Quarterly economic review

Introduction

Notable features of the South African economy in the third quarter of 1988 included a rate of increase in real gross domestic product which, although moderately higher than in the preceding quarter, was lower than the firm rates of output growth that had been registered in the fourth quarter of 1987 and the first quarter of 1988. An actual decline in aggregate real gross domestic expenditure was recorded for the first time since the fourth quarter of 1986, but this was largely due to a significant drawing-down of real inventories.

In foreign trade and payments, a remarkable further reinvigoration of the South African merchandise export performance and a slight fall-off in the volume of merchandise imports in the third quarter of 1988 contributed to a marked further strengthening of the surplus on the balance of payments on current account, after a dip into a current account deficit in the first three months of the year. A continued large outflow of capital was responsible, however, for major further declines in the foreign reserves and for downward pressure on the exchange rate which was reversed only from the first few days of November 1988. In the area of monetary and financial developments, few signs of abatement were apparent up to September in the inordinately rapid increase in monetary institutions' domestic credit extension and the monetary aggregates. Between them, sustained high levels of domestic expenditure and the twin developments of high rates of monetary expansion on the one hand and of downward pressure on the foreign reserves and the exchange rate on the other hand, pointed to a need for a further tightening of monetary and fiscal policies. Bank rate was raised, for the fourth time in the course of the year, from 12,5 to 14,5 per cent with effect from 3 November 1988.

Having receded from nearly 5½ per cent in the fourth quarter of 1987 and more than 3½ per cent in the first quarter of 1988 to about 2 per cent in the second quarter of 1988, the rate of growth in real gross domestic product was provisionally estimated at approximately 2½ per cent in the third quarter. The slow-down of real growth in the middle quarters of 1988 was not unlike the temporary slackening of the pace of real output advances in the June and September quarters of 1987 and could partly be attributed to somewhat similar causes. Firm rates of output growth were recorded again, however, in the secondary sectors of the economy and, to a lesser extent, in the non-primary sectors in general. Viewed in conjunction with recent behaviour of leading business cycle indicators and some loss of buoyancy in the prevailing business mood, the more recent movements in aggregate production levels nevertheless should probably be read as evidence of a levelling-out of the current economic upswing, which had started early in the second quarter of 1986.

Total real gross domestic expenditure declined in the third quarter of 1988 at a provisionally estimated annual rate of nearly 8 per cent. Aggregate spending was, however, still well above levels of one year earlier; its average level in the first three quarters of 1988 exceeded its level in the corresponding period of 1987 by an impressive 8½ per cent.

The decline in aggregate real domestic expenditure in the third quarter of 1988 was accounted for by a further shrinking of real government consumption expenditure and a drawing-down of real inventories. Spurred on *inter alia* by unusually high levels of "pre-emptive" buying, the rate of increase in aggregate real private consumption expenditure in the third quarter significantly exceeded the rates of increase of the preceding two quarters as well as the average rate of increase during the preceding nine quarters from the second quarter of 1986. Aggregate real gross domestic fixed investment in the third quarter of 1988 rose for the fifth consecutive quarter and did so at a seasonally adjusted annual rate that was appreciably higher than in the preceding six months.

An 18 per cent increase in the value of merchandise exports, a mild further rise in the value of net gold exports despite the sharp drop in the dollar price of gold in the second half of September, and a slight further contraction of the *volume* of merchandise imports caused the surplus on the current account of the balance of payments to rise from an annualised level of close to R1 billion in the second quarter of 1988 to an annualised level of approximately R4,5 billion in the third quarter. A sustained large outflow of non-reserve-related capital, amounting to R2,4 billion, nevertheless caused the South African gross and net gold and other foreign reserves to decline by more than R300 million and by as much as R1 026 million, respectively, from the end of June to the end of September 1988. Outflows of capital in the third quarter of 1988 were explained primarily by widening disparities between real interest rates in South Africa and in major overseas economies from approximately June 1988, and by leads and lags and related speculative capital movements that were linked to perceptions of prospects for the exchange value of the rand.

Given the contractionary effect of declines in the monetary system's net foreign reserve holdings, the continued rapid expansion of the monetary aggregates in the third quarter of 1988 was a direct reflection of high rates of increase in banks' and building societies' domestic credit extension. Sustained rapid growth in M3 could still be attributed partly to reintermediation phenomena. It was also fostered by investors' increased demand for fixed-value depository investments in an environment of rising interest rates.

The marked further rise in private sector demand for bank credit clearly derived a large part of its strength from the third-quarter surge in household expenditure on consumer durables. It also reflected banks' increasing penetration of the home mortgage loan market. As in the case of investors' demand for depository investments (which make up the monetary aggregates), a part in the explanation of the surge in the banks' lending to the private sector was also played by reintermediation phenomena; higher levels of private sector fixed investment spending were not, for example, accompanied by any significant increase in private companies' recourse to long-term loan or equity financing in the capital markets. Finally, the accelerated outflow of non-reserve-related short-term capital through the capital account of the balance of payments also meant a switching from foreign to domestic sources of finance.

The capital market in the third quarter of 1988 witnessed significantly higher turnovers in public sector stock and company shares. The average price level of all classes of shares showed a mild further rise despite the generally upward movement of short-term interest rates.

In the area of public finance, Exchequer issues remained comfortably within Budget limits during the first two quarters (April to September 1988) of fiscal 1988/89. Exchequer receipts, on the other hand, ran well ahead of the Budget estimates. Exchequer issues may, however, be expected to accelerate significantly during the remainder of the fiscal year. The eventual deficit for the whole of fiscal 1988/89 will therefore probably exceed the ratio of 4,9 per cent of gross domestic product that was envisaged in the Budget proposals of March 1988.

The Exchequer deficit before borrowing and debt repayment in the first half of fiscal 1988/89 amounted to only 36 per cent of the deficit as budgeted for in March 1988 for the current fiscal year as a whole. It would obviously account for an even smaller proportion of the increased deficit that is now in prospect for the whole of fiscal 1988/89. The reverse side of this development is that the stimulative impact which stands to be exerted by the deficit in the second half of the fiscal year will be correspondingly more powerful.

Assuming that the South African economy did indeed find itself close to an upper turning-point of the business cycle in the third quarter of 1988, the then prevailing situation was unusual in at least four interrelated ways. Firstly, inventory accumulation, rather than the drawing-down of inventories actually observed in the third quarter of 1988, is customary in the advanced stages of cyclical upswings and the earlier stages of cyclical downswings.

Secondly, partly because the recent surge in private consumption expenditure and increased commodity exports were met out of inventories to a major extent, the current account deficit of the first quarter of 1988 could be converted back into significant surpluses in the second and third quarter. Current account surpluses are unusual near the upper turning-points of the business cycle in the South African economy. The reconversion of the first-quarter current account deficit into subsequent surpluses took place despite the obvious effect of relatively high levels of domestic demand in pulling in imports and absorbing domestic supply.

Thirdly, current account deficits in the upper ranges of cyclical expansions have "traditionally" been made good in part by capital inflows that have been attracted by rising interest rates and by the improved profit performances of domestic companies.

Finally, for reasons that have been well analysed and much commented on lately, a relatively restrictive stance of monetary and fiscal policy was required in the currently prevailing conditions even in the absence of a current account deficit and for the very purpose of maintaining a current account surplus. Such a policy posture would have been needed even in a closed economy because of the threat of increased inflation posed by the excessive rates of increase in domestic credit and the money supply.

Conditions in the South African economy in the third quarter and in October 1988 resembled those in the middle quarters of 1984 in various "external" respects with regard to, for example, the recent weakening of the dollar price of gold, substantial outflows of capital and downward pressure on the exchange rate and the foreign reserves. Similarities in "domestic" aspects of the economy were present in the form of clearly excessive rates of increase in domestic credit and the money supply; relatively high levels of, and a recent further surge in, real private consumption expenditure; heavy reliance of private consumption expenditure on bank credit; and low, although in 1988 not as yet negative, values of the personal savings ratio.

*Dis*similarities between the general economic situations of 1988 and 1984 *inter alia* consisted of the presence of fairly substantial current account surpluses in the second and third quarter of 1988 and of the "cautious", relatively non-expansionary stance of fiscal policy in the first half of fiscal 1988/89. A substantial widening of the fiscal deficit before borrowing in the remainder of fiscal 1988/89 would, however, cause monetary and fiscal policy to operate at cross purposes – as they did in 1984.

In November 1988 several factors nevertheless held out prospects that the South African economy in 1989 would prove capable of maintaining appropriate moderation in domestic demand and would be able to generate fairly substantial surpluses on current account while still displaying significantly positive rates of real economic growth:

Firstly, the "packages" of demand-restraining fiscal, monetary and credit measures of May and July-August 1988 had already been in place for some time and should impinge gradually more strongly on spending plans; "pre-emptive" buying in the second and third quarter of 1988 may well have masked some of these measures' early effectiveness.

Secondly, the need for restrictive policy action would appear to be more clearly appreciated, and the potential results of such action more clearly understood, in 1988 than in 1984. Improved understanding of the reasons for and the potential consequences of tighter policies should enhance businesses' and households' responsiveness to such policies. A more realistic assessment of the challenges still facing the South African economy would also appear already to have tempered somewhat the exuberant business mood of late 1987 and early 1988.

Finally, *real* interest rates have already been on an upward course since late 1986 or early 1987. Allowing for realistic expectations concerning the inflation rates of 1989, a variety of nominal interest rates have now become significantly positive again in real or inflation-adjusted terms. A deterrent effect on consumer spending, both directly and in more roundabout ways, may also be expected to be attached to recent increases in mortgage lending rates and in the maximum permissible finance charges rates.

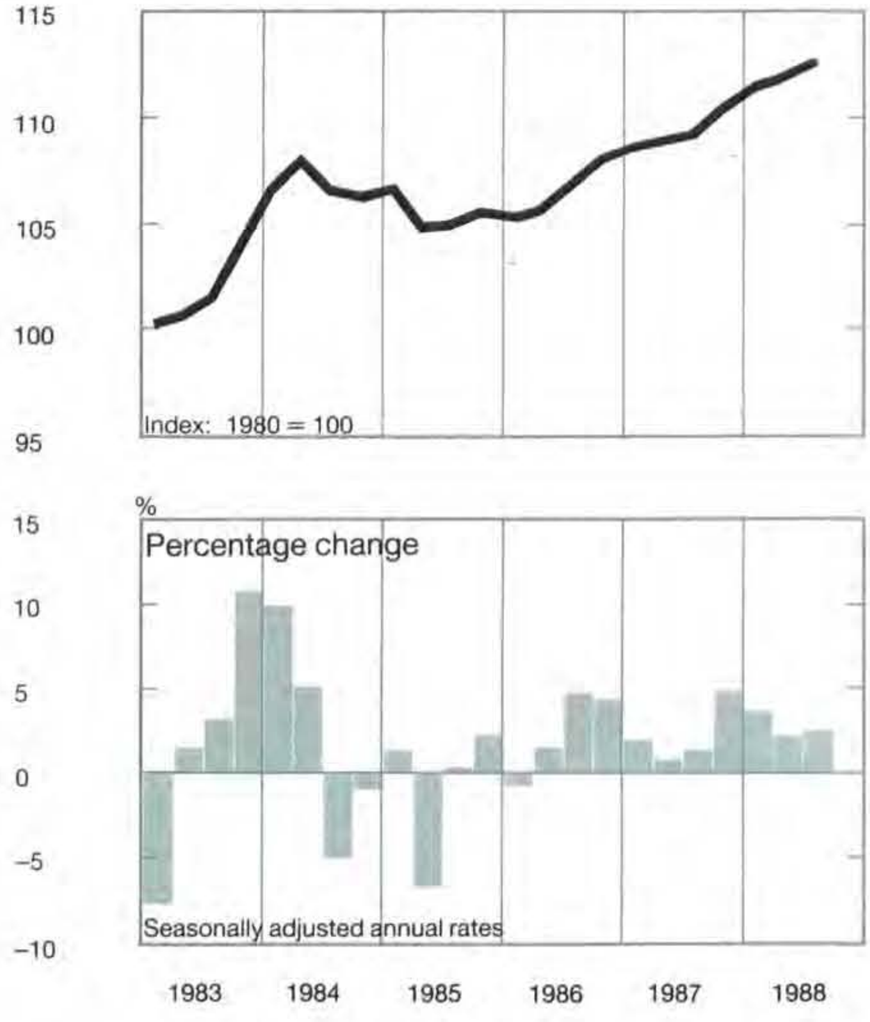
As already indicated, however, it is of vital importance that an appropriate mix of monetary and fiscal policy be applied in order to achieve the desired balance between domestic output and domestic demand. The most suitable stance of monetary policy will therefore depend in considerable measure on the nature of fiscal policy in the months ahead.

Domestic economic developments

Growth in the South African real gross domestic product, which had reached seasonally adjusted annual rates of nearly 5 per cent in the fourth quarter of 1987 and of slightly more than 3½ per cent in the first quarter of 1988, slowed down to a rate of slightly more than 2 per cent (revised upwards from 1½ per cent) in the second quarter of 1988 and to an estimated rate of approximately 2½ per cent in the third quarter. This slackening of the pace of production increases in the middle quarters of 1988 somewhat resembled the temporary waning of output growth in the June and September quarters of 1987 and could to some extent be accounted for by broadly similar reasons. However, viewed in conjunction with a continued downward drift of the leading composite business cycle indicator and some loss of buoyancy in the prevailing business mood, the more recent movements in aggregate production levels should probably be read as evidence of a topping-out of the current economic upswing, which had started early in the second quarter of 1986.

The level of real gross domestic product in the third quarter of 1988 was somewhat more than 3 per cent higher than in the third quarter of 1987. Similarly, the

Real gross domestic product



level of real gross domestic product in the first three quarters of 1988 was nearly 3 per cent higher than in the corresponding period in the preceding year. Current projections point to a real growth rate of the South African economy – as measured by real gross *domestic* product – of between 2½ and 3 per cent in the calendar year 1988. This will follow growth rates of 1 per cent and 2½ per cent in 1986 and 1987.

