

Quarterly economic review

Introduction

The modest recovery in the South African economy that had commenced in the second half of 1985 but had been interrupted in the first quarter of 1986, was confirmed persuasively in the second quarter and more firmly in the third quarter. The most recent national accounts estimates show that the contraction in real gross domestic product at a seasonally adjusted annual rate of about 2½ per cent in the first quarter of 1986 was followed by renewed expansion at moderate annual rates of about 2 per cent in the second quarter and approximately 4 per cent in the third quarter. Partly because of the relatively severe setback in total real domestic output in the first quarter of the year it now seems unlikely, however, that growth in real gross domestic product during 1986 as a whole will significantly exceed 1 per cent.

Total real gross domestic expenditure, having receded at an annual rate of about 3½ per cent in the second quarter of 1986, rebounded remarkably vigorously in the third quarter. The seasonally adjusted annual rate of increase in aggregate real domestic expenditure in the third quarter is provisionally estimated to have been of the order of 26 per cent. This unusually strong recovery, which calls to mind the broadly similar rates of increase in total real domestic spending during the cyclical upswing in the second half of 1983, was explained primarily by a substantial reversal of the drawing down of inventories that had been in evidence uninterrupted from the first quarter of 1985. The renewed build-up of inventories consisted partly of an accumulation of commercial and industrial stocks that may have been attributable to some extent to a fear of international trade sanctions. It is, however, also likely to have been influenced by a perceived need for a replenishment of inventories from their uncommonly low levels of preceding quarters, by some improvement in the ratio of unfilled orders to sales in manufacturing industry (more particularly in non-durable goods industries), to an anticipated improvement in sales, and to the reduced interest cost of carrying inventories.

Positive inventory investment as a component of the aggregate increase in total domestic demand was supported by a significant further improvement in real private consumption expenditure, notably on durable and semi-durable goods. Since total real personal disposable income declined in the third quarter, however, the continued revival in real consumer demand also caused the personal savings ratio to decline further to approximately 1½ per cent from its recent high point of 9 per cent in the recessionary conditions of the fourth quarter of 1984. The moderate further recovery in real consumer spending in the third quarter of 1986 probably was attributable partly to the increased significance of replacement demand. In addition to various other factors (such as the fading-away of consumer boycotts in certain urban areas after the middle of June 1986), it may, however, also be held to have reflected an improvement in consumer sentiment.

A marked decline was recorded in the third quarter in real consumption expenditure by general government. A slight increase was measured, however, in total real gross fixed domestic capital formation, mainly because of a substantial rise in real fixed investment by public authorities and a further decline in the rate of contraction in real fixed investment by the private sector.

The substantially higher rate of increase in total real gross domestic expenditure than in real gross domestic product necessarily was accompanied by a sharp contraction in the so-called foreign balance, i.e. in the excess of the volume of exports of goods and non-factor services over the volume of imports of such goods and services. A substantial surplus, although slightly smaller than the surplus in the second quarter, nevertheless continued to be recorded on the balance of payments on current account in the third quarter of 1986. The third-quarter current account surplus, at an annualised level of R5,8 billion, brought the cumulative current account surplus for the first three quarters of 1986 to an annualised level of R5,4 billion. A current account surplus in excess of R5 billion may, therefore, be expected for 1986 as a whole.

Also aided by a slight net inflow of capital not related to reserves, the net gold and other foreign reserves in the third quarter of 1986 increased for the second consecutive quarter. The effective exchange rate of the rand recovered slightly on balance from a lower turning point on 12 June 1986 up to the end of August. From the beginning of September, however, the abrupt rise in the dollar price of gold contributed to a sharp appreciation of the rand against all currencies. On 21 November the effective exchange rate was 23,7 per cent above its mid-June turning point.

The moderate recovery in aggregate economic activity in the second and third quarters of 1986 had little positive impact on employment up to the middle of the year and on registered unemployment up to September 1986. Total non-agricultural employment actually declined in the second quarter of 1986. Registered unemployment in September 1986 was only marginally below the high point in such unemployment recorded in January. In addition, the inflation rate, *inter alia* because of the delayed effects of the weakening of the exchange rate of the rand from mid-March to mid-June 1986, reaccelerated in the third quarter of 1986, after having improved, on a year-on-year as well as on a quarter-to-quarter basis, during the second quarter.

The recovery up to September 1986 also failed to be reflected in any significant re-acceleration of the rates of increase in bank credit to the private sector, total bank credit, and the money supply. Measured over a period of twelve months, the rate of increase in bank credit to the private sector continued to slow down almost uninterruptedly from approximately 16 per cent in December 1985 to only 6,6 per cent in September 1986. The quarterly average of banks' total claims on the private sector showed virtually no change in the second quarter of 1986

and actually declined during the third quarter. The twelve-month rate of increase in total bank credit similarly contracted from approximately 18 per cent in December 1985 to about 6½ per cent in September 1986. Provisional money supply data for October show the broad monetary aggregate, M3, to have fallen short of the lower limit of its target range by approximately R4,3 billion or somewhat more than 5 per cent.

Money market and other short-term interest rates declined, broadly in accordance with the Reserve Bank's Bank rate reductions in May, August and September 1986, throughout most of the second and third quarters up to approximately the middle of September 1986. In sympathy with the sharp reversal of the downward movement in long-term interest rates from the third week of September, money market interest rates subsequently firmed mildly in the remainder of September. They then showed little further change on balance during October and fell back slightly in early November. The Reserve Bank's accommodation to discount houses and banks at the discount window declined to nil on a number of days in August. On 6 November 1986 no accommodation at all was required by the discount houses from either the Reserve Bank or the Corporation for Public Deposits. This situation repeated itself on a number of days between 11 and 21 November.

The capital market in the third quarter of 1986 witnessed sustained high levels of activity in various areas, as evidenced by sharp further increases in turnover of company shares and public sector stock and rising share prices. The marked drop in long-term interest rates from mid-June to the third week of September was sharply reversed, however, during the remainder of September. This turnabout in long-term interest rates, which briefly wiped out approximately half of the preceding rate decline, apparently was brought about mainly by a deterioration in inflation expectations and renewed concern about the Government's domestic borrowing needs. The resultant unreceptive mood of the securities markets, and other considerations, caused the Reserve Bank to stop selling stock almost completely in October and early November 1986.

Exchequer issues slowed down markedly in the July to September period, but accelerated again in October. The increase in these issues during the first seven months of fiscal 1986/87 in comparison with the corresponding period of fiscal 1985/86 therefore ran well ahead of the budgeted increase in government expenditures for the fiscal year as a whole. The rise in Exchequer receipts, on the other hand, was only marginally above the budgetary estimates. Also in the light of the package of additional stimulatory fiscal measures that was announced by the Minister of Finance on 17 June 1986, both total government expenditure and the eventual deficit before borrowing are likely to exceed the original Budget estimates by substantial amounts.

Domestic economic developments

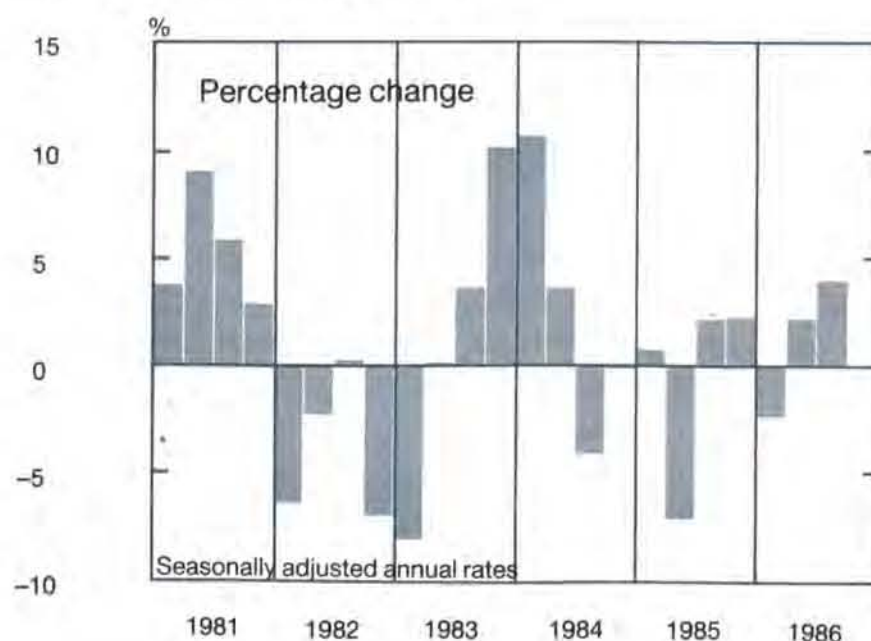
Domestic output

Preliminary national accounts estimates indicate that the modest economic recovery that had commenced in the third quarter of 1985 but had faltered in the first quarter of 1986, regained upward momentum in the third quarter of 1986.

Quarterly changes in real gross domestic product, at seasonally adjusted annual rates, from the third quarter of 1985 to the third quarter of 1986 amounted to approximately 2, 2½, -2½, 2 and 4 per cent. In the third quarter of 1986 real gross domestic product was approximately 1½ per cent higher than in the third quarter of 1985 and about 2 per cent higher than the low point in real gross domestic output that had been recorded in the second quarter of that year. In the course of the fourth quarter of 1986 it appeared unlikely, however, that real gross domestic product in the calendar year 1986 would exceed the domestic product of 1985 by more than approximately 1 per cent. This relatively poor growth performance from one calendar year to the next arose from the fact that the average level of real gross domestic product in 1985 was being supported by the still relatively high level of output in the first quarter of that year. It also reflected the effect of the relatively severe contraction in aggregate output that had occurred in the first quarter of 1986.

Sectoral estimates of real value added show the rise in output in the third quarter of 1986 to have been widely spread through the economy. Significant advances in production were recorded in particular in the manufacturing of clothing, chemicals, machinery and transport equipment; in electricity generation; and in the wholesale, retail and motor trade. Declines in output were recorded,

Real gross domestic product



however, in mining and the basic metal industries. Gold production responded, in the usual inverse fashion, to the higher rand price of gold. Coal mining and basic metals production could have been affected by the potentially adverse impact of actual or threatened trade sanctions against South Africa.

Domestic expenditure

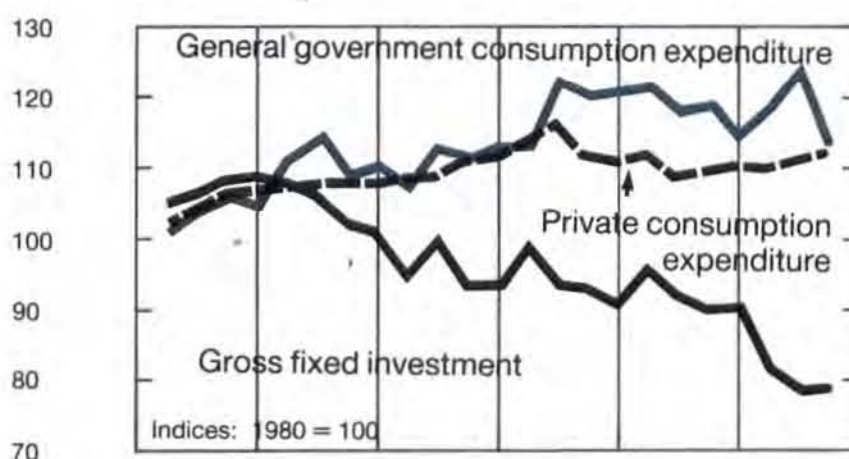
Total real gross domestic expenditure, having declined at a seasonally adjusted annual rate of about 3½ per cent in the second quarter of 1986, rebounded sharply in the third quarter. The annualised rate of increase in total real gross domestic spending in the third quarter is provisionally estimated at approximately 26 per cent. This remarkable recovery was essentially accounted for by a significant rebuilding of inventories and a mild further recovery in private consumer expenditures. Between them, the turn-around in the sustained de-stocking process of earlier quarters and the further revival in consumer demand substantially outweighed a relatively sharp decline in government consumption expenditure. In addition, total real fixed investment spending increased marginally in the third quarter.

