Quarterly economic review

Main developments

The South African economy continues to experience rapid growth, full employment, buoyant business conditions, exceptionally high liquidity and persistent inflation. Indeed, all the available evidence suggests that a new cyclical upswing started some time during the first half of 1966 and gained further momentum during the third quarter.

In broad terms, the course of the business cycle in South Africa during recent years appears to have been as follows: From roughly the middle of 1961 until about the middle of 1965 there was a relatively long economic upswing, which eventually brought considerable pressure to bear upon the balance of payments and upon internal prices and costs. This phase was followed by a distinct levelling-off tendency—from roughly the middle of 1965 some economic indicators increased at a lower rate than formerly, some moved horizontally and quite a few even declined sharply. Although total capital and consumption expenditure still remained excessive and the inflationary pressure therefore persisted, this marked cyclical change appeared to hold out the prospect of an early return to greater stability, particularly after fixed investment outlays began to decline during the first quarter of 1966.

But from October, 1965, onwards, as import control was applied more strictly and capital flowed into the country on a large scale, one economic indicator after the other began to rise again, until by the second quarter of 1966 most economic time series except the all important fixed investment, had joined in the new upward movement. Finally, during the third quarter of 1966, fixed investment by both private enterprises and public authorities also resumed an upward movement, while many of the other indicators increased to new record levels.

Despite a very substantial increase in gross domestic expenditure during the third quarter, the balance of payments as a whole remained slightly favourable during this period and the official gold and foreign exchange reserves accordingly increased somewhat further. Imports increased sharply and the surplus on the current account of the balance of payments was transformed into a small deficit, but this shortfall was more than offset by a further net inflow of capital.

As a result mainly of the favourable balance of payments and an increase in bank credit to the private sector, total money and near-money increased further during the third quarter and remained abnormally high in relation to gross national product. This constituted an important potential inflationary factor, as it meant that a considerable rise in total expenditure could be financed without recourse to additional bank credit, for example through inter-company borrowing.

In retrospect, therefore, it is fortunate that the authorities applied various additional disinflationary measures in July and August, including an increase in the interest rate level, fiscal measures and the relaxation of import control. If these steps had not been taken, then in all probability the supply of money and near-money in the private sector would to-day have been even greater than it is, investment and consumption spending would have been higher, the supply of goods would have been less and the inflationary pressure on costs and prices stronger.

Nevertheless, the developments during the third quarter indicated clearly that the battle against inflation had not yet been won. Further steps to reduce the inflationary pressure were therefore announced by the Minister of Finance and the Minister of Economic Affairs in a joint statement issued on the 7th December.[1] The new measures included additional restraints on expenditure by the public sector, a substantial further relaxation of import control, a tightening of the direct restrictions on credit extended by monetary banks to the private sector and a more restrictive money market policy aimed at making the existing Bank Rate more effective and reducing the scope and incentive for inter-company lending. These steps were intended to intensify and complement the earlier measures, with the general objective of reducing excessive liquidity, increasing the supply of goods and the degree of competition in the economy, and restraining the rate of increase of total capital and consumption spending.

National accounts

Gross domestic product

Gross domestic product at market prices increased at a considerably faster rate during the third quarter of

[1] The full text of this statement is published on p. 13.

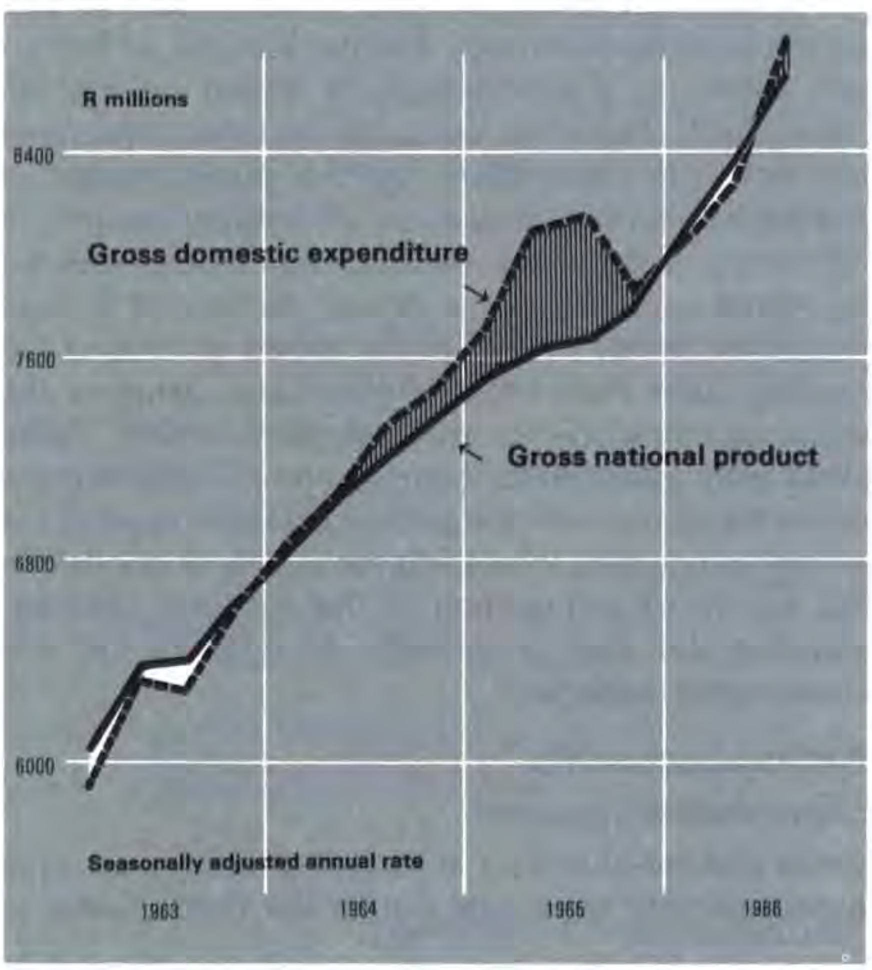
1966 than during the first and second quarters. This was, however, mainly if not entirely attributable to an acceleration of the rise in prices—the *real* domestic product would appear to have increased at roughly the same annual rate as during the first half of 1966, namely about 5 per cent. As net factor payments to the rest of the world showed little change during the first three quarters of 1966 compared with the corresponding period of 1965, gross *national* product may have increased at a somewhat higher rate than the gross domestic product during this period.