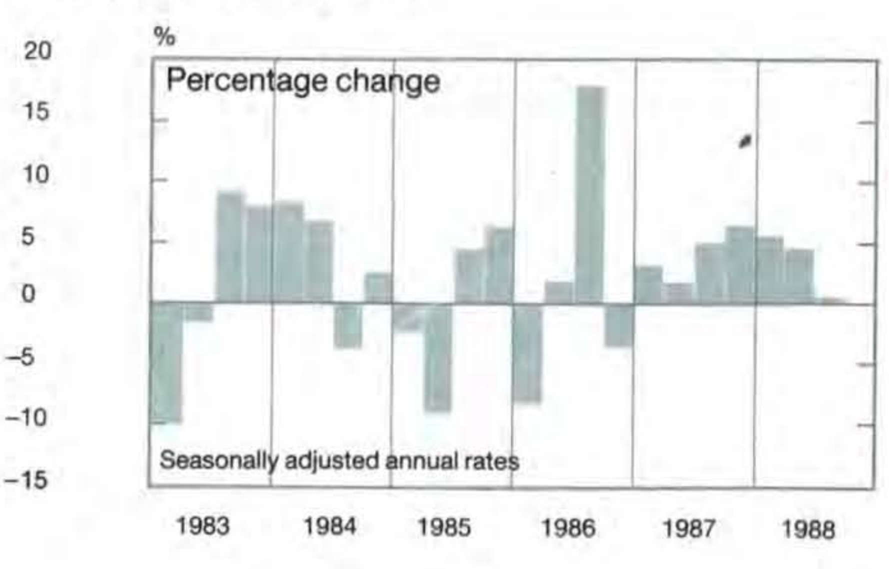
As in the third quarter of 1987, actual *declines* in real value added were recorded in the third quarter of 1988 in the primary sectors of the economy, i.e. in agriculture and mining. The non-primary sectors collectively displayed an annualised rate of real output growth of 4½ per cent. Real production of the secondary sectors actually advanced impressively at an annualised rate of 7½ per cent.

The decline in real value added by the agricultural sector largely resulted from a decline in the maize crop, which for the 1987/88 season is now estimated at 7,0 million tons against 7,1 million tons in 1986/87. In addition, substantially increased expenditures in real terms were incurred in this sector on intermediate goods and services. Because of the expected large wheat crop in the fourth quarter, total real agricultural production in the calendar year 1988 may nevertheless show some improvement on the preceding year.

In the mining sector, the production of gold, diamonds and "other" minerals receded in the third quarter from their comparatively high second-quarter levels. Notwithstanding an increase in coal production, this caused the total volume of mining output to contract in the third quarter at an annualised rate of 6 per cent. A small increase in mining production may, however, still be expected for calendar 1988.

Among the non-primary sectors, appreciable increases in real value added were recorded in the third quarter by the manufacturing sector, by commerce, and by transport, storage and communication. Notable production increases in manufacturing in the third quarter (more particularly in food products, basic metals, and machinery and transport equipment) partly represented a rebound from abruptly lower output levels in the second quarter, which had been due to some extent to the effect of stay-aways, strikes and public holidays and to technical problems in the iron and steel industry. Production in both manufacturing and commerce in the third quarter also responded favourably, however, to the strengthened merchandise export performance of that quarter, to marked further increases in real private consumption expenditure (including a continued firm demand for new motor vehicles), and to stepped-up levels of aggregate real gross domestic fixed capital formation. Output growth in commerce and manufacturing in the calendar year 1988 may be expected to reach levels of 3½ and 5 per cent, respectively.

Real gross national product

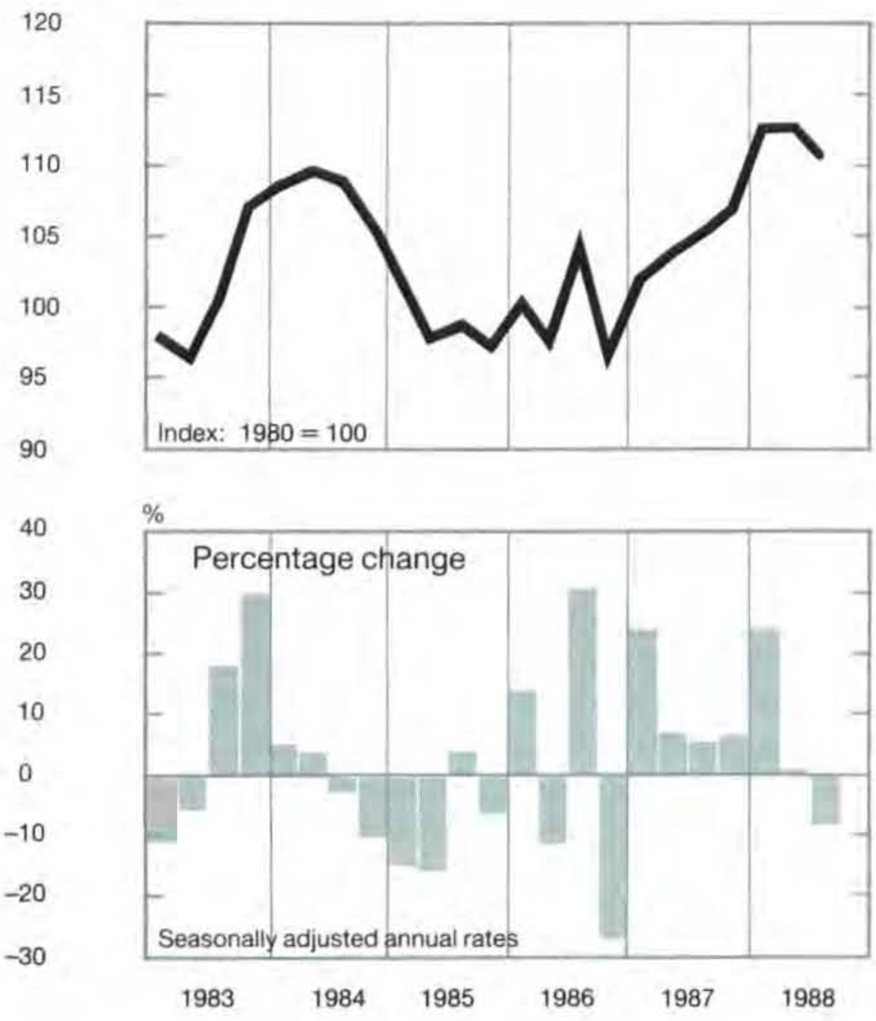


Domestic expenditure

Aggregate real gross domestic expenditure, which had increased strongly (at a seasonally adjusted and annualised rate of 24 per cent) in the first quarter of 1988 but had shown only a marginal further increase in the second quarter, fell back at an annualised rate of nearly 8 per cent in the third quarter. As a result, the year-on-year increase in the level of such expenditure was reduced from 9 per cent in the second quarter of 1988 to only some 5½ per cent in the third quarter. For the first nine months of 1988, however, the average level of aggregate real gross domestic expenditure still exceeded its counterpart in the first nine months of 1987 by an impressive 8½ per cent. Taking into account a probably gradual strengthening of the effect of the "packages" of demand-restraining policy measures of May and July-August 1988 and of the rising trend in interest rates in the course of 1988, aggregate real gross domestic expenditure in 1988 as a whole may nevertheless still be expected to exceed domestic expenditure in calendar 1987 by some 6 to 7 per cent.

The average level of "aggregate real demand" in the South African economy (comprising both aggregate real gross domestic expenditure *and* real exports of goods and non-factor services) was some 7 per cent higher in the first three quarters of 1988 than in the first three quarters of 1987. By far the larger part of this increase – i.e. some 90 per cent – was accounted for by the rise in the average level of real gross domestic expenditure. The rise of nearly 3 per cent, already referred to, in real gross domestic *product* from its average level in the first three quarters of 1987 to its average level in the first three quarters of 1988 was capable of providing in only approximately one third of the increase in aggregate real demand between these two periods. The 24½ per cent increase in the volume of *imports* of goods and non-factor services that

Real gross domestic expenditure



accordingly was needed to supplement domestic production was also, of course, the principal factor in explaining the decline in the surplus on the current account of the balance of payments from R5,3 billion in the first three quarters of 1987 to R1,8 billion in the first three quarters of 1988.

The decline in total real gross domestic expenditure from the second to the third quarter of 1988 was due to a further shrinkage of real consumption expenditure by general government and to a significant drawing-down of real inventories. Quite substantial further increases were recorded, however, in real private consumption expenditure and in aggregate real gross domestic fixed investment. To an important extent the behaviour of private sector consumption and investment spending in the past several quarters probably reflected elements of self-reinforcement (such as those that are inherent in the multiplier-accelerator mechanism, and also including a cumulative strengthening of business and consumer "confidence" and of more positive expectations) that are typical of cyclical expansions. However, real private sector consumption expenditure and, to a lesser extent, real *private* fixed investment expenditure in the middle quarters of 1988 were also subject to an unusual concurrence of factors that tended to foster "pre-emptive" buying and to raise the apparent propensity to consume and inducement to invest.

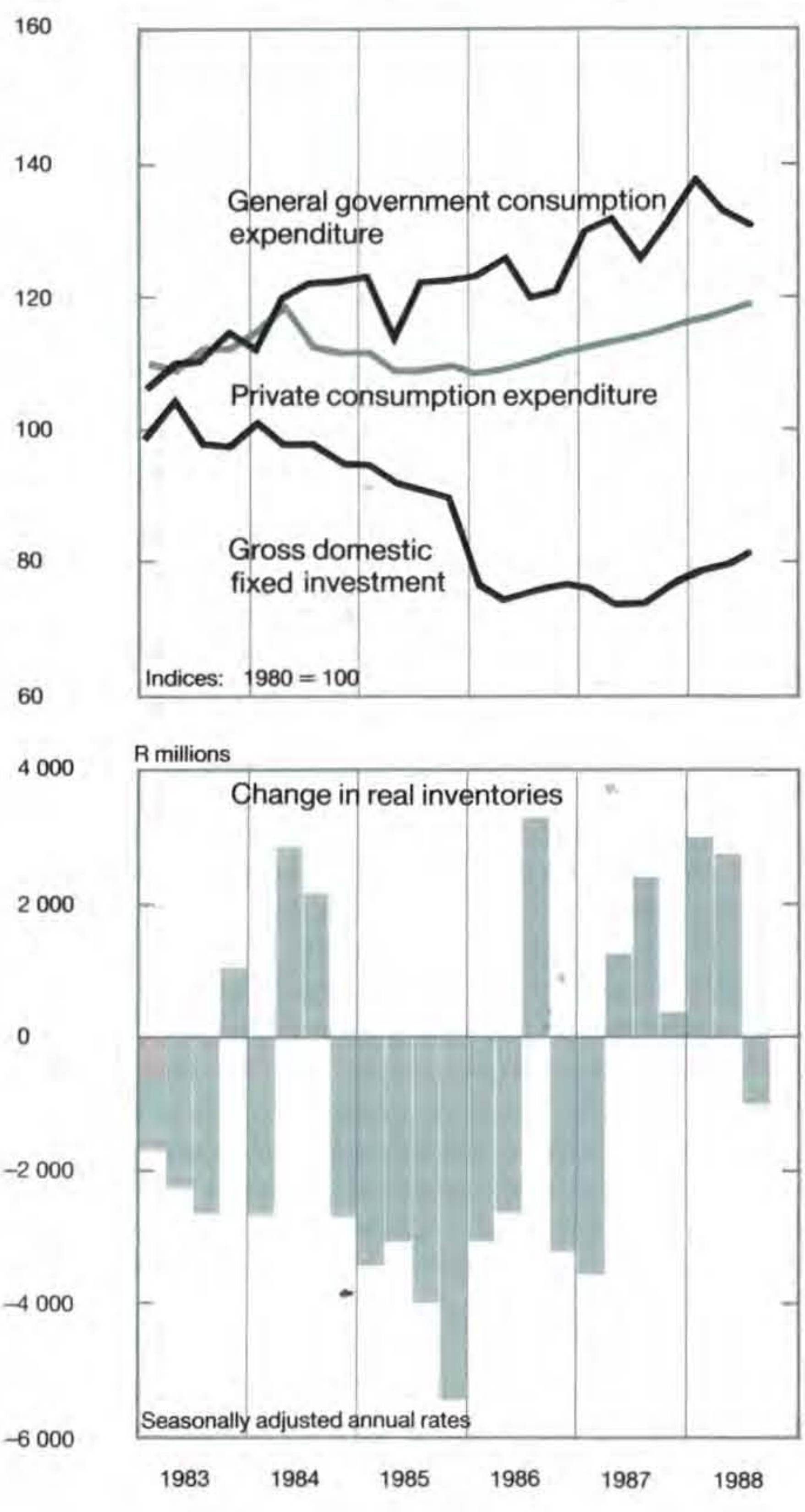
Real *private consumption expenditure* rose in the third quarter of 1988 at an annualised rate of 5½ per cent. This rate of increase significantly exceeded both the annualised rate of increase of more than 4 per cent in the preceding two quarters and the average annual rate of nearly 4 per cent during the preceding nine quarters from the second quarter of 1986 to the second quarter of 1988. The average level of real private consumption expenditure in the first three quarters of 1988 was 4 per cent higher than in the first three quarters of 1987; the rise in this level from the first nine months of 1987 to the first nine months of 1988 was equal to roughly three quarters of the rise in the average level of real gross domestic product between these two periods.

The increases in real private consumption expenditure in the middle quarters of 1988 were supported by a marginal increase in aggregate real personal disposable income. As in many earlier quarters, however, real private consumption in the second and third quarter of 1988 was also encouraged by expectations of price increases, the ready availability of consumer credit, and very low or negative real after-tax rates of return on most of the more popular financial savings media. Further stimuli towards "pre-emptive" purchases of consumer goods in these two quarters derived from fears of accelerated price increases because of the renewed depreciation of the rand from early January 1988, the possibility of an increase in general sales tax or some similar form of demand-restraining fiscal action, expectations regarding a tightening of hire-purchase and related credit conditions, and concerns about a possible future scarcity or unobtainability of imported goods because of sanctions and boycotts or import curbs.

In the third quarter of 1988 substantial amounts of "pre-emptive" buying appear to have been engaged in for the specific purpose of avoiding the price increases that would result from the imposition of increased surcharges on certain categories of imported goods from 15 August 1988. Increased household spending on consumer durables normally seems to take place at the expense of private saving in the form of financial asset accumulation rather than at the expense of spending on non-durables and semi-durables. The surge in household spending on "old" stocks of consumer durables at their "old" prices in the third quarter of 1988 is likely to have contributed significantly to the drawing-down of commercial inventories during that quarter.

The increase in real private consumption expenditure in the third quarter of 1988 was broadly based. The more notable rates of increase were recorded, however, in real spending on durable and semi-durable goods. Following annualised rates of increase of 8½ and 7 per cent in the second quarter of 1988, the rates

Main components of real gross domestic expenditure



of increase in these two categories of spending in the third quarter amounted to 13½ and 10 per cent, respectively. The third-quarter rates of increase in real expenditure on non-durable goods and on services amounted to 4½ and 2½ per cent.

