Quarterly economic review

Introduction

After having grown briskly in the fourth quarter of 1987 and the first quarter of 1988, real gross domestic product in the South African economy slipped back to a considerably more subdued rate of expansion at an annualised level of approximately 1½ per cent in the second quarter of 1988. Real gross domestic expenditure, having increased strongly in the first quarter of 1988, showed almost no further change in the second quarter. Real gross *national* product, however, still advanced further at an annualised rate of 3½ per cent in the second quarter after having reached a rate of 5½ per cent in the first quarter. It thereby strengthened the additions of the preceding three quarters to gross national product *per capita*.

The slowing down of growth in both real gross domestic product and real gross domestic expenditure in the second quarter of 1988 was likely to have signified a levelling-out of the current upswing. A waning of the pressures of domestic monetary demand in the second and the early third quarter of 1988 was also apparent from a marginal decline in import volumes in the second quarter and from a significantly larger decline in real imports in July. More generally, a fading-away of the upward momentum of economic activity and domestic demand in the middle quarters of 1988 would not be at variance with the behaviour of the composite index of leading business cycle indicators (which has been on a gradual downward path since September 1987), and would bear out reports of a slight loss of buoyancy in the prevailing business mood.

Special and non-cyclical factors, however, undoubtedly contributed to the less vigorous growth performance of the economy in the second quarter, which was largely due to declines in real value added in agriculture and in manufacturing industry. Agricultural output was held back by a smaller than expected maize crop. Production levels in manufacturing, more than production levels in other sectors, were affected adversely in the second quarter of 1988 - as in the second quarter of 1987, although generally not to the same extent – by stay-aways, strikes and the large number of public holidays.

The levelling-off of aggregate real gross domestic expenditure in the second quarter of 1988 was mostly a matter of a decline in real government consumption expenditure, a marginal slow-down in the rate of increase in real gross domestic fixed investment, and a significantly smaller net addition to total real inventories. Cutbacks in real government outlays on goods and non-labour services accorded well with the Government's declared intention of reducing the relative importance of government spending in the national economy, but, by their nature, were essentially unrelated to spontaneous cyclical developments.

Firm growth, on the other hand, was maintained in real private consumption expenditure, which during the second quarter of 1988 rose at an annualised rate of 4½ per cent. Increases in consumer expenditure in the second quarter and in wholesale and retail sales in July are, however, likely to have contained significant amounts of pre-emptive buying in anticipation of price increases, a tightening of hire-purchase conditions, higher interest rates, or a possible increase in the surcharge on imported goods. Retail sales in August also reflected attempts to "beat" price increases arising from the imposition of the new system of differentiated import surcharges, which became effective from 15 August. This will probably also have affected banks' extension of hire-purchase credit, personal loans and other forms of consumer credit during that month.

A more fundamental weakening of the forces driving the upswing was, however, to be expected for various reasons. Firstly, although *nominal* interest rates have generally been rising only since late 1987, *real* interest rates – although still at only moderately positive levels in the third quarter of 1988 – have already been increasing since late 1986 or early 1987, as the decline in the inflation rates through the greater part of 1987 outpaced the slight further declines or reductions in most nominal interest rates. Given the fact that inflation *expectations* cannot readily be measured, the exact extent of this rise in real interest rates is a matter of estimation. It would, however, have been substantial on any reckoning and, in the case of the "real" prime rate on the clearing banks' overdraft facilities, may have been of the order of 8 percentage points.

Secondly, the volume of South African exports has generally been on a downward trend from the high point in the exportation cycle in the third quarter of 1986. Conversely, the volume of South African imports has been on an upward trend from its cyclical low point in the second quarter of 1986. In the course of the seven quarters from the end of the third quarter of 1986 to the middle of 1988, the diminishing excess of real exports of goods and non-factor services over real imports of goods and non-factor services (i.e. South Africa's shrinking "net foreign balance") contributed a negative 2 percentage points to growth in the South African real gross domestic product.

Thirdly, allowing for the normal lags in effect of most policy measures, a substantial if not the greater part of the impact of the Bank rate increases and associated changes in monetary policy of 9 March, 5 May and 29 July 1988, of the packages of fiscal, credit and import-restraining measures of May and August 1988, and of the changes in income tax legislation of 15 July 1988, still has to assert itself.

Finally, the rise in real private consumption expenditure (which amounted to an average annual rate of nearly 4 per cent from its start in the second quarter of 1986 to the second quarter of 1988, and has come to rely increasingly on consumer credit) will not be able to maintain itself indefinitely at its recent levels in the face of a less than fully commensurate rate of increase in real personal disposable income.

Merchandise imports in the second quarter of 1988 showed only a limited further increase in value terms; merchandise exports strengthened quite significantly. As a result, the small deficit on the current account of the balance of payments in the first quarter of 1988 was reconverted into a small surplus (at a seasonally adjusted and annualised rate of close to R1 billion) in the second quarter. A reappearance of leads and lags in international payments and receipts, rising interest rates in several major overseas economies since June 1988 in particular, and half-yearly lump sum repayments on foreign debts in terms of the Second Interim Arrangements with foreign creditor banks on 15 June, were responsible, however, for a marked worsening of the outflow of foreign capital in the second quarter of 1988 from its fairly modest average level in the preceding five quarters. The gold and other foreign reserves consequently showed a major decline in the second quarter and continued to do so in July and August, although by proportionally much smaller amounts.

Weakening of the exchange rate of the rand from the second week in January 1988 caused an abrupt and very sharp reacceleration of the rise in prices of imported goods from the second quarter of 1988. This was a major factor in explaining the renewed upward movement of the quarter-to-quarter and twelve-month rates of increase in production prices in the first two quarters of 1988 and also contributed to the reversal of the decline in the quarter-to-quarter rate of increase in consumer prices in the second quarter. This will almost certainly be followed in the remainder of 1988 by higher levels of the twelve-month rate of increase in the consumer price index, which stood at 12,4 per cent in both June and July. A once for all effect on the general level of consumer prices also stands to be exerted by the increases in surcharges on imports from 15 August and by the petrol and related fuel price increases from 1 September.

High rates of increase were still recorded in the M3 money supply and in monetary institutions' claims on the private sector in the second quarter and in July. The pattern of statistical causes of changes in M3 since September 1987 – i.e. rapid increases in domestic credit extension in combination with declines in the net foreign reserves of the monetary system – has traditionally been symptomatic of the advanced stages of cyclical upswings and the earlier stages of cyclical downswings. M3 at R105,5 billion at the end of July 1988 was R4,5 billion or 4,4 per cent above the upper boundary of the 1988 target tunnel and broadly equal to the figure of R105,0 billion that, in terms of the monetary target for 1988, was to be aimed at as the average amount of M3 in the fourth quarter of the year.

In its statement accompanying the Bank rate increase of 29 July 1988 (by which Bank rate was raised to 12½ per cent), the Reserve Bank reaffirmed its intention of curbing its own credit creation with a view to bringing down the rates of increase in bank credit and the money supply. At its annual general meeting of stockholders in late August 1988, however, the Bank made clear that it did not intend to force M3 back into the tunnel in the remainder of 1988, since the steps that would be required to attain this result might have undue contractionary effects on the economy.

Trading activity in the capital market, having recovered slightly in the first quarter of 1988, slipped back to somewhat lower levels again in the second quarter. New-issue activity in the primary market, however, was somewhat higher than in the preceding three months. The fixed property market witnessed a moderate further rise in real estate transactions and a further increase in mortgage lending by banks in particular.

In the area of fiscal policy and government finance, various steps for a further fiscal de-stimulation of domestic monetary demand were contained in the "packages" of fiscal, monetary, credit and import-restraining measures of 4 May and July-August 1988. A number of changes in income tax legislation, which were aimed at increased standardisation of the tax system and at a dismantling of certain tax shelters, were gazetted on 15 July. In harmony with the authorities' more cautious and less expansionary fiscal policy intentions, the rate of increase in Exchequer issues in the first four months of fiscal 1988/89 was markedly lower, and the rate of increase in Exchequer receipts markedly higher, than envisaged in the March 1988 Budget for the fiscal year as a whole. The deficit before borrowing in this period accordingly amounted to only 38 per cent of the budgeted deficit for the full fiscal year, against 59 per cent in the corresponding period in fiscal 1987/88.

The cumulative longer-term effects of rising *real* interest rates from late 1986 and of rising nominal interest rates from late 1987, of the packages of demand-restraining measures of May and August 1988, and of the less expansionary stance of fiscal policy in general, may – after the occasionally perverse announcement and impact effects of these measures have worked themselves out – ensure a gradual contraction of domestic monetary demand to levels that are in keeping with the present supply capabilities of the South African economy and the need for re-estabilishing and preserving a minimum current account surplus. The resultant environment of restrained domestic demand should then be utilised for effecting structural adjustments and for working towards appropriate values of key macro-economic variables (such as the level of real interest rates, the real exchange rate, tax rates and real wages) that will be conducive to intensified saving, investment and export performances, enhanced production capabilities, and rising levels of the real growth rate and welfare in the South African economy.

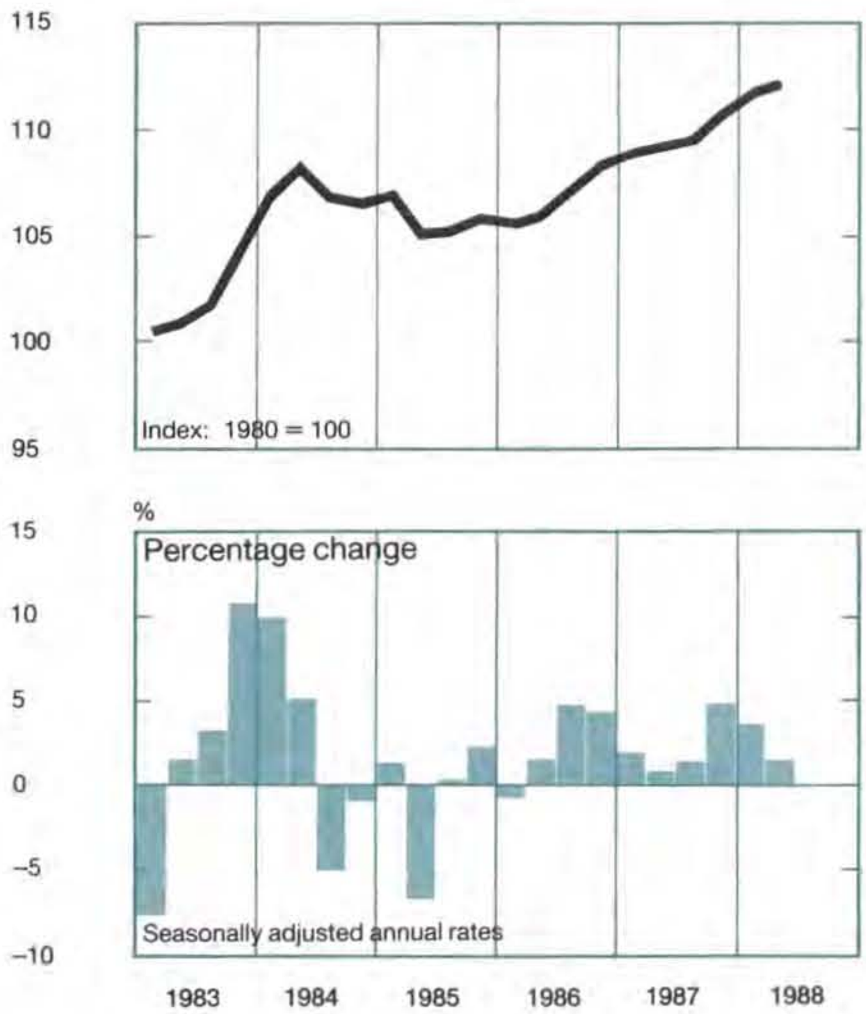
Domestic economic developments

Domestic output

Real gross domestic product in the South African economy grew relatively briskly at seasonally adjusted annual rates of nearly 5 per cent in the fourth quarter of 1987 and of slightly more than 3½ per cent (revised downwards from close to 4 per cent) in the first quarter of 1988, but sank back to a considerably more moderate pace of expansion at a provisionally estimated annual rate of only about 1½ per cent in the second quarter of 1988. Real gross domestic product in the second quarter and in the first half of 1988 nevertheless still exceeded their 1987 counterparts by nearly 3 per cent and by rather more than 2½ per cent, respectively. The annualised rate of growth from the second half of 1987 to the first half of 1988 amounted to nearly 3½ per cent.

The renewed slowing down of real output growth in the second quarter of 1988 could mainly be attributed to actual *declines* in real value added in agriculture and manufacturing and – despite marginally higher output levels in construction – also in the secondary sectors in

Real gross domestic product



general. Among the tertiary sectors, a significant further increase in real value added was shown by the sector commerce as a reflection of buoyant conditions in retail trade and a strong demand for new motor vehicles; only marginal output increments were recorded, however, by the sectors transport, finance and general government. A marked recovery, on the other hand, was shown by real value added in the mining sector, after a decline in mining production in the first quarter of 1988. Largely because of this improved performance of the mining industry, the seasonally adjusted annual rate of increase in total *non-agricultural* production in the second quarter of 1988 still amounted to nearly 2 per cent.

Agricultural production in the second quarter of 1988 was held back by the disappointing maize crop of the 1987/88 season which, according to preliminary estimates, will not match the harvest of 1986/87. Real value added in agriculture was also adversely affected by a strong rise in the relative cost of agricultural inputs. Real expenditure on intermediate goods and services in agriculture in the second quarter of 1988, compared with the second quarter of 1987, showed an increase of more than 40 per cent.

Declines in real output in manufacturing were recorded in the sub-sectors basic metals, machinery and transport equipment in particular. These and similarly placed industries were affected adversely to an above-average degree by interruptions of their production processes as a result of labour strikes, stay-aways and the large number of public holidays in the second quarter of the year. Mainly because of lower output levels in manufacturing, real value added in the secondary sectors in the second quarter of 1988 contracted at a seasonally adjusted annual rate of as much as 6 per cent. Aggregate real output of the secondary sectors in the first quarter and in the first half of 1988 nevertheless still exceeded their levels of the preceding year by more than 3½ per cent and by 4½ per cent, respectively.

