

QUARTERLY ECONOMIC REVIEW

SUMMARY AND CONCLUSIONS

- (1) The current expansion phase of the business cycle in South Africa has now entered its fourth year and, although the rate of increase of certain economic indicators has tended to decline during recent months, present indications are that the upswing will continue.
- (2) Fixed capital outlays in both the public and private sectors continued to rise during the second quarter of 1964, while inventory investment remained at a relatively high level. Current Government expenditure and private consumption likewise increased further, although the rate of increase of the latter tended to decline. Merchandise exports decreased somewhat, but gold production increased moderately.
- (3) As a result of the further expansion of both capital and consumer outlays, imports continued to rise during the period April to August, 1964. During the second quarter, the current account of the balance of payments still showed a small surplus, but this was transformed into a fairly substantial deficit during July and August. Since there was also a net outflow of capital during the period April to August, the total gold and foreign exchange reserves held by the Reserve Bank, the commercial banks and the Government declined from R567 million at the end of March, 1964 to R503 million at the end of August.
- (4) Largely as a result of a substantial further rise in commercial and other bank credit, the liquidity of the private sector, as measured by the seasonally adjusted ratio of money and near-money to gross national product, continued to increase during the months April to July, notwithstanding the deficit in the overall balance of payments.

During August, however, it declined. Moreover, in the prevailing circumstances, the increase in bank credit brought about a significant reduction in the liquidity ratios of banking institutions and, therefore, in their ability to create further money and near-money. For these and various other reasons, short-term interest rates moved upwards during the period under review.

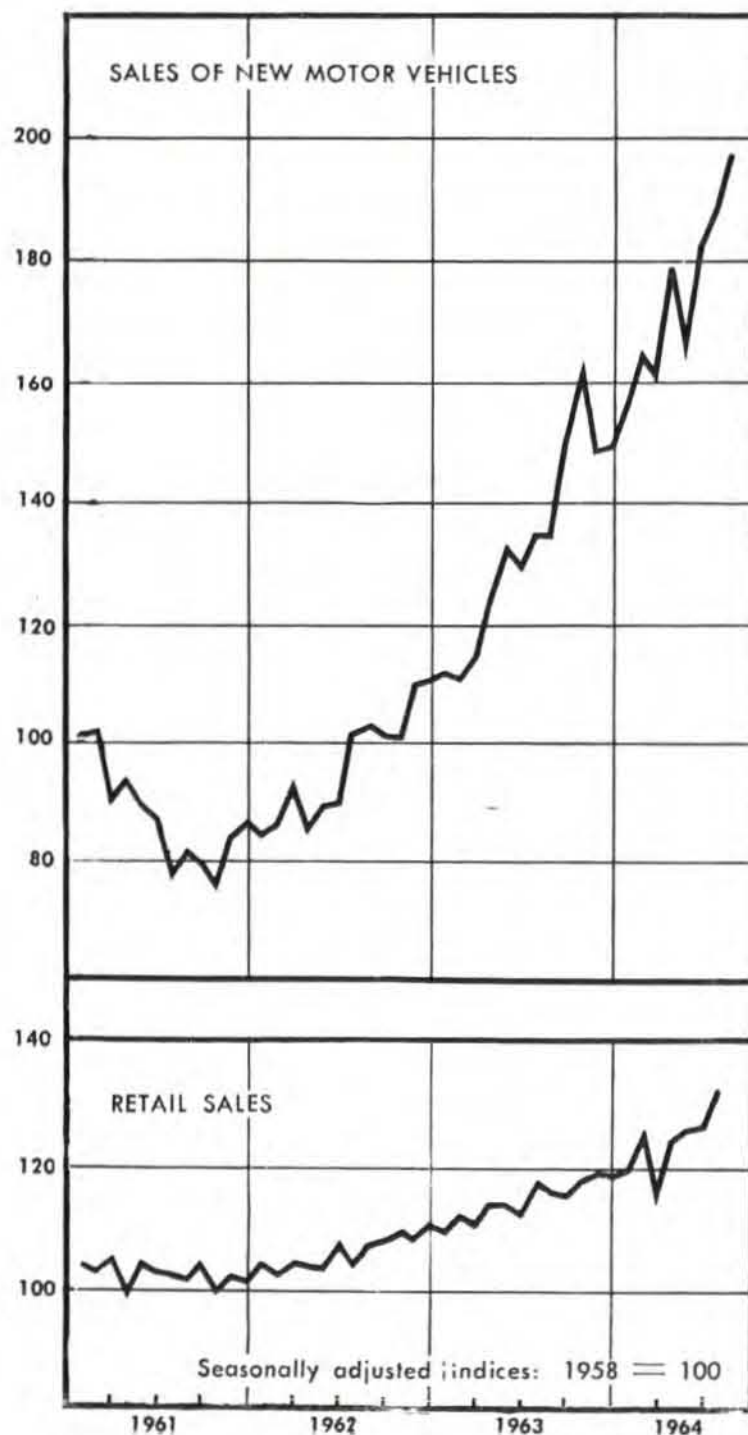
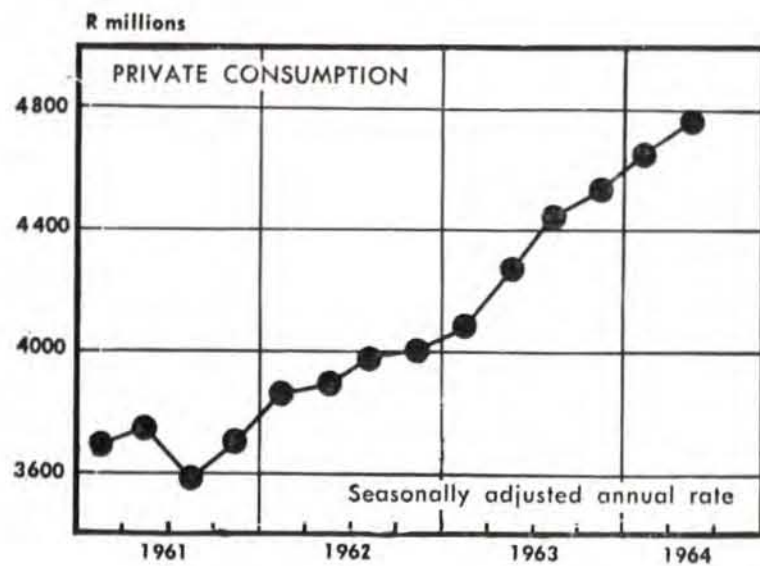
- (5) Important changes occurred in the capital market during the period April to August. The continued economic upswing, coupled with the deficit in the balance of payments, helped to bring about a more normal relationship between supply and demand in the markets for medium and long-term loanable funds, while stock exchange turnover and security prices declined noticeably.
- (6) Although the South African economy is still combining rapid growth with a substantial degree of stability, there have during recent months been some signs of total demand pressing unduly upon available resources and of excessive credit creation for certain purposes, such as purchases of motor cars. At the same time, however, important new stabilising forces of a self-regulating nature have come into operation, particularly in the money and capital markets, where conditions have become somewhat tighter, credit less readily available and interest rates higher.

