Quarterly economic review

Main developments

The official policy of curbing inflation by means of restrictive monetary and fiscal measures on the one hand, and the progressive relaxation of import control on the other, met with considerable success during the second half of 1967. *Excess* monetary demand – the root cause of both the internal price inflation and the deterioration in the current account of the balance of payments – was substantially reduced and the undue pressure upon scarce resources relieved to an appreciable extent.

The clearest evidence of the attainment of a better balance between demand and supply was provided by the substantial improvement in the balance of payments on current account. During the first half of 1967 the deficit on current account still amounted to a seasonally adjusted annual rate of about R325 million, but during the second half of the year this was transformed into a seasonally adjusted annual surplus of about R26 million. This was mainly attributable to a sharp rise in merchandise exports during the second half of the year and a marked downward movement in imports beginning in February 1967. The fact that imports showed this pronounced declining tendency despite the progressive relaxation of import control, suggests that the restrictive monetary and fiscal measures succeeded in substantially reducing the excessive demand for goods and services. This becomes even clearer if it is taken into account that the rise in export earnings must have operated in the opposite direction, namely that of stimulating demand.

Further evidence of a decline in the inflationary pressure was provided by the behaviour of prices. The seasonally adjusted consumer price index, for example, increased by only 1·8 per cent between December 1966 and December 1967 and at an annual rate of only 0·3 per cent between June 1967 and December

1967, compared with 3·8 per cent between December 1965 and December 1966. Moreover, this decline in the rate of increase was only partly attributable to a decline in food prices during the second half of the year – other consumer prices increased at a much slower rate during this period than previously. Even more encouraging was the slower rate of increase shown by the seasonally adjusted index of wholesale prices during 1967. After rising by 4·5 per cent between December 1965 and December 1966, this index increased by only 0·8 per cent during the next twelve months and actually declined at an annual rate of 1·7 per cent during the second half of 1967.

In addition, it now appears from an analysis of the main components of gross domestic expenditure and most other general economic indicators that the new upswing in aggregate demand which had begun during the second quarter of 1966, levelled off from roughly the middle of 1967. Some indicators, such as private consumption and bank debits, increased at a noticeably slower rate than formerly. Others, including total fixed capital outlays and manufacturing production, tended to move horizontally; while a third group, including inventory investment, the number of new motor cars and commercial vehicles sold, real estate transactions and railway earnings, declined noticeably.

A further gratifying feature of the situation was the fact that the restrictive measures succeeded in reducing the inflationary pressure with a minimum of dislocation and without resulting in either significant unemployment or a reduction in the *real* growth rate of the economy. In fact, according to provisional estimates, real gross domestic product increased by nearly 7 per cent during 1967, compared with 6 per cent in 1966 and the Economic Development Programme's average rate of 5½ per cent per year. Even if allowance is made for the fact that this high growth rate was partly the result of an exceptionally large *increase* in agricultural production, which will not be repeated in 1968, it still represented a satisfactory performance.

At the same time, however, there appeared to be important influences at work which threatened to upset the approximate balance reached between total demand and supply and to produce a new inflationary upswing. These influences included not only the persistent shortage of skilled labour and the fact that increases in salaries and wages in the public sector appeared to be imminent, but also the implications for the South African economy of the widespread international currency fears and gold speculation which followed the devaluation of the British pound in November 1967. These international developments tended to create new internal inflationary pressure in three main ways. In the first place, they produced fresh inflationary expectations, which threatened to neutralise the sobering effect of the internal disinflationary tendencies referred to earlier. Secondly, they brought about a large net inflow of foreign capital for investment in shares as well as in other forms, thereby increasing the liquidity of both the banking sector and the non-bank private sector and tending to offset the contractionary effects of the official monetary and fiscal policies. And thirdly, they helped to produce a sharp rise in share prices and turnover on the Johannesburg Stock Exchange, which resulted in substantial realised or anticipated capital gains.

In these circumstances, the authorities deemed it essential to persist with their main disinflationary measures, while keeping a close watch on international as well as domestic economic developments.[1]

[1] This Review was printed before the contents of the latest Budget were known.

National accounts[1]

Gross domestic product

Gross domestic product increased by 9·3 per cent from R8,793 million in 1966 to R9,607 million in 1967. In real terms, i.e. after correction for price increases, this represented a growth rate of nearly 7 per cent, compared with 6 per cent during 1966 and an average of just over 6 per cent during the six years between 1960 and 1966. It must, however, be taken into account that the contribution of agriculture to real gross domestic product showed an abnormally large increase of about 23 per cent during 1967 and that the rest of the gross domestic product increased in real terms by only about 5 per cent during this period.

Since the increase in the contribution of agriculture occurred mainly in the second and third quarters of the year, the quarterly domestic product estimates show an exceptionally large increase during these two quarters, followed by an actual decline in the fourth quarter. If agriculture is excluded, however, the rest of the gross domestic product increased at a fairly steady rate throughout the year.

