Quarterly economic review

Introduction

Economic conditions in the second quarter of 1985 continued to reflect the success achieved by the authorities in curbing inflationary overspending and improving the underlying balance of payments. The stringent monetary policy measures adopted in 1984 and the fiscal discipline imposed in the March 1985 Budget resulted in substantial further decreases in real consumption expenditure and investment. Accordingly, real gross domestic expenditure declined to 9 per cent below its high level in the second quarter of 1984.

Although the effects of the depressed domestic demand on output volumes were cushioned by an increasing international demand for South African exports, real gross domestic product, at a seasonally adjusted annual rate, declined by 2½ per cent in the second quarter.

The deceleration of the growth of monetary demand during the first half of 1985 was reflected in a decline in the growth of the money supply aggregates as well as in their velocities of circulation. The rate of increase in total bank credit also slowed down in the second quarter of 1985.

The reduced rate of increase of spending and bank credit creation resulted in a substantial improvement in domestic savings. The savings ratio increased from 20 per cent of gross domestic product in the second quarter of 1984 to a level of 26 per cent in the second quarter of 1985. The largest contribution to this improvement came from personal saving, while the savings shortfall of general government was reduced appreciably. A slowdown in the profits of companies, however, led to a decline in corporate saving.

Considerable further success was also achieved in the second quarter in improving the balance of payments. The demand for imports continued to decline, while both the prices and volume of exports rose for the seventh consecutive quarter, mainly as a result of an increasing foreign demand for South Africa's mining products. More favourable agricultural conditions led to lower agricultural imports and moderately higher agricultural exports. As a ratio of gross domestic product, the surplus on the current account of the balance of payments amounted to 4½ per cent, which is large by any standard.

In addition, the net outflow on the capital account of the balance of payments decreased from R2 453 million in the first quarter of 1985 to only R9 million in the second quarter. This pronounced change was especially evident in the movements of short-term capital. The inflow of long-term capital declined somewhat, largely because non-residents from May onwards became net sellers of domestic securities. As a result of these changes and the considerable surplus on current account, the net gold and foreign exchange reserves increased by R1,4 billion during the second quarter, while the effective exchange rate of the rand remained relatively stable.

As expected, the delayed effects of the over-spending experienced until the middle of 1984 and of the depreciation of the rand brought about upward adjustments in administered prices and an increase in the domestic inflation rate. Measured over a twelve-month period, the rate of increase in consumer prices accelerated from 13,3 per cent in December 1984 to 16,4 per cent in June 1985, before it declined slightly to 15,9 per cent in July. The increase in unit labour costs, however, abated somewhat in the first part of 1985.

These circumstances emphasise the importance of continued fiscal restraint. In this regard it is significant that, although Exchequer issues during the first five months of the 1985/86 fiscal year increased at a rate in excess of the budgeted figures for the fiscal year as a whole, these expenditures deviated only moderately from the projected expenditures of departments for this period. Moreover, Exchequer receipts increased at an even higher rate, contributing to the financing of the deficit before borrowing without recourse to bank credit.

Against the background of the restrictive March 1985 Budget of the Central Government, the decline in total spending and the increase in the surplus on the current account of the balance of payments, the Reserve Bank progressively relaxed its monetary policy from early May onwards. To this end it lowered its refinancing rates in four steps of 1 per cent each between 6 May and 4 July. On 20 August, the Bank took the further step of setting its new formal Bank rate at 16 per cent, i.e. 1¾ per cent below the then prevailing rediscount rate on Treasury bills to discount houses. In this manner the Reserve Bank brought about a marked decline in both short-term and long-term interest rates from early May onwards.

These developments during the second quarter illustrated that the adjustment process had created a sound foundation for the resumption of positive real economic growth. Subsequently, however, socio-political developments tended to neutralise the sound economic "fundamentals" by adversely affecting overseas perceptions of the domestic economic situation. As a result, certain foreign banks became reluctant to renew maturing credits to South African banks, while non-residents became net sellers of domestic securities. In addition, leads and lags in foreign payments and receipts developed, leading to severe strains on foreign exchange holdings and a sharp depreciation of the rand. The effective exchange rate of the rand declined by as much as 27 per cent from the end of June 1985 to 27 August.

Even though this abnormal pressure on the capital account and the rand exchange rate was unrelated to the healthy underlying economic conditions in the country, it was a reality that had to be taken into account. It was therefore decided to close the foreign exchange market and the Johannesburg Stock Exchange from 28 August to 1 September 1985 as a prelude to the introduction of new restrictions on outward capital movements. These restrictions, as announced on 1 September, basically comprised the introduction of a four month "standstill" period in repayments of foreign debt and the reintroduction of the financial rand system.

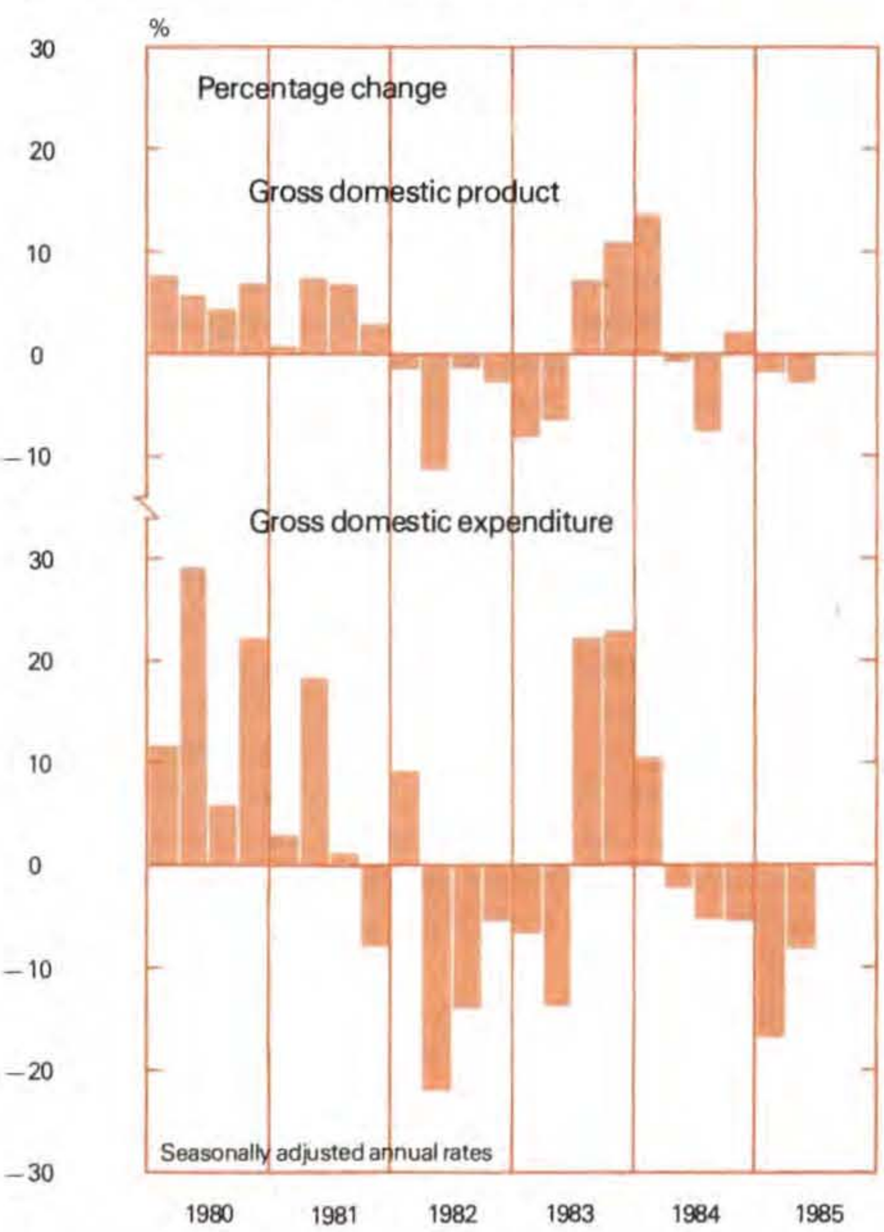
Domestic economic developments

Output

Reflecting the downward movement in economic activity, real gross domestic output continued to decline during the second quarter of 1985. Taken at a seasonally adjusted annual rate, the contraction in aggregate domestic output amounted to 2½ per cent, compared with 1½ per cent in the first quarter of the year.

The depressed domestic demand situation was responsible for further declines or lower growth in the output of nearly all the sectors of the economy. In particular, the contribution of wholesale and retail trade declined at a seasonally adjusted annual rate of 14 per cent. The contributions of construction, manufacturing, agriculture and transport, storage and communication also declined further, while the real output of all other sectors, with the exception of mining, rose moderately. Buoyant international demand conditions led to a further sharp increase in mining output.

