Quarterly economic review

Summary of main developments

Although the rate of increase in gross domestic expenditure, which had declined somewhat in the first quarter of 1981, accelerated considerably in the second quarter, a moderation of the rate of growth in the real gross domestic product of the non-agricultural sectors of the economy occurred during both the first and second quarters. It would appear, therefore, that the real product was prevented from maintaining its high rate of growth of 1980 during the first half of 1981 mainly by physical constraints, such as shortages of skilled labour and certain production inputs and an almost full utilisation of production capacity in several branches of industry. Although total monetary demand remained excessive, there was a decline in the foreign demand for South African goods and a lower rate of increase in some components of gross domestic expenditure.

To an important extent the sharp rise in nominal as well as real gross domestic expenditure in the second quarter was caused by a substantial increase in strategic inventories and in the fixed investment expenditure of public corporations and the Railways Administration, all of which have a high import content, and by a build-up of diamond and agricultural stocks owing partly to special circumstances. Nevertheless, the increase in the other components of expenditure was sufficiently strong to maintain pressure on available domestic resources and, therefore, also on the prices of domestically produced goods and services. In these circumstances, despite some deceleration, the rate of inflation remained at a high level.

The further increase in demand in the second quarter from an already high level, and in particular the high import content of the fastest rising components of demand, caused imports to increase markedly during this period. This, together with a decline in exports and in the net gold output, contributed substantially to a large deficit on the current account of the balance of payments. Since only part of the deficit was covered by a net inflow of capital (excluding changes in liabilities related to reserves) this resulted in a sharp decline in the net gold and other foreign reserves and a further depreciation of the rand against the US dollar and most other currencies.

The strong monetary expansion during the ten-month period to the end of April 1981, which made an important contribution to the upward surge in total monetary demand, slowed down considerably during the three-month period May to July. At a seasonally adjusted annual rate, the increase in the broadly defined money supply (M2) decelerated from 53 per cent during the first four months of 1981 to 14 per cent during the subsequent three months. This welcome decline largely reflected the Reserve Bank's restrictive monetary policy of permitting the balance of payments deficit on current account to drain liquidity from the economy and to bring about a tightening of financial markets and a marked rise in interest rates. Moreover, it would appear that the process of re-intermediation, which from September last year had artificially inflated the increase in bank credit to the private sector and, therefore, also the increase in the money supply, had run its course.

The continued tightening of conditions in the financial markets during the five-month period April to August, resulted in a further sharp rise until recently in short-term interest rates and a moderate further increase in long-term interest rates. After having risen substantially since October 1980, long-term security yields reached more realistic market-related levels in the second quarter of 1981. Consequently, most expectations of a further rise in these yields abated and the actual investment in fixed-interest securities showed a marked increase. Other sections of the capital market, in particular the share, mortgage and real estate markets, became more subdued as a result of the decreased general availability and higher cost of funds.

In recognition of the further sharp rise in short-term interest rates and as part of the Reserve Bank's restrictive monetary policy, Bank rate was raised in two steps by an additional 2,5 per cent during the second quarter and by a further 2,0 per cent to a level of 12,5 per cent in July. Apart from increasing Bank rate, the Reserve Bank continued to pursue a rediscount policy of restricting its accommodation to the alleviation of seasonal shortages of cash in the money market and of providing accommodation only at penalty rates. In addition, the Bank's open-market operations were directed mainly at selling long-term government stock to the private non-banking sector so as to assist in curbing the growth in the money supply.

The 1981/82 Budget was presented to Parliament on 12 August. In his presentation the Minister of Finance stated that the broad aims of budgetary policy would be to consolidate the economic gains made during the recent cyclical upswing in the economy and to assist the economy in its adjustment to adverse external circumstances, even if this meant that demand would have to be restrained at a time of slower economic growth. Therefore, although the economy might have moved into a downward phase of the business cycle, a policy of outright stimulation of demand through increased deficit spending financed by bank credit could not be pursued. Government expenditure could, however, be allowed to rise moderately in real terms in the fiscal year 1981/82 and the "deficit before borrowing" could be permitted to increase to a more normal figure in relation to gross domestic product.

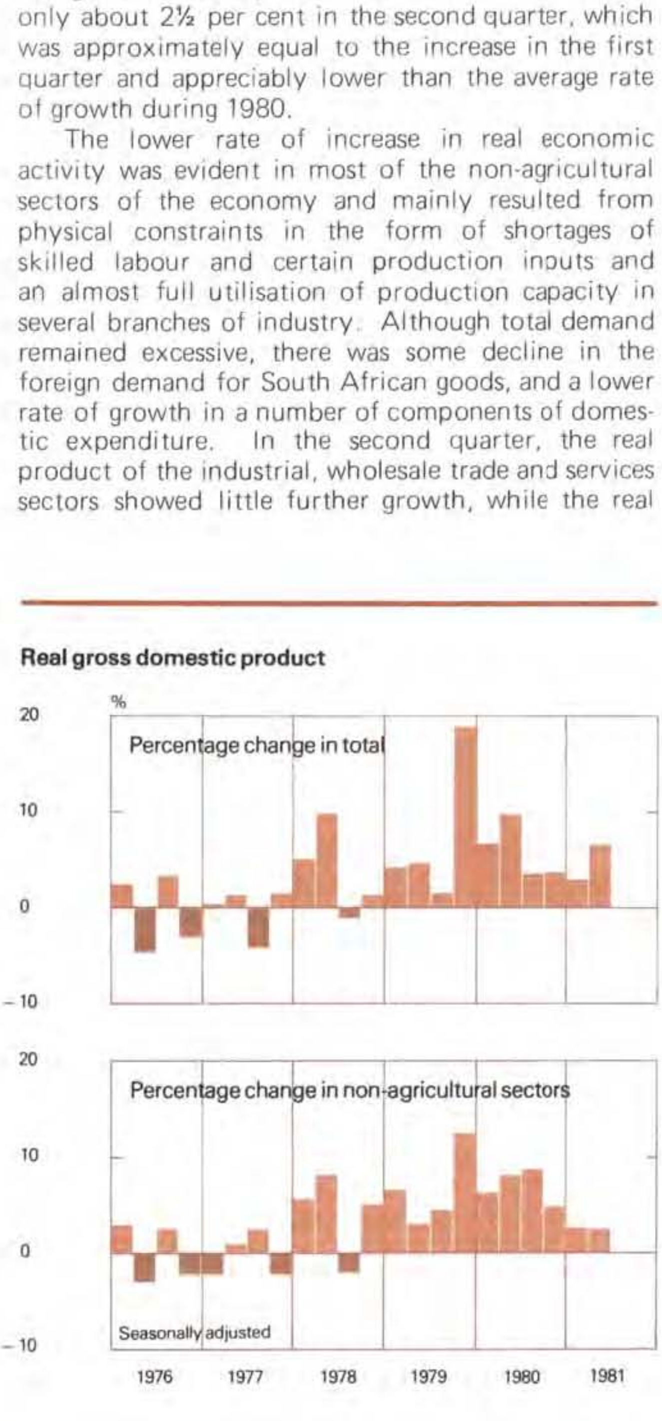
National accounts*

Moderation of real economic growth rate

After amounting to about 8 per cent in 1980, the rate of increase in real gross domestic product slowed down considerably in the first quarter of 1981, but re-accelerated notably to an annual rate of about 6½ per cent in the second quarter. However, this acceleration was entirely due to the harvesting of part of the record agricultural summer crops during this period. Excluding the contribution of agriculture, real gross domestic product rose at an annual rate of only about 2½ per cent in the second quarter, which was approximately equal to the increase in the first quarter and appreciably lower than the average rate of growth during 1980.

