Quarterly economic review

Introduction

The period since the middle of 1984 has been characterised by a downward adjustment in the economy from the previously prevailing unsustainably high level of total expenditure. In response to the more resolute application of stabilisation policy, real gross domestic expenditure and its main component, real private consumption expenditure, have declined continuously. In the first quarter of 1985, the former was 6½ per cent and the latter 7½ per cent below their levels in the second quarter of 1984. Inevitably, the decline in spending has resulted in a marginal decrease in real gross domestic product and a rise in unemployment. Thus, over the nine months to the first quarter of 1985 the decline in total real gross domestic product accumulated to 2 per cent.

The successful curbing of excessive spending, assisted by a considerable increase in exports, has had the beneficial result of transforming the deficit on the current account of the balance of payments into a surplus. In the first quarter of 1985 this surplus amounted, at a seasonally adjusted annual rate, to about R4,2 billion. The current account surplus from the fourth quarter of 1984 onwards has been accompanied by an appreciable reduction in South Africa's net foreign indebtedness. In addition, the stronger balance of payments has found expression in a more stable exchange rate of the rand. Significant progress has, therefore, been made in achieving the initial objectives of the current stabilisation policy, namely to curb total spending and to strengthen the balance of payments and the exchange rate of the rand.

The further short-term policy objective of lowering the rate of inflation has not yet materialised. Already the pressure of excess demand has been eliminated, but the beneficial effect of that is bound to be reflected in prices only with a time lag. For the time being, price rises are still accelerating as several delayed administered and other price adjustments are made in the wake of the excess demand situation of 1983/84 and the accompanying sharp depreciation of the rand between September 1983 and January 1985.

The money supply figures themselves have continued to be misleading and have not yet reflected the favourable results of the more restrictive monetary policy stance adopted from about the middle of 1984. During the initial phase of the economic downswing, namely the second half of 1984, the increase in the money supply accelerated notably. The key to the understanding of the monetary situation, however, was the continuing decline in the velocity of circulation of money, which indicated that the actual spending of money increased at an appreciably lower rate than the money supply itself.

The main counterpart of the accelerated increase in the money supply during the second half of 1984 was a faster expansion of bank credit to the private sector. To an important extent, this was a symptom of the process of downward adjustment in the economy. Additional credit was used, among other things, for the financing of an involuntary build-up of inventories stemming from a slackening of demand, for supplementing company cash flows and for capitalising accrued interest on credit extended previously. More recently, during the first quarter of 1985, however, the rate of increase in bank credit to the private sector and in the money supply has slowed down considerably.

The heavy reliance placed on monetary policy until March 1985 naturally meant that interest rates had to rise to levels higher than they might otherwise have been. Accordingly, the March 1985 Budget of the Central Government was designed to increase the share of fiscal policy in the overall policy "mix". To this end, the Budget "deficit before borrowing" was restricted to an amount that could be financed by means of borrowing in the domestic market without contributing to any upward pressure on interest rates.

The better balance between monetary and fiscal policy embodied in the Budget and the relatively small borrowing requirement of the Government in the 1985/86 fiscal year have created expectations of a prospective decline in interest rates. In addition, the cooling down of the economy, the weakening of the private sector's demand for bank credit, the improved balance of payments and the more stable exchange rate of the rand have not only served to confirm these interest rate expectations, but have contributed to an actual decline in rates from the middle of March onwards.

Recognising the better alignment of monetary and fiscal policy as well as the fundamental change in economic circumstances from the middle of 1984 and the decline in interest rates that had already occurred, the Reserve Bank on two occasions during May lowered its refinancing rates by predominantly 1 per cent. As part of the general downward movement of interest rates, the clearing banks' prime overdraft rate declined from 25 to 23 per cent during May.

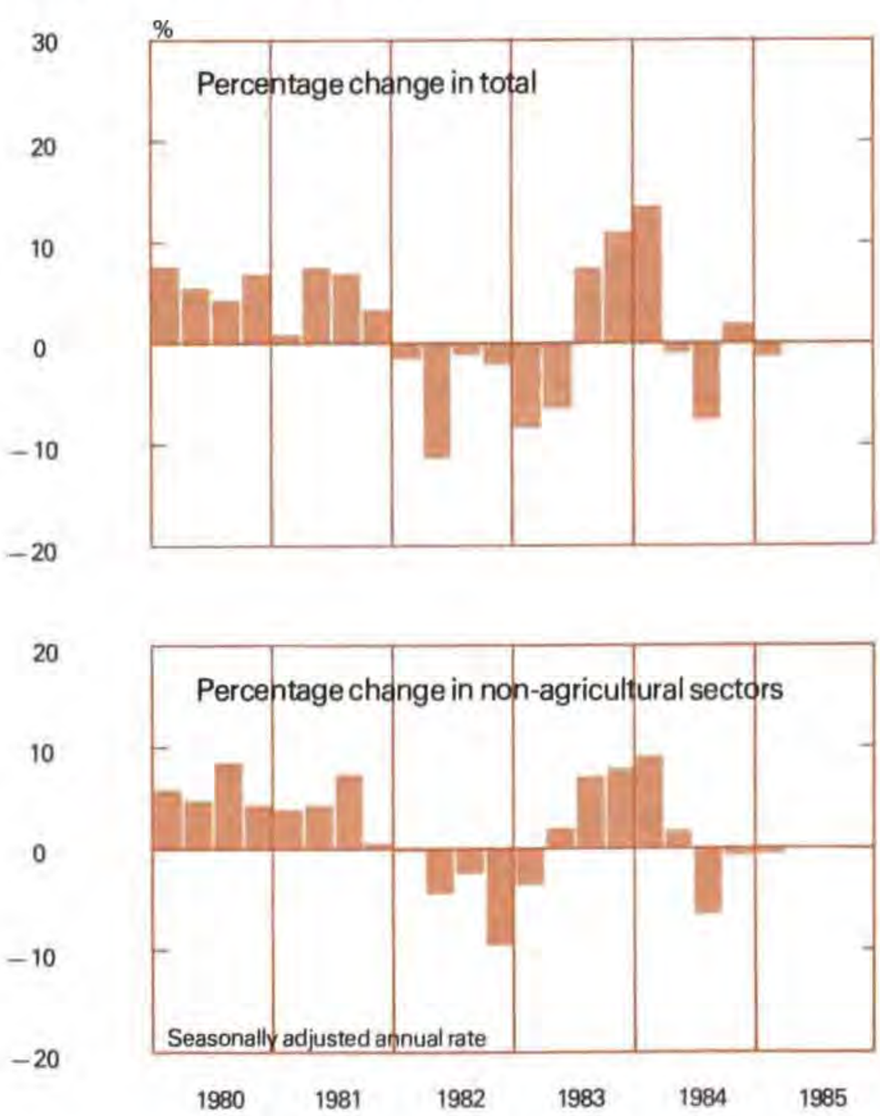
Domestic economic developments

Domestic output

The downswing in the South African economy from about the middle of 1984 continued in the first quarter of 1985. Real gross domestic product, which had risen temporarily in the fourth quarter of 1984 because of a fortuitous increase in real agricultural output, resumed its moderately downward course in the first quarter of 1985. Considering only the real gross domestic product of the non-agricultural sectors, a continuous decline occurred from the third quarter of 1984 to the first quarter of 1985.

A sectoral breakdown of changes in real output shows a significantly diverse picture. The real output of the export-orientated mining sector rose substantially further, while that of the sectors electricity, gas and water; general government; and other services (excluding financial and transport services) also increased, but at lower rates than in the preceding quarter. Real manufacturing output remained more or less unchanged. In contrast, sharp real output declines occurred in construction, transport, and the retail and motor trade, while a small decline was also experienced in the financial sector.

Real gross domestic product



Domestic expenditure

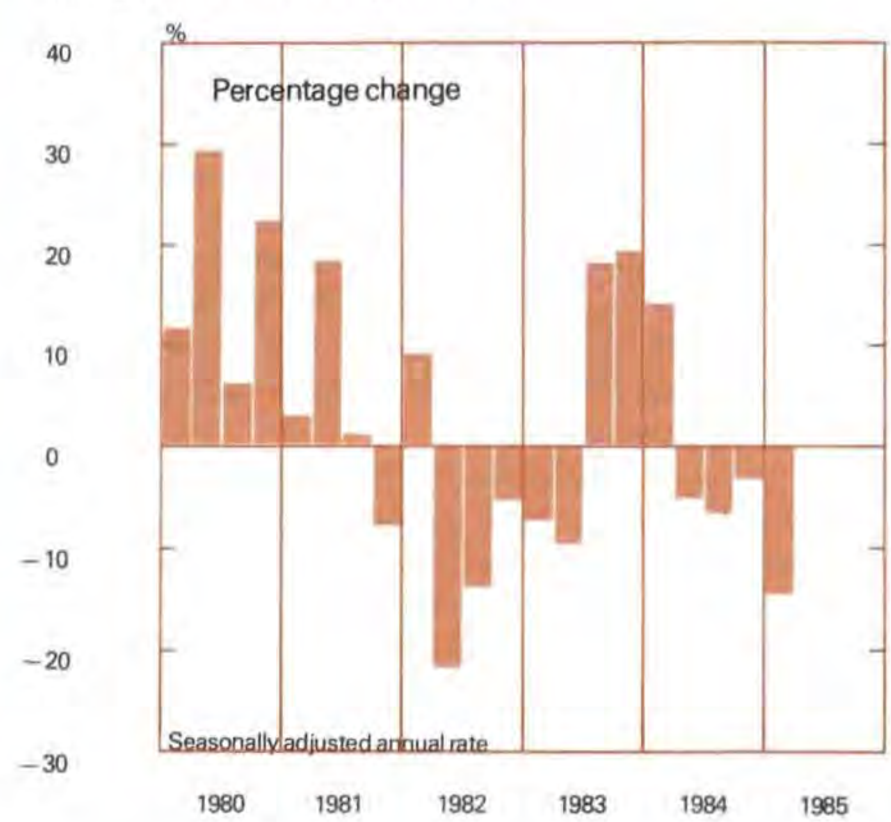
The downward movement in real gross domestic expenditure from the second quarter of 1984 gained momentum in the first quarter of 1985. Real government consumption expenditure remained approximately unchanged, but the other main expenditure components all declined in real terms.

In the case of real private consumption expenditure, the decline in the first quarter of 1985 was a continuation of the downward trend that had been in progress from about the middle of 1984. Sharp declines occurred in expenditure on durable and semi-durable goods and even outlays on non-durable goods showed a small decline. Expenditure cut-backs on durable and semi-durable goods were particularly prominent in the categories clothing and footwear, personal transport equipment, and furniture and household appliances.

As during the fourth quarter of 1984, real government consumption expenditure showed little change in the first quarter of 1985. Over the twelve months to March 1985, covering the full financial year of the Central Government and most other public authorities, real government consumption expenditure, however, rose by 4 per cent.

