Quarterly economic review

Summary of main developments

According to the available economic indicators, South Africa entered a period of slower economic growth in the first quarter of 1981. This was not unexpected because important productive resources, such as production capacity in manufacturing and skilled labour, had become almost fully employed and could no longer sustain a rate of economic growth as high as the 8 per cent recorded in 1980.

The domestic demand for goods and services, on the other hand, continued to rise at a relatively high rate, even in real terms. Owing to the almost full utilisation of production capacity and the high import content of domestic expenditure on capital goods, inventories and durable consumer goods, the strong monetary demand caused imports to remain at a high level. At the same time, there was a decline in exports and in the value of the net gold output, which reflected a substantially lower price of gold. Mainly as a result of these changes, the current account of the balance of payments showed a moderate deficit. The emergence of a current account deficit after the economy had been in an expansionary phase for about three years, was, of course, not unusual. Normally, a current account deficit appears much earlier during periods of economic expansion and increasing domestic demand, but during the recent upswing the current account was kept in surplus for a prolonged period by an exceptionally sharp rise in the price of gold, and therefore in the value of the net gold output, until September 1980, as well as by an accompanying strong rise in merchandise exports.

As during the second half of 1980, the increase in total monetary demand during the first quarter was again accompanied by an excessive increase in the broadly defined money supply. Taking into account its lagged effect on expenditure and prices, the sharp rise in the money supply since the middle of 1980 has clearly made an important contribution to the persistently high rate of inflation and will continue to do so for some time to come. With a view to ultimately achieving a reduction in the inflation rate, the curbing of the high rate of increase in the money supply has become the main objective of monetary policy. During the first quarter both the net gold and other foreign reserves of the monetary banking sector and this sector's net claims on the government sector declined substantially, thereby exerting a contractionary influence on the broadly defined money supply, but an unprecedentedly large increase in bank credit extended to the private sector exerted a strong positive effect. Measures to slow down the increase in bank credit to the private sector by restricting the growth in the liquidity base of banking institutions and by increasing the cost of bank credit, therefore, form an integral part of the current overall monetary policy.

In recognition of the preceding sharp rise in short-term interest rates and in order to raise the cost of bank credit, Bank rate was increased from 7 to 8 per cent with effect from 3 February. Partly because of steps taken by the Reserve Bank to alleviate the seasonal tightness of the money market during the first quarter, short-term interest rates remained fairly stable from about the middle of February, but resumed an upward course in early May. In addition, Bank rate was increased by a further 1,5 per cent, with effect from 6 May. The Bank rate increases were followed by upward adjustments in the commercial banks' overdraft rates, which raised the prime overdraft rate from 10 per cent in February to 13 per cent in May. Despite this increase, the overdraft rate remained well below the prevailing rate of inflation and considerably lower than the overdraft rates in most other countries with roughly similar or lower rates of inflation.

The high level of private sector liquidity contributed to generally buoyant conditions in the capital market. Share prices, which had declined from September 1980 to February this year, rebounded in April and May, while real estate transactions and mortgage lending remained at high levels during the first quarter. In the market for fixed-interest securities, however, activity during the first quarter was inhibited by expectations of further increases in long-term interest rates, but these expectations weakened considerably during April and had been largely dispelled by the middle of May. This change was reflected in the successful issue of two new government loans with respective maturities of 3 and 22 years on 15 May. By pitching the effective yield on the long-term issue slightly above the then prevailing market rate, the Government was able, as part of the broad monetary policy, to draw an amount of funds from the private non-bank sector which was sufficiently large to achieve a meaningful reduction in private sector and bank liquidity. The combined proceeds of the short and the long-term issue also contributed materially to meeting the Treasury's financial requirements in the 1981/82 fiscal year.

The strong demand for bank credit and housing loans gave rise to active competition for funds among banking institutions and building societies. As a result, deposit interest rates were increased on several occasions during the first five months of 1981. In line with these increases, the building societies' mortgage rates were raised in two stages by 2,25 per cent. Like the prime overdraft rate of the commercial banks, the increased mortgage rates nevertheless remained below the prevailing rate of inflation.

National accounts*

Lower rate of economic growth

According to preliminary estimates, the rate of increase in the real gross domestic product slowed down appreciably from the fourth quarter of 1980 to the first quarter of 1981. This deceleration was not unexpected because already in 1980 it had been generally anticipated that the available productive resources would not much longer be able to sustain the high rate of economic growth that had been attained from the end of 1979. By the end of last year, production capacity in manufacturing and skilled labour resources had become virtually fully employed and scarcities of production inputs had begun to emerge. However, despite the lower rate of increase in the first quarter, the real gross domestic product in this period was still about 4½ per cent higher than in the first quarter of 1980. The corresponding increase in 1980 as a whole amounted to 8 per cent.

The slow-down in real economic growth produced by the physical constraints outlined above was especially evident in manufacturing and commerce. In addition, the real value added by gold mining declined further in the first quarter, while the real product of non-gold mining and agriculture remained more or less at the level of the preceding quarter. In contrast, real activity in the construction sector rose at a high rate owing to sustained buoyant conditions in the building and construction industry.

Mainly as a result of the sharp decline in the price of gold, South Africa's terms of trade deteriorated considerably in the first quarter. This caused the real gross **national** product to show an actual decline from the level of the fourth quarter of last year.

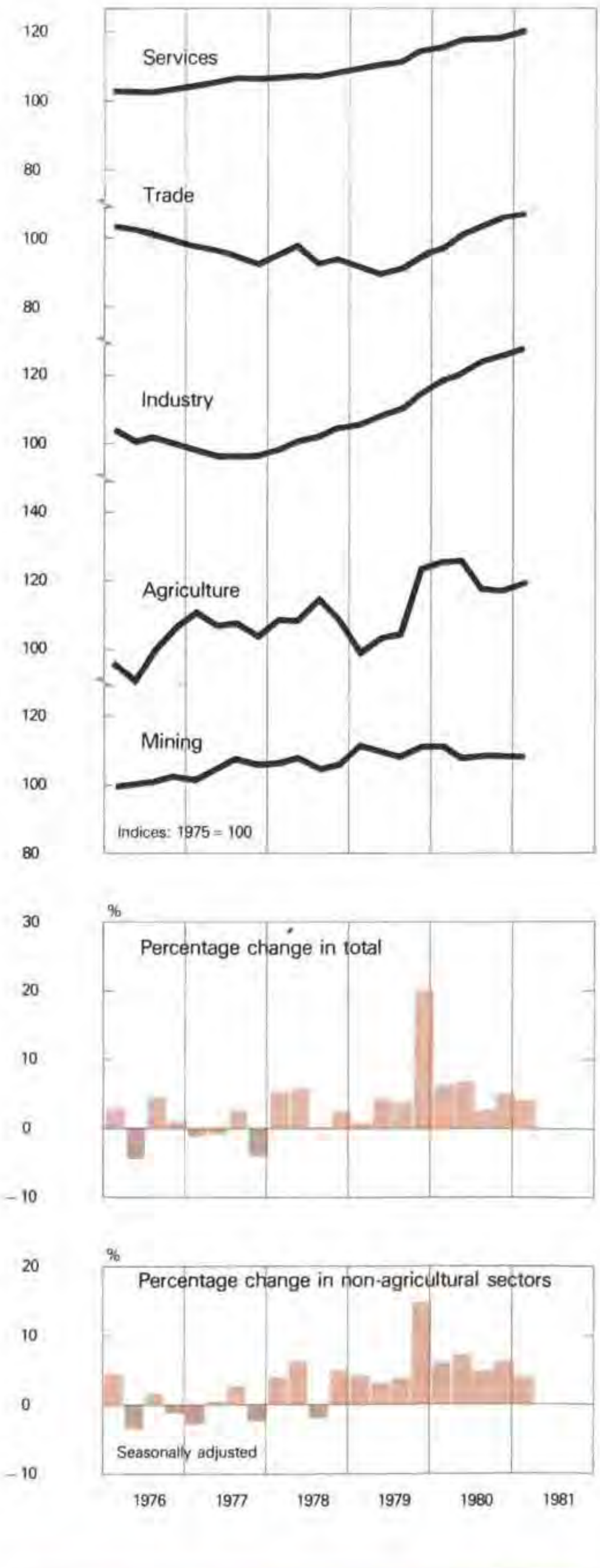
At current prices, the rate of increase in the gross domestic product also decelerated in the first quarter, largely as a result of a sharp decline in the total gross operating surplus. This decline, in turn, reflected considerably lower profits of mining companies, especially in the gold mining industry. The operating surpluses of manufacturing, construction and commerce, on the other hand, continued to rise. Following the decline in the first quarter, total gross operating surplus was at the same level as in the corresponding quarter of 1980. Total remuneration of employees rose further in the first quarter to reach a level about 19 per cent higher than in the corresponding quarter of 1980.