The lower rate of increase in real economic activity was evident in most of the non-agricultural sectors of the economy and mainly resulted from physical constraints in the form of shortages of skilled labour and certain production inputs and an almost full utilisation of production capacity in several branches of industry. Although total demand remained excessive, there was some decline in the foreign demand for South African goods, and a lower rate of growth in a number of components of domestic expenditure. In the second quarter, the real product of the industrial, wholesale trade and services sectors showed little further growth, while the real value added by both the gold and non-gold mining sectors actually declined. The real product of the retail and motor trade, on the other hand, increased moderately in response to a renewed rise in real private consumption expenditure on durable and semi-durable goods.

Real gross domestic product



Further sharp increase in gross domestic expenditure

Gross domestic expenditure continued to rise strongly during the first half of 1981, in particular during the second quarter. In nominal terms, it exceeded gross national product by a substantial margin in the second quarter, indicating that a large deficit was recorded on the current account of the balance of payments.

After a temporary slow-down in the first quarter, real gross domestic expenditure increased at a higher rate in the second quarter of 1981. With the exception of real government consumption expenditure, which declined during this period, all components of real gross domestic expenditure contributed to this higher rate of increase.

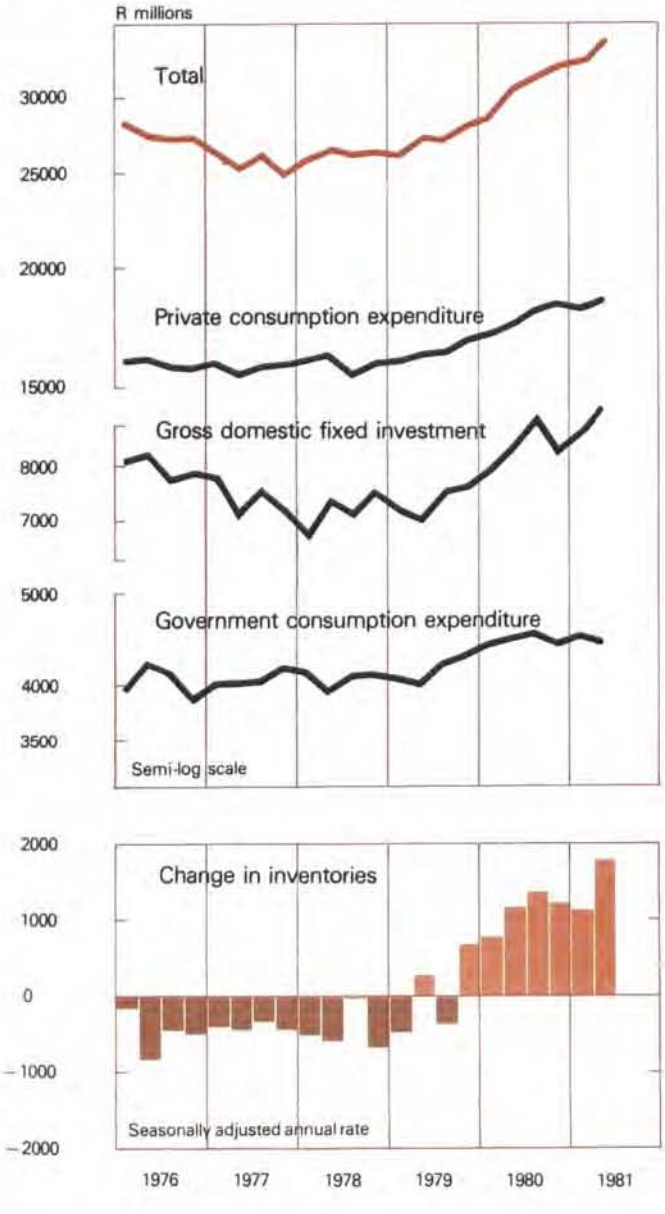
Real private consumption expenditure, which had declined in the first quarter because of lower outlays on durable consumer goods and on services, increased appreciably in the second quarter, when expenditure on durable goods rebounded sharply and that on semi-durable goods (mainly clothing) increased at an exceptionally high rate. Consumer outlays on non-durable goods and on services, however, rose only marginally in the second quarter. In general, private consumption expenditure was increased by the upward adjustment of salaries and wages in the public sector in the second quarter. However, the swings during the first half of 1981 in expenditure on durable consumer goods, which were particularly evident in purchases of new motor vehicles, also reflected temporary shortages of certain classes of goods.

Real gross domestic fixed investment continued to rise at a high rate in the second quarter and made a major contribution to the sharp rise in total real gross domestic expenditure during this period. This further increase was entirely accounted for by outlays of the public sector, in particular by those of Sasol, Escom and the South African Railways Administration. In the private sector, increases in the real fixed capital expenditure of agriculture and manufacturing were more or less counterbalanced by declines in such outlays on residential buildings and by the transport, commercial and services sectors.

A substantial contribution to the further increase in real gross domestic expenditure in the second quarter was also made by an exceptionally large rise in real inventories. Strategic, gold mining and diamond inventories and agricultural stocks increased markedly during this period, showing the effect of,

*Quarterly changes are based on seasonally adjusted data.

Gross domestic expenditure at constant 1975 prices



among other things, the weaker foreign and domestic demand for diamonds and the harvesting of record agricultural crops. In contrast, industrial and commercial inventories showed almost no change as a result of the continuing strong domestic demand for goods.

Decline in gross domestic saving

As a ratio of gross domestic product, gross domestic saving declined from a peak of about 33 per cent in the third quarter of 1980 to 24 per cent in the second quarter of 1981. In the second quarter, gross domestic saving was substantially lower than gross domestic investment, reflecting the extensive use of foreign funds to finance the latter.

The different components of gross domestic saving showed divergent changes in the second quarter. Corporate saving remained more or less at the level of the first quarter, while provision for depreciation continued to rise in accordance with the increase in fixed capital assets. Personal saving and the saving of general government, on the other hand, declined, mainly as a result of the marked increase in private consumption expenditure, and a decrease in current receipts and a strong rise in expenditure by the Government, respectively.

