

# Quarterly economic review

## Introduction

Having advanced at annual rates of 3½ per cent in the third and fourth quarters of 1986 and of 2 per cent in the first quarter of 1987, real gross domestic product increased at an annual rate of only 1 per cent in the second quarter. Output levels in the second quarter were adversely affected, however, by various work stoppages and by the unusually large number of non-working days in April and May.

The increase in real gross domestic product in the *third* quarter of 1987 is provisionally estimated to have amounted to an annual rate of 1½ per cent. The average level of total real gross domestic product in the first three quarters of 1987 nevertheless was some 2¾ per cent higher than in the first three quarters of 1986. Current projections are for a growth rate of the South African economy in the calendar year 1987 of between 2 and 2½ per cent.

The disappointing growth performance of the economy in the third quarter of 1987 ran counter to the impressions and expectations of most economists. It was also at variance with the more positive business mood, the gradual return of "confidence", and the strengthening of spending intentions, that would appear to have prevailed during the third quarter, as well as with informal business reports indicating enhanced degrees of capacity utilisation, the occasional re-emergence of capacity constraints and stock shortages in certain industries, and rising importation needs.

Sectoral analyses of output data, however, show the low growth rate of the third quarter to have been attributable almost exclusively to marked declines in production in the primary sectors (agriculture and mining) of the economy. A relatively impressive increase in aggregate real value added, at an annual rate that is provisionally estimated to have been of the order of 6½ per cent, actually was recorded in the non-primary sectors. The average level of real output in the non-primary sectors in the first three quarters of 1987 exceeded the average level of output in these sectors in the corresponding nine months of 1986 by some 3½ per cent.

Real gross domestic expenditure in the third quarter of 1987 continued to rise firmly for the third consecutive quarter, although at a rate that was moderately lower than in the preceding six months. Total real gross domestic expenditure in the first three quarters of 1987 was some 3 per cent higher than in the corresponding period of 1986. The third-quarter increase in total real gross domestic spending was

accounted for mainly by a further rise in private consumption expenditure and an increase in real inventories.

Real private consumption expenditure in the third quarter of 1987 recorded its sixth consecutive quarterly increase at annualised rates which had varied from 2½ to 4 per cent. Despite an increase in tax burdens, the fairly steady upward course of real private consumption from the second quarter of 1986 was based on a broadly commensurate rate of increase in real personal disposable (after-tax) income as well as on sustained low levels of the personal savings ratio. Real *government* consumption expenditure, having grown exceptionally rapidly in the first quarter of 1987 but at a more moderate pace in the second quarter, actually decreased in the third quarter.

Total real gross domestic fixed investment, after renewed declines in the first half of 1987, is estimated to have recovered marginally in the third quarter. An encouraging increase was recorded in real fixed capital formation in the private sector. Aggregate real inventories rose in the third quarter mainly because of significant additions to industrial and commercial inventories. This caused the ratio of industrial and commercial inventories to non-agricultural real gross domestic product to flatten out in the course of the first three quarters of 1987 at a level of approximately 20 per cent.

Rising volumes of merchandise imports, at relatively stable import prices, provided the principal explanation of some further shrinking of the surplus on the current account of the balance of payments in the third quarter. The third-quarter surplus, at an annualised rate, nevertheless still amounted to R5,4 billion or to approximately 3 per cent of gross domestic product. After allowing for fairly modest further outflows of both reserve-related and non-reserve-related capital, the current account surplus caused the gross gold and other foreign reserves to rise by another R0,8 billion in the third quarter to R8,6 billion at the end of September.

Notable features of the South African economy in the third quarter of 1987 therefore included, firstly, continued steady expansion of real private consumption expenditure, a modest resumption of inventory accumulation, and a bottoming-out of the fixed investment cycle; secondly, a firm rate of expansion of non-primary production that would have been reflected in aggregate output growth but for unexpectedly poor results in agriculture and mining; and thirdly, continued healthy, although gradually diminishing, surpluses on the balance of payments on



current account. Between them, these features outlined a picture of an economy that - after an unusually long warming-up period and earlier false starts, despite certain obvious abnormalities, and in the face of a number of externally imposed adverse developments and constraints - nevertheless appeared to have moved out of the preparatory into the early expansionary stages of a fairly typical cyclical upswing.

Total employment rose relatively rapidly in the second quarter of 1987. Higher employment levels, however, did not succeed in reducing the total number of registered unemployed, which reverted in August and September to levels clearly in excess of the 1986 average. Inflation rates mostly subsided further in the third quarter.

In the area of monetary and financial developments, fairly marked accelerations were apparent in the rate of increase in the M3 money supply and in bank credit to the private sector after the fourth quarter of 1986 or from cyclical lower turning points in the early months of 1987. A sharp rise in the money supply in September caused M3 as at the end of that month to fall within the targeting "cone" for the first time in the 1987 targeting year.

Easy conditions continued to prevail in the money market in the third quarter, October and November 1987. Short-term interest rates mostly were very stable at levels well below the Reserve Bank's relevant rediscount rates. Mild further encouragement of the money market's ease and liquidity was provided by the Reserve Bank through the Bank's operations in the market after the sharp downward adjustment of share prices on the stock exchange from 20 October.

The capital markets, in the third quarter and the first part of October 1987, witnessed another round of increases in trading activity and a further acceleration of the rise in share prices. From 20 October to 5 November, however, share prices on the Johannesburg Stock Exchange, in broad correspondence with the slump in share prices that had commenced on the world's major stock exchanges on 19 October, fell back by an average of some 40 per cent.

Little immediate impact of these stock market developments was apparent on other South African financial markets up to early December 1987. The major decline in domestic share values of October-November nevertheless could reasonably be expected somewhat to lower the ceiling on growth prospects for the South African economy in 1988. By early December 1987 no evidence had become available as yet, however, that the stock exchange losses of October-November were having or would have a seriously detrimental effect on domestic private-sector propensities to consume or invest. Share market declines well ahead of the upper turning points of the general business cycle (with leads of varying

lengths) have, in fact, been a regular feature of post-war South African business cycle developments.

The South African economy would not be able fully to insulate itself, however, from a further weakening of growth in the international economy that was widely expected to follow in the wake of the world-wide re-rating of equity values. The eventual impact of the global drop in share prices from 19 October on domestic economic developments would, therefore, also depend to an important degree on the policy responses of the monetary and fiscal authorities in the world's top industrialised economies.



Domestic economic developments

Domestic output

Growth in total real gross domestic product in the third quarter of 1987 is provisionally estimated to have amounted to a seasonally adjusted annual rate of 1½ per cent. This followed upon an annualised growth rate of 1 per cent (revised downwards from the earlier estimate of 1½ per cent) in the second quarter of the year. The average level of total real gross domestic product in the first three quarters of 1987 nevertheless was some 2¾ per cent higher than in the first three quarters of 1986. On present estimates, further real growth at a seasonally adjusted annual rate of some 5¾ per cent would be needed in the fourth quarter of 1987 if the growth rate for the calendar year 1987 is to reach 2½ per cent. Current projections are for a growth rate of the South African economy in 1987 of between 2 and 2½ per cent.

The disappointing overall growth performance of the South African economy in the third quarter of 1987, which would appear to have run counter to the considerably more favourable impressions and expectations of most economists, was attributable

almost entirely to sharp setbacks to output levels recorded by the primary sectors, i.e. by agriculture and mining. In contrast, quite considerable strength was displayed again by the non-primary sectors of the economy.

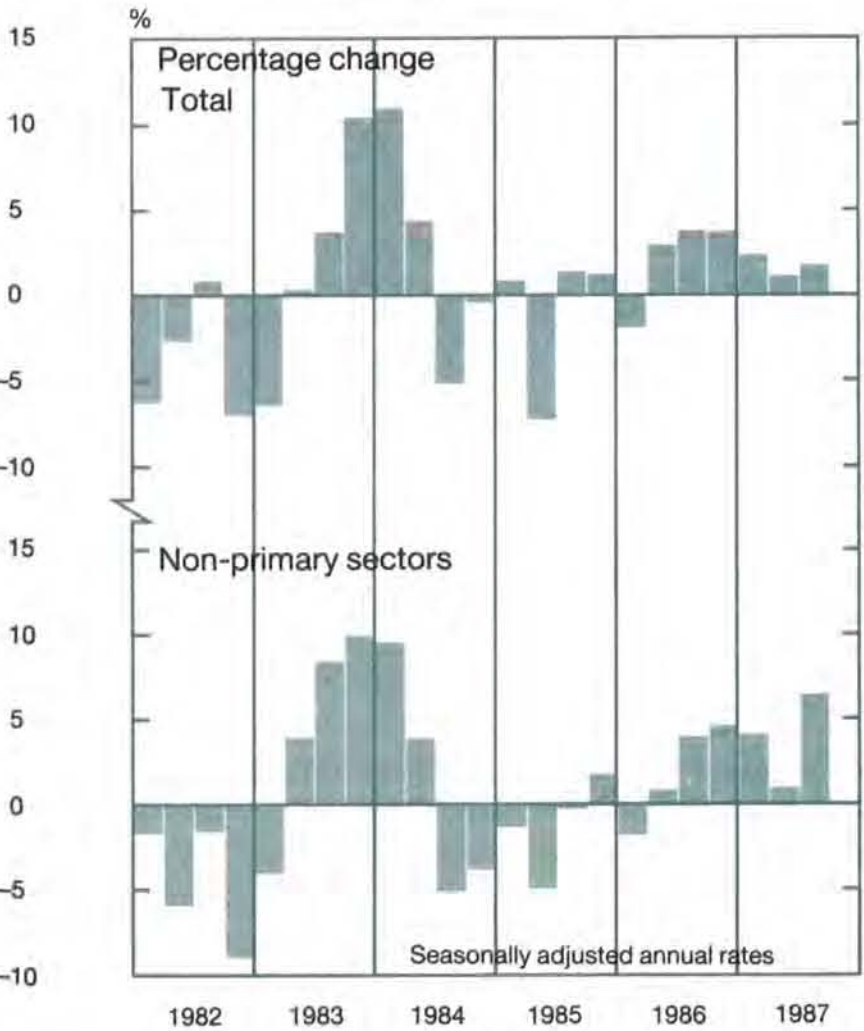
Real output in the agricultural sector during the third quarter of 1987 was significantly lower than in the third quarter of 1986 mainly because of recent sharp downward revisions of maize crop estimates for the 1986/87 agricultural season. The maize crop estimate of 7,4 million tons for 1986/87 compares with an actual harvest of 7,9 million tons in 1985/86. In addition, lower-than-expected production levels were recorded in sugar and citrus farming. A sharp third-quarter decline in real value added by the mining sector was accounted for mostly by the labour strike during August in a major part of the gold mining industry.

At a seasonally adjusted annual rate, the decline in real output in the primary sectors of the economy from the second to the third quarter of 1987 amounted to nearly 12 per cent. During the five-quarter period from the third quarter of 1986 to the third quarter of 1987 the annualised rate of contraction of real value added in these sectors amounted to 2½ per cent. Aggregate output in these sectors in the first three quarters of 1987 was some ½ per cent lower than in the corresponding period of 1986.

Relative buoyancy of the *non*-primary sectors, on the other hand, was evident from further acceleration of the growth tempo in these sectors in the third quarter of 1987 to an annualised rate of approximately 6½ per cent. The relative importance of these sectors in the national economy is apparent from their percentage contribution to nominal gross domestic product, which varied from 71 per cent in 1980 to 81 per cent in 1984 and 78½ per cent in 1985, for an average over this six-year period of some 78 per cent.

The 6½ per cent annualised rate of output growth in the non-primary sectors of the economy in the third quarter of 1987 represented a further improvement on the annualised growth rates, ranging from 3½ to 5 per cent, that had been attained by these sectors in the second half of 1986 and the first quarter of 1987. In the second quarter of 1987, however, various non-recurrent factors - including strikes and labour disputes and the unusually large number of non-working days in that quarter - had caused the growth rate in aggregate real non-primary production to fall back temporarily to approximately 1 per cent. During the five quarters from the third quarter of 1986 to the third quarter of 1987 the average annual rate of increase in real value added in the non-primary sectors amounted to 4 per cent. The average level of real output in these sectors in the first three quarters of 1987 was some 3½ per cent higher than in the first three quarters of 1986.

Real gross domestic product





Output increases in the non-primary sectors of the economy during the third quarter of 1987 were broadly based. Following upon a decline in manufacturing output in the second quarter, the most prominent rise in real value added in the third quarter was recorded by manufacturing industry, notably by the production of food and chemicals. Appreciable further rises in real output in continuation of second-quarter increases were registered by the sector commerce (more particularly by the wholesale and motor trades), the financial services sector, and general government. An increase in real value added was also recorded by the sectors providing electricity, gas and water.

