Quarterly economic review

Summary and general observations

Following the prolonged economic downswing from about the middle of 1974 to the end of 1977, real economic activity recovered moderately during 1978. Large swings in private consumption expenditure contributed to a sharp increase in the real gross domestic product in the second quarter and a subsequent decline in the third quarter, and made it difficult to judge the strength of the upswing, but information for the fourth quarter confirmed a moderate upward trend in economic activity. In 1978 the real gross **domestic** product increased by about 2½ per cent. The gross **national** product rose at a somewhat higher rate of about 4 per cent as a result of a considerable improvement in South Africa's terms of trade.

In contrast to the preceding year, economic growth in 1978 originated largely in the secondary and tertiary sectors of the economy, whereas lower rates of increase were recorded in the real product of agriculture and mining. This change was due to a significant increase in the real value added by manufacturing, which had still shown a considerable decline in 1977, and to the fact that the substantial negative contribution to growth by the real product of wholesale and retail trade in 1977 was not repeated in 1978. The general recovery, however, did not extend to construction, and its real value added continued to decline appreciably in 1978.

The increase in the real gross domestic product was based not only on an increase in the volume of exports and of net gold output, but also on a moderate rise in real aggregate domestic demand. This rise in real gross domestic expenditure, which followed upon a decline in 1977, was accounted for by increases in real private and government consumption expenditure, whereas real fixed and real inventory investment decreased by smaller amounts. At current prices, the higher level of gross domestic expenditure was still considerably lower than the gross national product, resulting in a substantial surplus on the current account of the balance of payments.

The economic recovery was reflected in a slight increase in non-agricultural employment during the first nine months of 1978. (More up to date statistics are not yet available.) This increase, however, was accounted for largely by higher employment in the public sector and in the gold mining industry. Employment in the private sector as a whole declined slightly, mainly because of a decrease in employment in manufacturing, construction and non-gold mining. The slight increase in non-agricultural employment was reflected in somewhat lower unemployment figures for all population groups.

Despite increases in several administered prices and the introduction of the general sales tax, the rate of inflation declined slightly in 1978. If the non-recurring effect of the introduction of the general sales tax is eliminated, a more distinctly downward trend in consumer prices was observed in 1978. The level of the inflation rate nevertheless remained high and a double-digit figure was recorded for the fifth consecutive year.

A further improvement in the current account of the balance of payments resulted in a substantially larger surplus on this account than in 1977. This was due to a sharp increase in the net gold output, reflecting mainly a rise in the price of gold, and to considerably higher merchandise exports, stemming from a moderate increase in volume and appreciable rises in the prices of major export commodities. Offsetting increases, which did not match those in exports and the net gold output, occurred in the value of imports and in net payments to foreigners on the invisibles account.

The surplus on the current account, supplemented by a net inflow of long-term capital to public corporations and the private sector, allowed a sizeable reduction in the short-term liabilities related to reserves as well as repayments on long-term foreign loans by the central government. A net outflow of other short-term capital, however, also had to be accommodated and the gross gold and other foreign reserves, disregarding valuation adjustments, showed only a small increase during 1978. Because of the reduction in liabilities related to reserves, the net gold and other foreign reserves rose appreciably during the year.

An increase in the net gold and other foreign reserves of the monetary banking sector was a major cause of a substantially higher rate of increase in the supply of money and near-money during 1978. The most important cause of the increase, however, was a marked rise in the monetary banks' claims on the private sector. Partly offsetting the expansion produced by these factors, were a decline in net claims on the government sector and a sharp rise in the long-term deposits of the private sector with monetary banks. The considerable increase in bank credit to the private sector, which occurred mostly during the second quarter, reflected high rates of increase in hire-purchase and leasing finance and in investments in private sector securities. Other loans and advances, representing mostly loans and advances for industrial and commercial purposes, however, still rose at a relatively low rate during 1978. The decline in the net claims on the government sector was due to an increase in government deposits which, in turn, reflected successful borrowing from the domestic non-banking sector and an increase in government revenue in excess of Budget estimates. Government revenue was boosted by substantially higher than expected income tax and mining lease payments by gold mining companies, resulting from a sharp rise in the price of gold and consequently also in gold mining profits.

On 12 March 1979 the Reserve Bank announced that, in addition to the regular monthly increase, the ceilings on banking institutions' credit to the private sector would be raised from 31 March by 5 per cent of the base figures as at the end of December 1975. At the same time, the total amount of credit extension to the private sector which a banking institution may not exceed without becoming subject to the ceiling requirements, was raised from R15 million to R20 million. It was also announced that the liquid asset requirements for banking institutions would be eased from the date of the banks' certification of their monthly returns for February.

The money market experienced varying periods of tightness and ease during 1978 and the early part of 1979. Most of these changes were caused by flows of funds to and from the government sector. Money market interest rates generally tended to move downwards during 1978 and declined further during January and the first half of February, especially after the redemption of a large amount of maturing government stock early in February. In conformity with the movements in short-term interest rates and to provide further stimulus to domestic economic activity, Bank rate was reduced on two occasions early in 1979, namely from 8½ to 8 per cent on 6 February and from 8 to 7½ per cent on 17 March. The major commercial banks responded by reducing their prime overdraft rates by ½ per cent in February and by a further ½ – 1 per cent in March. On both occasions deposit interest rates, with the exception of the rate on ordinary savings deposits, were lowered by ½ per cent.

A pronounced easing of capital market conditions was evident in 1978, especially in the market for fixed-interest securities. Notwithstanding a substantial net borrowing of funds by the public sector, fixed-interest security yields declined appreciably. Share yields followed suit because of a marked rise in share prices. In contrast to the buoyancy of the fixed-interest security and share markets, activity in the mortgage and real estate markets was more subdued, but a noticeable improvement was nevertheless observed in 1978.

On 24 January 1979 it was announced that the Government, after consultation with the Reserve Bank and other interested parties, had decided to initiate a gradual and systematic process of changing South Africa's exchange rate policy and practices, based on recommendations in the interim report of the Commission of Inquiry into the Monetary System and Monetary Policy in South Africa. The eventual aim of this process is a unitary exchange rate system under which an independent and flexible rand will find its own exchange rate level in well developed and competitive spot and forward exchange markets. Exchange rate movements will, however, be managed through Reserve Bank "intervention" by means of purchases and sales of foreign exchange. The Government accepted the Commission's view that the eventual system can best be attained only through a gradual process of adjustment. As set out later in this review, various steps were taken to give effect to the new policy, and within a fairly short period of time some of the initial transitional measures were replaced by more permanent arrangements.

National accounts

Moderate revival of economic growth

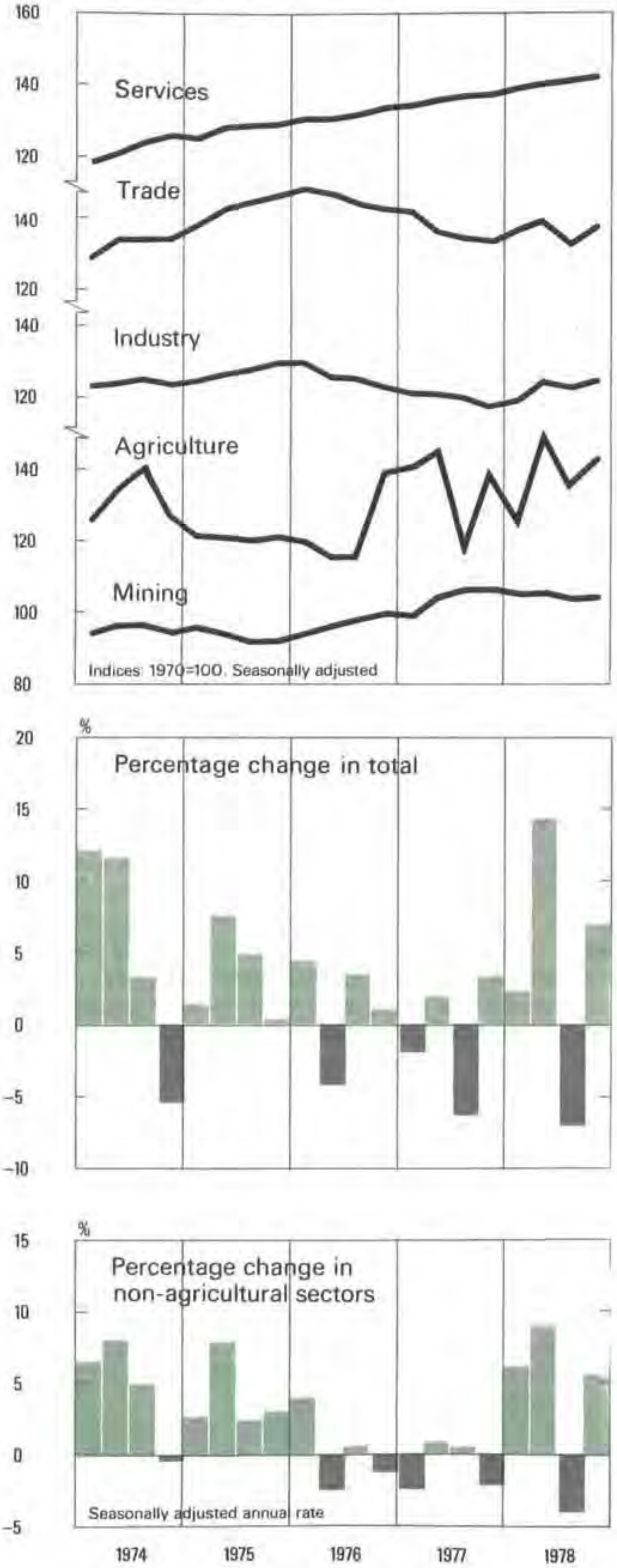
Real gross **domestic** product increased by 2,5 per cent in 1978, compared with approximately no growth in 1977 and a rate of increase of only 1,3 per cent in 1976. South Africa's terms of trade improved considerably during 1978 because of a higher rate of increase in export prices (including gold) than in import prices and because of a decline in real net factor payments to the rest of the world. As a result, the real gross **national** product increased by about 4 per cent in 1978, as against no growth in 1977 and a decline of 1 per cent in 1976.

