrying | 8,4 | 7,0 | 6,4 | 0,6 |
| **Secondary** | **29,9** | **27,9** | **24,4** | **1,3** |
| Manufacturing | 22,9 | 21,2 | 18,7 | 1,1 |
| Electric, gas & water | 3,8 | 3,5 | 2,9 | 3,5 |
| Construction | 3,2 | 3,2 | 2,8 | 0,2 |
| **Tertiary** | **57,1** | **61,3** | **65,8** | **3,3** |
| General government | 15,2 | 16,2 | 16,5 | 0,1 |
| Finance, insurance | 14,8 | 16,4 | 20,2 | 5,8 |
| Other | 4,7 | 5,5 | 6,1 | 1,5 |
| Wholesale & retail | 13,9 | 14,3 | 13,0 | 1,8 |
| Transport, communications & storage | 8,4 | 8,9 | 10,0 | 7,2 |

*1 Average for the first three quarters of 2000*
*2 To the third quarter of 2000.*

*Primary sector improves on back of agriculture*

Growth in the primary sector was kept from declining further by real agricultural sector growth of 6,7 per cent in the third quarter of 2000 compared to the third quarter of 1999.

*Decline in mining output…*

As a proportion of total GDP, mining has fallen from a decade high of 7,7 per cent in 1993, to an estimated 5,8 percent in 2000 – largely as a result of the decline in gold production.

*…moderated by platinum boom*

With prices soaring above US$600 per ounce, the contribution of platinum group metals to total mineral sales has doubled from 10 to 20 per cent over the past five years.

*Greater certainty in the mining sector*

Government has recently released a draft Mineral Development Bill. This new legislation is expected to:

- Promote small-scale mining, employment creation, exploration and domestic and foreign investment in the mining sector
- Ensure security of tenure in respect of prospecting and operations.

## Labour market developments

*Divergent labour market trends*

South Africa's labour market continues to reflect divergent trends, with continued weakness in the formal sector contrasting with employment and income growth in the informal sector.

### Employment trends

*Restructuring continues in the formal sector…*

Formal sector employment continued to decline in 2000, indicating continued adjustment by firms to the new global environment, streamlined production processes and rationalisation of government employment.

The changing employment structure of the economy, as measured by the annual October Household Survey, is shown in figure 2.7.

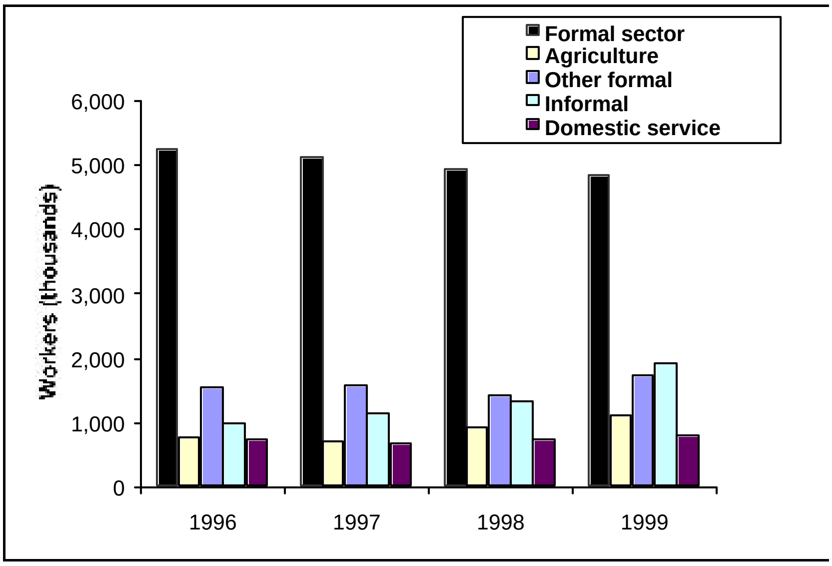
*…while informal economic activity becomes more vibrant*

The data suggest that informal sector employment has grown strongly. Since the decline in apartheid-era restrictions, informal economic activity and flexible short-term contract labour have increased and incomes in this sector have grown more rapidly than in the formal business sectors.