Real consumption expenditure by general government rose at a seasonally adjusted annual rate of 22 per cent in the first quarter of calendar 1988 (the final quarter of fiscal 1987/88), but declined at an annualised rate of 13½ per cent in the second quarter. It then shrank further at an annualised rate of 6½ per cent in the third quarter. Its average level in the first three quarters of 1988 was, however, still some 3½ per cent higher than in the first three quarters of 1987.

The higher average level of total real government consumption expenditure in the first three quarters of calendar 1988 could be attributed in broadly equal measure to higher outlays on real salaries and wages on the one hand and on goods and non-labour services on the other hand. The decline in total real government spending in the third quarter of 1988 was, however, the result of further cutbacks (following those of the second quarter) in spending on goods and non-labour services. These cutbacks more than fully neutralised an increase in spending on real salaries and wages. General government's higher total real wage bill in the third quarter of 1988 was a reflection of increased employment; revised labour statistics for the first two quarters of 1988 show that a rise in the number of workers employed by the provincial administrations and the self-governing states outweighed a decline in employment by the central government during this period.

Aggregate *real gross domestic fixed investment* rose in the third quarter of 1988 for the fifth consecutive quarter and did so at a seasonally adjusted annual rate (of 13½ per cent) that was appreciably higher than in the preceding six months. The level of total real fixed investment in the first three quarters of 1988 was nearly 8 per cent higher than in the first three quarters of 1987.

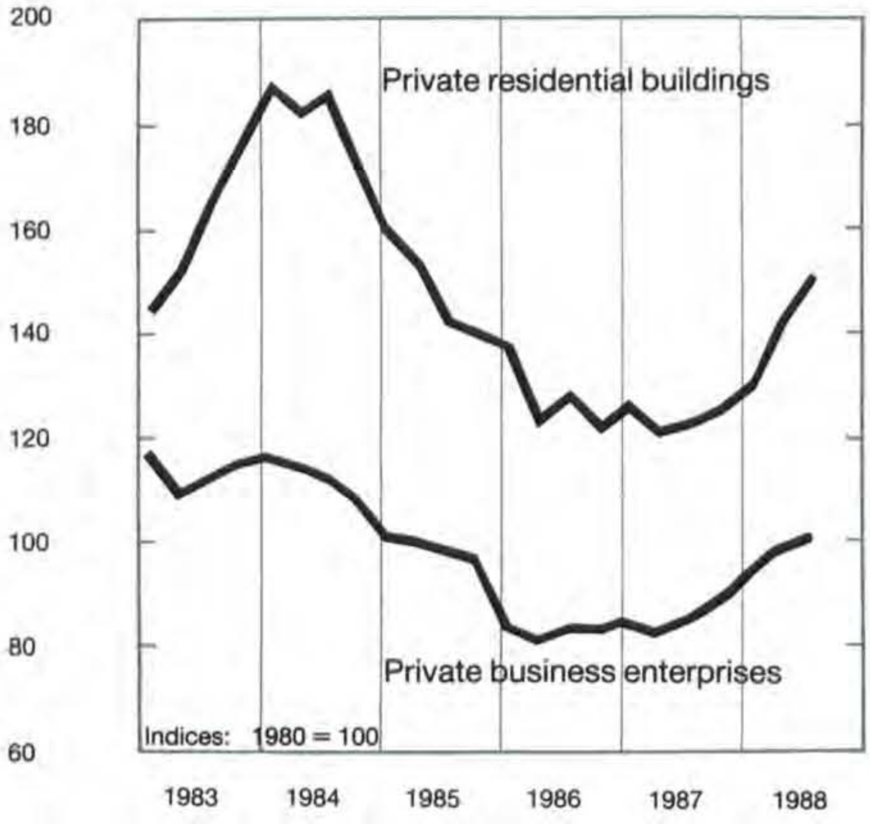
The marked further strengthening of the economy's gross fixed investment performance in the third quarter of 1988 was mainly the result of increased fixed capital formation by the private sector and by public corporations. This was supported, however, by some shrinking of the decline in real fixed investment by public authorities.

The rise in real fixed investment spending by the *private sector* in the third quarter of 1988 was broadly based. Above-average rates of increase were posted by the mining industry, manufacturing, transport and finance. The seasonally adjusted and annualised rate of increase in real fixed investment spending by the private sector in the third quarter amounted to 9½ per cent. Contrary to the behaviour of *total* real gross fixed investment expenditure, however, this rate of increase actually represented a slow-down from the very high growth rates in real private sector fixed investment spending that had been recorded in the first and the second quarter of 1988.

Higher levels of real gross fixed investment in manufacturing did not yet succeed in arresting the decline in the physical production capacity of manufacturing industry. The further shrinking of the real fixed capital stock in manufacturing in the third quarter of 1988 was, however, the smallest to be recorded since the fourth quarter of 1985.

An analysis of real gross fixed investment by types of assets shows that, after the slump in residential build-

Real gross domestic fixed investment



ing from 1985 to 1987, real expenditure on private residential buildings was approximately 14½ per cent higher in the first three quarters of 1988 than in the first three quarters of the preceding year. Residential building was boosted in recent quarters *inter alia* by the build-up of housing needs in the years from 1985 to 1987 and the pent-up demand remaining from that period; by relatively low mortgage interest rates in the initial stages of the recovery in building activity from the middle of 1986; by increased private sector interest in the development of Black townships; and by the active marketing and high popularity of the new so-called "duet" units and of retirement schemes. Building activity now stands to be curbed, however, by recent increases in mortgage rates and in interest rates generally.

Real fixed capital spending by *public corporations* declined in the first half of 1988, but recovered significantly in the third quarter. This was due to stepped-up investment activity by public corporations in manufacturing and in electricity, gas and water. Increased investment spending in manufacturing largely reflected an increase in some pre-production expenditure by Mossgas. In electricity generation, severe cutbacks in real investment spending by Eskom in the first six months of 1988 were followed by an increase in such spending in the third quarter. This was still in accordance with budgetary intentions, which are aimed at a reduction in Eskom's nominal fixed investment outlays in the calendar year 1988.

Real fixed capital expenditure by *public authorities* declined somewhat further in the third quarter of 1988 from its relatively low second-quarter level. An *in*crease of 15 per cent was actually recorded in seasonally adjusted real fixed capital investment by government business enterprises. This increase was more than fully offset, however, by further reductions in real capital spending by general government, more specifically by central government and by the provincial administrations.

Aggregate *real inventories,* which had been on a rising trend during the five quarters from the second quarter of 1987 to the second quarter of 1988, fell back significantly in the third quarter of 1988. This represented the net result of an increase in the third quarter of 1988 in aggregate real "*final* demand" (i.e. the sum total of real private and government consumption expenditure, real gross fixed investment, and real exports of goods and non-factor services) at a seasonally adjusted annual rate of 11 per cent against an increase in aggregate "real supply" (i.e. in the sum total of real gross domestic product and real imports of goods and non-factor services) at a seasonally adjusted annual rate of only 2 per cent.

The drawing-down of inventories in real terms in the third quarter of 1988 was unusual in having occurred in what may be presumed to have been the vicinity of an upper turning-point of the business cycle. At least two factors contributed to this disinvestment in inventories:

Firstly, the marked and probably largely unanticipated acceleration of growth in real private consumption expenditure, and rising real fixed investment, in the third quarter of 1988 are likely to have caused an involuntary running-down of stocks; in as far as the third-quarter surge in consumer spending was aimed at "old" stocks of (imported) consumer durables, it would not necessarily have been accompanied by increased *imports* of such goods or by increased *orders* for imports of such goods.

Secondly, the increased foreign demand for South African export goods in the third quarter of 1988 was met partly from available inventories.

In a longer-run context, the increased cost of imports on account of the surcharge on imports and the depreciation of the rand will discourage inventory accumulation of imported goods. At the same time, the rising level of interest rates from late 1987 will discourage inventory accumulation in general.

The more notable declines in real inventories in the third quarter of 1988 were recorded in the sectors mining, manufacturing and retail trade and in diamond stocks-in-trade. The ratio of industrial and commercial inventories to gross domestic product, which had advanced slowly to 20 per cent in the first and the second quarter of 1988, retreated slightly again in the third quarter to approximately 19½ per cent.

Factor income and saving

The quarter-to-quarter rate of increase in aggregate nominal factor income, in seasonally adjusted and annualised terms, accelerated significantly from 16 per cent in the second quarter of 1988 to 18 per cent in the third quarter. The year-on-year increase in total nominal factor incomes advanced from 18½ per cent in the second quarter to 19½ per cent in the ensuing three months.

Reflecting substantial wage increases in the first half of the year, the annualised rate of increase in total nominal remuneration of employees rose from 14½ per cent in the first quarter of 1988 to 15 per cent in the second quarter. It then remained at this level in the third quarter. This was largely the result of the absence of general salary adjustments in the public sector. In addition, smaller wage increases than in preceding quarters were granted in the private sector in certain activities such as electricity generation, transport and finance.

The year-on-year increase in total remuneration of employees in the third quarter of 1988 amounted to 17½ per cent. This was well in excess of the year-on-year increase in the consumer price index of 12½ per cent.

The quarter-to-quarter rate of increase in the gross operating surplus (mainly profits), seasonally adjusted and annualised, eased from 21 per cent in the first quarter of 1988 to 16 per cent in the second quarter, but reaccelerated to about 17 per cent in the third quarter. The gross operating surplus in the third quarter of 1988 was 19 per cent higher than in the third quarter of 1987. The most important sectoral increases were recorded in the mining industry and in the sectors commerce, construction and finance.

Gross domestic saving rose slightly in the third quarter of 1988. At the same time, *gross domestic investment* – comprising both fixed investment and inventory investment – declined as a result of the drawing-down of inventories. Between them, these movements in the domestic savings and investment aggregates caused the excess of gross domestic saving over gross domestic investment to increase substantially. The ratio of saving to investment accordingly rose from 99 per cent in the first quarter of 1988 to nearly 111½ per cent in the third quarter. At its third-quarter level, however, the savings-to-investment ratio still fell significantly short of its average value of 119 per cent in 1987.

Sectoral analysis of gross domestic saving shows that net personal saving declined further in the third quarter. Net corporate saving rose slightly. A marginal improvement was also shown in net dissaving by general government.

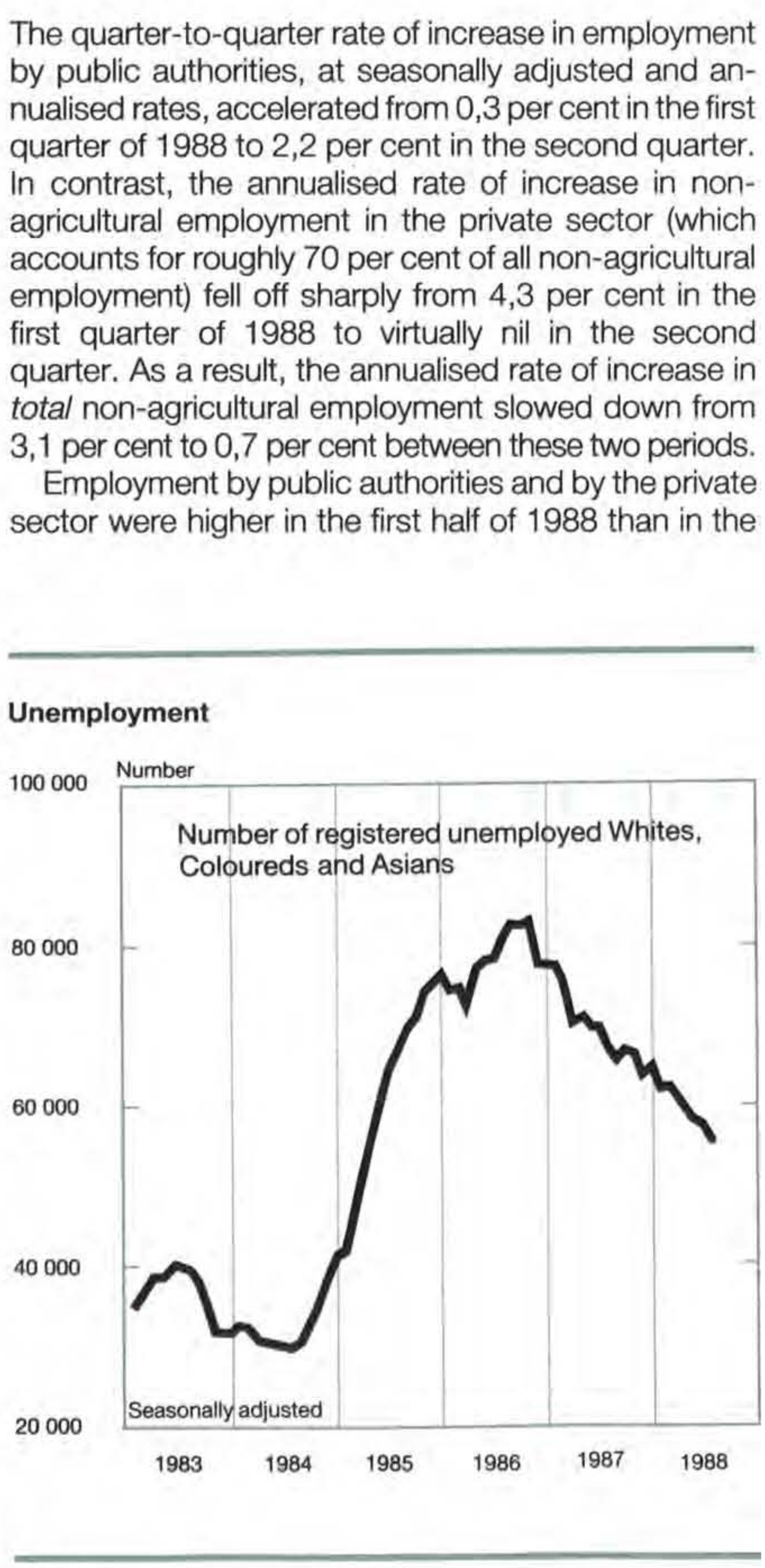
The ratio of net personal saving to personal disposable income declined to slightly less than 1 per cent in the third quarter of 1988, against a ratio of about 2 per cent in both the first and the second quarter of 1988 and an average level of this ratio of approximately 3 per cent in calendar 1987. The decrease in net dissaving by general government could be attributed to an improvement in revenue receipts. This reflected a tightening-up of tax collection procedures, higher than expected revenues from the minimum tax on companies and the effect of the import surcharge and the fuel levy. In addition, increased company profitability and higher levels of economic activity and domestic spending at current prices resulted in larger than expected receipts from indirect taxes and income tax collections.