Real gross domestic fixed investment declined during the last three quarters of 1984 and fell to a still lower level in the first quarter of 1985. The latter decline was particularly evident in the real fixed capital outlays of public corporations and to a lesser extent in those of public authorities and the private sector. A sharp decline in the real fixed investment of Escom, the South African Transport Services and the Department of Posts and Telecommunications was largely responsible for the

Real gross domestic expenditure

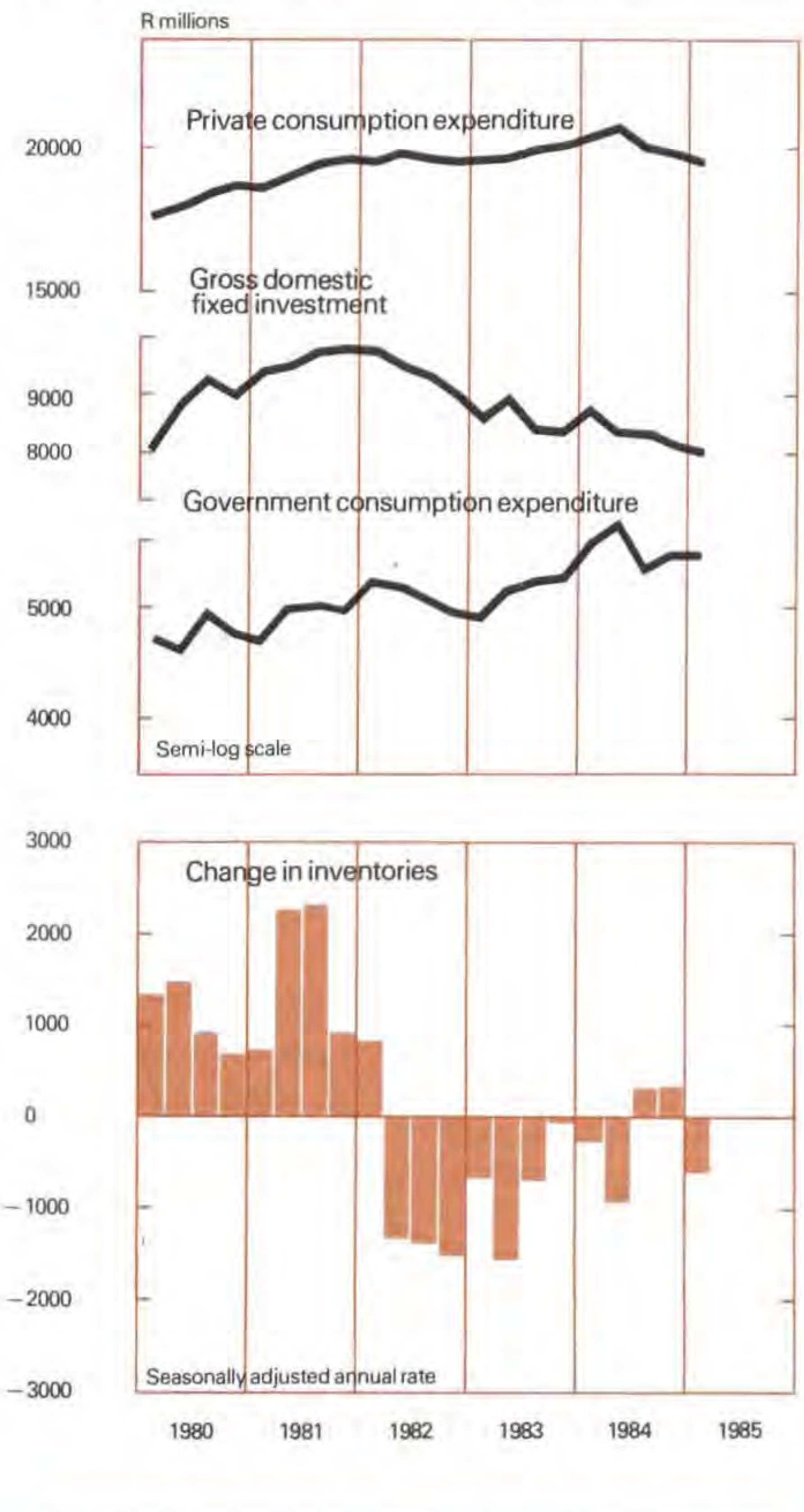


fall in the overall figure for the public sector. In the private sector, an increase in the real fixed investment of mining was more than offset by declines in that of manufacturing and construction as well as by lower real fixed investment in residential buildings.

Although the decline in the private manufacturing sector's real fixed investment during both 1983 and 1984 continued in the first quarter of 1985, the real fixed capital stock of this sector still increased marginally in the latter period. However, the real fixed capital stock of the manufacturing sector as a whole declined from the fourth quarter of 1984. Despite this decline, the utilisation of production capacity in manufacturing decreased to about 85 per cent in the first quarter of 1985, compared with its most recent peak of 87 per cent in the second quarter of 1984.

Following a temporary build-up during the second half of 1984, total real inventories declined considerably in the first quarter of 1985. Consistent with the further fall in real private consumption expenditure, however, real commercial inventories continued to rise in the first quarter. In real terms, an increase also occurred in diamond stocks, but appreciable declines were recorded in mining, construction and manufacturing inventories. The ratio of real industrial and commercial inventories to real non-agricultural gross domestic product, which had risen temporarily from a recent low of 22,5 per cent in the second quarter of 1984 to 23,8 per cent in the fourth quarter, decreased marginally to 23,5 per cent in the first quarter of 1985.

Components of real gross domestic expenditure



Factor income and saving

The increase in nominal gross domestic product at factor costs decelerated from 20 per cent in the fourth quarter of 1984 to 15½ per cent in the first quarter of 1985. Over this period, the increase in the one component, namely remuneration of employees, slowed down from 15 to 12 per cent, while the increase in the other component, namely gross operating surplus, accelerated from 20½ to 28 per cent.

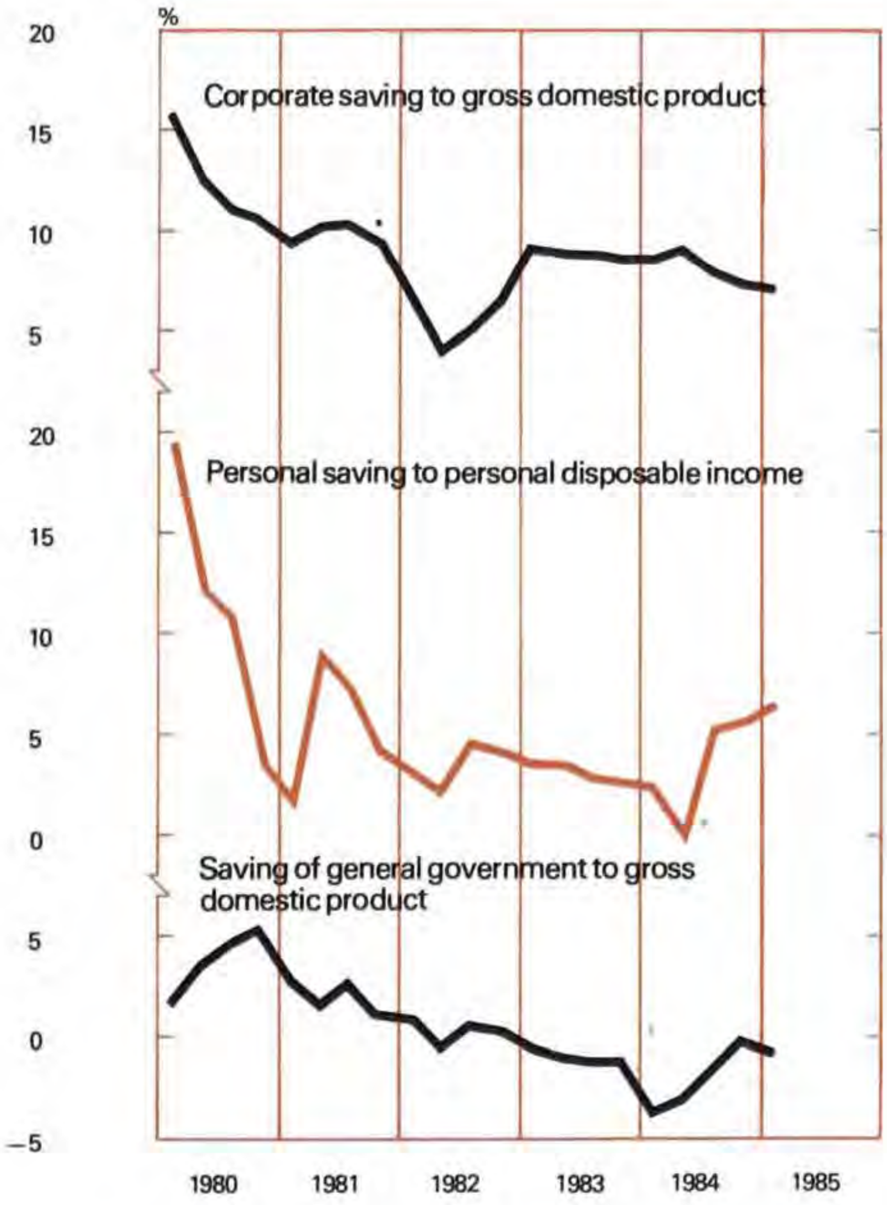
The increase in the total salary and wage bill decelerated sharply in such important sectors as manufacturing, construction and trade, largely because of reduced working hours and the retrenchment of labour. Accelerated increases were, however, recorded in the sectors general government, mining, finance, transport and communication, and electricity, gas and water.

The higher rate of increase in gross operating surplus was prominent in the mining sector, reflecting larger export volumes and higher rand export prices, and also in the case of the South African Transport Services and Escom, resulting from tariff increases. On the other hand, a slow-down of the increase in gross operating surplus occurred in manufacturing, construction, trade and finance.

Gross domestic saving increased further in the first quarter of 1985 to maintain its ratio of 25 per cent of nominal gross domestic product recorded in the fourth quarter of 1984. Previously, in the second quarter of 1984 this ratio had fallen to an all time low of 20½ per cent, compared with an average of almost 29 per cent during the period 1977 to 1983.

The increase in gross domestic saving in the first quarter of 1985 was due to higher depreciation allowances and personal saving. The increase in personal saving was in conflict with an insignificant small increase in real personal disposable income and was probably attributable to the net repayment of consumer debt. The ratio of personal saving to personal disposable income, which had actually turned negative in the second quarter of 1984, rose to 5½ per cent in the fourth quarter and to 6½ per cent in the first quarter of 1985.

Savings ratios



Corporate saving declined in the first quarter because of the lower rate of increase in the gross operating surpluses of dominant sectors such as manufacturing and trade. As during the preceding two years, general government saving was negative in the first quarter of 1985. A temporary slight improvement in this form of saving in the fourth quarter of 1984 was not sustained in the first quarter of 1985 because of increased current expenditure.

