QUARTERLY ECONOMIC REVIEW

SUMMARY AND CONCLUSIONS

(1) The upswing in general economic activity in South Africa which began about three years ago continued throughout the first four months of 1964. Income and production increased substantially, while most other economic indicators revealed definite further upward tendencies.

(2) Fixed capital outlays in both the public and private sectors continued to rise strongly, while consumer spending, which had tended to level off during the last quarter of 1963, advanced with new vigour during the first quarter of 1964. The expansionary effect of these increases was reinforced by a new upturn in Government expenditure, but merchandise exports showed little change and the gold output increased only moderately. Inventories in general continued to rise.

(3) As investment and consumption moved forward together, imports understandably increased further and during the first five months of 1964 the current account of the balance of payments showed a small deficit. If seasonal movements are excluded, however, there would still appear to have been a small current surplus. Since there was also a net outflow of capital during this period, the total gold and foreign exchange reserves held by the Reserve Bank, the commercial banks and the Government declined noticeably, namely from R578 million at the end of December, 1963, to R547 million at the end of May, 1964.

(4) Despite the decline in the reserves, the quantity of money and near-money in the hands of the private sector not only increased further during the first five months of 1964 but, after allowing for seasonal influences, more or less kept pace with the rapidly rising gross national product. The main reason for this was a substantial increase in credit extended to the private sector by commercial banks and other liquidity-creating banking institutions. In the prevailing conditions, however, this process of credit expansion brought about a considerable decline in the liquidity ratios of most of these institutions. Although continuing to be affected by shifts of tax and other funds to and from the Government, money market conditions in general tended to tighten somewhat and short-term rates moved up gradually.

(5) In the capital market, the balance between the demand for and supply of scrip improved considerably as the tempo of new issues increased at a time when the "spilling over" of liquidity into medium and long-term securities of various kinds was showing signs of drying up. From about April, stock exçhange activity slowed down noticeably and yields on most shares either ceased to decline or actually began to rise, while moderate upward pressure on interest rates became noticeable in the gilt-edged and mortgage markets.

(6) In general, the South African economy still appears to be combining growth with stability. Despite the existence of virtually full employment and even bottlenecks, the further increase in the various components of domestic spending has not yet given rise to any overall demand inflation. The Reserve Bank has, however, recently come to feel some concern at the extent to which the various classes of banking institutions have been creating credit for such purposes as consumption and speculation in shares and real estate. For this reason the Bank has allowed interest rates to rise gradually in response to the operation of the natural forces described earlier, while the emphasis in monetary policy in general has tended to shift slightly in the direction of greater caution.

NATIONAL ACCOUNTS[1]

Gross National Product

During the first quarter of 1964 the real gross national product increased at an annual rate which, although lower than the abnormally high tempo attained during the second and third quarters of 1963 (when considerable slack still existed in the economy), was still in the vicinity of 6 - 7 per cent.

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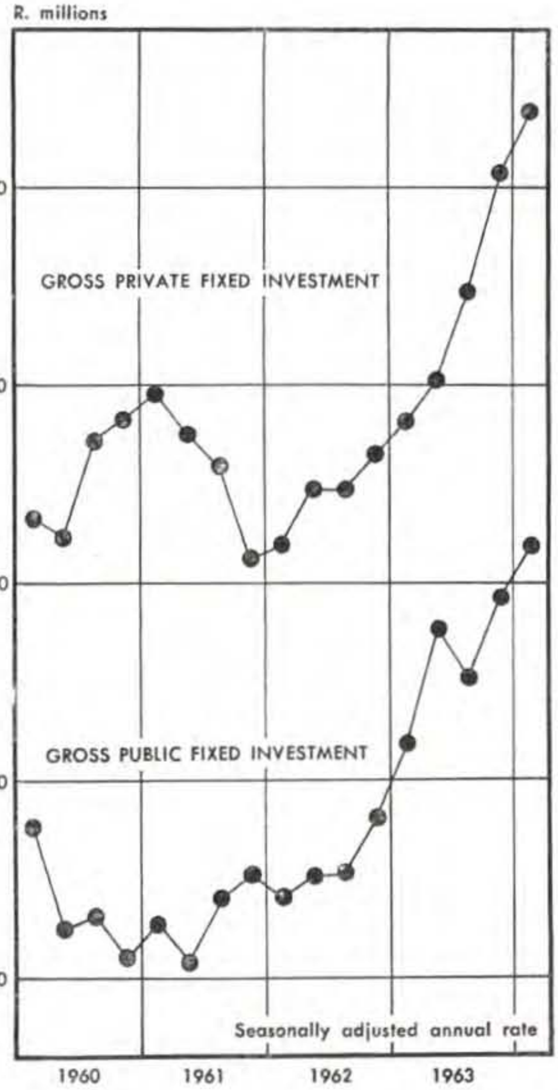
1 The analysis in this section of the review is largely based on the Reserve Bank's quarterly estimates of the national accounts, after adjustment for seasonal tendencies. Since these quarterly figures are not yet judged reliable enough for publication, the analysis is confined to pointing out broad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