The fairly rapid rise in real private consumption expenditure, which amounted to a seasonally adjusted annual rate of increase of approximately 4½ per cent, was aided by the fading-away of consumer boycotts in certain urban areas after the middle of June 1986. It also reflected a gradual diminution of the mood of uncertainty, reservedness and lack of confidence that had inhibited consumer spending in the first half of 1986. Although all major categories of private consumption expenditure showed increases, the more important gains were recorded in outlays on durable and semi-durable goods. The aggregate rise in real private consumption expenditure exceeded the third-quarter rise in real household

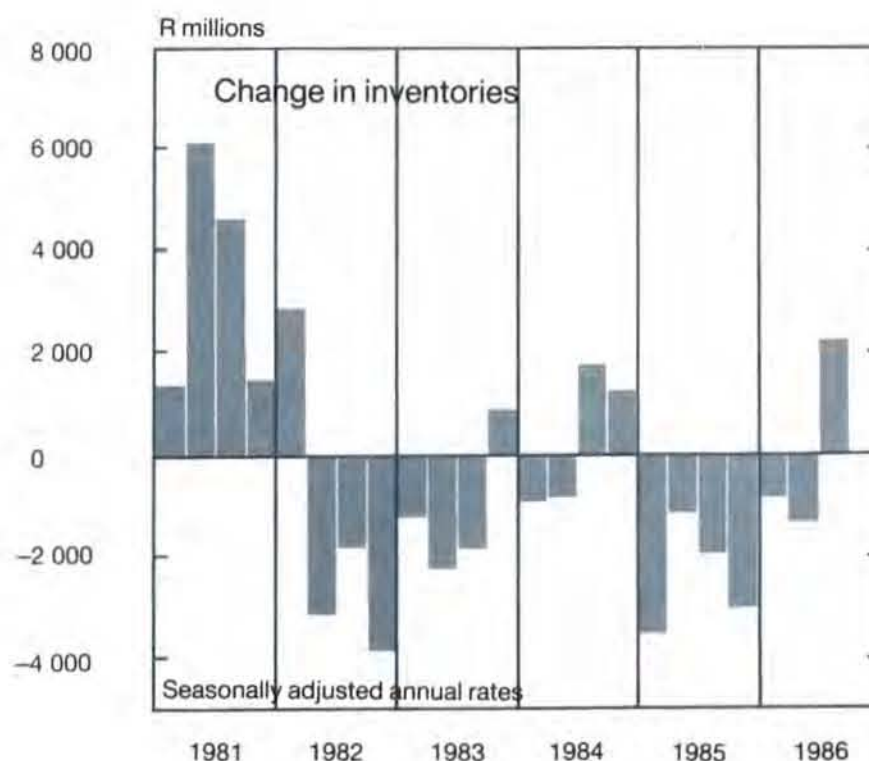
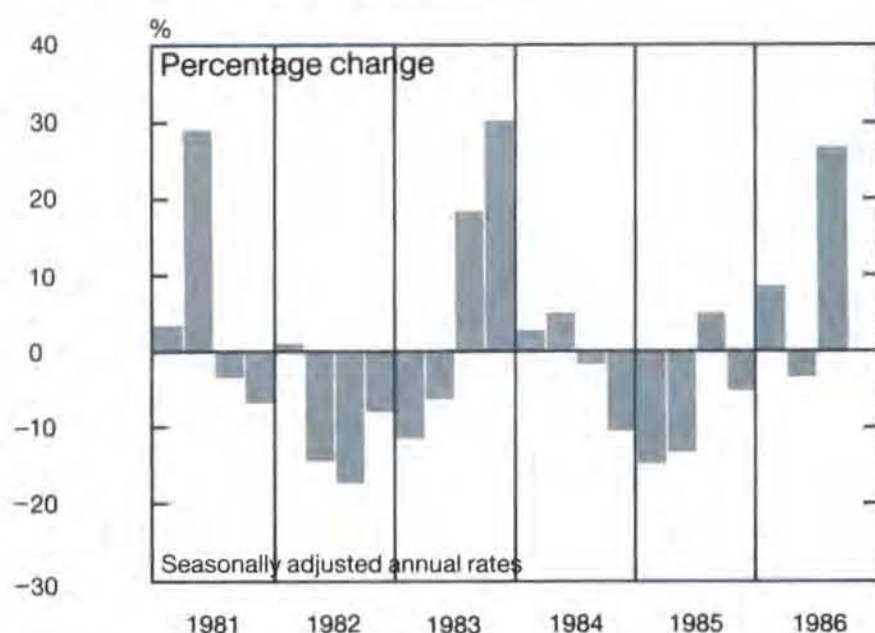
incomes. Because total real personal *disposable* income actually declined in the third quarter, the continued revival in consumer demand also caused the personal savings ratio to decline further to as little as 1½ per cent.

Having shown sharp increases in the first and, at a more moderate pace, in the second quarter of 1986, real consumption expenditure by general government decreased sharply in the third quarter. Modest rises (at an annual rate of approximately 2 per cent) continued to be recorded in aggregate real salary and wage payments, mainly because of further small increases in government employment. A decline occurred, however, in nominal government outlays on goods and non-employment-related services, after a marked concentration of such outlays had occurred in the second quarter of 1986. In conjunction with a sudden acceleration in the relevant rate of price increases, this reduction in nominal government outlays in the spending categories concerned, caused the volume of total real government consumption expenditure in the third quarter of 1986 to contract at an unprecedented annual rate of approximately 30 per cent.

Main components of gross domestic expenditure



Real gross domestic expenditure



During the first three quarters of 1986, total real government consumption expenditure was approximately 1 per cent lower than in the comparable nine-month period of 1985. Government expenditure in the third quarter of 1986 did not yet incorporate any major effect of the additional package of stimulatory fiscal measures that had been announced by the Minister of Finance on 17 June 1986.

The persistent decline in total real gross fixed investment that, with only brief interruptions, had been in evidence since early 1982, again changed course and a slight increase was recorded in the third quarter of 1986. Real gross fixed investment by public authorities actually rose substantially. This reflected a sharp rise in the capital outlays of the Department of Posts and Telecommunications and a stabilisation, at fairly low levels, of fixed capital outlays by the South African Transport Services, after severe cutbacks in its capital programmes had been effected in the first two quarters of 1986. Continued decreases were, however, recorded in real capital spending by public corporations. The level of real fixed capital spending by these corporations in the third quarter of 1986 was almost 40 per cent lower than the peak in such spending that had been reached in the fourth quarter of 1985.

Capital formation in the private sector also continued to decline but did so at a somewhat lower rate than during the first two quarters of 1986. This welcome slowdown in the decline in total real private fixed investment was primarily accounted for by investment in agriculture and the trade sector. However, despite the generally lower cost of capital funds, real fixed capital formation in private manufacturing industry continued to decline, being influenced adversely, among other things, by a continuing decline in the rate of capacity utilisation.

Most of the increase in aggregate real domestic expenditure in the third quarter of 1986 was attributable to a significant turnabout in inventory investment. Reductions in real inventories, which, at a seasonally adjusted annual rate, had amounted to R1½ billion in the second quarter of 1986, were succeeded by an inventory build-up at an annual rate of more than R2 billion in the third quarter. The extent of this turnabout from de-stocking to re-stocking was equivalent to no less than 5½ per cent of the gross domestic product. The resumption of positive inventory investment, which brought to a halt a process of continuous inventory depletion that had lasted uninterruptedly from the first quarter of 1985 to the second quarter of 1986, was accounted for mainly by increases during the third quarter in agricultural stocks-in-trade and in commercial and industrial inventories. The renewed inventory build-up of the third quarter caused the ratio of total real inventories to the real gross domestic product to rise by about ½ percentage point to 34 per cent at the end of September 1986. At the same time the ratio of commercial and industrial inventories to sales also rose significantly. As a result this ratio nearly regained the level of 166 per cent it had attained in the third quarter of 1985.

The increase in aggregate real gross domestic expen-

diture in the third quarter of 1986, at its seasonally adjusted annual rate of 26 per cent referred to earlier, obviously far exceeded the increase in the gross domestic product at its seasonally adjusted annual rate of 4 per cent. The resultant shortfall in the supply of real goods and services for domestic use necessarily had to be made good by increased imports and/or decreased exports of goods and non-factor services. In the event, a decline in the so-called foreign balance (i.e. in the excess of the volume of exports over the volume of imports of such goods and services) of 28 per cent contributed to the availability of goods for domestic expenditure.

Factor income and saving

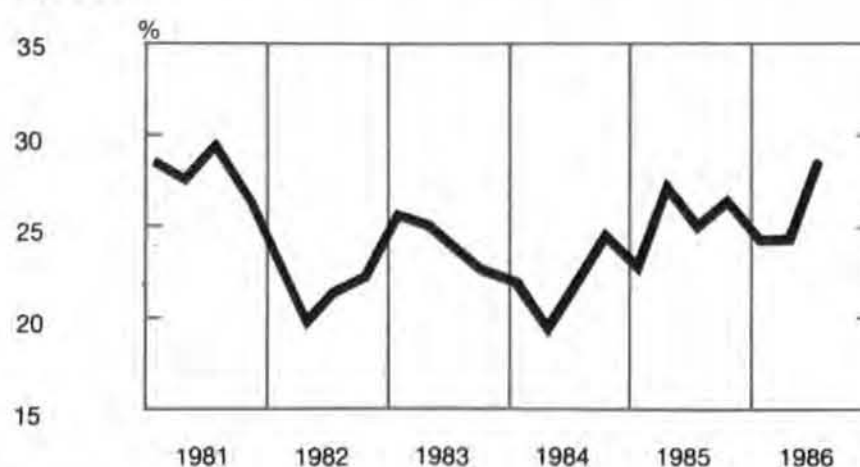
Aggregate nominal factor incomes increased sharply in the third quarter of 1986. Reflecting higher volumes of physical output, the rate of increase in aggregate nominal incomes significantly exceeded the current inflation rate.

Increases in labour remuneration generally fell short of the increases in gross operating surpluses. The increase in *aggregate* labour remuneration, moreover, also fell short of the inflation rate. The resultant decline in *aggregate real* labour remuneration obviously acted as a constraint on the revival in real private consumer demand and also contributed to the decline in the personal savings ratio.

Gross operating surpluses, making up the difference between total nominal factor incomes and nominal labour remuneration, rose vigorously in the third quarter of 1986. Particularly large increases in operating surpluses were reported by agriculture, mining, manufacturing and trade.

Corporate savings were boosted by the increase in gross operating surpluses. Together with a small rise in public savings, the sharp third-quarter increase in corporate savings more than fully neutralised the decline in personal savings. The extent of the resultant improvement in the national savings performance was apparent from the increase in the ratio of gross domestic savings to the gross domestic product from 24½ per cent in the

Ratio of gross domestic savings to gross domestic product



second quarter of 1986 to 28½ per cent in the third quarter. At this level, the value of this ratio exceeded the recent peak level it had attained in the recessionary conditions of the second quarter of 1985.

Employment*

Labour market conditions remained slack during the first half of 1986. After having recovered moderately in the second half of 1985, seasonally adjusted employment in the non-agricultural sectors of the economy increased by only 0,1 per cent from the second half of 1985 to the first half of 1986. On a quarter-to-quarter basis total non-agricultural employment showed little change from the fourth quarter of 1985 to the first quarter of 1986 and actually declined at an annual rate of 1,2 per cent in the second quarter. Employment by public authorities, which had increased fairly significantly in the third and fourth quarters of 1985, continued to rise in the first and second quarters of 1986 albeit at diminishing rates. The decline in total non-agricultural employment in the first half of 1986 therefore was due to reductions in private sector employment; the rate of these reductions actually accelerated significantly from the first to the second quarter. Information from the manufacturing and construction sectors, electricity generation and the South African Transport Services indicates that employment in these sectors declined further in the third quarter of 1986.