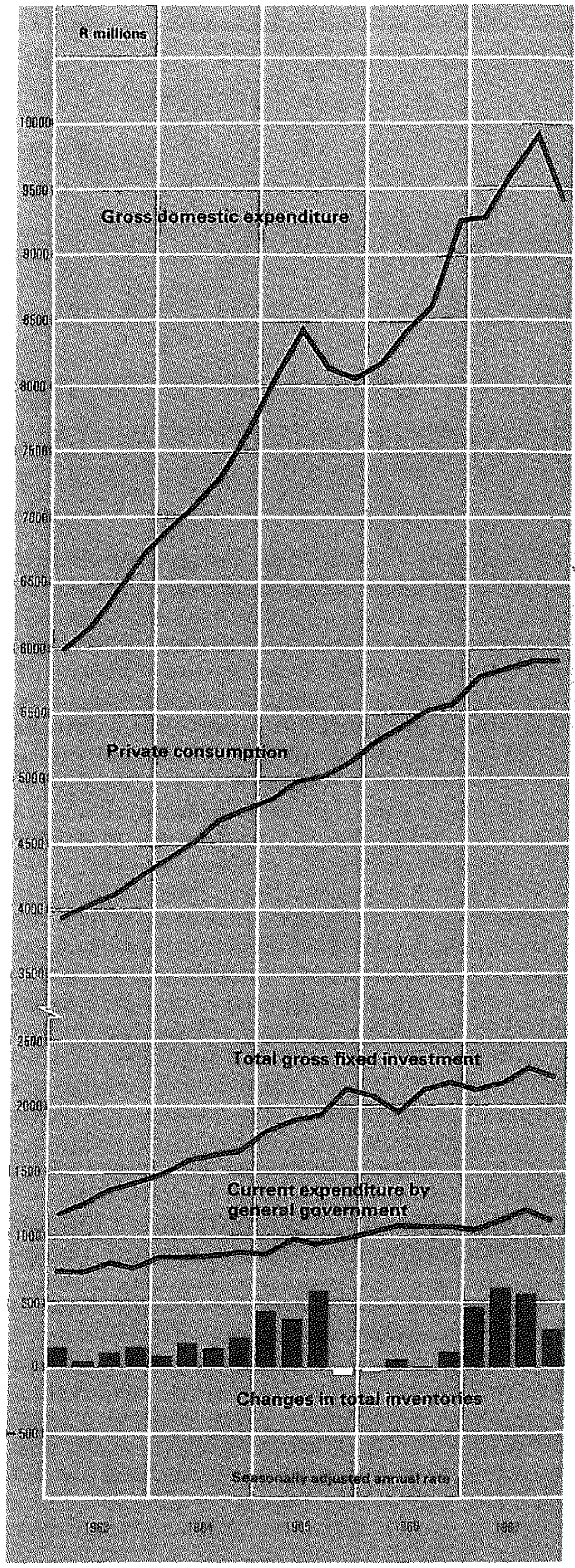
Gross domestic expenditure

Gross domestic expenditure increased by more than 11 per cent during 1967, compared with about 5½ per cent during 1966 and an annual average of about 9 per cent during the six years between 1960 and 1966. The main reason for this considerable increase was an exceptionally large rise in inventory investment, namely from R55 million in 1966 to R491 million in 1967; the total of the other components of gross domestic expenditure, i.e. private consumption, current government expenditure and fixed investment, increased by only about 7 per cent between 1966 and 1967.

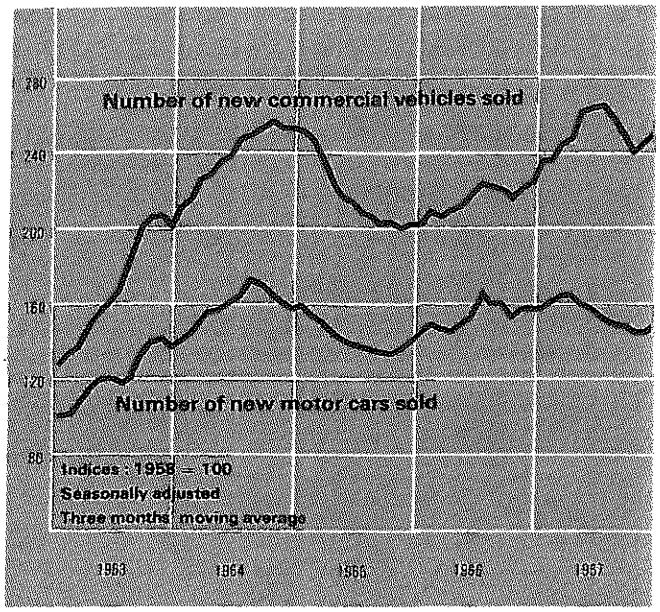
It appears to be significant, however, that after already slowing down somewhat during the third quarter, gross domestic expenditure for the first time since the third quarter of 1965 showed an actual decline – a fairly sharp one – during the fourth quarter.

Private consumption and current government expenditure

The behaviour of private consumer spending during 1967 was most encouraging. After rising at an average annual rate of about 8 per cent during the six years between 1960 and 1966 and by nearly 9½ per cent during 1966, it slowed down to a rate of only about 7½ per cent during 1967. This meant that, in real terms, consumption increased by only about 4½ per cent during the year, which was considerably less than the



[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.



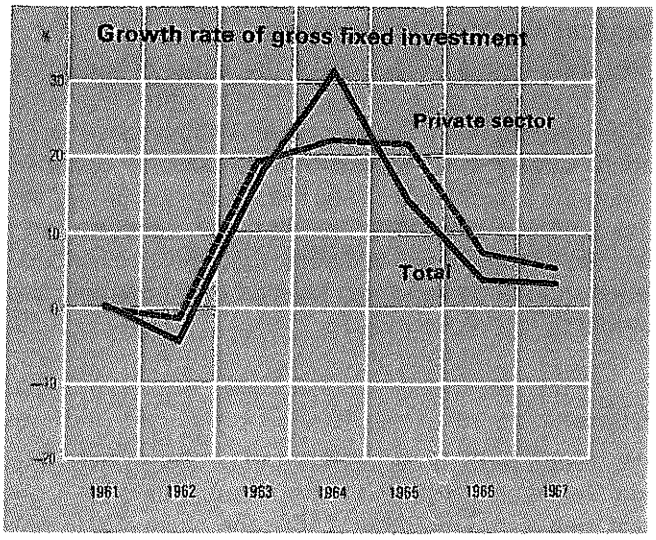
rate of increase of nearly 7 per cent shown by real gross domestic product. Spending on both durable and non-durable goods, as well as on services, increased by much less during 1967 than during the previous year.

Moreover, during the course of 1967 private consumption increased at a progressively slower rate until, during the fourth quarter, it showed practically no increase at all.

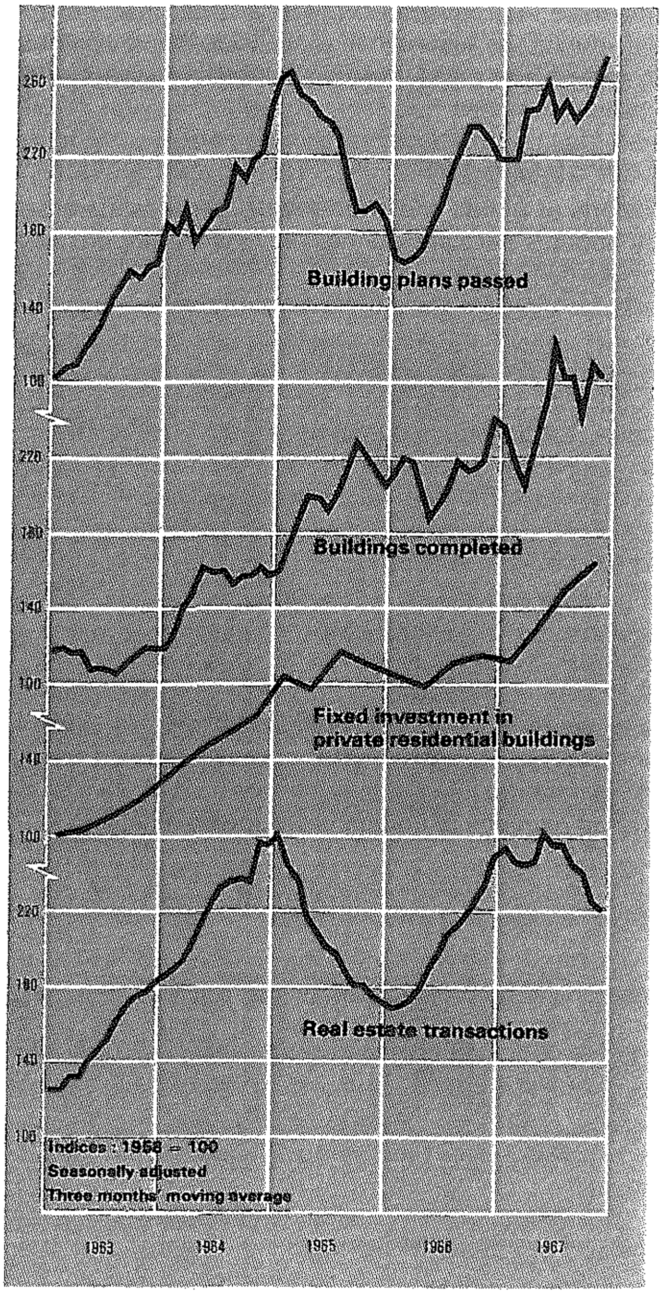
Current government expenditure also increased at a considerably slower rate during 1967, namely by about 6 per cent, compared with 14 per cent during 1966 and an average annual rate of about 12½ per cent between 1960 and 1966.