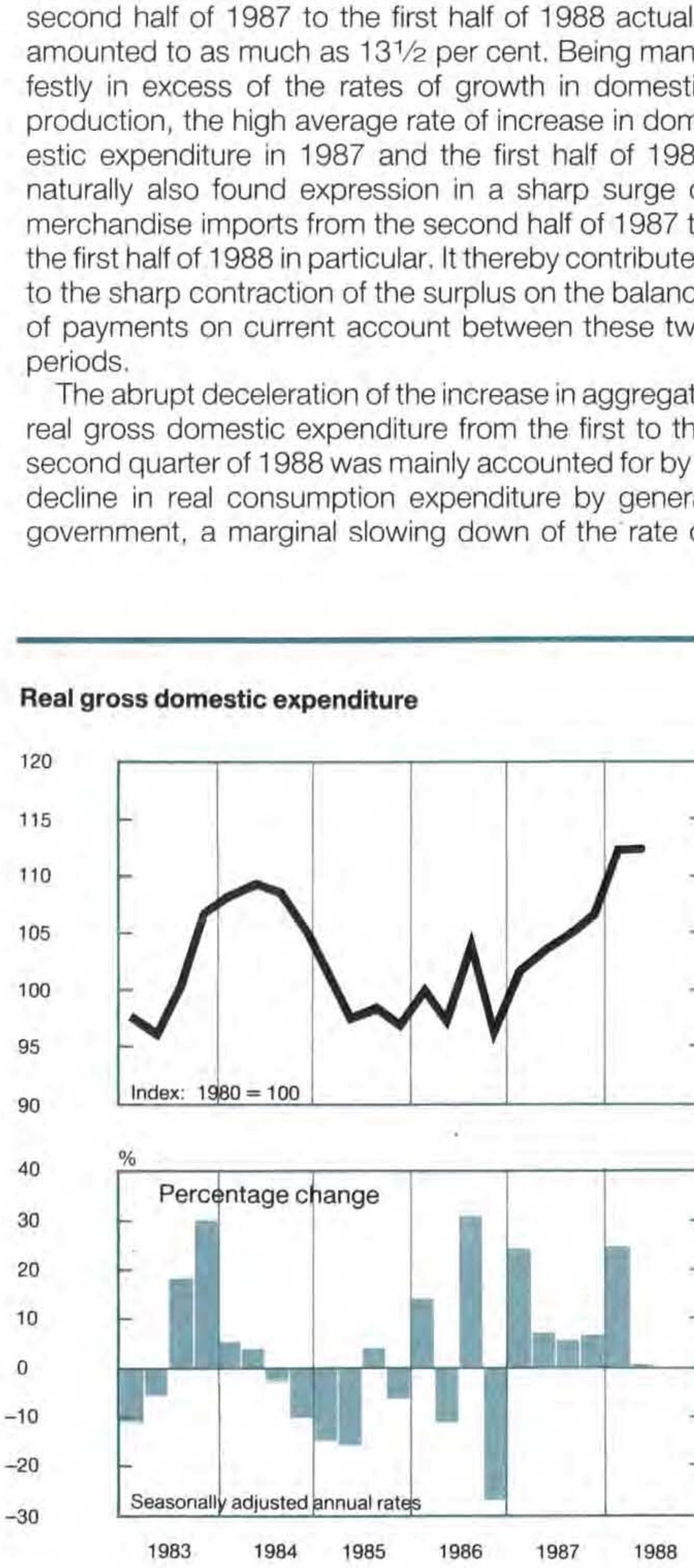
Aggregate real gross *national* product grew at a seasonally adjusted annual rate of 5½ per cent in the first quarter of 1988 and of 3½ per cent in the second quarter. Substantially faster growth in real gross national product than in real gross domestic product – which could be attributed to a sustained improvement in the terms of trade as well as to a decline in net South African factor payments to the rest of the world – caused real gross national product per head of the South African population to advance quite impressively by approximately 3 per cent during the four-quarter period from the third quarter of 1987 to the second quarter of 1988. This compared favourably with an increase in real gross national product *per capita* of 1½ per cent in the calendar year 1987, and with declines of 3½ per cent and 1 per cent in the calendar years 1985 and 1986.

Domestic expenditure

Aggregate real gross domestic expenditure rose very strongly in the first quarter of 1988 but advanced only marginally further in the second quarter. Aggregate real gross domestic expenditure in the first quarter, the second quarter and the first half of 1988 accordingly exceeded aggregate expenditure in the corresponding periods of 1987 by approximately 10½ per cent, 9 per cent and nearly 10 per cent. The annualised rate of increase in total real gross domestic spending from the second half of 1987 to the first half of 1988 actually amounted to as much as 13½ per cent. Being manifestly in excess of the rates of growth in domestic production, the high average rate of increase in domestic expenditure in 1987 and the first half of 1988 naturally also found expression in a sharp surge of merchandise imports from the second half of 1987 to the first half of 1988 in particular. It thereby contributed to the sharp contraction of the surplus on the balance of payments on current account between these two periods.

The abrupt deceleration of the increase in aggregate real gross domestic expenditure from the first to the second quarter of 1988 was mainly accounted for by a decline in real consumption expenditure by general government, a marginal slowing down of the rate of

Real gross domestic expenditure

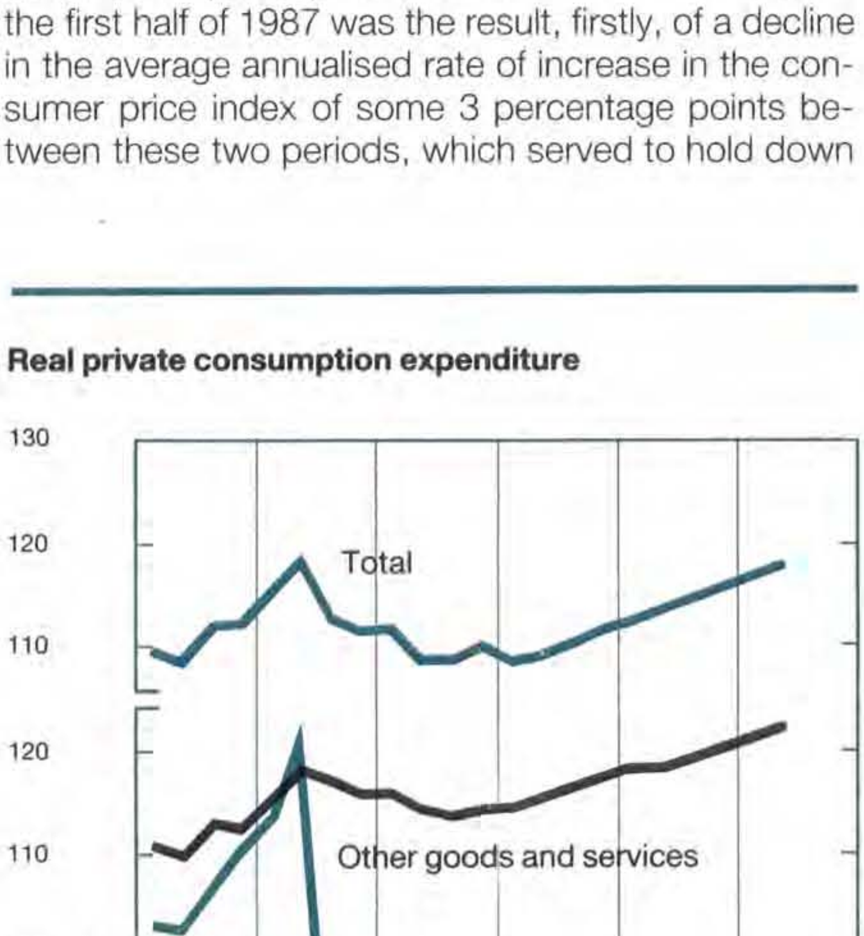


increase in real gross domestic fixed investment, and a significantly smaller net addition to total real inventories.

Total *real private consumption expenditure* continued to rise in the second quarter of 1988 for the ninth consecutive quarter. The seasonally adjusted and annualised rate of increase in real private consumption expenditure in the second quarter of 1988 amounted to nearly 4½ per cent; its level in this quarter was some 4 per cent higher than in the second quarter of 1987 and some 8 per cent higher than in the second quarter of 1986.

Continued steady expansion of total real private consumption expenditure in the first half of 1988 was supported by further increases in aggregate real personal disposable income, which during this period grew at a seasonally adjusted annual rate of 3½ per cent. Real personal disposable income *per capita* rose slightly in 1987 and the first half of 1988 after having declined significantly (by 4½ and 6 per cent) in 1985 and 1986. The somewhat higher level of real disposable income *per capita* in the first half of 1988 than in the first half of 1987 was the result, firstly, of a decline in the average annualised rate of increase in the consumer price index of some 3 percentage points between these two periods, which served to hold down the erosion-through-inflation of the purchasing power of nominal wages. Secondly, total nominal wage payments (or the total wage "bill") in the first half of 1988, although being held back by more moderate rates of nominal wage increases in the first quarter, were strengthened significantly by the markedly lower number of labour strikes and of man-days lost because of such strikes during this period than in the first half of the preceding year.

Real private consumption expenditure



Major increases continued to be recorded in private sector expenditure on durable and semi-durable goods. Having increased at seasonally adjusted and annualised rates of 12 per cent in the fourth quarter of 1987 and 13 per cent in the first quarter of 1988, real private expenditure on consumer durables (notably personal transport equipment and furniture and household equipment) rose further at an annualised rate of 9 per cent in the second quarter of 1988. Apart from the average household's slightly more comfortable real income position and the gradual strengthening of consumer "confidence", purchases of consumer durables in recent quarters may also have been stimulated somewhat by financial institutions' intensive marketing of consumer credit facilities. In the second quarter of 1988 such purchases also appear to have contained a significant quantity of "pre-emptive" buying in anticipation of price increases, an expected tightening of hire-purchase and related credit conditions, higher interest rates, or curbs on the importation of certain consumer goods. At the same time the slump in equity values on the Johannesburg Stock Exchange in October – November 1987 and the subsequent dull behaviour of share prices through the first eight months of 1988 apparently continued to have little effect on private households' consumption propensities.

Private sector spending on semi-durables rose at annualised rates of 6½ and 6 per cent in the fourth quarter of 1987 and the first quarter of 1988 respectively, and at an accelerated rate of more than 7 per cent in the second quarter of 1988. Real expenditure on non-durable goods and on consumer services in the second quarter of 1988 rose at annualised rates of 4 per cent and 2 per cent.

Real government consumption expenditure rose sharply in the final two quarters of fiscal 1987/88 (i.e. in the fourth quarter of calendar 1987 and the first quarter of calendar 1988), but decreased in the first quarter of fiscal 1988/89 at an annualised rate of 13½ per cent. This decline in government spending was the result of major cutbacks in real government outlays on goods and non-labour services which accorded well with the Government's declared intention of reducing the relative importance of government spending in the national economy. Government spending on real salaries and wages reflected the general absence of any significant increase in government employment levels. It increased only marginally in the second quarter of 1988 at an annualised rate of ½ per cent.

Aggregate *real gross domestic fixed investment*, which had started to recover cautiously from a lower turning point in the second quarter of 1987, showed fairly significant further increases in both the first and the second quarter of 1988. The level of total real gross fixed investment still remained low, however, in comparison with the early 1980s. It had amounted to 27½ per cent of real gross domestic product in the calendar year 1982, but reached a level of only 18½ per cent in calendar 1987. It then recovered to slightly more than 19 per cent in the first half of 1988.

Real gross fixed investment in the private sector showed a modest revival from the second half of 1986. The mild further acceleration of this revival in the course of 1987 was sustained into the first half of 1988. Major contributions to the further rise in real fixed capital expenditure by the private sector in the second quarter of 1988 – which was broadly based, both as regards its sectoral origins and as regards the various types of capital assets – were made by manufacturing industry, commerce and finance. The annualised rate of increase in real outlays on private residential buildings accelerated significantly from 4 per cent to 6½ per cent from the first to the second quarter of 1988.

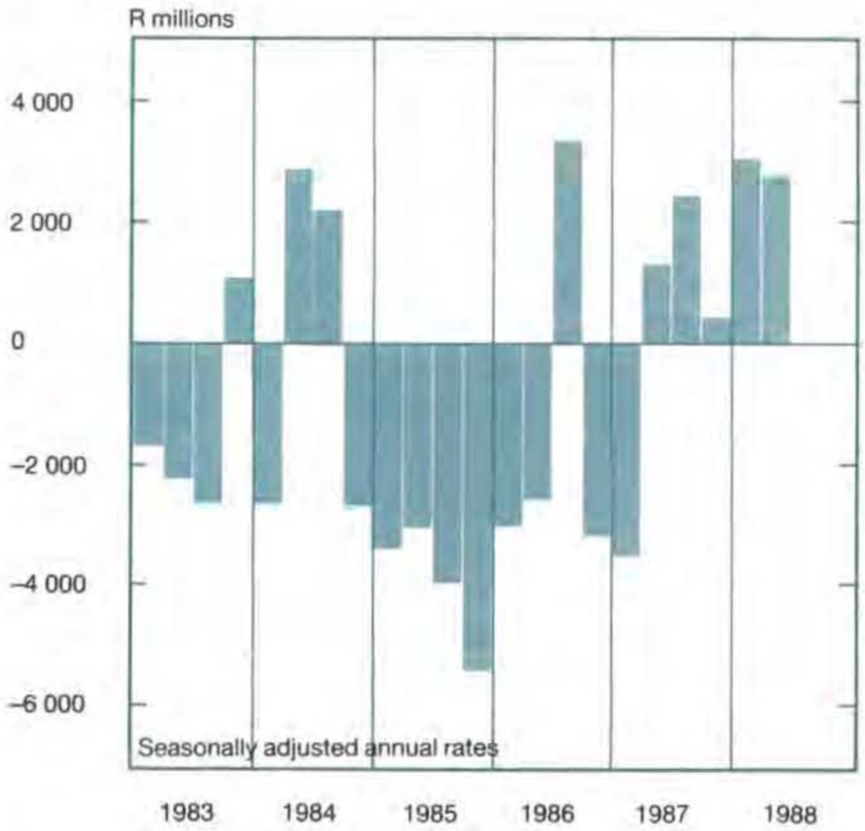
Real gross fixed investment by *public corporations* decreased further in the second quarter of 1988. Real fixed capital formation by public corporations in the manufacturing sector declined markedly; an increase was shown, however, by capital spending for the generation of electricity. Aggregate real fixed investment by all public corporations in the second quarter of 1988 contracted at an annualised rate of 12½ per cent.