Prices

Consumer prices

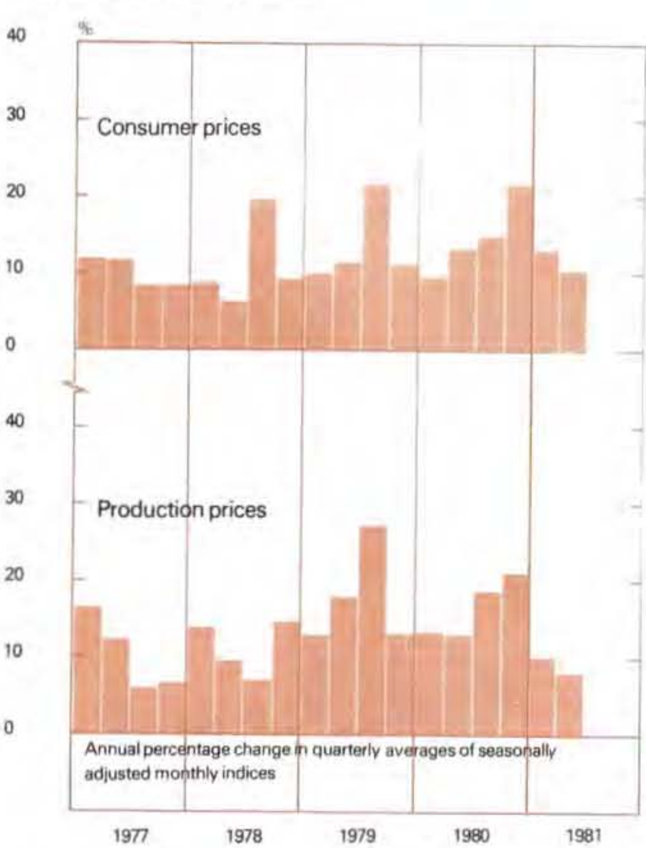
The further increase in total monetary demand during the first half of 1981 continued to exert upward pressure on prices. Nevertheless, the rate of increase in consumer prices slowed down considerably from a seasonally adjusted annual rate of 22,0 per cent in the fourth quarter of 1980 to 13,1 per cent and 10,4 per cent in the first and second quarters of 1981, respectively. This slow-down was largely due to a sharp deceleration of the increase in food prices, namely from an inordinately high seasonally adjusted annual rate of 54 per cent in the fourth quarter of 1980 to only 9 per cent in the second quarter of 1981. The rate of increase in the prices of other goods, however, remained high and a notable acceleration of the increase in the prices of consumer services occurred in both the first and second quarters.

In July, consumer prices rose at a markedly higher rate. From June to July the seasonally adjusted consumer price index increased by 1,7 per cent to reach a level 15,5 per cent higher than in July 1980. Higher rates of increase were recorded in the prices of petroleum products, clothing and footwear, and tobacco products as well as in the costs of housing and certain other services. Housing costs were raised substantially by higher rent, mortgage rates, property taxes and other home-owners' costs.

Production prices

As a result of a slower rise in the prices of imported as well as domestically produced goods, the increase in production prices decelerated from a seasonally adjusted annual rate of 20,7 per cent in the fourth quarter of 1980 to 10,1 per cent and 8,1 per cent in the first and second quarters of 1981, respectively. Lower rates of inflation in trading-partner countries were mainly responsible for the slow-down of the increase in import prices. The increase in the prices of domestically produced goods decelerated mainly because of comparatively moderate rises in government-administered production prices. From June to July the seasonally adjusted production price index rose sharply by 1,2 per cent, reflecting higher rates of increase in the prices of both imported and domestically produced goods. After this increase, the production price index was 13,4 per cent higher than in July 1980.

Percentage change in prices



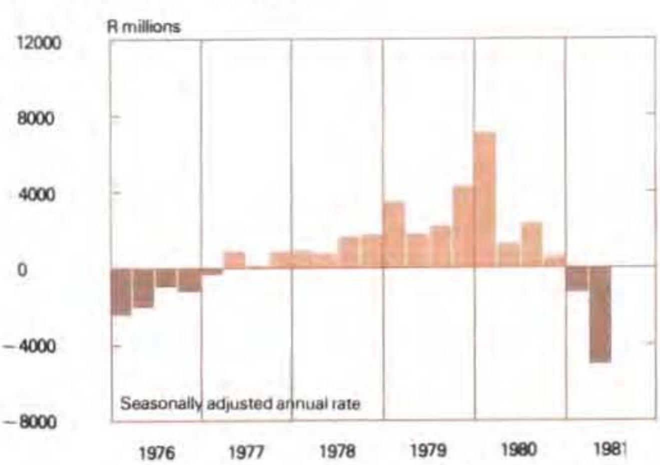
Balance of payments

Substantial deficit on current account

After the seasonally adjusted balance of payments on current account had been transformed from a surplus to a deficit in the first quarter of 1981, a substantially larger deficit was recorded in the second quarter. At a seasonally adjusted annual rate, the deficit increased from R1 290 million in the first quarter to R5 050 million, or 7 per cent of the gross domestic product, in the second quarter. This increased deficit was due to a sharp decline in the value of the net gold output and substantial further increases in merchandise imports, part of which was caused by special circumstances, and net service and transfer payments to foreigners. Merchandise exports, which had shown a declining trend from early 1980, rose slightly in the second quarter.

At a seasonally adjusted annual rate, the value of the net gold output declined from R8 490 million in the first quarter of 1981 to R7 610 million in the second quarter. This change was entirely due to a decrease in the volume of the net gold output, which reflected lower production and an increase in mine inventories as a result of a decline in Krugerrand sales. Although the US dollar price of gold declined further in the second quarter, the depreciation of the rand against the US dollar caused the rand price of golc to rise slightly from R400 per fine ounce in the first quarter to R401 per fine ounce in the second quarter. In July, the volume of the net gold output increased notably because of higher Krugerrand sales and lower mine inventories, causing the value of the net gold output, at a seasonally adjusted annual rate, to rise to R8 330 million despite a decline in the price of gold to an average of R377 per fine ounce. The price of gold increased slightly to an average of R390 per fine ounce in August.