Real gross domestic product and expenditure

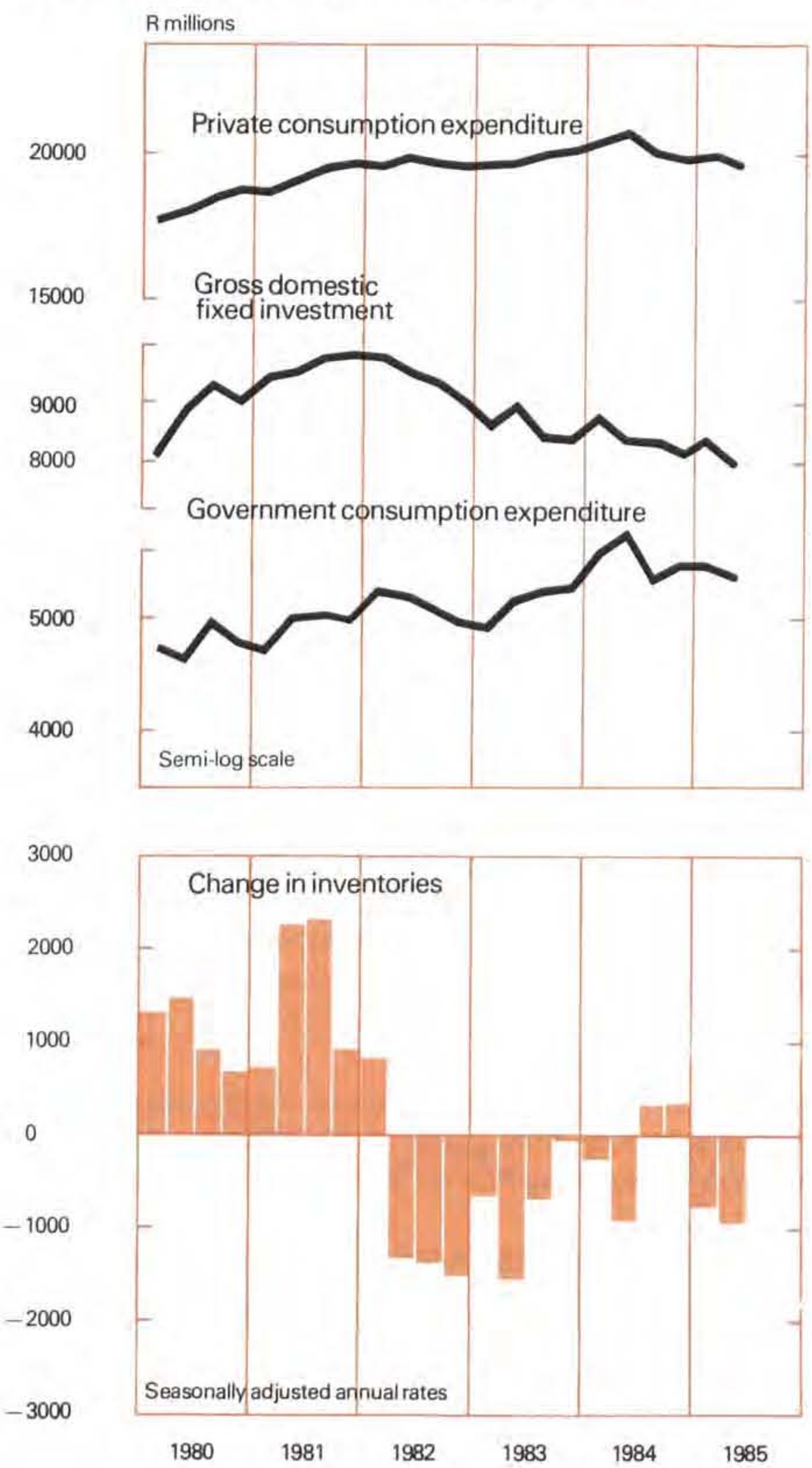


Expenditure

Real gross domestic expenditure declined at a seasonally adjusted annual rate of 8 per cent in the second quarter of 1985. All the main expenditure components contributed to this fifth consecutive quarterly decline.

At a seasonally adjusted annual rate, private consumption expenditure at constant prices declined by 5½ per cent after its downward tendency had been temporarily interrupted by an increase of 4 per cent in the first quarter of 1985. The decline during the second quarter was particularly evident in real outlays on durable goods, which decreased by 28 per cent. Expenditure on non-durable goods also declined, but at a substantially lower rate of 5 per cent. This low level of consumption expenditure continued during July and August.

Components of real gross domestic expenditure



In accordance with the commitment by the authorities not to allow real government expenditure to increase in the 1985/86 fiscal year, government consumption outlays in real terms, taken *at a seasonally adjusted annual rate,* declined by almost 8 per cent during the second quarter of 1985. Real outlays on goods and services other than salaries and wages declined to a level of 19 per cent below its recent peak in the second quarter of 1984.

Real gross domestic fixed investment, at a seasonally adjusted annual rate, declined by 13½ per cent in the second quarter of 1985. This substantial decrease was mainly attributed to declines in the real fixed capital outlays of both the public authorities and the private sector. The decrease in the real capital expenditure of public corporations amounted to only 4½ per cent. The decline in capital formation was widely dispersed among the various sectors of the economy, but was particularly evident in agriculture, construction, commerce and finance. Although the real fixed capital formation of the mining sector improved somewhat in the second quarter of 1985, it was still 27 per cent below its peak in the third quarter of 1981.

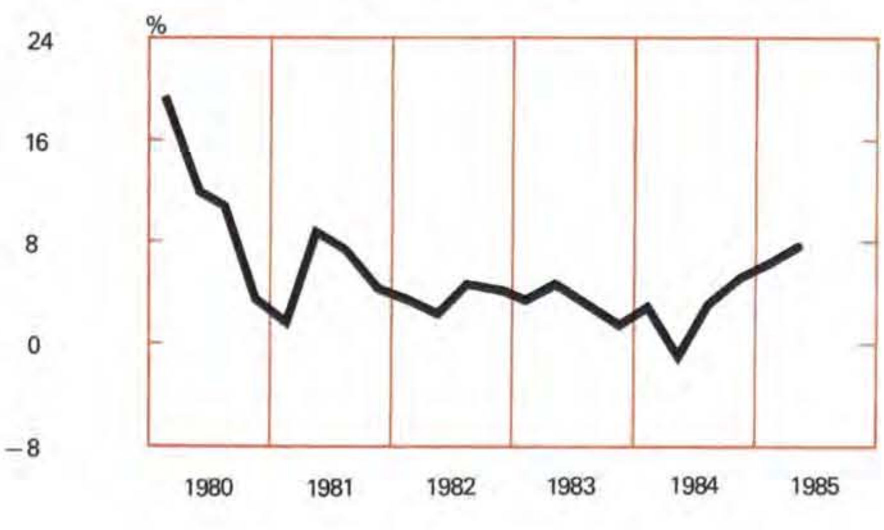
Steps were taken during the first half of 1985 to reduce inventories because of an involuntary build-up of stocks during the last half of 1984 as domestic consumption and fixed investment declined in real terms. Declines were reported in the second quarter in all inventory categories with the exception of real wholesale stocks and agricultural stocks-in-trade. As a result of the inventory run-down in the first half of 1985, the ratio of real industrial and commercial inventories to real non-agricultural gross domestic product declined from 23,8 per cent at the end of 1984 to 22,7 per cent at the end of June 1985.

Factor income and saving

Nominal factor income increased at rates well below the current rate of inflation during the second quarter of 1985. A slow-down in employment growth and a moderation of wage increases resulted in an increase in total remuneration of employees at a seasonally adjusted annual rate of only 9½ per cent during this quarter. The other main component of factor income, namely total gross operating surplus, increased by only 5 per cent because of the impact of the economic downswing on corporate profits. A large increase in the operating surplus of the mining sector reflecting higher rand export prices as well as higher export volumes of metals and minerals, was partly neutralised by declines in the operating surpluses of the sectors electricity, gas and water; commerce; and transport, storage and communication.

Despite the lower rate of increase in factor income, domestic saving improved substantially during the second quarter, and the savings ratio increased from a recent low of 20 per cent in the second quarter of 1984 to a

Ratio of personal saving to personal disposable income



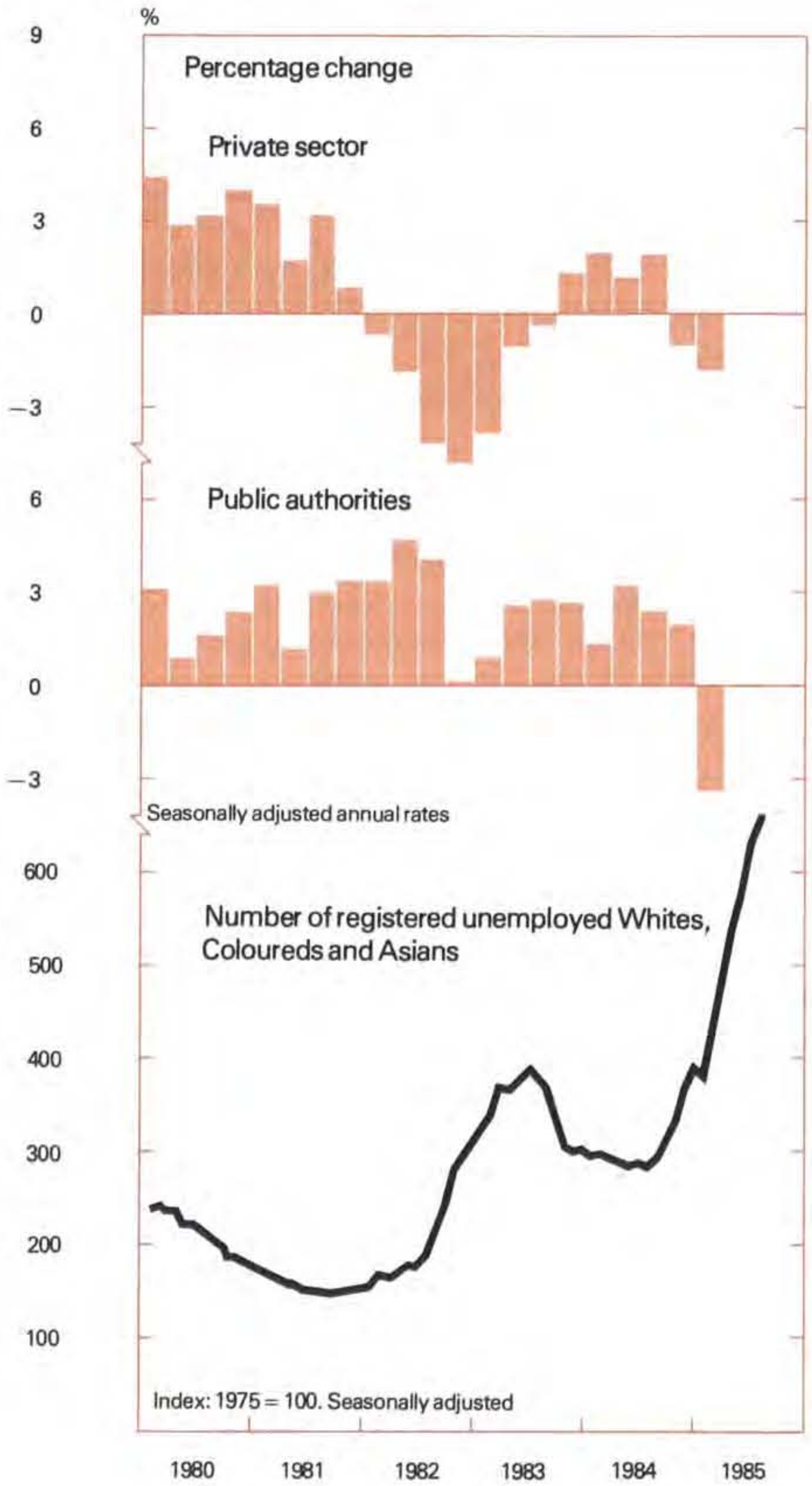
level of 26 per cent of gross domestic product. The largest contribution to this improvement came from increased savings by private households. Personal saving as a percentage of personal disposable income, in fact, changed from a negative figure in the second quarter of 1984 to a positive figure of 7½ per cent in the second quarter of 1985. General government saving remained negative, but the savings shortfall was reduced appreciably in the second quarter. Corporate saving, however, declined as company profits slowed down.

