Quarterly economic review

Main developments

During the period April to August, 1966, there were divergent tendencies in the South African economy. Fixed capital outlays and inventory investment, which had already declined during the first quarter of 1966, both decreased further during the second quarter. This suggested that a more general slowing down in the economy and a reduction in the inflationary pressure were imminent. Many other economic indicators, however, pointed the other way, namely towards a new cyclical upswing.

But while there was some uncertainty as to the direction in which the economy was about to move, the facts clearly indicated (1) that economic growth was continuing at a very satisfactory rate despite the effects of the drought, (2) that general economic activity and employment were at a very high level, (3) that the economy was in an exceptionally liquid state and (4) that the underlying monetary demand for goods and services still tended to be excessive. Indeed, the inflationary pressure turned out to be so strong and sustained that the existing anti-inflationary measures had to be extended and progressively intensified with a view to restraining the rate of increase of total capital and consumer spending.

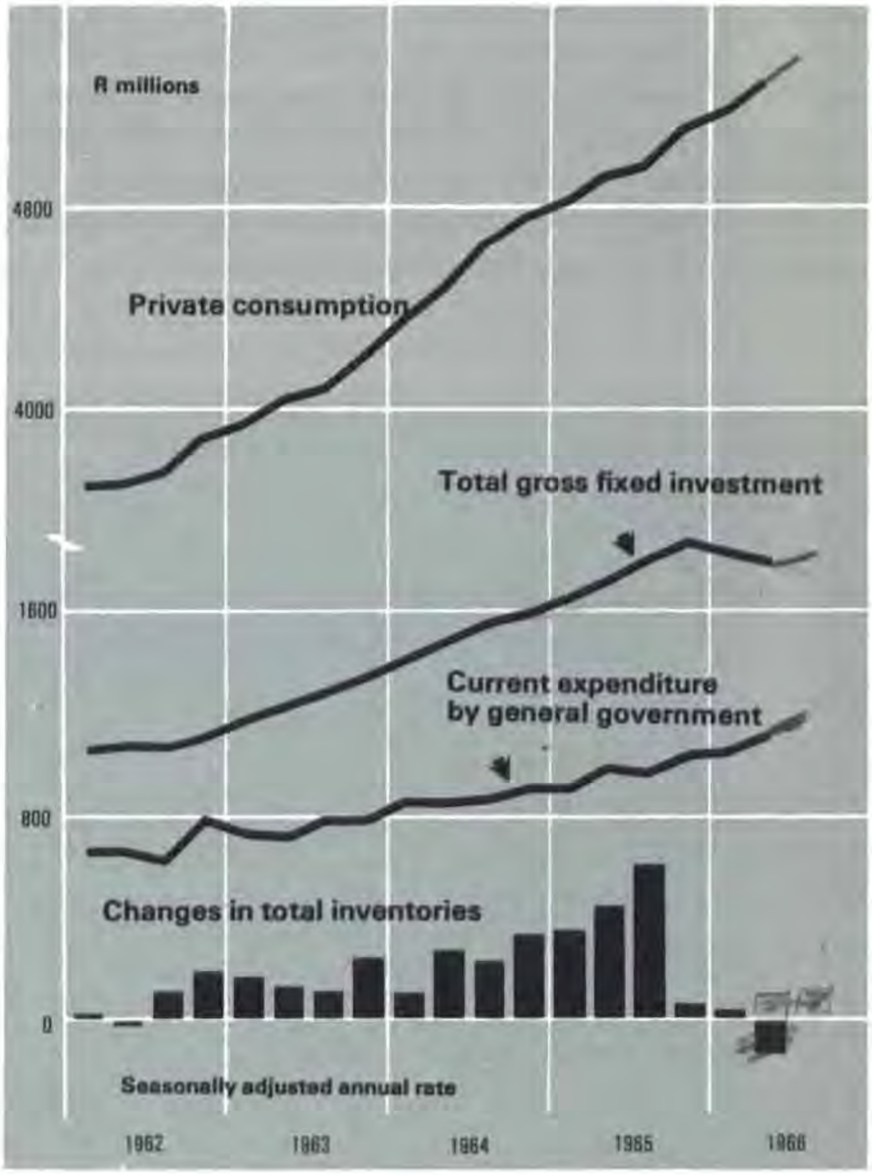
On the 8th July, 1966, the Minister of Finance accordingly announced a new and concerted attack on inflation, including an increase from 5 to 6 per cent in Bank Rate, increases in interest rates on long-term government stock, the abolition of deposit rate control, the extension for a further period of six months of the existing direct restrictions on bank credit, the relaxation of import control, and fiscal measures, details of which were subsequently given in the Budget on the 17th August. The Budget, in fact, provided for substantial increases in a wide variety of direct and indirect taxes and in various other ways reflected the Government's intention to finance its expenditure in a non-inflationary manner.

The balance of payments showed a fairly substantial surplus on current account during the second quarter of 1966, but this was transformed into a small deficit during the period July to August, partly owing to the relaxation of import control as a deliberate disinflationary step. Private capital continued to flow into the country on such a scale, however, that the total gold and foreign exchange reserves increased strongly up to the end of July, before declining slightly during August.

National accounts[1]

Continued rise in gross domestic product

Preliminary indications suggest that the gross domestic product, measured in money terms, increased at a somewhat faster annual rate during the first half of 1966 than during the previous year, but that, in real terms, it increased at roughly the same annual rate as during 1965, namely by about 5 per cent. The gross national product likewise continued to rise strongly and, in sharp contrast to the position during the preceding eighteen months, exceeded gross domestic expenditure during both the first and second quarters of 1966, which meant that there was a surplus in the current account of the balance of payments during this period.