Employment, productivity and labour costs*

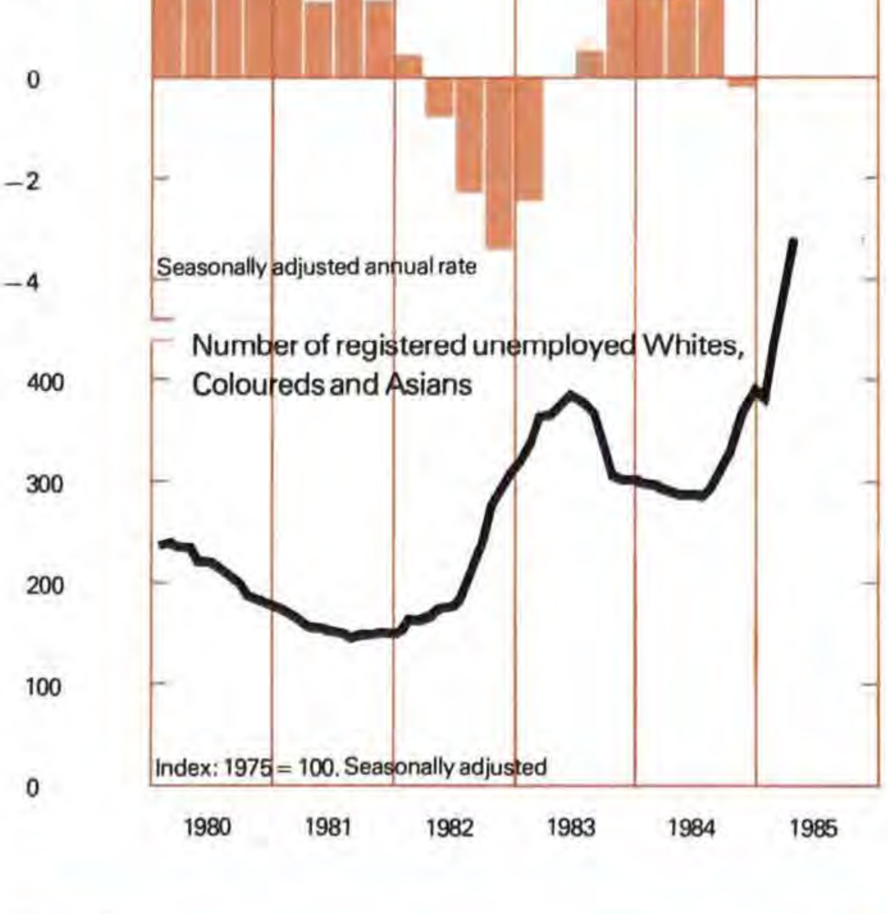
The cyclical downswing in the economy also found expression in a decline in non-agricultural employment in the fourth quarter of 1984. In the third quarter a seasonally adjusted annual rate of increase of 2,0 per cent had still been recorded, but this turned into a comparable rate of decline of 0,5 per cent in the fourth quarter. This decline was attributable to lower employment in the private sector and, according to selected statistics for part of the private sector, it continued in January. Employment by public authorities continued to rise in the fourth quarter, but at a lower rate.

In relation to a steady increase in the economically active population, the employment decline inevitably resulted in a higher rate of increase in unemployment. Seasonally adjusted, the number of registered unemployed Whites, Coloureds and Asians rose from a low of 29 350 in July 1984 to 32 430 in September and to 40 570 in December. Subsequently, the number increased even more rapidly to 55 760 in April 1985. Black unemployment, as a ratio of the economically active Black population, rose from a low of 7,6 per cent in January 1984 to 8,2 per cent in November.

Nominal salaries and wages per worker in the non-agricultural sectors increased by 15,8 per cent in 1984, compared with 12,7 per cent in 1983. This accelerated rise was due to a sharp increase in the average remuneration per employee of public authorities. In real terms, this remuneration rose by as much as 9,6 per cent in 1984. Remuneration per worker in the private sector actually showed a slower increase in nominal as well as in real terms in 1984.

Labour productivity, as measured by the real gross domestic product per worker in the non-agricultural

Non-agricultural employment



* Comprehensive statistics are available only up to the end of 1984.

Percentage change in remuneration per worker in the non-agricultural sectors

		1983	1984
Private sector	– Nominal	14,1	13,2
	Real	1,7	1,4
Public authorities	– Nominal	8,9	22,4
	Real	–2,9	9,6
Total	– Nominal	12,7	15,8
	Real	0,4	3,7

sectors, declined during the second half of 1984 and was 0,5 per cent lower in the fourth quarter than in the corresponding quarter of 1983. In 1984 as a whole, productivity still increased by 2,7 per cent, after declining by 0,2 per cent in 1983.

Owing to increased productivity and lower salary and wage increases in the private sector, the rate of increase in unit labour costs in 1984 remained at its 1983 level of
129 13 per cent. In the course of 1984, however, the increase in unit labour costs accelerated markedly and by the fourth quarter these costs had risen by 17 per cent compared with the corresponding quarter of 1983.

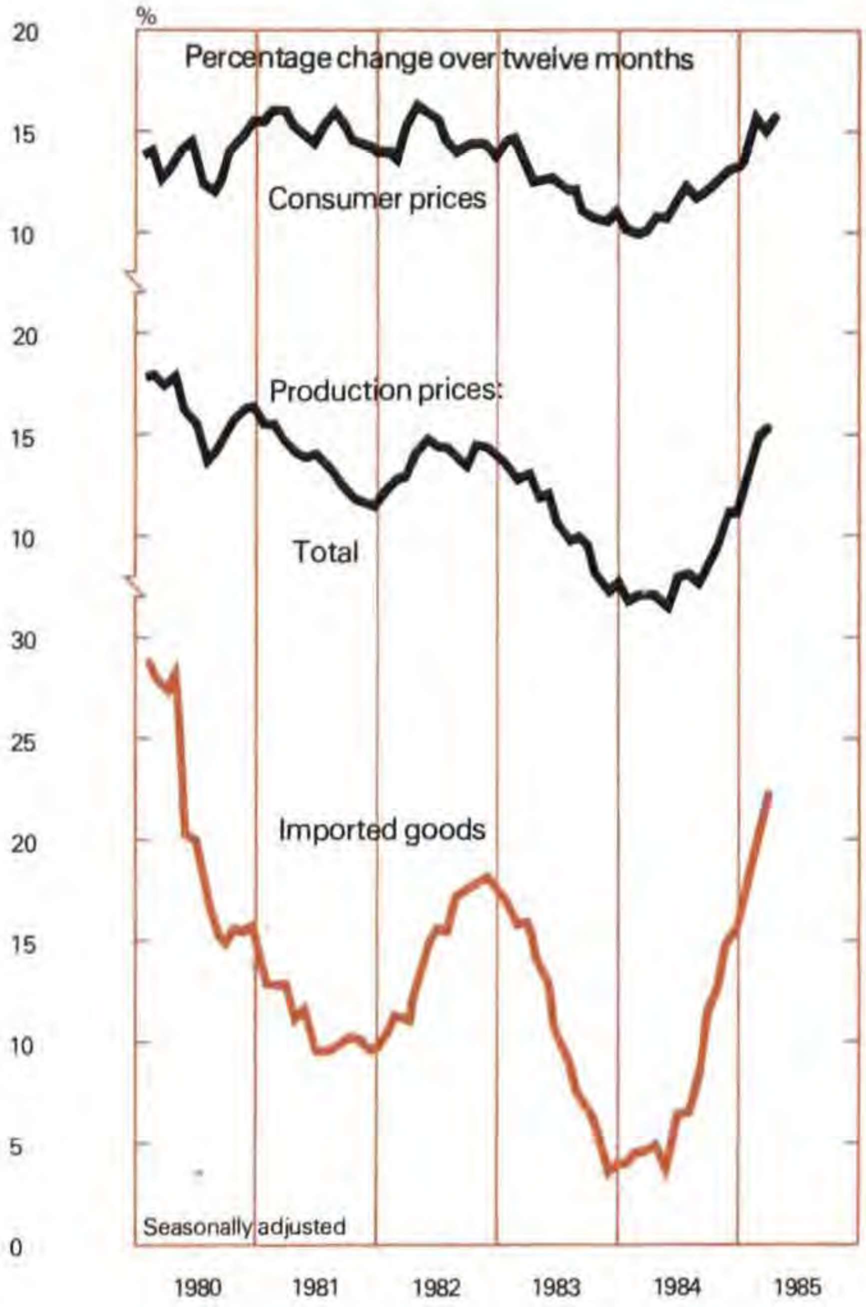
Prices

The seasonally adjusted annual rate of increase in consumer prices, which had accelerated from 11,8 per cent in the third quarter of 1984 to 13,7 per cent in the fourth quarter, accelerated still further to 19,6 per cent in the first quarter of 1985. In addition to the sharp rise in petrol prices and transport tariffs in February, higher rates of increase in other prices occurred fairly generally. The 2 per cent increase in the general sales tax rate from 25 March 1985 (contributing an estimated 1 per cent to the increase in consumer prices in April) as well as upward adjustments in certain administered prices, such as postal, telephone and transport tariffs, in April contributed to a rise of 2 per cent in the consumer price index from March to April.

Measured over a twelve month period, the increase in consumer prices accelerated from 10,0 per cent in February 1984 to 13,3 per cent in December and to 15,8 per cent in April 1985.

Prices of imported goods started to rise at considerably higher rates from the third quarter of 1984, reflecting with some time lag the effect of the sharp depreciation of the rand between September 1983 and January 1985. At a seasonally adjusted annual rate, the increase in the import price component of the production price index accelerated from 7,4 per cent in the second quarter of 1984 to 33,4 per cent in the first quarter of 1985. The corresponding acceleration in the rate of increase in the overall production price index was from 10,4 per cent to 23,2 per cent. Measured over a twelve-month period, the increase in production prices accelerated from 6,6 per cent in May 1984 to 11,4 per cent in December and to 15,5 per cent in March 1985.