Employment*

In response to the lower domestic demand and the consequential decline in the output of goods and services in the economy from the third quarter of 1984, the demand for labour also diminished. After a sustained growth during the six preceding quarters, employment declined at seasonally adjusted annual rates of 0,2 per cent and 2,2 per cent in the fourth quarter of 1984 and the first quarter of 1985, respectively. Employment by public authorities increased at lower rates during the second half of 1984, before declining in the first quarter of 1985. This decline was the first in six years and occurred in both the general divisions and the business enterprises of the public authorities. Private-sector employment, on the other hand, showed a distinct cyclical downturn in the fourth quarter of 1984 and the first quarter of 1985. Information available for manufacturing, construction and mining for April and May indicates that this downward trend continued in the second quarter of 1985.

The net effect of the simultaneous decline in the demand for labour and the steady growth of the economically active population was an increase in unemployment among all population groups. Seasonally adjusted, the

Non-agricultural employment



number of registered unemployed Whites, Coloureds and Asians rose from a low of 29 350 in July 1984 to 40 570 in December and 67 900 in July 1985.

Labour costs and productivity

The easier labour market conditions were accompanied by a slow-down of the rise in nominal remuneration per worker in the first quarter of 1985. Measured over a four-quarter period, nominal salaries and wages per worker increased by 12,0 per cent, while in real terms they actually declined by 2,7 per cent in the first quarter of 1985.

* Employment and labour remuneration statistics refer to the non-agricultural sectors of the economy and comprehensive data are available only up to the first quarter of 1985.

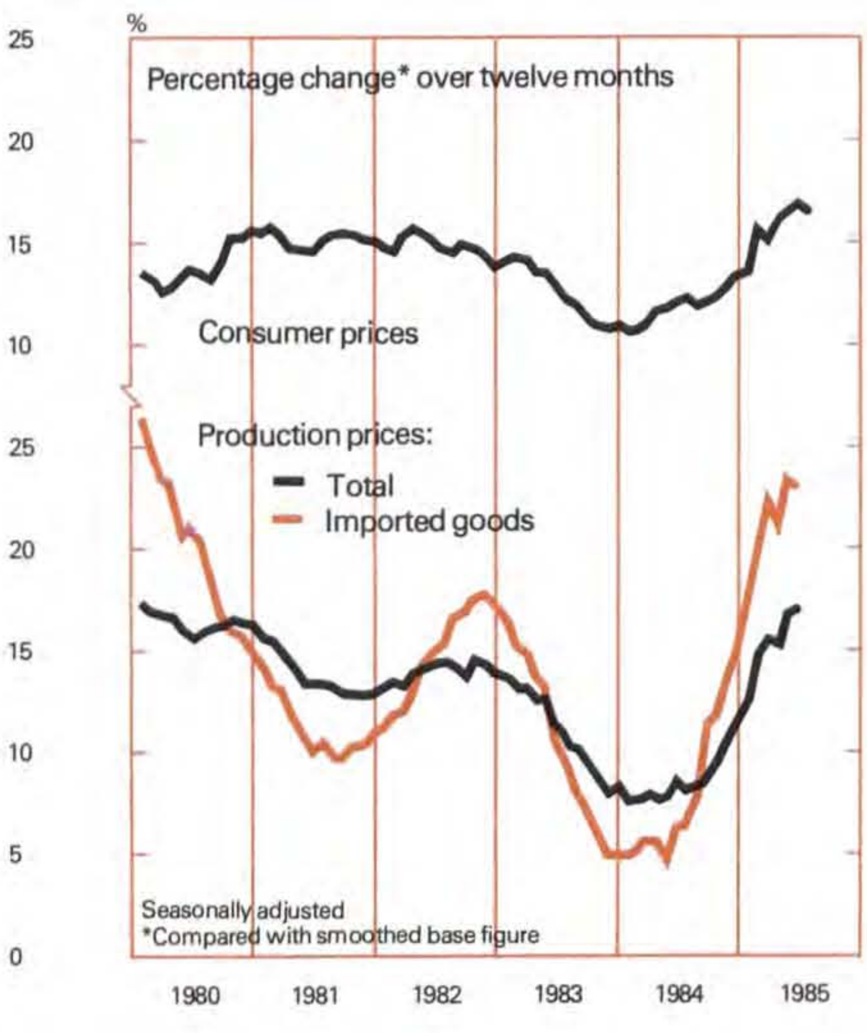
Labour productivity, as measured by the real gross domestic product per worker in the non-agricultural sectors of the economy, started to decline sharply in the second half of 1984 on account of cyclical factors. Measured over a four-quarter period, productivity declined further at a rate of 1,8 per cent in the first quarter of 1985. As a result of the decline in productivity and a further rise in nominal remuneration in the second half of 1984, the rate of increase in unit labour costs accelerated and by the fourth quarter the increase, measured over a four-quarter period, amounted to 17 per cent. In the first quarter of 1985, however, the increase in unit labour costs abated somewhat to 14 per cent because of the slow-down in the rise of nominal wages.

Prices

The rate of inflation, as measured by changes in consumer and production price indices, accelerated from the second quarter of 1984 to the second quarter of 1985. The higher rate of increase in prices initially emanated mainly from excessive monetary demand during 1983 and the first half of 1984. Although demand pressures eased substantially from the third quarter of 1984, the after-effects of overspending as well as marked increases in import prices following the earlier depreciation of the rand and delayed upward adjustments in administered prices contributed to a continued high inflation rate. Increases in the general sales tax rate, which came into effect on 1 July 1984 and 25 March 1985, also contributed to the rise in the consumer price index.

Measured over a twelve-month period, the increase in consumer prices accelerated from a recent low of 10,0 per cent in February 1984 to 13,3 per cent in December 1984 and to 16,4 per cent in June 1985, before slowing down marginally to 15,9 per cent in July. The sharp depreciation of the rand from the end of 1983 resulted in an acceleration of the rate of increase of the import price component of the production price index from a low of 3,5 per cent in May 1984 to 25,2 per cent in July 1985. The corresponding acceleration in the rate of increase in the overall production price index was from a low of 6,9 per cent in January 1984 to 17,4 per cent in July 1985.

Prices



Balance of payments

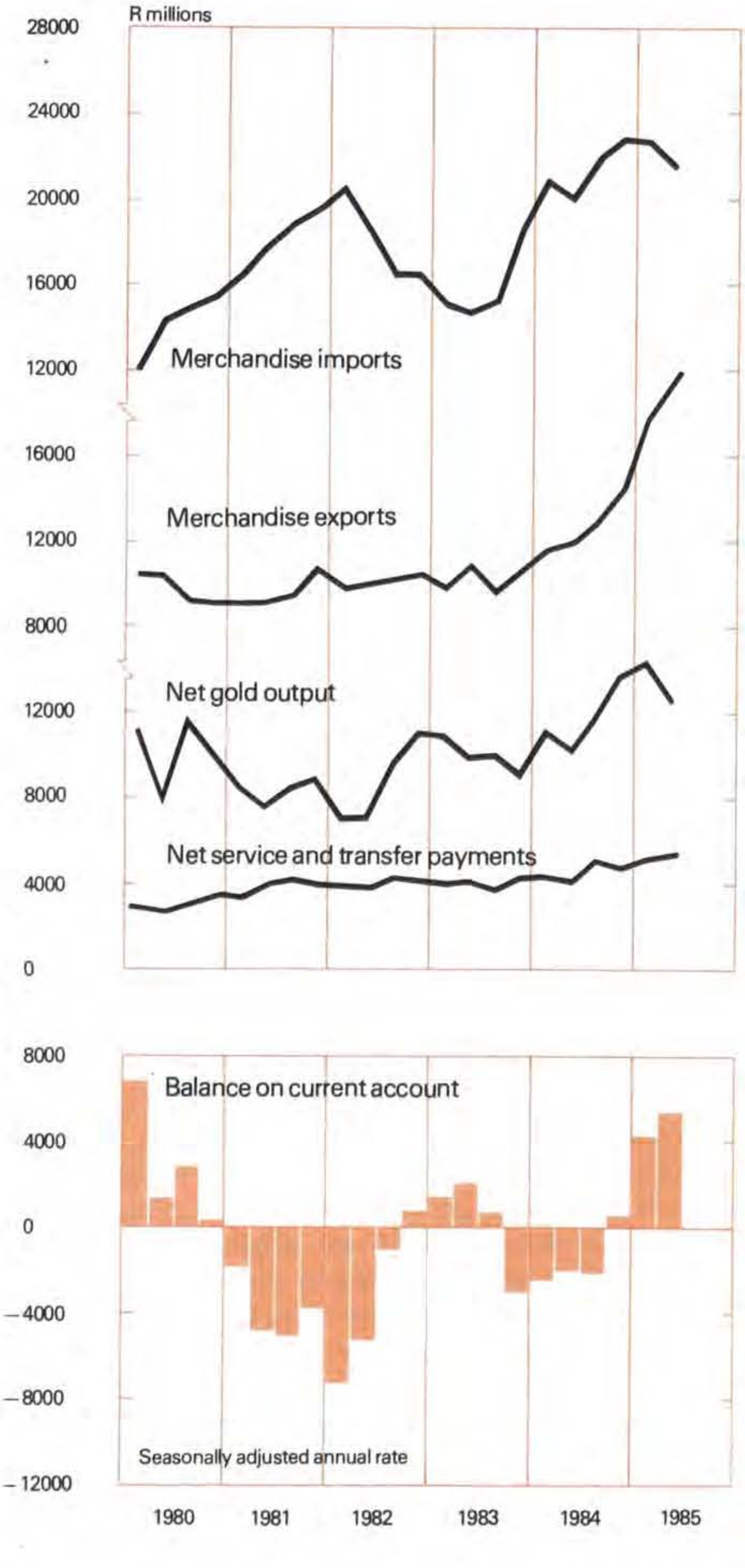
Current account

Despite a deterioration in South Africa's terms of trade, a further substantial improvement was recorded on the current account of the balance of payments during the second quarter of 1985. At a seasonally adjusted annual rate, the surplus on the current account increased from R4,3 billion in the first quarter of 1985 to R5,4 billion in the second quarter. This increase was brought about mainly by a continued sharp rise in merchandise exports as well as a further decline in merchandise imports. These developments were partly offset by a decline in the value of the net gold output and a moderate rise in net service and transfer payments to the rest of the world.