Generally low levels of resource utilisation in the South African economy were apparent, not only from relatively low ratios of capacity utilisation in manufacturing industry, but also from substantial numbers of registered unemployed. The seasonally adjusted number of registered unemployed more than doubled from the beginning of the

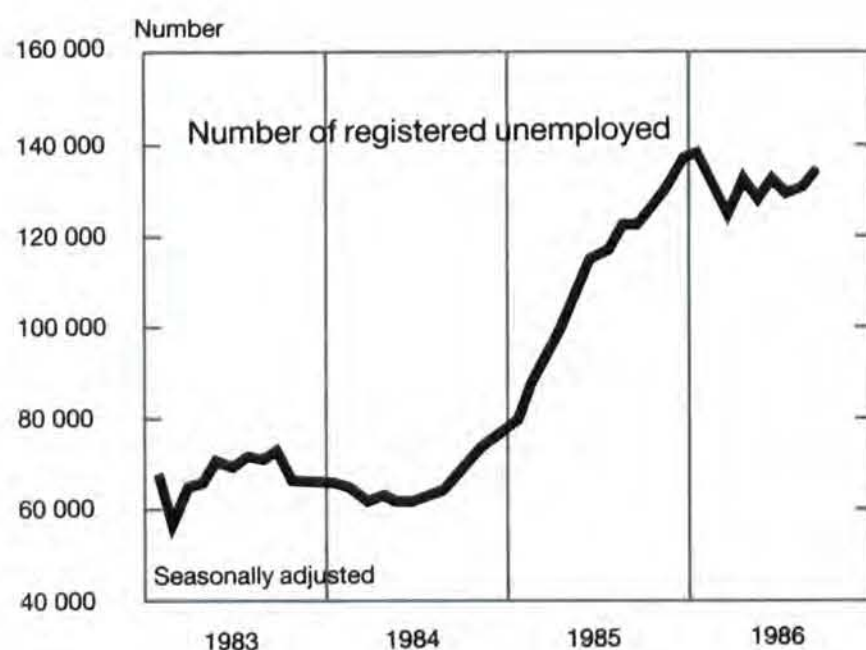
1984/85 recession up to early 1986, rising from 60 800 in May 1984 to 137 700 in January 1986. During the subsequent eight months this number fluctuated around a monthly average level of about 129 700. It amounted to 133 100 in September 1986.

Special training and job creation programmes, as implemented by government since 1985, contributed substantially to the levelling-off in registered unemployment during the first nine months of 1986. During this period approximately 318 000 people completed their training in terms of these programmes, and it is estimated that a further 160 000 people will receive training during the remainder of the fiscal year 1986/87. At the end of September 239 000 people were employed in various special projects. According to the Department of Manpower 63 000 employment opportunities will also be created in the informal and small business sectors on account of these special programmes.

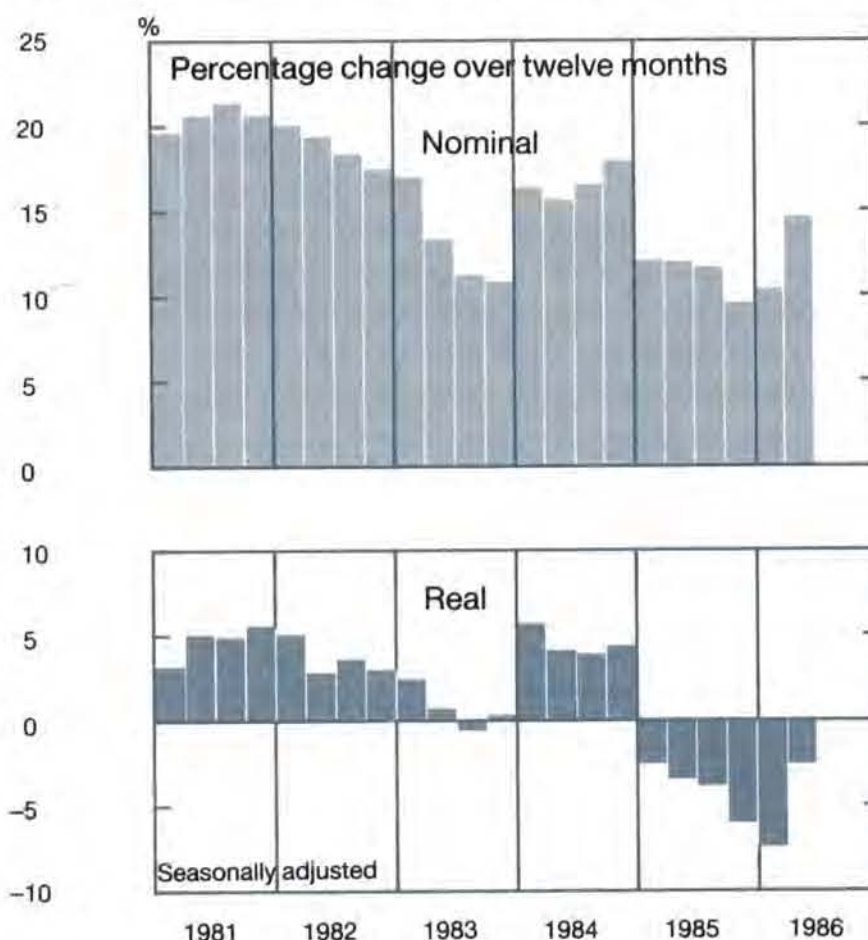
Labour costs and productivity

Slow increases in overall employment and comparatively high levels of registered unemployment persisted from the middle of 1985 despite the mild recovery in aggregate economic activity and despite declines in average real wages during this period. The rate of increase in *nominal* remuneration per worker, measured from the level of such remuneration in the corresponding quarter of the preceding year, slowed down from 17,9 per cent in the

Unemployment



Remuneration per employee in non-agricultural sectors



*Comprehensive employment and labour remuneration statistics are available only up to the second quarter of 1986.

fourth quarter of 1984 to 10,0 per cent in the first quarter of 1986 before reaccelerating to 14,7 per cent in the second quarter of 1986. The renewed rise in this rate of increase that occurred in the second quarter of 1986 could be observed in both the private and public sectors. Since this higher rate of increase still fell short of the inflation rate, however, average *real* wages in the second quarter of 1986 were still 2,5 per cent below their level in the second quarter of 1985 and as much as 6,0 per cent below their level in the second quarter of 1984.

Labour productivity, as measured by real gross domestic product per worker, increased by about 1/2 per cent in the second quarter of 1986, mainly reflecting the increased level of aggregate physical output. Output per worker in the second quarter of 1986 showed little change from its level in the second quarter of 1985.

Showing the impact of the accelerated rise in nominal labour remuneration, the rate of increase in unit labour costs also accelerated in the second quarter of 1986 despite the rise in labour productivity. The year-on-year rate of increase in unit labour costs advanced from 12,4 per cent in the first quarter of 1986 to 14,8 per cent in the second quarter.

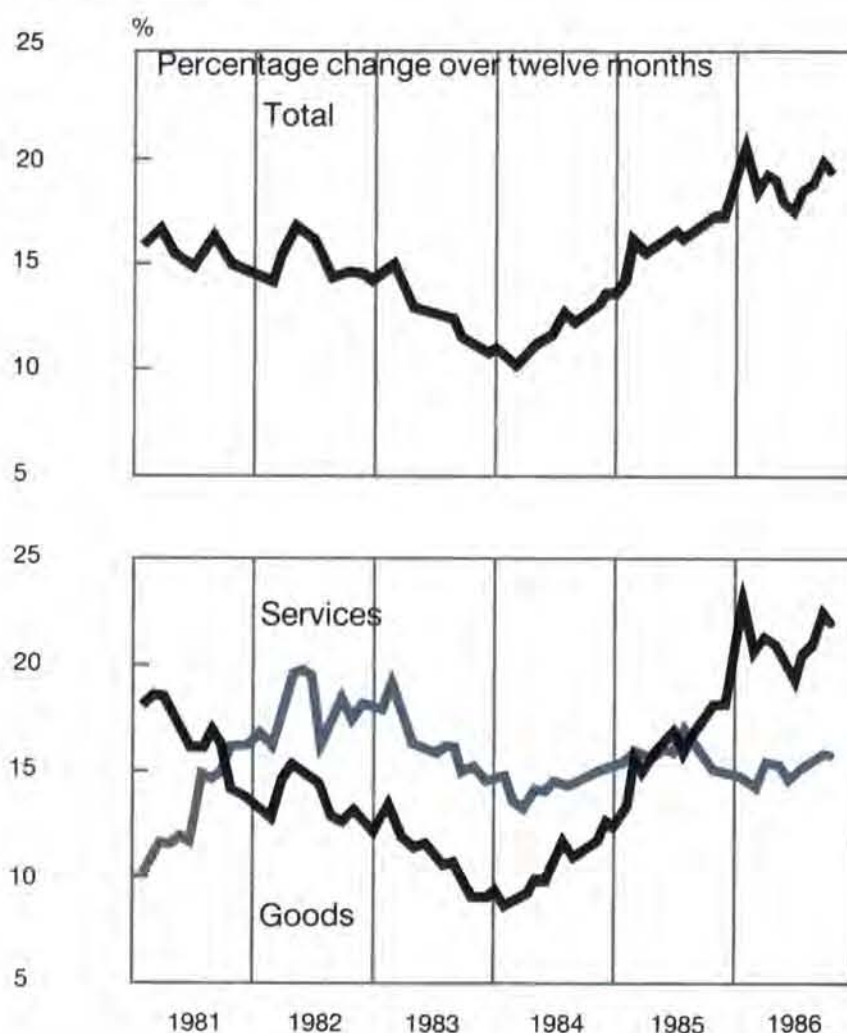
Prices

The rate of increase in consumer and production prices accelerated up to the first quarter of 1986, slowed down in the second quarter but increased again in the third quarter. These fluctuations in the inflation rate mainly reflected the lagged, varying and occasionally opposite effects of changes in the exchange rate of the rand on the prices of imported goods, the decline in crude oil prices, relatively high and variable rates of increase in the prices of various foodstuffs, and the continued high rate of increase in the cost of certain services, in particular the cost of housing, education and communication.

On a shorter-term basis, the annualised quarter-to-quarter rate of increase in the seasonally adjusted consumer price index declined from a peak of 27,2 per cent in the first quarter of 1986 to as relatively little as 12,8 per cent in the second quarter, but accelerated again to 18,3 per cent in the third quarter. The reacceleration of the inflation rate in consumer prices in the third quarter of 1986 was attributable mainly to higher rates of increase in the prices or cost of food, motor cars, furniture and housing. The prices of goods other than food actually continued to rise slightly more slowly, on average, during the third quarter of 1986 than during the preceding two quarters; the annualised rates of increase in these prices in the three quarters concerned amounted to 37,5, 14,4 and 13,5 per cent, respectively. Measured over a twelve-month period, the rate of increase in the consumer price index rose from 16,9 per cent in June 1986 to 19,7 per cent in September, before slowing down somewhat to 19,2 per cent in October.

Major effects of variations in the exchange rate of the rand on the import price component of the production price index continued to be exerted during the first nine

Consumer prices



months of 1986. Following the marked recovery in the exchange value of the rand from mid-December 1985 to mid-March 1986, the rand prices of imported goods declined in April, May and June; the subsequent decline in the exchange rate to mid-June then contributed, however, to rising import prices in the third quarter of 1986. The twelve-month rate of increase in imported goods prices declined from a peak of 32,7 per cent in January 1986 to 20,4 per cent in June before reaccelerating to 21,0 per cent in September. The comparable rates of increase in the *overall* production price index amounted to 22,2 per cent, 19,1 per cent and 20,1 per cent in January, June and September 1986, respectively.

Balance of payments and exchange rates

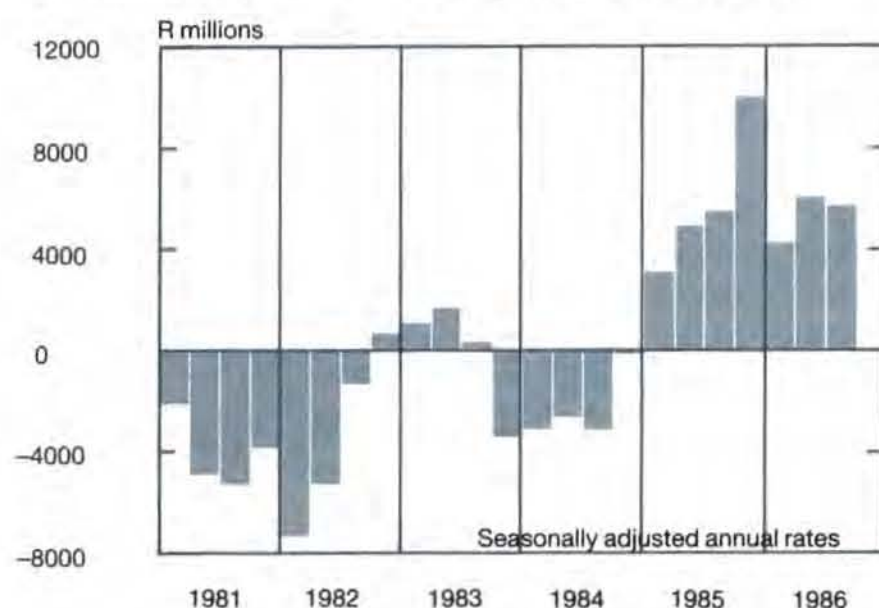
Current account

A seventh consecutive quarterly current account surplus was recorded on the balance of payments in the third quarter of 1986. At a seasonally adjusted annual rate of R5,8 billion, this surplus was slightly smaller than the surplus during the second quarter of 1986 (R6,0 billion) but notably larger than the surplus during the first quarter of the year (R4,3 billion). The third-quarter surplus brought the cumulative current account surplus for the first nine months of 1986 to R4,0 billion; at a seasonally adjusted annual rate the cumulative surplus ran to R5,4 billion. A surplus of well over R5 billion may now be expected for 1986 as a whole.