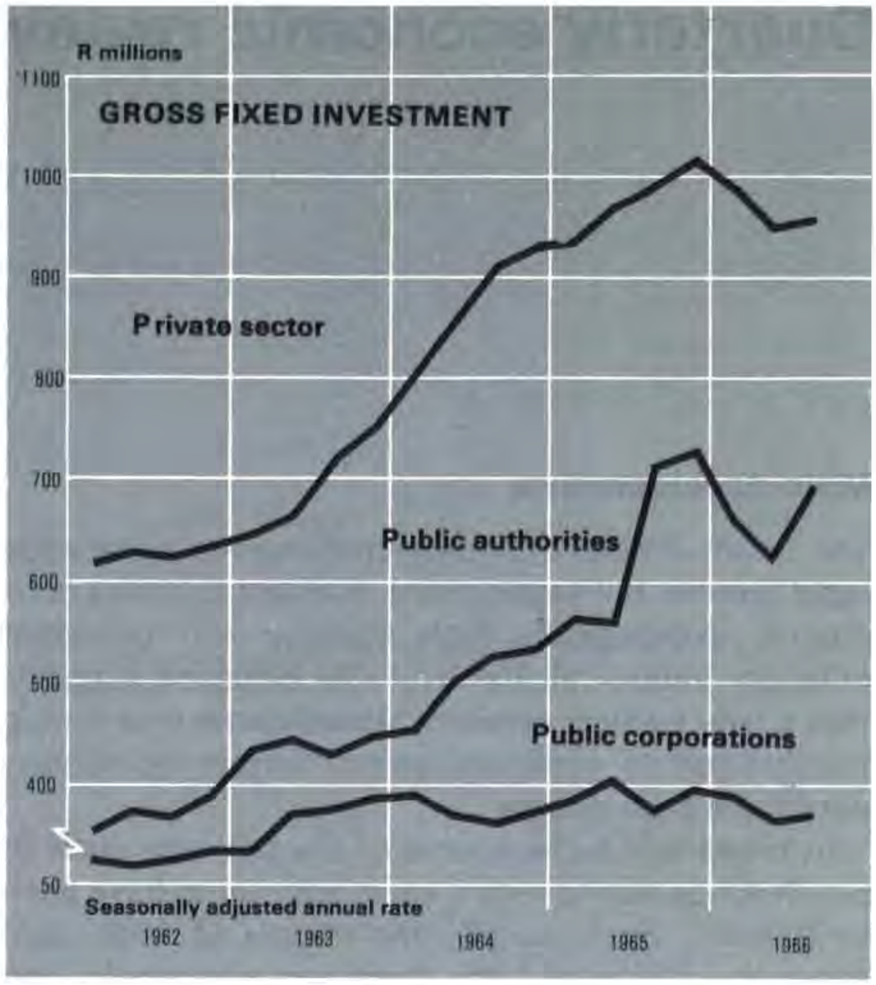
Accelerated increase in gross domestic expenditure

But rapid as the rise in gross national product during the third quarter was, gross domestic *expenditure* increased even faster and for the first time in 1966 exceeded gross national product, so that the current account of the balance of payments once again changed from surplus to deficit. Exports of goods and services increased by about 8 per cent between the second and third quarters of 1966, which represented the sharpest quarterly rise since the fourth quarter of 1961 and naturally exerted an expansionary influence on the economy. But imports of goods and services increased by an even higher percentage during this period, namely by about 18 per cent.

Renewed increase in fixed capital outlays

All the main components of gross domestic expenditure increased fairly sharply during the third quarter. Particularly significant is the fact that both public and private fixed investment, which had declined moderately during the first and second quarters, increased again during the third quarter, although they did not reach the peak levels attained in the last quarter of 1965. The downturn in fixed investment during the first half of 1966, which had at one stage looked as if it might be the forerunner of a more general slowing down in spending, therefore had a relatively short duration. Moreover, during the first three quarters of 1966, gross domestic fixed investment was more than 3 per cent higher than during the corresponding period of 1965.