NATIONAL ACCOUNTS¹

Gross National Product

During the second quarter of 1964 the real gross national product increased at more or less the same rate as during the first quarter, namely 6 to 7 per cent.

¹ The analysis in this section of the review is largely based on the Reserve Bank's quarterly estimates of the national accounts, after adjustment for seasonal tendencies. Since these quarterly figures are not yet judged reliable enough for publication, the analysis is confined to pointing out broad tendencies.



Expenditure Tendencies

Capital outlays on plant, equipment and construction showed a significant further upward movement in both the private and public sectors and again constituted a major expansionary factor. In addition, inventory investment remained substantial, mainly as a result of a further accumulation of commercial and manufacturing stocks. At the same time, the current outlays of the Government and other public authorities continued to rise. Partly as a result of the additional income generated by these forms of expenditure, consumer spending also increased further. But while sales of new motor vehicles continued to rise sharply, the rate of increase of private consumption as a whole was noticeably lower than that of a year earlier.

Merchandise exports declined slightly, but gold production increased moderately during the second quarter, so that, despite a continued rise in imports, the current account of the balance of payments did not deteriorate further during this period and still showed a small surplus. During July and August, however, as imports continued to increase, a fairly substantial current deficit emerged, as will be set out in greater detail later on.

Saving

Gross domestic saving would appear to have risen moderately during the second quarter. This was mainly attributable to some recovery in personal saving, following its substantial decline during 1963 and the first quarter of 1964.