A continued decline in real gross fixed capital spending by *public authorities* resulted from further reductions in capital spending by the South African Transport Services and the Department of Posts and Telecommunications as well as by general government departments.

A build-up of aggregate *real inventories* was recorded in the second quarter of 1988 for the fifth consecutive quarter. Significant increases in real inventories were shown by the mining sector, by private manufacturing industry, and by wholesale and retail trade. Inventories were drawn down further, however, in the motor trade. This was a reflection of a sustained strong demand for cars and commercial vehicles in the first and second quarters of 1988, which was based *inter alia* on fleet owners' replacement demand, the buoyancy of the car-rental market, the popularity of leasing agreements as a financing technique, the flourishing Black taxi and mini-bus transport industry, and fears of impending price increases because of the declining exchange value of the rand.

Stocks-in-trade in the diamond industry, which had shrunk in the first quarter of 1988 as a result of increased selling activity in the world diamond markets, were drawn down further in the second quarter. Increases in industrial and commercial inventories partly represented a not unusual delayed cyclical response to increased turnovers and higher levels of domestic monetary demand. However, a part of these inventory accretions undoubtedly also consisted of pre-emptive stockpiling of imported goods in particular, which derived from fears of increases in the prices of such goods because of the weakening of the exchange rate and from business firms' concerns about a possible intensification of anti-South African sanctions, a raising of customs duties, an increase in the import surcharge, or a reimposition of quantitative import controls. Accumulation of real industrial and commercial inventories caused the ratio of these inventories to real gross domestic product to rise mildly from an average of 19 per cent in 1987 to nearly 20 per cent in the first half of 1988.

Change in real inventories



Factor income and saving

The rate of increase in aggregate nominal factor income, seasonally adjusted and annualised, was marginally lower in the second quarter of 1988 than in the first quarter, mainly because of a lower rate of growth in the aggregate operating surpluses of business enterprises. The year-on-year increase in total nominal factor incomes in the second quarter of 1988, at 17½ per cent, nevertheless was marginally higher than the rate of 17 per cent which applied in both the first quarter and the first half of 1988.

The remuneration of employees, which accounted for approximately 57 per cent of total gross value added, rose at an annualised rate of 16 per cent in the second quarter of 1988, compared with 14½ per cent in the first quarter and 18½ per cent in calendar 1987. The increase in the second quarter of 1988 mainly resulted from higher wage bills in the mining sector, in manufacturing, in electricity, gas and water, and in finance. The year-on-year increase in total remuneration of employees in the second quarter of 1988 amounted to 19 per cent, against approximately 18½ per cent in both the first quarter and the first half of 1988.

The rise in aggregate nominal labour remuneration in the second quarter of 1988 was influenced upwards by various developments. Firstly, preliminary data indicate some mild further increases in employment in certain sectors (construction and electricity generation) during this quarter, as well as in overtime ratios in various sectors. Secondly, the number of man-days lost in this quarter on account of strikes and stay-aways was substantially smaller than in the second quarter of 1987. Finally, enhanced moderation in labour unions' initial *demands* for wage and salary increases allowed settlements to be reached at relatively early stages in the wage negotiating process.

Aggregate gross operating surpluses, which make up the remainder of aggregate nominal factor income, rose somewhat more slowly in the second quarter of 1988 than in the preceding quarter. However, the year-on-year increase in the total gross operating surplus still amounted to nearly 15½ per cent in both the first and the second quarter of 1988.

Substantial increases in operating surpluses were recorded in mining, manufacturing, construction and commerce in particular. Operating surpluses in the mining sector, which had fared poorly in 1987, were boosted by increased labour tranquility in the mining industry, the strongly rising prices of various minerals in the international commodity markets, and the depreciation of the exchange rate of the rand from the second week of January 1988 onwards. Other sectors benefited from high levels of domestic demand in the first half of 1988 and from an improvement in real export performances and nominal export earnings in the second quarter. The deceleration of the rate of increase in total gross operating surpluses from the first to the second quarter of 1988 therefore was mainly due to a significant decline in the gross operating surplus in agriculture. Little change was shown by the gross operating surpluses of the financial services sector.

Gross domestic saving increased slightly from 22½ per cent of so-called gross national disposable income[1] in the first quarter of 1988 to 23 per cent in the second quarter. Given the advanced stage of the economic upswing, the recent values of this ratio compared well with its average level of 24½ per cent since 1982, which, in turn, compares favourably with the savings rates in many rapidly growing economies.

Relative to gross domestic investment, gross domestic saving recovered mildly from 99 per cent in the first quarter of 1988 to 102½ per cent in the second quarter. The slight "excess" of gross domestic saving over gross domestic investment in the second quarter of 1988 helped to provide the wherewithal for financing the relatively heavy outflow of capital on the balance of payments during that period. The balance of *net* domestic saving (after providing for depreciation allowances *and* for the outflow of capital to the rest of the world) amounted to 26 per cent of *gross* domestic saving in the first *half* of 1988, having increased from a low point of only 1 per cent in the second quarter of 1987.

The slight increase in gross domestic saving during the second quarter of 1988 could mainly be attributed to a marginal increase in net corporate saving and to a decline in net *dis*saving by general government as a reflection of the decrease in real government consumption expenditure. Net personal saving remained at a low level which in the second quarter of 1988 was equal to approximately 2 per cent of personal disposable income. Gross "*private*" saving, comprising both gross corporate saving and gross personal saving, increased at an annualised rate of 14 per cent from the second half of 1987 to the first half of 1988, and also displayed an actual long-term strengthening from 21 per cent of gross national disposable income in 1982 to 22 per cent in the first half of 1988.

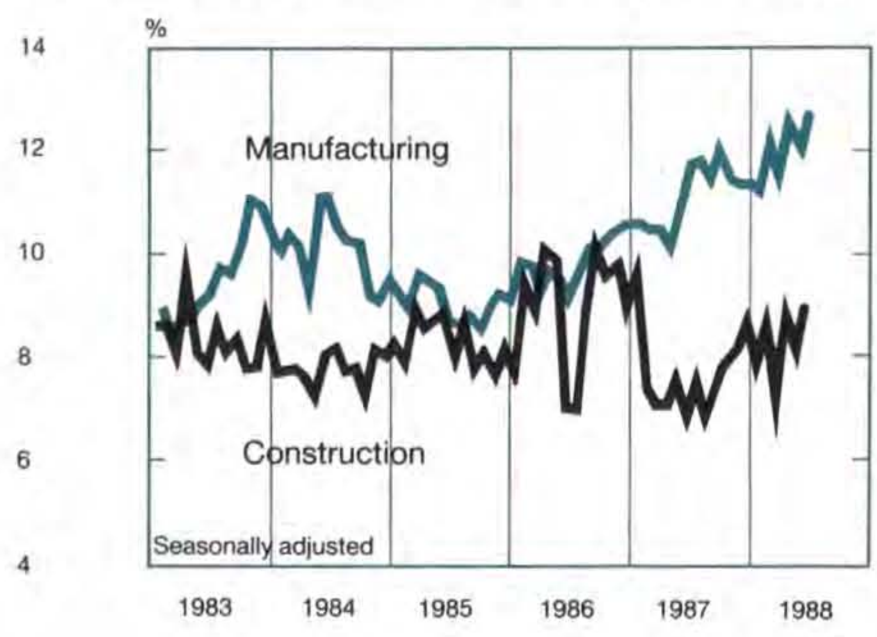
Employment

Having increased by only 0,3 per cent in 1986 and by 0,9 per cent in 1987, total employment in the non-agricultural sectors of the economy was some 1,1 per cent higher in the first quarter of 1988 than in the first quarter of 1987. On a shorter-term basis, however, the seasonally adjusted annual rate of increase in total non-agricultural employment from the fourth quarter of 1987 to the first quarter of 1988 amounted to a somewhat more impressive 1,9 per cent. This rate of increase was made up of seasonally adjusted annual rates of increase of 0,7 per cent in employment by public authorities and of 2,5 per cent in employment in the private sector; in the past six to eight years, rates of increase in private sector employment in excess of rates of increase in employment by public authorities have occurred only infrequently.

Increases in employment in the first quarter of 1988 were recorded in all sub-sectors of the private sector with the exception of the hotel industry. Information for the second quarter of 1988 shows employment to have advanced further in the construction industry and

[1] Gross national disposable income = gross national income adjusted for net current transfers received from the rest of the world.

Overtime hours as percentage of ordinary hours worked



in electricity generation but to have contracted in the manufacturing sector.

Some further cyclical strengthening of the demand for labour was more clearly apparent from increases in overtime ratios. In construction the ratio of overtime to ordinary hours worked rose from an average of 7,7 per cent in calendar 1987 and the first quarter of 1988, to 8,7 per cent in the second quarter of 1988. In manufacturing this ratio continued to rise further from its lower turning point of 8,5 per cent in the third quarter of 1985 to 12,5 per cent in the second quarter of 1988 – its highest value in the course of the current upswing to date. More intensive use of labour complements in manufacturing industry therefore compensated partly for the decline in total numbers employed in this sector in the second quarter of 1988.

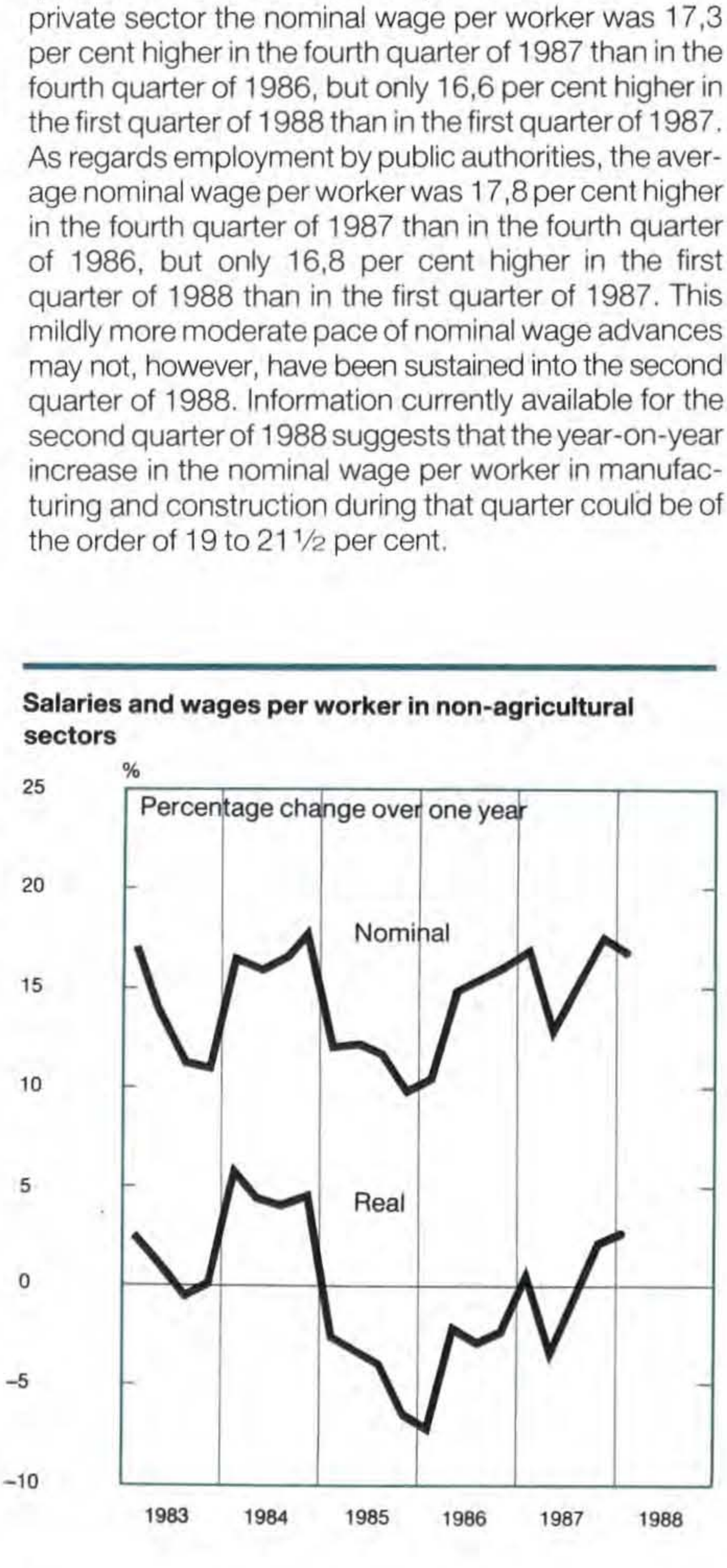
The slow-down in aggregate real output growth in the second quarter of 1988 did not stand in the way of a significant further contraction of the seasonally adjusted number of registered unemployed workers in the White, Coloured and Asian population groups from its high point of 82 500 in August 1986 and from 60 300 in March 1988 to 58 800 in April 1988 and 57 100 in May. The *total* number of registered unemployed declined from 138 100 in September 1987 to 121 900 in May 1988. According to the Current Population Survey, the number of Black unemployed decreased from 1 180 000 workers (19,4 per cent of the economically active Black population) in July 1986 to 940 000 workers (14,7 per cent of the economically active Black population) in April 1988.

Labour costs and productivity

The average nominal amount of salaries and wages per worker in the non-agricultural sectors of the economy rose by 14,2 per cent in 1986 and by 15,6 per cent in 1987. In the first quarter of 1988 the average nominal wage per worker was 16,7 per cent higher than in the first quarter of 1987.