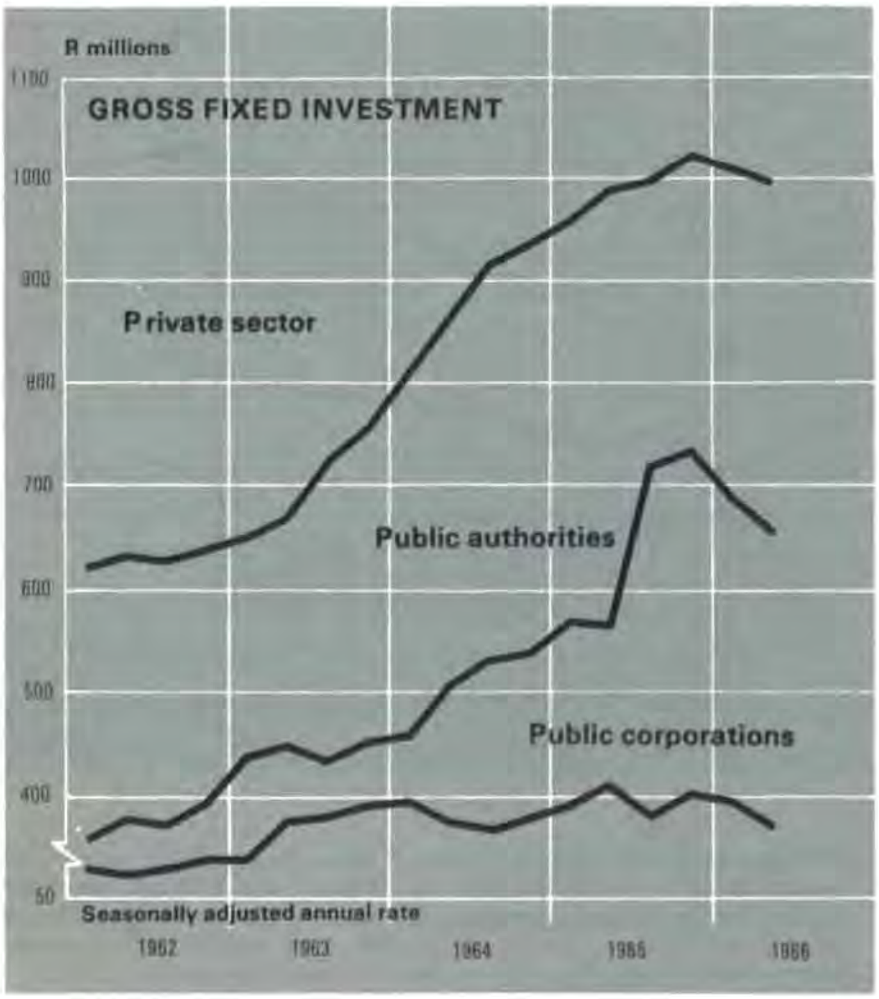


[1] The analysis in this section of the *Review* is largely based on the Reserve Bank's quarterly estimates of the national accounts, *after adjustment for seasonal tendencies.* Since these figures are not yet judged reliable enough for publication, the analysis of quarterly developments is confined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

Increase in gross domestic expenditure

Gross domestic expenditure itself, although remaining below gross national product, increased during both the first and second quarters of 1966. Its main components, however, showed divergent tendencies during this period. Both private consumption and current expenditure by public authorities increased strongly, but fixed capital outlays by private enterprises, public authorities and public corporations all declined moderately. In addition, inventory investment, which had already decreased considerably during the two preceding quarters, continued to decline and even became negative during the second quarter, i.e. total inventories were actually reduced.

It is too early yet to determine the real significance of these expenditure tendencies. Fixed capital outlays and inventory investment are normally strategically important generators of income and a downturn in them is often the forerunner of a more general slowing down in the economy. But it is not yet firmly established that a genuine downturn in fixed capital outlays has, in fact, taken place, while the behaviour of inventory investment was undoubtedly influenced to some extent by the tighter application of import control and does not therefore necessarily signify an important change in the underlying cyclical tendency in the economy. Nevertheless, despite these qualifications, it would appear that the underlying demand for capital goods has, at least, shown signs of levelling off, and from the point of view of reducing the inflationary pressure this is an encouraging development.



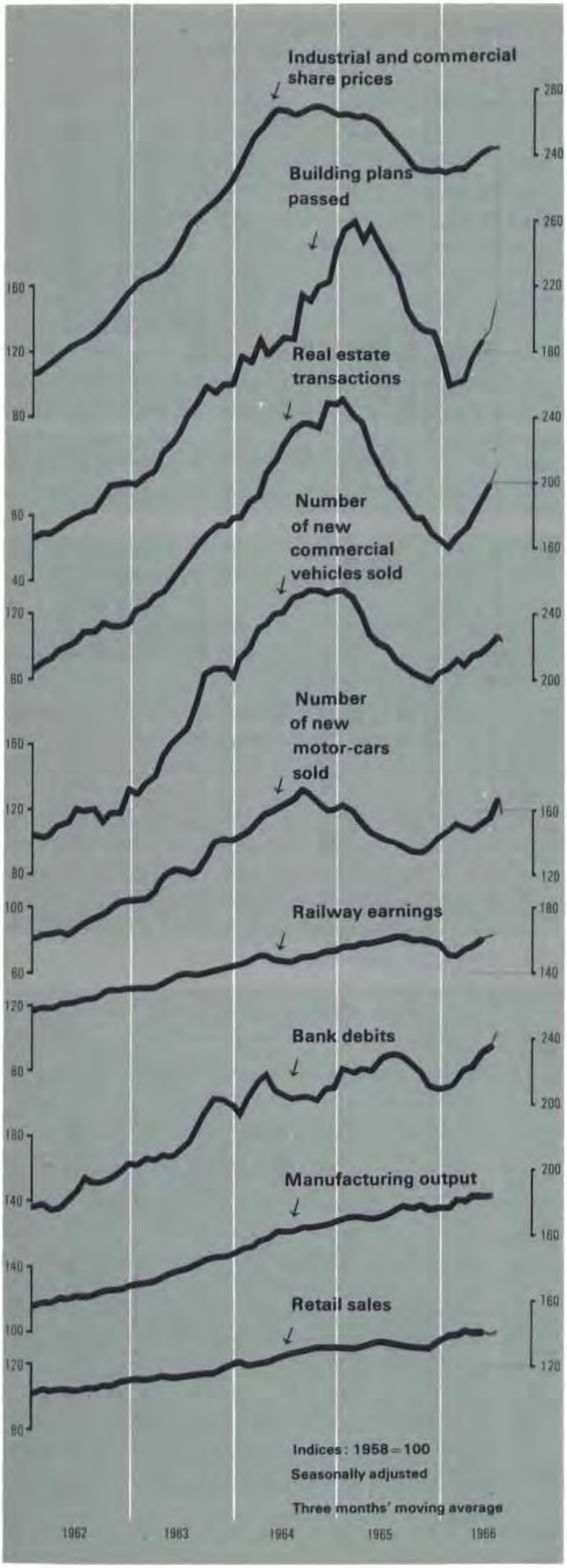
General economic indicators

The task of analysing recent short-term tendencies in the economy is further complicated by the fact that, whereas both fixed and inventory investment declined during the first and second quarters of 1966, various other economic indicators which had declined or levelled off during the course of 1965, actually began to rise again at some stage between October, 1965, and April, 1966. These indicators included building plans passed, real estate transactions, number of new motorcars sold, number of new commercial vehicles sold, bank debits, railway earnings, physical volume of manufacturing output, and retail sales. In addition, as will be indicated in more detail later, exports and the net inflow of private capital showed a marked increase after March, 1966, while imports rose substantially in August, after import control had been relaxed.