Employment

The quarter-to-quarter rate of increase in employment by public authorities, at seasonally adjusted and annualised rates, accelerated from 0,3 per cent in the first quarter of 1988 to 2,2 per cent in the second quarter. In contrast, the annualised rate of increase in non-agricultural employment in the private sector (which accounts for roughly 70 per cent of all non-agricultural employment) fell off sharply from 4,3 per cent in the first quarter of 1988 to virtually nil in the second quarter. As a result, the annualised rate of increase in *total* non-agricultural employment slowed down from 3,1 per cent to 0,7 per cent between these two periods.

Employment by public authorities and by the private sector were higher in the first half of 1988 than in the

Unemployment



first half of 1987 by 2,0 and 0,9 per cent. Total non-agricultural employment accordingly rose by 1,2 per cent over this period. Rates of increase in total non-agricultural employment have generally fallen short of the rate of increase in the South African labour force since 1982. In the past six to eight years, rates of increase in private sector employment in excess of the rates of increase in employment by public authorities have occurred only infrequently.

Further increases in private sector employment in manufacturing and construction are indicated by the available statistics for the third quarter of 1988.

Increases in overtime worked continued to be used as a substitute for increases in staff complements in the private sector. In manufacturing the ratio of overtime hours to normal hours worked rose steadily from 11,4 per cent in the fourth quarter of 1987 to 12,5 per cent in the third quarter of 1988. In construction this ratio rose from 7,8 per cent in the first quarter of 1988 to 8,6 per cent in the third quarter.

The number of registered *un*employed workers among the White, Coloured and Asian population groups, which had reached a peak of 82 500 in August 1986, declined further from 60 300 in March 1988 to 54 800 in July. However, the total number of registered unemployed workers, which had dropped by some 12 per cent from its peak in September 1987 to a low point of 121 900 in May 1988, subsequently reverted to 126 900 in July.

The number of unemployed Black workers as measured by the Current Population Survey declined from nearly 1,2 million in July 1986 to 940 000 in April 1988. It then fell back rapidly to 817 000 in August 1988. Black unemployment as in August 1988 amounted to approximately 12,5 per cent of the Black labour force.

Labour costs and productivity

The year-on-year increase in *nominal* wages per worker employed by public authorities amounted to approximately 16 per cent in both the first and the second quarter of 1988. In the private sector, however, this rate of increase accelerated significantly from 15,4 per cent in the first quarter of 1988 to 19,5 per cent in the second quarter. This confirmed an earlier impression that the mildly more moderate pace of nominal wage advances in the private sector in the first quarter of 1988 was unlikely to have been maintained in subsequent months.

The average nominal amount of salaries and wages per worker in the non-agricultural sectors of the economy in the first half of 1988 was 17,1 per cent higher than in the first half of 1987. This was the largest year-on-year increase in a half-yearly average of the nominal remuneration per worker since the second half of 1984.

The average *real* wage per worker was 3,3 per cent higher in the first half of 1988 than in the first half of 1987. This quite substantial rise in the average real wage over a twelve-month period followed declines in average real labour remuneration in the preceding three calendar years. The year-on-year rate of increase in real remuneration per worker advanced significantly from the first to the second quarter of 1988 in the private sector in particular and, with regard to the first half of 1988, was notably higher among workers in the private sector than among workers employed by public authorities.

Further increases in aggregate real non-farming production in the second quarter of 1988 in the face of only relatively small further increases in employment caused *labour productivity* (i.e. real gross domestic product per worker in the non-agricultural sectors of the economy) to rise faster in the second quarter of 1988 than in the preceding three months. The rate of increase in nominal unit labour costs amounted to 13,8 per cent in the calendar year 1987, but, largely because of the accelerated rise in the nominal wage per worker, rose sharply to an annualised level of 19,3 per cent in the second quarter of 1988.

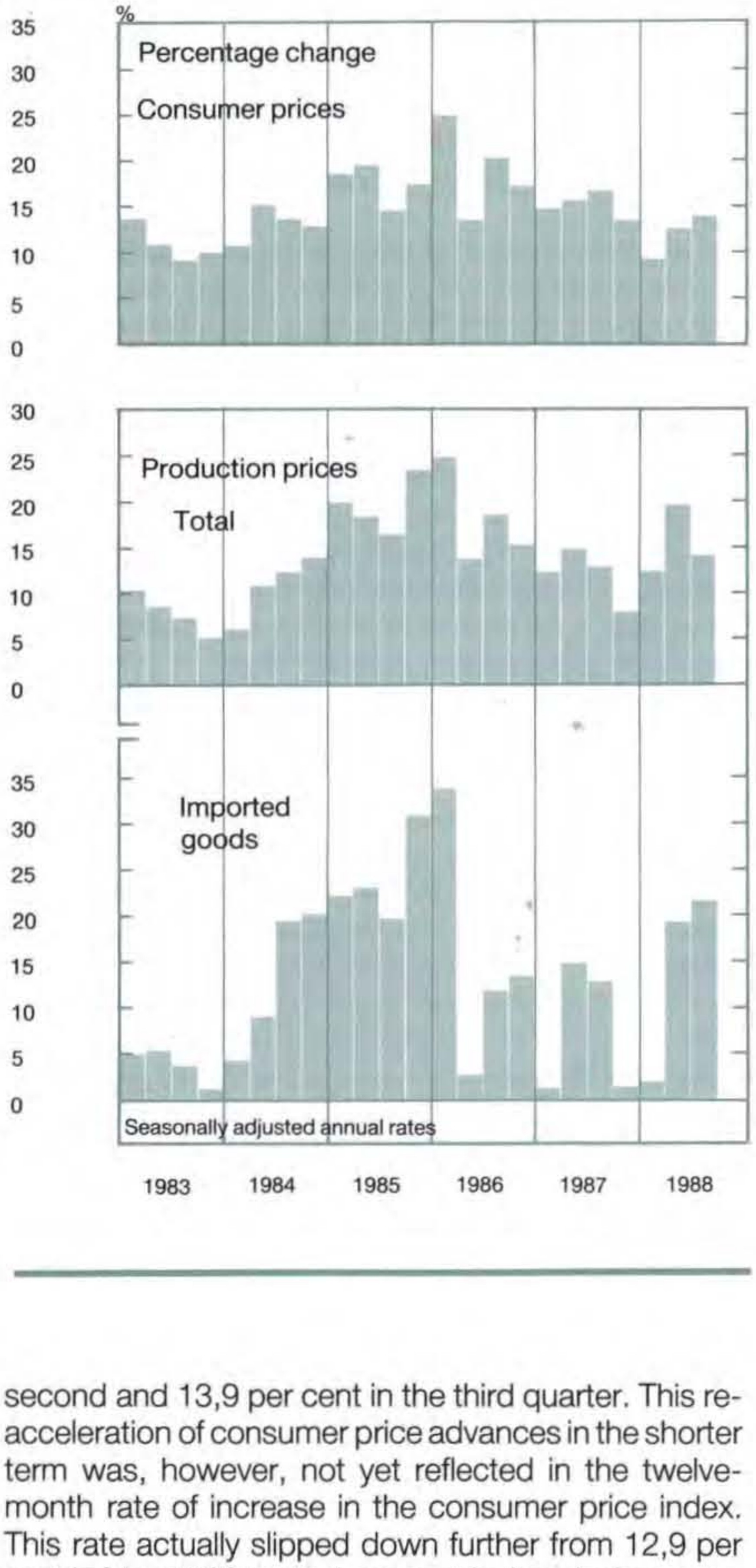
Prices

Mainly reflecting the weakening of the exchange rate of the rand from early January 1988, the quarter-to-quarter rate of increase in the prices of *imported goods,* in seasonally adjusted and annualised terms, reaccelerated abruptly and very rapidly from only 1,3 per cent in the fourth quarter of 1987 to as much as 21,7 per cent in the second and 24,2 per cent in the third quarter of 1988. This was also the principal factor in explaining the reacceleration of the annualised quarter-to-quarter rate of increase in the *production price index* from its low point of 7,9 per cent in the fourth quarter of 1987 to 12,6 per cent and 19,6 per cent in the first and the second quarter of 1988, respectively. The twelve-month rate of increase in production prices reaccelerated in its usual more subdued fashion from its trough of 11,3 per cent in December 1987 to around 13½ per cent in June, July and August 1988.

A quite remarkable slow-down (from 18,8 to 12,0 per cent) in the annualised quarter-to-quarter rate of increase in the prices of domestically produced goods from the second to the third quarter of 1988 – due mainly to a decline in the prices of agricultural products, and to lower rates of increase in the prices of several other domestically produced goods – subsequently caused the annualised quarter-to-quarter rate of increase in the production price index to fall back to 14,2 per cent in the third quarter. The twelve-month rate of increase in production prices receded slightly to 13,3 per cent in September.

The quarter-to-quarter rate of increase in the *consumer* price index, seasonally adjusted and annualised, rose from its single-digit (9,2 per cent) lower turning-point in the first quarter of 1988 to 12,6 per cent in the

Prices



second and 13,9 per cent in the third quarter. This re-acceleration of consumer price advances in the shorter term was, however, not yet reflected in the twelve-month rate of increase in the consumer price index. This rate actually slipped down further from 12,9 per cent in May 1988 to 12,4 per cent in June before moving sideways at levels of 12,4, 12,3, 12,4 and 12,3 per cent in July, August, September and October 1988, respectively.

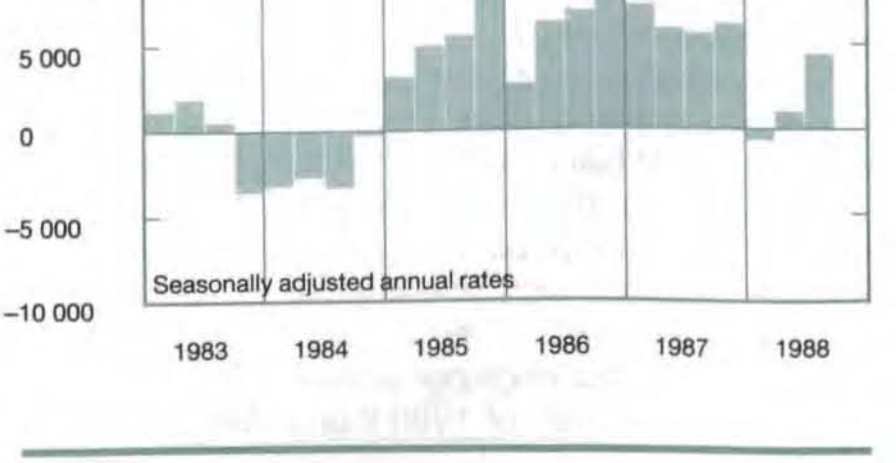
Balance of payments

Current account

Having already staged a moderate recovery in the second quarter of 1988, the current account of the balance of payments showed a marked further strengthening in the third quarter. The first-quarter deficit on the current account, amounting to R0,4 billion at a seasonally adjusted annual rate, was transformed into surpluses of nearly R1 billion in the second quarter and R4,5 billion in the third quarter. The continued improvement of the current payments position in the third quarter, which was an unusual occurrence in the prevailing business cycle situation, could mainly be attributed to a significant further reinvigoration of the South African merchandise export performance and a slight rise in the value of net gold exports. Between them, these two favourable developments more than fully offset a further rise in the value of merchandise imports and in net service and transfer payments to foreigners.

The value of *merchandise exports* rose by 18 per cent from the second to the third quarter of 1988. This was mostly a matter of increased export *volumes,* more particularly of increased volumes of agricultural and mining exports. Export *prices* in rand, however, also rose by 6 per cent on balance; although international commodity prices in dollars softened somewhat from July, this was more than fully neutralised by the decline in the average dollar value of the rand. The aggregate volume of merchandise exports in the third quarter of 1988 actually exceeded the cyclical high point in export volumes in the third quarter of 1986 by about 1 per cent. It was also some 15 per cent higher than the low point in export volumes in the first quarter of 1988.

Balance of payments on current account



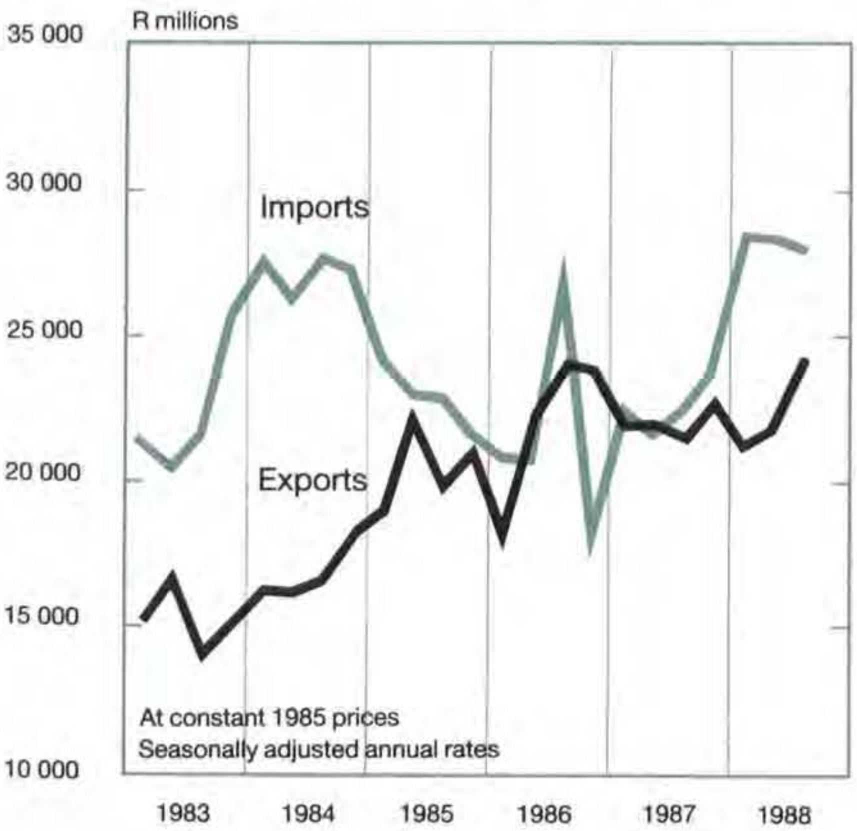
Balance of payments on current account
Seasonally adjusted annual rates
R millions

	1987	1988		
	Year	1st qr	2nd qr	3rd qr
Merchandise exports	25 146	26 300	28 660	–33 830
Net gold exports	17 792	18 530	19 610	–20 230
Merchandise imports	–28 320	–36 780	–38 310	–40 070
Net service and transfer payments	–8 466	–8 460	–9 000	–9 460
Balance on current account	6 152	–410	960	4 530

The value of *net gold exports* rose by 3 per cent from the second to the third quarter of 1988. This was also mostly a matter of higher export volumes, although the average grade of ore milled slipped down slightly further from 5,12 grams per ton in the second quarter to 5,08 grams per ton in the third quarter.