Current account of the balance of payments
(Seasonally adjusted annual rates)
(R millions)

	1985	
	1st qr	2nd qr
Merchandise exports	17 850	19 670
Net gold output	14 250	12 620
Merchandise imports	−22 630	−21 540
Net service and transfer payments	−5 140	−5 350
Balance on current account	4 330	5 400

Balance of payments : Current account



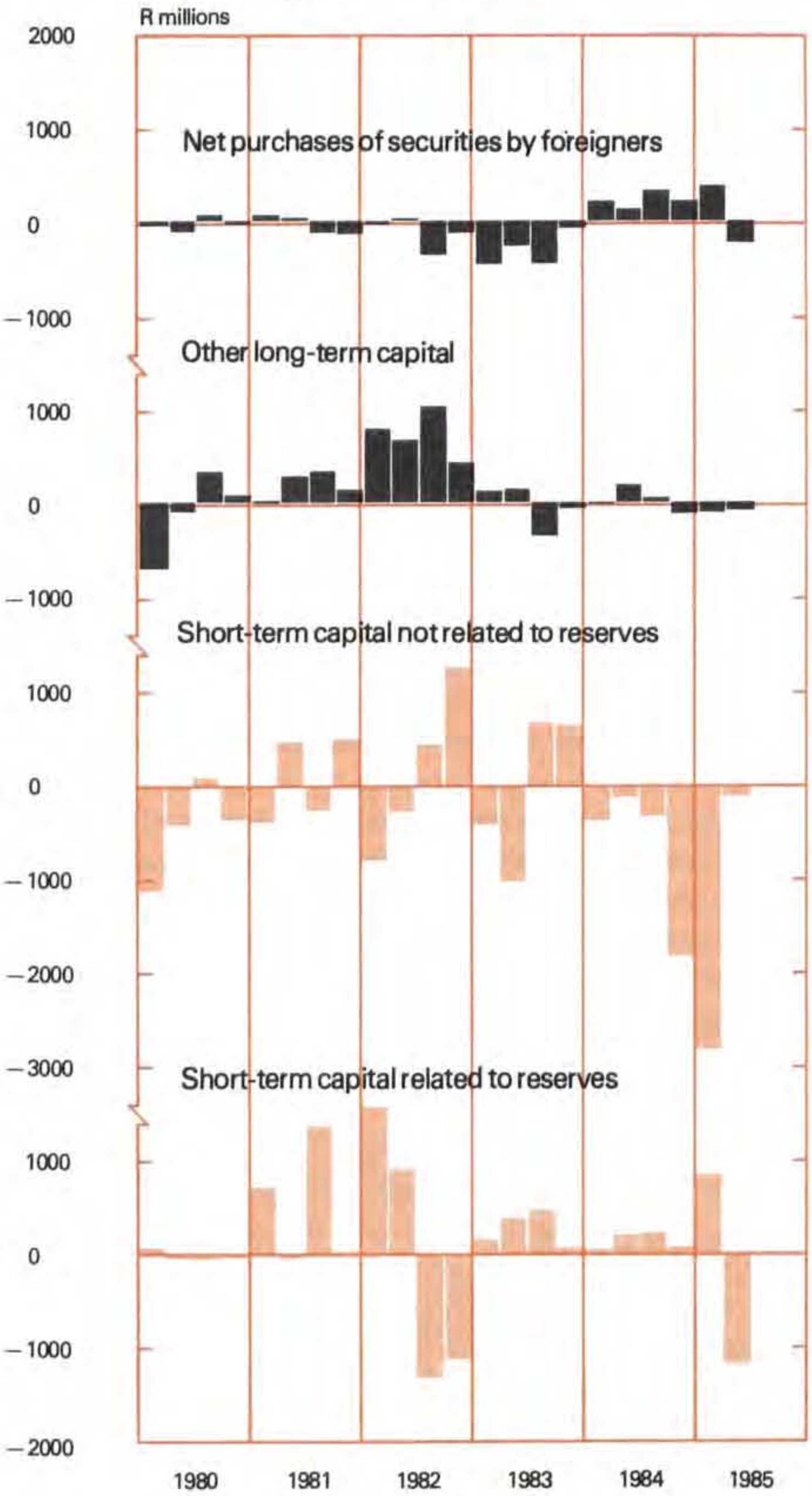
Substantial increases in both the volume and prices of exports during the second quarter of 1985, led to the seventh consecutive quarterly rise in the value of merchandise exports. This outstanding export performance was related to the rising demand for mining products stemming from the economic expansion in the industrial countries as well as to the increased price competitiveness of South African exporters. In the second quarter of 1985, this was supplemented by higher agricultural exports. Although commodity prices on international markets generally remained depressed, export prices in rand terms increased sharply owing to the decline in the effective exchange rate of the rand.

The value of merchandise imports declined further in the second quarter of 1985, reflecting a decrease of 9 per cent in the volume of imported goods and an increase of 5 per cent in import prices in terms of rand. Particularly large decreases were recorded in the import volumes of agricultural products, prepared food, chemical products and machinery and electrical equipment. On the other hand, the import volume of mineral products increased somewhat. The weak performance of the rand on exchange markets was the main contributing factor to the increase in import prices. The seasonally adjusted value of imports during July was slightly below its average monthly value during the second quarter.

A decline in volume was entirely responsible for a decrease of 11½ per cent in the value of the net gold output during the second quarter of 1985. In view of the higher rand price of gold, the mines continued with their policy of mining lower-grade ore. In addition, the quantity of ore milled also declined moderately in the second quarter. The average fixing price of gold on the London market in terms of rand increased from R617 per fine ounce in the first quarter of 1985 to R627 in the second quarter. Subsequently, it declined slightly in July, before

Gold price

Balance of payments: Capital account



surging to R787 per fine ounce in August because of the depreciation of the rand and a moderate increase in the US dollar price of gold. The latter price amounted to an average of $330 per fine ounce in August, moderately above its average of $317 in the preceding three months.

Net service and transfer payments to the rest of the world continued their upward trend in the second quarter of 1985. This further increase was mainly caused by higher payments in terms of rand in respect of freight and merchandise insurance, other transportation services and dividends and interest on foreign investments.

Capital account

During the second quarter of 1985 a net outflow of only R9 million was registered on the capital account of the balance of payments, compared with outflows of R983 million in the fourth quarter of 1984 and R2 453 million in the first quarter of 1985. This pronounced swing in the capital account was most evident in the movements of short-term capital not related to reserves, including unrecorded transactions. The net outflow of such short-term capital fell from R2 808 million in the first quarter of 1985 to only R113 million in the second quarter. This significant decline was related, *inter alia,* to a decrease in repayments on foreign trade credits and the absence of any significant unfavourable leads and lags in foreign payments and receipts during the three-month period.

Despite a substantial increase in loan capital obtained abroad by public corporations, the net inflow of long-term capital declined from R355 million in the first quarter of 1985 to R104 million in the second quarter. This decrease to a large extent reflected net repayments on foreign loans by the Central Government and a reversal of the inflow through security transactions of non-residents on the Stock Exchange. After non-residents had been net purchasers of domestic securities to the extent of R1 303 million in the preceding sixteen months, they became net sellers of such securities from May onwards. During the three months up to the end of July these sales amounted to R467 million.

From the last week of July, the capital account of the balance of payments deteriorated substantially, particularly after certain foreign banks had made known their intention to call up maturing credit facilities provided to

South African banks and other enterprises. The concern that these actions might prove contagious understandably brought about new unfavourable "leads and lags" and caused the rand to depreciate substantially.

These developments forced the authorities to suspend trading on the foreign exchange market and to close the Johannesburg Stock Exchange for three trading days as from 28 August, as a prelude to the introduction of the new restrictions on outward capital movements. These restrictions, as announced on 1 September, basically comprised the introduction of a four-month "standstill" period for foreign debt repayments and the reintroduction of the financial rand system.

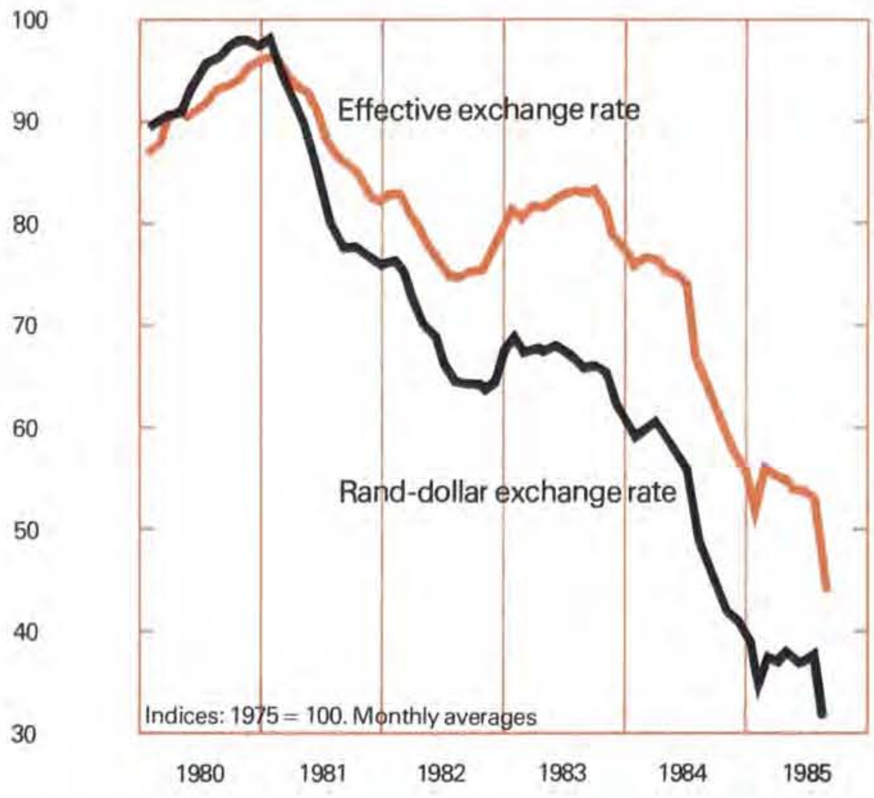
Foreign reserves

The substantial surplus on the current account of the balance of payments and the improvement on the capital account caused the total net gold and other foreign reserves to increase by R1,4 billion in the second quarter of 1985. This increase largely reflected a reduction by the Reserve Bank and other banking institutions of their reserve-related foreign liabilities by R1,2 billion during this quarter. Despite the subsequent negative developments on the capital account referred to above, an increase of R110 million was still recorded in the total net gold and other foreign reserves during July. However, in August the net gold and other foreign reserves of the Reserve Bank declined by R535 million.