Balance on current account

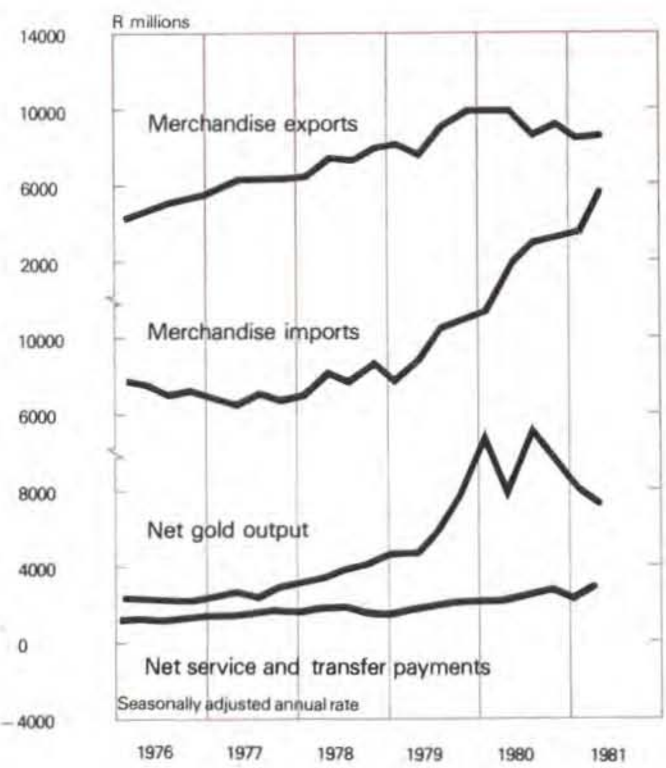


Merchandise exports, at a seasonally adjusted annual rate, increased slightly from R8 780 million in the first quarter to R8 940 million in the second quarter. Considerable increases were recorded in exports of maize, coal, platinum and base metals, while exports of uranium and diamonds declined substantially. The slight increase in the value of exports reflected a rise in export prices resulting from the depreciation of the rand against the currencies of most trading partners. The volume of exports, on the other hand, decreased further as a result of slack economic conditions in trading-partner countries. At a seasonally adjusted annual rate, exports amounted to R8 900 million in July.

The value of merchandise imports, at a seasonally adjusted annual rate, increased substantially from R15 800 million in the first quarter to R18 210 million in the second quarter. This rise in imports was mainly attributable to the further increase in domestic demand (including the build-up of strategic inventories) from an already high level. To some extent, however, it also reflected an easing of the congestion in the flow of containerised imports and the settlement of a dock-workers' dispute which had delayed import traffic from Britain. In July, the value of imports rose even further to a seasonally adjusted annual rate of R19 710 million.

Following a slight decline in the first quarter, net service and transfer payments to the rest of the world

Balance of payments current account

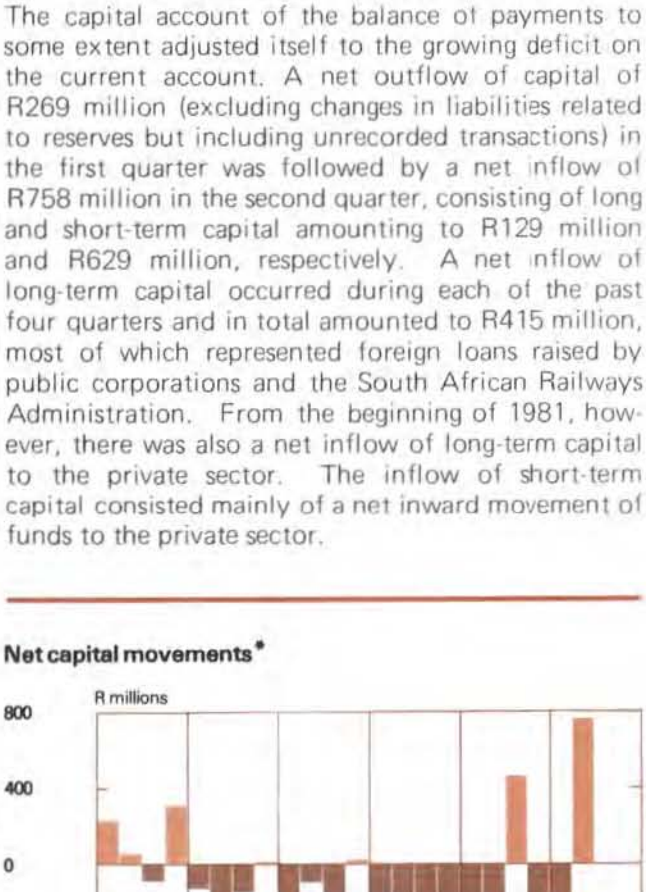


increased sharply in the second quarter. Higher payments in respect of freight and merchandise insurance and salaries and wages to foreign migrant workers were responsible for this increase. Dividend payments to foreigners, which had risen sharply during 1980 and the first quarter of 1981, did not increase in the second quarter, but nevertheless remained at a high level.

Net inflow of capital

The capital account of the balance of payments to some extent adjusted itself to the growing deficit on the current account. A net outflow of capital of R269 million (excluding changes in liabilities related to reserves but including unrecorded transactions) in the first quarter was followed by a net inflow of R758 million in the second quarter, consisting of long and short-term capital amounting to R129 million and R629 million, respectively. A net inflow of long-term capital occurred during each of the past four quarters and in total amounted to R415 million, most of which represented foreign loans raised by public corporations and the South African Railways Administration. From the beginning of 1981, however, there was also a net inflow of long-term capital to the private sector. The inflow of short-term capital consisted mainly of a net inward movement of funds to the private sector.

Net capital movements*

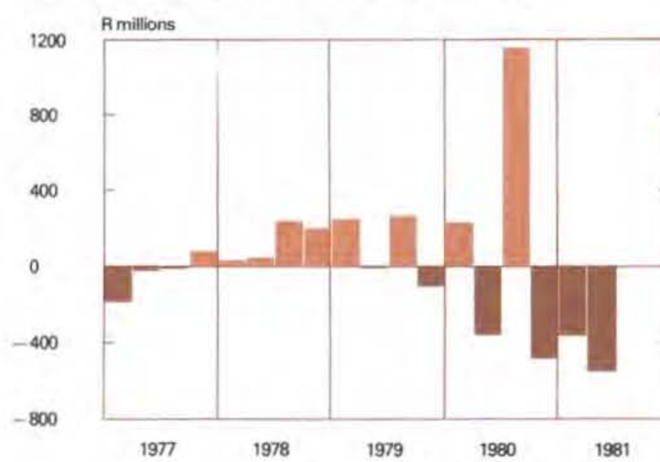


Sharp decline in foreign reserves

Despite the net inflow of capital, the net gold and other foreign reserves declined sharply by R556 million during the second quarter, which brought the total decline in net reserves during the nine-month period to the end of June 1981 to R1 417 million. Owing to a decline in liabilities related to reserves and negative valuation adjustments to the gold as well as the foreign exchange reserves, the gross gold and other foreign reserves decreased by an even larger amount, namely by R672 million, during the second quarter. At the end of June the gross foreign reserves amounted to R5 255 million, which was substantially lower than the peak of R6 807 million at the end of September 1980.

During July and August the gross gold and other foreign reserves of the Reserve Bank rose by R199 million. However, the Bank's liabilities related to reserves were increased by R377 million during this period as a result of short-term foreign borrowing to augment the foreign exchange reserves.

Changes in net gold and other foreign reserves



Foreign exchange market

The effective exchange rate of the rand continued to decline during the second quarter of 1981, reflecting the increase in the overall deficit on the balance of payments. A decline of 2,8 per cent during the first quarter was followed by further decreases of 3,9 per cent during the second quarter and 4,8 per cent during July. This decline of 11,1 per cent during the first seven months of 1981 resulted mainly from the rand's depreciation of 21,7 per cent against the US dollar. During August the rand appreciated slightly against the US dollar and most of the other major world currencies, causing the effective exchange rate to rise by 0,9 per cent.