Sustained strong domestic demand

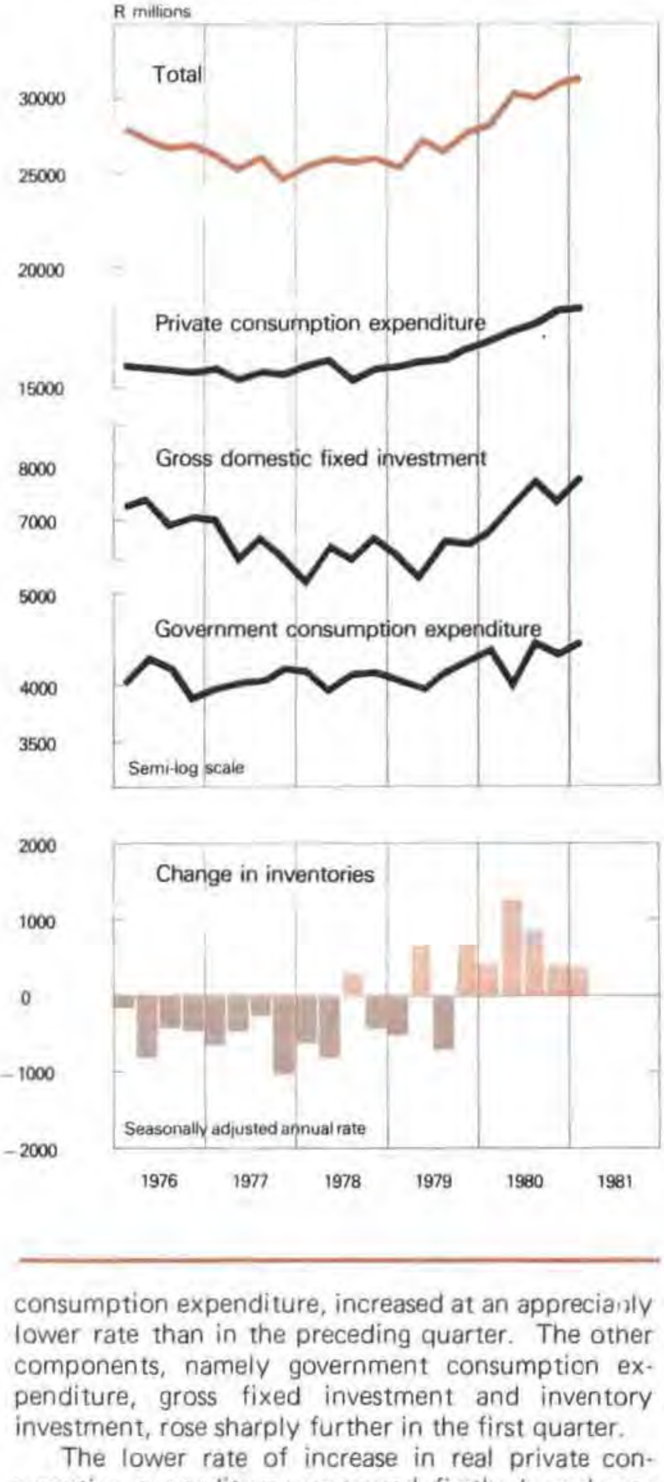
A generally strong domestic demand for goods and services continued to be in evidence in the first quarter of 1981. However, an important component of real aggregate domestic demand, namely private

*Quarterly changes are based on seasonally adjusted data.

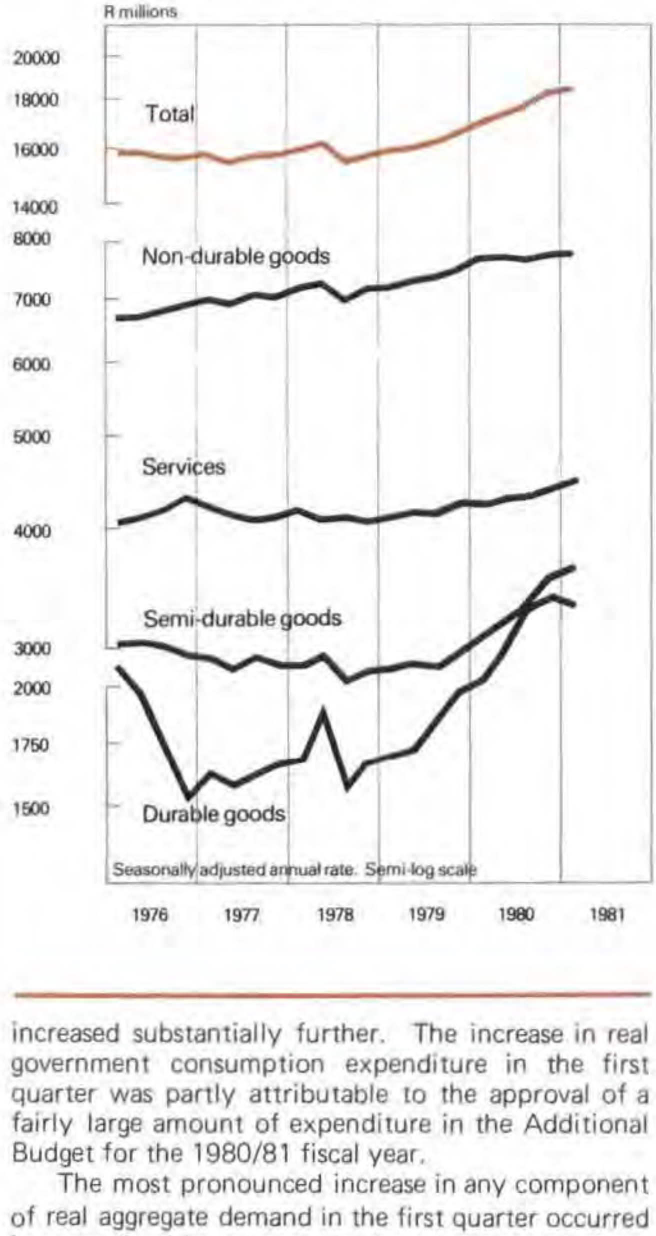
Gross domestic product at constant 1975 prices



Gross domestic expenditure at constant 1975 prices



Private consumption expenditure at constant 1975 prices



consumption expenditure, increased at an appreciably lower rate than in the preceding quarter. The other components, namely government consumption expenditure, gross fixed investment and inventory investment, rose sharply further in the first quarter.

The lower rate of increase in real private consumption expenditure was caused, firstly, by a slower growth in outlays on non-durable goods, mainly food. Secondly, expenditure on durable goods, in particular on new motor cars and recreational and entertainment goods, actually declined after a sustained increase had been recorded from the beginning of 1979. This decline may have been partly attributable to a scarcity of certain classes of durable consumer goods. In contrast, consumer outlays on semi-durable goods, mostly clothing and footwear, and on services increased substantially further. The increase in real government consumption expenditure in the first quarter was partly attributable to the approval of a fairly large amount of expenditure in the Additional Budget for the 1980/81 fiscal year.

The most pronounced increase in any component of real aggregate demand in the first quarter occurred in gross fixed investment. In the private sector, sharp rises in real fixed capital outlays were recorded in agriculture, manufacturing and private residential construction. Fixed investment in agriculture was encouraged by prospects of record summer crops. In manufacturing, the increase in fixed investment reflected the large number of capital expansion programmes that are still in progress, as well as new programmes to create additional production capacity. Fixed investment in private residential buildings rose in response to a continuing strong demand for housing. In the public sector, the fixed investment of public corporations increased sharply and an appreciable rise also occurred in the fixed capital outlays of public authorities, mostly those of government enterprises.

Real inventories rose considerably further in the first quarter as a result of appreciable increases in all categories of stocks other than industrial inventories and stocks of the motor trade. Judging by recent company reports and special surveys, it would appear that the existing level of industrial and commercial inventories, with the exception of some classes of durable consumer goods, is regarded as adequate for the purpose of sustaining expected sales.

At current prices, gross domestic expenditure exceeded the gross national product in the first quarter for the first time since the beginning of 1977. By definition this difference was reflected in a deficit on the current account of the balance of payments and in an excess of gross domestic investment over gross domestic saving.

Decline in domestic saving

Gross domestic saving decreased in the first quarter, mainly owing to a marked decrease in corporate saving, in particular in the mining and financial sectors. This decline, in turn, was caused mainly by substantially lower gold mining profits resulting from a decrease in the price of gold. Of the other components of gross domestic saving, the saving of general government and the overall provision for depreciation increased moderately, but personal saving rose substantially because of a larger increase in disposable income than in private consumption expenditure. The rise in personal disposable income reflected a considerable increase in the remuneration of employees. The further rise in the saving of general government, despite a notable increase in government consumption expenditure, was attributable to the fact that income tax receipts by the central government during the first quarter, especially from gold mining companies, did not, as yet, reflect the decline in company profits during this period.

Employment* and prices

Employment and remuneration of labour

The higher level of economic activity in 1980 was also much in evidence in the labour market. Not only did employment in the non-agricultural sectors rise sharply by 3,3 per cent in 1980, but the rate of increase accelerated during the last three quarters of the year, amounting to a seasonally adjusted annual rate of 3,6 per cent in the fourth quarter.