Fixed capital expenditure

One of the best indications of the effectiveness of the disinflationary monetary and fiscal policies of the past two years is provided by the behaviour of total fixed capital expenditure. After rising by 20 per cent in 1963 and 22½ per cent during both 1964 and 1965 – this, of course, was one of the main causes of the inflation during these years – it increased by only 7½ per cent in 1966 and 6 per cent in 1967.



Private fixed investment, which had risen by as much as 16½ per cent in 1963, 31 per cent in 1964 and 14½ per cent in 1965, increased by only 4 per cent in 1966 and 3½ per cent in 1967. Moreover, of the increase of R39 million shown by this important component of total spending during 1967, R34 million was accounted for by residential building, while fixed in-



vestment by manufacturing and commercial enterprises actually declined.

Fixed capital outlays by public authorities, which had risen by 8 per cent in 1966, increased by only 5 per cent in 1967, while the rate of increase of fixed investment by public corporations slowed down from 31½ per cent in 1966 to 23 per cent in 1967.

Inventory investment

As mentioned earlier, total inventory investment amounted to the abnormally high figure of R491 million in 1967, compared with R55 million in 1966. This was mainly attributable to increases in agricultural inventories (R157 million), industrial inventories (R103 million) and commercial inventories (R101 million). After rising to a peak in the second quarter of 1967, however, total inventory investment declined noticeably during the second half of the year, thereby helping to reduce the pressure upon imports as well as domestic resources.

Exports and imports

Exports of goods and (non-factor) services increased by about 9 per cent during 1967, while imports rose by about 17½ per cent, mainly reflecting the building-up of inventories. As will be pointed out in more detail in the balance of payments section, however, imports showed a pronounced downward tendency during the course of the year, while exports were much higher during the second half than during the first half, so that the balance of payments on current account improved considerably from about the middle of the year.

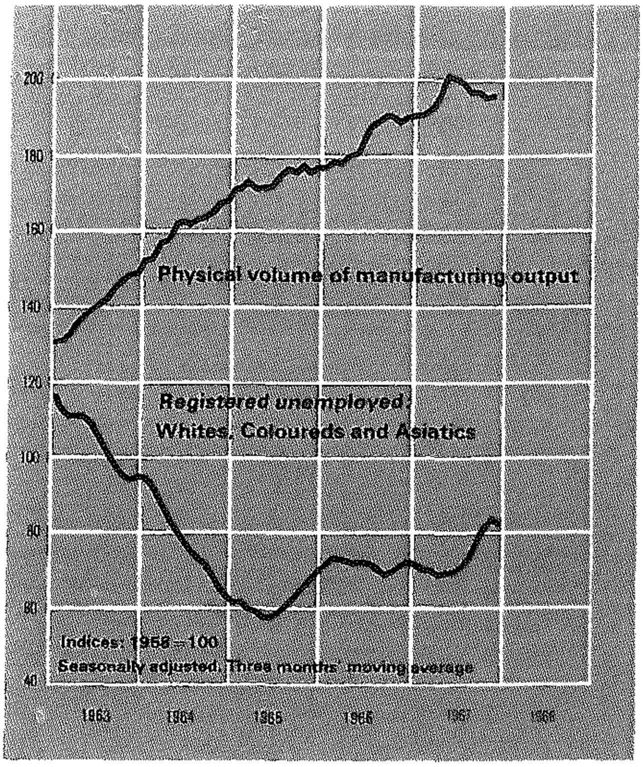
Gross domestic saving

The large increase in gross domestic product and the slowing down in the rate of increase of private consumption combined to bring about a welcome rise of R420 million or nearly 20 per cent in gross domestic saving during 1967. This mainly took the form of increases in personal saving and in the current surplus of general government; corporate saving, i.e. the retained earnings of companies, showed a decline.

Production and employment

After rising sharply during the first half of 1967, the seasonally adjusted index of the physical volume of manufacturing output levelled off completely during the second half. It's monthly average during 1967 nevertheless still exceeded that of 1966 by approximately 6 per cent. Metal products, food and transport equipment made the largest contributions to this increase.

Manufacturing employment maintained its upward movement during 1967 and was on average about 4 per cent higher than during the previous year.



The index of the volume of gold production declined moderately during 1967, while that of mining production other than gold was on average 3·8 per cent higher than during 1966. Employment in both gold mining and other mining enterprises declined somewhat during 1967.

After remaining more or less constant at a figure of about 70 during the first half of 1967, the seasonally adjusted index of registered unemployed Whites, Coloureds and Asiatics (1958=100) increased to 84·3 in December.

General economic indicators

With the notable exception of the index of industrial and commercial share prices, virtually all the available monthly economic indicators either increased at a much slower rate, moved horizontally or declined during the second half of 1967, thereby confirming the impression gained from the national accounts and balance of payments statistics that the cyclical upswing in total demand had levelled off from about the middle of the year.

Prices

After rising by 3·8 per cent between December 1965 and December 1966 and at an annual rate of 3·4 per cent between December 1966 and June 1967, the seasonally adjusted consumer price index increased at an annual rate of only 0·3 per cent between the latter date and December 1967. As the accompanying table shows, this marked slowing down was attributable partly to a decline in food prices during the second half of 1967, but partly also to a marked reduction in the annual rate of increase of other prices, namely from 2·7 per cent during the first half of the year to 1·3 per cent during the second half.

In January 1968 the total seasonally adjusted index (1958=100) amounted to 122·7, compared with 122·6 in December 1967.

Consumer price index – seasonally adjusted
Annual percentage rate of change

Period	Food	Other	Total
Dec. 1965–Dec. 1966 . . .	4·4	3·5	3·8
Dec. 1966–Dec. 1967 . . .	1·6	2·0	1·8
Dec. 1966–June 1967 . .	5·0	2·7	3·4
June 1967–Dec. 1967 . .	−1·8	1·3	0·3

The seasonally adjusted index of wholesale prices similarly reflected the reduction in inflationary pressure during the second half of 1967. After rising by 4·5 per cent between December 1965 and December 1966 and at an annual rate of 3·3 per cent between December 1966 and June 1967, it actually declined at an annual rate of 1·7 per cent between the latter date and December 1967. While this latter decline was mainly the result of an abnormally large decrease in wholesale prices in agriculture, forestry and fishing, the rate of increase of wholesale prices of South African manufactured goods also declined noticeably, namely from 4·6 per cent between December 1965 and 1966 to annual rates of 2·3 and 0·7 per cent during the first and second halves of 1967, respectively.

In January 1968 the total index (1958=100) stood at 118·2, compared with 117·8 in December 1967.