The rand export *price* of gold showed little change from the second to the third quarter despite a decline in the average *dollar* price of gold from \$451 to \$427 per fine ounce during this period. Declines in international oil prices and higher real interest rates in various major industrial countries subsequently caused the dollar price of gold to weaken sharply in the second half of September and to decline to an average of only \$407 in October. In November the gold price, responding to a firming of the prices of platinum and other precious metals, recovered to an average of \$420 per fine ounce.

Volume of merchandise imports and exports



The value of *merchandise imports* rose further from the second to the third quarter of 1988 by 4½ per cent. Increased imports by value were recorded in the categories of chemical products and transport equipment in particular. Declines in imports by value were shown by mineral products. Little change in imports by value was shown by the other main import categories.

The *volume* of merchandise imports in the third quarter of 1988 actually displayed a slight further decline from its first-quarter level. This decline occurred despite apparently substantial amounts of so-called "pre-emptive" buying of imported goods in both the second and the third quarter of 1988, in anticipation of measures (such as the imposition of increased surcharges) that were expected to be introduced for strengthening the overall balance of payments position and for protecting the gold and other foreign reserves.

The rise in the average *price level* of imports in terms of rand in the third quarter of 1988 again more than fully neutralised the slight decline in import volumes. The 5½ per cent increase in the average price level of imported goods arose mainly from a decline in the effective exchange rate of the rand.

Weakening of the exchange rate was also the principal factor in explaining considerable increases in both service payments to and service receipts from foreigners. However, increases in payments to foreigners for freight and merchandise insurance significantly exceeded increases in receipts from foreigners. As a result, the rise in net service and transfer payments to foreigners in the third quarter amounted to slightly more than 5 per cent.

Capital account

Very substantial further outflows of capital were recorded in the third quarter of 1988. The total outflow of capital not related to reserves rose from R0,7 billion in

Net capital movements (not related to reserves)
R millions

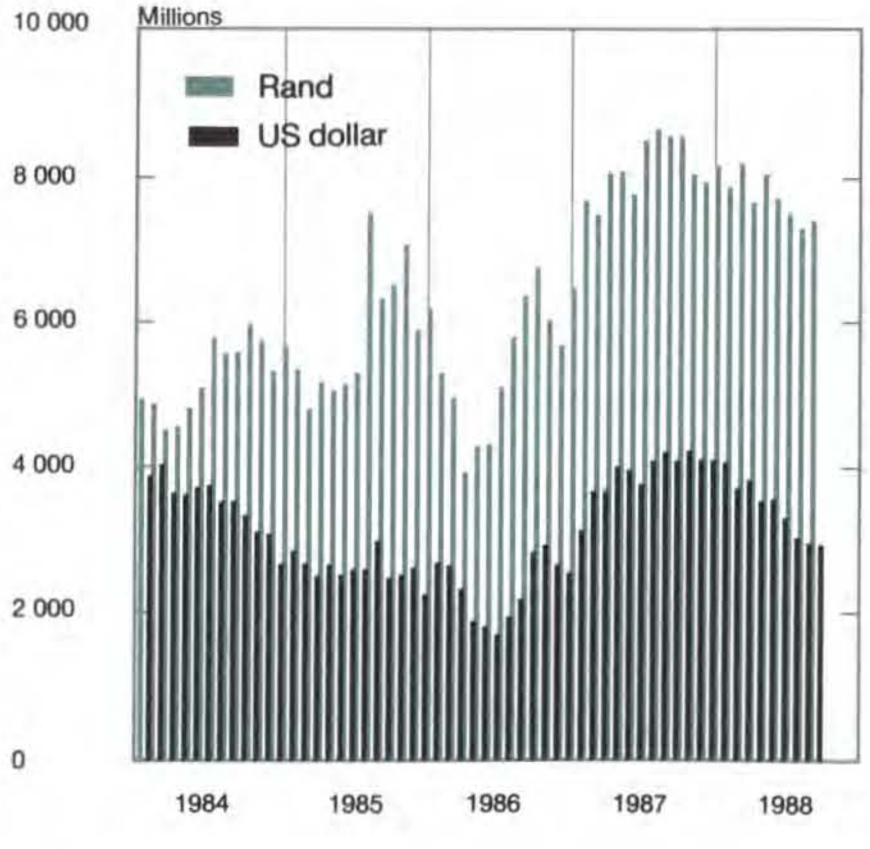
	1987	1988 1st qr	1988 2nd qr	1988 3rd qr
Long-term capital				
Public authorities	–529	–28	–137	31
Public corporations	817	–140	–179	–233
Private sector:				
Net purchases of listed securities by non-residents	–1 213	–35	9	75
Other capital	–773	–88	–307	5
Total long-term capital	–1 698	–291	–614	–122
Short-term capital including unrecorded transactions, but excluding reserve-related liabilities	–1 371	–386	–1 475	–2 285
Total capital movements excluding liabilities related to reserves	**–3 069**	**–677**	**–2 089**	**–2 407**
Change in liabilities related to reserves	–1 167	–13	1 668	601

the first quarter to R2,1 billion in the second quarter and R2,4 billion in the third quarter.

No "lump sum" repayments of debt inside the standstill net were made during the third quarter. Partly for this reason, the outflow of long-term capital shrank from R614 million in the second quarter to R122 million in the third quarter.

In contrast to the diminished outflow of long-term capital, the outflow of short-term capital not related to reserves (but including unrecorded transactions) increased sharply from R1,5 billion in the second quarter to R2,3 billion in the third quarter. The rise in this amount could be explained essentially from the widening differentials between real interest rates in South Africa and in several major overseas economies from approximately June 1988, as well as from leads and lags and related speculative capital movements that were linked to perceptions of prospects for the exchange value of the rand. South African importers also made extensive use of deposits, arising from the standstill, with the Public Investment Commissioners in view of the relatively low all-in cost of this type of finance.

Gross gold and other foreign reserves



Foreign reserves

South Africa's total gross gold and other foreign reserves fell by R306 million in the third quarter of 1988 after a drop of R480 million in the second quarter. The cumulative decline in the gross foreign reserves, measured in rand, from their high point in August 1987 was thereby brought to R1 253 million or 14½ per cent. Measured in rand and US dollars, the foreign reserves as at the end of September 1988 nevertheless still exceeded their low points of April 1986 by 88 and 55 per cent.

Exchange rates

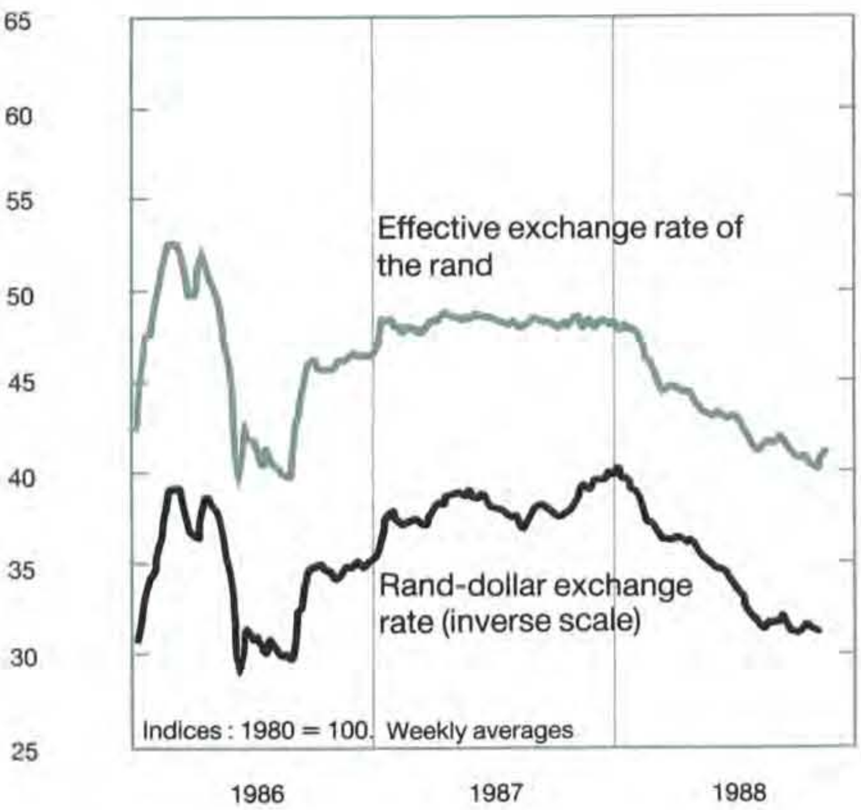
Largely because of capital outflows in the third quarter of 1988 and the sharp weakening of the dollar price of gold in the second half of September, the effective exchange rate of the rand declined by 4,9 per cent in the third quarter. This followed a decline of 10,3 per cent in the first half of 1988. Incorporated in the depre-

Changes in exchange rates of the rand

%

	31 Dec 1987 to 31 Mar 1988	31 Mar 1988 to 30 Jun 1988	30 Jun 1988 to 30 Sept 1988	30 Sept 1988 to 30 Nov 1988	31 Dec 1987 to 30 Nov 1988
Weighted average	–6,7	–3,8	–4,9	3,5	–11,7
US dollar	–9,1	–8,3	–6,9	8,3	–16,2
British pound	–9,4	–	–5,1	–1,0	–15,0
German mark	–4,7	–	–4,0	–	–8,3
Swiss franc	–2,7	0,9	–1,5	–1,4	–5,1
Japanese yen	–7,1	–2,6	–5,8	–1,9	–16,5
French franc	–4,7	–0,8	–2,4	–	–7,7
Financial rand	4,8	–13,4	–15,5	14,5	–12,2

Exchange rates



ciation of the rand in the third quarter were declines against the US dollar of 6,9 per cent and against sterling and the yen of 5,1 and 5,8 per cent, respectively.

Partly as a result of a renewed weakening of the dollar, the decline in the effective exchange rate of the rand was kept within moderate limits during October despite a lower monthly average level of the dollar price of gold. A significant recovery of the gold price, further softening of the dollar, and upward adjustments of South African interest rates subsequently caused the rand exchange rate to firm again after the first few days of November. As a result, the effective exchange rate of the rand actually rose from the end of September to the end of November by 3,5 per cent.

The *financial* rand weakened in the third quarter of 1988 for the second consecutive quarter. From the end of March 1988 to the end of September it depreciated from R2,97 to R4,06 to the US dollar, or by 26,9 per cent. During October and November the financial rand traded between levels from R3,49 to R4,10 to the dollar. This represented discounts vis-à-vis the commercial rand ranging from 33,1 to 40,3 per cent.

Financial markets

Money supply

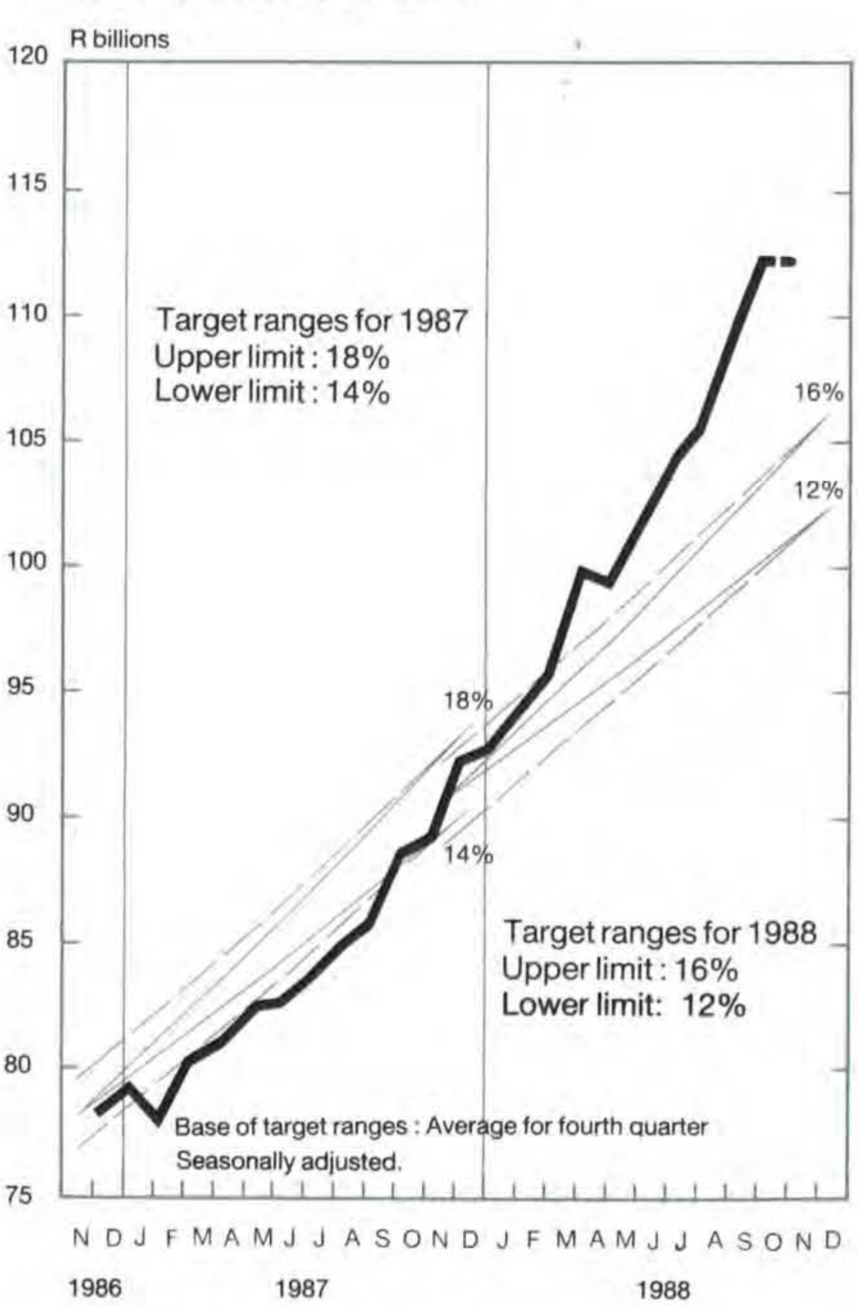
Very high rates of increase in the monetary aggregates and in domestic credit extension continued to be recorded in the third quarter of 1988. The quarter-to-quarter rate of increase in M3, seasonally adjusted and annualised, during this quarter amounted to 29,4 per cent. This followed similar rates of increase of 26,1, 23,5 and 25,0 per cent in the preceding three quarters from the approximate start of the further acceleration of the expansion of the money supply in September 1987.

