

Quarterly economic review

General observations

Economic indicators confirm that the cyclical downswing in real economic activity, which had been in evidence since the third quarter of 1974, came to an end in the last quarter of 1977. The subsequent behaviour of the economic indicators during the first quarter of 1978 pointed to the beginning of a cyclical recovery, but the expansionary tendencies during this period appeared to be modest.

The cyclical change in economic activity was reflected most clearly in a fairly sharp rise in the real gross domestic product of the non-primary sectors of the economy during the first quarter, following a small rise in the last quarter of 1977. Even if declines in the real value added by agriculture and non-gold mining during the first quarter are taken into account, the small positive growth rate in the aggregate gross domestic product in the fourth quarter of last year was maintained during the first quarter.

The slightly higher level of economic activity during the last quarter of 1977 was reflected in a small increase in employment in the non-agricultural sectors of the economy. During the first four months of 1978 a further improvement in employment conditions was indicated by a decline in the number of registered unemployed Whites, Coloureds and Asians.

The increase in the real gross domestic product of the non-primary sectors during the first quarter stemmed from an increase in real private consumption expenditure, particularly expenditure on durable goods, real government consumption expenditure and real gross fixed investment by public authorities. The other major components of real gross domestic expenditure, namely private fixed investment and inventory investment, continued to decline. Excess production capacity remained substantial and thus had a discouraging effect on private fixed investment expenditure. The decline in real inventories resulted in a further decrease in the ratio of real non-agricultural inventories to the comparable real gross domestic product. These phenomena are consistent with the normal course of events during the early stages of an economic recovery when increased demand is initially satisfied by a further depletion of inventories.

Notwithstanding the higher level of aggregate domestic demand, gross domestic expenditure at current prices was still less than the gross national product and this was again reflected in a surplus on the current account of the balance of payments. However, the seasonally adjusted surplus in the first quarter was only about half of that in the last quarter of 1977. The smaller surplus reflected the net effect of a marked decline in merchandise exports, a moderate increase in

merchandise imports, a sharp rise in net invisible payments to the rest of the world, and a partly offsetting increase in the net gold output.

A further substantial net outflow of capital, comprising a net outflow of short-term as well as long-term capital, occurred during the first quarter. Taken together, however, the surplus on the current account, before adjustment for seasonal influences, and the net outflow of long-term capital gave rise to a larger basic balance surplus than in the last quarter of 1977. As the net outflow of capital exceeded the current account surplus, the gross gold and other foreign reserves declined slightly further during the first quarter. In contrast, the net gold and other foreign reserves increased for the second consecutive quarter as a result of a reduction of liabilities related to reserves. During April the gold reserves of the Reserve Bank showed a substantial increase on account of their valuation at a market-related price for gold.

During the first quarter the supply of money and near-money continued to increase at a modest rate. This low rate of growth was caused by a decline in net claims of the monetary banking sector on the government sector and an increase in long-term deposits of the private sector with monetary banking institutions which off-set most of the moderate increase in the net gold and other foreign reserves of the monetary banking sector and in this sector's claims on the private sector. The increase in bank lending to the private sector and the seasonal movement of funds to the government contributed to a decline in the excess liquidity of banking institutions during the first quarter. The excess liquidity ratios of all groups of institutions were at low levels at the end of March.

Notwithstanding a substantial rise in Exchequer issues during the last quarter of the 1977/78 fiscal year, the increase in issues during the fiscal year as a whole was only slightly higher than the original Budget estimate. Revenue collections during the fiscal year fell short of original Budget figures, largely because of lower collections of customs duties and of income tax and mining lease payments by gold mining companies. Nevertheless, the deficit on the Exchequer Account that had to be financed by means of borrowing, was only slightly higher than in the preceding fiscal year. Successful borrowing from the private non-banking sector, together with a substantially larger net investment in government securities by the Public Debt Commissioners, enabled the government to repay part of its foreign debt and to limit the increase in its net indebtedness to the monetary banking sector.

Government borrowing from the private non-banking sector was greatly facilitated by an easing of the market for fixed-interest securities. Notwithstanding the raising

of a substantial amount of new funds in this market, yields declined continuously during the last nine months of 1977, and this downward trend was maintained during the first quarter of 1978 and the subsequent two months. As regards the other sections of the capital market, share prices and stock exchange turnover declined temporarily during February and March before resuming an upward trend in April, a larger inflow of funds and an apparent increase in the demand for mortgage finance enabled mortgage market intermediaries to increase their lending; and activity in the real estate market remained at a low level.

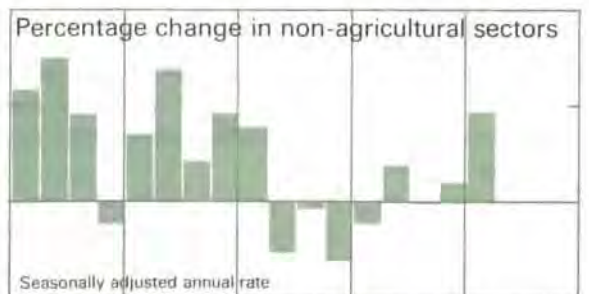
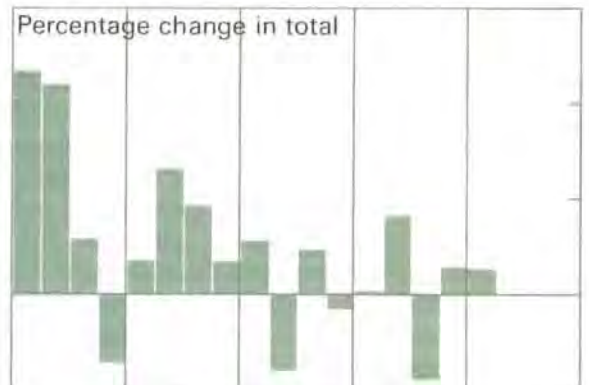
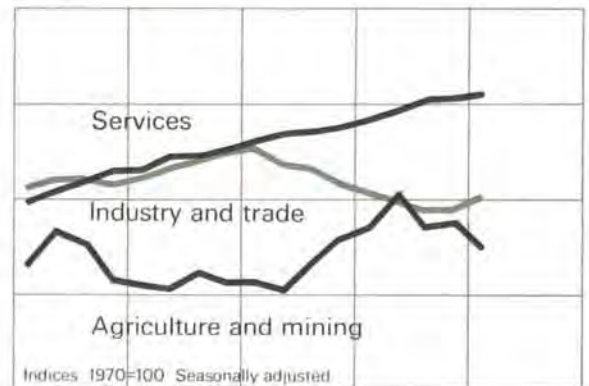
The rates of increase in wholesale and consumer prices, which had declined significantly in the course of 1977, accelerated again in January, largely because of increases in government-administered prices and higher prices of food and imported goods. Subsequently, however, the rates of increase slowed down again.

In view of the progress that had been made towards achieving the policy objectives of improving the balance of payments and eliminating demand-related causes of inflation, a further shift of emphasis in economic policy from selective stimulation to a mild general stimulation of the economy was announced in the 1978/79 Budget. It was emphasized, however, that policy would be aimed at encouraging economic growth within a framework of financial discipline. Monetary policy also became slightly more accommodating. With effect from 18 May the ceilings on bank credit to the private sector were raised by 4 per cent of the base figures as at the end of December 1975, and the amount of credit extension to the private sector, as defined for purposes of the credit ceilings, which a banking institution may not exceed without becoming subject to the ceiling requirements, was increased.

National accounts*

Higher rate of economic growth in non-primary sectors
Economic activity in the non-primary sectors of the economy, as reflected in real gross domestic product figures, expanded significantly during the first quarter of 1978 compared with the last quarter of 1977. Notwithstanding declines in the real value added by agriculture and non-gold mining, the rate of growth in

Gross domestic product at constant 1970 prices



* Unless indicated otherwise, this section of the review is based on seasonally adjusted quarterly estimates of the national accounts.

the total real gross domestic product in the first quarter equalled the rate of growth in the fourth quarter of 1977.