From the end of March to the end of July the financial rand depreciated by 9,6 per cent against the

US dollar, while at the same time the financial rand discount narrowed from 28,2 per cent to 23,5 per cent. During August the financial rand appreciated by 2,8 per cent, and the financial rand discount narrowed further to 22,3 per cent, mainly as a result of an increased demand for financial rand by foreign investors interested in investing in South African gold mining shares.

During the second quarter the Reserve Bank maintained its policy of fixing its forward exchange rates in such a way as to make the domestic financing of trade marginally more attractive than foreign financing. Towards the end of July, however, this policy was changed in response to the larger overall deficit on the balance of payments. Since then, forward exchange rates have been fixed at levels more favourable to the foreign financing of trade.

Money and banking

Slow-down of increase in monetary aggregates

The strong monetary expansion during the first four months of 1981, slowed down considerably during the subsequent three months. At a seasonally adjusted annual rate, the broadly defined money supply (M2) rose by no less than 53 per cent during the first four months of 1981, but by only 14 per cent during the period May to July. The corresponding rates of increase in the narrowly defined money supply (M1) amounted to 56 per cent and 12 per cent, respectively. Monetary banks' short and medium-dated repurchase agreements with the private sector declined during the first five months of 1981, but rose sharply during June and July. Overnight repurchases, however, declined again during July after a considerable increase during June. If these agreements are included in the money supply on the grounds that they are close substitutes for money, the seasonally adjusted annual rates of increase in M2 and M1 amounted to 40 per cent and 34 per cent, respectively, during the first four months of 1981 and to 21 per cent and 7 per cent, respectively, during the three-month period May to July.

Causes of changes in M2

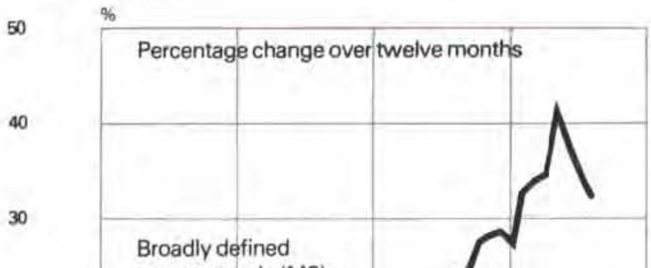
As during the first four months of 1981, the major statistical "cause" of the increase in M2 during the three months May to July was a strong expansion of the monetary banking sector's claims on the private sector. In addition, net bank credit extended to the government sector increased slightly. On the other hand, negative contributions to the growth in the money supply during the period May to July were made by a substantial further decline in the monetary banking sector's net gold and other foreign reserves and a small increase in the long-term deposits of the private sector with monetary banking institutions.

Causes of changes in M2*
Seasonally adjusted
R millions

	1981	
	January to April	May to July
Net gold and other foreign reserves	–776	–1 177
Net claims on government sector	185	88
Claims on private sector	2 467	1 682
Long-term deposits of private sector (increase –, decrease +)	–219	–27
Total	**2 423**	**612**

*Based on a consolidated balance sheet of the monetary banking sector.

Money supply



Lower rate of increase in bank credit to the private sector

Bank credit extended by the monetary banking sector to the private sector increased at a seasonally adjusted annual rate of 42 per cent during the period May to July, compared with an increase of 53 per cent during the first four months of 1981. The lower rate of increase was mainly due to a slow-down of the process of re-intermediation of credit which had previously been extended outside the banking system, the low level of excess liquid asset holdings of banking institutions, and the effect of higher interest rates on the demand for bank credit. Until the further increase in Bank rate late in July, the moderation of bank credit expansion was, however, countered by so-called "round-tripping", i.e. the practice of borrowing on overdraft from banks and investing these funds at higher rates, mostly in bank deposits and negotiable certificates of deposit.

An analysis of the rise in the monetary banking sector's claims on the private sector (unadjusted for seasonal changes) during the period May to July shows increases of R238 million in investments in securities of the private sector, R514 million in the cash credit advances by the Land Bank, and R982 million in the discounts, loans and advances of commercial, merchant and monetary general banks. The corresponding changes during the first four months of 1981 amounted to an increase of R148 million, a decline of R2 million and an increase of R2 218 million, respectively. The sharp rise in the Land Bank's cash credit advances during the period May to July reflected the financing of part of the record summer crops. During the same period the discounts, loans and advances of commercial, merchant and monetary general banks increased by a substantially smaller average monthly amount than during the first four months of 1981 owing to an actual decline in bills discounted, a slightly smaller increase in hire-purchase credit and leasing finance, and a substantially lower increase in other loans and advances. The average monthly increase in loans and advances other than hire-purchase credit and leasing finance, for example, amounted to R183 million during the three-month period to July, as against R365 million during the first four months of 1981.

Low level of bank liquidity

Bank liquidity, in the form of excess holdings of liquid assets, remained at a low level during the second quarter and during July. Bank liquidity was affected adversely by a sharp rise in the banks' required liquid asset holdings resulting from their large-scale creation of liabilities by the extension of credit. Despite a sharp decline in the Reserve Bank's net gold and other foreign reserves, the banks' actual holdings of liquid assets continued to rise appreciably. Important contributions to the expansion of the banks' liquidity base were made by net bank credit to the government sector and liquid-asset-creating net bank credit, mainly investment in liquid bankers' acceptances, to the private sector. The ratio of excess liquid assets to the banks' liabilities to the public declined from 2,1 per cent at the end of March 1981 to 2,0 per cent at the end of June, before rising again to 2,1 per cent at the end of July.

Money market

Money market conditions tightened considerably in early May and remained relatively tight during the ensuing period up to the middle of August. Temporary foreign borrowing by the banks prevented the market from tightening unduly over the June and July month-ends. From the middle of August the market eased somewhat, and the shortage of funds in the market over the August month-end, primarily as a result of the flow of tax funds to the Government, was much smaller than expected. This relative ease in the market over the month-end was caused, firstly, by an inflow of short-term foreign funds after the forward exchange rates of the Reserve Bank had begun to encourage the foreign financing of trade.

Secondly, the banks borrowed again on short term abroad for the purpose of meeting their liquid asset requirements at the end of the month. In early September, however, the market tightened substantially after part of the short-term foreign loans had been repaid.