Rates of increase in real gross *national* product were significantly higher in both the second and the third quarter of 1987 than those in total real gross *domestic* product. In annualised terms the rates of growth in real gross national product amounted to 3½ per cent (previously estimated at 4½ per cent) and 4½ per cent in the second and third quarters, respectively. Real gross national product in the first three quarters of 1987 accordingly exceeded its average level of one year earlier by a full 3 per cent. Unlike developments in the second quarter of 1987 (which saw a significant decline in net interest payments, and therefore in net factor payments, to foreigners), the growth rate differential in favour of gross national product in the third quarter was accounted for solely by an improvement in the South African terms of trade.

### Domestic expenditure

Total real gross domestic expenditure continued to expand firmly during the third quarter of 1987 for the third consecutive quarter, but did so at a lower rate than during the preceding six months. The seasonally

adjusted annual rates of increase in aggregate real domestic expenditure amounted to approximately 18½, 10 and 7 per cent in the first, second and third quarters, respectively. In the five-quarter period from the third quarter of 1986 to the third quarter of 1987 the average annualised rate of increase in aggregate real domestic spending reached a relatively impressive average figure of 6 per cent. The average level of total real domestic expenditure in the first three quarters of 1987, however, exceeded its average level in the first three quarters of 1986 by a more modest 3 per cent.

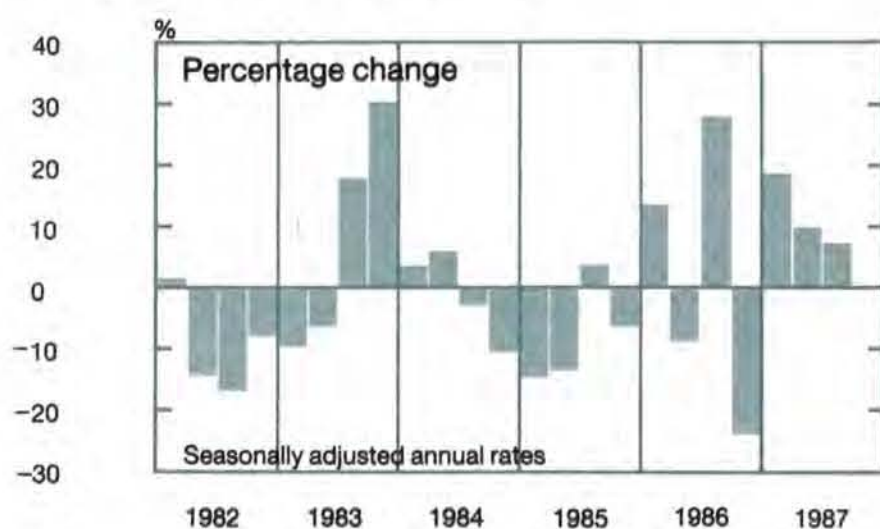
The third-quarter increase in aggregate real gross domestic expenditure mainly reflected a further strengthening of real private consumption expenditure and some further build-up of aggregate real inventories. Real private consumption expenditure in the third quarter of 1987 actually recorded its sixth consecutive quarterly increase at annualised rates which had varied from 2½ to 4 per cent. Its further rise in the third quarter of 1987 was based on a significant further rise in real personal disposable (after-tax) income and a sustained low personal savings ratio. Real private consumption expenditure in the third quarter of 1987 was some 5½ per cent higher than in the first quarter of 1986, against an increase in real personal disposable income during this period of some 6½ per cent. Like the rise in real private consumption expenditure in the third quarter of 1987, the third-quarter rise in real personal disposable income represented its sixth consecutive quarterly increase. The further rise in real disposable income in the third quarter of 1987 incorporated a marked increase in aggregate real salaries and wages as well as a sharp rise in real personal income from property.

Notable rates of increase were recorded in the third quarter of 1987 in real private spending on consumer durables, and in spending on personal transport equipment in particular. The strong advance in private outlays on personal transport equipment, which reached an annual rate of 11 per cent, was based on aggressive marketing by the motor trade and on successful introduction of new motor car models, as well as on relatively favourable financing terms and increasing pressures of replacement demand.

More moderate increases, amounting to annual rates of the order of 6 and 3 per cent, were registered in real private spending on semi-durable goods and consumer services, respectively. Relatively little change was shown by spending on non-durables, which advanced at an annual rate of some 1½ per cent.

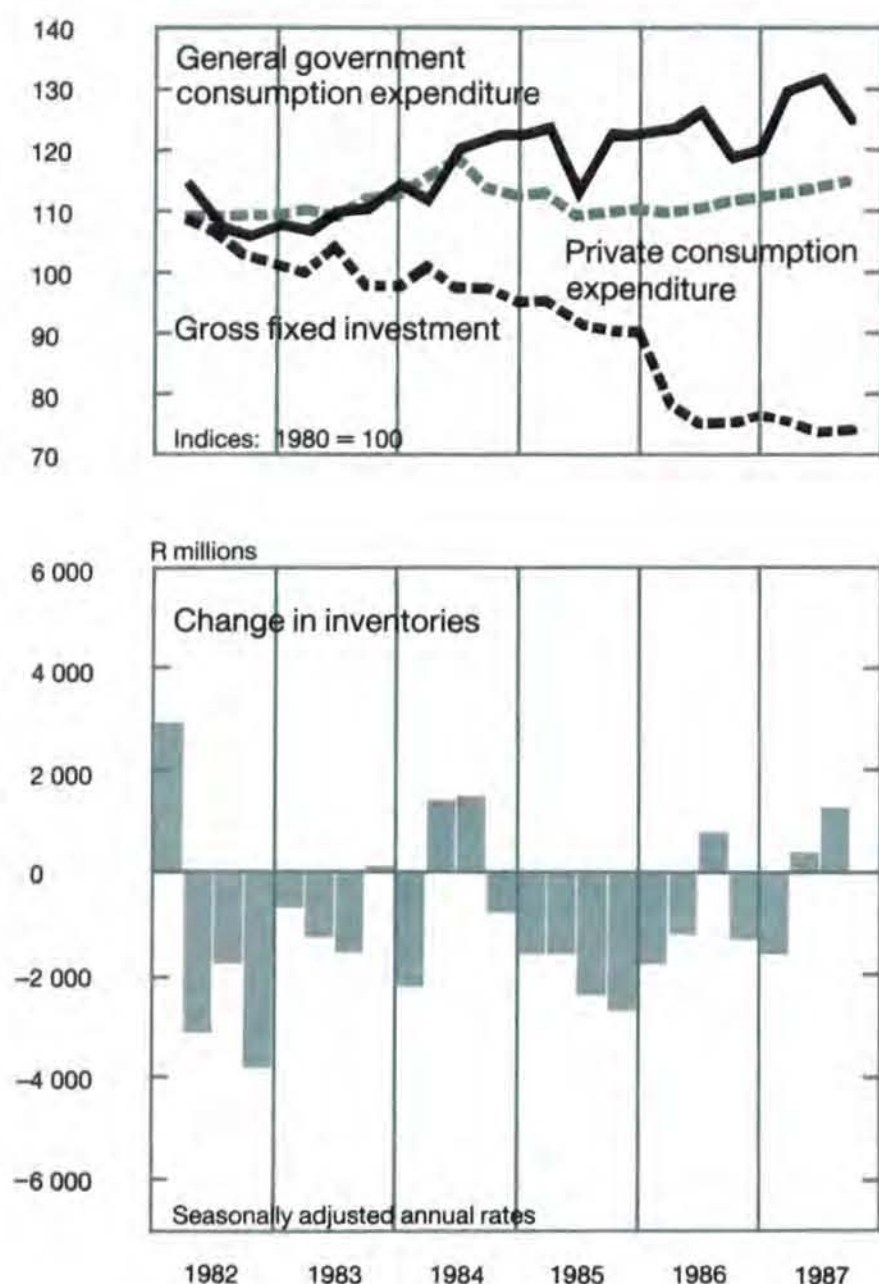
Real *government* consumption expenditure, having increased exceptionally rapidly in the first quarter of 1987 and at a more moderate pace in the second quarter, declined fairly substantially in the third quarter. This decline resulted mainly from cut-

**Real gross domestic expenditure**





### Main components of gross domestic expenditure



by increased fixed capital outlays in manufacturing and agriculture and under the headings of machinery and transport equipment in the financial services sector.

Among public authorities, real fixed capital formation by the South African Transport Services and the Department of Posts and Telecommunications rebounded markedly in the third quarter after a decline in the second quarter. This increase more than neutralised a third-quarter decline in real fixed investment by general government departments. In the general area of capital spending by government departments it would appear that proposed government expenditure on low-cost housing and supporting infrastructural developments has, as yet, been slow to materialise. Capital expenditure in real terms by public authorities on buildings and structures in the real estate sector actually decreased in the third quarter of 1987 and has remained essentially unchanged since the beginning of 1986.

Together, the quite impressive advances in real fixed investment by the private sector and by public authorities in the third quarter of 1987 marginally outweighed very large further cutbacks in real fixed capital outlays by public corporations. Further reductions in capital spending by the public corporations, although broadly based, to a major extent reflected Eskom's ongoing programme of rationalisation.

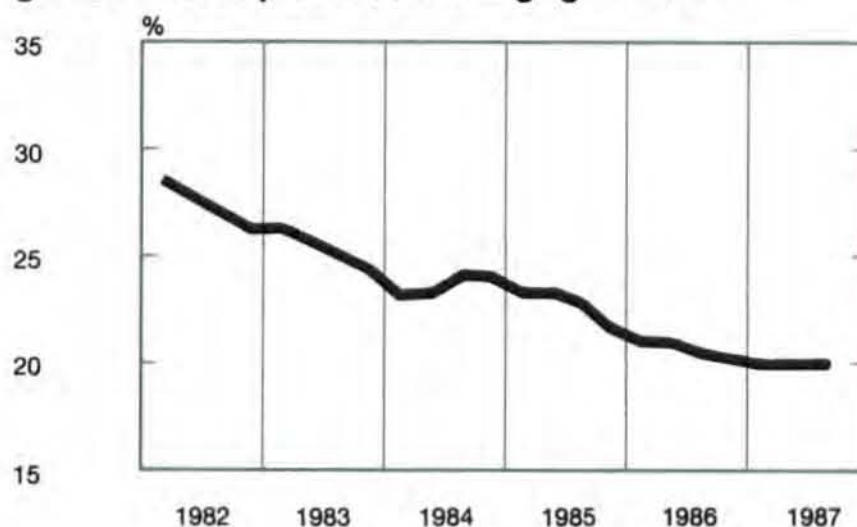
Aggregate real inventories rose in the third quarter mainly because of significant additions to industrial and commercial inventories. This caused the ratio of industrial and commercial inventories to non-agricultural gross domestic product to flatten out in the course of the first three quarters of 1987 at a level of approximately 20 per cent; a decline in this ratio had been in evidence almost continuously from a peak of 27½ per cent in 1982. Inventories also in-

backs in real outlays on goods and "other" (non-labour) services. The average level of aggregate real government consumption expenditure in the first three quarters of 1987 was nearly 5 per cent higher than in the first three quarters of 1986.

Total real gross domestic fixed investment, which had shown a modest recovery in the second half of 1986 but renewed declines - at annual rates of some 5 and 9 per cent - in the first and second quarters of 1987, crept up marginally again in the third quarter. Its average level in the first three quarters of 1987 was only slightly lower, on balance, than in the first three quarters of 1986.

Real fixed capital spending by the *private* sector actually increased markedly - at an annual rate of approximately 13 per cent - in the third quarter of 1987, after having declined significantly in the second quarter. This encouraging revival of private-sector real fixed capital formation was mainly accounted for

### Ratio of real industrial and commercial inventories to gross domestic product excluding agriculture





creased in most other sectors of the economy. They declined, however, in the mining sector as a result of the strike in the gold mining industry in August.

### Factor income and saving

The year-on-year percentage increase in aggregate nominal factor income slowed down mildly from 21 per cent in the second quarter of 1987 to 18½ per cent in the third quarter. This deceleration was mainly due to lower rates of increase in gross operating surplus. Total gross operating surplus advanced at an annual rate of only 2½ per cent in the third quarter after annualised increases of 10 and 18½ per cent in the first and second quarters, respectively. This sharply weakened performance was attributable inter alia to sharply lower working results of the gold mining industry and to poorer-than-expected gross income in agriculture, for reasons that were referred to earlier.

In contrast, the year-on-year percentage increase in labour remuneration, representing the other component of total factor income, accelerated from 16½ per cent in the second quarter of 1987 to 25 per cent in the third quarter. Aggregate nominal labour remuneration in the first three quarters of 1987 consequently was some 17½ per cent higher than in the

first three quarters of 1986. This compares with an increase of 14½ per cent in the preceding year. Increases in nominal labour remuneration were widely spread through the economy. Notable advances were apparent, however, in the general government sector as a reflection of civil servants' salary adjustments that had become effective from 1 July 1987, and in the mining sector as a reflection of the outcome of negotiated wage settlements.