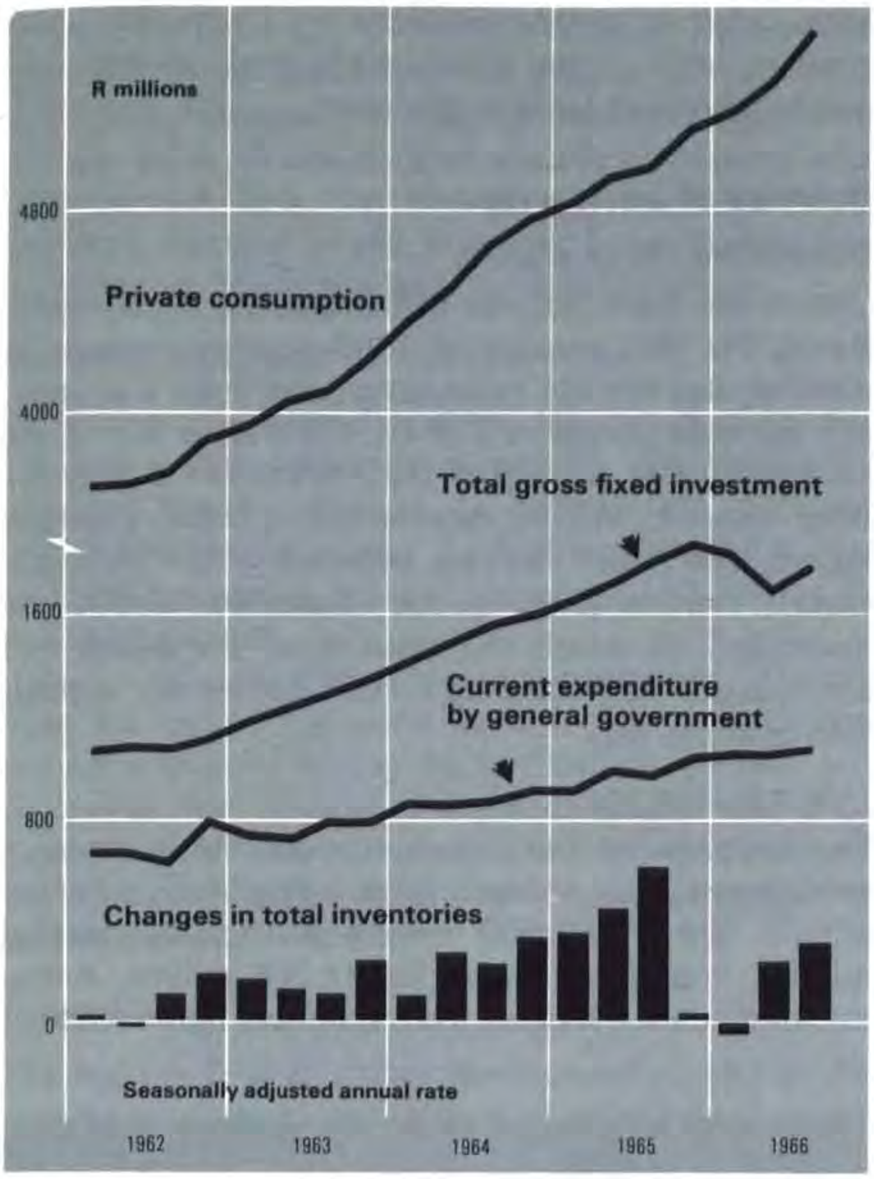


Increase in inventory investment

Revised estimates for inventory investment indicate that after becoming negative during the first quarter of 1966, it increased during the second quarter, mainly owing to a build-up of agricultural stocks and stocks of public corporations and the South African Railways and Harbours—industrial and commercial stocks still declined at that stage. During the third quarter, however, there was an increase in virtually all types of inventories except diamond stocks.

Substantial rise in private consumption and current government expenditure

In addition to the renewed rise in fixed and inventory investment, private consumption expenditure increased at a noticeably faster rate during the third quarter than during the second quarter, partly due to a substantial increase in expenditure on durable consumer goods. For the first three quarters as a whole, private consumption was between 8 and 9 per cent higher than during the corresponding period of 1965. Current expenditure by public authorities also increased during the third quarter and was about 11



per cent higher during the first three quarters of 1966 than during the corresponding period of the previous year.

Saving

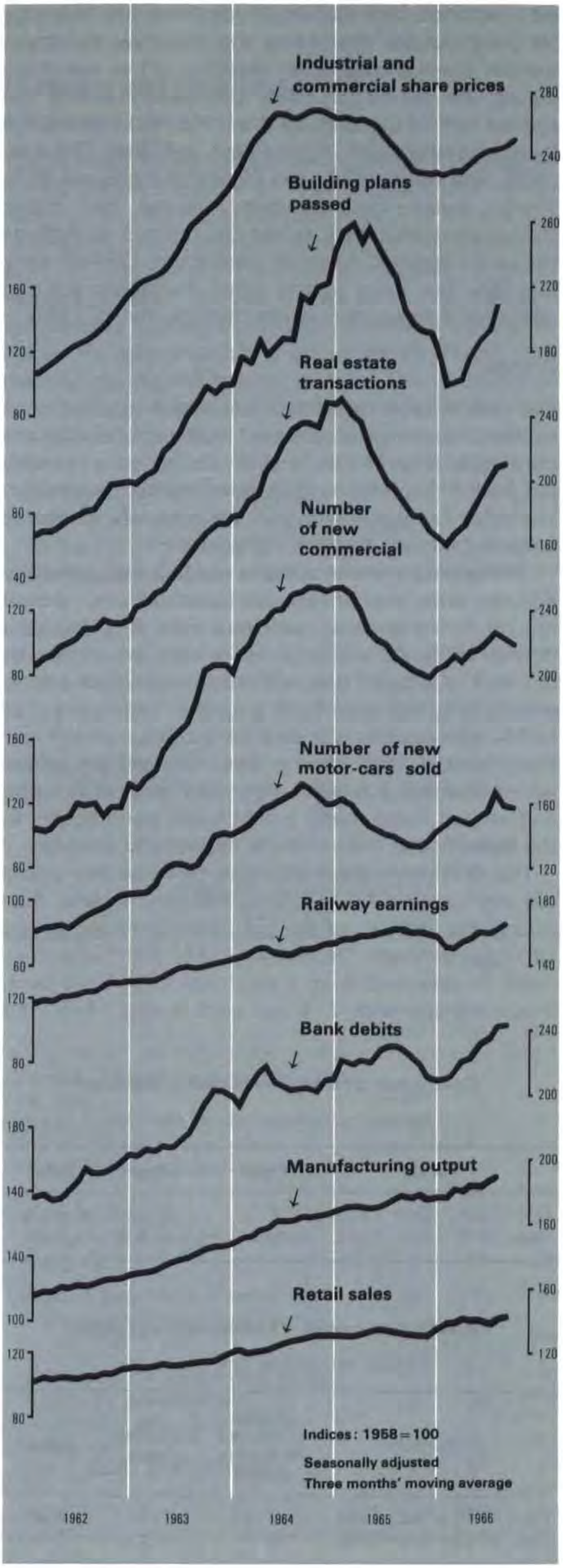
In view of these developments, it is not surprising to find that gross domestic saving increased by only about 6 per cent during the first three quarters of 1966 compared with the same period of 1965, and that during the third quarter of 1966 it was, in fact, lower than during the third quarter of the previous year.