Prices



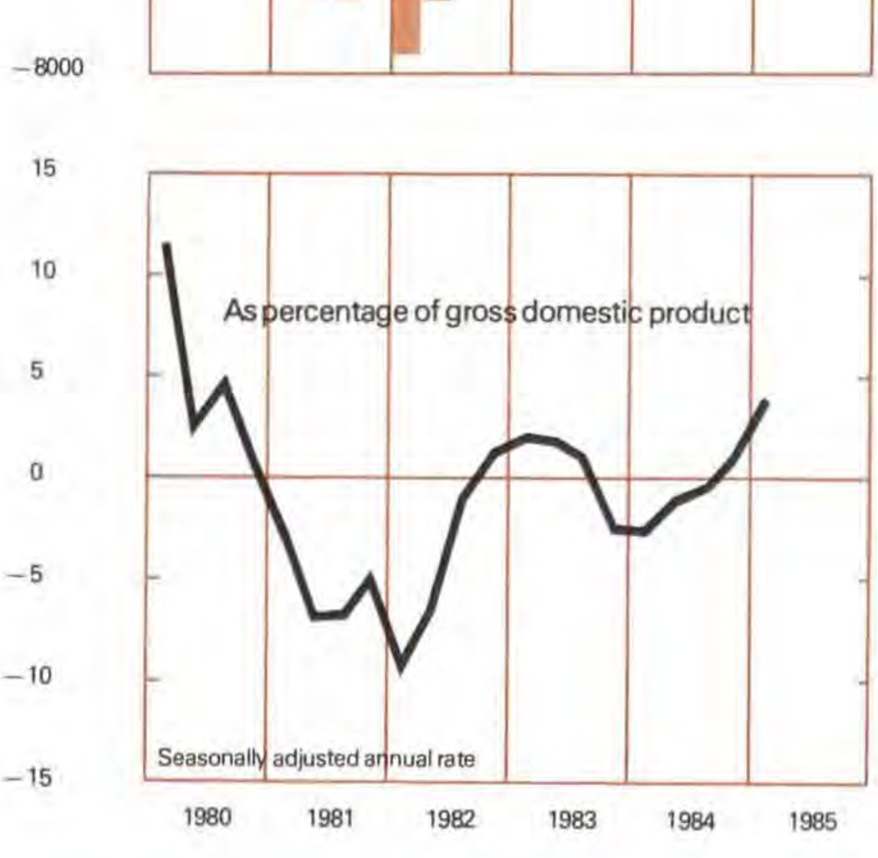
Balance of payments

Current account

A positive result of the adjustment in the economy since the middle of 1984 was a considerable improvement in the current account of the balance of payments. In the fourth quarter of 1984 the current account moved into surplus and in the first quarter of 1985 this surplus assumed substantially larger proportions. At a seasonally adjusted annual rate, the current account surplus grew from R0,9 billion in the fourth quarter of 1984 to R4,2 billion in the first quarter of 1985. This substantially larger surplus in the first quarter was largely due to a marked increase in exports and, to a lesser extent, to a higher net gold output. Imports remained approximately at the level of the fourth quarter of 1984, while net service payments to foreigners showed an appreciable increase.

The increase in merchandise exports in the first quarter of 1985 represented a continuation of the upward trend during the preceding five quarters. However, the tempo of increase accelerated notably in the first quarter. Increases were fairly widespread among the various categories of exports, but particularly large expansions occurred in the categories mineral products, base metals, precious stones, and paper and paper products. Although a rise in export prices, mainly as a result of the depreciation of the rand, contributed to the substantial increase of about 20½ per cent in the value of exports in the first quarter, about half of the latter increase represented a higher export volume.

Balance on current account



Current account of the balance of payments*
R millions

	1984				1985
	1st qr	2nd qr	3rd qr	4th qr	1st qr
Merchandise exports	11 610	12 326	13 624	14 796	17 850
Net gold output	11 019	10 208	11 803	13 706	14 250
Merchandise imports	−21 000	−19 847	−21 721	−22 728	−22 630
Net service and transfer payments	−4 406	−4 084	−4 602	−4 868	−5 240
Balance on current account	−2 777	−1 397	−896	906	4 230

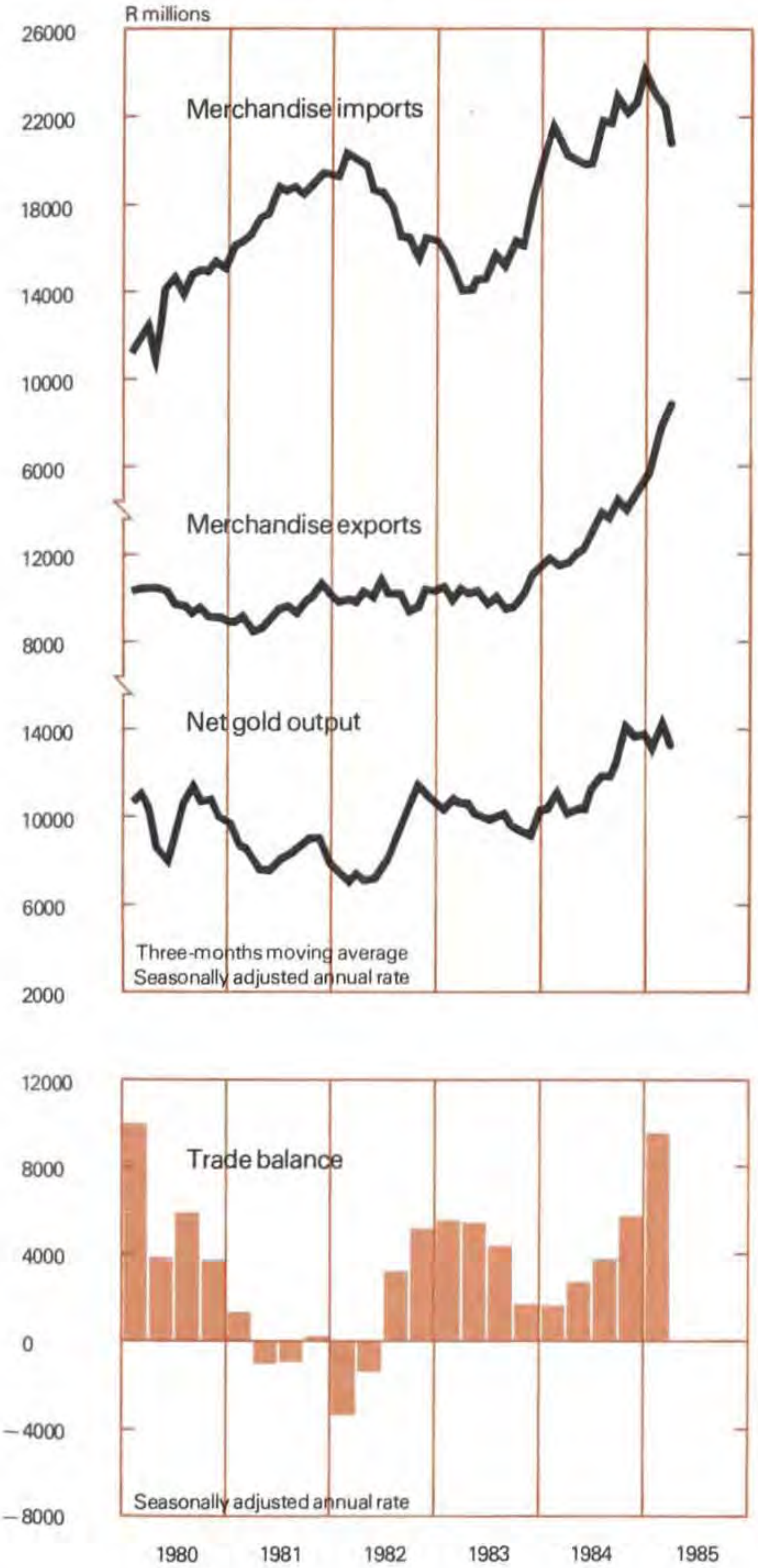
*Seasonally adjusted annual rates.

The value of the net gold output rose by about 4 per cent in the first quarter. Price and volume increases contributed about equally to this change. The rand price of gold rose from an average per fine ounce of R606 in the fourth quarter of 1984 to R617 in the first quarter of 1985 as a result of a further depreciation, on average, of the rand against the US dollar. In terms of the US dollar, the gold price on the London market declined from an average per fine ounce of $334 in the fourth quarter of 1984 to $302 in the first quarter of 1985. In April both the rand and dollar prices of gold increased, namely to averages per fine ounce of R628 and $325, respectively.

Although the value of merchandise imports remained approximately unchanged from the fourth quarter of 1984 to the first quarter of 1985, the volume of imports showed a decline of about 7½ per cent. This followed upon a decrease of about 3 per cent in the fourth quarter of 1984. The volume decline in the first quarter of 1985 was neutralised by a more or less equal increase in import prices. Value increases occurred in the import categories mineral products and chemical products, while notable declines were recorded in the categories textiles, machinery and electrical equipment, and transport equipment.

The main reason for the increase in net service payments to foreigners was a higher rand value of interest payments on foreign debt. In addition, there was also an increase in dividend payments on foreign investment in South Africa, reflecting the steady net rise in non-direct investment from the beginning of 1984.

Balance of payments: Trade account

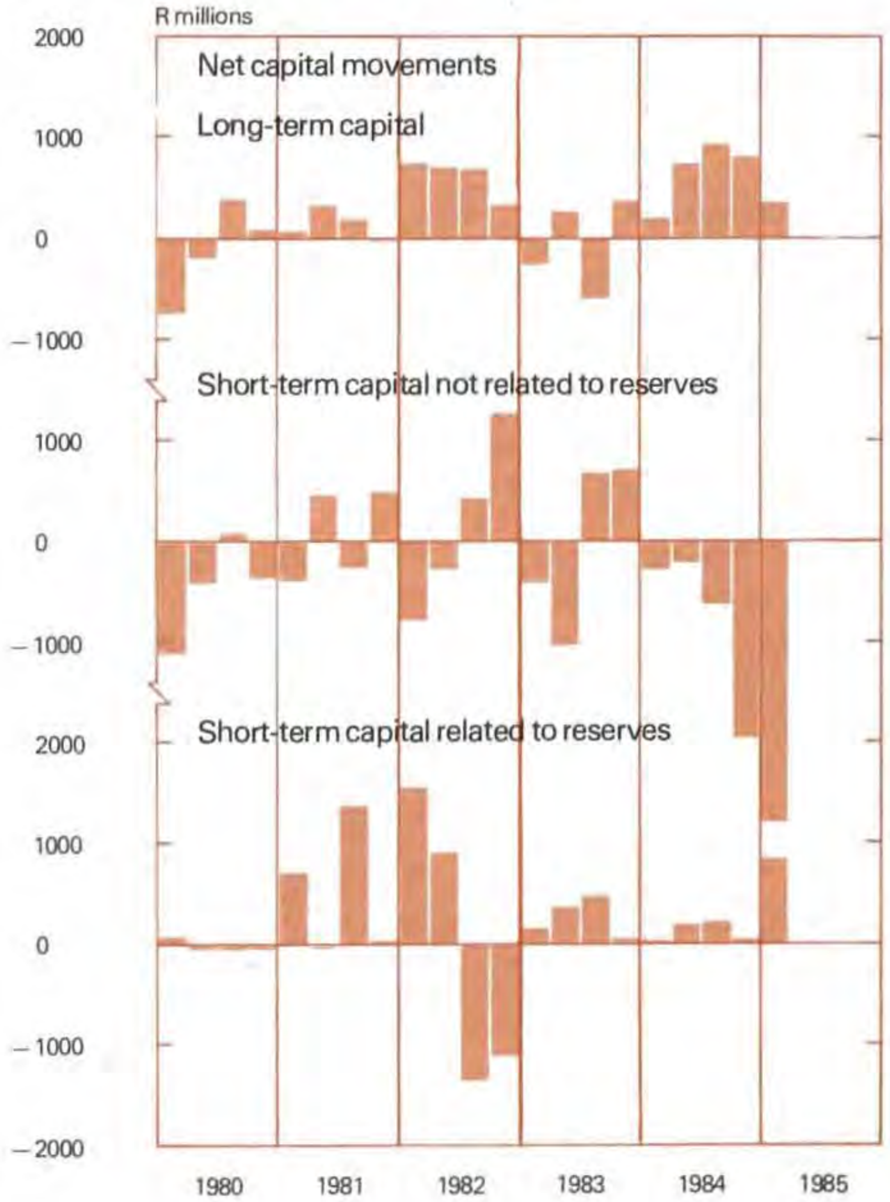


Capital account

As during the preceding four quarters, a net inflow of long-term capital in the form of net purchases by foreigners of securities listed on the Johannesburg Stock Exchange occurred during the first quarter of 1985. The amount of R353 million of such net security purchases in fact accounted for most of the total net inflow of long-term capital of R366 million during the first quarter. At the same time, however, there was a net outflow of other long-term funds from the private sector. The public sector continued to borrow funds abroad, but the extent of the foreign borrowing by the Central Government and public corporations diminished notably in the first quarter of 1985.