Gross domestic saving relative to gross domestic product amounted to approximately 22½ per cent, 23½ per cent and 24½ per cent in the first, second and third quarters of 1987, respectively. The most recent peak in this ratio, amounting to 26½ per cent, had been reached in the fourth quarter of 1986. Relative to gross domestic investment, gross domestic saving contracted from as much as 147½ per cent in the fourth quarter of 1986 to 115 per cent in the third quarter of 1987.

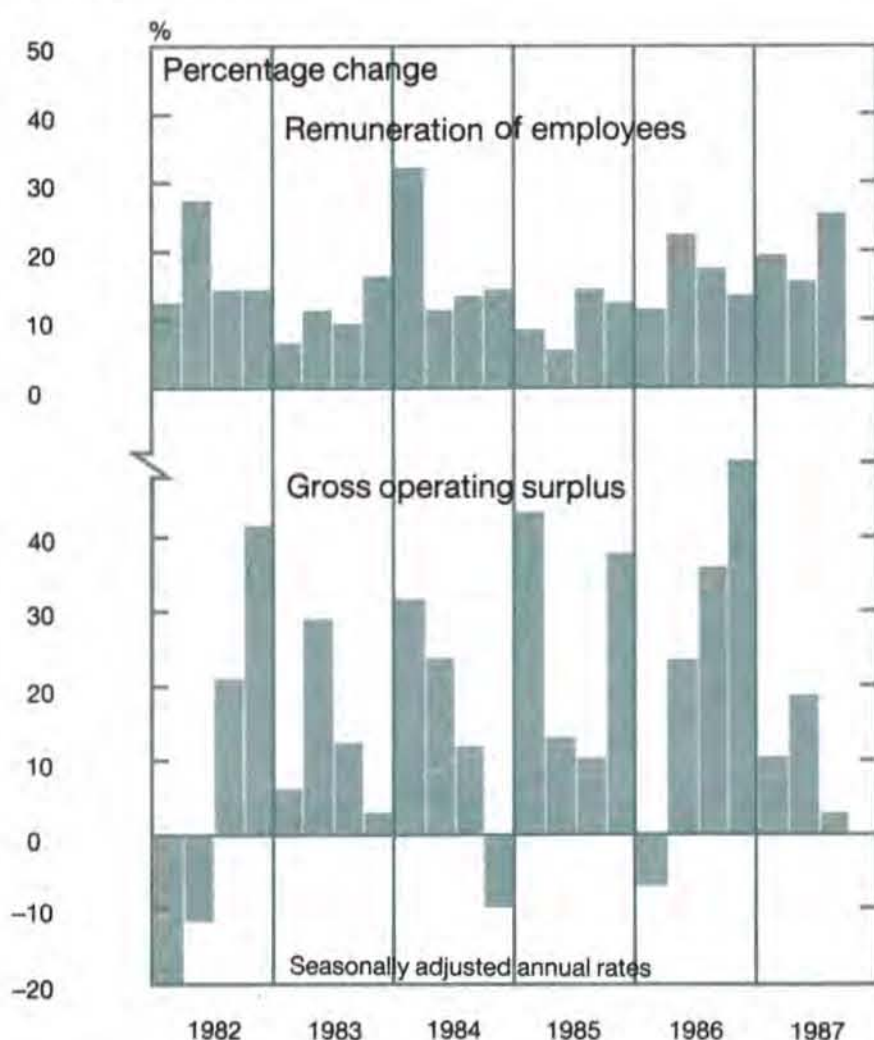
Dissaving by general government contracted substantially from a quarterly average, at a seasonally adjusted annual rate, of nearly R6 billion in the first half of 1987 to R3½ billion in the third quarter. Company saving, on the other hand, was held back by rises in operating costs and the adverse effects of labour strikes in various sectors of the economy. Personal saving remained at a relatively low level of 3½ per cent of personal disposable income, compared with its recent low point of 2 per cent in the course of 1986 and with an average of 4½ per cent during the five-year period from 1981 to 1985. Depreciation allowances proceeded on their normal upward course but did so at a slowly diminishing pace.

### Employment

Total employment in the non-agricultural sectors of the economy rose at seasonally adjusted annual rates of 0,7 and 2,0 per cent in the third and fourth quarters of 1986, showed almost no further change in the first quarter of 1987, but then advanced relatively rapidly, at a rate of 2,6 per cent, in the second quarter of 1987. These more recent employment increases reflected rising levels of private-sector employment as well as continued increases in employment by public authorities. The average level of non-agricultural employment in the first half of 1987 was a slender 0,9 per cent higher than in the first half of 1986. Data for July and August 1987 show further employment increases in construction but virtual stagnancy in employment in manufacturing and in electricity generation.

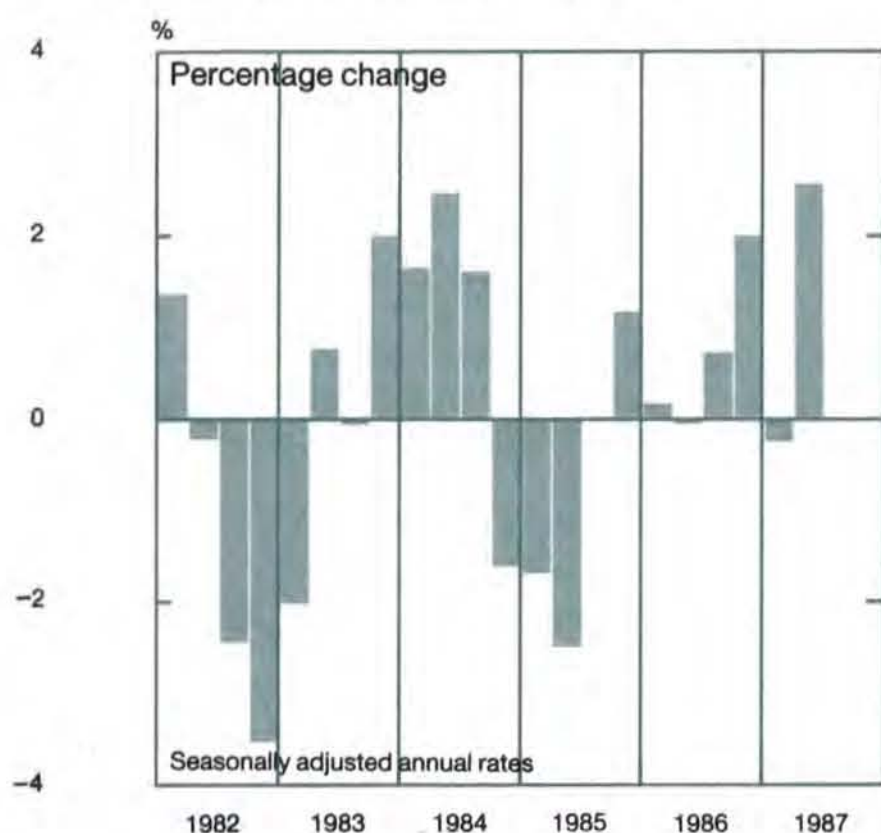
The modest employment increases of 1986 and parts of 1987 still failed significantly to affect the total number of registered unemployed. This number declined from 132 000 in January 1987 to 121 000 in May but then rebounded quite sharply to 139 400 in September. The number of registered non-Black un-

### Factor income





## Employment in non-agricultural sectors



employed, however, declined significantly, on balance, from 83 400 in September 1986 to 67 700 in September 1987. The Current Population Survey shows the number of unemployed Blacks to have decreased from 1 181 000 to 1 028 000, or from 19,9 per cent to 16,3 per cent of the Black labour force, from July 1986 to June 1987.

## Labour costs and productivity

The average amount of salaries and wages per employee in the non-agricultural sectors of the economy rose by 15,2 per cent in 1986, but at a somewhat lower rate of 13,7 per cent in the first half of 1987 compared with the first half of 1986. Average *real* wages per worker declined by 3,0 per cent in 1986 and further by 2,5 per cent in the first half of 1987.

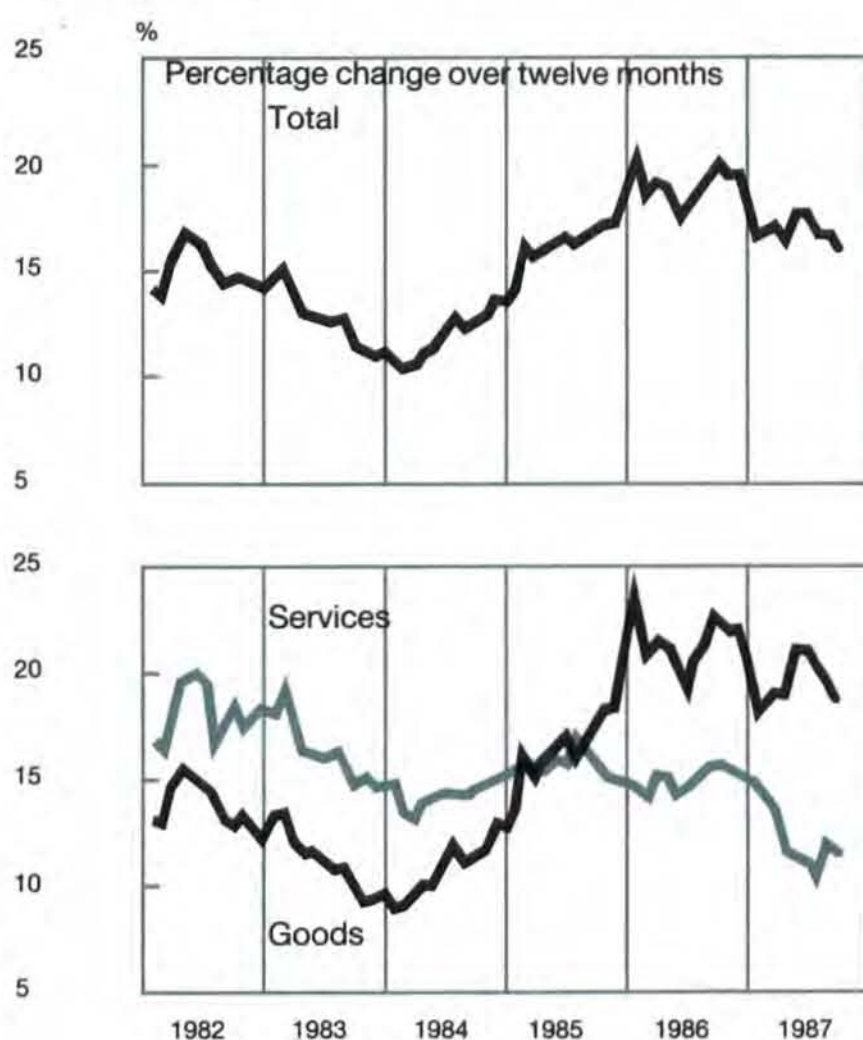
Labour productivity (i.e. real gross domestic product per worker) in the non-agricultural sectors of the economy declined by 1,0 per cent in 1985 and by 0,7 per cent in 1986, but rose by 1,3 per cent in the first half of 1987. This improvement in productivity, in conjunction with the mild slowdown in nominal wage increases, also caused the rise in unit labour costs to decelerate from 15,9 per cent in 1986 to 12,3 per cent in the first half of 1987.

## Prices

The quarter-to-quarter increase in the consumer price index, at seasonally adjusted annual rates, slowed down from 26,0 and 20,7 per cent in the first and third quarters of 1986 to 15,1 and 15,0 per cent in the first and second quarters of 1987, respectively, but reaccelerated to 16,9 per cent in the third quarter. This reacceleration was mainly accounted for by upward adjustments to a number of administered prices, in particular postal, transport and municipal tariffs. On a monthly basis, however, the twelve-month rate of increase in consumer prices in the third quarter of 1987 slowed down from 16,3 per cent in both July and August to 15,5 per cent in September.

Quarter-to-quarter changes in the production price index, at seasonally adjusted annual rates, subsided from 26,3 per cent in the first quarter of 1986 to 13,7 and 12,7 per cent in the first and second quarters of 1987, respectively. This rate then declined further to 12,5 per cent in the third quarter. The twelve-month rate of increase in production prices fell back from 20,7 per cent in October 1986 to 13,7 per cent in September 1987. Strengthening of the exchange rate of the rand contributed to a decline in the twelve-month rate of increase in the prices of *imported* goods

## Consumer prices



from as much as 32,5 per cent in January 1986 to only 12,0 per cent in September 1987. The twelve-month rate of increase in the prices of domestically produced goods retreated from 20,1 per cent in October 1986 to 14,3 per cent in September 1987.