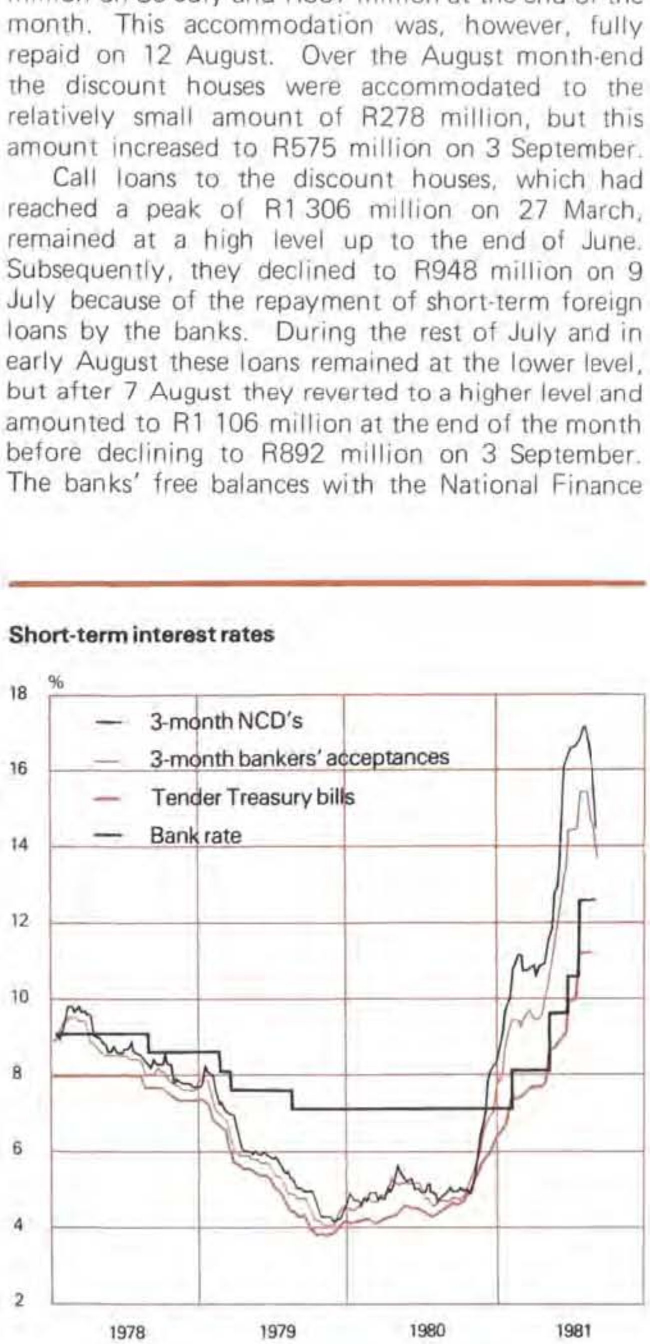
In line with the tightening of market conditions in May, the discount houses were accommodated by the Reserve Bank over the May month-end. The usual month-end accommodation was fairly small in June because of the banks' temporary foreign borrowing. In contrast, a large shortage of funds was experienced over the July month-end and accommodation to the discount houses amounted to R522 million on 30 July and R307 million at the end of the month. This accommodation was, however, fully repaid on 12 August. Over the August month-end the discount houses were accommodated to the relatively small amount of R278 million, but this amount increased to R575 million on 3 September.

Call loans to the discount houses, which had reached a peak of R1 306 million on 27 March, remained at a high level up to the end of June. Subsequently, they declined to R948 million on 9 July because of the repayment of short-term foreign loans by the banks. During the rest of July and in early August these loans remained at the lower level, but after 7 August they reverted to a higher level and amounted to R1 106 million at the end of the month before declining to R892 million on 3 September. The banks' free balances with the National Finance Corporation generally remained at a low level during the second quarter and the subsequent two months. On two occasions these balances were built up, namely before the issue of new government stock on 15 May and before the tax-payment peak at the end of August. Over the August month-end the balances were almost depleted.

Money market interest rates increased sharply from early May to the end of July, but remained fairly stable or even declined slightly during August. The rate on three-month bankers' acceptances, for example, rose from 10,0 per cent on 1 May to 15,5 per cent on 24 July before declining to 13,50 per cent on 11 September. The Treasury bill tender rate likewise increased from 7,80 per cent on 1 May to 11,25 per cent on 24 July, but rose slightly further to 11,28 per cent on 11 September.

The Reserve Bank raised Bank rate in two steps from 8,0 to 10,5 per cent during the second quarter and further to 12,5 per cent on 21 July. In response to these changes and, more generally, the strong demand for bank credit, the prime overdraft rate of the commercial banks was increased from 11,5 per cent at the end of March to 16,0 per cent in July.

Short-term interest rates



Open-market operations

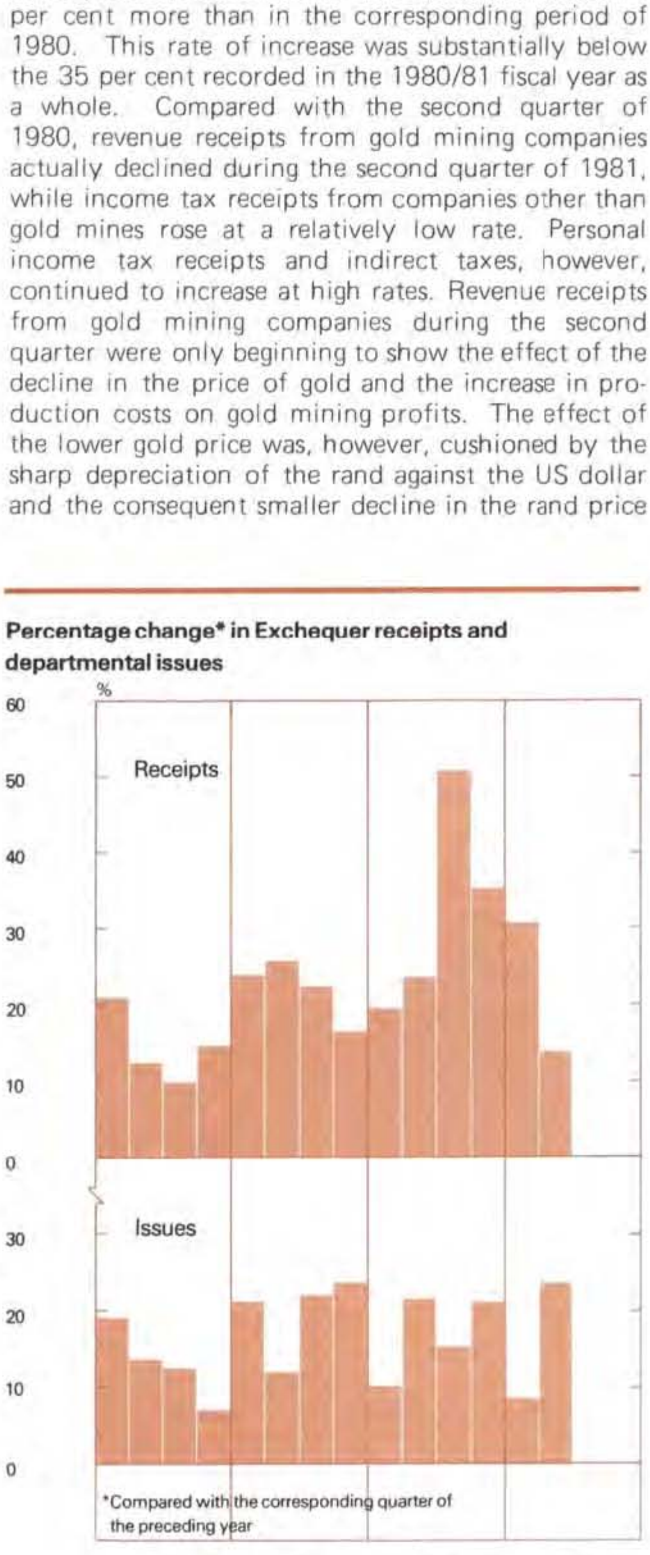
Open-market operations by the Reserve Bank during the period from April to August were aimed at supporting the general monetary policy objective of curbing the rate of growth in the money supply. Operations during this period consisted mainly of sales of long-term government stock, which on a net basis amounted to R393 million. From 21 August the Bank also engaged in operations aimed at the refinancing of government debt which is due to mature later in 1981. Up to the end of August, purchases of government stock maturing on 1 October and 1 December amounted to R156 million, while simultaneous sales of new two-year government stock, issued on tap to the Reserve Bank, totalled R197 million.

