QUARTERLY ECONOMIC REVIEW

SUMMARY AND CONCLUSIONS

(1) While the behaviour of certain important economic indicators during July and August confirmed the impression gained earlier that the boom was levelling off, total capital and consumer outlays remained excessive during this period and there was as yet no evidence of a significant reduction in either the internal inflationary pressure or the deficit on the current account of the balance of payments.

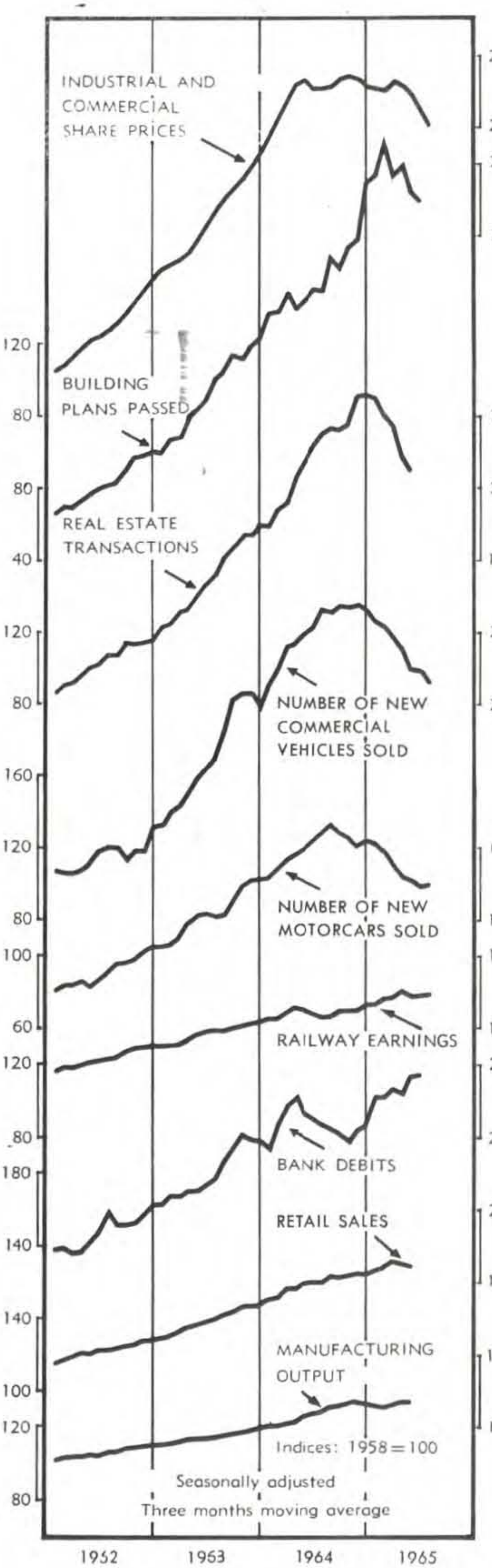
(2) Imports tended to decline slightly below the peak level attained during the second quarter. But since merchandise exports also decreased somewhat, the current account showed a deficit during July and August which, if taken at a seasonally adjusted annual rate, was even larger than that of the second quarter. The effect of this continued deficit on the official gold and foreign exchange reserves was, however, very largely offset by substantial drawings on official foreign loans and a large net inflow of private capital which mainly represented short-term funds.

(3) Although the inflationary tendencies in the economy were still being encouraged by an environment of abundant liquidity, there were signs during July and August that the various restrictive monetary measures applied earlier were beginning to have some effect. Commercial bank discounts and advances, for example, after rising further during July, actually declined somewhat during August.

(4) Central Government deposits with the Reserve Bank showed a further decline during the third quarter, particularly in September. This mainly reflected a decline in the Exchequer balance resulting from an excess of total Government issues over receipts and a net redemption of Government debt.

(5) Capital market conditions continued to tighten during July and August and further upward pressure was exerted on medium and long-term interest rates. In July those building societies which had not done so earlier, raised their mortgage rates to 7½ per cent and on the 16th August the Reserve Bank increased its pattern of rates for Government stock by ½ per cent, bringing the rate of stock with a maturity of more than 10½ years to 6 per cent.