Excess demand

As a result of these various tendencies, the total monetary demand for goods and services once again increased more rapidly than the capacity of the economy to supply goods and services from internal or external sources and thus exerted excessive pressure upon the country's skilled labour and other scarce resources. The inevitable result was a continuation of the inflationary rise in costs and prices.

General economic indicators

Further evidence that the economy moved into a new cyclical upswing at some stage during the first half of 1966, is provided by the behaviour of such general economic indicators as building plans passed, real estate transactions, number of new commercial vehicles sold, number of new motor-cars sold, rail-



way earnings, bank debits, physical volume of manufacturing output, retail sales and industrial and commercial share prices. After levelling off or declining during the course of 1965, particularly during the second half of the year, all these indicators reached a lower turning-point somewhere between October, 1965, and April, 1966, and thereafter increased fairly sharply again. Building plans passed, real estate transactions and share prices did not rise as high as the peaks reached towards the end of 1964 or early in 1965, but most of the other indicators attained new record levels during the third quarter of 1966.

Prices

The rate of increase of the seasonally adjusted consumer price index accelerated noticeably during the third quarter of 1966, mainly owing to a sudden jump of 1·5 points in the index during September. The latter rise partly reflected the increases in railway rates and indirect taxation in August.

During the first three quarters of 1966 the seasonally adjusted consumer price index increased at an annual rate of 4·5 per cent, compared with 3·2 per cent during 1965. As the accompanying table indicates, this was only partly due to a sharp rise in food prices, which occurred mainly during the first quarter of 1966—other prices showed an increase of 4·4 per cent (annual rate) during this nine-month period. An increase of 5.3 per cent in the cost of housing and related items made a significant contribution to the latter figure.

The seasonally adjusted index of wholesale prices did not increase faster during the third quarter than during the first half of the year, but continued to rise strongly. Between December, 1965, and September, 1966, it increased at an annual rate of 5·5 per cent, in comparison with 2·4 per cent during 1965. The price index of goods produced in South Africa increased by 6·1 per cent, while that of imported goods increased by 4·2 per cent.

Consumer prices – seasonally adjusted

Annual percentage rate of change

Period	Food	Other	Total
Dec. 1964 – Dec. 1965	2·0	3·7	3·2
Dec. 1965 – Sep. 1966	5·1	4·4	4·5

Wholesale prices – seasonally adjusted

Annual percentage rate of change

Period	Goods produced in South Africa	Imported goods	Total
Dec. 1964 – Dec. 1965	2·8	1·4	2·4
Dec. 1965 – Sep. 1966	6·1	4·2	5·5