As shown in the accompanying table, changes in the real gross domestic product of the principal sectors of the economy in 1978 differed considerably from those in the preceding year. Firstly, the rate of increase in the real value added by the primary sector decreased from 9 per cent in 1977 to only 1½ per cent in 1978 because of much lower rates of increase in agricultural and non-gold mining production. Secondly, a decline of 5½ per cent in the real product of the secondary sector in 1977 was followed by an increase of 3½ per cent in 1978. A significant increase in the real product of manufacturing, which had still shown a considerable decline in 1977, was largely responsible for this turnabout, but contributions were also made by a higher rate of increase in the real product of electricity, gas and water, and a lower rate of decline in the real value added by construction. Thirdly, the real product of the tertiary sector showed a higher rate of increase in 1978, namely 2 per cent, compared with only ½ per cent in 1977. This was largely due to the fact that the substantial

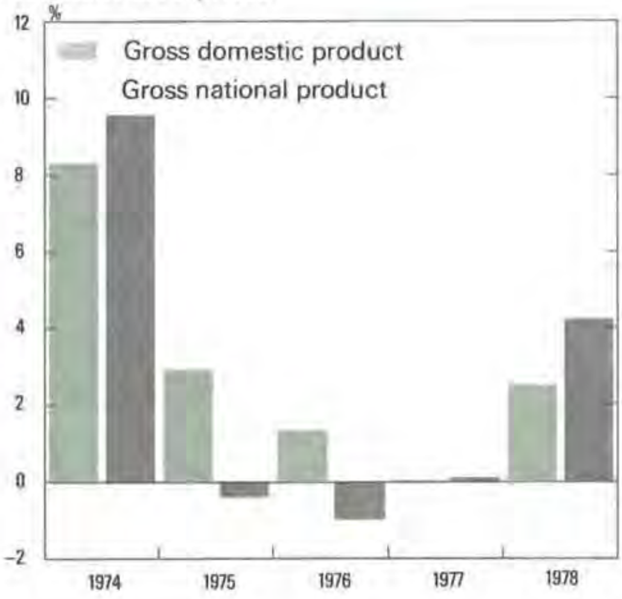
Percentage change in real gross domestic and national product

	1976	1977	1978
Primary sector	2	9	1½
Agriculture	1	10½	2½
Gold mining	—	−2	½
Non-gold mining	6	13½	1
Secondary sector	−1	−5½	3½
Manufacturing	−½	−6½	5
Electricity, gas and water	4	3½	5
Construction	−7	−6½	−5
Tertiary sector	3	½	2
Wholesale, retail and motor trade	2	−6½	−½
Transport and communication services	3	5	4½
General government services	6	4	4
Financial and other services	2	2	2
Gross domestic product at market price	**1½**	**—**	**2½**
Gross national product at market prices	**−1**	**—**	**4**

Gross domestic product at constant 1970 prices



Annual percentage change in gross domestic and gross national product at constant 1970 prices



negative effect of the decline in the real income generated by the wholesale, retail and motor trade in 1977 almost disappeared in 1978. The volume of wholesale sales, including diamonds and petroleum products, increased by ½ per cent in 1978, retail sales at constant prices declined by 4 per cent, and the real value added by the motor trade rose by 12 per cent.

The gross domestic product at current market prices increased by 14½ per cent in 1978, compared with 12½ per cent in both 1976 and 1977. An increase of 18 per cent in the gross operating surplus, as against a rise of 13½ per cent in 1977, was largely responsible for the higher rate of increase in 1978. The rate of increase in the remuneration of employees accelerated slightly from 10½ per cent in 1977 to 11 per cent in 1978. Higher rates of growth were recorded in the gross operating surplus of gold mining, non-gold mining, manufacturing and commerce, whereas lower rates of increase occurred in the case of agriculture and the sector transport, storage and communication.

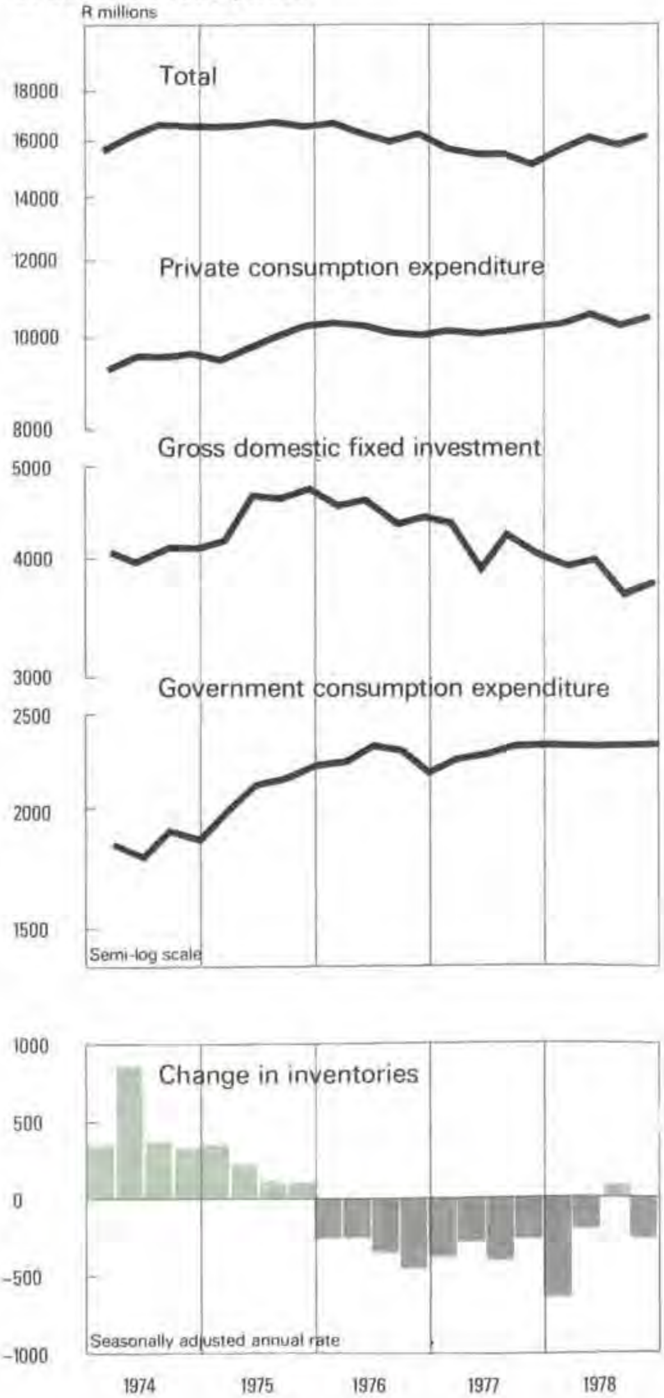
The difference between the growth rates in the gross domestic product at current and constant prices implies an increase in the gross domestic product deflator of 11½ per cent in 1978, as against 12½ per cent in 1977. This deceleration was the result of lower rates of increase in domestic wholesale and retail prices, which more than neutralised the increases in the gold price and in the prices of other export commodities.

Seasonally adjusted quarterly estimates of the real gross domestic product show that annual growth rates of 2½ per cent, 14 per cent and 7 per cent were recorded in the first, second and fourth quarters of 1978, respectively. In the third quarter the seasonally adjusted real gross domestic product declined at an annual rate of 7 per cent.

Moderate increase in real aggregate domestic demand

Real gross domestic expenditure increased by 2½ per cent in 1978, as against declines of 5 per cent and 2½ per cent in 1977 and 1976, respectively. Real

Gross domestic expenditure at constant 1970 prices



private consumption expenditure, which had declined by ½ per cent in 1977, increased at a rate of 2 per cent in 1978. Real government expenditure in 1978 recorded the same rate of increase as in 1977, namely about 1 per cent. Real fixed investment decreased by 7½ per cent, compared with 8 per cent in 1977, whereas the level of real inventories declined in 1978 by R259 million, which was smaller than the decrease of R336 million in 1977. Notwithstanding a notable increase in gross domestic expenditure at current prices in 1978, its level was considerably lower than that of the gross national product at current prices, with the result that the current account of the balance of payments showed a large surplus.

Small increase in real private consumption expenditure

The small increase in real private consumption expenditure in 1978 was attributable entirely to higher outlays on durable goods, as is shown in the accompanying table. In the durable goods category, expenditure on motor cars and other personal transport equipment rose by as much as 18½ per cent, but outlays on all other goods remained sluggish. Real outlays on semi-durable goods declined for the second consecutive year, probably because of the increased expenditure on durable goods and the further small decline in real disposable personal income. Real expenditure on non-durable goods and services on average recorded the same rate of increase as in 1977.

Quarterly changes in the seasonally adjusted real private consumption expenditure were distorted in the second and third quarters of 1978 by the reaction of consumers to changes in existing indirect taxes and the introduction of the new general sales tax. A sharp increase in the second quarter was followed by a decline in the third quarter. In the fourth quarter, however, real consumer outlays increased again, namely at an annual rate of 8 per cent. The largest increases were recorded in outlays on durable and semi-durable goods, particularly on furniture, motor cars, clothing and footwear.

Percentage change in real private consumption expenditure

	1976	1977	1978
Durable goods	½	−12	5
Furniture and household appliances	−3½	−2	½
Motor cars, etc.	−17	−10	18½
Other durable goods	34	−29	−½
Semi-durable goods	2	−3½	−2
Clothing and footwear	3	−4½	−2
Other semi-durable goods	½	−2½	−2½
Non-durable goods	3	3	2
Food, beverages and tobacco	3	3	2
Other non-durable goods	1½	3	1
Services	4½	2	3
Total private consumption expenditure	**2¾**	**−½**	**2**

Private consumption expenditure at constant 1970 prices

Further small increase in real government consumption expenditure

The current expenditure of general government at constant prices increased by about 1 per cent in 1978, which was also the rate of increase recorded in 1977. The real remuneration of employees showed the same percentage increase in 1978 as in the preceding year, namely about 4 per cent, but real outlays on goods and other services declined by 2½ per cent in 1978, after a decline of 3½ per cent had been recorded in 1977. On a seasonally adjusted quarterly basis, real government consumption expenditure remained sluggish during the first half of 1978, but increased moderately during the second half of the year.

Substantial further decline in real gross domestic fixed investment

Real gross domestic fixed investment continued to decline sharply during 1978. As shown in the accompanying table, declines occurred in the real capital outlays of all major sectors and were spread over virtually all classes of activity.

In the private sector, only real fixed capital expenditure by mining increased during 1978, largely because of higher outlays on uranium plant. A particularly large decrease was recorded in real investment outlays by manufacturing, reflecting the relatively high level of unused production capacity and the generally low level of domestic demand, and in real private residential construction. On a quarterly basis, the seasonally adjusted real fixed investment by the private sector reached its lowest level in almost nine years in the third quarter of 1978, but this was followed by a sharp increase in the fourth quarter.

Real fixed investment by public corporations rose marginally in 1978. The sharp increase in outlays on manufacturing concerns, in particular on the second oil-from-coal plant, was almost neutralised by a decline in fixed investment by mining and on electricity and transport facilities.

Real fixed capital expenditure by public authorities showed a further large decrease in 1978. Outlays by the South African Railways Administration showed the largest percentage decline, which was caused by the completion of a programme of acquiring new aircraft and of the railway line to Richards Bay. The sharp increase in residential construction was a reflection of the government's selective stimulatory measures to aid the ailing construction industry by providing housing for lower income groups.

Percentage change in real gross domestic fixed investment

	1976	1977	1978
Private sector	$-7\frac{1}{2}$	$6\frac{1}{2}$	−6
Agriculture	−20	1	−3
Mining	−4	−10	4
Manufacturing	−5	−11	−12
Private residential buildings	−8	−19	−16
Other business enterprises	−6	2	−4
Public corporations	$-1\frac{1}{2}$	7	$\frac{1}{2}$
Manufacturing	−29	41	43
Electricity, gas and water	31	34	−10
Other (mining, transport, etc.)	−8	−53	−46
Public authorities	5	$-17\frac{1}{2}$	−14
South African Railways Administration	29	−30	−37
Residential buildings	17	−36	51
Other business enterprises	−6	−12	1
General government	−5	−8	−10
Central government	−2	−4	−10
Provincial administrations	−11	−14	−4
Local authorities	−3	−10	−18
Total gross domestic fixed investment	**−2**	**−8**	$\mathbf{-7\frac{1}{2}}$

Smaller decline in real inventories

The book value of total inventories, excluding livestock, increased by about R600 million in 1978, of which industrial and commercial inventories contributed about R500 million. At constant 1970 prices the total value of inventories declined by about R259 million, as against a decrease of R336 million in 1977. Further declines in real industrial and commercial inventories and diamond stocks were countered to some extent by increases in real agricultural stocks-in-trade and in livestock inventories at constant prices.