(6) Various import restrictions affecting not only consumer goods but also capital goods and raw materials were imposed in August with a view, broadly, to supplement the other measures aimed at curbing the excessive monetary demand. This was followed in September by an announcement by the Minister of Finance of measures to curb the capital expenditures of not only the Central Government but also the Provincial Administrations and larger municipalities. In addition, it was decided to float a twenty-year Government loan in October at a rate of 6 per cent.



GENERAL BUSINESS CONDITIONS

In the Reserve Bank's Annual Economic Report published in August it was pointed out that while certain important economic indicators, such as sales of motor vehicles, building plans passed, real estate transactions and prices of industrial and commercial shares, either levelled off or began to decline during the first half of 1965, the pressure of total monetary demand upon prices and the balance of payments remained considerable and, in fact, appeared to be even greater during the second quarter of 1965 than during the first. The limited information which has become available since then and which relates mainly to July and August, suggests that during these two months general economic activity tended to move horizontally at a high level and that, while certain individual economic indicators declined somewhat further, total capital and consumer outlays remained excessive. In other words, while the boom continued to show signs of levelling off, there was as yet no evidence of a significant reduction in either the internal inflationary pressure or the deficit on the current account of the balance of payments.

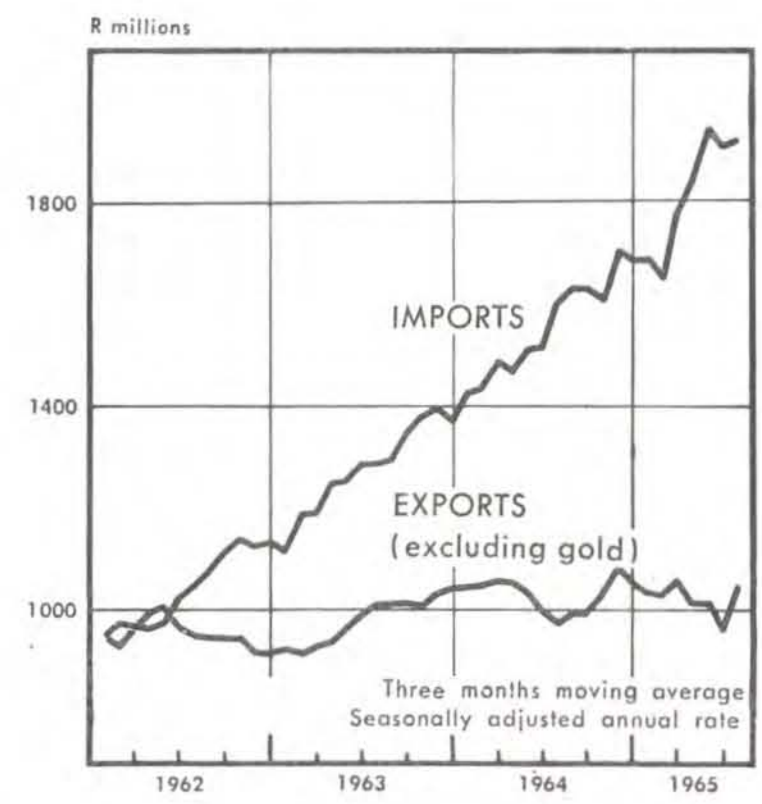
PRICES

The seasonally adjusted index of consumer prices (1958=100) increased further by 0.6 points in July and August to 114.7, despite the fact that food prices showed no further rise during this period as a whole. A somewhat smaller increase was shown by the seasonally adjusted index of wholesale prices, namely from 110.8 in June to 111.0 in July. This rise mainly reflected increases in the prices of South African, as opposed to imported, goods.

BALANCE OF PAYMENTS

Continued Deficit on Current Account

Imports amounted to a seasonally adjusted annual rate of about R1,820 million during July and August, compared with R1,680 million during the first quarter and R1,960 million during the second quarter. In other words, they declined only slightly and still remained at an excessively high level. At the same time, merchandise exports declined somewhat to a seasonally adjusted annual rate of about R980 million during July and August, while the net gold output increased only moderately. The result was that, after allowing for net invisible payments, the seasonally adjusted deficit on the balance of payments on current account amounted to an annual rate of roughly R480 million during these two months, compared with R188 million during the first quarter and R420 million during the second quarter.