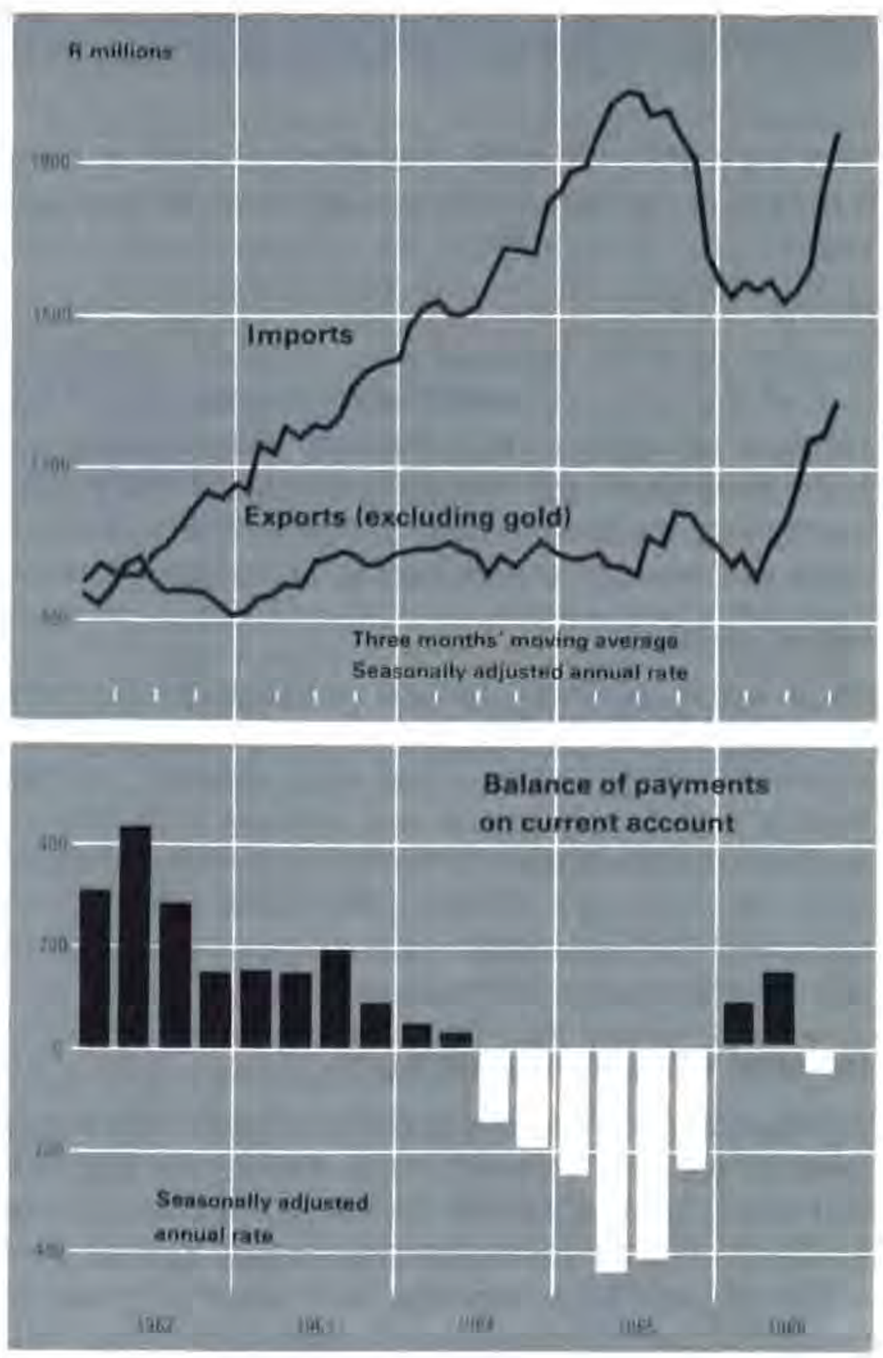
Balance of payments

Substantial rise in exports

One of the main features of the balance of payments during the third quarter of 1966 was an increase in merchandise exports (excluding gold) from a seasonally adjusted annual rate of R1,128 million during the second quarter to one of R1,304 million during the third quarter, which represented a new quarterly record. The major increase occurred in the statistical class "manufactured goods classified chiefly by materials", of which the main items are pearls and precious stones (including certain diamonds), copper, lead and pig-iron.

Upsurge in imports

But sharp as the rise in exports was, the increase in imports was even sharper. From a seasonally adjusted annual rate of R1,500 million during the second quarter, imports increased to R1,768 million during the third quarter. Indeed, the September figure reached



R1,950 million, which was only slightly less than the record level of just over R2,000 million attained in June and September, 1965. This sudden upward spurt in imports followed the relaxation of import control in July as a deliberate disinflationary measure and reflected not only the strength of the underlying monetary demand in the economy but probably also the tendency towards a new cyclical upswing.

Net gold output and current "invisibles"

As during the second quarter, the net gold output showed a slight declining tendency. The seasonally adjusted figure, taken at an annual rate, declined from R804 million during the first quarter of the year to R764 million in the second and R740 million in the third quarter.

As far as current invisibles are concerned, receipts from the rest of the world remained on more or less the same level as during the first half of the year, but payments for services increased during the third quarter, mainly due to increases in investment income payments and higher freight and insurance payments on the increased imports.

Current deficit

The net result of all these developments was that the current account of the balance of payments changed from a surplus of R26 million during the second quarter of 1966 to a deficit of R7 million during the third quarter. After adjustment for seasonal fluctuations and taken at an annual rate, this represented a change from a surplus of R148 million during the second quarter to a deficit of R48 million during the third quarter.

Further net inflow of capital

The current account deficit of R7 million was, however, more than offset by a net inflow of R17 million of capital from abroad. Central government and banking capital showed a net outflow of R28 million during the third quarter, mainly due to repayments of foreign loans by the Government. But the net inflow of private capital amounted to R45 million, compared with R10 million in the first quarter and R64 million in the second. Of this inflow of R45 million, R14 million has been identified as net long-term capital.

Levelling-off in gold and foreign exchange reserves

The net result of the current deficit of R7 million and the net inflow of total capital of R17 million was an increase of R10 million during the third quarter in the total gold and foreign exchange held by the Reserve Bank, the rest of the banking sector and the Government. In fact, however, after rising from R578 million at the end of June to a record R604 million at the end of July, the total reserves declined to R588 million at the end of September and showed little change during October. There has, therefore, been a clear tendency for the reserves to level off from about the middle of the year.

Monetary and banking situation

Money and near-money

The liquidity of the private sector remained excessive during the third quarter of 1966. Indeed, total money and near-money increased further by R74 million to a level of R2,596 million at the end of September. In view of the substantial further increase in gross national product, however, the ratio of money and near-money to gross national product declined slightly below the exceptionally high figure of 30 per cent reached during the second quarter. The existence of so much liquidity in the economy must greatly have encouraged the sharp rise in gross domestic expenditure during the third quarter and was clearly an important factor contributing to the continued inflation in the economy.

As the accompanying table shows, the main reasons for the further increase in total money and near-money during the third quarter were an increase of R69 million in the claims of the banking sector on the private sector and a rise of R30 million in the *net* gold and foreign exchange reserves of the banking sector, i.e. after deducting short-term foreign liabilities. The increase in bank credit to the private sector largely represented a rise in Land Bank advances and an increase in investments, although the banks' dis-