This sustained rise in the demand for labour led to severe shortages of skilled and semi-skilled workers in various sectors of the economy, a rise in the number of overtime hours worked, and also to a decrease in unemployment. The seasonally adjusted number of registered unemployed Whites, Coloureds and Asians declined from 26 931 in December 1979 to 18 356 in December 1980 and then further to 17 147 in March 1981. The ratio of unemployed Blacks to the economically active Black population declined from 9,0 per cent in January 1980 to 8,1 per cent in January 1981.

In nominal terms, the average remuneration per worker in the non-agricultural sectors of the economy rose sharply by 18,0 per cent in 1980, compared with an increase of 12,1 per cent in 1979. The average real remuneration per worker in the non-agricultural sectors of the economy, i.e. after adjustment for price rises, increased by 3,4 per cent in 1980, following a decline of 0,9 per cent in 1979. On average, workers of all population groups benefited from the higher real salaries and wages in 1980.

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

	1979	1980
Whites		
At current prices	11,9	17,5
At constant prices	−1,0	3,3
Other population groups		
At current prices	13,0	19,9
At constant prices	0,5	4,3
Total		
At current prices	12,1	18,0
At constant prices	−0,9	3,4

The effect of the increased wage bill on labour costs was, however, partly offset by increased labour productivity. In manufacturing, for instance, output per man-hour rose by 4,5 per cent in 1980 as against only 2,4 per cent in 1979. But the rate of increase in unit labour cost nevertheless accelerated from the second quarter of 1980 and showed an increase of 11,9 per cent in 1980, following a rise of 9,8 per cent in the preceding year.

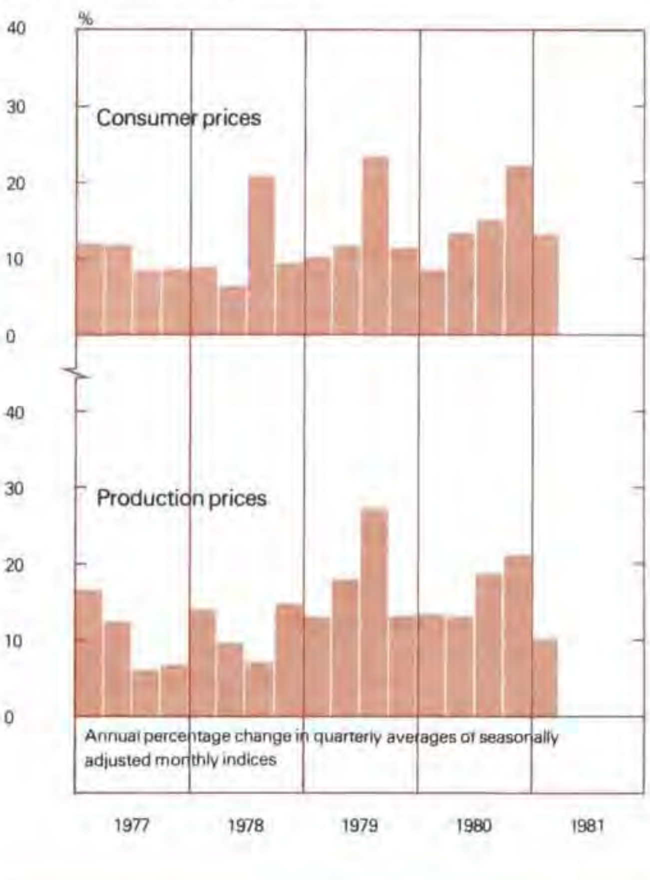
*Statistics relating to employment and the remuneration of labour are only available up to the end of 1980.

Slow-down of inflation rate

Both consumer and production price rises slowed down somewhat in the first quarter of the year, but nevertheless remained at high levels. A factor contributing to this lower rate of price increases was the absence of any material upward adjustment in government-administered prices. The seasonally adjusted increase in consumer prices decelerated to an annual rate of 13,1 per cent in the first quarter of 1981, compared with 15,0 and 22,0 per cent in the third and fourth quarters of 1980, respectively. This slow-down was mainly the result of a reduced rate of increase in the prices of food and motor cars. Prices of non-food consumer goods continued to rise at the same rate as during the fourth quarter of 1980 and higher rates of increase were actually recorded in the prices of furniture, clothing and footwear. The increase in the price of services accelerated in the first quarter, especially the cost of housing, personal and educational services. House and flat rents rose sharply as a result of the relative scarcity of rentable accommodation and the increased prices of residential property. From April 1980 to April 1981 the seasonally adjusted consumer price index increased by 15,5 per cent.

The production price index showed a similar tendency as the consumer price index. After accelerating sharply to seasonally adjusted annual rates of 18,1 and 20,7 per cent in the third and fourth quarters of 1980, respectively, the increase in the production price index decelerated to 10,1 per cent in the first quarter of 1981. Both imported and domestically produced goods contributed to this slowdown. Apart from higher rates of increase in the prices of coal and electricity and water tariffs, the prices of locally produced agricultural products and various manufactured goods, such as base metals, non-metallic mineral products, electrical machinery, processed food, beverages and tobacco rose at lower rates. From April 1980 to April 1981 production prices rose by 14,3 per cent.

Percentage change in prices



Balance of payments

Deficit on current account

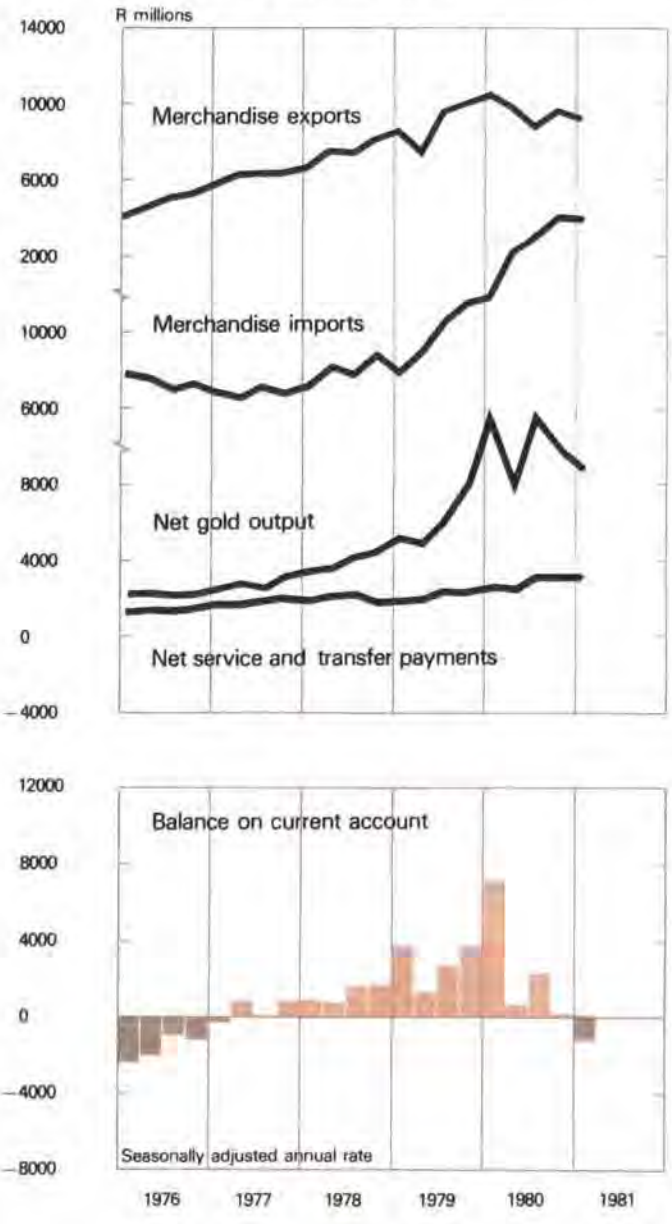
The continuing strong domestic demand for capital and consumer goods, together with an increase in import prices, caused imports in the first quarter of 1981 to remain at the high level to which they had risen in the preceding quarter. The spill-over of demand into imports was partly attributable to an almost full utilisation of domestic production capacity. More important, however, it reflected the high import content of domestic expenditure on capital goods, inventories and durable consumer goods. Net service and transfer payments to the rest of the world also remained approximately unchanged in the first quarter. Exports, on the other hand, declined as a result of the economic slow-down in trading-partner countries and the high level of domestic demand for locally produced goods. At the same time, a decline in the price of gold caused an appreciable decrease in the value of the net gold output. These developments gave rise to a small deficit of R107 million, or R1 010 million at a seasonally adjusted annual rate, on the current account of the balance of payments in the first quarter.

The emergence of a current account deficit, after the economy had been in an expansionary phase for about three years, was not unexpected. During preceding periods of economic upswing, current account deficits of considerably larger proportions were recorded much earlier. The strength of the current account up to an advanced stage of the present upswing was due to the fact that an exceptionally sharp rise in imports was more than offset by the effect of a quadrupling of the gold price from 1977 to 1980 on the value of the net gold output, and by a strong rise in merchandise exports that continued well into 1980.