The seasonally adjusted annual rate of increase in M3 from the beginning of the 1988 targeting year (mid-November 1987) to the end of September 1988 amounted to 27,8 per cent. The twelve-month rate of increase in September 1988, at 27,3 per cent, exceeded the peak value of this rate in the early stages of the mini-boom of 1983-84 and was close to the record value of this rate (of 29,1 per cent) in the advanced stages of the "gold boom" in April 1981. Preliminary data indicate, however, that no further increase in M3 occurred during October. This would have the effect of reducing the seasonally adjusted annual rate of increase in M3 from the beginning of the 1988 targeting year to approximately 25,0 per cent.

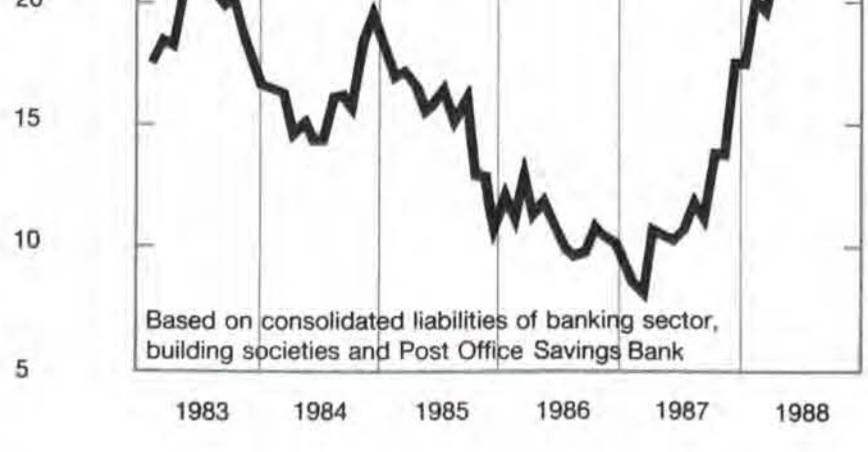
M3 broke through the ceiling of the target tunnel in February 1988 and continued to exceed the upper limit of the tunnel by generally rising amounts in the course of the ensuing seven months. At the end of September the extent of this overshoot amounted to approximately R8,9 billion, or 8,6 per cent. In October the extent of the overshoot, according to the provisional estimate of M3 for that month, shrank fairly significantly to about R7,7 billion or 7,4 per cent.

At somewhat more than R112 billion, M3 as at the end of both September and October was also close to R9 billion higher than the amount of R103,2 billion that, in terms of the monetary target for 1988, was to be aimed at as the centre point of the target range for the quarterly average value of M3 in the fourth quarter of 1988. In its statement accompanying the Bank rate increase (from 12,5 to 14,5 per cent) of 3 November, the Reserve Bank reiterated that the monetary authorities did not intend to force M3 back into the target tunnel during the remainder of 1988, because such action would almost certainly require measures that might prove unduly damaging to the economy.

Target ranges for growth in M3



Money supply



Sustained rapid growth in the monetary aggregates continued to be explained partly by reintermediation phenomena as induced, for example, by a further narrowing of the gap between monetary institutions' average lending and average deposit rates. "Round-tripping" occurred – for the first time since early 1982 – in the tight money market conditions at the end of August and September 1988. Monetary institutions have sought to resist these tendencies by deliberate attempts at taking more business "off-balance sheet".

Rapid money supply growth was also fostered by investors' enhanced liquidity preference and increased demand for fixed-value depository investments in an environment of rising interest rates. Long-term insurers, for example, doubled their holdings of depository investments as included in M3 to R12,1 billion in the year to the end of March 1988. Preliminary indications are that relatively liquid positions were maintained by the contractual savings intermediaries in the second and the third quarter of 1988.

The rapid increase in M3 during the third quarter again exceeded that of the nominal gross domestic product, resulting in a further decline in the velocity of circulation. M3's velocity of circulation slowed by 2,3 per cent during the third quarter and, at 1,844, in that quarter was 6,1 per cent lower than the recent peak in velocity of 1,961 in the first quarter of 1987.

Expectations of rising interest rates also caused the increase in M3 to be concentrated heavily in deposits in the relatively shorter-term segments of the maturity spectrum. The comparative rates of increase in M1A, M1, M2 and M3 during the twelve months to the end of September 1988 amounted to 28,1 per cent, 30,3 per cent, 37,9 per cent and 27,3 per cent. "Other" short and medium-term deposits (i.e. the non-M1 component of M2) rose by as much as 44,9 per cent. In contrast, long-term deposits rose by only 1,3 per cent during this period; they therefore showed little effect of the introduction of the interest rate subsidy for senior citizens in May 1988.

The principal statistical counterpart of the R8,1 billion increase in M3 (seasonally adjusted) in July, August and September 1988 was an increase of R8,1 billion in monetary institutions' domestic credit extension. The net gold and other foreign reserves of the monetary system declined by R1,4 billion during this period.

Domestic credit extension

Rates of increase in monetary institutions' claims on the private sector in the third quarter of 1988, in seasonally adjusted and annualised terms, exceeded 40 per cent for banks and 30 per cent for all monetary institutions.

The twelve-month rate of increase in monetary institutions' claims on the private sector rose from single-digit figures as recently as July 1987 to as much as 29,2 per cent in September 1988. As in the case of M3, the speed of this acceleration in credit extension was considerably higher than in the gold boom years from 1979 to 1981.

Changes in claims on private sector

Quarter-to-quarter percentage changes in quarterly averages

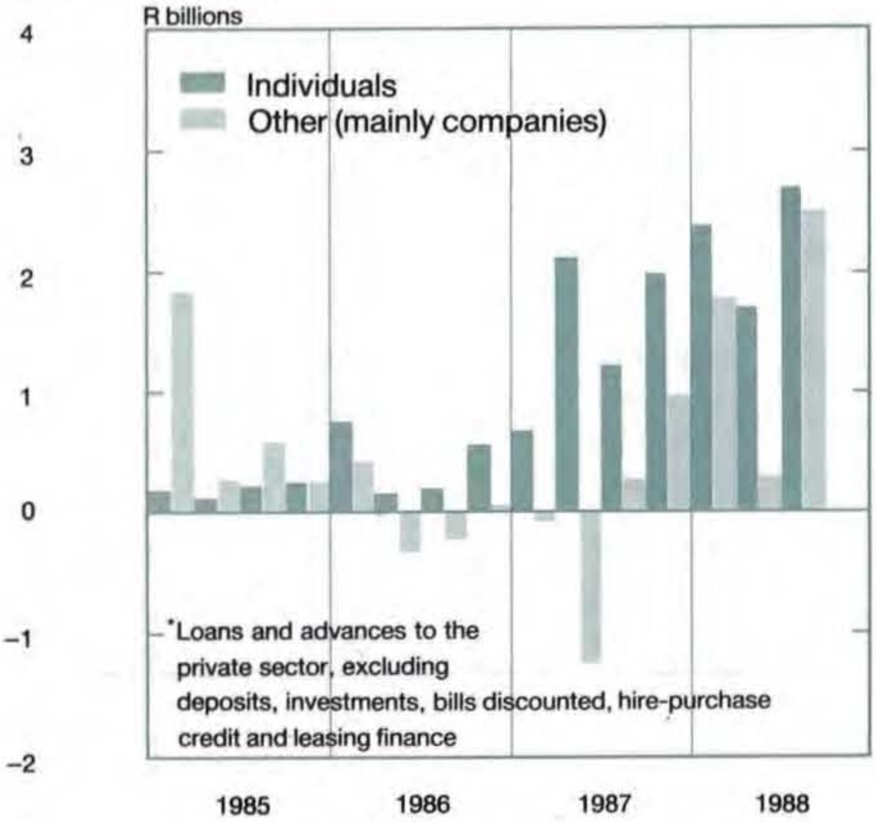
Seasonally adjusted annual rates

	Banking system %	All monetary institutions %
1987: 1st quarter	13,7	11,7
2nd quarter	2,5	9,3
3rd quarter	13,1	14,6
4th quarter	36,0	22,1
1988: 1st quarter	32,8	26,1
2nd quarter	31,0	24,1
3rd quarter	43,0	31,5

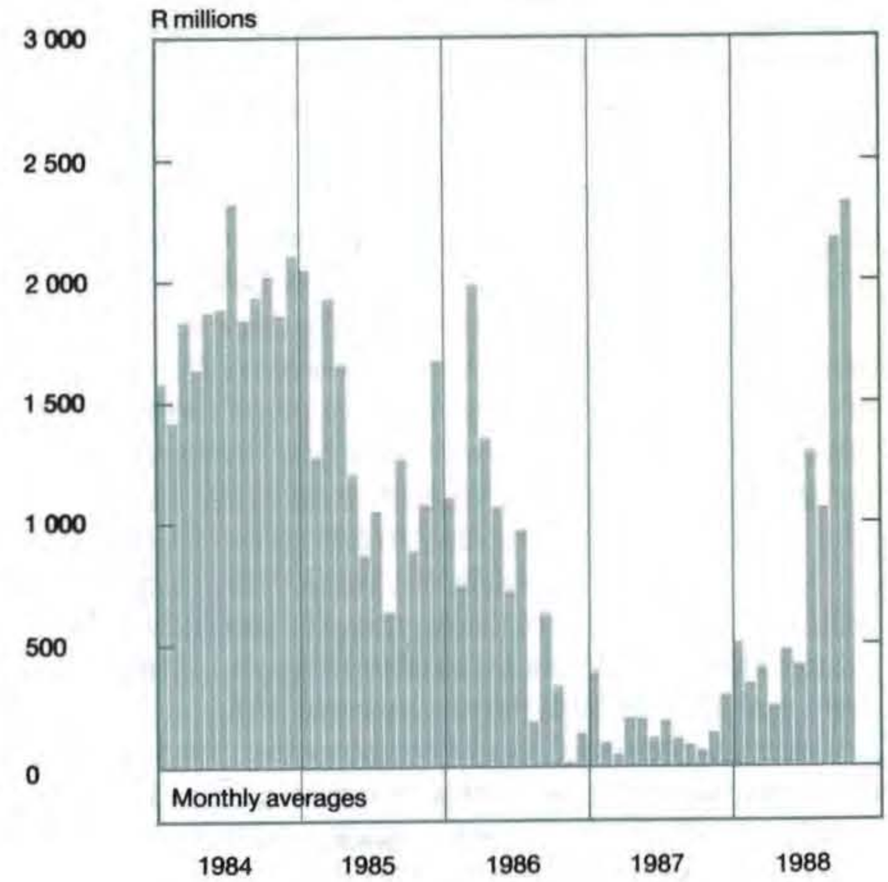
Total claims of monetary institutions on the private sector, seasonally adjusted, rose by R9,6 billion in the third quarter of 1988. Hire-purchase credit and leasing finance extended by banking institutions, reflecting *inter alia* house-holds' "pre-emptive" buying of consumer durables and the somewhat higher levels of private sector fixed investment activity, rose by R308 million in July, R472 million in August and R499 million in September; the September increase actually somewhat exceeded the earlier record increase of R490 million in March 1988. Banks' holdings of bills discounted increased by R873 million during the third quarter. Banks' "other" loans and advances rose by R5 376 million during the three months concerned.

During the twelve-month period from the end of September 1987 to the end of September 1988, banking institutions' "other" loans and advances to the non-household subsector of the private sector (i.e. mainly to companies) rose by R5,5 billion. In percentage terms, the extent of this increase (31,5 per cent) was broadly in line with the percentage increase in all *monetary* institutions' claims on the *total* private sector during this period. In contrast, banking institutions' "other" loans and advances to individuals rose by a quite remarkable R8,7 billion, or by 64,7 per cent. Banks' continuing penetration of the mortgage loan market made a substantial contribution to this increase: from the end of September 1987 to the end of September 1988 banks' aggregate mortgage loan portfolios expanded by R4,6 billion. Building societies' mortgage advances rose by a comparatively modest R3,5 billion during this period.

Changes in general advances* of banks according to type of borrowers



Accommodation at the discount window



Unexpectedly strong revenue receipts contributed to a rise in government deposits in the third quarter of 1988. Monetary institutions' net claims on the government sector accordingly decreased by R1,5 billion during this period. Net claims on the government sector at the end of September 1988 nevertheless were 28,0 per cent higher than at the end of September 1987.

Reserve Bank operations in the money market

Money market conditions tightened appreciably during the third quarter of 1988 and remained stringent during October and, to a somewhat lesser extent, also during November. This essentially reflected the impact of the twin developments of rapid domestic monetary and credit expansion on the one hand and declines in the Reserve Bank's net gold and foreign exchange reserves on the other hand. Subsidiary factors in causing money market tightness included the rising amounts of banknotes in circulation and a narrowing of the statutory definitions of cash reserves and liquid assets for banks and building societies from August 1988. In addition, the market was affected by the Reserve Bank's manifestly reduced willingness to provide assistance to the market other than at the discount window, by the rising levels of overseas interest rates from June 1988 in particular, and by the rate expectations engendered by these developments. The somewhat easier conditions experienced in November could largely be attributed to a reversal of the earlier liquidity outflow through the balance of payments.

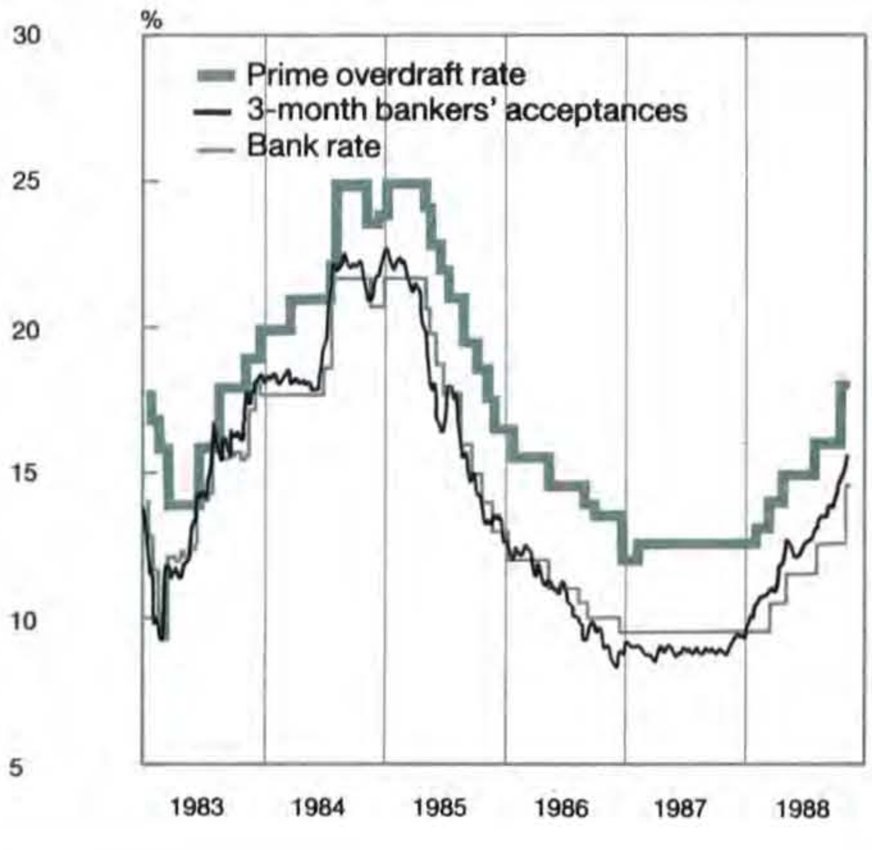
The average amount of accommodation provided at the discount window rose from R149 million in 1987 to R408 million, R364 million and R1 499 million in the first, second and third quarter of 1988. Accommodation at the window reached amounts of R2 175 million, R3 255 million, R2 723 million and R2 360 million over the month-ends of August, September, October and November 1988. Repurchase agreements to an amount of R800 million were entered into by the Reserve Bank over the August month-end. These agreements were phased out fully by 8 September.

