

Quarterly economic review

Introduction

The more pronounced upswing in the South African economy that had become apparent from approximately the middle of 1986, appeared to have lost some further momentum in the second quarter of 1987. Aggregate real output in the second quarter of 1987 nevertheless was some 2¾ per cent higher than in the second quarter of 1986 and also marginally exceeded the previous high point in real domestic production at the peak of the mini-boom of 1983-84.

Successive quarterly increases in real gross domestic product from mid-1986, at seasonally adjusted annual rates, amounted to approximately 3½ per cent in the third and fourth quarters of 1986, 2 per cent in the first quarter of 1987 and a provisionally estimated 1½ per cent in the second quarter of 1987. Output levels in the second quarter of 1987 were adversely affected, however, by various work stoppages and by the unusually large number of non-working days in April and May. To that extent, the further shrinkage of the real growth rate in the second quarter may not have been indicative of a further weakening of the underlying growth trend and would not, therefore, necessarily rule out a return to somewhat stronger rates of real economic expansion in the remainder of the year.

Total real gross domestic expenditure, after having shown marked fluctuations in 1986, advanced both more steadily and more strongly in the first half of 1987. Aggregate real domestic spending was some 6½ per cent higher in the second quarter of 1987 than in the second quarter of 1986, and – at a seasonally adjusted annual rate – nearly 7 per cent higher in the first half of 1987 than in the second half of 1986.

Real private consumption expenditure, notably on consumer durables, posted signal if moderate increases in both the first and the second quarter of 1987. Real government consumption expenditure, after an uncommonly rapid rise in the first quarter of 1987, increased further at a more moderate pace in the second quarter. A small increase was recorded in aggregate real inventories in the second quarter. Total real gross domestic fixed investment, however, registered another disappointing decline, mostly because of severe cutbacks in real capital spending by the business enterprises of general government and because of renewed declines in real fixed capital formation by the private sector. Mild improvements nevertheless were shown by real gross fixed investment in private manufacturing in both the first and the second quarter of 1987. This mild recovery did not suffice, however, to prevent further shrinkage of the total real fixed capital stock in manufacturing industry.

Rates of increase in aggregate domestic expenditure in excess of the rates of increase in domestic production in the first half of 1987 also found expression in a rising level of most merchandise imports which, in turn, contributed to a narrowing of the surplus of the balance of payments on current account from its very high level in the fourth quarter of 1986. At an annual rate of R5,8 billion, the current account surplus in the second quarter of 1987 none the less still amounted to a quite substantial 3½ per cent of gross domestic product. Offset partly by a moderate outflow of capital not related to reserves and by significant further redemptions of foreign liabilities related to reserves, the sustained current account surplus caused the total gold and other foreign reserves to rise by another R1,0 billion in the second quarter and in July 1987, after an increase of R1,8 billion during the preceding three months.

Apart from the sustained surpluses on the current account of the balance of payments, a notable feature of the South African economy in the second quarter of 1987, as in the second half of 1986, was the markedly stronger growth performance of gross *national* product than of gross *domestic* product. Real gross *national* product in the second quarter of 1987 was some 5 per cent higher than in the second quarter of 1986. Substantially faster growth of gross national product than of gross domestic product in the second quarter of 1987 was attributable entirely to a continued decline in real net factor payments to non-South African owners of productive resources that are employed in the South African economy. The drop in such payments in the second quarter was mostly accounted for by diminishing net payments of interest which, in turn, reflected the effect of the net repayment of foreign debt from the fourth quarter of 1984 on the level of South Africa's international indebtedness.

The fairly strong showing, in the first half of 1987, of growth in real gross domestic expenditure, on the one hand, versus the slackening of real output growth, on the other hand, again focused attention on the apparent inability of the recovery in domestic production from the middle of 1985 to gather momentum in the manner of upswings in the 1960s and 1970s and to assume a more cumulative and self-reinforcing character. Slow average output growth since mid-1985 obviously was related in part to the volatility and generally sluggish expansion of aggregate real domestic demand in the second half of 1985 and during 1986. These were accounted for partly by a succession of adverse extraneous developments, the lack of business and consumer confidence, and general uncertainty. In addition, however, households entered the economic recovery

from mid-1985 with an unusually large and inhibiting relative burden of real household debt. This debt was also carried at initially very high positive real interest rates.

As was noted in the Reserve Bank's recent *Annual Economic Report* for 1987, the lack-of-confidence factor then also played a part in helping to account for the failure of earlier increases in export volumes, the moderate rises in real private consumption expenditure, and government spending programmes, to be translated in a significantly positive manner into real fixed investment and extensions of production capacity. Of major significance, too, was the fact that an uncommonly large part of the cyclical rise in domestic final demand (i.e. in the sum total of private and government consumption expenditure and aggregate domestic fixed investment) during an uncommonly large proportion of the upswing period from mid-1985 to mid-1987 was met from a drawing-down of inventories. Relatively slow growth in the volume of merchandise imports, on the other hand, meant that a smaller-than-usual part of the potential impact of domestic expenditure on domestic output was deflected to foreign markets. The lower-than-usual marginal propensity to import during the upswing period itself partly was a reflection of subdued fixed investment demand.

The more modest rates of real output growth in the first half of 1987 were accompanied by an unchanged level of employment in the first quarter but by employment growth at an annual rate of 2 per cent in the second quarter. Total employment outside agriculture in the second quarter of 1987 exceeded its one-year-earlier level by a modest 1,1 per cent. Registered unemployment, having contracted significantly up to May 1987, rebounded quite sharply in June and July. The rate of inflation in consumer and production prices, on the basis of quarter-to-quarter changes in these prices at seasonally adjusted annual rates, was markedly lower in the first half of 1987 than in the first and third quarters of 1986.

The broadly defined money supply, M3, continued to grow only slowly in the first quarter of 1987 but somewhat more rapidly in the second quarter. At 10,9 per cent, the annual rate of increase in M3 from the beginning of the 1987 targeting year up to the end of July 1987 still fell significantly short, however, of the lower bound of the 14 – 18 per cent target range. The M3 velocity of circulation continued to rise sharply in the first quarter of 1987 but, on the basis of preliminary estimates, would appear to have shown little further change in the second quarter.

Bank credit to the private sector in the first seven months of 1987 still advanced only slowly at an annualised rate of somewhat more than 6 per cent. Sluggish growth continued to be exhibited by banks' "other" loans and advances, which are likely to have incurred most of the effect of increased recourse to "set-offs" of corporate clients' debit and credit balances

in the books of banking institutions. Fairly substantial increases were observed, however, in hire-purchase credit and leasing finance from low base data at the end of March 1987. If these increases are sustained, the rise in the non-corporate component of hire-purchase financing may signal a waning of households' resistance to renewed increases in consumer debt.

A relatively high degree of stability, in accordance with the Reserve Bank's unvaried monetary policy stance, was observed in money market interest rates throughout the second quarter and in July, August and early September 1987. In the capital markets, the high levels of activity of the first quarter of 1987 were maintained, or surpassed, in the second quarter. Long-term interest rates hardened temporarily in the second quarter but fell back in July, August and early September. They thereby created conditions that were receptive to the Reserve Bank's security sales.

Substantial further increases were recorded in share prices on the Johannesburg Stock Exchange. In August 1987 the average level of all share prices exceeded by some 148 per cent the level of these prices at the start of the current upward phase in the share market from early 1985.

Substantially higher-than-budgeted percentage increases in Exchequer issues, and lower-than-budgeted percentage increases in Exchequer receipts, during the June quarter and in July 1987 caused the deficit before borrowing on the Exchequer Account in this four-month period to amount to R5,0 billion. This was some R1,5 billion more than in the corresponding four months of fiscal 1986/87 and equal to some 60 per cent of the deficit as provided for in the Budget for fiscal 1987/88 as a whole.

Domestic economic developments

Domestic output

Real gross domestic output, in continuation of the more decisive upswing in economic activity that had become apparent from the middle of 1986, advanced further in the second quarter of 1987 from its first-quarter level but did so at a diminished pace. Aggregate real output in the second quarter of 1987 was some 2¾ per cent higher than in the second quarter of 1986. In seasonally adjusted and annualised terms, the rate of increase in total real gross domestic product receded from approximately 3½ per cent in the third and fourth quarters of 1986 to approximately 2 per cent in the first quarter of 1987. It then slipped down somewhat further to a provisionally estimated 1½ per cent in the second quarter.

The progressive decline in the real growth rate in the first half of 1987 would appear to point to a gradual fading of the various forces that have supported the upswing to date. The diminished rate of output growth in the second quarter of 1987 should be viewed, however, against the background of various work stoppages and of the unusually large number of holidays

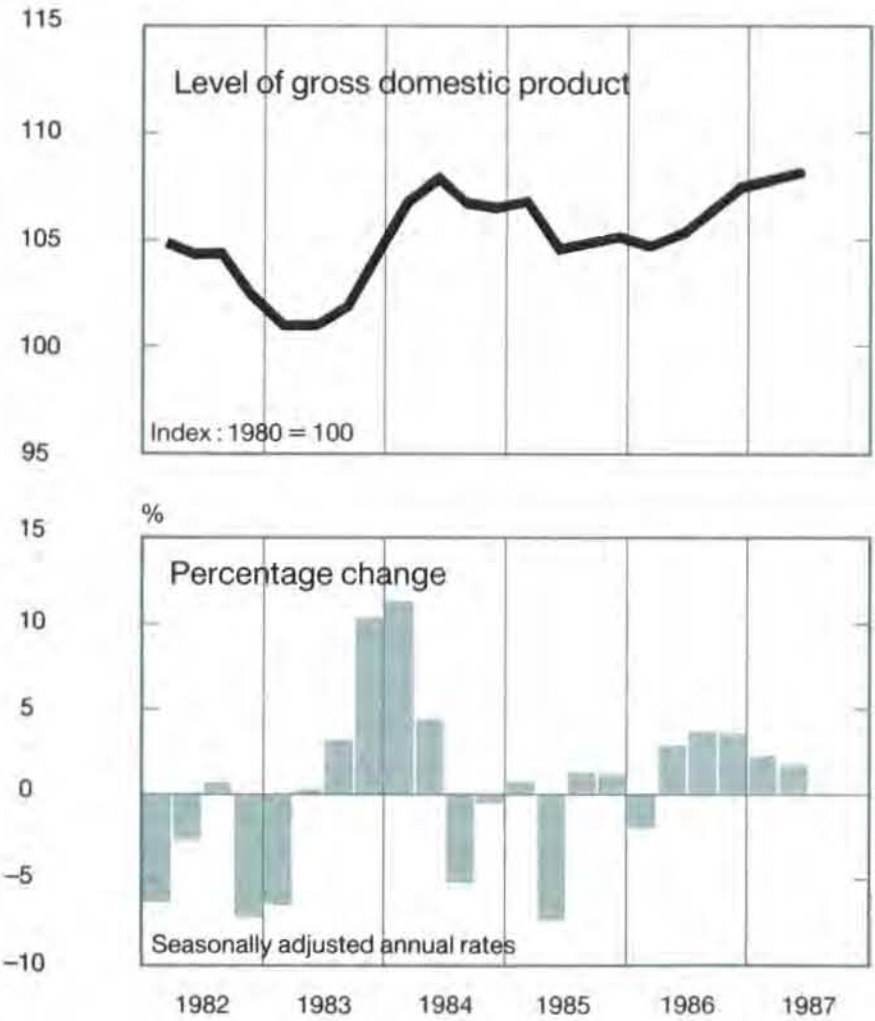
and non-working days in that quarter, which adversely affected production in a broad range of sectors of the economy. To a not insignificant extent the further shrinkage of the real growth rate in the second quarter of 1987 (and possibly in August, inter alia because of the strike in the gold mining industry) may therefore not have been indicative of a further weakening of the underlying growth trend and would not rule out a return to somewhat stronger rates of real economic expansion during the remainder of the year.

The sustained, if modest, rise in aggregate real output during the second quarter of 1987 was accounted for mainly by increases in real value added in the agricultural sector, motor trade, finance and general government. Declines in real value added were recorded by manufacturing, mining, transport, and wholesale and retail trade.

Agricultural output expanded in the second quarter of 1987 because of relatively favourable weather conditions in the summer rainfall areas during the preceding rainy season. Continued very high levels of activity in the financial markets, notably the securities markets, contributed to sustained growth in real value added by the financial services sector. Real output in this sector has been rising consistently since the fourth quarter of 1985. The increase in real value added by the sector commerce largely derived from the improving fortunes of the motor trade; sales of new passenger cars and light commercial vehicles were 13½ per cent higher, and sales of all types of motor vehicles 12½ per cent higher, in the second quarter of 1987 than in the second quarter of 1986. The rise in real value added by general government services was associated closely with higher levels of employment by general government.