The sustained current account surpluses that were realised from the first quarter of 1985 onward were based primarily on the continued rise in the value of merchandise exports that had been in evidence from late 1983. The effect of rising merchandise exports on the current account surplus was supported during much of this period by higher, although strongly fluctuating, net gold exports as well as, of course, by the restrictive effect of the 1984/85 recession and of the subsequent slow economic recovery on import demand.

Having levelled off from the third quarter of 1985 to the second quarter of 1986, the value of merchandise exports advanced strongly again, namely by 10½ per cent, in the third quarter of 1986. This renewed rise in export earnings reflected volume as well as price increases. Price increases were attributable mainly to the decline in the weighted exchange value of the rand; the effect of this decline outweighed a moderate decrease in international commodity prices. Volume increases again reflected the price com-

Balance of payments: Balance on current account



Current account of balance of payments

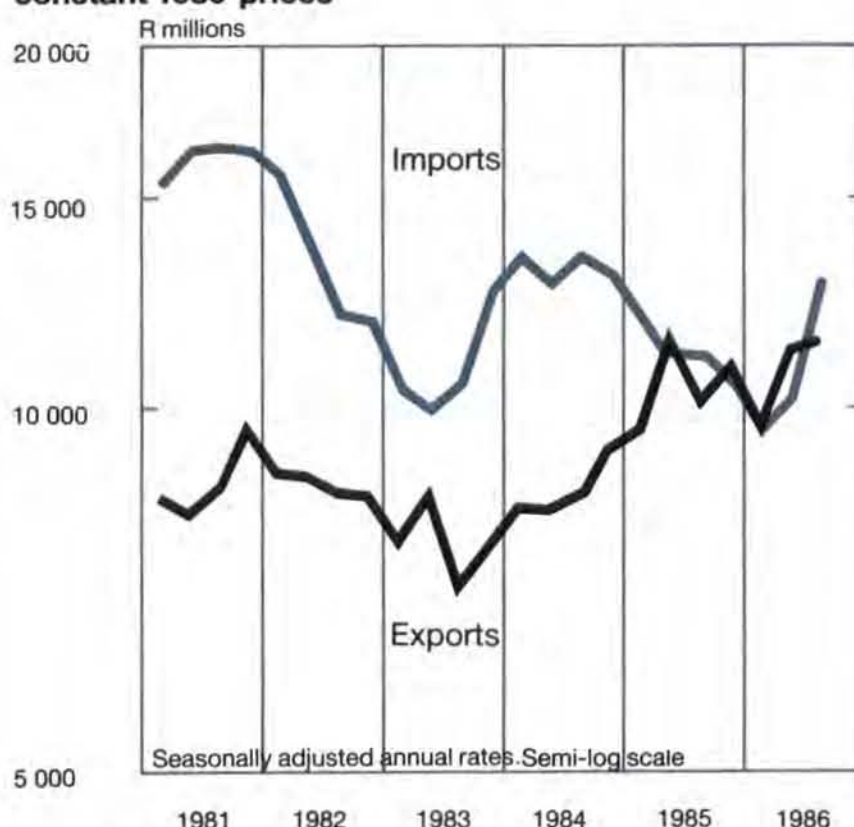
Annualised seasonally adjusted figures
R millions

	1986		
	1st qr.	2nd qr.	3rd qr.
Merchandise exports	21 360	24 020	26 540
Net gold exports	14 850	15 770	18 360
Merchandise imports	-23 710	-24 580	-30 670
Trade balance	12 500	15 210	14 230
Net service and transfer payments	-8 220	-9 190	-8 470
Current account balance	4 280	6 020	5 760

petitiveness of South African goods in overseas markets coupled with relatively firm rates of economic growth in industrialised trading partner countries. Volume increases occurred over a wide range of exports. Above-average rates of increase were recorded, however, in agricultural exports and in exports of prepared foodstuffs and mineral products.

Net gold exports rose by 16½ per cent in the third quarter of 1986 despite a further decline in the physical volume of gold production. Like the preceding two quarterly increases in net gold exports, this rise in the third quarter therefore again was based on an increase in the average fixing price of gold, which rose from R771 per fine ounce in the second quarter of 1986 to R945 per fine ounce in the third quarter. Although this higher rand price

Merchandise imports and exports at constant 1980 prices



of gold reflected to some extent the third-quarter depreciation of the exchange value of the rand, the average dollar price of gold also rose in this quarter, namely from US \$342 per fine ounce to US \$381. A weakening of the dollar in the foreign exchange markets, coupled with strong gold demand, caused the dollar price of gold to rise dramatically in the first few days of September 1986 in particular to US \$442,75 (its highest level since mid-May 1983) on 22 September. However, a recovery of the dollar *vis-à-vis* other currencies towards the end of October subsequently caused the dollar price of gold to fall back to a level that only slightly exceeded \$400 by the month-end. From the middle of November the gold price declined further to about \$380 per fine ounce.

The rise in the value of merchandise imports in the third quarter of 1986 actually somewhat exceeded the combined rise in the value of merchandise exports and net gold exports, amounting to as much as R6,1 billion or approximately 25 per cent. This sharp rise in the value of imports was more than fully accounted for by higher import volumes. Higher values of merchandise imports were spread widely over a large number of import categories and appeared to have been due to a major extent to fears of the potential impact of international trade sanctions. Although the exchange value of the rand declined on balance during the third quarter of 1986, the average level of import prices in terms of rand declined marginally because of the lower level of international oil prices.

Net service and transfer payments to non-residents, which had increased substantially from the beginning of 1985, declined in the third quarter of 1986, mainly because of lower interest and dividend payments to non-residents and higher overall service receipts.

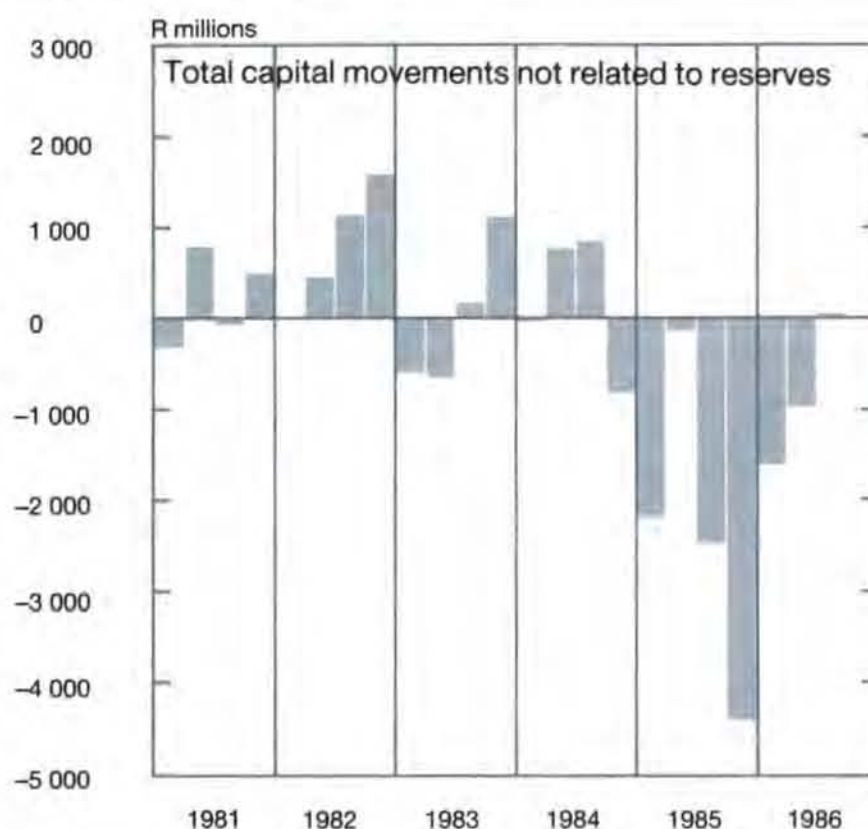
Capital account

A further improvement in the capital account of the balance of payments was recorded during the third quarter of 1986. Having declined from R1 614 million in the first quarter of 1986 to R972 million in the second quarter, the net outflow of capital not related to reserves was transformed into a small net *inflow* of R43 million in the third quarter. This turnaround in the net capital flow in the third quarter of 1986 was attributable primarily to a reversal of unfavourable leads and lags in foreign payments and receipts. In addition, certain public corporations were able to raise long-term foreign credits in the form of project financing. A net inflow of R21 million of long-term capital to public corporations was recorded in the third quarter of 1986.

Non-residents continued to be net sellers of securities listed on the Johannesburg Stock Exchange. The net total of such sales amounted to R278 million in the third quarter. The financial rand system obviously prevented these sales from acting as a drain on the country's gross gold and other foreign reserve holdings.

A net *inflow* of short-term capital not related to reserves (including unrecorded transactions) was recorded in the third quarter as a whole. This inflow was, however, limited

Capital movements



mostly to July and August. A renewed substantial outflow of short-term capital appeared to have occurred during September. The resumption of short-term capital outflows during September apparently was related to the high cost of forward cover, which favoured domestic rather than foreign financing of foreign trade transactions.

Foreign reserves

The substantial surplus on current account, supported by the small net inflow of capital not related to reserves, caused the *net* gold and other foreign reserves in the third quarter of 1986 to rise by R1 177 million. Further repayments on reserve-related foreign liabilities were, however, made to the amount of R451 million. Not considering valuation adjustments, these various balance of payments transactions on current and capital account therefore resulted in a third-quarter increase in the *gross* gold and other foreign reserves of R726 million. Mainly because of the higher rand price of gold, however, substantial positive valuation adjustments also affected the foreign reserve position. When these adjustments are taken into account, the total gross gold and other foreign reserves rose by R2 055 million during the third quarter and amounted to R6 358 million at the end of September 1986.

Exchange rates

Having reached a lower turning point on 12 June 1986, the effective exchange rate of the rand recovered slightly on balance up to the end of August. From the beginning of September, however, the abrupt rise in the price of

Changes in the exchange rates of the rand

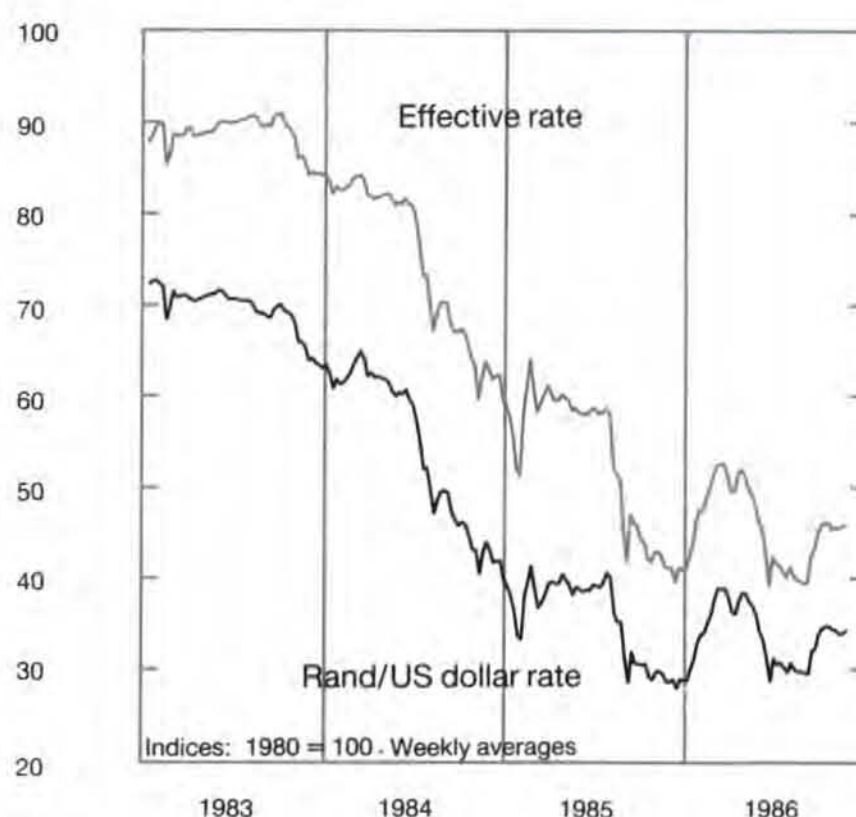
%

	18 Dec 1985 to 13 Mar 1986	13 Mar 1986 to 12 June 1986	12 June 1986 to 21 Nov 1986
Weighted average	30,1	-28,7	23,7
US dollar	36,4	-29,1	25,3
British pound	33,3	-32,0	35,5
German mark	24,6	-31,8	14,1
Swiss franc	25,2	-33,2	15,7
Japanese yen	21,9	-34,9	22,9
French franc	25,2	-29,3	17,9

gold helped to bring about a sharp appreciation of the rand against all currencies. On 21 November, the effective exchange rate of the rand was 23,7 per cent above its turning point of 12 June. Despite the net strengthening of the exchange rate in September and October, however, the average exchange value of the rand in terms of a basket of currencies of South Africa's principal trading partners in the third quarter of 1986 was below its average level in the second quarter. The lower average level of the exchange rate obviously contributed to the marked rise in the rand value of merchandise exports and imports during the third quarter of 1986.