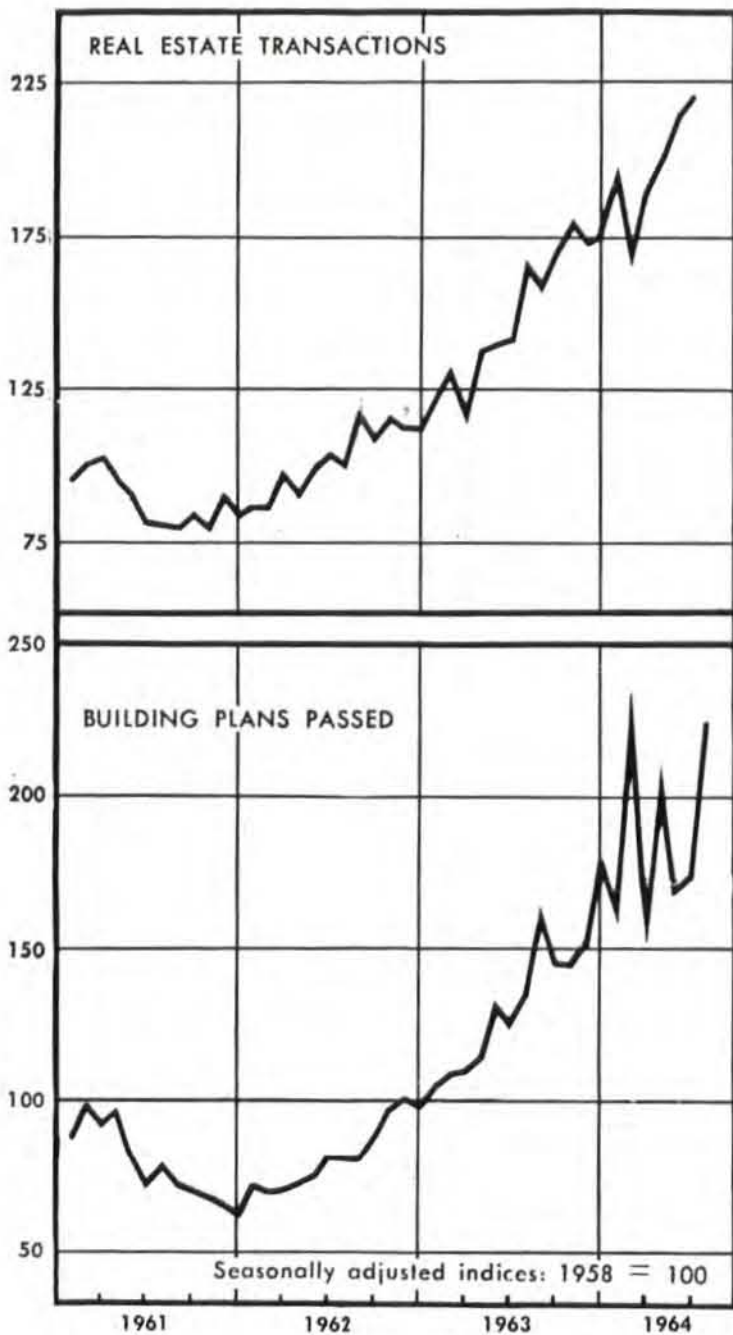
PRODUCTION AND EMPLOYMENT

Despite the state of virtually full employment prevailing in the economy, the seasonally adjusted index of the physical volume of manufacturing output continued to rise and was, on average, about $7\frac{1}{2}$ per cent higher during the second quarter of 1964 than during the first quarter. The branches of secondary industry responsible for the largest contributions to this increase were those producing chemicals and chemical products, clothing and footwear, metal products and textiles.

In the prevailing circumstances, the seasonally adjusted index of registered unemployment, which had previously already reached a very low level, declined even further. At the end of July, 1964 the number of registered unemployed Whites, Coloureds and Asiatics stood at the low figure of 14,773.

BUILDING AND REAL ESTATE

As the accompanying graphs indicate, the index of the value of building plans passed showed a tendency to level off during the second quarter of 1964, but real estate transactions increased sharply to a new record level.



PRICES

With both capital outlays and consumption rising under conditions of virtually full employment, there was some evidence during June and July of total demand beginning to press unduly upon available resources. The consumer price index (1958 = 100) increased from 108.2 in May, 1964, to 109.8 in August, mainly owing to a rise in food prices. In addition, the wholesale price index moved upward from 106.3 in May to 108.1 in August, largely reflecting a rise in the prices of South African as opposed to imported goods. Although these increases occurred mainly in forestry, mining and agriculture, the wholesale prices of certain manufactured goods, such as food, machinery, wood products and basic metals, also increased noticeably. In general, these various price increases would appear to have been more than seasonal.