The more pronounced increase in the real gross domestic product of the secondary and tertiary sectors of the economy in the first quarter was preceded by a small rise in the fourth quarter of 1977, prior to which declines had been recorded for six consecutive quarters. The main reason for this favourable development was the sharp reversal of quarterly changes in the real value added by industry and commerce from declines during 1976 and 1977 to an increase in the first quarter of 1978. The volume of manufacturing production during the first quarter of 1978 was about 2½ per cent higher than during the last quarter of 1977, after the downward trend had levelled off during the second half of 1977. The value of wholesale sales at constant prices increased by about 1 per cent in the first quarter of 1978, compared with the fourth quarter of 1977, after having declined for eight consecutive quarters. The value of retail sales at constant prices, which had stabilised at a relatively low level during the last three quarters of 1977, showed little change during the first quarter of 1978. The number of new motor vehicles sold during the first quarter of 1978 was about 12 per cent higher than the figure for the fourth quarter of 1977. In addition, the real value added by the sector electricity, gas and water showed further moderate increases during the first quarter of 1978, while the decline in the real product of construction during the preceding eight quarters did not continue in the first quarter of 1978. Notwithstanding these improvements, the real value added by industry and commerce in the first quarter of 1978 was still about 1 per cent lower than the level in the first quarter of 1977 and about 8 per cent below the most recent peak reached during the first quarter of 1976.

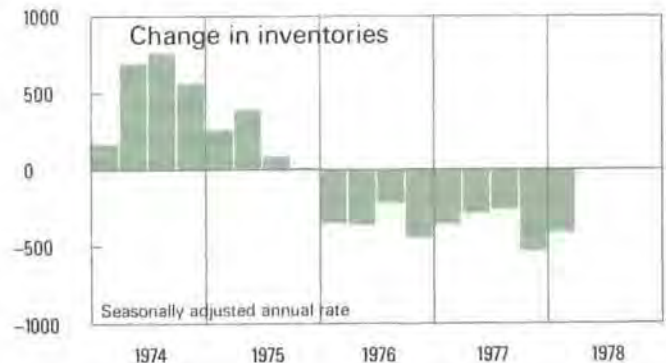
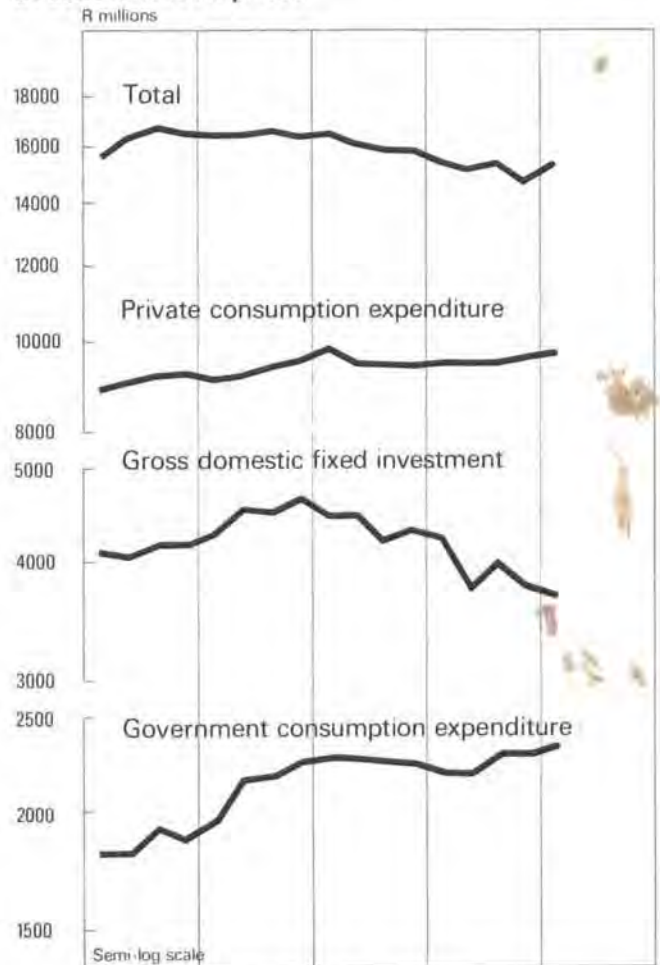
In contrast to the increase in real economic activity in industry and commerce and a moderate further increase in real income generated by the services sector, the real value added by agriculture declined sharply in the first quarter of 1978, whereas that of mining declined moderately after having stabilised at a high level during the second half of 1977. The volume of gold mining production increased by about 2 per cent in the first quarter of 1978, but the volume of non-gold mining production declined for the second consecutive quarter. The divergent contributions to growth by the various sectors during recent quarters are shown on the accompanying graph.

Quarterly estimates of the gross domestic product at current prices show that the remuneration of employees as well as the gross operating surplus increased further during the first quarter of 1978. Increases in the gross operating surplus of mining, manufacturing and the wholesale, retail and motor trade were partly neutralised by declines registered by agriculture, and transport, storage and communication.

Rise in real gross domestic expenditure

The increase in real gross domestic product in the non-primary sectors of the economy in the first quarter of 1978 stemmed predominantly from an increase in real aggregate domestic demand, as measured by real gross domestic expenditure. Notwithstanding this increase, real gross domestic expenditure during the first quarter of 1978 was still about 2 per cent lower than in the corresponding quarter of 1977.

Gross domestic expenditure at constant 1970 prices



The main components of real aggregate domestic demand showed varied tendencies during the first quarter of 1978. Compared with the fourth quarter of 1977, real private consumption expenditure, particularly on durable goods, real gross domestic fixed investment by public authorities and real government consumption expenditure increased. In contrast, real private consumption expenditure on semi-durable goods, private fixed investment and real inventory investment declined, whereas real fixed investment by public corporations showed little change relative to the fourth quarter of 1977.

At current prices, gross domestic expenditure was exceeded by gross national product, but the difference was smaller than in the fourth quarter of 1977. This development was also reflected in the balance of payments on current account, which showed a smaller surplus in the first quarter of 1978 compared with the preceding quarter.

Increase in real private consumption expenditure

The increase in private consumption expenditure during the first quarter of 1978 contributed materially to the rise in real aggregate domestic demand. The largest increase was observed in the case of real outlays on durable goods, particularly on personal transport equipment (new motor cars), whereas real expenditure on furniture and household appliances increased more moderately. The decline in real outlays on recreational and entertainment goods in the first quarter of 1978 should be considered in conjunction with the increase recorded in the fourth quarter of 1977 as a result of a sharp increase in sales of portable television sets. Real expenditure on semi-durable goods (mainly clothing, footwear, glassware and household furnishings) decreased, but real outlays on non-durable goods and on services increased at about the same rate as during the preceding quarter.

Small rise in real government consumption expenditure

After having shown a small decline during the fourth quarter of 1977, real government consumption expenditure increased moderately during the first quarter of 1978. As defence expenditure declined slightly during this period, the increase was accounted for by a rise in salaries and wages as well as in outlays on goods and other services. Particularly noticeable was the rise in real current expenditure by the central government, excluding defence spending, as against smaller increases in the case of other levels of general government.

Decline in real gross domestic fixed investment

Contrary to the rise in private and government consumption expenditure at constant prices, real gross domestic fixed investment declined during the first quarter of 1978, after having increased moderately during the second half of 1977. However, real capital outlays by different sectors displayed divergent

tendencies. Real private fixed investment, which had increased during both the third and fourth quarters of 1977, declined markedly during the first quarter of 1978 to a level slightly lower than in the second quarter of 1977. The reason for this turnabout was the inclusion of ships acquired for the containerisation programme and the export of iron ore, in the figures for the second half of 1977. Real fixed investment by private manufacturing also declined during the first quarter of 1978, but real capital expenditure by the rest of the private sector showed little change, compared with the fourth quarter of 1977. It would appear that the decrease in real private residential construction levelled out during the fourth quarter of 1977 and the first quarter of 1978.

Real fixed capital expenditure by public authorities increased moderately during the first quarter of 1978, after having declined to a relatively low level in the fourth quarter of 1977. Increases in capital outlays on government housing projects during the first quarter of 1978, were counterbalanced to some extent by lower capital expenditure of the South African Railways. Mainly as a result of new projects and extension programmes, real fixed investment by public corporations remained at a relatively high level during the first quarter of 1978.

Further decline in real inventory investment

The book value of total real inventories (excluding livestock), which had declined throughout 1977 at annual rates ranging from approximately R250 million in the third to as much as R500 million in the fourth quarter, declined further during the first quarter of 1978. The decrease during the first quarter of 1978 was somewhat larger than the average for 1977, but smaller than the decline in the fourth quarter of that year. The larger decrease during the first quarter of 1978 was mainly attributable to the rise in real consumption expenditure. Major contributions to the overall decline in total real inventories were made by private industrial and commercial inventories, agricultural stocks in trade and diamond stocks. The level of real motor trade inventories and manufacturing stocks of public corporations showed little change in the first quarter of 1978, compared with the preceding quarter.