The main items on the current account of the balance of payments, seasonally adjusted, are shown in the accompanying table. The decline in merchandise exports in the first quarter was evident in most categories of export commodities, but in particular in exports of diamonds, processed food and base metals. In volume terms, the decrease in exports was more pronounced. Mainly because of a fairly large depreciation of the rand against the US dollar and an increase in the prices of some commodities, export prices expressed in rand actually showed a small rise during the first quarter.

The value of the net gold output declined by 11 per cent in the first quarter because of a further fall in the price of gold. A small increase was recorded in the volume of the net gold output. On the London market, the average fixing price of gold decreased from US $627,08 per fine ounce in the fourth quarter

Balance of payments current account



Current account of balance of payments
Seasonally adjusted figures at an annual rate
R millions

	1980				1981
	1st qtr.	2nd qtr.	3rd qtr.	4th qtr	1st qtr.
Merchandise exports	10 470	9 770	9 040	9 550	9 120
Net gold output	11 460	7 760	11 520	9 830	8 720
Merchandise imports	11 890	14 290	14 970	16 000	15 920
Net service and transfer payments	2 570	2 370	2 970	2 940	2 930
Balance on current account	**7 470**	**870**	**2 620**	**440**	**1 010**

of 1980 to US $519,30 per fine ounce in the first quarter of 1981. This declining trend continued during April and May, and the average London market price of US $480,09 per fine ounce in May was well below the monthly peak of US $675,99 in September last year. The decline in the price of gold was strongly related to the strength of the US dollar in foreign exchange markets, which, in turn, reflected expectations that the new United States Administration's economic policy would bring about improved economic conditions and a decline in the rate of inflation. Other factors contributing to the lower gold price were the relatively stable oil prices and some slackening of international political tensions.

Despite a further rise in import prices, the value of imports in the first quarter of 1981 remained approximately at the level of the preceding quarter as a result of an appreciable decline in the volume of goods imported. Lower volumes were particularly evident in the case of imports of mineral products (including petroleum products) and transport equipment, but were also noticeable in other categories of imports. To some extent the lower volume of imports was due to problems that had been experienced in clearing containerised imports in certain congested customs warehouses, and to a dock workers' dispute in Southampton which had delayed southbound container traffic from Britain.

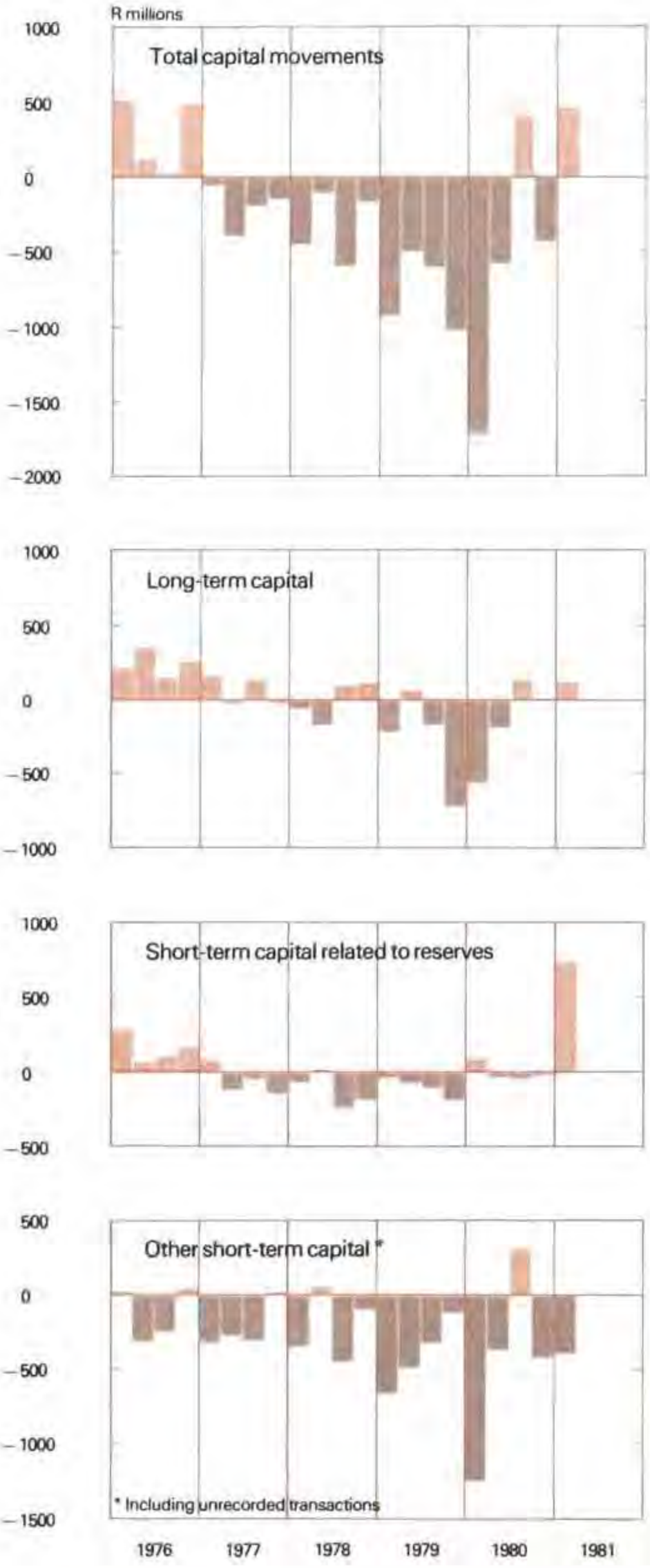
Net service and transfer payments to the rest of the world remained approximately unchanged from the fourth quarter of 1980 to the first quarter of 1981. Higher interest and dividend payments to foreigners and increased freight and insurance charges on imports were counterbalanced by an increase in charges for transportation services rendered to foreigners and in foreign investment income receipts.

Overall net inflow of capital

The deficit on the current account of the balance of payments in the first quarter was accompanied by a net outflow of capital amounting to R260 million, excluding changes in the so-called liabilities related to foreign reserves. This outflow was accounted for by the repayment of foreign short-term liabilities by public corporations and a net outward movement of short-term capital from the private sector. A partly offsetting net inflow of long-term capital was recorded, consisting of long-term foreign borrowing by public corporations and a small net inward movement of long-term capital to the private sector.

During the first quarter the effective cost of trade financing in terms of dollars and in terms of rand was kept more or less on par by means of appropriate changes in the discounts on the US dollar in the Reserve Bank's forward exchange transactions. This was done in order not to drain liquidity from the domestic money market during a seasonally tight period. From April, however, the discounts were fixed in such a way as to make the domestic financing of trade marginally more attractive than foreign financing with a view to discouraging short-term capital movements that could contribute to an increase in bank liquidity and the money supply.

Net capital movements



Capital account of balance of payments
R millions

	1980				1981
	1st qtr.	2nd qtr.	3rd qtr.	4th qtr.	1st qtr.
Long-term capital					
Central government and banking sector	−72	−31	−65	−145	−20
Public corporations and local authorities	−185	30	148	186	107
Private sector	−309	−177	49	−37	31
Total	−566	−178	132	4	118
Short-term capital not related to reserves (including unrecorded transactions)	−1 245	−365	312	−408	−378
Change in net gold and other foreign reserves owing to balance of payments transactions	230	−366	1 161	−494	−367
Liabilities related to foreign reserves	90	−29	−38	−22	−727
SDR allocations and valuation adjustments	525	1 094	−142	−498	−226
Change in gross gold and other foreign reserves	845	699	981	−1 014	134

In order to cushion the effect of the current account deficit and the net outflow of capital on the gold and other foreign reserves, the Reserve Bank borrowed temporarily abroad in March. Liabilities related to reserves were further increased during the first quarter by short-term foreign borrowing by some banking institutions which were experiencing difficulty in complying with the compulsory liquid asset requirements. In total, liabilities related to reserves increased by R727 million during the first quarter, resulting in an overall net inflow of capital of R467 million.

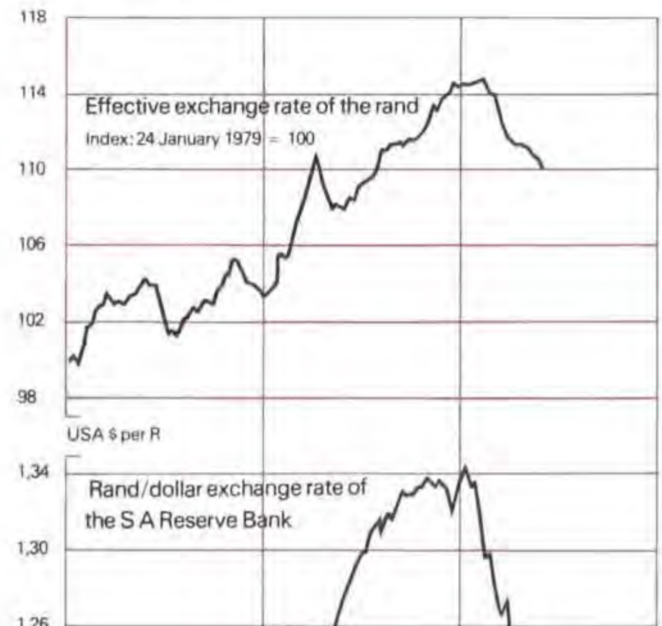
Depreciation of the rand

Because of the change in the balance of payments and the strength of the US dollar, the appreciation of the commercial rand up to the end of 1980 was reversed in the first quarter of 1981. Although the rand continued to appreciate against most Western European currencies, it depreciated sharply by 6,6 per cent against the US dollar during the first quarter and by a further 5,8 per cent during April and May. During this five-month period, the rand also depreciated slightly against the Japanese yen. The effective exchange rate of the rand, which had risen by 10,9 per cent during 1980, declined by 2,8 per cent during the first quarter and by 1,1 per cent during April and May. The financial rand depreciated by 5,9 per cent against the US dollar during the first five months of 1981 and the financial rand discount narrowed from 30,2 per cent at the end of 1980 to 25,5 per cent at the end of May.