Net Inflow of Capital

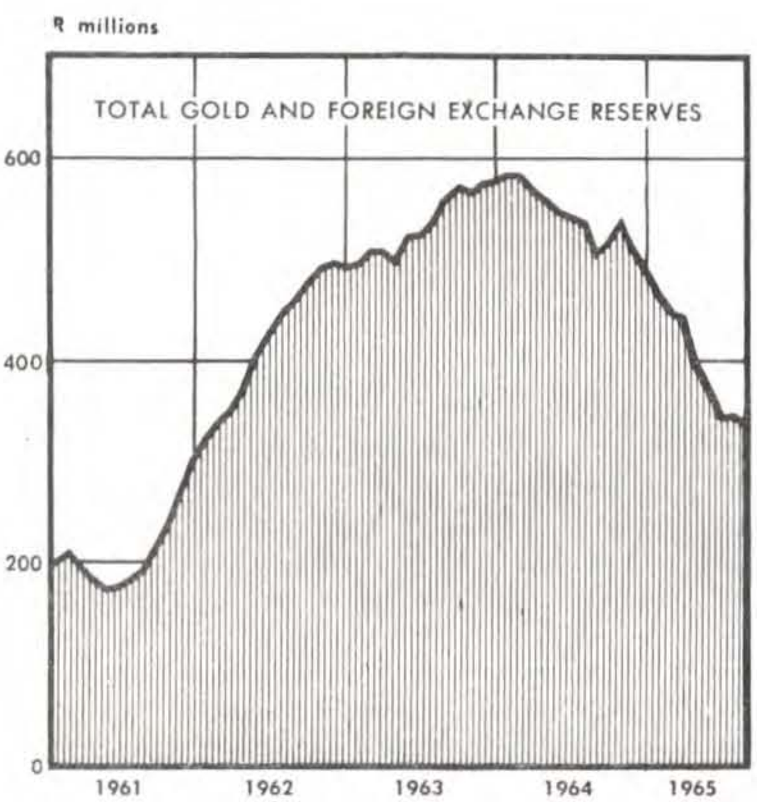
But while the current account deteriorated further, the capital account of the balance of payments showed a net inflow of official and private capital during July and August of as much as R78 million (including errors and omissions in the balance of payments estimates). Official and banking capital showed a net inflow of about R29 million, which included drawings of about R11 million on loans from Amercian banks by the Government and a drawing of about R7 million on a loan from a foreign banking institution by the Reserve Bank. These borrowings brought the total drawings on official loans since the beginning of the year to R63 million.

The net inflow of *private* capital during these two months amounted to roughly R49 million. Net purchases by foreigners of South African securities on the Johannesburg Stock Exchange accounted for about R3 million of this figure, while the remainder mainly represented movements of short-term funds associated with South Africa's foreign trade, and also credit facilities obtained by local concerns from their associated companies overseas.

Gold and Foreign Exchange Reserves

As a result of these various balance of payments tendencies, the total gold and foreign exchange reserves held by the Reserve Bank, the commercial banks and the Government only declined by about R7 million during the two months to a figure of R337 million at the end of August. It may be noted, however, that, since this slowing down of the rate of decline of the reserves was not attributable in any significant way to either a decline in imports or an increase in exports, but mainly to a net inflow of short-term official and private capital, it did not as yet indicate a basic turn of the tide as far as the balance of payments was concerned.

Between the end of August and the 24th September the Reserve Bank's gold and foreign exchange holdings decreased by only R1 million, but it is not possible at this stage to determine to what extent this levelling out tendency was again the result of an inflow of short-term capital and/or to what extent it reflected an improvement in the current account.



MONETARY AND BANKING SITUATION

Money and Near-Money

Although the supply of money and near-money in the hands of the private sector declined by about R38 million during July, it still amounted to the relatively high figure of R2,906 million at the end of July, which meant that the inflation and balance of payments difficulties were still being encouraged by an environment of abundant liquidity.

Commercial Banks

The total discounts and advances of commercial banks, which had risen by R302 million during the twelve months to June, 1965, increased further by R20 million in July. Of this increase advances to the Land Bank accounted for R12 million, compared with R13 million during the whole of the second quarter.

DISCOUNTS AND ADVANCES OF COMMERCIAL BANKS

	Increase (R millions)
2nd Quarter, 1964	+ 97
3rd Quarter, 1964	+ 57
4th Quarter, 1964	+104
1st Quarter, 1965	+ 96
2nd Quarter, 1965	+ 44
July, 1965	+ 20

During August, however, according to preliminary indications, total commercial bank discounts and advances actually registered a decline of some R20 million, of which advances to the Land Bank accounted for about R13 million.