These developments by themselves pointed more to a potential new economic upswing, with inflationary consequences, than to a further slowing down of general economic activity. At the very least, they provided evidence of the continued buoyancy and sustained optimism in the economy and help to explain why the inflationary pressure persisted during the first half of 1966 and why the authorities deemed it necessary to apply further disinflationary measures in July and August. These measures themselves have probably already exerted some restraining influence on monetary demand and will, no doubt, continue to do so in the months ahead. But since most of the available statistics cover only the period up to July, and in the case of the national accounts only up to June, it is not yet possible to determine accurately what the effects of the additional measures have been so far. What the available statistics do show, however, is that it was indeed very necessary to apply additional measures of one kind or another.

Prices

The continuation of inflation in South Africa during the first eight months of 1966 is indicated also by the behaviour of the consumer and wholesale price indices, as adjusted for seasonal changes by the Reserve Bank. As the accompanying summary tables show, consumer prices increased during the first eight months of 1966 at roughly the same annual rate as during 1965, while wholesale prices increased during the first seven months of 1966 at about double the rate of 1965, reflecting a faster rise in the prices of both imported and locally produced goods. The acceleration in the prices of locally produced goods was attributable to a more rapid rise in the prices of manufactured products as well as products of agriculture, forestry and fishing.



Consumer prices – seasonally adjusted

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Annual percentage rate of change

Period	Food	Other	Total
Dec. 1964 – Dec. 1965	2·0	3·7	3·2
Dec. 1965 – Aug. 1966	3·6	3·0	3·1

243.4
244.9 Jul.

Wholesale prices – seasonally adjusted

192.9 Jun.
210.6 Jul.

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 – July 1966	4·9	5·3	5·0

198.2
208.2 Jul.

226.4
222.4 Aug.

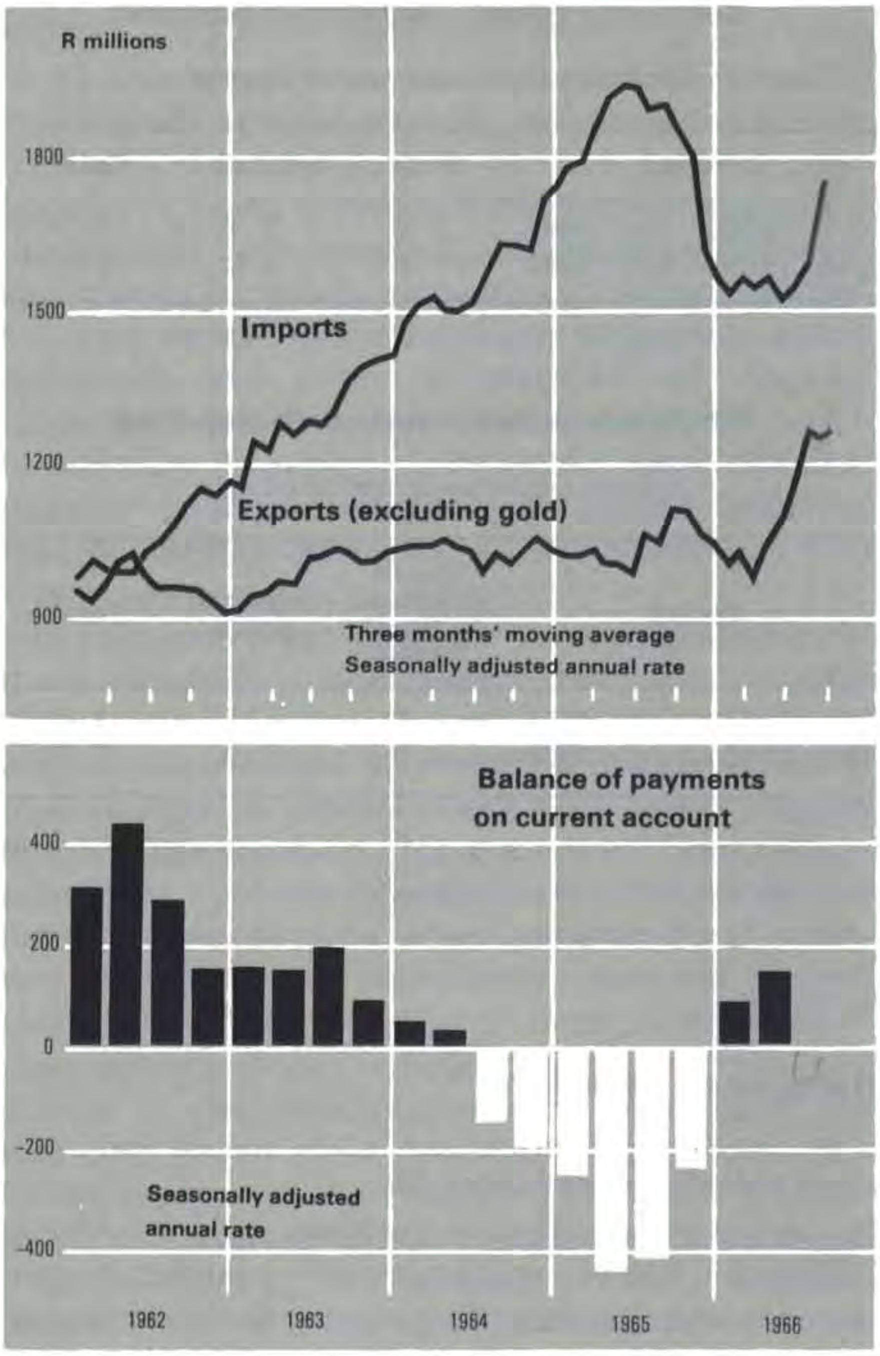
Balance of payments

New deficit on current account

As set out in more detail in the Reserve Bank's *Annual Economic Report,* the seasonally adjusted current account of the balance of payments, taken at an annual rate, changed from a deficit of R424 million during the second quarter of 1965 to a surplus of R148 million during the second quarter of 1966, owing mainly to a substantial decline in imports. After the middle of 1966, however, the current account position began to change once again, particularly following the relaxation of import control announced in July. Thus, after declining from over R1,900 million during the second and third quarters of 1965 to R1,500 million during the second quarter of 1966, seasonally adjusted imports, taken at an annual rate, increased sharply to about R1,760 million in August. Although merchandise exports also increased strongly from May onwards and reached a new record annual rate of R1,430 million during August, this rise in imports was sufficient to produce a small deficit on the current account during the two-month period July to August.