Seasonally adjusted quarterly figures show that real inventories declined during most of 1978. An increase occurred only during the third quarter because of the sharp decline in real private consumption expenditure referred to above.

Further marked increase in gross domestic saving

After gross domestic saving had increased substantially by R1 903 million in 1977, it rose markedly further by R1 298 million in 1978. All components contributed to this increase, with the exception of personal saving which declined sharply as a result of the larger increase in private consumption expenditure (facilitated by a substantial recourse to bank credit) than in disposable personal income. Total gross domestic saving amounted to R10 539 million in 1978, and with total financing requirements for fixed and inventory investment amounting to R9 127 million, a record amount of R1 412 million was available to reduce South Africa's net indebtedness to the rest of the world. Notwithstanding the further improvement in the country's savings performance in 1978, the savings ratio, i.e. the ratio of gross domestic saving to gross domestic product, remained unchanged at its 1977 level, namely about 26½ per cent. These ratios were markedly higher than the ratio of 23,8 per cent in 1976 and also higher than the average annual ratio of about 25 per cent during the period 1970 to 1975.

Cyclical upswing in economic activity

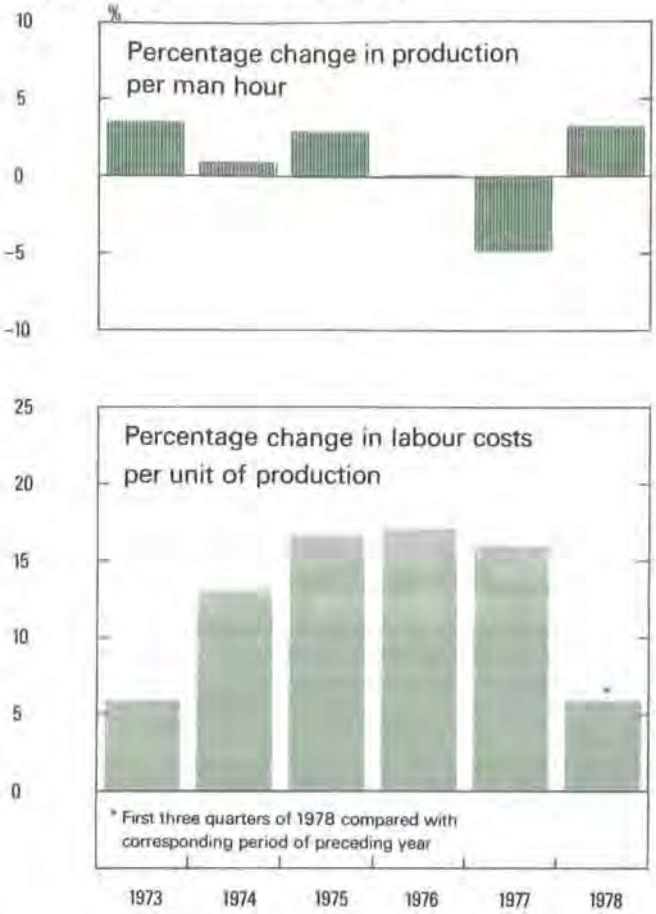
Economic indicators show that a moderate cyclical upswing in real economic activity occurred during 1978, following the prolonged economic downswing from about the middle of 1974 to the end of 1977. The recovery gained considerable momentum during the second quarter, but slowed down again during the third quarter. This effect was produced by large swings in real private consumption expenditure which gave rise to a sharp increase in the real gross domestic product in the second quarter and a subsequent decline in the third quarter. During the fourth quarter, however, real economic activity resumed its moderately upward trend. Illustrating this course of events, the seasonally adjusted real gross domestic product of the non-primary sectors of the economy increased at annual rates of 7 per cent, 10 per cent and 6 per cent in the first, second and fourth quarters of 1978, respectively, whereas a decline at an annual rate of 4 per cent was recorded in the third quarter. Major contributions to the increase during the fourth quarter were made by commerce, the real value added of which had still declined during the first nine months of the year, and by manufacturing. Certain sectors of the economy, however, continued to experience slack conditions, especially the construction sector.

Slight increase in employment and productivity

The moderate economic recovery during 1978 was reflected in a slight increase in employment. Employment in the non-agricultural sectors of the economy, which had shown no growth in 1977, increased by 0,6 per cent in the first three quarters of 1978, compared with the corresponding period in 1977. Increases of 2,7 per cent and 4,5 per cent in employment in the public sector and in gold mining, respectively, were largely responsible for the small rise in non-agricultural employment in the first three quarters of 1978. Employment in the private sector as a whole declined by 0,3 per cent during this period.

In contrast to the preceding three years, during which the increase in public sector employment was accounted for largely by a rise in central government employment, a more significant contribution to the increase in the first nine months of 1978 was made by higher employment in the rest of the public sector. The decline in private sector employment during the first nine months of 1978 was due mostly to decreases of 0,3 per cent, 2,9 per cent and 3,1 per cent in employment in manufacturing, construction and non-gold mining, respectively. In addition to the rise in gold mining employment referred to above, slightly higher employment levels were recorded in the case of the wholesale, retail and motor trade,

Productivity and labour costs per unit of production in manufacturing



hotels, laundries and dry cleaners, banks and building societies.

The slight increase in non-agricultural employment was reflected in somewhat lower unemployment figures. The seasonally adjusted number of registered unemployed Whites, Coloureds and Asians declined from 34 190 in December 1977 to 31 059 in December 1978 and to 28 490 in February 1979. It is estimated that the latter figure represented about 1½ per cent of the comparable labour force. Surveys by the Department of Statistics show a decrease in the number of unemployed Blacks, which amounted to approximately 9,9 per cent of the economically active Black population in September 1978.

Overall productivity, as measured by the production per worker in the non-agricultural sectors of the economy, increased by 1,5 per cent in the first three quarters of 1978, compared with a decline of 1,0 per cent in 1977. In manufacturing, for which more detailed statistics are available, production per man-hour in manufacturing showed a significant rise of 3,3 per cent in the first nine months of 1978, as against a decline of 4,8 per cent in 1977. The improved productivity lowered the rate of increase in unit labour costs. In manufacturing, for example, the rate of increase in labour costs per unit of production declined from 17,1 per cent and 16,0 per cent in 1976 and 1977, respectively, to 5,9 per cent in the first nine months of 1978.

Further decline in the real remuneration of labour

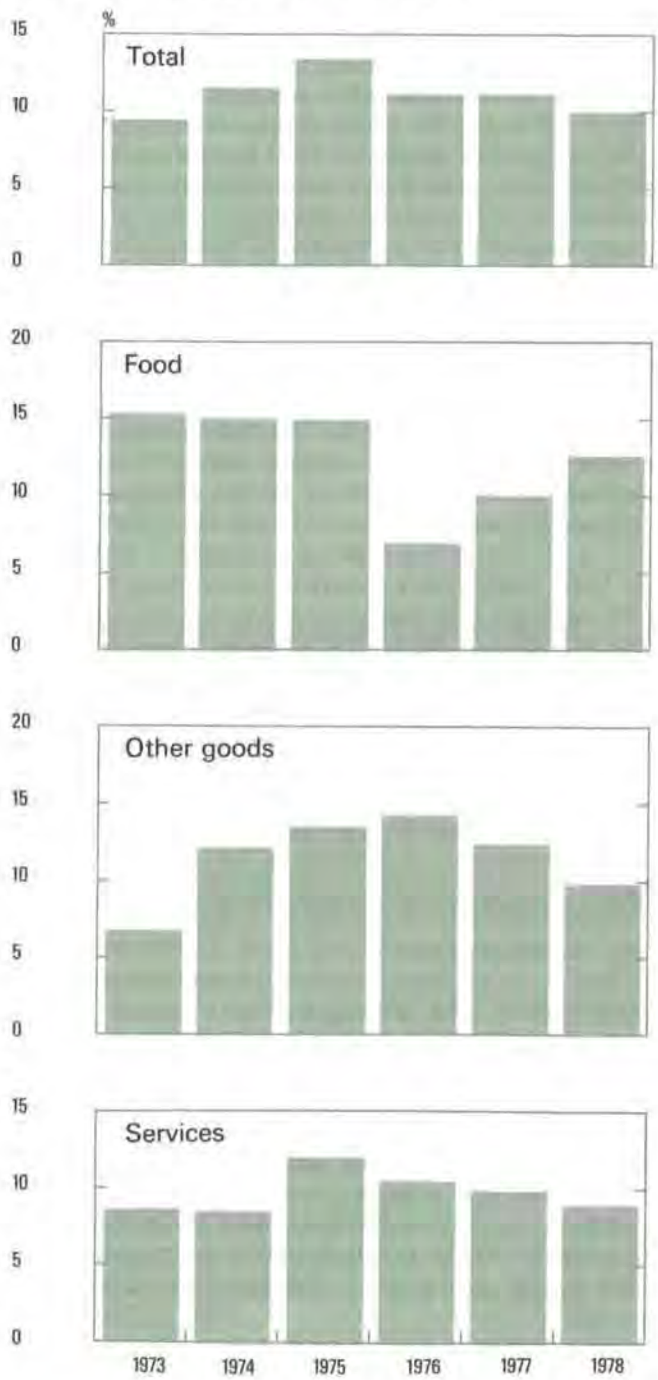
The average remuneration of workers in the non-agricultural sectors of the economy rose by 9,1 per cent in the first three quarters of 1978, compared with 10,0 per cent and 13,2 per cent in the calendar years 1977 and 1976, respectively. In real terms, however, a decline of 1,1 per cent in the average remuneration per worker in 1977 was followed by a further decrease of 1,4 per cent in the first nine months of 1978. The average real remuneration of Non-White workers, which had increased in preceding years, declined in the first three quarters of 1978, whereas the decrease in that of White workers during this period was preceded by declines in 1976 and 1977.

Percentage change in salaries and wages per worker in the non-agricultural sectors

	1976	1977	1978*
Whites:			
At current prices	10,1	8,4	8,2
At constant prices	–0,9	–2,6	–2,2
Non-Whites:			
At current prices	15,9	11,9	10,2
At constant prices	4,3	0,6	–0,4
All population groups:			
At current prices	13,2	10,0	9,1
At constant prices	1,9	–1,1	–1,4

*Figures up to 30 September 1978 compared with figures for the corresponding period of the preceding year.

Percentage change in consumer prices



Slightly lower rate of inflation

The rate of inflation declined slightly in 1978 despite increases in several administered prices, the introduction of the new general sales tax, and the adverse effect of a decline in the exchange rate of the rand on prices of imported goods. The average monthly consumer price index rose by 10,1 per cent (8,6 per cent if the estimated effect of the general sales tax is eliminated), compared with an increase of 11,2 per cent in 1977. Lower rates of increase occurred in the prices of durable consumer goods, alcoholic beverages and tobacco, and in home owners' costs and the cost of transport services. Higher rates of increase, however, were recorded in prices of food, clothing and recreational and personal services, and in flat rent.

On a quarterly basis, the seasonally adjusted annual rate of increase in consumer prices declined from 9,2 per cent in the first quarter of 1978 to 5,3 per cent in the second quarter, but rose to 22,7 per cent (9,9 per cent if the estimated effect of the general sales tax is excluded) in the third quarter, and then declined to 8,5 per cent in the fourth quarter. A lower rate of increase was recorded in the fourth quarter, notwithstanding more rapid increases in food prices, flat rent, servants' wages and the cost of certain personal services. From January 1978 to January 1979 consumer prices increased by 11,2 per cent. With the exception of a continued sharp rise in food prices and an increase in the price of petrol, the prices of all other goods and services in January maintained the lower rate of increase recorded in the fourth quarter of 1978.