In contrast to the declining growth rate in real gross domestic product, real gross national product grew at a fairly impressive annual rate of 4½ per cent in the second quarter of 1987, after already having shown a quite substantial increase in the second half of 1986. Real gross national product accordingly was some 5 per cent higher in the second quarter of 1987 than in the second quarter of 1986. In the second half of 1986 the notably more rapid expansion of real gross national product than of real gross domestic product was attributable in broadly equal proportions to improvements in the South African terms of trade and to a substantial drop in real net factor payments to the rest of the world. In the second quarter of 1987, however, markedly more substantial growth in real gross national product than in real gross domestic product was accounted for solely (and notwithstanding a deterioration in the terms of trade) by further declines in real net factor payments to non-South African owners of productive resources in the South African economy. The drop in such payments was mostly a matter of diminishing net payments of interest; lower interest payments, in turn, partly reflected the gradually strengthening effect of

Real gross domestic product



net repayments of foreign debt from the fourth quarter of 1984 on the level of South Africa's international indebtedness.

Domestic expenditure

After having shown major quarter-to-quarter fluctuations in 1986, the seasonally adjusted annual rate of increase in total real gross domestic expenditure amounted to 18½ and 11 per cent in the first and second quarters of 1987, respectively. In the second quarter of 1987 rates of increase of 21½ per cent and 5½ per cent, respectively, were recorded in real private sector consumption expenditure and in real consumption expenditure by general government. At the same time, changes in total real inventories turned around from a significant decrease in the first quarter of 1987 to a small increase in the second quarter. Together, these various positive elements in spending behaviour more than offset a decline in aggregate real gross domestic fixed investment at an annual rate of about 10 per cent.

Real personal disposable income rose at an annualised rate of 4½ per cent in the second half of 1986 but then declined marginally in the first half of 1987. Real

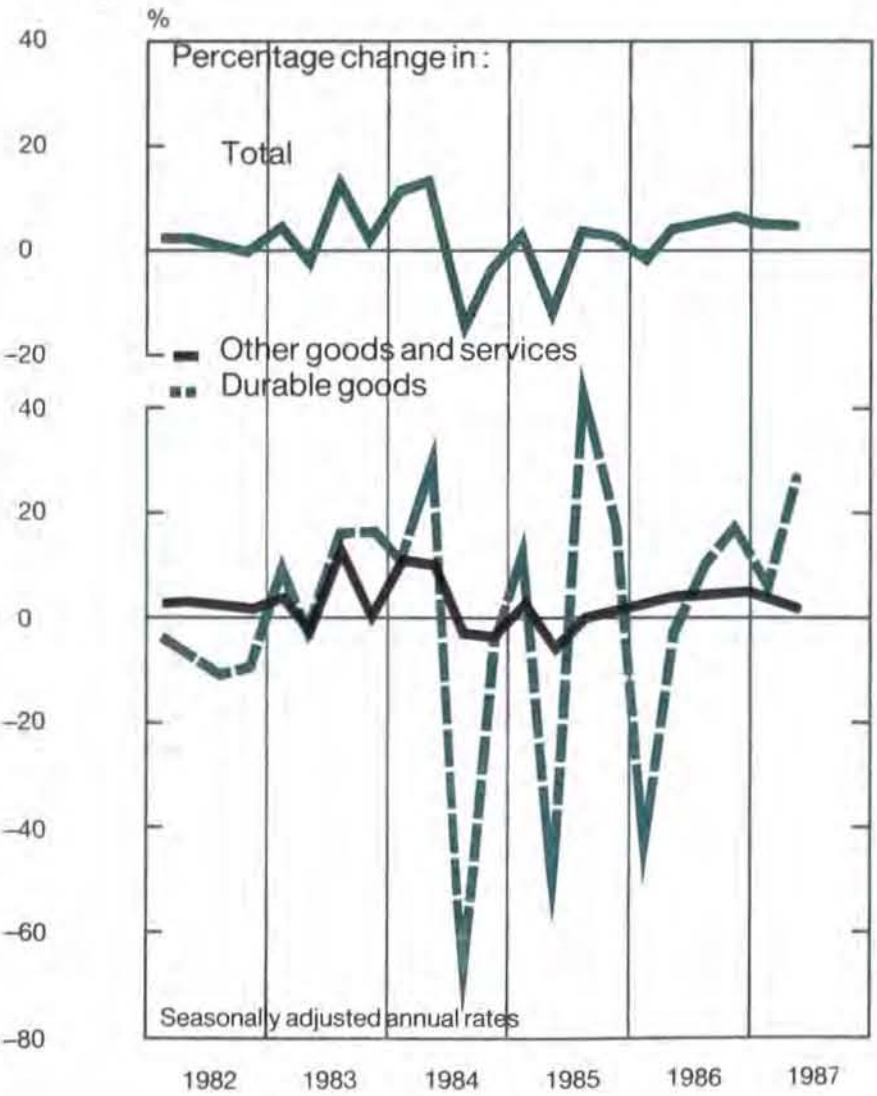
private consumption expenditure nevertheless increased at annual rates of 3½ and 2½ per cent in the first and second quarters of 1987, respectively. This rate of growth in aggregate real private consumption spending was significantly in excess of the average annual rate of increase in such spending of only 1½ per cent during the years from 1980 to 1986. Rising consumer outlays therefore clearly also provided a major part of the forces driving the modest expansion of the South African economy in the first half of 1987. Limits obviously exist, however, to the potential for further expansion of real consumer demand in the absence of renewed increases in real disposable household incomes. Such increases would depend essentially on income and employment-generating forces from outside the sphere of private consumption itself.

Most of the second-quarter rise in aggregate real private consumption expenditure derived from increased household spending on durable goods. Increases in such spending were spread widely across the spectrum of consumer durables. The highest percentage increase, however, was recorded in spending on personal transport equipment, which was being strengthened to a growing extent by pent-up replacement demand. Stock shortages, partly due to work stoppages, were reported in respect of various motor manufacturers' product lines. Notable increases were also registered in net consumption expenditure by foreigners in the domestic market and in spending on transport and communication services. Little change, on the other hand, was apparent in spending on non-durable goods. Spending on semi-durables actually declined marginally despite a significant rise in outlays related to the maintenance of private motor cars.

Real government consumption expenditure increased uncommonly sharply at an annualised rate of some 36½ per cent in the first quarter of 1987 but rose at a decidedly more moderate pace of 5½ per cent in the second quarter. Real salaries and wages, which normally account for some three-fifths of aggregate real government consumption expenditure, rose at an annual rate of approximately 7½ per cent, mainly because of a rise in employment by general government. Following an exceptionally rapid rise at an annualised rate of some 66 per cent in the first quarter of 1987, government expenditure on "other" consumption goods and services advanced further in the second quarter at an annual rate of approximately 4½ per cent.

Total real gross domestic fixed investment declined at a seasonally adjusted annual rate of 10 per cent in the second quarter of 1987. This substantial decrease was mainly attributable to declines at annual rates well in excess of 10 per cent in real fixed capital formation by public authorities and by the private sector. These declines appreciably exceeded an increase in real capital expenditure by public corporations.

Private consumption expenditure at constant 1980 prices



A decline in real fixed capital spending in the private sector was apparent in most sectors of the economy. It was particularly prominent, however, in agriculture, mining and finance.

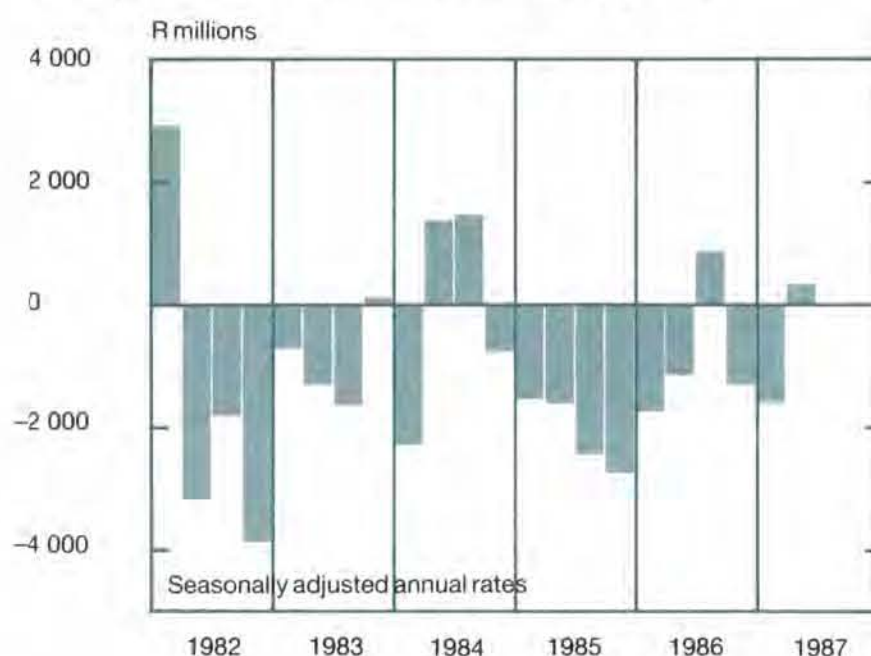
Real gross fixed capital investment in private manufacturing actually improved in both the first and the second quarter of 1987. Its recovery in these two quarters was insufficient, however, to prevent further shrinkage of the total real fixed capital stock in the manufacturing sector, such as has been in evidence since the first quarter of 1985. The percentage degree of utilisation of production capacity in manufacturing accordingly rose further to 79,7 per cent. This was significantly higher than the recent low point of the utilisation rate of 77,4 per cent in the second quarter of 1986 but still well below the peak value of this rate of 86,5 per cent in both 1974 and 1981. Accelerated obsolescence due to technological progress may, however, have reduced somewhat further the actual size of the economically re-employable physical capital stock, at least in certain sub-sectors of manufacturing industry. The current value of the utilisation rate of the "effective" capital stock therefore may conceivably be somewhat higher than 79,7 per cent.

From the first to the second quarter of 1987 total real capital outlays by public authorities were reduced by 12½ per cent, or at an exceptionally high annual rate of approximately 42 per cent. This was accounted for mainly by severe cutbacks in fixed capital spending by the South African Transport Services and the Department of Posts and Telecommunications. Such cutbacks were made in the light of the availability of transport and communication facilities of various kinds and in various areas which are large relative to the demands that are likely to be made on these facilities in the next several years.

After having declined almost uninterruptedly from the fourth quarter of 1984, aggregate real inventories in the South African economy exhibited a small increase in the second quarter of 1987. The main categories of inventories contributing to this increase were mining stocks, agricultural stocks-in-trade and diamond stocks-in-trade. Marginal increases in inventories were, however, recorded in many sectors of the economy. Reductions in inventories, on the other hand, were registered in manufacturing, electricity, gas and water, and wholesale trade.

The overall rise in the book value of inventories did not prevent a decline in the ratio of all inventories to gross domestic product to a record low figure of 31½ per cent in the second quarter of 1987. This may be compared with the most recent peak in this ratio of 41 per cent in the first quarter of 1982. The ratio of industrial and commercial inventories to gross domestic product in the non-agricultural sectors of the economy also receded somewhat further in the second quarter of 1987 to an unprecedented low of 19½ per cent.