BALANCE OF PAYMENTS

Current Account

The main feature of the current account of the balance of payments during the period April to August, 1964, was the continued rise in imports brought about by the further expansion of internal economic activity. During the second quarter, this increase was more than offset by an upward movement in the total of gold output and merchandise exports, so that



the current account showed a small surplus of R1 million for this period, compared with a deficit of R7 million during the first quarter. But preliminary indications suggest that a fairly substantial current deficit was recorded during July and August.

If seasonal movements are excluded, there were still small current surpluses during the first and second quarters of 1964, but during July and August a distinct deficit would appear to have emerged.

Balance of Payments on Current Account (R millions)

	1963				1964	
	1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	1st Qtr.	2nd Qtr.
Actual Surplus (+) or Deficit (-)	26	37	43	42	-7	1
Seasonally Adjusted Annual Rate	160	168	196	76	12	30

Private Capital Movements

The net outflow of private capital (including errors and omissions in the balance of payments estimates) declined from R38 million during the first quarter of 1964 to R23 million during the second quarter. The main reasons for this were (1) a smaller outflow of short-term capital in the form of trade and other credits and (2) a decline in the net sales of South African securities by foreigners to South African residents from R25 million in the first quarter to R12 million during the second quarter. The latter decline, in turn, was mainly attributable to a gradual reduction in the allocations of foreign exchange under the "arbitrage" scheme of exchange control relaxation.

Preliminary indications suggest that a substantial further decline in the net outflow of private capital occurred during July and August. In view *inter alia* of the emergence of a deficit on the current account of the balance of payments, allocations under the "arbitrage" scheme were cut off altogether after the first week of August.

Official and Banking Capital Movements

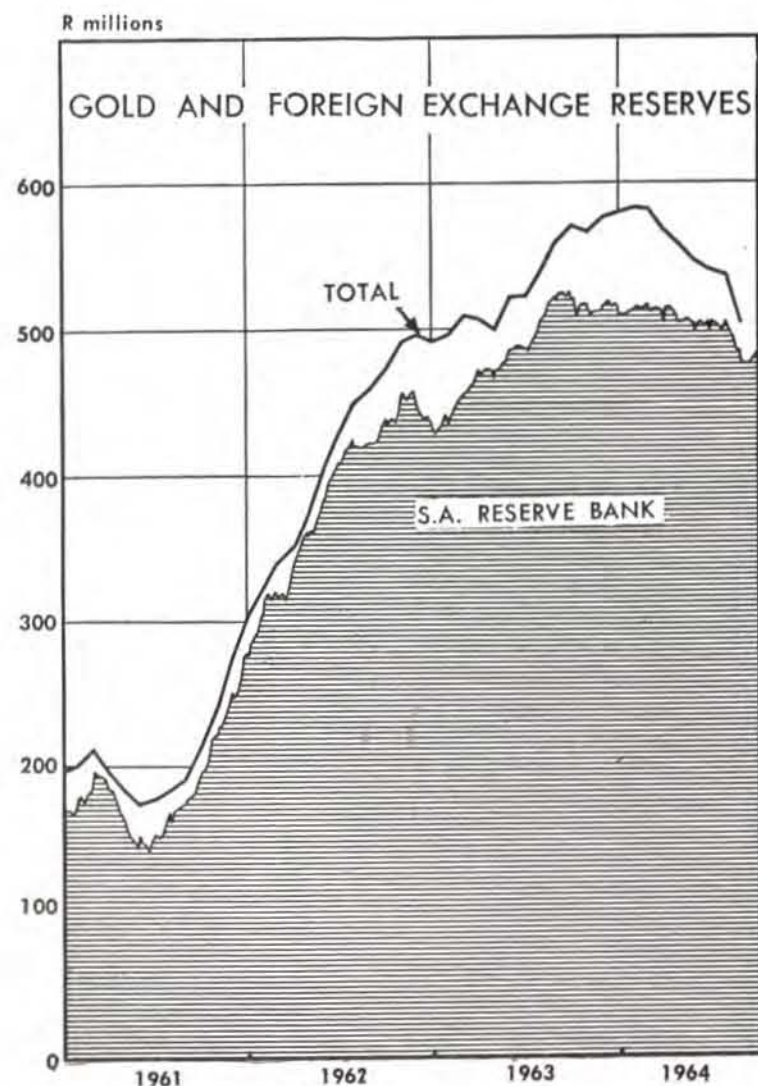
As against a net inflow of R34 million during the first quarter, official and banking capital registered a net outflow of R5 million during the second quarter, mainly owing to repayments of official loans. No special Blocked Rand Bonds were issued by the Government to foreigners during this period. The first and

second issues of the new five-year Non-Resident Bonds on a tender basis were made during August and September, respectively, and in both cases the Treasury subsequently announced that only tenders of 95 per cent and higher had been accepted.