Continued net inflow of capital

But while the current account was transformed into a small deficit during July–August, the net private capital inflow continued at a rate of roughly R20 million per month, of which the greater part appeared to be short-term funds. Central government and banking sector capital, on the other hand, showed a small net outflow of R2 million during these two months.



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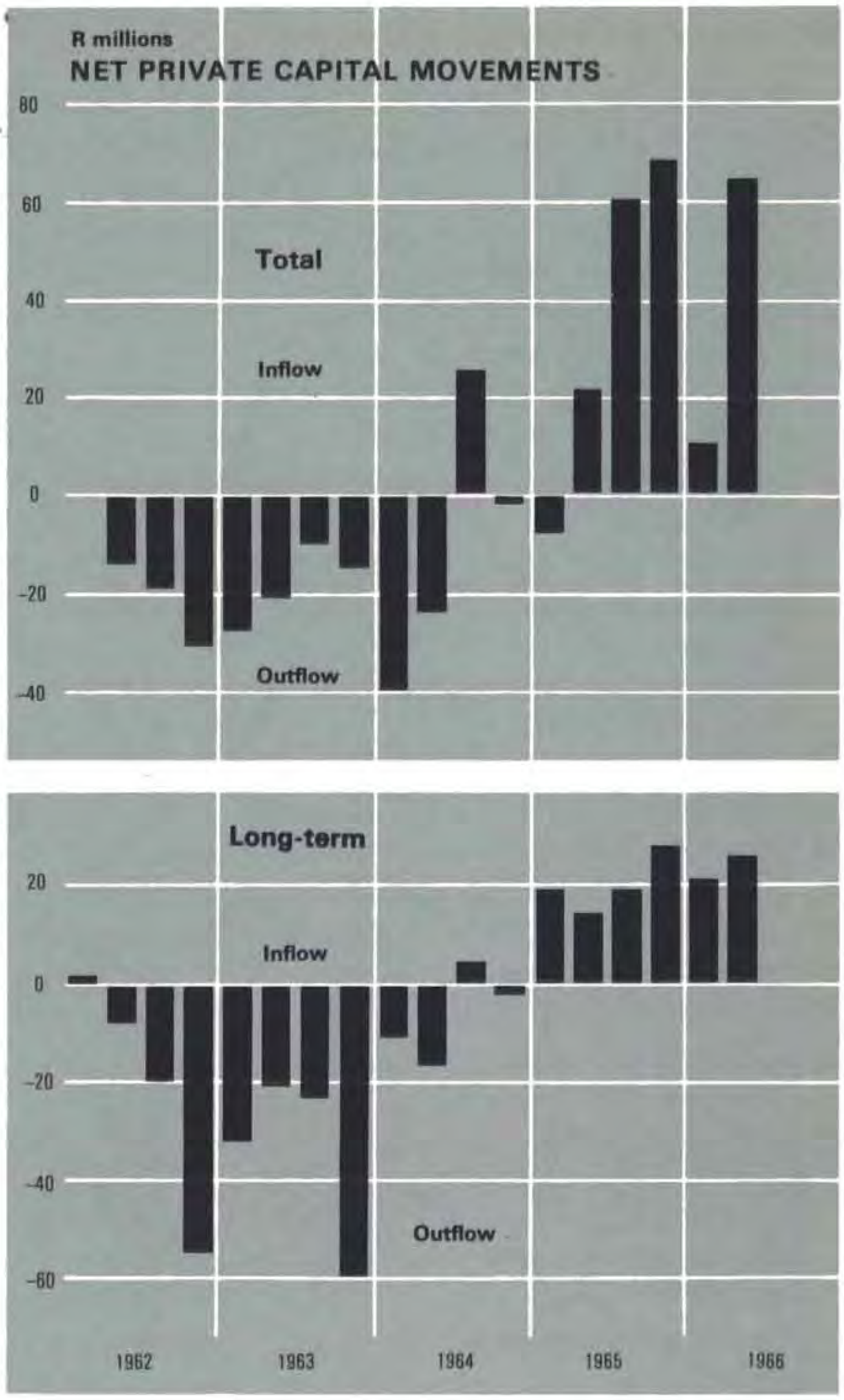
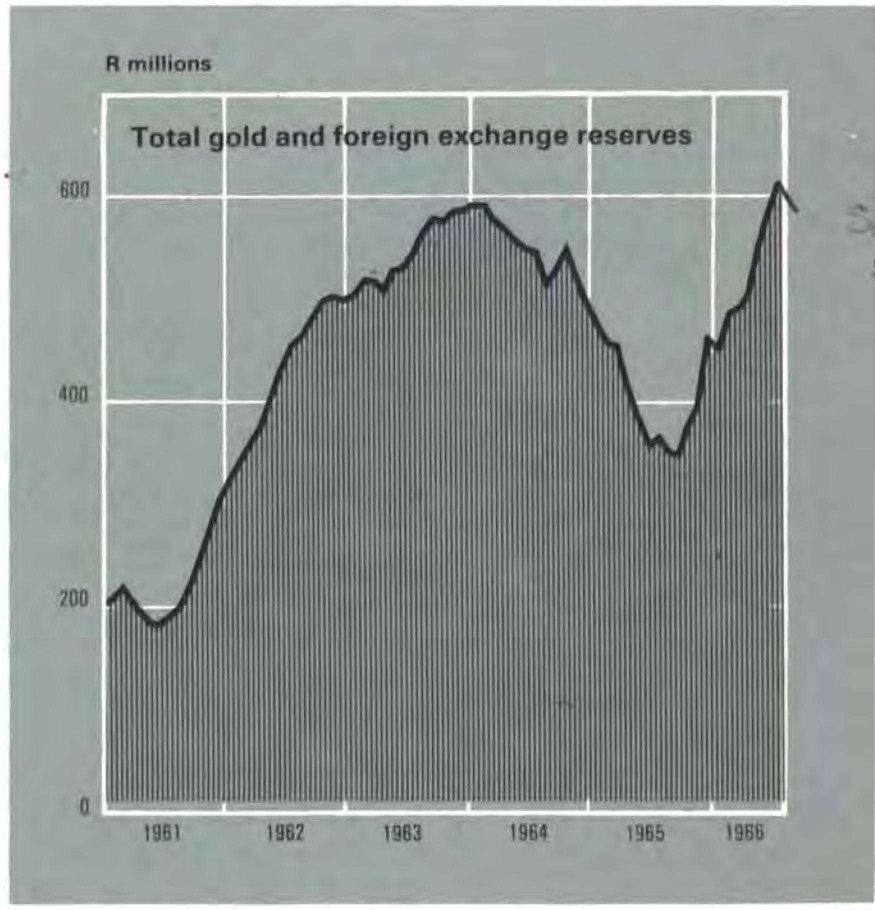