Change in inventories at constant 1980 prices



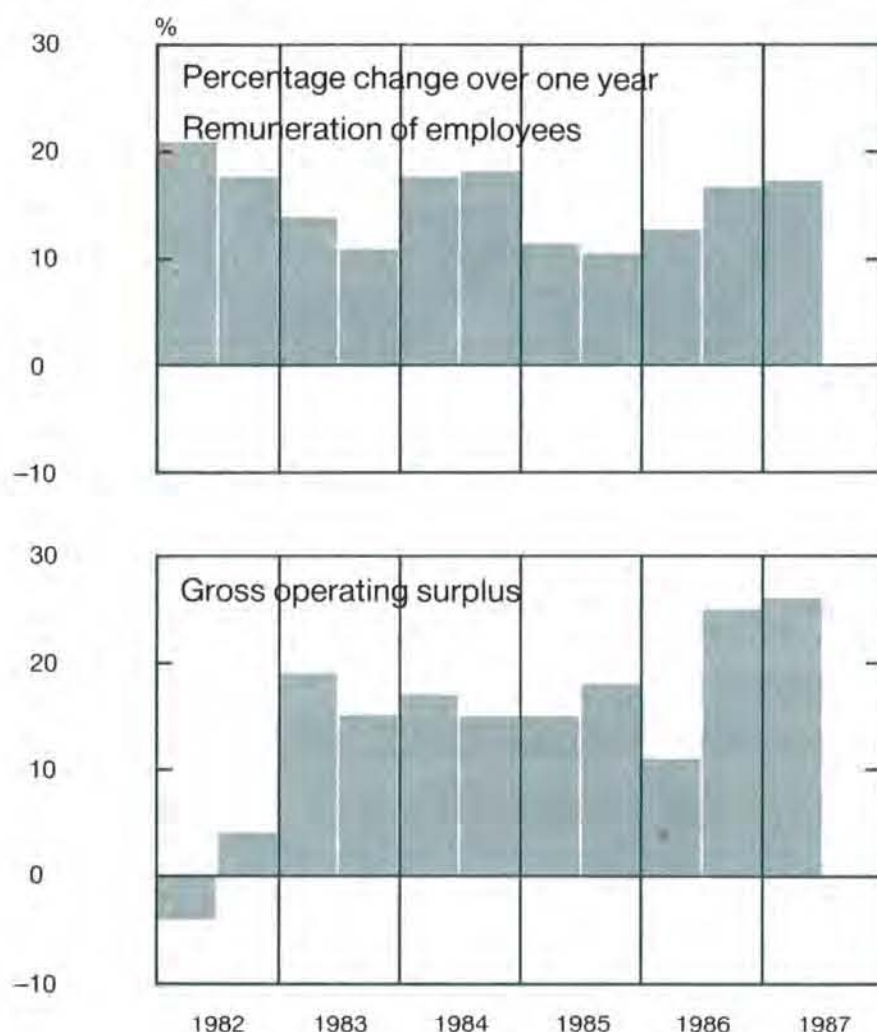
Factor income and saving

The seasonally adjusted and annualised rate of increase in aggregate nominal factor income slowed down from 19½ per cent in the first quarter of 1987 to 18 per cent in the second quarter of 1987. This deceleration was mainly due to lower rates of increase in remuneration of employees. Aggregate nominal labour earnings were held back in the second quarter of 1987 inter alia by an increase in work stoppages and strikes, by the unusually large number of non-working days in this quarter, and by postponements of wage and salary increases in certain sectors of the economy. Included in the last of these items was the fact that wage and salary increases in the civil service took effect only from 1 July 1987.

The total gross operating surplus, representing the remainder of aggregate factor income, rose appreciably in the second quarter of 1987 at an annual rate of 21 per cent. Enhanced operating surpluses were spread widely through the various sectors and sub-sectors of the economy. The relatively strong performance of the aggregate gross operating surplus therefore corroborated reports of marked recoveries in company profits of the past several quarters, which have also been evident from the declining number of company liquidations since the middle of 1986.

Rising levels of business profitability were accompanied by a marked increase in net corporate savings during the first and second quarters of 1987. The ratio of net corporate savings to total gross domestic saving advanced from an average level of 28 per cent in 1986 to an average level of no less than 37 per cent in the first two quarters of 1987. Dissaving by general government, on the other hand, rose from 5½ per cent of

Factor income



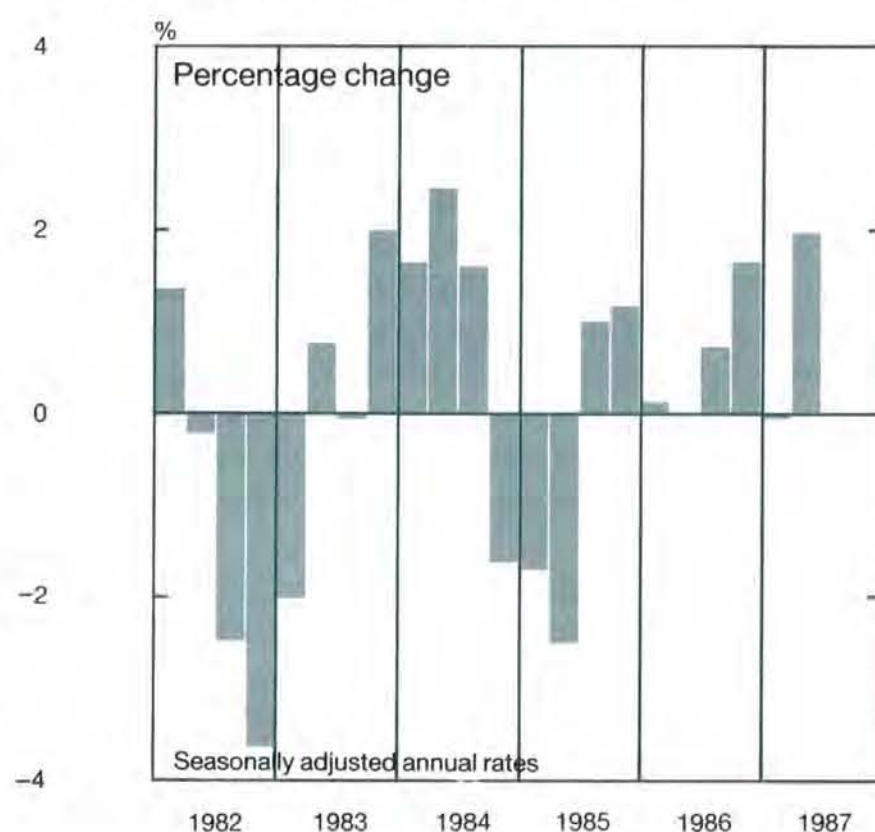
gross domestic saving to 17 per cent over this period. Depreciation allowances in the second quarter proceeded on their steady upward course.

Personal saving remained at relatively very low levels. In the second quarter of 1987 the ratio of personal saving to gross domestic saving amounted to 4½ per cent and its ratio to personal disposable income to a meagre 2 per cent. Factors exerting downward pressure on these savings ratios included relatively modest nominal wage increases in the second quarter of 1987, high inflation and a resultant decline of 2 per cent in the level of real personal disposable income per capita from the second half of 1986 to the first half of 1987, the difficulty in effecting a downward adjustment in living standards, high current prices of certain household financial assets exerting "wealth effects" and inviting monetisation of such assets for consumption purposes, and the pressures of pent-up replacement demand for durable consumer goods.

Employment

Fairly vigorous growth of the economy in the second half of 1986 and its continuation at more modest rates in the first half of 1987 were accompanied by increased employment by public authorities as well as in a number of industries in the private sector, notably in gold

Employment in non-agricultural sectors



mining, manufacturing and construction and among building societies, insurance businesses and hotels. Further reductions in employment were observed, however, in the South African Transport Services and in electricity generation, largely because of internal rationalisation and reorganisation programmes in these industries.

Total employment in the non-agricultural sectors of the economy rose at annualised rates of 0,7 and 1,7 per cent in the third and fourth quarters of 1986, showed no further change in the first quarter of 1987, but, according to preliminary estimates, advanced again at a rate of 2,0 per cent in the second quarter of 1987. Total employment outside agriculture in the second quarter of 1987 accordingly exceeded total employment in the second quarter of 1986 by a modest 1,1 per cent.

The seasonally adjusted number of registered unemployed hovered around 130 000 in the course of 1986, declined to approximately 121 000 in May 1987, but then rebounded quite sharply in the subsequent two months to 133 500 in July. Registered unemployment among workers other than Blacks declined significantly from a peak of 83 000 in September 1986 to 69 000 in March 1987 and 67 000 in July.

The revised Current Population Survey for Blacks showed the number of unemployed Blacks to have retreated from 1 181 000 in July 1986 to 1 040 000 in March 1987. In March 1987 the ratio of unemployed Black workers to the Black labour force amounted to 16,7 per cent.

Labour costs and productivity

The average amount of nominal salaries and wages per worker in the non-agricultural sectors of the economy rose by 14,3 per cent both in calendar 1986 and in the first half of 1987 compared with the first half of 1986. Relative moderation in wage settlements and wage increases was maintained despite the mild cyclical strengthening of the demand for labour and the increased incidence of strikes in certain industries.

The rate of increase in average nominal labour remuneration in the first half of 1987, as in 1985 and 1986, fell short of the rise in the consumer price index. The average real wage per employee, which had decreased by 4,3 per cent and 3,7 per cent in 1985 and 1986, respectively, therefore declined further, by 2,0 per cent, in the first half of 1987 compared with the first half of 1986.

Fairly pronounced increases in total physical production, against limited increases in employment, caused labour productivity (i.e. real gross domestic product per worker) in the non-agricultural sectors of the economy to rise by 1,3 per cent in the first half of 1987 after declines of 1,0 per cent in 1985 and of 0,7 per cent in 1986. In conjunction with the steady 14,3 per cent rate of increase in the average nominal wage per worker in 1986 and the first half of 1987, this improvement in labour productivity also caused a mild slowdown of the rise in unit labour costs. The tempo of the rise in these costs, in nominal terms, receded from 15,0 per cent in 1986 to 12,8 per cent in the first half of 1987.

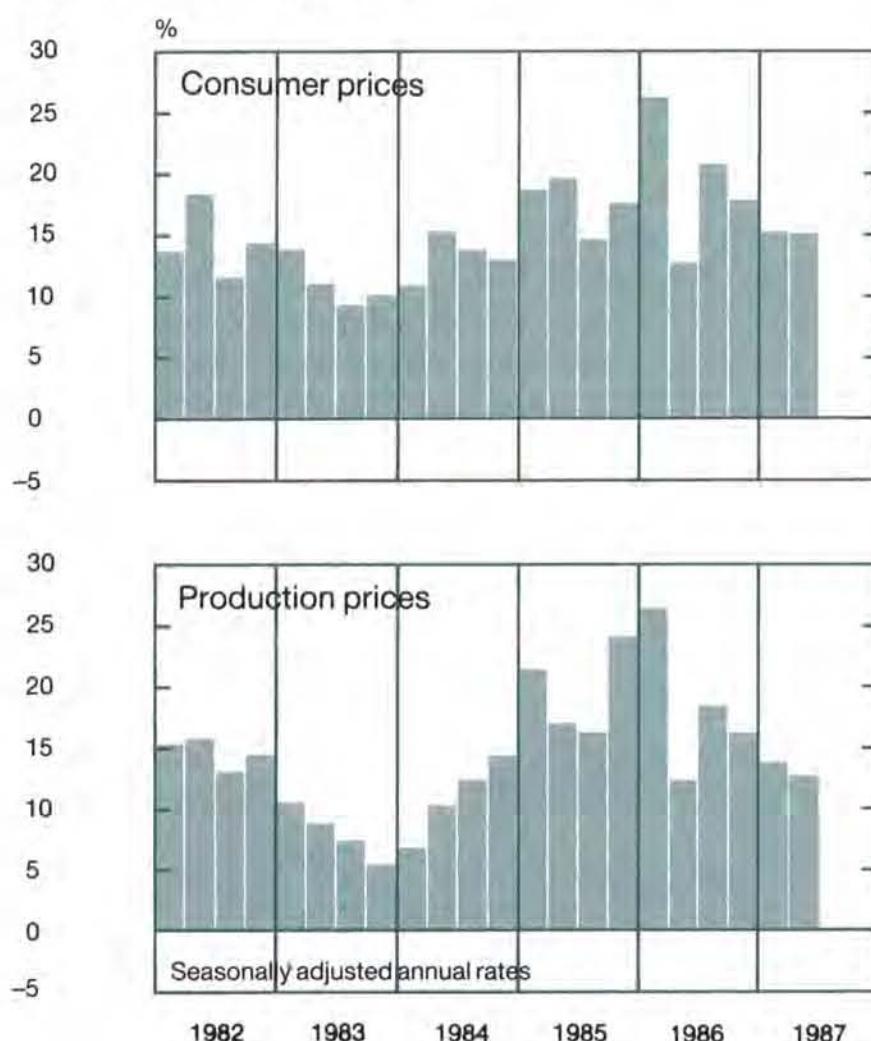
Prices

The rate of inflation in consumer and production prices slowed down significantly from high levels in the first and third quarters of 1986 to comparatively more moderate figures in the first half of 1987. The quarter-to-quarter increase in the average level of consumer prices, at a seasonally adjusted annual rate, subsided from 26,0 per cent in the first quarter and 20,7 per cent in the third quarter of 1986, to 15,1 and 15,0 per cent in the first and second quarters of 1987, respectively. Measured in the same way, the rate of increase in the production price index fell back 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.

Variations in the inflation rate in the course of 1985, 1986 and the first half of 1987 primarily reflected the lagged effects of movements of the exchange rate of the rand on the prices of imported goods. The twelve-month rate of increase in the imported-goods component of the production price index reached a high point of 32,5 per cent in January 1986. Mainly because of the appreciation of the rand from mid-June 1986, this rate then declined eventually to 12,0 per cent in July 1987.