Wholesale price index – seasonally adjusted
Annual percentage rate of change

Period	Goods produced in S.A.			Imported goods	Total
	Agriculture, etc.	Manufacturing	Total		
Dec. 1965–Dec. 1966	7·3	4·6	5·0	3·2	4·5
Dec. 1966–Dec. 1967	−4·2	1·5	0·5	1·4	0·8
Dec. 1966–June 1967	6·7	2·3	3·4	2·6	3·3
June 1967–Dec. 1967	−14·0	0·7	−2·3	0·2	−1·7

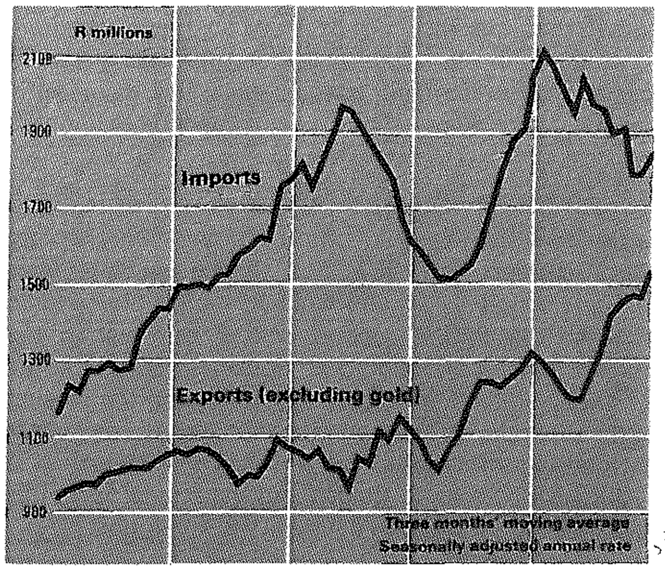
Balance of payments

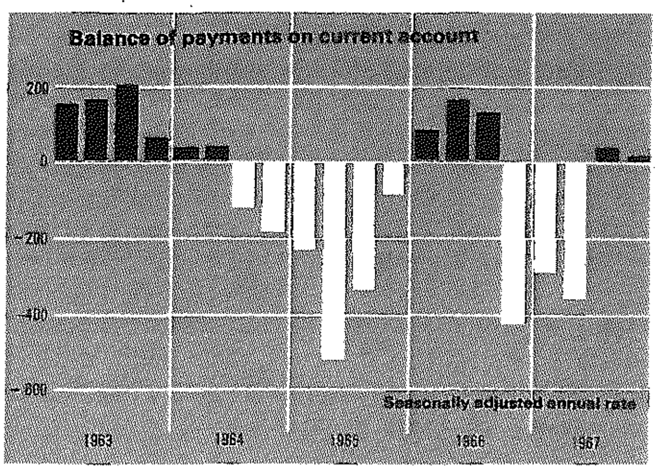
Balance on current account

Important changes occurred in South Africa's balance of payments on current account during the course of 1967. Thus, while this account still showed deficits of R85 million and R96 million during the first and second quarters, respectively, it yielded a deficit of only R5 million during the third quarter, followed by a surplus of R35 million during the fourth quarter. After adjustment for seasonal tendencies, and taken at an annual rate, the current account showed deficits of R290 million and R360 million during the first and second quarters and surpluses of R40 million and R12 million during the third and fourth quarters, respectively.

Increase in exports

One important reason for this improvement was a sharp rise in merchandise exports from about July. After amounting to annual rates of R1,280 million and R1,232 million during the first and second quarters, seasonally adjusted exports increased to annual rates of R1,476 million and R1,332 million during the third





and fourth quarters, respectively. The main categories contributing to this increase were foodstuffs, raw materials and certain classes of manufactured goods. During January 1968 this figure increased further to R1,642 million.

Declining tendency in imports

The other main reason for the emergence of a current surplus during the second half of the year was a downward tendency shown by imports from February onwards. After reaching a record level of more than R2,200 million in January 1967, seasonally adjusted imports, taken at an annual rate, declined to R1,772 million during the fourth quarter, the major decreases occurring in the statistical classes "machinery and transport equipment" and "manufactured goods". In January 1968, however, imports increased again to an annual rate of R2,015 million.

The downward tendency in imports during the course of 1967 would appear to have been directly attributable to the "cooling down" of the internal economy, particularly since it followed the relaxation of import control in three main stages, namely in July and December 1966 and in May 1967. Experience has shown that imports in South Africa are highly sensitive to changes in aggregate monetary demand – a mere levelling off in demand, after an excessive increase, is generally accompanied by an actual decline in imports.

Other current transactions

South Africa's net gold output showed only a very slight increase in 1967, but service receipts from foreigners increased by R83 million, mainly owing to an increase during the second half of the year in the number of ships stopping at South African harbours for ships' stores and bunker fuel following the closing of the Suez Canal. On the other hand, service payments to foreigners increased by R75 million, largely as a result of increases in freight and insurance payments and investment income payments to foreigners.

Substantial inflow of private capital

The fourth quarter of 1967 marked the eleventh consecutive quarter in which the South African private sector received a net inflow of capital from abroad. Although the net private capital inflow decreased from R89 million in the second quarter to R44 million in the third quarter and to R47 million in the fourth quarter of 1967, the total net inflow of R198 million for the year as a whole was about R38 million more than the figure for 1966. This brought the total net inflow of private capital during the three years 1965 to 1967 to R520 million. According to preliminary indications, there was a large further net inflow of private capital during January 1968.

The net inflow of R198 million during 1967 consisted of R143 million in the form of long-term capital and only R55 million in the form of short-term capital (including errors and unrecorded transactions). During the fourth quarter of the year, when the net inflow of private funds amounted to R47 million, the identified *long-term* private capital inflow actually amounted to R68 million, while *short-term* private capital (including errors and unrecorded transactions) showed a net outflow of R21 million. To some extent the large inflow of long-term funds during this period would appear to have been related to international uncertainties regarding certain foreign currencies and the dollar price of gold. Transactions by foreigners in South African securities listed on the Johannesburg Stock Exchange, for example, resulted in a net capital inflow of R17 million during the fourth quarter of 1967, compared with R1 million, R2 million and R9 million during the first, second and third quarters, respectively.

Further net outflow of official and banking capital

Central government and banking capital showed a net outflow of R18 million during the fourth quarter of 1967 to bring the total net outflow of this kind of capital for the year as a whole to R73 million, compared with a net outflow of R11 million during 1966.