The average monthly wholesale price index rose by 9,7 per cent in 1978, as against an increase of 12,9 per cent in 1977. The decline in this rate was the result of smaller increases in the prices of domestically produced as well as imported goods. With the exception of marginally higher rates of increase in the prices of agricultural products, non-electrical machinery and tobacco, the prices of all major items which are included in the index of domestically produced goods, rose at lower rates.

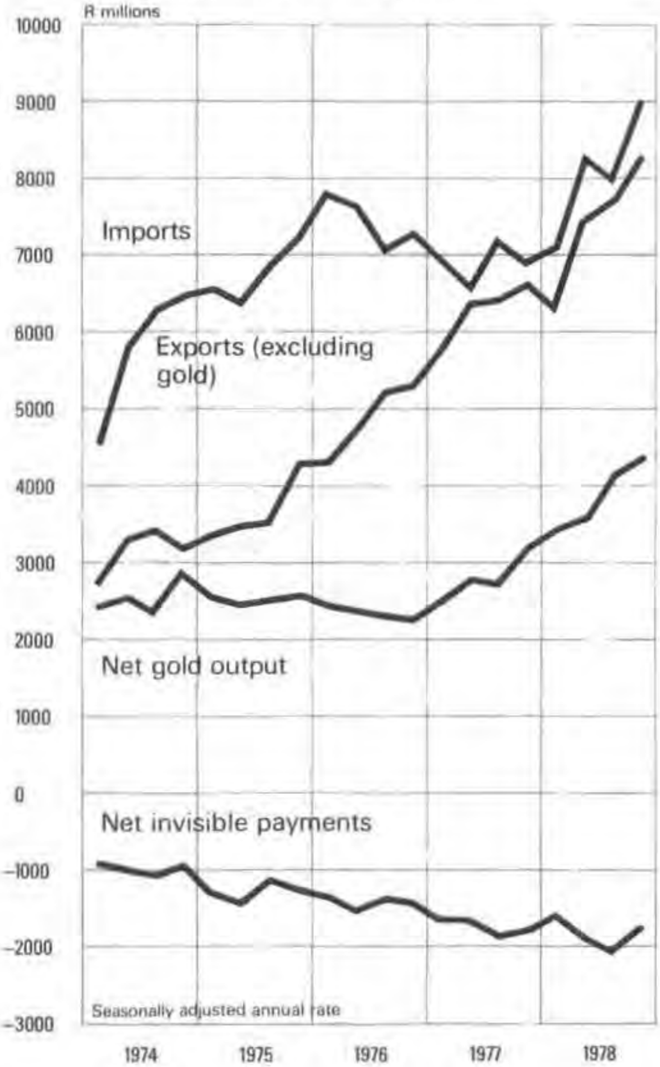
At a seasonally adjusted annual rate, wholesale prices increased sharply by 13,8 per cent in the first quarter of 1978. This was followed by lower rates of increase of 9,6 per cent and 6,8 per cent in the second and the third quarters, respectively. Mainly as a result of higher rates of increase in the prices of agricultural products, manufactured basic metals and metal products, machinery and transport equipment, and imported goods, the rate of increase in wholesale prices accelerated to 12,3 per cent in the fourth quarter of 1978. From January 1978 to January 1979 wholesale prices increased by 10,5 per cent.

Balance of payments

Substantial further improvement in the current account

After the first calendar-year surplus in nine years had been recorded on the current account of the balance of payments in 1977, a further improvement occurred during 1978. According to preliminary figures, the surplus in 1978 amounted to R1 412 million, compared with R465 million in 1977. This substantially larger surplus was brought about mainly by increases in export prices as well as by a rise in the volume of exports. Not only the price of gold, but also the prices of several other important export products rose sharply during 1978. These favourable developments were countered partly by an increase in the value of merchandise imports and in net invisible payments to foreigners.

Balance of payments current account



Surplus on current account

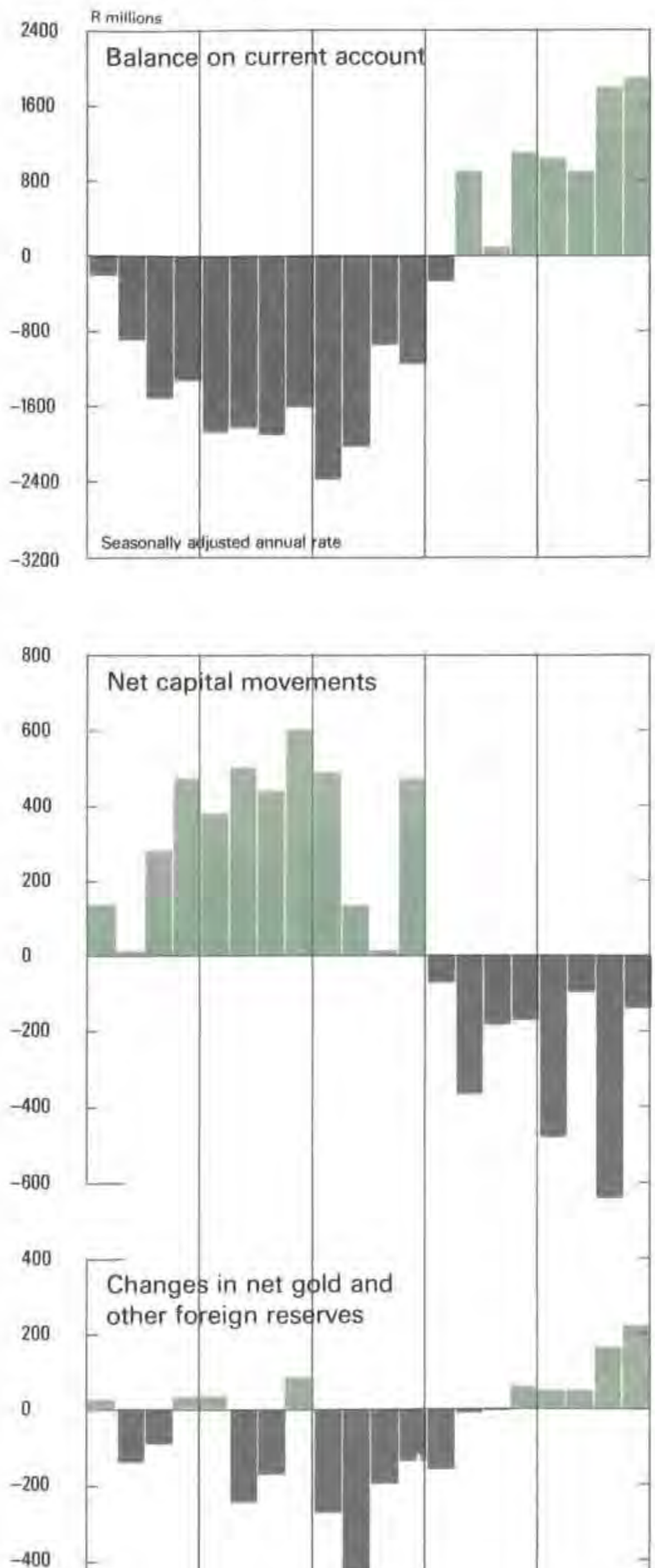
		Seasonally adjusted annual rate (R millions)	Percentage of gross domestic product
1977	3rd qtr.	96	0,3
	4th qtr.	1 110	3,1
1978	1st qtr.	1 054	2,8
	2nd qtr.	896	2,3
	3rd qtr.	1 798	4,4
	4th qtr.	1 900	4,5

During the first half of 1978 the surplus on the current account, seasonally adjusted, was slightly smaller on average than in the last quarter of 1977. Thereafter the surplus increased sharply during the next six months and reached a seasonally adjusted annual rate figure of R1 900 million in the fourth quarter of 1978. This further improvement of the current account during the second half of 1978 occurred despite a sharp rise in merchandise imports, and was attributable to increases in merchandise exports and the net gold output and a decline in net invisible payments to foreigners.

A sharp rise in the price of gold and a slight increase in the volume of gold production caused the value of the net gold output to rise from R2 795 million in 1977 to R3 863 million in 1978, an increase of about 38 per cent. The increase in the price of gold was most pronounced during the second half of 1978, notwithstanding sharp fluctuations during the fourth quarter. After a new record price per fine ounce of $243,65 had been reached on 31 October, the price declined to a low of $193,40 on 30 November. Subsequently, it increased again to $226,00 per fine ounce on 31 December and to a peak of $254,00 on 8 February 1979, and then fluctuated between $240 and $252 during the remainder of February. The average fixing price of gold per fine ounce on the London market amounted to $193,26 in 1978, compared with $147,71 in 1977.

Increases in the prices of a number of important export commodities were mainly responsible for a rise in the value of merchandise exports from R6 293 million in 1977 to R7 434 million in 1978, an increase of about 18 per cent. Substantial increases occurred in the prices of diamonds, platinum, uranium, and fruit and smaller increases were recorded in the prices of ferro-chrome, wool and coal. These price rises were supplemented by increases in the volume of exports such as ferro-chrome, coal, maize and deciduous fruit, which exceeded a decline in the volume of sugar, wool and asbestos exported. Quarterly figures show a sharp rise in the value of merchandise exports in the fourth quarter of 1978, namely from a seasonally adjusted annual rate figure of R7 695 million in the third quarter to R8 285 million in the fourth quarter.

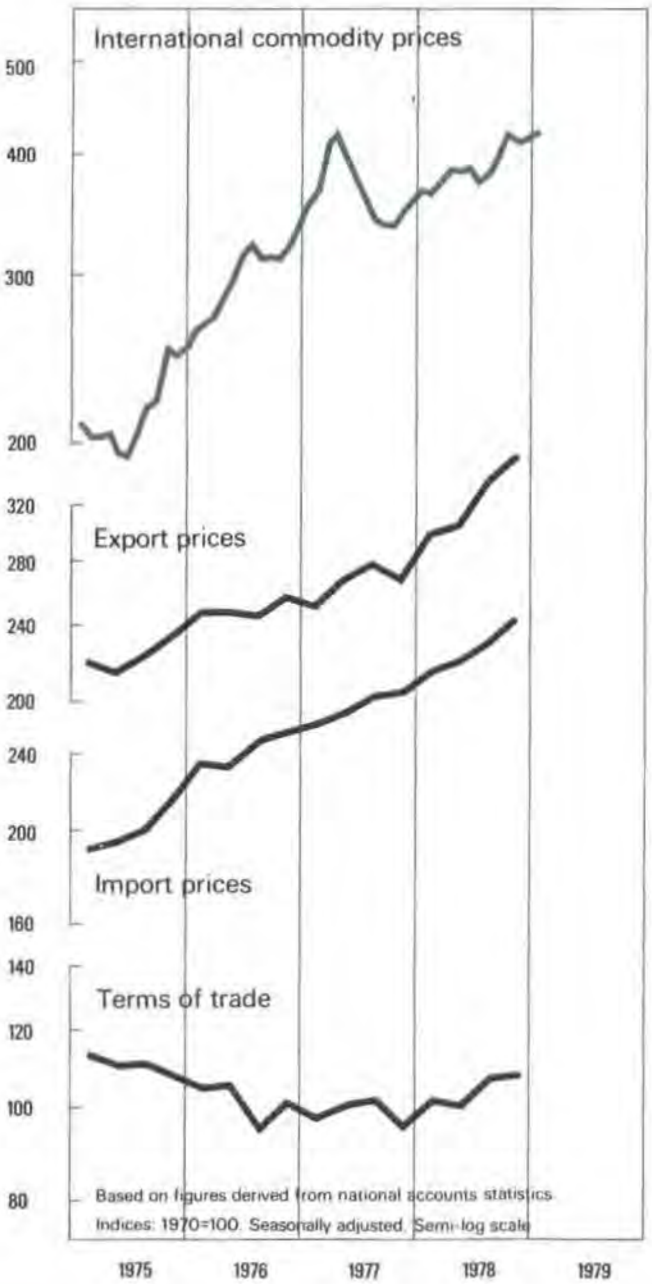
Balance of payments



After the value of merchandise imports had declined from R7 443 million in 1976 to R6 881 million in 1977, it increased by about 17 per cent to R8 069 million in 1978. The sharp rise in imports during 1978 reflected mostly an increase in the prices of imported goods but also a small rise in volume. The increase in imports occurred over a wide range of goods, but was notably large in the case of machinery and electrical equipment, transport equipment and chemical products. Considering quarterly changes, imports increased sharply in the fourth quarter of 1978 when a seasonally adjusted annual rate figure of R8 980 million was recorded.