Gold and other foreign reserves

Balance of payments transactions were responsible for a decline of R367 million in the **net** gold and other foreign reserves during the first quarter. This decline was, however, more than offset by the appreciable increase in liabilities related to reserves, which caused the **gross** gold and other foreign reserves to rise by R134 million, despite negative valuation adjustments to the gold as well as the foreign exchange reserves. During April the gross gold and other foreign reserves of the Reserve Bank declined by R562 million, partly as a result of the revaluation of the gold reserves at a lower price.

Exchange rates



Money and banking

Excessive increase in money supply

Total monetary demand, which already had begun to exert inflationary pressure during the second half of 1980, increased further in the first quarter of 1981 and was again accompanied by an excessive increase in the money supply. By accommodating a sustained increase in aggregate demand, the strong monetary expansion since the middle of 1980 has made an important contribution to the persistently high rate of inflation and, through its lagged effect on expenditure and prices, will probably continue to do so for some time to come. Curbing the excessively high rate of growth in the money supply has, therefore, become an important intermediate objective of monetary policy in the process of ultimately achieving a reduction in the rate of inflation.

Following an increase of 27 per cent during 1980, the broadly defined money supply (M2) rose at the exceptionally high seasonally adjusted annual rate of 46 per cent during the first quarter of 1981. The growth in the narrowly defined money supply (M1), however, declined slightly from 36 per cent in 1980 to a seasonally adjusted annual rate of 32 per cent during the first quarter. If the banks' short and medium-dated repurchase agreements with the private sector, which declined notably during the first quarter, are taken into account, the seasonally adjusted annual rates of increase in M2 and M1 amounted to 37 per cent and 24 per cent, respectively.

Reasons for the increase in the money supply

An **ex post** analysis of the statistical "causes" of the increase in M2 during the first quarter is presented in the accompanying table. The sole "cause" of the growth in M2 during this period was an unprecedentedly large rise of 65 per cent, at a seasonally adjusted annual rate, in bank credit extended to the private sector. As during the last four months of 1980, which followed the abolition of the credit ceilings, part of the expansion in bank credit during the first quarter represented the "re-intermediation" of credit which had previously been extended outside the banking system. To an important extent this expansion was directly related to a strong cyclical demand for consumer credit and the greater use of bank credit in the financing of investment expenditure by companies which previously had been able to arrange credit outside the banking system or had sufficient internal funds at their disposal. The banks were enabled to extend credit on a large scale by an increase in their liquidity base and by reducing that portion of their liquid asset holdings which was in excess of the legally required minimum.

The expansionary effect of bank credit to the private sector on M2 during the first quarter was only partly neutralised by the other three main causes of change in this monetary aggregate. The seasonally adjusted net gold and other foreign reserves of the monetary banking sector declined markedly during this period. Likewise, a decline was recorded in the seasonally adjusted net claims of the monetary banking sector on the government sector, mainly because of an increase in government deposits after the receipt of a substantial amount of tax funds at the end of February. In addition, a further, but comparatively small, increase occurred in long-term deposits held by the private sector with monetary banking institutions. It is customary for long-term deposits to increase very little or to decline during periods, such as the first quarter of 1981, when further increases in long-term interest rates are generally expected.

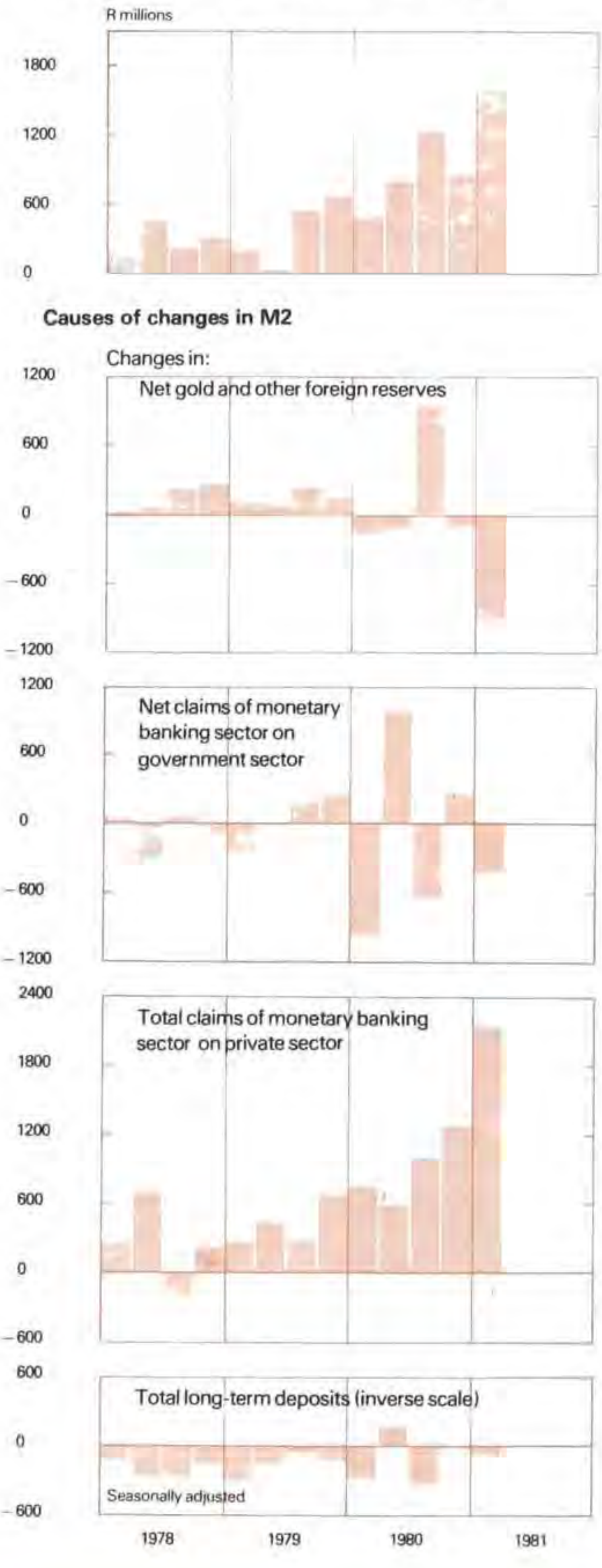
Breakdown of bank credit to the private sector

The sharp rise in credit extended by the monetary banking sector to the private sector during the first quarter was evident in all the main credit components. Investments in private sector securities increased by R279 million, but the major contribution was made by the increase of R1 727 million in the

Causes of changes in M2
R millions

	Not seasonally adjusted			Seasonally adjusted		
	1980		1981	1980		1981
	3rd qtr.	4th qtr.	1st qtr.	3rd qtr.	4th qtr.	1st qtr.
Net gold and other foreign reserves	1 161	-494	-367	1 105	-115	-918
Claims on government sector						
Gross claims	354	372	-204			
Government deposits (increase –, decrease +)	-1 159	67	-617			
Net claims	-805	439	-821	657	264	-439
Claims on private sector	1 118	1 139	2 087	1 009	1 269	2 153
Long-term deposits of private sector (increase –, decrease +)	-264	91	-143	-347	-28	-68
Net other assets	167	-37	102	...	...	...
Total causes of changes	**1 377**	**1 138**	**858**	**1 242**	**860**	**1 585**

Changes in broadly defined money supply (M2)



discounts, loans and advances of commercial, merchant and monetary general banks. Bills discounted rose by a comparatively small amount of R57 million, mainly because of a reduction in the commercial banks' holdings of their own acceptances which do not rank as liquid assets. Hire-purchase credit and leasing finance increased strongly by R460 million, reflecting a continuing high level of demand for capital goods and certain classes of consumer goods. Other loans and advances, which had risen by R781 million during 1980, rose by as much as R1 210 million during the first quarter because of a generally strong demand for credit and a switch from non-bank financing to bank credit as a source of funds.