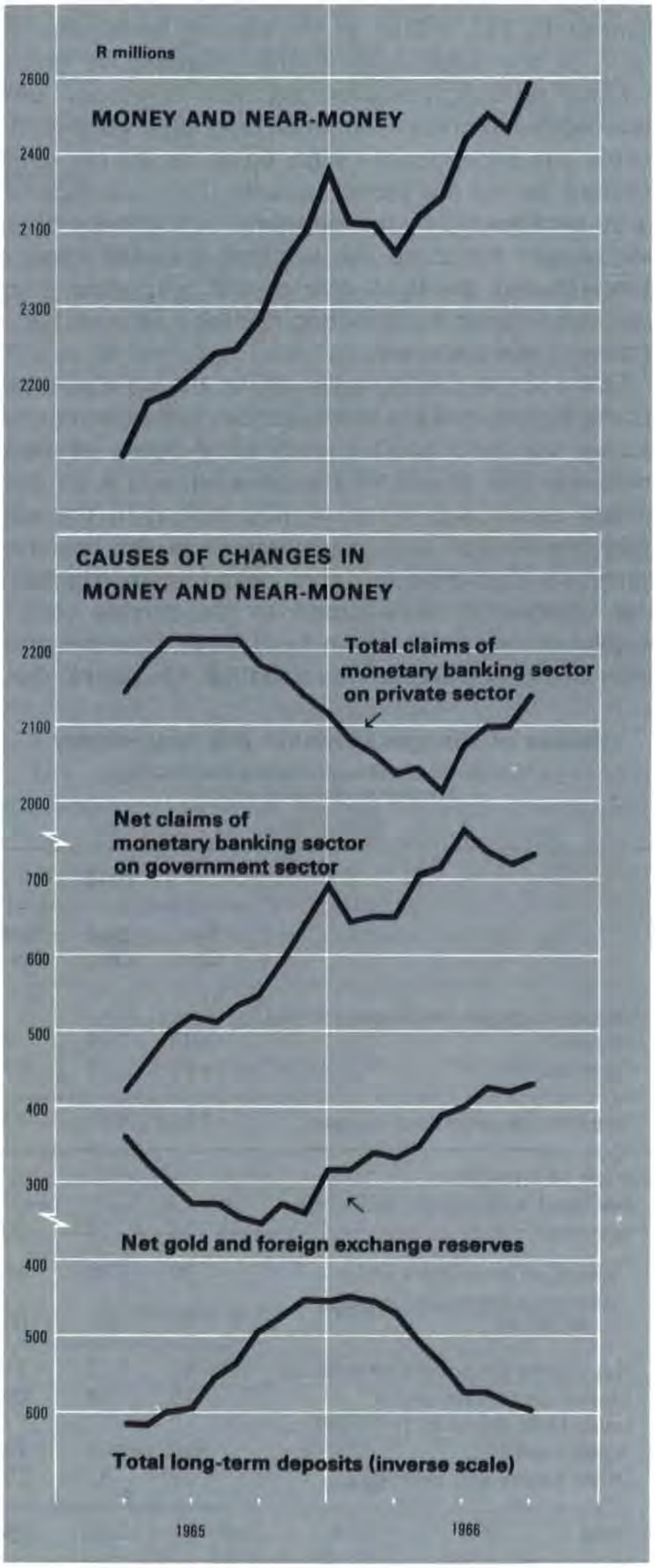
Causes of changes in money and near-money

(Changes in consolidated assets and liabilities of monetary banking sector)

R millions

	1966		
	1st Qtr.	2nd Qtr.	3rd Qtr.
Changes in money and near-money:			
Money	−39	126	7
Near-money	−78	24	67
Total money and near-money	−117	150	74
Causes of changes:			
Net gold and foreign exchange reserves	18	66	30
Claims on government sector	32	136	69
Government deposits (increase −, decrease +)	−74	−24	−100
Net claims on government sector	−42	112	−31
Claims on private sector	−79	38	69
Long-term deposits (increase −, decrease +)	−16	−102	−23
Other assets and liabilities	2	37	29
Total	−117	150	74

counts and advances also moved up somewhat. A welcome development, however, was a decline of R31 million in the net claims of the banking sector on the government sector, which showed that the government sector was no longer financing its expenditure in an inflationary way. There was also an increase of R23 million in long-term deposits with the banking sector, which are not considered to be near-money.