The further decline in total real non-agricultural inventories and the marked increase in the comparable real gross domestic product, lowered the ratio of these inventories to 31,0 per cent of the real gross domestic product of the non-agricultural sectors in the first quarter of 1978, compared with 31,7 per cent in the fourth quarter of 1977 and the most recent peak of 36,1 per cent in the third quarter of 1975. The further decline in this ratio during the first quarter of 1978 is consistent with its normal behaviour during the early stages of an economic recovery, when increased demand is initially satisfied by a further running-down of inventories.

Decline in gross domestic saving

Although gross domestic saving declined during the first quarter of 1978 from the exceptionally high level attained in the fourth quarter of 1977, it was still about 15 per cent higher than in the first quarter of 1977, and also exceeded the amount required to finance gross fixed and inventory investment. The resulting surplus of domestic savings was employed to reduce the country's net indebtedness to the rest of the world. Corporate saving, the current surplus of general government, and provision for depreciation increased, but personal saving decreased markedly during the first quarter, mainly as a result of a substantial decline in net agricultural income.

Business cycle trends, labour situation and prices

End of cyclical downswing

Economic indicators show that the cyclical downswing in real economic activity, which had been in evidence since the third quarter of 1974, came to an end in the fourth quarter of 1977. Although the downward movement of a number of indicators classified as coinciding with changes in the business cycle, was reversed towards the end of last year, their behaviour during the first quarter of 1978 appeared to reflect only a hesitant take-off of economic activity on a cyclically upward course.

In this regard, the real gross domestic product of the non-agricultural sectors of the economy, which had shown successive quarterly declines, from the second quarter of 1976 to the third quarter of 1977, with the exception of the second quarter of 1977, increased moderately during the fourth quarter of 1977 and at a somewhat higher rate during the first quarter of 1978. An even more pronounced increase occurred in real economic activity in the non-primary sectors of the economy. This upward trend during the first quarter was confirmed in more modest terms by indicators such as the volume of manufacturing production, wholesale and retail sales at constant prices, the volume of imports, and unemployment among Whites, Coloureds and Asians. Economic indicators of building and construction activity did not show any reversal of the declining trend, but the downward movement tended to level out. Employment figures are not yet available for the first quarter, but a slight improvement in overall employment occurred towards the end of last year.

Slight improvement in labour situation

Following the same course as real economic activity, employment in the non-agricultural sectors of the economy declined during the first quarter of 1977, remained more or less unchanged during the second and third quarters, and rose slightly during the fourth quarter. Employment in these sectors, on average, was 0,1 per cent lower in 1977 than in the preceding year. As far as individual sectors are concerned, employment in the public sector, excluding local authorities, continued to rise in all four quarters of 1977; local authority employment, as well as employment in private manufacturing declined during the first three quarters but increased during the fourth quarter; employment in private construction decreased in all four quarters, but the rate of decline was noticeably smaller in the fourth quarter; gold mining employment increased during the second half of 1977, the increase being especially large during the last quarter; and employment in non-gold mining decreased during the second half of last year, with the rate of decline actually rising during the fourth quarter.

Hours worked by production workers in manufacturing and construction, 1977

	1st qtr.	2nd qtr.	3rd qtr.	4th qtr.	Year
Percentage change in total hours worked:					
Manufacturing	3,1	-2,3	-1,2	-0,5	-1,4
Construction	3,4	-3,9	-2,2	-4,3	-7,0
Overtime hours as percentage of ordinary hours worked:					
Manufacturing	10,7	10,1	10,2	10,5	10,4
Construction	10,8	9,2	9,5	9,6	9,8

The slight improvement in overall employment towards the end of 1977 was confirmed by a decline in unemployment among some population groups during the first four months of 1978. The registered number of unemployed Whites, Coloureds and Asians, which had risen from 21 084 in December 1976 to 34 641 in December 1977, decreased to 30 229 in April. It is estimated that in the first quarter of 1978 unemployment among these groups, on average, represented about 1,5 per cent of the corresponding labour force.

The total number of hours worked by production workers in manufacturing and construction decreased during the last three quarters of 1977. In the case of manufacturing, however, the rate of decline decreased noticeably in the fourth quarter. The average number of weekly overtime hours worked by production workers in

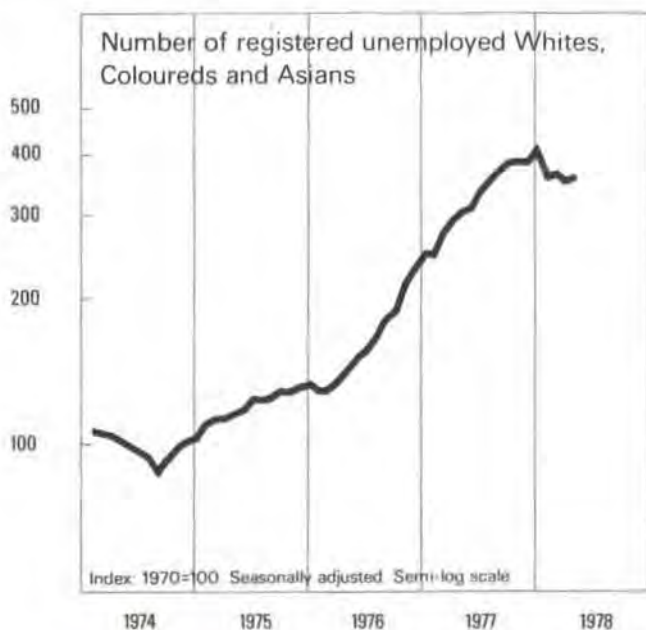
the two sectors concerned increased slightly during the last two quarters of 1977 and this was reflected in the ratio of overtime to ordinary hours worked. In the fourth quarter the number of overtime hours worked in manufacturing and construction was on average 7 per cent and 8 per cent, respectively, higher than in the fourth quarter of 1976.

Temporary acceleration of rate of price increases

After the rates of increase in wholesale and consumer prices had declined significantly in the course of 1977, they accelerated again in the first quarter of 1978, largely because of an increase in government-administered prices and higher prices of food and imported goods. However, a slight deceleration of both rates of increase occurred in March.

On a quarterly basis, the seasonally adjusted annual rate of increase in consumer prices rose from 9,8 per cent in the fourth quarter of 1977 to 10,2 per cent in the first quarter of 1978. The rise in the first three months was largely due to higher food prices, particularly of sugar, grain and grain products. However, if the effect of food prices on the consumer price index is excluded, the declining trend in the rate of increase in the index which had been observed during 1977,

Unemployment



Prices

Percentage change over twelve months



continued during the first quarter of 1978. Compared with the corresponding month in the preceding year, consumer prices had increased by 11,3 per cent in January, 10,6 per cent in February, 9,9 per cent in March, and 9,7 per cent in April.

The seasonally adjusted annual rate of increase in wholesale prices accelerated from 6,5 per cent in the fourth quarter of 1977 to 13,8 per cent in the first quarter of 1978. This was largely due to higher rates of increase in the prices of coal and locally manufactured basic metals, metal products and food, in electricity tariffs, and in prices of imported goods. The sharper rise in prices of imported goods was partly attributable to the decline in the exchange rate of the rand, reflecting the depreciation in line with the American dollar. Compared with the corresponding month in the preceding year, the wholesale price index had increased by 10,2 per cent in January, 10,4 per cent in February, 9,5 per cent in March and 9,7 per cent in April 1978.

Annual percentage change in quarterly averages of seasonally adjusted monthly indices
%

	4th qtr. 1976 to 1st qtr. 1977	1st qtr. 1977 to 2nd qtr. 1977	2nd qtr. 1977 to 3rd qtr. 1977	3rd qtr. 1977 to 4th qtr. 1977	4th qtr. 1977 to 1st qtr. 1978
Consumer prices					
Goods	13,0	11,2	11,2	9,8	10,2
Services	14,5	11,5	10,6	9,6	10,9
Total, excluding food	9,8	10,2	12,4	10,3	7,9
Wholesale prices					
South African produced goods	12,3	12,1	12,0	9,5	7,9
Imported goods	16,0	13,1	6,9	6,5	13,8
South African produced goods	18,0	12,3	6,1	7,3	14,1
Imported goods	10,0	16,0	9,2	4,2	13,0