The financial rand reached a lower turning point of US \$0,1825 on 7 August 1986 but subsequently appreciated by 15,1 per cent to \$0,2325 on 1 October. At this level, the financial rand stood at a discount of 48,3 per cent *vis-à-vis* the commercial rand. Announcements by certain American companies concerning their intended withdrawal from South Africa subsequently caused the financial rand to depreciate again to US \$0,2075 on 4 November, bringing its discount *vis-à-vis* the commercial rand to 52,7 per cent. Thereafter the financial rand appreciated again to US \$0,2350 on 21 November reflecting a discount of 47,5 per cent against the commercial rand.

Exchange rates of the rand



Money and banking

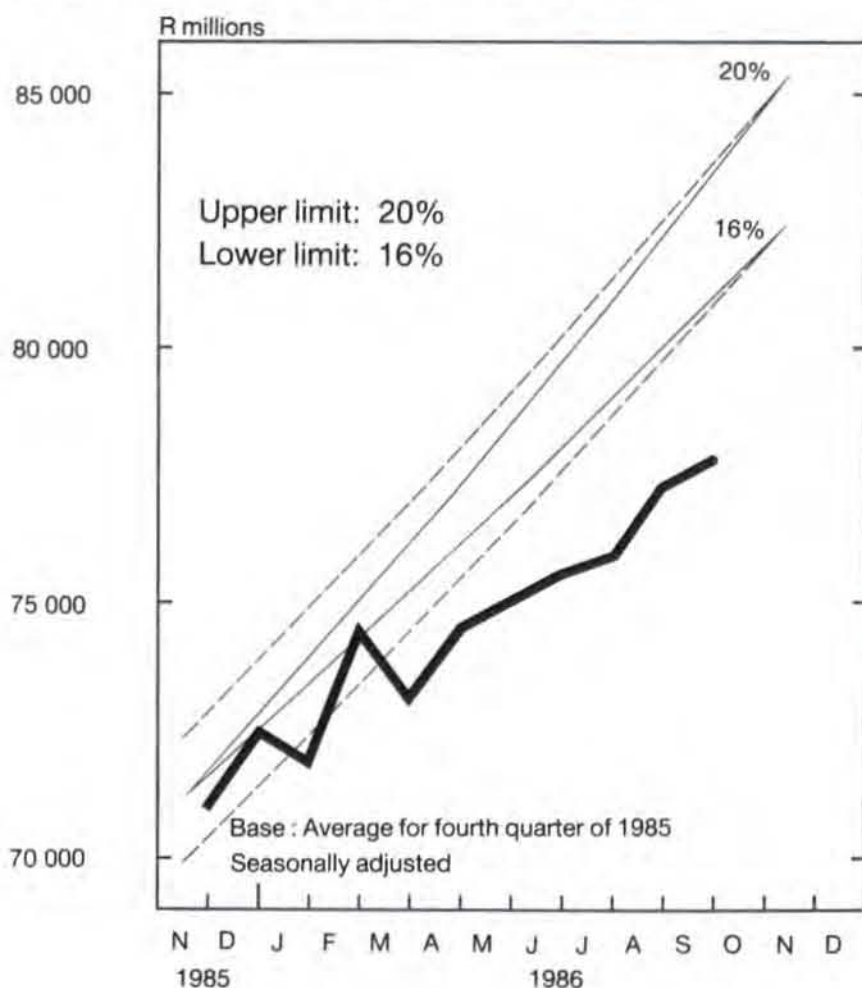
Money supply

The rate of increase in the broadly defined money supply, M3, showed a mild reacceleration in August and September 1986. Having slowed down from 12,3 per cent in December 1985 to 11,1 per cent in March 1986 and 9,4 per cent in July, the rate of increase in M3 over twelve-month periods rose fairly markedly during the subsequent two months to 9,6 per cent in August and 10,8 per cent in September. Preliminary data indicate that it amounted to 9,5 per cent in October.

Relatively slow growth in M3 during most of 1986 caused its seasonally adjusted value on month-ends to fall consistently short of the lower limit of the target range for the money supply (as indicated by the targeting "cone") from March 1986 onward. Provisional data for the money supply as at the end of October 1986 show M3 to have been below the lower targeting limit as on that date by approximately R4,3 billion or 5 per cent. The seasonally adjusted annual rate of increase in M3 from the beginning of the targeting "year" (mid-November 1985) to the end of October 1986 amounted to 9,7 per cent.

The seasonally adjusted annual rate of increase in the quarterly average of M3 from the fourth quarter of 1985 to the third quarter of 1986 amounted to 10,4 per cent.

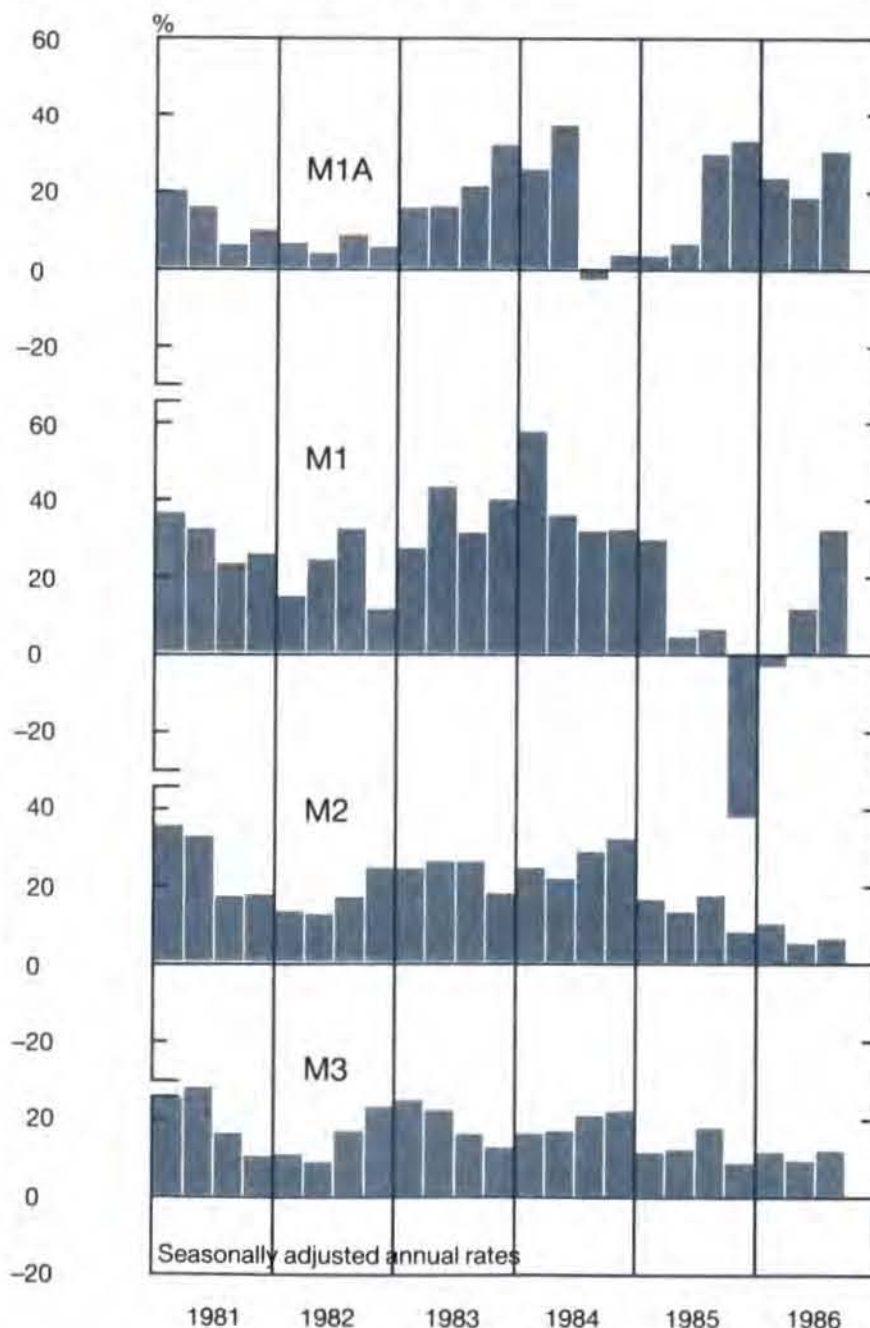
Target ranges for growth in M3 during 1986



Since the increase in the gross domestic product at current prices, also at a seasonally adjusted and annualised rate, is provisionally estimated to have amounted to approximately 17 per cent during this three-quarter period, the so-called income velocity of circulation of M3 (i.e. the ratio of the quarterly gross domestic product to the quarterly average of the money supply) during this period is estimated to have increased by 4,6 per cent.

The rate of increase in M2, measured over periods of twelve months, fluctuated downwards from 14,1 per cent in December 1985 to 5,9 per cent in August 1986 but subsequently increased to 6,4 per cent in September. The twelve-month growth rates of M1 and M1A still continued to be influenced by the effects of the abolition, from September 1985, of the banks' procedure for "averaging" their demand liabilities in calculating their short-term liabilities for purposes of their liquid asset requirements. The one-off shift in various deposit holdings that resulted from this measure also caused M1 to con-

Changes in monetary aggregates



tinue to show negative growth rates over twelve-month periods up to August 1986. This rate turned positive again, however, in September. The twelve-month growth rate in M1A, on the other hand, rose from 19,8 per cent in December 1985 to 30,4 per cent in June 1986 before receding slightly to 28,1 per cent in September. Rather more comparable and similar rates of increase in M1 and M1A were recorded, however, with regard to more recent periods that exclude most of the initial shock effect of the abolition of "averaging". From the end of December 1985 to the end of September 1986, for example, the respective seasonally adjusted annual rates of increase in M1 and M1A amounted to 12,8 and 26,4 per cent.

Private sector holdings of money and close money substitutes generally, are likely to have been influenced downwards in recent quarters by lower levels of deposit interest rates relative to the inflation rate. At the same time, however, reductions in the interest rates on deposits and expectations of further reductions in these rates also favoured a relative shift by depositors to the longer-term components of the M3 money aggregate, as is customary in periods of prolonged declines in interest rates. From the end of December 1985 to the end of September 1986, long-term deposits with "monetary" institutions (i.e. banks, building societies and the Post Office Savings Bank) accordingly increased by as much as 24,7 per cent. Demand deposits with these institutions, on the other hand, increased by a considerably smaller 7,7 per cent during this period, while medium-term deposits actually declined by 3,5 per cent.