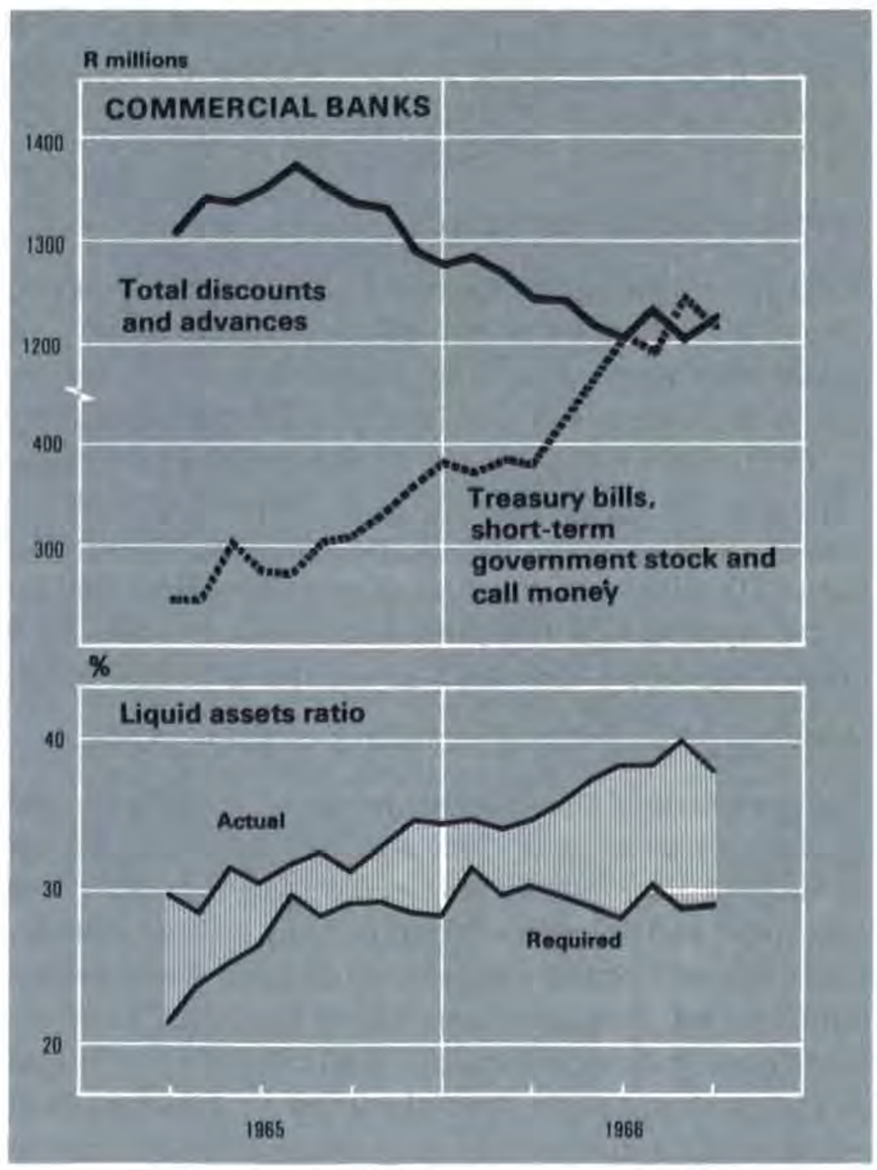


If it had not been for these latter two developments, total money and near-money would have increased by much more than it actually did.

Bank credit

The continued state of high liquidity in the economy meant that private firms and individuals in general had substantial amounts of money not only to spend but also to lend. It was therefore possible for them to increase their fixed and inventory investment, as well as their durable consumption expenditure, without necessarily borrowing more *from the banking system*. In fact, as the following summary table shows, the "controlled credit" of commercial banks and merchant banks increased only moderately between June and September, while that of monetary hire-purchase and general banks showed no change at all over this period. Moreover, at the end of September the controlled credit of all monetary banking institutions was collectively about R134 million below the level of March, 1965, and about R177 million below the permissible level, i.e. the figure for March, 1965, plus $2\frac{1}{2}$ per cent.

At the end of September the commercial banks still had *excess* liquid assets amounting to R195 million or nearly 9 per cent of their liabilities to the public. The corresponding figure for merchant banks was R48 million or 17 per cent and for monetary hire-purchase and general banks, R77 million or 13 per cent.



Bank credit
R millions

	March 1965	June 1966	September 1966
Commercial banks			
Total discounts and advances . .	1,307	1,205	1,228
"Controlled credit"	1,288	1,161	1,185
Shortfall in controlled credit below figure for March, 1965 . .	—	127 (9·9%)	103 (8·0%)
Merchant banks			
"Controlled credit"	60	52	53
Shortfall in controlled credit below figure for March, 1965 . .	—	8 (13·5%)	7 (11·1%)
Acceptance facilities utilised .	148	148	146
Monetary hire-purchase and general banks			
"Controlled credit"	402	379	379
Shortfall in controlled credit below figure for March, 1965 . .	—	22 (5·5%)	22 (5·5%)

Government finance

It was mentioned earlier that the *net* claims of the banking sector on the government sector declined by R31 million during the third quarter and that this was a most welcome development, as it signified that the government sector's financing operations were having a contractionary instead of an expansionary effect on the supply of money and near-money. In actual fact, the banking sector's holdings of Treasury bills, government stock and other claims on the government sector increased further by R69 million during this quarter, but the effect of this on total money and near-money was offset by an increase in government deposits of R100 million.

"Government sector" in the above analysis includes not only the South African Central Government but also provincial administrations, the Administration of South West Africa, the Government of the Transkei and the Governments of Lesotho, Botswana and Swaziland. The main developments during the third quarter in the *Exchequer Account as such* are summarised in the accompanying table. It appears that while the monetary banking sector's holdings of Treasury bills and government stock increased by R64 million during the third quarter, the Exchequer's cash balance with this sector increased by R67 million, so that the Exchequer decreased its *net* indebtedness to the banking sector to the extent of R3 million. This decrease, which was partly seasonal, contrasted