### Labour supply

Skills constraints remain an impediment to faster growth in the South African economy, despite increases in the number of individuals participating in the labour market.

**Figure 2.7 Changing composition of employment, 1996 to 1999**




*Expanding supply of labour*

The 1999 October Household Survey indicated a marked increase in the number of individuals working and seeking work in the economy.

However emigration contributes to a decline in the labour supply, especially of professionals and managers.

*Skills development moving forward*

Over the past year, 25 Sector Education and Training Authorities were established and have begun planning for skills development for the future. Several learnership programmes will get under way this year. The progressive enhancement of skills should sustain continued improvements in job matching, productivity and earnings.

*Policy response to impact of HIV/Aids*

Human development and training policies must also take account of the economic impact of HIV/Aids. Increased mortality in the adult population, the extra Aids-related labour costs to, and training needs required by firms, and the increase in demand for government services (health and welfare mainly) are among the more significant effects. Government faces several challenges:

- Adapting health services to respond effectively to HIV-related needs.
- Broadening welfare and social security to meet the needs of Aids orphans and affected families.
- Strengthening further education and training in response to labour market needs.
- Ensuring that policies and services are affordable and implementable.

### Wages and productivity

*Real wages lag the economic cycle*

The slowdown in economic activity which began in 1998 has, with a normal lag of about eighteen months, resulted in slower real wage growth. In 1999 and 2000, real wages increased by 0,9 and 1,5 per cent respectively.

*Differential growth rates by sector and skill*

The slowdown in real remuneration from 1998 reflects decelerating nominal wages and the rise in inflation in 2000. Performance related and higher-skilled remuneration grew at a reduced pace, while wage settlements in the collective bargaining system averaged about 7,5 per cent in 2000, compared with 8 to 9 per cent in 1999.

*Productivity advances moderate unit labour costs*

Productivity advances have moderated unit labour costs significantly. In 1999 unit labour costs rose by 2,8 per cent. In the first three quarters of 2000 they rose by 1,5 per cent, compared with the same period in 1999.

*Expect reduced inflation expectations and stronger investment*

These wage and labour cost trends reflect the slowdown in economic activity, and will contribute to lower inflation and stronger investment as the economy gains momentum in 2001. Later in the growth phase of the business cycle, wage income is expected to rise more strongly.

*Better income distribution*

Moderate formal sector earnings have been matched by increasing earnings in the informal sector. This has largely occurred as individuals seek employment in the informal sector, resulting in rising economic activity – and a better distribution of income across the economy as a whole.

**The Formal and informal labour markets in KZN**

Recent analysis of the KwaZulu-Natal Income Dynamics Surveys suggests that the informal sector appears to be larger and more economically vibrant than is often thought. A significant number of prime working-aged individuals (25 to 54 years) who were in the informal sector in 1993 and 1998 experienced sizeable real gains in income over time.

Real increases in income even extended to many of those who moved from employment in the formal to the informal sector (45 per cent), and was widespread across workers with different education levels.

Studies on informal sectors in Latin American economies show that the combination of costly regulation and weak enforcement induce businesses to move from the formal to the informal sector. This has a number of negative consequences for the economy, particularly a reduction in the tax base in the formal sector. Policies to induce firms and individuals to move back into the formal sector would facilitate a progression for individuals from unemployment, to work in the informal sector, to employment in an expanding formal sector.