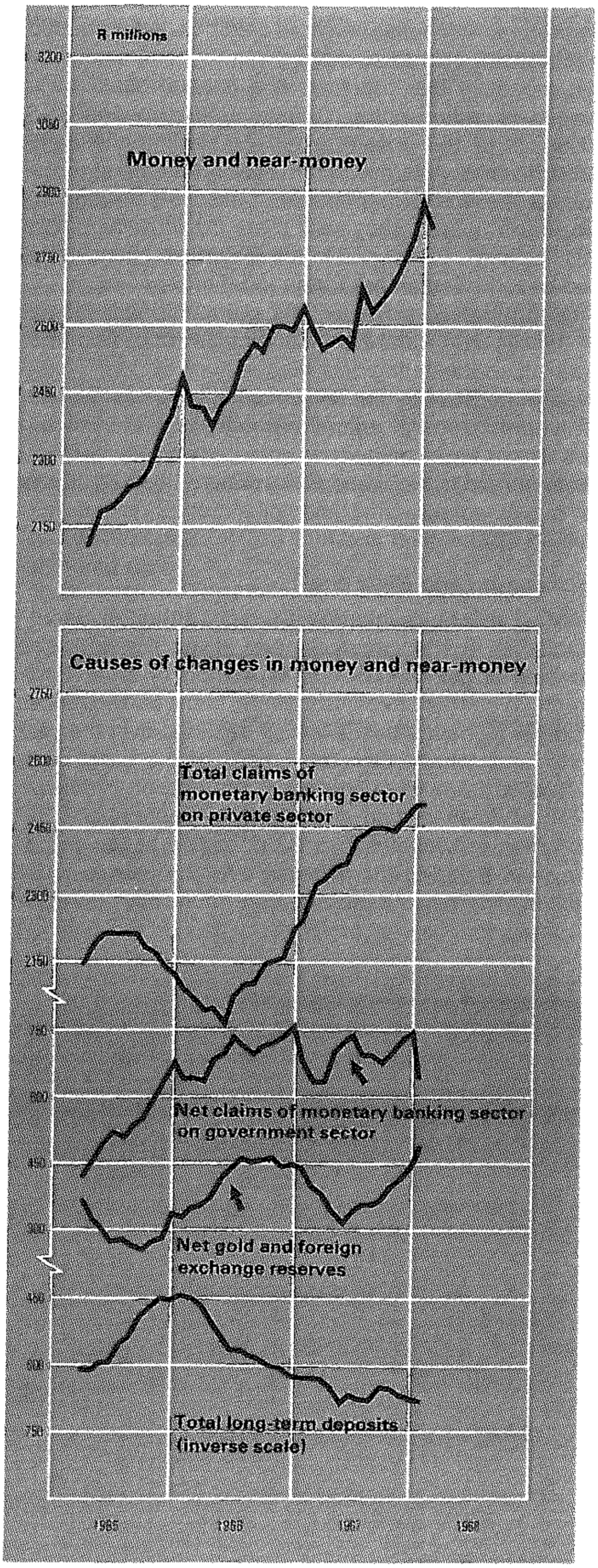
Gold and foreign exchange reserves

The behaviour of the total gold and foreign exchange reserves held by the Reserve Bank, the rest of the monetary banking sector and the Government during 1967 largely reflected the transformation in the current account over this period. Thus, during the first five months of the year, when the current deficit was much larger than the net capital inflow, these reserves declined from R589 million to R455 million. But from that point onward, as the current account improved considerably, they began a new upward movement and by the end of 1967 had already reached a figure of R557 million. During January and February 1968 they increased further to a new record level of approximately R630 million at the end of February.

Monetary and banking situation

Further increase in money and near-money

After rising by only 1·6 per cent during the first nine months of 1967, total money and near-money increased sharply by R187 million or 7·0 per cent during the fourth quarter, mainly as a result of the expansionary effect of the rapidly rising gold and foreign exchange reserves and an increase in bank credit to both the private and government sectors. In so far as this acceleration reflected the increasing surplus on the current account of the balance of payments, it may be interpreted as a result of the decline in excess monetary



demand and therefore as a favourable sign. For the rest, however, it was a disconcerting development, as it tended to make the monetary environment conducive to a resurgence of inflationary pressure.

Nevertheless, despite this acceleration in its rate of increase during the fourth quarter, the total supply of money and near-money increased by only R230 million or 8·7 per cent over 1967 as a whole. Although this rate of increase exceeded that of 6·2 per cent registered during 1966, it was considerably slower than the average of 11·7 per cent attained during the years 1963 to 1965. Moreover, according to calculations based on new seasonally adjusted figures which have just become available, the ratio of money and near-money to gross domestic product during the fourth quarter of 1967 amounted to 28½ per cent, compared with a peak of over 29 per cent reached during the first quarter of 1966. It was, however, still considerably higher than the average of roughly 26 per cent registered during the years 1955 to 1964.

Preliminary indications suggest that, in accordance with the normal seasonal pattern, total money and near-money declined noticeably during January 1968. The contractionary effect of the largely seasonal decline in the net claims of the banking sector on the government sector during this month would appear to have more than neutralised the expansionary effect of the rapidly rising gold and foreign exchange reserves.

Causes of changes in money and near-money
(Changes in consolidated assets and liabilities of the monetary banking sector)
R millions

	1967				
	1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	Total
Changes in money and near-money:					
Money	−75	94	−56	148	111
Near-money	−9	29	59	39	119
Total	−84	123	3	187	230
Causes of changes:					
Net gold and foreign exchange reserves	−68	−41	27	79	−3
Claims on government sector	−158	49	122	12	26
Government deposits (increase −, decrease +)	40	54	−183	53	−36
Net claims on government sector	−118	103	−61	65	−10
Claims on private sector	112	86	27	56	282
Long-term deposits (increase−, decrease+)	−12	−33	16	−28	−57
Other assets and liabilities	2	8	−6	15	18
Total	−84	123	3	187	230

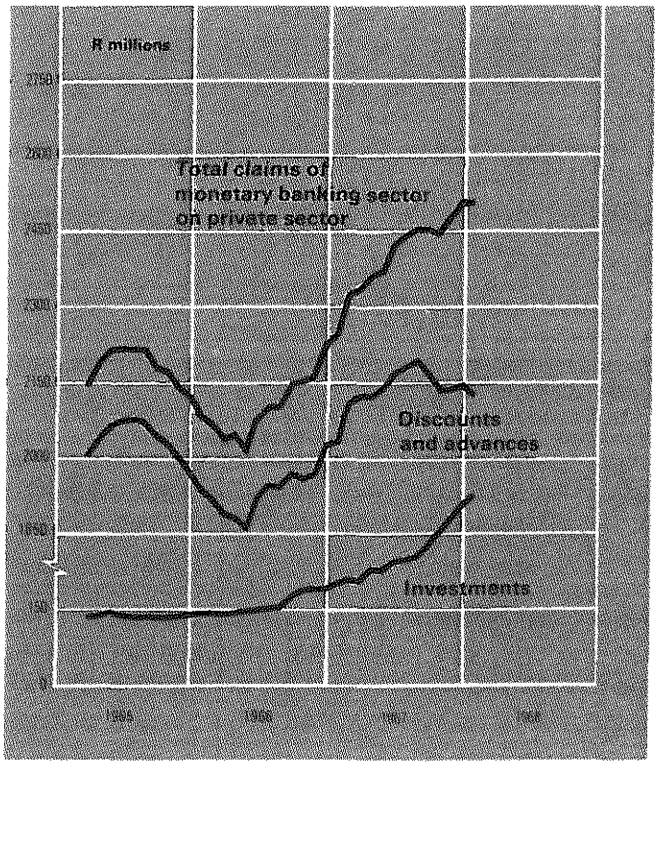
Increase in bank credit to private sector