Expenditure Tendencies

The main reason for the further rise in the gross national product would appear to have been a continuation of the sharp upward movement in both public and private fixed capital outlays which had become evident from about the middle of 1963. At the same time, consumer spending, which had tended to level off during the last quarter of 1963, resumed its upward movement, particularly in the field of motor cars and other durable goods. The expansionary effect of these increases was, moreover, reinforced by a new upturn in the current expenditure of the Government. In addition, inventory investment remained substantial, mainly as a result of a further accumulation of commercial and manufacturing stocks.



Exports of merchandise goods and services, which had tended to level off from about the middle of 1963, again showed little change, while the gold production continued to rise moderately. Since the continued rise in domestic expenditure was accompanied by a substantial further increase in imports of goods and services, the current account of the balance of payments accordingly deteriorated noticeably, as will be set out in greater detail later on.

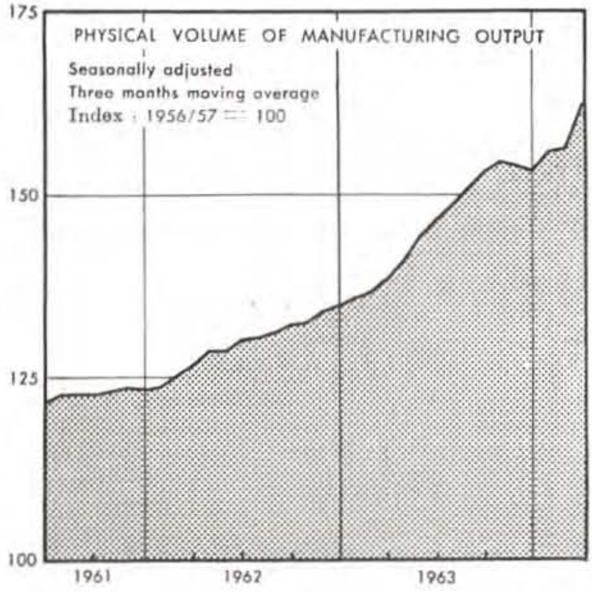
Saving

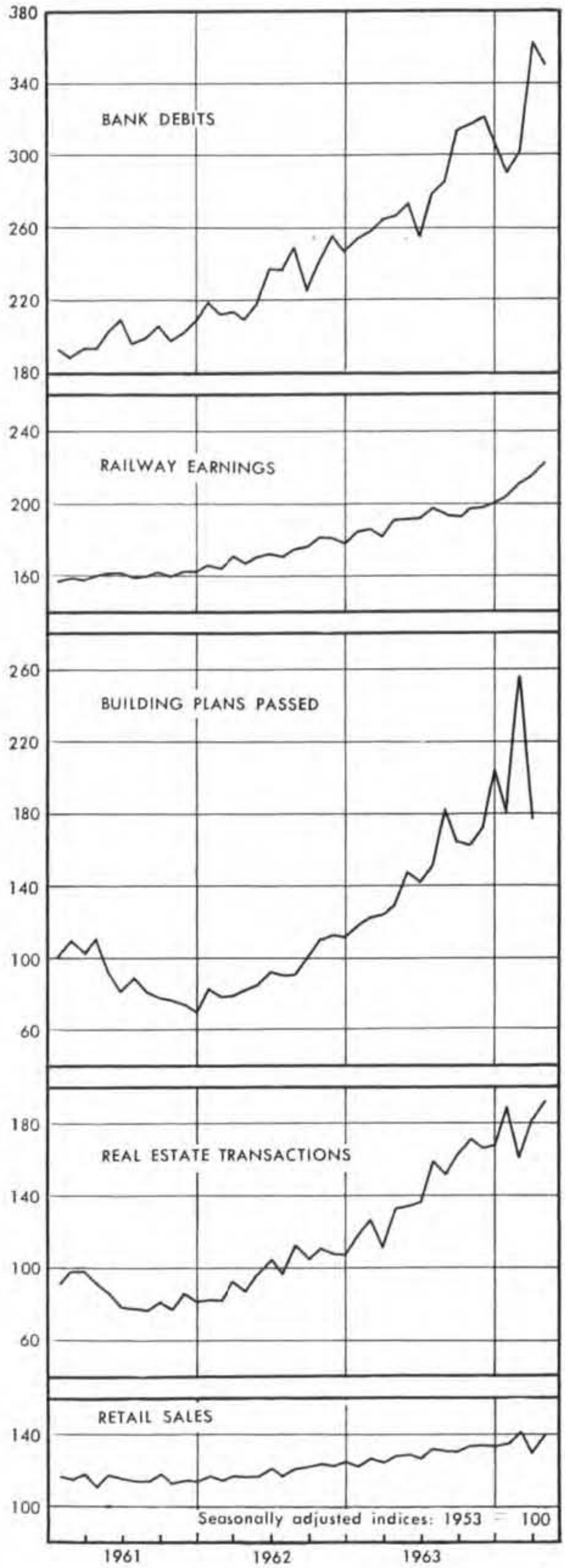
Gross domestic saving declined slightly during the first quarter. Preliminary estimates suggest that the biggest decrease occurred in personal saving, which largely represented the counterpart of the substantial increase in private consumption.

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, which had tended to level off towards the end of 1963, increased quite sharply during the first quarter of 1964. The main branches of secondary industry contributing to this new upward movement were those producing products from petroleum and coal, non-metallic mineral products and textiles.

As expected, the seasonally adjusted index of registered unemployment, which had risen slightly during January, declined again during February, March and April.





PRICES