Significant decline in excess bank liquidity

The banks' large-scale credit extension to the private sector resulted in a substantial increase in the amount of liquid assets that the banks are required to hold. In this way, their holdings of liquid assets in excess of the required minimum were reduced appreciably. At the end of 1980, the ratio of excess liquid assets to the banks' liabilities to the public amounted to 2,5 per cent, but it declined to only 1,4 per cent at the end of February 1981 before increasing to 2,2 per cent at the end of March. It is interesting to note that the banks' holdings of liquid bankers' acceptances, increased considerably during the last four months of 1980 and the first quarter of 1981. For purposes of complying with the liquid asset requirements, only 20 per cent of the required amount of liquid assets (excluding required cash reserves) may consist of these acceptances. At the end of March holdings of liquid bankers' acceptances were just short of the 20 per cent limit imposed by the Banks Act.

Money market conditions and interest rates

Although the first quarter of each year is characteristically a period of seasonal tightness in the money market, conditions in the market were prevented from tightening unduly during this period by a number of steps taken by the Reserve Bank to iron out seasonal changes. Firstly, from about the middle of 1980 tap Treasury bills and Reserve Bank debentures, maturing at the end of February 1981, were sold by the Bank with a view to countering the effect of the large tax flows to the government towards the February month-end. Secondly, from the end of January to the end of March the Bank operated as a net buyer of securities in the market. Thirdly, the amount of Treasury bills offered at the weekly tender was reduced from 23 January so as to effect a net repayment of bills. Fourthly, securities were bought by the Bank from banking institutions other than the discount houses under repurchase agreements maturing at the end of February. On 26 February the Bank entered into further repurchase agreements which matured on 19 March but could be extended at the option of the banking institutions involved to

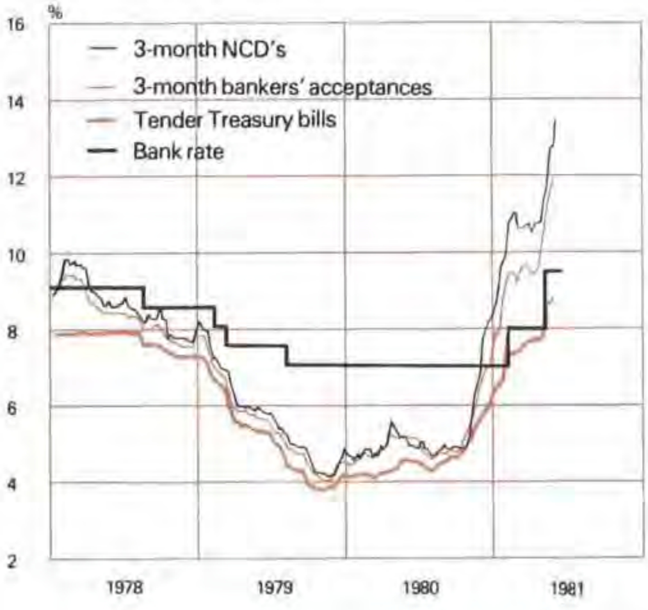
7 April. Finally, the Bank made certain concessions in its accommodation of the discount houses over the February and March month-ends. During April and most of May money market conditions remained easy because of the effect of the seasonal increase in central government expenditure at the beginning of the new fiscal year.

Mirroring the absence of undue tightness of the money market, Reserve Bank accommodation of the discount houses amounted to only R192 million at the end of February, when the seasonal tightening usually reaches its peak. This accommodation declined during March and was fully repaid on 9 April. No further accommodation was provided before the May month-end. Call loans to the discount houses did not show unduly large fluctuations during the first five months of 1981, except for moderate declines over the January and February month-ends. During this five-month period the banks' free balances with the National Finance Corporation generally remained at low levels, but were built up substantially before the tax-payment peak at the end of February and before the new government stock issue on 15 May.

Money market interest rates increased sharply up to the middle of February, remained fairly stable until early May, and then resumed an upward trend. On 29 May the rate on three-month bankers' acceptances, for example, amounted to 12,00 per cent, compared with 7,0 per cent on 24 December 1980. On these dates the Treasury bill tender rate amounted to 8,88 per cent and 6,04 per cent, respectively.

In recognition of the increase in short-term interest rates, Bank rate was raised from 7 to 8 per cent, with effect from 3 February, and to 9,5 per cent, with effect from 6 May. This rapid succession of relatively large increases indicated greater flexibility in the adjustment of Bank rate so as to reflect changes in market conditions more clearly and to assist in the attainment of monetary policy objectives. In response to these changes in Bank rate and, more generally, the strong demand for bank credit, the prime overdraft rate of the commercial banks was raised from 10,0 per cent to 11,0 per cent in February, to 11,5 per cent in March, and to 13,0 per cent in May. Despite these increases, the prime overdraft rate was still well below the prevailing rate of inflation and substantially below those in other countries with roughly similar or lower rates of inflation. Because of an increase in lending rates of banking institutions and building societies and more active competition for funds, deposit interest rates were also increased on various occasions and by varying percentages during the period from January to the middle of May.

Money market interest rates



Government finance

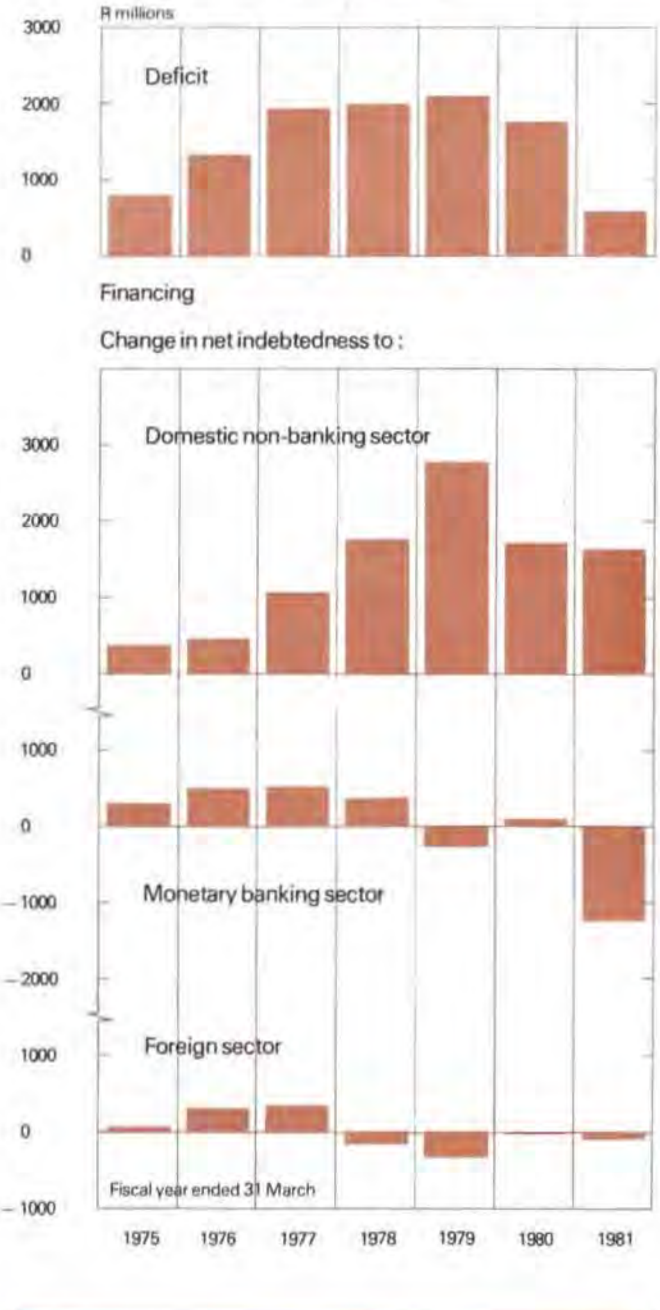
Considerable decline in monetary banking sector's net claims on the Exchequer

The decline in the monetary banking sector's net credit extended to the government sector as a whole during the first quarter of 1981 was largely accounted for by a substantial decrease in net banking sector claims on the central government, as reflected in transactions on the Exchequer Account. However, the Exchequer Account is closely interlinked with the Paymaster-General Account and the Stabilization Account and transactions on the Exchequer Account have, therefore, been adjusted to take account of those on the other two accounts.

Because of a major peak in tax payments to the central government at the end of February, receipts on the Exchequer Account increased markedly in the first quarter. These receipts were in fact 31 per cent higher than in the corresponding quarter of 1980. On the other hand, Exchequer issues, which had been rising at high rates in the preceding three quarters, increased only moderately in the first quarter. As a result, the Exchequer Account recorded a revenue surplus of R716 million. Borrowing from the Public Debt Commissioners added another R522 million to receipts on the Exchequer Account so that a substantial amount of funds was available for either making repayments on debt or increasing cash balances. Government securities in the hands of the private non-banking sector and the monetary banking sector were reduced by R221 million and R728 million, respectively, while cash balances were raised by R311 million. Taken together, the decrease in the monetary banking sector's holdings of government securities and the increase in cash balances with this sector caused a decline of R1 039 million in net bank claims on the Exchequer during the first quarter.

During April, the first month of the new fiscal year, government expenditure showed its seasonally large increase. In order to finance this expenditure, the government had to draw down its balance on the Stabilization Account by R640 million.