Moreover, mainly as a result of the raising, in various stages since March, of the minimum liquidity ratios for commercial banks up to the maximum of 40 and 30 per cent of short and medium-term liabilities, respectively, the *excess* liquid assets of the banks had by the end of July been reduced to R38 million or 1.9 per cent of total liabilities to the public, compared with R159 million or 8.4 per cent of such liabilities at the end of March. During this same period the "other prescribed investments" of the banks had also declined from R71 million or 3.7 per cent of their total liabilities to the public to R53 million or 2.7 per cent of these liabilities. By the end of July, therefore, the ability of the banks to create additional money by further expanding their discounts and advances had, at least temporarily, been considerably reduced.

Merchant Banks, Discount Houses and the National Finance Corporation

In the case of merchant banks, data for July indicate both a further increase in acceptance facilities granted of R6 million to a level of R170 million and a rise in acceptances held of R3 million to R38 million. Merchant bank deposit liabilities increased by R8 million to a new month-end peak of R116 million.

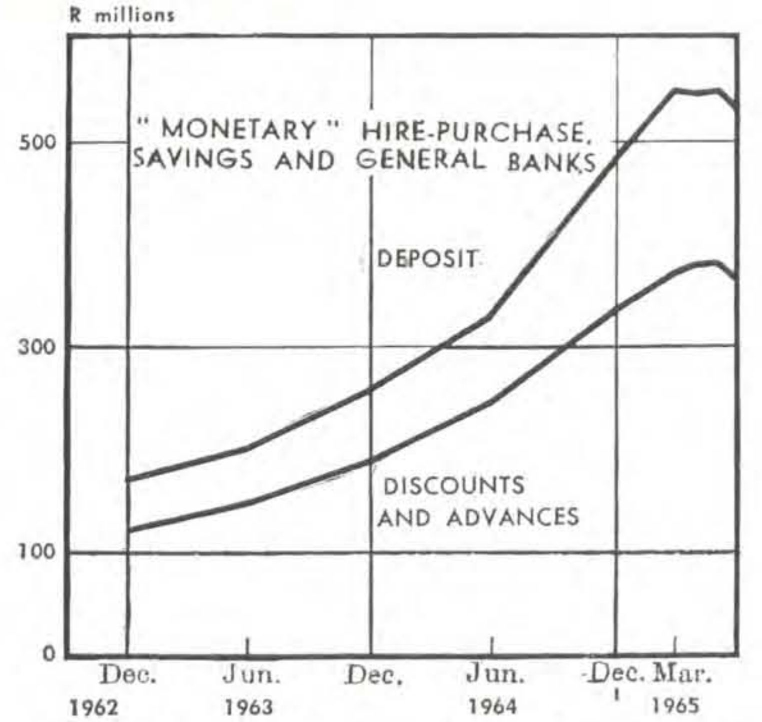
Deposits with discount houses and the National Finance Corporation amounted to R259 million at the end of August, 1965, compared with R260 million a year earlier. The amount of acceptances held by discount houses, which at the end of June had for the first time at a month-end exceeded R100 million, declined to R78 million at the end of August.

Hire-Purchase, General and Savings Banks

The nine "monetary banking institutions"[1] registered as either hire-purchase or general banks experienced a decline in deposits of R17 million during the second quarter of 1965, compared with an increase of R62 million during the first quarter. Their total discounts and advances, which had increased by R30 million during the first quarter, declined by R4 million during the second quarter. The remaining 35 hire-purchase, general and savings banks showed an increase of

1 "Monetary banking institutions," in terms of the Regulations under the new Banks Act, include the Reserve Bank, the National Finance Corporation, discount houses, commercial banks, merchant banks and those other banking institutions whose short-term liabilities amount to at least R500,000 and which for that reason are required to maintain a minimum balance with the Reserve Bank.

R3 million in deposits and expanded their discounts and advances by a similar amount during the second quarter.



Such data as are available for the nine monetary banking institutions referred to above in respect of July, indicate a further small decrease in deposit liabilities of about R3 million and an increase of about R16 million in total discounts and advances.

Reserve Bank

The total discounts, advances and investments of the Reserve Bank declined from R226 million at the end of June, 1965, to R207 million at the end of August, mainly owing to a decrease in credit extended to discount houses and the National Finance Corporation. The amount of Land Bank bills discounted for the Land Bank continued to rise.