Government finance

Exchequer receipts and issues

Receipts on the Exchequer Account* in the second quarter of 1981, i.e. the first quarter of the 1981/82 fiscal year, amounted to R2 765 million, or about 14 per cent more than in the corresponding period of 1980. This rate of increase was substantially below the 35 per cent recorded in the 1980/81 fiscal year as a whole. Compared with the second quarter of 1980, revenue receipts from gold mining companies actually declined during the second quarter of 1981, while income tax receipts from companies other than gold mines rose at a relatively low rate. Personal income tax receipts and indirect taxes, however, continued to increase at high rates. Revenue receipts from gold mining companies during the second quarter were only beginning to show the effect of the decline in the price of gold and the increase in production costs on gold mining profits. The effect of the lower gold price was, however, cushioned by the sharp depreciation of the rand against the US dollar and the consequent smaller decline in the rand price of gold. Income tax receipts from companies other than gold mines were apparently affected adversely by a backlog in the processing of tax returns by the receivers of revenue.

Percentage change* in Exchequer receipts and departmental issues



*Compared with the corresponding quarter of the preceding year

Issues from the adjusted Exchequer Account increased sharply in the second quarter of 1981 and exceeded those in the corresponding quarter of 1980 by no less than 24 per cent. The amount made available to government departments during the second quarter amounted to R4 109 million.

Substantial deficit on Exchequer Account

The high rate of growth in issues and the slow-down of the increase in revenue resulted in a deficit before borrowing of R1 348 million on the adjusted Exchequer Account in the second quarter. Slightly more than half of this deficit, or R681 million, was financed by means of borrowing from the private non-banking sector, part of which reflected the successful issue of government stock in May. The Public Debt Commissioners contributed only R37 million to the financing of the deficit. Foreign borrowing amounted to R44 million and the remainder of the deficit, namely R586 million, was financed by means of an increase in the Exchequer's net indebtedness to the monetary banking sector. The latter amount included a decline of R213 million in the cash balances on the Exchequer and Paymaster-General Accounts and the use of R284 million of the funds available on the Stabilization Account.

The 1981/82 Budget

In view of the fact that the economy was already in the process of "cooling down" owing to natural economic forces and that a tight monetary policy was being pursued by the Reserve Bank, only a moderately contractionary Budget for 1981/82 was presented to Parliament by the Minister of Finance on 12 August 1981. In his presentation, the Minister concluded that the prevailing economic situation called for a budgetary policy of "consolidation and adjustment". Firstly, this policy would aim at consolidating the economic gains made during the recent cyclical upswing in the economy. Secondly, it would assist in the adjustment to the adverse impact on the economy of the set of conditions created by the prevailing international recessionary tendencies, the abnormally high interest rates in the United States and elsewhere, the substantial appreciation of the US dollar, and the sharp decline in the price of gold.

The Minister stated that although the economy appeared about to follow Western Europe into a downward phase of the business cycle, a policy of outright stimulation of demand through increased

* The Exchequer Account is adjusted to take account of changes in the cash balance on, and the net borrowing from, the Paymaster-General Account and to incorporate the Stabilization Account.

deficit spending financed by bank credit could not be pursued. Any premature stimulation of demand, while the economy was still operating at full capacity, would result in an acceleration of the rate of price increases. Inflation remained a major problem and its combating would continue to receive the highest priority. Fiscal and monetary policy would not be used to neutralise the adverse changes in the external circumstances affecting the economy. Accordingly, the balance of payments adjustment process would be permitted to proceed and would be assisted by fiscal and monetary policies, even if this meant that demand would have to be restrained at a time of slower economic growth. Government expenditure could therefore be allowed to rise moderately in real terms in the fiscal year 1981/82, provided that it would continue to increase at a lower rate than aggregate real gross domestic expenditure. For the same reasons, the "deficit before borrowing" could be permitted to rise to a more normal figure in relation to the gross domestic product, provided that it would continue to be financed without net recourse to the banking sector.

Against this broad policy background, the Budget provided for expenditure of R15 871 million in the 1981/82 fiscal year, or 16,8 per cent more than in the preceding fiscal year. Aggregate revenue in 1981/82, including a moderate increase in customs and excise duties on certain non-essential products, was estimated at R13 164 million, or about 1 per cent less than in the preceding fiscal year. This decline was primarily due to an expected drop of R1 473 million in income tax and mining lease payments by gold mining companies. The deficit before borrowing was estimated at R2 707 million. This amount, together with loan repayments of R2 842 million, would result in an estimated financing requirement of R5 549 million. It was envisaged that foreign and domestic borrowing would amount to R350 million and R5 159 million, respectively, and that the remaining amount of R40 million would be financed from available cash balances. In the amount to be borrowed domestically, provision was made for reinvestment of loan redemptions and new marketable stock issues of R2 714 million, an increase of R595 million in non-marketable debt, and borrowing of R1 850 million from the Public Debt Commissioners.

As part of the further structural reform of the tax system, the Minister announced the phasing-in of a tax on fringe benefits over the 1982/83 and 1983/84 tax years; the phasing-out of separate taxation of Blacks from 1 March 1982; and an amendment to the PAYE tax-deduction system from 1 March 1982, in terms of which individual taxpayers with taxable incomes of not more than R7 000 per annum will be relieved from rendering income tax returns, provided that such incomes are derived from salaries and wages.