Gold and Foreign Exchange Reserves

As a result of the various changes in the balance of payments referred to above, the total gold and foreign exchange reserves held by the Reserve Bank, the commercial banks and the Government continued to decline and at the end of August amounted to R503 million, compared with the month-end peak of R583 million attained in January. Of the decline of R80 million between January and August, R33 million occurred during August, when as mentioned earlier, the current account showed a fairly substantial deficit. During September, however, the reserves increased moderately again.

As the total reserves declined, the amounts held abroad by the commercial banks under special "swop" arrangements with the Reserve Bank were utilised first, and by the end of August only R7 million of these funds remained. The Treasury's holdings of foreign currency were also reduced and amounted to only R5 million at the end of August.



MONETARY AND BANKING SITUATION

Money and Near-Money

Despite the overall balance of payments deficit and the decline in the gold and foreign exchange reserves, the private sector as a whole remained in an exceptionally liquid state during the months April to July, 1964. Indeed, the seasonally adjusted ratio of money and near-money to gross national product increased further during this period to the high level of over 35 per cent. The main reason for this was a substantial further rise in bank credit, which was, no doubt, associated with the continuing upward movement in investment, consumption, imports and economic activity generally, and which more than offset the tightening effect of the balance of payments deficit. During August, however, as the balance of payments deficit increased, the ratio of money and near-money to gross national product declined somewhat.