Short-Term Interest Rates

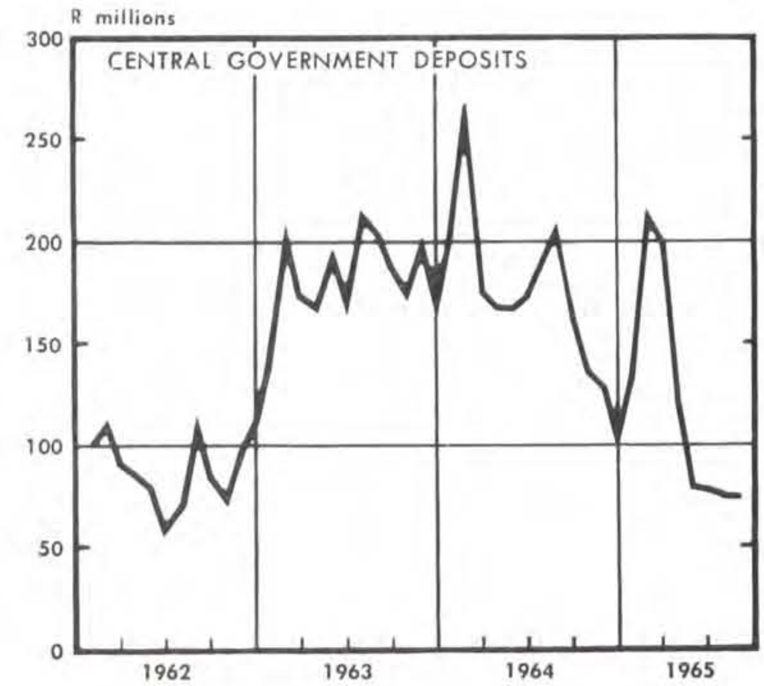
The Treasury bill tender rate showed only a slight further increase from 4.02 per cent on the 2nd July, 1965, to 4.24 per cent on the 24th September. As before, this was mainly associated with the decline in the reserves, which was at times offset by a further decrease in Government deposits with the Reserve Bank.

Deposit rates continued to be pegged at the levels determined in March until the 26th July, after which two new types of deposit rates were permitted, namely $5\frac{3}{4}$ per cent for deposits of 24 months or more but less than 36 months, and 6 per cent for deposits of 36 months or more.

By the end of August the difference between the Treasury Bill tender rate and the yield on long-term Government stock, which had been less than $1\frac{1}{2}$ per cent at the end of 1964, had increased to just over $1\frac{3}{4}$ per cent.

GOVERNMENT FINANCE

Central Government deposits with the Reserve Bank, commercial banks and discount houses, which had already declined from R172 million at the end of June, 1964, to R79 million at the end of June, 1965, declined slightly further to R75 million at the end of August despite the seasonal increase in income tax receipts during this period. This was followed by a sharp further, partly seasonal, decline to R 19 million on the 24th September.



As during the second quarter, the downward tendency in Government deposits during July and August mainly reflected a decline in the Exchequer balance resulting from an excess of *total* Government issues over receipts and a net redemption of Government debt.

CAPITAL MARKET

The tight capital market conditions which had prevailed during the second quarter of 1965 continued into the third quarter and further upward pressure was exerted on capital market yields in general.