Net invisible payments to the rest of the world increased from R1 742 million in 1977 to R1 816 million in 1978. An increase in service payments was not offset fully by a rise in service and transfer receipts. The rise in service payments was caused by increased freight and merchandise insurance, more tourists visiting other countries, and higher dividend payments. The rise in service receipts, in turn, was mainly the result of increases in transportation services rendered to foreigners and in dividends received on foreign investment.

Terms of trade



Large net capital outflow

In 1978 a net capital outflow of R1 370 million was recorded on the capital account of the balance of payments, compared with R810 million in the preceding year. Various factors contributed to this substantial outflow. Firstly, the monetary authorities made net repayments on foreign short-term loans which had been obtained previously to support the level of foreign exchange holdings. Secondly, the success of the Treasury's domestic borrowing operations and the higher than anticipated increase in Exchequer receipts allowed net repayments of foreign long-term debt by the government. Thirdly, the relatively low rate of growth of the domestic economy, the existence of surplus production capacity in most sectors of the economy, and the relatively easy conditions in the domestic capital market were not conducive to new foreign investments. Fourthly, political uncertainties regarding Southern Africa had a negative influence on foreign investors' attitudes. Fifthly, a sharp increase in the foreign relative to the domestic cost of trade financing from about the middle of 1978 led to an outflow of short-term funds. Finally, expectations of a depreciation of the rand at times resulted in speculative capital outflows.

From the accompanying table it is apparent that the outflow of capital during 1978 consisted mostly of short-term capital, including unrecorded trans-

Net capital movements
R millions

	1977	1978
Long-term capital		
Central government and banking sector	–58	–426
Public corporations and local authorities	98	210
Private sector	256	179
Total	296	–37
Liabilities related to reserves	–221	–437
Other short-term capital, including trade finance and errors and omissions	–885	–896
Total	**–810**	**–1 370**

actions. In addition, there was a large net outflow of long-term capital from the central government and banking sector and a sharp decline in liabilities related to reserves. In contrast, a considerable net inflow of long-term capital to public corporations and local authorities and to the private sector was recorded. This net inflow of long-term capital was accounted for mainly by loans obtained abroad for the new oil-from-coal plant, the nuclear power station and purchases of container ships.

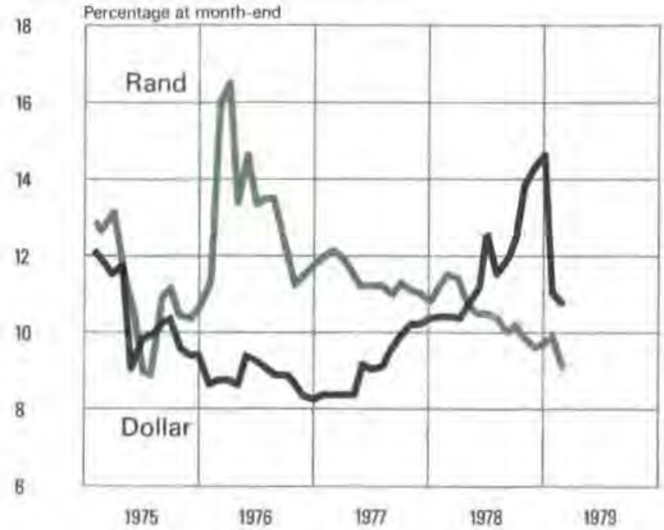
Sharp fluctuations in the net outflow of capital occurred in the course of 1978. The net capital outflow declined from R481 million in the first quarter to R100 million in the second quarter of the year, before it increased to R648 million in the third quarter. Subsequently, it declined to R141 million in the last quarter of 1978. The relatively small net outflow of capital during the fourth quarter consisted of a decline in liabilities related to reserves, repayments on long-term government loans, an inflow of other long-term capital, and a moderate net outflow of short-term capital not related to reserves.

Increase in gold and other foreign reserves

The gross gold and other foreign reserves increased by R1 442 million during 1978 to a level of R2 230 million at the end of the year. This substantial increase, however, was due almost entirely to the revaluation of the country's gold reserves at market-related prices. If valuation adjustments are excluded, the gross gold and other foreign reserves increased by only R42 million during 1978 as a result of balance of payments transactions. This increase was reflected largely in the foreign exchange holdings of private sector banks, but a slight increase was also recorded in the foreign exchange reserves of the Reserve Bank. If the effect of the montly revaluation of gold reserves is eliminated, the gross gold and other foreign reserves of the Reserve Bank increased by R234 million during January and February 1979. This increase was apparently due to, firstly, a speculative inflow of capital following on the revaluation of the rand against the US dollar during February. The subsequent appreciation of the rand under the system of managed floating contributed towards a favourable situation developing in the "leads and lags" arising from trade financing. Although data for the foreign exchange holdings of the commercial and other banking institutions as at the end of February are not yet available, it can be expected that under the circumstances these have been reduced to minimum amounts. Secondly, the change in the forward exchange cover arrangements at the end of January stemmed the outflow of capital resulting from switches from foreign to domestic sources of trade financing.

Substantial net repayments on loans ranking as liabilities related to reserves, resulted in an increase of R479 million in the net gold and other foreign reserves during 1978, compared with a decrease of R124 million in 1977. The increase in the net gold and other foreign reserves accelerated considerably during the second half of the year. Whereas the average quarterly increase amounted to R48 million in the first six months, it rose to R163 million in the third quarter and R220 million in the fourth quarter of the year.

Effective cost of trade financing



Changes in exchange rate policy and practices

On 24 January 1979 the Minister of Finance announced that, after consultation with the Reserve Bank and other interested parties, the Government had decided to initiate a gradual and systematic process of changing South Africa's exchange rate policy and practices based on recommendations in the interim report of the Commission of Inquiry into the Monetary System and Monetary Policy in South Africa. The eventual aim of this process is a unitary exchange rate system under which an independent and flexible rand will find its own level in well developed and competitive spot and forward foreign exchange markets. In this system, movements of the exchange rate of the rand will be managed through Reserve Bank "intervention" by means of purchases and sales of foreign exchange. The Government accepted the Commission's view that the eventual system cannot be implemented fully at the present stage, but can best be attained only through a gradual process of adjustment.

Various steps were taken to give effect to the new policy:

I. Initially the Reserve Bank would continue to quote predetermined buying and selling rates for US dollars at which it would be prepared to enter into transactions with authorised foreign exchange dealers. These rates would be adjusted more frequently in accordance with changing circumstances.

2. In order to develop a broader, more active, and competitive foreign exchange market, the Reserve Bank would cease to prescribe mandatory buying and selling rates at which authorised foreign exchange dealers were to conduct their transactions in US dollars with the public.
3. Authorised foreign exchange dealers would be allowed to maintain reasonable "open positions" in foreign exchange and to deal for their own account in foreign exchange within limits prescribed by the Reserve Bank.
4. To expand the volume of direct foreign exchange transactions outside the Reserve Bank, the Bank, in consultation with the Department of Finance, would examine the practicability of channelling through the authorised dealers at least a portion of the receipts of sales of Krugerrand and diamonds as well as of foreign loans to public corporations and local authorities. The Reserve Bank would continue, however, to market gold bullion and sell the dollar proceeds in the market. The Bank would also continue to handle the proceeds of its own and the Government's foreign borrowing.
5. Initiating the process of gradually developing an active and competitive forward exchange market, the Reserve Bank would no longer quote a fixed charge or commission to be paid by both importers and exporters for forward cover. In future one (middle) price for forward dollars of any specific maturity would be quoted and forward margins would be determined on a variable and a more market-related basis. Authorised dealers would be encouraged to offset as far as possible forward exchange purchases against forward sales and to cover, within the imposed limits, their net forward foreign liabilities by holding spot foreign assets.
6. The Reserve Bank would be prepared, through the intermediation of authorised foreign exchange dealers, to extend forward cover facilities to foreign loans negotiated by the private sector with exchange control approval, but only in respect of the rand-dollar exchange risk and only for a period of one year at a time. Forward cover would still be provided by the Reserve Bank to public corporations and other bodies in the public sector, but the rate on forward cover against liabilities denominated in stronger currencies, such as the German mark or the Swiss franc, would be set at a higher level than that in respect of the US dollar and other less strong currencies.
7. As a first step in the direction of a market-related unitary exchange rate for the rand, the "securities rand" would be transformed into a "financial rand" by expanding the uses to which it can be put by non-residents. Instead of using securities rand only to purchase quoted securities and the special non-resident bonds of the Government, non-residents would be allowed to invest also in unquoted securities and other capital assets. The transformation of securities rand into financial rand would proceed gradually under the management and guidance of the Reserve Bank. The purpose of this change is to provide an incentive to foreigners to invest in South Africa, particularly since the dividends on their investments will be remitted at the commercial exchange rate. The foreign reserves of the country, however, will not benefit directly from such transactions because one non-resident will be buying financial rand from another.

From 29 January to 26 February 1979 the Reserve Bank adjusted its rate quoted for US dollars on two occasions, namely on 8 February when the rand was appreciated by 1,7 per cent to a middle rate of $1,17 per R1, and on 20 February when another upward adjustment to $1,18 per R1 was made. On 27 February the Reserve Bank discontinued the practice of quoting fixed predetermined rates for US dollars. Since then the rand appreciated slightly against the dollar.

On 5 March a new procedure came into effect in terms of which the proceeds of Krugerrand sales are channelled directly to authorised dealers in the foreign exchange market instead of to the Reserve Bank. The intention is that at least part of the proceeds of diamond sales will also be sold directly in the market instead of to the Reserve Bank.

The commission of 1 per cent per annum on forward cover was abolished on 25 January 1979 and the Reserve Bank's forward margin on US dollars was set at a dollar discount (or rand premium) of 2 per cent per annum. This forward dollar discount, or forward rand premium, largely reflected the fact that dollar interest rates were at higher levels than those in South Africa. The immediate effect of this change was a narrowing of 3 percentage points of the margin between the effective cost of trade financing in US dollars and in rand. At the end of January the differential accordingly declined to less than 1 per cent, but a more rapid decline in short-term interest rates in South Africa than in the United States caused the margin to widen to 1,6 per cent on 9 March. As indicated above, the foreign exchange reserves of the Reserve Bank increased substantially during February, mainly because of an inflow of short-term capital which occurred despite the widening of the interest rate differential. On 8 March the Reserve Bank started to base its forward rates on the ruling spot rate. Formerly it was determined on the basis of the closing spot rate of the preceding day.