Gold and foreign exchange reserves

During July the total gold and foreign exchange reserves held by the Reserve Bank, the rest of the banking sector and the Government increased further by R26 million, but during August the net capital inflow was not quite sufficient to offset the current deficit, so that the reserves declined by about R6 million to a level just below R600 million.

The recent balance of payments developments, particularly the increase in imports and the disappearance of the surplus on current account, have been strictly in accordance with the official disinflationary policy and have therefore been welcomed by the authorities. To have continued using import control to produce a surplus on the current account of the balance of payments at a time when full employment and inflationary pressure existed in the economy and capital was flowing into the country, might seriously have aggravated the inflation.



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Monetary and banking situation

Excessive liquidity of private sector

The private sector remained in an excessively liquid state during the period April to July. Total money and near-money actually increased by R150 million during the second quarter and by a further R36 million during July, i.e. by R186 million in four months. Furthermore, the ratio of money and near-money to gross national product during the second quarter amounted to the exceptionally high figure of 30 per cent, compared with 29 per cent during the corresponding quarter of 1965 and an average of roughly 27 per cent during the period 1954 to 1965. Despite the various disinflationary measures applied by the authorities during the preceding fifteen months, the monetary climate during the second quarter of 1966 was therefore, if anything, even more conducive to inflation than it had been a year earlier.

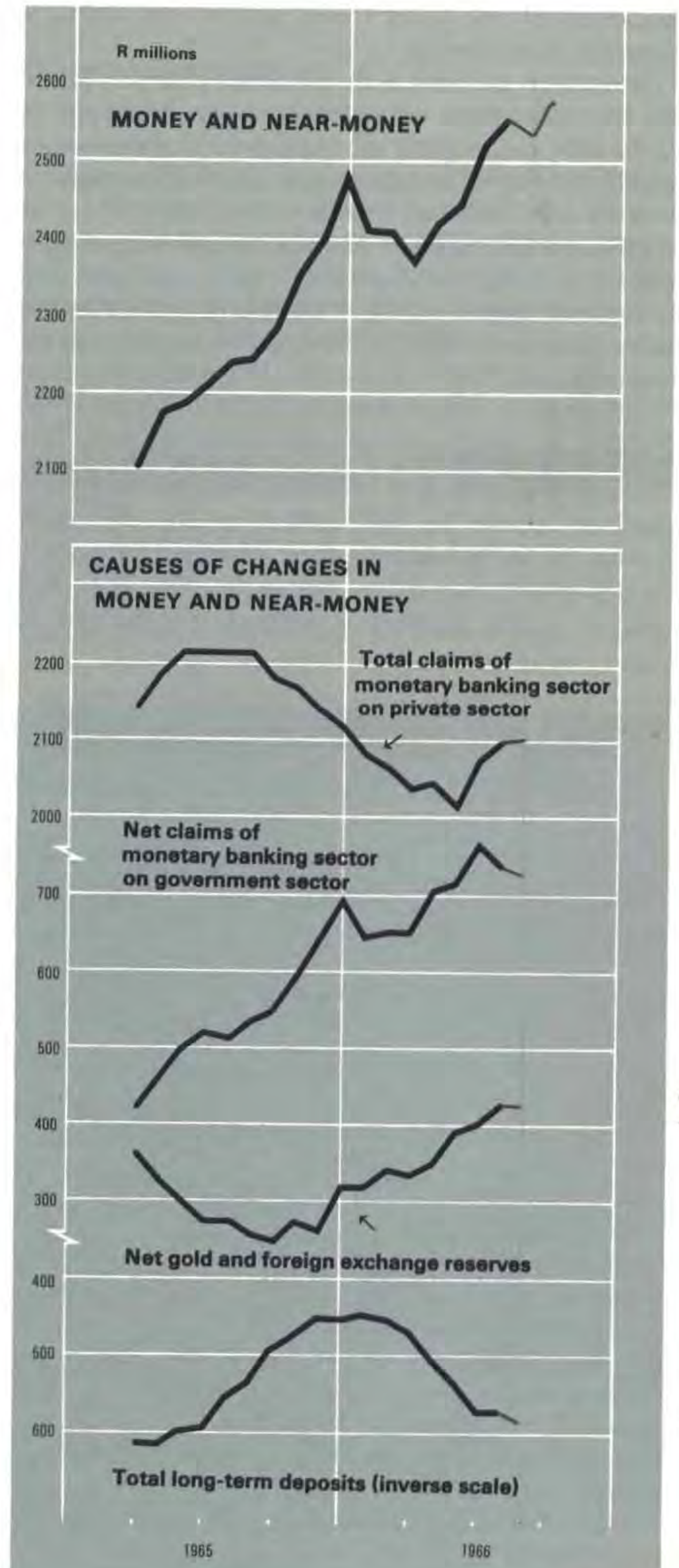
As the accompanying table shows, the main reason for the increase in total money and near-money during the second quarter was a further rise in the net credit extended directly or indirectly to the government sector by the monetary banking sector, as reflected in an increase of R112 million in the *net* claims of the banking sector on the government sector during this period. It is significant to note, however, that this tendency was reversed in July, when the banking sector's net claims on the government sector actually declined by R27 million. At the same time, it must be taken into account that both the increase during the second quarter and the decrease during July in these claims were partly of a seasonal nature.