As was the case in the preceding quarter, a substantial net outflow of short-term capital, amounting to R2,8 billion, occurred in the first quarter of 1985. This net outflow was caused by repayments of foreign short-term debt, mostly trade credits, and an increase in foreign short-term claims arising from the increase in exports. Unfavourable "leads and lags" in foreign payments and receipts also contributed to the net outflow of short-term funds, in particular during January 1985.

Balance of payments: Capital account



Foreign reserves

Owing to the large net outflow of short-term capital not related to reserves, total net gold and other foreign reserves declined by R1 119 million during the first quarter of 1985. In April, however, the net gold and other foreign reserves as well as the gross foreign reserves of the Reserve Bank increased substantially, namely by R742 million and R400 million, respectively.

Exchange rates

After the effective exchange rate of the rand had declined by 35,6 per cent from its most recent peak at the end of September 1983 to the end of 1984, it increased by 5,0 per cent to the end of the first quarter of 1985. The rand appreciated against all major currencies, except the British pound, during the first quarter. However, during April and May it depreciated again against all major currencies to levels slightly below those prevailing at the end of 1984.

On average, the effective exchange rate of the rand declined by 6 per cent from the fourth quarter of 1984 to the first quarter of 1985. During the same period the average depreciation of the rand against the US dollar amounted to 11 per cent.

Changes in the exchange rates of the rand*

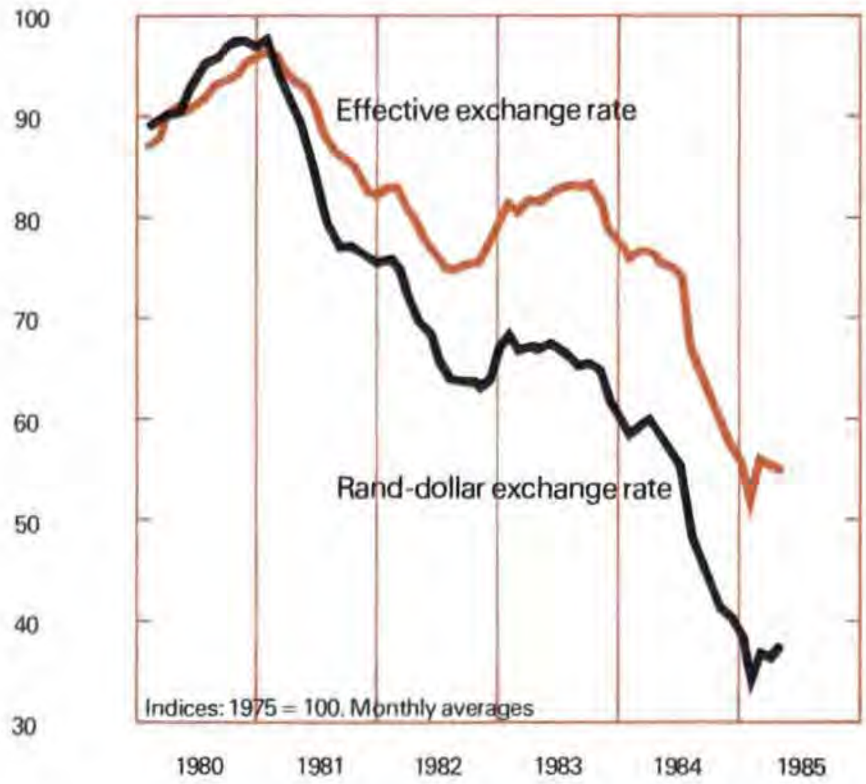
%

	Sept 83 to Dec 84	Dec 84 to Mar 85	Mar 85 to May 85
Weighted average	–35,6	5,0	–5,4
US dollar	–44,5	6,0	–5,9
British pound	–28,7	–1,6	–7,4
German mark	–33,7	3,9	–6,0
Swiss franc	–32,2	6,1	–6,0
Japanese yen	–40,8	5,7	–5,5
French franc	–33,3	3,7	–6,2

*Based on figures as at month-ends

After the exchange rate of the rand had fluctuated widely during the first three months of 1985, it stabilised to a large extent during April and May. As shown in the accompanying table, the spread between minimum and maximum exchange rates narrowed from nearly 9 US cents per rand in January to about 2½ US cents per rand in May 1985.

Exchange rates of the rand



Minimum and maximum dollar/rand exchange rates*

Month	Minimum	Maximum
January 1985	0,4282	0,5175
February 1985	0,4574	0,5451
March 1985	0,4740	0,5461
April 1985	0,5042	0,5359
May 1985	0,4895	0,5125

*Weighted average middle rates for five largest foreign exchange dealers at 10h30 on every business day.

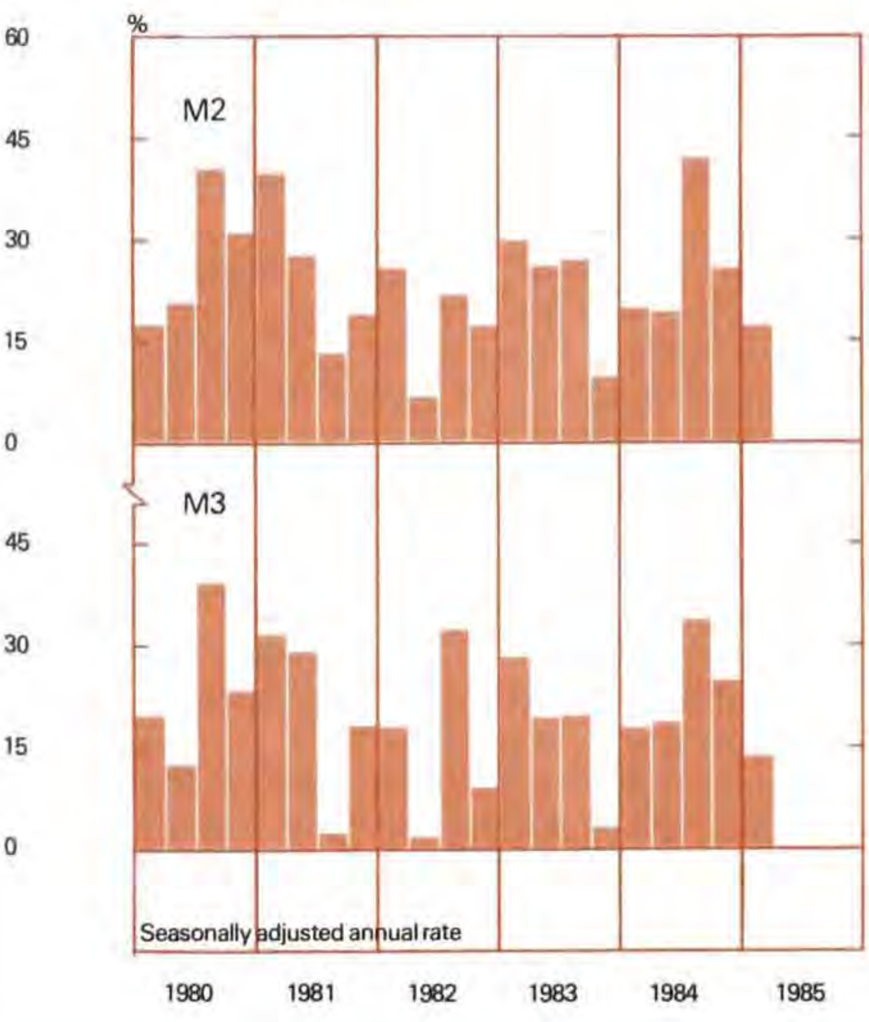
Money and banking

Money supply changes

The rate of increase in the money supply, which had accelerated considerably from the middle of 1984, showed a significant slow-down during the first quarter of 1985. At seasonally adjusted annual rates, M1, M2 and M3 increased by as much as 38 per cent, 41 per cent and 33 per cent, respectively, during the third quarter of 1984. However, by the first quarter of 1985 these rates of increase had slowed down to 20½ per cent, 15 per cent and 12 per cent, respectively.

Moreover, the decrease in the velocity of circulation of the money supply during the second half of 1984 continued during the first quarter of 1985, indicating a notable deceleration of the rate of increase in monetary demand in the latter period. *Ex post* confirmation of such a slow-down was provided by the continued decline in real gross domestic expenditure in the first quarter. The velocity of circulation of M3, for example, which had already declined by 2,1 per cent and 3,3 per cent in the third and fourth quarters of 1984, decreased by a further 0,4 per cent in the first quarter of 1985. Similar tendencies were observed in the velocity of circulation of M1 and M2.