### Balance of payments

#### Current account

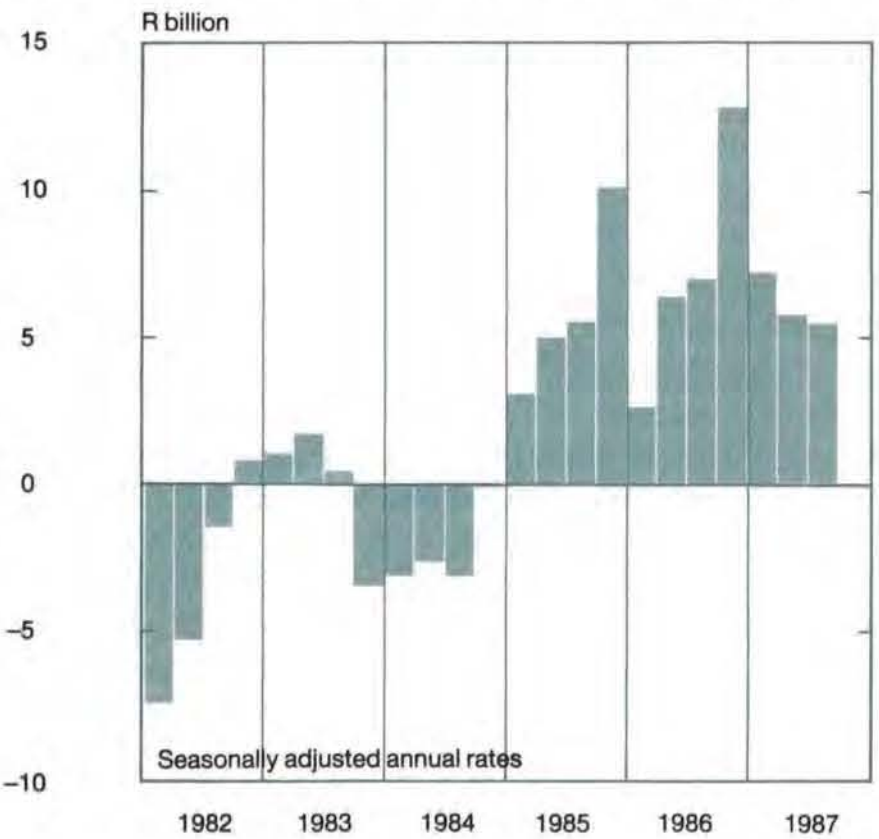
Having declined from R7,2 billion in the first quarter of 1987 to R5,8 billion in the second quarter, the surplus on the balance of payments on current account, at a seasonally adjusted annual rate, narrowed somewhat further to R5,4 billion in the third quarter. The third-quarter figure nevertheless still amounted to more than 3 per cent of gross domestic product, compared with an average of 4½ per cent since the beginning of 1985.

#### Current account of the balance of payments

Seasonally adjusted annual rates  
R millions

	1987		
	1st qr	2nd qr	3rd qr
Merchandise exports .....	23 850	24 430	24 770
Net gold exports .....	18 370	17 030	17 890
Merchandise imports .....	-26 410	-27 370	-28 820
Net service and transfer payments.....	-8 650	-8 320	-8 440
Balance on current account .....	7 160	5 770	5 400

#### Balance of payments: Balance on current account





Further shrinkage of the current account surplus in the third quarter of 1987 mainly reflected a quite substantial further increase in the value of merchandise imports. This was offset partly by a significant recovery in the value of net gold exports and a slight further rise in the value of merchandise exports.

Merchandise imports, responding to further mild increases in aggregate domestic economic activity and firm rises in gross domestic expenditure, increased further by 5½ per cent in value terms in the third quarter. This was mainly accounted for by a rise in import volumes; notably higher quantities of imports were recorded under the headings of machinery and electrical equipment and of transport equipment. The average level of import *prices* increased only slightly (by about 1 per cent), largely because of relative stability of prices in the international oil market and because of the very limited extent of the decline in the average effective exchange rate of the rand during the third quarter.

The value of net gold exports recovered significantly in the third quarter despite a decline in physical gold production. The volume of net gold exports contracted during the third quarter because of a slight further lowering of the average grade of ore mined and because of the mine workers' strike in an important part of the gold mining industry in August. The decline in physical output was more than offset,

however, by an increase in the average gold price. The average *fixing* price of gold on the London market rose from US \$450 (R906) per fine ounce in the second quarter to US \$457 (R942) in the third quarter.

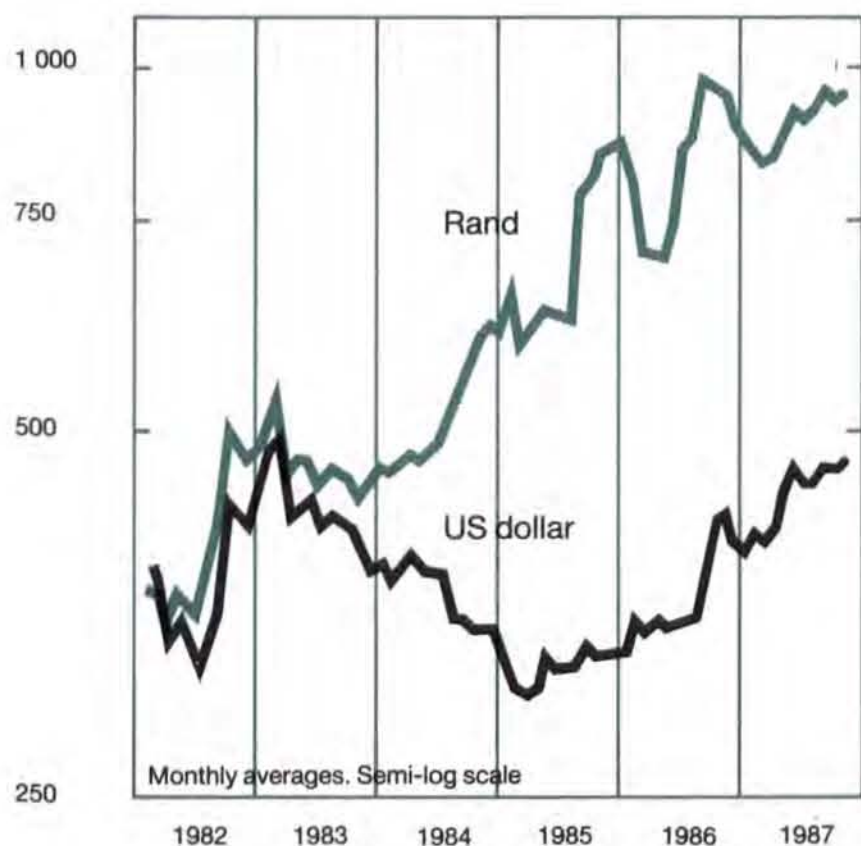
The steep drop in share prices internationally from 19 October, and renewed declines in the exchange value of the US dollar after that date, resulted in a further increase in the monthly average gold price to a level of US \$466 in October. On 20 October the fixing price of gold in the London market momentarily reached a high point of US \$481,60. The highly unsettled conditions which prevailed on the world's major stock exchanges and foreign exchange markets in the second half of October and early November 1987 were not, however, accompanied at once by a sustained shift towards an appreciably higher average level of the gold price. This may have been attributable partly to a forced liquidation of gold positions by certain large investors worldwide and by the availability in the financial markets of new instruments and techniques for hedging against possible further share market declines. More important, however, is likely to have been a perception that the global re-rating of equity values and the attendant negative "wealth effects" on private sector propensities to consume and invest should rank as a potentially growth-depressing and deflationary element in the world economic situation.

After having retreated to \$457,55 in the afternoon fixing in London on 5 November, the gold price advanced to a new high in 1987 of \$493,90 on 30 November. For the first eleven months of 1987 the average price of gold amounted to \$443, compared with \$365 in the first eleven months of 1986.

The total value of merchandise exports increased marginally, by 1½ per cent, during the third quarter of 1987. At this level, however, merchandise export earnings still fell short quite significantly (i.e. by some 11 per cent) of the quarterly average of the uncommonly strong export performance of the South African economy in the second half of 1986.

As in the case of net gold exports, the slight third-quarter improvement in the value of merchandise exports also occurred in spite of a decline in export volumes. After having increased in the second quarter, export volumes contracted by approximately 2½ per cent in the third quarter. The aggregate volume of merchandise exports in the first nine months of 1987 nevertheless still exceeded by some 1½ per cent the volume of exports in the corresponding period of 1986. Export *prices* increased in the third quarter of 1987 mainly because of a moderate further firming of prices in the international commodity markets during that quarter and because of the slight further decline in the average effective exchange rate of the rand.

## Gold price





Service payments as well as service receipts declined in the third quarter. The larger proportionate decrease, however, was displayed by service receipts. *Net* service and transfer payments accordingly increased by some 1½ per cent. Service receipts declined mainly because of a decrease in dividend receipts. The largest single contributing factor to the decline in service payments was a decrease in travel expenditure. Unlike developments in the first half of 1987, no significant further change was recorded in interest payments to foreigners in the third quarter.

### Capital account

A moderate further outflow of capital not related to reserves was registered in the third quarter. At R776 million, the amount of this outflow was of a broadly similar size as the outflow of non-reserve-related capital in the second quarter. The third-quarter outflow comprised outflows of R484 million and R292 million of long-term and short-term capital, respectively, and was mainly related to the redemption, on 15 July 1987, of about US \$300 million of foreign debt as the "upfront" payment to be made in terms of the Second Interim Arrangements with foreign creditor banks. Non-residents also continued to be net sellers of securities on the Johannesburg Stock Exchange. The extent of the outflow through this channel (which, under the financial rand system, does not, of course, result in an actual loss of foreign exchange) was R531 million.

Public corporations continued to be net importers of capital for the third consecutive quarter. The net amount of funds taken up by public corporations in the form of new loans and drawings on existing loan

facilities in the third quarter was R107 million. The net amount of public corporations' foreign borrowing in the course of the first nine months of 1987 thereby was brought to a substantial R802 million.

The total outflow of short-term capital not related to reserves increased modestly from R158 million in the second quarter to R292 million in the third quarter. The total net outflow of non-reserve-related short-term capital in the first three quarters of 1987 accordingly amounted to a fairly insignificant R228 million. This may be compared with an outflow of as much as R1,7 billion in the first three quarters of 1986.

The penultimate instalment, amounting to R259 million, on South Africa's 1982 loan from the International Monetary Fund was repaid in August 1987. Mainly because of this repayment and other redemptions of reserve-related liabilities under the standstill net, total liabilities related to reserves were reduced further by R415 million in the third quarter. This followed upon a similar reduction of R377 million in the preceding quarter. The final instalment, amounting to R260 million, on the IMF loan was repaid on 7 November.

### Foreign reserves

The total gross gold and other foreign reserves rose by R1 798 million and R282 million in the first and second quarters of 1987, respectively, and by a further R796 million in the third quarter. At R8,6 billion the total foreign reserves at the end of September 1987 were equivalent to approximately 3½ months of goods imports. They were also R4,6 billion, or 117 per cent, higher than the level to which they had shrunk by the end of April 1986. In October 1987 the gross

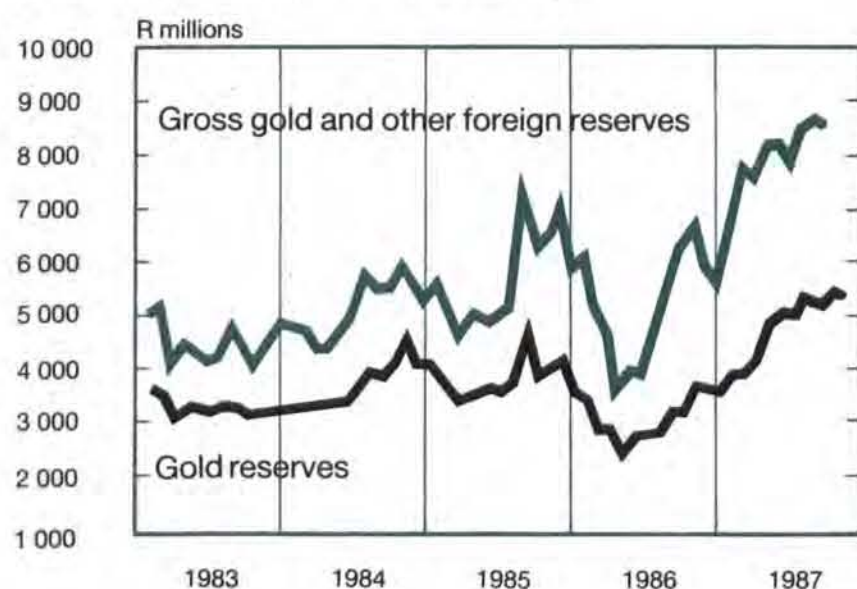
### Net capital movements

R millions

	1987		
	1st qr	2nd qr	3rd qr
Long-term capital			
Public authorities.....	-9	-217	-60
Public corporations .....	347	348	107
Banking sector .....	38	-60	19
Private sector:			
Net purchases of listed securities by non-residents.....	-209	-546	-531
Other capital.....	18	-278	-19
Total long-term capital .....	185	-753	-484
Short-term capital including unrecorded transactions, but excluding reserve-related liabilities.....	222	-158	-292
Total capital movements excluding liabilities related to reserves .....	407	-911	-776
Change in liabilities related to reserves .....	-627	-377	-415



## Total gold and other foreign reserves



gold and other foreign reserves held by the Reserve Bank rose by another R83 million. They declined, however, by R556 million in November.