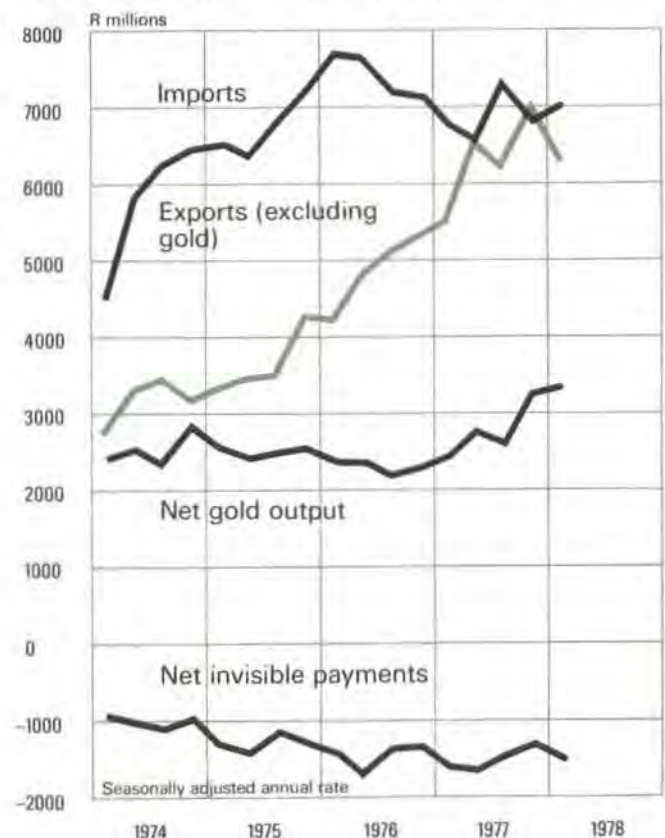
Balance of payments

Further surplus on current account

The current account of the balance of payments again showed a surplus in the first quarter of 1978, the fourth consecutive quarterly surplus to be recorded since the balance on the current account turned favourable early in 1977. The surplus of R503 million in the first quarter was substantially larger than the corresponding figure of R205 million in the fourth quarter of last year, but this increase was due to seasonal influences. At a seasonally adjusted annual rate, the surplus declined from R2 192 million in the last quarter of 1977 to R1 193 million in the first quarter of 1978. This decrease represented the combined effect of a marked decline in merchandise exports, a moderate increase in merchandise imports, a sharp rise in net invisible payments to the rest of the world, and an only partly off-setting increase in the net gold output.

At a seasonally adjusted annual rate, merchandise exports declined to R6 319 million in the first quarter of 1978, after having increased substantially during 1977 to reach the high level of R7 034 million in the last

Balance of payments current account



quarter. This decline occurred notwithstanding the fact that the prices of most of South Africa's main export products showed a more favourable trend on international commodity markets. Sharp increases were recorded, for example, in the prices of platinum and maize, whereas the rate of decline in the prices of copper and wool decreased considerably. The lower level of exports during the first quarter was almost entirely due to smaller diamond and sugar exports. The seasonally adjusted value of diamond exports declined substantially, partly due to the introduction in March of a levy of 40 per cent on diamond sales by the Central Selling Organisation. The decrease in sugar exports was attributable to the new International Sugar Agreement which came into effect at the beginning of 1978. After sales had been advanced during 1977 in anticipation of the implementation of the new agreement, the volume of sugar exports declined substantially during the first three months of 1978.

Merchandise imports, at a seasonally adjusted annual rate, rose moderately from R6 818 million in the fourth quarter of 1977 to R7 037 million in the first quarter of 1978, reflecting price as well as volume increases. The rate of increase in import prices accelerated notably in the first quarter because of higher rates of inflation in most trading-partner countries and a depreciation of the effective exchange rate of the rand. The volume of merchandise imports fluctuated considerably during the past five quarters and, after having declined in the fourth quarter of 1977, increased again in the first quarter of 1978. The increase in the value of merchandise imports occurred in most categories of imported goods, but large increases were recorded in imports of machinery and electrical equipment, chemical products, textiles and minerals. In contrast, imports of transport equipment declined sharply.

The increase in service payments to foreigners exceeded the rise in service receipts, while net invisible payments to the rest of the world, at a seasonally adjusted annual rate, increased sharply from R1 298 million in the last quarter of 1977 to R1 465 million in the first quarter of 1978. The increase in service payments was caused by a marked rise in payments for transportation services and higher dividend payments on foreign investment. An increase in the value of stores provided to foreign vessels and in earnings on investment in other countries, accounted for most of the increase in service receipts from foreigners during the first quarter.

At a seasonally adjusted annual rate, the net gold output increased further from the high level of R3 274 million in the fourth quarter of 1977 to R3 376 million in the first quarter of 1978. This was due mainly to a rise in the price of gold. The average price of gold per fine ounce on the London market increased from \$160,48 in the fourth quarter of 1977 to \$178,39 in the first quarter of 1978, or by 11,2 per cent. The price of gold reached a peak of \$190,00 per fine ounce on 8

March before declining to a low of \$167,65 on 25 April. Subsequently, the price improved again to \$179,20 on 22 May 1978.

Substantial net outflow of capital

A substantial net outflow of capital, amounting to R531 million, was recorded during the first quarter of 1978, compared with an outflow of R264 million in the preceding quarter. The outflow during the first quarter consisted of a net outflow of short-term as well as long-term capital. However, the surplus on the current account, not seasonally adjusted, improved to such an extent that even after taking into account the long-term capital outflow, the basic balance increased from a surplus of R263 million in the fourth quarter of 1977 to a surplus of R392 million in the first quarter of 1978.

The net outflow of long-term capital during the first quarter was partly accounted for by the central government's further repayments on foreign loans. These repayments were facilitated by the improvement in the current account of the balance of payments and the government's successful borrowing operations in the domestic capital market. The appearance of a fairly large net outflow of long-term capital from the private sector was mainly due to an increase in foreign branch balances stemming from diamond sales towards the end of March. In addition, the still low level of domestic investment and the existence of surplus production capacity offered little inducement to an inflow of foreign capital and instead, net repayments were made on long-term foreign loans. In contrast to these outflows of long-term capital, the net inflow of such capital to public corporations and local authorities increased sharply during the first quarter. As in the preceding quarter, new loans were obtained for the financing of Sasol's oil-from-coal project and Escom's nuclear power station. Public corporations, however, were also net borrowers abroad, largely for the financing of other infra-structural development projects.

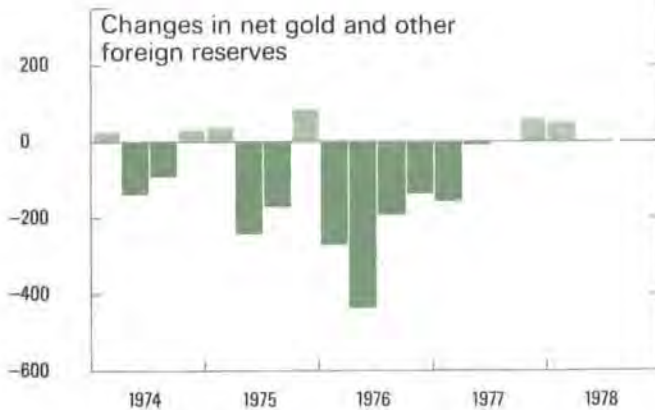
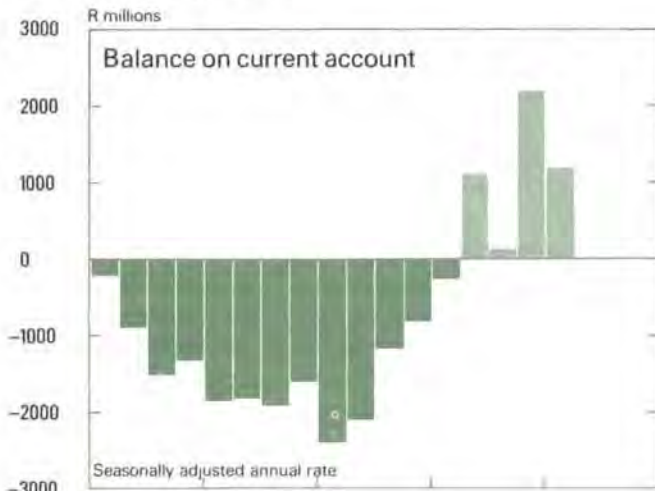
Regarding the net outflow of short-term capital, further repayments were made by the monetary authorities on short-term foreign loans obtained previously for the purpose of supporting the level of foreign reserves.