Security Prices and Yields

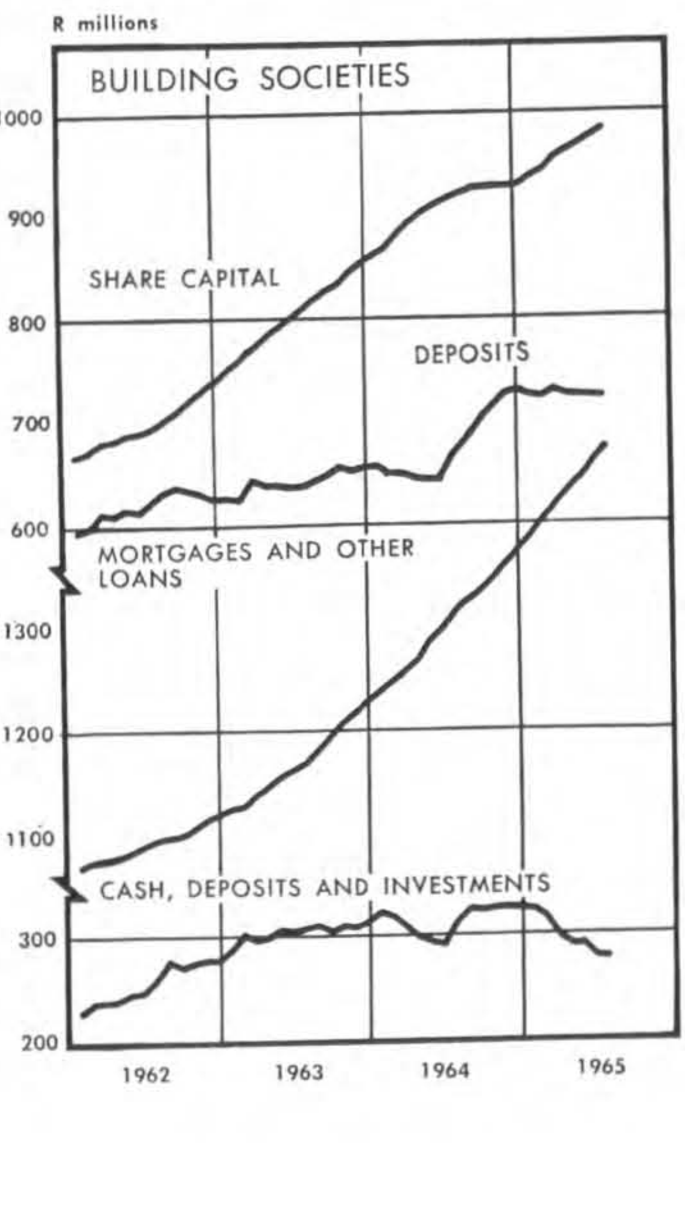
The index of industrial and commercial share prices (1958 = 100) declined further from 241 in June to 235 in July. Mainly under the stimulus of foreign buying, the index of gold mining share prices (1958 = 100) increased to 151 in August, compared with 123 in September, 1964, when the upward tendency first became evident. Notwithstanding the price movement, however, the average yield on gold mining shares increased to 7.2 per cent in August, which was equal to the corresponding figure for September, 1964, and mainly reflected increased dividend payments by gold mining companies.

Further Upward Pressure on Gilt-Edged Rates

In the gilt-edged market continued upward pressure on yields resulted in a further increase, on the 16th August, of ½ per cent in the pattern of rates quoted by the Reserve Bank for transactions in Government stock, which brought the rate for stock with a maturity of more than 10½ years to 6 per cent. Compared with this level of 6 per cent, public loans were floated by a local authority and a public corporation during August at coupon rates of 6½ per cent to yield 6.74 per cent on a maturity of 15 years and 6.66 per cent on a maturity of 20 years. The spread between the effective yields to redemption on Government stock and other gilt-edged securities thus approached ¾ per cent in August.

Building Societies

The building societies continued to operate under pressure during July and August. Their total resources showed a further rise of about R12 million, the net results of increases of R12 million and R5 million in their capital and savings deposits, respectively, and a decline of R5 million in their fixed deposits. But this was not sufficient



to enable them to meet completely the abnormally strong demand for their mortgage loans, even after running down their liquid assets and other investments still further. Nevertheless, their total outstanding mortgage and other loans still increased by as much as R22 million during July and August, compared with R42 million and R48 million during the first and second quarters of 1965, respectively.

In an attempt to increase their resources, many societies raised their rates on savings deposits to the legal limit of 4 per cent. This, together with the fact that they were paying commission on new funds at the legal maximum rates and attracting relatively more in the form of share capital and relatively less in the form of deposits, naturally increased the average cost of their funds, and eventually, in July, 1965, even the larger societies were forced to raise their mortgage rates to 7½ per cent, as the others had done previously.

RECENT POLICY MEASURES

Although, for reasons set out in the Reserve Bank's Annual Economic Report, the monetary measures introduced earlier in the year were slow to take effect, there were signs during the third quarter that they were beginning to exert some restrictive influence. Thus, as mentioned earlier, the advances and discounts of the commercial banks (excluding credit extended to the Land Bank) showed only a small increase in July, followed by a moderate decline in August. Furthermore, although credit extended by other monetary banking institutions increased noticeably in July, it showed a distinct levelling off tendency over the period April to July as a whole.