Net sales of government stock by the Reserve Bank in the open securities markets amounted to R2,4 billion during the period July to September 1988. This could be compared with net sales of R4,7 billion during the preceding three months and with total net sales of R5,2 billion in the course of the full fiscal year 1987/88. Net sales in October and November amounted to R0,7 billion and R0,9 billion, respectively.

Money market interest rates

Money market interest rates hardened further after the Bank rate increase of 29 July 1988 as a reflection of the prevailing tightness in the money market, the sus-

Short-term interest rates



tained demand for bank credit, banks' funding difficulties, rising overseas interest rates, and the market's views concerning the policy measures that would eventually have to be taken in the light of the prevailing monetary and credit developments, the weakening of the exchange rate, and the shrinking level of the gold and other foreign reserves.

Call rates in the money market rose from an average of 13,40 per cent in August to 13,94 per cent in September and to 14,65 per cent in October. With the Reserve Bank's minimum rate for rediscounting three-month liquid bankers' acceptances for the discount houses still being held at 12,8 per cent, the market rate on these acceptances amounted to 13,5 per cent at the end of August, 13,85 per cent at the end of September and more than 14 per cent from 19 October, reaching a high point of 14,7 per cent on 29 October. Implicit in these market rates was the market's "already having discounted" an impending increase in Bank rate of up to 1½ or possibly 2 per cent.

Bank rate was raised from 12,5 to 14,5 per cent with effect from 3 November 1988. In its statement accompanying this increase the Reserve Bank noted that this step signalled a further tightening of monetary policy with the intermediate objective of reducing the prevailing excessive rates of increase in the money supply and in total spending and with the ultimate aims of countering inflation and removing the existing downward pressure on the exchange rate and the foreign reserves. Excessive increases in investment and consumption spending had been made possible by inordinate increases in the M3 money supply. Rapid monetary expansion had largely been a reflection of large increases in credit extended by banks and building societies to the private sector, which, in turn, had been made possible by the Reserve Bank's own credit creation. Curbing the Reserve Bank's creation of cash reserves for the banks and the building societies would inevitably imply at least a temporary rise in short-term interest rates. The upward adjustments to Bank rate and the Reserve Bank's set of associated refinancing rates therefore had to be regarded as both a consequence and an integral part of the further tightening of monetary policy.

Following the Bank rate increase of 3 November, the clearing banks immediately raised their prime overdraft rates by 2 percentage points to 18 per cent. A new prime rate of 17½ per cent was set by one banking institution. Rates on money market instruments also showed significant further increases. The market rate on three-month liquid bankers' acceptances hardened to 16,1 per cent on 29 November. It therefore continued to exceed appreciably the Reserve Bank's new minimum rediscount rates for liquid bankers' acceptances for the discount houses of 14,8 per cent and for the banks of 15,3 per cent.

In accordance with the generally upward trend in interest rates that had persisted after the earlier Bank rate increase of 29 July, the interest rates on certain tax-free, partially tax-free and other investments with the building societies, the Post Office and the Treasury were raised by margins ranging from ½ to 1 percentage point with effect from 1 October 1988.

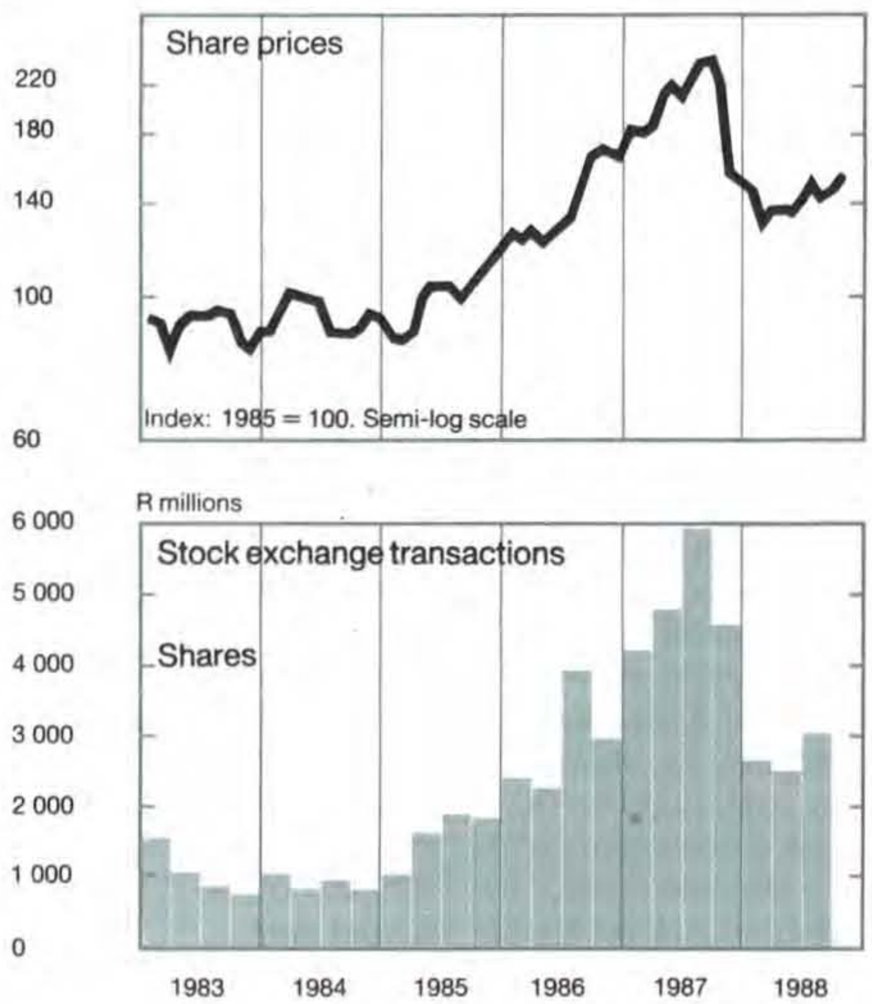
Capital market activity

Trading activity in the capital market, which had fallen off somewhat in the second quarter of 1988, picked up mildly again in the third quarter. Share prices showed a modest further recovery.

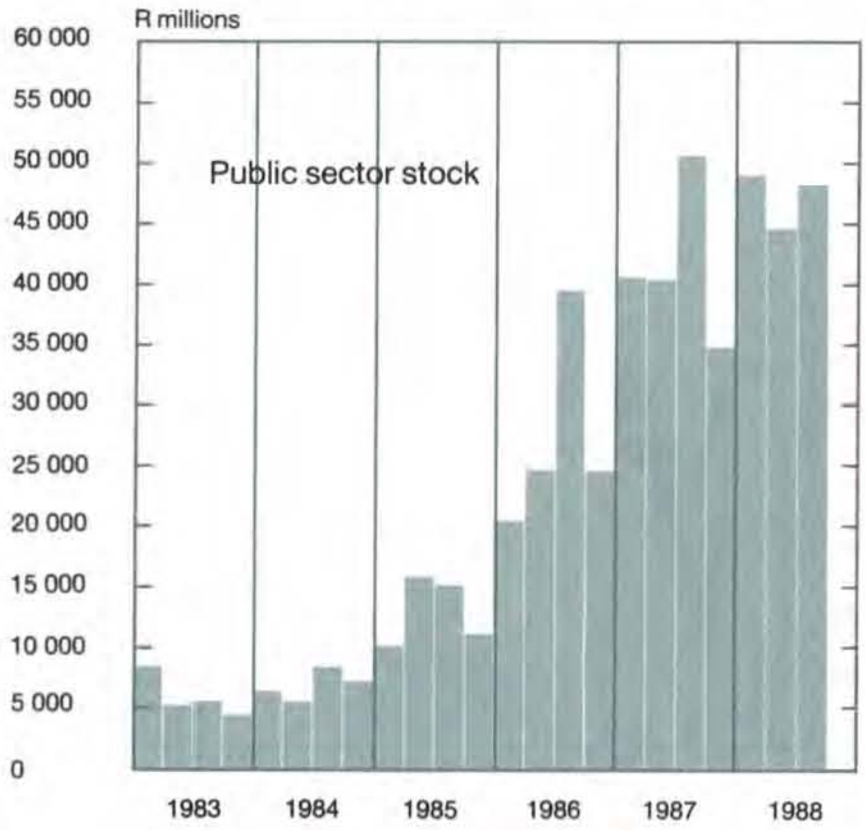
The value of public sector stock traded on the stock exchange rose moderately from R44,2 billion in the second quarter of 1988 to R47,9 billion in the third quarter. The value of real estate transactions, however, remained virtually unchanged at R4,9 billion. The level of these transactions in the third quarter of 1988 was nevertheless a substantial 26 per cent higher than in the third quarter of 1987.

The value of shares traded on the stock exchange rose from R2,5 billion in the second quarter of 1988 to R3,0 billion in the third quarter; in contrast, the quarterly turnover close to the peak of the 1985-1987 share market boom (i.e. in the September quarter of 1987) had amounted to R5,9 billion. The average level of share *prices*, although being held back by the rising trend in shorter-term interest rates and by the September decline in the dollar price of gold, nevertheless rose

Share prices and stock exchange transactions



Stock exchange transactions



by 2,9 per cent in the third quarter of 1988 after having increased by 3,9 per cent in the second quarter. In October, it rose more impressively by another 5,0 per cent.

In the primary markets, no new issues of fixed-interest-bearing securities were made by companies during the third quarter of 1988. In the second quarter of 1988 the amount of such issues was R38 million. An amount of R326 million was, however, raised by companies listed on the stock exchange through issues of ordinary shares during the third quarter. The comparable amount in the second quarter was R150 million.

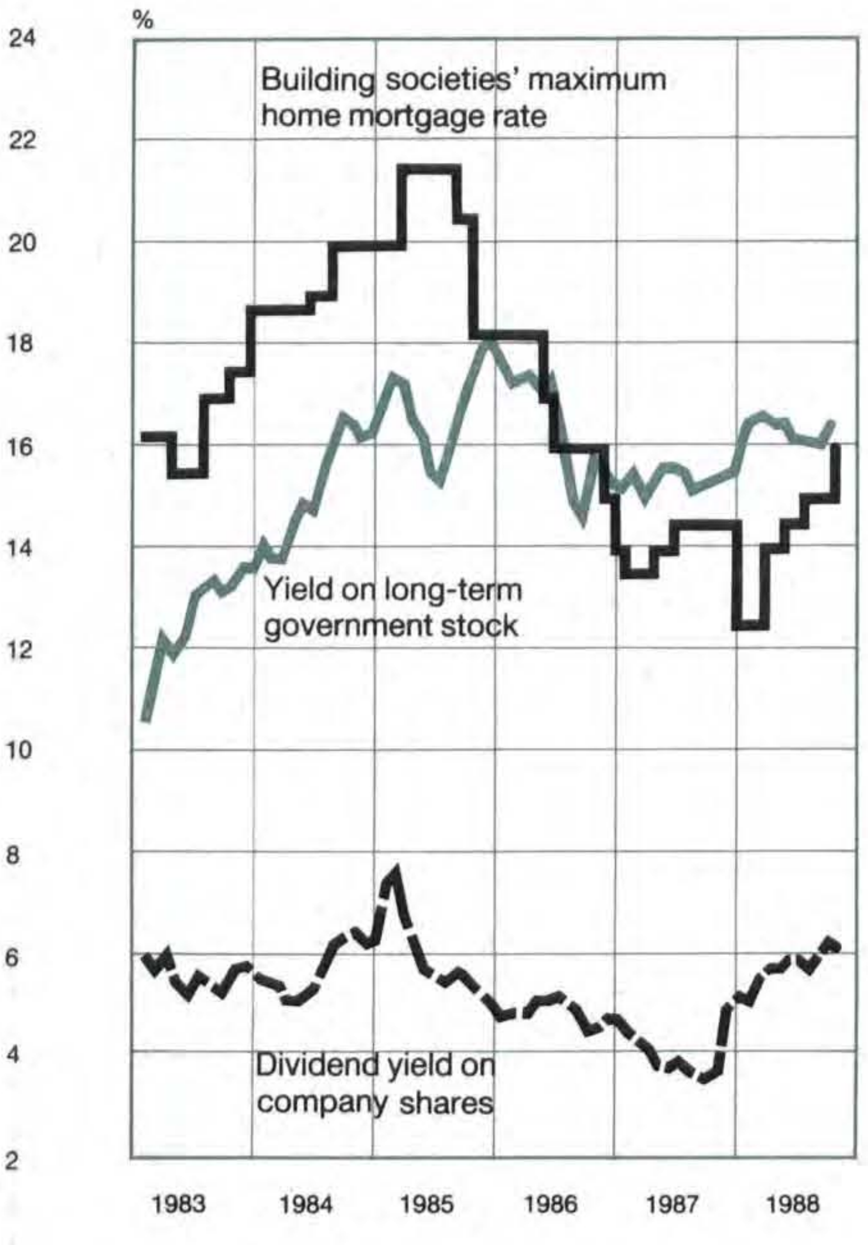
In the mortgage market, the amount of loans paid out by building societies in the third quarter of 1988 was R2,7 billion. This was slightly higher than the amount of R2,6 billion in the second quarter. Banks' total holdings of housing finance mortgages rose by R1,8 billion in the third quarter, against an increase of R1,5 billion in the second quarter. However, substantial capital redemptions arising from borrowers' switching from mortgage financing by the building societies to financing from other sources caused the mortgage holdings of building societies to increase by only R0,9 billion in the second quarter of 1988 and by R1,0 billion in the third quarter.