Notwithstanding the combined rise in domestic investment and consumption, there was little evidence of total demand pressing unduly upon available resources during the first five months of 1964, and both wholesale and retail prices increased only slightly. After remaining on virtually the same level from August, 1963, to February, 1964, the consumer price index (1953=100) did increase from 123.3 in February to 124.4 in April. But this rise was mainly the result of an increase in food prices and in May the index declined slightly to 124.3.

OTHER ECONOMIC INDICATORS

As the accompanying graphs indicate, the seasonally adjusted indices for bank debits, railway earnings, building plans passed, real estate transactions and retail sales all reveal a definite further upward tendency during the first four months of 1964, although considerable fluctuations again occurred from month to month. The behaviour of these indicators confirms the impression that the South African economy remained in an expansionary phase of the business cycle during this period.

BALANCE OF PAYMENTS

Current Account

The continuing upswing in general economic activity during the first quarter of 1964 was accompanied by a substantial further rise in imports. Exports of merchandise, on the other hand, remained at more or less the relatively high level attained during the third and fourth quarters of 1963. After taking into account also the net gold output and net invisible payments to the rest of the world, the result of these changes was that the balance of payments on current account, for the first time since the last quarter of 1960, showed a deficit, namely of R7 million. If seasonal movements are excluded, however, there would still appear to have been a small current surplus.

Balance of Payments on Current Account

(*R millions*)

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

Private Capital Movements

In addition to the deterioration in the balance of payments on current account, a net outflow of private capital (including errors and omissions) of as much as R38 million occurred during the first quarter of 1964, as compared with only R14 million during the preceding quarter. This increase was mainly due to a reversal of the short-term capital inflow which had been a feature of the balance of payments during the last quarter of 1963 and which would appear to have arisen in part from trade credits extended to South African importers by foreign suppliers. It is possible that this reversal partly represented a switch from foreign to domestic financing of trade.