Net capital movements

R millions

	1977 4th qtr.	1978 1st qtr.
Long-term capital		
Central government and banking sector	-166	-92
Public corporations and local authorities	53	119
Private sector	171	-138
Total	58	-111
Short-term liabilities related to reserves	-118	-78
Other short-term capital, including unrecorded transactions	-204	-342
Total net capital movements	-264	-531

Balance of payments



Short-term liabilities related to reserves, therefore, declined further during the first quarter, bringing the total decline during the past four quarters to R354 million. The net outflow of short-term capital not related to reserves was responsible for the largest part of the overall net capital outflow during the first quarter. This outflow may still have been related to political uncertainties in Southern Africa and a decline in financing abroad of foreign trade transactions. During the first quarter the effective cost of trade financing in US dollars and sterling remained below the corresponding cost of domestic financing. During April a decline in

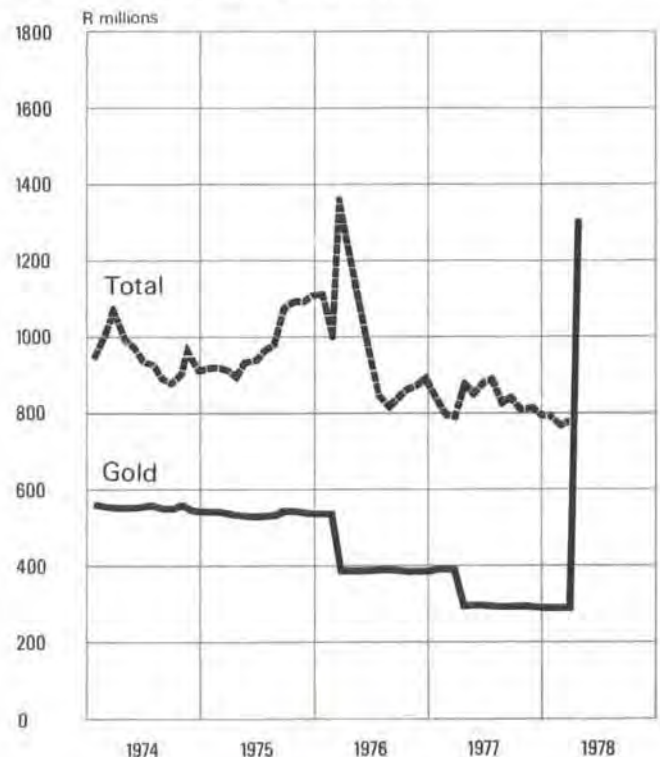
domestic short-term interest rates and, at the same time, an increase in such rates in the United States, caused the margin between the effective cost of trade financing in rand and in US dollars to disappear. However, after having declined early in April, the margin between the effective cost of trade financing in rand and in sterling returned to its former level by the end of the month.

Gold and other foreign reserves

The surplus on the current account and positive valuation adjustments were exceeded by the net outflow of capital, with the result that the gross gold and other foreign reserves declined by R16 million during the first quarter of 1978 to R772 million at the end of March. The net reduction of liabilities related to reserves caused an increase in the net gold and other foreign reserves of R50 million during the first quarter, compared with an increase of R59 million in the preceding quarter. Although the gross gold and other foreign reserves declined by R64 million from the end of September to the end of March, the net gold and other foreign reserves increased by R109 million over this period.

During April the gold and other foreign reserves of the Reserve Bank increased by R1 025 million to a level of R1 659 million at the end of the month, largely as a result of the revaluation of the gold reserves in accordance with the announcement made by the

Gold and other foreign reserves



Minister of Finance on 10 April 1978. Formerly the Bank's gold reserves were valued at the statutory price of R29,55 per fine ounce. On 1 April 1978 the amended Articles of Agreement of the International Monetary Fund came into effect, which means, *inter alia*, that the official price of gold has been abolished and that the monetary authorities of Fund member countries are now legally free to buy and sell gold at market related prices. In accordance with these new arrangements, the Reserve Bank's gold holdings will in future be valued at the end of every calendar month at a price equal to 90 per cent of the average of the last ten London fixing prices before the end of the month. The price determined according to this formula amounted to R132,28 per fine ounce at the end of April.

Monetary and banking situation

*Low rate of increase in money and near-money**

The annual rate of increase in the money and near-money supply, which had declined sharply from 23 per cent during the second quarter of 1977 to only 2 per cent during the fourth quarter, remained at the same low level during the first quarter of 1978. At the end of March 1978 the quantity of money and near-money was only about 1 per cent, i.e., R98 million, higher than at the end of September 1977.

After having declined at an annual rate of 3 per cent during the second half of 1977, the narrowly defined money supply increased at an annual rate of nearly 4 per cent during the first quarter of 1978. However, at the end of March 1978, it was still slightly lower than at the end of June 1977.

Causes of changes in money and near-money

The small increase in the money and near-money supply during the first quarter of 1978 was caused by moderate increases in the net gold and other foreign reserves of the monetary banking sector and in this sector's claims on the private sector. These increases were almost completely offset by a decline in the net claims of the monetary banking sector on the government sector and a further sharp increase in long-term deposits of the private sector with monetary banking institutions.

Net claims on the government sector, which on balance had shown no increase during the second half of 1977, decreased slightly by R65 million during the first quarter of 1978. A substantial increase in government deposits was largely responsible for this decline. Claims of the monetary banking sector on the government sector did not increase over the past year and were actually about 1 per cent lower at the end of March 1978 than at the end of March 1977.

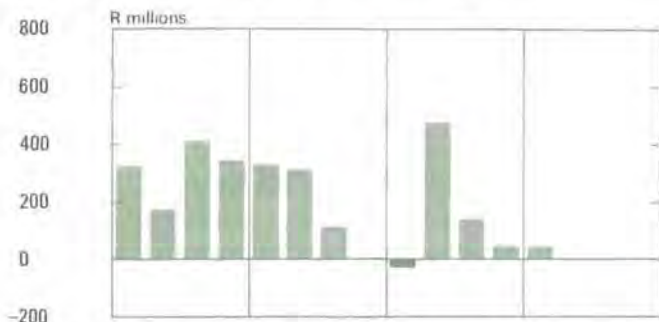
* Unless indicated otherwise, changes in the supply of money and near-money and causes of such changes are calculated from seasonally adjusted data.

Causes of changes in money and near-money

R millions

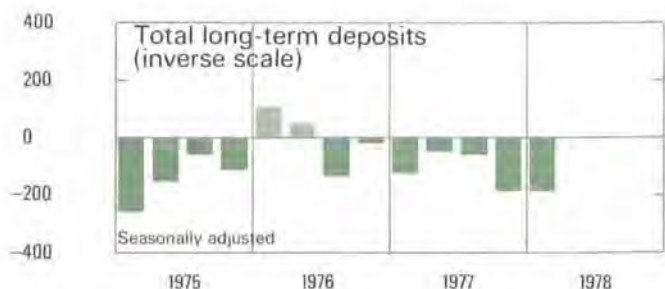
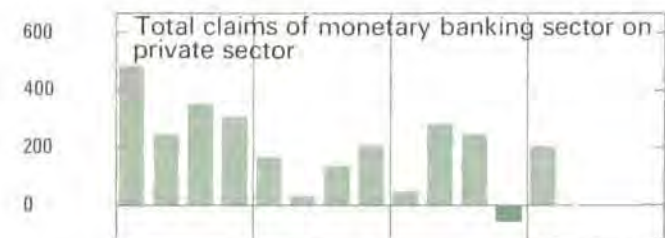
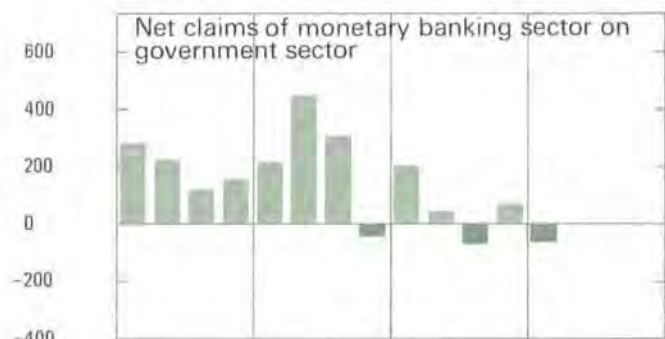
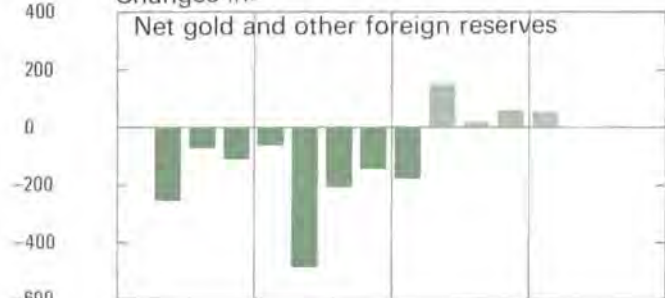
	Not seasonally adjusted			Seasonally adjusted		
	1977		1978	1977		1978
	3rd qtr	4th qtr	1st qtr	3rd qtr	4th qtr	1st qtr
Net gold and other foreign reserves	-6	80	45	20	63	57
Claims on government sector:						
Gross claims	348	77	-47			
Government deposits (increase-, decrease +)	-732	41	-306			
Net claims	-384	118	-353	-71	71	-65
Claims on private sector	322	-61	215	247	-60	204
Long-term deposits (increase-, decrease +)	-12	-196	-128	-61	-187	-186
Net other assets	134	207	82			
Total causes of changes	54	158	-139	140	50	48

Changes in money and near-money



Causes of changes in money and near-money

Changes in:



The net gold and other foreign reserves of the monetary banking sector, which had increased during the last three quarters of 1977, rose further by R57 million in the first quarter of 1978. Long-term deposits of the private sector with the banking sector, which had been increasing since the third quarter of 1976, continued to rise during the first quarter of 1978. This rise amounted to about 7 per cent or R186 million, bringing the total increase from the low level reached at the end of July 1976 to R782 million.