Changes in money supply



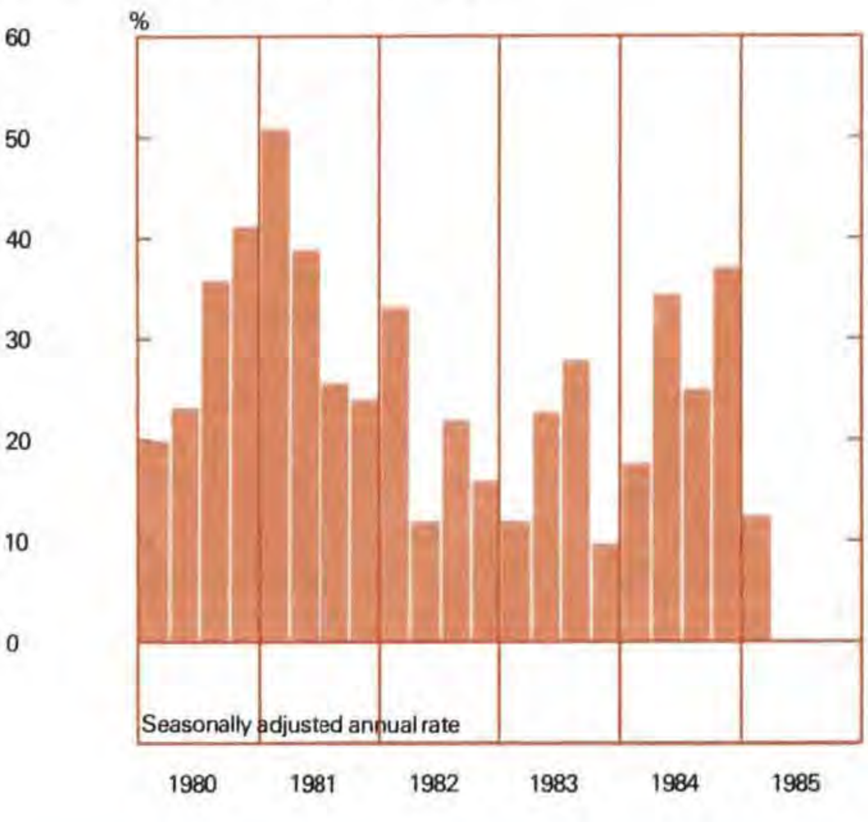
Despite the deceleration of the short-term increase in the money supply, the longer-term growth rates of the various monetary aggregates remained at high levels. Measured over a time span of twelve months, the increases in M1, M2 and M3 amounted to 26 per cent, 22 per cent and 20½ per cent, respectively, in April 1985. These rates of increase were nevertheless moderately lower than the corresponding figures of 34 per cent, 26 per cent and 23 per cent, respectively, in December 1984.

As during the second half of 1984, the main counterpart of the further increase in the money supply during the first quarter of 1985 was an expansion of bank credit to the private sector. Declines in net foreign reserves and net bank credit to the government sector exerted a contractionary influence on the money supply. During April, however, the private sector's demand for bank credit weakened considerably. Accordingly, the rate of increase in the money supply slowed down further, despite an increase in net foreign reserves.

Bank credit to the private sector

Although bank credit to the private sector continued to expand during the first quarter of 1985, the rate of increase decelerated sharply. At a seasonally adjusted annual rate, the increase slowed down from 37 per cent in the fourth quarter of 1984 to only 13 per cent in the first quarter of 1985. Measured over a longer time span of twelve months, however, the rate of increase in bank credit to the private sector remained at a high level and declined only marginally from 28 per cent in December

Changes in bank credit to private sector



1984 to 27 per cent in March 1985 and to 24½ per cent in April.

Having regard to the slight increase in nominal gross domestic expenditure in the first quarter of 1985, the increased bank credit to the private sector was not used to finance additional consumption and investment expenditure. At most, credit was used to finance a small, and probably involuntary, build-up of industrial and commercial inventories. To a much larger extent, additional bank credit was used for tax payments, in particular at the end of February, as well as for augmenting company cash flows, for capitalising accrued interest on previously existing bank credit and for financing increased exports. In addition, there was some re-intermediation of credit transactions owing to tighter conditions in the intercompany market for funds. The argument that additional bank credit was not used to finance real expenditure is supported by the fact that hire-purchase credit and leasing finance increased only moderately during the first quarter.

Financial markets

Reserve Bank's operations in financial markets and refinancing transactions

The Reserve Bank's operations in the financial markets during the first five months of 1985 consisted, firstly, of active participation in government debt management. Net sales of government stock by the Bank amounted to R342 million during the first quarter and were stepped up to R1 704 million during April and May, the first two months of the 1985/86 fiscal year. In addition, the Bank sold government stock, amounting to R323 million, due for settlement during June. Apart from direct stock sales by the Bank, government stock to the amount of R450 million was privately placed with investors through a stockbroker.

Expectations that interest rates had peaked and would decline in the period ahead created a receptive market for government stock. Accordingly, a substantial portion of the Government's gross borrowing requirement in the 1985/86 fiscal year was satisfied in the first fiscal year quarter. These borrowing transactions, in the form of Reserve Bank sales of government stock, served the additional purpose of mopping up excess liquidity introduced into the markets by the Government's seasonally high expenditure in the early months of the new fiscal year. In this way, the Bank ironed out seasonal fluctuations in interest rates and promoted an orderly downward adjustment of rates.

Secondly, the Reserve Bank's operations in the financial markets during the first quarter of 1985 were aimed at relieving temporary cash shortages in the money market and the accompanying upward pressure on interest rates. For this purpose, the Bank entered into repurchase agreements, totalling R500 million, with banking institutions over the March month-end. During the second quarter, when the seasonal increase in government expenditure resulted in increased liquidity in the money market, the Bank switched its operations to the absorption of liquidity. In addition to the government stock sales referred to earlier, the Bank sold special Treasury bills to the amounts of R200 million and R100 million during April and May, respectively.

Thirdly, funds of the Corporation for Public Deposits were placed by the Reserve Bank with the discount houses. These funds amounted to R500 million at the end of 1984 as well as at the end of March 1985 and to R600 million at the end of May.

The net result of the Reserve Bank's operations and the other factors affecting the money market was that the discount houses and other banking institutions had to be accommodated by the Reserve Bank by varying amounts during the first five months of 1985. During the first quarter of 1985 the average daily amount of refinancing outstanding was R1 743 million. At the end of March the amount of refinancing stood at R2 256 million, but it declined subsequently to R1 853 million at the end of April and to R1 586 million at the end of May.

With effect from 6 May 1985, the Reserve Bank reduced its rediscount rates for discount houses by 1 per cent to 20,75 per cent for Treasury bills, 21,0 per cent for Land Bank bills and 21,25 per cent for bankers' acceptances. Broadly corresponding decreases were effected in the Bank's rediscount rates for banks and in its interest rates on overnight loans to discount houses and banks. With effect from 21 May, these rediscount rates were lowered by a further 1 per cent, while broadly the same adjustment was made to the other refinancing rates.

As part of the longer-term process of reducing the liquid asset requirements for banking institutions, the Reserve Bank lowered these requirements in the last week of March. The requirement in respect of short-term liabilities to the public was reduced from 25 to 22 per cent and that in respect of medium-term liabilities from 18 to 16 per cent.

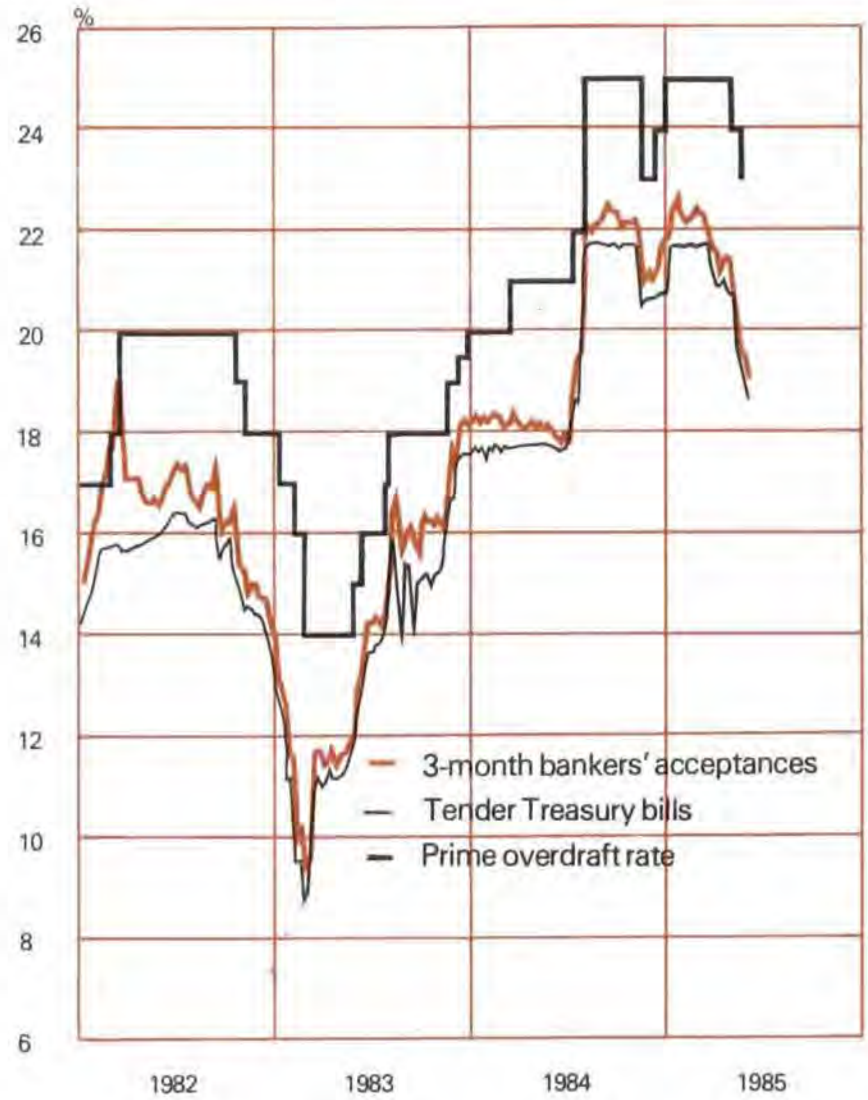
Short-term interest rates

Short-term interest rates reached new peaks at the end of February 1985 owing to seasonally tight market conditions and eased only marginally during the first two weeks of March. Several factors contributed subsequently to a decline in interest rates. The Reserve Bank's repurchase agreements with banking institutions over the March month-end and the lowering of liquid asset requirements towards the end of March served to reduce upward pressure on interest rates at that time. More fundamentally, the better balance between monetary and fiscal policy embodied in the March 1985 Budget, together with the relatively small borrowing requirement of the Government in the 1985/86 fiscal year, created expectations of a prospective decline in interest rates. In addition, the cooling down of the economy, a weakening of the private sector's demand for bank credit, an improved balance of payments (including the effect of a slightly higher and somewhat more stable gold price) and a more stable exchange rate of the rand contributed to the decline in interest rates during April and May.

Recognition of a fundamental change in economic circumstances and the decline in interest rates that had already occurred, prompted the reductions in the Reserve Bank's refinancing rates referred to earlier. These reductions strengthened prevailing interest rate expectations and resulted in a better alignment of bank overdraft rates and other short-term rates.