Monetary and banking situation

More rapid increase in money and near-money

The supply of money and near-money, which had increased at a relatively low rate of 7 per cent during 1977, expanded more rapidly by 12 per cent during 1978. Similarly, the rate of increase in the narrowly defined money supply rose from 5 per cent in 1977 to 10 per cent in 1978.

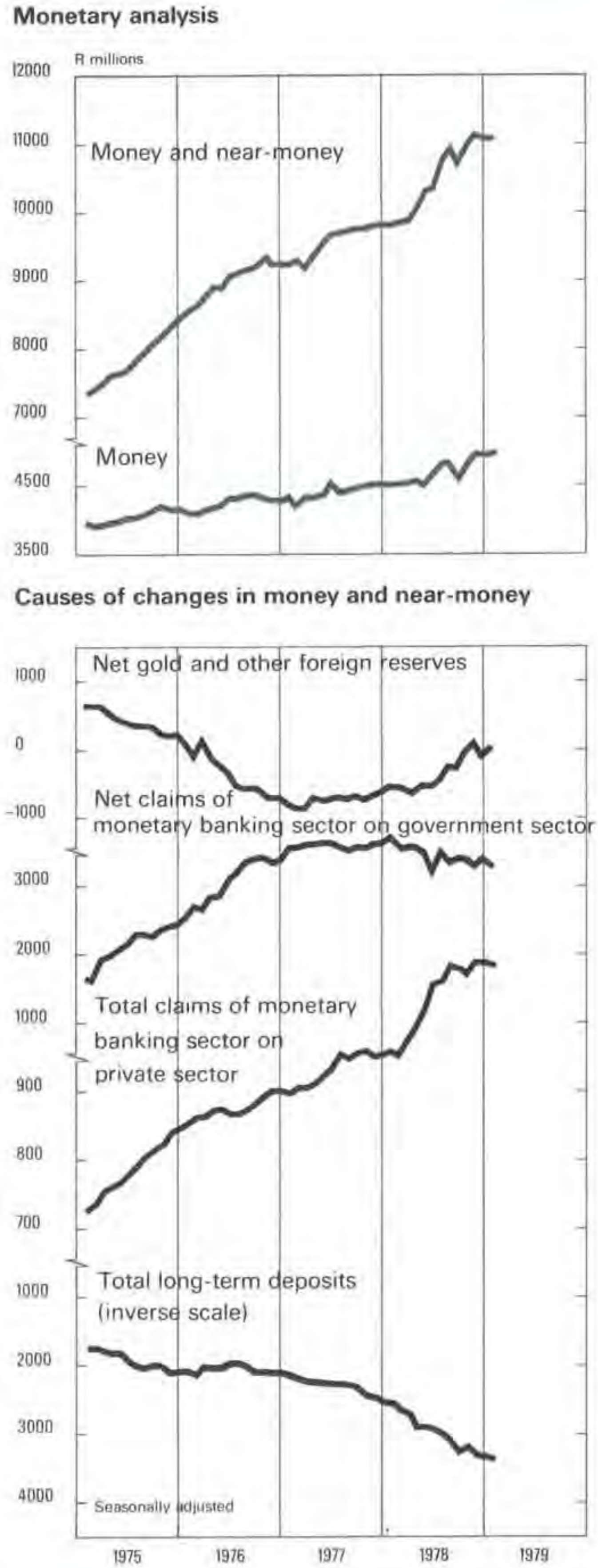
On a quarterly basis, the rate of increase in the seasonally adjusted supply of money and near-money became significantly larger from the second quarter of 1978. An annual rate of increase of only 2 per cent during the first quarter was followed by successive annual rates of increase of 17 per cent, 15 per cent and 13 per cent during the last three quarters of the year. The narrowly defined money supply rose sharply at a seasonally adjusted annual rate of 34 per cent during the fourth quarter of 1978, as against an average annual rate of increase of only 3 per cent during the preceding three quarters. During January 1979, the seasonally adjusted money and near-money supply showed only a minor change, decreasing by about R9 million.

Causes of changes in money and near-money

The higher rate of increase in the supply of money and near-money during 1978 was caused by a rise in the net gold and other foreign reserves of the monetary banking sector and in monetary banks' claims on the private sector. Net claims on the government sector declined during 1978 and long-term deposits of the private sector with monetary banks showed a marked further rise.

In contrast to an increase of only R60 million during 1977, the net gold and other foreign reserves of the monetary banking sector rose by as much as R501 million during 1978, reflecting mainly a reduction of R418 million in this sector's short-term foreign liabilities. The largest part of the increase in net reserves occurred during the second half of 1978, especially during the third quarter.

Seasonally adjusted claims of the monetary banking sector on the private sector increased substantially during the period February to August 1978. During September and October these claims declined marginally before rising again during the remainder of the year. Net claims of the monetary banking sector on the government sector, seasonally adjusted, decreased by R450 million during the first half of 1978, largely because of an increase of R374 million in government deposits during this period. During the second half of the year, however, net claims on the government sector increased by R201 million, mostly during the third quarter. The increase in domestic credit extension, i.e. the total of the monetary banking sector's net claims on the government sector and its claims on the private sector, slowed



Causes of changes in money and near-money
R millions

	Not seasonally adjusted	Seasonaly adjusted				
	Year		1978			1979
	1978	1 qtr.	2 qtr.	3 qtr.	4 qtr.	Jan.
Net gold and other foreign reserves	501	57	44	242	146	137
Claims on government sector						
Gross claims	−14					
Government deposits (increase −, decrease +)	−246					
Net claims	−260	−65	−385	181	20	−109
Claims on private sector	1 265	204	732	210	110	−40
Long-term deposits (increase −, decrease +)	−797	−186	−251	−287	−76	−34
Net other assets	489					
Total causes of changes	**1 198**	**48**	**406**	**378**	**346**	**−9**

down from seasonally adjusted annual rates of 11 per cent and 12 per cent in the second and third quarters, respectively, to only 4 per cent in the last quarter of the year.

The seasonally adjusted long-term deposits of the private sector with the banking sector continued to increase in each of the four quarters of 1978. After sharp increases during the first three quarters of the year, however, a substantially smaller rise was recorded during the fourth quarter.

During January 1979 a further increase in net gold and other foreign reserves, seasonally adjusted, was more than offset by decreases in the seasonally adjusted net claims on the government sector and in claims on the private sector, as well as by a further rise in long-term private deposits. The decline in net claims on the government sector was caused mainly by a substantial increase of R160 million in government deposits during January.

Higher rate of increase in bank credit to the private sector

Bank credit to the private sector increased by about 13 per cent during 1978, compared with an increase of only 6 per cent during the preceding year. During the second quarter of 1978 the seasonally adjusted annual rate of increase amounted to as much as 34 per cent; during the third and fourth quarters, however, it reverted to lower levels of 8 per cent and 5 per cent, respectively. The substantial increase during the second quarter was largely based on an upsurge in consumer expenditure prior to the introduction of the general sales tax in early July.

Investments by monetary banking institutions in private sector securities increased consistently throughout 1978 and accounted for R271 million of the overall increase of R1 265 million in claims on the private sector. Cash credit advances by the Land Bank were seasonally high during the second and third quarters, but did not decline in accordance with the usual seasonal pattern during the fourth quarter, largely because of less favourable production conditions in agriculture.

The discounts, loans and advances of the commercial banks, merchant banks and monetary hire-purchase and general banks increased by 12 per cent in 1978, compared with an increase of only 2 per cent during 1977. Hire-purchase and leasing finance extended by these banks expanded rapidly by R603 million, or about 38 per cent, during the year. Bills discounted, on the other hand, decreased by R95 million. All other loans and advances of the banks concerned, representing mostly loans and advances for industrial and commercial purposes, increased by only 6 per cent during 1978. Although bank credit to the private sector, seasonally adjusted, decreased moderately by R40 million during January, the discounts, loans and advances of commercial banks increased by R72 million, whereas investments by monetary banking institutions in private sector securities declined by R34 million.

On 12 March 1979 the Reserve Bank announced that the ceilings on banking institutions' discounts, loans and advances to the private sector and on their investments in private sector securities would be raised by an additional 5 per cent of the respective "base" figures as at the end of December 1975, these increases to become effective from 31 March. The regular monthly increases in the ceilings by ½ per cent of the relevant base figures would continue to apply. At the same time, the total amount of credit extension to the private sector, as defined for purposes of the ceilings, which a banking institution may not exceed without becoming subject to the ceiling requirements, was raised from R15 million to R20 million. In the same statement, it was announced that the supplementary liquid asset requirements applying to "large" banking institutions (i.e., banks having total assets exceeding R800 million) in respect of increases in their short-term and medium-term liabilities to the public since the end of September

1975, would be reduced from 20 to 10 per cent and from 8 to 4 per cent, respectively, this reduction to become effective from the date of the banks' certification of their monthly returns for February 1979. For smaller banking institutions, the 20 per cent supplementary liquid asset requirement against increases in their short-term liabilities was abolished entirely. The corresponding requirement against increases in their medium-term liabilities already had been withdrawn in September 1978.

Improvement in bank liquidity

The excess liquidity of monetary banking institutions, which had been at relatively low levels during the first eight months of 1978, improved during the remainder of the year. The liquidity position of other banking institutions, however, remained tight throughout the year. As may be observed from the accompanying table, the major cause of the improvement in the liquidity position of the banking institutions during 1978 was the increased contribution of the foreign sector to the banks' actual holdings of Liquid Assets. During the last few months of 1978 the government sector and, to a lesser degree, the banking system itself, also contributed to the improved excess liquidity position.

During January 1979 the excess liquidity ratio of all banking institutions declined fairly sharply for seasonal reasons. The excess liquidity ratio of monetary banking institutions declined from 3,2 per cent to only 1,7 per cent. The ratio for all banking institutions decreased from 3,1 per cent to 1,6 per cent. Total deposits with the discount houses, however, showed wider fluctuations than during previous years. This was due largely to the generally low level of the free balances held by the banks with the National Finance Corporation, which meant that fluctuations in call deposits held by the banking system had to be absorbed by the discount houses rather than by the Corporation. For the same reason, the discount houses had to approach the Reserve Bank for accommodation more frequently and for larger amounts than during preceding years.

The money market tightened during the first quarter of 1978, eased notably during most of the second quarter, but tightened sharply again over the June month-end. It eased during July and August, was tight again over the August month-end, and then eased continuously until the end of November, notably after the first week in October. The market then tightened over the November month-end, experienced a continuing shortage of funds during December, and tightened particularly during the first week of January 1979. After remaining tight during January and over the January month-end, the market turned extremely liquid during February. It tightened sharply over the February month-end, however, and remained tight during early March.

Call deposits with the discount houses varied from low levels of approximately R580 million in early March 1978 and little more than R600 million during early January 1979, to peaks of R971 million in August and R990 million in February 1979. Free balances of the banks with the National Finance Corporation were depleted for large parts of the year and rarely exceeded R100 million. Accommodation of the discount houses by the Reserve Bank reached its highest peak over the June month-end and in early July 1978, being R371 million on 5 July. It was also high over the August month-end, when it reached R323 million, in early January 1979, when it amounted to R350 million, and during early March 1979, when it rose to almost R316 million.