**Real mean earnings (in rand) by skill and education in the formal and informal sectors (prime working-aged individuals):**

| | 1993 | 1998 | Change per year (%) |
|---|---|---|---|
| Unskilled | 575 | 637 | 2,7 |
| Semi-skilled | 838 | 1 185 | 10,3 |
| Skilled | 1 699 | 1 955 | 3,7 |
| Self-employed | 314 | 634 | 25,5 |
| No education | 370 | 447 | 5,2 |
| Primary education | 527 | 634 | 5,1 |
| Secondary education | 846 | 1 234 | 11,5 |
| Post-secondary | 2 043 | 2 060 | 0,2 |

*Source: Fields, Leibbrandt & Cichello, "Which African Workers Have Gotten Ahead and by How Much? The Story of KwaZulu-Natal, South Africa, 1993-98," Report to the National Treasury, February 2001.*

## Finance, saving and investment

### Saving trends

*Marginal recovery in domestic saving*

Gross saving as a percentage of GDP declined from 19,1 per cent of GDP in 1990 to a low of 14,3 per cent in 1998. The saving ratio has since improved to an average of about 15,3 per cent of GDP in the first three quarters of 2000. This is attributable in part to a reduction in government's (dis)saving since 1994, from R28,3 billion to an average of about R14,9 billion in the first three quarters of 2000.

*Household saving rises on the back of tax cuts*

Gross saving by households has declined from 3,6 per cent of GDP in 1992 to just 0,2 per cent of GDP in 1999, before rising again to 0,4 per cent in the second and third quarters of 2000. The higher saving performance was accompanied by a 10,6 per cent increase in nominal disposable income during the first three quarters of the year.

### Investment trends

*Investment cyclically weak in first half of 2000*

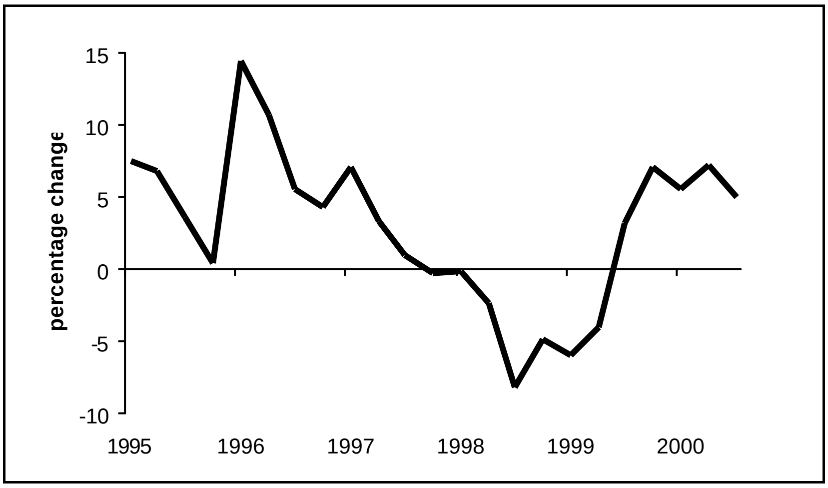
Gross fixed capital formation declined by an average of 1,5 per cent a year during the period 1990-1994, but turned around to grow by an annual average of 4,7 per cent in real terms over the next five years.

GFCF fell to 15,2 per cent of GDP in 1999 and 14,8 per cent in the first half of 2000.

*…but stronger in the second half*

Weakened confidence in emerging markets from the 1998 international financial crisis resulted in a slowing of investment in South Africa by non-residents and domestic business. Nonetheless, private sector investment began to increase in late 1999. That of public corporations began to increase in the third quarter of 2000. In the first three quarters of 2000 gross fixed capital formation increased by a real 5 per cent compared with the same period of 1999.

**Figure 2.8 Private sector investment (quarterly, seasonally adjusted)**




Much of the recent decline in gross fixed capital formation can be attributed to specific sectors, such as mining and construction. Other sectors continue to exhibit rapid rates of investment spending, and are likely to provide the economy's growth-orientation well into the future.

*Telecommunications and transport lead*

Real fixed capital formation in transport, storage and communication rose faster than in any sector over the past 5 or 10 year periods, with capital spending increasing by 20,4 per cent in 1997 and 62 per cent in 1998. Since the decline of 20,1 per cent in 1999, investment increased by 5,3 per cent in the first three quarters of 2000 compared to the same period of 1999.