Competitive investment opportunities offered by building societies and the Post Office Savings Bank caused the share of these institutions in the total deposit liabilities of all monetary institutions to rise slightly from 31,4 per cent and 3,6 per cent, respectively, at the end of December 1985 to 32,8 per cent and 4,4 per cent, respectively, at the end of September 1986. The share of banking institutions in total deposits with monetary institutions declined commensurately from 65,0 per cent to 62,8 per cent during this period.

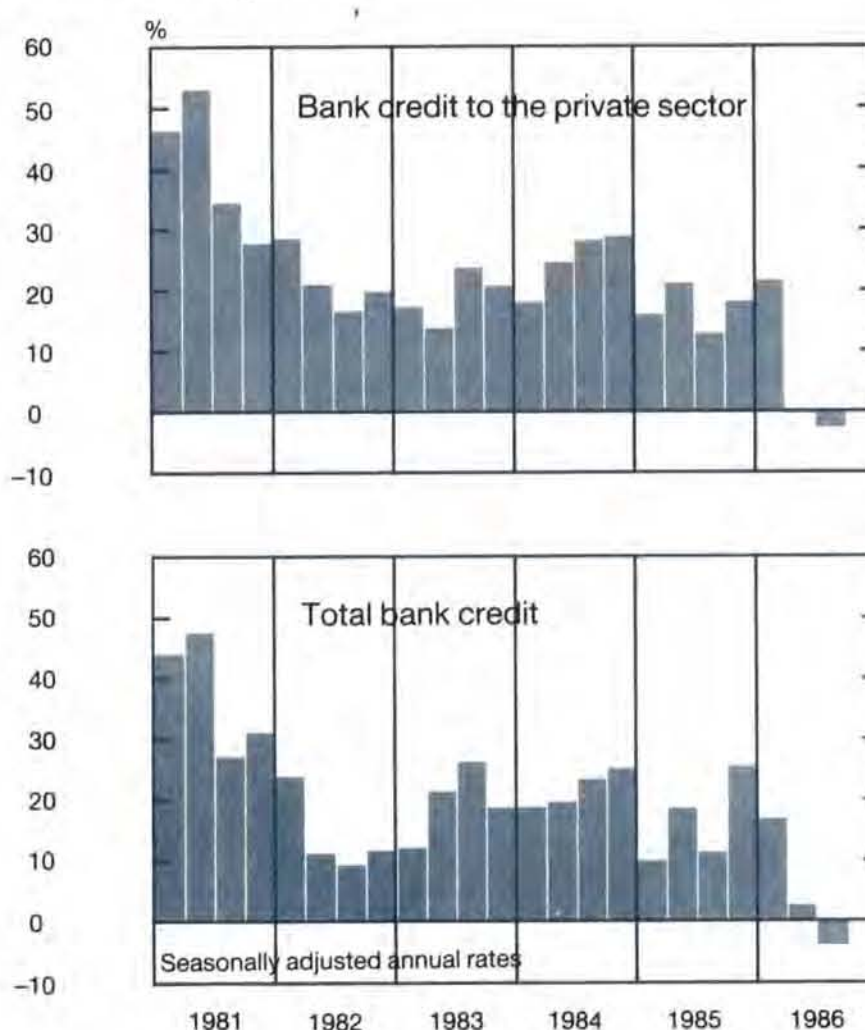
The principal "cause", in accounting terms, of the relatively low rate of growth in M3 during the first nine months of 1986 was the slow-down in total new credit extension by monetary institutions during this period. Measured over twelve months, the rate of increase in total credit extended by the monetary sector decreased from 16,8 per cent in December 1985 to 9,7 per cent in September 1986; the twelve-month rate of increase in September therefore fell well short of the concurrent twelve-month inflation rate. Having declined during the first quarter of 1986, the net gold and other foreign reserve holdings of the monetary sector made a positive contribution to M3 growth in the second quarter and continued to do so in the third quarter.

Bank credit

Low and declining levels of fixed capital formation, reductions in inventory holdings during the first half of 1986, consumers' apparent reluctance to increase their financial indebtedness even in nominal terms, and banks' cautiousness in lending while still burdened with substantial amounts of bad debts, caused the twelve-month rate of increase in bank credit to the private sector to slow down further at an accelerating pace during the most of the first nine months in 1986 from the cyclical peak rates of increase in such credit that had prevailed towards the end of 1984. The twelve-month rate of increase in the banks' claims on the private sector accordingly declined from 15,7 per cent in December 1985 to only 6,6 per cent in September 1986. The quarterly average of banks' claims on the private sector showed virtually no change in the second quarter of 1986 and actually declined, at a seasonally adjusted annual rate of 2,7 per cent, during the third quarter. A slight increase in these claims did, however, occur from the end of June to the end of September.

Lack of demand for new investment in machinery and equipment continued to be reflected in a decline in leasing finance. Leasing finance decreased at seasonally adjusted annual rates of 12,6 per cent and 4,9 per cent during the first six months of 1986 and during the third

Changes in bank credit



quarter of 1986, respectively. Hire-purchase credit declined at a seasonally adjusted annual rate of 3,9 per cent during the first six months of 1986 and, despite the mild further revival in consumer demand for durables, subsequently declined further at an annual rate of 6,0 per cent from the end of June to the end of September. Households' reluctance to incur new debt in the face of declining real after-tax incomes also would appear to have contributed, however, to renewed stagnation in banks' "other" loans and advances. The total of this kind of bank credit actually contracted marginally at a seasonally adjusted annual rate of 2,3 per cent between the end of June and the end of September after having increased at an annual rate of 14,2 per cent during the first half of the year.

Net claims on the government sector decreased in the third quarter partly because large tax receipts in August allowed the central government to reduce its net indebtedness to the banking system. In conjunction with the very limited increase in bank credit to the private sector, this reduction in the government sector's net borrowing from banking institutions also caused *total* bank credit in the third quarter of 1986 to contract at a seasonally adjusted annual rate of 2,6 per cent. Measured over a twelve-month period, the rate of increase in total bank credit slowed down from 17,7 per cent in December 1985 to 11,1 per cent in June 1986 and to 6,5 per cent in September.

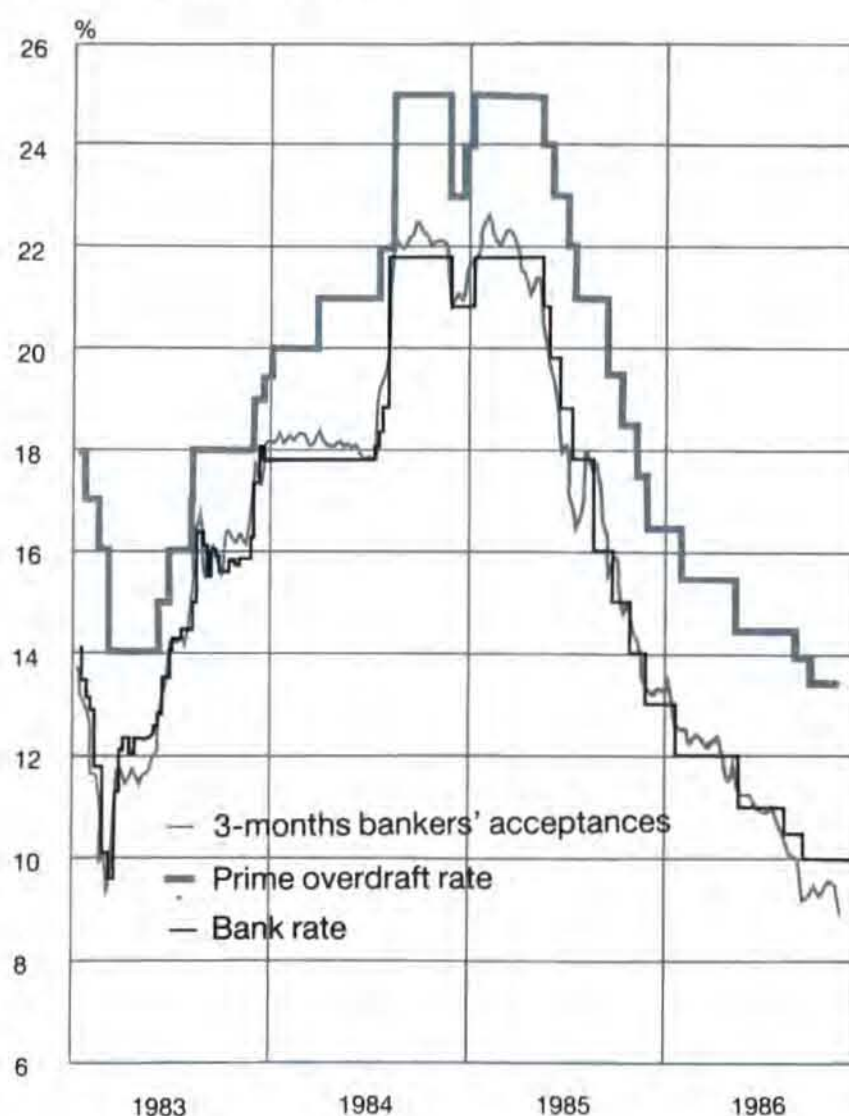
Financial markets

Bank rate policy and interest rates

The low to moderate tempo of the economic recovery in the second and third quarters of 1986, continuing large surpluses on the current account of the balance of payments, an enhanced measure of stability of the exchange rate from mid-June, below-target rates of growth in the money supply, and actual declines in total bank credit in the third quarter, justified further reductions in Bank rate and the associated refinancing rates in the period May to September 1986. Bank rate was reduced by 1 per cent (to 11 per cent) on 5 May 1986, by $\frac{1}{2}$ per cent on 5 August, and by a further $\frac{1}{2}$ per cent (to 10 per cent) on 5 September. In accordance with these changes, the clearing banks' prime overdraft rate was cut to 14,5 per cent from the middle of May, to 14,0 per cent from 25 August, and to 13,5 per cent from 20 September.

Money market rates remained well below the relevant Reserve Bank rediscount rates during the period from August to early November. Rates tended to firm some-

Short-term interest rates



what from approximately the middle of September from low points reached in the course of the month but then showed little further change on balance up to the end of October. The market rate on three-month bankers' acceptances, for example, declined from 10,45 per cent at the end of July (when the Reserve Bank's rediscount rate for bankers' acceptances was 11,50 per cent), to 9,90 per cent at the end of August (when the Bank's rediscount rate for acceptances amounted to 11,00 per cent), and to 9,10 per cent on 16 September (when the Bank's rediscount rate for acceptances was 10,50 per cent). This rate then rose to 9,60 per cent at the end of September and fluctuated around this level during October.

The rate on three-month bankers' acceptances of 9,10 per cent on 16 September represented its lowest level since early February 1981. To some extent, this low rate came about as a result of an increased demand for statutory liquid assets by banking institutions as banks sought to comply with the liquid asset requirements of 20, 15 and 5 per cent against their short-, medium- and long-term liabilities that came fully into effect from the date of the banks' certification of their monthly returns for August 1986.

Market rates eased substantially further during November. By 21 November the three-month bankers' acceptance rate had eased to only 9,00 per cent.

Debt management and refinancing operations

Considerable success was attained with the Reserve Bank's debt management operations in the first two quarters of fiscal 1986/87. As in earlier quarters, these operations continued to be aimed primarily at funding the Government's borrowing requirements. Net sales of government stock from the beginning of April to the end of September 1986 amounted to no less than R2 744 million. Relatively high levels of the Government's balances with the Reserve Bank, less receptive market conditions when medium- and long-term interest rates reverted to higher levels from the third week of September, and the Bank's unwillingness to add to the upward pressure on long-term interest rates, provided reasons, however, for a temporary reining-in of the Bank's selling activities in late September and during October and early November 1986. Net sales of government stock in October accordingly ran to a negligible amount of only R1 million.

Specially-dated Treasury bills to an amount of R500 million were redeemed at the end of August 1986. Partly to resist an unduly large and rapid seasonal easing of money market conditions after the August month-end, the Bank again sold by tender R500 million of such bills during the first nineteen days of September. Of these bills, R300 million will mature at the end of November and R200 million at the end of February 1987.