The gold reserves of the Reserve Bank increased from 6,05 million fine ounces at the end of the second quarter of 1987 to 6,30 million fine ounces at the end of September but declined again to 6,21 million fine ounces at the end of October. They then increased marginally again to 6,24 million fine ounces at the end of November.

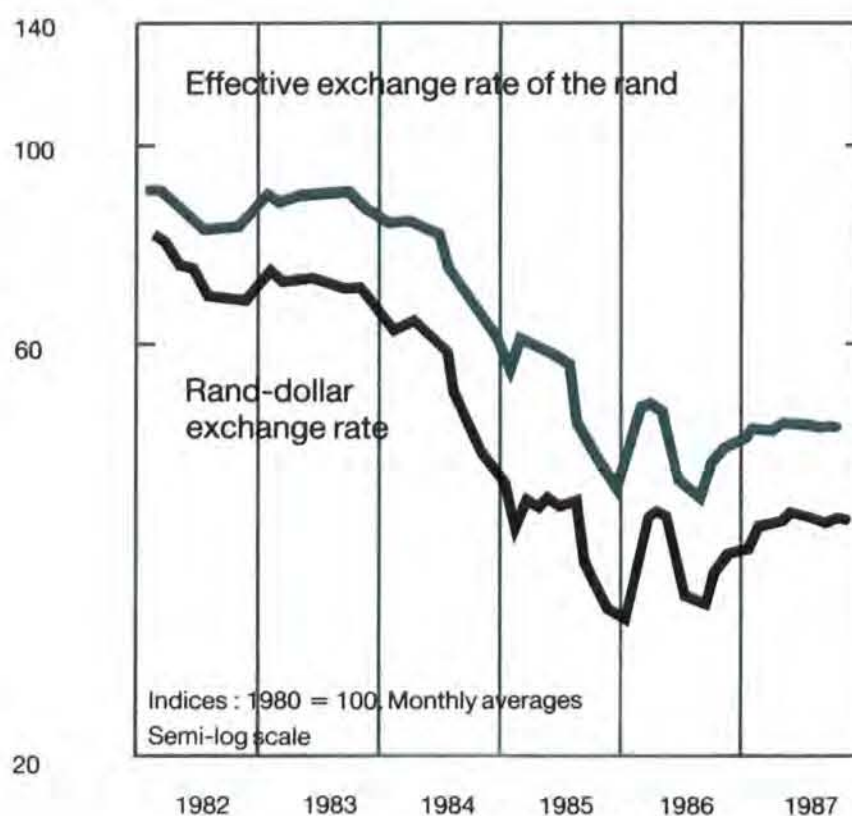
## Exchange rates

The exchange rate of the rand vis-à-vis the US dollar fluctuated between relatively close limits of 46 and 51 US cents from the beginning of 1987 to late November, and within an even narrower range from approximately 48 to 49 US cents from mid-June to the end of October. It broke out of this tight band, however, on 2 November and advanced to approximately 51½ US cents on 10 November, and again on 30 November, as a reflection of the dollar's decline in recent weeks to new post-war lows vis-à-vis the German mark and the yen.

The effective exchange rate of the rand rose by a slender 0,5 per cent from the end of June 1987 to 30 November. On 30 November the effective exchange rate of the rand was 4,2 per cent higher than at the end of 1986, 5,5 per cent higher than its average in 1986, and 29,0 per cent higher than its low point of 12 June 1986.

The financial rand fluctuated between 21½ and 35½ US cents during the first half of 1987 and between 27½ and 33 US cents from July to November. The financial rand discount vis-à-vis the commercial rand amounted to 44,2 per cent on 28 October, this being the highest level of the discount since March

## Exchange rates



1987. This was mainly a result of the strengthening of the commercial rand against the dollar and of continuing sales by non-residents of securities quoted on the Johannesburg Stock Exchange. A narrowing of the discount was apparent in the course of November. The average exchange rate of the financial rand in 1987 up to end of November was, however, still some 10 per cent higher than the average for 1986.

## Changes in exchange rates of the rand

	31 Dec 1986 to 30 June 1987	30 June 1987 to 30 Nov 1987
Weighted average .....	3,5	0,5
US dollar .....	7,0	5,4
British pound .....	-1,9	-7,5
German mark .....	0,5	-5,6
Swiss franc .....	-0,2	-6,5
Japanese yen .....	-1,8	-5,6
French franc .....	1,3	-3,7
Financial rand .....	36,1	12,8



Financial markets

Money supply

The quarter-to-quarter rate of increase in the M3 money supply, in seasonally adjusted and annualised terms, accelerated appreciably from 9,1 per cent in the fourth quarter of 1986 and 5,0 per cent in the first quarter of 1987 to 15,9 per cent and 14,1 per cent in the second and third quarters of 1987, respectively. As a result of this acceleration, M3 as at the end of September 1987 fell within the targeting "cone" for the first time in the 1987 targeting year. The seasonally adjusted annual rate of increase in M3 from the beginning of the current targeting year (i.e. from mid-November 1986) to the end of September 1987 amounted to 14,4 per cent. It therefore exceeded the lower limit of the target range by 0,4 percentage points. The twelve-month rate of increase in M3, having reached a presumed cyclical lower turning point of only 7,7 per cent in February 1987, amounted to 13,6 per cent in September.

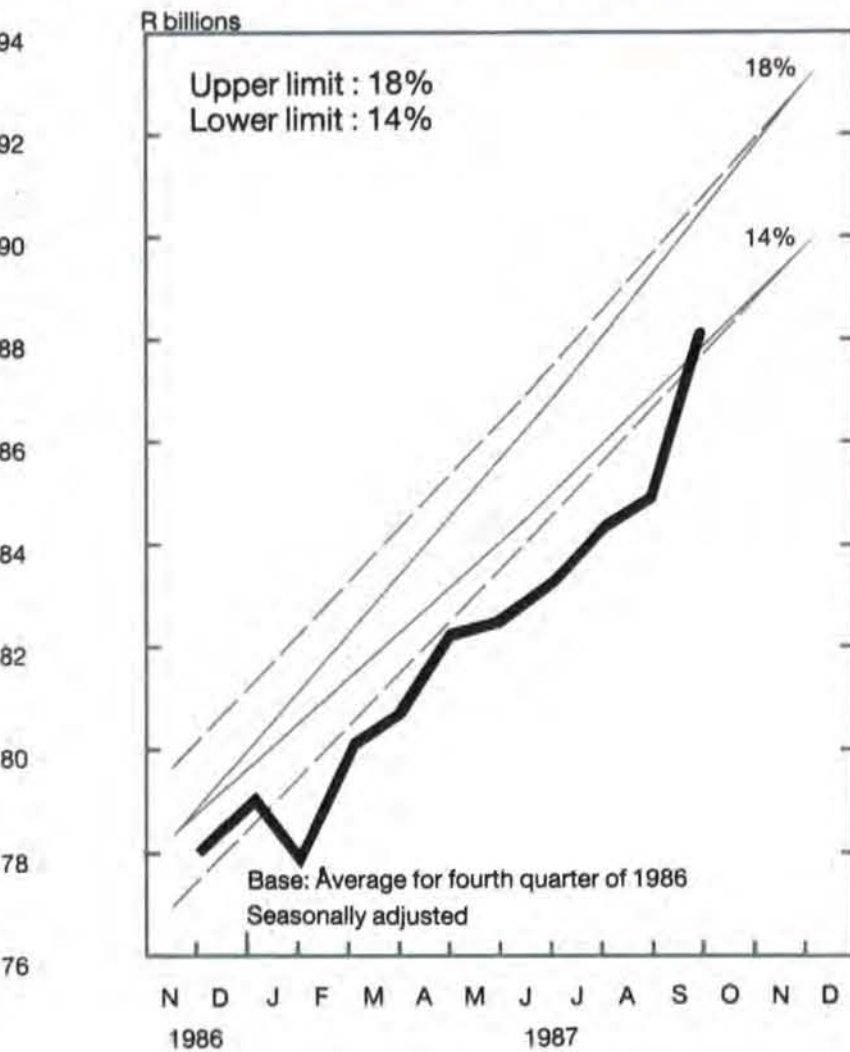
The annualised quarter-to-quarter rates of increase in M3 in the second and third quarters of 1987 of between 14 and 16 per cent broadly matched the

growth in gross domestic product at current prices during this period. As a result the income velocity of M3, which had still increased by 2,3 per cent in the first quarter of 1987, remained virtually unchanged in the second and third quarters. From the beginning of the accelerated rise in velocity in the third quarter of 1986 up to the third quarter of 1987 (i.e. during the past five calendar quarters) the overall increase in the income velocity of M3 amounted to 9,9 per cent. Velocity changes therefore clearly still were the junior partner in explaining the 25,3 per cent increase in the "effective" money supply during this period.

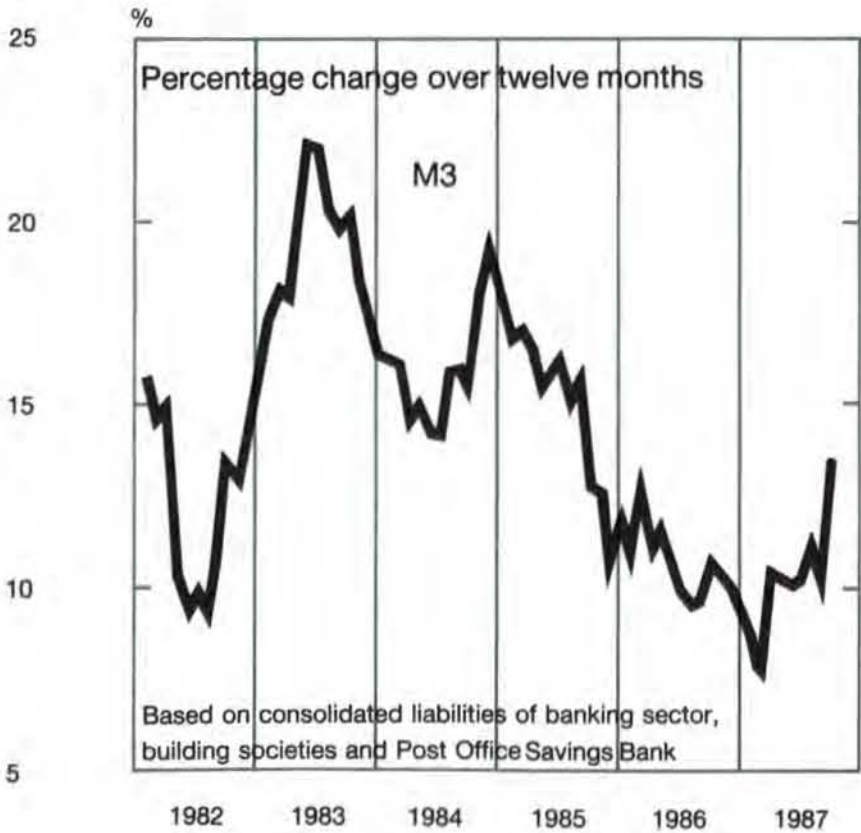
Increases in velocity since mid-1986 have been attributed mainly to various "disintermediation" phenomena. Disintermediation (i.e. the substitution of "direct" lending and borrowing between non-bank parties for deposit-holding with and borrowing from banks or other monetary institutions) could be explained by various factors. These included low real after-tax rates of return on depository investments with banks and building societies; the attractions of alternative investment opportunities offered by long-term savings institutions, the strongly rising share market, unit trusts and - from June to early August 1987 - by Senior Citizen Savings Bonds; and banks' introduction of various schemes for managing more closely the cash positions of their clients.

Some recent developments, such as termination of the original issue of Senior Citizen Savings Bonds in August and the abrupt halt to the rising phase of share prices on the stock exchange in Octo-

Target range for growth in M3 during 1987



Money supply





ber, now have caused a few of these factors to become inoperative. Rulings as to the permissibility or otherwise of various forms of "set-offs" of debit and credit balances of corporations or groups of corporations in the books of banking institutions as part of the banks' management of corporate clients' cash positions, were issued by the Reserve Bank in late October 1987. More generally, however, a levelling-off of the velocity of circulation of the M3 money supply in the course of 1987 was to be foreseen as wealth holders would eventually complete the rearrangement of the composition of their asset portfolios in favour of increased relative holdings of non-monetary assets in the prevailing inflationary and interest rate conditions. Some increase in the relative demand for monetary assets, somewhat accelerated growth in the monetary aggregates, and a partial reversal of the increase in M3 velocity, may reasonably be expected to flow from the changed prospects for share price rises on the stock exchange after the sharp drop in these prices from 20 October.