The Post Office Budget

Despite the effect of the high rate of inflation on the finances of the Department, no tariff increases were announced by the Minister of Posts and Telecommunications when he presented his Budget for 1981/82 to Parliament on 1 September 1981. Revenue for 1981/82 was estimated at R1 282 million, or 14 per cent more than in 1980/81, while operating expenditure was estimated to rise by 22 per cent to R1 188 million. After taking into account various appropriations, it was estimated that R41 million of the operating surplus would be used to help finance the expected capital expenditure of R565 million during 1981/82. It was anticipated that the remainder of the capital expenditure could be financed by means of using provisions for the replacement of fixed assets to the extent of R166 million, employing an expected net increase of R240 million in funds invested with the Post Office's savings schemes, and reducing available cash balances by an amount of R118 million. The Minister also announced increases in the interest rates offered by the Post Office on savings bank certificates and savings accounts.

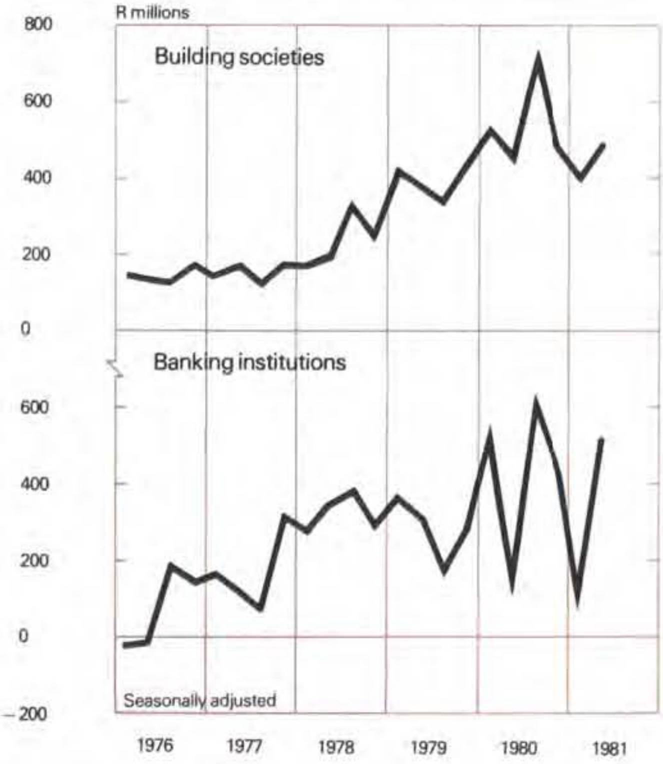
Capital market

Holdings of longer-term funds with non-contractual savings institutions

Holdings of longer-term funds with banking institutions, building societies, participation mortgage bond schemes and government savings schemes increased by R1 130 million during the second quarter or by slightly more than the quarterly average of R1 100 million for 1980. However, most of this increase occurred during April and this was followed by a marked slow-down during May and June. In fact, holdings of longer-term funds with banking institutions barely increased during May and the building societies had no net inflow of new funds during June.

The changes in the intake of new funds by deposit-receiving institutions were accompanied by active competition for funds. The deposit rates of banking institutions were accordingly raised by between 0,75 and 1,75 per cent during the period May to August. Likewise, interest rates on deposits with building societies were increased further by 0,5 to 1,5 per cent in June, and on building society shares by similar margins in August.

Change in holdings of longer-term funds



Increased activity in the fixed-interest security market

Expectations of further increases in long-term interest rates during 1980 and the first quarter of 1981 caused a reluctance on the part of investors to invest in fixed-interest securities. However, after long-term interest rates had risen to more realistic levels, most of these expectations abated in the second quarter and a record amount of new capital was raised in the fixed-interest security market. New issues of public sector stock during the second quarter, excluding the increase in the borrowers' holdings of their own securities, amounted to R1 276 million, or only slightly less than the total for 1980 as a whole. In addition, an amount of R62 million was raised by the private corporate sector in the market. In the secondary market, the value of listed gilt-edged and semi-gilt-edged stock traded on the stock exchange amounted to R2 076 million in the second quarter, compared with a quarterly average of R1 055 million in 1980.

Secondary market yields on long-term fixed-interest securities, which had eased slightly during the latter part of March and during April 1981, increased moderately during May and remained relatively stable during the subsequent three months. The monthly average yield on long-term government stock increased from 12,75 per cent in March to 13,05 per cent in May and to 13,10 per cent in August. The corresponding increases in the monthly average yield on long-term semi-gilt-edged stock of the highest grade was from 12,93 per cent to 13,11 per cent

Secondary market yields

and 13,17 per cent, respectively. In contrast, the monthly average yield on company loan securities decreased from 14,02 per cent in March to 13,80 per cent in May before rising to 14,27 per cent in August.

Resumption of downward trend in turnover and prices in share market

Turnover and prices in the share market, which had been on a downward course from October 1980, recovered temporarily during March and April and maintained their somewhat higher levels during May. In June, however, the downward trend was resumed. The number of shares traded on the stock exchange was 49 per cent lower in the second quarter of 1981 than in the third quarter of last year, while share prices in July were on average 33 per cent below the peak in September 1980. The declining trend was evident in all classes of shares; mining shares showed the largest, and industrial and commercial shares the smallest, decrease after the September peak.

With relatively stable dividend payments, the fall in share prices during June and July was reflected in a further increase in dividend yields. The average dividend yield on all classes of shares, which had risen from 4,75 per cent in September last year to 6,78 per cent in March, increased further to 7,37 per cent in July.

Decline in new mortgage lending by building societies

In view of the declining rate of inflow of new funds, the building societies reduced their new mortgage lending even further during the second quarter. New mortgage loans granted by the building societies, seasonally adjusted, declined from a quarterly average of R1 150 million in 1980 and an amount of R484 million in the first quarter of 1981 to R462 million in the second quarter. Seasonally adjusted new mortgage loans paid out, which had increased from a quarterly average of R1 050 million in 1980 to R1 304 million in the first quarter of 1981, subsequently declined to R811 million in the second quarter. By maintaining mortgage loan pay-outs at a high level and reducing new mortgage loans granted, the societies were able to lower their outstanding loan commitments from R1 635 million at the end of 1980 to R1 105 million at the end of March and R831 million at the end of June. Holdings of prescribed investments, which had decreased from R1 903 million at the end of 1980 to R1 598 million at the end of March, rose slightly to R1 676 million at the end of June because the inflow of new funds to the societies during the second quarter was somewhat larger than the increase in their mortgage loans outstanding.

The building societies' mortgage rates were raised by a further 1 per cent from 13 August in respect of new loans and from 1 October in the case of existing loans. After this increase, the home mortgage rates ranged from 12,25 to 14,25 per cent.

Levelling-off tendency in real estate transactions

After reaching a high level in the fourth quarter of 1980, the increase in the value of real estate transactions levelled off in the first quarter of 1981 before rising to a new record level in the second quarter. The seasonally adjusted value of transactions amounted to R1 594 million in the second quarter, compared with R1 510 million and R1 537 million in the preceding quarter and the fourth quarter of 1980, respectively. The rate of increase in these transactions showed a distinct slow-down during the first half of 1981, mainly as a result of a decline in the general availability of funds, including new mortgage lending by building societies, and the effect of the higher mortgage rates and property prices on the demand for real estate.

Fixed property market