Some slowing down of the rate of nominal wage increases in the first quarter of 1988 was apparent, however, from a decline in the year-on-year rate of increase in nominal wages per worker from the fourth quarter of 1987 to the first quarter of 1988. In the private sector the nominal wage per worker was 17,3 per cent higher in the fourth quarter of 1987 than in the fourth quarter of 1986, but only 16,6 per cent higher in the first quarter of 1988 than in the first quarter of 1987. As regards employment by public authorities, the average nominal wage per worker was 17,8 per cent higher in the fourth quarter of 1987 than in the fourth quarter of 1986, but only 16,8 per cent higher in the first quarter of 1988 than in the first quarter of 1987. This mildly more moderate pace of nominal wage advances may not, however, have been sustained into the second quarter of 1988. Information currently available for the second quarter of 1988 suggests that the year-on-year increase in the nominal wage per worker in manufacturing and construction during that quarter could be of the order of 19 to 21½ per cent.

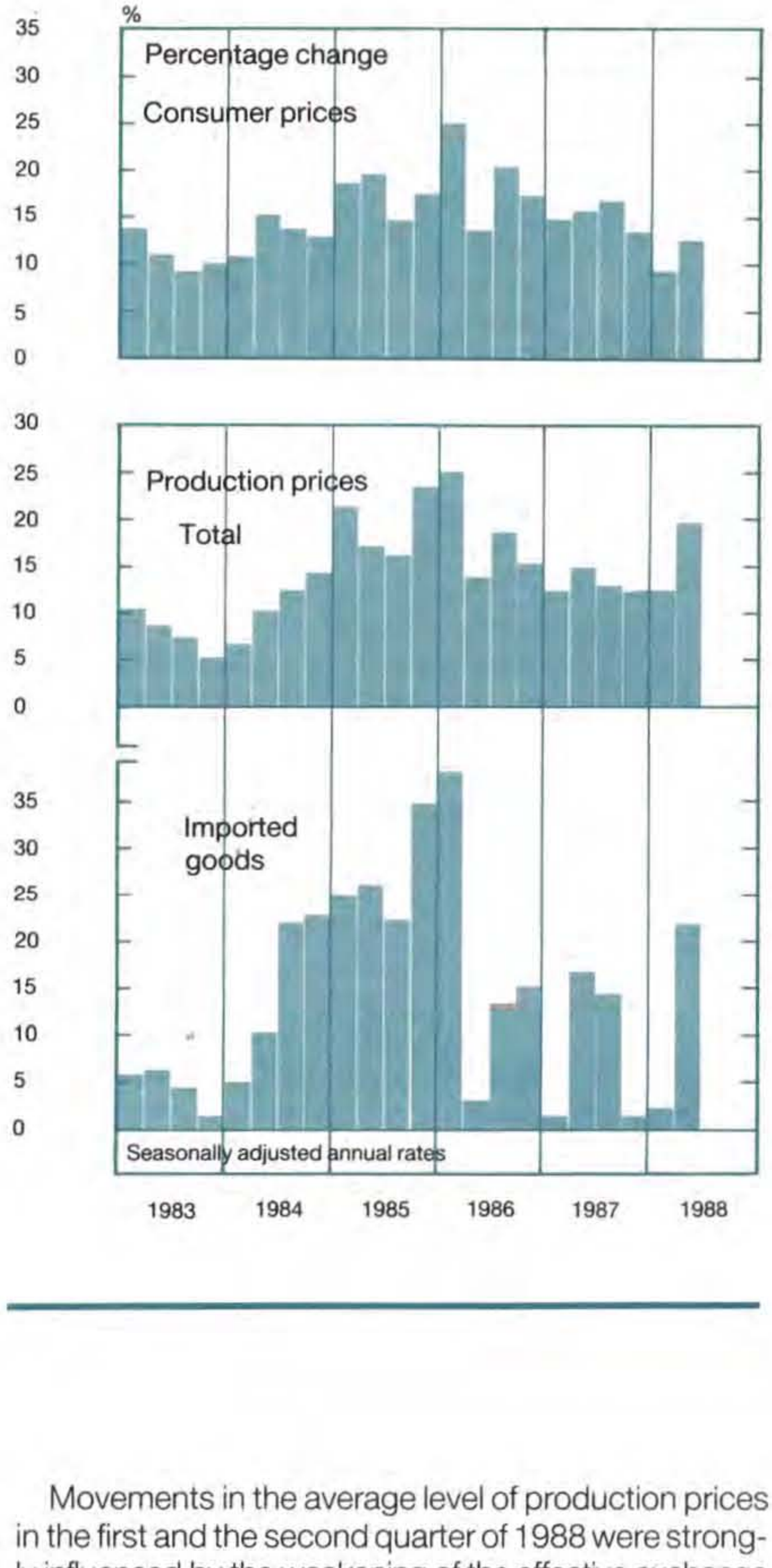
Salaries and wages per worker in non-agricultural sectors



The average real wage per worker showed a slight further decline in calendar 1987 both in the private sector and among workers employed by public authorities. The average extent of this real wage decline was 0,5 per cent. In the first quarter of 1988, however, the real wage per worker exceeded the average real wage in the first quarter of 1987 by a quite remarkable 2,6 per cent.

Labour productivity (i.e. real gross domestic product per worker in the non-agricultural sectors of the economy) increased by 1,2 per cent in calendar 1987 and at a seasonally adjusted annual rate of 1,8 per cent in the first quarter of 1988. Nominal unit labour costs rose by 14,1 per cent in 1987 and were 15,1 per cent higher in the first quarter of 1988 than in the first quarter of 1987.

Prices



Prices

The rate of inflation in consumer prices, as measured by the seasonally adjusted and annualised quarter-to-quarter rate of change in the consumer price index, retreated to only 9,2 per cent in the first quarter of 1988 (from a high point of 24,9 per cent in the first quarter of 1986). This rate of inflation then reaccelerated, however, to 12,6 per cent in the second quarter of 1988 under the impact of faster increases in the prices of foodstuffs and alcoholic beverages in particular.

The reacceleration of consumer price increases in the second quarter of 1988 was not yet reflected in a turnabout in the twelve-month rate of increase in the consumer price index, which declined further from its peak of 20,6 per cent in January 1986 and from 13,3 per cent in April 1988 to 12,9 per cent in May 1988 and to 12,4 per cent in both June and July. The month-to-month rise in consumer prices was significantly larger, however, from June to July 1988 than from May to June, mainly because of more pronounced increases in July in the prices of foodstuffs, alcoholic beverages and tobacco, housing rent and the prices of certain other sevices.

The quarter-to-quarter rise in production prices, at seasonally adjusted annual rates, sank from 25,0 per cent in the first quarter of 1986 to only 7,9 per cent in the fourth quarter of 1987, but then reaccelerated quite remarkably quickly to 12,5 per cent in the first quarter of 1988 and to 19,6 per cent in the second quarter. To a major extent, this was the result of an even more rapid and abrupt reacceleration of the seasonally adjusted and annualised quarter-to-quarter rate of increase in the prices of imported goods from 1,3 per cent in the fourth quarter of 1987 and 2,1 per cent in the first quarter of 1988 to as much as 21,7 per cent in the second quarter of 1988.

The twelve-month rate of increase in the production price index troughed at 11,3 per cent in December 1987. It amounted to 13,6 per cent in June 1988.

Movements in the average level of production prices in the first and the second quarter of 1988 were strongly influenced by the weakening of the effective exchange rate of the rand from the second week of January 1988. The decline in the exchange value of the rand is also likely to have had some early effect on the rise in the quarter-to-quarter rate of increase in consumer prices in the second quarter of 1988 and will in due course also be reflected in the twelve-month rate of change in the consumer price index. Once for all increases in the level of consumer prices (which will, however, probably take some time to work themselves out) will also result from the increases in the surcharge on imports from 15 August 1988 and the 14-16½ per cent increase in the retail prices of petrol and related liquid fuels from 1 September 1988.

Balance of payments

Current account

Having been transformed from substantial surpluses in the course of 1987 into a deficit of R0,4 billion in the first quarter of 1988, the balance on the current account of the balance of payments, at seasonally adjusted annual rates, reverted to a small surplus of nearly R1,0 billion in the second quarter of 1988. This was the result of a mild further recovery of the South African merchandise export performance and some further strengthening of the value of net gold exports, which outweighed a further rise in the value of merchandise imports and an increase in net service and transfer payments to foreigners. Preliminary trade statistics indicate that the trade account of the balance of payments will have shown a substantial further improvement in July 1988.

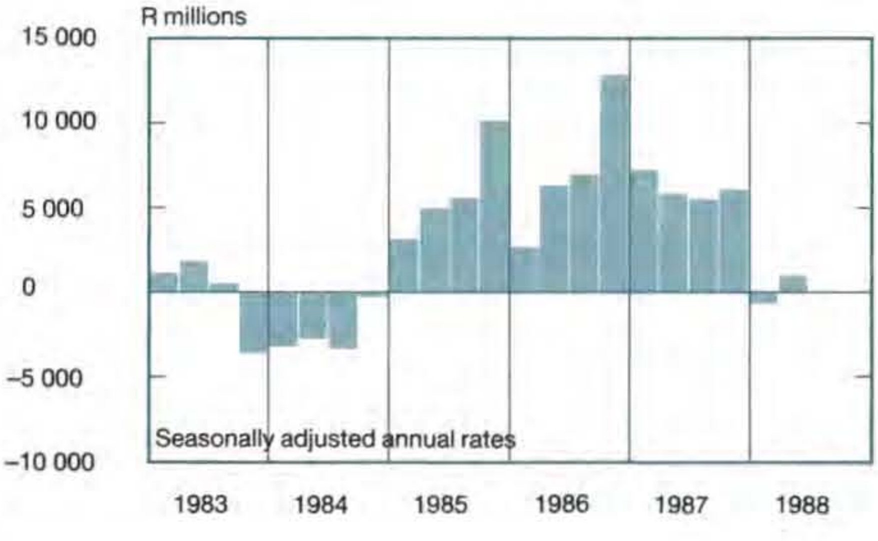
The *value* of *merchandise exports*, at an annualised figure of R28,7 billion, was some 9 per cent higher in the second quarter of 1988 than in the preceding three months. Export *volumes*, which have been trending downwards since the second half of 1986, recovered by about 3 per cent from the first quarter of 1988 to the second quarter mainly because of increased physical exports of agricultural products, precious metals and stones, and paper and paper-making materials. Export *prices* in rand advanced by some 6 per cent from the first to the second quarter of 1988 as a reflection of continued buoyancy of the international metal and other commodity markets and because of the decline in the effective exchange rate of the rand.

Contrary to developments in the first quarter of 1988, the 6 per cent increase in the value of *net gold exports* in the second quarter was more than fully explained by an increase in the average *rand* price of gold. Having fallen back disappointingly to an average of US $454 per fine ounce in the first quarter of 1988, the *dollar* price of gold showed a marginal further weakening to $451 in the second quarter. Depreciation of the rand vis-à-vis the dollar, however, caused the average rand price of gold to advance by some 7 per cent from R932 to R997 during this period. The *volume* of net gold exports in the second quarter of 1988 returned to its long-term downward trend because of a further decline in the average grade of ore mined. The average gold content of ore milled slid down from 5,28 grams per ton in 1987 to 5,17 grams per ton in the first quarter of 1988 and to 5,12 grams per ton in the second quarter.

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

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

Balance of payments on current account

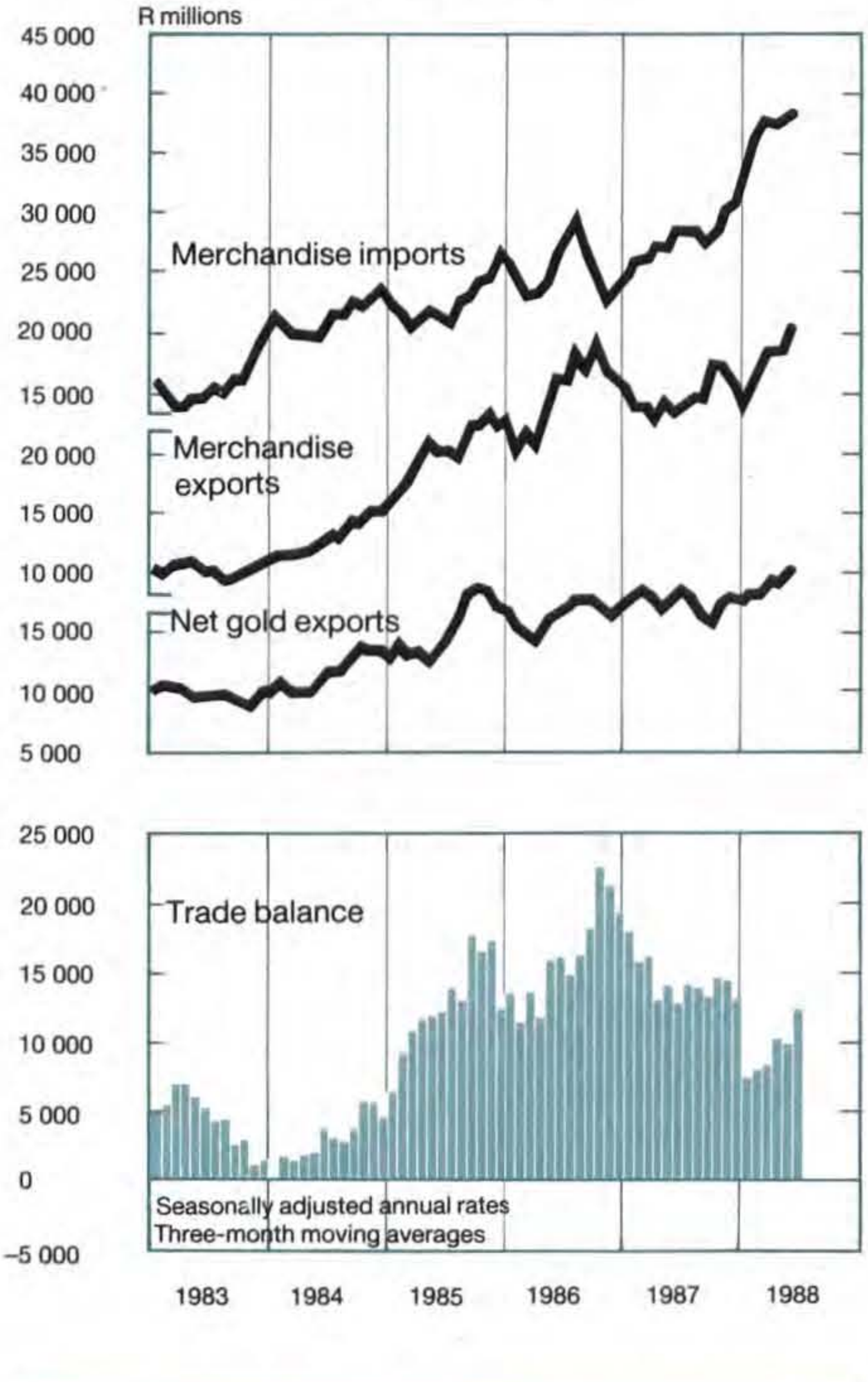


Gold price

In July and August 1988 the dollar price of gold declined further to an average of $434 per fine ounce, mainly as a result of new surges of strength of the US dollar in the international foreign exchange markets and because of increases in interest rates in most of the more important industrialised economies. The rand price of gold, however, rose further to an average of R1 053 per fine ounce during this period.