*Consistent investment in manufacturing*

Between 1995 and 1999, manufacturing sector investment grew by a real annual average of 4,2 per cent, the fastest growing sector next to transport, storage and communication. Compared with the same period a year earlier, manufacturing investment increased by 4,3 per cent in the first three quarters of 2000 in real terms.

*Wholesale and retail trade remains moderate*

Fixed capital formation in the wholesale and retail trade, catering and accommodation sectors recorded the third highest growth rate from 1995 to 2000, due to expansion in entertainment and shopping centres.

## Prices and money market developments

### Inflation

*Impact of oil price increases on inflation moderates*

The economy experienced an increase in all measures of inflation in 2000, initially driven by increases in agricultural prices, but given further impetus by the 28 per cent rise in international oil prices from January to November last year.

Nominal depreciation in the value of the rand, in addition to the effect of oil prices, also raised the prices of imported and domestically produced goods. The rate of increase in prices of imported goods rose from 13,1 per cent in the year to January 2000 to 15 per cent in the year to December. Domestic producer prices increased by 7,9 per cent in the year to December 2000.

*Only minor feed-through of imported prices into CPIX*

Consumer prices as measured by the target CPIX index (consumer prices minus mortgage interest costs) remained moderate despite the increases in imported goods prices. CPIX increased from 7,0 per cent in the year to January 2000 and peaked at 8,2 per cent in the year to August before falling to 7,6 per cent by December 2000.

*CPIX inflation declining rapidly*

Seasonally adjusted and annualised, CPIX rose by 9,3 per cent between December 1999 and June 2000, and by 6,2 per cent during the second half of 2000.

**Reducing the Net Open Forward Position**

The South African Reserve Bank and the National Treasury have used inflows of foreign currency to reduce the net open forward position (NOFP) and Forward Book from their 1998 highs of US$ 23,2 and 25,3 billion.

The NOFP of the South African Reserve Bank is equal to net reserves minus outstanding forward contracts in the rand (the Forward Book).

Research conducted by the IMF has indicated that the NOFP continues to weigh on South Africa's interest rates.

The Forward Book is composed of contracts on the exchange of rand for foreign currency at some point in the future. Losses on profits on the Forward Book depend on fluctuations in the exchange rate and accrue to the fiscus. Scenarios for potential profits and/or losses on the Forward Book are accounted for in Government's overall debt strategy. The substantial reduction in the NOFP in 2000 should lend itself to more stable exchange rates and lower interest rates.

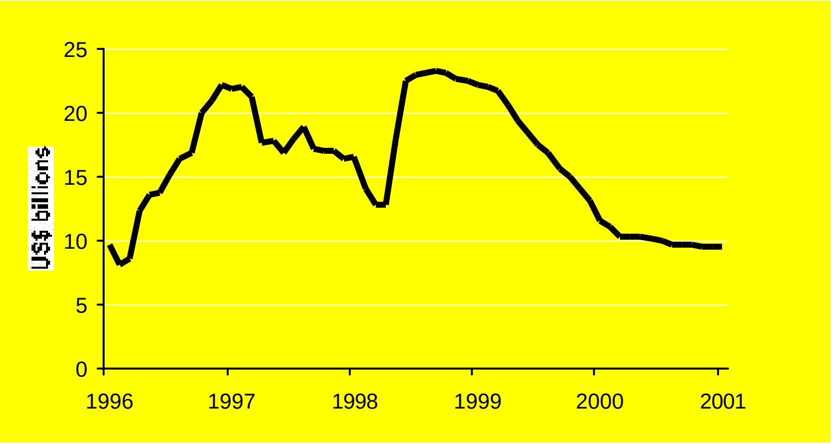


**Table 2.4 Inflation in 2000 (monthly percentage change from previous year)**

| | March | June | September | December |
|---|---|---|---|---|
| CPIX | 7,4 | 7,9 | 8,1 | 7,6 |
| *Minus oil prices* | *6,7* | *7,3* | *7,2* | *6,7* |
| Producer prices | 8,6 | 8,8 | 9,4 | 10,0 |
| *Imported component* | *14,6* | *14,0* | *13,3* | *15,0* |
| *Domestic component* | *6,7* | *7,0* | *7,9* | *7,9* |