Exchequer Account deficit and financing



Highly successful new issues of government stock

Two new stock issues were made on 15 May with a view to redeeming maturing stock of R837 million on 15 May and of R121 million on 1 June. Apart from the refinancing of maturing debt, these issues were aimed at meeting the Treasury's financing requirements in the 1981/82 fiscal year and at reducing excess liquidity in the economy. The new loans consisted of the issue of 3-year stock with an effective yield of 10,142 per cent and 22-year stock with an effective yield of 13,066 per cent. The short-term loan drew subscriptions of R335 million, including R80 million and R203 million subscribed by the Public Debt Commissioners and the monetary banking sector, respectively. Applications for the long-term stock amounted to R1 143 million, of which R180 million and R185 million came from the Public Debt Commissioners and the monetary banking sector, respectively.

In terms of the objectives of monetary policy, these issues were highly successful, in particular because of the large subscription by the private non-banking sector. Subscriptions to the new issues by this sector will exert a contractionary influence on both the money supply and the banks' liquidity base to the extent that these funds find their way into higher government deposits with the banking sector.

Government finance in the 1980/81 fiscal year*

The 1980/81 fiscal year was characterised by an exceptionally large increase of 36 per cent in central government revenue, a rate of increase that was substantially in excess of the Budget estimate of 11 per cent. Total revenue collections actually exceeded the Budget estimate by no less than R2,4 milliard. These markedly higher than expected collections of revenue resulted from a sharp rise in the price of gold and, consequently, in gold mining profits, and from the effect of the buoyant economic conditions on direct as well as indirect tax collections. Income tax and mining lease payments by gold mining companies more than doubled from R1,5 milliard in 1979/80 to R3,6 milliard in 1980/81. Other income tax payments to the government, reflecting considerably higher company profits and salaries and wages, increased by 16 per cent. Likewise, indirect taxes in the form of customs and excise duties and general sales tax rose by as much as 24 per cent as a result of the sharply higher levels of imports and private consumption expenditure.

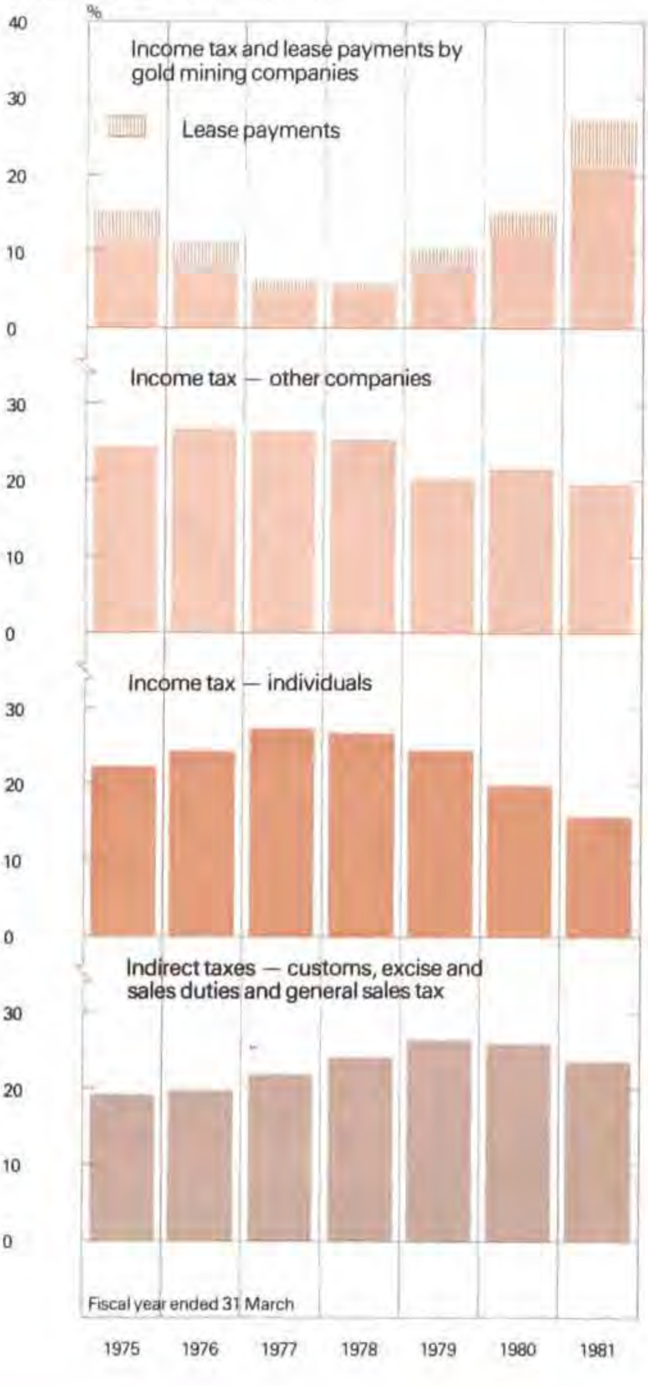
State Revenue Fund — main components of revenue
R millions

	Fiscal year ended March		
	1980	1981	
	Actual	Budget	Actual
Income tax			
Gold mines	1 167	1 850	2 795
Other	4 067	4 141	4 729
Total	5 234	5 991	7 523
Gold mining leases	334	635	838
Indirect taxes			
Customs and excise duties	1 293	1 070	1 482
General sales tax	1 249	1 550	1 659
Total	2 542	2 620	3 141

The government continued to pursue its policy of fiscal discipline in 1980/81 by limiting the rate of growth in government expenditure to a figure that was only slightly in excess of the prevailing rate of inflation. Expenditure by the central government, as represented by the adjusted issues from the Exchequer Account, increased by 18 per cent in 1980/81, compared with an original Budget estimate of 14 per cent. This difference was accounted for by expenditure approved in the Additional Budget.

Because of the high level of government revenue, the deficit before borrowing on the Exchequer Account, as adjusted, amounted to only R552 million. This deficit was not only R1 384 million less than in 1979/80, but also the smallest deficit recorded during the past seven years. Net borrowing from the Public Debt Commissioners and the private non-banking sector amounted to R1 048 million and R597 million, respectively, in 1980/81 and this enabled the government to reduce its foreign debt and its net indebtedness to the monetary banking sector by R96 million and R997 million, respectively. The decline in the net indebtedness to the monetary

State Revenue Fund — relative importance of main items of revenue to total collections



*As usual, the figures for the fiscal year were compiled mainly from statistics published in the **Government Gazette**. In the analysis the Exchequer Account was consolidated with the Paymaster-General Account and the Stabilization Account. The figures will, therefore, not correspond exactly with those used for Budget purposes.

banking sector consisted mostly of an increase of R961 million in cash balances with this sector. The balance on the Stabilization Account rose by R1 242 million, but other cash balances declined by R281 million. The increase in the Stabilization Account balance made an appreciable contribution to the curbing of the growth in the money supply.

Capital market

Change in investors' expectations in market for fixed-interest securities

From the beginning of the current phase of rising long-term interest rates in early 1980, investment in long-term fixed-interest securities was inhibited by investors' expectations of further interest rate increases. These expectations were strengthened by the sharp rise in the inflation rate towards the end of 1980 and the monetary authorities' announcement at the time of the Bank rate increase in February 1981 that they intend to curb the excessive growth in the money supply. In early May, however, these expectations weakened and investors came to accept that long-term interest rates would for the time being not advance significantly beyond the prevailing market levels. The main reasons for this change of mood were the substantial increases in long-term interest rates that had already occurred, especially during the fourth quarter of 1980 and the first two months of 1981; the relative stability of interest rates generally during March and April; the realisation that long-term interest rates need not change to the same extent as short-term rates, but are normally determined by a different set of conditions; the fact that investors' assessments of the yield on new long-term investments should take into account the expected average rate of inflation over the whole investment period instead of just the prevailing rate of inflation; and the effect on investment income of unduly large

Secondary market security yields

holdings of low-yielding liquid assets by long-term investors in anticipation of increases in long-term interest rates. These expectations were further dispelled by the pitching of the effective yield on the new issue of long-term government stock on 15 May at a level slightly above the then prevailing market rate, namely at 13,066 per cent.

Secondary market yields on long-term fixed-interest securities continued to rise sharply during the first two months of 1981 and in early March, but then remained relatively stable up to the time of the new issue of government stock in the middle of May. The monthly average yield on long-term government stock rose from 11,81 per cent in December last year to 12,75 per cent in March before easing to 12,69 per cent in April. In the case of long-term semi-gilt-edged stock of the highest grade, the monthly average yield increased from 12,20 per cent in December 1980 to 13,05 per cent in February 1981, and thereafter declined to 12,98 per cent in April. The monthly average yield on company loan securities, which had amounted to 13,03 per cent in December last year, peaked at 14,27 per cent in February before declining to 13,77 per cent in April.