The *value* of *merchandise imports* rose further from the first to the second quarter of 1988 by some 4 per cent. However, the *volume* of these imports (which had increased by 6 per cent and by as much as 19 per cent in the preceding two quarters, and in the first quarter of 1988 had been some 36 per cent higher than its quarterly average in the first half of 1986) actually contracted slightly (by 1/2 per cent) from the first to the second quarter of 1988. This levelling-out of import volumes in the face of various import-encouraging developments was probably related primarily to the slow-

Balance of payments : Trade account



down in the expansion of South African domestic monetary demand. To some extent it may, however, also have reflected the impact of the weakening of the effective exchange rate of the rand from the second week of January 1988 on the relative prices of imported goods.

The average level of import *prices* rose by $4\frac{1}{2}$ per cent from the first to the second quarter of 1988 mainly because of the depreciation of the rand. Relative weakness still prevailed, however, in the international oil markets. In addition, inflation in trading partner countries, although somewhat higher in the second than in the first quarter of 1988, was still at generally low levels during this period.

Net service and transfer payments to foreigners rose in the second quarter of 1988 after having declined on balance in 1987 and the first quarter of 1988. This could be attributed mainly to higher freight and insurance payments which accompanied the rising value of merchandise imports. Interest payments to foreigners rose significantly because of interest rate increases in several industrialised countries and because of the lower exchange value of the rand.

Capital account

The capital account of the balance of payments, which had improved considerably in most of 1987 and in the first quarter of 1988, deteriorated again in the second quarter. The total outflow of capital not related to reserves rose to R2,1 billion in the second quarter of 1988 from an average of R0,7 billion in the preceding five quarters.

The outflow of long-term capital not related to reserves rose from R0,3 billion in the first quarter of 1988 to R0,6 billion in the second quarter. The increased amount of this outflow was mainly related to repayments on foreign debts in terms of the Second Interim Arrangements with foreign creditor banks on 15 June 1988, and to repayments on bearer bonds and notes which do not fall under the standstill net. Foreigners, however, were net purchasers of securities listed on the Johannesburg Stock Exchange to an amount of R9 million in the second quarter of 1988, after having been net sellers to amounts of R1,2 billion and R35 million in the calendar year 1987 and in the first quarter of 1988, respectively.

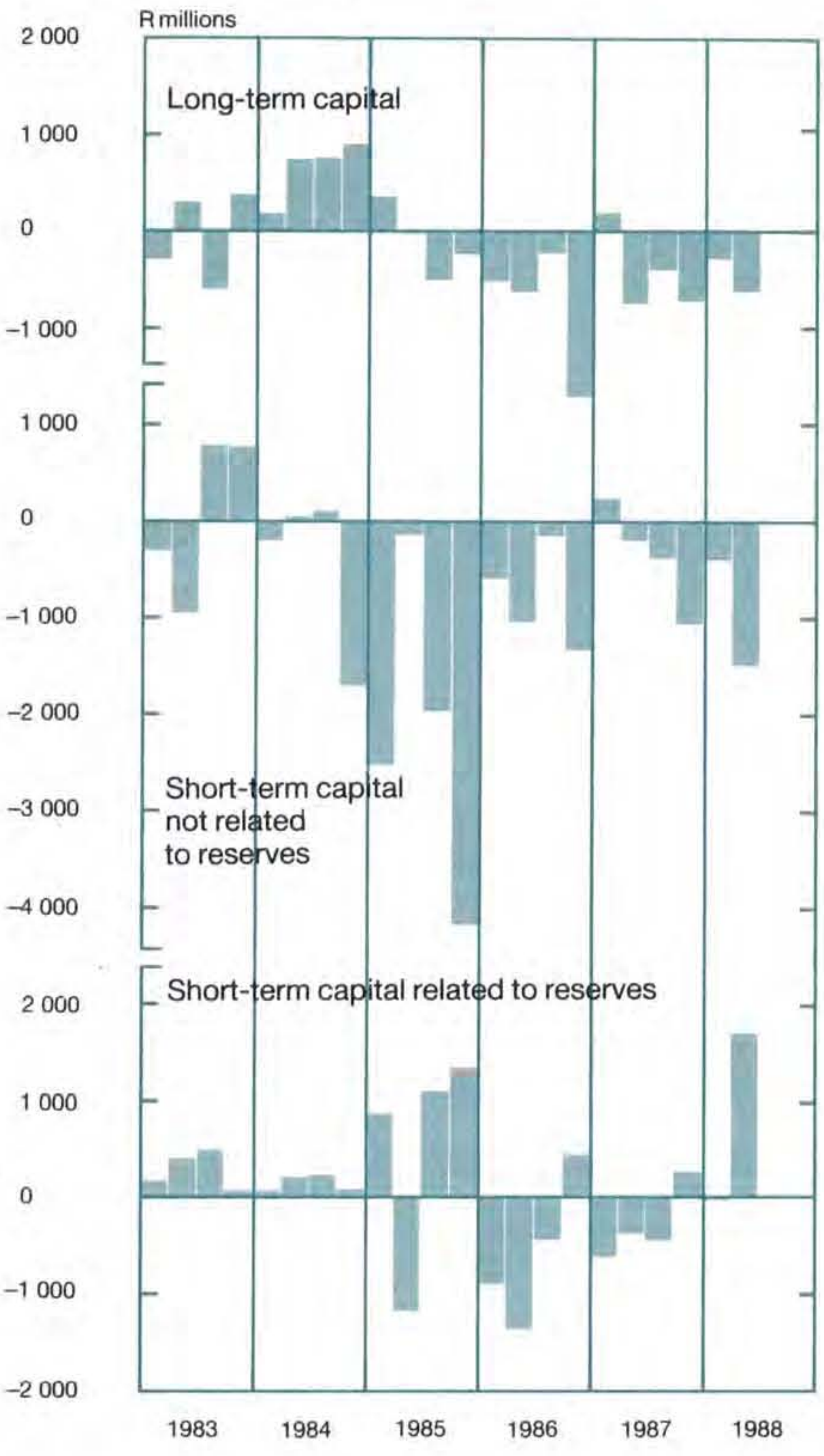
The outflow of short-term capital not related to reserves (but including unrecorded transactions) rose from R0,4 billion in the first quarter of 1988 to R1,5 billion in the second quarter. As in the case of long-term capital outflows, this was accounted for partly by repayments in terms of the Interim Arrangements with foreign creditor banks. Relatively heavy outflows of short-term capital in the second half of June in particular were also related, however, to the upward trend in overseas interest rates and to leads and lags in foreign payments and receipts which were occasioned by fears of progressive further declines in the exchange value of the rand.

Extensive borrowing was engaged in by the South African monetary authorities during the second quarter of 1988 to bolster the dwindling gold and other foreign reserves. The small outflow of reserve-related capital of R13 million in the first quarter of 1988 accordingly was transformed into an inflow of nearly R1,7 billion in the second quarter.

Net capital movements (not related to reserves)
R millions

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

Net capital movements



Foreign reserves

The total gross gold and other foreign reserves decreased by R480 million in the second quarter of 1988. The level of these reserves at the end of June 1988, at R7,7 billion, was some R1 billion lower than the peak level of the reserves at the end of August 1987. In July 1988 the foreign reserves of the Reserve Bank declined further by R84 million despite the greatly improved condition of the trade account of the balance of payments. The gold holdings of the Reserve Bank shrank rather more markedly than the Bank's foreign exchange holdings from 5,86 million fine ounces at the end of March 1988 to 4,28 million fine ounces at the end of June, but recovered slightly to 4,38 million fine ounces at the end of July.

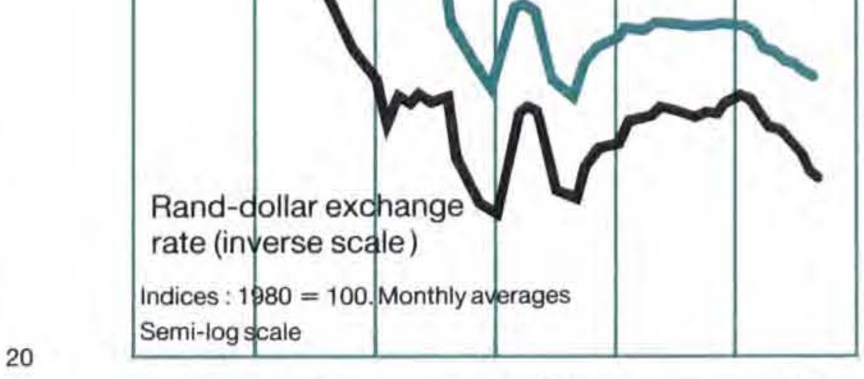
Exchange rates

The effective exchange rate of the rand strengthened by 3,1 per cent in the course of the calendar year 1987 but then fell back by 6,7 and 3,8 per cent in the first and the second quarter of 1988, respectively. The rand's depreciation in the second quarter, however, was mostly a matter of a new surge of strength of the US dollar, which from early June 1988 appreciated markedly against most other currencies. The external value of the rand accordingly declined in the second quarter by as much as 8,3 per cent against the dollar, but remained virtually unchanged in terms of sterling and the German mark.

Further pressure on the South African foreign reserves in combination with continuing strength of the dollar caused the effective exchange rate of the rand to depreciate further by 3,3 per cent from the end of June to the end of August 1988. The decline in the effective exchange rate from the beginning of 1988 to the end of August was thereby brought to 13,3 per cent.

The financial rand traded within a relatively narrow band from R2,82 to R3,07 to the US dollar during most of the second quarter of 1988. Proposals for legislation in the United States concerning intensified sanctions and disinvestment measures against South Africa, and resultant large sales of South African securities by

Exchange rates



Changes in the exchange rates of the rand

%

	31 Dec 1987 to 31 Mar 1988	31 Mar 1988 to 30 Jun 1988	30 Jun 1988 to 31 Aug 1988	31 Dec 1987 to 31 Aug 1988
Weighted average	–6,7	–3,8	–3,3	–13,3
US dollar	–9,1	–8,3	–5,2	–21,1
British pound .	–9,4	–	–3,5	–12,6
German mark .	–4,7	–	–2,3	–6,9
Swiss franc	–2,7	0,9	–0,4	–2,6
Japanese yen..	–7,1	–2,6	–3,7	–13,1
French franc ..	–4,7	–0,8	–1,4	–6,7
Financial rand .	4,8	–13,4	–4,7	–13,5

American investors in the second half of June, then caused the financial rand to weaken to R3,43 to the dollar on 30 June. During July the financial rand fluctuated between even narrower limits of R3,41 and R3,54 to the dollar before sliding to a low point of R3,75 on 2 August. This represented a discount vis-à-vis the commercial rand of 34,9 per cent. During the remainder of August the financial rand traded at somewhat firmer levels, ranging from R3,47 to R3,73.

Financial markets

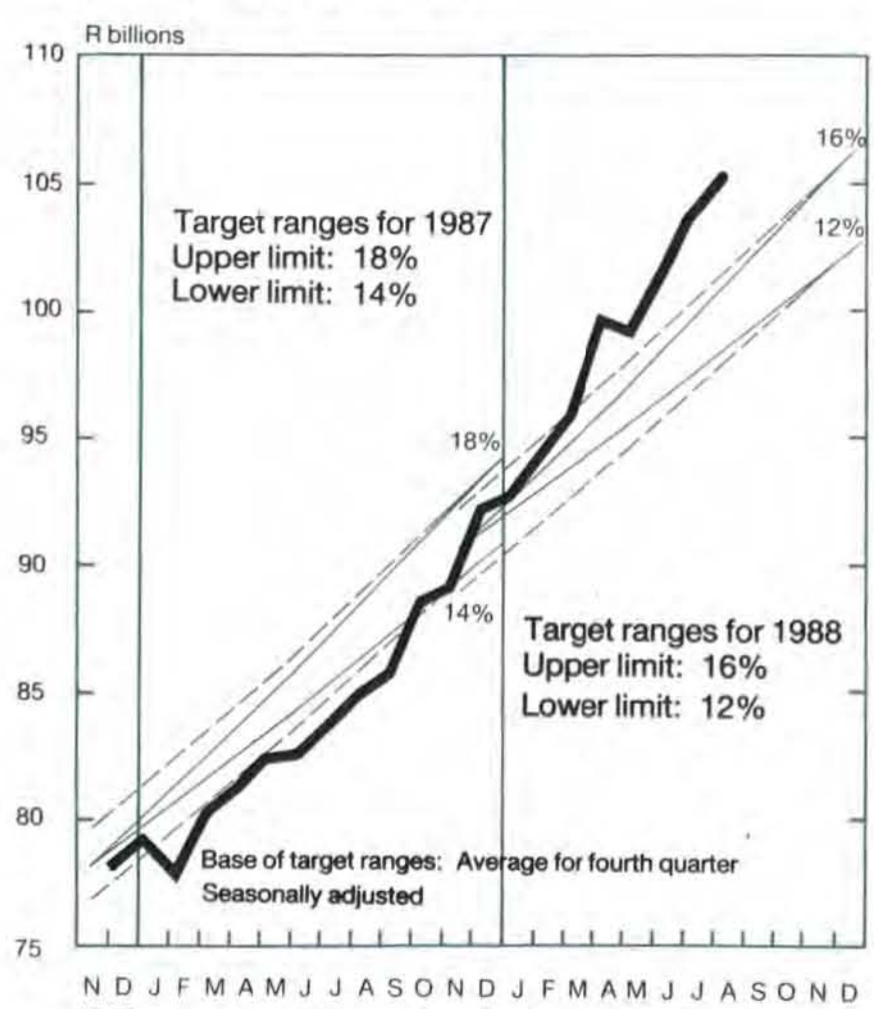
Money supply

After a sharp further acceleration of money growth in September 1987, high rates of increase in the M3 money supply were recorded in the last few months of 1987 and the first half of 1988. The quarter-to-quarter rate of increase in M3, seasonally adjusted and annualised, rose from 15,9 per cent in the third quarter of 1987 to 26,1 per cent in the fourth quarter and amounted to 23,5 per cent and 25,0 per cent in the first and the second quarter of 1988, respectively. A similar high rate of growth in M3 was registered during July.