### Interest rates and money market trends

*Nominal interest rates remained low in 2000*

Nominal money market interest rates remained stable in 2000, while the yield on government debt continued to decline in the latter half of the year and into January and February of this year.

*Demand for liquidity reflects easing of monetary conditions*

The repo rate remained at 11,75 per cent until mid-October, when it was raised to 12 per cent. The prime rate charged by banks did not increase in response, indicating the broad health of the banking system and underlying easing in monetary conditions.

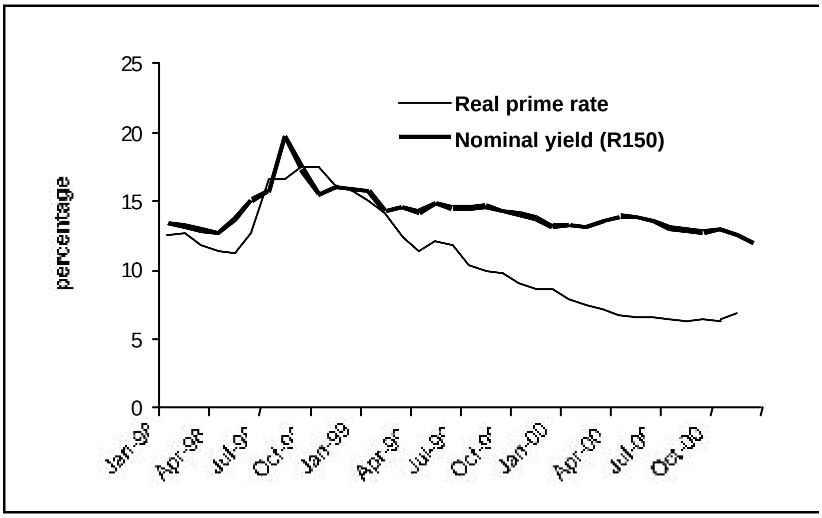
*Money supply and private sector credit still moderate*

The money supply rose by 7,6 per cent in December 2000, down from growth of 10,2 per cent in December 1999. Growth in credit extension to the private sector remained moderate at 11,1 per cent in December 2000, although somewhat higher than the increase of 8,7 per cent recorded in December 1999.

*Real interest rates continue to decline*

The real interest rate (prime rate deflated by CPIX) fell to about 6,9 per cent by December from over 10 per cent in 1998 and early 1999.

**Figure 2.9 Real prime rates and nominal market yield on medium-term debt**




*Equity markets to strengthen*

Declining nominal and real interest rates have contributed to rising volumes of shares traded on the JSE Securities Exchange, despite the poor global conditions for equities. Weak share prices in 2000 need to be assessed in the light of the 57,3 per cent increase in share prices in 1999.

**Financial sector assessment by the IMF**

In 1998, South Africa agreed to participate in the pilot programme of the IMF's Financial Stability Assessment Programme (FSAP). A Financial Sector Stability Assessment (FSSA) was undertaken at the end of 1999, followed by a Progress Report at the end of 2000.

The initial FSSA and the follow-up Progress Report have served to assess potential vulnerabilities in the South African financial system, thus providing an opportunity to address potential risks. Beyond this, the process has opened up channels of cooperation and consultation between financial sector institutions and Government.

The FSSA presents a broadly positive endorsement of the South African financial system. South Africa's markets are described as "highly developed and balanced", government financial and monetary policies as "sound", the national payment system as "modern and sophisticated", and the legal and regulatory framework "impressive in the comprehensiveness of its coverage". The FSSA notes that the financial sector is not prone to major vulnerabilities, and that its resilience contributed to the economy's successful weathering of the 1997/98 financial crises.