A second factor contributing to the large outflow was substantial further allocations under the arbitrage and permit schemes of exchange control relaxation, which helped to bring about net sales of South African securities by foreigners to South African residents of R25 million.[1]

Official and Banking Capital Movements

In contrast to the behaviour of private capital, official and banking capital registered a net inflow of R34 million during the first quarter, as compared with a net outflow of R20 million during the fourth quarter of 1963. This inflow included an amount of R12 million which was subscribed to the special Non-Resident Bonds issued by the South African Government and an inflow of capital to the commercial banks amounting to R10 million.

Gold and Foreign Exchange Reserves

The net result of the current deficit of R7 million, the net private capital outflow of R38 million and the net inflow of official and banking capital of R34 million was a decline of R11 million in the total gold and foreign exchange reserves held by the Reserve Bank, the commercial banks and the Government during the first quarter. These reserves reached a month-end peak of R583 million in January before declining to R567 million at the end of March.

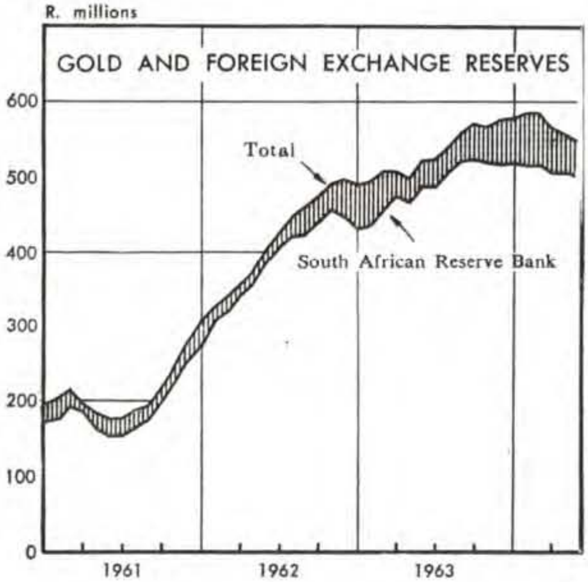
1 This figure includes an adjustment for nominee and direct transactions, while the capital movements attributable to South African investment in foreign securities listed in Johannesburg were negligible. The purchases and sales by South African residents as reported by stockbrokers and unadjusted for nominee and direct transactions have been as follows since the beginning of 1963.

(R millions)

	Purchases	Sales	Net Purchases
1963:			
1st Quarter	25.7	11.1	14.6
2nd Quarter	30.6	12.5	18.1
3rd Quarter	27.5	11.1	16.4
4th Quarter	33.0	9.5	23.5
1964:			
January	10.4	3.8	6.6
February	10.7	4.1	6.6
March	12.8	5.8	7.0
April (provisional)	9.8	4.9	4.9
May (provisional)	7.0	3.6	3.4

Developments during April and May

Although imports set a new monthly record in April before declining somewhat in May, the current account of the balance of payments did not deteriorate further during these two months, but would appear to have been more or less in balance. As a result of a net outflow of both private and public capital, however, the total gold and foreign exchange reserves declined by another R20 million to a level of R547 million at the end of May. Of this total the Reserve Bank held R502 million, the commercial banks R25 million and the Government R20 million. During June the Reserve Bank's holdings remained more or less unchanged, but preliminary indications are that the foreign exchange held by the commercial banks decreased further.