Variations in the rate of increase in the consumer

Percentage change in prices



price index also incorporated the effect of sharp and variable upward adjustments in the prices of foodstuffs. Quarter-to-quarter percentage increases in the prices of consumer goods other than food actually were significantly lower in the first two quarters of 1987 than the average of such increases in the course of 1986. Decelerations in the rate of increase in the cost of housing and other consumer services from the fourth quarter of 1986 to the second quarter of 1987 also contributed to the moderately lower rates of increase in the consumer price index.

Measured over twelve months, the rate of increase in the consumer price index slowed down fairly significantly from nearly 21 per cent in January 1986 to 16,1 per cent in January 1987. This rate then reaccelerated to 17,2 per cent in June 1987 but fell back once more to 16,3 per cent in July. The July 1987 decline in the twelve-month inflation rate in consumer prices was recorded despite upward adjustments to certain administered prices, which included increases in postal, transport and municipal tariffs from 1 July.

The twelve-month rate of increase in the production price index subsided from 20,7 per cent in October 1986 to 14,5 per cent in February 1987. This rate then increased to 16,1 per cent in April 1987 before slowing down again to 14,1 per cent in July.

Balance of payments

Current account

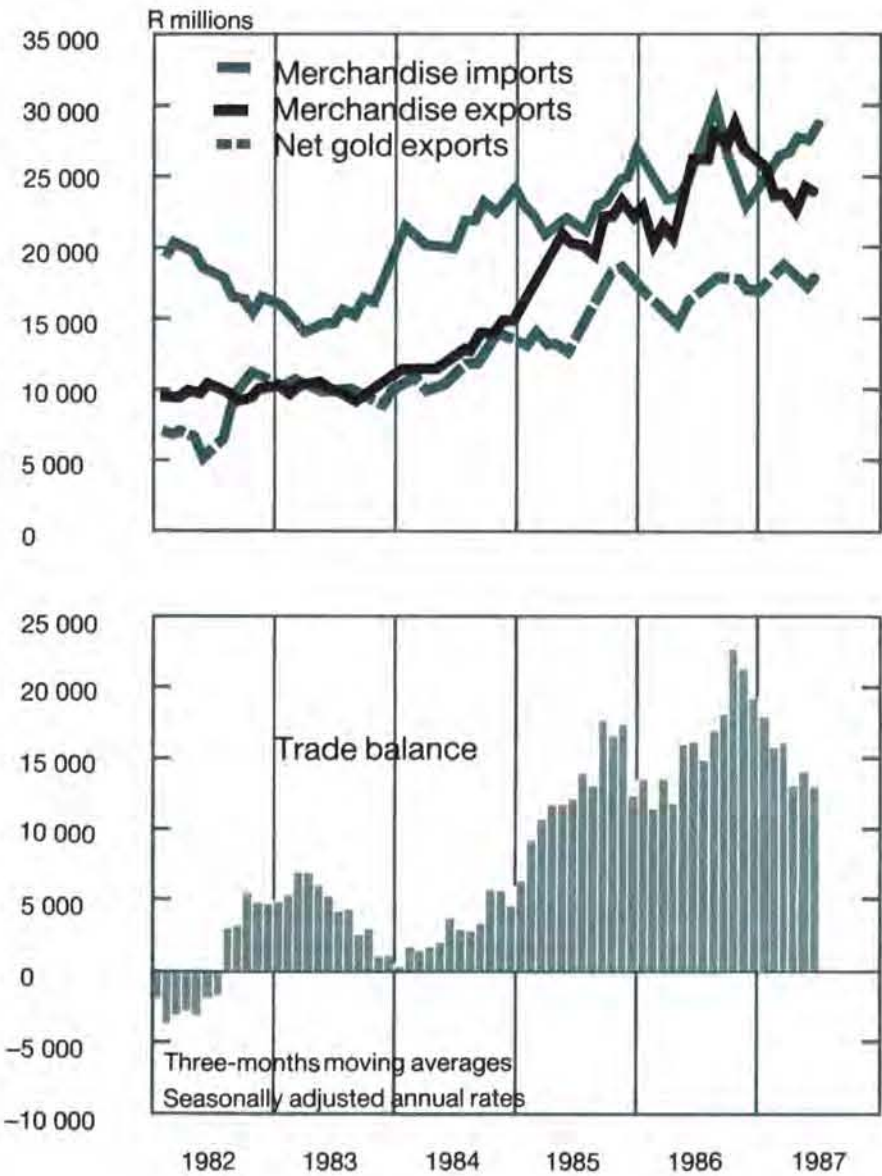
The surplus on the current account of the balance of payments, at a seasonally adjusted annual rate, declined from its record high point of R12,9 billion in the fourth quarter of 1986 to R7,2 billion in the first quarter of 1987 and to a still very substantial R5,8 billion in the second quarter. In terms of the ratio of the current account surplus to gross domestic product, this decline was from 8½ and 4½ per cent to 3½ per cent.

Further shrinkage of the current account surplus in the second quarter of 1987 was due to a fairly large decline in net gold exports and a significant further rise in the value of merchandise imports. Between them, these two developments outweighed the effect of some recovery in the value of merchandise exports and a decline in net service and transfer payments to foreigners.

The value of merchandise exports decreased substantially (by 12 per cent) in the first quarter of 1987 but staged a modest recovery (of some 2½ per cent) in the second quarter. The average level of the value of these exports in the first half of 1987, however, still fell short significantly (i.e. by 13½ per cent) of its very strong showing in the second half of 1986.

The mild recovery in merchandise exports in the second quarter of 1987 was attributable to slight increases in both export prices and export volumes. International commodity prices, in terms of the US dollar, showed accelerated rises in the second quarter of 1987 which brought these prices to their highest average level since the second quarter of 1984. The effect of these price increases on South African export earn-

Balance of payments: Trade account



Current account of the balance of payments

Seasonally adjusted annual rates

R millions

	1986		1987	
	4th qr	1st qr	2nd qr	
Merchandise exports	27 076	23 850	24 430	
Net gold exports	16 989	18 370	17 030	
Merchandise imports	-22 777	-26 410	-27 370	
Net service and transfer payments	-8 409	-8 650	-8 320	
Balance on current account	12 879	7 160	5 770	

ings was partly neutralised, however, by a further strengthening of the effective exchange rate of the rand. A marginal increase in South African export volumes was attained despite some further slackening of growth in the world economy and the effect of sanctions against certain South African export goods.

The value of net gold exports declined from its record level of R18,4 billion in the first quarter of 1987 to R17,0 billion in the second quarter. This decline was more than fully accounted for by a decline in the volume of gold production which, in turn, was due to a further lowering of the grade of ore mined. The price of gold rose both in terms of the US dollar and of the rand. The dollar price of gold per fine ounce advanced from an average of \$406 in the first quarter of 1987 to \$450 in the second quarter, and then rose further to an average of \$456 in July and August 1987; the average price during July-August 1987 may be compared with its counterpart in July-August 1986 of only \$362. The average rand price of gold amounted to R844, R906 and R942 in the first and second quarters of 1987 and in July and August 1987, respectively.

The value of merchandise imports rose by 3½ per cent from the first quarter of 1987 to the second quarter of 1987. This was attributable entirely to an increase in import prices. An increased average level of import prices resulted from higher prices in the international oil market (reflecting, inter alia, the market's response to the increasingly tense situation in the Persian Gulf) and from a moderate rise in the average inflation rate experienced by South Africa's principal international trading partners.

Conversely, the 4 per cent decline in import volumes during the second quarter of 1987 was more than fully explained by a sharp decline in the volume of imports of mineral products. When mineral products are excluded, the volume of the remaining categories of merchandise imports actually increased by more than 7 per cent. The rise in these imports may be held to have been in broad accordance with the sustained, if moderate, further rise in domestic economic activity in recent months and with more pronounced recent increases in real gross domestic expenditure. The aggregate volume of all merchandise imports in the second quarter of 1987, however, still only mildly (i.e. by some 4 per cent) exceeded the volume of all merchandise imports in the second quarter of 1986 and, as noted in the Reserve Bank's recent *Annual Economic Report*, still fell short very substantially (i.e. by 21½ per cent) of the peak level of the volume of such imports during the mini-boom in the first quarter of 1984.

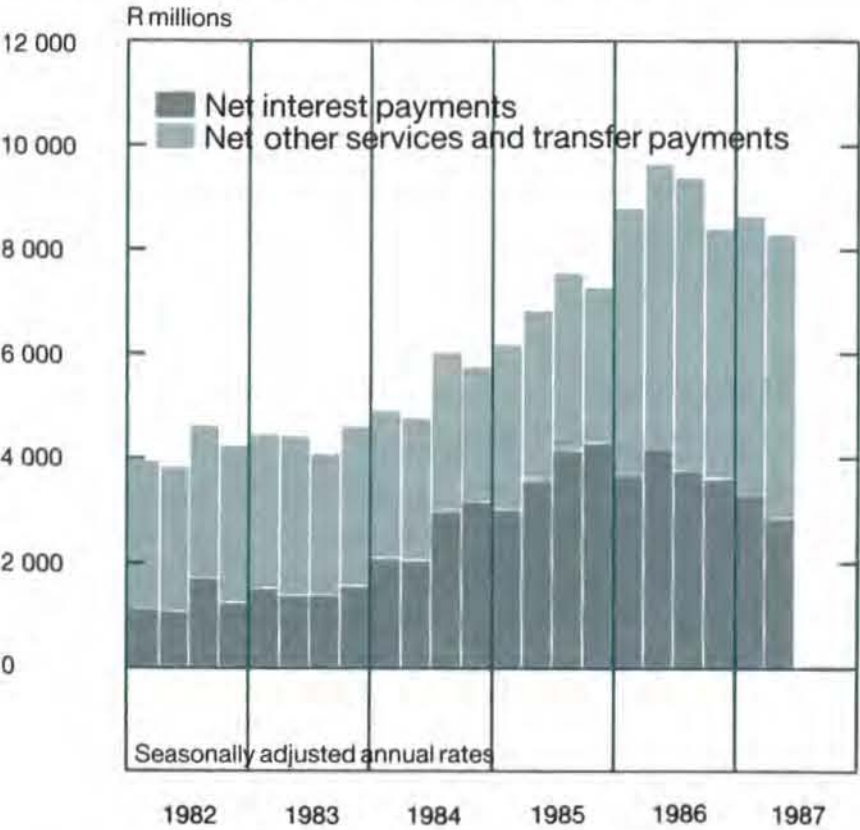
Net service and transfer payments to foreigners, which had reached a high point at a seasonally adjusted

annualised rate of R9,6 billion in the second quarter of 1986, declined further from R8,7 billion in the first quarter of 1987 to R8,3 billion in the second quarter. This decline resulted mainly from diminishing interest payments to foreigners and from an increase in dividend receipts from South African investments abroad. The decline in interest payments, in turn, reflected partly the reduction of South Africa's foreign debt obligations from the high point in the country's foreign indebtedness in 1985, as well as the strengthening of the effective exchange rate of the rand from mid-June 1986. The various favourable changes in interest payments and dividend receipts more than offset increases in international freight and insurance payments, travel expenditures, and dividend payments on foreign equity interests in the South African economy.

Capital account

A net inflow of capital, not related to reserves, of R407 million in the first quarter of 1987 was followed by a moderate outflow of R911 million during the second quarter. The net outflow during the first half of 1987 accordingly amounted to a fairly limited R504 million, which may be compared with outflows of R2,7 billion and R3,4 billion during the first and second halves of 1986, respectively. Similarly, the net outflow of capital

Net interest, services and transfer payments



Net capital movements

R millions

	1987		
	1st qr	2nd qr	1st half
Long-term capital			
Public authorities	-9	-217	-226
Public corporations ...	347	348	695
Banking sector	38	-60	-22
Private sector:			
Net purchases of listed securities by non-residents	-209	-546	-755
Other capital	18	-278	-260
Total long-term capital ..	185	-753	-568
Short-term capital including unrecorded transactions, but excluding reserve-related liabilities	222	-158	64
Total capital movements excluding liabilities related to reserves	407	-911	-504
Change in liabilities related to reserves	-627	-377	-1 004

of R911 million in the second quarter of 1987 by itself compared favourably with average quarterly outflows of approximately R2,3 billion and R1,5 billion during the years 1985 and 1986, respectively.