Funds of the Corporation for Public Deposits with the discount houses, which had been restored to R800 million at the end of August, were kept at this level, with

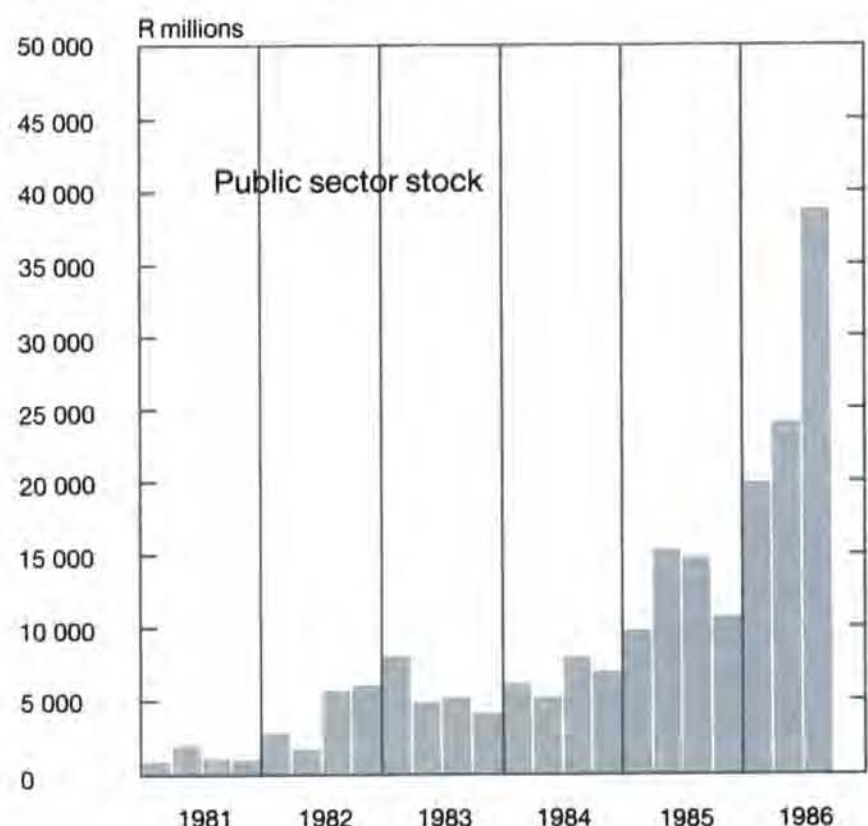
exceptions on only a few days, throughout September and October 1986. In an unusual development, the amount of such funds was, however, reduced to nil on 6 November and again on a number of days up to 21 November.

Accommodation at the discount window continued to show substantial fluctuations. The amount of such accommodation was allowed to drop to nil on a number of days in August, but was raised again to R901 million on the August month-end. It subsequently fluctuated between a high point of R1 418 million on 8 September and a low point of R85 million on 16 September before reverting to R950 million at the end of September. The amount then decreased rapidly to only R1 million on 21 October and to R71 million on the October month-end before declining to nil on 6 November. On 6 November, therefore, no accommodation at all was required by the discount houses from either the Reserve Bank or the Corporation for Public Deposits. This situation repeated itself on a number of days up to 21 November.

Capital market activity

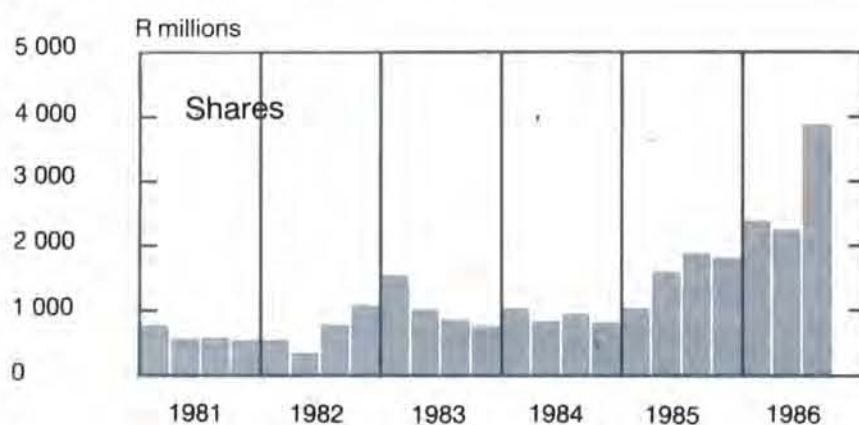
Activity in the capital markets gained further momentum in the third quarter of 1986. This was clearly reflected in considerable increases in turnover in public sector stock and in shares listed on the stock exchange, as well as in further increases in share prices. However, new issues of stocks and shares were substantially lower than the generally high levels that had been attained earlier. A small decline was also recorded in the value of real estate transactions.

Stock exchange transactions



In the secondary market, the value of public sector stock traded on the stock exchange rose from R24,4 billion in the second quarter to R39,2 billion in the third quarter. It amounted to R12,1 billion in October. The value of company shares traded on the stock exchange increased similarly strongly from R2,3 billion in the second quarter to R3,9 billion in the third quarter. This increase in turnover was accompanied by substantial increases of 25 per cent in the average price of all classes of shares and of no less than 48 per cent in the average price of gold mining shares during the period from June to September 1986. In October, these average price levels rose slightly further by 2 and 3 per cent. Contrary to the upward trend in trading activity in the securities markets, real estate transactions declined slightly in value from R2,7 billion in the second quarter of 1986 to R2,6 billion in the third quarter.

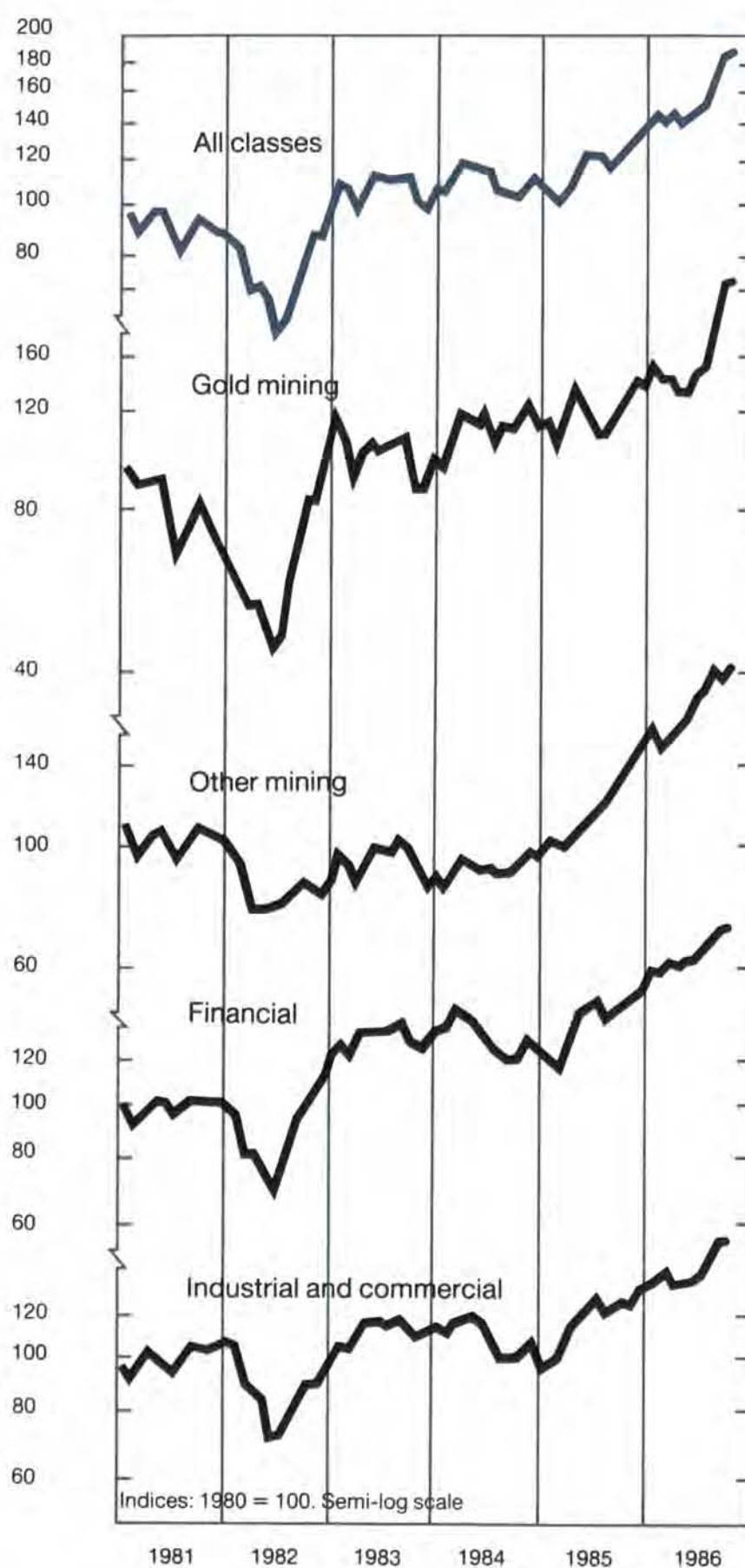
Stock exchange transactions



Public sector borrowing by means of new issues of marketable securities amounted to R0,9 billion in the third quarter, compared with R1,8 billion in the second quarter and a relatively modest amount of only R0,4 billion in the third quarter of 1985. The corresponding amounts with regard to new fixed-interest securities issued by companies listed on the stock exchange ran to R0,2 billion, R0,1 billion and R0,2 billion, respectively. For newly listed share capital the amounts concerned were R0,1 billion, R0,6 billion and R0,8 billion, respectively. Funds taken up in the capital market in this way contributed to a reduction in the use of bank credit by companies of R363 million from the end of June to the end of September 1986.

In the mortgage market, the improved net inflow of funds to building societies allowed these institutions to increase their mortgage lending to R1,8 billion during the third quarter of 1986, compared with a quarterly average of R1,4 billion during the first half of 1986.

Share prices



Long-term rates and yields

Following upon their mildly downward movement from the beginning of 1986 to the middle of June and their subsequent sharp decline to the middle of September, long-term interest rates rebounded to markedly higher levels in the second half of September. This sharp turnabout of the decline in long-term interest rates also was in marked

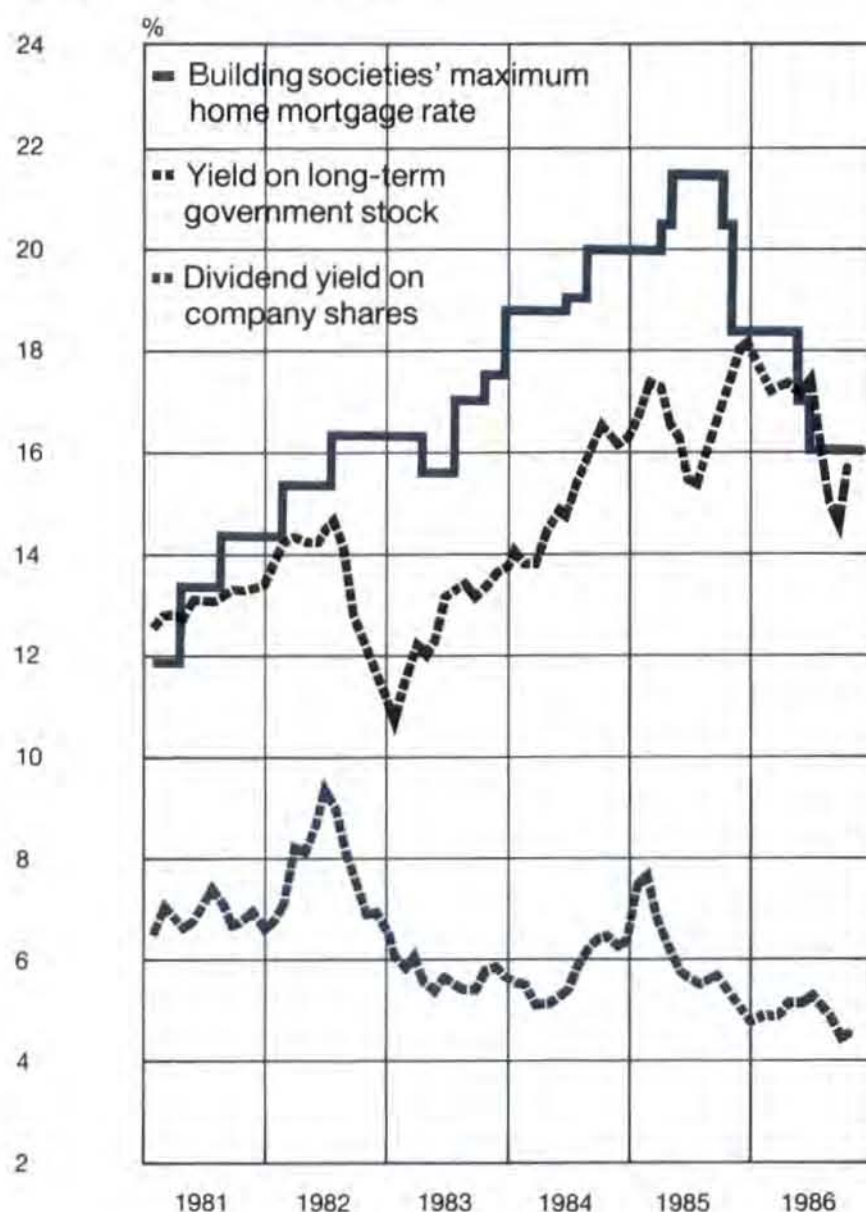
contrast with the relatively slight firming of money market interest rates in the second half of September and early October 1986. The yield on long-term government stock declined from a monthly average of 17,4 per cent in June 1986 to 16,4 per cent in July, 14,9 per cent in August and 14,5 per cent in the first half of September, before reverting to 15,7 per cent at the end of September and to a monthly average of 15,8 per cent in October. A major factor in explaining this reversal of the downward interest rate movement was the market's reaction to the worsening of the inflation rate. In addition, the slower-than-budgeted increase in government revenue may have been perceived by the market as having raised the probability of increased government borrowing.