Commercial Banks

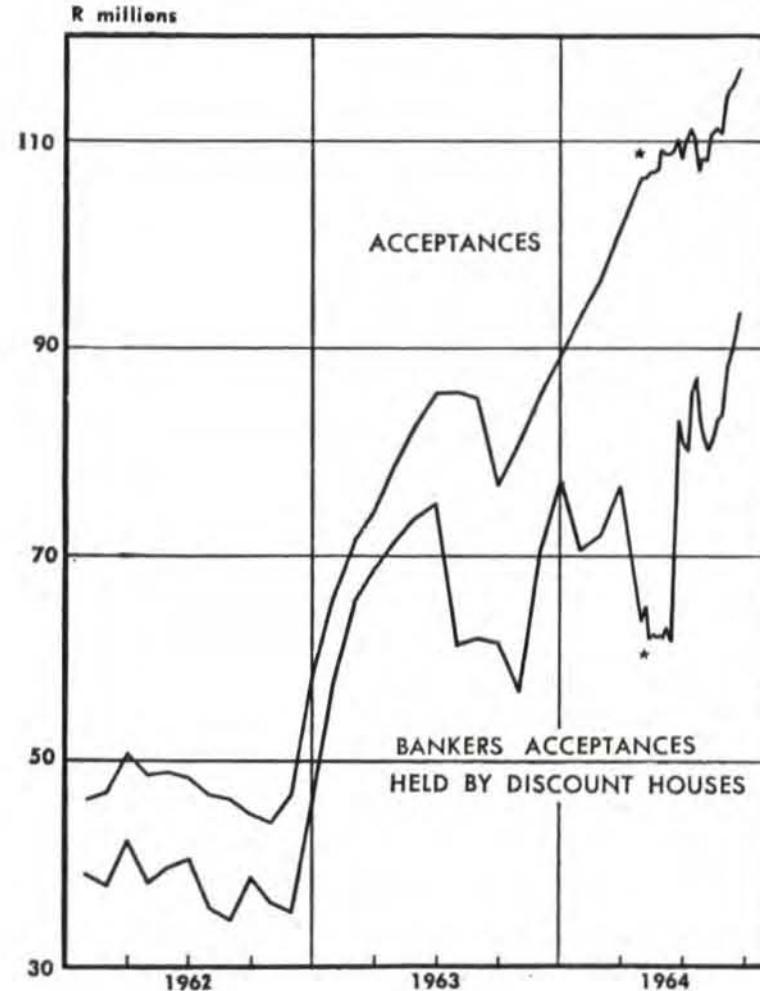
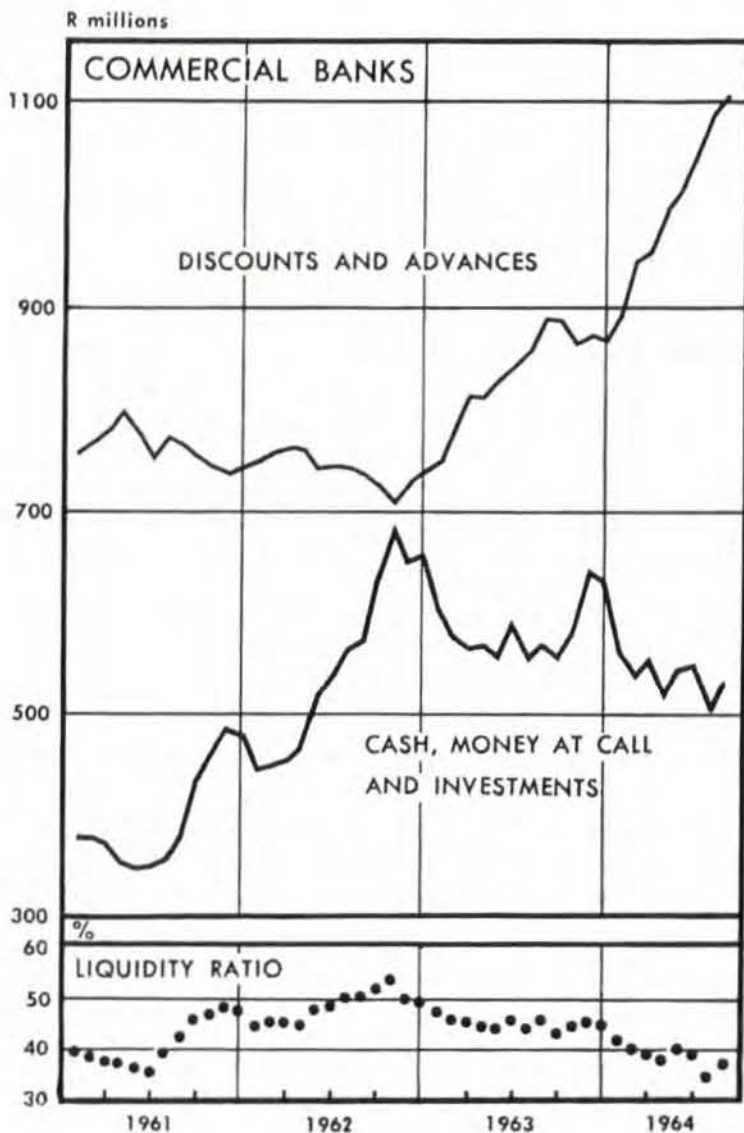
In sharp contrast to the increase in the liquidity of the private sector, the average liquidity ratio of the commercial banks, which had already declined from 44.4 per cent at the

end of December, 1963, to 39.3 per cent at the end of March, 1964, decreased further to 35.1 per cent at the end of July, before recovering to 37.4 per cent at the end of August. The July ratio was the lowest registered since the Banking Act of 1942 came into operation.

This decline in the liquidity of the banks was largely the joint result of a slight further downward tendency in their cash, money at call and investments (mainly owing to the deficit in the overall balance of payments), and a substantial further rise in their discounts and advances to a figure which at the end of August was 28 per cent higher than that registered at the end of 1963.

Merchant Banks

The increase in commercial bank credit was accompanied by a further rise in acceptance facilities extended to the private sector by merchant banks. Thus, compared with R89 million at the end of December, 1963, and R102 million at the end of March, 1964, merchant bank acceptances amounted to R114 million at the end of August, 1964.



* Weekly figures from the 1st May, 1964.

National Finance Corporation and Discount Houses

Total call money held with the National Finance Corporation and the discount houses continued to fluctuate round a more or less horizontal trend during the period April to July and amounted to R289 million at the end of the latter month, compared with R295 million at the end of 1963. During August, however, it declined by R29 million to a figure of R260 million. Of this total, R51 million represented funds of the Government and the Public Debt Commissioners, compared with R65 million at the end of March, 1964.