The FSSA notes that most of South Africa's financial institutions (commercial banks, insurance companies, retirement funds and unit trusts as well as leasing, factoring and venture capital companies) are privately owned and strongly capitalised. Supported by generous tax concessions on retirement savings, the contractual savings institutions (life assurance companies and retirement funds) are large and mobilise vast financial resources. The securities markets for equities, bonds and derivatives are described as highly developed, by standards of both developed and developing countries. Attention is drawn to the considerable strength and moderate levels of debt of the corporate sector, and the internationally acceptable standards of corporate disclosure.

The strong capital position of the banking sector is highlighted, with capital adequacy ratios well above international norms, and adequate provision against impaired loans. Of the core principles against which banks are assessed, there is full compliance with 21 and partial compliance with 8.

The FSSA Report finds that good bank supervision aided the resolution of liquidity problems affecting smaller banks in 1999. Procedures for facilitating assistance to small banks and adjustments to capital adequacy and reporting requirements have been designed to provide greater stability in the event of future economic shocks.

Further amendments to regulations issued by the Minister of Finance in November 2000 provide, among other things, for increased transparency in banks' business activities, increased limits on foreign currency exposures, separate reporting of derivative instruments, and prudential requirements to be based on average daily balances rather than month-end positions. Enhanced monitoring of the financial system by the Bank Supervision Department of the South African Reserve Bank and the Financial Services Board and adjustments to prudential regulations will continue to lower risks from credit portfolios and market risks.

*Bond yields reflect benign inflation expectations and high returns*

The nominal yield on South Africa's sovereign debt indicates that future inflation and interest rate expectations remain benign with demand for bonds rising. High prices in the bond market in 2000 contributed to South Africa's comparatively good showing in bond returns relative to the rest of the world.

## Macroeconomic forecasts and risks

### International outlook

*Slower growth in the global economy*

Global economic growth appears to have peaked in the first half of 2000. A number of indicators point towards slower world growth in 2001, including high crude oil prices in the final quarter of last year, weakening in many equity markets, and lower industrial production.

*Deceleration in US means fewer exports for the rest of the world*

The extent of the slowdown in world growth depends in part on the reaction of the US economy to the interest rate cuts in early January and February. A decelerating US economy will pull fewer imports in from the rest of the world. At this time, OECD-wide output growth is expected to slow to 2,8 per cent in 2001, but improve to 3 percent in 2002.

*Hard-landing in the US unlikely*

The probability of a hard-landing in the US economy has been reduced by the US Federal Reserve's cuts in the benchmark US interest rate to 5,5 per cent.

*Downward revisions to European growth estimates*

The US is the European Union's second largest trading partner and growth cycles are reasonably correlated. Hence slower growth in the US is expected to reduce projected growth rates for Europe from about 3,5 to 2,8 per cent for 2001.

*Euro and dollar volatility a risk*

With large current account imbalances in the US and the prospect of weakening growth in Europe, the possibility of continuing euro and dollar volatility remains a risk.

*US interest rate cut positive for emerging markets*

The easing of monetary policy in the US should provide a boost to emerging markets. Lower US interest rates reduce the pressure on emerging economies to raise their own rates to maintain capital inflows and should ensure that the US remains a strong source of demand for emerging market exports.

### Commodity prices

*Oil prices expected to stabilise*

Despite increases in OPEC production since the beginning of 2000, oil prices remained high for most of the year. Crude oil is expected to trade in a range of US$22 to 28 in the medium term as prices decline from the increase in January of this year.

*Non-oil commodity prices affected by global cycle*

Although industrial raw material prices have generally recovered since the East Asian crisis, the non-oil commodity price response to improved global demand conditions was below expectations. Sustained growth in industrial production, while slowing in 2001, should be sufficient to underpin moderate increases in commodity prices over the medium term.