Exchange rates

After the external value of the rand had increased during the first quarter, it drifted moderately downwards during the second quarter of 1985 and the first part of July. Political uncertainties and the withdrawal of foreign short-term capital subsequently resulted in a sharp depreciation of the rand from the last week of July to a new record low of 34,8 US cents on 27 August. Between the end of June and the temporary closure of the domestic foreign exchange market from 28 August to 1 September, the effective exchange rate of the rand declined by 27,2 per cent. Over the same period the depreciation of the rand against the main currencies ranged from a low of about 26 per cent against the US dollar to a high of just more than 34 per cent against the Swiss franc.

Exchange rates of the rand



When the foreign exchange market reopened on 2 September 1985, the Reserve Bank quoted its opening middle rate of exchange at 41,50 US cents. Between that morning and 16 September the rand-dollar rate ranged from 37,95 to 45,00 US cents. The weighted average value of the rand increased by 12 per cent from 27 August to 16 September.

In relatively thin trading the financial rand opened at 37 US cents per rand on 2 September 1985, reflecting a discount of 17,8 per cent compared with the discount of 16,1 per cent on 4 February 1983, when the financial rand was last quoted. Subsequently, the financial rand discount narrowed to 7,8 per cent on 16 September 1985.

Changes in the exchange rates of the rand*

%

	Dec 1984 to Mar 1985	Mar 1985 to Jun 1985	Jun 1985 to 27 Aug 1985	27 Aug 1985 to 16 Sept 1985
Weighted average	5,0	–5,0	–27,2	12,0
US dollar	6,0	–4,9	–25,9	10,4
British pound	–1,6	–8,2	–31,1	14,8
German mark	3,9	–5,9	–32,6	14,8
Swiss franc	6,1	–6,4	–34,1	15,5
Japanese yen	5,7	–5,6	–29,5	12,4
French franc	3,7	–6,0	–32,7	14,9

*Based on figures as at month-ends.

Money and banking

Changes in money stock

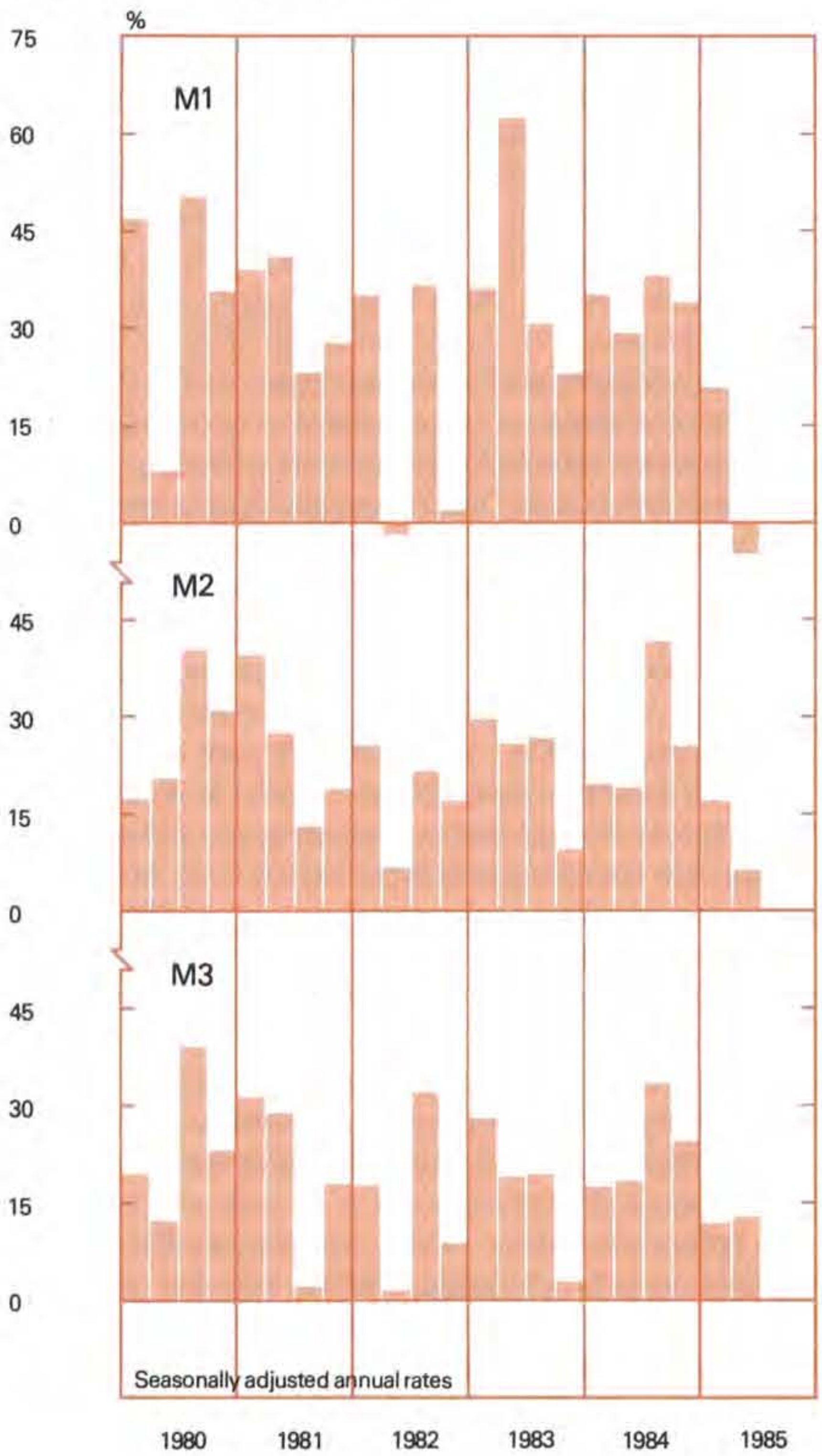
The growth rate of the money stock continued to decline steadily during the first seven months of 1985. Measured over a twelve-month period, the rate of increase of M3 declined from 24,7 per cent in November 1984 to 20,5 per cent in June 1985 and to 18,8 per cent in July. The growth rates of the more narrowly defined monetary aggregates, M1 and M2, declined in a more or less similar way, but the rates of decline exceeded that of the broader monetary aggregate M3. The comparable growth rates of M1 and M2 decreased from 39,6 per cent and 28,9 per cent, respectively, in November 1984 to 20,8 per cent and 21,3 per cent, respectively, in June 1985. This more rapid decline in the growth of the narrower monetary aggregates was caused by a shift from short-term to long-term deposits based both on actual and expected lower interest rates as well as the expected change in the term structure of interest rates. In July a slight increase in interest rates reversed this situation, and contributed to a substantial decline in the long-term deposits of the private sector with banks. Although the growth rate of M2 continued to decline in July, a slight rise was recorded in the rate of increase of M1.

The growth rates measured over a fairly long timespan of twelve months referred to above underestimate the extent of the deceleration in money growth. The tempo of short-term changes is better reflected by measuring the rates of increase of the various monetary aggregates as quarterly changes at seasonally adjusted annual rates. Measured in this way, the quarterly increases in M3, M2 and M1 declined from 24,3 per cent, 25,3 per cent and 34,0 per cent, respectively, in the fourth quarter of 1984 to 13,2 per cent, 6,0 per cent and –4,8 per cent, respectively, in the second quarter of 1985.

From the point of view of monetary control the slowdown in the rate of increase in the money stock was indeed very satisfactory during the first seven months of 1985. Moreover, the velocity of circulation of the various monetary aggregates declined further during the first quarter of 1985 and then remained more or less unchanged during the second quarter. The combined changes in the money stock and the velocity of circulation indicated a further deceleration in the rate of increase in monetary demand during the second quarter of 1985.

Net foreign reserves, which still exerted a contractionary influence on the money stock during the first quarter of 1985, overtook credit to the private sector during the second quarter as the predominant counterpart of monetary expansion. In the latter three months credit demand weakened considerably, while the overall balance of payments position changed to a large surplus. Net bank credit to the government sector remained more or less unchanged during the second quarter and then increased moderately in July.

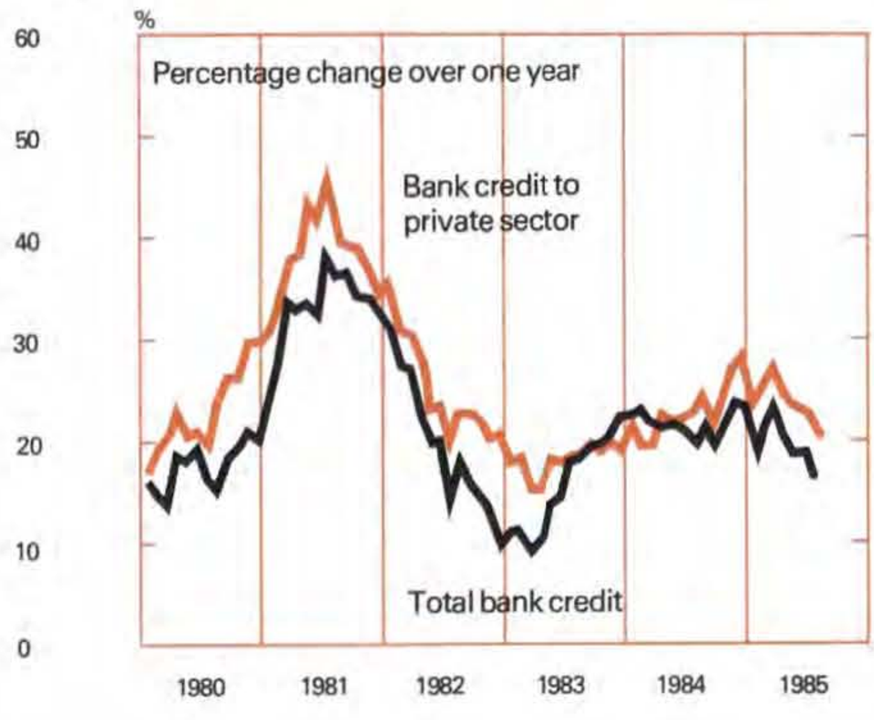
Changes in money stock



Bank credit

Despite the fact that net bank credit to the government sector remained more or less unchanged during the four months up to July 1985, total bank credit extension increased further. However, taken at a seasonally adjusted annual rate, the growth in total bank credit decelerated from 11,9 per cent in the first quarter of 1985 to 8,3 per cent in the next four months. These changes in total bank credit mainly reflected similar increases in bank credit to the private sector. At a seasonally adjusted annual rate, the rate of increase in bank credit to the private sector decelerated from 37,2 per cent in the

Bank credit



fourth quarter of 1984 to 13,0 per cent in the first quarter of 1985 and 12,0 per cent in the subsequent four months.