Shifts in the composition of M3 continued to be dominated by a relative movement towards the more transactions-related demand and call money components of the M3 money supply. This was reflected in the twelve-month rate of growth in M1, which in September amounted to 23,7 per cent. In contrast, the total of "other" short-term and medium-term deposits (i.e. the non-M1 component of M2) showed relatively little change in the twelve months to September 1987. The twelve-month growth rate in M2 in September accordingly amounted to a below-average 13,2 per cent. Growth in long-term deposits appeared to be aided by somewhat higher interest rate differentials in favour of these deposits. The twelve-month growth rate in these deposits in September amounted to 14,5 per cent.

Growth in M3 in the third quarter of 1987 was explained primarily, in the accounting sense, by an increase of R1,96 billion in credit extended by monetary institutions. The net gold and other foreign reserve holdings of the monetary sector, however, also increased by R0,82 billion.

### Bank credit

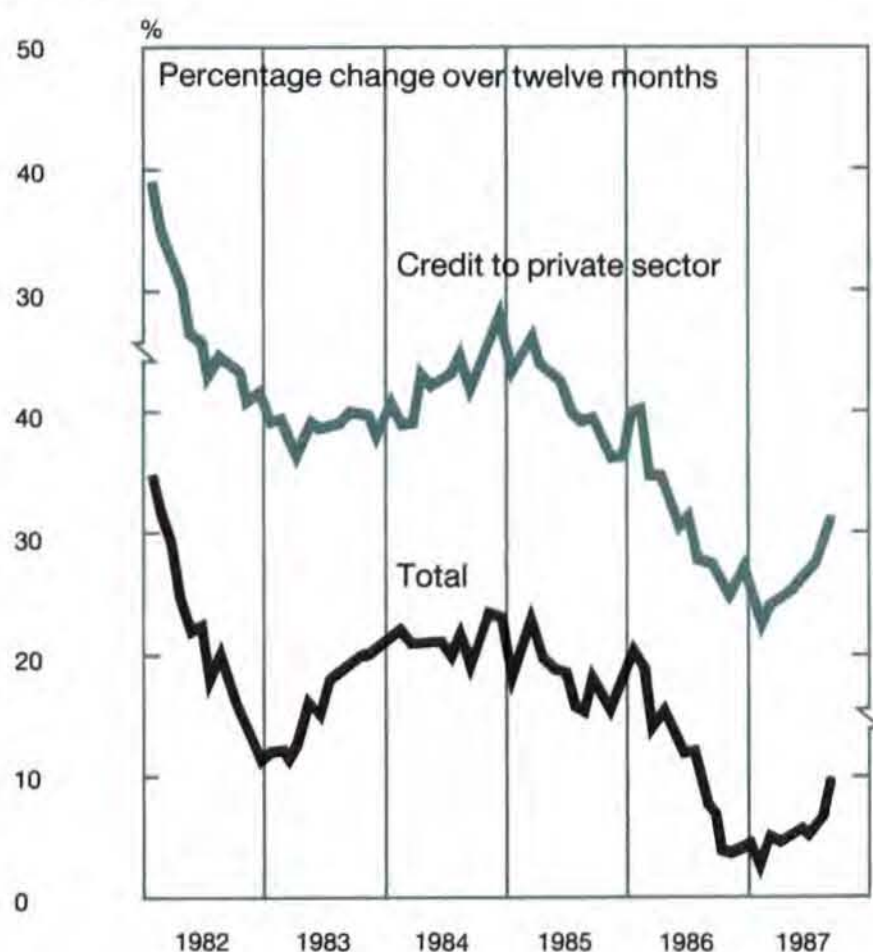
The seasonally adjusted annual rate of increase in bank credit to the private sector advanced from 8,2 per cent in the first half of 1987 to 13,6 per cent in the third quarter. Partly as a result of this acceleration in new credit extension, the twelve-month rate of increase in bank credit to the private sector also rose markedly from its presumed lower turning point of only 1,7 per cent in February 1987 to 5,8 per cent, 6,6 per cent, 8,8 per cent and 11,2 per cent in June, July, August and September 1987, respectively. Recent quarterly increases in the banks' claims on the private

sector, however, clearly still failed to match the rates of increase in gross domestic product and gross domestic expenditure at current prices. The continued relatively sluggish growth in bank credit in the past few quarters could still be explained primarily in terms of continued operation of the disintermediation phenomena referred to earlier. It also reflected persistent low levels of fixed investment in the economy and the modest extent of recent additions to inventories.

Banks' "other" loans and advances, which comprise most of their lending for industrial and commercial purposes, advanced relatively slowly in the third quarter of 1987 at an annualised rate of 8,8 per cent. Considerably higher rates of increase were recorded, however, in the banks' holdings of bills discounted and in hire-purchase credit. Hire-purchase credit, being linked more closely to the strengthening sales of consumer durables, rose at an annualised rate of 14,4 per cent from January to September 1987 and of as much as 18,0 per cent in the third quarter.

The banks' net claims on the government sector fell back by R1 531 million in the third quarter of 1987 after having increased by R711 million in the second quarter. The twelve-month rate of increase in *total* bank credit in September consequently was significantly lower than the rate of increase in the banks' lending to the private sector. This rate rose from 5,7 per cent in June to 9,1 per cent in September.

### Bank credit





## Reserve Bank operations in the money market

Partly because of the expansionary effect of continuing increases in the Reserve Bank's gold and other foreign reserves, money market conditions continued to be experienced as "easy" during most of the third quarter, October and November 1987. The Bank, by its operations in the market, endorsed and, after the collapse of share prices on the stock exchange from 20 October, gave mild further encouragement to the market's ease and liquidity.

Bank rate was maintained at 9½ per cent throughout the third quarter, October and November. Because of the market's essential easiness, a need for cash reserves to be provided to the market by means of Reserve Bank repurchase agreements was perceived by the Bank only sporadically. Similarly, tender funds from the Corporation for Public Deposits generally were made available to the banks and the discount houses only at or near month-ends and for amounts of no more than a few hundred million rands at a time. The amount so provided reached a peak of R350 million on 28 and 29 October.

Reserve Bank refinancing accommodation of the discount houses and the banks at the discount window reached a daily average of only R117 million in the third quarter of 1987, R53 million in October and R126 million in November. Accommodation at the window rose to R626 million at the end of August and to R402 million at the end of September. These market shortages were wiped out, however, within a few days after the month-ends concerned. A shortage of R240 million on 26 October was rapidly neutralised through the provision of CPD tender funds and buy-back agreements which, at the end of the month, amounted to R300 million and R102 million, respectively. No accommodation at the window accordingly was required by the discount houses or the banks over the October month-end. On 30 November accommodation amounted to R641 million. Buy-back agreements to an amount of R250 million were entered into over the November month-end.

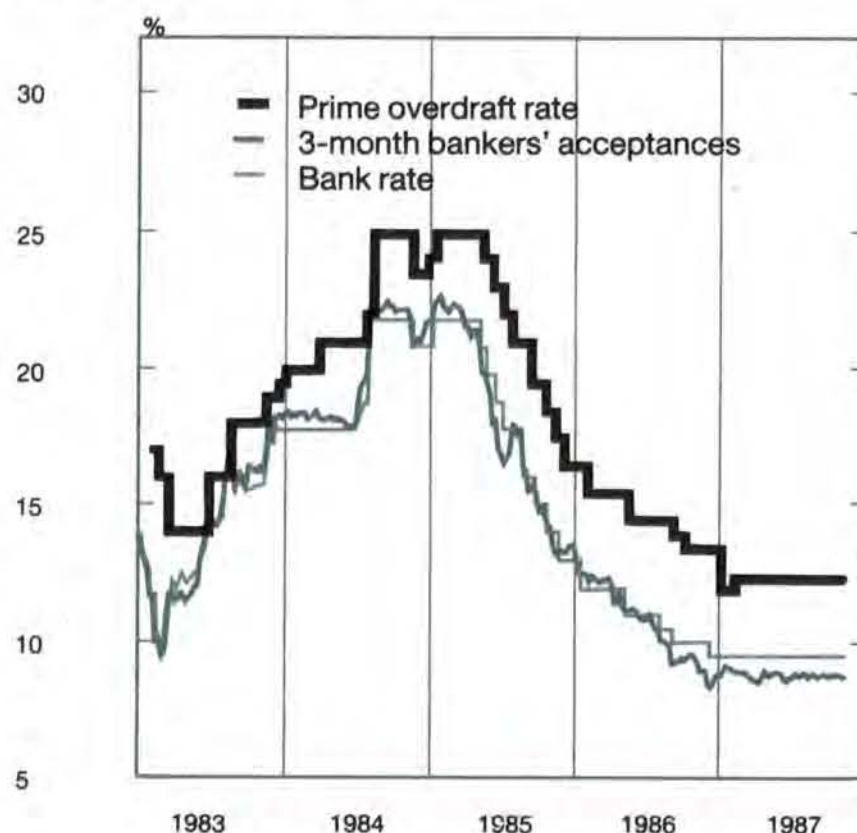
Reverse buy-back transactions to drain *surplus* cash reserves from the market were engaged in by the Reserve Bank on a substantial number of days during the third quarter, October and November.

Net sales of government stock by the Reserve Bank amounted to R1 979 million during the third quarter of 1987, compared with R1 952 million during the second quarter and only R247 million during the first quarter. A further net amount of R1 007 million was sold during October and November 1987.

## Short-term interest rates

Money market rates, reflecting the market's liquidity and the Reserve Bank's consistently relaxed policy stance, remained stable at levels well below the

## Short-term interest rates



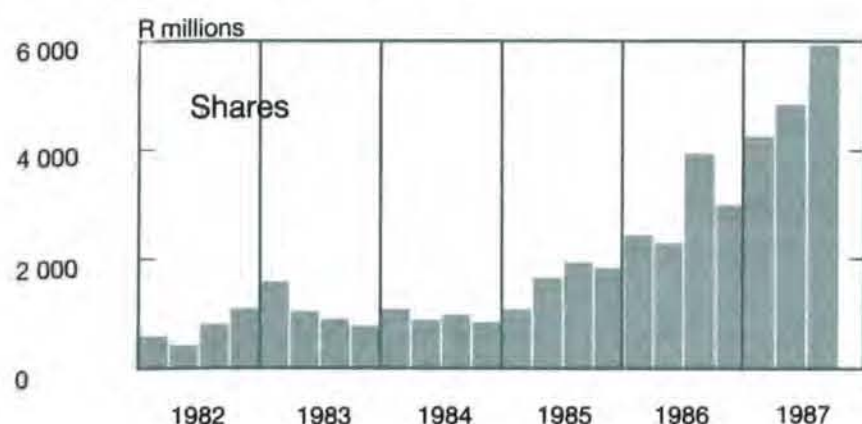
Bank's relevant rediscount rates throughout the second and third quarters, October and the first three weeks of November 1987. They therefore also remained essentially unaffected by developments in the South African and overseas stock exchanges and foreign exchange markets from 19 October. The rate on three-month liquid bankers' acceptances, for example, moved within a narrow band from 8,75 to 9,00 per cent from the beginning of June 1987 to late November. It amounted to 8,85 per cent over the August, September and October month-ends and to 9,00 per cent on 30 November. Wholesale call rates showed somewhat larger movements in response to changes in the banks' cash and liquid asset positions. The rate on interbank call deposits, for example, ranged from a low point of 8,10 per cent on 21 August to high points of 9,75 per cent at the month-ends of September and October. On 30 November this rate amounted to 10,25 per cent.

## Capital market activity

The capital markets in the third quarter and October 1987 saw another round of sharp increases in trading activity. A new high point in the turnover of public sector stock was reached in the third quarter. Further increases in real estate transactions and mortgage lending were recorded in the fixed property market. In the primary capital market, new issues of fixed interest securities rose sharply during the third quarter.



### Stock exchange transactions



In the share market very heavy volumes of share trading, which caused the Johannesburg Stock Exchange to reduce trading time to only two hours on 21 and 22 October and to four hours thereafter, were recorded from 20 October, after the start of the steep drop in equity prices which commenced on the world's major stock exchanges on 19 October.

The value of public sector stock traded on the stock exchange rose substantially further from R40,3 billion and R40,1 billion in the first and second quarters of 1987 to R50,3 billion in the third quarter. It amounted to R16,4 billion in October. The value of real estate transactions amounted to R3,3 billion,

R3,6 billion and R3,9 billion in the first, second and third quarters of 1987, respectively.