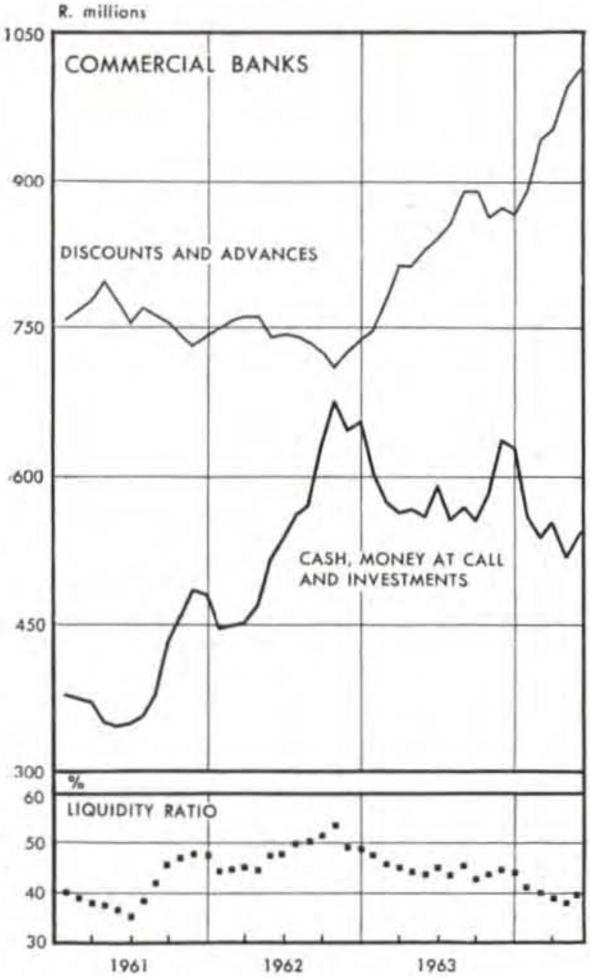
MONETARY AND BANKING SITUATION

Money and Near-money

Despite the decline in the gold and foreign exchange reserves referred to earlier, the quantity of money and near-money in the hands of the private sector increased by R95 million during the first five months of 1964. This was entirely attributable to an increase of R103 million in credit created for the private sector by the banking sector. The latter increase, in turn, largely represented increased lending by the commercial banks.

The main other factor affecting the supply of money and near-money in the private sector during this period was the behaviour of Government deposits with the banking sector. After rising substantially during January and February to a level of R287 million, these deposits declined sharply to R182 million at the end of May. This return of funds from the public to the private sector naturally helped to augment the supply of money and near-money in the hands of the latter.

As far as can be judged, it would appear that, notwithstanding the further upswing in economic activity, the seasonally adjusted ratio of money and near-money to gross national product increased slightly during the first quarter of 1964. In other words, the tightening influence which the change from surplus to deficit in the overall balance of payments must have had on the liquidity of the private sector, was more than offset by the creation of new money by the banking system.



Commercial Banks

After having shown a distinct tendency to level out during the final quarter of 1963, the commercial banks' discounts and advances increased further by R148 million or 17 per cent during the first five months of 1964. This substantial increase would appear to have been largely associated with the strong upward tendency shown during this period by investment, consumption, imports, stock exchange turnover and economic activity generally.

Although fluctuating as a result mainly of the shifts of funds to and from the public sector, the commercial banks' cash, money at call and investments tended to move downwards during this period. The inevitable result was a sharp decline in their average liquidity ratio, namely from 44.4 per cent at the end of December, 1963, to 38.1 per cent at the end of April, which was the lowest level attained since June, 1961. In May, however, this ratio increased slightly to 39.7 per cent.

Merchant Banks

Acceptance credit facilities extended to the private sector by the merchant banks, which unlike the discounts and advances of commercial banks had continued to rise during the fourth quarter of 1963, showed a substantial further increase during the first five months of 1964. In March they exceeded R100 million for the first time and at the end of May attained a value of R109 million.

Deposits with merchant banks, which had declined slightly between January and March, showed a fair rise in April and May, also for the first time passing the R100 million mark.

A further significant feature of merchant banking during the first five months of 1964 was a persistent increase in their holdings of "other bills" (mainly bankers' acceptances) to a total of R39 million at the end of May.

National Finance Corporation and Discount Houses

Total call money held with the National Finance Corporation and the discount houses fluctuated around a more or less horizontal trend during the first five months of 1964 and amounted to R290 million at the end of May, compared with R295 million at the end of 1963. From time to time, however, notable shifts occurred in the composition of this total according to the type of depositor, mainly as a result of the temporary placement of Government funds with the discount houses with a view to easing the strain caused by the movement of tax and other funds from the private to the public sector. At one stage, at the end of March, the Government had as much as R65 million on deposit with the discount houses, but this figure declined to R27 million at the end of June.

An important feature of the investing activities of discount houses during this period was a marked decline in their Treasury bill portfolio. Thus, in comparison with an approximate one to one ratio in October last year, the houses' holdings of bankers' acceptances in May, 1964, were more than double those of Treasury bills. This development would appear to have been associated with the further upswing in economic activity generally and, more particularly, with the increased acceptance facilities granted by the merchant banks.