The continued slow-down in the credit demand of the private sector during the four months up to July was largely the counterpart of a substantial decrease in nominal gross domestic expenditure. In particular, the demand for bank credit to finance the purchases of durable consumer goods and capital expenditure declined sharply. In fact, hire-purchase credit and leasing finance provided by banks actually declined in absolute terms during the second quarter and July 1985. The demand for bank credit by companies, however, remained relatively high. Additional bank credit was still needed by companies to augment their cash flows and to capitalise accrued interest on previously existing credit transactions.

Financial markets

Reserve Bank operations in financial markets

The main objective of the Reserve Bank's operations in the financial markets during the five months up to August 1985 was the promotion of an orderly downward adjustment in short-term interest rates. The improvement in the "mix" of monetary and fiscal policy from April 1985 onwards, the decline in total spending and the large surplus on the current account of the balance of payments, induced the Reserve Bank to relax its monetary policy progressively during the period April to September 1985.

In recognition of the changed economic circumstances and the decline in money market interest rates, the Bank reduced its rediscount rates for discount houses in four steps of 1 per cent each from 6 May to 4 July. Subsequently, taking the view that the tightening in money market conditions towards the end of July and early in August was mainly the result of abnormal socio-political conditions and not caused by changes in economic fundamentals, the Bank on 20 August lowered its refinancing rates by an additional 1,75 per cent. These adjustments brought the Bank's rediscount rates for discount houses to 16,00 per cent for Treasury bills, 16,25 per cent for Land Bank bills and 16,50 per cent for bankers' acceptances. At the same time, in accordance with the recommendations of the Commission of Inquiry into the Monetary System and Monetary Policy in South Africa, the Reserve Bank re-introduced the traditional "Bank rate" as its formal rate for rediscounting Treasury bills for the discount houses. These changes were accompanied by broadly corresponding reductions in the Bank's rediscount rates for banks and in its interest rates on overnight loans to discount houses and banks.

The Reserve Bank's net sales of government stock amounted to R2 139 million during the second quarter of 1985 and to R341 million during July and August. These operations were aimed mainly at funding the Government's deficit before borrowing in a manner consistent with the strategy of reducing the rates of increase of the money supply aggregates.

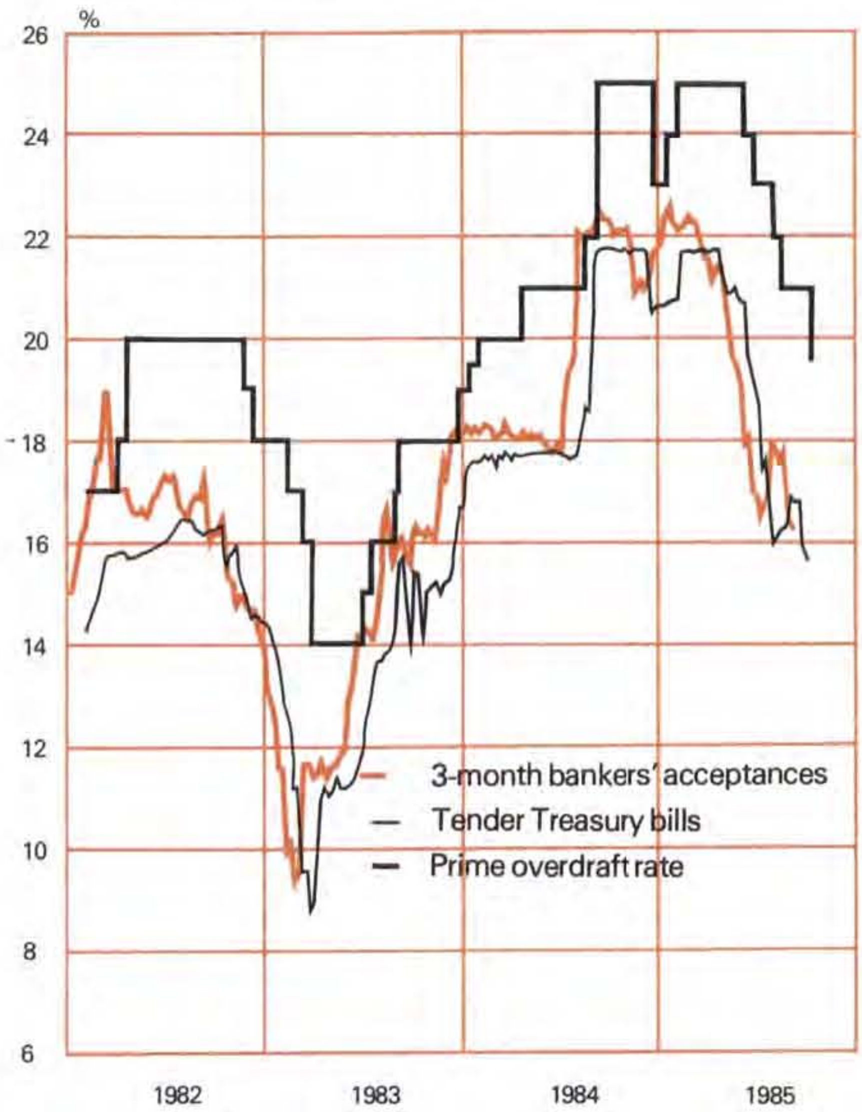
Although the Reserve Bank's operations in the foreign exchange market were undertaken largely to stabilise exchange rate movements and to acquire foreign exchange for meeting outright forward exchange commitments, they also exerted an appreciable influence on conditions in the money market during the five months up to August 1985.

In order to assist the money market over the seasonally tight August month-end, resulting from the customary large flow of tax funds to the Government, the Reserve Bank made considerable use of repurchase agreements with banking institutions from 30 August onwards. Special tax Treasury bills amounting to R500 million, which matured at the end of August, also alleviated the tight market conditions over the month-end.

The net result of the Reserve Bank's operations and other factors affecting the money market was a decrease in the Bank's refinancing in the form of rediscounts and overnight loans to discount houses and other banking institutions from a daily average of R1 921 million in March 1985 to R860 million in June. In July such refinancing increased again to R1 037 million. It then increased to R1 656 million at the end of August, before declining again to R965 million on 13 September 1985. Funds of the Corporation for Public Deposits placed with the discount houses were raised from R600 million at the end of May to R750 million at the end of June 1985 and, with minor fluctuations, were then held at this level up to 13 September 1985.

As recommended by the Commission of Inquiry into the Monetary System and Monetary Policy, the liquid asset requirements for banks were lowered to 20 per cent in the case of short-term liabilities and to 15 per cent in the case of medium-term liabilities. This was done in terms of an amendment to the *Banks Act,* promulgated on 31 July 1985. The 5 per cent requirement in respect of long-term liabilities remained unchanged, but the 5 per cent requirement in respect of acceptance liabilities and certain other contingent liabilities was abolished.

Short-term interest rates



Short-term interest rates

The progressive relaxation of monetary policy and the easing in money market conditions stemming from the lower level of economic activity, the further weakening of the private sector's demand for bank credit and the improvement in the overall balance of payments, resulted in a further decline in interest rates during June and early July 1985. The three-month bankers' acceptance rate declined from 19,00 per cent at the end of May to 16,40 per cent in the first week of July. The reductions in the refinancing rates of the Reserve Bank referred to earlier, induced the clearing banks to lower their prime overdraft rates from 23,0 per cent to 22,0 per cent on 24 June and to 21,0 per cent from the middle of July 1985.

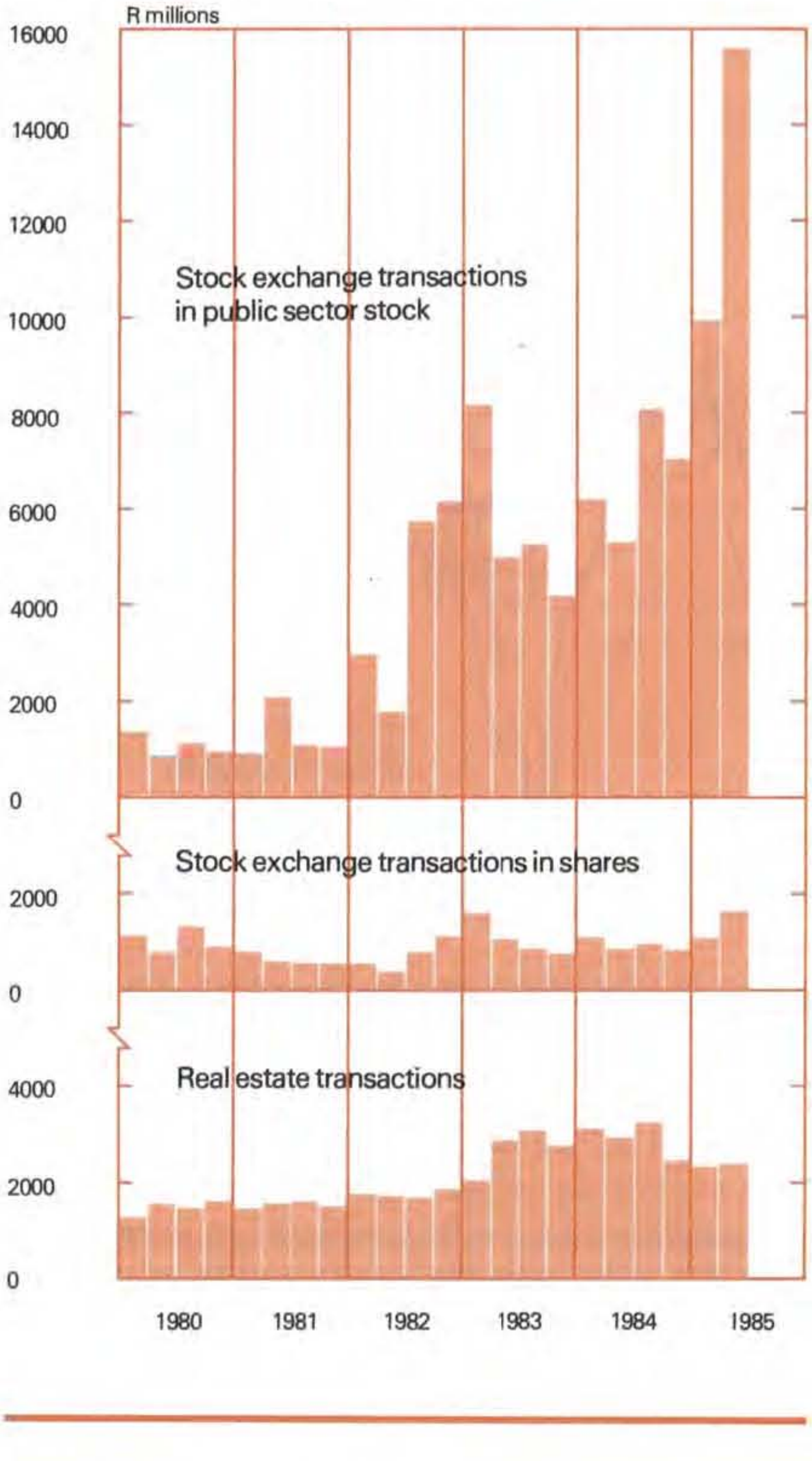
Money market conditions tightened again during the second half of July and the first half of August because of socio-political developments which caused an increased demand for foreign exchange and a concomitant sharp decline in the exchange rate of the rand. The countervailing action taken by the Reserve Bank, as set out earlier, resulted in a resumption of the downward movement in short-term interest rates. Following the Bank rate reduction of 20 August, the rates on three-month bankers' acceptances and Treasury bills, which had risen to 18,0 per cent and 17,75 per cent, respectively, on 15 August declined again to 16,25 per cent and 15,72 per cent, respectively, at the end of August. The prime overdraft rates of the clearing banks were also lowered to 19,5 per cent at the beginning of September.