Another important factor contributing to the further increase in total money and near-money was the favourable over-all balance of payments, which resulted in an increase of R66 million in the net gold and

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.	July
Changes in money and near-money:			
Money	−39	126	−29
Near-money	−78	24	65
Total money and near-money	−117	150	36
Causes of changes:			
Net gold and foreign exchange reserves	18	66	24
Claims on government sector	32	136	2
Government deposits (increase −, decrease +)	−74	−24	−29
Net claims on government sector	−42	112	−27
Claims on private sector	−79	38	24
Long-term deposits (increase −, decrease +)	−16	−102	—
Other assets and liabilities	2	37	15
Total change	−117	150	36



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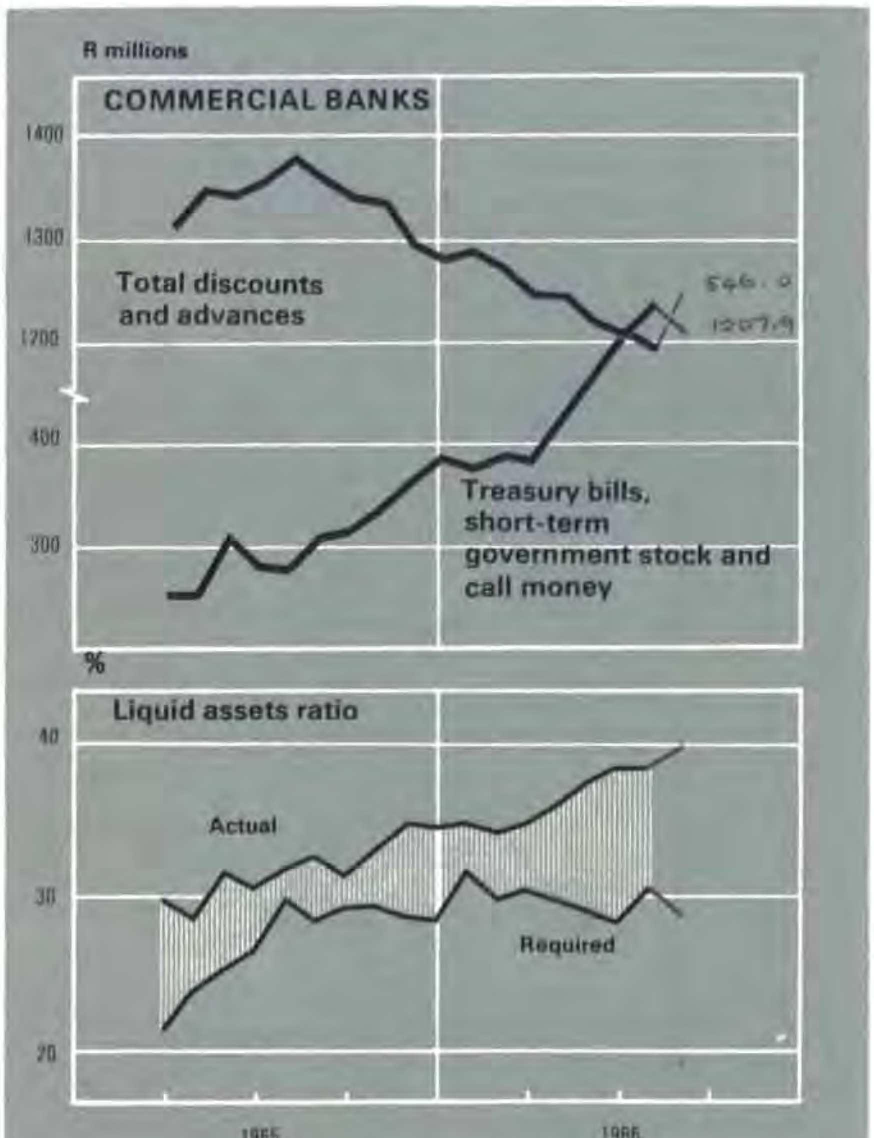
foreign exchange reserves during the second quarter, followed by a further rise of R24 million in July. In addition, the banks also extended additional credit to the private sector, as reflected in increases of R38 million and R24 million during the second quarter and July, respectively, in the claims of the banking sector on the private sector. The latter increases were, however, mainly the result of a sharp rise in the cash credit advances of the Land Bank, which was largely a seasonal phenomenon.

Long-term deposits with the banking sector, which are not considered to be near-money, increased by R102 million during the second quarter, but showed no significant further change in July. Since these deposits had, however, declined substantially during the second, third and fourth quarters of 1965 before rising moderately during the first quarter of 1966, they were only R18 million higher in July, 1966, than a year earlier and still substantially (R42 million) below the level at the end of March, 1965.

Commercial banks

The total discounts and advances of commercial banks declined further by R40 million to R1,205 million during the second quarter, then increased temporarily by R30 million during July, before declining again by a roughly similar amount in August. At the end of August, the banks' "controlled credit", i.e. their discounts and advances subject to the Reserve Bank's credit directive, was more than R120 million or between 9 and 10 per cent below the permissible level. This suggests that the private sector was in general so liquid, as a result of the factors mentioned earlier, that it did not require additional commercial bank credit during this period.