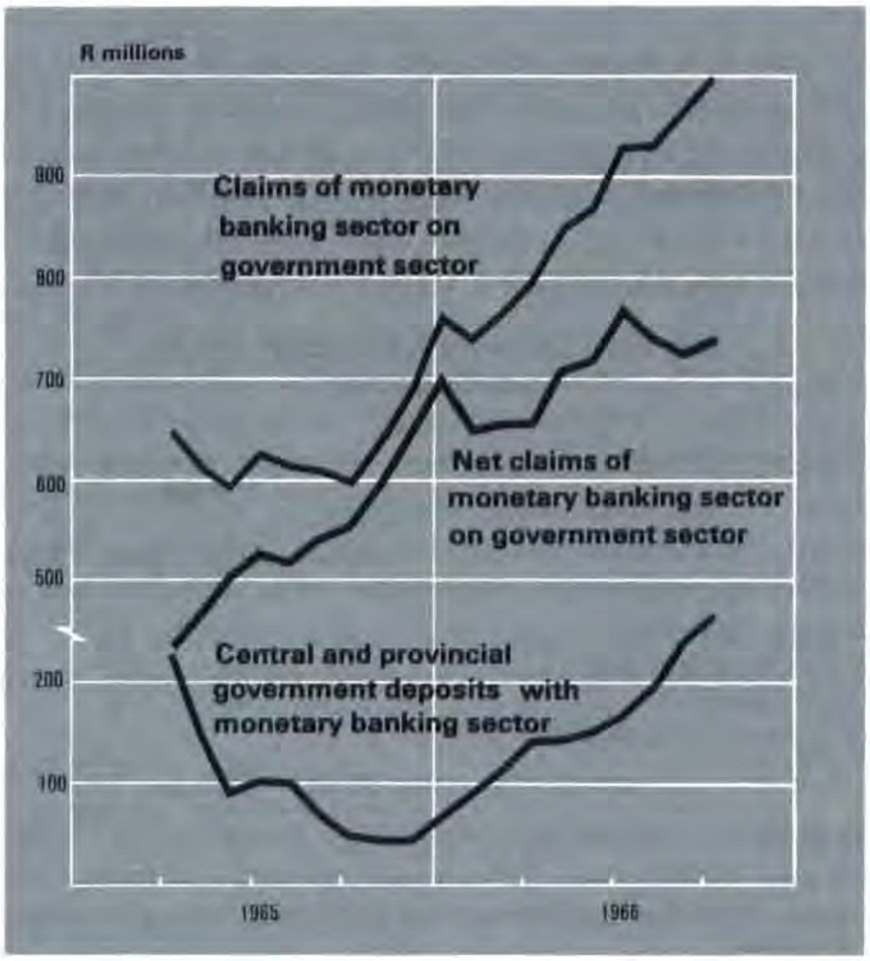
Exchequer finance
R millions

	1966 2nd Qtr.	1966 3rd Qtr.
Total deficit, excluding borrowing . .	107	53
Financing:		
Change in net indebtedness to:		
Foreign sector	4	4
Private non-bank sector	28	30
Public Debt Commissioners . . .	19	22
Paymaster-General and social security funds	−1	—
Monetary banking sector:		
Change in government securities .	129	64
Change in Exchequer balance* .	−72	−67
Total	57	−3
Total financing	107	53

*Increase −, decrease +

sharply with an increase of R57 million in the preceding quarter.

Moreover, following the raising of the rate of interest on long-term government stock and the introduction of legislation requiring insurance companies, pension funds and unit trusts to hold more government stock, the Treasury was able to raise substantial loan funds from non-inflationary sources in October. Conversion facilities into a 5 per cent 1969 and a 6½ per cent 1991 stock were offered to the holders of 3½ per cent 1963/66 local registered stock, which fell due for redemption on the 1st October. In addition, cash



applications were invited for both these stocks. In the event, if the Public Debt Commissioners are excluded, cash applications totalled R87·5 million, of which R11·8 million came from the monetary banking sector, while repayments amounted to R7·7 million, including R7·5 million to the monetary banks. Net receipts therefore amounted to R79·8 million, to which the monetary banking sector contributed only R4·3 million. In other words, the Treasury raised a net amount of R75·5 million from outside the monetary banking sector and excluding the Public Debt Commissioners.

The details of the cash applications were as follows:

R millions

	5% 1969	6½% 1991	Total
Public Debt Commissioners	—	15·0	15·0
Monetary banking sector:			
Commercial banks	0·3	0·8	1·1
Discount houses	0·1	0·1	0·2
Merchant banks	2·0	—	2·0
Other monetary banks	8·0	0·5	8·5
Total	10·4	1·4	11·8
Building societies	7·3	2·4	9·7
Insurers	1·3	23·5	24·7
Pension Funds	—	20·7	20·7
Nominee companies	—	5·9	5·9
Mining houses	0·5	2·0	2·5
Corporate businesses	—	10·3	10·3
Individuals	—	0·8	0·8
Others	0·7	0·3	1·0
Total	20·2	82·3	102·5

Capital market

Despite the abnormally high liquidity of the private sector, which reduced the need for many companies to resort to the capital market, capital market conditions remained relatively tight during the third quarter. The public sector's capital requirements were again substantial, as indicated by the following table:

Net new security flotations* of the public sector

R millions

	1966			
	July	Aug.	Sept.	Oct.
Local authorities	2	14	8	8
Public corporations	—	—	50	—
Government	21	46	14	74
Of which subscribed by P.D.C.	(22)	(46)	(14)	(−6)
Total	23	60	72	82

*Gross issues less conversions and cash repayments of maturing securities.

Share prices and yields

After tending to level off or to decline during the second quarter and July, the prices of almost all the major classes of shares showed new increases during August and September. Gold mining share prices reached their highest level for 1966 in September and the average yield on these shares, which had risen steadily during the first seven months of the year, remained approximately at the level of 9·3 per cent attained in July. The upward movement of mining financial share prices continued during the third quarter, while the temporary decline in the prices of industrial, commercial and industrial financial shares during June and July was reversed in August.

Share price indices (1958 = 100)

Type of share	1966				
	Mar.	June	July	Aug.	Sept.
Gold mining	145	140	140	144	147
Coal mining	124	123	118	118	114
Financial:					
Mining houses	192	199	207	213	215
Other mining	216	232	239	252	256
Industrial	231	230	210	220	217
Industrial and commercial	246	241	229	239	243

Building societies

The resources of the building societies increased noticeably during the third quarter of 1966, namely by R32 million, to which savings deposits contributed R17 million and fixed deposits R15 million. The increase in savings deposits was largely of a seasonal nature, but the increase in fixed deposits was probably partly attributable to the increase in deposit rates following the removal of deposit rate control on the 8th July. Share capital showed no change over the quarter, confirming that this investment medium has recently become less popular relative to fixed deposits.

Against this increase in resources, mortgage and other loans advanced by building societies increased by the moderate amount of R14 million. But the rate at which new advances were being granted increased markedly and the societies' commitments in respect of mortgage advances granted but not yet paid out, increased by R12 million during this period.

The increased resources furthermore allowed for an addition of R5 million to liquid assets and other prescribed investments, which brought the excess of these assets over the statutory minimum to R123 million at the end of September. This was the highest figure recorded for any quarter-end since the new Building Societies Act came into operation at the beginning of 1965.