*Gold to remain weak but platinum strong*

Gold is expected to strengthen somewhat and trade in a $270 to 300 range during the forecast period. Due to supply constraints in Russia, the platinum price is expected to remain high.

### Domestic economic outlook

*Economy continues strong expansion*

GDP is expected to maintain its upward trend with growth rates of 3,5 and 3,7 per cent forecast for 2001 and 2002 respectively.

More rapid growth will be supported by several factors:

- Stronger growth on the demand side as domestic confidence improves.
- Further productivity improvements on the supply side.
- Real growth in government spending.

*Stronger household spending*

Final consumption expenditure by households is expected to grow by 3,5 per cent in 2001, as a result of increases in real purchasing power due to higher wages, lower petrol prices, further tax cuts, and continued low interest rates.

*Improving business confidence*

Business confidence and hence fixed capital formation are expected to continue strengthening following the lows reached in 2000.

*Positive long-term capital flows*

South Africa has received investment grade ratings, which should ensure sustained capital inflows.

*Private and public investment to grow*

Private sector and public corporations' investment is expected to continue its recent good performance. Growth in gross fixed capital formation is expected to average 6,6 per cent from 2001 to 2003.

*Real growth in Government capital expenditure*

Real final government consumption expenditure is planned to rise by about 2,5 per cent a year in real terms over the next three years. Government's capital expenditure is projected to rise by about 5 per cent a year in real terms.

*More competitive rand…*

The real depreciation in the value of the rand against the dollar coupled with a relatively strong global economic environment after 2001 is likely to provide a further impetus to stronger export growth over the longer term.

*expected to improve export growth*

In the short and medium run, export volumes are expected to rise by more than 5 per cent this year and to average about 6,4 per cent a year over the period 2001 to 2003 as global demand improves.

*Higher imports…*

Merchandise import volumes have increased in 2000 as domestic demand recovered. This trend is expected to continue as domestic economic activity gains momentum and the demand for imported goods accelerates.

*… and moderate current account deficit*

The current account deficit has been revised downwards to about 0,1 per cent of GDP for 2000. Although the deficit on the current account is expected to increase again as demand picks up, it is not expected to rise above 1,3 per cent of GDP.

*CPIX decline in line with inflation targets*

CPIX inflation peaked at 8,1 per cent in October. Lower oil prices should contribute to further downward movements over the next year. Consequently, CPIX inflation is expected to decline to 6,6 per cent in 2001, 5,3 per cent in 2002, and to 4,7 per cent in 2003.

## Potential risks to the forecast

Key factors that could impact negatively on the forecast are:

- Hard-landing in the US economy
- Renewed cutbacks in oil production and decline in business confidence

*Policy delivery key to better growth performance*

South Africa's economic growth is expected to be robust over the next few years. The probability of more rapid growth is strong, however, as key policy initiatives have a greater potential to drive growth than is currently projected. Increases in government spending and progress in important areas of infrastructure provision may provide a boost to demand and expectations. Key positive factors that may affect the forecast are:

- Lower crude oil prices
- Lower inflation

- Higher fixed investment levels both in the private and public sectors underpinned by restructuring of state-owned assets and public corporations
- Greater stability in the real exchange rate at the current competitive level.