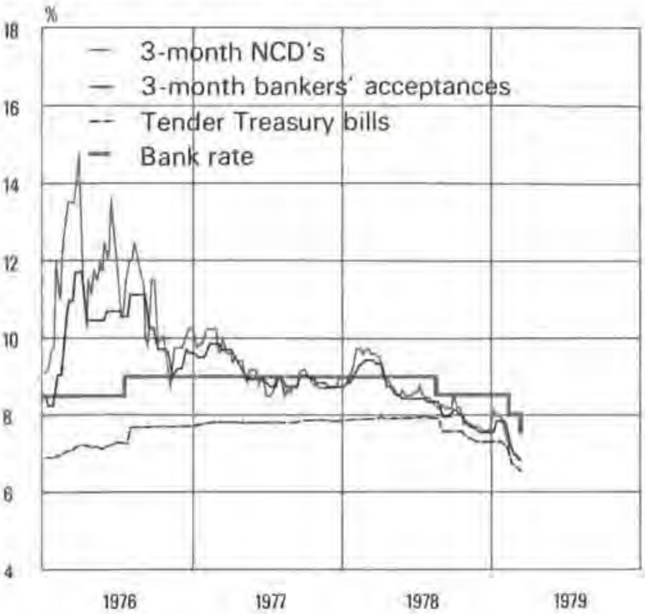
Sectoral sources of bank holdings of liquid assets and excess liquidity ratios of banking institutions
R millions

	1978					
	Mar.	**June**	**Sept.**	**Oct.**	**Nov.**	**Dec.**
Foreign sector	102	94	321	605	755	519
Government sector	2 557	2 688	2 579	2 495	2 699	2 729
Non-bank private sector	694	678	804	756	494	685
Banking system	856	1 009	985	927	983	1 082
Total holding of liquid assets	4 209	4 469	4 689	4 783	4 931	5 015
Less:						
Liquid assets not usable for liquid asset requirements	−13	−14	−11	−6	−8	−9
Less						
Required liquid assets	−4 035	−4 162	−4 334	−4 334	−4 416	−4 531
Excess liquid assets	161	292	344	443	507	475
Excess liquidity ratio, %	1,2	2,0	2,3	2,9	3,3	3,1

Money market conditions and interest rates

The money market experienced varying periods of tightness and ease during 1978 and in January and February 1979, the main cause of these fluctuations being flows of funds to and from the government sector.

Money market interest rates



Interest rate movements reflected the above fluctuations in money market liquidity, but rates generally tended to move downwards during the year. The rate on 3-month negotiable certificates of deposit, for example, which amounted to 9,0 per cent in early January 1978, rose to 9,75 per cent in February, but then declined throughout most of the remainder of the year (although showing temporary increases over the June and September month-ends) to reach 7,6 per cent in December. It then hardened in January 1979 to 7,9 per cent before continuing its decline to 6,85 per cent on 9 March. The rate on 3-month bankers' acceptances and the basic call rate of the discount houses behaved in a similar manner. The Treasury bill tender rate hardened marginally from 7,95 per cent in January-February 1978 to 7,99 per cent on 11 August. It then fell sharply in sympathy with the reduction in Bank rate and stood at 7,65 per cent on 25 August. Thereafter it continued to fall and reached 6,57 per cent 9 March 1979.

During the year under review the Reserve Bank conducted substantial open-market sales with a view to maintaining an orderly decline in interest rates. It also, at times, conducted open-market purchases to help the market over periods of stringency. During the second half of September 1978, for example, the Reserve Banks' open-market purchases of short-term government stock amounted to R44 million.

In conformity with movements in short-term interest rates and with a view to provide further stimulus to domestic economic activity, Bank rate was reduced from 8½ to 8 per cent on 6 February and from 8 to 7½ per cent on 17 March. Following these reductions, the major commercial banks lowered their prime overdraft rates from 11½ to 11 per cent in February and from 11 to 10 – 10½ per cent in March. On both occasions deposit interest rates, with the exception of the rate on ordinary savings deposits, were reduced by ½ per cent.

Government finance

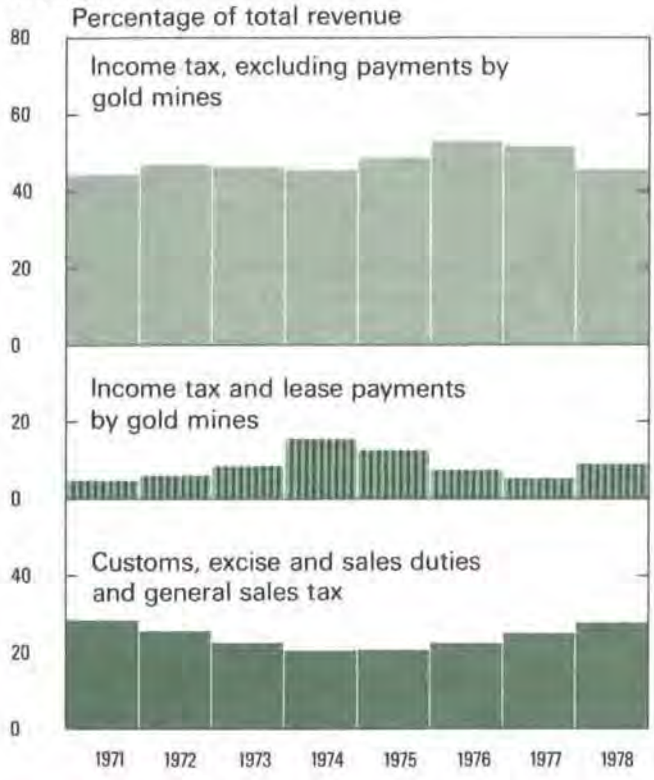
Relatively high rate of increase in Exchequer issues

Exchequer issues increased by 17 per cent in 1978, a rate of growth substantially higher than the 6 per cent recorded in 1977. This relatively high rate of increase was caused by a concentration of issues in the last quarter of the 1977/78 fiscal year, specifically in March 1978, and a large incidental statutory payment of R157 million from the Exchequer Account to the Public Debt Commissioners. Even if the statutory payment is excluded, the rate of increase of 15 per cent remained the highest since 1975. During the first nine months of the 1978/79 fiscal year, i.e. the period April to December 1978, the increase of 10 per cent in Exchequer issues (excluding the statutory payment) conformed closely to the Budget estimate for the fiscal year as a whole.

Change in the composition of Exchequer receipts

Receipts on the Exchequer Account (excluding borrowing) rose by about 16 per cent in 1978, compared with an increase of 11 per cent in 1977. The composition of the tax and other current receipts of the central government changed significantly in 1978, firstly because of a changed tax structure in which greater emphasis is placed on indirect tax as a source of revenue, and secondly as a result of a rise in the price of gold which caused the profits of gold mines, and hence their income tax and mining lease payments to the government, to increase sharply. Indirect tax receipts, consisting of the proceeds of customs, excise and sales duties, the surcharge on imports, and the newly introduced general sales tax, rose by 31 per cent in 1978. In addition, income tax and mining lease payments by gold mining companies almost doubled during this period. Receipts of income tax from taxpayers other than the gold mining industry, on the other hand, increased by only 3 per cent. Indirect taxes, income tax and mining lease payments by gold mines, and other income tax payments accounted for 28 per cent, 9 per cent and 46 per cent, respectively, of total revenue collections in 1978, compared with 25 per cent, 5 per cent and 52 per cent, respectively, in 1977.

Composition of central government revenue collections



Exchequer receipts during the first nine months of the 1978/79 fiscal year were 14 per cent higher than during the corresponding period in the preceding year. This rate of increase was about 4 percentage points above the rate of increase which had been anticipated in the Budget for the fiscal year as a whole.

Revenue collections – State Revenue Fund[1]

	1976 Rm	1977 Rm	1978 Rm	Percentage change 1977-1978
Customs duties[2]	345	575	730	27
Excise duties	780	855	951	11
Sales duties	267	308	215	−30
General sales tax	—	—	377	
Income tax and lease payments by gold mines	457	370	727	96
Other income tax	3 278	3 628	3 733	3
Other receipts[3]	1 114	1 247	1 470	18
Total revenue collections	**6 241**	**6 985**	**8 202**	**17**

1 Including amounts paid to neighbouring countries in terms of Customs Union Agreements.
2 Including the surcharge on imports.
3 Adjusted to preserve comparability over time.

Successful borrowing operations

Exchequer issues exceeded receipts by R2 145 million in 1978. In financing this deficit the government succeeded in borrowing R2 418 million from the domestic non-banking sector. This successful borrowing operation enabled the central government to reduce its foreign debt by R219 million and its net indebtedness to the monetary banking sector by R54 million. An exceptionally large net investment in government securities of R993 million, or R694 million more than in the preceding year, was made by the Public Debt Commissioners in 1978. Part of the increased net investment of the Commissioners was accounted for by a substantially larger amount of funds received for investment from the South African Railways Administration. The private non-banking sector's net investment in government securities, excluding compulsory loan levies of R292 million, amounted to R1 133 million, or R441 million more than in 1977.

Exchequer account financing
R millions

	1976	1977	1978
Deficit (excluding borrowing and debt repayment)	**1 936**	**1 728**	**2 145**
Financed by:			
Domestic non-banking sources:	999	1 368	2 418
Public Debt Commissioners	227	299	993
Paymaster-General	−120	—	—
Private sector	891	1 069	1 425
Monetary banking sector	487	384	−54
Foreign sector	450	−24	−219
Total	**1 936**	**1 728**	**2 145**

Because of its successful borrowing programme in 1978 and its large available cash balances, the government decided to redeem maturing government stock of R376 million on 1 February and not to follow the usual procedure of making new stock available for investment. In addition, the Minister of Finance announced in January 1979 the earlier repayment to companies of the 1973 and 1974 loan levies, which were due for redemption in 1980 and 1981, as a means of improving company liquidity. An amount of about R160 million (including interest) was repaid on 15 February.

Railway Budget

In presenting the 1979/80 Budget for the South African Railways Administration to Parliament on 7 March 1979, the Minister of Transport stated that instead of the deficit of R168 000 that was anticipated originally for the financial year ending on 31 March 1979, a surplus of R53 million was now expected. The improved financial results were due largely to an increase in the volume of exports during 1978/79 but also to a deliberate effort to reduce labour cost, increased efficiency in the utilisation of material, and a reduction in financial losses on certain services.

Current revenue for the 1979/80 financial year is expected to increase by 6,3 per cent to R3 374 million and current expenditure by 14,5 per cent to R3 575 million, resulting in a shortfall of R201 million. The salary adjustments for all workers announced by the Minister accounted for a substantial part of the increase in expenditure. Notwithstanding the expected deficit, no immediate upward adjustment of tariffs was proposed. Certain tariff concessions were announced to encourage an increase in the utilisation of available facilities.

Gross investment during the 1979/80 financial year is estimated at R1 080 million, an increase of 24 per cent compared with the revised estimates for 1978/79.

Post Office Budget

With a view to finance about the same proportion of the Post Office's capital expenditure from internal sources as in recent years, increases in various postal tariffs and the unit rate for telephone calls were proposed by the Minister of Posts and Telecommunications when he presented his Department's Budget to Parliament on 20 March 1979. The proposed increases will probably not come into effect before 1 October this year. It is expected that the Department's operating expenditure will increase by 14,6 per cent to R808 million and its revenue by 14,8 per cent to R884 million during the 1979/80 financial year. Capital expenditure is estimated at R364 million, or 9,7 per cent more than the expected figure for 1978/79. It is anticipated that about 47 per cent of the capital expenditure in 1979/80 will be financed from internal sources.