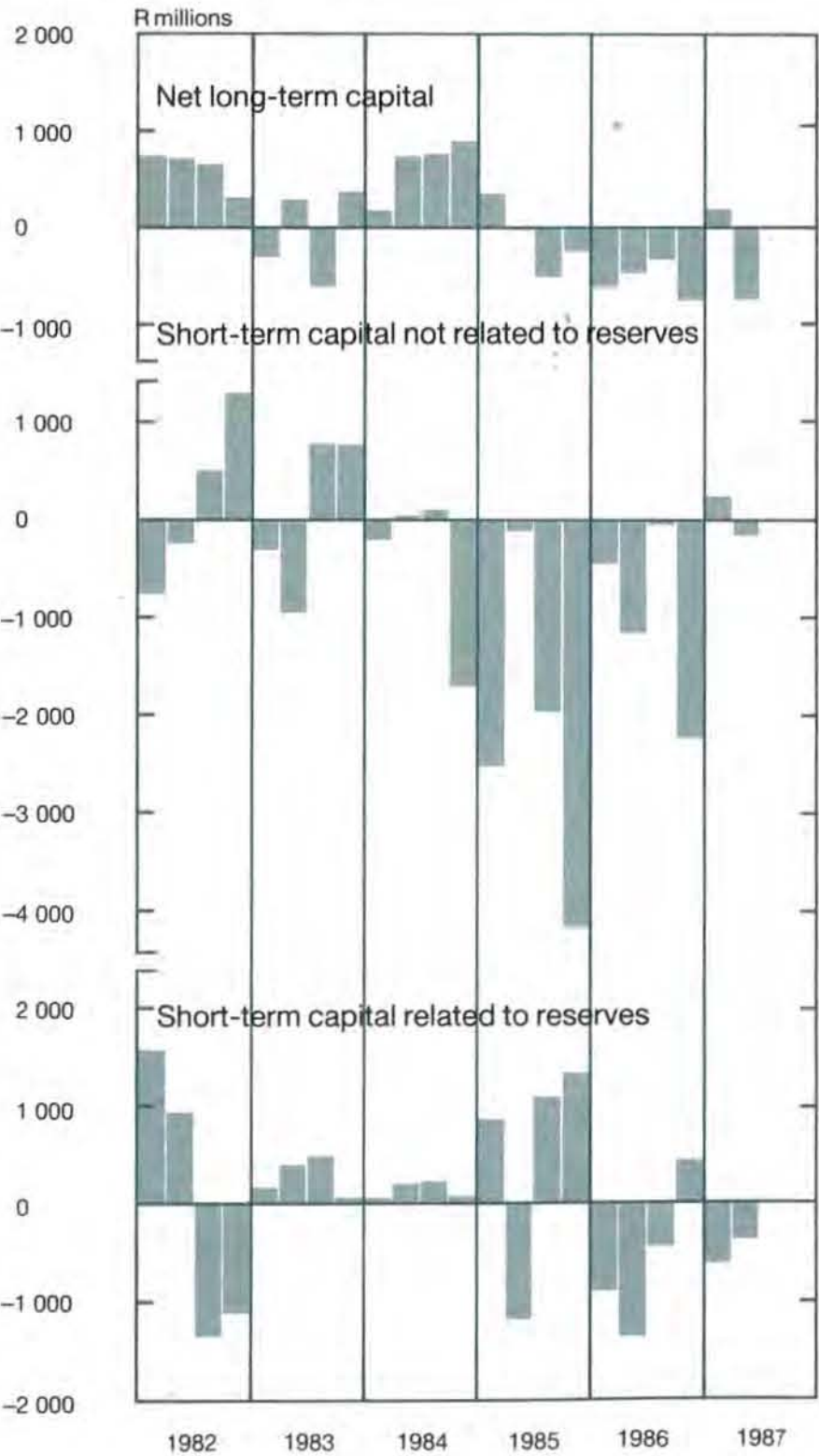
The total net outflow of capital, not related to reserves, in the second quarter of 1987 was made up of an outflow of R753 million of long-term capital and R158 million of short-term capital. The outflow of long-term capital mainly consisted of repayments by public business enterprises on bearer bonds and notes and by private enterprises on trade-related loans outside the so-called standstill "net". Non-residents also continued to be net sellers of securities listed on the

Johannesburg Stock Exchange, which, although they are recorded as outflows of long-term capital, do not, of course, under the financial rand system result in an actual loss of foreign exchange. In contrast to these outflows, public corporations for the second consecutive quarter were net importers of foreign capital in the form of new loans raised as well as of drawings on existing loan facilities for project financing. The amount taken up in these ways was R348 million.

Short-term capital movements, not related to reserves but including unrecorded transactions, changed from an inflow of R222 million in the first quarter of 1987 to a moderate outflow of R158 million in the second quarter.

Reserve-related foreign liabilities were reduced further during the second quarter of 1987 by R377 million. Of this amount R240 million represented a further repayment on South Africa's loan from the International Monetary Fund. Another repayment on this loan, of R259 million, was made in August 1987. The final instalment in these repayments, amounting to SDR99,4 million, is to be made in November 1987.

Net capital movements



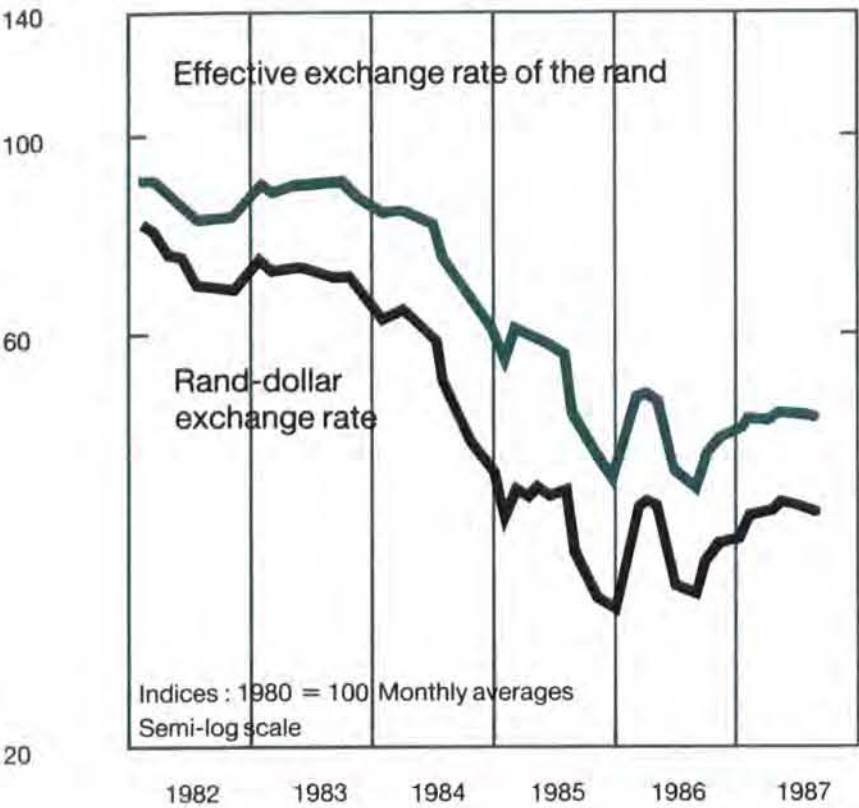
Foreign reserves

The continued large surplus on current account and the moderate extent of capital outflows caused the total gross gold and other foreign reserves, which had increased by no less than R1,8 billion in the first quarter of 1987, to rise by another R282 million during the second quarter. During July and August 1987, moreover, the gross gold and other foreign reserves of the Reserve Bank increased further, on balance, by R494 million. This more recent increase in the Reserve Bank's total reserve holdings occurred despite the "upfront" payment of US \$300 million to foreign creditor banks on 15 July 1987 in terms of the "Second Interim Arrangements" for the repayment of affected foreign debt and despite the repayment of the penultimate instalment on the IMF loan in August. The gold holdings of the Reserve Bank rose from 5,5 million fine ounces at the end of March 1987 to 6,2 million fine ounces at the end of August.

Exchange rates

The exchange rate of the rand vis-à-vis the US dollar increased almost continuously from its lower turning point of only about 36 US cents on 12 June 1986 to 45½ US cents by the end of 1986 and 50½ US cents on 20 May 1987. The rand's appreciation in terms of the dollar from mid-June 1986 to mid-May 1987 accordingly amounted to some 41 per cent. To a large extent, this appreciation reflected the decline of the US dollar against other major currencies. The rand also appreciated, however, in terms of other leading currencies, such as the pound sterling, the French franc and the yen.

Exchange rates



20 May 1987. Its dollar value between these two dates rose from 20,25 to 31,50 US cents, or by 55,6 per cent. The discount of the financial rand vis-à-vis the commercial rand during this period accordingly declined from 43,4 to 37,5 per cent. From 20 May 1987, however, various factors, including foreigners' continued net sales of listed securities on the Johannesburg Stock Exchange, caused the finrand to decline to 29 US cents at the end of August 1987. Its discount vis-à-vis the commercial rand then amounted to 42 per cent.

From late May 1987 the value of the rand in terms of the US dollar generally fluctuated between 48 and 50 US cents. Increased strength of the US dollar in July and early August 1987, however, caused the rand's exchange rate vis-à-vis the dollar to dip to 47,26 US cents on 14 August 1987. By the end of August, the dollar/rand exchange rate had reverted to 49 US cents. Little change was shown by the weighted average exchange value of the rand from 20 May 1987 through August 1987.

Like the commercial rand, the financial rand strengthened considerably on balance from 12 June 1986 to

Changes in the exchange rates of the rand

	12 June 1986 to 20 May 1987	20 May 1987 to 31 Aug 1987
Weighted average	29,3	-0,4
US dollar	40,9	-2,6
British pound	27,9	0,8
German mark	13,2	-0,2
Swiss franc	12,3	0,3
Japanese yen	18,7	-0,7
French franc	18,8	-0,3
Financial rand	55,6	-9,5

Financial markets

Money supply

The broadly defined money supply, M3, continued to grow only slowly in the first quarter of 1987 but somewhat more rapidly in the second quarter. The seasonally adjusted and annualised rate of increase in M3 as at quarter-ends rose from approximately 9 per cent in the first quarter of 1987 to not quite 13 per cent in the second quarter.

From the beginning of the 1987 targeting year (taken as mid-November 1986) up to the end of July 1987, the seasonally adjusted annual rate of increase in M3 still amounted to only 10,9 per cent. This rate of increase therefore still was appreciably less than the lower limit of the target range for 1987 of 14 per cent. M3 as at the end of July 1987 accordingly fell short of its minimum target value by approximately R1,7 billion, or by 1,9 per cent. Relatively slow growth in M3 during the 1987 targeting year up to the end of July 1987, as during preceding months in the course of 1986, continued to be explained essentially by various disintermediation phenomena that could be traced to relatively poor real after-tax rates of return on deposits with banks and building societies, relatively low rates of interest on depository investments compared with the banks' average lending rates, the attractions offered by alternative financial investments with long-term

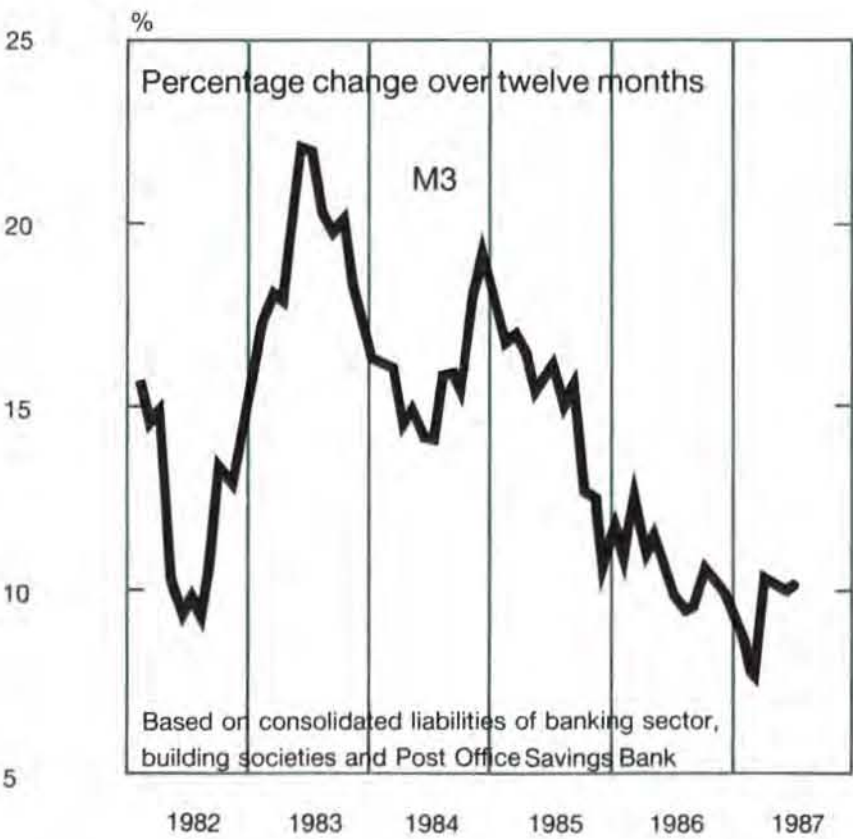
savings institutions and by investments on the stock exchange, and the rapid spread of new cash management techniques.