Reserve Bank

Reserve Bank credit remained moderate throughout the first five months of 1964. Indeed, after rising to R125 million in January in response to the tightening of money market conditions resulting from the then prevailing flow of funds to the Government, the Bank's discounts, advances and investments declined to R60 million at the end of May. At the end of most months during this period, however, the Bank's credit to discount houses attained the relatively high level of about R30 million.

In sharp contrast to the commercial banks, whose average liquidity ratio, as mentioned earlier, had declined to a relatively low level by the end of May, the Reserve Bank had a legal gold reserve ratio of over 90 per cent at that stage.

CAPITAL MARKET

As in the banking sector, conditions in the capital market tightened gradually during the course of the first five months of 1964. Not only did the "spilling over" of liquidity into medium and long-term securities tend to be reversed, but the continuing rise in fixed investment brought with it a strong demand for capital, as indicated by the fact that net borrowing by the Government, local authorities and public corporations plus new capital raised by the private sector amounted to about R122 million in the first quarter of 1964, which was roughly equal to the figure for the fourth quarter of 1963 and noticeably higher than the average quarterly figure for 1963 of R97 million.

During April and May the tempo of new issues picked up still further. Preliminary figures indicate that during these two months new capital amounting to about R138 million was raised. The private sector's recourse to the capital market accounted for R63 million of this amount, compared with R31 million during the first quarter. The Government's share amounted to R49 million and, as during the first quarter, represented mainly borrowing from the Public Debt Commissioners.

In addition to the new issues referred to above, the supply of scrip was further increased during the first five months of the year by the purchases by South African residents from foreigners of securities listed on the Johannesburg Stock Exchange to the extent of R29 million.[1]

Share Prices and Yields

These factors helped to bring about a better balance between the demand for and supply of scrip in the capital market and would appear to have been partly responsible for a change of mood on the Stock Exchange from about April. Thus the index of the number of shares purchased declined substantially during April and May, while security prices stopped rising and, in general, tended to stabilise. The prices of gold mining shares, which had risen again during the first quarter, actually declined somewhat during April and May and the average yield on these shares rose to above $6\frac{1}{2}$ per cent. The strong upward movement in industrial and commercial share prices likewise came to an end during April, at which stage the average yield on these shares had already declined below the 4 per cent level.

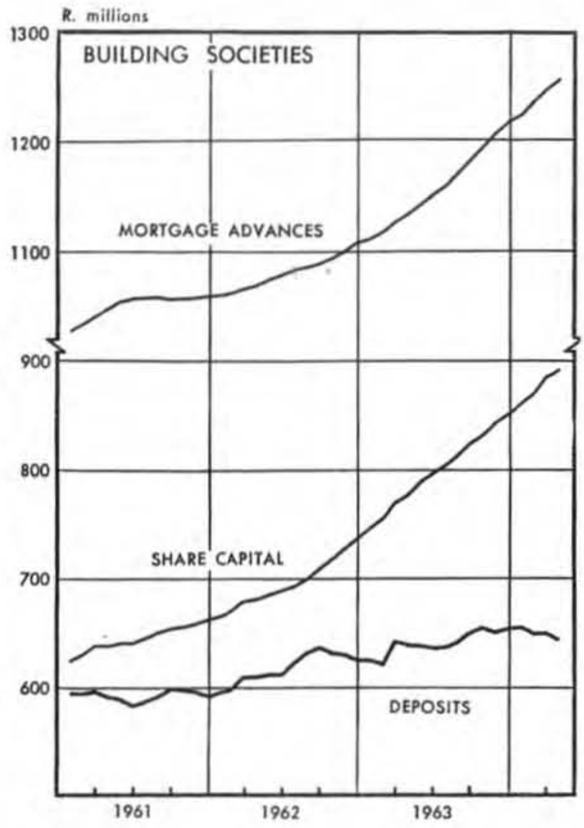
Gilt-edged Market

In the gilt-edged market a gradual change became noticeable during the second quarter. Moderate but increasing upward pressure was exerted on gilt-edged rates and the Reserve Bank found itself called upon to buy a fair amount of Government securities. Towards the end of this period, these purchases were effected at rates above the Bank's normal pattern.

Building Societies

Mainly owing to a substantial further rise in their share capital, which more than offset a slight downward tendency in their deposits, the building societies experienced a considerable further increase in their resources during the first five months of 1964. But as the building boom progressed, the demand for mortgage advances increased even more strongly, with the result that towards the end of this period the societies found themselves unable to meet all reasonable demands made on them for loans.