Share prices on the rebound

Following a decline from the September 1980 peak, share prices rebounded in March and April. The comprehensive share price index rose by 3 per cent in March and by a further 4 per cent in April. Share prices were nevertheless 9 per cent lower in April than in December last year and 20 per cent below the peak in September 1980. The improvement in share prices during March and April occurred at a time when interest rates in both the money and capital markets tended to ease or to remain unchanged, and also reflected some excellent financial reports by companies and a selective interest in shares by large groups of institutions which had to find investment outlets for substantial amounts of new funds.

The effect of falling share prices was reflected in an increase in the dividend yield on all classes of shares from 5,86 per cent in December 1980 to 6,97 per cent in February 1981. Subsequently, the yield declined to 6,78 per cent in March and 6,55 per cent in April. The yield gap between long-term government stock and shares widened from 5,95 per cent in December to 6,14 per cent in April.

Smaller increase in holdings of longer-term funds with financial institutions

The seasonally adjusted increase in holdings of longer-term funds with deposit-receiving and other savings institutions amounted to R752 million during the first quarter of 1981, or somewhat less than the corresponding increase of R962 million during the preceding quarter and the quarterly average of R1 099 million for 1980. The different groups of institutions were not equally successful in attracting new longer-term funds. As shown in the accompanying table, the increase in the savings and long-term

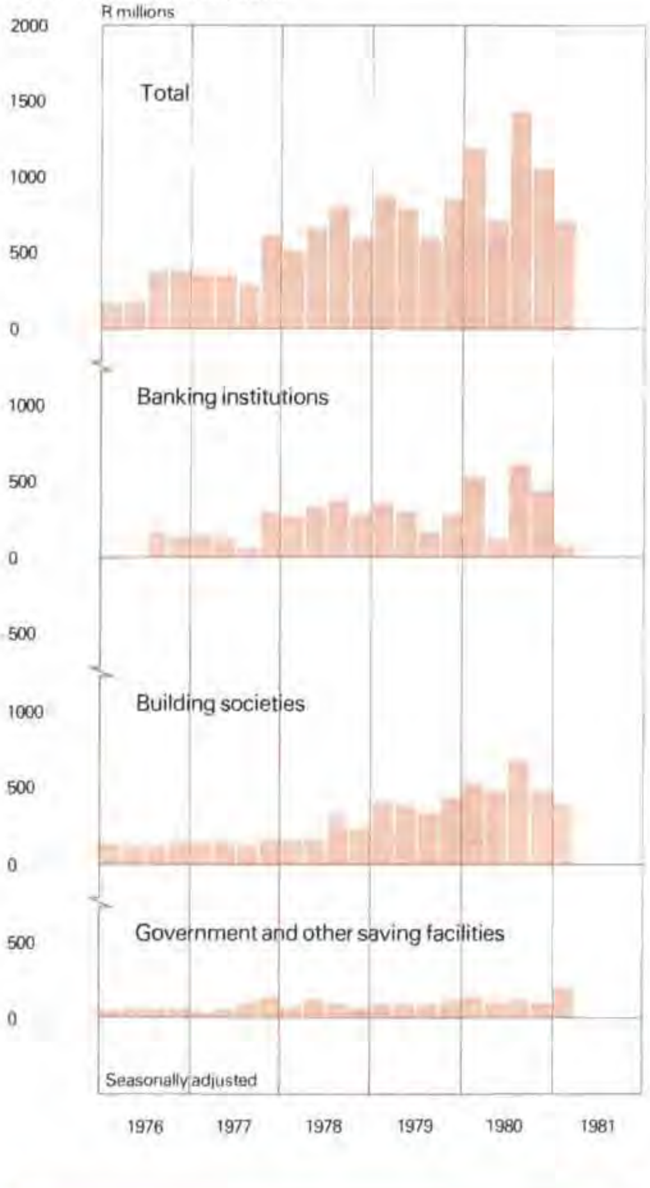
Stock exchange

deposits of banking institutions and the rise in the building societies' shares and deposits were notably smaller during the first quarter of 1981 than during the preceding quarter and also appreciably less than the quarterly average for 1980. On the other hand, the intake of new longer-term funds by participation mortgage bond schemes and government savings institutions during the first quarter of 1981 exceeded the figure for the preceding quarter and the quarterly average for 1980. The smaller intake of new funds by

Change in holdings of longer-term funds with financial institutions
Seasonally adjusted
R millions

	1980		1981
	4th qtr.	Quarterly average	1st qtr.
Banking institutions	377	428	135
Building societies	480	550	404
Participation mortgage bond schemes	29	16	34
Government savings institutions	76	105	179
Total	**962**	**1 099**	**752**

Change in longer-term fund holdings with financial institutions



banking institutions and building societies reflected mainly the high level of private consumption expenditure and its effect on deposit-type savings, as well as the effect of the withdrawal of funds which had been invested temporarily with these institutions by corporate and institutional investors. These funds were reinvested elsewhere at higher yields or used for the financing of fixed and inventory investment.

Because of a continuing strong demand for housing finance and bank credit, deposit-receiving institutions already in 1980 started competing very actively for funds. This gave rise to several adjustments in deposit and related interest rates. An indication of the extent of these changes is given in the accompanying table.

Selected interest rates[1]
%

	30 June 1980	31 Dec. 1980	31 May 1981
Ordinary savings deposits	3,50	3,50	4,00
Special savings deposits	5,50[2]	5,50[2]	8,00[3]
Fixed deposits:			
12 months	7,50	8,50	10,50[4]
24 months	8,00	9,50	11,00
36 months	9,00	9,50	12,00
60 months	9,00	9,50	12,00
Building societies' indefinite period paid-up shares	8,00	8,00	10,00
Building societies' tax-free shares	7,00	7,00	8,25
Post Office savings bank certificates	7,00	7,00	8,00
National savings certificates[5]	7,50	7,50	9,10
Tax-free Treasury bonds	7,00	7,00	8,00

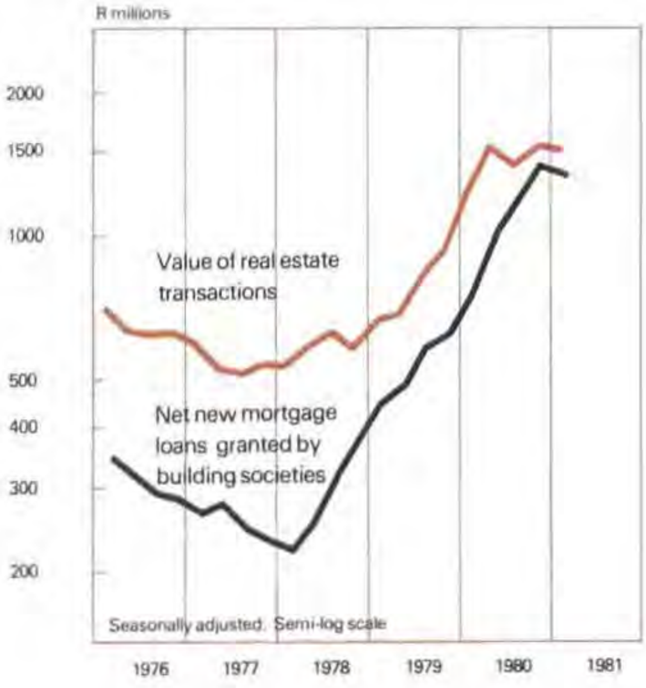
1. Predominant rates.
2. Deposits of less than R20 000.
3. Deposits of up to R15 000, effective early June.
4. Effective early June.
5. Average rate over full period of investment.

Continued high level of activity in real estate and mortgage markets

Turnover in the real estate market during the first quarter of 1981 remained at the high level to which it had risen in the fourth quarter of 1980. The seasonally adjusted value of real estate transactions amounted to about R1 510 million in the first quarter, compared with R1 537 million in the preceding quarter. Mortgage loans paid out by the building societies, seasonally adjusted, amounted to R1 304 million, or 86 per cent of the total value of real estate transactions, in the first quarter, compared with R1 364 million in the preceding quarter and a quarterly average of R1 048 million for 1980.

In order to maintain a high level of mortgage loan pay-outs in the face of a smaller intake of new funds, the societies had to liquidate part of their holdings of prescribed investments. These investments, which had peaked at R2 155 million at the end of August 1980, were reduced to R1 903 million at the end of 1980 and declined further by R305 million during the first quarter of 1981. Because of the decline in their intake of new funds and the high level of

Fixed property market



outstanding commitments in respect of new mortgage loans granted but not yet paid out, the societies were compelled to reduce their new mortgage lending. New mortgage loans granted during the first quarter, seasonally adjusted, amounted to R484 million, compared with R1 075 million during the preceding quarter and a quarterly average of R1 150 million for 1980. By cutting back on their new mortgage lending and by maintaining their mortgage loan pay-outs at a high level, the societies were able to reduce their loan commitments by R530 million during the first quarter, namely from R1 635 million at the end of 1980 to R1 105 million at the end of March 1981.

In line with the rise in their deposit rates, the societies in January and again in April announced increases of 0,75 per cent and 1,5 per cent, respectively, in their mortgage rates. After these adjustments, the rates now range from 11,25 - 13,25 per cent. Although these rates are substantially higher than in 1980, they are, like the prime overdraft rate of the commercial banks, still well below the current rate of inflation.