M3 breached the upper limit of the target tunnel in February 1988 and by the end of July exceeded this limit by no less than R4,5 billion, or by 4,4 per cent. The seasonally adjusted annual rate of increase in M3 from the beginning of the 1988 targeting year (i.e. from mid-November 1987) to the end of July amounted to 24,2 per cent, as opposed to the 1988 target range of 12-16 per cent.

Sustained rapid growth in M3 through the second quarter of 1988 and during July could still be explained in terms of reintermediation phenomena and investors'

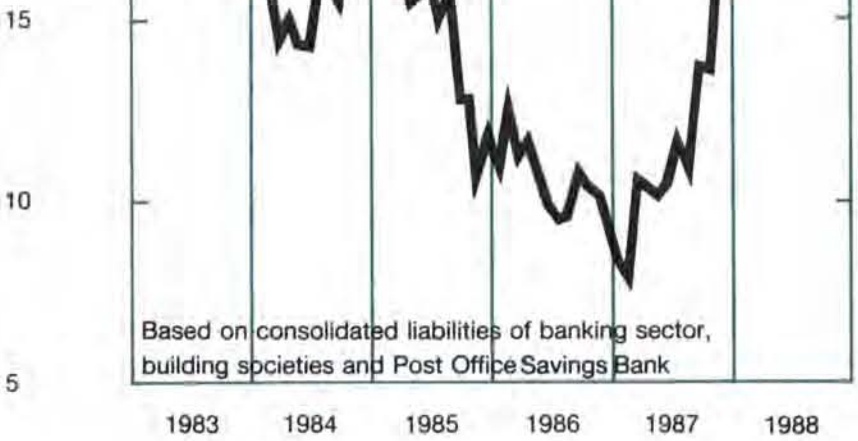
Target ranges for growth in M3



demand for fixed-value depository investments in addition to the effects of a mild further strengthening of domestic economic activity and a slight further increase in domestic monetary demand. As in the preceding four quarters, however, the rate of increase in the quarterly average of M3 from the first to the second quarter of 1988 exceeded the rate of growth in gross domestic product at current prices between these two quarters. M3's velocity of circulation accordingly declined by a further 1,9 per cent from the first to the second quarter of 1988. At 1,885, M3's velocity of circulation in the second quarter of 1988 was some 3,9 per cent lower than the recent peak value of M3 velocity of 1,961 in the first quarter of 1987.

Wealth holders' increased liquidity preference in an environment of rising interest rates caused the growth in M3 in the second quarter of 1988, as in the preceding quarter, to be concentrated heavily in deposits at the shorter end of the maturity spectrum. This was reflected in a very rapid increase in M2, which in the second quarter of 1988 amounted to a seasonally adjusted annual rate of 35,1 per cent. Among the various components of M2 the strongest growth was recorded in "other short and medium-term" deposits, i.e. in deposits with unexpired maturities or periods of notice ranging from one day to six months. In contrast, the long-term deposit component of M3 (seasonally adjusted) actually declined marginally during the first six months of 1988. This decline occurred despite the fact that by the end of June 1988 an amount of R949 million of longer-term deposits was held with banks and building societies

Money supply



which were enjoying the benefit of the so-called senior citizen interest subsidy that had been instituted in May 1988. At the end of July the provisionally estimated amount of these deposits was R1,1 billion.

During July 1988 the pattern of deposit growth of the preceding months was reversed as long-term deposits rose markedly along with "other short and medium-term" deposits, whereas demand deposits declined. The twelve-month rate of increase in M3 as at the end of July 1988 amounted to 24,5 per cent. The corresponding rates of increase in M0, M1A, M1 and M2 amounted to 25,5 per cent, 15,1 per cent, 29,1 per cent and 32,4 per cent.

The predominant "cause" of the increase in M3 – in the statistical or accounting sense – during the second quarter and in July 1988, as during the preceding four quarters, was a further large increase in monetary institutions' domestic credit extension. Increases in monetary institutions' total claims on the private sector and net claims on the government sector accounted for R5,7 billion of the R5,8 billion increase in M3 during the four months concerned. Declines in the net gold and other foreign reserves held by monetary institutions were a negative cause of change in M3 during this period to an amount of no less than R2,5 billion.

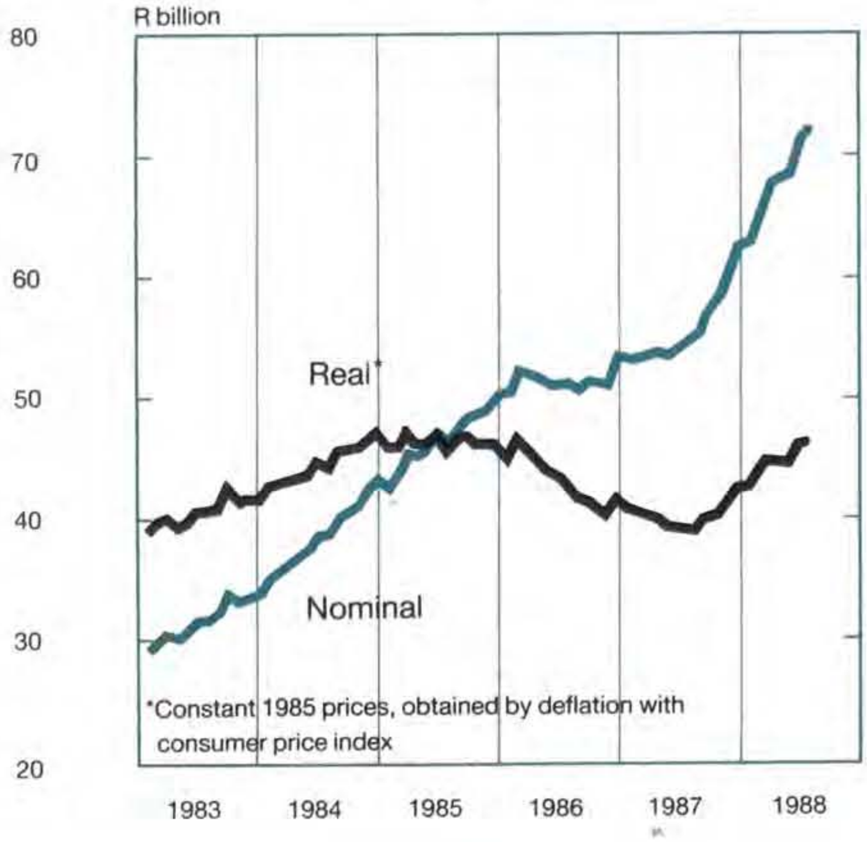
Domestic credit extension

High rates of increase in monetary institutions' credit to the private sector continued to prevail in the second quarter of 1988, reflecting further increases in spending and economic activity, reintermediation, and considerable switching from foreign to domestic sources of trade finance. Not seasonally adjusted, the increase in monetary institutions' claims on the private sector in the second quarter of 1988 amounted to R4,2 billion. This may be compared with an increase of only R1,2 billion in the corresponding three months in 1987.

From the end of March to the end of June 1988, hire-purchase credit and leasing finance provided by banks rose by approximately R1,0 billion for the third consecutive quarter, reflecting continued strong private sector spending on durable consumer goods as well as a strengthening of business demand for capital goods. The aggregate increase in these two forms of bank credit in the nine months to the end of June 1988, amounting to R2,9 billion or 21,5 per cent, was broadly similar in percentage terms to the increase of R2,0 billion or 23,4 per cent at the height of the surge in household spending on consumer durables during the final three quarters of the 1983-84 mini-boom to the end of June 1984.

Banks' holdings of bills discounted or purchased similarly rose by R1,0 billion in the second quarter of 1988, partly because of the banks' attempts to strengthen their liquid asset portfolios. The banks' *holdings* of liquid bankers' acceptances, in fact, rose by as much as R1,2 billion during this quarter and in mid-1988

Bank credit to domestic private sector



were broadly twice as high as in late 1987. "Other" loans and advances rose by R2,3 billion. Of this amount, no less than R1,3 billion consisted of increases in the banks' mortgage loans. In contrast, building societies' home mortgage advances rose by a comparatively modest R0,8 billion during the three months concerned.

Quarter-to-quarter changes in total bank credit to the private sector, at seasonally adjusted annual rates, amounted to more than 30 per cent in each of the three quarters from the end of September 1987 to the end of June 1988. The total increase in banks' claims on the private sector during this period amounted to 24,6 per cent in nominal and to 15,3 per cent in "real" or inflation-adjusted terms.

Changes in claims of monetary institutions on the 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

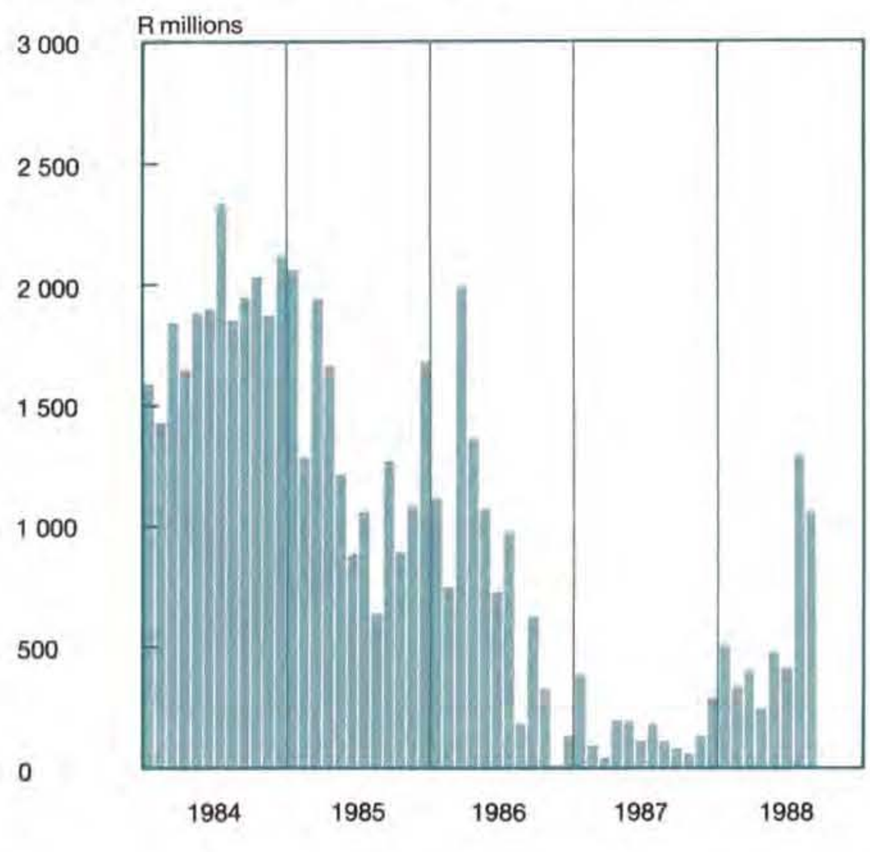
The twelve-month rates of increase in banks' claims on the private sector surged from single-digit figures as recently as August 1987 to 32,7 per cent in July 1988. The twelve-month rate of increase in all monetary institutions' claims on the private sector rose from less than 10 per cent in July 1987 to 24,7 per cent in July 1988.

Monetary institutions' net claims on the government sector, before seasonal adjustment, declined from R4,3 billion at the end of March 1988 to R3,8 billion at the end of April, but rebounded to R5,5 billion at the end of June before declining to R4,0 billion at the end of July. Parallel but less extreme fluctuations were displayed by these claims on a seasonally adjusted basis. The twelve-month rate of increase in these claims amounted to 33,7 per cent at the end of June but to only 14,8 per cent at the end of July.

Reserve Bank operations in the money market

Money market conditions tightened appreciably in the course of most of the first four months of 1987. Further tightening and rate-raising pressures were exerted by the Bank rate increase (from 10½ to 11½ per cent) of 4 May 1988 and the accompanying changes in the Reserve Bank's accommodation policies. In terms of these policy changes, accommodation to the money market other than at the discount window would henceforth be provided by the Bank only for the smoothing out of

Accommodation at the discount window



unduly large month-end or other seasonal fluctuations in market conditions.

In combination with the decline in the net foreign reserves in the second quarter and July 1988, the change in the Reserve Bank's accommodation policies and procedures resulted in sharply higher levels of refinancing assistance at the discount window. The amount of this kind of accommodation rose from a monthly average of R363 million in the first four months of 1988 to R457 million in May and R405 million in June, and to as much as R1 279 million and R1 045 million in July and August, respectively. On 31 August the amount of this accommodation was R2 175 million.