In June, the discount houses added substantially to their holdings of bankers' acceptances, resulting in an approximate 3 to 1 ratio of acceptances to Treasury bills and approximate equality of their investments in acceptances, on the one hand, and their holdings of Treasury bills and short-term Government stocks on the other. These relationships were more or less maintained during July and August.

South African Reserve Bank

The changes in the general monetary and banking situation referred to above were not without their effect on the Reserve Bank's activities. Thus, although the Bank's discounts, advances and investments remained at a relatively low level during the months April to August, they did show a tendency to rise during the latter part of this period and at the end of August amounted to R133 million, compared with a low point of R60 million at the end of May. As the Bank's gold and foreign exchange holdings decreased during this period, its legal gold reserve ratio declined from 90.5 per cent at the end of May to 78.2 per cent at the end of August, the lowest month-end level in about one and a half years.

Short-term Interest Rates

After showing little change during April and May of this year, the Treasury bill rate increased from 2.67 per cent on the 29th May to a temporary peak of 3.20 per cent on the 7th August, which was the highest rate attained since April, 1962. Thereafter it declined to 3.10 per cent on the 28th August, before rising again to 3.13 per cent on the 25th September. Similar movements were shown by related money market interest rates.

The increase in the Treasury bill rate from the end of May to the first week in August may be attributed largely to the following factors, some of which operated only at certain stages during this period:

- (1) An increase in Government deposits with the Reserve Bank during June and the first half of July;
- (2) an increase in the discount houses' holdings of bankers' acceptances relative to Treasury bills;
- (3) an increase during May and June in the total supply of Treasury bills in the market;
- (4) a change in the Reserve Bank's discounting procedure from the 21st May onwards, which involved the application of Bank rate to discounts of Treasury bills and advances against the security of these bills, instead of a (lower) rate equal to $\frac{1}{2}$ per cent above the current average tender rate, as had been the practice for some time previously; and
- (5) an increase in Bank rate from $3\frac{1}{2}$ to 4 per cent from the 15th July.

The temporary decline in the Treasury bill rate after the 7th August would appear to have been related *inter alia* to a levelling off in the discount houses' holdings of bankers' acceptances, a decline in the amount of Treasury bills outstanding and a strong demand for Treasury bills on the part of certain individual tenderers.

CAPITAL MARKET

The various short-term economic tendencies discussed earlier helped to bring about significant changes in capital market conditions during the period April to August, 1964. On the one hand, the substantial rise in fixed capital outlays was accompanied by a sharp increase in the demand for capital, as indicated, for example, by the fact that new issues of securities by public corporations, local authorities and the private sector amounted to R112 million during the second quarter and R55 million during July and August, compared with an average of R51 million during the preceding five quarters. On the other hand, as a result of the internal expansion and the

accompanying deterioration in the balance of payments, the "spilling-over" of liquidity into equities and medium and long-term debt instruments tended to cease. The result was that the relationship between supply and demand in the capital market became more normal.