Capital market

Demand for loanable funds in fixed-interest security market outweighed by supply

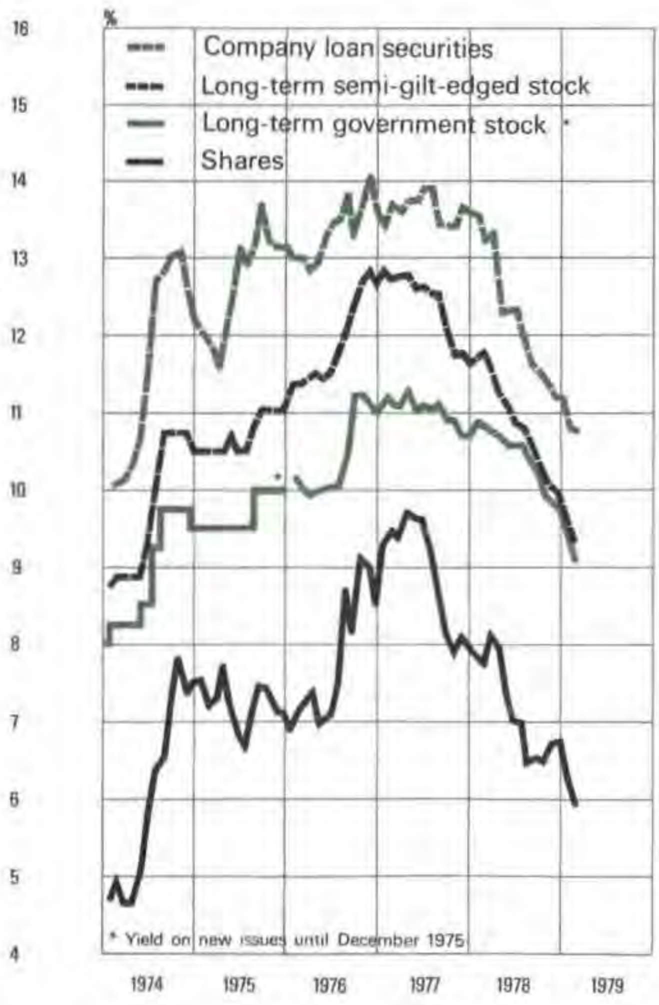
The easing of conditions in the market for fixed-interest securities from about March 1977, continued, and became even more pronounced, during 1978. A high rate of increase in domestic saving, together with sustained investors' expectations of a further downward adjustment of security yields and a general lack of appropriate alternative investment outlets during a period of low real investment activity in the economy, caused the supply of loanable funds in the market to exceed the demand. New government stock issues were well supported and most new issues of semi-gilt-edged stock were heavily over- subscribed. Secondary market transactions in fixed-interest securities increased substantially and yields declined to their lowest levels since June 1974.

Net new issues of marketable stock by the public sector, excluding the increase in the relevant borrowers' holdings of their own stock, amounted to approximately R2 087 million in 1978, compared with R2 060 million in 1977 and R1 112 million in 1976. The increase in the stock debt of the public sector during 1978 was reflected in a substantial rise of about R1 740 million in the private non-banking sector's holdings of public sector stock, following an increase of R1 277 million in 1977. The monetary banking sector's holdings of public sector stock rose by about R250 million in 1978, which was appreciably less than the increase of R729 million in 1977. In addition to the amount of loanable funds raised in the market, holdings of public sector stock by the internal funds of public sector borrowers and by the Public Debt Commissioners increased by the record amount of about R1 500 million in 1978, almost double the amount of increase in 1977. New issues of fixed interest securities by private sector companies listed on the Johannesburg Stock Exchange amounted to R222 million in 1978, compared with R190 million in 1977, and was accounted for mainly by two exceptionally large issues.

The further easing of market conditions during 1978 was reflected in a decline in the secondary market yield on long-term gilt-edged stock from 10,69 per cent in December 1977 to 9,72 per cent in December 1978 and a corresponding decrease in the secondary market yield on long-term semi-gilt-edged stock from 11,62 per cent to 9,95 per cent. These changes during 1978 narrowed the yield margin between semi-gilt-edged and gilt-edged stock from 0,93 to 0,23 percentage points. The secondary market yield on company loan securities decreased from 13,58 per cent in December 1977 to 11,18 per cent at the end of 1978.

The easier conditions in the fixed-interest security market continued during the first two months of 1979 when the secondary market yield on gilt-edged and semi-gilt-edged stock decreased further to 9,07 and 9,35 per cent, respectively. The secondary market yield on company loan securities declined likewise to 10,75 per cent.

Secondary market security yields



Share market buoyant

Except for minor temporary relapses during the period February to April and again during October and November, share prices and stock exchange turnover generally maintained a strongly rising trend during 1978. The number of shares traded on the stock exchange was 24 per cent higher in 1978 than in 1977, whereas the value of shares traded showed an increase of 29 per cent. The comprehensive share price index, covering all classes of shares, rose by 19 per cent from the end of 1977 to the end of 1978. During the first two months of 1979 the number and value of shares traded rose sharply above their levels in December 1978, and share prices on average increased by a further 16 per cent. In terms of broad categories, the largest price gains during 1978 were recorded by mining shares, followd firstly by com-

Percentage change in share prices

Year ended 31 December	Mining shares			Financial shares				Indus-trial shares	Commer-cial shares	All classes of shares
	Gold	Coal	Other metals and minerals	Mining	Indus-trial and general	Real estate	Banking and insur-ance			
1977	16,8	13,2	31,4	15,7	16,5	−11,5	22,6	8,7	−3,2	13,7
1978	18,8	32,2	33,6	23,3	22,6	−2,2	13,2	14,0	30,0	18,8

mercial and industrial shares, and lastly by financial shares. Changes in the prices of individual classes of shares are shown in the accompanying table.

The average dividend yield on all classes of shares declined from 8,0 per cent at the end of 1977 to 6,8 per cent at the end of 1978, notwithstanding an increase in the dividend yield on mining shares. The inverse yield gap between shares and long-term government stock widened from 2,7 per cent in December 1977 to 2,9 per cent in December 1978. The dividend yield decreased to 5,9 per cent in February, widening the inverse yield gap still further to 3,1 per cent.

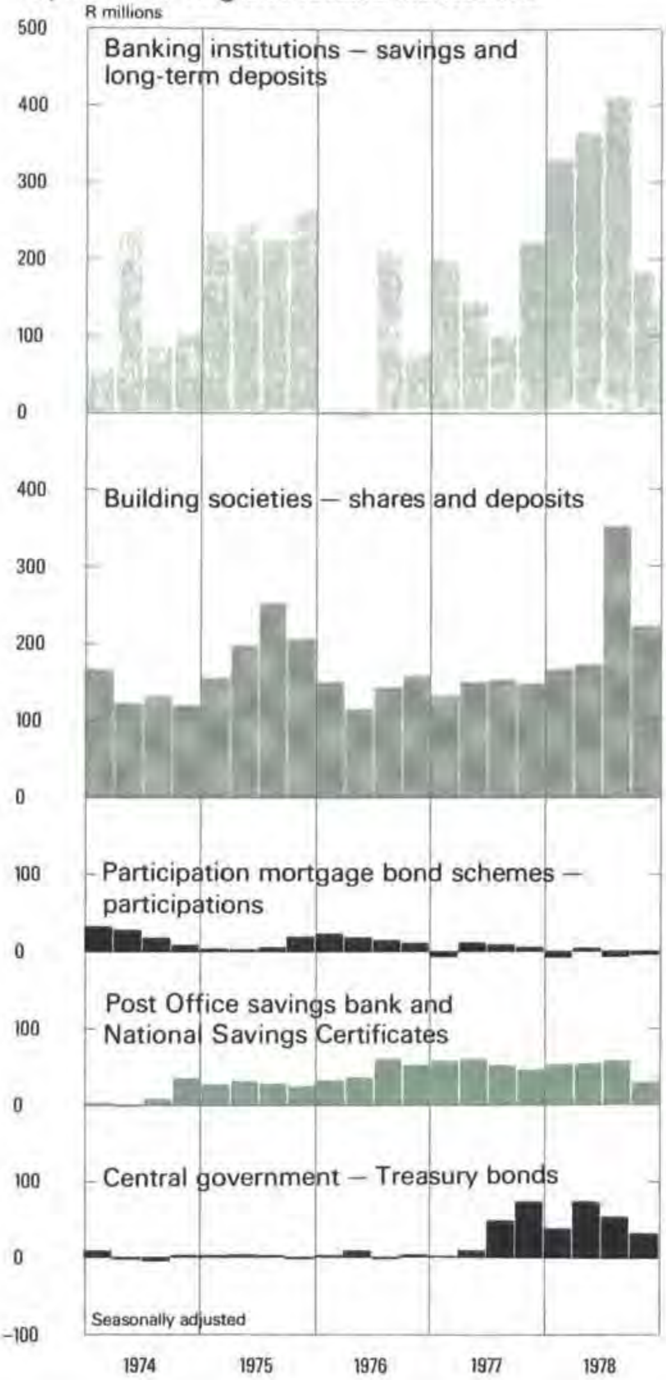
Unit trusts recorded a net outflow of funds of R13 million during 1978. The improvement in share prices, however, caused the market value of the trusts net assets to rise by R65 million to a level of R390 million at the end of 1978 and further to R418 million at the end of February 1979.

Substantially larger flow of longer-term funds to deposit-receiving and related institutions

The flow of longer-term funds to banking institutions, building societies, participation mortgage bond schemes and government savings facilities, which had increased markedly in the fourth quarter of 1977, continued at an even higher level during 1978. The total inflow of longer-term funds to the institutions concerned amounted to R2 571 million in 1978, 61 per cent more than in 1977. Banking institutions recorded the highest inflow, namely R1 292 million, followed by building societies with a figure of R914 million. Net investments in Treasury bonds amounted to R192 million and those in Post Office savings facilities to R191 million. Participation mortgage bond schemes experienced a small net outflow of funds of R21 million, mainly because of a slack demand for this form of mortgage financing. Scheme managers are obliged to return funds which are not invested in participation mortgage bonds within a period of sixty days. Because of this requirement, scheme managers were unwilling to accept further funds for investment and repaid some of the funds which had become available for reinvestment.

The larger inflow of longer-term funds exerted downward pressure on deposit and related interest rates, and during the fourth quarter of 1978 the various rates were reduced by ½ – 1 per cent. Most

Flow of longer-term funds to deposit-receiving and related institutions



deposit interest rates were lowered by ½ per cent in February and again in March, following the reductions of Bank rate referred to earlier.

Improved activity in mortgage and real estate markets

New mortgage loans granted by building societies, which had declined by 10 per cent in 1977, increased by approximately 40 per cent in 1978, indicating a much improved level of activity in the residential mortgage market. Increased mortgage lending by building societies, however, did not match funds available for investment and, as a result, the societies increased their cash, deposit and security holdings by an amount of R410 million during 1978.

Following the decline in deposit interest rates, the societies lowered their mortgage rates from a 10,5 – 12,0 per cent range to a 10,0 – 12,0 per cent range as from 2 October 1978 on new loans and from 1 January on existing loans. The further decline in some of their borrowing rates in February, however, did not affect their lending rates.

The value of real estate transactions, which had declined sharply by 15 per cent in 1977, increased by 7 per cent in 1978. A moderately upward trend in these transactions became evident in the fourth quarter of 1977 and it continued throughout 1978.

Value of real estate transactions