Assistance in the form of repurchase agreements was provided by the Bank to an amount of R300 million over the April month-end. In accordance with the policy statement of 4 May, no further assistance of this nature was made available by the Bank from early May up to 30 August 1988. However, conditions over the August month-end (which were expected to be very tight, partly for seasonal reasons and partly for non-recurrent reasons which similarly were beyond the banks' control) led the Bank to enter into R800 million of repurchase agreements which ran from 31 August to 5 September 1988. In addition, R250 million of specially-dated tax Treasury bills matured at the August month-end. Amounts of R400 million and R200 million of repurchase agreements subsequently were renewed for the period from 5 to 6 September and from 6 to 8 September 1988, respectively.

In its statement accompanying the Bank rate increase of 28 July, the Reserve Bank again stressed its intention to curb the tempo of its own credit creation so as to curtail the rates of increase in bank credit and the money supply. Within the framework of the Bank's more restrictive policies, penalties could in future be applied to banks, or to banking groups, which had expanded their credit excessively. Such penalties could take the form of higher rediscount or interest rates on that part of the Reserve Bank's accommodation of the bank concerned which exceeded the refinancing limit that was to be laid down for each bank. No such limits would apply to the discount houses. In view of the tight money market conditions which prevailed during August, however, the Bank indicated that these penalty rates would be introduced only at a later stage, if circumstances were to make such action desirable.

Net sales of government stock by the Reserve Bank in the open securities markets during the first five months of fiscal 1988/89 (April to August 1988) amounted to no less than R6,7 billion. This could be compared with the amount of R5,2 billion of securities sales by the Bank in the course of the full fiscal year 1987/88.

Money market interest rates

Short-term interest rates hardened further during most of the second quarter and in July and August 1988. They did so under the impact of the strongly rising demand for bank credit, the above-target rate of growth of the money supply, the markedly weaker position of the balance of payments on current account and the declines in the foreign reserves, the progressively more restrictive policy stance of the monetary authorities and the Bank rate increases of early May and late July 1988, and the interest rate expectations engendered by these various developments.

Interest rate increases in several of the world's major industrialised economies from June 1988 onward also played a part in shaping the market's rate expectations. Finally, the banks' holdings of gold coins effectively ceased to rank as cash reserves for purposes of the cash reserve requirements effectively from the date of the banks' certification of their monthly returns for July 1988, while the status as statutory liquid assets of building societies' demand deposits with banks and of overdraft facilities utilised by the Land Bank was abolished with effect from 1 August. In conjunction with a considerable increase in the banks' required minimum liquid asset holdings, these changes to the definitions of cash reserves and liquid assets added to the observed money market shortage and contributed to a scarcity, or anticipated scarcity, of statutory liquid assets. As a result, they also contributed to banks' more intensive bidding for deposits and to lingering and unusually

Short-term interest rates

large disparities between the rates on liquid and non-liquid market instruments.

Following the increases in Bank rate to 10½, 11½ and 12½ per cent from 9 March, 5 May and 29 July 1988, the clearing banks raised their prime overdraft rates by 1 percentage point on each occasion to 14, 15 and 16 per cent.

Movements in market interest rates led rather than followed these Bank rate increases. The market rate on three-month liquid bankers' acceptances, for example, stood at 11,85 per cent immediately prior to the Bank rate increase of 5 May; the Reserve Bank's rediscount rate for such acceptances for the discount houses at that stage still amounted to only 10,8 per cent. Similarly, the market rate on three-month liquid acceptances reached a high point of 12,65 per cent before the Bank rate increase of 29 July; the Bank's lowest rediscount rate for these acceptances at that stage was still only 11,8 per cent.

During August the market rate on three-month liquid acceptances rose to a peak of 13,75 per cent. It fell back, however, to around 13,50 per cent immediately after the Reserve Bank's announcement of assistance to the money market in the form of repurchase agreements from 31 August. This rate then declined marginally further to 13,45 per cent by mid-September 1988.

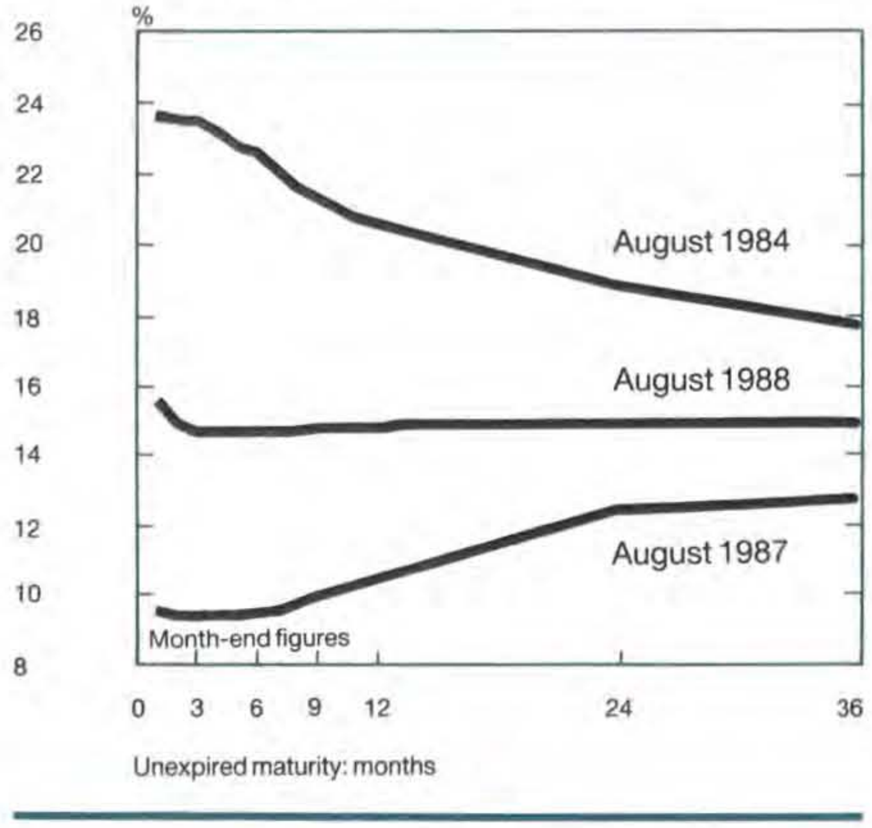
Rates on call money and interbank funds rose to high points of 15,75 and 14,75 per cent shortly before the August month-end, but subsequently softened again to 13,50 and 13,75 per cent by mid-September. High rates on call and overnight funds as paid by certain banks gave rise to a return of "round-tripping" phenomena (i.e. to the utilisation of overdraft or other credit facilities with a bank for the purpose of making deposits with another bank, or even with the same bank or group of banking institutions) for the first time since 1982.

The yield curve in respect of negotiable certificates of deposit of up to three years' unexpired maturity – which may be regarded as representative of interest rate relationships in the money market and at the short end of the capital market – was relatively flat in September 1988. The downward-sloping segment of this curve at the very shortest end of the maturity spectrum was a reflection of seasonally tight money market conditions which clearly were not expected to last for more than a fairly short period. In contrast, the generally downward-sloping and generally upward-sloping shape of the entire yield curve as in August 1984 and August 1987, respectively, reflected expected *cyclical* rate declines and rate increases which might require considerable time for their completion.

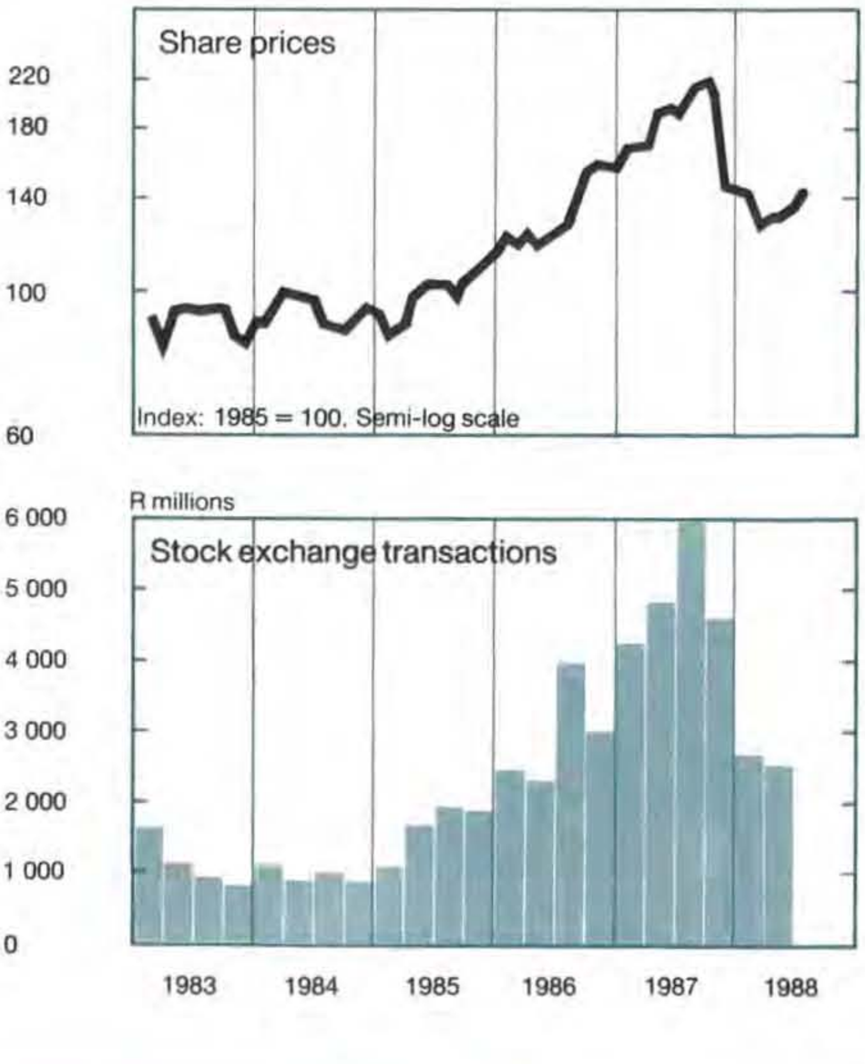
Capital market activity

Having recovered slightly in the first quarter of 1988, trading activity in the capital market generally was somewhat lower again in the second quarter. This was reflected in marginally lower turnovers of public sector stock and of company shares that are traded on the stock ex-

Yield curves for negotiable certificates of deposit



Share prices and stock exchange transactions



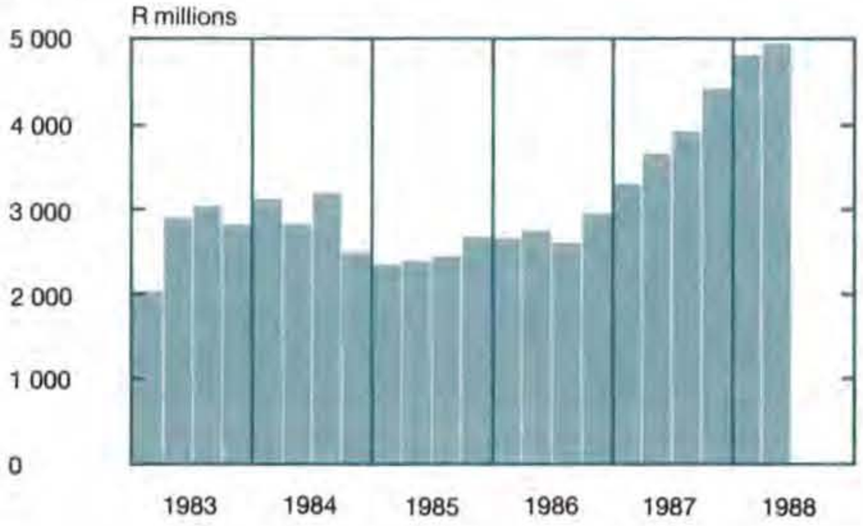
change. Activity in the primary capital market, however, was somewhat higher than in the preceding three months. Similarly, the real estate market witnessed a moderate further rise in real estate transactions and a further increase in mortgage lending.

The value of public sector stock traded on the stock exchange declined quite significantly from R48,6 billion in the first quarter of 1988 to R44,2 billion in the second quarter but recovered to R18,2 billion during July as compared with the monthly average of R14,7 billion in the second quarter. Real estate transactions advanced from R4,8 billion in the first quarter of 1988 to R4,9 billion in the second quarter. The level of these transactions in the second quarter of 1988 was a substantial 36 per cent higher than in the second quarter of 1987. However, it then declined by 8 per cent from the monthly average of slightly more than R1,6 billion in the second quarter of 1988 to R1,5 billion during July.

The value of shares traded on the stock exchange contracted slightly further from R2,6 billion in the first quarter of 1988 to a monthly average of R0,8 billion in the second quarter, but recovered to R1,1 billion in July. Share prices were not, however, affected adversely by the mild further shrinkage in trading activity during the second quarter. The 4 per cent rise in the average price level of all classes of shares in the second quarter actually suggested some renewed institutional buying interest. A further increase of 7 per cent in the average share price level was recorded in July prior to a 6 per cent decline in August. Share prices were thereby on balance raised to an average level that had previously been attained in the third quarter of 1986.

In the primary markets, funds were raised by the public sector in the second quarter of 1988 through new issues of fixed-interest securities to bank and non-bank private sector investors to a net amount of R3,5 billion, against net *repayments* of as much as R1,3 billion in the preceding three months. Net new issues of *government* stock to bank and non-bank private sector investors in the second quarter accounted for nearly 94 per cent of the total amount of such issues by the public sector as a whole.

Real estate transactions



New issues of fixed-interest securities by private sector companies in the first and the second quarter of 1988 ran to insignificant amounts of only R1 million and R38 million, respectively. New issues of ordinary shares by companies that are listed on the stock exchange amounted to R103 million in the first and to R126 million in the second quarter. The relatively low levels of these various kinds of private sector issues were related to *inter alia* the less buoyant condition of the stock exchange, the relatively high level of corporate saving and the availability of internally generated funds, and the continued low although strengthening level of private sector real fixed investment activity.

In the mortgage market, mortgage loans paid out by the building societies amounted to R2,0 billion in both the first and the second quarter of 1988. Banks, however, continued to show substantial further increases in their activities in this area, especially with regard to housing finance. Banks' holdings of housing finance mortgages rose by R1,3 billion in the first quarter of 1988 and by R1,5 billion (to a total of R7,2 billion) in the second quarter. The corresponding increases among the building societies were R0,7 billion and R0,8 billion (to a total of R27,6 billion) respectively.