The value of shares traded on the stock exchange rose from R4,2 billion in the first quarter of 1987 to R4,8 billion in the second quarter, R5,9 billion in the third quarter and no less than R2,6 billion in October alone. Up to 19 October, share prices were swept upward further in this sharply rising trading activity. The average price level of all classes of shares increased by 9 per cent, 11 per cent and close to 13 per cent in the first, second and third quarters of 1987, respectively. The total rise in these prices in the course of the upward phase in the share market from the end of February 1985 to the end of September 1987 thereby was brought to 149 per cent. In comparison, the total increase in share prices in the rising market of the second half of the 1960s, which may be measured to have lasted from January 1966 to May 1969, had amounted to 152 per cent.

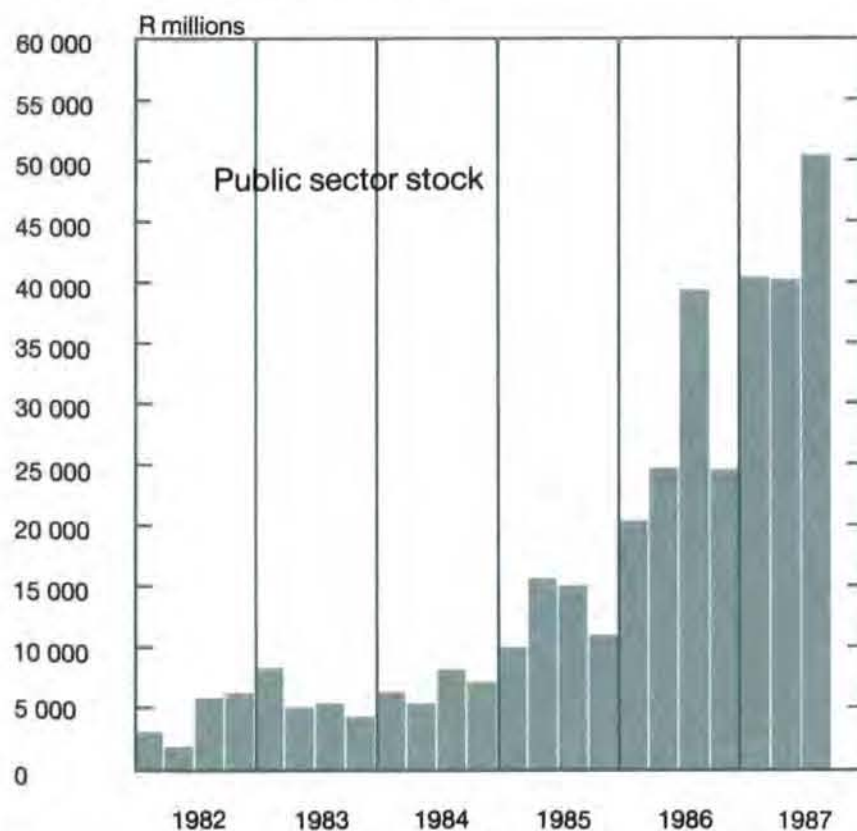
### Johannesburg Stock Exchange share prices: upward and downward phases

All-shares index

Period	Phase	Duration (months)	Total change in average price level, %
Jan 1966 – May 1969	Upward	41	152,0
Jun 1969 – Jan 1971	Downward	20	-60,7
Feb 1971 – Apr 1974	Upward	39	147,3
May 1974 – Jun 1977	Downward	38	-44,1
Jul 1977 – Sep 1980	Upward	39	276,3
Oct 1980 – Jun 1982	Downward	21	-51,7
Jul 1982 – Mar 1984	Upward	21	102,9
Apr 1984 – Feb 1985	Downward	11	-14,2
Mar 1985 – Sep 1987	Upward	31	149,2

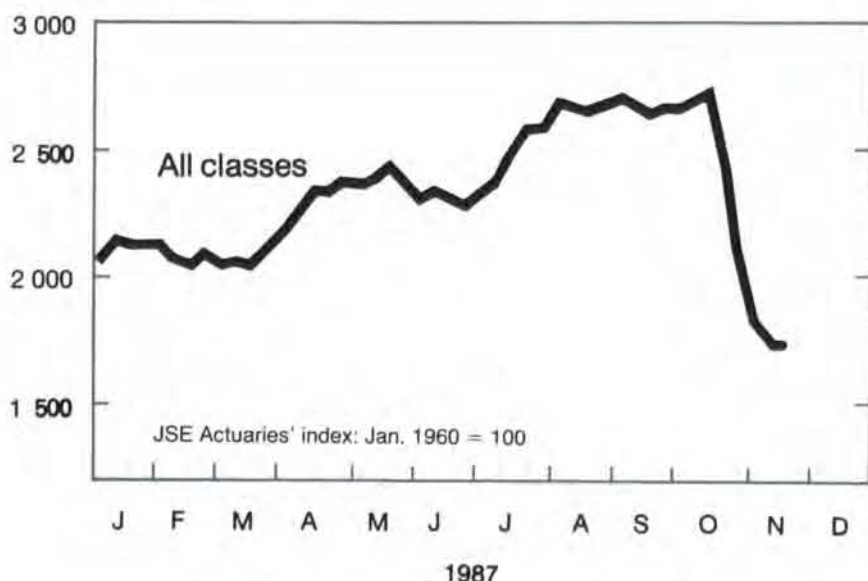
In the course of the thirteen trading days from 20 October to 5 November 1987 the average level of prices of all classes of shares, as measured by the JSE Actuaries daily index, fell back by no less than 40,0 per cent. This precipitous price decline exceeded the extent of the drop in prices on various overseas stock exchanges during this period and was also considerably larger than the downward price adjustments in the corresponding early stages of previous stock market "crashes", as in May 1969. Failure of the dollar price of gold to rise to a sustained higher level in the turbulent conditions that prevailed on the world's major stock and foreign exchange markets in late October and early November 1987 contributed to a drop in the all-gold price index on the Johannesburg Stock Exchange which somewhat exceeded the average drop in share prices. During

### Stock exchange transactions





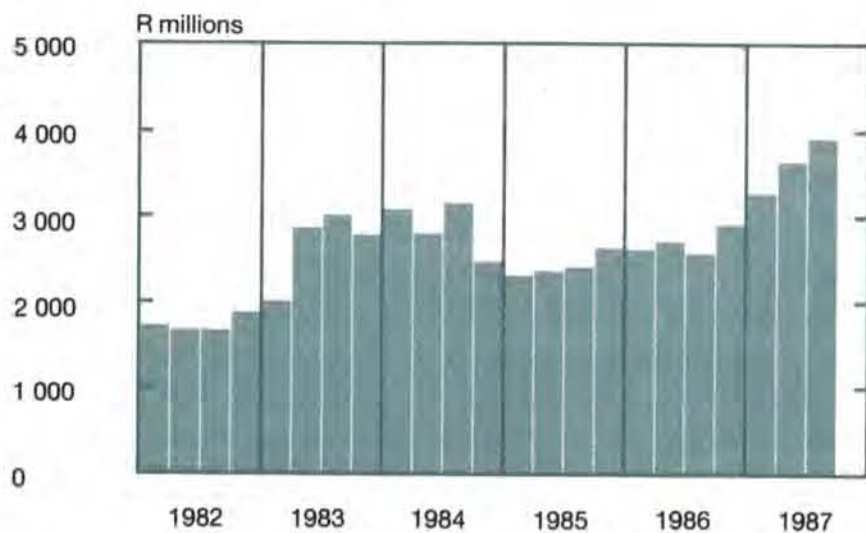
## Share prices



November as a whole, however, the average price of all classes of shares decreased by 29 per cent against a 26 per cent decline in the average price of gold shares. Below-average declines were recorded in November by the prices of financial and industrial shares.

In the primary markets, the public sector raised new funds during July and August through issues of fixed-interest securities to banks and private non-bank investors to an amount of R1 108 million compared with R858 million and R454 million in the first and second quarters of 1987. Companies listed on the stock exchange raised R101 million through new fixed-interest securities issues during July and August, against R201 million in the first quarter; no such issues were made in the second quarter. New issues of share capital by listed companies amounted to R221 million during July and August, compared with

## Real estate transactions



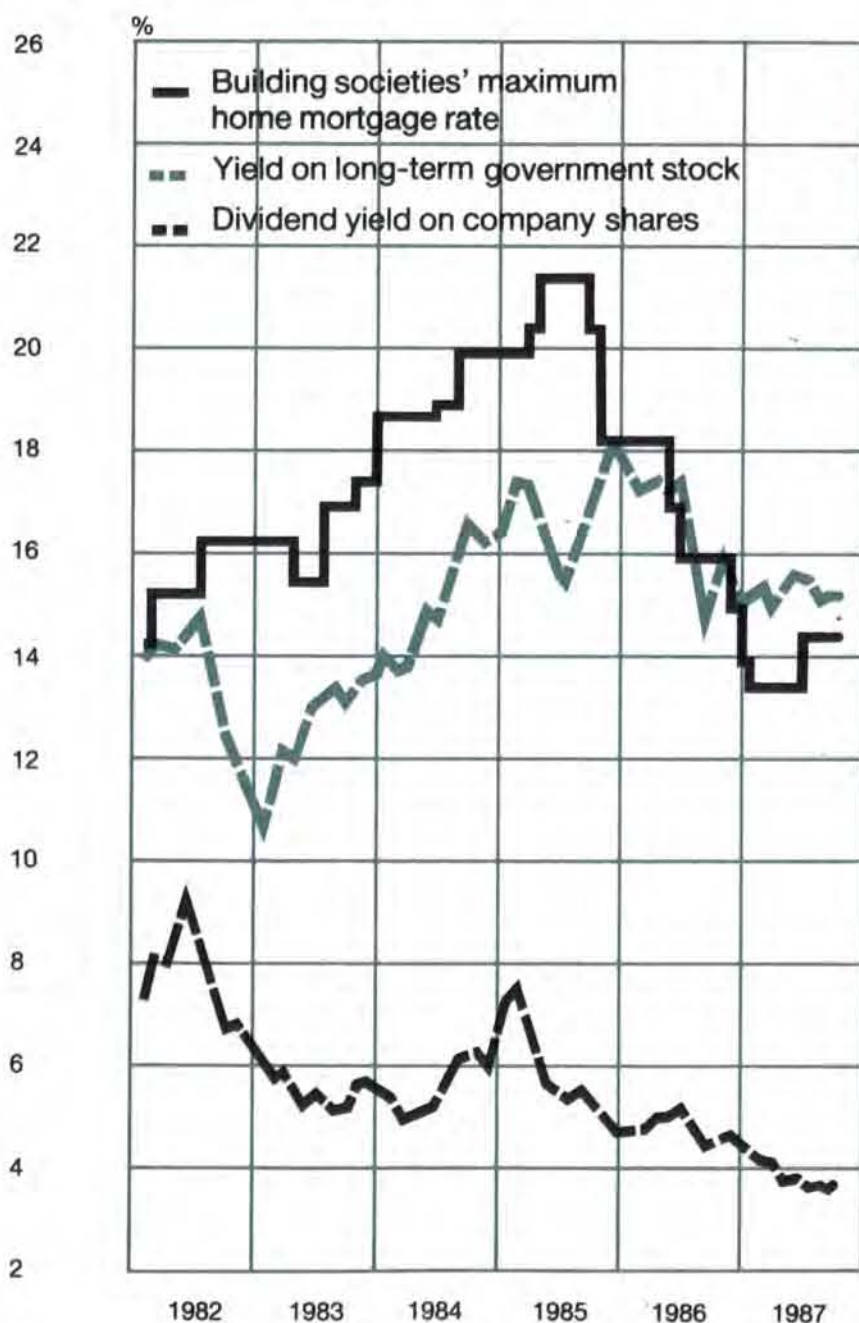
R205 million and R927 million in the first and second quarters of 1987, respectively.

In the mortgage market the sustained demand for mortgage financing and increasing availability of funds enabled the building societies to maintain the upward trend in the level of their mortgage lending. Mortgage loans paid out increased from R2,0 billion and R2,1 billion in the first two quarters of 1987 to R2,4 billion in the third quarter.

## Long-term rates and yields

Long-term interest rates, having hardened somewhat in the second quarter of 1987, eased again in the third quarter on the basis of more sanguine inflationary expectations and more favourable perceptions of the Government's future borrowing needs. A mild firming of these rates was apparent, however, in the wake of the collapse of share prices on the stock exchange

## Long-term interest rates





from 20 October. In terms of monthly averages, the yield on long-term government stock eased slightly from 15,3 per cent in December 1986 to 15,0 per cent in March 1987, hardened temporarily to 15,6 per cent in June and eased to 15,2 per cent in September. After retreating slightly further to 15,0 per cent on 19 October, this yield firmed to 15,4 per cent on 26 October. The average for the month of October, however, was unchanged at 15,2 per cent.