1 Unadjusted for nominee and direct transactions.



CREDIT POLICY AND INTEREST RATES

Despite the state of virtually full employment prevailing in the economy and the continued existence of certain bottlenecks, the Reserve Bank did not view the further increase in commercial and other bank credit during the first four months of 1964 with any alarm, but accepted it as a natural corollary to the continuing upswing in general economic activity. More recently, however, the Bank began to feel some concern at the extent to which the various classes of banking institutions were creating credit for such purposes as consumption and speculation in shares and real estate, and consulted these institutions with a view to obtaining their co-operation in forestalling the emergence of excesses of this kind.

In the meantime it had become clear that interest rates were at last showing a definite tendency to rise from the abnormally low level at which they had remained for about a year and a half. This was not at first so apparent in the case of the Treasury bill tender rate and other related money market rates. Indeed, the Treasury bill rate which had risen steadily during January and February of 1964, mainly owing to a substantial build-up of Government funds with the Reserve Bank, tended to level off temporarily during March, April and May at round about 2.60 per cent. This levelling off would appear to have been related to an easing of the money market under the influence of *inter alia* a decline in both the Government's deposits with the Reserve Bank and in the amount of Treasury bills outstanding. From the last week in May, however, the Treasury bill rate resumed an upward movement and by the 26th June had reached 2.86 per cent.

Although the monetary authorities, from the end of January onwards, transferred a substantial part of the Government's deposits from the Reserve Bank to the money market in order to relieve the strain produced by the flow of funds from the private to the public sector, they did not at any stage during this period consciously strive to bring about an actual decline in short-term interest rates. On the contrary, with a view to the prevailing economic situation, it remained the official policy to permit the Treasury bill and other short-term rates to rise gradually in response to the operation of natural forces.

The gradual shift in emphasis in monetary policy also led the Reserve Bank to announce on the 21st May that the procedure which it had followed since May, 1962, of quoting a separate rate, namely $\frac{1}{2}$ per cent above the current average tender rate, for the discount of Treasury bills and for advances against the security of these bills, was no longer considered appropriate, and that it would, therefore, revert to the more customary money market procedure of applying Bank rate to such accommodation. The increase in the cost of Reserve Bank credit caused by this policy change probably contributed to the new upward movement in the Treasury bill tender rate towards the end of May and the beginning of June.

But while the Treasury bill rate and related money market rates moved up only gradually, the tightening of the position of the commercial banks and building societies as a result of the increased demands made on them, brought about a sudden and fairly substantial increase in the rates on fixed and savings deposits quoted by these institutions in May and June. The building societies set the ball rolling by raising their rates on fixed deposits of 15 months and longer from 4 to 4½ per cent on the 30th April. The commercial banks, which had allowed their fixed deposit rates to remain somewhat below those of the building societies during the preceding period of abnormal liquidity, followed on the 2nd June by bringing their rates up to the level then paid by building societies. Thereupon, the Association of Building Societies on the 18th June recommended to their members a general increase in rates on both deposits (including savings deposits) and shares, as well as an increase from 6½ to 7 per cent in the rate on new mortgage loans, leaving it to individual societies to decide what to do about the rate on existing loans.

Indices — Excluding Seasonal Changes (1953=100)

	1963				1964		
	1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	1st Qtr.	Apr.	May
Bank Debits	258	264	292	314	318	364	301
Discounts and Advances of Commercial Banks	191	201	217	221	227	240	247
Stock Exchange Turnover	416	423	486	420	671	940	438
Manufacturing Output (1956/7=100)	137	144	151	154	157	173	......
Value of Gold Production	230	231	234	236	239	240	240
Value of Imports	141	148	152	165	169	196	170
Value of Exports	161	161	171	174	178	183	173
Railway Earnings	185	191	194	198	210	222	......
Value of Retail Sales	124	127	131	133	134	140	......
Value of Property Transactions	118	134	158	168	177	192	......
Value of Building Plans Passed	121	139	166	180	205	176	232
Employment:							
Private Manufacturing	126	128	132	134	......	......	......
Private Construction	103	112	119	121	......	......	......
Mining	122	120	120	119	122	123	......
Unemployment	181	172	155	145	152	135	......