The income velocity of circulation of M3 rose by 2,9 per cent from the fourth quarter of 1986 to the first quarter of 1987 but, on the basis of preliminary estimates, would appear to have shown little further change in the second quarter of 1987. When the increase in velocity is taken into account, the increase in the "effective" M3 money supply, at a seasonally adjusted annual rate, from the fourth quarter of 1986 to the second quarter of 1987 amounted to 16,9 per cent. This was well between the 14 and 18 per cent lower and upper bounds of the 1987 target range.

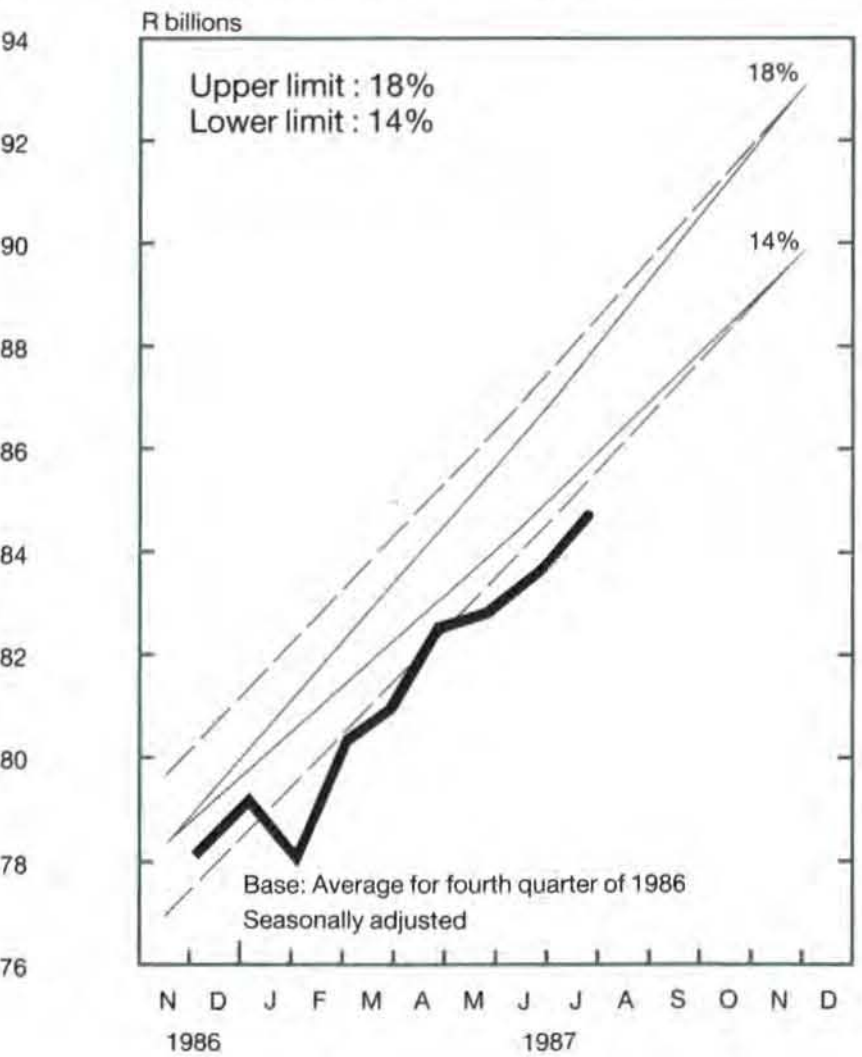
Measured over twelve months, the rate of increase in M3 shrank to a low point of only 7,7 per cent in February 1987 but, in accordance with M3's somewhat more rapid expansion in the second quarter of 1987, then advanced to 11,2 per cent in July.

Among the narrower monetary aggregates, the twelve-month growth rate of M1A declined from 20,5 per cent in December 1986 to 9,8 per cent in June 1987 before rebounding sharply to 21,2 per cent in July. M1A was affected downwards initially by the spread of new cash management techniques, which inter alia allow depositors to reduce (or "economise

Money supply



Target range for growth in M3 during 1987



on") their net holdings of current account balances. Since M1A ranks among the smaller ones of the various monetary aggregates currently monitored, the effect of such reductions on depositors' total holdings of the M1A varieties of money also tends to be comparatively large in relative terms. The sharp reacceleration in M1A growth in July 1987 was due to an unusually large rise in the amount of currency in circulation at the July month-end.

The twelve-month growth rate in M1 was favoured by the new techniques for managing cash balances and other factors fostering increased holdings of overnight and call deposits. This rate accordingly rose from 12,8 per cent in December 1986 to as much as 25,6 per cent in May 1987 before sliding back to 20,6 per cent in July. The twelve-month growth rate in M2 continued to be held down by depositors' shifts in 1986 and early 1987 out of "other" short-term and medium-term deposits into long-term deposits, such shifts being a common feature of periods of declining interest rates and expected further declines in interest rates. The twelve-month growth rate in M2 accordingly amounted to only 6,2 per cent in March 1987 and to approximately 8,4 per cent in the four months from April 1987 to July.

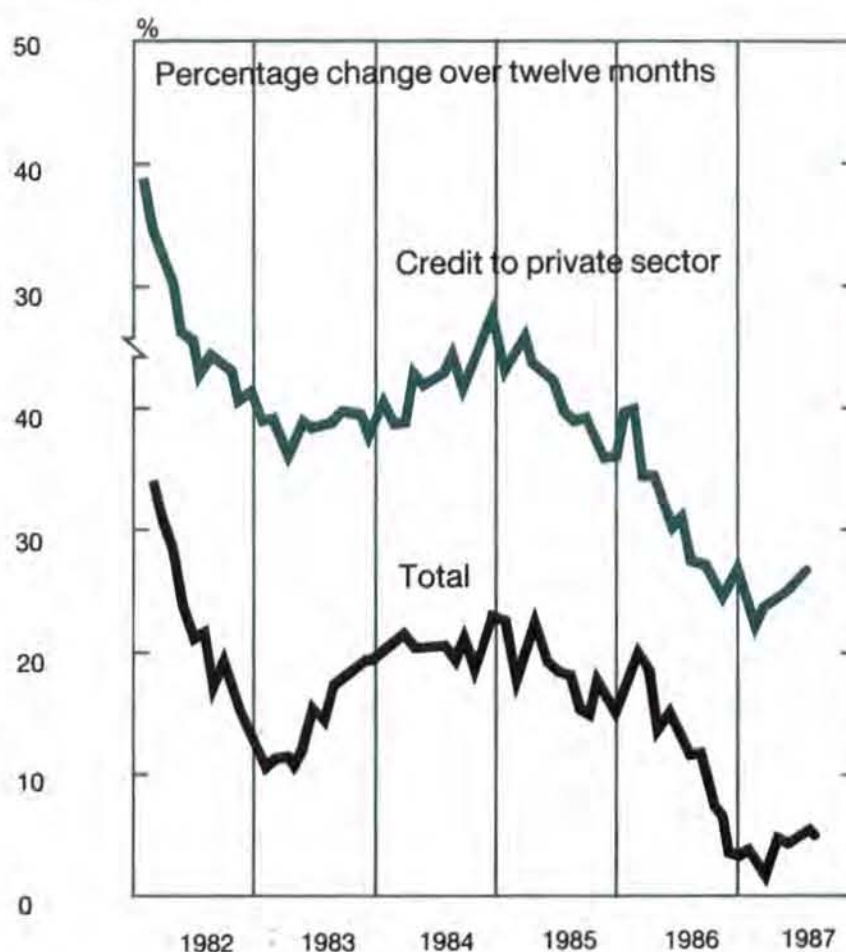
Low rates of increase in total credit extended by institutions in the "monetary" sector still provided the principal explanation, in accounting terms, of the sustained relatively sluggish growth in M3 during the first seven months of 1987. A considerably smaller contribution to M3 growth than in the first quarter of 1987 was made by the rise in the net gold and other foreign reserve holdings of the monetary sector in the second quarter of the year.

Bank credit

The twelve-month rate of increase in credit extended by banking institutions to the private sector advanced from a low point of 1,7 per cent in February 1987 to 6,6 per cent in July. The seasonally adjusted annual rate of increase in bank credit to the private sector from December 1986 to July 1987 amounted to 6,4 per cent. This rate of increase therefore meant a marked further contraction of the volume of private sector indebtedness to the banking system in real or inflation-adjusted terms.

The sustained decline in the real volume of bank credit outstanding during the first seven months of 1987 – which was unusual in that it occurred in a period of modest real economic expansion and relatively low nominal interest rates – was accounted for by developments such as increased recourse to the practice of "setting off" corporate clients' debit and credit balances in the books of banking institutions and by other disintermediation phenomena, as well as by a low need for bank credit in the light of low levels of fixed investment, relatively slow growth in imports, and de-

Bank credit



clining inventories. The large number of new share issues on the stock exchange also directly or indirectly allowed a reduction of bank credit.

Absolute declines were recorded during the second quarter of 1987 in banks' holdings of bills discounted and in their holdings of deposits and private sector securities. Only slow growth was observed in banks' "other" loans and advances, which are likely to have incurred most of the effect of the "set-offs" of clients' debit and credit balances. Fairly substantial increases were registered during the second quarter, however, in hire-purchase credit and leasing finance from low base figures at the end of March 1987. The former increase in particular seems likely to have been related to the second-quarter pick-up in sales of motor vehicles and other consumer durables. If sustained, it may indicate a gradual diminution of households' reluctance to add to the burden of consumer debt.

The banking system's net claims on the government sector rose from R2 036 million at the end of December 1986 to R2 875 million at the end of June 1987. This caused the relative increase in *total* bank credit during the first six months of 1987 to be larger than the increase in bank credit to the private sector only. However, net claims on the government sector declined sharply, to only R1 705 million, in July. The seasonally adjusted annual rate of increase in total bank credit

from December 1986 to July 1987 accordingly amounted to only 5,1 per cent, which was less than the rate of growth in the banks' credit to the private sector.

Reserve Bank's operations in the money market

Limited vigour of the prevailing upswing, continued strength of the balance of payments on current account, below-target growth in the money supply, and the sluggish expansion of bank credit, caused the Reserve Bank to adhere during the first 8½ months of 1987 to the moderately expansionary stance of monetary policy that had been reached through the progressive lowering of Bank rate in the course of 1985 and 1986. No increase in Bank rate and no hardening of the general level of interest rates generally were envisaged or intended by the Reserve Bank in these conditions. Little positive result, on the other hand, was to be expected in the Bank's opinion from even further cuts in Bank rate or from further declines in the level of nominal interest rates generally. Bank rate therefore was maintained throughout the first 8½ months of 1987 at the level of 9½ per cent to which it had been reduced on 10 December 1986.

Active use was made on a number of occasions from the end of March 1987 of the Reserve Bank's amended procedure for providing cash reserves to the money market by allowing discount houses and banks to tender for funds from the Corporation for Public Deposits. In alliance with the Bank's other instruments within the general area of its open-market operations (including outright purchases or sales of government stock and other money-market assets, "buy-backs" or "reverse buy-backs", and currency swaps), the provision of CPD funds by means of the tender system was employed by the Bank for managing more closely the market's need for refinancing at the Bank's discount window and, in the generally easy policy and stable interest rate environment aimed at by the Bank, for limiting the amount of such refinancing.