Increase in bank credit to the private sector

Claims of the monetary banking sector on the private sector, which had increased markedly during the period from April to July 1977, fluctuated considerably during the remainder of the year and on balance showed a small decrease during the last five months of 1977. Fluctuations continued during the first three months of 1978, and for the first quarter as a whole, the claims of monetary banks on the private sector increased by R204 million, representing an annual rate of increase of almost 9 per cent. This exceeded the rate of 6 per cent for the year 1977, and was apparently due to a fairly general increase in the private sector's demand for bank credit. Preliminary data in respect of the discounts and advances of the five largest banking institutions and their subsidiaries, suggest, however, that this increase in bank lending may not have been sustained during April.

An analysis of the claims on the private sector, not seasonally adjusted, shows that the discounts, loans and advances of the commercial banks, merchant banks and monetary hire-purchase and general banks rose by R269 million during the first quarter of 1978, the increase during March alone being R99 million. This may be compared with a decline of R157 million during the fourth quarter of 1977 and an increase of only R117 million during 1977 as a whole. Although hire-purchase credit showed very little change during the first quarter of 1978, leasing finance increased by R59 million. Bills discounted by monetary banking institutions and cash credit advances of the Land Bank, on the other hand, declined by R119 million and R99 million, respectively.

As a result of the relatively large increase in bank lending to the private sector, the amount of unused facilities under the ceilings on credit to the private sector declined by R116 million during the first quarter of 1978. In the case of certain banking groups, the remaining facilities under the ceilings at the end of March left relatively little scope for further credit expansion.

To provide more scope for credit extension, the credit ceilings were raised by an additional 4 per cent of the base figures as at 31 December 1975, with effect from 1 May. In addition, the total amount of credit extension to the private sector, as defined for purposes of the credit ceilings, which a banking institution may

not exceed without becoming subject to the ceiling requirements, was increased from R10 million to R15 million. The arrangement whereby the ceilings are raised each month by $\frac{1}{2}$ per cent of the base figures, continues to apply.

Seasonal decline in bank liquidity

The excess liquidity of banking institutions, which had been fairly substantial at the end of December 1977, showed a largely seasonal decline during the first three months of 1978. The excess liquidity ratio in respect of all banks declined from 3,3 per cent at the end of December to 1,0 per cent at the end of February, before rising slightly to 1,2 per cent at the end of March. These developments reflected mainly the seasonal movement of funds to the government as well as the fairly large increase in bank lending during the first quarter. In the case of the commercial banks, the decline in excess liquidity was even more pronounced, namely from 4,7 per cent at the end of December to 1,3 per cent at the end of both February and March.

Excess liquidity ratios of banking institutions
%

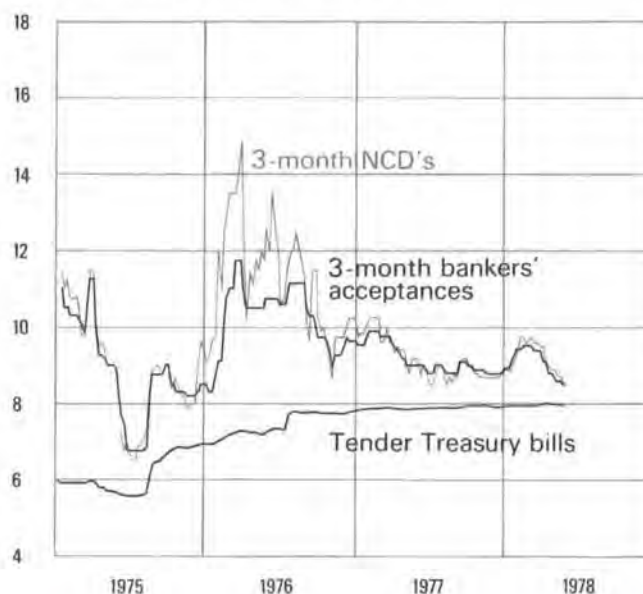
	1977		1978	
	Dec.	Jan.	Feb.	Mar.
Commercial banks	4,7	1,8	1,3	1,3
Other monetary banks	0,9	0,7	0,7	1,3
Other banks	-1,1	-0,8	-1,3	-1,3
All banks	3,3	1,3	1,0	1,2

Money market

Money market conditions were moderately easy at the beginning of 1978, but tightened progressively throughout January and February, with the market experiencing its tightest conditions over the February month-end and during the first week of March. Thereafter the market eased only slightly during the rest of March but significantly during April and the first two weeks of May. Throughout the first few months of the year the most important cause of change in money market conditions was the flow of funds to and from the government, tax revenues being largely responsible for the tightening during January and February while government spending caused the rapid easing during April.

Call loans with the discount houses reached their lowest level this year over the February month-end, amounting to R607 million on 3 March. After having increased moderately during March, these loans rose rapidly throughout April and early May, reaching an amount of approximately R866 million on 12 May. The net free balances of monetary banking institutions with the Reserve Bank and the National Finance Corporation similarly showed seasonally low levels over the February month-end and early in March. After having shown little change during the remainder of March, the

Money market interest rates



monetary banks' net free balances with the Reserve Bank and the National Finance Corporation increased, however, by R255 million from the end of March to 12 May. Reserve Bank accommodation to the discount houses, which had amounted to over R200 million at the end of February, declined to approximately R93 million at the end of March and to nil on 12 May.

Short-term interest rates reflected these changes in the availability of funds in the money market. Having reached a peak during the first few days of March, they eased slightly during the rest of the month and more markedly throughout April and early May. The 3-month NCD rate, for example, eased from 9,75 per cent on 3 March to 9,5 per cent on 31 March, before declining steadily to 8,55 per cent on 12 May. Similarly, the rate on 3-month bankers' acceptances declined from 9,5 per cent to 9,4 per cent during March and then to 8,6 per cent on 12 May. The discount house call rate decreased from 8,5 per cent on 31 March to 7,8 per cent on 12 May. The Treasury bill tender rate hardened slightly from 7,97 per cent to 8,00 per cent during March, but declined again to 7,98 per cent on the second Friday in May.

During the first four months of 1978 the Reserve Bank continued to absorb excess liquidity by selling short-term, medium-term and long-term government securities in the open market to banking institutions, the discount houses and institutional investors. The Bank's total sales of such securities during this period amounted to slightly more than R85 million.

Government finance

Increase in Exchequer issues during last quarter of fiscal year

Following the less than budgeted increase in Exchequer issues during the first nine months of the 1977/78 fiscal year, issues during the last quarter of the fiscal year, i.e. the period January to March 1978, were as much as 34 per cent higher than during the last quarter of the 1976/77 fiscal year. Exchequer receipts (excluding borrowing), which had started to increase at a faster rate towards the end of 1977, were 20 per cent higher in the last quarter of the 1977/78 fiscal year than in the corresponding period of the preceding fiscal year. This increase, which was considerably larger than the rise of 12 per cent during the first nine months of the fiscal year, was due to increased collections of customs, excise and sales duties and of income tax and other payments by gold mining companies.

The high level of issues during the three-month period concerned resulted in an Exchequer deficit of R378 million. However, domestic non-bank borrowing of R391 million more than covered this revenue shortfall. As the Treasury also repaid R119 million on foreign loans, its net indebtedness to the monetary banking sector increased by R106 million, largely because of a decline in the cash balance on the Exchequer Account.

The 1977/78 fiscal year

During the fiscal year that ended on 31 March 1978, Exchequer issues amounted to R9 268 million, or 11.3 per cent more than in 1976/77. Although higher than the original Budget estimate, this percentage increase

was substantially lower than the 17 per cent recorded in 1976/77 and reflected the policy of financial restraint adopted in the 1977/78 Budget. Revenue collections during the fiscal year amounted to R7 370 million, or 16 per cent more than in 1976/77, but fell short of Budget expectations.