**Table 2.5 Macroeconomic indicators: 1997 to 2003**

| Calendar year | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 |
|---|---|---|---|---|---|---|---|
| ***Real growth in demand:*** | | | | | | | |
| Final household consumption | 2,7% | 1,3% | 1,1% | 3,2% | 3,5% | 3,5% | 3,1% |
| Final government consumption | 4,5% | -0,5% | -1,9% | -2,2% | 2,5% | 2,7% | 2,5% |
| Gross fixed capital formation | 5,2% | 5,8% | -6,0% | 1,7% | 6,0% | 7,2% | 6,6% |
| Gross domestic expenditure | 2,4% | 0,4% | -0,2% | 2,7% | 4,1% | 3,8% | 3,3% |
| Exports | 5,5% | 2,2% | 1,3% | 7,3% | 5,2% | 7,1% | 6,8% |
| Imports | 5,4% | 1,2% | -7,4% | 6,4% | 8,2% | 7,7% | 7,4% |
| **Real GDP growth** | **2,5%** | **0,7%** | **1,9%** | **3,0%** | **3,5%** | **3,7%** | **3,3%** |
| GDP inflation | 7,9% | 6,8% | 6,2% | 6,8% | 6,5% | 4,9% | 4,5% |
| **Gross domestic product at current prices (R billion)** | **683,7** | **735,1** | **795,6** | **875,9** | **965,2** | **1 050,2** | **1 133,8** |
| ***CPI inflation:*** | | | | | | | |
| Headline | 8,6% | 6,9% | 5,2% | 5,3% | 6,1% | 4,9% | 4,6% |
| CPIX (Metropolitan and urban areas) | - | 7,1% | 6,9% | 7,7% | 6,6% | 5,3% | 4,7% |
| ***Balance of payments:*** | | | | | | | |
| Current account balance (% of GDP) | -1,5% | -1,8% | -0,4% | -0,1% | -1,1% | -1,3% | -1,1% |

**Table 2.6 Macroeconomic projections: 1999/00 to 2003/04**

| Fiscal year | 1999/00 | 2000/01 | | 2001/02 | | 2002/03 | | 2003/04 |
|---|---|---|---|---|---|---|---|---|
| | Outcome | 2000 Budget | Revised | 2000 Budget | Revised | 2000 Budget | Revised | |
| **Gross domestic product (R bill)** | **811,9** | **885,2** | **897,9** | **958,2** | **987,2** | **1 036,7** | **1069,3** | **1154,9** |
| Real GDP growth | 2,3 | 3,6 | 3,1 | 3,2 | 3,7 | 3,3 | 3,5 | 3,3 |
| GDP inflation | 6,0 | 5,5 | 7,3 | 4,9 | 6,0 | 4,8 | 4,7 | 4,6 |
| *CPI inflation:* | | | | | | | | |
| Headline | 3,8 | 5,5 | 6,4 | 5,2 | 5,6 | 4,7 | 4,8 | 4,5 |
| CPIX | 6,9 | 6,6 | 7,7 | 5,3 | 6,2 | 4,5 | 5,2 | 4,6 |

**Further steps in exchange control liberalisation**

Government remains committed to a gradual approach to exchange control liberalisation.

The past few years have seen a rapid rise in the level of portfolio diversification by South African financial institutions on behalf of private individuals. The foreign asset holdings of the major financial institutions are reaching levels in line with appropriate prudential limits. With this in mind, the limits on the foreign asset holdings of institutional investors are to be retained as part of a broader shift to prudential regulation. These foreign asset limits are 15 per cent of total assets for long term insurers, pension funds and fund managers, and 20 per cent of total assets for unit trusts.

The institutional asset swap mechanism has served a useful purpose in the past in facilitating a fairly rapid portfolio rebalancing after many years of exclusion from foreign investment. However, it suffers from a lack of transparency and is no longer appropriate in the context of normalised diversification levels. The asset swap mechanism pertaining to institutions is to be terminated. Institutions will continue to be able to invest in foreign portfolio assets, up to the defined foreign asset limits through cash transfers based on a prescribed percentage of the previous year's net inflow of funds.

The global expansion of South African firms holds significant benefits for the economy – expanded market access, increased exports and improved competitiveness. In order to support this expansion from a South African base, the limits on the use of South African funds for new approved foreign direct investment is increased from R50 million to R500 million. As part of Government's commitment to African economic recovery, South African firms will be permitted to utilise up to R750 million of local cash holdings for new approved foreign direct investment in Africa. In addition, firms will continue to be able to use local cash holdings to finance up to 10 per cent of the remaining investment outlay.