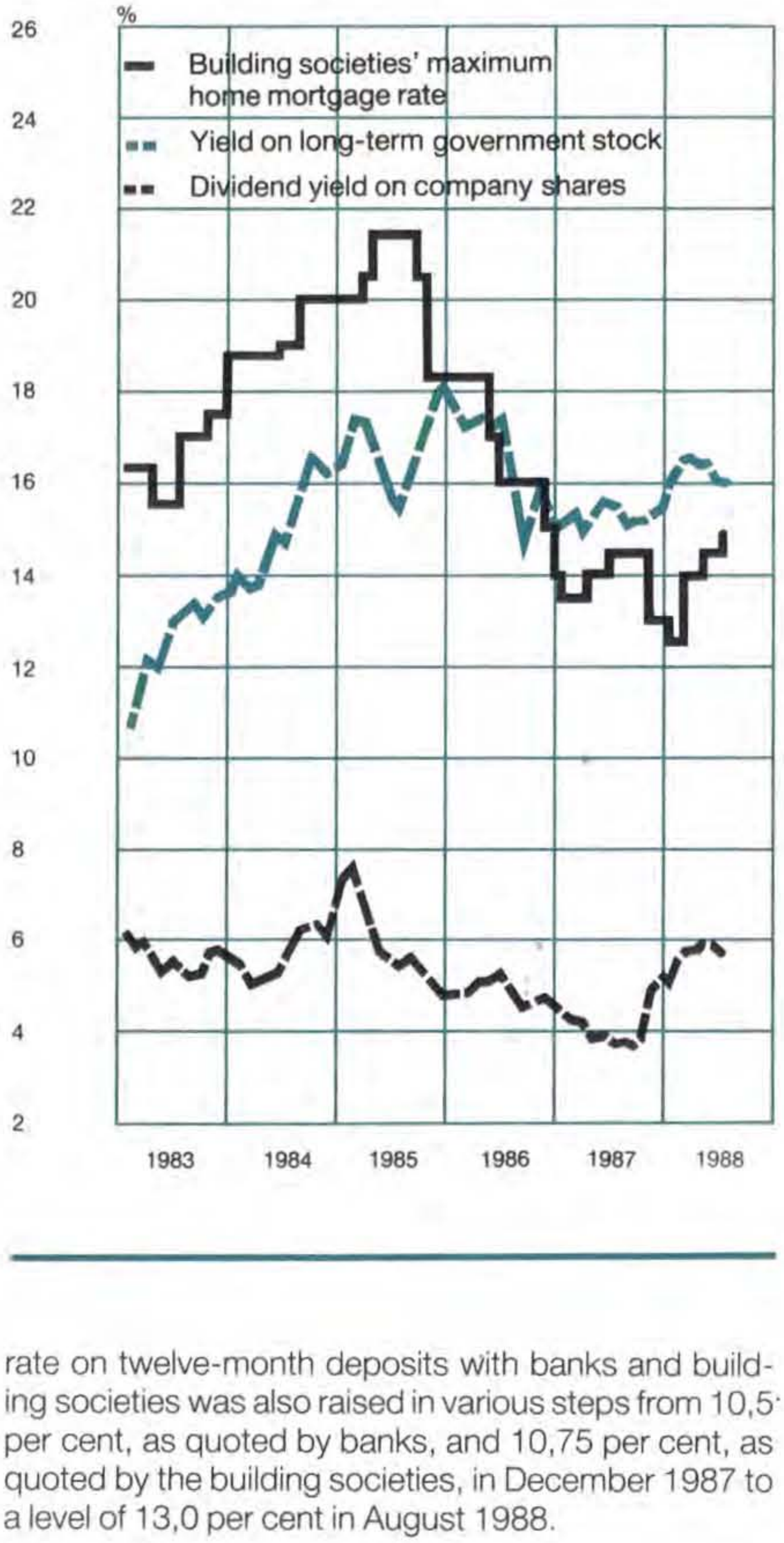
Long-term interest rates and yields

Long-term rates firmed after the start of the drop in share prices on the Johannesburg Stock Exchange in the third week of October 1987 and continued to do so up to high points in the course of March 1988. They eased slightly in the course of the second quarter of 1988 in the light of the continued amelioration of the inflation rate in consumer prices and the market's perception of the limited size of the borrowing needs of the central government and the public sector. The monthly average of the yield on long-term government stock, which had advanced from 15,1 per cent in August 1987 to 16,6 per cent in March 1988, retreated to 16,1 per cent in June and maintained this level into August 1988.

Mirroring the very large movements in share prices from September 1987, the average monthly dividend yield on all classes of shares rose from 3,6 per cent in September 1987 to 5,7 per cent in March 1988 and to 5,9 per cent in June. It then eased slightly to 5,7 per cent in July before recovering to 6,0 per cent in August.

The persistently strong demand for mortgage finance and the general upward movement of short-term rates caused the building societies to raise the predominant rate on their mortgage loans in steps from 12,5 per cent in December 1987 to 15,0 per cent in July 1988 and to 16,0 per cent in September. The predominant

Long-term interest rates



rate on twelve-month deposits with banks and building societies was also raised in various steps from 10,5 per cent, as quoted by banks, and 10,75 per cent, as quoted by the building societies, in December 1987 to a level of 13,0 per cent in August 1988.

Government finance

Use of fiscal policy measures for stabilisation purposes

The more cautious and less expansionary approach to fiscal policy that had been adopted in the Central Government's Budget of March 1988 was taken several steps further by the introduction of additional fiscal measures in the second and third quarters of 1988. Fiscal adjustments contained in the package of demand-restraining fiscal, monetary and credit measures of 4 May 1988 included actions such as the phasing-out of the debtors' allowance in respect of sales tax payments and a raising of the valuations placed on company cars for the purpose of fringe benefit taxation.

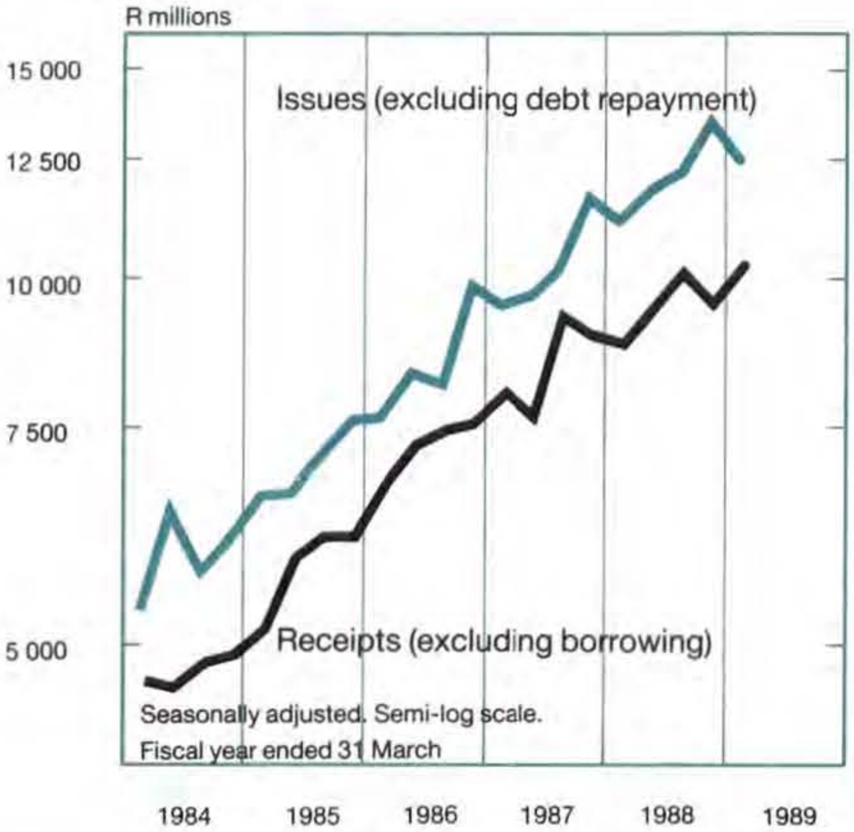
Five further changes in income tax legislation were announced by the Minister of Finance on 3 June 1988 and gazetted on 15 July. The measures concerned were aimed at increased standardisation and simplification of the tax system and at a dismantling of certain tax shelters by means of *inter alia* a consolidation, replacement or abolition of certain income tax allowances.

Additional fiscal measures were also announced on 12 August 1988. These measures were the counterpart in the fiscal policy area of the Bank rate increase and associated monetary policy actions of 29 July and of some further tightening, as proclaimed on 12 August, of the conditions relating to credit transactions and of the exchange control regulations. As explained by the Minister of Finance, the full set of these measures in their various policy areas was meant to curb domestic demand, slow down the rate of merchandise imports and protect the balance of payments. The fiscal policy measures in the de-stimulatory package of July-August 1988 included an increase in the fuel levy, a raising of the import duty on assembled motor cars, and replacement of the 10 per cent surcharge on certain imports (which initially had been imposed in September 1985) with a graded system of surcharges ranging from nil to 60 per cent.

Exchequer issues and receipts

In harmony with the authorities' less expansionary fiscal policy intentions, the rate of increase in Exchequer *issues* to the departments of the Central Government (after the usual adjustment for changes in the balance on the Paymaster-General Account, and as compared with the corresponding quarters of the preceding fiscal year) declined further from 14,8 per cent in the March quarter of 1988 to only 7,2 per cent in the June quarter (i.e. the first quarter of fiscal 1988/89). The increase in the June quarter therefore was quite substantially lower than the budgeted increase in government expenditure of 12,6 per cent for the fiscal year 1988/89 as a whole.

Exchequer account



A lower than projected increase in Exchequer issues continued to be recorded during July 1988. Total issues to government departments in the first four months of fiscal 1988/89 were accordingly only 7,5 per cent higher than in the corresponding period of fiscal 1987/88. In *real* terms Exchequer issues during the four months to July 1988, as compared with their level one year earlier, actually decreased by 4,7 per cent. The nominal amount of Exchequer issues during these four months was equal to 30,5 per cent of total budgeted Central Government expenditure for fiscal 1988/89 as a whole. This may be compared with an average percentage share of such issues during the first four months of the fiscal year to total issues during the fiscal year, of 32,3 per cent in the three fiscal years from 1985/86 to 1987/88.

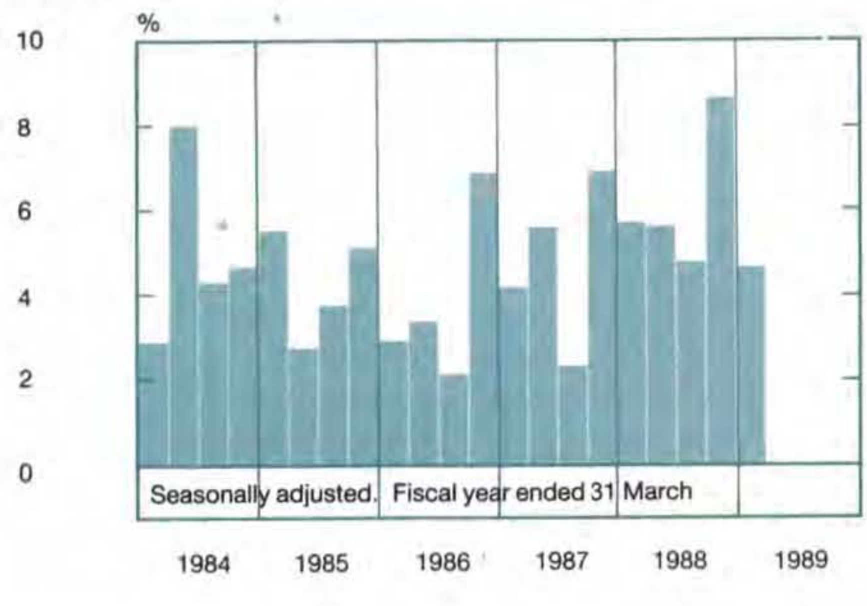
Also in comparison with levels in the preceding year, the rate of increase in Exchequer *receipts* rose from 6,0 per cent in the March quarter of 1988 to as much as 22,3 per cent in the June quarter. This rate of increase then showed a moderate further acceleration in July. Total receipts in the first four months of fiscal 1988/89 accordingly were 22,8 per cent higher than in the first four months of fiscal 1987/88. The rate of increase in Exchequer receipts in the first four months of fiscal 1988/89 was also markedly higher than the increase of 16,3 per cent that had been envisaged in the March 1988 Budget for the fiscal year as a whole.

The unexpected strength of Exchequer receipts in the first four months of fiscal 1988/89 could be attributed mainly to unanticipatedly large increases in receipts from the consolidated fuel levy and in customs duties. Total receipts during this period were equal to 28,7 per cent of total budgeted revenue for the whole of fiscal 1988/89. This slightly exceeded the average share of 27,2 per cent of Exchequer receipts in the first four months of the fiscal year to total revenues during the year in the fiscal years from 1985/86 to 1987/88.

Deficit before borrowing

Lower than expected Exchequer issues and higher than expected Exchequer receipts caused the deficit before borrowing and debt repayment in the first four months of fiscal 1988/89 to be held down to a fairly modest amount of R3 781 million, or R1 203 million less than in the first four months of fiscal 1987/88. The deficit in the first four months of fiscal 1988/89 was equal to 38 per cent of the deficit of R9 860 million that had been envisaged in the March 1988 Budget for the fiscal year as a whole. In comparison, the deficit in the four months to July 1987 had amounted to as much as 52 per cent of the total actual deficit in fiscal 1987/88.

Deficit before borrowing as percentage of gross domestic product



The deficit of R3 781 million in the four months to July 1988, and the discount of R1 031 million on new issues of government stock, were financed from the following sources:

	R millions
Public Investment Commissioners	1 785
Non-bank private sector	3 879
Banking sector:	
Corporation for Public Deposits	–1 145
Other banks	315
Foreign sector	–22
	4 812
Less: discount on government stock	1 031
Total financing	3 781