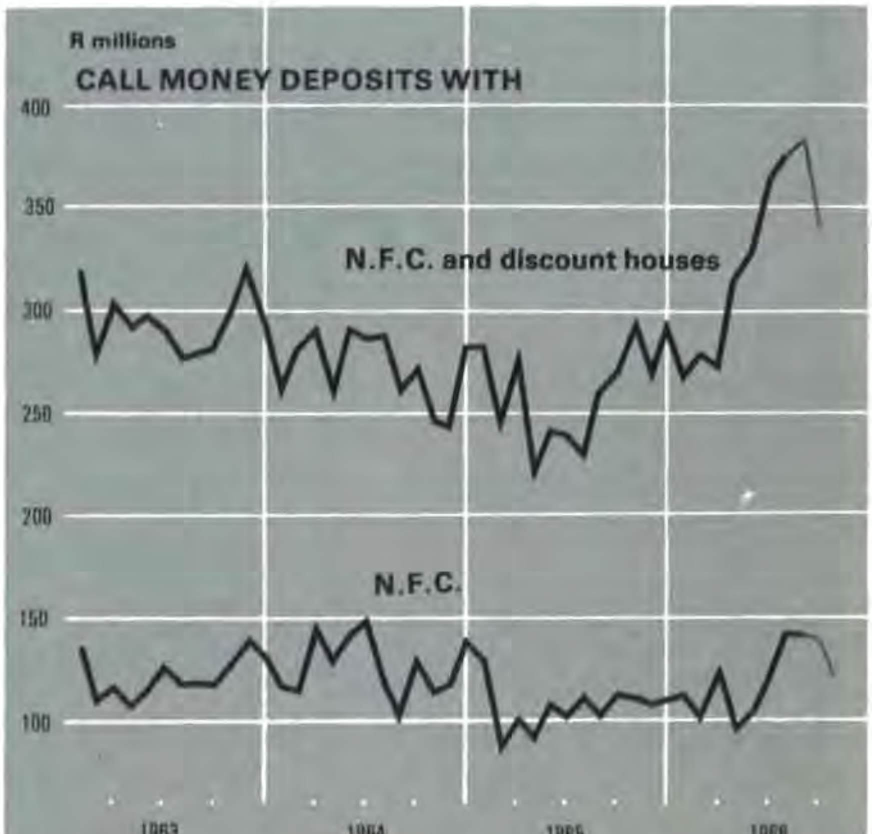


At the same time, as a result of such factors as the surplus on the over-all balance of payments and the Government's increased borrowing from the banks by means of Treasury bills and short-term stock, the commercial banks' total liquid assets increased further from R703 million at the end of March, 1966, to R878 million at the end of August, of which R243 million or 11 per cent of their total liabilities to the public represented *excess* liquid assets.

Merchant banks and monetary hire-purchase and general banks

The experience of merchant banks and monetary hire-purchase and general banks during the period April to July was broadly similar to that of the commercial banks. The "controlled credit" of the merchant banks, for example, declined from R55 million at the end of March to R53 million at the end of July, which was R7 million or 12 per cent below the "base" figure of March, 1965, while their "acceptance facilities utilised" declined from R150 million at the end of March, 1966, to R143 million at the end of July.

Similarly, although the controlled credit of monetary hire-purchase and general banks increased slightly by R3 million during the second quarter and by a further R3 million to R382 million at the end of July, it was still R19 million below the "base" figure of R402



million on the latter date. At that stage these banks maintained *excess* liquid assets of R73 million or nearly 13 per cent of their total liabilities to the public.

Increase in call money

In the existing circumstances it is understandable that call money held with discount houses increased from R149 million at the end of March to R242 million at the end of June, before declining to R232 million at the end of July. Similarly, call deposits with the National Finance Corporation increased from a low point of R95 million at the end of April to R143 million at the end of July.

Short-term interest rates

After declining from a peak of 4·43 per cent on the 28th January to 3·71 per cent on the 8th July, the Treasury bill tender rate, although showing weekly fluctuations, moved upward again to reach 4·22 per cent on the 23rd September. In general, this increase would appear to have been associated with the following factors:

(1) The increase in Bank Rate from 5 to 6 per cent on the 8th July;
(2) an increase of R62 million in government deposits with the Reserve Bank between the 8th July and the 23rd September;
(3) an increase of R65 million in total tender Treasury bills outstanding during this period;
(4) the issue of "tap" Treasury bills, which on the 19th July amounted to as much as R39 million; and
(5) the sale of government stock by the Reserve Bank to the National Finance Corporation from time to time under repurchase agreements.

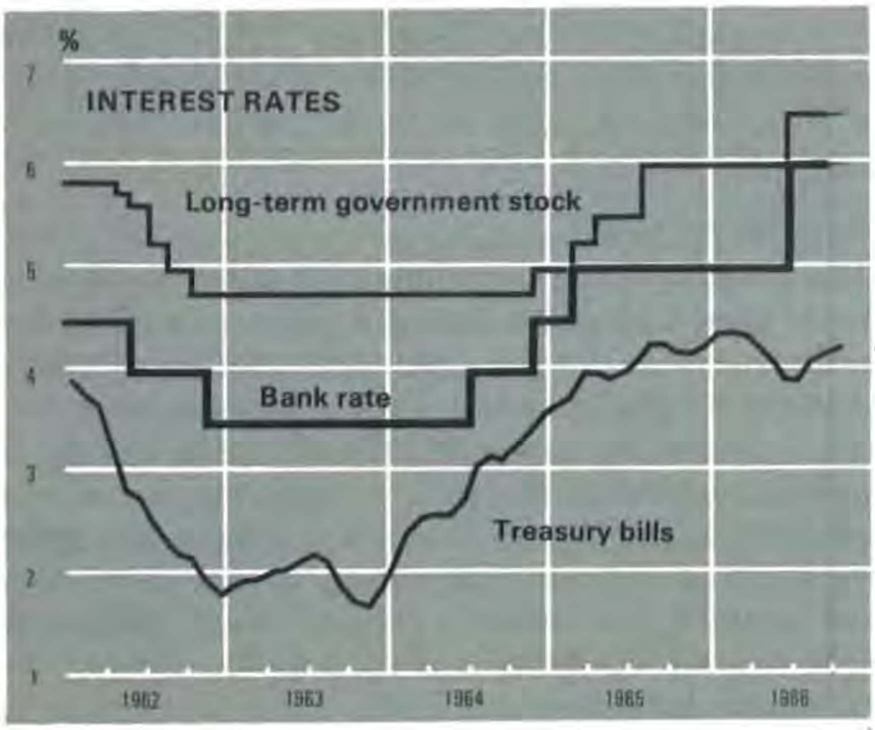
These tightening factors were partially offset by easing influences such as an increase of R23 million in the gold and foreign exchange holdings of the Reserve Bank and a rise of R17 million in Reserve Bank credit to the Government and other institutions outside the money market proper.

An interesting development during the period under discussion was an upward adjustment as from the 29th July in the call money rate of the National Finance Corporation, namely to 15 cents below the tender Treasury bill rate as compared with about 25 cents formerly.

Government finance

It was mentioned earlier that the main reason for the increase of R150 million in total money and near-money during the second quarter of 1966 was a further rise in the net credit extended directly or indirectly to the government sector by the monetary banking sector, as reflected in an increase of R112 million in the net claims of the banking sector on the government sector during this period. The latter increase, in fact, arose from an increase of R136 million in the banking sector's holdings of Treasury bills, government stock and other claims on the government sector, which was offset to an amount of R24 million by a rise in government deposits.