Considering the year 1967 as a whole, the gold and foreign exchange reserves and the net claims of the monetary banking sector on the government sector both exerted a slight contractionary effect on total money and near-money. The substantial increase of R230 million in the latter total over the year was almost entirely accounted for by an increase in the claims of the banking sector on the *private* sector. On a quarterly basis, changes in this item were built up as follows:

R millions

	1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	Year
Discounts and advances . .	+98	+46	−4	−24	+116
Investments	+15	+40	+30	+78	+163
Other	—	—	+1	+2	+3
Total change in claims on private sector	+112	+86	+27	+56	+282

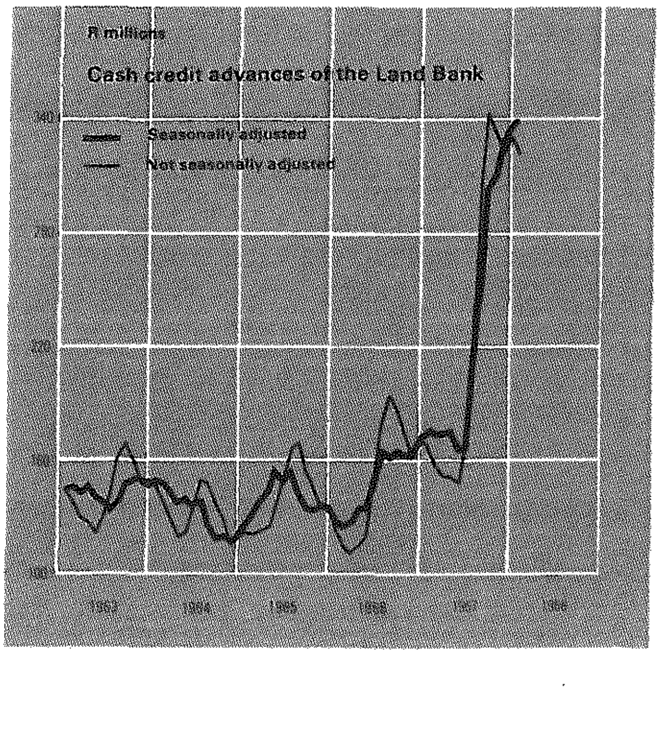
As the above figures show, the Reserve Bank's restrictive credit policy succeeded in reducing the monetary banking sector's discounts and advances to the private sector during the third and fourth quarters. Indeed, if the cash credits of the Land Bank and net remittances in transit are excluded, these discounts and advances declined by as much as R150 million during the third quarter and remained virtually unchanged during the fourth quarter. It is also gratifying to note that, if allowance is made for certain amounts which were specifically exempted from the Reserve Bank's credit directive, such as credit to certain public corporations, all the commercial banks, merchant banks and monetary hire-purchase and general banks succeeded in reducing their outstanding discounts and advances to the private sector (excluding the Land Bank) to below the maximum level set by the authorities for the end of September. Moreover, throughout the fourth quarter, they kept these credit items below this "ceiling", which had in the meantime been extended beyond September for an indefinite period.



Unfortunately, however, the contractionary effects of the decline in the banking sector's total discounts and advances during the second half of 1967 were more than offset by the sharp rise in its "investments", which in the fourth quarter amounted to R78 million. The latter figure included increases in the banking sector's holdings of Land Bank debentures and stocks of public corporations and local authorities of R20 million, R20 million and R25 million, respectively.

Increase in Land Bank credit

Another recent development which, although understandable in the circumstances, gives rise to some concern is the tremendous expansion of Land Bank credit. In contrast to the discounts, loans and advances of other monetary banks, which declined over the year 1967 as a whole, the cash credits of the Land Bank increased from R171 million at the end of 1966 to a peak of R345 million at the end of September 1967 and then only declined to R332 million at the end of the year, bringing the increase over the year to R161 million. The Land Bank therefore more than fully accounted for the rise of R116 million in the banking



sector's discounts and advances to the private sector mentioned above.

At the end of 1967 bank credit to the Land Bank amounted to R238 million, compared with R96 million a year earlier. Of this amount of R238 million, Land Bank bills accounted for R175 million, compared with R50 million at the end of 1966.

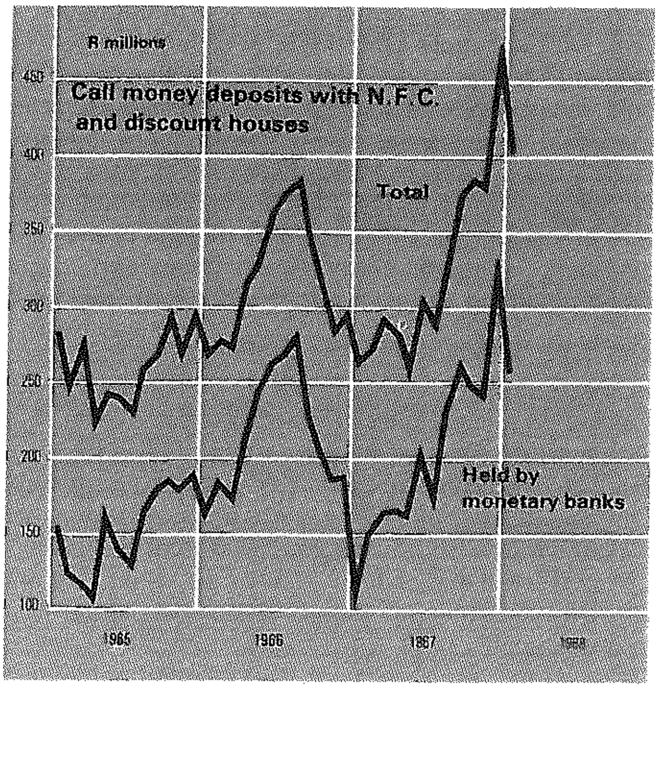
By the end of January 1968 the cash credits of the Land Bank still amounted to the very high figure of R321 million, while bank credit to the Land Bank still stood at R230 million.

Bank liquidity

A third development in the field of banking which was not conducive to monetary stability was the substantial further increase during the second half of 1967 in the excess liquid assets of the various classes of banking institutions – the result of such factors as the rapid rise in the gold and foreign exchange reserves and an expansion of Reserve Bank credit to the Land Bank. The extent of this increase is indicated by the following table:

Excess liquidity ratios

	1967				1968
	March %	June %	Sept. %	Dec. %	Jan. %
Commercial banks . .	5·2	6·9	10·3	14·5	8·6
Merchant banks . . .	14·8	19·3	12·0	12·5	19·5
Monetary hire-purchase and general banks .	9·4	15·3	12·8	11·0	12·4
Other banks	4·8	5·0	3·7	8·4	...



This addition to the liquid assets of banking institutions was also reflected in a sharp rise in the total call money held with the National Finance Corporation and the discount houses, namely from a low point of R254 million in May 1967 to a new record high of R469 million at the end of December.

Short-term interest rates

In these circumstances, the Treasury bill rate, which had risen to 5 per cent by the end of March 1967 and had then fluctuated around a level just below this until the end of July, naturally tended to decline and, in fact, did fall to 4·70 per cent on the 8th September. Subsequently, however, the authorities took various steps to bring the Treasury bill and other related money market rates into better alignment with Bank Rate and the lending rates of banking institutions.