The predominant building society rate on home mortgage loans was raised from 13,5 per cent to 14,0 per cent in May 1987 and to 14,5 per cent in July. However, because of the competitive mortgage lending rate of 12,5 per cent offered by certain banks, a major building society lowered its rate on new mortgages to 12,95 per cent in August. In November certain other major societies similarly reduced their new lending rates to 13,5, 13,0 or, on certain conditions, 12,5 per cent.

The predominant rate on twelve-month deposits with banks and building societies, which serves as an indicator of deposit interest rates generally, was raised from 9,5 to 10,0 per cent in February 1987. This rate then was increased further by the building societies, in three monthly steps of 0,25 per cent each, from 10,0 per cent in early May 1987 to 10,75 per cent in July. Banks raised their twelve-month deposit rate only to 10,50 per cent, and did so only from July.

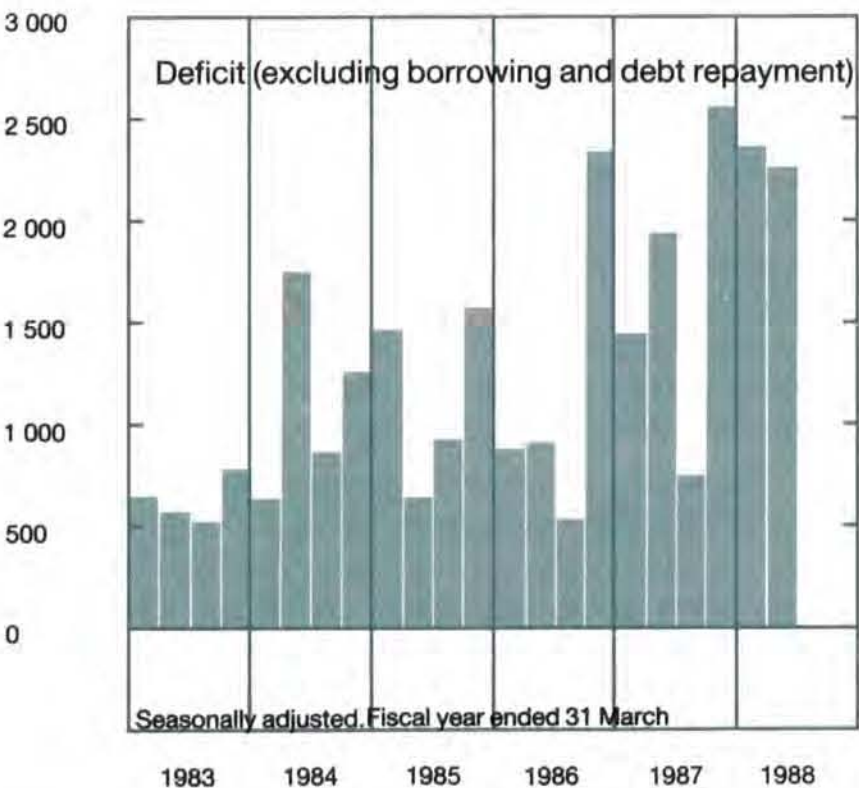
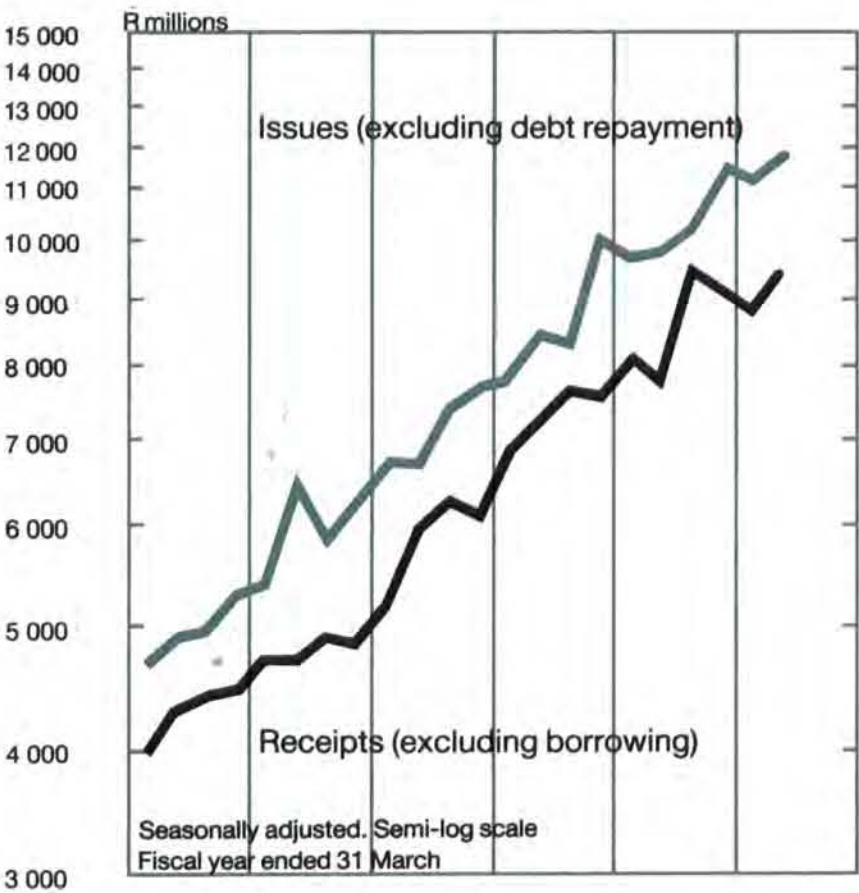
Mirroring the sharp rise in share prices, the dividend yield on all classes of shares contracted steadily from a monthly average of 4,7 per cent in December 1986 to 4,2 per cent, 3,9 per cent and 3,6 per cent in March, June and September 1987, respectively. The sharp drop in share prices from 20 October then caused this yield to rise on a daily basis from 3,0 per cent on 19 October to 5,0 per cent on 5 November. Immediately prior to the start of the 1985-87 upward phase in share prices, i.e. in February 1985, this yield had reached a cyclical peak value of 7,7 per cent.

## Government finance

### Expenditure by general government

Aggregate expenditure by general government on final goods and services, in comparison with such expenditure in the corresponding quarter of 1986, rose by as much as 23,7 per cent in the first quarter of 1987 and somewhat more moderately by 18,7 per

### Exchequer account





cent and 20,1 per cent in the second and third quarters of 1987, respectively. The ratio of aggregate expenditure by general government to nominal gross domestic product accordingly declined from 23,4 per cent in the first quarter and 23,3 per cent in the second quarter of 1987 to 21,2 per cent in the third quarter.

Exchequer issues

Exchequer issues to government departments (after the usual adjustment for changes in the balance on the Paymaster-General Account) in the June and September quarters of 1987 - i.e. in the first and second quarters of fiscal 1987/88 - exceeded such issues in the June and September quarters of 1986 by 18,2 and 21,7 per cent. The average increase in these issues in the first half of fiscal 1987/88, compared with the first half of fiscal 1986/87, accordingly amounted to 19,9 per cent. A slightly lower rate of increase in October 1987 brought the increase in these issues for the first seven months of fiscal 1987/88 down marginally to 19,1 per cent. This was still significantly in excess of the budgeted increase in central government expenditure of 16,2 per cent for the fiscal year as a whole.

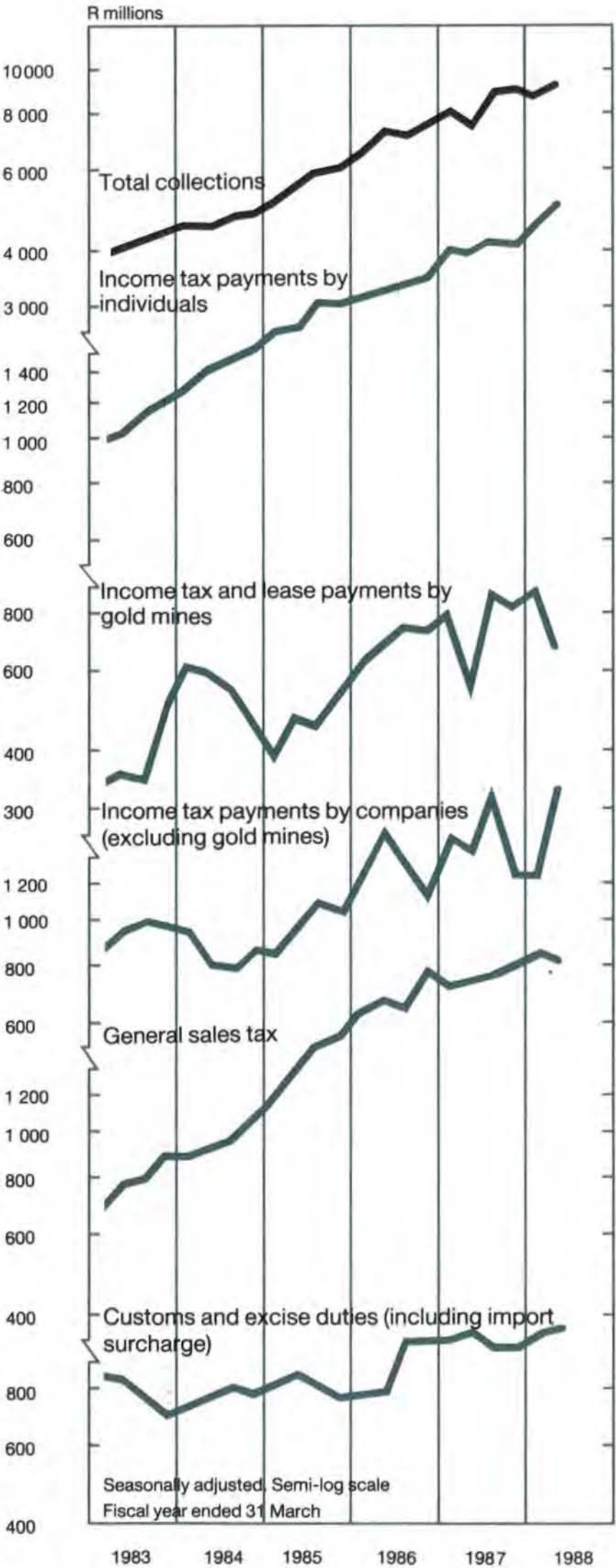
Exchequer receipts

Exchequer receipts during the June and September quarters of 1987 exceeded their one-year-earlier counterparts by 5,6 and 22,4 per cent, respectively, for an average increase in the first half of fiscal 1987/88 of 15,1 per cent. This increase, too, was significantly in excess of the budgeted increase in revenue for the fiscal year as a whole, which amounted to 12,6 per cent. Relatively low proceeds in October, however, brought the rate of increase in the first seven months of the fiscal year more closely in line with the Budget estimates at a level of 12,8 per cent.

The sharp acceleration from the low year-on-year increase in revenue in the June quarter of 1987 to the unusually large increase in the September quarter was accounted for primarily by the introduction of the new fuel levy from 1 July 1987 and of a third provisional tax payment by individuals. Revenue collections in terms of the new provisional tax payment were made for the first time in August 1987.

Rates of increase in total revenue in the first half of fiscal 1987/88 that were in excess of the budgeted percentage increase in revenue for the fiscal year as a whole were explained mainly by above-Budget increases in excise duties, personal income tax and "other" inland revenue, i.e. inland revenue other than income tax, general sales tax and gold mining leases. Such "other" inland revenue increased by 32,6 per cent, compared with a budgeted decrease of 15,7 per cent.

Revenue collections – State Revenue Fund





The year-on-year increase in income tax paid by individuals amounted to 22,4 per cent, against the Budget estimate of 19,4 per cent. Income tax paid by gold mines, on the other hand, declined slightly by 2,8 per cent against the Budget estimate of a decline of 0,8 per cent. The increase in income tax receipts from non-mining companies, at 12,7 per cent, similarly fell somewhat short of the Budget estimate of 15,2 per cent. The 16,9 per cent increase in aggregate income tax receipts other than from gold mining companies nevertheless was very close to the Budget estimate of 16,6 per cent.

### Deficit before borrowing

The deficit before borrowing and debt repayment during the first seven months of fiscal 1987/88 amounted to R6 142 million. This was R1 903 million more than the deficit in the first seven months of fiscal 1986/87 and equal to 73 per cent of the budgeted deficit of R8 425 million for the fiscal year as a whole. In comparison, the deficit during the first seven months of fiscal 1986/87 amounted to 67 per cent of the actual deficit eventually recorded during that year.

Information up to September 1987 (i.e. for the first *six* months of the current fiscal year) shows the deficit of R5 566 million during this period, including the discount of R517 million on new government stock issues, to have been financed from the following sources:

	R millions
Public Investment Commissioners.....	741
– Government stock.....	2 340
– Treasury bills.....	–1 599
Non-bank private sector.....	3 820
Banking sector.....	1 073
Foreign sector.....	–68
	5 566
Minus: discount on government stock ..	517
Total financing .....	5 049