Long-term yields and interest rates

Long-term interest rates showed little change in the third quarter of 1988. The monthly average of the yield on long-term government stock declined marginally from 16,1 per cent at the end of the second quarter of 1988 to 16,0 per cent in September. Upward pressure exerted on this yield by the rising trend in short-term interest rates was neutralised by the market's perception of the apparently limited borrowing requirement of the Central Government and other public sector bodies, by the approximate stability of the inflation rate as measured by twelve-month changes in the consumer price index, and by a view – then still held by one school of thought among market participants – that short-term interest rates actually were about to peak and would begin to decline from late 1988 or early 1989.

During October the long-term government stock yield hardened to as much as 16,6 per cent on 26 October, as the market absorbed information concerning the lower dollar price of gold, the severe downward pressure on the foreign reserves, the increased likelihood of further upward adjustments to short-term interest rates, the less favourable outlook for inflation, and the probable widening of the Central Government's budgetary deficit because of the 15 per cent pay increase to be granted to civil servants from 1 January 1989. The monthly average long-term government stock yield during October amounted to 16,5 per cent. Following the 2 per cent increase in Bank rate

Long-term interest rates



from 3 November, this yield during the ensuing fifteen trading days was quoted at an average of 16,8 per cent.

The slow recovery of share prices and improved company results caused the dividend yield on all classes of shares to rise significantly throughout the first three quarters of 1988. The average yield on all classes of shares rose from 5,1 per cent in December 1987 to 6,3 per cent in September 1988. The more substantial rise in share prices in October then caused it to ease to 6,1 per cent.

The predominant rate on home mortgage loans extended by building societies was raised from an average of 14,5 per cent in June 1988 to 15 per cent in July and to 16 per cent in October. On 31 October and 1 November, certain major building societies announced increases of their bond rates to 16,75 and 17,25 per cent, to become effective on new bonds immediately and on existing bonds from 1 December 1988. Other societies followed soon afterwards with bond rate increases ranging from 1 to 1,25 per cent.

The predominant rates on twelve-month deposits with banks and building societies were raised in a number of steps from respectively 12 and 12,3 per cent in June 1988 to 14,5 per cent in both cases in November.

Government finance

Exchequer issues

Exchequer issues stayed within the limits implied by the March 1988 Budget proposals during the first two quarters of the 1988/89 fiscal year. The year-on-year increase in Exchequer issues to government departments (after the usual adjustment for changes in the balance on the Paymaster-General Account) rose to 16,6 per cent in the September quarter of 1988 – the second quarter of fiscal 1988/89 – after having amounted to a modest 7,2 per cent in the June quarter.

Total issues to government departments in the first half (April to September) of fiscal 1988/89 were 11,9 per cent higher than in the first half of fiscal 1987/88. During the six months to the end of September, the total year-on-year percentage increase in these issues was therefore still mildly smaller than the increase of 12,6 per cent in government expenditure that had been envisaged in the March 1988 Budget for fiscal 1988/89 as a whole. It also amounted to a slight decrease (of 0,6 per cent) in Exchequer issues in real or inflation-adjusted terms.

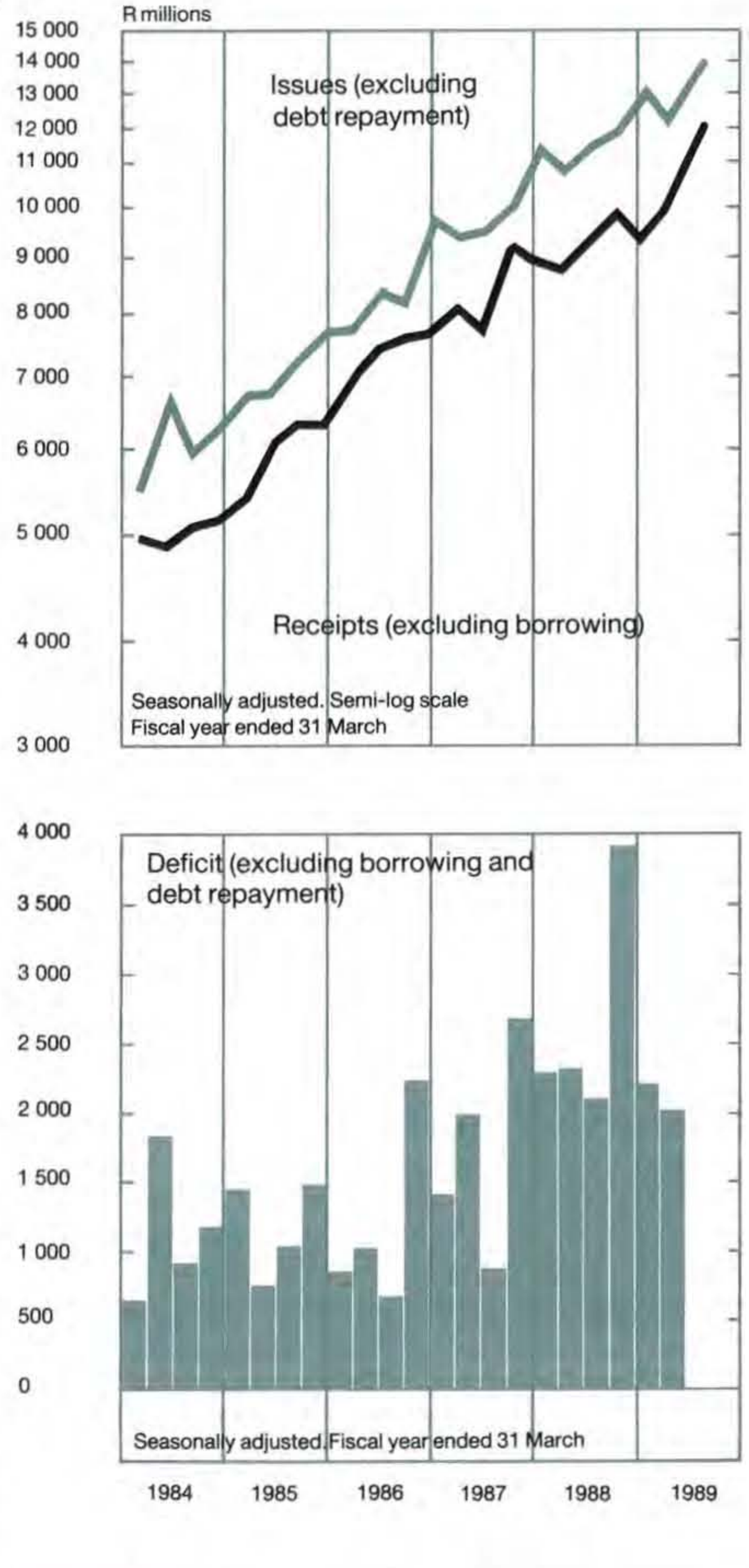
Exchequer issues in the first six months of fiscal 1988/89 were equal to 47,8 per cent of total budgeted government expenditure for the whole of the fiscal year. This may be compared with an average ratio of issues in the first half of fiscal years to budgeted expenditure for the full fiscal years amounting to 50,8 per cent in the preceding three fiscal years. On the basis of these figures, the effective stance of fiscal policy in the first six months of fiscal 1988/89 may therefore be considered to have been in general agreement with the "cautious" and "less expansionary" fiscal policy intentions of the Budget of March 1988.

In October 1988 the increase in Exchequer issues, compared with the corresponding month in the preceding year, amounted to 14,3 per cent. Total issues to government departments in the first seven months of fiscal 1988/89 accordingly were 12,2 per cent higher than in the first seven months of fiscal 1987/88. Increases in salaries and pension benefits for civil servants, which had not been provided for in the March 1988 Budget and are to become effective from 1 January 1989, were announced on 26 September 1988. In the light of these increases and of other additional government expenditure, the tempo of Exchequer issues may be expected to rise further in forthcoming months. Total Exchequer issues in fiscal 1988/89 as a whole may be expected to be appreciably in excess of the Budget estimates.

Exchequer receipts

Exchequer receipts during the first two quarters of fiscal 1988/89 were well ahead of the Budget estimates.

Exchequer account



Exchequer receipts in the June quarter and the September quarter of 1988 exceeded receipts in the June and September quarter of 1987 by 22,3 and 24,1 per cent, respectively. Total receipts in the first half of fiscal 1988/89 accordingly were 23,3 per cent higher than receipts in the first half of fiscal 1987/88. They were also an estimated R450 million higher than could be expected if the average ratio of receipts in the first half of fiscal years to receipts in full fiscal years were

Central Government receipts
Percentage increase

	Budgeted for fiscal 1988/89[1]	Realised in first half of fiscal 1988/89[2]
Customs and excise duties ..	58,5	113,0
Income tax:		
Gold mines	−18,9	−23,9
Other mines	0	−18,2
Non-mining companies	29,9	35,5
Individuals	14,2	18,5
General sales tax	14,0	20,7
Gold mining leases	−10,1	−9,4
Other receipts	1,0	0,3
Total	**16,3**	**23,3**

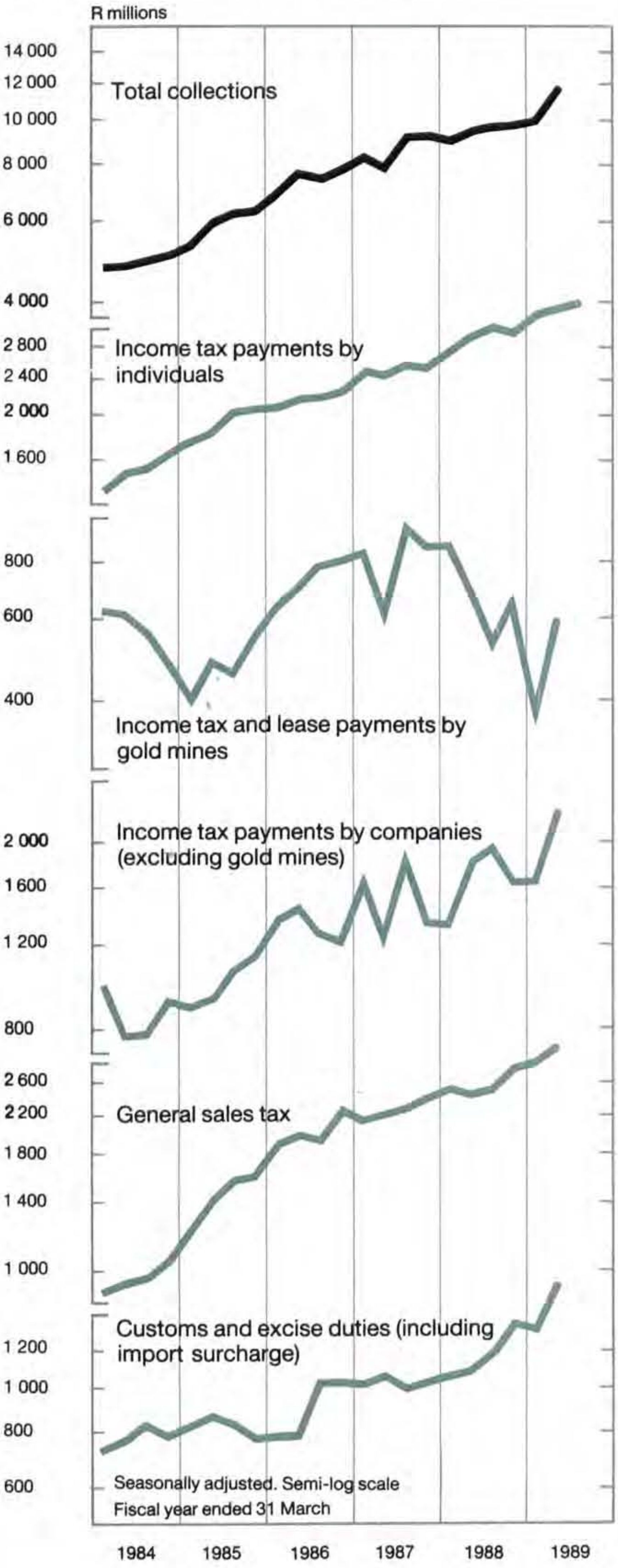
1 Budget Speech, March, 1988.
2 Compared with the first half of fiscal 1987/88.

applied to total revenue as budgeted for in the Budget of March 1988.

The rate of increase in Exchequer receipts of 23,3 per cent in the first half of fiscal 1988/89 was also well in excess of the budgeted increase of 16,3 per cent in these receipts for the fiscal year as a whole. This could mainly be attributed to increases that were higher than budgeted for in receipts from the surcharge on imports and from customs duties in general, as well as in receipts from the general sales tax (*inter alia* because of the phasing-out of the debtors' allowance on these payments) and from the minimum tax on companies (which became payable in September 1988). Total receipts in the first six months of fiscal 1988/89 were equal to 50,5 per cent of total budgeted revenue for the fiscal year as a whole. This may be compared with an average ratio of receipts in the first half of fiscal years to budgeted revenue in the full fiscal years of 47,8 per cent in the preceding three fiscal years.

The high rate of increase in Exchequer receipts accelerated further in October 1988. The rate of increase in these receipts for the first seven months of fiscal 1988/89 accordingly amounted to 28,7 per cent. Exchequer receipts for the fiscal year as a whole are also expected to exceed the Budget estimates to a significant extent.

Revenue collections – State Revenue Fund



Deficit before borrowing

The deficit before borrowing and debt repayment in the first seven months of fiscal 1988/89 was well below the deficit in the first seven months of fiscal 1987/1988. Exchequer issues somewhat below the Budget estimates and Exchequer receipts well in excess of the Budget estimates in the first seven months of fiscal 1988/89 caused the deficit before borrowing and debt repayment (excluding the discount on new issues of government stock, which amounted to R1 580 million) to be 44 per cent smaller than the deficit in the first seven months of fiscal 1987/88. At R3 436 million, the deficit in the first seven months of fiscal 1988/89 also amounted to only 35 per cent of the deficit of R9 860 million as budgeted for in March 1988 for fiscal 1988/89 as a whole.

Information available for the first six months of fiscal 1988/89 shows that the deficit of R4 953 million during this period, including the discount of R1 389 million on new government stock issues, was financed from the following sources:

	R millions
Public Investment Commissioners	3 545
Non-bank private sector	3 834
Banking sector:	
Corporation for Public Deposits	–2 360
Other banks	–44
Foreign sector	–22
	4 953
Less: discount on government stock	1 389
Total financing	3 564