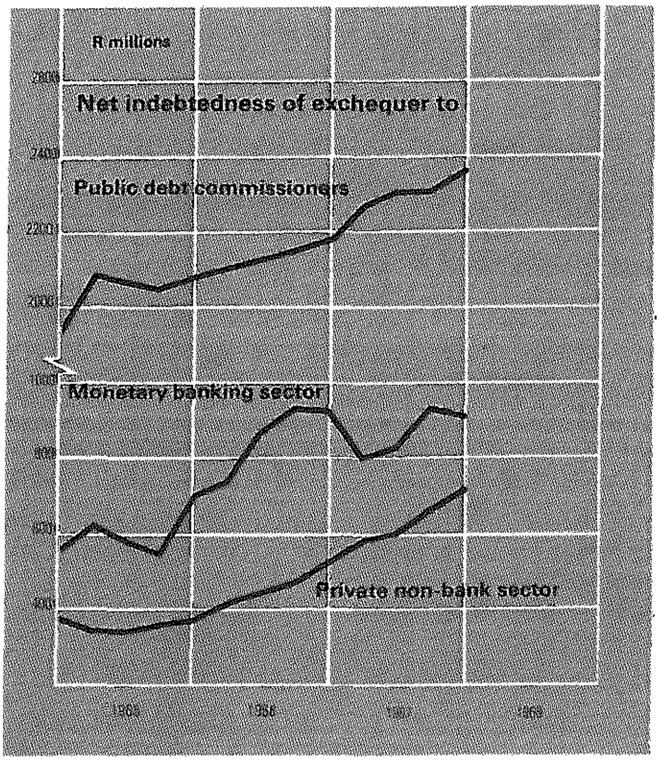
In the first place, the amount of tender Treasury bills offered weekly was raised further until the total amount of these bills outstanding reached R220 million on the 24th November, compared with about R100 million in April – thereafter it was reduced again. Secondly, the authorities at times issued additional "tap" Treasury bills to the market. Thirdly, as from the 7th July, the Reserve Bank sold Land Bank bills to the discount houses under special repurchase agreements in order to neutralise to some extent the effect of its increased credit to the Land Bank – the amount sold in this way reached a peak of R74 million on the 24th November before declining to nil on the 29th February 1968. Finally, the Reserve Bank at times allowed the commercial banks to invest short-term funds abroad under the so-called "swop" arrangements.

Largely owing to these steps, the Treasury bill tender rate increased from 4·70 per cent on the 8th September to 5·08 per cent on the 8th March 1968 and was accompanied upwards by other related short-term interest rates. In addition, the rate on government stock with a maturity of between 3 and $3\frac{1}{2}$ years was raised by 1/8 per cent to $5\frac{1}{2}$ per cent for a new issue in February, which proved to be a great success and attracted R94 million.

Government finance

The picture presented by the finances of the central government during the nine months April to December 1967, i.e. the first three quarters of the current financial year, is very satisfactory indeed. During this period the Exchequer succeeded not only in reducing its indebtedness to the foreign sector by R33 million but also in reducing its net indebtedness to the monetary banking sector by R54 million, compared with an increase of R36 million during the corresponding period of the previous year. Thereby it exerted an important contractionary effect on the supply of money and near-money in the hands of the private sector. In actual fact, the banking sector's holdings of government stock (mainly short-term) and Treasury bills increased by R106 million during this period, but this was more than offset by an increase of R160 million in the Exchequer balance. Both these latter developments were the result of the official money market policy of providing short-term investment outlets to banking institutions as well as the private non-bank sector, with a view to withdrawing the proceeds from the spending stream and "sterilising" it with the Reserve Bank.

The welcome decrease in the Exchequer's net indebtedness to the banking sector was attributable to two main factors. In the first place, the total budget deficit (excluding borrowing) was reduced from R205 million during the first three quarters of the 1966/67 financial year to R107 million during the corresponding period of the current financial year. This was the direct result of the fiscal policy of, on the one hand, restraining government expenditure as far as possible and, on the other, increasing both direct and indirect taxes. Secondly, owing to such factors as an increase in loan levies, the issuing of tax-free Treasury bonds to personal savers, realistic interest rates on government stock and legislative changes to force insurers, pension funds and unit trusts to invest a larger proportion of their funds in government stock, the Exchequer succeeded in borrowing a net amount of R129 million from the private non-bank sector during this period, compared with R111 million during the corresponding three quarters of the 1966/67 financial year and R65 million during the whole of the 1965/66 year.



Exchequer finance
R millions

	1967/68			April to December	
	April-June	July-Sept.	Oct.-Dec.	1966/1967	1967/1968
Total surplus or deficit (excluding borrowing)	−41	−10	−56	−205	−107
Financing:					
Change in net indebtedness to:					
Foreign sector	−23	−9	−1*	−12	−33
Private non-bank sector	18	56	55	111	129
Public Debt Commissioners . . .	38	−2	29*	71	65
Paymaster-General and social security funds .	20	−20	—	−1	—
Sub-total	53	25	83	169	161
Monetary banking sector:					
Change in holdings of government securities .	25	103	−22	188	106
Change in Exchequer balance (increase −, decrease +)	−37	−118	−5*	−152	−160
Sub-total	−12	−15	−27	36	−54
Total financing	41	10	56	205	107

*After adjustment for foreign loans (R7·1 million) invested abroad and for investments (R20 million) with the P.D.C.

Capital market

Demand and supply

Although the upswing in the economy showed signs of levelling off after the middle of 1967, the demand for loanable funds in most sections of the capital market remained exceptionally strong throughout the year. On the supply side, the flow of funds in general tended to favour equities and other investments which held out the prospect of capital appreciation, rather than fixed-interest investments. This tendency appeared to be associated with inflationary expectations based on the experience in the internal economy during the four preceding years and, towards the end of the year, also on international currency uncertainty and speculation regarding an increase in the dollar price of gold.

Yields on long-term stock and debentures

In these circumstances, further upward pressure was exerted on interest rates on fixed-interest investments. Although the Reserve Bank's pattern of rates for long-term government stock remained unchanged at 6·50 per cent during 1967, the yield on long-term stock issued by local authorities increased from about 7·21 per cent at the end of 1966 to 7·27 per cent at the end of 1967 and that on public corporation stock from approximately 7·03 to 7·27 per cent. The margin between the yields on local authority and public corporation stock was thus eliminated during 1967. Yields on newly issued company debentures increased from a level of about 7·75 per cent at the end of 1966 to about 8·5 per cent at the end of 1967, but building society mortgage rates remained at 8·5 per cent throughout this period.

Insurers and private pension funds

During the first three quarters of 1967 (figures for the fourth quarter are not yet available), the emphasis in the investment policy of insurers and private pension funds was placed, as during 1966, on investments in prescribed securities. Not only were the yields offered on these securities relatively high, but the institutions also had to comply with the new statutory investment requirements introduced in 1966. As their holdings of government stock were substantially less than the new statutorily required minimum, they directed a considerable portion of their available investment funds to this type of stock during both 1966 and 1967. During the second half of 1966 this was accompanied by a decline in the amount of new funds invested by them in public corporation and local authority stock, but during 1967 their investments in these semi-gilt-edged securities returned to a more normal figure.