Reflecting these developments, the rate on three-month bankers' acceptances declined from 22,2 per cent on 15 March to 21,5 per cent on 29 March, to 21,0 per cent on 30 April and to 19,0 per cent on 30 May. Likewise, the Treasury bill tender rate declined from 21,80 per cent on 15 March to 21,26 per cent on 29 March and subsequently to 18,78 per cent on 30 May. The clearing banks' prime overdraft rates were lowered

Short-term interest rates



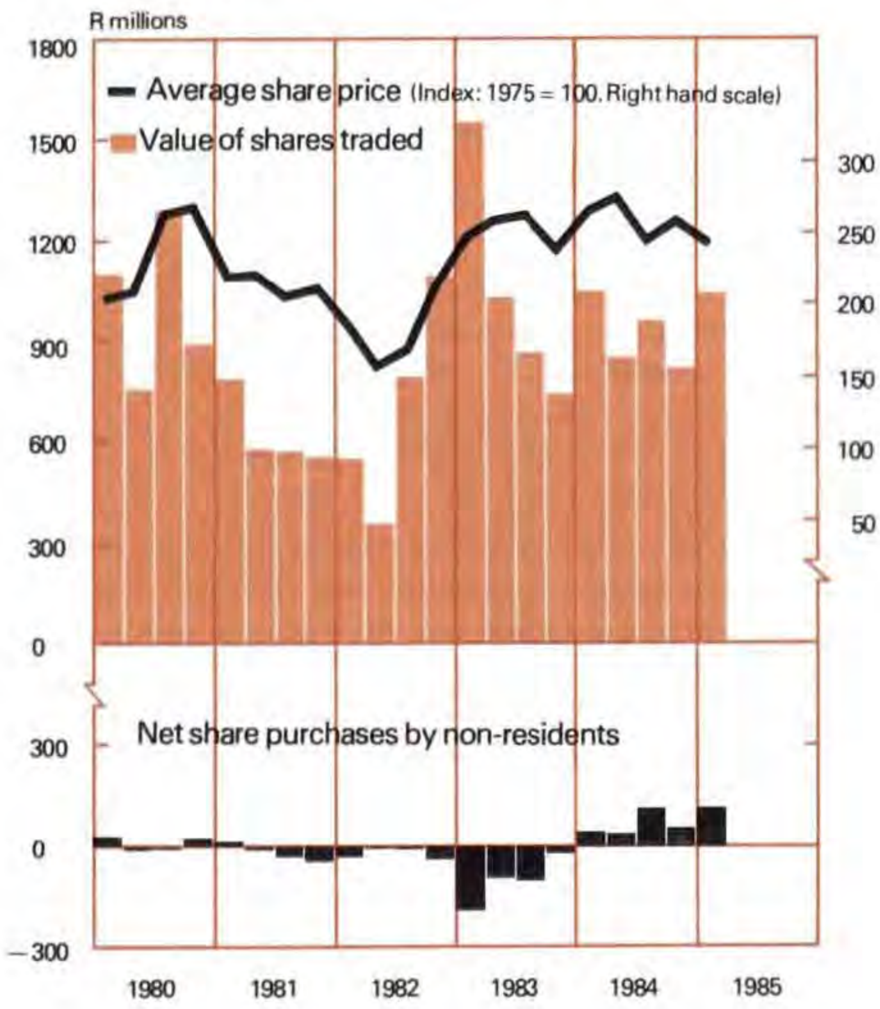
from 25,0 to 24,0 per cent during the period 6 to 8 May and to 23,0 per cent on 27 and 28 May.

Capital market activity and long-term interest rates

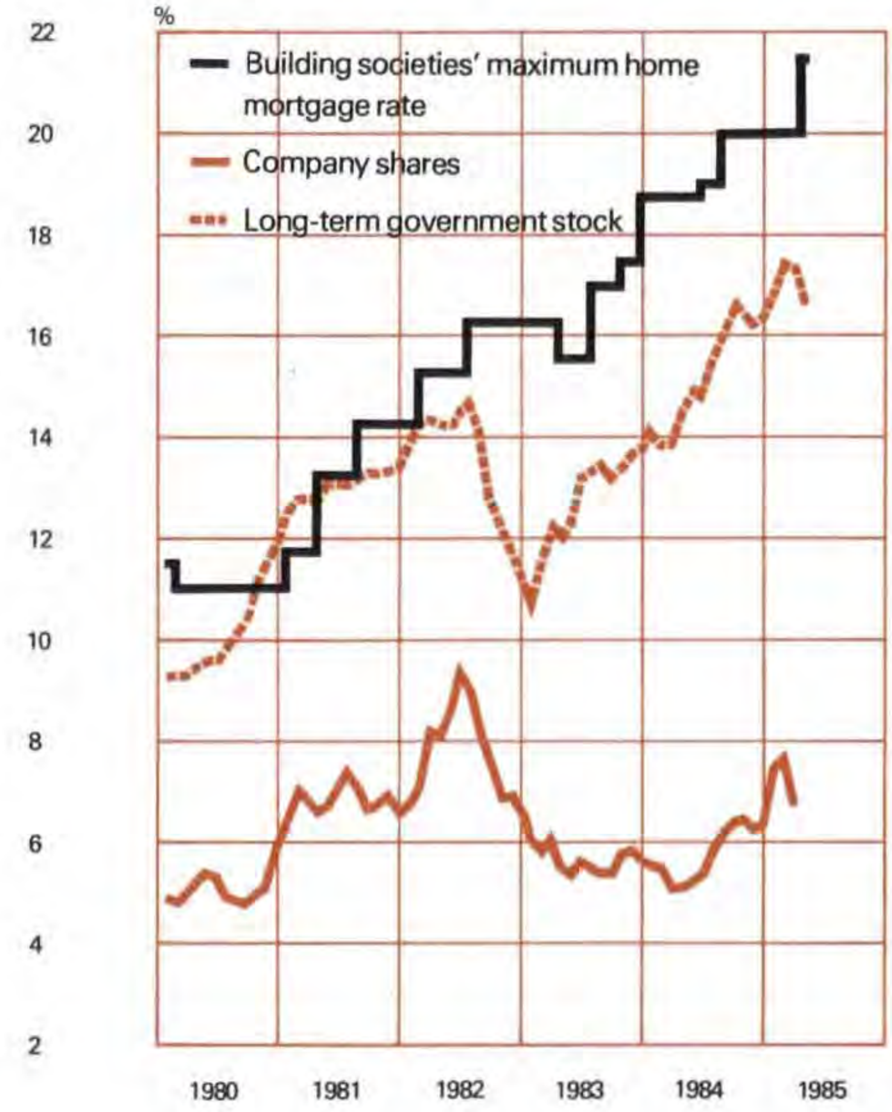
Capital market activity, which had slowed down during the fourth quarter of 1984, increased considerably during the first quarter of 1985. For example, the stock exchange turnover in public sector stock and company shares increased from the fourth quarter of 1984 to the first quarter of 1985 by 41 per cent and 27 per cent, respectively, while the building societies' new mortgage lending increased by 13 per cent during this period, mainly because of an improved inflow of funds. On the other hand, the value of real estate transactions declined further by 5 per cent during the first quarter of 1985. In April the stock exchange turnover in public sector stock and company shares rose further by 12 per cent and 32 per cent, respectively.

Owing to the continued interest of foreign investors in South African company shares, a strong institutional investment demand for shares and the moderate recovery in the gold price, the average decline of 6 per cent in the prices of all classes of shares during January and February 1985 was reversed during March and April. On

Stock exchange



Capital market interest rates



average, share prices rose by 14 per cent to reach a level in April that was 7 per cent higher than in December 1984. The average dividend yield on all classes of shares rose from a low of 5,1 per cent in March 1984 to 6,3 per cent in December 1984 and to 7,7 per cent in February, but declined subsequently to 6,2 per cent in April.

Monthly average yields on fixed-interest securities also peaked in February and declined subsequently in accordance with the general easing of interest rates discussed earlier. Long-term yield movements were influenced by expectations not only of a general decline in interest rates in the short-term, but also of an ultimately lower rate of inflation. The latter expectations were created by the pronounced downward adjustment of real aggregate demand in the economy, the more stable exchange rate, the more restrictive fiscal policy stance adopted by the Government in the March 1985 Budget, and the Government's firm stand on increases in salaries and wages in the public sector and in certain administered agricultural prices. The yield on long-term government stock, for example, rose from an average of 16,3 per cent in December 1984 to 17,4 per cent in February 1985, before easing to 16,3 per cent in May. The actual and expected further decline in long-term yields created a strong market for fixed-interest securities. This explains the new higher turnovers in public sector stock in the first four months of 1985 as well as the successful marketing of new government stock by the Reserve Bank from April onwards.

Deposit interest rates, which had continued their upward trend during the first quarter of 1985, started to decline in May. For example, the predominant rate quoted on twelve-month deposits by banks and building societies rose from 18,0 per cent in December to 20,5 per cent in March, before declining to 19,5 per cent in early May and to 18,5 per cent later in May. The building societies' range of mortgage rates was raised during April, with the predominant rate on new mortgage loans in excess of R60 000 being increased from 20,0 per cent to 21,5 per cent. Some banks had already increased their rates for similar loans to 25 per cent before the end of 1984. The fall in deposit rates in May prompted two major building societies to reduce their mortgage rates for new loans above R60 000 from 23 to 22 per cent, thus bringing their rates more in line with the other societies' predominating rate for similar loans.

Government finance

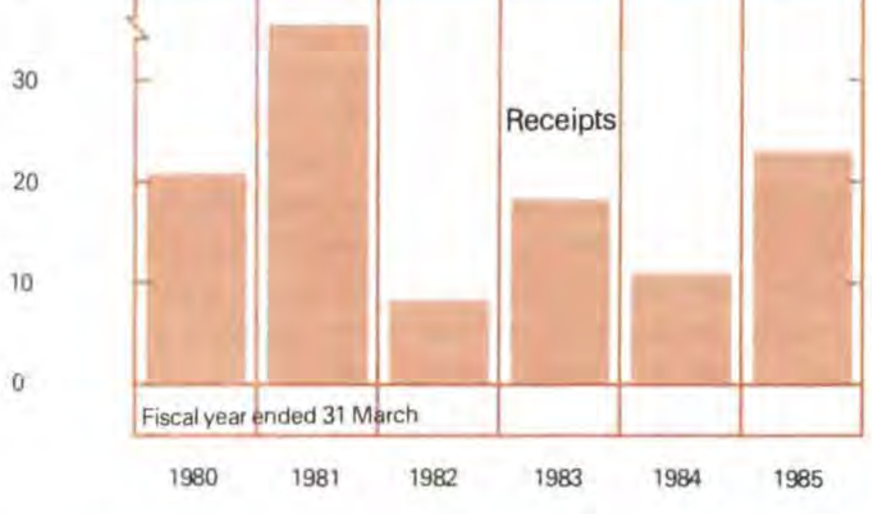
Expenditure, revenue and financing operations

Issues to government departments from the Exchequer Account* during the last quarter of the 1984/85 fiscal year, i.e. the first quarter of 1985, were 22,7 per cent higher than in the corresponding quarter of the preceding fiscal year, while Exchequer receipts increased by 24,8 per cent over the same period. A deficit on the Exchequer Account of R269 million was recorded during this quarter. In financing this deficit, an amount of R617 million was borrowed from the Public Investment Commissioners. This enabled the Treasury to reduce its net indebtedness to the monetary banking sector and the non-bank private sector by R245 million and R98 million, respectively, and to make net repayments of R5 million on foreign debt.