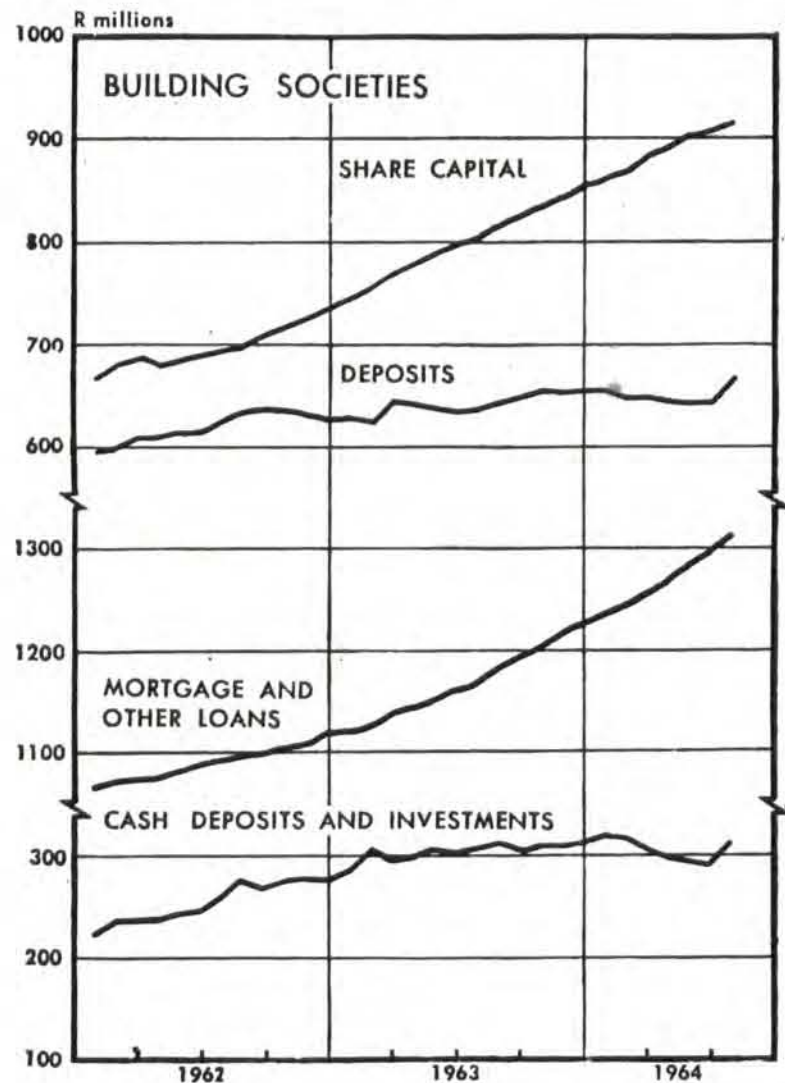
Share Prices and Yields

On the Stock Exchange, these developments were reflected in a reversal of the upward tendency in turnover and in certain share prices. The index of gold mining share prices (1953 = 100), for example, declined to 113 in August, compared with 123 in March, the highest figure recorded in 1964, while the index of industrial and commercial share prices decreased to 244 in July after a peak of 267 had been reached in April, 1964. The average yield on gold mining shares in August exceeded 7 per cent for the first time since May, 1961, while the average yield on industrial and commercial shares, which had declined to less than 4 per cent in April, increased to nearly 5 per cent in June.

Gilt-edged Market

In the gilt-edged market, the Reserve Bank was called upon to buy a modest amount of Government securities during the second quarter and such purchases were at times effected at rates exceeding the Bank's normal "pattern" by as much as 0.20 per cent. During July and August, however, the Bank did not buy or sell Government stock to any notable extent and such transactions as there were, were concluded at normal "pattern" rates.

There was further a definite tendency during the period under review for the margin between rates on Government stock and those on municipal and public utility securities to widen. One reason for this was the exclusion of the latter from the new definition of liquid assets as embodied in the amending legislation for banking institutions and building societies passed by Parliament in June. Another important contributory factor was the strong incentive which the building societies had at that stage to sell some of their municipal and public utility securities (of which they held considerably more than the legally required amount) in order to meet the increased demand for their mortgage loans.



Building Societies

Following the increase in their deposit and lending rates towards the end of June, 1964, building societies experienced an inflow of new funds of as much as R31 million during July, of which R24 million took the form of deposits and only R7 million represented share capital. As a result of this substantial increase in their resources, the societies were again able to meet all reasonable demands for mortgage loans.

Insurance Organisations

The changes in capital market conditions during the second quarter naturally also influenced the investment policy of insurance organisations. Thus, these organisations' net investment in ordinary shares (excluding investments in subsidiary companies) amounted to R9 million during the second quarter, compared with virtually nothing during the first quarter, when share prices were at a peak and yields exceptionally low for South African conditions.

Indices — Excluding Seasonal Changes (1958 = 100)

	1963				1964			
	1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	1st Qtr.	2nd Qtr.	Jul.	Aug.
Bank Debts	166	169	187	201	204	212	219	....
Discounts and Advances of Commercial Banks	117	123	132	135	139	152	163	166
Stock Exchange Turnover	253	257	295	255	408	396	260	257
Manufacturing Output (1956/7 = 100)	137	144	151	154	157	169	....	....
Value of Gold Production	166	168	170	172	174	176	181	....
Value of Imports	107	112	115	125	128	133	142	144
Value of Exports	122	122	129	132	135	131	128	111
Railway Earnings	132	137	139	141	150	149	....	....
Value of Retail Sales	111	113	116	119	120	126	132	....
Value of Property Transactions	123	140	164	175	184	213	....	....
Value of Building Plans Passed	108	124	147	160	182	183	224	....
Employment:								
Private Manufacturing	104	106	109	111	....	....	....	....
Private Construction	93	100	106	108	....	....	....	....
Mining	110	108	108	108	110	112	112	....
Unemployment	117	111	100	94	98	81	74	....