Investments by these institutions in ordinary shares remained moderate during the first three quarters of last year, except for a temporary upsurge at the time of the short-lived decline in share prices after April 1967. At present, the reaction of these investors to the speculative upsurge in share prices after the sterling devaluation of November 1967 is not yet known.

Fixed-interest securities of the private sector and fixed property proved to be relatively unpopular investment outlets for these institutions during the first three quarters of 1967, but they appeared to show more interest in mortgage loans towards the end of this period.

Annual changes in assets of insurers and private pension funds
R millions

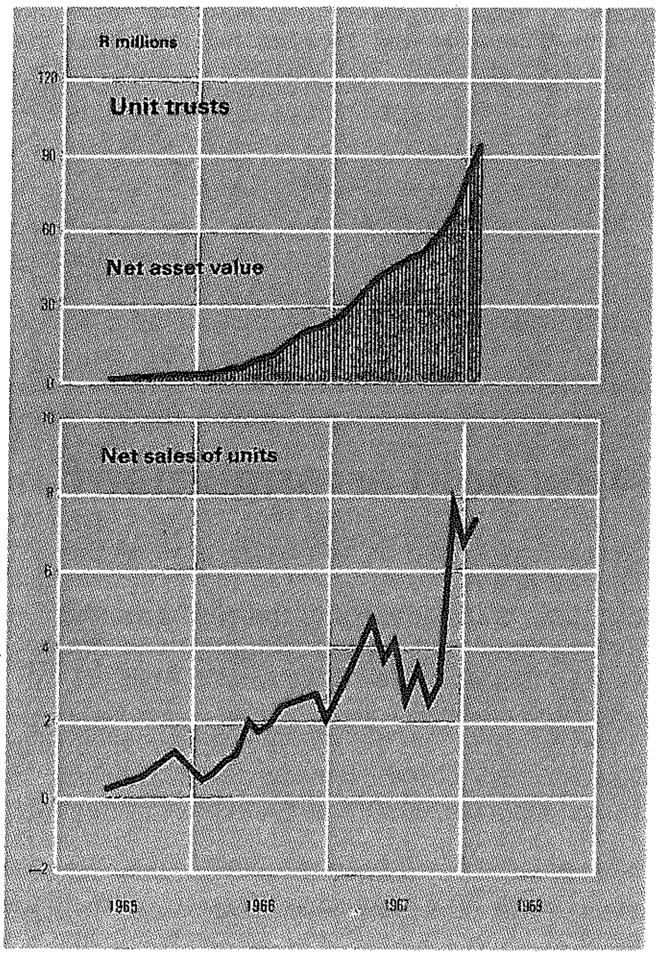
	1963	1964	1965	1966	1967*
Government stock	−1	−15	+3	+71	+71
Public corporation and local authority stock and loans	+54	+71	+75	+50	+74
Total prescribed securities	+53	+56	+78	+121	+145
Other fixed interest investments:					
Securities	+28	+32	+31	+22	+12
Mortgage loans	+5	+38	+55	+51	+37
Other loans	+3	+5	+22	+23	+24
Ordinary shares	+74	+75	+51	+43	+53
Fixed property	+3	+23	+12	+24	+12
Cash and deposits	+10	+12	+8	+11	+3

* Figures for the first three quarters of 1967 adjusted to an annual rate.

Unit trusts

Notwithstanding the over-all shortage of funds in the capital market and the intense competition from other financial institutions, unit trusts raised new funds amounting to R48 million during 1967, compared with R21 million during the previous year. During the last quarter of 1967 alone, they received R17 million, followed by a further amount of R8 million during January 1968. This brought the total for the four months to R25 million, compared, for example, with the R18 million which flowed to building societies during that period. The market value of the trusts' net assets increased by R59 million during 1967 and by R12 million during January 1968, and stood at R95 million at the end of that month. This rise reflected partly the increase in funds placed with them and partly the increase in the market value of their portfolios.

After a decline during the period May to July 1967, the selling prices of trust units moved upward again, and over the year 1967 as a whole increased by 19 per cent. They continued to rise during the first two months of 1968 and the combined index of unit prices (June 1965=100) rose to 157 in February, compared



with 140 in December 1967 and 118 at the end of 1966. The average yield on units declined from 3·8 per cent at the end of 1966 to 3·0 per cent in January 1968.

Building societies

The tightening of conditions in the markets for fixed-interest securities during 1967 naturally also affected the building societies. On the one hand, the general buoyancy of the economy helped to bring about an abnormally strong demand for their mortgage loans. On the other hand, the ready availability of alternative forms of investment such as investments in unit trusts, participation mortgage schemes, tax-free Treasury bonds and ordinary shares, which provided either the prospect of capital appreciation or exceptionally high effective interest rates, served in the prevailing inflationary conditions to reduce the relative attractiveness of building society deposits and shares, as indeed of fixed-interest deposits in general.

In the circumstances, the building societies did very well during 1967. Their total resources increased by R110 million over the year, while their mortgage and other loans outstanding showed a rise of R135 million, which was not only more than double the increase of R63 million during the previous year but also approached the record increase of R146 million during 1964. In order to make this high rate of lending possible, however, the societies had to reduce their prescribed investments by about R28 million during 1967, which brought their excess holdings of these investments over and above the statutory minimum to R70 million at the end of 1967, compared with R110 million a year earlier. In the circumstances, they deemed it necessary to reduce the amount of new mortgages granted to R64 million during the fourth quarter, compared with an average of R89 million for the first three quarters.

Moreover, during January 1968 the total resources of the building societies actually declined by R5 million, apparently owing to the combined operation of normal seasonal influences and such factors as the investment of substantial amounts in tax-free Treasury bonds, the increased attractiveness of ordinary shares and increased competition from unit trusts. The societies' mortgage and other loans outstanding increased by a further R3 million during this month, but their prescribed investments declined by R2 million.

In order to alleviate the position, the Minister of Finance announced on the 14th February that the Government would be prepared to deposit with the societies an amount equal to the amounts guaranteed by the Government under the 100 per cent housing scheme for public servants, i.e. about R8·5 million, and also that it would allow building societies to issue to individuals a special class of permanent shares, the interest on which would be tax-free up to a maximum of R400 per taxpayer per year.

New gold arrangement

Statement issued by the Governors of the central banks of Belgium, Germany, Italy, the Netherlands, Switzerland, the United Kingdom and the United States on the 17th March 1968.

The Governors of the Central Banks of Belgium, Germany, Italy, the Netherlands, Switzerland, the United Kingdom, and the United States met in Washington on March 16 and 17, 1968, to examine the operations of the Gold Pool, to which they are active contributors. The managing director of the International Monetary Fund and the general manager of the Bank for International Settlements also attended the meeting.

The Governors noted that it is the determined policy of the United States Government to defend the value of the dollar through appropriate fiscal and monetary measures and that substantial improvement of the U.S. balance of payments is a high priority objective.