In September money market interest rates declined further. The three-month bankers' acceptance rate, for example, declined to 15,60 per cent and the Treasury bill rate to 15,16 per cent on 13 September 1985.

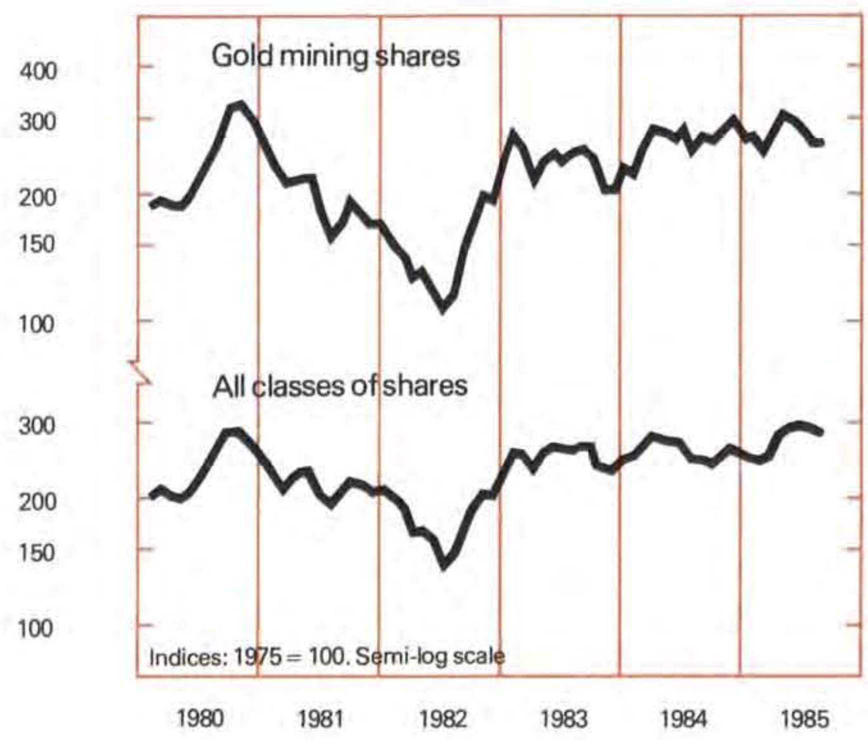
Capital market activity

The activity on the capital market rose to new record levels during the second quarter of 1985, partly as a result of an increase in the general availability of funds and the simultaneous decline in real economic activity. This is illustrated by an increase in the value of public-sector stock traded on the Stock Exchange from R9,9 billion in the first quarter of 1985 to R15,5 billion in the second quarter. In July and August the turnover of these stocks averaged R5,4 billion, compared with the average monthly figure of R5,1 billion in the preceding three months. Likewise, the value of shares traded on the Stock Exchange rose from R1,0 billion to R1,6 billion in the first and second quarter of 1985, respectively, followed by a monthly average of R0,6 billion in July and August. In contrast, activity in the fixed property market remained relatively slack, and the value of real estate transactions improved only slightly from R2,3 billion in the first quarter of 1985 to R2,4 billion in the second

Security and real estate transactions



Share prices



quarter. In July real estate transactions amounting to R0,8 billion were approximately in line with the average level during the preceding three months.

The increased turnover in shares was partly related to sales by non-residents in the wake of the disinvestment sentiment generated abroad. However, the resilience of the share market was such that this selling pressure and the consequent decline of 17 per cent in gold mining share prices did not unduly depress the average price for all classes of shares. From the recent lower turning-point in February 1985, share prices rose on average by 19 per cent to a new peak in June and then declined by 4 per cent in the next two months. After the Stock Exchange had re-opened on 2 September following the closure on 28 August, share prices showed a further decline of only 3 per cent in the first week of September.

In the primary markets, the public sector raised new funds through issues of fixed-interest securities amounting to R1 972 million in the second quarter of 1985, compared with R822 million in the first quarter. On the other hand, companies listed on the Stock Exchange made no new issues of fixed-interest securities during the first quarter of 1985 and raised only R213 million through new share capital issues in the second quarter. In view of the decline in real fixed investment, low cash flows associated with recessionary conditions, and the capitalisation of interest on existing credit, companies preferred to increase their use of bank credit. Accordingly, this credit (including leasing finance) increased by a further R212 million in the second quarter of 1985, over and above the increase of R706 million in the first quarter.

An improved net inflow of funds to building societies and participation mortgage bond schemes enabled these institutions to increase their mortgage lending from R894 million during the first quarter of 1985 to R1 111 million during the second quarter. Nevertheless, the demand for mortgage finance remained low because of the high cost of mortgage financing, and the lower growth in personal disposable income.

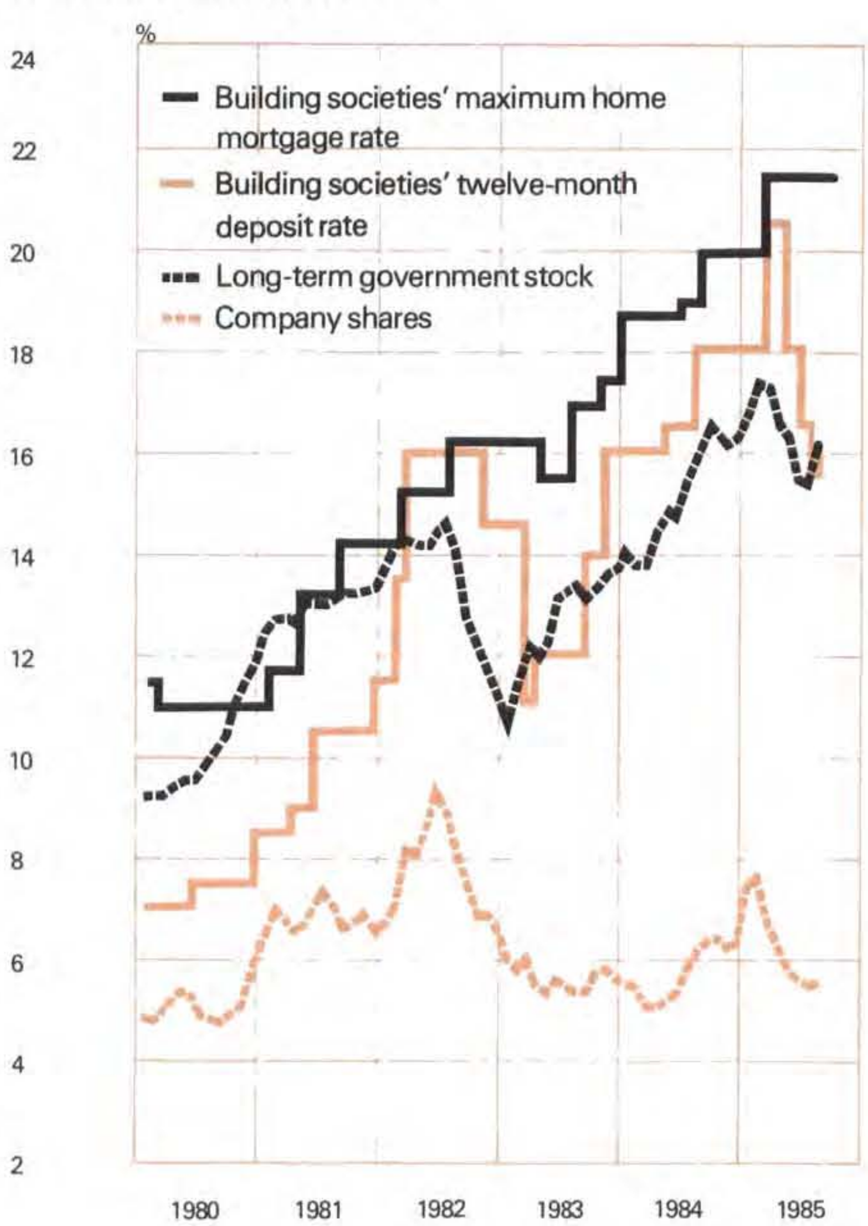
Long-term interest rates

The greater availability of funds led to an easing of long-term interest rates during most of the period under review. After these rates had reached a peak in February 1985, they moved downwards until early July, but then rose again during the remainder of the month and during August. The monthly average yield on long-term government stock decreased from a peak of 17,4 per cent in February 1985 to 15,5 per cent in June and 15,3 per cent in July, before rising again to 16,2 per cent in

August. Likewise, the average dividend yield on all classes of shares declined from 7,7 per cent in February to 5,6 per cent in June and 5,4 per cent in July before rising again to 5,6 per cent in August. The building societies' maximum home mortgage rate, which had been increased to 21,5 per cent in April 1985, did not follow the decline in other long-term yields and interest rates until early September, when rates were reduced by as much as 1 per cent. Participation mortgage bond schemes revised their mortgage rates from 23,6 per cent in January 1985 to 20,0 per cent in June and 18,3 per cent in August.

An indication of the movement in long-term deposit rates is provided by changes in twelve-month deposit rates of banks and building societies. The predominant rate on these deposits, which had been increased to 20,5 per cent in March 1985, was reduced in steps to 16,0 per cent in June and 15,0 per cent in July. In August the banks lowered their predominant rate further to 14 per cent, but the building societies raised their corresponding rate to 16 per cent.