The lower than anticipated collection of revenue was evident in virtually all revenue items, but especially in customs duties, which were affected adversely by the decline in imports, and in income tax receipts. In particular, income tax and mining lease payments by gold mining companies remained well below Budget estimates, notwithstanding the substantial increase during the last quarter of the fiscal year when the effect of the earlier sharp rise in the price of gold on mining profitability became evident.

The deficit on the Exchequer Account during the fiscal year under review amounted to R2 013 million, or R41 million more than in 1976/77. Successful domestic borrowing enabled the Treasury to finance the major part of this shortfall from non-banking sources and at the same time to repay a substantial portion of its foreign debt. Repayments on foreign loans amounted to R157 million, against an increase of R356 million (including drawings on the International Monetary Fund) in foreign debt during 1976/77. Borrowing from the private non-banking sector amounted to R1 222 million, even after taking into account the repayment of import deposits of R232 million, and this amount exceeded the corresponding figure for 1976/77 by R324 million. Funds were raised in the private non-banking sector largely by means of stock issues. Net new issues of marketable stock amounted to R866 million and were well supported by financial institutions which had to comply with higher prescribed investment requirements at a time of limited

Revenue collections – State Revenue Fund

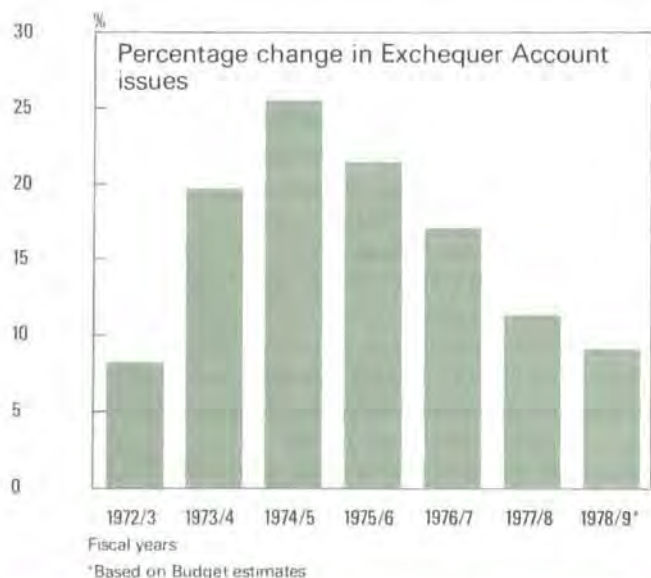
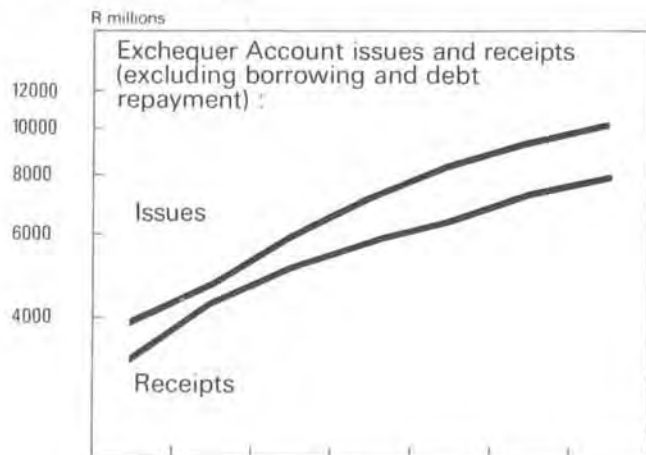
R millions

	Jan.–Mar.		Fiscal years ended 31 March		
	1977	1978	1977	1978	
				Budget estimate	Actual
Customs, excise and sales duties¹					
Customs duties	73	170	324	741	673
Excise duties	219	247	834	894	883
Sales duties	66	95	273	337	337
Total	358	512	1 432	1 972	1 892
Inland revenue					
Income tax (excluding payments by gold mines)	1 075	1 179	3 395	3 822	3 732
Payments by gold mines ²	98	173	408	560	445
Other	363	415	1 145	1 195	1 299
Total	1 536	1 767	4 948	5 577	5 477
Total revenue collections	1 895	2 280	6 379	7 548	7 370

1. Including collections in respect of payments to neighbouring countries in terms of customs agreements.

2. Comprising income tax and gold mining lease payments.

Exchequer Account

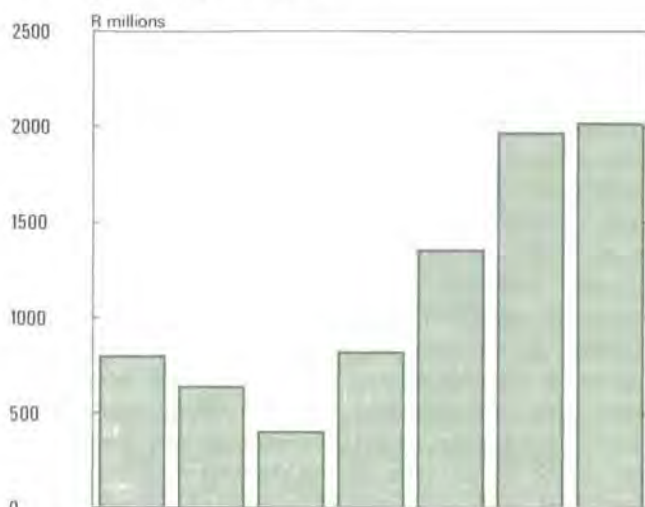


alternative investment opportunities in the private sector. The Public Debt Commissioners' net investment in government securities increased from R185 million in 1976/77 to R573 million in 1977/78, and would have been higher still had they not invested an amount of R375 million with the National Finance Corporation and the discount houses at the end of the fiscal year. The Treasury's net indebtedness to the monetary banking sector increased by R374 million during 1977/78, or by R158 million less than during the preceding fiscal year. This sector's investment in government securities rose by R446 million, but at the same time the Exchequer balance increased by R71 million.

The 1978/79 Budget

The short-term policy strategy embodied in the central government Budget, presented by the Minister of Finance to Parliament on 29 March 1978, was one of encouraging economic growth within a framework of

Exchequer Account deficit



Percentage of Exchequer Account deficit financed by domestic non-banking sector



financial discipline. This approach was adopted in view of the success that had been achieved during the past year in improving the balance of payments. The Minister expressed the view that not only was the stage set for a new business cycle upswing, but important expansionary influences were already at work in the economy. The need for a shift of emphasis in economic policy had already been pointed out by the Minister in August 1977 and steps had been taken in that direction, notably in November last year, by the adoption of mildly stimulative measures. In order to provide further momentum to this shift of emphasis, the Budget aimed to remove those restraints on economic expansion which no longer served the purpose of either improving the overall balance of payments or reducing the rate of inflation.

As regards expenditure, the policy of financial restraint adopted in 1977/78 was broadly maintained in the Budget. However, certain expenditure items were considered to warrant special attention. Substantial

increases in expenditure were accordingly announced by the Minister in respect of export promotion, housing, public works, and the new oil-from-coal project, while pension and social benefits were raised significantly. Total expenditure in 1978/79 is expected to rise by slightly more than 9 per cent, or by about 2 percentage points less than in 1977/78. The major reason for this relatively low rate of increase is an actual decline of almost 6 per cent in the Defence Vote. Excluding defence, expenditure is expected to increase by almost 13 per cent, compared with 9 per cent in 1977/78.

As envisaged in the 1977/78 Budget speech, the Minister proposed the introduction of a general sales tax at the retail level as from 3 July 1978. This tax, to be levied at a rate of 4 per cent, is expected to yield R650 million during 1978/79. The existing sales duties will be retained for the time being, but were reduced by 5 percentage points *ad valorem*. The Minister accepted in principle the proposal by the Standing Commission on Taxation Policy to convert the existing sales duties on certain selected less essential goods, which are subject to relatively high rates, into *ad valorem* excise duties. It is intended that this change will be implemented later in the fiscal year. Because of the need for additional income, the temporary 15 per cent surcharge on imports, imposed in March 1977, was not abolished but reduced to 12,5 per cent. However, the Minister stated his intention to reduce the surcharge further, with a possibility of phasing it out as and when fiscal circumstances permit. He also estimated that the imposition of the general sales tax and the reduction of the sales duties and the import surcharge will result in net receipts of R395 million during 1978/79. In order to reduce the regressive nature of the new tax, the Minister provided R20 million to help stabilise the prices of basic foodstuffs and also abolished the fixed tax levied on adult Black males.