Nevertheless, in view of the continued high level of imports and the declining reserves, the Minister of Economic Affairs on the 16th August announced that import control would be tightened in the following ways:

Firstly, in order to reduce stocks of raw materials, the issue of import permits to industry for the importation of such materials would in future be based on approximately four months' consumption, instead of six months' consumption as formerly. Stocks of vehicles and components in the motor industry, which had become excessive, would also be reduced to more reasonable levels.

Secondly, more care would be exercised in the issue of import permits for capital equipment, and, as in the case of raw materials, importers would be expected to obtain their requirements from local sources wherever it was feasible to do so.

Thirdly, all applications for the establishment of new factories or for major expansions would be viewed more critically by the New Industries Committee, particularly in those cases where the new factory concerned relied heavily on imported raw materials or would otherwise contribute relatively little to the country's foreign reserves.

Fourthly, existing industries producing goods of a less essential nature and which relied on a large proportion of imported raw materials would be pegged at their 1964 level of imports—in most cases a fairly high level.

This was followed, on the 25th August, by an announcement regarding the importation of consumer goods, in which the Minister stated that the same principle as that applicable to raw materials and equipment for industry would hold, namely that stricter import control would be applied in those cases where supplies in the country were such that a reduction thereof would have no adverse effect on the country's economy or on the economic activities of the sector concerned. To this end, most of the goods appearing on the "Free List" would in future also be subjected to import control. Furthermore, a small number of commodities were transferred to the "Restricted List" because they were either produced in quantity locally or did not have to be imported on a large scale. At the same time the basis for the exchange of general consumer goods permits for goods on the "Restricted List" was changed from two rand for one rand to three rand for one rand. The concession to exchange the first R5,000 on the basis of one for one would, however, continue to apply.

As regards those types of consumer goods in respect of which a third round permit issue was normally made, the Minister decided that, as it would appear that stocks thereof were at a reasonably high level, no third round issue would be made this year.

In addition to these import restrictions, which were broadly designed to supplement the other measures aimed at curbing the excessive monetary demand, the Minister of Finance on the 13th September announced the following fiscal policy measures[1]:

Firstly, the Government itself would endeavour to reduce its expenditure during the coming months, especially on capital works, and all important tenders for Government purchases would first be considered by a special Cabinet Committee before going to the Tender Board.

Secondly, the Government had obtained the whole-hearted co-operation of the Provincial Administrators in keeping the expenditure of the Administrations in check. Discussions had also been held with the most important municipalities, and the Government expected them to cut back on their expenditure. Similarly, the Government also intended approaching the most important public corporations in this regard, and expected to get their co-operation.

Thirdly, while the Government accepted that certain capital works, such as that of the Railways as well as housing, could not be postponed for economic and social reasons, it realised the importance of financing these essential works in a non-inflationary manner. With this in mind, it had decided to float a 20-year loan on the 15th October at a rate of 6%, the highest ever offered on a Government loan in South Africa. The Minister also expressed the hope that life insurance organisations, pension funds and other financial institutions would support the loan in the national interest. He further appealed to large private organisations with substantial funds at their disposal to subscribe to Government loans rather than to continue with large new capital projects at this stage.

1 The full text of the Minister's statement appears on page xiii of this Bulletin.

NOTE.—Attention is drawn to new tables for commercial banks appearing on pages 4(a) to 4(d).

Indices — Excluding Seasonal Changes (1958 = 100)

	1964			1965		
	Qrt. 2nd	Qrt. 3rd	Qrt. 4th	Qrt. 1st	Qrt. 2nd	Jul.
Banks Debits	213	204	204	222	234	232
Discounts and Advances of Commercial Banks	152	164	182	194	201	204
Stock Exchange Turnover	357	271	250	239	200	201
Manufacturing Output	159	163	165	168	169	......
Value of Gold Production	177	183	188	185	189	190
Value of Imports	135	145	152	148	173	158
Value of Exports	132	127	138	131	129	110
Railway Earnings	148	149	153	158	159	161
Value of Retail Sales	125	131	134	132	135	......
Value of Property Transactions	214	233	251	241	209	......
Value of Building Plans Passed	185	209	219	273	245	220
Employment:						
Private Manufacturing	127	130	132	......	......	......
Private Construction	122	125	127	......	......	......
Mining	111	112	112	109	111	......
Unemployment	81	73	66	63	58	58