Capital market interest rates



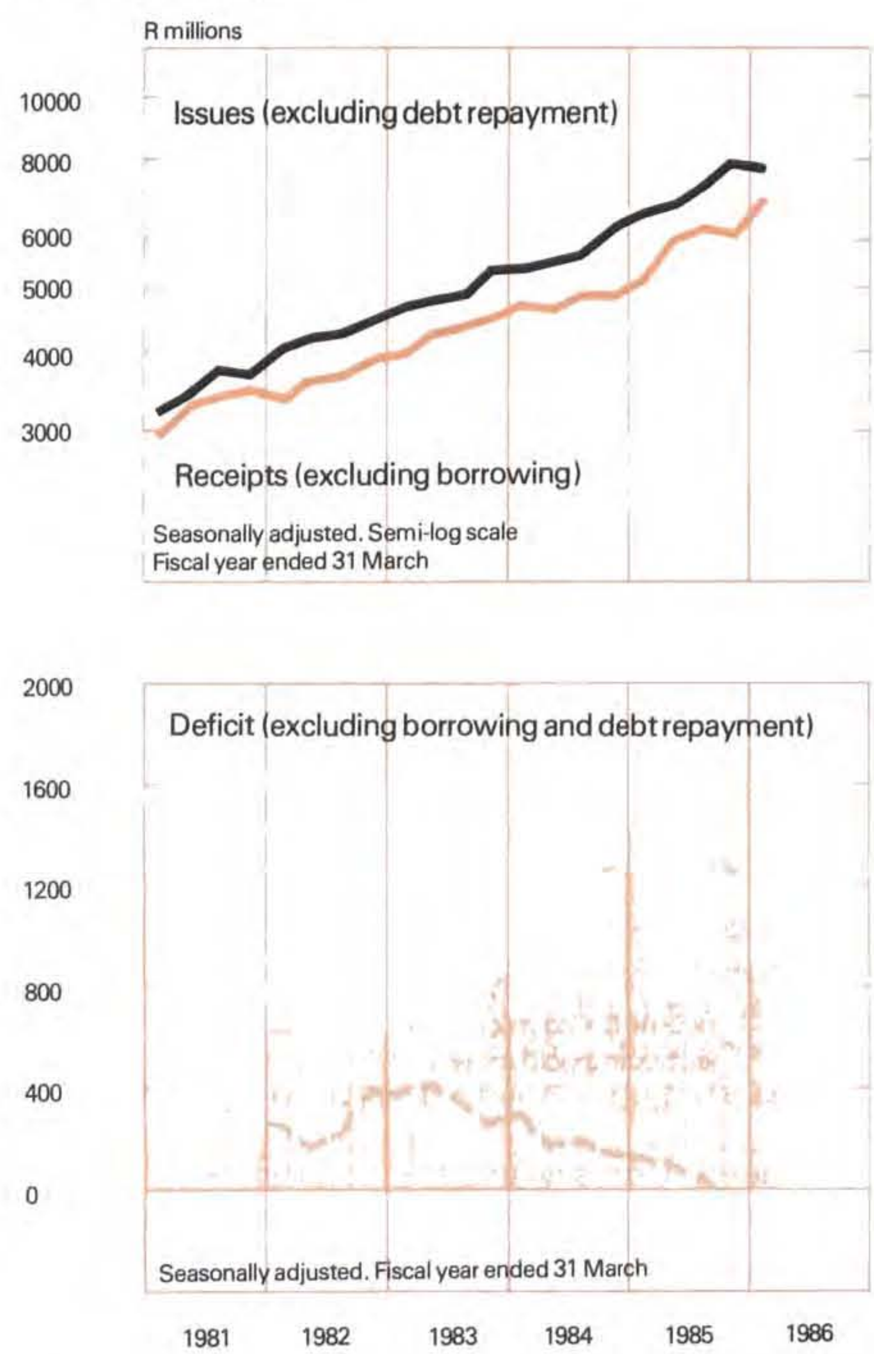
Government finance

Exchequer issues* and receipts

As during the past few years, Exchequer issues increased sharply during the first quarter of the 1985/86 fiscal year, namely April to June 1985. Compared with the same period of the preceding fiscal year, Exchequer issues to government departments increased by 18 per cent during this quarter. A substantial rise in issues during July and a very moderate increase during August, brought the growth rate of these issues to 22 per cent for the first five months of the fiscal year compared with the corresponding five months of 1984. This rate of increase, though higher than the budgeted increase in expenditure for the fiscal year as a whole, reflects only a small

* The Exchequer Account is adjusted for changes in the balance on the Paymaster-General Account

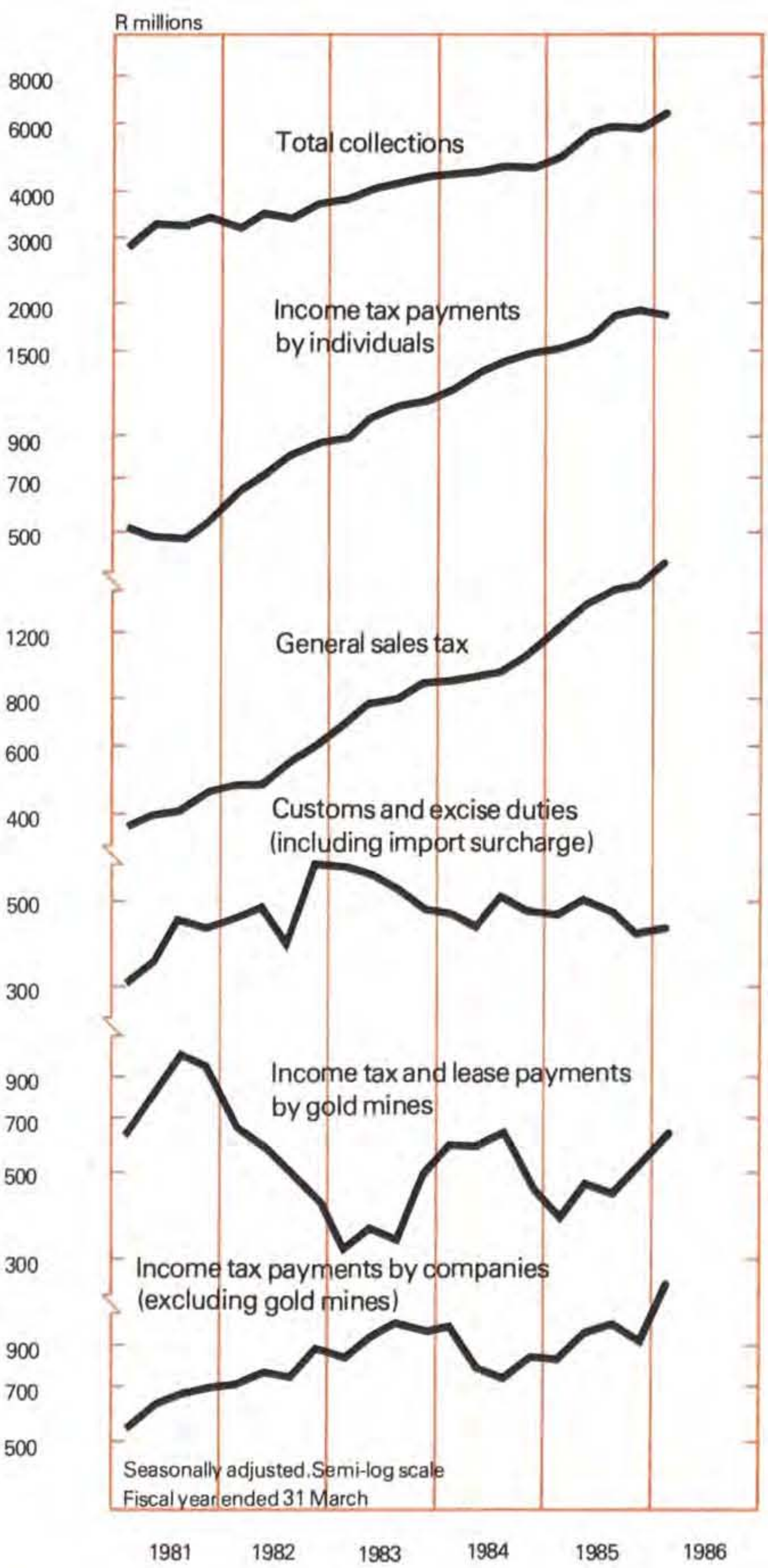
Exchequer Account



deviation from the projected expenditure of departments for the first five months of 1985/86.

Exchequer receipts, on the other hand, increased at an even more rapid rate than issues. Compared with the same quarter of the preceding year, an increase of 33 per cent was recorded in Exchequer receipts in the first quarter of the 1985/86 fiscal year. This substantial improvement in total receipts was mainly the result of higher income tax payments by non-mining companies owing to the "overflow" of tax receipts that were due in the preceding fiscal year and substantially higher receipts from general sales tax associated with the increase in this tax rate from 10 to 12 per cent. In addition, income tax payments by gold mines also rose sharply because of higher rand proceeds related to the depreciation of the rand. The lower value of imports, however, resulted in a decline in receipts from customs duties.

Revenue collections — State Revenue Fund



In July and August, Exchequer receipts accelerated even more rapidly. This brought the increase in these receipts to 34 per cent during the first five months of the fiscal year, compared with the same period during the preceding year. This rise is considerably in excess of the budgeted increase of 18,8 per cent for the fiscal year as a whole. The further acceleration in total receipts during July was due to a sharp rise in income tax receipts from non-mining companies following the recently introduced additional third provisional tax payment by companies. It represents, therefore, the shortfall between the final estimate of the relevant companies' annual tax liability and the first two provisional payments, which fall due six months after the end of their financial year. A further increase in revenue collections from gold mines was mainly responsible for the rapid rise in receipts during August.

Financing of the deficit before borrowing

The deficit before borrowing and debt repayment for the first five months of the 1985/86 fiscal year amounted to R2 217 million, or R462 million below the figure of the corresponding period in the preceding year. Data available for the first four months of the fiscal year 1985/86 indicate that the higher deficit of R2 982 million for this period was financed without recourse to bank credit. It is also evident that by the end of July a substantial part of the Government's borrowing requirement for the whole 1985/86 had already been satisfied.

During the first four months of 1985/86 the deficit was financed from the following sources:

	R millions
Public Investment Commissioners	1 067
Non-bank private sector	2 131
Monetary banking sector	–264
Foreign sector	48
Total	2 982