During July the banking sector's gross claims on the government sector increased further by R2 million, but since government deposits increased by R29 million, the *net* claims of the banking sector on the government sector declined by R27 million. This was a most welcome development, since the avoidance of a further rise in net bank credit to the government sector forms



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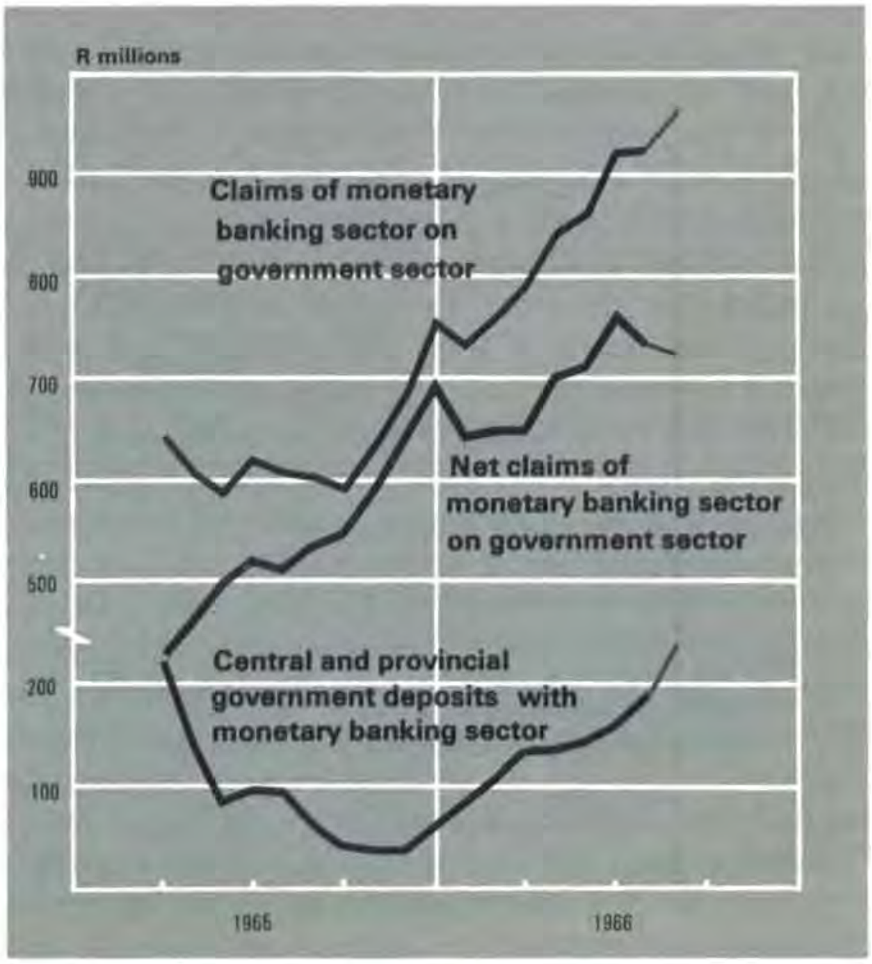

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an important part of current monetary and fiscal policy, which aims *inter alia* at reducing the excessively high ratio of money and near-money to gross national product. Indeed, in his recent Budget speech, the Minister of Finance placed great emphasis upon the desirability of financing government expenditure in a non-inflationary way, i.e. by means of taxes and long-term loans from outside the monetary banking sector. To this end, the rate of interest on long-term government stock was raised on the 8th July, while the Minister announced in his Budget speech that legislation would be introduced during the current session of Parliament to require insurance companies, pension funds and unit trusts to hold more government stock.

It must be noted, however, that the "government sector" referred to 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 administrations of Basutoland, Bechuanaland and Swaziland. The main developments during recent months in the Exchequer Account as such are summarised in the accompanying table. It appears that during the second quarter of 1966 the Exchequer had to increase its indebtedness to the monetary banking sector by R129 million and that this was offset to the extent of only R72 million by a rise in government deposits, so that the Exchequer's *net* indebtedness to the banking sector increased by as much as R57 million. This was, however, partly a seasonal movement and during July the position improved considerably, as the Exchequer succeeded in reducing its net indebtedness to the banking sector by R7 million.

Exchequer finance

R millions

	1966 2nd Quarter	1966 July
Total deficit, excluding borrowing	107	16
Financing—		
Change in net indebtedness to:		
Foreign sector	4	4
Private non-bank sector	28	7
Public Debt Commissioners	18	12
Monetary banking sector:		
Change in government securities	129	2
Change in Exchequer balance*	−72	−9
Total	57	−7
Total financing	107	16

*Increase −, decrease +.

Capital market

The increase in the supply of loanable funds stemming from the further rise in money and near-money during the period April to July naturally prevented the tendency for capital expenditure to exceed the available supply of savings from having its full effect on capital market conditions. Nevertheless, conditions remained tight in most sections of the capital market and further upward pressure was exerted on long-term interest rates during this period.

Rise in rates on fixed interest-bearing securities

In the gilt-edged market, for example, this pressure led the Reserve Bank, as part and parcel of the official anti-inflationary policy, to raise its rates for government stock with maturities of $10\frac{1}{2}$ years and longer on a graduated scale, starting with 6 per cent for maturities of $10\frac{1}{2}$ years and longer to $6\frac{1}{2}$ per cent for maturities of 25 years and longer. This adjustment was followed by an increase in the yields on municipal and public corporation securities. Indeed, recently announced issues of such securities offered a yield to redemption as high as 7·2 per cent, compared with about $6\frac{3}{4}$ per cent in May. The yield on new issues of private debentures, which had already risen to as much as $7\frac{3}{4}$ per cent by the middle of 1966, also increased further.

Share prices and yields

The prices of all the major classes of shares, with the exception of mining financial shares, tended either to level out or to decline during the second quarter and July. Gold mining share prices fluctuated around a more or less horizontal level, while the prices of coal mining, industrial financial, industrial and commercial shares showed noticeable declines during June and July. The average yield on gold mining shares continued its upward course and stood at 9·3 per cent in July, compared with 9·1 per cent in April, while that on industrial and commercial shares declined to about 5·0 per cent in April before increasing to 5·3 per cent in June.

Building societies

The position of the building societies remained relatively tight during the period April to July and they were again unable to meet completely the strong demand for their mortgage loans. They did, nevertheless, succeed in increasing their mortgage and other loans outstanding by R20 million and in adding another R20 million to their liquid assets and other investments during these four months. Moreover, during June and July the rate at which they were granting new advances was considerably higher than during the early months of 1966.