Partly because of these open-market actions (and aided by the easing effect on the market of the Bank's rising gold and other foreign reserves), the amount of the Bank's assistance to the market in the form of rediscounts and overnight loans at the discount window on most occasions in the second and third quarters of 1987 did not rise above more than a few hundred million rands. The daily average amount of such refinancing assistance during the period from April to August 1987 was less than R200 million. At the end of August 1987 the amount of refinancing rose to R626 million but subsequently changed to a *surplus*. On 18 September the surplus amounted to R150 million. Surpluses of cash reserves that arose from time to time were "accommodated" by the Bank by allowing the discount houses or the banks that found themselves holding such surpluses, to tender on an overnight basis for assets (mostly money market paper, and cur-

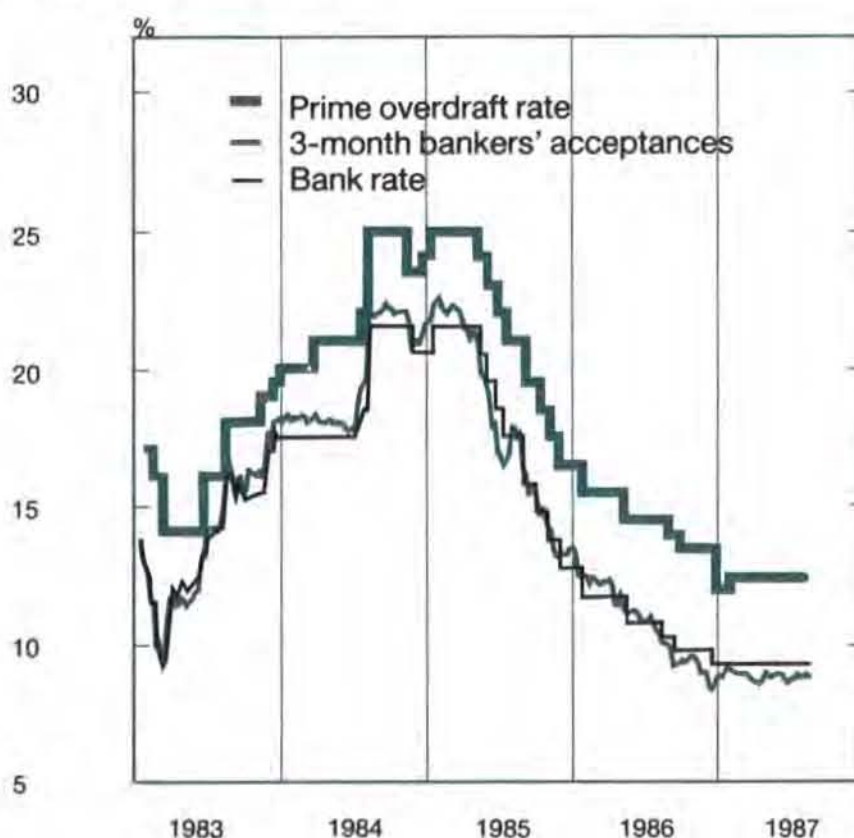
rently mostly Land Bank bills) that were made available out of the portfolio of the Corporation for Public Deposits.

Short-term interest rates

Short-term interest rates hardened temporarily in April 1987 but then settled down to more stable levels from May to August 1987. The rate on three-month liquid bankers' acceptances, for example, fluctuated during this period only between a high point of 9,05 per cent in the last week of May 1987 and a low point of 8,65 per cent in the middle of June. This rate amounted to 8,90 per cent on 18 September. Rates on rediscountable instruments during this period consistently remained well below the Reserve Bank's rediscount rates. More pronounced volatility was observed, however, in the banks' rates on wholesale call funds and on funds solicited in the interbank market. The call rate, for example, occasionally touched 10 per cent.

The clearing banks' prime rate was held unchanged at 12,50 per cent from late January 1987 through the second and third quarters of 1987 up to mid-September despite the firming of deposit interest rates that followed upon the introduction of the so-called Senior Citizen Savings Bonds by the Minister of Finance in his Budget speech in June 1987. The original issue of these bonds was, however, terminated on 8 August 1987 in the light of investors' very heavy response to this issue and to forestall significant distortions of flows of funds in the markets for retail deposits and related fixed-interest investments.

Short-term interest rates



Capital market activity

The high levels of activity in the capital market that were recorded in the first quarter of 1987 generally were maintained, or surpassed, in the second quarter and in July and August 1987. Further increases were registered in turnovers in the share market and in share prices. The real estate market witnessed a further rise in mortgage lending and a further increase in real estate transactions. Trading activity in public sector securities in the second quarter of 1987 was broadly maintained at the record level that had been reached in the first quarter of the year.

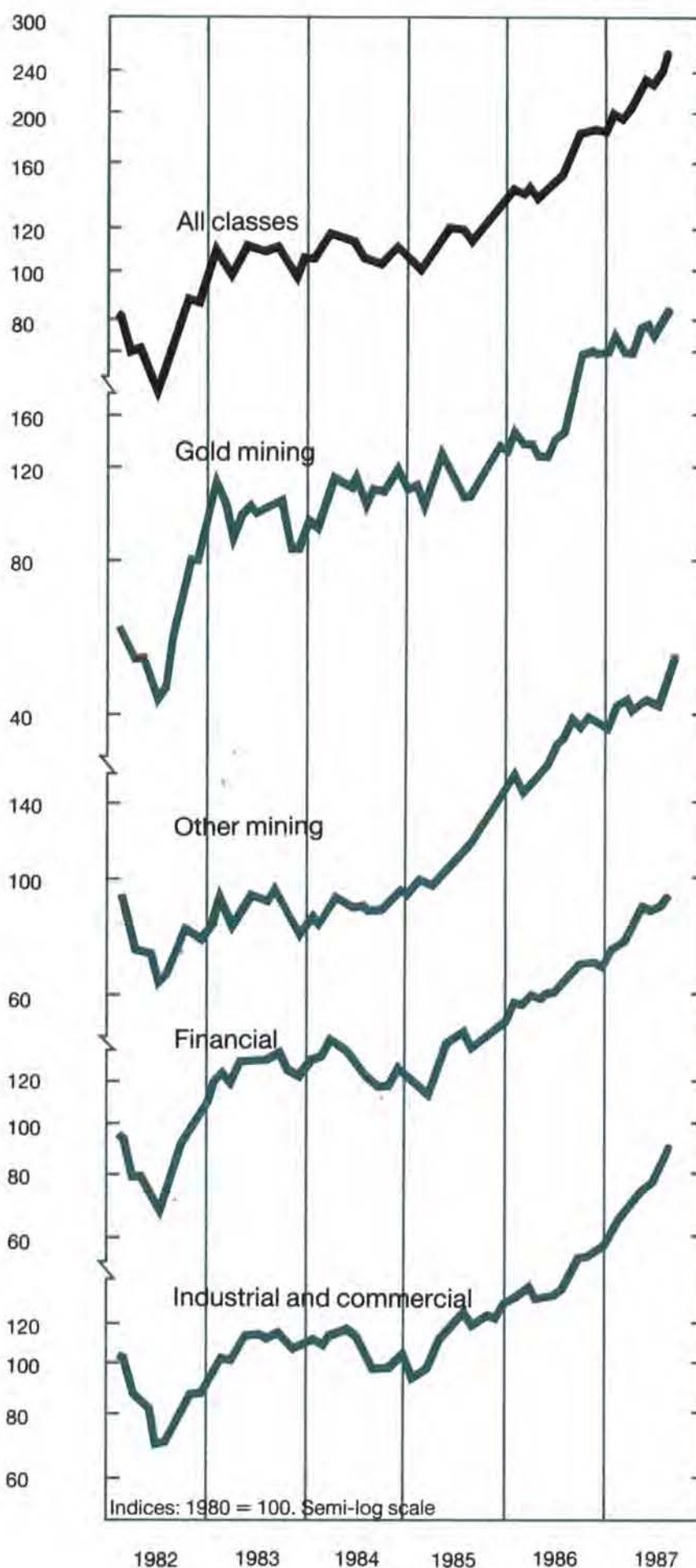
The value of public sector stock traded on the stock exchange declined marginally from R40,3 billion in the first quarter of 1987 to R40,1 billion in the second quarter. In July and August, however, the monthly average turnover of these stocks amounted to no less than R18,2 billion, exceeding by 36 per cent the monthly average value of stock traded during the preceding three months. Real estate transactions rose from R3,3 billion in the first quarter of 1987 to R3,6 billion in the second quarter. The monthly average value of these transactions then advanced substantially further, i.e. by 11 per cent, to R1,3 billion in July.

The value of shares traded on the stock exchange increased from R4,2 billion in the first quarter of 1987 to R4,8 billion in the second quarter and to a monthly average of R1,8 billion in July and August. Share prices were swept up further in this increase in trading activity. Having increased by 9 per cent in the first quarter of 1987, the average price level of all classes of shares rose further by 11 per cent in the second quarter, mainly because of a 14 per cent increase in financial share prices. A further rise in the average price level of 12 per cent was recorded in July and August.

In the course of the entire current upward phase in share prices to date, i.e. during the past 32 months from the beginning of 1985 up to August 1987, the average price level of all classes of shares rose by about 133 per cent. The price-earnings ratio in respect of financial, industrial and commercial shares rose during this period from 7,2 to 14,6. In comparison, the average price increase of all classes of shares in the stock exchange boom during the 41-month period from the beginning of 1966 up to May 1969 amounted to 152 per cent. Highly speculative buying activity in the closing stages of that bull phase before the major setback in share prices that commenced in May 1969, eventually carried the price-earnings ratio of non-mining shares to a peak level of 24,4.

In the primary markets, the public sector in the second quarter of 1987 raised new funds through issues of fixed-interest securities to banks and private non-bank investors to an amount of R649 million. The first-quarter amount of such issues was R845 million. No new funds were raised in the second quarter of 1987 by companies listed on the stock exchange through new issues

Share prices



of fixed-interest securities. New issues of share capital by these companies, on the other hand, amounted to R817 million. This may be compared with first-quarter amounts of R201 million and R205 million raised through new issues of debentures and of share capital, respectively.

In the mortgage market, sustained further improvements in the net inflow of funds to building societies and participation mortgage bond schemes, in conjunction with increased mortgage demand, allowed these institutions further to increase their mortgage lending. Mortgage loans paid out by these institutions rose from R2,0 billion in the first quarter to R2,2 billion in the second quarter.

Long-term rates and yields

Long-term interest rates declined during the first quarter of 1987 but reverted to markedly higher levels in the second quarter. More favourable perceptions of the prospects for inflation and for the public sector borrowing requirement then caused rates to soften again in July and August and the first week of September. 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,

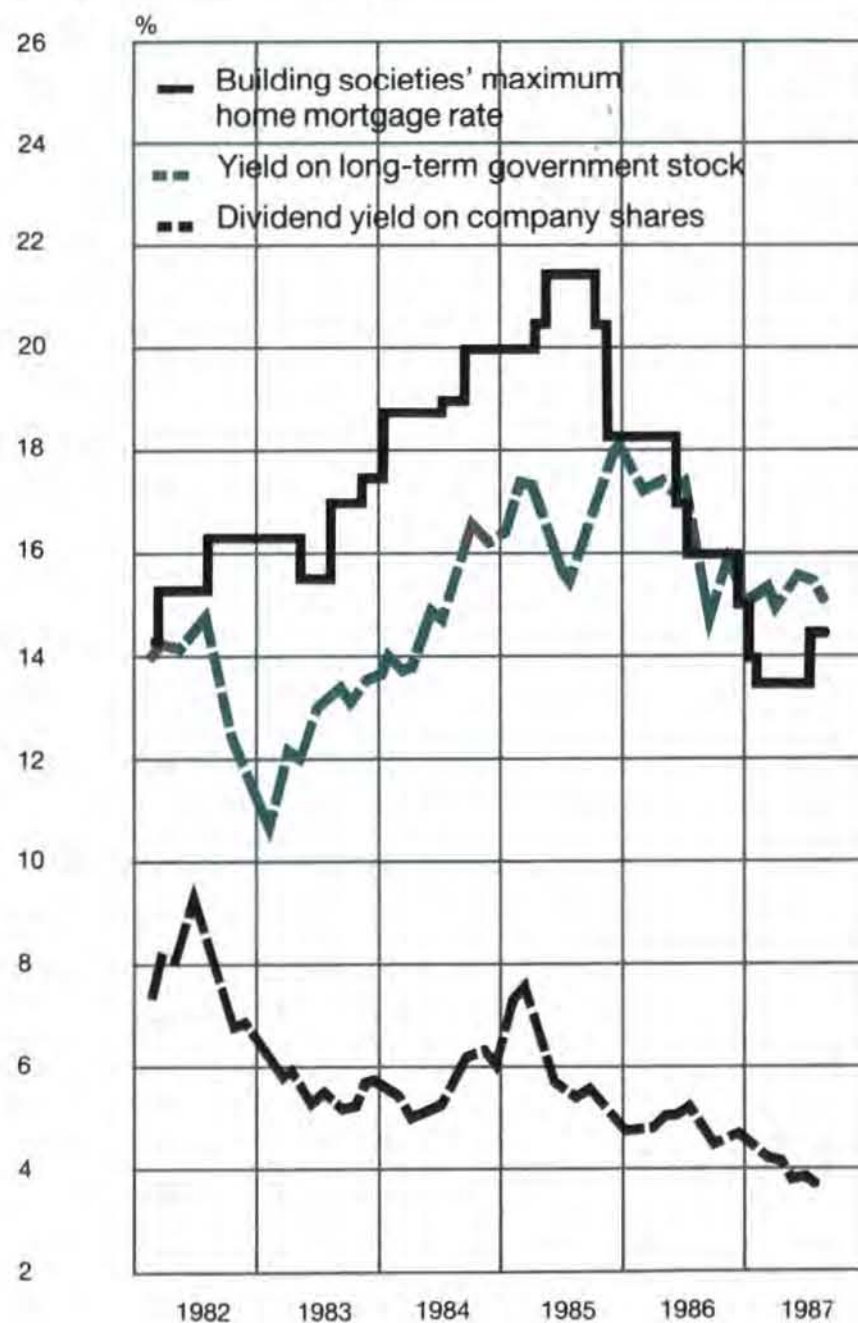
hardened temporarily to 15,6 per cent in June, but then retreated further to 15,1 per cent in August.