In the share market, the gradual downward drift of the yield on shares mirrored the sustained upward movement of share prices. The average monthly yield on all classes of shares declined substantially from 5,2 per cent in June 1986 to 4,5 per cent in September. It amounted to 4,6 per cent in October.

Reflecting the sustained sluggish demand for credit and the decline in short-term market interest rates, the in-

terest rates on deposits with financial institutions also maintained their generally easier trend. The rate on twelve-month deposits, which had been reduced in steps from 14,5 per cent in December 1985 to 12,0 per cent in June 1986, was lowered further to 11,0 per cent in August and, in the case of certain major banks, to 10,5 per cent in September. This rate level was maintained in October and early November. The reduced cost of funds enabled the building societies to lower their home mortgage rates from a minimum of 17,75 per cent and a maximum of 18,25 per cent (depending on the size of the loan) in April 1986 to a uniform rate, applying to all home mortgage loans, of 16,0 per cent in June and 15,0 per cent in November.

Long-term interest rates



Government finance

Exchequer issues* and receipts

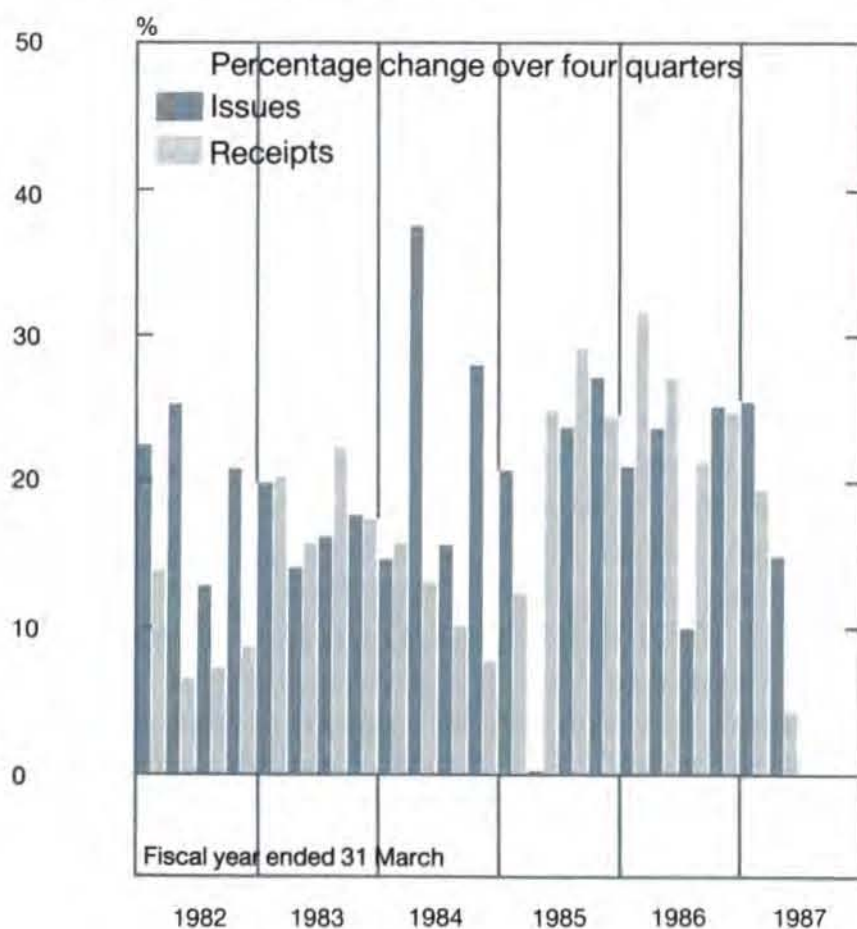
The rate of increase in Exchequer issues slowed down markedly in the period from July to September 1986, i.e. in the second quarter of fiscal 1986/87. Compared with the corresponding period in fiscal 1985/86, this rate of increase declined from 22,1 per cent in the first quarter of fiscal 1986/87 to 14,8 per cent in the second quarter. However, in October it accelerated again to 30,0 per cent. During the first seven months of fiscal 1986/87, total issues to government departments accordingly were 20,1 per cent higher than in the same period of the preceding year. This may be compared with the increase of 13,9 per cent in government expenditure that had been envisaged in the March 1986 Budget for the fiscal year 1986/87 as a whole. In the light of the package of additional stimulatory fiscal measures that was announced by the Minister of Finance on 17 June 1986, and related developments, the Treasury's final expenditure figure for fiscal 1986/87 may be expected to exceed the budgeted figure by a substantial amount.

Compared with the corresponding period of the preceding fiscal year, receipts on the Exchequer Account

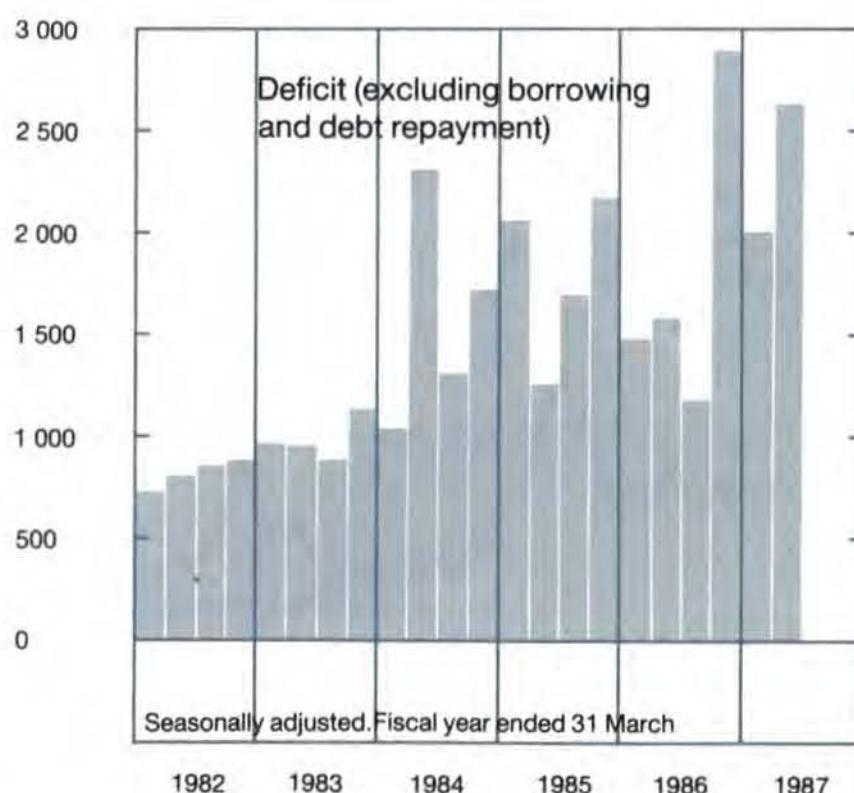
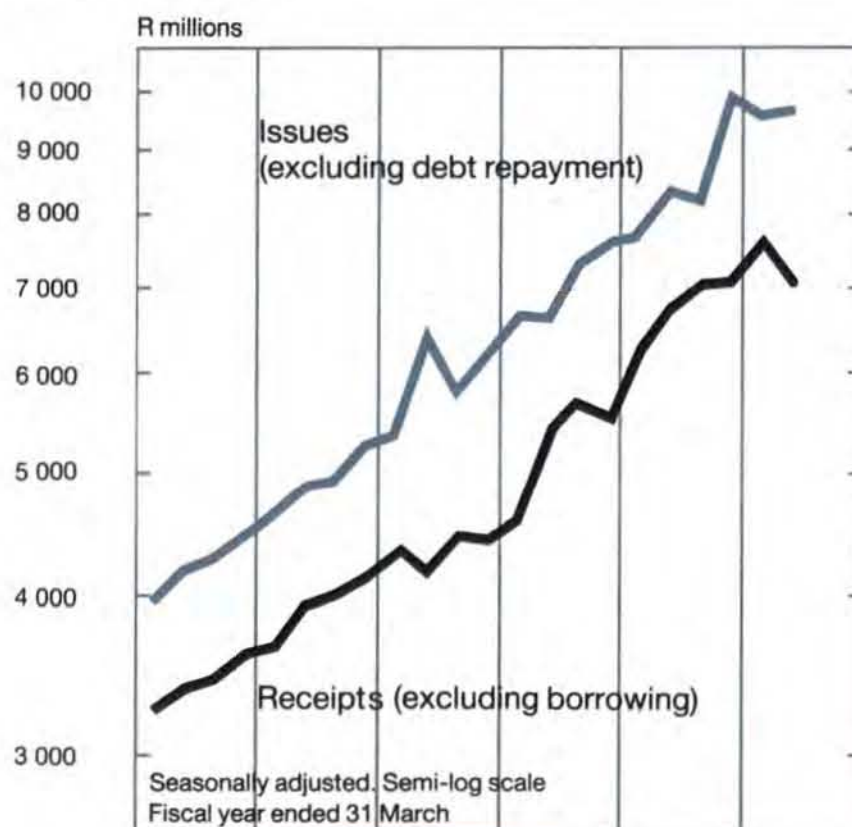
rose by only 4,2 per cent in the second quarter of the fiscal year 1986/87, but accelerated substantially in October. The rate of increase in the first seven months of the fiscal year amounted to 13,6 per cent. This rate of increase was slightly higher than the Budget estimate of 13,1 per cent for the fiscal year as a whole.

This fairly satisfactory performance of revenue occurred despite the fact that certain revenue items during the first half of fiscal 1986/87 were substantially below their budgeted increases. In particular, increases in receipts from general sales tax and personal income tax amounted to only 11,3 per cent and 18,4 per cent, respectively, com-

Exchequer issues and receipts



Exchequer Account



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

pared with budgeted estimates of 16,3 per cent and 20,1 per cent, respectively. Failure of these items to meet the Budget expectations was related mainly to the continued slow expansion in real economic activity.

In contrast to these developments, net receipts from customs and excise duties rose by 57,6 per cent in the first half of fiscal 1986/87, which substantially exceeded the budgeted increase of 20,9 per cent for the fiscal year as a whole. This was due mainly to the high value of imported goods and to the effect of the surcharge on imports. Tax receipts from gold mining companies decreased by 1,8 per cent, against a rate of decrease, as anticipated in the Budget, of 8,4 per cent. Increases in the other major categories of tax receipts, such as income tax payments by non-mining companies and by mining companies other than gold mines, were also slightly higher in percentage terms during the first half of the fiscal year than the Budget estimates for the fiscal year as a whole.

Deficit before borrowing

A deficit of R538 million was recorded in the second quarter of the fiscal year 1986/87, against a surplus of R319 million in the corresponding quarter of the preceding year. The deficit in the first half of the fiscal year consequently increased to R3 655 million. This amount was financed from the following sources:

	R millions
Public Investment Commissioners	2 132
Non-bank private sector	1 011
Banking sector	1 004
Foreign sector	-87
	<hr/>
	4 060
Less discount on government stock	-405
	<hr/>
	3 655