In accordance with the general aim of the Budget, various other concessions were made, the most important being the reduction by $2\frac{1}{2}$ percentage points of the surcharge on normal tax payable by all companies and the abolition of the 10 per cent surcharge payable by individuals. The loss of revenue during the 1978/79 fiscal year resulting from these concessions, is estimated at R48 million and R132 million, respectively. The compulsory loan levy payable by companies and individuals was maintained at existing rates, but in order to improve taxpayers' cash flows the Minister proposed that the 1972 loan levy, which was due to be repaid in February 1979, be repaid in July this year.

As shown in the accompanying table, total expenditure is estimated to rise by 9.1 per cent above its 1977/78 level, and revenue by 8.8 per cent. The deficit before borrowing is estimated at R2 143 million, or R200 million (10.4 per cent) more than the estimated shortfall for 1977/78. Taking loan repayments of R1 754 million into account, the government's total

The 1978/79 Budget

	R millions	Per- centage change
Expenditure	9 811	9,1
Revenue	7 668	8,8
Deficit (excluding borrowing and debt repayment)	2 143	10,4
Debt repayment:		
Domestic	1 522	
Foreign	232	
Total borrowing requirement	3 897	
Financing:		
Domestic loans:		
Public Debt Commissioners	650	
Reinvestment of maturing stock	1 230	
New stock issues	750	
Non-marketable debt	795	
Foreign loans	75	
Use of available cash balances	397	
Total financing	3 897	

borrowing requirement is estimated at R3 897 million. The Minister expected that R3 425 million, or about 88 per cent, of this amount will be financed by domestic borrowing, while available cash balances will be employed to the extent of R397 million. New foreign borrowing during the fiscal year is estimated at only R75 million, and it is anticipated that the government's indebtedness to the foreign sector will be reduced by R157 million during the 1978/79 fiscal year.

Capital market

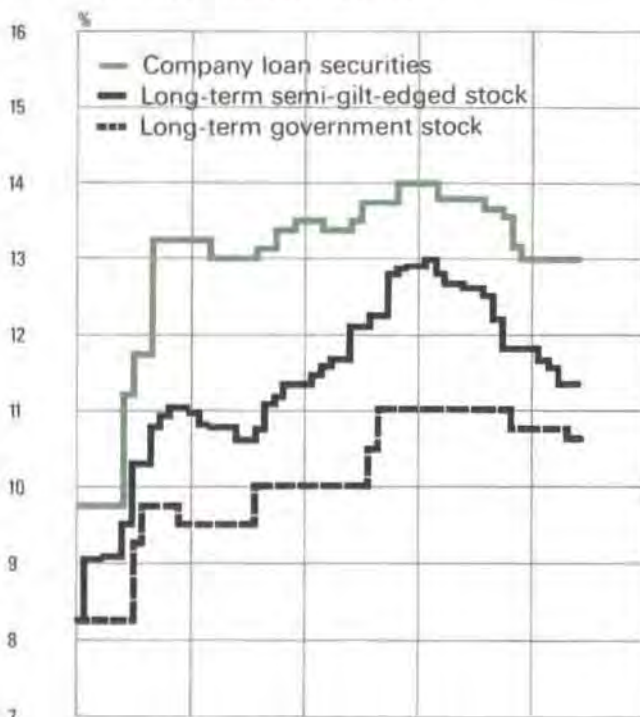
Further easing of market for fixed-interest securities

The easing of conditions in the market for fixed-interest securities, which had been in progress during the last three quarters of 1977, continued during the first five months of 1978. This was reflected in a further decline in security yields and in the over-subscription of new issues. The yield on new issues of the highest grade long-term semi-gilt-edged stock, for example, decreased from 11,80 per cent at the end of 1977 to 11,34 per cent in April. Yield declines in the secondary market for semi-gilt-edged stock during this period were even

more pronounced. The yield on a new issue of long-term government stock in February remained unchanged at 10,75 per cent, but the yield on a new issue in May was lowered to 10,625 per cent. No issues of company loan securities were made during the first five months of 1978, but secondary market yields on such securities showed a decline of the same order as those on semi-gilt-edged securities. The yield margin between long-term semi-gilt-edged and gilt-edged stock narrowed from 1,05 per cent at the end of 1977 to 0,71 per cent in May. This margin was appreciably lower than the average of 1,20 per cent for the preceding five years.

Virtually all new issues of semi-gilt-edged stock during the period January to April 1978 were over-subscribed. New stock issues of R157 million, excluding short-term Land Bank debentures, were offered for subscription during this period, but subscriptions of more than R235 million were received. Some issues scheduled for this period were postponed in anticipation of a still further decline in borrowing rates.

Yields on fixed-interest securities



Yield margin between long-term semi-gilt and gilt-edged stock



Interruption of upward trend in share prices

The upward trend in share prices during the second half of 1977 and January 1978 was temporarily interrupted during February and March, but resumed during April. Only the prices of gold mining shares declined further during April, largely because of a decrease in the price of gold. The main reasons for the behaviour of share prices were, at first, a growing concern that the recovery of economic activity would take longer to materialise than had been anticipated earlier, and a pre-Budget view that the need to maintain a surplus on the current account of the balance of payments and reduce the rate of inflation would preclude a general stimulation of the economy. Thereafter, market sentiment improved because of the policy of mild general stimulation of the economy adopted in the Budget and the emerging signs of economic recovery.

Gold mining share prices declined by 16 per cent during the period February to April; coal mining share prices decreased by 16 per cent during February and March before increasing by 8 per cent during April; and the prices of other metal and mineral shares declined by 6 per cent during February and March and then remained unchanged during April. Financial and industrial and commercial share prices, which had shown equal declines of 8 per cent during February and March, rose again by 3 per cent and 4 per cent, respectively, during April. The comprehensive share price index, covering all classes of shares listed on the stock exchange, declined by 9 per cent during both February and March and improved only marginally by 1 per cent during April because of the further decline in gold mining share prices. Share price movements during the period February to April were closely correlated with stock exchange turnover. Turnover

Stock exchange



during February and March, on average, was 30 per cent lower than in January, and in April it remained more or less at the same level as in March.

The average dividend yield on all classes of shares rose from 7,84 per cent in January to 8,13 per cent in March before decreasing to 8,00 per cent in April. The inverse yield gap between long-term government stock and ordinary shares narrowed marginally from 2,91 per cent in January to 2,75 per cent in April.

Further marked increase in flow of longer-term funds to deposit-receiving institutions and related savings facilities

The flow of longer-term funds to deposit-receiving and related institutions and government savings facilities, which had risen markedly during the fourth quarter of 1977, increased still further during the first quarter of 1978. Seasonally adjusted, this flow was 16 per cent higher during the first quarter than during the preceding quarter and 38 per cent higher than the quarterly average for 1977.

As during the preceding quarter, banking institutions were the largest recipients of longer-term funds during the first quarter, and their relative share in the inflow of new funds was noticeably larger than in the fourth quarter of last year. The inflow of funds to building societies also increased during the first quarter, but their relative share in the larger total inflow remained approximately the same as in the preceding quarter. The net investment in Treasury bonds, which had increased markedly during the third and fourth quarters of 1977 following the introduction of a new series of bonds, declined during the first quarter. The net investment in the Post Office Savings Bank and in National Savings Certificates during the first quarter was maintained at the same level as the quarterly average for 1977. Following upon small quarterly net inflows of funds to participation mortgage bond schemes during the last three quarters of 1977, the schemes experienced a net outflow of funds during the first quarter of 1978.

Seasonally adjusted flow of longer-term funds to deposit receiving and related institutions

R millions

	1977					1978
	First quarter	Second quarter	Third quarter	Fourth quarter	Quarterly average	First quarter
Building societies	134	150	151	149	146	166
Banking institutions	200	141	99	221	165	306
Participation mortgage bond schemes	-7	10	7	4	4	-9
Post Office Savings Bank and National Savings Certificates	57	59	51	45	53	53
Other government savings facilities	1	8	47	54	27	27
Total	385	368	355	473	395	543

Increase in mortgage lending but further decline in real estate transactions

After having declined during the first three quarters of 1977, mortgage lending by building societies increased during the fourth quarter and the rising trend in new mortgage loans granted was maintained during the first quarter of 1978. New loans granted by the societies during this quarter, seasonally adjusted, amounted to R257 million, compared with R236 million during the preceding quarter and a quarterly average of R231 million for 1977. Mortgage lending by building societies was influenced not only by the availability of funds and the demand for housing loans, but also by their obligation to meet the new statutory investment requirements introduced in the 1977/78 Budget. The societies' total prescribed investments increased by R122 million during the last nine months of 1977 and by a further R34 million during the first quarter of 1978.

The real estate section of the capital market remained depressed during the first two months of 1978. The value of real estate transactions continued to show a downward trend and transactions during January and February, on average, were 2 per cent lower than in the last quarter of 1977.

Building societies