In the 1984/85 fiscal year as a whole Exchequer issues to government departments increased by 22,9 per cent, a rate of increase that was considerably higher than that envisaged in the original 1984/85 Budget. The additional expenditure appropriated by Parliament towards the end of the fiscal year was mainly in respect of interest payments on government debt and further aid to the agricultural sector.

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

Changes in Exchequer issues and receipts



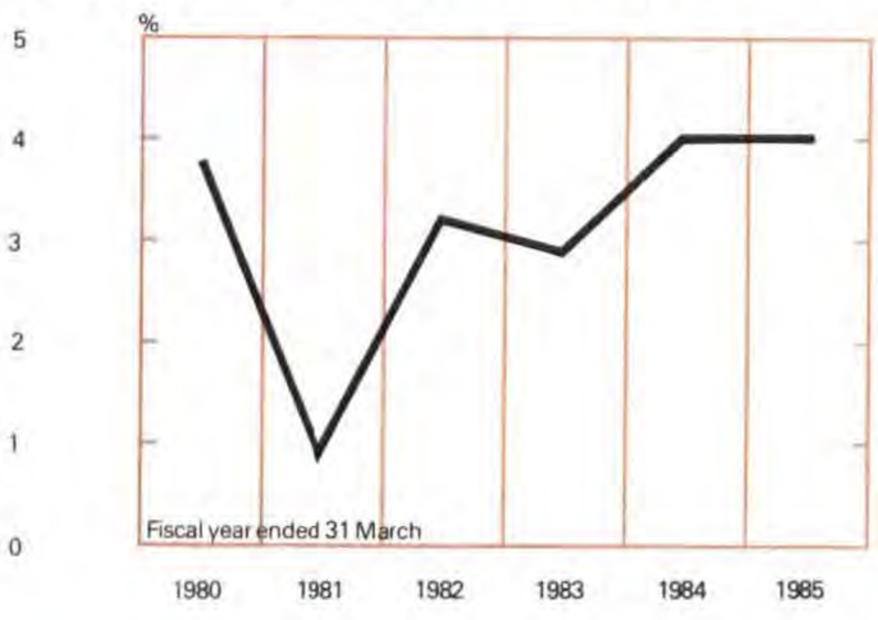
Revenue receipts rose by 23,2 per cent in the 1984/85 fiscal year, also a substantially higher rate of increase than the original Budget estimate. As shown in the accompanying table, all the main components of revenue performed notably better than had been envisaged in the 1984/85 Budget. The rate of decline in receipts from gold mining companies was lower than had been expected, mainly owing to a higher rand price of gold than had been projected for the purpose of Budget estimates. Tax collections from non-mining companies showed a marked increase, as against a budgeted decline, largely because of the greater than anticipated influence of the withdrawal of certain tax allowances announced in the preceding Budget. Income tax collections from individuals deviated only slightly from Budget expectations.

State Revenue Fund – Revenue collections in 1984/1985

	Budget[1]		Actual collections	
	R millions	Percentage change[2]	R millions	Percentage change[2]
Total collections from gold mines	1 844	–17,0	1 973	–11,2
Other income tax collections	10 955	20,3	11 296	24,1
General sales tax	5 820	50,2	5 862	51,2
Customs and excise duties[3]	1 789	–7,4	1 893	–2,0
Other collections	2 110	11,5	2 404	27,0
Total revenue collections	22 518	18,4	23 428	23,1

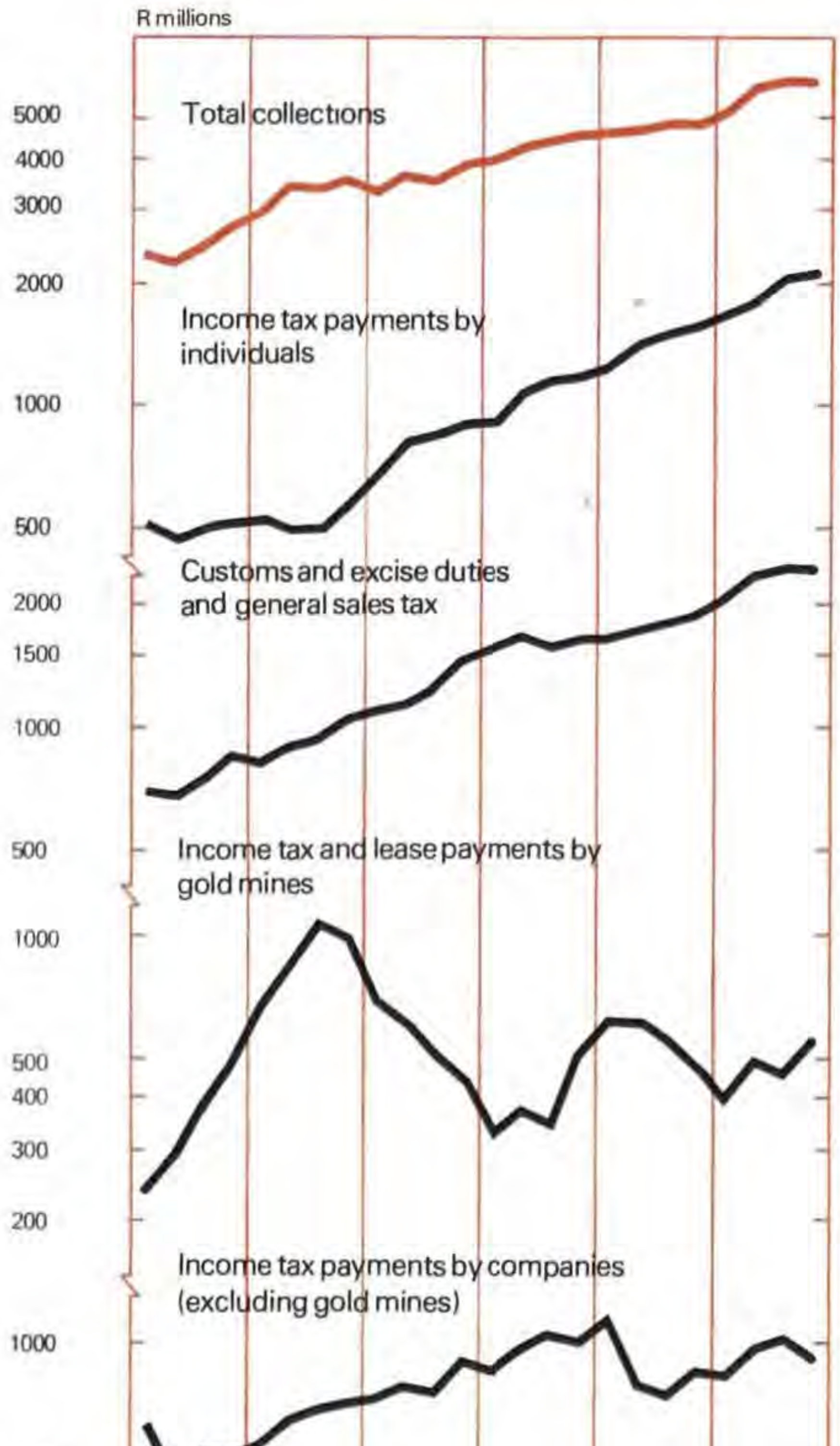
1) Second and final print.
2) Compared with actual collections during the 1983/84 fiscal year.
3) Excluding amounts transferable to neighbouring countries.

Ratio of Exchequer deficit to gross domestic product



The deficit before borrowing and debt repayment for the 1984/85 fiscal year amounted to R4 351 million. Net amounts of R2 123 million and R3 101 million were borrowed from the Public Investment Commissioners and the non-bank private sector, respectively, in addition to net borrowing of R253 million from the foreign sector. This borrowing enabled the Treasury to reduce its net indebtedness to the monetary banking sector by R1 126 million.

State Revenue Fund — Revenue collections



The 1985/86 Central Government Budget

The 1985/86 Central Government Budget was presented to Parliament on 18 March 1985 by the Minister of Finance. In outlining policy priorities, the Minister stated that priority still had to be accorded to counteracting inflation and strengthening the balance of payments, the exchange rate and net foreign reserves. The Government continued to attach great importance to the objectives of growth and employment, but the best way to achieve these aims in the longer term would be first to curb inflation and strengthen the balance of payments. However, special attention would have to be given to the amelioration of the effects of unemployment.

In terms of these priorities, the intended economic strategy would operate in the following way: Firstly, the process of reducing total public and private sector spending in real terms, which had begun after the middle of 1984, would be continued. Secondly, the surplus which had already been achieved on the balance of payments on current account would have to be maintained long enough to bring about an appreciation of the rand and a meaningful rise in the net foreign reserves. Thirdly, the rate of inflation would have to decline as the pressures of excess demand diminish and the influence of the lower exchange rate of the rand dissipates.

Only when these objectives had been achieved, would the stage be set for a new economic upswing and a period of high and sustainable economic growth, which remained the fundamental policy objective. This approach ruled out any artificial stimulation of the economy. Instead, in the opinion of the Minister, the economic situation called for an effective and not a notional continuation of the economic strategy of curbing the expansion of total spending in the economy by means of monetary and fiscal policies.

In this regard, there was an essential need to add more fiscal policy to the overall policy "mix". Throughout the preceding two fiscal years, notwithstanding the intended restrictive policy stance, the unduly expansionary results of fiscal policy had meant that monetary policy had had to bear too great a share of the burden of stabilisation.

For fiscal policy to play its full and fair part in overall strategy in the year ahead, the Budget had to meet three basic conditions. Firstly, there had to be no increase in real terms in total government expenditure in 1985/86, compared with 1984/85. Secondly, current expenditure could not again be financed, as had happened during the preceding two years, by borrowed funds. Thirdly, the Budget "deficit before borrowing" had to be kept below 3 per cent of gross domestic product in order that it could be financed without either significant resort to bank credit or contributing to any upward pressure on interest rates.

In accordance with these objectives and conditions, government expenditure was designed to increase by 11,4 per cent in 1985/86, compared with the estimated

1985/1986 Budget

R millions

Revenue	28 322
Expenditure	31 292
Deficit (before borrowing)	–2 970
Financing (net of debt repayment)	
Public Investment Commissioners	2 500
New Government stock issues	716
Non-marketable securities*	–515
Foreign loans	179
Use of available balances	90
Total	2 970

*Including loan levies and certain loan expenditure.

comparable expenditure in 1984/85. Expenditure estimates for 1985/86 incorporated a cut in staff-related costs of about R500 million. Assisted by a fairly wide range of direct as well as indirect tax increases, revenue was estimated to rise by 18,8 per cent in 1985/86.

The deficit before borrowing for 1985/86 was estimated at R2 970 million, amounting to 2,5 per cent of the expected gross domestic product. Taking into account loan redemptions of R1 695 million, the Government's total financing requirement was expected to amount to R4 665 million. The proposed financing of the Budget deficit is shown in the accompanying table.