The predominant 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. In August 1987, however, a major building society lowered its rate on new mortgage loans to 12,95 per cent.

The predominant rate on twelve-month deposits with banks and building societies, serving as a representative rate for rates on depository investments generally, was raised from 9,5 to 10,0 per cent in February 1987. This rate then was increased further by building societies to 10,25 per cent in May, 10,50 per cent in June, and 10,75 per cent in July. The predominant twelve-month deposit rate of banks was raised only to 10,50 per cent, and was raised to this level only in July.

Mirroring the sharp rise in share prices, the dividend yield on all classes of shares declined from 4,7 per cent in December 1986 to 4,2 per cent in March 1987, 3,9 per cent in June 1987 and 3,7 per cent in August. At the start of the current bull phase in share prices in January 1985, the average dividend yield on all classes of shares still amounted to 6,3 per cent. After adjustment for the prevailing rate of inflation in consumer prices, the "real" dividend yield on all classes of shares may be considered actually to have increased marginally between January 1985 and August 1987 from -10,0 to -9,9 per cent. In the rising share market from January 1986 to May 1989 the dividend yield on all classes of shares declined from 6,8 to 3,1 per cent. The "real" dividend yield was reduced from 2,8 to -0,6 per cent during this period.

Long-term interest rates



Government finance

Expenditure by general government

Aggregate expenditure by *general* government on final goods and services increased by a very large 25,3 per cent in the first quarter of *calendar* 1987 and by a still very substantial 18,7 per cent in the second quarter. The ratio of such expenditure to gross domestic pro-

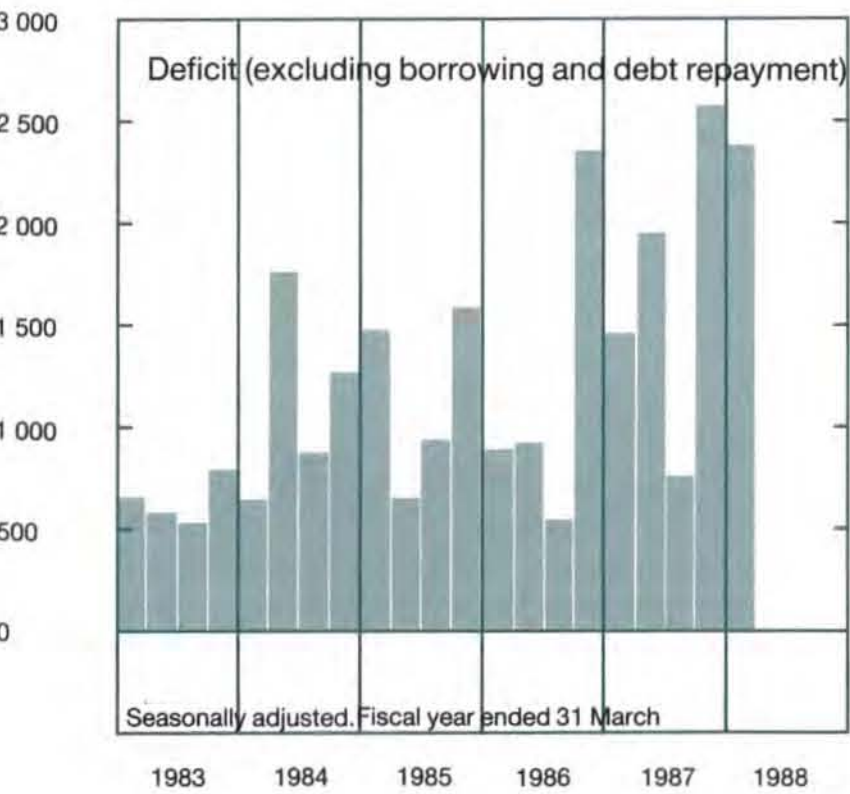
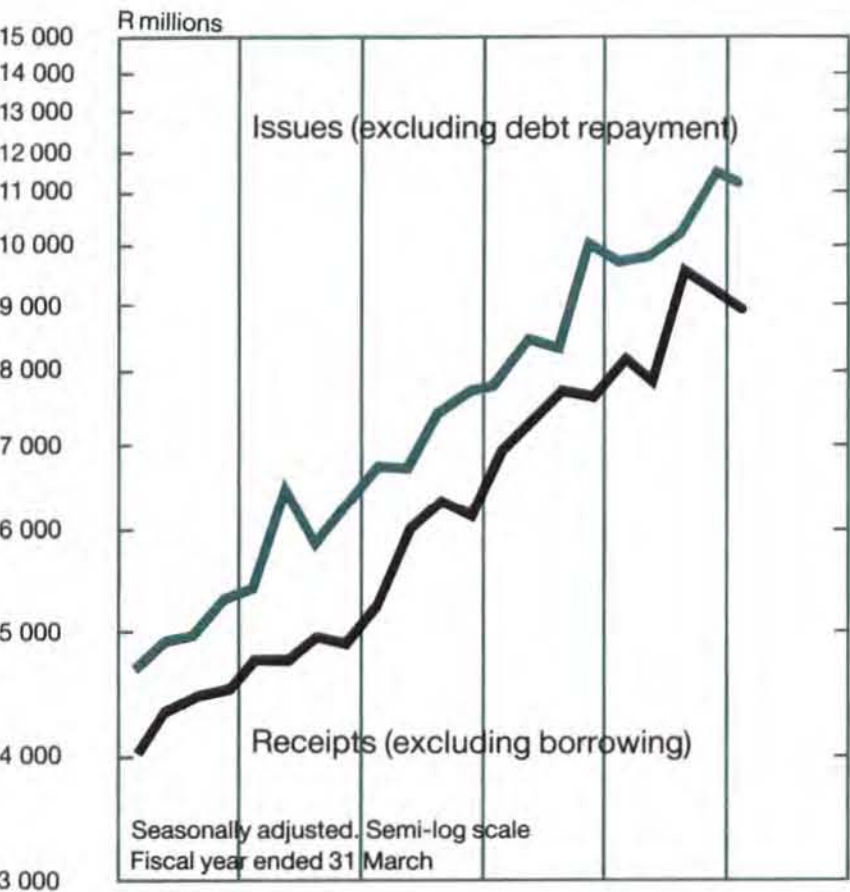
duct accordingly declined from 24 per cent in the first quarter of the calendar year to slightly more than 23 per cent in the second quarter.

Exchequer issues and receipts

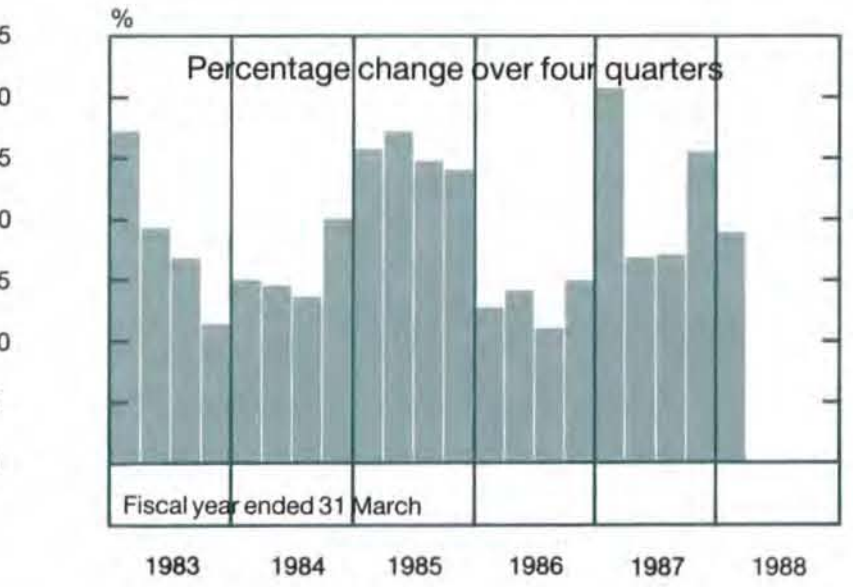
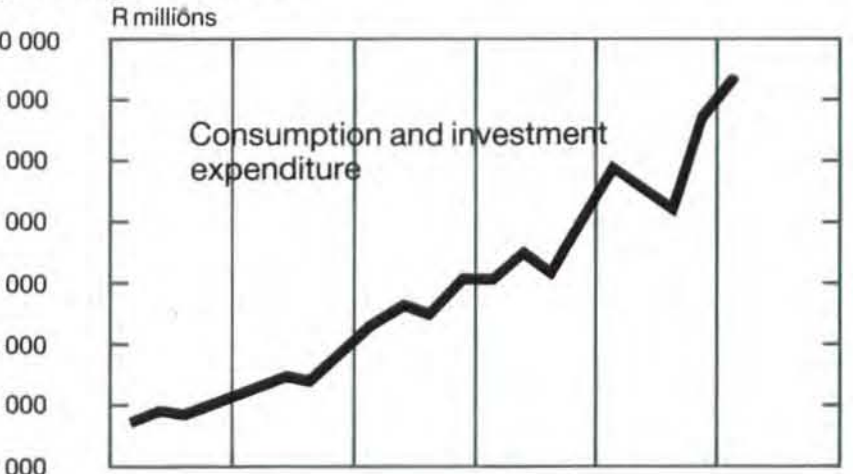
As already suggested by the behaviour of general government expenditure, the Exchequer issues of the Central Government - after the usual adjustment for changes in the Paymaster-General Account - also increased sharply further in the second quarter of calendar 1987, i.e. in the first quarter of fiscal 1987/88. During the preceding three months to March 1987, the increase in Exchequer issues to government departments in comparison with the level of these issues during the three months to March 1986 had amounted to as much as 30,1 per cent. Despite the marked further increase in Exchequer issues from the March quarter to the June quarter of 1987, the increase in these issues in the June quarter of 1987 when compared with the June quarter of 1986 amounted to a more moderate 18,2 per cent.

A moderate further acceleration in Exchequer issues was recorded, however, in July 1987. As a result, total issues to government departments during the four months to the end of July 1987, i.e. during the first

Exchequer Account



Consumption and investment expenditure by general government



four months of fiscal 1987/88, were 18,7 per cent higher than during the corresponding period in fiscal 1986/87. This may be compared with the increase of 16,2 per cent that had been envisaged for the fiscal year 1987/88 as a whole in the Budget as presented in June 1987.

Also in comparison with one-year-earlier levels, the increase in Exchequer *receipts* contracted from 17,9 per cent in the March quarter of 1987 to only 5,6 per cent in the June quarter. Receipts accelerated, however, in July. Total receipts during the first four months of fiscal 1987/88 accordingly were 9,1 per cent above their level in the four months to July 1986, an increase that was notably smaller than the budgeted increase of 12,6 per cent for the fiscal year as a whole. The year-on-year percentage increase in income tax receipts, in particular, fell well short of the percentage increase as envisaged in the Budget for the full fiscal year. In addition, receipts from customs and excise duties actually declined in absolute terms.

Deficit before borrowing

The deficit before borrowing and debt repayment during the first four months of fiscal 1987/88 to the end of July 1987 amounted to R4 984 million. This was R1 484 million more than in the corresponding period of fiscal 1986/87 and equal to nearly 60 per cent of the deficit of R8 425 million as envisaged in the Budget for the current fiscal year as a whole. In comparison, the deficit during the first four months of fiscal year 1986/87 amounted to 56 per cent of the *actual* deficit eventually recorded for that fiscal year.

Data currently available for the period from April to July 1987 indicate that the deficit of R4 984 million during this period, plus the discount of R404 million on new government stock issues, was financed from the following sources:

	R millions
Public Investment Commissioners	45
Non-bank private sector	3 609
Banking sector	1 796
Foreign sector	-62
	<hr/> 5 388
Less: discount on government stock	404
Total financing	<hr/> 4 984

Restructuring of the tax system

The report of the Commission of Inquiry into the Tax Structure of the Republic of South Africa (the Margo Commission) was released in August 1987. New tax legislation occasioned by this Report is likely to be introduced in the course of the 1988 parliamentary session but will probably be fully implemented only in the Budget proposals for fiscal 1989/90.